

South Africa's social investment context in 2010

Prepared by
Tshikululu Social Investments
January 2010

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Table of Contents

1. THE POLITICAL ENVIRONMENT	3
1.1. Grace before the meal	3
1.2. Society's political make-up.....	3
1.3. Groupings of dialogue.....	3
1.4. Inequality and transformation.....	4
1.5. Dynamism emerging.....	5
2. THE ECONOMIC ENVIRONMENT.....	7
2.1. Introduction	7
2.2. Africa and Southern sub-region summary	7
2.3. South African Outlook.....	8
2.4. Assumptions.....	9
3. THE NON-PROFIT LEGAL ENVIRONMENT.....	11
3.1. King III	11
3.2. New Companies Bill	12
4. THE PHYSICAL ENVIRONMENT	15
5. THE SOCIAL ENVIRONMENT	16

1. THE POLITICAL ENVIRONMENT

1.1. Grace before the meal

The very essence of “politics” is the human intercourse about how we are governed, where we are going, what our context is, where we find ourselves among broader humanity, and the essential and ever-changing debate about how best to divvy up limited resources.

This very short overview will not attempt to discuss politics in any depth as to do any justice to politics in such a space would be incredible. Rather, this summary tries to give an overview of broader trends affecting political and societal development and allows readers to draw their own conclusions.

1.2. Society’s political make-up

Last year’s general election results continue the entrenchment of the one-party dominant state. This should not be surprising. After all, there is no society on Earth whose history is characterised by deep racial, ethnic or religious division that has seen voters cross these divides in significant numbers with the advent of democracy. This isn’t to say that this can’t happen; just that it never has, with the remarkable exception of the United States in its election of Barack Obama as president in 2008.

Nevertheless, the 2009 April election results did signify significant change in some ways. The ANC saw its core support base shift ethnically and geographically to KwaZulu-Natal for the first time. In this province the ruling party did exceptionally well, and in every one of the other eight provinces it saw its support merely consolidate or more likely dip, if in some more spectacularly so than others.

Opposition parties also saw change, with a slow consolidation of voters taking place under the official opposition DA to the detriment of the IFP, FF+, UDM and ID. The PAC and Azapo were virtually destroyed and the newcomer Cope has subsequently seen its initial momentum diluted by internal wrangling. It could be doubted whether Cope will regain the electoral momentum again. Indeed, the nature of this society’s voting patterns could lead to opposition parties having to opt for a “coalition of the opposition” sometime soon.

The ANC, however, enjoys the very strong advantages that come from historical positioning, state patronage of the poorer classes through service provision and welfare payments of various sorts, and the dependency on it of the black middle classes through its policies of BEE and related interventions in the private sector. But all of this means that opposition to the ANC, not being accommodated in the normal opposition parties through their supporter make-up, can become factious and sometimes violent, as seen in around 500 separate incidents of “service delivery protest” in 2008 alone.

1.3. Groupings of dialogue

A unique feature of the South African political scene is that a very high proportion of personal income tax is collected from people who do not support the political party in power, and that they have no

realistic hope of seeing the parties that they do support coming to power. This uncomfortable fact has enormous and uniquely South African consequences for ordinary political discourse as different centres of power and interest are working in somewhat removed spaces from one another. Nonetheless, it should be noted that this distribution of the taxpayer base is changing; that South Africa's across-the-board ability to collect both direct and indirect taxes points to a high legitimacy of the State; and that upper quintile taxpayers form a group of increasing fluidity.

In this situation, common ground is most often found through groupings-of-interest, such as those found in business, developmental NGOs, churches, academia, the media, civic groupings, and the like. Typically, this works in interest-specific circumstances but can be less satisfactory in pushing for overall coordinated programmatic policy change. It is critical to note that in this process in South Africa, organised business has largely opted out of the public debate, leaving this to others as the seemingly most risk-averse thing to do. As a powerful home of middle class interests, and as the group most in day-to-day touch with global trends, this fact is highly detrimental to the trend of the national discourse, to providing a countervailing force to state power, and so to tempering attempts at social engineering. Late 2009 saw some incipient change to this with some hopeful signs of a more muscular approach to engaging in public debate by a combination of business and trade union personalities working to some degree in concert.

1.4. Inequality and transformation

Be that as it may, South Africa's overall picture is one of gross inequalities of outcome stemming from historical and current inequalities of opportunity and positioning. Whatever policy is adopted to try reduce inequality, it should be noted how pernicious such inequality is, and this is partly to do with the realities of long-term capital accumulation. Thus it could be argued that the destruction of the capital bases of Afrikaners of the now northern provinces during the 1899 to 1902 Boer War is still keenly evident in their economic position a century on.

When measured by the Gini coefficient (where 0 is perfect inequality and 1 is perfect equality), then SA is now the world's most unequal society in terms of income distribution. But this blunt measure tells us little about nuances of progress or the lack of it (so a uniformly disastrous economy would register high equality, but not the sort we would want). Within the inequality measures we find that the inequality ratio between the top-earning quintile of Blacks (Africans, Indians and coloureds) and the lowest quintile is higher than between that of the all-inclusive top and bottom quintiles, and that there are now more Black people in the top quintile than whites. Yet the overall income averages (and indeed those of educational qualifications, property ownership, literacy, longevity, etc.) for whites are still much higher than for Blacks in general, and Africans in particular.

In among this lie issues of ownership, and they are very difficult to untangle. Thus, who is the owner of a company whose major shareholder is a pension or insurance scheme whose own owners are

spread through the population of certain strata? And who is the ultimate owner of things owned by the state?

The easiest way, then, for social engineering that attempts to upend historical racial inequality is to determine by legislative fiat that management of private sector entities, and very loosely defined ownership of shares of these, pass to some degree to racially-defined groups of individuals, even when this redress is not linked to individual income or other economic need. Demographic representivity, presumably among the middle classes, is then the first aim, and South Africa is legislatively and in practice well down the path of attempting ownership changes in this form.

But this cannot effects ownership realities for the poorer classes and the latter must increasingly rely on the “developmental state” model adopted in President Thabo Mbeki’s second term and reiterated in President Jacob Zuma’s first for support. This has the state supply infrastructure, utilities and related services to the poor, retaining control of the means of providing these. Where services themselves are not provided, then cash in the form of welfare payments is, and the latter is probably the most efficient way of providing relief in the short term. Any notion of breaking up state-owned (or quasi-owned) utilities into shares to be distributed among the least well-off (Czech or Polish style) is simply not the on the present policy table.

Similarly, there has been little movement in transferring land ownership from the state (the country’s largest landowner, especially in rural, “communal” and tribal areas) to private African ownership through simple title conversion. Until this occurs on a far greater scale than currently envisaged, much of black South Africa will remain locked out of capital accumulation and surety against debt.

1.5. Dynamism emerging

Even so, none of the above speaks to a pre-ordained outcome in life. The situation that the country finds itself in is an increasingly dynamic one in which people who have sometimes the most base of opportunities are able to effect transformative change in their lot. And the State can indeed assist in its way.

Let’s start with jobs. President Jacob Zuma has been excoriated in the media for using his opening of parliament address to say that government would create 500 000 new jobs by this past December as a first phase of its new public works programme. Except, of course, that he had said no such thing. Rather, President Zuma spoke of the creating of “employment opportunities” which is government-speak for something different. It means low-paid, unskilled, temporary work of the sort that you come across in road works and the Working for Water and the Working on Fire programmes.

Indeed, government announced its intention in 2004 of creating 1 million such work opportunities within five years and, when 2009 duly came around, had overshoot that target by fully 400 000.

Government certainly did not achieve its current target by December but may get there by March this year. Make no mistake, this is very good news indeed.

The critical thing is that of per capita GDP growth versus that of growth in population. On 2007 figures, South Africa's population growth rate had slowed to 0,97% and will hit 0% in the next very few years. This, remember, is population growth, and is unrelated to the death rate. It is largely a normal function of urbanisation.

Against this must be seen GDP growth of an average much higher, with resultant growth, sometime to be exponential, of purchasing power parities. As economist JP Landman noted in 2007: "The beauty of SA is that per capita incomes will still rise and at an accelerating rate. In the 14 years since democracy, per capita incomes have increased by 26%. At 4% growth for the next 7 years to 2014, per capita incomes can again increase by26%!! Consider what has happened in the last 14 years, it can happen again over the next 7".

And as then-candidate Bill Clinton liked to say in 1992, "it's the economy, stupid".

2. THE ECONOMIC ENVIRONMENT

2.1. Introduction

This report aims to provide insight into the prevailing economic condition in Africa and South Africa in particular, using assumptions that are based on consensus estimates and actual data derived from the Reserve Bank of South Africa, Stats SA, African Development Bank and the International Monetary Fund. The focus is on economic variables that are expected in 2010 mindful of the political and international factors that have a direct impact on economic performance.

2.2. Africa and Southern sub-region summary

The global economic downturn has naturally had a negative impact on African economies. After five years of above 5% growth rates, Africa as a whole was expected to grow by 2.8% in 2009, down from the 5.7% expected before the global economic crisis. Growth is expected to recover to the 4.5% level in 2010 as the global economic recovery reaches this continent.

The fall in commodity prices with declining global demand has negatively impacted Africa's budget balances with the overall deficit for the continent in 2009 expected to be 5.5% of total GDP compared to a surplus of 3.4% that was expected the year before. Foreign direct investment (FDI) decreased by 10% together with a sharp decline in donor aid due to donor countries budgetary constraints.

This may see an erosion of benefits achieved during the growth phase over the last five years. Thus a 2.8% growth rate will see many Africans fall back into poverty and this trend will be protracted. The achievement of the Millennium Development goals - particularly the target of halving the share of Africans living on less than one US dollar a day by 2015 - will be beyond most countries.

The upside is that the years of sensible economic reform that enabled half a decade of growth have greatly improved Africa's competitiveness. Future progress may depend on the extent of regional and continental economic integration to allow for greater competitiveness in the global trading and financial economy.

In the Southern African subregion (SADC), growth was 7% in 2007, 5.2% in 2008 and only around 0.2% in 2009. In 2010 growth should improve markedly. Regional integration priorities set by the SADC governments (including SA) are:

- Establishment of a free trade area (2008/2009)
- Regional Customs Union (2010)
- Common market and monetary union (2015/2016)

The regional central banks have thus completed drafting a proposal for a SADC central bank model law.

2.3. South African Outlook

The overriding monetary policy condition for South Africa is that of the maintenance of price stability with the Reserve Bank tasked with, among other priorities, the maintenance of inflation within a target rate of 3-6%. This is a sometimes unpopular but necessary condition for solid and sustained economic growth. What is in question is the theoretical justification for this particular target range relative to the country's economic output, developmental and growth needs.

Average annual inflation from 1994 to date has been in the range of 6.5%. This is significantly lower than the 14% averaged from 1980 to 1994 although the inflation rate volatility in recent times has been high, induced typically by exogenous inflation drivers such as volatility in global oil prices. The rand has not helped this equation due to its extreme volatility to the US dollar, driven in large part by the dependence on short term equity, bonds and other money market foreign capital flows.

The recent increased militancy of strike actions and the upward trend in some major wage settlement offers should be an immediate cause for concern as a general wage settlement above projected inflation and above productivity gains undermines the Reserve Bank inflation targets being achieved. This results in wage increases above those of trade partners and causes an overall decline in competitiveness. Inflation in South Africa in 2009 drifted from a high of 8.1% in January to 6.7% in July and 6.4% as at August with a consensus forecast supported by the Reserve bank monetary policy committee is for an inflation rate of at least 5-6% by second quarter 2010. The new ANC government and recently appointed governor of the SARB are expected to maintain the current inflationary targeting regime under immense pressure within the ruling alliance, particularly from the Left generally and organised labour particularly, to scrap it.

The Repurchase rate (Repo) dropped by 500 basis points (5%) from December 2008 to August 2009 (11.5% to 7%). The Prime Overdraft Rate dropped from 15% to 10.5% over the corresponding period. It is expected that more pressure will be placed on banks to narrow the lending margin which is at 3.5%. The impact of imported inflation could cause some revision depending on timing and severity. However, this is unlikely if the rand maintains its strength against the dollar and oil prices are at levels of below R70 a barrel of crude.

The GDP growth outlook for 2010 is in the region of 2.5% - 3%. A successful World Cup should raise South Africa's profile and could stimulate tourism and other potential investment spinoffs in the medium term. The positive or negative effects of the capital infrastructure programme related to this event are, however, less easy to determine.

A second increase in Eskom's electricity tariff (30% in 2009) is expected to be approved for 2010 by the energy regulator. The justification provided for these increases relate to Eskom's need to invest in an extensive capitalisation/recapitalisation programme to avert the disastrous power cuts experienced in 2008 and which are still being experienced in parts of the country and by particular industries.

These increases will negatively impact the consumer and increase the costs of doing business. The net result will be increased inflationary pressures as businesses pass on these additional costs to consumers.

The recession has fuelled massive job losses in a number of economic sectors, predicted to be at levels approaching 1 million. Job creation processes will depend heavily on the level and pace of economic recovery. The IMF forecasts that South Africa needs annual GDP growth rates of above 6% for the country to make meaningful inroads in addressing unemployment and poverty. To achieve this level of economic growth, major structural changes would need to occur in the South African economy that could put the ruling alliance partners at odds.

The 2010 budget deficit is forecast to be as wide as 8% of GDP (R70 billion) due to reductions in tax revenues fuelled by the recession and increased government expenditure. The government has experienced an expenditure shift with education and social welfare receiving an increasing share of the budget at the expense of other government sectors. The social expenditure requirements on the national budget in 2010 will be severe and government will probably be forced to increase borrowing to cover the gap in the 2010 budget, including through the issuing more bonds in the local market.

2.4. Assumptions

- The inflation rate is expected to fall into the Reserve bank target of about 6% by April 2010 and may fall further into the band to 5.5% by mid year.
- Prime interest rates of 10.5% during first quarter 2010 with possibility for a 50 basis point rate cut by the second quarter 2010. This depends on the domestic inflationary outlook and on the rand staying firm with external international factors being favourable.
- Increased electricity tariffs (30%) as a form of indirect tax in 2010 to fund the Eskom capital programme and electricity imports.
- Introduction of a social security scheme and national medical aid scheme which may be financed through additional income and corporate taxes. The process to fully implement these schemes is still subject to intensive debate.
- The economy should start a slow recovery fuelled by positive global developments. South Africa's major trade partners, particularly in Asia, will be a major driver. The ratio of trade to GDP is currently at 70%, making this an important part for any possible recovery. Asia accounts for 25% of this trade ratio.

- Increase in the budget deficit to 8% of GDP due to lower revenue collections and increased fiscal pressures from rescuing troubled state enterprises, above inflation wage offers, capital expenditure requirements and increased social welfare expenditure. (*Current forecast at R70 billion for the 2010 financial year.*)
- The rand is expected to trade within the R7.5 to R8.5 ranges to the US\$ during the year. Concerns around the current account deficit, budget deficit, social stability, interest rates and international factors will weigh heavily on the level of volatility to be expected in 2010.
- Continued moves towards regional economic integration per SADC milestones. The challenges for SADC will be in dealing with governmental turmoil in Madagascar and Zimbabwe and with the Angolan elections set for this year.

3. THE NON-PROFIT LEGAL ENVIRONMENT

The areas below affect all involved in the social investment space:

3.1. King III

In contrast to the King I and II Reports, King III applies to all companies. All entities should apply the principles in the Code and consider the best practice recommendations in the Report. There is an 'apply or explain' approach specified in King III and this implies that a more considered approach to reporting and implementation is required than purely 'comply or else'. This is because a 'comply or else' approach ends up with a "tick box" approach to governance issues which does not necessarily mean that due thought has been applied to the process.

There are a number of principles in the Code. *Each principle is of equal importance and together form a holistic approach to good governance. Consequently, 'substantial' application of this Code and the Report does not in itself achieve compliance (see Introduction and background: King Code of Governance for South Africa 2009 – Institute of Directors).*

Key aspects of the above report:

- **Leadership** – good governance is essentially about effective leadership. Good leaders should display the values of responsibility, accountability, fairness and transparency. Responsible leaders direct company strategies and operations with a view to achieving sustainable economic, social and environmental performance.
- **Sustainability** – the primary moral and economic imperative of the 21st century. Nature, society and business are interconnected and this should be understood by decision-makers. There should therefore be a corresponding shift in the way companies and directors act and organise themselves
- **Corporate citizenship** – the company is a person and should operate in a sustainable manner.

There are nine affected company areas covered in the Code:

- Board and directors;
- Corporate citizenship – leadership, integrity and responsibility;
- Audit committees;
- Risk management;
- Internal audit;
- Integrated sustainability reporting and disclosure;
- Compliance;
- Managing stakeholder relationships; and

- Fundamental and affected transactions

3.1.1. Role and function of the board

- The board is the focal point for corporate governance;
- Strategy, risk performance and sustainability should be managed as inseparable matters;
- Risk management is a function of the board;
- A risk internal audit function should be appointed;
- The effectiveness of internal financial controls should form part of the board's reporting responsibility;

3.1.2. Composition of the board

- The chairman should be both independent and non-executive.

3.1.3. An annual evaluation of the board, directors and board committees should be undertaken.

3.1.4. Audit committee

- The committee should be effective with the chair a independent non-executive director;
- Responsibilities include integrated sustainable reporting;
- The committee is also responsible for oversight of internal audit, risk and reporting, internal financial controls, fraud and IT risks.

3.1.5. Risk management

- Risk philosophy should be approved by the board and there should be a risk management plan;
- Risk management process should be a part of the internal audit process;
- A risk management report should be part of the reporting process.

3.1.6. Compliance

- Effective compliance processes and frameworks should be implemented;
- Risk management should include compliance as part of its function.

The above points are only a small element of King III.

Effective date - probably 1 March 2010

3.2. New Companies Bill

Effective date – probably 1 July 2010

There two types of companies:

- Profit companies:
 - State-owned company
 - private company
 - personal liability company
 - public company
- Non profit company (NPC)

An NPC is not required to have members unless the Memorandum of Association provides for it.

There is a specific section which deals with NPCs. – Schedule 1:

- An NPC must apply all of its assets and income, however derived, to advance its stated objectives;
- May acquire and hold shares issued by a profit company;
- May directly or indirectly, alone or with any other person, carry on any business, trade or undertaking consistent with or ancillary to its stated objects;
- On winding up or dissolution net asset value must be distributed to one or more NPCs;
- A NPC may not amalgamate or merge with, or convert to a profit company or dispose of any part of its assets undertaking or business to a profit company;
- A NPC is not required to have members but its Memorandum of Incorporation may provide for it to do so.

Every section 21 company is deemed to have amended its Memorandum of Incorporation as of the general effective date to expressly state that it is a NPC and to have changed its name accordingly.

The Companies Bill applies to NPCs except for certain specified sections and must adhere to Schedule 1 as above.

The board must consist of at least three directors. A company's Memo of Inc may specify a higher number. Boards may appoint any number of committees of directors except to the extent that the Memorandum of Incorporation provides otherwise.

Except to the extent that the Memorandum of Incorporation provides otherwise:

- **The committee may include persons who are not directors but no such person may have a vote on an issue to be decided by the committee.**

NPCs do not have to have a company secretary, but there are specific functions for a company secretary. NPCs do not have to have audited financial statements but can have independently reviewed ones.

4. THE PHYSICAL ENVIRONMENT

South Africa's heavy reliance on fossil fuels has brought about a call for renewable and alternative energy sources. Around 75% of South Africa's primary energy needs are provided by coal. The Department of Science and Technology-driven Innovation Fund is looking at support for technologies that improve solar energy capturing and storage devices. The Department of Energy has recently announced its intention to launch a "green jobs" initiative to stimulate both employment and awareness of environmental sustainability. It is widely recognised that energy saving is an economic imperative together with government's intention to see carbon emissions peak by 2030.

The International Energy Agency has released a report outlining the world's energy viewpoint for the next 22 years. The report states that the world needs to invest \$26 trillion by 2030 and highlights that the world's 800 + current oil fields will experience faster declines as the industry moves offshore into smaller production fields. Carbon trading is proving contentious as some groups say that credits allow polluters off the hook to easily because they can buy their way out of making reductions at home while others believe that the reduction of gases anywhere in the world would have the same effects.

South Africa's available freshwater resources are already almost fully-utilised and under stress. At the projected population growth and economic development rates, it is unlikely that the projected demand on water resources in South Africa will be sustainable. Water is increasingly becoming the limiting resource in South Africa, and supply will become a major restriction to the future socio-economic development of the country, in terms of both the amount of water available and the quality of what is available.

South Africa's coastal and marine resources are also under considerable threat and are already severely degraded in many areas due to over-harvesting and careless urban/industrial development. Unless management of ecosystem integrity and coastal sensitivity to development is improved soon, these resources could be lost. This will make it very difficult to attain much-needed economic growth and meet basic needs in a sustainable manner. Longer term issues such as global warming and sea level rise may also need to be considered.

5. THE SOCIAL ENVIRONMENT

South Africa's population by mid-2008 was estimated to be approximately 48.7 million people while life expectancy dropped from 56.2 years to 50.5 years according to Stats SA. At the same time, the population was broken down as follows: Africans (79%), Whites (9.4%), coloured (9%) and Indians (2.6).

In 2008, 32% of the population was younger than 15 years old and 7% was 60 years or older. Limpopo had the highest number of child headed households (40 000) followed by KZN (37 000). The effect that the HIV/Aids pandemic is having on our country cannot be discounted as there has been a marked decrease between the ages of 35 – 39 in the African population. The decrease is also notable in the white population between the ages of 24 – 34.

Further to this, we have seen an increase in the number of both skilled and unskilled illegal immigrants who live from hand-to-mouth, without access to basic amenities and rights. The xenophobic attacks that occurred last year have resulted in displacement and horrendous conditions for those affected while it has been determined that most of people affected were in the country legally.

More than 10% of South Africans older than 20 years had no schooling in 2006. The number of university graduates who were unemployed decreased to 196 000 in 2007 as opposed to 229 000 in 2006. The previous Minister of Education put forward a proposal to extend three year university degrees to four years to ensure graduates are better prepared for the work place.

South Africa's school system ranks poorly among 156 developing countries. Infrastructure surveys in some schools highlight the fact that 2 891 schools have no source of water and a range of others were served by boreholes, mobile tankers, communal standpipes and yard connections. More than 7 200 girls did not attend schools as a result of pregnancy in 2006 and since 2000, 55 teachers have been struck off the roll after being found guilty of sexual offences against pupils.

Spending on early childhood development in 2007 is stated at R983 million in 2007 with a projected increase of around R600 million projected in 2008 taking the spend in this area to almost R1.5 billion.

We have seen a decrease in infant mortality rates with 46 deaths per 1 000 being reported in 2007. The rate of malnourished children had improved to 5.7 per 1 000 children in 2006 from 25 per 1 000 children in 2000. This may be attributable to the expansion of the social welfare system. At present there are in excess of 12 million people receiving some level of State support in the form of social grants. By May 2008, 8 243 240 children were benefiting from the child support grant alone.

The province with the HIV highest prevalence rate is KwaZulu-Natal where it is estimated that around 16% of people in the province are HIV positive.

While there has been a significant increase in the number of economically active people in South Africa (9 787 000 in 1997 to 16 919 000 in 2007) the number of unemployed people increased as a whole across all race groups with the exception of the Indian population. The level of inequality highlighted in the above-mentioned points presents a barrier to economic growth in South Africa and highlights the severe strain placed on our social fabric.

(Many of the statistics used above are taken from the annual SA Survey, published by the SA Institute of Race Relations.)