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New US Development Entity Will Spur Investment In Africa

By **Thomas Trimble and John Bryant** (January 15, 2019, 5:03 PM EST)

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The global emerging-markets private equity community is abuzz with the prospect of a new U.S. development funding institution coming on the scene this year. This new entity – the United States International Development Finance Corporation, or USIDFC, is being eagerly awaited by myriad U.S. and foreign equity investor groups, especially those looking to invest in Africa and Latin America in the next three to five years. By all counts and legislative protocol, the USIDFC is expected to become operational in the fourth quarter of this year.

With the promise to substantially improve upon the existing capability of the United States' current development funding entities, the USIDFC is expected to promote significant growth in emerging markets private equity investing, especially in the lower- and middle-income countries of Africa. Proponents of the USIDFC expect its launch into the market will increase competition among the existing European and Asian development funding institutions currently contributing to the African markets, expand the breadth of equity investment across a broader spectrum of industries and markets on the African continent and encourage "new" investor monies to these markets which have heretofore been sidelined due to perceived political and emerging market risks. All with the result of enhancing and increasing global private equity investing in Africa.

Development Financing in the Emerging Markets

Emerging markets worldwide are in need of government-sponsored financial assistance, whether in the form of loans, loan guarantees, private equity investment and/or technical assistance and Africa is by far no exception. Until now, much of that assistance has come from the International Finance Corporation (the private sector arm of the World Bank), European "development finance institutions" (or DFIs), regional finance institutions and, on a somewhat more restricted and less competitive basis, the United States. In October of last year, however, the United States authorized the USIDFC as a new, more capable and competitive DFI which is expected to have a significant positive impact on foreign private investment in the emerging markets.

European DFIs have been in existence since the mid-20th century. The United Kingdom established the CDC Group, the first European DFI, in 1948. Other European nations soon followed the United Kingdom's lead — Germany in 1962 with the creation of the DEG, the Netherlands in 1970 with the creation of FMO and France in 1977 with the creation of Proparco. However, it was in the early 2000s that DFI financing commitments really began to grow — from approximately $10 billion in 2002 to $70 billion in recent years, according to the Center for Strategic and International Studies. The projects have been mixed, both in terms of types of financing and geographic locations, but Africa has been consistently targeted. According to a January 2018 policy paper by the Center for Global Development,[1] the global commitments by the Overseas Private Investment Corporation, DEG, Proparco and FMO between 2012 and 2016 were largely in the form of loans, whereas 70 percent of the CDC's activity was in equity. In that same period, DEG was second behind CDC with between one-quarter and one-third of DEG's commitments in the form of equity. Three-quarters of their portfolios consisted of finance industry and utility projects. The regional breakdown for that same time frame is also very telling — the largest recipients for each DFI being either India or Turkey.[2]

OPIC, the United States' DFI, was established by the Foreign Assistance Act of 1961 and began operations in 1971. OPIC is permitted to offer loans, loan guarantees and political risk insurance, but not direct equity investment. In addition, this largely debt financial assistance requires a level of "U.S. content" that has limited OPIC's ability to fund non-U.S. sponsored projects or projects which otherwise do not involve U.S. investors or the U.S. private sector.

In 2017, for example, OPIC's two most active geographic regions were Africa and Latin America, and the two leading industry sectors receiving OPIC support included the finance and utility sectors. However, though DFIs primarily exist to serve the lower- and middle-income emerging markets, since 2012 OPIC has also financed significant amounts in upper-middle- and high-income countries such as Chile and Israel.[3]

Key Drivers for the USIDFC

There are several drivers behind the creation of the USIDFC. One of the major catalysts was the concerns harbored by newly elected President Donald Trump regarding China's foreign investment in emerging markets, particularly in Africa, and the president's overall ambition to advance U.S. influence and foreign security around the globe. At the same time, in recent years there have been voices from the private sector as well as various industry associations and think-tank organizations calling for OPIC to become more competitive in the market. The U.S. Congress has also been considering whether the United States "can and should do more to support international economic development with partners who have embraced the private sector-driven development model."[4] In response to these various concerns, on Oct. 5, 2018, the president signed into law the Better Utilization of Investments Leading to Development Act of 2018, creating the USIDFC which will combine OPIC together with portions of the United States Agency for International Development — the Development Credit Authority, the Office of Private Capital and Microenterprise, and their enterprise funds.

Impact on Africa

This is important for Africa because the creation of the USIDFC will benefit private equity investors and impact the African market in a number of new and powerful ways.

First, the USIDFC will have an authorized maximum contingent liability of $60 billion — more than doubling OPIC's current liability exposure cap of $29 billion. This will be a large increase of investment funds available for deployment in Africa and other emerging markets and allow the USIDFC to undertake a broader range of projects with a far greater impact. This in turn is expected to motivate existing funds with cash siting on the sidelines to re-enter the market and deploy such funds. Furthermore, the

USIDFC's greater emphasis on low- and lower-middle-income countries will result in increased equity investment in a broader range of countries and industry sectors on the African continent.

Second, one of the most powerful new tools that the USIDFC will have is the ability to make direct equity investments. The ability to make equity investments will allow the USIDFC to compete with Chinese, European and other DFIs for private investors' funds, in Africa and other emerging markets. Equity investors will likewise now have an additional choice when bringing in DFI equity into their equity investment transactions.

Additionally, this new equity investment tool will give the USIDFC greater flexibility to collaborate and co-finance with other European DFIs in projects that would not have qualified for U.S. support through OPIC. Co-financed projects, in which a particular investment is financed by two or more DFIs, have one particular advantage: The risk is spread among the portfolios of the participating DFIs. As a result, co-financed projects are of particular importance in African private equity transactions. Reportedly, as much as 35 percent of co-financed projects have been located in the lower-income countries of sub-Saharan Africa. Historically, CDC, DEG and FMO have been the most active co-financiers, proportionate to the rest of their portfolios. Now the USIDFC will be able to join their ranks.

Another way in which Africa will benefit from the USIDFC's new equity tool is the addition of more first-time funds as investments. According to the Emerging Markets Private Equity Association, or EMPEA, first-time, and even second- and third-time fund series are declining in part in number due to commercial limited partners looking for more experienced fund managers.[5] Less crowded markets, such as Sub-Saharan Africa, make for a more open and competitive area for first-time funds to be successful. Indeed "… in Sub-Saharan Africa — rated among the top three most attractive destinations for general partner investment in the EMPEA's 2015 Global Limited Partners Survey, and also identified as a region where the lack of established managers makes LP commitments challenging — first-time funds represented 78 percent of the number of funds holding a final close in 2014 ... ."[6] It is expected that the USIDFC will contribute to this trend. The United States has another competitive advantage regarding first-time funds, in that most training programs for first-time fund managers were developed here.

Lastly, the USIDFC presents a tremendous opportunity for foreign — i.e., non U.S. — private equity investors and funds to have access to U.S.-based DFI funding for its projects in Africa. Whereas OPIC previously required projects to have a meaningful U.S. connection to be eligible for support, the USIDFC will have a broader scope of qualifying projects. The USIDFC will be required to give only "preferential" consideration to projects sponsored by or involving U.S. private companies. This looser requirement both expands the universe of eligible projects that the USIDFC can support and would also allow more foreign investors to utilize the support of the USIDFC and its large capital reserves.

As a result of such changes, the USIDFC is positioned to be substantially more competitive and impactful in the African market than its predecessor. Additionally, the European DFIs may be encouraged to re-evaluate some of their own operating methods and internal requirements to account for the USIDFC's entry into the market if they want to remain competitive. The reality is that many countries across the continent of Africa remain underserved, and thus there will be plenty of opportunities for equity investors and equity funds who are willing to invest in Africa to take advantage of DFI funding and co-financing. And now, with the creation of the new USIDFC, there should be more room than ever for competition in the emerging markets of Africa.

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[1] Charles Kenny, Jared Kalow, Ben Leo, and Vijaya Ramachandran. 2018. "Comparing Five Bilateral Development Finance Institutions and the IFC." CGD Policy Paper. Washington, DC: Center for Global Development, https://www.cgdev.org/publication/comparing-five-bilateral-development-finance-institutions-and-ifc.

[2] Id.

[3] Id.

[4] U.S. Congress, House Committee on Foreign Affairs, Financing Overseas Development: The Administration's Proposal, Opening Statement of Ed Royce, Chairman of the House Foreign Affairs Committee, 115th Cong., 1st sess., April 11, 2018.

[5] EMPEA Brief, First-time Funds in Emerging Markets, August 2015, https://www.empea.org/research/empea-brief-first-time-funds-in-emerging-markets/.

[6] Id.