ALTERNATIVE
Emerging Investor
Issue 3 - October / November

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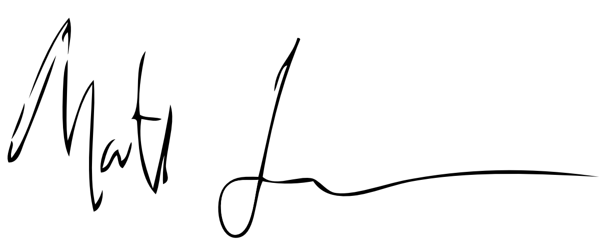
In a world of ever increasing complexity, the alternative investments industry is among the most complex, from quantitative analysis and black box hedge strategies to MBS, REITs, LBOs, SIVCAV – the list goes on. The acronyms alone are enough to boggle the mind. As we create more intricate ways to increase our returns it becomes easy to forget about the underlying fundamental needs on which some of these instruments are based: shelter (real estate), heat (energy), clothing (retail), and for our issues focus, food (commodities/agribusiness).

I find agribusiness to be more crucial to the development of emerging markets than other sectors, for two reasons: First, compared with other industries, the raw materials needed to build a robust agribusiness sector originate from these commodity-based economies. Second, most people would agree that it's easier to make packaged flour than it is to make an iPad. For an emerging economy to grow into a developed economy, one of the first steps is the progression from exporter of raw goods and importer of finished goods to meeting internal demand for finished goods and also exporting them. This also provides an excellent opportunity for investors, who can capitalize on the availability of land, internal and external demand for products, and low levels of investment, technology and infrastructure. There are entry points all along the value chain, from production to processing, storage and shipping, and ending in sale, as seen in the rapidly developing supermarket and fast food sectors.

Our job is to produce the best rate of return, and there is nothing wrong with that. However, I think along the way we have forgotten the purpose of these investments. Ultimately it's to house someone, feed someone, educate someone – to meet basic human needs. Keeping this in mind will, I believe, improve the quality of our investments, the return for investors and the benefit to emerging markets and their people.

Saludos,



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Emerging Investor

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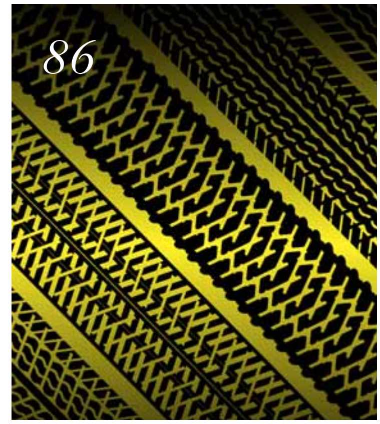

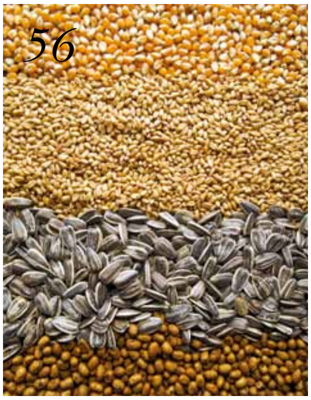

Commodities

Agribusiness

Private Equity

Renewable Energy

Emerging Markets' Euro Nemesis

Daniel Gros

Emerging market currencies are crashing, and their central banks are busy tightening policy, trying to stabilize their countries' financial markets. Who is to blame for this state of affairs?

A few years ago, when the U.S. Federal Reserve embarked on yet another round of "quantitative easing," some emerging-market leaders complained loudly. They viewed the Fed's open-ended purchases of long-term securities as an attempt to engineer a competitive devaluation of the dollar and worried that ultra-easy monetary conditions in the U.S. would unleash a flood of "hot money" inflows, driving up their exchange rates. This, they feared, would not only diminish their export competitiveness and push their external accounts into deficit; it would also expose them to the harsh consequences of a sudden stop in capital inflows when U.S. policymakers reversed course.

At first glance, these fears appear to have been well founded. As the title of a recent paper published by the International Monetary Fund succinctly puts it, "Capital Flows are Fickle: Anytime, Anywhere." The mere announcement that the Fed might scale down its unconventional monetary policy operations has led to today's capital flight from emerging markets.

But this view misses the real reason capital flowed into emerging markets over the last few years, and why the external accounts of so many of them have swung into deficit. The real culprit is the euro.

Quantitative easing in the U.S. cannot have been behind these large swings in global current-account balances, because America's external deficit has not changed significantly in recent years. This is also what one would expect from economic theory: in conditions approaching a liquidity trap, the impact of unconventional monetary policies on financial conditions and demand is likely to be modest.

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Indeed, the available models tell us that, to the extent that an expansionary monetary policy actually does have an impact on the economy, its effect on the current account should not be large, because any positive effect on exports from a weaker exchange rate should be offset by larger imports due to the increase in domestic demand.

This is what has happened in the U.S., and its recent economic revival has been accompanied by an expansion of both exports and imports. The impact of the various rounds of quantitative easing on emerging markets (and on the rest of the world) has thus been approximately neutral.

But austerity in Europe has had a profound impact on the eurozone's current account, which has swung from a deficit of almost US$100 billion in 2008 to a surplus of almost US$300 billion this year. This was a consequence of the sudden stop of capital flows to the eurozone's southern members, which forced these countries to turn their current accounts from a combined deficit of US$300 billion five years ago to a small surplus today. Because the external-surplus countries of the eurozone's north, Germany and the Netherlands, did not expand their demand, the eurozone overall is now running the world's largest current-account surplus – exceeding even that of China, which has long been accused of engaging in competitive currency manipulation.

This extraordinary swing of almost US$400 billion in the eurozone's current-account balance did not result from a "competitive devaluation" – the euro has remained strong. So the real reason for the eurozone's large external surplus today is that internal demand has been so weak that imports have been practically stagnant over the last five years (the average annual growth rate was a paltry 0.25%).

The cause of this state of affairs, in one word, is austerity. Weak demand in Europe is the real reason emerging markets' current accounts deteriorated (and, with the exception of China, swung into deficit).

Thus, if anything, emerging-market leaders should have complained about European austerity, not about U.S. quantitative easing. Fed Chairman Ben Bernanke's talk of "tapering" quantitative easing might have triggered the current bout of instability, but emerging markets' underlying vulnerability was made in Europe.

The fickleness of capital markets poses once again the paradox of thrift. As capital withdraws from emerging markets, these countries soon will be forced to adopt their own austerity measures and run current-account surpluses, much like the eurozone periphery today. But who will then be able – and willing – to run deficits?

Two of the world's three largest economies come to mind: China, given the strength of its balance sheet, and the eurozone, given the euro's status as a reserve currency. But both appear committed to running large surpluses (indeed, the two largest in the world). This implies that, unless the U.S. resumes its role as consumer of last resort, the latest bout of financial-market jitters will weaken the global economy again. And any global recovery promises to be unbalanced – that is, if it materializes at all.

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China's American Bailout?

Alexander Friedman

The 21st-century economy has thus far been shaped by capital flows from China to the United States – a pattern that has suppressed global interest rates, helped to reflate the developed world's leverage bubble, and, through its impact on the currency market, fueled China's meteoric rise. But these were no ordinary capital flows. Rather than being driven by direct or portfolio investment, they came primarily from the People's Bank of China (PBOC), as it amassed US$3.5 trillion in foreign reserves – largely U.S. Treasury securities.

The fact that a single institution wields so much influence over global macroeconomic trends has caused considerable anxiety, with doomsayers predicting that doubts about U.S. debt sustainability will force China to sell off its holdings of U.S. debt. This would drive up interest rates in the U.S. and, ultimately, could trigger the dollar's collapse.

But selling off U.S. Treasury securities, it was argued, was not in China's interest, given that it would drive up the renminbi's exchange rate against the dollar, diminishing the domestic value of China's reserves and undermining the export sector's competitiveness. Indeed, a U.S. defense department report last year on the national security implications of China's holdings of U.S. debt concluded that "attempting to

use U.S. Treasury securities as a coercive tool would have limited effect and likely would do more harm to China than to the [U.S.]."

To describe the symbiotic relationship between China's export-led GDP growth and America's excessive consumption, the economic historians Niall Ferguson and Moritz Schularick coined the term "Chimerica." The invocation of the chimera of Greek mythology – a monstrous, fire-breathing amalgam of lion, goat and dragon – makes the term all the more appropriate, given that Chimerica has generated massive and terrifying distortions in the global economy that cannot be corrected without serious consequences.

In 2009, these distortions led Ferguson and Schularick to forecast Chimerica's collapse – a prediction that seems to be coming true. With the reserves' long-term effects on China's internal economic dynamics finally taking hold, selling off foreign-exchange reserves is now in China's interest.

Over the last decade, the vast quantities of short-term capital that were being pumped into China's banking system drove commercial banks and other financial institutions to expand credit substantially, especially through the shadow banking system, leading to a massive credit bubble and severe over-investment. In order to manage the resulting increase in risk, China's new leaders are now refusing to provide further liquidity injections, as well as curbing loans to unprofitable sectors.

But these efforts could trigger a financial crisis, requiring China to initiate a major recapitalization of the banking system. In such a scenario, non-performing loans in China's banking system would probably amount to roughly US$1 trillion. The most obvious means of recapitalizing China's banks would be to inject renminbi-denominated government debt into the banking sector. But China's total public debt, including off-balance-sheet local-government financing vehicles, probably amounts to around 70% of GDP already.

To describe the symbiotic relationship between China's export-led GDP growth and America's excessive consumption, the economic historians Niall Ferguson and Moritz Schularick coined the term "Chimerica."

Despite debate over the details, the conclusion of Carmen Reinhart and Kenneth Rogoff – that a high debt/GDP ratio can inhibit economic growth – remains widely accepted, so it is unlikely that raising the debt ratio to 100% would be in China's long-term interest.

Even if China's leaders decided that they had the necessary fiscal latitude to pursue such a strategy, they probably would not owing to the risk of inflation, which, perhaps more than any other economic variable, tends to lead to social unrest.

Given this, in the event of a crisis, China would most likely have to begin selling off its massive store of U.S. debt. Fortunately for China, the negative consequences of such a move would probably be far less severe than previously thought.

To be sure, an injection of U.S. Treasuries into the banking sector, and their subsequent conversion to renminbi, would still strengthen China's currency. But the rise would most likely be offset by capital outflows, as looser capital controls would enable savers to escape the financial crisis. Moreover, even if the renminbi became stronger in the short term, China is no longer as dependent on maintaining export competitiveness as it once was, given that (excluding assembly and reprocessing) exports now contribute less than 5% of China's GDP.

Against this background, the U.S. Federal Reserve, rather than focusing only on "tapering" its monthly purchases of long-term securities (quantitative easing), must prepare itself for a potential sell-off of U.S. debt. Given that a Fed-funded recapitalization of China's banking system would negate the impact of monetary policy at home, driving up borrowing costs and impeding GDP growth, the Fed should be ready to sustain quantitative easing in the event of a Chinese financial crisis.

After spending years attempting to insulate the U.S. economy from the upshot of its own banking crisis, the Fed may ultimately be forced to bail out China's banks, too. This would fundamentally redefine – and, one hopes, rebalance – U.S.-China relations.

Are Emerging Markets Submerging?

Kenneth Rogoff

With economic growth slowing significantly in many major middle-income countries and asset prices falling sharply across the board, is the inevitable "echo crisis" in emerging markets already upon us? After years of solid – and sometimes strong – output gains since the 2008 financial crisis, the combined effect of decelerating long-term growth in China and a potential end to ultra-easy monetary policies in advanced countries is exposing significant fragilities.

The fact that relatively moderate shocks have caused such profound trauma in emerging markets makes one wonder what problems a more dramatic shift would trigger. Do emerging economies have the capacity to react, and what kind of policies would a new round of lending by the International Monetary Fund bring? Has the eurozone crisis finally taught the IMF that public and private debt overhangs are significant impediments to growth, and that it should place much greater emphasis on debt write-downs and restructuring than it has in the past?

The market has been particularly brutal to countries that need to finance significant ongoing current-account deficits, such as Brazil, India, South Africa and Indonesia. Fortunately, a combination of flexible exchange rates, strong international reserves, better monetary regimes and a shift away from foreign-currency debt provides some measure of protection.

Nevertheless, years of political paralysis and postponed structural reforms have created vulnerabilities. Of course, countries like Argentina and Venezuela were extreme in their dependence on favorable commodity prices and easy international financial conditions to generate growth. But the good times obscured weaknesses in many other countries as well.

The growth slowdown is a much greater concern than the recent asset-price volatility, even if the latter grabs more headlines. Equity and bond markets in the developing world remain relatively illiquid, even after the long boom. Thus, even modest portfolio shifts can still lead to big price swings, perhaps even more so when traders are off on their August vacations.

The market has been particularly brutal to countries that need to finance significant ongoing current-account deficits, such as Brazil, India, South Africa and Indonesia.

Until recently, international investors believed that expanding their portfolios in emerging markets was a no-brainer. The developing world was growing nicely, while the advanced countries were virtually stagnant. Businesses began to see a growing middle class that could potentially underpin not only economic growth but also political stability. Even countries ranked toward the bottom of global corruption indices – for example, Russia and Nigeria – boasted soaring middle-class populations and rising consumer demand. This basic storyline has not changed. But a narrowing of growth differentials has made emerging markets a bit less of a no-brainer for investors, and this is naturally producing effects on these countries' asset prices.

A step toward normalization of interest-rate spreads – which quantitative easing has made exaggeratedly low – should not be cause for panic. The fallback in bond prices does not yet portend a repeat of the Latin American debt crisis of the 1980s or the Asian financial crisis of the late 1990s. Indeed, some emerging markets – for example, Colombia – had been issuing public debt at record-low interest-rate spreads over U.S. treasuries. Their finance ministers, while euphoric at their countries' record-low borrowing costs, must have understood that it might not last.

Yes, there is ample reason for concern. For one thing, it is folly to think that more local-currency debt eliminates the possibility of a financial crisis. The fact that countries can resort to double-digit inflation rates and print their way out of a debt crisis is hardly reassuring. Decades of financial-market deepening would be undone, banks would fail, the poor would suffer disproportionately, and growth would falter.

Alternatively, countries could impose stricter capital controls and financial-market regulations to lock in savers, as the advanced countries did after World War II. But financial repression is hardly painless and almost certainly reduces the allocative efficiency of credit markets, thereby impacting long-term growth.

If the emerging-market slowdown were to turn into something worse, now or in a few years, is the world prepared? Here, too, there is serious cause for concern.

The global banking system is still weak in general, and particularly so in Europe. There is considerable uncertainty about how the IMF would approach an emerging-market crisis after its experience in Europe, where it has had to balance policies aimed at promoting badly needed structural change in the eurozone and those aimed at short-run economic preservation. That is a topic for another day, but the European experience has raised tough questions about whether the IMF has a double standard for European countries (even those, like Greece, that are really emerging markets).

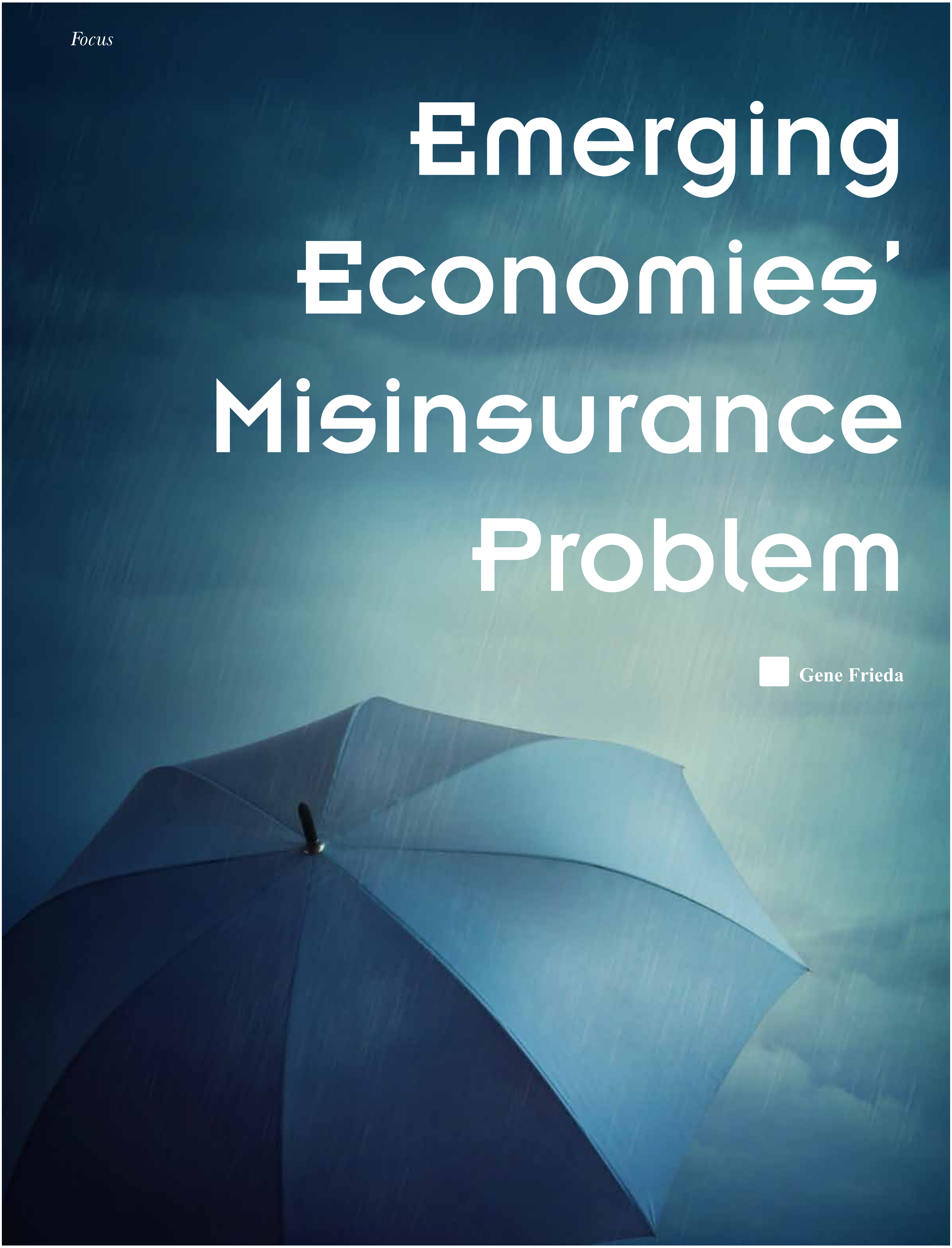
It is to be hoped, of course, that things will not come to that. It seems unlikely that international investors will give up on emerging markets just yet, not when their long-term prospects still look much better than those of the advanced economies.

Besides, the current sentiment that the eurozone has gotten past the worst seems exceedingly optimistic. There has been only very modest structural reform in countries like Italy and France. Fundamental questions, including how to operate a banking union in Europe, remain contentious. Spain's huge risk premium has almost disappeared, but its debt problems have not. Meanwhile, across the Atlantic, the political polarization in Washington is distressing, with another debt ceiling debacle looming. Today's retreat to advanced-country asset markets could quickly revert to retreat *from* them.

The emerging-market slowdown ought to be a warning shot that something much worse could happen. One can only hope that if that day should ever arrive, the world will be better prepared than it is right now.

Emerging Economies' Misinsurance Problem

Gene Frieda



Over the last decade, America's expansionary monetary policy and China's rapid growth have been the two key drivers of global financial flows. Now, both dynamics are being reversed, generating new risks for the global economy – particularly for emerging markets. Whether they can cope with these changes will depend on whether they have taken out enough insurance against the right risks.

Following the Asian financial crisis of the late 1990s, emerging economies began to accumulate massive foreign-exchange reserves to protect themselves against the risks of external over-indebtedness. In fact, they amassed far more than they needed – US$6.5 trillion, at last count – effectively becoming over-insured against external balance-of-payments shocks.

But they remained underinsured against domestic credit risks – the leading threat to emerging economies today. After the global financial crisis erupted in 2008, interest rates plummeted, fueling private-sector credit booms in many of the largest emerging markets, including Brazil, India, Indonesia and Turkey.

Although these booms were initially financed by domestic capital, they soon became dependent on foreign capital, which flowed into their economies as advanced-country central banks pumped huge amounts of liquidity into financial markets. Now, just as the U.S. Federal Reserve contemplates an exit from its unconventional monetary policies, emerging economies' current-account positions are weakening, making their reliance on capital inflows increasingly apparent – and increasingly dangerous.

Ironically, today's pain stems from one of the great successes that emerging economies have achieved: the reduction of foreign-currency funding in favor of local-currency debt. As emerging-market central banks leaned against heavy capital inflows in order to mitigate exchange-rate appreciation, their currencies became less volatile. The resulting perception that currency risk was declining bolstered capital inflows further.

This virtuous feedback loop has now turned vicious, with capital inflows amounting to only a fraction of outflows. Given this, the likely upshot of monetary tightening in the advanced economies will be a long depreciation of emerging-market currencies and, in turn, a significant interest-rate hike – a trend that puts emerging economies at risk for the kinds of credit crises that have bedeviled developed economies over the last six years.

Had emerging economies resisted the temptation of excessive private-sector credit growth, raising interest rates in order to stabilize currencies would not pose a severe threat to economic performance.

The higher interest rates rise to stabilize emerging markets' currencies, the more severe their crises will be. Ultimately, even if emerging economies manage to diversify their funding away from foreign currencies, they will remain hostages to U.S. monetary-policy cycles.

Had emerging economies resisted the temptation of excessive private-sector credit growth, raising interest rates in order to stabilize currencies would not pose a severe threat to economic performance. But, unsurprisingly, they did not; rather, they succumbed to the notion that unprecedentedly high rates of GDP growth were the new normal.

Nowhere was this more apparent than in China, where double-digit annual output gains long obscured the flaws in a state-led, credit-fueled growth model that favors state-owned enterprises (SOEs) and selected industries, like the real-estate sector, to the detriment of private savers.

Since 2008, banking-sector credit growth in China has been among the fastest in the world, far outpacing GDP growth, and China's total debt has risen from 130% of GDP to 220% of GDP. As of this year, ¥1 of GDP growth is consistent with more than ¥3.5 of credit growth. China's financial sector is now increasingly feeling the strain of this rapid credit growth, which has led to overcapacity in favored sectors and mounting debt problems for local governments, SOEs, and banks.

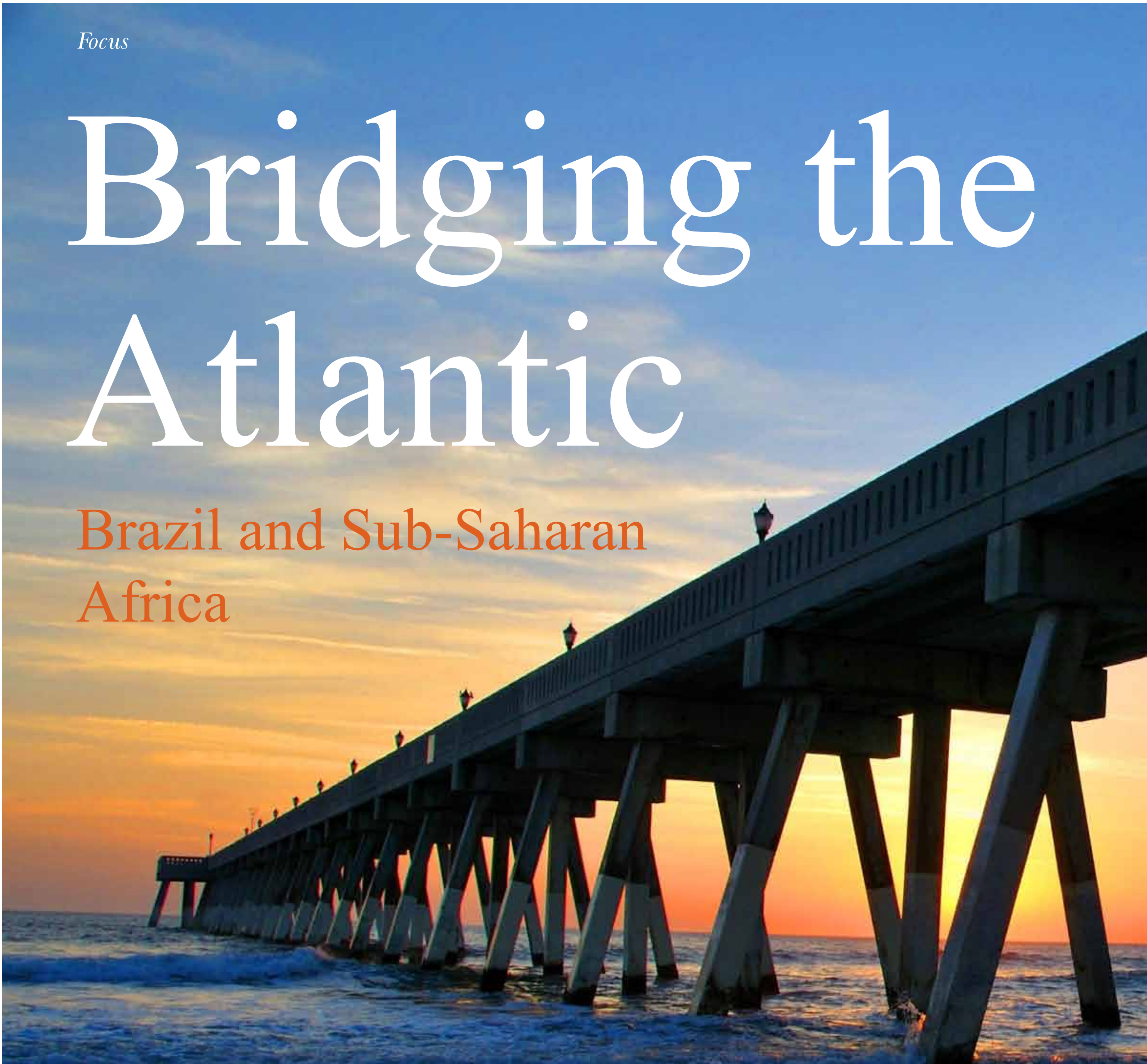
Meanwhile, China's shadow banking system has expanded at an unprecedented rate. But here, too, mounting risks have been largely ignored, owing partly to the collateralization of real property, which is believed to retain its value permanently, and partly to the system of implicit government guarantees that backs loans to local governments and SOEs.

At the very least, the combination of higher interest rates in the shadow banking sector and weaker nominal GDP growth undermines borrowers' debt-repayment capacity. In a worst-case scenario, falling property prices or diminishing faith in implicit government guarantees would compound the risks generated by the shadow banking system, severely undermining China's financial stability.

In that sense, although China, with its US$3.5 trillion stock of foreign-exchange reserves, may seem to exemplify emerging economies' tendency to be over-insured against external risks, it actually faces the same credit risks as its counterparts. The difference is that China has implemented structural – and thus longer-lasting – credit-based policies, while other emerging economies have been drawn into a cyclical lending binge.

Indeed, China's slowness to implement an alternative to the investment-led, debt-financed growth model that has prevailed for the last two decades means that its domestic credit risks are the most significant threat to the global economy today. While China may have the financial resources to cover its debt overhang, it risks being left with a low-to-middle-income economy, high debt levels and nominal growth rates roughly two-thirds lower than the 17% average annual rate achieved in 2004-2011. This is bad news for other emerging economies, which have depended heavily on China's growth for their own.

Unless emerging-market governments take advantage of the limited space provided by their foreign-exchange reserves and floating currencies to enact vital structural reforms, the onus of adjustment will fall on interest rates, compounding the effects of slowing growth and the risks associated with bad debt. Whether this becomes a systemic issue affecting the entire global economy will hinge on China.



Bridging the Atlantic

Brazil and Sub-Saharan Africa

Bridging the Atlantic is a descriptive study of Brazil's involvement with counterparts in sub-Saharan Africa over the last decade through knowledge exchange, trade and investments. The objective of the study is to understand these relations better with the intent to forge concrete and mutually beneficial partnerships between Brazil and sub-Saharan Africa. Two elements explain the focus on the last decade. First, although Brazil and sub-Saharan Africa have interacted with one another for at least 200 years, only in the last decade was a more robust engagement built, through stronger partnerships and long-term projects. Second, neither in Brazil nor in Africa was there a practice of collecting, organizing and analyzing data on early partnerships, a serious obstacle to obtaining reliable information.

Brazil and sub-Saharan Africa are natural partners, with at one point a shared geography and later a shared history. About 200 million years ago, Africa and Brazil were parts of the landmass of Gondwana (figure ES.1). Between the sixteenth and early nineteenth centuries, the transatlantic slave trade united the two regions until slavery's abolition. Now, the two areas are reestablishing connections that will affect each other's prosperity and development in major ways. This renewed engagement reflects new, positive realities in the evolution of development cooperation, Africa's

rapid growth in recent years, and Brazil's rise as a global economic power interested in intensifying its ties – cultural and commercial – with Africa.

South-South Cooperation Is Transforming Development Assistance

The traditional North-South model of development aid, challenged since the 1970s, has given way to alternative arrangements for financial and technical cooperation among developing countries. The 1990s brought a broad recognition that previous models had failed to promote development and tackle the root causes of poverty. In search of alternatives, and to increase their bargaining power in the new century, developing countries began to devise new arrangements. On the economic front, the creation of the Group of 20 (G-20) in December 1999 reflected the new role of large developing economies in the global architecture, and, in 2001, the four growing economies of Brazil, Russia, India and China were joined under the "BRIC" label. In late 2010, after the group had held two summit meetings, South Africa joined the group, now known as "BRICS." On the political front, the India-Brazil-South Africa (IBSA) Dialogue Forum was established in Brazil in mid-2003 as a space for the three emerging multiethnic and democratic global players to exchange knowledge and reinforce common interests.

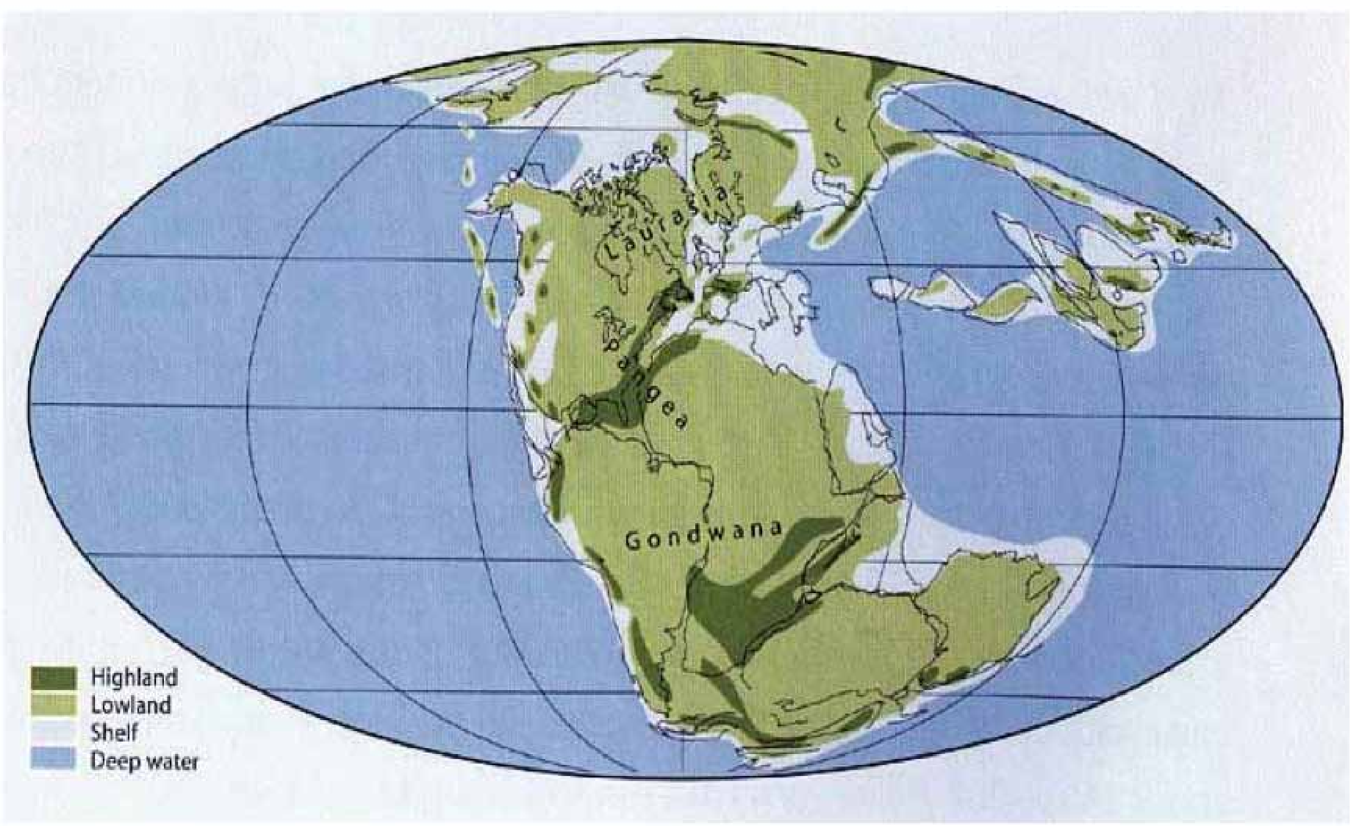
such as the Africa and South America Cooperation Forum, the Common Market of the South (Mercosur), and the Southern African Customs Union.

Over the past decade Africa has become a continent of opportunities, with positive economic trends and improved governance. The continent is now often portrayed as a new frontier for those seeking partners and markets. The growth of some African countries, their resilience to recent global crises, and policy reforms that have strengthened markets and democratic governance are increasing trade and investment. Yet despite these positive trends, many African countries still face an enormous infrastructure gap, are vulnerable to climate change, and suffer from weak institutional capacity. Hence aid remains one of the main sources of development support in several countries on the continent, and transfers and exchanges of knowledge are still urgently needed.

The administration of Luiz Inácio Lula da Silva (2003-10) revived Brazil's interest in Africa and set it on a surer footing, as part of a larger goal of expanding Brazil's global profile. For example, President Lula da Silva visited Africa during his tenure 12 times, taking in 21 countries, something unprecedented among Brazil's past leaders.

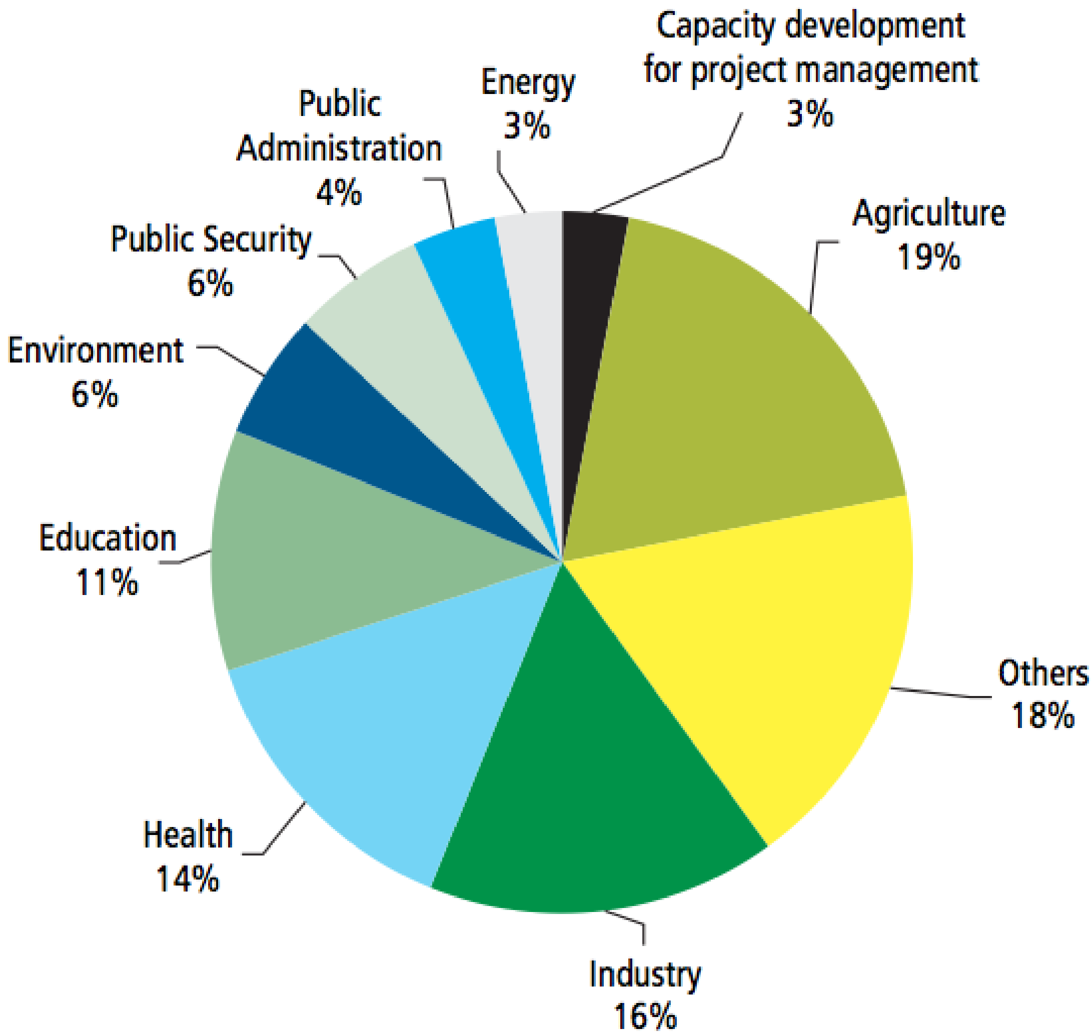
Traditionally, studies of Brazil-Africa relations have tended to concentrate on the links of both Brazil and Africa to countries in the Northern Hemisphere. While these North-South studies have contributed to an understanding of Brazil and Africa in an international context, they have also distorted the cultural, political and social history that binds Brazil and Africa, including the legacy of the transatlantic slave trade. Research on Brazil-Africa relations has brought new perspectives to the traditional pattern of North-South analysis by looking at the South Atlantic as a channel of cultural transfers or political and social experiences, rather than as a geopolitical ocean like the North Atlantic. Such research has shown that strong connections, cultural identities and common patterns were created by the long-term experiences of Africa in Brazil and vice versa, and improved the historiography of Brazil-Africa relations.

Figure ES.1 Millions of years ago, Africa and Brazil were joined in a single landmass



Source: Natural Resources Canada 2007.

Figure ES.2 Main areas of Brazil's involvement in South–South cooperative arrangements, 2009



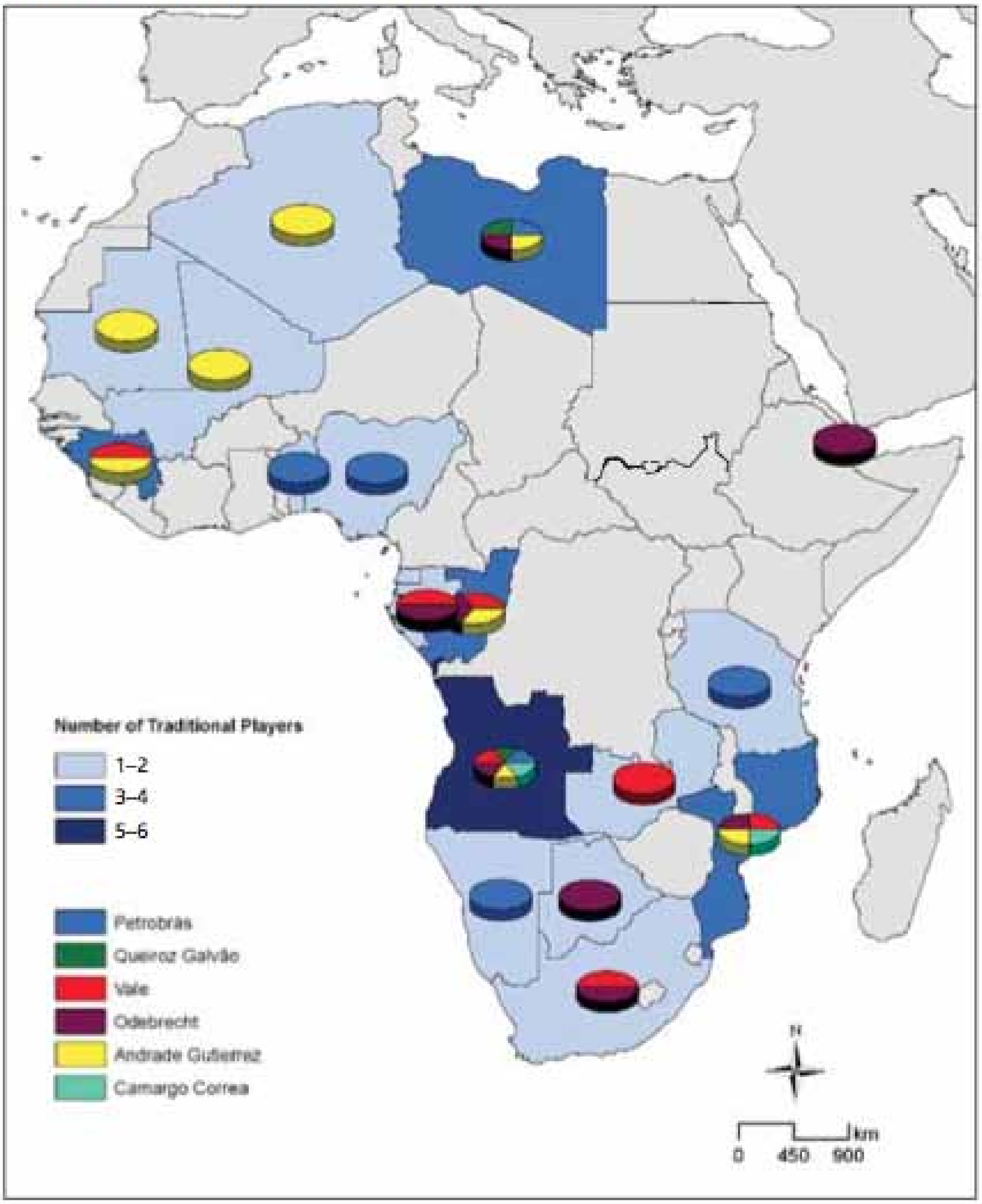
Source: ABC 2009.
Note: Shares are percentages of total project portfolio.

Complementary Interests

Since the turn of the 20th century, Africa has become one of the major fronts of Brazil's international agenda. Africa is rapidly changing and Brazil has expressed growing interest in supporting and taking part in African development. Brazil's intensified engagement with Africa demonstrates both geopolitical ambition and economic interest, but its strong historical ties and affinities with Africa set it apart from the other original BRIC countries. Brazil's economic growth, its increasing role as a global player, its success in narrowing social inequality, and its development experience offer lessons for African countries. African countries are therefore increasingly seeking Brazil's cooperation, technical assistance and investment. Brazilian international enterprises, non-governmental organizations and social groups are including Africa in their plans. In other words, the new Africa coincides with a global Brazil. Moreover, in the past five or six years the Brazilian "Black movement" has helped to develop a new set of public policies and norms, including new federal institutions on racial issues, mandatory study of Afro-Brazilian and African history and culture in public and private schools and universities, and incentives to increase the number of people of African descent attending the Instituto Rio Branco, Brazil's renowned school of diplomacy.

Complementing these strong historical and cultural links, Brazilian technology seems

Figure ES.3 Brazilian corporations in Africa, 2010



Source: Prepared by authors.

to be easily adapted to many African nations because of similarities in soil and climate, among other things. Brazil's recent successes on the social and economic fronts have attracted attention from many African countries beyond the Portuguese-speaking nations with which Brazil has historical connections. Brazil now has 37 embassies in Africa, up from 17 in 2002, a rise matched by the increase in African embassies in Brazil: since 2003, 17 embassies have opened in Brasilia, adding to the 16 already there, in the largest concentration of African embassies in the Southern Hemisphere. Countries in sub-Saharan Africa have requested cooperation from Brazil in five key areas: tropical agriculture, tropical medicine, vocational training (to support the industrial sector), energy and social protection (figure ES.2). (Areas of less interest include higher education and sports.)

Tropical agriculture. The Brazilian Agriculture Research Corporation (EMBRAPA) – with the Brazilian Cooperation Agency (ABC) and several other Brazilian research institutions – has engaged with local partners in implementing model projects in agriculture that aim to replicate successes in the Brazilian savannah (cerrado) and improve agricultural development and agribusiness. Examples include the Cotton Four Project (Benin, Burkina Faso, Chad and Mali), the project on Technical Support to the Development of Agricultural Innovation in Mozambique and the Rice-Culture Development Project in Senegal.

Tropical medicine. As of 2011, Brazil has 53 bilateral agreements on health signed with 22 African countries. Brazil's approach to HIV/AIDS treatment and other prevalent diseases, including malaria and sickle cell anemia, is highly regarded by African peers. The Oswaldo Cruz Foundation (FIOCRUZ), a Brazilian institution for research and development in the biochemical sciences, is leading partnerships with local institutions in Africa. As well as running model projects on tropical medicine, FIOCRUZ is partnering with the government of Mozambique to build a pharmaceutical plant to produce generic drugs to treat HIV/AIDS and other diseases. The plant will enable Mozambique to export to neighboring countries.

Vocational training. The Brazilian National Service for Industrial Apprenticeship (SENAI) has built vocational centers in Cape Verde, Guinea-Bissau, Mozambique, and São Tomé and Príncipe, and has recently established partnerships with Angola, Congo and South Africa to address vocational training for promoting industrialization and supporting youth employment policies.

Energy. Sustainable energy is another area in which Brazilian expertise has gained the attention of several African nations. Successes in agriculture were not enough to reduce poverty. Thus, public policies that promote economic growth and social inclusion are at the heart of Brazil's sugarcane production – for example, local and family-based farms have been helped to produce ethanol. The Brazilian private sector is also involved with energy issues in Africa. A good example is BIOCOM, a joint venture between the Brazilian firm Odebrecht, the Angolan state company Sonangol and the Angolan firm Demer. An investment of US$400 million aims at using sugarcane to produce sugar, ethanol and power.

Social protection. Despite the huge challenges faced by policy makers in a country known for having one of the largest income-inequality gaps in Latin America, a few programs offer social protection. Since 2003, policies aimed at fighting hunger and marginalization have been implemented, one of the most successful being the Zero Hunger initiative, which includes several programs (such as the renowned Bolsa Família) sponsored through a strong partnership among 12 ministries and agencies. The Brazilian experience in social protection is now being adapted and replicated in other developing countries, including Angola, Kenya and Senegal, with activities to build conditions for more inclusive growth.

Since most projects between Brazil and African countries began less than 10 years ago, proper evaluation of the outcomes still falls short. Initial results have, however, often been positive, highlighting the potential for more sustained and longer-term engagement.

Brazilian private investment in Africa emerged in the 1980s and has now reached such an extent that Brazilian corporations are present in almost every area of the continent, concentrated in infrastructure, energy and mining.

Unprecedented Growth in Economic Relations

Brazil's trade with Africa increased between 2000 and 2010 from US$4 billion to US$20 billion, creating a propitious environment for the Brazilian National Economic and Social Development Bank (BNDES) to launch measures for furthering trade between the two regions on the basis of Brazilian loans. The stimulus given to Brazilian exports has also been central to the expansion of trade. In 2008, stimulus programs for Brazilian companies active in Africa (under an initiative known as Program Integration with Africa) resulted in the disbursement of R$477 million (approximately US$265 million), a sum that jumped to R$649 million (US$360.5 million) the following year.

Brazilian private investment in Africa emerged in the 1980s and has now reached such an extent that Brazilian corporations are present in almost every area of the continent, concentrated in infrastructure, energy and mining (figure ES.3). The Brazilian presence stands out because of the way Brazilian corporations do business. They tend to hire a local workforce for their projects, favoring the development of local capacity, which ultimately raises the quality of services and outputs. The leading Brazilian companies in Africa by investment and sales volume are Andrade Gutierrez, Camargo Correa, Odebrecht, Petrobras, Queiroz Galvão and Vale.

Given the favorable business environment for Brazilian investment in Africa, the Brazilian Export Agency has been fostering small and medium-sized enterprises in Africa – through business fairs, for example. At one event in April 2010 in São Paulo, Brazilian and African companies signed contracts and closed deals worth about US$25 million in sectors such as food and beverages, clothing and footwear, automotive, electronics, housing and construction, and cosmetics.

The trends analyzed in this report indicate that, overall, Brazil and Africa are jointly developing a model of South-South relations that could benefit both.

Useful Lessons for International Organizations

The World Bank Group has played a peripheral role in forging the growing relationship between Brazil and sub-Saharan countries, although this is now changing under the Bank's renewed Africa Strategy. South-South cooperation will play a key role in the future through partnerships, knowledge exchange and finance. But better tools and incentives are needed if the Bank is to systematically incorporate and leverage South-South engagement in implementing this strategy, particularly in investment and trade.

While relations between Brazil and Africa have greatly intensified over the past decade, substantial obstacles remain – in particular, a knowledge gap on both sides of the South Atlantic. Most Brazilian individuals and companies – including many small and medium-sized enterprises – have limited and often outdated information on Africa. What information they have is often limited to Angola, Mozambique and occasionally South Africa. Many non-Lusophone African countries are faced with language obstacles when obtaining information from Brazil, especially from the government, since such information is rarely available in English or French. Another impediment is that – despite the geographic proximity of West Africa and eastern Brazil – there are few direct flights between the two, and bureaucracy on both sides can slow maritime trade to 80 days instead of a possible 10. The World Bank could assist in overcoming these obstacles, enabling the Africa-Brazil relationship to expand and bring additional benefits to all sides.

The growing relationship between Africa and Brazil reveals broader lessons for the World Bank and other international players, who would do well to strengthen support for South-South initiatives overall. There are, of course, unique historical, cultural, and geographic aspects of the Brazil-Africa case that make the willingness of Brazil (to share its successes) and the interest of African countries (to learn from Brazilian experiences) fertile ground for the Bank to demonstrate its role as connector and knowledge facilitator.

The World Bank could also play a direct role in catalyzing South-South cooperation through promoting the participation of Brazilian companies (and those in other emerging markets like India and South Africa, for example) in the Bank's procurement, particularly in Africa. This would have the beneficial effect of bringing more directly relevant experience from Brazilian companies to Africa, as well as signaling the growing role that emerging nations are playing in the Bank. Through the Enterprise Outreach Services – which aim to strengthen the World Bank Group's relations with the private sector so as to inform and promote the participation of private companies – the Bank could organize awareness-raising workshops in Brazil (as it does for European and U.S. firms) about the Bank's products and services to foster private sector investment in Africa.

The growing relationship between Africa and Brazil reveals broader lessons for the World Bank and other international players, who would do well to strengthen support for South-South initiatives overall.

Other ways in which the Bank could strengthen Brazil-Africa relationships:

Supporting South-South collaboration – Providing support to the parties (Brazilian government or private sector, African governments or private sector) for specific South-South projects, through lending, guarantees, or other forms of assistance. This could entail, for example, expanding projects that originated in bilateral relations between Brazil and a given African country to other African countries. A Brazilian technical assistance project in Mozambique may, for instance, be highly relevant to Tanzania; the Bank could help disseminate information on that project, either through Bank staff or by funding Brazilian or Mozambican experts to apply the experience in Tanzania. The Bank could also facilitate broader knowledge and best-practice exchange between Brazil and Africa, particularly Lusophone countries, given the interest among African countries in Brazilian best practices. It would be equally beneficial to promote joint applied research between African and Brazilian academic and learning institutions.

Examining the current and potential impact of the Bank's traditional activities of relevance to South-South cooperation through the prism of that cooperation. Relevant areas include the investment climate, governance, agriculture, health, education and justice. As an example, Brazil's highly successful program on HIV/AIDS and malaria prevention and treatment are directly relevant to the Bank's initiatives.

Improving coordination across Bank regions and between sectors and regions by setting up cross-regional teams (for example, between the Latin America and the Caribbean Region and the Africa Region) to exchange experiences and implement specific South-South activities, sometimes with initiatives already under way.

Systematically incorporating measurable South-South dimensions into country assistance strategies, country partnership strategies, country assistance evaluations, and so on. Also, evaluating whether specific internal incentives or mechanisms to support South-South cooperation (such as through work programs and job evaluations) could be useful, while not creating new bureaucracies. As part of this exercise, it would be useful to gather and disseminate successful examples of Bank work in this area, such as the Brazil Country Management Unit's work program for South-South cooperation, to help streamline such activities in a more systematic and strategic way across the Bank.

Systematically consulting with the Brazilian government as well as with other major emerging-nation governments involved in South-South cooperation as practitioners or donors, such as the BRICS nations, to get their views on how Bank support could be made more relevant and effective. The objective would be both practical and strategic – namely, to help the Bank overcome the perception among some stakeholders that it does not sufficiently recognize and understand their contributions to development. A specific example could be the exploration of a joint program between the World Bank Group and BNDES to support Brazilian trade and investment in Africa.

Within the Bank, expanding the focus of actual South-South activities from the World Bank Institute to other areas (particularly infrastructure, investment climate and private sector development, governance, health and education) and including more technical assistance and lending in these areas (in addition to knowledge exchange). In particular there is the need for more activities directly related to investment, private sector development and job growth, which so far seems to be outside the main scope of South-South activities contemplated in Bank programs.

Exploring where there are specific areas or aspects of programs that relate to South-South development projects that could benefit from joint work programs or goals, because coordination between the Bank, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency remains a challenge for supporting South-South cooperation. Two among many examples are greater alignment between the Bank and IFC country offices in key emerging markets for the promotion of sustainable South-South investment and better training, and incentivizing Bank (and IFC) staff in country offices to "cross-sell" the guarantee services of the Multilateral Investment Guarantee Agency.

Further strengthening coordination with other multilateral bodies, particularly the newer South-South mechanisms, for the Bank to be an effective player in South-South cooperation, overcome some stereotypes in developing countries, and avoid duplication of efforts. The Bank, for example, is in an excellent position to facilitate an annual global South-South development summit, preferably in an emerging or developing country.

About the Author

Summary Provided by World Bank
www.worldbank.org/bridgingtheatlantic.org

Alternative Energy Investments in Central America

Ed Gish & Stephen Kaczor

This article examines recent developments in energy integration and the generation and transmission of alternative energy sources such as hydroelectric, wind and solar in Central America. A series of case studies provide insights into the sector.

International investment banks, public financing and private equity investors are banking on SEIPAC, the new "Central American Electrical Interconnection System" connecting the power grids of six Central American nations. As of early 2013, new transmission lines connect 37 million consumers in Panama, Costa Rica, Honduras, Nicaragua, El Salvador and Guatemala.

This level of energy integration is not even enjoyed by the European market, and SIEPAC is the first step of a Pueblo-Panama plan, a multi-billion dollar integration project enabling energy exports from Central America to Mexico.

Transmission; Regional Energy Integration

What are the opportunities and risks? What is the outlook for individual investors?

The Inter-American Development Bank provided three reasons justifying public financing of SIEPAC:

1. In the absence of a regional project, the individual countries would not have the incentive to carry out such infrastructure investments.
2. There are imbalances between the returns and risks involved in the transmission of electric power that are not conducive to private investment in a regulated activity where vertical integration is not permitted.

"The electrical companies are making money at the expense of Panamanians. Obviously it's an imbalance. End users could be paying up to 260% of the cost of production."

3. The strategic importance of electric power transmission in creating incentives and disincentives for investments.

SIEPAC promises to increase coordination and competition. One of the objectives is to create a platform with public financing that ensures the private sector takes an increasingly greater role in the sector, particularly in generating capacity, which requires more investment and, historically, risk.

It is essential to consider the perspective of SIEPAC's opponents. Critics argue that SIEPAC will not make electricity cheaper for Central Americans, as developers suggest. The initial Environmental Impact Assessment financed by the IDB analyzed only the direct impacts of transmission lines and not indirect impacts. (Source: www.InterAction.org.) In the case of hydroelectric, many believe tariffs will increase as foreign corporations gain exclusive concessions to develop formerly public rivers.

Financing Case Study

ACON Latin America Opportunities Fund is a private equity investment firm that leads a consortium that includes the Netherlands Development Finance Company FMO and the French Development Bank PROPARCO to invest in a controlling interest in Panama's Hidrotenencias S.A. in partnership with Mexico's Asergen, S.C. and financing from Panama's Banco General. Hidrotenencias owns three 10MW run-of-the-river hydroelectric projects in Panama's Chiriqui province, for a total of 30MW capacity.

Washington-based ACON was one of the first private equity firms to invest in Latin America. Founded in 1996, it manages US$2.25 billion of capital in its various funds, including three focused on Latin America. In the last decade, ACON has invested in over 28 transactions in nine different countries in the region.

In the latest instance, ACON's Latin American Opportunities Fund (ALAOF) financed Hidrotenencias, S.A. Its investment strategy in Latin America focuses on scenarios "where limited access to financing in the middle-market creates opportunities to achieve private equity returns with instruments that rank higher in the capital structure and are often highly collateralized." (Source: ACON Press Release.)

Generation: Hydroelectric Case Study

The Bonyic Hydroelectric Project is Panama's newest, scheduled to come online in August 2014. It is in the territory of the indigenous Naso tribe where the Rio Bonyic flows through the Palo Seco Forest Reserve. It is a public-private consortium with

Panama's government and Colombia's Grupo EPM based in Medellin.

The Bonyic project consists of a 30MW plant utilizing three turbines to generate 150GW per year. The turbines are fed by a 13-Hectare reservoir via a 4,000 meter tunnel at a cost of US$160 million. It will connect to Panama's grid on the Caribbean where transmission lines from the country's largest dam, La Fortuna, pass en route to Costa Rica's grid to join SIEPAC.

The turbines at Bonyic have a useful life of 50 years, according to project engineer Humberto Serracin. Amortizing the construction cost over this period, the annual output of 150GW costs US$3.2 million, or 8 cents per kilowatt hour. Larger hydroelectric projects produce one kilowatt hour of electricity for 4 cents. Transmission costs average 1 cent and distribution costs (utility companies) average 5 cents per kilowatt hour.

So the cost of hydroelectric power ranges between 10 and 14 cents per kilowatt hour. Panama's average retail sales price per kilowatt hour is 18-22 cents.

"The electrical companies are making money at the expense of Panamanians. Obviously it's an imbalance. End users could be paying up to 260% of the cost of production." (Source: Jose Blandon, Director, IRHE (Instituto de Recursos Hidraulicos y de Electrificacion).)

Billing of kilowatt hours in Costa Rica parallels U.S. prices, peaking at 32 cents per kilowatt hour. (Source: ICE website.) Exporting electricity via SIEPAC is obviously an attractive initiative for those holding concessions in Panama.

Generation: Wind Case Study

In August 2013 Panama's first wind farm was celebrated with a press conference near Penonome in central Panama. When the project is completed at an estimated cost of US$450 million, it is expected to provide approximately 10% of Panama's electricity requirements.

These turbines are to be operated by Spanish-owned Union Eslica, whose director, Rafael Perez-Pire Angelo told Reuters, "It will be the biggest in Central America, without a doubt, and one of the top five in Latin America." According to Perez-Pire Angelo, when completed, there will be 135 turbine towers covering 47,000 acres supplying power for an estimated 850,000 people.

While two-thirds of Panama's electricity comes from hydroelectric power plants, and more are being built, dry season droughts have forced the rationing of electricity, resulting in the closing of schools and government offices. Energy Secretary Vicente Prescott told Reuters, "The dry season is when we have the least rain but when we have the most wind. For this reason the new wind farm would have an immediate impact."

Wind power is being looked at as the new go-to source for electricity across Latin America. In Nicaragua, by 2014, it is believed that almost one-third of total energy demand during peak hours will be met by wind power. Honduras unveiled a large wind farm in 2012 and Costa Rica plans to have developed 100MW of wind power by 2015.

Growth and demand created by an expanding economy in Latin America have made the development of alternative power sources like wind and solar a practical necessity.

Generation: Solar Case Study

In February 2013, Nicaragua began construction on a solar farm that will benefit 1,100 homes in the Carazo province. The state-owned National Company of Electricity Transmission, or Enatrel, states the farm contains almost 6,000 solar panels. Japan donated US$11 million for the project and the Nicaraguan government invested US$500,000.

Nicaragua's new farm will generate enough energy to supply homes that consume an average of 150KW hours per month and will supply 2,000MW to the national electrical grid, displacing 1,100 tons of carbon dioxide. This is equivalent to planting one square mile of forest.

While there is no shortage of sunlight in Central America, solar power represents only 4% of the Latin America's energy. (Source: Americas Society/Council of the Americas 2013 Energy Update.) "With electricity costs rising and significant price decreases for solar photovoltaic (PV) equipment, there has been a boom in solar investments throughout Latin America. At the beginning of this year, 10GW of solar projects were planned for the region, though only 90MW are currently operational."

Costa Rican beverage company Florida Bebidas has installed a large solar array on the roof of its distribution center in the city of Liberia in the country's province of Guanacaste. The project is part of a pilot program by the Costa Rican state-run electricity and telecommunications services company, Grupo ICE, which has also installed more than 1,654 solar panels in off-grid projects in rural and indigenous communities, schools, health clinics, ranger stations, community centers and police stations.

Latin America is booming economically, and a growing number of people are climbing out of poverty. This new affluence has created an increased demand for power by industry. In the last ten years the demand for more electricity has grown over 35%. This has attracted energy investors. The fact that the cost of producing solar energy has gone down dramatically in last few years, coupled with its simplicity of production, makes solar power potentially the most profitable and sustainable option.

Prominent movers and shakers in the global solar industry are so optimistic they have made Latin American solar projects a funding priority. GTM Research, a consulting company with a focus on green industries, forecasts that the region will see installation of 450MW of solar capacity in 2013, nearly 400% more than in 2012.

Summary

The European Investment Bank (EIB) announced in August 2013 its agreement to provide US$230 million to support investment in renewable energy programs across Central America.

The joint program with the Central American Bank for Economic Integration will enable more than US$500 million of investment in projects in six Central American countries, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

“Considerable investment is needed to harness the potential of renewable energy and more efficient energy use to reduce carbon emissions and provide energy essential for economic growth,” said Magdalena Álvarez Arza, European Investment Bank vice president responsible for lending in Latin America.

“We have a strong track record of partnership with the Central American Bank for Economic Integration and look forward to continuing this cooperation to benefit investment in the region,” she adds.

The new lending scheme will allow support for public and private sector investment in both renewable energy and energy efficiency projects, the EIB says.

About the Authors

Ed Gish was CEO and Creative Director at Gish Sprague and Associates an advertising agency. He became Vice President of Prime Time On Air Promotion for CBS Entertainment. He subsequently joined King World Productions where he became Vice President of Marketing and Creative Director. He has written and directed numerous television documentaries. He is also the author of “The Sweet Sixteen Murders” published by Next Century Publishing. Mr. Gish presently lives and writes in Boquete, Chiriqui, Panama.

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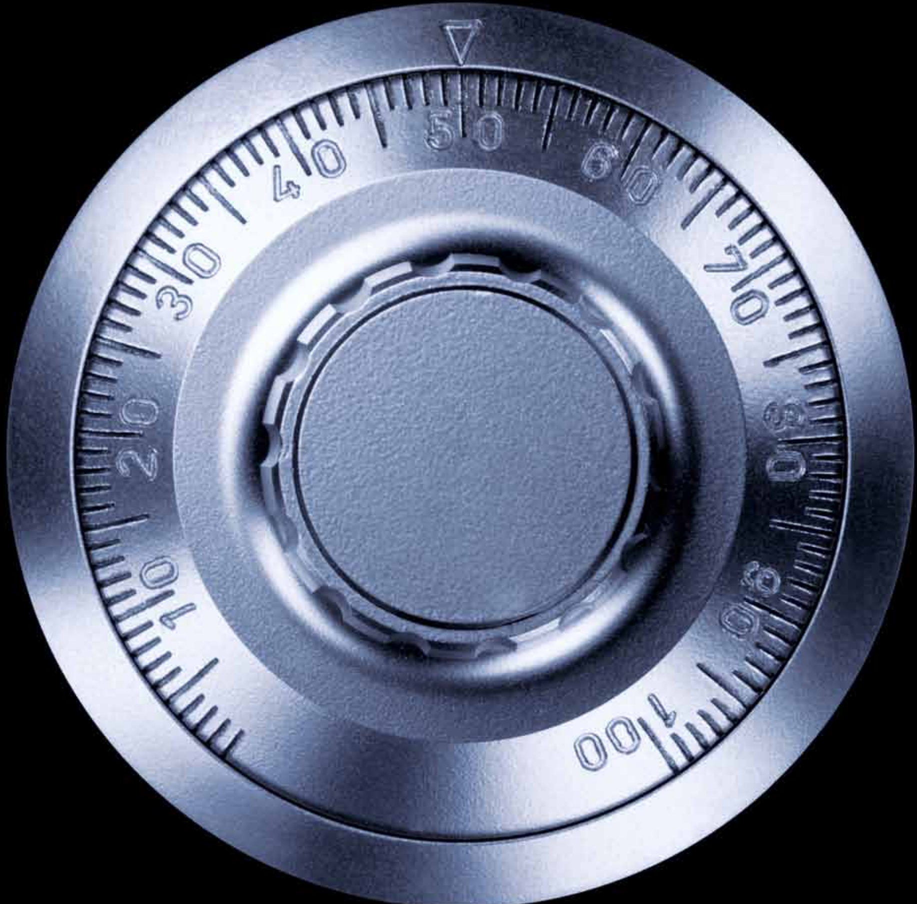
Understanding Asset Protection



The techniques that individuals and business entities are using to safeguard their assets are becoming more and more sophisticated. Additionally, offshore protection measures continue to gain momentum as a way of limiting creditors' access within a legally recognized framework.

"With asset protection you set up a structure where legally you don't own anything, but you control it," says Evgeny Orlov of the New Zealand law firm Equity Law. "Money cannot be taken away if you don't carry it with you, for instance. If placed in a trust it will earn shares in companies and no one will know who the trust belongs to."

"And there are other levels of sophistication. For example, if someone finds out who is behind the trust and wants to break it, then you would have to understand the jurisdiction. In New Zealand it is virtually impossible to break a trust, but if you want a trust that is even more failsafe then you can use New Zealand with a Cook Islands clause jurisdiction, which means that if your trust is sued then all assets are shifted to the Cook Islands. The advantage of that is that the Cook Islands don't recognize foreign judgments."

The better-known techniques for guarding assets generally fall into three categories: exempt assets, trusts or limited liability companies (LLCs). However, James Duggan, Founding Principal of Duggan Bertsch, LLC, a Chicago-based wealth planning firm, says that diversifying your protection schemes by placing assets in a combination of all 3 of these is the ideal solution. He adds that there are pros and cons to dealing with each of these structures.

While exempt assets are inherently protected, non-exempt assets should be transferred to trusts or LLCs. LLC business enterprises are solely managed by the client, and there is a "charging order" protection against a suit. If sued, and if the court upholds the governing statute, then the creditor cannot gain access to the underlying assets, Mr. Duggan says. "They are on the outside looking in." The charging order remedy only entitles creditors to receive any future profit distributions. With LLCs though, the client maintains control of all management and distributions.

"With trusts, you relinquish control, by design, whereas with LLCs you keep the control. But unlike the LLC there is simply no remedy for creditors. For the asset protection trust that is properly structured and implemented by the courts, the creditors are stuck, and there is no asset they can draw from; nothing in that trust should be available for creditors. However, to get this, you have given up control."

Offshore protection

Over the years, those wishing to protect their assets have often been forced to structure their funds and LLCs overseas in order to gain the most favorable terms. And this has been widely adopted, especially in countries or states where asset protection laws are rigid.

In the U.S., for example, many states allow asset exemptions for certain amounts of real estate, retirement assets, and for personal property. However, the laws can vary widely in each state within the U.S. For those states with poor exempt asset statutes or court enforcement, the client must focus more on trusts and LLCs for protection, and often the offshore jurisdictions provide the better solution.

"All states have a statute that governs bankruptcy, so that you can walk away with a basket of assets for a fresh start," Mr. Duggan says.

"Each state differs greatly. And each asset has varying levels of protection. Illinois, for real estate, for example, has a US$15,000 protection rule. However, in Texas or Florida you can have unlimited exemption amounts. It's all down to the legislature. If the home state doesn't serve a client well for asset protection, then the client will have to go elsewhere, such as Delaware, Nevada, Alaska, etc. The client is simply reaching beyond the home state for better laws. So why stop at domestic borders if forced to leave one's hometown anyway? The best laws may actually be outside the U.S."

Offshore protection has often been viewed as an improper way of managing assets, and has carried a stigma of sorts. However, this is something that Mr. Duggan wants to set straight, noting that offshore management is, on occasions, the most logical way to structure assets, and highlighting that this stigma is now greatly "watered down" as more and more states in the U.S. create laws to mirror the offerings of the offshore jurisdictions.

"There is definitely a stigma attached to offshore banking. The IRS has continued its onslaughts and has tried to make that stigma even darker. The reality is, while there is no doubt that there is criminal activity going on offshore, just as much is going on onshore, too. So the issue of compliance has to be raised, and a non-compliant structure is non-compliant outside or in the U.S. We have no interest in non-compliant offshore planning."

"The headlines come from the tax evaders and the criminals. If you set up something and report it within the rules then you should not be audited because of your offshore structures. Everything we do is fully disclosed."

A Critical View

Analyzing the Emerging Markets

Detecting the investment potential and anticipating the risks of the emerging market countries is not an easy task. And as many seasoned investors know, it is not always as simple as analyzing the country as a whole; sector-specific research and accessibility play crucial parts in those all-important decisions.

Investment firm Aberdeen Asset Management has undertaken a project to classify the potential real estate investment hotspots of over 100 emerging market countries. The firm has positioned its selected countries on a consistent and comparable scale, based on 41 independent variables. Ten of these have then been highlighted as being the significant indicators of underlying scale, market opportunity and risks, to "provide a strong indication of the broad position of individual countries."

"Whilst the research highlights some clear country preferences, as some countries scored consistently highly, we have not tried to present an overall rank of countries, as that can be misleading. One could make unwise investments in a 'preferred' country and vice versa, as ultimately any successful investment will be determined by the stock or fund specifics, and they are not necessarily driven by the macro posi-

tion," says Andy Allen, Director of Global Property Research at Aberdeen Asset Management.

"However, we believe having an ability to compare across emerging markets on a consistent basis across the regions of the world, through Asia, Africa, Europe and the Americas, is a valuable starting point."

Analyzing the Details

Mr. Allen says that there are several less understood markets that score very well in terms of multiple factors, such as population growth, the political background and transparency. But critically, Aberdeen's project highlights how accessible to investors these markets are, and how this could suddenly change. Ultimately it is the accessibility of the appropriate investment product that really matters, he says.

"We now have the confidence to understand what macro barriers we may face when investing in emerging markets globally. Some countries look solid in everything other than their accessibility. If these markets become more open and transparent, then they may well be the emerging markets of the future, and ones that everyone wants to think about – we believe these are valuable insights to hold."

Aberdeen analyzes real estate property types that are currently undersupplied and that attract demand from a large base of low- and middle-income households, which includes logistics, retail, and housing.

"Across Aberdeen's 32 'Highly Favorable' countries, 27 have at least one access point and 16 have both a private fund and listed property market. Our proprietary research compares 105 global emerging markets across all regions on a comprehensive, consistent and fully comparable basis. Out of the 215 countries in the World Bank database, we excluded developed countries, which are those with a GDP per capita above US$21,000, and countries with a GDP per capita below US$450 and small islands."

For Aberdeen, the most significant "mega-trend" across the emerging markets is the growth and emergence of the middle class.

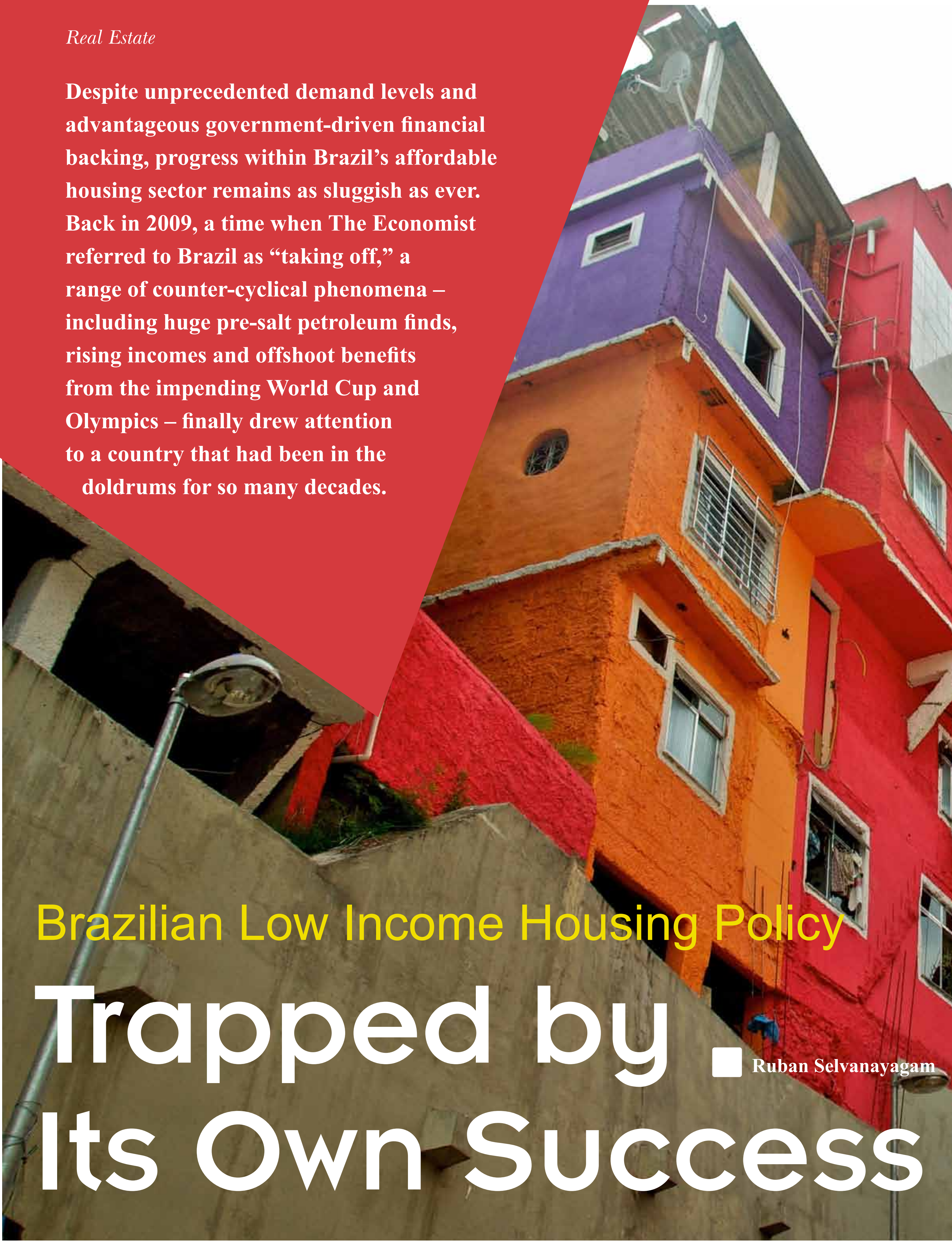
Aberdeen's examples of "Highly Favorable" countries include Chile, Malaysia, Brazil, Poland, Turkey and Ghana. Examples of its "Less Favorable" countries include Ukraine, Cambodia, Gambia and Nicaragua. Mr. Allen stresses that the firm's research is not static, and allowances are made for the possible changes that lie ahead in each sector and country, within the context of the dynamic characteristics of each emerging market.

However, the firm has made more concrete projections that place some emerging market sectors on the world stage. And amid the recent uncertainty over U.S. monetary policy and the impacts and perception of risk in emerging markets, Mr. Allen says that the firm's estimates indicate that by 2030 emerging markets will comprise over 40% of the world's investible real estate market, compared with around 13% today.

"This means it would capture a larger proportion of the global real estate universe than the U.S. or Europe today. No doubt there are short-term questions regarding a focus on such markets, but the long-term trend that we see suggests investors should at the very least be educating themselves now. The next steps of our research are to think about strategies within emerging markets."

For Aberdeen, the most significant "mega-trend" across the emerging markets is the growth and emergence of the middle class. Its suggested strategies that serve the needs of this trend will be particularly appealing for investor research, Mr. Allen says. Ultimately, the firm believes in finding a cautious strategy that provides a proxy for the economic expansion of its listed countries.

"Taking this further, we are particularly interested in the essential needs of the population. How do they get housed? How do they shop for convenience-based goods? We propose that following such strategies should correlate more closely with the economic expansion than, say, the development of offices for global financial service occupiers."



Despite unprecedented demand levels and advantageous government-driven financial backing, progress within Brazil's affordable housing sector remains as sluggish as ever. Back in 2009, a time when The Economist referred to Brazil as "taking off," a range of counter-cyclical phenomena – including huge pre-salt petroleum finds, rising incomes and offshoot benefits from the impending World Cup and Olympics – finally drew attention to a country that had been in the doldrums for so many decades.

Brazilian Low Income Housing Policy

Trapped by Its Own Success

Ruban Selvanayagam

Nevertheless, as witnessed during the recent demonstrations, the deep-rooted socioeconomic questions that were bound to emerge alongside this newfound potential could never have been brushed aside so easily. Today, in fact, much of the population is asking why taxpayer money and key investment capital has been thrown into big-ticket stadiums and other seemingly frivolous expenditures as opposed to education, public health services and dealing with the traffic jams that form part of everyday life.

Accompanying this dissatisfaction has been the lack of attention to clearing the pent-up demand for low-income housing that, particularly since the large-scale exodus of rural migrants to the cities starting in the 1960s, has produced a deficit currently estimated at anything between 5 and 15 million units.

While successive governments were criticized for being unable to confront the issue, in 2009, basking in the benefits of an apparently booming economy, then-President Lula da Silva set out to transform this situation. Social housing, alongside other broadly complementary infrastructure development programs, subsequently became integral parts of a strategy to boost support for his Worker's Party (PT) successor Dilma Rousseff's electoral campaign – principally via the launch of the Minha Casa, Minha Vida ("My House, My Life") program.

At face value, the initiative's proposition was, and still is, attractive: means-tested subsidies to low-income homebuyers complemented by historically low interest rates, conditions for base-of-the-pyramid populations to enter into "lease to own" housing partnerships (with very affordable monthly commitments and no down payments) and competitive production finance for established construction companies. What followed were self-assured publicity campaigns and government speeches that created a certain hope for a segment so used to being neglected.

But not long after Rousseff stepped into power, the cracks began to appear and, some four years later, the idyllic imagery has now faded.

First, let's look at the questionable published data. Analyzing Minister of Planning, Budgeting and Management Miriam Belchoir's recent statement, for example, that "75% of the program's pre-2014 target has been met," we see that, of the 2,783,275 units, a total of 1,272,624 have been contracted to "strand 1," or households with monthly earnings of up to R$1,600 (US$690) – a population bracket that accounts for the lion's share of the housing deficit. Of this figure, just 340,774 units are actually being inhabited by the target population.

Then there are the qualitative standards of these delivered units. Despite claims by the financial administrators of the program, Caixa Econômica Federal, that only 1% of the units awarded to the program's beneficiaries are classifiable as "problematic," the abnormal rise in complaints and negative news reports point to major problems. Inferior standard materials (developments in the north of Brazil have been described as equivalent to concentration camps), deficient infrastructure, reports of home invasions (due to poor security), and inefficient post-acquisition service levels are just a handful of complications that have emerged.

The quandary lies in the fact that building for the low-income segment simply doesn't pay off and, unfortunately, Minha Casa, Minha Vida has not bought the stimulus necessary. The Brazilian government's own construction cost index, SINAPI, sheds some light here: in July 2013 the national average cost per square meter was published as R$893.58. Multiply this figure by the minimum useful area space required under the Minha Casa, Minha Vida program for an apartment unit of 45.56m² (R$40,712); add at least 2m² for the total construction area (bringing the total up to R$42,499) and then the necessary supplementary corporate, land, licences, equipment and federal tax costs (likely to aggregate a minimum 33% extra), and total construction cost arrives in the region of R$56,524. With the government paying between R$57,000 and R$76,000 (to cover the costs of construction, with the remainder taken as profit), the margins are clearly uninteresting.

Working in this segment has subsequently evolved into no more than a gamble that developers attempt to mitigate by slashing quality standards, building in more distant peripheries (where land is cheaper and/or donated) or shifting target markets to higher income brackets. Yet even this latter strategy has backfired, not only due to rising build costs and difficulties in finding qualified labor, but also because such units, which are unfit to meet real demand, have ended up saturating marketplaces.

Aimed at bringing more technical professionalism into the sector, July 2013's more rigorous revisions of the most commonly cited engineering norm, NBR 15.575, are also likely to create further cash flow implications given that sector specialists are expecting average aggregated cost structures to rise by at least 5%. Other encumbering factors include the notoriously heavy bureaucracy involved at all levels of the housing production chain as well as the tarnished reputation that resulted from well-publicized corruption scandals, such as the extensive money laundering operation involving ex-civil servants of the Cities Ministry exposed in April of this year.

Among what seems like an endless list of flaws, we should not be so quick to attribute blame to the policy making. Many of the questions are equally, if not more so, due to the archaic nature of Brazil's construction industry itself. Minha Casa, Minha Vida certainly has the ability to serve as a prime example of how the emerging/developing world can create dignified housing at scale – but for this to happen, more innovative approaches need to be embraced that genuinely attend to the needs of low-income populations.

About the Author

Ruban Selvanayagam is the partner-director at the Fez Tá Pronto Construction System, a patented, copyrighted and fully consolidated real estate development model focused on serving the base of the pyramid with genuinely affordable, high quality, technically adherent and ecologically friendly housing.

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Interpreting the Emerging Markets

The emerging market countries account for an estimated 45% of the world's GDP, a figure that is expected to surpass 50% in the next year, eclipsing the economies of the developed markets. Additionally, the emerging markets have represented 70% of global GDP growth over the past few years, and projections by the World Bank point to a further 6% growth this year, while developed markets expect to total a mere 2%.

"Obviously, we are talking about it because 80% of the world's population is located in these countries, and of course we're seeing enormous growth in the population. It is expected that by 2050 we're going to add about 2.3 billion to total about 9 billion in population," says Professor Andrew Karolyi, Co-director of the Emerging Markets Institute at Cornell University.

The Growth Story

What makes the progress story of the emerging markets such a hot topic is that, unlike the more developed economies, each emerging country is completely unique in how it contributes to GDP growth, with some regions not yet contributing anything at all.

"It's not just about rapid growth. I think many people simplify it, equating emerging markets with fast growth, and I think that's a disservice to them and a disservice to that clustering of countries," says Mr. Karolyi. "These are countries that are not only experiencing fast growth but are also conjoined together with the fact that they are undercapitalized. In terms of their capital market and development, they don't have strong and vibrant enough capital markets to support the current and projected growth."

"Undercapitalization continues to be the biggest burden for the emerging market economies, simply because they are fraught with problems that prohibit the free flow of capital," Mr. Karolyi explains. "Even if they don't have the markets developed themselves (which they don't), well developed capital markets in the developed world don't naturally flow forward because they have these sort of inherent problems that stop that flow of capital at the door."

And China is a prime example of this, Mr. Karolyi notes, as it is underserved in terms of the depth and breadth of its capital market. Looking at China's growth story, the global market has witnessed a shift in the country's balance toward the flow of foreign direct investment to other parts of the world. Emerging markets are currently capturing 50% of FDI inflows and 25% of FDI outflows, and China is currently acting as the driving force behind this.

The Use of Acronyms

Acronyms have long been embedded in the cultural language of finance. Terms such as BRICS, CIVET and MIST are a way to help market players make sense of a region's appetite, potential and risk. However, as the needs of the emerging market countries become more and more specific in terms of their unique financials, it is perhaps time to ask if these acronyms serve the purpose they once did.

"Under-capitalization continues to be the biggest burden for the emerging market economies, simply because they are fraught with problems that prohibit the free flow of capital."

"I don't find them particularly useful anymore – I know where they came from and I guess they served a purpose for the time that they were there. If I'm trying to read inside the heads of the people developing them, I think they are often simplifying the focus on growth and exclusively growth, and not the things that are impeding them like these undercapitalized markets," Mr. Karolyi says.

Instead, Mr. Karolyi says that when evaluating an investment, he would turn his attention to the components of political risk, capacity constraints, the operational efficiency, the degree of openness, as well as factors such as the quality of corporate governance, transparency and disclosure rules in these countries.

"Those six buckets of risk really define emerging markets, which are more acute than the developed markets, while defining an index on those dimensions as a sort of a continuous model, not as an 'are you in the club or not in the club,' but deciphering countries' strengths and weaknesses on these critical dimensions that matter. I think that's the secret to success, not the acronym."

Due Diligence

Another issue economists must consider when investing in or analyzing emerging markets is corporate governance, and the standards for corporate governance, as well as the rules that govern transparency for corporations in these countries. These issues have been obstacles that have notoriously held the emerging markets back in terms of their ability to secure capital investment and promote and accelerate growth.

"We see that in so many dimensions when you look around the world, one of the unique characteristics of corporations in emerging markets is the dominant presence of large block holders. Often these are family managers and/or family founders that have staked a claim and launched the firm and grown it to the point where they have gone public and continue to maintain a steady presence," Mr. Karolyi says.

"It could be other forms of block holders or shareholders there in terms of cross holdings by other firms, for example in many countries like in India we have the presence of a business group that sort of represents a natural interlocking force in terms of cross-held ownership in groupings of firms. In countries like Korea it might be centered around a bank that has large stakeholdings in the various firms, and of course vice versa as well."

The presence of these closely held ownership stakes often concerns global investors as prospective co-investors. However, Mr. Karolyi adds that financial globalization has been seen over the last 20-30 years, and has signaled to many firms, including the firms within the emerging markets, that there are great opportunities to be seized. Firms have leveraged their ability to raise capital, perhaps outside of their home markets, which has been enhanced by borrowing from the best practices in some of the developed markets with better transparency rules.

"There's a wave of companies from around the world, including emerging markets, that have been sort of renting those better standards, and that has not gone unnoticed by many of the market regulators and other firm managers that haven't pursued those, so we've been seeing almost sort of a race to the top sort of a competitive pressure, peer pressure as it were, among firms in these countries to elevate their standards. So one example would be the Nova Mercado in Brazil. It was created as a super elite exchange on the São Paolo/Rio Exchanges. Firms that meet certain standards in terms of disclosure strategies, reporting strategies, governance, construction of boards of directors, and so on are eligible for listing and trading on this Nova Mercado, and that gives them access to more capital than they would have had otherwise."

Political Risk

Assessing political risk in emerging markets has at times been unique to each investor, while corporates are more frequently using average scores and judgments, favorable or not, to hedge a country's stability. However, one thing that is generally agreed upon is that the political risk weighting of each country or region is dependent on the impending changes of its political landscape.

"The uncertainty and volatility that they can change so rapidly is what really defines emerging markets, and I think that's the most important thing to associate – the factors that impede the free flow of capital to the point of realizing their growth are not just the political problems that exist but the uncertainty about those political problems. It's the uncertainty that's the key," Mr. Karolyi claims.

"I think it was demonstrated in the last Peruvian election. When Humala got elected, investors thought he would be far left and they all pulled out, but when he was more midline there was sort of a vacuum of opportunity created by people fearing the political risk of a very leftist president. A wonderful example, and one of the important checks and balances is that their legislators force them to build these coalitions that inhibit their ability to make the kinds of dramatic policy shifts that they might have been promising during the campaign in one direction or another. Those are the good signs. Those are the reasons why you should be paying attention as a political risk watcher."

The Consumer Story

One of the key drivers for growth in the emerging market economies has been and will continue to be the consumer story. With emerging markets representing over 80% of the world's population, the next 20 years will see another 2.3 billion people entering into the world, with "almost all of them expanding in the emerging markets to a tally of about 9 billion," Mr. Karolyi says. These future consumers in the marketplace will have the purchasing power of the sustained cumulative 6% growth rate, which will all be personal disposable income.

"Many of these creative and entrepreneurial companies building out the housing stock are savvy enough to know that they need to go outside of their home country to actually source the capital to help fund their construction," notes Mr. Karolyi.

"That's why it all comes together. You've got companies like Country Garden and China Vanke – these guys are all listed and trading on major exchanges around the world including here in the U.S., sourcing capital from global investors, deploying that capital into strategic investments in their home country to support this trend that we're seeing. It all comes full circle."

Commodities

Sustainable Coffee

Impact of Best Practices

Stephen Kaczor

A shift toward sustainable farming practices among Colombia's coffee growers is showing significant benefits, according to a report by the Rainforest Alliance.

The May 2013 report by David Hughell & Deanna Newsom reviews the results of 4 studies conducted by Cenicafe, a Colombian coffee research institute. Cenicafe set out to evaluate the impacts of best practices certification on water quality, soil quality, farmer livelihoods and wildlife. The first 3 studies were farm-based, comparing a large sample of certified and noncertified farms. The fourth studied the movement of mammals native to the region where shaded coffee farms comprise much of the habitat.

Fundación Natura certified the first coffee farm in Colombia in 2004. Within 5 years of working with the Rainforest Alliance, 2100 farms covering 12,400 hectares were certified in the Santander region. Farms not certified in this region represent the control group for the study.

Water Quality

Streams were found to be healthier on the 27 certified farms than on the 27 non-certified farms. Measures of stream health took into account the condition of the stream channel, vegetation and woody debris and water clarity, among other indicators.

The percentage of the stream bank covered in vegetation − another indicator of stream health − was significantly higher on certified farms. Streams on certified farms contained significantly more pollution-sensitive macro-invertebrate species than those on noncertified farms, indicating higher water quality. The chemical oxygen demand was significantly lower on certified farms than noncertified, again indicating higher water quality on certified farms.

Soil Quality

The study compared the soil characteristics of 52 certified farms and 52 noncertified farms. The main indicator of soil life was the presence of insect species.

A total of 36,288 soil arthropod specimens were collected, mainly beetles, ants, cicadas, hoppers, aphids and wasps. Arthropod richness was significantly higher on certified farms than on noncertified farms in both regions, which indicates better soil health on certified farms.

Farmer Livelihoods

Researchers found that the productivity of certified farms was twice as high as that of noncertified farms. Researchers calculated net revenue by subtracting each farmer's expenses (including certification costs) from production income. Results showed that in Santander, average net revenue was significantly higher on certified farms (US$2,029/hectare) than on noncertified farms (US$813/hectare). The prices that certified and noncertified farmers received for their coffee were also compared, but no significant difference was observed, indicating that the difference in net revenue is entirely due to farm productivity.

Wildlife

Researchers observed 12 species of tree-dwelling mammals in natural forests, 9 species in coffee farms with dense shade (more than 80%) and 2 species on coffee farms with medium shade (60-80%). The researchers conclude that densely shaded coffee plantations can serve as a buffer for designated protected areas (such as the Yariguíes National Park, one kilometer away from Santander) by providing habitat for a variety of mammals.

Coffee Rust

Santander is one of 4 coffee-growing regions in Colombia that are free of coffee rust, a debilitating fungus that is devastating coffee plantations Latin America. This region stands in stark contrast to others in the hemisphere, such as Costa Rica, where coffee yields this year are expected to be down by as much as 50%. Cenicafé deserves credit for developing rust-resistant coffee plant strains and helping growers to plant and harvest according to best practices.

The National Federation of Coffee Growers of Colombia declared that 36,000 hectares in Santander are coffee rust-free, helping to boost coffee production in the country by 26%. "It is basically a milestone of the long path," said Luis Fernando Samper, the organization's chief communications officer, in an interview with The Huffington Post. Other countries, he stressed, could learn a great deal from Colombia's research institutions.

Best Practices

In summary, the certified farms are performing better than noncertified farms in the implementation of best practices, the multivariable sustainability index, many structural and biological indicators of water quality, resistance to fungus, improved yield and economic viability. There were no variables for which noncertified farms performed better than certified ones.

All available information suggests that implementation of best practices is the right thing for coffee farmers to do. The standards are maintained by the Sustainable Agriculture Network and published in a 50-page document called the Sustainable Agricultural Standard. The 10 principles of the standard are: social & environmental management; ecosystem conservation; wildlife protection; water conservation; fair treatment & good working condition for workers; occupational health & safety; community relations; integrated crop management; soil management & conservation; and integrated waste management.

The number of coffee farms certified as environmentally and socially responsible by Fair Trade USA and Rainforest Alliance reached a record high in 2012. Production of Rainforest Alliance certified coffee reached 4.5% of global output last year. Fair Trade certified imports to the United States and Canada rose to a record high in 2012, attracting 60 new importers and roasters last year. Over 118,000 coffee farms covering almost 800,000 acres are now Rainforest Alliance Certified and meet rigorous standards for best practices and environmental and social sustainability.

The full report (24-pages) is available as a PDF published by the Rainforest Alliance.

About the Author

Stephen Kaczor is a regular contributor to Alternative Emerging Investor Magazine and Chairman of the Big River Foundation, a non-profit focused on river and watershed ecology conservation initiatives throughout the Americas. He is an organic farmer, eco-entrepreneur, consultant, and a writer with a documentary film in production in Central America. As a Panama-based consultant, Mr. Kaczor's focus is sustainable organizational development, research & management.

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The Global Implications of Falling Commodity Prices

The decade-long commodity-price boom has come to an end, with serious implications for global GDP growth. And, although economic patterns do not reproduce themselves exactly, the end of the upward phase of the commodity super-cycle that the world has experienced since the early 2000s dims developing countries' prospects for continued rapid catch-up to advanced-country income levels.

José Antonio Ocampo & Bilge Erten

Over the year ending in July, *The Economist's* commodity-price index fell by 16.5% in dollar terms (22.4% in euros), with metal prices falling for more than two years since peaking in early 2011. While food prices initially showed greater resilience, they have fallen more sharply than those of other commodities over the past year. Only oil prices remain high (though volatile), no doubt influenced by the complex political events in the Middle East.

In historical terms, this is not surprising, as our research into commodity super-cycles shows. Since the late nineteenth century, commodity prices have undergone three long-term cycles and the upward phase of a fourth, driven primarily by changes in global demand. The first two cycles were relatively long (almost four decades), but the third was shorter (28 years).

The upward phases of all four super-cycles were led by major increases in demand, each from a different source. During the current cycle, China's rapid economic growth provided this impetus, exemplified by the country's rising share of global metals consumption.

While these cycles reached similar peaks, the downswings' intensity has varied according to global economic growth. The downswings following World War I and in the 1980s and 1990s were strong; in contrast, the dip after the Korean War, when the world economy was booming, was relatively weak. After World War II, the super-cycles of different commodity groups became more closely synchronized (including oil, which had previously shown a different pattern).

Just as China's economic boom drove commodity-price growth in the current cycle, so the recent weakening of prices has largely been a result of its decelerating GDP growth, from double-digit annual rates in 2003-2007, and again in 2010, to roughly 7.5% this year. While projections of China's future growth vary, all predict weaker economic performance in the short

term – and even lower growth rates in the long term.

The fundamental short-term issue is the limited policy space to repeat the massive economic stimulus adopted after the collapse of Lehman Brothers in 2008. China's investment-led strategy to counter the crisis left a legacy of debt, and the continued deterioration of the demand structure – now characterized by an extremely high share of investment (close to half of GDP) and a low share of private consumption (about 35%) – further constrains policymakers' options.

There is a consensus that these abnormal demand patterns must change in the long term as China moves to a consumption-led growth model. But, to accomplish this transition, China's leaders must implement deep and comprehensive structural reforms that reverse a policy approach that continues to encourage investment and exports while explicitly and implicitly taxing consumption.

The uncertainty surrounding China's impending economic transformation muddies the growth outlook somewhat. Some forecasters predict a soft landing, but differ on the growth rate. Official estimates put annual GDP growth at 6.5% in 2018-2022, while Peking University's Michael Pettis, for example, regards 3-4% growth as consistent with continuous rapid consumption growth and the targeted increase in consumption's share of GDP.

While hard-landing scenarios, associated with a potential debt crisis, are also possible, the authorities have enough policy space to manage them. In any case, downside risks are high, and room on the upside is essentially non-existent.

The main engine of the post-crisis global economy is therefore slowing, which has serious implications for one of the last decade's most positive economic trends: the convergence of developed and developing countries' *per capita* income levels. Just as China's economic boom benefited commodity-dependent economies, primarily in the developing world, its slowdown is reflected in these economies' declining growth rates. (In fact, while several South American countries have been among the hardest hit, even developed countries like Australia have not been immune.)

If weak global demand causes the current commodity super-cycle's downswing to be as sharp as those of the post-1918 period and the late 20th century, the world should be prepared for sluggish economic growth and a significant slowdown – or even the end – of income convergence worldwide.

JOHNSON
Cornell University
Emerging Markets Institute

Innovation in Latin America

New approaches to discover and foster innovation in Latin America.

OPENING ADDRESS:
Ambassador Sandra Fuentes-Berain, Consul General of Mexico in New York

KEYNOTE ADDRESS:
Virun Rampersad, Managing Director and Head of Global Innovation, BNY Mellon

PANEL SESSIONS TO EXPLORE:
Economic Overview of Latin America
Innovation in Financial Services
Innovation in the IT Sector
Innovation in Manufacturing Processes

Plus, the release of a new report by the Inter-American Development Bank on the Impact of Infrastructure on Latin American Trade.

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Agribusiness

Six Companies Investing in African Agribusiness,

and What We Can Learn from Them

Jaco Maritz

Africa's agriculture and food industries are attracting increasing interest from investors. This trend is largely fueled by the fact that the continent has 60% of the world's uncultivated arable land, with favorable weather conditions in many countries. There is also a belief that rising incomes will spur demand for food products in the years to come. To examine the opportunities and challenges on the continent, How we made it in Africa looks at six companies that have invested in the region's agribusiness sector.

Silk Invest – Betting on food

Silk Invest is a United Kingdom-based frontier market investment company. The firm manages the Silk African Food Fund, which is a private equity fund that invests in processed food, beverages and quick-service restaurant companies on the continent.

Silk Invest sees opportunities in targeting the African consumer from a food and beverages perspective. The fund invests in scalable food companies with the potential to become national and regional leaders.

A significant volume of the packaged food that Africa consumes is currently being imported, creating opportunities to produce these products locally. In a 2011 webcast, Waseem Khan, Silk Invest's head of private equity, gave the example of Ethiopia, which he says is a large consumer of biscuits. More than 50% of the biscuits consumed in Ethiopia are currently imported. Khan notes that there is a small company based in the Middle East that quadrupled its earnings when it started exporting biscuits to Ethiopia.

Silk Invest's fund is currently focusing on Kenya, Ethiopia, Egypt, Morocco, Ghana and Nigeria. The fund has so far invested in a confectionery company in Egypt, a quick service restaurant brand in Nigeria and a biscuit manufacturer in Ethiopia.

Silk Invest believes there is currently a formalization of food products happening in Africa – a move to branded and better packaged items. “It is about a formalization of something that is already consumed. It is basically moving from fresh milk directly from the farmer, to fresh milk in a bottle. The price typically does not change, what is changing is the packaging,” says the firm’s CEO Zin Bekkali.

He adds that by selling products in improved packaging, many food companies on the continent have been able to grow their revenues by between 20% and 30% annually.

It is often difficult and expensive for African companies to borrow money from banks, and therefore private equity offers an alternative for them to grow their businesses. Khan, however, says that it is important to show these companies that Silk Invest is not there to take over their companies, but to help them grow. “Our view is to be involved in active management with them, and to be there with them for the next three to four years, where they can make money, and we can make money,” he notes.

AGCO – Taking advantage of the trend toward mechanization

Suppliers of agricultural equipment are also looking to Africa as a new growth market. AGCO, a New York Stock Exchange listed multinational company that designs, manufactures and distributes agricultural machinery such as tractors and harvesters last year announced that it will invest US$100 million into Africa. AGCO is the world’s third-largest agricultural equipment maker and a manufacturer of brands such as Challenger, Massey Ferguson and Fendt.

AGCO’s push into the continent is mainly based on a belief that African agriculture is drawing growing interest from international investors, attracted by the shift to commercial farming. According to Nuradin Osman, AGCO’s director for Africa and the Middle East, there are three reasons why the company is optimistic about the continent’s agricultural sector. These are:

- Global factors such as rising populations, increasing income levels in emerging markets, and a growing scarcity of arable land and water.
- The World Bank attributes 60% of the world’s uncultivated land to Africa, and also suggests that investment in agriculture has the potential to create millions of jobs on the continent.
- About 10% of cropped land in Africa is prepared by tractor, and only 4% of the land is irrigated.

It is often difficult and expensive for African companies to borrow money from banks, and therefore private equity offers an alternative for them to grow their businesses.

In addition to large-scale commercial farms, AGCO is targeting smallholder farmers. The vast majority of African farmers are smallholders, and most agricultural companies have some kind of strategy to also cater for their demands. However, most of these small-scale farmers cannot afford tractors and other equipment. To address this, AGCO is partnering with local and regional banks, as well as various development organizations, to provide financing solutions to these farmers. The company is also looking at leasing tractors to farmers.

AGCO also sees value in partnering with local companies in Africa. “There are numerous other benefits for being part of a joint venture with a local partner in Africa. We benefit from the local partner’s knowledge about the country’s culture, language, political system and business systems. Since a joint venture also entails a significant equity investment, both companies invest significantly in resources, talents, and commitment to the new firm. This provides both companies with advantages in terms of sharing development costs and risks,” says Osman.

He adds that joint ventures have less chance of being nationalized, as the local company also has a significant stake in the business.

Thai Farm – Adding value while overcoming challenges

Thai Farm is a cassava processing company in Nigeria. Cassava, a woody shrub with an edible root that looks like a large sweet potato, is one of the most widely grown crops in Nigeria, produced largely by subsistence farmers. Although cassava roots can be processed into a variety of products – including cassava flour, starch, ethanol and glucose syrup – the crop has not been a great commercial success.

Thai Farm is processing cassava into baking flour, and it is also looking at moving a step up in the value chain by producing starch. There is currently a growing interest in high-quality cassava flour. This is because the Nigerian government has issued a directive that requires bakers to add a certain percentage of cassava flour into their mixes. This was done to reduce dependency on imported wheat flour, and to boost the local agricultural industry. Cassava flour is also much cheaper than wheat flour. Last year, Flour Mills of Nigeria, a Nigerian Stock Exchange listed company and one of the country's largest wheat milling companies, bought a controlling stake in Thai Farm.

Thai Farm's South African-born founder, Louw Burger, tells How we made it in Africa that despite the company's success, it is facing a number of challenges.

One of the company's headaches is finding the right people to work at its plant. Cassava factories need to be situated close to the farms due to the crop's short shelf life. After it has been taken out of the ground, cassava needs to ideally be processed within 48 hours before it goes bad. This means that once the crops come in, the factory often needs to operate 24 hours a day. "Finding people in these villages that actually have an education, that actually have a work ethic, that can apply themselves, that have a place to sleep during the day, so that when they are on night shift they have rested during the day – these are all major challenges," Burger explains.

Transport is also a challenge. Burger notes that transport is generally very expensive in Nigeria, and typically run by small companies that are often not that reliable.

In addition, he has to deal with bad roads and harassment by officials. Burger says that he carries 48 different documents in his vehicle, and even then he gets stopped by somebody trying to squeeze money from him by selling him another permit.

Zeder – Not naïve about the risks

Zeder is the agribusiness arm of South Africa-based investment company PSG Group. Zeder has stakes in a variety of South African agricultural food businesses. Last year, however, it made its first investment into the rest of the continent when it bought a controlling stake in a company called Chayton, which owns a commercial farming business in Zambia. Crops cultivated include soybeans and wheat.

Cassava factories need to be situated close to the farms due to the crop's short shelf life. After it has been taken out of the ground, cassava needs to ideally be processed within 48 hours before it goes bad.

One of the reasons Zeder felt comfortable with Zambia as an investment destination is the government's strong focus on agriculture as a way to diversify the economy away from mining.

Chayton's land is part of a designated farming block that was bought by the government from local chiefs. To encourage investment in the region, the Zambian authorities supplied infrastructure such as roads and electricity. The land can be acquired on a 99 year lease. There are currently around 90 farmers in the area from countries across the world such as Zimbabwe, South Africa, the U.S., Australia and Russia.

Chayton's farm in Zambia caters primarily to local demand, and the business hasn't built its model on exports. However, Chayton has the opportunity to export, as Zambia is bordered by eight countries, all of which are net food importers.

Despite the generally favorable conditions, Zeder did take some measures to protect itself from political risk. "Although this investment looks very good on paper, we are not so naïve as to think that there aren't any risks," said Willem Meyer, an analyst at Zeder who was instrumental in the Chayton acquisition.

Chayton is covered by political risk insurance from the World Bank's Multilateral Investment Guarantee Agency (MIGA). In case of any trouble, the company is covered for all the capital that it invests in Zambia. In addition, the business has signed an Investor Promotion and Protection Agreement with the Zambian government. Among various things outlined in the document, it allows Chayton to continue to export commodities in the event of a closure of the country's borders.

During 2012, the Zambian government did introduce two measures that could negatively impact companies operating in the country. Firstly, it drastically increased the minimum wage. Secondly, it prohibited companies from invoicing in U.S. dollars.

Despite the potential that Africa's agricultural sector offers, doing business on the continent is often romanticized. Although Chayton's farming block comprises a community of farmers with a country club offering golf, tennis and cricket facilities, Meyer acknowledges that the life of a foreign farmer in Africa can often be very isolated, taking its toll on marriages and relationships.

Even though Chayton currently has good managers, one of the company's biggest challenges in expanding the business will be finding the right management. "If we want to build a big business, we need the right management and we need to make it attractive for them to go and work in Zambia. It will cost us more in terms of salaries to convince the good guys to relocate, but it makes sense when one looks at the possible returns," Meyer says.

KFC – An opportunity for farmers

Although fast-food restaurant chain KFC is not strictly an agribusiness firm, it does get all its products from farming, and its expansion into the continent is opening up various opportunities for farmers.

KFC has been operating in South Africa and some of its neighboring countries from as early as the 1970s. However, it was only at the end of 2009 that it expanded its footprint further north into sub-Saharan Africa with the opening of the first KFC outlet in Nigeria.

By the end of 2012 KFC had stores operating in Angola, Nigeria, Namibia, Botswana, Mozambique, Lesotho, Malawi, Swaziland, Ghana, Kenya and Zambia. KFC has plans to extend its reach to Zimbabwe, Tanzania and Uganda in 2013, with much longer-term growth plans to establish itself in the Democratic Republic of Congo, Ethiopia and Senegal.

Keith Warren, KFC's managing director for Africa at the time, notes that in some African countries KFC burgers do not have lettuce on them. This was not to cater to local tastes, but because KFC couldn't source lettuce in the qualities and quantities it required.

Demand for quality fresh produce comes not only from the growing number of fast food restaurants in Africa, but also from supermarket chains expanding into the continent.

Warren says that in many cases growth is being held back by inadequate farming capacity to supply the company with chickens and vegetables. Warren uses the example of Nigeria. "The only limiting factor we've got in Nigeria right now is actually chicken supply, and finding suppliers who are able to meet our global quality standards in sufficient quantity. The commercial chicken industry is horribly underdeveloped."

When KFC entered the Nigerian market, the company had difficulty in persuading farmers to become its suppliers. "When we first went into Nigeria, it took a lot of convincing to get one of the chicken farmers to partner, because of the amount of investment [he] needed to make to achieve our quality standards. The other chicken producers weren't particularly interested. But once they saw the success we were achieving with that one farmer, they then went and said, 'We'd better get on board'," Warren explains.

Demand for quality fresh produce comes not only from the growing number of fast food restaurants in Africa, but also from supermarket chains expanding into the continent. South Africa-based retailer Shoprite has arguably been one of the most successful in this area, while its rival Pick n Pay has also been growing its footprint. South African supermarkets are, however, not the only ones with plans to expand their operations. Kenyan retailers such as Nakumatt and Uchumi have also entered countries outside their home market.

Karuturi – It takes time

Karuturi is an Indian agribusiness company that first started operations in Ethiopia in 2005 with a 10 hectare flower farm. Today it is a major producer of cut roses in the country. Karuturi has also started with the growing of cereals, rice and sugar from its 100,000 hectare farm in Gambella province, in western Ethiopia. Some commentators have described the deal as a land grab.

While many still associate Ethiopia with famine and poverty, it has been one of the world's fastest growing economies in recent years. With a population of over 84 million, it is Africa's second most populous country.

The land that Karuturi is farming on has never been cultivated. "We are talking of virgin lands, which have never been plowed for hundreds of years. We are trying to do that for the first time," says Birinder Singh, executive director of Karuturi Agro Products.

Another challenge faced by Karuturi is the scarcity of workers in the thinly populated area of Gambella. Singh notes that when Karuturi's farm is fully developed it will require around 25,000 people to work in the fields. Urbanization is also not helping the situation. "Able-bodied men who can work on the fields are leaving the villages and going to the urban areas. What is left behind is children and women," says Singh.

Karuturi has, however, discovered that people are willing to relocate to the area if they are given proper housing. "We are creating large-scale infrastructure in terms of bringing people from outside our farm. People live in straw houses, and if you are able to create infrastructure and provide them proper housing, people are ready to come and stay over there."

Some of the difficulties faced by the company are also more unusual. Next to Karuturi's farm is a major national park with around 800,000 antelope. To protect its crops from the animals, Karuturi has now requested that the government give it permission to put solar-powered electric fences around its farm.

Singh says that the Ethiopian government has assisted Karuturi with some of the problems it was facing. For example, Karuturi was struggling to find quality seeds and agro-chemicals in the local market, but the government has allowed it to directly import these inputs. Four mobile network towers have also been installed on Karuturi's farm. "Communication has become easy, internet has become easy."

He underlines the importance of making the challenges experienced by commercial farmers known to the government. "For the country this type of commercial farming is new. As we are new to the country, the country is new to this concept of commercial farming. There are enough interactive sessions where you can put forward your points. If the decision makers are convinced that there needs to be a policy change, it happens."

Despite the challenges, Karuturi remains optimistic about its ventures in Ethiopia. "There are challenges, there are concerns, but still Ethiopia is a wonderful country to cut into agriculture. It offers an excellent recipe for agriculture – excellent lands, water, fertility of the lands, cheap labor, stable government, and a corruption-free regime."

"Agriculture is a journey, and we have only made a beginning. The results cannot come overnight," Singh adds.

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African Agribusiness Opportunities

Poor seed production and sharp climate changes are set to exacerbate an already critical food shortage in sub-Saharan Africa. Africa's population has been growing 50% faster than its ability to increase food productivity, and without action Africa's food deficit is projected to increase to 60 million tons and to US$14 billion by 2020.

Alliance for a Green Revolution in Africa (AGRA), through its Program for Africa's Seed Systems (PASS), provides seeds to farmers with the potential to increase their yields in Africa and seeks to establish effective breeding and seed systems across the continent. The program funds and trains local entrepreneurs to establish and grow private and independent seed companies. Reflecting the success of this campaign, the majority of farmers who accessed the new seed via the program have to date doubled their produce, AGRA confirms.

Launching its operation in March 2007, the PASS program has a US$150 million fund pool to improve seed quality and policy frameworks, with public breeding institutes and support for the creation of a private seed industry.

"We created a private African seed industry through providing startup capital, business training, and technical training. The breeding of new varieties is all done in the public sector, through a decentralized approach, to shift the breeding function out to where the farmers are to make it more of a participatory process. Then, on the other side, we asked how we would get all of this new technology to the farmers," says Joe DeVries, Director of AGRA's PASS program.

He adds that other organizations have unsuccessfully attempted this in the past through private business, public agencies and NGOs, and in doing so have taken the wrong approach.

"We knew business people here who would help focus on the seed needs of smaller farmers and being able to market

seed at prices that local farmers can afford. We then worked hard to link the new seed entrepreneur to the local breeders. We also focused US$40 million on the training and deployment of 14,000 agro-dealers who were selling seeds and fertilizers at the small retailer level in villages. Aside from this we have our distribution side."

Mr. DeVries explains that agricultural funds in Africa require a dedication of between 10 and 15 years. The local farmers, he adds, have been taking advantage of every new technological edge, provided that it is available to them in ways that are affordable. In this sense, AGRA's PASS program has been able to bring world class resources to bear on many farmers' problems regarding technology.

However, financing, Mr DeVries adds, is stopped at the public sector with certain constraints, while help is only sought out within the private sector for distribution and delivery.

"This was very controversial at the time, as seeds are normally controlled by governments or NGOs, or institutions who had the funding available, although when this ran out, so did the seed, which is no way to treat the most precious input for these farmers, and what you want is a vibrant, competitive seed industry."

The PASS program has worked with approximately 80 seed companies, which are already the largest seed suppliers in Africa, and in aggregate the program is delivering more seeds to farmers than any other group in Africa.

"Before us there was a leading seed company in Africa, based out of Zimbabwe, Seed Co. But in terms of scale we're reaching a stage that people are having to take notice of. And we have a lot of room for expansion right now," Mr. DeVries explains.

"We have just started a program in collaboration with the USAID IAB, the U.S. government, which is called the Scaling Seeds and Technology Partnership, it will operate in six countries including Ghana, Senegal, Ethiopia, Tanzania, Mozambique and Malawi."

"In many countries that we operate in, 17 in total, we have seen positive changes in encouraging entrepreneurship and more farmer-friendly trade policies for grain trade."

AGRA says it is seeing an increase in attention from the big international seed companies, as well as some of the lesser known companies in the U.S., India, and Europe, a sentiment that is expected to grow, Mr. DeVries says.

Government Support

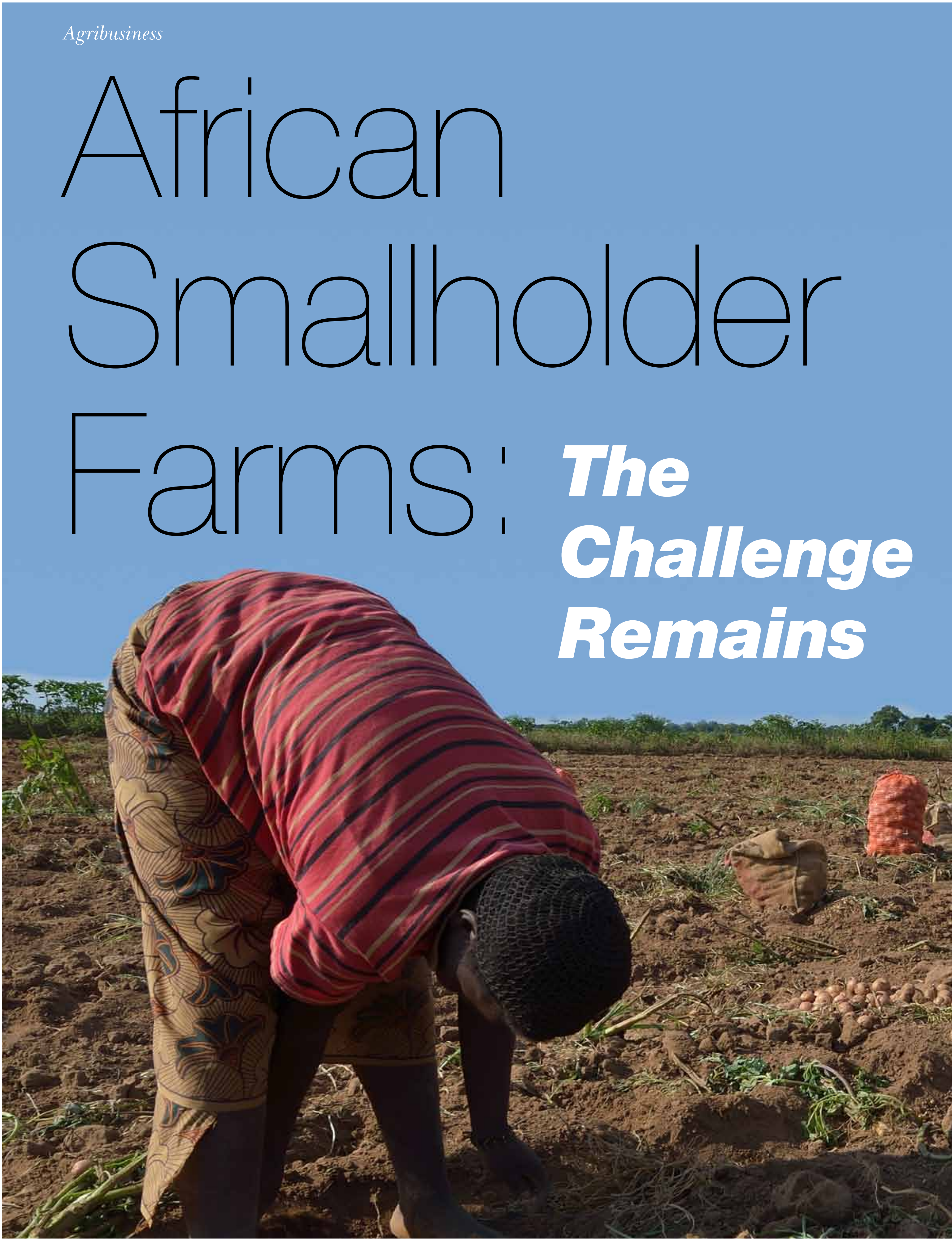
AGRA has received strong support from African governments in conducting its programs, especially when garnering help in enhancing technology for agricultural breeding.

"In many countries that we operate in, 17 in total, we have seen positive changes in encouraging entrepreneurship and more farmer-friendly trade policies for grain trade. If you prove there is value in this part of the economy then there is willingness from the African governments to improve policies and research, which is critical for the long haul."

In the short term, Mr. DeVries says that the program has witnessed "a remarkable increase" in commodity trade taken up by local entrepreneurs who are shifting food from areas of production to areas of demand.

"We are also working with several venture capital funds, and there are two that are currently active in the seed industry. One is the African Seed Investment Fund, and INJARO Agricultural Capital Holdings Limited. We are partnering with several other groups in these investment funds, including the Soros Economic Development Fund, and several other investors have come in to express their interest, so we hope this will continue in the years to come."

African Smallholder Farms: *The Challenge Remains*



Africa holds 60% of the world's fertile land, although the majority of this remains undeveloped due to poor farming conditions and resources – and perhaps most importantly, lack of government support.

The agricultural business in Africa remains for the most part in the hands of smallholder farms, yet for the majority of African countries farming accounts for 70% of the labor force and 25% of its GDP, according to WIEGO, a global action-research-policy network. Additionally, crop yields in Africa are between one-third and one-half of the global average. If African countries can capitalize on their resources and commodity-based industrialization, it will go a good way toward promoting the continent's competitiveness, while reducing its heavy dependence on primary commodity exports.

However, African governments are not supplying the adequate means to invest in the development and productivity of the continent's biggest sector. And the fact remains that without this much-needed investment in agricultural infrastructure and research, Africa's smallholder farms will remain in poverty, and their lands barren.

"What is really missing is adequate investments by African governments themselves," says Robert Paarlberg, Professor of Political Science at Wellesley College. "They have known for years that they should have been investing more in the rural sector and in agriculture development in particular, and yet they have not done it. In 2002 they promised to invest 10% of their public budgets in agricultural development by 2008, and when 2008 came most governments were still investing 5% or less."

Infrastructure bottlenecks within the African agricultural sector are proving to be a sticking point. And although huge development projects that require international capital and expertise prove hard to accomplish, smaller-scale changes could in

fact make the difference, through the basic building of connecting roads and bridges.

"These are countries where 60 to 70% of the people are dependent on farming for income and employment, and in these places in the countryside there is no electricity, and no roads that are passable in the rainy season, and no agricultural storage. And yet the governments are failing to put in those basic public goods. Private investors are not going to provide this basic infrastructure; they will not come in until they can get reliable electrical power in the countryside and a road system that they can use," Mr. Paarlberg says.

He adds: "It's all being held up by the lack of basic public goods, including rule of law, and protection for investors. In Tanzania where they are promoting SAGCOT, the county still has a strict liability system, which tends to scare away private investment. You can be sued if anything goes wrong, even if you obeyed the law and followed best practices."

Financing the Future of African Farming

Mr. Paarlberg says that most of the investments into Africa are coming from sovereign wealth funds, while some efforts are being pushed by the World Economic Forum to develop ambitious agricultural corridors in countries like Tanzania, which has recently launched the SAGCOT Project. SAGCOT will identify existing and potential project opportunities in the southern agricultural corridor for the infrastructure and agriculture sectors. However, despite efforts to privately finance this project, Mr. Paarlberg says that it is looking unlikely.

"I'm not sure that they've had much luck; and it looks mostly like sub-commercial investments that they're mapping out, which are heavily reliant on the World Bank and the government of Tanzania, rather than for-profit private investment. But whether this will change may largely depend on commodity prices, and I'm not sure where this is going. There has been a long-term downward trend in food prices until the most recent decade, despite income growth and population growth worldwide, so a lot of the interest in the agricultural sector in Africa was triggered by the international price spikes of 2008, and I don't know if this will be a secure foundation for such investments over the long run."

Africa's agricultural business is also sorely lacking the attention and expertise of researchers. Mr. Paarlberg notes that "very little of Africa's foreign capital is used for to research purposes."

Indeed, farmers could perhaps bear the dip in commodity prices if selling their produce at a good price was guaranteed and access to the nearest market places was available. According to the United Nations Economic Commission for Africa (UNECfA), one-fifth of farming surpluses are lost due to poor storage and lack of connecting roads. Additionally, the lack of finances available forces small farmers to sell low rather than wait for the best seasonal prices.

UNECfA's 2013 Africa report says that infrastructure development will help to ease these bottlenecks, while providing employment for unskilled and semi-skilled workers. "Industrial and development policy in Africa should include strategic investment in infrastructure and avoid 'enclave' infrastructure projects and programmes aimed only at satisfying the needs of commodity producers."

Instead, the report urges African governments to use commodity access to secure favorable infrastructure financing in the form of bilateral agreements, while also leveraging public-private partnerships and restructuring institutions to provide soft infrastructure.

Africa's agricultural business is also sorely lacking the attention and expertise of researchers. Mr. Paarlberg notes that "very little of Africa's foreign capital is used for research purposes." According to the Alliance for a Green Revolution in Africa (AGRA), an Africa-based organization that works to improve productivity and incomes of resource poor farmers in Africa, the continent has just 70 agricultural researchers for every one million people, while the whole of Latin America has 550, and North America 2,640. Such research and manpower could help governments determine agricultural policies and new frameworks for the development of the sector. However, instead of foreign capital being put into research, Mr. Paarlberg says it is "a division of labor" into other areas.

"The Bill and Melinda Gates Foundation puts money to work in seed improvement and seed systems for smallholder farmers. USAID focuses its money on value chain development, and agribusiness in Africa. The Word Bank puts a little bit more money into basic infrastructure, but there still is not enough money going into rural roads and power, partially because of resistance from the environmental community. The World Bank has largely gotten out of the business of large-scale irrigation projects because of a strong resistance from green groups and human rights organizations who see those big projects as disruptive."

Irrigation Issues

According to Mr. Paarlberg, one big obstacle standing in the way of developing Africa's agricultural lands and improving its business is public opposition to irrigation projects. Around 4% of agricultural land is irrigated in Africa, with almost as much resistance to building dams for hydroelectric power as there is to mining coal for electricity and coal-fired power plants, which are essential for developing roads and access points for farmers.

"In countries like Germany that got rich burning coal, Green party leaders are telling Africa they cannot do the same thing. The Chinese are making huge investments in energy in Africa, but they want it mainly to be exportable back to China. China is making the kind of investments that Western agencies are not making, often in countries that are not democratic and are not transparent. Additionally, they are making large infrastructure investments with large environmental consequences of the kind Western and U.S. agencies cannot make. Most farm labor in Africa is done by women, on small plots, using traditional techniques with no power machinery, almost no fertilizer, and usually no irrigation," Mr. Paarlberg explains.

"Seventy percent of these farmers live at least two kilometers from the nearest all-weather road, and most cannot read or write. Cereal yields are only about one-tenth as high as in rich countries, and income is usually not much more than a dollar a day. Without much larger public sector investments in roads, power, storage, agricultural research, rural schools and rural clinics, the farm sector in Africa will continue to lag."

The Cassava Opportunity

The cassava crop has become a major staple food product of sub-Saharan African countries over the last decade, acting as a cheaper alternative to wheat for the production of flour. Concerted efforts are being made by the continent's local governments to increase cassava production, particularly in Nigeria, which is notoriously dependent on importing crops from abroad to provide for its fast-growing population. The increase in cassava production also promises to help stimulate Nigeria's agriculture and manufacturing industries, while reducing expensive wheat purchases.

In 2004 the Nigerian government announced a policy requiring all wheat flour mills to add 10% cassava flour to wheat flour used to bake bread, biscuits, snack foods, pasta and noodles. As a result, Nigeria now produces 9 million metric tons of cassava a year, a figure expected to double by 2020.

If the commercialization of cassava production does reach its peak, it is expected that it will reduce the nation's wheat imports by a minimum of N127 billion, and in turn will pour money back into the Nigerian farming, processing and baking industries. To speed this process up, the government is supporting the private sector in an aim to access cheap financing to import 18 large-scale cassava processing plants.

Louw Burger, Chief Executive Officer and Managing Director of Thai Farm International, a Nigerian company that processes locally grown cassava tubers, says that the cassava roots grown in Nigeria are used in traditional food-oriented markets, and that very little is processed for industrial applications.

Mr. Burger adds that, unfortunately, the government's policy to expand cassava production was largely ignored, with only token compliance by a few wheat flour millers. However, despite the lackluster support for the government policies, a number of biscuit companies and snack food producers have been using cassava produce to blend with their wheat flour to reduce costs – cassava flour sells at a 30% discount to wheat flour.

"We sell the cassava flour to biscuit producers, snack food producers and bread

bakeries in Nigeria and they buy it because it saves them money – for every bag of our flour that they use they save over 1000 naira," Mr. Burger says.

However, he adds that the government's cassava policies have been "aggressively revived" with the inauguration of the new government in April 2011, and that the sector is now experiencing strong growth.

"Thai Farm's capacity will be approximately 20,000 tons a year which will translate into only a small portion of the unsatisfied market demand. We came up with the capital to start a factory. Our business is very simple. We grow cassava to a limited extent and purchase cassava from over 2000 local (mainly) small farmers, which we process into high quality cassava flour, of the best quality in the market," Mr. Burger says.

"Last year, Flour Mills of Nigeria, a publicly listed company in Nigeria, bought out all the minority shareholders of our company and now they control our company. We have essentially used Thai know-how and technology. Thailand produces starch, and not flour, so we had to adapt their technology slightly, but with the help of a good food science engineer we were able to come up with the solutions to produce flour from a starch plant."

Thai Roots

Thai Farm International took inspiration from the Thai manufacturing process for cassava, which produces around 20 million tons of cassava a year, largely on farms that are smaller than 10 hectares. The company imported a cassava flour processing plant from Thailand that could produce 60 metric tons a day, which was then installed and commissioned at its factory site located in Ososa, Nigeria, 120 kilometers from Lagos. To ensure the reliable supply of raw materials, Mr. Burger says that the business farms cassava roots on leased land and farmland under various joint venture farming projects with the local communities surrounding the project.

According to Mr. Burger, Thai cassava manufacturers "have produced a very effective technology for small field farming. The result is that the rural areas remain largely populated, with relatively few people being pushed off their land by big scale farmers."

Mr. Burger says that founding the business in Nigeria grew out of the success he saw in Thailand's cassava manufacturing model. Thai Farm International aims to give the bigger companies land at lower costs in order for them to produce big volumes and create the model and technology needed, which is derived from the Thai experience, for the small Nigerian farmers to follow.

"The market price of high quality cassava flour has largely stayed the same, although in Nigeria the price of cassava tubers has doubled in the last 18 months, largely due to a flood that wiped out an estimated 500,000 hectares of land under cassava cultivation," Mr. Burger notes.

"At the same time, the government added duties on rice and wheat so a lot of people switched to the traditional cassava food, which is called garri, fermented cassava flour that is roasted. The demand for cassava tubers went through the roof but at the same time the supply dropped because of the floods. The result was a much higher cassava tuber price. But because of this price increase, there has been an increase in cassava planting, and so we believe we will soon see a saturated market and, of course, the prices swinging in the opposite direction. I think we will see a continuing pattern of this and prices swinging quite wildly until the cassava growing and processing industry becomes more established and stable."

The Gluten Factor

With many confectionery companies investing in technologies to produce gluten-free products, the cassava industry has the chance to cash in on lucrative opportunities. Mr. Burger explains that cassava flour is an additive, and whether gluten is added or removed through the chain, the percentage of cassava included can increase. Therefore, for many countries that need industrial development, it presents a good prospect, as long as the regulations are in place to facilitate investment in the sector.

"Our flour product doesn't contain protein (gluten) which is something end users have to add to maintain the 'lift' in their bread or biscuits. Also, with the growth in gluten free-products in the developed economies, due to allergies, we will be developing technologies to produce our cassava flour in a way that end users don't have to include the gluten, as is being done by end users today. And we will aim to do this without any sacrifice to the quality of the product," Mr. Burger says.

"Looking forward to the future of cassava flour, there is no reason why poor countries that don't have the necessary climates to grow corn or, especially, wheat, cannot develop cassava flour as an alternative, and that the product cannot reach far-flung places. I have been approached by investors in countries such as Guinea, Uganda, and the Asian Pacific region. None of these areas have a cassava flour industry, but they cultivate cassava as a subsistence food and want to set up factories. I see big growth potential in this sector going forward."

LatAm Agribusiness Focus

Investing in South America's agricultural sector can be a risky business. Although there are many different ways to invest in the continent's agricultural business, most are subject to short-term volatility. Global supply and demand, planting cycles, weather variations, and energy and shipping costs have contributed to price spikes over the last decade, deterring investor sentiment.

However, despite recent uncertainties, Brazil has continued to demonstrate a strong performance and has stepped up to become the continent's biggest agricultural player. The country dominates the sugar, orange juice and coffee markets and is also one of the world's biggest soybean exporters, a trend that continues to gain pace. Indeed, Brazil's agricultural business has provided that much-needed boost amid the country's economic slowdown of late.

Investment in Brazil's agriculture has increased this year on the back of a forecasted record harvest, with capital being injected into the purchase of construction materials, trucks and machinery, and fertilizers. Agriculture grew 9.7% in the second quarter of this year compared with the previous quarter, up 17% from the same period in 2012.

Roberto Viton, founder and partner of Valoral Advisors, a niche advisory firm that focuses on South American agribusiness investments, says that there has been a sharp appreciation in farmland values across South America. This is particularly evident, he says, in countries such as Uruguay and Brazil that experienced large capital inflows into the farmland sector.

"This is combined with an expectation of lower prices across the agricultural commodity complex as global grain stocks are replenished, also at a time when emerging markets are more prone to capital outflows and currency instability resulting from the expected shift in U.S. monetary policy," Mr. Viton says.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Valoral Advisors supports investment firms, alternative asset managers and private equity funds, while also advising family offices and private banking firms. In 2010 Mr. Viton founded Valoral to help clients expand their exposure to the global agribusiness asset class.

“Although our research capabilities and networks are global, we mostly focus on South America. It’s interesting that even though we live in a global economy, most people from Europe and other regions in general are still unfamiliar with South America. They don’t know the language, whom to trust, or the way things work there, so to an extent there is still a great deal of work ahead to create awareness about the agribusiness opportunities in the region,” Mr. Viton says.

“In the last two years we have worked with fund managers who are typically in the early stages of launching new funds, which can include all sorts of investment instruments. We help them to build the investment strategy, to identify and evaluate opportunities and to develop partnerships with local operators.”

Future Opportunities

After a decade of strong fundamentals, followed by growing capital inflows and healthy returns in most assets and geographies, Mr. Viton expects a period of stabilization and consolidation in the value of agribusiness related assets. And to a large extent this reflects a moderation in some of the major growth drivers of the last decade.

It is therefore logical, he says, to see more caution among investors, especially those who are not yet invested into the region or are not experienced in the agribusiness sector. But for those investors with a long-term view, Mr. Viton believes that they can position themselves and prepare for the next wave of investments into the sector.

“I think there will continue to be opportunities in the agribusiness sector in South America in the next five to 10 years as the global structural trends in the sector are robust and point to a challenging food supply and demand scenario. I think there is value here and there is a window of opportunity for those who are willing to enter the market. It’s all about understanding the opportunities and risks across assets and geographies, and I’m thinking more on the private equity side.”

“Of course, capitalizing on the competitive advantages of the region will continue to be a major investment theme. South America has an enviable position in terms of the scale, quality, diversity and competitiveness of its agricultural sector that could position itself to feed more of the world in the next decades. We continue to see value in Colombia and Peru for intensive production of high value tropical fruits, we like cattle raising in Uruguay, which has an excellent reputation in global markets, and we believe that sustainable development of native land across the region will continue attracting investments – here we continue to see the frontier expanding in Brazil, and also in Paraguay and Bolivia. And If we think about all the services and infrastructure required to implement these projects, we can quickly visualize the opportunities in the private equity arena.”

Soybean Competitiveness

A Look at Export Cost Curves & Seasonality

Kyle Wendling

Soybeans were first domesticated in Northern China around the 11th century B.C. However, it was not until the 18th century A.D. that the crop made its way to Europe and the New World, and even longer before its full potential was realized. For many years after its introduction to the West, both soybean consumption and production stalled. In 1926, the entire U.S. soybean crop was planted on less than 2 million acres and yielded no more than 133,000 metric tons – a minuscule amount compared with the U.S. corn crop of the same year, which was approximately 99 million acres and yielded more than 54 million metric tons.

Over the last several decades, soy production and consumption has grown steadily around the world. Currently, the crop is grown in more than 50 countries, and the top three producers are the U.S., Brazil and Argentina. By far the largest soybean consumer is China, which consumed approximately 76 million metric tons in 2012 – 26 million more than the U.S., the second-largest consumer. However, China's annual soybean production is a mere 14 million metric tons, resulting in a 61 million metric ton deficit. This deficit is filled by imports, primarily from the three largest exporters – the U.S., Brazil and Argentina. This raises two important questions: What is the relationship between U.S. and South American (Brazilian and Argentine) beans? And, are they substitute or complementary products? In an attempt to answer these questions, the following analysis examines the differences in the export cost curves and seasonality of these two production regions.

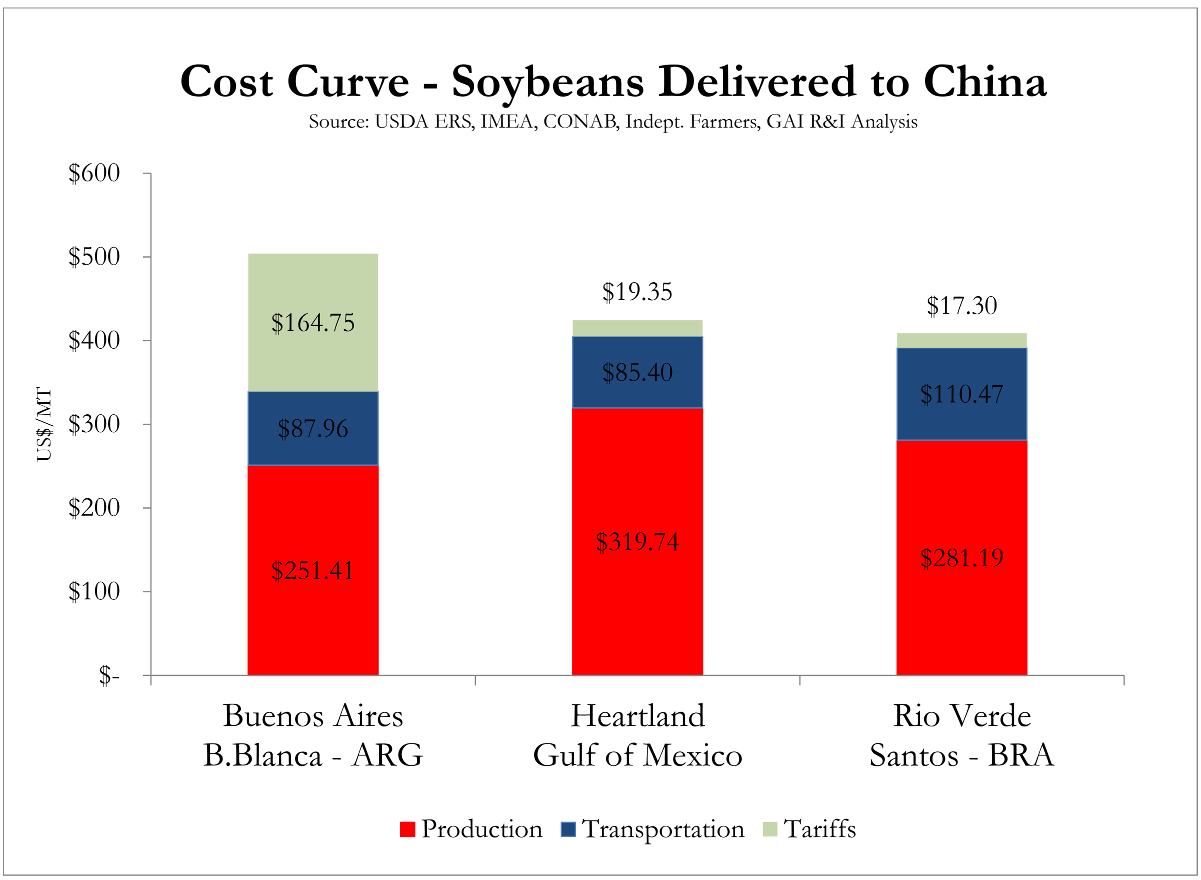
Export Cost Curves

To understand the economic differences between production regions, representative export cost curves have been constructed from 2011/12 crop year data for the U.S., Brazil and Argentina. By examining these cost curves, we can determine which country has an inherent advantage in export pricing. Figure 1 illustrates the differences between each country's production costs, transportation costs and tariffs. It is clear from the graph that Argentina has the lowest cost of production and the U.S. has the highest, with Brazil somewhere in the middle. However, insufficient transportation infrastructure in the South American countries reduces their competitiveness. The highest transportation cost is in Brazil, with Argentina in the middle, and more closely aligned with the U.S. As Brazil and Argentina continue to develop their internal infrastructure, the U.S.'s logistical advantages will deteriorate over time. Additionally, in the medium to long term, the expansion of the Panama Canal will most likely reduce the transcontinental shipping costs of all origins considered in this analysis. It should be noted that the expansion of the canal will most likely have a detrimental affect on the competitiveness of U.S. beans exported out of the Pacific Northwest.

Although Argentina has the lowest production costs, the government has imposed a 35% differential export tax. The tax is intended to protect Argentina's soybean crushing industry. If the government were to reduce or eliminate this tax, Argentina would realize a significant increase in the competitiveness of its soybean exports.

Seasonality

China is and will continue to be the most important market for soybean exports from the U.S., Brazil and Argentina. As the largest soybean importer in the



world, China is able to exert its monopsony power over the market to extract the greatest profits from its soybean imports. Consistent with its position in the world import market, China chooses to import soybeans from multiple locations, reducing price risk. Further analysis shows that this diversified sourcing strategy has also allowed exporting countries to develop a complementary relationship for their exports.

The U.S. and South America have opposing harvest seasons, which benefit all stakeholders (i.e. Chinese importers and U.S. and South American exporters). In North America, crops are planted in late April or early May and harvested around September or October. Conversely, South America's planting season is around September or October, and harvest begins in April or May. These alternating harvests allow China to import freshly harvested beans, without incurring additional storage costs. It is clear from the oscillations in trade flows that China is easily able to switch between origins based on the current supply and price of beans. In other words, by exerting its monopsony powers and originating soybeans from the lowest cost supplier, China is able to maximize the value derived from its soybean imports.

Additionally, when the trade flows are mapped against price swings from the two origins, we see that the price data supports the theory that it is most cost efficient for China to have multiple suppliers and switch origins based on production seasonality. As climate change continues and unseasonable weather affects agricultural production, the ability of importers to originate products on a seasonal basis may be reduced. In the near term, seasonality will continue to be an important factor for soybean importers.

Conclusion

From the above analysis, we can draw the following conclusions:

- Soybean production costs are the lowest in Argentina, but due to its differential export tariff system its beans are priced above the world's reserve price. This is a measure implemented by the Argentine government to support domestic soybean crushers.
- The U.S. presently realizes an advantage in internal transportation costs. However, their advantage is likely to decrease as Brazil and Argentina continue to invest in their transportation infrastructures.
- The largest soybean importer, China, is able to exert significant market power over its suppliers. China uses its monopsony position to maximize import profits.
- Due to China's price risk mitigation strategy and the seasonality of global soybean production, U.S. and Latin American beans are complementary products. When one region's harvest period ends, the other's harvest season begins. This allows China to import beans from both regions without incurring additional storage charges.

About the Author

Kyle Wendling is Senior Analyst & Business Development Manager for the Global AgInvesting Research & Insight (R&I) platform at HighQuest Partners, a global food and agribusiness consultancy. In this role, Mr. Wendling has responsibility for the production of all R&I publications, including setting the agenda for research initiatives, managing the R&I team in the collection and analysis of data, and writing reports.

In addition to being the editor of the R&I publications, Global AgDevelopments and Global AgInvesting Quarterly, Mr. Wendling is responsible for the marketing and positioning of the R&I platform, as well as developing new business and working with his network of industry experts to deliver in-depth, sector focused research.

Mr. Wendling has a B.S. in Agricultural Economics from Purdue University. He can be reached at kwendling@highquestpartners.com or (978) 887-8800 ext. 124.

Emerging Market Private Equity Highlights

Brazil-focused private equity funds have had a hard time raising capital of late. Commitments fell 35% to US$758 million in the first half of 2013 from the same period the year before, according to the Emerging Markets Private Equity Association. As a result, economists have cut Brazil's growth forecasts to 2.21% and 2.5% for 2013 and 2014, respectively.

Brazil's private equity market was said to make up approximately 70% of South America's deal activity in the first half of this year. However, this could soon change, with investors becoming increasingly tense as the country's buyout market is overheating and costs are rising. Additionally, an economic slowdown and the depreciation of the Brazilian real against the dollar have led many to turn to the more mature Latin American markets for opportunities, such as Colombia, Peru and Mexico.

However, global private equity and wealth manager Quilvest believes that Brazil has more depth in terms of GPs and scale for sector specialization than any other South American country.

"Even in the slower period we are seeing now there are some sector-specific opportunities. Some sectors such as Agribusiness and IT services and software still have backwinds and significant opportunities for sector-focused GPs to exploit," notes Daniel Arippol, Principal at Quilvest's São Paulo office.

"Many agricultural investments in Brazil have the benefit of being driven by demand from both the domestic and the international side, which mitigates some of the risk of external or internal demand shocks. Although IT services and software sectors are mostly driven by domestic demand, we're still seeing significant growth all across the value chain."

Quilvest has approximately US$22 billion in assets under management, and private equity in particular has been a core focus for the group, with its first private equity investment in South America being made over 40 years ago. Today the firm manages approximately US$4.5 billion in private equity through both fund and direct investment activities globally, and within that figure the emerging markets represent close to US$1 billion of the private equity assets it manages on its balance sheet and on behalf of third-party investors. Latin America has been a core and strategic segment for Quilvest, representing approximately 25% to 35% of its emerging market exposure.

With the firm's background and expertise lying within South American investments, Quilvest was an early player in the private equity market and began its business by backing a "highly successful manager" in the late 1990s. Since then, the firm has broadened and diversified its exposure as the market has developed, expanding into Colombia, Peru and Chile to cash in on the "large market opportunity" and lack of competition. Today however, Quilvest categorizes around half of its assets within Brazil – with a focus on the middle to lower middle market – and half within the Andean region and Mexico.

"In terms of outsourcing of IT services, it is still unlikely to happen on a significant scale, as labor costs in Brazil are high, and many services are not outsourcable. Brazil generally does not have as much cross-country IT outsourcing opportunity as some other countries do," Mr. Arippol says.

Carlos Heneine, Partner and Co-Head of emerging markets at Quilvest, adds, "Latin America generally has a limited number of PE managers that have a long track record, solid history, unique angle and rational fund size. Therefore it may be easier in Latin America to narrow down to the small list of groups one would like to work with given that we are talking about 15 to 20 names that may fit into this category. Getting privileged access and sizable allocations to those groups is part of the challenge many new investors to Latin America may face."

Quilvest's clients consist of shareholders and third-party investors, while geographically it has a large investor base in Europe and the Middle East, with more recent investors coming from Latin America and Asia. Mr. Heneine says that family offices, UHNWI, and large and small institutions are all generally seeking to increase their exposure to the emerging markets, or at least outside of their home geographies. He adds that the underlying drivers are diversification into high growth markets, exposure to the growing consuming middle class, and the need to achieve higher returns than what can be achieved through their fixed income portfolios.

"In terms of outsourcing of IT services, it is still unlikely to happen on a significant scale, as labor costs in Brazil are high, and many services are not outsourcable."

Fundraising

Mr. Heneine explains that the firm's fundraising activities center around both its fund of fund vehicles and direct investment activities. However, the business is also focused on providing access to the middle market, veering away from raising large pools of capital that would be at odds with its underlying strategy.

"This is mainly due to our resolve to stay right-sized in order to remain focused on the real performing investment opportunities, and these are not necessarily the big global mega-funds," he explains.

When it comes to transparency in the market, Mr. Heneine says that investors must accept a different level of expectation when dealing with the emerging markets.

"Depending on the markets and the levels of sophistication we're working with, we find that a lot of the managers we have invested with work extremely hard to be very transparent with their approach, processes and access to their portfolio companies. Part of this transparency is driven through a realization that they have to spend a lot of time educating investors about their particular markets given the inherent skepticism or perceptions that may exist. They realize that this is a must, especially if they are in their early stages of development."

Mr. Arippol adds, "Our experience in Latin America has been positive . . . with the groups we have purposefully chosen to work with. That being said, there is always a higher degree of concern about the underlying portfolio companies' books and records. There have been instances where numbers may have been misrepresented by an underlying portfolio company, but we have fortunately not come across a situation where that has translated into any ethical concerns about the managers we have chosen to work with."

The Outlook for Asia and Other Emerging Markets

Turning to Asia, so far China and India have been the primary recipients of private equity capital across Asia, as well as the emerging markets generally. Mani Saluja, Partner and Co-Head of emerging markets at Quilvest, says that over the last two to three years the company has been cautious about investing in both of these markets, given the macro disruption as well as the radically shifting private equity landscape. It has, though, been very proactive in the secondary markets due to the interesting opportunities that present themselves during any slowdown.

"China and India have been the primary recipients of private equity capital across Asia (and the emerging markets generally). Over the past two to three years, we have been cautious about investing in both of these markets given the macro disruption as well as the radically shifting private equity landscape. We have, however, become very proactive in the secondary markets given the interesting opportunities that present themselves during any slowdown," Mr. Saluja says.

Mr. Heneine adds that despite the current macroeconomic environment, growth opportunities are still available. And for Quilvest, it is more about the importance of locating the right players, who are "hands on, and that that can do hands on or control transactions that are low- or mid-market focus." This way, the investor is still likely to see very compelling returns, and more importantly distributions, he explains.

Outside of China and India, the firm has taken exposure to Southeast Asia, specifically Indonesia, Thailand and Vietnam, where it has seen more captive and proprietary deal flow due to the lower number of sustainable private equity groups that exist in each respective market. Within the more developed parts of Asia, Korea has particularly been of great interest for private equity opportunities, Mr. Saluja says.

Across the emerging markets, Quilvest has looked at a number of frontier and niche sector-specific areas in sectors including healthcare, mining, energy or venture focused funds, although its commitments to anything niche-oriented are premised on finding the right groups to work with, Mr. Saluja says. Evaluating these niche opportunities, such as Mongolian mining, promises to be more complex, and a solid review of a completely different risk profile needs to be undertaken.

"We typically would work with industry experts to help us evaluate certain sectors," Mr. Saluja says. "We also like to work alongside the manager on one or two co-investments to gain a deeper understanding of the underlying portfolio risks before committing to a blind pool."

With a view to Africa, Quilvest broadened its exposure to the continent three years ago, and has found the markets to be generally less competitive compared with many of the other emerging markets.

Mr. Saluja says, "We are quite optimistic about the prospects of PE in sub-Saharan Africa and are looking to increase our exposure . . . although we are closely monitoring and reviewing the increasing levels of competition in certain segments of the market relative to the number of attractive investment opportunities that exist."

Taking a Look at African Equity Funds

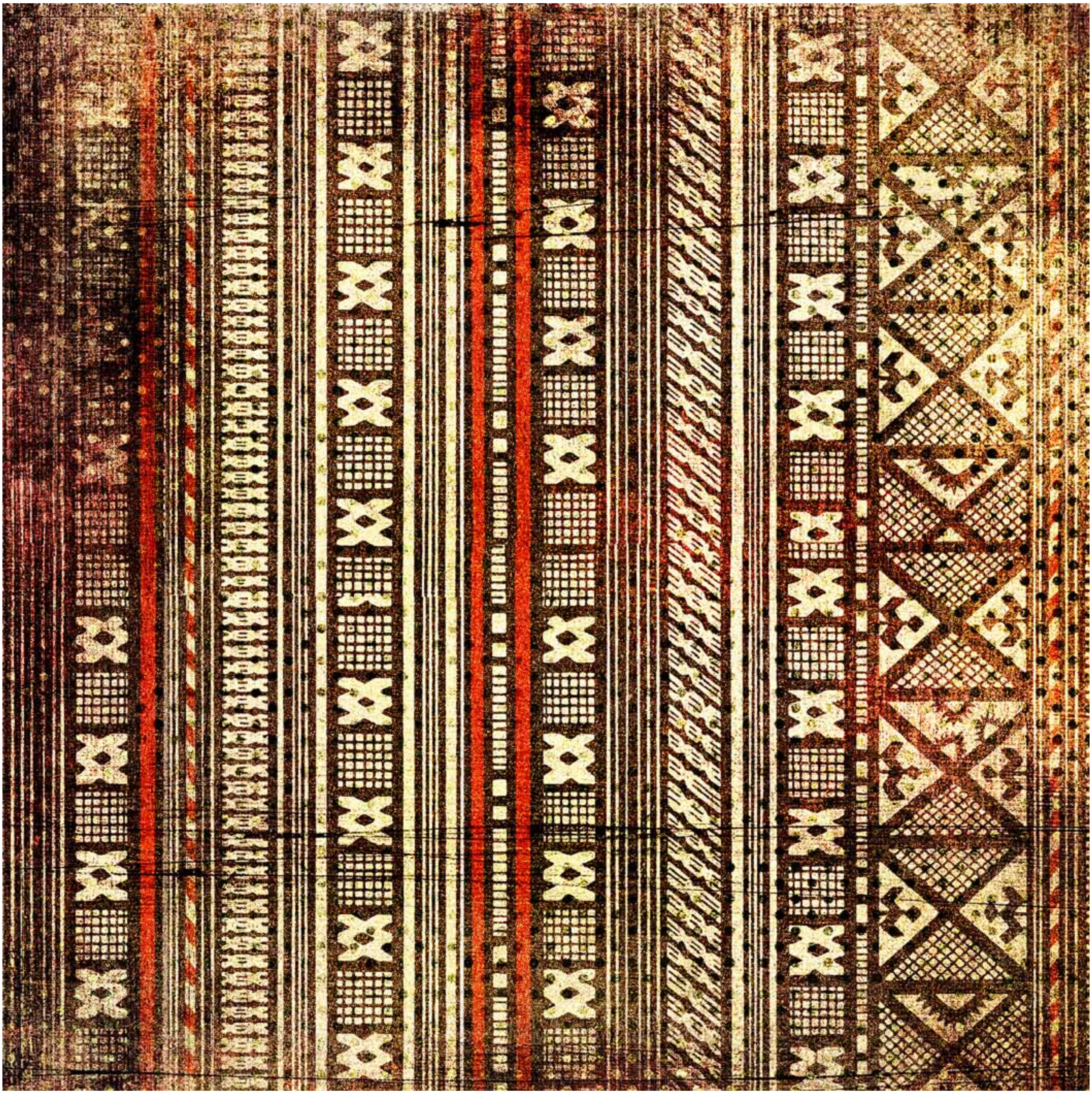
The African economies have undergone a huge transformation through prudent macroeconomic policies, increasing foreign direct investment, a young and productive population and the development of technology. Adding weight to Africa's investment appeal, Europe's unstable economies and high wage costs are expected to push corporates to relocate to North Africa, specifically Morocco, according to Jamie Allsopp, Africa Portfolio Manager at asset management company Insparo.

"With oil finds in East Africa boosting growth I think we will also see Kenya and specifically Nairobi becoming a hub for international companies moving into sub-Saharan Africa. Already companies such as IBM and Google have opened offices, and the new Kenyan government has proved to be business friendly."

Insparo launched its first fund in 2008, the Africa and Middle East Fund, a multi-strategy fund that invests across asset classes, both in hard and local currency debt and foreign exchange, as well as equity. In 2011 the firm launched a pan-African equity fund, which excludes South Africa, as well as an African fixed income mandate fund. In response to Africa's increasing investor interest, Mr. Allsopp confirms, the firm has appointed a private equity specialist to look at the smaller corporate end of the unlisted space, making it one of the few fund management companies that can offer access to African equity, credit and private equity funds.

"There is the reality versus perception gap when it comes to Africa. There has been a lot more volatility recently in some of the African markets, but the growth outlook remains positive," Mr. Allsopp says. "The Arab Spring and post-election Zimbabwe have muddied the political waters, but if you look at countries such as Kenya, which has successfully carried out peaceful elections while its economy is growing at 6.5%, and Nigeria with 7% growth, there is a plenty to be lauded."

He adds that over the last five years the continent's falling inflation has positively impacted consumers. Africa's young and productive workforce not only demands goods and services, but is a large and effective labor group for companies moving out of more developed parts of the world.



African Hedge Funds

Insparo's Africa and Middle East Fund is able to hedge positions and have outright shorts. The fund is managed in a more active manner than its equity fund, Mr. Allsopp says, while its shorting universe consists of currencies, indices and CDS, along with other derivatives.

"In the African equity fund we have a very much more long-biased approach. African markets, excluding South Africa, are frontier markets, and liquidity is low compared to mainstream emerging markets; companies can be inefficiently priced and will trade on very small volumes. It is often illegal to short equities on many African markets, and the only place you can get liquid borrow is in South Africa."

The firm excludes South Africa from its African equity fund and only looks to hedge in times of stress, using correlated assets such as indices and currencies to achieve this. Mr. Allsopp says that Insparo affords itself the flexibility of being a hedge fund but remains very much long-biased, noting that there are currently no hedges on the equity fund. "The long-term story is incredibly positive," he adds.

Insparo's clients consist mainly of high-net-worth individuals, family offices and financial institutions, although it is currently seeing much more interest from the U.S. than from anywhere else in the world. Endowments on the East and West Coast of the U.S. have picked up considerably within the African equity fund investment sphere, although interest from institutions in Europe is also increasing, Mr. Allsopp confirms.

"It's a process of education; sub-Saharan equities is a nascent market, but it's being covered by the media a great deal, and there is significant growth and also yield. Larger institutions have become more involved in Africa, with GEM funds investing in the larger sub-Saharan stock exchanges such as Nigeria and Kenya. These markets have performed very well over the last 12 months and still have much more in them. This momentum has attracted the attention of larger funds and company road shows, and conferences are getting much busier."

The African stock exchanges now include a wide range of locally listed consumer facing companies, which are subsidiaries of major multi-nationals such as Nestle, GlaxoSmithKline, Cadbury and Heineken. The parent companies derive a small percentage of their earnings from the region, Mr. Allsopp says, and therefore there is little correlation with the Nigerian listed entity. However, investing directly in exposures is the great growth story of international standards of systems and governance, he explains.

"WPP has just bought a 51% stake in a Kenyan advertising agency with a pan-African reach. This is happening across the region as parent companies seek greater exposure to Africa, ratifying our investment strategy. There is a concern, however, that they are reducing the available stock, so attention is paid to make sure that good governance with regard to minorities is obeyed and the right price is achieved."

Middle Class Growth in Africa

Global consulting firms Deloitte and McKinsey estimate the size of the African middle class between 200 million and 300 million people, while Global Pacific states that only 5% of Africans earn enough to qualify for the "global middle class," bringing the number down to 50 million, Mr. Allsopp says.

"The African Development Bank defines a 'floating lower middle class' with per capita consumption levels between US$2 and US$4 a day. However, the U.S. characterizes families that are living on US$2 or less a day as living in extreme poverty. So we don't have a great deal of agreement and a wide spectrum from 50 to 300 million with almost everything in between," Mr. Allsopp notes.

He adds that in sub-Saharan Africa alone there are 800 million people importing US$30 billion-worth of goods a year, with 15 million people remitting US$40 billion to relatives every year. Adding to this, 5% of Africa's total GDP over the last decade has been derived from consumer-related sectors. However, consumer appetite is still left unsatisfied by the underdeveloped local retail market. Retailer-owned co-operative Shoprite has said that although there are three supermarkets in Lagos, Nigeria, the realized capacity stands at 198.

French retailer Carrefour is also cashing in on the opportunities available on the continent, recently announcing that it will open in eight countries in West and Central Africa. The largest chains will be Carrefour, Shoprite and Walmart, and the move should alleviate consumers' complaints of poor selection and high prices in sub-Saharan Africa. 3G mobile and fiber optic cable connectivity are expected to be entering the continent's retail arena in the short term too, and "opportunities for the rollout of innovative internet retailers abound," Mr. Allsopp says.

"Luxury brands such as Porsche and Ermenegildo Zegna have set out their stall in Lagos. Zegna is the first luxury fashion house to open, with the founder declaring that his African consumers spend on average 50% more than the typical Zegna shopper. Harrods of London would concur, as on a per capita basis Nigerians spend more than all nationalities but the Saudi Arabians in the upmarket store."

"Admittedly this is hardly representative of an emerging consumer, but South Africa does have a high proportion of luxury brand shoppers. There are 48,000 U.S. dollar millionaires in South Africa, 23,000 in Egypt and 15,900 in Nigeria. The establishment of the black middle class in South Africa is well documented, and retailers listed on the Johannesburg stock exchange have performed incredibly well over the last decade, with the share price of a company such as the clothing retailer Truworths rising 1000%."

South African ETF Market

The global ETF industry has seen incredible success, with assets from both institutional and individual investors boosting numbers of late. So far this year, global ETF inflows for all funds and products have reached US$96.3 billion, dipping below the pace of last year, which hit US$105.5 billion by mid-2012.

South Africa's ETF market in particular has proved to be a successful sector. The country's first ETF was launched nearly 13 years ago, and with the number now totaling 45, it has in 10 years achieved what South Africa's mutual fund industry did in more than 30.

However, the global volume of ETFs, as well as those in the emerging markets, have started to slip after the Federal Reserve recently announced it will curtail its bond-buying program. Since June this year, investors have withdrawn US$6.6 billion from ETFs linked to the emerging markets, in what would be a decline for the fifth consecutive month.

According to the Financial Times, asset manager BlackRock has advised its clients to temporarily cut back on their emerging markets exposure until the end of the year. The advice was administered with a particular emphasis being placed on South Africa, as outflows from both gold and emerging market assets have caused the ETF industry to lag behind.

However, the investment banking division of Absa Bank, Absa Capital, launched its successful platinum-backed ETF on April 26. The ETF rose to above half a million ounces within 10 weeks, marking a turning point for African ETFs. The fund now accounts for one-quarter of all global platinum ETF reserves, with its NewPlat ETF holding 503,613 ounces of platinum, while its inflows total nearly 76,000 ounces, or US$99.96 million.

The fund has seen high demand, as investors are choosing physical exposure on more

and more occasions. Additionally, in a bid to expand its presence in the African markets, Absa listed its NewGold ETF on the Mauritius Stock Exchange (SEM) on July 26.

ETF Appetite

Dr. Vladmir Nedeljkovic, Principal and Head of Investment at Absa Capital, says that the bank's launch of its platinum ETF was something that has been worked on for two years – a longer time frame than the average, due to regulatory issues.

"There had been a strong and consistent demand from our institutional investors for this product, throughout the development process. Because of that, we did expect strong demand for it upon listing, but we were surprised by the extent of that demand."

Three months after its listing, the NewPlat ETF has over US$750 million in assets and is backed by over 17 tons of platinum bullion, making it the second largest platinum ETF globally.

According to Mike Brown, Managing Director of ETF platform etfSA, "What you can do here is invest directly in platinum or gold metal rather than in gold mining shares or platinum mines, etc., which haven't been good investments for some time because of labor disturbances and other issues in the mining industry."

Due to South Africa's exchange control restrictions, all of the ETFs, including the gold and platinum, require physical collateral. And as South Africa is still without a futures market, it requires investors to purchase the gold or platinum in the spot markets.

"South Africa is one of the world's largest producers of minerals and commodities but we still don't have a local metals market to trade them on, and the reason is because of exchange control, you need to lay your risk off internationally and you need to be able to take foreign currency hedges to do this," Mr. Brown says.

Due to these exchange control restrictions in South Africa, Mr. Brown explains that the local government would rather sell its commodities internationally in London and elsewhere, and bring in the currency, rather than trade them in rands on the South African market.

Launching ETFs

Mr. Nedeljkovic explains that there are two main ways to select how an ETF is going to work. The first is simply based on customer demand. An example of this, he says, is the bank's launch of a component ETF, and a whole family of ETFs to track the major exposures in the different asset classes.

"In the fixed income space, we cover nominal and inflation-linked government bond indices. We have the only cash ETF in the South African market covering money market instruments. In the equity space, we provide exposures to all major risk factors – value (with our eRAFI series of ETFs), momentum (we are the only ETF provider in South Africa offering exposure to the momentum factor) and broad market," Mr. Nedeljkovic says.

One of Absa's strategies is to bring ETFs to the wider Pan African region, and in order to kick-start the product into the capital markets Mr. Nedeljkovic says that Absa is applying secondary listings for its gold ETFs. So far, the bank has listed its gold ETFs in Botswana, Nigeria, Ghana, Uganda and Zambia.

"All these listings have been done in close cooperation with exchanges and market regulators in these jurisdictions – whose interest is to expand the product offering and offer new, previously unavailable asset classes to the local investors, improve the liquidity and trading volumes, as well as strengthen governance and streamline processes to facilitate efficient trading."

Meanwhile, Mr. Brown explains that he helped to set up the first ETF in South Africa, going on to launch etfSA.co.za in order to offer direct access to ETFs/ETNs through an online business. By launching the product, Mr. Brown says that it was filling a much needed gap in the market, as at the time stock brokers were typically only looking at high net worth clients, disregarding the smaller investors.

He says that the decision behind the business was to service a part of the market that no one else was investing in, and so far, the business has been unmatched in competition.

"Stock brokers typically only look at high net worth clients. They don't look at the smaller investor, they have a high cost structure and it's the same thing with our investment banks and private bankers. Where they were missing out was that the general population that couldn't get access to low-cost retail investment products, so what we do is get people to invest in any ETF and there are 60 of them in South Africa, from fairly small amounts, i.e., R1000 lump sums or R300 per month."

Mr. Brown adds, "The unit trust industry has always sold through IFAs, but they have moved in the last few years to building their own platforms so this can be appealing for those who do not wish to go through a financial intermediary value chain. etfSA.co.za is the only such platform, operating for ETPs as people are realizing that you don't have to have a high cost distribution channel. So the online business for financial providers is starting to pick up in all sorts of areas."

Retirement ETFs

Retirement funds are a growing trend within the ETF market, as they can be seen as a low risk option for retirement investors looking to gain exposure to a wide portfolio of bonds and stocks.

Capitalizing on this trend, etfSA.co.za will soon launch its own retirement low cost fund purely from using ETFs and ETNs as components; a development that Mr. Brown says will be greatly welcomed by the South African government.

The growing trend comes as South Africa's government recently announced a reform in its pension fund industry that allows individuals to put up to 10% of their total assets in commodities. Regulators, meanwhile, have advised that this should be in the form of ETNs and ETFs.

"There is a strong case to be made for using commodities in a long-term pension fund portfolio, so we will see some institutional demand from this source. For South African investors looking to have exposure to international equity markets, there are now 11 ETFs/ETNs listed on the JSE which will give you access to the FTSE 100 or the MSCI USA or the Chinese or Japanese markets, and it is just the issuing company that has to get the exchange control permission, they're quite big concessions in the South African context. These offshore products that give access to offshore markets are starting to generate quite a bit of interest, both for retail and institutional investors," Mr. Brown says.

"There is starting to be some institutional involvement, typically South African pension funds and institutional investors. Most money in South Africa is actively managed, but increasingly the performance numbers are showing that it is quite difficult to beat passive investment in South Africa because the liquid trading on the JSE is confined to 60/70 stocks out of around 500. It is possible to buy the performance of the liquid 60/70 stocks by investing in index tracking ETPs."

The Changing Landscape of Colombia's Pension Fund Industry

Yasin Ebrahim

Colombia's pension fund market is expected to surpass US$121 billion by 2014. This article aims to explore the potential developments contributing to the success of Colombia's pension fund industry and potential impacts pension reforms will have on portfolios of pension fund companies, with particular consideration aimed at changes in asset allocation toward the private equity sector.

Colombian Pension Funds Positioned for Growth

Figures released by Latin Asset Management and Cerulli Associates predict that inflows into Colombia's compulsory pension system will surpass US$121 billion in 2014. More importantly, US$36 billion is expected to be invested offshore, and will attract foreign asset managers keen to get their feet wet in this quickly growing market. Despite its small size relative to major players such as Brazil and Mexico, Colombia is home to one of the fastest growing private pension fund industries in the LatAm region, with current assets under management (AUM) of US$80.8 billion.

Major reforms coupled with a stable regulatory environment and a growing economy have contributed to the rapid growth of Colombia's pension industry. Pension reforms such as the introduction of multifunds in 2010 have helped widen the range of services that Colombia's pension companies, known as AFPs, can offer contributors.

Multifunds represent a "bait the hook to suit the fish" type of system, whereby each participant contributes to a pension fund ranging from a high-risk fund to a retirement fund, whichever best suits their risk profile.

Younger participants' contributions are likely to be invested in a high-risk fund heavily concentrated in equity and foreign investment in order to maximize their pension at retirement. Conversely, contributions of older participants and those close to retirement will be invested in the moderate fund, conservative fund or retirement fund, the focus on the latter being capital preservation.

Major Players in the Colombian Pension Fund Industry

Colombian private pension fund AUM increased by 17.5% during 2012 to US$80.8 billion, according to figures released by financial services regulator Superfinanciera. The increase in assets was mainly due to an increase in the asset valuation of portfolios. The 6 major pension fund companies, each with AUM in excess of US$1 billion, account for 45% of all institutional investment. Therefore, the importance of Colombian pension funds to the domestic capital markets can't be ignored. Foreign asset managers support this view and are actively seeking to get involved in this quickly growing segment.

Scotiabank, one of North America's premier financial institutions, has taken the opportunity to both increase its footprint in Colombia and build upon the success of Colombian pension funds by acquiring a majority stake in Colfondos, Colombia's fourth-largest pension company, with US$9.25 billion in AUM. Brian Porter, Group Head of International Banking at Scotiabank, realizes the potential for rapid growth in the market coupled with an improving economy as reasons to gain exposure.

"Expanding Global Wealth Management's footprint in Latin America is a strategic priority for Scotiabank, and the acquisition of a majority stake in Colfondos will increase our regional presence in this segment. Colfondos has achieved a great deal of success, and with our partners at Mercantil Colpatria, we look to continue the growth and expansion of this business."

On the domestic front, Porvenir, one of Colombia's leading pension fund managers, recently announced plans to buy AFP Horizonte, a Colombian subsidiary of Spain's second-largest bank, BBVA, with a view to capitalize on the growth opportunities and boost their customer base by about 34% to 5.3 million.

Moves within Colombia's pension fund sector by both domestic and foreign asset managers clearly underline the demand for exposure to the sector as well as the desire to remain competitive. Competiveness is an increasing concern amid plans by the government to adjust how the minimum profit percentages that private pension funds have to report each year are calculated.

The government plans to adjust the portfolio composition limits required by pension funds with a bias toward overseas investment amid concerns that pension fund portfolios are too concentrated in pesos, according to Colombia's Finance Minister Mauricio Cardenas. "We need a more diversified pension portfolio, which includes more dollars," Mr. Cardenas recently noted. "Right now they are too concentrated in pesos. They've put all their eggs in the same basket."

The revised method for determining minimum profit levels together with diversification concerns will incentivize pension fund managers to expand their overseas exposure as well as generate dollar purchases of approximately US$4 billion in the local foreign exchange market.

A key sector set to benefit is private equity, with a particular focus on industries such as infrastructure, energy, real estate and general services.

Positive on Private Equity

Private equity transactions undertaken by local or international private equity funds are referred to as PEFs in Colombia. The implementation of key legislation in 2007 allowed Colombian pension funds to invest up to 5% of their assets in the local private equity and venture capital funds.
The accessibility of local capital spurred growth in Colombia's private equity industry, and it is currently one of the few economies showing a steady increase in its PE environment, as shown by the Latin American Venture Capital Association (LAVCA) scorecard.

Colombia is the currently ranked fourth among LatAm countries in terms of its PE/VC environment. Continuing regulatory improvements including fund formation and operation of local institutional investors such as pension funds will continue to be Colombia's strength when compared with the region.

Currently, US$6.4 billion is available for investment in local and offshore private equity funds with only US$2.9 billion (45%) of the total US$6.4 billion available having been invested. As a result there is growing appetite among offshore investment managers actively seeking commitments from pension funds to raise funds in local markets.

Advancements within the macroeconomic, political and socioeconomic conditions such as a growing young population will result in more contributors, inevitably leading to an increase in the AUM of Colombia's pension funds.

Given the lack of publicly traded investment opportunities and the need to remain diversified, pension funds will be incentivized to explore alternative investment opportunities, including private equity. Private equity is set to become increasingly attractive among investors, according to a recent Emerging Markets Private Equity Association (EMPEA) report, "The growth in dry powder exceeds the supply of publicly traded investment opportunities, pushing them into alternative assets, including private equity."

Infrastructure funds are a key area set to attract private equity funding as an ever expanding population, a rising middle class and political stability create the need for investments in various public works (toll roads, airports, ports, transportation, etc.).

A closer look at the fundraising efforts of PE managers only highlights the increasing commitment from investors toward the sector, as 27% of total funds raised have been allocated to infrastructure. Infrastructure investment will remain topical for the foreseeable future, as improvements to the country's subways, roads, ports and airports are required to support the increased domestic and export demand for its mining, agriculture, oil wells and other industry sectors.

In the nearer term, sectors sensitive to consumer discretionary spending such as tourism, hospitality and entertainment will see a healthy influx of capital due to a rapidly expanding middle class, enhanced macro and social conditions, regulatory improvements and political stability. These advancements had a favorable impact on Colombia's credit rating as it was raised to investment grade and will surely spur investments from abroad. Although the outlook is positive, there always remain underlying risks such as the government's plans to curb the strength of the peso against the dollar, which may lead to diminished activity by private equity funds and more activity by strategic investors in the short term.

However, those familiar with Colombian private equity are optimistic that Colombia will remain attractive to international managers. "Colombia is by far the most open market in Latin America to allocate internationally, and to meeting international managers and diversify their portfolio" according to Maximiliano Del Vento, Vice President at Partners Group.

Colombia – An Opportunity Worth Exploring

Gone are the days when rampant street crime, fear for personal safety and drug cartels were endemic across Colombia. Over the last decade Colombia has strived to tackle these issues while delivering a political, macro and social environment to attract foreign investors and spur growth opportunities closer to home.

As a result Colombia is the third most "business friendly" nation in Latin America and boasts one of the lowest risk premiums in the region. Planned amendments to regulation as well as looser restrictions on the portfolios of institutional investors, including pension funds, will lead to a plethora of capital, creating investment opportunities in the public and private equity markets both domestically and abroad.

Private equity in Colombia is fairly new, with 31 closed funds and 15 new funds currently targeting a total of US$803 million. Despite the nascent state of Colombia's private equity market, it has expanded rapidly in a short period, as capital commitments have grown annually at a rate of 71% according to a report released by Bancoldex Capital, a state-owned commercial bank.

The fact that pension fund assets are predicted to surpass US$121 billion by 2014 bodes well for private equity, as there is a trend among pension funds to invest in managers with good track records.

Despite key concerns such as a strong peso, lack of entrepreneur or manager awareness of private equity and the need to establish a private equity market with a solid track record, investors seeking exposure to a rapidly growing middle class, impressive GDP growth and a buoyant stock market should consider an allocation toward Colombia. This will not only enhance their diversification requirements at a time when the "BRICS" are losing momentum, but enable exposure to a country set to become an "alpha generator" in the future portfolios of investors.

About the Author

Yasin Ebrahim is an investment professional researching developments in the alternative investment space through exposure in traditional and social media. His background in risk and investment management coupled with leading industry qualifications provide him with a sound background to explore alternative investments.

Cooper Tire/Apollo Timing Unclear on RBI Review – Analysis

Freny Patel in Mumbai, Claudia Montoto in Fort Lauderdale and Reuben Miller in Washington, with additional reporting by Brandon Hamilton in New York

The planned acquisition by Apollo Tyres of Cooper Tire & Rubber (NYSE:CTB) faces increased timing uncertainty four months ahead of an expiration of the deal's merger agreement and financing.

Indian media reports that the Reserve Bank of India (RBI) plans to review the US$2.5 billion transaction as part of new regulations that require review of direct overseas investment by Indian companies greater than 100% of their net value. The Cooper deal is approximately 450% of Apollo's valuation, according to news reports.

When Cooper reached a deal to sell to Apollo in June, the companies are understood to have not anticipated a review by the RBI. It could not be learned if Apollo can contest the reported review on the grounds that it reached a deal before the regulations were announced.

The cash-based transaction may not be complex, but a U.S.-based attorney said he would advise clients not to use a short closing timeline in such a deal involving multinational companies, a joint venture in China, and high leverage.

The Cooper merger agreement and committed debt and equity financing all expire on December 31. The first attorney questioned which party in the Cooper deal asked for the arguably short drop-dead date. He said the fate of the deal will ultimately come down to Apollo's commitment to the transaction.

Reportedly, there continues to be a strong strategic rationale for the merger, and financing markets remain strong. Cooper and Apollo did not respond to requests for comment.

The RBI could take three to four weeks to review the Cooper deal, an India-based attorney estimated. However, this attorney cautioned that the deal will likely be the first transaction the RBI reviews, and it may take more time to examine the transaction in light of the falling value of the rupee and possible political pressure.

"The RBI approaches each application for approval on a case-to-case basis," said a second attorney based in India. "It would be difficult to ascertain at this stage the approximate time that the RBI might take to give such approval in the Apollo case."

Apollo is funding the transaction with US$2.375 billion in debt financing that is only guaranteed by Cooper and Apollo's European operations. The equity portion of the deal is provided by a US$450 million Standard Chartered facility that is recourse to Apollo Tyres and structured via a subsidiary in Mauritius.

An India-based industry banker said Indian companies typically raise funds for overseas acquisitions by leveraging the balance sheet of the target, so the RBI's rules should have a limited impact on transactions unless a target company's balance sheet cannot support a deal.

The development in India comes as Cooper and Apollo have been confronted with concerns by workers and executives at Cooper's 65% owned Chinese joint venture with Chengshan Tire.

Chengshan has filed suit against Cooper in China for the disbandment of the JV. The complaint, Case Docket No. (2013) Wei Shang Chu Zi No. 69, alleges that the proposed sale of Cooper has caused the joint venture's labor union to strike and will subject the joint venture to operational risks.

Under Chinese corporate law, shareholders with more than a 10% stake in a company can bring action against the corporation if there are concerns about a value-destructive transaction. The first hearing in the Chengshan suit is scheduled to take place September 24 in Weihai Intermediate People's Court. The second attorney described the hearing as a "show-cause" that may not provide much clarity on the matter.

Any court action is likely to take some time to process, said the second U.S. attorney, noting that the merger is likely to close ahead of a definitive court decision. He estimated a lawsuit could take one to two years to run its course.

It is unclear if Chengshan really wants to cut ties with Cooper since the companies have worked for six years to develop the JV, the second U.S. attorney said.

Li Qiang, executive director of China Labor Watch, said he does not believe Chengshan wants to be bought out of the JV. Chengshan is not completely state-owned, but there is government interest in the company, Qiang said.

Strikes are illegal in China, and the Chengshan workers' union is part of the Communist Party, so the government is likely involved in the strike, Qiang said. Cooper has said in a statement to Indian media that workers have returned to the Chengshan factory and it has started to resume operations.

A former Cooper executive, Dick Stephens, told The Courier newspaper in Findlay, Ohio, that he believes one of Apollo's primary reasons for buying Cooper is to acquire the Chengshan facility. If the JV is dissolved, Stephens said he believes the chances of the deal closing would drop significantly.

Policy and Regulatory Report

DEALREPORTER

About the Authors

The Policy and Regulatory Report (PaRR) is an intelligence and analytical news service that focuses on the development and adaptation of competition law around the world. Its coverage spans North America, South America, Europe, the Middle East, Africa and the Asia-Pacific region. PaRR focuses on the intersection of global competition law with intellectual property, trade and sector specific change in which there is a direct impact on the fair market practices of governments and corporations worldwide. To learn more about PaRR visit www.PaRR-Global.com. For information on becoming a subscriber or to arrange a free trial, contact sales@PaRR-Global.com.

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Getting to Grips with the Nigerian Market

The case for investing in the African frontier markets right now is strong, and Nigeria in particular with its high growth potential is looking like one of the continent's strongest contenders. The country is expected to grow rapidly over the next 10 years, and as many other markets continue to look uncertain, investors are now looking at Nigeria as the next big thing.

Citigroup reported in May this year that Nigeria, along with United Arab Emirates, Bulgaria, Kenya, Sri Lanka, Pakistan and Vietnam, is one of the top 7 performing frontier markets of 2013. However, the country is not without its problems. Regulatory restrictions and political risks lurk at every turn, and throwing another spanner in the works is the news that Finance Minister Ngozi Okonjo-Iweala will continue tightening Nigeria's monetary policy.

Rising Rates

The Central Bank of Nigeria is keeping its high benchmark interest rates, which were implemented initially to help boost the country's economic growth and curb inflation, even though inflation is now down.

Adetola Odukoya, Head of Investment Research at Nigeria-based investment house Dunn Loren Merrifield, believes that the Central Bank will continue to focus on price stability and exchange rates rather than on domestic growth, for the time being. Another reason the government is keeping rates at an all-time high is the expectation of higher government spending, and borrowing, after the launch of military operations against Islamic insurgents in Nigeria's northeast. However, Mr. Odukoya says that high rates may actually help boost foreign-currency reserves.

"There has been an expansion in government spending due to military operations in the northern part of the country, and the monetary authorities are not very eager to reduce the benchmark rate due to the increase in government spending."

Nigeria's Increase in Wealth

The rise in Nigeria's middle class population will also play a large part in its investment appeal as a frontier market destination. The rise in relative wealth, and therefore the rise in savings, creates opportunities for those asset management firms that have the desire to invest. Africa's middle class is estimated to be 313 million people, and bank deposits as a percentage of GDP amount to 26.3%. Nigeria's middle class now accounts for around 23% of the population – with incomes between N1m and N1.2m (US$6,000-7,000) a year, according to the African Development Bank.

The World Bank data shows that sub-Saharan Africa's (SSA) assets under management (AUM) (classified as pension funds and mutual funds) as a percentage of GDP is currently 33%. South Africa has the largest AUM to GDP percentage with over 38.9%, and Nigeria trails with 7%.
"The scope of growth is staggering when these figures are compared with Europe's AUM to GDP percentage of 104%," Mr. Odukoya says.


FIFTY
NAIRA
₦500
₦200
Central
Of Nigeria
Two
Hundred Naira
CENTRAL BANK
OF NIGERIA
TWENTY
NAIRA
20

According to Nigeria's SEC, only about 5 million out of Nigeria's population of 160 million invest (either directly or through fund managers) in the capital market. However, with the population's increased income and the compulsory pension fund savings policy in place, AUM and investment growth is inevitable, Mr. Odukoya predicts.

"To put this in perspective, AUM for the PFAs in Nigeria rose from N265 billion in 2006 to N2.739 trillion in 2012, a growth of 934%."

Nigeria's Fund Capacity

Nigerian banks are also seen to be expanding their capabilities. The banks' capital has grown from US$2 billion in 2008 to US$50 billion now. Similarly, the country's hedge fund market has altered dramatically over the last 5 to 10 years, Mr. Odukoya says, due to it being much more open and connected to the global financial markets.

The equity market is a little different, however, and it still has not reached the depth that local bankers would like it to reach. However, according to Mr. Odukoya, one or two Nigerian private equity funds have been created recently due to the high interest rates, which started to increase in Q4 2010.

"At present, about 40 out of 200 stocks account for 80% to 90% of equity market capitalization, so the market obviously lacks depth, although it's a lot more liquid than what we had a few years back. Over the last year, the increase in liquidity can be attributed to the introduction of market making to the equity market, among other market development initiatives coming out of the Nigerian Stock Exchange."

In addition, Mr. Odukoya says that institutional funds in search of growth have allocated more capital to sub-Saharan Africa and Nigeria in the last few years, which resulted in an increase of capital flowing into African-dedicated equity funds at the end of last year, reaching US$878.4 million. This was the biggest monthly inflow in over two years and four times the amount in the previous month, according to Emerging Portfolio Fund Research Global.

Adding more weight to Nigeria's case as an up-and-coming frontier market is global investors' increased appetite for the country's equity and debt over the last 18 months, driven by its strengthening economic performance and inclusion of Nigerian bonds in JP Morgan's Emerging Markets Bond Index. As a result, the Nigerian stock market has been one of the better performing stock exchanges, returning 71% in this period, Mr. Odukoya confirms.

"Portfolio flows accounted for about 76% of total investment funds inflows of US$6.07 billion in Q3 2012. The CBN puts the total portfolio investment in the system at about US$5 billion, with a further US$1.5 billion expected to flow into naira-denominated assets."

In terms of foreign direct investment, offshore investors have been increasingly taking up private placements, along with the rise of pension funds, a trend that local bankers hope will catch on in the institutional side of the market too. Mr. Odukoya explains that the Nigerian market was largely oversold in 2011, which then saw an influx of offshore pension funds coming into the country with the scope to expand their portfolios.

In sub-Saharan Africa, Nigeria emerged as Africa's main destination for foreign direct investment in 2011 with US$8.92 billion, according to the 2012 World Investment Report by the United Nations Conference on Trade and Development. Nigeria received US$8.92 billion in foreign direct investment, placing it first in Africa, while South Africa was ranked second with US$5.81 billion during the same period.

Mr. Odukoya says, "Emerging market investors realize that deep local knowledge is the key to success, and without it they are fearful. Successful investments in emerging markets using this model include MTN's and SINOPEC's successes in Nigeria; failures as a result of direct unguided investments include Telkom SA's acquisition of Multilinks Nigeria."

"Nigeria and West Africa are notoriously difficult to crack. Hence acquisitions or direct marketing remain the best ways for larger internationals. Acquisitions by large foreign companies are common, as they guarantee local exposure to experts with knowledge of the local market and the ability to navigate regulatory and operational hurdles."

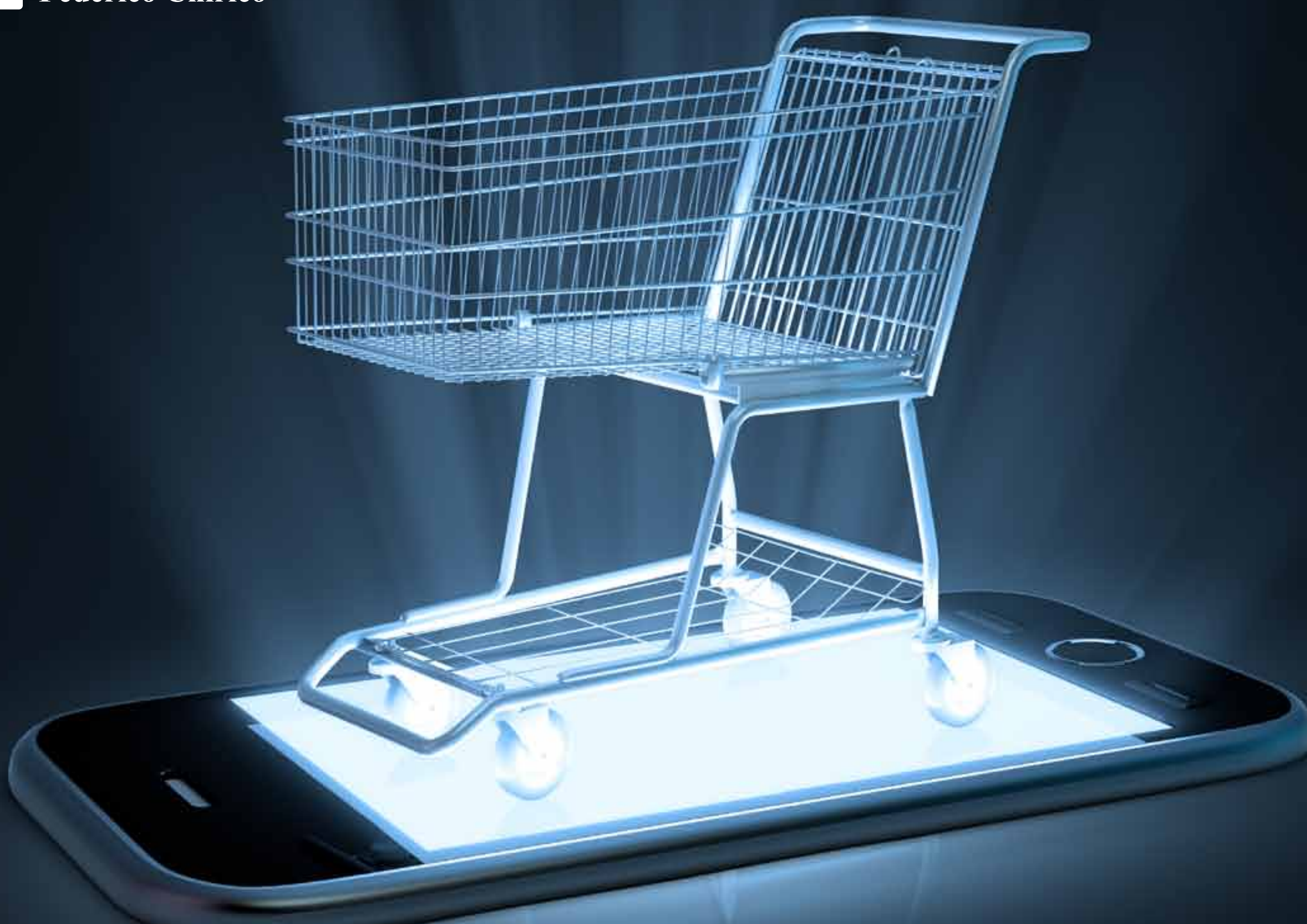
As press reports continue to circulate about Nigeria's soaring interest rates and tightening monetary policy, it is inevitable that investors will be cautious when considering this developing market. However, despite its challenges, it is clear that Nigeria has a wealth of unknown potential.

"The country has great potential, but we need to get the politics and the policies right in order to fulfill this potential. And perhaps once this has happened we will be able to compete with the other bigger emerging markets, such as Brazil," Mr. Odukoya says. "There has been solid growth in sub-Saharan Africa and there is significant potential for further growth."

Mobile Money

Africa's Best Contribution to Innovation So Far?

Federico Chirico



The evolution of mobile money in Africa is a clear example of a business in which the continent is leading and not lagging. Besides the money transfer services already present for years, many providers are now expanding their services by entering the banking industry and opening up to interesting scenarios so far unexplored by the "developed" economies. There are of course some issues to be addressed in order to further enhance the potential of this business, but the current mobile penetration together with several other factors point to plenty of opportunities ahead.

When it was first launched several years ago, mobile money was just a transfer tool for microfinance institutions to help borrowers receive and repay loans in a more convenient manner. Nowadays, it is a business that can represent an incredible opportunity to connect people participating in the formal and informal economy. According to GSMA's Mobile Economy 2013 report, "more than 2.5 billion adults do not have access to a formal bank account and are not able to access basic financial services in order to save, borrow or transact."

Most importantly, it represents one of the most interesting innovations contributed by the African continent, because it is in Kenya that it all started in 2007 through the launch of the first platform: M-Pesa. Since then, the mobile money service provider controlled by Safaricom has been rapidly expanding and is currently an important conduit for Kenyan people's daily expenses. Its operations are now consolidated in other African countries such as Tanzania and South Africa, while several other mobile operators have now joined the business by tapping major markets such as Ghana and Nigeria. The continued consolidation of this business is no longer news; what is more interesting at this point is the expansion of services.

Cost cutting and liquidity increases are two important trends: besides being able to pay electricity bills and school fees, now customers in Ghana can also buy life insurance through MTN. Moreover, M-Pesa customers can now pay for retail goods for a commission of 1.5% per transaction charged exclusively to the seller – a competitive rate compared with other less accessible and more expensive instruments such as credit cards, currently charging between 3% and 5% commission. Another step forward in terms of financial inclusiveness is related to borrowing: Safaricom is entering the Kenyan savings and loan business through a service called M-Shwari in collaboration with Central Bank of Africa, achieving very promising results so far.

The GSMA's report also warns about potential pitfalls that should be considered in assessing mobile money services: operational challenges, lack of regulation and a need for consumer education could limit the diffusion of mobile money. Nevertheless, lower-cost transactions, higher liquidity and financial inclusiveness together with the increasing levels of mobile penetration on the continent represent an interesting opportunity. In some instances this system has even demonstrated better relative safety than conventional banking: in the 2008 post-election violence, Kenyans regarded M-Pesa as a safer place to store their savings than financial institutions which were, heavily compromised in ethnic disputes at the time.

About the Author

Federico Chirico is the founder and editor of "The African Frontier," a blog dedicated to the discovery of African financial markets. He started his career at UBS Investment Bank in 2007, and he then moved to Ghana for a few years, where we worked as business analyst for a Ghanaian based financial boutique called Canal Capital. Currently, Mr Chirico works for a large media and information company as financial markets executive, and is a CFA level 2 candidate.

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