



cutting through complexity

Sector Report Manufacturing in Africa

kpmg.com/africa

The series has the following reports:

- Oil and Gas in Africa
- Private Equity in Africa
- Fast-Moving Consumer Goods in Africa
- Luxury Goods in Africa
- The African Consumer and Retail
- White Goods in Africa
- Insurance in Africa
- Agriculture in Africa
- Power in Africa
- Construction in Africa
- Banking in Africa
- Healthcare in Africa



Contents

OVERVIEW	1
The Significance of Manufacturing	1
Africa's Manufacturing Environment	2
INVESTMENT & TRADE	4
Investment in Manufacturing	4
Trade in Manufactured Goods	4
KEY DRIVERS	5
Infrastructure	5
Sourcing Products Locally	6
Labour Market	6
Capacity for Innovation	8
Government Initiative	9
REGIONAL DEVELOPMENTS	10
Kenya	10
Ethiopia	11
Nigeria	11
South Africa	12
Morocco	13
Tunisia	14
SOURCES OF INFORMATION	15
CONTACT DETAILS	back page

Overview

The Significance of Manufacturing

The impact of manufacturing on economic development has been widely studied. Very few countries have been able to grow and accumulate wealth without investing in their manufacturing industries, and a strong and thriving manufacturing sector usually precipitates industrialisation. The manufacturing sector is widely considered to be the ideal industry to drive Africa's development. This is due to the labour-intensive, export-focused nature of the industry. There is a direct correlation between exportation levels and the economic success of a country. By increasingly adding value to products before they are sold, revenues are boosted, thereby raising average earnings per input. Furthermore, the manufacturing sector is also more sustainable and less vulnerable to external shocks than commodities for instance.

Many African economies are based on raw-commodity exports, which make them highly susceptible to global price movements. In most cases, the general population does not directly benefit from the country's natural resources, with large transnational corporations and the political elite the primary beneficiaries of the resource base.

In contrast, a strong manufacturing industry contributes to the development of the private sector, which increases an economy's resilience to external shocks. Furthermore, domestic manufacturing improves external accounts by both decreasing imports and diversifying exports. Producing goods to supply the domestic market has a positive impact on the structure of the trade balance, and manufactured exports have a much wider scope and more stable demand than commodity exports.

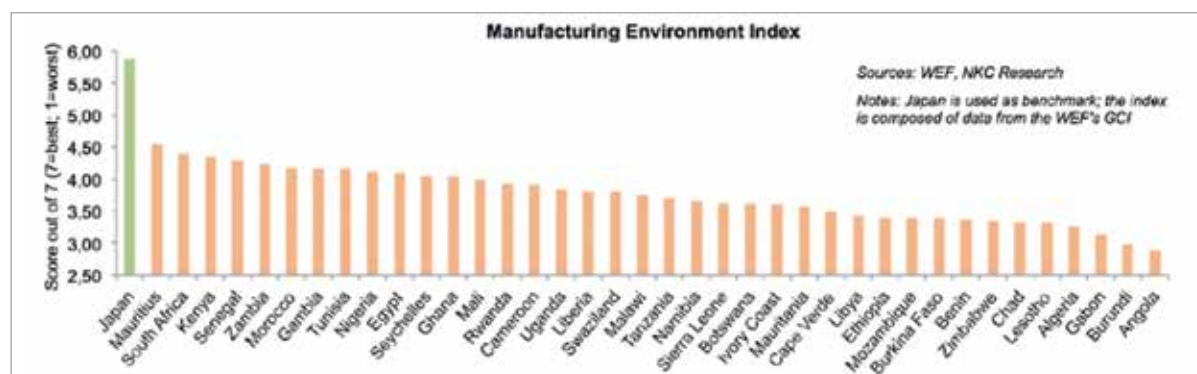


Africa's Manufacturing Environment

There are significant issues facing the manufacturing sector in African countries, the most critical being lack of access to an effective and efficient labour force, and inadequate infrastructure on the continent. In addition, Africa is seen as a continent of conflict, corruption and instability, none of which is conducive to long-term capital investments. Rising fuel and electricity prices also continue to impact Africa's manufacturing sector adversely. In most parts of West and East Africa, backup power systems (diesel-powered generators) are used by manufacturing companies as their main energy source. The reliance on higher-priced electricity for production processes inhibits African manufacturing companies from competing effectively with Asian and developed world counterparts. On the other hand, there are several factors driving this growing manufacturing trend in Africa, including the cheap

labour force and the abundance of raw materials and low-cost agricultural products. Still, manufacturing still plays a relatively small role in the Sub-Saharan Africa (SSA) region when compared to other regions.

According to a 2012 report by the World Bank titled 'Performance of Manufacturing Firms in Africa', manufacturing accounts for only 13% of GDP in SSA, a smaller share than in any other region except the Middle East and North Africa (MENA) region. Given the small size of the manufacturing sector in most countries, it is not surprising that manufacturing exports are not important sources of export earnings in most African countries. According to the World Bank, manufacturing only accounts for around 25% of exports in SSA, lower than any other region except MENA. In comparison, manufacturing exports account for roughly three-quarters of East and South Asian countries' exports.



For a comparison between manufacturing sectors in various African countries, NKC created a **Manufacturing Environment Index** to provide a snapshot of the sophistication and scope of different manufacturing industries. The index is based on data from the World Economic Forum's (WEF) Global Competitiveness Report 2013-14, and takes into account factors such as the quality and extent of local supply chains, the spread and depth of development clusters, and the breadth of the domestic value chain. The index measures the current state of development of the domestic manufacturing sector, and the ease with which the sector can be expanded in terms of both size and sophistication. (Note that the index does not look directly at economic policies, infrastructure or education levels, though some of these could

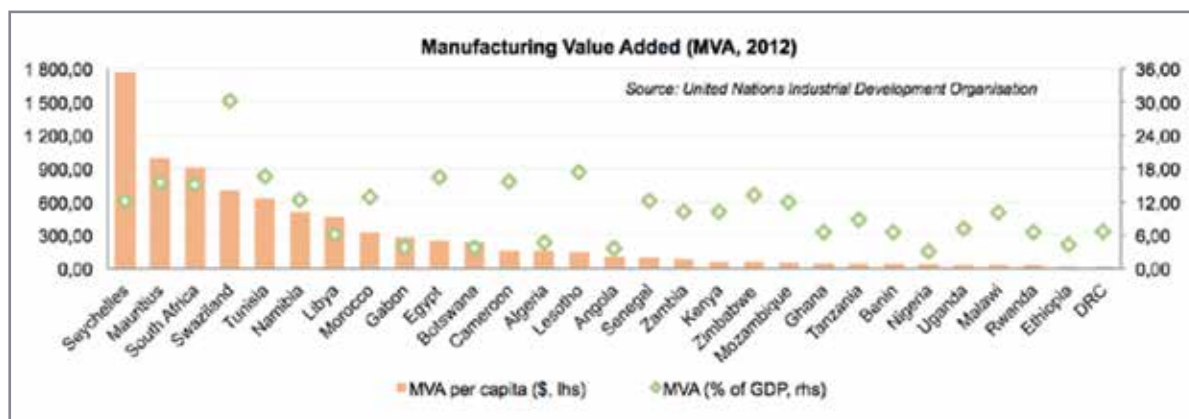
be indirectly captured via their impact on private sector development. These and other relevant issues are discussed elsewhere in this report.) The accompanying graph shows that Mauritius, South Africa and Kenya are the three best performing African countries in the index. Mauritius is a good example of how institutional support is able to create a robust manufacturing industry. Mauritius focused on boosting trade by setting up special trade zones and reducing the barriers to manufacturing, while favourable tax treatment for exports, macroeconomic stability, technical expertise to raise the efficiency of firms, trade preferences and knowledge of export markets were all elements of effective policies adopted which proved successful.

Overview

In South Africa, the government is keenly focused on factories and heavy industry as an employment creator, while Kenya's manufacturing sector is dominated by food and consumer goods processing, and the country is expected to remain one of the top exporters of manufactured goods in SSA over the medium to long term. In turn, the worst performing countries in the index are Angola, Burundi and Gabon. The index also shows countries like Angola, Gabon and Algeria at the bottom-end of the index which are all highly dependent on hydrocarbons exports, and whose economies are thus largely undeveloped outside of these sectors. In addition, many countries at the bottom end of the index have underdeveloped private sectors, and institutional factors prevent these sectors from developing. These factors include pervasive government involvement in economic affairs, and strict

regulation hampering the private sector. In addition, some large economies such as Angola and Algeria have difficulties with regard to the domestic supply of intermediate goods, which creates an additional hurdle to value-added manufacturing.

It is interesting to note how unfavourably the most advanced African manufacturing sectors compare to Japan, the leading nation in the index globally. This illustrates the distance that the manufacturing sector in Africa needs to progress before becoming globally competitive. However, it should be noted that economies such as Japan specialise in technologically sophisticated manufacturing, while many developing-world manufacturing industries are built on a structure of low-cost, mass production. The latter industries will also form the basis of African manufacturing.



To illustrate the qualitative difference between developed world manufacturing sectors and most African manufacturing sectors, the accompanying graph shows the manufacturing value added (MVA). MVA per capita provides an indication of the size of the manufacturing sector relative to the size of the population, while MVA per GDP indicates the size of the manufacturing sector relative to the economy. Again Mauritius and South Africa are in top positions in terms of MVA per capita due to their relatively sophisticated manufacturing sectors. Although Seychelles has the highest MVA per capita figure, this is largely due to the small size of its population. That said, the country also performs well in a number of the 'Key Drivers' of manufacturing development, including infrastructure, labour force

productivity and quality of education. Swaziland records a remarkably high MVA per capita figure due to strong state support for the manufacturing industry with incentives and the provision of factory shells, together with the country's small population when compared to other African countries. Swaziland also has the highest MVA per GDP ratio in Africa. At the bottom end of the scale we see countries that have significant scope for development in low-cost, mass production, particularly Ethiopia due to its relatively stable institutional environment. Still, even Mauritius and South Africa have substantially lower MVA per capita figures compared to a country such as Japan, which had an estimated MVA per capita of US\$7,693 in 2012.

Investment & Trade

Investment in Manufacturing

Foreign investment directed towards the African consumer is becoming increasingly widespread. Data from the most recent United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2013 shows some incipient signs of an investor reorientation towards the burgeoning African consumer market, as some of the most attractive sectors during the past

decade have been consumer-related manufacturing industries. There are a rising number of success stories of manufacturing FDI in Africa that are not directly related to extractive industries, including in the automotive sector in South Africa, the leather industry in Ethiopia, the garment business in Lesotho and pharmaceuticals across East Africa.

Trade in Manufactured Goods

International trade, particularly intra-African trade will have significant implications on manufacturing sectors in African economies. Cross-border value chains will allow the development of specialised domestic sectors, while the availability of intermediate goods will further support manufacturing development. Regional integration can serve as a launch pad for manufacturing development in Africa. However, the share of manufacturing in both intra-African and in extra-regional trade has been falling since 1996, signalling a process of deindustrialisation. This is due to manufacturing development in Africa being confronted with competitiveness challenges, and the boom in commodity prices shifting policy focus and resources into commodity exports. According to UNCTAD, the share of manufactured goods

in total intra-African trade averaged 42.6% in the period from 2007 to 2011, compared to 53.6% in the period from 1996 to 2000. In the period from 2007 to 2011, the share of manufacturing in trade between regional economic communities was highest in East African Community (58.3%), followed by the Southern African Development Community (51.4%), Common Market for Eastern and Southern Africa (44.8%), Intergovernmental Authority on Development (39.1%), Arab Maghreb Union (35.2%), Community of Sahel-Saharan States (34.3%) and Economic Community of West African States (25.7%). These variations in numbers can be associated with the differing levels of manufacturing development of the member countries of the regional blocs.



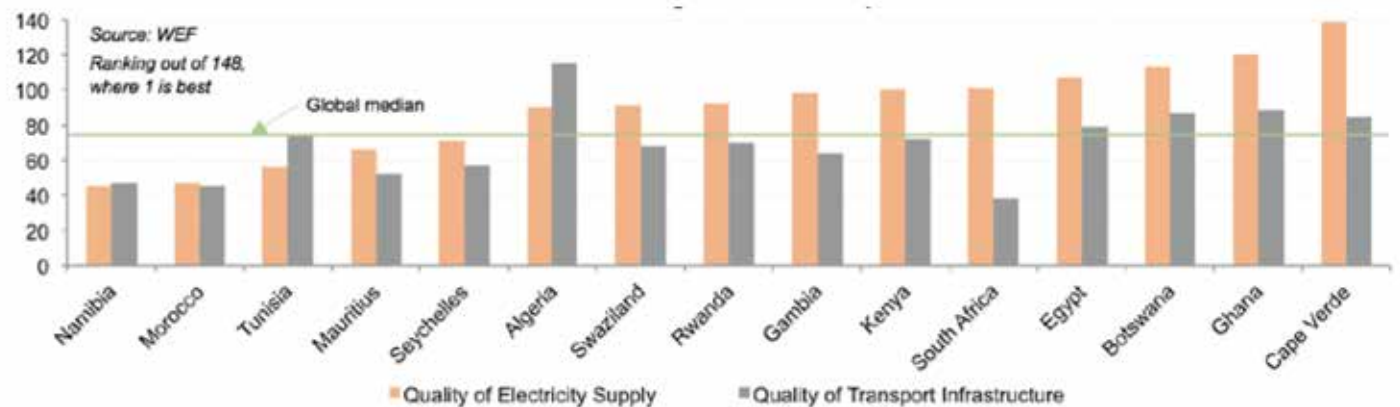
Key Drivers

Infrastructure

Easy access to quality infrastructure is vital for the development of the manufacturing sector. Transport infrastructure is needed throughout the value chain – from the sourcing of input goods to delivering manufactured goods to the domestic market and shipment to foreign destinations. Meanwhile, access to a reliable supply of water and especially electricity is key for the production process. However, these are all areas where Africa lags the rest of the world. According to the 'Quality of Transport Infrastructure' index of the WEF's Global Competitiveness Index (GCI), only 10 African countries are ranked among the top half globally (i.e. they are in the top 74). Meanwhile, in the 'Quality of Electricity Supply' index, only five African countries are above the global median. The graph below shows all the African countries that are rated in the top 90 in at least one of the two abovementioned categories. Some of these countries perform reasonably well in one of the categories but not in the other. Most notably, South

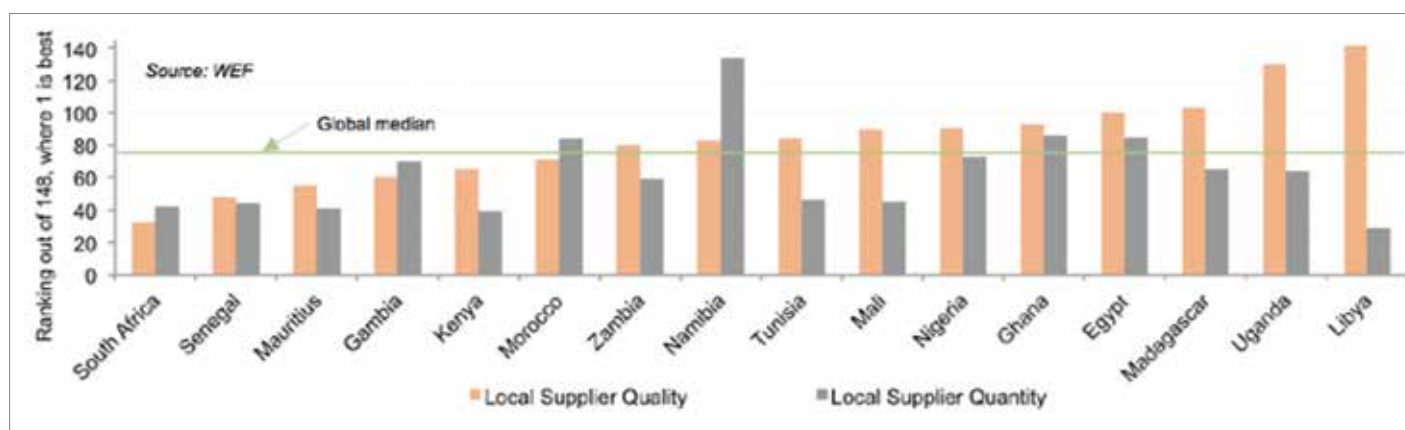
Africa has good transport infrastructure, but is hampered by a relative lack of electricity. Over the past decade and a half, South Africa's electricity generation has grown at much too slow a pace to keep up with rising demand, and this may be holding back the development of the manufacturing sector. A mere five African countries are in the top 90 in both categories. These are Namibia, Morocco, Tunisia, Mauritius, and Seychelles. Not surprisingly, therefore, these are among the countries with the highest levels of MVA per capita on the continent. A number of African countries are making concerted efforts to improve their electricity supplies, which in turn will boost the potential for the manufacturing sector in the long term. Notably, Ethiopia, the DRC, Cameroon, Zambia, and Mozambique, amongst others, have massive hydropower plans; Nigeria is in the process of privatising the power sector; Ghana is set to complete gas processing infrastructure that will ease electricity shortages; and, Morocco, has large solar and wind power plans.

African Countries' Rankings in Global Competitiveness index



Key Drivers

Sourcing Products Locally



A reliable supply of local input products – whether it is grains or olives for an agro-processing company, cotton for textile companies, or iron ore for heavy industries – is an advantage for manufacturers and improves their competitiveness. This does not mean there are no prospects for manufacturers that are unable to source goods locally, but they would need to import goods, which will cost considerably more – with shipping and other transport costs, import tariffs and exchange rate risk all weighing on their cost competitiveness. Africa has a wealth of mineral and agricultural resources that could give African manufacturers a competitive edge in years to come. Currently though, the quality and quantity

of local suppliers are still lacking. As shown in the accompanying graph, only five African countries are rated better than the global median in terms of both the quality and quantity of local suppliers, according to the GCI. These countries are South Africa, Mauritius, Kenya, Senegal and the Gambia (a country that is surrounded by Senegal). Other countries that perform reasonably well in this regard are Morocco, Tunisia, Mali and Zambia. Most African countries are however, outside the top 100, with the quality of local suppliers being particularly poor in most countries – 12 of the bottom 20 countries in this index are African.

Labour Market

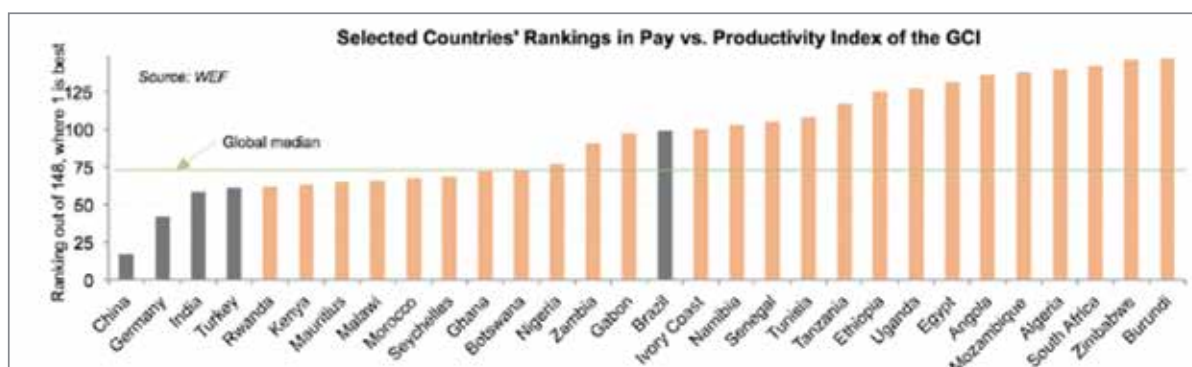
The most important factor of production for many manufacturers is their employees. As such, the cost and skills of the local workforce are key drivers of the manufacturing sector's development. African labour is relatively cheap; however, this is more than offset by the lack of relevant skills, implying that the marginal revenue product of labour in Africa is low compared to the average wage. This is illustrated in the accompanying graph, which shows African countries' ranking in the 'Pay vs. Productivity' category of the GCI. The graph also shows the performance of a few major emerging markets to illustrate how these compare with African countries. Only 10 African countries are ranked in the top half of the global standings. The small economies of Gambia and Madagascar are the best-rated in

this index, followed by Rwanda, Kenya, Mauritius, Malawi, Morocco and Seychelles – most of which also perform well in the other 'Key Drivers'. Of these countries, Gambia, Seychelles, Mauritius, Kenya and Rwanda are those that have the best education systems on the continent, according to the GCI. These countries are therefore among the best placed to provide companies with skilled and productive workers. For some African countries, like South Africa, Namibia, Egypt and Algeria, the poor quality of education is one of the biggest constraints for businesses operating in these countries. Even in Morocco, this is an issue that needs to be addressed to ensure that the manufacturing sector reaches its full potential.

Key Drivers

A Note on the GCI's Quality of Education Measure

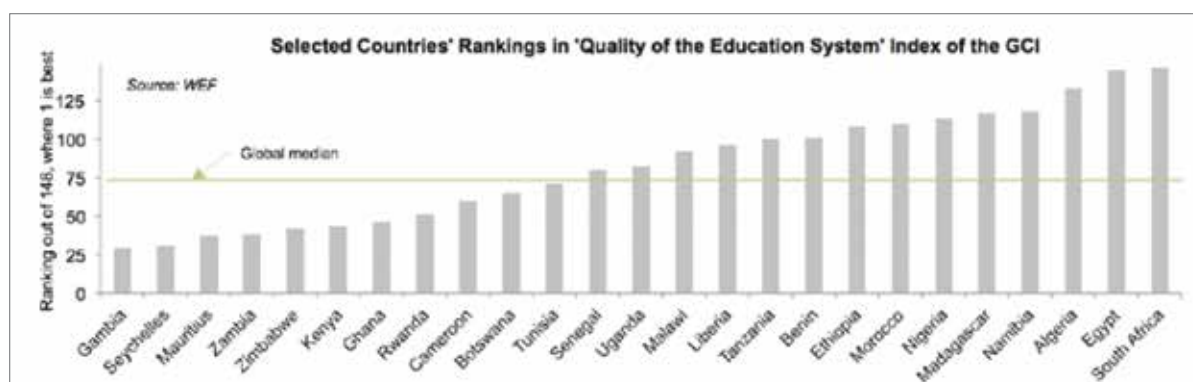
The GCI separates the quality of Education from the quantity of education. In its 'Quality of the Education System' index, the GCI attempts to capture the quality of education, while the 'quantity of education' measures how many people are enrolled at educational establishments. Specifically, the WEF surveys business people on how well the educational system in their country meets the needs of a competitive economy. We use this measure in this report due to the assumption that the quality of education will be more important for the development of the manufacturing sector than the quantity of education. For example, South Africa performs fairly well in terms of enrolment rates – it is ranked 55th globally for secondary education enrolment – but since it performs substantially worse in terms of the quality of education, many South Africans might not be able to perform skilled labour. Studies by the Southern and Eastern Africa Consortium for Monitoring Educational Quality (SACMEQ) provide further evidence of South Africa's poor educational performance. It shows that South African pupils get among the lowest scores for both mathematics and reading in the region. In terms of reading, for instance, South African pupils are ranked ninth out of 14 countries in the region, with only Uganda, Mozambique, Lesotho, Zambia and Malawi performing worse. According to SACMEQ, pupils from Mauritius, Seychelles, Tanzania, Kenya and Swaziland performed the best in the region in terms of reading and mathematics. The results are comparable with those in the GCI's quality of education index, except that Tanzania is one of the best performers in the SACMEQ studies, while Zambia is among the worst.



Out of the bottom 25 countries in the GCI's 'Pay vs. Productivity' index, African countries occupy 17 positions. One of the reasons why Africans have low productivity is that many Africans have subsistence livelihoods, where the marginal product of labour is very low. The high incidence of subsistence living, in turn, can be traced back to the lack of job opportunities in the commercial economy. This is partly because of a lack of entrepreneurship in Africa, which is a result of other underlying issues, such as a lack of education, weak property rights, a lack of economic freedom, challenging business environments, excessive state involvement, corruption, and a lack of financial development. Consider property rights for example: the quality and effectiveness of property rights in Africa are well below the global norm. A lack of property rights in

Africa means that there is a risk of an individual's capital savings been expropriated, with an absent legal framework to protect the individual. Therefore, instead of accruing capital (i.e. saving), Africans are more likely to simply consume, which in turn goes some way in explaining Africa's low savings and investment rates. In order to change this situation, governments need to improve the incentive to save so that long-term capital will be available for the creation of manufacturing companies. In turn, this would require various reforms. These reforms would differ from country to country: for most, improvements in human capital, energy supply, and goods market efficiency are needed; for some, there is also a need for more prudent fiscal policies, so that inflation and exchange rate risk declines.

Key Drivers



Africa's labour productivity could improve if more people shift from rural subsistence agricultural livelihoods to commercial industries, though a shift in economic policies would have to coincide with this. As opposed to many Asian countries where slave wages, poor working conditions, and labour market regulations that encourage exploitation and child labour ensure their competitiveness, the emergence of democratic regimes in Africa has by extension promoted the rights of workers to the point (such as in South Africa) where these rights

have become disincentives to direct investment and employment creation. These factors hinder economic growth and significant change in the medium term remains unlikely at the political level. The overall conclusion is that for a variety of reasons including an adherence to democratic practice, labour market regulation that favours the rights of workers, populist governments and inadequate levels of education and training, it would be difficult, if not impossible for Africa to mimic the Asian labour market model.

Capacity for Innovation

Countries that have the ability to innovate have a distinct advantage and are most likely to experience strong and sustainable manufacturing growth. In these countries, innovative individuals and companies can often find the best ways to deal with constraints, and to identify and exploit gaps in the market. According to the GCI, South African and Kenyan companies have high capacity for innovation, and are ranked 33rd and 34th in the world on this indicator. As one would expect, there is a correlation between the quality of education in countries and their capacity to innovate; however, there are some notable exceptions. Specifically,

South Africa's innovative capacity ranking is 113 places better than its education ranking, perhaps reflecting the gap in the quality of education between schools. South Africa's capacity for innovation helps to explain why the country has the most developed manufacturing sector in Africa. Most African countries perform very poorly though, with 13 of the 20 worst rated countries being African. Among these is Morocco, ranked 129th out of the 148 countries globally. Although we consider Morocco as having among the most manufacturing potential, it is important that education and the capacity to innovate improve.

Key Drivers

Government Initiative

As is the case in other parts of the world, African governments use industrial policies to support domestic industrial development. Often, these policies are centred on the creation of special economic zones (SEZs), where companies benefit from higher quality infrastructure, tax breaks, and duty free imports. Furthermore, companies in these zones are often able to import or export goods in less time. According to a report by the World Bank, electricity outages and downtime in Kenyan SEZs are much less frequent than for companies outside the SEZs, while it also takes fewer days to get an electricity connection. In addition, SEZs give governments an opportunity to provide zones where companies can benefit from good business environments without having to make wholesale reforms to the country's overall business environment, since this is usually challenging politically. Most recently, the Kenyan government announced that it plans to set up three SEZs in order to attract global textile firms. A 2,000 km² plot of land has been identified near the Mombasa port, where the first zone will be located. A second zone will be created at the planned Lamu port, while a third will be situated in Kisumu near Lake Victoria. Incentives will include duty-free imports and waivers on value-added tax (VAT). Cabinet Secretary for Industrialisation and Enterprise Development Adan Mohamed however acknowledged that though it is a good concept, "implementation is going to be hard" due to bureaucratic obstacles. Mr Mohamed said it could take up to three years to identify the

land, draw up master plans, and market the zones to investors. Still, given Kenya's educated workforce, relatively strong manufacturing sector, and good capacity for innovation, the SEZs should receive a good uptake. Apart from SEZs, initiatives taken by governments have been to restrict imports of or impose tariffs on certain goods in order to encourage the domestic production thereof. In Nigeria, for instance, the government imposed measures to curtail cement imports and to boost domestic production. These measures included a high import duty and the cessation of import licences. According to the Oxford Business Group (OBG), the government continues to only provide licences to companies that signal their intent to establish local manufacturing capacity. The policy has led to a substantial increase in domestic cement production over the last decade, with capacity rising from two million tonnes in 2002 to 28 million tonnes in 2012. There are also plans to boost output further, with Dangote, for instance, set to raise the company's annual capacity from around 19 million tonnes at present to at least 32 million tonnes by 2015. Despite the increase in domestic production, import restrictions have led to inadequate domestic supplies, which mean that cement prices in Nigeria are very high. Therefore, although the policy is good for domestic producers and for Nigeria's external accounts, it has negative consequences for construction companies and other cement consumers.



Regional Developments

In this section, the manufacturing sectors of six African countries that have strong growth potential will be discussed. These countries are Kenya, South Africa, Morocco, Tunisia, Ethiopia, and Nigeria. Of these, the first four already have established manufacturing sectors, while the last two have strong potential. In Ethiopia's case, favourable demographics, the country's geographic location, as well as supportive government initiatives point

towards the potential development of a thriving manufacturing sector. Meanwhile, Nigeria's large population and strong projected economic growth are expected to support the demand for manufactured goods, while the privatisation of the power sector as well as government policies to favour local production are expected to give manufacturers incentive to invest in the country, especially over the medium to long term.

Kenya

Kenya's manufacturing sector is relatively strong when compared to countries that are in a similar phase of economic development. The sector contributed an estimated 10.6% to GDP in 2013. Furthermore, the country is one of the top exporters of manufactured goods in the SSA region, and it is expected that this will remain the case over the medium to long term. According to the United Nations Industrial Development Organisation (UNIDO), Kenya's manufacturing value added per capita (in constant 2005 US dollars) was US\$61.8 in 2012, up 2.6% in real terms from 2005. This is merely a fraction of South Africa's 2012 level of US\$910.9, but is much higher than that of regional peers Tanzania (US\$41.4), Uganda (US\$30.5), and Rwanda (US\$25.1). Generally, Kenya's business environment is not considered to be better than these countries, so a key question is 'why is Kenya's manufacturing sector stronger?' One possible reason is that Kenya has a relatively skilled labour force, while the country is generally open to innovation. Kenya is ranked 53rd in the innovation and sophistication factors pillar of the 2013-14 GCI of the WEF, compared to Tanzania's 109th, Uganda's 107th, and Rwanda's 66th. Within this pillar, it is notable that Kenya performs very well in terms of companies' capacity to innovate and companies' spending on research and development.

Kenya's manufacturing sector is dominated by food and consumer goods processing. Meat and fruit canning, wheat flour and maize meal milling, and sugar refining are notable sub-sectors. Kenya manufactures a range of other goods, including

the following: chemicals, textiles, ceramics, shoes, beer and soft drinks, cigarettes, soap, machinery, metal products, batteries, plastics, cement, aluminium, steel, glass, rubber, wood, cork, furniture, and leather goods. Real growth in the manufacturing sector averaged 4.1% p.a. during 2006-2013, lower than the average annual growth in overall real GDP of 4.6%. As a result, the manufacturing sector's share in output has declined in recent years. According to the US Department of State, this exposes "a gap in the country's ability to achieve a fully industrialised economy by 2020." Manufacturers are hampered by electricity shortages and lengthy bureaucratic procedures. "Out of 100 hours of manufacturing, 30 hours you have to spend using oil or incur the cost of downtime because you have no power – it is a choice manufacturers have to make", according to Jackson Mutua, managing director of Eveready East Africa.

There is still a lot of room for expansion in Kenya's manufacturing sector, but for this to happen, reforms to the business environment need to be made to encourage foreign companies to operate in Kenya. In addition, policies must be such that they encourage savings in the economy rather than hinder it, so that long-term capital will be available for the creation of sustainable manufacturing industries. Such policies would include higher deposit rates, and policies that ensure low and stable levels of inflation.

Regional Developments

Ethiopia

The Ethiopian manufacturing sector has been experiencing strong growth in recent years, with annual growth averaging around 12.9% between 2007 and 2011. The Ethiopian Ministry of Industry and Trade is currently involved in numerous projects to increase manufacturing revenue through foreign trade, promoting investment, supplying inputs, improving custom services and global market relationships. The sector is currently dominated by light manufacturing and agro-processing with products mainly consisting of leather and leather products, textiles and garments, chemical and pharmaceutical products, and processed agricultural products. More recently, the announcement by clothing megabrand H&M that it wants to source clothing from Ethiopia raised speculation that Ethiopia could become an international garment manufacturing hub. Ethiopia's government is placing special emphasis on the textile industry – by 2016,

the country aims to export more than US\$1 billion worth of apparel.

To encourage growth in the sector, the government is offering tax breaks and competitive interest rates. This has shown some positive results, with H&M following in the footsteps of supermarkets Tesco and Walmart, which have both started sourcing clothes from Ethiopia. Additional benefits to manufacturing in Ethiopia include the favourable climate for the cultivation of cotton, and the country's proximity to the European market through the Suez Canal. Furthermore, the most significant comparative advantage that manufacturing in East Asian countries such as Bangladesh and China have enjoyed, namely low labour costs, is steadily waning. With the general increase in Asia's prosperity has come an increase in the cost of doing business in the region, which could induce large companies to look for other manufacturing destinations to keep costs low.

Nigeria

The Nigerian manufacturing sector is still small, accounting for an estimated 2.6% of GDP in 2012, and the country's MVA per capita is also among the lowest in Africa. Growth in the sector is usually quite good, although it is at times hampered by supply bottlenecks, including disruptions to the electricity supply. Real growth in the sector averaged 8.5% p.a. during 2005-12. Manufacturing capacity utilisation is low, averaging just above 57% in 2011-12. The issue of electricity is one of the biggest obstacles for the development of the manufacturing sector, and therefore improving electricity generating capacity will be an important driver of manufacturing growth. Encouragingly, good progress is being made in this regard, with a number of transmission lines and substation capacity having recently been commissioned and completed according to the Ministry of Power. The privatisation of the power sector will also support the development of this sector.

Automobile - According to the Oxford Business Group (OBG), automakers in Nigeria have experienced double-digit growth rates in sales over the past year. Currently, the country still imports nearly all of the automobiles that are sold.

The imported car market is dominated by Toyota, which has garnered around 70% of the total market share. Ford announced in September 2013 that it would introduce five new models to the Nigerian market. Ford's sales in the country rose by 33% y-o-y in the first half of 2013, after increasing by 40% in 2011 and by 8% in 2012 "despite overall challenges in the Nigerian auto industry", according to Eugene Prinsloo, Ford's senior manager in SSA. Other automakers that have indicated interest in entering or expanding in the Nigerian market include Nissan, Mercedes-Benz, and Skoda. Some small automobile assembly plants have been established, but thus far strong demand for imported models has prevented notable success being achieved in this arena. In 2010, the government raised the age limit on imports of used vehicles from 10 to 15 years, while gradually lowering tariffs on fully assembled imports. However, the government now seems keen to protect the domestic industry, with the New Automobile Industrial Policy Development being approved by the Federal Executive Council (FEC) in the last quarter of 2013. This will entail higher tariffs on used vehicle imports, an improvement in industrial infrastructure, skills development,

Regional Developments

and promotion of investment. “The Nigerian auto development plan will promote investments in the assembly of inexpensive cars in the country at prices [that] Nigerians can afford, and will gradually substitute the large and growing car imports coming into the country”, according to Olusegun Aganga, the minister of trade and investment. These inexpensive cars will reportedly be sold at a price of N1.2 million - N1.5 million, or US\$7,500 - US\$9,375. Meanwhile, the director general of the National Automotive Council, Aminu Jalal, believes that Nigeria’s auto sector can provide 70,000 skilled and semi-skilled jobs when operating at “full capacity”, while a further 210,000 indirect jobs can be created in related industries. The policy should provide a boost for car makers that are already established in Nigeria and could attract other international auto manufacturers to enter the market as well. However, other obstacles such as inadequate infrastructure, insufficient electricity supplies and a very challenging business environment need to be overcome as well in order to see the new automotive policy succeed. Until it does, the effect of the policy will be an increase in prices of imported cars due to the sharp increase in import tariffs.

Challenges - Some of Nigeria’s key medium-term challenges to attracting investment in the manufacturing sector are its challenging business environment, widespread corruption, and high levels of poverty. These issues could see companies looking to enter the West African market choosing Ghana rather than Nigeria, especially since Ghana has a significantly more investor-friendly business climate. The country is ranked 67th in the world in the World Bank Doing Business Index, compared to Nigeria’s 147th position. Over the short term, though, Ghana has many challenges of its own, mainly due to fiscal indiscipline in recent years. Large increases in government spending have led to high inflation and interest rates, a sharp depreciation of the cedi, as well as foreign exchange shortages. The country has also suffered from power shortages, though the completion of gas processing infrastructure (expected by the end of April 2014) should boost the availability of electricity and reduce the need to import expensive fuel to generate power. If the Ghanaian government can also rationalise fiscal spending and thereby reduce the budget deficit significantly, then Ghana is expected to reclaim its position as one of the best opportunities for investment in Africa.

South Africa

The South African government is keenly focussed on factories and heavy industry as an employment creator despite operational and profitability challenges in the secondary sector. This is based on the observed horizontal and vertical impacts of these industries on growth and employment in other sectors. Top growth and employment multipliers in South Africa include the manufacturing of footwear, textiles and leather products; automotive, machinery and related equipment; as well as food and furniture

production. The Department of Trade and Industry (DTI) launched the latest annual iteration of the Industrial Action Plan (IPAP) in April 2013. Minister of Trade and Industry Rob Davies stated that the action plan “focuses on value added production, with state support centred on nurturing and defending industrial development”. To achieve this, the IPAP also emphasises re-aligning the country’s value-added exports towards other developing economies in SSA and other emerging markets.

Regional Developments

Morocco

The manufacturing industry is an important component of the Moroccan economy, accounting for 15% - 16% of GDP as well as being an important source of export earnings. The most important manufacturing industry is that of textiles, an industry that is facing increasing difficulties owing to strong competition from some Asian countries. Textiles account for 5% of GDP and almost a third of the total manufacturing sector, while the manufacturing of electronic and automotive components is becoming increasingly important, accounting for 10% - 15% of merchandise exports. In recent years, these industries have struggled due to weak demand in the euro zone as well as strong foreign competition. The decline in these industries has been partially offset by strong growth in some newly emerged manufacturing industries, such as aeronautics, automobile manufacturing, and electronics, with foreign companies entering the market to take advantage of Morocco's low wage costs, adequately skilled labour force, and its proximity to Europe. These industries, which are geared towards exports, have attracted a significant amount of FDI in recent years and have all recorded strong export growth recently.

Aeronautics - These newly emerged industries have been supported by the government through the creation of industrial zones, such as the aeronautics-orientated Midparc Casablanca Free Zone. According to International Business Times, over 100 companies already operate in the aeronautics industry, including large international companies like Boeing. Notably, Canadian aircraft manufacturer Bombardier established itself in the Midparc free zone in June 2012 and is busy constructing a US\$200 million plant for the making

of parts for its Learjet 70 and 75 and CRJ aircraft. The facility is scheduled to be opened in June 2014 and hopes to employ 850 people. One major constraint to the continued growth of these industries will be the supply of skilled labour; however, the government has taken some action in order to develop the country's skill base. For example, in May 2011 the government opened the Institut des Métiers de l'Aéronautique (IMA), with plans to train 800 people annually by 2015.

Automobile - The government is also supporting the growth of the automotive sector by offering fiscal incentives and tax exemptions in free zones. In February 2012, Renault opened a new plant in Tangiers, giving a boost to the growing automotive sector. Renault also added a second assembly line in 2013, which increased the plant's capacity to 340,000 units p.a., though actual output is still well below this mark. The plant is revolutionary in that it emits very little carbon dioxide by optimising energy consumption and using renewable energy. Compared to other plants of similar size, the Tangiers plant emits 98% less carbons, consumes 70% less water, and has zero industrial liquid discharges. Apart from this plant, Renault operates another plant in Casablanca with a capacity of 75,000 units p.a. According to the Economist Intelligence Unit, Morocco assembled 156,000 vehicles in 2013, which made the country the second largest supplier of vehicles in Africa after South Africa. Apart from vehicle assembly, Morocco produces parts and equipment for various auto companies. Both Indian conglomerate Tata and Japan's Nissan are interested in investing in the Morocco automotive industry.



FMCG Growth Spots In Africa

Tunisia

The manufacturing sector is one of the most important components of the Tunisian economy. Production is mainly geared toward exporting to Europe and manufacturing exports account for some 70% of total exports. The sector's growth over the past decade has mainly been driven by the mechanical and electrical equipment industry. In fact, between 2000 and 2010, almost 60% of the manufacturing sector's growth is attributable to this industry and led to it overtaking textiles, which was traditionally the largest manufacturing industry. The mechanical & electrical industry has consistently been the largest industry in the manufacturing sector over the past six years. The main exports in this industry are wiring, cables and cable harnesses; electrical command apparatus; transformers; printed circuits; and refrigerators. According to the Foreign Investment Promotion Agency (FIPA), automotive cable harnesses account for more than 30% of total output in this industry. Many foreign companies already operate in this industry. In fact, according to FIPA, there were 312 foreign mechanical and metallurgical companies and 263 electronics companies operating in Tunisia at the end of 2012. Combined, they provided over 88,200 jobs, mostly at the electronics companies. Although the textiles and leather industry has stagnated in recent years, it

still accounts for around 20% of the manufacturing sector, and 3.6% of GDP and employs close to 8% of the labour force. However, investment in the industrial sector has declined in recent years as political and macroeconomic risks as well as weak growth prospects have constrained investment. Furthermore, the Tunisian banking sector is fragile, with banks having liquidity shortages and many banks likely to need to be recapitalised over the next few years. As a result, credit growth is expected to be relatively low over the short to medium term, which will prevent many small businesses from obtaining loans for investment. African manufacturing is still in its infancy and is curtailed by a number of structural shortcomings. These include a lack of quality transport infrastructure and electricity supplies, low levels of productivity, and shortages of skilled labour and innovative entrepreneurs. Another key obstacle is a lack of savings, as these are needed to make large capital investments necessary for the establishment of manufacturing enterprises. Manufacturing sectors around the continent are however showing signs of expanding, driven by factors like strong growth in demand, improving infrastructure, and increased openness to foreign investment.



Conclusion

African manufacturing is still in its infancy and is curtailed by a number of structural shortcomings. These include a lack of quality transport infrastructure and electricity supplies, low levels of productivity, and shortages of skilled labour and innovative entrepreneurs. Another key obstacle is a lack of savings, as these are needed to make large capital investments necessary for the establishment of manufacturing enterprises. Manufacturing sectors around the continent are however showing signs of expanding, driven by factors like strong growth in demand, improving infrastructure, and increased openness to foreign investment.

In East Africa, Kenyan companies have proven that they have a strong capacity for innovation, partly thanks to relatively high quality education. The country also has good local supply chains and reasonable transport infrastructure, which stand manufacturers in good stead. In recent years, the country has shown strong growth potential, especially in agro-processing industries. Another East African country with good potential is Ethiopia. The scope for production to satisfy increasing

domestic demand, as well as the country's proximity to European markets, creates sufficient incentives for domestic production from the demand side, while an abundance of labour and favourable weather conditions support the feasibility of domestic manufacturing from a supply point of view.

In North Africa, two countries with strong potential are Morocco and Tunisia. Both countries already have established manufacturing sectors, good infrastructure, and reasonably skilled labour forces that have attracted many European manufacturing companies. Newly developed industries in Morocco – including aeronautics and automobile manufacturing – are particularly exciting areas. Both countries are having some short-term challenges due to weak European demand and a lack of liquidity in the domestic banking sectors. However, longer-term potential is strong.

Finally, Nigeria's manufacturing sector is also expected to expand rapidly over the medium term, especially in industries supported by government policies. These include automobile manufacturing and cement production.

Sources of Information

Bloomberg
Economist Intelligence Unit
International Business Times
Moroccan Investment Development Agency
Oxford Business Group
Renault
Reuters
Southern and Eastern Africa Consortium for Monitoring Educational
NKC Independent Economists
Tunisian Foreign Investment Promotion Agency
United Nations Conference on Trade and Development
United Nations Industrial Development Organisation
World Bank World Economic Forum



Contact details

Moses Kgosana

CEO

KPMG in Africa

T: +27846478012

E: moses.kgosana@kpmg.co.za

Anthony Thunstrom

COO

KPMG in Africa

T: +27837008862

E: anthony.thunstrom@kpmg.co.za

Katherine Miles

Africa High Growth Markets

KPMG in Africa

T: +27827107408

E: katherine.miles@kpmg.co.za

Shelley Hunt

Africa High Growth Markets

KPMG in Africa

T: +27827109807

E: shelley.hunt@kpmg.co.za

Nick Southon

Head of Diversified Industrials

Southern Africa

T: +27834197150

E: nick.southon@kpmg.co.za

Jacob Gatheca

Head of Consumer markets

East Africa

T: +254202806000

E: jgatheca@kpmg.co.ke

Fernando Mascarenhas

Head of Consumer markets

Angola

T: +244227280102

E: femascarenhas@kpmg.com

Amanor Dodoo

Head of Consumer markets

West Africa

T: +233302770454

E: adodoo@kpmg.com

kpmg.com/social media



kpmg.com/app

