CASE STUDY: WHAT IF

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MINING HAS POTENTIAL TO UPLIFT BUT NEEDS STATE SUPPORT

In 2017, we conducted a survey among our members in an attempt to understand the investment and employment potential of the mining sector in the event of a return to best practice in policy, legislation and regulation formulation.

We asked: "What if the South African mining sector could get back into the top 25% of investment attractiveness rankings, which is where our potential suggests we should be?" Altogether, 16 companies responded to the survey, representing a cross-section of the various commodities and making up the overwhelming bulk of mining production in South Africa.

The South African mining industry's real GDP in 2017 was 3.9% lower than that recorded in 1994. The financial services industry has in contrast grown by 168% over the same period. The question is whether this divergence is due to lack of potential or the negative effects of the regulatory environment. The responses to the survey present an indication of the effect of the regulatory environment of which the Chamber has been highly critical.

South Africa has consistently fallen short on the Fraser Institute investment attractiveness index (with regard to best practice policy, legislation, regulation and operating environment). In contrast, the same Institute ranks South Africa in the top quartile for its mineral potential. Clearly, there is a fundamental mismatch between the potential and the current outcomes.

Mine development has long lead times so certainty and a conducive policy environment are important determinants of hurdle rates for return on investment. In an adverse environment, hurdle rates have to be reviewed constantly and repriced upwards as the risk premium associated with the operating environment increases. In an unstable environment, the probability of potential investment not taking place significantly increases, rendering projects unviable.

Some companies stressed that investment generally depends on a wider variety of determinants than the political and policy stability of the operating environment. For example, the commodity price cycle and forecast price assumptions are important in making investment decisions. The aim of the survey was an attempt to isolate the effect on investment of the policy environment from the operating environment.

To understand the potential positive effect of policy certainty, we quantified the amount of current capital expenditure already in the system. Company reports, the 2017 Nedbank report on Capital Expenditure Project Listings, Statistics South Africa and South African Reserve Bank numbers were used in this regard.

The estimated current capital spending in the mining sector (stretching over the next four years) amounts to more than R145 billion. The potential capital expenditure in a more certain and conducive environment (covering at least another three years) could amount to an additional outlay of more than R122 billion.

Capital expenditure on mining projects could therefore be 84% higher than the current R145 billion. The positive effect on employment creation, according to the survey results, would be nearly 48,000 people.

Much of the planned investment is to 'stay in business'. Investment in new mines halved from 2012 to 2016 and that was before the 2017 publication of the reviewed Mining Charter. The survey clearly indicated that this adversely affected the trend.

Five companies indicated that potential new investment was not being considered, while one company is contemplating divesting from South Africa. These respondents could either not see worthwhile investment opportunities or the adverse environment had shifted their focus to other geographies.

An interesting finding is that the relative contribution to investment of the R122 billion potential spend does not correlate with the relative employment effect. For example, the coal sector has the highest investment potential, representing 42% of the total potential investment, but only 31% of the employment potential.

The converse is true of the gold sector, which has the highest employment potential (62% of the total potential jobs) but only 31% of the capital spend. Of the current capital expenditure, the PGM subsector is spending the most, or nearly 46% of the total.

Based on these findings, the mining industry certainly has significant investment and employment potential, but unlocking this potential will require a nurturing environment to stimulate long-term investment. It will also require the support of a pro-business regulator in creating partnerships for growth in order to foster investor confidence.