Local Insights: Nigeria

The recent slowdown in growth rates in many emerging markets has piqued asset managers' interest in frontier markets. With their comparatively under-developed economies, frontier markets offer compelling long-term growth stories, particularly if resources and demographic drivers are in place.

One such well-placed frontier market is Nigeria. With a population over 150 million and a low dependency ratio, the country enjoys a large and growing labor force. Oil revenues have been managed more prudently in recent years, leading to the establishment of a sovereign wealth fund. These factors, along with promising agricultural development, and a stable government, have led some analysts to view Nigeria as one of the higher sustainable growth stories in the coming decades.[1]

Growth of Asset Management

As Nigeria's economy expands, its asset management industry also offers tremendous long-term potential. The private sector is making good strides, with a few companies serving as regional leaders, and a middle class is in the early stages of development. State institutions and capital market infrastructure, while not as far along when compared to regional powerhouses like South Africa, are making good strides.

Today, Nigeria's fund market is just developing, with $551 million in assets under management as of mid-year 2012.[2] The first exchange-traded fund, the NewGold ETF, was listed in December 2011. While the number of mutual funds is up nearly 50% since 2008, assets have been cut in half over that time period.[3] "Nigeria's capital market was a booming capital market up until about August 2008, and has been on the road to recovery since then," notes Kemi Adewole, Citi Securities Country Manager, Nigeria. "The present growth in the Nigerian capital market is a sustained growth," she continues. Whereas many markets and asset management industries across the globe recovered in 2009 and 2010, the same was not true in Nigeria, as a 17% loss in the NSE All Share Index in 2011 led investors to become even more risk averse.

If the upswing in 2008 reflected the first sizeable retail participation in a bull market, the bear market had a psychological effect on their confidence. "This was the first real crash our market had ever suffered," explains Adewole, "Since then, investor confidence has been slow to return." Although the NSE increased the Investor Protection Fund to N600 million to compensate investors in the case of fraud, market participants realize that there is more to be done to bolster trust in the markets.

[1] Global Growth Generators: Moving beyond "Emerging Markets" and "BRIC," Citigroup Global Markets, February 21, 2011.
[2] Nigeria Securities & Exchange Commission, Citigroup.
[3] Ibid.

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Beyond the creation of the sovereign fund, Nigeria's institutional channels include a growing pension marketplace. As of 3Q 2011, pension assets stood at N2.2 trillion (approximately $14 billion), with investments in stocks and real estate rounding out a core allocation to money markets and fixed income.[4] "The federal government has carried out reforms in the pension sector," states Adewole, in order to better provide retirement solutions through the decade-old system.

Globalization

On the investment side, Nigeria has seen globalization take hold. "As custodians," Adewole says, "we have seen an influx of foreign investors investing in T-bills and bonds." This uptake has been driven both by foreign investors' quest for yield, and by the easing of capital controls. "In a bid to encourage foreign investments into the country, the government removed the one-year restriction on investments in government securities by foreign investors," Adewole notes. Foreign investors do still need to be issued a certificate of capital importation, but the document serves as more of a tracking mechanism than a control mechanism. "Now, you can invest and divest as wish," Adewole explains.

On the equity side, a handful of managers based in developed markets have identified Nigeria as a target market given its consumption story and its low market capitalization-to-GDP ratio, which is low even relative to emerging markets.[5] A strong case could be made that investors in Nigeria have the opportunity to get in early in a market with a population similar to Russia.

Next Steps for the Market

Given that the Nigerian Stock Exchange is over 50 years old, "One expects an extremely vibrant exchange, and it is moving in that direction very quickly," remarks Adewole. "We are also beginning to reap the dividends of various reforms in the market," she continues, "and the good thing about this is that the current growth is sustained." While equities typically trade T+3, the settlement process is not fully dematerialized, with as much as 30% of settlement still paper based. "The depository, key market participants and the SEC are working on making Nigeria a fully dematerialized market," Adewole asserts.

In any market, the barriers to development can be intertwined: Without a greater number of funds, liquidity can't be improved, yet without the presence of large domestic institutions and foreign investors, it becomes difficult to raise assets. "This is an area the SEC is focusing on," states Adewole, "by registering a few more funds and putting guidelines in place for the management of these funds."

Regulators are also trying to facilitate and handle future market growth by improving market infrastructure today. The NSE is in the process of converting from a member-owned exchange to a shareholder-owned one, which should improve corporate governance and efficiency. In June of 2011, the NSE selected NASDAQ Group Inc. to upgrade the exchange trading platform in order to speed up and increase the capacity for trades. "What they are trying to achieve is to ensure that when the market does fully bounce back, it's structurally sustainable," Adewole explains.

The current plans for securities lending should deepen the capital markets and make them more

[4]National Pension Commission Pension Industry Quarterly Review, Third Quarter 2011.
[5]The Frontier Markets' Ship is Sailing, SilkInvest.com, June 2012 and Managers bet on frontier markets, Citywire Global, January 2011.

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attractive to investors. Additional governance improvements came earlier this year through the mandatory adoption of the International Financial Reporting Standard (IFRS) for all exchange-listed companies. Finally, developing a variety of products across the risk spectrum will create appropriate solutions throughout the market cycle, thus fostering long-term investors.

Market Entry: Don't Go It Alone

The incredibly fast pace of change in emerging markets makes local partnerships highly desirable for foreign managers. In frontier markets, those partnerships become indispensable.

A key role to be played by local partners is to provide foreign managers with an understanding of the investment landscape, from local law and registration requirements, to distribution dynamics. "Citi has been in Nigeria for 28 years," Adewole states, "Regulators and key market participants view us as a partner: They can rely on us to transplant global best practices." For these reasons, regulators have awarded Citi a seat on the Capital Market Committee, the Demutualization Committee, and the Capital Market Technical Committee on CSD/Registrar procedures. Citi can bring these insights to clients as well, to help them navigate the market.

Although Nigeria offers foreign managers a promising future, Adewole cautions against taking shortcuts. Price is important, but it always pays to go through professional firms and obtain the proper documentation. "If you conduct proper due diligence, work through credible institutions and obtain proper documentation," Adewole asserts, "then the law is on your side."

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