strategy&

What foreign investors want

South African insights from a global perspective on factors influencing FDI inflows since 2010

pwc

Contents

Addressing South Africa's deteriorating foreign direct investment (FDI) inflows

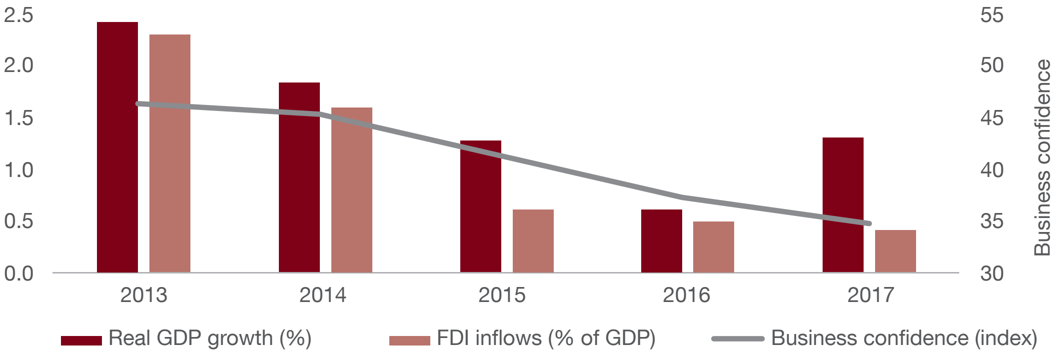
President Cyril Ramaphosa announced in April 2018 that he is spearheading a drive to generate R1.2 billion in private sector investment over the next five years in order to create 1–1.5 million new job opportunities in South Africa. To this end, he has assembled a team of finance and business experts – former finance minister Trevor Manuel, former deputy finance minister Mcebisi Jonas, former Standard Bank Group CEO Jacko Maree, and Astrapak Chairperson Phumzile Langeni – as 'investment envoys'.[1]

FDI is an important enabler of economic growth. For emerging market economies, foreign investment inflows are crucial for transferring money and expertise from multinational companies to local enterprises. Emerging markets also need FDI to help finance infrastructure deficits.

Data from the United Nations Conference on Trade and Development (UNCTAD) indicates that foreign direct investment (FDI) inflows into South Africa declined from an equivalent 2.3% of gross domestic product (GDP) during 2013 to 0.5% of GDP in 2016, with our own analysis providing an estimate of around 0.4% of GDP for 2017.[2]

The overall number of completed deals in South Africa declined from 163 in 2015 to 117 in 2016 and fell to just 79 in 2017.[3]

Exhibit 1
Slippery slope of economic decline



Sources: Business Monitor International (BMI), Bureau for Economic Research (BER), United Nations Conference on Trade and Development (UNCTAD), PwC's Strategy& analysis

1 Bloomberg, 2018. "Ramaphosa Vows to 'Hunt' $100 Billion in South Africa Investment." https://www.bloomberg.com/news/articles/2018-04-16/ramaphosa-vows-to-hunt-100-billion-in-south-africa-investment

2 United Nations Conference on Trade and Development (UNCTAD), 2018. Statistics. http://unctad.org/en/Pages/statistics.aspx

3 Strategy& calculations based on data from Mergermarket

Economic growth in the country was on a downward trajectory in 2014–2016, with a small recovery seen in 2017. As a result, real GDP growth averaged just 1.6% per annum during 2012–2017, in contrast to the National Development Plan's (NDP) goal of economic growth exceeding 5% per annum towards 2030.

The NDP aims to address the country's challenges of poverty and inequality through stimulating economic growth and job creation. The NDP originally envisioned the unemployment rate falling from 25% in 2012 to 14% by 2020 and 6% in 2030. This would require the creation of an additional 11 million jobs. Instead, economic growth has been disappointing and often below the population growth rate of 1.5%, The unemployment rate has actually increased since 2012.[4]

As a result of the economic under-performance, the National Planning Commission (NPC) admitted in September 2018 that the 6% unemployment rate goal is impossible to achieve. Instead, the NPC sees a reduction to 14% as the best possible outcome.[5]

Given this wide chasm between actual and desired economic outcomes, business sentiment suffered as well: business confidence was at a seven-and-a-half-year low during the second quarter of 2017, with seven-out-of-10 respondents being unhappy with business conditions at the time.[6] Sentiment was slightly better in the second half of the year, before making a marked recovery in the first half of 2018. Nonetheless, according to the Bureau for Economic Research (BER), business confidence remained net negative in 2018H1.[7]

Economic growth was on a downward trajectory in 2014–2016, with a small recovery seen in 2017.

4 South African Government, 2012. "National Development Plan 2030." https://www.gov.za/issues/national-development-plan-2030

5 Business Day, 2018. NDP's 6% jobless rate by 2030 'out of reach'. https://www.businesslive.co.za/bd/economy/2018-10-01-ndps-6-jobless-rate-by-2030-out-of-reach/

6 Bureau for Economic Research (BER), 2017. "RMB/BER Business Confidence Index 2017Q3." https://www.ber.ac.za/BER%20Documents/BER-press-release/?doctypeid=1068

7 Bureau for Economic Research (BER), 2017. RMB/BER Business Confidence Index 2018Q1. https://www.ber.ac.za/knowledge/pkviewdocument.aspx?docid=7781

Analysis of factors influencing FDI inflows

On a positive note, President Ramaphosa's investment drive has already yielded some results. During a visit to Jeddah in July, the president received a commitment by Saudi Arabia to investment $10 billion (about R133 billion at the time) in South Africa's energy sector. [8]

Only a few days later, the United Arab Emirates made a commitment for the same size of investment in industries such as mining and tourism, among others.[9] And during the BRICS Summit hosted in South Africa during July 2018, China announced plans to invest $14.7 billion in areas like infrastructure development, the oceans and green economies, science and technology, agriculture, finance and the environment.[10]

President Ramaphosa's Investment Summit is fast approaching, currently scheduled for October 2018. The aim of the event is to "market the compelling investment opportunities to be found in our country" to domestic and international investors, according to his State of the Nation Address (SONA) 2018.

In this context, it is important to consider what foreign investors are looking for when they consider a direct investment into a specific country? What characteristics differentiate one economy from another? What do potential investors want to see to improve the attractiveness of an economy to them? These are some of the questions challenging governments and investment agencies worldwide in their quest to attract FDI inflows. Evidently, some countries are more successful than others in this mission.

The value of South Africa's FDI inflows during 2010–2016 was equivalent to an average of 1.2% of GDP, compared to a global mean of 5% of GDP. Countries that received a similar level of FDI to South Africa include Cote d`Ivoire, Hungary, New Zealand, Nigeria, Sri Lanka, and Swaziland. All experienced FDI inflows below the global average. In turn, countries like Antigua & Barbuda, Djibouti, Niger, São Tomé and Príncipe, Turkmenistan, and Palau received FDI inflows that equalled around 10% of their respective GDP estimates.[11]

In order to answer these questions, PwC's Strategy& has considered a selection of the macro factors that influence FDI decisions. Our analysis takes a global perspective and considers all countries with available data on the selected factors. Data sources include Business Monitor International (BMI), Fraser Institute, Fund for Peace (FFP), Heritage Foundation, International Monetary Fund (IMF), UNCTAD, World Economic Forum (WEF) and World Bank.

Based on academic research, in-house expertise, and PwC's experience in facilitating foreign investment, we have collected a dataset of important variables that potential investors will consider in their investment decisions.

8 Fin24, 2018. Saudi Arabia pledges to invest R133bn in SA energy sector. https://www.fin24.com/Economy/just-in-saudi-arabia-pledges-to-invest-r133-billion-in-sa-energy-sector-20180712

9 Engineering News, 2018. UAE pledges $10bn in investment, South Africa says. http://www.engineeringnews.co.za/article/uae-pledges-10bn-in-investment-south-africa-says-2018-07-16

10 Bloomberg, 2018. China Pledges $14.7 Billion in Investments to South Africa. https://www.bloomberg.com/news/articles/2018-07-24/south-africa-agrees-14-7-billion-of-investments-from-china

11 Strategy& calculations based on UNCTAD data

These factors include:

- Political stability;
- Policy continuity;
- Exchange rate stability;
- Labour force affordability and flexibility;
- Safety and security;
- Property rights;
- State stability;
- Investment freedom;
- Competitiveness of the economy;
- Quality of infrastructure;
- Efficiency of government regulation;
- Control of corruption;
- Rule of law;
- Quality of governance;
- Trade openness;
- Investor protection;
- Corporate tax rate;
- Ease of trading across borders; and
- Natural resources.

Several of these indicators are represented on a scale of 0–100. We have also scaled the others, both for statistical analysis and for visual representation in this publication.

In the following sections we discuss 7 of the most influential factors, based on the correlation results.

19 key variables *that potential investors will consider in their investment decisions*

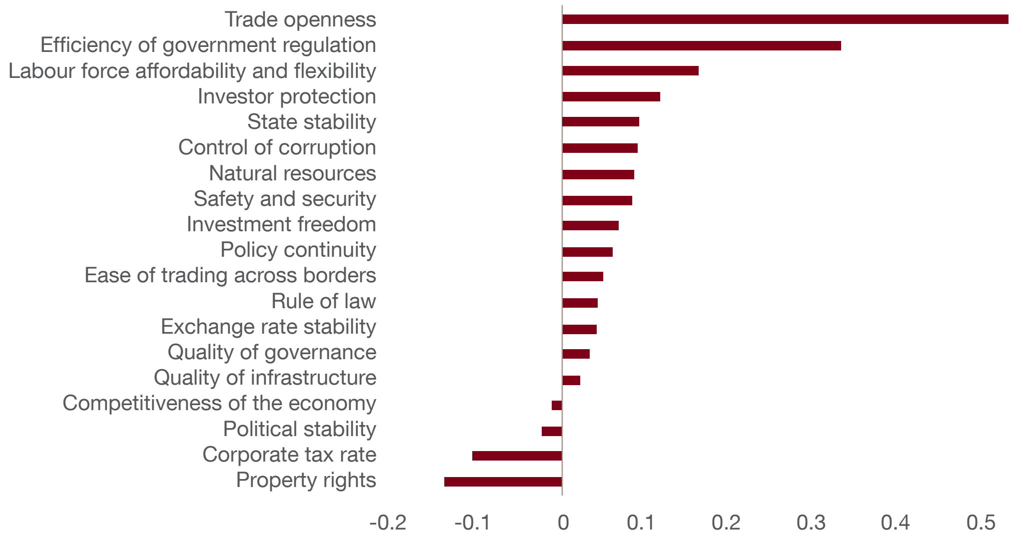
Global determinants of FDI inflows

These 19 factors were analysed to try to explain different levels of FDI inflows across countries over the period 2010–2016. Based on the available data, we were able to analyse the impact of macro factors on FDI inflows as a percentage of gross domestic product (GDP) for 132 countries. The use of the ratio of foreign investment to the size of the economy excludes the need for considering the size of a country's economy in our analyses. The size of GDP explains a significant amount of FDI dynamics[12] simply by offering investors a large market with a large pool of potential acquisitions. In this analysis, we examine other factors that influence FDI inflows.

We used correlation coefficients as an indication of the relationship between FDI and the other variables. The correlation coefficient is a measure of the extent to which two measurement variables vary together. The value of the correlation coefficient does not depend on the units of the measurement variables. The value of any correlation coefficient must be between -1 and +1 inclusive, where the closer to 1 or -1, the stronger the relationship between the two variables. The direction of the correlation coefficient is also important. If the coefficient is positive, then it implies that an increase in the one variable should result in an increase in the other variable.

Our findings show that, across 132 countries, the two factors showing the highest correlation with FDI inflows are openness to trade and the burden of government regulation. The following subsections consider relevant information for South Africa. The analysis considers South Africa' global ranking in the areas considered, some comparative information against other countries, as well as deeper insight into the reasons why South Africa is performing well/poorly in these areas.

Exhibit 2
Correlations with FDI inflows – all countries

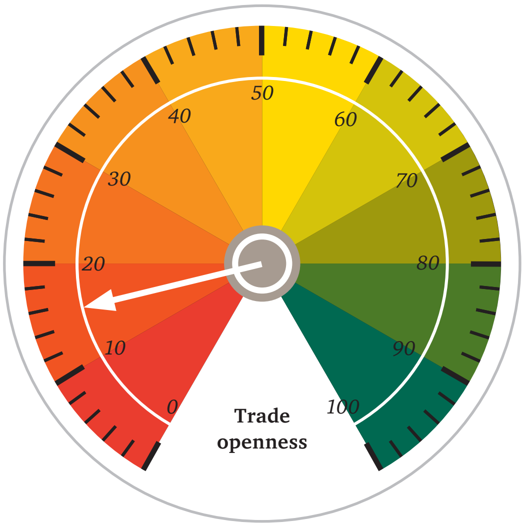


Sources: Calculations by PwC's Strategy& based on data listed above

Exhibit 2 indicates trade openness as having the strongest positive relationship with FDI inflows. This implies that countries with highly open economies or with improvements in trade openness can expect to see benefits reflected in FDI receipts.

12 L Artige & R. Nicolini, 2015. Evidence on the Determinants of Foreign Direct Investment: The Case of Three European Regions. http://pareto.uab.es/wp/2005/65505.pdf

Trade openness



The World Bank calculates trade openness as the sum of exports and imports of goods and services, measured as a percentage of GDP. The calculation represents the relative size of goods and services traded as an indication for how open an economy is to trading.[13]

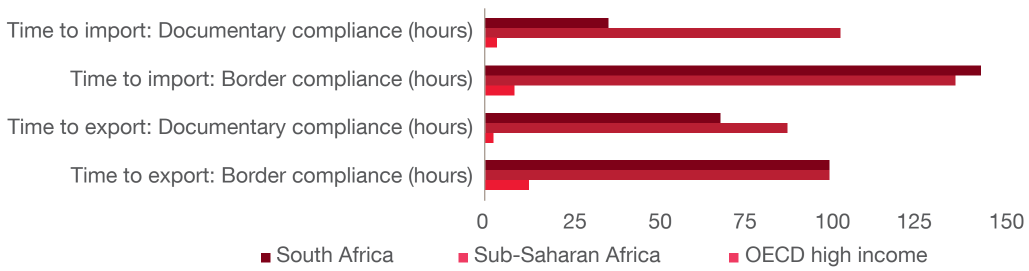
Trade openness would positively influence FDI inflows by signalling the ability and willingness of the destination country to make exports and secure imports. According to the International Monetary Fund (IMF), trade liberalisation would reduce trade and administrative barriers, thereby improving the business environment and helping to attract FDI.[14]

South Africa's trade equalled 61% of its GDP during 2010–2016, similar to that of other African countries like Algeria, Burkina Faso, Mali and Niger. At this level, these countries were below the global median of around 84%, with South Africa and ranked **135th out of 181 countries**.[15]

Several non-structural factors (i.e. possible to change) hamper South Africa's trade performance. These include the time and cost associated with importing and exporting goods. The World Bank Doing Business project assessed the time and costs associated with importing and exporting a standard shipping container through South African ports. It found that the time needed (68 hours) to comply with export documentation requirements is 28 times longer than the average of Organisation for Economic Co-operation and Development (OECD) countries (2.4 hours).[16] Seaports handle some 98% of South Africa's trade.

Research conducted at the University of KwaZulu-Natal found that crane and ship work-rate performance at South Africa's largest ports are below targeted levels, with associated time and cost implications. This underperformance is associated with a number of factors, including suboptimal crane utilisation, equipment downtime, poor coordination between the port operator and shipping companies, as well as inefficient labour and land operations. Some of these factors are associated with operational issues at seaports, while other factors link to regulatory issues in general.

Exhibit 3
Time-consuming border compliance for South African



Sources: World Bank

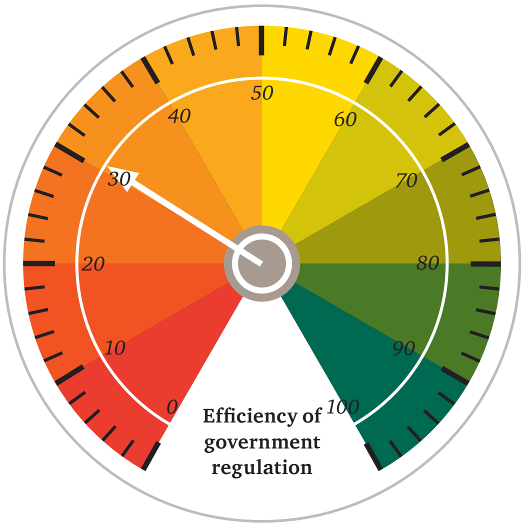
13 World Bank, 2018. Trade (% of GDP). https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS

14 International Monetary Fund (IMF), 2006. Foreign Direct Investment in South Africa: Why Has It Been So Low? https://www.imf.org/external/pubs/nft/2006/soafrica/eng/pasoafr/sach5.pdf

15 Strategy& calculations based on World Bank data.

16 World Bank, 2018. Ease of Doing Business in South Africa. http://www.doingbusiness.org/data/exploreeconomies/south-africa#trading-across-borders

Efficiency of government regulation



The annual WEF Global Competitiveness Index (GCI) publications provide data representing the burden of government regulation, based on a representative survey of CEOs. The respondents indicate how burdensome it is for companies in their country to comply with public administration's requirements (e.g. permits, regulations and reporting). The WEF score these responses on a scale from 1 (extremely burdensome) to 7 (efficient and not burdensome at all).[17] The efficiency of government regulation would impact FDI inflows by influencing the transaction process as well as future operational and administrative processes associated with the target enterprise.

South Africa's score for the efficiency of government regulation averaged 2.87 points during 2010–2016. This placed it below the mid-point of 4 and global median of 3.42, and at a similar level to upper middle-income economies like Ecuador, Jamaica, Mexico and Romania.[18]

In the 2016 edition of the WEF GCI, South Africa ranked **106th out of 138 countries** in this category.[19] This scenario is of particular concern for small-, medium- and micro-sized enterprises (SMMEs). Specifically, constraints on SMME growth keeps these entities from expanding into large enough companies to attract FDI.

Inefficient government bureaucracy is the most problematic challenge to doing business in South Africa

Source: World Economic Forum (WEF) Global Competitiveness Index (GCI) 2016-17[20]

Research by the Small Business Project (SBP), an independent, not-for-profit company focussed on private sector development, found the following challenges faced by SMMEs regarding regulation:

- Frequent changes in the regulatory environment;
- The need to keep track of overlapping and sometimes conflicting regulatory requirements across multiple departments and levels of government;
- Poor communication and access to information; and
- Bureaucratic inefficiencies in government departments and municipalities.

17 World Economic Forum (WEF), 2016. Global Competitiveness Index (GCI) 2016-2017. http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

18 Strategy& calculations based on World Economic Forum (WEF) data.

19 World Economic Forum (WEF), 2016. Global Competitiveness Index (GCI) 2016-2017. http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

20 World Economic Forum (WEF), 2016. "Global Competitiveness Index 2016-2017." http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

This results in SMME owners spending a disproportionate amount of their work time dealing with regulatory compliance. According to SBP, these owners identify their top red tape challenges as:

- Dealing with the South African Revenue Service (SARS);
- Labour-related issues;
- Dealing with local government (municipalities); and
- Compliance with broad-based black economic empowerment (B-BBEE) rules[21]

According to the Small Business Institute (SBI), the lack of a common definition for what SMMEs are creates inconsistency among the policies and laws applicable to this class of enterprises. This generates "a mind-boggling amount of red tape, confusion, and barriers for SMEs starting, running or growing their businesses".[22]

Top red tape challenges include *dealing with SARS, labour issues, local government, compliance and B-BBEE rules*

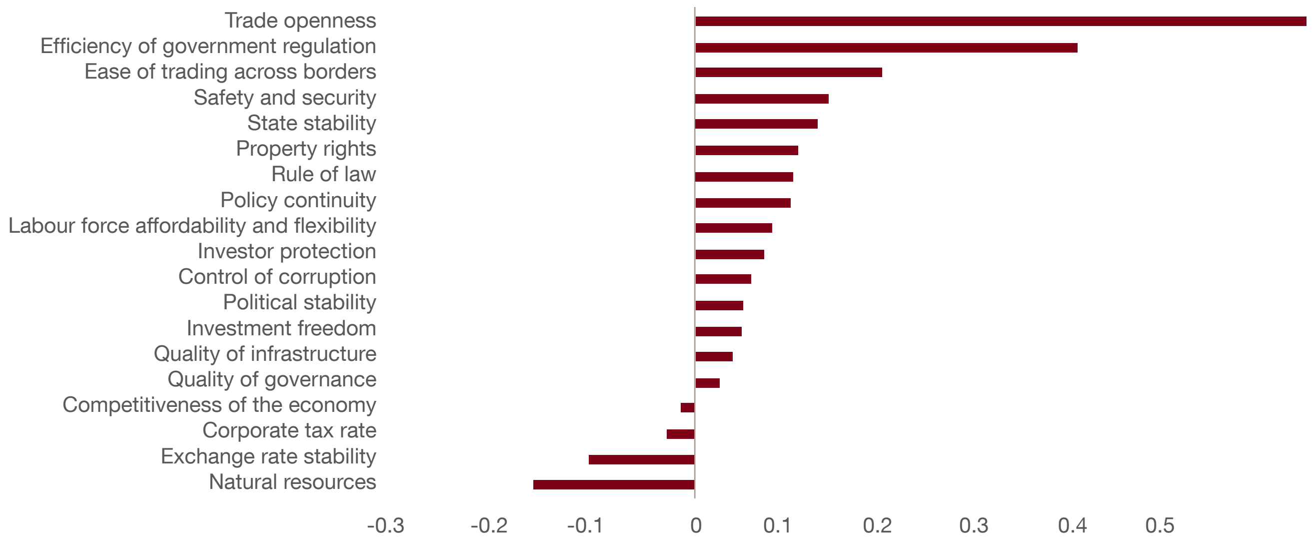
21 Small Business Project (SBP), 2014. "Examining the challenges facing small businesses in South Africa." http://www.sbp.org.za/uploads/media/SBP_Alert_-_Examining_the_challenges_facing_small_businesses_in_SA_01.pdf

22 Small Business Institute (SBI), 2018. "Baseline data and policy changes needed for small business to deliver jobs target for NDP." http://www.smallbusinessinstitute.co.za/2018/07/24/baseline-data-and-policy-changes-needed-for-small-business-to-deliver-jobs-target-for-ndp/

Trends among upper middle-income economies

In order to get a more focussed look at the correlation results, we used a smaller sample of South Africa's peer countries that the World Bank classifies as upper middle-income economies. This reduced the original sample of countries to 50 states. The correlation results indicate that, in addition to the trade and regulation factors already discussed, a safe and secure operating environment and protected property rights were most strongly positively associated with FDI in upper middle-income countries during 2010–2016.

Exhibit 4
Correlations with FDI inflows – upper middle-income economies



Sources: Calculations by PwC's Strategy& based on data listed above

Safety and security

Research company BMI provides data on security of the operating environment, assessing each country's operating conditions with respect to interstate conflict risk, terrorism and crime, including cybercrime and organised crime. The indicator scores range between 0 and 100, with a higher number indicating greater security.[23] Conflict, terrorism and various forms of physical and electronic crime would influence FDI inflows by affecting investors' perception of the safety and security of human, physical and intellectual capital assets.

23 BMI database.

South Africa's average score for safety and security is 52.6 – ranking it **80th out of 189 countries** – versus a weaker upper middle-income peer average of 45.7. The country's performance is also comparable in this upper middle-income grouping to those of BRICS partners Brazil and China.[24]

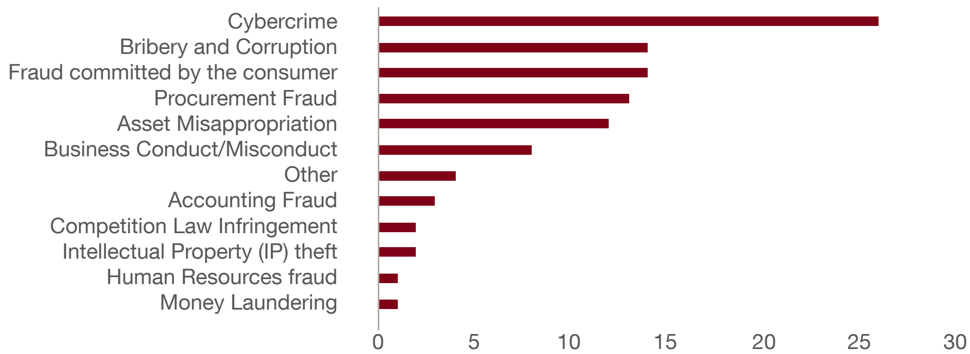
Apart from South Africa's well-known challenges with physical crime, challenges in addressing cybercrime hampers its overall security assessment. The United States Federal Bureau of Investigation (FBI) and security experts Rapid7 rank the country among its top 10 countries for cybercrime vulnerability.[25] [26]

One in three companies operating in South Africa has been a victim of cybercrime, and the country reportedly has the third highest number of cybercrime victims worldwide.[27] Cybersecurity software provider Norton estimates losses at R50 billion in 2014[28] alone – equal to 1.5% of GDP.[29]

Seven out of 10 South African companies expend a high degree of effort in building up business processes (such as internal controls) in order to avoid cybercrime incidents. PwC research shows that companies in emerging markets (including South Africa) are investing in advanced technologies – such as artificial intelligence – at a faster rate than developed nations. However, only four out of 10 companies report spending a high level of effort promoting ethical decision-making by individual employees.[30]

When a crime is committed, the judiciary is challenged by a conundrum of fast-changing technology enabling cybercrime and slow-changing legislation used to combat the threat.[31] The Cybercrimes and Cybersecurity Bill aims to address some of these issues, and has been many years in the making – a very long time in technology terms. The Bill was first introduced to the National Assembly and amended in early 2018 following public hearings and submissions. At the time of writing, the Bill was in the process of being enacted.[32]

Exhibit 5
Most disruptive economic crimes likely to be experienced over the next 24 months



Source: PwC Global economic crime and fraud survey 2018

24 Strategy& calculations based on Business Monitor International (BMI) data.

25 Engineering News, 2017. "Cybercrime becoming a major threat in South Africa." http://www.engineeringnews.co.za/article/cybercrime-becoming-a-major-threat-in-south-africa-2017-09-19/rep_id:4136

26 Huffington Post, 2017. "Expanding Opportunities in Cybersecurity for South Africa." http://www.huffingtonpost.co.za/stephen-w-orfei/expanding-opportunities-in-cybersecurity-for-south-africa_a_22013422/

27 Cape Times, 2017. "SA has third highest number of cybercrime victims in world." https://www.iol.co.za/capetimes/news/sa-has-third-highest-number-of-cybercrime-victims-in-world-11594553

28 Lexology, 2017. "Corporate South Africa still not taking cybercrime seriously enough." https://www.lexology.com/library/detail.aspx?g=d7f9ac5d-5cdc-473d-8374-b5bc3b4b4da4

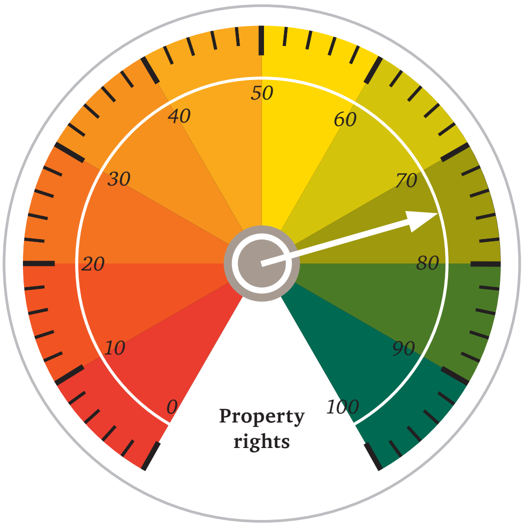
29 Calculation by PwC's Strategy&

30 PwC, 2018. "Global Economic Crime and Fraud Survey 2018: 6th South African edition. https://www.pwc.co.za/en/assets/pdf/gecs-2018.pdf

31 Lexology, 2017. "Corporate South Africa still not taking cybercrime seriously enough." https://www.lexology.com/library/detail.aspx?g=d7f9ac5d-5cdc-473d-8374-b5bc3b4b4da4

32 Parliamentary Monitoring Group, 2018. "Cybercrimes and Cybersecurity Bill (B6-2017)." https://pmg.org.za/bill/684/

Property rights



The Fraser Institute's Economic Freedom of the World reports provide data on the protection of property rights. The institute uses information from the WEF GCI to score property rights protection (including that of financial assets) on a scale from 0 (not protected by law) to 10 (well protected by law).[33]

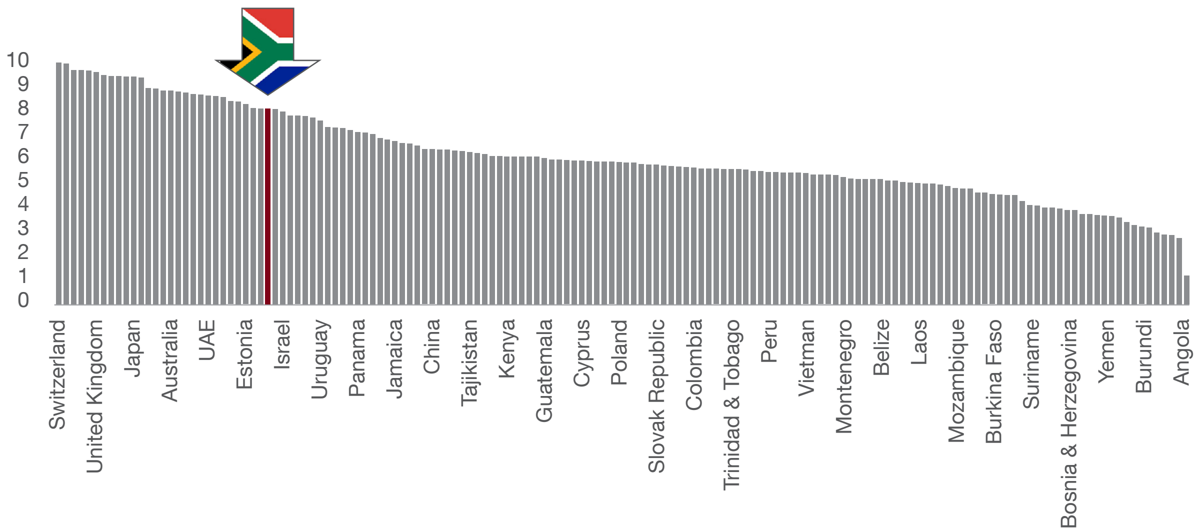
Protection of property rights would influence FDI inflows by affecting investors' perceptions about the safety of their investments from unexpected confiscation. Both economic theory and economic history suggest that secure private property rights plays an important role in creating incentives for investment that lead to economic growth and widespread prosperity over the long term.[34]

South Africa's average score for property rights was 7.45 out of 10 in 2010–2016, which was the highest among 39 of the upper middle-income economies ranked by the Fraser Institute in this category.

South Africa was ranked **21st out of 177 countries** (i.e. among the top 15% globally), with its property rights protection seen in the same league as OECD member countries like Australia, France, Iceland and Belgium.[35] The South African Constitution explicitly guarantees private property, and the acquisition of land and real estate is relatively easy and fast.[36]

Exhibit 6

South African property rights ranked among the top 15% of countries globally



Source: Fraser Institute

33 Fraser Institute, 2017. Economic Freedom of the World 2017 Annual Report. https://www.fraserinstitute.org/sites/default/files/economic-freedom-of-the-world-2017.pdf

34 T. Miller, 1997. The Role of Property Rights in Economic Development that Benefits the Poor. https://www.researchgate.net/publication/228434733_The_Role_of_Property_Rights_in_Economic_Development_that_Benefits_the_Poor

35 Strategy& calculations based on Fraser Institute data.

36 Bertelsmann Stiftung, 2016. South Africa Country Report. https://www.bti-project.org/fileadmin/files/BTI/Downloads/Reports/2016/pdf/BTI_2016_South_Africa.pdf

Of particular interest to foreign investors is the country's land reform process. President Ramaphosa said in his SONA in February 2018 that in order to accelerate land distribution, expropriation of land without compensation 'should be implemented'. This is part of a broader acceleration in land reform.

He added that, based on resolutions at the African National Congress (ANC) 54th National Conference in December 2017, the process should be executed in a way that increases agricultural production and improves food security[37] and does not damage future investment in the economy.[38]

Since this announcement, Parliament's constitutional review committee has toured the country to obtain input from South Africans on the issue of changing Section 25 of the constitution, which deals with property rights. The committee is expected to report back to Parliament in November 2018.

In the latest African National Congress (ANC) quarterly newsletter, the ruling party indicated that its policy on land is based on the 1993 Ready to Govern document. This text identifies land targeted for redistribution, including land held for speculation, under-utilised or unused land with a productive potential, land which is being degraded, hopelessly indebted land, and land acquired through nepotism and corruption.[39]

This is broadly in line with President Ramaphosa's own stated list of targets: "unused land, derelict buildings, purely speculative land holdings, or circumstances where occupiers have strong historical rights and title holders do not occupy or use their land, such as labour tenancy, informal settlements and abandoned inner-city buildings."[40]

However, there is still significant uncertainty about what the ruling party is planning with regards to expropriation without compensation. One of the reasons for this is the many top-level political voices from within the ANC making (often divergent) statements about economic policy.

Veteran South African journalist and newspaper editor, Ferial Haffajee, wrote in September 2018 about this group. In the absence of President Ramaphosa assuming the mantle of South African economic policy czar, the country now has half a dozen ministers influencing the broader economic policy debate.[41]

Policy continuity and uncertainty is discussed elsewhere in this document. Policy uncertainty is among the major growth-constraining factors identified in South Africa by the IMF.[42] With South Africa's property rights still ranked very high from a global perspective, and no change as yet made to any relevant legislation, it is the uncertainty about land policy and property rights over the medium to long term that is a great inhibitor to productive investment.

37 South African Government, 2018. "State of the Nation Address by President of the Republic of South Africa, Mr Cyril Ramaphosa." http://www.thepresidency.gov.za/speeches/state-nation-address-president-republic-south-africa%2Cmr-cyril-ramaphosa

38 Business Day, 2018. Cyril Ramaphosa. "This is no land grab". 24 August 2018 https://www.businesslive.co.za/bd/opinion/2018-08-24-exclusive-this-is-no-land-grab-writes-cyril-ramaphosa/

39 "Umrabulo no. 43." African National Congress, 2018. http://www.anc.org.za/sites/default/files/pubs/umrabulo43.pdf

40 Financial Times, 2018. Land reform in South Africa is crucial for inclusive growth. https://www.ft.com/content/c81543d8-a61b-11e8-926a-7342fe5e173f.

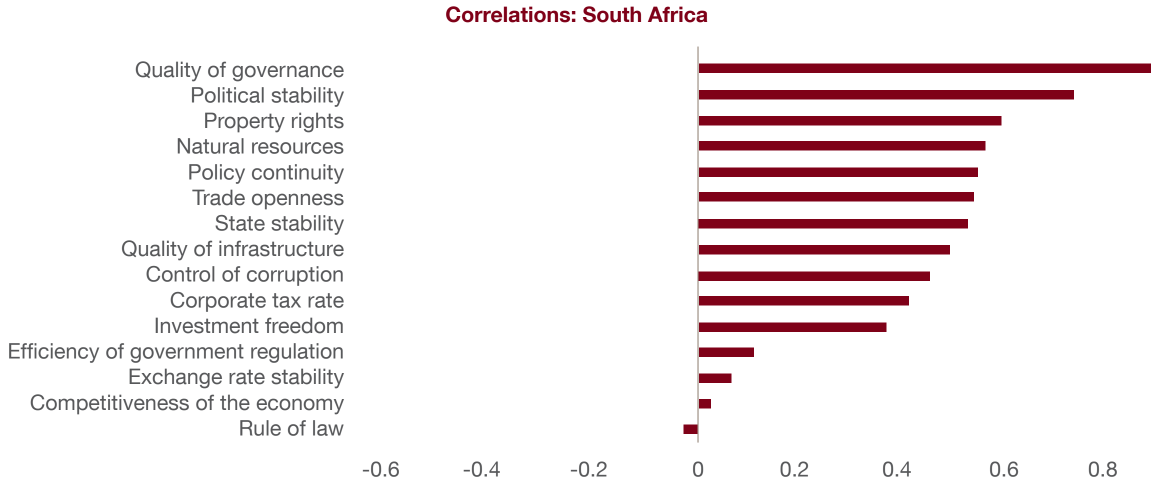
41 Fin24. 13 September 2018. Ferial Haffajee. "South Africa's soup of seven 'finance ministers' spoils the broth." https://www.fin24.com/Opinion/ferial-haffajee-south-africas-soup-of-seven-finance-ministers-spoils-the-broth-20180913

42 International Monetary Fund, 2018. "South Africa: 2018 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for South Africa." https://www.imf.org/en/Publications/CR/Issues/2018/07/30/South-Africa-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-46132

South Africa-specific analysis over time

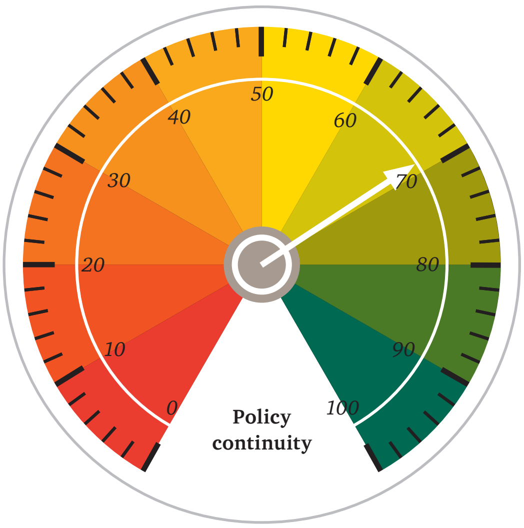
To gain further insight into South Africa's FDI dynamics, we undertook a time series study of the country's inflow data and the factors already considered above. The aim was to understand the correlation between South African variables over time. In addition to the factors discussed above, another three variables that showed strong correlations with FDI inflows were the quality of infrastructure, control of corruption, and policy continuity.

Exhibit 7
Correlations with FDI inflows – South Africa over time



Sources: Calculations by PwC's Strategy& based on data listed above

Policy continuity



BMI provides data on long-term policy continuity. The research company assesses the stability of policy direction over a decade-long period – in most democratic states, this would encompass a change of government.

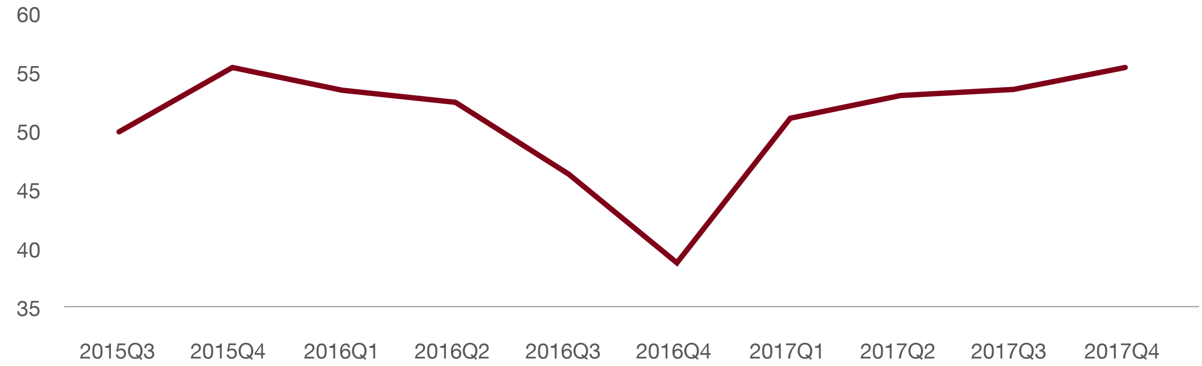
Policy continuity suggests a lack of polarisation (divergent ideologies between different stakeholders) within the political system. Long-term policy continuity would be influence FDI inflows by providing a stable and predictable policy environment for an economy and the specific industry that foreign investors find attractive.

South Africa's average score for policy continuity was 68.6, which placed it **112th out of 190 countries**. The country's performance was similar to the mean scores for Brazil, Macedonia, Serbia, Turkey, and Vietnam[43] – all countries whose sovereign debt is currently rated non-investment grade (speculative) by S&P Global Ratings, Fitch Ratings and Moody's Investors Service.[44]

BMI identified a deterioration in policy continuity during 2014–2015. It indicated that its analysts' expectations in 2013 of reform momentum going forward changed following the May 2014 municipal elections to expectations of 'more of the same' in terms of policy uncertainty.[45]

Exhibit 8

Heightened policy uncertainty (readings above 50) around party and national leadership changes



Sources: North-West University

What causes disruptions in policy continuity, i.e. policy uncertainty? According to the North-West University (NWU) School of Business and Governance (SBG) Policy Uncertainty Index (PUI), unexpected political developments in South Africa are key factors affecting policy uncertainty. These include the multiple changes in the finance minister seat in December 2015, the cabinet reshuffle in April 2017, as well as the run-up to the leadership election and policy decisions at the ANC's 54th National Conference in December 2017.[46]

From a policy perspective, the BER reported that nearly 9-out-of-10 manufacturing companies surveyed during 2017H2 indicated that the country's political environment was a constraint on their business operations.[47]

43 Strategy& calculations based on BMI data.

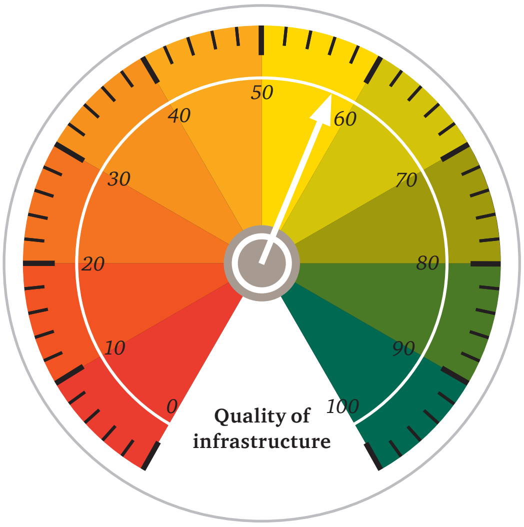
44 Trading Economics, 2018. Credit Rating. https://tradingeconomics.com/country-list/rating

45 Business Monitor International (BMI), 2014. "South Africa Country Risk Report - Q4 2014." https://bmo.bmiresearch.com/reports/view?productid=40&issue=20141001&active_pillar=Reports%20Subtab

46 North-West University (NWU), 2017. Policy Uncertainty Index (PUI) 2017Q4.

47 Bureau for Economic Research (BER), 2017. Manufacturing Survey. https://www.ber.ac.za/BER%20Documents/Manufacturing-Survey/?doctypeid=1067

Quality of infrastructure



The WEF GCI provides data on the quality of infrastructure based on a representative survey of CEOs. The respondents are asked to indicate the general state of infrastructure (e.g. transport, communications, and energy) in their country, with the WEF scoring the responses on a scale from 1 (extremely underdeveloped and among the worst in the world) to 7 (extensive and efficient, and among the best in the world).[48]

The quality of infrastructure would influence FDI inflows by providing an enabling environment for business operations by the targeted investment enterprises. The National Development Plan (NDP) sees infrastructure as essential for faster economic growth and higher employment, both of which are needed to promote inclusive growth and economic development.[49]

South Africa's average score for the quality of infrastructure was 4.37, which was similar to that of African countries like Morocco, Rwanda, The Gambia, and Tunisia.

Over the period under consideration, the quality of South Africa's overall infrastructure ranked **56th out of 149 countries**. While the country's quality of road and air transport infrastructure was placed in the top 25% of countries worldwide, its overall rating for infrastructure was weakened by the quality of electricity supply, which was ranked 112th – in the bottom 25% of countries.[50]

Both the quantity and quality of infrastructure can have a positive effect on economic growth and development by improving labour productivity and by raising the marginal productivity of capital. However, objective data on the quality of infrastructure is scarce compared to information on the quantity.[51] This is problematic as information on the quality of infrastructure investment is important in order to make a distinction between the value of infrastructure inputs and outputs.

For example, data from Statistics South Africa (StatsSA) indicates that the real value of fixed capital – broadly, the country's stock of infrastructure – increased by an average of 2% per annum over the past five years. In turn, fixed capital productivity declined by an average of 1% per annum over the same period. This shows a clear challenge in translating infrastructure investment into quality investments.

*… a clear challenge in **translating infrastructure investment into quality investments**.*

Nonetheless, some indicators are readily available to assess the quality of infrastructure. One of these is the transmission and distribution losses of electricity as percentage of system output.[52] Data from the World Bank indicates that South Africa's electricity losses have been on a broadly upward trend since the mid-1980s, peaking at 10% by 2004. The ratio oscillated between 8% and 10% in the decade thereafter, and most recently recorded at 8.4% in 2014. This is barely above the global average and weaker than the average for other upper middle-income countries.[53]

48 World Economic Forum, 2016. "Global Competitiveness Index 2016-2017." http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

49 South African Government, 2012. "National Development Plan 2030." https://www.gov.za/sites/default/files/NDP-2030-Our-future-make-it-work_r.pdf

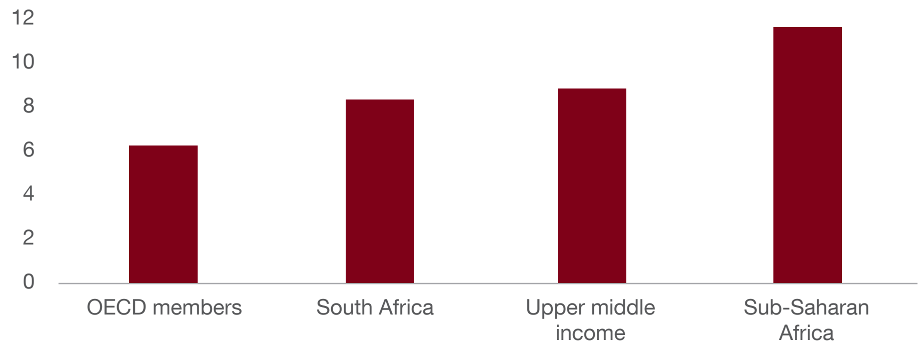
50 Strategy& calculations based on WEF data.

51 J. Fourie, 2007. "A Note on Infrastructure Quality in South Africa." https://www.ekon.sun.ac.za/wpapers/2007/wp032007/wp-03-2007.pdf

52 J. Fourie, 2007. "A Note on Infrastructure Quality in South Africa." https://www.ekon.sun.ac.za/wpapers/2007/wp032007/wp-03-2007.pdf

53 Strategy& calculations based on World Bank data.

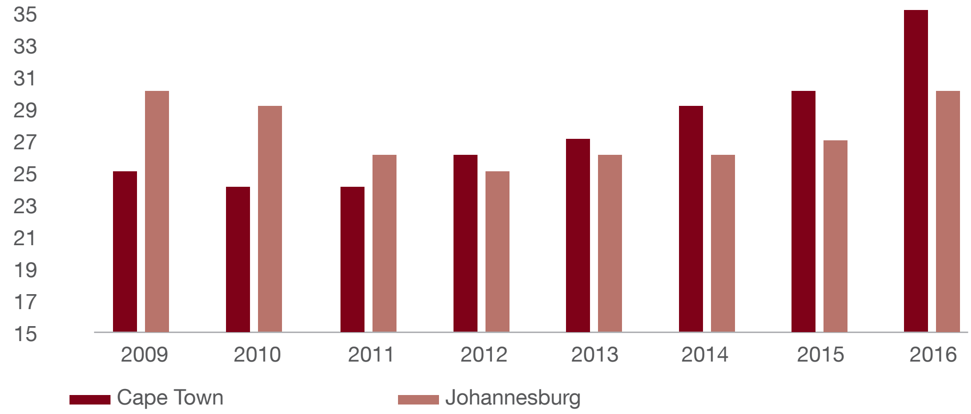
Exhibit 9
Electric power transmission and distribution losses (% of output)



Source: World Bank

Another indicator for infrastructure quality is the travel time to work in main cities.[54] The TomTom Traffic Index, for example, currently ranks Cape Town 48th out of 189 global cities (1st = worst) for congestion, based on the slowdown in traffic seen during morning and afternoon peak periods. Extra travel time during these periods increased from 24% in 2011 to 35% in 2016.[55]

Exhibit 10
Increasing travel delays during rush-hour traffic (% of normal travel time)

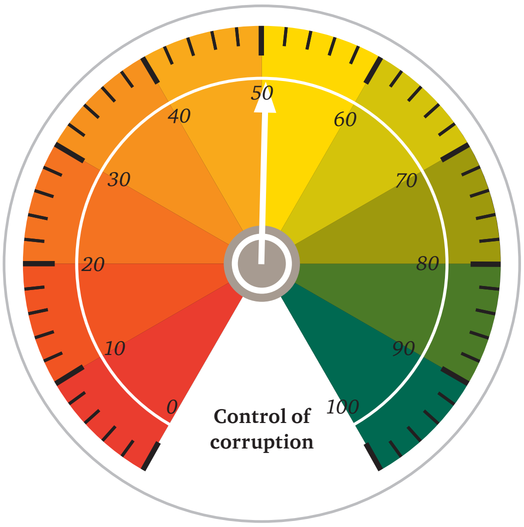


Source: TomTom Traffic Index

54 J. Fourie, 2007. "A Note on Infrastructure Quality in South Africa." https://www.ekon.sun.ac.za/wpapers/2007/wp032007/wp-03-2007.pdf

55 TomTom Traffic Index, 2016. Full Ranking. https://www.tomtom.com/en_gb/trafficindex/list?citySize=LARGE&continent=ALL&country=ALL

Control of corruption



The World Bank's World Governance Indicators (WGIs) provide data on the control of corruption. The WGIs assesses perceptions "of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests".

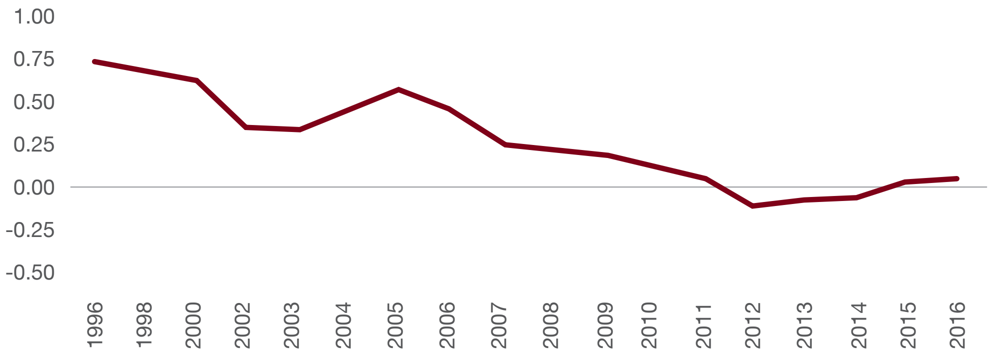
The World Bank makes use of multiple qualitative and quantitative sources to determine its assessment of corruption. Country scores range between -2.5 and +2.5.[56] The prevalence of corruption would influence FDI inflows as investors would have to evaluate the impact bribery or other corrupt practices would have on their investments.

South Africa's average score was 0 (i.e. in the middle of the range) compared to a global average of -0.1. The country's performance ranked it **72nd out of 191 countries**.

While South Africa's average ranking places it in the top half of countries globally, the country ranked much higher at 45th out of 187 in mid-1990s. While the country has 13 public sector agencies with legal and/or policy roles to play in combatting corruption, national mechanisms like the National Anti-Corruption Task Team to coordinate the functions of these agencies,[57] and a robust anti-corruption framework, civil society organisation Corruption Watch believes the relevant structures inadequately enforce these laws.[58]

Exhibit 11

Big fall in Control of Corruption rating since mid-2000s (score between -2.5 and +2.5)



Source: World Bank

56 World Bank, no date. "Control of Corruption." https://info.worldbank.org/governance/wgi/pdf/cc.pdf

57 GAN Integrity, 2015. South Africa Corruption Report. https://www.business-anti-corruption.com/country-profiles/south-africa

58 Corruption Watch, 2014. "Why is Corruption Getting Worse in South Africa?" http://www.corruptionwatch.org.za/why-is-corruption-getting-worse-in-south-africa/

Reputational research by Brand South Africa found that among potential investors in Germany, the United Kingdom, and the United States, corruption ranks among their top three deterrents to conducting business in South Africa (Other factors include political instability and a lack of security and safety.[59]) These three countries are among the largest economies in the world, with the US and UK the largest sources of FDI inflows into Africa.[60]

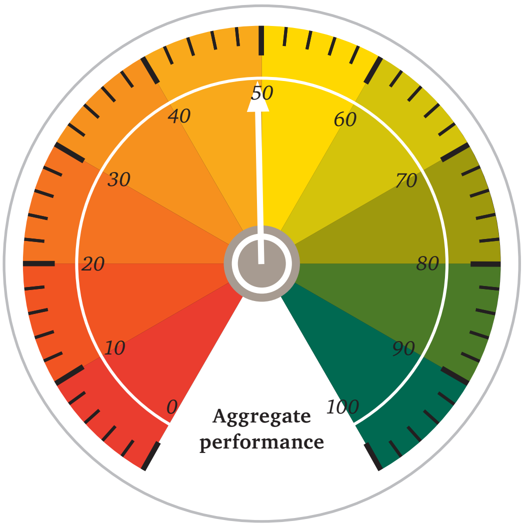
Perceptions about corruption in South Africa among potential foreign investors are clearly detrimental to FDI inflows. What's particularly concerning is that corruption in South Africa is a top-of-mind issue – the questions asked by Brand South Africa were open-ended, meaning that respondents identified corruption as a top-three problem without being prompted to pick issues from a list.[61]

59 Brand South Africa, 2017. "International Reputation Research." https://www.brandsouthafrica.com/about-us/research-analysis/international-reputation-research

60 Strategy& calculations based on Chinese Africa Research Initiative (CARI) data.

61 Brand South Africa, 2017. "International Reputation Research." https://www.brandsouthafrica.com/about-us/research-analysis/international-reputation-research

Looking ahead



This publication set out to determine what foreign investors are looking for when investing in a country, with a particular focus on South Africa's performance in this regard. Our analysis of empirical research found that differences in key factors such trade openness, efficiency of government regulation, safety and security, property rights, quality of infrastructure, control of corruption, and policy continuity are associated with differences in FDI inflows.

Based on the provided scores for each of the 7 factors discussed, South Africa has an average reading of 49.89 out of 100. This places it just below halfway point between the best and worst possible scores. This suggests significant room for improvement in South Africa's characteristics if it wants to attract more FDI.

Encouragingly, South Africa has already made promises to address these issues. In his SONA 2018, President Ramaphosa promised "a major push this year to encourage significant new investment in our economy. To this end, he committed to organising an Investment Summit during the second half of 2018, "targeting both domestic and international investors, to market the compelling investment opportunities to be found in our country." The conference is set for late-October 2018, with special envoys of investment travelling the globe in the run-up to the summit.

President Ramaphosa also made specific promises relating to the factors identified here in his SONA 2018, specifically:

- **Trade openness:** "South Africa has acceded to the Tripartite Free Trade Area agreement…. It will open market access opportunities for South African export products, contribute to job creation and the growth of South Africa's industrial sector."

- **Efficiency of government regulation:** "We will reduce the regulatory barriers for small businesses. We will work with our social partners to build a small business support ecosystem that assists, nourishes and promotes entrepreneurs."

- **Safety and security:** "In improving the quality of life of all South Africans, we must intensify our efforts to tackle crime and build safer communities. This will include personnel and other resources, to restore capacity and experience at the level at which crime is most effectively combated."

- **Property rights:** "We are determined that expropriation without compensation should be implemented in a way that increases agricultural production, improves food security and ensure that the land is returned to those from whom it was taken under colonialism and apartheid."

President Ramaphosa made specific ***promises in SONA 2018 related to the factors*** *identified in this publication.*

- **Quality of infrastructure:** "We will focus on improvements in our budget and monitoring systems, improve the integration of projects and build a broad compact on infrastructure with business and organised labour."

- **Control of corruption:** "This is the year in which we will turn the tide of corruption in our public institutions. We must fight corruption, fraud and collusion in the private sector with the same purpose and intensity."

- **Policy continuity:** "We have taken decisive measures to address concerns about political instability and are committed to ensure policy certainty and consistency.

Economic stimulus and recovery plan

President Ramaphosa commented during September 2018 that in the period since SONA 2018, his government has taken "decisive steps to rebuild investor confidence". However, he also admitted that South Africa's economic difficulties "are severe and will take an extraordinary effort – and some time – to overcome". In order to address this, he announced a Cabinet-approved economic stimulus and recovery plan.

"The stimulus and recovery plan we are outlining consists of a range of measures, both financial and non-financial, that will be implemented immediately to firstly ignite economic activity, secondly restore investor confidence, thirdly prevent further job losses and create new jobs, and fourthly to address some urgent challenges that affect the conditions faced by vulnerable groups among our people," said President Ramaphosa.

The plan is focused on five pillars:

- **Implementation of growth-enhancing economic reforms**
  Reforming visa regime to boost tourism; approval of the Mining Charter to create policy certainty in the sector; allocation of high-demand radio spectrum towards making communication more competitive.

- **Reprioritisation of public spending to support job creation**
  R50 billion directed to activities that have the greatest impact on economic growth, domestic demand and job creation, with a particular emphasis on township and rural economies, women and youth.

- **Establishment of an Infrastructure Fund**
  The fiscus will contribute R400 billion over the medium term, which the government will use to leverage additional resources from developmental finance institutions, multilateral development banks, and private lenders and investors.

- **Addressing urgent and pressing matters in education and health**
  Redirecting resources towards immediate social challenges, including the dire state of sanitation facilities in many public schools, material shortages in hospitals, and the filling of critical medical posts, including nurses and interns.

- **Investing in municipal social infrastructure improvement**
  The government has identified 57 priority pilot municipalities in order to unlock infrastructure spending in the short term, which will cover, among other things, sewerage purification and reticulation, refuse sites, electricity reticulation and water reservoirs.[62]

62 Fin24, 2018. "President Ramaphosa's economic recovery plan speech" Fin24, 21 September 2018. https://www.fin24.com/Economy/full-text-president-ramaphosas-economic-recovery-plan-speech-20180921

Recommendations

This report has identified the factors that foreign investors evaluate when considering investments in South Africa. In addition, the previous section highlighted the specific promises made by President Ramaphosa earlier this year in addressing these challenges. It is important that the government's upcoming investment conference allows for frank discussion about these issues. Some recommendations for actions to be taken during approaching time periods are set out below.

Exhibit 12
Recommended investment supporting actions

Near term (remainder of 2018)

Period overlapping investment conference

- Investment envoys must be empowered with information on progress and plans regarding the promises made in SONA 2018.
- Importantly, local investors and the domestic business community must also be well informed about these factors.
- The planned investment conference must address investment-related issues in detail. An honest Q&A session would be ideal.

Short term (towards 2019 elections)

The coming 12 months

Near-term steps, plus:

- Get investment-enablers on board, e.g. organised business, labour, professional services providers, marketing companies, etc.
- Ensure election campaigning is consistent with national government objectives and statements about the economy.

Medium term (towards mid-2023)

5-year horizon for R1.2 trillion investment campaign

Near- and short-term steps, plus:

- Provide the public, business and investment communities with regular updates about envoy visits and progress on the topics identified in this report. Transparency about challenges and announcements on big wins are essential.

Reaching the goals of the NDP 2030

Near-, short- and medium-term steps, plus:

- Align R1.2 trillion investment goals and strategies with NDP 2030 goals and strategies.
- Ensure that economic planning beyond 2030 is communicated timeously.

Sources: PwC's Strategy&

Contacts

Lullu Krugel
Partner, Strategy&
Chief Economist, PwC South Africa
lullu.krugel@pwc.com
+27 (0) 11 797 4929

Christie Viljoen
Manager, Strategy&
Economist, PwC South Africa
christie.viljoen@pwc.com
+27 (0) 21 529 2595

Notes

Notes

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