Invest in SA: Risks, mitigation & mechanisms

All investors whether they be Development Finance Institutions, multinationals, banks, and investment funds take jurisdictional investment risks into account before exploring the investments themselves.

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There are a number of key risk attributes to consider in relation to a specific country to decide whether the country is "investable" and there is a fair amount of competition between countries for international investment.

Certain industries will also be more attractive at any time for example presently commodity prices are higher, so people are interested in commodity investments. During Covid the South African agricultural sector showed great returns but is generally considered highly risky.

The main risk factors

1 Political risk

No matter what people say, the primary issue is always political risk and it can present both opportunities as well as challenges for investors. In particular, political stability is a key factor in ensuring a conducive business environment.

All investors should closely monitor political developments including changes in government policies and regulatory and legal changes. Social unrest became a high-risk factor after the riots in KwaZulu Natal and South Africa is by no means the only country to have social unrest issues.

To manage political risk, it is recommended to engage with local stakeholders, industry associations, and government bodies to provide up-to-date insights and help assist mitigate political risks.

2 Economic risk

The South African economy virtually ground to a halt during Covid and unfortunately, the economy faces various risks including slow economic growth, very high unemployment rates possibly the highest in the world, and inflation rates (although there are indications that this may be stabilising).

Investors have to evaluate the economic climate and assess the factors such as GDP growth, fiscal policies, interest rates and inflation rates. Many investors use diversification strategies across sectors to mitigate economic risks.

3 Grey listing

South Africa's grey listing by the Financial Action Task Force (FATF) will result in increased scrutiny, due diligence, stringent regulations, and increased compliance and associated costs. Investor confidence has been affected, which could result in a decrease in foreign direct investments and cash flows. It is imperative that money laundering concerns are effectively addressed at all levels.

4 Power outage risk

The risk of power outages and potentially even grid collapse is a significant concern for South African businesses and all investors. These outages have varying impacts on different sectors of the economy.

Whether an investor is looking at investing in a retail business, a manufacturing business, or even a financial services business, it is essential to make provision for the energy crisis and consider its impact on the bottom line.

5 Crime

SA's crime rates have been well-publicised internationally and pose a significant challenge to South Africans and foreign investors. Corruption in particular is currently one of the biggest bugbears of all investors and that is why many now have specific policies identifying issues such as corruption, collusion, anti-bribery, and conflicts of interest.

It is thus essential to assess the security situation in the specific sector and place of business and implement robust security measures in order to protect assets, employees, and operations. Presently South African business is trying to work together with the government to tackle the barrage of crime. It is recommended that investors engage security experts to provide guidance on risk mitigation strategies and consider insurance options and costs.

6 Foreign exchange risk

The foreign exchange rates are highly fluctuating and presently there is a downward trend in ZAR against all major currencies. Weak exchange rates favour exporting businesses.

Most international businesses develop strategies to manage currency risks including hedging strategies, diversifying revenue streams, and managing balanced currency exposures.

7 Market risk

The general trend in Africa was to see growth in the middle class and in buying power however, this is no longer as certain.

Investors have to do market research to identify specific target segments, preferences, and potential barriers to entry. Competitive Pricing in particular is essential in South Africa along with effective supply chain and logistics.

8 Taxation risk

Corporate and personal tax rates are high which constitute a significant tax risk. It's important to consider withholding taxes on dividends, interest and royalties but fortunately SA has a large double taxation network. Exchange control is also a noteworthy challenge for foreign investors.

Mechanisms for investing in South Africa

1. Direct investment

This requires establishing a physical presence in the country by setting up subsidiaries, branches, or joint ventures with local companies. This route provides more control over operations and allows for direct engagement with the local market.

Joint ventures are quite common especially to ensure that companies have the correct empowerment status. Note joint ventures are complex constructs requiring significant legal agreements, structures, and operations.

Certain industries do have more regulation e.g. financial services, medical, and the relevant licenses /authorisations need to be acquired before one can operate.

The structuring of the investment vehicle is essential to manage tax regulations, especially dividends, interest, and royalties. Robust labour laws can be challenging for some investors and it's best to obtain local advice on how to manage recruitment and ongoing operations correctly.

2. Portfolio investments

Where investors do not wish to have direct operational involvement they can invest by buying shares in publicly listed companies, mutual funds, or alternatively private equity funds which may be more general or have a specific industry target.

3. Public-private partnerships (PPPs)

PPPs involve collaboration between the government and private sector to set up and operate projects including infrastructure, construction, transportation, energy, or telecommunications.

The process is complex and highly regulated. To participate requires bidding for contracts through tender process and forming a joint venture with local partners to provide the necessary skills and B-BBEE credentials. With the current power crisis, there are significant investments being made into the renewable energy projects. The PPP mechanism is designed as a shared risk model and may also provide long-term investment opportunities.

4. Greenfield investments

As the name implies greenfield investments involve building from scratch a new operation such as a factory, facility, or even a mining operation. There is significant interest in the mining of rare earth metals in South Africa presently.

5. Mergers and acquisitions

Many multinational corporations consider M&A as a way to enter the South African market or to expand their existing operations. SA companies have been targeted by international companies such as MNCs and funds for investment and expansion.

Acquiring or merging with existing companies allows for quick market entry and access to established customer bases, distribution networks, and local expertise. M&A activities are also heavily legally focused and will involve thorough due diligence, structuring opportunities, legal considerations, valuations, etc.

6. First loss

Development finance institutions perform a valuable function when they use the concept of first loss to reduce risk in their investment portfolios. The DFI takes the first portion of any potential loss incurred in an investment, thereby cushioning the other investors' risk.

South Africans are problem solvers

While we live in challenging times it's important to remember that this country has produced some world-class inventions, companies, and technological skills. South Africans are problem solvers whose solutions transport very well to other economies both in emerging markets and developed markets. ■

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