A PIONEERING Spirit


Photography: Wendy Stone

Renée Blasky, CFA, on investment prospects for East Africa

BY JONATHAN BARNES

With 19 years of investment and financial experience in East Africa, Renée Blasky, CFA, clearly knows the region. As the founder and managing director of Vista Capital Limited, a financial consulting firm based in Nairobi, Kenya, Blasky provides advisory services and has at times helped link investors to private equity. She also is chair of the East African Society of Investment Professionals, which hopes to become the next CFA member society in Africa. In 2006, she was a consultant for the Kenyan Capital Markets Authority in a survey on investors' perceptions of the Kenyan markets. In this interview with CFA Magazine, *Blasky discusses the challenges and opportunities of investing in East Africa and future prospects for growth and returns.*

What are investors' perceptions of East Africa?

People ask me, "What is it like in Kenya?" I ask them to envision living in California in the 1800s. You must have an entrepreneurial pioneering spirit. There are tremendous opportunities, but there are also a lot of areas you need to look out for—in terms of what could go wrong. Your risk management needs to be very strong, and you need to have a very long-term outlook.

If you're a local investor or have been in the area a long time, it's much like investing anywhere—you know where the opportunities are, the players, the required procedures, and you know the local politics. However, for a foreign investor coming into the East African market for the first time, it can be an interesting experience.

What should foreign investors be aware of?

If you are a direct investor, there are a lot of procedures and licensing. The East African governments are trying to make the process more investor friendly in terms of reducing the number of licenses and the time frame. But it can still take a long time to close a deal, particularly if you are working with the government as an investment partner. I am working with a foreign investment group that is trying to put a deal together in Kigali, Rwanda. The general partner had been very frustrated that after a year [the deal] hadn't closed, and I was shocked that she thought that it would have. Deals in this region can take two to three years to negotiate and close when governments are involved.

What is the Kenyan business culture like?

You have a different protocol than in more developed markets. It is much more formal here in terms of introducing yourself and getting to know someone. When you talk to somebody on the phone, you don't start off immediately with what you want to talk about. You ask them how they are, how their family is, and how work is going. Eventually, you can get around to what you want. It is more like Japan. Business here is much more centered on relationships than in the U.S. In the U.S., you meet somebody, you shake hands, and you get down to business pretty quickly. Not here. It's about the person first.

What are some of the operational risks?

You have issues with electrical power and with telephones. You have issues with licensing and taxes. It is just not as straightforward as in other markets. For instance, power in my office goes off at least once a week—for a full day. Supposedly, it's going off for maintenance, but it's been like this for the past six months. So you have to always have a backup plan in order to continue operating.

Sometimes it can be frustrating. One client had to deliver a document to a third party on deadline, and the courier service got into a motorcycle accident. As a result, they didn't meet the deadline. Traffic here is horrific and a huge challenge. To get to a client's office only 15 kilometers away could take me an hour and a half, depending on what time of day I leave my office.

How big of a story is the Nairobi Securities Exchange (NSE) demutualization?

Most financial people want to get it done. It's an important step, as the markets have been stymied by being mutualized. It's going to provide a lot more governance to the market. The stock market in Nairobi has always been a boys' club, but that is starting to change. The Capital Markets Authority (CMA) has begun to implement risk-based supervisory rules to help with governance within the stockbroker and investment banking community. They've taken away licenses recently from three or four firms because of abuse of client funds or governance issues.

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There was a notice in the paper the other day from a stockbroker that had let 11 staff go in an investigation of KSh10 million stolen from a client account. A public announcement like that has never happened before. The broker would have kept it quiet. I take my hat off to them. The brokers have come a long way, and I look forward to even further improvements.

What else is changing?

There are some big players coming into the market. We have Moscow-based Renaissance Capital in the market, and I believe HSBC is looking at coming in as well. I think J.P. Morgan is looking around. That speaks volumes. These firms are not going to come in to play a small role. They are going to come in to do major things. The FTSE is working with the NSE to build indices. And Bloomberg is coming in. The markets are going to be much more competitive, and I hope the commissions will come down.

More and more, the East African region is acting as one market. There was talk of a common currency—I don't see that [happening] for some time. But the common market is really a game changer for attracting foreign investment. You are effectively dealing with an entire region, not just five separate countries. Kenya has about 40 million people; Tanzania, more than 43 million; and Uganda, about 30 million people. Rwanda and Burundi combine for another 20 million. Instead of targeting individual countries, you can target the region as a whole—the likes of at least 130 million people. That's the type of market that can attract a manufacturing or consumer goods company, or even a financial services company.

How large is consumer demand?

When I first got here 19 years ago, there was a very, very small middle class. Now the middle class is very active. When you go to the big shopping malls, you would never know that anybody is having an economic crisis in the world. It is packed.

There are Apple stores here, and you have iPhones. Blackberry is very popular. There are close to 20 million mobile phones. You see a lot of BMWs, Mercedes, Land Rovers, and Range Rovers. It is a pretty mobile society. I believe there is a Marriott hotel coming in and also a Radisson. I saw statistics the other day that internet usage in Africa has grown almost 2,500 percent since 2000 (compared with 400 percent in the rest of the world). We are coming from a lower base, sure, but the growth is huge.

How would you rate the political risks?

Very high, I am afraid, and I don't think it's declining in the near future. We are still paying the price for the violence following the last general election of 2007 in Kenya. The economy was effectively shut down for two months. We had very high security risks. A lot of people were shutting down their businesses trying to safeguard their belongings. When I was at a client's office, we would get phone calls saying, "Send your employees home because things are heating up."

It was quite bad for a while—riots and demonstrations in the streets. People were killed and a lot of people were displaced. And some of those victims are still displaced, living in tents basically. They haven't been relocated. With the new elections closing in, it's not necessarily going as smoothly as I would like to see. Some of the things that caused the political violence in the last election have yet to be resolved.

Could the situation repeat itself?

It could repeat itself. I have spoken to a lot of Kenyans, particularly younger Kenyans in Nairobi, to get a feeling about what is going to happen in the upcoming election. They don't think there will be violence. But in Nairobi, you have a more politically sophisticated population. It is in the rural areas where you have more tribal affiliations and tribal tensions. A lot of the population is still living below the poverty line. They have nothing to lose. They are the ones who are potentially going to think, "Let's go for it. We have everything to gain and nothing to lose."

The next election is supposed to be in August 2012, but it may be pushed to 2013 as they haven't worked out all the modalities of implementing the new constitution. This uncertainty is hard on business, because a lot of investment decisions (particularly direct investment decisions) aren't made until after elections. People are a little hesitant to make a business decisions before an election, because if you have new parliamentarians and a new cabinet, things can change.

Do you encounter a lot of corruption?

Corruption can be encountered in dealing with policemen all the way through to different government departments. I'm not sure if corruption is actually worse than before or if we are just hearing about it more because there is more freedom of the press.

The government is aware of corruption. They know it is harmful for the country, but it is going to take some time because it is part of the culture of tribal affiliations. In the 1970s, the governor of the Central Bank of Kenya effectively said it was OK for government employees to operate their own businesses on the side. That way, the government didn't have to pay them as much of a salary. Because of that, you had a lot of government employees setting up logistics companies and transportation services to sell their services/products to the government. I think that started the whole thing.

If you knew what policemen here were earning as a wage, you would certainly understand why they are trying to take bribes on a daily basis. They are just not paid a living wage. They can't send their kids to school, and they can't pay their rent.

How does corruption affect your work?

When you're dealing with the private sector, you don't face much corruption. When you're dealing with the exchanges, you don't have corruption. It is more when you are dealing with big government projects—road contracts, power contracts, and telecommunications. Part of our traffic problem is because the roads aren't built correctly. Somebody got money instead of buying bitumen. I don't know what the specs are, but let's say that instead of building a six-inch foundation, they built only a three-inch foundation and the missing three inches is in somebody's pocket.

The government, however, is reducing the amount of licensing required in an attempt to reduce corruption and bureaucracy. If you don't need a license and you don't need to deal with all of the bureaucracy, there are fewer possibilities of corruption.

How are professional standards in the financial industry?

For the most part, Kenya has pretty high standards. It is improving all of the time. Previously, some risk management issues were lacking, but again, the regulatory bodies are beginning to implement risk-based supervision. I think the CFA Program has done a lot to increase professional standards in the region. We now have between 500 and 600 candidates registered for the exams every year. The exam takes up a whole conference center.

How many charterholders work in the region?

Right now, I believe we have 35 charterholders in Kenya and another 5–10 in other East African countries. To start a CFA member society, we need 50 regular members. We have enough now and just need to make sure they become members of the East African Society of Investment Professionals so we can make a formal application.

In the past, the biggest challenge to increasing our CFA Institute member numbers has been that Kenyans got their charter and then left the country. They wanted to go to developed markets—such as New York, London, South Africa, and Dubai—to gain experience. That was good, because they gained a different perspective, but we wanted them to come home afterward. Since 2008, the financial crisis actually has benefited us in some ways because a lot of people are coming home.

What other investments are available—outside the NSE?

There are mutual funds. We call them collective investment schemes or unit trusts. I don't know the value of assets under management, but we have about 45 unit trusts operated by 12 different service providers. It's not as popular as I had hoped it would be. I think it's partly because the front-load is still too high—between 5 percent and 6 percent for an equity fund. In the downward market we are facing now, that is just not viable.

Also, a number of private equity funds are coming into play. We have foreigners coming in for private equity as well as locals. The president of Kenya is calling for pension funds to play a larger role in the funding of infrastructure. The Retirement Benefits Authority currently regulates the percentage a pension fund can allocate to private equity or alternative investments. We don't have any public–private partnership types of investment from the pension funds yet. But I think this is a huge opportunity for pension funds because they can match their long-term assets to their long-term liabilities.

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The NSE has stated it wants to grow to 100 listed companies by 2015.

That's been the goal for years, decades it seems. The listed numbers have ranged between 52 and 56 companies for years. Every CEO of the NSE has had the goal of increasing listings, but there are challenges to being publicly listed. One of them is a tax issue. A lot of these family-run companies or even larger, private companies have not necessarily declared all of their revenue. As a result, they can't value their company properly. They want a company to have the highest value for their shareholders, but the financials don't support it.

One of the things that the government is considering is a tax amnesty. But until that issue gets resolved, I think [NSE CEO] Peter Mwangi, CFA, has a challenge on his hands.[1] The NSE is trying to do a small and medium enterprises (SMEs) exchange, but it also just goes back to one of our biggest problems, which is liquidity. You have all of these investors—the pension funds in particular have contributions coming in every single month—and they have got to figure out where to put that money. Typically speaking, the equity proportion of the asset allocation for a Kenyan pension fund can be between 25 percent and 45 percent. That's low when you consider the average age of the pension member is probably in the low 40s and has another 20 years in the work force.

So where does the money go?

A lot of it is going into government debt. New regulations for real estate investment trusts are expected shortly. This is highly awaited by the whole industry. The pension plans are really looking forward to the real estate investment trusts (REITs) because it will provide them with a property exposure—and a liquid one.

The government issued another 30-year infrastructure bond. They are also issuing a diaspora bond to try to get the Kenyans who are living overseas to invest back into their country. It didn't go as well as they had hoped, though. It was undersubscribed. I think the Kenyan diaspora have less to invest as they are sending more home to their families for basic upkeep with increasing food and electricity prices.

There are more opportunities outside the NSE than on it. If you want liquidity and a dividend yield, you go to the stock exchange. If you want long-term growth and you are a risk-taking, venture-capitalist type, then you go private equity.

What's the state of the Kenyan shilling?

Our currency has depreciated against the U.S. dollar by about 24 percent since the beginning of 2011. Inflation is running around 18 percent [annually]. So life is getting hard. Costs are really increasing, and most of it is because the middle class wants imported goods. Commodity food prices are skyrocketing. Electricity is going up because 80 percent of our power is hydropower and we are in a drought. The reservoirs are low, and the power company is running diesel generators.

The government claims a lot of the banks are holding hard currency and not turning it into Kenyan shillings, which is really putting pressure on the shilling. And with the inflation, even government securities yielding 12–14 percent can give a negative real return.

So what is your outlook?

Amazingly, I'm very positive long term for the whole region. You have a very young population. You have a well-trained, English-speaking, highly educated population. There are massive growth opportunities in transport and infrastructure, health care, education, IT, telecommunications, tourism, and the financial markets.

In the short term, we are in a very uncertain period because of political risk and economic challenges. The new constitution is still in the infant stages. Provincial governments are being introduced effectively for the first time, so there are some teething problems. But overall, I think the long term looks fabulous. Where you have problems to solve, you have investment opportunities!

Jonathan Barnes is a freelance journalist and author of the novel Reunion.

1 For more on the NSE and East Africa investing, see the *CFA Magazine* interview with Peter Mwangi, CFA (July/August 2011).