‘FIRST-MOVER’ INVESTMENT ADVANTAGES IN SUB-SAHARAN AFRICA: WHY NORTHERN MULTINATIONALS SHOULD REACT (QUICKLY) TO THEIR SOUTHERN COUNTERPARTS

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A continent of economic misperceptions

The underlying economic landscape in much of Sub-Saharan Africa has fundamentally changed over the past decade and a half. For the first time in Africa’s modern economic history, a large portion of the continent has been registering uninterrupted economic growth. It is no longer an overstatement to say there are bona fide African economic success stories.

The image of an African country that comes to many people’s minds when they hear this is an oil rich country. To the contrary: although most oil producing countries do exhibit the highest growth rates on the continent, ultimately these countries suffer from the ‘resource curse’ and experience growth volatility. Instead, the most sustained economic growth in Sub-Saharan Africa has been produced by non-resource dependent countries. From 1998 to 2008, among these countries and where 40 percent of Africans live, annual average real GDP grew at a rate of 5.6 percent (Broadman 2009).

Throughout much of the current global economic crisis, many of these economies have also proven to be more resilient than most African countries.

Surprisingly, among many of the most sophisticated international businesses and investors – even among some of the keenest of the geopolitical Africa-watchers – there is scant recognition of this unprecedented and unanticipated turn of events. Yet, this record of economic performance is indicative of the fact that an increasing portion of Sub-Saharan Africa is presenting significantly profitable opportunities for new investments and/or expansion of existing investments. Multinational corporations (MNCs) from countries in the South, most notably China and India, have been far quicker to appreciate – and to capitalize on – these changes than have their counterparts from the North (Broadman 2007). In fact, not only have Chinese and Indian firms, but also Brazilian, Middle Eastern, and Russian businesses have begun to substantially increase their investments in Africa (Broadman 2008). These investments are all occurring despite the fact that there is a deeply held perception that Africa is a highly risky, if not a dangerous, place to do business.

To be sure, Sub-Saharan Africa is a difficult place to do business. But so are many countries in the former Soviet Union, Latin America and Asia. Indeed, there are several countries in Sub-Saharan Africa where the risks of doing business are arguably much lower than in comparable parts of the world. To wit, it is quite a misnomer to even refer to ‘Africa’ as a unit of analysis. Sub-Saharan Africa is not a single monolithic country but a heterogeneous continent comprised of 47 very different countries.2

Not only is there a lack of knowledge about the fact that there has been robust and continuous growth on the African continent, but that this economic performance is, in some significant part, the result of hard-won economic reforms implemented by African policy-makers. Indeed, investments of the type and scale now taking place would not have been consummated if real economic policy, institutional and political reforms had not in fact taken root. On this score, there is substantial – and growing – empirical evidence: there have been improvements in leadership succession, reduction of entry barriers to new businesses, liberalization of trade

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1 The analogous GDP growth rate for oil producing countries was even higher.

2 Different institutions employ varying definitions of ‘Sub-Saharan Africa’, which leads to variations in the count of countries. I use here the World Bank/IMF definition of Sub-Saharan Africa, which encompasses 47 countries.
regimes, reduction of civil strife and armed conflicts, among other measures.

Of course, the reform record among African countries is far from uniform. The countries are, after all, quite diverse with wide variations in prosperity, population, landlocked vs. coastal, geographic size, degree of urbanization, language and culture, etc. At the same time, there is little question that many more reforms need to be done on many fronts in many countries throughout the African continent. And, like other regions of the world, even where there has been progress, there has been and will be setbacks in Sub-Saharan Africa.

The simple fact is that Sub-Saharan Africa has become a ‘continent of economic misperceptions’. Even if the investment risks in Africa are high so too are the rewards. Indeed, unlike virtually any other region of the world, Sub-Saharan Africa is the one location where true investment ‘first-mover advantages’ can still be found – and they exist across a number of different sectors and in varying locales. In Africa’s markets today, the most profitable ventures are those that exploit the economic misperceptions and employ effective risk-mitigation strategies.

Have MNCs from the South already cornered Africa’s investment opportunities?

Some of the largest European and US multinationals – Africa’s traditional investors – are beginning to step up their existing investments or start up new ones on the continent. But there is little question that compared to the multinationals from the South – many of them are comparable to Fortune 100 firms – the vast majority of Northern multinationals are taking a ‘wait and see’ approach. Meanwhile, there is a burgeoning cluster of small European and US private equity funds actively investing in Africa.

Still, over 90 percent of the cumulative stock of foreign direct investment (FDI) in Africa originates from Northern companies, especially those domiciled in the EU and the United States. This fact is surprising news to virtually all observers of Africa, who believe that Chinese firms now ‘rule’ Africa’s economies. The confusion arises because it is the growth rate of inflows of FDI in recent years that has been dominated by Chinese and Indian multinationals as well as other firms from the South. While press accounts on this issue rarely, if ever, make these distinctions, it is the latter dimension that is what propels the headlines. Thus when one looks dispassionately at the data, the reality is that Chinese and Indian firms hardly dominate Africa’s economies – at least at this juncture.

Some observers in fact go so far as to suggest that the Chinese and Indians have colonization as their underlying motive for investing in Africa. All available evidences, however, suggest that it would be quite a mistake to conflate China’s or India’s increasing commercial interest in Sub-Saharan Africa with colonization, either the old style or some modern variant. Simply put, these are developing countries trading and investing with other developing countries: South-South commerce. This is trade and investment among cohorts and is qualitatively different than commerce between advanced countries and developing countries. At the same time, each of these two countries is huge and already has its plate full with complex domestic challenges. It is dubious their leaders are looking to take on more challenges, and overseas ones at that. The sizeable culture and language gaps, especially in China’s case, cast further doubt on a colonization motive.

This is not to dismiss the fact that the issue of Chinese and Indian investments in Africa is not a highly charged one. To state the obvious, public opinion on both sides of the equation (recipient markets and source markets) varies appreciably among different constituencies. At the risk of oversimplification, while some African government and business leaders believe there is much to be gained from Chinese investments on the continent, many African workers and university students, for example, hold negative attitudes towards inward Chinese FDI flows. On the other hand, workers in China, for example, resent outbound FDI by their native firms in Africa, voicing a preference for these firms to invest more in poor regions in the domestic economy.

Conventional wisdom has it that the Southern investors in Africa – China and India, the most prominent among them – are exclusively involved in the natural resources sectors, especially oil and minerals. In many cases investing in natural resources has been a natural point of entry, in light of both Africa’s resource availability and China and India’s growing needs, and indeed for certain
Chinese and Indian businesses in Africa today, natural resources remain their sole line of business. But the on-the-ground reality shows a more nuanced picture: an increasing portion of investments in Sub-Saharan Africa from the South are becoming more diversified and being made in a variety of manufacturing and services sectors. New firm-level data on the business operations of Chinese and Indian MNCs in Africa indicate that these investments are starting to diversify into other sectors beyond oil and minerals, such as telecommunications, financial services, food processing, infrastructure and tourism, among others. To be sure, natural resource-based investments still dominate Southern MNCs’ FDI portfolios in value terms, but the number of FDI projects outside that sector is beginning to increase rapidly and in time so will the overall value of investment.

While China and India do not have as long or as deep a track record of investing in Africa as their Northern counterparts, e.g. the EU and the United States, there is a popular misconception that these two emerging economic giants of Asia have only recently ‘discovered’ Africa. In fact, both nations have centuries-long histories of international commerce, dating back to at least the days of the Silk Road, where merchants plied goods traversing continents, reaching the most challenging and relatively untouched markets of the day. In contemporary times, Chinese trade and investment with Africa actually dates back several decades, with most of the early investments made in infrastructure sectors, such as railways, at the start of Africa’s postcolonial era. India, too, has a long history of trade and investment with modern-day Africa, particularly in East Africa, where there are significant expatriate Indian communities. Suffice it to say, however, that the scale and pace of China and India’s current trade and investment flows with Africa are wholly unprecedented.

Taken together, although it is clear that the MNCs from the South do not dominate Africa, they are not only investing at a rapid pace on the continent, but they are making such investments in an increasingly deliberative fashion. Should these trends continue unabated, there is little question that some of the ‘first-mover investment’ advantages that exist today in African markets will disappear. In this type of dynamic environment, a static corporate strategy of ‘wait and see’ is unlikely to be a winning one.

Who are the ‘new investors’ in Africa?

In general, multinational corporations are firms that enjoy some form of competitive advantage at home relative to domestic counterparts who do not invest abroad or who penetrate foreign markets only through trade, i.e. exports. The notion that ‘success at home breeds success abroad’ is a central tenet of one of the received theories of the rise of multinational enterprise. While mainstream attention for decades has focused on the rise of the MNCs from advanced countries, in the case of Southern MNCs, such firms are enjoying those advantages in emerging market economies rather than in advanced economies. In the case of Chinese and Indian MNCs, whether investing on the African continent or elsewhere, the vast majority of them – whether one considers the state-owned enterprises from China or the privately-owned firms from India – are generally some of the best performing firms in their respective home countries.

Of course, just as Sub-Saharan Africa is a starkly heterogeneous continent of countries, owing to fundamental differences between China and India’s histories, cultures, political systems and approaches to economic development, there are significant differences between Chinese and Indian firms operating in Africa. The vast majority of Chinese businesses operating in Africa are large and medium state-owned (or –controlled) enterprises (although there are increasing numbers of small private firms making a go of it). The typical Indian company in Africa is of varying size and most often privately owned (sometimes family held) or occasionally of mixed private-public ownership. China has made significant progress over the past two decades in reforming its SOEs, but it has proven too difficult to fully reconcile the goals of retaining state ownership and maximizing commercial efficiency. India faced its own enterprise reform program, but of a much smaller scale and through much more head on privatization.

As a result, in their African operations Chinese and Indian firms perceive risks differently, and this colors their business strategies on the continent in a variety of ways. The average Chinese firm operating in Africa tends to enter new markets by building de
novo facilities, is highly vertically integrated (buying large portions of inputs or selling large portions of outputs internally through corporate affiliates), sources a significant fraction of inputs from China (rather than in local markets), rarely encourages the integration of its management and workers into the African socioeconomic fabric, conducts the vast majority of its sales in Africa with government entities, and knowing that it can avail itself of its home government’s deep pockets, is influenced by its ability to out-compete other bidders for African government procurement contracts.

The average Indian firm in Africa, on the other hand, enters new markets most often through acquiring established businesses, is much less vertically integrated (sometimes preferring to procure inputs directly on the African market), sources much fewer inputs from Indian suppliers in the home market (and increasingly purchases them in international third markets), facilitates (indeed sometimes encourages) the integration of management and workers into the African socioeconomic network (either through informal ethnic networks or more formally by participating in local political activities), and engages in far greater local sales with private entities rather than government agencies.

In both cases, however, China and India’s investments in Africa reflect a rational response by businesses in these countries to evolving market incentives in both their home markets and in Africa. Indeed, this evolution in incentives is what is responsible for the significant rise more generally of South-South FDI and trade flows that have been occurring over the past few decades: multinational firms domiciled in developing countries almost always penetrate other developing countries as their initial host markets and tend to make such countries their principal permanent host markets.

The rise of some of the largest MNCs from the South – especially those from the BRIC countries (Brazil, Russia, India and China) – is increasingly posing a threat to Northern MNCs. Some of the threats are occurring in the South itself. And it does so in different facets. It is reflected in head to head competition, such as when a Chinese SOE oil firm operating in Africa is able to outbid US oil major in the acquisition of newly discovered oil deposits on the continent. It is also occurring when Northern MNCs become embroiled in trade disputes in third countries where South-South investment is taking place, such as footwear trade between China and Brazil. It is just a matter of time until one of the third countries is an African one.

**First-mover advantages and Africa’s entry into network trade**

Africa’s ‘first-mover investment advantages’ are being affected by the South’s growing investments on the continent through more subtle channels. Some of these MNCs are engaged in comparatively sophisticated production processes, sometimes linked to global trade networks. The result is that semi- to fully-processed goods are sometimes now being exported from the African continent, embodied with a relatively high value-added content. This is contrast to the raw materials that African firms have historically – and most still –continue to export.

Indeed, China and India’s rapidly growing commerce with the Sub-Saharan continent presents to its people a new major development opportunity – one that is arguably qualitatively different than that provided by its traditional commercial partners from the North. In recent years, the international marketplace has witnessed a big change: production processes have been fragmented and tightly integrated global production and distribution networks have emerged, boosting trade in intermediate goods and components. These transformations are a major challenge but also an opportunity for the businesses operating or hoping to operate in Africa and for African policymakers – provided all understand how they fit in the new international division of labor.

Technological advances in information, logistics and production processes have enabled corporations worldwide to become more footloose as a result of production chains being divided into discrete functions that can be performed by separate entities such as foreign subsidiaries or suppliers. The advent of data systems that provide information on real-time international movements up and down the production chain has allowed for more efficient and ever cheaper shipping over large distances not only of assembled durable goods, but also of components for just-in-time manufacturing products and – this is important for developing countries in Africa – even perishable goods. The result has been the rapid growth of intra-industry trade, or ‘network trade’
(such as importing cotton that is then manufactured into garments and exported to third countries) especially relative to the more traditional inter-industry trade of final goods and services (such as exporting cotton and importing machinery).

Such global value chains have been creating opportunities for African countries to increase the volume and the diversity of, as well as the value added to, their exports. African companies in several industries – automobiles (South Africa), fresh-cut horticulture (Uganda) and apparel manufacturing (Kenya) – have either already engaged in or have strong prospects for engaging in network trade, even though they face far tougher standards and competition in international markets than do the continent’s raw commodities dealers. In the services sector, too, African participation in network trade has been emerging: foreign tourism in Africa is rapidly growing not only in traditional destinations such as Botswana and Kenya, but also in ‘newer’ locales like Malawi, Mozambique, and Zambia.

That many of the Chinese and Indian firms active on the Sub-Saharan continent are relatively sophisticated businesses, often part of larger international group structures already integrated into global value chains, this has created opportunities for African companies to expand and leverage their own engagement in network trade. This is evident in food processing (Tanzania), textiles (Ghana), fishing (Senegal), and outsourcing and back-office services (Ghana, Kenya and Tanzania).

Moreover, as a result of their integrated corporate structures, Chinese and Indian firms engaged in Africa have been playing a significant role in facilitating links between trade and FDI on the continent. New business case studies and firm-level survey data on these enterprises’ African operations show that their trade and investment activities are mutually reinforcing – one result being that inward flows of investment to Africa by these firms are engendering an increase in the volume of African exports.

Another consequence is that Chinese and Indian businesses in Africa are able to achieve larger-sized operations – and so greater economies of scale – than their African counterparts. As a result, Chinese and Indian firms have been able to export more goods from the African continent that are more diverse and higher up the value chain than have African firms in the same sectors. They also have more extensively integrated into Africa’s own regional trade networks and reached a geographically wider set of markets outside of Africa.

Although, at present, their share of overall foreign investment on the African continent is still quite modest, the trend of what the Chinese and Indian firms operating in Africa are doing is unmistakable. In some cases, more so than African firms themselves, they are forming the vanguard of the integration of both the African economies on the continent and into the global marketplace. This is a form of a first mover advantage that could well be costly to replicate.

**Is it really aid versus trade?**

To an important extent, the debate surrounding the North’s versus the South’s investments in Africa has less to do with investor nationalities *per se* and more to do with the fact that African countries are now undergoing the almost always painful transition that all economies do as they increase their exposure to international competition. As one might expect, such economic transitions stir both optimism and controversy. Optimism because some Africans see that finally someone is really interested in investing in their continent – and not just in natural resources but in other sectors that are key to development. Controversy because, in general, people do not like change and, in particular, because these changes will most likely be temporarily painful in the short to medium run, with gross production cuts, factory closures and job losses. But one thing that an increasing number of Africans are learning: one way or another their countries have got to integrate into international markets if they are going to develop and that doing so will necessarily engender transition costs.

So what is the proper response? There are public actions, such as the provision of effective social safety nets, development of infrastructure and access to re-training, which should be taken to reduce those costs and protect the most vulnerable. That is a legitimate and proper role of government, supported, where most effective, by the international donor community. Not only have the Northern countries been active on the African continent in this regard – a fact that is well-known – but increasingly the South, epitomized by China and India, has also
played a role. More so than the North, foreign assistance by the South to Africa has increasingly focused on facilitating commercial activity that benefits their investors.

For the North, foreign assistance to Africa has centered largely on increasing Official Development Assistance (ODA) resource flows to support the attainment of reaching the Millennium Development Goals (MDGs) to reduce poverty. In this regard, pressing the G8 countries to live up to their 2005 Gleneagles commitments has been the prominent objective on the development community’s agenda. The primary agency for US ODA is USAID which is part of the US Department of State. Trade and investment finance for US firms in Africa is provided by the US Export-Import Bank, with political risk insurance provided by the Overseas Private Investment Corporation.

The Chinese government began giving financial support to African countries in the 1970s. At the outset, the objectives of support were largely ideological in nature – to demonstrate China’s ‘solidarity’ with the developing world. With the advent of its economic reforms in 1978, China’s government stepped up its aid to Africa and such assistance began to serve multiple purposes including economic objectives. In the last several years the Chinese government has dramatically boosted its economic support to Africa. At the same time, the assistance has become both more sophisticated, in terms of instruments utilized, and more geographically diverse.

In the 1980s, China’s government provided much of its economic aid in-kind – in the form of building large non-commercially oriented projects, such as sports stadiums and government office buildings like those in Gambia and Sierra Leone, among other countries. In the 1990s, support began to shift from in-kind to grants. Today, the provision of in-kind and grant support is a decreasing proportion of China’s aid to Africa, with loans accounting for the vast majority of Chinese government-sponsored African assistance.

China’s Export-Import Bank, which was established in 1994 as a state policy-bank directly under the leadership of the State Council (China’s ‘Cabinet’), is the sole state-owned entity the Chinese government uses to dispense official economic aid worldwide including to Africa. The Export-Import Bank provides not only ‘concessional’ loans – akin to those provided by the multilateral aid institutions such as the World Bank or the African Development Bank – but also ‘non-concessional’ loans – support given on terms that are more in line with commercial lending. The Export-Import Bank also provides export credits, international guarantees, on-lending of foreign governments and financial institutions, and other functions.

Like its Chinese counterpart, India’s Export-Import Bank plays a significant role in facilitating trade and investment between India and African countries. It has in place various financial and promotional programs to do so. India’s Export-Import Bank provides lines of credit to government agencies, banks and financial institutions in African countries for financing export of projects, goods and services from India. It also provides information and advisory services and finance for promoting participation of Indian companies in projects in Africa funded by African Development Bank as also the World Bank.

Historically, much of the activity by India’s Export-Import Bank has been in Eastern and Southern Africa, where Indian commerce has a long tradition and the Indian diaspora and ethnic network are relatively mature. In recent years, India’s Export-Import Bank has begun to focus on ECOWAS (Economic Community of Western African States) to finance India’s exports to the regional grouping of ECOWAS’ fifteen member countries (Benin, Burkina Faso, Cape Verde, Ivory Coast, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo).

In 2009 India’s Export-Import Bank entered into a co-financing arrangement with the African Development Bank to leverage available resources for financing a larger number of projects on the continent. Under the arrangement, Indian companies are exploring procurement opportunities in African Development Bank funded projects in areas where they possess significant competitive advantage and domain expertise.

Towards win-win

China and India’s ‘newfound’ interest in investing in Africa – home to 300 million of the globe’s poorest people and the world’s most formidable development challenge – is beginning to present a potentially significant opportunity for growth and integration.
of the Sub-Saharan continent into the global economy. It is also yielding some handsome profits for Chinese and Indian multinational corporations. When will the multinationals from the North make their move?

References

