SOUTH AFRICA
Moving Opportunities: an analysis of the logistical sector

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Summary
The constant, and increasing, economic growth of South Africa has led to developments in the logistics sector that are critically important for the future development of the economy. Traditionally, South Africa has a sound logistical infrastructure. However, lack of investments combined with state bureaucracy have driven a widening gap between the needs of the clients and the performance of Transnet, the State owned transport company. As a result, the rail/road ratio continues to deteriorate because clients prefer to use road transport under their own control rather than the rail transport provided by Spoornet, a wholly owned subsidiary of Transnet. In response to this, focused restructuring processes have been put in place within Transnet and are in the process of achieving the desired results.

Against this background, immediate opportunities for the international investor can be found in the restructuring activity - consisting of the disposal of non-core Transnet assets - and in the investment programs and funding of the infrastructure facilities. Medium term corporate restructurings in the form of public private partnerships are also being explored. Services in respect of operational efficiency and intelligent operational use offer strong niches for profitable investments in parallel with the investment opportunities.

South Africa continues to offer investment opportunities in the sectors spearheading its economic growth: telecommunications, financial services, mining, automotives and tourism.

Research and analysis
The First State of Logistics Survey, carried out in October 2004 by the Council for Scientific and Industrial Research (CSIR), the Department of Trade and Industries (DTI) and Spoornet, offered as its key conclusion that South Africa is spending far too much (15.2% of GDP, compared to approximately 10% in well developed economies) on its logistics: R180bn, of which R134 bn is being spent on direct transport and R45 bn on associated logistical costs. In addition to the high cost levels, it also concludes that three quarters of the long haul tonnage in South Africa is transported by road - contrary to the international best practise of transporting it by rail - and that the challenge facing South Africa is to achieve greater efficiencies between road and rail, with the second best option being to create improvements within either mode of transport. Unfortunately, the Second State of Logistics Survey of October 2005 was forced to conclude that the trend has not yet been reversed. Although the declines in rail transport from 1997 to 2003 have been halted, growth in tonnage available for transport is being captured by road transport companies. To reverse this trend, structural changes are required.

This need for structural change in the new South Africa that emerged with the first full election in 1994 was identified by the Transport White Paper of 1996. This focused attention on the sector and, subsequently, led to the articulation of strategies for the long term development of South Africa's transport and logistical infrastructure. The paper's key findings were that operational planning continued to reflect old priorities, that there was systematic under investment, and that broad prioritisation took precedence over focused resources for specific clients. It also noted that although highly concentrated transport corridors linked dense industrial locations, high prices, poor service levels and low reliability were undermining export competitiveness.

In general, the attitude of South African companies towards logistics is defined by a lack of strategic optimisation in the supply chain, the absence of collaboration between industries, a lack of focus on customer satisfaction and insufficient performance management systems

In addition to working within the above constraints, different businesses must also battle the specific problems of their own supply chains. The *chemicals industry* has developed primarily around the gasification of coal to produce petrochemicals, and consists of four broad categories of products: base chemicals (ethylene and other petrochemical building blocks, ammonia, acids); intermediate chemicals (waxes, solvents, plastics); chemical end products (paints, explosives, fertilizers); and speciality end-products (pharmaceuticals, agro chemicals). Some of these products are hazardous and the challenge now facing the supply-chain challenge is not only to ensure safety but also to save transport costs while still maintaining reliability. The structure of the *agriculture and processed foods* industry has changed as a result of the growth of chains of supermarkets. Economies of scale now allow supermarkets to offer a wider variety of products all year round. This means that the industry must maintain the national availability of high-quality fresh products with limited shelf life by delivering perishable goods from the farm to the shelf within 11 days. *Logistics service providers are* shifting their positioning from being transporters and wharehousers to providers of such services as procurement, demand forecasting, clearing and forwarding, network-planning and channel design, as well as using information technology for supply-chain strategy development and to enhance the visibility of the supply chain. The *mining* sector is advocating the concession of some of its railway lines to private operators to improve efficiency and ease export bottlenecks. The key challenge facing the *national health care* system is finding a way to provide the country with all the supplies needed, while still keeping the inventory levels to a minimum.

To be globally competitive, South Africa will have to develop a supply chain that is globally sustainable and which offers global security. It must provide visible and transparent systems from beginning to end, all challenges of which it is very well aware.[1]

Government policy

Traditionally, the logistical sector has been totally dominated by one large parastatel (state agency): Transnet. Transnet combines all the transport by rail (Spoornet), by port (Portnet) and by pipeline PoTransnet. Transforming this sector, therefore, requires therefore state intervention. That the government is fully committed to such a revitalization of the logistical sector is clearly evidenced by the funds being made available and by the managerial and organisational changes currently taking place.

Table 1: Budget focus on key infrastructure sectors (in millions of Rands)

Sector	2005/06	2006/07	2007/08	2008/09	Total
Water	6 039	7 422	6 176	5 706	19 304
Sanitation	2 297	2 422	2 494	2 606	7 522
Electricity	13 233	18 018	18 719	21 310	58 047
Housing	8 398	9 594	11 075	11 746	32 415
Education	2 481	3 022	3 351	3 894	10 267
Health	6 381	6 744	7 425	8 087	22 255
Roads	13 851	16 310	22 079	24 791	63 180
Rail	4 465	5 090	6 321	6 380	17 791
Ports	2 843	5 244	5 172	4 268	14 684
Courts	253	980	851	831	2 662

[1] The First State of Logistics Survey for South Africa 2004, page 11.

Police	447	498	708	1 188	2 394
Prisons	235	398	451	570	1 419

Source: Budget Review

Maria Ramos, the successful Director General of the powerful Treasury Department – and a woman with the reputation of getting things done - was appointed CEO of Transnet in October 2003 for a three year period after a number of heavyweight incumbents (such as Saki Macozoma and Mafika Mkhwanazi) had taken the helm without making an impact. However, despite the clear direction and progress she has made, the transformation is far from finished. In August 2004, she set out a strategy giving priority to: a redirection of the group's focus; a restructuring of the balance sheet (burdened with pension fund liabilities and a hedge book); the adoption of strict corporate governance; the implementation of a structured risk management process; a review and improvement of the procurement process; a review of the IT strategy; and development of the human capital.

Maria Ramos assembled a strong team around her. When Dolly Mokgatle resigned as CEO of Spoornet after not delivering the necessary results, Ramos appointed Port Authority CEO Siyabonga Gama who, as CEO of the National Port Authority, turned around the once notorious Durban terminal and also overhauled the port's pricing system. Important new blood was injected into the organisation with the appointment of the Stanbic lawyer Vuyo Kahla - legal advisor to Mandela and to the extremely successful finance minister Trevor Manual, and familiar with Ramos from his time at the Treasury's legal department – as the head of the legal department responsible for litigation, corporate governance and legal services. Pradeep Maharaj, who gained experience in the prestige Gauteng Blue IQ projects and who headed up the Gauteng finance department, has been appointed as head of strategy. Key to that strategy is a focus on core business and the disposal of non-core assets. This process has strained the relationship with the unions, who want as much influence in the process as possible, but who nevertheless signed after strike actions against the restructuring pact on May 17.

Table 2: Opportunities in the disposal of non-core assets

Assets	Shareholding	Estimated Value R bn
Metro Rail	100%	3.2
Victoria & Alfred Waterfront	25%	2.5
Second Network operator	15%	0.3
SA Express	100%	1.4
Blue Train	100%	1.0
Arivia.kom	32%	1.2
Shosholoza Meyl	100%	0.7

The disposal process will make Transnet a supply chain company focused on its rail, port and pipeline operations, with a vertical separation between operations and the custodianship of infrastructure, and an intermodal co-ordination to ensure a seamless integration between rail and ports. The performance of Spoornet is improving with unscheduled trains down from 28% to 1%. In addition, 148 locomotives are in the process of being delivered by early 2007, mainly for application at the Orex iron line from Sishen to Saldanha and at the Coallink line to Richards Bay. Spoornets Vulindlela ('Open the way' in Zulu language) project is achieving tangible reductions in journey time of as much as 80%. The improved co-ordination between rail and port operations is reducing the required storage space dramatically, improving the value chain in the process. The improvements are also reflected in the Transnet financial results. The revenue for the year till March 2006 increased 7% to R 26.3 bn, while the operating profit increased with 57% from R 5.4 bn to R 8.5 bn. At the presentation of the results Maria Ramos stated explicitly that the long term goal is to reduce the transport cost of the South African economy to around 8% of GDP.

Business improvements of Transnet are beginning to show and are being supported by private sector developments. 30% of Boss Logistics, which provides logistics for bulk rail, was acquired by the South African company Mendo. A joint venture between Mitsui (59%) and black empowerment companies Sibambene and African Sky Innovative Solutions (together making up 49%) entered into a contract with Spoornet to deliver 110 electronic locomotives for R3.5bn. Private sector initiatives from Barloworld logistics and Sheltam in Namibia have also enhanced the productivity of rail freight operations substantially. Transnet itself has ambitions to move into Africa: with its 22,298 km of track, Spoornet already has a substantial share of Africa's 84,000 km of railway lines.

Table 3: Opportunities in the infrastructure

Sector	**Amount R bn**
Spoornet	
Coal line	8.0
Ore line	2.7
General freight	10.8
Maintenance	8.1
Petronet	
Multi-product pipeline	4.2
Gasline upgrade	0.4
National Port Authority	
Durban	8.7
Cape Town	3.9
Coega	2.5
Richards Bay	1.4
SA Port Operations	
Durban	1.5
Richards Bay	1.0
Coega	1.2
Cape Town	0.9
Saldanha	0.6
Transwerk	
Equipment	2.6

Source Financial Mail 7 July 2006

Opportunities in a vibrant economy

Creating and maintaining the logistical efficiency analysed in this chapter is critically important for the continued and accelerated growth of the South African economy. Sectors such as *telecommunications, financial services, mining and metal, tourism*, as well as the consumer boom, continue to be the pillars of the economic prospect. And with the exception of the consumer boom, all these sectors include an 'into Africa' dynamic in the opportunities they offer.

The opportunities offered by the *telecommunications* sector are driven by the recently signed Electronic Communication Bill and the enhanced competition it intends to create. The Telkom monopoly legally ended on February 1, 2005, but it will take many years, and many future actions by competitors to break down its entrenched position. The *financial services* sector is in the process of identifying the opportunities offered by the second economy of the townships and rural areas. Together with the ability of the underdeveloped small and medium sized company sector - critically important in all economies the world over - to create employment, this is one of South Africa's main challenges and will definitely concentrate the minds of this sector. The *mining and metal* sector is traditionally the cornerstone of the South African economy. Current high commodity prices, combined with political and economic developments on the African continent - a result not only of NEPAD but also of international attention and local stabilizing processes – are strengthening the sector's outlook. As for *tourism,* South Africa continues to remain an unrivalled tourist destination - with the beauty of the country offering exciting opportunities for all age groups – which in turn offers excellent employment opportunities in the sector.

That said, the dynamics of the South African economy can be better understood by an assessment of the advances that Black Economic Empowerment (BEE) continues to make. The current empowerment framework was laid down in the BEE's code and has, over the years, been prudently developed. Sector-specific BEE charters then specify the framework of conditions and are generally accepted as instrumental in achieving the objective of a more even distribution of economic power. They are based on a balanced score card approach, one that rewards pro-active enterprises and avoids direct government intervention. But without consistency in application, the effectiveness of the charters is limited. Broad-based empowerment aims not only for equity ownership but also for participation in management positions and supply side empowerment. And contrary to the sensational media exposure of the enrichment of a few well-connected individuals, the reality is that much empowerment activity is generated by the smaller and medium-sized entities that operate creative structures for broad-based communities and employee participation. BEE is, in fact, such a vibrant sector that some 75% of all corporate activity in South Africa is empowerment-based, and needs prioritisation by serious investors. The Economist of April 23, 2005, summarised the situation aptly by noting that if empowerment comes at a cost to the economy in the short-term, it must surely be a very small price to pay for the considerable structural advantages it brings in the longer term, not to mention the underlying social stability it will also create.

Table 4: Additional opportunities reflecting Black Economic Empowerment

Industrial Sector	Target Company	Source Company	%	R bn
Mining	Xstrata	ARM	30	2.4
Health care	Netcare	GHG	51	23.7
Banking	Absa	Barclays	60	33.0
Insurance	Old Mutual	Skandia	55	38.0
Mining	Harmony	Goldfields	*	
Telecommunication	Vodafone	Ven-Fin	30	22.0
Beverages	SAB	Bavaria	72	52.0

* Hostile merger offer, abandoned May 5, 2005

The fundamentals[2] and challenges of an emerging robust democracy

The outlook for economic growth for South Africa is based on the stable economic environment created since 1994. Financial authorities have complimented the country on its determined pursuit of a prudent economic policy[3], a policy that continues to be subject to an open and healthy debate, as evidenced by African National Congress (ANC) papers that examine the balance between - on occasion - conflicting dimensions of economic policy in the flexibility of labour law, the position of the currency, BEE, levels of investments, employment and reduction in poverty.

[2] Euromoney, Venture Capital & Private Equity Yearbook, 2000/2001, page 83-86.
[3] The Economist, October 12, 1996; December 13, 1997; May 29, 1999; February 24, 2001; IMF and World Bank; Financial Times, November 26, 2001.

Launched by the government earlier this year, the Accelerated and Shared Growth Initiative commits, over a 3 year period, R372 bn to three priority projects: railway freight links, water supply dams and broadband. And while the national general council elections earlier this year have confirmed the political superiority of the ANC, the stability of the ANC is, nevertheless, being put to the test by the succession to President Mbeki in three years' time. Directly related to this, and part of the process, is the position of the deputy ANC President, Jacob Zuma, who is surrounded by controversy and who was asked to resign by President Mbeki as State Vice President once it became clear that he would be tried for allegations of corruption.

Despite the continued uncertain global economic outlook, the country continues to strengthen its consistent growth pattern: growth in its GDP rose from -2.1% in 1992 to 4.2% in 2000 and 3.5% in Q1,2005 while, according to the recent budget speech, economic growth is estimated to be 5% on average for the next three years [4]. Inflation[5] has also been reduced: from an average of 12.5% between 1990 and 1994, to an historic low of 4.3% in 2004 and 3.9% in Q1, 2005. (And even though inflation is currently rising, it should remain comfortably within the Central Bank's 3-6% target.) The budget deficit has also narrowed: from 10% in 1993/4 to 1.1% in 2002/2003. Subsequently, it has been allowed a controlled rise to 3.1% in 2005/06, but is intended to be kept to 1.4% in the next three years. And finally, after the sudden rise in the prime rate in 2002 to 17.0%, interest rates have also fallen sharply again, although a slight rise early in June 2006 left it at the present level of 11.0%. Worldwide, the Rand continues to be a strong performer against the US dollar: it has moved from an average of 6.44R=1US$ during 2004[6], to its present level of around 6.9R=1US$, a considerable improvement since its rate of 14.00R=1US$ in December 2001. As a result, the South Africa Confidence index has reached its highest level in 15 years.

South Africa's strengths continue to lie in its constitutional democracy, its strong banking and legal systems, good communications infrastructure, mineral resources, English-speaking business community, strategic geographical position, climate and, not least, its proud track record in negotiating practical political solutions. The land-reform program appears to be going well and offers a proactive approach to securing longer term socio-economic stability. South Africa's free press, tolerance of political opposition, and strongly independent judicial system are also all vital cornerstones for its democratic future.

However, although apartheid has ended, racism has not. Despite the achievements of the last eleven years, race is still a dominant factor in the distribution of resources, skills and opportunities.

Table 5: Structure of the South African economy

GDP (R bn)[A]	2002	%	2003	%	2004	%	2005	%
Agriculture[B]	28.3	3.2	26.6	2.9	26.9	2.8	27.1	2.7
Mining	63.9	7.2	66.7	7.3	69.4	7.3	73.2	7.4
Manufacturing	168.7	18.9	167.3	18.2	171.6	18.0	179.7	18.0
Energy/Water	22.0	2.5	22.1	2.4	22.5	2.4	22.9	2.3
Construction	23.4	2.6	24.7	2.7	26.2	2.7	28.1	2.8
Wholes/Retail	127.9	14.3	136.5	14.8	145.4	15.2	156.3	15.7
Transport[C]	93.4	10.5	98.3	10.7	103.7	10.9	108.7	10.9
Financial services	179.6	20.1	187.0	20.3	194.1	20.3	201.3	20.2

[4] Budget speech, February 22, 2006.
[5] CPIX inflation (consumer prices excluding mortgage interest).
[6] Financial Times Special Report, May 24, 2005.

Government	132.6	14.8	133.9	14.6	135.5	14.2	137.2	13.8
Personal services	53.9	6.0	56.5	6.1	58.7	6.2	61.1	6.1
Total value added (basic prices)	**893.7**	**100.0**	**919.3**	**100.0**	**954.0**	**100.0**	**995.6**	**100.0**

A: STATS SA B: including Forestry and Fishing. C: including communications.

While the South African government has a comprehensive programme on HIV/AIDS, including the recent introduction of anti-retroviral treatment in the public health sector, the burden on the economy is showing. It should be noted, however, that private sector initiatives have been taken to protect the interests of employees and companies alike.

The ambitious infrastructure plans from the government may make South Africa face a real capacity problem of qualified professionals, a problem which could partly be resolved by the employment of foreign consultants, or by South African nationals repatriating from abroad.

As a result of the high unemployment, labour relations in South Africa remain delicate. Depending on how unemployment is measured, the percentage is anywhere between 25% (according to the official ILO definition) and 40% (according to the expanded definition)[7]. Traditionally, the unions have been, and still are, strong. However, they are also pragmatic and have adjusted to the requirements of a global economy. Putting privatisation on the back burner in favour of PPIs is also likely to improve the stability of labour relations. The good news is that since 2003, the economy is generating more jobs than it is shedding. Small and medium-sized enterprises (SMEs) are most likely to generate the new jobs, and will be subject to more flexible labour laws. It should be noted that all the sectors covered in this chapter can be supplied by SMEs.

A number of specific programmes currently support economic growth: the Strategic Industrial Projects (SIP), the Industrial Development Zone Programme (IDZ), the Small and Medium Enterprises Programme (SMEDP), the Skills Support Programme (SSP) the Foreign Investment Grant Programme (FIG) and the Critical Infrastructure Programme (CIP). A lowering of the corporate tax rate to 29% has also helped competition.

Conclusion

In order to develop to their full potential the other opportunities South Africa offers, the opportunities offered by the supply chain must be turned into successes. If it is to succeed, the country has no other option than to resolve the 'blood circulation' of its economy, although it must also be said that it is well on its way to making progress in this respect.

The immediate opportunities lie in the disposal of non-core assets and in investments in infrastructure and the funding thereof. Internal developments for the restructuring of Transnet offer as many opportunities as there are preconditions for sustained interests by the private sector. In the medium term, there are several exciting restructuring opportunities in corporate restructuring, direct investments by private sector and - in addition to all the investments - in the synergy between the public and private sector.

However, in order to keep up with the many changes in so many different directions in South Africa, as well as to judge correctly the opportunities that

[7] The Economist, January 22, 2005, page 27.

these offer, interested investors are well advised to link themselves very closely to a local partner with good local knowledge.

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