Africa: potential, challenges & risks

Africa is drawing increasing attention, not only from the perspective of businesses based in China and Europe, but also from operators in Africa itself. In particular, closer economic ties between Africa and China have been covered extensively by the media recently—with fairly mixed reviews. This paper highlights the potential, challenges and risks for doing business in Africa over the next few years.

Africa rebounds quickly

In 2001 *The Economist* described the continent, perhaps with undue harshness, as the “hopeless continent”. But Africa, one way or another, has managed to survive the steepest contraction in global economic activity since the 1930s, and has been rebounding quickly since the last decade.

African GDP has outpaced world growth since the start of the last commodity boom in 2001, reaching 6% in mid-decade. Despite slowing sharply in 2009, as global growth and trade retreated, African growth stayed positive at about 2%, and the downturn has clearly been “V-shaped”. In 2011-12 Africa is expected to grow faster than any other region or country in the world, apart from China and India—and this is more than a just a commodity story. Although Africa is not immune to global conditions—as seen in 2009—the continent is fairly resilient. For instance, a downturn a decade ago would have resulted in negative growth of 6-10%, and it would have taken another decade for growth to return to positive territory.

The favourable outlook for the region is based on modest inflation, steadier exchange rates, and a smaller debt burden owing primarily to the debt write-offs in 2006 and 2007 (although some countries...
have been building up their debt again since then). Thus, with growth prospects buoyant, and the number of African consumers rising, businesses can no longer afford to ignore this vast continent, with its 53 countries—54 now with Sudan—and immense natural resources, including people.

**Real GDP growth 2012 forecasts**

![Map of Africa showing GDP growth forecasts.](image)

However, although returns can be high, so are the risks. Africa’s growth trajectory in 2012 can be mapped by a breakdown into regions: the North, South, East and West. Growth is forecast to hit over 8-9% in some countries in the regions. In West Africa, for example, Nigeria, Angola and the oil-based economies will dominate the region. Ghana also joined the oil club in 2011, with its first commercial output.

East Africa is forecast to be the fastest-growing region. Although Kenya has no natural resources, it is the key financial and business hub, and the Kenyan economy is expected to grow by 5-6% on the back of ongoing development and reforms. Across the border, Uganda’s discovery of oil will boost development and growth, and the country will join the oil club in a few years’ time. Key mineral producers will also perform well (Tanzania), as will strong agricultural economies (Ethiopia). Africa will become an increasingly important food supplier to global markets. Countries without major resources but with a strong reform record, such as Rwanda, will also join the ranks of high growth achievers.
In the South, South Africa is the country most exposed to the global economy. A global slowdown will not be good news for South Africa, which is forecast to manage growth of only 3% in 2011-12. Some countries will be poor performers, such as Zimbabwe and Swaziland. Given an ineffective political situation and poor policy, growth of even only 1% would be an achievement. In order to expand operations, businesses will need to look elsewhere on the continent.

**The driving forces for growth**

There are many factors behind Africa’s growth spurt, including robust commodity prices, improved economic management, substantial debt relief and increased private capital flows. However, unlike earlier short-lived booms, two additional engines of growth that were largely absent before are underpinning output.

The first main driving force is surging external demand, especially from China and India, which are the fastest-growing countries in the world and hungry for resources—especially oil and minerals. OECD growth will be weak and fragile but China and India—and most other emerging markets—will power ahead and be the main source of new demand for African goods. Emerging-market demand will help to keep commodity prices high.

The second main driving force is the increasing pace of urbanisation and “consumerisation” in Africa. As Africans flock to the cities, and disposable incomes rise, their demand for modern goods and services (such as telecommunications and banking services) will accelerate. Global businesses—whether based in Asia, Europe or the Americas—as well as home-grown African firms will strive to meet this demand.

The impact of these two forces offers hope that the bubble will not burst. But how quickly they translate into actual growth in particular countries depends on a host of other variables, including democracy and governance, the state of infrastructure and the pace of deregulation.
The demographic dividend
Demographics is very important for Africa. It is one of the most populated and youngest markets in the world, with more than one-half of its population under 24 years of age. By 2050, Africa’s population of 2bn will have overtaken that of India (1.6bn) and of China (1.4bn).

Nigeria’s population will lead the pack in Sub-Saharan Africa, followed by Ethiopia, the Democratic Republic of Congo (DRC) and South Africa. Tailing them will be the three East African partners—Tanzania, Kenya and Uganda (with a combined population of 110m).

By 2015, the proportion of Africa’s youth (under 15 years) is expected to rise to 45% of the total population. This raises some interesting possibilities—they will want to learn, earn, and burn their earnings.

At the same time, Africa is urbanising rapidly and about 40% of the population now lives in cities (a lower ratio than in China but higher than that in India). The youthful demographic is urbanising the fastest.

A consumer boom
As Africans move to the cities and acquire more disposable income, and the middle class grows, demand for modern goods and services will surge.

By 2030, the continent’s top 18 cities could have a combined spending power of US$1.3trn. By 2050, 63% of Africa’s population will be urban. Africa’s consumers can be divided into three main tiers, and businesses will need to build their strategies accordingly. The first tier is the rising and the future middle-class market of 350m-500m, similar to the segments in India and China. The second tier is the number of consumers at the bottom of the pyramid, which is growing, and the ascent of the mobile phone has proven that there is a market. The third is the challenge for firms to move from basic goods to affordable products—Branding Africa is important.

Companies will need to look at all three strategies, but new investors and existing investors will also need to look at the broader consumer markets.

The mobile-phone revolution
Against all expectations, the mobile-phone market has grown extremely rapidly in a very short time. The reason for this is Africa’s very poor land line infrastructure. The number of mobile subscribers jumped from around zero in the mid-1990s to 88m in 2005, and reached an incredible 360m in 2010, which equates to 45% of the population. Africa’s ongoing connection to the global fibre-optic network is a major boost for the sector. Three new submarine cables were laid in 2009/10—Teams, Seacom and Eassy—and more have been laid or are planned.

What does the rise in mobile usage mean for other sectors? The mobile phone is more than a conversation tool or for tele-banking: it provides farmers and traders with up-to-date market information, and is becoming the main tool for accessing the Internet. Mobile Internet is growing rapidly in some markets, such as in Kenya, where subscriber numbers more than doubled in 2010 alone to 4.7m—and this trend will continue.
However, the emergence of the mobile phone as a financial instrument is one of the most important developments. Pioneered in Kenya (by a market leader, Safaricom) and now spreading to other markets are money transfer systems (such as M-Pesa). These are proving immensely popular, especially given the difficulty that many people face in accessing formal banking services. M-Pesa now has more than 12m subscribers, and M-Kesho (another transfer system) hit 600,000 within just a few months. Consequently, there has been a rapid emergence of competing products, which will facilitate the spread of real commerce and e-commerce as well as provide a new platform for official transfers and the payment of bills. And last but not least, the mobile phone (and the Internet) played a role in the Arab Spring (see “Africa’s democratic waltz”).

Mining is the bedrock
Although African consumers will be a key growth driver, the continent’s natural resources, especially minerals (and particularly oil), will remain central to many countries. Resource-rich countries are benefiting from stronger global demand in the aftermath of recession, driven in particular by the burgeoning appetites of China and India for minerals and energy products, which is boosting commodity prices. Higher commodity prices, in turn, are driving investment in exploration and extraction.

Oil has been the main focus of foreign direct investment (FDI), but key minerals, such as gold, copper, iron ore, chrome and diamonds, and more exotic elements, are major draw-cards. Most notably, new junior mining firms, which tend to be more dynamic and responsive, are playing a key part in the investment surge. However, mining firms (whether big or small) will continue to face several obstacles, ranging from weak or non-existent regulations in some states (for example, in the DRC) to over-regulation in others (such as the overly restrictive BEE laws in South Africa). Land disputes and infrastructure bottlenecks will also be a burden.

Another key area that is part of Africa’s growth story is regional trade blocs. Regional integration is advancing in Africa, despite stops and starts, offering the hope of larger markets, fewer barriers and potential economies of scale. (Proposals for a single African trade zone will, however, still take time to be realised.) The main blocs are the SADC (South), EAC (East), COMESA (East/South) and ECOWAS (West). The main obstacles are non-tariff barriers, incompatible regulations, clashes over common external tariffs and weak infrastructure connections. Cross-membership of trade blocs is a further problem, as they are integrating at different speeds.

The EAC is moving the quickest and introduced a common market in July 2010, but the impact will be gradual as many laws still need to be harmonised, and Tanzania has preserved some opt-outs. Proposals for a unified trade bloc (comprising the SADC, COMESA and the EAC) are advancing but make take several years to be realised.

The EAC plans to fast-track the introduction of a single currency by 2012, but given the need to harmonise fiscal and monetary policy, 2015 is a more realistic deadline. The UEMOA (West) and the CEMAC (Central), as part of the Franc Zone, already have single currencies (linked to the euro).
FDI slips but will recover

FDI has been picking up in Africa. Interest is rebounding, and several major deals have been concluded or are in the pipeline. Telecommunications and banking remain the biggest non-commodity draws for foreign investors, and this trend is likely to continue. But retailing is on the rise, spurred by urbanisation and the rise of the modern African consumer. In June 2011, Massmart, a South African retailer, concluded the sale of a 51% stake to Wal-Mart, the US retail giant, for US$2.4bn, after a lengthy battle with regulators (mainly because of trade union opposition). Wal-Mart aims to use Massmart as a launch-pad into the wider African market.

The main deal in 2010 was Bharti Airtel’s purchase of Zain’s African assets (in 15 countries) for US$10.7bn—one of the largest-ever investments in Africa and certainly the biggest from India. As expected, a fierce price war has ensued. Of course, these sums just represent initial investment and most firms will continue investing to build their market position.

South Africa is one of the key gateways to the rest of Africa. Most African markets are open to FDI in telecoms and banking, albeit with restrictions in some cases. Ethiopia allows FDI in neither sector, which is impeding innovation.

China’s investment in Africa

China has emerged as a leading investor in Africa, and not only in the resources sector. China’s rising trade and investment links to the continent will remain a very important contributing element of Africa’s growth story in the long term. Although resources has been the initial big investment on the continent, rising from US$681m in 2000 to US$9.3bn in 2010, there has also been a shift into services,
and the sector has taken the largest chunk of investment. In addition, the next few years will see the development of industrial parks in key African countries. One industrial park is already operating in Mauritius, and more are planned in Nigeria, Ghana, Kenya and South Africa. The aim of these parks is to improve infrastructure and the regulatory environment, and to encourage Chinese firms to establish manufacturing industries in the parks, as they benefit from tax break holidays, favourable regulations and good infrastructure.

**Chinese foreign direct investment in Africa**

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
</tr>
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<tbody>
<tr>
<td>2000</td>
<td>Agriculture: 7.0, Services: 18.3, Manufacturing: 46.3, Others: 0.8, Mining: 27.6</td>
</tr>
<tr>
<td>2010</td>
<td>Agriculture: 3.1, Services: 42.3, Others: 3.4, Manufacturing: 22.0, Mining: 29.2</td>
</tr>
</tbody>
</table>

Source: Economist Intelligence Unit.

Trade between the two continents has also been rising: 12.4% of all exports from Africa went to China last year, a fifteenfold increase on 2001. Angola is the leading supplier of oil to China, followed by Nigeria. There has been a real shift in the last decade and South-South is taking increasing importance.

One key issue that has arisen is whether it is the responsibility of Chinese investors to develop skills and provide education, or the responsibility of the African governments to develop the skills needed to create opportunities, jobs and growth. Based on the trends to date, both the governments and investors, whether they are Chinese or other international operators, will need to invest in education, skills and infrastructure. If not, as in Europe, history will repeat itself and show that the transfer of skills and development of human capital will remain one of the biggest challenges in Africa. This is something, however, that Indian investors are addressing to some extent. As part of their African strategy, which is to secure resources, efforts to transfer skills—on a small scale—are taking place. If left unchecked, the prospect of an African Spring cannot be discounted.

**The key risks of doing business in Africa**

But despite the enormous opportunities, there are also risks, both economic and sociopolitical, of doing business in Africa.
The key economic risks range from weak fiscal and monetary policies, high inflation, volatile currencies, high taxes, nationalisation issues, skills shortages, inadequate infrastructure and red tape.

**Inflation ebbs but remains a concern**

Inflation has now returned to levels recorded before the commodity price spike in 2007/08. In Sub-Saharan Africa, the average rate of inflation jumped to 11.7% in 2008 on the back of soaring oil and food prices, but retreated to 8.5% in 2009 as the global downturn curbed price pressures. The annual average rate is expected to hover at around 7.1% in 2010-12. However, inflation will remain comparatively high in a global context and will be vulnerable to fluctuations in commodity and product markets. The ongoing power crisis, severe infrastructure bottlenecks and higher tariffs will also have an impact on inflation.

![Inflation Graph](source: Economist Intelligence Unit)

The question is whether Africa can become the global food basket, an issue discussed at great length by African leaders, investors and donors. Recent pressures in food markets will prove inflationary in Sub-Saharan Africa, especially given the high proportion of disposable income spent on food by Africa’s poorer consumers (who are in the majority). Moreover, World Bank data indicate that in Africa only 6.6% of land is irrigated, compared with 33.3% in Asia and 15% in Latin America.

**An infrastructure crisis**

Most operators in Africa will agree that the poor state of physical infrastructure, especially electricity and transport, is one of the biggest impediments to business. For instance, Nigeria, with a population of 150m, has the same power capacity as Hungary, with a population of less than 10m. These issues have also had a profound effect on investors. Very few locations have sufficient infrastructure, with the exception of South Africa, but even there power and transport provision is inadequate.
Faster growth in recent years has highlighted deficiencies, exposing bottlenecks in ports, roads, rail and power supply. Although substantial infrastructure investment is under way—for example, resource extraction deals secured by Chinese and Indian firms typically involve a commitment to build local infrastructure—improvements will take time. Africa will need investments of at least US$93bn in the power sector alone.

**The business climate**

Although the key business indicators are improving, the region’s operating environment remains one of the most difficult in the world, suffering from high corruption, shortages of key skills, stop-go policies, poor regulations and labour union issues. And above all—as already mentioned—very poor infrastructure. As a result, African countries still dominate the lower reaches of the World Bank’s “Doing Business” rankings.

Business climates are hugely divergent. In Rwanda, it is possible to set up a business in two days; in Kenya, it can take 18 months. In some countries, such as Angola, it is still very difficult to get a business visa. But there is an overall trend of improvement. According to the World Bank, over a five-year horizon, from 2006 to 2010, doing business in most African states improved, in some by large margins, led by Rwanda. Only a few countries (seven in total) did not see any improvement over the period.

Mauritius, South Africa and Botswana are the three best locations for doing business in Africa.

**The sociopolitical challenges**

In terms of the sociopolitical challenges facing Sub-Saharan Africa, the primary challenge is the prevalence of authoritarian, repressive, undemocratic or simply ineffective governments. However, there is a gradual move towards more transparent and accountable governments.

Despite international headlines, armed conflicts and political instability have become less frequent occurrences in the last decade. There were 21 successful coups on the continent in the 1960s and 18 in the 1980s. But no more than five have take place since the turn of the century. Elections have now become the norm in Africa, and there are increasingly more examples of peaceful transfers of power.

**Africa’s democratic waltz**

Political reform in Africa is advancing, although it may often take the form of a democratic “waltz”—two steps forward and one step backward.

Democracy, as measured by the Economist Intelligence Unit’s proprietary index, declined in all world regions between 2008 and 2010, possibly because of the recession. However, the decline in Sub-Saharan Africa was smaller than in most (albeit from a low initial base).

Our democracy index is based on five parameters: electoral process, government functioning, political participation, political culture and civil liberties. On this basis, the region still has only one full democracy, Mauritius.

Sub-Saharan Africa therefore accounted for almost one-half of the world’s 55 authoritarian regimes.
There is obviously a long way to go, and many countries are still ruled by “big men” or hegemonic single parties with little intention of giving up power. A sudden change at the top (or if a country’s leader dies) can spark instability, as was the case in Côte d’Ivoire. Tribal and ethnic divisions are another blot on the political landscape, and a lack of effective opposition parties is widespread.

On the demographic front, the picture is not entirely positive, owing to weaknesses in capacity, healthcare systems, and education and skills levels. Rapid growth in the urban population, of 4–5% a year, will put enormous strains on weak municipal infrastructure and lead to growth in shantytowns, where living conditions are poor. This can fuel social tensions—and crime and drug problems—although slum dwellers still need basic goods and entrepreneurs do emerge.

Africa’s youth bulge will exert pressure on already stretched education systems, and skills shortages will persist. Alongside other major diseases, in particular malaria, life expectancy is low—at an average of about 50 years—compared with closer to 70 years globally.

Haphazard, badly planned or uncontrolled urbanisation has the potential to foster social and political unrest, although the Arab Spring revolts were primarily driven by better-educated, better-off groups, and were mainly directed against political repression, rather than against poverty and overcrowding. However, a lack of urban employment opportunities can underpin discontent, and will remain a key challenge.

What are the prospects of an “Arab Spring” spreading into the rest of Africa and translating into similar examples of widespread discontent, mass protests and regime change (and even civil war, as is happening in Libya’s case)? In some ways, the underlying conditions that sparked the Arab revolts can be found in large parts of Africa, namely repressive and undemocratic governments, long-serving leaders, high levels of poverty and unemployment (especially among the youth), rapid population growth, over-regulation of business and widespread corruption (among the elite).

But there are also crucial differences, such as larger rural populations, less extensive use of the Internet and social networking, smaller-sized middle classes, less well-organised opposition groups
and weaker governments, which have less ability to control the lives of ordinary people, and trigger and squash dissent. (Some Sub-Saharan states, however, obviously do have fairly effective repressive machinery, such as Ethiopia.)

In addition, despite the region’s relatively weak standing in the democracy stakes, it performs better than the MENA region. These factors make it unlikely the revolts will “spread” (or erupt spontaneously) in Sub-Saharan Africa in the next few years. But food and fuel price protests will still take place—and there is a perennial risk of military coups.

Emerging Africa?

Africa is on the move. The previous decade has been very positive for Africa, removing some of the downsides. The global recession caused little damage and may even prove beneficial for Africa, in the sense that investors are more favourably inclined towards emerging markets given the weak outlook in the OECD.

Our central forecast assumes that a steady flow of investment, strong Asian demand, favourable demographics, good resources, gradual reforms and ongoing development will support long-term annual average growth of 6-7%. However, factors such as an acceleration of reforms, political stability, democratic deepening and better governance could generate a stronger growth rate of 8-10% a year, which is required to make a rapid dent in poverty and unemployment.

Politics and policy still matter in Africa. Events in Zimbabwe and Côte d’Ivoire highlight that previously stable and prosperous countries can easily become near basket cases if the politics and policy go wrong. It is easy to break successful countries, but much harder to fix them.

The game may be over for some North African autocrats, but the risk of similar, popular revolts in Sub-Saharan Africa is unlikely in the near term. Autocrats are more likely to fade away than to be thrown out, but unless governments tackle the barriers to growth and development, the risk of an African Spring will increase. And Africa’s next generation may not be so forgiving.
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- practical ways Chinese companies can expand their businesses abroad
- information and advice to help companies looking to expand their business in China.

Read the full event programme and register to find out if you qualify for a free place. Spaces are limited.

We hope to see you in Shanghai so we can discuss how to prepare your business for opportunity. If you have any questions, please contact us using the contact details below.

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