Tony Manning's

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TRENDS, ISSUES & CHALLENGES FOR THE SOUTH AFRICAN BUSINESS AGENDA

In this issue:

A new era of uncertainty

The SA economy got off to a fast start in 2006. The black middle class has expanded fast and spends furiously. Consumer and business confidence have been at record levels. House prices rose faster than anywhere else in the world in 2005 and the commercial property market is in exceptional shape. Vehicle sales kept hitting record levels.

The retail sector has enjoyed a golden ride, and while sales growth started to dip from mid-2005, retailers remain bullish and the Bureau of Market Research expects formal retail sales to grow by 6.4% this year. And although gold output is at a 35-year low, the gold price is at a 30-year high – and many experts see it going even higher as a result of global uncertainties.

Policymakers now talk of SA as a "developmental state." Government is intent on pushing GDP growth to a sustainable 6% p.a. by 2011 through the Accelerated and Shared Growth Initiative for SA (ASGISA), and intends spending R372 billion on infrastructure.

The Gautrain rapid rail system has been given the go-ahead (though the project is being delayed by legal challenges), work at the Coega deep-water port and industrial zone continues (though slowly), and Eskom and Transnet have big spending plans. The 2010 Soccer World Cup will focus attention on SA and could have a significant multiplier effect (optimists say it'll be worth R21 billion to the country altogether).

However, while the country might well be in a "virtuous cycle" of growth, and while there are many reasons to be very optimistic about prospects for the years ahead, this is no time for complacency. Across the globe, there are new fears of multiple problems ahead.

The one thing that's clear right now is that nobody knows what the hell is going on. Each day, new events shake things up and reports, new surveys, and conflicting opinions add to the confusion.

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Losing momentum

Stock markets everywhere are taking strain, investors are worried about the outlook for profits, and after many years there's once again talk of "stagflation." In recent weeks, perceptions of risk in emerging markets have risen sharply. Commodity prices have come off, leading to concerns that the boom is over. Interest rates have been hiked in the US, the EU, the UK, Japan, Australia – and there are signs of further upward moves. Oil prices are at record highs, and chances are that events in the Middle East will keep them high and possibly drive them even higher.

In this environment, it's not surprising that the SA economy has suddenly lost momentum.

The current account has swung from surplus to a record deficit of more than 6% of GDP – not good news when there is negative sentiment about emerging markets generally. Business confidence fell to a seven-month low in June. Consumer confidence is also down (though still at a high level). Growth in house prices is back where it was 4.5 years ago, and property economists see it flattening by December. July car sales were the highest ever for that month, but the rate of growth has dipped. The rand has weakened and is hovering around US$/R7.

The exchange rate has helped manufacturers, but slower growth in key global markets is sure to affect SA's exports in coming months. Meanwhile, imported goods continue to pour into the country, stealing market share from home producers and squeezing their profit margins (but benefiting retailers and consumers). Base minerals are doing well, but there is now some uncertainty in commodity markets. Agriculture is under pressure.

Inflation is well within the target band, but is edging upwards. The SA Reserve Bank hiked rates preemptively on June 8, in line with actions by other central banks, again on August 3, and further increases before the end of the year seem highly likely.

Eskom's extraordinary power supply problems have raised doubts about economic growth, but the organization appears to be managing the situation quite well. It's estimated that blackouts have cost Western Cape business more than R5.6 billion this year, plus another R3.3 billion for generators and other equipment to deal with the problem, but the full impact on confidence and investment is yet to be felt.

As always, managers need to keep things in perspective, and keep a close eye on events. It is critical that you and your team think through your assumptions about the future, and plan carefully for what's ahead.

Three big questions:

1. When will rising interest rates – and warnings from Reserve Bank Governor Tito Mboweni about the dangers of personal debt – really put the brakes on consumer spending, and how serious will the impact be?
2. What happens to the SA economy if the global economy cools even faster and further than expected? (Many economists have turned seriously bearish.)
3. How will SA exporters deal with the Asian tidal wave now bearing down on them? (Hint: do not rely on the revaluation of the Chinese yuan, or on bilateral trade deals for salvation!)

Some issues to watch

1. In 2005, a **fault line in SA politics** suddenly appeared – and it's getting wider. Tensions are growing between the ANC and its alliance partners, Cosatu and the SA Communist Party.

In 2005, there were more than 800 demonstrations countrywide against the slow pace of delivery to the poor, and a major strike against unemployment. The president's decisive action after his deputy, Jacob Zuma, was charged with corruption brought him widespread approval and reinforced positive perceptions of SA's commitment to constitutional democracy and fighting corruption. But huge popular support for Zuma and anger at raids on his homes by the Scorpions lit a firestorm in SA politics. A more recent allegation against Zuma of rape, and his media-hyped trial and acquittal on this charge, have made things even more complicated and divisive.

Questions now: Will *all* corruption cases be pursued with even-handedness, openness, and courage? What will be the fallout from the Zuma cases? How much will the political temperature rise as the race to succeed President Thabo Mbeki gains pace, and what might be the implications? And, of course, how successful will government be in boosting economic growth and improving delivery on all fronts?

2. **Unemployment** is a chronic problem (at 26.5% to 40.5% of the working-age population, depending on the measure you choose.) There is a view that official statistics probably over-estimate unemployment, but recent reports from Statistics SA confirms how tough it will be to meet government's goal of halving unemployment by 2015. While jobs are being created, the workforce is growing faster than the economy's absorption capacity.

   Most firms are likely to keep a tight lid on hiring as they intensify their efforts to meet new competition. While government lost the first round in its effort to revise labour laws (mainly for small businesses), the issue is on the table and there might be some changes ahead.

3. The **poverty** gap remains dangerously wide. Government is committed to narrowing it – social grants have helped enormously – but companies need to intensify their efforts to make a difference. Even though corporate social investment (CSI) is higher as a proportion of total business turnover than in many other countries, it's nowhere near enough. Besides, it’s likely that just 20 large companies account for 80% - 90% of CSI spending!

4. In recent months there has been a surge in **violent crime**. Government appears to be taking this extremely seriously, and promises that plans are in place to deal with the scourge. Meanwhile, banks, retailers, restaurants, and other businesses need to take additional measures to protect themselves and their customers.

5. Pressures for **land reform** are growing, and events in Zimbabwe add to fears about where things are headed. Although there has been much progress in settling claims, this is a very touchy subject with the potential to flare into real trouble. Mbeki has announced an end to the principle of "willing buyer, willing seller," so there's much uncertainty ahead. Government is also rethinking foreign ownership of land in SA.

6. The devastation of **HIV/Aids** continues. The Actuarial Society estimates that 11% of the population – about 5 million people – are HIV-positive. An antenatal clinic survey in 2004 suggested that one-third of women are infected. The cost to companies is rising fast (though few medium-sized firms acknowledge this). Apart from rising medical costs, absenteeism, the diminished ability of sufferers to perform while at work, and time off for funerals, there is also the prospect of limited market growth as a result of this disease.

Government's programme to deal with HIV/Aids has been slow to take off. However, more and more firms are putting comprehensive plans in place. But the stigma surrounding the disease makes people reluctant to come forward for testing, so antiretroviral treatment does not reach as many as it should.

7. **Black economic empowerment (BEE)** is powering ahead, but many deals have been concentrated in just a few hands and there is growing popular pressure for more broad-based structures. At the same time, there's growing anger – and hot debate – about the impact of greed and the need for a new set of values based on *ubuntu*. For firms trying to do deals, finding appropriate partners remains problematic and funding is complicated. Many black beneficiaries will be heavily indebted for years. What's more, if economic growth – and business growth – falls short of expectations, their payback will be disappointing and they could lose their "investments." In the early stages, charters were hastily negotiated, but set different standards; soon a single code will override most of them. Expect compliance to become a costly burden.

8. **Affirmative procurement** is forcing changes in buying practices. For many firms, administrative procedures have become much more complicated. There's a shortage of suppliers in some areas, and finding them and working with them is both time-consuming and difficult. Fronting and corruption are rife. For many buyers, supplier training and support – including finance – is key. At the same time, vendors have to review their own practices - so a marketing revolution is under way.

9. There is a growing **shortage of key skills** at all levels (the Deputy President rightly calls it a "fatal constraint."). The past decade saw tens of thousands of experienced whites put out to pasture, while government departments found themselves straining to serve 45 million people rather than just 5 million and companies rode an unprecedented growth wave.

   Thabo Mbeki believes it may be necessary to recruit key executives internationally in order to fix the mess in municipalities. Engineering firms are already looking to the East for the people they need. There's talk of importing education administrators and teachers. Almost every organization has undergone rapid transformation, and more lies ahead. (Put a big question mark against planned infrastructural development while there's a managerial deficit. Add another one each for the lack of professionals and artisans.)

   Fortunately, government has shifted this issue to the top of the national agenda. Yet another new initiative – the Joint Initiative on Priority Skills Acquisition (JIPSA) – has been announced to deal with it.

10. **Developing tomorrow's workforce -** and specifically, tomorrow's leaders – is a matter of extreme urgency. Attracting, developing, and retaining talent has to be a priority for every organization. But the jury is out on how pressure for rapid change will clash with conventional views about the time it takes to grow competent leaders. *Preparing for a CEO job takes 25-35 years of systematic grooming in the US, Europe, and Japan; in SA, people are being put into the hot seat with just a few years of experience and little proper development.* This can't make sense.

    Firms need to give more thought to this issue, and spend more on finding ways to deal with it. If poaching was a sensible strategy in the past, it's becoming far less so. If there's not a concerted effort by firms to grow their own talent, salary bills will keep rising and there will always be a skills deficit.

11. Making **organizational diversity** work is a challenge that demands lots more attention. Too much is taken for granted. While it's politically correct to say that "diversity is a good thing," merely throwing a diverse bunch of people together can cause more problems than it's worth. *Without careful management, dysfunctional behaviour is likely*. With care and skill, however, the rewards can be immense.

12. **Corporate governance** is getting much attention - and placing strenuous new demands on companies. Compliance has become a growth industry for advisors, and a massive cost to business. The structure, conduct – and liabilities – of boards are serious topics. Being a director has become an onerous and risky job. (Watch the backlash against Sarbanes-Oxley in the US; it's likely to spread.)

13. **"Conflict of interest"** is fast becoming a foreign concept in SA. Although companies boast about their compliance with the King Report, pragmatism requires that they turn a blind eye to best practices and act expediently. Some believe this is just a short-term blip; more likely, it will become part of the country's value system and have long-term consequences.

14. Studies show that **high telecoms charges** are a major impediment to SA's competitiveness. The launch of a second network operator should see pricing pressure sometime in the future. But don't expect dramatic changes anytime soon.

    Meanwhile, the changing competitive landscape and the relentless march of new technologies demand new ways of thinking and new business models. Companies that want a share of the global economic pie will need to be far clearer about what it takes to compete, and more creative and aggressive about building the technological capabilities they need for the future.

15. **Red tape** has been estimated to cost SA business around R79 billion a year – 6.5% of 2004 GDP. Untangling it must be a priority. Progress in this area will make it easier to start new businesses and lighten the load on existing ones ... but also make this a more competitive environment for everyone. Unfortunately, there's little sign so far of substantive action.

Time to act

Business in SA never faced more opportunities ... but there's a daunting list of challenges too. This is, to use President Thabo Mbeki's words, an "age of hope." Turning it into an age of delivery will take extraordinary imagination, hard work, and a team effort.

So, two questions:

i. What lies ahead for your business?
ii. What should you do about it?

Want help in thinking through these issues? Give me a call. I'll help you make sure everything important is on the table, then create a really robust strategy – and develop the capabilities you need to implement it.