SNG Grant Thornton

Grant Thornton's Global Research

South African mid-market survey:
Business insight and outlook

Second Half-Year (H2) Period 2022

Energy costs and economic uncertainty are the primary concerns for South African Businesses.

Faced with high levels of economic uncertainty, optimism among **EMEA** (Europe, Middle East and Africa) mid-market businesses has fallen seven percentage points to 46% (down from 53% in the first half of 2022). This compares to the 59% of mid-market businesses **globally** that are optimistic about the outlook for their economies (down from 64% in the first half of 2022).

Grant Thornton's International Business Report (IBR) tracks sentiment among global mid-market business leaders. The IBR provides a complete view of the health and prospects of mid-market companies – those employing between 50 and 500 staff - at a global, regional, country, and sector level. In South Africa, approximately 100 business leaders, including chief executive officers, managing directors, chairpersons, and other senior decision-makers from various industry sectors, were surveyed in the second half of 2022.

After flagging **a bumpy road in our previous report (H1 2022),** the country's economic activities are already confirming a challenging road ahead. While we can take some encouragement from the marginal improvement, in both demand constraints and supply constraints, restrictions are firmly rooted at their current high levels due to economic uncertainty. Inflation remains a big driver and is pushing up labour and energy costs while other challenges relate to access to finance, availability of skills, regulations and red tape.

According to the **South African Reserve Bank data,** the country's Gross Domestic Product (GDP) growth rate in 2022 was 1.6% in the third quarter compared to 0,7 in the second quarter. Although this is low, the increased growth rate had a positive impact on mid-market businesses, as it led to an increase in consumer spending for the fourth quarter of 2022. In line with trends highlighted in H1 2022, 74% of mid-market businesses see energy costs as a major issue due to loadshedding and high cost of diesel, compared to 47% of those surveyed pre-pandemic, causing some businesses to close down and adding to the already high unemployment rate and financial constraints.

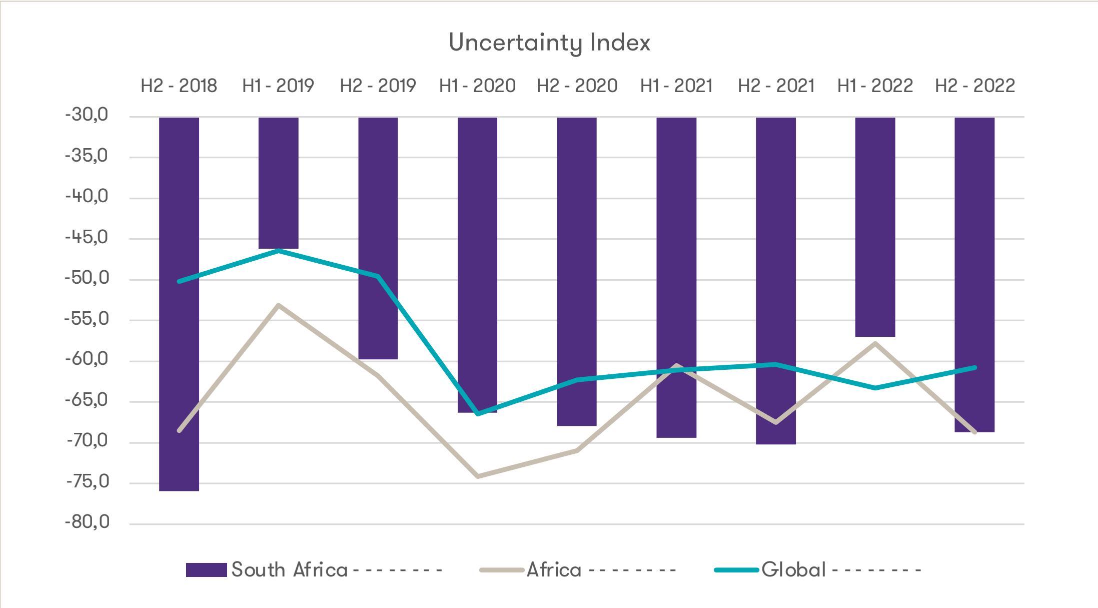
The other concerning aspect of the results is that 67% of mid-market businesses believe that economic uncertainty is another major constraint in growing their business.

The International Monetary Fund (IMF) states that global economic activity is slowing down more broadly and sharply than expected, with inflation higher than it has been in several decades. The cost-of-living crisis, tightening financial conditions in most regions, Russia's invasion of Ukraine, and the lingering effects of COVID-19 pandemic all loom large in the forecast for the next 12 months. Mid-market businesses would need strategies such as resilience planning and dealing with the components that businesses can control such as managing cash flow or holding on to cash.

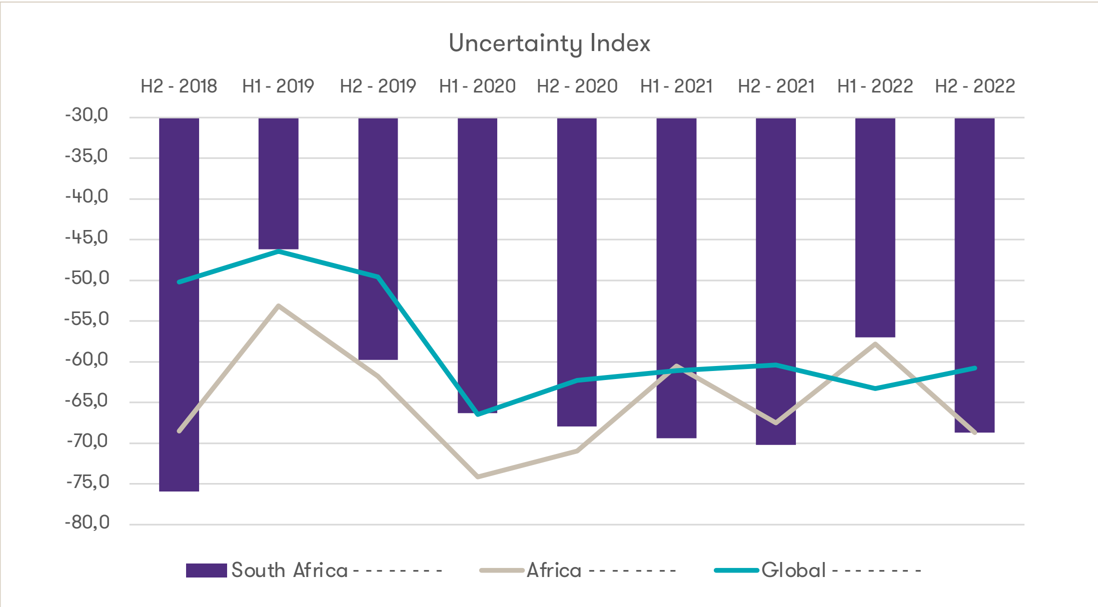
Index overview

The overall index results for South Africa show a significant increase from 0.5 points in the first half of 2022 to 3.5 points in the latter half of 2022. The latest South African data shows that mid-market businesses' optimism for the country's economy over the next 12 months has dropped from 56% in H1 2022 to 52% in H2 2022, but it is still higher than it was during the Covid-19 pandemic. This could be due to organisations expecting most things to remain consistent - at least where they have some control in areas such as profitability, investment, etc. The biggest dip is in general optimism relating to aspects regarded as out of their control such as inflation, geo-political climates, and the energy crisis.

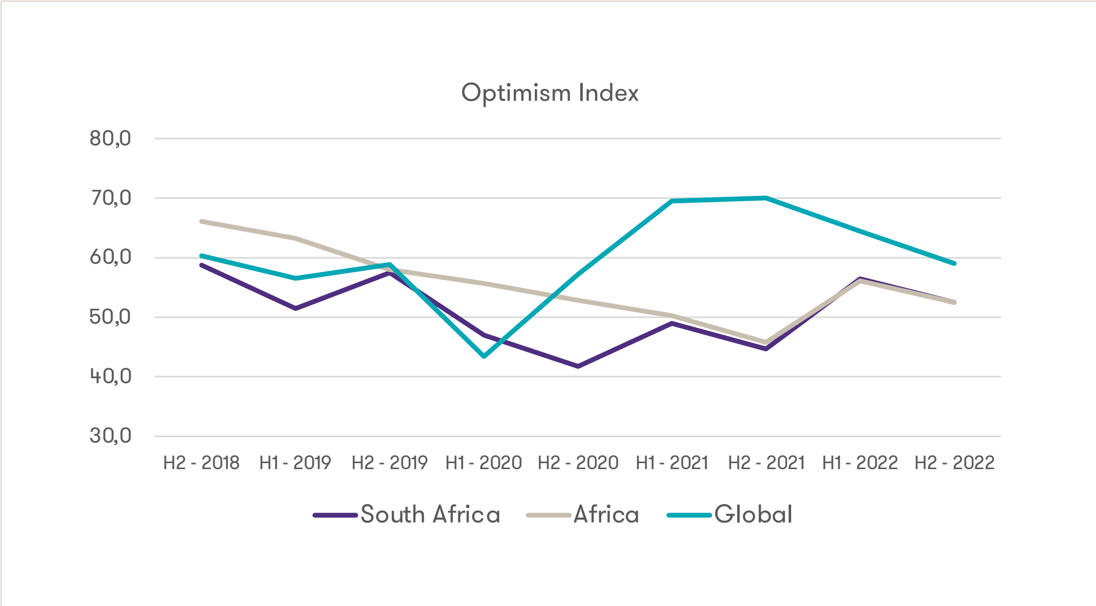
Uncertainty has increased to 68.7 in South Africa in H2 2022 compared to the rest of the globe, which has remained in the lower 60 points area for H1 and H2 2022 (63.3 points and 60.7 points respectively).



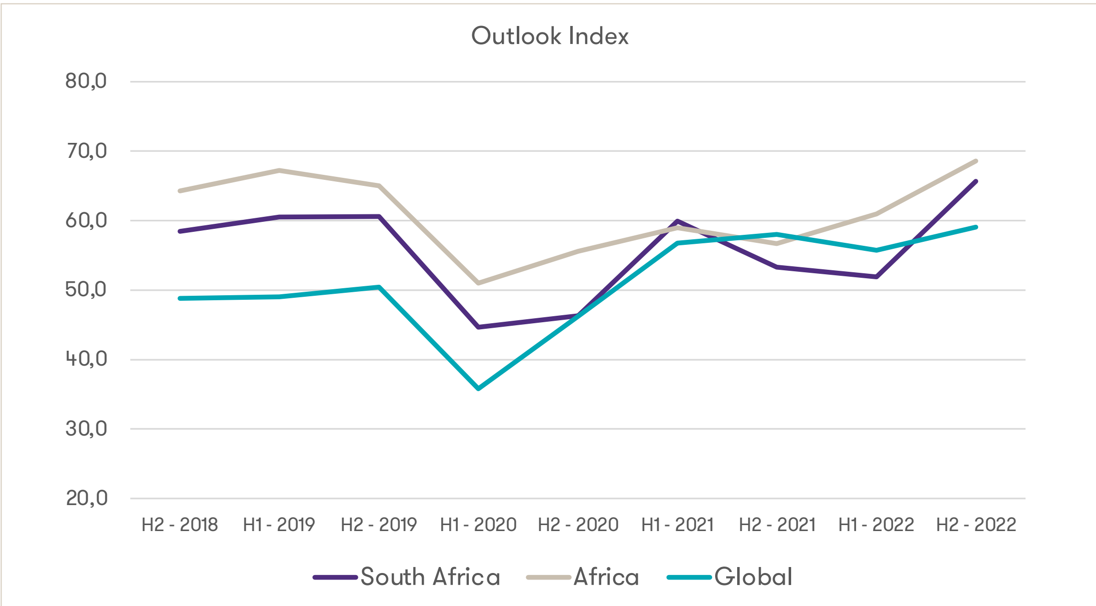
Demand Constrains moderated globally in H2 2022 compared to H1 2022, while there was an improvement in South Africa from -47.5 points to -41.6 points.



Optimism is volatile, and on the downside compared to the 2021 H1 survey



Economic Outlook expectation for the next 12 months has heightened across all the regions.



Performance Indicators:

From a performance standpoint, the South African economy carries optimism in terms of revenue growth and profitability. The results from the H2 2022 period suggest a rebound in expectations for revenue growth, with 69% (59% in H1 2022) of South African mid-market businesses hoping to record an increase in revenue in the next 12 months. According to the H2 2022 results, the revenue growth is mainly aligned to the expectation of an increase in the selling price, which is trending at pre-COVID-19 levels. It is important to note that the selling price to foreign markets is influenced by expectations on the exchange rate movements. In the second half of 2022. The Rand to the US Dollar exchange rate depreciated by 12.5% from 15.41 in the first half of 2022 (to 17.33 in H2 2022) the peak time of survey (i.e., October 2022) the exchange rate was at a low level of 18.1%. Therefore, the optimism is due to the selling price being higher in Rand (ZAR) terms given the prevailing exchange rate movements.

The positive prospects for prices and revenues reflects that South African companies expect demand to pick up to pre-COVID levels. The revenue growth is also associated with expectations on export growth and non-domestic revenue growth.

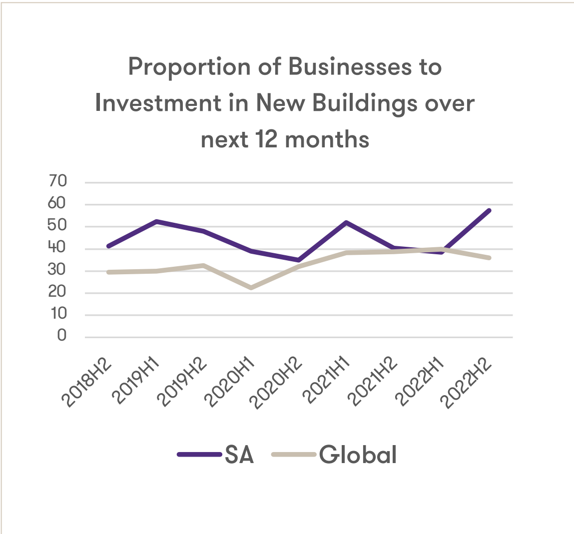
The H2 2022 results indicates that 54% of mid-market businesses are expecting an increase in exports with a similar proportion expecting to see an improvement in non-domestic markets revenue.

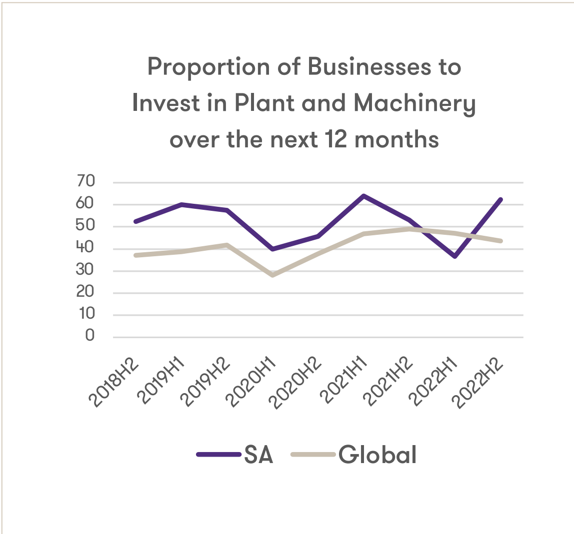
However, it is concerning that at a global level there is less optimism on revenue and profitability prospects. This is largely due to the notion that there are glittering fears of a prospective global recession. Inflationary pressures triggered by the Russia-Ukraine conflict resulted in central banks globally raising interest rates in a highly synchronised manner and this is weighing negatively on investment. As a result, the World Bank forecasted a significant slowdown in global economic growth setting at 1.7% in its January 2023 forecast (compared to a previous forecast of 3%). Any higher-than-expected increases in inflation and associated response by Central Banks on interest rates as well as worsening geo-political tensions could worsen things and push the global economy into a recession.

Slow global growth and a prospective recession would potentially slow down external demand thereby weighing negatively on exports revenue growth.

Investment Prospects

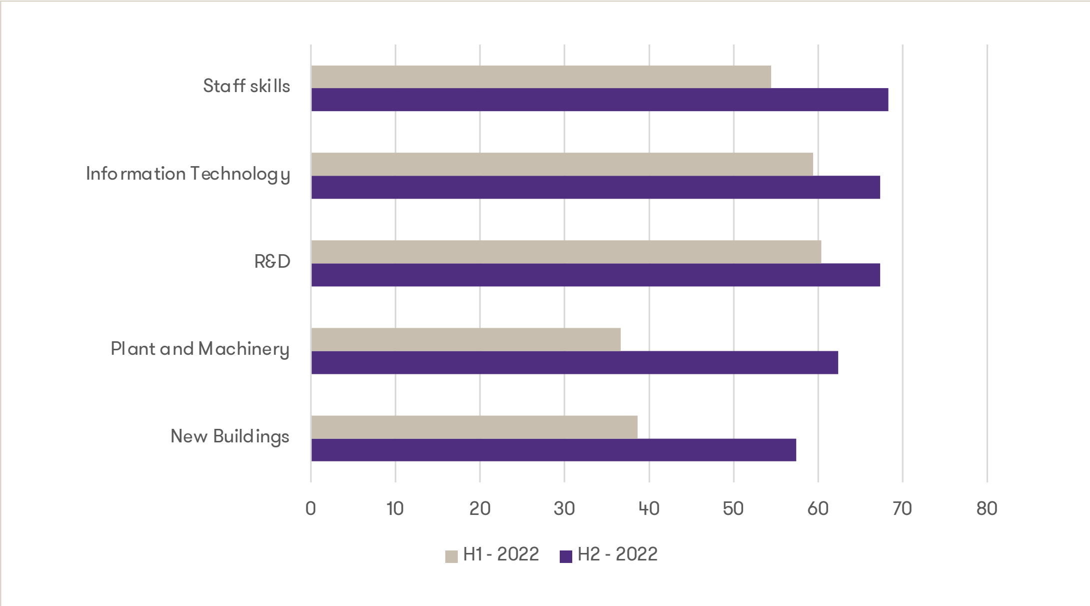
South African businesses are faring well on pushing for new capacity and this is contrary to trends observed globally. The upturn on investment reflects optimism on recovery as most businesses curbed their investment plans with the advent of COVID-19. As COVID-19 subsides with a perceived return to 'normalcy', there are stronger prospects to improve capacity and invest in plant and machinery as well as buildings. Investments in Research & Development as well as Technology is also being sustained.





While 70% of South African businesses expect an increase in profitability over the next 12 months, f**uture business investment intentions** are down across the board. **Technology investment** is the key area businesses are focused on, cited by 53% of EMEA businesses (down from 54% in H1 2022), followed by **investment in staff skills** at 50% (down from 52%) and investment in research and development at 46% (down from 48%), however, **investment in new buildings** and machinery have picked up momentum in terms of what the mid-market business would invest in post-Covid-19 and that is due to the low base set during the Covid-19 pandemic.

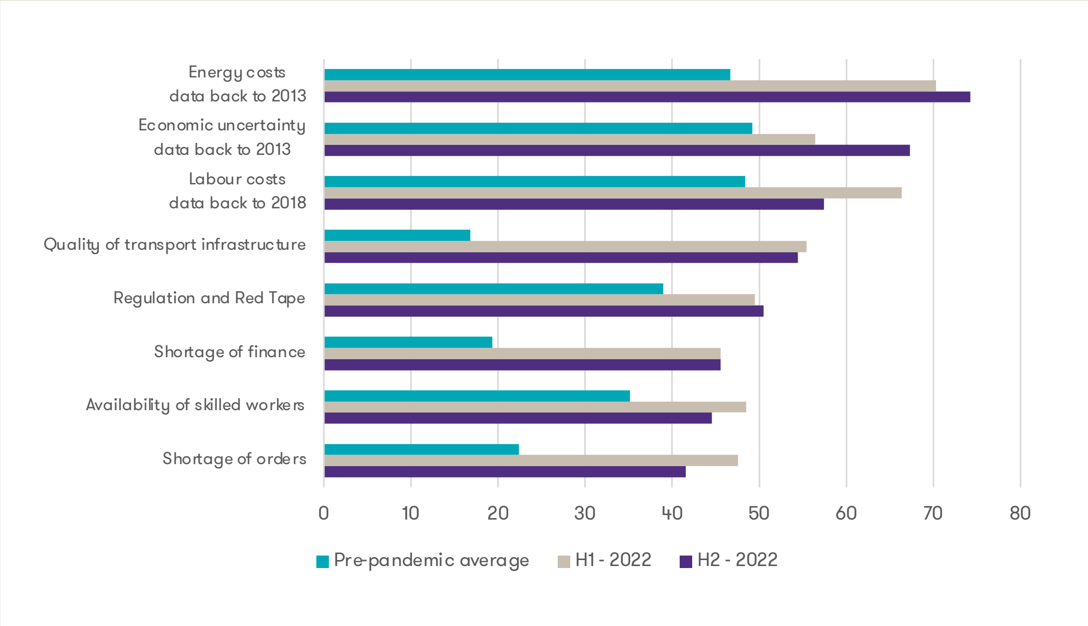
Investment expectations in South Africa



Key Constraints

Energy cost as a constraint has gained momentum in South Africa in H2 2022. At 74%, it signals a historical high supporting the belief that the mounting energy crisis in South Africa, characterised by a high frequency of loadshedding, is causing financial challenges for businesses. Loadshedding is disruptive for businesses resulting in excessive downtime. It calls for alternatives such as back-up generators, uninterrupted power supply (UPS) and solar power solution. While companies have tried alternative means, it has all come at an extra cost – especially generators, which use diesel, a commodity that has gotten significantly expensive due to rising international oil prices pushed by geo-political concerns (particularly the Russia-Ukraine conflict). As a result, loadshedding causes businesses to shut down operations thereby affecting sales and causing supply chain disruptions. The government suggested the implementation of 5-Point plan for addressing the energy crisis, which was outlined by the Mineral Resources & Energy Minister, Gwede Mantashe. The 5-Point Plan consists of maintaining and servicing Eskom power plants, acquiring more electricity from outside of our borders, revitalising the emergency energy procurement process, and enhancing Eskom's skill capacity.

Energy costs (74%) and economic uncertainty (67%) remain the top concerns in South Africa. This is followed closely by labour costs (57%). Economic uncertainty has increased significantly; up 11% from H1 2022. Concerns over a shortage of finance have remained at H1 2022 levels (46%). The true impact of rising interest rates can be seen when comparing historic data as this increased significantly compared to pre-pandemic averages.

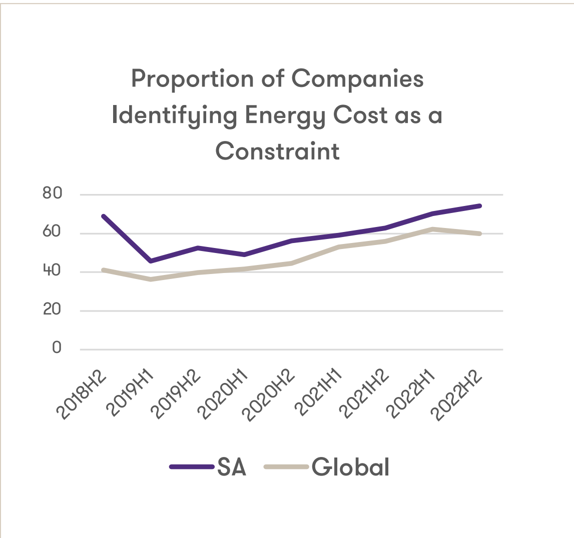


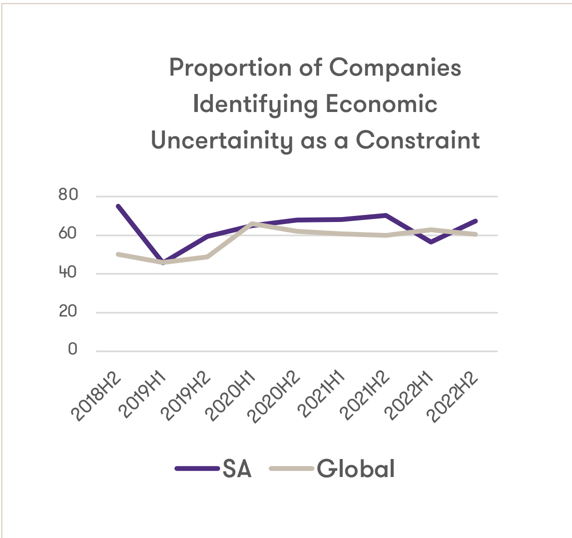
Should we be preparing for a short-lived recession?

SA Economy Faces Challenges as mid-market struggle with rising inflation.

Economists are predicting a recession amidst the country's woes in grappling with the energy crisis. Other economies around the world are also preparing for a rather unusual recession that is expected to be a shallow and short one. This means businesses should not respond by imposing long-term measures to address the recession, as the 'usual' response to a recession may not be the right course of action for businesses. For example, if the recession is short-lived, layoffs could leave businesses short-staffed when demand picks up again.

62% of mid-market businesses expect the employment rate to increase despite what the data says about economic uncertainty. The reason for this positive sentiment around employment could be that 42% of South African mid-market businesses surveyed, increased their staff levels by more than 5% in the last year. This led to the unemployment rate slightly decreasing to 27.9% in the third quarter of 2022 (from 29.1% in the same quarter in 2021) among workers aged 35 to 44 years from 29.1%. During Covid-19, companies decreased their staff headcounts. So, the increase in staff levels mid-2022 was due to companies capacitating to pre-pandemic levels and the termination of the National State of Disaster.





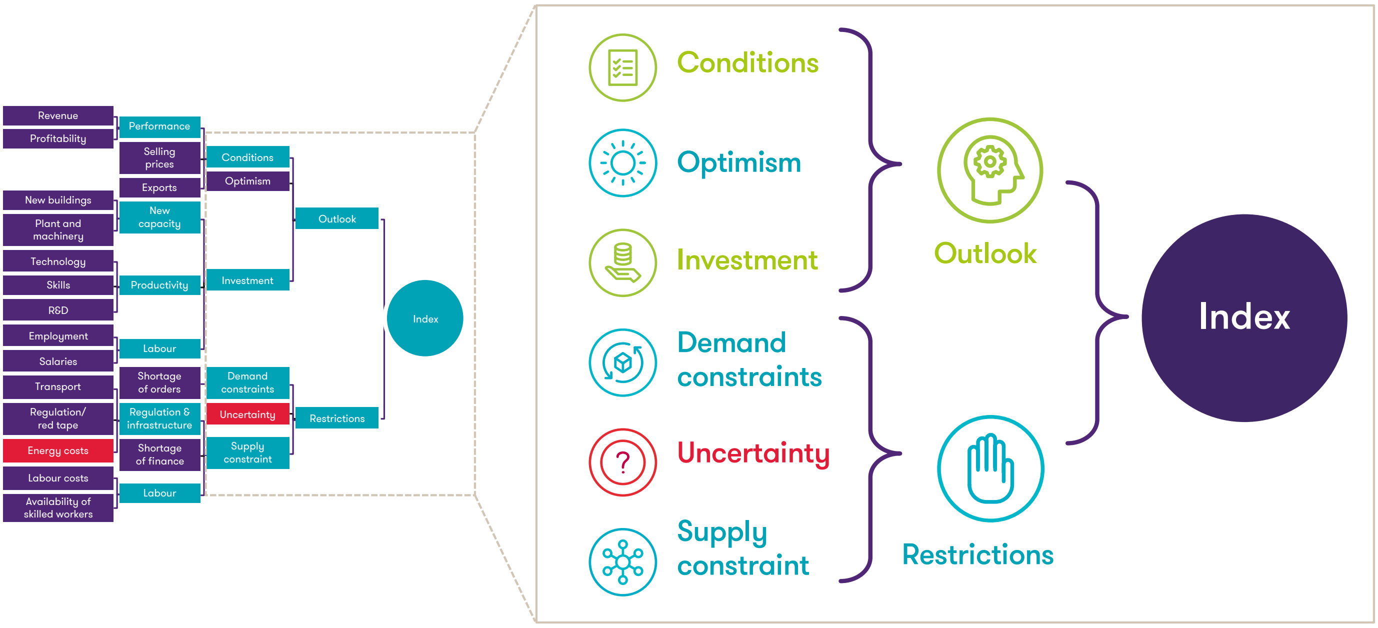
Outlook over the next 12 months

We anticipate an improvement in the outlook over the next 12 months, particularly in terms of investment and economic conditions. This despite President Cyril Ramaphosa's announcement that the country is now in a State of Disaster on electricity and that he will appoint the Minister of Electricity.

The Minister of Electricity will deal with the electricity crisis by expediting energy projects and limiting regulatory requirements while maintaining strict environmental safeguards, procurement principles, and technical standards. It will be evaluated in the H1 2023 report whether the President's announcement has had a significant effect on the country's economic outlook.

However, mid-market businesses need to cushion themselves against a prospective recession if revenue growth is to be realised.

The most alarming components are shown in red in the figure below, while the index's positive components are shown in green. Optimism among mid-market businesses in South Africa has fallen four percentage points to 52% (down from 56% in the first half of 2022). Despite the fall, optimism remains above the 2021 levels and historic averages, indicating businesses' hope for a return to normality. Demand constraints have moderated, which are affected by the energy cost and economic uncertainty. Conditions appear good buoyed by business expectations on revenues and profitability, mainly linked to an anticipation of improvement in selling prices as well as hopes to export more, which will increase non-domestic sources of revenue.

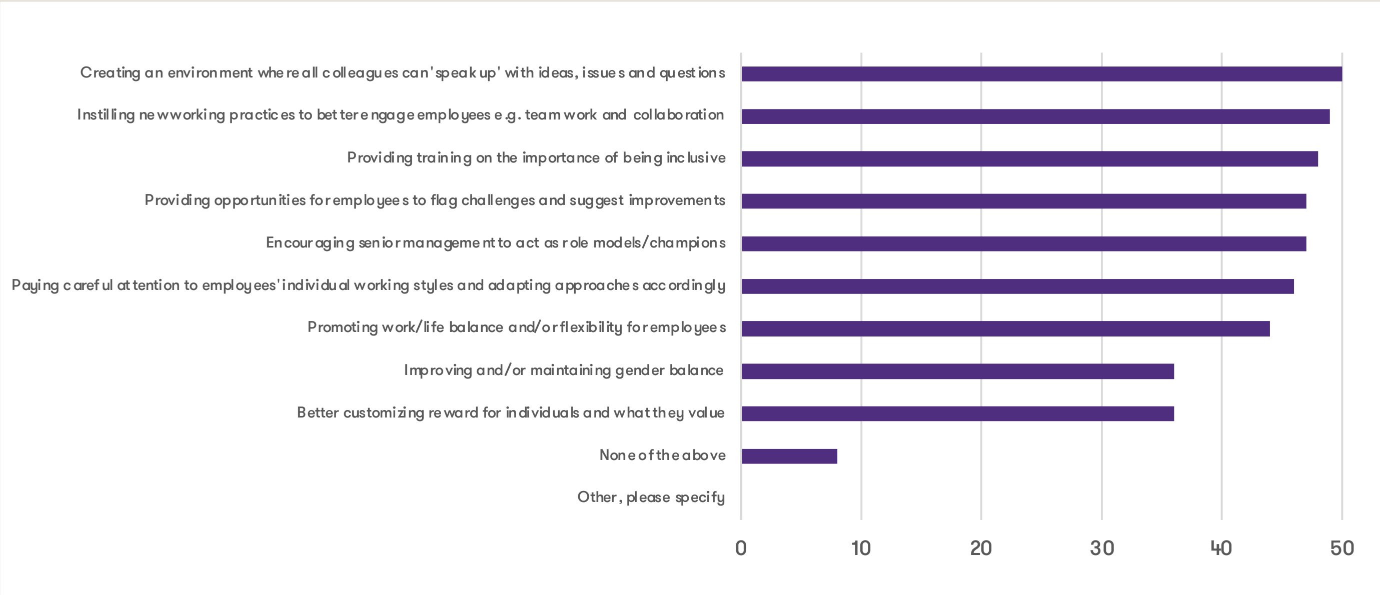


The Journey Ahead

There is a pressing need for all businesses to better understand the international risks they face, to prioritise these and to make sweeping changes to become more resilient, ultimately leading them to be sustainable.

How is your business breaking down boundaries to enhance the employee experience as a way of attracting and retaining a strong and engaged workforce?

While the COVID-19 pandemic shifted the global landscape of way of work, particularly with the introduction of remote and the hybrid way of working, many companies had to quickly learn to adopt and implement strategies to improve their employee experience. Employee experience is becoming more important across the globe. Organisations have discovered that a positive employee experience outweighs the costs associated with it. Our IBR data highlights that 50% of mid-market businesses are creating an environment where all colleagues can 'speak up' with ideas, issues and questions and while 49% are instilling new working practices to better engage employees e.g., teamwork and collaboration. These are some of the strategies needed to enhance the employee experience as a way of attracting and retaining a strong and engaged workforce.



What is the risk of not having the right tax skillsets internally?

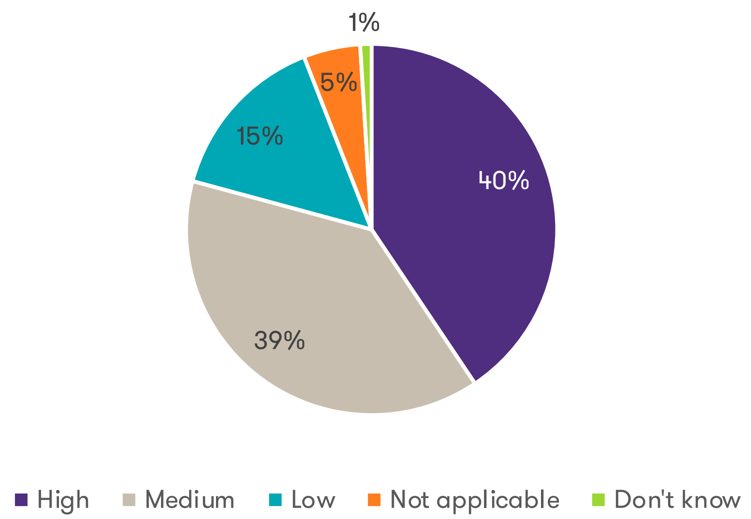
Tax risk management needs to be a proactive process. Lacking the appropriate tax expertise can have far-reaching implications for mid-market businesses beyond just financial repercussions. It can also affect their reputation and legal compliance. It is important for businesses to ensure that they implement tax strategies in line with their business strategies. Respondents to the H2 2022 survey, when questioned on the risk of not having the right skillsets, 41% of mid-market businesses agreed that the risk was high, 39% believed the risk was medium, and only 15% said the risk was low.

It is important for mid-market businesses to consider some of the risks of not having the right tax skillsets internally, these are:

1. **Incorrect tax filings:** A lack of tax expertise can lead to incorrect tax filings, resulting in over- or underpayment of taxes and possible hefty tax penalties.
2. **Non-compliance with tax laws:** Businesses that lack the necessary tax expertise may be unaware of the tax laws and regulations that apply to them, resulting in possible non-compliance and legal disputes.
3. **Loss of credibility:** Errors in tax filings can undermine a business' credibility and erode its reputation among stakeholders such as investors, customers, and partners.
4. **Responding to enquiries:** Inability to effectively respond to tax audits and government agency enquiries.
5. **Missed opportunities:** Businesses without tax expertise may miss out on tax saving opportunities, which could negatively impact their financial performance.

Outsourcing the tax advisory and/or compliance services does not necessarily mitigate the inherent tax risks. In fact, when considering outsourcing, it is more important for the necessary skillsets to be present internally. If outsourcing is being considered and the internal skillset is not at the required level, the business may be exposed to further risks, such as:

1. Complex, expensive, and non-compliant tax structures;
2. Lack of transparency regarding specific tax statuses;
3. Unplanned and unexpected tax consulting fees; and
4. Lack of data ownership.

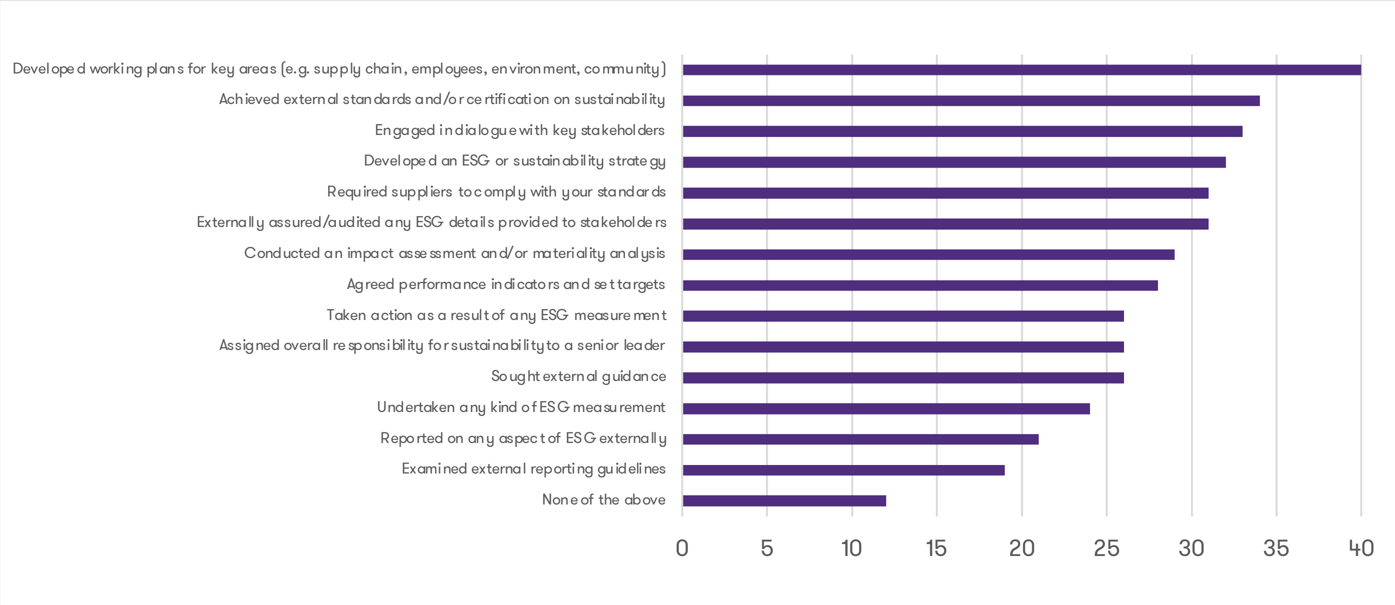


How has your company integrated Environmental Sustainability & Governance (ESG) as well as the UN's Sustainable Development Goals (SDG's) in your strategy and/or supply chain process to ensure your business is purpose-driven and sustainable?

In recent years, many South African companies have begun to integrate Environmental Sustainability & Governance (ESG) and the UN's Sustainable Development Goals (SDGs) into their business strategies and supply chain processes. This is to ensure that their operations are sustainable and have a positive impact on people and planet. The mid-market entities are in the perfect position to operate sustainably and make a positive contribution towards the ESG agenda as they can manage their impact upon it. This is underpinned by their resilience and confident outlook for a prosperous business and investment performance in the long term. According to the IBR data survey data, 40% of mid-market businesses have developed working plans for key areas such supply chain, employees, environment, community, while 32% have developed an ESG or sustainability strategy.

However, there is still scope for mid-market businesses to integrate ESG and SDGs in areas such as:

- Investing in renewable energy and implementing energy-efficient practices to reduce their carbon footprint.
- Developing sustainable products and services that align with the SDGs.
- Implementing sustainable procurement practices and working with suppliers to improve their environmental and social performance.
- Communicating transparently about their ESG performance and progress towards the SDGs.
- Engaging with stakeholders and communities to understand and address their concerns and expectations.
- Incorporating sustainability into their risk management and reporting processes.
- Investing in training and awareness within their entities
- Implementing suitable frameworks for reporting
- Implementing the UN's SDG standards to ensure intent to action



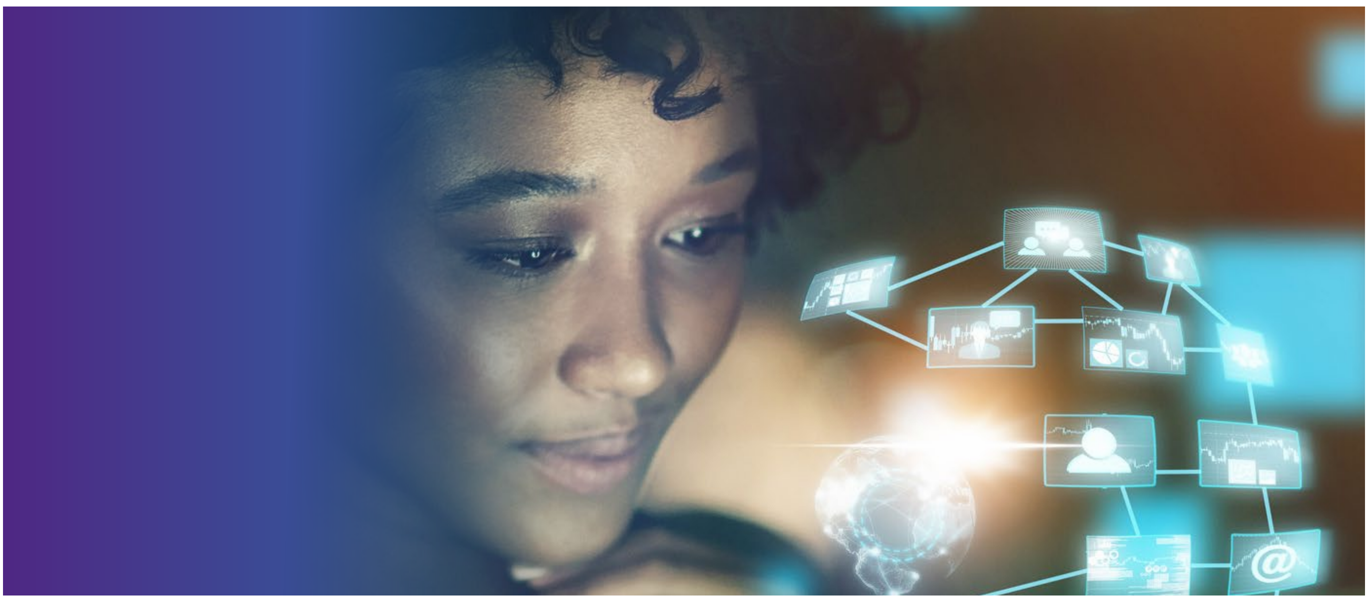
What limitations is your business facing in attaining digital transformation and automating business processes?

South Africa ranks the 3rd most optimistic in terms of the outlook of the economy for the next 12 month. This optimistic view will not be possible without investment in technology, which is an enabler. Notwithstanding the downwards trend in technology investment, the country is still amongst the top 10 globally, ranking 7th in terms of future technology investments intentions. The country also invested heavily in technology during COVID-19 period, where the investment shot up to 84% in H1 – 2021.

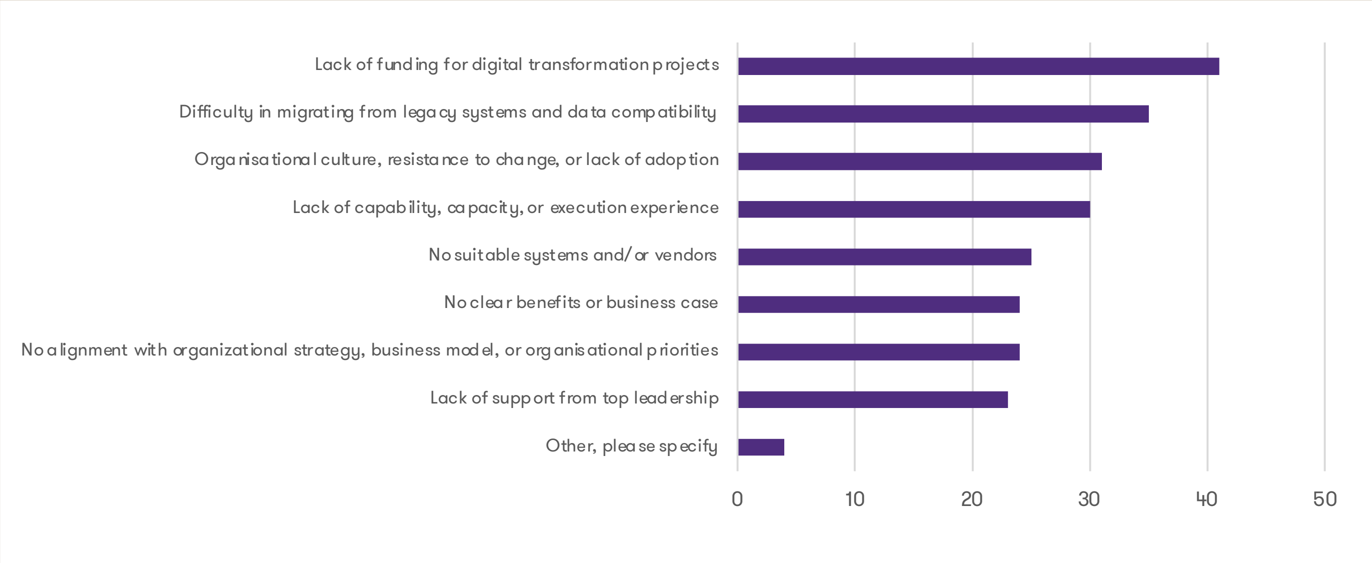
The country ranks 5th globally in investing in staff skills, aligning with technology investment plans. Skills will have to be re-harnessed to aid the adoption and utilisation of technology and to realise the benefits from the technology investments.

A recent study concluded by the University of Johannesburg on Emerging Technologies in South Africa: A landscape analysis (2022), which included a data set from 262 firms, found that the country is investing in the following top 10 technologies to enable economic growth and development.

1. Next generation health;
2. Artificial intelligence;
3. 3D printing;
4. Energy storage solutions;
5. Biotechnology;
6. Water purification technologies;
7. Hydrogen technologies;
8. E-commerce technologies;
9. Software/ mobile applications; and
10. Next generation agro-processing.



Digital transformation is about how businesses bring people, processes and data together to create value for stakeholders. The key consideration for the digital and automation transformation journey is to take people/ employees along, otherwise the envisaged benefits will not be fully realised. The IBR data survey highlights the limitation to digital transformation to be more people related than technology related. The survey revealed the following insights:



Technology is advancing rapidly; therefore, it is important that funders understand what they are investing in. There is a need for a strong business case advocating for the transformation and related benefits of technology, as well as making sure that funders and senior executives understand the reasons and benefits of introducing advanced technologies so they can invest confidently. The difficulty in migrating legacy systems and compatibility challenges can be overcome by rationalising the current processes. Implementing inefficient processes into a new digital platform will not yield the benefits. Training and reskilling people, while encompassing cyber security will support an easier adoption of technology.

What do you think will be the three biggest challenges that your business will face in the next 12 months?

Despite their optimism, businesses continue to face challenges. Some mid-market companies are still concerned about the lingering impact of the COVID-19 pandemic. According to IBR data, 29% of respondents identified future pandemics as one of the challenges they may face in the future due to the inability to fully prepare for one as we do not know what form it will come in. However, 50% of respondents believe that the most significant challenge is economic slowdown, which is supported by an annual inflation rate of 6.9% in 2022. The energy crisis and increased cost of living has a severe impact on the economy. To negate financial challenges during inflation, mid-market businesses would need to implement short to medium-term strategies. This issue was covered in the H1 2022 IBR report, where we provided guidance on how businesses can respond to inflation and how they can use technology to increase their profit margins.

Some recommended first steps included managing costs carefully and creatively, buying more in advance to lock in prices, hedging where appropriate, and even looking into reverse auctions, while also attempting to become more effective and accomplish more with less. This year, we are adding more action plans that mid-market businesses can use to hedge against inflation as depicted by the graphic below

	Benefits
Identify and mitigate the risks of inflation for your business	Builds an initial understanding of the forces at work and agreed actions for addressing them.
Take action to limit external cost increases (for example by locking in prices, bulk buying, renegotiating terms with suppliers, or changing suppliers)	This is the basic countermove to keep cost increases to a minimum. Limiting these is always important, but vitally important now.
Outsource more activities to lower costs and ameliorate labour shortages	Traditionally the main benefit of outsourcing has been to lower costs. This is still important but outsourcing can also improve access to skills in a time of shortages.
Improve your understanding of the true cost to serve clients	Provides a better understanding of the costs at a customer level so you can prioritise profitable and tackle unprofitable ones.
Change your pricing strategy so it is more in line with cost increases	This will help to offset some or all of the cost increases depending on your pricing power in the marketplace.
Take action to improve capital structure	Helps control the rising cost of capital and provides you with the working capital you need for essential actions in other areas.
Take steps to improve internal efficiency and costs, and/or reduce waste	Greater efficiency – normally associated with digital investment – allows you to do more with less which is good for your profits and the planet.

SNG Grant Thornton has vast experience and the expertise in providing advisory services to businesses going through investment and adoption journeys to ensure growth.

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