BUSINESS OPPORTUNITIES AND CHALLENGES IN AFRICA

Lois René Berman
Sakina Balde

EUROMONITOR INTERNATIONAL

BUSINESS CHALLENGES AND OPPORTUNITIES IN AFRICA

Lois René Berman
Research Manager, Middle East & Africa

Sakina Balde
Senior Research Analyst, Middle East and Africa

CONNECT WITH US

EUROMONITOR INTERNATIONAL

CONTENTS

INTRODUCTION

Robust GDP growth rates in Africa redefine the map of opportunities

Some 10 years ago, The Economist ran a cover on Africa headlined “The Hopeless Continent”. While the Western world was described to offer infinite business opportunities, Africa was deemed to offer none. The global financial crisis has since then redefined the world map of opportunities. While the Western world is struggling to recover from financial crisis, posting sluggish GDP growth, seven of the 10 fastest-growing economies are African, including Ethiopia, Mozambique, Tanzania, Congo, Ghana, Zambia and Nigeria. Africa is now the second fastest growing region in the world, with GDP growth across the 54 countries estimated at 6% in 2012, according to the International Monetary Fund (IMF).

Previously seen as the ‘risky’ continent or only considered for its natural resources, the current high economic growth coupled with a much-improved business environment is now making Africa an increasingly attractive hub for international fast moving consumer goods (FMCG) companies. The emergence of a class of consumers driving the growth is one the main reasons for this.

A boom in consumerism drives growth on the continent

Empirical evidence shows that a “white-collar middle class” is emerging in most African countries, driven partly by fast-growing industries such as telecommunications, banking and services. Employees from these industries are seeing their purchasing power increase substantially and are now embracing consumer lifestyles popular in the West, i.e. purchasing aspirational branded goods in modern retailing outlets. In most African countries, consumption from this group has been the major driver for growth, representing more than 60% of the continent’s overall GDP in 2012, according to the World Bank.

For example, in South Africa, which is the leading economy of the continent, higher consumption spending from the emerging "black middle class" has been the main driver of growth in the last decade, with their spending size more than doubling in 10 years. This has translated into a shopping boom, driven by a desire for imported brands in industries such as packaged food, clothing and electronics.

The same phenomenon is now spreading in the rest of sub-Saharan Africa, including Nigeria, Kenya and Cameroon. The African Development Bank estimates that Africa has the fastest-growing middle class that of individuals spending between US$2 to US$20 a day. This group rose by a 100% in less than 20 years. By 2060, the number of middle-class Africans, as defined by the Bank, is expected to reach 1.1 billion, 42% of the predicted population.

The retail sector is a good indicator of the boom in consumer spending

The emerging African middle class with higher disposable incomes has generated substantial demand in the retailing sector. In Africa, where shopping traditionally meant walking to an open air market or neighbourhood shops and haggling over prices, consumers are now able to browse the aisles of air-conditioned supermarkets and shopping centres. The retail sector in Africa is booming and considered one of the "hottest" industries in Africa, surpassing that of natural resources extraction. Euromonitor International research shows store-based retail sales in countries such as Nigeria and Kenya are expected to experience double-digit value increases in 2013, 19% and 13%, respectively.

Hundreds of malls have opened all over the continent where the growing "white-collar middle class" can ostentatiously show their new wealth and status and buy a wide range of products under one roof, from imported grocery products to branded clothes and electronics.

The African middle class shows a strong penchant for imported goods, perceived to be of higher quality, and favours aspirational goods that they can easily find in the burgeoning shopping malls such as the Accra Mall in Ghana and The Palms in Lagos, Nigeria. These shopping centres are often in stark contrast to the world outside. They offer a respite from the outside environment that has yet to catch up with the growing sophistication of the population.

The boom in demand for international FMCG products is attracting new international players, particularly amongst large South African grocery chains, making substantial progress in the rest of Africa. Like their European counterparts, retailers are escaping modestly- performing domestic markets for the fast-growing consumer markets in Africa. In early 2013, Carrefour, the leading French grocery retailer, announced its decision to expand its presence throughout Africa, including Nigeria, Côte d'Ivoire and Ghana.

Africans' increasing taste for trendy fashion is also attracting global international brands to the urban centres. In Kenya, the Spanish clothing retailer Zara entered the market in 2013 through a distribution agreement with local retailer Deacons, which also launched the Massimo Dutti clothing line. The South Africa-based retail chains Foschini and Edgars are also planning to enter Kenya by the end of 2014. The growth in real estate development has also helped boost spending on furniture and household goods such as electronics.

Another way for investors to take a leap into Africa appears to be by collaborating with local players. For example, Carrefour teamed up with African distribution company CFAO to expand its presence, and Foschini, the South African fashion retailer, is working with its Franchise partners Nakumatt in Kenya to open three stand-alone stores in Nairobi by the end of 2013. Partnering with local players appears to be a good strategy for multinationals to reinforce their global footprint in Africa and maximise opportunities in the 54 countries of the continent.

The stereotypical image of African "hopelessness" is now changing among Western investors. The Economist recently reversed its previous stance with an article titled "The Hopeful Continent" as Africa is increasingly seen by investors as "one of the few bright spots" on the economic horizon.

PACKAGED FOOD IN AFRICA

Africa, a net food importer

Africa has drawn the attention of food companies in recent years, with many seeing it as a widely underserved market with untapped potential. It is not hard to see why. With rising global prosperity, which includes increases in GDP and disposable income, and a large, growing, youthful population, Africa appears ideal for product introduction and expansion. However, its untapped potential also highlights its internal challenges, underscoring the issues many companies confront when trying to service the African region.

Africa remains a continent largely dependent on imports for its basic food needs. This has included food such as dairy, meat, sugar and cereal, indicating how essential food imports are for the continent. While import dependency varies by country, Africa's high food import bill remains a challenge to the various African nations to develop ways to reduce it and to ensure food security for its citizens. The reason for this large-scale dependence is basic supply and demand. An increasing population, coupled with poor agricultural infrastructure and technology, means that the continent is unable to support an ever-increasing demand for food.

According to the Food and Agriculture Organisation, sub-Saharan African countries' food import bill was in excess of US$40 billion in 2012.

To add to this, Africa's population has been growing at a rate higher than in any other region. From 2011 to 2012, the population rose from just under 1 billion to over 1.02 billion, an increase of 2.3%. Moreover, Africa has a very young population, with over 40% under the age of 30. Despite this growth in population, per capita food consumption has increased. This is likely due to a shift in dietary habits, prompted by globalisation, and an increase in disposable income. A trend towards urbanisation, which has allowed for a growing number of food outlets to appear all over the continent, has also introduced consumers to a wider range of food options.

The continent is also not helped by the continued rise in food prices over the past few years. Food prices are a particular concern as an essential item rather than a discretionary choice, and in low-income countries, higher food prices can result in social unrest and political instability.

Looking at the food value chain

Modern food production methods, including the processing of raw materials, have equally proved insufficient in meeting Africa's enormous food needs, even for manufacturers on the ground. While Africa has abundant resources, from minerals to agricultural produce, poor technology and industrial infrastructure means that many raw materials must be processed abroad. Equally, to compete on a global level Africa needs to meet international standards, including the technology and skilled labour capable of carrying it out. Without these basics, productivity is low. As such, investment is needed along the food chain by manufacturers to bring standards up, as well as to increase cost efficiencies within the system. This ranges from the factories to the roads to transporting goods. Other challenges plaguing Africa for decades include inadequate electricity supply, cumbersome and expensive transport, political instability and high corruption..

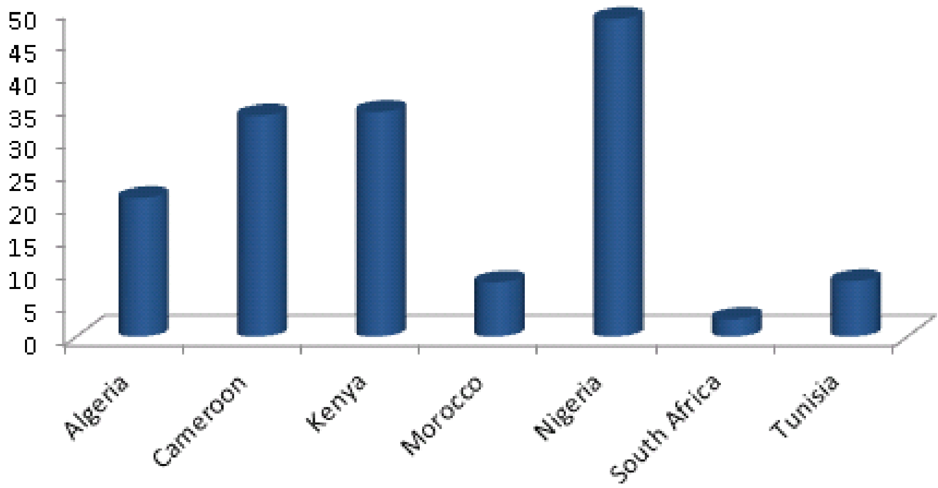
Modern retail increasing

While modern food production methods have mainly stalled in Africa, modern retail distribution of food products is developing at a quicker pace. In the African countries researched by Euromonitor International for packaged food, the supermarkets/hypermarkets channel is edging closer to independent small grocers, 35% vs. 43% in 2012, though its lead is largely spearheaded by South Africa at nearly 70% with a supermarket presence for over 60 years. However, growth and expansion outside South Africa is a recent occurrence, facilitated by political and economic liberalisation, increased urbanisation and, more importantly, a rising middle class. Supermarkets have spread fast in Southern and Eastern Africa, already proliferating beyond middle- class big-city markets into smaller towns and poorer areas such as townships in South Africa. In Kenya, supermarkets/hypermarkets account for nearly 40% of the market for packaged food.

In Algeria, Morocco and Cameroon, independent small grocers make up around 60% of all distribution channels

Yet other distribution channels still carry weight. In Algeria, Morocco and Cameroon, independent small grocers make up around 60% of all distribution channels, whereas in Nigeria, "other grocery retailers", such as kiosks and outdoor markets make up nearly 50%. In fact, supermarkets make up only 4% of the Nigerian market, though its share has doubled since 2006, indicating a growing trend. Cameroon and Kenya also have a strong "other grocery retailers" presence at nearly 40% in each country. Discounters and forecourt retailers have also been gaining share.

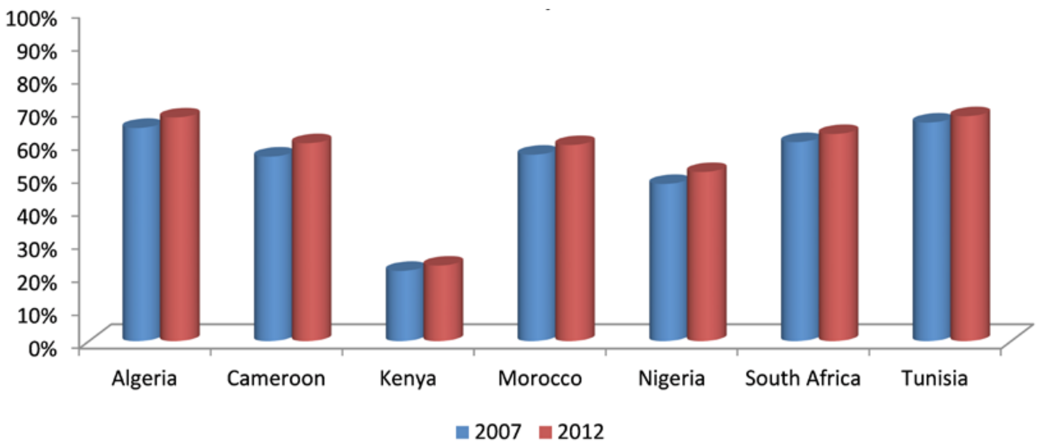
Other Grocery Channels in 2012



Source: Euromonitor International

What has assisted growth in modern retailing is an increase in the urban population. With the exception of Kenya, over 50% to 70% of a country's total population live in urban areas, though even in Kenya, the urban population has grown significantly over 2007-2012. Urban communities are becoming a focal point for African development, with companies using urban centres as a springboard into the wider market.

Percent Urban Population

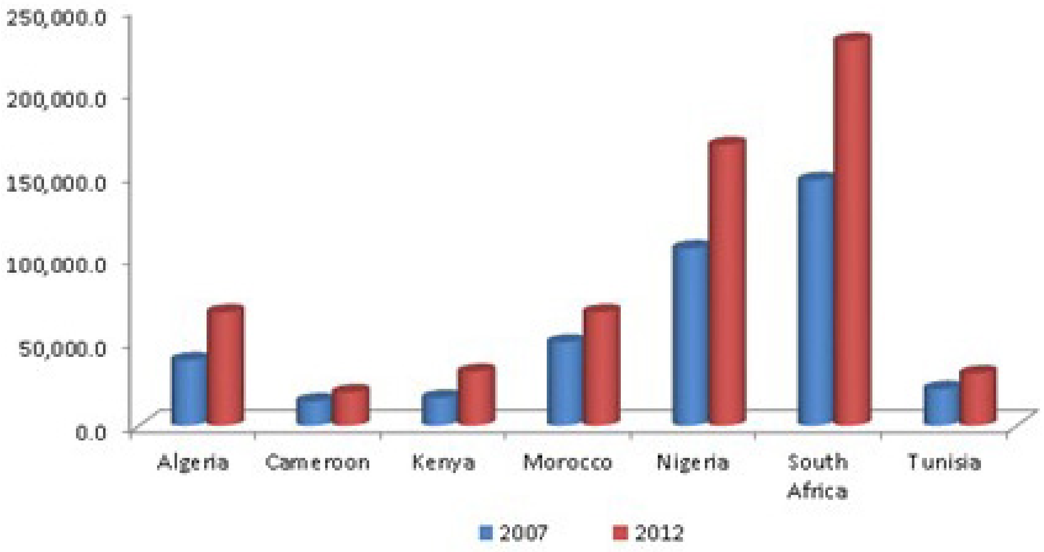


Source: Euromonitor International

Along with the rise of the urban population, there has been the rise in disposable income. As the chart below shows, there has been a significant increase in disposable income from 2007 to 2012, with Kenya and Algeria showing the largest percentage increases between those years, 95% and 73%, respectively. Nigeria and South Africa have also seen a sharp increase between these two years, both at nearly 60%. This overall growth in Africa has coincided with the growth of the middle class, and the target of many food companies. The definition of middle class varies from country to country and what constitutes "middle class" in many of these countries is at a much lower level than in Western Europe. Moreover, as they make up only a small percent of the population, companies would not want to miss the opportunities available to them among the larger low-income population.

Disposable Income 2007 vs. 2012

US$ Millions



Source: Euromonitor International

For countries with a high low-income population, food expenditure takes on a higher proportion of disposable income, with less spent on health, leisure, household goods and miscellaneous goods and services. In contrast, in countries such as South Africa, only 20% is spent on food. Thus, as food is the major spend in African countries, finding innovative ways of reaching low-income consumers is a necessity.

All roads lead to … the challenges of distribution

Whether it is a supermarket or a kiosk, supplying these retailers presents both challenges and opportunities for food manufacturers. Poor road infrastructure in many African countries makes transport both difficult and costly and even delivery at specific ports does not guarantee prompt delivery, with many ports remaining unreliable and products being delayed by paperwork.

In South Africa, food distribution is mainly carried out directly by the food manufacturers. The big supermarket chains, such as Pick 'n Pay, Shoprite and Checkers, have their own warehouse distribution, receiving goods from suppliers and distributing them to their own warehouses, and stores. Moreover, as larger supermarkets involve purchase consolidation, as well as necessitating specialised wholesalers and higher quality and safety standards, food manufacturers need to make investments. This is harder for smaller producers indicating why multinationals, already proficient in such procedures, have a strong presence in the continent.

Others follow a similar model used by Coca-Cola. In this Micro Distribution Centres (MDC) model, these local owned depots operate within a densely populated area with links to the company headquarters that may provide technical support and credit to the MDCs. With delivery information in hand, the MDCs generally crate and transport the goods. For further out locations, small trucks from the MDCs take the products up to a certain point where a group of locals employed by the MDCs take over, carrying the products the last few miles, often by bicycle or push carts.

For companies that do not use direct distribution, distribution is quite fragmented with no major players. These small-scale distributors operate regionally rather than nationally. Delivering to these more informal channels is itself a challenge and can be quite costly. However, as there are a large number of small retail stores in Africa, there is often a strong dependence on distributors, agents, wholesalers and intermediaries who can deliver goods to both large-scale retail chains and smaller outlets.

However, even this can be risky as relationships are often not direct and manufacturers need to ensure distributors receive "incentives" beyond general payment for providing their services. In some cases, the needs are more practical in that the manufacturer may need to provide the vehicles for distributing the products. With others, there needs to be frequent monitoring and reviews of distributors. For example, a hot drinks brand in Nigeria noted it is standard practice for products to be left un-distributed, as distributors give prominence to other brands or simply do not bother to sell them. Equally, the products may not necessarily be distributed into areas that ensure high visibility of the brand.

In countries such as Nigeria, it is typical for manufacturers to make use of outdoor markets for the distribution of their products. These products are delivered to wholesalers who then take them to the outdoor markets where they are exchanged with distributors and retailers directly, saving on costs. In addition, the exposure exists in getting these products among low-income consumers who, in many cases, are still accustomed to low-quality alternatives.

Rural areas are also reached through larger outdoor markets where representatives from retailers in smaller markets come to the open markets and take products back to sell to smaller retailers in rural areas. Euromonitor International estimates that 70% of distribution arrangements in Nigeria go through outdoor markets. In addition to this service, wholesalers can also break "bulk" packages for smaller retailers who cannot afford to buy the larger bulk products. For the outdoor markets themselves, some distributors also provide top-ups, vans that drive around providing outside vendors with low-running stock. More rural areas would receive a less frequent top-up service, about once a month.

70%

of Nigeria's distribution arrangements go through outdoor markets.

In some cases, manufacturers choose exclusive distribution relationships to ensure only their products are distributed, allowing for more national coverage through secondary partnerships engaged by these primary distributors. For example, a pasta company in Nigeria uses an exclusive distributor to engage with smaller distributors to broaden its coverage. These smaller distributors may not have an exclusive relationship with the manufacturer but are given targets and provided with incentives for good performance. A presence in outdoor markets remains crucial to these relationships.

Another key concern is security with crime a rampant problem on the continent. For example, Nestlé's distribution centres in South Africa are fortified with steel fences due to previous problems with theft. Delivering products to smaller establishments such as open-air market stalls, informal kiosks such as spaza or tuck shops and proper mini-markets, can be dangerous. Nestlé uses nondescript vans when delivering to spaza shops in South Africa due to robberies on staff. Collecting payments can be challenging as many are still in cash, and as such, added costs and procedures are introduced into the process. Companies often work with owners who have very little capital and, in some cases, less willingness to expand beyond their own space.

A BLANKET APPROACH WILL NOT WORK

In addition to being mindful of the distribution challenges, manufacturers also need to be cognisant of the nuances in the African market. There is a need to consider price sensitivity and cultural distinctions between the various countries, as Africa is not just a single continent but also a collection of diverse countries that make up a continent.

As a large proportion of the population does not have a great deal of discretionary income, marketing products at affordable prices is essential. A well-known practice in Africa, called bulk breaking, where items within a larger bag are sold individually, has long been adapted by smaller retailers to offer lower price points. This idea has proliferated into offering smaller pack sizes to consumers, something companies such as FrieslandCampina WAMCO Nigeria Plc and Nestlé have already done with their milk products. These types of products are particularly popular at local shops and kiosks, vendors of choice for lower-income consumers.

Packaging also plays a strong role in brand identity. In some African countries, high illiteracy rates mean that brands are primarily identified by the colour of their packaging. Consumers may often describe a brand by its “green and gold” packaging; thus, a change in packaging colours may inadvertently lead to a decrease in brand sales.

Food companies should also look at individual countries rather than at taking a blanket approach across the continent, as there are distinct cultural differences. Food manufacturers should think more in terms of “sub-clusters”, such as East Africa, West Africa and Southern Africa. More also needs to be done in understanding unique elements of the African landscape such as food that does not require refrigeration or that lasts longer in a hot climate, or the limits of electricity and water in keeping food from spoiling quickly or limiting the amount of water needed in food preparation.

Equally, Africa should not be defined to a single country experience but represents a diverse group. Companies should develop innovative approaches tailored to the specific country and consumer, as one might look at the differences between the Germans and the French and not just as Europeans. Moreover, taking an urban-centred approach is essential in Africa due to the high and still-growing urban population. This is particularly important in gaining scale in a particular country, as well as in targeting consumers with higher disposable incomes.

With an ever-rising high food import bill, Africa cannot afford to waste time in becoming more self-sufficient. Yet it is a development not happening immediately but will take years before a proper infrastructure is in place. Still there will be small wins along the way. As more manufacturers and investors seek to take advantage of improving conditions and growing opportunities, Africa will inevitably become the land that food manufacturers expected.

HOW CAN EUROMONITOR INTERNATIONAL HELP?

FMCG companies use our market research database, Passport, for market and strategy reviews, market entry, target-setting, merger and acquisition analysis, promotional campaigns, customer segmentations, trend spotting and forecasting. Our research supports companies of all sizes in a multitude of industries make strategic business decisions.

For more information about our research, please request a demonstration.