

Trouble in the rainbow nation

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Labour pains: public servants on strike in Johannesburg last month. Industrial action is a constant concern for multinational investors

During this year's football World Cup in South Africa, a host of multinational companies jumped at the chance to associate themselves with the event. Stadiums were surrounded by hoardings for sponsors ranging from Budweiser to Castrol. The tournament attracted attention from other foreign businesses impressed by the country's improving infrastructure, its growing consumer market and the professional management of the event.

Since then, some high-profile cases have damped sentiment, reminding investors of the challenges of doing business in South Africa, with concerns centring on corruption, government policy and labour issues.

When more than 1m civil servants walked out over pay last month in a strike that lasted 19 days, health and education services fell into disarray. Such unrest is not limited to the public sector. The strength of South Africa's large trade unions means that industrial action is a constant possibility for many companies, forcing some into wage increases at more than double the rate of inflation. That has seen South African labour costs climb well above those of many emerging market peers.

After a strike at car factories last month, Toyota, Volkswagen and General Motors agreed to a wage increase of 10 per cent. Chris Thexton, chairman of the Automobile Manufacturers Employers Association, says such strong wage pressures could threaten the long-term viability of the industry in South Africa. "This rate of increase is not something we can sustain in the long term," he says.

Meanwhile, mining companies have taken fright at a recent pair of disputes that have raised concerns about the transparency of mineral rights awards. Last month, Lonmin, the London-listed platinum miner, was told to stop mining base metals over which rights had been awarded to a company controlled by a former government minister. Kgalema Motlanthe, the country's deputy president, told the Financial Times last week that "security of tenure is guaranteed", but added that big companies like Lonmin should not expect more benefits than smaller ones.

The order to Lonmin – later reversed – came after the eruption of a row over mineral rights between the state and Anglo American, which is now set to go to court. Peter Leon, a partner at law firm Webber Wentzel, says that the case could undermine confidence in the rule of law in South Africa, seeing the country "grouped with Zimbabwe and the Democratic Republic of Congo as a destination for mining investment".

The case hit the headlines in March after Kumba Iron Ore, an Anglo American subsidiary, had an application rejected for a share of mining rights to its Sishen operation, the biggest iron ore mine in Africa. The rights share had previously belonged to the South African subsidiary of the steelmaker ArcelorMittal, which allowed Kumba to manage all mining operations in exchange for a preferential deal on iron ore supplies. ArcelorMittal failed to renew its rights in time for a state deadline last year. Kumba then stepped in with an application – but was beaten by a rival bid from Imperial, a largely unknown company whose directors include Gugu Mtshali, who is rumoured to be linked romantically to Mr Motlanthe, although neither has confirmed the reports.

Given that ArcelorMittal's failure to convert the rights was not public knowledge, there has been speculation about how Imperial learnt of the opportunity. Furthermore, Kumba alleges as part of its legal challenge numerous irregularities in Imperial's application.

Jagdish Parekh, chief executive of Imperial and a business associate of Duzane Zuma, President Jacob Zuma's son, dismissed Kumba's claims this month, saying he was "shocked at the allegations and distortions". Kumba has launched a legal challenge to the state's award of the rights and court proceedings are expected to begin early next year, says a spokeswoman for the company.

Cynthia Carroll, Anglo American CEO, insisted last month that the tussle had not deterred the company from future investment in South Africa. "Absolutely not. We are committed to South Africa; we are performing exceptionally well in our businesses," she said.

But the controversy has put other international mining companies off the country, says Peter Major, an analyst at Cadiz Corporate Solutions. "It's harder and harder to get people to look at South African mining."

Speculation about a possible nationalisation of the mines – a continual demand of the powerful African National Congress (ANC) Youth League – has added to investor jitters, despite official denials that it is part of government policy. Mr Motlanthe dismissed such calls saying they seemed to come from "people who do not know that the Treasury collects revenues from these companies".

Such words may not be enough to reassure multinational companies, Mr Major says: "This is a popular slogan. If you get populist rhetoric gaining momentum it doesn't really matter what the government says, because the government can be changed within a year or two."

ArcelorMittal, meanwhile, has attracted controversy by offering to buy Imperial and carrying out a R9bn (\$1.25bn) deal under the black economic empowerment (BEE) system that involved several of Imperial's directors, as well as Duduzane Zuma. Nonkululeko Nyembezi-Heita, CEO of ArcelorMittal's South African arm, defended the deal: "We had to contend with the fact that Imperial was now part of the firmament – we couldn't just wish them away."

A key plank of BEE is the transfer of assets into black ownership. Few argue against the reasoning behind it – intervention is necessary to redress the racially based economic imbalances that remain 16 years after the end of apartheid – but there has been criticism that the scheme has disproportionately benefited a relatively small class of wealthy individuals, often with links to the ruling ANC. "A handful of people have benefited extravagantly, and there hasn't been enough benefit to ordinary black South Africans," says Alana Bond, managing director of Bravura Consulting, which advises companies on empowerment compliance.

Energy-intensive industries like steelmaking are also threatened by rising electricity tariffs, which will increase by 25 per cent in each of the next three years. There are further fears about thinly stretched generating capacity: rolling blackouts hit the country in 2008, and are expected to return in the next few years as the economy rebounds from the recession. Concerns about security of electricity supply led Rio Tinto to cancel a planned aluminium smelter last year.

While mining and manufacturing are under pressure, the leisure and retail industries are set to benefit from strong consumption by a growing middle class. McDonald's recently announced plans to expand its South African network from 100 to 235 outlets in the next five years, while its rival KFC already has 624 restaurants in the country. Coffee chain Starbucks in May announced distribution deals with a pair of South African leisure groups – a move widely seen as a possible precursor to a roll-out of its own cafés.

Furthermore, many see a new emphasis on South Africa's role as a regional services hub – a "gateway" to the rest of Africa.

"Companies will come here to participate in the growth of Africa," says David Shapiro, a fund manager at Sasfin, a financial services group. He highlights the example of HSBC, the British bank that last month said it was seeking a 70 per cent stake in Nedbank, South Africa's fourth-biggest lender.

"We've got the infrastructure and the know-how," Mr Shapiro says. "But we've got to clean up our act on corruption and corporate governance."

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Banking precedent

As HSBC eyes South Africa's Nedbank, it will be studying the experience of Barclays. The British bank's £2.9bn move in 2005 for Absa, one of the country's big four lenders, was turbulent. Tito Mboweni, the then Reserve Bank governor, sounded a protectionist note, trade unions complained it would hold back the move towards a more equal economy and the deal was delayed by a court application demanding Barclays pay reparations for allegedly benefiting from the apartheid regime.

Eventually, the deal was waved through with the support of Thabo Mbeki, then South African president.

Barclays later had reason to be thankful. With little exposure to the US subprime market, Absa held up well during the financial crisis, contributing £552m to Barclays' pre-tax profit in 2008, or 9 per cent of the total.
