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THE **SOCIAL VALUE** OF BUSINESS

An analysis of the role of business in South African society

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About this report

This report was commissioned by Business Leadership South Africa to support public insight into business and its role in South Africa. It was independently produced by Stuart Theobald of Intellidex. It consists of conceptual analysis and data drawn from a variety of official sources.

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Cover image: Pieter Bruegel the Elder's Netherlandish Proverbs.

BUSINESS LEADERSHIP SOUTH AFRICA

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Introduction

There are many ways to define what "business" is.

All of us are in some sense involved in business whenever we do something that is intended to earn us a return, either in the form of wages, profits from investment, or less tangible benefits. This is true in every country in the world. But how successful we are depends on the business environment in which we find ourselves. An entrepreneur will make no progress if she can't find suppliers of the necessary inputs, or staff with the skills she needs to produce her goods or services, or financing to enable her to set up her business. It also matters whether the environment provides the right infrastructure for her to operate and whether there is enforcement of laws so she can rely on agreements with customers and suppliers. Some of these depend on the rest of the business sector, such as access to finance and suppliers of goods and services. Others, such as most transport infrastructure and law and order, depend on the government. A healthy business environment requires both effective businesses operating in it and an effective government that can help support the environment. Government in turn depends on a healthy business sector that can generate growing tax revenue for government to deliver on its social objectives. Business and government need each other to be as effective as possible.

This report focuses on the social value that the business sector creates in South Africa. The overarching argument is that the existing business sector is an important asset to the country. It is one that generates returns for all South Africans, helping to create the kind of country we want. It creates jobs, provides goods and services, generates wealth and contributes taxes that fund most public services. It also contributes to a business environment that supports entrepreneurs and produces goods and services that all South Africans can consume. Since the dawn of democracy it has grown in size, changed its racial composition, created millions of jobs and dramatically increased the billions it pays in wages. Its impact is seldom looked at in isolation and appreciated for what it is. This report explains the ways that business affects our society and draws out data to show the quantum of these effects. Business is an asset that makes many things possible in South Africa.

There are also ills. Some businesses have been caught up in corruption including cartels and other illegal activity. We have to constantly be vigilant about corruption. We do, however, have a culture of vigilance. South Africa has a well-developed investment industry that ensures close monitoring of listed companies by analysts and regulators. South Africa's world-leading corporate governance regulations aim to ensure that our companies have effective boards that strive to guide companies to sustainable activities that deliver for stakeholders. This allows companies to act as instruments for the delivery of returns for shareholders, among other objectives.

While this objective goes wrong at times, particularly when the management and employees of companies engage in illegal activity in an effort to capture illicit gains for themselves, the governance frameworks provide the mechanisms for redress. It is for this reason that it is often companies themselves that turn to regulators, such as the Competition Commission, to report wrong doing they may have encountered within their own businesses. Companies can only be instruments of those who lead them. The leadership of corporate South Africa functions within a detailed institutional framework to ensure that companies are well managed. Companies are also accountable. Even when regulators fail to act, clients, shareholders and other stakeholders demand that companies meet high standards of behaviour. Recent examples such as KPMG and McKinsey show how clients can react when companies are found lacking in standards of behaviour.

This should be contrasted with companies that are instruments for other purposes. Unfortunately, we have seen several recent examples of companies that are instruments for rent-seeking from tenders, money laundering and other corruption. Some have suggested these are examples of a general type, that all companies can be painted with the same brush. This is wrong. To see the difference, ask who the principals of the company are – the board and shareholders – and what they intend to achieve with the company. In South Africa, it is a great strength that the answer is usually to deliver on fiduciary responsibilities to pensioners, insurance beneficiaries and other savers who are the ultimate owners of companies in the formal business sector. When their companies get caught up in corruption, it is to the harm of those principals. Share prices are damaged causing pension funds and other savers to lose value. Shareholders have a strong incentive to weed corruption out from their companies. They don't always get it right, but the incentives to try are clear.

South Africa is a substantial middle-income economy. It has a large industrial sector that means our economy can add a great deal of value to inputs in the process of creating outputs. This can be contrasted with many other developing countries, where the manufacturing sectors take intermediate inputs and add limited value in creating outputs. In South Africa, our economy can straddle the value chain from the planting of seeds right through to the sale of finished goods to consumers. For instance, we can grow Rooibos tea, then dry and process it in an agriprocessing plant, then package it into tea bags with paper made in South Africa, and package that into boxes made and printed in South Africa, before sealing them with cellophane made in South Africa. The process can be performed by machines engineered in South Africa in a factory built by a South African construction firm. The company can be financed by equity raised on the Johannesburg Stock Exchange and debt from the local banking system. The fact that all of these stages in a supply chain can be fulfilled by South African businesses is a major strength. Many other developing countries are able to perform only one or two segments of such a supply chain, often relying on inputs that are mostly complete. That means end products are more expensive, fewer people are employed in the country and less tax is paid.

This strength is seldom acknowledged. Instead, the public domain is often a space for the propagation of myths about business. The myth that all businesses are corrupt is one of them. But other myths abound: that businesses externalise profits instead of investing; that companies are foreign owned; that business is white; that business is selfish and only enriches itself. These myths are dangerous, because they negatively influence public perceptions that could lead to harmful policy decisions. Every national priority – creating employment, alleviating poverty, reducing inequality – can be achieved only if we nurture and grow the economy. A growing economy leads to more taxes to fund social services, increased savings to fund investment and increased employment. But to get the economy to grow, we need an efficient and capable government that can develop and implement policy – setting the rules in which businesses can thrive – while delivering the broader infrastructure and services that are essential for business to operate.

This report confronts the myths head on. We explain at the conceptual level how business works. Often, what is lacking is an understanding of the fundamentals of the business environment and drivers of business behaviour. When made explicit, it becomes clear that the myths are false. We then also consider the data on just how much business contributes to society.

Executive summary: the myths and the facts

1	Business uses its power and resources to extract rents from the public	• Business is about adding value to inputs to sell outputs at a higher price. • Rent seeking occurs when parties unnecessarily intermediate between value-adders and recipients. • In SA, business added R3.2bn of value to the economy in 2016, out of GDP of R4.3bn. (StatsSA figures)
2	Business is white	• In 1994, the workforce was 21% white, 63% black and 17% Indian/Coloured; proportionately white at higher skills levels. • By 2014, the workforce had grown by 68%, was 72% black and 15% Indian/Coloured. • But the real change is in skill levels. Black African, Indian and Coloured members of the workforce now make up 82.5% of the semi- and skilled-workers from 69.7%. • So while the total workforce has been growing, the rate of growth of black people in semi- and high-skilled jobs has been even higher. (StatsSA figures)
3	Business externalises its profits	• The reality is mixed. South Africans invest abroad and foreigners invest here. • In 2015 (thanks to rand weakness) the total value of SA investments abroad (now R6.3trn) overtook the value of foreign investments in SA (R5.6trn). • While dividend flows favour foreign investors, this is changing as SA investments mature. Dividend outflows are now 2.1 times inflows, down from 4.1 times in 2009. • This cross-border investment pattern facilitates skills transfer and linkages to support international trade and integration of SA into the world economy. Drives competitiveness. (Reserve Bank figures)
4	Business does not create jobs	• Employment growth is strongest during periods of economic growth, disproving the notion of "jobless growth". • During the 2009 recession, formal sector employment shrank 2.5% when the economy shrank 1.5%. • Since 2010, 1.4-millions jobs have been added. (StatsSA QES figures)
5	Business does not invest and grow the economy	• Business has and does invest billions. The volumes closely track economic growth. • The amount invested has grown every year since 1994, accelerating sharply up to 2008. It began recovering in 2011, but has been tapering in the past few years. Nevertheless, business invested R859bn in 2015 in building to expand the economy, the most ever. • Business will invest when the outlook for risk-adjusted returns is higher than the cost of capital. Policy uncertainty makes predicting the future more uncertain and therefore reduces investment volumes. (StatsSA and Reserve Bank figures)

6	Business is selfish	• Business pays significant amounts of tax, wages to employees and investment in communities. • In 2016, corporate income tax collected was R192bn, enough to cover the social grants budget and budget for higher education, combined. • In the same year, R389bn of employee tax was collected by business. • While corporate income tax has been growing, it has become a smaller proportion of the total tax collected since the 2009 recession, from 24% to 18%. This is because economic conditions have constrained company profitability. Economic growth leads to higher corporate income tax collection. • Business invests in communities supporting them with clinics, other social infrastructure. • In nominal terms, the amount paid by businesses in the formal sector to employees has risen from R212bn per year to R585bn over the last 10 years. • In 2016, business spent R8.6bn on corporate social investment, money to help develop communities. This has risen from R3.2bn 10 years ago. (StatsSA (QES), Trialogue and Sars figures)
7	Business is corrupt	• South Africa has a well-developed investment industry that closely monitors companies. Shareholders are hurt by corruption and demand high standards from companies, hence the creation of tools like the King Code. • It is still possible for individuals within companies to commit criminal acts for personal gain. Business must be vigilant to fight against this. When wrongdoing is discovered, businesses should approach the authorities. • Businesses are instruments of their shareholders. Businesses can be corrupt when they are used by their owners to achieve corrupt outcomes. We need vigilant, capable, investigatory and prosecution services to minimise this. However, the large business sector is owned mostly by institutional shareholders who do not intend companies to be corrupt. When they are caught up in corruption they are made to be accountable by shareholders and other companies.

1 The overall theme: Business as a national asset

Business is a national asset in South Africa because it generates value. "Value" is a tricky concept to understand. In principle, every voluntary transaction between two parties is undertaken because each wants what the other has. By transacting, each is made better off. The value after the transaction is greater than before the transaction. But it is very difficult to measure this value because it really consists within something intangible, a personal sense of value rather than a hard monetary measure. For this reason, economists often talk about "utility" maximisation rather than profit or some other monetary measure. But when it comes to measuring economic activity, the numbers are all we have to go on, and we interrogate these in this section.

The value that business adds in the economy is what makes it an asset. That return is distributed to employees, shareholders, lenders and the government, and is used to finance investment to generate future value. We can think of business as an asset because it provides a "return" in this form – the addition of value to the country. The value is then subject to taxation, so it is essential to the funding of the government. Business is the goose that lays the golden eggs for the entire country. It is a critical component of building a successful South Africa and it must be protected and nurtured.

What do we mean by adding value?

Here is an example where both parties are made better off.

Before	After
Every day Thando has to walk 7km to work. This means she has less time to spend with her family. She also has less time for her home business of mending clothes for her neighbours.	A taxi driver decides to start a new route. Thando can now get to work in 20 minutes by paying R7.50 per trip. This not only gives her more time to spend with her family but also to mend clothes. The money she earns from clothes mending is more than the cost of the taxi. Thando's life overall is now much better. The taxi operator also is better off because of the income he can earn from his service.

Clearly value has been created for both Thando and the taxi driver. The problem is that measuring this value is difficult. We focus on the prices – Thando effectively makes a "profit" through the extra earnings from clothes mending, and the taxi driver makes a profit from the fares he collects. We measure this figure and call it "value added". It is the key part of calculating GDP – it is the "domestic product" of the economy. While the value that both parties gain from the transaction is partly intangible, we can capture a significant part of it by measuring the financial gain to each party.

An asset is a good that provides a return. Some offer returns that are intangible. For example, many of the personal assets we own such as cars and houses provide returns like a sense of comfort or convenience that don't have obvious monetary value. Other assets provide a return in the form of cash flows, like shares and bonds. There is no direct value in a share or bond certificate, for example. Their value stems from the fact that the holder has a right to a certain set of cash flows.

Business is an asset in this sense. It generates cash flows. Those cash flows touch on every single person in South Africa, whenever they use the public infrastructure that is paid for by public spending, or whether they own shares in companies. Business adds much more value than this, though, because it produces the goods and services that help us to live the kind of life we want to. Everything we buy is provided by a business, whether it be small businesses in our communities or giant multinationals. The goods and services they provide add value to our lives.

We want business to add value in our societies and to maximise this value. When this happens, the surplus available grows and larger amounts of tax, salaries, dividends and investment can take place.

Business can add value and grow this value in many ways. Here are some of them:

1. Innovations that make things possible or lower their cost. For example, money transfer services that mean people don’t have to undertake expense and risky activities to execute themselves.
2. Any exchange where both sides walk away better off than when they come together. Almost all businesses are like this. A township hair dresser provides services in exchange for money. Both she and her client are better off after the exchange.
3. Any process that makes a product or service worth more at the end of the process than the beginning. So if I bake a loaf of bread, the bread is worth more than the flour, eggs and other ingredients I started with.
4. Big businesses are usually doing all three of these things:
    a. Businesses are innovating and creating products that make our lives better. Think of the huge difference to our lives that some of the products introduced just in the past two decades have made: cell phones, electronic money transfer services, satellite TV, fibre internet, among many.
    b. As customers, we buy their goods and services because we are better off after the exchange (so business maximises “utility”, that intangible notion of well-being that each side of a transaction gains from it).
    c. Many process intermediate goods into finished products. They produce food (eg Nestle, Tiger Brands), build buildings (Murray & Roberts, Aveng), provide services (Imperial, Bidvest, the banks and retailers).

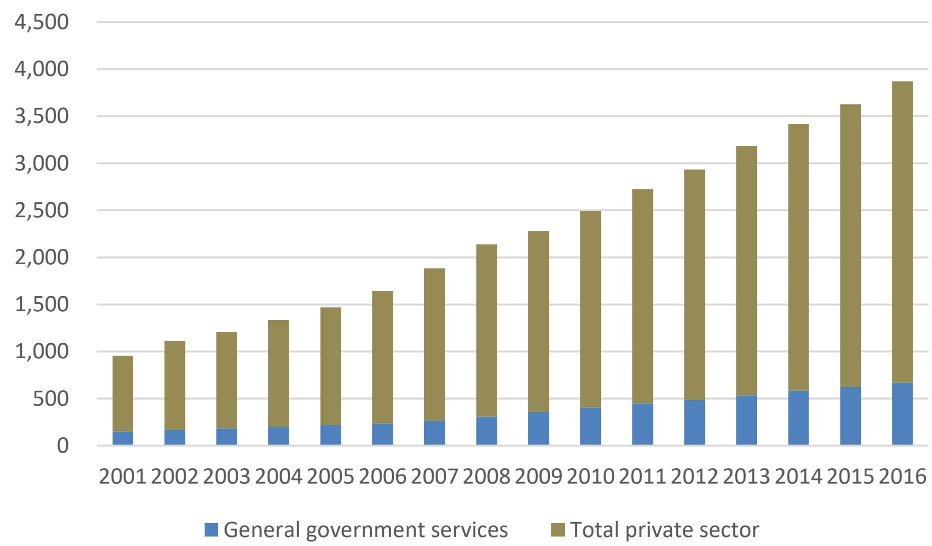
Measuring the value that business adds

The value that business adds is the difference between the cost of inputs and the value of outputs. This is known as “value added” and is measured by Statistics South Africa whenever it measures economic activity.

It is determined by taking the price of finished goods and deducting the price of intermediate goods that went into producing them. The difference is the value added. That amount is used to pay salaries, interest on loans, dividends to shareholders and to finance the company’s growth.

Here is an illustration of how value added has increased, showing both the private sector and government services. The key insight is that over the past 15 years, it has grown from R803m to R3.2bn, an increase of almost 400%.

Figure -: Total value added by companies (Rbn, current prices)



Every business is both a consumer and a producer. It takes inputs, processes them and creates outputs. “Final consumption” refers to consumers who end up consuming goods in their final finished form. Many businesses occupy different points on the value chain. They could be producing raw materials like agricultural output, intermediate goods like chemicals or final goods like finished food products. Each business at each step of the way is taking inputs and adding value to them before selling their outputs. Those outputs can form the inputs of the next step in a value chain, or can be the final goods that are consumed by the public.

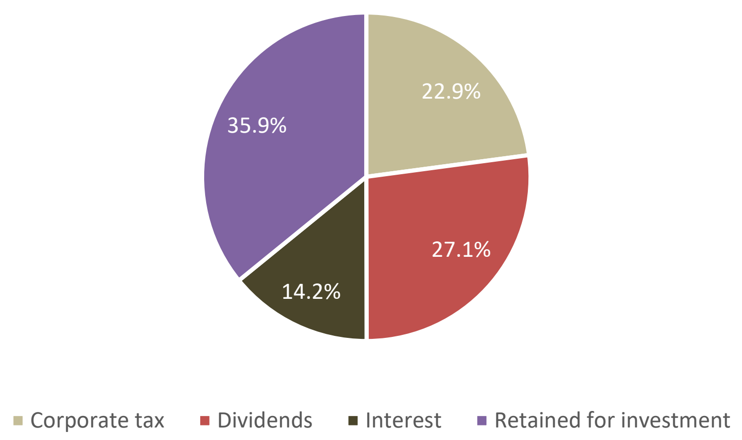
Data from StatsSA for the most recent year (2015) shows the following:

Total output of all businesses:	R7 921bn
Intermediate consumption:	R4 295bn
Gross value added:	R3 645bn
Compensation of employees:	R1 903bn
Gross operating surplus:	**R1 652bn**

The gross value added is every company's value added, added together. Companies are both suppliers and consumers, so one company's consumption will be of other companies' production. Consumption includes services like telecommunications, bank charges, rent of land and buildings, and so on, as well as the raw ingredients that go into producing goods. The gross value added figure represents the total value that companies have added to inputs. From this amount (R3.65trn), money is paid to employees (R1.90trn). The balance is then split between government (taxes), lenders, shareholders and money retained to invest.

We can estimate approximately how this is distributed by extrapolating from data that StatsSA collects from companies' annual financial statements.

Figure 1: Distribution of value added by companies



Dividends and interest are paid to the providers of capital – shareholders and lenders – and represent their return for taking on the risk of financing companies. The money that companies retain for investment is the money they can use to expand their operations. This is a key driver of economic growth, enabling companies to invest in additional capacity, hire new employees and expand the value they add in the economy. The larger this amount is, the greater economic growth will be.

We traditionally think of dividends and the money retained for investment as the profits of companies, after tax. Profitability is crucial to drive taxes and investment. As we will show in section 6, when profitability is constrained, taxes fall and investment slows down.

The distribution of surplus in Figure 2 includes corporate tax, but there are many other taxes that occur before this. In particular, employees pay PAYE, the single biggest form of tax. Also, the total value added is subject to Value-Added Tax. So, the more value that is generated in the economy, the more VAT is collected. There are many other minor taxes such as excise duties and the fuel levy that companies pay as a tax on their inputs. The healthier a business is and the more it grows, the more funding government will have access to for it to fund the social objectives we all desire, including health and education.

It is important to understand this process of adding value and distributing it between different types of recipients in order to see the crucial role that business plays in the economy. It touches every part of our society, providing employment, creating value that is taxed and creating profits that can be used to finance investment and economic growth. Understanding both the way value added is measured, as well as the philosophical concept of value addition, helps to make clear what kinds of businesses are good for society and which are not. Businesses that are able to add significant value to their inputs are those that do the most to make society better off. Other businesses that do not add any value, for example by intermediating themselves unnecessarily between producers and consumers, do not help society. In the sections that follow we make this distinction clearer.

In what follows, we confront several myths about business. It is important to us at this stage of South Africa's history and given current national debates, to establish the importance of business as a type of institution that underpins the wellbeing of every South African. Some of the myths about business threaten its ability to add value and therefore threaten the entire country.

2 Myth: Business uses its power to extract rents and resources from the public

The reality check: Businesses compete for their customers

In a competitive economy, businesses attract customers by offering better value than alternatives. Policy and regulations can guide competitiveness. One good example of this is the Renewable Energy Independent Power Producers' Programme. The South African government designed this programme so that different producers bid a price at which they can supply electricity. This was effective policy in that it lowered renewable energy prices in South Africa dramatically. This approach has now been implemented in several other countries and has had dramatic effects on the cost of power production. Energy is a major cost item for the entire economy, so lowering its cost has a significant impact on all economic activity. This is a good example of how competition can be used to drive down prices and add more value to an economy.

The Competition Commission is an active regulator that enforces competition law and has successfully prosecuted several companies that have engaged in uncompetitive behaviour. This sets a strong example and has served to drive businesses to be cautious about uncompetitive behaviour.

When consumers have choice, they have the power to get companies to conform to their will. In a competitive economy, companies aspire to attract customers by selling products that are better than competitors'. The more competitive it is, the better the products and services consumers have access to.

What is rent-seeking?

Rents are about capturing wealth rather than creating it. For example, whenever someone positions themselves as an intermediary between a buyer and seller, without offering value to either side, they can use their position to extract rents on the transaction. This can occur with government tenders, where someone positions themselves as the gate keeper and demands payment. Rent seeking adds no value to an economy as it tries to capture economic value rather than create it. It damages economies by harming returns to real value-adding economic activity.

A key part of this process is innovation. Companies come up with new inventions and new ways of doing things that make their products cheaper or more useful to consumers. For examples, South

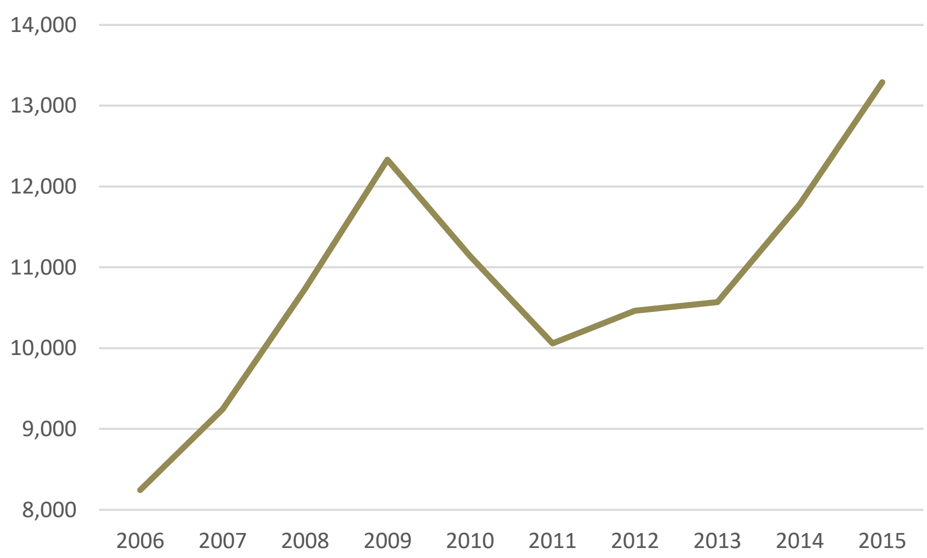
African banks have pioneered the electronic transfer of money to people who don't have a bank account. You can SMS a code to someone that enables them to draw cash from an ATM, even if they don't have a bank account or bank card.

Businesses often partner with government to deliver innovative solutions that make citizens' lives easier. The renewable energy programme is a good example. Another is Med-e-Mass, part of the Altron group of companies. In Altron 2016 partnered with the City of Johannesburg to improve healthcare delivery by changing from paper-based patient health records to an electronic health platform with the Electronic Health Record system. The digitisation project created a single body of patient records easily accessible to healthcare workers. A total of 81 clinics in the City of Johannesburg have been linked to the system.

No matter which hospital or clinic a patient goes to, healthcare workers are able to access their records, making it easier to improve turnaround times, services, record keeping and the overall patient experience. With the eHealth@Joburg facility, healthcare workers will use technology to improve health delivery, reduce clinic waiting times, improve patient record keeping and ultimately improve patient health care. This benefits government health workers, business and the public.

In 2014/15, businesses spent R13.3bn on research and development, which was 45% of total R&D spending in the country (the balance is done by universities and science councils). This amount fluctuates with the economic cycle, but has recovered strongly after the financial crisis of 2008/9 as you can see in Figure 3.

Figure 2: R&D spending by South African companies (Rm)



(source: Human Sciences Research Council)

The country's economic growth after 1994 was significantly higher than it was in the decade before. Interestingly, this was driven much more by innovation and improvements in the use of existing capacity than it was from the creation of new capacity[1]. This has both positive and negative implications. On the positive, it means SA business became far more efficient at using what it had in terms of capital and labour. On the negative, it meant that less labour was absorbed to support that growth. But this factor also drives something that is clearer in the next section, which is that the labour force has become more skilled.

3 Myth: Business is white

The reality check: Since democracy, business has changed

Imagine a company in 1994 of 100 people and the same company 20 years later in 2014. How would a picture of that company look? How would it have grown, how would the occupations of people working there have changed, and most importantly, the colour of the workforce changed?

Let's start with skill levels. Our photo of 100 people would have changed in the following ways:

	1994	2014
High skilled (managerial, technical)	20	42 (108% growth)
Semi-skilled	47	78 (66% growth)
Low-skilled	33	49 (49% growth)
Total	100	170 (69% growth)

(Source: StatsSA)

This shows that there has been a proportional shift into higher skilled workers. Our economy has become less driven by unskilled workers and more by high skilled workers. So skills are being created in the economy, which means employees are becoming more productive and able to earn higher salaries. The number of skilled workers is growing as a bigger slice of the overall growth in the size of the workforce.

Now, let's look at the company photo in terms of race, and we will again see some significant changes. The work force has become proportionately much blacker, and this has happened at all skill levels. In our photo, the growth of the workforce has a strong racial dynamic. While the growth has been 69% overall, it has been much higher for black Africans. So our picture will have changed quite a bit, not only in having more skilled people, but also in having proportionately more black people.

The numbers of people in our workforce, broken down by race are:

	1994	2014
White	21	23 (9% more)
Indian/Asian	4	6 (47%)
Coloured	13	19 (45%)
Black African	63	122 (95%)
TOTAL	100	169

[1] https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2003/_wp03178.ashx

So our company of 100 would have grown to 168 people. But this change in racial composition of the workforce is also reflected at different skills levels.

	Highly skilled		Semi-skilled		Unskilled	
	1994	2014	1994	2014	1994	2014
White	8	13	11	8	1	1
Indian/Asian	1	3	2	2	0	0
Coloured	1	4	7	9	5	5
Black African	9	22	26	59	28	43

The photo makes a few things clear:

- The number of skilled workers has grown more than less skilled workers.
- The number of black workers has grown at every skill level, but particularly highly skilled.

The shift of workers into higher skilled roles has a negative implication in that it means the economy is less geared to absorb low skilled workers. The reason for the shift to higher skilled workers is because the economy has become more services-focused, which requires skilled workers. Our unemployment problem is at the level of unskilled workers and the changing structure of the economy exacerbates the problem. Nevertheless, there has been growth of 49% in the number of unskilled workers, even though the number of higher skilled workers has grown faster. As we show in section six, salaries have grown faster than employment levels, and that is partly driven by the increase in average skill levels.

These macro numbers show the state of the economy as a whole, but there are many specific examples of black-run and owned companies. By ensuring an active and growing economy, these businesses have the opportunity to become long term success stories.

4. Myth: Business externalises profits

The reality check: Foreigners own assets in SA and South Africans own assets abroad. It's a two-way street that maximises efficiency

There is a perception that the South African economy is owned by foreign corporations and South Africans who send their profits abroad. The real picture is much more mixed – South Africans, at the moment, own more assets abroad than foreigners own in South Africa. It is a good thing that there are cross-border ownership patterns like this. Multinationals in South Africa bring skills, knowledge and capital to the economy while South African companies are able to take their skills and know-how to the rest of the world to generate revenue. This enhances efficiency – for example Sasol can build gas-to-liquids plants in Qatar that allow it to generate much better returns than if it tried to build it in a saturated South African market. On the other hand, we're better off having a highly efficient foreign-owned operation in South Africa like Unilever, than if we tried to replicate it in South Africa, because it can create products at lower prices and add more value in the economy.

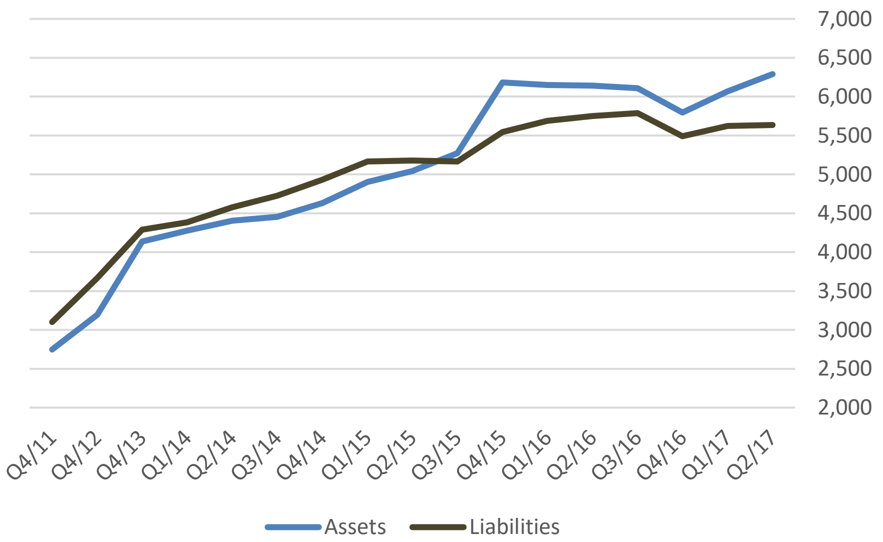
The Data

From a macro-perspective, since 1994, there has been a dramatic inflow of capital from the rest of the world into South Africa. This investment has financed a great deal of development. It has also brought international linkages and skills to the country. Because savings levels in South Africa were very low when apartheid ended, we needed foreign capital to invest in order to grow the economy.

While South Africans have also invested abroad this is traditionally not seen as significant. Things have changed recently though. Due to some major disinvestments (particularly Barclays exiting from Absa) and weakness in the rand, the total investment by South Africans abroad has overtaken the value of the total investments by foreigners in South Africa[2]. This can be seen as good or bad: the value of South Africans' assets abroad has grown, though this is primarily because the rand has been weakening, while foreign investors have been withdrawing. The figures include both direct investment and portfolio investment.

Examples of South Africans investing abroad include the banking groups buying banks in the rest of Africa and Sasol's major investments in Qatar and the United States.

Figure 3: South Africa's international investment position (Rbn)



(source: SA Reserve Bank).

This investment position results in dividends flowing to foreigners abroad for their assets in SA, and dividends flowing to South Africans for their assets in the rest of the world. This picture does not look so good for South Africa and it is a major contributor to the negative position of the current account of the balance of payments. But the trend is in the right direction, as dividend receipts have been growing relative to dividend payments. The table above suggests this trend will continue because South Africans now own relatively more abroad than foreigners own in South Africa.

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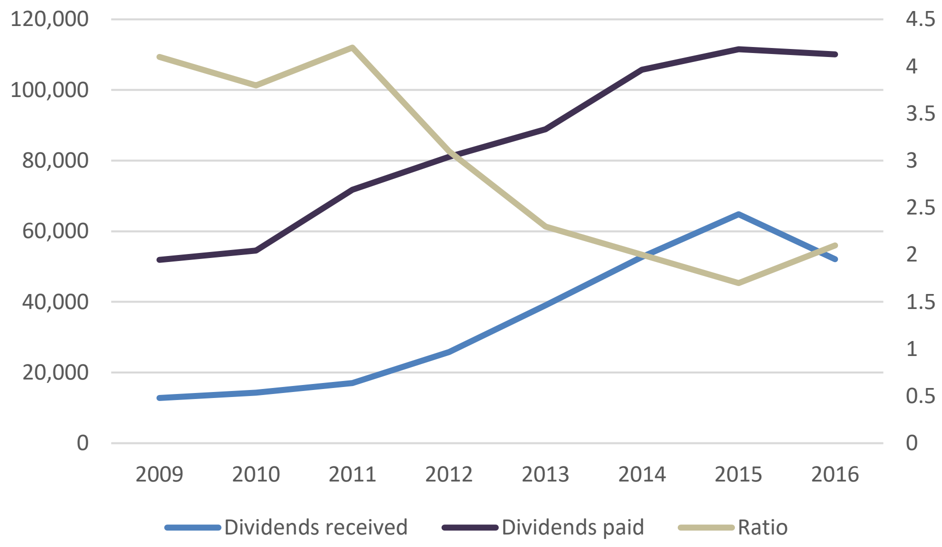
2 https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8002/IIP%20internet%20summary%20-%20June%202017.pdf

Figure 4: Dividends received and dividends paid (Rm, LHS) and the ratio between them (RHS)



(source: SA Reserve Bank)

5 Myth: Business does not create jobs

The reality check: Business has created millions of jobs over the past decade, especially when the economy is growing

There is a general confusion between unemployment and job creation. The good fact about South Africa is that we've added 6.4-million jobs since democracy (based on StatsSA's Quarterly Labour Force Survey), but the sad fact is that the need for jobs has grown faster. We should not ignore the positive though – business has and does create jobs. With the right policy environment, it could add more.

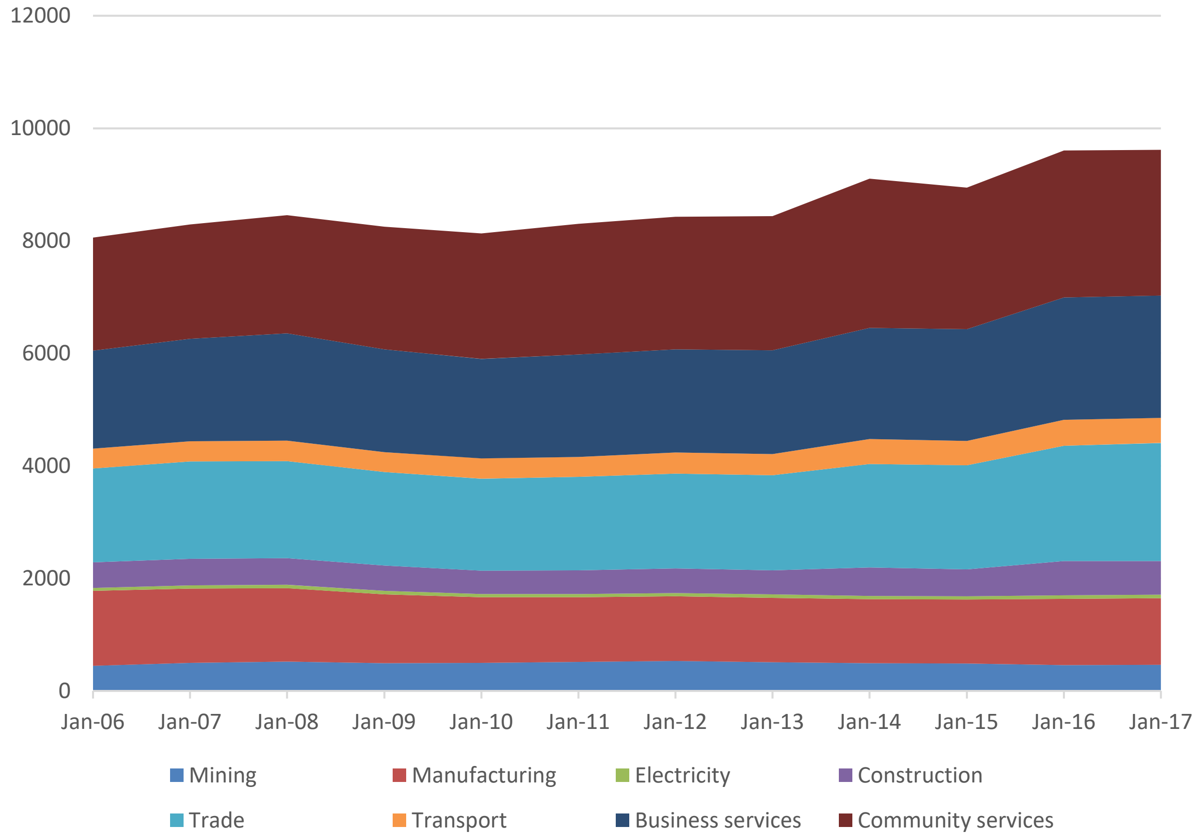
One myth is that growth has been "jobless". This is the idea that even when the economy was growing at 4% in the mid-2000s, it was not creating jobs. The data do not support this contention. Employment follows the same trend as the broader economy, even though structurally the labour force has become relatively more highly skilled.

The data

The data we examine come from the StatsSA Quarterly Employment Survey (note that this is different to the Quarterly Labour Force Survey that is used to calculate unemployment – the QES is a survey of 20 000 VAT-registered businesses asking about their employee numbers, which is then extrapolated to the economy as a whole. So it's the formal business sector and consequently the numbers are smaller than the QLFS survey figures). Unfortunately, QES only goes back to 2006 when the survey was created. It succeeded the "Survey of Employment and Earnings", but the basis for that survey was very different, so the numbers are incomparable.

What we do have, leads to a graph like this:

Figure 5: Total people employed, by economic sector in '000. From QES

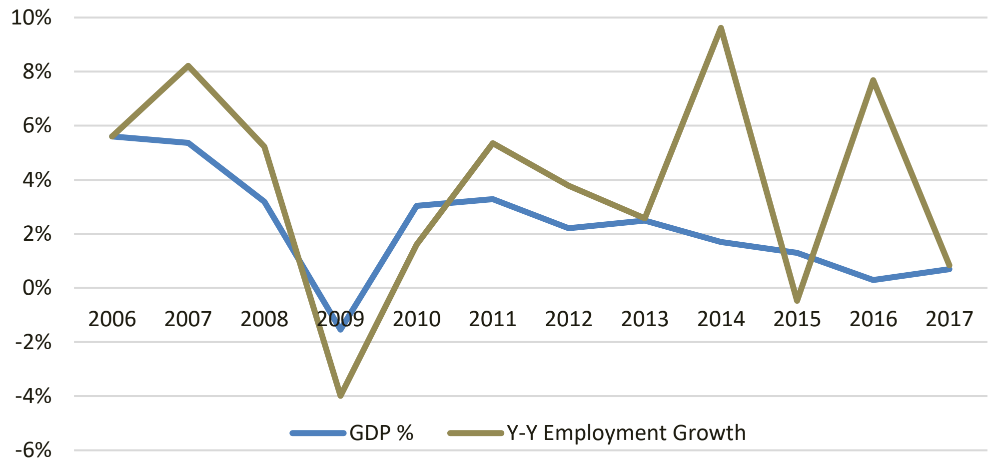


This shows that the number of people employed has grown by 1.6m people over the period (growth of 20%). Much of this has happened in the past four years, during which 1.2m jobs have been added (growth of 14%).

The industry segmentation shows that growth has been in trade and services. There has been little employment in mining.

To see how GDP affects employment, Figure 7 plots year-on-year employment growth, as per the QES, against GDP growth. Employment was sharply negatively affected by the 2008 recession, but has since seen significant growth in some years. The volatility in employment growth reflects considerable business uncertainty in the recovery since the financial crisis, however the relationship between employment growth and economic growth seems to be clear.

Figure 6: Employment growth compared to GDP growth (2010 constant prices)



6 Myth: Business does not invest to grow the economy

Reality check: Business invests billions every year to expand operations. But it can do so only when the prospective returns justify the risk. Policy can make a big difference to how much investment happens by improving the risk and return outlook.

The fact is that business is investing extensively. But companies (and anyone else) can only invest when the "net present value" of a potential investment is positive, i.e. when the returns compensate for the cost of capital and the risks involved. All savings in the economy are available for investment – they are either used by banks to lend to people or by business owners to finance companies. But the decision on whether to invest depends on the projected returns. If entrepreneurs, banks and companies can't find opportunities that will give them reliable returns, then they won't invest. The expected returns to an investment depend substantially on how predictable the returns are. In periods of high uncertainty, investment will fall because investors can't be certain what the returns will be.

The Data

Data on investment levels that are collected in South Africa are a little blunt. We typically look at gross fixed capital formation. This refers to spending on fixed property, but this figure does not capture the other ways that businesses invest, such as into research and development. It is calculated as a gross figure – the new spending, less sales of old property/plant, but doesn't take into account whether the spending is on replacement capital or on new expansion. Another problem is that the StatsSA figures don't distinguish household and business investing, so it includes, for instance, investment in building new homes.

The most recent full year's data determined that R853.6bn was spent by business on GFCF in 2016. This has grown three-fold since 1994 in real terms, and nine-fold in nominal terms. It is clear from this that there is significant investment by business.

This investment is a lot of money and represents spending on fixed assets (less sales of fixed assets). When the economy is doing well, GFCF does well because businesses can invest with confidence that their expectations of returns can be met. This is clear when you look at the history of GFCF as shown in Figure 8.

Figure 7: Gross fixed capital formation (Rbn)

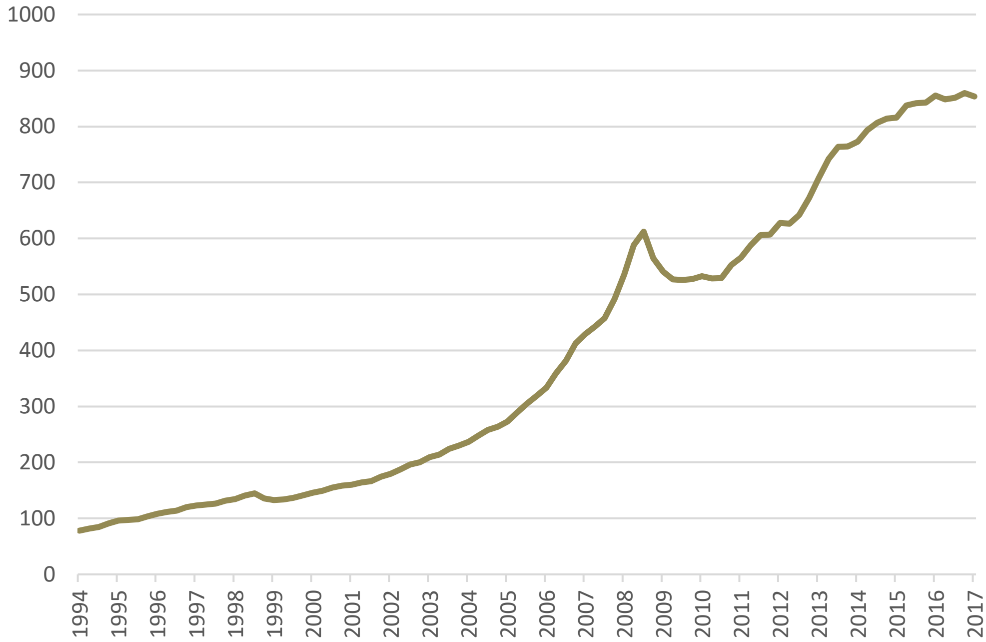


Figure 8 shows how investment is driven by economic growth. The 2009 recession led to a sharp reduction in fixed capital spending. It recovered solidly after that, but has been tapering in the past two years. This tracks falling business confidence.

7 Myth: Business is selfish

The reality check: Business pays billions to employees, to government and to support good causes

The myth is that business is only about generating profits. But in the normal course of business a great deal of value flows to employees, to government through taxes, and through corporate social investment by companies. As we discussed in section 1, the gross profit of companies is the money that is available for taxes, dividends and new investments. Without profits there cannot be economic growth because there would be no money to invest.

Companies aim to generate profits to expand. But they also create value that is used to pay employees and taxes. In addition, companies often undertake corporate social investment, which includes spending that companies do on various social causes. In this section we look at the data on tax, wages and corporate social investment.

7.1 Tax

The data

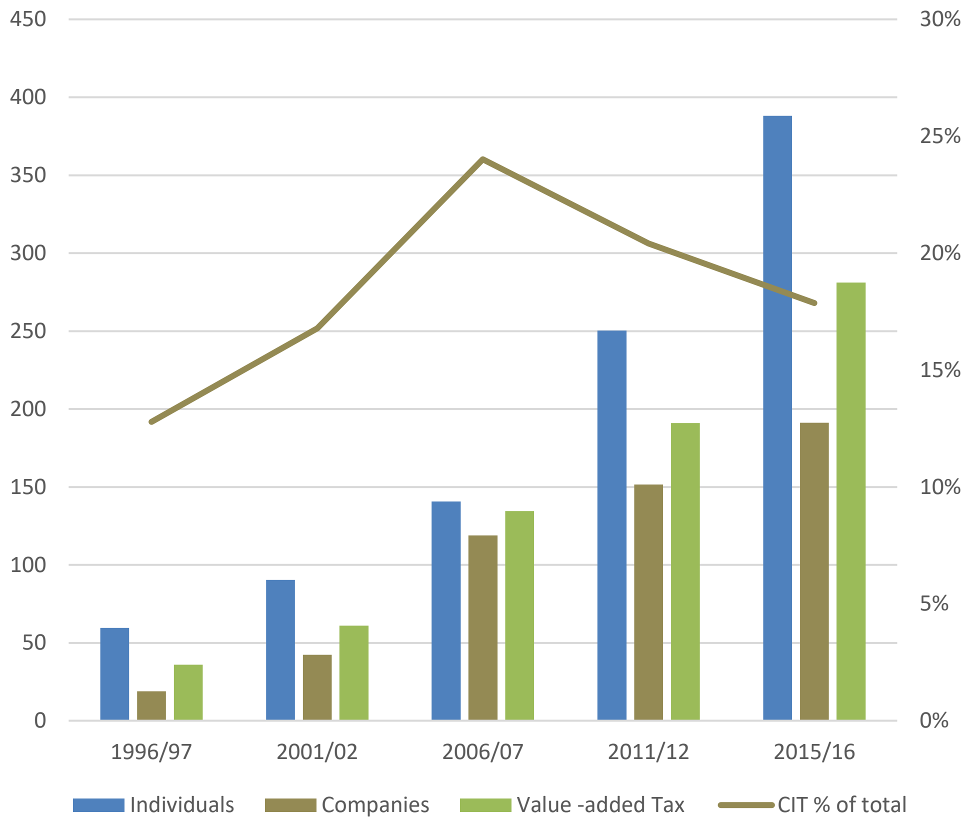
In 2016, the most recent year for which statistics are available, the following taxes were collected, according to figures from Sars:

Taxes collected in 2015/16 tax year (Rbn)	
Personal income tax:	389.3
Corporate income tax:	192.4
VAT:	281.1
Other	207.2
Total:	1070.0

There are now 3.3m companies registered for corporate income tax, up from 2.0m in 2012. There are 19m individuals registered for income tax, up from 13.7m in 2012.

The amount of tax paid has increased dramatically over the past 20 years. Up until the financial crisis, corporate income tax was becoming a greater proportion of the total, but since then it has shrunk. This reflects that companies have been less profitable since the crisis. The data include all personal income tax, including that paid by government employees.

Figure 8: Types of tax collected (Rbn, LHS) and company income tax as a percentage of the total (RHS)

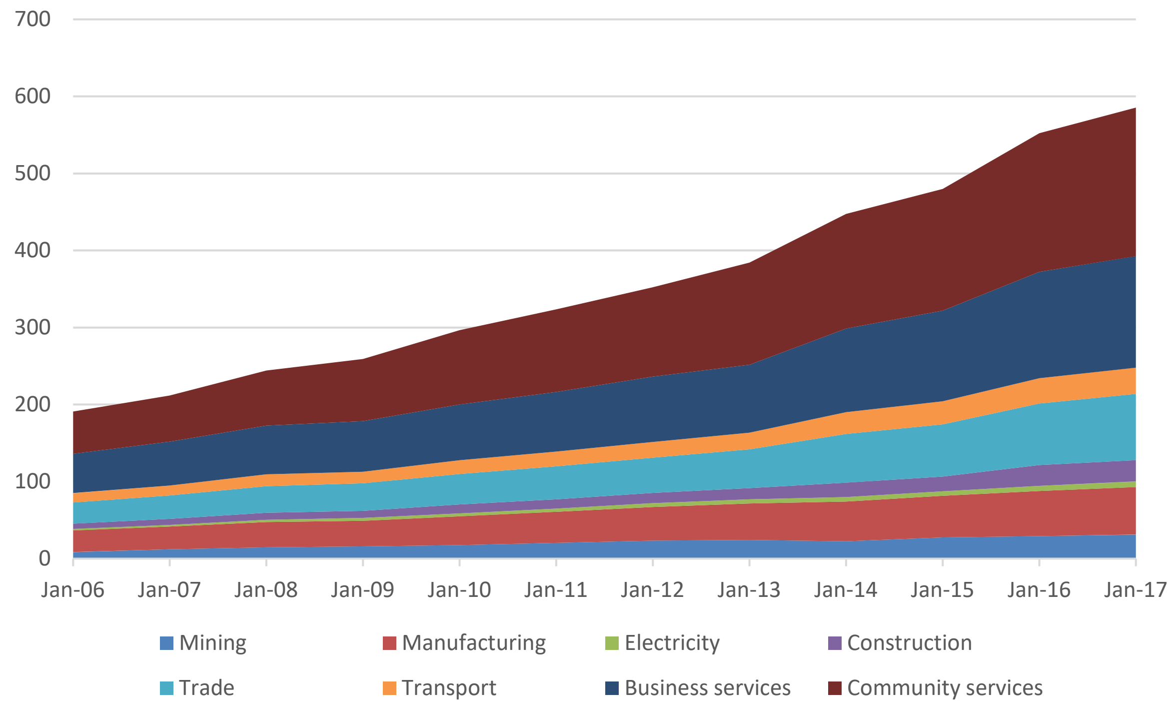


The tax that business pays makes a huge difference to the lives of ordinary South Africans. It supports much of the national budget. A more successful business sector would generate more tax to fund many social objectives. But the considerable tax-generating capacity of formal business as it stands illustrates the critical role that it plays in our society. It is a national asset.

7.2 Wages

According to StatsSA's Quarterly Employment Survey, formal VAT-registered businesses pay billions in wages to workers. Last year, companies paid R585bn in wages, up from R212bn 10 years earlier. In the past 10 years, wages have almost tripled in nominal terms. This reflects the shift of employment into higher skilled roles as well as salary increases.

Figure 9: Wages paid by formal sector per year (Rbn)

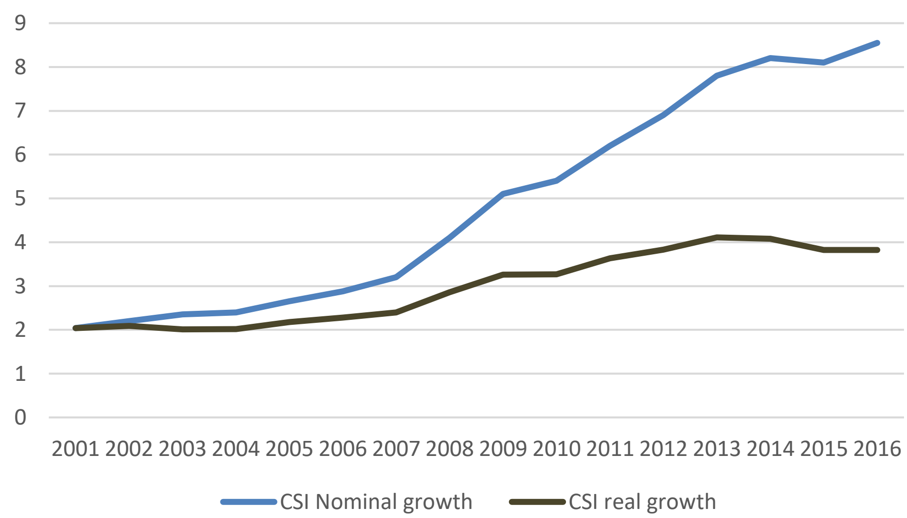


7.3 CSI

The data

The main assessment of corporate social investment (CSI) is an annual study undertaken by Trialogue on corporate social investment. The Trialogue 2016 research showed that SA business spent R8.6bn in total that year. This amount has been growing every year, and is more than double what it was 10 years ago in nominal terms. The nominal and real spending figures are shown in Figure 11.

Figure 10: Total corporate social spending by SA business (Rbn)



8 Myth: Business is corrupt

The reality check: Business depends fundamentally on the rule of law. It cannot survive without it. Business has every reason to fight corruption, including within its own ranks

There is a narrative that business is just as corrupt as those implicated in state capture. This is a propaganda strategy known as “false equivalence” which is designed to undermine the credibility of established business when it speaks out against instances of corruption. When specific cases are cited, we see mention of the pre-World Cup collusion between construction companies, or more recently the role KPMG, McKinsey and others have played in state capture. So those implicated in state capture can say they are no worse than the construction companies, and so on.

The challenge to this narrative is not based on data, but is conceptual. Business and the rule of law are intimately bound up with each other. A competitive and dynamic business sector cannot exist without the rule of law. Business is about transactions – between companies and their customers and suppliers. These transactions have to take place within an environment of trust. Contracts must be respected and transactions settled. Without this, business becomes much more difficult. The cost of ensuring compliance with contracts increases in an environment in which businesses can’t trust each other to operate according to the rule of law. It is critical that the law is enforced properly, with vigilant investigators and prosecutors to maintain the rule of law upon which business depends. Indeed, the biggest risk to business now is that certain elements of the criminal justice system have been compromised, weakening the enforcement of the rule of law. This is harmful to business, and it has a strong incentive to try and reinforce those institutions.

There are always going to be criminal elements within the formal business sector. Businesses cannot control all of their employees all of the time. There will be instances where employees, including management, can use their positions to corruptly extract benefits for themselves. They can also engage in activities to corruptly benefit the business they work for to gain access to some or other reward. So, for instance, employees can collude with competitors to fix prices or can corruptly manipulate tender decisions such that they meet targets to entitle themselves to bonuses.

We need to recognise, however, that the individuals who undertake such activities are different personalities to the business as a whole. When individuals act corruptly, it does not follow that the company they work for is corrupt. For a company to be corrupt it has to be an instrument of corrupt people. In other words, it has to serve the interests of corrupt people by enabling them to further their aims. There are such companies, but generally the formal business sector strives to eliminate them.

This is why. Companies are primarily instruments of shareholders. They are the principals, while the management of companies, and in turn the employees, are their agents. Shareholders oversee all of the company’s activities by choosing the board, which in turn chooses the management. Complex corporate governance guidelines have been developed to govern the responsibilities of shareholders and management to ensure that the relationships between different stakeholders are appropriate.

Shareholders play this role because they carry the primary financial risk of a business. If it does badly, they lose money. Employees and other creditors also have risk in that if a business collapses they will lose too, but shareholders are the first in line. When a business is distressed it is usually they who have to rescue it by contributing more capital.

Shareholders in the formal business sector of a modern economy usually consist of large institutions managing money on behalf of pensioners and savers. On the JSE, foreign investors own 38% of the shares while retirement funds, insurance companies and collective investment schemes hold 34%.

Companies are the instruments of these shareholders. These shareholders depend on companies complying with the law. They have entrusted money to the companies and they need those companies to use it in the ways that they expect. The principal-agent relationship between shareholders and companies is one that is based on trust that companies will do what they say they will do with shareholders' money. To claim that companies are corrupt, you would have to argue that these shareholders *intend* the companies to engage in corrupt practices. However, the shareholders depend very much on companies and their management also obeying the law in order for them to trust that management.

When companies do fall foul of regulations, shareholders are often the ones who suffer. They can be directly defrauded when employees embezzle money, but can be indirectly affected when a company's reputation is damaged or the company is subject to official sanction. The construction companies paid a fine of R1.4n over the 2010 cartel case and had to commit another R1.5bn on mandated investments. This hurt shareholders, both in terms of the fine, but also in terms of reputational damage to the companies. The construction and materials index of the JSE has lost half its value since 2010, though this was caused by economic conditions as well as the fallout over the cartel behaviour. The share prices of food companies implicated in the bread price-fixing scandal were also damaged.

Shareholders have not benefited from corrupt behaviour in the formal business sector. They have every incentive to do what they can to ensure that management complies with the law. When instances of corruption emerge, the individuals involved are often dismissed. Criminal sanctions can follow.

Formal businesses, even those caught up in corrupt behaviour such as price fixing, cannot therefore be *instruments* of corruption. Shareholders are damaged too, and they certainly do not intend their companies to behave in such ways. Companies are accountable – they can be prosecuted and fined. They are subject to extensive regulatory oversight and are audited in order to report to shareholders. JSE-listed companies are also required to publish a great deal of information, including annual financial statements and details about senior executive remuneration. This information is available to analysts and the media to interrogate further, helping to ensure that there is extensive oversight of companies.

This should be contrasted with companies that *are* instruments for corruption. When corrupt individuals knowingly use companies that they own to enter corrupt contracts or to launder ill-gotten gains, they are using those companies as instruments to further their corrupt behaviour. It should be clear that these are a different category of company from those in the formal business sector. Corrupt companies are instruments for corruption, and the people who have instrumental power are the shareholders who use the companies for corrupt ends. In the formal business sector, shareholders like local institutions and foreign investors depend on companies obeying the law. They depend on companies respecting the contracts between shareholders and it, and with all other parties.

Business and politicians must work hard to ensure that corruption is tackled and eliminated. That requires the right policy environment and institutions of oversight, from the media to regulators. Formal business has a strong incentive to be part of that process. A well-regulated, corruption free business sector is in the interests of shareholders and all other stakeholders. It is what formal business strives for. Businesses that are instruments for corruption, of course, have no such similar interest. Their ambition is to avoid accountability. It is in the interest of formal business to do what they can to eliminate such corrupt businesses. They should not do business with them, but should also report all evidence to authorities to enable them to take action. Several pieces of legislation make it a crime to not report corruption when someone becomes aware of it. Businesses have reported many instances of corruption to the police in terms of this legislation.

What is most crucial, however, is the fact while corruption and absence of the rule of law is severely detrimental to business, it is far more harmful to the vulnerable in society. Rent extractions at government and SoE level directly rob funds that are intended for the poor in terms of welfare and other benefits. It also results in higher taxes, so directly affects the employed as well.

Finally, it cannot be emphasised strongly enough that business needs strong rule of law to be successful. It also needs an operating environment that is conducive to growth, that will encourage businesses to take risks with their capital to reinvest in their business operations so as to generate more revenue, hire more people and, of course, pay more taxes, which in turn benefits the entire population.

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