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Small Factories Take Root in Africa

ANKETRAKABE, Madagascar—After a bumpy two-hour truck ride and a river crossing by canoe, Tim McCollum reached this village set beside a canopy of cacao trees, the first link in a supply chain that would help boost production at his small African chocolate factory.

The good news was that Mr. McCollum's Madécasse Chocolate LLC. had located a rare source of premium cocoa before another competitor. That was also the bad news.

Mr. McCollum learned villagers had zero experience dealing with global customers—one 71-year-old told him he was the first white man he'd seen here since Madagascar gained independence from the French in 1960. Then there was the river. Nobody on his team was sure how to move a ton of cocoa across it in a canoe. But after meeting with the local farming cooperative, Mr. McCollum became convinced that cocoa grown here could make the 600-mile journey to his factory and be shipped to U.S. supermarkets from Madagascar, an island off Africa's southeast coast.

"There's a solution," insisted the 34-year-old year old entrepreneur from Brooklyn, N.Y., clutching an armful of cocoa leaves to be tested back home. "It just takes a little more time and a little more thought, but there's no reason it can't be done."

"For decades, Africans have produced what they do not consume and consumed what they do not produce," says Andrew Rugasira, a Ugandan entrepreneur. Two years ago, his company, Good African Coffee, broke ranks with local bean exporters to open the country's first instant-coffee plant.

Why Africa doesn't make more stuff has been an enduring mystery of the global economy. As wages rose in manufacturing powerhouses such as China, many economists predicted that factories would flock to cheaper pools of labor in Africa, helping to spur the same sort of rapid industrial growth that lifted living standards across Asia.

It hasn't happened.

Africa's economy has averaged solid 5% annual growth over the past decade, thanks to rising commodity prices and new consumer demand. The continent, however, accounts for just 1% of global manufacturing, compared with Asia's 25%. Africa's share of labor-intensive manufacturing—a vital source of jobs for underemployed farmers—is actually shrinking, according to a July United Nations report.

The situation so alarmed the World Bank that it began talks with Chinese trade officials on how to move more factories to Africa from China, according to World Bank President Robert Zoellick. The bank estimates there are now 85 million manufacturing jobs suited for unskilled workers in China, out of a population of 1.3 billion, but only 10 million in all of Africa, population 1 billion.

Western multinational manufacturers mostly have shied from the continent even as they have plunged into other developing countries. A report by UBS Investment Research concluded that China's share of low-end manufacturing exports—including toys, clothes and

shoes—has peaked, but production was moving to other low-cost countries in Asia, such as Vietnam and Bangladesh.

Africa is regarded as a riskier destination. Many countries are plagued by corruption. There have been repeated clashes between ethnic groups. And this year's civil conflict in the Ivory Coast demonstrated once again how power struggles can damage promising economies.

And yet, executives on the ground note improvements in local governance and say Africa is becoming more conducive to private investment. Rwanda lost nearly a million lives in a 1994 genocidal conflict, but it is now among east Africa's fastest-growing economies.

"The dysfunction of Africa has become part of business folk memory that keeps Western multinationals from doing anything," says Paul Collier, director at the Center for the Study of African Economies at Oxford University. "But Africa of the 1980's and '90s is not the same Africa of today."

Those Western multinationals that are expanding in Africa are doing so mainly to reach an emerging class of consumers.

The South African unit of Nestle SA is spending about $56 million to expand production of instant noodles and cereals such as Cheerios. The Swiss conglomerate is also opening an instant noodle factory in the Democratic Republic of the Congo, one of Africa's poorest countries. Before Nestle invests in a new African country, it sizes up access to water and electricity.

The company will also walk away at the first hint of corruption, according to executive vice president Frits van Dijk. "We have lost opportunities where we had to say no because of that," he says. Nestle aims to have 33 factories on the continent by 2015, up from 28 now.

Rival Kraft Foods Inc., the U.S. snacks giant, earns about $1 billion in annual sales from Africa, where it also manufactures. But it must contend with the continent's constraints. Chief among them: an acute shortage of skilled labor that forces Kraft to rely on expatriates. "If you want to pull off large-scale manufacturing projects you bring in expats, which drives up costs," says Johan van Zyl, manufacturing director in Johannesburg for Sub-Saharan Africa.

Smaller manufacturers can't match the production muscle of a multinational. But they are usually quicker to spot opportunities and gutsier in pursuit of them, according to Mark Paper, chief operating officer of Business Partners International, a South African financial institution specializing in lending and investing in smaller companies.

One of the companies Business Partners is backing is Primolitos, a South African supplier of hot sauces and condiments that in May opened a glistening new factory in Johannesburg. It hasn't been smooth sailing. During an unrelated metal workers strike, a brick came through the company's conference-room window. Trucks transporting its condiments have been hijacked. But Primolitos is now among the few local food manufacturers that can meet standards for global customers.

Earlier this year, Wal-Mart Stores Inc. struck a $2.4 billion deal to acquire a majority stake in South Africa's Massmart Holdings Ltd., making Primolitos a supplier to the global retailer. Primolitos wants to use the deal as a springboard to global exports, which now only account for 5% of its sales. "Wal-Mart," says 42-year-old founder Roberto Vasconcelos, "was a wake-up call."

Not many African manufacturers are so ready for the global economy. Mthuli Ncube, chief economist at the African Development Bank Group, estimates that one-quarter of Africa's gross domestic product—about $450 billion—comes from 65 million small and medium-sized enterprises. But the contribution from manufacturers is tougher to measure; many are tiny cottage factories that sell goods in open-air bazaars to avoid paying tax.

Africa's industry isn't so different from the modest roots of China's own industrial revolution. In the 1980s, Chinese farmers invested in factories to make goods for rural consumers. Multinationals arrived later to fuel an export boom, according to Zhang Chunlin, an economist at the World Bank in Pretoria who specializes on private-sector development.

China's challenge was "to develop in an imperfect environment," says Mr. Zhang, who once worked at a village brick kiln in the northern China. "That is also Africa's challenge."

Many small manufacturers in Africa not only survive but thrive in imperfect environments. To maintain shoe production, Fut Conceptus Manufacturing Nigeria Ltd. runs four electric generators, at a cost of $500 in fuel a day. The chronic power outages have scared off bigger Chinese shoemakers and allowed Fut Conceptus to build up a brand in west Africa, according to Olumide Wole-Madariola, the factory's 44-year-old Nigerian founder. It makes men's moccasins and ladies' sandals out of Nigerian leather that used to be sold only abroad.

"Nobody was ready for what we were doing," says Mr. Wole-Madariola. "Nobody was ready for "Made in Nigeria."

Tim McCollum's company, Madécasse Chocolate, sought to exploit a paradox. Africa produces 60% to 70% of the world's cacao, but most of the chocolate is made outside the continent.

Mr. McCollum and his partner Brett Beach, who had served together as Peace Corps volunteers in Madagascar, thought they could create jobs and alleviate poverty by making chocolate there.

"If Africa could sell the world chocolate…it wouldn't solve all the continent's problems, but it could make a big dent," said Mr. McCollum.

Messrs. McCollum and Beach ran up $97,000 in credit-card debt and borrowed heavily from friends and got a substantial investment from Prosperity Equity Partners, a Cape Town, South Africa, venture capital fund, to get the company off the ground. Mr. Beach bought a nonrefundable ticket to Madagascar in March 2009 to search for a factory that could make chocolate.

He arrived in the capital, Antananarivo, just in time for Madagascar's military to overthrow the democratically elected president. From his hotel room, Mr. Beach said he heard street protests and the pop of rubber bullets.

Back home in Brooklyn, would-be investors weren't impressed. Nobody dared commit capital to a plan that seemed more an altruistic adventure than a business.

"First red flag was that we were in Africa. Second was when we told people there had just been a coup," recalls Mr. McCollum of his meetings with potential investors.

But during his trip to Madagascar, Mr. Beach engineered a coup of his own. He found a local contract manufacturer, chocolatier Shahin Cassam Chenai, who understood the company's direction.

The new partners developed odd but evocative combinations of chocolate bars: pink pepper and citrus, among others. In the U.S, the bars retailed for about $6 each.

As production took off, Madécasse convinced big retailers, such as Whole Foods Markets, to peddle its bars. Last year, the company's sales more than doubled to $480,000 from $200,000 in 2009.

But success in the U.S. came with setbacks in Africa. In their absence from Madagascar, Messrs. Beach and McCollum said they discovered an employee had embezzled cash and sold their cacao to other buyers. The company lost about $15,000, they said.

"It was quite a blow," admits the 36-year-old Mr. Beach.

In August, Mr. McCollum arrived in Madagascar to smooth out production issues. Not least of the problems was that Madécasse's lead taste tester, factory owner Mr. Cassam Chenai, had developed an allergy to chocolate.

Madécasse had been rushing to develop a new bar made from Madagascar coffee and another with cinnamon and hot pepper ahead of a late-September food show in South Africa, but Mr. Cassam Chenai, who is of Indian descent and grew up here, said he could taste very little of it because he would break out in a skin rash.

"That's why product development is taking so long" said Mr. McCollum.

The company also needed to secure new sources of cacao to ramp up production. He received leads from his employees who worked with the region's farmers.

Madagascar produces less than 1% of the world's cacao, but a significant portion is of high quality. Mr. McCollum learned that tests around Anketrakabe village area suggested an unusually high 10% of the cacao there could be the premium variety known as Criollo, the most expensive on the market.

Madécasse wasn't able to alert Anketrakabe residents about its visit because, it turned out, the closest cell-phone signal was about three miles away on top of a hill. Even so, the head of the local farming cooperative, George Jaomiarana, was glad to see Mr. McCollum. Villagers believed they could get better prices dealing with foreign customers, rather than local middlemen who took cuts on cacao sales before passing onto exporters.

Speaking in French and the national Malagasy language, Mr. McCollum held out the prospect of investing in new storage and fermentation facilities for cacao beans and training farmers how to use them properly.

He peered into one storage bin to see wasps and spiders crawling among the beans. "Gross," he said in English.

But examining the cacao trees just beyond the village, Mr. McCollum grew upbeat about what he saw. Huge blood-red pods loaded with beans drooped from branches. He took out his pocket knife to cut leaves for more genetic tests.

After returning to Brooklyn, Mr. McCollum pledged to buy one ton of cacao per month from the farmers starting as early as next month. If things went well, Madécasse would purchase two tons a month—in dollar terms about triple what the cooperative is selling now.

At some point, Mr. McCollum ventured, they would talk about building a bridge across that river.

"We'll canoe it for a while," he said.

—Nicholas Bariyo in Kampala, Uganda, and Devon Maylie in Johannesburg contributed to this article.