The Role of the Private Sector in African Development

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The role of the private sector in African development is critical. Bluntly, without private sector buy-in the vision of a growing and prosperous Africa will not materialize. Government can provide the yeast which will make the bread rise but it is business that will have to provide the "dough' – in all the meanings of the word. The NEPAD vision document, for example, outlines an ambitious agenda for raising the average economic growth rate of the Continent from some 2.6 per cent per annum in the 1990s to 7 per cent per annum for the next 15 years, the latter being the minimum required to halve the incidence of poverty over the period. According to this vision, achieving 7 per cent per annum growth requires that fixed investment must rise above current levels by some $64 billion per annum, this additional sum to be funded by a combination of increased domestic savings, foreign aid and foreign direct investment. How much will come from each of these sources is not specified, but as this amount is equal to some 20 per cent of Africa's GDP the vision document notes that the bulk will clearly have to come from outside the Continent.

Accepting for the moment the figures above, the required additional $64 billion per annum compares with official development assistance – or aid – flows to Sub-Saharan Africa in 1999 of only $12.3 billion, which itself was only two-thirds of the $18.1bn received in 1994. In real terms foreign aid has fallen by 7 per cent per annum throughout the 1990s. The efficacy of aid is itself a matter for debate and certainly there is an argument that aid should be more focused on backing winning nations. But aid has fallen also for countries such as Ghana, Mozambique, Uganda and Tanzania who are widely applauded for having improved their economic policies. Even if this decline is reversed, a doubling of aid from 1999's levels (and its focus on investment spending) would provide less than one-fifth of the additional $64 billion per annum that is deemed to be required for continental investment.

Most of the remaining $52 billion will have to come from private sector direct investment and commercial bank loans. To put the magnitude of this sum into perspective, if South Africa is excluded both as a source and destination of investment in the region, only $2.9bn of foreign direct investment flowed into Sub-Saharan Africa annually during the 1990s. This amount represents less than 1 per cent of global foreign direct investment and only about 3 per cent of global FDI into low or middle-income countries. Moreover, the bulk of this investment went into just 3 countries – Nigeria ($920 million), Angola ($657 million) and Lesotho ($175 million). Five other countries – DRC, Cote D'Ivoire, Equatorial Guinea, Namibia and Sudan – accounted for another $700 million, which means that the remaining countries of Sub-Saharan Africa received just $600 million per annum between them.

Raising African investment levels to meet desired growth goals is clearly a mammoth task. This is especially so when the attractiveness of the Continent as an investment destination is judged against the reality of its small size as a market. Sub-Saharan Africa has a population of some 660 million people - some 12 per cent of the population of the globe – and this population is growing at a rate of 2.7 per cent per annum. But the economic output (GDP) of Sub-Saharan Africa of $320 billion represents only some 1 per cent of global production. As a result per capita income of $500 is only some one-tenth of the global average. Put differently, in value terms Sub-Saharan Africa represents a market less than 4 per cent the size of that of the United States. More starkly, the entire Sub-Saharan African market is smaller than the quantum by which the US economy grew each year from 1997 to 2000 or in 2003.

The blunt reality, therefore, is that Sub-Saharan Africa represents a market of many people, but as customers they are presently like window shoppers with limited buying power. The implications of this for attracting investment into Africa are profound. It means that larger investments will tend to focus on one of two areas: Firstly, those where Africa has a specific advantage – for example, oil, mining and other natural resources. Such industries usually produce for a global market and are therefore not necessarily limited by the size of the domestic market. Moreover, natural resources are necessarily location bound. This means that, where favourable deposits exist, natural resource companies are more willing to work their way through bureaucratic obstacles, poor infrastructure and unfavourable fiscal regimes in an effort to ensure than prospective projects are able to match their required investment criteria. This is not to say that even the most favorable natural deposit cannot be effectively sterilised by a hostile investment climate; but, rather, that natural resource companies will be more patient and persistent in seeking to overcome existing problems than would a more footloose manufacturer.

The second type of investment for which Africa is potentially attractive is in the production of exports – especially in the labour-intensive fields of agriculture, textiles and clothing. Examples of this are investments taking advantage of Africa's preferential access to large global markets - such as provided by the US Africa Growth and Opportunity Act, the Lomè Convention or South Africa's free trade agreement with the European Union. Thus the US for instance anticipates that imports of African-made clothing could rise from US$250 million to US$4.2 billion over 8 years as a result of preferential treatment provided by AGOA.

But even these investments will not occur if the perceived risk of doing business is too high. President Obasanjo of Nigeria some years ago berated Africa's critics, pointing to evidence that the returns on investment in this Continent are often as high as 35 per cent. How can such investments be considered risky, he asked? But this argument confuses cause and effect. It is precisely because doing business in this Continent is considered risky that investment is pretty much limited to the opportunities where such returns are available. And such investments are few and far between – there are certainly not $52 billion per annum of investments generating a 35 per cent return. The required rate of return simply has to be reduced by lowering perceived risks.

In this regard a number of questions need to be answered:

1. It was argued above that natural resource industries are necessarily location bound and that companies in this field will necessarily be more patient in overcoming regulatory obstacles. Yet in mining, while it is easy to produce a long list of new South African mining projects both in South Africa and the rest of the Continent, a list of foreign miners being active in either South Africa or the rest of Africa remains embarrassingly short. This is despite a raft of potential opportunities. Why, for example, has no major global mining group – even at the Rand's lowpoint - made a bid for, say, Impala Platinum, Lonro or even Gold Fields? The blunt reality is that these companies either perceive the risks of investing in the Continent as being too large relative to the rewards or they believe that their shareholders will penalise them for what they believe to be too big an investment risk. The latter point is important and is perhaps best illustrated by AngloGold's experiences in its recent bid for Ashanti. At the time of the bid many analysts predicted that one of the other major global gold producers, such as Newmont or Barrick, would enter the fray. But neither did. In the end AngloGold's only rival was a relative minnow, Randgold, whose ability to contest the bid was based not on a superior track record but on the simple fact that its paper enjoyed a higher valuation than AngloGold's – purely because it is listed outside of Africa and therefore enjoys a higher rating in the eyes of global investors. Such remains the African discount which investors must address.

2. Yet non-African companies are very active in Africa in the oil industry. Why oil and not mining? Is it simply that Africa is so important a future resource base in oil that they simply have to be here? Or are the shareholders of oil companies more used to perceived political risks whereas mining companies have less politically risky alternatives (Australia, Canada, Chile)?

3. South African companies have also made highly successful investments in Africa in the areas of retail, cellular telephones and even aluminum smelting (Mozal) and even many large South African firms can point to a meaningful contribution to their bottom-line from sales in the rest of Africa. But again the question must be asked why it was, say, a South African company (MTN) that led the way in Nigeria and not a UK firm? Is it because South African exchange control regulations make investments in Africa easier that elsewhere in the world? Do South African companies have an advantage emanating from a long experience of working with government to make things happen? Or is the advantage more practical than this – for example, MTN was able to directly translate its experience in South Africa where cellphones have developed into the communications medium of the masses and not just the rich through a combination of cheap cellphones to remove barriers to entry and pay-as-you-go charging for airtime to avoid costly problems of collecting unpaid bills?

4. Perceptions are critically important – they are reality. South Africa's positive attributes – world-class infrastructure, declining fiscal deficits and tax rates, low inflation and positive investment ratings - have thus far generated a disappointing response in terms of foreign direct investment. It is notable that most of the foreign investment attracted since 1994 has been from companies with a long

presence in South Africa – such as the motor vehicle manufacturers and mining groups. New investors even in these same sectors are still disappointingly few in number. This suggests that outsiders take a different view of this country's prospects than those with more intimate knowledge of the true realities of doing business.

What can be done to address these perceptions and reduced the perceived risks of investing in Africa?

- Quite simply, the costs of doing business have to be reduced. These costs include corruption, bureaucracy and an uncertain legal environment including, importantly, security of tenure. High taxes, cost of capital, shortages of skilled labour, transport and security, all add to the cost of doing business.

- The suspicion with which business and government too often view each other in Africa is an important negative. Former US Treasury Secretary, Jim O'Neil, memorably noted that "capital is a coward". Capital will only go where it feels wanted and in Africa this is often not the case. Where in Africa would one find a politician echoing the following words of Britain's Michael Heseltine: "If I have to intervene to help British companies .. I'll intervene - before breakfast, before lunch, before tea and before dinner. And I'll get up the next morning and I'll start all over again"?

- The burden of risk can be reduced through the participation of international agencies such as the IFC and the Commonwealth Development Corporation. But this means true risk sharing. Too often international institutions seem to demand higher than commercial returns for their participation while taking a less that proportionate share of the risks.

- In terms of global institutions the World Bank's response to the Extractive Industries Review (EIR), which it sponsored, is critical. The hugely positive impact that single projects (such as Mozal in Mozambique or the Skorpion zinc project in Namibia) can have on individual economies cannot be sacrificed on the ideological altar of special interest groups who predominantly share a Northern hemisphere, post industrial agenda.

- Poor transport, water and other infrastructure can be a significant impediment to investment and trade growth. For example, gold mines can flourish in the absence of bulk transport systems, but copper mines (cf the DRC) cannot. Upgrading infrastructure through public/private partnerships provides a significant opportunity for attracting foreign investment, but in practice this often runs into obstacles of established interests.

- Vested interests can be problematic in other areas also. Thus while one can point to the success of private sector investments in telecommunications this has been mainly confined to cellular networks. Fixed line telecommunications remains largely the monopoly of inefficient state enterprises and yet it is this mode of communication that is essential to the data transmission on which modern business is dependent. Even in South Africa deregulation and privatization of this key sector has been achingly ponderous.

- Small is often better than big. The lesson of the European Union in this regard is important. The EU started with the Treaty of Rome and a focus on the steel industry and this developed over the decades into the current European Union. Talk of a common currency or a continental free trade area in Africa is premature. Africa should be disaggregated into individual countries and winning nations should be backed more aggressively. Individual success will then spillover into broader regional success and initiatives, though some regions already are viable building blocks (eg SACU).

- One area in which business and government can unite in uncontested terrain is that of improved access for African goods to global markets. If this goal of market access can be achieved then Africa will immediately become a more attractive destination for investors wishing to produce for export to the rich industrial countries. The current stalled round of WTO negotiations may still offer one such opportunity, but these are likely to be lengthy and embroiled in larger global issues. Therefore Africa should also push for improved access in bilateral interactions with the developed nations such as the G-8 Summit. These demands should be pursued with private sector support and input at least as doggedly as requests for increased aid and Africa's so-called supporters should be continuously exposed when they deny this access. Africa should put its own house in order, too, addressing continental trade barriers in order to stimulate greater intra-regional trade. Countries such as South Africa should lead here. Naturally the private sector must set aside its own short term special interests in this area.

- The NEPAD framework may provide a politically useful framework for African development, particularly regarding the medium-term debate and vision. But it is unlikely that calls for action and important practical policy steps can be exclusively or even mainly located within such a grand overarching design. Disaggregation and focusing on winners is likely to achieve far more practical success than continental initiatives that inevitably become bogged down in special interests and lowest common factors.

- One practical area in which business can be immediately involved is in looking at itself and its own behaviour. The need for good corporate governance is fundamental to business success and business often needs to be reminded that for each corrupt official accepting a bribe in Africa there is a corrupt businessman paying the bribe. The NEPAD Business Forum has been doing important work in this area. But, while the commitment by a large number of businesses to upholding the principles of good governance in their dealings in Africa, is symbolically important, achievement of such goals will in practice be a long hard process. Business can be just as guilty as politicians of empty rhetorical flourishes.

- We all need to counter unwarranted Afro-pessimism wherever it is found so that the perceived risks of investing in this Continent are brought closer to the actual risks even as the latter are themselves being lowered. There are already clear signs that Africa's policy makers are beginning to face up to global economic realities. In most countries tariffs have been reduced, exports are growing, budget deficits have been lowered, state assets privatised, inflation brought down, democratic governments elected and the general environment for private business has improved. While economic growth in the 1990s was only 2.6 per cent per annum, this was better than the only 1.7 per cent per annum in the 1980s. Moreover, the continental average conceals some growth performances that are impressive even by global standards. Thus, for example, Benin, Botswana, Ghana, Lesotho, Malawi, Mozambique and Uganda all grew by more than 4 per cent per annum over the period 1990-1999. Most remarkably, Mozambique turned around from economic contraction from 1980-1990 to growth of 6.3 per cent per annum from 1990-1999 and Uganda grew by 7.2 per cent per annum in the latter period. Botswana, too, remains the Continent's star performer – a fact which those who wish to project that diamonds have brought nothing but economic misery would do well to dwell upon.

- The rise in global commodity prices in recent months is accompanied by a generally bullish prognosis which most commentators hold for commodities for the foreseeable future. The *Financial Times*, for example, last year entitled a full page special on commodities "Commodities are a big new theme. The next five to ten years will reverse the downward trend of the past twenty." This optimism is driven not just by the short-term pickup in global growth but also by the fact that such a pickup is expected against a background in which increases in capacity have been modest for a number of years. Investors are now anxious to expand and this desire is increased when the phenomenon of China is added to the already positive industry mix. China's high rates of growth, and the concentration therein of fixed investment and infrastructure construction, is generating a seemingly insatiable demand for almost all commodities. One consequence of this will inevitably be new mines and new oil fields. Producer consolidation and the rigid focus of investors on returns of capital should ensure that this expansion is orderly. Africa stands by virtue of geology to benefit. However, the rigid focus of producers on returns on investment and their increasing global nature means that investment in specific localities is not assured. Africa can benefit, but only if it offers competitive risk-adjusted returns.

- Finally, we must recognize the reality that very few western politicians would be willing to sacrifice electoral support for any real material sacrifice in favour of Africa (or other developing countries). It can be argued that the terrorist attacks in the US have created a greater awareness of the dangers of a world divided between "haves" and have-nots". Africa also has a growing future role as a producer of oil and hence its political stability is of strategic importance.

But former US Treasury Secretary Jim O'Neil reminded African critics of increased agricultural protection in the US that 424 of the 435 members of the US House of Representatives had voted in favour of the measure. Where were the alleged supporters of Africa then – or for that matter the proponents of the War on Terrorism?

- In a like vein, what are the incentives for Africa to change (or the disincentives not to remain the same)? NEPAD provides for a system of "peer review" but there is no indication what disincentives will apply to deviants. Should undemocratic governments be denied foreign aid or access to markets and will they be automatically suspended from the African Union? In the absence of such rules and their implementation investors' perceptions are formed by the apparent acceptance by much of Africa of the election process in Zimbabwe, actions such as the blocking of an investigation of human rights abuses in that country by the United Nations and Southern African opposition to Zimbabwe's suspension from the Commonwealth.