Investing in Transition States: The Horn of Africa Opportunity

A briefing note for South Korean investors
Front cover picture: Cityscape of Khartoum, capital of the Republic of the Sudan
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Foreword

It is my pleasure to introduce this report on the investment opportunity in the Horn of Africa.

As a development financial institution, the African Development Bank works to promote economic growth and social progress across the continent. The Transition States Coordination Office (RDTS) was established to support the Bank’s commitment to play a leadership role in stimulating economic and social development in countries in transition. Our ‘Strategy for Addressing Fragility and Building Resilience in Africa (2014-2019)’ recognizes the potential of private sector investment to kick-start transformational change by leveraging the opportunities present in these markets and providing better livelihoods and economic prospects to vulnerable populations.

Investing in Transition Countries presents, not only the prospect of making a difference in Africa, but a real financial opportunity with potential for outsized returns, for those willing to engage in these markets and seize the first-mover advantage. This report outlines the Horn of Africa opportunity, namely the investment climate and opportunities in Djibouti, Eritrea, Somalia, South Sudan and Sudan, with Ethiopia also considered as an entry point to these markets.

I commend the report to you, and assure you of my office’s every support as you consider your participation in these markets.

Sibry Tapsoba 
Director, Transition States Coordination Office 
African Development Bank
The Horn of Africa is a large and dynamic market – with 174 million people and a total GDP of $188bn.

Total foreign direct investment to the region is USD 4.8 BN annually, and has been growing 12% year on year. In addition, Korean investors have had a longstanding relationship with the region – the Korean Trade-Investment Promotion Agency (KOTRA) has offices in Sudan and Ethiopia, and Korean FDI has increased five-fold since 2014.

This summary briefing note presents the “Horn of Africa opportunity”. It outlines the market dynamics in each country, as well as specific sectors for consideration:

- Automotive, electrical machinery, and infrastructure. Three additional sectors are also introduced for consideration in this region: textiles, agriculture and extractives.
- For the engaged investor, there are opportunities to invest to tap the large, local market; as well as to manufacture for export, both regionally and further afield.

We invite you to read this summary note. A copy of the full, extended version of this report can be obtained by contacting the Transition States Coordination Office of the African Development Bank.

Methodology

This, ongoing, work was commissioned by the AfDB’s Transition States Coordination Office (RTDS), with support from KOAFEC Trust Fund. Dalberg Advisors and CrossBoundary LLC have prepared this summary note.

In late 2017 Dalberg Advisors analysed 80+ metrics across 16 countries and four regions in Africa; Sahel, Mano River Basin, Great Lakes region and Horn of Africa. This work focused on ‘transition states’ and aimed to evaluate which region might have the best ‘fit’ for Korean investors. These regions were assessed based on their local economy, available resources (e.g. land and labour), prior relationship with Korea, regulatory environment, risks and the region’s trading relationships. Based on typical investor patterns, the Horn of Africa emerged as the first priority region. In 2018, the African Development Bank, supported by CrossBoundary, is facilitating investments from Korean businesses into this region.
The Horn of Africa Opportunity

The Horn of Africa has a large and growing GDP, with most economic activity and wealth concentrated in Sudan and Ethiopia. Total GDP for the region is $188B, with 89% from these two markets ($95bn and $72bn respectively). Economic growth is high across the region — Sudan, Ethiopia, Djibouti and Eritrea are between 5 and 9% GDP growth per annum; although conflict has led to the South Sudanese economy shrinking, while that Somalia is growing at a slow pace. GDP per capita is highest in Sudan at $2,899. In Eritrea, Somalia, S. Sudan and Ethiopia it is less than $800. Total FDI into the region largely goes to Ethiopia; which has been growing its FDI flows by 12% p.a. and could be higher as official figures may not capture all of the FDI flows. In terms of the relationship with South Korea, Sudan is slightly ahead of Ethiopia as the primary importer of South Korean goods (USD 178M annually).

Each market is different – and local conditions evolve swiftly. There is a wide range in the level of market readiness, and each market needs to be individually understood (see country profiles and full report for more detail). Recent development and efforts to secure peace in the Horn present a new dynamic for investors. Sudan, having had sanctions lifted in 2017, has great opportunities to invest (alongside a large domestic market). However, doing business in neighbouring South Sudan remains challenging. Whilst Eritrea remains largely closed to overseas investment, the peace deal with Ethiopia in July 2018 has brought renewed optimism and momentum, and we expect that the foreign investor climate will soon improve.

FDI inflows into the Horn of Africa
USD Millions; including Ethiopia

<table>
<thead>
<tr>
<th>Year</th>
<th>Sudan</th>
<th>Ethiopia</th>
<th>Somalia</th>
<th>South Sudan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>3,009</td>
<td></td>
<td></td>
<td></td>
<td>4,794</td>
</tr>
<tr>
<td>2013</td>
<td>2,827</td>
<td></td>
<td></td>
<td></td>
<td>4,794</td>
</tr>
<tr>
<td>2014</td>
<td>3,633</td>
<td></td>
<td></td>
<td></td>
<td>4,794</td>
</tr>
<tr>
<td>2015</td>
<td>4,329</td>
<td></td>
<td></td>
<td></td>
<td>4,794</td>
</tr>
<tr>
<td>2016</td>
<td>4,794</td>
<td></td>
<td></td>
<td></td>
<td>4,794</td>
</tr>
</tbody>
</table>

Source: UNCTAD, World Bank Development Indicators 2017, UNECA 2016, Ethiopian Investment Commission, Korea EX

The investor climate may also vary within a single country. Somalia itself remains very challenging; but Somaliland, an autonomous region within Somalia, is peaceful and more open. Country-wide ‘doing business’ rankings will not always reflect the local nuance. Some regions in the country may be difficult to do business in.

Public stakeholders are committed to streamlining the investment process. There is an appreciation from public stakeholders that in order to successfully attract investment into the various markets, the creation of and support for investment promotion agencies will be essential. This is evident in various markets (e.g., Somalia, and South Sudan) where entities have been established to provide the necessary interface with investors.

South Korea’s exports to the Horn of Africa (2016)
USD Millions

<table>
<thead>
<tr>
<th>Category</th>
<th>Somalia</th>
<th>Sudan</th>
<th>Ethiopia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicles</td>
<td>13</td>
<td>44</td>
<td>22</td>
</tr>
<tr>
<td>Mechanical</td>
<td>40</td>
<td>33</td>
<td>11</td>
</tr>
<tr>
<td>Machinery</td>
<td>26</td>
<td>18</td>
<td>5</td>
</tr>
<tr>
<td>Plastics</td>
<td>16</td>
<td>11</td>
<td>2</td>
</tr>
<tr>
<td>Electrical</td>
<td>18</td>
<td>17</td>
<td>33</td>
</tr>
<tr>
<td>Machinery</td>
<td>25</td>
<td>92</td>
<td>1</td>
</tr>
<tr>
<td>Organic</td>
<td>18</td>
<td>18</td>
<td>2</td>
</tr>
<tr>
<td>Chemicals</td>
<td>14</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Pharma</td>
<td>8</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Rubber</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Zinc</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Medical</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Source: International Trade Centre, Dalberg analysis.

Note: South Sudan figures negligible; no reported data for Djibouti or Eritrea.
The transition markets in the Horn of Africa, and the focus of this report, are Sudan, South Sudan, Djibouti, Eritrea and Somalia.

However there are many regional entry points, which can provide a stable platform for a region-wide investment, and to build experience with local market dynamics. These border the Horn of Africa region, and include Ethiopia, Kenya, the Democratic Republic of the Congo, and Uganda. Based on data from regional private equity flows, a third of investors make multi-country investments, rather than in any one market.

**Ease of Doing Business Score**

- Sudan: 44.5
- South Sudan: 32.9
- Djibouti: 49.6
- Eritrea: 22.9
- Somalia: 20.0

**Note:** Ease of Doing Business is an annual ranking and score published by the World Bank on the business and investment climate in each country. A score is provided, from zero (poor) to 100 (comparable to the best any country has performed in the ranking’s history). Countries are also ranked regionally and globally. For more details, see www.doingbusiness.org
### Country Profiles

#### Djibouti
- **GDP**: USD 1.7B, growing at 7%
- **GDP Per Capita**: USD 1,928
- **FDI Inflows, 2016**: USD 160M
- **Population**: 0.9M, growing at 2%

#### Eritrea
- **GDP**: USD 2.6B, growing at 9%
- **GDP Per Capita**: USD 583
- **FDI Inflows, 2016**: USD 52M
- **Population**: 4.5M, growing at 2%

#### Somalia
- **GDP**: USD 6.2B, growing at 2%
- **GDP Per Capita**: USD 500
- **FDI Inflows, 2016**: USD 339M
- **Population**: 14.4M, growing at 3%
Vehicles are the number one export from Korea to the Horn of Africa, especially in Sudan and Ethiopia. In East and North East Africa there is a trend towards developing local assembly plants and present opportunities for the Transitions States to be part of the automotive value chain. There are now seven domestic assembly plants in Ethiopia (alongside three outside the Horn, in Kenya). The local growth of the middle class continues to support domestic demand for vehicles, and high entry tariffs for vehicle exports supports the economics of local assembly.

Electrical machinery is the number one Korean export globally. Major Korean electrical and electronics brands already have a strong foothold in Africa — for example Samsung has 35% of overall smartphone market. The assembly of electrical goods for large domestic markets (e.g., Sudan and Ethiopia) is likely to be attractive, particularly for bulky white goods. LG has already invested in a local assembly plant in Sudan for washing machines.

- In Sudan, Haggar Holdings Company is responsible for the assembly and distribution of Samsung products. Ethiopian firms Techno Mobile and G-Tide manufacture handsets for the Ethiopian and East African markets.
In post-conflict situations, construction is generally the first sector to receive FDI as reconstruction and expansion of infrastructure investment are a priority, especially in both energy and transport. For example, Djibouti has recently announced a USD 442M investment from the UAE to build a new port. In addition, Sudan is seeking to commission the development of several renewable energy (solar & wind) projects, supported by government incentives, which have undergone feasibility studies and are ready for investor consideration. South Korean firms have also been involved in energy infrastructure, including hydroelectric dams, elsewhere in the continent. The region’s infrastructure plan, the “Horn of Africa Initiative” crafted by the Intergovernmental Authority on Development, has prioritised interconnectivity on transport and energy via interconnection links. Infrastructure investment can also strengthen the broader business ecosystem to enable higher value investment (e.g., manufacturing).

- There have been improvements in the status of infrastructure in the Horn. Between 2014 and 2016, Ethiopia and Sudan had the largest gains, for countries in the Horn, in the AIDI primarily due to improvements in ICT infrastructure

- The governments of Djibouti, Ethiopia, Eritrea and Somalia have stated an intention to increase infrastructure investment in their national development plans. Recent external investments have largely gone to Ethiopia for electricity generation and transmission projects valued at USD 1.9B

- The Horn of African Initiative has facilitated some infrastructure investment although some gaps remain. Projects under preparation still require an investment of USD 1.4B and projects that still need to be prepared require a USD 1.3B investment.

AIDI is based on four components: (i) Transport; (ii) Electricity, (iii) ICT, and (iv) Water & Sanitation. These components are measured by 9 indicators that have an impact on productivity and economic growth. The AIDI measures the following indices: total paved roads, total road network, number of internet users, electricity generation, access to improved water sources, improved sanitation facilities, total phone subscriptions, fixed-line phone subscriptions, mobile phone subscriptions, number of internet users, fixed broadband internet subscribers and international internet bandwidth.
Tier-two Sectors

As well as our priority sectors of vehicles, electrical machinery and infrastructure, there are many other opportunities in other parts of the economy. We have profiled three further examples below.

Textiles

Opportunities for garment manufacturing are available in Sudan, Eritrea and Djibouti — although the level of existing textile industry in each of these countries varies. The opportunity to invest is enhanced by the preferential trade agreements available to Least Developed Countries. For example, the European Union initiative “Everything But Arms” grants duty and quota free access to the European Union; and the Africa Growth and Opportunity Act (AGOA) grants preferential access to the United States. South Korean firms are taking advantage of these in other markets (for example, South Korean firm “Sea-A” has set up a textiles plant in Haiti to take advantage of preferential trade agreements) — and there is opportunity to bring Korean investment to these sectors in the Horn of Africa. A delegation of Korean textiles manufacturers visited Ethiopia and Kenya in 2016, both of which serve as entry points to the wider Horn of Africa, to conduct initial field work on the suitability for textiles investment.

Agriculture

This is the largest single sector in the Horn of Africa (approximately 35% of total GDP), with coffee the number one export from the Horn to Korea. Agricultural transformation is also key for the AfDB as it strives to boost food security through its ‘Feed Africa’ focus, one of its five strategic priorities, the ‘High Fives’. However, in South Korea, agriculture contributes just 2% of the economy. South Korea has deep technological expertise, and so there may be opportunities to boost food production using technical support and transferrable innovation. In 2016, Lotte Confectionary became the first Korean food company to enter the African market, when they set up their operations in Kenya.

Extractives

In the more challenging markets in the Horn of Africa (i.e. Eritrea, South Sudan, Somalia), oil and mining (especially gold) have historically been the source of the majority of private sector investments. Typically these kinds of investments are investor-led rather than facilitation-led, given the need for detailed groundwork assessments.

There are “huge opportunities for Korean investment in the Sudan.” — Minister of Information for Sudan
Mutual interests

Both Korean investors and private sector players in the Horn of Africa have expressed interest in increasing their connections, particularly through new investments. Each has its own reasons to find these investment opportunities appealing, but both are ultimately aligned in that additional Korean investment in the Horn of Africa is welcome.

From the Korean perspective, many investors are looking to diversify away from their current geographic portfolio i.e. South East Asia. The Horn of Africa represents a sizeable market that has demands for the types of services Korean companies are placed to offer.

At the same, public stakeholders in the Horn of Africa are investing domestically to ensure their business environment is attractive to foreign investors, like the Koreans. They are taking steps to set up the necessary infrastructure, such as industrial parks with subsidized utility costs, provide a seamless investment process through one-stop-shop services to set up businesses, and prove additional incentives such as tax holidays, custom duty exceptions or priority access during foreign currency shortages. As these countries continue to implement favourable policies, the attractiveness of the region will grow.

Transition countries in the Horn of Africa are also keen to engage with Korean investors, as compared to their peers. Korea’s level of technological innovation is admired. Korean products are considered great value for money – although slightly higher priced than competitor products, they are more durable and reliable. Countries in the Horn of Africa are excited not only by access to these products, but also by the possibility of knowledge transfer from such a well-regarded player. Countries in the region also find the possibility of combining low-cost funding from KEXIM bank, albeit limited, with project execution capabilities, an attractive value proposition.
The Way Forward – Overcoming Current Barriers

Despite this mutual interest to grow their relationship, there are challenges that hinder both sides from fully engaging. These are typically based on past investment experiences or perceptions on the political and business environment. Continued efforts from both transition countries in the region to strengthen their business environment, and from Korean investors to adapt their approach to suit the specific regional context, are required to overcome these challenges.

Transition countries could significantly enhance the attractiveness of their markets to Korean investors by providing a more stable policy environment and ensuring their governments are a reliable partner for investors. Korean businesses are often weary of conducting business in the Horn of Africa given the past and current political environment. The high turnover within government departments can result in a lack of clarity and changing business policies, specifically around establishment of an international business and foreign investment policy. Moreover, Korean businesses are hesitant to collaborate on government projects due to these changes.

Additionally, transition countries in the region could implement policies to strengthen the supply of key inputs to allow Korean business to operate effectively. Most of the countries in the Horn of Africa have a constrained supply of foreign currency and Korean businesses have previously experienced trouble securing letters of credit to finalize business deals or accessing foreign currency to meet their operational needs. The region also suffers from a shortage of highly skilled manpower, and certain tech intensive Korean businesses must provide their own human capacity building to successfully operate. Unfortunately, due to limited infrastructure, Korean investors struggle to find international staff that are willing to relocate to the area. Without the required capital and human resources, it can be difficult for Korean businesses to flourish.

Korean investors looking to invest in the region could benefit from adjusting their risk appetite and streamline their decision making to allow them to better compete with other players. Transition countries in the Horn of Africa often view Korean investors as more onerous to deal with, due to required investment of time and capital to close a deal. Korean investors generally have a lower risk appetite compared to other emerging market actors i.e. Chinese, Indian and Turkish players. This is compounded by the fact that Korean conglomerates are often highly bureaucratic and hierarchical, meaning that country level heads and middle level managers are not empowered to make decisions. Investment related decisions are reserved for senior executives in the head offices which creates delays and can lead to local stakeholders quickly growing frustrated and pursuing alternative partners.

In addition, Korean companies could explore and offer additional financing solutions that are better adapted to the needs and capabilities of local partners, and are more competitive relative to other actors. Korean investments are often seen as more financially expensive by local partners. Most Korean companies do not provide funding for their projects and expect local partners to secure private funding from development banks, therefore limiting the number of local parties they are able to collaborate with. This limits possibilities to invest in countries like Somalia, Somaliland and Eritrea, that have limited to no engagement with international development partners. In trade relationships, Korean companies expect upfront payments or provide short credit facilities, which does not match with the credit offerings provided by competitors i.e. Chinese and Indian companies. On top of this, Korean projects are 15-20% more expensive, on average, than the competition, albeit higher quality. The higher price coupled with lack of financing options causes many African businesses to seek alternative partners.

The Korean government also has a role to play in creating an enabling environment for Korean investment in the Horn of Africa. In contrast to China, Korean companies have argued that they have limited government support when pursuing overseas investment opportunities particularly in Africa. Furthermore, Korean foreign policy prohibits travel to some transition countries, thereby making the possibility of business collaboration difficult.

While these markets can be highly challenging, there is a strong potential for outsized returns. As the Horn of Africa continues to improve its political and business environment and Korean companies become more comfortable with the region, the possibility for investment will continue to grow even further.
Conclusion

This report outlines the investment opportunity in the Horn of Africa, alongside some of the most promising sectors for Korean investment. Investing in the markets listed in this paper, which are still in transition, may allow the investor exposure to opportunities which are not commonly available—and allow the investor to gain a strong foothold in high-growth markets before they become mainstream. Of course, all investments carry risk, and full analysis of any opportunity must be conducted before launching the venture.

To find out more, please visit: https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/fragility-resilience/promoting-private-investment-in-transition-states/

For support with investment facilitation, to understand the local markets better, or to request a copy of the full report, please contact the African Development Bank, on the details below.

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