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Lions on the move: The progress and potential of African economies

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Preface

Africa's collective economy grew very little during the last two decades of the 20th century. But sometime in the late 1990s, the continent began to stir. GDP growth picked up and then bounded ahead, rising faster and faster through 2008. Today, while Asia's tiger economies continue to expand rapidly, we foresee the potential rise of economic lions in Africa's future.

Lions on the move: The progress and potential of African economies is the result of a joint research project by the McKinsey Global Institute (MGI) and McKinsey & Company's Africa offices to look at the continent's economies. We sought to examine the sources behind Africa's economic growth acceleration since 2000, analyze the prospects for future growth, and identify some of the most compelling business opportunities ahead. We also developed a framework for understanding how growth challenges and opportunities will differ for Africa's 53 individual countries.

MGI leaders Charles Roxburgh and Susan Lund and Africa office partners Norbert Dörr, Acha Leke, Amine Tazi-Riffi, and Arend van Wamelen directed the research. Mutsa Chironga led the project team, which comprised Tarik Alatovic, Charles Atkins, Nadia Terfous, Sanya van Schalkwyk, and Till Zeino-Mahmalat. Nell Henderson provided editorial support. The team would like to thank MGI's operations and communications team, Deadra Henderson, Rebeca Robboy, and Tim Beacom, as well as Sarah-Ann Wiltshire for her overall support of the project.

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Vijaya Ramachandran, a senior fellow at the Center for Global Development; and Vera Songwe, an economist at the World Bank. We are also grateful to many other experts who shared their knowledge with us: J.P. Landman, an independent South African economist; Iraj Abedian, economist and chief executive of Pan-African Capital Holdings; Eric Kacou, managing director of OTF Group; Alex-Handrah Aime, a director at Emerging Capital Partners; Tope Lawani, a founding partner of Helios Investment Partners; Ngozi Edozien, head of West Africa for Actis; and J. Kofi Bucknor, managing partner at Kingdom Zephyr.

Our aspiration is to provide business leaders and policy makers with a fact base to better understand the most important trends shaping the global economy today. As with all MGI projects, this research is independent and has not been commissioned or sponsored in any way by any business, government, or other institution.

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June 2010

Africa today

$1.6 trillion

Africa's collective GDP in 2008, roughly equal to Brazil's or Russia's

$860 billion

Africa's combined consumer spending in 2008

316 million

the number of new mobile phone subscribers signed up in Africa since 2000

60%

Africa's share of the world's total amount of uncultivated, arable land

52

the number of African cities with more than 1 million people each

20

the number of African companies with revenues of at least $3 billion

Africa tomorrow

$2.6 trillion
Africa’s collective GDP in 2020

$1.4 trillion
Africa’s consumer spending in 2020

1.1 billion
the number of Africans of working age in 2040

128 million
the number of African households with discretionary income in 2020

50% the portion of Africans living in cities by 2030

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Executive summary

Africa's economic pulse has quickened, infusing the continent with a new commercial vibrancy. Real GDP rose 4.9 percent per year from 2000 through 2008, more than twice its pace in the 1980s and '90s. Telecom, banking, and retail are flourishing. Construction is booming. Foreign investment is surging.

To be sure, many of the 50-plus individual African economies face serious challenges, including poverty, disease, and high infant mortality. Yet Africa's collective GDP, at $1.6 trillion in 2008, is now roughly equal to Brazil's or Russia's, and the continent is among the world's most rapidly growing economic regions. This acceleration is a sign of hard-earned progress and promise.

While Africa's increased economic momentum is widely recognized, less known are its sources and likely staying power. This prompted the McKinsey Global Institute and McKinsey & Company's four African offices to launch a joint research project. We sought to understand the causes of Africa's growth acceleration, the economic outlook for the years ahead, and the emerging opportunities for businesses. While poor government policies, wars, and other events could disrupt growth in individual countries, our analysis suggests that Africa's long-term economic prospects are quite strong. Global businesses cannot afford to ignore the potential. Among our key findings:

- Africa's growth acceleration resulted from more than a resource boom. Arguably more important were government actions to end political conflicts, improve macroeconomic conditions, and create better business climates, which enabled growth to accelerate broadly across countries and sectors.

- Africa's future growth will be supported by external trends such as the global race for commodities, Africa's increased access to international capital, and its ability to forge new types of economic partnerships with foreign investors.

- Long-term growth also will be lifted by internal social and demographic trends, particularly Africa's growing labor force, urbanization, and the related rise of middle-class consumers.

- For companies, our analysis suggests that four groups of industries together will be worth $2.6 trillion in annual revenue by 2020. These are consumer-facing industries (such as retail, telecommunications, and banking); infrastructure-related industries; agriculture; and resources.

Each African country will, of course, follow a unique growth path. We developed a framework for understanding the opportunities and challenges in different countries. Though imperfect, this framework can help guide business executives and investors developing strategies for the continent and policy makers working to sustain growth.

MORE THAN A RESOURCE BOOM

To be sure, Africa benefited greatly from the surge in global commodity prices over the past decade. Oil rose from less than $20 a barrel in 1999 to more than $145 in 2008. Prices for minerals, grain, and other raw materials also soared on rising global demand.

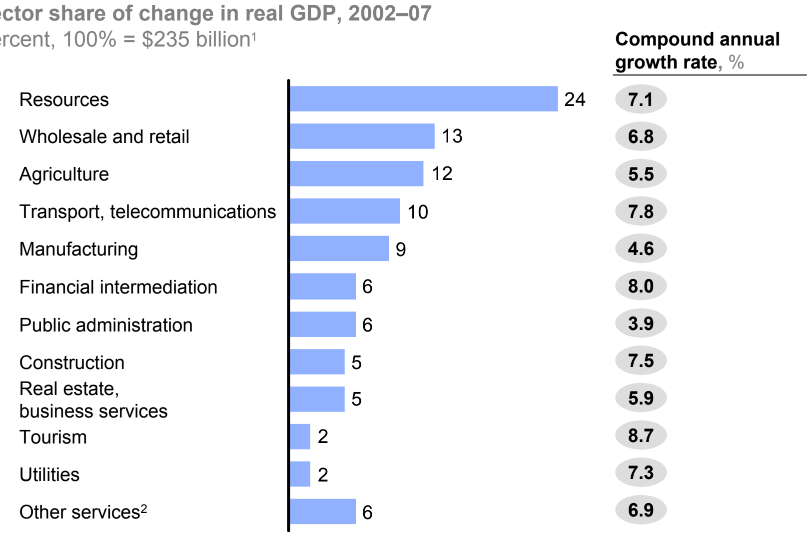
Yet the commodity boom explains only part of Africa's growth story. Natural resources directly accounted for just 24 percent of Africa's GDP growth from 2000 through 2008.[1] The rest came from other sectors, including wholesale and retail trade, transportation, telecommunications, and manufacturing (Exhibit A). Economic growth accelerated across the continent, in 27 of its 30 largest economies. Indeed, we find that GDP grew at similar rates in countries with and without significant resource exports.

Exhibit A

Africa's growth was widespread across sectors

Sector share of change in real GDP, 2002–07

Percent, 100% = $235 billion[1]



1 In 2005 dollars. The total is the sum of 15 countries for which data were available, and that together account for 80 percent of Africa's GDP: Algeria, Angola, Cameroon, Egypt, Ethiopia, Kenya, Libya, Morocco, Nigeria, Senegal, South Africa, Sudan, Tanzania, Tunisia, Zimbabwe.
2 Education, Health, Social Services, Household Services.

SOURCE: Global Insight; Arab Monetary Fund; African Development Bank; McKinsey Global Institute

The key reasons behind Africa's growth surge were improved political and macroeconomic stability and microeconomic reforms. To start, several African countries halted their deadly hostilities, creating the political stability necessary to foster economic growth. Next, Africa's economies grew healthier as governments lowered inflation, trimmed their foreign debt, and shrunk their budget deficits. Finally, African governments increasingly adopted policies to energize markets. They privatized state-owned enterprises, reduced trade barriers, cut corporate taxes, and strengthened regulatory and legal systems. Although many governments still have a long way to go, these important first steps enabled a private business sector to emerge.

1 In addition, resources contributed indirectly to growth through government spending. We estimate this was equivalent to an additional 8 percent of the GDP growth since 2000. We did not calculate the contribution of increased labor income from resources, since employment has changed only minimally in Africa's oil, gas, and mining sectors (and is declining in many countries).

Together, these structural changes helped fuel an African productivity revolution by helping companies to achieve greater economies of scale, increase investment, and become more competitive. After declining through the 1980s and 1990s, labor productivity started rising, and it has climbed by a robust 2.7 percent annually since 2000.

PROMISING LONG-TERM GROWTH PROSPECTS

Looking ahead, a critical question is whether Africa's surge represents a onetime event or an economic takeoff. The continent's growth also picked up during the oil boom of the 1970s but slowed sharply when oil and other commodity prices collapsed during the subsequent two decades. Today, while individual African economies could suffer many setbacks, our analysis suggests that the continent's long-term growth prospects are strong, propelled by both external trends in the global economy and internal changes in the continent's societies and economies.

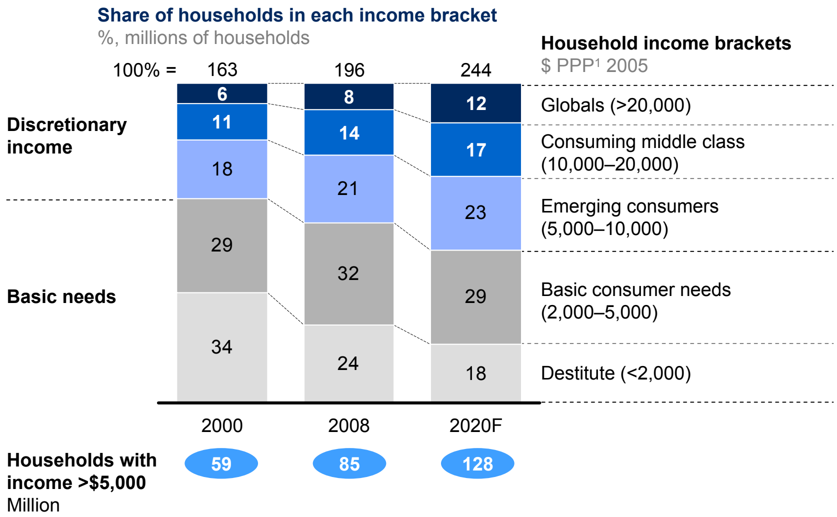
To begin, Africa will continue to profit from rising global demand for oil, natural gas, minerals, food, arable land, and other natural resources. The continent boasts an abundance of riches, including 10 percent of the world's reserves of oil, 40 percent of its gold, and 80 to 90 percent of the chromium and the platinum group metals. Demand for raw materials is growing fastest in the world's emerging economies, which now account for half of Africa's total trade. As trade patterns have shifted, African governments are forging new types of economic partnerships in which buyers from these countries provide up-front payments, make infrastructure investments, and share management skills and technology. Foreign direct investment in Africa has increased from $9 billion in 2000 to $62 billion in 2008—almost as large as the flow into China, when measured relative to GDP.

Africa's long-term growth also will increasingly reflect interrelated social and demographic trends that are creating new engines of domestic growth. Chief among these are urbanization and the rise of the middle-class African consumer. In 1980, just 28 percent of Africans lived in cities. Today, 40 percent do—a portion close to China's and larger than India's—and this share is projected to increase. And as more Africans move from farmwork to urban jobs, their incomes are rising. In 2008, roughly 85 million African households earned $5,000 or more[2]—the level above which they start spending roughly half their income on items other than food. The number of households with discretionary income is projected to rise by 50 percent over the next 10 years, reaching 128 million (Exhibit B). By 2030, the continent's top 18 cities could have a combined spending power of $1.3 trillion.

2 Measured in terms of purchasing power parity (PPP), which takes into account the relative prices of nontradable goods in different countries.

Exhibit B

By 2020, more than half of African households will have discretionary spending power



1 Purchasing power parity adjusts for price differences in identical goods across countries to reflect differences in purchasing power in each country.

SOURCE: Canback Global Income Distribution Database (C-GIDD); McKinsey Global Institute

Meanwhile, Africa's labor force is expanding. By 2040, it is projected to reach 1.1 billion, overtaking China's or India's. If Africa can provide its young people with the education and skills they need, this large workforce could account for a significant share of both global consumption and production.

AFRICA'S DIVERSE GROWTH PATHS

While Africa's collective long-term prospects are strong, the growth trajectories of individual countries across the continent will differ. To understand how growth opportunities and challenges vary, we classify countries[3] according to their levels of economic diversification and exports per capita. This highlights progress toward two related objectives: developing diverse sources of economic growth in addition to resources and agriculture, and generating export revenue to finance the imported capital goods necessary for investment. History shows that as countries develop, they move closer to achieving both of these objectives.

Within this framework, most African countries today fall into one of four broad clusters: diversified economies, oil exporters, transition economies, and pre-transition economies (Exhibit C). Although countries within each cluster differ in many ways, their economic structures and challenges are similar. This framework is useful for assessing growth potential across a heterogeneous continent.

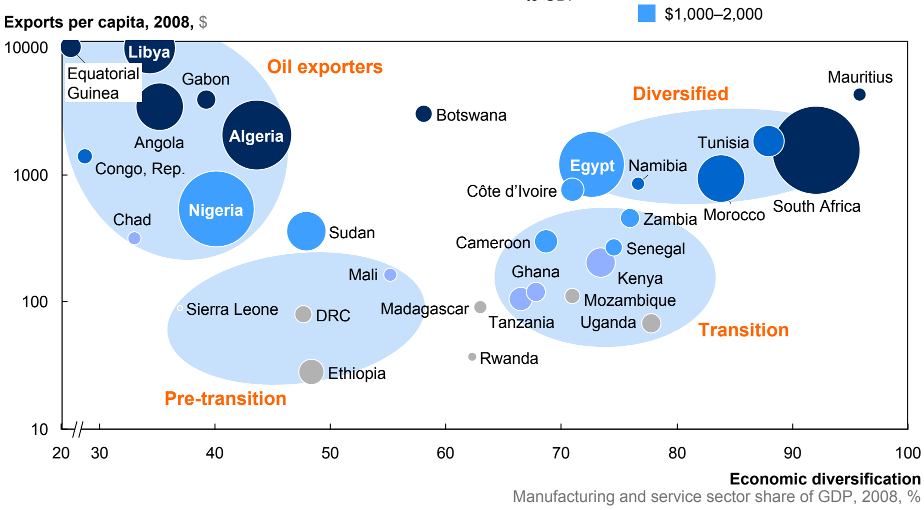
3 We focused on 31 of the largest economies, or countries that had GDP of $10 billion or greater in 2008 or real GDP growth of at least 7 percent a year from 2000 to 2008. These countries accounted for 97 percent of African GDP in 2008.

Exhibit C

Segmenting Africa in this framework yields four groups of countries

Size of bubble proportional to GDP

GDP per capita
<$500
$500–1,000
$1,000–2,000
$2,000–5,000
>$5,000



NOTE: We include countries whose 2008 GDP was approximately $10 billion or greater, or whose real GDP growth rate exceeded 7% over 2000–08. We exclude 22 countries that accounted for 3% of African GDP in 2008.
SOURCE: Organisation for Economic Co-operation and Development; World Bank World Development Indicators; McKinsey Global Institute

Diversified economies: Africa's growth engines. Africa's four most advanced economies—Egypt, Morocco, South Africa, and Tunisia—already have significant manufacturing and service industries. Over the past decade, service sectors such as construction, banking, telecom, and retailing accounted for more than 70 percent of their GDP growth. Their cities have gained more than ten million additional residents since 2000, and real consumer spending grew by 3 to 5 percent per year. Today, 90 percent of all households have some discretionary income. These economies have the least volatile GDP growth in Africa and stand to benefit greatly from increasing ties to the global economy. However, Africa's diversified economies today have higher unit labor costs[4] than China or India and must move toward competing in higher-value industries. Looking ahead, they face the challenges of expanding exports to both global and regional markets, improving education to create the skilled workforce essential in advanced industries, and building the infrastructure needed to support growth.

Oil exporters: Enhancing growth through diversification. Africa's oil and gas exporters have the continent's highest GDP per capita but the least diversified economies. Rising oil prices have lifted their export revenue significantly; the three largest producers—Algeria, Angola, and Nigeria—earned $1 trillion from petroleum exports from 2000 through 2008, compared with $300 billion in the 1990s. However, manufacturing and services remain relatively small, accounting for just one-third of GDP on average. These countries have strong growth prospects if they can use petroleum wealth to finance the broader development of their economies. The experience of other developing countries, such as Indonesia, shows this is possible. Continued investments in infrastructure and education will be essential. Africa's oil exporters face challenges common to others around the world, including maintaining political stability and momentum for economic reforms; resisting the temptation

4 Unit labor costs are defined as wages divided by labor productivity.

to overspend and overinvest, which would create vulnerability to commodity price declines; and creating a business environment that enables companies across industries to flourish.

Transition economies: Building on recent gains. Africa's transition economies—including Ghana, Kenya, and Senegal—have lower GDP per capita than the countries in the first two groups, but their economies are growing rapidly. The agriculture and resource sectors together account for as much as 35 percent of GDP and two-thirds of exports. However, these countries increasingly export manufactured goods, particularly to other African countries. Successful products include processed fuels, processed food, chemicals, apparel, and cosmetics. Expanding intra-African trade and creating larger regional markets will be one key to the future growth of the transition economies. These countries could also compete globally with other low-cost emerging economies if they improve their infrastructure and regulatory systems. And while their service sectors are expanding rapidly, the penetration rates of key services such as telecommunications, banking, and formal retail remain far lower than those in the diversified countries, creating an opportunity for businesses to satisfy the unmet demand. Finally, several transition economies are likely to increase their resource exports in coming years, which could turbo-charge growth. Ghana and Uganda, for instance, will benefit from recent oil finds, generating additional revenue that—if invested wisely—could spur further diversification.

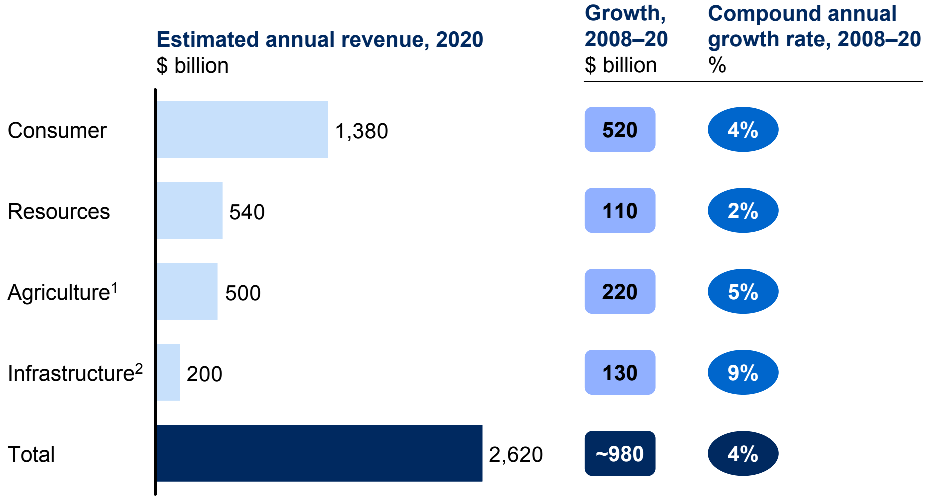
Pre-transition economies: Strengthen the basics. The pre-transition economies are very poor, with annual GDP per capita of just $353, but some are growing very rapidly. Three of the largest—the Democratic Republic of the Congo, Ethiopia, and Mali—grew, on average, 7 percent a year since 2000, after collectively not expanding at all in the 1990s. Even so, their growth has been erratic at times and could falter again. Although the individual pre-transition economies differ greatly, their common problem is a lack of the basics, such as strong, stable governments and other public institutions, good macroeconomic conditions, and sustainable agricultural development. The key challenges for this group include maintaining political stability, getting the economic fundamentals right, and creating a more predictable business environment. International agencies and private philanthropic organizations have an important role to play.

AFRICA'S $2.6 TRILLION BUSINESS OPPORTUNITY

Africa's economic growth is creating substantial new business opportunities that are often overlooked by global companies. Our projections show at least four categories of opportunities that together could be worth $2.6 trillion in annual revenue by 2020 (Exhibit D).

Exhibit D

Four groups of industries could have combined revenue of $2.6 trillion by 2020



1 We took the 2030 value of $880 billion and calculated straight-line equivalent for 2020.
2 Represents investment. Assumes need remains as same share of GDP through 2020.
SOURCE: McKinsey Global Institute

Africa's consumer-facing sectors (consumer goods, telecom, and banking, among others) present the largest opportunity and are already growing two to three times faster than those in countries belonging to the Organisation for Economic Co-operation and Development (OECD). The continent's households spent a combined $860 billion in 2008, more than those in India or Russia. This is projected to rise to $1.4 trillion over the next decade if real GDP continues to grow at its current pace. Food and beverage spending is projected to increase more in absolute terms than any other consumer category, though spending patterns will shift toward higher quality goods. Consumption will grow even faster in other categories as household incomes rise, with the most rapid increases occurring in retail banking, telecom, and housing. This growth will create more consumer markets large enough to be attractive to multinational companies. The continent's five largest consumer markets in 2020—Alexandria, Cairo, Cape Town, Johannesburg, and Lagos—will each have more than $25 billion a year in household spending and be comparable in size to Mumbai and New Delhi. More than a dozen other African cities (among them Dakar, Ibadan, Kano, and Rabat) will develop consumer markets worth more than $10 billion each per year.

Africa's agriculture holds enormous potential for companies across the value chain. With 60 percent of the world's uncultivated arable land and low crop yields, Africa is ripe for a "green revolution" like the ones that have transformed agriculture in Asia and Brazil. The barriers to raising production in Africa are well-known and complex, including lack of advanced seeds and other inputs suited to the continent's ecological conditions; inadequate infrastructure to bring crops to market; perverse trade barriers and tax incentives; unclear land rights; and lack of technical assistance and finance for farmers. But if Africa could overcome these barriers—and some countries are creating credible plans to do so—we estimate that agricultural output could increase from $280 billion per year today to as much as $880 billion by 2030.[5] Growth of this magnitude would increase demand for upstream products such as fertilizers, seeds, and pesticides, while spurring growth of downstream activities such as grain refining, biofuels, and other types of food processing. Together, these could be worth an additional $275 billion in revenue by 2030.

The outlook for further growth in Africa's resource sectors remains promising. Our analysis suggests that the continent's production of oil, gas, and most minerals, measured by volume, may continue to grow steadily at between 2 percent and 4 percent per year. Even at current prices, this would raise the value of resource production from $430 billion today to $540 billion by 2020. Higher global commodity prices could lift this even further. However, with the entrance of China and other new players, the field of buyers is getting more crowded. More common are deals that now include foreign investment in infrastructure and resource processing in addition to extraction. By our count, nearly one-quarter of the major resource deals over the past four years included such components, compared with just 1 percent in the 1990s.

Finally, we see large opportunities for companies in building Africa's infrastructure. Currently, African governments and private sources combined are investing about $72 billion a year in new infrastructure across the continent.[6] Africa's private infrastructure investment accounts for 13 percent of the emerging market total, up from 7 percent in 2000. However, Africa still faces huge unmet needs—particularly in the provision of power, water, and transportation—that will require at least $46 billion more in spending per year. We calculate that this goal could be met through a combination of higher spending by African governments, private companies, and non-OECD investors, along with regulatory reforms aimed at boosting operational efficiency.

□ □ □

If recent trends continue, Africa will play an increasingly important role in the global economy. By 2040, Africa will be home to one in five of the planet's young people and will have the world's largest working-age population. Global executives and investors cannot afford to ignore the continent's immense potential. A strategy for Africa must be part of their long-term planning. Today the rate of return on foreign investment in Africa is higher than in any other developing region. Early entry into African economies provides opportunities to create markets, establish brands, shape industry structure, influence customer preferences, and establish long-term relationships. Business can help build the Africa of the future.

5 This estimate assumes resource prices remain at 2008 levels.

6 This figure includes spending on the construction and maintenance of infrastructure, not spending by users for infrastructure services (such as revenues of port operators or utilities).

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