

Sizing Up Luxury Goods Opportunity In Africa's Frontier Markets

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Kenyan consumers Foreign investors are flocking in their droves to sub-Saharan Africa, attracted by some of the fastest growing economies in the world and by projections of a bulging middle class.

Is this the next frontier for luxury goods, or is the opportunity more hype than substance?

Africa's new gold rush

The dust has barely settled on London 2012, but there is already talk of who might bid for the 2024 Olympics (Rio de Janeiro will host 2016, and the 2020 short-list is made up of Madrid, Tokyo and Istanbul). The 2024 race is almost certain to include a US heavyweight, probably New York or San Francisco. But, expect to see a sub-Saharan African city in the mix too.

Kenya's Nairobi is a probable bidder and would fully expect to win, with or without a US metropolis as rival. This is because Sub Saharan Africa has a newfound global confidence, fuelled by its burgeoning economic prowess. GDP in Kenya, for example, is projected to grow more than 200% at US dollar prices over the period 2011-2020, according to data from Euromonitor International.

A host of frontier (off-the-beaten-path) African economies are projected to show double-digit compound annual growth (CAGR) to 2020, which is why so many yield-hungry investors are digging around for untapped opportunities. The region's youthful demographics, maturing political infrastructures and abundant natural resources are fuelling the gold-rush climate.

What is more, Africa's frontier markets are promising to bud at a time when growth in the BRICs is set to slow. South Africa itself, the continent's standout emerging market of the past decade, is entering a period of softer growth, reflecting sluggish activity in the mining sector.

Investment in Sub Saharan Africa still carries plenty of risk, however. Economic and political fundamentals might be stronger than a decade ago, but stories of corruption, conflicts and instability are never far from the news headlines, and are often enough to deter more cautious investors.

Even investors who are currently active in the region will acknowledge that the best opportunities are typically opportunistic. And there is still the tricky issue of how easy it is to get money out, once an inward investment has been committed.

Those notes of caution in mind, is frontier Africa in its current state of development realistically accessible to luxury goods manufacturers and retailers and is now the right time to build stronger positions, along the lines of emerging Asia and Latin America? Or, is there a case for a more prudent and patient approach, taking a long-term view and building a growth strategy for the future?

Social classes A and B hold the key to growth

In emerging Asia and Latin America (China and Brazil, in particular), the key to luxury goods development over the past decade has been firstly, the growth of a new super-rich consumer base – there are now over a million US dollar millionaires in China, for example – and, secondly, in the growth of an aspirational middle class. The latter has helped fuel strong demand for affordable luxury goods, such as sub-US\$1,000 luxury handbags and diffusion brands of designer labels.

Africa is a long way behind both emerging Asia and Latin America in terms of the size of its middle class, but the combination of rapidly growing economies and youthful populations auger well for the next ten years (and beyond). Equally, a recent spate of oil and gas discoveries – and the high probability of more to come, for example in Ghana (oil) and in Tanzania (gas) – could provide a get-rich-quick spawning ground for a new generation of high net worth individuals (HNWIs).

Indeed, in terms of Social Classes A and B, sub-Saharan Africa appears on the cusp of a major growth spurt. In Kenya, for example, Social Class A is forecast to grow by 28% between 2011 and 2020, according to data from Euromonitor International. That is one of the highest projected growth rates in the world for A-class consumers. Social Class A in China, for example, is forecast to grow by 4% over the corresponding period, while in Russia it is forecast to contract 2%.

In terms of actual (absolute) growth, Kenya's Class A consumer base would expand by 839,200 people to 2020, which is a bigger increase than in many higher profile emerging markets, including Turkey, Saudi Arabia, Vietnam, Colombia and South Africa. Kenya's Social Class B is also forecast to show one of the world's biggest growth rates between 2011 and

2020, bulging by a projected 590,000. That is almost four times the projected absolute growth of South Africa's B-class.

These socio-demographic projections show that Kenya could become an important engine of growth for luxury goods , spearheading potentially a new era of opportunity across Sub-Saharan Africa, especially post-2020. If Nairobi was to host the 2024 Olympics (and the IOC has declared it would be receptive to a strong African bid) there would almost certainly be a big upside in terms of retail investment. This is happening now in Istanbul (bidding for 2020) with its shopping mall boom.

There is already upward momentum in retail real estate investment in Nairobi. Garden City, a 32-acre mixed-use retail development on the city's Thika Highway will be the largest retail mall in East Africa when it opens in mid-2014, for example. Its developer, Actis, built Nigeria's first shopping mall (The Palms) in 2006, and Ghana's first A-grade shopping mall (Acera) in 2008. This type of modern retail initiative will be key to the potential accessibility of luxury brands.

South Africa and Nigeria afford some insight into potential demand Consumers' appetite for luxury goods and the extent to which aspiration consumption culture might take root in frontier Africa are difficult to predict. Those factors were easier to get a handle on in emerging Asia and Latin America, not least because Hong Kong " in the case of Asia " and Miami, in the case of Latin America, were showcases of luxury branding that many consumers aspired to. There is no obvious retail luxury magnet for Sub-Saharan Africa.

South Africa and Nigeria are the region's main emerging markets (rather than frontier markets) and, as such, do afford some insight into regional luxury goods demand. According to Euromonitor International, Nigeria was the second fastest growing market in the world for champagne between 2006 and 2011, with CAGR of 22%. Total consumption reached 752,879 bottles (75 cl) in 2011 (higher than in Russia or Mexico), and placed Nigeria among the top 20 champagne markets in the world.

And in luxury cosmetics, South Africa was one of the world's strongest growth markets over the period 2006-2011 with retail spending (at fixed US dollar prices) showing CAGR of 15%, according to Euromonitor International. That valued South Africa's total premium cosmetics market at around US\$773 million in 2011. In both South Africa and Nigeria there are signs that luxury goods culture has taken root, therefore. And that bodes well for the frontier markets.

A risk too far, or an opportunity too good to miss?

What seems clear is that any new luxury goods venture into frontier Africa needs to be motivated by long-term rather than short term potential. The most significant growth stories " and returns on investment - will probably not happen until post 2020. That is a long way hence, and in the meantime there are richer pickings for luxury goods manufacturers and retailers in emerging Asia and Latin America. That would probably be the view taken by many company shareholders, for example.

Equally, by building a new position in a market such as Kenya there would be an opportunity to develop brand heritage for the future. And that could turn into a key point of competitive differentiation post 2020. Furthermore, the prized retail real estate locations of the future will be markedly better value today than in five or ten years' time.

It comes down to global strategic priorities and economies of scale. For the world's biggest luxury goods companies , frontier Africa looks to be a long-term opportunity too good to miss. As such, markets such as Kenya ought to become part of their position building portfolios sooner rather than later. For smaller and mid-sized players, short-term investment could present more pitfalls than opportunities. This is because the sweet spot of the opportunity is simply too far into the future.

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