POLICY BRIEFING 46

Economic Diplomacy Programme

March 2012

South Africa as Africa's Gateway: A Perspective From Business

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RECOMMENDATIONS

- South Africa should step up its economic diplomacy, to strengthen its standing and relationships in Africa and to provide growth opportunities for its own companies.
- South Africa needs to improve the operating environment, to ensure the private sector remains competitive in the increasingly crowded African marketplace, and identify priority interventions, countries and sectors to focus on.
- Developmental finance institutions such as the Development Bank of Southern Africa could provide greater linkages between the projects they fund and the South African private sector, including local content provisions in certain instances and credit lines linked to local goods and services. The country could also establish itself as a hub of specialised skills training for Africans in partnership with other African governments.
- To remain competitive, South Africa needs to ensure better leadership and performance of key state agencies, improve productivity benchmarks and allow foreign skills to assist with building the economy. Preference could be given to Africans.

EXECUTIVE SUMMARY

For more than a decade, international companies have chosen South Africa as the preferred entry point into Africa. With its strong institutions, South Africa is a leading foreign direct investment (FDI) destination on the continent, attracting investors looking to set up their African headquarters.

Recently, investors from emerging markets have joined companies from developed countries in establishing offices in South Africa with a view to using the country as a springboard into other states in Africa. With the new wave of interest in Africa as an investment destination, South Africa can be a pivotal entry point for foreign investors. The government has finally embraced the concept of being a business (rather than just a political) gateway to the continent. However, the country faces many internal challenges that affect its reputation as the best base for foreign companies in Africa, while, externally, other countries are becoming more attractive to investors.

INTRODUCTION

South Africa has many attractive attributes for foreign companies looking at investment opportunities in Africa and has the most diversified and sophisticated economy on the continent. Compared to other African countries, it has a large formal sector, a strong services sector, a sound legal system and strong industrial base. It also offers decent health, education, housing and lifestyle options not readily available elsewhere on the continent.

For several decades, South Africa has provided foreign companies with a base to explore opportunities within the country as well as on the continent. Initially, these companies were almost exclusively from developed country markets such as the US, the United Kingdom, Europe and Japan, reflecting the trend of foreign investment in the 1990s. During the past decade, more companies from developed markets have moved their African operations from London, Paris, Rome and Dubai to the continent, as growing competition means they need an on-the-ground presence, and new emerging market investors are joining them. Yet, the gateway concept is not just about bricks and mortar: South Africa is also a financial hub for business into the continent and a source of acquisitions and skills.

Despite being a popular base for African operations, South Africa officially positioned itself as a political, rather than a business, gateway focusing on African renaissance and the New Partnership for Africa's Development. The government did not recognise the potential benefits of having foreign companies on its doorstep, nor look at ways to attract more. However, over the past five years, South Africa seems to have embraced the idea of being a business gateway, following the surge of interest from new, emerging market investors from the BRIC countries (Brazil, Russia, India and China). The BRICS (Brazil, Russia, India, China, South Africa) membership has had economic benefits, with countries such as Turkey and South Korea investing in the country while looking for opportunities elsewhere on the continent.

South Africa's political efforts have paid off: it is the only African member of the G20 group of nations and the BRICS. The country also has commenced its second term as a non-permanent member of the UN Security Council, where it has joined forces with its BRICS partners in trying to forge a new global order.

Parties outside Africa view South Africa as the political leader of the continent. They assume it speaks on behalf of all Africans and has significant influence over continental debates and agendas. However, despite this premise in international forums, countries within the continent do not unanimously embrace this notion.

New business considerations (costs, logistics and geography) are changing the gateway debate. As other African countries reform their economies, the continent has become more disaggregated in foreign investors' minds. Increasingly, they are are seeking more than one gateway and starting to see South Africa as an entry point into Southern Africa, rather than sub-Saharan Africa.

SOUTH AFRICA AS A GATEWAY

For more than a decade, South Africa has been a top FDI destination. Although sometimes pipped at the post by oil-producing states on the statistics front, investment in South Africa is broad-based and multi-sectoral, reflecting its diversified economy.

Since 1994 South Africa has also been one of the biggest non-oil investors in Africa. The country's FDI into the rest of Africa has increased at four times the rate of its global FDI, from ZAR 3.8 billion in 1994 to ZAR 115.7 billion in 2009.[2] However, just 8% of South Africa's total foreign investment is in the rest of Africa.

South African multinational companies have expanded their African networks rapidly, building businesses and skills that foreign investors are eyeing to build their own African footprint, resulting in a significant number of mergers and acquisitions.

South Africa has the biggest and best capitalised banks, attracting investors who want to access loans, trade finance and other products for African business. The Johannesburg Stock Exchange (JSE) is by far the biggest bourse on the continent.

The country has also positioned itself as a private equity hub. In 2011, more than ZAR 100 billion funds were under management, with an increasing chunk being directed to assets elsewhere in Africa.

The Reserve Bank has relaxed exchange controls both for general investment into the continent and private equity. It has also relaxed local listing rules to position the JSE as a gateway for investment in African stocks.

South Africa has the best infrastructure on the continent and in 2010 completed a four-year, $60 billion infrastructure programme. However, the demand for new infrastructure and expansion of existing assets is still largely unmet and delivery is slow.

For decades South Africa has been the preferred transport and logistics hub for Southern Africa, thanks to its superior infrastructure and services industry. Despite its distance from regional markets, Durban has remained the port of choice for goods from as far afield as the Democratic Republic of

Congo more than 2 000 kilometres away. OR Tambo Airport in Johannesburg has maintained its position as the best airport in Africa, and despite facing stiff competition, South African Airways remains the continent's leading airline. South Africa's location between Asia and Latin America makes it well positioned for airlines, shipping and logistics.

The Development Bank of Southern Africa (DBSA) and Industrial Development Corporation (IDC) are principal agencies of South Africa's economic diplomacy in Africa. Both are pivotal to South Africa's regional ambitions, as financing cross-border infrastructure and projects highlights the country's developmental role and opens up opportunities for South African-based companies. As a result of South Africa joining BRICS, the DBSA and the IDC have direct links with their counterparts in those markets, enabling them to leverage mutual funding and explore other partnerships. DBSA is part of the BRICS Banking Mechanism[3] and sits on a BRICS liaison group that is examining ways to develop South–South trade.[4] The IDC is looking at new operating models with Brazil's development bank, BNDES, and maintains close links with counterpart banks in Europe, China and Japan.

Policymakers are looking for sectors in which South African can become the hub in Africa, including renewable energy, the petro-chemical industry, and ship building and repairs. Another area is the trans-shipment of goods to other African countries from South Africa's deepwater ports; South Africa is already an important centre for goods and services in the rest of Africa, notably equipment, car parts and food products.

CHALLENGES TO SOUTH AFRICA'S GATEWAY STATUS

South Africa faces many challenges at home that are starting to affect its reputation as the best place for foreign companies to establish themselves in Africa. External factors are also changing the way investors make their choices about such issues.

EXTERNAL FACTORS

Geography and logistics play an increasing role in multinationals' business decisions, leading to the creation of multiple gateways into African regions. Increasingly, South Africa is seen as the gateway to Southern Africa rather than sub-Saharan Africa. And even within SADC, Brazilian companies prefer Luanda as an entry point into Africa.

Although China's political rhetoric highlights South Africa as its gateway to Africa, its companies (and politicians) tend to deal with African states directly from Beijing. The China–Africa Development Fund may have been established in Johannesburg, but now also has offices in Ethiopia, Zambia and Ghana.[5]

Airline options are also increasing in Africa with the network growth of African carriers such as Kenya Airways and Ethiopian Airlines as well as Emirates from Dubai. This means that visitors no longer have to fly via South Africa to other African destinations. The high cost of transporting goods across Africa has also led to companies shipping goods directly to market from overseas countries, not via South Africa.

INTERNAL FACTORS

South Africa is battling to balance the needs of investors with the political demands of its electorate. Investors are concerned about the strong labour unions, rising wages, low levels of technical and management skills, declining state efficiency coupled with greater government intervention in the economy, the lack of policy transparency and a rise in political populism.

Frequent strikes are also a concern. In the first half of 2011, more than 30 million man days were lost due to strikes – a 22% increase over 2010[6] and considerably more than the 4.75 million man days lost to strikes in Nigeria between 2004 and 2009.[7] Labour productivity growth was negative during 2011.[8]

Investors are worried by the government's negative attitude to foreign investment, despite its public pronouncements. This was highlighted by the treatment of Walmart in its bid for local retail giant Massmart.

Other challenges to South Africa's attraction as a gateway include:

- exchange controls, which are hardly present in other African countries, including the financial centres of Mauritius and Botswana;

- declining industrialisation, as exporters struggle with high business costs, a volatile currency, onerous empowerment quotas, skills shortages and rising labour costs. They battle to compete with cheap Asian goods flooding African markets;
- the decline of key investment sectors, notably mining. South Africa has missed out on the commodities boom because of concerns about nationalisation, uncertainty over mining rights regulations, long delays in issuing licences, logistical challenges and power shortages. Investment growth in mining over the past decade averaged 7% a year compared to 24% in Australia;[9]
- high costs at Durban port make it a less attractive entry/exit point to the region. State-owned utility Transnet charges $182,151 for an average container vessel to dock – more than double the global average and the highest of 100 harbours globally.[10] Transnet has also neglected the country's rail networks. Competition from other African ports such as Maputo, Dar es Salaam, Lobito, Mombasa and Walvis Bay may reduce regional dependence on Durban;
- congestion at the Beit Bridge border post, which remains a significant bottleneck to regional trade between South Africa and its hinterland;
- increasing competition from other African banks, particularly from West Africa;
- hikes in the cost of power because of resource mismanagement. Users face a hike of 50–65% up to 2014;[11] and
- high, albeit declining, crime rates and rapidly rising corruption.

CONCLUSION

South Africa has placed great importance on its BRICS membership to maintain its status as a gateway to Africa. However, the danger is that the BRICS will run out of steam before South Africa has realised tangible benefits from the arrangement.

South Africa is likely to remain the gateway to Southern Africa in the future, but companies wanting to do business in sub-Saharan Africa will probably increasingly opt for multiple gateways based on regional interests. These include Mauritius and Kenya in the east, Nigeria and Ghana in the west, with external players such as Dubai also playing a role.

South Africa has not capitalised sufficiently on its proximity to the rest of Africa. The country has failed to balance its continental interests through economic diplomacy with its quest for advantage outside the continent. This lack of economic leverage in Africa reduces the potential advantages of running African operations from South Africa.

ENDNOTES

1 Dianna Games is the CEO of research and consulting company Africa at Work.

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The Economic Diplomacy Programme is funded by the Swedish International Development Cooperation Agency, the Danish International Development Agency, and the Foreign and Commonwealth Office through the British High Commission in South Africa. SAIIA gratefully acknowledges this support.