Africa

African PE must rise to job creation challenge

Without investment in manufacturing, continent faces a Malthusian crisis

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Workers preparing clothing for export to the US at a factory in Athi River, Kenya. Africa needs urgent investment in manufacturing to provide jobs for the continent's fast-growing populations. © Bloomberg

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Mass job creation is the central economic development challenge in Africa. Given the demographic trajectory of most African countries, the need to generate employment for growing numbers of young people is unprecedented in human history.

Of the nearly 1.2bn people on the continent, 19.4 per cent are between 15 and 24 years old, and 41 per cent are 14 or younger. Official youth unemployment rates, which greatly underestimate the scale of the problem across sub-Saharan Africa, averaged 10.9 per cent in 2016, and more than 51 per cent from 2013 to 2016 in South Africa. Vulnerable employment in the region was 68 per cent; the informal service economy absorbs many new entrants to the job market.

This is the real Malthusian crisis — the aspirations of the smartphone generation are rising exponentially while the means to meet them are growing arithmetically at best — and the consequences could be dire. This stark reality means many of Africa's young people are seeking opportunity and meaning on rickety boats across the Mediterranean and others are joining extremist groups promising salvation.

The tried and tested formula of job creation includes industrialisation and manufacturing. Taiwan, South Korea and now China have generated hundreds of millions of jobs in the past five decades by following the same playbook. At the same time, African countries have fallen behind their developing country peers such as Cambodia and Vietnam in terms of industrialisation.

The problem is even greater in that many countries on the continent are less industrial now than in the immediate decades after independence. Commodity dependence, governance problems, infrastructure deficits and cheap imports from countries in other regions are some of the issues that have reversed manufacturing-led value-added industrialisation in countries such as Ghana, Zimbabwe, Malawi and Congo-Brazzaville.

However, the conditions for industrialisation in sub-Saharan Africa are now improving thanks to rising labour prices in Asia and growing local consumption in African markets. To seize this moment of opportunity and combat the insecurity that results from mass unemployment, there must be a concerted effort to invest in manufacturing across the region.

African governments and international organisations have recognised manufacturing's importance and started to mobilise a public-sector response. The African Union adopted an Action Plan for the Accelerated Industrial Development of Africa (AIDA) in 2008, more than 30 governments have prioritised industrialisation in their national development strategies, and the African Development Bank (AfDB) includes "Industrialise Africa" in its 'High 5' priorities for accelerating Africa's economic transformation.

Including manufacturing in national strategies and regional action plans is a good start. But, if manufacturing is to drive significant and rapid economic transformation, private sector investment is required. Manufacturing-focused investment does not just provide capital for fulfilling a company's strategic, operating, and physical asset-related needs. It also provides technology and knowledge transfer and helps local firms to become part of regional and global supply chains. Additionally, investments in African manufacturing can help with import substitution, allowing economies to add more value to raw materials locally and save valuable foreign exchange.

Private equity has largely ignored investment in African manufacturing and industrial projects. The Emerging Market Private Equity Association's data show that 23 PE firms have made only 53 investments in the industrials sector in sub-Saharan Africa since 2008. Those investments were highly concentrated in just three countries: 21 were in South Africa, seven in Kenya, and five in Senegal. Investee companies included General Plastics in Kenya and Universal Paints in South Africa. There are an additional 20 Africa fund managers with manufacturing in their fund descriptions who have not yet made a single investment in the sector.

This is not surprising. PE investment in industrials in African markets requires a deep commitment and willingness to innovate. There remain overarching structural issues that may be off-putting to fund managers, including poor infrastructure and a shortage of operational management skills. Many African manufacturing firms are shuttered or distressed, and the challenges they face may be too much of a headache for PE investors compared with other opportunities. The emergence of middle market funds that prioritise African manufacturing could play a key role in developing the sector by investing in and growing these small-ticket projects into bigger companies that interest larger PE funds. To date, there are less than a dozen middle-market funds targeting manufacturing investments.

Though it may be difficult, it is getting easier thanks to a combination of macro trends and a local governmental focus on industrialisation across African markets. PE's first wave of investments on the continent went to financial services and telecoms companies, and its second wave has focused on consumer goods. Now is the time for the Africa PE community to take advantage of a wide-open field where it has only scratched the surface and start a third wave of investments in manufacturing. Middle market funds, in particular, have an enormous opportunity to unlock potential in this sector.

Doing so will not only create value for investors by creating a robust deal pipeline with attractive exit opportunities; it will also help to address the critical job-creation challenge facing the continent.

Aubrey Hruby is co-founder of the Africa Expert Network and co-author of "The Next Africa" (Macmillan, 2015).

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