Challenges and Prospects for Economic and Business Development in Africa

Professor John Luiz
Wits Business School, University of the Witwatersrand
John.Luiz@wits.ac.za
Aggregate economic performance poor…
but…

<table>
<thead>
<tr>
<th>GDP per capita, annual growth rate (%), 1975-2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and the Pacific</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>High-income OECD</td>
</tr>
<tr>
<td>World</td>
</tr>
</tbody>
</table>
But these aggregates hide nuances –

A tale of 3 major recent development phases in Africa: A mixed bag

1. 1970s – poor; 1980s even worse

2. Recovery starts in early 1990s and escalates e.g. economic growth in SSA was 7% in 2007 and 5.5% in 2008

3. Impact of the current global crisis: less dramatic than elsewhere - grew at 2% in 2009 and expected to grow at 4.75% in 2010 and 6% in 2011
Growth in Africa has slowed more gradually than in other regions.
Growth tied strongly with commodity prices...

Commodity Prices

...commodity prices to plunge...

(Index, 2003=100)

Sub-Saharan African metals

Sub-Saharan Africa, other

Sources: IMF, Commodity Prices; and UN Comtrade.
1 Composite of cocoa, coffee, sugar, tea, and wood, weighted by sub-Saharan African exports.
Africa’s growth was widespread across sectors.

Sector share of change in real GDP, 2002–07
100% = $235 billion

- Resources: 24%
- Wholesale and retail: 13%
- Agriculture: 12%
- Transport, telecommunications: 10%
- Manufacturing: 9%
- Financial intermediation: 6%
- Public administration: 6%
- Construction: 5%
- Real estate, business services: 5%
- Tourism: 2%
- Utilities: 2%
- Other services: 6%

---

1 In 2005 dollars.
2 Government spending from resource-generated revenue contributed an additional eight percentage points.
3 Education, health, household services, and social services.

Source: McKinsey Global Institute analysis
Reasons for growth surge

• Civil conflict declined and political stability improved
• Better macroeconomic conditions e.g. inflation dropped from 22% in 1990s to 8% after 2000; foreign debt declined by one quarter and budget deficits by two thirds
• Markets have been reinvigorated through: privatization (e.g. Nigeria privatized more than 116 enterprises between 1999 and 2006); increased openness to trade; lower corporate taxes; strengthened regulatory and legal systems; and improved physical and social infrastructure
Long term prospects

• Demand for commodities likely to continue growing especially from Asia (result is that Asia’s share of African trade doubled between 1990 and 2008 to 28% whilst Europe’s declined from 51% to 28%; China is bidding for millions of tons of resources in Africa in exchange for infrastructure)

• Rise of the African urban consumer
  – Urbanization is spurring construction of infrastructure
  – Labour force is expanding
  – Its consumer sectors are growing two to three times faster than OECD

• Africa’s growth path is becoming more diverse
Opportunities for business in Africa

• According to UNCTAD, Africa offers the highest return on FDI in the world, far exceeding all other regions. And it is not as competitive as the BRICs!

• If Africa were a single country it would be the 10th largest economy ahead of India, Brazil and Russia.

• Africa offers a consumer base of more than 900 million people. While more than half of Africa lives on $1 or less a day, the other half does not, and they are hungry for products and services. Even among the poor, there are surprising opportunities – see Prahalad’s book *Fortune at the Bottom of the Pyramid*. And the demographics bode well for Africa as a market as more than half its population is under 24. Whilst Europe’s population will lose 60m people by 2050, Africa will add 900m - creating opportunities. 9
• Ironically, Africa’s very poverty creates opportunities: Education; Healthcare; Infrastructure; Banking the unbanked; Middle class aspirational consumer goods etc

• One of the fastest growth areas is telecommunications: 1999 to 2004, cellphone use in Africa grew at an annual rate of 58%, whereas in Asia, the region with the next highest growth, cell phone use only grew at 35%.

• Africa is of increasing strategic interest to the global economy. The continent is expected to provide the US with more petroleum than the Middle East. China and India are rapidly increasing their business dealings with Africa and are often beating out American and European firms.

• The risks of investing in Africa remain high, just as they are for most emerging markets, but the perceived risk is much greater than the real risk. And once the risk goes down, the returns won’t be as good. The key is the management of that risk.
Challenges of doing business in Africa

- Social challenges: business not conducted in a vacuum
- Country risk: Political; legal and institutional; regulatory
- Infrastructure
- Complex labour markets, skills, AIDS
- Cross cultural risk
- Currency risk
- Transaction costs of doing business
Past Political and institutional mismanagement: How leaders leave office in Africa, 1960-1999 … but…

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Overthrown in coup, war or invasion</td>
<td>27</td>
<td>30</td>
<td>22</td>
<td>22</td>
<td>101</td>
<td>5.7</td>
</tr>
<tr>
<td>Die of natural or accidental causes</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>3</td>
<td>12</td>
<td>11.7</td>
</tr>
<tr>
<td>Assassination</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td>7.8</td>
</tr>
<tr>
<td>Retire</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>9</td>
<td>17</td>
<td>11.7</td>
</tr>
<tr>
<td>Lose election</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>12</td>
<td>13</td>
<td>14.8</td>
</tr>
<tr>
<td>Other (interim or caretaker regime, impeachment)</td>
<td>6</td>
<td>8</td>
<td>4</td>
<td>14</td>
<td>32</td>
<td>1.2</td>
</tr>
<tr>
<td>All regime transitions</td>
<td>37</td>
<td>43</td>
<td>37</td>
<td>63</td>
<td>180</td>
<td>7.2</td>
</tr>
</tbody>
</table>
But it is getting better…

• Since early 1990s, direct multiparty elections have been held in more than 40 sub-Saharan African countries. In many of them, the elections were the first post-independence multiparty elections.
Cost of Doing Business Indicators – high but…

<table>
<thead>
<tr>
<th>Economy</th>
<th>Number of procedures to start a business</th>
<th>Cost of starting a business (% of per capita income)</th>
<th>Rigidity of employment index (0-100)</th>
<th>Protecting investors (disclosure index 0-7)</th>
<th>Enforcing contracts (number of procedures)</th>
<th>Enforcing contracts (cost % of debt)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>14</td>
<td>884.6</td>
<td>75</td>
<td>2</td>
<td>47</td>
<td>9.2</td>
</tr>
<tr>
<td>Australia</td>
<td>2</td>
<td>2.1</td>
<td>17</td>
<td>6</td>
<td>11</td>
<td>14.4</td>
</tr>
<tr>
<td>Chad</td>
<td>19</td>
<td>344.2</td>
<td>80</td>
<td>1</td>
<td>52</td>
<td>54.9</td>
</tr>
<tr>
<td>DRC (Congo)</td>
<td>13</td>
<td>556.8</td>
<td>77</td>
<td>1</td>
<td>51</td>
<td>256.8</td>
</tr>
<tr>
<td>Egypt</td>
<td>13</td>
<td>63.0</td>
<td>53</td>
<td>1</td>
<td>55</td>
<td>18.4</td>
</tr>
<tr>
<td>Ghana</td>
<td>12</td>
<td>87.5</td>
<td>34</td>
<td>2</td>
<td>23</td>
<td>14.4</td>
</tr>
<tr>
<td>Mali</td>
<td>13</td>
<td>187.4</td>
<td>66</td>
<td>1</td>
<td>28</td>
<td>34.6</td>
</tr>
<tr>
<td>Niger</td>
<td>11</td>
<td>396.4</td>
<td>90</td>
<td>1</td>
<td>33</td>
<td>42.0</td>
</tr>
<tr>
<td>Russia</td>
<td>9</td>
<td>6.7</td>
<td>27</td>
<td>3</td>
<td>29</td>
<td>20.3</td>
</tr>
<tr>
<td>Rwanda</td>
<td>9</td>
<td>316.9</td>
<td>76</td>
<td>1</td>
<td>29</td>
<td>49.5</td>
</tr>
<tr>
<td>Singapore</td>
<td>7</td>
<td>1.2</td>
<td>0</td>
<td>5</td>
<td>23</td>
<td>9.0</td>
</tr>
<tr>
<td>South Africa</td>
<td>9</td>
<td>9.1</td>
<td>52</td>
<td>6</td>
<td>26</td>
<td>11.5</td>
</tr>
<tr>
<td>Tanzania</td>
<td>13</td>
<td>186.9</td>
<td>65</td>
<td>1</td>
<td>21</td>
<td>35.3</td>
</tr>
<tr>
<td>Togo</td>
<td>13</td>
<td>229.4</td>
<td>76</td>
<td>2</td>
<td>37</td>
<td>24.3</td>
</tr>
<tr>
<td>United States</td>
<td>5</td>
<td>0.6</td>
<td>3</td>
<td>7</td>
<td>17</td>
<td>7.5 14</td>
</tr>
</tbody>
</table>
How to do business in Africa

• The principles of good management apply universally - however, the business environment (including the social, economic, legal and political) is highly complex in Africa because of the continent’s unique history, diversity, geography, political and institutional landscape. E.g. a firm entering SA with the aim of using it as a platform to do business in Africa needs to understand that it will have to confront the country’s apartheid legacy and the country’s attempt to overcome that legacy. e.g. BEE legislates ownership requirements so as to redistribute assets to those who were previously disadvantaged.

• Managers in Africa need to contend with challenges that may be foreign to outsiders. There is a sense of social responsibility that goes hand in hand with leadership in Africa.
• In terms of strategy, it is necessary to be creative and innovative and understand the peculiarities of this market.

• A lack of purchasing power or a lack of infrastructure/competencies in developing countries suggests that ‘down scaled’ or even different product portfolios might be required to harvest this potential fortune at the bottom of the pyramid.

Thus business needs to ensure that its products are affordable in the market it is entering, and if not, an important strategic question arises: should a new product that suits the purchasing power of the African market concerned be developed, and if it is will its cost of development be covered by cash flows emerging from the market involved?
Practical “Tips” on Business in Africa

Conducting business in Africa is fraught with challenges, including:

• Payment may be a problem. The preference is to deal in cash.
• There are port issues in terms of congestion and getting goods through customs and excise. Some suppliers under – or over-invoice to minimise duties, creating big pricing challenges.
• Markets often awash with counterfeit goods. This lowers the market price of branded goods.
• Currency fluctuations pose a problem.
• Industries that depend on reliable transport and logistics find the operating environments extremely challenging.

“Tips” on dealing in Africa

• It is important to have a trustworthy person on the ground to get from place to place and to provide good market intelligence.
• It is better to enter the market slowly or in phases.
• Managers need to be more generalist than EU managers, who specialise.
• Companies cannot operate exactly as they do back home.
• One has to work hard at both government and local community relationships.
• Business leaders need to be flexible, and handle and manage change – often in challenging environment.
So what does this all mean?

• Opportunities for companies in SSA are immense and it would be foolish to ignore. Others will make a lot of money in SSA. Many examples of SA companies making huge profits off the African operations relative to their turnovers. The demographics of rising populations which are young and middle class means there is money to be made.

• BUT do not buy into rosy idealistic pictures (it is going to be the African cha-cha-cha – few steps forward and a few back – mainly because of political backsliding

• There are going to be winners and losers amongst countries and companies in SSA.
Conclusion: Looking forward…

• It is the right time for international business to take a close look at a continent which has had a difficult recent past but where the conditions for growth, development and profits have never looked better. The institutional environment has improved, a major democratic wave is underway and international business is being welcomed. Africa does not provide the risk profile today that it did three decades ago. Much still needs to occur and certainly doing business in Africa will be a challenge but if one embraces the challenges then the opportunities are greater here than almost anywhere else.
A little advertising: