

# **Conducting Due Diligence in Africa**

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## **SUMMARY**

*Africa's abundant natural resources have long been a temptation for foreign investors but the combination of political instability, lack of regulatory certainty, corruption and nightmarish red tape has traditionally acted as a pretty convincing deterrent. However times are changing and increasingly mining and petroleum investors are looking to Africa as the source of the next big resources boom.*

*Before diving into Africa's seemingly infinite wealth however, cautious investors should ensure that their due diligence process incorporates considerations particular to the region. Using the specific examples of Angola, Cameroon and Cote d'Ivoire, this paper touches on the practical and logistical obstacles that may be faced by a foreign investor when dealing in Africa's developing countries. This paper then explores some of the more specific concerns that investment in Africa raises, including the legal systems of the relevant country, taking into account the different requirements of a civil law system, the political regime and regulatory requirements and the economic pitfalls that could render a potentially prosperous project unviable.*

## **INTRODUCTION**

In 2006, Australian-based companies were the third largest exploration investors in Africa, spending approximately \$160 million.<sup>1</sup> What international investors are beginning to realise, however, is that Africa cannot be treated as a single entity. Each of the continent's 54 countries has different investment opportunities, infrastructure and levels of political and economic stability. Therein lies the importance of thorough due diligence.

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<sup>1</sup> Kevin Skinner, "Africa's resources sector thrives as political, economic stability improves" *Mining Weekly Online*, 7 September 2007 available at [http://www.miningweekly.co.za/article.php?a\\_id=116433](http://www.miningweekly.co.za/article.php?a_id=116433)

This paper focuses on the specific issues which may arise in the course of a mineral or petroleum development in Africa and the attention that should be given to those issues at the due diligence stage of the project. Using the case examples of Angola, Cameroon and Cote d'Ivoire, we examine the practical, legal, political and economic considerations that a prospective foreign investor should be alert to in Africa and provide an indication as to the path that these particular obstacles seem destined to take in the future.

## PRACTICAL CONSIDERATIONS

The risk evaluation process undertaken during due diligence can be surprisingly complicated even before investigation of the companies involved or the project itself begins. Due diligence in Africa brings with it a number of practical considerations which, although not necessarily unique to the region, are magnified by the diverse political history and regulatory processes in place. For Africa as a whole, there is the challenge of a relative dearth of information, a variety of language barriers and increased complexity of searches.

### **Availability of Information**

It has been observed that the biggest challenge to doing business in Africa is the lack of quality information about Africa.<sup>2</sup> The combination of inadequate information technology infrastructure, unskilled professionals, political instability and a previous lack of interest have meant that the quantity of information regarding Africa's regulatory approvals process, available resources and general country statistics is limited.

This lack of information not only makes life difficult for foreign investors but a lack of documented information on companies in West African countries is thought to have contributed to the slow pace of business development in the sub-region: "Moreover, lack of proper documentation on corporate bodies operating in West Africa makes people unaware of the business opportunities inherent in the region."<sup>3</sup>

For a conscientious due diligence undertaker, this can be an enormous hurdle. Short of travelling to the region personally, companies are extremely reliant on the information published by government agencies, industry groups and regulatory authorities. When this information is unavailable or unreliable, the task of conducting a thorough due diligence on both the project and the country becomes considerably more complicated.

<sup>2</sup> "Overview of Africa" *MBendi Information for Africa*, accessed on 19 September 2007 available at <http://www.mbendi.co.za/land/af/p0005.htm>.

<sup>3</sup> Sulaiman Adenekan, "Lack of Information Impedes Development" *Punch on the Web*, 17 September 2007 available at <http://www.punchng.com/Articl.aspx?theartic=Art20070917255254>.

## Language

There are an estimated 2000 languages spoken in Africa,<sup>4</sup> ranging from Portuguese in Angola, Arabic in Mauritania and Swahili in Tanzania. Although English is the official language of some African countries (including Namibia, Zambia and South Africa<sup>5</sup>), the most commonly spoken language is French. Francophone Africa is made up of 29 countries.<sup>6</sup>

Although language barriers are obviously not unique to African projects, the variety of African languages means that the potential that a company will be investigating a project in a language, or several languages, that are not its native ones is extremely high. This complicates matters not only by limiting the research information available to them but also because the majority, if not all, of the material contracts and corporate information will be in a foreign language. Consideration should be given to how these documents are going to be translated and how the ongoing communications between the company looking to invest and the project operators and other shareholders are going to be managed.

## Complexity of Searches

Language may also prove a burden in Africa when it comes to communicating with the regulatory authorities who need to approve various aspects of a mineral and petroleum project. In addition, the lack of information about the processes and procedures that a particular authority requires to be followed can prove time consuming. Even determining which government agency has control over a particular industry can be difficult, especially when the country has been ravaged by civil war, keeping foreign investment and the need for regulatory authority to have well established processes in place to a minimum.

Searches of registries, such as those set up to identify title holders, encumbrances over those titles and environmental restrictions and litigation searches can also prove difficult.

## Engaging Local Lawyers

One mechanism for mitigating the above factors is the engagement of African lawyers. Most African countries now contain reputable full service law firms that will have capacity to communicate with foreign companies in English. Local lawyers will usually be specialised in doing business in the particular country.

<sup>4</sup> "Languages of Africa" *Wikipedia*, accessed on 19 September 2007, available at [http://en.wikipedia.org/wiki/African\\_languages](http://en.wikipedia.org/wiki/African_languages).

<sup>5</sup> Note that South Africa has 11 official languages: English, Afrikaans, IsiNdebele, IsiXhosa, IsiZulu, Northern Sotho, Sesotho, Setswana, SiSwati, Tshivenda and Xitsonga.

<sup>6</sup> Lisa Jokivirta, "Foreign Higher Education Activity in Francophone Africa" *World Education News and Reviews*, April 2006, Vol 19, Issue 2 available at <http://www.wes.org/ewenr/06apr/feature.htm>.

Alternatively, finding local partners, or forming a joint venture with a local company often facilitates the process of exploration and production of a mineral and production project in Africa. In Angola, foreign investors are often encouraged, or even pressured, to form joint ventures with local Angolan partners. Additionally, finding a local partner, well known to the government often facilitates the process of learning about business opportunities in the country and can help circumvent any restrictions on foreign investment that the country may prescribe.

Regardless of the engagement of local lawyers or not, be prepared for the due diligence process, and consequently project start up, to take longer and cost more in Africa than in other regions.

## LEGAL CONSIDERATIONS

Whilst the legal systems of each specific African nation, as a result of colonisation, political instability and indigenous influences, are quite different there are two legal considerations that a foreign investor looking to Africa should consider. The first is that civil law<sup>7</sup> is the predominant system of law in Africa. Insufficient knowledge of the legal nature or characteristics of mining requirements in a civil law country can be the source of difficulties which can sometimes have dramatic effects. The second concern is the effect that OHADA, the French acronym for the Organisation for Harmonisation in Africa of Business Laws,<sup>8</sup> has, or could have on an African resources project.

### Investing in Civil Law Countries

In civil law countries, legislation is seen as the primary source of law and courts base their judgments on the provisions of codes and statutes, from which solutions in particular cases are derived. Courts therefore have to reason extensively on the basis of general rules and principles of the code, often drawing analogies from statutory provisions to fill in the gaps and to achieve coherence. By contrast, in the common law system, cases are the primary source of law, while statutes are seen as incursions into the common law and thus interpreted narrowly.

This distinction becomes important in a resources due diligence context as under a common law system, it is extremely important to focus on the drafting of the mining agreement (or other side agreements) in which most of the “life” of the mining rights will be set out, such as the renewal, pledging, transfer, etc of rights and obligations in the mining agreement. In a civil law driven jurisdiction however, it is the administrative legal written procedure for the granting of mining titles that sets out the mining rights and it is essential to ensure that the written rules contained in the *Mining Code* relating to the mining titles are fully respected.

<sup>7</sup> Also known as Continental law or Romano-Germanic law.

<sup>8</sup> *Organisation pour l'Harmonisation du Droit des Affaires en Afrique.*

In the predominantly civil law jurisdiction of Cameroon (note that Cameroon has a dual civil law/common law tradition due to its split colonial heritage) a mining title is not a contractual right which may be dealt with freely in any kind of contract. Instead, it is a unilateral administrative right (such as an exploration permit) governed by the *Mining Code*<sup>9</sup> and completed by its implementation decree<sup>10</sup> and is always subject to the State's control.

It is vital to understand that in civil law countries the respect of the principle of legal hierarchy is fundamental to the validity and enforceability of a project. In increasing order of seniority, each of the following must be in conformity with the one above: Orders, Decrees, Laws, Treaties and the Constitution. Therefore, the provisions of a signed mining agreement will only be valid to the extent that they comply with applicable decrees, laws, treaties, and the Constitution at the time of execution.

The purely administrative nature of a mining title and the related control by the State means that nothing can be done in regards to a mining title without the State's prior authorisation or, at the very least, without first notifying the State. This applies not only to the transfer of the title and other acts of disposal but also when there is a change in the constitutional documentation of the company holding the mining title, of its directors, or other events which may affect the "management" of the rights which derive from such mining title.

Too often, a mining company originating from a common law country seeks to transfer or otherwise grant rights over their mining rights through a contract, without taking into account the restrictive conditions provided by applicable written legislation, and such transfers are often unenforceable in the country of the project. Due to the dual legal nature of Mining Titles (as both an administrative right and "property"), their transfer in a civil law jurisdiction may not be done through contractual arrangements between the parties alone, but is also subject to prior approval by the State.<sup>11</sup>

When a mining agreement has not been drafted to take all the peculiarities of the civil law system of the country of the mining project into account and contains provisions in respect of the mining rights that fall within the exclusive jurisdiction of the applicable legislation (defining the Mining Title) which cannot therefore be agreed by contract (mining agreement in civil law country), major difficulties can arise.

## **Organisation for Harmonisation in Africa of Business Laws**

On 17 October 1993, 16 West African States<sup>12</sup> signed a treaty known as OHADA. The main objective of this treaty was to remedy the legal and judicial insecurity that

<sup>9</sup> Enacted by the law No 001-2001 of 16 April 2001.

<sup>10</sup> N° 2002/648 PM of 26 March 2002.

<sup>11</sup> Article 27 (1) of the Decree.

<sup>12</sup> The 16 signatories were Benin, Burkina Faso, Cameroon, the Central African Republic, the Comoros, Congo-Brazzaville, Cote d'Ivoire, Gabon, Guinea, Guinea Bissau, Equatorial Guinea, Mali, Niger, Senegal, Chad and Togo.

prevails in the contracting states by modernising and harmonising business law in those member states. The additional objectives of the Treaty are to:

- (a) put common rules that are simple and adapted to the economic situation at the disposal of each State;
- (b) promote arbitration as a speedy and discreet instrument for settling commercial disputes;
- (c) improve the training of judges and auxiliary officers of justice; and
- (d) encourage the setting up of an African Economic Community.

The Treaty consists of two main components. The first of these is the enabling section which provides for the setting up of institutions charged with the realisation of the terms of the Treaty.<sup>13</sup> The second provides for the so-called “Uniform Acts” to be adopted. These Uniform Acts are directly applicable and obligatory in contracting states, notwithstanding any contrary provisions of a previous or subsequent internal law.

The first laws passed under the Treaty came into force in 1998<sup>14</sup> and to date, eight Uniform Acts have been passed, including those relating to General Commercial Law, Organising Securities and Commercial Companies and Economic Interest Groups. The Treaty also makes provision for the referral of any contract litigation in which the parties apply an arbitration clause to the court if any of the parties is based in a contracting state or the contract is to be enforced partially or in its entirety in a contracting state.

Due diligence investigations should take into account the effect that these Uniform Acts could have on a potential project. For example, Cameroon applies the OHADA Uniform Act relating to commercial companies and economic interest groups, the provisions of which are in fact directly enforceable in the Cameroonian internal law order. The Uniform Act regulates every detail of the company law regime enforceable in the contracting states and, in particular, the creation of a commercial company, its functioning, the civil liability of company executives, the legal links between companies, their transformation, mergers, scission, transfers of assets and their dissolution or liquidation. It also contains special provisions which apply to all companies in regard to their specific form.

## POLITICAL CONSIDERATIONS

The long term and capital intensive nature of international mineral and petroleum investments increases the vulnerability of the foreign investor to the

<sup>13</sup> Sharif A Touray, “The OHADA Treaty: Recent Developments Will Spur African Investment and Project Financings”, *FindLaw* 1999, available at <http://library.findlaw.com/1999/Jul/1/130357.html>.

<sup>14</sup> Alec Werner, “Harmonisation of company law: The West African experience” *Managing Partner*, 14 March 2006 available at [http://www.mpmagazine.com/display.asp?articleid=D0128CE7-DA17-44F8-9049-5DD015BCA669&eTitle=South\\_Africa\\_country\\_report\\_Harmonisation\\_of\\_company\\_law](http://www.mpmagazine.com/display.asp?articleid=D0128CE7-DA17-44F8-9049-5DD015BCA669&eTitle=South_Africa_country_report_Harmonisation_of_company_law).

political nuances of the host country. Africa's combination of political instability, lack of regulatory certainty, corruption and red tape magnifies this vulnerability, exposing potential investors to considerable risk. Thorough due diligence should therefore include a comprehensive investigation into both the political stability and the internal political procedures of the relevant country.

## Political Stability

Political stability is essential to minimising project risk and encouraging foreign investment. In the case of Africa however, this is easier said than done. Political repression, electoral fraud, virulent ethnic nationalism, religious fundamentalism, civil unrest, armed conflict and the proliferation of illicit arms have all contributed to make Africa the least politically stable place on Earth.<sup>15</sup>

Cote d'Ivoire, for example, which was formerly seen as a haven of peace and economic stability in volatile West Africa, was plunged into civil war in 2002, lasting until the signing of a peace agreement in Pretoria on 6 April 2005. Presidential and general elections were scheduled for October 2006 but were postponed when neither of the two prerequisites to an election, the disarmament of combatants and a population census, were satisfied. On 1 November 2006, the UN Security Council passed a resolution extending the current President's mandate for a final 12 months.<sup>16</sup> Although a peace agreement was signed on 4 March 2007 and has the support of the UN Security Council, the security situation remains fragile.<sup>17</sup>

A lack of political stability can impact on all areas of a potential mineral or petroleum project. On the lower end of the spectrum, a change in government – especially if it is an acrimonious change – could lead to delays in regulatory approvals or the unenforceability of project contracts. In more extreme circumstances, such as a coup or an outbreak of civil war, the entire project as well as the safety of the proponents involved could be in jeopardy.

Some commentators have observed that the political changes in South Africa are starting to create a ripple of peace and democracy throughout the region<sup>18</sup> and that this greater stability is contributing to the continent's resources boom. The number of African democracies has jumped from just four in 1990 to 17 in 2007

<sup>15</sup> Okechukwu Emeh, "Africa and the Crisis of Instability" *Global Policy Forum*, 30 March 2004 available at

<http://www.globalpolicy.org/nations/sovereign/failed/2004/0330crisis.htm>.

<sup>16</sup> "Cote d'Ivoire Background" *Energy Information Administration*, available at

[http://www.eia.doe.gov/emeu/cabs/Cote\\_dIvoire/Background.html](http://www.eia.doe.gov/emeu/cabs/Cote_dIvoire/Background.html).

<sup>17</sup> "Excessive bureaucracy in Africa contributing to poverty and unemployment" *BBC Trade Law Centre*, 9 September 2004, available at

<http://www.tralac.org/scripts/content.php?id=2893>.

<sup>18</sup> Okechukwu Emeh, "Africa and the Crisis of Instability" *Global Policy Forum*, 30 March 2004 available at

<http://www.globalpolicy.org/nations/sovereign/failed/2004/0330crisis.htm>.

and a recent World Bank ranking noted that at least 13 countries had significantly improved their stability ratings by last year compared to their standing in 1996.<sup>19</sup>

The fundamental issue for foreign investors going forward will be whether Africa's political system, following the upheavals of recent years, will provide for the enduring stability so critical for investor confidence and further economic development.

## Transparency of Regulatory System and Corruption

The abundance of natural resources, a history of autocratic, unaccountable government and conflict and crisis throughout the continent have posed particular challenges to transparent governance in Africa to the point that several countries have become virtually synonymous with corruption.

The institutions that are intended to provide checks and balances within the system are generally under-resourced and lack independence. The prospects for systematic reforms which could counter corruption vary considerably among African countries. Unfortunately, in most of the region,<sup>20</sup> governments are either unwilling or unable to address corruption effectively, and progress is slow even in those countries where the political will to reform exists. In addition, the level of development and organisation of civil society also varies considerably.<sup>21</sup>

Cote d'Ivoire is one of the worst offenders. Transparency International's 2007 "corruption perception index" has ranked Côte d'Ivoire 154th of 180 countries and many foreign companies view corruption as an insurmountable obstacle to investment in Côte d'Ivoire.<sup>22</sup> Corruption has the greatest impact on judicial proceedings, contract awards, customs, and tax issues. Most applications to regulatory authorities carry a supplemental "commission", the size of which varies with the cost of the approval being sought. If the commission is refused, the application is not processed. Some United States investors have raised specific concerns about the rule of law and the Government's ability to provide equal protection under the law.<sup>23</sup>

<sup>19</sup> Kevin Skinner, "Africa's resources sector thrives as political, economic stability improves" *Mining Weekly Online*, 7 September 2007 available at [http://www.miningweekly.co.za/article.php?a\\_id=116433](http://www.miningweekly.co.za/article.php?a_id=116433).

<sup>20</sup> Note, however, that in Transparency International's most recent survey, Botswana is rated less corrupt than Italy or Greece

<sup>21</sup> "Africa and the Middle East – Sub-Saharan Africa" *Transparency International*, accessed on 19 September 2007 available at [http://www.transparency.org/regional\\_pages/africa\\_middle\\_east/about/africa](http://www.transparency.org/regional_pages/africa_middle_east/about/africa).

<sup>22</sup> Côte d'Ivoire signed the UN Anti-Corruption Convention on December 10, 2003 but has not yet ratified it. Côte d'Ivoire is not a signatory to the OECD Convention on Combating Bribery. Neither Transparency International, nor any regional or local non-governmental "watchdog" organization operates in Côte d'Ivoire.

<sup>23</sup> A poor record in enforcing the rule of law was one reason cited for the country's loss of eligibility for benefits under the African Growth and Opportunity Act at the end of 2004.



In addition, sporadic unrest in the country has led to an increase in the number of police, military and gendarme checkpoints on the roads, and consequently an increase in the solicitation of bribes at these checkpoints.<sup>24</sup> Transport companies have been particularly hard hit. Trucks moving cargo from the western agricultural belt to the rebel-controlled Northern region pay a total of US\$100 to US\$400 at the various checkpoints they must pass through, depending on the cargo.<sup>25</sup>

Corruption is, in the majority of cases, merely an annoyance for foreign mineral and petroleum investors. Regulatory approvals can be more expensive and time consuming than anticipated and a lack of transparency can hinder project development. However, corruption has the potential to undermine potential projects altogether, especially in the case of undisclosed agreements with, or commitments to, third parties.

### **Enforcement of Dispute Resolution Mechanisms**

Difficulty in resolving commercial disputes, particularly the enforcement of contractual rights against government, remains one of the serious obstacles to investment in Africa. The enforcement of judicial decisions is often slow and fraught with administrative and legal bottlenecks. In Angola, for example, litigants wait an average of three years before a ruling is obtained and a contract can be enforced.<sup>26</sup>

In some countries, judges sometimes fail to base their decisions on the legal or contractual merits of the case and tend to rule against foreign investors in favour of entrenched interests. It is widely believed that magistrates are subject to political or financial influence on occasion. Some investors stipulate in contracts that disputes must be settled in the international commercial arbitration court in Paris or the Hague. However, even if stipulated in the contract, international or regional arbitration decisions are sometimes not honoured by local courts.

Most African states are members of the International Centre for the Settlement of Investment Disputes (ICSID)<sup>27</sup> which provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Once the parties have consented to arbitration under the ICSID, neither can unilaterally withdraw its consent and all ICSID Contracting States, whether or not parties to the dispute, are required to recognise and enforce ICSID arbitral awards. However, recourse to ICSID

<sup>24</sup> Extracted from the "Côte d'Ivoire Country Review 2007", *CountryWatch Incorporated*, p 1, 2 p. Business Source Premier database available from <http://www.countrywatch.com>.

<sup>25</sup> For more information see the US Department of State 2007 Investment Climate Statement 2007 for Côte d'Ivoire available at <http://www.state.gov/e/eeb/ifd/2007/80692.htm>.

<sup>26</sup> "Excessive bureaucracy in Africa contributing to poverty and unemployment" BBC, *Trade Law Centre for Southern Africa*, 9 September 2004 available at <http://www.tralac.org/scripts/content.php?id=2893>.

<sup>27</sup> ICSID was established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States which came into force on October 14, 1966.

conciliation and arbitration is entirely voluntary and in the event of a recalcitrant State, there are limited options for a foreign investor.

In addition, many African states are parties to the Washington Convention,<sup>28</sup> which provides facilities for the conciliation and arbitration of investment disputes between member countries and individual investors and/or the New York Convention,<sup>29</sup> which applies to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought. Again, however, recourse to these Conventions is largely optional.

Many African nations recognise the potential deterrent of such a slow and unjust dispute resolution mechanism. The Ivorian Government, for example, is attempting to speed up its judicial system through computerisation and swift publication of decisions and to ensure impartiality by having more cases decided by three-judge panels instead of by a single judge.

Potential investors in Africa need to appreciate the significance that a delayed and/or biased judicial result can have on a project. The resolution of a construction dispute, for example, can hold up construction of essential infrastructure and delay the project by months or even years.

## **Bureaucracy**

One of the most baffling, and the most frustrating, aspects of exploring mineral and petroleum rights in Africa is the sheer quantity of bureaucracy or red tape that a prospective project proponent needs to wade through, from the exploration permit application phase right through to the infrastructure and export phase.

According to a 2004 World Bank report, four-fifths of the most difficult countries in the world in which to do business are located within Africa. Not only does this draw accusations against African governments of perpetuating poverty and restricting business by overwhelming them with a web of regulations, but it means that companies cannot afford to underestimate the time and cost that wading through the regulatory maze could cost them.

Although commentators believe efforts have been made by governments to make it easier for companies to navigate bureaucracy, sensitive areas remain.<sup>30</sup> In Mozambique, for example, it takes 153 days or about five months to register a firm, while in Chad the time increases slightly to 155 days.<sup>31</sup> Nigeria has the

<sup>28</sup> *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*. For more information see <http://www.worldbank.org/icsid/>.

<sup>29</sup> *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*. For more information see [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html).

<sup>30</sup> Jonathan Faurie, "The new scramble for Africa" *Mining Weekly Online*, 13 July 2007 available at [http://www.miningweekly.co.za/article.php?a\\_id=111707](http://www.miningweekly.co.za/article.php?a_id=111707).

<sup>31</sup> "Excessive bureaucracy in Africa contributing to poverty and unemployment" BBC, *Trade Law Centre for Southern Africa*, 9 September 2004 available at <http://www.tralac.org/scripts/content.php?id=2893>.

dubious distinction of requiring 21 procedures to be complied with before a firm can begin business, while Chad is only marginally better with 19 procedures needing to be completed.<sup>32</sup>

From a due diligence perspective, there is not too much that can be done about the bureaucratic hoops that foreign investors are required to jump through as it's not usually a significant enough deterrent to dissuade investors altogether. The frustration can be minimised somewhat through comprehensive knowledge of the system in place, and this may be facilitated through the engagement of a local lawyers and/or a local consulting firm.

## ECONOMIC CONSIDERATIONS

Although poor governance might be one of the first obstacles to investment in Africa that springs to mind, private sector participants often point to inadequate infrastructure, especially in the transport and energy sectors, as a major bottleneck: "When machines cannot be powered and products cannot get to market, pro-business reforms are unlikely to succeed."<sup>33</sup>

In addition to the practical, legal and political impacts to be considered when investing in an African country, there are a certain number of economic factors which will determine whether or not the project will be viable. These economic factors can be broadly categorised into two types: firstly, the economic regime of the relevant country, which includes any restrictions on foreign investment, the tax system in place and the potential for inflation or fluctuating currencies, and secondly, the infrastructure available for the project.

### Restrictions on Foreign Investment

Most African countries, recognising the difficulties in attracting investment to Africa and the potential ripple effect that investment will have for the wider community, officially welcome foreign investment. This means that there are rarely any harsh financial burdens placed on foreign companies in comparison to local investors.

Angola, for example, has designated the National Private Investment Agency to assist investors and facilitate new investment. Angola's Basic Law for Private Investment lays out the general parameters, benefits, and obligations for foreign investment in Angola, and recognises that investment plays a vital role in the country's economic development. It encourages domestic and foreign investment by providing equal treatment, offering fiscal and custom incentives, simplifying the investment application process and lowering the required investment capital.

<sup>32</sup> Ibid.

<sup>33</sup> "Profitable investment in Africa now easier", *AFROL News*, 26 September 2007 available at <http://www.afrol.com/articles/18933>.

However, most countries have some level of restriction on the types of investments that they will allow foreign corporations to make. These restrictions are generally more for the benefit of local industry and communities rather than a means of exploiting foreign investors. The Promotion of Angolan Private Entrepreneurs Law adopted in July 2003, for example, gives Angolan-owned companies preferential treatment in tendering for goods, services and public works contracts and Angolan companies or other companies familiar with the bureaucratic and legal complexities of the business environment often hold an advantage.

Most African countries are also looking for increasing levels of reciprocity. In recognition of the enormous value of their resources, countries are now expecting companies to make an undertaking that they will contribute as much as they are taking out. This contribution usually comes in the form of infrastructure development and community involvement.<sup>34</sup>

## Tax

Recently, a seminar was convened between African policy-makers, international investors and International Monetary Fund staff to discuss how the growth in investments in Africa could be accelerated. They noted that:

“evidence indicates that cumbersome tax systems sometimes coupled with corrupt and coercive tax administrations are among the greatest obstacles to investment and deter entrepreneurship and the establishment of formal businesses.”<sup>35</sup>

Participants suggested that simplifying tax systems, reorganising tax administrations along functional lines, and establishing responsive taxpayer services would provide opportunities to promote voluntary compliance and widen tax bases. One of the main challenges, however, will be to design tax systems that can support long-term development objectives. Current practices were said to be “almost exclusively geared to short-term revenue collection.”<sup>36</sup>

An additional concern is the volatility of many tax regimes. With extremely narrow tax bases and weak tax-collecting capacity, African governments have been overly dependent on taxes on international transactions for their fiscal revenue and this often leads to unexpected tax rate increases. There is a real difficulty in finding alternative secure sources of tax revenue and instituting efficient tax-collecting systems in the short to medium term, leading to perpetual fiscal imbalance.<sup>37</sup>

<sup>34</sup> Jonathan Faurie, “The new scramble for Africa” *Mining Weekly Online*, 13 July 2007 available at [http://www.miningweekly.co.za/article.php?a\\_id=111707](http://www.miningweekly.co.za/article.php?a_id=111707).

<sup>35</sup> “Profitable investment in Africa now easier”, *AFROL News*, 26 September 2007 available at <http://www.afrol.com/articles/18933>.

<sup>36</sup> *Ibid.*

<sup>37</sup> Ernest Aryeetey et al, “Strengthening Africa’s Participation in the Global Economy” *United Nations University and the African Economic Research Consortium* accessed on 19 September 2007 available at [http://www.unu.edu/Hq/academic/Pg\\_area4/globalafrica.html](http://www.unu.edu/Hq/academic/Pg_area4/globalafrica.html).

For potential investors, this can be a major deterrent. A greedy government can often reduce the expected profit from a major project and the lack of certainty at the due diligence stage can often be enough to make the project too risky to pursue.

## **Inflation and Fluctuating Currency**

Inflation in Africa is wildly inconsistent. In 2005, the mean inflation rate for the African continent was 8.2% and the number of countries experiencing high inflation, that is, above 10%, declined from 16 in 2004 to 14. Nonetheless, inflation increased in 30 out of 51 countries, including eight of the 13 oil producing countries.<sup>38</sup> Inflation remained high in Angola at 22%, but this represented a major improvement from 2004 (43.6%) and a gigantic achievement from the triple-digit inflation rates experienced until 2002.

The most extreme case though, is that of Zimbabwe whose annual inflation figure remains the world's highest, despite a controversial price freeze imposed in June by President Robert Mugabe, in a bid to stem runaway price increases.<sup>39</sup> Zimbabwe's inflation rate slowed to 6,592.8% in August from a year earlier, from a record 7,634.8% in July according to the government's Central Statistical Office. Many economists believe the actual rate is many times higher.

An additional consideration is the fluctuating currencies of some nations. The minerals that African countries produce are priced on global markets and therefore usually priced in US Dollars. Mining companies can often make a profit when the currency that they are dealing in depreciates because they get more revenue as the Dollar exchange rate strengthens. However, when the currency strengthens, mine companies experience a weaker exchange rate resulting in less profit. The mine revenue decreases but its costs do not decline therefore the "mine margins" (difference between revenue and costs to produce minerals) get squeezed.

Both of these factors should be given careful consideration in the due diligence phase of the project as neither will be avoidable once the project commences and both have the potential to reduce, or even eliminate, a project's profitability.

## **Infrastructure**

Recent commentary has suggested that the biggest deterrent to investment in Africa is no longer poor governance or institutions, but rather the inadequate infrastructure in most of Africa.<sup>40</sup> Unstable power access was in particular highlighted and areas such as telecommunications and transportation are also

<sup>38</sup> Cameroon, Chad, Côte d'Ivoire, Egypt, Equatorial Guinea, Gabon, Libya, and Nigeria.

<sup>39</sup> "Zimbabwe: Official Inflation Rate Falls" *The New York Times*, 19 September 2007 available at <http://www.nytimes.com/2007/09/19/world/africa/19briefs-zimbabwe.html?ex=1347854400&en=c30502971544b71c&ei=5088&partner=rssnyt&emc=rss>.

<sup>40</sup> "Profitable investment in Africa now easier", *AFROL News*, 26 September 2007 available at <http://www.afrol.com/articles/18933>.

unreliable. For example, in Rwanda, transport costs alone can add 30% to the total cost of doing business because of the country's landlocked position.<sup>41</sup>

In addition, there is often a shortage of the goods and services required to construct the required infrastructure and a company's ability to import goods may be limited by either cost or governmental restrictions. Water availability is also sometimes an issue. Parts of Cote d'Ivoire, for example, are suffering from extreme drought and water availability may be limited.

Another potential issue is insufficient skilled staff to develop and operate the project. Although the International Labour Organisation has released a study which shows that one in five young people in Africa are unemployed,<sup>42</sup> there is a lack of qualified personnel at all levels and the ability to use foreign labour is often limited.

Another key constraining factor is the nature of current mining activity on much of the continent. Much of the activity is still artisan in nature, characterised by individuals or groups exploiting mineral deposits with the simplest equipment, often outside of the relevant mining legislation, which often means that the resource is not exploited optimally, while the informal nature of this activity means that governments do not benefit fully through an expanded revenue base.

That said, there is a growing consciousness of the need for a mix between local community involvement and benefit from the extraction of resources, and the desire to introduce larger-scale projects, backed by material financial and technical resources. This may require a formalisation of small-scale mining in some instances, and major investment in large projects in others.

## CONCLUSION

Mining and petroleum investments in Africa are subject to multiple legal, political and economic risks. These risks, along with the practical difficulties encountered when dealing in the region, should be anticipated and incorporated into any due diligence investigations.

Africa is, however, in the process of relatively rapid change, including in the mineral and petroleum industry. Governments are beginning to appreciate that, in order for local communities to profit from the minerals which their country owns, a long-term commitment from both government and the private sector for transforming the industry has to occur.<sup>43</sup> Whether this will eventually lead to stable, transparent government agencies, low inflation and reliable infrastructure remains to be seen.

<sup>41</sup> Mills Soko, "Political stability key to trade" *The Herald Online*, 19 September 2007 available at [http://www.theherald.co.za/herald/news/n16\\_12092007.htm](http://www.theherald.co.za/herald/news/n16_12092007.htm).

<sup>42</sup> "Excessive bureaucracy in Africa contributing to poverty and unemployment" BBC, *Trade Law Centre for Southern Africa*, 9 September 2004 available at <http://www.tralac.org/scripts/content.php?id=2893>.

<sup>43</sup> Jonathan Faurie, "The new scramble for Africa" *Mining Weekly Online*, 13 July 2007 available at [http://www.miningweekly.co.za/article.php?a\\_id=111707](http://www.miningweekly.co.za/article.php?a_id=111707).