Fifteen years Fifteen lessons from Africa

Chapter I: Lessons of Strategy

INVESTISSEURS & PARTENAIRES

1 *Lesson of Strategy*

1. Lesson n°1: Africa is one continent, but a diverse one
2. Lesson n°2: The business environment is improving, but in a gradual and disparate way, which engenders integrity risks for firms
3. **Lesson n°3: The African middle class is shaking up market dynamics but has not closed the debate on growth patterns**

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At the end of the 2000s/2010s, both African and international investors gradually began to observe a pattern of economic growth based on the emergence of an African middle-class and generated by a growing demographic dividend, population densification and the urbanization process. This economic growth model, grounded on strong macroeconomic parameters, (notably a strong increase in private consumption and substantial budget and trade deficits in countries that do not produce gross materials) has driven a growing number of investment decisions.

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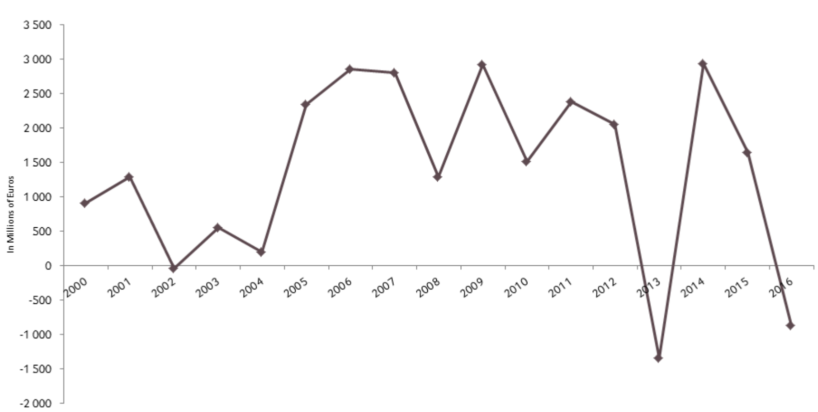
For the first time in history, the African continent has been perceived, not as a vast empty space of natural resources and labor to be extracted, but rather as a densely populated continent where the investment rationale is based on the demographic growth explosion and the emergence of a middle class with a high demand for consumer goods that while sometimes basic or necessitating adaptation for Africa, could also be satisfied by global brands. This consumer trend has begun to affect the manufacturing sector as can be observed in the automotive industries in Nigeria and Kenya. It resulted in a significant growth of international investments, that can exemplified through the investment flows from French multinational firms during the last 15 years.

Net Investment flows from French Multinational firms to Sub-Saharan Africa



Source: Banque de France (2017)

I&P has been involved – in its small way – in Africa's unprecedented social and economic transformation. During the last fifteen years, many large-sized international companies have invested in the production, distribution, and sales of products and services that have benefited the emerging African middle-class, and a myriad of business opportunities have opened up for African entrepreneurs in various industries including local food production, education and health services (health infrastructure, wholesale and retail pharmaceutical production and distribution), construction, modern mass retail, financial services and information technology. There are many entrepreneurial initiatives that have become interesting targets for SME-focused investment funds and larger firms.

This trend will continue to grow. Indeed, it is grounded on a strong foundation of profound demographic and societal transformation whose magnitude will encompass the entire 21st century. Furthermore, the increasing movement of international investment flows toward the consumer sectors of the African economy shows no signs of stopping. We have entered a new period of dynamic African-economic growth based on the development of domestic markets and fueled by local production and distribution.

Zoom: Eden Tree

The vast majority of the companies supported by I&P (90%) directly address local unmet needs, in a wide variety of sectors, ranging from essential goods and services (health, food, education, energy) to construction, equipment... Companies operating in the agribusiness and health sectors – two sectors that are widely represented in the portfolio – are particularly benefitting from the demographic dividend, finding opportunities in the emergence of the middle classes and taking advantage of the development of distribution channels.

This is for example the case with Eden Tree, a company that provides fresh fruits and vegetables in Ghana. Its founder, Catherine Krobo-Edusei, explains the origins of the company: "When I came home to Ghana, I saw there was a need for freshly and safely produced vegetables, herbs and fruits. There was a lot of worry about growing vegetables with contaminated water. I must say I was blown away by the scale of demand that existed!"

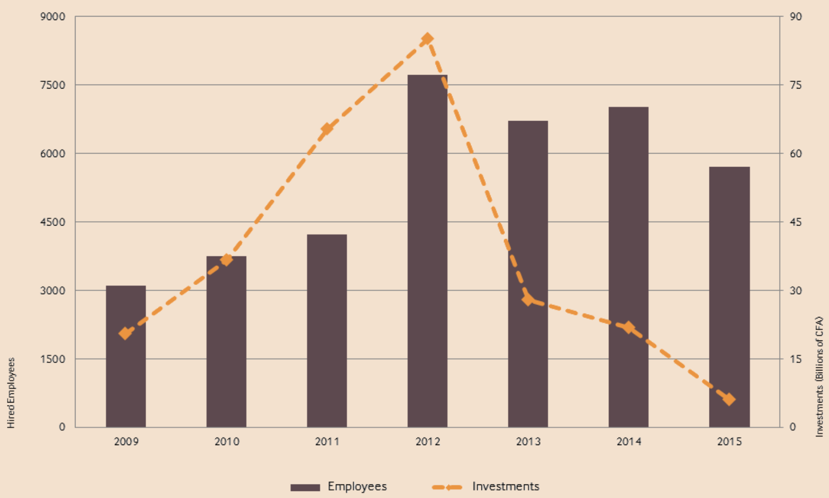
However, three aspects of this growth should be taken into account.

The first aspect refers to the macroeconomic instability in Africa, which has been acutely illustrated by the recent Ghanaian crisis and the financial collapse of the oil-producing countries, which were strong pillars of the emergence of Africa's middle-class. As a result, this middle class has slowed and overly optimistic and even excessive expectations of some investors have not been met. Like Africa's economic growth, this instability is here to stay. The public debt of African governments continues to grow, which will further increase this instability. New macroeconomic adjustments are expected in numerous countries in the coming decade, in oil producing and mining countries, as well as others, whose dependency on commodity prices will continue. These adjustments will also affect the growth rate of African middle-class incomes. In addition, other countries struggling to enter their demographic transition and facing increasing security challenges – as in the Sahelian region – will benefit from Africa's general growth trend to a much lesser extent. The tremendous dynamics of the African domestic market that we have emphasized above will primarily affect the coastal countries in West and Eastern Africa. It will also concern some landlocked countries that are well governed, such as Rwanda today, and to a lesser extent the rest of the continent.

Case Study: Construction Industry in Gabon

Between 2009 and 2014, the Gabonese construction industry experienced tremendous growth at a rate that reached over 150%! Since then, it has been severely affected by a significant decrease in public procurement.

Evolution of investments and jobs in the Construction industry in Gabon



Source: Global Entrepreneurship Monitor (2016)

On a more positive note, a second aspect is linked to a less discussed feature of African growth: the increasing attempts by African investors and entrepreneurs to upgrade channel exports. These initiatives affect first and foremost agribusiness production (coffee, cocoa, fruits and vegetables) and complement the increasingly abundant supply of food products targeting domestic markets. We will return to this later.


IOT © Joan Bardeletti

Case Study: Madagascar

If we take the example of our investments in Madagascar, out of the six companies that we funded throughout our investment vehicles, four have export-oriented strategies. This is the case of Phileol, a company specializing in the collection and processing of oil seeds in southern Madagascar. The company produces castor oil for export, but also seeds such as jatropha, moringa, prickly pears, marula and baobab. Other agricultural companies have turned to the export market in order to generate greater margins than those available in their domestic market, through the supply of quality products: this is the case of Scrimad, an export and processing company for lychees targeting the European markets, or of the company IOT, which produces sea cucumbers for the Asian market. In another sector, the textile industry, Ultramaille specializes in hosiery, knitting and pullover manufacturing and exports mid-range and high-end knitwear to European markets. The impact of these enterprises is therefore less downstream in the value chain than upstream, through the number of farmers and small producers to whom they provide a stable outlet and provide a regular source of income, in addition to the number of jobs they create and the inflows of foreign exchange that they facilitate.

The third aspect related to Africa's economic transformation is also positive. It refers to the ever-increasing dynamism due to the relocation of Chinese factories to East Africa as well as to some African countries that are not part of East Africa but that have developed dynamic Asian-style manufacturing export sectors, such as Mauritius and Madagascar. The dynamism under way is a result both of the burgeoning working force that Africa previously lacked and the explosive productivity and structural changes occurring in the Chinese economy; it is thus a long-term phenomenon.

Our third lesson is related to the demographic explosion that the continent is currently experiencing and that is generating both countless market opportunities and a productive workforce which is repositioning Africa in international trade. Although investing in this demographic trend will surely be beneficial in the long run, Africa's macroeconomic volatility requires general precaution, common sense and avoidance of any excess optimism. The growing investment opportunities in manufacturing and agribusiness sectors, offered by the world market and domestic public policies should also be considered for their potential benefits in terms of foreign currency risk reduction.