Frontier Advisory

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Summary report

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Welcome and Context

Karthi Pillay, Director: Risk Advisory, Deloitte

With more than 100 years of experience in Africa, and with 34 offices covering 51 countries across the continent, Deloitte strongly believes in the opportunity that is Africa. However, companies are differently geared to manage various risks they encounter in doing business in what is a vast and diverse region.

While diversification prospects linked to the growing middle class are among the most referenced opportunities enticing clients to expand into the continent, some of the cited risks that need to be navigated include rising political risk; terror attacks and how to plan towards these; regulatory risks and policy uncertainties in different industries with prospective investors looking to engage decision makers in order to help create and shape these policies; as well as the challenges posed by poor infrastructure.

Interactive Dialogue:
Neutralising the Threat of Fraud and Corruption in Africa

Daniel Malan, Director, Centre for Corporate Governance in Africa, University of Stellenbosch Business School

Clayton Thomopoulos, Director: Risk Advisory Southern Africa, Deloitte

Moderated by **Francis Herd,** Business Anchor, SABC

Corruption is a widespread problem in many economies throughout the world, however, its extent and impact varies from country to country. Due to its clandestine nature, the actual size and impact of corruption remains unknown and in many incidences corruption remains undetected. The 2014 Transparency International *Corruption Perception Index* lists five African countries among the ten most corrupt countries in the world. While corruption is widespread in Africa, Daniel Malan reckoned that it is not a generic but an endemic problem on the continent.

It is widely accepted that corruption undermines the development of economies and aggravates socio-economic problems. Yet, most countries struggle to develop effective measures to fight corruption, which is often symptomatic for deep-rooted socio-economic problems including inequality, jobless growth and a lack of leadership. Corruption both aggravates and feeds off these conditions. In many African countries corruption hampers socio-economic progress as it diverts funds from activities and projects with potentially high social returns to activities that present opportunities for embezzlement and self-enrichment for select individuals.

In addition to the negative socio-economic impact, bribery, fraud and corruption are serious impediments to the establishment and growth of sustainable businesses. Corrupt practices raise the cost of doing business for companies and expose companies tolerating or engaging in these practices to far-reaching reputational and business risks including criminal prosecution and loss of revenues. In the African context, the lack of effective agencies that allow for the verification of potential business partners increases the risk of falling victim to fraud and corruption.

Companies are well-advised to adopt more proactive measures to tackle the issue of corruption instead of continuing to try and address the consequences of corruption in a reactive manner. Yet, Clayton Thomopoulos highlighted that even companies that operate in a corruption-prone sector or environment fail to put appropriate measures in place to prevent corruption.

Due to the absence of tangible data on corruption and the lack of an understanding of the returns of investing into anti-corruption measures, companies tend to be reluctant to put these measures in place.

In order to develop and implement effective anti-corruption measures, companies and governments have to work hand-in-hand. By strengthening and resourcing government institutions, demonstrating that leadership is committed to a zero-tolerance of corruption as well as by reassessing current procurement practices, governments are able to support the fight against corruption.

In addition, the private sector has to move away from merely paying lip-service and instead instil a culture of a zero-tolerance to corruption. Executive teams of corporations should lead by example and demonstrate their seriousness to combating corruption. The adoption and implementation of high ethical standards in conducting business especially in corruption-prone environments allows companies to shield themselves from the negative impact of corruption and to redefine the purpose of their business beyond profit-seeking.

Panel Discussion:
As Africa Rises, are its Politics Regressing?

Prof Gilbert Khadiagala, Head of the Department of International Relations, University of the Witwatersrand

Dr Sipho Moyo, Africa Executive Director, ONE

Moderated by **Francis Herd,** Business Anchor, SABC

Despite high rates of economic growth in the last decade, Africa still needs to mature politically. This year has been an important one for the continent with a number of elections in leading economies, such as Nigeria and Tanzania, raising the possibility of significant political reform in these countries.

To implement political reforms the continent needs committed leadership. To follow a similar rapid economic development path as was done by Asian countries, African leaders need to own the ideology and strategy for growth, argued Dr Sipho Moyo. This strategy needs to be coupled with consistent policy, and to a national imperative that everyone in the country is committed to. However, some African countries that are successfully driving sustainable economic development through a national strategy, like Rwanda and Ethiopia, tend to be politically noxious.

The dichotomy of good economic progress but a lesser degree of human rights is evident in a number of African countries. Although citizens tacitly understand that in order to build their economies, Africa's leadership needs to build democratic political processes, leaders using this argument to justify political oppression are often not pushing economic development. However, Tanzania and Senegal are examples of countries that are pursuing both political and economic liberalisation. Ghana was moving in the same direction but has arguably taken a few steps back.

Africa is the only continent that has been tasked by the international community to combine economic and political liberalisation. This is in contrast to Asia, where economic liberalisation was often placed before political liberalisation, for example, in countries such as Singapore and the Republic of Korea. As Africans are more connected with the rest of the world through technology than their Asian counterparts were at the time, they are demanding both economic and political reforms.

Africans have also moved into a new era of shared governance and shared responsibility. To remain relevant, African leaders need to own the policy space by having a national strategy and ideology that their population will buy into. Thus, to build a strong nation, lessons need to be learnt from the countries that have been successful, noted Prof Gilbert Khadiagala. Constitutions need full political buy-in so that they will always be respected, irrespective of who is in power. Positions of power need to be 'deglamourised' in Africa; political power should not be linked to economic gains. Power should rather be vested in institutions. Importantly, political problems need to be solved by tolerance and true power-sharing, otherwise political peace will always be temporary.

African economies cannot develop in isolation, which requires the continent to invest in building regional institutions. This will especially benefit small economies that need a good framework to develop within. The African Union (AU) has developed such frameworks but these need to be properly implemented. Regional integration, strong institutions and a unifying ideology need to be supported and strengthened on the continent and will then allow Africa to progress both politically and economically.

Presentation:
Terrorism and its Impact on Africa's Outlook

Anton du Plessis, Managing Director, Institute for Security Studies

Following the end of the Cold War, Africa experienced a rapid decrease in the number of conflict-related deaths. However, since 2010, internal armed conflict has been on the rise. Africa and the Middle East now carry the largest conflict burden, with contemporary African conflicts increasingly fragmented, fought on a smaller scale, and on the periphery of states.

Anton du Plessis likened terrorism to a great white shark; everyone is scared of it, but the chances of being killed by it are slim. As a result, the fear is disproportionate to the risk. Similarly, the goal of terrorism is to instil fear which then drives reactions by the state (such as sacrificing human rights, the rule of law, and due process) to eliminate the extremist group which in turn causes more conflict.

Terrorism in Africa is not a new phenomenon; it is complex, mired in politics, history and religion. It is largely driven by non-state actors operating within countries and across state lines. Deteriorating governance, poverty and a democratic deficit are the current main drivers of terrorism on the continent, resulting in young, angry Africans that are acutely aware of their relative deprivation and are "easy pickings" for trans-national extremist groups recruiting vulnerable people to their cause.

There are also concerns of "blow-backs" from the thousands of African fighters in the Islamic State (ISIS) fighting in the Middle East. Approximately 8,000 of the 30,000 ISIS fighters in Iraq and Syria are from Africa. Their return will have a significant destabilising effect on the Maghreb region.

The deadliest terrorist group in the world that too has publicly aligned itself to ISIS in 2014 is Boko Haram in West Africa. Boko Haram is not trying to create legitimate political party space. Instead, they are a religious sect that has become radicalised due in part to Nigeria's anti-terrorism tactics such as ex-judicial executions of Boko Haram's leadership. In East Africa, Al-Shabaab have aligned themselves to al-Qaeda and are exploiting the failed state situation in Somalia.

South Africa is not immune to terrorism, especially given the tendency of these groups to target global firms and institutions. There are approximately 400 South Africans fighting in Syria. The US Embassy security warning in September was serious and the state needs to be vigilant and take heed of such warnings. Any attack in South Africa is likely to be a lone wolf attack as the country's highly unequal society provides a fertile environment for this form of radicalisation.

ISIS uses social media to inspire lone wolf attacks by manipulating the truth and is becoming a stronger force on the continent. Terrorist groups in Africa are imitating ISIS in order to control territory and global headlines. Governance deficits in the Sahel and West Africa have resulted in numerous ungoverned spaces in which ISIS can, and likely will, operate.

The conflation between terrorist groups and organised crime, which has emerged the last few years, is able to fund and sustain extremism.

Although not yet the new "global frontier" for terrorism, the continent is currently on the wrong trajectory. To correct this, Africa's military anti-terrorism strategy needs to shift to being community-led and more developmental in nature. States need to remove the conditions that fuel anger within populations, whether this is driven by profit in the case of crime, or by ideology in terms of terrorism. Security issues need to be dealt with to drive development. A heavy-handed military response will not curb terrorism, only exacerbate it.

In order to fight terrorism, front-end drivers, such as poor governance, corruption, cronyism and lack of service delivery need to be addressed. Africa's leadership has an important role to play in this regard – both at the state level and within private firms – and needs to be held accountable. Leaders too cannot be allowed to use counter-terrorism as an excuse to clamp down on the opposition and human rights as this will only fuel the cycle.

Panel Discussion:

Rising Risk in a Low Commodity Price Environment

Peter Major, Divisional Head Mining & Resources, Cadiz Corporate Solutions

Andrew Lane, Africa Energy and Resources Industry Leader, Deloitte

Lesego Mosupye, Chief Risk Officer, Export Credit Insurance Corporation of South Africa

Annabel Bishop, Group Chief Economist, Investec

Jurgen Kogl, Director, Tractus Consulting

Moderated by **Dr Martyn Davies,** Managing Director, Emerging Markets & Africa, Frontier Advisory Deloitte

Very few countries anticipated or prepared for a collapse in oil and commodity prices. During the boom, economies such as Angola, the DRC and Ghana, experienced growth propelled by high oil prices and strong Chinese demand for commodities. Global headwinds, including lower commodity prices and weaker Chinese demand have led to diminishing growth prospects in Africa.

According to Annabel Bishop, a lower commodity price environment with minimal chances of another commodities super cycle should be expected. The impact thereof is already being felt by many countries as government revenues fall and current account surpluses across the continent dwindle.
Oil averaged around US$110 per barrel for a few years during the commodities super cycle and suddenly dropped to half this. With 50% of revenue wiped off the balance sheets of African oil-producing states, while production costs continue to be high, the consequences are likely to be dire. Angola is amongst the minority of countries that tried to create a buffer against such shocks in the form of a sovereign wealth fund. However, for most of the continent – mainly commodity producers – tough times lie ahead.

With the anticipation of the US Fed rate normalisation, which has already seen currencies depreciate, debt servicing is becoming more expensive for African states and the risk of sovereign debt crises is increasing. Linked to this, firms are becoming more cautious of investing in mining and infrastructure projects, according to Lesego Mosupye. As it becomes more challenging to service debts, businesses need to switch back to equity funding.

Peter Major expects oil exporters with high populations such as Nigeria to be worse hit by low oil prices compared to less populated oil exporting nations due to greater pressure on the national budget from demands of a larger population. The low commodity price dilemma is deepened further as China cuts credit to suffering economic sectors with overcapacity (such as steel and construction) in efforts to rebalance its economic model for more sustainable long-term growth.

Private companies understand the trend and are taking necessary measures to hedge against low prices; while African governments arguably have been slow to react. Jurgen Kogl was of the opinion that political elites are becoming more defensive. Andrew Lane agreed, stating that countries and companies need to become more innovative and ultimately more competitive to rise above the current slump.

Despite the uncertain prospects for the continent, beyond commodities, Africa's growing population and demographics provide an opportunity for economies to diversify into industrial activities and services to meet increasing domestic demand. The "Africa rising" narrative is not yet over and the current predicament provides an opportunity for economies to diversify.

More innovative forms of financing will be important in driving this growth. The significant growth of offshore remittances as young African expatriates return to invest on the continent is a good example. Furthermore, foreign investment may shift towards less commodity-driven countries like Kenya and possibly more towards agriculture and manufacturing activities. In conclusion, investors and policymakers in Africa need to budget for low commodity prices for the next 20-30 years. Investors should look out for governments with rich resource deposits that are factoring in low commodity prices in their long-term budgets.

Panel Discussion:

The Rising Risk Temperature of Currency and Stock Market Risk

Tsidiso Disenyana, Senior Economist, Export Credit Insurance Corporation of South Africa

Clive Ramathibela-Smith, Chief Investment Officer, Clivera Incorporated

Konrad Reuss, Managing Director and Regional Manager: Sub-Saharan Africa, Standard & Poor's Rating Services

Terence Saayman, Head of Risk in Post Trade and Information Services Division, JSE

Moderated by **Hannah Edinger,** Associate Director, Frontier Advisory Deloitte

With the recent culmination of the commodity super cycle, the continued anaemic global economic outlook and the anticipation of a US Fed rate hike, currency and capital market uncertainty is rising for businesses in Africa. Tsidiso Disenyana noted that African economies being currency price acceptors rather than price setters contributes to this rising uncertainty in the continent. In a crisis, adjustment costs mostly affect price takers and as most African states did not focus on building sizable foreign reserves during the commodity boom, the risk of widespread currency volatility is currently high.

Adding to this, Clive Ramathibela-Smith indicated that despite the region contributing a notable share in production of commodities, it has little control over commodity prices. With a focus on building relationships outside the continent rather than intra-continental trade, the region has become increasingly over-reliant on raw materials with minimal beneficiation. Consequentially, African economies agonise rather than take advantage of currency depreciation.

Moreover, availability of capital has not improved despite widespread economic growth. According to Konrad Reuss, only 20 out of Africa's 54 states are currently rated as investment grade and the debt burden of governments is rising. Echoing this, Terence Saayman emphasised the difficulty of raising capital on African stock exchanges. The amount of capital raised on Africa's bourses is a tenth of that raised in London. While disconnected from the country's realities, a major factor underlying the current positive performance of the Johannesburg Stock Exchange (JSE) is the income generated by domestic firms from capital raised offshore and from foreign investments.

Though the South African Reserve Bank holds fund deposits of around R700bn, investors remain reluctant to allocate these funds given current market volatilities and weak policy fundamentals. Compared to emerging peers the fundamentals of policy and debt management remain weak for many African states. Unlike Asian and Latin American states, African countries do not have sophisticated domestic capital markets.

Ethiopia and Côte d'Ivoire are among the few African countries that have gotten the fundamentals right. They have shown sound fiscal management and ensured that they are not over-exposed to foreign-denominated bonds. They are also amongst the few in the region that can buffer against rising market volatility without assistance from the IMF as they have managed to build strong foreign exchange reserves. Policy prudence of these economies is also reflected in their relatively high expected GDP growth rates.

Behind policy issues and public finance mismanagement, developments in China and rate normalisation in the US are key triggers of African market volatility. Though rate normalisation is beyond the control of African states, governments can manage debt burdens resulting from high public wages and infrastructure expenditure. In this light, African states need to learn from Greece and Puerto Rico's debt crises. As debt can catch up to governments, with Ghana a case in point, countries are at risk of losing sovereignty if authorities do not limit public expenditure.

Ultimately, the risks of investing in Africa are not going to disappear and businesses need to factor these risks into their investments. Though the financial risk temperature is rising throughout the continent, instead of cutting back, investors should rather view the evolving situation as an opportunity. To mitigate against currency and stock market risks and become more attractive to investors, African states need to diversify their economies and reform weak policy and economic fundamentals where these exist.

Presentation:

Managing Environmental and Security Risk in Africa – Maximising the Opportunity and Minimising the Risk

Mark Naysmith, Associate Director: Risk Advisory, Cyber Risk & Resilience, Deloitte

Establishing and operating a business in Africa presents exceptional opportunities but also high risks. Managing security risk in Africa is about protecting a firm's infrastructure, people and processes. Geopolitical events and socio-economic issues cannot be controlled nor influenced by private firms, yet often present significant risks. Therefore, the price of effective security can be viewed as an inherent cost of doing business.

In order to build adequate security planning, firms need to understand the challenges presented in different markets. Geopolitical and socio-economic risk analysis forms the basis of security planning on the continent. Yet, security remains a discretionary spend for most businesses. A balance needs to be struck between having enough security to protect assets and security that is cost effective, argued Mark Naysmith.

Security needs to link to the operating lifecycle of the business; security processes need to be in place during the pre-market entry stage in the form of a focused threat study; during in-situ business operations through the use of a country risk tracker; and in the rare case of a permanent or temporary market exit, as a post-incident review. Security needs to be 'architected' to the business requirements of the firm. Furthermore, security in all forms, is concerned with the capability and intent of the aggressor and therefore the vulnerability of the organisation. Specific location analysis relies on information that relates to the organisation as well as the external environment and therefore investment decisions need to rely on a broad panel of sources.

The *Situational Awareness* offered by Deloitte analyses issues at both a national and sub-national level.

The *Situational Awareness* product offers information on political stability, critical national infrastructure, logistics and the local risk operating picture. To provide a comprehensive product, Deloitte works through a security risk lifecycle, which is applied to project preparation and continues through to operations and a possible market exit, and assists with continuous improvements.

In Africa security should not be seen as a business cost but as a business enabler that must be mapped to business objectives and the business lifecycle. Although there are no guarantees and black swan events do occur, by underpinning their security strategy with analysis and ongoing monitoring of the security risk operating picture, firms are able to ensure the security of their staff and assets to the best of their ability.

Summary Session and Close

Dr Martyn Davies, Managing Director: Emerging Markets & Africa, Frontier Advisory Deloitte

Emerging markets, with the possible exception of India, have seen their GDP growth slow down in recent months. The rising risk environment now present in Africa is due to low commodity prices, volatile currencies, changing politics and bad governance. This is in comparison to China, which has seen its economy double in size in the last seven years due largely to a committed leadership and policies that have focused on more sustainable, consumer-driven economic growth.

African countries, particularly South Africa, have not been agile enough to deal with the current set of financial shocks. Africa as a whole was not able to capitalise on the commodity super cycle of the last decade and is now paying the price. In order to drive more sustainable growth in Africa – growth that is not reliant on the extraction of resources – Africans need to invest in innovation and skills.

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