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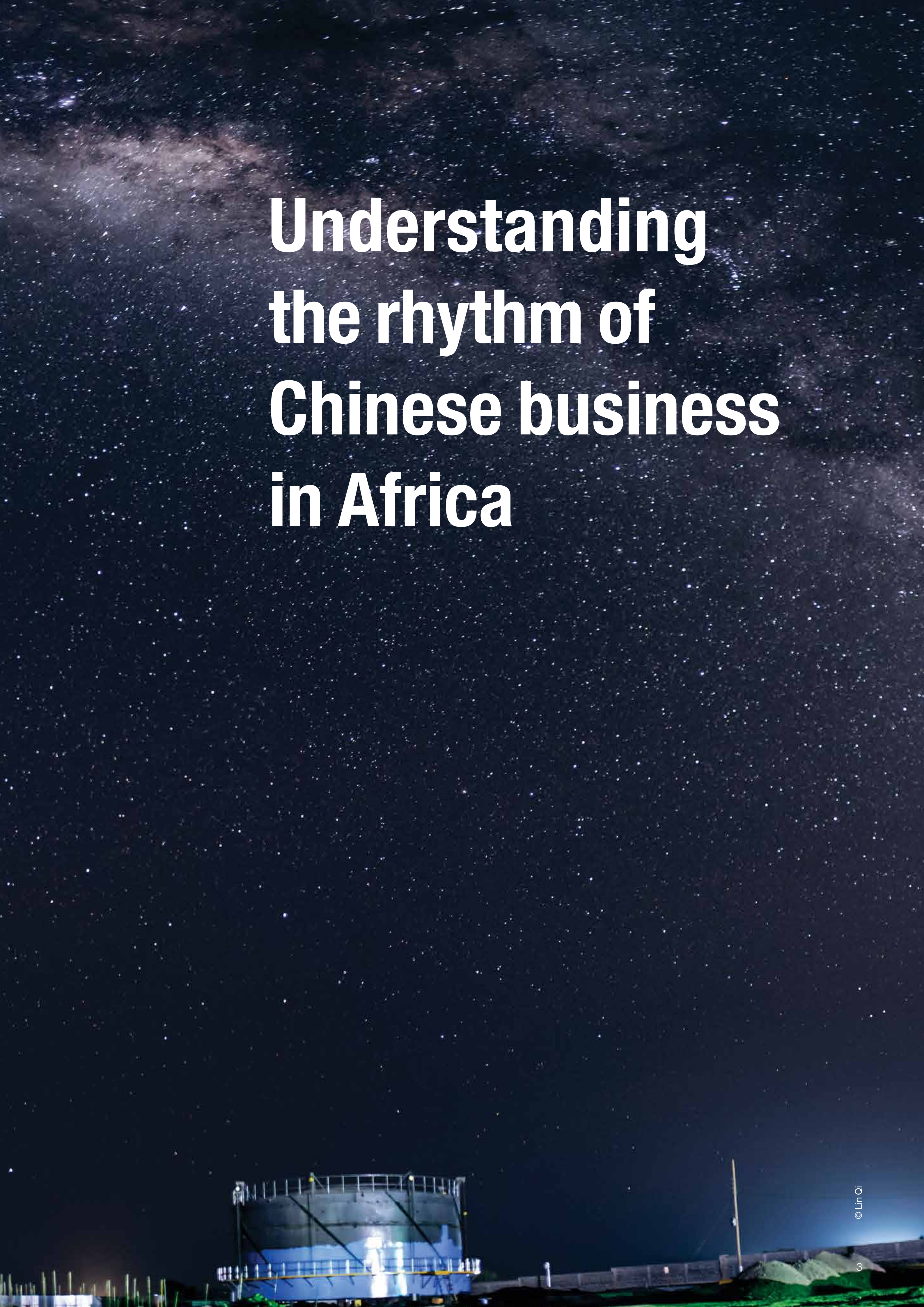
Dance of the lions and dragons

How are Africa and China engaging, and how will the partnership evolve?

EXECUTIVE SUMMARY

Understanding the rhythm of Chinese business in Africa



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Kajiado County, Kenya, might not be the obvious place to look for evidence of large-scale business. A sleepy, mostly rural area about two hours from Nairobi, the county's greatest claim to fame is its views of snow-capped Mount Kilimanjaro, Africa's highest mountain just over the border in Tanzania.

But when we made the 70-kilometer journey from Nairobi one rainy morning, we were astonished to witness a massive, modern factory—the size of several football fields—rising out of the savannah. We had arrived at the Twyford ceramic tile factory, built in just eight months in 2015–16. One of our teammates commented, "It took me longer to retile my roof and bathroom!"

The factory is a joint venture between two Chinese firms, the SunDa Group and Keda Clean Energy Company. SunDa started as a trading operation in Nigeria, focused on importing tiles from China, but it has since switched to manufacturing in several African countries. Its partner, Shanghai-based Keda, is a major supplier of industrial machinery. The two companies invested $30 million in the first phase of the Kenya factory alone.

Our visit to Kajiado took some time to arrange. The Twyford factory's managers, like many other Chinese business builders in Africa, prefer to keep a low profile. While we were learning more about Chinese industrial firms like Twyford, many business leaders we spoke to in Nairobi were unaware that such a large-scale factory could exist in Kenya. If even such a large industrial facility can remain hidden in plain sight, it's no surprise that the extent of Chinese business activity in Africa is so widely underestimated—and misunderstood.

Our tour of the factory—once we'd trudged through the ankle-deep mud surrounding the construction site of the massive second phase—shed light on several aspects of Chinese business activity in Africa. Inside, the factory is bright, spacious, and modern. It is also enormous: each production line is three-quarters of a kilometer long. Most workers we encountered were Kenyans; the myth that Chinese firms typically avoid employing locals was shown to be just that.

Twyford, like many other Chinese firms in Africa, is not just creating jobs—1,500 at its Kenya factory alone—it is also helping to build skills. Moreover, these employees are not simply engaged in manual labor: many work as technical operators of Keda's advanced machinery. Most of the factory's management and supervisors, including its overall manager, are Kenyan.

The smaller group of Chinese managers and workers, unlike their Kenyan counterparts, live on site—in a housing compound complete with a volleyball court—and rarely leave the factory precinct, even on weekends. With a year or more between their visits back to China, several told us of their homesickness. The camaraderie between Chinese and Kenyan employees was clear for us to see on the factory floor, but the Chinese are far from integrated into the local community.

Since we visited Twyford, we have seen Kenyans also starting to take notice of the factory, which has received coverage by multiple news outlets. We think that shift is emblematic of the increased visibility of Chinese businesses across the continent: the many thousand dragons are emerging into view.

In a mere two decades, China has become Africa's biggest economic partner. Across trade, investment, infrastructure financing, and aid, there is no other country with such depth and breadth of engagement in Africa. The Chinese "dragons"—firms of all sizes and sectors—are bringing capital investment, management know-how, and entrepreneurial energy to every corner of the continent—and in so doing, they are helping to accelerate the progress of Africa's "lions," as its economies are often referred to. Yet to date, it has been challenging to understand the full extent of the Africa-China economic relationship due to a paucity of data.

This report aims to provide a fact-based picture of the Africa-China economic relationship. Its foundation is a large-scale data set about the economic relationship between Africa and China, including on-site interviews with more than 100 senior African business and government leaders, as well as the owners or managers of more than 1,000 Chinese firms and factories spread across eight African countries that together make up approximately two-thirds of Sub-Saharan Africa's gross domestic product (GDP).

1 **THE DRAGON HAS LANDED:** AFRICA'S BIGGEST ECONOMIC PARTNER

Since the turn of the 21st century, China has catapulted from being a relatively small investor in the continent to becoming Africa's largest economic partner. And since the turn of the millennium, Africa-China trade has been growing at approximately 20 percent per year. Foreign direct investment (FDI) has grown even faster over the past decade, with a breakneck annual growth rate of 40 percent.[1] Yet even this number understates the true picture: we found that China's financial flows to Africa are around 15 percent larger than official figures suggest when nontraditional flows are included. China is also a large and fast-growing source of aid and the largest source of construction financing; these contributions have supported many of Africa's most ambitious infrastructure developments in recent years.

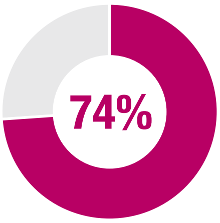
We evaluated Africa's economic partnerships with the rest of the world across five dimensions: trade, investment stock, investment growth, infrastructure financing, and aid. China is in the top four partners for Africa in all these dimensions. No other country matches this depth and breadth of engagement.

1 The trade and investment figures cited in this report are derived from International Trade Centre (ITC) Trade Map; the United Nations Conference on Trade and Development (UNCTAD); *2015 statistical bulletin of China's outward foreign direct investment*, Ministry of Commerce of the People's Republic of China (PRC); National Bureau of Statistics of the PRC; and the State Administration of Foreign Exchange. Unless otherwise stated, the increases cited are in nominal terms.

2 TEN THOUSAND BUSINESS BUILDERS: CHINESE FIRMS' DIVERSITY, SCALE, AND AMBITION

Behind these macro numbers are thousands of previously uncounted Chinese firms operating across Africa. In the eight African countries we focused on, the number of Chinese-owned firms we identified was between double and nine times the number registered by China's Ministry of Commerce (MOFCOM), until now the largest database of Chinese firms in Africa. Extrapolated across the continent, these findings suggest there are more than 10,000 Chinese-owned firms operating in Africa today. Around 90 percent of these firms are privately owned—calling into question the notion of a monolithic, state-coordinated investment drive by "China, Inc." Although state-owned enterprises (SOEs) tend to be bigger, particularly in specific sectors such as energy and infrastructure, the sheer multitude of private Chinese firms working toward their own profit motives make Chinese investment in Africa a more market-driven phenomenon than is commonly understood.

Among surveyed Chinese firms,



are optimistic about their future in Africa.

Chinese firms operate across many sectors of the African economy. Nearly a third are involved in manufacturing, a quarter in services, and around a fifth in trade and in construction and real estate. In manufacturing, we estimate that 12 percent of Africa's industrial production—valued at some $500 billion a year in total—is already handled by Chinese firms. In infrastructure, Chinese firms' dominance is even more pronounced, and they claim nearly 50 percent of Africa's internationally contracted construction market. The firms we talked to are profitable; nearly one-third of them reported 2015 profit margins of more than 20 percent. They are also agile and quick to adapt to new opportunities. Except in a few countries such as Ethiopia, they are primarily focused on serving the needs of Africa's fast-growing markets rather than on exports.

What of the years ahead? An overwhelming 74 percent of Chinese firms said they feel optimistic about the future. Reflecting this, most Chinese firms have made investments that represent a long-term commitment to Africa rather than shallower trading or contracting activities.

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3 BIG BENEFITS, BUT REAL ISSUES: WEIGHING THE IMPACT OF CHINESE INVESTMENT IN AFRICA

Our research points to three main economic benefits to Africa from Chinese investment and business activity: job creation and skills development, transfer of new technology and knowledge, and financing and development of infrastructure:

- At the more than 1,000 companies we talked to, 89 percent of employees were African, adding up to more than 300,000 jobs for African workers. Scaled up across all 10,000 Chinese firms in Africa, these numbers suggest that Chinese-owned business already employ several million Africans.
- Nearly two-thirds of Chinese employers provide some kind of skills training. In companies engaged in construction and manufacturing where skilled labor is a necessity, half offer apprenticeship training.
- Half of Chinese firms have introduced a new product or service to the local market, and one-third have introduced a new technology. In some cases, Chinese firms have lowered prices for existing products and services by as much as 40 percent through improved technology and efficiencies of scale.
- Chinese construction contractors command around 50 percent of Africa's international engineering, procurement, and construction (EPC) market. African government officials overseeing infrastructure development for their countries cited Chinese firms' efficient cost structures and speedy delivery as major value-adds.

Chinese firms contribute to African economies—but they can do more.

89% of employees are African

64% of firms provide training

44% of managers are African

On balance, we believe that China's growing involvement is a strong net positive for Africa's economies, governments, and workers. But there are areas that need significant improvement:

- By value, only 47 percent of the Chinese firms' sourcing was from local African firms, representing a lost opportunity for local firms to benefit from Chinese investment.
- Only 44 percent of local managers at the Chinese-owned companies we surveyed were African, though some Chinese firms have driven their local managerial employment above 80 percent. Other firms could follow suit.
- There have been instances of major labor and environmental violations by Chinese-owned businesses. These range from in inhumane working conditions to illegal extraction of natural resources including timber and fish.

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4 **DIFFERENT DANCES:** FOUR WAYS AFRICAN COUNTRIES ARE ENGAGING WITH CHINA

We focused our research on eight large African economies, and we found four distinct archetypes of the Africa-China partnership:

Robust partners. Ethiopia and South Africa have a clear strategic posture toward China, along with a high degree of economic engagement in the form of investment, trade, loans, and aid. For example, both countries have translated their national economic development strategies into specific initiatives related to China, and they have also developed important relationships with Chinese provinces in addition to with Beijing. As a result, China sees these African countries as true partners: reliably engaged and strategic for China's economic and political interests. These countries have also created a strong platform for continued Chinese engagement through prominent participation in such forums as the Belt and Road initiative (previously known as One Belt, One Road), and they can therefore expect to see ongoing rapid growth in Chinese investment.

Solid partners. Kenya, Nigeria, and Tanzania do not yet have the same level of engagement with China as Ethiopia and South Africa, but government relations and Chinese business and investment activity are meaningful and growing. These three governments recognize China's importance, but they have yet to translate this recognition into an explicit China strategy. Each has several hundred Chinese firms across a diverse set of sectors, but this presence has largely been the result of a passive posture relying on large markets or historical ties; much more is possible with true strategic engagement.

Unbalanced partners. In the case of Angola and Zambia, the engagement with China has been quite narrowly focused. In Angola's case, the government has supplied oil to China in exchange for Chinese financing and construction of major infrastructure projects—but market-driven private investment by Chinese firms has been limited compared with other

African countries; only 70 to 75 percent of the Chinese companies in Angola are private, compared with around 90 percent in other countries. Zambia's case is the opposite: there has been major private-sector investment but not enough oversight from regulatory authorities to avoid labor and corruption scandals.

Nascent partners. Côte d'Ivoire is at the very beginning of developing a partnership with China, and so the partnership model has yet to become clear. The country's relatively small number of Chinese investors are focused on low-commitment sectors such as trade.

5 THE $440 BILLION OPPORTUNITY: UNLOCKING THE FULL POTENTIAL OF THE AFRICA-CHINA PARTNERSHIP

One thing is clear to those who are closest to the Africa-China relationship: it will grow. We interviewed more than 100 senior African business and government leaders, and nearly all of them said the Africa-China opportunity is larger than that presented by any other foreign partner—including Brazil, the European Union, India, the United Kingdom, and the United States.

But exactly how quickly will the Africa-China relationship grow in the decade ahead? We see two potential scenarios. In the first, the revenues of Chinese firms in Africa grow at a healthy clip to reach around $250 billion in 2025, from $180 billion today. This scenario would simply entail "business as usual," with Chinese firms growing in line with the market, holding their current market shares steady as African economies expand. Under this scenario, the same three industries that dominate Chinese business in Africa today—manufacturing, resources, and infrastructure—would dominate in 2025 as well.

Chinese firms can expand into **5 new sectors:**

- Agriculture
- Banking and insurance
- Housing
- ICT and telecommunications
- Transport and logistics

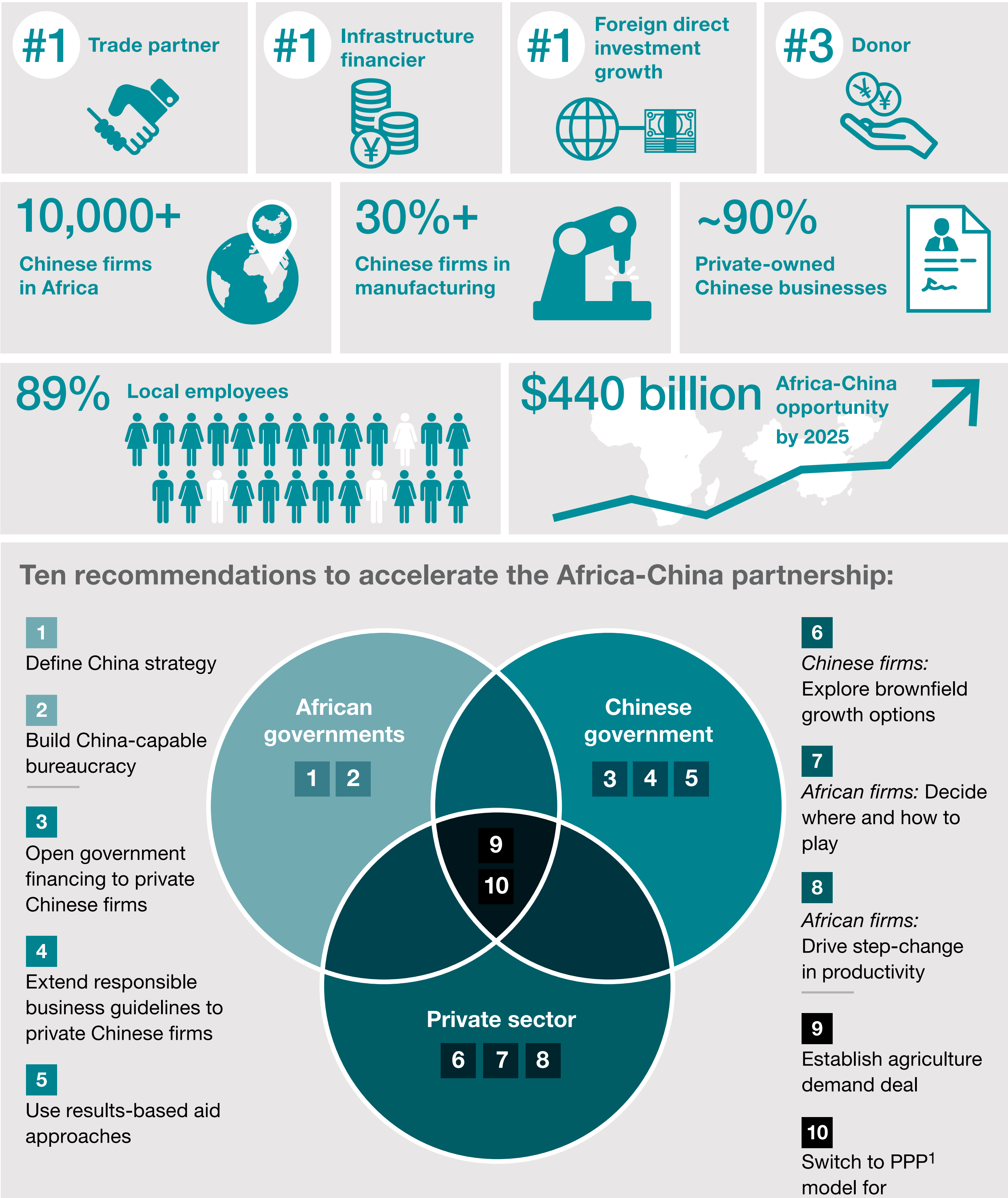
We believe much more is possible: in a second scenario, Chinese firms in Africa could dramatically accelerate their growth. By expanding aggressively in both existing and new sectors, these firms could reach revenues of $440 billion in 2025. In this accelerated growth scenario, not only do the three established industries of Chinese investment grow faster than the economy, but Chinese firms also make significant forays into five new sectors: agriculture, banking and insurance, housing, information communications technology (ICT) and telecommunications, and transport and logistics. This expansion could start with Chinese firms moving into sectors related to the ones they currently dominate—for example, from construction into real estate and housing. Another part of this accelerated growth could come from Chinese firms more fully adapting their formulas that have proved successful in China to markets in Africa, including business models in consumer technology, agriculture, and digital finance.

There is considerable upside for Africa if Chinese investment and business activity accelerate. At the macroeconomic level, African economies could gain greater capital investment to boost productivity, competitiveness, and technological readiness, and tens of millions more African workers could gain stable employment. At the microeconomic level, however, there will be winners and losers. Particularly in sectors such as manufacturing, where African firms lag behind global productivity levels, African incumbents will need to dramatically improve their productivity and efficiency to compete—or partner effectively—with the new dragons on their turf.

Exhibit E1

Dance of the lions and dragons:

How are Africa and China engaging, and how will the partnership evolve?



1 Public-private partnerships.

SOURCE: McKinsey analysis

For the foreseeable future, the dragons are here to stay. And with continued and likely growing Chinese involvement, it will become ever more urgent to address the gaps in the partnership, including a greater role for African managers and partners in the growth of Chinese-owned businesses. Moreover, both Chinese and African actors will need to address three major pain points: corruption in some countries, concerns about personal safety, and language and cultural barriers. In five of the eight countries in which we conducted fieldwork, 60 to 87 percent of Chinese firms said they paid a "tip" or bribe to obtain a license. After corruption, the second-largest concern among Chinese firms is personal safety. For their part, our African interviewees described language and cultural barriers that lead to misunderstanding and ignorance of local regulations. If these problems are left unaddressed, the misunderstandings and potentially serious long-term social issues could weaken the overall sustainability of the Africa-China relationship.

Everyone—African or Chinese, government or private sector—has a role to play in realizing the promise of the Africa-China partnership. We suggest ten recommendations, consisting of actions to be taken by African and Chinese businesses and governments, to ensure the Africa-China relationship grows sustainably and delivers strong economic and social outcomes (see Exhibit E1).

In the words of one of the many Chinese entrepreneurs we interviewed across Africa, "There is a wise saying in Yoruba: should I wash my left hand or my right hand? The answer is that the right hand should wash the left, and the left hand should wash the right. That is the way to do things. Africa is one hand; China is the other. Working together is the way to do things."

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