ARE WE STILL INVESTING IN SOUTH AFRICAN AGRICULTURE? : PERCEPTIONS, EVIDENCE AND ANALYSIS

Paper for area V: Agribusiness risk

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Abstract

In this paper the question of investment in the South African agro-food and fibre complex is explored. The analysis is based on empirical values and opinions/perceptions from ±400 agribusinesses operating in this complex. From the analysis it is clear that decisions to invest in the agro-food and fibre complex in South Africa must be viewed as on "knife-edge". A range of recommendations and policy options will be required to activate investment drivers and to address constraints in order to stimulate investment and to achieve growth.

1. INTRODUCTION

A recurring theme in the South African agricultural business environment today is "what is the future of the sector or industry?; Should we continue to invest?; etc" Answers are complex because a range of variables determine the investment activity in any economic sector of a country. These include the current and expected levels of economic activity; competitiveness and profitability; the cost of capital; the availability of finance; the cost of technology and of capital goods imports and also government policy and strategy. In addition investor confidence in the economic system, the investment environment and perceptions of the chance factor are critical. These factors to a large extend, describe the factors determining the competitiveness of a specific industry or even country (Porter, 1998). In this paper the question of investment in the South African agro-food and fibre complex will be explored. This sector include the natural resource intensive manufacturing and processing industries. Food and beverages as well as fibre industries (tobacco, wood and paper) are included in this analysis. The analysis is based on emperical values and opinions/perceptions from ±400 agribusinesses operating inthis complex. Data for this analysis was largely drawn from the CIC Investment Study[1] by Van Rooyen and Esterhuizen, (2000).

2. TRENDS AND LEVELS OF INVESTMENT

Trends in domestic investments in this complex are shown in Fig 1. Recent declines can be explained by factors impacting negative on the competitiveness and profitability of firms. In the agribusiness environment most firms are under pressure. Good crops for this year, however, may enhance cash flow positions. Figure 2 shows the change in foreign direct investment in South African agriculture, broken down into specific periods for which data are available from the Reserve Bank. According to Kirsten and Vink (1999) the data largely corresponds with the major political events in South African over the past decade, and show the outflow of foreign investment in the turbulent period of the mid-1980s and the rapid build-up in foreign investment in the post 1990 period. A climate of uncertainty in the years immediately before the election in 1994 was probably the main reason for the slowdown in foreign investment in those years. The recent drop-off however is concerning.

[1] This paper is based on a research project by the authors initiated by the Office of the President of the South African Government on investment in South African industry and manufacturing – the CIC Investment Study, (2000).

fibre complex

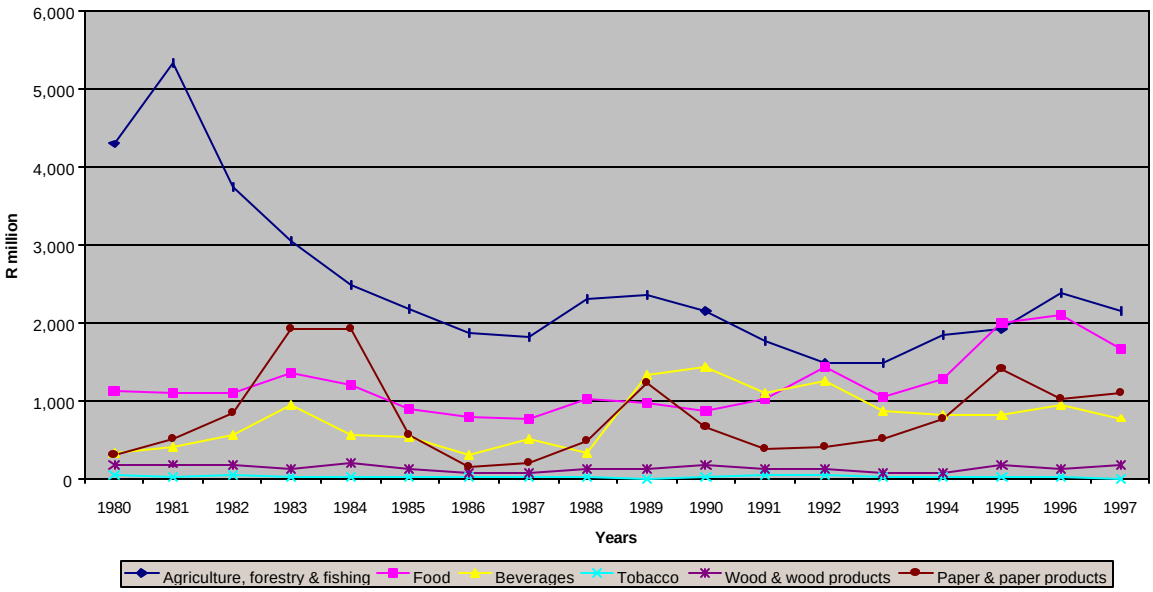
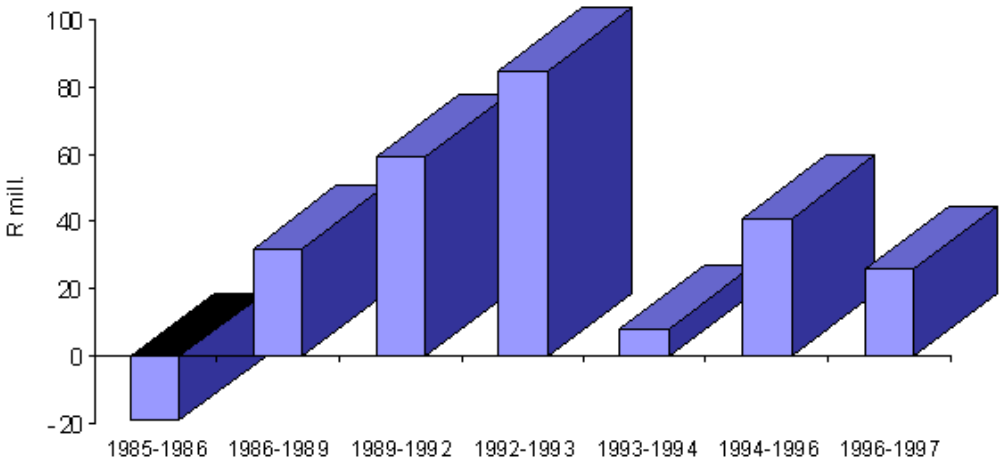


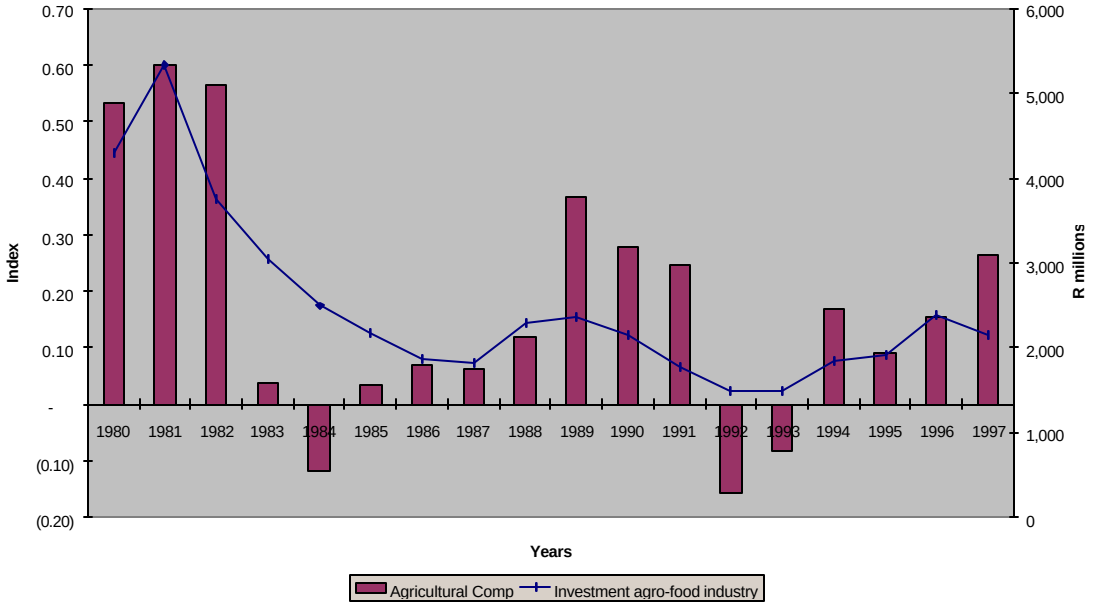
Figure 2: Foreign direct investment in agriculture, 1985 – 1997



3. THE RELATIONSHIP BETWEEN INVESTMENT AND COMPETITIVENESS

An industry, which is not competitive, will not attract investment and vice versa. In Figure 3 this pattern is illustrated. A correlation analysis indicted a correlation coefficient of 78% which confirm this phenomena. Investment levels closely follow the aggregate competitiveness index of the agro-food and fibre complex. As in the case of competitiveness, levels of investments have dramatically declined since the early 1980s. However, since 1993/94 increases in investment and competitiveness are observed although trends for investment are again declined somewhat since 1996/97. This could be a lagg effect of the temporary decline in the competitiveness index.

Figure 3: The correlation between competitiveness and investment in agro-food industry



4. THE NATURE OF INVESTMENT

The general negative outlook on production factor conditions, especially the high costs of production inputs, capital and new technology must be noted (see section 6). The high cost of "doing business" such as high interest rates, the implementation of labour regulations, the general impact of crime, and also high costs of freight on railways, freight handling at harbours and sea freight constrained investment levels.

Sound investment opportunities in some sectors notably the wine, maize, sugar, apple, groundnut, fruit juice and pineapple industry however emerged due to the increased competitiveness of these industries (refer to Van Rooyen & Esterhuizen, 2000 for particulars). Aggregate competitive ratios for certain sectors in this complex are still increasing. Sectors for which new investment is likely included maize (food) and orange, apple and grape (beverage) industries. The paper and wood industry, with the exception of dissolving and chemical wood pulp and wood charcoal (Bethlehem, L, 1993) are under pressure as well as the meat industry (food) and cotton (fibre).

Spare capacity: Firms, operating in this complex, indicated that financial systems to support direct investment functioned well although the cost of capital remains a concern. Many firms are currently also using internal funding to expand business. This, however, may only provide a short-term solution. Firms indicated a degree of spare capacity related to plant and equipment use (less for the paper and pulp sector). A current future growth phase will however require expansion in capacities. Innovative financial support systems will therefore be necessary to facilitate the flow of financial investments to successful firms.

5. THE QUALITY OF INVESTMENT

The quality of investment describes the link between investment and growth of output and employment: **Growth in output:** Since 1993 there was a relative positive trend in real output in all the sectors. This can be attributed to political changes, increased consumer demand for food due to lower food price increases and higher exports due to the decreased value of the Rand. For the agricultural sector there is a great variance in real output every year because of this sector's climatically dependency; **Performance:** The relationship between investment and the resultant output (ICOR[2]) shows that a relative low return was recorded for the agribusiness sector (4.28 for 1996/97). This can be attributed to the typical biological lagg effect in these industries. This lagg effect is also observed on the impact of research and development (R&D) in the agricultural production sector. The high rates of return for agricultural R&D (ROR+44%p.a.) observed indicate the importance of sustained investment in certain basic drivers for growth in output in this complex such as technological development and market development. Technology, infrastructure (and maintenance), labour capacity, managerial capacity and market knowledge were identified by all firms as major drivers (see section 6). Future investment, where possible in partnership with the public sector, should thus focus on these.

The general upward trend in the capital:labour ratio for the complex (except for wood and agriculture) shows increasing capital intensity. Employment dropped for all skills group in the agro-food sectors, with increases only in the wood and paper sectors (except for semi-skilled labour in the paper industry).

The relative stable capital labour ratio currently observed in agricultural industries is due to a reduction in employment and the recent drop in capital invested in this sector. However, in general reduced employment led to the increasing trend in the capital-labour ratio in this complex as a whole. The long-term trend in this context may change as capital is expected to become more expensive (ie high cost of technology and a declining Rand value). This assumes, however, that a more flexible labour dispensation could be organized which will allow increased employment.

Technological innovation together with the reduction in employment, particularly in semi and unskilled labour groups, increased labour productivity in all sectors. This is so despite high capital costs. Technology investment was mainly funded through "own" funds (see section 4). The longer term scenario could argue for a decrease in this ratio to stimulate employment, provided innovative financial support systems and more flexible labour relationships, combined with human capital improvement at all skills levels in the complex – management, skilled, semi-skilled and unskilled, could be achieved.

6. DRIVERS AND OBSTACLES TO INVESTMENT

In addition to competitiveness, the two most important drivers for investment in both large and small firms as perceived by the sector, are to raise market efficiency and to improve product quality through more up-to-date technology (Table 1).

[2] ICOR = I (t-1)/(GDPt – GDP(t-1)
I=Investment in sector; GDP = Gross Domestic Product of Sector; t = time periods

Table 1: Most important drivers of investment

Drivers	Most important (% of respondents)		2nd most important (% of respondents)	
	Large firms	*Small firms*	*Large firms*	*Small firms*
To take advantage of expected sales growth	**32.6**	**25.9**	9.3	13.8
To reduce total wage costs by cutting the workforce	2.3	8.6	9.3	3.4
To reduce costs of labour conflict by cutting the workforce	4.7	1.7	2.3	1.7
To raise efficiency through more up-to-date technology	**30.2**	**15.5**	**27.9**	**12.1**
To improve product quality through more up-to-date technology	7.0	10.3	**18.6**	**20.7**
To replace machinery no longer working	11.6	8.6	4.7	8.6
To increase export competitiveness	4.7	3.4	7.0	5.2
To diversify product lines	2.3	8.6	7.0	10.3
Other	4.65	6.9	7.0	1.7

In Table 2 the major obstacles to future investment as perceived are indicated. High interest rate and fluctuations in the interest rate, poor long-term sales outlooks, costly and cumbersome labour regulations, high crime levels and related social problems such as aids are currently the five most important obstacles to investment in the agro-food industry for large firms.

The five most important obstacles for small firms are a too high interest rate, uncertainty over government economic policy, the application of labour regulations, and uncertainty over future labour relations and crime and related problems.

Table 2: The obstacles of investment

Obstacle	Average – large firms	Average – small firms
Interest rates too high	2.63	2.02
Fluctuations in interest rates	2.68	2.48
More attractive returns on alternative uses of funds	3.19	3.29
Poor sales outlooks	2.85	2.93
Level of exchange rates	2.92	2.89
Unstable exchange rates	3.05	2.82
Labour regulations	2.80	2.24
Uncertainty over future labour relations	2.95	2.27
Inability to penetrate export markets	3.21	3.33
Increased competition in SA markets	2.95	2.63
Lack of own finance	3.08	2.89
Lack of access to borrowed funds	3.47	3.20
High company income tax rates	3.10	2.48
Inadequate tax incentives for investment	2.97	2.45
Inadequate public infrastructure	3.63	3.47
Uncertainty over government economic policy	3.08	2.40
Crime and related problems	2.76	1.82
1 = insurmountable 2 = severe	*3 = moderate*	*4 = no impact*

7. HOW CAN INVESTMENT BE STIMULATED?

From the above analysis it is clear that decisions to invest in the agro-food and fibre complex must be viewed as on "knife-edge". Current declining trends could be continued. A range of recommendations and policy options will be required to activate investment drivers and to address constraints in order to stimulate investment and to achieve growth. These are:

(i) Increased competitiveness: The firms in the agro-food and fibre complex will have to increase their competitiveness to survive in the global market and to attract new investments. The government together with industry/sector groupings can play an important role. Although differences in this complex are apparent, solutions to the major constraints are of a common nature. In all sectors technological innovation, improved labour management systems, human capital development and innovative financial and other support arrangements are required. Industries are challenged to operate more competitively in a "global village". Collaborative actions, supply chain networks and partnerships within sectors/industries and with the public sector is urgently required to allow firms in this complex to operate at the competitive edge.

(ii) Understanding the market – customers, partners and consumers: The rapid changing market require a substantial shift in the current "business paradigm". A customer/consumer focus, supply chain relationships, and community public, private sector partnerships is necessary. A policy initiative to stimulate the paradigm change in this complex is required. This will lead to the redesign of support systems and the development of an understanding of stakeholders. Currently government initiatives are not well received yet by firms in the agro-food and fibre complex. Consultative workshops, joint studies, facilitated by government and advocacy interest groups, would promote a strong collaborative thrust to understand the market better. This will lead to better policies and useful support schemes. Innovative financial support schemes will be required to sustain factor investments.

(iii) Fair trade in an unfair environment: The international trade environment is by no means fair and equal. South Africa is a small player in this global environment. The big industrial blocks are highly competitive, aggressive and subsidized. Industry together with government needs to develop focussed strategies in this context. Both export strategies and anti-dumping measures are important. A stronger "new market" development thrust between industry and government is required. A "South Africa Identity" depicting South African firms as worthwhile and high quality business partners will support such a "globalization impact" strategy.

(iv) Cost of doing business in South Africa: Most firms interviewed complained of the high cost of "doing business". Interest rates, labour administration, high input and transportation/freight costs, and crime were highlighted as high cost items. Bench marking of best practise models would assist in driving costs down.

(v) Productivity management and human capital development: Capacity is required to manage sustained productivity. Supply chain management, improved labour relations, a reduction in the administration of labour regulations and training across a broad front needs to be highlighted. It will be important for each industry to develop a strategic plan within which Sector Education and Training Agencies (SETAS) could function. (SETAS administer employment

levies from industry.) A clear demand statement by industries within the agro-food complex should be developed to guide human capital development funded by SETAS.

(vi) Infrastructural development incentives: Although South African infrastructure is considered as positive factor, concern was expressed about the future quality of infrastructure – roads and harbour facilities in particular. The government must consider incentives to interest the private sector to participate in the maintenance and creation of infrastructure. Sound cost benefit considerations should be applied to joint projects. Examples are the maintenance of the road system in high potential agricultural production areas by private sector users.

(vii) Towards an agribusiness policy for South Africa: The agro-food and fibre complex will increasingly operate as integrated business networks. Supply chain relationships will dominate business contracts. Industries within this complex will have to collaborate with the public sector, science councils and universities to promote and finance "cutting edge" R&D and technology development

The Agricultural Business Chamber recently accepted a brief by its members to promote an agribusiness policy framework for South Africa aiming at "creating competitive advantage for South African agribusinesses". The following strategic programmes were identified (ABC, 2000):

- Market driven innovation focusing on consumer demands, locally and in the international market.

- Capacity development, which included improved business intelligence systems, training, black empowerment initiatives, and network development.

- Rationalization of efforts to mobilize public sector support, and to stimulate R&D and technology development, etc, and

- A strong and positive "South African Identity" in the international environment, promoting South African agribusiness as worthwhile, reliable and quality partners to do business with.

These proposals by the ABC accommodate most concerns of all sectors in the complex as determined by the CIC study. Collaborative efforts in this context should therefore strengthen the position of individual agribusiness firms considerably.

8. CONCLUSIONS

Investment trends in the agro-food fibre complex are currently declining. However, competitiveness ratings are increasing. Decisions to invest in the various sectors of the agro-food and fibre complex is clearly in the balance. Various factors, common to most sectors, were identified by the industry as constraints of future investment. A concerted effort through innovative measures and policies will now be required to "kick-start" agricultural activity in South Africa.

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