INVESTMENT CLIMATE IN SOUTH AFRICA FOR AMERICAN COMPANIES

2015 / 2016

Foreword

In 2015 Amcham commissioned globally respected research firm AC Nielsen to carry out an economic survey amongst American companies in South Africa, with a view to understanding the significance of American investment in South Africa. Questions were also asked about barriers to trade, trade in Africa, skills development and training and corporate social investment. The responses are analysed in this report.

A total of 63 companies (25%) of the membership of Amcham, responded to the survey.

The results indicate that trading opportunities in the South African market are geared to increase the bottom line for effective and competent companies. American companies are committed to growing the South African economy, and to fighting the triple burden of poverty, inequality and unemployment. South Africa, with its offering of world-class financial services, well developed infrastructure, and rule of law remains an attractive business destination.

We must do everything in our power to ensure that South Africa remains a competitive business destination. As a country, South Africa competes against very attractive business destinations that offer bigger and more competitive markets and are located closer to global trading corridors. It is for these reasons that business and government must hone policy issues to ensure that, as a country, South Africa continues to attract foreign direct investment.

South Africa is the power nation of Africa and all who live and work in the country must contribute to grow the economy. That is the contribution American investment brings to South Africa.

Carol O'Brien
Executive Director

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Introduction

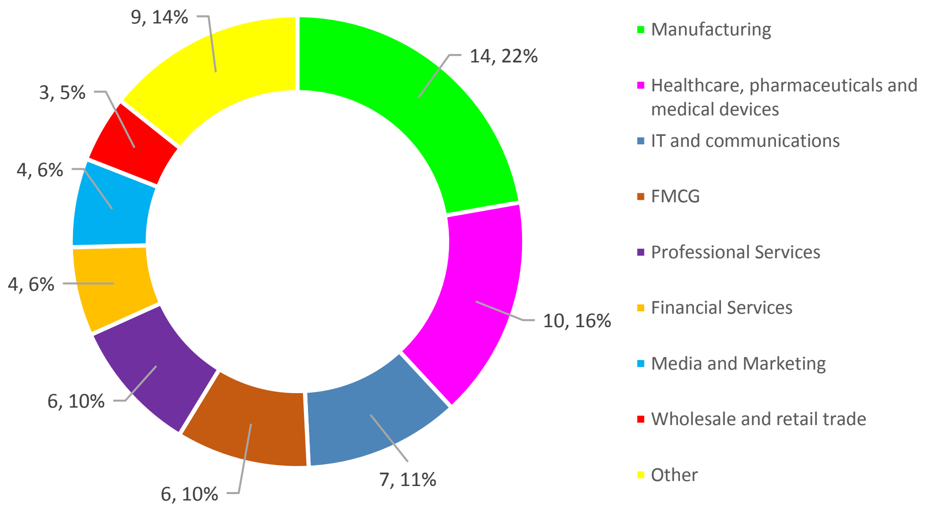
The American Chamber of Commerce consists of 250 American companies. These companies represent the sectors set out in Table 1 below. The Services Sector which consists auditing, consulting, research and other is the biggest sector consisting 41 (16%) companies followed by the Manufacturing sector which has 24 companies in this sector (10%). The ICT and electronics sector consists 21 (8%) whilst the Financial sector (including insurance) represents 19 companies (8%).

Table 1: Sectoral Representation of all members of the American Chamber of Commerce in SA

Sectors	No
Advanced Materials (including ceramic, glass, metals, composites)	**2**
Automotive products, components, medium/heavy commercial vehicles	**8**
Business process services (covering all Business, Consulting, Auditing, Research and Other Services)	**41**
Clothing, textiles, footwear and leather	**1**
Construction (including engineering)	**10**
Creative Industries: Crafts, music and film	**3**
Education	**2**
Financial (including insurance)	**20**
Food and Beverages	**9**
Green & Energy-saving industries (including power generation)	**3**
Health & Welfare Services (including wholesale trade of medical equipment and devices)	**8**
ICT & Electronics	**21**
Integrated Transport (including freight and express services)	**6**
Legal	**7**
Manufacturing	**24**
Metals fabrication, capital and rail transport equipment	**2**
Pharmaceuticals	**14**
Retail	**14**
Security	**3**
Tourism (including hotels and travel agents)	**6**
Transformation (including B-BBEE ratings agencies)	**4**
Oil & Gas Services and Equipment	**5**
Nuclear	**1**
Other	**36**

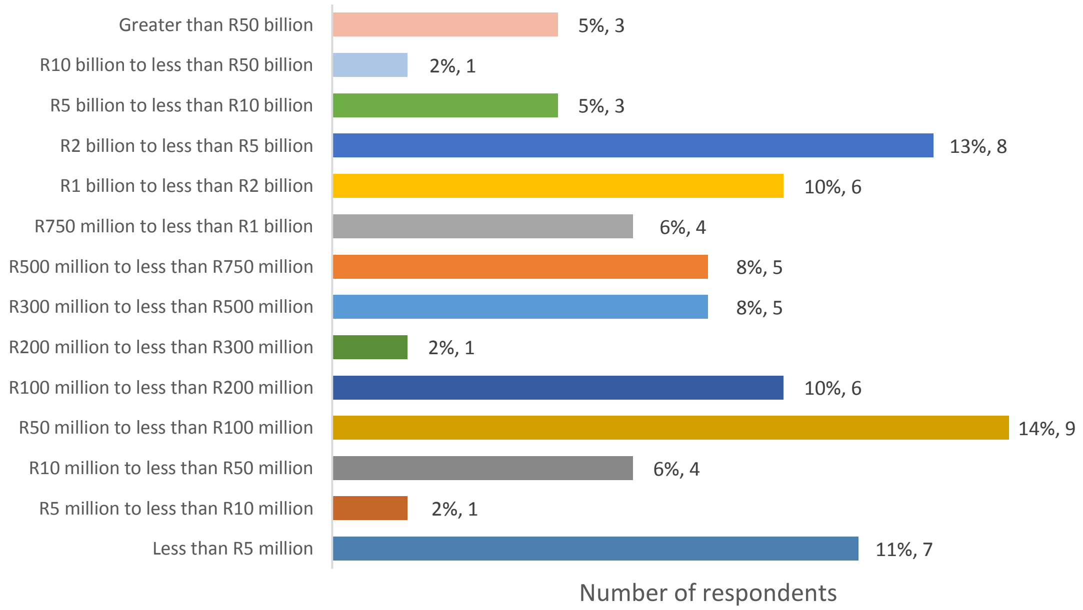
The 63 companies that responded to the Economic Survey represent the following sectors:

Industry Sectors of respondents to Survey



Manufacturing (22% of respondents), Healthcare and Pharmaceuticals (16%), and IT (11%) make up nearly half of the total sectors of the respondents. The remaining industry sectors such as FMCG and Professional Services, per the respondents, were evenly distributed.

Stratification of revenue earned



14% of respondents indicated that they earned between R50 million and R100 million for their financial year ending 2014. Interestingly, the second highest level of respondents came from the converse spectrum of revenue earners. 13% of respondents indicated that their company earned between R2 billion and R5 billion for their financial year ending 2014. Respondents from low and high-revenue earning categories are almost evenly distributed as 49% of respondents earned more than R500 million for the 2014 financial year.

Intention to Expand in South Africa

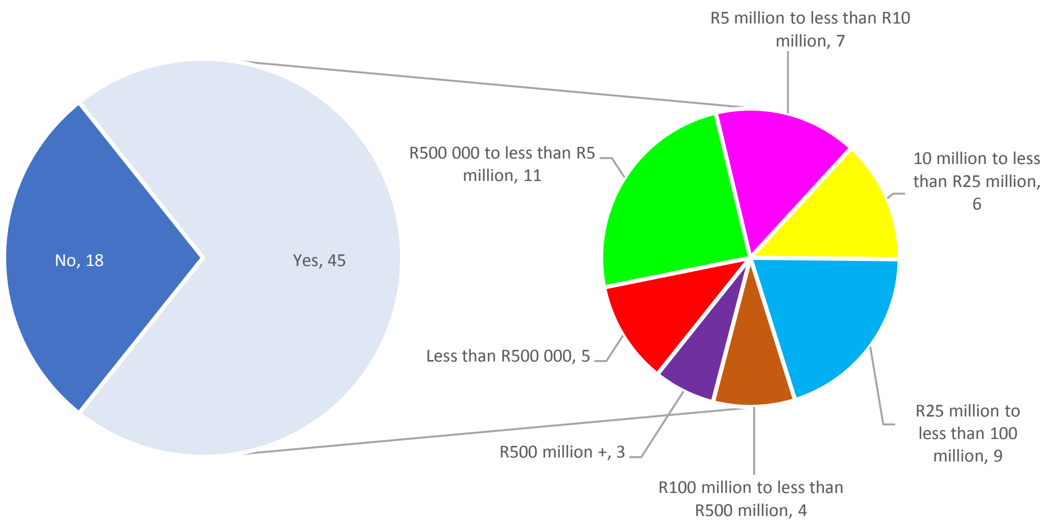
The most recent FDI statistics for OECD and G20 countries[1] which was updated on 20 July 2016, indicate that foreign direct investment into South Africa peaked in 2010 at US$180 million. FDI into South Africa has subsequently decreased to US$139 million in 2015, a decrease of 23%. This is significant if compared to other developing countries - we highlight India and China which are partners in the BRICS grouping. China increased its FDI into South Africa from 2010 (1 594 600) to 2015 (2 842 300), an increase of 78%. India increased its inward FDI by 23% (2010 (R205 603) and 2015 (R252 818)).

Foreign direct investment is important for a country as it brings with it jobs, increased fiscal revenue, higher productivity and training for employees. Many countries are vying for scarce foreign investment and it is for this reason why South Africa should focus on creating policies that are business friendly. If companies make profits then they can expand and create jobs. It's as simple as that.

In terms of the World Economic Forum's Competitiveness Ranking, 3 Sub Saharan Africa countries feature in the top half of the Most Competitive Countries Ranking being Mauritius at 46, South Africa at 49, and Rwanda at 58. South Africa scores high in banking and related infrastructure but falls to the very bottom in terms of labour and labour regulation.

In response to our question as to whether respondents would invest expansionary capital within the next two years the following diagram is illustrative:

Intention to invest expansionary capital within the next two years



45 (71%) of respondents indicated that they planned to invest in the next two years for further expansion in South Africa. Of the 45 respondents, 15 respondents (64%) intend investing between R10 million and R100 million. 7 respondents (16%) indicated that they were planning investing in large capital projects.

This diagram signifies a degree of investor confidence in the country but we caution that investment decisions are made from 5 to 7 years prior to the investment becoming a reality and this must be taken into account as decisions are impacted by the investment climate at that time and are not necessarily reflective of the current economic environment. The investment climate at the time of writing this report is depressed and we believe that, given the economic climate at present, South Africa may struggle to reach the foreign direct investment targets of previous years.

However, if the country focuses on ensuring policy stability, we believe that investment in South Africa will indeed continue to take place.

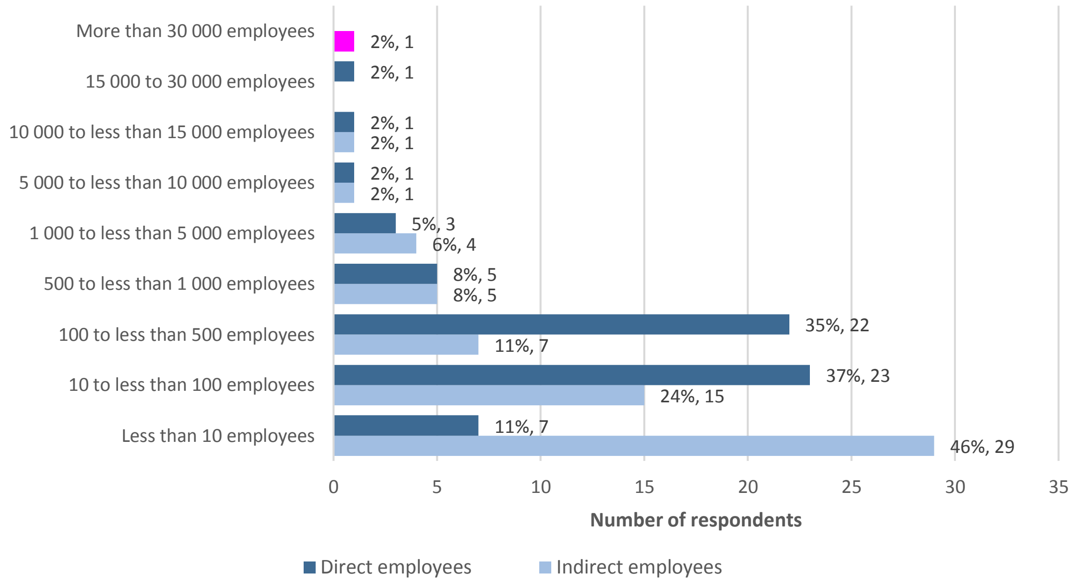
[1] http://www.oecd.org/corporate/mne/statistics.htm

Value of American Foreign Direct Investment (FDI) in South Africa

There are 600 American companies who call South Africa home and a conservative extrapolation of the annual contribution of the 63 respondent companies surveyed indicates that these companies contribute at least 10% of South Africa's GDP.

Foreign Direct Investment is valuable to a host country when the companies employ and upskill local staff. Indirect staff refer to staff who are employed on a cyclical basis such as the retail stores who function adequately with permanent staff on average, but hire extra staff during busy periods such as month end and during holidays.

Analysis of direct and indirect employees

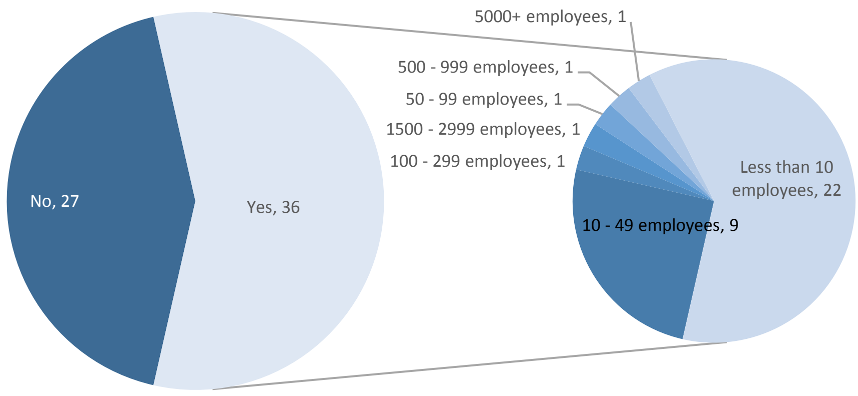


72% of respondents indicated that their companies employ between 10 and 500 employees directly. Only 6% indicated that they employ over 10 000 employees. 46% of respondents indicated that they employ less than 10 employees indirectly. The number of companies employing direct vs indirect employees are almost similar where the respondents employ over 500 employees.

Linked to the number of staff that are hired, employers indicated that they intend to hire more employees during the next two years. This statistic can be linked to the intention to expand operations during the forthcoming years. It bodes well for South Africa's unemployment figures where the unemployment rate is 27% (the unexpanded rate). Again we caution that expansionary plans are made in advance and the current economic climate does not lend itself to hiring additional employees, particularly as South Africa scores near the bottom on the Labour Flexibility sector of the WEF Competitive Rankings. It is particularly difficult to hire persons and then to release them if they do not perform, with the result that companies prefer not to hire additional staff unless it is critical to the operation.

We again emphasise that policy certainty is a key contributor to the decision-making process of major US companies.

Intention to hire more employees within the next two years

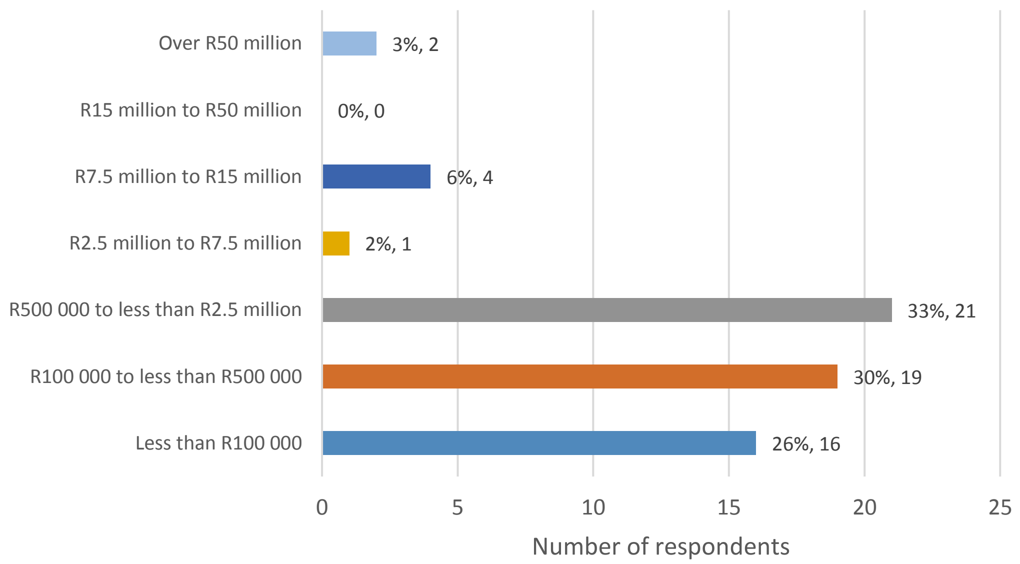


57% of respondents, (the majority) indicated that they intend hiring more employees within the next two years, albeit incremental increases. 22 of the 36 respondents (61%) indicated that they planned on employing less than 10 new employees. In addition, 9 of the 36 respondents (25%) indicated that planned on employing between 10 and 50 new employees. One respondent (3%) planned to employ over 5,000 new employees over the next two years.

Corporate Social Investment

The ethos of American companies is to invest heavily in corporate social investment in the host country, inter alia, building schools, clinics, roads, and upskilling communities. Expertise and technology is transferred to the local population in this way which is supplemented with funding, benefitting the country as a whole.

Total annual spend on Corporate Social Investment in the 2014 calendar year



All 63 respondents indicated that their companies allocated spending towards Corporate Social Investment (CSI) during 2014 which is indicative of their seriousness to develop and grow local economies. 56 respondents (89%) indicated that they spent less than R2.5 million on CSI during 2014, whilst 3% indicated that they spend more than R50 million.

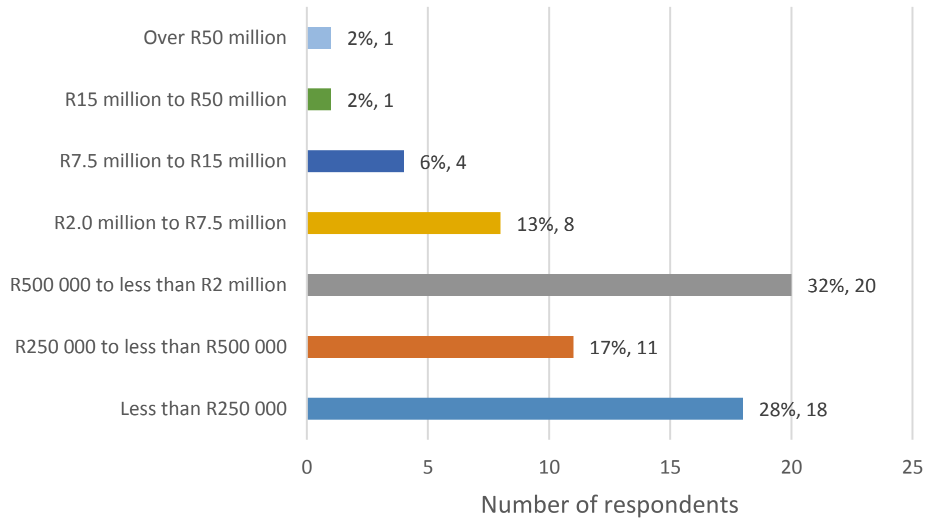
Skills Development

Skills development of staff is built into the culture of the way that American companies in South Africa do business.

Legislation requires that every company contribute 1,5% of its annual payroll turnover to SETAs (Sector Education and Training Authority) which is utilised by the specific SETA to train people and grow skills in 23 specific sectors. SETAs are concerned with learnerships, internships, learning programme type matrix and unit based skills programme.

The question asked in the survey reflects skills spend over and above what is already paid in terms of the legislative SETA requirement.

Total spend on Skills and Development

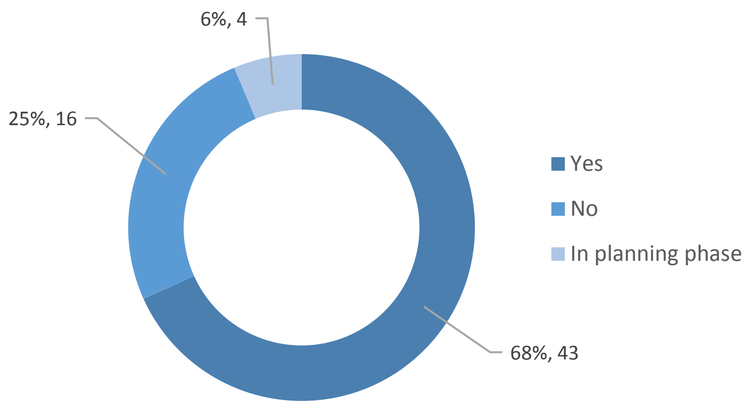


All 63 respondents indicated that their companies allocated spending towards Skills and Development during 2014. A possible reason for the positive response is that skill shortages in South Africa are emphasised by American companies as an impediment towards economic growth, particularly since most companies bring advanced technology to South Africa. The largest number of respondents (32%) allocated between R500,000 and R2 million towards Skills and Development. Two respondents contributed over R15 million to skills development during the year.

Expanding into Africa

South Africa is located at the bottom tip of Africa. As the future of trading in Africa becomes more and more popular, South Africa is well positioned as the 'gateway' to Africa provided that it positions itself as a competitive investment destination. The back-office work is done in South Africa as it has outstanding banking infrastructure, is compliant with the rule of law, and has competitive transport infrastructure. The table below indicates that South Africa remains a key country from which to do business in Africa.

Is South Africa your gateway to the rest of Sub-Saharan Africa?

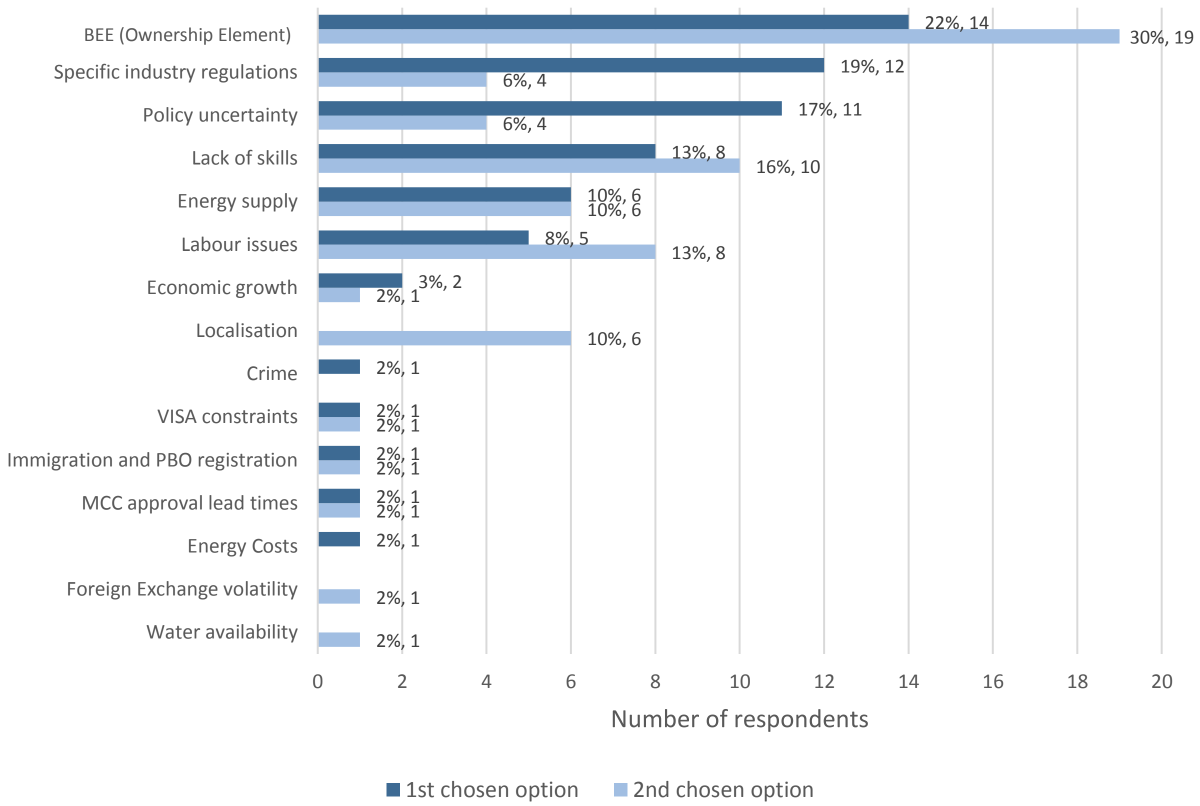


43 (68%) of respondents indicated that their South African office would serve as a gateway for current expansion into Sub-Saharan Africa. American multinationals still view South Africa as a start to establish operations before embarking on establishing a footprint into Africa. This could be ascribed to the quality of South Africa's infrastructure, constitutional security and political stability as well as available skills, in which South Africa still maintains a leading position over its African peers.

Barriers to Trade in South Africa

Respondents were requested to itemise the barriers that they experience when doing business in South Africa out of an identified list of 15 barriers. We outline the barriers below (utilising the ranking from respondents) and then discuss each barrier separately.

Ranking of barriers to doing business in South Africa



Respondents indicated that the top seven challenges impacting their business were:

- BEE (Ownership) (22%);
- Specific industry regulations (19%);
- Policy uncertainty (17%);
- Lack of skills (13%);
- Energy supply (10%);
- Labour issues (8%); and
- Economic growth (3%)

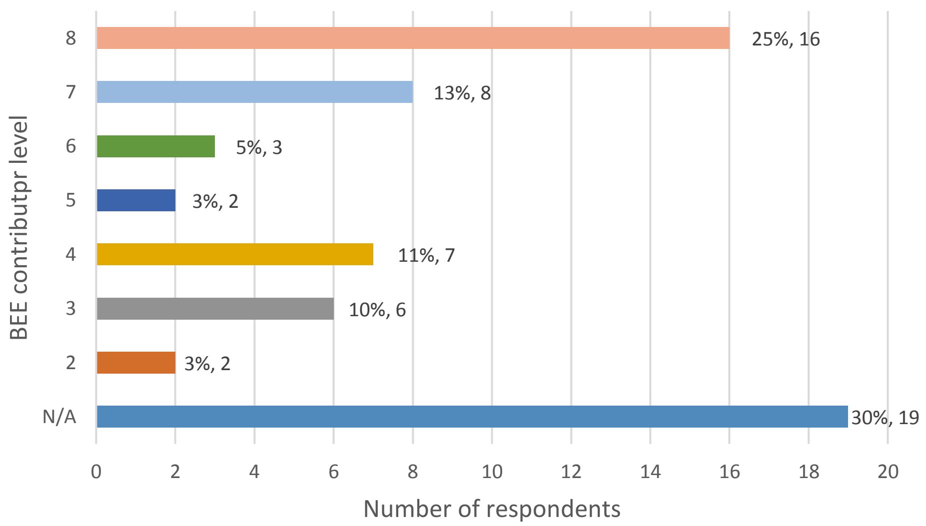
The majority of respondents indicated that both their first and second options fell within the ambit of the aforesaid seven challenges.

Coming out on top was the ownership element of BBBEE. This is almost an insurmountable barrier primarily because US multi-nationals do not give up equity in any shape or form. Recognising this fact way back in 2008, Amcham proposed an alternative scheme to the Department of Trade and Industry which allowed for a level playing field in terms of competing with local companies who were required to sell 25% equity to Black persons as the country sought to redress the injustices of the past. This proposal, known as Equity Equivalents, was accepted as an alternative to selling equity, and was duly legislated. It required that 4% of turnover be invested in an authorised programme designed to benefit previously disadvantaged persons.

Unfortunately, the scheme did not necessarily find favour with the authorities and only six equity equivalent programmes were authorised in the past 7 years. Linked to that is the capital expenditure amount which is required and which does not benefit all sectors equally. Some of the principals of the multi-nationals in South Africa consider this requirement unaffordable and have indicated that since the newly released BBBEE Codes have made ownership compulsory, and if they become uncompetitive as a result, then they will simply divest. It must be remembered that the South African market is small (53 million persons), and often the turnover of multinationals in South Africa registers below 0,5% of the global turnover of major companies.

As the equity equivalent model is not functioning, multi-nationals are placed in a precarious position now that the BBBEE Codes have been amended. The ownership element has become a compulsory element which carries a penalty on the BBBEE scorecard if it is not implemented. The amended Codes of Good Practice of the Broad-Based Black Economic Empowerment Act No. 46 of 2013 as amended in 2015 (Government Gazette No. 38764), will result in most companies experiencing a deterioration in terms of their ranking. This may make some multi-nationals uncompetitive and they would have to re-examine their options going forward.

<u>Analysis of US Multinationals and BEE in South Africa</u> (Old Codes of Good Practice, Government Gazette No. 29617, Act 46 of 2013)



Only 24% of respondents indicated that their BEE score ranked between a contributor level of 2 and 4. A level 4 is on average, the minimum BEE score needed to obtain government contracts or satisfy provisions of South Africa's preferential procurement framework. Not one respondent indicated that they were a level 1 contributor, the highest possible ranking a company can achieve in respect of the BEE scorecard.

Respondents were asked to provide commentary in respect of their BEE score. Other than the 26 respondents (41%) who did not provide BEE commentary, responses highlighted the concerns. We do not wish to highlight negativity, but emphasise that we are displaying the verbatim responses below as a barometer of the concern regarding ownership of multinationals in South Africa.

Verbatim Commentary from respondents
"Getting harder and harder to maintain - currently level 2 on old codes and will drop to level 3. Cost of doing BBBEE is increasing every year"
"It is difficult for a Multi-National Company to give up ownership"
"It is pretty much difficult to comply with the regulations and the scorecard for a multinational like us - our structure and global set up put us in a disadvantaged position"
"No one plays a game where the goal posts keep moving"
"The design of the new scorecard makes it unattractive for our company to make a direct commitment to BEE"
"The new BBEE codes are impossible to attain as a small company"
"Too much focus on shareholding and uncertainty what happens next"
"No other than for a small company like ours, we are spending a huge amount of man hours trying to comply and understand the regulations, never mind the amount of time we have to spend actually complying"
"Currently a level 4 on the original codes. Will likely move to level 7 on the amended codes, with a one level penalty for scoring zero on the ownership element, will drop to level 8"

Localisation Requirements

Respondents indicated in their second option that localisation i.e. the decision of the authorities to purchase from companies that manufacture products in South Africa using local products and skills, as opposed to supporting those companies that import a finished product, was impacting their business.

Multinationals are globally competitive because they design a product in one country, manufacture it in another, assemble it in another and then distribute these products in many countries. This 'slicing up the value chain' is designed to ensure that wherever the product is at any one time it's in the most competitive place.

It is accepted that host countries need to balance skills transfer aspirations along with creating employment. South Africa's IPAP policy states that manufacturing must become a strategic sector, but this is out of sync with global value chains that focus on delivering realistic competitive advantages.

South Africa can grow its local industry without turning away the technological advancement, expertise and employment that multi-nationals bring. This conundrum must be carefully managed to ensure that the host country benefits from both localisation and foreign investment.

Specific Industry Regulations

Industry specific regulations were listed as barriers, most particularly in the pharmaceutical and electric wire technology sectors.

Pharmaceutical companies raise the concern that the time taken when a medicine enters the South African process for compliance testing until it is ultimately made available to the patient, is up to five years. This impacts morbidity because new medicines are invariably more effective and these are not reaching patients timeously. This length of time also reduces the time available for protection of the patent.

Electrical wire technology products (examples are computers, refrigerators, TVs) are impacted by the time it takes for Letters of Authority (LOAs) to be awarded before the product can be sold in South Africa. No product can be sold without the LOA. The Regulator responsible for issuing LOAs is the National Regulator of Compulsory Specifications (NRCS) which allows itself 120 days to issue the LOAs. Most companies are kept waiting for more than 120 days whilst some are nearing 400 to 500 days waiting time and so incur unnecessary storage and other demurrage costs. The South African consumer is the real loser because internationally branded products are not being brought to the country as they go out of date before the LOA is granted.

These are just two examples of industry specific regulations that exasperate companies when doing business in South Africa.

Policy uncertainty

A count of various legislatory instruments determined that there were 64 different legislative changes in the pipeline at the end of 2015. This is of concern to business as they have to scramble to keep up with continual changes.

Companies voice concern that the ‘goal posts’ move – for example, the Black Economic Empowerment codes were again amended in 2015 after being in place for five years. Companies had planned how to comply with the codes and then had to re-group to cope with the new codes. Companies prefer to know what they have to deal with and have policy certainty, rather than having to continually comply with new laws. The CEOs of multi-nationals are continually competing with their counterparts in other countries for expansion projects. Each Country CEO works hard to attract new investment from his principals to the country he heads up. It becomes very difficult to convince the principles in the US to expand operations in countries when policy is uncertain and continually changing.

Lack of skills

It is argued that to achieve higher economic growth, South Africa must dramatically increase its pool of skills. There are two ways of doing this: equip South Africans with knowledge and skills and compensate for the existing skills shortage by recruiting skilled persons from abroad.[2]

Multi-nationals are invariably at the cutting edge of innovation and development which is linked to requiring increased skill sets. It is because innovation is taking place at a fast rate that often the required skills are not available in the host country. Unfortunately, South Africa is of the view that expatriating skilled personnel will take away jobs from South Africans and so makes entry into the country for expats very difficult.

A second factor is the education that school going learners receive. School leavers in South Africa are deemed unemployable due to the poor standard of, mainly, the schools in the townships. Many employers bemoan the fact that after obtaining a university degree, the students are, in the main, unemployable.

The South African Government has recognised that a skills deficit exists but has failed to address it by allowing skilled persons into the country, with the result that companies struggle to fill the gaps.

[2] http://www.cde.org.za/skills/

Energy supply

At the time that the survey was done Eskom was the monopoly energy supplier in South Africa. No new energy sources had been planned although the economy grew from 1994. As a result, South Africa went through a sustained period of 'load-shedding' where rolling blackouts were the order of the day. Big Industry was rationed to ensure that enough power was available so that the wheels of trade could continue whilst the unreliability of having power on demand caused great damage to the economy in every sector.

The energy crisis gave rise to a booming renewable energy sector which has become a benchmark for the rest of the world in the way it developed into a multi-million Rand industry in South Africa.

Labour issues

The World Economic Forum's Global Competitiveness Report 2015-2016 measures South Africa as last out of 140 countries in terms of labour-employer relations. South Africa is measured 138th for hiring and firing of workers, 137th for flexibility of wages and 127th for linkage between pay and production.

Companies cite the hiring and firing of employees as a key impediment to creating new jobs because once an employee has been employed, it is difficult to dismiss that employee if he or she does not perform. The requirements to dismiss a worker are particularly expensive and stringent.

Another problem raised is the incidence of strikes; South Africa recognises the right of employees to strike, but the length of strikes and the violence that often accompanies strikes is distressing.

Over time, workers have sought to heighten the impact of strikes by vandalising property, preventing non-strikers from going about their routines, and resort to intimidatory tactics that threaten the safety of non-striking workers and other stakeholders. There are three main factors contributing to the damage that strikes cause in South Africa:

i) the lack of a secret ballot when deciding to strike,

ii) the use of replacement labour during strike action; and

iii) the failure of the system to regulate protracted strike action accompanied by violence and harm to the economy.

Closing Remarks

An American investment is a quality investment. The US companies create decent jobs, invest in local communities, employ local employees, and upskill their employees. This is the type of direct investment that South Africa must work on attracting; quality investment. The policies within a country should be reviewed before implementation to ensure that they are investor friendly, so that additional investment can be attracted. Companies are competing against one another, and indeed, are competing against their global peers for additional expansionary investment. Although not the only method to grow the economy, this is one of the quickest ways to create jobs. South Africans will be the ultimate winner if we can get the balance right.

About the American Chamber of Commerce:

The American Chamber of Commerce in South Africa (Amcham) was founded in 1977 as a not for profit organization and operates without financial assistance from any government. Amcham is the collective voice of US investment in South Africa and serves as a representative voice for American business in South Africa. Amcham maintains an open dialogue with the SA Government on topical business issues whilst representing the needs of members.

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