Opportunities for Mergers & Acquisitions: The Case for Africa

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I. Introduction

The continent of Africa is rarely seen as a collection of diverse nations, but instead as one monolithic nation-state relegated to a condition of perpetual poverty. With the exception of South Africa, African nations are rarely discussed for what they might offer, but instead for the assistance they constantly need. The viewers and speakers of course are the developed western economies of the United States and Western Europe, the current hegemonic powers of the global marketplace. The vast majority of the western business community believes that Africa has little to offer them.

Currently, the west’s primary relationship with Africa is in sending humanitarian aid to the continent. While this aid provides significant benefits to the people of Africa, those providing the aid only get the benefit of achieving a public interest initiative by doing a good deed for a great many people. This is not to diminish the benefits to the donors of charitable contributions; however, equal or better use could be made of the financial aid that the west sends to Africa annually.

There are real economic opportunities in Africa; they simply do not look like the ones we are accustomed to in the United States. Instead of maintaining a relationship with Africa where the west perpetually sends aid to continent in the name of humanitarianism, western businesses can achieve this same public interest initiative, while also extracting value for themselves and their shareholders, from the continent.

Mergers and acquisitions should be the primary vehicle for investment into the Africa. Merger and acquisition activity will bring new capital to the continent in a way that is mutually beneficial to both foreign acquirers and African targets. Moreover, once both parties recognize the benefits of these deals, there will be a greater incentive for foreign investment into Africa and for African governments to make their countries more business friendly.

II. The Benefits of Mergers and Acquisitions in Africa

Mergers and acquisitions in Africa are beneficial to both foreign investors and African targets. The major benefit that these deals provide Africa are the financial investments into African markets that stem from the transactions. However, less obvious, are the benefits of these deals to foreign investors.

There are two primary benefits that mergers and acquisitions in Africa provide foreign investors. First, foreign investors have a huge opportunity for growth in the various underdeveloped markets. Second, engaging in merger and acquisition deals in Africa does not require as much capital as engaging in similar deals in other regions.
The goal is to get more investment dollars into Africa. To get more investment dollars into Africa through merger and acquisition activity, foreign investors need incentives to make deals. Thus recognizing the benefits of mergers and acquisitions in Africa is an important step in knowing what incentives to provide foreign investors to invest in the continent.

The primary goal of business corporations is to maximize the value they provide to their shareholders. To do this, businesses, are always looking for new ways to increase their revenue and improve their bottom lines. The more money these companies make, the more valuable they are to their shareholders. In the mature western markets, it is difficult to make significant strides in increasing revenue. This is because these markets are over-saturated, innovation is at the cutting edge, and consumers have been over marketed to. African markets do not suffer from this problem.

Africa offers foreign investors the opportunity for growth within its markets. In Africa, foreign investors have the opportunity to expand their consumer base and their market presence. Each of these opportunities has a direct affect on how much value these companies can provide to their shareholders.

Africa has enjoyed sustained economic growth with an average GDP exceeding 5 percent annually, for the past decade. According to forecasts by World Bank and the African Development Bank, this growth is expected to continue for the foreseeable future. As a result, many larger African markets have seen a steady growth of their consumer classes over that same period of time, with the current consumer market worth over $1 billion.

Moreover, according to African Economic Outlook, a number of African countries will be among the top ten fastest growing economies in the world, notably, Angola, Uganda, and Ethiopia. This data is made even more notable by the fact that the economic growth occurred during a time when the world was experiencing a recession.

This data is positive affirmation of Africa’s future economic potential. African economies are developing at a consistent rate, and as a result so is the economic power of the consumer class in many African markets. This new consumer class is expected to grow as the African economies grow.

Nevertheless, this consumer class is still new and relatively small, thus western companies seeking new ways to increase their value have largely ignored it. Herein lies the first opportunity for foreign investors. This new consumer class offers foreign businesses, an opportunity to expand their consumer base. These businesses can market and sell their widgets to these new consumers in much the same way that they do to their home consumers. They can do this by establishing a base of operations in the African markets where these consumers exist, through a series of acquisitions. This is exactly what Wal-Mart did when it purchased a $2.4 billion stake in South African retailer Massmart.

Along with expanding its consumer base, mergers and acquisitions allows foreign businesses to increase and diversify their market presence. According to African Development Bank, this has been a driving force in the increase of global merger and acquisition activity. For instance, if
these businesses could have established themselves in the growing African economies prior to the recession, the losses they incurred in their western markets might have been assuaged by the gains they made in their African markets.

Moreover, establishing a market presence in these developing markets helps with brand equity for foreign businesses. Although these African markets are still young, they are growing quickly. Companies who gain an early foothold in these markets, will not only have current access to a new consumer base, but will have put themselves in prime position to dominate the future consumer base of that market. This is already the case with South African companies who have been conducting deals throughout Africa for the past 20 years.

South African companies have built up a trust, loyalty, and goodwill with consumers at the expense of companies who are only now arriving. Accordingly, the intangible consumer benefits afforded to businesses who establish an early market presence, will turn into realized profit when consumers recognize the brand of these businesses as the go to brand for a certain product or widget.

Aside from the enormous opportunities for growth that African markets offer, mergers and acquisitions in Africa are also beneficial to foreign investors because they do not require as much capital to complete as compared to western markets. Accordingly, foreign investors benefit by not having to risk as much capital to facilitate a deal.

Most merger and acquisition deals in western markets require a huge amount of capital to facilitate, because of how mature the markets are. However, African markets are still developing, and as such, deals are smaller and do not require nearly the same amount of capital to facilitate. The African M&A market represents no more than 3 percent of the global market, according to the African Development Bank.

Furthermore, because there are very few substantial assets to acquire in Africa, acquisitions must often be done piecemeal rather than en masse. For example Shoprite has targeted Nigeria as a market where it would like to grow and eventually have as many stores there as it does in South Africa. However, because there are so few other stores like Shoprite that exist in the Nigerian market, Shoprite must acquire these individual stores then grow the chain organically as opposed to simply acquiring a similar Nigerian store chain. These piecemeal acquisitions do not generate the same costs or require the same capital to facilitate because of how small they are.

Of course because these deals are so small relative to those transacted in western markets, they also cannot generate near the same value, however this is beside the point. The small amount of capital required to facilitate these deals in Africa is a supplemental benefit to foreign investors who have already recognized the various opportunities for growth that exist on the continent.

Very few deals in Africa can provide value similar to that found in western markets. Currently, South Africa is the only African nation where merger and acquisition transactions can provide such value. In 2012, $12 billion worth of deals were directed towards South African targets according to Thompson Reuters Deals Intelligence report on Sub-Saharan Africa Investment Banking Analysis.
However, the point of using mergers and acquisitions as a vehicle for investment in Africa is not to achieve deals of a similar scale to that of western economies, but instead to transform dollars that are going into the continent as pure aid, into investments that have the potential to realize a tangible return for the investor as well aid in the continued growth and development of the continent. The return on investment will encourage investors to continue to invest, while the investment dollars will also aid the continent in a way similar to that of the humanitarian aid dollars.

The focus on using mergers and acquisitions as a vehicle for investment in Africa should be on foreign investors. They are the people with the money that African countries should be trying to court to invest in their markets. However, African countries also need to better understand the full benefits that these transactions can provide them.

African countries benefit from foreign investment through mergers and acquisitions, in three significant ways. First, African markets gain new capital and business knowledge. Second, this mode of foreign investment can engage the private sector in these countries to tackle infrastructure problems that the various governments are unable to fully handle. Third, foreign investment through mergers and acquisitions can improve the business climates that exist in African countries.

Africa will always benefit from new capital that comes from foreign investment regardless of the vehicle through which it enters the continent. Mergers and acquisitions generate new capital through the fees that arise in facilitating the acquisition of the target as well as the actual capital paid to facilitate the acquisition. Since 2005, African Development Bank found that there have been 1,562 merger and acquisition transactions in Africa worth $249 billion. The great value amassed from these deals can be used to support projects and initiatives that benefit the people of Africa. However, another benefit inherent in the actual acquisition is the knowledge that it brings to the African business.

In mergers and acquisitions, new knowledge is derived from new management and synergistic learning between the target and acquirer. Knowledge from new management can come from a change in actual leadership, a change in management structure or a change in management style. Whereas new knowledge from synergistic learning, comes from the interplay of knowledge that takes place between the two companies that are newly merged.

Although most deals in Africa are likely to be acquisitions, African targets can still realize the benefits of new knowledge from both new management and synergistic learning. As applied to mergers and acquisitions in Africa, foreign investors can introduce new knowledge by installing their own leadership once they have taken over the African target. For synergistic gains, African targets provide their foreign counterparts with knowledge of the local market, while foreign investors provide the African targets knowledge of superior business practices. These two items of interact synergistically to make the newly acquired African target more competitive in its home market.
In addition to the benefits to African targets that flow directly from the actual acquisitions, merger and acquisition activity also engages Africa’s private sector, to tackle infrastructure problems that local governments cannot properly handle. In this scenario the acquisitions by foreign investors would be of African companies that are involved in the various infrastructure-building industries, (i.e. building roads, railways, and seaports). Through new knowledge and capital, these companies advance the infrastructure projects at a scale that neither the government nor the former targets could meet. Ethiopia is looking to benefit from this exact scenario, as the government there is actively seeking investors to help develop a rail network in the country.

Accordingly, while African governments and businesses are still able to propose various infrastructure projects that would advance their countries, foreign investors are able to acquire locally based infrastructure companies and facilitate the government proposed projects through superior knowledge and capital. The ability of merger and acquisition activity to engage the private sector in this way is a pertinent benefit to African targets and African markets, given their poor infrastructures.

Note, merger and acquisition activity in Africa does not only tackle infrastructure problems, it also allows foreign investors to handle many other projects, and exploit many other advantages that local African governments cannot do. A primary example of this is foreign mining of the abundant natural resources in Africa.

Just as foreign investors can aid African infrastructure projects by acquiring African infrastructure companies, so too can they acquire mining companies in Africa and use them to mine the natural resources therein. The South African division of the professional services firm KPMG notes that mining continues to be a vibrant sector for growth in merger and acquisition activity in Africa.

Moreover acquisition in the infrastructure and mining sectors both benefit African countries. An improved infrastructure benefits Africa from a renewed ability to move goods, people, and commerce. Whereas the exploitation Africa’s natural resources are another means for local governments to raise capital by selling mining rights to newly acquired companies.

Finally, merger and acquisition activity can make Africa a more business friendly climate. In order for more merger and acquisition deals to be done in Africa, more African countries need to comply with the rules of modern business. Thus for countries to make themselves more open to these deals, they will have to alter their business practices to be more in line with the international business community.

Ethiopia for example, has gone to great lengths to make itself more business friendly. There the government has made efforts to privatize strategic economic sectors as well as help companies still in the start-up phase. As a result, the Ethiopian M&A market, which was basically non-existent prior to 2006, has recently experienced the takeover of three formerly state owned breweries, by foreign firms. The combined value of those deals topped $500 million.

As more deals more and more deals are transacted in Africa, this too will improve the business climate in the continent. These changes to the business climate will have positive externalities
that bleed into the socio-political and socio-economic fabric of countries of Africa (i.e. improving the business climate means improving hospitals for business professionals, which means better healthcare for the local population).

Despite the benefits that exist in facilitating merger and acquisition deals in Africa, there are still significant hurdles that must be overcome in order for more deals to be made. Creating incentives to facilitate more deals in Africa is a two-step process. The first step involves showing investors the value to be had in Africa, while the second step is to make it easier for these investors to do deals in the continent. Thus to attract foreign investors, attention also needs to be paid to the hurdles that prevent more deals from being transacted in Africa.

III. The Obstacles to Deal Creation in Africa

The primary obstacle that prevents more investment in Africa is the level of risk involved in doing deals there. Recently, a report was conducted by the U.S. professional services firm Marsh, Mercer, and Kroll, in cooperation with the Economist Intelligence Unit. This report found that Africa was the riskiest region in the world to conduct M&A transactions, based on the responses of the various investors surveyed.

Foreign investors are afraid to risk their capital in a region that they do not understand and that provides little to no assurance of a return on their investment. Nevertheless, dealing with this risk is something that must be taken up by both the African governments, and foreign investors. The first step to facilitating more deals in Africa is for African governments to address the obstacles that make mergers and acquisitions such a high-risk endeavor in the continent.

African countries must address the basic infrastructure issues that slow down the pace of modern business, as this was one of the issues that the Kroll report cited as making Africa a high-risk investment destination. Primary attention must be given to inadequate transportation flow due to bad roads, seaports, and railways, and inadequate telecommunications due to poor Internet access and cell phone communications. Without an adequate transportation and telecommunication infrastructure commerce cannot flow, making merger and acquisition transactions difficult to facilitate. African countries need to get their physical infrastructures to the point where business professionals can safely and quickly travel within their borders, while also being able to communicate via a well-connected telecommunications network.

In addition to basic infrastructure issues, the Kroll report also noted that rampant political and economic instability made Africa too risky for foreign investment. Struggles for power, currency volatility, and perceptions of corruption, are all elements that contribute to political and economic instability. Many of these elements can be found in most African countries and are a contributing factor to their instability. Political and economic instability makes it difficult for new investment to come into a country, because it creates too much uncertainty as to whether there will be any return from the investment.

Along these same lines, African countries must address their uncertain legal systems that make investments in Africa a risky endeavor. Merger and acquisitions are a highly technical practice governed by a complex set of corporate rules. African governments need to establish clear rules
addressing risk management, corporate governance and reporting requirements, as these were the key aspects of its business infrastructure that respondents to the Kroll report cited as weak. Furthermore, these rules need to be transparent and must be clear that they will be upheld, and not randomly altered or deleted at the whim of the next leader.

If African countries can work to address the issues that affect their infrastructure, political and economic stability, and legal system, then the African business climate will be more conducive to facilitating mergers and acquisitions. African countries, however, are not the only ones with a role in facilitating more deals in the continent. Foreign investors can also do more to manage the risks in conducting deals in Africa. Foreign investors have a responsibility to their shareholders to address the issues that make investing in Africa a risky endeavor for them.

The primary obstacle to more foreign investment in Africa is a lack of knowledge. One of the biggest reasons most mergers and acquisitions fail in East Africa is a lack of adequate due diligence on target companies. Foreign businesses need to make a real effort to learn more about the African business climate and the value it offers, rather than brushing it off as a worthless cause. To do this, these businesses need to setup advisory firms on the ground in major African markets to learn about the local business climate and culture, as well as a layout of the terrain. Additionally, foreign businesses must work harder to attract top talent to work on deals in Africa.

IV. Conclusion

Africa provides an incredible opportunity for foreign investors with its consistent growth rate, billion dollar consumer market, and abundant natural resources. It is true that Africa still needs much foreign aid, however, it is just as true that there is value to be had from the continent. Merger and acquisition activity is the ideal vehicle for foreign investment into Africa, because it provides much needed aid to the continent, while also providing value to the acquirer, giving foreign investors an incentive for continued investment.

The many risks inherent in investing in Africa are well documented, but over time, these risks are being ameliorated, while the value to be had from African investments continues to grow. Companies such as Airtel in India, and Wal-Mart in the U.S. have already recognized this value in Africa, while others have taken note and are looking to follow suit. Whichever company has the patience, knowledge, work ethic and foresight to take advantage of all that Africa has to offer, will be in a prime position to provide consistent value to its shareholders well into the future.
References


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