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## *Creating value in Africa*

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**Using and  
enhancing your  
capabilities to  
succeed across  
the continent**



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# ***About the authors***

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# *Executive summary*



**Companies from around the world** have begun to make expansion across Africa a priority, recognising that, despite many problems, it is among the fastest-growing regions in the world. But their attempts often lack an understanding of local market dynamics and the associated skills required for success. As a result, many of these companies have destroyed value instead of benefitting from growth opportunities. At the same time, part of the problem is that companies often embark on their expansion plans without first looking inward, examining what they can bring to these new markets. A capabilities-driven strategy, which builds on and enhances a company's existing capabilities, will create more shareholder value than an approach that seeks out markets based purely on their intrinsic attractiveness.

Africa's markets are too diverse for one business model to be successful everywhere. Companies venturing in can pick the markets that are most suitable by being more conscious of their own distinct capabilities, and by adding new capabilities that will complement them. As successful firms have shown, strong human capital development, partnering, and cross-border coordination are also needed to successfully execute such a strategy in Africa.

# Opportunities abound

As the bright sun emerges over the horizon and morning rush-hour traffic reaches its horn-blaring stationary peak, executives in Johannesburg, Lagos, Casablanca, Nairobi, and other African cities are already at their desks. The mood in those executive offices is noticeably buoyant and dynamic. This atmosphere reflects the invigorating day-to-day unpredictability of African business and the confidence that opportunities are coming, and fast.

Africa's long-term economic potential has never been in doubt. The continent has 600 million hectares of uncultivated arable land, 40 percent of the world's gold, 90 percent of its platinum, 8 percent of its oil, 26 percent of its liquid natural gas, and abundant additional resources.<sup>1</sup> Historically, however, it was generally seen as a region of frontier nations, mostly too risky or ill-developed to invest in — except as a source of commodities.

But businesses are finally recognizing the potential in this region. Since 2000, Africa has been growing consistently at about 1 percent above the global average,<sup>2</sup> and the ambitious, consumption-hungry middle class has tripled in the last three decades to around 400 million people.<sup>3</sup> Demand is booming in less-developed African countries, while more established economies around the world, including South Africa, stagnate. As a result, companies around the globe — in the U.S., Europe, China, Japan, and even Africa itself — are looking to build powerful pan-African enterprises. If only it were that easy.

*Since 2000, Africa has been growing consistently at about 1 percent above the global average.*

# ***Growth through strength***

Unfortunately, horror stories about expansion forays into Africa are legion. The continent's business press provides daily updates on the latest gigantic write-down on a dud acquisition, catastrophic loss due to macroeconomic and currency swings, sudden factory shutdown due to power cuts, embarrassing and costly case of fraud or corruption, and nightmarish security scramble to extricate endangered employees. Just two of many cases include Glencore's recent suspension of mining operations in Zambia and the Democratic Republic of the Congo (DRC), due to weakening macroeconomic conditions, and the repeated shutdown of South Africa's manufacturing base due to electricity shortages. It can sometimes seem as though Africa's rising economic tide is sinking more corporate boats than it lifts.

Yet navigating Africa successfully is feasible, if a company approaches the challenge with the right course of action. Start from your strengths, don't spread your efforts too widely, and focus on the businesses where you have a distinctive edge. Consciously deploy the capabilities that served you best in your home markets, and enhance them locally to meet the needs of consumers and businesses.

Consider, for example, the story of Sanlam, a South African financial-services group founded in 1918. Through its long experience serving the relatively affluent and sophisticated South African market, Sanlam developed world-class technical insurance capabilities, such as pricing and risk management, claims management, reinsurance, and capital management. Though these important capabilities were relevant and in short supply in the under-penetrated neighbouring countries, Sanlam knew that its South African model would not succeed in other parts of the continent without change.

According to Heinie Werth, CEO of Sanlam Emerging Markets, the 2005 acquisition of African Life Insurance Company was critical to enabling the expansion. African Life provided access to Botswana, Kenya, Ghana, Zambia, and Tanzania and focused on the low-cost product offerings and mass-market distribution that were missing at Sanlam. Based on the combination of Sanlam's strong technical skills and African Life's

mass distribution, Sanlam has built a direct interest in 11 countries across Southern, West, and East Africa, as well as India and Malaysia. Werth stresses that the firm continues to approach new markets with flexibility and sensitivity to local context, looking for acquisitions and local partners to provide additional capabilities as necessary.

Another example, from the retail industry, is Pick n Pay. A leading grocery chain in South Africa since 1967, Pick n Pay is the second-largest supermarket chain in Southern Africa (after Shoprite) and is currently establishing a footprint in West Africa. According to Dallas Langman, head of group enterprises (including international operations), the retailer has set out to generate compelling customer value in these new markets by deploying its distinctive operational capabilities. These include quality management and in-store service, as well as open and fair business practices.

Langman notes that Pick n Pay has generally focused on markets where these capabilities can be deployed with limited adaptation, thus reducing investment requirements and risk. Nevertheless, Pick n Pay is prepared to develop specific capabilities where necessary. These typically include proficiency at local sourcing and supplier development. They enable Pick n Pay to create sustainable long-lasting relationships in each country.

Both Sanlam and Pick n Pay set out to distinguish themselves in each country they entered. They chose to grow where the sophisticated technical capabilities and management processes they had developed in South Africa were in demand and would differentiate them from local players.

A capabilities-driven strategy can help a company plan and execute its expansion into Africa. The heart of such a strategy is a firm's capabilities system: the three to six mutually reinforcing, distinctive capabilities that are organized to support and drive the company's strategy, integrating people, processes, and technologies to produce something of value for customers. Understanding your own capabilities system allows you to coherently focus financial investment, management time, and organizational energy to the areas where they have most impact.

To generate growth, the capabilities-driven firm looks to generate as much business as possible in markets where its existing capabilities are relevant and differentiating (as Pick n Pay does). In addition, it looks for ways to enhance its capabilities system to address attractive new markets (as Sanlam does). When you adopt such a capabilities lens, the results are significantly better than when you simply look to own a piece of a growing market.

*A capabilities-driven strategy can help a company plan and execute its expansion into Africa.*

# *The data supporting capabilities-oriented growth*

The value of adopting a capabilities-driven approach to African expansion was clearly demonstrated in an analysis of major expansion deals across Africa between 2007 and 2013. Of the mergers and acquisitions made by companies listed on the Johannesburg, Lagos, and Nairobi exchanges, we identified a total of 82 suitable expansion deals. Using generally available data about these public company transactions, we tracked company performance following each expansion deal, comparing it to other expansions and to relevant industry benchmarks.

Using knowledge of the companies involved in the transactions, supplemented by additional research, we divided deals into three broad categories:

- **Leverage:** The acquirer applied its current capabilities system to incoming products and services. One acquirer that uses such a strategy is RCL Foods, the leading South African poultry producer. According to Pierre Rossouw, Group Africa development manager, RCL believes its Vector Logistics cold-chain distribution capability is what most clearly differentiates it in foreign markets, so it takes stakes in local product manufacturers and distribution networks that will benefit from that type of distribution.
- **Enhancement:** The acquirer added new capabilities to fill in gaps or respond to market changes. For example, Clover, the well-known South African dairy producer, has an international expansion strategy based on enhancing its differentiated manufacturing capabilities and product portfolio. According to Marcelo Palmeiro, head of brands and corporate development, Clover seeks out local acquisitions to provide it with the local distribution capabilities necessary for success in new markets. (It will also seek distribution partners instead of using M&A.)
- **Limited fit:** The acquirer largely ignored capabilities, doing the deal for other reasons, including diversification and control of attractive assets.



It turned out that enhancement deals were dramatically successful, with shareholder returns that were, on average, 18.3 percent higher than the return posted by limited-fit deals after two years. Leverage deals also did well, scoring 12.2 percent higher. Limited-fit deals performed poorly; even the top quartile of these deals produced 3.7 percent lower total shareholder returns than the relevant index (see *Exhibit 1, next page*).

Unfortunately, this last group is prevalent in Africa. We found that almost one-third of deals had limited fit with the buyer's capabilities system, with even higher proportions in the consumer and financial-services industries. The decisions to pursue such deals are not surprising, given the pressure African executives feel to grow their companies, the immaturity of capabilities-system thinking on the continent, and the inherent difficulty of finding deals that neatly match a firm's capabilities system.

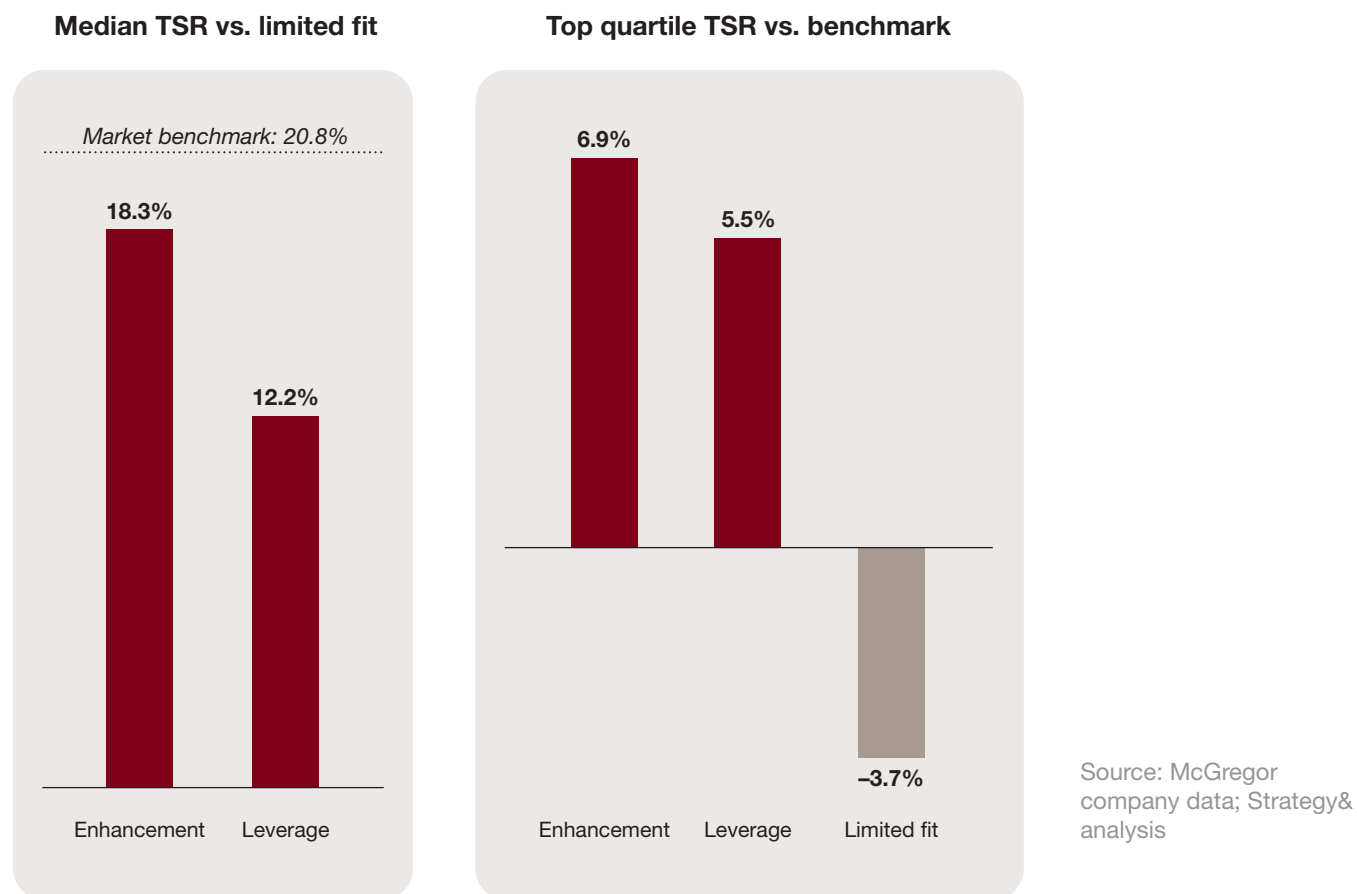
The difficulty of finding and structuring deals that make the most of capabilities is amplified in Africa. Greg Davis, CFO of Standard Bank International, a leading African bank with operations across 20 countries, points out the challenges that affect many deals in this region: overvalued assets, along with difficulties conducting due diligence and integrating purchases. These challenges in finding, valuing, and structuring deals around capabilities provide a compelling explanation for why mergers and acquisitions generally underperform in Africa, with fully 66 percent of buyers returning less value than the relevant industry benchmark over the two years following the deal.

This analysis also provides interesting comparisons between Africa and industrialized economies. The most telling difference is that in industrialized economies like the United States, leverage deals outperform enhancement deals on average.<sup>4</sup> It seems the value of improving capabilities is even stronger in Africa than it is elsewhere. African markets are so diverse that enhancements to the existing capabilities system are often necessary to survive and thrive in a new geography. Although these enhancements are more challenging and risky than simply replicating the home model, the effort is worthwhile to get traction and win customers in the target market.

*Almost one-third of deals had limited fit with the buyer's capabilities system.*

*Exhibit 1*

**Performance of the three types of deals in Africa**



## ***Analytical methodology***

The study considered 82 deals of significant value (more than 10 percent of buyer market capitalisation) in sub-Saharan Africa for the period 2007 to 2013. The performance of each deal was measured using the buyer's total shareholder return (TSR) — growth in share value plus dividends — two years after the deal was completed, minus the TSR of the national industry index. The relevant JSE index was used for South Africa-based buyers,

while national all-share indexes were used for other African countries. This normalization allowed us to identify company-specific factors as opposed to changes in the macroeconomic and stock market environments. Arm's-length investments by asset management firms were excluded from the analysis as nonrelevant. The classification of the capability fit of each deal was based on PwC Strategy& knowledge and additional analysis of the deal.

# Selecting and entering new markets

Navigating which markets in Africa might be appropriate brings up two questions that every company will need to consider. Which specific markets should you enter to get the most value from your existing capabilities? (That's the leverage question.) And which new capabilities do you need to add in each market to ensure success? (That concerns enhancement.)

Answering these questions can seem bewilderingly complex when you are faced with the world's second-largest and second most populated continent. Africa has 54 fully recognized sovereign states, covering a vast range of natural environments and hosting around 2,000 languages with their associated cultures.<sup>5</sup>

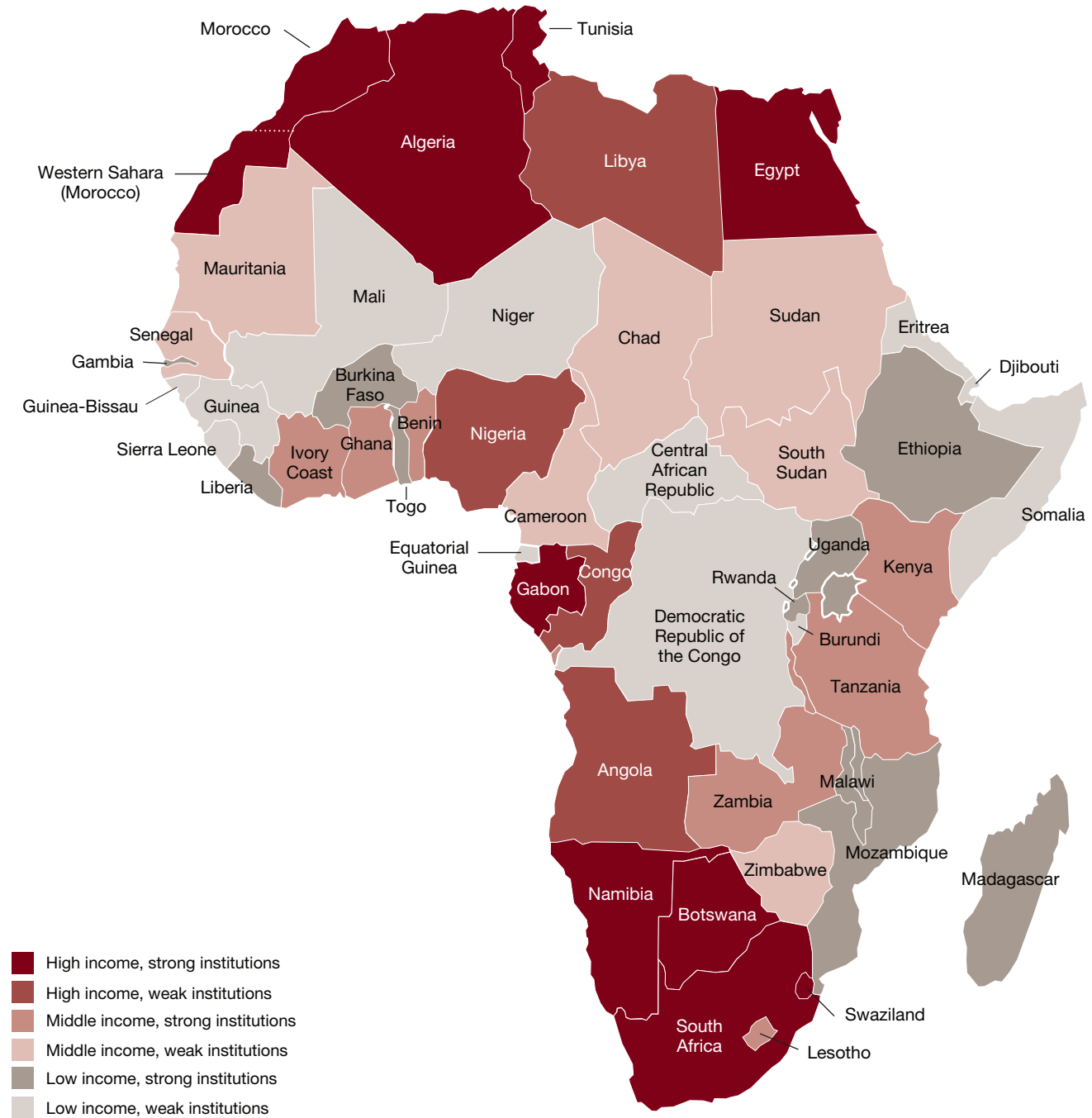
Although a great many factors and a great deal of due diligence will come into play, our experience suggests that a good way to start choosing markets is by studying two basic market criteria: wealth (measured by GDP per capita) and institutional quality<sup>6</sup> (measured by the World Bank Doing Business Index). These factors will provide a solid basis for companies to broadly understand country-specific capability needs and select appropriate markets. Based on these criteria and how the two are combined, African countries fall into six basic categories (*see Exhibit 2, next page*).<sup>7</sup>

Some of the wealthiest African markets have built strong governmental and civil institutions. They have reliable ports, roads, judiciary, police, and educational resources to draw on. Companies that might find these markets rewarding include those whose capabilities include world-class innovation, quality, technology, and branding. For instance, First National Bank, a South African bank, has delivered impressive profits based, in large part, on its world-leading customer engagement and loyalty capabilities.

But then there are high-income countries that have weak institutions. These markets require a host of country-specific capabilities to ensure success, and might be good places for a company with strong capabilities in managing relationships with government and other

*Based on wealth and institutional quality, African countries fall into six categories.*

*Exhibit 2*  
**Market types in Africa**



Source: Strategy& analysis

stakeholders, planning for and managing security challenges and crises, and creating supply chain resilience to ensure consistent service. Dangote Cement, a leading player in Nigeria, ensures the resilience of its supply chain through vertical integration from raw material sourcing to production and distribution, while the stakeholder engagement capability provided by the Dangote Group, one of the largest conglomerates in Africa, allows the firm to create the right partnerships and agreements.

In middle-income countries with strong institutions, aspirational customers demand premium products and services but need them to be delivered at a lower cost point. The widely publicized success of Kenya's Safaricom provides a powerful example of how the capabilities of technological innovation (M-PESA mobile money proposition) combined with cost leadership (low-cost distribution network) can be used to dominate an aspirational middle-income market. Middle-income countries with weaker institutions face even more acute challenges to achieve an affordable cost-to-serve, given limited infrastructure, less efficient and transparent regulation, and weaker human capital. To overcome these hurdles, relationship and crisis management skills are essential.

Although some low-income countries (like Mozambique and Liberia) have relatively strong institutions, all suffer from weak infrastructure. This means that successful businesses, whether exporters or serving local demand, must have strong capabilities in building and operating every component of their business independent of external support. Christo Weise, chairman of the pan-African retail chain Shoprite, points out how operating in low-income markets "taught us self-sufficiency and forced us to develop an extensive infrastructure to ensure the efficient operation of our stores."<sup>8</sup> For instance, Shoprite frequently takes the unusual step for a retailer of building shopping centres to house its stores, requiring entirely new capabilities in real estate development.

Of course, strong institutions and a stable environment make it easier to do business everywhere. In institutionally strong countries across the income spectrum, from Ethiopia to South Africa, companies can focus on competing in the market, in broadly the same way as they would in developed Western markets. Conversely, you can never be complacent about your ability to move capabilities from one country to its neighbour. Deploying the capabilities developed for South Africa to Namibia, Botswana, and Swaziland works well, but success in Mozambique, Angola, Zambia, and Zimbabwe requires adding new capabilities. Similarly, expansion across the Maghreb is often successful, whereas moving farther south requires adaptation. Companies that target the popular markets of South Africa, Nigeria, and Kenya face the challenge of tailoring their capabilities significantly for each market.

*Companies that target the popular markets of South Africa, Nigeria, and Kenya face the challenge of tailoring their capabilities for each market.*

Similarly, blindly adopting the popular “oil slick” strategy of exploiting a region from one hub country is a risky approach. Though linguistic, cultural, legal, and economic blocs are becoming increasingly important, neighbouring countries often differ significantly with regard to wealth and institutional quality. The map suggests, for example, that a Nigerian company would need to enhance its capabilities in differing ways in order to operate successfully in Ghana or Burkina Faso.

Starting from this country categorization, your due diligence must go deeper. Despite the difficulties and time investment required to gather reliable data in the African context, leading players stress how critical this can be. Tava Madzinga, head of East Africa for Old Mutual, a leading financial-services group, explains that often the devil is in the detail, as small differences in local product preference can disrupt the economics of entire business models. Notably, firms need to understand the diversity that sits beneath the surface of national markets and factor it into their planning. In Nigeria, for example, wealth is concentrated in the urban centres of the South South Zone and the Greater Lagos region.<sup>9</sup> Companies whose strengths lie in quality, branding, and innovation need to focus their distribution strategy on these regions.

RCL approaches each individual market with a 50-question evaluation framework. According to Rossouw, the framework requires such challenging tasks as estimating long-term changes to agricultural policy based on underlying political dynamics. To complete this data-gathering and analysis exercise, the firm taps the knowledge of contacts and clients and devotes months of staff time to research on the ground.

# ***Expansion into Africa, day by day***

Once a company has identified the African markets most suited to its capabilities and the additional capabilities it will need for those markets, it can turn to execution — particularly, how to replicate home-market capabilities in other environments, add the new capabilities you need, and manage a pan-African business. To overcome each of these challenges and turn a great African expansion strategy into a great pan-African business, the following deployment approaches are critical.

## ***Develop local human capital***

Capabilities are put in action by people on the ground. Since relying heavily on expatriates is not financially sustainable or positively viewed by African governments, local human capital is essential. Africa's labour markets generally lack people with the necessary technical skills and relevant industry experience, meaning that companies must develop their own talent.

Start by embedding a core team of home-country experts. Deploy your home-country staff as expatriates, but only for a defined period of time. These individuals will oversee the new business at first while quickly transferring practical skills to local hires. Old Mutual, for example, relies on a pool of expats with relevant qualifications and experience for functions where local talent is generally weak, such as actuary work. These expats are selected as much for their cultural agility as for their technical skills, to ensure that they can quickly connect with local employees and make a positive impact in a new environment.

Invest heavily in training and development. Successful companies allocate significant resources to accelerating skills transfer. This often includes both on-the-ground training and bringing local employees to the home office to understand the firm's culture and ways of working. Pick n Pay sets its expert expat managers time-bound targets for

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training and handing over responsibility to local staff. Thus, in its Zimbabwe operation, the management team and 99 percent of the staff are local.

Do what you must to maximize retention. Successful companies that invest in training must find ways to prevent competitors from poaching their talent. They develop compelling value propositions for the local staff, including attractive (often above-market) compensation, additional benefits like pensions or housing, career development opportunities, a positive work environment, and a sense of community. Standard Bank invests heavily in human resources at junior and senior levels, empowering employees to make decisions in their region and encouraging cooperation between regions to develop talent and build relationships and community affiliation.

### ***Add new capabilities by partnering with locals***

This is generally the fastest, least risky, and least capital-intensive way to enhance capabilities for local conditions. This partnering relationship could take the form of a merger, a joint venture, or a simple supply arrangement.

Of course, you must select your local partner carefully. Leading players clearly define what capabilities, values, and ways of working they want from a partner and then evaluate potential candidates carefully against these requirements. RCL, for instance, has strict requirements regarding a partner's ethical reputation and track record of teaming with international players. According to Rossouw, the company minimises risk by undertaking thorough financial and operational diligence before making any agreement. These stringent criteria mean RCL has to be patient, turning down 95 percent of the deals it is pitched.

Having picked the right partner, pay attention to the quality of the relationship. In Africa, enduring partnerships are founded on aligned interests and personal connections, more than on legal contracts. Sanlam avoids competitive bids, preferring to invest 18 to 36 months to establish a trusted relationship with a new partner and demonstrate the unique benefits it can bring to develop the partner's business (including inviting management to visit Sanlam operations in South Africa). According to Werth, to build successful relationships it is essential to adopt an open-minded approach and show respect, interest for the partner's perspective, and a constructive approach to resolving disagreements.

*In Africa, enduring partnerships are founded on aligned interests and personal connections.*

### ***Balance central control with local entrepreneurialism***

Don't smother local subsidiaries with ill-suited control policies and processes. But as you loosen the reins, ensure that you won't be exposed to major failings of local judgment, or to ethics violations. To accomplish this, you have to set your company's risk tolerance and manage against it. Leading players understand that operating in Africa requires higher risk tolerance than operating in developed markets. According to Greg Davis, much of Standard Bank's success in Africa can be attributed to its ability to strike a balance between regional compliance and risk oversight with full local accountability to empower decision makers. For instance, though the bank establishes a consistent corporate and investment banking capability globally, it grants country teams the autonomy to develop and execute distinct strategies tailored to their own market.

### ***Geographic diversification can also help you manage risk***

African economies are and will remain highly volatile and unpredictable, vulnerable to both commodity price swings and political instability. The fortunes of individual countries can vary dramatically. For example, Ghana's GDP per capita has grown 106 percent in the last 25 years while that of the DRC fell 39 percent.<sup>10</sup> To dampen exposure to these idiosyncratic risks, leading players like Sanlam choose to build a broad portfolio of businesses across a variety of markets.

### ***Conclusion***

Begin this entire process by understanding the capabilities that have driven your success at home, and then look for other geographies where these capabilities are relevant. If you can navigate all of the challenges, you will have an enviable position: architect of one of the first pan-African powerhouses, something your shareholders have been dreaming of.

# Endnotes

<sup>1</sup> See PwC's report, "From fragile to agile: Africa Oil & Gas Review 2015," [www.pwc.co.za/en/publications/oil-and-gas-survey.html](http://www.pwc.co.za/en/publications/oil-and-gas-survey.html); Mbendi Information Services, "Mining in Africa," [www.mbendi.com/indy/ming/af/p0005.htm#5](http://www.mbendi.com/indy/ming/af/p0005.htm#5); and the New Partnership for Africa's Development (NEPAD), [www.nepad.org/](http://www.nepad.org/).

<sup>2</sup> Strategy& analysis of World Bank GDP annual growth data, comparing "world" with "sub-Saharan Africa (all income levels)"; <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>.

<sup>3</sup> See PwC's report, "The African Business Agenda 2014"; [www.pwc.com/ke/en/africa-business-agenda.html](http://www.pwc.com/ke/en/africa-business-agenda.html). The 2010 estimate from the report was extrapolated using GDP growth.

<sup>4</sup> See Gerald Adolph, Cesare Mainardi, and J. Neely, "The Capabilities Premium in M&A," *strategy+business*, Spring 2012; [www.strategy-business.com/article/12105](http://www.strategy-business.com/article/12105).

<sup>5</sup> Bernd Heine and Derek Nurse, eds., *African Languages: An Introduction* (Cambridge University Press, 2000).

<sup>6</sup> Institutional quality encompasses several important and highly correlated market characteristics, including regulatory efficiency, corruption, security, and human capital (literacy).

<sup>7</sup> Strategy& analysis of World Bank GDP per capita data (constant 2005 US\$), <http://data.worldbank.org/indicator/NY.GDP.PCAP.KD>. We define "low income" countries as those below \$800 per capita per year. "High income" is defined as above \$2,000 per capita per year. "Strong institutions" countries are defined as those that have a global ranking above 154.

<sup>8</sup> See the Chairman's Report in *Shoprite Holdings Annual Report 2014*; <http://shopriteholdings.co.za/InvestorCentre/Pages/Annual-Report.aspx>.

<sup>9</sup> See the United Nations Development Programme, "Human Development Report, Nigeria 2008–2009: Achieving Growth with Equity," [http://hdr.undp.org/sites/default/files/nhdr\\_nigeria\\_2008-2009.pdf](http://hdr.undp.org/sites/default/files/nhdr_nigeria_2008-2009.pdf); and Barbara Burungi et al., "African Economic Outlook, Nigeria 2015" (African Development Bank, OECD, and UNDP), [www.africaneconomicoutlook.org/en/country-notes/west-africa/nigeria/](http://www.africaneconomicoutlook.org/en/country-notes/west-africa/nigeria/).

<sup>10</sup> Strategy& analysis of World Bank GDP per capita (constant 2005 US\$) data from 1990 to 2014 (see note 7, above).

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