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Investing in Shea in West Africa

A U.S. Investor's Perspective

West Africa Trade Hub Technical Report



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Cover photos

Left: Women processing shea nuts using traditional methods.

Right: A woman arranges shea nuts on a drying rack.

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3 Acronyms and Abbreviations

AAK	AarhusKarlshamn UK Ltd
ASEPEX	<i>Agence sénégalaise de promotion des exportations</i>
BRIC	Brazil-Russia-India-China
BRVM	<i>Bourse Régionale des Valeurs Mobilières</i>
CBE	cocoa butter equivalent
CIA	U.S. Central Intelligence Agency
cif	cost, insurance and freight
EU	European Union
FASB	Financial Accounting Standards Board
FAO	U.N. Food and Agricultural Organization
FDIC	U.S. Federal Deposit Insurance Corporation
GDP	gross domestic product
HIPC	highly-indebted poor country
ICCO	International Cocoa Organization
IDA	Infrastructure Development Association
IT	information technology
IPO	initial public offering
lbs	pounds
MT	metric ton
SDR	Special Drawing Rights
SME	small and medium enterprise
UBA	United Bank for Africa Group
UNIFEM	United Nations Development Fund for Women
WHO	World Health Organization

4 Introduction

Africa is poised for continued growth and development resulting from reforms undertaken by countries that have attracted investment to the region. Notably, Africa has achieved significant GDP gains over the past decade. From 2004 through 2008 growth was in excess of 6%, however, this growth remains uneven and many countries are still dependent on commodity exports. In order to achieve sustainable economic expansion, Africa must diversify its economies away from commodities exportation towards a value added industrial base and services sector. There remain major structural impediments to this type of industrial development with the remedies lying in governments and donor agencies making investments in essential infrastructure improvements in electrical power, sanitation and transport. The World Bank recently announced that the Infrastructure Development Association would increase its facility for Africa from \$600 million to \$3.6 billion for investments to upgrade this type of infrastructure and allowing Africa the opportunity to lay a firm foundation for the development of a much needed value added industrial base and services sector.

However, other obstacles remain that hamper the development of a value added industrial base and services sector such as the inefficiency and underdevelopment of the banking sector and financial markets in Africa relative to the rest of the world. Availability of credit is a major issue identified by companies and banks alike as a barrier to the economic growth and development of the entrepreneurial class, which negatively affects Africa's competitiveness globally. The main reasons for the lack of credit availability are centered on transparency and accurate pricing of risk. The institutional infrastructure that would allow banks to collect and evaluate information on borrowers is primitive and there are few remedies in the form of injunctive relief or insurance protection; therefore, the banks will not expand lending unless they can make sound business cases for doing so. Financial market development is closely linked to the banking sector. Many people in Africa remain "unbanked"; so, significant portions of economic activity are informal and untracked by economists. These uncaptured capital flows lead to a substantial liquidity leakage from financial markets and the underdevelopment of an institutional investor class, which would form the basis of a sophisticated and efficient financial market.

But thanks to some positive changes in Africa right now, specifically with some projects relating to the banking sector and progress on large infrastructure, these things will be changing. There is opportunity in West Africa for investment!

5 Objective/Methodology/Purpose

The Trade Hub examined the shea industry in detail for this analysis. The sector was analyzed and evaluated in terms of Africa's general economic and financial development, its overall market dynamics, its competitive position globally, structural issues constraining or contributing to potential growth, export potential, potential for investment and U.S. demand for the sector's products.

6 Executive Summary

The shea crop is unique to sub-Saharan Africa and in high demand from several world markets. Of the estimated 600,000 tons of shea nuts harvested in West Africa, about 350,000 tons are exported, mostly as raw nuts. The remaining 250,000 tons are processed and consumed locally and effectively left out of the traded market. Currently 90% of shea demand comes from the confectionary industry affording chocolate manufacturers an alternative to cocoa butter. Shea also has a high demand in natural cosmetics sectors, which could serve as an important source of diversification of demand. The market dynamics in the global market for vegetable fats are complex and generally dominated by publicly traded commodities, while the shea market is highly artisanal and fragmented. This presents an ongoing challenge to properly value shea and its supply network relative to other fats (palm oil and cocoa butter in particular). Palm oil represents about 40% of the total world vegetable fat production and the shea market is small in comparison to either palm oil or cocoa butter; therefore, it is unlikely shea will compete with either as its production is simply too small to meet world demand in personal care or food use. However, shea has tremendous potential as a niche input to high-end cosmetics products. The shea industry is subject to structural issues – reliable electric power, transport and access to financing. The path to development for shea lies in the investment of processing equipment, skills training, and most important, organizational restructuring of the supply chain.

7 Overview of Africa's Business Climate

Developing African markets represent the last frontier in emerging markets investment. The next decade will present tremendous opportunities to patient investors as Africa moves from a continent of underdeveloped markets to one of vibrant, dynamic economies. However, significant risks compromise Africa's competitiveness as much of its physical and institutional infrastructure lags behind the rest of the world. Comparing Africa today to the BRIC (Brazil-Russia-India-China) countries of 15 years ago can offer direction on ways to move forward. Those countries moved squarely out of the low-income status to middle- and upper middle-income status due to reforms they undertook, attracting foreign investors interested in higher returns than they would have achieved in the developed world. Africa is poised to enter a new phase of growth, which should attract sustained investment to the region. Provided that governments continue making reforms to improve the business climate this growth has the potential to bring lasting and tangible benefits to its people. The Investment Climate Facility for Africa, a private-public partnership, actively works with African governments to help decrease the levels of bureaucracy constraining efficiency in a move to improve operating environments, which in turn attract investment. This was critically important as the global financial crisis has hit the developed world, increasing the likelihood that foreign direct investment in Africa will slow.

This past year, according to the World Bank's 2009 *Doing Business* report¹, Africa instituted more reforms than in any year since the year the report was first published, and two of the world's top ten reformers are located in West Africa – Senegal and Burkina Faso.² The report presents a qualitative analysis of business regulations and protection of property rights that can be compared across 181 economies worldwide and across time. Specific metrics measured include: time to start a business, dealing with construction permits, employing workers, registering property, acquiring credit, protecting

¹ <http://www.doingbusiness.org/features/DB2009Report.aspx>

² World Bank, *Doing Business 2009*, p. 1

investors, paying taxes, trading across borders, enforcing contracts and closing a business. All are critical factors assessed by investors when looking at investments in developing countries. Of all the countries the West Africa Trade Hub works in, Ghana ranked highest on the list at 87 and Guinea-Bissau was the lowest at 179. For context, Brazil was 125, Russia was 120, India was 122 and China was 83. Mauritius was the highest ranked African country at 24. The United States was 3.³ Africa has a stigma about its business climate – 17 of the 20 most difficult business environments in the world are African countries. Interviews conducted for this report with both private African companies and investors in the region confirmed that access to financing is one of the primary constraints to doing business. Transparency and access to information is what concerns investors most while cost of financing is the most difficult issue faced by companies.

7.1 African Economics

The potential to create sizeable markets for goods and services in Africa is tremendous, as it possesses abundant natural resources, ample arable land⁴, and 15% of the world's population at 1 billion people.⁵ In terms of economic output, Africa's GDP growth has well outpaced that of the OECD for the last decade but the continent remains very underdeveloped relative to the size of its population: the average GDP per capita in PPP terms for Africa in 2008 was \$3,178 compared to \$47,000 for the U.S., \$33,400 for the EU, \$10,100 for Brazil, \$15,800 for Russia, \$2,800 for India and \$6,000 for China.⁶ The wealthiest country in Africa was Seychelles at \$23,294 and the poorest was Liberia at \$500⁷. In West Africa, Ghana and Nigeria, the two most sophisticated economies, have average GDP per capita at \$1,500 and \$2,300, respectively.⁸ Viewed another way, Africa's total GDP was \$3.2 trillion in 2008 or roughly the same size as that of Germany, which has about 82 million people.⁹

Growth has been especially strong in recent years, registering 6%+ in the last four consecutive years¹⁰. The boom in commodity prices has contributed significantly to this growth and there is increasing evidence that these windfalls are having a lasting impact on domestic investment rather than being drained from the economy and sent abroad. Diversification of Africa's economy away from commodity dependence is increasing and will help insulate it from the commodity boom and bust cycle in the future. The transition to production of more manufactured goods and services is critical for Africa to achieve sustained long term growth and increased living standards. This is especially important as world commodity prices have fallen sharply in the past year. Despite the global slow down, growth in Africa is still expected to outpace world GDP, although it will be significantly affected – recent World Bank

³ World Bank, *Doing Business 2009*, p. 6

⁴ According to a 2006 UNEP study by the FAO, Africa's potential arable land is 300 million hectares and that less than half is being used for agriculture currently. West Africa had the highest arable land use at nearly 60% of capacity. Data from FAOSTAT land use.

⁵ U.S. Census Bureau, <http://www.census.gov/cgi-bin/ipc/idbrank.pl>

⁶ CIA World Fact Book, April 2, 2009.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

¹⁰ World Bank, *Doing Business 2009*, p. 2

revisions on GDP growth for sub-Saharan Africa are now coming in at 2.4%, down from 4.8% at the onset of the global financial crisis.¹¹

While growth in Africa should rebound as the world economy recovers, it is unclear how deeply the financial crisis will affect its economies. Sovereign credit quality is at risk of continued decline, currencies will continue to weaken against the dollar and the Euro and government budget deficits are likely to widen with renewed inflation risks; therefore, significant downside investment risks remain.¹² In March 2009, Fitch Ratings downgraded Ghana's long term sovereign debt to negative from stable, citing widening current account imbalances, high inflation despite a slowing economy and increasing budget deficits. This will further constrain the country's ability to borrow and its currency will remain under pressure, attracting less outside capital and forcing Ghanaian banks to charge yet higher rates for loans. Ghana, which made its debut on the international Eurobond market in 2007 selling \$3 billion of bonds¹³ to investors in the U.S., UK and Europe and the first former heavily indebted poor country (HIPC) to do so, is one of only a few countries in Africa to issue sovereign debt on international markets, the others being Morocco, Egypt, South Africa, Gabon and Seychelles.

7.2 African Financial Market

Financial markets in Africa are small and in many cases thinly traded relative to markets in the developed world. Total African stock market capitalization is about 1% of total world stock market capitalization, or about \$320 billion,¹⁴ roughly the same size as that of Exxon Mobile or one half that of the Zurich SXE. South Africa's markets comprise about 90% of that amount, followed by Nigeria at 5% and the rest of Africa at 5%.¹⁵ There are 25 public exchanges in Africa and West Africa has six: Cameroon, Cape Verde, Ghana, Nigeria, which has both equities and commodities exchange, as well as the BRVM of the West African Monetary Union countries.

The BRVM (Bourse Régionale des Valeurs Mobilières) is a regional exchange in Abidjan covering the eight countries of the WAMU: Benin, Burkina Faso, Guinea Bissau, Côte d'Ivoire, Mali, Niger, Senegal and Togo. The BRVM is a private corporation established in 1998. Hailed as a technical and political success, the exchange is entirely electronic and provides securities quotation, trading services and regulation/issuing services. These countries would not be competitive with their own markets as they are too small individually to provide enough liquidity to create a viable public market. Burkina Faso, for example, has only one public company. This common market structure makes investment in private West African companies more appealing to investors as exiting the investment via an IPO or sale to another public company is a realistic option. As such, this market could provide a competitive advantage to the region as investment grows.

As the macroeconomic environment improves and formal banking begins to reach greater numbers of the population, these markets will become more liquid. Actors that would create liquidity are also quite underdeveloped relative to world markets. African markets lack a well developed institutional class of

¹¹ World Bank, <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/0,,contentMDK:22122200~pagePK:64165401~piPK:64165026~theSitePK:469372,00.html>

¹² Eurasia Group, Sub-Saharan Africa 2009 Outlook, January 2009, p.2.

¹³ African News Switzerland, <http://www.african-news.ch/?p=268>, September 28, 2007.

¹⁴ Offering prospectus, FMG Africa Fund, February 2009.

¹⁵ Company interview, Greylock Capital Partners.

investors in the form of pension funds, insurance companies, public savings schemes and a broader consumer banking function. These institutions feed liquidity into the market creating an investor base that will make the markets more efficient. However, before a “first tier” investor class, i.e. institutional investors such as pension funds and insurance companies, can develop more of the populace must be formally brought into the banking system. According to IMF estimates, only about 20% of African families have bank accounts.¹⁶ It is therefore difficult to ascertain exactly how much potential liquidity is not being captured in the market as well as how much of the economy generally is informal.

7.3 Access to Financing

Access to financing for trade and investment is probably the single greatest challenge to doing business, as identified by the companies interviewed for this report. Bank lending rates are very high and credit is difficult to obtain if at all. The banking sector in Africa is largely focused on asset management and lending to large companies they perceive to be low risk. In some countries, government requirements further restrain lending to SMEs and individuals. In Ghana for example, a high reserve requirement of 9% set by the government acts as a tax on bank profits since this money has to be placed with the central bank earning no interest. This is required by the government in an effort to protect depositors in the absence of an institutional structure equivalent to the American Federal Deposit Insurance Corporation (FDIC).

Several bankers interviewed for this report conceded that while the SME sector of the market is vitally important to the economy, they simply do not perceive it to be a good credit risk. Smaller companies tend not have professionally audited financials and may have substantial informal business done in cash. Credit rating in Africa is generally very primitive and information collection is difficult. For example 60% of the people in Ghana living in villages do not have an official street address,¹⁷ so the likelihood that they would have a bank account is very low, making information collection on payment patterns to properly price their credit risk difficult. Most banks only want to lend to larger corporations having the equivalent of \$12 million or more of revenue¹⁸ leaving the SMEs with very few options to access credit at reasonable rates, if at all. As such, there is a gap in funding for loans between \$500,000 and \$2,000,000.¹⁹ Loans under \$500,000 have many sources for funding from aid agencies and microcredit institutions while loans over \$2,000,000 are large enough to attract interest from banks.

The real problem is the banking system structure does not compensate banks for taking on risk for allocating the additional capital it would take to increase lending to individuals and small companies. This additional risk has a reasonable chance of reducing the banks’ profits and return on equity, which puts downward pressure on their share prices. In order to convince banks to lend, greater transparency on the real costs of doing business and the real potential profit opportunities from expanded lending is vital. The required institutional reforms needed to achieve this include: a functioning credit rating system to properly assess credit quality and loan performance, courts that enforce contracts and adjudicate on behalf of claimants to a suit, a robust accounting system with a framework equivalent to

¹⁶ African Executive, <http://www.africanexecutive.com/modules/magazine/articles.php?article=3814>

¹⁷ Company interview with a representative of Stanbic Bank.

¹⁸ Company interview with a representative of UBA.

¹⁹ Judd Welsh, financial services consultant to the Trade Hub.

the American FASB, corresponding services capable of preparing audited financials and IT infrastructure that support these reforms and reduces transaction costs.²⁰

²⁰ Chris Barltrop, Senior Financial Markets Advisor, USAID.

8 SHEA

8.1 Shea Industry Overview

The shea tree is unique to Africa. It grows across the semi-arid Sahel region from Senegal to Uganda and has probably been used for thousands of years in food, skin balms, soaps and shampoos, traditional medicines and cooking and lamp oils. The use of shea butter has been increasing steadily in recent years as consumers are demanding better quality natural, minimally processed ingredients in personal care items and food. Shea has long been recognized for its emollient and healing properties, ideal for soothing skin in the dry climate of the region. Reports of its use go back as far as the 14th century.

It is not known exactly how many shea trees there are in Africa; so, it is hard to know the exact size of the potential shea crop. Estimates put the total area covered by the shea trees at about three million square kilometers across Africa. Understanding the changes in parkland tree cover over time is important because shea has a long maturation period, and as such lends itself poorly to cultivation. It takes approximately 20 years for a tree to bear fruit and produce nuts, maturing on average at 45 years. Most trees will continue to produce nuts for up to 200 years after reaching maturity.

Conflicting statistics on shea nut production, processing and exports present an ongoing challenge for the industry. According to Dr. Peter Lovett, a shea expert and technical advisor to the West Africa Trade Hub, the potential nut production in Africa could surpass 1 million tons per year if all 20 nut-producing countries were fully participating in the market. But shea buyers seek product mainly from eight countries which are able to produce in the quantities and stearin content demanded by the market: Burkina Faso, Mali, Ghana, Nigeria, Côte d'Ivoire, Benin, Togo and Guinea. The total potential nut

Shea Nuts Exported in 2008 (2007 harvest)²¹	
Country	Tons
Burkina Faso	90,000
Mali	80,000
Ghana	50,000
West Nigeria	45,000
Côte d'Ivoire	40,000
Benin	20,000
Togo	15,000
Guinea	10,000
Total	350,000

production of these countries was estimated to be about 600,000 tons in 2008 and 350,000 tons were exported. The remaining 250,000 tons are thought to be consumed locally as "traditional use." Exports of shea nuts have increased dramatically in recent years, from 50,000 tons in 1994 to 150,000 in 2004 and finally to 350,000 in 2008.

Until recently, as much as 90% of

²¹ Estimates by Dr. Peter Lovett.

exported shea product was raw nuts that were processed abroad. Presently that figure is 65% as processing operations in West Africa have increased in the last five years. Dr. Lovett estimates that 30,000 to 35,000 tons of butter are processed in Africa for export to Europe and Asia for further refinement into value added shea butter to be used in food and cosmetics. Raw shea nut prices have increased steadily in recent years as well. In the late 1990s the average price per ton was \$180, and by 2008 the average price had risen as high as \$800 at its peak to settle at an average of about \$450²². Prices have since fallen along with other commodity prices to about \$250 per ton.²³ At current prices the export value of 350,000 tons of raw shea nuts would be worth \$87.5 million. The total market for shea nuts and butter is projected to expand to \$500 million within five years.²⁴

Most refined shea butter is produced in Europe, which then exports the refined product to manufacturers of food and cosmetics. Most unrefined shea butter comes from producers in Africa who export the product for further refining. This is an important distinction because the higher value added products come from refined shea butter and fractionated stearin sought after by cosmetics and confectionary producers. As such, West Africa currently captures very little of the highest value portion of the value chain. However a notable exception is Ghana Specialty Fats, a joint venture between American agricultural processor Archer Daniels Midland Company and its Singaporean partner Wilmar Holdings, which is processing shea nuts into stearin and oil in Ghana and exporting refined product to confectioners and cosmetic producers in Europe, the U.S. and Asia. The plant has been operational since 2008 and sources its nuts from women's collectives in the northern part of the country. Ghana Specialty Fats' planned shea nut processing is expected to reach 25,000 tons a year, making it the largest shea processor in Ghana.²⁵

8.2 Factors Driving World Demand for Shea

Shea is in high demand in several sectors and world markets. Principal factors driving demand include: continued rising demand for cocoa butter equivalents (CBEs) due to rising world consumption of chocolate, high prices for cocoa, and strong demand for natural cosmetics and soaps. In Europe, North America, and Japan shea butter is highly sought-after for its superior healing and moisturizing properties and is a desired ingredient in creams, sunscreens, soaps, shampoos and conditioners. Commercial interest in shea mostly centers on its use as a substitute for cocoa butter (CBE) in the confectionary industry. This demand comes principally from the EU where shea butter is approved as a CBE in chocolate up to 5%. India is also an important edibles market for shea butter. Shea and other CBEs have not yet been approved for use in food in the U.S. market. The U.S. and Europe are the main markets for shea butter use in cosmetics and natural products.²⁶

The primary factor driving demand for shea butter is rising demand for CBEs as an alternative to cocoa butter in the manufacturing of chocolate. Chocolate and confectionery products account for 90% of

²² Industry case studies, Dr. Peter Lovett.

²³ Dr. Peter Lovett estimates and interviews with company representatives.

²⁴ AllAfrica.com <http://allafrica.com/stories/200904030782.html>.

²⁵ FlexNews, referencing Reuters, <http://www.flex-news-food.com/pages/4320/ADM/adm-wilmar-process-shea-nuts-ghana.html>

²⁶ 3F Ghana, <http://3fghana.com/sheanut.htm>

shea butter demand, with only 10% percent currently used for cosmetics and pharmaceuticals.²⁷ Regulatory changes are the factors likely having the strongest impact on European demand for shea use in CBEs where various European countries have allowed greater use of CBEs in chocolate and other foods. Asia is also an important growth market for CBEs as most Asian countries do not have any labeling regulations against using CBEs in chocolate. Together, Western Europe and Asia consume about two thirds of global CBE production.²⁸ World chocolate consumption is increasing overall, especially in the growing economies of Latin America and Eastern Europe where disposable incomes are rising. Despite the relative maturity of the Western European market, chocolate consumption is still strong and shea butter use in CBEs has been growing steadily since 2000 when the EU approved its use in chocolate. From 2000 to 2005 the global CBE market grew 29% from 20,000 MT to 90,000 MT.²⁹ It should be noted that shea will never be a significant input to chocolate as a change in taste can be detected at concentrations of 15% or more of CBE.³⁰ In many countries, particularly in Asia and Brazil, fats from rapeseed (canola), soybean and cotton seed are also used as CBEs. In the EU the only fats approved for CBE use are palm oil, illipe, sal fat, shea fat, kokum and mango kernel fat. Theoretically any fat rich in the triglycerides found in cocoa butter could be used in formulating CBEs used in chocolate. Choice of fat and its combination with cocoa butter depends on end use and consistency desired.

Consumer awareness around hydrogenated oils as with trans fats has also played an important role in the increased use of shea in CBEs, which is relatively low in trans fats. Palm oil and a number of other oils can be used as CBEs in making chocolate but are high in trans fats which have been found in recent years to be very unhealthy, and linked to obesity. There has been considerable controversy over whether palm oil contributes to heart disease and it is currently the position of the World Health Organization that it does.³¹ The process of hydrogenation makes these fats more saturated (and therefore more unhealthy), but particularly well suited for use in chocolate and baked goods due to their high melting point.

8.3 Comparison of Production Volumes: Shea, Palm and Cocoa

Cocoa and palm oil are commodities traded on public commodity exchanges. Their production volumes and prices are therefore carefully followed and documented by industry analysts and trade associations. Their supply chains are well organized and mature. Shea, on the other hand, is still very artisanal in nature and industry statistics are conflicting and fragmented. Shea is not publicly traded and there is not yet a well organized industry association that gathers industry data on crop production volumes, annual harvest volumes, prices, numbers of producers and their networks, volumes of raw materials exported and consumed domestically, and volumes of refined and unrefined shea butter produced. Data inconsistencies and the specified end use of the raw material make a true 'like-for-like' market comparison difficult; so, a macro comparison of gross volumes of raw materials and fats of each will be discussed to make a point.

²⁷ U.S. Trade Commission, Sub-Saharan Africa: Factors Affecting Trade Patterns of Selected Industries, Second Annual Report, April 2008, p 2-28.

²⁸ Ibid. p. 2-29.

²⁹ Ibid, p. 2-29.

³⁰ FAO, <http://www.fao.org/docrep/005/X3940E/X3940E10.htm>

³¹ [Diet, Nutrition and the Prevention of Chronic Diseases](#) WHO Technical Report Series 916. Geneva. 2003. pages 82, 88

West African production of shea nuts per year is about 600,000 tons and cocoa bean production is about 2.6 million tons,³² resulting in about 200,000 tons of shea butter and 483,000³³ tons of cocoa butter being produced. Assuming that there is about 20%³⁴ oil in fresh fruit bunches of palm, West African production of palm raw material would be about 11 million tons and crude palm oil about 2.2 million tons.³⁵ The shea industry is tiny by comparison to both cocoa and palm oil. In terms of demand it is interesting to note that West Africa cannot meet its own demand for palm oil and must import the balance from Southeast Asia.³⁶ By contrast, domestic demand for chocolate in Africa is low due to limited disposable incomes. Additionally, cocoa is a valuable commodity on international markets, serving as a major source of hard currency for Côte d'Ivoire and Ghana specifically; therefore, most cocoa is exported. Domestic production of shea exceeds domestic demand as more than half of shea harvested is exported mostly as raw nuts and some as butter. The actual harvest potential of shea is thought to be more than twice its current level.³⁷ There is overlap of applicability of all these fats in both food and cosmetics, but more so in food. In fact, the majority of world vegetable fat production is processed for use in food and for the three fats being compared here the ratios are also high: shea – 90%, cocoa – 90%³⁸ and palm – 80%.³⁹

8.4 Relative Market Sizes

Shea

From the relative crop sizes and current pricing levels it is possible to calculate approximate market sizes. Estimating the market for shea is a bit complex because the shea market is divided into two-tiers: domestic or “traditional” consumption and export. The two market tiers command a different set of prices for both raw nuts and butter. In essence, approximately 45%⁴⁰ of the market is undervalued relative to what export markets command but exact prices are not available. This is an important distinction since shea is traded privately. Cocoa and palm, on the other hand, are publicly traded and these market differentials do not exist; so, true price discovery is possible.

The total market value of 600,000 tons raw shea nuts produced at the current market price of \$250 per ton would be \$150 million. It is important to note that these are export values; the true value of the market based on what is paid locally compared to what is exported is less. The value of the 350,000 tons

³² Production estimates for Cote d'Ivoire, Ghana, Cameroon and Nigeria for the 2007-08 season from the International Cocoa Organization.

³³ According to the European Cocoa Association world production of cocoa butter is 700,000 annually. The share coming from West African beans is assumed to be the same as its share of world cocoa bean production which is 69%, according to ICCO.

³⁴ LMC International.

³⁵ LMC International estimates.

³⁶ LMC International.

³⁷ The potential shea crop is estimated to be more than 1 million tons but only about 600,000 are harvested. Estimates by Dr. Peter Lovett.

³⁸ LMC International estimates.

³⁹ LMC International estimates.

⁴⁰ Estimate of shea crop consumed as “traditional use” by Dr. Peter Lovett.

exported last year at today's prices would be about \$87.5 million, and at the end of last year at \$450 a ton it would have been \$158 million. If the value of shea butter is added, then the total market for shea is even higher; however, due to the two-tiered market in shea it is very difficult to estimate what the value of all the butter produced is because it is not known what percentage of nuts is refined into butter that is actually sold locally. So, it is necessary to define the total market for shea by a set of parameters which best reflect value – exported nuts and butter produced from those nuts. If the current value of exported nuts is \$87.5 million and the current value of a ton of butter is estimated at \$1,750⁴¹ then the 35,000 tons of butter is worth \$61.3 million for a total market value of \$149 million.

Cocoa

The world production value⁴² of cocoa for the 2007/2008 season was estimated to be about 3.7 million tons of beans worth \$8.8 billion at today's prices.⁴³ West Africa produces \$6.1 billion⁴⁴ worth of world supply or 69%, with the majority coming from Côte d'Ivoire, which produces 1.4 million tons, and Ghana which produces 675,000 tons. Global production for the 2008/2009 harvest is expected to fall 5% to 3.5 million⁴⁵ tons due to the global recession. This represents a 10% decline from projections a year ago of world production reaching 3.9 million tons for the 2008/2009 harvest. Demand shocks are being felt most strongly in Asia and Oceania where overall grindings are expected to fall 10%, with Malaysia down 12% and Indonesia down 20%.⁴⁶

Forecasts of National and Regional Cocoa Production through 2012/2013

1000 tonnes	Estimates					Forecasts	Projections				
	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007		2007/2008	2008/2009	2009/2010	2010/2011	2011/2012
Africa	2231	2550	2375	2643	2334	2578	2709	2815	2894	2999	3117
Cameroon	180	186	185	186	188	185	191	196	201	204	208
Côte d'Ivoire	1352	1407	1288	1408	1229	1370	1421	1482	1542	1588	1635
Ghana	497	737	509	740	615	675	747	771	774	821	882
Nigeria	173	180	200	200	190	210	219	229	236	240	244
Americas	428	462	443	446	415	445	475	499	512	518	520
Brazil	183	163	171	182	128	180	188	178	185	190	191
Ecuador	88	117	116	114	115	115	120	124	125	125	125
Dominican Republic	47	47	31	42	44	50	53	54	54	55	55
Asia/Oceania	510	525	559	670	627	690	732	762	788	807	822
Indonesia	410	430	460	560	520	580	614	639	661	678	693
Malaysia	38	34	29	34	33	34	35	37	37	37	38
WORLD	3169	3537	3377	3759	3376	3713	3915	4076	4193	4324	4459

Source: ICCO, Executive Committee Briefing, May 2008

⁴¹ Industry estimates based on current price at a multiple of 7, from Dr. Peter Lovett.

⁴² World production values are quoted in SDRs (Special Drawing Rights) which are based on a basket of currencies set by the IMF in an effort to neutralize the effect of currency movements. For purposes of this analysis, values are quoted at current trading prices.

⁴³ ICCO, "Annual Forecasts of Production and Consumption and Estimates of Production Levels to Achieve Equilibrium in World Cocoa Market," Executive Committee Briefing, May 27-28, 2008, p. 7.

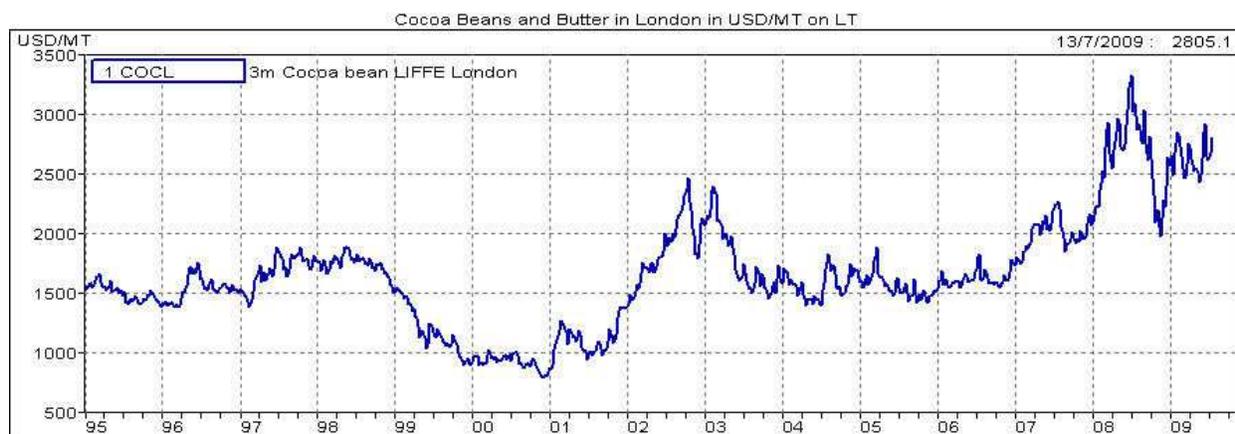
⁴⁴ ICCO, Executive Committee Briefing, May 2008. Calculated as 2,578,000 tons at the current market price of \$2,380 per ton. <http://data.tradingcharts.com/futures/quotes/CC.html>

⁴⁵ Alibaba.com referencing Reuters, <http://news.alibaba.com/article/detail/agriculture/100065358-1-update-2-icco-cuts-cocoa-grindings.html>

⁴⁶ Ibid.

Cocoa butter/powder ratios are perhaps a better indicator of true cocoa demand than price alone. Industry estimates suggest that the price of cocoa butter should sell at a multiple to the current bean price of about 3.5 and at 3.2 margins are barely breakeven,⁴⁷ at which point butter production ceases to be viable; so, many factories will trade only in cocoa liquor at these levels. Currently the ratio is about 2.1,⁴⁸ a level not seen since 2000.⁴⁹ If approximately 700,000⁵⁰ tons of cocoa butter are produced annually worldwide then the value at current market rates is about \$3.5⁵¹ billion, bringing the total value of cocoa beans and butter to about \$12.3 billion.

Cocoa bean prices, January 1995 to July 2009, in US\$



⁴⁷ Industry estimates, ICCO.

⁴⁸ Alibaba.com referencing Reuters, <http://news.alibaba.com/article/detail/agriculture/100065358-1-update-2-icco-cuts-cocoa-grindings.html>.

⁴⁹ Ibid.

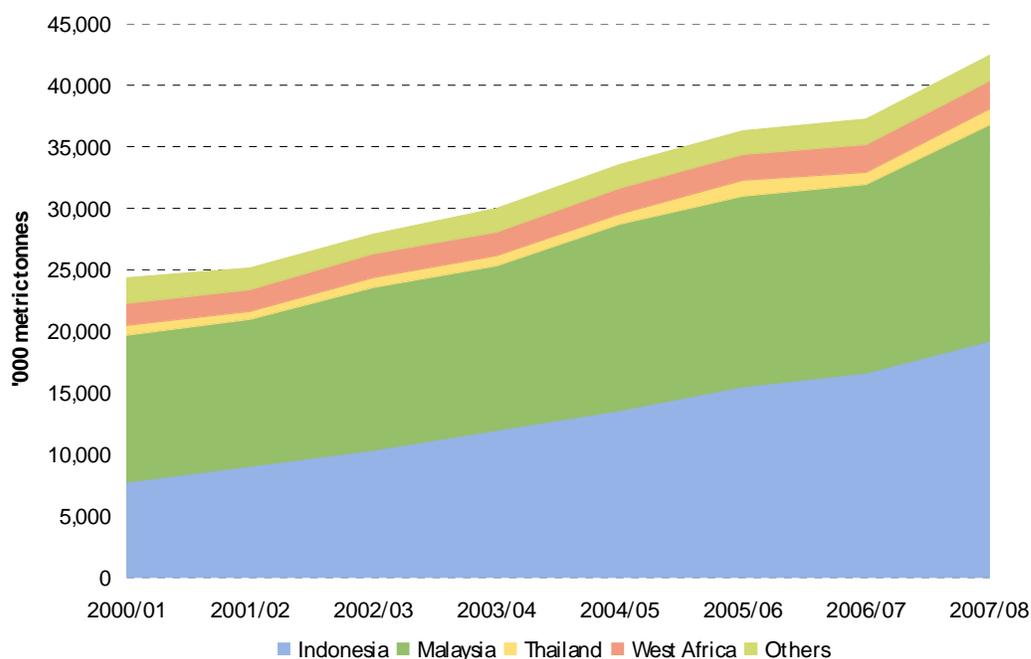
⁵⁰ European Cocoa Association, <http://www.eurococoa.com/cocoa/story/weurope.htm>

⁵¹ Calculated as the current bean price of \$2,380 times the current butter ratio of 2.1 times volume of 700,000 tons of butter produced.

Palm

Palm oil is the dominant vegetable oil in the world market, accounting for about 40% of the global total with over 42 million metric tons of production.⁵² Indonesia is the world's largest producer, followed closely by Malaysia, which together produce about 90% of the world supply. The chart below shows the relative proportions and trends in production in different palm oil-producing countries.

Global Production of Palm Oil



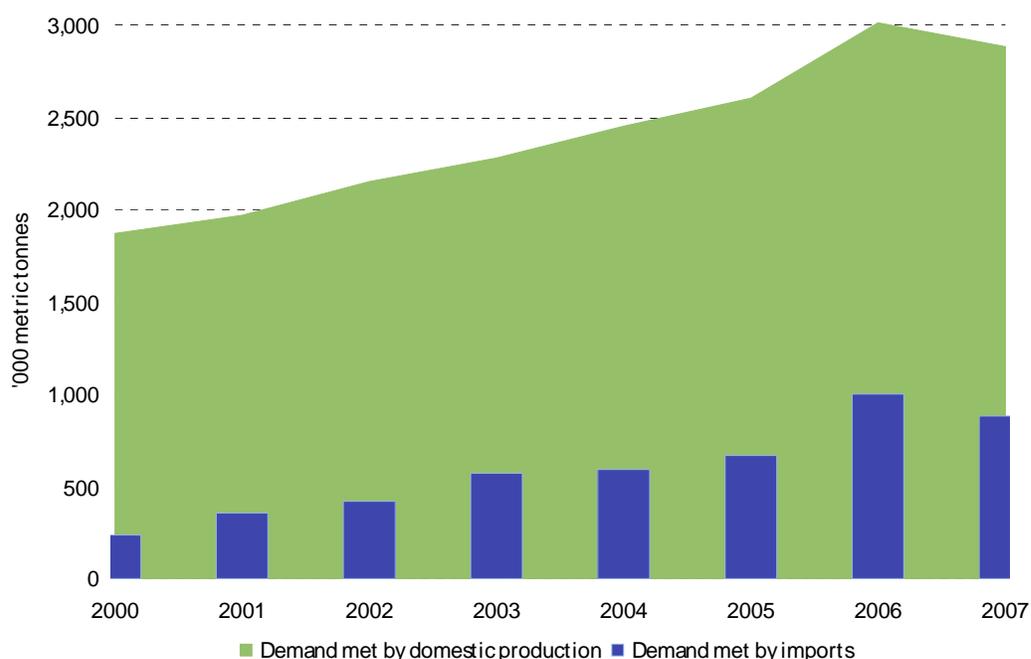
Source: LMC International

Production in West Africa is growing slowly with combined output from all 17 producing countries totaling about 2.2 million tons per year since 2006,⁵³ most of which is consumed in those countries. Domestic demand exceeds supply and the difference is fulfilled by imports from Indonesia. Côte d'Ivoire is the only significant regional exporter. Nigeria is by far the largest producer and consumer in the region.

⁵² LMC International.

⁵³ LMC International.

Consumption and Imports of Palm Oil in West Africa



Source: LMC International

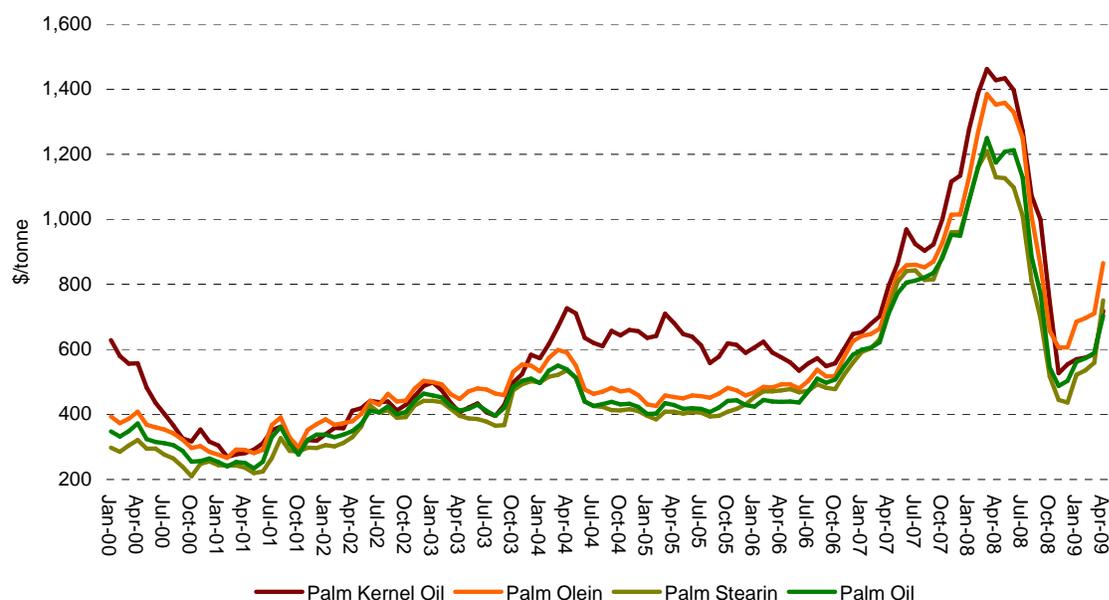
Most production and processing in West Africa comes from small landholders, thus the market is fragmented and the presence of multinationals in the region is insignificant in most markets, except in Ghana, Cameroon and Côte d'Ivoire where they dominate both production and processing. These countries also give palm oil imported for use in soap manufacturing favorable import tariff consideration, with the import duty set at half that of palm oil used for food purposes. About 40% of the palm oil demand in West Africa comes from soap manufacturers. In 2007, the estimated consumption of palm oil for use in soap was over one million tons. Growth in demand for soap follows that of population growth, and there is a seasonal surge in demand during the dry season.

Currently, crude palm oil is selling for about \$702 per ton.⁵⁴ At total global production volumes of 42 million tons, global palm oil production is valued at about \$29.5 billion. It should be noted that not all forms of palm oil command the same price, although the prices are close and do tend to move together. The price commanded by palm oil produced in West Africa runs anywhere from \$1,000 to \$2,000 per ton due to high demand, import duties to protect local producers, and higher operating costs in West Africa.⁵⁵ West African production only amounts to 5% of the world market and would be valued between \$2.2 billion and \$4.4 billion if it traded at the prices it currently commands in Africa. If the average price for West African production of 2.2 million tons were \$1,500 per ton, then its production would be worth \$3.3 billion and the rest of world supply would be valued at \$28.1 billion, bringing the global total to \$31.4 billion.

⁵⁴ Provided courtesy of LMC International.

⁵⁵ LMC International.

Prices of Palm Oil Derivatives



Source: LMC International

8.5 Comparison of Shea, Cocoa and Palm

Shea, cocoa and palm overlap in end uses across the food and cosmetics/personal care sectors. Additionally, the respective ratios of fats produced and used in food are similar: shea – 90%, cocoa – 90%, palm – 80%. Shea is unique to Africa while both cocoa and palm are international crops. Africa produces the majority of world cocoa supply at 69% and Asia produces the majority of world palm oil supply at 90%.

The market sizes are vastly different in market value and both volumes of raw material and fats produced. Shea is tiny by comparison to both cocoa and palm. On a fats basis, both shea and cocoa are more expensive per ton than palm oil at current prices of \$1,750 and \$4,998, respectively, versus a range of prices for palm oil from \$703 per ton for crude palm oil to \$866 per ton for palm olein.⁵⁶ It should be noted also that both shea and cocoa raw materials are traded as a product that constitute a portion of total market value for the industry, especially so for cocoa beans, while palm is only traded as a fat.

Shea, at only 600,000 tons of raw nut production, 350,000 of which are exported, and 35,000 tons of butter export production, versus 42 million tons for crude palm oil, will most likely never be a significant competitor to palm in any of the markets in which they compete. Shea is effectively crowded out by palm and the world demand for fats used in food and personal care items simply cannot be met by shea. As for shea competing with cocoa, shea production is again small relative to cocoa. The annual cocoa crop is about 3.7 million tons of beans and 700,000 tons of butter. While food demand for cocoa in food

⁵⁶ Palm oil prices provided cif Rotterdam courtesy of LMC International.

goes almost exclusively to chocolate, shea can be used as fat for other foods as well. However, most demand for shea use in food currently goes to CBEs.

As for pricing, comparing shea butter to palm oil is not really meaningful given the difference in production volumes, nor is comparing cocoa and palm oil. Comparing shea and cocoa, however, is more instructive as cocoa butter costs approximately three times as much per ton as shea butter. Given that the cocoa crop sold on world markets is approximately ten times as large as the shea crop exported as raw nuts, and that the fat production is approximately 20 times as large, it is counterintuitive that shea butter sells at a significant discount to cocoa butter. This difference can best be explained by shea supply chain fragmentation and market inefficiencies associated with the artisanal nature of shea trading. Under such conditions true price discovery is difficult. The cocoa industry is better organized and as a publicly traded commodity, the markets are highly developed and efficient. Increasingly, the price of shea butter is affected by its quality, i.e. high stearin content, and not by its relationship to cocoa. This is especially true as cosmetic demand for shea butter grows. Cosmetic companies are now expanding relationships directly with the women's collectives that collect the nuts and produce butter to ensure high quality and integrity of supply by offering price premiums. The Body Shop and L'Occitane are prime examples of companies using this strategy and the results so far are encouraging.

8.6 Shea in Skin Care

The most compelling market for shea products in the U.S. is natural cosmetics and cosmeceuticals⁵⁷. The global market for cosmetics and toiletries in 2007 was estimated to be about \$290 billion with growth of about 5% per year.⁵⁸ The global market for natural cosmetics is estimated to be about \$7 billion and growing at about 20% a year.⁵⁹ The current market share of the total U.S. cosmetics market for naturals is thought to be about 10%.⁶⁰ The anti-aging and skin-nourishing subset of the total cosmetics market is the fastest growing segment and accounts for 23% of the total at \$17.7 billion (2008) and is expected to grow to \$22.1 billion by 2013.⁶¹ This segment's growth is particularly relevant for shea, which has significant claims to serve both purposes. The overall skin care market is predicted to be worth \$43 billion by 2010 and the strongest growth is forecasted to be in emerging markets, driven by an aging population and growing consumer affluence, particularly in China and Brazil,⁶² with continued strong growth in the U.S. market. Another trend gaining strength is the increased use of "naturals and bioactives," which again plays to the strengths of shea.

Shea in the U.S. cosmetics and personal care market is mostly used in specialty brands in the naturals segment, however the largest brands are steadily getting into the market. Jergens, a very well known U.S. brand owned by the Japanese company Kao Brands, features a lotion made with shea butter that has received very positive reviews. Proctor and Gamble has added shea butter to its Puffs Plus line of

⁵⁷ A cosmetic that has or is purported to have medicinal properties.

⁵⁸ Euromonitor International, "Global Insights 2008: Cosmetics and Toiletries Market," p.4.

⁵⁹ Cosmetics and Toiletries, <http://www.cosmeticsandtoiletries.com/formulating/category/natural/10413962.html>

⁶⁰ Ibid.

⁶¹ ICIS, <http://www.icis.com/Articles/2009/04/14/9208022/cosmeceuticals-are-seeing-ever-growing-demand.html>, quoting Euromonitor.

⁶² Cosmetics Design, <http://www.cosmeticsdesign.com/Products-Markets/Future-of-skin-care-lies-with-emerging-markets>

lotion tissues, a category growing at 7% a year and now comprising 20% of the tissue market.⁶³ The CVS drugstore chain has launched a hand sanitizer made with shea. Softsoap by Colgate Palmolive has formulated a liquid soap with shea, complete with shea “moisture beads.”

Two of the best known specialty brands featuring shea significantly in their product offerings are non-U.S. companies. L’Occitane, a French company, and the UK-based The Body Shop, which was bought by the French cosmetics giant L’Oréal in 2006 for £652 million⁶⁴ or about \$1.1 billion, are both prominent actors in the global shea market well known for their corporate social responsibility platforms. In fact, when The Body Shop, an ethical brand, was bought by the global cosmetics giant L’Oréal, the deal raised quite a few eyebrows. However, that transaction together with numerous others, solidifies the trend toward naturals and perhaps more importantly, the trend towards ethical brands with a social mission. Also in 2006, the French brand Clarins bought a small stake in French organic cosmetic firm Kibio and Colgate acquired Tom’s Of Maine, a natural/ethical personal care brand. In 1997, Estee Lauder was an early trendsetter with its acquisition of Aveda, a natural/ethical brand that refuses to test on animals.⁶⁵

8.6.1 Case Study: L’Occitane

L’Occitane is perhaps the best known brand using shea butter. As a naturals brand and socially responsible company founded in 1976, the company was truly ahead of its time from the outset. Its story is worth examining because its model could be replicated with other companies in the region, bringing both economic advancement and sustainable development to West Africa.

The company has been sourcing its shea butter from Burkina Faso since the early 1980s. It was early to advance the idea of “joint development” viewing its relationships with Burkinabe women’s collectives not just as one of buyer and supplier but rather one of true partnership. Founder Olivier Baussan first went to Burkina Faso in 1983 and observed firsthand how shea butter was made. He grasped very quickly that there was truly an art to making the butter, from picking up the nuts to packaging the product. He noted, however, that the process was long and not standardized, leading to varying degrees of quality. As a solution, L’Occitane provided training, increasing efficiency and production while preserving and standardizing quality. Baussan then set up a partnership with a collective to buy shea butter directly at a negotiated price that allowed the women to cover their true costs, including investment costs required to produce to L’Occitane’s quality specifications.

By 1995, L’Occitane decided to start using shea in cosmetics. The company partnered with UNIFEM, which financed the organization and training of the women’s collectives, and CECI, which set up the Women’s Project and Shea Network to give practical training to ensure standardization. The women were unable to fill the order due to upfront costs and a lack of financing; so, the company decided to pay a 30% advance on the order. Due to lack of trade credit in Africa, the pre-financing/advancing was crucial to continuing the project – it probably would have failed otherwise. By 2003, the company began offering 50% advances and obtained “Ecocert” organic certification, which in turn was more profitable to the producers. By 2007, L’Occitane launched the Shea Center in Ouagadougou, Burkina Faso and built a 4,300 square foot production facility to further train the women on butter neutralization in its effort to

⁶³ Brandweek, http://www.brandweek.com/bw/content_display/news-and-features/packaged-goods/e3ie41d3cb71a4f00677add6eec3eccc53

⁶⁴ BBC, <http://news.bbc.co.uk/1/hi/business/4815776.stm>

⁶⁵ Taipei Times, <http://www.taipeitimes.com/News/feat/archives/2007/04/12/2003356385>

optimize quality and reduce losses. The unit included space for manufacturing, storage and an analysis laboratory. In that same year the company ordered 336 tons of shea butter from the collectives including 60 tons of organic butter. Today L'Occitane buys shea butter from three unions representing 11,000 women.⁶⁶

L'Occitane today is a global business valued at approximately €800 million.⁶⁷ Its revenues have increased at a spectacular pace from €55 million in 2000 to €400 million by 2007,⁶⁸ amounting to a CAGR of 33%. In 2008 it filed for an IPO to raise \$300 million on the Hang Seng index in Hong Kong, taking advantage of its rapid expansion in Asia, but later withdrew the deal due to market conditions. L'Occitane has so far managed to resist the advances of larger brands although in the 1980s Baussan did lose control of the company to venture capitalists. In 1994, he was brought back by the new ownership who bought out the VCs. In 2007, one half of the interest held by Clarins was also repurchased and now management owns 80% of the company.

8.7 Potential for Investment

Increased use of shea in the cosmetics and personal care industries would serve as an important source of diversification for the shea market which is currently dominated by demand from chocolate manufacturers for use in CBEs. This demand has not helped the shea industry develop a value-added sector but rather has only increased the demand for raw shea nuts. Chocolate and confectionery products account for 90% of shea butter demand, with only 10% percent currently used for cosmetics and pharmaceuticals.⁶⁹ Currently AAK and 3F Group dominate the market for shea raw nuts, buying up about 70% of all nuts exported.

Major Shea Processors

Company	Estimated Buying Market Share	Tonnage		Processing Location	Major Selling Market
		(Nut Wt Equivalents)	Export Type		
AAK	60%	210,000	nuts	Denmark	EU, US, Russia, Asia
Loders Kralaan	25%	87,500	butter	Ghana, Togo	NA
3F Group	10%	35,000	nuts	India	India, UK
Ghana Specialty Fats	5%	17,500	stearin	Ghana	Europe, Asia
	100%	350,000			

Source: US ITC, industry representatives

CBE manufacturers much prefer to import the raw material and refine it into shea butter themselves since their requirements are quite stringent. Loders Croklaan imports raw, unrefined shea butter and Ghana Specialty Fats produces shea stearin in the region, the only commercial producer to do so. AAK has by far the largest market share and can effectively set the market price for the raw nuts. All other sources of demand are too small and fragmented to affect raw material prices significantly.

⁶⁶ Company website, <http://usa.loccitane.com/FO/Content/About/Brand-Terminology.aspx#CoDevelopment>

⁶⁷ The Times Online, http://business.timesonline.co.uk/tol/business/industry_sectors/consumer_goods/article4327001.ece

⁶⁸ Ibid.

⁶⁹ U.S. Trade Commission, Sub-Saharan Africa: Factors Affecting Trade Patterns of Selected Industries, Second Annual Report, April 2008, p 2-28.

Developing a native value added sector for shea in West Africa would decrease the majority of shea exports leaving as raw nuts to be refined and resold elsewhere. It is widely believed by industry experts that additional idle supply exists and remains unharvested. Sourcing additional supply to service another industry such as cosmetics could be achieved by several means: optimizing butter export supply networks that already exist, bringing some traditional use supply into the formal market and developing more relationships with high-end specialty cosmetics producers along the lines of the L'Occitane model. These buyers are willing to invest in equipment and training the butter producing collectives. They also pay premiums for quality and extend trade credit. Additional investment in butter production equipment is essential to harmonize quality and efficiency and is likely to come from foreign companies setting up operations in-country, development banks extending loans to existing operators or partnerships with firms using the end product as an input to their own production.

9 Conclusion

The frontier markets of Africa present investors with myriad opportunities and risks. There are opportunities for high returns as African economies continue to modernize and economic growth continues to outpace that of the developed world. Investors who step into these markets typically have a view that is more long term than investors in mature markets and can make higher returns over the long term if they are patient and creative. Africa continues to make great progress on reforms that make doing business in the region easier, which is essential to attracting continued foreign investment and developing a domestic entrepreneurial class. However, the region still has many impediments affecting this development with 17 of the 20 most difficult business environments in the world located in Africa, according to the World Bank's annual *Doing Business* report. Of all the metrics considered in this report investors place the most importance on investor rights, enforcement of contracts, registering property, employing workers, and closing a business because these factors most likely affect their investment returns.

Africa's GDP growth in recent years has been impressive. In each of the last four consecutive years growth registered 6% or more; still, on a GDP per capita basis, the continent still remains very underdeveloped. The commodity boom has contributed to a majority of this growth but with the onset of the global financial crisis and the resulting recession, commodity prices have fallen precipitously and this will have a significant impact on many African economies. The World Bank recently projected that GDP growth in Africa will fall to 2.4% this year. Côte d'Ivoire earns significant hard currency reserves from the sale of cocoa meaning a collapse of cocoa prices will cause its fiscal position to deteriorate in the coming year. Nigeria has already been severely impacted by the sharp decline in oil prices, which has forced painful budget cuts after a period of soaring oil prices lifted its foreign reserves as high as \$60 billion.

In order to insulate against the boom and bust cycle of commodity-driven economic expansion, Africa must diversify its economies away from dependence on commodities towards production of more value added goods and services. This is especially true since much of Africa's native industrial capacity is artisanal in nature and as such much of the value added potential of these sectors is not captured by Africa but rather exported abroad. In order for this type of industrial development to take hold, governments, in conjunction with aid and development agencies, need to invest in large-scale infrastructure improvements in electrical power, sanitation, and transport because much of the needed capability for world-class industrial output is not currently available in Africa.

Access to financing for SMEs is an ongoing problem in Africa and is cited repeatedly by companies as their primary challenge. Financial sector institutional development will have the biggest impact on sustained investment, as it will improve access to credit, create an investor class that will in turn create liquidity and efficient financial markets, and formalize more of the economy which is currently not captured by official GDP tracking. Expanded lending will not increase until there are functioning credit rating agencies, deposit insurance authorities, accounting standards boards, and courts that adjudicate on behalf of claimants. All of these bodies serve to increase transparency, which helps banks properly price credit risk.

In West Africa, the shea sector faces challenges, but still presents interesting opportunities.

The shea sector, despite being a negligible share of the global vegetable fats market, has excellent prospects. Shea is an important input to the high-end cosmetics sector, which is expected to see continued strong growth for years to come. Shea is very much a self-contained industry, which could scale very quickly with investment in processing machinery and skills training, in addition to organizational restructuring of the supply chain.

The story of L'Occitane demonstrates that artisanal industries in Africa can reap benefits from partnerships with outside investors if they can find viable partners who see value in their products, craftsmanship and are willing to invest in the technology to achieve efficiency gains without fundamentally altering the product's intrinsic value. Consumers' willingness to pay "ethics" premiums for fair trade goods creates further investment opportunities in industries like shea, allowing a greater chance of being mutually beneficial to both the investor and the people. Companies are responding to public pressure to work in a socially responsible manner and this will certainly benefit Africa and the wider developing world. Profiting on the fair trade trend offers a viable path to growth for Africa in the short term while it solves its economic, financial, governmental and infrastructure problems that stifle its competitiveness.