Transcript of podcast with Zhi Yong Heng: "Investment in Africa Is About to Explode"

May 18, 2018

Hello, I'm Bruce Edwards, and welcome to this podcast produced by the International Monetary Fund. In this program: the promise of private investment in sub-Saharan Africa.

MR. HENG [soundbite]: *I would say that foreign direct investment is going to explode, and I believe that this region is on the cusp of an economic revival.*

MR. EDWARDS: With public debt on the rise in sub-Saharan Africa, boosting the private section has become more important than ever. Zhi Yong Heng is a private investor for TLG Capital, an investment firm that focuses on equity opportunities in Africa. Heng says Investors are missing out on great investment opportunities because of misperceptions of risks in the business environment. Heng joined a panel discussion on the topic at the 2018 IMF/World Bank Spring Meetings.

MR. HENG: We tend to look at deals that are smaller sized. What I mean by that is, we typically look at deals of $1 million all the way to even $20 to $25 million.

MR. EDWARDS: So, $20 to $25 million is considered a small business?

MR. HENG: I would say substantially small compared to the grand scheme of things where your larger capital companies, like oil and gas; and infrastructure companies that go beyond $100 million dollars.

MR. EDWARDS: I see.

MR. HENG: And when you have that, you typically focus only on three sectors: infrastructure; natural resources; and extractive industries.

MR. EDWARDS: And, of course, there's a lot more than that …

MR. HENG: There's a lot more than that. In fact, there are so many more interesting areas that you don't see it if you are subjected to a minimum deal size, which we do not have. We do look at anything that's $1 million, but there are times where we even work with entrepreneurs for $500,000 for the first year to get them through the working capital initial phase. And then we ramp it up to a $1 million, and then $2 million the next year, and so forth. So, we do partnership capital rather than investment capital, and I think that's how we have survived in Africa so far.

MR. EDWARDS: So, explain to me how that works. What do you mean by partnership?

MR. HENG: Well, I wouldn't generalize, but I'd say the plain vanilla standard private equity firms, when they invest, they have already a pre-determined exit horizon. They have determined the exit strategies and they're duration-bound.

MR. EDWARDS: So, they have an idea of what kind of return they want to get from their investment?

MR. HENG: Yes, and how they want to exit. And it's not only because of that, but also how their funds are structured; how their strategy is structured. And for us, we are more structured like a permanent capital vehicle, and the reason we do that is because we began to realize that is how you align your views with that of other entrepreneurs. You align your values with them. Rather than being an activist, you are a "suggestionist", I would say. So, you put in partnership capital rather than investment capital.

And it's a longer duration. So, when you're a permanent capital vehicle, you are able to maximize value for your shareholders and your portfolio companies without having this predetermined arbitrary divestment date.

So, that's why I call it partnership capital rather than an investment capital. You want to learn about the companies, be their partner, rather than coming in as an investor/activist and telling them: "You have to do this, you have to do that," so that your company can grow exponentially and that gives me the right to exit in five years' time.

MR. EDWARDS: How much research do you do on these companies that you're interested in? Do you go on the ground and poke around and see who's doing what? How much of that do you do?

MR. HENG: Yes. I would say even 80 percent of time is spent on the ground. I could not emphasize enough the understanding of local market peculiarities. It's more important than sitting at your desk, doing your due diligence, looking at data points. A better understanding of local market peculiarities could be negotiating with suppliers, learning how to do a new business, getting new clients, or even navigating the bureaucratic government channels in certain countries. That all comes down to being on the ground; being in the know.

To put it in perspective, I was looking at an entrepreneur that does apparels and textiles. Back then, I was in Uganda. I was in Kampala visiting a factory and he was showing me around the different places and I asked the question: "So, where do you sell your apparels?" I was pointed to an up-market shopping center. But, then I realized that's not where the main business is. The main business is in downtown Kampala where the marketplace is;

the people on the ground. People on the road selling, peddling, you know, doing active buying and selling, that's where you can actually see and sniff out the rise of the African consumers there. And you wouldn't know that if you're not on the ground.

MR. EDWARDS: You mentioned data just a few minutes ago. There is a perception that doing business in Africa is risky. How much of that perception has to do with the lack of data? How much of a problem is the lack of data in Africa?

MR. HENG: Oh, huge. But I would say that there are two parts in terms of perception. The first part is, yes, the lack of data is immaterial in terms of the way people look at things, the way people view Africa. But, that also comes down to investment opportunities. What do I mean by that? When you have the US and UK, there are also investment opportunities and what I call "efficiency". In the US and UK, you look at efficiency: the efficiency of information, doing due diligence on management, or a background check on a company, the country, the macro level or micro level, it's very easy. Whereas, in Africa, the lack of data is a headache, but that also presents what I call an "arbitrage opportunity". This is what I mean by an information arbitrage.

Arbitrage is something that you know that the other person does not know and so you make money or you find an opportunity to leverage upon this. So, in Africa because of the inefficiency in information, the lack or inertia of people trying to understand beyond just what is given and publicly published, the inefficiency creates arbitrage opportunities for foreign investors like us who are willing to spend the time, the effort to go down there, to speak to people, to appreciate the local on-the-ground knowledge. That's one area of perception.

But another side of perception is what I would call "investor prejudicism". What do I mean by that? To really give you a perspective, maybe I can use credit spread as an example. Credit spread is a bond that reflects investors' perception of the risk for a particular asset. The credit spread has three layers, in my opinion. The first layer is what I call the *quantitative layer*. You have your GDP per capita, you have your revenues, you have debt-to-GDP, the amount of leverage you take up. That can be easily done on the desktop, looking at numbers. So, you have the quantitative layer.

The second layer that you have is what I call *policies layer*. You look at the ability of the government, the policies they're making. What are they doing, the structural reforms that you have, the ease of doing business index, the corruption index that you see that's published. And then you can always put it into your notes, your models, and then you say: "Okay, this is the amount of spread and risk that I'm willing to take."

But the third layer is what I call the *prejudice layer*. I think the prejudice layer is the perception that people have when you talk about doing a deal in Nigeria, doing a deal in Sudan. There's this prejudice layer—I would call it an exaggerated "riskception"—that people put on these companies.

MR. EDWARDS: The fear of investing in a company in Africa?

MR. HENG: Exactly. That's what I call it, and you can see the phenomenon right now. What you have is people overinvesting, overlooking assets in developed markets versus under-location, underinvesting in maybe even frontier economies. And this is what I like to term as investor prejudicism/biasness.

MR. EDWARDS: And so, on that same theme, trust. You mentioned that the companies that need the capital don't trust the people who have the capital.

MR. HENG: A lot of those local entrepreneurs, they may want your capital, but they are not receptive to external feedback, an external partner coming in to give them constructive feedback, constructive management advice in terms of how to build up the comparative advantage to make the company more efficient in the bigger picture.

MR. EDWARDS: So, they may interpret it as being told what to do?

MR. HENG: Exactly. They often see it is as more of an intimidation. They are so used to doing what they do. And typically, look even at family-run businesses there. They have good opportunities. In every single African country there's loads of opportunities, because they have a big market, huge population, high literacy—well, an improving literacy rate—and a huge market that they can tap into. So, opportunities abound. But the ability to get better, to get efficient, that's where you need to be receptive to views.

But at the same time for us, as foreign investors, we also need to align our views and values with them. We do not go in as if we are a big brother, but rather we go in as a partner. Which comes down to my second point, which you just mentioned: the lack of trust. I think it goes two ways. The lack of trust between people who want capital and people who have capital. Because of this lack of trust there, things do not move. There's always inertia because you get stuck at the term sheet stage and from a foreign investor perspective, you always want to heap in layers and layers of clauses because you think, "What if the guy out there is going to cheat me?" And the entrepreneurs on their own are thinking, "Why are you doing this, unless you do not trust me?" So, it's actually a negative feedback that you go along with.

So, at some point, there needs to be a bit of trust there. The best hatch to do business in Africa is what I call "intimacy": the ability to be intimate.

MR. EDWARDS: The power of the handshake.

MR. HENG: Exactly. The power of the handshake, the power to assimilate into the culture, to see them as a friend rather than just a counterpart that I want to invest with and make my 25 percent IR from this. But rather, I see it as a win-win situation. And so, for us at TLG, where we have a permanent capital vehicle structure, we are not bounded. For myself, I'm not bounded by a fund mandate that tells me I need to get out my money in five years, and I need to achieve my return in X years. But rather, I have this flexible mandate that allows me to say, "Okay, let me work with you and if we can do well, the company doubles, quadruples in size. I not only make my rate of return, but you as an entrepreneur will also be very satisfied that you just doubled the size of your company."

MR. EDWARDS: So, you're in Washington to talk about and encourage investors to go to Africa, and it's on a grand scale where there's international financial institutions like the World Bank, the IFC, and the IMF—everybody's in there, trying to get investors to get more interested in Africa. Do you think that the international community is focusing on the right things or are we not getting it? It seems that it's been tried before, and it hasn't been all that successful.

MR. HENG: No, I think that the focus is in the right place. I think what the IFC and the World Bank are doing is commendable. But, what I would like to preach is that investors, especially individual private investors, should see the region from a country perspective rather than creating one narrative for the entire region. I think that is key here. One country might have its own set of problems, but that does not translate into the similar set of problems in the other country. So, there's always a way to do business there. There's always opportunities.

MR. EDWARDS: How many companies like yours are out there right now? How much appetite is there for this kind of investment outside of Africa? How much appetite is there from European or North American investors?

MR. HENG: Well, I would say that foreign direct investment is going to explode. The explosion of more foreign direct investment is there. If it's going to happen anywhere around the world in the next couple years, in my opinion, it's going to be in sub Saharan Africa. Timing is key in everything we do, and I believe that this region is on the cusp of an economic revival. The penetration rate of private capital in this region is still considered low. And therefore, because it's low, a lot of assets tend to be overlooked. And because of that, competition is low and that's why assets are now attractively priced.

So, coming back to your point. The penetration rate is still considered low here. So, now is the right time for private capital to go in. And how do you want to do it there? It's actually by education. So, a lot of investors want to get in, they're interested, they understand the common narrative here about the rise of the African consumers, the rise of the middle class, how attractive Africa is, the demographics. But, they do not have the inner assurance of navigating through this risk and that forces them to say, "You know what? Let me put it on my back page." Because some foreign investors do not just focus on sub Saharan Africa. They have a wider mandate. And so, if they're not going to sub Saharan Africa, they're going to look at Latin America, you know, Eastern Europe. So, they have a selection of choices.

So, what we have to do is to educate them, to understand them. What the IMF is doing is very commendable, which is having this sort of talks, these forums that improve the understanding of Africa. You know, bringing different individuals who have skin in the game to speak about this and say, "Hey, you know, it's not as bad as it seems. It's all about the perception." There' s a perception gap here between the people who have already been in the market and people who haven't.

MR. EDWARDS: So, a lot of people are going to be happy to hear what you're saying. It's a fairly optimistic outlook on the future of investment in Africa.

MR. HENG: Definitely. For me, I can say that I'm very optimistic as to the potential that this region can provide. Why? Because, from a macro perspective, a political perspective, and even a social perspective, there is a lot of room for improvement and there's an intent by not only the government, but at the individual level to try to move towards the stage where they're ready to pursue global capital. But, what is very important that I like to tell a lot of investors as well, is that you've got to be nimble and open-minded about how you invest there. Being selective, nimble, creative, and open-minded is key to doing business in this region.

But, at the same time, the governments, if they want to attract people and external capital like ours, have to focus on political reforms; focus on policies where investors like us are comforted to know that our interests are being protected by the eyes of the law; policies that are in place so that we can just focus concentrating on supporting the local community. I think that is key.

MR. EDWARDS: Thank you very much.

MR. HENG: Thank you very much for having me.

MR. EDWARDS: Zhi Yong Heng is a private investor for TLG Capital. He joined a panel discussion about attracting private investment in sub-Saharan Africa during the 2018 IMF/World Bank Spring Meetings. You can watch the webcast of the seminar at imf.org. You can also find there the latest regional economic outlook which includes an entire chapter on private investment. And if you like this podcast, subscribe on iTunes or on your favorite podcast app. Just search for "IMF podcasts." And you can also now follow us on Twitter: @imf_podcast.

* * * * * *