The New Investment Case for Africa

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Introduction

From the days of African independence to the turn of the 21st century, developed countries' economic engagement with African nations was largely limited to the provision of humanitarian and development aid. The beginning of the new millennium saw a shift as traditional donor countries began to focus on boosting African economic growth via increased trade. Over the past decade, this dynamic has shifted once more, with an increased emphasis on facilitating private investment into African economies.[1] The United States' Prosper Africa initiative, launched in 2018, has put additional focus on facilitating bilateral investment and trade between the US and the continent.[2] In Europe, the UK has pledged to invest an additional USD 4.5 billion in Africa by 2022, and EU countries are now responsible for 40% of all foreign direct investment (FDI) into African markets.[3,4,5] Other non-Western countries, including China, India, Turkey, and the United Arab Emirates, have increasingly turned to Africa for investment opportunities as well.

This new investment-centered approach to development is based on the idea that mobilizing private capital into transparent markets is key to driving sustainable economic growth over the long term. Investing in a country's productive capacity allows companies to produce more goods and services that the country can then trade under pre-existing global preference programs. Prior development approaches that solely focused on facilitating trade did not address the fundamental lack of this productive capacity, which is needed to produce exports in the quality and quantity demanded in developed markets. Despite the COVID-19 health and economic crisis, these new investment-focused efforts are continuing to gain momentum and attract private sector interest.

The business case for investing in African markets can no longer rest solely on the dated adage that six of the 10 fastest-growing countries are in Africa – it now needs to be updated to the post-COVID emergent economic reality. The COVID-19 pandemic has increased the risk of a global economic recession, and has resulted in the first recession in African markets in over 20 years.[6] Africa's rapid recovery will depend on targeted, organized, and voluminous FDI and portfolio investment flows that capitalize on positive structural trends that were present before COVID-19.

An unprecedented mobilization of global private capital would drive mutually beneficial economic growth that addresses key priorities including job creation, infrastructure development, and improved social services. From improving relative political risk and strong economic fundamentals to reduced transaction costs and the rapid adoption of technology, African markets now present investors with attractive opportunities for returns in a broad range of sectors, from emerging industries such as financial, education, and health technology, to more traditional sectors including energy and agribusiness.

The Business Case for Africa

The new business case for Africa rests on the following factors that have made African markets increasingly attractive to investors in recent years, and will continue to do so after the pandemic.

1. Improving Relative Risk

The political risk calculation around African investments has dramatically shifted due to COVID-19 and the resultant economic recession. Although rising political risk in developed markets is not a new trend, the pandemic has added yet another stress to already shaky economic and geopolitical fault lines in the US, China, and Europe.[7,8] Investors are facing uncertainty in what have typically been safe markets, and are applying risk analyses usually reserved for foreign markets. Other emerging markets to which investors have traditionally turned for opportunities, such as South Korea and India, face similar risks. As a result, the risk and return calculus for African investment opportunities has significantly improved in relative terms, complementing the decades of positive structural improvements that have occurred across the continent.

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2. Improving Regional Resilience

The pandemic's present economic shock is not the end of the African growth story. As seen in past economic crises, such as the 2008 financial crisis and the 2014 commodity crash, the major regions of Africa will likely recover much more quickly than predicted, although at different rates reflecting their pre-COVID-19 economic structure and relative strengths.

The IMF projects that East African nations are likely to have a faster return to growth, reaching 1.4% by the end of 2020, due to more diversified economies and relative success containing the coronavirus compared with other regions. Other economically diversified countries sharing similar structural qualities include Côte d'Ivoire, Egypt, Mauritius, Morocco, Namibia, South Africa, and Tunisia.[9] Notably, the manufacturing and services sectors make up 70% to 90% of these countries' GDPs, making them less reliant on commodities than others on the continent. Another set of countries - including Senegal, Ghana, Mozambique, Uganda, and Zambia - have not yet reached the same level of diversification, but have begun to move away from reliance on commodities towards producing exports for regional markets. Overall, African countries' considerable and improving resilience to economic shocks should not be underestimated.

3. Positive Long-Term Structural Trends

Many of the long-term positive market fundamentals present in African economies before COVID-19 will continue despite the pandemic's economic impacts. Across the continent, four key structural trends are driving this growth and shaping opportunities for potential investors in African markets.

a. Young and urban

Africa is the world's youngest continent – the median age is only 18 years old, compared with 31 in Latin America and Asia, 38 in the United States, and 42 in Europe.[10] It also has the highest urbanization rate in the world, with almost one billion Africans projected to move to cities in the next three decades.[11,12]

Sub-Saharan Africa's 143 cities generate half a trillion dollars in economic activity, equal to 50% of the region's GDP.[13] By 2030, Africa will be home to 17 cities with more than five million inhabitants, as well as 90 cities with at least one million.[14] Cities contribute to strong economic growth rates through their higher consumer density (which reduces transaction costs), higher labor productivity, and higher levels of disposable income among urban residents, making the continued development of urban centers and megacities like Lagos, Cairo and Kinshasa important drivers of economic growth.[15]

These demographic changes will continue to outpace those of similarly positioned economies such as India and China in the coming decades, securing Africa's position as the most demographically attractive investment destination in the world.[16]

b. Connected

In addition to being increasingly urban, Africa's young population is more connected than ever before – by 2025, more than half a billion Africans will have access to mobile data.[17] Mobile connections are growing not just because of improved access to data, but also the speed of that data: there will be 270 million mobile broadband (LTE) subscriptions by 2025, and total mobile data traffic flows will increase twelvefold over the next five years.[18]

As a result, telecom companies are expanding the services they provide to their customers, including moving into mobile money with services such as M-Pesa and MTN's transfer service.[19,20] These developments will allow African consumers and foreign investors to take advantage of opportunities in fintech, edtech, and healthtech, all of which have increased importance in a post-COVID world.

c. Tech-optimistic and entrepreneurial

Young Africans are quick adopters and leading users of new technologies such as mobile applications, making them a truly mobile-first generation.[21] As mobile penetration rates continue to surge, Africans are looking to their phones to accomplish more tasks. This willingness to adopt new technology has played a significant role in the explosion of mobility apps, such as ORide and Max.ng, throughout the continent.[22]

This optimistic and entrepreneurial spirit is also present throughout the vibrant African startup scene. Last year saw total African startup funding surpass USD 1 billion for the first time.[23] While Lagos is perhaps the best-known tech hub on the continent, Cairo-based startups raised USD 90 million in funding last year, while Cape Town startups attracted USD 47 million.[24,25] Forty-one percent of all such funding went to fintech, followed by logistics and mobility, energy, and health-related startups.[26]

This tech-focused entrepreneurism will continue to create opportunities for investors to support innovative firms across the continent.

d. Falling transaction costs through greater integration

African markets have traditionally been small and fragmented, resulting in high transaction costs for businesses and investors. This has placed the continent at a disadvantage relative to other high growth regions such as India and China, which are single, large, and contiguously regulated markets. About one-third of African countries are land-locked, and the average size of an African economy is USD 49 billion – around the size of the US state of Montana.[27]

These characteristics, along with 54 different tax, regulatory, and banking regimes across Africa, have led to prohibitively high business transaction costs and have deterred many investors from taking a serious look at opportunities on the continent. However, advances in digitalization, regional integration, and investments in infrastructure are reducing these transaction costs for domestic and international businesses alike.

For example, competition in the mobile money sector has lowered the costs of sending and receiving funds across African borders by over 5% since 2014. The integration of traditionally fragmented small markets through the African Continental Free Trade Area (AfCFTA) will be especially important in creating business opportunities that were not present just a few years ago.[28] A singular African market under the AfCFTA is projected to generate USD 6.7 trillion in consumer and business spending by 2030, and allow companies to scale across regions and the entire continent more quickly and efficiently.[29]

Finally, hundreds of billions of dollars have been invested into African infrastructure in the past decade, which has begun to lower transportation costs.[30] Additional projects currently under development will further strengthen and expand the transportation networks needed to facilitate intracontinental trade flows, lowering costs and further improving the business environment.

These trends have defined African markets in the 21st century, and will underpin opportunities for the right type of investor to realize returns equivalent to or exceeding those that can be achieved in developed markets, if these investments are focused on the right set of companies and sectors across the continent.

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Right-Sizing the African Opportunity for Investors

When investors examine whether to enter a new market, one of their first considerations is the presence of adequately sized potential partners or customers. Both are abundant in African markets. Throughout the continent, there are 400 companies with annual revenues exceeding USD 1 billion, with another 700 firms generating over USD 500 million a year.[31]

These enterprises compete in diverse sectors and are globally competitive. Yet, some of the largest of these African companies are equivalent in size to small and medium enterprises (SMEs) in the United States.[32] This means that many of the opportunities for multimillion-dollar business to business (B2B) deals in Africa during the coming decade are ripe for American and European SMEs, if they are able to gain access to the information and networks necessary to begin operating on the continent.

While large US multinationals such as Coca-Cola and General Electric have been present in Africa for a century or more, US SMEs have largely remained unengaged on the continent, preferring to stay focused on North America. With the B2B sector in Africa expected to grow to USD 3.5 trillion in the next five years, investments in, and partnerships between, international SMEs and African companies can be a significant source of mutual growth over the next several decades.[33] The US Prosper Africa initiative, as well as Germany's new EUR 1 billion Development Investment Fund to support SME investors in African markets, both seek to unleash a new wave of investor interest in the region.[34] Successfully doing so will require targeted outreach, education campaigns and the marketing of opportunities in priority sectors.

Emerging Sectors of Opportunity

The next wave of investment into African markets should focus on sectors that will define the continent's growth in the coming years. The last 10 years saw FDI flow into areas such as telecommunications, consumer products, and industrials, but mobile penetration, COVID-19 dynamics, and growing energy demand are creating opportunities in new sectors. Emerging sectors of opportunity for investors include the following.

1. Financial Services

Africa's financial services sector is projected to grow by 8.5% a year, and with the continent's retail banking penetration rate at just 38%, the sector will likely remain attractive for the next decade.[35] Mobile money alone in West Africa serves 13 times more customers than traditional banks. Africa's fintech sector is already attracting multinational players such as Mastercard, which participated in Nigerian fintech company Flutterwave's USD 20 million funding round.[36,37] Similarly, Stripe recently acquired Lagos-based startup Paystack for over USD 200 million, a successful exit that will further contribute to the growing investor interest in this sector.[38]

2. Education Technology

This year will cap off a decade that saw USD 32 billion invested into edtech ventures globally.[39] African innovators were already making waves in the edtech space before the pandemic.[40] Now, their work is crucial in a context where almost 300 million African students will be learning from home.[41] African edtech startups have positioned the continent to embrace a transition to virtual learning, even as profound challenges relating to access to computer hardware, software, data, and electricity remain.[42]

3. Healthcare Technology

Africa's healthcare technology sector is rising to meet the immense challenge of expanding healthcare accessibility in Africa. Healthcare startups are leveraging high mobile penetration to close gaps between urban and rural healthcare access. Investors are recognizing this potential: between 2019 and the first half of 2020, funding to health-tech startups more than quadrupled, growing from USD 20 million to more than USD 90 million.[43,44] From delivering medicines via drone to telehealth applications, mobile technology development is improving African healthcare every year.

4. Creative Industries

Digitization and mobile penetration have also drawn attention to a less traditional investment destination: Africa's creative industries.[45] Africa's cultural goods sector is estimated to employ about half a million people and generate USD 4.2 billion in revenue, and major companies such as Netflix, Universal Music Group, Sony Music, and Warner Music Group have recently entered the African market.[46,47,48] This international recognition and integration will sustain the sector's growth, a fact reflected by the African Export-Import Bank's recent announcement of a USD 500 million credit facility to support African cultural and creative products.[49]

5. Renewable Energy

Abundant opportunities and strong donor support mean that renewable energy will likely be the largest source of new generation capacity in African markets in the coming years. The African Development Bank's Desert to Power initiative, for example, seeks to develop the Sahel region's 310 GW worth of energy potential to supply countries including Burkina Faso, Djibouti, Eritrea, Mali, Mauritania, Niger, and Nigeria.[50] Such regional integration of renewable energy projects can stabilize energy supplies across multiple countries and reduce energy costs for businesses, with cascading effects throughout the economy.[51]

Conclusion

The COVID-19 pandemic has created a global crisis, but also an opportunity to reframe private sector engagement with African nations. Now is the time to demonstrate that private investment can invigorate broad-based economic growth while generating real returns for investors. Africa's relative political risk, resilience to the current economic crisis, long-term fundamentals, and digital potential have all positioned the region as an attractive investment destination for decades to come.

With the business case for Africa now clear, focusing on driving private investment into the continent will create business opportunities, jobs, growth, and prosperity for Americans, Europeans, and Africans alike.

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