GP Salon

Business as Part of the Solution: Dance of the Lions and Dragons

Investigating China‘s role in Africa and approaching new impulses for Germany‘s cooperation with African countries

Follow-up

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Follow-up

In just a decade, China has become Africa's largest economic partner. No other country engages in such depth and scope in the areas of trade, investment, infrastructure, and services. The collaboration makes Africa one of China's greatest allies in the current global market environment. At the 7th Forum on *China-Africa Cooperation (FOCAC)* in Beijing in September 2018, China's President Xi Jinping announced another 60 billion USD for the next three years in investment, aid, and loans for Africa, emphasizing that no political conditions would be attached to it. The strong Chinese engagement has long fueled fears of a "new colonialism", hardened common misconceptions and doubts that the primary motivations behind China's push are genuinely propelling Africa's development.

China is on the rise in Africa. But its engagement fuels fears and misconceptions.

Together with our partners, the *Ministry of Economic Cooperation and Development (BMZ)*, and the *Federation of German Industries (BDI)*, we hosted another prominent GP Salon on our Africa-series "Business as part of the solution". Three renowned Africa experts, Irene Yuan Sun, Associate Partner at *McKinsey*, Prof. Dr. Andreas Fuchs from the *Kiel Institute for the World Economy (IfW)* as well as the journalist and author Andreas Sieren, took a closer look at the nature of China's involvement in Africa, deriving new impulses and opportunities for Germany's and Europe's future engagement on the continent, which is to date characterized by restraints. The results of the discussion partly surprise and help to debunk some of the dominating myths.

Our Africa experts take a differentiated view.

In between hype and anxiety, there is a lack of facts and data

"The face of Africa is changing", Matthias Wachter (BDI) said in his welcoming words, "and we have to ask ourselves: How does China's engagement affect Europe, Germany and German companies in their activities on the ground?" Tackling this question is not trivial given the often one-dimensional picture that is drawn of China. This was one of the major motivations for Irene Yuan Sun and her team at *McKinsey* to conduct an in-depth study on the relationship between Africa and China in 2017. It resulted in *McKinsey's* report "Dance of the Lions and Dragons – How are Africa and China engaging, and how will the partnership evolve?"

"There is this very unique combination when looking at China's engagement that shape the public perception", Irene said, referring to the enormous hype that comes amidst sharp anxiety and the lack of facts and reliable data. Closing this gap is crucial in order to lead a profound conversation on real opportunities and related risks. Indeed, some of the presented facts come as a surprise. Others allow for a more differentiated picture. Details on the specs of the study can be reviewed here.

The lack of facts and the clash of various publicly perceived phenomena led to *McKinsey*'s study.

1. The "Dragon" has truly landed

McKinsey took the notion of the economic engagement and broke it down into the five dimensions of trade, FDI stock and growth, infrastructure financing and aid. China is the only country being in the top 5 in all of these dimensions. No other country can claim this level of engagement. They furthermore discovered that 10.000+ Chinese firms have settled in Africa – 4 times as much as previously assumed.

2. There is an enormous diversity of Chinese investment in Africa

There is the presumption that Chinese companies are predominantly involved in infrastructure and natural resources – the opposite is the case. Manufacturing and trade are at the core of their engagement and something they have been successfully doing in the past as part of their global economic overall engagement. China draws on its core strengths. *McKinsey* estimates that one out of ten African goods is already made by Chinese-owned factories in Africa. Hitherto neglected was the fact that there is a fairly well developed Chinese service sector in Africa according to the findings of the study.

Yet, the construction business remains a strong component. "Chinese construction and infrastructure companies are incredibly competitive", Irene said, "and they are the biggest winners in internationally run tenders from players like the *World Bank* and the *African Development Bank*." On the other hand, Andreas Fuchs dispelled the frequent impression that China represents the only infrastructure investor pointing towards impactful EU-Africa infrastructure initiatives in a competition based on quality as well as price.

Infrastructure is only one of many ways China engages in Africa.

3. China has, to some extent, a measurable positive impact on Africa

While China's engagement frequently encounters great prejudices among Western media and the public, there are some surprising facts worthwhile mentioning. One is that 89 percent of the employees working in Chinese companies in Africa are locals. Given the fact that the costs for Chinese labor have risen in the past years, this has become a genuine business imperative.

There is a strong African workforce in Chinese companies.

China has furthermore adopted a business strategy in Africa that brings up technical innovations solely tailored to the African market. By way of example, Irene mentions *TECNO*, a company based in Hong Kong whose entire business was initially based in Africa only before expanding to South-Asian markets. *TECNO* produces affordable smartphones and offered improved camera exposures calibrated to darker skin tones before many of its global competitors. In the meantime, it has developed into the "first dual-SIM handset supplier in Africa" with an estimated market share of 30–40 percent. Overall, half of Chinese companies have introduced a new product or service into African markets and a third have introduced a new technology according to *McKinsey's* findings fueling the surprising fact that China, in some ways, is indeed helping to modernize some of the markets in Africa.

China's engagement also stands for innovation and the ability to entirely adapt business models to the African markets.

4. In numbers, privately held companies exceed state-owned enterprises

Contrary to common beliefs, the majority of the operating Chinese factories are privately held, *McKinsey's* research revealed, challenging the notion of a monolithic, state-coordinated investment drive. This applied to 80–90 percent of the 1,000 firms *McKinsey* interviewed. "There is not one China. There is not one Chinese way or one type of Chinese business. China has two faces: the state-owned enterprises (SOEs) and the private sector. Whereas SOEs are usually bigger in size, an equally large portion is private. These are people who are investing their own money which they draw from strong family networks. This is a pattern of business that originated historically in China and it is now being extended to Africa. Members of the families finance each other and create a community", Irene added.

The predominance of state-owned businesses is a myth.

The human aspect of these privately-driven Chinese-African businesses is important, too. "The life of Chinese entrepreneurs in Africa is unglamorous and stark. Even many of the rich ones are down to earth, live in humble ways, some of them sleep in shipping containers. They are working from early morning until late at night. They do not give themselves weekends", Irene remarked. "People have sunk their life savings into their venture in Africa – because Chinese private firms have difficulties to get financed by state-owned banks. They are risking their fortunes. They are giving it their all. This is an important other aspect of the human story unfolding on the continent."

Chinese entrepreneurs risk their private fortunes when investing in Africa.

McKinsey's research points to three main economic benefits to Africa from Chinese investment: job creation and skill development, transfer of new technology and knowledge, and financing and development of infrastructure. Yet, on balance, there are areas that require further improvement.

There are three major areas of positive impact for China in Africa.

Violations, corruption, procurement, and debt-levels – the greatest crunch-points remain

Despite the positive impacts, negative aspects were also discussed during the GP Salon. Local managers, for example, only make up 44 percent of managers at Chinese firms In Africa – a level that ought to increase to improve on quality of jobs and the salary provided. "Also, there is a low level of local procurement", Irene commented. Only half of the procurement value of Chinese firms are currently being sourced locally. "When you think about the value of economic development: if you get this number higher, that would lift the local economy extremely as African firms would be benefitting in terms of their own businesses."

The challenges and downsides remain.

McKinsey also points out instances of major labor and environmental violations by Chinese-owned businesses. These range from inhumane working conditions to illegal extraction of natural resources including timber and fish, according to the report.

One of the largest concerns remains corruption. The fieldwork revealed that in five of the eight countries, 60 to 87 percent of Chinese firms said they paid a "tip" or bribe to obtain a license. Andreas Fuchs hinted towards earlier research indicating that Chinese

Corruption is the major concern followed by personal safety.

projects are disproportionately sited in the hometowns of African leaders. These birth regions would receive significantly more aid and finance than other parts of the countries. This means in turn: fewer benefits are going to politically marginalized regions.

The Africa-China "debt diplomacy" was controversially discussed during the GP Salon, touching on the area of transparency as well as on the debt trap narrative. To African leaders, China's loans are attractive as they come with fewer conditions linked to the granting, such as governance, democracy or human rights. Nevertheless, Africa's growing public debt has sparked a renewed debate about debt sustainability and China's long-term objectives. Africa expert Andreas Sieren argued that the percentage of Chinese loans is comparatively low and other players such as the *IMF*, the *World Bank* or bilateral partners would carry their stake, too.

A debate on debt sustainability and Chinese loans is re-ignited.

Andreas Fuchs referred to the American economist and Professor at the *Harvard Kennedy School*, Carmen Reinhart, who once expressed her concern that almost all of Chinese loans (90 percent) would not get reported to the *World Bank*. He argued that we, therefore, cannot make reliable statements on the level of Chinese debt in Africa. More pressure should be exerted on China to disclose that amount of debt according to Fuchs, calling for a greater level of transparency. Andreas Sieren countered that we would have to live with a certain lack of transparency nowadays. "Who are we to always demand this and that. This is not how the world works anymore."

The unclear level of Chinese loans in Africa lead to a calling for greater transparency.

A more differentiated debate in Germany and Europe is needed

Michael Krake *(BMZ)* pointed out that the current debate is coined by stereotypes and problem-driven arguments. The opportunities would be huge, so should be the approach – solution-driven. Andreas Sieren added that the developments in Africa were remarkable. China started pushing the continent on to the economic trajectory. It has made tremendous moves towards an Africa that has opened up itself to foreign investments, he stated, arguing that the influx on the market and impact on the people's perception are there. Where there was skepticism in the first place, a certain level of trust has been established now.

China has paved the way for Europe.

"We are the bride and we can choose the groom" – Recognizing German strengths

This statement was coined by an African business leader a few years ago. Andreas Sieren noted that China's asset lies in acknowledging their own strengths and on matching them with knowledge on what the continent needs most. China came in and invested in an area that now poses the basis for further business opportunities to follow: infrastructure – an area they are very competitive in. Africa knows: China has something to offer and they have the freedom to choose. Germany's opportunities lie in looking for those industries where it can play on its core strengths. Matthias Wachter *(BDI)* added that a German or European engagement would not be about copying China, but on strengthening what we are already good at.

Africa has the freedom to choose its partners.

Germany shall not copy China.

"Chinese investment in Africa is not suited to be the sort of investment that Germany would do, but it is paving the way for other things, the sophisticated part of the value chain to actually become relevant in the future. That creates opportunities", Irene added.

Western business may complement China's engagement
"Africa has been a place of aid, rather than one of business in the eyes of western countries", Irene explained. By contrast, China has seen Africa as a place of enormous business opportunities and profitability levels, she explained. They have developed healthy, profitable businesses with private investments being even more profitable than SOEs in Africa. China has understood: there are great market opportunities, there is business to be done! The role of western businesses is a complimentary one, Irene suggests. "I would encourage German companies to take a serious look at the African market and even consider partnering with Chinese initiatives in certain industries."

Germany's role may be to complement China's engagement.

Increasing the level of trilateral cooperations is key
"There are a lot of things that China has never done before. There is still a lot they need and want to learn", Irene commented. She sees one opportunity for Europe in the creation of stronger trilateral partnerships with China and Africa. In general, the discussion took up the notion that Germany could become a strategic partner to China. Dr. Werner Schnappauf, former CEO of *BDI*, agreed: "We should combine our efforts."

Trilateralism is an option.

Frequently, the discussion about the engagement of German industries in Africa revolves around perceived market disadvantages like the lack of speed in the decision making, the lack of a one-stop-shop, offering "incompatible products" and high-level standards like compliance or governance. Irene tried to counter this perception: "The German way of doing things doesn't appear bad", she said. "There is a lot of respect for the European way of doing things, the ethos, the system. Most African leaders send their kids to study in Europe if they can afford it. That speaks a lot about who they truly want to emulate at the end of the day. There is a lot of room for corporation." Andreas Fuchs agreed by saying: "The European model is attractive to African leaders."

Germany has unrivalled skills to offer.

Europe is highly respected in the way they engage globally.

Andreas Sieren added that trilateralism would already work in practice and mentioned the German engineering company *Gauff* as one example. The company is doing the quality insurance for Chinese implemented infrastructure projects, he explained.

Europe needs a clear Africa-strategy
Though there are several initiatives cementing the relationship between Africa and the EU as well as Africa and Germany, it seems that the force of attraction from the Far East is bigger and more sustainable. With FOCAC alone, China has established diplomatic relations with 53 African countries and the *Commission of the African Union*. And also this year, dozens of African leaders have made the trip to Beijing, with the aim of bolstering political and commercial ties with China.

China is strong in creating lasting ties with Africa while Europe lags behind.

Andreas Fuchs analyzed: "We can learn a lot from China. Almost all African leaders go to Beijing. But they lack coming to the EU." Ingrid Hamm said it needed a strong European voice and genuine will, but also a consistent approach. This was also true for Africa, Irene added. They, too, require to re-consider and re-define their objectives when it comes to collaborating with foreign partners in the future.

Conclusion

"In 1990, China was as poor as several African countries. China itself has undergone a transformation driven by business – and in particular the private sector. It managed to lift 750 million people out of poverty in a single generation", Irene said. "If you achieved half of that in Africa, you would have eliminated extreme poverty on the continent. This is what's at stake", she said highlighting the importance of combined solutions and mutual approaches. Michael Krake noted there already is a lot of movement. The decisive fact is: there are a lot of misconceptions and misleading interpretations of China's investment in Africa.

Germany has to focus on its core strengths.

The business narrative in Europe and also Germany has long been characterized by a problem-focused approach in which Germany often perceived itself as disadvantaged, non-competitive and non-compatible in competing for business with China in Africa in various ways. Often, the debates on risks dominated, thereby sidelining those on opportunities. However, this narrative is changing. Germany has an undisputed and unparalleled leadership role in many business and industry areas and should apply these strengths to the continent of Africa as well. By identifying promising business cases, identifying the right markets, filling, and by bringing in sophistication where sophistication is needed. Rather than competing with a country, this is a competition for successful business solutions. It's about bringing together sets of skills, competencies and experiences to be even more impactful on a continent whose future is directly linked to ours.

The business narrative on investing in Africa has to change.

When the dragon is dancing with the lion, the German eagle shall lift the two up. This way, Africa could truly reach the next level in its development

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