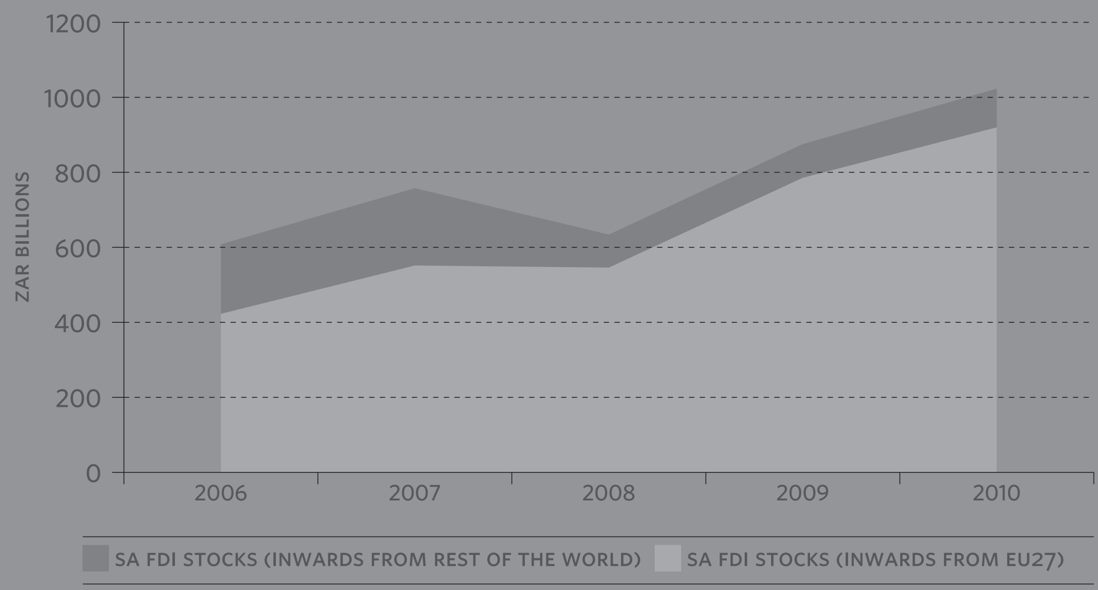
WHITE BOOK

ON EU TRADE AND INVESTMENT IN SA

EU-SA TRADE GROW TO A PEAK OF
R420 BILLION
IN 2008

88%
PROPORTION OF TOTAL FDI STOCK
IN SA THAT IS EU-HELD (2010)

EU ACCOUNTS FOR
1/3
OF SA'S TOTAL TRADE WITH
THE WORLD (2010)



SA IS
NO 1
ACP TRADING PARTNER
WITH EU (2010)

EU IS
BIGGEST
EXPORT MARKET FOR SA'S VAUE- ADDED MANUFACTURED GOODS (2011)

Identifying and overcoming obstacles in business operation and growth

Foreword by the EU Ambassador

The European Union nurtures its relation with South Africa. The country is a significant presence in Africa and in the world, and is playing an important role to help reshape the global landscape. For these reasons, and also because of the historic links that tie us together, the EU and its member countries are committed to sustain and strengthen our partnership with South Africa.

Our engagement is an active and robust one. South Africa and the EU maintain strategic dialogues in key areas and the EU contributes meaningfully to development programmes in this country. But perhaps the most important aspect of our collaboration is to keep commercial channels open and thriving. It is by these means that we will contribute to economic growth, create much-needed jobs and help our peoples to prosper.

Our commercial relationship is already a sophisticated, formalised one. Bilateral trade is rooted in a fully-fledged free trade agreement – the Trade, Development and Cooperation Agreement – which entered into force in 2000 and as of this year is fully operationalised. The TDCA gives South African goods open access to 95% of the EU market, while EU goods enjoy the same in 86% of the South African market. In addition, the investors of South Africa and those of 13 EU Member States enjoy protection in each other's respective markets through formal bilateral investment treaties.

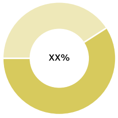
Our economic ties are thus well cemented. This is also borne out by the figures. The EU, by a significant margin, is the biggest foreign investor in this market. And as a trade bloc the EU is also South Africa's most important trading partner. Perhaps even more important is the nature of this trade: well over half of goods exported to the EU leave these shores in semi-processed or processed form. The only other markets in which South Africa enjoys such a dominant value-added export profile are markets in Africa.

South Africa's desire to escape the resource curse and expand her manufacturing abilities to give employment to her people is well documented. We are therefore proud to say that the EU-SA trade composition reflects our partner's industrial development objectives.

It is in this context that the EU Delegation and Member State Embassies in South Africa, with financial support from the Embassy of The Netherlands, have commissioned a study on EU investors' presence and attitudes in South Africa. As the figures indicate, they are a significant presence in this country and their views could therefore provide a valuable gauge for policy makers. We wanted to know from European investors what they do here to help achieve the South African government's growth and development objectives through employment, empowerment and skills development. We asked them about the opportunities which they see in operating in this country, but also specific obstacles they encounter here, which are deterring them from expanding their investments. The intention with this latter exercise was to help pinpoint areas where action – often at little or no cost – could help remove barriers to new and expanded investment in this country. The results of this study are contained in this report. We believe it makes for a rich read and could make a significant contribution to stimulate efforts towards strengthening our commercial links in the interest of economic growth and job creation.

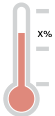
Roeland van de Geer
Head of the Delegation of the European Union to South Africa

KEY TO DASHBOARD



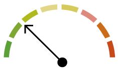
RESPONSE RATE

Indicates the percentage of respondents who cited an obstacle as one faced by their business.



PERCEIVED SEVERITY

Indicates the aggregate perceived severity of the obstacle.

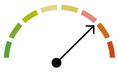


PERCEIVED CHANGE OVER TIME

Improving over time

PERCEIVED CHANGE OVER TIME

No change



PERCEIVED CHANGE OVER TIME

Getting worse over time

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1. Executive Summary

Between the months of January and March 2012, 88 companies shared their perceptions on doing business in South Africa. Specifically, they were asked to identify and gauge both the extent and severity of any perceived obstacles to continued business operations and growth. The culmination of this exercise is South Africa's first White Book on Trade and Investment.

A White Book presents a transparent form of communication from the viewpoint of the private sector, in this case - foreign investors in South Africa originating from the EU – setting out concrete proposals for improvements to the business environment[1] .

88 companies participated
Employing 25,289 permanent staff
Operating across 11 sectors
Drawn from 12 EU member states

1.1. The EU in SA

The EU is a vital partner in achieving South Africa's aspirations to enhance its economic performance onto an accelerated and job-creating growth path. In 1999, South Africa entered into a Trade, Development and Co-operation Agreement (TDCA) with the European Union (EU) and Member States; which sought to establish a free trade regime over 12 years, covering 90% of bilateral trade. As a result of the TDCA, the value of EU-SA trade grew 61% between 2000 and its 2008 peak of nearly R420 billion.

The EU has since been South Africa's most significant bilateral trade and investment partner, accounting for a third of South Africa's total trade with the world and 88% of total inward FDI stocks in 2010, valued at 34% of GDP or R916 billion. The EU also represents one of the most important export markets for South Africa's value-added manufactured goods, especially those which derive from the labour-absorbing, priority sectors identified in the Industrial Policy Action Plan (IPAP).

2010: 88% of all inward investment stocks to SA originate from the EU.
2011: the EU imports the largest share of SA's value-added manufactured goods.

1.2. Perceived obstacles to trade and investment

Although many EU firms are satisfied with current business conditions in South Africa, they nonetheless reported having experienced certain obstacles to their business operation and growth, which, if addressed, would result in greater satisfaction and would support higher levels of investment and employment.

Three quarters of respondents are satisfied with business conditions in South Africa.
84% would recommend South Africa as an investment destination and/or trading partner.

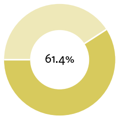
The five most frequently cited obstacles by respondents in rank order were:
1) Workforce skills and Education;
2) BEE legislation;
3) Government bureaucracy;
4) Corruption; and
5) Currency volatility.

These issues, along with Public Procurement Processes, Cost of Utilities and Labour Regulations, were considered as major or severe obstacles to trade and investment. These are explored in greater detail, including practical recommendations for the South African Government to address these obstacles to the benefit of the broader South African economy.

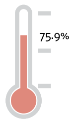
1. *Foreign Investors Council, 2012.*

1.3. Selected obstacles

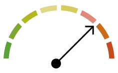
WORKFORCE SKILLS AND EDUCATION



RESPONSE RATE



PERCEIVED SEVERITY



PERCEIVED CHANGE OVER TIME

EU companies find the scarcity of skills in South Africa to be a key constraint in realizing their growth and competitiveness aspirations. The effect of this situation is one in which a relatively limited and increasingly privileged cohort of skilled workers are ensconced or circulate within the formal economy, and where employers are increasingly less inclined to employ and train greater numbers of workers due to the high costs in doing so.

ISSUES:

- ***Companies face increasingly high labour costs.*** *Where the skills exist, personnel are often hired at a price premium, where an additional premium is frequently paid to acquire skilled BEE candidates;*
- ***Bureaucratic red tape is causing delays in skills acquisition and attainment****. Work permit turnaround and qualification recognition hampers skill acquisition, as does slow registration and accreditation of training courses and academies;*
- ***Government incentives for training are not competitive.*** *The red tape associated with SETAs increases transaction costs and the negligible Skills Development Levy rebate pales in comparison to the investment made; and*
- ***Difficult to lock-in the benefit of investing in skills development.*** *Companies' return on investment in skills development is frequently diluted by the churn of skilled workers in a skills-poor economy.*

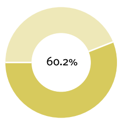
RECOMMENDATIONS:

Companies and the Government have limited ability to transform the South African skills economy in the short term; however, basic measures can be taken to reduce the burden to business while more systemic change is effected within the South African skills and education system.

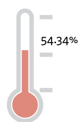
THESE MEASURES COULD INCLUDE:

- ***Develop an updated model to project demand and supply of critical skills*** *– focusing on occupational and trade skills – to respond to changes in the demand and supply of the skills available in the labour market;*
- ***Liberalise and fast-track immigration policy*** *for workers with qualifying university degrees;*
- ***Increase capacity at the Department of Home Affairs*** *to improve and maintain turnaround performance in processing critical skills permits;*
- ***Review the standards of selected South African education institutions covering critical skills in priority sectors****. Based on the findings, institute support to secure the alignment of standards with those in the EU.*
- ***Offer a matching-grant to incentivize firms to meet their skills needs*** *through the occupational training provided by Further Education and Training Colleges (FETS) to reduce the risk and costs associated with skills development and training; and*
- ***Introduce a support mechanism for investors to aid understanding of the complexities of the SA labour market.***

BEE LEGISLATION



RESPONSE RATE



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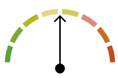


PERCEIVED CHANGE OVER TIME

EU companies appreciate the need to achieve social transformation in South Africa; however they experience cost and practicality barriers in complying with BEE legislation. These companies often feel hamstrung by a combination of being prohibited or financially unable to sell equity stakes or implement equity equivalents, and struggle to hire BEE candidates who are either suitably skilled or affordable. When EU companies make efforts to comply, they find it difficult and expensive, yielding little to no commercial benefit. Ironically, this low commercial benefit is often experienced in the course of competing for business within the public sector, where BEE is purportedly most rigorously and consistently applied.

ISSUES:

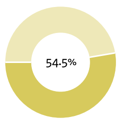
- ***Equity equivalents option is usually unaffordable*** *for the South African start-up operation of an EU company;*
- ***Employment equity is encumbered*** *by the lack of availability and cost associated with attracting appropriately skilled black professionals;*
- ***BEE in public procurement processes is often mis-applied;*** *and*
- ***Difficulty in attributing sales to BEE compliance*** *diminishes the incentive to comply.*

Recommendations:

The New Growth Path (2010-2020) policy document recognises that current BEE provisions have been unable to ensure a broad-based approach and is imposing significant costs on the economy which undermine sustained growth and employment creation. The proposals suggested below buttress those tabled in the NGP:

- ***B-BBEE Commission (proposed in the B-BBEE Amendment Bill) should play an active role*** *in tackling constraints faced by Industry;*
- ***Employment equity should focus on job creation and career progression*** *at the middle and bottom of the economy;*
- ***Conduct a Regulatory Impact Assessment (RIA) on BEE legislation,*** *focusing on the cost of equity equivalents and the constraints to complying with Employment Equity legislation;*
- ***Continue efforts within government to improve consistency in understanding and application of PPPFA rules****; and*
- ***Increase transparency in public procurement*** *to address the problem of attributing sales to BEE compliance.*

GOVERNMENT BUREAUCRACY



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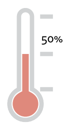

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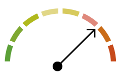


PERCEIVED CHANGE OVER TIME

EU companies have found that their financial sustainability and/or growth is compromised by government delays in payment for services/goods rendered, licensing and approvals, and general decision-making. In short, government departments/agencies are perceived as slow or unresponsive. An often ignored impact is the knock-on effect within the supply chain companies. When a company experiences delays in licensing and approvals, it damages the business pipeline of the suppliers to the company that has made the application. Uncertainty in the timing and outcome of government applications has a negative impact on the investment decisions of EU companies, in some instances resulting in direct losses.

Issues:

- ***Critical business processes are compromised by non- or poor communication of decisions****, due to a lack of accountability of government officials and poor feedback mechanisms; and*
- ***High costs are incurred by businesses*** *in the course of employing staff/outsourced services dedicated to dealing with government bureaucracy.*

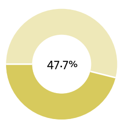
Recommendations:

In line with Government's service delivery strategy, the following strategic actions are emphasised as a means to reduce the burden on firms and strengthen accountability and efficiency in the public service:

- ***Establish a cross-departmental Red-Tape Reduction Task-Force*** *to simplify and rationalise critical business-related administrative procedures, systems and regulations; and*
- ***Give the Department of Performance Monitoring and Evaluation (DPME)*** *a leading role in monitoring progress towards micro-economic reforms.*

CORRUPTION AND PUBLIC PROCUREMENT PROCESSES

CORRUPTION



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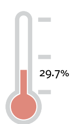

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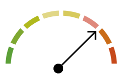


PERCEIVED CHANGE OVER TIME

Despite corruption and public procurement processes being presented to respondents as two separate themes, qualitative analysis revealed that distinction between these issues was largely absent for a majority of respondents. More often than not, when respondents cited corruption as an obstacle to business operation and growth, they were referring to corrupt practices within the public procurement process. More specifically, EU companies identify favouritism and bureaucratic inconsistency in procurement as the key problems.

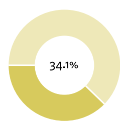
Issues:

- ***Lack of transparency and feedback in tender adjudication*** *processes can allow corrupt activities to flourish;*
- ***Government Departments' impromptu withdrawal of tenders or changes to specifications is costly to bidders;*** *and*
- ***Adjudication panels are sometimes technically ill-suited*** *to make informed decisions.*

Recommendations:

Weaknesses in public procurement have a wider negative impact on the business relationship with the private sector, leading some EU companies to shift their business focus away from government towards private sector business. This loss of competition in government bidding processes serves to weaken the public sector's ability to achieve value for money. Furthermore, it diminishes the market potential for these EU companies, leading to lower levels of investment in the South African economy.

PUBLIC PROCUREMENT PROCESSES



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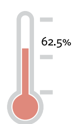

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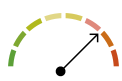
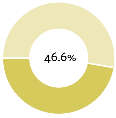


PERCEIVED CHANGE OVER TIME

MEASURES THAT THE GOVERNMENT CAN TAKE TO ADDRESS THIS ARE AS FOLLOWS:

- ***Activate fraud and corruption risk management plans as a pre-requisite for Department budget approval;***
- ***Invest more resources in anti-corruption investigating capacity*** *to prevent, detect and investigate un-ethical practices in the public service;*
- ***Encourage pro-active citizenship among firms to make use of institutions*** *set-up to monitor, investigate and address corruption and mal-administration;*
- ***Publish online the vital statistics of tender bids to strengthen accountability****; and*
- ***Use ICT tools to implement SCM practices*** *more consistently across provincial, and national government departments.*

CURRENCY VOLATILITY



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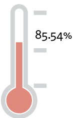


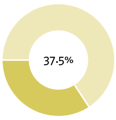
PERCEIVED SEVERITY

PERCEIVED CHANGE OVER TIME

The major risk associated with the volatility of the Rand is that it often results in direct financial losses. Equally as severe, is the impact on uncertainty of returns on investment decisions.

The South African Rand is one of the most traded currencies in the world and its volatility is viewed by respondents as part of the South African business cycle. Recognition of the currency's volatility as an obstacle to trade and investment is mainly a symbolic one. The risk is well understood by those firms that are concerned about Rand volatility. Respondents were of the opinion that little could be, and/or was expected to be, done about currency volatility, and international businesses simply needed to accept this as a frustrating but unavoidable component of South African business conditions.

COST OF UTILITIES



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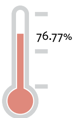

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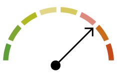


PERCEIVED CHANGE OVER TIME

The rapidity in electricity price hikes has had a dual impact on the companies surveyed. The direct impact has been that companies, especially manufacturers, have experienced higher production costs. The indirect impact has been a dampening in demand for manufactured goods, as spending across the economy decreased due to a higher cost environment, twinned with a global economic recession at the same time.

Issues:

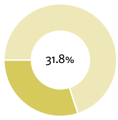
- ***Businesses are investigating alternative energy solutions*** *to mitigate higher electricity costs; and*
- ***Rapid electricity cost increases have compromised international competitiveness and more generally reduced demand for goods.***

Recommendations:

Although there is not much that can be done to immediately lower the cost of electricity, there are steps that the Government has taken to invest in additional capacity to lower the long-term costs, lower carbon emissions and environmental costs and to provide sustainable and dependable power generation by diversifying the existing power generation pool.

- ***Streamline and clarify regulatory compliance requirements for REFIT selection and procurement processes*** *to attract and facilitate greater private investment in the burgeoning renewable energy sector in South Africa; and*
- ***National Government should make its policy framework clear for high utility usage investors,*** *where potential concessions and incentives can be devised to reduce the burden on investors that may make a substantial contribution to the South African economy in other areas.*

LABOUR REGULATIONS



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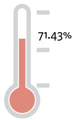


PERCEIVED SEVERITY

PERCEIVED CHANGE OVER TIME

A number of businesses feel that they are faced with increased input costs in order to generate disproportionately low levels of output, and that there are higher risks associated with hiring workers in South Africa.

Issues:

These perceptions are fuelled by the following impediments:

- ***The labour dispute mechanism (CCMA) is perceived as cumbersome.***
- ***Higher minimum wages, increasing industrial action and labour inflexibility makes it difficult to incentivise higher productivity.***

Recommendations:

At present, the labour regulations in South Africa are being reviewed for anticipated gazetted amendments in 2012. It is important to note that the functioning of the dispute resolution system has undergone reforms to improve access, simplify procedures and improve turnaround times. In light of some of these changes, the following aspects should continue to be highlighted:

- ***Support on-going simplification of dismissal*** *procedures on substantiated grounds of productivity or misconduct;*
- ***More resources are required to fund and capacitate the CCMA;***
- ***Conduct an investigative review of the 'con-arb' process*** *to improve participation rates and assess the cost-benefit of this process on business;*
- ***Reintroduce the 'ballot requirement' before protracted industrial action or lock-out occurs;*** *and*
- ***Establish a division within the Department of Trade and Industry or Department of Labour that proactively (and reactively) supports foreign investors as they navigate the complexities of the SA labour market.***

2. The EU in SA

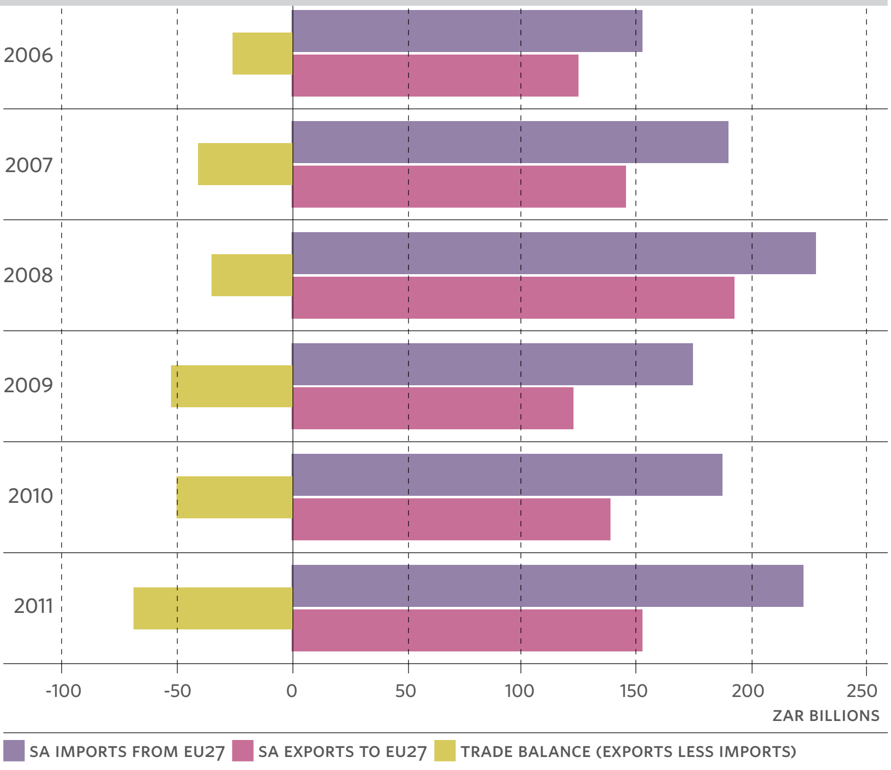
The evidence on bilateral trade and investment shows that the EU is South Africa's most significant bilateral trade and investment partner, accounting for a third of South Africa's total trade with the world and 88% of total inward FDI stocks in 2010.

The EU also represents one of the most important export markets for South Africa's value-added manufactured goods, especially those which derive from the labour-absorbing, priority sectors identified in the Industrial Policy Action Plan (IPAP). The EU is therefore a vital partner in achieving South Africa's aspirations to enhance its economic performance onto an accelerated and job-creating growth path.

2.1. Trade

The EU is South Africa's largest trading partner, accounting for approximately 33% of South Africa's total trade in goods and commercial services, by value in 2010[2]. In 1999 South Africa entered into a Trade, Development and Co-operation Agreement (TDCA) with the EU which sought to establish a free trade regime over 12 years, covering 90% of bilateral trade. As a result of the TDCA, the value of EU-SA trade between 2000 and 2008 increased by 61%. Figure 1 below illustrates the growth in the value of trade between South Africa and the EU between 2006 and 2011.

FIGURE 1: VALUE OF SA-EU TRADE[3]



Source: South African Revenue Service (SARS), 2012

2. *European Commission*, 2012
3. *There are discrepancies between SARS and EuroStat data, however the trends are largely the same.*

Figure 1 also shows that, apart from a declining trend in 2008/9[4], bilateral trade between South Africa and the EU has grown steadily from R280 billion in total trade[5] in 2006 to nearly R375 billion by 2011. In 2011 SA goods imports from the EU totalled approximately R223 billion and SA goods exports to the EU totalled approximately R153 billion[6]. In 2011, South Africa's primary exports to EU comprised of mineral products (21%), precious and semi-precious stones and metals (19%), machinery and mechanical appliances, electrical equipment (14%) and vehicles, aircraft, vessels and associated transport equipment (12%); whilst EU imports into South Africa are composed of machinery and mechanical appliances, electrical equipment (29%); vehicles, aircraft, vessels and associated transport equipment (15%), products of the chemicals and allied industries (13%) and other original equipment components (10%)[7].

FIGURE 2: SHARE OF SA EXPORTS PER REGION IN 2011, ACCORDING TO HARMONISED SYSTEM

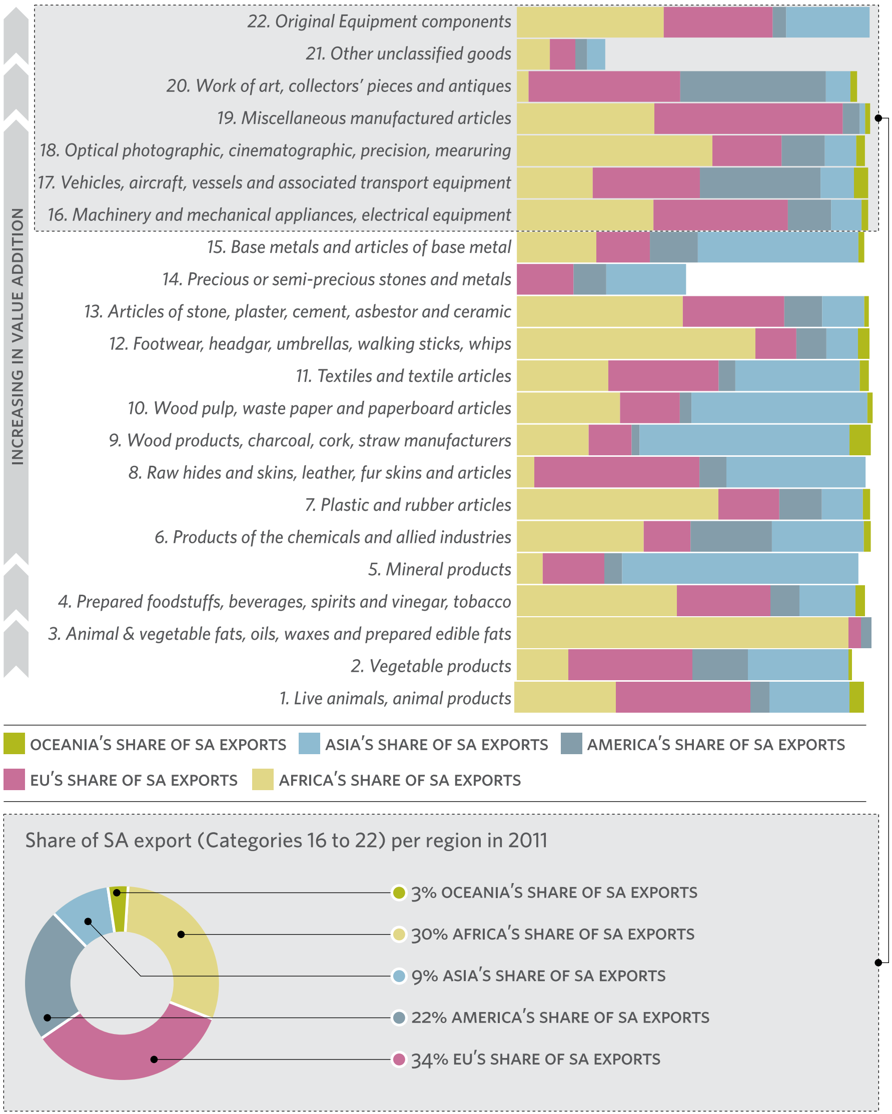
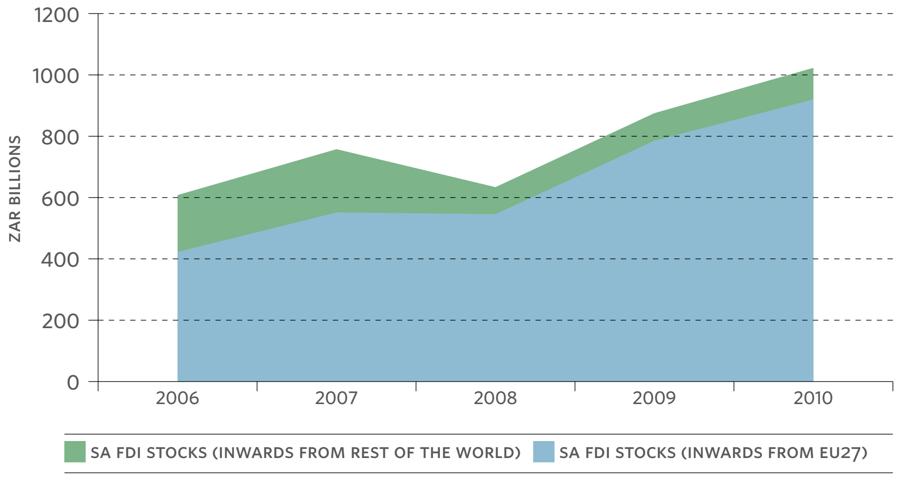


Figure 2[8] shows the proportion of South African exports imported by various regions in the world in 2011. Overall, the EU is South Africa's second largest importer. While Asia and Africa dominate in the fields of low value-added goods, EU states are the main importers of South Africa's highest valued-added goods. These high value-added goods include machinery and mechanical appliances, transport equipment, original equipment components and other miscellaneous manufactured articles. The production and export of these high value-added goods is in line with the strategic prescriptions of the Industrial Policy Action Plan, and plays a crucial role in the growth and development of the South African economy as well as in employment creation in the country.

4. *The 2008 Global Financial Crisis significantly dampened trade. In 2007/8 bilateral trade peaked at R420 billion and saw a 42% decline in total trade value between the SA and the EU.*
5. *Total trade is the value of imports plus exports.*
6. *South African Revenue Service (SARS), 2012*
7. *South African Revenue Service (SARS), 2012 – Based on Sections of the Harmonised System*
8. *Note: SARS regional trade data does not add up to 100% due to unallocated trade figures.*

Figure 3 below compares SA's total inward FDI stock from the world with those originating from the EU over the period 2006 to 2010. The chart reveals that the EU accounts for the majority of FDI stocks in South Africa and this share is growing. In 2010 the EU share of SA's total inward FDI stocks was 88% (R915.7 billion) of the total or 34% of GDP.

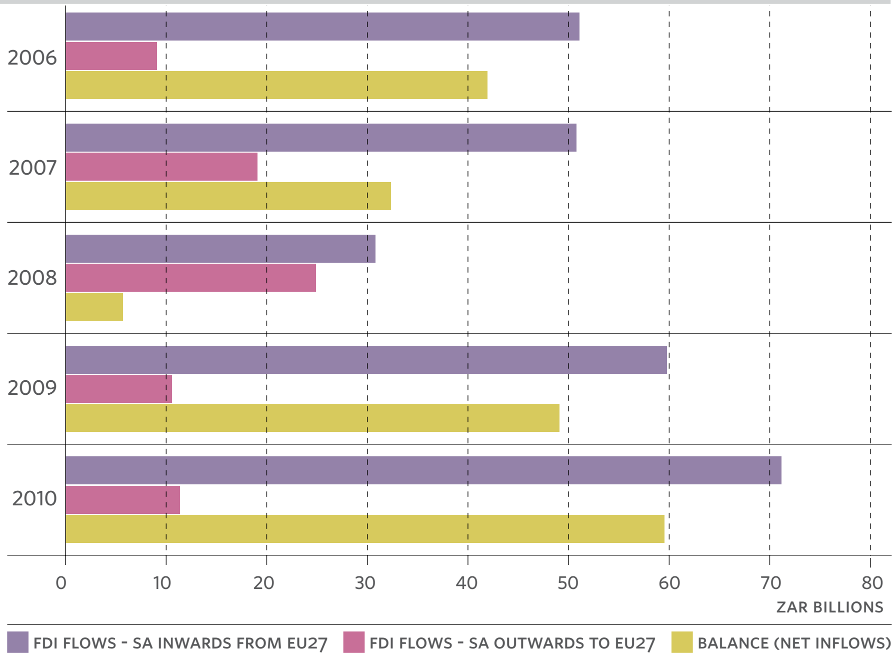
FIGURE 3: SA FDI STOCKS



Source: South African Reserve Bank, 2012 and European Commission , 2012

Figure 4 below shows that the net FDI inflows[9] to South Africa from the EU grew from R42.2 billion in 2006 to R59.3 billion in 2010 (European Commission , 2012). The impact of the Global Financial Crisis saw net FDI inflows fall from R32.4 billion in 2007 to R5.4 billion in 2008; which then recovered in 2009 to R48.8 billion.

FIGURE 4: SA-EU FDI FLOWS



Source: European Commission, 2012

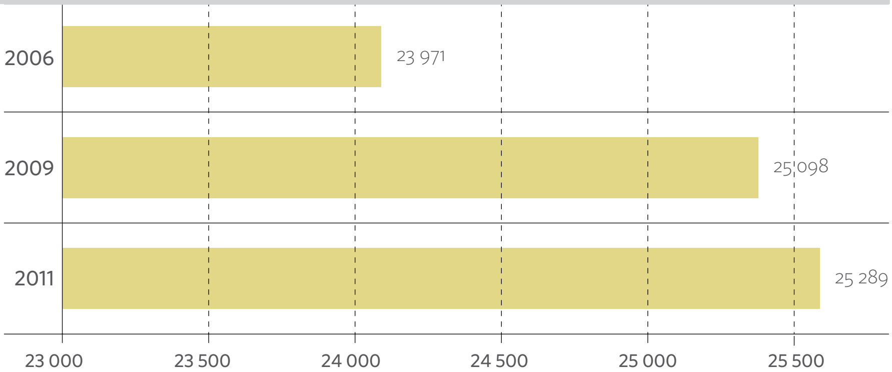
9. *Net inflows are calculated and FDI flows inwards less FDI flows outwards.*

2.2. Firm-level contributions[10]

At the firm level, EU companies have made a positive socio-economic contribution to the South African economy. Companies that participated in this White Book study were requested to disclose information on: 1) the number of permanent jobs created, 2) the percentage of their workforce that is exposed to training, and 3) the average annual company income tax contributions to the fiscus. The aggregated data over a five year period is presented below.

2.2.1. Employment

FIGURE 5. NUMBER OF PERMANENT JOBS CREATED IN SA BY SURVEYED COMPANIES



Source: Genesis Analytics, 2012

Approximately 88% of respondents reported the number of permanent employees within their South African operations in the years 2006 (23 971), 2009 (25 098) and 2011 (25 289). Respondent companies that had been operating in the SA market prior to 2006 shed the equivalent of approximately 2% of their permanent employees between 2006 and 2011. This is most likely due to the global economic recession. However, the new investments (between 2006 and 2011) account for increase in the number of reported jobs, with this group accounting for 1,582 jobs between 2006 and 2009 and 353 jobs between 2009 and 2011. Whilst it is not possible to determine how many of these jobs were new jobs, this broadly confirms how important FDI is to growth and development in this economy.

2.2.2. Skills training[11]

Two thirds of respondents reported that their respective companies offered training to over 70% of their South African operation's workforce on an annual basis, of which a third offer training to 100% of their South African workforce. Of those companies that offer training to 100% of their workforce, approximately 10% employ over 1,000 people.

In many cases, the training offered by companies surveyed ranges across a broad spectrum of skill sets, from technical skills through to higher level specialist and managerial skills. This training represents in many cases a sizeable investment on the part of these companies in terms of both financial investment and delays in operations whilst time is spent on training.

2.2.3. Tax contributions

Of the respondents[12] who provided information regarding average annual tax contributions of their South African operations, just over half reported contributions of below R5 million[13]. Average annual contributions of between R5 million and R25 million were reported by a quarter of respondents, while contributions of between R25 million and R50 million and of over R50 million accounted for the remainder.

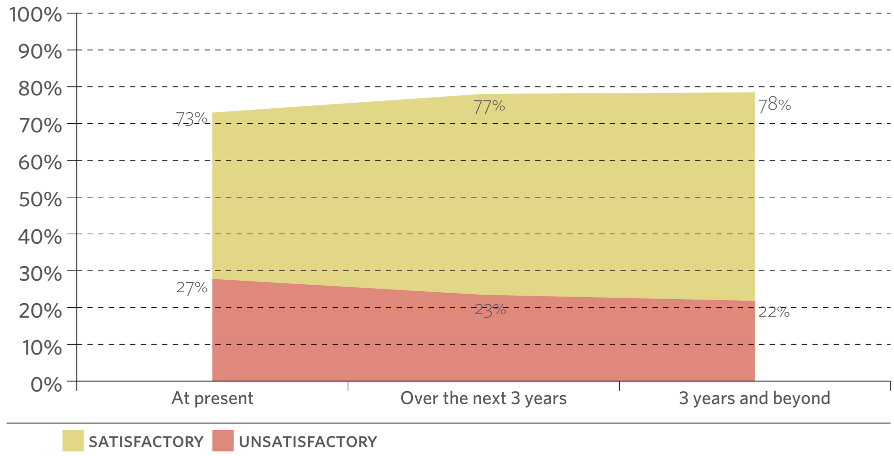
10. *The sample was taken between January and March 2012 and comprised of 88 companies operating across 11 sectors in South Africa, drawn from 12 participating EU member states.*
11. *Information on skills training was provided by 89% of respondents.*
12. *69% of respondents provided information regarding average annual tax contributions.*
13. *The disjuncture of reported tax contributions and company size is most likely due to assessed losses or under-reporting due to the predominant legal status (private company) of respondents.*

FIGURE 6: AVERAGE ANNUAL INCOME TAX CONTRIBUTIONS MADE BY SURVEYED COMPANIES

Source: Genesis Analytics, 2012

Gratifyingly, the positive trend in EU trade and investment with SA is mirrored by the perceptions of EU businesses operating in SA. Figure 7 below shows that just less than three quarters of respondents consider the current business conditions in South Africa to be satisfactory, with an increasing number of respondents expecting business conditions in the country to remain satisfactory over the next three years and beyond.

FIGURE 7: SATISFACTION/ DISSATISFACTION WITH SA BUSINESS CONDITIONS OVER TIME



Source: Genesis Analytics, 2012

Respondents describe the South African market as exhibiting tremendous potential for growth and development, and are positive about the dynamic economic environment and political stability – especially relative to other emerging markets, particularly other African states – and the country's role as a gateway to Africa. Respondents noted that there had been considerable improvements in South African business conditions in recent years, and that the plans and programmes proposed by the South African Government yield much promise for continued improvement and growth and generate optimism amongst investors. This is reinforced by the fact that 84% of respondents stated that they would recommend South Africa as an investment destination and/or trading partner.

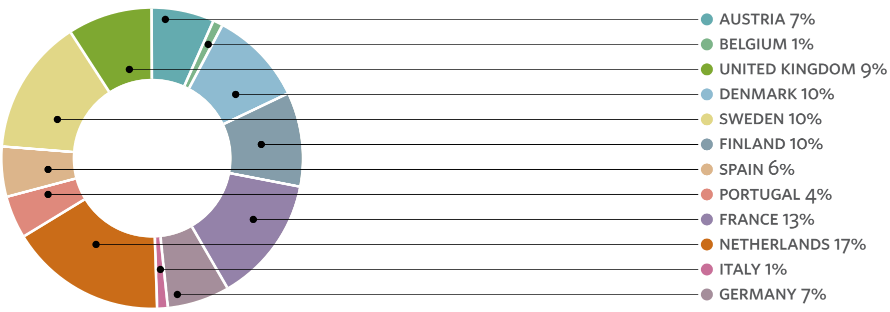
3. Obstacles to trade and investment

3.1. Summary perceptions

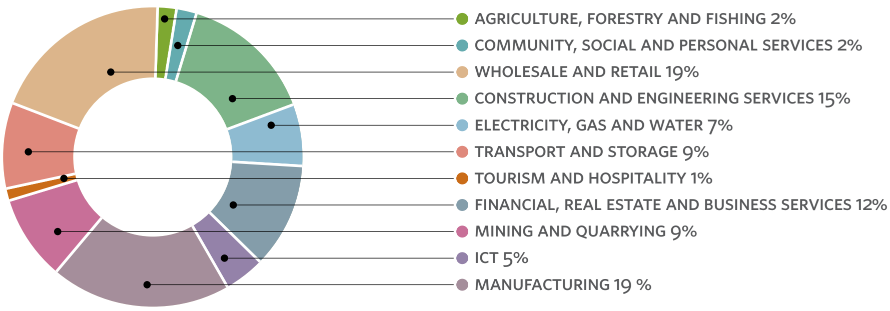
Although many EU firms are satisfied with current business conditions in South Africa, they nonetheless reported having experienced certain obstacles to their business operation and growth, which, if addressed, would result in higher levels of satisfaction and support increased investment and employment. The charts (Figure 8) below give a brief snapshot of the profile of respondent companies, followed by summary results for the perceived obstacles.[14]

FIGURE 8. RESPONDENT PROFILE BY COUNTRY OF ORIGIN AND BY SECTOR OF OPERATION

DISTRIBUTION OF EU COMPANIES SAMPLED, BY COUNTRY OF ORIGIN



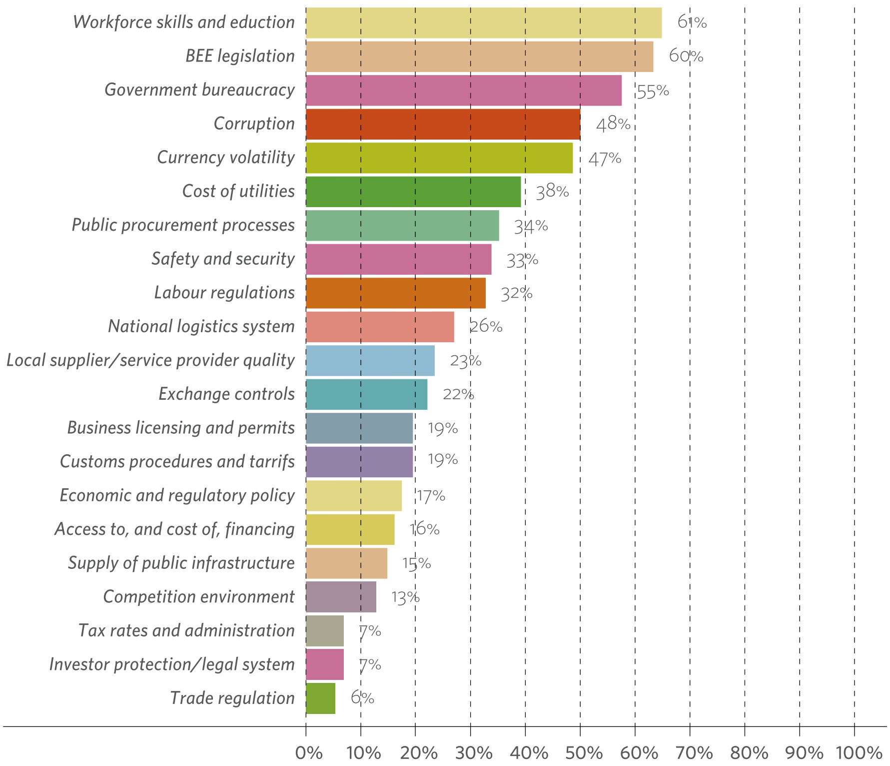
RESPONSES BY SECTOR



14. *Further information on the profile of respondents and the study methodology can be found in the appendix.*

As shown in Figure 9 below, the five obstacles cited most frequently by respondents were: 1) Workforce skills and education; 2) BEE legislation; 3) Government bureaucracy; 4) Corruption; and 5) Currency volatility.

FIGURE 9: RESPONSE RATE PER OBSTACLE



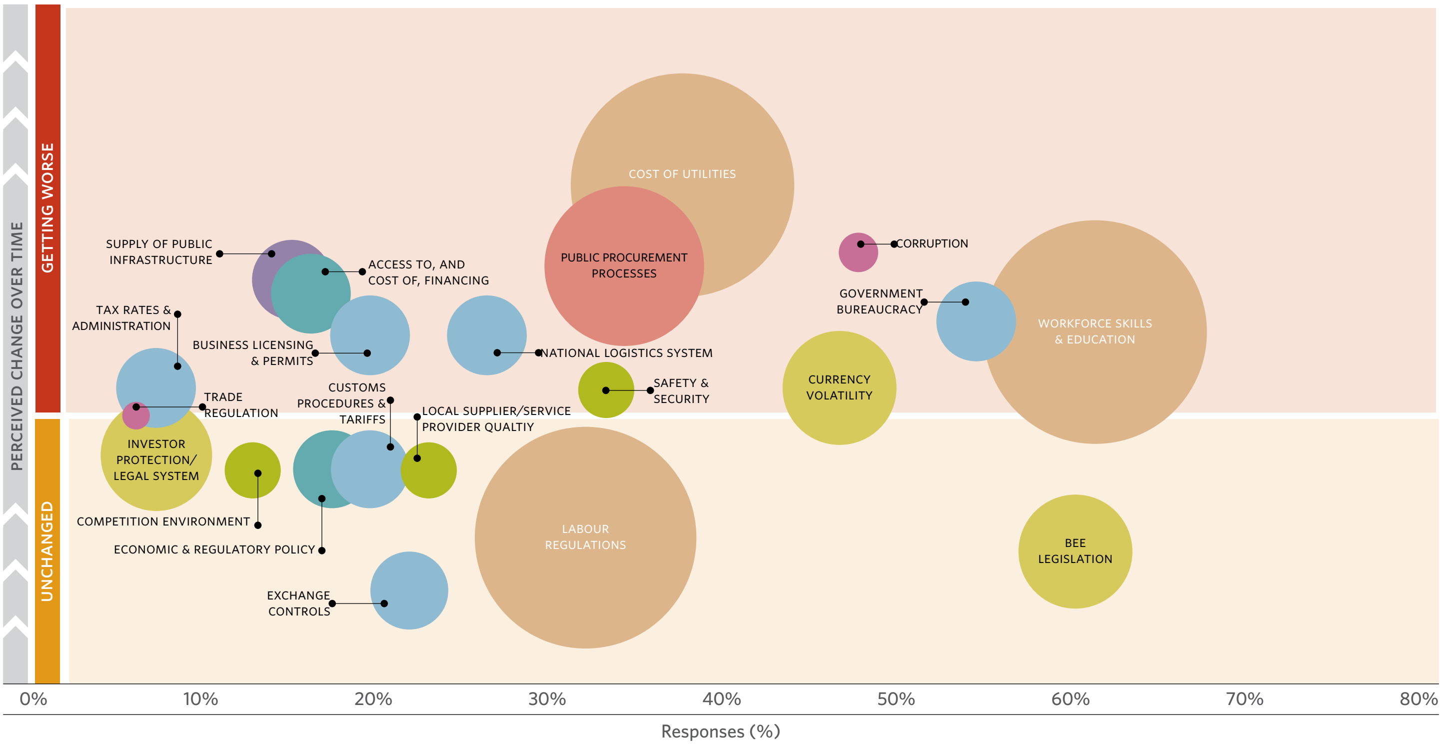
The survey tried to capture the dynamic nature of these obstacles, with respondents expressing an opinion on whether their experience of the obstacle was getting better, remaining unchanged, or getting worse. Of the five most frequently identified obstacles, respondents gave a negative prognosis for four, with the obstacles around BEE legislation perceived, on average, as remaining unchanged over time.

Respondents were also asked to indicate the level of severity the obstacle posed to their business. In addition to workforce skills and education, other obstacles that were deemed severe by respondents included the cost of utilities, labour regulations, and public procurement processes. Obstacles associated with the cost of utilities and those associated with public procurement processes were perceived to be worsening over time, while on average, those associated with labour regulations were perceived to be unchanged.

Figure 10 further below captures all three dimensions of the perceived obstacles

1) Response rate;
2) Severity; and
3) Change over time.

FIGURE 10: OBSTACLES TO TRADE AND INVESTMENT BY NUMBER OF RESPONSES, SEVERITY, AND CHANGE OVER TIME[15]



Source: Genesis Analytics, 2012

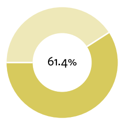
The following section will discuss in greater detail, a selection of issues which were considered as major or severe obstacles to trade and investment in South Africa. The issues are presented in the order of those issues which were most frequently cited.

15. *This graph shows the respondents' perceptions of 21 identified obstacles to trade and investment in terms of: 1) The percentage of respondents who cited an obstacle as one faced by their business (represented by the x-axis of the graph); 2) The aggregate perception of any changes in the status of the obstacle over time (represented by the y-axis of the graph); and 3) The aggregate perceived severity of each obstacle (represented by the size of each sphere).*

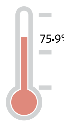
4. Selected obstacles

4.1. Workforce skills and education

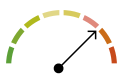
4.1.1. SURVEY RESULTS



RESPONSE RATE



PERCEIVED SEVERITY



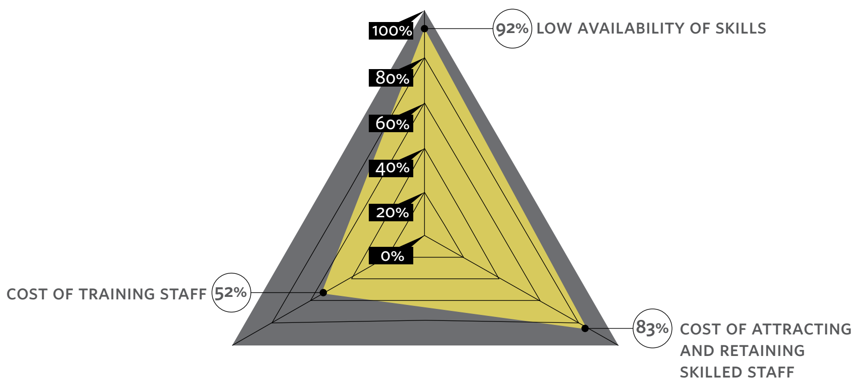
PERCEIVED CHANGE OVER TIME

Labour is a critical input in business operations. The quality and availability of appropriately qualified and experienced workers is a necessary condition to sustain growth and competitive advantage. For instance, highly-skilled workers, with technical and managerial knowledge, are needed to innovate and act entrepreneurially to unlock new growth opportunities. Furthermore, investing in training of low-skilled workers ensures that productivity and international competitiveness is maintained. Any shortage in the quality or availability of both high- or low-skilled workers undermines productivity growth and competitiveness.

In the survey, the issue of workforce skills and education was the most frequently identified obstacle to business operation and growth South Africa. In addition, of those respondents that mentioned workforce skills and education as an obstacle, three quarters of respondents described it as a major/ severe problem for continued business operations and growth and perceived the problem to be worsening.

The online survey divided the issue of workforce skills and education into three dimensions: a) low availability of skills; b) the cost of attracting and retaining skilled staff; and c) the cost of training staff. Figure 11 below shows that there was near unanimity of respondents deeming the low availability of skills as the main problem in workforce skills and education.

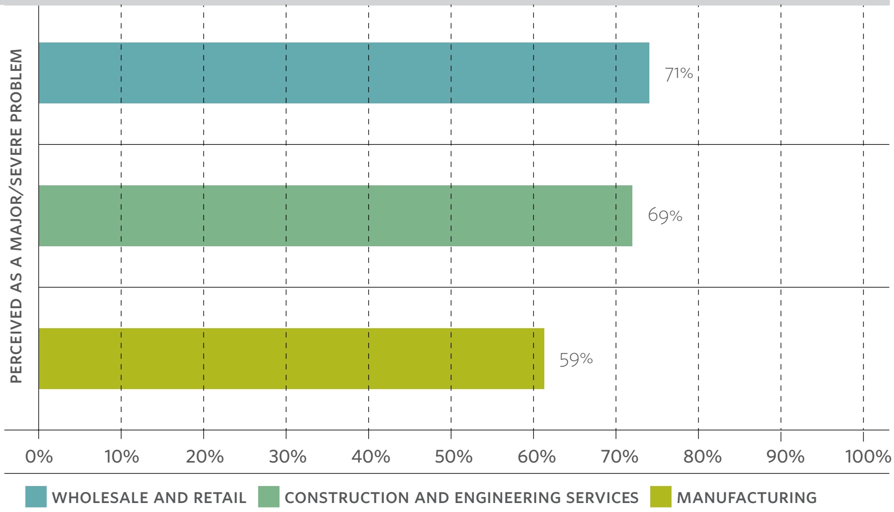
FIGURE 11: RESPONSES ON WORKFORCE SKILLS AND EDUCATION, BY SUB-FACTORS



Source: Genesis Analytics, 2012

Figure 12 below also shows by sector the respondents who cited workforce skills and education as an obstacle. Low availability of skills is a critical concern for the wholesale and retail, construction and engineering, and manufacturing sectors. Qualitative data revealed that the experiences of those businesses operating in niche industries, which require specialised skillsets and substantial practical experience, were acutely affected by low availability of the required skills. However, it is important to note that skills shortages are reported to exist across the labour market, from the most basic of numeracy and literacy skills required to train low-skilled workers, through to mid- and especially high-level technical and managerial skills.

FIGURE 12: RESPONSES ON LOW AVAILABILITY OF SKILLS, BY SECTOR



Source: Genesis Analytics, 2012

In addition to a restricted supply of skilled labour, respondents also reported that even when they do manage to find workers with specific qualifications or experience, the quality of these qualifications, or experience, is often below comparable standards expected in Europe. As a result, investment in additional training, even for qualified workers, is necessary to ensure that business operations are performed to international standards.

This finding is borne out by the efforts of companies to address skills deficiencies within their workforce. Two thirds of respondents reported that their respective companies offered training to over 70% of their South African operation's workforce, while one third of EU-owned companies surveyed offer training to 100% of their South African workforce. Of those companies that offer training to 100% of their workforce, approximately 10% employ over 1,000 people. One respondent, a large manufacturer, reported that they offered training for 100% of their 7,500 employees.

In many cases, the training offered by these companies ranges from basic skills and training to highly specialised technical training. The extent of this training represents a sizeable investment on the part of these companies in terms of financial capital, as well as the cost of foregone opportunities to invest in expansion, due to insufficient human capacity.

4.1.2. VIEWS AND ANALYSIS

The low availability of suitably skilled workers in the South African labour market is perceived by respondents to be a product of a failing education system. The experience has been that the throughput of new entrants into the labour market, who exhibit basic numeracy and literacy skills, is extremely low and that the quality and availability of suitably qualified tertiary-level graduates is often significantly lower than in Europe. South Africa is ranked 139th in the world in terms of literacy and numeracy rates at the primary education level. This low standard carries through to the secondary and tertiary levels of education, and into the South African labour pool (National Planning Commission, 2011). The 2011 matric pass rate of 70.2%, while a definite improvement from previous years, was achieved in the context of 1) a high pre- or early-high school dropout rate, 2) a grade between 30% and 40% is considered a pass, and 3) less than 50 000 students obtained a passing grade in mathematics. The university graduation rate is also very low at approximately 15% (HSRC, 2008). At the same time, South Africa has suffered significantly from brain-drain. The result is that the pool of skilled workers is not growing apace with the demand for the skills, whilst the pool of unskilled workers continues to grow, especially as new entrants join the labour market. A secondary concern raised by some respondents was that the productivity of their workers was low by international standards. Respondents attributed this to both the low quality of available skills and other factors such as over-protective labour laws, which make it difficult to incentivise higher levels of output per worker.

According to the respondents, the consequences of low skill availability in South Africa have the following implications on their operations and growth prospects:

1) ***Companies face increasingly high labour costs.*** Firms are finding that the dearth of skilled professionals means they have to pay a significant premium to attract sufficiently skilled and experienced workers into all strategic management positions, compared to their European counter-

parts. This is especially so for black employment equity candidates, the premium for who can be as high as 40% in some instances (CDE, 2007). This means that firms feel that it is increasingly beneficial to turn to the international labour market and bring in skills from abroad to fill the gap;

2) ***Bureaucratic red tape is causing delays in skills acquisition and attainment.*** Firms have essentially two options through which to bridge the skills gap. They can bring in foreign skills or invest in training. In the first instance, firms mentioned that work permit application procedures were generally improving, but that it is still concerning that decision-making lead times were inconsistent; taking anywhere from one to twelve months and that foreigners with trade skills (such as artisans, boiler-makers and welders) were finding it difficult to obtain work permits because their qualifications are not being recognised by the South African Qualifications Authority (SAQA), despite the critical shortage of these skills in South Africa. Similarly, some firms that have invested significantly in training have found it difficult to register and accredit their training courses and academies with their relevant Sector Education and Training Authority (SETA). Some companies reported that they have been waiting for over a decade for approval;

3) ***Government incentives for training are not competitive.*** The red tape associated with SETAs increases transaction costs and the negligible Skills Development Levy rebate pales in comparison to the investment made[16].

For example, a respondent pointed to the fact that in their business, for every R500 000 spent on training, they only receive R17 000 (0.03%) back from the SETA;

4) ***Difficult to lock-in the benefit of investing in skills development.*** Despite the significant search costs associated with recruiting talent and further investment in additional skills training, firms are struggling with retaining staff, mentioning that "Skilled South Africans, regardless of race, have a tendency to job-hop, after one to three years, for higher remuneration – there's no loyalty."

One company reported that they had invested in excess of R10 million in training in 2011. Every single employee who received training subsequently left the company and joined a competitor which could afford to pay higher salaries for the newly trained workers.

Ultimately, the mismatch between the underlying growth opportunities and the skills availability means that companies are hesitant to invest in and expand their operations in South Africa. If such conditions persist, companies must either invest outside of South Africa to meet demand, or they must introduce more automation into their production processes to contain costs and prevent any further loss of competitiveness.

An example of this is in the manufacturing sector, where a leading technology supplier noted that the company's highly accelerated growth plan for Africa was being severely hindered by the shortage of technical skills in the South African labour market. The company serves the regional African market from South Africa, however, they perceive the skills problem to persist into the future and have thus launched an investigation regarding the potential of more suitable sites across the continent to set up a new base of African operations.

4.1.3. RECOMMENDATIONS

To address the workforce skills and education challenge, the South African Government has compiled two strategic frameworks; namely the National Skills Development Strategy 2011/12 to 2015/16 (NSDS III) and the Human Resources Development Strategy 2010-2030 (HRDS); both of which were designed to complement the priority needs identified in the industrial policy framework, in terms promoting labour-absorbing growth. In alignment with the aims of these national strategies, some basic measures can be taken to reduce the burden to business while more systemic change is effected within the South African skills and education system. These measures could include:

1) ***Develop an updated model to project demand and supply of critical skills – focusing on occupational and trade skills***. It is essential that Government policy-makers and administrators are able to plan ahead and be flexible enough to respond to changes in the demand and supply of the skills available in the labour market. In this way, industry and government have the following roles to play in order to maintain a net inflow of critical skills in the economy:

    a) ***Industry*** knows the level of productivity, quality of skills and qualifications required to remain competitive and grow. Therefore they are responsible for reporting regularly on the type of skills and numbers needed in each sector.
    b) ***Government's*** role is to ensure that it regularly consolidates updates and publishes in a timely fashion the national skills data. In this way, the critical skills list and quotas are made flexible enough to respond to current demand-supply mismatches.

16. *For firms that meet the SETA requirements, the rebate allows these firms to claim back up to 50% of their skills development levy contribution from the SETA as a mandatory grant (This does not account for the actual cost of training incurred). The levy is a payroll tax incurred per employee at 1% of total cost of employment (TCOE).*

2) ***Liberalise and fast-track immigration policy for workers with qualifying university degrees.*** A more liberal policy is possible for degreed migrants, where evidence shows they will readily be employed or start their own business[17]. In this instance, quotas would be unnecessary, with room for Industry and Government to agree on, and periodically review, the definition of "qualifying degrees". It is proposed that the Department of Home Affairs give all workers with qualifying university degrees a fast-track three year visa and then permit automatic renewal conditional on employment (Levinsohn, 2007).

3) ***Increase capacity at the Department of Home Affairs to improve and maintain turnaround performance in processing critical skills permits***. Much progress has already been made to speed up the processing of both temporary and permanent placements of appropriately skilled and qualified foreign work seekers. However, the Department of Home Affairs' human resource capacity constraints (numbers and skills) need to be addressed to maintain a consistent turnaround performance.

4) ***Review the standards of selected education institutions covering critical skills in priority sectors.*** Based on the findings, institute support to secure the alignment of standards with those in the EU. This would ensure EU subsidiaries operating in SA are not disadvantaged relative to their sister companies in the EU, and that SA remains a viable base for expansion into Africa.

5) ***Offer a matching-grant to incentivize firms to meet their skills needs through the occupational training provided by Further Education and Training Colleges (FETS) to reduce the risk and costs associated with skills development***. The skills development levy offers a negligible incentive (relative to company training spend) of up to a 50% rebate on contributions made by firms. Furthermore, a greater incentive is required to increase the aggregate supply of skills to match those demanded by industry.

   Over and above the mandatory grant[18] component available to firms from the SETAS, the non-discretionary portion from the National Skills Fund[19] (which has gone underspent in previous years), needs to be better used to catalyse public-private partnerships with Further Education and Training Colleges (FETS) (see graphic further below).

   The NSF should offer a matching-grant to incentivize firms to meet their skills needs through the occupational training provided by FETS. This funded partnership should be extended to ensure that the quality of the curricula, teaching and workshop infrastructure is 'fit-for-purpose' (aligned with EU standards, where desirable). With increased industry involvement, greater influence will be exerted over FETS to assure the quality of outcomes.

   Overall, by using the economies of scale offered by FETS it will increase the aggregate supply of the appropriate skills demanded by industry over the medium-term; in turn reducing the direct cost and premium paid for acquiring skills in the sector.

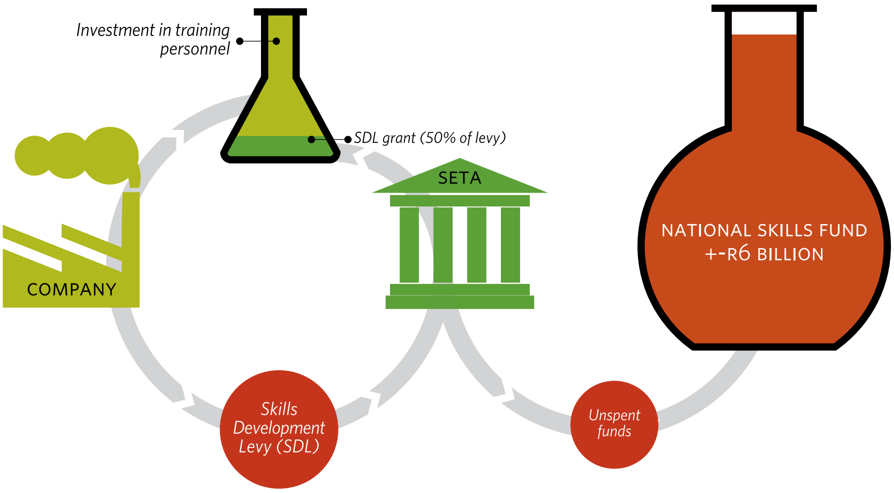
6) ***Introduce a support mechanism for investors to aid understanding of the complexities of the SA labour market.*** By helping investors fully understand key elements of the labour environment (i.e. EE legislation, Basic Conditions of Employment, bargaining council requirements, and SETAS), these can be factored into the overall business strategy of individual investors (through an associated human resource strategy) to maximise positive labour-related outcomes.

17. *Unemployment for individuals with university degrees is on average 5% and less.*

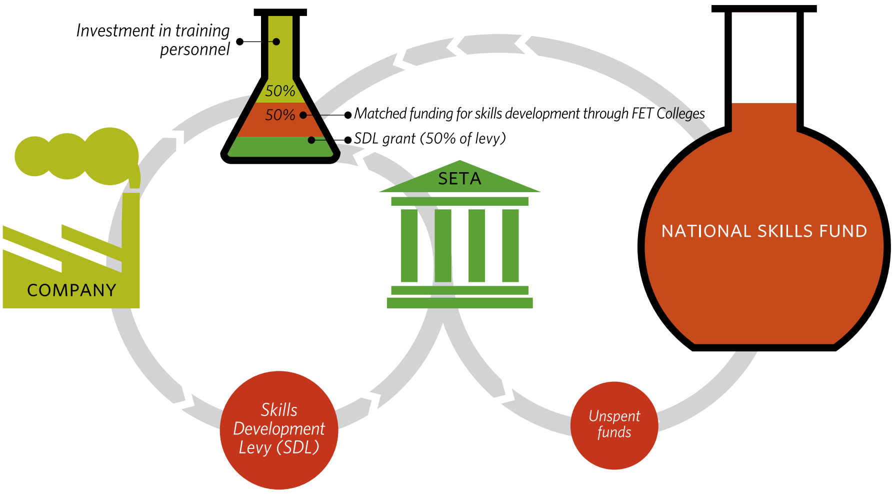
18. *Mandatory grant per qualifying firm is up to 50% rebate on the Skills Development Levy contribution.*

19. *National Skills Fund (NSF) allocates non-discretionary funds to SETAS for special projects. The NSF is capitalised at approximately R6 billion.*

CURRENT SITUATION



PROPOSED SITUATION



4.2. BEE legislation

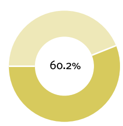
4.2.1. SURVEY RESULTS

Evidence from the survey shows that BEE legislation is the second most reported obstacle experienced by survey respondents. The issue of BEE legislation was cited as a major/severe obstacle to business growth and operation and over half of the respondents perceive the problems associated with BEE legislation as remaining unchanged over time.

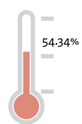
The following five dimensions of BEE legislation were assessed in the survey:

a) The cost of compliance to BEE legislation;
b) The difficulty to comply with BEE legislation;
c) Low commercial benefit to compliance with BEE legislation;
d) Risks arising from compliance; and,
e) Lack of clarity and certainty around relevant requirements.

Figure 13 below graphs how respondents rated these dimensions and shows that the low commercial benefit to compliance and the difficulty to comply are considered to be the most problematic.



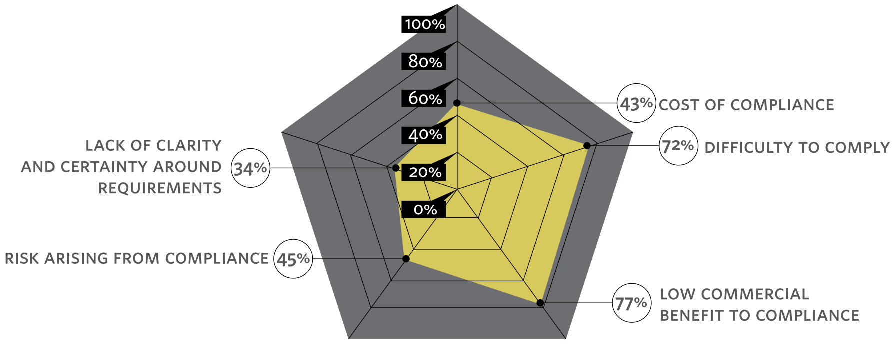
RESPONSE RATE



PERCEIVED SEVERITY

PERCEIVED CHANGE OVER TIME

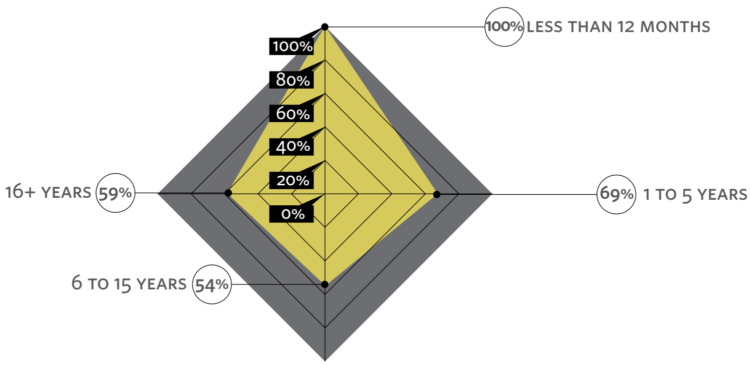
FIGURE 13: RESPONSES ON BEE LEGISLATION, BY SUB-FACTORS



Source: Genesis Analytics, 2012

There was little variation in the experience of companies predominantly serving private sector clients and those serving public sector clients – 66% of the former and 56% of the latter identifying BEE legislation as an obstacle. The high dissatisfaction from companies dealing with the public sector is somewhat surprising since the Government, in particular, is bound by clear and consistent preferential procurement guidelines – which would suggest that companies seeking a business relationship with government should be in a position to more readily and consistently derive a commercial benefit from complying with BEE. Figure 14 below illustrates that those companies which have only recently entered the South African market perceive BEE legislation as a greater obstacle than those companies which have been operating in the country for a longer period.

FIGURE 14: RESPONDENTS THAT SELECTED BEE LEGISLATION AS AN OBSTACLE, SORTED BY RECENCY OF ENTRY INTO SA MARKET



Source: Genesis Analytics, 2012

4.2.2. VIEWS AND ANALYSIS

Interviews with respondents revealed that many companies support the social transformation efforts in South Africa, and the reduction in the levels of inequality and poverty in society. However, they perceive a disjuncture between the written and applied BEE legislation. Furthermore, they experience cost and practicality barriers in complying with BEE legislation. The following observations have implications on fair access to business opportunities and company competitiveness:

1) ***Equity equivalents option is expensive***. On entering the SA market, foreign-owned multinationals struggle to obtain BEE points on the ownership and control dimensions of the scorecard. This is either because the perceived risk associated with acquiring a local equity partner is too high, or the company's global governance policies prevent transfers of equity and control in subsidiaries. Companies have explored the possibility of investing in equity equivalents, which allow them to obtain BEE points without having to sell shares. This option is usually unaffordable for an EU company's South African start-up operation, as this is typically achieved by contributing the equivalent of 25% of the value of the local operation to an enterprise development- or socio-enterprise development-type programme. Alternatively 4% of turnover can be contributed over a 10 year period[20];

20. (*BEESA* Consulting, 2009)

2) ***Employment equity is encumbered by the lack of availability and cost associated with attracting appropriately skilled black professionals.*** Respondents say that because of the general lack of skills in the economy there is low availability of qualified black candidates and the cost of attracting and retaining such individuals is very high. Furthermore, for many firms that have invested in training black professionals in-house to the requisite level of skill, experience and seniority in the business, they have not been able to retain these skills long enough to achieve the full benefit of their investment, and continue to struggle to comply with employment equity plans and targets;

3) ***BEE in public procurement processes is often mis-applied.*** In spite of the different channels through which compliance may be achieved, there is a perception that exists, which asserts that if an entity would like to participate in in any significant business transaction, then decision-makers want to see black ownership and management control. The remaining dimensions are not meaningfully interpreted as BEE compliance. For many companies in this survey, this is especially problematic because transfer of equity ownership is contrary to their global governance strategies – which require foreign subsidiaries to be controlled by the parent company, headquartered in the EU. Therefore, firms feel that they are sometimes unfairly disadvantaged and excluded from business opportunities, despite achieving compliance, and that their proposals would add significant value to the client; and

4) ***Difficulty in attributing sales to BEE compliance diminishes the incentive to comply.*** Due to a lack of transparency in decision-making for government tenders, companies mention that it is often not entirely clear on what basis tenders have been awarded. They have observed that in some cases tender awards have gone to firms with little or no BEE compliance or that these firms have used an unknown black-owned firm, with no track-record to front[21] for them.

Despite the positive moral sentiment expressed by respondents, companies will comply with BEE to the extent that it is commercially viable (see BEE compliance graphic further below). If there is an inadequate return on investment (relative to that company and its circumstances), the company may respond by:

a) segmenting (and in effect limiting) their market so that they minimise the effect of their BEE compliance;
b) withdrawing from the market to entirely avoid BEE compliance;
c) engaging in corrupt behaviour to compensate for their lack of BEE compliance; or
d) not entering the market at all (if relevant observations and calculations are made prior to entry).

None of these responses are desirable for the South African economy, as they result in reduced levels of investment and lower levels of competition. In particular, it reduces the ability of Government to achieve value for money in public procurement.

4.2.3. RECOMMENDATIONS

The New Growth Path (2010-2020) policy document recognises that current BEE provisions have been unable to ensure a broad-based approach and is imposing significant costs on the economy which undermine sustained growth and employment creation. The proposals suggested below echo those tabled in the NGP:

1) ***B-BBEE Commission should play an active role in addressing constraints faced by Industry.*** The B-BBEE Amendment Bill proposes the creation of a B-BBEE Commission, with one of its aims being "to strengthen and foster collaboration between the public and private sector in order to promote and safeguard the objectives of B-BBEE". Given the structural nature of the skills shortage in South Africa, especially among black South Africans, the Commission should endeavour to craft a pragmatic solution to assist companies that are struggling with EE attainment;

2) ***Employment equity should focus on job creation and career progression at the middle and bottom of the economy.*** Employment equity has received disproportionate attention at top management levels, where limited numbers of black South Africans with elite qualifications limit the pool of talent. Government should address this structural constraint by focusing on building the pools of elites (training black Chartered Accountants, for instance) and incentivizing industry to create jobs at the bottom of the economy. Thus, generic BEE scorecards should reward firms more for hiring and training, especially from unemployed groups, and for providing progressive career paths for skilled EE candidates (Andrews, 2007);

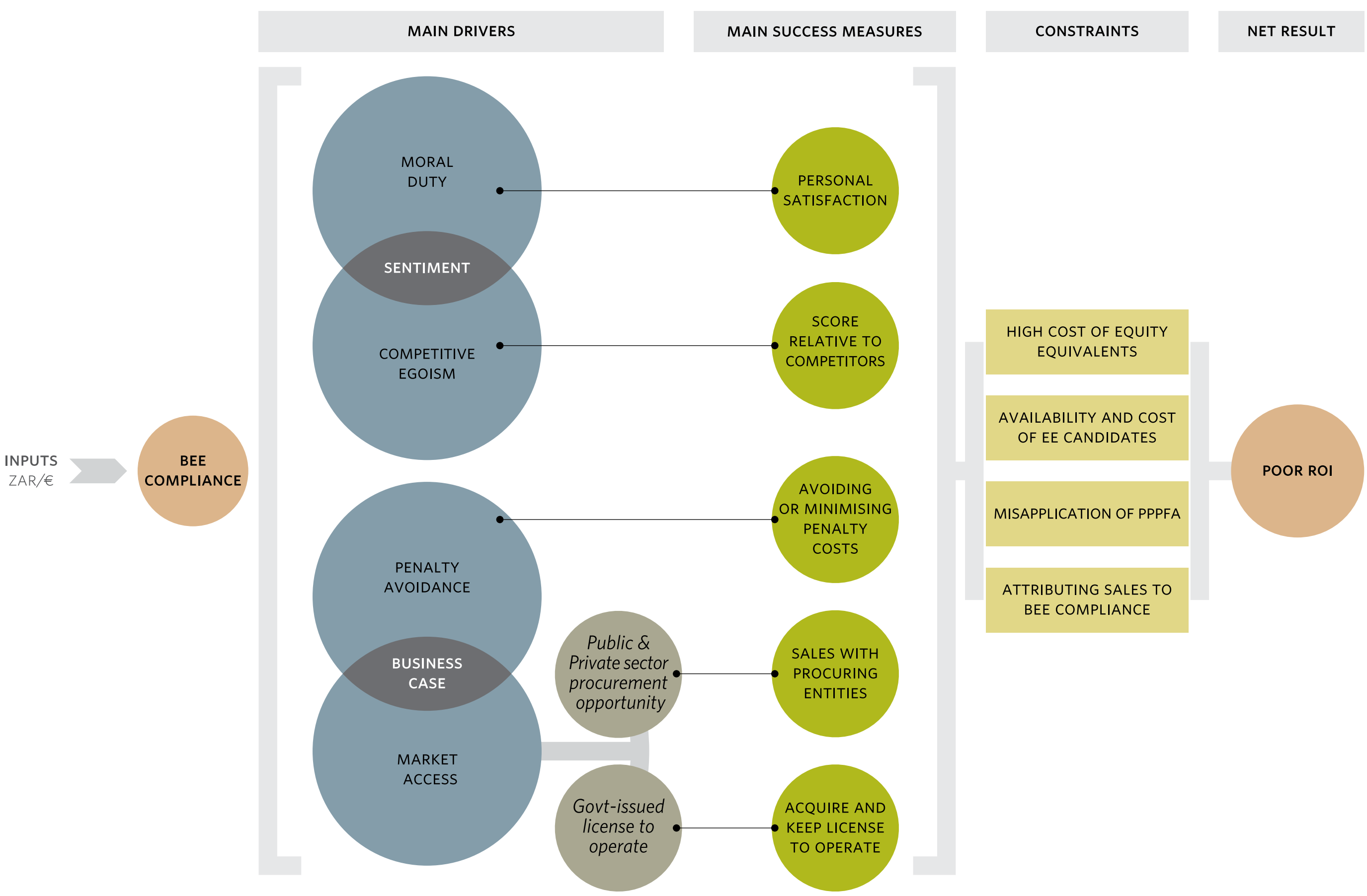
21. *BEE fronting refers to an unethical practice whereby non-compliant firms create a separate company owned by unqualified and incapable black individuals, to bid for tenders on their behalf, in order to maximise their ownership scorecards.*

3) ***Conduct a Regulatory Impact Assessment (RIA) on BEE legislation, focusing on the cost of equity equivalents and the constraints to complying with Employment Equity legislation.*** Conducting a RIA allows policy-makers to evaluate both the direct and indirect costs and benefits of a legislative amendment on business. However, since the amendment bill is already at an advanced stage, it is suggested that the DTI implement a "light-touch" RIA on the constraints to implementing the amendment bill and its likely impact on the cost of capital and investment, before it is finalised;

4) ***Continue efforts within Government to improve consistency in understanding and application of PPPFA rules.*** National Treasury should maintain the momentum and level of importance ascribed to this effort, in order to reduce the likelihood of mis-application of PPPFA rules, especially in the light of changes to the PPPFA in 2011; and

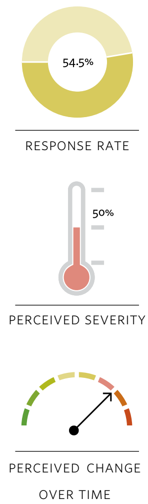
5) ***Increase transparency in public procurement to address the problem of attribution.*** Due to Government's unified preferential procurement policy (as distinct from the private sector) and the requirement for fairness and transparency in its operation, Government is strongly positioned to positively address the difficulty that many private sector companies experience in attributing sales to BEE compliance. If government entities are required to consistently publish tender results (including unsuccessful bid prices and claimed BEE scores of competing firms), this will serve to a) reduce the misapplication of PPPFA rules and corruption; and b) allow bidders to objectively assess the influence of price, BEE score and functionality (where appropriate) on their ability to win. For those companies who struggle to comply with BEE, they can alter their future bidding strategy to focus on price and functionality (where appropriate). If the PPPFA rules are correctly and consistently applied, the most desirable result for Government should always be achieved. For example, if a company with a low BEE score wins purely based on price, then Government will have more money available to spend on its social development mandate; or if a company with a high BEE score wins, Government achieves both value for money (the chief requirement for public procurement) and strong contribution to BEE.

TYPOLOGY OF BEE COMPLIANCE AND THE CONSTRAINTS TO SUCCESS



4.3. Government bureaucracy

4.3.1. SURVEY RESULTS

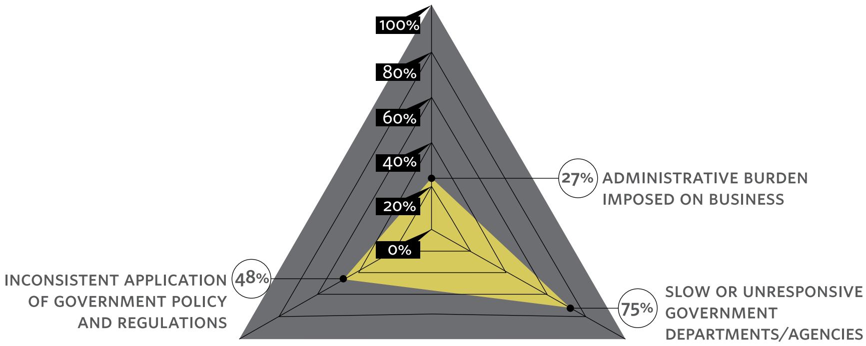


An inefficiently managed government bureaucracy causes red tape costs, which are borne by business. Red tape can be described as unnecessary and copious reporting requirements, delays in decision-making and approvals, inconsistent service levels and a lack of communication and feedback. This has negative implications on the perceived levels of good governance, transparency and accountability of the state.

Government bureaucracy was described as a major/severe issue by half of the respondents who identified it as an obstacle to business operation and growth in South Africa. Over half of the relevant respondents also noted that they perceived this obstacle to be worsening over time.

Figure 15 below shows the three main dimensions of government bureaucracy which were presented in the survey. These included: a) the administrative burden imposed on businesses; b) slow or unresponsive government departments/agencies; and, c) the inconsistent application of government policy and regulations. Of these, the most severe issue, reported by three quarters of respondents, was that of slow or unresponsive government departments/agencies.

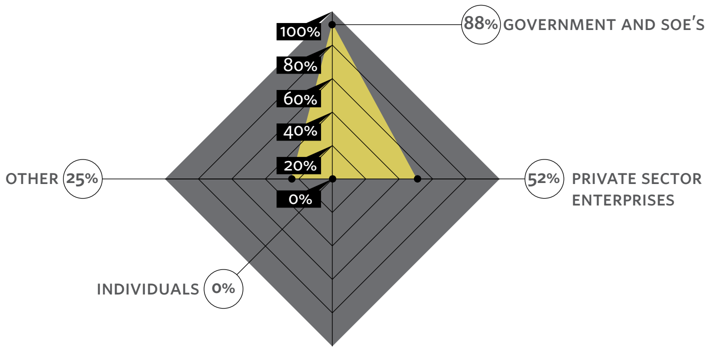
FIGURE 15: RESPONSES ON GOVERNMENT BUREAUCRACY, BY SUB-FACTOR



Source: Genesis Analytics, 2012

Figure 16 below shows that government bureaucracy was cited as an obstacle by 88% of those companies whose main domestic client was a government entity or state-owned enterprise.

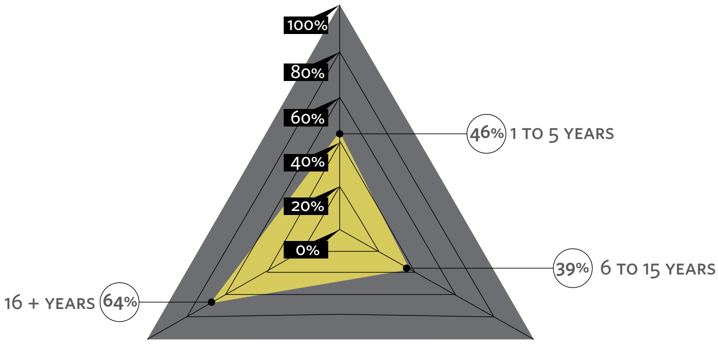
FIGURE 16: RESPONDENTS THAT SELECTED GOVERNMENT BUREAUCRACY AS AN OBSTACLE, SORTED BY TYPE OF DOMESTIC CLIENT



Source: Genesis Analytics, 2012

While no notable differences between large and small businesses across a range of sectors were reported, those companies that have been operating in South Africa for 16 years or longer were more likely to report frustrations with government bureaucracy than those companies which had more recently entered the South African market (see Figure 17 below). One can speculate as to the reasons for this distinction, but perhaps at a basic level it can be attributed to a longer timeline over which change can be observed.

FIGURE 17: RESPONDENTS THAT SELECTED GOVERNMENT BUREAUCRACY AS AN OBSTACLE, SORTED BY RECENCY OF ENTRY INTO SA MARKET



Source: Genesis Analytics, 2012

4.3.2. SURVEY RESULTS

Dealing with slow or unresponsive government departments/agencies often directly impacts business operations – especially in the case of those companies for which the public sector makes up a large portion of their client-base. The problems associated with slow/unresponsive government departments/agencies were reported in the following ways:

1) ***Critical business processes are compromised by non- or poor communication of decisions, due to a lack of accountability of government officials and poor feedback mechanisms.*** These are characterised as follows:

   a) ***Delays in decision-making, approving licences to operate and receiving timely payment for work done.*** The public sector, particularly at the provincial and local spheres of government, is faced with capacity constraints and administrative system failures. Respondents often mentioned that any administrative enquiries or adjudication processes were either dealt with by individuals who were inadequately qualified to make an informed decision, or that those who were qualified, were over-burdened by the workload, due to high vacancy rates in departments. The frequency of staff turnover in sector departments also meant that one has to constantly deal with someone new and start over from the beginning as if there was no record of any previous engagement or communication.

   b) ***Lack of communication and accountability.*** It was noted that it was particularly frustrating that Government outsourced much of their administrative functions to ineffective call-centres, because they still could not track decision-making processes nor escalate matters to the decision makers. Even when decisions are made, there is no communication to inform the company that a determination has been arrived at. It was generally noted that, in all respects, a greater level of transparency is required, because the perception currently is that many parts of Government are like a "black hole of decision-making", where it is not clear how a decision was arrived at, or whether it will be concluded. As a consequence, some businesses have resorted to legal means to compel Government to make a decision or provide information as is required in the both the Promotion of Access to Information Act, Act 2 of 2000 (PAIA) and the Promotion of Administrative Justice Act, Act 3 of 2000 (PAJA). Some companies say they avoid the legal route as they do not want to be ostracised for taking Government to court and suffer the reputational risk and perhaps lose future business from their major client;

In the case of a company in the tourism and hospitality industry, these delays existed in the licensing process, where standard processes which usually take two days took as long as four weeks to complete. Similarly, a firm operating in the information, communications and technology sector, was unable to obtain necessary documentation for importing and exporting operations for a number of months. Delays in payment were voiced across sectors, in particular in the health sector, the engineering services sector, as well as in the in the wholesale and retail sector

2) ***High costs are incurred by businesses in the course of employing staff/outsourced services dedicated to dealing with government bureaucracy.*** Companies reported that they spend a significant proportion of their consulting fees on legal and accounting services or that they have appointed permanent employees who manage government liaison, ranging from labour law matters at the CCMA to preparing and following-up on public procurement bids and administration.

The general view is that dealing with bureaucratic red tape is a frustration, but that it is not a unique problem to South Africa. What is important to note is that those businesses that depend primarily on government business are adversely affected. Some businesses say that they have made strategic decisions to avoid certain departments, municipalities or provinces as a whole, because they are notorious for non-payment and red tape.

A large manufacturer made the point, "if payment delays (especially for SMEs) were eliminated, then all other delays could be tolerated in the normal course of doing business. Restricting cash flow to a business does irreversible damage, with spill-overs into the supply-chain, because workers are laid-off and smaller companies are foreclosed and they cannot be resuscitated thereafter."

4.3.3. RECOMMENDATIONS

The Department of Public Service and Administration (DPSA), together with the Public Service Commission (PSC) have the mandate to ensure that the Government administration delivers services efficiently and effectively by fostering good governance principles, sound administration systems and procedures and a customer-centric culture of service. In line with Government's service delivery strategy; namely Outcome 12[22], the following strategic actions are emphasised as a means to reduce the burden on firms and strengthen accountability and efficiency in the public service:

1) ***Establish a cross-departmental Red-Tape Reduction Task-Force.*** Simplification and rationalization of business-related administrative procedures and regulations, such as licensing, permits and registrations, is key to enabling the business environment. This task-team would have the following mandate:

   a) Establish a Red-Tape Hotline and Survey to understand and assess burden perceptions directly from firms on an on-going basis;

   b) Use the insights and data to quantify the burden and set burden-reduction targets into each of the relevant authority's performance targets, linked to their budget negotiation cycle;

   c) Publish guidelines on good administrative practices and processes which help achieve burden-reduction in Local and Provincial Government and SoEs – highlighting the impact on targeted groups such as SMEs. For example, ensuring that SMEs are paid within 30 days or facilitating online tendering and contracting.

   d) Advocate for the implementation of ICT tools (e.g. e-Governance portals and back-office systems integration) to improve the inter-operability of information requirements between government entities and streamline key business approvals such as business and intellectual property registrations, site development plans, environmental impact assessments, operating licences/permits and online procurement/tendering. This would reduce waiting-times and transaction costs for business and increase transparency and communication.

   e) For non-critical approvals, introducing the "silence is consent" concept into business regulations would also make administration more efficient.

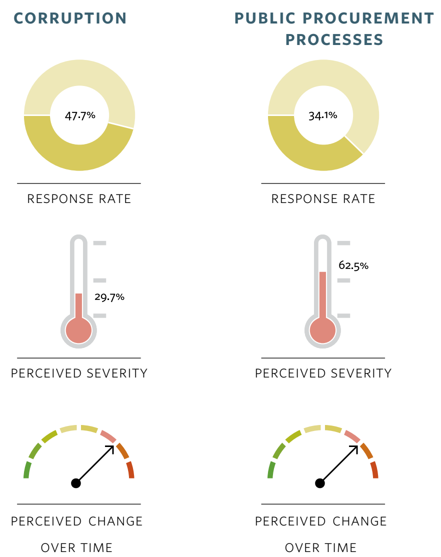
2) ***Give the Department of Performance Monitoring and Evaluation (DPME) a leading role.*** The DPME should take a lead role in monitoring progress towards the above-mentioned micro-economic reforms.

4.4. Corruption and public procurement processes

4.4.1. SURVEY RESULTS

Individually the issue of corruption was identified as an obstacle by almost half of surveyed respondents, but was described as relatively less severe (by less than a third of respondents). However, qualitative analysis revealed that the non-transparent nature of corruption meant that many respondents were unsure of the extent of corrupt practices in the South African economy and due to its sensitive nature, some preferred to highlight it as a concern, but provide no further comment or rating on the issue. This uncertainty and non-response accounts for the relatively low severity associated with an issue with a relatively high identification rate as an obstacle to trade and investment. On average, respondents felt that the issue of corruption was worsening over time.

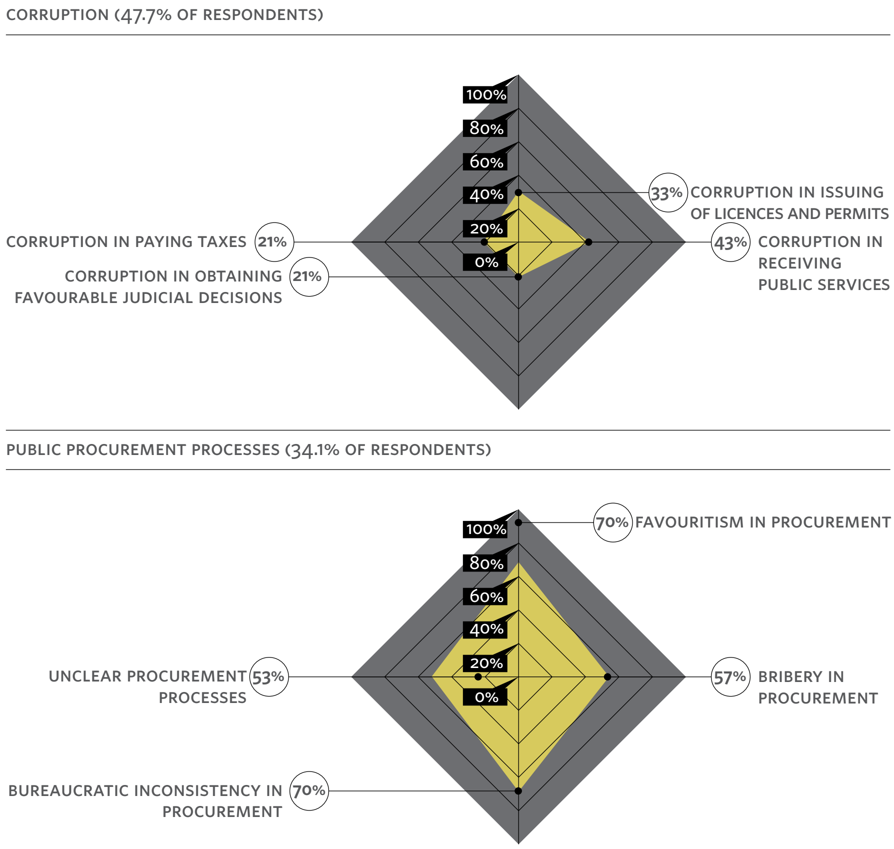
On the other hand, the issue of public procurement processes was identified less frequently by only a third of surveyed respondents. For those who did report that public procurement processes hindered investment, nearly two-thirds of these respondents considered the issue as severe and worsening over time.



22. *Outcome 12: An efficient, effective and development oriented public service and empowered, fair and inclusive citizenship.*

Figure 18 below illustrates the connectedness of the dimensions which link corruption and public procurement. Respondents that identified Corruption as an obstacle say that the problem lies in corruption in receiving public services and respondents that identified Public Procurement Processes as an obstacle say that favouritism and bureaucratic inconsistency in procurement equally describe the problems in public procurement processes.

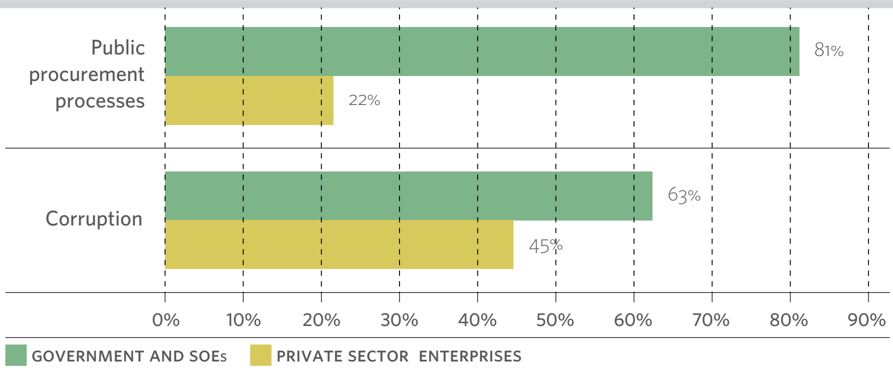
FIGURE 18: RESPONSES ON CORRUPTION AND PUBLIC PROCUREMENT, BY SUB-FACTOR



Source: Genesis Analytics, 2012

Problems with corruption and public procurement processes were reported frequently by respondents whose businesses deal largely in the public sector (see Figure 19 below). Of those businesses whose main domestic clients include government entities and state-owned enterprises, four in five respondents reported problems with public procurement processes and nearly two-thirds of respondents reported problems with corruption.

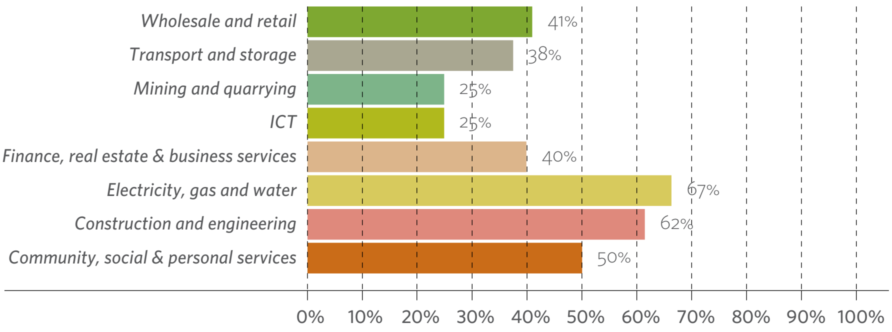
FIGURE 19: PUBLIC PROCUREMENT PROCESS AND CORRUPTION, BY TYPE OF DOMESTIC CLIENT



Source: Genesis Analytics, 2012

When viewing responses by sector (see Figure 20 below) we find that problems with public procurement processes were particularly frequently noted by those companies in the electricity, gas and water sector and the construction and engineering sector. Private sector corruption was most commonly reported by businesses in the wholesale and retail sector (70.6%).

FIGURE 20: PUBLIC PROCUREMENT PROCESSES, BY SECTOR



Source: Genesis Analytics, 2012

4.4.2. VIEWS AND ANALYSIS

Although corruption in general, and especially in public sector procurement processes, is said to be prevalent, it is inherently something difficult to identify accurately and confidently. For any company, being associated with any unethical practices is fraught with reputational risk. Therefore, for fear of being ostracised or being associated with negative publicity, many companies are hesitant to come forward in public, as whistle-blowers; although they acknowledge in private that corruption is taking place. Reporting corruption is also made difficult by the perception that there is neither the political will nor the institutional capacity to deal with the problem.

A number of respondents reported that they had first-hand experience with solicitation by officials, specifically relating to government tenders.

Lack of accountability and transparency in the government bureaucracy does perpetuate corrupt practices. Experiences, as described above, where suspected corruption is reported, but is not taken seriously by officials makes it incredibly difficult to convince the public that there is a zero-tolerance attitude towards corruption.

The problems experienced with favouritism in public procurement and inconsistent procurement processes are a little more clear-cut and can be summarised thus:

1) ***Lack of transparency and feedback in tender adjudication processes can allow corrupt activities to flourish.*** Respondents highlighted the tendency of government departments and agencies to refuse to provide feedback to bidders as to who all the tenderers were and how they were scored. Respondents believe that this lack of accountability is not in line with the spirit of the Promotion of Access to Information (PAIA) and that there are few avenues bidders can take, apart from legal action, to compel departments to review decisions or provide more feedback on the adjudication process.

The lack of communication in the tender processes is highlighted by the experiences of a certain ICT based company which claims to have received responses to less than one third of submitted proposals in 2011.

2) ***Government Departments' impromptu withdrawal of tenders or changes to specifications is costly to bidders.*** For multi-million rand tenders, it is especially critical that government departments are consistent with their own tender preparation procedures to ensure that the final requests for proposals do not result in needless changes, delays or withdrawals.

3) ***Adjudication panels are sometimes technically ill-suited to make informed decisions.*** Many companies mentioned the delay in decision making by adjudication panels, but what frustrated them most was that these panels were composed of administrators and non-technical panellists. Therefore, they often made, what was perceived as, the wrong decisions.

For example, a manufacturer and distributor of health equipment mentioned that the specifications of their equipment needed regular updating to ensure that patients were not using sub-standard devices to assist with their disability. However the Department's panel was using outdated specifications lists as they did not have the skills in-house to maintain the lists. Although, subsequently, consultants were used to update the lists, the adjudication panel were not technically skilled to make an informed decision and procured, what appeared to be, purely on the basis of price, and not value-for-money.

The implications of these experiences is that some companies find it too risky to take part in public procurement processes and turn their focus to private sector business, which reduces the market potential. A respondent in the survey took the step to completely exclude the public sector when designing their on-going business strategy for their South African operations. In this case, the company's investment in the country has been limited to one third of its calculated potential, had they included the public sector as part of the market potential. For Government, the result is reduced competition in procurement processes, which would imply that the state is not getting the best value-for-money proposition available. Furthermore, it is important for service delivery that the private sector supplies the best skills available for public sector projects, which are intended to drive growth in the economy.

4.4.3. RECOMMENDATIONS

The DPSA and PSC are responsible for integrating departments and the three spheres of Government to ensure that there are commonly understood norms and standards in applying the National Treasury's supply-chain management (SCM) guidelines in the public service. Furthermore, they are tasked with tackling corruption in the public service. In this regard the following measures are highlighted to promote transparency and accountability in public procurement processes:

1) ***Activate fraud and corruption risk management plans as a pre-requisite for Department budget approval.*** Regular fraud and corruption risk assessment were introduced as a good governance and financial management practice to complement anti-corruption units set-up in a selection of provincial and national government departments and SoEs. In order to ensure that these assessments are conducted regularly and the plans complied with, departmental budgets should only be approved with an audited risk assessment report.

2) ***Invest more resources in anti-corruption investigating capacity to prevent, detect and investigate unethical practices in the public service.*** By building institutional capacity in Integrity Management Units, at a more localised level (provincial and municipal level), sends a strong signal to companies that the public service is taking the fight against corruption seriously.

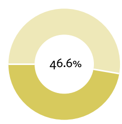
3) ***Encourage pro-active citizenship among firms to make use of institutions set-up to monitor, investigate and address corruption and mal-administration.*** These include the National Anti-Corruption Hotline, CoGTA Municipal Anti-Corruption Unit, Corruption Watch, the Public Protector and the Presidential Hotline to lodge complaints and identify areas of administrative weakness.

4) ***Publish online the vital statistics of tender bids to strengthen accountability.*** It should be a standard practice for all government entities to provide on their websites transparent and accessible feedback on the outcome of tenders, including: vital statistics (bidding company, bid price and claimed BEE score) of bids received, summary assessment of each bid and successful bidder. This allows the public to hold Government procurement processes to account and assures administrative consistency. If government entities cannot be required to publish such information, National Treasury may be able to provide appropriate budget incentives to drive the right behaviour, based on a cost-benefit analysis of improving transparency in public procurement.

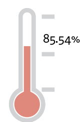
5) ***Use ICT tools to implement SCM practices more consistently across provincial, and national government departments.*** The Integrated Financial Management System (IFMS) is being developed to replace manual reporting systems inside government by integrating back-office systems and improving inter-operability between departments. It has core modules in Supply Chain Management (SCM), Finance, Procurement of Catalogue Management, Business Intelligence (BI) and Payroll. The implementation of these modules needs to be fast-tracked to simplify the implementation of SCM administration, benchmark administrative performance and make the system more accountable. This will help to monitor and reduce instances when decision-makers depart from norms and standards articulated in SCM guidelines.

4.5. Currency volatility

4.5.1. SURVEY RESULTS



RESPONSE RATE



PERCEIVED SEVERITY

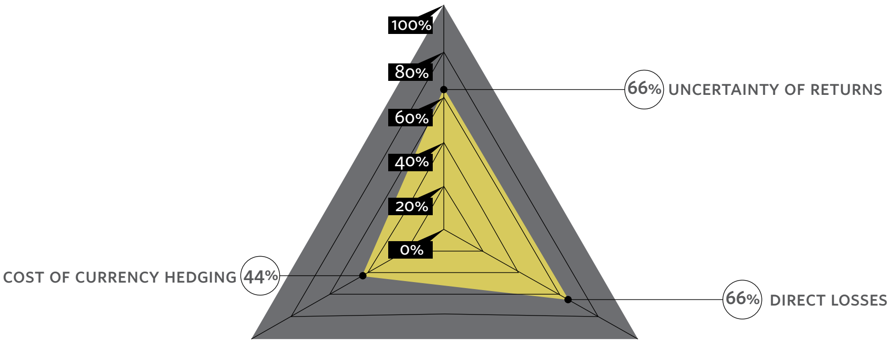

PERCEIVED CHANGE OVER TIME

Currency volatility can often leave many investors either deeply in-the-money or completely out of pocket if their earnings are fully exposed to exchange-rate risk. This creates uncertainty for firms which need to make planned transactions in foreign currency.

Currency volatility is a challenge which affects a wide range of businesses across a broad variety of sectors, client-bases and sizes. Nearly half of survey respondents cited currency volatility as an obstacle to business operation and growth in South Africa. Over half of these respondents cited it as a severe problem which has remained unchanged.

Currency volatility was described according to three dimensions in the survey: a) uncertainty of returns; b) cost of currency hedging; and c) direct losses. Figure 21 below illustrates the response rates on each of these dimensions.

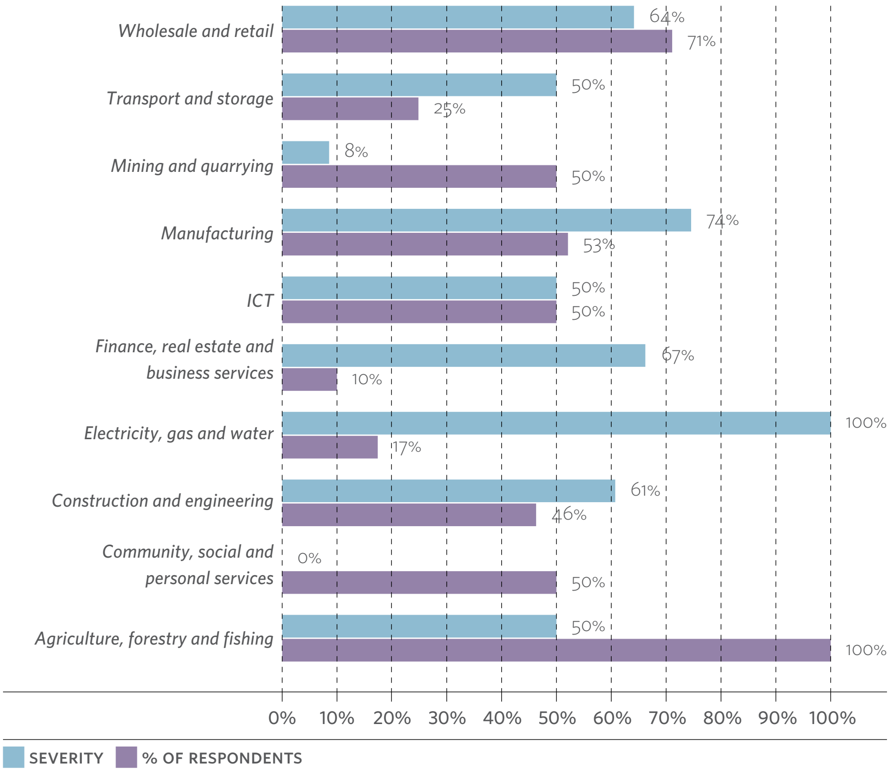
FIGURE 21: RESPONSES ON CURRENCY VOLATILITY, BY SUB-FACTORS



Source: Genesis Analytics, 2012

Two-thirds of respondents noted that the major risk associated with the volatility of the Rand was that it often resulted in direct financial losses. Equally as severe, are the impacts of uncertainty of returns on investment decisions. As noted with regard to previously discussed obstacles, uncertainty often results in a perception of higher risk – which acts as a disincentive to investment.

FIGURE 22: RESPONSE RATES AND PERCEIVED SEVERITY OF CURRENCY VOLATILITY BY SECTOR



Source: Genesis Analytics, 2012

Figure 22[23] above illustrates the fact that a variety of sectors monitor currency volatility as a risk to their business. In this survey, the sectors which found currency volatility to be particularly severe were the electricity, gas and water; and the manufacturing sectors, with companies in the agriculture, forestry and fishing sector seemingly most affected by currency volatility.

4.5.2. VIEWS AND ANALYSIS

The South African Rand is one of the most traded currencies in the world and its volatility is viewed by respondents as part of the South African business cycle. Recognition of the currency's volatility as an obstacle to trade and investment is mainly a symbolic one. The risk is well understood by those firms that are concerned about Rand volatility, and they say that their business pricing models can tolerate fluctuations within certain ranges, before profit margins are eroded over the long-run. South

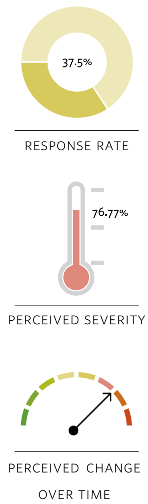
23. *The Tourism and Hospitality sector response was removed because it is an outlier response in the data as only one respondent rated this obstacle.*

Africa's well-developed financial system allows for easy access to financial instruments which allow firms to hedge against currency risks. Respondents were of the opinion that little could be, and/or was expected to be, done about currency volatility, and international businesses simply needed to accept this as a frustrating but unavoidable component of South African business conditions.

The NGP loosely asserts that the government's macroeconomic stance in the future should be guided by measures to contain inflation, lower real interest rates and enhance the competitiveness of the Rand through a counter-cyclical fiscal stance and purchasing foreign-currency inflows in order to stimulate inward investment and support exports. It is not entirely clear how far these policy measures have been developed or if they are at all desirable and effective, given that the South African economy is small by global standards.

4.6. Cost of utilities

4.6.1. SURVEY RESULTS

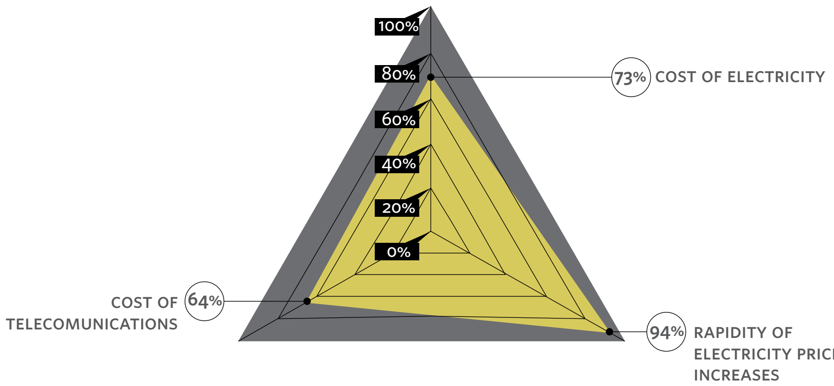


Utilities refer to basic services such as water, electricity and telecommunications services. The companies which provide such services are typically regulated by Government. The cost-effective, efficient and reliable provision of such infrastructure services enables businesses to produce goods competitively. When these costs escalate, they spill over into the aggregate economy and slow down the pace of economic growth.

Although the cost of utilities was only cited by one-third of respondents as an obstacle to business operation and growth, this issue was rated as highly severe by three-quarters of respondents and was described by an overwhelming majority of respondents (85%) as worsening over time.

Figure 23 below shows the dimensions which were used to describe the Cost of Utilities obstacle. These include a) the cost of electricity; b) the rapidity of electricity price increases and c) the cost of telecommunications. The evidence shows that nearly all respondents were particularly concerned about the rapidity of electricity price increases.

FIGURE 23: RESPONSES ON COST OF UTILITIES (INCL. TELECOMMUNICATIONS), BY SUB-FACTORS

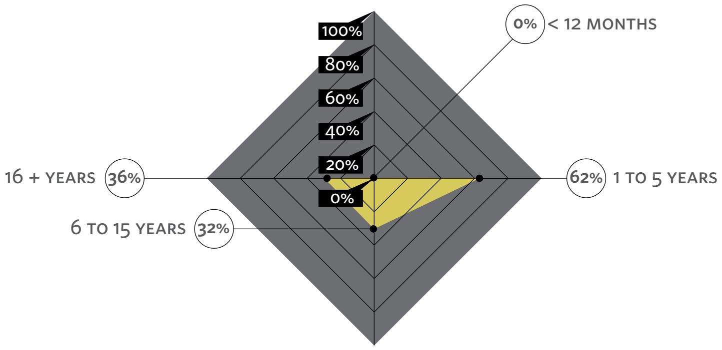


Source: Genesis Analytics, 2012

The cost of utilities (particularly electricity) was reported as a notable obstacle for the majority of companies that had entered the South African market within the past five years, and also for the majority of companies operating within the manufacturing sector[24] (see Figure 24 and Figure 25 below).

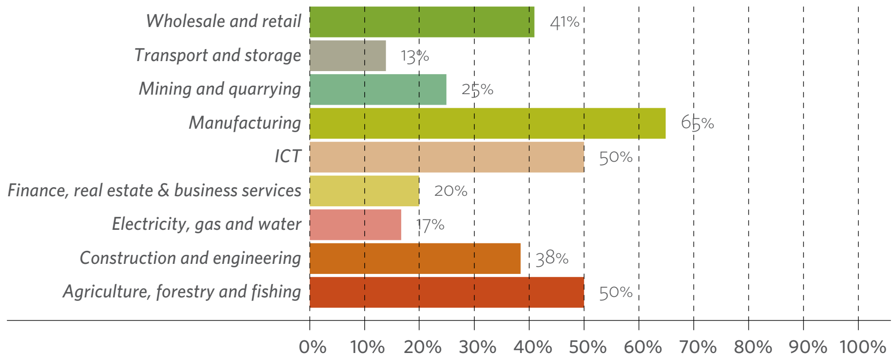
24. *The Tourism and Hospitality sector response was removed because it is an outlier response in the data as only one respondent rated this obstacle.*

FIGURE 24: COST OF UTILITIES, BY RECENCY OF ENTRY INTO THE SA MARKET



Source: Genesis Analytics, 2012

FIGURE 25: COST OF UTILITIES, BY SECTOR



Source: Genesis Analytics, 2012

4.6.2. VIEWS AND ANALYSIS

The rapidity in electricity price hikes has had a dual impact on the companies surveyed. The direct impact has been that companies, especially manufacturers, have experienced higher production costs. The indirect impact has been a dampening in demand for manufactured goods, as spending across the economy decreased due to a higher cost environment, twinned with a global economic recession at the same time.

Respondents do not foresee electricity costs decreasing into the future, nor do they expect rapid deregulation of utilities to allow greater competition in power generation capacity in the near future, despite Government's intentions to support the introduction of Independent Power Producers (IPPs) and green technologies.

It is important to mention that the cost of telecommunications (ICT) infrastructure was cited as a concern to those companies that rely on online transactions, services and systems as part of their core business. Their perspective is that the quality and reliability of ICT in South Africa (although generally improving) do not justify the costs and that SA still lags behind the global average in terms of access and cost.

For one company, of the 27 countries in which they operate , SA is the most expensive in terms of ICT costs. The WEF Global IT Report ranks SA 72nd of 142 countries due to lack of skills and high cost of access.

The implication of high electricity costs has meant the following for EU companies:

1) ***Businesses are investigating alternative energy solutions to mitigate higher electricity costs.*** Some respondents have had to change their operational strategies to include alternative energy solutions to diversify their energy supply pool and seek energy efficient production processes.

2) ***Rapid electricity cost increases have compromised international competitiveness and more generally reduced demand for goods.*** For other respondents, the higher utility costs, in such a short space of time, has made it difficult for them to remain internationally competitive and their parent companies are concerned about the long-term viability of the South African operation. Lower aggregate demand due to a higher cost environment has also served to dampen sales.

A mining and quarrying enterprise mentioned that they have already invested over R50 million in alternative energy research and supplies so as to limit dependence on unreliable and costly South African utility suppliers. For another respondent, the demand for energy efficient technologies has boosted their sales, as their energy efficient equipment sets them apart from their competitors.

4.6.3. RECOMMENDATIONS

Although there is not much that can be done to immediately lower the cost of electricity, there are steps that the Government has taken to invest in additional capacity to lower the long-term costs, lower carbon emissions and environmental costs and to provide sustainable and dependable power generation by diversifying the existing power generation pool. The National Integrated Resource Plan (IRP2) sets out ambitious targets to augment South Africa's power generation mix with Independent Power Producers (IPPS) feeding renewable energy and nuclear power into the grid and sets out energy efficiency measures to manage consumer demand. The institutional framework is modelled in the Renewable Energy Feed-in Tariff (REFIT) guidelines which are near finalisation. In order to achieve this, the following needs emphasis:

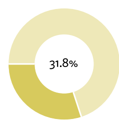
1) ***Streamline and clarify regulatory compliance requirements for REFIT selection and procurement processes.*** It is necessary to provide certainty, clarity and reduce the compliance complexity in the institutional arrangements governing IPP procurement, power purchase tariffs, grid connection arrangements, defined roles and responsibilities and costs. This is necessary to attract and facilitate greater private investment in the burgeoning renewable energy sector in South Africa.

Whilst respondents focused on electricity, it is worth noting that other utilities (e.g. water) contribute to the cost of manufacture. Where the combined exposure to the cost of these utilities contribute significantly to the cost of manufacture (e.g. automotive, textiles and chemicals industries) the competitiveness prognosis is considered to be poor for such companies. Consequently:

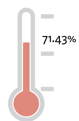
2) ***National Government should make its policy framework clear for high utility usage investors.*** Potential concessions and incentives can be devised to reduce the burden on investors that may make a substantial contribution to the South African economy in other areas e.g. employment, activity multipliers, technology spill-over effects and taxes. These should be codified and made explicit to potential investors – as well as provincial and local Governments in South Africa, as these are the organs of state that generally provide the utilities.

4.7. Labour regulations

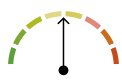
4.7.1. SURVEY RESULTS



RESPONSE RATE



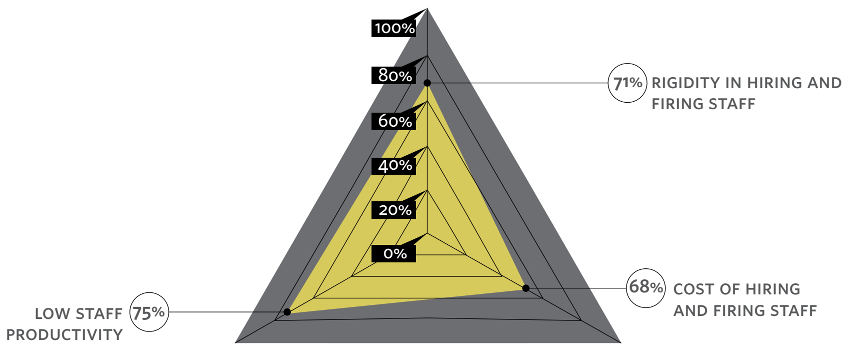
PERCEIVED SEVERITY



PERCEIVED CHANGE OVER TIME

The severity of the issue of labour regulations featured strongly within the sample group. Of the one in three respondents who cited labour regulations as an obstacle to business operation and growth, nearly three-quarters described the issue as major or severe. On average, respondents described obstacles associated with labour regulations as remaining relatively unchanged over time.

FIGURE 26: RESPONSES ON LABOUR REGULATIONS, BY SUB-FACTOR



Source: Genesis Analytics, 2012

South African labour regulations were described by respondents as being overprotective of employees and not protective enough of employers. This understanding of overly protective labour law was perceived to be one of the main drivers of low productivity of workers – with three-quarters of respondents stating that low productivity of workers was a major/severe problem (see Figure 26). In addition to being unproductive, respondents described South African workers as expensive by international standards (in terms of general wages and also in terms of output relative to cost), and raised concerns over the influence of labour unions in the South African economy. These issues act as a disincentive to employment creation in South Africa.

4.7.2. VIEWS AND ANALYSIS

A number of businesses feel that they are faced with increased input costs in order to generate disproportionately low levels of output, and that there are higher risks associated with hiring workers in South Africa. These perceptions are fuelled by the following impediments:

1) ***The labour dispute mechanism (CCMA) is perceived as cumbersome.*** The Commission for Conciliation, Mediation and Arbitration (CCMA) is an independent labour dispute resolution body established under the Labour Relations Act. The experience of respondents has been that there are long lead times from the time a dispute is lodged by an employee to the time the matter is arbitrated and then concluded. Meanwhile the cost burden is on the employer to follow the procedures and continue remunerating the employee whilst they are not working. The concern is that these delays and costs are not in keeping with the promotion of administrative justice (PAJA) and that some employees appear to knowingly lodge disputes without substantive grounds with the expectation that the employer will settle out of court to avoid the CCMA process.

2) ***Higher minimum wages, increasing levels of industrial action and labour inflexibility make it difficult to incentivise higher productivity.*** The loss in production caused by lengthy and repeated strike action is causing lower productivity for some firms. An internal study conducted by one respondent found that the combination of rigid labour regulations and highly influential trade unions in South Africa resulted in the average South African worker costing an employer roughly four times as much as would be the case for an equally skilled and experienced worker in Europe.

The persistence of these conditions creates a disincentive for employers to invest in growing the labour force and encourages businesses to rather invest in mechanisation/automation (if suited to the business model).

A leading transport and storage supplier reported that in one instance, an employee was dismissed after being caught engaging in illegal activities. However, the employee presented a case of unfair dismissal to the CCMA, and the company was advised by its legal counsel to simply settle out of court to avoid a lengthy and even more costly legal battle. In effect, the company had to pay a settlement to an employee who should never have been granted the option of legal recourse as this employee was dismissed according to clearly stipulated internal regulations.

One manufacturer stated that the influence of labour unions and the overly protective (of employees) nature of South African labour regulations had resulted in such a high increase in minimum wages in their industry that the company had been forced to cancel performance-based incentive schemes due to a subsequently diminished budget and the decreased productivity.

4.7.3. RECOMMENDATIONS

At present, the labour regulations in South Africa are being reviewed for anticipated gazetted amendments in 2012. It is important to note that the functioning of the dispute resolution system has undergone reforms to improve access, simplify procedures and improve turnaround times. In light of some of these changes, the following aspects should continue to be highlighted:

1) ***On-going simplification of dismissal procedures on substantiated grounds of productivity or misconduct.*** Labour laws need to allow more flexibility for companies to dismiss workers, which after a fair disciplinary review process, are found lacking beyond reasonable doubt, in terms of performance or misconduct. These cases are usually tied-up unnecessarily in CCMA processes.

2) ***More resources are required to fund and capacitate the CCMA***. The CCMA continues to be overwhelmed by increasing caseloads, which cause delays in adjudication turnaround times;
The CCMA's public information and front desk services need to be bolstered to screen referrals before they are considered by Commissioners. Many of these cases merely seek to frustrate or cause delays in the system;

3) ***Conduct an investigative review of the 'con-arb' process to improve participation rates and assess the cost-benefit of this process on business.*** The 'con-arb' provision was enacted to expedite procedures into a one-stop process where both conciliation and arbitration can take place as a continuous process on the same day. However, it is not certain why it enjoys a low participation rate and whether it is better suited for specific sectors or types of disputes. It is necessary to assess and understand whether 'out-of-court' settlements meaningfully reduce the cost implications of the CCMA process on business;

4) ***Reintroduce the 'ballot requirement' before protracted industrial action or lock-out occurs.*** The ballot system is intended to prevent industrial action from taking place if, in fact, the action enjoys minority support. This is a means of reducing the use of violence and intimidation to undermine workplace productivity agreements;

5) ***Establish a division within the Department of Trade and Industry or Department of Labour that proactively (and reactively) supports foreign investors as they navigate the complexities of the SA labour market.*** For example:
   a) Proactive:
      i) Support "cultural alignment" by providing investors with the necessary insights to be able to marry their corporate culture with the realities of the South African workforce – to enhance labour relations, ensure clear communication of rules and procedures, etc.

   ii) Provide on-going seminars on various elements of the South African labour market to capacitate investors to fully understand the local environment and operate effectively in the country.

b) Reactive:

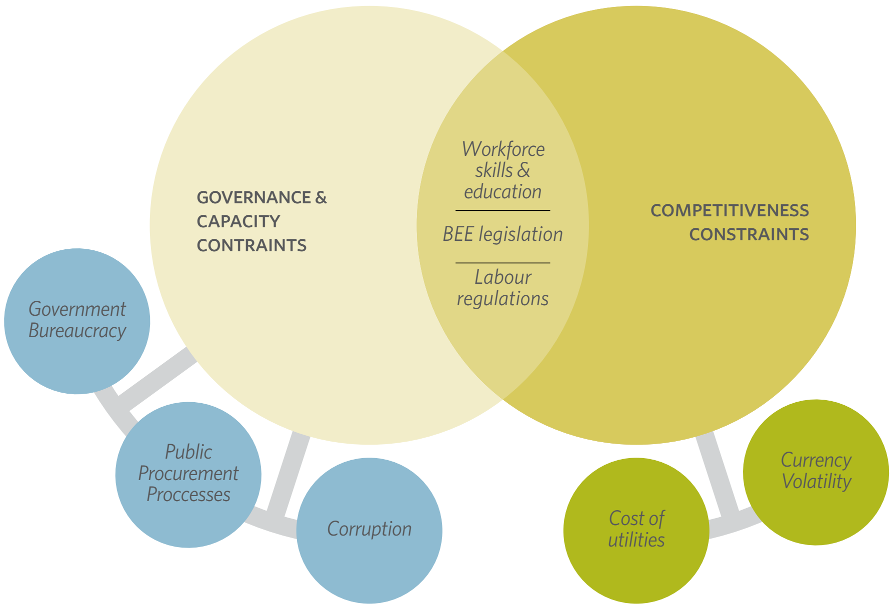
   i) For a period of time, provide new investors with advisory and support services on challenges they may experience in the labour market as they adjust to operating in the country.

5. Links between key issues

This study has identified a number of major/severe obstacles to trade and investment in South Africa, which do not exist in isolation of each other. These obstacles can be loosely divided into those related to governance and capacity constraints, and those impacting upon international competitiveness.

Within each of these categories clear linkages are identifiable. See Figure 27 below.

FIGURE 27: SCHEMATIC REPRESENTING LINKS BETWEEN KEY ISSUES



Source: Genesis Analytics, 2012

Qualitative analysis revealed that the challenges posed by the low availability of skills, the consequent high cost of skilled individuals and the low productivity of South African workers, were clearly connected. These challenges on occasion are exacerbated by the limitations placed on businesses by labour regulations and BEE legislation. The net result of the accumulated impacts of these interconnected issues is that businesses are not incentivised to hire South African workers and will invest less in the South African economy than would be the case if these companies felt that they had access to the required skills and could acquire them with the necessary ease and flexibility.

The links between corruption and the public procurement process have been highlighted, and are enabled by a lack of transparency in government administration. This constraint to a conducive business environment is further frustrated by the delays created by a frequently unresponsive public service. The major result of these obstacles is a high degree of uncertainty regarding the credibility of the South African public sector and how it may hinder successful business operation.

Those obstacles which directly impact the operational costs of South African business operations, such as the cost of utilities and currency volatility, can have a notable impact on the international competitiveness of international firms operating in South Africa. Decreased competitiveness creates a disincentive for global head office investment in South African operations.

It is critical to address these issues to counter the possible downside outcomes, where investors perceive South Africa to be a high risk or unattractive investment, which has serious and negative impacts on economic growth and employment creation in the South African economy.

6. Appendix

6.1. Study methodology

The research surveyed a targeted population[25] of firms (those originating from the European Union member states) of various sizes, participating in different sectors across the South African economy. An online survey was designed to assess the environment for European trade and investment in South Africa by acquiring the perceptions of EU businesses operating in South Africa. Specifically, it sought to identify and gauge the extent and severity of any perceived obstacles to European companies' continued business operations and growth in South Africa. Answers were substantiated with qualitative evidence and experiences gleaned through face-to-face interviews with the respondents.

The survey explored 21 factors, commonly used in leading international enterprise and business environment surveys of a similar nature[26].

1) Government bureaucracy
2) Public procurement processes
3) Corruption
4) Business licensing and permits
5) Economic and regulatory policy
6) BEE legislation
7) Workforce skills and education
8) Labour regulations
9) Local supplier/ service provider quality
10) Competition environment
11) Safety and security
12) Supply of public infrastructure
13) Cost of utilities (incl.Telecommunications)
14) National logistics system
15) Customs procedures and tariffs
16) Trade regulations
17) Exchange controls
18) Currency volatility
19) Tax rates and administration
20) Access to, and cost of, financing
21) Investor protection/ legal system

These factors illustrate a range of channels through which the business operating environment can be distorted, causing costly inefficiencies and making the market less competitive. Ultimately, when such conditions persist, they yield subdued levels of aggregate growth and investment in the economy and make it more difficult to attract greater amounts of foreign direct investment into the country.

The survey instrument was first piloted among a respondent group of 25 representatives from EU Member State Embassies and Bilateral Chambers of Commerce. Thereafter, firms were invited to participate, on a voluntary basis, between January and March 2012. The respondents were prompted to identify a maximum of ten factors, from the list of 21, which they considered to be the most significant obstacles to business operation and growth[27].

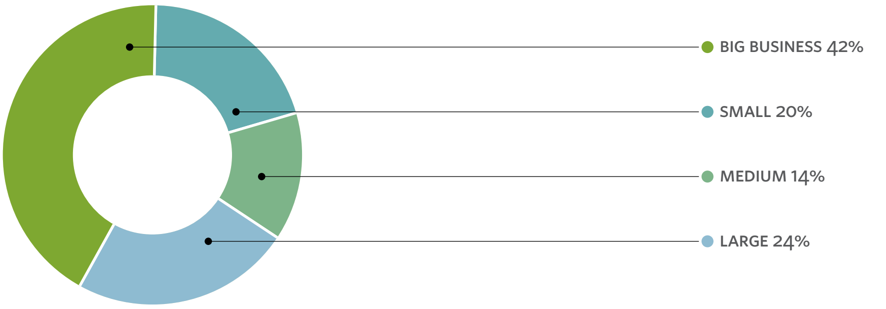
25. *It was not intended to obtain a statistically representative sample of respondents from all 27 EU Member States.*
26. *The survey content and method drew from prominent examples, such as the World Bank Country Enterprise Survey, Investment Climate Survey and Doing Business Survey, along with the World Economic Forum Competitiveness Survey, the RTFP research on FDI in SA and the Finland Government report on barriers to trade (among others).*
27. *The survey was designed so as not to lead responses in any particular direction and respondents were given multiple opportunities to raise issues that were not presented in the list of 21 above.*
28. *The chapter on Limitations sets out some of the difficulties in obtaining a representative sample from all 27 EU member states.*
29. *The guidelines defining SMMEs in South Africa are articulated in the National Small Business Act 102 of 1996. The Small Business Act does not describe "Big Business", as presented in this survey. This was specially included for the purposes of this study.*

The final survey sample[28] comprised of 88 companies, drawn from 12 participating EU member states and operating across 11 different sectors.

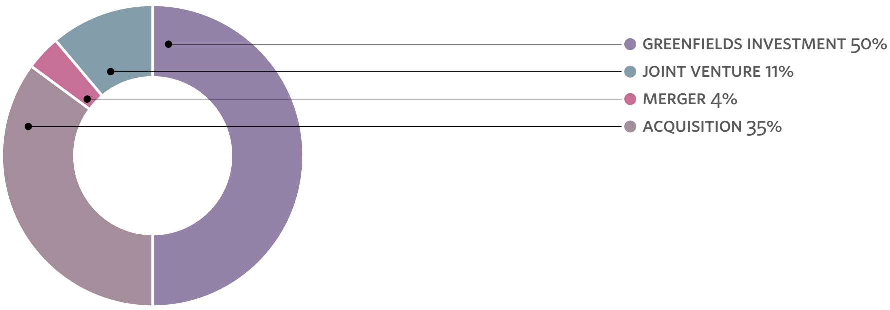
The survey data also profiled the respondents according to size (using annual turnover as a proxy)[29], initial investment mode into the country, registered legal form of the entity in South Africa, years operating in South Africa, provincial location of their main operation in South Africa, their main domestic client (public or private sector clients or individuals) and their main geographical sales region (SA, SADC, EU or the rest of the world). These profiles are illustrated in Figure 28 below:

FIGURE 28: SURVEY RESPONDENT PROFILE

BUSINESS SIZE OF RESPONDENTS

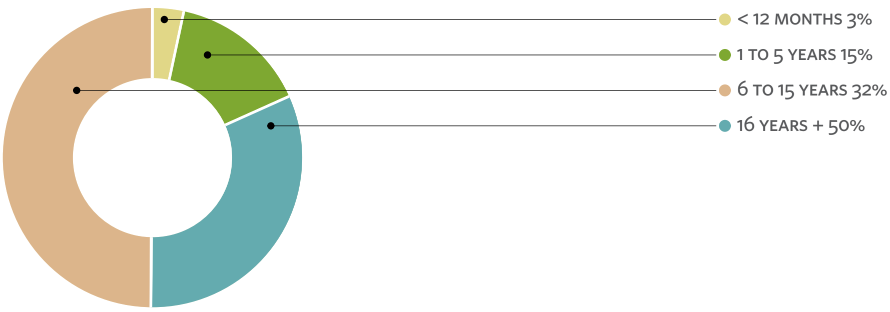


DISTRIBUTION OF RESPONENTS BY MODE OF INITIAL INVESTMENT INTO SA

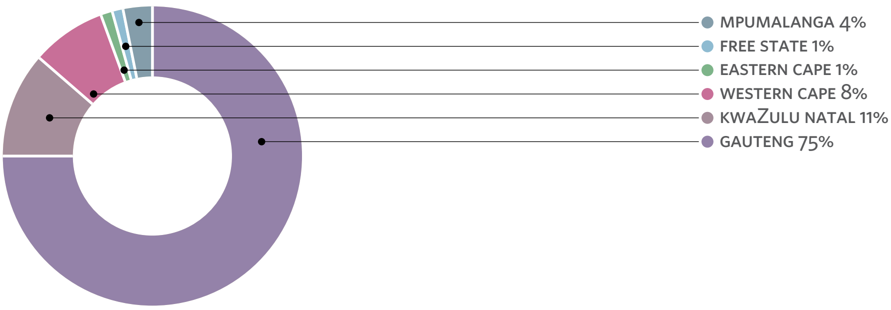


LEGAL STATUS OF RESPONDENTS

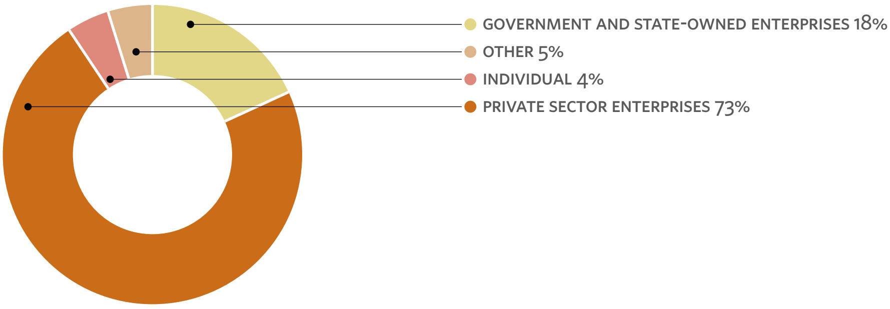
YEARS OPERATING IN SA OF RESPONDENTS



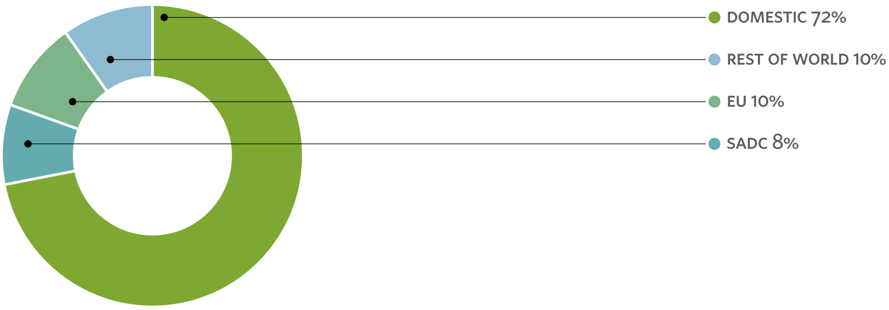
LOCATION OF RESPONDENTS MAIN OPERATIONS IN SA



RESPONDENTS BY TYPE OF DOMESTIC CLIENT



RESPONDENTS MAIN GEOGRAPHICAL SALES BY REGION



Source: Genesis Analytics, 2012

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8. Appendix (for client report only)

8.1. Introduction to the study

The Embassy of the Kingdom of the Netherlands in Pretoria, in close cooperation with the European Union (EU) Delegation to South Africa (SA) and EU Member States, contracted Genesis Analytics, an independent economics advisory firm, to investigate and identify the main obstacles to bilateral trade and investment between the EU and South Africa, specifically in relation to the experiences of companies originating from the EU Member States.

The purpose of the White Book is to promote greater levels of bilateral trade and investment between the EU Member States and South Africa. Since 1994, SA-EU trade and investment has been underpinned by Bilateral Investment Treaties and investment policies which saw SA undergo significant reforms to encourage further growth in trade and attract foreign direct investment (FDI). Furthermore, the 2007 SA-EU Strategic Partnership proposes cooperation in areas of science and technology for poverty alleviation, energy and climate change, trade, migration, space and aviation, education and training, employment and social affairs, crime and justice and health. As part of building this bilateral partnership, and in the spirit of cooperation, the White Book intends to inform the EU Delegation, and their South African Government counterparts, of the challenges faced by EU companies in South Africa and offer practical recommendations to remove or reduce the identified obstacles. The White Book also highlights the positive impact made by European firms in South African economy and demonstrates the EU's on-going commitment to South Africa's dual developmental objectives of growing the economy and increasing job creation.

8.2. Methodology

The research surveyed a targeted population of firms (those originating from the European Union member states) of various sizes, participating in different sectors across the South African economy. An online survey was designed to assess the environment for European trade and investment in South Africa by acquiring the perceptions of EU businesses operating in South Africa. Specifically, it sought to identify and gauge the extent and severity of any perceived obstacles to European companies' continued business operations and growth in South Africa. Answers were substantiated with qualitative evidence and experiences gleaned through face-to-face interviews with the respondents.

The survey explored 21 factors, commonly used in leading international enterprise and business environment surveys of a similar nature .

1) Government bureaucracy
2) Public procurement processes
3) Corruption
4) Business licensing and permits
5) Economic and regulatory policy
6) BEE legislation
7) Workforce skills and education
8) Labour regulations
9) Local supplier/ service provider quality
10) Competition environment
11) Safety and security
12) Supply of public infrastructure
13) Cost of utilities (incl.Telecommunications)
14) National logistics system
15) Customs procedures and tariffs
16) Trade regulations
17) Exchange controls
18) Currency volatility
19) Tax rates and administration
20) Access to, and cost of, financing
21) Investor protection/ legal system

These factors are presented in more detail in Table 1. These factors illustrate a range of channels through which the business operating environment can be distorted, causing costly inefficiencies and making the market less competitive. Ultimately, when such conditions persist, they yield subdued levels of aggregate growth and investment in the economy and make it more difficult to attract greater amounts of foreign direct investment into the country.

The survey instrument was first piloted among a respondent group of 25 representatives from EU Member State Embassies and Bilateral Chambers of Commerce. Thereafter, firms were invited to participate, on a voluntary basis, between January and March 2012. The respondents were prompted to identify a maximum of ten factors, from the list of 21, which they considered to be the most significant obstacles to business operation and growth .

The final survey sample comprised of 88 companies, drawn from 12 participating EU member states and operating across 11 different sectors.

The survey data also profiled the respondents according to size (using annual turnover as a proxy) , initial investment mode into the country, registered legal form of the entity in South Africa, years operating in South Africa, provincial location of their main operation in South Africa, their main domestic client (public or private sector clients) and their main geographical sales region (SA, SADC, EU or the rest of the world). These profiles are illustrated in Figure 28 below:

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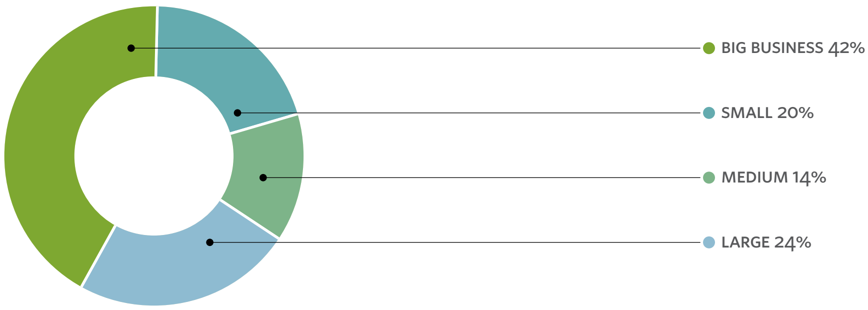
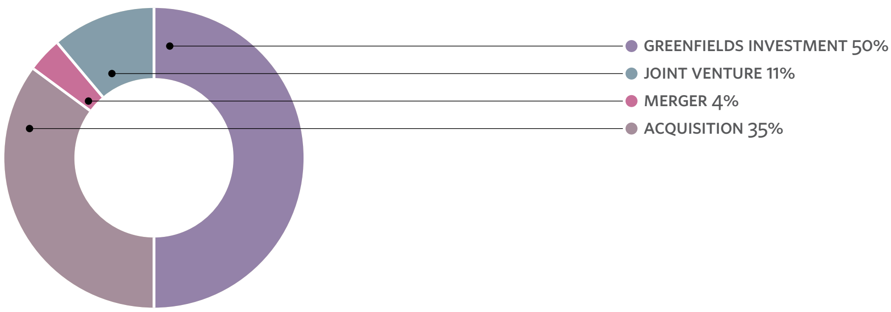
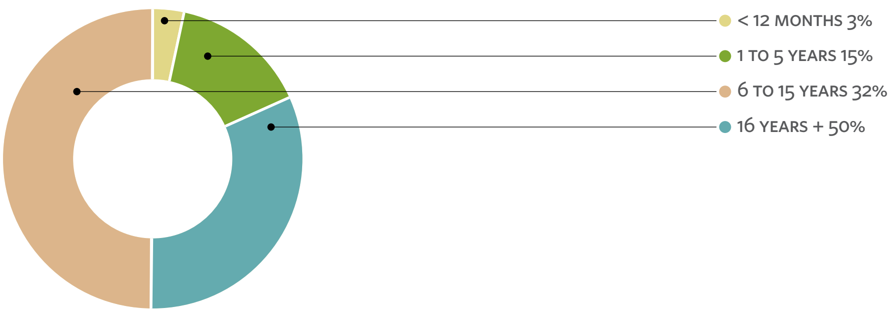


DISTRIBUTION OF RESPONENTS BY MODE OF INITIAL INVESTMENT INTO SA

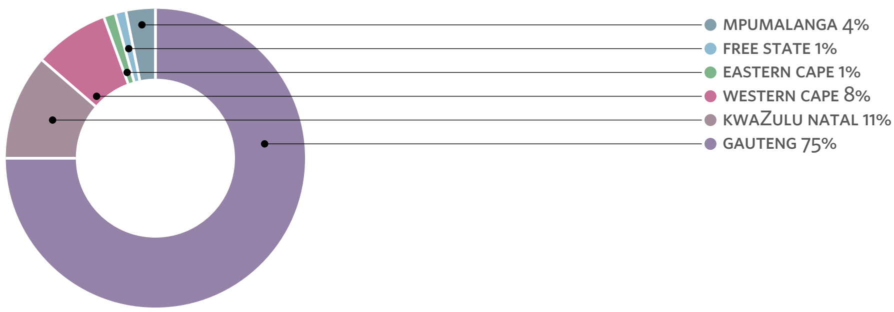


LEGAL STATUS OF RESPONDENTS

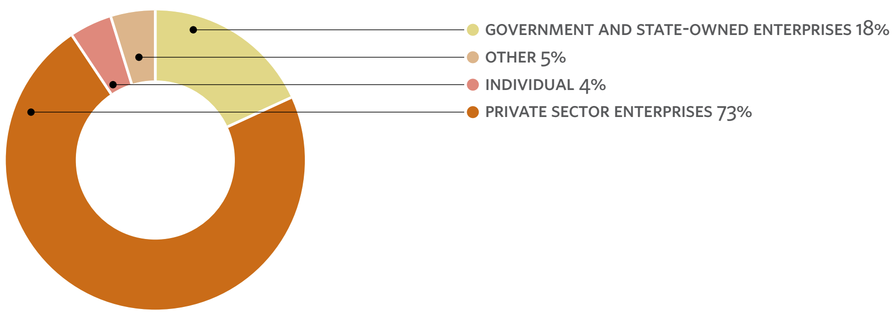
YEARS OPERATING IN SA OF RESPONDENTS



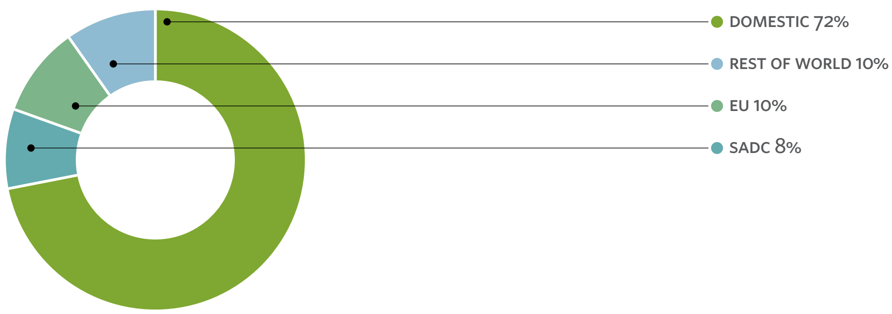
LOCATION OF RESPONDENTS MAIN OPERATIONS IN SA



RESPONDENTS BY TYPE OF DOMESTIC CLIENT



RESPONDENTS MAIN GEOGRAPHICAL SALES BY REGION



Source: Genesis Analytics, 2012

8.3. Description of main obstacles cited

TABLE 1. OBSTACLES TO BUSINESS OPERATIONS AND GROWTH IN SA

Obstacle to business operations and growth	Description
Government bureaucracy	An inefficiently managed government bureaucracy affects the effective implementation and administration of public policies and regulations and causes delays in business operations, which then spill-over into the rest of the economy. These are accounted for as inefficiency costs or opportunity costs. Failures in effective government administration or human and technological capacity constraints in the bureaucracy are broadly described as “red tape”. Red tape costs are incurred by businesses and manifest as copious reporting requirements, delays in decision-making and approvals, inconsistent service levels and a lack of transparency and accountability.
Public procurement processes	Public procurement processes govern fair evaluation of government tenders open to private-sector participation. Lack of transparency in adjudication and delays in decision-making creates uncertainty in this market and increases the risk of corruption in the procurement process. This makes businesses hesitant to bid for work and invest in the market for government business.
Corruption	Corruption is an obstructive misuse of power or position for personal gain and which occurs in both the public and private sector. Corruption undermines the credibility of governance arrangements that ensure ethical and fair business practices. It is a cost to doing business in that it fuels bureaucratic inefficiency and negatively influences investment decisions and results in a risky and uncompetitive market.
Business licensing and permits	Delays and difficulty in acquiring permissions to legally operate or to register a technology generates red tape-related costs, increases the risk of corruption and ultimately delays job-creating investments and innovation in the economy.
Economic and regulatory policy	Regulatory burden, policy gaps and political uncertainty make it difficult for businesses to confidently invest in the economy over the longer-term and take-on the risk of entering new markets. For example, some sectors may be over-regulated, or new entrants are artificially prevented from entering monopolistic markets. In both cases, the economy forgoes new investment and markets are less efficient or competitive.
BEE legislation	Black Economic Empowerment is a transformation policy aimed at redressing social and economic imbalances of the past by providing access to substantial economic opportunities for historically disadvantaged groups. This may be achieved by complying with sector-specific scorecards measuring the degree of transfer of equity ownership, transfer of management control, employment equity in the workforce, investment in skills development for historically disadvantaged groups, employing preferential procurement from “black” or BEE compliant businesses, investing in “black” enterprise development and investing in socio-economic development initiatives. Firms may find it difficult and costly to comply with sector-specific scorecards, realise commercial benefit from compliance or find the legislation to be unclear and uncertain with respect to their sector’s requirements. This could be perceived as a regulatory burden on business, restrict access to market opportunity for non-compliant firms, negatively impact investment decisions of foreign investors or create political uncertainty in some sectors.
Workforce skills and education	Workforce skills and education refers to the availability of appropriately qualified and experienced workers. Companies require technical and managerial skills to act on business opportunities that can grow the business. Similarly, low-skilled workers need to be trained to remain productive and internationally competitive. An absence the quality or availability of both high- or low-skilled workers increases costs associated with attracting and training new workers.
Currency volatility	Currency volatility refers to the unpredictability of the South African Rand to appreciate/depreciate within a wide margin; which can often leave many investors either deeply in-the-money or completely out of pocket if their earnings are full exposed to exchange-rate risk. This creates uncertainty risk for firms which need to make planned transactions in foreign currency.

Source: Genesis Analytics, 2012

8.4. Study limitations

Participation in the survey was voluntary for EU Member State Embassies, their Bilateral Chambers of Commerce and their respective firms. The research team intended to draw a sample of 166 firms on the assumption that companies from all (27) EU member states would participate and where 14 member states would have more than 10 companies that could participate . This has not proved to be the case, due to either the non-participation by certain member states or the lack of company presence in SA (or awareness thereof) by others. The table on the following page shows that 8 of the 27 EU member states did not participate in the study. Of the participating EU member states, 11 supplied company lists, 7 of which comprised of 10 or more companies. These various factors notably lowered the population size of the study. Of the total 249 companies for which details were provided, 88 ultimately took part. In our understanding, for a population of this size, the average response rate is around 26%. We have managed to achieve a 35% response rate, which we believe provides us with a good quantity of data for meaningful data analysis.

Country	Business Chambers/ Trade Commissions			Companies			
	Chamber exists?	Survey completed?	List received	List received	Number of companies on list	Surveys completed	Interviews completed
Austria	Yes	Yes	No	No	N/A	6	4
Bulgaria	No	N/A	N/A	No companies	N/A	0	0
Belgium	Yes	Yes	Yes	Yes	7	1	1
Cyprus	No	Yes	N/A	No companies	N/A	0	0
Czech Republic	No	Yes	N/A	No companies	N/A	0	0
Denmark	No	Yes	N/A	Yes	22	9	8
Estonia/ Luxembourg	Not Participating						
Finland	No	Yes	N/A	Yes	23	9	7
France	Yes	Yes	Yes	Yes	27	12	7
Germany	Yes	Yes	Yes	Yes	36	6	4
Greece	Not Participating						
Hungary	No	Yes	No	No	N/A	0	0
Ireland	No	Yes	No	No	N/A	0	0
Italy	Yes	Yes	No	No	N/A	1	1
Latvia	Not Participating						
Lithuania	Not Participating						
Malta	Not Participating						
Netherlands	Yes	Yes	Yes	Yes	23	15	13
Poland	No	No	No	Yes	1	0	0
Portugal	No	No	No	Yes	9	4	3
Romania	No		No	No companies	N/A	0	0
Slovakia	Not Participating						
Slovenia	Not Participating						
Spain	No	Yes	No	Yes	8	5	4
Sweden	No	Yes	No	Yes	75	13	3
UK	No	Yes	Yes	Yes	18	8	5
Total					**249**	**88**	**60**

8.5. Compelling examples drawn from interviews

Government Bureaucracy

Delays on the part of government departments/agencies were noted as a severe problem by many respondents. In the case of one particular company in the tourism and hospitality industry, these delays existed in licensing process, where standard processes which usually take two days took as long as four weeks to complete. Similarly, these delays in administrative processes have left a certain firm operating in the information, communications and technology sector, unable to obtain necessary documentation for importing and exporting operations for a number of months. Delays in payment are also a severe problem, as in the case of a leading electronics supplier in the wholesale and retail sector, which has had to resort to legal action against government departments in order to secure payment for services rendered which has been outstanding for up to two years.

Public Procurement Processes

The lack of communication in the tender processes is highlighted by the experiences of a certain ICT based company which claims to have received responses to less than one third of submitted proposals in 2011. In one particular case, a certain transport and storage company which relies heavily on public procurement contracts reported having experienced such dissatisfaction with the public procurement process in South Africa, that serious investigations were being conducted regarding the viability of relocating the company's entire operation to a neighbouring African state. Another company in the electricity, gas and water sector has expressed similar tendencies towards relocation as the South African market makes up only 1% of this company's global operations and is proving increasingly inefficient in terms of securing public procurement contracts. Similarly, a decision has been made by one particular company in the finance, real estate and business services sector to completely exclude the public sector when designing business strategy for South African operations. In this case, the company's investment in the country has been limited to one third of its potential in the case of including the public sector markets. A leading construction and engineering firm has also reported having taken legal action to the value of approximately R20 million to contest a particular procurement decision. Excessive legal expenses related to contesting procurement decisions was also reported to be a major problem by a certain company in the transport and storage sector.

A number of respondents reported that they had had first-hand experience with blatant solicitation by authorities of, specifically, the public procurement process. In one particular instance, a respondent based in the tourism and hospitality industry noted that corruption within government departments/agencies had resulted in confidential documents containing critical information regarding the company in question being used for attempted fraud. When the respondent reported the incident, the only response offered was that the documents had been misplaced and should be resubmitted.

BEE Legislation

One transport and storage multinational noted that each international branch of this company is initially given a set amount of start-up capital to set up operations in any particular country. The costs of BEE compliance are costs that branches in other countries do not have to cover and as such the South African branch will in effect appear as far less competitive if it does invest heavily in BEE compliance. In such cases, this kind of investment is a major operational cost which yields comparatively low (if any) commercial benefit. A certain manufacturing company reported that due to the administrative and financial burdens associated with BEE compliance, they were seriously investigating and had in some senses already begun relocation of operations to Kenya.

Workforce Skills and Education

A leading technology supplier noted that the company's highly accelerated growth plan for Africa was being severely hindered by the shortage of technical skills in the South African labour market. This company also has plans to increase investment in local for local manufacturing across its international operations. However, due to the low availability of relevant skills for local manufacturing, this company has launched an investigation regarding the potential of more suitable sites across the continent to set up a new base of African operations.

"Training is expensive and should not be the responsibility of the private sector"- a wholesaler and retailer

One construction and engineering firm reported that the lack of skills in the South African market was resulting in severe financial losses as training is not only expensive but also because any time invested in training results in delays in project 'readiness'. This has resulted in the past in a loss of contracts as this company could not locate and/or train South African workers within the necessary timeframe.

A certain manufacturer reported that the company had invested in excess of R10 million in training in 2011. Every single employee who received training subsequently left the company and joined a competitor which could afford to pay higher salaries for the newly trained workers.

Certain respondents reported that in order to combat the skills shortage they had invested in training courses and/or colleges. The accreditation for these courses was a highly administrative and lengthy process which took in one case almost two years, and in another, more than a decade.

One large manufacturer reported that they offered training for 100% of their 7500 employees. Training on this scale represents a massive but undeniably necessary investment on the part of this company.

Cost of Utilities

One particular mining and quarrying enterprise has invested over R50 million in alternative energy research and supplies so as to limit dependence on unreliable and costly South African utility suppliers.

A certain company based in the agriculture, forestry and fishing sector cited that high and rapidly increasing utility costs were a major disincentive to investment and that the negative impacts of these high costs on productivity and competitiveness decreased the comparative performance of the South African branch. This resulted in a lower proportion of capital being assigned from head office to this branch, which further decreased the branch's ability to afford utilities. This leads to a vicious cycle of underinvestment and decreasing productivity and competitiveness.

Examples that highlight certain linkages

A certain airline reported that a lack of clarity around how best to implement BEE in this industry was preventing their ability to do business with government. However, this respondent also noted that due to issues with government bureaucracy (especially those related to delays in payment or non-payment issues), increased business with the public sector was not desired in any case. As such, there is very little incentive to comply with BEE legislation.

"There is no benefit to BEE accreditation unless you bid for government tenders – which are not awarded fairly anyway – so there is no point in even attempting to comply"- a leading wholesale and retail sector company.

A certain finance, real estate and business services provider noted that the specific skillsets demanded by this particularly niche market were difficult to find in the South African labour pool – particularly in terms of EE candidates. However, since many of this company's clients were demanding a higher BEE rating from this company, the respondent reported that the company had had to settle for less competent staff members as a means of increasing compliance with BEE regulations. This is a highly inefficient business strategy and places unnecessary strain on the company's financial resources and its time.

Labour Regulations

A leading transport and storage supplier reported that in one instance an employee was dismissed after being caught engaging in illegal activities. However, due to the inefficiencies present in South African labour regulations, the employee presented a case of unfair dismissal to the CCMA, and the company was advised by its legal counsel to simply settle out of court to avoid a lengthy and even more costly legal battle. In effect, the company had to pay a settlement to an employee who should never have been granted the option of legal recourse as this employee was dismissed according to clearly stipulated internal regulations.

An internal study conducted by one finance, real estate and business services provider found that the combination of rigid labour regulations and highly influential trade unions in South Africa resulted in the average South African worker costing an employer roughly four times as much as would be the case for an equally skilled and experienced worker in Europe.

In the mining and quarrying sector, one company reported that the inability of companies to fire incompetent workers results in a complacent attitude in South African workers. These workers are described as notably unproductive, and this specific company reported that on average, in order to generate a similar level of output, it has to invest in three times as many workers in South Africa as it would in Europe.

"The South African workforce is a risk to productivity"- a player in the manufacturing sector

One manufacturer stated that the influence of labour unions and the overly protective (of employees) nature of South African labour regulations had resulted in such a high increase in minimum wages in the relevant industry that the company had been forced to cancel performance based incentive schemes due to a subsequently diminished budget and the decrease in productivity caused by these regulations.

National Logistics System

South African logistics systems are described by respondents across a wide range of industries as costly and inefficient. In one particular instance, a company in the mining and quarrying sector reported that due to inefficiencies in the national logistics systems, multiple shipping containers containing high level explosives had been misplaced during transport. A satisfactory explanation was not provided.

A number of companies across a variety of sectors reported that they had invested in using neighbouring ports, especially Maputo and Namibia, and in one case Ivory Coast, so as to avoid dealing with the administrative and financial burdens associated with the South African systems.