CENTRE FOR CHINESE STUDIES
STELLENBOSCH · SOUTH AFRICA

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The China-African Development Fund (CADFund) as a sovereign wealth fund for Africa's development?

The China-Africa Development Fund (CADFund) forms part of the Chinese government's practical implementation, for some of its plans and objectives, for the African continent. CADFund was established as part of the eight measures announced by then Chinese President Hu Jintao, at the 2006 Forum on China-Africa Cooperation (FOCAC). While operating according to market principles, the Fund is an economic and diplomatic tool of the Chinese government to encourage Chinese enterprises' investments in African countries. Chinese investments might boost African economies; yet, there is no automaticity in developmental effects. CADFund's operations as a sovereign wealth fund can be compared to other such funds in the African context. This policy brief elaborates on the setting and policy of CADFund, specifically in comparison to Norfund, Norway's sovereign wealth fund for investments in developing countries, which also has a development vocation. The policy brief concludes with recommendations for change.

CADFund's mandate is to facilitate China-Africa co-operation and to enhance capacity building of African economies through direct investment and advisory services. CADFund is presented by its management as China's first fund that focuses on African investment, and that encourages and supports Chinese enterprises' investments in Africa. According to its mandate, CADFund is to operate in line with market principles.

The Fund was allocated an overall US$ 5 billion, with an initial US$ 1 billion paid in 2007. The fund received another capital injection of US$ 2 billion during a July 2012 Conference of Chinese and African Entrepreneurs, related to the Forum on China-Africa Cooperation (FOCAC). It is expected to reach its full US$ 5 billion capitalisation in 2014. Up until 2012 CADFund has (co-)financed and supported 60 projects across 30 African countries. Another 100 projects are reportedly in the pipeline (as of 2012).

Sovereign wealth funds

CADFund is not unique as a sovereign wealth fund. State-owned investment funds can be composed of financial assets such as stocks, bonds, property or other financial instruments; most sovereign wealth funds are funded by foreign exchange assets. Examples of sovereign wealth funds are the Government Pension Fund of Norway, the Abu Dhabi Investment Authority, Angola's Fundo Soberano Angolano and Botwana's Pula Fund. Norfund from Norway is a sovereign wealth funded dedicated to developmental purposes (see Box 1).

Some sovereign wealth funds may be held by a central bank, which accumulates the funds in the course of its management of a nation's banking system. This type of fund is usually of major economic and fiscal importance. Other sovereign wealth funds are simply the state savings that are invested by various entities for the purposes of investment return, and may not have a significant role in fiscal management. Risk diversification is important for sovereign wealth funds as they constitute the savings of national economies. The investments of sovereign wealth funds are global in nature, investing in Europe, North America, Africa and elsewhere.

China has a foreign exchange reserve in excess of US$ 3 trillion and is looking for ways to invest these in a sustainable manner. Several wealth funds operate alongside each other, such as the China Investment Corporation or the National Social Security Fund. CADFund is a comparatively small sovereign wealth fund, similar in size to the Angolan Fund.

Structure of CADFund

The Fund has been operating since 2007 and is a subsidiary of China Development Bank (CDB). This "stockholder" - by now a commercially operating bank – is indicated as first in the chain of command (see Figure 1). CADFund, however, is also a policy tool and reports annually to a Supervisory Board which consists of members from various Chinese Departments - for example, the Department of Foreign Affairs and the Department of Commerce. The directorate comprises members from the CDB and CADFund.

The fund currently has representative offices in four African countries: South Africa, Ethiopia, Zambia and Ghana. These offices are meant as providers of advisory services for Chinese businesses wishing to operate in African countries. Each office is in-charge of supplying funding and consultation services to specific African countries in their region.

CADFund underwent an organisational reconstruction in April 2012. According to the Fund, the investment function has been re-organized from geographic-based departments to sector-based departments. The four investment departments concentrate on infrastructure, mineral resources, agriculture and manufacturing respectively (see figure 1). In addition, a Marketing Development Department was established in 2012 to co-ordinate different investment projects and to manage CADFund's regional offices in Africa. This is likely a response to difficulties experienced in identifying suitable projects for the first billion dollars of investment, as reported by the CEO of CADFund in December 2011.

Investment approaches: identifying Chinese interests

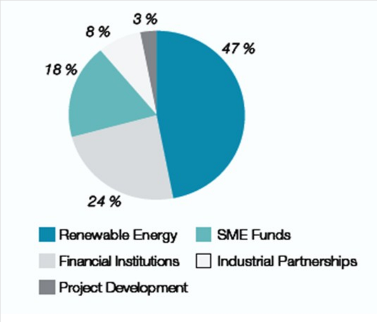
CADFund aims at facilitating Chinese investment in Africa. According to the websites of CADFund and CDB, there are four main investment approaches which CADFund utilises when obtaining shares in Chinese enterprises. All of these are promoting China-Africa exchanges, and are essentially catering towards Chinese business interests.

- The first approach is *equity investment*, offering support for Chinese enterprises to conduct economic and trade activities as well as set up operations, in Africa. In this case CADFund will not seek a majority share in a company.
- The second approach is *quasi-equity investment*. In this, CADFund may make any manner of investment under the

Box 1: Norfund as a benchmark?

Norfund is operated by the Norwegian Government and serves as a tool in Norway's development policy. While providing investments, not aid, Norfund is not only a commercial investor; it accepts higher risks and lower returns than fully commercial investors. The aim of the fund is to also contribute to economic growth and poverty reduction. The Norwegian parliament allocates annual capital grants to Norfund in its development assistance budget.

Norfund has ten years experience in the field of equity funding and also pursues a development vocation in its investment decisions. Norfund aims to invest in the establishment and development of profitable and sustainable enterprises in developing countries. In the choice of investment areas, Norfund appears to be clearly driven by the priorities of the Norwegian government. Norfund's emphasis in investments is on Least Developed Countries.



Norfund investment sectors: Committed investments by sectors (year end 2011)

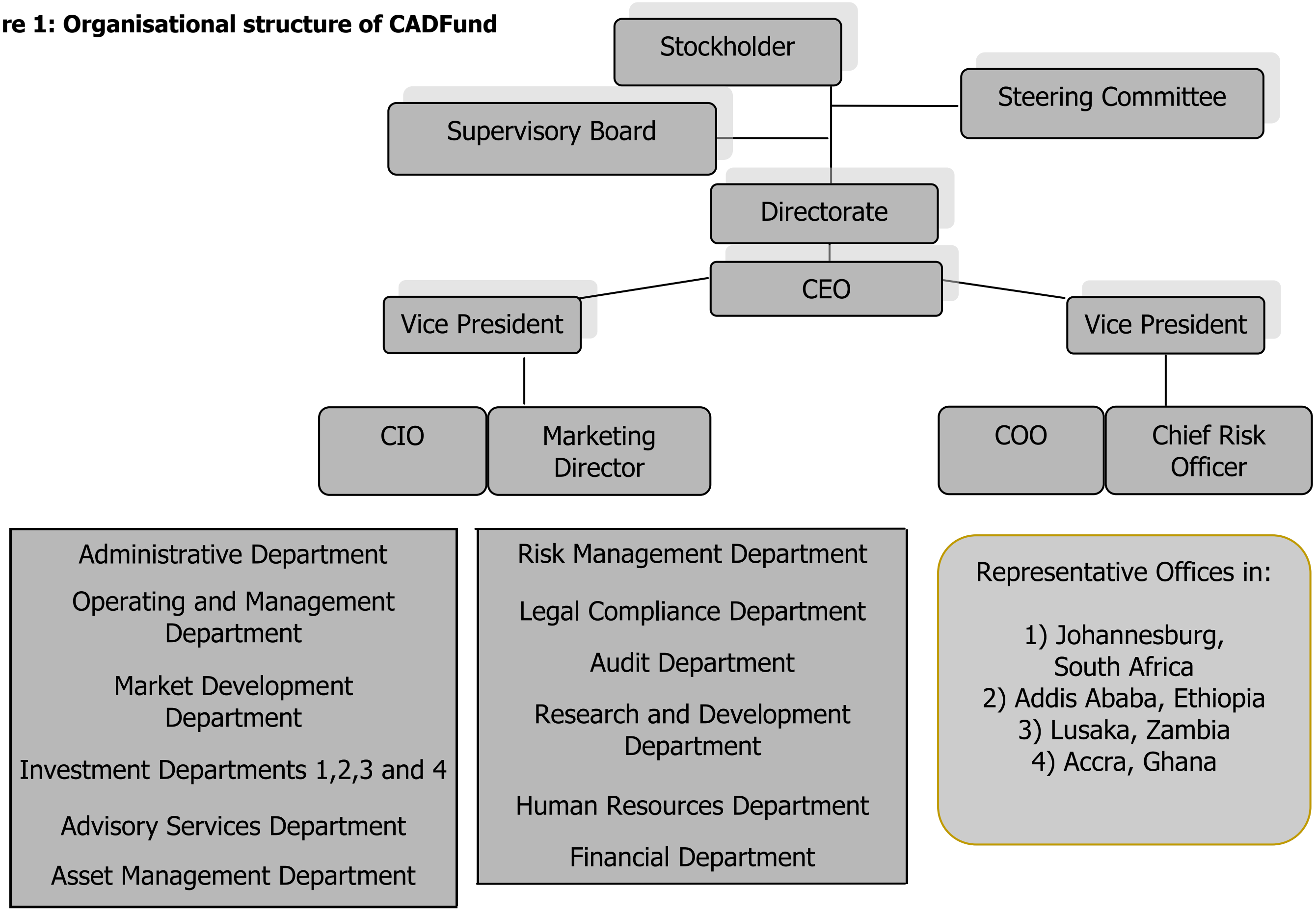
Source: www.norfund.no

Norfund's geographical approach is broader than the China-Africa Fund and includes projects in South- and Southeast Asia as well as in Central America. An overall of 46 per cent of its portfolio is invested in African states (by 2011), with the main areas of investment on the continent being in Eastern- and Southern Africa. In Africa, Norfund has regional offices located in Johannesburg, Nairobi and Maputo.

At mid-year 2012, Norfund had a project portfolio of about US$ 1.3 billion and 50 employees. Norfund invests with partners, Norwegian or foreign, focusing on renewable energy, agri-business and financial institutions. Unlike CADFund, there is thus no direct linkage to investors from the Fund's home country in order to grant funding.

Norfund's organisational structure is similar to that of CADFund in that Norfund also has an investment committee and has regional and specific sector departments. Norfund claims notable success in the setting up and running of projects in Africa and provides a list of investment partners in its annual report. Unlike CADFund, Norfund's website offers user-friendly and up-to-date access to annual reports, reports regarding projects, resource allocation and future objectives.

Figure 1: Organisational structure of CADFund



Source: own diagram

auspices of Chinese state policy and that of the host country. This form of investment may include preferred stock, hybrid capital instruments and convertible bonds.

- Thirdly, *fund investment* may be undertaken, in which case CADFund may invest, as a "fund of funds", a reasonable proportion of its capital in other funds that invest in African countries.
- Lastly, CADFund may also provide *knowledge investment* in the form of management, consulting and financial advisory services to all Chinese enterprises.

According to CADFund's stated policy, projects which are invested in must abide by China's economic and foreign policies towards Africa; follow regulations regarding Chinese enterprises' overseas investments; and satisfy relevant legislation and policy requirements in corresponding African host countries.

The minimum amount that CADFund will engage with is US$ 5 million, which effectively means that projects will have to have a minimum value of US$ 10 million. Originally set to acquire majority shares, CADFund can now engage in a range between 10 per cent and 40 per cent of company shares. Joint ventures between Chinese and African enterprises also theoretically qualify for CADFund engagement, but only if the flow of investment is towards Africa.

CADFund's main funding criteria are based on an assessment of the return of investment; qualified projects are supposed to demonstrate promising market prospects with a rapid yet steady growth potential and the ability to generate profits. The timeframe for CADFund is around eight years per investment; after these, investments should be profitable and thus self-sustained. Thus far, one investment is said to have reached the point already.

A senior manager of CADFund in an interview noted that potential partners should possess complementary advantages *vis–à–vis* CADFund, combined with relevant industry competitiveness, African investment experience, the existence of local networks, competent management capability and team advantages, as well as an understanding and recognition with CADFund investment and capital market principles. Market leaders in specific sectors in China could also quality for equity injection, being complemented with Africa knowledge through CADFund participation. This would, *de facto*, often exclude smaller private enterprises from finance via CADFund and favour

Chinese state-owned business, both central and provincial.

In order to receive funding from CADFund, "qualified projects", must fulfil certain criteria related to the "Africa vocation" that is to be found in the fund's name. The criteria on the African development impact suggest a broader ambition, but are rather vague. Projects need to be an investment undertaking that is based in Africa or - if it is based outside of Africa - it must be indirectly invested in Africa or "serve the interests of African countries". Other criteria for CADFund's decisions are that qualified projects should facilitate local economic development, and contribute to general public well-being improvement.

While CADFund emphasises that qualified projects must follow African laws and abide by local labour and environmental standards, it is unclear what checks and balances are put in place by the Fund to monitor this. Also lacking, is a clear indication for a role of African partners in this assessment. Overall, limited attention seems to be given to external communication; CADFund's website offers little information on the fund's operations and information is often out-dated.

As examples of CADFund activities, the Fund has invested in a cotton cultivation project in Malawi, Mozambique, and Zambia (US$ 22.6 million) and in a power plant in Ghana (US$ 16.4 million). Investments have also been undertaken in Ethiopia's manufacturing sector, for example in leather processing (US$ 20.9 million), cement production (US$ 30 million) and in glass production. Shares are owned by CADFund in two Special Economic Zones, Lekki/Nigeria and Suez/Egypt; the latter at a volume of US$ 24 million.

Conclusions

As the Fund grows, so does the need for it to improve its efficiency and transparency. The Fund might claim business involvements and the related need for discretion. However, as it is not unique, practice of similar sovereign wealth funds can be taken as benchmark behaviour.

Even though the Fund is meant to be operating according to market principles, and is independent of the government in its day to day operation, CADFund is occasionally briefed by the supervisory committee regarding the Chinese government's foreign policy agenda, and it clearly serves Chinese policy goals. A similar statement could nonetheless also be made about Norfund.

China has a large amount of currency reserves and CADFund is one area to which the Chinese government is allocating these reserves which in turn promotes investment ties with Africa. Return on investment is expected and a key driver. The example of Norfund shows that these policy guidelines do not necessarily oppose a development vocation of funding. Increased economic and political engagement as well as "solidarity and co-operation with African countries" are objectives laid out in many of the Chinese government's policies regarding Africa.

Recommendations

China's African investment fund could learn valuable lessons from experiences of other sovereign wealth funds, and not least so Norfund, in providing sovereign wealth for projects in Africa.

CADFund finance is currently excluding African owned enterprises and does not adequately cater for small scale businesses- the fund caters first and foremost to Chinese big business priorities. While this might still positively impact development, these shortcomings make an orientation towards African development clearly less certain.

If the fund is to fully serve the purpose stated in its name (China-*Africa* development), its mandate should include minority engagement in African enterprises to boost their export capacities, including to China. This might not be first priority for a sovereign wealth fund, if considered from a narrow perspective of Chinese self-interests. However, it would assist in re-balancing trade and thereby work towards long-term Chinese interests, as it would assist in overall sustainability of China-Africa relations.

Last, but not least, CADFund would need to engage more proactively with the public. CADFund lays out numerous stipulations regarding funded enterprises adhering to local laws and acting in an environmentally and social conscious way. However it is unclear how this is monitored. Improving transparency will ultimately result in improved knowledge and understanding about CADFund's operations in Africa, which will contribute to improving the efficiency, the effectiveness and the legitimacy of the fund.

Dr Sven Grimm
Director
Centre for Chinese Studies
Stellenbosch University

Elizabeth Schickerling
Centre for Chinese Studies
Stellenbosch University

Contact Us
Centre for Chinese Studies
Stellenbosch University
PO Box 3538
Stellenbosch
South Africa

Tel: +27 21 808 2840
Fax: +27 21 808 2841
Email: ccsinfo@sun.ac.za
Web: www.sun.ac.za/ccs
Twitter: CCS_STELL

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