Opinion **Africa**

Commodities: Destination Africa

Trading houses are looking at the vast potential that lies in meeting the continent's surging consumer demand

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An economy to fuel: heavy traffic, common on roads such as the Lagos-Abeokuta expressway, helps make oil demand in Africa among the fastest growing in the world

Javier Blas in Lagos, Nigeria NOVEMBER 10 2013

At the food processing plant he runs in Lagos, Mukul Mathur describes the thousands of miles that his tomatoes travel. At first, their odyssey between Nigeria and California appears unremarkable in an age of globalisation.

Mr Mathur would seem to be just another trader buying raw materials in Africa and selling them to distant, wealthier markets. But he actually runs a supply chain at odds with old, colonial-era trade routes.

“We farm tomatoes in California, process them into triple concentrate and ship them to Nigeria,” Mr Mathur, an Indian-born trader, says at the $12m plant that Olam, a leading commodities house, opened in Lagos this year. “We process the concentrate here and package the tomato to sell it to consumers,” he adds, holding a sachet of 70 grammes of tomato paste that fetches 25-30 naira (10 to 20 US cents) in the ubiquitous kiosk-shops in Nigeria’s biggest city.

The California-to-Lagos commodities supply route would have been unthinkable only a decade ago, when international businesses still considered Africa a continent of declining economic activity. But as economic growth accelerates, driven by increasing political stability, booming populations, the spread of mobile telecommunications, high commodity prices and surging foreign direct investment, so does commodities demand within Africa.

For the trading houses, this is a big new opportunity that is upending their traditional business model.

“Africa is fundamentally changing,” says Ketan Patel, managing director of Export Trading Group, a commodities trading house in Tanzania which counts Carlyle Group, the private equity firm, as major shareholder. By 2020, he explains, “Africa will be majority young and urban, with an expanding middle class and they will demand energy and food.”

In the jargon of the industry, Africa has been an “origination” business since colonial times, providing raw materials for overseas consumers: gold from South Africa, coffee from Ethiopia, crude oil from Nigeria, cocoa from Ivory Coast and copper from Zambia. This business model is still crucial to the big trading houses and exporting Africa’s commodities has funnelled millions of dollars into the hands of foreign tycoons.

But over the past five years, a new "destination" business has emerged. The commodities traders say that this shift to supplying African consumers means that they are moving away from colonialist models. While they concede their motives are hardly altruistic, they argue that the business of selling to the booming sub-Saharan market is more of a boon to regional development, linking African consumers into broader international markets.

"Africa's potential is huge," says Ivan Glasenberg, chief executive of Glencore Xstrata, the world's top commodities trader.

The International Monetary Fund forecasts that the sub-Saharan African region will be the second fastest growing in the world in 2014, behind only developing Asia, which includes China. Such robust economic growth means that Africa is moving away from being "just a low-cost production centre" into also a demand centre, says Sunny Verghese, chief executive of Singapore-listed Olam. "Africa's economic growth over the last decade has been above trend, only next to Asia," he says.

Olam is far from alone in its passion for Africa. Other big commodities trading groups, including Vitol and Trafigura of Switzerland, have invested billions of dollars in the continent over the past five years to cater to consumers there.

Cargill, the world's largest agricultural commodities trader, is exploring its first investment in Nigeria, looking at farming cassava locally to produce starch and sweeteners for the domestic food industry. Louis Dreyfus Commodities, its agribusiness rival, is also investing into Africa, recently forming a joint venture with the Willowton Group of South Africa to sell packaged rice to consumers there.

Booming demand for commodities is not unique to Africa. Asia and Latin America also have voracious appetites for raw materials but, in their case, state-owned companies play a larger role in the commodities business. Africa gives the trading houses far greater leeway in their operations.

The new destination business is creating supply chains that look a world apart from what the industry has been used to for decades. For example, Saudi fuel oil is flowing into Kenyan power stations; wheat from Kansas is arriving at flour mills in the Tanzanian port of Dar es Salaam; Chilean copper is consumed in South Africa, and Thai rice is a staple in Nigeria.

Striking a note of caution, some traders observe that it would be misleading to compare Africa's immediate needs with those of Asia.

Some commodities businesses in Africa are conspicuously lagging – in particular metals and minerals such as copper and aluminium. Traders say imports of these metals will only accelerate once African countries embark on costly infrastructure programmes in power, railway and public buildings, much as India and China have.

Other commodity traders are even more dismissive of the "Africa Rising" mantra, branding it hype outside a few pockets of strength in commercial magnets such as Nairobi and Lagos. For all its recent progress, Africa remains poor and many obstacles, from rickety infrastructure to corruption, remain.

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But demand is only expected to rise. African countries have been growing at breakneck pace over the past decade, breaking away from a 30-year period of lacklustre performance. According to the International Monetary Fund, the sub-Saharan Africa region expanded at an average of 5.6 per cent a year between 2000 and 2012, more than double the 2.2 per cent of the 1990s. The robust economic expansion has lifted gross domestic product per capita in spite of booming population growth. In 1999, African income per capita was the same as it had been 25 years before, according to the Conference Board, a research organisation. But since then it has jumped almost 40 per cent.

The commodities houses are attracted to the African destination business for three reasons. First, demand is rising fast, in many cases at double-digit annual rates. Second, many African governments subsidise basic commodities such as petrol and wheat, in effect guaranteeing a return to the traders. Third, most African countries lack the infrastructure needed to import raw materials, from silos for storing wheat and rice to terminals for unloading petrol. The commodities houses say that, as they build this infrastructure, they will be able to secure a market and benefit from years of rising demand.

So far, oil leads demand growth in Africa. The International Energy Agency believes Africa is set to "provide one of the fastest paces of global oil demand growth in the medium term", rising by an average of more than 4 per cent annually between 2012 and 2018, double the rate in Asia and far above the global average of 1.3 per cent for the period. "The region's rapid income gain means that great leaps in demand growth may be on the cards," says the IEA.

Oil traders including Vitol, Trafigura and Oryx Energies of Geneva have positioned themselves to profit from the surge in the destination business. Jean Claude Gandur, the businessman behind Oryx, has no concerns about tempting fate with his bullish projections. "We cannot see the end of this market," he says.

This growth in oil demand comes from obvious places, such as motorists in Nigeria and Kenya. But it also hails from more obscure areas such as imports of bitumen to seal thousands of miles of roads across Africa and the millions of cylinders of liquefied natural gas that are replacing wood and charcoal for cooking from Burkina Faso to Tanzania.

Vitol, the world's largest independent oil trader that once only specialised in exporting crude oil from Africa to Europe and the US, now boasts the third-largest network of petrol stations in Africa. Its 1,400 outlets in 15 countries trail only Total of France and Engen Petroleum of South Africa. The trading house, which is based in Geneva, bought the petrol stations in 2011 from Shell for about $1bn. Vitol's partner in the deal was Helios Investment Partners, an Africa-focused private equity group.

The partners in Vivo Energy, the new company, each hold a 40 per cent stake, with Shell remaining an investor and keeping a 20 per cent stake. Vivo plans to spend over $250m in Africa during the next three years expanding its business to profit from the increase in local demand for refined oil products. "We are talking about some countries that are moving from walking and bicycles to motorbikes and cars, boosting consumption," says Mark Ware, executive vice-president at Vivo Energy.

Trafigura has followed suit, acquiring for $296m – through its subsidiary Puma Energy – the network of petrol stations that BP owned in Africa. Since then, Puma has invested another $1bn to expand its presence.

Christophe Zyde, chief operating officer for Africa at Puma Energy, says the continent offers a rare combination of enticements. "Some emerging markets have either strong demand growth or [a] need for infrastructure. But it is rare to find markets where both the demand is booming and there is also a strong need for infrastructure. Africa has the two," he says.

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Shipping agricultural commodities into Africa has also become a far more important business. In the 1980s and early 1990s, food traders grew exasperated with Africa due to sluggish import growth and slow economic growth. According to the US Department of Agriculture, Africa imported in 1995-96 about 27.5m tonnes of grain, the same as in 1983-84. But that changed in the late 1990s as economic growth began to accelerate. In just over a decade, grain imports jumped from less than 30m to more than 70m tonnes.

Louis Dreyfus Commodities has led the food traders in building a destination business in Africa. Guy de Montule, a senior executive at the company, says starkly that the consumer market for food in Africa is “going to be giant”. Backing its optimism with acquisitions over the past three years, Louis Dreyfus has bought SCPA-Sivex International, the leading distributor of fertilisers and pesticides in west and central Africa and Gulf Stream Investment Limited, a vegetable oil storage terminal in Mombasa, Kenya. It has also recently formed a joint venture with Willowton Group, the South African crushing company to sell packaged rice.

Cargill already supplies flour millers in west and east Africa. Only five years ago, very few people could have imagined that the prospect of selling all these commodities– including Mr Mathur’s tomatoes – inside Africa could have sparked such excitement.

Domestic production: Needless dependency on imports

The rise in Africa’s commodity imports certainly highlights the continent’s strong economic growth over the past decade. But it also exposes the weakness of local food production and oil refining capacity. Both have been hobbled by inadequate government policies and investment.

Nigeria exemplifies the problem. The country is Africa’s largest crude producer, pumping about 2.5m barrels per day. With domestic consumption of about 300,000 b/d, Nigeria should be able to bypass the trading houses and instead refine enough petrol, diesel and other products at home. Instead, every day it buys about 80 per cent of its refined products from commodities trading houses because its four domestic refineries are old and in need of maintenance, according to the US Energy Information Administration. The country’s four refineries operated only at 24 per cent of their capacity in 2011.

Other African countries are struggling to build refining capacity, providing exporter-oriented refineries in Europe, the Middle East and India with an outlet for their products. Oil is not the only commodity that Nigeria buys from international traders. The country is the second-largest rice importer, behind only China. Until the early 1970s, Nigeria was self-sufficient in the grain but it abandoned much of this production, using petrodollars instead to buy high-quality rice on the international market. Agronomists say that Nigeria could be self-sufficient again – and even become a regional exporter – as the country has fertile farmland and the weather could even support rice crops.

Nigeria is not alone. Across Africa, countries have become dependent on imported food and, in turn, on global commodities trading houses. According to the UN Food and Agriculture Organisation, Africa spent $21bn in 2000 importing food. By 2011 – the latest annual data available – the bill had grown to $81bn, boosted by both higher agricultural commodities prices and much larger volumes. The FAO estimates that Africa imports today about 40 per cent of the food it consumes, compared to just 10-15 per cent in the 1960s.

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Letter in response to this article:

Commodities imports pose problem for 'destination' Africa / From Mr Ejeviome Eloho Otobo