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Industryline

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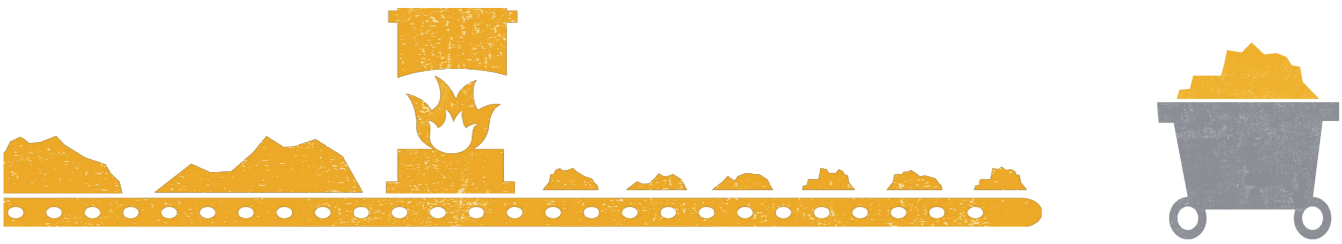
After being referred to as the “lost continent”, more recently the African continent has held the promise of economic prosperity for investors the world over, and as such has attracted investment from many global companies.

The past five years have been especially painful for Africa. The commodities boom came to an end and the El Niño drought struck causing many countries’ growth rates to plummet. Following the initial hype of the African growth story, it emerged that many economies were still overly reliant on commodity exports. The expected diversification into more consumption-led sectors has seemingly not materialised.

Many are now questioning whether there are still opportunities on the continent and if these are just linked to the cyclical nature of mining. We disagree with this sentiment and believe there are still opportunities for those who do their homework before investing, and who are realistic about the risks and returns.

While one should always remember that Africa consists of 54 unique countries and many more tribes, the broad growth story for the continent remains intact and in its major cities. Even though clichéd, it is still the ‘last frontier’ to be developed and the fundamental factors underscoring its growth potential are still strong.

Africa’s favourable demographics and relatively small middle-income market offer generous potential in the retail sector for those with a long-term vision and the right offerings. The continent may be facing headwinds now, but it will continue to grow in importance in future.



Africa is still rewarding but a carefully planned, long-term vision is needed

BY IAN SCOTT: CEO, GRANT THORNTON CAPE

Learn from the challenges of those who went before

At the time of the last significant drive into Africa – following headlines from international publications hailing the continent's vast potential – global investors on the lookout for yield and untapped opportunities expanded in high-potential economies with unprecedented enthusiasm.

This initial exuberance has since been tempered as investors realised that there are still very real risks to growth. In our view, the most significant lesson has been that companies should be adequately prepared for African expansion and have the right partners on the ground.

For retailers in particular, logistics have often presented a major challenge, as there is still a massive infrastructure deficit that has hindered expansion and growth. Some businesses have invested too heavily too fast in an attempt to achieve economies of scale and had to retreat at great cost.

Misconceptions about the nature and size of the emerging middle class have also halted a number of businesses. Several retailers were under the impression that the African middle class is similar to that of Europe's, while not taking into account that the growth – while phenomenal in some instances – came off a low base.

Companies need to be aware that it takes time for consumers to move from informal markets to shopping at middle-income shops. This does not necessarily mean there is enough of an upper-middle income market either, as Truworths and Woolworths realised when their Nigerian expansions did not bear fruit. Pick n Pay also incurred losses in Mauritius.

One of the big hurdles from an accounting perspective has been the different tax regimes across several countries, which make it incredibly complicated to do business. As taxes are universally seen as an important revenue generator, there is significant resistance from countries to simplify measures.

Opportunities still out there?

Even taking into account the challenges, we believe there are still opportunities in a number of markets for those who want exposure to the long-term attractive fundamentals of the continent.

Telecommunications has grown beyond expectations and this has fed through to the retail industry. The availability of a wide array of handsets and smartphones, coupled with a significant increase in bandwidth and a subsequent lowering of data costs have changed the way consumption decisions are being made. According to the University of Cape Town's (UCT) Unilever Institute, the positive trends in telephony have gone a long way to empowering consumers and have led to innovations in sectors from education to financial services.

In this regard, the unbanked market has presented healthy growth for new operations who offer mobile banking solutions in particular. Infrastructure is steadily improving, with Africa still attracting healthy inflows of foreign direct investment (FDI), one of only two regions in the world to show an increase in FDI levels last year.

Even though some in the consumer product market have had a challenging experience, opportunities remain here too. Disposable incomes are still growing and this means consumers will continue to trade upwards.

The key lies in selecting those markets and regions with the right consumer profile, which are underserviced, and being able to provide a cost-effective solution.

Many companies have also underestimated the power of established local competitors and businesses such as Nakumatt (in East Africa) and Choppies (in Botswana) that have been able to crowd out even successful businesses such as Shoprite in certain markets.

Several private equity companies have been attracted to the opportunities in the consumer-led sectors of the continent, as the longer-term nature of investments have suited their models. This approach has led to handsome returns for several businesses, but even in this instance some international giants have made expensive mistakes.

Notably, Bain Capital acquired control of Edcon – South Africa's most established and largest clothing retailer – in 2007 for R25bn, representing the country's biggest corporate deal. Unfortunately the timing – just as the credit crisis ensued – was not ideal for a business to service debt financing. After yielding no return on its initial investment, Bain poured another R6.7bn into the business, proving that even more mature markets are no guarantee for success.

Keys to capitalise

The most important elements for success in Africa are the need for thorough research and the right team on the ground who understands local market conditions. The research should include spending extensive amounts of time 'on the ground' to get a better understanding of a country.

This will ensure insight into the finer nuances affecting each market. There are often significant differences in income distribution between cities in the same country which may have a big impact on a business' distribution channels.

Key to understanding what drives the consumption market on the continent is getting to grips with the nature of the middle class in each region. Research from UCT's Unilever Institute suggests that businesses should adjust their thinking to look at Africa as a series of cities – rather than countries that are often not proper nation states due to historical reasons.

The presence of a local partner that fully understands the market is often highly beneficial for a company entering a new country. This has worked well with professional and financial services firms in obtaining the necessary referrals, and as a source of local knowledge and experience.

Many retail companies have also had to adapt their business models to operate effectively in Africa – what works in Europe and even in South Africa will not necessarily do well in Nigeria, Ghana or Kenya. Businesses need to be adaptable and willing to use different capabilities as markets differ. Some countries might be a good source for manufacturing, while distribution works better in others.

Africa is still fragile in most areas due to the commodity downturn, but it will be rewarding for those companies willing to withstand the short-term headwinds and focus on the long-term potential.

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