

# AFRICAN REALITIES

Africa is now the Next Big Thing. Every company boasts of its Africa strategy as a key plank of its growth plan. But, as Erika van der Merwe finds out, Africa is no sure thing. Shareholders need to learn the difference between a good Africa strategy and a bad one.



Picture: 123rf

**T**HE LATE-NIGHT arrival at Lagos' Murtala Muhammed Airport, typical timing for flights out of SA, is a reasonable metaphor of what lies ahead for business executives hoping to tap into Nigeria's vigorous and sizable economy. Besides the shock of the enervating tropical heat, a tedious customs queue will test your commitment. The reward comes

as you venture into the city, through the maelstrom of snarled traffic and hustling entrepreneurs. Provided you keep your wits about you – and can breathe through the pall of generator-spewed diesel fumes – you could discover the possibilities presented by this city of more than 10-million keen consumers.

Nigeria's rapid catch-up growth – the fourth-fastest rate of economic expansion of any economy during the decade to 2010

– is becoming a typical feature on the African continent. Now benefiting from macroeconomic and political stability, sub-Saharan African growth has hovered above the world average for most of the years since the turn of the millennium.

While there are moments of trepidation, such as in Nigeria now or Kenya following its disputed elections of 2007, the general picture has never looked so good. For investors with a stomach for frontier-

market risk characteristics, African assets are becoming an antidote to dull and uncertain performances in the advanced economies. And for corporate heads from Johannesburg and Mumbai to Lisbon and London, a large, underdeveloped and underserved market holds the promise of lively long-term earnings support.

A number of JSE-listed companies began exploring their options in the African hinterland long before this more recent wave of interest and hype. Miners, banks, construction companies, telecommunications players and retailers moved into the region because of minerals, tenders and markets which were too good to be missed. Often pull factors were combined with the fact that they had outgrown the South African market and were seeking better application for their cash. In many cases, their South African service providers, from banks to consulting firms, expanded alongside them, and continue to do so.

Seen in context, this cross-border drive has been more of a trickle than a flood. In fact, operators from outside the continent have at times seemed more enthusiastic than South Africans about opportunities up north. There is evidence aplenty to keep the doubters at home. Remember how **Super Group's** Angolan bosses were hoodwinked by a general's son into parting with hundreds of trucks? The group literally had the trucks taken from

### ***"A successful strategy for extending one's reach in Africa is not a cookie-cutter approach"***

them, leading to a write-off of R197m. A couple of years before that **Group Five** lost millions through its involvement in a Luandan housing project. **Telkom** and **Vodacom** both have awkward memories of acquisitions in Nigeria, done at inflated prices, and **Altech** more recently had a sobering realisation that the potential of its East African assets were not as fulsome as it originally estimated. Even **Avusa** had its turn, and heaved a sigh of relief in 2008 when Capital Alliance Private Equity took its Nigerian assets off its

#### **PICKING STOCKS WITH EXPOSURE TO AFRICAN GROWTH**

- Africa is a long-term play. Beware of promises of quick and easy successes.
- Seek out companies with a diversified presence across various African regions.
- Question management on risk-mitigation strategies.
- Establish whether the company has consistent ethical standards across all its regional operations.
- Avoid companies that are battling to make it on their home turf. They're unlikely to have the focus for successful expansion.
- Make allowances for currency risk.
- Focus on valuations but remember that the risk premium ought to be high.

hands and the Silverbird Group relieved it of its Kenyan business.

#### **IGNORE AT YOUR PERIL**

Although many corporations have returned from their African adventures with bloodied noses, Roelof Horne, who has run Investec's Africa Fund for more than six years, believes the region offers a growth imperative that ought not to be ignored. "The growth potential of African markets will become even clearer over the next 20 years," he says, by which time it could be too late to find a foothold. "The sooner companies expand into the continent, the greater the benefit from doing so."

MTN can attest to the earnings payoff from the early-mover advantage, having nestled itself into African markets long before most others considered such a route viable, let alone hugely profitable.

portion of group earnings, analysts hail SABMiller alongside **MTN** and **Shoprite** as being the best examples of how to undertake the foray into Africa.

**Standard Bank**, with its enduring and widespread presence across the region, is another JSE-listed business lauded for its approach, even though shareholders are growing increasingly impatient with the slow conversion of its non-South African income growth into earnings growth.

"It has always succeeded in generating growth; revenues in the 16 or so countries outside SA in which it operates have swelled by around 18% per annum over the past 10 years. But what hasn't come through is growth in earnings," says Patrice Rassou, head of equities at SIM. "In some cases this is because the country operations don't have sufficient scale. And, as the bank moved further north to the bigger and more challenging economies, the returns have been less appealing."

Rassou reckons African banking operations have earnings growth potential of 10% to 12% over the medium term. Although attractive, this is not enough oomph to transform any of the big South African banks into fully fledged pan-African businesses "unless they succeed in doing a massive acquisition".

#### **HOW GOOD IS THE STRATEGY?**

With the hype and bluster about Africa, juxtaposed with the unfamiliarity of the terrain, the lengthy investment lead times, and the sector-related considerations, it is essential that shareholders assess carefully and critically whether the companies in which they are invested are going about



**Simon Harford ...**  
Rigorous homework is required.

Africa the right way.

Analysts stress that a successful strategy for extending one's reach in Africa is not a cookie-cutter approach to be manoeuvred from the home base, nor can new entrants hope to duplicate the forerunners' modus operandi. Local experience, networks and commitment are indispensable.

Simon Harford, co-head for Africa at private equity firm Actis, cautions that it is risky to talk of Africa as one entity; rigorous homework is required to establish what it takes to succeed in each market. "You can't generalise about 54 countries; you're dealing with multiple and very varied business markets. One of the challenges is to understand the cultural, social, economic and historic differences within the region."

Among the surprises businesses might encounter in their research is the level of competition in some of the markets. "It would be an error to assume that there are no or weak competitors, or that SA brings the best in leadership and innovation. Some of the top African companies are not South African," Harford says.

Horne agrees. He says he's seeing a steady influx of new contenders in various sectors. "South Africans must not make the mistake of sending weak staff or inferior products to build up their new operations. Companies with plans to build a sustainable business instead will send their best people, those with the wherewithal to cope with demanding conditions. They will be competing with a cohort of well-qualified local business



**Peter Leger ...**  
Symbiotic solutions sought.

people, many of whom have years of experience in developed markets."

**DROP THE SWAGGER**

On this theme, one of the primary lessons which companies have learned on the continent is to shed the vestiges of colonial mindsets. "You can't walk in with an attitude that 'we're bigger and better and can tell you how it's done'," says Mohamed Mayet, MD of Sentio Capital Management. He cites as examples some of the initial retail experiments in Africa, including Woolworths', and the JSE's limited success in attracting African companies to list in Johannesburg. "In general, African companies have preferred

***"Outsiders have in many instances underestimated how difficult it is to set up shop in African markets"***

London as a first choice to raise capital before considering SA, even if this is sometimes more expensive and difficult."

Another lesson is the degree of conviction with which one ought to set up shop, Mayet says. "The suitcase businessman won't make it. You need to have a local mindset, with local partners."

With that comes the need for balance between testing the waters carefully, with limited capital, while still committing wholeheartedly to a particular product or service that makes sense. "The franchise partnerships with which Truworths, Woolworths and Mr Price moved into various African territories didn't work, largely because the partner never had the

same strategic imperative."

Woolworths, for one, has since announced its plans to dump the franchise model and take on joint venture partnerships with locals instead. The shift from a relatively hands-off wholesale player towards a more involved retail player will apply to most of the 46 stores which it has in 10 countries outside SA.

Adrian Saville, chief investment officer at Cannon Asset Managers, is a fan of Woolworths' new thinking. "Rather than imposing an identity and brand on the market, as it did with the franchises, the revamped model gives the local businesses a fluidity that will serve the group well."

Fashioning these local networks, building experience and committing to the long term are the only route to making it work. "You can't run such a business by remote control from SA," says Rassou. "And you would be mistaken if you thought you could copy the strategy proven by others." Indeed, the barriers to entry in most African markets are simply too high for that.

Pick n Pay, which recently announced its plans to roll out into Africa, is a case in point, with analysts warning that it can't simply piggy-back on Shoprite's structures and experiences. "Shoprite has the early-mover advantage, having paid plenty

of school fees before getting it right," Rassou says. The strong networks which the retailer built to ensure that its goods were moved from the ports to its shops, for instance, came after several of those cargoes rotted in transit.

**PATIENCE IS A VIRTUE**

Harford's advice to companies and their shareholders is to be realistic about the time frame for results. Africa is, after all, a frontier market. "Give yourself time; it takes time to learn how to do business in the various African economies and there's no room for cutting corners. Nigeria, for instance, can be a difficult market in which to do business, but also extremely



**Mohamed Mayet ...**  
Politicians could do more to help.

rewarding if you're patient."

Despite his patience, Shoprite's Whitey Basson is still far from seeing his African dream materialise. He'll be opening his second shop in Lagos this year, having planned to be running more than five by now. His team has been battling infrastructural backlogs, regulatory and legal quagmires and has been held back by the absence of a functioning property and property rental market in key countries.

Peter Leger, head of Coronation Fund Managers' specialist Africa unit, observes that outsiders have in many instances underestimated how difficult it is to set up shop in African markets. "Aside from finding the right site, there's the matter of setting up reliable power to the site and finding suppliers who, for example, can deliver fresh products on a consistent basis. Although Shoprite is doing very well in Lagos, it's been a multi-year process to get it all working."

After all that effort, non-South African revenue remains a small portion of Shoprite's total revenue and, although pockets of these operations are surprisingly profitable, the overall regional performance is unimpressive. "It took Shoprite a long time to make decent returns from outside SA. Even now, operating margins are more or less the same as those in SA," says Nedbank Capital's retail specialist Syd Vianello.

He is sceptical about what South African retailers will find in the region, years from now. "I doubt whether Africa will represent a huge contribution to the

bottom line of these companies. They're facing recurring costs and reinvestment in infrastructure. What's more, the lack of credit data in most countries prohibits retailers from using credit sales to drive volumes. The successful guys will make profits, but certainly not everyone will."

**GOING IT ALONE**

Mayet is critical of the South African authorities for failing to put relationships and treaties in place to help smooth over some of these deep wrinkles. "Where simple diplomatic relations would have helped, South African corporations are left largely on their own. Yes, SA can be a gateway to Africa, but the longer our policy makers dither, the less likely this becomes."

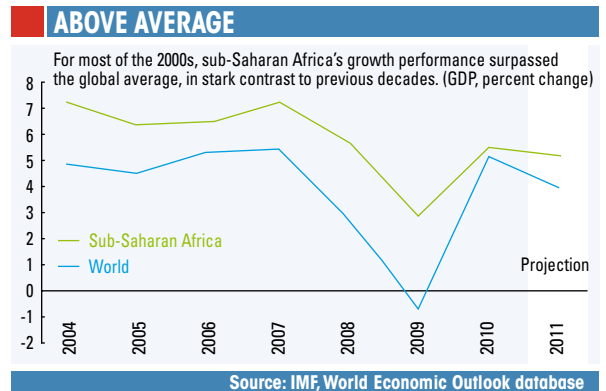
But the successful South African players have proven themselves more than capable of fending for themselves, usually by engaging directly with the relevant authorities and proposing symbiotic solutions. "SABMiller, for instance, has been clever in launching a cassava beer in Mozambique," Leger says. "Although this is cheaper than hops-based beer, its success relative to the informal beer market depends on relief from excise duty and the use of local products. The government recognises the merits of supporting Mozambican cassava farmers and it has agreed to cut back on duties. So far the strategy has worked remarkably well and sales volumes have been firm."

Having burnt their fingers some years back, South African construction companies are returning to the rest of Africa and are employing similarly symbiotic partnerships to ensure the move pays off, particularly when it comes to safeguarding payment for public sector work. These partnerships include collaboration with Chinese institutions, who lack local operational experience but have access to funding. In this way, contracts for government-related work can be negotiated with the government as

a party, but payment is received directly from the financier.

Saville includes Group Five as a particular example of a business that had gotten its non-South African strategy quite wrong a decade ago, but which has learned from those mistakes. It has contracts under way in 17 countries outside South Africa and a third of its order book is allocated to these countries. "Group Five's African operations are still in the early stages of growth, but its collaborative, level-headed and far-sighted approach will pay off over time."

With its broad regional spread, Group Five is an example of a portfolio approach to African market – a sensible way of lessening vulnerability to localised shocks. As one would expect in frontier markets, such shocks could be jolting. "One can't expect to benefit from the high growth of these markets without the associated risk;



margins are higher here for a reason," Mayet says. "The way around this is for investors to seek out those companies with superior risk and portfolio management of their Africa operations."

Africa is certainly no get-rich-quick scheme. The successful companies have paid their school fees, while others have given up trying. While JSE-listed firms now all boast of an Africa strategy, wise shareholders have to assess whether the promises are realistic. Profits are always further off than first believed and local conditions can undo the best made plans. But, as MTN, SABMiller and a handful of others have proved, when you get it right, it can be very profitable indeed. **IM**