ARIA
Africa Resilience Investment Accelerator

Foundations of Growth

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Investment opportunities and needs in frontier markets across Africa: Insights from ARIA countries

British International Investment

FMO
Entrepreneurial Development Bank

Foundations of Growth is a series of publications that shares the trends, lessons, challenges, and opportunities of investing in frontier markets across Africa. The series is aimed at helping development finance institutions, impact investors and donors develop their strategies and capabilities for operating in these markets

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You can find other reports in the series at **ariainvests.org.**

1. Introduction

This publication is the second in our Foundations of Growth series. It provides a classification of companies operating in frontier markets, analyses related investment opportunities for development finance institutions (DFIs) and highlights some of the existing challenges of investing in these markets. The report then outlines how DFIs can support greater investment into these companies by providing pre-investment technical assistance and investment products tailored to their needs.

This analysis is based on a review of over 400 companies in the five countries where the Africa Resilience Investment Accelerator (ARIA) operates – Benin, the Democratic Republic of the Congo (DRC), Ethiopia, Liberia and Sierra Leone. Out of these 400 companies, 128 have been referred to DFIs for preliminary review.

ARIA was launched in 2021 and aims to help frontier markets in Africa develop into thriving commercial hubs. The five countries the initiative operates in have been selected due to their high growth potential. ARIA is led and supported by the UK's DFI, British International Investment (BII), and FMO, the Dutch entrepreneurial development bank.

2. Classification of companies operating in ARIA countries

Companies fall into 5 categories

Companies in countries where ARIA operates fall into one of five broad categories:

1. large multinationals and international companies
2. regional players
3. major local conglomerates
4. local mid-sized businesses
5. small companies

Banks fall into 3 groups

Banks fit into three broad groups:

1. major international and regional banks
2. private banks
3. state-owned banks

Companies operating in ARIA's target markets can be broadly grouped into five main categories, ranging from large multinationals to small local firms.

- **Large multinationals and international companies.** Large multinationals and other international companies operate in multiple African countries. In frontier markets, their activities are typically concentrated in sectors such as mining (Barrick, Anglogold, for example), telecom (MTN, Orange), and transport and logistics (APM Terminals, Bollore). While DFIs often partner with international banks, large multinationals in other sectors, generally, do not require funding from DFIs as their solid organisational structure and financial capacity allow them to raise capital in international markets. However, they may seek financing from DFIs for local joint ventures, which local banks are unable to support, to spread risk and benefit from the association with reputable international investors. In Ethiopia, for instance, Safaricom partnered with BII and IFC to bid for the first telecom licence awarded to a foreign private sector operator. Similarly, DP World partnered with BII to invest in several African ports, including in Berbera, Somaliland. In similar cases, multinationals may create opportunities for DFIs to establish joint ventures in new markets. Often, funding can be granted at the holding level (reducing risk for DFIs) and earmarked for investments in specific markets.

- **Regional players.** Several international companies with a regional focus are active in the countries where ARIA operates and other frontier markets. They include, for instance, pan-African financial institutions

Figure 1. Overview of company types and relevance to DFIs in ARIA countries

	Local small companies	Mid-sized companies	Local conglomerates	Regional players	Large multinationals
Description	Smaller, and often younger companies, sometimes semi-informal	Less diversified companies, with sizeable revenues in their sector of activity	Major local conglomerates and the most successful companies in respective countries	Well-established international companies operating in ARIA countries and beyond	Well-established international companies operating in ARIA countries and beyond
Examples	• BioPhyto • Lovegrass • West Coast Energy	• Afropa • Go Shop • Tomoca Coffee • Capitol Foods	• Amibara Business Group in Ethiopia • Erevan Group in Benin • Sethi Brothers and Group Fouta in Liberia	• Bboxx • Powergen • Baobab • Finca • Equity Bank	• Safaricom • Firestone • MTN • ATM terminals • Arcelor • Olam
Features	• Sector focused • Limited financial capacity • Limited analytical capacity	• Sector focused • Aim at diversifying • Relatively strong financial capacity • Relatively weak analytical capacity	• Multi-sector activities • Strong financial and analytical capacity	• Sector focused • Relatively strong organisational capacity • Significant capital needs	• Strong organisational capacity • Access to internal and external sources of finance
	Few opportunities	*Limited smaller opportunities*	*Most opportunities*		*Limited large opportunities*

(UBA, Access Bank, etc.), and companies such as Bboxx (a distributor of solar home systems) and Baobab (a microfinance company) which are active across the continent. These companies generally do not have the financial strength of local conglomerates but, with their international management teams and access to international investors, are better positioned to raise capital than most local companies. They often require investment for expansion and market diversification and, given their existing track records, typically present major opportunities for DFI investment.

- **Major local conglomerates.** Major local conglomerates are typically the most successful companies in their respective countries. Examples include AJA Group Holding and Sethi Brothers in Liberia, the Amibara Business Group in Ethiopia, and the Erevan Group in Benin. These companies are privately owned and significant in size, with diversified operations across various sectors. Given their track records, they are likely to create new business lines that will succeed and are thus attractive investment candidates for DFIs. Opportunities to invest in these companies can be limited, however, as they sometimes rely on internal resources and international sources of capital to finance expansion and diversification projects. When this is not the case, DFIs have a major role to play in financing major investment projects and contributing to the development of best practices in areas such as developing corporate governance and implementing high environmental and social (E&S) standards. To become a preferred financial partner for new opportunities with these organisations, DFIs need to cultivate long-term relationships with them.

- **Local mid-sized businesses.** Unlike diversified conglomerates, promising mid-sized companies have a tighter focus and fewer internal resources to commit to investment projects, but they do present opportunities for growth and diversification. Examples include Les Fruits Tillou in Benin, a pineapple juice business, and Afropa, a food and beverage distribution company in Liberia that has received support from IFC. These companies may have the financial capacity to invest significant amounts but have limited familiarity with the specific requirements of DFIs (for example, in terms of documentation, compliance and environmental, social and governance (ESG) requirements) and little in-house capacity to respond to them. In addition, the investment opportunities that they develop are often below US$5 million, the minimum investment threshold of most DFIs.

- **Small companies.** Smaller companies in frontier markets often operate as quasi-artisanal and semi-informal businesses. They typically generate less than US$1 million in revenues. Some of these companies offer growth investment opportunities but require smaller and phased funding, and may need to be backed by technical assistance, which few international funds or development banks can offer locally.

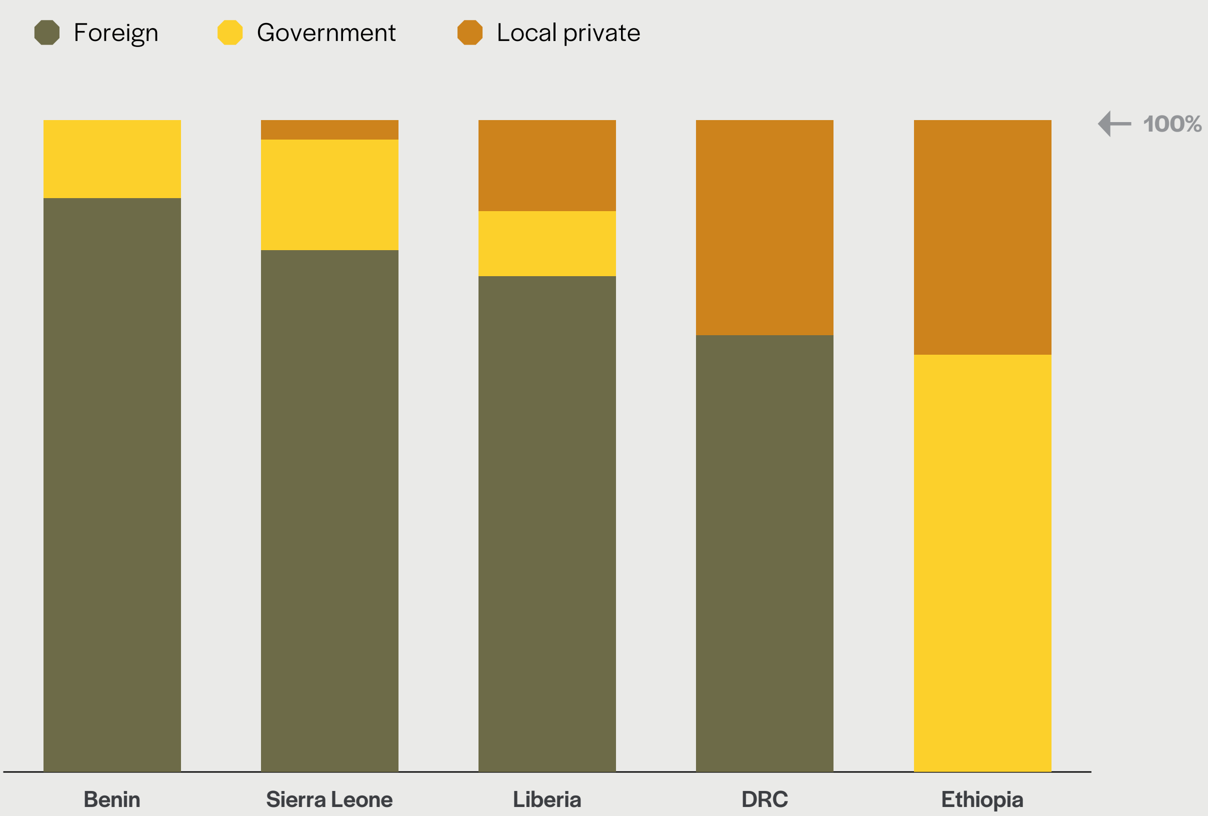
Due to constraints on their financial and operational capacity, DFIs face challenges in directly investing in small and medium-sized enterprises (SMEs). Often, instead, DFIs channel their investments through financial intermediaries, such as banks, microfinance institutions, and SME investment funds. This approach allows DFIs to leverage the established infrastructure and expertise of these intermediaries to reach more SMEs and support their growth.

Banks, which offer the majority of opportunities for DFI investment in frontier markets, can be grouped into three major categories. Banks play a crucial role in fostering economic growth and financial inclusion. By backing them, DFIs can contribute to the development of the financial sector, reach a larger number of SMEs, and facilitate long-term economic and social progress in sub-Saharan Africa. Across the region, banking can be broadly categorised into three groups.

- **Major international and regional banks** operating in multiple countries, such as Ecobank, Bank of Africa, Orabank and Equity Bank.
- **Local private banks,** such as Rawbank in the DRC, Dashen Bank in Ethiopia, the International Bank in Liberia, and the Union Trust Bank in Sierra Leone.
- **State-owned banks,** such as the Commercial Bank of Ethiopia and the Liberia Bank for Development and Investment (LBDI).

This range of banking institutions, present to varying degrees across the continent (figure 2), and with varying degrees of operational and financial performance, offers DFIs and donors a variety of opportunities to support the development of the local financial sector.

Figure 2. Distribution of bank assets in ARIA countries in 2021, by ownership categories (%)



Source: Central banks of respective countries

3. Sector of activity and investment needs

Of the investment opportunities in the ARIA pipeline:

27% are in agribusiness

21% are in financial institutions

19% are in manufacturing

17% are in energy

128 companies

that ARIA has identified are looking for a combined US$2bn in investment

53%

of projects require US$5m to US$20m

45%

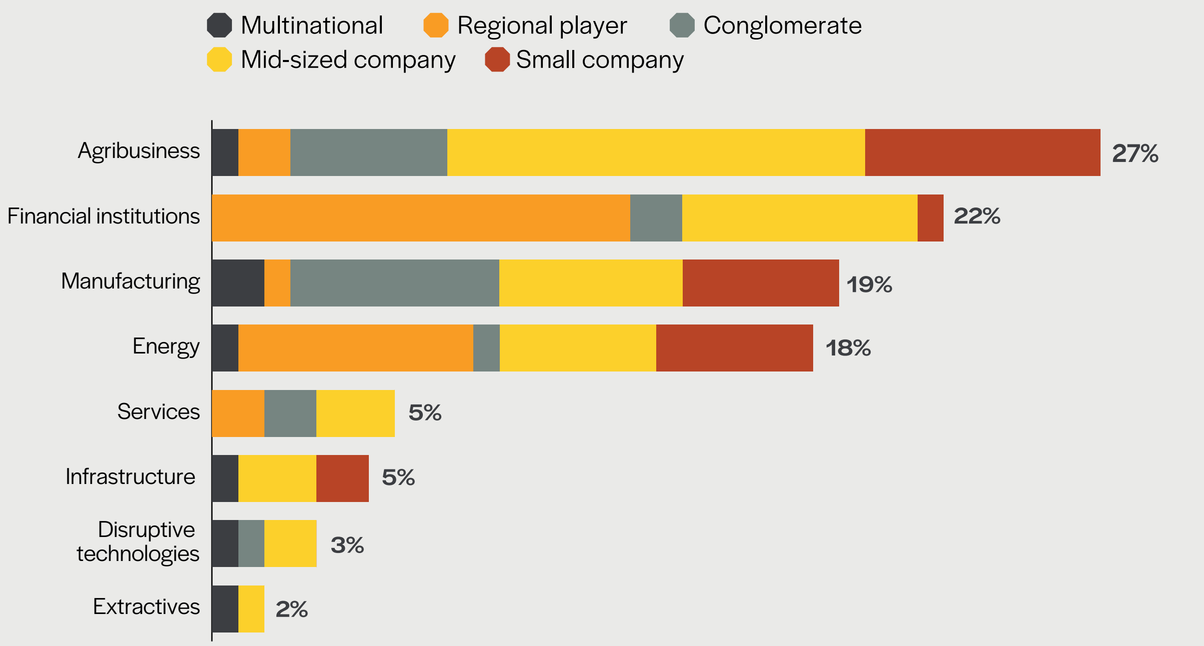
of pipeline business are looking for debt financing only

37%

of pipeline businesses are looking for a combination of debt and equity

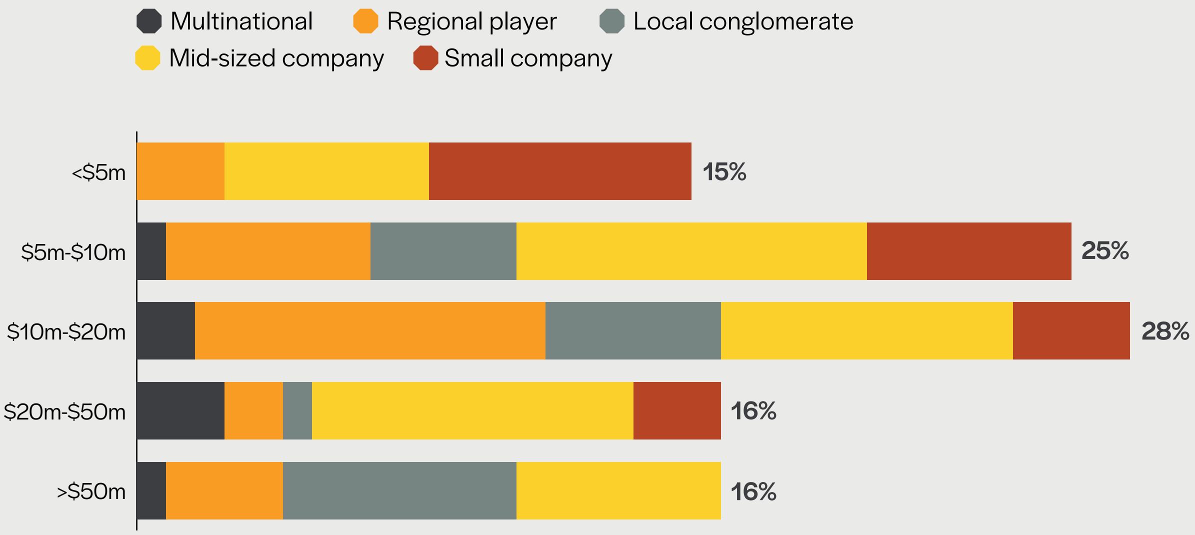
The 128 investment opportunities identified in the five ARIA countries are concentrated in the financial services, agribusiness, manufacturing, and energy sectors (figure 3). In the financial services sector, opportunities include those in the banking sector (particularly in the largest private banks), in mid-sized microfinance institutions, and (more rarely) in SME funds. In the agribusiness sector, opportunities exist in forestry, agricultural production, agri-processing, and a combination of these sub-sectors. In the manufacturing sector, the ARIA pipeline includes companies producing food and consumer goods, construction materials, textiles, and chemicals. In the energy sector, opportunities include large-scale electricity generation projects (solar PV, hydropower and geothermal), mini-grids and solar home system companies. Additional opportunities exist in the infrastructure sector (including logistics and telecom), services (education, health and retail), disruptive technologies and extractives.

Figure 3. Proportion of investment opportunities by sector in the ARIA database



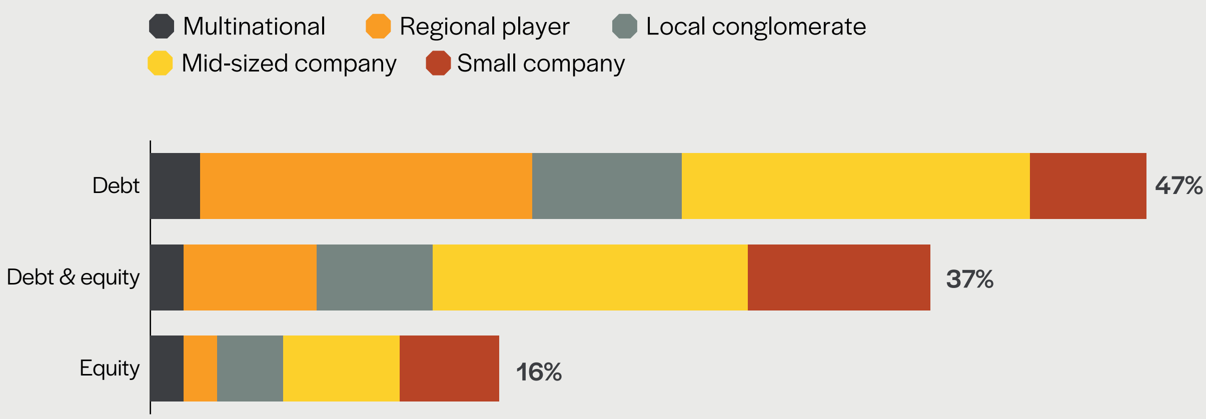
The companies in the ARIA pipeline are looking for a combined investment of more than US$2 billion. While funding needs range from US$2 million to US$200 million, most opportunities (53%) fall in the US$5 million to US$20 million range (figure 4). Nevertheless, 16% of companies in the pipeline, generally large local conglomerates with significant financial power, are seeking more than US$50 million to finance their investment projects. They are typically large projects in the energy sector (such as utility-scale generation), the telecom sector, the industrial manufacturing sector (cement and building materials), and the agriculture sector (seed oil refinery, and sugar and rice producers). There are also significant opportunities in the financial sector, particularly in major local and regional banks seeking capital to expand lending activities to critical areas such as SMEs, agri-processing and energy access.

Figure 4. Financing needs from companies in the ARIA database according to their size (%)

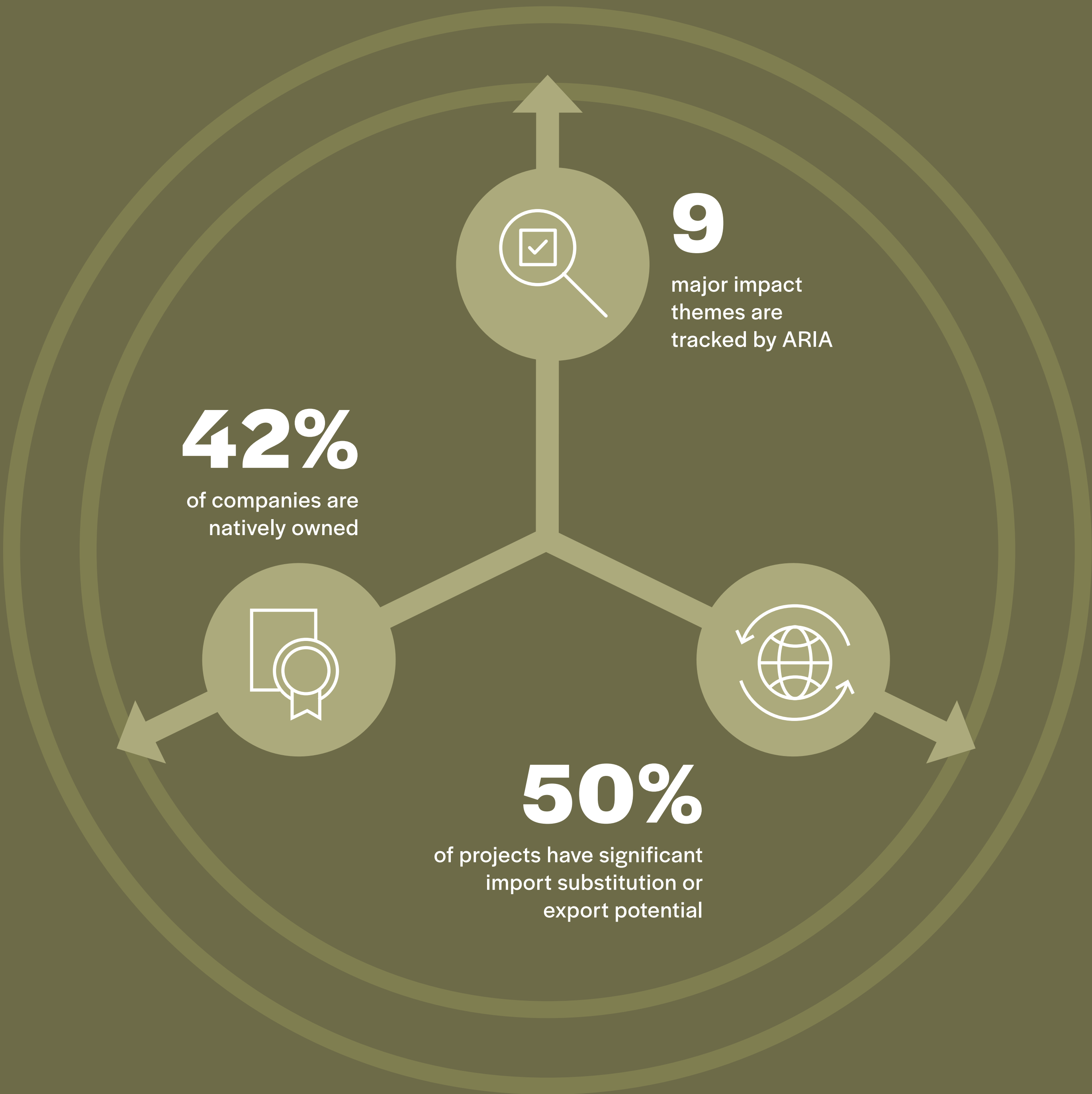


47% of the companies are seeking debt, 37% are seeking a combination of debt and equity, and 16% are seeking equity (figure 5). The companies looking for equity, in addition to funding, would often benefit from identifying a technical equity partner. Companies are generally flexible and willing to take loans in foreign currency. Nevertheless, for companies generating revenues in local currency (such as industrial companies targeting import substitution in the local market) liabilities in foreign currency make them vulnerable to potential currency depreciation and devaluation. Providing products in local currency would allow these companies to reduce the levels of exchange rate risk they face. Section 6 of this report highlights how some DFIs are working to expand their local currency solutions in frontier markets.

Figure 5. Proportion of shortlisted deals in the ARIA database according to their required financial instrument (%)

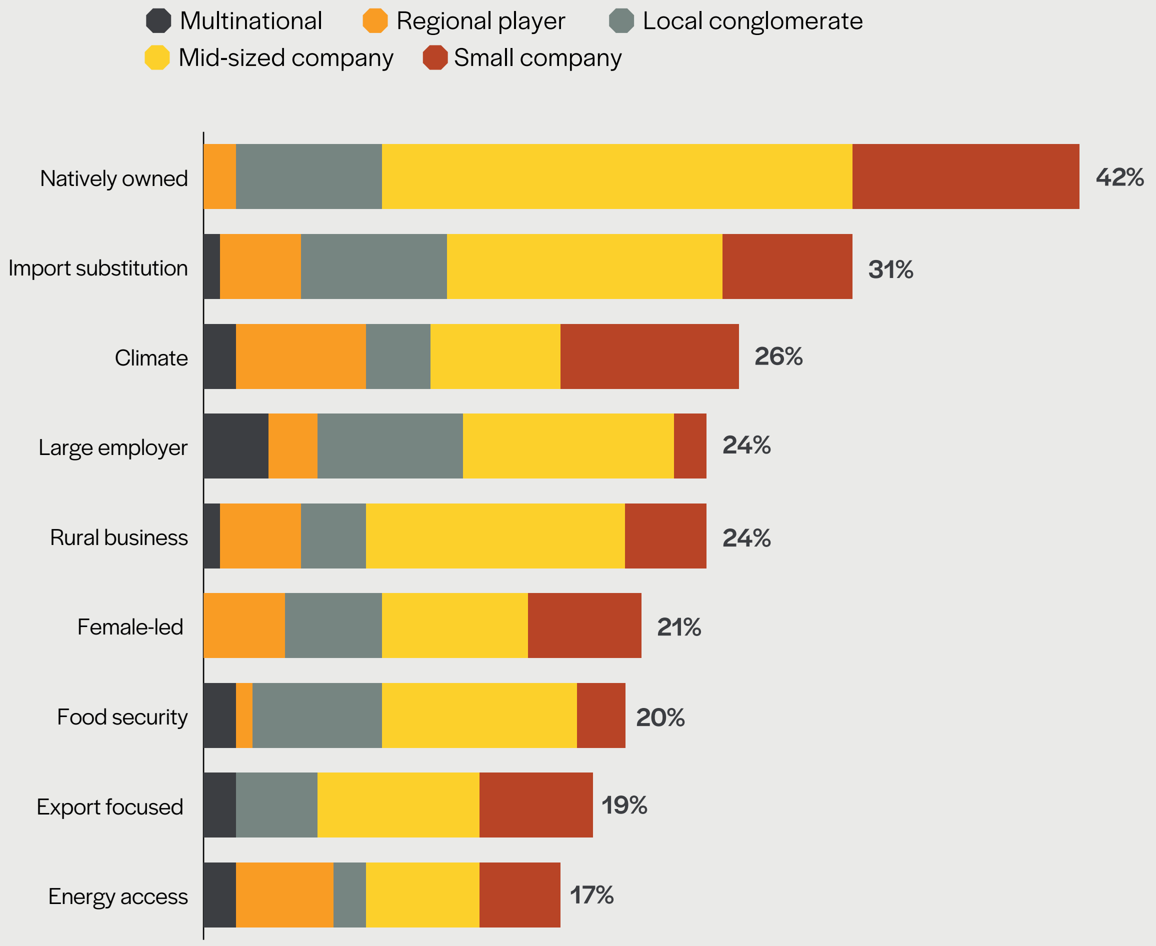


4. Impact potential



ARIA tracks nine major impact themes across investment opportunities (figure 6). While these themes are not exhaustive, they are the most recurrent in the ARIA pipeline. They include supporting natively owned and female-led businesses, promoting exports and import substitution, promoting employment, rural development, food security, energy access, and climate. Most impact opportunities involve supporting the development of locally owned companies – underlining the critical role that local businesses play in frontier markets. There are fewer opportunities to invest in women-led businesses, which reflects a wider trend of companies at this stage of investment-readiness being founded or led by men. To address this issue, gender-focused approaches and capacity building programmes can be instrumental in unlocking the full potential of women's entrepreneurship.

Figure 6. Main impact themes of the opportunities in the ARIA database (% of pipeline companies*)



* The same pipeline project can have multiple impact themes and catalytic roles

Multiple projects have the potential to deliver significant long-term transformational impact. Transformational projects are those that can significantly improve the business operating environment or transform the economic structure of a country. One-third of the companies in the ARIA pipeline can contribute to import substitution, while one-fifth have export potential. Similarly, infrastructure projects have the potential to reduce production costs and increase productivity. Most of the transformational infrastructure projects are in the energy sector and involve large utility-scale projects that can increase access to electricity. Existing telecom companies and internet service providers are developing projects to expand connectivity and decrease communication costs. Opportunities also exist in the logistics sector, with companies such as GLS Logistics in Liberia having recently developed a 5,000-square-metre open-access commercial warehousing facility with support from InfraCo – an infrastructure investor backed by the governments of the UK, Netherlands and Switzerland. Several projects in the financial sector also have significant impact potential – for example by increasing access to finance in underserved sectors such as agriculture.

Other impact themes include climate, supporting rural businesses, food security, and energy access. Climate-related opportunities are mostly linked to companies in the renewable energy sector, but also include businesses in the forestry and agriculture sectors. One example is OKO Environmental in Sierra Leone, which is reforesting indigenous rainforests to enhance biodiversity and carbon sequestration. Opportunities to improve food security generally include local champions in the agri-processing and retail sectors, which are expanding the production and availability of food products. The opportunities to invest in rural businesses are mostly related to agriculture and agri-processing but they also include a bank and a microfinance institution, which have portfolios that reach companies operating in rural areas.

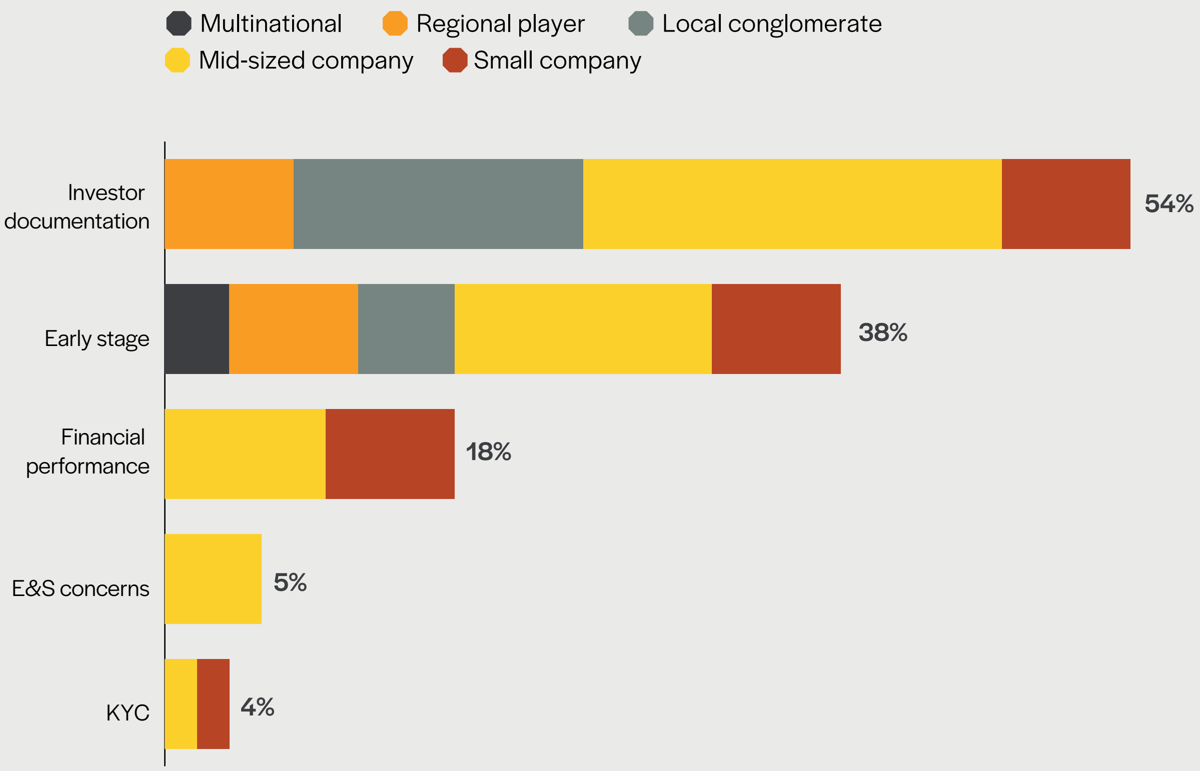
5. Investment readiness and technical assistance needs

38%
are at too early a stage for DFI investment

43%
of pipeline companies are not investor ready

54%
of these are companies have significant gaps in required documentation (including business plans, investment memos or financial models)

Figure 7. **Main identified investment readiness issues in ARIA pipeline (% of the non-investment ready companies)**



While the pipeline companies present significant investment opportunities, 43% require technical assistance support to become ready for DFI investment. Local companies, whether they are small companies or large local conglomerates, are generally not familiar with DFIs and their requirements, particularly when it comes to documentation and compliance (figure 7). Multiple projects are at an early stage and require further analysis to determine feasibility and be properly structured. Some promising projects are negatively affected by the limited track records and financial performance of sponsoring companies. E&S issues are particularly relevant for larger companies, given their greater footprint and the potential for creating more significant impact.

Technical assistance needs to be tailored to the specific requirements of each company. ARIA, DFIs and donors can enable the development of investment projects by providing specialised support to develop robust financial models, craft detailed investment memos, and clearly articulate business plans. Such approaches are particularly beneficial for both SMEs and local conglomerates. Local conglomerates may benefit from support in developing enhanced governance and E&S systems aligned with DFI and international standards, while multinationals may benefit from advisory services to structure and navigate transactions in complex country environments.

Examples of opportunities for technical assistance support include:

1. **Financial and operational review.** This includes providing companies with support in enhancing and rebuilding their financial models. This kind of exercise allows for a better understanding of the operational performance and projections of a company and may involve substantive operational advice aimed at improving a client's financial performance.

2. **Preparation of investor documentation.** For example, technical support in preparing comprehensive, investor-grade documentation and data rooms that are critical for investors to assess an opportunity and progress discussions.

3. **ESG issues.** Companies in frontier markets are often unfamiliar with international ESG standards and require guidance to help understand them and respond to DFI requirements. For example, some palm oil firms are looking for technical assistance to prepare for the new EU Deforestation Regulation, which will be implemented by 2025. Technical assistance may involve conducting mock assessments and support in drafting and implementing policies and manuals. Technical assistance programmes designed to strengthen internal policies and corporate governance are particularly important for local conglomerates and mid-sized companies.

4. **Operational capacity building.** DFIs can contribute to building the capacity of local companies by sharing best practices. For example, DFIs supporting local banks in frontier markets to promote on-lending to specific sectors such as agriculture, will typically also need to provide capacity building support. This may involve guidance on designing financial products tailored to the needs of agricultural clients, developing robust credit assessment tools and methodologies that account for the specific risks associated with the sector and implement relevant IT management tools.

5. **Technical partnerships.** Local companies can often benefit from support in identifying and negotiating partnerships with technical partners. These may include equipment suppliers or international buyers for export products that can help them strengthen their business plans and investment cases.

6. **Strategy and go-to-market support.** This involves providing expert advice and support to companies in developing and implementing effective market entry strategies. It can include market analysis, identifying potential customers and partners, developing marketing and sales strategies, and offering guidance on the regulatory and cultural nuances of the target market.

7. **Other examples.** Further opportunities for technical assistance include structuring gender-focused investment support, which can help break down barriers for women-led businesses. Meanwhile, employment and training programmes can enhance the skill sets of the local workforce, which in turn can lead to increased productivity, higher employment rates, and broader overall impact.

6. Potential for investment instruments tailored to the needs of local companies

As highlighted in the first publication of ARIA's Foundations of Growth series, DFIs are creating innovative blended-finance solutions to address the unique challenges of ARIA countries and other frontier markets and foster investments. DFIs, with their mandate for private sector development, must be additional by funding riskier investments compared to commercial investors, ensuring they do not distort the market. To fulfil their mandate in frontier markets, DFIs can add unique value by developing instruments such as donor-funded guarantees, lower ticket sizes, local currency products, new debt products, more early-stage equity investments, and other risk mitigation instruments. While many of these products are already used by DFIs, their potential is still yet to be completely realised.

Blended finance guarantees allow DFIs to invest more in riskier frontier markets by providing risk coverage for their equity and loan exposures. For example, to jumpstart private investments in fragile and conflict-affected states, in 2017, the World Bank Group launched the International Development Association (IDA) Private Sector Window (PSW) comprising four facilities: a Blended Finance Facility (to guarantee equity and debt investments), a Local Currency Facility (providing hedging for local currency loans), a Multilateral Investment Guarantee Agency (MIGA) Facility and a Risk Mitigation Facility. By partially mitigating the risks of the IFC and the MIGA Bank Group, the PSW makes transactions possible in IDA countries and fragile and conflict-affected situations. As an example, the PSW has allowed the IFC to invest in a regional West African mortgage refinancing company with the goal of scaling up the market for longer-term affordable mortgages and construction projects in the region.

More equity investments targeting early-stage high-potential projects can allow them to develop a robust capital base and initiate the development of transformative projects in sectors such as manufacturing, energy, and agri-processing. Frequently, high-potential projects in these markets encounter a significant challenge in establishing a robust capital base, hindering their ability to secure necessary debt investments. To bolster such projects, DFIs and the donor community could explore the development of innovative investment products with heightened risk tolerance and/or lower investment return thresholds. A potential model for such a facility could be drawn from InfraCo, which specialises in early-stage development of infrastructure projects. InfraCo's approach involves providing funding and expertise to enable infrastructure projects to reach a stage where they can attract debt funding and private sector investment. In Liberia, for instance, Infraco committed US$7.5million to the development of the Liberia Inland Storage Facility (LISF) project (Liberia's first commercial open-access, storage facility) in partnership with the GLS Group, a leading local integrated supply chain services company[1]. Another relevant example is ElectriFI, which makes earlier stage and riskier investments that could pave the way for subsequent DFI investment. In the DRC, for instance, ElectriFI invested in mini-grid developer NURU's series A funding round. The company then went on to raise a series B from DFIs such as Finnfund, and Proparco[2].

1 https://infracoafrica.com/project/liberia-inland-storage-facility/
2 https://energyalliance.org/nuru-40m-metrogrid-drc/

As highlighted earlier in the publication, a significant number of the projects reviewed by ARIA fall below the investment thresholds of major development banks and investment funds. Potentially impactful projects can have relatively small investment tickets of US$1 million to US$2 million. However, DFIs typically target deals between US$5 million to US$10 million and aim to reach smaller businesses by investing in local banks and investment funds. However, some DFIs have been developing new approaches to support smaller projects in frontier markets. Solutions include BII's Kinetic blended finance programme or DFC's PI[2] and Proparco's "Explorer" programme, which allow investments of smaller ticket sizes in target countries. Another example is the FMO Ventures Program, which focuses on early stage, tech-enabled direct investments and indirect investments with a more generalist focus in funds,, provides support for target companies to meet relevant standards, improve company performance efficiency and revenue, and increase the impact of their business. Given the nature of existing growth opportunities, the allocation and disbursement of funds should be flexible. For instance, a sizeable investment opportunity may require much smaller interim investments to develop a project. A fund structure targeting tranches of investments can benefit both the project developer and investors, limiting risks and allowing time for partners to get to know each other and develop a project together.

Products in local currency can contribute to ensuring the viability of local business. Foreign-currency loans can dramatically impact the financial viability of a company with revenues in local currency if the local currency depreciates. Consequently, to promote loans in local currency, the World Bank Group launched the Local Currency Facility (LCF) providing long-term local currency to IFC investments in IDA countries where capital markets are not developed, and market solutions are not sufficiently available. However, the vast majority of DFI loans are still denominated in foreign currency, due to organisations' financial policies, operational constraints, and structural challenges in local currency markets. To address this issue, BII's Kinetic programme is exploring the potential of taking on investments denominated in unhedged foreign currency. In addition, a recent report[3] from the IGC, co-funded by the African Development Bank (AfDB), BII, IFC, and ARIA, suggests developing a local currency credit guarantee focused on frontier markets. This would take on part of the credit risk of facing the local counterparty in loans or derivative transactions, combined with providing technical assistance to central banks to support the development of money markets and facilitate their potential role as hedge counterparties.

3 https://www.theigc.org/publications/mitigating-foreign-exchange-risk-local-currency-lending-fragile-states

7. Conclusion

In the frontier markets where ARIA operates, companies broadly fall into one of five categories – large multinationals and international companies, regional players, major local conglomerates, local mid-sized businesses, and small companies. While the most common and relevant investment opportunities are those offered by local conglomerates and regional players, there is potential across all categories, which often need specific approaches to investing and delivering technical assistance.

Opportunities to invest are largely concentrated in the agricultural, financial and infrastructure sectors, but they exist also in sectors such as manufacturing and services. These investments have the potential to deliver significant impact, especially by promoting local entrepreneurship and energy access, reaching rural communities and improving food security. They can also transform the economic structure of a country – for instance by decreasing energy, transport and communications costs, promoting exports and contributing to import substitution.

From financing to technical assistance, companies operating in ARIA countries and other frontier markets often need a flexible approach from DFIs that can more closely match their needs. For example, many impactful projects require lower ticket sizes, some companies need local currency products or – at the larger end of the scale – they would benefit from advisory support on structuring complex transactions.

It is positive to see the World Bank, Proparco, FMO, BII and others responding to these needs – particularly when it comes to developing strategies for reaching smaller companies in frontier markets and providing local currency products. With the right guidance and support, these businesses can grow and make a positive impact in the countries where they operate.

Acknowledgements

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To learn more about ARIA and to explore partnership opportunities, please visit our website at **www.ariainvests.org.**

You can contact the ARIA team at **info@ariainvests.org.**

About ARIA

ARIA exists to unlock investment in frontier markets in Africa. It was launched in 2021 at the G7 summit. It is sponsored by the UK's DFI, British International Investment, and the Netherlands' DFI, FMO (the Dutch entrepreneurial development bank).