Advisory Outlook

Infrastructure Development in Nigeria: Better late than never

Adekalu Balogun

Nigeria remains at the centre of Sub Saharan Africa's growth story. With a population of over 177 million[1] and an estimated GDP of over US$587 billion[2] in 2015, the country has abundant natural resources including one of the largest natural gas and crude oil reserves in Africa, over 300,000 square kilometres of arable land, and significant deposits of largely untapped minerals. Strong demographic growth with an improving age mix, increased technological innovation, and fast urbanisation also continue to shape the future of Nigeria.

Current realities

Despite these strong fundamentals, Nigeria has found it difficult to convert her unique advantages into economic and social benefits for the country and the majority of her citizens. Whilst the political environment is improving with the recent successful handover to an opposition party in May 2015, the crash in oil prices from a high of US$115/barrel in August 2014 to current levels of ~US$30/barrel, has drastically reduced the federal government's revenues, of which oil revenues used to be about 75%[3].

As a largely import-dependent country (for goods ranging from rice, fish, and wheat to refined oil and gas products), the huge decline in government revenues has created significant pressure on Nigeria's currency due to: (1) the overdependence on oil revenues, and (2) limited investments in infrastructure when there was a boom in oil prices. This makes diversification of the economy a top priority in being able to build value-adding processing / manufacturing industries that can compete globally and supply the domestic market with essential products.

Diversifying the Nigerian economy will require huge investments in infrastructure and the Nigerian government has identified this as a major priority in the 2016 budget, increasing capital expenditure by 223% to N1.8 trillion (~US$9.05 billion). This amount accounts for 30% of the total 2016 budget compared with ~11% (N557 billion) of the total 2015 budget.

Given the current realities and cash position of the Nigerian government, developing Nigeria's infrastructure will require significant private sector funding, strong collaborations between government and the private sector, and a medium to long term view on the benefits and economic returns on investments to the country.

The infrastructure landscape

Nigeria will not be able to sustain her current levels of population and economic growth without enhancing her infrastructure. PwC's 2014 report titled "Trends, Challenges and Future Outlook: Capital Projects & Infrastructure in East, South & West Africa" indicates an opportunity-filled future for infrastructure development in Nigeria with infrastructure spend estimated to grow from $23 billion in 2013 to $77 billion in 2025.

Investing in infrastructure will drive economic growth, provide jobs, and deliver vital services to the country and the majority of its citizens. The World Economic Forum estimates that every dollar spent on capital projects (in utilities, energy, transport, waste management, flood, defense, and telecommunications) generates an economic return of 5% to 25%.

This readily translates to opportunities for sponsors or investors that are keen on developing infrastructure projects in Nigeria. Opportunities exist across all core and social infrastructure sectors in Nigeria ranging from energy, transport, and urban development / real estate, to healthcare, water, agriculture, waste management, and Information Communication Technology (ICT).

Stable and cost-efficient power availability has been widely acknowledged as pivotal to the successful economic development of any country. Yet, the power sector remains one of Nigeria's greatest infrastructure challenges, with extremely limited electricity access across the country. Nigeria currently generates about 3,879MW of electricity in a country with a population of about 177million compared to South Africa's 45,645MW with a population of 54million. It has been a couple of years since the national power utility was unbundled and partly privatised, but the gap to be filled is still huge and continues to grow with the country's increasing population. This is despite an abundant availability of energy resources in the form of coal, oil, gas, hydro and other renewable sources, most of which remain under-exploited as a result of low investments, limited institutional capacity, limited technical capabilities, and emerging regulatory frameworks.

Other infrastructure sectors such as transportation (roads, rail, seaports and airports) have equally significant gaps and similar challenges. For example, road transport is the predominant mode of transportation and accounts for 80% of goods' traffic in Nigeria, but only 20% of the road network in the country is paved. There are also significant gaps in both rural and urban ecosystems across Nigeria ranging from availability of basic infrastructure such as housing, healthcare, water, and waste management, to other enabler infrastructure like ICT, hospitality, and industrial / commercial real estate.

As Nigeria continues to grow and its cities seek to become more competitive, sustainable, livable, smart, and resilient (given demographic and social changes, climate change, resource scarcity, and rapid urbanisation rates), the opportunities to invest in both core and social infrastructure will continue to grow.

Translating potential into reality

The significant infrastructure opportunities in the Nigerian market necessitates a close collaboration between the public and private sectors. This also means regulatory, monetary and fiscal policies have to be aligned with clearly defined overall developmental objectives. These policies should, more importantly, be able to attract investors (local and foreign) into the infrastructure sectors in Nigeria.

While the government continues to work on improving the regulatory environment, articulating infrastructure master plans, building capacity at implementing agencies, and partnering with the private sector investors, it is equally important that private sector sponsors are adequately prepared and well positioned to effectively harness the opportunities that will be unlocked.

From the private investors perspective, some of the important factors that will accelerate sustainable infrastructure development in Nigeria and ensure the realisation of the country's potential include better project planning, stronger technical partnerships, mobilising the "right" equity for infrastructure projects, and innovative financing arrangements.

1. Better project planning

Robust and diligent project planning is usually perceived by project sponsors to be an expensive undertaking. However, the shortcuts sometimes taken by sponsors consistently result in very expensive project failures, as well as improperly structured or poorly executed capital projects. These have significant unfavorable implications for the sponsors, investors, and financiers of such projects, and the infrastructure sector track record in Nigeria as a whole.

In developing projects and ensuring that the right results are achieved, it is necessary that the project sponsor be more deliberate about the business case development and project appraisal process. The sponsor should also ensure the necessary feasibility, traffic, environmental, legal/regulatory and other relevant studies are carried out to support the business case for investment. While ensuring that the objectives of infrastructure projects are clearly articulated and communicated among the key stakeholders, attention should be given to risk identification, allocation, and management. It is extremely important that relevant risks are allocated to the stakeholder that is best positioned to handle them, especially when dealing with Public Private Partnerships (PPPs). The importance of technical expertise cannot be overemphasized at this stage. Adequate project preparation goes a long way to build credibility and demonstrate bankability for a project, and enables the project attract the right "partners" and investors, many who continue to show interest in the Nigerian market but are unable to find properly developed / structured, i.e. bankable, projects to invest in.

2. Stronger technical partnerships and commitment to knowledge transfer

Infrastructure projects typically require a broad mix of diverse skills and competencies for successful delivery. The level of competence required for successful and timely execution of these projects is usually built over several years of successful project design, development, and delivery. Unfortunately, Nigeria is challenged on this front as there is a dearth of skilled manpower and only a limited number of infrastructure projects have been successfully delivered in the country over the last five decades.

Nigeria must therefore forge stronger relationships between local sponsors and foreign technical partners that have significant experience successfully delivering infrastructure projects in other countries. This is necessary for credible infrastructure development, and the subsequent management and maintenance of the infrastructure assets after delivery. Sponsors must ensure that the interests of their technical partners are aligned with theirs, and the arrangement must deliberately create opportunities for local capacity building by pairing local talent with international expertise right from the start of the project for necessary skills and knowledge transfer.

3. Mobilising the "right" equity for infrastructure projects

Many project sponsors sometimes underestimate the quantum of equity required for infrastructure projects and look for ways to seek short-term returns or save on project developments costs. This usually ends up being detrimental to project viability, quality of delivered assets and project completion timeline. It is important for sponsors to understand the long-term nature of infrastructure projects and also seek to work with other co-investors with similar interests as it relates to risk, investment horizon and expected returns.

Private equity and infrastructure funds play an important role in providing financing for projects at different stages, and are always looking to partner with credible and experienced local sponsors to develop projects. The technical expertise and track record of the sponsors are extremely important factors for these financial investors, in addition to the sponsors' deep understanding of the local environment. Other sources of equity that need to be tapped into include pension and insurance funds, subject to regulation by their respective regulatory bodies. For example, pension funds in Nigeria are allowed to invest in infrastructure projects through infrastructure bonds and infrastructure funds, and the project shall not be less than N5 billion in total with limits of 15% and 10% set for infrastructure bonds and infrastructure funds[4] respectively.

4. Innovative funding arrangements

The Nigerian economy is dominated by short-term financing of three to five years terms, traditionally provided by domestic commercial banks. However, a limited number of deals in the market have been funded with seven to ten year loan tenors usually with participation from international banks and development finance institutions, and in some cases with risk guarantees from multilateral organisations like the World Bank.

One of the major issues faced by foreign investors and financiers include the exchange rate risk for dollar-denominated transactions, where revenues of the project / investee companies are in Naira, as well as the limited hedging options / instruments to mitigate this risk. With limited options for hedging against currency risks, investors tend to (1) focus on improving their expected return profile to make up for the potential loss should the Naira devalue, and (2) become more cautious: only investing when there is some comfort around the stability of the Naira, or where there is an opportunity to transfer the currency risk to the users / customers.

Project sponsors should actively explore development grants, project development funds (either loans or convertible instruments) and equity participation by technical partners. There is also a need to explore alternative business models where opportunities exist to collaborate with other stakeholders in the value chain, such as equipment or feedstock suppliers, and other vendors in order to reduce the initial cash outlay for projects. These should be explored in addition to other financing sources such as Sovereign Wealth Funds (SWFs), Development Finance Institutions (DFIs) and International Development Agencies (IDAs).

Better late than never

The development of Nigeria's infrastructure and its positive impact on industrialisation, economic empowerment, balance of payments and strength of the Naira cannot be over-emphasized. It is not too late to translate the much-talked-about economic potential of Nigeria into reality. It will definitely require political willpower to ensure the environment is investor ready, new ways of partnering with government agencies, private sponsors, companies and countries, and also a realistic medium to long term view on the lasting benefits of infrastructure investments to all key stakeholders.

For investors that are ready to get involved in Nigeria's infrastructure space, and are ready to carefully identify, assess and mitigate risks while working closely with government and other key stakeholders to shape the investment landscape, there are significant opportunities to generate returns.

There is no better time to invest in Nigeria's infrastructure and no better time to contribute to the diversification of the Nigerian economy.

[1] The World Bank
[2] The World Bank
[3] The World Bank
[4] National Pension Commission, Nigeria (PenCom)

About the author
Adekalu Balogun is an Associate Director in the Deals Advisory practice of PwC Nigeria with specific focus on Capital Projects and Infrastructure. He can be contacted through adekalu.balogun@ng.pwc.com

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