

SOUTH AFRICA: Unlocking the potential of an economic middle and working class

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Summary

In the year 2007, South Africa is approaching a crossroads. In December 2007, the African National Congress (ANC) will decide on its new chairman, who under current tradition will also be a candidate for the next president of the nation. That president will face the challenge of creating economic development opportunities for much broader layers of the South African population than the country's solid economic performance over the last 12 years has achieved. Meeting that challenge will extend the middle and working class in South Africa and is the country's only hope for reducing its high crime levels. One of the most important economic developments in South Africa in the last 17 years has been the creation of the fast growing 'black' middle class. These young professionals, entrepreneurs and civil servants from previously disadvantaged communities have helped create the consumer boom that is currently propelling the economy to record levels. They buy houses and cars. They invest. However, they come out of poverty and face the day-to-day challenges of the serious crime threats in South Africa. This chapter describes the opportunities that the black and coloured middle class, the fight against poverty and the fight against crime offer for the stability of South Africa. In so doing, it will develop the concept of 'Economic Base Camps' being used to meet this challenge.

The crossroads¹ for a robust but still maturing democracy

South Africa is a pragmatic country. The African National Congress is a pragmatic movement. That is why they beat apartheid. That is why they reached a negotiated settlement for the transition to democracy between 1990 and 1994. And that is why a pragmatic choice may be expected in the critically important decision – to be taken in December 2007 – about the next ANC president. Three individuals have shown an interest in this position.

Thabo Mbeki, the current president of the ANC and of South Africa, is the first of these. He would like to extend his current ANC presidency to a third term. However, he is restricted by the constitution from also extending his presidency of South Africa, a condition that he has regularly announced he will respect. If his presidency of the ANC were to be extended, it would be the first time that the president of the ANC was not also the president of the country. It would also create a new centre of power, one that would extend his influence on the political process in South Africa. However, his legacy as president is mixed, with his Zimbabwe and HIV/AIDS policy and lack of progress in crime the obvious weak points. These deficiencies are balanced, though, by his economic and foreign achievements. During his presidency, he has built up a considerable power structure around him and developed a network of 'followers'.

The Deputy ANC President, Jacob Zuma, is the second interested individual. He is surrounded by controversy after being asked to resign by President Mbeki as State Vice President once it became clear that he would be tried for allegations of corruption. However, he has the support of the left wing and all other corners of the party who believe that, under Thabo Mbeki, far too much power has been concentrated in the ANC president's office. Although Zuma indicates that he will stick to current ANC policies, the future of South Africa is felt to be more uncertain under his reign.

The third interested individual is Tokyo Sexwale, a successful businessman, a former premier of Gauteng province and a freedom fighter who spent 15 years in prison on Robben Island together with Mandela. He has strong support in some corners of the ANC. He recently articulated his political agenda in a speech at Wits University, where his charisma and leadership style also confirmed a more forceful, direct, pragmatic and broad-based approach than the current president. He sees the private sector as the engine for job creation and intends to privatise poor-performing state enterprises. He is a strong advocate of a 'free thinking, more tolerant and open society'.

¹ Euromoney, Venture Capital & Private Equity Yearbook, 2000/2001, page 83-86.

In addition to these three, a fourth name is regularly mentioned: Cyril Ramaphosa. Cyril Ramaphosa was the chief negotiator for the ANC in the transition to democracy between 1990 and 1994. (He was also Mandela's preferred candidate to succeed him.) He chaired the interim constitutional committee as the basis for the elections in 1994 and was also the chairman of the parliamentary committee that delivered the final constitution in 1996. Other political experience includes his time as the General Secretary of the Union of mineworkers. Currently he is, like Tokyo Sexwale, a successful businessman. However, although he would probably be an excellent candidate – acceptable to a broad range of ANC-constituencies and in a good position to maintain unity in the ANC while developing it further – it is uncertain to what extent Cyril Ramaphosa is interested in the position.

The new president of the ANC will have to oversee its evolution from a liberation movement to a political party. In addition, it will also have to deal with the political implications of the emergence of a black middle class. For while the ANC is likely to remain the chief political force in South Africa for the foreseeable future, the main opposition party of the Democratic Alliance now has a new leader: Helen Zille. Zille is embarking on the extremely challenging combination of her position as mayor of Cape Town with the political leadership of the Democratic Alliance. Although this alliance is still struggling to make inroads into the black electorate, a growing middle class could well be a fertile ground for its growth. And this in turn could threaten the power of the ANC.

SWOT analysis of South Africa

The country's strong and weak points, as well as the opportunities and the threats facing it, can be easily identified. Its 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, last but not least, its proud track record in negotiating practical political solutions. The land-reform program appears to be going reasonably well – although delays are being incurred – and does offer a proactive approach to securing longer-term socio-economic stability. The country's free press, tolerance of political opposition, and strongly independent judicial system are also all vital cornerstones for its democratic future.

Within the positive 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 4.9% in 2006 while, according to the recent budget speech, economic growth is estimated to be 5% on average for the next three years² aiming for 6% in 2010. Inflation³ 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. Since then inflation has risen and is currently moving around the upper limit of the Central Bank's 3-6% target.

The usual budget deficit has been turned into a small surplus: from a 10% deficit in 1993/4 to 1.1% in 2002/2003. Subsequently, it has been allowed a controlled rise to 3.1% in 2005/06, but turned into a R5.0bn surplus (0.3%) in 2006/07 and is expected to increase to 0.6% (R10.7bn) for the current financial year. And finally, after the sudden rise in the prime rate in 2002 to 17.0%, interest rates have also fallen sharply to a low of 10.5% – although a rise in June 2006 and two subsequent rises left it at its present level of 12.5%, with a further upward move expected. Worldwide, the Rand continues to be a strong performer against the US dollar: it has moved from an average of 6.44R=1US\$ during 2004⁴, 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 a year ago reached its highest level in 15 years (although this has currently been reduced to the level of 11 months ago). This 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

² Budget speech, February 21, 2007.

³ CPIX inflation (consumer prices excluding mortgage interest).

⁴ Financial Times Special Report, May 24, 2005.

a prudent economic policy⁵, a policy that continues to be subject to an open and healthy debate, as evidenced by ANC papers that examine the balance between conflicting – on occasion – dimensions of economic policy in the flexibility of labour law, the position of the currency, BEE, levels of investments, employment and reduction in poverty.

Table 1: Structure of the South African economy

GDP (R bn)^A	2003	%	2004	%	2005	%	2006	%
Agriculture ^B	26.6	2.9	26.9	2.8	27.1	2.7	27.2	2.6
Mining	66.7	7.3	69.4	7.3	73.2	7.4	77.5	7.4
Manufacturing	167.3	18.2	171.6	18.0	179.7	18.0	188.5	18.0
Energy/Water	22.1	2.4	22.5	2.4	22.9	2.3	24.1	2.3
Construction	24.7	2.7	26.2	2.7	28.1	2.8	31.4	3.0
Wholesale/Retail	136.5	14.8	145.4	15.2	156.3	15.7	170.7	16.3
Transport ^C	98.3	10.7	103.7	10.9	108.7	10.9	116.3	11.1
Financial services	187.0	20.3	194.1	20.3	201.3	20.2	210.5	20.1
Government	133.9	14.6	135.5	14.2	137.2	13.8	138.3	13.2
Personal services	56.5	6.1	58.7	6.2	61.1	6.1	62.9	6.0
Total value added (basic prices)	919.3	100.0	954.0	100.0	995.6	100.0	1047.4	100.0

A: STATS SA. B: includes Forestry and Fishing. C: includes Communications.

The challenges facing South Africa are obvious: the HIV/AIDS epidemic, unemployment, poverty and crime. According to government estimates, South Africa has at least 5.5 million HIV-infected individuals. And although this year saw the launch of a R45 bn National Strategic Aids Plan – a comprehensive programme, including anti-retroviral treatment in the public health sector – the burden laid by the disease on the economy is evident nevertheless. It should be noted, however, that private sector initiatives have been taken to protect the interests of employees and companies alike.

Crime rates in South Africa are, in some areas unfortunately, rising again. This is illustrated by Table 3.

Table 2: Crime statistics for South Africa

Crime category	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Murder	21 405	21 553	19 824	18 793	18 545	19 202
Attempted murder	31 293	35 861	30 076	24 516	20 553	20 142
Rape	54 293	52 425	52 733	55 114	54 926	52 617
Indecent assault	7 683	8 815	9 302	10 123	9 805	9 367
Robbery at business premises	-	5 498	3 677	3 320	4 387	6 689
Cash-in-transit robbery	238	374	192	220	385	467
Bank robbery	356	127	54	58	59	129

Source: Business Day, Thursday July 5, 2007

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)⁶. Traditionally, the unions have been, and still are, strong as illustrated by the recent weeks-long strike by public workers. However, they are also pragmatic and have adjusted to the requirements of a global economy.

The middle class as an engine for the economy of South Africa

⁵ The Economist, October 12, 1996; December 13, 1997; May 29, 1999; February 24, 2001; IMF and World Bank; Financial Times, November 26, 2001.

⁶ The Economist, January 22, 2005, page 27.

The existence of a strong and growing black/coloured middle class in the South African economy is a new but irreversible phenomenon in the country's economy. And in 2005, the University of Cape Town/Unilever Institute conducted its first 'Black Diamond' survey: the first serious attempt by the marketing profession to understand the dynamics of this new phenomenon. The recent second version of this survey shows that the black middle class has grown by 30% in the last 15 months, adding 600,000 black adults to the middle class. This middle class makes up 30% of retail demand, which (measured in constant 2000 prices) grew consistently on a year-by-year basis from a modest 3.7% in early 2005, to a peak of 13.2% in August 2006, before declining to its current level of around 6%.

The survey estimates that the collective purchasing power of the black middle class in the first quarter of 2007 to be R180 bn, up by R50bn (38%) from the final quarter of 2005. This trend is confirmed by the South African Advertising & Research Foundation, which found that between 2004 and 2006, there was a 91% increase in the number of adults with a personal income in excess of R12,000, while other categories achieved similar growth percentages.

However, TNS Research Surveys have established that the total 'debt to disposable income' ratio is 63%, which is relatively low for the black middle class when compared to the South African average of 76%. The majority of this R114 bn debt lies in home loans (68% or R77.5 bn) and motor vehicles (24% or R27.3 bn). The overall figures can be broken down into different categories.

The main spending power of the middle class is reflected in the South African housing market. Over the last 10 years, South Africa has been the top performer in the global housing market with *The Economist's* house price indicator showing a 351% rise between 1997 and December 2006.

Table 3: Average house prices in South Africa's major metropolitan areas

	J'burg	East London	Pretoria	Port Elizabeth	Durban	Bloem forntein	Cape Town	Mpuma langa
2000	281 818	227 298	305 726	245 214	232 380	231 646	338 299	194 503
2003	480 937	356 363	539 885	372 318	401 253	372 138	498 858	303 281
2006	875 508	796 358	921 884	771 215	854 238	761 285	970 331	661 745

Source: ABSA

Some concern about the sustainability of this growth in middle class spending patterns could be drawn from the even higher growth figures for private credit extension, especially when combined with the National Credit Act coming into force in June 2007 and the recent rises in interest rates. Private credit extension has accelerated in recent years. It began at around 15% in early 2005, then accelerated sharply to 24% by June of that year. Although it declined to 19% later in 2005, it continued to grow through 2006 to its current level of around 25%.

However, on June 1, 2008, the National Credit Act will be operational. This will require a much more thorough credit lending process than has been applied so far. It will consist of formal steps for: checking customer credit records; recording financial information; affordability tests; quotations; signed agreements and release of funds.

The high unemployment levels in the economy of South Africa

One of the biggest challenges for South African politicians and the South African economy is the need to make severe inroads into the country's extremely high level of unemployment. A number of specific programmes currently support economic growth: the Strategic Industrial Projects (SIP), the Industrial Development Zone Programme (IDZP), the Small and Medium Enterprises Programme (SMEP), the Skills Support Programme (SSP) the Foreign Investment Grant Programme (FIGP). Unfortunately, no dramatic successes have yet been achieved. Historically, SMEs have proved (internationally) to be the engine for job creation.

The Industrial Development Corporation is the governmental agency set up to stimulate business development; unfortunately, many entrepreneurs can easily become the victim of its bureaucratic processes. Khula Enterprise Finance is a wholesale institution and not a direct lender: it helps entrepreneurs to arrange their funding and provides guarantees to the banks for the loans they make. The Department of Trade and Industry is supposed to be at the 'coal

face' of the government's small business efforts – and thinks highly of its own performance – but the many reorganisations it has gone through have resulted in a widespread suspicion about its overall effectiveness.

South African entrepreneurs often find themselves kicked around between different government agencies before they find the right one. Banks are, by definition, poorly positioned to assist new entrepreneurs because they look to past performance and ask for collateral assets. Venture capitalists are the only institutes with the professional knowledge and expertise to judge cash flows and identify the potential of new ventures. Unfortunately, they restrict their focus to companies in which millions of Rand are to be invested. Against all this must be set the emergence of a niche market: mutual support from fellow small companies. Services ranging from offering office space, to assisting with legal documents to data storage can help the new South African entrepreneurs concentrate on closing their first deals.

Boosting skill levels

But employment also requires skills and these are in short supply in South Africa. The two areas most requiring them are in engineering (welders, electricians, fitters, turners, millwrights, sheet metal workers, boilermakers, mechatronics, mechanics, toolmakers and patternmakers) and construction (bricklayers, plumbers, carpenters, joiners, shutterhands, steel fixers, glaziers, plasterers and tillers).

The training of artisans has fallen dramatically since 1975. Then, 33,000 were trained. That number fell to 7,500 in 1990, 3,000 in 2000 and only 1,440 in 2005. At the same time, the average age of skilled artisans has risen to 53 and South Africa currently has many relatively young white retirees. They received a golden handshake in the early years after apartheid, but now their experience and skills are badly needed, particularly in the municipal environment.

Yet the government is making little progress. The Education and Training Authority, set up by the Skills Development Act in 1998, has backfired and the government response has been too bureaucratic.

The Joint Initiative on Priority Skills has been launched within the Shared Growth Initiative (AsgiSA). This is supposed to tackle the skill crisis by bringing together a team of high-powered business leaders and ministers on all fronts (from educational reform to financial and engineering mentoring programmes in town councils). The hope is that the private sector could offer a more pragmatic approach by 1) training artisans, 2) getting the South Africans working abroad to come back to South Africa, 3) bringing retirees into the workforce, 4) importing foreign skills.

Economic Base Camps: extending opportunities to the poor

Could South Africa learn something from the principles of Venture Capital & Private Equity? The first of these principles is *'opportunity driven'*. The second is *'long term profitability'*. The third is *'growth'*. The fourth is *'cash flow'*. The fifth is *'professionalism'*. Would it be possible for South Africa – inspired by these principles – to create tangible success stories not only for individual entrepreneurs, but also for communities as a whole? Could such success stories be broadcast so that they inspire a sense of opportunity throughout the country, at each and every level, as a 'medicine' against the threats of crime?

The struggle against Apartheid took South Africa 42 years to win. Would it be possible – using the principles listed above – for South Africa to launch a serious 'war on poverty', and conduct it with the military precision and determination required to win any war? The concept of 'Economic Base Camps' combines and incorporates the principles of Venture Capital & Private Equity, to make the best use of both the public and private sector as well as the mobility of guerrilla warfare.

Base camps are the starting point for a journey, often one not without risk or danger. Each and every economic opportunity can be turned into an Economic Base Camp, provided the Venture Capital & Private Equity principles are met. An Economic Base Camp is a

(combination of) economic activity(ies), within a defined area in which individual entrepreneurs, together with community interests, form an entity of sufficient critical mass to offer a realistic and sustainable growth path. Specific examples could include a taxi ramp, strategically positioned at a crossroads, and designed to offer car servicing, maintenance, travel services and various public infrastructural improvements. Another example could be illegal waste dumps: these could be turned into municipal solid waste management centres with satellite recycling centres. Social activities in townships could also be the starting point for an Economic Base Camp (Zethu Ngecza, 17 years old, from Kwazakele township in Port Elizabeth; as reported in the *Mail & Guardian*, May 18 to 24, 2007).

The professional support for Economic Base Camps would be provided by visiting Professional Mobile Teams. These would belong to a central organisation – a Command Centre – of either a private, a public or a public/ private partnership. This Command Centre would have its own funds to invest - as well as further access to more funds - and would provide the institutional framework for the work of the Professional Mobile Teams. Commanders of such teams would be seasoned professionals, while the 'soldiers' would be young, talented professionals. Such Mobile Professional Teams would provide necessary support at crucial stages of the journey, liaise with local authorities and assist in decision-making, funding and the setting up of a managerial and financial infrastructure.

As part of the drive, success stories would be broadcast each day on SABC I, II, or III, and designed to inspire other individuals - and communities - to pass on the lessons learned.

Conclusion

The challenges of South Africa offer as many, if not more, opportunities. Meeting the challenges will extend the middle class. It will continue the spending power in such areas as housing, furniture, telecommunications, financial services, consumer goods, travelling and holidays. It is, however, understandable that potential investors allow South Africa to live through 2007 and to make its own decisions. This of course means that these decisions are critically important. However, confidence that the country will continue its pragmatic development is easy to support by looking at the evidence of the last 20 years. In short, the opportunities that South Africa has offered since the start of its democracy can be expected to continue for a long time to come.

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