Conduits of Capital

Onshore Financial Centres and Their Relevance to African Private Equity

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FSD Africa (www.fsdafrica.org) is a non-profit company, funded by the UK's Department for International Development, which promotes financial sector development across Sub-Saharan Africa. It sees itself as a catalyst for change, working with partners to build financial markets that are robust, efficient and, above all, inclusive. It uses funding, research and technical expertise to identify market failures and strengthen the capacity of its partners to improve access to financial services and drive economic growth.

FSD Africa believes that strong and responsive financial markets will be central to Africa's emerging growth story and the prosperity of its people.

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TABLE OF CONTENTS

FOREWORD

With growing interest in Africa as an investment destination, the question arises as to which of its major cities are going to emerge as the region's financial centres. Which cities are going to be able to attract international capital at scale, as well as growing numbers of financial firms and their technically skilled employees? Johannesburg stands out because of the sheer size of its capital markets relative to other centres, but we can construct plausible narratives for the development of other centres in Africa—Nairobi, for example, with its aspiration to be a regional gateway funnelling capital into East and Central Africa, or Casablanca and Lagos, serving the needs of North Africa and Africa's largest economy respectively. It is possible to imagine a continent with several credible, internationally significant financial centres, each serving somewhat different purposes and each individually shaped by their particular political and geographic circumstances.

Recognising the role that well-functioning financial markets can play in stimulating investment and creating jobs, a number of African cities now have explicit financial centre strategies which aim to attract international capital and financial firms, as well as drive improvements in the investment climate for domestic investors. Sometimes these strategies involve tax and visa exemptions to attract inward investment.

Behind these initiatives is the idea, first, that finance can drive, as well as respond to, economic development. Africa is underinvested and, fundamentally, more finance is needed to deliver basic needs to fast-growing populations, and create opportunities for more people to benefit from economic growth. Thus, financial sector development has a political as well as commercial impetus.

Second, these strategies, with their policy frameworks, acknowledge the need for an effective mechanism, or organising principle, to address the cross-governmental coordination challenges which must be solved if financial market development on the continent is to succeed. Financial markets do not operate in isolation. They depend on good information communications technology infrastructure, tax policies that are fair and predictable, legal systems that respect property rights and allow for effective dispute resolution, well-functioning transport systems, decent housing for people who work in financial markets, schools for their children, and so on. Financial centres tend to operate with the blessing of a country's political leadership and may be able to smooth the friction that can arise when government departments are required to collaborate.

Third, financial centre strategies are an expression of a country's economic direction of travel and can therefore be a powerful branding instrument. Economic strategies that give finance a prominent role indicate a country's willingness to be globally connected and competitive. Countries that focus on such strategies are not especially interested in being competitive on the regional, or even African, stage—rightly, they want to be benchmarked against global comparators. Their professional classes are obtaining jobs in London, Dubai and New York and no longer see the logic of settling for standards that are not global.

These countries' financial sector strategies symbolise their support for the development of an enabling environment (finance being an important economic enabler) that encourages economic diversification and innovation. Implicitly, they also recognise the importance of other services industries, including professional services, which can add value to a country's primary economic base. Financial centres attract, and depend on, a wide range of support service companies—accounting firms, law firms, ratings agencies, fund administrators, analytical organisations, information technology companies, training companies and the like.

Unquestionably, the economic dividend that flows from the successful development of financial markets is not contingent on a country establishing a financial centre *per se*. Many cities around the world have evolved into financial centres without having to offer aggressive incentives (although, for sure, they will not have succeeded without having been at least as competitive as other centres): they are there because they have an industrial or trading infrastructure that needs access to financial services. It seems plausible that those countries that do establish financial centres might stand a better chance of achieving hoped-for financial sector development outcomes more quickly than those that do not. But the research in this report seems to suggest that, with the exception of small jurisdictions whose financial centre activities are disproportionately large in relation to the rest of the economy (e.g., Mauritius, the Cayman Islands), the economic value of a financial centre itself may in fact be quite modest. What matters much more is that the increased investment that a financial centre is able to attract finds its way into the local economy—funding infrastructure, helping new firms to establish themselves, paying for new plant and equipment, and so on.

In view of the above, a number of donor agencies, the UK's Department for International Development ("**DFID**") among them, are interested in better understanding what they can do to stimulate financial markets and spur investment and growth. DFID has put economic development at the heart of its agenda. In January 2014 it published a strategic framework for economic development which emphasised *inter alia* the importance of well-functioning financial sectors to catalyse investment and trade. DFID believes that capital markets are critical not just for driving long-term growth, but also for supporting a sustainable exit from aid in its partner countries.

FSD Africa ("**FSDA**"), like DFID, has broad financial sector development goals. It aims to support financial sector development across Sub-Saharan Africa by encouraging skills development and the transfer of knowledge (e.g., research, business models, policy approaches, etc.) across borders, and by building the capacity of financial systems in other ways. FSDA is increasingly focused on supporting the development of capital markets in Africa, given their central role in channelling investment and driving economic growth, and because of their ability to galvanise entire financial systems (e.g., by making long-term capital more accessible) with important consequences for financial inclusion.

However, the trigger for this research programme, now published under the title *Conduits of Capital – Fund Domiciles and African Private Equity*, was a more specific question raised by CDC Group plc ("**CDC**"), the UK's development finance institution ("**DFI**"), which has partnered with FSDA and DFID on this research.

As is the case with other DFIs and international finance institutions ("**IFI**") (e.g., African Development Bank, European Bank for Reconstruction and Development and International Finance Corporation), much of CDC's indirect investment in Africa is structured through investment funds and / or investment vehicles domiciled in Mauritius. Mauritius and other offshore financial centres, which are commonly used for fund and investment structuring purposes, have been (and continue to be) subject to political / civil society criticism for: (i) a perceived lack of transparency; (ii) perceived "harmful tax practices"; and (iii), the facilitation of capital flight from developing countries. CDC, other DFIs / IFIs and their fund managers have been criticised for their use of investment vehicles domiciled in Mauritius, Guernsey, the Cayman Islands, etc., notwithstanding those countries' successful participation in the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, which deems each country to be largely compliant with its standards.

CDC has expressed an interest in broadening the available options when it considers: (i) how and where to structure its investments; and (ii), the domicile of prospective investment funds in Africa. The question has arisen, therefore, as to whether other African countries, or cities, could, over time, become viable onshore alternatives to offshore financial centres and, if so, how they could be encouraged to develop into credible, transparent financial services centres that are sufficiently attractive to African and international investors seeking to invest long-term, patient capital in African businesses.

There is a symmetry between CDC's specific question and DFID and FSDA's desire to identify interventions that would support broad financial sector reform in Sub-Saharan Africa. The reforms that are needed to encourage private equity fund managers to domicile funds in an *onshore* African centre—improvements to the rule of law, tax reforms and treaties, better quality information, and better professional and technical skills—are very similar to those needed to build financial markets (and especially capital markets) generally. It has therefore been possible to run a research project that addresses all three partners' goals.

The research has quantitative and qualitative components.

The quantitative component has been led by the Emerging Markets Private Equity Association ("**EMPEA**") which conducted an online survey of private equity industry practitioners active in Africa. The survey asks specific questions around fund domiciles, including what factors drove the practitioners to choose the domiciles they chose and how satisfied they were with the choices they made. The practitioners were also asked if they would consider onshore domiciles and what conditions would need to be met in order for them to opt for an onshore domicile. This line of questioning was intended to obtain an objective measure of how likely it would be that an onshore centre could emerge as a serious rival to Mauritius, which has become the default domicile option for funds and other investment vehicles targeting Sub-Saharan Africa (and India). The survey was complemented by in-depth interviews with fund managers, institutional investors and professional service providers.

The qualitative component was to commission a group of five "issues papers" from experts in the field. The aim was to gather contrasting expert opinions on how likely it was that: (i) fund managers would start to consider using onshore financial centres in Sub-Saharan Africa for the purposes of fund and / or investment vehicle domiciliation; and (ii), investors would support onshore investment as an alternative to investment via offshore financial centres. If the answers to the above were "yes," which countries would these be and what sort of reforms would be needed to encourage these fund managers and investors to do so?

The experts were asked to make recommendations on how FSDA (and / or DFID) could best support the transformation of particular countries into viable onshore centres—for example, by providing technical assistance and supporting in-country advocacy initiatives to build political will.

The results of the survey and the five issues papers are reproduced in this publication.

From the survey, it is very clear there is a strong preference among fund managers for offshore structures (mainly for tax efficiency reasons) as well as a high degree of satisfaction among fund managers and institutional investors in Mauritius. As one interviewee said, "The industry has found a very safe model in Mauritius that works and that everyone loves." DFI / IFI respondents, whilst acknowledging differences among them, were in general markedly more sensitive about offshore centres than "private" institutional investors.

However, the report did identify a growing interest in the use of onshore centres. Some global investors are concerned about the negative perceptions of offshore centres—notably lack of transparency and harmful tax practices—and the civil society criticism that ensues. African investors such as pension funds, by contrast, are pushing for onshore centres because they are becoming increasingly interested in private equity as an asset class and are often prevented by regulation from investing in private equity funds domiciled offshore.

Survey respondents' opinion has coalesced around South Africa, Kenya, Botswana, Nigeria and Morocco as being the most attractive onshore centres, with South Africa (most attractive) leading Kenya (second most attractive) by a large margin.

While respondents ranked the legal and regulatory environment as their most important consideration when deciding on a domicile, tax remains a significant consideration, especially for fund managers. According to one interviewee, a fund manager, *"The first driver of our decision of where to domicile our fund is of course tax optimisation for our limited partners [i.e. investors]; the second is tax optimisation for us."* Lion's Head, one of the authors of the issues papers, puts it in the following way, *"Financial capital…will always be very sensitive to the level of taxes levied…One of the issues…that goes to the heart of the [discussion on] offshore financial centres is the question of what constitutes an appropriate level of taxation and where taxes should be levied."*

The survey suggests that, in contrast to fund managers, institutional investors are marginally less driven by tax as a decision factor for the choice of domicile than they are by the legal and regulatory environment. However, it is not unimportant for them and, furthermore, the survey may not have been able to distinguish fully between general regulatory matters and tax regulation. Interestingly, the existence (or otherwise) of double taxation avoidance agreements ("**DTAAs**") is an important tax consideration alongside tax rates on capital gains and dividends. Why some leading onshore centre contenders have not yet put these DTAAs in place is unclear and somewhat surprising.

The main messages from the issues papers are consistent with the survey findings, although the authors' terms of reference were broader. Together, the papers constitute a rich resource that, first, helps us define what we mean by a financial centre and, second, identifies what donor agencies can do to build up onshore financial centres. While the five papers have different emphases (for example, only three of the five are particularly focused on the role of private equity), there are commonalities. A synthesis paper by Z/Yen, which is also responsible for the Global Financial Centres Index, distils and summarises the five papers.

So what can donors usefully do to promote investment through financial markets, whether by means of financial centres or otherwise? We suggest that there are four main headings: legal and regulatory reform, information, skills development and subsidies.

Donors can play a useful market-building role because private sector entities do not tend to invest where returns are highly uncertain or where competitors are able to "free ride" on the back of their own investment. Circumstances such as these can justify the use of public funding to create public goods that benefit the market as a whole.

Capacity constraints—both skills and information gaps but sometimes also financing gaps—afflict financial markets in Sub-Saharan Africa to a considerable extent. Donor interventions should focus on investing to address these capacity constraints in ways that strengthen investor confidence, create competition and support innovation.

Legal and regulatory reform

From the survey findings, it is clear that strengthening the legal and regulatory environment would be the single most important contribution that donors could make towards bolstering investor confidence. The regulatory environment for capital markets is fairly specialised and donors can play a useful role in linking policymakers, regulators and central banks to scarce international expertise and providing funding for consultancy support. Many countries have already adopted financial sector strategies, often embedded within strategies for economic development, but the process of transforming these strategies into legislation, and then regulation, can be inordinately slow because of the complexities of coordination and the absence of critical technical expertise. It can also be the case that, even where specialist expertise is secured, solutions are proposed that are inappropriate for the local context.

Mechanisms need to be put in place that drive regulatory processes and bring stakeholders together to build consensus around policy and regulatory reform. While the decisionmaking is best done by local stakeholders, donors can facilitate the decisionmaking process in numerous ways—paying for research, convening workshops, assisting with procurement processes, and so on. The importance of the consensus-building process cannot be underestimated. It is an unfortunate fact that in some Sub-Saharan economies, especially where there is a strong socialist or statist economic tradition, there is a lingering suspicion towards capital markets development (despite a stated recognition of the need for infrastructure and other investment) which means that insufficient parliamentary time is given to much-needed legislative reform. That has to change.

One way to galvanise regulatory reform is to conduct cross-country research that benchmarks countries against each other—for example, comparing tax rates or specific facets of legislation—and to benchmark countries against relevant international standards.

A major challenge for many would-be onshore centres is that they start from a position of regulatory deficit—absent or inappropriate regulation which needs to be fixed at a time when global financial markets regulation (Anti-Money Laundering / Combating the Financing of Terrorism standards, Basel III, corporate governance standards, etc.) is evolving very rapidly. In addition, many onshore centres are having to consider how to harmonise their domestic regulatory frameworks with regional frameworks as processes of regional integration gather pace.

These challenges would be serious enough for well-resourced regulators but many regulators, especially in the capital markets arena, are small and rather weak, and most are under-resourced, not least because the markets they oversee do not produce sufficient income (e.g., from listing fees or other levies) and so they are forced to rely on government support.

FSD Africa is firmly of the view that supporting capital markets regulators on legal reforms, but also on internal capacity strengthening, can be transformative in building investor confidence.

Finally, it is not simply a question of introducing new or better regulations. These also need to be enforced. It is an unfortunate fact that while perfectly adequate regulation may exist, all too often it is not enforced, perpetuating the perception that markets are rigged in favour of local interests.

Information

Building the information base is a clear opportunity for donors. Information, freely available to the market, can be highly beneficial in a market building sense. There are innumerable ways that information can help to strengthen the way markets function—by creating a baseline, allowing for target-setting and monitoring, making a business case, highlighting problems, demonstrating impact through case studies, and so on. Research (as mentioned above in the context of much-needed regulatory reform) is fundamentally about information provision—to decisionmakers, investors, surveillance departments of regulators, and so on.

Because of the fragmented nature of African financial markets, it remains very difficult to access information on the state of stock or bond market development in particular countries. Over time, as private investors demand such information as they do routinely in developed capital markets, the private sector will provide the information the market needs; but while markets remain underdeveloped, there is limited incentive for the likes of Bloomberg or Thomson Reuters to fill the gap.

It is also the case that incumbents benefit from opaque markets and so are reluctant to support initiatives that shine a light into parts of the markets that they would consider to be their own.

Skills development

Many Sub-Saharan African markets are now professionalising in the sense that regulators are demanding minimum professional standards based on globally recognised professional qualifications. FSDA is supporting this process by encouraging adoption of the Chartered Institute for Securities & Investment's certifications, adapting to local contexts where necessary. This is an important development which will also strengthen investor confidence.

Skills gaps exist all along the investment finance chain. As has already been mentioned, skills need to be strengthened in regulatory agencies. A number of the issues papers in this report point to the need to strengthen skills in private equity and asset management. Market practitioners require training not just in technically advanced areas such as derivatives but in some quite basic areas such as valuation. Pension fund trustees also need technical training—for example, not just to understand the benefits of investing in alternative assets such as private equity, but also fundamentals around the private equity limited partnership model, the J-Curve's impact on short-term performance, and the asset class's liquidity profile.

It is not just financial or technical skills where support is needed, however. There is also a dearth of leadership and broad management skills in the financial sector in many African countries. One of the papers in this report also points to the need for financial centres to market themselves effectively to international investors. This is also a skills issue.

The current culture in financial markets in Africa is such that private entities routinely underinvest in skills development. Donors can help fill this gap by providing financial support for systemic interventions (such as the development of certification systems) as well as technical and management training (preferably on a cost-share basis and preferably involving local training institutions such as business schools). The paper by Michael Fuchs also argues that it may be worthwhile to subsidise private equity funds in order to make the expertise of fund managers more accessible to SMEs.

Considerable effort needs to be made to work with training delivery techniques that could be more effective than classroom-based approaches whose track record has been quite disappointing.

Subsidy

There may be circumstances in which it may be justified to use donor funding for financing investments. Donor agencies will each have their own rules as to when it is appropriate to intervene in markets but, typically, subsidy can be justified (i) for demonstration purposes—for example, to trial a new product; or (ii), to crowd in third-party capital—for example, through the use of "first loss" instruments or tiered capital structures.

It is often said that African capital markets are not particularly innovative. Donors could help to catalyse the development of new investment products by supporting product design processes, and underwriting the public issuance of new kinds of product.

More controversially, donors could support market intermediaries, the dealmakers who have the skills, networks and incentives to create investment transactions. African capital markets do not have a culture of paying financial advisers fees (except on success) and there are few investment banking businesses that are able to absorb deal origination costs, especially in markets that are generally more unpredictable than those in developed economies and where there are simply fewer viable transactions.

There is greater recognition in the donor community that investment instruments are often a more appropriate means to achieving development outcomes than grants, and may result in less market distortion (i.e., uneven playing fields). Besides their ability to leverage private capital, thereby making more capital available to the market, investment instruments encourage partners (i.e., investees) to take risks without *transferring* risk, which is what happens with grants. Thus, they require that partners properly assess risks and think through the achievability of goals and how to best allocate capital in the most efficient way.

Conclusion

It goes without saying that donors cannot do everything (and obviously should not attempt to do so). However, *Conduits of Capital* has shown that in nascent markets there are numerous entry points where donors can play a constructive role investing in "soft" market infrastructure, such as regulation and skills. This requires effective market facilitation and intervening where there is a clear market-building opportunity to do so, but avoiding becoming a market player where possible. The guiding principle should be to provide the real market actors with the resources they need to carry out their functions effectively—occasionally providing funding, but more often access to information, networks and skills.

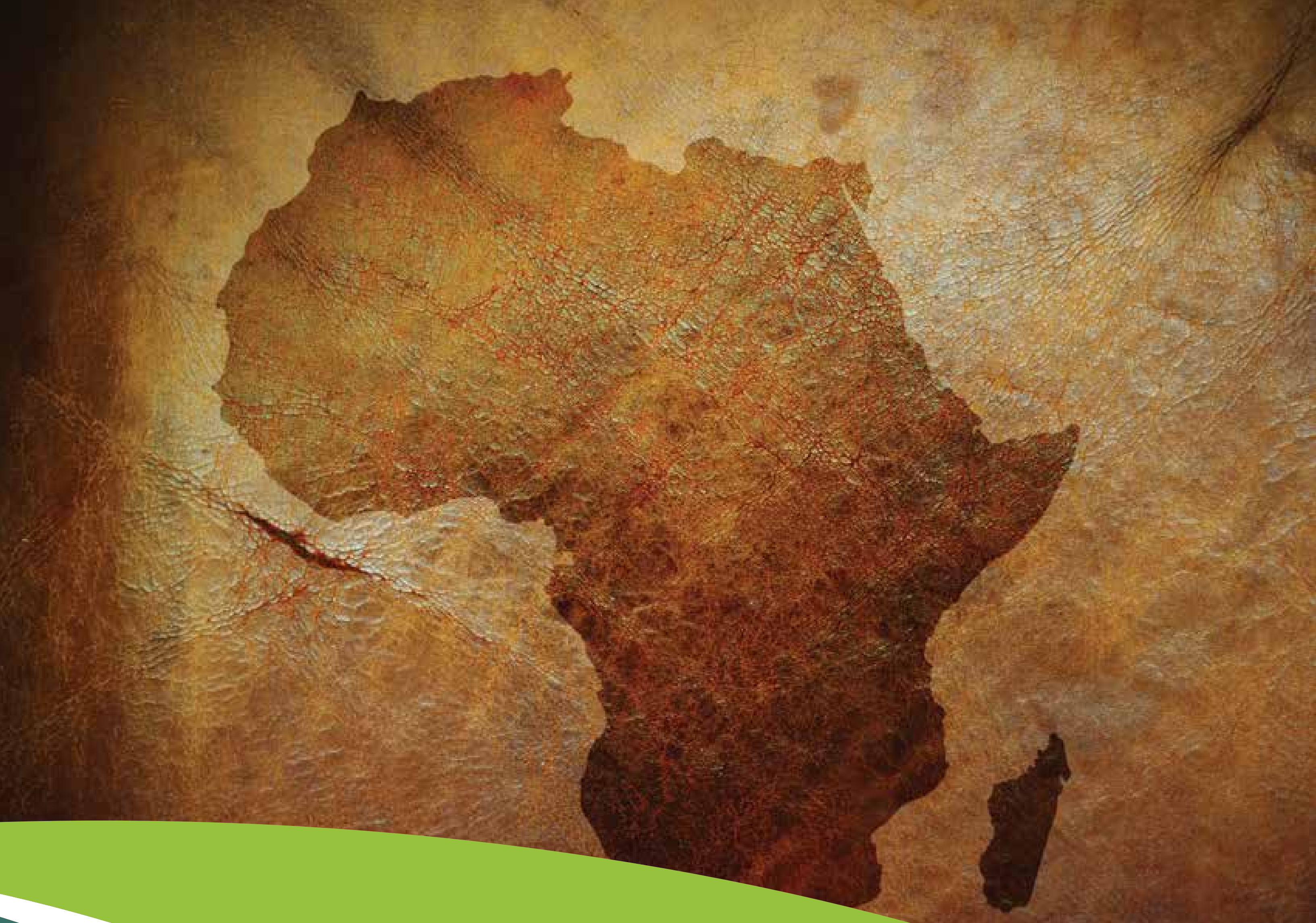
Our hope with *Conduits of Capital* is that it will lead to a better understanding of what needs to be done to create viable onshore financial centres in Sub-Saharan Africa, and how donors can play a supportive role in accelerating their development.

No one is pretending this is an easy task. For centres such as Nairobi or Lagos, they will have to either outcompete Mauritius at its own game, which they will find very difficult (as Michael Fuchs argues in his paper), or commit to creating a new kind of financial centre which offers advantages (not least locational advantages such as proximity to investment opportunities) that Mauritius can never offer. Moreover, they must do so whilst ushering in the basic regulatory and tax reforms which international investors regard as a prerequisite.

Michael Mainelli from Z/Yen describes this as "getting real"—setting proper targets, being accountable for delivery of these targets and ensuring that real political capital is invested in the achievement of those targets.

We hope that this publication assists all stakeholders in "getting real" about the challenges of building onshore financial centres, but that it also demonstrates the agency we all have in driving toward a more financially inclusive future.

Mark Napier
Director, FSD Africa
October 2015



Industry Views:

EMPEA 2015 African Fund Domicile Survey

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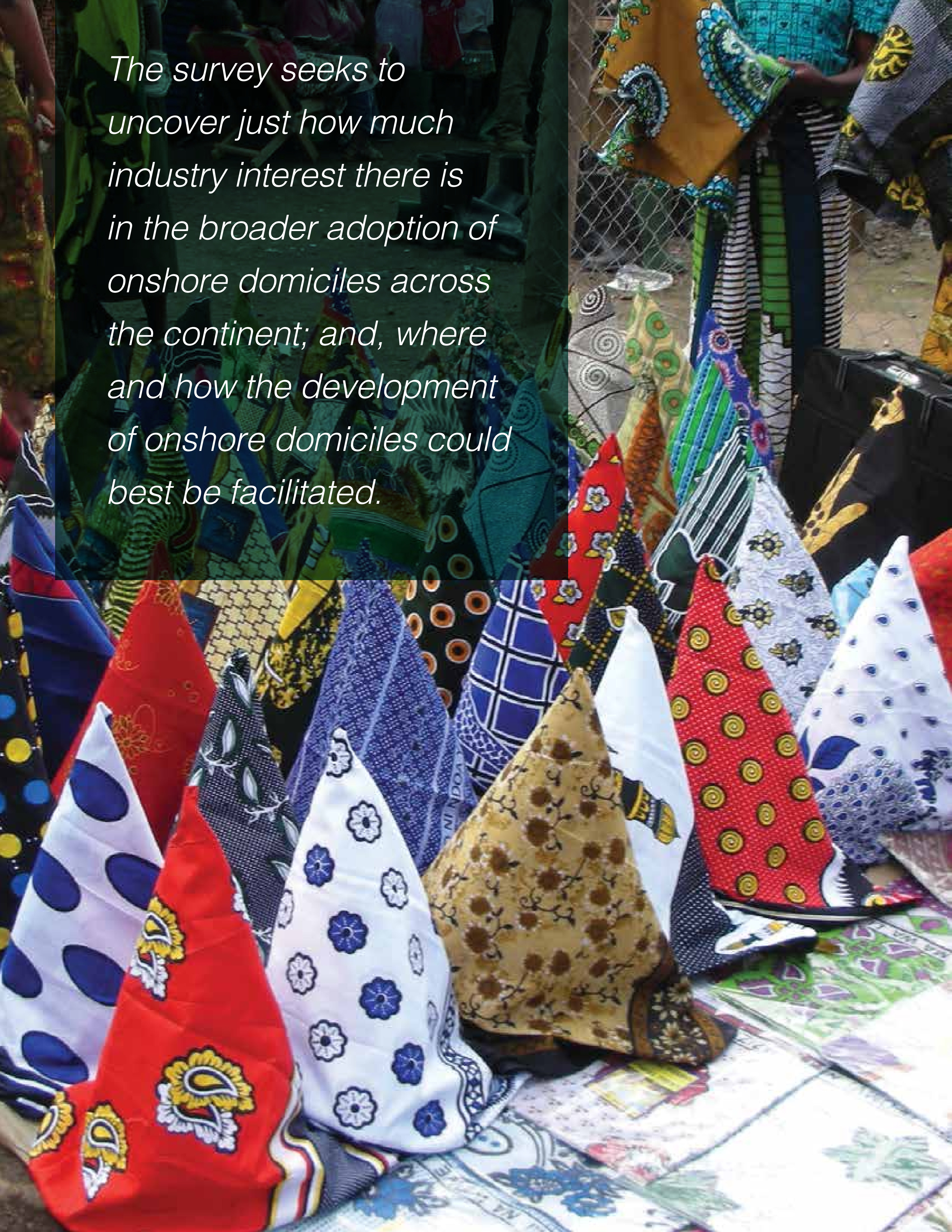


The survey seeks to uncover just how much industry interest there is in the broader adoption of onshore domiciles across the continent; and, where and how the development of onshore domiciles could best be facilitated.

EXECUTIVE SUMMARY

In April 2015, FSD Africa (FSDA) and EMPEA Consulting Services surveyed 118 individuals active in Sub-Saharan African private equity from over 90 firms in order to better understand how industry participants view fund domiciles—both onshore and offshore—including how satisfied they are with their current jurisdictions and which factors are most important to them when choosing a location for their funds. The survey also seeks to uncover just how much industry interest there is in the broader adoption of onshore domiciles across the continent; and, where and how the development of onshore domiciles could best be facilitated. We hope the findings of this analysis provide the industry—and stakeholders more broadly—with a greater understanding of the role that fund domiciles play as conduits for investment into Sub-Saharan Africa, why they are important for private equity participants and partners, and what can be done to improve both existing and new potential jurisdictions.

Key findings from the *EMPEA 2015 African Fund Domicile Survey* include:

I. **The use of offshore jurisdictions is standard practice for Sub-Saharan Africa's private equity industry.** The majority of the 59 GPs participating in the survey (nearly 75%) have chosen an offshore jurisdiction for their largest currently active private equity fund, with Mauritius leading as the most popular jurisdiction (30) followed by Jersey / Guernsey (5). Of those fund managers who have chosen an onshore jurisdiction, most (13) are structured in South Africa.

II. **The prevalence of offshore structures—including the use of Mauritius—is largely explained by the weight industry participants place on a domicile's tax efficiency for distributions.** Approximately 61% of GPs and 64% of SPs cite this consideration as important in a fund domicile. Of note, LPs place greater importance on transparency than tax efficiency, with 44% citing it as a leading factor in their preference for a fund domicile.

III. **The vast majority of the industry views Mauritius favourably despite the fact that the market has come under political criticism in recent years, and is viewed suspiciously by some civil society groups.** GPs with vehicles domiciled in Mauritius give it a high approval rating, with 97% of respondents reporting that they are satisfied or very satisfied with the jurisdiction. When asked if they had any concerns about Mauritius as a domicile, only 17% of all survey participants responded yes—a ratio that is relatively consistent across LP, GP and SP respondents.

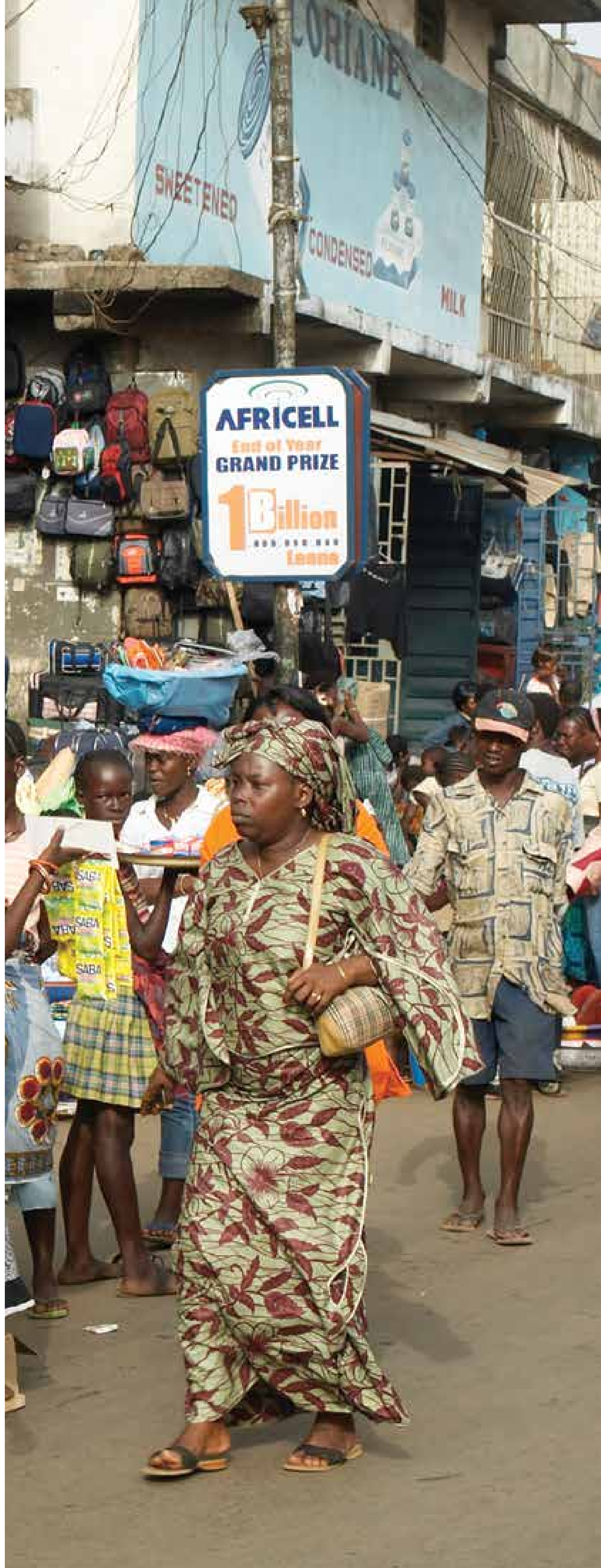
IV. **Concerns about Mauritius appear to be stronger among DFIs**, with 33% of DFIs expressing caution compared to 17% of all LPs. Moreover, 75% of the total LP respondents who expressed concerns about Mauritius were representatives from DFIs. In general, LPs' biggest concerns pertain to transparency and exchange of tax information, and the degree of civil society / political criticism attendant with the domicile, whilst GPs—perhaps unsurprisingly—are primarily worried about LP concerns. That said, the attitude of DFIs toward Mauritius differs by institution. Some DFIs do not have an issue with Mauritius per se, but rather with the tax treatment of certain corporate investment vehicles permissible in the country, which they regard as a harmful tax practice.

V. **Despite the prevalence of offshore funds in the industry, the majority of the GP and LP survey participants have experience with—or have expressed an openness to—onshore fund domiciles.** With respect to the GPs, 26% report that they relied upon onshore domiciles for parallel / feeder funds as part of a broader fundraising effort, whilst 20% relied exclusively upon an onshore domicile. An additional 31% of GPs would consider domiciling in an onshore African country in the next three to five years. In the case of LPs, 46% of surveyed participants have committed to an onshore vehicle while an additional 44% would consider doing so.

VI. **South Africa is viewed as the most attractive onshore fund domicile in Sub-Saharan Africa.** When asked to rank the leading onshore African fund domiciles, survey respondents listed South Africa as the most attractive market with 102 of the 118 survey respondents ranking it as one of their top three onshore African fund domiciles. South Africa was followed by Kenya, Botswana and Nigeria, which garnered 65, 47, and 35 votes, respectively. Other notable jurisdictions receiving interest include Morocco, Ghana, Rwanda, Tunisia and Egypt.

VII. **Greater use of most onshore jurisdictions, including South Africa, is inhibited by the quality of local legal and regulatory environments.** In South Africa, tax and cost competitiveness join the legal and regulatory environment as leading inhibitors, while political stability is the second-biggest hurdle in Kenya, and the availability of skilled human capital and efficient support services are cited as core challenges in Botswana. This finding maps to survey responses regarding what is important to participants when considering a fund domicile: a sound legal and regulatory environment, tax competitiveness and political stability.

VIII. **Survey respondents would advise stakeholders who are interested in promoting the broader adoption of onshore domiciles by Sub-Saharan Africa-dedicated private equity funds to focus on strengthening legal and regulatory environments and implementing tax reforms.** These two actions received 69% and 56% of survey respondents' votes, respectively.



INTRODUCTION

Across the emerging markets, private companies face two persistent growth constraints: expansion capital and expertise.[1] Frequently, small and mid-size businesses are unable to secure bank lending to finance their aspirations for growth, particularly if they lack hard assets that can serve as collateral. Local banks often tend to prefer vanilla, asset-based—and frequently short-term—lending, and shy away from cash flow-based lending, let alone more exotic structures. Moreover, for the most part, local capital markets remain out of reach for all but the largest emerging market companies.

In addition to the financing gap, companies frequently face an expertise, or human capital, gap. Whether it's corporate governance, financial management or operations, there are often many international standards and efficiencies that can be implemented to enhance an emerging market company's enterprise value. These two constraints of financial and human capital are particularly evident in Sub-Saharan Africa, the focus of this report.

Private equity is uniquely suited to fill these gaps. On the one hand, private equity fund managers are a source of long-term, patient capital that can help to finance a company's growth. On the other, private equity fund managers can take companies to their next level of development by instilling management expertise, inculcating global best practices, and leveraging experience and networks to help companies achieve scale—either organically or through acquisitions. Indeed, private equity fund managers are incentivised to work closely with entrepreneurs and company management teams to create value—it is how they make money.

OVERVIEW OF PRIVATE EQUITY FUND STRUCTURING AND CONSIDERATIONS

Private equity funds are typically structured as limited partnerships, wherein the fund sponsor (the private equity fund manager, or general partner (GP)) raises capital from qualified investors (limited partners or LPs) for a pooled fund, whose capital the GP then invests in portfolio companies.[2] The LPs retain limited liability (meaning their financial liability is limited only to the amount that they have committed to the fund), whilst the GP, which retains decision-making authority, faces unlimited liability.

Many African private equity funds, however, are not structured as limited partnerships but as companies due to the popularity of Mauritius corporate structures for funds. Whilst there are significant differences between limited partnerships and corporate structures, the commercial terms for both tend to be similar.

The prevailing wisdom is that taxation and a credible legal and regulatory regime are the key drivers that LPs, GPs and their advisors contemplate when structuring a fund, along with limited liability for investors. In broad terms, there are three levels—the fund level, above the fund, and below the fund—that come into consideration.

- **The fund level** – fund vehicles are usually located in a jurisdiction that enables a limited partnership structure. The fund itself typically operates as a pass-through vehicle, and is often located in what the GP views as a tax-efficient jurisdiction so that there is minimal leakage of cash flows among the LPs, the fund and the underlying portfolio companies. In addition, the fund domicile may have investment and / or tax treaty networks with the market(s) the GP is targeting for deals, providing favourable tax treatment and enhanced legal protections. As noted above, corporate structures may be preferred in some jurisdictions, such as Mauritius.

[1] For more on this topic, see Roger Leeds, *Private Equity Investing in Emerging Markets* (Palgrave Macmillan: 2015).
[2] The content for this section is drawn from a Debevoise & Plimpton presentation, "Legal Strategies: Protecting GP Interests and Maintaining Competitive and Marketable Positioning to LPs," delivered at EMPEA's Fundraising Masterclass, held in Washington, DC on 14 May 2015. The information presented in this section should not be construed as legal, tax, investment or other advice.

- **Above the fund (i.e., where the LPs are based)** – some of the LPs that commit to private equity funds (e.g., banks, insurance companies, high net-worth individuals and family offices) face tax liabilities in their home jurisdictions, while others may enjoy tax exemptions (e.g., pension plans, endowments, international / development finance institutions). Regardless, a layer of tax at the fund level effectively reduces the net return to the LP, thereby decreasing the attractiveness of international investments. Tax efficiency in fund jurisdictions thus facilitates international capital flows, an important consideration for regions that suffer from a paucity of local financing, such as Sub-Saharan Africa.

- **Below the fund (i.e., where the portfolio companies are based)** – the selection of a fund domicile can impact the ease and flexibility with which a fund can deploy capital into a portfolio company. In addition to double taxation avoidance agreements (DTAAs)—bilateral agreements that seek to avoid or eliminate double taxation of the same income in both countries—some jurisdictions, such as Mauritius, have networks of investment promotion and protection agreements (IPPAs), which aim to provide equitable treatment of investments, protections against expropriation, and agreed-upon means of enforcement.

However, beyond taxation, there are additional factors that stakeholders consider in the fund domicile selection process. This survey seeks, among other goals, to determine just how important tax considerations are in selecting a fund domicile, while exploring market participants' overall views toward other hard (e.g., legal and regulatory regimes) and soft (e.g., availability of support services) components.

THE OFFSHORE ADVANTAGE

Given the considerations highlighted above, GPs frequently domicile their funds in offshore jurisdictions, which typically provide LPs limited liability and tax efficiency, and GPs the flexibility to identify, structure and deploy capital into promising portfolio companies. For example, of the 59 GPs that participated in this survey on African fund domiciles, nearly 75% report that they currently use an offshore jurisdiction for their current fund domicile (e.g., Mauritius, Jersey / Guernsey, Cayman Islands, British Virgin Islands). Moreover, of the African Development Bank's 38 approved commitments to Africa-focussed funds as of January 2014, the majority were legally domiciled in Mauritius.[3] Clearly, market participants are comfortable and familiar with offshore structures, and it is a model that has facilitated capital flows to Africa.

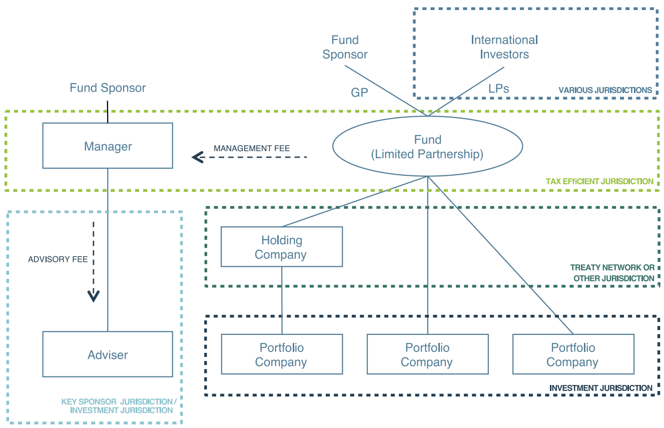
THE ONSHORE PUSH

In spite of the attractiveness of offshore jurisdictions—covered later in this study—two forces are contributing to a growing interest in the use of onshore jurisdictions in fund structures. Outside Africa, some global investors have cited concerns about transparency, harmful tax practices and civil society criticism of offshore jurisdictions, prompting a push to onshore international investment activity.

Within Africa, local institutional investors, such as pension funds, are increasingly looking to private equity as a potential means of driving performance and diversifying their investment portfolios. As a result, some are encouraging GPs to create onshore fund structures so that they may make commitments and build experience with the asset class, whilst maintaining compliance with local regulations. This nascent, but important, pool of capital is one that could unlock more than US$29 billion in capital for private equity investment in Africa.[4]

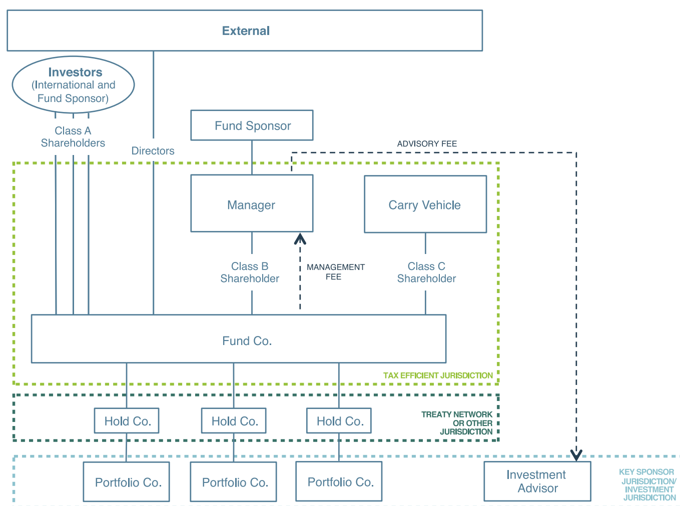
[3] African Development Bank, *Mauritius: Country Strategy Paper 2014-2018*, January 2014, Annex 9.
[4] Commonwealth Secretariat, EMPEA and Making Finance Work for Africa, *Pension Funds and Private Equity: Unlocking Africa's Potential*, 2014.

Example partnership fund structure



Source: Debevoise & Plimpton LLP.

Example corporate fund structure



Source: CDC Group plc.

As a general rule, GPs tend to follow their LPs' leads when considering fund domiciles. Today, some market participants are creating parallel funds in onshore jurisdictions, such as Nigeria, to raise local capital as part of a broader fundraising effort. Yet these dual structures can raise complications in terms of running a blind pool vehicle, ensuring limited liability for LPs and maintaining alignment of interest amongst fund participants. The devil, as they say, is in the details.

THE INDUSTRY VIEW

This survey is an attempt to uncover more of those details, exploring how Sub-Saharan Africa-focussed private equity participants currently view fund domiciles—both onshore and offshore—including how satisfied they are with their current jurisdictions and which factors are most important to them when choosing a location for their funds. The survey also seeks to understand how much industry interest there is in the broader adoption of onshore domiciles across the continent; and, where and how the development of onshore domiciles could best be facilitated. We hope the findings of this analysis provide the industry—and stakeholders more broadly—with a greater understanding of the role that fund domiciles play as conduits for investment into Sub-Saharan Africa, why they are important for private equity participants and partners, and what can be done to improve both existing and new potential jurisdictions.

RESPONDENT PROFILE AND GLOSSARY OF TERMS

In April 2015, FSD Africa (FSDA) and EMPEA Consulting Services surveyed 118 individuals active in Sub-Saharan African private equity from over 90 firms. The respondents represent limited partners (LPs), general partners (GPs) and service providers (SPs) headquartered across more than 30 countries, with 39% of respondents from firms based in Sub-Saharan Africa.

To glean qualitative insights that complement the survey's quantitative findings, FSD Africa and EMPEA Consulting Services also conducted structured interviews with approximately a dozen stakeholders representing a blend of local and international constituencies, as well as country-focussed, sub-regional, pan-African and global private equity strategies.

For greater detail on the survey respondents, please see Appendix 1 (page 37).

Exhibit 1: Respondents by firm type

% of respondents

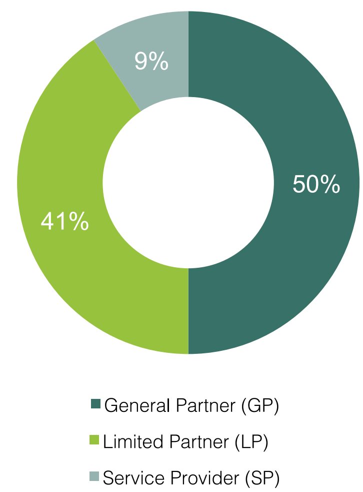
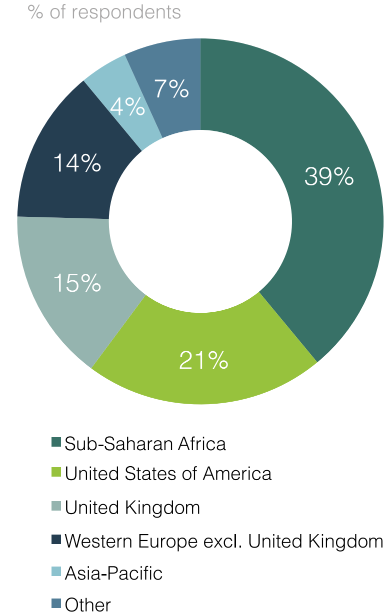


Exhibit 2: Respondents by location

% of respondents



GLOSSARY OF TERMS AND SURVEY DEFINITIONS

"Africa" refers to all 54 countries comprising the African continent.

"Alternative Investment Fund Managers Directive" (abbreviated to "AIFMD") is a European Union directive governing the regulation—including management, administration and marketing—of alternative investment funds operating in the European Union.

"Blind pool vehicle" refers to a pool of investment capital raised by a fund manager from third-party investors, who have no involvement in the decision making as to how the capital is invested.

"DFI" refers to a development finance institution with a private equity fund investment program.

"Dual structures" refers to a private equity fund that operates two parallel vehicles, one offshore and one onshore. The offshore structure often caters to international limited partners, while the onshore structure typically caters to domestic limited partners. There will typically be contractual arrangements between the two parallel vehicles to ensure an equitable participation in deals for both international and domestic limited partners.

"Foreign Account Tax Compliance Act" (abbreviated to "FATCA") is a US law aimed at foreign financial institutions and other financial intermediaries to reduce the levels of tax avoidance by both US citizens and entities through offshore accounts.

"Limited liability" refers to a situation in which an investor's financial liability is limited only to the amount that it has invested.

"Limited partners" (abbreviated to "LPs") are investors in PE funds.

"General partners" (abbreviated to "GPs") are investment managers of PE funds.

"North Africa" refers to Morocco, Algeria, Tunisia, Libya, Egypt and Sudan (but not South Sudan).

"Offshore" refers to a jurisdiction that is not located on the continent of Africa (e.g., Jersey / Guernsey, Cayman Islands, Luxembourg, etc.). Note that for the purposes of this survey, Mauritius is considered an "offshore" domicile, even though it is an African country.

"Onshore" refers to jurisdictions located on the continent of Africa, and excludes island nations (i.e., Mauritius).

"Pass-through vehicle" refers to an entity through which income flows to investors, potentially avoiding double taxation on revenue, dividends, etc.

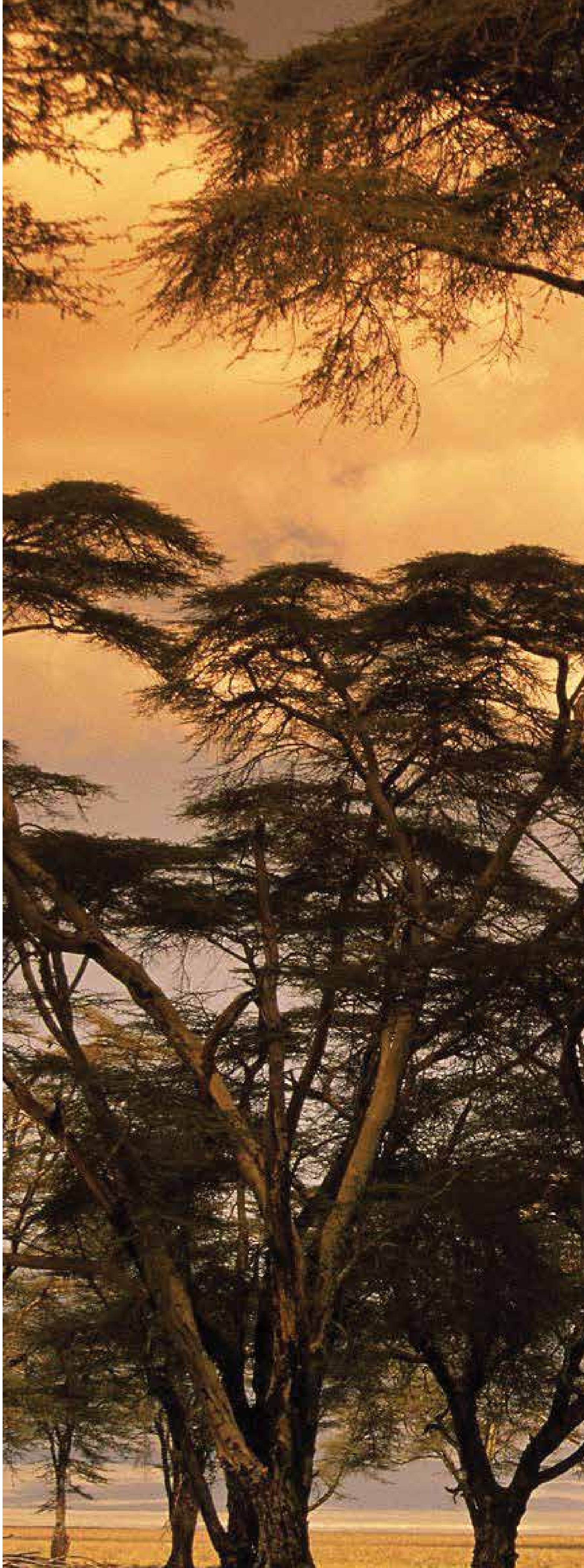
"Private equity" (abbreviated to "PE") encompasses leveraged buyouts, growth capital, venture capital, mezzanine and private credit investments.

"Service providers" (abbreviated to "SPs") refers to professional services firms catering to private equity funds such as law firms, accounting firms, fund administrators, placement agents, etc.

"Sub-Saharan Africa" (abbreviated to "SSA") refers to all African countries that are not constituents of North Africa.

"Transparency" in this report refers to the openness and consistency with which tax laws are applied, as well as clear and open exchange of tax information.

Note: In some exhibits, percentages may not sum to 100% due to rounding.

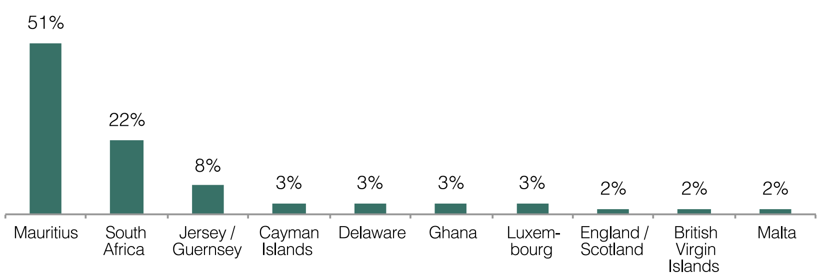


THE CURRENT STATE OF PLAY FOR SUB-SAHARAN AFRICA-FOCUSSED PRIVATE EQUITY FUND DOMICILES

While private equity in Sub-Saharan Africa remains a relatively nascent industry in comparison to other emerging market regions, interest in the subcontinent has exploded over the last several years. According to EMPEA data, US$12.8 billion has been raised for Sub-Saharan Africa-focussed private equity funds between January 2010 and March 2015, while EMPEA's annual *Global Limited Partners Survey* reveals that the region has ranked as one of the top three most attractive emerging markets for private equity investment over the last three years. This dynamic has resulted in a growing number of new entrants—both local and global—investing in the region, as well as an increase in the number of fund managers raising larger vehicles (US$700+ million funds).

Exhibit 3: Nearly 75% of GP respondents utilise an offshore location for their current fund domicile

% of GP respondents



Where are these funds being domiciled? The survey asked fund managers to identify the location of their largest currently active fund. Among the 59 GPs that participated in the survey, the majority (nearly 75%) have chosen an offshore jurisdiction. In particular, 30 have chosen to domicile their current fund in Mauritius, followed by five domiciled in Jersey / Guernsey. The balance of offshore fund domicile locations represents a geographically disparate collection of jurisdictions. Of those fund managers who have chosen an onshore jurisdiction, most (13) are structured in South Africa. It is important to note that surveyed GPs have selected jurisdictions with extant legal and regulatory frameworks that are largely conducive to the private funds industry.

Overall, GPs report that they are pleased with their current fund domicile, with 90% of firms stating that they are either satisfied or very satisfied. GPs with vehicles domiciled in Mauritius are particularly content, with 97% of respondents reporting that they are satisfied or very satisfied with the jurisdiction. In addition, whilst South Africa is the most frequently utilised onshore domicile, satisfaction is relatively low compared to other jurisdictions.

WHAT ACCOUNTS FOR THE POPULARITY OF, AND SATISFACTION WITH, OFFSHORE FUND DOMICILES?

To better understand why certain fund domiciles are chosen for Sub-Saharan Africa-focussed funds, the survey asked respondents which factors are of greatest importance to them when considering a jurisdiction. However, we first sought to determine how material fund domiciles are overall to the private equity industry by asking all GP, LP and SP respondents to indicate how important a jurisdiction is to their fundraising and allocation decisions. Seventy-five survey respondents—nearly 65% of the total—believe the location of a fund is either important or very important in their—or their clients'—decision to raise or commit to a fund, while only 10% report that a fund's domicile is not important. For more detail on how firm type, respondent location and experience with Sub-Saharan African private equity impact views on the importance of fund jurisdictions, please see *Spotlight: The Import of Fund Domiciles in Fundraising and Allocation Decisions.*

When asked why—in general—the location of a fund domicile is important to their allocation / fundraising decisions, respondents relay that tax efficiency for distributions is the leading factor, which may explain the preference toward offshore domiciles. Tax efficiency for distributions was ranked as an important consideration by 47% of all respondents, followed by transparency (43%) and tax treaties with target markets (28%).

However, LPs and GPs differ in their opinions on which factors are most important with regard to the location of a fund's domicile. (SP views are generally in line with those expressed by GPs). Over 61% of GP respondents consider tax efficiency for distributions to be an important issue, and they give greater weight to tax treaties with target markets (39%) than LPs do (10%). In contrast, LPs place greater importance on transparency and reputational risk than GPs do.

Exhibit 4: 90% of GPs are satisfied with their current fund domicile

Degree of satisfaction with current domicile | % of GP respondents

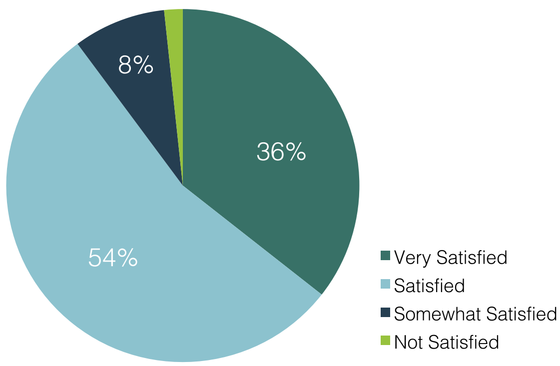


Exhibit 5: Among the three most commonly used domiciles, South Africa has the least GP satisfaction with the jurisdiction

Degree of satisfaction with current domicile | % of GP respondents

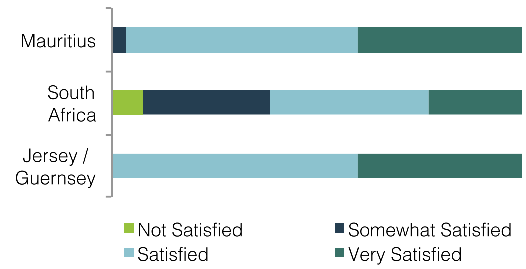


Exhibit 6: Only 10% of respondents state that the location of a fund domicile is not important in their allocation / fundraising decisions

% of respondents

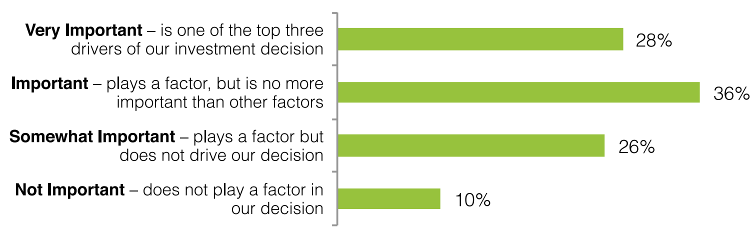


Exhibit 7: Tax treatment and transparency are the most important issues in the location of a domicile

Why the location of a fund is important | % of respondents ranking factor as important

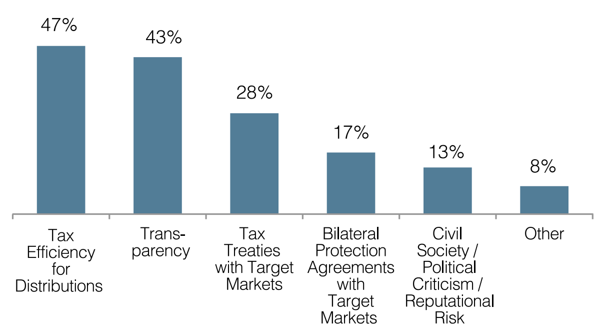
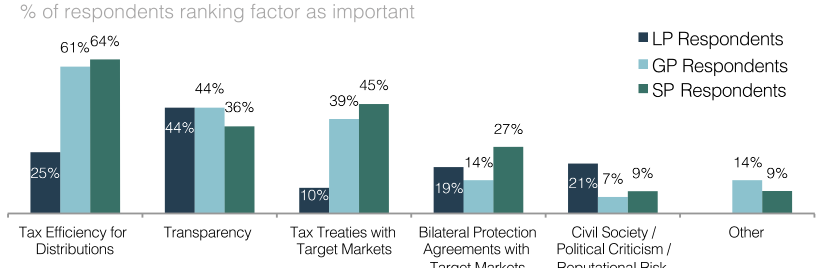


Exhibit 8: LPs prioritise transparency whilst GPs and SPs focus on tax efficiencies and tax treaty networks

Why the location of a fund is important to allocation / fundraising decisions

% of respondents ranking factor as important



Responses to "Other" include:

"The demands of some investors."

"Avoidance of currency exchange risk."

"Proximity to deal environment and networks."

STAKEHOLDER VIEWS ON KEY FACTORS IN CHOOSING A FUND DOMICILE:

"The first driver of our decision of where to domicile a fund is of course tax optimisation for our LPs; second is tax optimisation for us; third is regulatory approvals and regulatory burden; and, fourth is the composition of our LPs—some of whom face constraints with certain jurisdictions, such as Cayman."

– Sub-Regional GP

"The most important factor for us when evaluating a fund domicile is the limited liability status of the investors. It has to be watertight."

– Fund of Funds

"An important variable for us was the ability to use one global administrator. At the time we launched our most recent fund-raise, we had no idea whether we would have one fund vehicle or a number of parallel vehicles, nor did we know where they would be domiciled."

– Pan-African GP

THE ROLE OF MAURITIUS IN SUB-SAHARAN AFRICAN PRIVATE EQUITY

The importance industry participants place on tax efficiency in a fund domicile helps to explain why Mauritius has emerged as the preferred jurisdiction for fund vehicles targeting investments in Sub-Saharan Africa. Mauritius has implemented a lean effective corporate tax rate. It maintains zero taxes on capital gains and has very low or often zero effective rates on dividends. This creates a relatively neutral environment for investment funds that pool capital from limited partners located across the globe, each of which faces its own idiosyncratic tax code and reporting requirements.

Source: https://en.wikipedia.org/wiki/Ebene_CyberCity.

Moreover, Mauritius has built up a robust network of double taxation agreements and investment promotion and protection agreements with Sub-Saharan African countries. These not only provide limited partners with tax efficiency, but they also offer fund managers a greater ability to enforce contracts. Mauritius has an increasingly experienced pool of professional advisors—accountants, administrators, arbitrators and lawyers—who are familiar with fund administration, structuring and dispute resolution. Its judiciary increasingly deals with fund-related matters. In addition, as one experienced private equity lawyer relays, "Mauritius is part of the Commonwealth, and, as such, any appeals of Mauritius legal decisions go to the Privy Council in London. So there is a reliability and robustness of the legal regime that is very important to investors and fund managers."

Nonetheless, Mauritius, similar to other offshore and onshore financial centres, has come under political criticism in recent years and is viewed suspiciously by some civil society groups.[5] To get a better sense of industry views, the survey asked participants if they had any concerns about Mauritius as a domicile. In response, only 17% of respondents report that Mauritius raises concerns as a domicile—a ratio that is relatively consistent across LP, GP and SP respondents.

[5] For example, some of the concerns that civil society groups have raised include clarity over corporate ownership and control, tax evasion, money laundering, secrecy and non-disclosure over banking, financial and tax information.

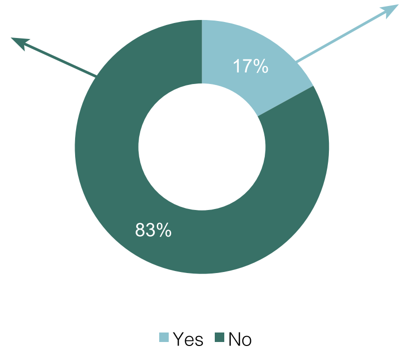
"The industry has found a very safe model in Mauritius that works and that everybody loves."

"Mauritius has wholeheartedly embraced FATCA,* so it is ahead of other jurisdictions on that front, as well as on money laundering, anti-bribery and other investor protections. Mauritius has really tried to be at the forefront of these issues."

** See Glossary of Terms for more information on FATCA.*

Exhibit 9: Does Mauritius raise concerns as a fund domicile?

% of respondents



"South African tax authorities treat Mauritius with suspicion no matter what the tax treaties say."

"We have concerns over the level of expertise and availability of professionals in private equity."

"The partnership law remains untested."

"High overhead costs."

A CLOSER LOOK AT LPS AND GPS THAT HAVE CONCERNS WITH MAURITIUS

For those respondents who do have concerns with Mauritius, opinions diverge on why the jurisdiction raises concerns as a fund domicile. LPs' biggest concerns pertain to transparency and exchange of tax information, and the degree of civil society / political criticism attendant with the domicile, whilst GPs—perhaps unsurprisingly—are primarily worried about LP concerns. (Only two SPs expressed concerns with Mauritius.) The percentage of LP respondents highlighting the impact of civil society / political criticism (at 30%), is an intriguing finding, small sample size notwithstanding. One hypothesis why this might be the case is that DFIs play a critical role as a source of capital for Sub-Saharan Africa-focussed private equity funds. Assessing this theory requires taking a closer look at the LP base constituting this data set.

LP concerns about Mauritius appear to be strongest among DFIs, with 33% of DFIs expressing caution compared to 17% of all LPs. Moreover, 75% of the total LP respondents who expressed concerns about Mauritius were representatives from DFIs. Given that these organisations have a developmental mandate and often deploy taxpayer funds, one could reasonably infer that politics in their home countries are shaping perceptions toward Mauritius. It is worth noting, however, that the attitude of DFIs toward Mauritius differs by institution. One DFI reportedly has a strong preference for investing through Mauritius-domiciled funds, while another invests sparingly and then only through particular investment structures (typically a Mauritius limited partnership). Some DFIs do not have an issue with Mauritius per se but with the tax treatment of certain corporate investment vehicles permissible in the country. Notably, whilst pension fund respondents express more concerns about the reputational risks of a given domicile than other types of LPs participating in the survey, no pension funds—either public or corporate—reported concerns over Mauritius.

Exhibit 10: Amongst those who have concerns LPs are primarily worried about transparency and civil society / political criticism

% of respondents by firm type

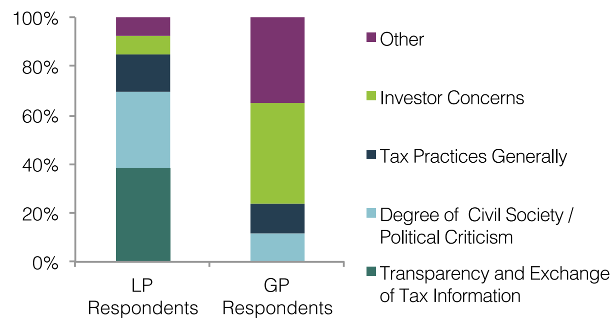
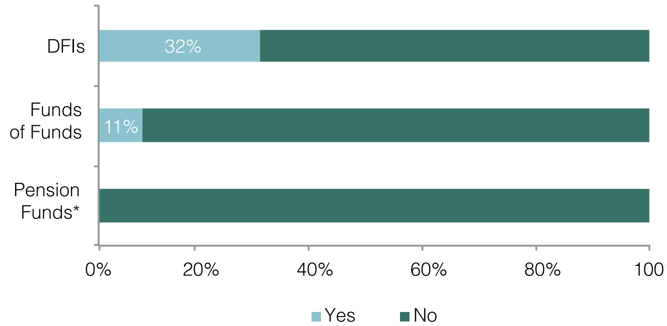


Exhibit 11: Amongst LPs, DFIs expressed the most concern about Mauritius, while pension funds shared none

Does Mauritius raise concerns as a fund domicile?

% of LP respondents by type



*Includes public and corporate pension funds.

STAKEHOLDER VIEWS ON MAURITUS:

"When it comes to investing in Africa, it would be highly unusual for us to make an investment directly from a fund. You would invariably engage in some transaction analysis, primarily driven by tax, which means that you will have one or more intermediate vehicles through which you will invest. That may be because of the particular requirements of the sponsor or the type of investment that you're making. It may be that you are bringing in a management team that is taking some kind of participation and their requirements dictate a certain structure; or, there may be a double-tax treaty you are trying to take advantage of."
– Pan-Emerging Market GP

"We invest across Sub-Saharan Africa, so no single specific local domicile would be efficient for the portfolio, the LPs or the GP. Furthermore, no Sub-Saharan African jurisdiction at present offers equal or better efficiencies than Mauritius."
– Sub-Saharan African GP

SPOTLIGHT: THE IMPORT OF FUND DOMICILES IN FUNDRAISING AND ALLOCATION DECISIONS

Although the majority (64%) of survey respondents view fund domiciles as important or very important in their—or their clients'—fundraising and allocation decisions, these aggregate figures mask some notable nuances by firm type, respondent location, and experience with Sub-Saharan African private equity.

Perspectives by LP Segment: While 50% of LPs indicate that the location of a fund domicile was either important or very important to a fund commitment decision, nearly 75% of GPs report this to be the case. One possible reason for this discrepancy between LP and GP perceptions could be that GPs think more closely about how tax impacts net returns to LPs. Another possible explanation could be a function of the fact that a number of Sub-Saharan Africa-focussed GPs rely heavily on development finance institutions (DFIs) as investors in their funds. Of note, 58% of DFI respondents reported that domiciles were important or very important compared to only 25% of public pension funds.

Exhibit 12: DFI respondents were two times as likely to say the location of a fund was important than public pension fund respondents
Importance of the location of a fund | % of respondents

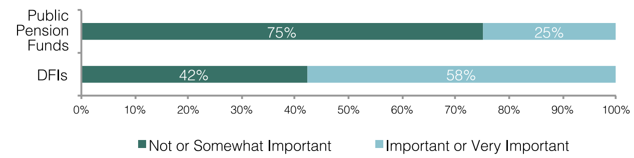


Exhibit 13: Respondents from Sub-Saharan Africa, Canada and the UK are more sensitive to the location of a fund
Importance of the location of a fund | % of respondents (excluding DFIs)

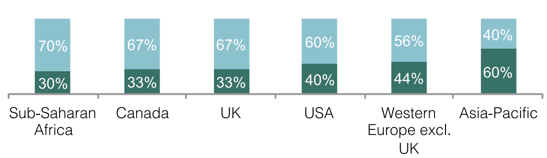
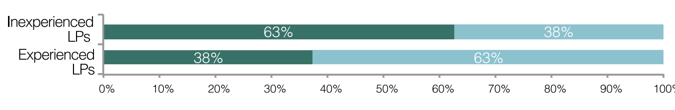


Exhibit 14: Experienced LPs attributed a greater importance to fund domiciles than inexperienced LPs
Importance of the location of a fund | % of respondents



Perspectives by Geographic Segment: More respondents from Sub-Saharan Africa, Canada and the UK deem the location of a domicile as important or very important to their fundraising / allocation decisions than those from Asia-Pacific economies.

Perspectives by Level of PE Experience: Experienced LPs—defined as those with more than six Sub-Saharan Africa-focussed funds in their portfolio—give more weight to the importance of the location of a fund's domicile than inexperienced LPs; 63% of experienced LPs report that the location of a domicile is either important or very important compared to 38% of inexperienced LPs. In contrast, regardless of their level of experience, GPs are more likely to say the location of a domicile is either important or very important in their decision to raise a fund.

INDUSTRY ATTITUDES TOWARD ONSHORE AFRICAN FUND DOMICILES

Nearly half of LP and GP respondents have either previously committed to or raised a fund vehicle domiciled onshore in Africa. With respect to the GPs, 25% of all respondents report that they have relied upon onshore domiciles for parallel / feeder funds as part of a broader fundraising effort, whilst 20% relied exclusively upon an onshore domicile. An additional 31% of GPs would consider domiciling in an onshore African country in the next three to five years. In the case of LPs, 46% of surveyed participants have committed to an onshore vehicle while an additional 44% would consider doing so.

However, 24% of GPs report that they would not consider an onshore domicile, compared to 10% of LPs. Of note, 36% of SP respondents noted that they would not advise their clients to consider funds domiciled in an onshore African country.

Perhaps unsurprisingly, local LPs and GPs are more likely to utilise onshore domiciles than their global counterparts on a percentage basis; however in absolute terms, more non-Sub-Saharan Africa-based LPs have committed to funds domiciled onshore. Experienced firms—defined as LPs with more than six Sub-Saharan Africa-focussed funds in their portfolios, or GPs that manage two or more Sub-Saharan Africa-focussed funds—are more likely to commit to, or raise, funds through onshore vehicles. From a GP perspective this is likely due to the fact that many of the more experienced fund managers are based in South Africa or Nigeria, and have been able to raise capital from both local investors and international LPs.

Exhibit 15: Have you committed to a fund domiciled onshore in Africa? // LP cut

"Onshore jurisdictions are not tax efficient for us."

"The reputational risk is too high."

"We require the rule of law, transparency, and experience."

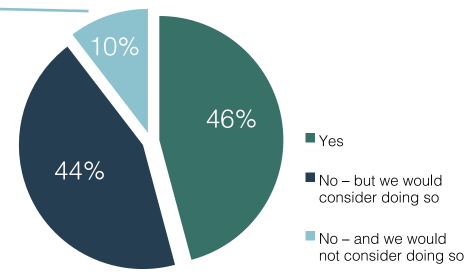


Exhibit 16: Have you raised a fund domiciled onshore in Africa? // GP cut

"Onshore domiciles currently are not accepted by our LPs, but that could always change with the right governance."

"Taxation—as it impacts distributions—and transparency are key issues requiring that we use domiciles that have acceptable track records for LPs."

"Onshore Sub-Saharan African countries are too complicated, regulations are cumbersome, processes slow and regulatory stability low."

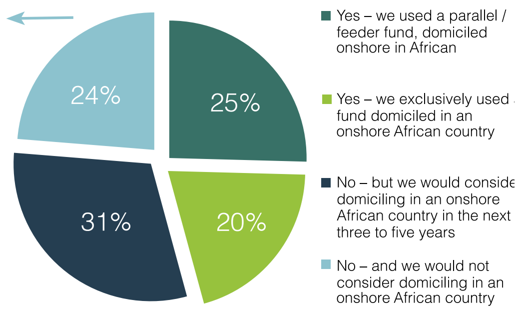
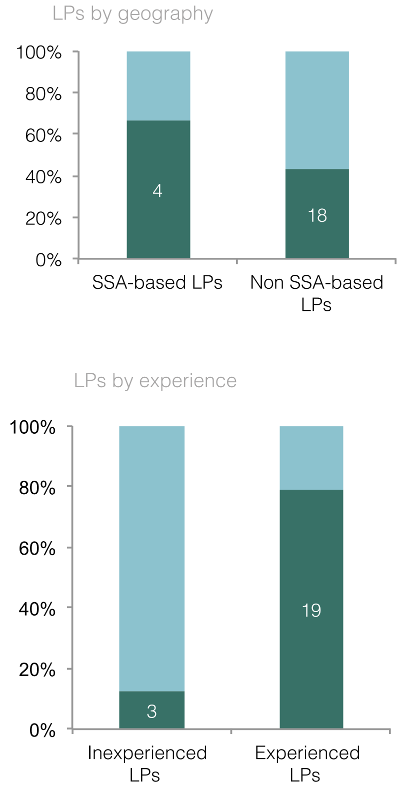
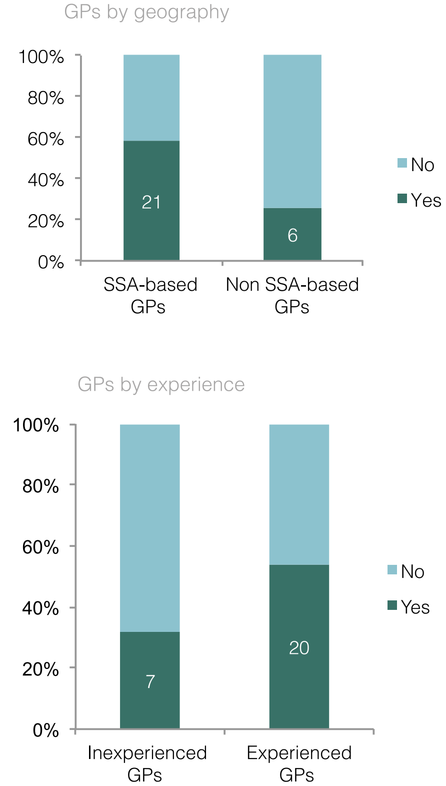


Exhibit 17:
Have you committed to a fund domiciled onshore in Africa?



Have you raised a fund domiciled onshore in Africa?



STAKEHOLDER VIEWS ON THE USE OF ONSHORE STRUCTURES FOR SUB-SAHARAN AFRICAN PE FUNDS:

"If I were to speculate, I think it is probably only a matter of time before we get to a position where developed market taxpayers question how it would be appropriate for a government-owned DFI to be investing in Africa through structures that use an offshore location. These structures are all about reducing the tax leakage for investors, which means less tax revenue taken by the government of the jurisdiction in which the company has its operations.

It is quite possible that LPs, and particularly DFIs, will become much more sensitive to structuring through offshore locations. That then gives you a proper problem in that you may have investors in your fund who are not aligned—those that are interested in achieving an optimal tax structure and those for whom this is a negative."

– Pan-Emerging Market GP

"One of the problems with being onshore in Africa is that you become more susceptible to local politics. Also, you're not going to have the number of bilateral tax treaties and investment treaties, or the level of development and depth of expertise with globally prevailing norms such as FATCA and the European equivalent of FATCA. We are able to mobilise investment into Sub-Saharan Africa because our investors will pay tax where they are based, but they don't want to pay two or three levels of tax, which would reduce the attraction of investing."

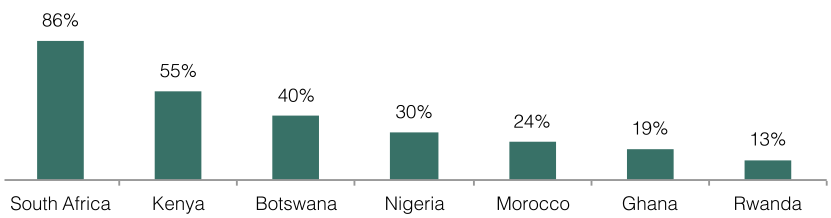
– Pan-African GP

A RANKING OF ONSHORE FUND DOMICILES

When asked to rank the leading onshore African fund domiciles, survey respondents view South Africa as the most attractive market with 102 of the 118 survey respondents ranking it as one of the top three onshore African fund domiciles (see *Spotlight: Making Sense of South Africa*). South Africa was followed by Kenya, Botswana and Nigeria, which garnered 65, 47, and 35 votes, respectively. Notably, these countries have some of the largest pools of local pension capital that could be available for private equity investment, which may, in part, explain industry interest in these markets as onshore fund domiciles. Other notable jurisdictions receiving interest include Morocco, Ghana, Rwanda, Tunisia and Egypt.

Exhibit 18: Respondents view South Africa, Kenya and Botswana as the most attractive onshore domiciles

Ranking of onshore domiciles by attractiveness | % of respondents voting for market



STAKEHOLDER VIEWS ON POTENTIALLY ATTRACTIVE ONSHORE AFRICAN FUND DOMICILES:

"Kenya and Nigeria are hubs for East and West Africa, respectively, and there is a lot of deal flow in those regions. They are also both common law-based jurisdictions. South Africa has the best DTA network after Mauritius, and is itself a large investment destination; however, it has exchange controls and a relatively high corporate tax rate. Botswana has a good DTA network, a good regulatory environment and is politically stable, but there is limited infrastructure and skilled human capital. Mauritius would generally be preferred."

– Service Provider

"Rwanda's progress has been impressive and it is one of the countries where one feels regulations will be well enforced. Moreover, I have heard that Rwanda will be trying to put in place advantageous tax treaties in the near future."

– LP

"One jurisdiction we believe could make it as an onshore financial centre is Rwanda. Its main industry is tourism, which drives a service-oriented economy. In addition, it is both a French- and English-speaking nation, has a good legal framework, and there is an ease of doing business. If it remains stable for the next five to ten years, Rwanda is a place where we would consider establishing a presence."

– Fund Administrator

SPOTLIGHT: MAKING SENSE OF SOUTH AFRICA

South Africa is the biggest and deepest market for private equity on the African continent. It also has one of the best-regulated capital markets in the world. So if one were looking for an onshore alternative, the immediate next step would be South Africa. – DFI

South Africa is a viable onshore domicile and that's because they have made huge strides to make the regulatory approval process to flow funds across borders, as well as the foreign exchange issue, much easier than they used to be. However, issues remain. – Private Equity Lawyer

How does one explain the seemingly contradictory findings that South Africa is ranked as the most attractive onshore domicile, whilst GP satisfaction with the jurisdiction is the lowest amongst all domiciles?

For starters, compared to every other Sub-Saharan African country, South Africa has a well-established private equity industry, with a healthy crop of financial institutions and experienced service providers; and—with 380 listed companies and a market cap of US$934 billion—the deepest capital markets in Africa.* In addition, the government has made moves to increase foreign investment into the country through, for example, the introduction of the Headquarter Company Regime, which took effect in January 2011. Thus, the private equity ecosystem is quite robust, with a demonstrable track record of GPs executing the full lifecycle of investment, value creation and exit. South Africa "ticks the box" in many respects.

However, the legal and regulatory environment and the country's tax policies continue to constrain GP satisfaction with the domicile. As one South Africa-based GP that utilises both onshore and Mauritius structures relays, "Ideally, we would love to have our funds purely onshore in South Africa. The primary concern for investors with other African countries as a domicilium for funds is exchange controls, followed by the tax and regulatory regimes."

The sentiments from this GP are broadly shared by his peers—of the 13 respondents with funds domiciled in South Africa, 11 are headquartered in the country.† As a number of local GPs are eyeing opportunities to expand their remit and deploy capital in other countries, South Africa's regulations—despite gradual improvements—continue to impinge upon their ability to do so—limiting their ability to offer international LPs, many of which may be interested in the market as a gateway to the broader continent, access to a more flexible regional or pan-African mandate in the process.

* As of 31 December 2014. PricewaterhouseCoopers, *IPO Watch Africa 2014* (January 2015).
† The two remaining respondents did not disclose the location of their firm's headquarters.

INHIBITORS TO GREATER USE OF ONSHORE DOMICILES

We asked each of the survey respondents to outline which factors were preventing them from using onshore fund domiciles to a greater extent. In each of the nine most-attractive onshore jurisdictions—save for Rwanda—the quality of the local legal and regulatory environment is the primary inhibitor to broader use of the country as a private equity fund domicile (see *Spotlight: What Constitutes a Sound Legal and Regulatory Environment?*). In South Africa, tax and cost competitiveness join the legal and regulatory environment as the leading inhibitors, while political stability is the second-biggest hurdle in Kenya, and the availability of skilled human capital and efficient support services are cited as core challenges in Botswana.

Exhibit 19:

RANK	MARKET	TOP FACTORS INHIBITING GREATER USE OF DOMICILE (% OF VOTES)				
1	South Africa	23% Legal & Regulatory Environment	20% Tax & Cost Competitiveness	15% Political Stability	14% Availability & Efficiency of Support Services	10% Availability of Skilled Human Capital
2	Kenya	23% Legal & Regulatory Environment	16% Political Stability	13% Availability & Efficiency of Support Services	13% Availability of Skilled Human Capital	12% Capital Markets Depth
3	Botswana	20% Legal & Regulatory Environment	20% Availability of Skilled Human Capital	19% Availability & Efficiency of Support Services	12% Tax & Cost Competitiveness	10% Political Stability // Capital Markets Depth (tied)
4	Nigeria	19% Legal & Regulatory Environment	17% Availability & Efficiency of Support Services	16% Availability of Skilled Human Capital	12% Political Stability	11% Capital Markets Depth
5	Morocco	24% Legal & Regulatory Environment	17% Availability & Efficiency of Support Services	14% Tax & Cost Competitiveness	13% Capital Markets Depth	11% Availability of Skilled Human Capital
6	Ghana	21% Legal & Regulatory Environment	20% Availability & Efficiency of Support Services	13% Availability of Skilled Human Capital	13% ICT Infrastructure	11% Political Stability // Capital Markets Depth (tied)
7	Rwanda	21% Availability of Skilled Human Capital	16% Legal & Regulatory Environment	16% Political Stability	16% Availability & Efficiency of Support Services	11% Tax & Cost Competitiveness
8	Tunisia	27% Legal & Regulatory Environment	18% Availability & Efficiency of Support Services	18% Tax & Cost Competitiveness	15% Political Stability	9% Availability of Skilled Human Capital
9	Egypt	20% Legal & Regulatory Environment	17% Political Stability	17% ICT Infrastructure	13% Availability & Efficiency of Support Services	13% Capital Markets Depth

STAKEHOLDER VIEWS ON LIMITATIONS OF ONSHORE AFRICAN FUND DOMICILES:

"It is very clear that the easiest way for foreign investors to invest in Africa is through a Mauritius domicilium. I don't think an onshore domicile gives one, as an investor, any greater advantage or disadvantage provided the onshore authorities have dealt with the necessary changes required to exchange controls, tax and regulatory regimes."

– South Africa-based GP

"The thing nobody is saying is that 'offshoring' actually gives you the flexibility you need to do deals across the continent. If we are to take away the 'offshoring' and bring it 'onshore,' would we have the same flexibility? And if you have to figure out rules for 54 countries, then God help you."

– Local LP View

"There are some major hurdles for an onshore jurisdiction to overcome to actually take off—this will take time. The first hurdle is demonstrating that it would be a neutral jurisdiction for all stakeholders; the second is building trust and a track record; and, the third is service orientation. All three of these are required. As an example, a domicile will fail if it does not have the service orientation—even though it has the funding, the legal framework and the buildings and facilities."

– Fund Administrator

"Most of the funds we invest in are domiciled in Mauritius and we are comfortable with this domicile. The location becomes much more an issue if a Sub-Saharan African fund is domiciled onshore. We have a very mixed experience with onshore Sub-Saharan African domiciles."

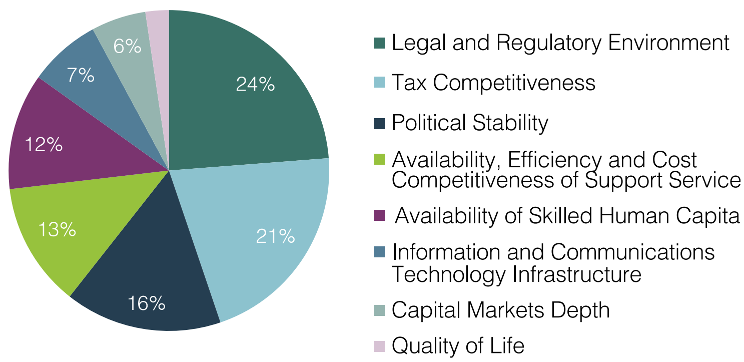
– International LP

WHAT COULD MAKE ONSHORE SUB-SAHARAN AFRICAN DOMICILES MORE VIABLE?

Respondents were asked to participate in a forced-weighting exercise to identify the most important factors they look for when considering any given fund domicile. Each respondent was given 100 points to allocate toward eight factors, with a greater number of points being allocated to the factors having greatest importance. While sentiment by firm type differs, there is a general consensus on what is important in a fund domicile: a sound legal and regulatory environment, tax competitiveness and political stability are the key drivers, followed by the availability, efficiency and cost competitiveness of support services, and the availability of skilled human capital.

Exhibit 20: A sound legal and regulatory environment and competitive tax practices are the most crucial factors in a fund domicile

Cumulative weight given by respondents to most important factors in a fund domicile
% of all responses



SPOTLIGHT: WHAT CONSTITUTES A SOUND LEGAL AND REGULATORY ENVIRONMENT?

While intuitively the rule of law is a cornerstone for investors the world over, private equity funds have specific requirements if their investments are to be optimised. EMPEA's Legal & Regulatory Council—composed of legal experts and practitioners—developed a set of 10 Guidelines as a general framework to foster constructive dialogue amongst policymakers, regulators and investor who seek to promote private equity investment in emerging markets.

The EMPEA Guidelines are intended to identify those elements of legal and tax regimes that experience from other markets has demonstrated will help attract robust international and local private equity investment. While the Guidelines contain important details and nuance, in broad terms they suggest a legal and regulatory environment that provides:

1. Effective, clear and flexible corporate and securities laws, with the ability to negotiate rights in capital structures
2. Conformity to international standards of business integrity and anti-corruption
3. Clear, consistent and internationally competitive taxation
4. Reliable and consistent approach to dispute resolution and enforcement
5. Non-discriminatory treatment of cross-border investment
6. Efficient, transparent and fair regulatory environment
7. Transparent and reliable rules for state expropriation
8. Stable and fair framework for property rights
9. Flexibility in insolvency proceedings and fairness for stakeholders
10. Ability to contract freely, with minimum prescription by statute

For more information, please download a copy of the EMPEA Guidelines at www.empea.org/resources/empea-guidelines.

TAKING ACTION: STRENGTHENING THE POTENTIAL FOR ONSHORE DOMICILES

Industry stakeholders who are interested in catalysing greater capital flows into private equity funds focussed on Sub-Saharan Africa recognise that fund domiciles matter in the capital allocation process (see *Spotlight: Do Fund Domiciles Drive LP Allocation Decisions?*).

"I think that a big part of the solution—and I say this as an African—is for us to make our jurisdictions better, full stop. This all comes back to the fundamental business environment. We as Africans need to take ownership of this issue and fix it."

– Local LP Perspective

Mirroring the findings on the most important considerations in a fund domicile and the factors inhibiting greater use of the most attractive onshore African domiciles, respondents suggest that the top two actions an interested third-party could take to enhance the use of onshore domiciles are strengthening legal and regulatory reforms and implementing tax reforms, which received 69% and 56%, respectively, of survey respondents' selections.

One segment witnessing a notable difference of opinion is that between local sources of capital and international LPs. Sub-Saharan Africa-based LP respondents attach greater value to strengthening legal and regulatory reform as well as supporting professional and technical skills development, while global investors favour tax reforms and access to better market information.

PERSPECTIVES ON THE MOST NECESSARY ENHANCEMENTS BY FIRM TYPE

When segmenting responses by type of firm, the general consensus for legal and regulatory reforms remains; however, GPs and SPs attach greater significance to the necessity of implementing tax reforms than LPs, who remain most concerned about the legal and regulatory environment. In addition, LP and GP respondents would value access to better market information and the development of local human capital.

Exhibit 21: LPs and SPs agree upon the primacy of an enabling legal and regulatory environment whilst GPs slightly prioritise tax

Cumulative weight given by respondents to most important factors in a fund domicile
% of responses by firm type

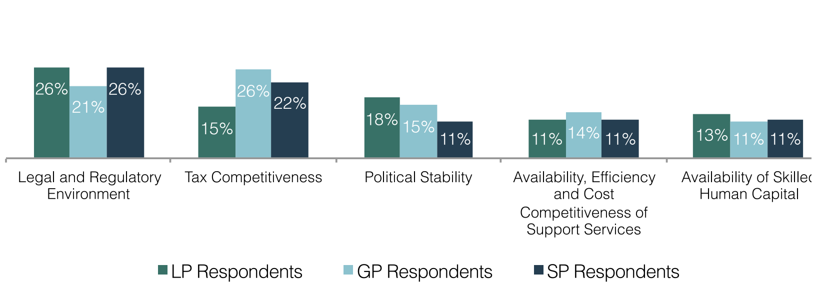


Exhibit 22: Strengthening legal and regulatory environments in Sub-Saharan Africa is the single most important factor for greater use of onshore domiciles

Most frequently selected third-party actions | % of all respondents

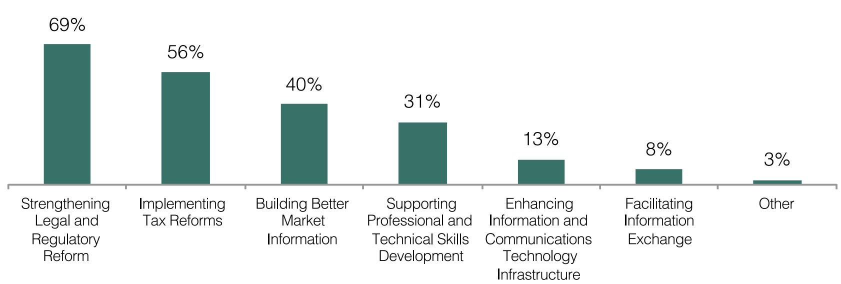


Exhibit 23: Local LPs would like to see greater skills development whilst international LPs favour tax reforms and better market information

Most frequently selected third-party actions | % of LP respondents

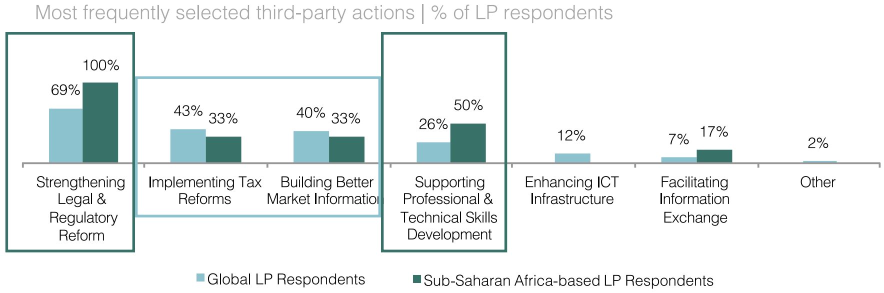
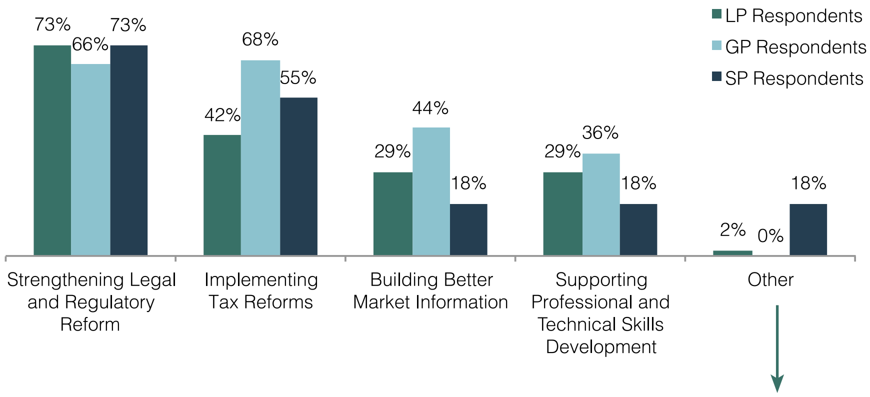


Exhibit 24: Each type of firm favours legal and regulatory reform; however, GPs and SPs attach greater significance to tax reforms than LPs

Most frequently selected third-party actions | % of respondents



"Other" actions include:
"removing exchange controls" and "infrastructure upgrades, including roads, transit, and ports."

STAKEHOLDER VIEWS ON MAKING ONSHORE FUND DOMICILES VIABLE:

"You have to have very strong local investors drive the process of domiciling a fund onshore. It just doesn't make any sense for offshore investors to drive changes in an onshore country."

– Sub-Regional GP

"Knowledge of new international legal frameworks, such as FATCA and AIFMD, is not yet well developed onshore in Africa. The regulatory infrastructure in these jurisdictions is not yet ready to cope with the requirements of these global regulations."

– Fund Administrator

"To help create a credible onshore domicile, work would need to be done by regulators in the local jurisdiction to build a regulatory and legal environment that permitted operationally flexible vehicles—in terms of enabling structures that reflect investors' concerns and the fund's strategy. A jurisdiction also needs regulatory oversight that is reliable and robust, as well as a strong supply of service providers. That would take some work."

– Private Equity Lawyer

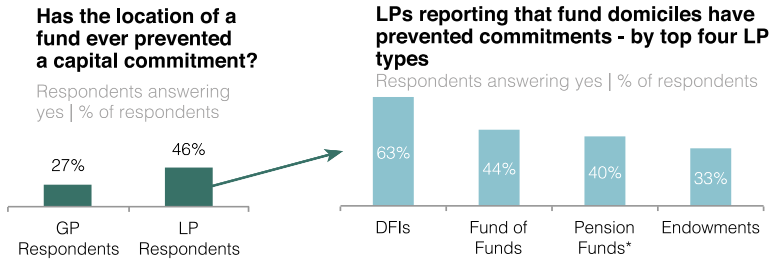
"My biggest concern is that every African country is trying to figure it out on its own—and the more differentiation there is between each country, the higher the cost of review by an investor, which lowers the likelihood of them actually investing. You don't want to have 53—or even 12—different rules and regulations about private equity on the continent. Someone needs to take a more active role on the continent on this issue—and it shouldn't just be lawyers, but also practitioners who have seen the other side of it and care about costs and efficiency."

– Fund of Funds

SPOTLIGHT: DO FUND DOMICILES DRIVE LP ALLOCATION DECISIONS?

Amongst survey respondents, 46% of LPs and 27% of GPs report that the location of a fund's domicile has, in their experience, prevented a commitment to a Sub-Saharan Africa-focussed private equity vehicle. When segmenting LP responses by type of institution, DFIs were more likely to decline a commitment due to the jurisdiction of a fund domicile.

Exhibit 25:



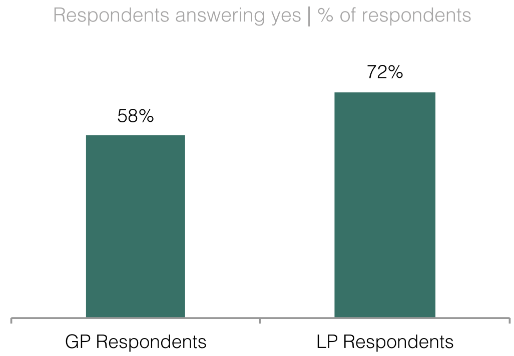
* Includes public and corporate pension funds.

Domiciles that Have Prevented LP Commitments

When prompted to disclose the location of the domicile(s) that prevented commitments, LPs listed the following jurisdictions:

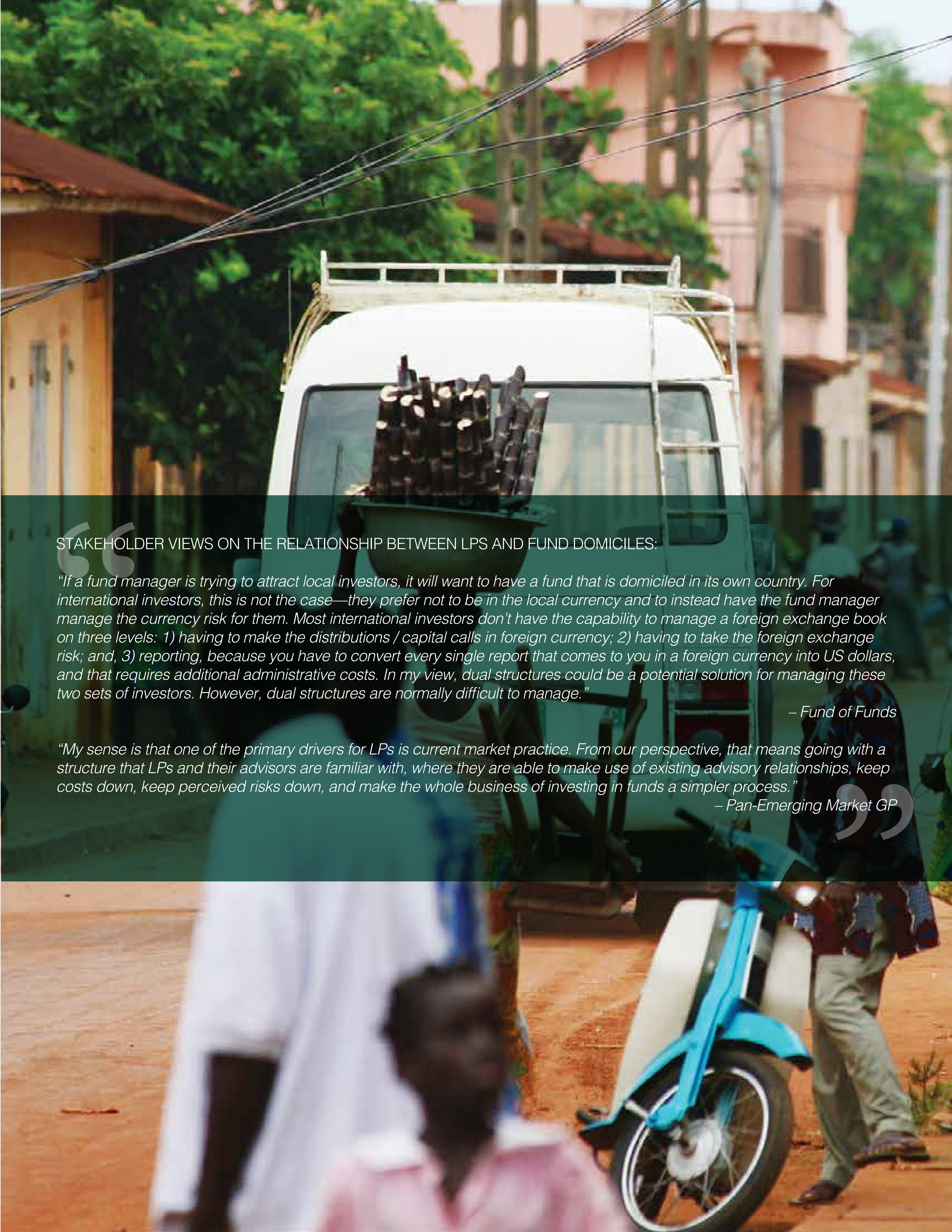
- Bermuda;
- British Virgin Islands;
- Cayman Islands;
- Kenya;
- Luxembourg;
- Mauritius;
- Mozambique;
- Nigeria;
- South Africa; and,
- Zimbabwe.

Exhibit 26: A majority of GPs and LPs report that the location of a fund could prevent future allocations



It should be noted, though, that LPs' perceptions of the suitability of a domicile for a fund can and do change. A domicile deemed unsuitable in 2013 may well be acceptable in, say, 2016 if, for example, the jurisdiction's status under the OECD Global Forum of Tax Transparency and Exchange of Tax Information changes.

Prospectively, a majority of LPs and GPs believe that a fund domicile could prevent an LP commitment to a fund.



STAKEHOLDER VIEWS ON THE RELATIONSHIP BETWEEN LPS AND FUND DOMICILES:

"If a fund manager is trying to attract local investors, it will want to have a fund that is domiciled in its own country. For international investors, this is not the case—they prefer not to be in the local currency and to instead have the fund manager manage the currency risk for them. Most international investors don't have the capability to manage a foreign exchange book on three levels: 1) having to make the distributions / capital calls in foreign currency; 2) having to take the foreign exchange risk; and, 3) reporting, because you have to convert every single report that comes to you in a foreign currency into US dollars, and that requires additional administrative costs. In my view, dual structures could be a potential solution for managing these two sets of investors. However, dual structures are normally difficult to manage."

– Fund of Funds

"My sense is that one of the primary drivers for LPs is current market practice. From our perspective, that means going with a structure that LPs and their advisors are familiar with, where they are able to make use of existing advisory relationships, keep costs down, keep perceived risks down, and make the whole business of investing in funds a simpler process."

– Pan-Emerging Market GP

CLOSING THOUGHTS

The findings of this survey demonstrate that fund domiciles play an important role for the private equity industry in Sub-Saharan Africa, and that the jurisdiction where a fund is located can have a material impact on the ability of GPs to raise and invest capital, and LPs to commit to a given fund. Using offshore jurisdictions, such as Mauritius, is currently standard practice, largely because offshore jurisdictions have the legal and regulatory frameworks and supporting infrastructure that are critical to the funds industry (e.g., limited liability partnerships or appropriate corporates, the ability to contract freely, reliable and consistent approaches to dispute resolution and enforcement, etc.). Moreover, the tax efficiency offshore centres offer facilitates the ability of international capital to flow into Sub-Saharan Africa.

That said, there is growing demand from institutional investors, such as pension funds and insurance companies, within Sub-Saharan African countries for access to private equity. As a result, onshore fund structures are becoming more important to the industry. However, without at least meeting the regulatory and tax policies offshore centres—including Mauritius—have in place, it will be hard for onshore centres to become broadly used domiciles for private equity funds. Moreover, as several practitioners noted in this survey, managing dual structures could become unwieldy given disparate approaches to regulation on the continent, and indeed, could impact the ability of GPs to offer their LPs limited liability. It could take years to foster the development of onshore legal and regulatory regimes and tax reforms that are conducive to private equity fund activity, and still more years of experience to prove the viability of onshore models. This is not a near-term solution for the industry.

Taking a step back, it's important to remember the role of a fund domicile—it is the conduit that connects global sources of capital with local companies. Given the scarcity of capital available to private businesses in Sub-Saharan Africa, there is a clear commercial opportunity for private equity investors to provide long-term growth financing. Equally important, however, is the opportunity for private equity to catalyse private sector development. Development finance institutions, including the African Development Bank, BIO, CDC, COFIDES, the Development Bank of Southern Africa, DEG, the European Bank for Reconstruction and Development, the European Investment Bank, Finnfund, FMO, IFC, IFU, Norfund, OEEB, the Overseas Private Investment Corporation, PROPARCO and Swedfund—among others—have long recognised this critical role, and have supported the development of private equity funds for decades.

We hope this publication provides greater transparency on the role of fund domiciles, and industry participants' perspectives on what they look for in a jurisdiction. We believe some of the findings could be useful for making existing domiciles work even better, and helping future onshore domiciles operate in line with internationally accepted norms and best practices. All, of course, while focussing on the objective of fostering investment in growing African companies. Ultimately, sound legal and regulatory reforms and the adoption of competitive tax policies could be a benefit not only for private equity funds, but for broader private sector and financial sector development within these economies. Enhancements to the local business environment would go a long way toward increasing global investor confidence in—and thus commitments to—Sub-Saharan Africa.

APPENDIX 1 – DETAILS ON SURVEY PARTICIPANTS

SNAPSHOT OF GP RESPONDENTS

Of the 59 GP respondents, the vast majority—93%—manage traditional private equity funds, with the remaining GPs focussing on non-traditional vehicles (i.e., investment holding / platform companies). In terms of the total dollar value of exposure to Sub-Saharan Africa private equity, firms participating in the survey range in size from US$4 million to US$1.6 billion. In addition, the respondents represent a blend of country-dedicated, sub-regional and pan-African funds, as well as a mix of first-time and experienced fund managers. With respect to role, nearly half of respondents (46%) are Executive / Senior Management, with Investment Team (27%) and Investor Relations / Marketing professionals (19%) rounding out the top three.

Exhibit 27: Number of Sub-Saharan Africa-dedicated funds per GP respondent

% of respondents

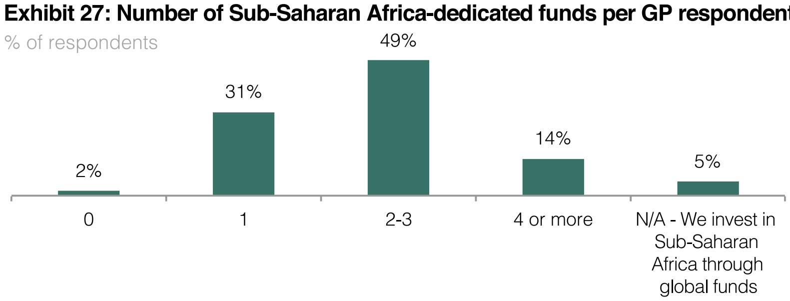
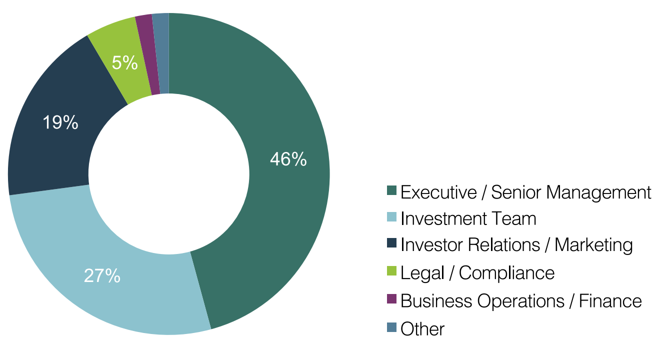


Exhibit 28: GP respondents by role

% of respondents



SNAPSHOT OF LP RESPONDENTS

Forty-eight limited partners participated in the survey. Amongst those that disclosed their commitments, the respondents collectively represent institutions that have allocated more than US$7.5 billion in capital to Sub-Saharan Africa-dedicated private equity funds. The LP respondents represent a diverse mix of institutions, including development finance institutions, public and corporate pension funds, family offices, endowments / foundations, banks / asset managers, insurance companies, sovereign wealth funds, government-owned organisations and funds of funds.

There is a broad range of experience with Sub-Saharan African private equity amongst LP respondents. Nearly one-third are relative newcomers to Sub-Saharan African private equity, working at firms that have allocated commitments to between one and five funds; while 42% are with institutions that have committed to more than 11 funds. In terms of role, 52% of respondents serve on their firm's investment team, whilst executives / senior managers account for 23%, and portfolio managers 10%, of the LP sample.

SNAPSHOT OF SERVICE PROVIDER RESPONDENTS

In addition to GPs and LPs, 11 service providers completed the survey, representing fund formation and private equity lawyers, placement agents, fund administrators and investment consultants / pension advisers. Nearly 65% of these firms represent six or more clients that manage or invest in Sub-Saharan Africa-specific private equity funds.

Exhibit 29: LP respondents by firm type

% of respondents

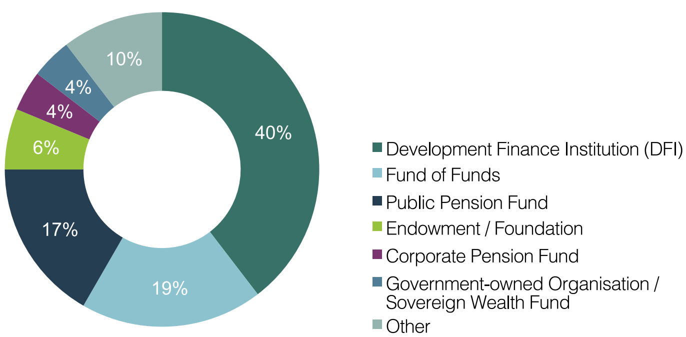


Exhibit 30: Number of Sub-Saharan Africa-dedicated funds per LP respondent

% of respondents

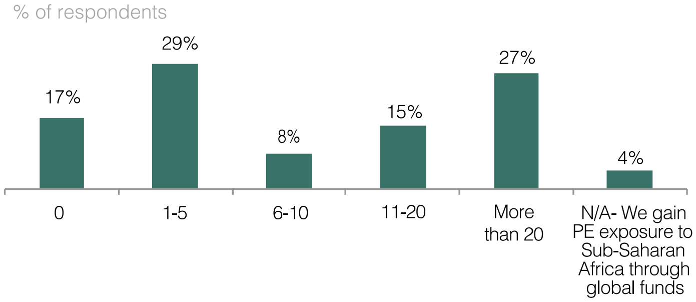
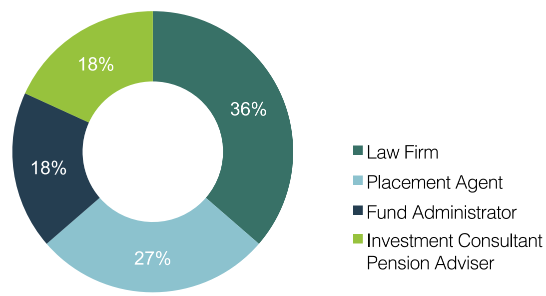


Exhibit 31: Service provider respondents by type

% of respondents



Expert Perspectives:

Onshore Financial Centres – Definititions, Challenges and Opportunities for Development

fsdafrica EMPEA UKaid from the British people

Onshore Options for Africa-Focussed Investment Funds and Vehicles
SYNTHESIS REPORT

April 2015
Prepared for FSD Africa

by

The Z/Yen Group

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1. SYNTHESISING OPTIONS REPORTS

FSD Africa invited Z/Yen Partners Limited to produce a synthesis report based on (i) a series of five reports exploring the feasibility of establishing onshore financial centres for private equity investment funds, financed by African and international capital, focussed on Africa, and (ii) a Round Table discussion that was held to discuss the five reports. This synthesis report has three objectives, to:

- Provide an overview of the five reports;
- Contrast and collate findings and recommendations; and,
- Identify areas for further research.

This synthesis report is structured as follows: Section 2 provides an overview of content across the five reports; Section 3 analyses the findings; and Section 4 reviews possible actions for donors to undertake. Appendix A provides an overview of the documents reviewed to produce this synthesis report.

The reports were commissioned by FSD Africa in November 2014 to the following terms of reference:

"The primary purpose of the exercise is to gather expert opinions on how likely it is that: (i) fund managers will start to consider seriously onshore financial centres in Sub-Saharan Africa for the purposes of fund and / or investment holding company domiciliation; and (ii) investors will support onshore investment as an alternative to investment via offshore financial centres (OFCs). If the answer is "yes," which countries would these be and under what conditions would these fund managers and investors be prepared to invest?

The main output of the Services is a short issues paper summarising the Consultant's views. In identifying specific countries as potentially viable onshore markets, the Consultant should suggest (at a high level) what sort of reforms would be needed to attract international capital and how long these reforms might take to implement."

Experts were asked to make recommendations on which reforms would be needed to attract international capital and how FSD Africa and / or the UK's Department for International Development (DFID), FSD Africa's funder, could best support the transformation of particular countries or cities into viable onshore centres, for example, through technical assistance or support to in-country advocacy initiatives to build political will.

The series consists of the following five reports:

- Bella Research Group, "White Paper on Private Equity and Financial Hubs," March 2015 (referred to as Bella Research hereafter);
- Econsult Botswana Ltd, "The Potential of Onshore Financial Centres for Africa-focussed Investment Funds and Vehicles", March 2015 (Econsult Botswana hereafter);
- Michael J. Fuchs, "Onshore Options for Africa-focussed Investment Funds and Vehicles," January 2015 (Fuchs hereafter);
- Lion's Head Global Partners, "African Onshore Financial Centres," January 2015 (Lion's Head hereafter); and,
- Z/Yen Partners Limited, "Onshore Options for Africa-focussed Investment Funds and Vehicles," March 2015 (Z/Yen hereafter).

2. CONTENT OVERVIEW

While the five reports share common attributes (see Section 3), each report brings some unique contribution in analysing the feasibility of establishing an onshore financial centre for investment funds in Africa:

- Bella Research provides a comprehensive review on the role, importance, location and impact of private equity on a financial centre and the economy. Further, it explores the drivers behind domicile decisions and the impact of private equity domiciliation on economic growth by analysing Mauritius in greater detail, noting Mauritius's first-mover advantage;
- Fuchs analyses how a local private equity industry that provides risk capital to smaller domestic companies could be a powerful tool for economic development in Africa;
- Econsult Botswana provides a comprehensive comparison of African financial centres and explores the link between regulatory frameworks supporting financial centre development and results in practice;
- Lion's Head explores how agglomeration effects and economies of scale support a thriving financial centre and suggests that a successful regional financial centre results from finding an equilibrium between decentralising (proximity to clients) and centralising (agglomeration) forces; and,
- Z/Yen provides quantitative evidence of how African financial centres compare with each other and with a peer group of similar centres in other regions of the world based on the Global Financial Centres Index, and qualitative evidence based on interviews.

Table 1 below provides an overview of the different topics explored in each report. These topics or dimensions can be broadly categorised into four groups:

- Financial centre—definition, typology and requirements;
- Private equity—importance of a local private equity industry, drivers of funds or investment company location, and impact on the economy;
- African financial centres—current and future outlook, comparison, and assessment of their potential to become an established onshore financial centre; and,
- Reform requirements as well as scope and format of donor support (see Section 5).

Table 1 – Overview of topics explored

Topic	Bella Research	Econsult Botswana	Fuchs	Lion's Head	Z/Yen
Financial centre definition		X			X
Onshore versus offshore financial centres (financial centres)	X	X	X	X	X
Typology of financial centres		X		X	X
Prerequisites for a new / thriving financial centre		X	X	X	X
Economic benefits associated with financial centre		X			X
Importance of private equity (including role, location and economic impact)	X		X		
Attracting international companies and / or private equity funds domiciliation	X	X	X	(X)	
Africa-focussed private equity investment opportunities and local private equity industry development	X		X		
Fund managers attitude towards financial centre (including drivers underpinning fund domiciliation)	X	X	X		
Comparison of African financial centres	X	X	X	X	X
Role of donors and technical assistance	(X)	X	X	X	X

2.1 Financial Centre – Definition, Typology and Requirements

All reports agree that it is difficult to classify financial centres as 'onshore' or 'offshore' financial centres. Definitions and criteria vary. Most reports outline how typically 'offshore' financial centres are conceptualised in terms of their favourable regulatory environment and attractive tax regimes. Z/Yen adds secrecy and long-term finance to the list of offshore financial centres' comparative advantages. Lion's Head and Fuchs highlight how in offshore centres, financial services tend to account for a significant share of the economy but only represent a narrow range of actual financial services, such as administrative and legal services to support non-resident capital, funds and companies' domiciliation. Both the Lion's Head and Fuchs reports suggest that onshore financial centres usually reflect a broader development of the financial services industry.

Three of the five reports outline frameworks to categorise financial centres. The resulting typologies vary in terms of scope and criteria, and are summarised below.

- Econsult Botswana proposes to compare the dimensions of a financial centre in terms of the size of international business compared to domestic; sources of capital and investment destination—local, regional, international; the type of financial service activities; and the compliance with international requirements and best practice.
- Lion's Head categorises financial centres into global, regional and administrative according to their size, scope and breadth of activities. Accordingly, global centres are the largest and most influential financial centres providing the most sophisticated services at a global scale and hosting the largest collection of financial services providers. Regional financial centres draw their competitive strength from their location and provide sophisticated financial services to their region. Administrative financial centres provide administrative and legal services to a broad cross section of clients.
- Z/Yen Group categorises financial centres by global-transnational-local, broad-shallow and specialised-diversified, according to three dimensions. First, connectivity—the extent to which a centre is well known around the world and how much non-resident professionals believe it is connected to other financial centres. Second, diversity—the breadth of financial industry sectors that flourish in a financial centre. Third, speciality—the depth within a financial centre of the finance industry, in particular investment management, banking and insurance.

Three out of five reports—again Fuchs, Lion's Head, and Z/Yen—outline the prerequisites for a successful financial centre. Prerequisites that are common across all reports include infrastructure; connectivity; a conducive business environment; a stable political environment, political will to develop a financial centre; and, human capital. It should be noted that Bella Research and Econsult Botswana also analyse these requirements, but in relation to factors influencing fund managers' decision-making on office location or fund domiciliation. Table 2 below provides an overview.

Table 2 – Prerequisites for a successful financial centre

Prerequisites for a thriving financial centre	Fuchs	Lion's Head	Z/Yen
Infrastructure – urban infrastructure (including transport, accommodation, education, health infrastructure), technology, etc.	X	X	X
Connectivity – travel and communication	X	X	X
Conducive business environment – free movement of capital (e.g., absence of exchange controls)	X		X
Stable political environment – conducive and effective regulatory, legal, fiscal frameworks	X	X	X
Political will – commitment and dedicated policies	X	X	
Market activity / economic activity	X	X	X
Financial sector development	X		X
Human capital – availability of skills / expertise, favourable immigration laws	X	X	X
Reputation and transparency	X		X

2.2 Private Equity – Role, Importance and Domiciliation

Three of the five reports—Bella Research, Econsult Botswana, and Fuchs—analyse in greater detail the importance and economic impact of private equity activity and funds' domiciliation. Bella Research distinguishes between office location, which may be of particular importance to access domestic capital and / or domestic investment opportunities (deals), and fund domiciliation. Table 3 below provides an overview of the drivers and incentives underpinning the choice of location.

Table 3 – Drivers of fund domiciliation and office location

Drivers and incentives	Bella Research	Econsult Botswana	Fuchs
Favourable tax treatment and network of double taxation agreements (DTAs)	X	X	X
Perception by foreign investors or regulators	X	X	
Effective and functioning legal and regulatory frameworks	X	X	X
Stable political and economic environment		X	X
Availability of support services, skills and infrastructure	X	X	X
Access to domestic capital (e.g., local pension fund asset)		X	X
Access to domestic investment opportunities (and networks)	X	X	X
Familiarity	X	X	
Geography and membership to multilateral organisations (e.g., economic cooperation)	X		

2.3 African Financial Centres – Current and Future Outlook

All five reports compare existing African financial centres and analyse their prospects for the future, but the comparisons focus on different dimensions:

- Bella Research provides a detailed analysis of Mauritius and then compares it to other African financial centres according to legal and cultural aspects considered by fund managers;
- Econsult Botswana compares African financial centres based on their regulatory environment (including political will to support financial centre development) and on how these centres fare in selected classifications or assessments of financial centres including the IMF's listing of Offshore Financial Centres, Z/Yen's Global Financial Centres Index, the OECD-Global Forum Assessment, and the Tax Justice Network's assessment of financial secrecy;
- Fuchs compares African financial centres according to the size of their private sector compared to GDP, the size of their private sector asset base and the volume of private equity investment they attract;
- Lion's Head compares African financial centres on the characteristics of a financial centre that are important to financial practitioners, including the strength of capital markets, GDP, financial market institutions, infrastructure, quality of life, legal framework, stability and professional services; and,
- Z/Yen compares selected African financial centres and peer group financial centres based on data from the Global Financial Centres Index and according to the financial centre type and stability, their competitiveness, and their reputational advantage. Financial centre performance is also explored across sectors of financial services (investment management, banking, insurance, government and regulatory, professional services) and dimensions of competitiveness (business environment, financial sector development, infrastructure, human capital, reputation and general factors).

All five reports consider well-known African financial centres such as Mauritius, Lagos, Nairobi, and Johannesburg. As Table 4 below shows some reports go beyond these to include other financial centres in Sub-Saharan and North Africa in their analysis.

Table 4 – African financial centres analysed in each report

Topic	Bella Research	Econsult Botswana	Fuchs	Lion's Head	Z/Yen
Accra (Ghana)		X	X		
Cape Town (South Africa)		X			
Cape Verde		X			
Casablanca (Morocco)		X	(X)	X	X
Djibouti					X
Gaborone (Botswana)	X	X	X		X
Kigali (Rwanda)	X		(X)		
Lagos (Nigeria)	X	X	X	X	X
Liberia		X			
Libreville (Gabon)					X
Port Louis (Mauritius)	X	X	X	X	X
Nairobi (Kenya)	X	X	X	X	X
Johannesburg (South Africa)	X	X	X	X	X
Seychelles		X			X

3. FINDINGS

3.1 Evolution and Comparison of African Financial Centres

Mauritius is the financial centre most cited in the reports, followed in order by Nairobi, Johannesburg, Botswana, and Casablanca. Mauritius is widely recognised as an established offshore financial centre specialising in fund domiciliation and related support services. Most reports agree that Mauritius is likely to remain an important financial centre servicing funds and investment flows between Africa and Asia. Lion's Head suggests that there is limited scope in replicating this model with a new onshore financial centre or to compete directly with such an established centre, while Z/Yen suggests "Djibouti, Botswana, Gabon, and the Seychelles might make a larger play to be international financial centres if they so desired."

Fuchs, and to some extent Z/Yen, suggest that access to local authorities and decision-makers might be a comparative advantage of onshore financial centres compared to offshore financial centres. This potential is hindered however by the relatively small size of their financial systems and their relatively high degree of fragmentation.

Table 5 summarises the experts' leading candidates for larger regional financial centres.

Figure 1 - African financial centres by number of mentions across the five reports

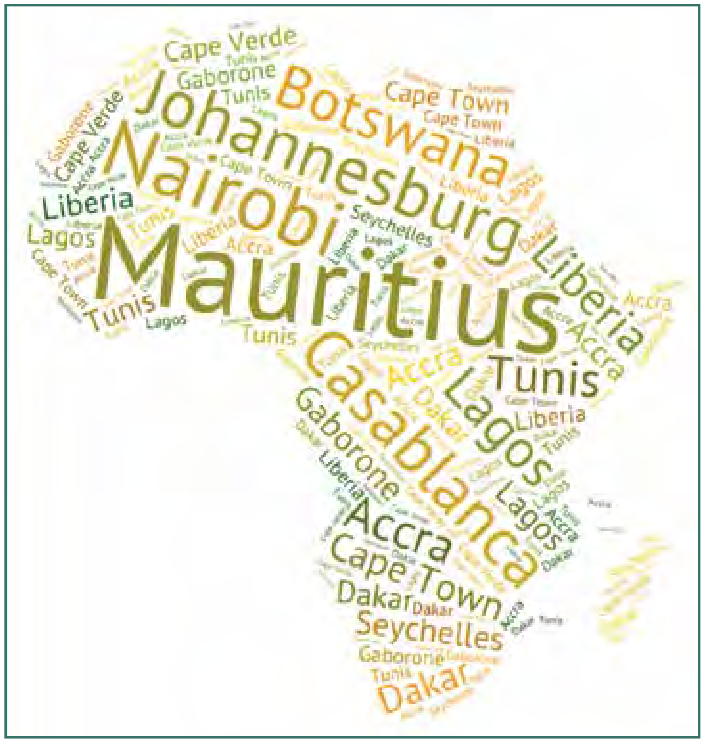

Table 5 – Leading African onshore financial centre candidates

African Financial Centre	Bella Research	Econsult Botswana	Fuchs	Lion's Head	Z/Yen
Casablanca (Morocco)			X	X	X
Gaborone (Botswana)	X	(X)			(X)
Johannesburg / Cape Town (South Africa)	X	X	X	X	X
Lagos (Nigeria)		(X)	X	X	
Nairobi (Kenya)		(X)	X	X	X

Bella Research believes that Mauritius is likely to continue to be favoured by private equity groups for domiciliation. Their report suggests that South Africa and Botswana could provide a credible alternative provided that the former enhances its quality of governance (including political stability and security) and improves the terms of its tax treaties; and the latter simplifies its regulatory environment to become more conducive to business activity.

Econsult Botswana finds that the most compelling financial centre jurisdiction for international funds besides Mauritius is South Africa due to its size, financial sophistication, and infrastructure, but suggests that the country should work on improving exchange controls, taxation, immigration laws, and a reduced crime rate. The report suggests that other possible contenders, including Botswana, Nigeria, and Kenya, could grow in the future, provided that they work on improving conditions for a successful financial centre.

Fuchs suggests that the importance of South Africa, Kenya, Nigeria, and Morocco in cross-border banking in Africa is rising and highlights how Nigeria and Kenya have relatively more depth in domestic financial systems compared with other countries in Sub-Saharan Africa.

Based on a comparison of financial centre characteristics important to financial practitioners, Lion's Head finds that Nigeria, Kenya and Morocco offer the greatest potential. The report stresses that Nigeria might be a suitable candidate in terms of size of the domestic market, while South Africa could be a natural candidate given its infrastructure and sophistication.

Z/Yen provides quantitative ratings for four African financial centres: Mauritius (local specialist), Casablanca (transnational specialist), Johannesburg (established local), and Nairobi (emerging local). Casablanca's and Johannesburg's ratings and instrumental factors exhibit high sensitivity and volatility. This volatility means both have the potential to move up, or down, swiftly in response to changes in instrumental factors. Casablanca has a strong reputational advantage compared to Johannesburg, Port Louis and Nairobi—possibly too strong, suggesting that the marketing of the centre in recent years may have overtaken its ability to deliver.

3.2 Developing an African-focussed Local Private Equity Industry

Of the three reports analysing private equity activity (Bella Research, Fuchs and Econsult Botswana), two reports (Bella Research and Fuchs) come to the conclusion that the encouragement of local private equity activity, including the development of a conducive business environment, adequate expertise and industry activity, is likely to create more economic development than private equity fund domiciliation or investment company presence. The private equity industry in Africa focuses investment in larger, well-established, brand-name enterprises. Both reports recommend that private equity investment towards SMEs is supported through investment in local expertise and local presence.

These ideas fed clearly into the Round Table conclusion—"Private equity (PE) has a key role to play in African economies. PE activity has grown in the region across all size segments over the last 10-15 years, especially in large cap deals (US$50+ million). There is a need for equity / risk capital for growing African businesses, for public-private partnerships (PPPs) and infrastructure finance. PE can also provide significant local economic benefits by enhancing firm competitiveness, and increasing the transparency of the corporate investment market in Africa as a whole."

4. RECOMMENDATIONS FOR REFORM AND DONOR SUPPORT

4.1 Areas for Reform

Based on pre-requisites for a successful financial centre, as a group the reports agree that larger African-focussed onshore financial centres will develop because of increased economic and market activity, rather than through deliberate intent to create a financial centre. The reports agree that some onshore financial centres could become larger regional financial centres channelling financial flows in and out of a region provided that they:

- Encourage economies of scale in investment;
- Deepen their financial services skills;
- Exhibit political will to develop financial centres; and,
- Provide a conducive regulatory environment.

The five reports provide a variety of suggestions with many areas of overlap, but the emphases differ:

- Bella Research suggests encouraging **development of private equity investment** in delivering real returns in country than on creating financial centres—"The encouragement of local PE activity will likely create more economic development than will domiciliation."
- Econsult Botswana focuses in particular on the **rule of law and taxation**. Potential donor interventions include: 1) Reviewing and developing legal, regulatory and fiscal frameworks for international financial and business services; 2) Ensuring that the legal, regulatory and fiscal frameworks are: compliant with international best practice; consistent with the requirements for satisfying the OECD EOI assessment; and offer competitive tax rates to investors while not falling foul of international efforts to combat tax base erosion; 3) Negotiating a network of double taxation agreements; 4) Determining where bottlenecks might occur and which supportive reforms and investment might be necessary in a

particular jurisdiction (communications, transport, immigration, land / buildings, etc); 5) Developing publicity and awareness material / programmes; and, 6) Establishing the necessary institutional structures (promotional, regulatory, etc.).

- Lion's Head also focuses on the **rule of law and taxation**—"The main themes around which technical assistance can be structured are: tax policies; transparency and the rule of law; developing capital markets and adopting sophisticated financial products."
- Fuchs highlights new ways of **structuring funds and reducing investment costs**—"providing support to PE funds that are committed to targeting smaller enterprises is best structured as technical assistance provided *directly* to defray PE running costs and to prospective PE investee companies so as to strengthen the pipeline of prospective investible projects."
- Z/Yen emphasises **better information, provable long-term government commitment, and improving skills:**
  - Get real – more aggressive promotion addressing shortcomings with long-term planning yet avoiding the appearance of capricious regulatory change, combined with a clear legislative cycle in finance where finance bills change regularly but not too rapidly;
  - Get integrated – consider 'mid-shore' strategies where there is a symbiotic offshore relationship with larger or neighbouring nations allowing businesses to function under less-than-ideal or complex onshore regulation;
  - Get better – tackle long-term skills shortages with better training for indigenous populations rather than relying on imported skills; improve power, transportation and communications infrastructure;
  - Get connected – host high-profile regular events, create strong academic links, simplify visa and work permit processes; and,
  - Get serving – increase levels of service both for those entering the centre and long-term residents; use benchmarks, data comparisons, and awards to keep service high, encourage innovation.

4.2 Donor Support

The reports realise that donors cannot do all things. Z/Yen invokes Jared Diamond's Anna Karenina principle from the opening line of Tolstoy's novel: "Happy families are all alike; every unhappy family is unhappy in its own way." The Anna Karenina principle describes situations where a number of activities must be done correctly in order to achieve success, while failure can come from a single, poorly performed activity. Fuchs—"It is important to underline that a necessary condition for establishing a successful onshore centre would require excellence in **all** rather than just a few of these areas." Yet donors do not have unlimited resources. Responding to conditions on the ground probably means shoring up the weakest current factors or laying down long-term foundations in a short-term environment. The papers expect that donors will have to chop and change direction over time.

Figure 2 – Keywords by number of mentions across the five reports

An interesting point was made by Econsult Botswana—"donors could play a role in developing and financing a large scale publicity, branding and marketing initiative"—favouring speed first, fixing later, and suggesting that a 'cheerleader' role might be worthwhile.

It is also interesting to ponder whether financial centres should be a focal point for donors—Lion's Head, "Does it really make sense for donors to promote the creation of more than one administrative (offshore) centre for Africa when it seems that most fund managers find that Mauritius is serving these needs well?" The Round Table noted—"Any attempt to build onshore centres will need to be differentiated from, and competitive with, Mauritius's offer."

The Round Table concluded that the principal options for technical assistance to prospective onshore centres might include:

1) Providing **case studies** of successful examples of financial centre development, including Mauritius's own evolution as an offshore centre;
2) Creating a **diagnostic roadmap** to support a country to gain international approval, identifying risks and pitfalls along the way;
3) Expanding **Double Tax Avoidance Agreements (DTAA) networks**, and helping stakeholders understand the process of regulatory reform;
4) Improving **messaging and communication** to mend the political reputation of tax efficient centres and highlighting the sensible character of their structures;
5) Establishing a **policy performance bond**, supported or underwritten by donors, as a political risk mechanism to hold governments to account on promises made. Scoping could establish how risk could be fairly and effectively shared among partners; and,
6) A **benchmarking service for national governments** to assess appetite and ensure that projects are effective and not wasteful.

The Round Table concluded that the principal donor support for private equity might include:

1) **In-depth research** to understand what does and does not work when building PE in emerging markets;
2) A **survey of preferences and insights** from financial institutions in the region, who are well positioned to assess, assist and monitor the market;
3) A **system of professional standards** that can be applied across the continent;
4) Better **benchmarking of cities, countries and companies**; an accurate, potentially pan-African system of information can help companies share knowledge and observe market dynamics;
5) **Better incentives for fund managers** such as the adjustment of hurdle rates (the return after which carried interest is received), rather than soft funding / capital support; and,
6) **Technical assistance funding** to capable fund managers, that is structured to ensure managers bear part of the costs.

4.3 Conclusion

On balance, the reports indicate two principal axes for donors to consider:

- **Public sector or private sector emphasis** – the reports at times emphasise engaging with governments, at other times engaging directly with businesses and investors. The reports also switch between the need for substantive reform preceding development and the need for achieving economies of scale quickly. Fuchs favours specific engagement on specific issues with business—"Looking beyond the issue of scale experience suggests that the political economy of financial sector reform is an uncertain process, particularly when such reforms entail provision of public goods, such as a conducive legal and regulatory framework, strong judicial and oversight processes, efficient financial infrastructure, etc. Local private sector parties most impacted by shortfalls in current systems are likely to be the most vocal and effective drivers of such reform processes. Thus, rather than engage directly in dialogue with authorities on the reform process, the most impactful approach to supporting improvement may well be to build on the influence of those local private sector parties most impacted by current circumstances (such as PE fund managers whose activities are hampered by shortfalls in the enabling environment). They are likely to be the most effective drivers of such reform processes;" and,
- **People or information or institutions emphasis** – the reports vary from Z/Yen emphasising training and education as well as information, to Bella Research recommending improved information provision for investors, to Econsult Botswana, Fuchs and Lion's Head focussing on institutions. All of the reports make suggestions on infrastructure as well. Infrastructure issues range from power, water, telecoms, sanitation, and transportation to schooling, security, rule of law, and public information. However, there is no clear infrastructure theme possibly due to an assumption

that it is obvious: a well-functioning financial centre will require adequate infrastructure across-the-board, as well as the fact that Africa is diverse and infrastructure weaknesses vary.

There is an optimistic tone to the reports, a feeling that Africa has a chance for rapid development and that simultaneous financial centre development can speed and reinforce African advancement. The FSD Africa process of encouraging a diversity of opinion has achieved the desired effect of having a number of worthwhile suggestions for donor action.

APPENDIX A - DOCUMENTS REVIEWED

FSD Africa sources

Document description	Reference
CDC Group plc, Department for International Development (DFID) and FSD Africa (FSDA), Round Table Discussion – Executive Summary, 25 February 2015	Round Table summary

External sources

Document description	Reference
Bella Research Group, "White Paper on Private Equity and Financial Hubs," March 2015	Bella Research, 2015
Econsult Botswana Ltd, "The Potential of Onshore Financial Centres for Africa-Focussed Investment Funds and Vehicles," March 2015	Econsult Botswana, 2015
Lion's Head Global Partners, "African Onshore Financial Centres," January 2015	Lion's Head, 2015
Michael J Fuchs, "Onshore Options for Africa-Focussed Investment Funds and Vehicles," January 2015	Fuchs, 2015
Z/Yen Partners Limited, "Onshore Options for Africa-Focussed Investment Funds and Vehicles," March 2015	Z/Yen, 2015

White Paper on Private Equity and Financial Hubs

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1. INTRODUCTION

Private equity (PE) funds—which encompass venture, growth equity, and buyout transactions—are recognised as increasingly important financial intermediaries because they provide a combination of capital, governance, and mentoring to the companies in which they invest. This role is particularly helpful in emerging economies, where research suggests that there is a substantial need for risk capital along with a substantial number of firms that are poorly managed relative to their Western counterparts.

Extensive research also suggests that PE is a local business, with investment success—and the accompanying social benefits—frequently flowing from the presence of a firm based (or at least with an office) in a local economy. This has triggered an intense interest on the part of many governments in promoting the establishment of local PE industries. This issue is particularly relevant in Africa, where some investment groups have chosen to be based locally (e.g., AfricInvest-TunInvest Group, African Capital Alliance), others are based in a global centre such as London or Washington with local offices (e.g., Emerging Capital Partners, Actis, Carlyle Group, Helios), and yet others have worked on a "fly in, fly out" basis from the West (the traditional approach of Development Partners International).

An additional complication is introduced by the presence of offshore domiciles for many funds. Whether in response to restrictive domestic laws (as is the case for Chinese and Indian funds) or a desire for tax savings, PE funds often have a legal domicile that is different from their physical bases. While the regions that serve as the homes to such funds, such as the Cayman Islands and Mauritius, may experience some degree of increased economic activity as a result of hosting these firms, these back office facilities typically do not confer the same types of benefits as private equity investment activity would.

This paper—based on a review of academic literature and practitioner surveys and reports, as well as our general experiences from advising PE groups and governments—explores these issues in detail. The remainder of the report is structured as follows: Section 2 explains the importance of PE in frontier markets. In particular, we touch on why PE is important and how it impacts firms and economies. Section 3 discusses the "localisation" of PE and the impact of office proximity in these markets. Section 4 details the drivers of PE domiciliation decisions. Section 5 looks at the attractiveness of Mauritius as a domicile for Africa-focussed funds. Finally, Section 6 touches on specific implications for Africa. We argue the following:

- Already-established domicile choices for PE, such as Mauritius for Africa-focussed funds, have a "first-mover" advantage in terms of tax treaties with a host of countries in addition to the familiarity and existing support systems developed by PE firms. Such existing infrastructure and patterns of behavior make PE firms reluctant to change.

- The development of an onshore financial centre is not merely a matter of legality but largely a function of cultural changes. Investors must feel confident in the region with respect to political stability and regulatory risks.

- Whereas the location decisions of PE firms have significant impacts on the local economies, it appears domiciliation offers considerably more modest benefits. We therefore suggest that it is more important for most African nations to focus on the development of PE activity in the region (i.e., local HQs and offices) than on establishing an onshore financial centre for PE fund domiciliation.

2. THE IMPORTANCE OF PRIVATE EQUITY IN FRONTIER MARKETS

Enterprises in frontier markets face many challenges, including inadequate infrastructure, scarce management skills, competition from the informal sector, and corruption. Beyond these factors, recent data from the World Bank Enterprise Surveys suggest that 23.4% of firms in Sub-Saharan Africa (SSA) identified "access to finance" as the biggest obstacle to their establishment—the largest of all obstacles identified.[1]

Private equity is a critical form of risk capital—i.e., money contributed to high risk investments that have exceptional growth potential but also run the possibility of complete default—in frontier markets. On the firm level, PE offers financially constrained firms a viable alternative to traditional debt financing, which is often unattainable. On the country level, PE investment can help create demonstration effects that can propel an economy forward, beyond the direct impact of the given investment. PE teams provide advice to the entrepreneurs in their portfolios, which builds domestic business capacity on a broad level. We discuss these benefits in more detail below.

2.1. Firm-level Benefits of Private Equity Participation

Risk capital in the form of PE can alleviate financial barriers to growth for SSA firms for which bank loans are extremely difficult to obtain. Bank financing in frontier markets is impeded by the difficulty of finding reliable information on both the entrepreneur and the business. The impact of such information gaps is substantial.

In a study of the transition economies of Central and Eastern Europe, James Barth, et al. found that small- and medium-sized enterprises (SMEs) with external auditors had improved the verifiability of their financial statement and thus could better access credit from large creditors that specialised in "hard information" lending.[2] In SSA, the World Bank Enterprise Surveys suggest that roughly half of firms do not have an annual financial statement reviewed by external auditors,[3] which often makes banks unwilling to lend.

Another challenge to SMEs seeking finance is the poor quality of the judicial system, which complicates property claims. In light of the information asymmetries and judicial system issues, lenders de-risk investments with collateral requirements. Heywood Fleisig, et al. pointed out, however, that in low income countries there is a typically a mismatch between the type of assets that firms have—namely, moveable assets such as the goods they produce and manufacturing machinery—and those that lenders typically accept as collateral (i.e., new motor vehicles or urban real estate).[4] In fact, research suggests that 78% of the capital stock of a business enterprise in the developing world is movable assets, while only 22% is immovable property—that is, the collateral that the banks want is exactly the type that the SMEs lack.[5]

As a result, researchers using data from the Enterprise Surveys found that 22% of firms in SSA are "Fully Credit Constrained," as they had obtained no external loans (of any form) during the previous fiscal year because either their loan applications were rejected or no loans were sought despite a need for capital.[6] Risk capital (i.e., PE, typically in the form of venture capital or growth capital) can provide the financing critical to growth and economic development. In addition to capital, research (though mostly on US and European companies) indicates that PE can add substantial value to firms with respect to governance (e.g., improving management practices, reducing earnings management, etc.) and professionalization (e.g., recruiting, CEO choice, etc.).[7]

2.2. Country-level Benefits of Private Equity Participation – Benefits Beyond Portfolio Companies

Beyond the provision of desperately needed capital, PE availability can also have broader country-level demonstration effects from the creation of role-model companies with good management practices.

Sampsa Samila and Olav Sorenson looked at regional economic activity in US metropolitan areas from 1993 to 2002 and reported that venture capital positively affected firm starts, employment, and aggregate income (i.e., wage, salary, bonuses, and benefits). The authors suggested that venture capital stimulates the creation of more firms than it funds through two mechanisms: (i) capital constrained would-be entrepreneurs are more inclined to start firms; and (ii) VC-backed firms promote spin-offs as employees absorb tacit knowledge on how to properly build and run entrepreneurial ventures.[8]

Despite numerous differences between venture capital in the United States and that in frontier markets—from the way deals are structured to the exit avenues available—we suggest that Samila and Sorenson's findings hold for frontier markets. Because research has found that the management practices of companies in developing markets generally lag their Western counterparts,[9] the exposure to VC-level management practices may even be disproportionately valuable.

The Bella Research Group also encountered the "role-model" effect first hand in our evaluation of a risk capital program (IFC SME Ventures) in pre-frontier, conflict-affected markets (Liberia, Sierra Leone, and Democratic Republic of Congo). In particular, we found that successful portfolio companies engendered entrepreneurial interest in the local community. In interviews, we heard numerous accounts of entrepreneurs in VC-backed firms advising friends on startup management.

Given the importance of PE in frontier markets at both the firm- and country-level, we next explore the research suggesting that these benefits are maximised when PE firms are based in the local economies of their portfolio companies.

3. THE LOCALISATION OF PRIVATE EQUITY

In this section, we explore the importance of a local presence for Africa-focussed PE funds. The saying that "all politics is local" can be equally applied to PE activity, where the actual investment origination, assessment, and monitoring processes require a detailed knowledge of the local market, a network of local contacts, and the ability to visit the company on a regular basis.

Because PE strategies must be tailored to the specific needs of the market, there is near unanimous agreement among practitioners that an on-the-ground presence is critical to success. Experts in development finance institutions (DFIs), consultants, and trade groups have concurred that a local presence is attractive to limited partners (LPs) because it differentiates the fund managers, facilitates "[a]ccess, reputation checking, due diligence, management, acquiring talent, [and] acquiring leverage,"[10] and generates proprietary deal flow.[11]

Yet the benefits do not accrue only to the fund manager or its LPs—a local PE fund confers benefits on its portfolio companies as well, which we describe below.

3.1. The Mutual Benefits of Localised Private Equity

We briefly observe the mutually beneficial effects of localised private equity for PE firms and their portfolio companies. We first describe two key academic studies suggesting the importance of locality in value creation. It is important to note that that the academic literature described below refers to venture capital (VC) in the United States. We suggest, however, that the main issues faced by venture capitalists in the United States—i.e., information problems, contract enforcement challenges, etc.—are analogous to those of PE fund managers in developing markets. We also survey practitioner opinion generally and, as a "mini-case," describe Blackstone's efforts to establish a local presence in Brazil.

Academic Literature

Venture capitalists play an important advisory role in the start-ups in which they invest. As one might expect, geographic proximity impacts value creation. Shai Bernstein, et al. examined the impact that venture capitalists have on their portfolio companies and found that geographic proximity (more specifically, travel time) affects value creation. To do so, the authors considered how the introduction of new airline routes that reduced travel time between venture capitalists and their portfolio companies affected portfolio companies with respect to the quantity and quality of their innovations and success (i.e., exits via IPO or acquisition). The authors found that reductions in monitoring costs stemming from these new airline routes indeed translated into better portfolio company performance. The authors hypothesized that such success could be attributed to more time spent by the venture capitalists at the portfolio companies where they could advise executives, provide access to key resources, and aid the operation's professionalization.[12] While this study exclusively examined VC activity in the United States, it offers a persuasive argument for the impact of proximity in this context.

Further supporting the impact of location on company oversight, Josh Lerner found that venture capitalists typically served on the boards of geographically proximate companies. In particular, Lerner found that more than half of the biotechnology firms he examined had a venture director with an office within 60 miles from their headquarters, and the distance was within seven miles for a quarter of the companies. In other words, the data suggested that the cost of oversight is sensitive to the distance between the PE firm and its portfolio companies.[13]

Practitioner Perspectives

In frontier markets, and Africa specifically, a local presence may be even more significant, given, for example, weak or nonexistent internet connections and expensive travel. In fact, a 2014 survey of 106 global limited partners by the Emerging Market Private Equity Association (EMPEA) found that 55% of respondents felt that a "limited number of established fund managers" would likely deter SSA PE investment within the next two years.[14]

What is it specifically that gives an advantage to local firms? We consider two such factors below, deal access and due diligence. Particularly in emerging markets where PE firms have not differentiated by brand, a local presence is critical for both deal access and deal assessment.

- Deal access

David Wilton, then of the International Finance Corporation (IFC), emphasised that access to deal flow, especially proprietary deal flow, requires local contacts.[15] The United Nations Economic Commission for Africa also noted that deal flow is mainly generated by "personal networks of fund managers," and just one-third of deals are generated through company / sector tracking.[16]

- Due diligence and reputation checking

The British Private Equity & Venture Capital Association (BVCA) has detailed a variety of challenges impeding private equity due diligence in SSA.[17] These included the need to understand the business and political connections of company founders, and the difficulty of finding executive talent, all in the face of limited public information. The stakes are high: missteps can leave the PE firm (even if it has a minority position) vulnerable to anti-corruption legislation. In addition, regional and country-specific political risk also complicates the already risky business of investing in SMEs.

Uncertain official economic information in frontier markets also complicates the process of deal assessment. Without reliable estimates of, for instance, economic sector activity, market size numbers could be inaccurate and "sector picking" strategies could be futile.[18] As a result, success in frontier markets appears to dictate that a PE firm establish at least a local office in a country of interest.

To dig a little deeper into the PE firm and portfolio company benefits of "localised" private equity, we offer a brief description of Blackstone's minority investment in a local Brazilian PE firm, Pátria Investimentos. Blackstone's investment in Pátria illustrates a broader trend of Western fund managers becoming "local" through partnership with established local players.[19]

3.2. The Importance of a Local Presence – Mini Case: Blackstone and Pátria Investimentos

The value of subtle local knowledge for PE is clearly illustrated in Blackstone Group's partnership with Brazil-based Pátria Investimentos. On October 1, 2010, the Blackstone Group invested US$200 million for 40% equity in Pátria, a local Brazil-focussed alternative asset manager founded in 1988 with one of the strongest records in Latin America.[20] The Pátria investment was part of Blackstone's broader emerging markets strategy.[21] At the time of the transaction, Brazil had a burgeoning macro-environment (i.e., attractive long-term GDP projects, a booming consumer market, an emerging IPO market) and the PE industry was recovering from its collapse in 2009 due to the financial crisis.[22] A Coller Capital and EMPEA survey in 2010 found that 19% of emerging market PE investors expected to begin investing in Brazil (the highest of any region) in the next two years, and Ernst & Young reported that several reputable GPs were investing in Brazilian deals (e.g., Actis, Advent, Carlyle).[23]

Blackstone's CEO Stephen A. Schwarzman explained that a *local presence* was critical to success in the region in a number of ways. In Blackstone's 2010 10-K, Schwarzman noted that the deal would "enhance [Blackstone's] 'intellectual library' by providing all of Blackstone's businesses with increased access to information and deal flow."[24] He also affirmed that Blackstone's partnership with Pátria would "…enable Blackstone's limited partners and advisory clients to benefit from the fast-expanding business opportunities in the country, as well as from Pátria's deep knowledge of the local market."[25] Access to deal flow was of critical importance, as more than 50% of Brazil's private equity transactions were done by local PE firms.[26] This point was further acknowledged by Sergio Galvis of the law firm Sullivan & Cromwell:

> ...a fragmented market composed of smaller companies with less sophisticated management and consolidation potential tends to favour firms with local knowledge and ties, which are better positioned to identify and take advantage of such opportunities ahead of their competitors... Foreign firms are seeking to tap into such local expertise to have access to more attractive opportunities.[27]

Schwarzman believed that success in the region (e.g., deal flow, market knowledge, value creation) required an on-the-ground presence in Brazil.

4. THE DRIVERS OF PRIVATE EQUITY LOCATION DECISIONS FOR DOMICILIATION

In this section, we move from the drivers of office location to the drivers of domicile location. It is important to note that while "offshore financial centres" are not uniform in nature, scholars have found that they typically exhibit the following features, as summarised by Ahmed Zoromé of the International Monetary Fund (IMF): "(i) the primary orientation of business toward nonresidents; (ii) the favourable regulatory environment (low supervisory requirements and minimal information disclosure) and; (iii) the low-or zero-taxation schemes."[28]

While these definitions give a sense of the nature of an offshore financial centre, some experts take issue with this definition's lack of objectivity. As a result, Zoromé suggested that offshore status could be indicated by a high ratio of net financial services exports to GDP to suggest that the "[provision of] financial services to nonresidents [is] on a scale that is incommensurate with the size and the financing of its domestic economy." Still, Zoromé noted two key limitations with this definition. First, data limitations often inhibit the calculation of financial services exports directly. Instead, proxies must be used to estimate this figure. Even with complete data, however, the definition ultimately depends on a subjective determination of an "incommensurate" ratio, which itself can depend on the comparative sample.[29]

While precise definitions are challenging, it is fair to say that in reference to "offshore status," the literature we discuss below typically refers to those jurisdictions that clearly exhibit the traits summarised by Zoromé (noted above), as is the case with, for example, Mauritius and the Cayman Islands. We first look at the distribution of domiciles in a variety of markets and subsequently draw on recent surveys of fund managers in the alternative asset industry.

4.1. Where do Private Equity Fund Managers Domicile Their Funds?

A PE fund's domicile—i.e., its legal home—often differs substantially from the location of its headquarters or other offices. A July 2014 Preqin article explored the variety of domiciles used by PE fund managers relative to their geographic base (see Exhibit 1). The authors used data from Preqin's Funds in Market database and looked at the distribution of domiciles over the past 10 years among fund managers based in different geographies. For fund managers based in emerging markets such as China and India, at least a third of funds in the sample were domiciled offshore (e.g., Cayman Islands, Mauritius).

This information raises the question of domicile choice—what qualities do Mauritius, the Channel Islands, Luxembourg or the Cayman Islands have that make them so attractive to PE fund managers? Moreover, why do fund managers in different countries appear to have different preferences for places of domicile? We explore these themes below.

4.2. Drivers of Domicile Choices

Given large discrepancies in the domicile choices for fund managers based in different countries, we next explore what factors PE firms consider when choosing where to domicile a fund. Some important questions we considered were how tax incentives play into decisions and what non-tax factors are most important. We then (in Section 5) explore these questions in finer detail with respect to Mauritius, a prominent domicile choice for Africa-focussed PE fund managers.

In mid-2012 IFI Global surveyed investors and managers of both PE and hedge funds, along with lawyers and consultants, on domiciliation practices in the alternative fund industry. The study found that fund investors preferred

Exhibit 1:
Private equity domiciles for funds raised in the past 10 years (as of July 2014), by base of fund manager[30]

BASE OF FUND MANAGER	PERCENT OF FUNDS BY DOMICILE
United States	87% in United States *(of which 73% in Delaware)* ≈ 7% in Cayman Islands
United Kingdom	34% in United Kingdom 30% in Channel Islands 13% in Luxembourg
France	35% in Luxembourg
Germany	≈ 50% in Germany 32% in Luxembourg
China	63% in China 34% in Cayman Islands
Hong Kong	78% in Cayman Islands 12% in China
India	≈ 50% in India 38% in Mauritius

to participate in funds domiciled in "tried and trusted jurisdictions," and that this quality was more important than its onshore or offshore status. Interestingly, the study also indicated that the investors were equally or more concerned with the brand names of the fund's service providers. To reduce anxiety among the investors, the fund managers will prefer jurisdictions familiar to their investors.[31]

A 2011 Oliver Wyman study noted that alternative investment funds (hedge funds, PE funds, and real estate funds) have traditionally preferred offshore domiciles due to "favourable tax regimes, confidentiality, lower levels of 'red tape,' and the higher quality of fund infrastructure available at these locations." The study did find, however, that offshore centres have attracted some negative attention and that certain institutional investors require onshore funds, due to, for example, their own bylaws / constitutions and perceived investor demand.[32] Along these lines, we note that political rationales have led the European Investment Bank (EIB) to invest increasingly only in funds domiciled onshore. In contrast, however, the majority of private equity funds in which the African Development Bank has invested are legally domiciled offshore in Mauritius.[33]

In a 2014 follow-on study, Oliver Wyman explored the primary domiciles of alternative investment funds in the Americas and Europe and highlighted key domicile decision drivers across private equity, real estate and hedge funds.[34] The authors noted the following characteristics of jurisdictions typically considered by these fund managers: an attractive tax system with favourable tax rates and a network of double taxation avoidance agreements; a legal environment that accommodates flexible limited partnership regimes and follows international standards and regulations, especially with respect to investor protection rights; high-quality local service providers; manageable investor requirements with respect to re-domiciliation, registration, and fees; and responsive, trustworthy authorities.

In addition, we found a broad consensus that domicile choices are also a function of country risk. Fund managers generally prefer to domicile in regions that exhibit political, regulatory, fiscal, and economic stability.[35] For example, in most cases funds domiciled in jurisdictions that lacked the regulatory capacities to negotiate a co-operation agreement with the European Securities and Market Authority (ESMA) and comply with the Alternative Investment Fund Managers Directive (AIFMD) would be unable to market to European investors.[36] Moreover, beyond the fact that political instability gives rise to increased fiscal uncertainty,[37] research suggests that without democratic political stability, institutions that protect investors, such as courts and regulators, cannot function properly.[38]

4.3. Economic Impact of Becoming a Private Equity Hub for Domiciliation

The economic impact of PE domiciliation is also significant. On a conceptual level, domiciling PE funds in a region brings additional tax revenue as well as growth in the overall fund management (e.g., administrators, custodians), and financial and legal services industries.[39] The establishment of tax stability and regulatory stability may attract other industries as well, such as hedge funds and real estate funds.[40]

It is important to note, however, that the PE domiciliation *does not* imply a boost in PE deals in the country. In fact, attractive PE domiciles facilitate PE activity in *other* countries through economic cooperation treaties (such as double taxation avoidance agreements): for example, Luxembourg and the Cayman Islands appear to have a very modest amount of economic activity from PE-funded firms' back office operations. While we found no empirical studies exploring the economic impact of increased PE domiciliation attractiveness, we suspect a relatively modest net impact with respect to indicators such as aggregate employment—particularly with respect to the low-skilled jobs that many emerging countries most need to create. It is important to note that while broadly speaking, financial sector development is essential to economic growth and poverty reduction—a claim supported by a large amount of empirical evidence—the developmental benefits that directly stem from legally housing PE groups is not clear.[41] The costs associated with the financial and regulatory shifts required to house the back office operations of PE firms, such as the development of suitable investment vehicles and the onshoring of the specific accounting and clerical services to PE funds (see Section 5 for more detail), are unlikely to drive proportionate development growth to these expenses.

In other words, the economic growth associated specifically with PE domiciliation is unlikely to be "pro-poor" growth, a phrase often used by the World Bank to describe types of growth strategies that boost the average income of the poor in absolute terms, or relative to the non-poor to decrease inequality.[42] As noted by the Organisation for Economic Co-operation and Development (OECD), "[d]evloping countries with similar rates of economic growth have experienced quite different levels of economic poverty reduction, due to initial conditions *and whether growth occurs in areas and sectors where the poor live and are economically active.*"[43] Because job creation driven by PE domiciliation primarily requires skilled labour—such as accountants, lawyers, fund administrators—and focuses on a small subset of financial activity (PE and venture capital), it largely bars the poor from participating in and benefiting from the growth. While the development of a skilled labour force could indirectly benefit the poor through increased remittances or unskilled jobs, we suggest that the extent would be modest.

One may suggest onshore financial centres have the potential advantage of being near larger pools of capital than offshore centres. Funds, however, typically have both an onshore component for domestic investors and an offshore component for foreign investors. While domestic investors often cannot escape regulatory and tax issues by going offshore, international investors typically favour the offshore vehicles for their regulatory and tax advantages. In addition, the speed with which global capital now moves in many cases reduces the impact of geographic barriers between limited and general partners.

Another question must address the feasibility of creating an onshore financial hub for PE in Africa. In the following section, we explore how Mauritius came to its present dominance as a PE domicile and the strategies another country would have to pursue to compete with it.

5. THE SPECIAL CASE OF OFFSHORE FINANCIAL CENTRES – MINI-CASE: AFRICA-FOCUSSED FUNDS AND MAURITIUS

In this section, we focus on the specific decision drivers for Africa-focussed PE funds. Experts suggest Mauritius is the domicile of choice for African PE funds,[44] and thereby serves as a fitting case study to understand the incentives behind domicile decisions.

5.1. Drivers for Mauritius Domiciliation for Africa-focussed PE Funds

In a review of practitioner opinions, we identify a number of key attributes leading private equity fund managers to domicile Africa-focussed funds in Mauritius. These include tax, legal, and financial incentives, geography and organisational memberships, political stability, and local professional service providers. We discuss each below.

1. Tax incentives

In response to a surge in foreign direct investment (FDI) investment from Mauritius-domiciled investment funds in 2010, Trident Trust—admittedly not the most objective source because it offers fund administration services there—examined the PE industry's attraction to the jurisdiction. The study found that PE funds capitalised on Mauritius's own low tax environment and its network of DTAAs (Double Taxation Avoidance Agreements):

> Mauritius is party to 34 [note: 39 have entered into force to date[45]] tax treaties. Most of these treaties exempt from capital gains tax the profit realised on the sale of shares of companies based in a treaty partner – a key private equity consideration. In addition, many of these treaties also exempt—or apply a lower rate—from withholding tax payments of interest, dividends and royalties. A further attraction for private equity is that Mauritius does not itself have a capital gains tax and does not impose a withholding tax on dividends paid by Mauritius companies to foreign shareholders. Funds are subject to a local 3% [effective] tax [rate] on ordinary income.[46]

Most other African countries typically levy substantial withholding taxes on dividends paid to nonresidents (generally between 10% and 20%) and also impose capital gains taxes at a rate between 30% and 35%. As a result, Mauritius-domiciled Africa-focussed funds can create material tax savings.[47]

2. Other financial / legal incentives

Mauritius also reduces investment risks associated with Africa-focussed funds through its African network of Investment Promotion and Protection Agreements (IPPAs).[48] Broadly speaking, IPPAs are bilateral treaties between governments designed to attract investment in each other's territory. IPPAs in Mauritius typically give to investors such guarantees as equitable protection / treatment of investments; equitable treatment of returns of investors; free transfer of monies relating to investments and returns; expropriation protections against nationalization of investments;[49] and the "most favoured nation" status with respect to treatment of investments and compensation for losses in the cases of war or armed conflict.[50] Moreover, Mauritius's absence of exchange control restrictions facilitates non-domestic investments made by PE funds as well as investment in PE funds made by international investors.

PE funds in Mauritius can be structured as a tax resident company with a Global Business License Category 1 (GBC1) and thus realise the benefits of Mauritius's DTAAs and IPPAs.[51] As noted by Roddy McKean, then a partner at South Africa-based law firm Webber Wentzel, most other countries in Africa lack the tax certainty that Mauritius offers PE funds.[52] Investors find tax certainty to be crucially important, as, for example, India-domiciled funds have suffered from an unstable tax policy / framework for both the fund and the investors.[53]

Mauritius also has overwhelming advantages over the SSA region with respect to its general business environment. Of particular importance to domicile choice, Mauritius appears far more attractive compared to the SSA regional average with respect to credit access, protection of minority investors, ease of tax payments, and contract enforcement (see Exhibit 2).

3. Geography and organisational membership

From a business perspective, then, Mauritius has the qualities of a developed market with substantial tax advantages—yet is in a proximate time zone to SSA, India, and China. In fact, geography becomes another advantage.

Mauritius's collective membership in regional organisations (e.g., Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA)) confers additional economic benefits.[55] For example, PE investors making deals in COMESA-member States could get approval of merger filings from the newly established Competition Commission (CCC), which acts as a one-stop-shop for cross-border mergers and acquisition. By avoiding the need to file with competition regulators in individual member states, a PE fund can substantially cut the costs and time involved in transaction approvals.[56]

4. Country stability

PE fund managers also seek a secure environment for their funds. According the World Bank's Worldwide Governance Indicators (WGI), Mauritius is far more attractive than the SSA regional average, as well as South Africa, for all six governance indicators—voice and accountability; political stability and the absence of violence; government effectiveness, regulatory quality, rule of law, and control of corruption.[57] Of particular importance, we note that for 2013 Mauritius's percentile rank (0 to 100; 100 being the best) from a sample of 215 countries is 78 with respect to "political stability and absence of violence / terrorism," relative to 44 for South Africa, and 34 for the SSA regional

Exhibit 2:
World Bank *Doing Business* 2015 rankings (1-189, 1 = best) for Mauritius and the SSA regional average[54]

DOING BUSINESS INDICATOR	MAURITIUS RANKING	SSA REGIONAL AVERAGE
Getting Credit	36	122
Protecting Minoring Investors	28	121
Paying Taxes (i.e., tax rates and administrative burden)	13	129
Enforcing Contracts	44	121

Note: *Doing Business* rankings are benchmarked to June 2014.

average. With respect to regulatory quality and rule of law, Mauritius's percentile rank is 79 and 78 respectively, relative to 64 and 58 for South Africa, and 30 and 29 for the SSA regional average.[58] Its regulatory quality is reflected by the fact that it has entered into a co-operation agreement with the European Securities and Markets Authority (ESMA) to allow Mauritius-domiciled funds to market in the European Union after the AIFMD became effective in 2013.[59]

With its reliable legal and regulatory institutions, investors can feel increasingly comfortable with the settlement of disputes in Mauritius, a key consideration for PE fund managers. In fact, international arbitration—generally speaking, a system to resolve disputes involving international agreements that is an alternative to litigation—will likely increase in Mauritius for two reasons. First, Mauritius recently opened the Mauritius International Arbitration Centre, which will apply the London Court of International Arbitration Rules. In addition, from a recent change in Mauritius's "substance" tests for tax domiciliation, it follows that if a fund's legal documents contain a dispute resolution mechanism (i.e., a constitutional requirement to settle disputes in Mauritius) then the fund is seen to be evidencing Mauritius "substance," which assists with tax domicile determinations.[60] Thus, not only will Mauritius domiciled funds be required to settle arbitration in that country, but its application of the London rules—which are well known internationally—will make funds willing to do so.

5. Fund service providers

Mauritius has a well-established professional services sector qualified to serve the PE industry. Internationally recognised banks (e.g., Barclays and Deutsche) and auditors (e.g., PwC and KPMG) have a presence in Mauritius. It is important to note that while the availability of such services does not differentiate Mauritius from other cities in Africa such as Nairobi, Johannesburg, and Lagos, the presence of internationally recognised firms is critical to investor confidence in the region. In addition, the Board of Investment Mauritius suggests that support services required by private equity funds are affordable.[61] Importantly, Mauritius boasts a largely bilingual labour force (English and French) to facilitate deals in English and French speaking African countries.[62]

5.2. How Does PE Domiciliation Affect the Economic Growth of Mauritius?

We are also interested in the impact that PE domiciliation in Mauritius has had with respect to economic growth. While no studies appear to directly explore this link, academic literature does suggest that, broadly speaking, Mauritius's overall economic growth has benefited significantly from its financial sector development. For example, one study found that higher levels of financing services and financial intermediary development from 1952 to 2004 in Mauritius had a measurable impact on output (real GDP per capita).[63] Another study using cross-country data further found that the existence of an international financial centre had a positive influence on domestic financial development (using a variety of indicators).[64]

Still, while financial sector development has indeed been shown to reduce inequality in African countries,[65] PE domiciliation contributes most directly to high-skilled jobs in the form of support services to the PE firms (e.g., legal, financial, accounting). In fact, Global Business Companies (GBCs) in Mauritius, which comprise the offshore financial sector, directly (i.e., not including financial, legal or accounting support services to GBCs) are estimated to contribute only about 0.2% of total employment (as of June 2012).[66] As discussed in Section 3, however, PE firm location decisions with respect to headquarters and offices appear to be extremely important with respect to value creation and can have a major impact on entrepreneurship in the country.

The above analyses offer just a snapshot of the investor attitudes that drive domiciliation choices and the subsequent impact on economic performance. Below, we highlight several implications regarding the viability of new onshore financial centres in Africa.

6. IMPLICATIONS FOR AFRICA

In this paper we discussed the location choices of PE firms with respect to headquarters / offices and domiciles. We explained how risk capital provided by PE funds can help loosen the financial constraints faced by SMEs in Africa, while the PE investment model adds value in other ways, such as improved management practices. Increased PE activity can have a more widespread entrepreneurial impact, extending beyond each individual deal. PE managers have found, however, that the "fly in, fly out" model is not appropriate for frontier markets such as Africa, because local presence confers competitive advantages with respect to deal access, due diligence, and deal monitoring. We also considered the drivers of domicile decisions and highlighted preferences for familiar, trusted regions with such features as a tax system with DTAAs and low tax rates, a stable legal and regulatory environment, and high-quality service providers. These features are particularly pronounced in the case of Mauritius, which currently serves as an attractive option for Africa-focussed PE funds.

Our final question is: What does this analysis imply for the establishments of future financial hubs for PE in Africa? We explore three implications: (1) established jurisdictions such as Mauritius have a significant "first mover" advantage due to investor aversion to new, "untested" domiciles; (2) a PE financial hub has "sticky" qualities based on already-established DTAAs, patterns of behavior, relationships with service providers, and cultural considerations; and (3) most African nations would likely be best served promoting local PE investment rather than PE domiciliation.

1. Familiarity is critical to investors for domicile choice.

PE fund managers appear to base their domicile decisions largely on familiarity. IFI Global found that fund managers (PE and hedge funds) chose jurisdictions with a solid reputation and were reluctant to change from "tried and trusted" locations. In fact, managers noted that investor or regulatory demands would be the main motivations to domicile in a new jurisdiction.[67] The force of familiarity can be seen in the Singapore-based PE fund managers' "predilection" to continue to domicile funds in the Cayman Islands, despite few "inherent advantage[s]" over Singapore in light of recent reforms.[68] As a result, absent any major legal restrictions against offshore funds or widespread changes in investor preference, the development of an onshore financial centre for Africa-focussed PE funds will be extremely difficult.

The familiarity extends to confidence in the stability of the region. Our research suggests that PE investors desire a domicile with a credible government to ensure fiscal certainty and political stability, as well as a stock of reputable professional service providers for fund administration. As a result, technical assistance (TA) programs must focus on building confidence in the region from regulatory, political, and technical perspectives as well. We discuss this further with our third point.

2. The choice of a fund domicile is sticky and competing with an already-established operation will be extremely difficult.

Expanding on the previous point, Mauritius has a significant first-mover advantage in providing fund domiciliation services. Any efforts to create a new financial hub for PE in Africa would involve the negotiation of tax treaties with the countries (especially African countries) that have already signed such agreements with Mauritius, as well as joining the relevant regional organisations, and creating the types of tax and legal structures that already exist in Mauritius. One can also suspect that service providers would be unwilling to invest in a nascent financial hub especially when Mauritius already exists.

It is important to note that other SSA cities—such as Johannesburg, South Africa; Nairobi, Kenya; Kigali, Rwanda; Gaborone, Botswana; and Lagos, Nigeria—each have elements of Mauritius's attractiveness as a financial hub. For example, South Africa has an even more extensive DTAA network (though Mauritius's treaties with African countries are often more favourable)[69] and has recently modified regulations to become more attractive to PE funds[70]; Kenya and Rwanda are members of COMESA; and well-established financial service providers are based in such cities as Johannesburg and Lagos. Still, Mauritius ranks favourably in almost every legal and cultural dimension considered by PE fund managers (see Exhibit 3; the leader in each category is noted in bold).

In addition, Mauritius has a substantially larger network of DTAAs than four of the five African countries listed above, with the exception of South Africa.[71] As mentioned previously, however, Mauritius's tax treaties with other African countries are often more favourable than South Africa's, particularly with respect to withholding tax rates.[72]

Given the familiarity of Africa-focussed GPs and their investors with Mauritius, as well its (i) cultural stability with respect to politics, regulations, and doing business and (ii) collection of other financial incentives and organisational memberships, we find it likely that Mauritius will continue to be favoured by PE groups.

For future research, it is important to understand the foundations of political pressures around offshore PE domiciliation in Mauritius. We suggest a close investigation of (a) the current perception of Mauritius among institutional investors and policymakers with respect to financial transparency and tax practices and (b) the rationales behind major criticisms.

Exhibit 3:
The rankings of legal and cultural dimensions considered by PE fund managers for Mauritius compared to select countries in SSA

	Mauritius	South Africa	Kenya	Rwanda	Botswana	Nigeria
Protecting Minority Investors *(DB, rank, of 189, 1 = Best)*	28	**17**	122	117	106	62
Paying Taxes (i.e., tax rates and administrative burden) *(DB, rank of 189, 1 = Best)*	**13**	19	102	27	67	179
Enforcing Contracts *(DB, rank of 189, 1 = Best)*	**44**	46	137	62	61	140
Political Stability and Absence of Violence / Terrorism *(WGI, % Rank of 215, 100 = Best)*	78	44	14	44	**85**	4
Regulatory Quality *(WGI, % Rank of 215, 100 = Best)*	**79**	64	39	53	73	25
Rule of Law *(WGI, % Rank of 215, 100 = Best)*	**78**	58	28	51	68	12
Control of Corruption *(WGI, % Rank of 215, 100 = Best)*	66	55	13	72	**79**	9

Note: *DB* = World Bank *Doing Business* rankings (rankings benchmarked to June 2014); WGI = World Bank Worldwide Governance Indicators rankings (2013 data). [Accessed January 14, 2015].

3. The encouragement of local PE activity will likely create more economic development than will domiciliation.

Academic research and Bella Research Group's own experiences in fund evaluation point strongly to the positive impact that PE investments can have on a region. Given that (i) PE domiciliation in a country does not imply increased PE investment in that country and (ii) fund managers are generally reluctant to change domiciles, we suggest that the donor funding intended for developing an onshore financial centre may be better utilised in the development of a business environment conducive to PE deals. Encouraging countries to adopt the reforms that would attract PE office or headquarters in a country—regional stability, a business-friendly environment, rule of law, enforcement of contracts and so forth—could also serve as a natural first step toward the encouragement of domiciliation in the country. In the interim, however, these reforms would foster growth through the economy in a more balanced and developmental way than efforts solely aimed at creating a financial hub.

We suggest that while donors, such as the European Bank for Reconstruction and Development (EBRD), could help increase the attractiveness of onshore financial centres, the risks are fairly high. Given the host of advantages of offshore domiciliation for international investors, they will likely stay with what they know absent any additional costs (perhaps reputational) that outweigh these benefits. Still, we suspect that donors could have an impact in creating onshore financial centres in Africa if substantial time is devoted to developing the proper ecosystem in which fund managers and their investors would feel confident. To do so, Botswana, for example, would need to simplify its regulatory environment to become more conducive to business activity (as reflected by the *Doing Business* rankings in Exhibit 3). South Africa, perhaps the most viable SSA financial centre alternative with respect to "doing business" considerations, would need to enhance its quality of governance (as reflected by the WGI rankings in Exhibit 3). Such changes would likely take many years, even decades, before an onshore alternative would emerge for investors.

ENDNOTES

[1] World Bank *Enterprise Surveys*, accessed December 3, 2014. For papers discussing the important role of access to finance in developing countries see Thorsten Beck and Asli Demirgüç-Kunt. "Access to Finance: An Unfinished Agenda." *The World Bank Economic* Review 22, no. 3 (2008): 383-396. See also, Hinh T. Dinh, Dimitris A. Mavridis, and Hoa B. Nguyen. "The Binding Constraint on Firms' Growth in Developing Countries." *World Bank Policy Research Working Paper 5485* (November 2010).

[2] James Barth, Dongyun Lin, and Keven Yost. "Small and Medium Enterprise Financing in Transition Economies." *Atlantic Economic Journal* 39, no. 1 (2011): 19-38.

[3] World Bank *Enterprise Surveys*, accessed December 3, 2014.

[4] See Chapter 1 in Heywood Fleisig, Mehnaz Safavian, and Nuria de la Peña. *Reforming Collateral Laws to Expand Access to Finance*. Washington: The World Bank, 2006.

[5] Alejandro Alvarez de la Campa, "Increasing Access to Credit through Reforming Secured Transactions in the MENA Region," *World Bank Policy Research Working Paper 5613*, March 2011.

[6] The World Bank's Enterprise Surveys collect firm-level panel data from a representative sample of private sector economies across the world. At the time of Kuntchev, et al.'s paper, the survey covered 41 countries in Sub-Saharan Africa. The dataset excludes fully government-owned firms, firms with fewer than five employees, and firms operating in agricultural, extractive industries. See Figure 2 in Veselin Kuntchev, Rita Ramalho, Jorge Rodríguez-Meza, and Judy S. Yang. *What have We Learned from the Enterprise Surveys regarding Access to Credit by SMEs?:* World Bank Enterprise Analysis Unit, May 2014.

[7] See Thomas Hellmann and Manju Puri. "Venture Capital and the Professionalization of Start-Up Firms: Empirical Evidence." *Journal of Finance* LVII, no. 1 (2002): 169-197; Malcolm Baker and Paul A Gompers. "The Determinants of Board Structure at the Initial Public Offering." J*ournal of Law and Economics* 46, no. 2 (2003): 569-598; Nicholas Bloom, Raffaella Sadun, and John Van Reenen. "Do Private Equity Owned Firms have Better Management Practices?" *LSE Research Online Documents on Economics 25482* (July 2009); Yael V. Hochberg. "Venture Capital and Corporate Governance in the Newly Public Firm." *Review of Finance* 16, no. 2 (2012): 429-480.

[8] Sampsa Samila and Olav Sorenson. "Venture Capital, Entrepreneurship, and Economic Growth." *The Review of Economics and Statistics* 93, no. 1 (2011): 338-349.

[9] See Nicholas Bloom, Christos Genakos, Raffaella Sadun, and John Van Reenen. "Management Practices Across Firms and Countries." *The Academy of Management Perspectives* 26, no. 1 (2012): 12-33. The authors conducted surveys with more than 10,000 medium-sized manufacturing companies (100-5,000 employees) across 20 countries. To measure management practices, they measured 18 "Management Practice Dimensions" that generally cover monitoring, targets (i.e., set and track goals), and incentives.

[10] David Wilton. *Emerging Market Private Equity: The Opportunity, the Risks & Ideas to Manage Them*, 2012. Similar points are made in David Wilton and Laird Reed. *The Case for Emerging Market Private Equity:* IFC, 2013.

[11] These arguments are articulated in: Jean-Marc Savi de Tové. *Private Equity in Africa – an Investors Perspective:* CDC, 2011; Mike Casey. *Views from EMPEA: Ignore the Noise: Emerging Markets Remain Attractive:* EMPEA, November 2013; Deloitte and Africa Assets. *2014 East Africa Private Equity Confidence Survey: Clarity and Distinction*, March 2014.

[12] See Shai Bernstein, Xavier Giroud, and Richard Townsend. "The Impact of Venture Capital Monitoring: Evidence from a Natural Experiment." (February 23, 2014).

[13] Josh Lerner. "Venture Capitalists and the Oversight of Private Firms." *Journal of Finance* 50, no. 1 (1995): 301-318.

[14] See Exhibit 17 in Emerging Market Private Equity Association. *Global Limited Partners Survey: Investors' Views of Private Equity in Emerging Markets.* Washington, DC: EMPEA, 2014.

[15] Emerging Markets Private Equity Association. *Perspectives of an LP in Emerging Markets Private Equity:* EMPEA.

[16] United Nations Economic Commission for Africa. *Private Equity in Africa (Issues Paper)*: UNECA, 2014.

[17] British Private Equity & Venture Capital Association. *Guide to Private Equity & Venture Capital in the Middle East & Africa:* BVCA, 2013.

[18] For details on this matter, see Morten Jerven. *Poor Numbers: How we are Misled by African Development Statistics and What to Do about It.* 1st ed. Ithaca, NY and London: Cornell University Press, 2013. See also, Novare Equity Partners. *Proprietary Research and On-The-Ground Presence Key to Private Equity Success in Africa:* Novare, February 2013.

[19] This strategy is broadly discussed in PricewaterhouseCoopers. *Game on: Private Equity Investment in Africa: A Discussion with US Private Equity Executives on some of the Newest Opportunities in Emerging Markets:* PwC, March 2014.

[20] Blackstone. *Annual Report 2010*, 2010, pp. 15, 31, 59.

[21] See Vincent Bevins. "Blackstone Joins the Private Equity Surge in Brazil." *FT.com*, September 30, 2010. The author quoted Schwarzman: "In 10-15 years [emerging markets] will be almost half of the world's economy. The idea of not participating in half of the world's economy in a robust way seems like sort of deficient corporate strategy from my point of view, and frankly an illogical strategy…I think the movement to create a larger middle class [in Brazil] has got very substantial momentum. As a long term bet for above average growth Brazil has moved to a stage where it's self-sustaining. I don't think that Brazil is an elective course anymore."

[22] Ernst & Young. *Private Equity in Brazil: Ready for its Moment in the Sun:* E&Y, 2010. For EM PE Fundraising in Brazil for 2006-10, see Emerging Markets Private Equity Association. EM *PE Annual Fundraising and Investment Review:* EMPEA, April 2011, p. 6.

[23] Emerging Market Private Equity Association and Coller Capital. *2010 EMPEA/Coller Capital Emerging Markets Private Equity Survey:* EMPEA and Coller Capital, April 2010; Ernst & Young. *Private Equity in Brazil: Ready for its Moment in the Sun:* E&Y, 2010.

[24] The Blackstone Group L.P. *Form 10-K for Period Ending 12/31/10*. Accessed December 8, 2014. http://files.shareholder.com/downloads/bx/0x0xs1193125-11-47389/1393818/filing.pdf.

[25] "Blackstone and Pátria Announce Partnership in Brazil." *BusinessWire.com*, September 29, 2010.

[26] This figure is stated by Claudia Zeisberger in, Cynthia Owens. "Private Equity Comes of Age in China, India and Brazil." *INSEAD*, July 25, 2011.

[27] "Attracting Foreign Private Equity to Brazil." *Financierworldwide.com*, April, 2011.

[28] This list is extracted from a literature review conducted by Ahmed Zoromé in Ahmed Zoromé. "Concept of Offshore Financial Centers: In Search of an Operational Definition." *IMF Working Paper* (April, 2007).

[29] Zoromé noted one complicating factor in selecting an appropriate sample is differences in financial development across countries. To deal with this, Zoromé groups countries by income level. In addition, researchers must carefully consider what constitutes a high ratio. For instance, when the threshold is set at one standard deviation from the mean the United Kingdom appears to be an offshore financial centre. See Ahmed Zoromé in Ahmed Zoromé. "Concept of Offshore Financial Centers: In Search of an Operational Definition." *IMF Working Paper* (April 2007).

[30] Matthew Morris. *Private Equity Fund Domiciles – July 2014:* Preqin, July 2014. For a comparison of fund jurisdictions (Ireland, Luxembourg, Malta, Cayman, United Kingdom, Singapore, Jersey, Guernsey, and France), see PricewaterhouseCoopers. *Seeing the Bigger Picture: Fund Domicile Matrix:* PwC, December 2012.

[31] IFI Global. *Regulation and Domiciliation: The Views of the Alternative Fund Industry:* IFI Global, 2012. The importance of investor preference for PE domiciliation decisions is also found in PricewaterhouseCoopers. *Reviewing the Private Equity Model in the New Financial World: How Specialist Financial Centres Compare:* PwC, February 2013.

[32] Stefan Jaecklin, Florian Gamper, and Amit Shah. *Domiciles of Alternative Investment Funds:* Oliver Wyman, 2011.

[33] African Development Bank. *Mauritius: Country Strategy Paper 2014-2018:* ADB, January 2014, Annex 9, p. 18.

[34] See David Clarkson, Stefan Jaecklin, and Kamil Kaczmarski. *Domiciles of Alternative Investment Funds:* Oliver Wyman, 2014, p. 10.

[35] These factors are described generally in PricewaterhouseCoopers. *Reviewing the Private Equity Model in the New Financial World: How Specialist Financial Centres Compare:* PwC, February 2013. With respect to Luxembourg, see Luxembourg Private Equity & Venture Capital Association. Private Equity in Luxembourg 2013 Edition: LPEA, 2013. With respect to Jersey, see Ashley Le Feuvre. *Why Jersey Remains an Attractive Domicile for Private Equity Funds:* Volaw Group, November 2011.

[36] PricewaterhouseCoopers. *Reviewing the Private Equity Model in the New Financial World: How Specialist Financial Centres Compare:* PwC, February 2013.

[37] The connection between fiscal instability and government instability is discussed in Luca Agnello and Ricardo M. Sousa. "Political, Institutional, and Economic Factors Underlying Deficit Volatility." *Review of International Economics* 21, no. 4 (2013): 719-732. See also, Jaejoon Woo. "Growth, Income Inequality, and Fiscal Volatility: Empirical Evidence." In *The Political Economy of Fiscal Policy: Public Deficits, Volatility, and Growth,* 117-146. Germany: Springer, 2006.

[38] Mark J. Roe and Jordan I. Siegel. "Political Instability: Effects on Financial Development, Roots in the Severity of Economic Inequality." *Journal of Comparative Economics* 39, no. 3 (2011): 279-309.

[39] These points are made with respect to India in Ernst & Young. *Private Equity: Breaking Borders:* E&Y, 2013, p. 9. In fact, under the Mauritian GBC1 regime, the company must have a principal bank account in Mauritius, accounting records kept in Mauritius, and financial statements audited in Mauritius. For more details, see http://www.pwc.com/mu/en/services/tax/gbcone.jhtml.

[40] We make this point because surveys have found key similarities in the domicile decision drivers for these asset classes, as discussed in David Clarkson, Stefan Jaecklin, and Kamil Kaczmarski. *Domiciles of Alternative Investment Funds:* Oliver Wyman, 2014.

[41] For a review of the academic literature related to the impacts of financial development, see Juzhong Zhuang, Herath Gunatilake, Yoko Niimi, Muhammad Ehsan Khan, Yi Jiang, Rana Hasan, Niny Khor, Anneli S. Lagman-Martin, Pamela Bracey, and Biao Huang. *Financial Sector Development, Economic Growth, and Poverty Reduction: A Literature Review:* Asian Development Bank, October 2009.

[42] John Page. *Strategies for Pro-Poor Growth: Pro-Poor, Pro-Growth Or Both?:* World Bank, November 2005.

[43] Italics added for emphasis. See Organisation for Economic Co-operation and Development. *Promoting Pro-Poor Growth: Key Policy Messages:* OECD, 2006.

[44] *AVCA Member Profile: International Financial Services:* AVCA, 2014. The prominence of Mauritius is also articulated by James Martin of Trident Trust in African Private Equity and Venture Capital Association. AVCA: *Guide to Private Equity in Africa:* AVCA, 2014, p. 39.

[45] For a list of DTAAs, see Board of Investment Mauritius, http://www.investmauritius.com/downloads/dtaas.aspx, accessed December 17, 2014.

[46] Trident Trust. *Fund Administration Report: Private Equity Africa Surge Pivots on Mauritius:* Trident Trust, June 2010.

[47] African tax figures, as well as additional information on the specifics of how specifically to capitalise on these tax advantages are found in Kieran Loughran and Sonia Xavier. *Private Equity Investment into Africa: The Cayman and Mauritius Route:* Conyers Dill & Pearman, January 2011. We do note that Conyers Dill & Pearman does have a Mauritius office and thus may not be the most objective source. AfrAsia Bank also reports withholding taxes in Africa jurisdictions of interest to international investors from 15% to 20% and capital gains tax between 30% and 40%. See "African Tax Certainty Vital to Continued Investment." *Investa*, July 15, 2013.

[48] For a list of IPPAs, see Board of Investment – Mauritius, from http://www.investmauritius.com/downloads/ippa.aspx.

[49] With the exception if the expropriation is "for public purposes, under due process of law, on a non-discriminatory basis and against prompt, adequate and effective compensation (which shall be made without delay, and be effectively realisable)."

[50] Craig Fulton and Nicolas Richard. *Mauritius Investment Promotion and Protection Agreements:* Convers Dill & Pearman, December 2011 and Board of Investment Mauritius. "Exploring the Emerging Potential of Africa." Invest Mauritius, Issue no. 46 (September, 2012).

[51] See page 55 in Yan Ng. "Special Report on Mauritius: The Gateway to Investing in Africa: Investment Regimes and Structures in Mauritius." *Private Equity Technical Journal* no. 3 (Q3 2013): 53-57.

[52] Graham Stokoe, Hugh Naylor, and Roddy McKean. "Private Equity in Africa." *Financierworldwide.com* (December, 2011).

[53] Ernst & Young. *Private Equity: Breaking Borders:* E&Y, 2013, p. 8.

[54] World Bank. *Doing Business 2015: Mauritius Economy Profile 2015:* World Bank Group, 2014.

[55] Kieran Loughran and Sonia Xavier. *Private Equity Investment into Africa: The Cayman and Mauritius Route:* Conyers Dill & Pearman, January 2011

[56] Adam Lovett and Heather Irvine. *New Regional African Merger Regulation: Impact on Private Equity:* EMPEA, August 2014.

[57] For more information, see http://info.worldbank.org/governance/wgi/index.aspx#home.

[58] World Bank Worldwide Governance Indicators database, accessed December 15, 2014.

[59] Funds already operational could continue to market on a pre-AIFMD basis until July 2014. See Gamal Ballam. *The Alternative Investment Fund Managers' Directive (AIFMD) - Impact on Third Country:* Financial Services Commission Mauritius, June 2013.

[60] The changes are described in detail in Ernst &Young. *Mauritian Financial Services Commission Introduces Additional Conditions to Enhance Economic Substance of GBL1 Companies:* E&Y, October 2013.

[61] Board of Investment Mauritius. "Exploring the Emerging Potential of Africa." Invest Mauritius, Issue no. 46 (September 2012).

[62] The importance of a bilingual population is articulated by Peggy Soobiah, Senior Director at Mauritian financial services company IFS in "Private Equity in Mauritius – What You Need to Know." *Biznews.com*, June 4, 2014. See also Kheswar Jankee. "Drivers of an International Financial Centre: Lessons for Mauritius." *Theoretical and Applied Economics* XII Edition (2014): 262-63.

[63] Boopen Seetanah. "Financial Development and Economic Growth: An ARDL Approach for the Case of the Small Island State of Mauritius." *Applied Economics Letters* 15, no. 10 (2008): 809-813.

[64] Kheswar Jankee. "Drivers of an International Financial Centre: Lessons for Mauritius." *Theoretical and Applied Economics* XII Edition (2014): 262-63.

[65] Michael Enowbi Batuo, Francesco Guidi, and Kupukile Mlambo. "Financial Development and Income Inequality: Evidence from African Countries." *African Development Bank* (2010).

[66] International Monetary Fund. *Mauritius: 2014 Article IV Consultation - Staff Report:* IMF, May 2014.

[67] IFI Global. *Regulation and Domiciliation: The Views of the Alternative Fund Industry:* IFI Global, 2012.

[68] This view was expressed by Low Kah Keong of WongPartnership LLP in Low Kah Keong. "Singapore." In *The Private Equity Review*, edited by Kirk Radke, August. 3rd ed., 125-134: Law Business Research, March 2014.

[69] Deloitte. *Choosing a Gateway into Africa: Comparison of South Africa's Headquarter Company Regime with the Mauritius Global Business License Category 1 Company Regime:* Deloitte Global Services, September 2012. For a list of South Africa DTAAs, see South African Revenue Service. *Double Taxation Agreements (DTAs) & Protocols:* SARS, October 2014, from http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx.

[70] Lance Roderick, Stephen Kennedy-Good, and Andrew Wellsted. "Private Equity in South Africa: Market and Regulatory Overview." *Thomson Reuters* (2014).

[71] Unfortunately, the DTAAs lists by many government websites are not frequently updated; as a result, we also examined the lists provided by UNCTAD, which list all DTAAs concluded as of June 1, 2011. We only count agreements listed as either "income" or "income and capital," and do not double-count countries. We note that while UNCTAD does not specify which were actually entered into force, or if they had since been terminated, these data give a rough comparison among the group. In addition, we do find some discrepancies in DTAA networks for a given country across different sources. For lists, see http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20%28IIA%29/Country-specific-Lists-of-DTTs.aspx?Do=1,50,,.

[72] Deloitte. *Choosing a Gateway into Africa: Comparison of South Africa's Headquarter Company Regime with the Mauritius Global Business License Category 1 Company Regime:* Deloitte Global Services, September 2012.

The Potential of Onshore Financial Centres for Africa-focussed Investment Funds and Vehicles

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Acronyms

DTA	Double Taxation Agreement
EAC	East African Community
EOI	Exchange of Information
EOIR	Exchange of Information on Request
FATF	Financial Action Task Force
FC	Financial Centre
FSAP	Financial Sector Assessment Programme
FSI	Financial Secrecy Index
GFCI	Global Financial Centres Index
IFSC	International Financial Services Centre
IIP	International Investment Position
IMF	International Monetary Fund
NIFC	Nairobi International Financial Centre
OECD	Organisation for Economic Co-operation and Development
OFC	Offshore Financial Centre
SARB	South African Reserve Bank
TJN	Tax Justice Network

1. INTRODUCTION

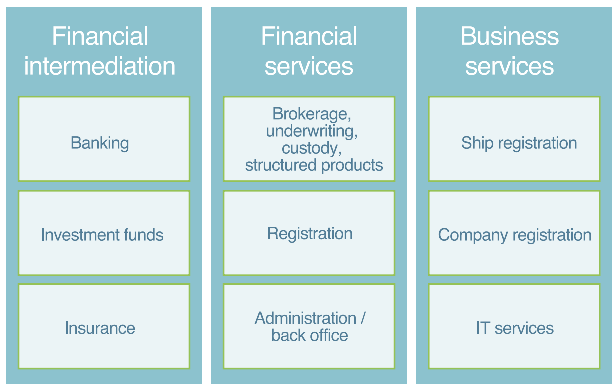
Consideration of the potential of "Onshore Financial Centres" first of all requires a definition of what the term means. The prefix "onshore" is generally contrasted with the alternative "offshore." But this contrast is not straightforward, and there is no single, accepted definition of what the terms mean. Indeed, the term "financial centre" can be preceded by a range of adjectives, including "offshore," "onshore," "regional," "international," and "global," each of which has a different—but not commonly agreed—perspective.

All economies have domestic financial centres, i.e., locations that specialise in the provision of financial services to domestic economic entities. However, a financial centre (FC) may be broadly classified as a jurisdiction that provides financial services on a scale that is disproportionately large relative to domestic economic and financial needs, and hence specialises to some extent in the provision of financial services to non-resident entities. This may be the result of a conscious strategy, or a less consciously pursued outcome of development processes, reflecting comparative advantage and the positive externalities of clustering.

The financial activities carried in financial centres can be broadly divided into those based around balance sheets and those involving financial services carried out for a fee. Balance sheet-based activities include banking, investment funds, insurance etc., where the financial institution has liabilities to one set of customers (e.g., insurance policy holders, fund investors, bank depositors) and a corresponding set of assets (bank loans, securities, etc.). These are all forms of financial intermediation. In a FC, these asset and liability relationships are significantly with non-residents. This may lead to a FC being characterised by a high level (say, relative to GDP) of international assets and liabilities in its International Investment Position (IIP).

Non-intermediation financial services do not involve issuing assets and liabilities directly, and may be carried out on behalf of financial institutions holding their balance sheets elsewhere. These services would be carried for a fee, and could include dealing in securities and foreign exchange, underwriting, asset management and custody fees, fund administration, accounting, credit rating, credit scoring, etc., and general back-office services for financial institutions.

Figure 1: Financial sector activities



Financial services can also extend to closely related business services, such as IT services, legal services, registration of international business companies. Financial centres may also offer unrelated business services such as ship and aircraft registration.

In principle, therefore, FCs may be distinguished by objective characteristics, such as the magnitude of exports of financial services (or finance and business services) relative to total exports or to GDP, or by the magnitude of IIP assets (adjusted for official reserve holdings) relative to GDP.

Conventionally, however, FCs are also conceptualised in terms of their operational characteristics, such as having a favourable regulatory environment (e.g., minimal supervisory and information disclosure requirements, or permitting particular types of corporate form), and / or low (or zero) tax regimes.

Although FCs by definition have a strong “offshore” component, in terms of significantly serving non-residents, they may nevertheless have important onshore elements. For instance, an investment fund domiciled in a particular country may raise funds from both international subscribers and domestic institutions (or individuals). Those funds may be partially invested domestically as well as internationally (or regionally). The relative proportions of domestic and international inflows and outflows will depend on the nature of the FC. A small, international FC such as the Cayman Islands would have virtually no domestic transactions, but a large international FC such as London would have a significant proportion.

Offshore Financial Centres (OFCs) are generally conceptualised as small economies with very large financial sectors that deal almost entirely with non-residents on both the asset and liability sides. They are also often considered to compete in terms of minimal regulatory requirements and low taxes. But distinguishing between “offshore” and “onshore” financial centres is a question of degree and highly subjective; what is “small;” what is “almost entirely;” and what is “minimal”? If a small FC deals with non-residents but has a compliant and internationally recognised and accepted regulatory regime, and a non-zero tax rate, is it still an “offshore” financial centre?

While large financial centres such as the US and UK are often considered to be “onshore,” the IMF’s definition classed them as offshore, due to their large volume of international business. Indeed, the distinctions between “domestic” and “international” financial centres may be more useful than the terms onshore and offshore. If an offshore centre is so classified because it primarily does business with non-residents, then an onshore centre is one that primarily does business with residents—i.e., it is just a country with a (large) financial sector mainly servicing the domestic economy. It is not evident that the concept of an OFC is particularly useful for assessing jurisdictions from a policy or operational perspective. The regulatory structures employed in some FCs may not necessarily be negative, and in fact in some instances have brought about innovation in regulatory practices more generally.[1]

To the extent that establishing or developing a FC is part of a conscious development strategy, the objectives are usually related to economic diversification, with the objectives of generating economic activity (output), employment, fiscal revenues or export earnings.

They may also have secondary objectives of providing additional opportunities for domestic investors (e.g., institutions) or attracting inflows of capital into the domestic economy. The relative magnitudes of domestic and international inflows and outflows in Figure 2 will vary considerably across FCs. The flows in a classic offshore financial centre would be mainly A-C.

Figure 2: Investment fund flows

Overall, there are many dimensions to a Financial Centre: the size of its international business relative to domestic business, with regard to both sources of investment funds and the destination of investments; the source and destination of the international business (regional, global); the nature of the business undertaken, whether balance sheet-based or fee-based; whether primarily administrative or including substantive management activities; and the extent of compliance with international requirements and best practice regarding legal structures, transparency and disclosure. This complexity does not really facilitate a simple distinction between offshore and onshore financial centres.

2. CLASSIFICATION OF FINANCIAL CENTRES

Depending on the basis of classification, around 100 jurisdictions may be identified as financial centres globally. The most direct classifications are the IMF's listing of Offshore Financial Centres (OFCs), and the Global Financial Centre Index (GFCI).[2] Indirect listings include the OECD listing of jurisdictions that have been reviewed for the Global Forum on Transparency and Exchange of Information for Tax Purposes,[3] and the Tax Justice Network's listing of jurisdictions from a "financial secrecy" perspective (focussed on what are more commonly known as "tax havens").[4]

The IMF's listing of Offshore Financial Centres relates to its programme of specific assessment of OFCs as a result of concerns about weaknesses in financial supervision in OFCs and a lack of information regarding their activities. This programme ran from 2000 to 2008, when OFC surveillance was integrated with the broader Financial Sector Assessment Programme (FSAP). Between 2000 and 2008, 53 OFC jurisdictions were identified for inclusion in the programme. However, the IMF has not used the OFC classification since 2008.

The GFCI (2014) rates 83 cities across a range of criteria and provides an overall ranking of GFCs. The GFCI ranks cities rather than countries. After including financial centres that are awaiting inclusion in the GFCI, there is a total of 96 cities in 69 countries. Of this total, 11 locations are identified specifically as offshore financial centres.

[1] *Morriss, A and Henson, C. (2012) Regulatory Effectiveness in Onshore and Offshore Financial Centers, University of Alabama School of Law Working Paper.*
[2] *IMF (2008) Offshore Financial Centers: A Report on the Assessment Program and Proposal for Integration with the Financial Sector Assessment Program; Z/Yen Group (2014) Global Financial Centres Index 16.*
[3] *OECD / Global Forum on Transparency and Exchange of Information for Tax Purposes (2014) Tax Transparency – Report on Progress 2014 (OECD).*
[4] *See: http://www.financialsecrecyindex.com/.*

The OECD has reviewed over 100 jurisdictions for the Global Forum. Some of these resulted from the earlier work of the Financial Action Task Force (FATF), while others were added later or as a result of requests from governments for a peer review. The main focus is on "Exchange of Information on Request" (EOIR) in relation to tax transparency and co-operation, which is carried out through peer reviews. The peer review process evaluates jurisdictions' compliance with the international standard of transparency and exchange of information on request. It focuses on three components: (i) availability of information; (ii) access to information; and (iii) exchange of information. Phase 1 reviews examine the legal and regulatory framework; Phase 2 reviews look into the implementation of this framework in practice. Countries are initially subject to a Phase I review, and those that are found to be sufficiently compliant—after taking remedial action to rectify any deficiencies, if necessary—can proceed to a Phase 2. After completion of both Phases of the review process, each jurisdiction receives an overall rating.[5]

The OECD-Global Forum assessment is one of the most important assessments for a financial centre. It is especially relevant for investments by government-related entities, which need to pay particular attention to governance and public policy related issues. The lack of a Global Forum assessment, or an adverse peer review finding, can seriously undermine a country's ability to attract internationally mobile financial investments. For a country with a significant financial services industry, or aspirations to develop one, the commercial implications are potentially large.[6]

Finally, an international research and advocacy group, the Tax Justice Network, has assessed 82 jurisdictions in terms of "Financial Secrecy." The Financial Secrecy Index is based on the degree of transparency (or not) according to 15 "key financial secrecy indicators" and an assessment of the country's global importance.

The jurisdictions included in these assessments are included as Appendix I.

3. FUND MANAGERS' ATTITUDES TOWARDS OFFSHORE / ONSHORE FINANCIAL CENTRES

The attitudes of fund managers and other key financial sector players towards FCs depends on their role, objectives and the regulatory environment.

Discussions with fund managers who have had experience of establishing funds in Africa indicate that a number of criteria are taken into account when deciding upon a jurisdiction for domicile.

These include:

Tax Arrangements and Effective Tax Rate:

- Headline tax rates
- Tax allowances
- Certainty of tax rates / arrangements
- Extent of Double Taxation Agreements (DTAs)

Legal and Regulatory Issues

- Nature of regulatory and legal framework
- Capability of regulator and speed of decision-making
- Regulatory transparency, consistency and efficiency
- Exchange controls
- Treatment by external regulators; external reputation and perceptions
- Bilateral investment protection agreements

Support Services, Skills and Infrastructure

- Services (company secretaries, accountants, administrators, etc.)
- Specialised skills (local availability or ease of immigration for expatriates)
- Transport, buildings, communications
- Stock exchange

Political and Economic Environment

- Political stability
- Macroeconomic stability
- Labour relations

[5] *The ratings are "Compliant"; "Largely Compliant"; "Partially Compliant"; and "Non-Compliant."*

[6] *As at the end of 2014, the following jurisdictions were Non-Compliant following a Phase II assessment: British Virgin Islands; Cyprus; Luxembourg; The Seychelles. The following jurisdictions were not eligible to proceed to Phase II following a Phase I assessment: Brunei; Marshall Islands; Dominica; Micronesia; Guatemala; Lebanon; Liberia; Panama; Nauru; Switzerland; Trinidad; Vanuatu.*

Importance of Domestic Flows

– Accessing domestic funds
– Domestic investment opportunities

The weighting of these different criteria will depend on the nature of the fund, of the potential investors in the fund, and the primary investment opportunities.

Taxation

Most funds operate in a competitive environment, and for them the returns paid to investors are crucial. Such funds seek as low as possible an effective tax rate. Given the competition from tax havens with zero tax rates, the effective tax rate needed to secure such footloose funds—i.e., those that have a wide choice of jurisdictions for registration—is close to zero.

However, this depends partly on the domestic tax regime applicable to the investor. If the investor is subject to domestic taxation—which determines the final tax rate—then it is not necessary for the fund to have a low tax rate in its home jurisdiction; what is important is that any taxes that are paid can be offset against the investor's domestic tax liability. Hence a wide network of Double Taxation Agreements (DTAs) is essential.

For financial centres dealing with mainly international flows (A-C in Figure 2 above), tax may be levied in the jurisdiction where the final investment takes place (C), and investors will be liable for taxation in their home jurisdiction (AC). If the FC imposes a significant additional layer of taxation, this is likely to be a disincentive for investment funds to be domiciled there.

Regulatory Framework

There is a common perception that fund managers seek jurisdictions with light regulation and that allow a high degree of secrecy regarding operations and beneficial ownership. This is not borne out by discussions with managers (although they might not admit it if this were their objective). What appears to be more important is a regulatory environment that is "reasonable," and most importantly, transparent, predictable and consistent, with a regulator that is efficient (i.e., takes decisions and acts quickly).

Also important is the knowledge and attitude of foreign regulators towards a particular jurisdiction. If a fund is intending to attract US investors, the attitude of the US regulator (SEC) and the investors themselves towards the jurisdiction is crucial.

An important component of the regulatory framework, although not directly related to financial service operations, is the extent of exchange controls. Jurisdictions without exchange controls have a distinct advantage, and investors are generally reluctant to be exposed to the restrictions and delays involved in abiding with capital controls, where they exist.

Support Services, Skills and Infrastructure

Fund managers prefer to have access to a well-developed network of support services to deal with administrative and financial management tasks, as well as to manage interaction with the regulator. Access to skills is essential, and this can cover a wide range from basic administrative and financial management skills through to more sophisticated banking, asset management, investment, financial engineering and legal skills. Access to the more sophisticated skills may not be essential in the early stages of developing a financial centre, however, as it is likely that the operational aspects of a fund will be located elsewhere. To the extent that more sophisticated skills are needed and are not available locally in the financial centre, a liberal and efficient immigration system is essential to enable access to foreign skills.

The availability of reasonable real estate (office and residential property), transport and communications are also essential.

There are many "clustering" advantages in developing a financial centre, i.e., success tends to be reinforcing. The establishment of financial service operations in a FC stimulates the emergence of support services, which then tends to attract further financial services investment, in a virtuous circle. One of the main challenges in developing new FCs is achieving this critical mass. It may be easier in a larger economy that already has a developed financial sector servicing the domestic economy than in a smaller economy that has to do so from scratch.

For funds that intend to undertake a stock market listing (which may be attractive to investors), a jurisdiction with a recognised and developed stock market is essential.

Importance of Domestic Flows

The relative proportions of domestic flows in a fund's operations are also important. For instance, if a fund is focussed on obtaining investment inflows primarily from a particular jurisdiction, it may well be necessary or advisable to domicile in that jurisdiction; for instance, regulations for institutional investors (life insurance companies and pension funds) often specify that a minimum proportion of funds must be invested locally, which could mean funds that are domiciled locally.[7]

Similarly, a fund may choose to domicile in a particular location because it primarily intends to invest in that jurisdiction. In that case, international attributes (such as low tax rates or DTAs) or domestic disadvantages (such as exchange controls) would be less relevant.

4. POTENTIAL FOR AFRICAN COUNTRIES TO BE UTILISED AS FINANCIAL CENTRES, AND ASSESSMENT OF SELECTED AFRICAN JURISDICTIONS

No African countries are yet acting as fully international financial centres, i.e., providing financial services predominantly for international clients. Mauritius is the closest to being an international financial centre; it plays an important role as a link between Africa and Asia, and also provides services for international clients investing in Africa. However, Mauritius does not yet provide significant services that are completely independent of its location (unlike say, Cayman Islands or Jersey, which provide services for international clients that are unrelated to the physical location of the jurisdiction), and hence could be classified as a regional financial centre.

There is a wide range of existing jurisdictions already established and offering international services, whether based on size (e.g., London) or tax efficiency (e.g., Cayman Islands). Global funds, including private equity funds, tend to use these existing jurisdictions, both for reasons of their intrinsic attributes and familiarity.

African countries are more likely to become established as regional centres, offering particular attributes that make them suitable for channelling financial flows into or out of a region.

However, there is no particular need for African-focussed funds to be domiciled in Africa—this is not generally a strong investor preference. African funds have a wide range of domiciles, including the Cayman Islands, Ireland, and Luxembourg. Within Africa, the most common location of domicile, by far, is Mauritius.

Elsewhere in Africa, the following countries have been included in one or more of the lists of financial centres: Botswana; Cape Verde; Ghana; Kenya; Liberia; Mauritius; Morocco (Casablanca); Nigeria; the Seychelles; and South Africa. Only four of these (Mauritius, Botswana, Morocco (Casablanca) and the Seychelles) have developed specific, dedicated legal and regulatory structures aimed at attracting international financial (and business) services. A brief assessment of the various African jurisdictions follows.

Cape Verde: In 2002, the government of Cape Verde decided that one of its long-term goals would be to develop Cape Verde into an international financial centre, primarily to serve the lusophone community and the West African market. As such, it was added to IMF's list of jurisdictions to be monitored under the Fund's OFC program. The 2009 FSAP assessment identified various shortcomings with regard to the supervision of Cape Verde's international financial institutions. Cape Verde has not had an OECD-Global Fund assessment.

Nigeria: As Africa's largest economy, Nigeria has a diverse and dynamic financial sector, with a range of banking and other financial institutions. The pensions sector has been growing rapidly following pension sector reforms, leading to rapid growth in the supply of investment funds. This has attracted some funds to Nigeria; given restrictions on the ability of Nigerian asset managers to invest outside of the country, funds domiciled in Nigeria have a greater likelihood of securing access to pension fund assets. Nigeria therefore benefits from its large size and potential, although concerns about macroeconomic and political stability, governance and corruption remain obstacles to the country developing further as a regional or continental financial hub.

Despite governance concerns, Nigeria has been cleared to undergo Phase 2 of the OECD Global Fund assessment

[7] *An alternative interpretation is that a fund's identity as domestic or non-domestic is determined by the location of its operations and investments, not its legal domicile.*

after passing the 1st phase. The Phase 2 assessment is scheduled for 2015.

Ghana: The Government has toyed with the idea of establishing an IFSC in Accra and in 2004 put forward a formal proposal to do so. It consequently signed an MoU with Barclays Bank of Ghana in 2005 to further investigate the prospects. By 2007, the country had drafted the regulatory framework for offshore companies. Eventually, however, Barclays handed back its offshore banking licence in 2011, with the agreement of the Bank of Ghana, citing a reluctance by the government to put in place the necessary legal, regulatory and fiscal frameworks. The original proposal generated a negative reaction by the OECD, and the fear of blacklisting by the OECD may have caused the government to backtrack.[8] There was also opposition from civil society. The project now appears to be on hold.

Ghana has been assessed under the OECD Global Forum, completing a Phase 2 review in late 2014, under which it was deemed "Largely Compliant." Of the African centres, Ghana has the 2nd best secrecy score, behind South Africa. However, it has the second lowest TJN FSI score because of its relative size.

Kenya has recently agreed to a plan to establish the Nairobi International Financial Centre (NIFC). This is part of Kenya's "Vision 2030," which identifies financial services as a key economic sector to be developed. The NIFC is seen as the flagship project in the financial sector, with two objectives: to stimulate economic activity in its own right, by making Kenya a regional financial services centre, and to provide a channel for attracting financial resources to meet Kenya's own investment needs under the Vision 2030 development plan.

In June 2013, the Kenyan Cabinet approved the establishment of the NIFC in order to "connect Kenya to international financial markets by providing for international banks to operate in Kenya," and directed that the centre be set up by December 2013. However, as of August 2014, Kenya is more than eight months behind schedule in creating the NIFC. No legal or regulatory framework has been designed, and no government agency has been assigned the task of overseeing the NIFC.[9]

Beyond the NIFC initiative, Nairobi is already the de facto financial hub of East Africa. This reflects the range of financial institutions and markets operating in Kenya. There are a large number of banks in operation, several of which have expanded into the region. Nairobi has a long-established and reasonably liquid stock exchange, and there is a moderately well-developed insurance, pensions and asset management sector. The Kenyan financial services sector has also been boosted by the rapid growth and success of mobile money operators, and the subsequent emergence of value-added service providers.

Kenya has been assessed under the OECD Global Forum programme; the country successfully completed Phase 1 and is due for a Phase 2 assessment in 2015. The GFCI identifies Nairobi as an emerging financial centre, which could be included in the GFCI. Kenya is not rated on the TJN FSI.

Liberia is included in international listings of financial centres, but this largely reflects its status as a 'flag state' providing corporate and maritime 'tax haven' services to vessel owners and operators since the 1940s. In practice, Liberia's shipping registry is administered from offices in Virginia in the United States.

Liberia is relatively opaque. The country has the second highest (worst) TJN FSI score of the sample (behind Mauritius), and it has not been cleared to proceed to Phase 2 of the OECD Global Forum assessment due to a failure to address issues raised in the Phase 1 assessment.

Morocco: The Casablanca Finance City Authority was established in 2010, to provide an international business and finance hub primarily focussed on North and West Africa, particularly francophone Africa. It offers tax incentives, exchange control exemptions, and business facilitation such as work permit processing. It is included in the GFCI, where it is ranked 51 (ahead of Mauritius but behind Johannesburg). Morocco has not yet had an OECD Global Forum review, but is expected to have a Phase 1 review in 2015.

[8] *Jeffrey Owens, Head of the OECD's Tax Centre was quoted as saying that "The last thing Africa needs is a tax haven in the centre of the continent." Another commentator noted that Ghana's initiative "could facilitate large-scale corruption and tax evasion, and pose a correspondingly large risk to good governance and economic growth in the region." The Guardian, 19 January 2010 (http://www.oecd.org/tax/transparency/44447449.pdf).*
[9] *Waris, A (2014) The Creation of International Financial Centres in Africa: The Case of Kenya. U4 Brief September 2014 No 8.*

Rwanda is not included in any of the classifications of financial centres, but has expressed a desire to become the financial hub of the East African Community. It is likely that measures will be implemented in support of this objective over the next five years. Rwanda has not had an OECD Global Forum review.

The **Seychelles** is classed as a financial centre and has legal provision for the registration of international business companies (IBCs) and offshore banks. The country has the most secretive environment of the African jurisdictions reviewed here, according to the FSI ranking. After going through the two Phases of the OECD Global Forum exercise, the country was rated 'Non-Compliant' with international standards.

South Africa is the main financial centre in Africa, in the sense of being the largest and most diverse. It has a wide range of banking operations, including both domestic and international banks; South African banks have an increasingly wide range of operations throughout the continent. Other financial institutions, including insurance and asset management, also operate regionally from South Africa. The JSE is by far the largest and most liquid securities market in Africa, and is indeed one of the largest emerging market exchanges in the world. The country has good travel and communications linkages, a broad and deep range of financial institutions and skills, sophisticated business services, and good corporate governance. However, it has a poor reputation for allowing companies to bring in expatriates to meet skills gaps, as the immigration system is very restrictive. The main financial centres are Johannesburg (for banking and securities) and Cape Town (for asset management).

The country is also the origin of several Africa-focussed investment funds, which, however, tend to be domiciled in Mauritius. Some funds are domiciled in South Africa, but these are largely focussed on domestic (i.e., South African) investments rather than outside of the country. Despite its many advantages, South Africa has largely failed to attract externally focussed investment funds, for a number of reasons. First, there is no dedicated legal or regulatory regime for international investment funds or financial activities more broadly. Second, South Africa has extensive exchange controls on capital movements, and these provide a major disincentive for international banking and fund activities, because they introduce a major level of delay and uncertainty to external financial transactions.[10] Third, despite the cosmopolitan nature of major South African cities, the high crime rate provides a major disincentive to international migration, which is compounded by a restrictive immigration policy. Fourth, South Africa has relatively high corporate tax rates.

However, although several investment funds originating in South Africa are legally domiciled in Mauritius, much of the substantive investment advisory and asset management work is still carried out in South Africa.

South Africa has the best (i.e., lowest) score in terms of financial secrecy under the FJN ranking. It is the only African country to be fully 'Compliant' with international standards as per the OECD Global Forum exercise. The GFCI rates Johannesburg as an "Established Player" in the category of Local Financial Centres.

Botswana established its International Financial Services Centre (IFSC) in 2004. The IFSC makes provision for a reduced tax rate (15%) for approved companies. Although the IFSC was originally intended to be focussed on financial services, in practice it has attracted a broader range of business services, particularly holding companies for firms that operate across different African countries, rather than banking and fund management. Botswana has a good reputation for macroeconomic and political stability, and has the highest sovereign credit rating in Africa. There are no foreign exchange controls.

However, the IFSC has been slow to take off, particularly for financial services. Although the general level of corporate governance is good, Botswana has been held back by somewhat out-dated legislation, a slow response to regulatory modernisation, a lack of transport links (especially international air travel connections), a shortage of specialised skills and a restrictive immigration policy that makes it difficult for firms to bring in skilled personnel from outside the country. The country also lacks the range of DTAs that Mauritius and South Africa have, and has a higher effective tax rate than Mauritius. And unlike Mauritius, the Botswana IFSC requires approved investors to have a physical (and not just legal) presence in the country.

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[10] *While exchange control approval for transactions in goods have generally been delegated to the commercial banks (authorised dealers) by the South African Reserve Bank (SARB), this does not apply to financial services transactions to the same extent. Furthermore, capital account transactions above a certain size are generally not subjected to such delegated approval. The time taken for SARB review extends the transaction process, and in addition because approval of capital outflows is discretionary, approval may be conditional. This all adds delay and uncertainty, especially for complex transactions.*

Botswana has the third best score (after Ghana and South Africa) under the TJN's FSI ranking. It initially performed badly under the OECD Global Forum exercise, and was slow to address issues raised under the Phase 1 assessment. However, after a supplementary report in early 2014, Botswana was deemed eligible to proceed to Phase 2, and is expecting a peer review in 2015.

Botswana has a small but steadily-growing and well-regarded stock exchange.

Mauritius is by far the most pre-eminent financial centre in Africa, and is well-established as a domicile for international businesses and financial services. The emergence of Mauritius as an international financial centre was assisted by its Double Taxation Agreement with India, which helped it to emerge as the primary gateway for Foreign Direct Investment into India. It has also benefitted from a good regulatory environment and a high standard of corporate governance. With an effective tax rate of 3%, Mauritius has sometimes been classified as a tax haven, and was at one point blacklisted by the FATF (the predecessor to the OECD Global Forum exercise). Following reforms to financial governance, the "tax haven" description is now outdated and is vehemently contested by the Mauritians themselves. Mauritius has the most widespread network of DTAs of any African jurisdiction, plus a large number of bilateral investment protection agreements in place with African governments.

Mauritius also offers a broad range of support services, including banking, accounting, administration, legal and increasingly offers more specialised financial sector skills, in part because of a liberal immigration policy. It has benefited from a virtuous circle of increased inward investment and increasingly extensive support services. A key role is played by Management Companies, which handle relations between regulated entities and the regulator, and play an important role in ensuring compliance. Mauritius offers good transport connections and infrastructure. In 2011, Mauritius established an international arbitration centre in a joint venture with the London Court of International Arbitration (LCIA).

For fund managers wishing to have funds domiciled in Africa, Mauritius is by far the preferred location for a combination of reasons: low taxes and an extensive DTA network, making for "tax efficiency;" good infrastructure; a high standard of regulation and governance; and, political and economic stability. Furthermore, Mauritius is increasingly known and, well-regarded by European investors (although less so amongst US investors).

Mauritius is the second best performing African country in the OECD Global forum assessment, having been through a Phase 2 assessment and rated "Largely Compliant." The TJN gives it a secrecy score of 80, better than the Seychelles and Liberia but worse than other African jurisdictions. Because of this and its relative importance, it has the highest (worst) score for any of the African countries rated on the FSI.

The development of financial services has been highly beneficial for Mauritius, contributing significantly to GDP, employment and economic diversification.[11] It has also been instrumental in attracting the Mauritian diaspora—often highly skilled professionals—to return, and in providing employment opportunities for young graduates.

Summary: Within Africa, the most compelling financial centre jurisdictions for international funds are Mauritius and South Africa (Johannesburg). The former is attractive for reasons of tax efficiency, increasing international awareness, a good reputation for regulation and corporate governance, skills and infrastructure. Nevertheless, while Mauritius's "tax efficiency" may mean low tax liabilities for funds, it may be of concern to governments that are concerned about "unfair" tax competition. South Africa is attractive due to its size, financial sophistication, and infrastructure, but is let down by onerous exchange controls, high taxes, immigration restrictions and its high crime rate. Some funds have squared this circle by having their domicile in Mauritius but high-level operations in South Africa. Botswana offers some attractions, but struggles to match Mauritius for tax efficiency or South Africa for infrastructure, and is also let down by immigration restrictions.

[11] *"Finance and Insurance" is the second largest sector of the economy in Mauritius after manufacturing, and contributed 10.2% of GDP in 2013. This compares with 5.3% in Botswana, which has a similar level of GDP per capita.*

Other possible contenders may emerge in future. In (Anglophone) Sub-Saharan Africa most jurisdictions (other than Botswana, Mauritius and the Seychelles) do not have legal and regulatory structures specifically aimed at attracting international financial service activity. Rwanda is actively considering moving in this direction, and could challenge other jurisdictions in the next few years with the introduction of competitive tax and regulatory regimes. Elsewhere in East Africa, Kenya offers advantages simply due to the size and sophistication of it financial sector—similar to South Africa, although on a more modest scale. Plans to actively pursue regional integration within the East African Community (EAC) could be a mixed blessing. On the plus side, deeper integration of regional financial and capital markets and payments systems will support the emergence of a regional hub, but on the minus side, if the EAC proceeds to introduce a single regional currency without political and fiscal integration this could—as in Europe—undermine the stability of financial markets. In West Africa, Ghana seems to have backtracked from its earlier interest in developing an internationally-focussed financial services sector, and while Nigeria benefits from its economic size, and the growth of domestic capital markets, its poor governance and oil-related macroeconomic instability are likely to hold it back for the foreseeable future.

Other African countries currently going through the OECD Global Forum EOI exercise include:

- Mauritania
  (Phase 1, 2014 H1 and Phase 2, 2015 H2)
- Burkina Faso
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Cameroun
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Gabon
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Senegal
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Uganda
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Lesotho
  (Phase 1, 2014 H2 and Phase 2, 2015 H2)
- Tunisia
  (Phase 1, 2015 H1).

5. POTENTIAL ROLE OF DONORS AND TECHNICAL ASSISTANCE

There are a number of areas where Technical Assistance is required and where donor support could be useful for a country intending to develop as a centre for international financial services.

The main technical requirements for such a strategy would be as follows:

1. Reviewing and developing legal, regulatory and fiscal frameworks for international financial and business services.
2. Ensuring that the legal, regulatory and fiscal frameworks are:
   - compliant with international best practice;
   - consistent with the requirements for satisfying the OECD EOI assessment; and,
   - offering competitive tax rates to investors while not falling foul of international efforts to combat tax base erosion.
3. Negotiating a network of double taxation agreements.
4. Determining where bottlenecks might occur and which supportive reforms and investment might be necessary in a particular jurisdiction (communications, transport, immigration, land / buildings, etc.).
5. Developing publicity and awareness material / programmes.
6. Establishing the necessary institutional structures (promotional, regulatory, etc.).

This is a challenging list of requirements, especially for a small economy that may lack the necessary skills. Many of the skills can be obtained on a commercial basis, but are likely to be expensive. Donors can play a role in meeting part of the costs, but beyond that can have additional beneficial influence by ensuring that compliance with international best practice is built into the structures, laws and standards that are developed by a new Financial Centre.

Given that the success of a Financial Centre is likely to be dependent on achieving sufficient scale, having a substantial initial impact is likely to be important; a slow, incremental build-up may not be feasible. Hence donors could play a role in developing and financing a large scale publicity, branding and marketing initiative.

6. POTENTIAL IMPACT OF DEVELOPING ONSHORE FINANCIAL CENTRES; IMPACT OF PRIVATE EQUITY FUNDS

Private Equity

Private equity has a potentially important role to play in many African economies. Most financial systems are bank-dominated, which means that debt is the primary source of finance. Most countries also have state-owned development finance institutions (DFIs), and some countries have emerging stock exchanges. Generally, however, there is shortage of equity / risk capital. Private equity investors can play an important role in filling this gap, by bringing structured financial packages that include debt and equity, along with specialised skills and the ability to identify investment opportunities and turn around under-performing companies. Some international broad-based private equity funds are already active in Africa (e.g., Carlyle, Blackstone), along with some specialised ones (such as the African Lion mining private equity funds).

Besides private equity investment opportunities in Africa, the continent is also an increasing source of investible funds. Financial sector reforms in many countries have stimulated the growth of pension funds. Traditionally pension sectors were dominated by state run funds that mainly invested in domestic real estate. Reforms have in many instances stimulated the emergence of private sector asset managers with a variety of mandates, often running portfolios for defined contribution funds that rely on good returns to build up pension pots. Asset manager mandates vary, but in most cases will to some extent allow investments outside of the home country, and across a range of asset classes, including "alternatives" such as property, infrastructure and private equity funds in addition to the conventional listed equities and bonds. For instance, in Botswana the largest pension fund (for government employees) has recently floated tenders for dedicated alternative funds in each of these three areas. Botswana also has flexibility for asset managers in a small economy, in that it allows up to 70% of pension assets to be invested externally. At least one of the major asset managers has set up its own private equity fund to accommodate investments from a small portion of its broad-mandate portfolios that permit investment in alternative assets.[12]

International Financial Centres

For small economies, developing a financial centre can offer significant benefits, in terms of adding a new sector of economic activity and hence diversifying both GDP and exports. The main benefits may not be in the form of fiscal revenues—a financial centre is unlikely to thrive unless it has relatively low tax rates—but are more likely to be in the form of employment, the promotion of complementary activities, and the building of an increasingly sophisticated financial sector. While this will primarily have an external focus, it is likely to have domestic benefits from the activities of an increasingly broad and deep range of financial institutions. For instance, if a country manages to attract investment funds that seek a stock market listing, this will help to develop the local stock exchange and add liquidity and exposure. A financial centre is likely to promote skilled immigration, and the return of skilled citizens working elsewhere. Certainly a financial centre poses regulatory challenges, but it can also be used as an opportunity to develop regulatory expertise.

Some countries see a financial centre as a channel for stimulating inflows of investment funds into the domestic economy. Whether this works in practice depends very much on the size and nature of the economy—it may well be true for Nigeria, South Africa and Egypt, but less so for smaller economies. To the limited extent that Mauritius has received investment inflows from funds domiciled there, it is because investment opportunities in Mauritius compare well with opportunities in other African countries, not because the funds are domiciled in Mauritius.

[12] *Interestingly, both this fund and another independent Botswana private equity fund are domiciled in Mauritius.*

APPENDIX 1: LISTING OF COUNTRIES IN RESPECT OF OFC OR RELATED STATUS BY INTERNATIONAL BODIES

Country / Territory	**Listed by:**			
	IMF[13]	**FSI[14]**	**OECD[15]**	**GFCI**
Andorra	X	X	X	
Anguilla	X	X	X	
Antigua and Barbuda	X	X	X	
Argentina			X	X
Aruba	X	X	X	
Australia		X	X	X
Austria		X	X	X
Azerbaijan				X*
Bahamas	X	X	X	X^
Bahrain	X	X	X	X
Barbados	X	X	X	
Belgium		X	X	X
Belize	X	X	X	
Bermuda	X	X	X	X^
Botswana	**X**	**X**	**X**	
Brazil		X	X	X
British Virgin Islands	X	X	X	X^
Brunei	X	X	X	
Bulgaria				X*
Canada		X	X	X
Cape Verde	**X**			
Cayman Islands	X	X	X	X^
Chile			X	X*
China			X	X
Colombia			X	
Cook Islands	X	X	X	
Costa Rica	X	X	X	
Curaçao	X	X	X	
Cyprus	X	X	X	X^
Czech Republic			X	X
Denmark		X	X	X
Dominica	X	X	X	
Dominican Republic		X		
Estonia			X	X
Finland			X	X
France		X	X	X
Georgia			X	
Germany		X	X	X
Ghana		**X**	**X**	

Country / Territory	Listed by:			
	IMF[13]	FSI[14]	OECD[15]	GFCI
Gibraltar	X	X	X	X^
Greece			X	X
Grenada	X	X	X	X
Guatemala		X	X	
Guernsey	X	X	X	X
Hong Kong	X	X	X	X
Hungary		X	X	X
Iceland			X	X
India		X	X	X*
Indonesia			X	X
Ireland	X	X	X	X
Isle of Man	X	X	X	X^
Israel		X	X	X
Italy		X	X	X
Jamaica			X	
Japan		X	X	X
Jersey	X	X	X	X^
Kenya			**X**	
South Korea		X	X	X*
Latvia		X	X	X*
Lebanon	X	X	X	
Liberia		**X**	**X**	
Liechtenstein	X	X	X	X*
Luxembourg	X	X	X	X
Macau	X	X	X	
Macedonia			X	
Malaysia	X	X	X	X
Maldives		X		
Malta	X	X	X	X^
Marshall Islands	X	X	X	
Mauritius	**X**	**X**	**X**	**X**
Mexico			X	X
Micronesia			X	
Monaco	X	X	X	X
Montserrat	X	X	X	
Morocco				**X**
Nauru	X	X	X	
Netherlands		X	X	X
New Zealand		X	X	X
Nigeria			X	
Niue	X		X	
Norway		X	X	X

Country / Territory	Listed by:			
	IMF[13]	FSI[14]	OECD[15]	GFCI
Palau	X			
Panama	X	X	X	X
Philippines		X	X	X
Poland			X	X
Portugal		X	X	X
Qatar			X	
Russia		X	X	X
St Kitts and Nevis	X	X	X	
St Lucia	X	X	X	
St Vincent and the Grenadines	X	X	X	
Samoa	X	X	X	
San Marino		X	X	
Saudi Arabia		X	X	X
Seychelles	**X**	**X**	**X**	
Singapore	X	X	X	X
Sint Maarten	X		X	
Slovak Republic			X	X*
Slovenia			X	
South Africa		**X**	**X**	**X**
Spain		X	X	X
Sweden		X	X	X
Switzerland	X	X	X	X
Taiwan				X
Thailand				X
Trinidad and Tobago			X	X*
Turkey			X	X
Turks and Caicos Islands	X	X	X	
United Arab Emirates	X	X	X	X
United Kingdom		X	X	X
United States		X	X	X
US Virgin Islands		X		
Uruguay	X	X	X	
Vanuatu	X	X	X	

** Awaiting inclusion in the GFCI.*
^ Classified by the GFCI as an Offshore Centre.

[13] *Listed as Offshore Financial Centre.*
[14] *Listed as Secrecy Jurisdiction (Tax Haven).*
[15] *Reviewed in respect of Tax Information Exchange and Transparency.*

APPENDIX 2: STATUS OF AFRICAN FINANCIAL CENTRES

Country	IMF OFC (2008)	Global Forum / OECD Status (2004)	TJN FSI 2013			GFCI 16 (Sept. '14)			Comments
			Secrecy Score	*Global Scale Weight*	*TJN FSI Score*	*Score*	*Rank*	*Status*	
Botswana	Included	Awaiting Phase 2 assessment after successfully completing Phase 1. Scheduled for H1 2015	73	0.002	99.0	N/A	N/A	N/A	– Slow to implement recommendations to improve legal and regulatory framework identified in the initial OECD Global Forum Phase 1 review. However, after a supplementary review in early 2014, has been cleared to proceed to Phase 2. – Owing to the very small size of the market and high secrecy score, Botswana has the lowest (i.e., best) FSI score of the sample countries. However, it does not meet most international transparency standards (has negative answers for 9 of the 15 KFSIs). – Doesn't make the GFCI rankings. – Owing to ambitions to be a Financial Centre (IFSC), it was added to the IMF's list of jurisdictions to be monitored under the Fund's OFC program.
Cape Verde	Included	N/A	N/A	N/A	N/A	N/A	N/A	N/A	– In 2002, the government of Cape Verde decided that one of its long-term goals would be to develop Cape Verde into an international financial centre primarily to serve the lusophone community and the West African market. As such, it was added to IMF's list of jurisdictions to be monitored under the Fund's OFC program.
Ghana	N/A	Largely Compliant	66	0.005	109.9	N/A	N/A	N/A	– The country is one of the four African countries to go through both Phase 1 and 2 of the OECD Global Forum EOI exercise. Rated 'Largely Compliant' with international standards. – Has 2nd least secrecy score, behind South Africa. However, it has the second lowest TJN FSI score because of its relative size.
Kenya	N/A	Awaiting Phase 2 assessment after clearing Phase 1	N/A	N/A	N/A	N/A	N/A	N/A	– Being readied for Phase 2 of the OECD Global Forum EOI exercise after successfully completing Phase 1. – Not rated by the TJN and the GFCI, although it has been identified as a potential entrant to the GFCI.
Liberia	N/A	Not eligible for Phase 2 as didn't act on recommen-dations from Phase 1	83	0.014	300.9	N/A	N/A	N/A	– Liberia is relatively opaque. The country has the second highest, behind Mauritius, TJN FSI score of the sample, and is the second most secretive after the Seychelles. – It has not been cleared to proceed to Phase 2 to of the OECD Global Forum assessment, due to a failure to address the issues identified in the Phase 1 assessment.

Country	IMF OFC (2008)	Global Forum / OECD Status (2004)	TJN FSI 2013			GFCI 16 (Sept. '14)			Comments
			Secrecy Score	*Global Scale Weight*	*TJN FSI Score*	*Score*	*Rank*	*Status*	
Mauritius	Included	Largely Compliant	80	0.047	397.9	69	608	Local Special-ist	– The sole Offshore Financial Centre in Africa according to the GFCI, which deems it a 'Local Specialist.' – Mauritius has the highest TJN FSI score. – The country is one of the four African countries to go through both Phase 1 and 2 of the OECD Global Forum EOI exercise. Consequently rated 'Largely Compliant' with international standards.
Morocco[16]	N/A	To be reviewed H1 2015	N/A	N/A	N/A	51	635	Trans-national Special-ist	– Morocco is due to go through the OECD Global Forum EOI exercise. It is scheduled to be reviewed H1 2015. – Casablanca is one of only three cities in Africa to be listed and rated in the GFCI. Moreover, the city has been deemed a 'Transnational Specialist.'
Nigeria	N/A	Awaiting Phase 2 assessment after clearing Phase 1	N/A	N/A	N/A	N/A	N/A	N/A	– Nigeria has been cleared to undergo Phase 2 of the OECD Global Forum EOI exercise after passing the 1st phase. The jurisdiction has almost all EOI requirements in place.
Seychelles	Included	Non-Compliant	85	0.011	293.5	N/A	N/A	N/A	– The country has the most secretive environment of the sample. – After going through the two Phases of the OECD Global Forum EOI exercise, the country was rated 'Non-Compliant' with international standards.
South Africa[17]	N/A	Compliant	53	0.260	209.8	38	659	Estab-lished Player	– Country has the least secretive environment of the sample. – South Africa is the only African country to be 'Compliant' with international standards as per the OECD Global Forum EOI exercise. – Johannesburg is one of the two cities in Africa to be listed and rated in the GFCI. Moreover, the city has been deemed a 'Established Player.'

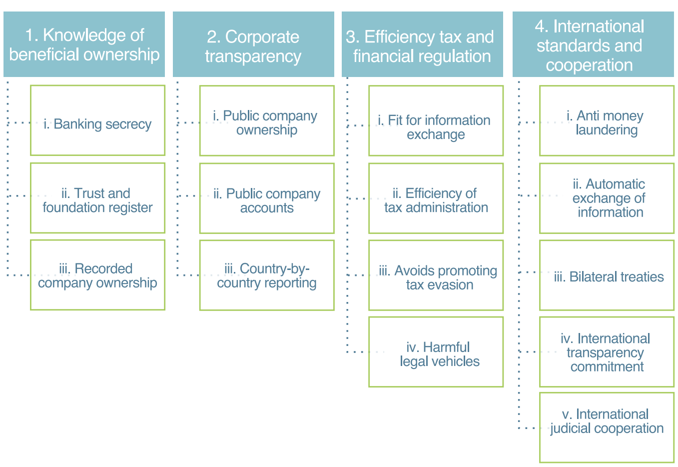
[16] *For the GFCI, Casablanca is rated.*
[17] *For the GFCI, Johannesburg is rated.*

APPENDIX 3: THE METHODOLOGY FOR THE TAX FOR JUSTICE FINANCIAL SECRECY INDEX

The Financial Secrecy Index (FSI) uses a combination of qualitative and quantitative data to create a measure of each jurisdiction's contribution to the global problem of financial secrecy. The qualitative data is used to prepare a secrecy score for each jurisdiction. It is based on laws, regulations, cooperation with information exchange processes and other verifiable data sources. On the other hand, quantitative data is used to create a global scale weighting, for each jurisdiction, according to its share of offshore financial services activity in the global total.

Secrecy Scores

The secrecy score is measured using 15 Key Financial Secrecy Indicators (KFSIs) which fall under any of the four dimensions of secrecy: knowledge of beneficial ownership; corporate transparency; efficiency tax and financial regulation; and, international standards and cooperation.



Each KFSI is assessed and given a value between zero and one. An average of all the 15 KFSI scores is then taken as the compound secrecy score for the jurisdiction. This resultant compound secrecy value (between 0 and 1) is then expressed as a percentage score between 0% (transparent) to 100% (secretive). Jurisdictions with the highest secrecy scores are more opaque in the operations they host, less engaged in information sharing with other national authorities and less compliant with international norms relating to combating money-laundering. Lack of transparency and unwillingness to engage in effective information exchange makes a secrecy jurisdiction a more attractive location for routing illicit financial flows and for concealing criminal and corrupt activities.

Global Scale Weights

The second component of the FSI is the global scale weight attributed to each jurisdiction. This allows jurisdictions to be ranked by their importance in the total global trade in financial services. It is based on an assessment of the size of each jurisdiction's share of the global market for financial services provided to non-resident clients. The global scale weights are based on publicly available data (IMF's Balance of Payments Statistics) about the trade in international financial services of each jurisdiction. However, the occasional gaps in the data are plugged by extrapolating stock data to generate flow estimates.

$$\textit{Global scale weight } i = \frac{\textit{Exports of financial services } i}{\textit{Total world exports of financial services } i}$$

Combining the Secrecy Scores and Global Scale Weight to Come to the FSI Score

The global scale weight and the secrecy scores are combined to create a ranking of each jurisdiction's contribution to the ultimate global problem of financial secrecy: this ranking is the Financial Secrecy Index.

The secrecy score is cubed and the weighting is cube-rooted before being multiplied to produce a Financial Secrecy Index which ranks secrecy jurisdictions according to their degree of secrecy and the scale of their trade in international financial services.

$$\textit{FSI Score } i = (\textit{Secrecy score } i^3) \times \sqrt[3]{\textit{Global scale weighting } i}$$

A jurisdiction with a larger share of the offshore finance market, and a high degree of opacity, may receive the same overall ranking as a smaller but more secretive jurisdiction. Therefore, the FSI ranking does not only reflect information about secretiveness of jurisdictions, but also the question of scale.

Onshore Options for Africa-focussed Investment Funds and Vehicles

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INTRODUCTION

Over the past decade decision-makers in a number of African countries have expressed aspirations with regard to establishing local financial centres. Looking to Mauritius and other more recently established financial centres, such as Dubai, they see opportunity in setting up locally-domiciled financial service hubs to compete with these foreign-domiciled centres. Examples of countries with such ambitions are Botswana, Kenya, Nigeria and Rwanda.[1]

The focus of this paper is on shaping the debate around onshore centres. What are the net gains to be achieved by establishing an onshore financial centre? What are the prospects for achieving these gains and what would be the expected development outcomes? And given these prospective outcomes, how would policymakers be best advised to focus their efforts?

1. OFFSHORE / ONSHORE – ATTITUDES AND TRENDS

1.1 Challenges Related to Onshoring Financial Centres

At the outset it is important to recognise that the business model and justification for offshore centres is dominated by a rather narrowly-focussed, thin sliver of the financial services industry. Rather than migrating to such centres 'en masse,' the services provided by offshore centres target foreign investors in Africa who prefer to avoid risks associated with investing directly in local African markets. The broader development of the financial services industry in Africa is still very much based onshore.

Foreign investors are understandably reluctant to assume risks as regards the functionality of local financial systems in developing countries. These risks span the whole universe of financial sector institutions and infrastructure, such as adequacy of the legal / regulatory regimes; functionality of judicial / redress mechanisms; implementation of accounting / transparency standards; reliability of custody / settlement processes; and, availability of qualified professional / administrative expertise. Any financial centre is no stronger than its weakest link, and a major challenge in establishing onshore financial centres that would fully satisfy the requirements of foreign investors would be the considerable strengthening of the legal, regulatory and institutional infrastructure that would be required to assimilate the standards delivered by offshore centres, such as Mauritius. While the capacity of the PE industry is already well-developed in several countries in Sub-Saharan Africa, see further below, the support provided by the local enabling environment still leaves much to be desired.

This burden might be lessened were countries to establish onshore hubs or zones providing a Mauritius-like environment isolated from the rest of the domestic financial services industry. However, this would (a) result in establishing a 'privileged island' within the local financial system; (b) require a continuing commitment to upgrading the legal / regulatory framework of the isolated zone; and (c) require significant policing to prevent onshore financial activities from migrating to the more advantageous circumstances of the privileged zone (regulatory arbitrage). A danger in going down this route could also be that the efforts required to establish an onshore hub or zone could detract from efforts to foster more broad-based financial sector deepening—and the services required to encourage the re-domiciling of the PE industry are unlikely to be on the 'critical path' required to encourage the deepening the local financial services industry.

[1] *Policy documents describing such aspirations are Financial Sector Strategy 2020 (Nigeria); Vision 2030 (Nigeria); Vision 2030 (Kenya); and Financial Centre Strategy (Rwanda). Botswana has already established an International Financial Services Centre.*

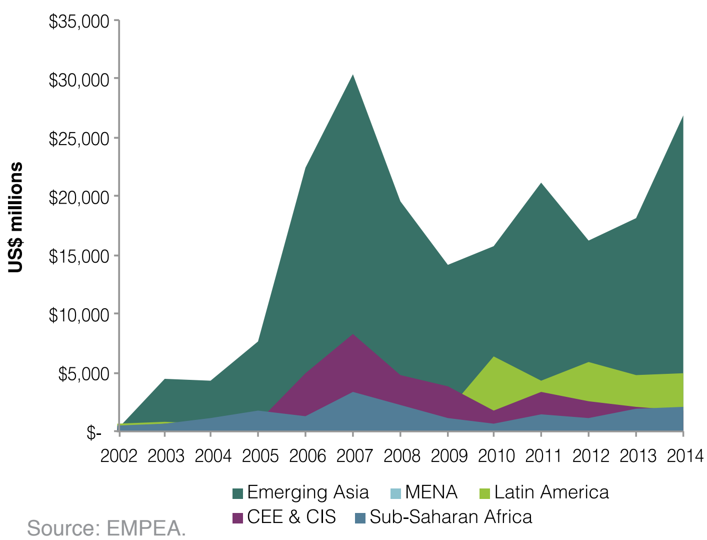
The specialised services offered by offshore centres depend on a well-developed legal and regulatory environment, expertise (professional, administrative and clerical); and, scale (i.e., returns from servicing a sizeable market). Onshoring such a service industry will require a huge effort and, even once successful, the specific services provided would serve only a narrow-base (predominantly accounting / taxation / legal / clerical services to the PE industry). Building trust in local capacity would be at best a medium-term endeavor. Altogether the development impact would take considerable time, require a concerted effort, be very costly to achieve, and be quite small.

1.2 Onshoring Services Rather Than Centres

The overwhelming challenges faced by countries wishing to onshore activities currently undertaken by offshore centres taken together with the rather narrow nature of the business being undertaken by these centres suggests that an alternative approach to onshoring might be more appropriate and contribute more significant development outcomes.

The key challenge faced by investors in Africa is the lack of a pipeline of viable, bankable projects, particularly in looking beyond the established cadre of medium and large scale enterprises. Invariably investors are left chasing the rather small universe of more well-established and larger companies. In the case of infrastructure, projects constraints may well relate to the legal / regulatory framework for undertaking private-public partnerships, whereas in the case of SMEs, investments are constrained by the SMEs' limited capacity to develop bankable projects coupled with investor / lender risk-aversion. The supply of early, risk-bearing finance for small enterprises in Africa is very scarce. Banks are notoriously cautious in providing loans to SMEs and due to the high-risk environment, the costs of bank borrowing are high. While subsistence entrepreneurs may initially rely on short-term funding provided by family and friends and to some extent by microfinance institutions and Savings and Credit Cooperatives (SACCOs), it is recognised that there is a 'missing middle,' where bank funding is insufficient and risk capital is unavailable.[2] To support their expansion and innovation SMEs need risk-capital as well as good business advice.

Figure 1: Private equity investment in emerging markets



Source: EMPEA.

As illustrated in Figure 1, the market for private equity remains relatively small in Sub-Saharan Africa. In interpreting this data and the steady growth of PE fund investment commitments in recent years, see Figure 2, it should be emphasised that the PE industry in Africa is highly heterogeneous, and much PE investment targets larger, well-established, brand-name enterprises. Servicing larger enterprises is more lucrative, as it requires PE fund managers to invest less capacity in developing / assessing business proposals, preparing investment proposals (often entailing enterprise restructuring), and, once investments have been made, monitoring project performance. This partly reflects scale economies, but also quite severe capacity scarcity and resultant high costs. Thus, were PE funds to modify their business models, they could potentially provide a crucial source of risk-capital thereby increasing the boundaries of available funding.

From their active involvement in investee enterprises PE fund managers would also be an invaluable source of business advice, e.g., in developing enterprise strategies, introducing utilisation of market intelligence, strengthening financial management of investee enterprises, and supporting recruitment for key staff, etc. However, as of now the contribution of PE funds to SME development falls far short of potential.

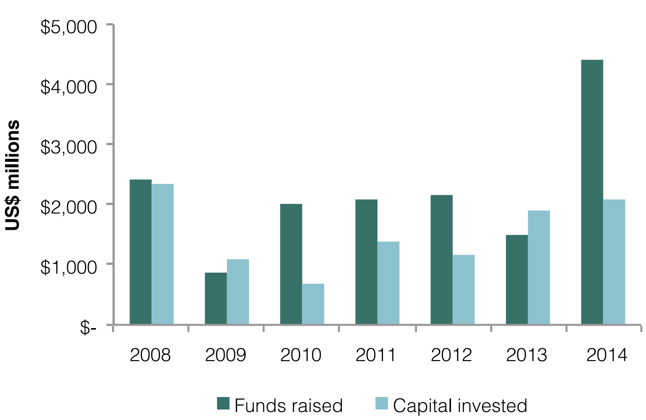
There can be little doubt about the high potential upside associated with onshoring of fund management and investment expertise. Local knowledge of potential borrowers, the risk profiles of their businesses, their management skills, their liquidity and inventory cycles, etc. are indispensable to any third-party investor or lender.

[2] *See: Beck, Thorsten and Robert Cull,* SME Finance in Africa*, World Bank Research Working Paper #7018, 2014, and Berg, Gunhild and Michael Fuchs,* Bank Financing of SMEs in Five Sub-Saharan African Countries: the role of Competition, Innovation and the Government*, World Bank Policy Research Paper # 6563, 2013.*

Developing skills in these areas requires investment in local expertise and local presence—i.e., in establishing local expertise in fund management, identifying suitable enterprises, providing support for business plan development, in developing financing instruments suited to the specific needs of SMEs, and in monitoring investee company performance.

Altogether there would appear to be much higher value-added associated with developing such investment and portfolio management skills than would arise were the professional, clerical and administrative functions that PE funds currently undertake offshore be transferred onshore. At present most investment management of PE in Africa is undertaken in Dubai, Paris, London and Washington DC, and to a lesser extent in Johannesburg, Nairobi and Lagos. Thus the benefits arising from deepening in-country investment analysis and asset management skills would be considerable. As discussed further below, incentives could be provided to channel this newly developed capacity towards greater involvement by the PE industry in providing finance to SMEs. Also important will be transferring knowledge to those responsible for portfolio management of pension funds, insurance companies and collective investment schemes. Indeed, seen from a broader perspective strengthening local expertise in investment analysis and asset management would support the development of the small enterprise sector, irrespective of the exact sources of external financing—whether through banks, PE funds or IPOs.

Figure 2: Private equity in Sub-Saharan Africa



Source: EMPEA.

2. WHAT NEEDS TO CHANGE FOR SUB-SAHARAN COUNTRIES TO BE TAKEN SERIOUSLY AS ONSHORE FINANCIAL CENTRES?

2.1 Challenges in Establishing Onshore Financial Centres

The scope of activities required to establish an onshore financial centre is broad and would need to include establishing:

- A reliable, updated legal and regulatory framework for fund management, particularly partnership law;[3]
- Effective judicial practices and procedures and regulatory agencies for enforcing the required legal framework;
- Tax treatment conducive to the fund industry;
- Payment, custody and settlement infrastructure conducive to the fund industry;
- Investment and managerial expertise; and,
- A cadre of well-trained and highly-motivated administrative staff.

It is important to underline that a necessary condition for establishing a successful onshore centre would require excellence in **all** rather than just a few of these areas. Furthermore a track record for reliable delivery of all these services would need to be established before one could expect that fund managers and investors would be comfortable in relocating the domicile of their investments. This sets a high bar.

Some further elaboration as regards factors impacting choice of domicile is provided in Box 1.

An important factor in motivating authorities to encourage funds to move onshore is to avoid situations where offshore based PE funds are attracted by low levels of tax and may be vehicles for tax avoidance.

Here a clear distinction needs to be made between tax efficiency and tax avoidance (or worse, evasion). Offshore

[3] *The scope of the required legal framework is much broader, including company law, collective investment schemes law, capital markets / securities laws and tax law.*

centres provide efficiency, as they have (a) the ability to offer proven and reliable tax transparency, and (b) a good range of legitimate double tax agreements[4] with relevant jurisdictions into which investments are to be made, thereby avoiding eventual double taxation.

It should be pointed out that almost all investment funds, wherever they are domiciled, are 'tax transparent.' This means that the tax point is moved from the fund (where no tax is levied) to the end investor in the fund. The investor will pay tax due in the country of tax residency. The fund is just a convenient vehicle for pooling investments and transmitting revenues.[5] It is also questionable whether there would be any fiscal gains, as PE funds, often established as limited partnerships, are generally fully tax transparent.[6] Altogether the motivations for onshoring PE funds due to lack of transparency and harmful tax practices appear weak.

It is important to note that in becoming attractive venues for foreign-based investors onshore jurisdictions would need to build the same tax arrangements (tax transparency and double tax agreements) as provided by offshore jurisdictions.

In addition to the factors outlined above an important consideration is that the viability of offshore centres, such as Mauritius, depends on economies of scale in providing processing capacity to a large number of funds. Any new centre will have to overcome this scale factor which in effect constitutes a serious barrier to entry.

In this context, one comparative advantage of onshore centres could be that they provide access to local authorities and decision-makers, whereas offshore centres are distanced by their nature. However, due to their small size financial systems in Africa are highly fragmented, and the platform provided by aspirant onshore centres, such as Rwanda or Botswana with small local financial systems, has limited value.[7] In effect funds that decide to shift their domicile to these smaller countries would benefit only marginally from local access, as for all intents and purposes, they will continue to invest predominantly outside their country of domicile.

BOX 1: FACTORS IMPACTING CHOICE OF DOMICILE

Legal Framework. A country that wishes credibly to position itself as a domicile for international funds will need a legal and regulatory framework that recognises the various types of funds, whether they are to be publicly offered collective investment schemes or more specialised professional schemes such as private equity funds or hedge funds. The importance of a steady regulatory regime and an efficient, trusted and rational regulator cannot be overemphasised.

Partnership law provides for the formation of partnerships and governs the relationship between partners as well as with third parties. Limited partnerships are regarded by most tax authorities as 'fiscally transparent' or 'pass through' provided that they pass certain tests, that is to say that, unlike a corporation, the partnership entity is not subject to tax but that it is its partners that are subject to tax on the income or profits they receive at whatever rate is appropriate to them. This is a very useful way of enabling a partnership to attract a wide diversity of limited partners, each of which may have a different tax status, since, for example, a limited partner, like a pension fund that is tax exempt, will not suffer unnecessary tax.

Role of Custodians. In the context of recent legislative changes the role of custodian is an increasingly important one. Keeping assets safe and separate from the assets of other clients ensures that the limited partners are able to enjoy their contractual rights and benefits by minimising potential conflicts of interest, which are potentially great. The opportunities for managers of any type of collective or pooled fund to maximise their profits at the expense of outside investors (limited partners, shareholders, unit holders or other kinds of beneficiary) are considerable. These include fair allocation, allocation of losses, affiliated and personal dealings, costs of execution, payment of fees to external advisers.

Administrative Capacity. Any kind of investment fund requires a sophisticated administrative backup. Typically for a private equity fund the services required would include:

- Set up and registration of a fund
- Fund launches
- Customer due diligence and anti-money laundering checks
- Receipt and administration of commitments and calls
- Fund accounting
- Valuation of enterprise assets
- Corporate and secretarial services
- Investment processing
- Investor relations and reporting
- Regulatory reporting

It is a precondition for any country that wishes to attract private equity funds that it be able to offer a good choice of administration companies to carry out the functions listed above. Indeed many fund domiciles insist that some or all of these functions are carried out locally, where the fund is based and registered in order to ensure that employment is created locally.

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[4] One of the reasons that the UK is such a popular investment destination for both direct and portfolio investment is one of the world's most extensive range of double tax agreements.

[5] In this respect an 'offshore' fund is no more a tax avoidance scheme than a UK unit trust or a Luxembourg SICAV. It is interesting to note that the UK has recently legislated for a new type of fund, the 'contractual' fund, which is designed specifically to attract a certain category of investor that requires an absolutely transparent tax regime.

[6] This does not mean that investors always pay tax. Unrelated to the domicile of the PE fund or any other fund, investors may invest through a pension fund (which are tax exempt in most countries) or establish vehicles that make tax avoidance possible. The latter is an arrangement the end investor may choose to make and has no connection with the domicile of the fund in which the investment is made.

[7] This could change if and when integration efforts within the EAC and SADC take on a more meaningful dimension, e.g., by introducing sub-regional currencies and free trade in financial services, including lifting of any exchange controls or limits of repatriation of profits.

2.2 Policy Issues Related to Onshoring the PE Industry

The prospects for onshoring financial services need to be assessed against the evolving development needs of financial markets in Africa. With recent years' growth in their asset base institutional investors, predominantly pension funds in countries such as Nigeria and Kenya,[8] are increasingly constrained in their investment choices. They are too heavily exposed to government securities, bank deposits and real estate. Recently investment guidelines have been modified so as to allow limited investment in PE funds (e.g., in Nigeria and Kenya).[9]

Two questions here are: (a) whether pension fund investors are better serviced by locally-domiciled PE funds; and (b) what efforts could be made to enhance the size of the PE industry so as to satisfy increasing investor demand.

Important questions arise as to whether (and if so, how) efforts should be made to encourage the development of the local PE industry. Would local institutional investors be better served, were PE funds to have an onshore rather than an offshore domicile? In the country of domicile this would make investment by local institutional (and indeed retail) investors much simpler, since investment in PE funds would become local and would not involve 'round-tripping' through an offshore centre that most likely will raise concerns among regulators and trustees. Nonetheless, for the foreseeable future local pension funds and their trustees might not be comfortable buying locally-domiciled PE funds —they realise that the reputation and efficiency of offshore domiciled PE funds would serve them better.

The Nigerian authorities are trying to encourage the establishment of a locally-domiciled PE industry by mandating that eligible PE funds be domiciled locally and that PE funds invest 75% of their funds locally. Given the reputation of Nigerian market institutions and the costs of doing business in Nigeria, there are considerable costs associated with these efforts to 'encourage' the onshoring of the PE industry, which will be borne by pension savers.[10]

Another policy issue is whether expansion of the PE industry in Africa detracts from the development of local capital markets. Despite the increasing demand coming from institutional investors there is a dearth of local investment opportunities. In part this reflects the preference of owners of medium- and larger-scale local enterprises for investment by major international PE funds. Were such enterprises to issue local IPOs, they would need to observe transparency requirements associated with being listed, such as disclosure of financial information and scrutiny by the tax authorities.

Thus, in the case of such more established enterprises—rather than expanding the frontier of available risk-capital available to local entrepreneurs—funding provided through PE funds often takes the form of 'replacement financing' and can be regarded as a substitute for local IPOs, and thereby as a vehicle for facilitating transfer of potentially sound investment returns from local to foreign investors. It can be argued that the activities of PE funds actually inhibit / crowd out the development of local capital markets.

Even in more developed markets PE is often regarded as "sucking life out" of issuance on the exchange. With the extreme scarcity of new issuance and the limited supply of viable and growing medium to large enterprises in Africa, the likelihood is that the potential damage caused by the PE industry could be serious.[11] Altogether, unless the PE funds are addressing a particular gap in the funding available to small enterprises, the question is whether donor efforts could be better spent on facilitating IPOs and thereby stimulating the development of the local capital market. Only if PE funds do provide risk-capital to SMEs that are too small to be listed would they appear to be unequivocally beneficial.

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[8] Kenya and Nigeria are referenced here because they have undertaken significant pension reforms in recent years, whereby pension savings are fully-funded and privately managed. For more discussion about PE fund investment by pension funds in Africa see "Pension Funds and Private Equity: Unlocking Africa's Potential," EMPEA, Making Finance Work for Africa and Commonwealth Secretariat, 2014.

[9] The regulations in Kenya and Nigeria stipulate that pension funds can invest 10% and 5% (respectively) of their assets in PE. The Nigerian regulations require that pension assets are invested in locally domiciled PE funds that invest 75% of their assets in Nigeria. The Kenyan regulations also prohibit investment by pension funds in offshore PE funds.

[10] Indeed several larger Nigerian PE fund managers have established 'mirror' PE funds catering specifically to the needs of local pension fund administrators (PFAs). These funds are registered locally, and – as one would expect – they face additional costs associated with operating in the local 'ecosystem.' These relate to fund administration (e.g., fund registration with the SEC typically takes two years), legal uncertainty (e.g., law defining limited partners only being on the statutes of the state of Lagos) as well as undue regulatory burdens and bureaucratic delays, see further discussion in Section 3.

[11] Recent dialogue with the heads of the stock exchanges in East Africa confirms that this is indeed a major cause of concern.

3. WHICH COUNTRIES IN SUB-SAHARAN AFRICA ARE LEADING CONTENDERS AS ONSHORE FINANCIAL CENTRES?

Given the considerable time and effort that would be required to establish a financial centre in Africa, the approach taken here is that it would be misleading to base the choice of prospective candidate countries on a specific scorecard of measures such as the ease of doing business, the need for improvement in the legal and regulatory framework, and the current capacity of the authorities to address these shortfalls. Were a country willing to put its mind to addressing existing gaps, the country's ranking could easily shift during the lengthy period of time that would be required to build an international financial centre.

It lies beyond the scope of this study to undertake a complete cataloguing of countries against particular requirements, see Annex 1 that provides an illustration of the scope of such an exercise as developed for the Rwandan authorities in 2011. While the listed items are illustrative of the hurdles that would need to be addressed, these hurdles would be surmountable given a concerted effort.

The factors determining whether a country could qualify to become an onshore financial centre include:

- ***Political will.*** Willingness of all parts of government to work towards a clearly established strategic goal with minimal changes in overarching policy goals. This implies a high degree of political stability and involves consistently motivating politicians, administrators, tax authorities, regulators, immigration officials, etc.
- ***Reputation for transparency.*** Reputation for transparency, particularly on tax matters, and willingness to address corruption. Having a reputation for preventing financial crime is important.
- ***Conducive legal framework.*** Legal framework permits the creation of types of structures that are most efficient for the private equity industry (such as limited partnerships, trusts and specialised investment funds).
- ***Fiscal transparency.*** Tax 'pass through' coupled with availability of a wide network of double tax treaties, and a favourable tax environment for fund management companies and their staff.
- ***Free movement of capital.*** Absence of exchange controls on inward and outward payments.
- ***Efficient regulation.*** Regulatory practices need to be efficient, implying minimum bureaucratic procedures, integrity and ability to make decisions rapidly as well as to accept and legislate for new developments quickly.
- ***Availability of qualified human resources.*** Availability of qualified professionals with specialised expertise in administrative, legal, accounting, IT and custodial matters as they relate to private equity.

BOX 2: THE POLITICAL ECONOMY OF PUBLIC GOODS IN FINANCIAL SECTOR REFORM

Reforms of the enabling environment for financial sector development (legal / regulatory / institutional infrastructure) in Africa are difficult to undertake and usually take much longer to implement than envisaged. This goes for an environment like Kenya, where legal reforms do get processed, but according to a frustratingly lengthy and uncertain time-line, but even more so in Nigeria. By way of an example, the World Bank Group has provided advice on establishing the legal / institutional basis for registering movable collateral in Nigeria for more than a decade. While there has lately been some progress in establishing the collateral registry, the agenda as regards reforming the legal foundation for security in the form of collateral still needs to be addressed. Similarly, efforts to establish credit bureaus in Nigeria have stalled, as the focus of the bureaus has hitherto been on collecting reliable data from the banks rather than on providing banks with analysis based on the available data. While greater strides have been made in Kenya, gaps in data collection, particularly as regards positive information and from parties other than banks remain. Although it is broadly recognised how important these reforms—collateral registration and credit information sharing—are for SME access to finance, and that SMEs have an important role to play as drivers of economic growth, the process of implementation has proven to be difficult and lengthy.

This drawn out process was not the outcome of lack of advice or guidance regarding desirable reform actions. Diagnostic work undertaken by the IMF / World Bank over the past decade and more under the auspices of the Financial Sector Assessment Program (FSAPs) and the Bank's MSME project has drawn the attention of country authorities to the content of the required legal / regulatory reforms. These efforts may have contributed to filling certain knowledge gaps, but clearly their impact on reform actions was limited in the shorter run.

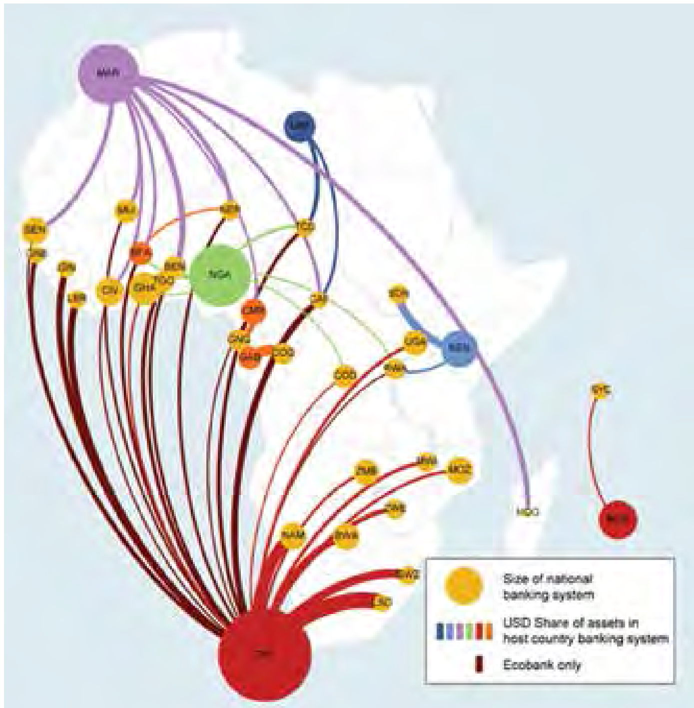
Thus the approach taken here is that such important environmental reforms do not take place in a vacuum. The impetus for reform relates to the opportunity cost of the status quo – i.e., of doing nothing. Rather than develop a long wish-list of reform actions, most of which the authorities will be quite familiar with already, the approach proposed here is to find ways of supporting the PE industry, partly so as to enhance access to finance by SMEs, but as much with a view to encouraging the private sector to apply pressure on decision-makers and the authorities to undertake the required sector-wide reforms of the institutional / legal / regulatory environment.

- ***Good accessibility.*** Good communications both international transit (including visa and immigration processes) and telecommunications are important.
- ***Locational appeal.*** Good and affordable infrastructure, accommodation, schooling and assured personal safety.

However, while all the above factors are necessary conditions for replicating the comparative advantages associated with an offshore centre, it is doubtful whether they are sufficient. Successful international financial centres around the globe—whether London, Hong Kong, Singapore or Switzerland—were not created in isolation, but arose in conjunction with development of a vibrant domestic financial services industry.

Looking beyond the issue of scale, experience suggests that the political economy of financial sector reform is an uncertain process, particularly when such reforms entail provision of public goods, such as a conducive legal and regulatory framework, strong judicial and oversight processes, efficient financial infrastructure, etc. Local private sector parties most impacted by shortfalls in current systems are likely to be the most vocal and effective drivers of such reform processes. Thus, rather than engage directly in dialogue with authorities on the reform process, the most impactful approach to supporting improvement may well be to build on the influence of those local private sector parties most impacted by current circumstances (such as PE fund managers whose activities are hampered by shortfalls in the enabling environment). They are likely to be the most effective drivers of such reform processes, see Box 2.

Figure 3: Ownership linkages among African banks



Note: The graph only shows ownership linkages between countries if the share of assets held by home countries constitutes at least 10% of the host country's banking system. The size of the bubbles is in proportion to the absolute size of each country's banking sector. The reference year is 2011; where 2011 data was not available, figures from 2009-2012 were used instead. Sources: Central Bank websites, annual reports of banking groups, Claessens and van Horen Bank Ownership Database, World Bank / IMF country reports, GIZ (2012a, 2012b, 2012c, 2012d).

Judging the prospects for onshoring in Africa in relation to the prospective depth of the local financial services sector is important, as African financial systems are significantly burdened by fragmentation. While not precluding small countries from becoming financial centres, their ability to assume this role depends on harvesting economies of scale and could be significantly handicapped unless they provide a 'gateway' to a financial sector of significant depth—e.g., as part of a currency union or a financial services free-trade zone. A small country that cannot provide such a 'hinterland' will find it much more difficult to compete with offshore centres, such as Mauritius. In setting up a locally-based financial services centre providing access to an investor base of significant size will be an important factor in determining the 'viability' of undertaking the required institutional and infrastructure investments.

Another important consideration is whether countries already aspire to becoming sub-regional hubs for financial services as reflected by the investments made by their financial systems in neighboring countries and their capacity—both human resources and technical—to expand their presence from their home base. A recent study[12] maps the increasingly important role of South-South investment in African banking, see Figure 3 above. While South Africa still has a dominant position in cross-border banking in Africa, the study documents the increasing importance of Kenya, Nigeria and Morocco as sub-regional hubs.

Given the East African Community common market and increasing liberalization of capital movements within the Community, Nairobi has developed a vision of becoming

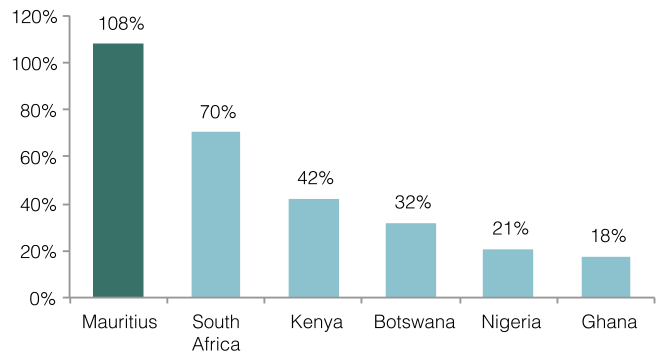
[12] *Thorsten Beck, Michael Fuchs, Makaio Witte and Dorothe Singer,* Making Cross-Border Banking World for Africa*, June 2014, published by GIZ, the World Bank the African Association of Central Bankers and the Making Finance Work for Africa partnership.*

the gateway for inbound capital into the Community and surrounding countries, such as South Sudan. In West Africa, PE fund managers are already adopting a hub and spokes model of operation with the main centre being Lagos. Several Nigerian PE fund managers have adopted this sub-regional approach as an integral part of their business strategy and are already operating in Ghana, Liberia and Sierra Leone.

In comparing these two countries, Kenya might be more highly ranked due to its track record of continued, successful innovation[13] combined with measured regulation, and lesser dependence on narrowly-focussed natural resource incomes, to which the Nigerian economy is heavily exposed. While Kenya's domestic financial system is smaller than that of Nigeria, Kenya is aspiring to become the sub-regional financial centre for the East African Community, see Figure 5.

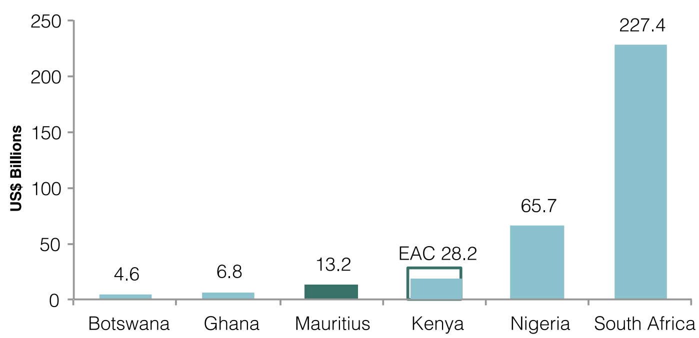
While Mauritius has a large financial sector related to the size of the country's GDP (due to its success as an offshore centre), see Figure 4, the asset base of the Mauritian financial system is relatively small when compared to other countries in Sub-Saharan Africa. The relative depth of the Nigerian and Kenyan domestic financial systems compared to other countries in Sub-Saharan Africa, see Figure 5, and the fact that they are already the main destination of PE investment in Sub-Saharan Africa, see Figure 6, confirms that they are potential candidates for becoming financial centres. Altogether onshoring of financial services needs to be seen as an integral part of the broader process of deepening the domestic financial services industry in these countries. The conclusion drawn from the above is that *Kenya and Nigeria* would be the two countries where onshoring of financial centres could be a viable option.

Figure 4: Percent of claims on private sector / GDP



Source: International Financial Statistics, IMF; end-2013 data.

Figure 5: Total claims on private sector (US$ Billions)



Source: International Financial Statistics, IMF; end-2013 data.
Note: EAC Countries combined make up US$28.2 billion. Kenya contributes US$17.4 billion, and other EAC countries contribute US$10.8 billon.

Overall the Nigerian environment for private equity is slightly more developed than the Kenyan. The impetus for reform in Nigeria was largely driven by the 2004 pension reforms whereby public sector defined-benefit schemes were transformed into fully-funded schemes and a robust regulatory environment was established to protect pension savings. Current investment guidelines stipulate that pension funds can invest up to 5% of their assets in PE funds provided they are locally domiciled. This has led several PE fund managers to establish 'mirror' funds domiciled on Mauritius and in Nigeria.[14] Another factor impacting the Nigerian PE industry is the presence of a number of highly-qualified professionals, usually re-turning diaspora educated abroad with considerable work experience from global financial centres, such as London and New York.

[13] *For example, as regards introduction of a variety of SME financing instruments, usage of mobile-money as well as the introduction of adjunct services, such as provision of microcredit using information on mobile-money usage as the basis for credit-scoring.*

[14] *Nigerian PE fund managers have accepted the need to work pragmatically with this market segmentation. The extra costs associated with local domicile include (a) very lengthy licensing and registration processes (up to two years); (b) requirements that require PE fund managers to live up to the same investor protection regulation and capital requirements as mutual funds, although PE funds rely predominantly on professional investors; and (c) the much lengthier, more uncertain and more costly local judicial / enforcement process.*

4. ROLE OF DONORS AND TECHNICAL ASSISTANCE PROGRAMMING

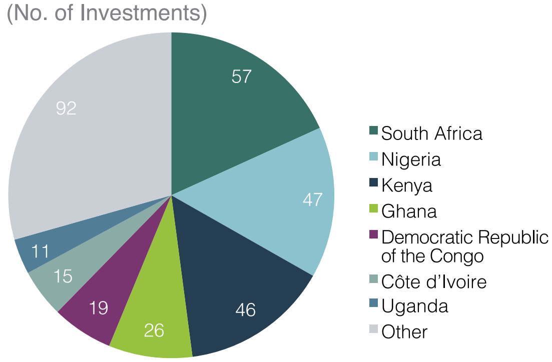
Two broad conclusions can be derived from the previous sections as regards the role of donors.

First, there is high potential associated with investment by PE funds in smaller enterprises in Africa. PE fund managers fully recognise the imperative of enhancing the contribution of the PE industry to servicing smaller enterprises. However, here they are confronted with a classic market-failure.

General partners (GPs) face a dilemma in servicing small enterprises in that the identification / search costs (often hampered by weak accounting / reporting), investee company preparation costs (enterprise restructuring, including governance and management) and investee company monitoring costs (often entailing close involvement in key decisions as well as quite intrusive micromanagement, such as oversight of cash-flows) tend to be as high or higher for small enterprises compared to more established enterprises. GPs are unable to fund these high fixed costs from the industry-wide standard 2% of capital that is devoted to the GP's annual management fees. As a result, the focus of the PE industry invariably drifts upward towards larger enterprises, particularly as the size of the enterprises in which PE funds are invested grows and the focus of GPs inevitably 'graduates' towards larger investments which are less costly to service.

Figure 6: Private equity investment in Sub-Saharan Africa

Sub-Saharan Africa Investment by Country, 2012-2014
(No. of Investments)



Source: EMPEA.

Were the factors outlined above to be overcome, extending the frontier of enterprises serviced by the PE industry to smaller enterprises could herald the next major innovation in development finance, similar to the microfinance revolution of past decades. While, as in microfinance, there is an important potential role for donor support in 'seeding' and providing technical assistance to new SME-focussed funds, care will need to be taken both in how this 'seeding' process is undertaken and in designing support so that it serves to catalyse rather than replace greater private sector involvement. Initially 'soft' capital could be provided by investors such as IFC and CDC to seed new PE SME-focussed funds. However, the objective would be that these funds establish a track record and, once the model is tested, private funding could be attracted to a second generation of funds.[15] The overall framework of the traditional and suggested fund structures is illustrated in Figures 7 and 8 below.

[15] *More radical suggestions might be explored, such as making SME-focussed PE funds open-ended, but this would immediately compromise the PE fund structure and the incentives of PE general partners focussed on realising capital value appreciation during the predesignated 10 year life of most PE funds.*

Figure 7: Traditional PE fund structure

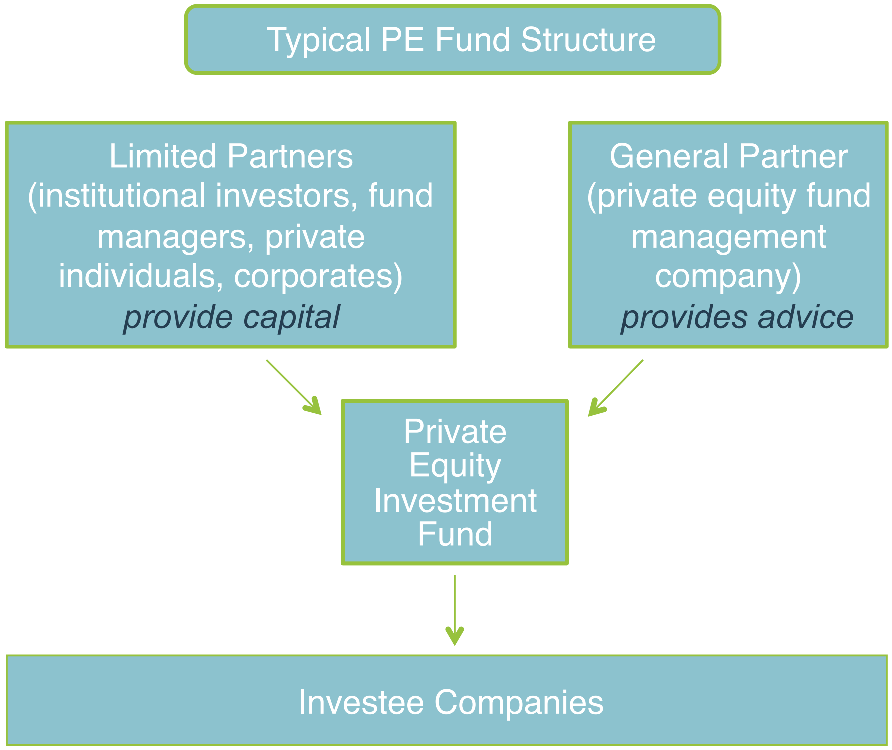
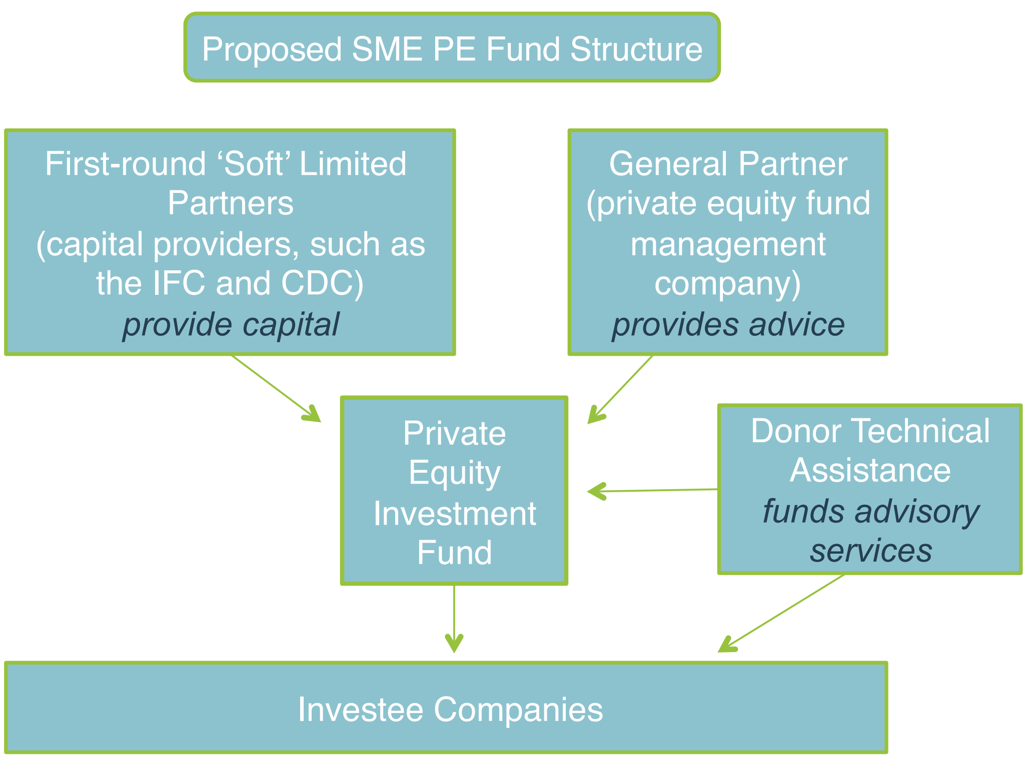


Figure 8: Proposed SME-focussed PE fund structure



Thus, while some PE general partners do see considerable potential in investing in smaller enterprises, they find it difficult to enhance their focus on small investee companies (with target investment sizes of below US$5 million) due to the costs involved. In the first instance—until the business model has been proven to work—there is a role for soft investors, such as the IFC and CDC to seed such PE funds. Clearly, a prerequisite for success with be identifying highly qualified and motivated PE GPs focussed on expanding the frontier of the PE industry.

SME-focussed PE fund managers will invariably need to assess and monitor a much larger number of (potential) investee companies.[16] While tailoring the fund structure and size, adjusting management expectations, and customizing (increasing) the fee structure could potentially contribute to resolving this challenge, it will be important that the SME-focussed funds are structured to avoid a situation where GPs have to alter their business models, processes and reporting structures significantly, as this would compromise their incentives and thereby their ability to access funding from private sector limited partners in successor funding initiatives. For example, were the fees provided to GPs increased, this would reduce the investable capital at their disposal and invariably raise questions as to whether the fund is 'competitive' in the eyes of limited partners.

It follows that providing support to PE funds that are committed to targeting smaller enterprises is best structured as technical assistance provided *directly* to defray PE running costs and to prospective PE investee companies so as to strengthen the pipeline of prospective investible projects.

Second, the scope of tasks relating to establishing onshore centres is so all-encompassing that it makes little sense to disassociate it from the much broader agenda of financial deepening in the identified candidate countries. Both Kenya and Nigeria already benefit from broad-based donor assistance in support of the deepening of their financial systems. As already emphasised above, it is highly unlikely that foreign-based limited partners will invest in onshore domiciled PE funds: for the foreseeable future building a track record as trusted PE domiciles lies beyond the scope of onshore locations in Africa.

In this context one approach adopted by the Nigerian authorities is to oblige pension funds to invest in locally-domiciled PE funds, in effect providing protection to support the development of the locally-domiciled PE industry. Due to quite significant gaps in the local legal / regulatory environment this is certainly not without costs in terms of net returns on pension investments. This model is probably not replicable in most African countries due to the small size of their financial systems and the limited potential for domestic-oriented funds.[17] However, in the Nigerian context there is a need to provide support to the Nigerian Securities and Exchange Commission to strengthen their oversight of the PE sector.[18]

As a complement to these broader programs specific technical assistance could be provided to facilitate the exit of PE funds from medium and larger scale enterprises, thereby facilitating IPOs on local stock exchanges. This targeted effort would both contribute to 'onshoring' and to deepening the local capital market, potentially providing relief from the dearth of new issues and the limited liquidity of existing issues. Given the accumulation of assets in defined-contribution pension schemes in Kenya and Nigeria, the shortage of local issuances will continue to constrain pension fund asset choices. Rather than establishing new exchanges for smaller companies, which has the potential of further fragmenting already small equity markets, these technical assistance efforts would focus on reducing the costs of, and simplifying, the IPO issuance process, increasing capacity of institutional investors to assess / participate in IPOs, and removing / lessening identified regulatory hurdles. These efforts could also be extended to developing the corporate bond market as a complementary source of enterprise finance.[19]

5. PROGRAMMING TECHNICAL ASSISTANCE

5.1 Pairing Technical Assistance Funding with Concessional Equity Investment

The IFC's SME Ventures program provides evidence that it is possible to undertake viable PE investments in small enterprises even in fragile states in Africa, but hitherto the

[16] *SME-oriented GPs speak of sifting through one hundred proposals to find one potential investee company. See Section 5.2 below for further specification of the kind of TA required.*
[17] *In Nigeria, domestically domiciled PE funds are required to invest 75% of their assets in Nigeria in order to qualify under the Pension Commission's investment guidelines.*
[18] *See footnote 14 above.*
[19] *The IFC has engaged in a local bond issuance program in selected African markets. An important outcome of this program has been to encourage regulatory reforms and strengthen the capacity of regulators and market intermediaries.*

return on equity of such investments are estimated to be in the range of 5% to 8%, i.e., below the return hurdles required of PE funds looking to multiply the equity of their investors by a factor of 2.5 over five years.[20]

Similar to the IFC, other funds, such as GroFin, have had access to concessional equity. Grofin has made investments in SMEs in some 15 countries in Africa, but their scope is hampered by the availability of concessional capital (in this case provided by the Shell Foundation). GroFin provides mezzanine financing rather than equity. While such financing performs an important role in providing access to working-capital financing, it is a complement rather than a substitute for equity.

Careful thought needs to go into designing a capital structure supportive of SME-targeted PE funds. As outlined above, given the market failure associated with SME-focussed PE funds, there would seem to be a role for 'soft' partners to seed new SME-focussed PE funds. As already pointed out, these efforts would need to be designed so as to catalyse further investment by the private sector.

Hitherto potential providers of 'soft' capital such as IFC have been reluctant to 'dilute' PE industry standards as regards investment practices and expected returns. They are concerned not to distort accepted PE industry standards. While there is every reason to continue supporting the PE industry according to 'market-conform' investment practices, the potential benefits associated with strengthening the PE industry's focus on the SME sector calls for parallel investment on 'softer' terms. This can be done while retaining basic PE industry standards, such as the 2% management fee and 20% carry (GP's share of capital appreciation), which will have the advantage of facilitating compatibility among funds, thereby encouraging private sector limited partner participation in subsequent funding rounds. Such future funding rounds could be organised as private-public partnerships, whereby private sector equity – where risk / return expectations are market-conform – is paired with concessional equity that is provided by development partners as grants and / or with lower yield expectations than that of the private sector. To encourage private participation the funding provided by DFIs could also be so designed so as to provide some first loss coverage.

5.2 Increasing the Availability of Suitable SMEs Suitable for PE Investment

Diseconomies arise because PE funds specialising in SMEs are typically small in overall size and by nature they invest in a larger number of smaller deals, both factors contributing to relatively high operational costs. Technical assistance grants would contribute to defraying these scale disadvantages and to enhancing the flow of viable financing opportunities.

TA support to investee companies is needed in such areas as:

a. Finance and financial accounting capacity;
b. Resource planning and budgeting;
c. Business plan development;
d. Marketing and market studies;
e. Strategic planning and governance;
f. Legal support;
g. Operational and process improvement; and,
h. Facilitating access to international supply chains.

Provision of such technical assistance is important both in the pre-investment and post-investment phases of PE fund engagement. The need for specific skills required to build the capacity of investee companies is broadly recognised, but they are in scarce supply. These skills are not best imparted at training courses or in class-room settings, but on-the-job in the form of mentoring programs delivered by experienced SME managers. Business Partners[21] has developed a high-quality network of mentors consisting of seasoned professionals to tutor younger entrepreneurs, but although the concept has been proven to work well, there are limits to how rapidly it can be replicated.[22]

5.3 Developing Local Fund Management Experience, Capacity and Competencies

When working with smaller enterprises the work of a PE fund manager is very much 'hands on' with the result that any one manager can monitor only a limited number of companies (estimated at between 6 and 9). Indeed such 'hands on'

[20] *This assessment is preliminary. While these funds have proven to be viable, they have not closed yet, so any assessment of investment returns is as yet partial. See Josh Lerner et al, Evaluation of the IFC's SME Ventures: Final Report, IFC (unpublished), April, 2013, for a detailed evaluation of this program.*
[21] *Business Partners is headquartered in South Africa with investments in Malawi, Namibia, Zambia and Zimbabwe and has established funds in Kenya, Madagascar, Mozambique and Rwanda.*
[22] *Shanthi Divakaran and Masood Shariff,* Understanding the Landscape for Private Equity and Related Technical Assistance to SMEs in East Africa, *World Bank, January 2013, provides an overview of TA provided to SME-focussed PE finds in East Africa. The study notes that "Despite the influx of investors and capital, the private sector ecosystem in East Africa is still embryonic and fragmented, particularly for those firms specialising in the SME space. The first SME-focussed PE firm only began investing in East Africa in 2007. It is worth noting that many funds have not gotten to the exit stage." (p.11)*

management extends to monitoring company revenues and inventory, being co-signatory to checks issued by the investee companies, preparing Board meetings and the basis for decisions to be taken, etc.

Strengthening the local presence of PE fund managers is a necessary complement to extending the support provided by PE funds to early stage, smaller investee companies and entrepreneurs. While some 'onshoring' of such capacity has started to take place in Nairobi and Lagos, strengthening the presence of PE funds under local management is important both from the perspective of enhancing growth of the PE industry[23] and so as to gain understanding and acceptance of PE investment among local institutional investors. Locally-domiciled PE fund management teams need to gain experience in long-term equity-type investments and business partnerships, sector know-how, business strategy development and enterprise management / monitoring. Support also needs to be provided to fund managers to build and maintain specialised operational capacity, organisational infrastructure and IT systems.

As outlined above, expanding investment by PE funds in SMEs will initially depend on investment and technical assistance made by DFIs and donors. In proposing that DFIs / donors step up their focus on providing support to PE investment in SMEs it is worth emphasising that PE fund managers see considerable potential hurdles associated with donor involvement, such as:

- Lengthy, bureaucratic and expensive set up procedures, which makes the whole start up process lengthy and complex: lengthy budgetary cycles of DFIs associated with complex legal procedures ('legal overkill').
- An uneasy mix of social and developmental objectives which are difficult to match with commercial reality.
- An unhappy combination of risk acceptance and risk aversion.
- Unrealistic targets for returns and short time horizons. 'Quick wins' and 'low hanging fruit' are familiar mantras.
- Burdensome standards of governance and reporting to 'best international standards' that deters commercial operators.
- Expensive and demanding due diligence procedures before making investments that can be seen as a major deterrent to private owners of potential investee companies.
- The provision of technical assistance is not well coordinated with the equity funding. Insufficient local ownership and capacity building for local professionals.

These factors do not necessarily deter the big multinational private equity funds which are looking for investments of US$25 million to US$50 million+ and can afford to engage in the process of observing the full panoply of international best practices, and are looking for quick profits and exits, but such processes can be major impediments to the smaller operation. Overcoming these hurdles will require concerted, even pioneering efforts outside of the mainstream operating environment of donor institutions. The IFC's SME Ventures program provides an example of an interesting initiative targeting the SME market in fragile states in Africa (and elsewhere), and provides some guidance as to how PE activities can be implemented even in very difficult circumstances. It is indicative of the challenges faced by donors that this initiative was specifically targeted at fragile states in part so as to avoid conflicting with the mainstream market-conform focus and philosophy of the IFC's PE investments.

Thus thought now needs to be given as to how donor-funded initiatives, such as the IFC's SME Ventures program, can be both replicated in mainstream markets and expanded so as to leverage DFI investment with private sector investments. There is also a lot to be learnt here from efforts made by GroFin and Business Partners, particularly as regards challenges faced in scaling up tailoring PE investments to smaller enterprises and scaling up these business models to achieve more significant impact.

6. IMPACT

The creation of a local PE industry that provides risk capital to smaller domestic companies is a powerful tool for economic development. Originating deals and monitoring investment performance requires detailed local knowledge, micromanagement and support in the form of consulting and mentoring programs, and cannot effectively be undertaken at arms-length. Establishing such capacity in Africa can contribute to closing the SME financing gap, "the missing middle."

Parallel efforts need to be undertaken to step up the role of local financial sectors in the providing the legal, regulatory and taxation framework as well as processing capacity for private

[23] *As noted above, a 'hubs and spokes' model is the most likely development here, where hub PE fund managers establish spokes in neighboring countries.*

equity funds. These efforts could be encouraged by coupling onshoring with introduction of a 'sunset clause' on investment in foreign domiciles.

Where the microfinance revolution provided short-term loans to microenterprises, the next revolution in development finance could well be in the realm of providing risk-capital to small enterprises. The potential impact could indeed prove to be highly significant.

In terms of impact measurement of greater investment in PE-funded SMEs, the focus will be on measuring employment generation. Care will need to be taken to develop an M & E framework that facilitates accurate attribution of the impact of PE fund investments. It will be important to measure employment on a net basis as well as average wages paid, given the PE investments often are associated with enterprise restructuring. The impact of employment created by PE investee enterprises will need to be measured against appropriate benchmarks, such as employment of comparator, similar enterprises within the same sector of the economy.

It will also be advisable to set up from the outset methods by which to assess the efficacy of advisory services using randomised control experiments. Such more rigorous project evaluation methods will be difficult to implement unless data collection routines are established prior to committing resources.[24] Information will need to be collected on a regular basis as to whether supported enterprises are able to access outside funding and on which terms (comparing with a control group). Eventually value at exit will provide an important outcome metric, although clearly more granular results measurement is also called for.

[24] *David McKenzie and Christoffer M. Woodruff, "What Are We Learning from Business Development and Entrepreneurship Evaluations around the Developing World", IZA Discussion Paper no. 6895, 2012.*

ANNEX 1: CATALOGUE OF FINANCIAL CENTRE ATTRIBUTES[25]

	Dublin	Mauritius	Dubai	Botswana
General Information				
Number of asset managers / promoters	431	135	14	14
Number of fund administrators	60	135 (the 'manager' is the administrator)	12	0
Number of law firms	30	22	16	Approx. 6 with cap mkt expertise
Number of audit firms	10	28	16	19
Custodians	23	6	13	3
Number of funds registered	1,136 (5,224 inc. sub funds) Listed 3,400	600	1,600 (foreign funds)	16 domestic, 60 foreign
Membership of regional blocs	European Union	African Union, the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA) and IOR-ASC	Gulf Cooperation Council	Southern African Development Community (SADC)
Tax Environment				
Fund	No tax on income or gains. No asset tax.	No capital gains tax. Deemed tax credit of 80% of theoretical WHT = 3% tax on ordinary income but with DT offset.	No capital gains tax. No tax on income. No withholding tax.	Funds in BIFSC: no capital gains tax. No withholding tax on payments of interest or dividends to non-residents (15% for residents).
Management company	12.50%	15% or alternative of 7.5% of accounting profits or 10% of dividends (see detail)	Exemption for 15 years from formation and extension further 15 years if corporate taxes introduced	If BIFSC based, not subject to capital gains tax, withholding tax: 15% corporation tax. Can offset foreign withholding tax
Value added tax	Exempt	No	No	Exempt in BIFSC
Other applicable taxes	None	No		Unclear
Stamp duty	No	No	No	No
Double tax treaties in effect	62 (see annexe)	34 (see annexe)	60	13 in place, 6 due for ratification, 6 in process
Name of regulatory body	Central Bank of Ireland. The Central Bank of Ireland is responsible for the regulation of most financial service firms (financial service providers) in Ireland; including funds, fund service providers (including managers, promoters and administrators).	Mauritius Financial Services Commission. The Financial Services Commission, Mauritius (FSC) is the integrated regulator for the fin-ancial services sector other than banking. (NB GBC set up under Companies Act) The FSC licenses, regulates, monitors and supervises the conduct of business activities in the non-banking financial services sector.	Dubai International Finance Centre (DIFC) is a separate jusrisdiction with its own laws. Dubai Financial Services Authority is the independent regulator of financial and ancillary services conducted in or from the DIFC, responsible for managing or distributing Collective Investment Funds (Funds).	Botswana IFSC is governed by laws of Botswana; BIFSC status is conferred by tax certificate. Non-Bank Financial Institutions Regulatory Authority regulates non-banks including collective investment schemes and their managers.
Applicable Law	No specific fund law but amended unit trust act and company act together with adoption of EU directives relating to UCITS.	Financial Services Act 2007. Securities collective investment schemes and closed-end funds regulations 2008.	DFSA Collective Investment Fund Law 2006.	Collective Investment Undertakings Act Chapter 56: 09. New CIU Bill drafted that will enable closed ended funds and partnership structure funds.

[25] *Source: Codogan Financial, Developing a private equity investment management industry in Rwanda (2011).*

	Dublin	Mauritius	Dubai	Botswana
Regulation				
Available legal structures (Common contractual fund, Investment company, Unit trust, Limited partnership)	All types. Also qualifying investment funds (QIFs) There are no investment restrictions imposed by the Financial Regulator (or by the Irish Stock Exchange if the fund is listed on the ISE).	Company (Public or private, fewer than 25 shareholders) Trust; other legal entity prescribed by regulator (i.e., protected cell company under GBC1) Closed ended company (unlisted or listed). Umbrella fund: Mauritius Global Business Licence sub fund of umbrella or feeder for non-Mauritius fund.	Companies, trusts, limited partnerships. Exempt funds investing in real estate, hedge, private equity, feeder, fund of funds and Islamic, not more than 100 investors minimum US$50,000.	Existing CIU Act - only investment company with variable capital, unit trust. Envisages open ended funds only. New CIU Bill envisages partnership structure funds and closed ended funds. CIUs will be exempt status (if privately offered only - domestic or foreign); licensed (domestic, public offer) or recognised (foreign, public offer).
Management arrangements	Of the fund promoters that do not have a physical presence in Ireland, many have established their own Irish registered management companies in the IFSC. If the fund is to be established as a unit trust, a management company will be required as an integral part of the fund's structure and will be a signatory to the trust deed constituting the fund. Where the fund is established as an investment company with variable capital, the use of a management company may still be helpful as it can act as the central co-ordinator of service providers on behalf of the fund company.	Management (operator) company must be licensed with FSC: an offshore fund must have a local administrator, custodian (usually a bank) and auditor; investment adviser anywhere: accounts and accounting documents kept in Mauritius; share register kept in Mauritius; issues and redemptions carried out in Mauritius; calculation of NAV carried out in Mauritius BUT can be elsewhere provided information available to FSC.	Management company established in a recognised jurisdiction (external fund manager) can establish fund in DIFC without further licence.	Under existing Act, CIU must have management company licensed in Botswana. Same will apply under new Bill unless fund is self-managed corporate structure.
MMOUs signed	IOSCO MMOU in progress	IOSCO MMOU	IOSCO MMOU	No
Share classes and rights. Can have different share or unit classes with different charging structures	Yes	Yes	Yes	Yes
Average set up time	4-6 weeks: QIF 24 hours	2-3 weeks	Exempt fund 2 week notification	Unknown, but months not weeks
Common contractual	Yes	Yes	No	No (existing Act and new Act)
Investment company	Yes	Yes	Yes	Yes (ICVC only existing Act, ICVC & ICFC new Bill)
Unit trust	Yes	Yes	Yes	Yes (existing Act & new Bill)
Limited partnership	Yes	Yes	Yes	No (yes under new Bill)
Can a fund be exempted from regulation	Exempt from regulation for retail funds, but must comply with regime	Not entirely	Yes specifically professional funds	Broadly, yes - once exempted must report some data
Documents required for setting up a fund, partnership (or GBL Mauritius)	Prospectus: deed of constitution (CCF) Trust deed of trust. Articles if company: custody agreement; partnership agreement (ILP): management agreement: investment advisory agreement: administration agreement; distribution agreement (if applicable).	Any fund to be approved, registered with, recognised and / or licensed must apply to FSC and hold a Global Business Licence Category 1. See The Securities (Collective Investment Schemes and Closed-end Funds) Regulations 2008.	Communication to any person in any form or by any means, presenting information on the terms of the offer and the Securities offered, so as to enable an investor to decide to buy or subscribe for those Securities requires prospectus. Exemption for offers to professionals in excess of US$100,000.	Prospectus, constituting document of company, trust deed for unit trust, licence of management company and trustee or supervisory custodian or custodian (under new Bill, also partnership deed for partnership structure fund).
Regulatory Fees and Duties for Fund	€2,000-€4,500	US$500 set up: US$1,500 annual FSC: US$200 register of companies.	US$4,000 and US$4,000 annual: Umbrella US$8,000, each sub-fund US$1,000	BWP2,000 per fund
Management Company				
Licensing required	Yes	Yes (but management company has different meaning)	DFSA licensed or external	Yes - CIU manager licence for publicly offered domestic fund; asset manager license for privately offered domestic fund
Licence fee	Yes	Yes	US$10,000 application: US$10,000 annual	BWP10,000; annual levy based on assets under management

	Dublin	Mauritius	Dubai	Botswana
Capital requirements management company	€125,000 or 3 months expenditure whichever is higher. Plus 0.02% of AUM over €250 mn up to max cap €10 million	No minimum		CIU manager presently BWP500,000 or 3 months expenditure whichever is higher
Promoter	€650,000	No definition	No definition	Not stated
Custody				
Status and supervision of custodian	Liable for duty of care	Must have	Must have (except certain exempt funds)	Must have - all funds (existing Act, new Bill also)
Marketing				
Domestic	EU Miffed	Only fully registered CIS (not GBLs)	Public (higher disclosure) Exempt (professionals) Foreign (approved jurisdiction and marketed by licensed firm) Less than 100 investors, min. US$50,000	Privately offered Publicly offered
International	If EU Miffed or later AIFMD; otherwise local rules	According to local rules but note division of expert and professional investors	Local rules	Privately offered Publicly offered
Accounts				
Need for audit	Audited	Audit; local auditor; filing with FSC; no public access	Audited	Audit required
Stock Exchange Listing Possible	Yes	Yes	Yes	Yes

African Onshore Financial Centres REPORT

January 2015

EXECUTIVE SUMMARY

Financial service providers tend to cluster in centres. These centres generally develop for commercial reasons. Thus over time they become the main centres of financial services, of international trade and they become the key components in international commerce. It is certainly possible to delineate reasons why some financial centres have developed and why some have grown to be the largest centres but it is more difficult to create a definitive blueprint for how to develop a new financial centre from scratch.

This poses a challenge for policymakers in developing countries that may be seeking to develop a specific financial centre as one of the pillars of their strategy for development and promoting growth. Clearly there is evidence to show that growing economies will attract providers of financial services. Normally, the development of a financial centre in any particular country goes hand in hand with broader development within the economy—i.e., large and growing economies develop financial markets as is demonstrated in Africa by South Africa, Nigeria and Kenya. There are only a few cases where creating a financial centre is itself the catalyst for significant growth and development; the best recent example of this is possibly Dubai.

It is important to recognise that there are different types of financial centres in today's world. They have developed for different reasons, they are of different sizes and often specialise in different activities. The largest and most influential centres are Global Centres such as London and New York; they provide the most sophisticated services at a global scale and host the largest collection of financial services providers. Next are the regional centres such as Hong Kong or Dubai that provide sophisticated financial services to their particular geography. Their growth in recent years has benefitted significantly from accelerated regional development. Finally, there are the administrative centres such as Mauritius or the Cayman Islands that provide certain administrative services for a broad cross section of clients.

A classification of these financial sectors into 'onshore centres' and 'offshore centres' is slightly more complex. In general the administrative centres are more likely to be classified as 'offshore centres.' They often act as jurisdictions for booking transactions or for locating certain financial vehicles such as funds. This is usually because of the favourable tax environment they provide for users of that particular centre. Administrative centres can also be seen as the link between sources of capital and users of capital—the reason why they are mostly 'offshore' is that they do not introduce additional taxation on top of taxes levied on users of capital (investees) and providers of capital (investors).

It is difficult to envisage building a new full service global financial centre from the bottom up without accompanying growth and development in that economy. In addition the host government needs to create policies which make their centre more attractive than possible competitors and makes the centre user friendly for international capital markets.

Thus, when policymakers consider building new African onshore centres, they need to consider first whether it is to be a regional or administrative centre. Some of the conditions needed to establish either of these are similar but some are definitely unique. Understanding these can help them understand which measures may be needed in order to succeed with their goals of building new onshore centres.

To some extent, policymakers also need to be aware that building regional financial centres may be a zero-sum game where a new centre might be seeking to compete with existing centres in providing some services to some of the possible users. It will not always be possible to create new centres simply on new activities.

Yet, there are some fairly obvious prerequisites that can be identified for a new financial centre to be established. In today's world, connectivity is vital. These include travel links to the outside world and in particular to other centres of commerce. They also include communication links that enable entities in that centre to have systems that are compatible with international markets. A certain critical mass of economic activity is generally also necessary.

Beyond that, there is a need for quality infrastructure and welcoming living standards such that high calibre staff can be attracted. In today's competitive world, companies are loathe to simply use financial inducements to move people to new locations. That being said, there are ways to attract foreign staff if attractive personal tax rates or high quality living standards can be provided. In certain cases, the employers will devise their own ways to attract staff. These can include bearing some of the burden of local taxes or providing assistance with local living costs or possibly cost of education for children.

To be attractive to private companies, new centres should offer a stable political environment, adequate regulation and an effective and functioning rule of law? In some cases favourable tax or financial incentives may be used to attract companies. Such policies were used in jurisdictions such as Ireland where very favourable tax treatment attracted many corporates and financial companies. Many administrative financial centres such as Cayman Islands and possibly Mauritius have used 'tax neutrality'[1] to attract certain types of activities to their country. However, in the past some centres also used less robust diligence and regulatory standards to attract business.

Offshore centres have been criticised for being 'tax havens' for permitting major international companies, or investment funds, to avoid paying taxes in countries in which they operate; or worse to be hosts to illegal activities such as money laundering. Tax evasion was typically enabled by secrecy and lack of disclosure. As a result, many donors that participate in funds or financial vehicles domiciled in such jurisdictions have sought out other locations for their activities or required higher standards of diligence and transparency.

In summary, financial centres are much more than just domiciles of investment funds. In fact the most successful financial centres (e.g., New York and London) thrive without being the physical location of capital. Financial centres develop on the back of increasing commercial activity and business opportunities for providers of financial services. This will give rise to local firms and attract international firms if the opportunity is sufficiently attractive. For all successful centres this has been assisted by policymakers providing a conducive environment with the explicit goal of building a financial centre. Governments can engage proactively with the financial sector in raising finance or executing privatisations or other corporate finance transactions. This can catalyse broader activity in the economy. In many developing countries, donors can play a role in advocating the benefits of efficient capital markets in developing a stronger private sector. They can make targeted interventions using training to overcome skills gaps or more broadly they can help execute initiatives that allow local markets or local entities to engage with the international markets more effectively.

We envisage that that we will see in Africa the development of a series of local financial centres as individual countries benefit from economic growth. However, there is the potential for a few larger financial centres that service not only the host country but also neighbouring countries and potentially play a role across the continent. Our hypothesis is that such centres are most likely to be in countries that have the highest levels of growth or highest levels of GDP and where the host governments build an enabling environment. So centres such as Johannesburg, Lagos, Casablanca and Nairobi are the ones that come most readily to mind. Currently, Mauritius fills the role of Administrative centre for Africa. Whether these functions can be readily brought 'onshore' will depend on the ability of one or other centre to offer a competitive environment and possibly some supportive policies from the host government. The possibility of turning Mauritius into a fully transparent financial centre that is aligned with the interests of donors ought to be considered as well.

[1] *No taxation for intermediating finance flows.*

1. ONSHORE FINANCIAL CENTRES

This paper considers the potential to create 'onshore' financial centres in Africa. This is done in the context of understanding whether and how the creation of such centres can enable Africa broadly, and certain African nations in particular, to capture more of the developmental and commercial benefits associated with the creation or further development of financial centres.

The focus of this study is to understand better the incentives for managers of private equity funds and investors in such funds to choose certain domiciles for the jurisdiction of their funds. A central question revolves around what could or should be done to influence investors to select onshore jurisdictions for their funds, as opposed to reverting to certain offshore locations (e.g., Mauritius) that specialise in providing fund services. But this needs to be done in a wider context which considers the factors are needed to create successful financial centres in the first place. Indeed the definition of financial centres is far from clear and is worth reviewing in more detail.

It is also worth highlighting that the focus on private equity is too narrow in the context of African financial markets. While an important source of capital, private equity funds, and their related activities are only a small portion of financial activity in most markets. Both Lagos and Nairobi have developed diverse and vibrant financial markets. Their potential lies in acting as regional hub for financial services, of which private equity funds represent just a small fraction.

We have chosen a wide array of examples against which various assertions are tested but we are conscious of the need to ensure our views are couched firmly in the African context. We have formed these views on the basis of desktop information or information gathered from previous studies conducted by Lions Head as well as our ongoing dialogue with fund managers and investors. This can be and probably needs to be expanded upon in due course with on the ground diligence.

2. WHY FINANCIAL CENTRES EXIST AND MATTER

Why Finance Clusters in Centres

To understand how and why financial centres locate in certain areas, we need to answer firstly the question why finance clusters in centres. Broadly, the distribution and resilience of centres across the globe is a result of decentralising forces based on proximity benefits and centralising forces based on agglomeration benefits.

The international geography of 'finance' suggests the presence of strong centralising forces. There are few truly global centres (e.g., New York, London and Tokyo), at a distance several regional centres (e.g., Frankfurt, Hong Kong and Singapore) and administrative centres (e.g., Cayman Islands, Mauritius). Differences between these centres are discussed in Section 3. In any particular case, the starting point might have been the development of commercial activity but over time the attractiveness of any one centre increases as it hosts more financial services. We observe that financial services companies see definite benefits in co-locating in centres. These agglomeration benefits are explained by economists through spill-over effects between different players in an industry if the industry is clustered.

Through these spill-over effects and economies of scale, financial centres become hypercompetitive and resilient. They become difficult to replicate and will flourish even if the initial spark of the agglomeration (e.g., tax breaks) has disappeared, unless this is their only competitive advantage.

Regional centres are the result of the equilibrium between decentralising and centralising forces—a strong decentralising force being proximity to clients. Mauritius serves the Indian and African market as it is in proximity to both of them and provides services more competitively than a more remote global centre. Mauritius is more competitive since it builds expertise in servicing these markets and hence the suppliers can benefit from economies of scale.

Why Financial Centres Matter

The relevance of financial centres to an economy varies considerably with the type of financial centre. Regional and global financial centres generally spring up as the result of commercial activity and political will. Business activity creates increasing demand for financial services ranging from simple banking services all the way through to sophisticated financial advice. The presence of capital facilitates investment for companies and can make other commercial industries more competitive. In the case of Africa, other sectors will also benefit from the additional need for contract enforcement and business friendly policies that financial centres require. As tax income grows, the government has more to invest in public goods.

In administrative financial centres, the financial centre is often the initial spark of the local economy. While administrative centres won't necessarily operate as sources of capital for the local economy, they produce consumption, investment in real estate, create tax revenue and require a business friendly policy environment.

Thus, our discussion about financial centres in (onshore) Africa is underpinned by two key assumptions:

1) The creation of financial centres on the continent has the potential to provide a substantial boost to the local economy.
2) Onshore financial centres are less likely to result in capital flight and / or allow the capturing of value added activities outside the continent that capital is invested in (i.e., mainland Africa).

However, it is important to distinguish between attracting the presence of international financial companies and merely attracting foreign capital. The former will have tangible benefits in creating a financial centre.

Building a financial centre will inevitably attract more qualified workers into the economy with inevitable benefits of skills transfer. Over time these international companies will create opportunities for local staff. In some cases local companies may be acquired by international players and this process of assimilating locals can happen more quickly.

As the centre grows and caters to international companies there will be a demand to follow best practice in most aspects of the financial markets. This will accelerate the development of local markets and the range of financial products available to domestic customers. However, the speed of this development will depend heavily on the desire and the ability of the host government to embrace these international practices and financial products.

3. CHARACTERISTICS AND DEFINITIONS OF FINANCIAL CENTRES

Financial centres vary greatly in their size, scope and the breadth of activities. They range from the truly global centres such as London, Tokyo and New York to many which are substantially smaller and which are largely national or regional in nature. There are others which are based on a specific industry or some specialised type of activity. But looking at the various models is informative in laying down some general indicators on what is necessary for the creation of a sustainable onshore financial centre.

Global Financial Centres such as New York, London and Tokyo are significantly larger and more developed than their closest competitors. They have developed over many decades and each of them is host to the largest financial institutions and as such they deal in the most sophisticated capital markets around the world. They are in many ways the cornerstones of the global capital markets. They deal in all financial instruments including debt, equity, commodities and derivative markets.

Each of the global financial centres is host to the biggest stock exchanges and in each case some of the largest companies, asset managers, financial institutions and other investors are located in close proximity. In general, these are defined by the fact that they are host to regulators and legal systems that are accepted by the international community and the largest financial institutions feel compelled to maintain a presence in these centres as a core part of their strategy.

Not only are New York, London and Tokyo home to a large financial industry, they also offer a broad range of other services and infrastructure that make them highly attractive as living destinations. Each one of these cities is large and excels in areas such as culture, sport and entertainment. As such, they attract finance professionals across the world, often without having to offer special tax incentives.

Clearly each of these financial centres is subject to regulatory and political change in the host country. But the experience to date has shown that policymakers in these countries have been aware of the need to protect their status as a financial centre. At times, regulators have created certain changes which have incentivised institutions to change the nature and scope of their activities. With capital becoming increasingly mobile, stakeholders and policymakers in the global financial centres have become aware of the competitive pressures they face in order to maintain their positions. These lessons are important for potential new entrants. For example, New York and Tokyo rely heavily on the size and strength of their domestic market while London relies on its position as home to many international markets, in particular the international bond markets. It is worth noting however, that despite their size and importance, neither New York, nor London are typical destinations for the administration of many capital market products such as loans, private equity funds or hedge funds. These are often booked and administered from administrative financial centres while the teams managing them are located in global or regional centres.

Alongside these are **Regional Financial Centres**. These include cities such as Singapore, Dubai, Hong Kong and Frankfurt. They draw their competitive strength from their location to service a particular region such as in the case of Dubai, or to service a particular industry in the case of Singapore which is a hub for the regional commodities and banking industries. Each of these financial centres lack the scale and breadth of New York, London and Tokyo but they deal in many of the same markets and have managed to attract many of the leading financial institutions.

As mentioned, these centres are currently smaller than the truly big global centres but they have the potential to match them or even usurp them. Their importance is sometimes backed up by their location (e.g., Frankfurt located in Europe's largest economy, or Hong Kong as the gateway to China), but each one of them had to put significant effort into establishing the lifestyle infrastructure required to attract financial professionals (most notably in Dubai where additional tax incentives are offered). This infrastructure generally includes a transport hub that connects financial centres to the rest of the world.[2]

What all of these financial centres have in common is a legal and regulatory environment that is considered highly developed and stable (Dubai, the most recent entrant into the club of regional financial centres, has largely opted to provide stability by adopting a more soft touch approach to regulation). Most of the regional financial centres (with the exception of Frankfurt) have provided tax incentives to the financial industry (e.g., Dubai) or are generally considered low tax jurisdictions (Singapore, Hong Kong).

Regional financial centres have all of the regulatory and institutional factors already in place and they are seen as attractive destinations for leading financial institutions and their staff. However, in Europe, Frankfurt does not currently match the scale of London and, in Asia, Hong Kong does not match the scale of Tokyo. But these positions can change. It is important to realise that each centre must be aware of the need to compete in order to preserve its position. It is the key competitive factors that are important to understand.

A third type of financial centre is best described as an **Administrative Financial Centre**. Their objective is to provide a tax neutral location for handling of financial flows; i.e., in the first instance they do not add a separate layer of taxation to that imposed in the source country of capital and the investment destination. These include historic examples such as the Cayman Islands and Luxembourg but also comprise more recent additions such as Mauritius. These financial centres have become important jurisdictions for the legal incorporation of investment funds, funding operations or trading arms of international banks and / or fund managers. These centres then attract the financial and legal infrastructure that is needed to provide the administrative and legal services; but in general they do not attract the financial professionals that carry out many of the 'front office' financial activities of global markets. Administrative financial centres such as Mauritius, Cayman, Luxembourg and others do not generally serve as operational base from which the major financial institutions carry out their core activities (lending, trading, M&A).

In the debate between 'onshore' and 'offshore' centres it is these 'administrative financial centres' that are generally defined as 'offshore' centres. The strong implication is that these offshore / administrative centres are using favourable tax regimes as their main means of competing. It is also asserted that they have much less stringent standards on transparency, due diligence and as such can be host to investors or other actors whose business practices would not be accepted in the world's largest financial centres. The very term "offshore" evokes a sense of remoteness and therefore opacity.

There is a certain amount of rhetoric behind many of these assertions. For example, many European centres such as Luxembourg, Switzerland and others have also used favourable tax regimes and certain privileges of secrecy for investors and clients to support their financial

[2] *A characteristic of the financial services industry is a fly-in fly-out culture. Financial business is both personal (i.e., face to face) as well as fast pasted. Being able to reach your clients by direct flight is critical for any financial centre. (It is not surprising that Dubai and Singapore have put so much effort into promoting global airlines).*

services industry. However, recent pressure has meant that Switzerland and other European centres (e.g., Liechtenstein) have been encouraged to adopt more transparent standards. The issue of tax avoidance is also one that can often be tackled by recipient countries of investments. Switzerland was forced to abandon its secrecy laws through a concerted effort by the US and European countries. African countries too have the means to ensure tax leakage is minimised. Kenya, for example, has recently entered into an information sharing agreement with Mauritius that enables it to enforce the collection of capital gains taxes.[3]

In general many of these 'offshore' centres are fairly small economies with few other significant sources of income. They found that hosting the administrative functions of many financial activities was an area that had relatively low barriers to entry provided they could offer an attractive tax regime to encourage financial institutions and investors to use them.

For example, the Cayman Islands have built local expertise in setting up financial vehicles and in administering their activities. In the case of private equity funds, this generally means fund administration and legal services. As noted above, there is little evidence that centres such as Mauritius and Cayman have tried to, or have succeeded in becoming host to the actual private equity fund managers (i.e., the teams that carry out the actual fund investment management). Most of the largest private equity companies and their staff are located in the largest global or regional financial centres. In some cases, they will locate staff and build offices in regions where they are investing capital. In this context, many of the managers have actually located staff in Africa. Currently their choice of location also reflects other factors such as quality of infrastructure and living standards. As a result, cities such as Johannesburg and Nairobi (both of which also serve as regional airline hubs) are favoured over others.

This has implications for the developmental impact that the financial activities can have for the local economy. Clearly it is preferable to attract not only the administrative functions but also the mainstream banking and fund management activities. This will mean that the financial centre will attract a larger cross section of high quality professionals and will be host to many of the value-added activities. Such an effect is even evident in global centres such as London.

4. PREREQUISITES FOR CREATING FINANCIAL CENTRES

As we have seen, financial centres come in different shapes and sizes. They vary in the range of services they offer and hence in the level of activity that effectively takes place within them. This complicates the picture for policymakers and in particular for external policy advocates that are seeking to influence certain factors with a view to catalysing the creation of these centres in specific locations. That said, there are certain factors that make cities more attractive as prospective financial centres.

At a macro level, the centre must offer a stable financial and legal environment. This has several important aspects to it. The most important one is the need for effective and transparent rule of law. This needs to encompass amongst other issues effective property rights, effective contract law and the basics of creating business entities that operate in an internationally recognisable manner. The legal framework should follow international principles and law firms from different countries should feel comfortable in dealing with it. There needs to be a degree of comfort that disputes can be resolved in a fair and transparent manner without interference from local vested interests.

Additionally, the economy should have accounting standards, disclosure requirements and a regulatory framework that are in line with international best practice. In particular the regulatory framework for the financial system should be robust and transparent. The financial regulatory framework will most likely include the central bank, the stock exchange and any other regulator with responsibility for the financial sector.

Ideally the political system is democratic and there are free elections but these points can be debated in the case of Singapore, Dubai, Hong Kong and certain other financial centres. But it would be true to say that economic and political stability are a prerequisite for attracting financial services companies. We cannot overemphasise the importance of a predictable regulatory and legal regime for the choice of legal jurisdiction of capital. Investors do not need ideological adherence to any political system; political

[3] *Of the three main types of taxes, income tax, withholding tax, and capital gains tax, the latter was most frequently circumvented by structuring investments through offshore financial centres. With information sharing in place, countries such as Kenya and Tanzania are now empowered to set the level of taxation they deem appropriate, and to collect these taxes in-country.*

volatility can be sustained if the legal framework is seen to be robust and if investors can be confident that property rights will be protected and the judicial system will act independently. A major fear in emerging markets is both the political intrusion into the commercial and legal process and, probably more crucially, the issues created by inadequately drafted regulation and lack of precedent interpretation.[4]

In addition to the financial and regulatory framework, there is the need for adequate physical infrastructure. This includes access to good quality office space and other administrative infrastructure. A vital requirement is good quality telecommunications including high speed internet and other modes of communication. These facilities need to be available at competitive rates and maintain a high level of reliability and quality.[5]

The importance of technology for a financial centre providing more than administrative services cannot be understated. Any financial market that seeks to compete (or participate) globally needs real time, guaranteed access to trading and settlement systems. Protection of data, especially in light of rising incidents of cyber-crime, is another consideration for investors.

If the ambition is to attract many of the largest institutions and high quality staff, then 'lifestyle infrastructure' is vital. This includes housing, access to schools which can provide international standard education, acceptable medical facilities and to some extent social and leisure facilities. If these amenities are not available then workers need to be offered greater financial inducements in order to relocate to that particular centre. This could be in the form of higher salaries or favourable tax arrangements. The full developmental benefits are only likely to accrue if major financial institutions or investment groups can be persuaded of the benefits to build a meaningful local presence and to relocate high quality staff.

A well-educated and well-trained labour force will attract the financial industry. This will allow international firms to build a local presence which is assimilated into the community and it will offer a better chance that developmental benefits can accrue to the local community. The depth of the pool of people needed and the quality of people needed will of course depend on the type of financial centre that is being envisaged.

There is no formula that specifies exactly what infrastructure is needed or how much of certain characteristics are needed in order to spark the agglomeration process. Equally there is nothing to say that new centres cannot develop and challenge existing ones. Indeed experience shows that new centres develop and that markets adapt to them. What is important to realise however is that this is a competitive process and different cities will use different strategies to compete. Competition for talent happens on many levels. Much as it may sound trite, financial centres are populated by humans who bring a vast range of preferences concerning their location—humans are driven by needs of security, gratification (in various forms) and social stimulation, amongst others. Certain human aspirations cannot be fulfilled by regulation (c.f. Frankfurt's perennial struggle to unseat London as Europe's financial centre).

There are lessons to learn from the financial centres that already exist. These can be assimilated and provide some pointers for policymakers both domestically and where relevant for donors.

5. THE IMPORTANCE OF TAX

Taxes invariably are an important consideration for both capital and human resources. As we outline herein, financial professionals are in fact less driven by taxes, provided other 'life style' factors are in place (e.g., New York City has one of the highest global personal tax rates). Financial capital, on the other hand, will always be very sensitive towards the level of taxes levied. One of the issues about taxation that we cannot fully analyse herein, but that goes to the heart of the issue of offshore financial centres, is the question of what constitutes an 'appropriate level of taxation' and where taxes should be levied.

Capital gains taxation is a particularly vexed issue because there is no global consensus on how to tax capital gains and if gains are taxed to whom this tax should accrue. The most recent trend in some African countries is to seek to tax capital

[4] *There are many examples of uncertainty created due to inadequately drafted regulation. We highlight as an example the Fair Competition Act in Tanzania which states that each merger has to be referred to the Fair Competition Commission. A merger is described as a transaction that involves a change of control. The latter is not defined which leads to the extreme interpretation that even the transfer of a single share leads to a degree of change of control. Legal advice on this matter cannot be conclusively obtained. As a result, the conservative market approach is to refer any and every transaction (whether it involves shares or assets) to the FCC—at considerable cost.*

[5] *Despite being connected to the worldwide fibre network and widely available mobile phone access, communication in many African countries remains a serious issue – internet access is intermittent, conference calls over mobile phones are virtually impossible.*

gains, even if it involves offshore transactions (recently implemented in e.g., Kenya and Tanzania). Leaving aside the issue of enforcement (which requires transparency and information sharing), efforts to collect taxes at source (including capital gains tax) should somewhat mitigate the concerns related to tax evasion.

Taxation is a contentious subject and has become more so since the financial crisis. Governments struggling with mounting deficits have become more vigilant in verifying that companies and investment companies pay their obligations. Supported by civil society, governments in developing countries including Africa have increased their efforts to capture tax revenues from international investors in order to fund economic development—even if they are sometimes conflicted in this endeavour by their desire to be tax competitive vis-à-vis their regional neighbours. Also, in light of rising inequality there is a desire to ensure that financial investors are not treated more favourably than ordinary citizens. As a result, tax is at the heart of many of the debates surrounding 'offshore' financial centres.

Tax is often a cornerstone of the competitiveness of regional and in particular administrative centres. Favourable tax policies have often been used by certain jurisdictions in order to attract the financial community. Certain countries with robust fiscal positions such as Dubai have always had very low taxes, both personal and corporate. Others such as Ireland have proactively adopted favourable corporate and personal tax regimes in order to attract businesses. Given that capital is increasingly mobile, investors will look closely at tax in order to assess the attractiveness of different locations.

However, it is worth looking in a little detail at the nature of the various taxes that might apply in the course of this debate. This may shed light on which taxes are the most important for investors. Investors and fund managers will be most concerned at a business level with taxes on profits and on the ability to repatriate profits in hard currency without punitive charges. They will also want to have the ability to make investments cross borders without incurring additional taxes or charges (or being taxed twice on the same profit). This involves having favourable double tax treaties between various countries. Beyond the absolute levels of tax, businesses also favour regimes that are relatively simple and easy to understand. There should be a readily available supply of legal firms and accountants that can enable international investors to transact easily and with little extra transaction costs.

This creates incentives for companies, banks and funds to use certain jurisdictions for either setting up funds or financial vehicles which can act as conduits for investment. This seems entirely logical since companies and investors are seeking to maximise their net returns. But the practice of using 'tax efficient' jurisdictions is attracting criticism. This is primarily on the basis that many companies or investment funds have substantial activities in particular countries but they pay very little tax in those countries at the corporate level.

The private equity industry has come under criticism for using only certain tax efficient jurisdictions for creating their funds and for all the administrative functions that surround them. Centres such as the Cayman Islands, Luxembourg and Mauritius have been able to benefit substantially from this. In the case of Africa, Mauritius has benefitted from many funds and financial vehicles which have been created for investing into Africa. NGOs and others have argued that this activity should be rightfully located 'onshore' in one of the major African markets such that the development benefits can be captured there. However, it should be borne in mind that Mauritius does not only serve as an 'administrative financial centre' for African markets but also for other significant investment destinations such as India. This means it captures a significant amount of business and hence is able to build expertise and scale. The providers of these services can benefit from economies of scale that allow them to be competitive on costs.

Beyond that, personal taxation needs to be competitive to make it worthwhile for foreign professionals to consider being based in the financial centre. By itself, personal taxation policy is relatively less important in its ability to attract financial institutions or investment funds. Even in the UK where personal taxation rates were increased after the financial crisis of 2008, few firms relocated to other centres.

But to offer meaningful advice on tax, more work is needed to understand the incentives that guide the actions of fund managers. In light of this, one can better understand whether certain African countries would be able to create tax environments that are better able to compete. However, the tax analysis would need to include not only national tax policy but also aspects of tax on cross border capital flows and double taxation treaties.

6. POTENTIAL AFRICAN ONSHORE FINANCIAL CENTRES

As outlined earlier in the paper there is no single factor which can determine the potential of any city to fulfil the role of a financial centre. Furthermore, we have determined that there are several different types of financial centres and hence policymakers must be precise in their objectives such that the most appropriate policies can be designed.

In the following table we have tried to offer a 'general' comparison of different African centres and their potential to become an important onshore financial centre. We discuss below why other geographies were not considered.

Table 1 outlines the strength of some African cities based on several characteristics that are important to financial practitioners (in each category the number of stars indicate a show of strength).

We have chosen a number of cities as the basis of comparison. In each case, we believe there is the potential to develop or grow the city's role as a financial centre and where we believe the city has the potential to serve a regional role.

Table 1: Comparison of African onshore financial centres

	Lagos	Nairobi	Lusaka	Accra	Casa-blanca
Capital Markets (a)	***	**	*	*	***
GDP (b)	***	**	*	*	***
Financial Market Institutions (c)	**	***	*	**	**
Infrastructure (d)	**	***	*	**	***
Quality of Life (e)	*	**	***	**	***
Legal framework (f)	*	**	**	***	***[6]
Stability (g)	*	**	***	***	**
Professional services (h)	***	***	**	**	**

(a) Capital Market: based on scoring of the African Domestic Bond Fund Feasibility Report (ADBF Report) from Concerto Financial Solutions on behalf of the African Development Bank in 2011. To assess Capital Markets we used the study's score attributed to the Domestic Investor Base which is based on different measures of total assets held by pension, mutual and insurance funds. (* 0-15; ** 16-25; *** 26 and above).

(b) GDP: based on country GDP data from IMF 2014 estimates in USD (* 0-50bn; ** 51bn-100bn; *** 101bn and above).

(c) Financial Market Institutions: based on ADBF Report's variable used to score institutions and organisations relevant to the Financial Markets. The variable is composed of the number of institutions that exist to facilitate financial markets: (*0-50; ** 51-70; *** 70 and above).

(d) Infrastructure: based on number of international (also intra-African) destinations reached directly from a city's airport (* 0-20 flights; ** 21-40 flights; *** 41 and above).

(e) Quality of Life: based on Mercer Quality of Living Survey 2012 Ranking: (* rank 200 or below, ** rank 199-150, *** rank 149-1).

(f) Legal framework: based on World Bank Governance Indicators 2013. Scores are based on average of percentile achieved in regulatory quality and rule of law. (* 0-20; **21-40; *** 41 and above).

(g) Stability: based on World Bank Governance Indicators 2013. Scores are based on percentile achieved in the political stability assessment. (* 0-10; ** 11-30; *** 31 and above).

(h) Professional services: based on LHGP assessment on using local expertise in accounting, consulting and other finance related services.

As we have seen, certain factors are important even if none of them can claim to be sufficient to enable any one city to accede to the role of becoming an important financial centre. Most of these factors have been discussed and their relative importance has been outlined above. In Table 1, we have tried to rank certain African cities with respect to their relative strengths in key areas. From this very high level analysis, the three centres that offer the greatest potential would seem to be Lagos, Nairobi and Casablanca. This analysis can and should be undertaken in greater detail before specific policy recommendations are made and at the very least there should be formal engagement with key policymakers and possible stakeholders.

In the African context, there may be some issues with regional differences. For example, West African countries may find it easier to be serviced from an offshore centre such as Mauritius

[6] *Casablanca is the only destination where the legal system is not based on English law. As most financial centres have legislations based on English law or at least based on common law, investors may consider Casablanca more challenging from a legal point of view than less well rated common law destinations.*

rather than an onshore centre that is in East Africa. Both are too far to benefit from proximity benefits, but Mauritius is already established. For that reason there is some rationale to promote centres such as Casablanca rather than to look to cities in East Africa.

When considering the potential of African cities to become major financial centres, it is useful to look at other examples where certain countries have tried to fulfil this role with mixed success. Building a financial centre becomes particularly difficult if you are competing against an already established centre. In the case of mainland Africa, this means competing against somewhat remote centres such as Dubai and less remote Mauritius. Their relative lack of proximity leaves scope for new centres to develop.

A good example might be the Middle East. Clearly Dubai has become an important financial centre, not only servicing the Middle East but in many cases also hosting companies that service India and Africa. It has successfully held its position against active competition from other cities in the region including Doha, Bahrain, Abu Dhabi and Jeddah. In particular, Doha and Bahrain have both created financial centres and there has been an active policy by the governments in those countries to encourage foreign companies and investors to build a local presence. Despite pressure from local governments to tie government contracts to the presence of a local office, in practice, local offices became something of a token gesture and the local presence was often a small office with the main Middle East presence remaining in Dubai. Similar policies could be more effective in Africa, in particular West Africa, where there is no immediate centre to compete against, as was when Dubai began its effort. Dubai can also serve as example that limited rule of law must not be a barrier to the development of a financial centre. International Arbitration can remedy bias of local courts.

The BRICS also serve as example that the size of the economy must not be the determinant of the location of a regional financial centre—in particular, if there are established financial centres to compete against. Cities such as Moscow, Mumbai and Shanghai are now host to a substantial amount of financial activity. But in general they service very large domestic economies and have so far failed to become a hub for the region. In the case of Mumbai and Shanghai, they will face competition for the role from the likes of Tokyo, Hong Kong and Singapore. These other centres have a greater history of being important centres for finance and trade and they also have legal systems and a business environment that is more closely aligned to international standards. Mumbai and Shanghai are also evolving out of economies that were or still are fairly closed. Until recently both had capital controls and in both cases the rule of law is viewed with suspicion by international investors.

In the absence of competition of the likes of Hong Kong for Shanghai in Africa, size could determine the location of its financial centres. Other than Nigeria, no African country has a sufficiently large domestic market to become a regional financial centre in its own right. One could argue that Johannesburg should be a natural onshore financial centre given its infrastructure and sophistication. But the historical political problems and more specifically the difficulties created by capital controls have meant that it has failed to fulfil its potential. Any other country would need to act as a wider regional centre covering multiple African geographies. Kenya in East Africa stands out in terms of market development, infrastructure, quality of life and overall human capital. French speaking West Africa is large enough to support its own financial centre.

An important lesson for Africa is that in the absence of a financial centre, without the political will to establish one, it is unlikely to emerge by itself as illustrated by Moscow. In the case of Moscow, there remain many issues including political stability, the rule of law and the quality of infrastructure. Theoretically, Moscow could be a centre that serviced several important regions such as Central Europe and countries from the former Soviet Union. But the Russian administration seems to have little interest in this.

7. THE ROLE OF DONORS

As donors seek new and innovative ways in which to catalyse development, they are keen to understand the benefits that may accrue from building financial centres.

As a starting point, this means that donors are willing to accept the benefits of financial markets in development. Indeed many donors and development banks are keen to promote capital markets development in African countries. The IFC and African Development Bank are both very active in working with African countries in promoting the development of local stock exchanges, in endorsing domestic bond markets and in helping African countries access the latest financial products from the international markets. Both of these issuers have executed bond transactions in domestic African markets in order to promote liquidity and to catalyse the development of the institutional investor market. Examples of studies include the African Development Bank's "*Structured Finance: Conditions for Infrastructure Project Bonds in African Markets.*"

There is evidence to suggest that financial centres go hand in hand with economic development. But what this means for donors in terms of shaping their policies and interactions in African countries needs more analysis. As a starting point, it is important to acknowledge the difference between regional centres and administrative centres in terms of the developmental benefits each model brings and the policies needed to catalyse the growth of either type of centre. This may also inform the debate between 'onshore centres' and 'offshore centres' since, as we have acknowledged elsewhere, most offshore centres are administrative centres.

Does it really make sense for donors to promote the creation of more than one administrative (offshore) centre for Africa when it seems that most fund managers find that Mauritius is serving these needs well?

If transparency is the main concern, there is an argument to focus efforts on that issue specifically and to work with policymakers and financial institutions in Mauritius to improve those standards. Indeed, there may even be an argument for donors to help Mauritius improve its current capabilities such that it is seen as a world class administrative centre. It will be able to achieve the benefits of economies of scale and may in due course attract international providers of these services.

Indeed, donors need to acknowledge that in the cases of countries such as Mauritius or the Cayman Islands, the creation of administrative centres was the result of proactive government policies to create development in those small economies. Those economies are not large enough or have enough other alternatives to be able to diversify if these activities moved elsewhere.

In the absence of a regional (onshore) centre in Africa, it is expected that as any African country develops, its main commercial centre will develop as a national financial centre.

We can even argue that this is important in order for the national economy to continue to grow and to benefit from best practice in financial markets and financial products. Donors should be looking to help at this national level by advocating the benefits of improving financial markets, the benefits of investing in infrastructure, and the benefits of commercial markets in key sectors of the economy. At the same time, building a regional financial centre would create a centre with greater capacities than a typical national centre. This may then attract financial activity to this centre at the expense of its surrounding national centres.

So, for the debate over creating bigger regional centres the key questions are:

- How many regional centres can the African continent accommodate?
- Which national centres have the ability to grow and service neighbouring countries?
- What would be the effect on the region and the immediate proximity of the regional centre?
- Do the relevant national centres have policymakers alive to this potential and willing to undertake the necessary policy measures?
- What policy measures are necessary to catalyse the growth of such centres?

For donors, the important questions revolve around understanding the advantages and possible disadvantages of creating larger regional centres. This does not need to be a purely theoretical exercise; there are obvious precedents. These show that global, regional and national centres coexist. However, once a regional centre has established itself, it is resilient and not easily dethroned by other national centres achieving the regional centre status.

For example, in the Middle East, Dubai occupies a role as the dominant regional financial centre. It is certainly the dominant financial hub, it has the largest regional stock market and it has the largest collection of financial services companies in the region. However, Doha, Bahrain and Abu Dhabi all have their own financial markets that coexist with Dubai. At the same time, Dubai coexists with the global centres. In fact, companies in Doha may need to work through Dubai for some specialised services and for other services—capital raising in particular—they will turn to London, New York or Hong Kong. So the role of Dubai varies according to the needs of the client.

Similarly, the development of Central Europe since 1989 went hand in hand with the development of their national financial centres in countries such as Poland, Slovakia and the Czech Republic. Yet, there has not been the creation of a single centre to service the region. They generally look to London or in some cases Frankfurt for external expertise.

8. PROGRAMMING TECHNICAL ASSISTANCE

Technical assistance always works best when it is designed to deal with specific challenges rather than on the basis of 'one size fits all.'

The main themes around which technical assistance can be structured are:

- Tax policies
- Transparency and the rule of law
- Developing capital markets and adopting sophisticated financial products

Tax policies attract a great deal of emotion and it is virtually impossible to get universal agreement on the optimal tax policy. Equally, experience shows that favourable tax regimes are an immediate and concrete source of competitive advantage for countries and indeed companies. Yet, civil society and the media continue to criticise private equity funds, private companies and individuals for seeking out the most efficient tax structures when setting up their businesses or their operations.

It is impossible to prevent governments from using favourable tax incentives to attract business. The frustration for African countries is that they generally find it difficult to use tax as a competitive strategy since many of them still struggle to build a broad tax-base and because their finances are generally quite challenged. Governments in particular face the challenge of balancing the need to raise revenue with the need to attract investments.

Technical assistance could help by giving more information on the effectiveness of different tax regimes in other countries. For example some central European countries were able to increase their tax take by simplifying their tax regimes and by cutting the top rates of tax. Donors ought to assist in designing policies able to attract investment while encouraging investors to pay taxes on value added within host countries.

Rule of law, transparency, property rights and regulatory reform are all issues where NGOs and civil society can play a role in introducing best practice into emerging economies. In particular, effective securities law is a cornerstone of a financial system. The introduction of new capital markets regulation into emerging economies should be done alongside robust regulatory frameworks. New financial centres should seek assistance from the more developed markets where appropriate. Markets such as Hong Kong and Doha have hired top regulators from the UK to build their regulatory bodies. Donors can assist relevant executive bodies (e.g., regulators and law enforcing bodies) and judicial bodies (i.e., different instances of the court system) in accessing top quality expertise.

Already we are seeing donors being proactive in encouraging the development of capital markets. Initially these efforts should be focussed on the basics of the capital markets such as the banking system, the stock market and the government bond market. Efforts should also be made to encourage domestic financial intermediaries that are vital for the functioning of capital markets. This can be taken further by offering assistance to domestic players seeking advice on how to use more sophisticated capital raising or risk management products. Lion's Head has already seen the IFC and the World Bank offering such assistance in Kenya and Nigeria.

A compelling example for the combination of leveraging transactions for capital market development is provided by the Frontier Clearing Fund being executed by Cardano Asset Management. It enables banks in developing markets to use their local currency collateral more efficiently in seeking credit from international counterparties. While being a transaction oriented entity, its TA window will be used to make markets ready for sophisticated transactions. As a result, its commercial interests are strongly aligned with the improvement of local capital markets.

We encourage the use of scarce donor funds in helping specific transactions to be executed since this can have a significant demonstration effect.

9. IMPACT

Impact can only be measured against objectives. For donors the most relevant measures of any policies would be centred around economic growth, employment creation, income growth and the ability of the financial sector to service the needs of a bigger part of the economy, in particular SMEs. Financial markets are only one of many elements of the economy that affect these outcomes.

If the broad objective is the creation of financial centres in

Africa, then at one level we can measure the importance of the financial sector in different cities across the continent. This can be done by measuring the financial sector as a percentage of GDP and by more qualitative assessment of the breadth and diversity of the services provided.

We can postulate that financial services activity will be focussed around activity in capital markets i.e., the banking market, the bond market and the equity markets. Capital market activity produces a lot of data at the micro-level that can be measured. Data points can be loan pricing, amounts borrowed, type of borrowers and maturities available. The underlying assumption is that improving the functioning of these markets leads to the social benefits that donors ultimately want to achieve, e.g., employment and rising incomes.

Similarly, if the objective is to improve the role of a city as a financial centre then one can also look at the arrival of foreign companies into that market (signalling increased importance in the international arena) and indeed the growth of regional business being executed in a particular city or financial centre.

Onshore Options for Africa-focussed Investment Funds and Vehicles

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by

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1. INTRODUCTION

1.1 Defining Financial Centres

The definition of a financial centre is bound up in the definition of a city. We can start by observing that financial centres are cities or districts of cities where finance is conducted. However, the definition of a city is problematic, as anyone who has tried to compare city populations knows. Is Paris bigger than London? Did we mean the core city, perhaps the medieval walls, the city as defined by political boundaries, the greater metropolitan area? In certain cases, such as offshore centres like the Cayman Islands, the financial centre is really just the jurisdiction.

Likewise, the definition of finance is problematic. All cities have financial transactions. Is a shipping transaction finance? Paying for fuel? When does a shipping transaction become just finance? Are we talking about transactions that are wholly financial? Funding a vessel, insuring it? So much finance is conducted electronically that one might be able to claim that server farms located anywhere are financial centres.

Z/Yen's definition—"financial centres are places with strong concentrations of financial professionals and their firms." It's the people that matter.

Financial centres funnel investment toward innovation and growth. Vibrant, competitive financial centres give cities economic advantages in information, knowledge and access to capital. A strong financial centre, whether domestic, niche, regional, international or global, connects the wider economy to the global financial community. Cities that are part of the global financial network gain from global trade and growth. Inward and outward investment opportunities increase the wealth of cities that have financial centres and the wealth of their citizens.

'Traffic' between the domestic economy and the global financial community is critical to national economic performance. The key function of the domestic financial community is not its ability to service the domestic economy's needs domestically, but rather its ability to service the domestic economy's needs wherever and however they are best serviced. But after a point a well functioning financial centre attracts global financial transactions in its own right, and this confuses matters.

Z/Yen sees the core value-added themes of finance and financial centres as:

THEME	SERVICE	FOCUS
Trust	Identities	Community
Space	Transactions	Payment Services
Time	Debts	Investment Services
Mutualisation	Pooling	Distribution and Concentration

- Community—financial centres are both 'open' and 'closed.' Access to the community needs to be via confirmation of identity and qualifications. At the same time, a too closed community cannot grow. A wider discussion might explore how diaspora often succeed internationally in growing networks, but with too restricted access to the community for outsiders they often fail to grow financial centres. A successful financial centre's over-riding principle is 'treating all comers fairly.' This obviously underscores recent emphasis on the 'rule of law' as a key institution.
- Payment services—are typically based around trade. Financial centres often grow from trade finance, and are thus often associated with ports or logistics interconnections.
- Investment services—with the increasing recognition that a financial centre can be significant without a large domestic economy, think Zurich, Geneva, Singapore, or Hong Kong before the 1997 transfer of sovereignty, it is more evident that financial centres facilitate multi-party investments, most often cross-border.
- Distribution and concentration—sophisticated financial centres often move into wholesale insurance and reinsurance, allocating risk capital where needed and adjusting returns from capital to provide good prices.

1.2 Financial Centre Profiles

Successful financial centres can and do fulfil more than one role:

- 'Global' financial centres that are truly global foci, where only a few can claim that role, such as London, New York, Hong Kong and Singapore;
- 'International' financial centres such as Seoul or Shanghai or Frankfurt that conduct a significant volume of cross-border transactions;
- 'Niche' financial centres that are worldwide leaders in one sector, such as Hamilton in reinsurance or Zurich and Edinburgh in fund management, as well as Toronto, Vancouver, Johannesburg and Sydney in mining and extractive industires;
- 'National' financial centres, often within federal countries, that act as the main financial centre for financial services within one country, such as Toronto or Frankfurt;
- 'Regional' financial centres that conduct a large proportion of regional business within one country, e.g., Boston or Vancouver.

There is much more information about the Global Financial Centres Index (GFCI) and its classification system online, www.globalfinancialcentres.net, but the table below provides a good indicator of a division based on quantitative parameters the categorises centres by global-transnational-local, broad-shallow and specialised-diversified.

The profiles assigned to each financial centre in the GFCI are based on mathematical clustering and correlation analysis. There are three determinants of a centre's profile—connectivity, diversity, and specialty:

- **Connectivity**—or connectedness, is the extent to which a centre is well known around the world, and how much non-resident professionals believe it is connected to other financial centres. Respondents to the GFCI online questionnaire are asked to assess only those centres with which they are personally familiar. A centre's connectivity determines whether it is 'Local,' 'Transnational' or 'Global' (the vertical axis of the table below). A centre's connectivity is assessed using a combination of 'inbound' assessment locations (the number of locations from which a particular centre receives assessments) and 'outbound' assessment locations (the number of other centres assessed by respondents from a particular centre).

- **Diversity**—is the **breadth** of financial industry sectors that flourish in a financial centre. We consider this sector 'richness' to be measurable in a similar way to that of the natural environment and therefore, use a combination of three widely respected biodiversity indices calculated on the instrumental factors) to assess a centre's diversity.
- **Speciality**—is the **depth** within a financial centre of the finance industry, in particular investment management, banking and insurance.

In the table below, the 83 GFCI centres are assigned a profile on parameters for the three measures: how well connected a centre is, how broad its services are and how specialised it is. We will look in detail later at a group of nine centres, four in Africa. One, Nairobi, has insufficient data to be properly classified. The remaining eight have been circled below. On the horizontal axis, a centre can be either:

- A 'emerging contender' if it has insufficient breadth and depth;
- A 'specialist' if it has sufficient depth in one or more sectors (but insufficient 'breadth');
- A 'diversified' centre if it has sufficient breadth in several sectors (but insufficient 'depth' in any sectors; or,
- A 'leader' if it has both sufficient depth and breadth.

	Broad and Deep	**Relatively Broad**	**Relatively Deep**	**Emerging**
Global	Global Leaders	Global Diversified	Global Specialists	Global Contenders
	Amsterdam	Brussels	Beijing	
	Boston	Dublin	Dubai	
	Frankfurt	Milan	Geneva	
	Hong Kong	Moscow	Luxembourg	
	London			
	New York			
	Paris			
	Seoul			
	Singapore			
	Tokyo			
	Toronto			
	Zurich			
Transnational	Established Transnational	Transnational Diversified	Transnational Specialists	Transnational Contenders
	Chicago	Istanbul	Abu Dhabi	Copenhagen
	Madrid	Kuala Lumpur	Almaty	Edinburgh
	Montreal	Prague	Cayman Islands	Jakarta
	Munich	Rome	Casablanca	
	San Francisco		Gibraltar	
	Shanghai		Isle of Man	
	Sydney		Jersey	
	Vancouver		Monaco	
	Vienna		Qatar	
	Washington DC		Shenzhen	

	Broad and Deep	Relatively Broad	Relatively Deep	Emerging
	Established Players	Local Diversified	Local Specialists	Evolving Centres
Local	Busan	Budapest	Bahamas	Athens
	Johannesburg	Lisbon	Bahrain	Bangkok
	Melbourne	Mexico City	British Virgin Islands	Cyprus
	Sao Paulo	Osaka	Buenos Aires	Glasgow
	Stockholm	Warsaw	Calgary	Hamilton
			Guernsey	Helsinki
			Mauritius	Malta
			Panama	Manila
			Riyadh	Mumbai
			Taipei	Oslo
				Reykjavik
				Rio de Janeiro
				St Petersburg
				Tallinn
				Tel Aviv
				Wellington

Of the group, Dubai is the only peer group centre which is 'Global.' Casablanca and Doha are Transnational Specialists. Istanbul is transnational but more diversified. The remaining four group centres are all 'Local' centres. It is likely that Nairobi, were it classified with enough data, would begin as a local evolving centre like Tel Aviv.

1.3 Roles – Onshore and Offshore

We would define an onshore financial centre as one whose primary mode of competition is not tax permissiveness or lack of certain accepted 'norms' of market regulation. Offshore and onshore cannot be hard and fast definitions. At what point does a country's sensible tax regime become permissive, or "light touch" regulation become disregard for investors, or individualism tip it from being an "onshore financial centre" (given this definition) to an "offshore financial centre"?

Interestingly, the OECD doesn't define financial centres yet it defines offshore financial centres starting with, "Countries or jurisdictions with financial centres that contain financial institutions…" This focus on offshore may have much to with the OECD's focus on tax avoidance / evasion issues. Large numbers of financial centres fall into small jurisdictions. Out of the world's 221 sovereign states and dependent territories in 2009, 67 have a population of less than 1 million (30%), such as the Bahamas, Guernsey, the Isle of Man, the British Virgin Islands, Mauritius or Gibraltar. Many have sought to become offshore centres, and some critics would argue that London and certain USA centres, such as Delaware or Nevada are 'offshore' [J.C. Sharman, Michael Findley and Daniel Nielson, Global Shell Games: Experiments in Transnational Relations (Cambridge: Cambridge University Press, 2014), 250 pages].

Offshore centres have used their constitutional independence to develop legislation, regulation, and tax vehicles that attract non-resident business. Many have used their comparative advantage to create world-class expertise in international financial services. The most enduring offshore centres offer ways of carrying out financial transactions, which are essential but complex from a regulatory point of view, such as reinsurance in Bermuda.

There are numerous other categorizations of offshore, and a desire amongst some offshore centres to be called 'international business centres,' but the term offshore sticks and is useful as many centres such as Geneva, Luxembourg or Zurich could equally be termed international business centres. Arguably, there could be about 15 offshore centres in the GFCI, heavily concentrated in the 'Transnational Specialists' or 'Local Specialists' profiles, often by having developed a legal or taxation approach, e.g., protected cell captives, fixed tax fees, facilitated nationalisation, or easily-established funds, that in turn are suited to particular financial segments, e.g., wealth management, asset management, fund management, gambling, or insurance / reinsurance.

Offshore centres tend to have four comparative advantages: long-term finance, regulatory simplicity and responsiveness, tax mitigation and secrecy. Offshore centres are famous for two of their four roles, tax mitigation and secrecy. Secrecy is easily attacked—why do you have something to hide? When looked at from a stable country, this seems a cutting question, but there are many legitimate reasons to desire secrecy. When looked at from an unstable country, secrecy can mean being less vulnerable to extortion or kidnap, or more able to consider positive reforms. Still, secrecy can too easily correlate with criminality, particularly where money laundering is involved. One solution is what Bermuda, Barbados and other offshore financial centres do—have information agreements that allow competent authorities to share essential information responsibly, without risking legitimate people. There are many small states that need to attain these essential levels of transparency, but so too do many larger states. Increasingly, the work of the OECD Global Forum on Exchange of Tax Information and Transparency and other international bodies means that many offshore centres have been peer reviewed as part of the Global Forum process and found to be largely compliant. Secrecy and lack of transparency are now rarely used by mainstream financial centres as a selling point.

Tax mitigation, as with all things to do with tax, is more complex. Offshore centres act as "way stations" that facilitate complex international trade and investment flows. Taxes are paid at the beginning of the journey where the activity takes place and when the investors are at the end of the journey, but not along the way. Tax mitigation (legal) can too easily become tax evasion (illegal), particularly where secrecy is too highly guarded.

The comparative advantage of offshore centres is displayed in how they 'signal.' In biology and economics, animals and people convey information about their abilities and intentions by 'signalling.' Offshore centres walk a tight-rope signalling that they are both capable of rapid change, and that they are havens of stability. For example, offshore centres simultaneously claim that they can change legal codes rapidly when laws impede sensible decisions, yet also avoid hasty legislation when larger nations are senselessly reacting to domestic calls for action.

A large nation can change tax rules or ownership rules at short notice. 'Long finance' structures set up to endure for a generation or two or three benefit from avoiding the capriciousness of larger nations' domestic agendas. Savvy offshore centres signal that they avoid hasty changes in their own self-interest. Perversely, bouts of regulatory change directed at offshore centres can increase the odds that an offshore centre thrives.

FINANCIAL CENTRES RISE AND FALL – TIMBUKTU

Timbuktu, a fabled city on the Niger now in the modern West African country of Mali, was an important centre for the gold, salt, cotton and slave trades from the 10^{th} to the 17^{th} centuries. Ibn Battuta in the 1300s and Leo Africanus in the 1500s celebrated its success and praised it as a centre of learning, of universities, of libraries.

"Tin" or "tain" is Tuareg for a water well. According to popular etymology, an old Malian woman, Buktu, lived by a well and was known for her honesty. Travellers, including the Tuareg, would entrust Buktu with possessions when they were on the road and the location became known as Tin Buktu, meaning Buktu's well. So Timbuktu started with trust, a familiar theme in finance.

From the 1375 Catalan Atlas of the known world (mapamundi), drawn by Abraham Cresques of Mallorca just after Ibn Battuta died and well before Leo Africanus, there is an inscription on the map which reads: "This Negro lord is called Musa Mali, Lord of the Negroes of Guinea. So abundant is the gold which is found in his country that he is the richest and most noble king in all the land."

But aside from trust, why did Timbuktu rise? Timbuktu was rather inaccessible, far upriver. This perhaps enhanced its mystical image, but was a practical hindrance. The native tongue is a Songhay family language Koyra Chiini, hardly a lingua franca, so traders probably spoke many languages, principally Arabic, later enriched with Portuguese and French. Aside from lying on several trade route intersections and having a water supply, Timbuktu challenges many conventional assumptions about why financial centres form—it's not just the location or seapower, not just the language, not just the time zone, not just the local industry needs for finance. Here's a modern speech by a modern Permanent Secretary for Financial Services and the Treasury:

> "What is it … that attracts investors and financial institutions to this city? The answer lies in our fundamental strengths. These include our simple and low taxes; high-quality services; free flow of capital with no foreign exchange controls, and a stable, fully convertible currency; as well as a free economy buttressed by the rule of law and an independent judiciary. Our regulatory regime is on par with international standards; and our regulators are tasked to ensure a fair, transparent and orderly market." [Miss Au King-chi, at the Hong Kong Investment Funds Association 3^{rd} Annual Conference on 29 September 2009 positioning Hong Kong as an International Financial Centre]

So, how do you get a small financial centre? Start with a large one. The BBC describes Timbuktu differently in our century, "Today, it is a desolate and impoverished town—renowned for its heat, isolation and sand dunes." [Source: http://news.bbc.co.uk/1/hi/world/africa/1911321.stm]. Financial centres depend on collective imagination being realised in intangible institutions. Financial centres can be made from the sands alone, yet also blow away with the winds.

2. COMPARING AFRICAN FINANCIAL CENTRES

2.1 Overall Comparisons

GFCI assigns ratings to financial centres using two main inputs:

- Instrumental factors—objective city or country assessments developed by a number of reputable, global organisations; and,
- Financial centres assessments—a range of financial centre assessments, on a scale of one to ten, provided by a number of international financial services professionals within the previous 24 months.

This report reviews Africa and its regional peer group with the data available from GFCI 16 (September 2014). Appendix E contains a summary table of country, capital, population, GDP, and $GDP/capita, arranged both by regional location and sorted by $GDP/capita.

In GFCI 16, only three African centres featured fully with sufficient data, viz:

- Casablanca—transnational specialist—wide North African connectivity;
- Johannesburg—local, broad and deep—largely based on local economy and strong mining, with local regional connections; and,
- Port Louis (Mauritius)—local specialist—access to India and regional trust structures, an important African investment and private equity fund domicile.

A number of assessors have begun rating Nairobi, so the GFCI 16 ratings are provided for comparison, but the ratings should be used with care as they are fewer than for the other three centres and have not been critically evaluated by the GFCI methodology. Assessors are providing assessments and comments on a number of other centres, but not in sufficient quantities for comparative, quantitative analysis, e.g., Abuja / Lagos, Lusaka, Djibouti, Cairo, Tunis, Harare and Kampala. The complete GFCI is available online, but for the purpose of this analysis a peer group might help to provide more realistic comparisons, rather than pointing out that Casablanca is not like London or New York. The peer group chosen consists of the following cities: Busan, Doha, Dubai, Istanbul and Tel Aviv.

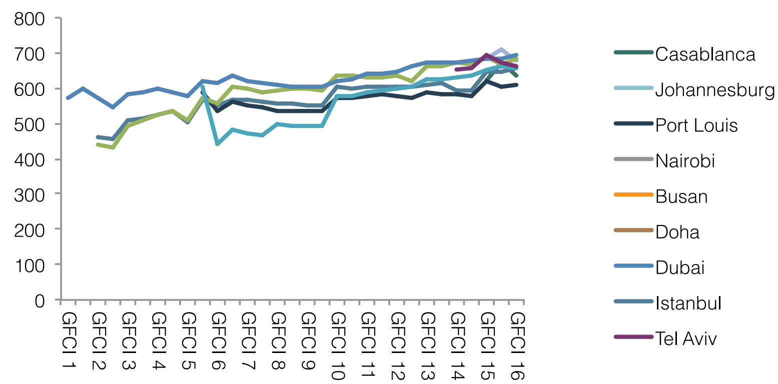
The table below shows the GFCI 16 rating of the group compared with GFCI 15:

Centre	GFCI 16 Rank	GFCI 16 Rating	GFCI 15 Rank	GFCI 15 Rating	Change in Rank	Change in Rating
Casablanca	51	635	62	622	▲11	▲13
Johannesburg	38	659	50	647	▲12	▲12
Port Louis	69	608	63	621	▼-6	▼-13
Nairobi	-	602	-	-	-	-
Busan	28	676	27	686	▼-1	▼-10
Doha	22	684	26	687	▲4	▼-3
Dubai	17	694	29	684	▲12	▲10
Istanbul	42	655	47	651	▲5	▲4
Tel Aviv	36	664	21	692	▼-15	▼-28

One can see that the group is fairly volatile. It is especially worth focussing on the rank volatility. Port Louis is falling in line with other 'offshore' centres. We will return to the rapid rise of Casablanca and Johannesburg later. Below we record the overall number of responses for the group:

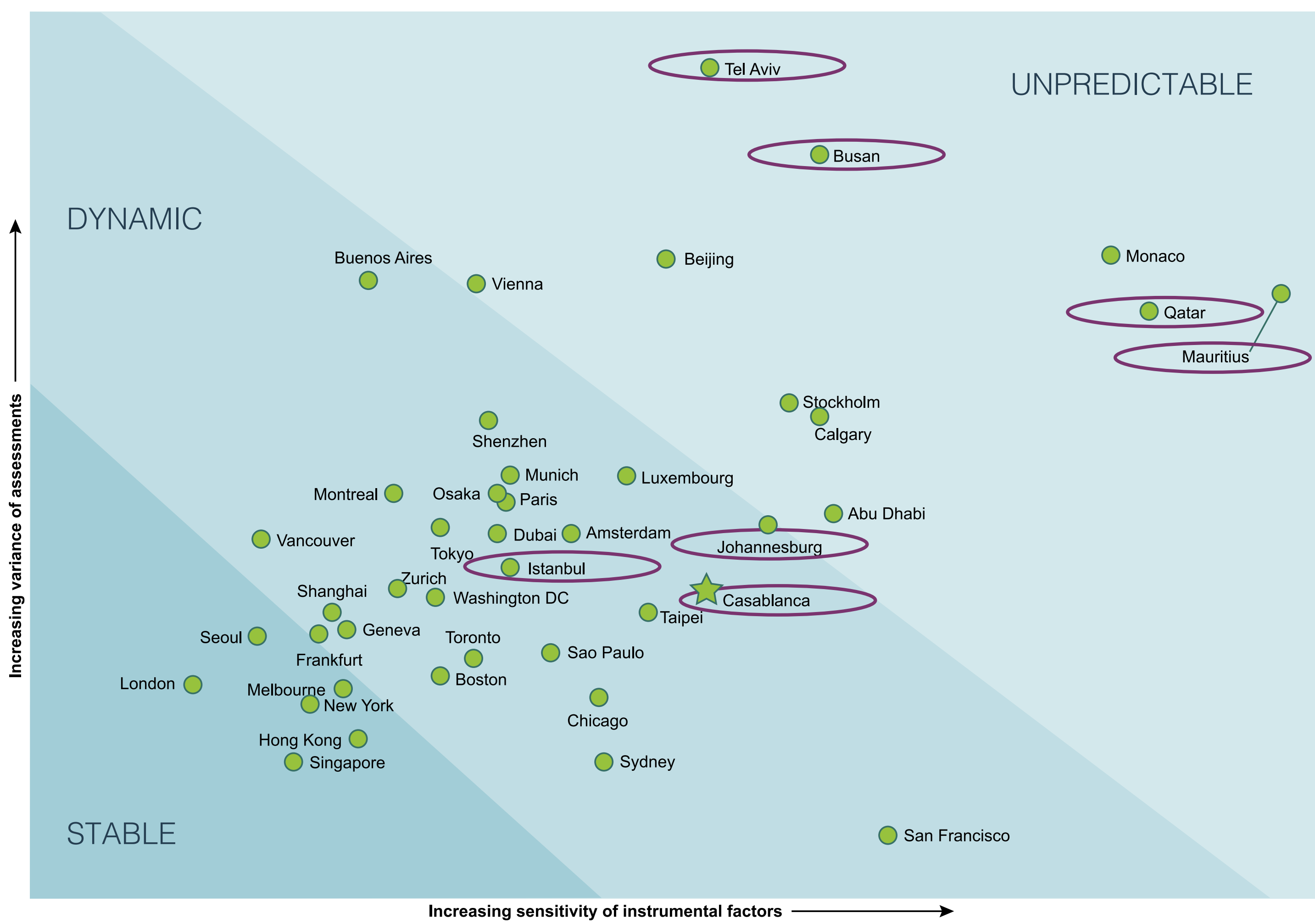
	GFCI 16		Home		Foreign		Total	
Centre	Rank	Rating	Number	Average	Number	Average	Number	Average
Casablanca	51	635	42	864	369	803	411	809
Johannesburg	38	659	1	500	207	660	208	660
Port Louis	69	608	1	1,000	215	570	216	572
Nairobi	-	602	2	550	70	603	72	601
Busan	28	676	21	952	272	827	293	836
Doha	22	684	8	725	341	680	349	681
Dubai	17	694	51	835	713	712	764	721
Istanbul	42	655	15	813	223	631	238	643
Tel Aviv	36	664	5	900	187	666	192	672

The graph to the right shows the historical rating of the financial centres in the group. Historically, the Middle Eastern centres of Dubai and Doha have led the group. Tel Aviv joined the GFCI in GFCI 14. Busan and Casablanca only joined the GFCI in GFCI 15.



2.2 Future Financial Centre Stability

The GFCI 16 model provides analysis of the financial centres with the most volatile positions. The chart below contrasts the 'spread' or variance of the individual assessments given to each centre with the sensitivity to changes in the instrumental factors:



There are three bands of financial centres. The 'unpredictable' centres in the top right of the chart have a high sensitivity to changes in the instrumental factors and a high variance of assessments. These centres have the highest potential volatility of the GFCI centres. This group includes four centres in the group (Tel Aviv, Busan, Doha and Port Louis). These centres are easily affected by changes in assessments and in instrumental factor scores and Tel Aviv and Port Louis in particular are 'outliers.'

The 'stable' centres in the bottom left of the chart (including the top four centres) have a relatively low sensitivity to changes in the instrumental factors and a low variance of assessments. These centres are likely to exhibit the lowest volatility in future GFCI ratings. Looking back at recent GFCI ratings, the stable centres are fairly consistently towards the top of the GFCI ratings.

The 'dynamic' centres in the central band including four from the peer group (Dubai, Casablanca, Istanbul and Johannesburg) are the most interesting. They have a potential to move and generally once in the 'dynamic' area tend to stay there and move towards greater stability. From this viewpoint, Casablanca and Dubai are the best positioned centres in the peer group.

2.3 Reputational Advantage

One of the great advantages of the instrumental factor approach to index construction is the ability to distinguish a centre's reputational advantage or disadvantage. The distinction emerges when examining the difference between the weighted average assessment given to a centre and its overall rating. The first measure reflects the average score a centre receives from financial professionals across the world. The second measure is the GFCI score itself, which represents the average assessment adjusted to reflect the instrumental factors.

If a centre has a higher average assessment than its GFCI 16 rating, this indicates that respondents' perceptions of a centre are more favourable than the quantitative measures alone would suggest. If a centre has a higher average assessment than its GFCI 16 rating, this indicates that respondents' perceptions of a centre are more favourable than the quantitative measures alone would suggest. This may be due to strong marketing or general awareness. Casablanca (as Dubai has done in the past) has spent a considerable amount on advice, marketing, conferences and promotion. It has had active French and UK advisors. Casablanca has a very high reputational advantage suggesting that the marketing of the centre has worked, perhaps too strongly as its reputation well outstrips its GFCI rating. If respondents did not know it was Casablanca, they would have rated it significantly differently.

Centre	Average Assessment	GFCI 16 Rating	Reputational Advantage
Casablanca	803	635	168
Johannesburg	666	659	7
Port Louis	572	608	-36
Nairobi	600	602	-2
Busan	825	676	149
Doha	656	684	-28
Dubai	710	694	16
Istanbul	637	655	-18
Tel Aviv	667	664	3

This reputational advantage might be seen to indicate that Casablanca and Busan are 'overtrading,' i.e., their marketing is working too well. It could be argued, and will be important later in sub-indices later, that a significant discount, perhaps up to 50 points, should be applied to the Casablanca and Busan ratings that follow.

2.4 Financial Centres of The Future

"I never predict anything, and I never will." Paul Gascoigne

Given the potential of Africa and the paucity of contemporary financial centres, it seems only right to hazard some thoughts on the centres that might become significant. A few observations on the sifting process are in order. Readers are referred to Appendix E to form their own thoughts. First, there is a distinction between federal countries and centralised countries.

The federal GFCI countries with multiple centres are clearly the USA, Canada, and Switzerland. A federal country which has consolidated on a single centre is Germany, i.e., Frankfurt. With the odd minor satellite centres—Osaka in Japan, Edinburgh and Glasgow in the UK (though arguably with a country label)—the only problematic centralised country is China, arguably not federal despite the provincial system with Beijing, Shanghai, Hong Kong and Shenzhen (also symbiotic with Hong Kong). Second, financial centres seem to grow either from a strong hinterland, implying a significant economy (no specific numbers but perhaps a 20+ million population and certainly a US$1,000/capita+ GDP; or third, from a commitment to building an international financial centre, e.g., Mauritius. Equally, there are smaller capital economy centres that might do very well relative to their economy, e.g., Windhoek, and deserve support yet not merit a GFCI rating.

With that background, a few centres beyond Casablanca, Johannesburg, Port Louis and Nairobi seem to be worth watching:

- **Offshore?**—Djibouti, Botswana, the Seychelles, Gabon, Equatorial Guinea and Réunion (Djibouti, Gaborone, Victoria, Libreville, Malabo and Saint-Denisare) are potential 'offshore' centres. That said, Réunion is unlikely, given the French system, to have the degrees of freedom needed to be an offshore centre. Equatorial Guinea has significant organisational stability issues. Thus, it seems only Djibouti, Botswana, Gabon and the Seychelles might make a larger play to be international financial centres if they so desired;
- **Capital Economy**—Harare, Lusaka, Accra, Abidjan, Dakar, Yaoundé, Khartoum, Algiers, Tunis, N'Djamena, Juba and Luanda should all be on a watch list as centres that would accompany successful economic development;
- **Federal**—South Africa (current financial centre Johannesburg, formal capitals Pretoria (executive), Bloemfontein (judicial), Cape Town (legislative)) and Nigeria (formal capital Abuja, vastly larger economic city Lagos) are both countries where the capital is ever unlikely to be the financial centre, yet might support multiple financial centres as do the USA and Canada.

3. GFCI SUB-INDICES ANALYSIS

3.1 Industry Sector Sub-indices

GFCI categorises participants according to the sector in which they work. We aggregate these into five main industry sectors:

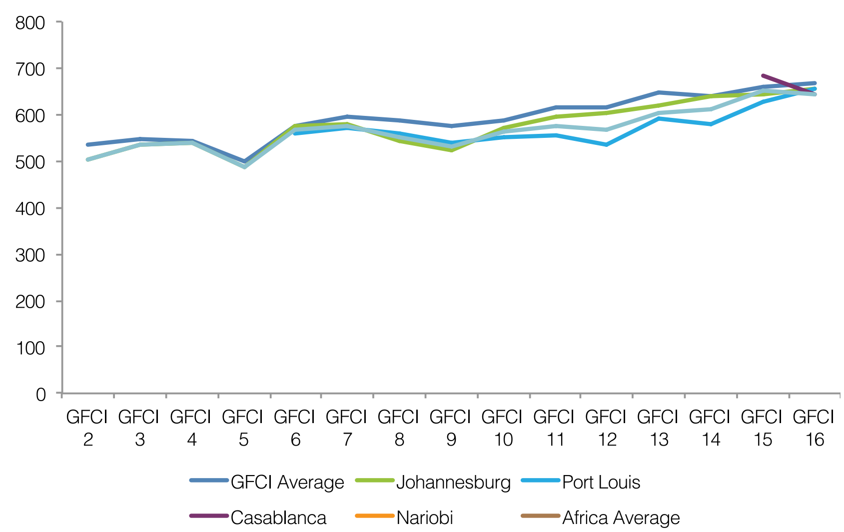
- Investment management;
- Banking;
- Insurance;
- Government and regulatory; and,
- Professional services.

The GFCI model is re-run to derive scores for each separate sub-industry by removing respondents from the other sectors; all the instrumental factors remain as inputs but the only responses considered are the ones that come from professionals working within a particular sector (e.g., responses from banking professionals only or responses from insurance professionals only). The tables below show the scores and ranks within each industry sector for the group:

	GFCI 16		Investment Management		
Centre	**Rank**	**Rating**	**Rank**	**Rating**	**Influence on Rating**
Casablanca	51	635	79	**642**	7
Johannesburg	38	659	47	**657**	-2
Port Louis	69	608	47	**657**	49
Nairobi	-	602	-	**623**	21
Busan	28	676	79	**642**	-34
Doha	22	684	33	**660**	-24
Dubai	17	694	17	**677**	-17
Istanbul	42	655	47	**657**	2
Tel Aviv	36	664	27	**663**	-1

African centres score well with investment managers. This may be due to Africa being 'hot' in the press, conferences, and discussions among this group. All of our interviews placed Africa as important as China and well above other regions for future investment. Given that the focus of this report is on investment funds, it is worth a specific look at African centres over time.

In sum, African centres are tracking the GFCI average due to a combination of being 'hot' and large sums of capital seeking returns. This level of interest is an opportunity for financial centres to capitalise upon.



	GFCI 16		Banking		
Centre	**Rank**	**Rating**	**Rank**	**Rating**	**Influence On Rating**
Casablanca	51	635	81	**632**	-3
Johannesburg	38	659	30	**654**	-5
Port Louis	69	608	43	**649**	41
Nairobi	-	602	-	**596**	-6
Busan	28	676	68	**641**	-35
Doha	22	684	26	**655**	-29
Dubai	17	694	10	**672**	-22
Istanbul	42	655	33	**653**	-2
Tel Aviv	36	664	33	**653**	-11

Bankers rate all centres in the group except Port Louis poorly. We have found that bankers worldwide favour firm regulation with good access to regulators and seem to find its regulation comfortable without being too lax, and a place in which they are prepared to invest, e.g., offices and staff.

	GFCI 16		Insurance		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	79	**642**	7
Johannesburg	38	659	61	**650**	-9
Port Louis	69	608	35	**656**	48
Nairobi	-	602	-	**636**	34
Busan	28	676	3	**733**	57
Doha	22	684	69	**648**	-36
Dubai	17	694	21	**664**	-30
Istanbul	42	655	35	**656**	1
Tel Aviv	36	664	55	**652**	-12

Busan, as the fifth largest container port in the world, has a successful shipping insurance industry. The strong showing by Port Louis reflects shipping and insurance captives. Anecdotally, Port Louis is also seen as a good place by Western investment managers to establish low cost investment fund structures for both Africa and India. We are unsure why insurers rate Nairobi so strongly, and the data is weak, but may reflect future prospects in retail insurance. Some of the people interviewed for this paper expected Kenyan retail insurance to mimic some of the Kenyan mobile payments successes.

	GFCI 16		Government and Regulatory		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	12	**651**	16
Johannesburg	38	659	38	**637**	-22
Port Louis	69	608	74	**615**	7
Nairobi	-	602	-	**614**	12
Busan	28	676	74	**615**	-61
Doha	22	684	38	**637**	-47
Dubai	17	694	14	**649**	-45
Istanbul	42	655	41	**636**	-19
Tel Aviv	36	664	17	**648**	-16

Government officials and regulatory professionals rank African centres better overall than many established centres. The suspicion is that they value the legal and regulatory framework on paper, while businesses value the way the legal and regulatory framework works in practice. Correcting for Casablanca's reputational advantage, then Johannesburg's strong South African governance rules may be helping it remain high here.

	GFCI 16		Professional Services		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	17	**637**	2
Johannesburg	38	659	32	**629**	-30
Port Louis	69	608	76	**612**	4
Nairobi	-	602	-	**591**	-11
Busan	28	676	81	**594**	-82
Doha	22	684	62	**620**	-64
Dubai	17	694	10	**647**	-47
Istanbul	42	655	23	**633**	-22
Tel Aviv	36	664	17	**637**	-27

Professional service providers tend to focus on access and cross-recognition. Johannesburg appears to have a number of barriers to entry on free movement of professionals.

3.2 Factors of Competitiveness Sub-indices

The instrumental factors used in the GFCI model are grouped into five key areas of competitiveness:

- Business environment;
- Financial sector development;
- Infrastructure;
- Human capital; and,
- Reputational and general.

In order to assess how financial centres perform in each of these areas, the GFCI 16 factor assessment model is run with only one of the five groups of instrumental factors at a time. The tables below show the peer group centres in each sub-index. In the case of Casablanca and Busan, it is likely that the reputational advantage, examined earlier, is so high that some of these sub-indices are suspect and a discount factor of approximately 50 should be applied.

	GFCI 16		Business Environment		Influence on Rating
Centre	**Rank**	**Rating**	**Rank**	**Rating**	
Casablanca	51	635	43	**650**	15
Johannesburg	38	659	48	**644**	-15
Port Louis	69	608	81	**569**	-39
Nairobi	-	602	-	**576**	-26
Busan	28	676	17	**685**	9
Doha	22	684	32	**666**	-18
Dubai	17	694	16	**686**	-8
Istanbul	42	655	34	**664**	9
Tel Aviv	36	664	38	**659**	-5

The Business Environment sub-index contains a variety of indicators, with a slight overlap with Financial Sector Development —political stability and rule of law, institutional and regulatory environment, macroeconomic environment, tax and cost competitiveness. In the Business Environment sub-index, Dubai and Busan lead the group. The African centres' business environments need work.

	GFCI 16		Financial Sector Development		Influence on Rating
Centre	**Rank**	**Rating**	**Rank**	**Rating**	
Casablanca	51	635	33	**668**	33
Johannesburg	38	659	56	**647**	-12
Port Louis	69	608	78	**614**	6
Nairobi	-	602	-	**579**	-23
Busan	28	676	41	**662**	-14
Doha	22	684	74	**622**	-62
Dubai	17	694	19	**684**	-10
Istanbul	42	655	30	**669**	14
Tel Aviv	36	664	22	**681**	17

In the Financial Sector Development sub-index, Dubai leads the group. Casablanca may be doing well based on the strength of marketing for its stock exchange.

	GFCI 16		Infrastructure		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	63	**642**	7
Johannesburg	38	659	32	**663**	4
Port Louis	69	608	54	**648**	40
Nairobi	-	602	-	**577**	-25
Busan	28	676	36	**659**	-17
Doha	22	684	24	**669**	-15
Dubai	17	694	25	**668**	-26
Istanbul	42	655	25	**668**	13
Tel Aviv	36	664	33	**662**	-2

In the Infrastructure sub-index, Port Louis does extremely well, perhaps because its good tourism infrastructure supports financial services needs well too, which may be a pointer to development of other centres—tourism-led financial leads.

	GFCI 16		Human Capital		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	43	**658**	23
Johannesburg	38	659	27	**673**	14
Port Louis	69	608	65	**643**	35
Nairobi	-	602	-	**649**	47
Busan	28	676	34	**668**	-8
Doha	22	684	59	**651**	-33
Dubai	17	694	24	**674**	-20
Istanbul	42	655	17	**683**	28
Tel Aviv	36	664	16	**685**	21

In the Human Capital sub-index, Tel Aviv and Istanbul lead the peer group due to strong academic institutions. However, it is clear that the African centres also do well. The human capital factors do not seem to be a constraint among assessors.

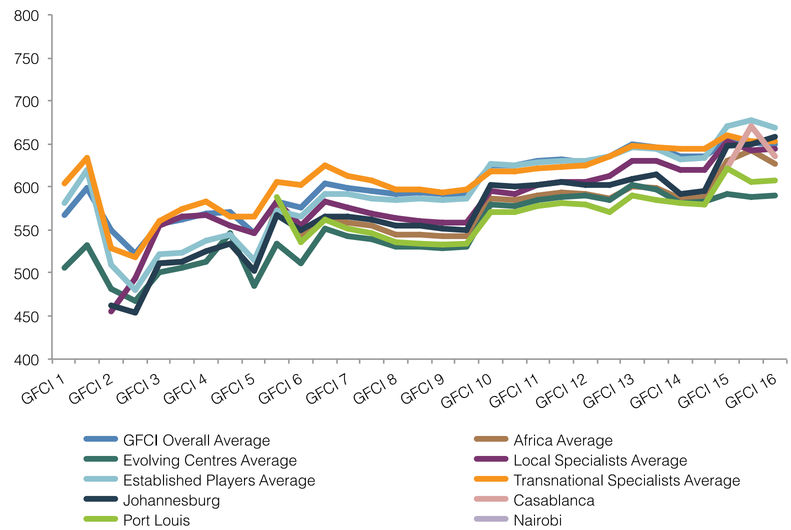
			Reputational and General		Influence on Rating
Centre	Rank	Rating	Rank	Rating	
Casablanca	51	635	51	**643**	8
Johannesburg	38	659	45	**648**	-11
Port Louis	69	608	79	**600**	-8
Nairobi	-	602	-	**597**	-5
Busan	28	676	44	**649**	-27
Doha	22	684	32	**662**	-22
Dubai	17	694	17	**683**	-11
Istanbul	42	655	32	**662**	7
Tel Aviv	36	664	24	**673**	9

Busan and Doha have been advancing recently, but better marketing could move them further. With the exception of Casablanca, the African centres could improve a bit with better marketing, but marketing is not their core problem. Overall, the primary need is to focus on improving the business environment.

4. HOW AFRICAN CENTRES CAN IMPROVE

4.1 Evolution of a Traditional Financial Centre

During other research, the GFCI model has been run to identify what sequence increases competitiveness from 200 points on the index to 800 points on the index. Before we start to examine each of the five competitive areas, it's important to recognise that a criterion that helped to cause success may not be particularly strong today, but set in train a sequence of positive events. For instance, low taxation might draw participants in, but not persist. Likewise, a criterion that is strong and important today, for instance, the availability of skilled personnel, may be an effect rather than a cause. Still, using the predictive model at various GFCI ratings, we can see what matters at each stage.



First, infrastructure. Infrastructure is all the stuff that's taken for granted. In major financial centres, many things are assumed, for instance, reliable electricity supplies and water, an absence of natural threats such as hurricanes or flooding, basic internet connectivity. Yet London used to have significant flood risk, and may again as the Thames Barrier comes to the end of its projected usefulness. Up to 400 points on the scale, basic 'infrastructure' matters. You can't have a financial centre without basic infrastructure. While it might appear that infrastructure ceases to matter after 400 points, it's rather the contrary. Infrastructure tends to get taken for granted as it grows in line with wealth and expectations, yet is crucial. Stuart Fraser at the City of London Corporation said, "You don't get to the top by being complacent. You have to be somewhat paranoid." ["On Top Of The World," Sunday Times, 9 October 2009].

Second, from roughly 400 to 600 points, 'business environment' is what matters. There's no point in building infrastructure and being open for business without having fundamental market activity. It's at this point that things such as setting up a stock exchange might make a difference. There are many ways of saying, "we're open for business," but commitment, simple financial laws, regulations efficiently and consistently applied and an open banking and investment regime get things going.

Third, starting after business environment, but before human capital, is 'financial sector development.' This means providing the panoply of financial sector regulation, connections, and training that prove a commitment to having a financial sector.

The fourth area of competitiveness, from 600 to 800 points, is 'human capital.' This may seem oddly late, after all people are the most important bit of finance, no? However, the going only starts to get tough after 600 points as more and more advanced skills are required to win and transact more and more complex transactions – transactions of advanced financial, structural or legal complexity in multiple languages. One could argue that this area is 'split,' i.e., good basic education is part of infrastructure, but later an emphasis on the skills and qualifications needed for financial services begins to dominate.

Finally, 'reputational and general' factors matter from 600 points. After 800 points, and here we're at the edge of our data envelope, it appears that infrastructure may start to matter again. However, throughout the climb from 200 to 800, business environment is always the key area of competitiveness, always the most important—stable politics, good regulation, low bureaucracy, low corruption. Policy matters. Interestingly, we have grouped good taxation (i.e., low personal and corporate tax rates, especially the overall GDP taken by tax) in business environment; when you examine taxation on its own, it tracks business environment almost perfectly. So, in summary, always, always work on a friendly business environment, then emphasise infrastructure, followed by market access, followed by good people.

4.2 Criticisms of African Investment Climate

During the course of this report, 20 investors (investment managers, asset managers, high net worth individuals and private banks) were asked about their opinions of future investment in Africa. They were ***very positive*** about the future, assuming that the business environment improved and political risk was held in check. As expected, some focussed on very near term issues, e.g., the Ebola crisis, however, their longer-term concerns included:

1 - **Rule of Law And Corruption**—probably the biggest and most common issue and one which could be discussed at great length. A number of people noted though that the "natural resource curse" might be abating due to the variety of investments (more than just mining) and the variety of investors (e.g., China) proving that Africa was now 'investable' in turn spurring more reform and transparency—["Twilight Of The Resource Curse," The Economist, (10 January 2015), pages 43-44 – http://www.economist.com/news/middle-east-and-africa/21638141-africas-growth-being-powered-things-other-commodities-twilight].

2 - **Pace of Reform**—the pace at which decisions are made and changes are made was widely criticised during this research. Successful economic development will be hindered if the slow pace of decision-making is not addressed. It is hard to recommend a precise course of action; however, corruption was seen as a huge issue for virtually all of Africa.

3 - **Joint Marketing**—it might appear from the reputational advantage exhibited by the centres, particularly Casablanca, that marketing has gone well. However, it was clear from interviews, and from the cross-correlations in ratings, that Africa needs to market Africa as much as individual centres. Another region with a similar problem is the Caribbean. Once there are problems, e.g., Antiguan scandals, then investors flee the region, not the specific centre.

4 - **Infrastructure**—an international financial centre needs high quality transport, building and ICT infrastructure. High quality infrastructure generally contributes to economic productivity, innovation, entrepreneurship and business sophistication. Casablanca has done as great deal to improve its transport infrastructure with highways being built. The port is being developed and in time the airport will need considerable expansion or replacement. Similar infrastructure tales must exist elsewhere, but investors were not aware of many.

5 - **Clear, Comparable Regulatory Frameworks**—two clear African opportunities are local fund management for inward investment and Islamic finance. Both of these sectors need very specific legislation, which can be and should be put in place fairly quickly. There are examples of best practice in Europe and the Middle East, which can be copied.

6 - **People**—primary and secondary education are perceived to be adequate in the few centres covered by GFCI, for the moment. If typical financial centre development is followed, then a large skills shortage will emerge quickly. Several interviewees were expecting an extremely tight labour market in the near future. However, what they wanted were more basic skills of bookkeeping, compliance, database management, not advanced financial skills. More vocational qualifications, rigorously vetted, were investors' key concerns.

7 - **Accurate Information**—people wanted clear, validated information. They wanted pan-Africa information. They wanted credit information on companies, on people. One report was particularly interesting in illustrating current problems, "*Stock Exchanges in Sub-Saharan Africa: Capturing Intent Towards ESG Requirements*" (ACCA, July 2014) - http://www.accaglobal.com/gb/en/technical-activities/technical-resources-search/2014/july/stock-exchanges-in-sub-saharan-africa.html. Examining stock exchanges in Botswana, Ghana, Malawi, Kenya, Nigeria, Mauritius, South Africa, Uganda,

Zambia and Zimbabwe, the report noted that while there are signs of intent to introduce ESG disclosures from some of the stock exchanges, there is room for exchanges to develop more extensive and meaningful disclosure requirements. The report finds that, with the exception of listed companies on the Johannesburg Stock Exchange (JSE), the level of sustainability reporting from the largest listed companies across Sub-Saharan Africa is very low, with only 13 companies (15%) reporting on sustainability, either through a sustainability report, combined report or integrated report.

5. HOW DONORS CAN HELP

A generic strategy for any financial centre might be:

- Get real—more aggressive promotion addressing shortcomings with long-term planning yet avoiding the appearance of capricious regulatory change, combined with a clear legislative cycle in finance where finance bills change regularly but not too rapidly;
- Get integrated—consider 'mid-shore' strategies where there is a symbiotic offshore relationship with larger or neighbouring nations allowing businesses to function under less-than-ideal or complex onshore regulation;
- Get better—tackle long-term skills shortages with better training for indigenous populations rather than relying on imported skills; improve power, transportation and communications infrastructure;
- Get connected—host high-profile regular events, create strong academic links, simplify visa and work permit processes; and,
- Get serving—increase levels of service both for those entering the centre and long-term residents; use benchmarks, data comparisons, and awards to keep service high, encourage innovation.

Some suggestions for donors focussed on building financial centre capacity might be programmes containing some of the following ideas:

Get Real – Hard Targets, Hard Measures, Hard Knocks

- Set out a standard for a **Memorandum of Understanding between a government and its domestic financial services** on such items as inward investment, infrastructure investment, tax changes, or venture capital rules – basically agreements on how governments will change the rules in consultation with industry. This could be combined with scorecards or indices (an African Regulatory Effectiveness Index, for example) that underpin targets and evaluation. African centres need to expose themselves to international scrutiny and competition—this obviously is important for attracting foreign investment but also for retaining domestic talent with knock-on benefits for domestic capital markets development. With sufficient take-up, a standard Memorandum could become a pan-African commitment.
- Consider **Policy Performance Bonds**, perhaps in conjunction with development agencies. Such bonds would pay investors if policies were not delivered, yet give interest-free money to governments that did deliver. Such bonds would be investment hedges and reduce political risk. Governments would pay for non-delivery of policy outcomes. The terms of the bonds would reflect the pace of change and the commitment to longer-term goals.
- For onshore countries, deliver **full, early compliance** on people and tax, e.g., anti-money laundering rules, FATCA, know-your-customer. Malta is a good example of a country which has attempted to be first to implement new EU regulations on the basis that delay rarely if ever helps it be competitive, whereas early compliance does. Outside the EU, identifying 'real' regulations versus norms, e.g., OECD, is more difficult, but leading on early compliance can still be a competitive angle.
- Equally fight for **tax simplicity** in all African centres. A good starting point for donors might be a comparative evaluation of the complexity (or simplicity) of African tax rules. A more radical step might be to promote the simple tax structures of land value taxes or flat consumption taxes that both make economic sense and simplify the tax system. Naturally there are wider tax issues of certainty and corruption, but simplification might be the positive theme.

Get Integrated – Present a United African Story

- Recognise that African centres stand separately but fall together. Encourage regional groupings, regional joint commitments, regional cross-recognition (e.g., of qualifications), regional information and reporting, a measure of regional marketing. Of these, the focus might be most on **cross-recognition of professional standards** (e.g., accountancy, securities trading, banking, legal – in line with the FTQI point below), and the establishment of right-to-work agreements which would facilitate cross-border trade and investment, e.g., no need for a visa for three months financial services work by a qualified professional.
- Establish information sharing agreements, particularly about statistics on financial services and investments.
- Consider the application of **voluntary standards markets**, e.g., ISO standards, for processes, perhaps development of an ISO standard for a well-run financial centre which in turn would be audited by the major certification agencies, equally areas such as anti-money laundering (AML) or know-your-customer (KYC) are amenable to this process certification approach.
- Develop **regional securitisation standards** to build scale, e.g., emulate the Hedge Fund Standards Board or the Climate Bond Initiative in African investment themes such as mining, tourism, or forestry. These would help investors invest cross-border by providing sufficient deal flow outside the capability of a single country.

Get Better – Professional and Firm Accreditation and Certification

- Consider establishing a regional **Financial Training and Qualifications Institute** (FTQI) drawing upon the Chartered Institute for Securities & Investment (CISI), City and Guilds, CFA, ACCA, and other organisations that can deliver accreditation and certification to training at a vocational level. The FTQI would set standards for practitioner and regulator training, and academic development for the financial sector. The FTQI would be an accreditor of other bodies (e.g., trainers) that would certify. Only world-class accreditation will suffice. It follows that certification would best be provided in partnership with leading international bodies, probably a limited number of core partnerships. AN FTQI could be somewhat ‘virtual,’ i.e., pulling together existing international and regional resources. The virtual resources should be spread throughout the region to help draw the region together on financial training and qualifications. An FTQI would need to be rigorous in its accreditations and certifications and still have some ‘physical core’ (with the regional jostling or, more positively, competition to host which that implies). To make an impact efficiently MOOCs (Massive Open Online Courses) and train-and-certify-the-trainer schemes are almost essential. The support and close involvement of regulators (particularly Central Banks) is desirable. The general assent and agreement of governments would be necessary, but they can have a back seat role. Ideally some some elements of compulsion, e.g., all participating countries require regulators and government officials involved in financial services to have achieved a minimal qualification, would help both to raise standards in the region more rapidly and to underwrite government commitment to the professional improvement the FTQI is required to deliver. Following several years of mutual recognition to bind things together, longer-term an FTQI should move to standardising regulations across the region leading to consistent qualifications, testing, and certification.
- Consider having such an FTQI build an **online professional community** consisting of areas such as:
  - A guide for existing courses and publicise those courses deemed to meet defined standards and criteria;
  - A centre for online training and courses, including certification, testing, and rating such courses;
  - Specifically commission courses in specific areas with specific characteristics and to defined standards;
  - Provide a portal for research; and,
  - Publicise conferences meeting defined criteria.
- Consider having such an FTQI develop a **“Who’s Who” and “What’s What” directory** on the regional industry, publishing relevant accreditations and certifications. The lack of comprehensive information means that even those within the industry have little idea of what is going on in different parts of the region, unless it is in their own particular market niche. Linking this with a jobs portal both provides a strong link to qualifications and partially answers individual members’ questions on ‘what’s in it for me?’

Get Connected – Ease Scaling Up In Africa

- Consider developing a **mutual financial client and worker identification** system that would provide AML and KYC passports. Some jurisdictions, notably Estonia, are working hard on providing 'identity' services for global use. Such an identity system would smooth entry into Africa (one AML or KYC check for a few dozen countries) from outside, and smooth cross-border working.
- **Engage universities directly with financial services**, also under appropriate international accreditation, to lay the foundations for future financial services expertise. Much work needs to be done to integrate vocational training with academic, e.g., graduating in accounting with accounting qualification tests already completed, equally actuarial, banking, or finance; pushing universities to accept vocational qualifications as credit for higher than entry level joiners; or targeting university success partially on job placement and salaries. An FTQI should equally promote the recognition of university qualifications, e.g., mathematics or statistics, for part of vocational qualifications.
- **Use cross-recognition and visa rules** to connect more with global professional and financial services firms to work across Africa. Can a major accountancy practice or bank send professionals freely across the region, African or not.
- **Develop a global dialogue on African financial services** using a portal's discussion groups to unite the region on topics, unite practitioners and regulators, unite academics and the industry; work on developing strong links with international fora—Geneva Association (insurance), SWIFT, IMF, etc.—especially consider not 'African' conferences but global financial conferences – and look to bringing in academics and financial intellectuals. Equally, the ability to consolidate African expertise when needed could build confidence and pride about regional capabilities, e.g., a South African professor and a Nigerian investment manager along with a Kenyan quant publish a paper to help answer a World Bank question on how to price Congo forestry for sustainability, a paper that no specific country had the expertise to develop.

Get Serving – Develop African Products

- Consider **'selling' regulation**, i.e., offering investors additional supervision and inspection of their local investments or investment managers though for an additional fee. Such services could be run by the centre's regulators and could provide local benchmarking information to investors. Donors could be particularly helpful in providing oversight and control for such services.
- Establish and publish **service benchmarks** that help raise customer service standards across the region, e.g., secret shoppers.
- Consider developing **FinTech Africa**, an incubation centre for software—given the African 'leapfrog' on mobile and payments, perhaps Africa can leapfrog in insurance or blockchain technologies.
- Consider how **financial literacy** might actually aid financial centre development, e.g., training games for children (such as CISI's CISIext) or getting finance into secondary school curricula. This could be a high-impact pathway for donors.

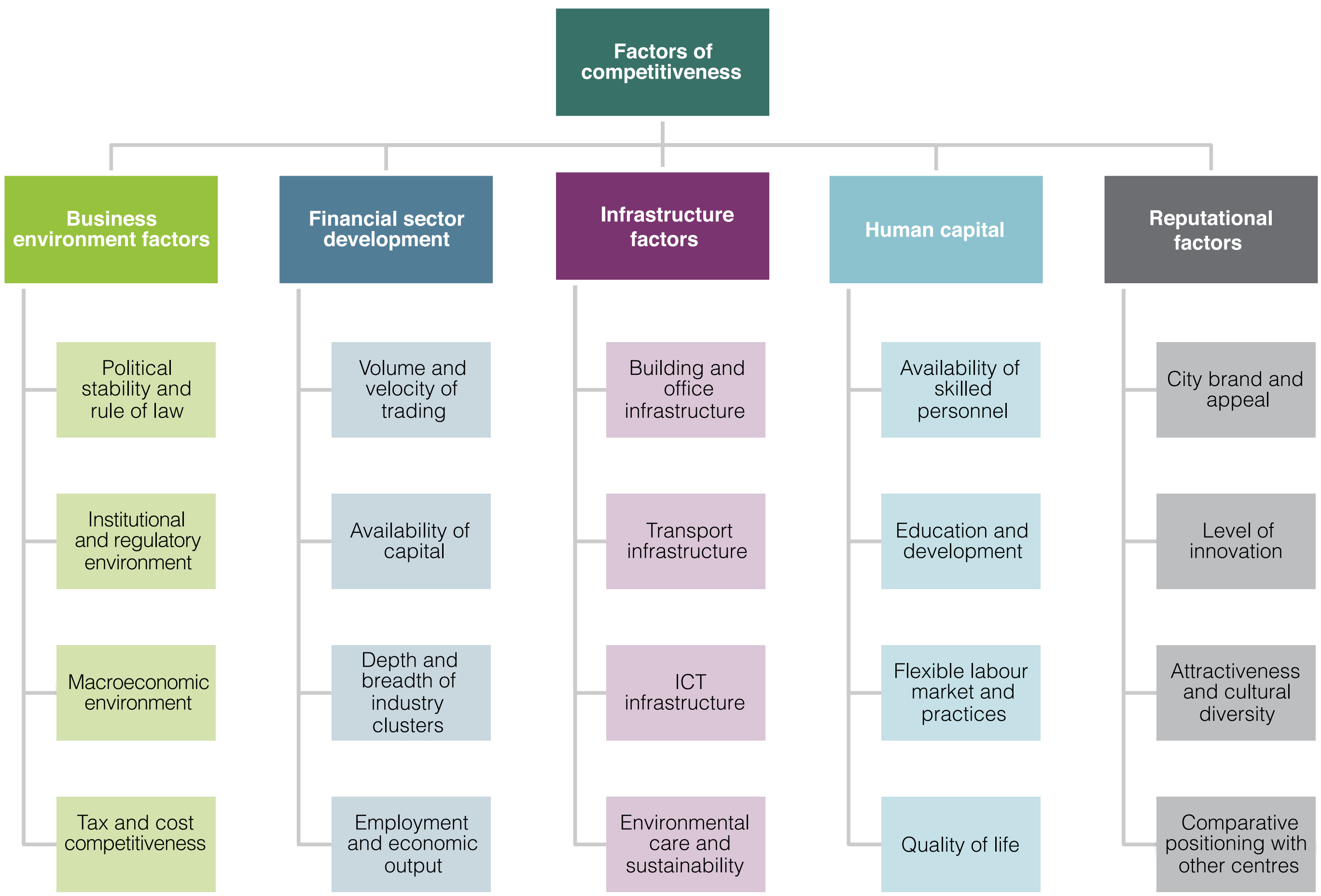
6. APPENDICES

6.1 Appendix A - GFCI Methodology

The GFCI provides ratings for financial centres calculated by a 'factor assessment model' that uses two distinct sets of input:

- Instrumental factors (external indices that contribute to competitiveness): objective evidence of competitiveness was sought from a wide variety of comparable sources. For example, evidence about the telecommunications infrastructure competitiveness of a financial centre is drawn from a global digital economy ranking (supplied by the Economist Intelligence Unit), a telecommunication infrastructure index (by the United Nations) and an IT industry competitiveness survey (by the World Economic Forum). A total of 105 instrumental factors were used in GFCI 16. Not all financial centres are represented in all the external sources, and the statistical model takes account of these gaps.
- Financial centre assessments: by means of an online questionnaire, running continuously since 2007, we use 29,226 financial centre assessments drawn from 3,663 respondents over the past 24 months.

The 105 instrumental factors were selected because the features they measure contribute in various ways to the five areas of competitiveness identified in previous research. These are shown below:



Financial centres are added to the GFCI model when they receive five or more mentions in the online questionnaire in response to the question: “Are there any financial centres that might become significantly more important over the next two to three years?” A centre is only given a GFCI rating and ranking if it receives more than 200 assessments from other centres in the online survey.

At the beginning of our work on the GFCI, a number of guidelines were set out. Additional Instrumental Factors are added to the GFCI model when relevant and meaningful ones are discovered:

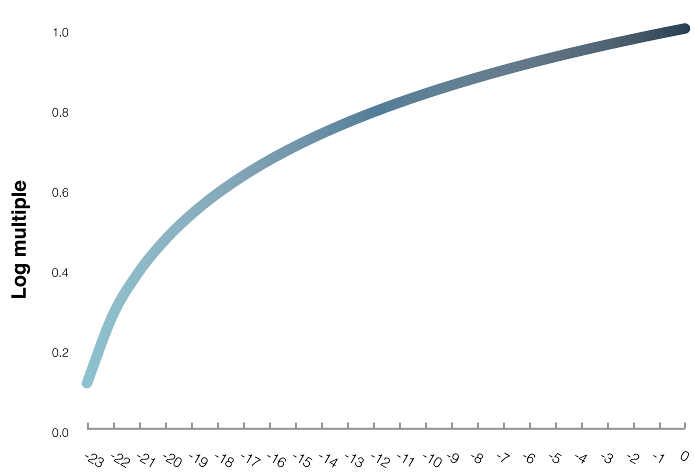
- Indices should come from a reputable body and be derived by a sound methodology;
- Indices should be readily available (ideally in the public domain) and be regularly updated;
- Updates to the indices are collected and collated every six months;
- No weightings are applied to indices (instrumental factors);
- Indices are entered into the GFCI model as directly as possible, whether this is a rank, a derived score, a value, a distribution around a mean or a distribution around a benchmark;
- If a factor is at a national level, the score will be used for all centres in that country; nation-based factors will be avoided if financial centre (city)-based factors are available;
- If an index has multiple values for a city or nation, the most relevant value is used (and the method for judging relevance is noted); and,
- If an index is at a regional level, the most relevant allocation of scores to each centre is made (and the method for judging relevance is noted).

Creating the GFCI does not involve totalling or averaging scores across instrumental factors. An approach involving totalling and averaging would involve a number of difficulties:

- Indices are published in a variety of different forms: an average or base point of 100 with scores above and below this; a simple ranking; actual values (e.g., $ per square foot of occupancy costs); a composite ‘score’;
- Indices would have to be normalised, e.g., in some indices a high score is positive while in others a low score is positive;
- Not all centres are included in all indices; and,
- The indices would have to be weighted—it should be noted that there is no weighting mechanism used in the GFCI modelling. If such a mechanism were used it would instantly be challenged as there is no neutral method to assess and allocate weightings.

The guidelines for financial centre assessments by respondents are:

- Responses are collected via an online questionnaire which runs continuously. A link to this questionnaire is emailed to the target list of respondents at regular intervals and other interested parties can fill this in by following the link given in the GFCI publications;
- Financial centre assessments will be included in the GFCI model for 24 months after they have been received;
- Respondents rating fewer than three or more than half of the centres are excluded from the model;
- Respondents who do not say where they work are excluded; and,
- Financial centre assessments from the month when the GFCI is created are given full weighting and earlier responses are given a reduced weighting on a log scale.



It is important to recognise that financial centre assessments are discounted according to how recently they were provided—assessments from the current month are given full weighting (1.0) and the weighting decreases with the age of the assessments (to approximately 80% after 12 months and 60% after 18 months).

The financial centre assessments and instrumental factors are used to build a predictive model of centre competitiveness using a support vector machine (SVM). The SVM used for the GFCI is PropheZy—Z/Yen's proprietary system. SVMs are based upon statistical techniques that classify and model complex historic data in order to make predictions of new data. SVMs work well on discrete, categorical data but also handle continuous numerical or time series data.

The GFCI is constructed by creating a large data table which contains a row for each respondent / centre combination with the rating each respondent give to each centre together with the score that that centre has for all of the instrumental factors:

Respondent Number	Centre Number	Assessments	Instrumental Factor 1	Instrumental Factor 2	Instrumental Factor 3	→	Instrumental Factor 103
Respondent 1	Centre 1	8	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent 1	Centre 2	7	BBB.BB	BBB.BB	BBB.BB		BBB.BB
Respondent 1	Centre 3	9	CCC.CC	CCC.CC	CCC.CC		CCC.CC
Respondent 1	Centre 4	6	DDD.DD	DDD.DD	DDD.DD		DDD.DD
Respondent 1	Centre 5		EEE.EE	EEE.EE	EEE.EE		EEE.EE
Respondent 1	Centre 6		FFF.FF	FFF.FF	FFF.FF		FFF.FF
Respondent 1	Centre 7		GGG.GG	GGG.GG	GGG.GG		GGG.GG
↓	↓						
Respondent 1	Centre 83		ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ
Respondent 2	Centre 1	7	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent 2	Centre 2	6	BBB.BB	BBB.BB	BBB.BB		BBB.BB
↓	↓						
Respondent 2	Centre 83		ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ
Respondent 3	Centre 1	6	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent 3	Centre 2	6	BBB.BB	BBB.BB	BBB.BB		BBB.BB
↓	↓						
Respondent 3	Centre 83		ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ
↓	↓						
Respondent XX	Centre 1	7	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent XX	Centre 2	9	BBB.BB	BBB.BB	BBB.BB		BBB.BB
↓	↓						
Respondent XX	Centre 83		ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ

The SVM then uses the data to predict values for all the centres that a respondent has not assessed:

Respondent Number	Centre Number	Assessments / Predictions	Instrumental Factor 1	Instrumental Factor 2	Instrumental Factor 3	→	Instrumental Factor 103
Respondent 1	Centre 1	8	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent 1	Centre 2	7	BBB.BB	BBB.BB	BBB.BB		BBB.BB
Respondent 1	Centre 3	9	CCC.CC	CCC.CC	CCC.CC		CCC.CC
Respondent 1	Centre 4	6	DDD.DD	DDD.DD	DDD.DD		DDD.DD
Respondent 1	Centre 5	**4**	EEE.EE	EEE.EE	EEE.EE		EEE.EE
Respondent 1	Centre 6	**3**	FFF.FF	FFF.FF	FFF.FF		FFF.FF
Respondent 1	Centre 7	**5**		GGG.GG	GGG.GG		GGG.GG
↓	↓						
Respondent 1	Centre 83	**7**					
Respondent 2	Centre 1	7	AAA.AA				
Respondent 2	Centre 2	6	BBB.BB				
↓	↓						
Respondent 2	Centre 83	**5**	ZZZ.ZZ				
Respondent 3	Centre 1	6	AAA.AA				AAA.AA
Respondent 3	Centre 2	6	BBB.BB	BBB.BB	BBB.BB		BBB.BB
↓	↓						
Respondent 3	Centre 83	**6**	ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ
↓	↓						
Respondent XX	Centre 1	7	AAA.AA	AAA.AA	AAA.AA		AAA.AA
Respondent XX	Centre 2	9	BBB.BB	BBB.BB	BBB.BB		BBB.BB
↓	↓						
Respondent XX	Centre 83	**8**	ZZZ.ZZ	ZZZ.ZZ	ZZZ.ZZ		ZZZ.ZZ

PropheZy uses the assessments given by a respondent to predict the assessments that they would have given if they were familiar with the other centres

Assessments from respondents' home centres are excluded from the factor assessment model to remove home bias. In effect, the model predicts how respondents would have assessed centres they are not familiar with, by answering questions such as:

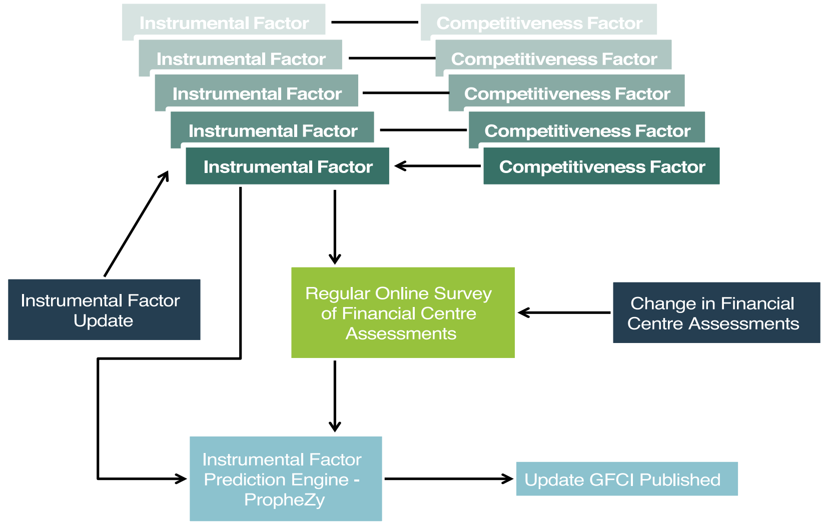
If an investment banker gives Casablanca and Dubai certain assessments then, based on the relevant data for Casablanca and Dubai, how would that person assess Tel Aviv?

or

If a pension fund manager gives Istanbul and Tel Aviv a certain assessment then, based on the relevant data for Istanbul, Tel Aviv and Doha, how would that person assess Doha?

The SVM used for the GFCI provides information about the confidence with which each specific classification is made and the likelihood of other possible classifications.

Financial centre predictions from the SVM are combined with actual financial centre assessments to produce the GFCI—a set of financial centre ratings. The GFCI is dynamically updated either by updating and adding to the instrumental factors or through new financial centre assessments. These updates permit, for instance, a recently changed index of rental costs to affect the competitiveness rating of the centres. No weightings are assigned to each instrumental factor, although the SVM uses each respondent's assessments in combination with the instrumental factors to predict the factors that are most important to each respondent. Different respondents place different emphasis on different factors. The process of creating the GFCI is outlined diagrammatically.



It is worth drawing attention to a few consequences of basing the GFCI on instrumental factors and questionnaire responses:

- Several indices care used for each competitive factor and there are alternatives available;
- A strong international group of 'raters' is being developed as the GFCI progresses;
- Sector-specific ratings are created by using the business sectors represented by questionnaire respondents. This makes it possible to rate London as competitive in Insurance (for instance) while less competitive in Investment Management (for instance);
- The factor assessment model can be queried in a 'what if' mode—"how much would London rental costs need to fall in order to increase London's ranking against New York?"; and,
- Part of the process of building the GFCI is extensive sensitivity testing to changes in factors of competitiveness and financial centre assessments. The accuracy of predictions given by the SVM is regularly tested against actual assessments.

6.2 Appendix B – GFCI Instrumental Factors

One of the two main inputs to the GFCI is a list of instrumental factors (105 in GFCI 16). Shown below are the 105 factors and the R-Squared of the correlation with GFCI—a higher R-Squared implies stronger correlation.

	Instrumental Factor	Country or City Based	R-Squared
1.	City Global Image	City	0.394
2.	Banking Industry Country Risk Assessments	Country	0.391
3.	Global City Competitiveness	City	0.368
4.	Global Power City Index	City	0.357
5.	Financial Secrecy Index	Country	0.320
6.	World Competitiveness Scoreboard	Country	0.305
7.	Global Competitiveness Index	Country	0.295
8.	Office Occupancy Costs	City	0.290
9.	Liner Shipping Connectivity Index	Country	0.279
10.	Global Cities Index	City	0.265
11.	FDI Confidence	Country	0.247
12.	Connectivity	City	0.240
13.	IPD Global Property Index	City	0.221
14.	Business Environment Rankings	Country	0.216
15.	Citywide CO^2 Emissions	City	0.209
16.	Securitisation	Country	0.208
17.	Institutional Effectiveness	City	0.206
18.	Office Space Around the World	City	0.204
19.	Innovation Cities Global Index	City	0.198
20.	Capitalisation of Stock Exchanges	City	0.193
21.	Total Net Assets of Mutual Funds	Country	0.191
22.	Foreign Direct Investment Inflows	Country	0.187
23.	Citizens Domestic Purchasing Power	City	0.179
24.	City GDP Figures	City	0.179
25.	Quality of Roads	Country	0.176
26.	Value of Share Trading	City	0.175
27.	Top Tourism Destinations	City	0.170
28.	Number of International Fairs and Exhibitions	Country	0.165
29.	Global Enabling Trade Report	Country	0.165
30.	Number of Greenfield Investments	City	0.163
31.	Number of High Net Worth Individuals	Country	0.161
32.	Volume of Stock Options Trading	City	0.159
33.	Volume of Share Trading	City	0.156
34.	City Global Appeal	City	0.153
35.	Price Levels	City	0.149
36.	Political Risk	Country	0.144
37.	Quality of Ground Transport Network	Country	0.140
38.	Global Information Technology	Country	0.138
39.	Capital Access Index	Country	0.137
40.	Global Talent Index	Country	0.135
41.	Tax as Percentage of GDP	Country	0.135
42.	Infrastructure	City	0.134
43.	Physical Capital	City	0.133
44.	Spatial Adjusted Liveability Index	City	0.125
45.	Metro Network Length	City	0.120
46.	Projected City Economic Growth 2010-2025	City	0.116
47.	Wage Comparison Index	City	0.116
48.	Human Capital	City	0.115
49.	IT Industry Competitiveness	Country	0.108
50.	Net External Positions of Banks	Country	0.100
51.	Operational Risk Rating	Country	0.099
52.	Global Intellectual Property Index	Country	0.093
53.	Global Innovation Index	Country	0.090
54.	GDP per Person Employed	Country	0.087
55.	Ease of Doing Business Index	Country	0.081
56.	Commodity Futures Notional Turnover	City	0.080
57.	Digital Economy Rankings	Country	0.074
58.	Regulatory Enforcement	Country	0.072
59.	Commodity Options Notional Turnover	City	0.066
60.	Open Government	Country	0.055
61.	Volume of Stock Futures Trading	City	0.054
62.	Corruption Perception Index	Country	0.053
63.	Healthcare	City	0.052
64.	Global Connectedness Index	Country	0.051
65.	Economic Freedom of the World	Country	0.051
66.	Real Estate Transparency Index	Country	0.051
67.	Domestic Credit Provided by Banking Sector (% of GDP)	Country	0.047
68.	Energy Sustainability Index	Country	0.040
69.	Human Development Index	Country	0.034
70.	External Positions of Central Banks	Country	0.031
71.	Linguistic Diversity	Country	0.031
72.	Value of Bond Trading	City	0.027
73.	Business Confidence Index	Country	0.024
74.	Urban Sprawl	City	0.022
75.	Personal Tax Rates	Country	0.021
76.	Currencies	Country	0.020
77.	Sustainable Economic Development	Country	0.019
78.	City GDP Composition (Business / Finance)	City	0.015
79.	Government Debt as % of GDP	Country	0.014
80.	Corporate Tax Rates	Country	0.014
81.	Percentage of Firms Using Banks to Finance Investment	Country	0.013
82.	Islamic Finance	Country	0.012
83.	Railways per Land Area	Country	0.011
84.	Graduates in Social Science, Business and Law	Country	0.010
85.	Cities Weight in National Incoming Investments	City	0.010
86.	Real Interest Rate	Country	0.010
87.	Roadways per Land Area	Country	0.009
88.	Employee Tax Rates	City	0.008
89.	The Web Index	Country	0.008
90.	Global Skills Index	Country	0.007
91.	Environmental Performance	Country	0.007
92.	Bilateral Tax Information Exchange Agreements	Country	0.006
93.	Broad Stock Index Levels	City	0.006
94.	Gross Tertiary Graduation Ratio	Country	0.006
95.	Global Services Location	Country	0.004
96.	Average Days with Precipitation per Year	City	0.004
97.	RPI (% change on year ago)	Country	0.004
98.	Press Freedom	Country	0.002
99.	Telecommunication Infrastructure Index	Country	0.001
100.	Happy Planet Index	Country	0.001
101.	Big Mac Index	Country	0.001
102.	Global Peace Index	Country	0.000
103.	Visa Restrictions Index	Country	0.000
104.	Homicide Rates	City	0.000
105.	City to Country GDP Ratio	City	0.000

In order to discover the factors that can be influenced by policymakers and which have a strong impact on the GFCI rating, we examine in the following appendix the 60 instrumental factors that are most highly correlated with the GFCI 16 ratings. We have grouped these instrumental factors into five areas of competitiveness—Business Environment, Financial Sector Development, Infrastructure, Human Capital, and Reputational and General Factors.

6.3 Appendix C – Group Performance in the Instrumental Factors

The following table is a summary of performance in the 60 most influential instrumental factors. The table shows how centres are ranked relative to each other in each separate instrumental factor (e.g., in the Banking Industry Country Risk Assessments measure, Busan is 1st (top) amongst the peer group centres; Doha, Johannesburg and Tel Aviv are tied for 2nd).

Key: (Casablanca (CA), Busan (BU), Doha (DO), Dubai (DU), Istanbul (IS), Johannesburg (JB), Port Louis (PL), and Tel Aviv (TA))

	Instrumental Factor	CA*	BU	DO	DU	IS	JB	PL	TA
1.	City Global Image				1				
2.	Banking Industry Country Risk Assessments	7	1	=2	=5	=5	=2		=2
3.	Global City Competitiveness		4	2	1	6	5		3
4.	Global Power City Index					1			
5.	Financial Secrecy Index		3		5		2	4	1
6.	World Competitiveness Scoreboard		4	2	1	5	6		3
7.	Global Competitiveness Index	8	3	1	2	5	7	6	4
8.	Office Occupancy Costs			5	2	4	1		3
9.	Liner Shipping Connectivity Index	3	1		2	4		6	5
10.	Global Cities Index	6		5	1	2	4		3
11.	FDI Confidence				1	3	2		
12.	Connectivity	3				=1	=1		
13.	IPD Global Property Index		2				1		
14.	Business Environment Rankings	7	3	2	4	5	6		1
15.	Citywide CO^2 Emissions								
16.	Securitisation		1						
17.	Institutional Effectiveness		1	6	2	5	3		4
18.	Office Space Around the World			4	5	3	1		2
19.	Innovation Cities Global Index	6	=3	5	=1	=3	7	8	=1
20.	Capitalisation of Stock Exchanges	7	1	4	6	5	2	8	3
21.	Total Net Assets of Mutual Funds		1			3	2		
22.	Foreign Direct Investment Inflows	6	3	8	4	1	5	7	2
23.	Citizens Domestic Purchasing Power			4	1	5	2		3
24.	City GDP Figures	6	2		5	1	4		3
25.	Quality of Roads	8	2	3	1	=4	=4	7	6
26.	Value of Share Trading	7	1	6	4	3	2	8	5
27.	Top Tourism Destinations			1	3	4	2		
28.	Number of International Fairs and Exhibitions	5	1	7	4	2	3	8	6
29.	Global Enabling Trade Report	6	=3	2	1	7	8	=3	=3
30.	Number of Greenfield Investments					1			
31.	Number of High Net Worth Individuals		2		1		3		4

	Instrumental Factor	CA*	BU	DO	DU	IS	JB	PL	TA
32.	Volume of Stock Options Trading					3	1		2
33.	Volume of Share Trading	7	1	6	5	2	3	8	4
34.	City Global Appeal		6	5	2	1	3		4
35.	Price Levels			2	5	3	1		4
36.	Political Risk	7	2	3	4	6	5	1	8
37.	Quality of Ground Transport Network	7	2	4	1	3	8	=5	=5
38.	Global Information Technology	8	1	3	4	6	7	5	2
39.	Capital Access Index	6	1		2	5	4		3
40.	Global Talent Index		2			4	3		1
41.	Tax as Percentage of GDP	6	2		1	4	7	3	5
42.	Infrastructure	3				2	1		
43.	Physical Capital		3	4	2	6	5		1
44.	Spatial Adjusted Liveability Index	3				2	1		
45.	Metro Network Length		1		3	2			
46.	Projected City Economic Growth 2010-2025			1		2			3
47.	Wage Comparison Index			1	5	2	3		4
48.	Human Capital		5	=2	1	6	=2		4
49.	IT Industry Competitiveness	8	1	3	4	6	7	5	2
50.	Net External Positions of Banks	4	2	3	6	1	7	5	8
51.	Operational Risk Rating	8	5	1	4	7	6	2	3
52.	Global Intellectual Property Index		1			4	3		2
53.	Global Innovation Index	8	2	4	3	7	6	5	1
54.	GDP per Person Employed	7	2	4	6	3	5		1
55.	Ease of Doing Business Index	8	1	6	3	7	5	2	4
56.	Commodity Futures Notional Turnover		3			2	1		
57.	Digital Economy Rankings		1		3	5	4		2
58.	Regulatory Enforcement	=3	1		2	=3	5		
59.	Commodity Options Notional Turnover						1		
60.	Open Government	4	2	1	5	6	3		

Please note that a full list of all Instrumental Factors, together with details of their providers and web links where applicable, is available in the GFCI 16 report.

Business Environment

Instrumental Factor		Source	Website
Banking Industry Country Risk Assessments		**Standard & Poor's**	http://img.en25.com/Web/StandardPoorsRatings/BICRA_Update_10_10_13.pdf
$R^2 = 0.391$	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This country-based ranking assesses the risk in 87 countries' banking systems in accordance to their respective economic, regulatory and legal environment as well as the credit positions of the financial institutions that operate in this environment. Countries are classed according to their banking systems' strengths and weaknesses into ten tiers. To obtain the rating S&P combines multiple factors that relate to the structure and performance of a country's economy, the legal and regulatory infrastructure underpinning the financial system, and the structure and credit culture of the country's banking industry itself. The score also reflects the quality and effectiveness of bank regulation and the track record of its central bank in financial crises management.			
Business Environment		**EIU**	http://www.eiu.com/public/thankyou_download.aspx?activity=download&campaignid=bizenviro2014
R2 = 0.216	Country Based	Public Sector Influence = High	Private Sector Influence = Low
This ranking covers 82 of the world's more significant economies and measures their attractiveness to business. It is based on business surveys, quantitative data and expert assessments and reflects the general criteria used by businesses for the development of their strategic and investment location decisions. It is based on 91 indicators, the data for which is gathered by EIU's global network of analysts. There are ten broad categories used: Political environment; Macroeconomic environment; Market opportunities; Policies towards free enterprise and competition; Foreign trade and exchange controls; Taxes; Financing; Labour market; and, Infrastructure.			
City GDP Figures		**Brookings Institute**	http://www.brookings.edu/research/interactives/global-metro-monitor-3
$R^2 = 0.179$	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This is a ranking of cities and / or their metropolitan areas by GDP. The list is based on projections and approximations as it is difficult to be exact when identifying GDP values. Depending on the methodology used, the rankings and values can vary and it is worth noting that some cities include larger urban areas which may result in lower per capita GDP estimates, whereas cities with a large portion of the working population living in metro areas, may have higher per capita GDP estimates as a result.			
Financial Secrecy Index		**Tax Justice Network**	http://www.financialsecrecyindex.com/
$R^2 = 0.320$	Country Based	Public Sector Influence = High	Private Sector Influence = Low
This index provides a measure of corruption, illicit financial flows and overall financial secrecy. The index highlights those places which give the greatest security, in terms of tax havens to tax refugees. Countries and territories are ranked according to the level of secrecy of their financial activities (derived from 15 financial secrecy indicators) combined with their scale (a weighting based on their share of the global market for offshore financial services). The important financial secrecy indicators (KFSI) draw on data collected from an array of regulatory reports, legislation, regulation and news available. They encompass 15 different qualitative assessments split into four groups: Transparency of Beneficial Ownership; the availability of public trusts and foundations register, and of company beneficial ownership records; Corporate Transparency Regulation—publicly available company accounts and ownership; Efficiency of Tax & Financial Regulation—relates to whether the jurisdiction avoids promoting tax evasion, is fit for tax information exchange, allows cell companies and trusts with flee clauses and the overall tax administration efficiency; International Standards and Cooperation—relates to anti-money laundering (compliance with FATF), international transparency commitments, international judicial cooperation, bilateral treaties and participation in automatic information exchange.			
Institutional Effectiveness		**EIU**	http://www.economistinsights.com/countries-trade-investment/analysis/hot-spots/
$R^2 = 0.206$	City Based	Public Sector Influence = High	Private Sector Influence = Low
This is one of eight categories used in the Global Cities Competitiveness Index and contributes a weighting of 15% to the overall ranking. It comprises five sub-indices: Electoral process and pluralism, local government fiscal autonomy, taxation, rule of law and government effectiveness. These indicators favour cities which have stability of regulations, predictability and fairness of political processes and effectiveness of the system.			
Number of Greenfield Investments		**KPMG**	http://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/Observatoire-des-Investissements-Internationaux-principales-metropoles-mondiales-2013.pdf
$R^2 = 0.163$	City Based	Public Sector Influence = Low	Private Sector Influence = Medium
Designed to compare and benchmark the present and future attractiveness of centres as an investment destination. It endeavours to make a distinction between perceptions and reality of investment decision making. To measure perceptions, the survey polls a representative sample of 512 companies in 25 countries, which have international business settlements. To measure reality, the survey measures the number of published international "greenfield" investments that took place in a particular city; a greenfield investment occurs when a business launches a new activity in a particular location.			

Open Government		**The World Justice Project**	http://worldjusticeproject.org/sites/default/files/files/wjp_rule_of_law_index_2014_report.pdf
$R^2 = 0.055$	Country Based	Public Sector Influence = High	Private Sector Influence = Low
Open Government is one of nine indices created by the World Justice Project for the Rule of Law Index: Limited government powers; Absence of corruption; Order and security; Fundamental rights; Open government; Regulatory enforcement; Civil justice; Criminal justice and Informal justice. Open Government measures the extent to which laws are stable, publicised and accessible, official information is available on request as well as public participation and the right to petition the government.			
Political Risk Index		**Exclusive Analysis Ltd**	http://www.exclusive-analysis.com/ (not available online)
$R^2 = 0.144$	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
This index based on analyses and forecasts assigning scores to individual countries according to a number of variables ranging from internal stability to external threats. The scores are therefore subjective as they are based on analysts' assessments; however the significant number of analysts involved as well as their geographically diverse locations means that any negative or positive bias towards a country is greatly reduced.			
Projected City Economic Growth		**McKinsey Global Institute**	http://www.foreignpolicy.com/articles/2012/08/13/the_most_dynamic_cities_of_2025
$R^2 = 0.116$	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This factor estimates 75 'urban agglomerations' economic growth rates in 2025. Higher economic growth implies more investment opportunities, return on capital, wealth creation and better long term prospects overall.			
Wage Comparison Index		**UBS**	http://www.ubs.com/1/e/wealthmanagement/wealth_management_research/prices_earnings.html
$R^2 = 0.116$	City Based	Public Sector Influence = High	Private Sector Influence = Medium
This index compares the earnings of workers in 71 cities. It provides a gross wage comparison and a net wage comparison, using New York as the base city (value of 100). The index covers 14 occupations that represent a cross section of the work force in the industrial and service sectors. It is based on questionnaires sent to a number of companies in the relevant sector for each city that take into account age, personal status, education and length of employment. The index measures annual gross income including profit sharing, bonuses, holiday pay, additional months' salaries payments and family allowances measured in US dollars. There is also classification of net income, i.e., gross income after taxes and social security contributions.			
Tax as Percentage of GDP		**The World Bank**	http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS
$R^2 = 0.135$	Country Based	Public Sector Influence = High	Private Sector Influence = Low
Tax revenue refers to mandatory transfers to the central government for public purposes. Certain transfers such as penalties, fines, and most social security contributions are excluded. Refunds and corrections of erroneously collected tax revenue are treated as negative revenue. These statistics provide an insight not just of the overall tax burden carried by individuals and businesses, but also of its importance for the relevant country as a share of its GDP.			
Ease of Doing Business Index		**The World Bank**	http://www.doingbusiness.org/custom-query
$R^2 = 0.081$	Country Based	Public Sector Influence = High	Private Sector Influence = Medium
The ease of doing business index is designed as a measure of regulations that directly affect running a business rather than more general conditions like infrastructure, macroeconomic conditions or a country's closeness to large markets. It ranks economies on the simple average of country percentile rankings on 10 topics including starting a business, dealing with licences, employing workers, registering property, getting credit, paying taxes and enforcing contracts.			
Regulatory Enforcement		**The World Justice Project**	http://worldjusticeproject.org/sites/default/files/files/wjp_rule_of_law_index_2014_report.pdf
$R^2 = 0.072$	Country Based	Public Sector Influence = High	Private Sector Influence = Low
Regulatory Enforcement measures the extent to which government regulations are effectively applied and enforced without improper influence, due process is respected in administrative proceedings and they are conducted without unreasonable delay, and whether the government does not expropriate without adequate compensation.			

Financial Sector Development

Instrumental Factor		Source	Website
Capital Access Index		**Milken Institute**	http://www.milkeninstitute.org/pdf/CAI2009.pdf
R^2 = 0.137	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
This index analyses the breadth, depth and vitality of capital markets across 122 countries that account for 99% of world GDP. It ranks countries according to their support to economic activity and allows them to see how they compare to others in terms of creating the conditions necessary for businesses to raise capital. There are 58 variables assessed for each country, grouped into 7 components that include: Macroeconomic environment; Institutional environment; Financial and banking institutions; Equity market; Bond market development; Alternative sources of capital and International funding.			
Capitalisation of Stock Exchanges		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R2 = 0.193	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators the latest available monthly figures were used.			
Commodity Futures Notional Turnover		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R^2 = 0.080	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators the latest available monthly figures were used.			
Commodity Options Notional Turnover		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R2 = 0.066	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators the latest available monthly figures were used.			
Linear Shipping Connectivity		**The World Bank**	http://data.worldbank.org/indicator/IS.SHP.GCNW.XQ
R^2 = 0.279	Country Based	Public Sector Influence = Low	Private Sector Influence = Low
This index measures the connectivity a country has to global shipping networks. It is computed by the United Nations Conference on Trade and Development (UNCTAD) and based on five components of the maritime transport sector. These include: number of ships, their container-carrying capacity, maximum vessel size, number of services, and number of companies that deploy container ships in a country's ports. The data comes from the International Containerization Online.			
Total Net Assets of Mutual Funds		**Investment Company Institute**	http://www.icifactbook.org/
R2 = 0.191	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This measure is compiled annually and is intended to provide an overlook of trends and activity in the investment industry as well as to promote a public understanding in that regard. Although the statistics are confined primarily to the US domestic market, the ICI provides a global comparison of mutual funds' total net assets worth in millions of US dollars.			
Value of Share Trading		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R^2 = 0.175	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators the latest available monthly figures were used.			
Volume of Stock Options Trading		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R2 = 0.159	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators the latest available monthly figures were used.			

Securitisation		**TheCityUK**	http://www.thecityuk.com/research/ZendSearchLuceneForm?Search=securitisation&action_ZendSearchLuceneResults=Go
R^2 = 0.208	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
Securitisation offers a way for an organisation to convert a future stable cash flow into a lump sum cash advance. This is achieved by converting the future cash flows into tradable securities which are sold as a means of raising capital. This factor ranks countries according to their annual value of securitization issuance in billions of dollars; the data is taken from the annual securitization survey compiled by IFSL Research.			
Volume of Share Trading		**World Federation of Stock Exchanges**	http://www.world-exchanges.org/statistics/monthly-reports
R^2 = 0.156	City Based	Public Sector Influence = Low	Private Sector Influence = Low
The World Federation of Exchanges provides a monthly newsletter called FOCUS, which contains monthly statistics tables. For all of the indicators used, we took the year-to-date figures for May (measured in thousands).			
Net External Positions of Banks		**Bank for International Settlements**	http://www.bis.org/statistics/bankstats.htm
R2 = 0.100	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
The Bank of International Settlements collects quarterly statistics from 42 countries' central banks that were first introduced in 1964 in order to monitor the development of Eurocurrency markets. This instrumental factor measures the external positions of these 42 banks (assets net of liabilities) with a given country. This indicates the relative importance of the country on the international finance scene.			

Infrastructure

Instrumental Factor		Source	Website
Connectivity		**EIU**	http://pages.eiu.com/rs/eiu2/images/EIU_BestCities.pdf
R^2 = 0.240	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
Connectivity is a measure of how easy it is to connect between cities. The two measures of connectivity used are: the average number of daily flights leaving from the city and how many other cities can be flown to from there. These two scores were averaged to obtain the final connectivity score.			
Digital Economy Ranking		**EIU**	http://www-935.ibm.com/services/us/gbs/bus/pdf/eiu_digital-economy-rankings-2010_final_web.pdf
R2 = 0.074	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
This ranks countries according to the conditions of their information and communications technology (ICT) infrastructure and the capability to its businesses, governments and consumers to utilise it. The index evaluates the way a country influences its information and communications infrastructure through political, economic, technological and social means. It is comprised of nearly 100 criteria with different weightings that are grouped in six main categories—connectivity, business environment, social and cultural environment, legal environment, consumer and business adoption or the scale on which businesses and consumers use ICT, as well as government and policy vision or how committed the country's government is.			
Global Information Technology		**World Economic Forum**	http://www.weforum.org/issues/global-information-technology/index.html
R^2 = 0.138	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
This data originates from a component of WEF's Global Competitiveness Report and explores the impact of information and communication technologies (ICT) on productivity and development. The report ranks 142 countries according to how well they leverage ICT to boost their economic competitiveness and improve their social environment. To derive the IT Competitiveness score this study uses ten composite measures comprising a range of quantitative and qualitative data, and grouped into four sub-indices: Environment; Readiness; Usage and Impact.			
City Infrastructure		**EIU**	http://pages.eiu.com/rs/eiu2/images/EIU_BestCities.pdf
R2 = 0.134	City Based	Public Sector Influence = High	Private Sector Influence = Medium
This measure is an EIU rating developed for its Liveability index. It is a combination of qualitative measures relating to road network, public transport, international links, quality housing, energy and water provision, and telecommunications.			

IT Industry Competitiveness		**BSA / EIU**	http://globalindex11.bsa.org/country-table/
$R^2 = 0.108$	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This index compares 66 countries on the extent to which they are capable of sustaining a strong IT sector. 26 indicators are used to create the index and these are split into six areas: Overall business environment; IT infrastructure; Human capital; R&D development; Legal environment and Support for IT industry development.			
Office Occupancy Costs		**DTZ**	http://www.dtz.com/Global/Research/
R2 = 0.290	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This report is a guide to total office occupancy costs across 124 business districts in 49 countries and territories worldwide. The report looks at the main components of occupancy costs in major office markets across the globe and provides a ranking based on annual costs per workstation paying due account to differences in space utilisation per workstation in all markets. This latest survey compares the total occupancy cost per workstation measured in USD at the end of 2011 and provides forecasts of total occupancy costs to 2016. The report also analyses the cost of occupying secondary space in selected locations, as well as the impact of a downside economic scenario on global office rents.			
Office Space Around the World		**Cushman & Wakefield**	http://www.cushmanwakefield.com/en/research-and-insight/2014/office-space-across-the-world-2014/
$R^2 = 0.204$	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This report shows office occupancy costs across the globe over the past twelve months, ranking the most expensive locations in which to occupy office space. This is a simple measure of average annual rental rates in various cities' business districts that is provided by Cushman & Wakefield in Euros, US dollars and local currency per square meter. Costs of office space are an important consideration for the running of any business, higher costs are clearly not beneficial but these are rarely viewed in isolation—what businesses receive in return for running an office is more important and this is what determines the demand for office space and consequently the costs.			
Physical Capital		**EIU**	http://www.economistinsights.com/countries-trade-investment/analysis/hot-spots/
$R^2 = 0.133$	City Based	Public Sector Influence = High	Private Sector Influence = Medium
Physical Capital is one of eight categories used in the Global City Competitiveness Index. It is made up of three sub-indices: quality of physical infrastructure, quality of public transport and quality of telecommunications infrastructure. This category reflects the availability of and access to developed and efficient infrastructure which helps businesses operate more efficiently. It also has an element of quality of life for residents and visitors.			
Quality of Ground Transport Network		**World Economic Forum**	http://www.weforum.org/en/initiatives/gcp/TravelandTourismReport/CompetitivenessIndex/index.htm
R2 = 0.140	Country Based	Public Sector Influence = High	Private Sector Influence = Low
This index is derived from the World Economic Forum's Travel and Tourism Competitiveness Index. The quality of ground transport network ranks countries according to the quality of their public transport network and is one of the measures used to compile a sub-index reflecting a country's ground infrastructure. It is based on an opinion questionnaire and is hence more indicative of the public's perception of the transportation network rather than hard data.			
Quality of Roads		**World Economic Forum**	http://www.weforum.org/en/initiatives/gcp/TravelandTourismReport/CompetitivenessIndex/index.htm
$R^2 = 0.176$	Country Based	Public Sector Influence = High	Private Sector Influence = Low
This indicator is used to compile a sub-index that reflects a country's ground infrastructure. It is based on WEF's annual Executive Opinion Survey conducted through a questionnaire among business executives around the world, and is hence more indicative of perception of the road network rather than hard data.			
Global Property Index		**Investment Property Databank**	http://www1.ipd.com/Pages/DNNPage.aspx?DestUrl=http%3a%2f%2fwww.ipd.com%2fsharepoint.aspx%3fTabId%3d425
R2 = 0.221	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This factor measures the five years total return on real estate investment in local currencies for 23 developed markets in Europe, North America and Australasia. The percentage returns are annualised and combine industrial, residential, retail and office properties. Unlike Office Space and Office Occupancy Costs, which look from the perspective of rents and business costs, this index views real estate from an investors' standpoint.			
Metro Network Length		**Metro Bits**	http://mic-ro.com/metro/table.html
$R^2 = 0.120$	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This factor looks at the distance covered by a city's metro, the number of stations and the average distance between stations.			

Human Capital

Instrumental Factor		Source	Website
Citizens Domestic Purchasing Power		**UBS**	http://www.ubs.com/1/e/ubs_ch/wealth_mgmt_ch/research.html
R^2 = 0.179	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This indicator measures the purchasing power of the citizens of 73 cities across the world. It is based on average earnings per city and a general basket of 154 goods and services based on Western European consumer preferences. Higher purchasing power implies a better standard of living and quality of local services available.			
Citywide CO^2 Emissions		**Carbon Disclosure Project**	http://www.cdpcities2013.net/#!/index/
R2 = 0.209	City Based	Public Sector Influence = Medium	Private Sector Influence = Medium
As measured by CDP—an international, not-for-profit organisation providing a global system for companies and cities to measure, disclose, manage and share vital environmental information. CDP holds a very extensive collection of primary climate change, water and forest-risk information.			
Global Talent Index		**EIU**	http://www.managementthinking.eiu.com/global-talent-index-2011-2015.html
R^2 = 0.135	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This index presents an outlook to 2015 for countries' talent development, attraction and retention potential. It gauges talent trends on two dimensions: at the international level through a benchmarking index of talent environments in 60 countries; and at the enterprise level, determining how executives view the outlook for their own firms' ability to attract and retain the people they will need. The index is based on data in seven categories: Demographics; Compulsory education; University education; Quality of the labour force; Talent environment; Openness and Proclivity to attracting talent.			
Human Capital		**EIU**	http://www.economistinsights.com/countries-trade-investment/analysis/hot-spots/
R^2 = 0.115	City Based	Public Sector Influence = Medium	Private Sector Influence = Medium
Human Capital is one of eight categories used in the Global City Competitiveness Index. It is made up of six sub-indices: population growth; working-age population; entrepreneurship and risk-taking mindset; quality of education; quality of healthcare and hiring of foreign nationals. It is an aggregate economic view of the human being acting within an economy. It looks at the combination of knowledge, creativity and personal attributes that are likely to contribute to economic performance—superior human resources are correlated with improved financial returns and increased shareholder value.			
Spatial Adjusted Liveability Index		**EIU**	http://pages.eiu.com/rs/eiu2/images/EIU_BestCities.pdf
R2 = 0.125	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This index examine spatial qualities such as the amount of green space and urban sprawl, the levels of pollution and cultural assets in concert with the categories used in the existing EIU Liveability index in order to incorporate spatial characteristics of the cities already present in the index. The initial liveability survey weighed up 30 factors, which broadly corresponded to five categories—including social stability, infrastructure, education and culture.			
Top Tourism Destinations		**Euromonitor Archive**	http://blog.euromonitor.com/2014/01/euromonitor-internationals-top-city-destinations-ranking.html
R^2 = 0.170	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This ranking of cities is comprised of the number of international arrivals over a year. It is estimated that around 80% of these arrivals are tourists but there is also an ever more important part – the MICE (Meetings, Incentives, Conventions and Exhibitions) travellers. International top tourist destinations have a powerful incentive to invest in travel infrastructure, hotels and convention centres and thus improve the overall quality of living and working there.			
Number of High Net Worth Individuals		**Capgemini**	http://www.uk.capgemini.com/thought-leadership/world-wealth-report-2013-from-capgemini-and-rbc-wealth-management
R2 = 0.161	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This factor represents the number of high net worth individuals per country as estimated by City Bank and Knight Frank's latest Wealth Report. There are two implications behind the presence of more high net worth individuals in a country: first there will be more demand for financial services as wealthy people will need private banking, asset management, insurance services, etc; second the country will be a relatively good place to live in.			

Reputational Factors

Instrumental Factor		Source	Website
City Global Appeal		**EIU**	http://www.economistinsights.com/countries-trade-investment/analysis/hot-spots/
R^2 = 0.153	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
Global Appeal is one of eight thematic categories which is used in the Global City Competitiveness Index. It is made up of five sub-indices: number of fortune 500 companies; frequency of international flights; number of international conferences and conventions; global leadership in higher education; and the number of globally renowned think-tanks (20%). This mix aims to gauge an indication of diversity, global attractiveness and civil society strength in each city—factors which add to a city's competitiveness.			
City Global Image		**KPMG**	http://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/Observatoire-des-Investissements-Internationaux-principales-metropoles-mondiales-2013.pdf
R^2 = 0.394	City Based	Public Sector Influence = High	Private Sector Influence = Medium
This measure is designed to compare and benchmark the present and future attractiveness of cities. To measure perceptions, the survey polls a representative sample of 512 companies in 25 countries, which have international business settlements. To measure reality, the survey measures the number of published international "greenfield" investments that took place in a particular city; a green-field investment occurs when a business launches a new activity in a particular location. Global City Image is part of the perceptions' survey – "Which 3 cities have the best overall image?" Number of Greenfield Investments is part of the objective data survey and measures the number of foreign green-field investments a made in a particular city.			
Foreign Direct Investment Inflows		**UNCTAD**	http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=P,5,27&sRF_Expanded=,P,5,27
R2 = 0.187	Country Based	Public Sector Influence = Medium	Private Sector Influence = Low
This factor measures the foreign direct investment inflows a country has received. Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest in and control by a resident entity in one economy (foreign direct investor or parent enterprise) of an enterprise resident in a different economy (FDI enterprise or affiliate enterprise or foreign affiliate). Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates. FDI inflows comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to a FDI enterprise, or capital received by a foreign direct investor from a FDI enterprise. FDI includes the three following components: equity capital, reinvested earnings and intra-company loans. Data on FDI flows are presented on net bases (capital transactions' credits less debits between direct investors and their foreign affiliates).			
GDP per Person Employed		**World Bank**	http://data.worldbank.org/indicator/SL.GDP.PCAP.EM.KD
R^2 = 0.087	Country Based	Public Sector Influence = Low	Private Sector Influence = Low
This measure by the World Bank uses GDP converted to 1990 constant international US dollars at PPP rates divided by total current employment in the economy. GDP per person employed is an important measure of a country's overall productivity. Higher productivity implies increased capital formation, higher living standards and lower probability of future inflation or tax hikes.			
Global Power City Index		**Institute for Urban Strategies & Mori Memorial Foundation**	http://www.mori-m-foundation.or.jp/english/index.shtml
R2 = 0.357	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This index is created by a panel of experts in urban planning and is intended to assess the comprehensive power of cities to attract creative people and excellent companies from around the world. The index is compiled from a function-specific factor (functional aspects of the cities), and an actor-specific factor (from the perspective of its citizens). For the function-specific measure, cities are ranked in six broad functions which represent the main strengths of a city: Economy; Research & Development; Cultural Interaction; Liveability; Ecology and Natural Environment and Accessibility. For the subjective actor-specific measure a range of evaluations were made from the perspectives of Managers, Researchers, Artists and Visitors.			
Global Cities Index		**AT Kearney**	http://www.atkearney.com/research-studies/global-cities-index
R^2 = 0.265	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This index measures the cities' international status and their influence on the rest of the world. The index ranks 66 cities according to 5 dimensions: Business activity, Human capital; Information exchange; Cultural experience and Political engagement.			

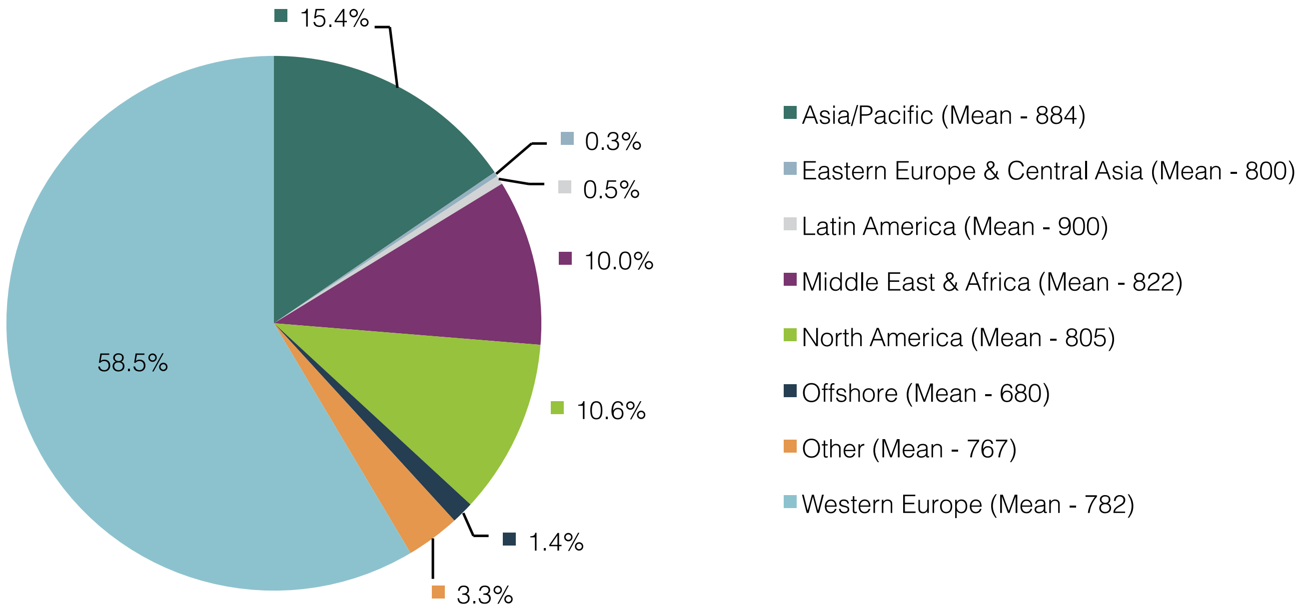
Global City Competitiveness		**EIU**	http://www.economistinsights.com/countries-trade-investment/analysis/hot-spots/
R2 = 0.368	City Based	Public Sector Influence = High	Private Sector Influence = Low
This index assesses 120 urban agglomerations around the world, comprising around 29% of the world's economy. Cities are rated on the basis of their demonstrated ability to attract capital, businesses, talent and visitors.' It is made up of 21 qualitative and 10 quantitative indicators grouped into eight categories: Institutional Effectiveness; Physical Capital; Global Appeal; Human Capital; Financial Maturity; Economic Strength; Environment & Natural Hazards and Social & Cultural Character.			
Global Competitiveness Index		**World Economic Forum**	http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm
R^2 = 0.295	Country Based	Public Sector Influence = Low	Private Sector Influence = Low
This index is derived from a combination of publicly available hard data and the results of the Executive Opinion Survey and ranks 144 countries, according to 12 broad indicators that the WEF refers to as the 12 pillars of competitiveness: Institutions; Infrastructure; Macroeconomic environment; Health and primary education; Higher education and training; Goods market efficiency; Labour market efficiency; Financial market sophistication; Technological readiness; Market size; Business sophistication and Innovation. The weightings on the pillars differ in accordance to a country's stage of development.			
Global Enabling Trade Report		**World Economic Forum**	http://www.weforum.org/issues/international-trade
R2 = 0.165	Country Based	Public Sector Influence = High	Private Sector Influence = Low
This index ranks 132 economies and measures the extent to which they have developed the institutions, policies, and services that facilitate free flow of goods over borders and to destination. The structure of this index comprises four sub-indices: Market access sub-index measures the extent to which the policy framework of a country welcomes foreign goods and enables access to foreign markets for its exporters. The border administration sub-index gauges the extent to which the administration at the border facilitates the entry and exit of goods. The transport and communications infrastructure sub-index assesses the country's transport and communications infrastructure. The business environment sub-index looks at the quality of governance and the overarching regulatory and security environment impacting the business of importers and exporters.			
Global Innovation Index		**INSEAD / WIPO**	http://www.globalinnovationindex.org/content.aspx?page=GII-Home
R^2 = 0.090	Country Based	Public Sector Influence = High	Private Sector Influence = Medium
This index gauges the innovation friendliness of 142 economies, which account for 99% of the world's Gross Domestic Product. It is constructed of two sub-indices, the Innovation Input Sub-Index and the Innovation Output Sub-Index, each built around composite measures (or pillars). Innovation Input is constructed of five pillars: Institutions; Human Capital, Infrastructure; Market sophistication and Business. Innovation Output assesses consists of two pillars: Scientific outputs and Creative outputs.			
Innovation Cities Global Index		**2thinknow Innovation Cities™ Project**	http://www.innovation-cities.com/
R2 = 0.198	City Based	Public Sector Influence = Low	Private Sector Influence = Low
This index uses 162 data points for each city, combined into 31 broader industry and community segments. Each of these segments is determined as a sector of an urban economy and thus a driver of jobs, community and economic activity. These are not however distinct economic sectors (e.g., like retail, automobile or telecommunication) but broader, more comprehensive measures that attempt to encompass every aspect of everyday life: Government & politics, Business, Logistics, Industry & manufacturing, Sports & fitness, Geography, Arts, Utilities, Environment, Fashion, Health, Education, etc.			
Number of International Fairs and Exhibitions		**World Economic Forum**	http://www.weforum.org/en/initiatives/gcp/TravelandTourismReport/CompetivenessIndex/index.htm
R^2 = 0.165	Country Based	Public Sector Influence = High	Private Sector Influence = High
This measures the fairs and exhibitions that were held within a country annually by taking the average for the period 2007-2009. It is a useful measure of a country's overall attractiveness and flow of (mainly) business travellers. A higher number of international events Has a 'spill-over' effect to the overall attractiveness and international image of a city. International events also justify investment in a city's development because they require adequate infrastructure which has a beneficial effect on every aspect of a city's life.			

Price Levels		**UBS**	http://www.ubs.com/1/e/wealthmanagement/wealth_management_research/prices_earnings.html
R^2 = 0.149	City Based	Public Sector Influence = Medium	Private Sector Influence = Low
This survey compares purchasing power in the world's major cities. It has three main measures – price levels and wage levels: The 'Price levels' measure ranks cities according to cost of living adjusted for exchange rates. It compares the prices of a standardised basket of goods and services, comprising 122 items based on a "common currency." The 'Wage levels' measure compares the earnings of workers across cities. It provides a gross wage comparison (used for GFCI) and a net wage comparison, using New York as the base city. The index covers 14 occupations that represent a cross section of the work force in the industrial and service sectors.			
World Competitiveness Scoreboard		**IMD**	http://www.imd.ch/research/publications/wcy/competitiveness_scoreboard.cfmue
R2 = 0.305	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This scoreboard ranks 59 economies into a competitiveness scoreboard based on 331 various criteria divided into 4 broad sub-groups: Economic Performance measures size, growth, wealth and forecasts for the domestic economy, international trade, international investment, employment and price levels; Government Efficiency measures business legislation in terms of openness, competition and labour regulations, the institutional framework, fiscal policy, public finance and societal framework; Business Efficiency reflects business productivity, efficiency, management practices, attitudes and values, financial management, bank and stock market efficiency as well as costs, relations and availability of skills in the labour market; Infrastructure measures basic, scientific and technological infrastructure as well as health, environment and education. A more detailed look into the index's constituent parts may help policymakers better understand where changes can be made to improve performance.			
FDI Confidence Index		**AT Kearney**	http://www.atkearney.com/research-studies/foreign-direct-investment-confidence-index
R^2 = 0.247	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This index is developed using data from an AT Kearney survey of senior executives. The respondents represent leading global corporations from 44 different countries spanning 17 industry sectors across all continents that together account for over 75% of global FDI flows. The index is a weighted average of the number of high medium and low responses to questions about the likelihood of direct investment in a market over the next three years. Heightened confidence in a country implies more inflow of capital and with it better economic prospects, financial stability and lower interest rates—all good news for the financial industry.			
Global Intellectual Property Index		**Taylor Wessing**	http://www.taylorwessing.com/ipindex/
R2 = 0.093	Country Based	Public Sector Influence = Medium	Private Sector Influence = Medium
This index, calculated by Z/Yen, measure the competitiveness of 36 jurisdictions in the areas of trademarks, patents, copyrights, designs and personal data. Within each of these areas, it examines the practicability of obtaining, exploiting, enforcing and attacking intellectual property.			

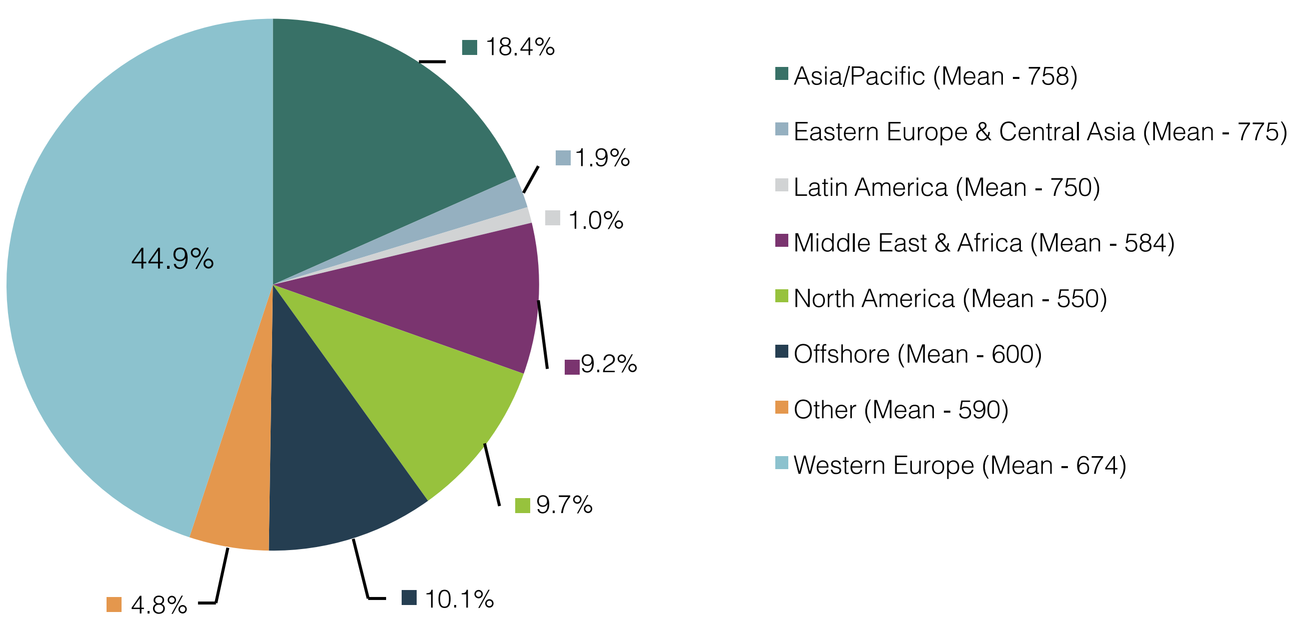
6.4 Appendix D – Group Respondent Profiles

With less than a third of the respondents of the next highest, and not formally part of GFCI, Nairobi's numbers have been omitted.

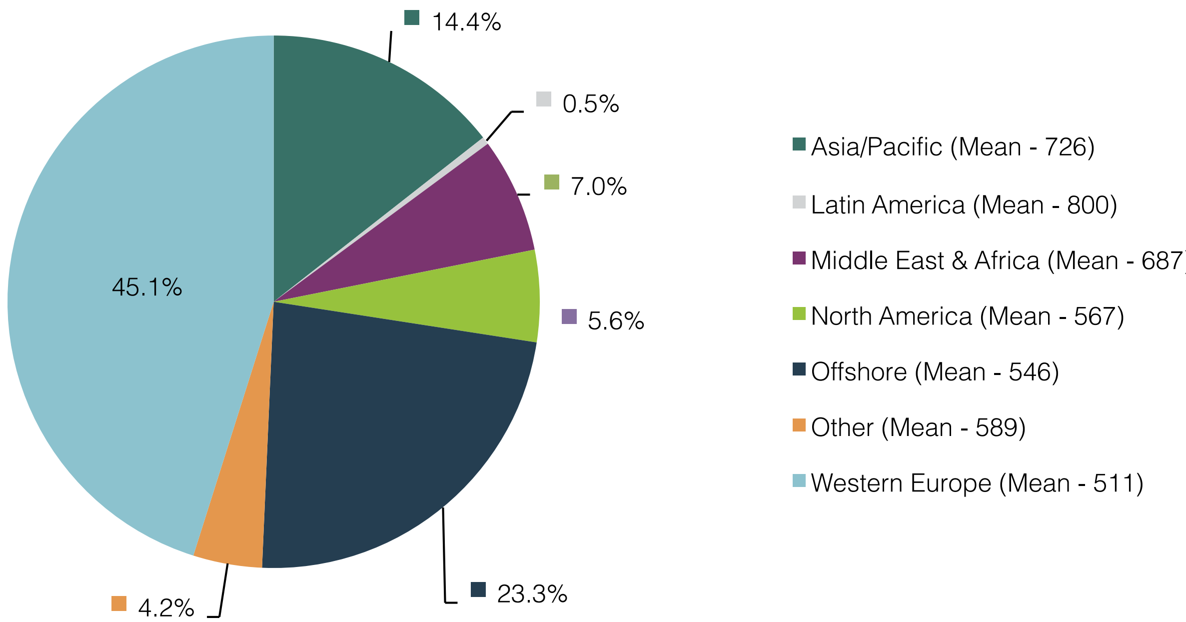
Casablanca



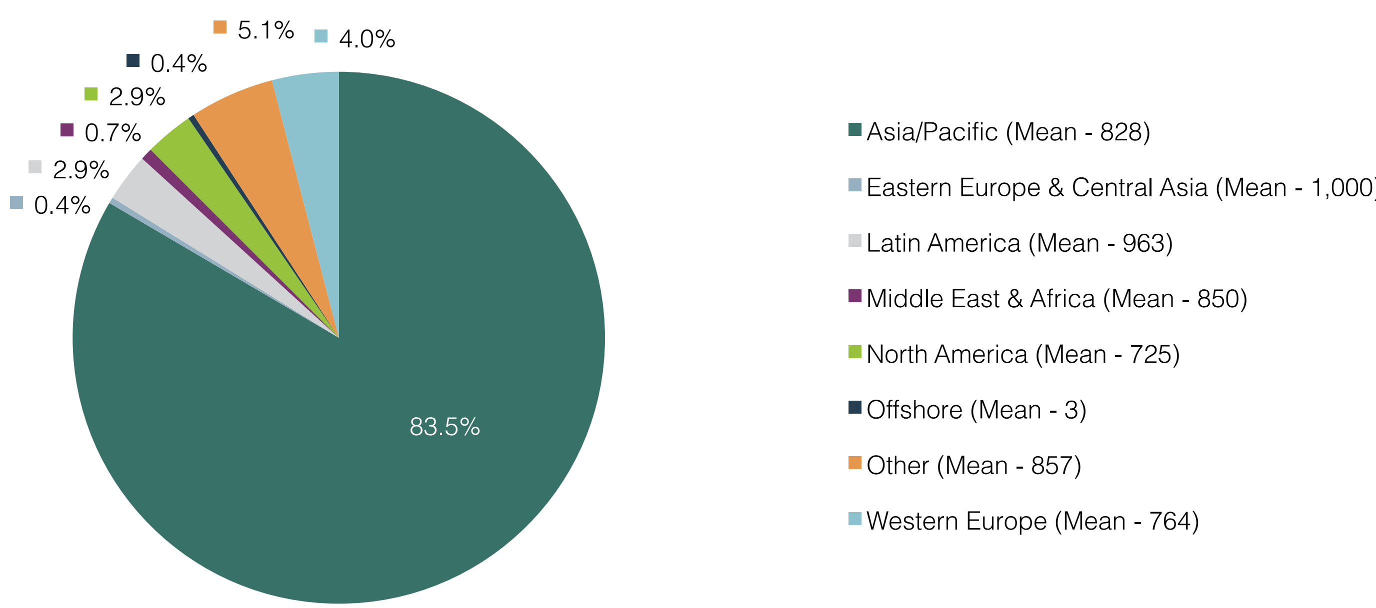
Johannesburg



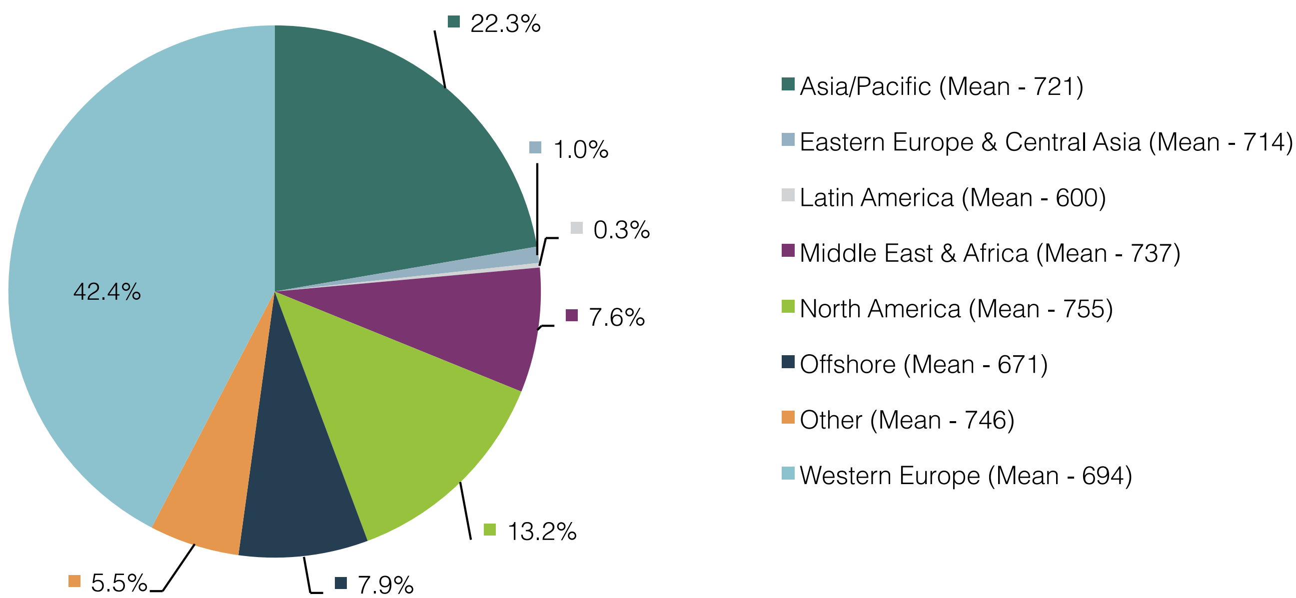
Port Louis



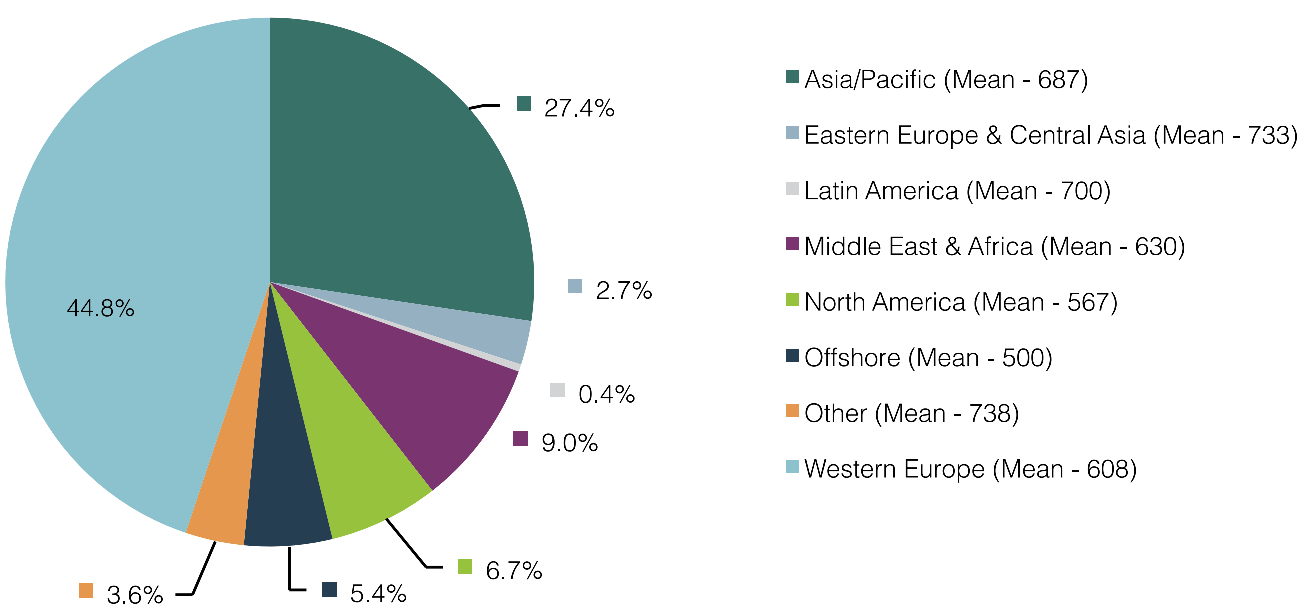
Busan



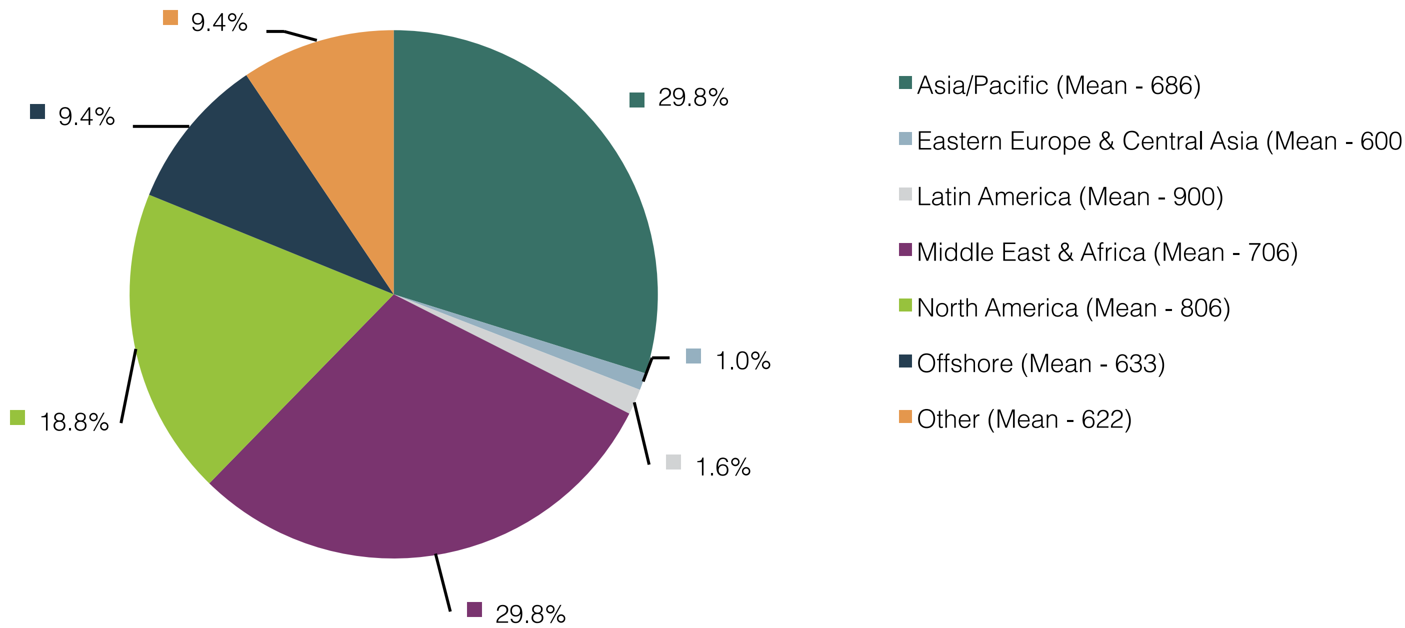
Dubai



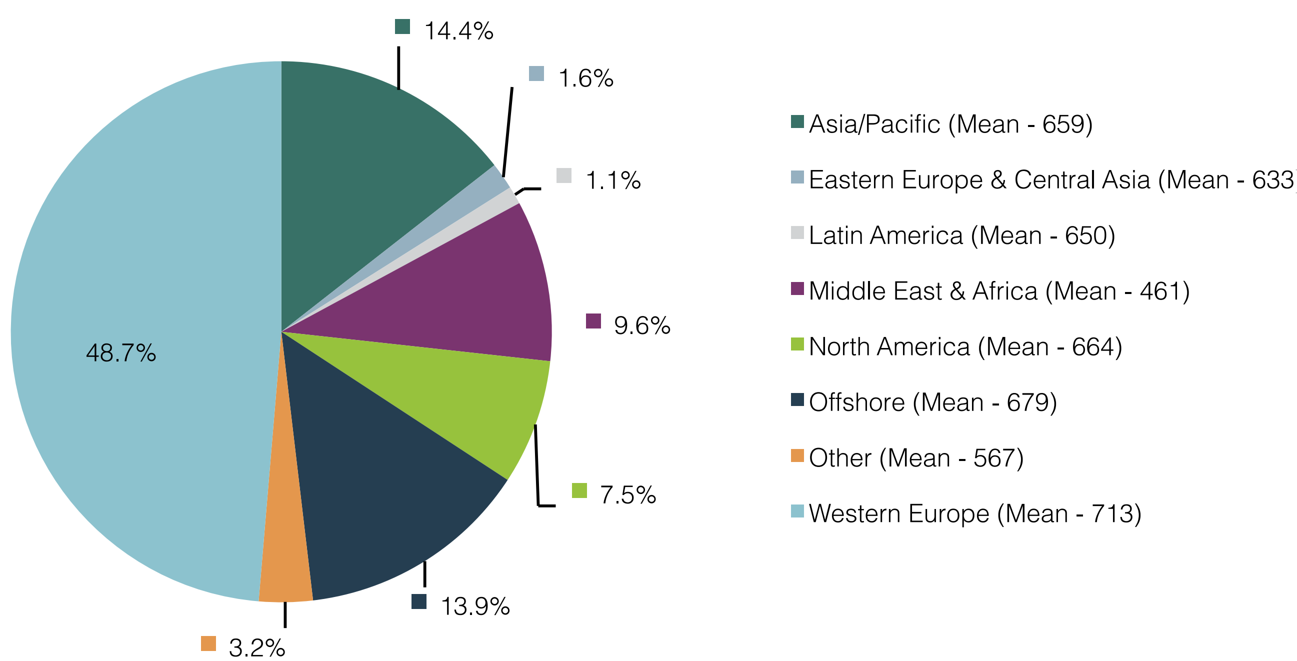
Istanbul



Doha



Tel Aviv



6.5 Appendix E – Country Summary

Overview

Country	GDP estimate (US$bn)	Population	$GDP/capita	Capital
Eastern Africa				
Burundi	3.037	8,500,000	357	Bujumbura
Comoros	0.722	727,000	993	Moroni
Djibouti	1.582	900,000	1,758	Djibouti
Eritrea	3.87	5,200,000	744	Asmara
Ethiopia	49.857	85,000,000	587	Addis Ababa
Kenya	62.722	40,000,000	1,568	Nairobi
Madagascar	11.188	20,100,000	557	Antananarivo
Malawi	4.408	15,400,000	286	Lilongwe
Mauritius	12.72	1,300,000	9,785	Port Louis
Mozambique	16.59	23,400,000	709	Maputo
Réunion	21.57	800,000	26,963	Saint-Denis
Rwanda	8.002	10,400,000	769	Kigali
Seychelles	1.473	100,000	14,730	Victoria
Somalia	5.9	9,400,000	628	Mogadishu
Tanzania	36.62	45,000,000	814	Dodoma, Dar es Salaam
Uganda	26.086	33,800,000	772	Kampala
Zambia	26.82	13,300,000	2,017	Lusaka
Zimbabwe	13.739	12,600,000	1,090	Harare
Central Africa				
Angola	131.407	19,000,000	6,916	Luanda
Cameroon	32.163	20,000,000	1,608	Yaoundé
Central African Republic	1.731	4,800,000	361	Bangui
Chad	15.841	11,500,000	1,377	N'Djamena
Congo, Rep. (Brazzaville)	14.7	3,900,000	3,769	Brazzaville
Congo, Dem. Rep. (Kinshasa)	32.665	67,800,000	482	Kinshasa
Equatorial Guinea	15.396	700,000	21,994	Malabo
Gabon	20.675	1,500,000	13,783	Libreville
São Tomé and Príncipe	0.362	200,000	1,810	São Tomé
Northern Africa				
Algeria	227.802	36,000,000	6,328	Algiers
Egypt	284.86	80,400,000	3,543	Cairo
Libya	49.341	6,500,000	7,591	Tripoli
Morocco	112.552	31,900,000	3,528	Rabat
South Sudan	11.893	9,000,000	1,321	Juba
Sudan	70.03	36,000,000	1,945	Khartoum
Tunisia	49.122	10,500,000	4,678	Tunis
Western Sahara	0.9	500,000	1,800	(El Aaiún)
Southern Africa				

Botswana	16.304	1,800,000	9,058	Gaborone
Lesotho	2.458	1,900,000	1,294	Maseru
Namibia	11.982	2,200,000	5,446	Windhoek
South Africa	341.216	49,900,000	6,838	Pretoria, Bloemfontein, Cape Town
Swaziland	3.842	1,200,000	3,202	Mbabane, Lobamba
Western Africa				
Benin	9.237	9,800,000	943	Porto-Novo, Cotonou
Burkina Faso	13.382	16,200,000	826	Ouagadougou
Cape Verde	1.975	500,000	3,950	Praia
Côte d'Ivoire (Ivory Coast)	33.963	22,000,000	1,544	Yamoussoukro, Abidjan
Gambia, The	0.918	1,800,000	510	Banjul
Ghana	35.475	24,000,000	1,478	Accra
Guinea	6.77	10,800,000	627	Conakry
Guinea-Bissau	1.04	1,600,000	650	Bissau
Liberia	2.073	4,100,000	506	Monrovia
Mali	10.94	15,200,000	720	Bamako
Mauritania	4.286	3,400,000	1,261	Nouakchott
Niger	8.29	15,900,000	521	Niamey
Nigeria	594.257	158,300,000	3,754	Abuja
Saint Helena	0.03	6,000	5,000	Jamestown
Senegal	15.881	12,500,000	1,270	Dakar
Sierra Leone	5.411	5,800,000	933	Freetown
Togo	4.838	6,800,000	711	Lomé

Sorted by $GDP/capita

Country	GDP estimate (US$bn)	Population	$GDP/capita	Capital	GFCI African Rank
Malawi	4.408	15,400,000	286	Lilongwe	
Burundi	3.037	8,500,000	357	Bujumbura	
Central African Republic	1.731	4,800,000	361	Bangui	
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Guinea	6.77	10,800,000	627	Conakry	
Somalia	5.9	9,400,000	628	Mogadishu	
Guinea-Bissau	1.04	1,600,000	650	Bissau	
Mozambique	16.59	23,400,000	709	Maputo	
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Mauritania	4.286	3,400,000	1,261	Nouakchott	
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Lesotho	2.458	1,900,000	1,294	Maseru	
South Sudan	11.893	9,000,000	1,321	Juba	
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Ghana	35.475	24,000,000	1,478	Accra	
Côte d'Ivoire (Ivory Coast)	33.963	22,000,000	1,544	Yamoussoukro, Abidjan	
Kenya	62.722	40,000,000	1,568	Nairobi	4
Cameroon	32.163	20,000,000	1,608	Yaoundé	
Djibouti	1.582	900,000	1,758	Djibouti	
Western Sahara	0.9	500,000	1,800	(El Aaiún)	
São Tomé and Príncipe	0.362	200,000	1,810	São Tomé	
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Swaziland	3.842	1,200,000	3,202	Mbabane, Lobamba	
Morocco	112.552	31,900,000	3,528	Rabat	2
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Nigeria	594.257	158,300,000	3,754	Abuja	
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Tunisia	49.122	10,500,000	4,678	Tunis	
Saint Helena	0.03	6,000	5,000	Jamestown	
Namibia	11.982	2,200,000	5,446	Windhoek	
Algeria	227.802	36,000,000	6,328	Algiers	
South Africa	341.216	49,900,000	6,838	Pretoria, Bloemfontein, Cape Town	1
Angola	131.407	19,000,000	6,916	Luanda	
Libya	49.341	6,500,000	7,591	Tripoli	
Botswana	16.304	1,800,000	9,058	Gaborone	
Mauritius	12.72	1,300,000	9,785	Port Louis	3
Gabon	20.675	1,500,000	13,783	Libreville	
Seychelles	1.473	100,000	14,730	Victoria	
Equatorial Guinea	15.396	700,000	21,994	Malabo	
Réunion	21.57	800,000	26,963	Saint-Denis	

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