

# **The opportunities for South Africa in a global economy**

by Adriaan Brouwers - Leverage; Ibrahim Khan - Wizcor; and Colin Reddy - Business Map

*South Africa is more than a doorstep to the rest of Africa: it is also well-positioned between Europe, The Far East and South America and, after the September 11th attack, a haven for people, and companies, in search of safe surroundings. It is a country that is not only well positioned to exploit the opportunities offered by an increasingly globalised economy, but also one that is confronted directly with the inherent challenges such a process faces. This is illustrated by the fact that when Johannesburg hosted the United Nations-sponsored World Summit on Sustainable Development (WSSD) in August, 2002, in the world-class Sandton Business District, protesters against the summit marched from the adjacent, poor, Alexandra Township to reach the convention centre – a distance of less than a mile. South Africa's policy on black economic empowerment is a concentrated effort to bridge the gap between the First and Third World segments of its population and by making a success of the opportunities South Africa offers, foreign investors will develop useful experience and perspectives on managing the integration of multinational businesses and the transformations brought about by a global economy.*

*This chapter is a stand-alone guide intended to help investors identify opportunities created by the country's natural resources, by its manufacturing, banking and financial services sectors, as well as those that exist in technology, media and telecoms.*

## **1. Summary**

### **The fundamentals of South Africa from a global economic perspective<sup>1</sup>**

Financial authorities have complimented South Africa on its determined pursuit of a prudent economic policy<sup>2</sup>. Despite the current global economic slowdown, the country continues to maintain its recent growth pattern: its GDP rose from -2.2% in 1992 to 3.4% in 2000 and approximately 3.0% in 2002 while, according to a recent budget speech, economic growth of 3.3%, 3.7% and 4.0% is predicted for 2003, 2004 and 2005<sup>3</sup>. Inflation<sup>4</sup> has also been reduced: from an average of 12.5% between 1990 and 1994, it fell to 5.2% in 1999. Although it then rose to 7.6% in 2000 and reached 11.8% in January, 2003, it is expected to return to the higher end of the 3%-6% target later in 2003. The budget deficit is narrowing: from 10% in 1993/4 to 2.1% in 2001/2002 and 2.4% in 2003/04. And, finally, interest rates have also fallen sharply, despite the rise in the prime rate in 2002 to 17.0%. Worldwide the Rand was the strongest performer against the US\$ in 2002, recovering from almost 14.00R=1US\$ in December 2001 to its current rate of approximately 8.00R=1US\$.

---

<sup>1</sup> Euromoney, Venture Capital & Private Equity Yearbook 2000/2001, pages 83-86.

<sup>2</sup> The Economist October 12, 1996; December 13, 1997; May 29, 1999; February 24, 2001; IMF and World Bank; Financial Times November 26, 2001.

<sup>3</sup> Budget speech February 26, 2003.

<sup>4</sup> CPIX inflation (consumer prices excluding mortgage interest).

**Figure 1: Current structure of the South African economy**

<b>GDP (billions of rand) <sup>1</sup></b>	<b>1999</b>	<b>%</b>	<b>2000</b>	<b>%</b>	<b>2001</b>	<b>%</b>	<b>2002</b>	<b>%</b>
Agriculture <sup>2</sup>	25.0	3	26.1	3	31.1	3	37.7	4
Mining and Quarrying	46.2	6	55.0	7	67.2	8	80.6	8
Manufacturing	136.0	19	150.2	19	166.4	19	188.2	19
Construction	22.3	3	23.8	3	25.5	3	27.5	3
Electricity, Gas & Water	21.7	3	22.7	3	22.6	3	23.9	2
Transport <sup>3</sup>	70.9	10	80.8	10	88.2	10	96.1	10
Trade	95.6	13	107.3	13	118.7	13	132.7	13
Business Services	143.5	20	160.9	20	177.2	20	194.6	19
Others	<u>167.5</u>	<u>23</u>	<u>181.5</u>	<u>22</u>	<u>198.0</u>	<u>21</u>	<u>217.6</u>	<u>22</u>
<b>Total</b>	<b>728.8</b>	<b>100</b>	<b>808.2</b>	<b>100</b>	<b>894.9</b>	<b>100</b>	<b>998.9</b>	<b>100</b>

1. South African Reserve Bank, GDP by sector. 2. Including Forestry and Fishing. 3. Including Communications.

### **Successes of South African companies around the world**

Successful South African companies and sectors are evident throughout the country and around the world with Thawte, Billiton, De Beers, South African Breweries, Anglo American, Harmony, Liberty, Afrox, Investec, not to mention the motor, wine and food industries, the most notable examples. The essence of their success is due to a combination of the country's mineral base, its commitment to innovation, its entrepreneurial spirit, its financial infrastructure, and the export advantages it enjoys.

### **The robustness of a young democracy**

The uninformed investor may read unsettling stories about South Africa in the international press, while its crime and violence and its neighbour, Zimbabwe, must give many potential investors food for thought. But these aspects are best understood from the perspective of a young democracy in a country with extremes of wealth and poverty. Reconciling such extremes is never easy and does not happen overnight.

South Africa's **strengths** are its banking and legal systems, its (communications) infrastructure, its mineral resources, its English speaking business community, its strategic geographical position on the globe, its climate and, not least, its track record in negotiating practical political decisions. South Africa's **weaknesses** are its high real interest rates, its uneven income distribution, its severe unemployment, its commodity-based economy, its poor (but improving) competitiveness, and its inadequate education system. **Risks** do exist (in its high crime rate and fractious labour relations, the AIDS epidemic, and worrying levels of corruption) but these are manageable.

That said, the robustness of this young democracy is evidenced by its consistent pursuit of strategic policies (e.g. financial discipline, the restructuring of state assets) and the fact that it continues to find pragmatic solutions for controversial policy issues (e.g. mineral and labour laws) by bringing all vested interests together. Its free press, its political opposition, its independent judicial system (which recently enabled civilians to sue their

government so that they could receive anti-retroviral HIV/AIDS drugs), are vital cornerstones for its democratic future.

### **South Africa's international position**

South Africa is in a position to be a critical axis between the developed world and the rest of the emerging African nations. As the most progressive and successful country on the continent, it would be the most probable engine for change if the objectives of NEPAD (the New Partnership for Africa's Development) are indeed secured. And while its government recognises that the country's fortunes are inextricably tied to ensuring that it maintains good trade and investment relationships with the developed world, it also just as clearly recognizes its role in the stabilisation of the less economically fortunate African countries. In this respect, the successful peace negotiations in the Democratic Republic of Congo offer a notable example of its diplomatic achievements.

**Figure 2: Small selection of recent cross border deals**

<b>Opportunity</b>	<b>Sector</b>	<b>Transaction sizeR(m)</b>
Airport expansion/improvement	Airport Services	2 000
Telkom listing	Telecommunications	3 900
Fairvest/Bonatla	Property	157
South Africa Chrome Jisco J.V.	Stainless Steel production China	800
Alcatel expansion into Africa	Telecommunications	1 750

### **Democracy forces South Africa to deal with issues mirrored in the global economy**

In South Africa, First and Third World segments of society co-exist side by side and the gap that exists between rich and poor mirrors the contrasts that exist on a global scale. For obvious electoral reasons, South Africa's democratic government will be forced to develop a balanced and practical approach to dealing with such a challenge and the policy that aims to bridge this gap is one of black economic empowerment. It is a policy that has been a constant and important election issue ever since the country's return to democracy.

Although the government's response to black economic empowerment has both increased and matured over the years it must be admitted that, in the early stages, its position has been varied, multi-faceted and, at times, confusing. In his State of the Union address in February of this year, President Thabo Mbeki gave only a broad outline of the government strategy, a strategy that included the setting up of an advisory council, legislation laying out a code of good practise and the need for a 'global transformation charter' rather than charters for each sector of the economy. But then on March 19th, Minister Alec Erwin delivered the long awaited broad-based strategy for black economic empowerment. Its focus continues to be on sectors where it is possible to directly influence the business process and it is intended to achieve progress in matters of ownership, operational participation, the transfers of skills to blacks (particularly in senior positions), the creation of employment and a reduction of income inequality.

South Africa's success in bridging the gap between the First and Third World segments of its society is limited. Although focused projects have been defined to improve and offer economic development to very poor townships (e.g. the Alexandra Renewal

Project), such projects are surrounded with political controversy while poverty in the rural areas remains untouched. Nevertheless, South Africa must continue to address these issues and, in being forced to face at home these challenges that mirror the process of globalisation, it now has the opportunity to gain useful experience in developing effective and practical economic policies. In the process, it can also strengthen its position as a link between the developed and the developing worlds, in particular, the African continent to which it belongs. For these reasons, South Africa is in a position to make a considerable contribution to the problems all international institutions face in learning to manage the process of globalisation better than they have done so far<sup>5</sup>.

## **2. Sector focus**

The following sections focus on the opportunities offered by South Africa's natural resources, its manufacturing industry, its banking and financial services and its technology-media-telecoms sector.

### **Natural resources**

South Africa's natural beauty is a major asset with an as yet, not fully developed economic potential. The best natural resources in the world, ranging from wildlife to pristine beaches combined with agreeable weather and a moderate climate are highly conducive to a robust tourist industry. In addition to major economic developments (e.g. the integration of separate national parks at the borders of Mozambique, South Africa and Zimbabwe to form the Limpopo Natural Park) the country's natural resources offer equally appealing opportunities for smaller scale developments that would also encourage black economic empowerment. These would take the form of employment for low-skilled labour in small and medium sized companies (e.g. shops and Bed and Breakfast accommodation). Two other factors should also be mentioned. The first is that, despite the considerable appreciation of Rand during 2002, the costs of living are still relatively low. Secondly, in view of its perceived neutrality, non-confrontational approach and distance from the American continent, South Africa was the only country to experience a surge in tourism after September 11<sup>th</sup>.

South Africa also has a wealthy mineral base. It has 88% of the world's platinum reserves, 83% of its manganese, 72% of its chromium, 45% of its vanadium, 39% of its gold and a large portion of its gem diamonds. During the boycott years of apartheid, the traditional mining houses (e.g. Gencor and Anglo American) developed into all-inclusive conglomerates but, since 1990, this trend has reversed itself. Non-core businesses were disposed of and international core business mining opportunities acquired (e.g. Billiton was acquired by Gencor from Royal Dutch Shell) which led, in turn, to listings on the London Stock Exchange. It should be noted that although the mining industry has been at the forefront of developments in black economic empowerment, the government's scorecard in this area (ownership, operational participation and control, transfer of skills

---

<sup>5</sup> Globalization and its discontents, by Joseph E. Stiglitz, page 214.

in senior positions, employment creation and reduction of income inequality) lacks certainty and transparency.

Despite this, however, the charter has opened the gates for a new generation of mining opportunities. The Department of Minerals and Energy has embarked on a small-scale mining programme aimed at encouraging and facilitating the development of economically viable, small-scale mining and mineral-based industries, in line with the government's wish that small miners gain access to mineral rights best suited to small mining activity. Mining is a dollar-based currency hedge that has produced excellent returns, especially in uncertain market conditions.

**Figure 3: Opportunities in natural resources (Mining & Tourism)**

<b>Opportunity</b>	<b>Description</b>	<b>Investment R(m)</b>
Platinum	12 platinum reserves	600
Diamonds	51% of Alexkor	150
Coal	Leeuw Mining	90
Junior mining	Start ups	10
West Fort	Tourist housing estate	35
Riveira Hotel Holdings	Upgrade and expansion	94

### **The manufacturing sector**

South Africa offers a potentially strong manufacturing sector. Sectors that are able to raise their productivity to international levels can turn their relatively low labour costs into a strong competitive advantage. The continuous strengthening of the Rand in 2002 was a new experience for the new South Africa and continues to have an impact on its competitive position.

Various manufacturing plants have been created, (e.g. Saldanha Steel, Columbus Stainless Steel, the Billiton Aluminium smelters at Richards Bay, Hulett Aluminium) to add value to this mineral base by middle- and end-product manufacturing. The stainless steel industry alone consists of over 400, mainly small or medium-sized, companies that employ 28,000 people. The country's steel industry has also undergone a considerable consolidation and international steel concerns now show specific interest in the investment opportunities arising from this (e.g. WPSC, Ferrostaal (Columbus), and Ispat/LNM, where 10% of the company belongs to Iscor, which split its mining and steel activities in Iscor Steel and Kumba Resources and exchanged the 50% IDC share in the troubled Saldanha project for Iscor shares).

The motor car industry in South Africa stands out and the country as a whole is very well positioned to benefit from the international trend towards more flexibility in automobile manufacturing <sup>6</sup>.BMW exports its 3-series from South Africa and is in the process of expanding its investment in its Rossalyn plant near Pretoria from 1.1 Rbn, with a further 2.2 Rbn to 3.3 Rbn for export. Volkswagen exports the Golf 4 to Europe while

<sup>6</sup> The Economist February 23, 2002.

DaimlerChrysler assembles the C-class Mercedes-Benz both for export and the local market. In addition to this, Ford and Toyota have established production plants while several component manufacturers (Arvin Exhust, Bloxwitch, Corning, Senior Flexonics,) have established production bases.

Chemical processing is the largest manufacturing sector of the country's economy, accounting for some 5% of GDP and its base in downstream, fine and specialty chemicals provides strong opportunities for investors. There are also significant opportunities in product manufacturing, pharmaceuticals, household products, agrochemicals and industrial chemicals.

The fact that South Africa's seasons are opposite to those of the Northern Hemisphere, combined with the strong market in Europe and the United States for delicacies and organic food, offers excellent global opportunities. South Africa is self-sufficient in food production and its well developed food and beverages industry has become a global player (e.g. SAB Miller in China, U.S.A. and Europe). It also has a strong tradition of food research achievements (e.g. cereals science, fruit technology, biotechnology, genetic engineering, fermentation chemistry, as well as essential oils and botanical extractions).

**Figure 4: Opportunities in the manufacturing sector**

<b>Opportunity</b>	<b>Description</b>	<b>Investment R(m)</b>	<b>Export R(m)</b>
Conveying pipes	Production of stainless steel pipes	82	2 300
Agro-processing	Various projects in agro-processing	246	NA
Coega development	Manufacture of special export steel	2 050	2 400
Coega development	Precision strip steel facility	820	3 500
Automotive industry	Low-cost titanium production	2 060	2 880
Steel production	Silicone metal and aluminium alloys	302	1 480
Gold beneficiation	Downstream projects	334	4 760
Swedish Match	Oral tobacco manufacture	955	2 865
Carbon manufacture	Carbon from wood purification	239	648

### **The banking and financial services sector**

This is a very well developed sector, one that competes at a global scale, as listings on the London stock exchange illustrate (e.g. Old Mutual, Investec). It also has many more fully developed financial institution (Nedcor, Sanlam, Liberty, Pension funds), as well as the ninth largest stock exchange (and a functioning partnership with the London Stock Exchange) in the world. In 2002, the country's banking and financial services sector began a still ongoing process of consolidation. It took the initiative in preparing a charter on black economic empowerment and has, since 1994, welcomed and nursed young black intellectuals and managerial talent. The year 2002 also saw some significant deals in asset management, with certain companies (First Rand/Future Growth, African Harvest, Alexander Forbes/Millennium Consolidated Investments, Nedcor-BoE Asset Management/Aka Capital) transferring shareholding to black owners.

Particularly important for the broader development of the country's economy is the micro lending sector. In its original form, micro lending was a niche business pioneered by specialised banks making suspiciously high profits. Unfortunately, keeping the bad debt to a minimum proved to be an hard act to follow for mainstream banks, as illustrated by the Saambou bankruptcy. Despite this, micro lending has a very definite future in South Africa because, to win the unemployment battle and enhance black economic empowerment, the country will have to make many small investments in small and medium sized companies. And if it is to do this, a mature and sound micro lending industry will prove to be vitally important.

Inbound and outbound cross-border financial structuring involving foreign and South African companies will find plenty of opportunity both in and outside the country. Within South Africa, the restructuring of state assets and the growing application of the concept of Public-Private Partnerships both offer a variety of opportunities for foreign expertise, as illustrated in Figure 5.)

**Figure 5: Public-Private Partnerships and the restructuring of state assets**

Project	Private partner	Status	Term	Value (Rm)	
Fleet Management North Cape	ImperialHoldings/Afrika Kosini	1	5 years	181	
Inkosi Albert Luthuli Hospital	Impilo consortium	1	15 years	4 500	
State Vaccination Institute	Biovac consortium	2	5 years	15	
Ministerial accommodation	Rainprop consortium	2	27 years	2 300	
Gautrain	2 companies short listed	3	>15 years	7 500	
Spoornet	Not yet identified	4	n/a	undecided	
Portnet	Not yet identified	5	n/a	undecided	
Eskom	Generation	Not yet identified	6	n/a	undecided
	Transmission	Not yet identified	6	n/a	undecided
	Distribution	Not yet identified	6	n/a	undecided
	Local distributors	Not yet identified	7	n/a	undecided

1: Financial Mail, 7 March 2003, page 51

2: 1: closed, 2: In negotiation 3: In feasibility, 4: Business Model 5: Restructuring, 6: Regulatory Framework, 7: Strategy

### **The technology-media-telecoms (TMT) sector**

In line with recent trends throughout the rest of the world, resulting from the economic binge of the 1990s, the technology-media-telecoms sector has slumped. Its market capitalisation has dipped from some R120bn to a mere R5bn. Under these conditions, certain major players are now reconsidering their positions (e.g. New African Investment Ltd and Jhonnice) and a general process of consolidation and restructuring is taking place. Despite this, the innovative spirit of many in the sector has not been deterred because they firmly believe that the power of Internet-based e-business to influence smarter business is still sound. At the same time, they admit that such soundness is more likely to manifest itself in integrated traditional business models and applications through such endeavours as seamless communications and convergence between voice, data, and new media. An example of this entrepreneurial spirit is the MTN-group<sup>7</sup>, which has made

<sup>7</sup> Owned for 36.5% by Jhonnice Holdings, 19.0% by Ice Finance and 44.5% by other shareholders.

important strides into Africa (Swaziland, Mauritius, Nigeria, Cameroon, Rwanda and Uganda).

The government's stake of 25% in Telkom was finally listed on March 4<sup>th</sup> of this year. This led to further liberalisation of the sector and this, in turn, is expected to stimulate the country's slumped telecommunications sector. In addition, the sector is expected to become more competitive with the issue of a license to a Second Network Operator (SNO), something in which Deutsche Telkom has shown an interest. To speed this process up, the procedure governing the SNO license has been switched from a tender to a negotiating process on the basis of (the controversial) section 35(a) of the amended Telecom Act.

From a contrary perspective, however, the slump presents attractive buying opportunities and the turnaround in the technology sector is evidenced by the launch of five new venture capital funds sponsored by the IDC in 2001 and totalling over R1bn, as well as the recent launch of a R250m venture capital fund by Ethos Venture Partners. Also worth noting is that South Africa has continued to develop its proven R&D track-record partly due the existence of incubator hubs in Pretoria, Cape Town and the eight specialist DTI sponsored incubators.

There is also a positive track-record of technology-related initiatives, with companies such as Thawte and Didata being very aggressive in keeping pace with world class technologies. Experts claim that the country's creativity and innovation is on a par with that of Israel and India. In addition, manufacturing costs are relatively low, making the country a leading destination for IT development and innovation, which creates easily exportable Intellectual Property. The converse is also true, with South African companies keeping abreast of world class technologies by buying and distributing leading edge products throughout the country.

**Figure 6: Specific investment opportunities in the TMT-sector**

<b>Opportunity</b>	<b>Sector</b>	<b>Transaction size/s R(m)</b>	<b>Amount invested R(m)</b>
Eskom Enterprise into the SNO	Telecoms	20 000	2 000
Venfin into Didata	IT services	3 000	2 000
Masterskills	e-learning	15	10
City of Joburg – Shared Services	IT switching	300	300
Wizcor	TMT investor	500	50
3R Telecoms	Telecoms	50	10
AST abbraxis	IT services	100	50
Johncom (restructuring)	Media	4 750	1 200
MTN International <sup>1</sup>	Telecoms	8 685	850

1. Opportunities in Africa (Swaziland, Mauritius, Nigeria, Cameroon, Rwanda, Uganda) average in range from R(m) .....

### **3. Conclusion**

To turn the opportunities South Africa offers into successful investments, decision makers would be well advised to develop relationships with South African companies,



either in partnership or through incorporated joint ventures. Such local partners would then need to balance a global perspective with close, in-depth South African relationships. The local opportunities with a global perspective that South Africa offers to foreign companies, combined with the international connections of the country's existing global players, offer cooperating foreign and South African companies a sound basis for financial success in a global economy. And by working with South African businesses, foreign companies will become an integral part of the challenge that South Africa itself faces: strengthening its grip on democracy by offering the Third World component of its society the full benefits of participating in its global economic successes.

Authors:

Adriaan Brouwers (Managing Director)

Leverage

Beurs van Berlage

Damrak 339 – 343

Amsterdam

The Netherlands

Tel: +31 20 622 8768

Fax: +31 20 622 8427

Mob : +31 62 256 5979

E-mail : [a.brouwers@leverage.nl](mailto:a.brouwers@leverage.nl)

Ibrahim Khan (Chief Executive Officer)

Wizcor

Wierda Valley, 98 Albertyn Avenue

Johannesburg

South Africa

Tel: +27 11 883 1915

Fax: +27 11 883 1913

Mob: +27. 83 600 3088

E-mail: [ikhan@wizcor.co.za](mailto:ikhan@wizcor.co.za)

Colin Reddy (Research Director)

Business Map Foundation

57 St Andrews Road, Houghton Estate

Johannesburg

South Africa

Tel: +27 11 487 3435

Fax: +27 11 487 2133

Mob: +27 83 284 2153

E-mail: [colin@businessmap.co.za](mailto:colin@businessmap.co.za)