ACHIEVING GROWTH IN AFRICA: THE CHALLENGES AND HOW TRADE AND TRADE FINANCE CAN HELP

It has been a difficult time economically for much of Africa over the last few years resulting in, with some exceptions, economic growth that has not lived up to hope or expectation. The reasons for this are many and diverse, differing from country to country and this article will be looking at some of the main challenges facing the continent and attempting to show how trade and trade finance can be a part of the solution.

Over the last few years political developments have hindered progress in a number of countries, notably in Zimbabwe where the actions of the previous government discouraged outside investment and caused severe economic problems. In Kenya the disputed (and re-run) election in 2017 caused much disruption to the Kenyan economy. There were other significant issues in South Africa, at the top of government causing economic problems which ultimately resulted in a change in the ANC leadership and subsequently the South African presidency. At the same time, Mozambique was dealing with the fallout from the hidden loans scandal. Political developments such as these almost always cause a drop off in inward investment levels and reduce growth.

From an economic perspective, there have been issues too. Tax shortfalls have been common across Africa over the last few years, the result in part of lower growth and therefore lower corporate profits. This meant there was less money available for governments to spend on projects which could promoted growth through trade. One major issue for African farmers and producers/exporters is the lack of transport infrastructure. It is incredibly difficult to move goods from region to region and more so to export from the continent, resulting in a much more limited marketplace for both the farmers and SME producers as well as the larger corporates to sell their goods and services.

A key driver for growth is the ability to borrow both to maintain businesses and to fund their expansion. It has been difficult for borrowers in certain countries to obtain sufficient funding for a number of reasons. It may be because hard currency funding is required but the level of hard currency reserves when combined with exchange control restrictions has meant it has been difficult to ensure borrowings could be repaid offshore in hard currency. This was the case in Ghana and, to a lesser extent Nigeria. Both had reduced hard currency revenues due to the lower oil price and, in Nigeria's case, the theft of oil assets "up country". With less hard currency liquidity in these countries, hard currency loans have been hard to come by as lenders look elsewhere rather than risk (as has happened) having to convert hard currency loans into local currency loans in order to be repaid or having to wait until cash is allocated from the limited reserves available.

It is not just hard currency loans that have proved

difficult to come by however. In Kenya for example, there remains an interest rate cap in place. As the cap has been set at a rate which is below the level lenders require for financing SME producer / exporter risk but at, or above, the market rate for government securities, lenders have been financing the latter – same return for less risk. This is good for raising cash at government level but it doesn't help private businesses looking to build and expand that are unable to access funds. Even though the rate has recently been reduced slightly, it is still too high.

The lack of available funds is exacerbated by many in the international lending market not being able to find borrowers with financeable deals. As many international banks have de-risked, in part by ending correspondent banking arrangements on the continent, they have neither the contacts nor the ability to carry out sufficient due diligence for deals which may well be financeable. Even where these challenges do not apply, the extent of the regulatory framework that applies now and the need for yields to be higher, due to capital relief reductions, means that many deals can only be done on a highly structured basis or for yields which are not feasible economically for the borrower. When you consider that those most in need of finance on the continent are likely to be SMEs and perhaps even individual farmers it is easy to see how problems can arise. As an international bank, how do you finance an individual farmer or even an SME? The deal value alone would not warrant the time and cost of structuring a deal in such a way as to make it economically viable for the bank. Additionally, the very fact that the potential borrowers are SMEs with no or limited track record means it is more difficult to due diligence them raising concerns from a reputational risk perspective.

So, what can be done to try to overcome these challenges? Well, the oil price has recovered somewhat recently so revenues for the oil producing countries have increased and unsurprisingly at the same time growth in those countries has increased commensurately. However, this is not yet sufficient to allow for massive investment in capital and infrastructure projects which would do much more to help promote trade and growth.

There also appears to be more stability now in the key markets of Nigeria, Zimbabwe, Kenya and South Africa whilst Mozambique is beginning to recover its international reputation. It is also finding alternatives to government borrowing to finance the massive potential for growth which the country has. More investment and an upturn in economic performance in these countries is starting to follow and should trigger a ripple effect of increased trade and growth into surrounding countries.

Other areas for improvement include the need for a consolidated approach by financial institutions, corporates, governments and regulators to provide an environment where growth can happen. Improved lobbying of, and discussion with, regulators by the financial institutions is vital to keep regulatory costs down as much as possible. This appears to be happening in parts of Europe, including the UK where a recent regulatory paper from the regulator on unfunded credit protections threatened to destroy the credit insurance market. There was a huge and consistent response from all corners of the financing industry (insurance, banking associations, trade industry bodies as well as major institutions individually) and there is an expectation that the regulator will listen this time. Whilst perhaps not reducing regulatory costs, it is hoped these can stabilise now and allow the lending markets to adapt and help create higher levels of growth in the future.

Another area where help is forthcoming is with organised finance programmes and technology. For the latter, much has been written and the possibilities are certainly very positive. It will take some time for the legal frameworks to catch up with the technology but the fintech revolution is gathering pace and should help to give those lower down the supply chain more access to the much needed funds previously unavailable to them. Of equal assistance to those same parties is the growth in warehouse receipt programmes, particularly on the agri side, and commodity exchanges such as those in Ethiopia and Ghana (and soon to be elsewhere). Governments have assisted by bringing in legislation to smooth the way for these initiatives, allowing better access to markets for the SME borrowers with more benchmark pricing so they get the full benefit for their goods. They could do more to reduce financing costs by also removing (or sufficiently lowering) interest rate caps, reducing stamp duty and relaxing exchange controls in connection with the financing of trade as well as allowing for the provision of self-help remedies in certain civil jurisdictions to help mitigate lender enforcement risk.

What is clear though is that significant increases in growth are most likely to come from increases in intra-regional trade and for that there needs to be major advances in transport infrastructure to allow for efficient movement of goods and the development of trade agreements between countries and regions within the continent. For both to happen, there has to be much more co-operation and for the former to happen there needs to be huge amounts invested into transport infrastructure projects. There is an element of catch-22 about the latter. However, the continental free trade association is taking steps to try to increase intra-regional trade which is a positive step and can provide a platform to assist future growth. Transport options must follow.

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The ability to add value to supply chains is also a key component of driving exponential growth. Not just adding value on exports from the continent but regional exports too. The more of the value chain that can be completed within the continent and sold within the continent can only be a good thing for achieving higher growth. This is by no means an easy task, but it is one which should generate a lot more focus than it has in the past.

The financiers can do more too. By working together, it should be possible to provide the levels of funding required whilst at the same time having different categories of lender assisting with different areas of risk thus providing lower overall risk profiles. The non-bank financial institutions are able to fund the lower value deals more than the larger banks but the yields they require are still too high for some. Can the risks and therefore the yields be reduced? By working with other types of investors, say banks or Development Finance Institutions (DFI) on more of a portfolio basis with lower returns for those investors so it works for all financiers, this could enable the larger institutions to fund lower value deals without the cost implications, thus increasing liquidity in the market overall.

It is up to borrowers to play their part too, though. For example, one European DFI and one European ECA have lending programmes designed for emerging market borrowers which today are largely unused.

There are a lot of misconceptions about the difficulties of doing business in Africa. Certainly, it is not without its issues, but it is after all a large and diverse group of emerging market countries and dealing with these types of issues is part and parcel of working in these markets. The legal regimes are generally sound and there is a lot of positive news with many more institutions focusing on Africa. With all interested parties taking a co-operative approach and with proper due diligence and structuring it ought to be possible to make a success of African growth over the coming 5-10 years.

Contributor's Profile

Simon Cook is a partner in the Trade & Export Finance Group in law firm Sullivan & Worcester's London office. He has experience in a wide variety of banking and finance transactions, including structured trade finance, trade finance, commodity finance, project finance, invoice discounting facilities, warehouse finance, supply chain finance, ECA finance and borrowing-base facilities. He advises on transactions across Africa, the Middle East, Asia and the CIS. His work covers a range of financings acting for both lenders (including multilateral agencies, development finance institutions and investment funds, as well as commercial lenders) and borrowers notably in the oil, telecoms, soft commodities and metals sectors in Africa and the Middle East, where he was based for four years. Simon also acts for industry bodies such as the International Trade and Forfaiting Association (ITFA) and is a member of ITFA's Africa Regional Committee.

Simon has recently authored a chapter on Trade Finance in Globe Law and Business' new book entitled Oil and Gas Trading and chapters for Sweet & Maxwell's book entitled A Practitioner's Guide to Trade and Commodity Finance. In Chambers UK, 2018 Simon is a Ranked Lawyer for Commodities: Trade Finance and in the UK Legal 500, 2017 he is recognised as a Leading Individual.