FW de Klerk FOUNDATION

INVESTMENT 101 FOR POLITICIANS

Theuns Eloff: Executive Director, FW de Klerk Foundation

A large part of President Ramaphosa's turn-around plans for the South African economy are to attract billions in foreign and local investment, which hopefully will create hundreds (if not millions) of jobs. One sometimes hears other politicians muttering about the "investment boycott" by South African businesses, which are sitting on "billions of rand" and "doing nothing with it".

But do politicians and government officials know how business people think? Do they know how to break the so-called investment boycott? Here are some insights - call it "Investment 101" for politicians.

A business (local or multi-national) usually starts with an entrepreneur who has a good business idea. He/she usually borrows money from someone (family, friends, the bank) to put the idea into motion. When the business starts to grow, they will list it on the stock exchange and invite the public to invest in the business. Individual investors (ordinary people) will look at the prospectus of the company and decide if an investment will deliver returns. Returns consist of annual dividends (paid annually from the profits of the company to shareholders) or capital growth - when the company's share price rises. Such returns have to deliver more in the medium and long-term than he/she can get by simply putting the money in the money market or a savings account. The company therefore competes with many other companies for the public's money.

What actually happens is that the individual investor "lends" their money to the company so that it can be used to make more money. The company must therefore use the money from the investor wisely and cautiously. If the investor - now a shareholder - is not satisfied, he/she will sell the shares and invest the money elsewhere. And if many shareholders decide to do this, the company's share price will fall and the stock will in effect lose value (or even become worthless). That is what happened to Steinhoff.

What should the company do with shareholders' money? The company, its Board and its management must at all times act in the interests of the shareholders. To waste the money, to invest unwisely, or in projects with unacceptably high risk, will not only be morally wrong, but investors may, under the *Companies Act*, hold Directors individually accountable. In fact, there may even be criminal charges against individual Directors if that happens.

Of course, the company also has a responsibility to a wider group of stakeholders: employees, the community in which they work, and the general public (especially if the company is, for example, in the food industry). But in choosing whether to invest in new projects and the nature of the investments, the first responsibility is to the shareholders. Only when their money starts working and profit begins to flow, can one look at the broader group of stakeholders. Incidentally, that was why the first Mining Charter was so short-sighted (and wrong) in its determination that community stakeholders should get a percentage of the turnover of the company (regardless of whether profits were made). It would have been a gross violation of the rights of shareholders (the real owners of the money).

How does a company determine whether or in what they invest? The answer is simple: projects that allow value to be added to the shareholder's investment. In plain language, these projects that allow more product to be produced in more cost-effective way, and which can thus be sold at a profit:

- *"More of the product"* means that the manufacturing or growth process must be effective. It doesn't help to spend a lot of money and just get a few products in return. The investment must be large and effective enough.
- *"Cheaper manufacturing"* means that product must be manufactured for the lowest possible cost. This means in practice that a company will inevitably look at technology and will try to save on labour (which is the biggest cost in most companies). Very few companies can be profitable if they have too many employees (just look at SAA and Eskom). An investment will therefore not always create many jobs, but hopefully create *new* jobs that were not there before.
- Products must be sold for a *"good price*"**.** Unless a company has a monopoly, they do not determine the price of their products. The "market" (the consumer) does. If a product is scarce, the price will be higher, and if a product is abundantly available, prices will be lower. A good example today is the maize price. Due to the drought, it seems not enough maize was planted, thus the maize price is now higher.
- And then the product must be *"sold"*. This requires people with income to buy the product. If ordinary South Africans are plagued by poverty and hardship (such as when the petrol price continuously climbs, or VAT increases), the company will not sell their products. The product will become, in the case of perishable products, unusable, and might even just have to be given away. In both cases, the result will be that the company is not profitable and that shareholders' money is wasted.

A company makes a decision on a new investment only after these factors have been taken into account. In addition, the risk posed by the investment is also examined. All public companies must, according to the *King IV Code of Conduct*, establish risk management committees. Such committees should look at all operating risks of the company, *including* new investments. And if it appears that a new investment is too risky (and of course there is a measure of risk in every investment), this committee should recommend that the Board abandon said investment.

The management of a company must also calculate whether there will be sufficient return on the investment, and whether the period during which the project will "repay" the investment (in terms of profit generated) is acceptable.

If President Ramaphosa therefore reaches out to companies asking for new investments, which will thereby create jobs, the Chief Executive Officer (regardless of his personal feelings) or the Board cannot automatically say "yes". Companies don't hold or work with their own money. It is other people's money, that is, shareholders' money. And even if politicians do not want to hear it, job creation cannot be the primary motivation when considering an investment. Creating new employment opportunities is the by-product of a successful investment. Every company must examine the risks of a new investment very closely.

The fact is that if a company is not 100% sure that the investment (and the property on which the company operates) is safe, it would simply be irresponsible to use investor's money for such an investment. One could safely place a bet that not one of the investments promised to the President last year will be realised before there is 100% certainty about expropriation without compensation. Promises and explanations are not enough - no responsible Board and management will make a decision on millions of rand of shareholder money based on the personal assurances of politicians. Of course (and this is probably true of some of the promises to invest), some companies decided long ago on certain investments, which only now came to fruition.

So it is therefore not helpful that President Ramaphosa explained to the business sector that certain troubling issues in the ANC election manifesto are only "wishes" and do not herald a change in policy. Such "wishes" (e.g. regarding the independence of the Reserve Bank) signal sufficient risk for new investments to be shelved. It is therefore encouraging to read that a group of business people recently met - thanks to mediation by Dr Johan van Zyl (Toyota) and Roelf Meyer - with the Cabinet Ministers in the economic cluster. According to reports, it was an open, honest conversation, and the business people were really "heard".

"Investment 101" reveals that business people not only think differently to politicians, but they are obliged to think differently. Business people do not work with their own money, it belongs to their shareholders. And if there is a semblance of risk attached to new investments, they won't materialise. Politicians will therefore have to change their thinking and approach if they want to persuade even well-meaning business people to invest anew and in so-doing, create new jobs. Sound economic policy and policy certainty are a good start.

***First published on Netwerk24 in Afrikaans**