Prepare for opportunity™ Economist Intelligence Unit

Into Africa:
Emerging opportunities for business
A special report from the Economist Intelligence Unit

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The rise of Africa

Ten years ago, *The Economist* ran a cover with the title "Africa: The Hopeless Continent". Today, this has been replaced by "Africa Rising" (last December's issue)—a reflection of the changes that the continent has experienced over a decade. What has engineered Africa's rise through difficult times? It is predominantly the emergence of the BRICs, particularly India and China, that has helped to put Africa back on the map of development and investor interests.

This paper looks at what is in store for Africa, its growth trajectory, other key driving forces, and the opportunities and risks for investors going forward.

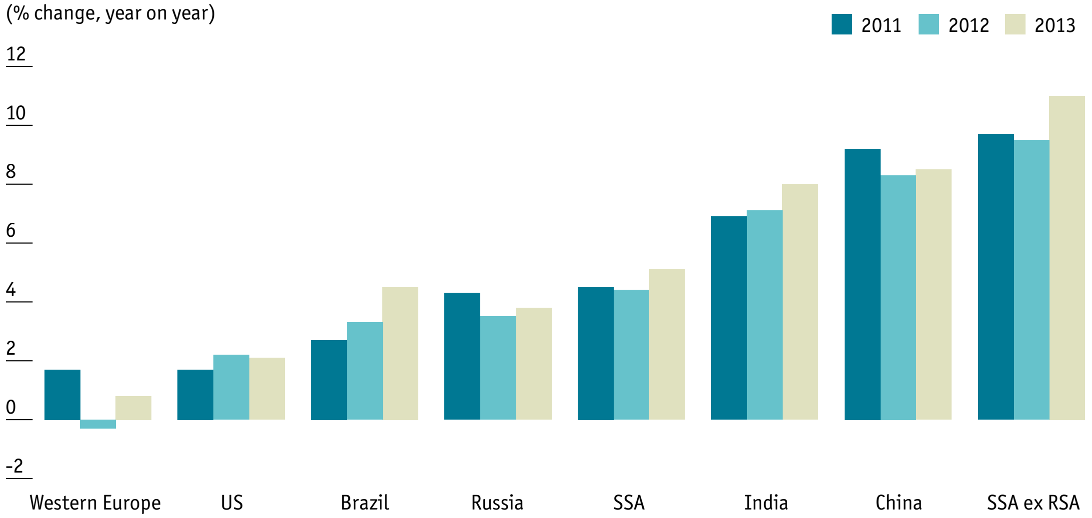
Africa today is for the most part at the beginning of the industrialisation stage. Take Eastern Europe 20 years ago or India in 1994—this is the stage of development in Africa at the moment. However, the last ten years have been positive for Africa. Growth has been rising by 5-6% per year, on the back of ongoing reforms, a fall in political risk, debt write-off and the well-documented commodity prices story.

What does this mean for Africa going forward? In economic terms: "Despite the growth seen in the last decade, and although there was a setback in 2008 owing to the global crisis, the continentstill managed growth of 2%." In a scenario like this, which would have happened a decade ago, Africa would have had negative growth of almost 10%, and would have failed to recover for a very long time. So this is simply an indicator of where it is heading now: this is a V-shaped recovery seen since 2008.

Growth in a stagnating world

- Africa is small: just 3% of the global economy;
- Sub-Saharan Africa (excluding South Africa) makes up less than half of the continent's GDP;
- But this group of countries is growing faster than anywhere else in the world;
- Investors are waking up to the enormous potential: the race to share in African growth has begun.

Real GDP growth
(% change, year on year)



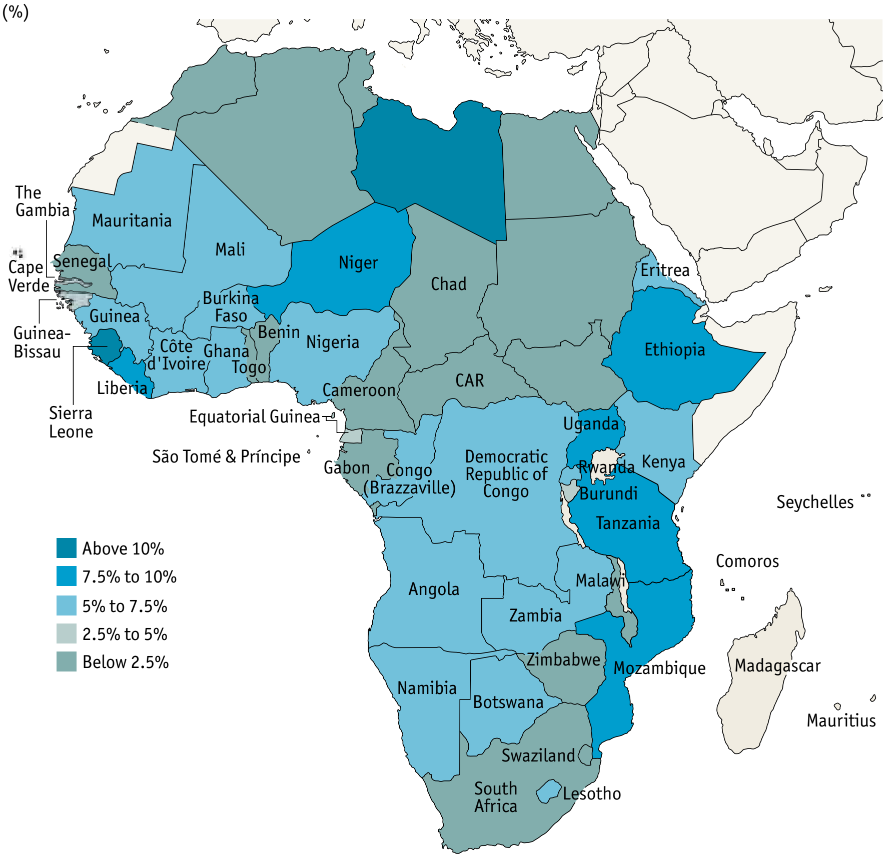
In terms of the global picture, Africa's contribution, despite investor interest, is very small at only 3% of the global economy. However, this is the continent that is attracting investors' attention across the globe. A recent survey of core types of investors, institutional investors into Africa, was carried out by the Economist Intelligence Unit across a number of multinational companies operating in Africa or looking at operating in Africa. The results found that Africa held the greatest overall investment potential for all frontier markets going globally, and this is also an area where investors plan to increase their asset allocation in the long term.

Africa is a continent, made up of a group of countries. It is not just one country. Businesses that have a better understanding of what this really means retain the key to realising the opportunities, risks and potential.

The growth picture

A total of 28 out of 52 countries are expected to see annual average growth of 5% over the next five years. Other countries, for example Ghana, which joined the other oil producers, Angola, Nigeria and Equatorial Guinea, last year with its first commercial production, grew by 9.8% in 2011. Given ongoing development in the oil sector and non-oil sector, Ghana is still expected to notch up a fairly high growth rate in 2012-16.

Real GDP growth (2012-2016 forecast)
(%)



Growth is uneven

- 28 out of 52 countries will grow by more than 5% per year between 2012 and 2016
- A huge informal sector means that actual growth is typically higher—but what cannot be measured cannot be measured!
- Sierra Leone and Libya to grow fastest, thanks to "one-off" events
- Ethiopia, Liberia, Mozambique, Niger and Ugranda will enjoy real growth between 7.5% and 10% per year
- Investors focus on growth drivers, rather than growth *per se*

Sierra Leone and some of the smaller countries will also provide great potential for opportunities. Sierra Leone, post-civil war, is now expected to post the fastest rate of growth this year, at 25%, once again on the back of the mining sector. The natural resources sector is also the area that has been attracting the lion's share of investor interest, and this will remain the case for a number of years. Another trend that has been developing in particular in the last six years is the rise in consumer markets. Thus, non-resource-based activity has also been growing—a clear indication that reforms, structures and regulations are changing for the better.

Key mineral producers like Tanzania and Mozambique will also continue to perform strongly, and investor interest will remain very high. Some countries, however, will struggle, for example Zimbabwe, where ineffective poor governance and bad policies continue.

Key engines for African growth

The 'peace dividend'

Africa and politics go hand in hand. The African continent is still considered to have the highest political risk factor in the world, and the recent coup in Mali is a reminder of the fragility of some of the countries. Mali was considered to be one of the most democratic nations, with freedom of press and a good human rights record, is another example. And South Africa's democracy is only 18 years old, so there is a substantial amount of work still to be done.

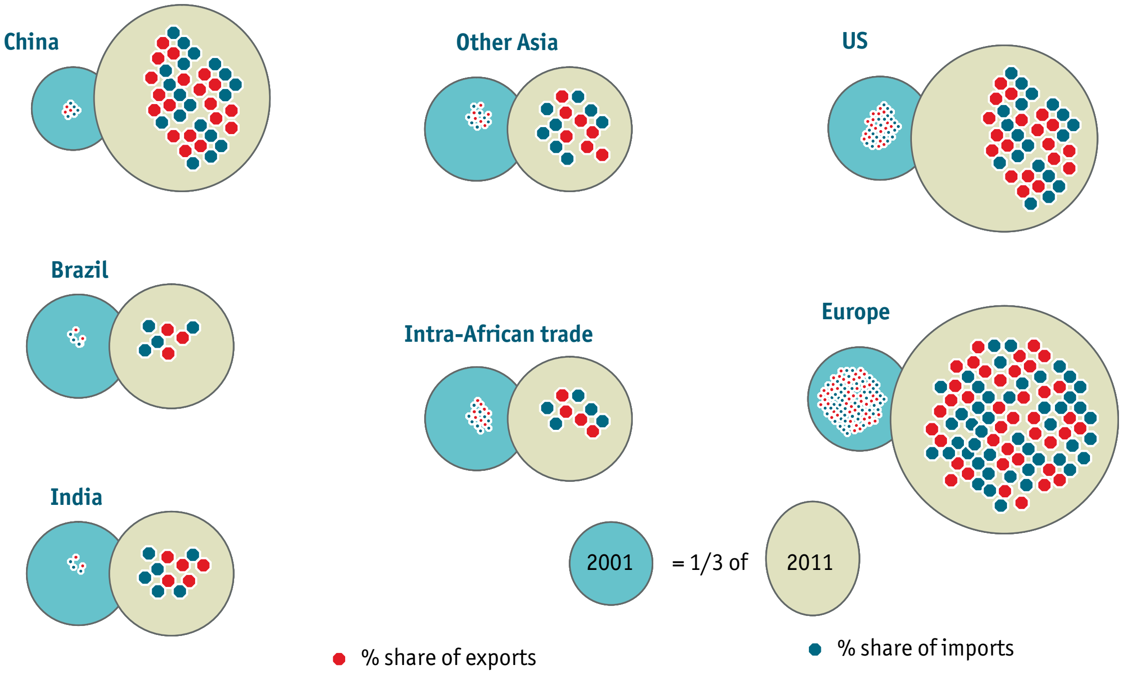
But a number of economies have made a transition. In 2000 Angola's civil war came to an end, and this is where the greatest opportunities have been realised.

Urbanisation

Urbanisation is taking place at a very fast pace, and the continent's demographic picture is rapidly changing. Its demographics is one of the youngest, and it is a dividend and a risk. In the 1990s, some 250 million Africans were town dwellers, excluding the slums. By 2000, the number had increased to 270 million. This represents an urbanisation pace of 4% a year. Forty nine African cities now have a population in excess of 1 million, and five of those—Cairo, Khartoum, Lagos, Luanda and Johannesburg—are home to over 7 million. With the exception of Luanda, all of these cities are larger than London. This creates a wealth of opportunities, but constitutes a number of drawbacks for the local governments as well.

Urbanisation, market sizing, is therefore one of the key areas of focus for international businesses as part of their African strategies going forward.

China's share of trade



Trade, not aid

The other main driving force of growth is trade, which has risen in terms of value since 2005. Oil and minerals are still the key exports. A large number of the economies, including South Africa, are very import-dependent.

Europe is still Africa's largest trading partner, but China's share of trade has exploded in the last decade. (The chart illustrates the absolute growth in the value of imports and exports, indicated by the relative size of the red and blue dots. In 2001 trade was worth about one-third of its US dollar value in 2011, and each dot—regardless of its size—represents 1 percentage share of trade in that year.) Ten years ago, China was not that significant as a trading partner. It supplied only 3% of African imports and purchased 5% of the continent's exports. Today, its share of trade is on a par with the United States. No other Asian country has such a dominant presence—even Japan accounts for only 7% of trade.

The growth in trade—and indeed of Chinese investment into Africa—is driven by China's own need for resources, but equally by its long-term policy of "going out", based on the need to develop consuming markets that will buy Chinese goods and services not today, not even tomorrow, but the day after tomorrow. Allied with that is the strategy of moving low-value added manufacturing offshore, to markets where real wages are lower than they are in mainland China.

The rise of technology

Another key area of growth is technological change. Mobile-phone penetration has indicated that there is a large untapped consumer market on the continent, which took the world by surprise when it started growing and deepening.

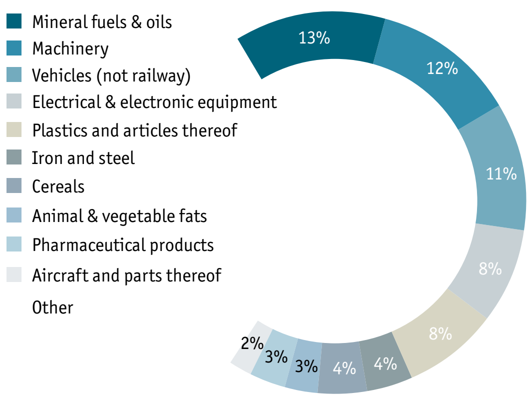
The number of mobile subscribers in Africa exceeded the 0.5 billion mark in 2010, and there is still further room for growth. With the exception of South Africa, all the markets are just taking off. Africa's ongoing connection to the global fibre-optic network continues: along with the rise in mobile phone usage, more fibre-optic cables have been laid. Last year, EAC, the East African countries, came on board. This will not only help to deepen the Internet and telecoms markets and allow businesses to operate more efficiently and cost effectively in the future, but will also present significant opportunities for the business sector.

Together, these dividends—urbanisation, expansion of trade and technological change—all indicate that growth is on a permanent trajectory. The road will be bumpy, but growth rates of 5-6%, and in some cases 8-10%, are certainly likely in the coming decade.

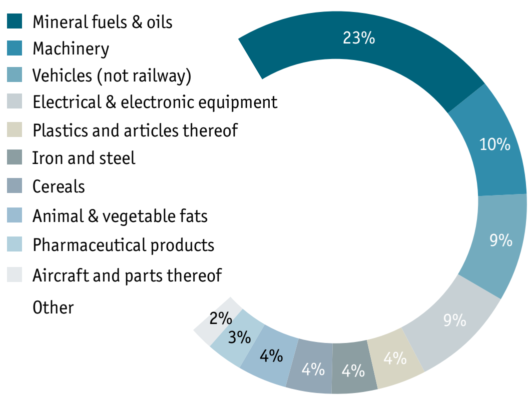
The needs of African consumers

Set against this background, what are the key opportunities? What do African consumers want? As already indicated, demographics is a key driving force, as evidenced by the three key trading blocs: ECOWAS, which covers all the West African countries; EAC, which covers Eastern Africa; and SADC, which covers all of Southern Africa. Combined, they account for most of Sub-Saharan Africa.

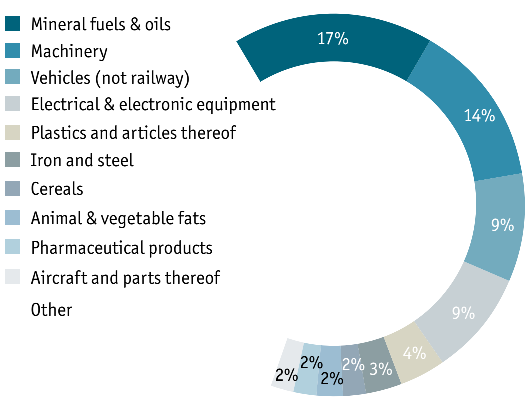
ECOWAS–top 10 imports



EAC–top 10 imports



SADC–top 10 imports



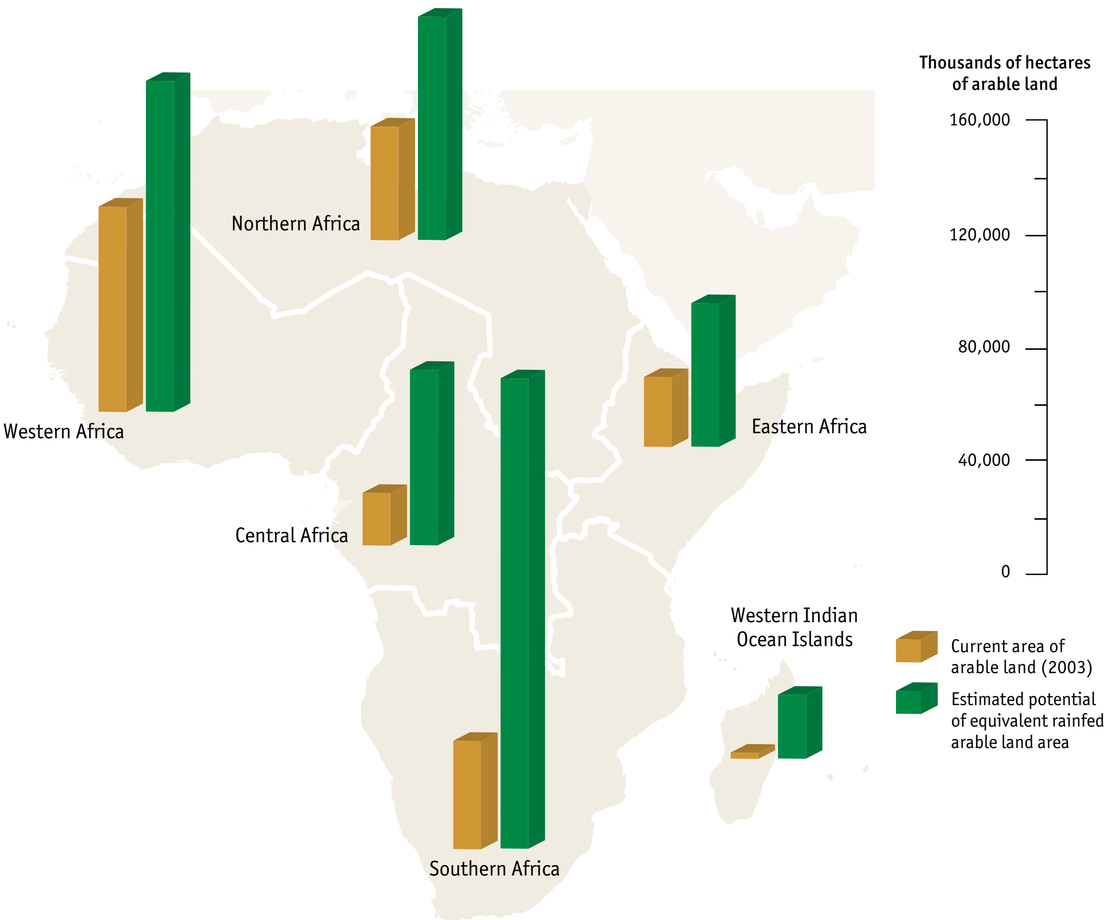
Africa needs development in almost every sector, and the demand for consumer goods is rising. How to tap into those markets is what business strategies must consider.

It is clear that Africa's production potential does not match its needs. It is a major oil producer and has a key mining sector, but it does not have refining capacity. Nor does it have manufacturing sectors or plants on the ground, with the exception of South Africa. But African consumers need everything, from electrical and electronic equipment to iron and steel and even cereals.

Key development areas

Agriculture and agriprocessing

Food is a surprising import requirement, as this is a region that should be supplying to the world. Africa's arable land makes up 40% of arable land globally. Yet only 10% of cultivated arable land globally. The main reasons for this are underinvestment, lack of clear policy, poor regulations, inefficient supply chains and inadequate fertilisation. But agriculture is still the largest employer and the key sector in many countries. Agriprocessing and the development of the agriculture sector will be top of the agenda for governments and the private sector alike in the coming years. Countries like Ethiopia have already started investing and are benefiting from that on the back of the private sector.



Infrastructure

Another area for opportunities is infrastructure. This is one continent in which decades of underinvestment and mismanagement have resulted in underperforming sectors in railways, roads and power. Almost 0.5 billion Africans do not have access to electricity. To highlight the depth of the problem: Nigeria, with a population of 180 million, has the same electricity capacity as Hungary, which has a population of 10 million. A substantial amount of investment is needed in Africa's infrastructure—an estimated US$100bn a year is needed in the power sector alone.

A substantial amount of work has been done in the last decade with the help of Chinese investment. Chinese companies are building roads and upgrading railways, ports and airports, but much more needs to be done. The congestion at airports is well documented: the cost of sending a crate from Dar to Durban is the same as the cost from Durban to Singapore, so investment opportunities abound.

- Decades of under-investment continue to take their toll
- Large-scale infrastructure projects covering most aspects of transportation exist but implementation is very slow
- Chinese companies have a comparative advantage but also face reputational issues
- Inadequate and unreliable power supply is typical in Africa:
    - Adds cost burden for businesses
    - Made worse by inefficient parastatals
    - Use of wood and kerosene adds to burden of disease and CO2 emissions
    - Renewable energy—especially solar—offers signifficant potential but legislative framework often lags

The services industry

Services is another key growth area in both commercial and retail outlets. Almost nine in ten Africans are unbanked, and as the economies grow and they move up the global chain, consumers will need access to banking services. The innovative payment solutions in the interim period, such as M-Pesa in Kenya, have helped to boost the services sector in that region.

The securities exchanges are very mature and provide plenty of room for growth as the economy and the financial sectors continue to grow. A number of private equity firms have been looking very closely at the continent for the last two years, particularly since the global crisis, and have realised the growth potential. One of the other benefits is that Africa is open to foreign banks across a number of countries.

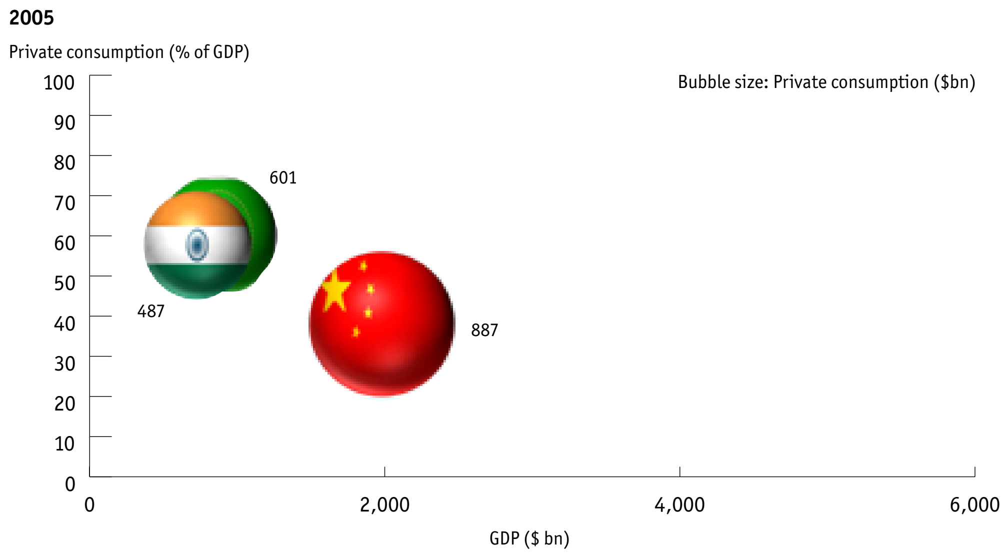
- Financial services:
    - Bank assets set to triple by 2020
    - Transactions: four out of five Africans don't have bank accounts ... yet
    - Innovative e-payment solutions
    - Most securities exchanges immature but growing investor appetite likely to force development
- Communications:
    - Mobile phone market not yet saturated
    - Mobile data sector offers huge potential
    - Internet penetration still very low, but growing
    - Price-sensitive mass market

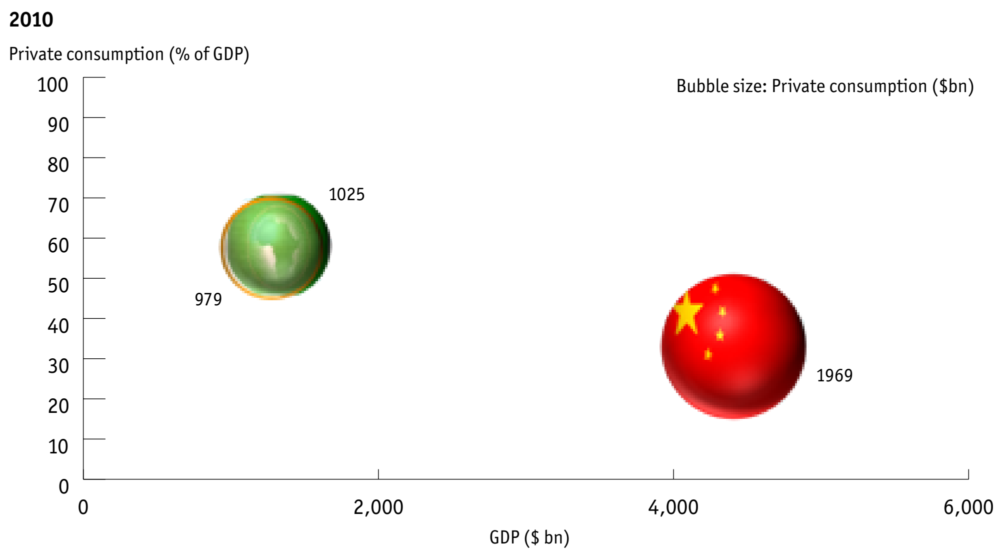
- Hospitality
- Healthcare
- Education

Consumer goods

The rate of private consumption in Africa is similar to that in India and is growing fast, but could grow faster. The lack of credit facilities constrains growth, as does the lack of availability of shopping opportunities. Shopping malls are growing, in tandem with growth in the cities, but they do not capture the large percentage of the consumer market.

The need and the demand for manufactured goods is strong and will continue to grow. However, very little is produced on the ground. This is what is needed both to create jobs and to supply to the local market.





- Private consumption is similar to that in India
- It is growing fast—but not as fast as it could
- Lack of credit facilities constrains
- Most manufactured goods are imported: local plants and/or assembly would generate jobs and increase consumption further
- Expansion of formal retail outlets (shopping malls) is an emerging trend
- Internet purchases are in their infancy

China is playing an increasing role in this area. One of the key planning areas over the next decade is to establish free economic zones in the main financial and business hubs of Sub-Saharan Africa. There is already one in Mauritius, and more are planned in Johannesburg, Nairobi, Lagos and Accra. Such key developments are crucial to establishing manufacturing industries on the ground in order to supply both to the local market and export markets.

The key markets over the coming decade

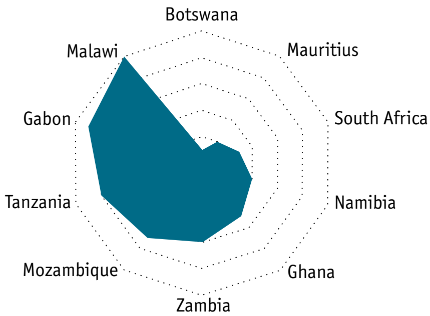
The Economist Intelligence Unit has identified the best-performing markets over the next decade according to four categories: countries with the lowest political risk; the fastest reformers; countries with the highest investment score; and the biggest countries by land size.

Political risk is very important, as already mentioned. Countries that are in the web of low political risk are Botswana and Mauritius. Although they are very small markets, they are safe countries in which to establish a business with a view to branching out into other parts of the region. Botswana has tried to compete with Mauritius, but it is still very weak in terms of technological development.

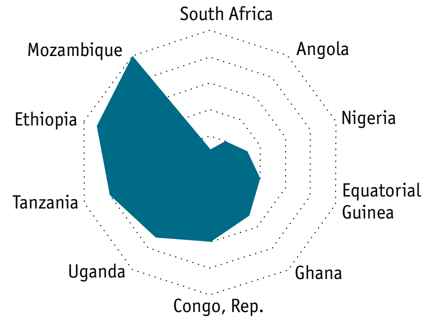
In terms of the fastest reformers, Ethiopia is the star performer. It has the second-largest market. Ethiopia is not on the radar of many investors, but it has the third-largest population in Sub-Saharan Africa, and the economy has been growing by double digits for the last decade across the agriculture sector, power, roads, ports, as well as a number of other areas. There are also opportunities in the financial telecoms sectors, which are earmarked to be privatised, underpinning further double-digit growth in the future.

- Botswana and Mauritius are the least risky countries in SSA, but are too small to be of interest to most businesses
- Botswana has tried to compete with Mauritius as a financial centre and is currently focusing on becoming a technological innovation hub
- Based on the World Bank Doing Business Report, score combines 2012 rank (1/3 weighting) and improvement on previous year (2/3 weighting)
- Ethiopia is also attracting huge investment, has the second-largest population in Africa, and is a star performer on three out of four measures
- The investment score is based on net foreign direct investment (FDI) and fixed investment in the economy
- South Africa wins by sheer size, but Angola, Nigeria, Equatorial Guinea and Ghana are all growing fast too
- Size measures the economy and the population, as well as GDP/head

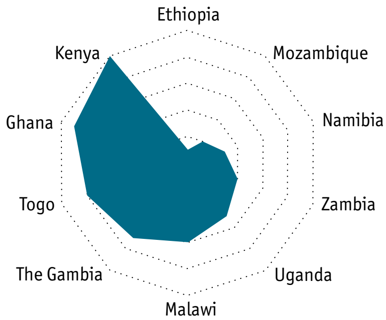
Lowest political risk



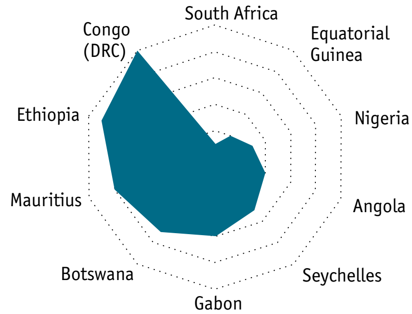
Highest investment



Fastest reformers



Biggest



- South Africa is obviously at the top of the league, but it won't be long before the country is overtaken by Nigeria and Angola, both of which are growing much faster

What are the challenges and risks?

The challenges and risks for investors in Africa are plenty and diverse. Africa is not a country, but 55 countries; or 56 if South Sudan is taken into account. This translates into 56 different regulations, governments and languages; 2,000 languages are spoken on the continent. Potential investors will therefore need to navigate through a very complex business environment.

- Africa is not a country!
- Political risk is high
- Corruption continues to be a problem at many levels
- Institutions are weak
- Even where the regulations are OK, local officials may not know what they are
- Communication can be difficult, especially across cultures
- Easy to underestimate the true cost of doing business – elevated because of the scarcity of key inputs (e.g. skilled labour, power, time to import/export)
- Despite this, more than one in five Fortune 500 global companies now operate in Africa!

Corruption, which comes a very close second to infrastructure problems, is still growing. The political will is lacking to address it, and we believe that the level of corruption is increasing as the individual economies grow. Their projects are big-ticket projects and the numbers are much bigger as well. So this is something that you need to take on board in a number of countries.

Also, institutions are very weak, bureaucratic and cumbersome. For instance, in Rwanda it takes two days and four procedures to set up a business. In Kenya, it takes 24 months and almost 30 procedures.

Another key concern is the poor skills base. Businesses already operating in Africa continue to highlight the skills shortage. Although governments are ploughing almost 10% of their budgets into education, we estimate that it will take a generation of public and private investment to make a difference.

Conclusion

Most of the top Fortune 500 companies are already operating in Africa, have been operating in Africa for the last decade, and will continue to have a presence in the coming decade. (The chart does not include oil and mineral companies.)

- Companies from every continentand sector are stepping uptheir operations in Africa

- The potential for growth is clear
- Key sectors include:
  - Agriculture & agriprocessing
  - Infrastructure
  - Services
  - Consumer goods

- Investors face significant challenges:
  - Corruption
  - Infefficiency
  - Political risk
  - Lack of skilled labour
- But reform is happening fast, spearheaded by Ethiopia,Mozambique, Namibia, Zambia and Uganda
- While the giant economies of Angola and Nigeria, likelyto overtake South Africa by 2016, offer significant upside to investors

The potential is clear. Various sectors have registered growth but almost every area still needs development. Opportunities abound, but the risks are equally challenging. Thus, when looking at Africa in terms of investment opportunities, companies need to do their homework. It is not just a continent, but a number of individual countries, and business models may need to be constantly revised. Zimbabwe was a success story but overnight became a headache for investors. *Companies must prepare for opportunity*.

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Americas: +1 212 698 9717
Asia: +852 2585 3888
Europe, Middle East & Africa: +44 (0)20 7576 8181

Media Enquiries for the Economist Intelligence Unit

Europe, Middle East & Africa

Grayling PR
Jennifer Cole
Tel: +44 (0)207 592 7933
Sophie Kriefman
Tel: +44 (0)20 7592 7924
Ravi Sunnak
Tel : +44 (0)207 592 7927
Mobile: + 44 (0)7515 974 786
Email: allgraylingukeiu@grayling.com

Americas

Grayling New York
Ivette Almeida
Tel: +(1) 917-302-9946
Ivette.almeida@grayling.com
Katarina Wenk-Bodenmiller
Tel: +(1) 646-284-9417
Katarina.Wenk-Bodenmiller@grayling.com

Asia

The Consultancy
Tom Engel
+852 3114 6337 / +852 9577 7106
tengel@consultancy-pr.com.hk
Ian Fok
+852 3114 6335 / +852 9348 4484
ifok@consultancy-pr.com.hk
Rhonda Taylor
+852 3114 6335
rtaylor@consultancy-pr.com.hk

Australia and New Zealand

Cape Public Relations
Telephone: (02) 8218 2190
Sara Crowe
M: 0437 161916
sara@capepublicrelations.com
Luke Roberts
M: 0422 855 930
luke@capepublicrelations.com

LONDON
26 Red Lion Square
London
WC1R 4HQ
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

NEW YORK
750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
E-mail: newyork@eiu.com

HONG KONG
6001, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

GENEVA
Boulevard des Tranchées 16
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
E-mail: geneva@eiu.com