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Why are German firms reluctant to invest in Africa?

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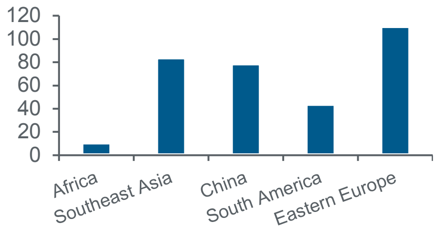
When we look at the distribution of German foreign investment, we must admit that only few companies invest in Africa. This contrasts with the former colonial powers France and Great Britain, as well as the US, which have a much stronger presence there. A shared language and cultural proximity through the African Diaspora are major reasons for this. German firms, on the other hand, focus on Asia and Central/Eastern Europe. Their direct investment portfolio is more than ten times higher in these regions than in Africa.

Figure 1: Foreign direct investment by world region

In USD billion



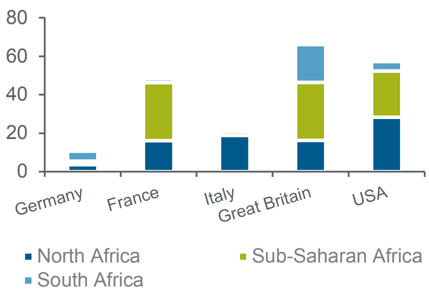
Sources: OECD, Deutsche Bundesbank, own calculation

Firms from France, Great Britain, Italy and the US have invested more in Africa than any other OECD country. Besides, direct investment is unevenly distributed across the African continent. German firms concentrate almost exclusively on North Africa (especially Egypt) and South Africa. There is hardly a German firm to be found between Cairo and Johannesburg. Firms from other major industrialised nations are spread out across more regions. US, British and French enterprises have undertaken significantly more direct investment in North Africa and Sub-Saharan Africa.

Foreign direct investment is motivated by new sales opportunities, lower production costs and natural resource extraction. In Africa, sales prospects are low because of the development gap and the small middle class. The continent's low level of industrialisation is another reason for German firms' reluctance. Germany has so far been able to play its strengths in engineering, machinery and automotive construction only in parts of the continent – north of the Sahara and in South Africa. The past has shown that German firms only find sales markets for their relatively expensive and technically sophisticated products where the middle class is growing, e.g. in Asia. The degree of industrialisation there is higher and its middle class larger. German enterprises therefore find adequate sales markets in Asia. Central/Eastern Europe is a low-cost production region close to European sales markets. North Africa would surely fit this description as well. But German firms prefer Turkey for its historic political stability and good infrastructure.

Figure 2: Geographic distribution of direct investment in Africa in 2016

In USD billion

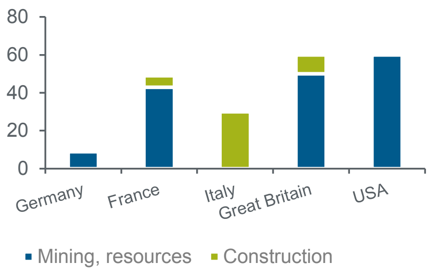


Source: OECD, own calculations.

Africa is one of the world's largest exporters of resources, which account for around one third of exports (as at 2016). The share of primary products in exports is higher here than anywhere else in the world. This also impacts on the possibilities for German firms to do business and set up production facilities on the ground. The crude oil and mining sectors are dominated by firms from Great Britain, France, Italy and the US. German firms in the sector are small compared to their international peers and, with few exceptions such as RWE and Wintershall, for example, are hardly concerned with resource extraction. German businesses have also been able to participate in only a fraction of Africa's construction boom. The reason is that there are very few German construction firms left, or they have been taken over by international companies, e.g. Hochtief as a subsidiary of Spain's ACS Group, or they are being restructured. These are also reasons that explain why German firms are challenged in Africa.

Figure 3: Sector distribution of direct investment in Africa

In per cent of the relevant country's total investment portfolio



Sources: Bundesbank, BdF, OECD, ONS*

But as Africa's economy develops with a growing middle class, increasing degrees of complexity and falling market risks, there is a chance that German firms will be able to increase their participation and, in this way, expand their involvement in Africa through direct investment as well. ■

* No data available on the mining and resources sectors for Italy and construction for the US.