Africa on the move

The quest for sustainable growth

Ernst & Young
Quality In Everything We Do

In collaboration with

SKOLKOVO
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Institute for Emerging Market Studies

Acknowledgment

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A picture showing the Carlton Centre and Trust Bank Building in downtown Johannesburg, two of the tallest buildings in Africa. The Carlton Centre is a bustling shopping precinct and the headquarters of Transnet, a key player in the quest to bridge the continent's infrastructure deficit.

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Africa on the move

Introduction

Over the past few years, Ernst & Young has been at the forefront of those showcasing Africa's growth story. Our *Africa attractiveness survey* provides evidence of the growing interest in the continent as an investment destination and place to do business. Over the past decade, Africa's GDP has more than tripled. According to *The Economist,* in 8 out of the 10 years from 2000, Africa grew faster than East Asia.[1]

Parts of Africa are well on the way to becoming some of the most dynamic places in the world for investment. In recent years, an encouraging economic environment — with significant reforms in macroeconomic management, improved incentives for the private sector and a broadly favorable international context for commodity exporting countries — has spurred high growth rates in many African nations. While most of the world is facing major economic and political uncertainty, Africa is expected to continue its growth trajectory in the coming years. According to the International Monetary Fund (IMF), growth in sub-Saharan Africa (SSA) is expected to average 4.8% in 2012 and 5.8% in 2013.[2] *The Economist* also predicts that between 2011 and 2015, 7 of the world's 10 fastest-growing economies will be African.[3] With 20% of

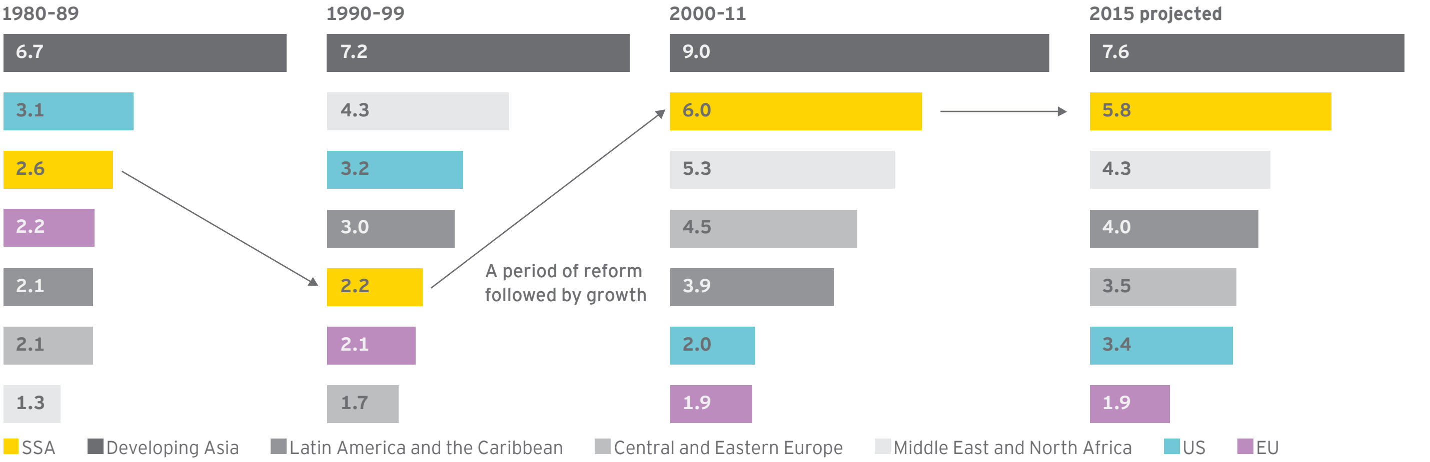
1. "Africa rising," *The Economist*, 3 December 2011, http://www.economist.com/node/21541015, accessed 8 February 2013.
2. "Gradual Upturn in Global Growth During 2013," World Economic Outlook Update, IMF, 23 January 2013.
3. "Africa rising," *The Economist*, 3 December 2011.

the world's land mass – more than China, India, the US, Japan and most of Western Europe put together – and 15% of its population, Africa is being touted as the world's last major economically untapped region.

Figure 1

GDP growth rates

Africa's evolution over the years vis-à-vis other regions (Real GDP growth rate in %)



Source: IMF World Economic Outlook Database, October 2012. The GDP growth rates have been calculated as an unweighted average for the respective time frames.

Factors driving Africa's success

In Africa, a broad range of factors have created favorable conditions for economic transformation, which could see rapid growth become sustainable and inclusive in the future.

Improving macroeconomic indicators and business environment

Government reforms and initiatives have reduced inflation, budget deficits and debt levels in Africa. In our sample of 15 SSA countries,[4] the debt burden – measured as the stock of external debt to gross national income (GNI) – decreased from an average of 120% in 1994 to 21% in 2011.[5] Africa's regulatory, legal and business environment has also improved.

According to the World Bank's 2013 Doing Business Report, among the 50 economies globally that have most improved their regulatory environment for business since 2005, the largest share – a third – are in Sub-Saharan Africa. In the 2013 rankings, 8 African countries rank ahead of China (the highest ranked BRIC country), 11 ahead of Russia, 16 ahead of Brazil, and 17 ahead of India.[6] Most African economies have also opened up to trade and investment. According to Ernst & Young's 2012 *Africa attractiveness survey*, over the past three years, the perception of Africa as a place in which to do business has improved – and will improve further over the next three years.[7]

4. Averages have been calculated for the following 15 countries: Botswana, Burkina Faso, Cameroon, Ethiopia, Ghana, Kenya, Mauritius, Mozambique, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda and Zambia.
5. World Development Indicators, World Bank, 2012.
6. *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises*, World Bank and International Finance Corporation, 2013.
7. *Building bridges: Ernst & Young's 2012 attractiveness survey: Africa*, Ernst & Young, 2012.

Demographic dividend, rising middle class and urbanization

It is estimated that Africa's population will double in the next 40 years to reach two billion — which will be 20% of the world's population in 2050. The median age in the continent is just 20 — making it the world's "youngest" continent. As a result, by 2040, Africa's potential labor force is expected to be more than 1.1 billion people, which exceeds projections for the Chinese and Indian workforces.[8] While severe income disparities still persist in Africa, a genuine middle class is emerging. Consumer spending is expected to increase from US$680 billion in 2008 to US$2.2 trillion by 2030.[9] This section of the population has increased spending power and represents a vast potential market with great opportunities. Furthermore, urbanization is an upward trend across the continent, increasing at 3.5% per year for the last two decades, the highest rate of urban growth in the developing world. It is estimated that the proportion of Africa's population living in urban environments will increase from 36% in 2012 to 50% in 2030 and 60% by 2050.[10] Rapid urbanization is resulting in efficiency, small-scale industrialization and infrastructure to major cities — all of which is attractive to investors.

Growing links with emerging economies

There has been a substantial increase in the economic presence of other emerging markets in Africa. The BRIC's share in African trade has increased from just 1% a generation ago to 20% today. By 2030, this share is expected to be 50%.[11] China and India in particular are looking to Africa to help meet their energy security needs, as a market for manufactured goods and potentially for long-term food security too.[12] Africa's raw material resources have caught the attention of the Chinese, both as a potential lender and trade partner. Similarly, Indian investment in Africa has grown significantly, particularly in telecoms, agriculture, infrastructure and mining. Importantly, Indian interest in Africa is led by emerging private sector companies. Brazil has also intensified its efforts to invest in Africa and compete with China and India.

Private sector participation

African leaders are eager to move away from dependence on aid and the accompanying conditions imposed by donors. This development has spurred a rising technocratic class in SSA that is well aware of the challenges to raising income and competing globally, including infrastructure investments, regulations and maintenance. The growing influence of the private sector in Africa is evident in the increasing number of leaders and cabinet members from the corporate world. Privatization programs in many African countries during the last two decades have resulted in the sharp fall in government equity share in privatized companies, from 89.1% to 10.3%.[13] This was particularly intensive during the 1990s, when privatization was a central element of reform programs. There is a further opportunity for wider private sector participation in areas that have traditionally been dominated by the public sector. In the energy sector, for example, private providers are participating in rural electrification projects to facilitate solar home-lighting systems.

Natural resources

Africa has great reserves of natural resources. Nigeria and Angola are among the top 20 oil producers in the world. African countries make up 11 of the top 50 countries in terms of proven oil reserves. South Africa, Ghana and Tanzania are among the top 20 gold producers; Zambia and the Democratic Republic of Congo the top 20 copper producers.[14]

8. "The sun shines bright," *The Economist*, 3 December 2011, www.economist.com/node/21541008, accessed 26 November 2012.
9. Calestous Juma, "Africa's new engine," *Finance & Development*, vol. 48 no.4, December 2011. This magazine is published by the IMF. Available at: www.imf.org/external/pubs/ft/fandd/2011/12/juma.htm, accessed 17 December 2012.
10. "Urbanization in Africa," Africa Development Bank Group, 13 December 2012.
11. "The sun shines bright," *The Economist*, 3 December 2011.
12. "Africa-India trade and investment — Playing to strengths," Standard Chartered, 8 August 2012.
13. John Nellis, "Privatization in Africa: What has happened? What is to be done?" Center for Global Development, Working Paper no. 25, February 2003, http://www.cgdev.org/files/2765_file_cgd_wp025.pdf, accessed 23 January 2013.
14. *Building bridges: Ernst & Young's 2012 attractiveness survey: Africa*, Ernst & Young, 2012.

More than just a resource boom

The commodities boom has been one of the major drivers of Africa's growth over the last decade. However, this boom illustrates only a part of the continent's broader growth story. Africa's economic potential extends well beyond commodity exporting. A significant part of Africa's rise is about burgeoning domestic consumption and improving macroeconomic indicators. Also contributing to the improved economic performance in Africa is the emergence of accountable and democratic governments.

Both the 2011 and 2012 Ernst & Young *Africa attractiveness surveys* highlighted growing diversification of foreign direct investment (FDI) as a key trend. This is an important lead indicator of a broader process of economic diversification that will continue to lessen Africa's dependence on natural resources and, by extension, commodity prices. There has been more investment into less capital-intensive sectors, resulting in a growing number of FDI projects in manufacturing, business services and sales, marketing and support. This highlights the shift away from extractive activities. Private equity firms are also attracted to the region's high growth rates and shift from commodity- and agrarian-based economies to consumer economies, driven by a growing middle class.

Sources: *It's time for Africa: Ernst & Young's 2011 Africa attractiveness survey* and *Building bridges: Ernst & Young's 2012 attractiveness survey: Africa*, Ernst & Young, 2011 and 2012.

Searching for economic transformation in Africa

Economic transformation: the key to sustaining growth

Although Africa's economy has grown rapidly over the past decade, questions are sometimes raised about the sustainability of this growth. While some observers believe that the continent will play an increasingly important role in the global economy, others are apprehensive about whether Africa's current development is sustainable and inclusive. More than anything, the concern is that economic growth will fail to create sufficient jobs and improve living standards for Africans. This highlights the need to implement transformation policies that expand the private sector, increase productivity levels and, most of all, create quality jobs. A robust structural transformation is the key to shaping Africa's ability to generate inclusive growth and tackle serious challenges, such as poverty and unemployment.

1. Creating job stability
Africa's biggest challenge today is arguably the creation of stable jobs. Many young Africans are either unemployed or work in low-level jobs and remain in poverty. Given its favorable demographic mix, the African continent is expected to have the largest labor force in the world by 2035.[15] However, failure to create meaningful employment for such a large segment of people will work against Africa's economic strength and could result in political and social unrest.

Africa's past growth has not been sufficiently employment-intensive. A greater focus on employment, especially youth employment, is necessary. More meaningful polices are required that create an environment that is conducive to job creation. Therefore, it is imperative that African governments identify a transformation agenda that will sustain growth and create decent jobs by diversifying growth sources toward labor-intensive sectors.[16]

2. Reducing poverty
Both the rate of poverty and the absolute number of people in poverty have fallen in Africa. According to the World Bank, the poverty rate in SSA declined from 56.5% to 47.5% in 2008, driven by steady economic growth. This rate is projected to decrease further to 35.8% in 2015. This is substantial progress, especially considering Africa's high population growth rate. Nevertheless, despite this improvement, Africa is still way behind the poverty reduction target for 2015 set out in the UN Millennium Development Goals. Poverty in Africa is declining much more slowly than in other developing nations. As a result of remarkable progress in countries such as China, Indonesia and Brazil, the overall share of the developing world's population living below the poverty line of US$1.25 per day has been reduced to 22%, just 0.4% above the 2015 target. While there are differences between Africa and these countries, this still demonstrates the effectiveness of economic transformation policies in accelerating poverty reduction.[17]

3. Diversifying risk and overcoming developmental deficits
While Africa's growth is not limited to the success of the commodity boom, the continent is still heavily dependent on revenues from natural resources. As a result, Africa's future growth prospects remain vulnerable to external risks. The continent also continues to face development deficits in infrastructure, education, human resources and science and technology. These deficits are undermining progress toward true and inclusive growth. This demonstrates the need for Africa to reduce reliance on natural resource revenues by strategically allocating funds and savings to modernize its economies and investing in key strategic sectors, such as manufacturing and agriculture.

15. Tom Stevenson, "Africa, the final frontier, but the challenges are daunting," *Sunday Telegraph,* 6 October 2012, www.telegraph.co.uk/finance/comment/tom-stevenson/9591567/Africa-the-final-frontier-but-the-challenges-are-daunting.html, accessed 23 January 2013.
16. *African Economic Outlook 2012*, African Development Bank, OECD Development Centre, UN Development Programme, UN Economic Commission for Africa, 2012.
17. *MDG Report 2012*, Economic Commission for Africa, African Union, African Development Bank Group, UN Development Programme, 2012.

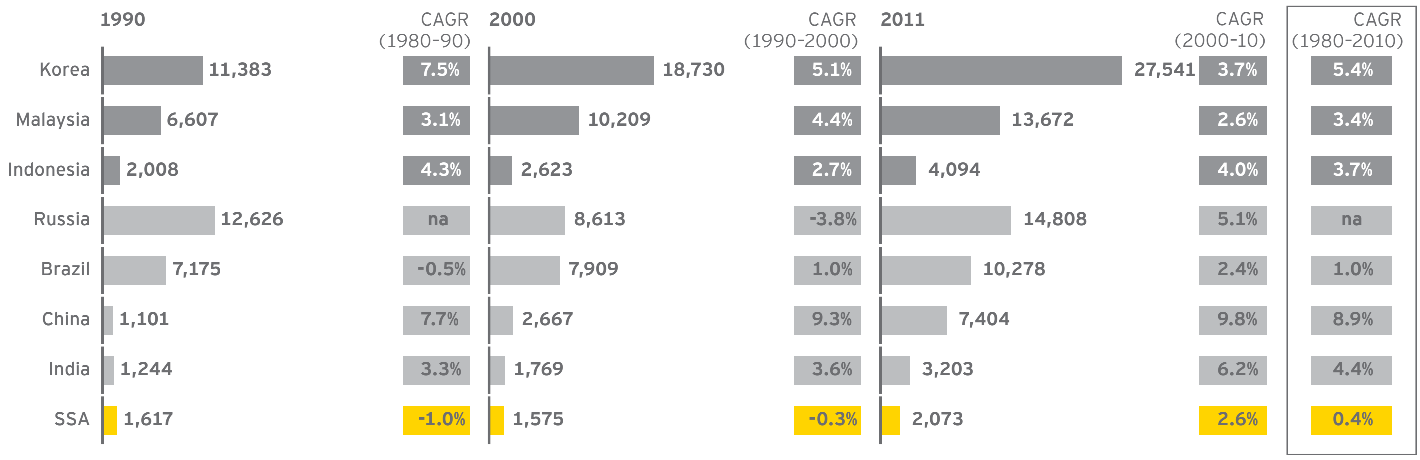
Framework for economic transformation: learning from examples

While many African countries have undoubtedly made tremendous progress over the past decade, the average annual per capita GDP growth rate of all SSA countries over the last 30 years was only 0.4%.[18] In comparison, the performance of countries such as China, India and South Korea has been much more impressive. The example of these, and other emerging nations, suggests that it is not possible to achieve sustainable growth, with increases in employment and productivity, without structural transformation. Economic focus must shift from raw materials to value-added manufacturing and services.

What have some of these other emerging economies done to drive economic growth and development over the past 30 to 40 years? Are there lessons we can learn from these experiences that can inform our thinking on how to sustain and accelerate growth and development in Africa over the coming years?

Figure 2

GDP per capita levels and growth rates 1980–2011 (purchasing power parity, constant 2005 international US$)

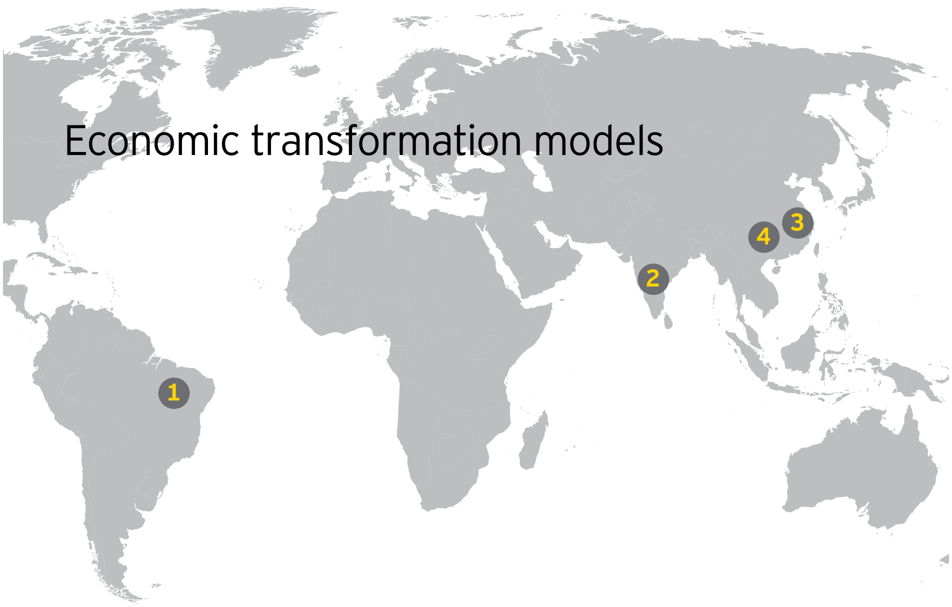


Source: World development indicators 2012.

18. World Development Indicators, World Bank, 2012.

Figure 3

How did other emerging markets drive economic growth and development?



3. East Asian

East Asian economies followed an export-promotion strategy, which capitalized on the widely perceived links between GDP growth and exports. It involved a shift in stance from protectionist strategies to outward-looking policies to combat the limitations of domestic markets and constraints of foreign exchange. These East Asian economies relied on the exports of light manufactured goods, such as textiles, leather goods, processed foodstuffs and rubber products. Market opportunities were unlocked by reforms in industrial and trade policies, capital-intensive FDI, technological and organizational skills, as well as international production and social intermediary networks.

1. Brazil

From the 1990s onward, Brazil undertook major reforms in order to inject growth into its agricultural sector. The country relied largely on market orientation rather than government intervention. During this decade, the Brazilian Government eliminated subsidies and price controls, deregulated markets for wheat, coffee and sugarcane and liberalized trade. Brazil also benefited from a greater integration within the South American trading bloc MERCOSUR, which is designed to enable the free movement of goods and services, capital and people between its member states. The government focus was toward renegotiating rural debts and building support programs through commercialization schemes. A shift in focus to developing efficiency and productivity has reinforced Brazil's status as an agricultural powerhouse.

2. India

In the 1980s, India introduced several pro-business reforms such as the liberalization of import regulations and industrial licensing requirements, extension of export incentives and liberal access to credit and foreign exchange. This period was followed by the economic liberalization process in the 1990s, which involved the elimination of licensing barriers, rationalization of non-tariff structures and narrowing the scope of the public sector.

4. China

After the enactment of a new law on joint ventures to provide a basic framework for the operation of foreign ventures, China created four designated "Special Economic Zones" (SEZs). In 1984, in a bid to attract FDI, the Government extended the concept of clusters to 14 additional administrative units. In 1986, numerous other benefits, such as reduced tax burdens and managerial autonomy were offered to "Foreign Invested Enterprises." In general, the introduction of SEZs has been instrumental to the transformation of the Chinese economy.

Searching for economic transformation in Africa

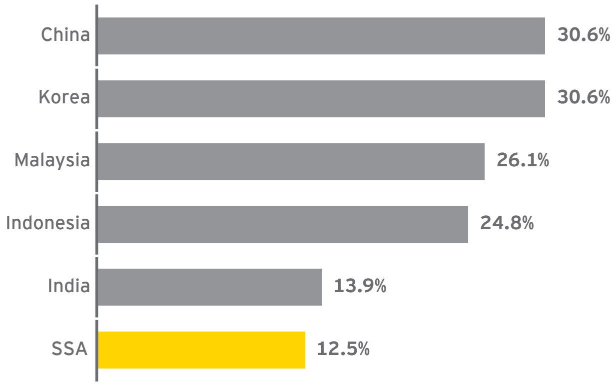
There is no single silver bullet for economic transformation. The fundamentals of every country's economy are different and the transformation path that one country follows might not be effective for another; the path of structural transformation is therefore likely to vary across SSA countries. Also, times have changed. The world is not the same as it was 30 or 40 years ago when markets in East Asia and the BRIC nations embarked upon their transformation agendas. At the same time, however, it is important to learn from past success and failure. Africa can take a cue from these examples to build policies that focus on development from short-term growth to long-term economic transformation.

1. Strengthening industrial capabilities

Industrial development has fallen behind GDP growth in the SSA countries since 1980. In 2011, value-added manufacturing only contributed 12.5% to GDP, compared with 25% for many emerging economies in East Asia, such as South Korea, Malaysia and Indonesia, and 31% in China.[19]

Figure 4

Value-added manufacturing as a percentage of GDP (2011)



Source: World Development Indicators 2012.

Low productivity and lack of large and medium-size organizations in the sector have been impediments to the growth of manufacturing in Africa. At the same time, the region has the resources and comparative advantage that could bolster its manufacturing sector. Its labor costs are nearly half of those in Vietnam and a quarter of those in China. Africa has abundant natural resources, which can be used as raw materials in the light manufacturing industry. Moreover, given its proximity to other regions of the world, an improvement in its labor productivity will result in a significant addition of manufacturing capacity in the continent.

However, these advantages need to be reinforced by policy action across a broad spectrum, including macroeconomic and "functional" industrial policies, such as the development of input industries, land property rights and the availability of finance. Additional reinforcements would include: provision of reliable and inexpensive trade logistics that enhance entrepreneurial and workforce skills, as well as the introduction of urban policies and maximizing productivity gains from agglomeration and innovation.

Learning from examples: China and Vietnam

China has cemented its status as the "factory of the world" through labor rate arbitrage and commitment to developing its manufacturing sector, despite low productivity levels, where Chinese producers have been able to achieve cost savings of 20%–40%. Both China and Vietnam provide valuable lessons and examples:

- **Plug-and-play industrial parks:** China's manufacturing sector has benefited from its successful industrial parks, which combine sound basic infrastructure with simplified government regulations and other incentives. Such a model can help in avoiding the "missing middle" problems (shortage of medium-sized organizations) and encourage the growth of manufacturing enterprises.
- **Key input industries:** China and Vietnam developed their input and output markets by making land and financing options available, providing support along the value chains, reducing trade barriers and providing technical assistance and information on input, technology and suppliers to SMEs.
- **Trade logistics:** China and Vietnam created industrial zones near ports and exempted them from various regulatory restrictions. African policy-makers can use this as an example and improve trade logistics along key business corridors, develop multimodal logistics systems and simplify or eliminate customs procedures, price controls and FDI restrictions.
- **First movers:** China has been supporting start-ups in complex sectors that require skilled labor and advanced technology to unleash the potential of new entrants. Governments in SSA nations can also share the high risks of market entry with first movers by initiating a matching-grants scheme and supporting them by disseminating relevant knowledge about markets and suppliers.

Source: *Light manufacturing in Africa: targeted policies to enhance private investment and create jobs,* The World Bank, 2012.

19. World Development Indicators, World Bank, 2012.

2. Capitalizing on agricultural potential

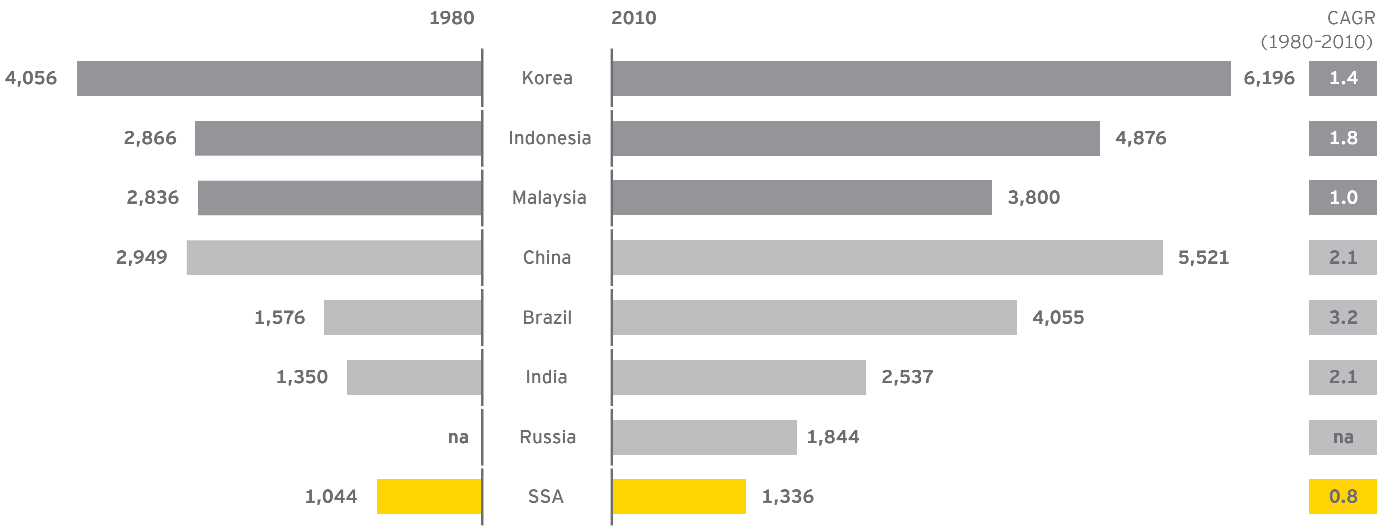
Agriculture and agribusiness are now considered the "next big thing" in Africa. The continent has the world's largest area of uncultivated land, as well as sizeable regions that are already under cultivation. Still, on average, yields in SSA only grew by 0.8% per year between 1980 and 2010 — far below the growth rates registered in other emerging market economies.[20]

Low agricultural yields have resulted in this potential not being realized. Some of the issues that blight the region's agriculture sector can be attributed to weak market structures, ineffective policies, inadequate infrastructure and the existence of small farmers with limited access to seeds, water, fertilizers, pesticides, and modern machinery and techniques.

The transformation from a minimally productive to a highly efficient agricultural sector will require a combination of government support and sponsorship, and private capital, as has been seen in BRIC economies (especially Brazil). Investing in achieving a substantial improvement in water management and access to cheap energy will make farming in SSA less susceptible to the adverse effect of droughts and floods. Efforts should be made to encourage mechanized agriculture by developing innovative tools and technologies and using the power of the marketplace.

Figure 5

Cereal yields (kg per hectare)



Source: World Development Indicators (2012).

20. World Development Indicators, World Bank, 2012.

Learning from examples: Brazil

Land in both Brazil and Africa is tropical and poor in nutrients. Brazil's agriculture boom (through R&D and science-based technologies) has established the country as a tropical agriculture giant and top food exporter.

- **Government support:** Brazil set up its own research institution, Brazilian Agricultural Research Company (Embrapa), by earmarking more funds for agricultural research in diverse areas such as plant genetics and livestock breeding.
- **Development of efficient crops and production systems:** Brazil embraced science-based technologies, including biotechnology, to accelerate productivity. Brazil's success is evident from the fact that the Cerrado region, once considered unfit for farming, now accounts for almost 70% of the country's farm output.
- **Streamlined process for implementation of new technologies and mechanization:** Brazil assisted cultivators in easily accessing updated technologies, by creating a smooth and effective regulatory approval process for new technologies and investing in mechanization as well as advanced and large-scale farming practices.
- **Macroeconomic stabilization and enhanced openness to trade:** Brazil supported private sector investment in the agricultural sector and opened up its markets. The country has substantially reduced tariff rates from an average of 51% to just over 10% today.
- **Improvement in infrastructure:** some farmers in Brazil's important Mato Grosso agricultural region have tried to overcome infrastructural challenges by building roads that link their farms with federal and state highways.

Source: "The miracle of the cerrado," *The Economist*, 26 August 2010, http://www.economist.com/node/16886442, accessed 17 December 2012.

3. Developing a diversified export-led growth strategy

Between 1994 and 2008, exports from SSA countries averaged a growth rate of 13% per year, compared with the US at 4%, Germany 8%, India 13% and China 19%. However, their share in the world's export markets is still negligible. The top five exporters — South Africa, Nigeria, Ghana, Kenya and Zambia — together contributed only 1% of global exports in 2010.[21]

Leading SSA economies, including Nigeria and South Africa, are still endeavoring to meet the standards set by their East Asian counterparts. For instance, while Korea's share in world exports rose from 0.71% to 2.83% between 1980 and 2011, South Africa's contribution declined from 0.8% to 0.53%.[22]

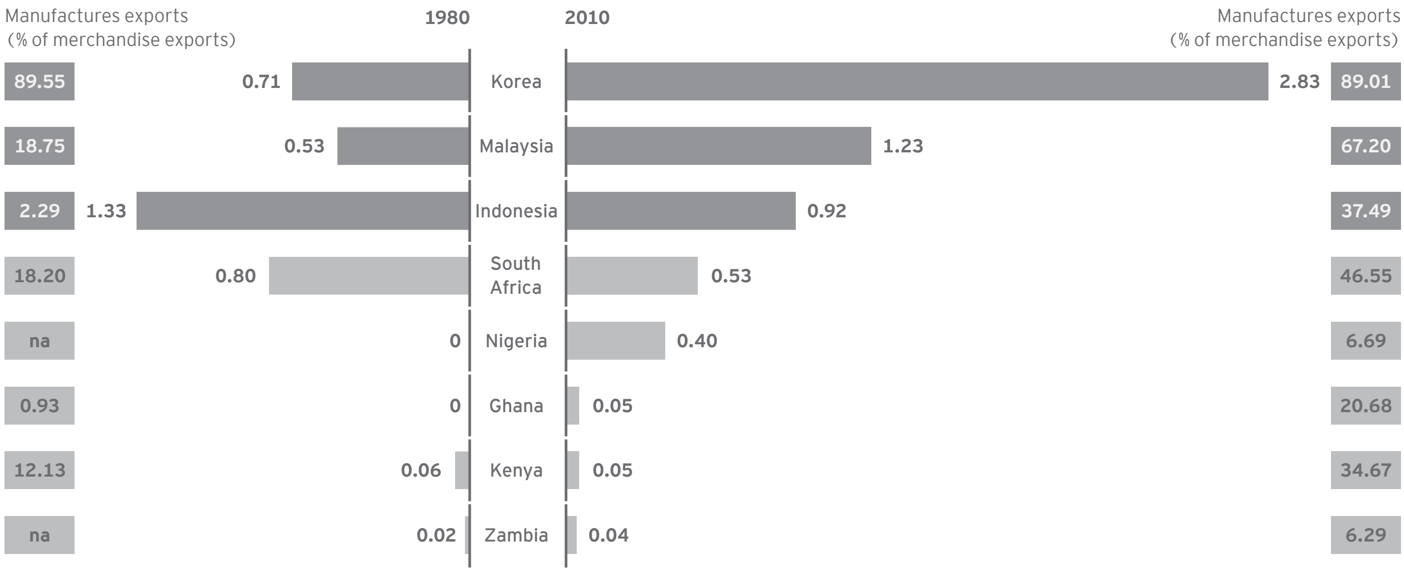
In terms of composition, exports from SSA are dominated by primary commodities, while the bulk of manufactured goods and knowledge-based services are imported. In 9 out of 15 countries, the top 5 exports account for more than 70% of their total composition of exports. Only Kenya, South Africa and Uganda have concentration levels comparable to those in export-led countries in Asia. The slow diversification of economies means African countries are yet to move up the value chain.

A successful export-led growth strategy will require significant improvements being implemented in institutions and services that support trade. Reducing tariffs, efficiently concluding free trade agreements and easing regulatory barriers are necessary, but will not be sufficient to boost exports in these countries. Complementary efforts will be required to strengthen institutions that support exports, improve logistics, provide adequate finance, increase the efficiency of infrastructure, reduce corruption and improve the skills of the labor force.

21. World Development Indicators, World Bank, 2012.
22. World Development Indicators, World Bank, 2012.

Figure 6

Share of world's exports and manufacturing exports



Source: World Development Indicators 2012.

Learning from examples: South Korea

An export-led growth strategy has helped South Korea to develop from a heavily indebted, poor country to a high-income one in less than 50 years. This strategy largely banks on outward orientation, macroeconomic stability and large investments in human and physical capital.

- **Evolution of export promotion policies:** export promotion strategies have undergone constant evolution in Korea. While in the early 1970s, light industries dominated the Korean manufacturing sector, in the 1980s, this trend shifted in favor of industries requiring enhanced economy-of-scale technologies. By 2000, heavy-chemical industries accounted for around 80% of manufacturing in Korea. In terms of markets, Korea has broadened its horizons from the US and Japan to new destinations such as China, India, Indonesia and Vietnam.
- **Foreign markets critical to strategy formulation:** in the 1960s and 1970s, expansion of world trade under the General Agreement on Tariffs and Trades (GATT) (the Kennedy Round and the Tokyo Round) and South Korea's easy access to the US due to implementation of General System Preference (GSP) capped the nation's efforts with success. Thus, access to foreign markets is an essential part of developing a successful export-promotion strategy.
- **Government incentives:** the Korean Government provided incentives that made export a profitable activity for private sector entrepreneurs and initiated measures to maintain a competitive exchange rate.

Source: *Comparative study on export policies in Egypt, Morocco, Tunisia and South Korea*, African Development Bank, 2012.

Enablers of economic transformation

Infrastructure development

A study conducted by the Africa Infrastructure Country Diagnostic (AICD) revealed that the continent's infrastructure lags behind other developing regions.[23] The African Development Bank claims that shortage of roads, housing, water, sanitation and electricity causes a 40% decline in SSA's output.[24] Political energy and private sector engagement are required to bridge the infrastructure gap in Africa. The AICD study has estimated that Africa will require an investment of about US$90 billion annually from 2010 to 2020 to reach the levels of infrastructure in other emerging markets.[25] Governments alone cannot shoulder the high costs of infrastructure, such as power, airports, ports and highways. In this regard, regulatory frameworks and policies that govern private sector investment must be reformed.

SME financing

In Africa, small and medium-sized enterprises (SMEs) are largely constrained in terms of access to finance from the formal financial sector. Only 20% of African SMEs have a line of credit from a financial institution.[26] SME financing should be a crucial objective for African governments. In this regard, the creation of the African Guarantee Fund for Small and Medium-sized Enterprises (AGF), which aims to provide, among other services, financial guarantees to banks on behalf of creditworthy SMEs, is very promising. However, governments and international donors must also gear themselves to assisting SMEs to strengthen governance and general managerial, financial and marketing capabilities.

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23. *Building bridges: Ernst & Young's 2012 attractiveness survey: Africa*, Ernst & Young, 2012.
24. "A road to somewhere," *The Economist*, 21 July 2011, http://www.economist.com/node/18989203, accessed 24 December 2012.
25. *Africa's infrastructure: a time for transformation,* The International Bank for Reconstruction and Development and The World Bank, 2010
26. "African Guarantee Fund for Small and Medium-Sized Enterprises," African Development Bank Group website, http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-guarantee-fund-for-small-and-medium-sized-enterprises/, accessed 24 December 2012.

Investing in human capital

Even though the majority of the world's 10 fastest-growing economies are in Africa, over 70% of the working-age population is unemployed or has no job security. University enrolment rates in SSA are among the lowest in the world.[27] There is also a skills gap that can make it difficult for companies to hire in Africa. Therefore, investments in the education sector must be increased. Curricula must be reformed to reflect the needs of the market and focus more on science, engineering, mathematics and entrepreneurship and less on social sciences and humanities. Public-private partnerships (PPPs) in skills training are also necessary to build Africa's education capacity. Governments must put in place enough institutional mechanisms to facilitate government-business collaboration.

Public-private partnerships

Although, in the last two decades, significant progress has been made in charting the respective roles of both the public and the private sector in Africa's economic progress, regulatory frameworks in this regard need greater strengthening. Governments should work toward providing the right incentives and conditions for PPPs to flourish in Africa. However, businesses must also make concerted efforts in following models that integrate local producers and communities into value chains or target the poor. Civil society groups can also play a key role in developing such partnerships. There have been several successful instances of PPPs in Africa, especially in the telecoms and electricity sectors, which can be replicated in other economic or social spheres.

27. *The Africa Competitiveness Report 2011*, World Economic Forum, May 2011.

Deeper regional integration

Our 2012 *Africa attractiveness survey* argues that the single biggest priority for Africa over the next decade should be the acceleration of the regional integration process. Traditionally, the African continent is viewed as a disparate region consisting of separate nations with similar problems and potentials. Africa needs to establish greater economies of scale via deeper regional integration in order to improve competitiveness and appeal to investors. Regional integration will make it easier and more efficient to conduct cross-border business and create markets with greater critical mass and more coherence. The African Union has already recognized eight Regional Economic Communities (RECs) and these should form the building blocks for accelerated regional integration. The agreement between the 26 member states from three RECs to establish a free trade area is another positive step.[28] Regional integration of markets and the accompanying harmonization of customs, regulations and trading rules will expand the size of the market and the number of firms in the marketplace.

Foreign direct investments

Even though FDI has returned to the continent (project numbers increased from 339 in 2003 to 857 in 2011), it still constitutes only 5.5% of global FDI projects in 2011.[29] Africa's weak showing in the global FDI arena is the result of a business environment and regulatory framework that is still inhibited. Africa needs to strengthen its ties with the global economy and create an environment more conducive to foreign investors. Disregarding the fact that more competitive economies generally attract greater investment, Africa must raise human capital and technological abilities, create open trade and investment regimes and develop infrastructure and its financial sectors.

28. *Building bridges: Ernst & Young's 2012 Attractiveness Survey: Africa*, Ernst & Young, 2012.
29. *Building bridges: Ernst & Young's 2012 Attractiveness Survey: Africa*, Ernst & Young, 2012.

Business implications

Economic transformation is high on the radar of African policy-makers. African countries want to build technologically advanced and globally competitive economies for shared prosperity. What does this mean for businesses and investors?

The Ernst & Young risk radar (below) presents a snapshot of the potential issues that could impact on companies doing, or planning to do, business in Africa. The risks at the center of the radar — such as infrastructure gap, regulation and compliance and ability to operate at low cost — are those that pose the greatest challenge to the most organizations.

Figure 7

Africa's risk radar

Economic transformation model

1. Source local partners to create efficient supply chains and distribution channels
2. Develop robust capabilities to manage regulatory compliance
3. Develop an effective cost management strategy
4. Create a strong due diligence process to identify the right market entry strategies
5. Create a localized manufacturing strategy
6. Invest in workforce development and training
7. Contribute to socioeconomic development
8. Monitor local and global market risks
9. Increase the use of technology to spur growth
10. Set and strictly follow moral and ethical principles

Here we explore some of the strategies that can help companies to mitigate these potential risks.

1. Source local partners to create efficient supply chains and distribution channels

An increasingly wealthy and urbanized African population is creating significant growth opportunities. However, poor infrastructure is an inhibitor of growth and a key risk to doing business successfully across Africa. The gap is particularly noticeable in terms of power generation capacity, the density of paved roads, and, to some extent, in communications technology. This makes supply chain efficiency more challenging and can substantially increase the costs of doing business. To overcome these barriers, companies need to establish a cost-effective and stable supply chain that can help them to serve African consumers while maintaining profitability. They should look for sourcing partners who understand the preferences and issues of local markets and have strong community links. A good sales and distribution network can be created by leveraging a mixture of third party, wholesale and direct-distribution models.

2. Develop robust capabilities to manage regulatory compliance

Africa is a vast continent, comprising 54 sovereign states, each with different and often fragmented sets of regulations. And in many nations, these frameworks are still evolving. Thus, managing complex regulatory compliance across multiple countries in Africa can be difficult for businesses. However, as regulatory systems continue to evolve and mature, companies must also anticipate that regulations will inevitably become more comprehensive and complex and this should be factored into the risk-planning process. Many organizations will need to develop robust capabilities in order to manage cross-border regulatory compliance at a relatively low cost. They will also benefit from the ability to influence the development of regulatory maturity in each country in which they operate.

3. Develop an effective cost management strategy

Because of low income levels, price remains the key consideration for the majority of African consumers. This creates increased pressure on companies in Africa to lower their operating costs so that products or services can be delivered to market at realistic prices for African consumers. This is a difficult task, as the cost of doing business in Africa can be high due to factors such as the regulatory environment, infrastructure challenges and human capital constraints. It is important to find innovative and disciplined ways, as, for instance, Grameen Bank did in Bangladesh, to bring products and services to market with fundamentally different cost structures. Process optimization and embedding of controls, streamlining of product portfolio and optimization of technologies are some strategies that companies can adopt while developing their cost management strategies.

4. Create a strong due diligence process to identify the right market entry strategies
Mitigating the risk of strategy errors, such as entering the wrong markets or making unwise investments, is crucial to long-term success. In African markets, pre-entry analysis and selection of an appropriate mode of entry into different markets is especially critical. While acquisitions are often a preferred route, viable acquisition opportunities can be scarce and investors will often need to consider multiple alternative approaches, such as strategic partnerships, joint ventures or PPPs. A robust due diligence process is essential, particularly for companies subject to legislation, such as the US Foreign Corrupt Practices Act or UK Bribery Act.

5. Create a localized manufacturing strategy
Africa offers significant manufacturing opportunities. Companies operating in the continent can capitalize on the vast labor and natural resources to scale up their manufacturing operations. Africa's diversified countries have different profiles — some with low costs but few skilled laborers and others with highly skilled workforces but higher costs to match. With relatively low labor costs and targeted policy support, Ethiopia has shown that it can be a globally competitive environment for "light manufacturing" in categories such as apparel, leather goods and garments. Similarly, a number of African countries could benefit from following the examples of other emerging markets, particularly China and its movement up the manufacturing value chain. There are also several countries that have shown that they can succeed in the high-value-added categories of manufacturing, as South Africa and Morocco have done in the automotive sector. The right manufacturing strategy should be tailored to each company's profile and context. To mitigate the risks arising from disruptions and ensure continued supply of natural resources, companies can introduce term contracts, invest in diversified geographical resources and make upstream acquisitions to lock in supply.

6. Invest in workforce development and training
Finding the right workers amid a general skills shortage is a key challenge for companies in Africa. In the majority of SSA, education levels are relatively low, but they are improving. African universities do not generally produce job-ready employees. The responsibility for skills development lies largely with the firms themselves. Companies therefore have to make substantial investments in their workforce development and training. Many companies in Africa also run the risk of overdependence on expatriate staff. Strategic sourcing of people, the management of a diverse talent pool spread across a large area and the ability to move talent efficiently across the continent, will therefore be critical contributors to success. The selection of new markets will be strongly influenced by the location of workforces with the necessary skills.

7. Contribute to socioeconomic development
There is an increasing demand for businesses in Africa to make a sustainable contribution to socioeconomic development. This is fundamentally about doing "good" business: creating jobs, paying taxes, developing people, making a positive social impact, operating ethically and minimizing environmental impact. Those organizations that can manage the increasing public pressure, and can embed an environmental or ethical focus in their culture, value proposition and competitiveness, will be well positioned.

8. Monitor local and global market risks
Many African economies are increasingly integrated into global markets and will be negatively impacted by general malaise in the global economy, as well as more specific incidents, such as commodity price shocks, refinancing of country debt or volatility in financial services. Organizations operating in Africa are going to need to develop very effective control environments that can actively monitor the market risk in the countries and regions where they operate, as well as in other influential economies around the world — including the Eurozone, the US and the increasingly important rapid-growth markets. In addition, the continued access to effective funding for growth will affect the cost of doing business and ease of market entry.

9. Increase the use of technology to spur growth
As Africa steps up its commitment to changing its destiny, technology and innovation will play a key role in assisting the continent to make the leap. The recent success of the telecommunications sector in Africa is a good illustration of how technology will become the touchstone of Africa's development. Africa has witnessed a dramatic rise in mobile telephone and internet subscriptions in recent years and there is also increasingly wide access to financial services. Companies should actively use technology in enabling innovation, enhancing business information systems and risk management. Africa's huge agricultural potential can also be exploited by using innovative tools and technologies that substantially increase productivity. The development of mechanized agriculture in Ethiopia is already playing a critical role in creating jobs in the country.

10. Set and strictly follow moral and ethical principles
Corruption is another factor that is cited as a key risk to doing business in Africa. This is clearly a critical concern. For example, companies subject to stringent anti-corruption legislation in their home countries may find it difficult to operate in countries with a poor reputation for managing corruption. Organizations need to establish their moral or ethical principles early when entering African markets. These principles can guide leadership teams as they make decisions. Leaving decision-making to chance increases the risk of becoming entwined in corrupt practices. A strong control environment will enable businesses to monitor processes and decisions to identify potentially corrupt practices.

Ernst & Young in Africa

> **"Africa is a huge continent and will remain a very important new market ... As a continent, this will have bigger potential than even India."**
>
> **Manoj Kohli**, Bharti Airtel International Operations

Our footprint

Although the risks in investing in Africa may appear high, risk can be managed, and the rewards can be great. That is why we are heavily investing in growing our highly integrated Africa presence and capacity to serve our clients who are also increasing their investment in and across the continent. We now enjoy a coordinated representation in 32 countries across Africa, described in the media as "one of the biggest changes in the accounting profession in more than 100 years."

Today, we are able to navigate successfully through the complexity that our clients are experiencing across the geographies and the diversity of market sizes and sophistication. We do this through our Africa Business Center™, the sole purpose of which is to support clients as they make their investment and expansion decisions in Africa.

Our deep integration across Africa benefits our clients through:

- Consistent quality standards everywhere
- A "single point of contact" service
- The best Ernst & Young resource irrespective of country location


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Ernst & Young Africa in numbers

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5 regions

162 years in Africa

1 African Executive

5,100 people

263 partners

1 integrated operating model

“Ernst & Young is a professional services network of firms that has set itself apart from its competitors by its extensive footprint across Africa (offices established in 33 countries on the continent), supported by a fully integrated business model. Ernst & Young’s ambitious growth strategy, its pan-African vision, inclusive leadership philosophy and leading people culture all contribute to attracting and retaining the best talent, allowing them to deliver seamless and innovative, value-adding solutions to their clients across the continent.”

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About the Skolkovo Business School – Ernst & Young Institute for Emerging Markets Studies (IEMS)

The Skolkovo Business School – Ernst & Young Institute for Emerging Markets Studies (IEMS) is a network-based think tank focused on managerial and economic issues. It is based in and dedicated to the study of emerging markets. Our mission is to undertake high-impact research that addresses critical issues in emerging market development.

The Emerging Markets Center

Ernst & Young's Emerging Markets Center is a "Center of Excellence" that quickly and effectively connects you to the world's fastest-growing economies. Our continuous investment in them allows us to share the breadth of our knowledge through a wide range of initiatives, tools and applications, thus offering businesses, in both mature and emerging markets, an in-depth and cross-border approach, supported by our leading and highly globally integrated structure.

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