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Africa's changing role in global supply chains

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EXECUTIVE SUMMARY

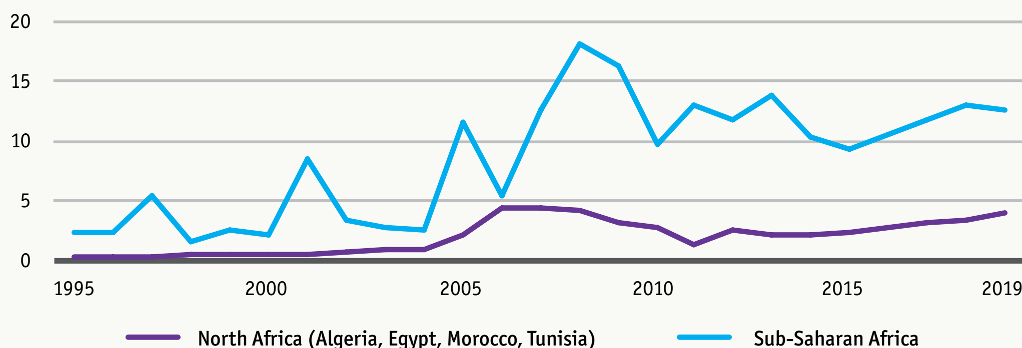
Sourcing products and services from Africa is an option that makes sense to more and more firms, both international and African, each year. Though the spikes in inward direct investment during the global financial crisis were temporary, the longer term trend of increasing flows into Africa is set to persist (see chart, below). As companies expand their supply chains into the continent, inward investment into sub-Saharan Africa is expected to grow by more than a third from 2015 to 2019, while investment into North Africa is set to rise by nearly 70% in the same period.

Pull factors include cheap labour—unskilled wages in East Africa are approximately a tenth of those in China—and abundant raw materials. A global trend towards shorter, simpler supply chains also makes the region particularly attractive for European firms. African governments are increasingly carving out a role for the private sector in their development and industrialisation strategies, and are introducing incentives such as duty-free exports and cheap land leases in target sectors. Infrastructure improvements to pave the way for further investments are in full swing, particularly in coastal areas, and the difficulties associated with exporting from African ports are diminishing slowly but surely. Large cities such as Nairobi and Lagos are also gaining access to broadband Internet, supporting a nascent services outsourcing sector.

Perhaps most importantly, an African middle class is emerging. Though affluent consumers with significant disposable income still represent a relatively small fraction of most African national populations, a combination of rapid wealth creation and urbanisation, particularly in regional hubs, is starting to

Investing in Africa: Not just a fad

Inward direct investment, US$bn



Source: The Economist Intelligence Unit.

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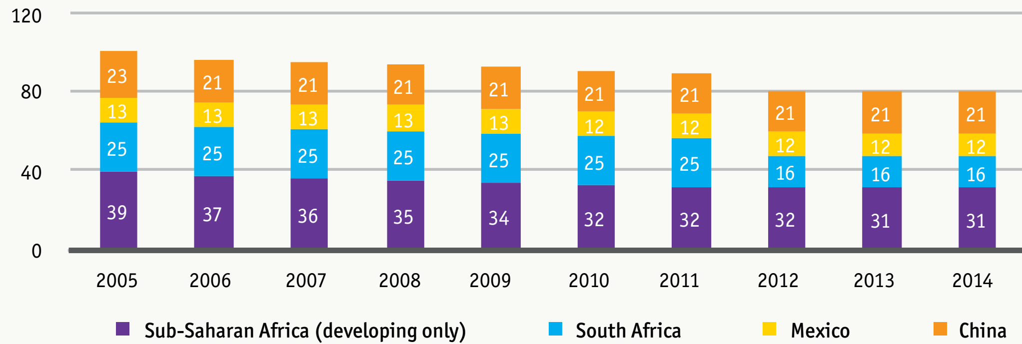
Bottlenecks to exporting from Africa are easing

Time to export, in days



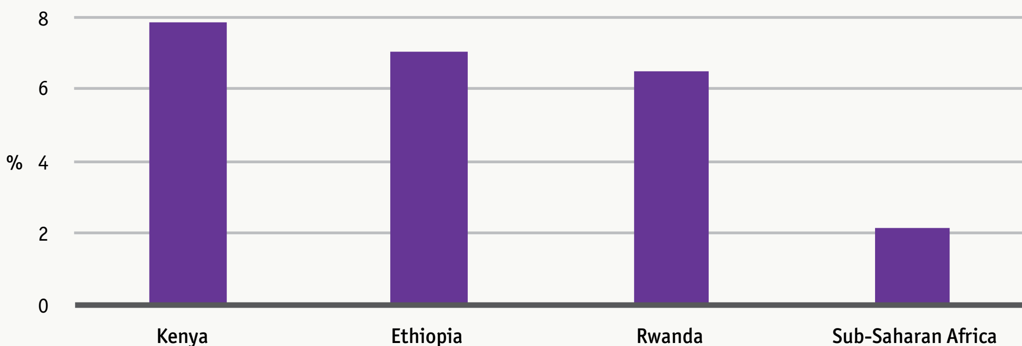
Source: World Bank.

catch the eye of some in the international business community. As a consumer market, the continent is likely to represent one of the biggest growth opportunities in coming decades, and this is starting to factor into the decisions of firms when they choose to establish or expand local production bases. Some firms are already wholeheartedly pursuing the local market, while others currently exporting from Africa are starting to explore opportunities throughout the continent.

The Economist Intelligence Unit (EIU) expects Sub-Saharan Africa's GDP per head to grow by an average yearly rate of 2.1% over the 2015-2019 period (inclusive). Yet wealth creation will progress much faster in the most vibrant and diversified African economies, such as those in East Africa working to develop a manufacturing and services base . Relying on imports to service the growing demand for consumer goods is neither desirable to locally-based firms, who wish to have cheap, responsive

Locating Africa's future middle class

Average annual growth in GDP/head, 2015-19



Sources: IMF World Economic Outlook, The Economist Intelligence Unit.

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supply chains; nor to consumers, who pay a premium for imports; nor to governments, who wish to capture more added value in the domestic economy.

And yet Africa, long exploited for its raw materials and flooded with cheap consumer goods from Asia, remains a largely overlooked destination for manufacturing and services. Many companies remain daunted by a prospect they view as risky. Data indicating rising inward investment flows, improving infrastructure and a rising middle class take time to overpower lingering impressions of dirt roads, impoverished populations, political violence, red tape and entrenched corruption. In many parts of Africa these impressions unfortunately still hold true. Forty out of 47 African economies were ranked in the bottom half of the World Bank's 2014 global "Ease of doing business" scoreboard. But Africa is a very large, diverse continent. Even at a sub-national level, some areas may be mired in conflict while others experience an economic boom. Nigeria – with Boko Haram causing ongoing troubles in the north-east, but Lagos in the south-west seeing growth in banking, retail, manufacturing and even a film industry—is just one such example.

The companies featured in these case studies all have one thing in common: a long-term vision of Africa, not simply as a source of minerals or market for imported goods, but as a vibrant, well-functioning environment for manufacturing and services. They want to get in early on the action. Rather than waiting around for local suppliers to reach a certain standard, they are committed to facilitating local partners to climb the value chain.

This report explores how established domestic and multinational firms have addressed the challenges of managing and developing their supply chains in African countries. The hurdles facing UK-based manufacturer of quality leather goods, Pittards, as it looks to expand its manufacturing presence in Ethiopia, demonstrate the need to actively engage with local suppliers to improve quality. Cafédirect, an ethical hot drinks brand based in the UK, is grappling with the impact of climate change and urbanisation on the long-term viability of tea, coffee and cocoa farming in Africa.

Multi-national conglomerate GE is establishing a regional manufacturing and services hub in Nigeria. In the process of developing a local supplier base, as well as providing access to training and finance, it is encouraging its global suppliers to invest in local partners. Services outsourcing firm Digital Divide Data (DDD), also based in the US, similarly offers opportunities for African talent to connect into global value chains.

Finally, Kenyan retail multinational, Nakumatt, is growing its footprint across East Africa as fast as the infrastructure and customer base allows.

Unless otherwise indicated, all dollar amounts are US dollars.

The EIU is deeply grateful to each of the people who gave up their time to be interviewed for this report.

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They are:

Reg Hankey, CEO, Pittards
Jeremy Hockenstein, CEO and founder, Digital Divide Data (DDD)
Jay Ireland, President and CEO, GE Africa
Violeta Stevens, head of supply chain and procurement, Cafédirect
Ramamurthy Thiagarajan, regional strategy and operations director, Nakumatt

Key findings

- Misunderstanding of Africa as a manufacturing and services environment is still rife. Many people underestimate the range of activities that can be carried out, yet those who do decide to invest in Africa are prone to underestimate the effort required to ensure a reliable supply of good quality products.

- The tendency of the international business community to underestimate Africa as a manufacturing and services location has been a competitive advantage for the early movers featured in this report. But as interest in the region grows, time may be running out to benefit from the early-mover advantage.

- Investors with existing international client and supplier networks have an advantage over local competitors, in that they are able to take on more risk when launching operations in Africa, where the client and supplier bases are still emerging.

- The firms interviewed do not view localisation policies—at least where these are well designed and implemented—as a hindrance, as such policies are aligned with their own strategies to move up the value chain in Africa.

- Africa's advantages as a source of agriculturally-produced raw materials are eroding, as land is lost to climate change and agricultural labour is lost to urbanisation. Buyers may therefore need to help introduce new methods and technologies to improve yield and quality, and to mitigate the impact of climate change, to ensure sustainable supply in the long term.

- Lack of finance is still a major constraint for smaller businesses and farmers. In order to help suppliers scale up their operations and access new equipment—which is beneficial to both supplier and buyer—some firms create supplier financing mechanisms, act as guarantors for their partners, or commit to paying premiums for higher-quality products.

- Intra-African trade remains well below potential, and this is a source of frustration for companies wishing to extend supply chains beyond or among the coastal nations.

- Wages are incrementally rising as African economies develop, and other costs (notably oil) are also set to go up. As the cost advantage compared to Asia gradually diminishes, gains in productivity and value-added will become more important over the coming five to ten years.

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CASE STUDY 1 SUPPLY CHAINS TO ADDRESS AFRICA'S 21ST CENTURY CHALLENGES

Even as Africa's longstanding problems such as lack of infrastructure are being addressed, new challenges related to climate change and urbanisation are emerging. The agricultural sector faces the most immediate impact. People sourcing from smallholders report a secular decline in yield and quality of produce, and producers' income, at the bottom of the value chain, is generally insufficient to allow investment in equipment or training to improve matters. Meanwhile, young people from rural areas are increasingly choosing to move to the cities rather than pursue an uncertain future in farming.

This presents a problem for the companies featured in this section—Cafédirect and Pittards—as both face a shortage of raw materials, which is holding back expansion plans and driving up costs. They are therefore engaged in tackling these challenges head-on. By offering suppliers better access to information, training and finance, companies can potentially increase the availability of good quality inputs. Producers also benefit by climbing the value chain—and this makes the whole supply chain more sustainable.

Pittards: Looking to transform meat and leather supply chains in Ethiopia

Pittards, based in south-west England, produces specialist leather products for well-known sports brands such as Nike and Merrell, high-end fashion brands including Dents, as well as military clients in the UK and the US. It has been sourcing sheepskins for gloves from Ethiopia since the start of the twentieth century, thanks to the fine-skinned hair sheep, a breed commonly raised by smallholders across the country. In recent years, however, it has rapidly scaled up its presence in Ethiopia and introduced more value-added activities into its Addis Ababa operations.

Reasons for expanding in East Africa: the future market opportunity

Part of the reason for expansion is necessity. Ethiopian authorities have progressively introduced measures to incentivise the leather industry to move up the value chain. Exports of raw skins have long been banned, and since 2008, tax rates of 150% have been introduced on certain semi-processed leather products. The industry has certainly taken off in the last decade, with exports of leather and leather products doubling from $66m to $112m from 2006-2012, according to the United Nations Industrial Development Organization. But Reg Hankey, CEO of Pittards, maintains that these government interventions were not the

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main reason behind his firm's recent focus on Ethiopian manufacturing.

"We chose Ethiopia partly as we had long-established links with it as a raw material source. But looking forward to the next five to ten years, we needed to also consider where we had the most development potential. While the China effect [on attracting international investors] has been very powerful for the last twenty-five years, in our opinion Africa does represent a serious alternative opportunity."

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From 2005 to 2009, Pittards therefore increased capacity by taking over management of and subsequently acquiring the largest tannery in Ethiopia. At the same time, with customers keen on seeing simpler supply chains, it made sense for Pittards to move up the value chain to produce more finished items. The company now operates four fully-owned garment and bag factories in Addis and runs another in a joint venture.

East Africa's manufacturing environment is often discussed with reference to Asia, owing to decisions by some Asian and Western apparel and footwear firms to shift or expand production out of China and the Indian subcontinent into the region. Despite its significant labour cost advantage, East Africa is still considered a risky prospect by many potential investors.

"China is still nearly three times more productive than Ethiopia, in terms of skills and efficiency," points out Mr Hankey. "Over time, there will be catch-up in Ethiopia's labour costs, and our challenge now is to improve productivity faster than the labour cost rises."

Improving Ethiopia's business environment: challenges for the government

Meeting this challenge will involve roles for both public and private sectors. From the government side, Pittards is keen to see more infrastructure and less red tape. "If the leather trade is to grow as we and the government hope, then there just aren't enough hides in Ethiopia, so therefore we are now beginning to import materials from other countries," says Mr Hankey. As sheepskins degrade over time, the speed at which imports can be brought in is key to quality. A few years ago, Pittards tried importing hides from Malawi. But in the absence of a viable overland link, it had to resort to shipping them up the coast and into Ethiopia via Djibouti. This explains the firm's recent focus on expanding domestic supply in Ethiopia, yet it remains keen to import skins from neighbouring countries as and when it becomes feasible.

Mr Hankey reports encouraging developments on this front, pointing to the rapid construction of the railway running from Addis to Djibouti, which is nearly complete. With funding flowing

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into East African railways from the Export-Import Bank of China, and to a lesser extent from private equity, links further inland to Kenya, Uganda, South Sudan and Burundi are also on the cards over the coming decade.

A well-known inefficiency of operating in Africa is the need to rely on generators because of black-outs, and Ethiopia is no exception. In the past few years, though power supply has improved, distribution has not been able to keep up with the large number of new users coming onto the grid. "We've bought generators for the glove factories and are in the process of buying them for the tannery. It's a big expense, but if [the power goes off] then we have 1,500 people sitting with nothing to do."

Yet from Pittards' perspective, the single greatest challenge to productivity in Ethiopia is red tape. "From business visas, to banking permits, foreign exchange and customs clearance. It's a major cause of delays."

Building quality control systems: challenges for the private sector

According to Mr Hankey, an active approach is needed to address issues of quality control and operational efficiency.

"The quality of skins in Ethiopia has deteriorated terribly over the last thirty years. Forty years ago we'd get about 60% best quality, and today it's about 12% to 15%. The cause is mainly parasitic." Over the next five years, Pittards plans to establish a best practice farm to demonstrate the benefits of parasite treatment programmes to local farmers. A pilot programme saw the proportion of best-quality skins reaching 70% to 80%, while carcass weights increased by 25%—a significant finding for the meat industry upon which Pittards is dependent. With reproductive rates of sheep in Ethiopia far below those of industry leaders such as Australia and New Zealand (at just 37% compared to 150% to 180% in the latter), Mr Hankey sees potential for a demonstration farm to foster improvements in animal husbandry.

If realised, such a scheme could dramatically increase the overall availability of usable skins. But implementing it will involve not just demonstrating best practice, but also incentivising farmers to adopt it. Pittards' plan is to invite farmers in the surrounding area to form cooperatives that operate according to established treatment routines and other quality control measures. A premium will be paid to members of the cooperative, in recognition of the additional investment they have put in.

"As soon as we do that, I think the vast majority of farmers in Ethiopia will copy the model and the whole flock will improve in numbers, quality and meat supply," predicts Mr Hankey. "The coffee

Pittards factory workers in Addis Ababa stitching work gloves.

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supply chain has been the flagship for this model. They've worked very hard to persuade people to work together in cooperatives, building trust. But the key was giving them a bit more money for their effort. And it's shown the way forward, it works very well now. Something similar needs to happen on the livestock side."

The other challenge that private firms must tackle head-on is a shortage of good middle-managers, capable of overseeing quality systems and improving efficiency. Mr Hankey observes that while many graduates with strong theoretical knowledge are coming out of Ethiopia's higher education system, as well as returning from overseas, there remains a gap in practical experience. "That will fill in, if you roll forward five years," he believes. "But the need to actively develop management skills is very important, as the depth of skills is limited—the country is going through its industrial revolution now."

Who dares, wins

So will Ethiopia become the next big manufacturing location? The answer, according to Mr Hankey, really lies in the level of commitment of individual firms. He warns against diving in and expecting to immediately run operations to the same standards of quality and productivity as in China, as the depth of skills, the infrastructure and the supply chain are at a very different development level. Yet on the flipside, he believes that too many people still underestimate the potential, finding it hard to get past images of the famine-struck Ethiopia of the 1980s.

Too many people still underestimate the potential of Africa, finding it hard to get past images of the famine-struck Ethiopia of the 1980s.

"You have to be a realist and recognise that there's massive opportunity—I see us doubling or trebling in Ethiopia in the next five years—but that you can't underestimate the amount of work you have to put in to make it happen. It's not easy, we have to work very hard on training and quality. But if we don't see the opportunity and recognise that it's in our hands to make it happen, then by the time we respond we could have missed it."

REG HANKEY is CEO of Pittards plc, a UK based listed company which manufactures leather for the shoe, glove, leather goods and aviation markets, together with finished leather goods and gloves. The company operates in the UK (founded in 1826) and Ethiopia where it now has c around 1,500 employees. Mr Hankey has been in the leather manufacturing industry for 43 years and first visited Ethiopia in 1991.

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CASE STUDY 2

CAFÉDIRECT: FOSTERING SUSTAINABLE SUPPLY CHAINS

Cafédirect is a fair trade hot drinks brand based in the UK. It reinvests over half of its profits into producer cooperatives and communities, funding initiatives to improve product quality, mitigate climate change and help producers climb the value chain. In Africa, it sources tea, coffee and cocoa from small-scale farmers through cooperatives in Kenya, Uganda, São Tomé, Tanzania and Rwanda. The vast majority of producers own shares in the business, and two out of the eight seats on the company's board are held by producers.

Helping small producers to climb the value chain

Violeta Stevens, Cafédirect's head of supply chain and procurement, explains that in a typical supplier development initiative the first step is to help create an aggregation point, a farmer cooperative or producer organisation. This better positions smallholders to pool resources, share risks and negotiate on a more even footing with buyers. Working through an aggregation point can reduce risk and thereby improve access to finance. It is also the point through which technical and other assistance can be delivered. Next, they might help the cooperative to access finance in order to acquire processing equipment; and in some cases assist them in achieving organic fair trade certifications. Both measures add value to the cooperative's end produce, particularly the ability to process, which can increase the value-added by a factor of several hundred.

Yet adding capacity and value is not enough to ensure a sustainable business model, particularly given that Cafédirect is a relatively small-sized firm itself. "It's one thing to set producers up and get them ready to sell, but it's also important to provide access to market," observes Ms Stevens. Cafédirect therefore collaborates with other Fairtrade brands, which enables them to seek efficiencies of scale in procurement and logistics.

A pragmatic necessity

But why is it important, from a supply chain management perspective, to enable producers to add more value? Ms Stevens suggests two answers: quality and sustainability. Working with producers to bring quality up to the standard required by European consumers is important to Cafédirect's commercial success; so when the company reinvests profits, part of this money always goes into quality improvements. As for ensuring sustainability, there are two aspects. First, by helping producers to develop a more robust business the company reduced the risk of suppliers going bust from one year to the next—which is a

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significant phenomenon in small-scale tea and coffee farming, owing to price volatility. Second, putting producers in a financial position to invest in climate change adaptation is viewed as crucial to ensuring the long-term sustainability of supply.

While social and environmental aims are core to Cafédirect's ethos, Ms Stevens insists that the firm's hands-on approach to managing supply chains is fundamentally a pragmatic necessity. She believes that the long-term success of the tea and coffee sectors in Africa will require more brands to adopt a similar model because of climate change, which is on track to decimate coffee production in some parts of Africa. Without sustainable financing of adaptation for smallholder farmers and adaptation measures, such as good agricultural practises, crop diversification, improved soil and water management and introduction of shade trees, many farms will cease to be viable.

In thirty years, the temperature won't be suitable for coffee growing in certain parts of Africa—there may be no Arabica coffee left in Ethiopia.

"Every time we visit, the producers take us and show us how the landscape has changed. In thirty years, the temperature won't be suitable for coffee growing in certain parts of Africa—there may be no Arabica coffee left in Ethiopia."

Ongoing innovation is therefore needed to find ways of adapting to climate change. In response, the Cafédirect Producer's Foundation, which is funded in part by Cafédirect's profit recycling but mostly by external donors, has established centres of excellence in Kenya, Tanzania and Uganda to develop and disseminate best practices. These function as innovation incubators and classrooms, where farmers can come from across the region to discover, test and share new methods. Seed funds are made available to encourage smallholders to try out the new approaches on their own farms.

There is also an urgent need to ensure that farming remains a viable and even attractive career, as Africa's youth flocks to the cities. "With suppliers, long-term relationships are very important—the producers need to know, for their own planning, that you will continue to buy from them year after year." In committing to regular purchases from cooperatives at minimum prices, Cafédirect offers its partners a degree of security. By contrast, larger players in the sector have traditionally tended to avoid long-term commitments, instead negotiating prices one year, and one smallholder, at a time. Yet this may now be changing, in light of the growing challenge of raw material availability. Some of the multinationals operating in Africa are starting to re-invest at origin with a view to ensuring long-term supply.

With suppliers, long-term relationships are very important.

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Coffee bean calibration in Tanzania.

This change in approach is probably driven in no small part by the impact of shortage of raw materials on costs. Ms Stevens expects costs of production and the cost of living to go up further over the coming five years.

Bridging the gaps

Africa's infrastructure gap also presents hurdles at various stages in the supply chain. "The main challenge for tea and coffee is getting the produce to the cooperative. In some cases there's just no road, and in others if it rains they can be completely cut off."

Fairtrade premiums can therefore be used to improve local roads or buy sturdy vehicles. Further along the supply chain, most produce leaves Africa via Mombasa and consequently faces frequent delays in this congested East African port.

Yet the challenges of transporting produce from coastal countries in Africa to Europe are nothing as compared to the difficulty and cost of moving goods from inland countries to the coast. "We have to pay for insurance for the coffee to cross out of Rwanda and get to the sea, and it's expensive as it is high risk for the insurers," explains Ms Stevens. This added cost makes the

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price of coffee almost prohibitive, and the company has had to reduce its purchases from Rwanda as a result.

As there is little that Cafédirect can do with regard to infrastructure, the company focuses its efforts on increasing supply by improving the yield and operational efficiency of its producers. Ms Stevens is adamant that a bottom-up approach, enabling producers to develop their own ideas is the best way to do this. Producers have a lot of knowledge, but they don't always have the resources they need. I believe there are two key elements that will enable producers to move up the value chain: access to information and access to finance."

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Most smallholders in Africa lack access to computers, but do have mobile phones. The Cafédirect Producer Foundation recently launched a mobile-based information sharing system, which allows producers to send off questions and seek answers from elsewhere in the global producer community. "This enables producers to learn from each other. They can exchange advice on very practical issues, like dealing with drought or landslides."

When it comes to financing, many producers are stuck in a vicious circle. As they lack experience in investing in new facilities and have little credit history, financing them is considered a risky proposition. But they cannot gain experience without initial finance. To break them out of this cycle and reassure finance providers, Cafédirect acts as guarantor for its cooperative partners and provides evidence of their trading history.

Striking a balance between running a successful business now and continually investing in the long-term sustainability of African agribusiness is far from easy. Amid volatile commodity markets, rising costs and declining demand for tea from British consumers, Cafédirect has recorded an operating loss for each of the last five years. Yet it remains committed to working to build up its producers—and Ms Stevens sees virtuous cycles evolving, with African cooperatives becoming more self-sufficient.

VIOLETA STEVENS is a Head of supply chain and procurement in Cafédirect plc. She is a senior supply chain professional with extensive experience in managing sustainable supply chains. Her skills in strategic reorganisation and implementation were developed during an established carrier in FMCG. Cafédirect works with over 40 producer organisations across Latin America, Asia and Africa.

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CASE STUDY 3 IMPACT SOURCING: MOVING VENDORS UP VALUE CHAINS

The term impact sourcing usually describes a socially-oriented business model, whereby a firm creates opportunities for employment and skills development for disadvantaged groups by linking them to a previously inaccessible client base. A market-based alternative to development aid, the idea hinges on the benefits to each party involved: the suppliers or employees move up the value chain; the business therefore develops the skills base it needs to succeed; while clients gain access to relatively cheap but good quality products or services.

DDD was a pioneer of impact sourcing, and developing skills among its local staff—most of who have grown up in Nairobi's slums—is central to its Kenyan operations. Yet while not all the firms featured in this report have an explicit social mission, in one way or another it can be argued that most are engaged in impact sourcing in Africa. The realities of doing business in an under-developed environment often require it. Whether a company is looking to source good quality products for export, or is setting up a local facility, a strong supplier or employee base is crucial. But in Africa, it is not

A GE oil & gas facility at the Sonils base in Luanda, Angola.

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necessarily in place when you arrive. As the case of GE shows, quite extensive investments may be in order for the first few years, for instance to provide training programmes or enable access to the finance or partners that suppliers need to increase capacity.

All this requires a long-term commitment, and recognition that a company's success is contingent on moving the local economy up the value chain.

GE: Integrating African suppliers into global value chains

GE opened its first African office in Johannesburg in 1898. Over the past few decades, the accelerating pace of development across the continent, combined with an infrastructure deficit, has presented GE with growing opportunities to supply facilities and equipment to governments and private institutions in the oil and gas, power generation, transportation, aviation and healthcare sectors. However, since around 2010, there has been a sea change in GE's Africa strategy. Whereas before, the company's focus was simply selling products to African customers, the emphasis has shifted to increasing local capacity to supply, support and service the growing customer base. Jay Ireland, chief executive of GE Africa, explains this change.

"As we looked at what our opportunities were and what we needed to do to compete, we realised that we needed to put more emphasis on localisation, building local capability. When you have an installed base, you need to have a service capability wrapped around it. So we're adding facilities, capabilities and service technicians."

Constructing a regional hub

Building local capacity means not just training local employees, but also developing a capable and reliable supplier base. GE recently expanded its operations in Nigeria, and has ambitious plans to position its facilities in and around the Niger Delta as a regional hub for manufacturing, services and innovation in support of its commercial operations. Of the $2bn GE plans to invest in Africa from 2014-18, around half is earmarked for Nigeria. A new facility just installed in Calabar, aimed at servicing the local oil and gas industry, is key to this plan. GE's leaders were well aware that this location did not come with a ready-made supplier ecosystem—so they set about creating one.

As we looked at what our opportunities were and what we needed to do to compete, we realised that we needed to put more emphasis on localisation, building local capability.

An aerial view of Lagos, Nigeria.

To scout for talent, GE held supply fairs around Africa. An internal supply chain team then travelled around identifying firms based on criteria such as technical competence and financial stability. Recognising that lack of access to finance was a major hurdle for smaller outfits, the firm put in place a system that allows suppliers who have pre-qualified technically to leverage their future business from GE to access finance.

Another tactic used by GE to improve local supply is to persuade its established global suppliers to follow it into Nigeria, and build their own partnerships with domestic firms. "If we can get some of our global suppliers to build out their own supply chain with local partners, then that's a good thing for us. We're hoping to be a catalyst for that."

In support of its efforts to grow the skills base needed for both employees and suppliers, GE is also collaborating with the Government Technical College, Calabar, to develop courses and recently committed $2m to upgrade the college's mechanical and electrical workshops. All the above initiatives not only have medium- and long-term benefits for GE as a business, but inevitably have an impact on the wider economy—which is why African governments tend to welcome them, and are gradually reducing the hurdles facing investors.

"We're seeing a lot of improvement across the region [in the operating environment]. Africa's leaders want investment, so if you're willing to come in and invest in developing supply chains and building up the economy, and not just sell things or take out raw materials, then it's a very amenable situation."

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> Africa's leaders want investment, so if you're willing to come in and invest in developing supply chains and building up the economy ... then it's a very amenable situation.

Give and take

Just as GE hopes to bring its global suppliers into Africa, it also hopes that in the future, its African suppliers will support its operations in other parts of the world. "Our suppliers in Africa face the same requirements as any of our other suppliers worldwide, so if they can supply us here, they also have the potential to become integrated into our global supply chains."

The extent to which this will happen remains to be seen. However, the rapid regional expansion envisaged by GE is unlikely to succeed if the firm remains reliant on bringing in supplies and support from outside Africa, so there is a strong incentive on GE's part. Its supplier development and partnership scheme offers one blueprint for the role that businesses can play, alongside governments, in addressing some of the difficulties traditionally preventing smaller African businesses from scaling up and capturing more value: insufficient skilled personnel, limited access to finance and a disconnect from global value chains.

This approach to developing a strong supplier base is cost-intensive in the early years, but Mr Ireland appears confident that it will pay off in the long run. As well as building up the supplier base it needs to succeed, it will presumably not do GE's business any harm to demonstrate to African governments—its current and potential clients—that it is willing to make significant investments in support of their policy goals, including localisation. To firms that have been holding off investment in Africa until the difficulties reduce, Mr Ireland issues a warning that the ship may have sailed by then.

"We're seeing a lot of different players moving in—Western European, Indian, Chinese, Turkish. For companies that aren't there, you need to start thinking hard about establishing a footprint."

JAY IRELAND is the President and CEO of GE Africa (appointed in 2011) located in Nairobi, Kenya, where he leads GE's operations on the sub-continent across power generation, healthcare, transportation, oil & gas and aviation. He is a member of GE's Corporate Executive Council. Prior his GE Africa appointment, Mr Ireland led GE Asset Management (GEAM), a global investment firm with about $120bn in assets under management.

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CASE STUDY 4 DDD: MARRYING AFRICAN TALENT AND GLOBAL CONNECTIONS

Kenya has struggled to achieve its goal of building a knowledge economy since East Africa was connected to high-speed Internet via submarine cables in 2009-2010. Business process outsourcing (BPO) firms have found it challenging to compete with their more established counterparts in India and South-East Asia. However, Digital Divide Data (DDD) has found some success. Since setting up a Nairobi office in 2011, it has built a multi-million dollar business from scratch in its first few years and expanded its client base to Tanzania, South Africa and Uganda.

DDD operates under an unusual business model. Starting out in Cambodia in 2001, DDD pioneered "impact sourcing", aimed at

A network server.

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distributing the benefits of globalisation to marginalised groups. By combining an economically sustainable BPO business with a donor-funded work-study scheme, DDD transitions high school graduates out of the developing world's large pool of unskilled labour, into a much more employable set of experienced and well-educated professionals. The model has turned out to work well commercially for DDD, bringing together a potent combination of a US-based sales team and well-trained staff in Asia and Africa.

Accessing East Africa's skills base

The high standard of English skills in Kenya was one obvious draw for a BPO business, but Mr Hockenstein, CEO and founder, explains that opening an office in Nairobi turned out to have other unanticipated advantages.

"Firstly, we've found that Kenya has more local management talent than we've seen in other places," notes Mr Hockenstein. "Coming from Cambodia and Laos, Kenya has much more developed education and corporate sectors, which produce strong managers. So our whole local team leading the operation is Kenyan, and we've been impressed with the leadership we've been able to hire. We've also generally found that the problem-solving skills of high school graduates in Nairobi are stronger than in South-East Asia." This has allowed DDD to develop a line of work in market research for clients in academia.

We've found that Kenya has more local management talent than we've seen in other places.

The benefits of being international

For DDD, another reason to set up shop in Nairobi was access to potential clients in the wider region. "Kenya is a headquarters for East Africa, and there's more of a regional client base than we have in South-East Asia. Around 90% of the clients we serve from our South-East Asian locations are in the US and the UK, but in Kenya around a third of our clients are based within Africa," says Mr Hockenstein. Nonetheless, the rate of growth in demand from within Africa has not quite matched expectations, and some services firms have fallen foul of this. This is where it comes in useful to be networked into other markets. "Because we already had a global client base and reputation, and a sales team in the US, we were able to tap into more work."

As an established international firm, DDD was also able to rapidly implement a quality system that met the expectations of its global client base. The local managers running DDD's Kenya office follow company-wide procedures overseen by a global COO.

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DDD's high school graduate trainees.

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Leveraging these international advantages, DDD’s Nairobi office has rapidly built up a revenue stream and despite making relatively slow progress with local clients, Mr Hockenstein continues to feel positive about the future of services outsourcing within the region.“ The concept of outsourcing is relatively new to Africa. People are used to doing things in-house. We expect to see people becoming more comfortable in the future with using outside providers. We definitely see growth, we went from $0 to $3m revenue in the first four years, and we plan to double that in the next few years.”

The concept of outsourcing is relatively new to Africa ... We expect to see people becoming more comfortable in the future with using outside providers.

Running an Internet-based services company in Africa still has its challenges. DDD has found that the broadband service in Nairobi remains somewhat slow and unreliable compared to South-East Asia. Preliminary tests in Nigeria, where the company is scoping out a future project, indicate that the quality will be lower still there. But where problems exist, Mr Hockenstein sees them as not just eminently manageable but also on a clearly improving trend. This comes as a surprise to some in the Western business community.

“People are surprised and shocked that we can do what we do. And look, it’s had more challenges than setting up in Boston or New York, but we’ve been able to tap into a talented pool of very motivated people, who just want an opportunity to perform. Africa is an underestimated destination, and that’s been a good competitive advantage for us.”

JEREMY HOCKENSTEIN is co-founder and CEO of DDD. Prior to DDD, Mr Hockenstein worked as a management consultant with McKinsey & Company and as an international non-profit consultant. For its business success and social impact, DDD and Mr Hockenstein have been recognized with the Skoll Award for Social Entrepreneurship as well as awards from the World Bank Development Marketplace, the IFC Grassroots Business Initiative and the Global Knowledge Partnership.

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CASE STUDY 5 TAPPING INTO AFRICA'S POTENTIAL

As a Kenya-based firm, retailer Nakumatt has benefitted from having its finger on the pulse of the economy during a time of rapid growth and change in East Africa. It has expanded rapidly by focusing on the increasing disposable income of the region's middle class, even as many multinational fast-moving consumer goods firms have continued to target the lower-income market segment.

One lesson seems to be that in such a fast-evolving environment, no strategy should be written off as unworkable without frequent review. Another is to not assume that you cannot shape that environment: Nakumatt is working to persuade developers to build the modern commercial real estate it needs, and by opening flagship stores in new areas hopes to entice African consumers into a new shopping paradigm.

Nakumatt: Anticipating the future African consumer

Nakumatt is the largest East African retail chain, selling goods from groceries to garden furniture as well as operating local franchises

View of downtown Nairobi.

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for a growing number of international brands, including Clarks and Skechers shoes. On the back of an expanding middle class and improving real estate options for modern retail, Nakumatt has opened stores in Uganda, Rwanda and Tanzania, and has plans in the medium term to expand further across the region. Though planned stores in Burundi and South Sudan appear to have been delayed because of escalating political violence, Nakumatt has shown itself resilient in the face of security threats. The company recently moved back into Nairobi's Westgate Mall, which was destroyed during an attack by Islamist gunmen in 2013.

We focus on the top-earning 10%, which in Kenya is around a million households. The lifestyle of these people is aspirational.

Focusing on Africa's most affluent 10%

Over the last decade, Nakumatt has pursued a markedly different strategy to many of the multinationals moving into Africa's fast-moving consumer goods sector. According to Ramamurthy Thiagarajan, Nakumatt's regional strategy and operations director, the key difference is in its target market.

"We focus on the top-earning 10%, which in Kenya is around a million households. The lifestyle of these people is aspirational, and inspired by global trends. As the middle class grows and the youth segment improves, people are looking for global iconic brands and looking at the sources where these products come from. The top 10% are looking for new, better products that relate to their lifestyle. That is how the market is growing."

As evidence of the opportunity at the top of the pyramid, Mr Ramamurthy points to the large volume of real estate investments currently underway in Kenya, much of which is going into commercial complexes and new housing for the middle class. According to international real estate firm Knight Frank's 2015 report on Africa, 220,000 square metres of retail space were under construction, with several large Western retailers including France's Carrefour and the UK's Debenhams planning to enter the market during 2015.

Seeing which way the wind was blowing, Nakumatt largely eschewed the wholesale market, concentrating its efforts instead on aspirational customers and modern retail outlets. Mr Ramamurthy is of the view that many rivals made an error in targeting the bottom-earning 80% of consumers over the last decade, and consequently, they risk missing out on the largest growth opportunity.

"Some of these firms are now running to catch up. They never realised that there would be [such a surge in] investment in real estate

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development, commercial complexes, mall concepts, destination shopping; these are things that they just didn't envisage ten years back."

Catering to an increasingly discerning pool of affluent urbanites raises new issues of quality control and branding. Nakumatt drills its sourcing agents on the importance of quality, rather than just pricing. Where they find that the available quality is not up to scratch, as an alternative to expensive imports, they sometimes work with domestic manufacturers and farmers to improve their processes and packaging.

Adapting supply chain strategies in the face of rising costs

Nakumatt currently sources around half its products locally, from domestic manufacturers as well as multinationals that produce locally and import. It also partners with private importers in order to target specific products, and more recently has started up its own franchises to do the same independently. For now, the costs are economical, but Mr Ramamurthy anticipates that the supply chain will become significantly more expensive over the next few years.

"For now, fuel prices are helping in terms of transportation costs. But going forward, the depreciation of the Kenyan Shilling and the increasing interest rate will affect logistic costs. We expect these factors to push costs up by around 15-20% and if the fuel cost goes up too,

A busy street in Nairobi.

it will push the figure up even further. Employee costs will definitely go up year on year, because of inflation. So the cost of operations, whether in services or manufacturing, will definitely go up over the next five years—we're expecting overheads to go up by at least 50%."

The cost of operations, whether in services or manufacturing, will definitely go up over the next five years.

Given the outlook, Mr Ramamurthy is keen to cut out the middle man wherever possible. One approach is to expand its own private label, which it intends to increase to 10% of total revenue over the next few years from just over 1% at present. The other is to set up direct franchises, particularly in the lucrative area of lifestyle products.

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The challenges and opportunities of expanding within Africa

As a home-grown firm, Nakumatt is closely tuned into regional developments affecting the retail sector and is constantly looking for new opportunities to grow its footprint. Transport infrastructure and modern commercial real estate are the basic necessities it looks for in its expansion across East Africa.

Within Kenya, Mr Ramamurthy points to the massive investments being made by both public and private sectors. Though infrastructure development has so far focused on the main cities, he expects Kenya's devolution process—under which new county-level governments are being established—to have the effect of distributing investments more evenly. "Since devolution, all 47 local governments are focusing on developing their counties. It's only a question of time until all the counties have good infrastructure," predicts Mr Ramamurthy.

Elsewhere in East Africa, the challenges and opportunities vary by country. From Nakumatt's perspective, Rwanda benefits from strong and improving infrastructure, monetary discipline and openness to investment; yet compared to Kenya, it lacks a significant population of skilled workers and disposable income is a relatively small fraction of total income. Uganda is a more complex political environment to navigate, but has the advantage of a very strong agriculture sector which allows retailers to keep some costs down. However, modern retail remains limited by a shortage of investment in commercial real estate.

This is also a problem for Nakumatt in Tanzania, along with the red tape which can make importing a headache. Mr Ramamurthy holds Tanzania's local manufacturing sector in very high regard: "Whatever they produce, they produce very well." Yet a number of products still need to be imported, and this can be slow and costly.

With supermarkets and department stores from South Africa, Europe, North America and elsewhere snapping at its heels in Kenya, Nakumatt appears to be taking a strategy of pushing further and faster into the interior of East Africa than its competitors. In so doing, it may find it is paving the way—and building up the supply chains—for these competitors to follow suit.

RAMAMURTHY THIAGARAJAN serves as the Regional Strategy and Operations Director at Nakumatt Holdings. He has also previously worked as a rubber technologist with TVS Group in Chennai (India) and IPS (Aga Khan) Group in Kenya.

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CONCLUSION

The firms featured in this report have all benefitted from an early mover's advantage, seeing potential in sectors from luxury garment manufacturing through to high-end retail and digital services, where many others did not. But the reason they were willing to invest in Africa, and perhaps the key to their success, has been a vision of what Africa could be as a business destination—and a long-term commitment to bringing that about.

Fundamental to each of these firms' growth stories in Africa has been a willingness to engage with suppliers and employees in a very hands-on manner, sometimes investing large amounts of capital in building the knowledge, skills and technologies needed to drive up capacity and quality standards. In the cases of GE, Cafédirect and DDD, capacity-building activities are generating new links between Africa-based vendors or staff and global value chains—with GE hoping to foster partnerships between its international and Nigerian vendors, Cafédirect introducing new buyers to build up the business of its partner cooperatives, and DDD training Kenyan students to provide international-standard services to Western clients. These new linkages can lead to a virtuous cycle as vendors gain security and confidence, and as a result have more resources to invest in their own development.

The consensus among the companies is that Africa represents a strong growth opportunity in manufacturing, services and retail, and that it is desirable to move Africa-based operations further up the value chain and avoid relying on imports, particularly as local demand from the African middle class rises. Yet Africa's potential role in both global and intra-African value chains will only be realised at the pace of infrastructure development and supplier capacity. Governments in many areas are now pushing the development of transport infrastructure forward quite rapidly, and private-sector investors are increasingly warming to African commercial real estate markets. These things are largely out of the hands of manufacturing and services firms; but they can play an important role in building up local supply chains and, more broadly, in developing a local skill base. This, in one way or another, is what all the featured firms are doing.

Over time, the initial outlay and effort required by firms moving into Africa will likely decline quite rapidly—but by then, those involved in kick-starting the region's growth will have settled into the strongest market positions. The situation is perhaps best summed up by Pittards' Mr Hankey:

"It's not easy, we have to work very hard…But if we don't see the opportunity and recognise that it's in our hands to make it happen, then by the time we come knocking we'll have missed it."

For more insights on emerging-market supply chains, visit growthcrossings.economist.com

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