Sales in Africa: Dos & Don'ts from Practice

12

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Contents

Abstract

According to the German Chambers of Foreign Trade, officially about 800 German companies are present in Africa. Of these, about 600 companies are active in South Africa alone. However, the number of companies distributing German products or services on the continent is likely to be significantly higher. Each of the 54 African countries deserves separate consideration, as the conditions and market opportunities are as diverse as the countries themselves. However, there are some essential aspects, some "dos & don'ts", that German medium-sized companies in Africa should consider. These are outlined in the following guide.

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T. Schmidt et al. (eds.), *Practical Handbook Business in Africa*,
https://doi.org/10.1007/978-3-658-42518-0_12

12.1 Selecting Target Markets

The often generalized view of Africa and the opportunities on the continent in public discussion is not productive. Africa is not a country, but a continent.

This does not mean that decision-makers in the company have to commit to a specific growth market from the outset. Rather, attention should be paid early in the planning process to the respective region for whose markets there is interest. A regional view of Africa makes sense for several aspects:

Logistics: Logistics is a crucial factor in planning market entry in the generally infrastructure-weak African growth markets. Smooth transport of goods over land and especially across national borders is not a given.

- For example, there is no road connection from the resource-rich Katanga region in the south of Congo to the capital Kinshasa. Border areas are often considered crisis areas, such as the border from Kenya to Sudan, which means increased risks for the transport of goods.
- Access to a high-performance seaport like the container port of Djibouti, inaugurated in 2009, can be important for market entry in the much larger market of Ethiopia. Ethiopia—as one of the largest and fastest-growing markets in East Africa, handles 85% of its foreign trade via Djibouti.[1]
- Morocco, on the other hand, offers free market access to the European member states through an agreement with the EU[2]. However, expanding activities in other countries in North and West Africa from there is only possible to a limited extent, as regional integration and in particular trade law convergence with the North and West African neighboring countries has not yet been completed.

Regional organizations: There are a number of regional organizations on the continent that offer different degrees of consolidation and standardization. The oldest (since 1910) and so far the only customs union on the continent is the so-called SACU (for: Southern African Customs Union) in Southern Africa. This connects the relatively small markets of Botswana, Eswatini, Lesotho, Namibia, and the most important market for German companies so far, South Africa. The much larger SADC (Southern African Development Community since 1992) also has a long tradition. Also successful in the gradual political and economic integration of intra-African markets are the ECOWAS (Economic Community of West African States) in the west, which already offers its own passport and

[1] https://www.dschibuti-botschaft.de/index.php/neuigkeiten/38-dschibuti-das-tor-zu-ostafrika as of 07.08.2021.

[2] Euro-Mediterranean Association Agreement (in force since 24.01.2000) EUR-Lex – 32000D0204 – EN – EUR-Lex (europa.eu).

travel facilitation within the community, and the EAC (East African Community), which offers good market access from Kenya to neighboring countries. However, the regional associations are not primarily aimed at facilitating market access for foreign investors. Rather, they aim primarily to promote Intra-African trade and thus exploit the still largely untapped intrinsic growth potential. This is also one of the main goals of the African Continental Free Trade Area, which came into force on 01.01.2021 and ultimately aims to create a common internal market for the 1.2 billion inhabitants of Africa.[3]

Other important criteria that should be considered when entering the market in the north, west, east, or south of the African continent are: Country risks • Political risks • Ease of Doing Business (World Bank Index) • Local partners • Market readiness of the product • Sales markets • Competition • Financing • Currency risks • Infrastructure and transport routes • (informal) distribution channels • Legal framework • Religion and culture.

The following discussion of market entry strategy will focus in particular on the most relevant points of "local partner" and "financing".

A crucial criterion for the approach and strategy of market entry is the target group, because in most African growth markets—with the exception of South Africa, Nigeria or Kenya—there is no established private sector. Therefore, the greatest investment opportunities lie in the public sector: especially for the energy, construction and engineering, or transport sectors. Accordingly, "PPPs" *(Public Private Partnerships)* are at the center of almost all government programs in Africa. This guide will therefore also discuss the approach that is recommended when focusing on public contracts.

12.2 Own Branch or Local Partner?

As a rule, German companies tend to be cautious when establishing themselves in an African market. The decision to start with sales activities in the target market as a first step is easier for many companies than immediately investing time and money in their own representation on site.

The respective market entry must fit the business plan and especially the specific offer of the company. Therefore, there are some concepts where a presence in the market can make sense from the outset. This applies, for example, to local production due to the raw materials available there (cocoa, bamboo, rare earths, etc.). It is also worth considering that a local presence is rewarded even in African growth markets. There are so-called *"tax free zones",* i.e., free trade zones, usually near ports or airports, where the settlement of companies is rewarded with tax incentives, among other things. It can therefore be worthwhile to find out which sectors are preferred in the respective government's

[3] https://www.hannover.ihk.de/internationalzoll/laender-und-maerkte/subsahara-afrika/aktuell/freihandelszoneafrika.html as of 07.08.2021.

infrastructure program. These are usually those sectors that address the greatest necessities, such as energy, construction and infrastructure, or agriculture.

In the context of public tenders, a local presence and a certain *local content* are almost always required. For example, the obligation to procure locally and to employ local workers will already have to be demonstrated in the offer. For large government contracts, this is a must in order to win the bid.

Of course, it also applies in the private sector that having your own representation creates customer trust in the market. The presence on site improves the understanding of the market and a local bank account also has advantages. It is not necessary to be on site in each of the 54 African countries. As described at the beginning, it is worthwhile to identify a target market from which neighboring countries can also be well served.

Interesting market entry markets and trade hubs for German companies are, for example: Morocco and Tunisia in the north; Ghana, Nigeria and Ivory Coast in the west; Kenya, Tanzania and Rwanda in the east and of course South Africa in the south, which despite major political challenges and a consistently difficult image still offers a significantly higher level of development than the other countries of the continent. Zambia in southern Africa is also interesting. Resource-rich Zambia does not have access to a coast, but maintains peaceful and stable relations with its eight neighboring countries, including the resource giant DR Congo. This is a unique selling point on the African continent and makes Zambia an interesting logistics location. For companies from the financial and service sector who want to become active in several African markets at the same time, it is worth taking a look at Mauritius. The island in the southeast of the continent is developing into a center for this sector and has become very attractive for the settlement of foreign investors, among other things with its offer of multilingual workers.

12.2.1 Local Partner

Of course, having your own representation on site means a very high effort and a high risk at the start. The most important point on the agenda is the identification of suitable management personnel, which maintains a good and trustworthy connection to Germany, brings a good understanding of the German parent company and at the same time has a very good market knowledge on site. The right approach to finding a local partner is to involve German institutions, such as the foreign trade chambers. The chambers have experience and above all a good reputation in terms of *matchmaking,* which ideally can be combined with a visit to relevant trade fair events on site.

Sufficient time and money should then be invested in the examination of the identified person/potential partner company. On the one hand, trust must be built up. On the other hand, a careful external review of the person or company *(Due Diligence)* should be carried out by a suitable consultant to avoid bankruptcy. When selecting the local partner, it is particularly important to check the touted network and the promised contacts, and also to exclude any political bias of the responsible parties.

12.2.2 Entry on Own Initiative

Another variant for market entry is the creation of new structures on one's own initiative without involving a local partner. Such a *Greenfield* entry has the advantage that one enters the market without any legacy issues. This may be interesting for companies and organizations that need to be very careful to maintain their integrity and independence in view of their field of activity. The *Greenfield* variant is also suitable when the initial costs—as with consultants and some service providers—are not too high. A not to be underestimated advantage is also that the own corporate culture is lived from the beginning also on site. The company management in Germany can establish and develop the company "tailor-made" according to their own ideas. This usually also ensures better control of product and service quality.

Major challenges with this variant, however, are above all the lack of market experience, the lack of knowledge of the competition and the non-existent network. Customer base and brand must first be built up on site. Accordingly, the selection of the right team on site is the decisive success factor. Start-up costs and time until the company is operational should not be underestimated. And the *local content* necessary for public tenders is not so easily demonstrable for a *Greenfield* operation.

12.3 Legal and Tax Framework for Various Distribution Forms

12.3.1 Framework Conditions with a Local Partner

The advantages of entering the market with a local partner are obviously the quick entry via the existing customer base, the brand that is usually already known in the market, the initially limited investment costs, and the market experience that the partner usually brings. It may also be appealing to eliminate a competitor right from the start by partnering with a local company.

Identifying a suitable local partner is therefore generally considered the best way and means to successfully enter the target market. Ideally, a German company would already have many years of experience with a distribution partner in Africa. The demand, competition, and product requirements are known. As a rule, the distribution partner is then gradually integrated. Exclusivity should only be agreed upon if a firm commitment of the partner also makes sense from the perspective of the German company. The next step is to negotiate how the joint management, financing, and development of the venture can be structured.

In the English-speaking markets of Africa, company law is strongly influenced by the English model. The partnership with the partner company can thus be regulated in most Anglophone markets in Africa in contract form or as a so-called *incorporated Joint Venture*. As a rule, it is advisable to establish a new company *(NewCo),* to enter the new market without any legacy issues. With regard to corporate governance, a "dual leadership" is recommended, in which another managing director from the German parent company is appointed alongside the local managing director. In this context, it should be regulated which decisions can only be made jointly by both managing directors.

The participation of foreign entrepreneurs in local companies is regulated differently in the African growth markets. Some countries require mandatory local participation. In other markets—such as Kenya[4]—you generally do not need a local shareholder.

The corporate structure into which the new African company is to be integrated must also be adapted to the new requirements. It must be checked whether the risky foreign business is sufficiently shielded from the core business of the parent company. The question of the legal form of market entry is not only relevant for the liability of the German parent company, but also for local taxation. For example, an independent, limited liability subsidiary in South Africa is taxed lower than a dependent branch. Transfer pricing issues are also becoming increasingly relevant in the African context.

12.3.2 Framework Conditions for Pure Sales or Project Activity

Even in the case of pure sales activity, a continuous review of the tax classification of the activities on site should be carried out to avoid inadvertently provoking a permanent establishment issue. That is, it must be clarified from what point the venture on site is considered a taxable branch. Special care should be taken when employing local staff. It is important to pay attention to the responsibilities with which this personnel is equipped. In some North African markets, such as Morocco, there is the possibility of establishing a so-called Representative Office (Rep Office)[5], which, however, may only be used for sales activities. Therefore, care must be taken to ensure that there is not a gradual transition from pure sales to actual, taxable business activities on site.

Some other important questions regarding the tax framework conditions for companies that are purely involved in sales in Africa are also: Can a warehouse be operated on site and to what extent is this possible? What obstacles are there to importing goods in terms of customs regulations, waiting times, import licenses? These issues should be clarified as far as possible before a contract is concluded or during contract negotiations. Overloaded ports lead to long waiting times for transport and possibly to penalties for delayed delivery. In many African countries, customs regulations are still not very transparent or it remains unclear why a container is being held in the port for a long time. Contact with an experienced clearing agent with a good reputation and local knowledge is therefore important.

[4] https://www.bizbrokerskenya.com/foreign-owned-business-in-kenya.html as of 05.08.2021.

[5] Chambre Allemande de Commerce et d' 'ndustrie au Maroc (https://marokko.ahk.de/dienstleistungen) as of 05.08.2021.

The time factor always plays a very important role in planning a project in Africa. For each project, it should be clarified in advance who supports which processes and how long the individual steps can take in the worst case scenario. If, for example, the deployment of personnel for a project is a decisive factor, the waiting periods for residence and work permits must be taken into account. Immigration and visa regulations in many African countries, such as Kenya, Nigeria or South Africa, have become more restrictive in recent years and worsen the predictability of a project. However, it may also be worthwhile to check the local investment programs for the specific project. In some markets, the planned employment of local personnel is rewarded by providing a certain contingent of residence permits with work permits for foreign workers.

12.4 The Product Determines the Form of Distribution

A central question is also what product is planned for entry into the respective market. A product that is successful in the German market does not necessarily have to be equally successful in Africa. Quality, price, and values such as sustainability are generally harder to convey.

It is particularly important to clarify whether local or international customers are the target group. Although there is a steadily and strongly growing middle class in most African growth markets, the social differences, especially between local and foreign consumers, are enormous. The distribution channels must also be aligned with the respective target group. For example, pharmaceutical companies cannot simply rely on a pharmacy network. Companies that manufacture medical devices must be prepared for the fact that there are large differences between public and private healthcare in many African countries. Manufacturers of consumer goods must also explore the informal distribution channels common on site to understand how the product reaches the consumer. The need for product registration and/or other market approval must be clarified and the respective process must be taken into account in the feasibility considerations and time planning.

12.5 The Conclusion: Analyze Carefully, Plan Long-Term

A German entrepreneur with ambitions in Africa should heed the following:

1. The product and business plan must be tailored to the respective market. Specialization in the target market is very important, as is price sensitivity for the respective target group and whether the market maturity matches the product. Thus, highly developed products, such as medical devices or products from the automotive sector, are more likely to be successful in a market like South Africa. This is still the country with the highest level of development on the continent and the only market in Africa (except Egypt) where vehicles are produced. Other products such as construction

machinery, energy production plants or engineering services can also be successful in slightly less developed markets.

2. The entrepreneur should be ready for a long-term commitment, not just to export, but also to invest. This offers a clear advantage in most African markets, especially if it is an industry that is specifically promoted by the government.
3. Emphasis should be placed on *Knowledge-Transfer* and training. This is where many funding programs come in and the training of local skilled personnel is accordingly rewarded. Entrepreneurs from the German Mittelstand often implement this much better than competitors from other countries.
   It is important to be on site. The leading management should be involved in business initiation in the target market. A local presence is recommended in the long term and the selection of local employees is a crucial success factor. The training of skilled workers is also very important, as a lack of well-trained skilled personnel on site can be assumed.
4. Good and long-term relationships with the local partner should be established. Respectful interaction with the African business partner on an equal footing is the key to good cooperation and the success of the venture. Lectures should be avoided and personal contact should be maintained.
5. The business model for Africa should be designed for the medium to long term. Patience and the courage to take risks are usually rewarded with a very good *Return of Invest*.
6. Finally, perhaps the most important advice to German companies that do not yet consider Africa as the continent of the future:

Don't ask about the risks, ask about the opportunities!

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