A newsletter from Credit Guarantee
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CREDIT NOTES

The credibility gap
Spotlight on credit disinformation

EXCHANGE CONTROLS: Just how relaxed *are* we?

THE ECONOMY: Is our current bliss set to end in misery?

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CREDIT GUARANTEE

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CREDIT GUARANTEE

Don't risk it without us.

SA companies have the edge in Africa

South African companies doing business in other African countries have a significant advantage over their competitors and achieve profit margins double or three times as high as those achieved in South Africa.

Moreover, notorious obstacles such as inadequate infrastructure and corruption are not nearly as big a problem as popular perceptions would have them. These are the reasons why more and more South African companies are expanding their operations in those countries, while those already established on the continent are optimistic about future prospects and they expect solid growth.

These are some of the conclusions drawn from the results of a survey done by research group *Who Owns Whom* among 40 of the top 100 companies quoted on the JSE Securities Exchange.

The survey is a joint project with the South African Institute of International Affairs and the first phase of the survey was supported by the SA Foundation. The second phase will be a survey among non-quoted companies.

The survey revealed that the 40 companies surveyed had already made 227 fixed investments in 27 African countries covering a wide spectrum – from mining and telecoms to construction, services and retail trade.

Investments in Africa really took off sharply after 1994. According to Andrew McGregor, managing director of *Who Owns Whom*, the response to his team's probing showed that companies were optimistic about their future operations in Africa.

South Africa's commitment to this continent gives local companies an enormous advantage over their competitors, particularly those from Europe. Respondents said European competitors were easily brushed aside because they were seen to be dumping inferior technology and products on the continent at inflated prices.

"China and India, instead, are regarded as future competitors," the survey found.

African markets are very loyal to local brands while products from companies with a presence in Africa enjoy a high degree of loyalty. Some products and solutions designed in South Africa for the lower end of its market are often ideally suited to these markets.

In fact, South African products dominate some markets in Africa and 17% of the respondents reported their investment had achieved a market share of over 75%. About 67% of investments still had less than 25% of market share and were regarded by those companies as growth opportunities.

Some companies limit their profit margins in order to keep out competition. They can do this because they still attain much higher profits than in South Africa.

Of course Africa presents many challenges, with poor road and rail links generally seen as obstacles.However, companies say telecoms infrastructure in most countries is adequate and is well managed.

Corruption is no longer such a great problem as it is generally thought to be. The only companies citing this as a problem were construction firms. Most companies who invested in Africa after 1994 do not see this as a problem.

The labour force in Africa was reported to be generally literate, very loyal and conscientious, but short on essential skills. Most South African companies therefore appoint skilled South Africans to key positions for the first number of years and use the opportunity to transfer skills to locals.

Some South African companies have had to step in and create their own infrastructure, which often took a long time. But they regarded this as part of their holistic approach of investing in the longer term.

It also offers benefits to local communities. The roads that MTN had to build in Nigeria to establish and maintain its mobile network are now being used widely by the rest of the community. And Shoprite's preference for locally produced perishable products has led to the development of secondary industries in the countries where it operates.

– David van Rooyen, Rapport

Weeding out delinquent directors (and others)

Company directors are ultimately custodians of shareholders' best interests, owing a duty of care to those who choose to invest in the organisations they manage. However, the global investing community has witnessed a number of cases where directors have forgotten their mandates, with millions being lost due to their destructive actions.

It seems though, that there is reason for hope. That's because the quest to weed out what have been termed "delinquent directors" from the boards of South African companies has received a shot in the arm with the amendments to the Companies Act, which essentially cast the liability net even further.

The title of section 218 of the Act, which outlines who is liable in the case of something going wrong at a company, has now been amended to read: "*disqualification of directors and others.*"

"The addition of the words 'and others' has implications for all senior staff at organisations," says Dave Walker, a director at Werksmans Attorneys. He said that besides disqualifying directors or managers who are directly involved in contraventions of the law, "any director or officer who knew, could know or could reasonably be expected to know of the contravention" shall now be guilty of an offence.

A further change states that these people "shall be liable, jointly and severally, for all debts incurred by the company for the period during which such person knows or could reasonably be expected to know of the contravention" – a daunting thought for anyone engaging in corporate fraud.

This is good news for investors and South Africa's economy, argue commentators. "When one considers that decisions made by directors may from time to time affect the lives of many thousands of citizens every day, there has never been a greater need for SA industry leaders and entrepreneurs alike to uplift their performances and those of their companies for the overall benefit of the various stakeholders and the country's economy at large," says Eric Levenstein, a director at Werksmans Attorneys.

Not only do directors need to ensure they carry out their fiduciary duties properly, they must also exercise decorum when they do not have their directors'caps on. Directors convicted of fraud and dishonesty cannot serve in similar positions again, according to section 218,

"Any person who has, in terms of an Act of Parliament, been removed from office for not being a fit and proper person to serve as a director or in the management or in any other position of trust of the body in question due to theft, fraud, forgery, uttering a forged document, corruption, whether in terms of the common law or not, or any other act involving dishonesty," states the amended act.

"Should a director be charged with any of these crimes, the clerk of the court must send that director's details and details of their offence to the registrar of companies, who must then notify the shareholders of the company within 60 days," says Walker.

Directors of dissolved companies are not easily forgotten, and provision for this not to happen is made by the act, says Walker: "The Companies Act requires the registrar of companies to keep a register of directors of dissolved companies that were unable to pay their debts, and requires the liquidators of such companies to notify the registrar of such a director, and which of them are considered to have been responsible for the insolvency."

However, in practice, the existence of this register is almost unknown. Perhaps the new focus by government on good corporate governance will spur companies to improve their use of the register.

– Ana Monteiro, Moneyweb

CregaLink gets better and better

The latest improvements to Credit Guarantee's CregaLink online policy administration system involve modificiation of the Alpha Listing and Download Listing to save policyholders even more time.

From the Alpha Listing you can now view:

*** A comments field.**

*** Nils only.**

*** All the trade styles of the buyer.**

*** Foreign currency limits for exporters.**

From the Download Listing:

*** We have included all of the above.**

*** We have also made the download so much simpler. So toss away those notes on the text import wizard and save your information in 'CSV' format, which means you can open up the information directly in Excel.**

Another brilliant enhancement is the *View Expiring Limits* option which allows you to view current and future dated expiring limits.

Log onto https://www.cregalink to see these changes for yourself. Remember to check the Help Menu for more details.

If you need any assistance, please call senior e-business administrator Nancy Ismail on 011 889 7417.

Soft factors threatening our bliss

Is all current *joie de vivre* justified, or is the bonhomie being displayed by consumers and business alike set to end in misery?

To the extent that the present prosperous times for the domestic economy are due to our own efforts, one must always bear in mind the crucial impact that external factors play. The rapid 40c fall in the exchange rate at the start of the year may yet prove to be transient with very few analysts expecting a continued freefall. Certainly European and US interest rates are expected to be hiked during the year and thus to put some pressure on the rand, but global dollar weakness should ultimately prevail.

We would concur with this anticipation of a stronger rand, and hence why some are chanting a mantra of 'survive or thrive at five'. In other words, we see little threat to the attainment of the inflation targets this year. Despite stronger oil prices of late, we foresee that this scenario should see local interest rates remain unchanged for most of 2005 although inflationary pressures in 2006 could alter the stance of the monetary authorities 15 months hence.

What is to be made now of our Christmas sales (November/December) forecast of R67,5bn, implying nominal and real growth of 15% and 11% respectively? Many retailers have given indications of sales levels of such magnitude and indeed we have no reason to doubt that such an overall performance was achieved.

Taking into account company liquidations that were 33,7% lower in November 2004 than a year earlier and 16,4% lower in the first 11 months of last year, this would appear to point towards a bountiful period for corporates. Likewise the 34% lower level of personal sequestrations would tend to indicate the improving financial health of individuals.

The SA Reserve Bank reports that, despite household debt to disposable income rising from 51,4% at end-2003 to 55,4% in q3 2004, debt servicing costs of 6% in the first three quarters of last year are in fact well below the 2003 average of 8%.

Interest rates

To the extent that the local economy is considered overheated from a spending perspective, many analysts including this one are still endeavouring to get an accurate handle on the evolution and deepening of spending patterns as transformation improves the economic standing of formerly disadvantaged tiers. As such, we are not overly concerned – from a macro perspective – at present but if global growth were to falter and the rand to depreciate moderately to closer to R7/$ in 2006, then interest rates could easily rise by say 2%.

That almost 20% hike in borrowing costs could throw many finely balanced household budgets into disarray. Current interest rates provide many with the best opportunity in two decades to make meaningful inroads into debt by repaying capital.

Wealth tax

Looking forward to the national budget, Finance Minister Manuel has already hinted at minimal tax relief this year given the mooted infrastructural capex thrust, although it could be argued that some degree of fiscal drag relief is justified. Some would also argue that the take from transfer fees on property transactions of close to R500m per month is exorbitant and just another form of wealth tax.

Our beef with the tax authorities, however, has to do with the lack of concerted efforts to widen the tax base and not merely to extract more from registered taxpayers. This taxpayer has thwarted successive attempts to incorrectly apply allowable deductions – this is all of an unnecessary, time-consuming and costly aggravation. But there are many with established businesses of varying sizes that remain totally outside of the net.

Finally, whether the current 18% Retirement Funds Tax will be reduced or more incentives introduced to promote individual retirement savings is also anyone's guess.

A Moral order

Government is attempting many laudable efforts, not least being equality in society in all of its tenets. However, goals should include a desire to leverage up rather than down with regards to education; to take justified criticism to heart and make practical adjustments where necessary; to emphasize a culture of endeavour being rewarded as opposed to entitlement; and to punish non-payers and engender a moral order of caring.

I would argue that real and concerted efforts at moral regeneration are merely hot air. The very people that are elected to serve the masses set poor examples and such actions are condoned – what has happened with the travel scam transgressors? Furthermore, meddling in the judiciary will serve to undermine the very cornerstones on which civil society rests. Interpretation of the law should rest on what is deemed right or wrong, nothing more.

The environment

We aspire to be a developed nation, yet our attitude towards the environment and pollution displays an abject 'don't care' approach. These are often forgotten or thought of as the 'soft' factors, yet they have the potential to derail the positive 'harder' economic sentiments espoused above.

– Luke Doig

Senior economist, Credit Guarantee

17 January 2005

Uganda – Africa's surprising gem

Uganda is in the same league as China and India in terms of investment climates in developing countries, according to a newly released World Bank report launched in Cape Town towards the end of last year. According to the *Better Investment Climate for Everyone* report, China, India and Uganda "illustrate some simple lessons about strategies for making investment climate improvements".

The three countries were singled out as success stories in research that included surveys of nearly 30 000 firms in 53 developing countries. About eight African countries were included (South Africa will be included in the next survey) in the research, which has the objective of "creating opportunities for people to escape from poverty and improve their living standards".

There is often a wide gap between perceptions of investment opportunities and the realities in developing countries, particularly in Africa, which translates into low foreign direct investment flows for these economies.

China and India have "both grown impressively in recent years, greatly reducing poverty", said the report. China's growth is officially reported at an average of 8% a year for the past 20 years, with the share of its population living on less than US$1 a day falling from 64% in 1981 to less than 17% in 2001.

India's growth is also impressive, increasing from an average of 2,9% a year in the 1970s to 6,7% by the mid-nineties. The share of its population living on less than US$1 a day fell from 54% in 1980 to 35% in 2000.

"Both countries unleashed growth and reduced poverty through what appeared to be fairly modest initial reforms," said the World Bank. These included a rudimentary system of property rights in China, which created "new incentives" for a substantial part of its economy. India, meanwhile, "began with early efforts to reduce trade barriers and other distortions that covered a significant part of its economy."

"In both cases the reforms addressed important constraints, and were implemented in ways that gave firms confidence to invest. And the initial reforms have been followed by ongoing improvements that addressed constraints that were less binding initially, and also reinforced confidence in the future path of government policy."

Such strategies, said the World Bank, "are not limited to large countries". Uganda, it pointed out, launched its programme of investment climate improvements in the early nineties after a period of civil conflict. Reforms covering many areas of the investment climate provided the basis for growing its economy by an average of more than 4% a year during 1993 – 2002, or eight times the average in Sub-Saharan Africa.

Ugandan president Juveri Museveni: His government's persistent reforms have enhanced its credibility and boosted private investment.

Uganda reduced the share of its population living below the poverty line from 56% in 1992 to 35% in 2000. "The persistence of government's reform efforts enhanced its credibility, giving firms the confidence to invest," the report said.

"As a result of investment climate improvements in the eighties and nineties, private investment as a share of GDP (Gross Domestic Product) nearly doubled in China and India; in Uganda it more than doubled."

Though foreign investment is "becoming more important" in developing countries, the bulk of private investment remains domestic, according to the World Bank.

– Jackie Cameron, Moneyweb

The credibility gap

Attorney Louis Rood probes with his forensic spotlight into the dark corners of credit disinformation*

The causes of business failure are many and varied. Sometimes, like the Biblical plagues of ancient Egypt (rivers of blood, frogs, cattle disease, lice, flies, hail, locusts, death of the firstborn), these are calamities from external factors over which the business has little control.

The modern-day pestilences of inflation, oil prices, wars, political turmoil, the impact of HIV/Aids, crime, dumping and drought can play havoc with the best-laid business plan. Finance Minister Trevor Manuel bluntly told the clothing and textile industries late last year to face up to the "tough realities" of a rapidly changing world trade environment if they want their sector to survive and grow.

All the potential dangers and possible mishaps which can befall any business should be factored into any credit risk assessment when considering an application for the granting of credit facilities, rating the credit risk of any potential customer, or underwriting such exposure.

The business entity requiring credit is usually required to complete and submit a written application. Typically, this provides the following information:

• The name of the business entity

• The nature of the business entity (company, cc, trust, partnership, sole proprietor)

> ***Information is not knowledge. It only becomes knowledge when you know it is correct.***

• Address – physical / postal / e-mail

• Telephone / fax / mobile numbers

• VAT registration number

• Directors / members / proprietors – their names, home addresses, phone numbers, identity numbers

• Bank, branch, account number

• Trade references

None of those details reveals anything at all about the creditworthiness of the applicant for credit.

The information does however allow the creditor:

• to contact the trade references,

• access a report from a credit bureau, and

• apply to Credit Guarantee for cover on the applicant.

The trade references supplied are often of doubtful value. An applicant is not likely to refer the creditor to anyone who will provide a negative rating.

The credit bureaux and Credit Guarantee are likely to have far more reliable information available upon which to base an assessment, in particular a history of prior default, adverse judgments, and other previous trade enquiries.

Obviously the more information you have, the more accurate the information, and the more recent the information, the more confident you can be in making a risk assessment. Or is it?

What is not always fully appreciated is that the information on which the assessment is based must be the right information. It must be relevant. It must be reliable. Its accuracy must be ascertainable. Information is not knowledge. It only becomes knowledge when you know it is correct.

The gaps in evidence

Consideration must also be given to evaluating the information which you do not have. A good lawyer will always pay attention to the significance of the documents which cannot be found, the details which are not supplied, and the gaps in the evidence.

American Defence Secretary Donald Rumsfeld has spoken of –

• The known knowns – those things you know (about your customers).

• The known unknowns – those things you know that you don't know (about your customer). These are the things you should find out.

• The unknown unknowns – these are things you are unaware of (about your customer). You don't know they exist. In fact, your customer may also not know they exist. For example, that he has cancer; that he is HIV positive; that his factory is about to be expropriated for a road-widening scheme; or that his

rivals are about to flood the local market with cheaper imported goods.

Former American President Dwight Eisenhower once told a group of graduating students: "Your business is to put me out of business."

In a competitive business environment, although the primary purpose of business may be to make money, it does not hurt to put your opposition out of business. The lion may kill the zebra to feed himself but will be at his most dominant when eliminating another predator that competes for the same meal, whether a leopard, cheetah, hyena or, indeed, lions from another pride. How do you rate a credit applicant's ability to compete, and thus to survive? Only those who survive are able to flourish and grow (and pay their debts).

Personal information

It is self-evident that the success of many a business directly depends on the persons who run that business. However, one aspect which is hardly assessed at all, and about which information is seldom asked for on which to base a risk evaluation, is personal information about the key personnel who own, manage or conduct the business of the applicant.

The Bill of Rights in our Constitution provides in Section 9(4) that no person may unfairly discriminate directly or indirectly against anyone on the grounds of race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language, birth, or any other grounds.

This does not mean that an applicant for credit cannot be requested to provide any such details about the directors, members or proprietors of the applicant business. The information must however be reasonably relevant for the purpose for which it is legitimately required. That would not be "unfair".

What this means is that to ask an applicant to supply his or her age, marital status, gender or nationality would normally be permissible.

Although an application for credit facilities is not an application for employment, guidance may be obtained as to which personal details may be requested and what would constitute an unfair labour practice.

To enquire whether someone is gay or

When vertical goes horizontal, the 4x4 runs out of gas and starts rolling downhill. The strain start showing on the persons who have to run the business – substance abuse, insomnia, marital discord, chronic depression, denial, aggression, withdrawal, embarrassment, humiliation, low self-esteem and a general deterioration in the ability of the key personnel to mount a rescue or salvage operation.

has a previous criminal record would probably not be permitted as not being reasonably necessary to assess credit-worthiness. However, to enquire whether someone is married in or out of community of property, with or without the accrual system, or whether someone who is unmarried is in a permanent life relationship with someone else (of the same or different sex) would probably be permitted, because of the financial rights and claims such spouses or life partners may have acquired. They would in effect be creditors of the applicant with preferent claims on his or her assets.

And although an application for credit is made for a different purpose to an application for life assurance, the personal health, medical and family history details typically sought in a life assurance application does indicate the extent to which private information may legitimately be sought if the purpose justifies it. Of course no applicant is under any obligation to supply any personal details if he or she does not want to. The creditor in turn is not obliged to grant credit if it is not satisfied it has sufficient relevant information on which to base a decision.

The credit bureaux and Credit Guarantee are likely to have far more reliable information available upon which to base an assessment, in particular a history of prior default, adverse judgments, and other previous trade enquiries.

Scavenging the carcass

But why are personal details relevant? The proof of the pudding is in its eating. When a business goes belly-up, and the mournful scavengers pick through its rotting carcass, stiffened joints and bare bones, what is revealed? Was death the result of an unforeseen lightening bolt from the blue, or some hidden predator that pounced? Not all that often.

A more usual autopsy reveals:

• A business that cost a lot more to run than the shareholders anticipated. Greater capital reserves had to be raised, overdraft limits were exceeded, extra loans scrounged at high rates, unlimited suretyships granted, property pledged, book debts ceded, extra bonds raised on homes, personal policies surrendered.

• The financial pressure then tells on the business. Marketing budgets are pruned, research and development investment is slashed, wages and staff salary increases are kept to the minimum. Dissatisfaction results in key personnel resigning, service levels drop, training takes a back seat, deadlines are not met.

• The good life the directors have lived suddenly lurches into the red zone. Up to now personal expenses have been channelled through the business. A wife's clothing has been debited as "uniforms", domestic groceries as "staff meals". Cell phones for the kids, home computers, family holidays and lavish entertainment have all been "perks" of owning the business. Compliant and under-skilled accounting and administration staff and creative write-offs have created a bubble of illusion waiting to pop.

• When vertical goes horizontal, the 4x4 runs out of gas and starts rolling downhill. The strain starts showing on the persons who have to run the business – substance abuse, insomnia, marital discord, chronic depression, denial, aggression, withdrawal, embarrassment, humiliation, low self-esteem and a general deterioration in the ability of the key personnel to mount a rescue or salvage operation.

Useful knowledge

It might have been helpful if a creditor had known 18 months earlier, when considering the credit application, that the applicant was previously divorced, with three minor children from his previous marriage, all at private schools, paying maintenance for his ex-wife and keeping her and his children on his medical aid, liable for their educational expenses, including tertiary education; that his present wife has two children of her own from a previous union, gets no maintenance from their father who has disappeared and has no income of her own; that the applicant suffers from hypertension and has a cholesterol problem for both of which he is on chronic medication, causing him to vastly exceed his medical aid cover each year; that the house he lives in is fully bonded, the furniture and household effects in the house are the property of his present wife in terms of their antenuptial contract; and that he supports his aged parents who are former Zimbabweans now in South Africa, both in poor health with no other assets, income, pension or medical aid.

** Louis Rood, author of this article, is a partner in the Cape Town law firm of Fairbridges*

This is a common enough profile of people who start and run businesses, some successfully, but many others unsuccessfully, and where creditors are blissfully unaware of any such personal circumstances.

False applications

Statistics in South Africa reveal a shocking level of fraud and falsification in job applications up to the highest level. Degrees and diplomas are forged. Work experience, knowledge and skills are fabricated, manipulated and misrepresented. False and misleading information taints many a credit application.

Yet potential credit grantors so often fail to check and verify what is submitted to them. Often the credit grantor never meets the applicant – with instant communication technology, this is not considered necessary.

A business may feel that it has its customer credit data well under control, with little realisation that from the outset up to 25% or more of that data is either false, or seriously misleading

because of non-disclosure.

Very little account is also taken of the ever-changing nature of such data. Details supplied in the original credit application rapidly become obsolete. Not only cellphone numbers and addresses are changed, but directors marry, divorce, die, resign or are fired, without the credit grantor ever being informed, or taking the trouble to update its data.

It is not only the profile of the debtor which can change completely within a year or two of the credit application being approved. Quite frequently the credit grantor itself undergoes a corporate restructure within its group, the result of which is that its business continues through a different entity under the same or another name. But the suretyship upon which credit was originally granted is no longer enforceable because the identity of the creditor has changed. Furthermore, the terms and conditions attached to the original credit application are no longer enforceable, because of this change of identity.

Updating debtor files

As long as business is being done with the debtor, and accounts are being paid, even if late, there is little incentive to go to the trouble of regularly updating and verifying information captured on file about that debtor. Yet the

The reliability of information on which credit risk assessments are based is often a lot less than that of the weather forecast.

comfort zone of complacency often rests on shaky foundations. Late last year the Supreme Court of Appeal handed down a judgment (Brink v Humphries & Jewell (Pty) Ltd), declaring invalid a suretyship on a commonly used credit application form which had been used by that particular creditor for 15 years without it ever being queried. Four Judges of Appeal came to the view that the credit application form was "a trap for the unwary" and the signatory was "unjustifiably misled" by it. One dissenting judge disagreed, but that is cold comfort.

The result of this judgment effectively means that unless a personal surety is contained in a separate document clearly called a suretyship, the distinct possibility exists that a defence will be upheld that the signatory was misled into believing that the credit application did not incorporate a personal suretyship, irrespective of the wording and prominence of the suretyship clauses.

Imagine the thousands of suretyships stored in the files of creditors who have granted credit on the strength of such suretyships which are now likely to be declared invalid and unenforceable if tested by our courts.

When default occurs, your lawyer will provide the firearms with which to do battle, but will ask you for the ammunition. That is often when the duds are revealed. In the case of Home Fires Transvaal CC v Van Wyk & Another 2002(2) SA375 (W), three judges of the Johannesburg High Court confirmed that a debtor was not bound by the terms and conditions on the reverse side of a document which had been faxed by the creditor to the debtor for completion and signature. Only the front of the form had been sent. It was duly completed and signed by the debtor and returned to the creditor who then acted on it.

No reverse side

When the debtor defaulted, the creditor tried to rely on the terms and conditions on the reverse side. Even though there was reference at the bottom of the front page to the conditions on the reverse side, the Court said that the debtor was not bound by his signature to a contract which he had not read. Where the creditor knew that the debtor had not read the reverse of the document, the creditor could not claim to be misled by the signature and only had himself to blame for the debtor's ignorance of the contents on the reverse side of the document.

It has become commonplace to transmit a credit application form by fax. This is then completed and signed by the applicant, and faxed back to the creditor, who duly approves the application. It is equally commonplace for the person faxing the blank form on behalf of the creditor not to bother to fax the terms and conditions on the rear but only those portions of the document with blank spaces which need to be filled in. In such circumstances, the terms and conditions on the reverse are unenforceable against the debtor.

For all these reasons, even in the best managed business, the reliability of the information on which credit risk assessments are based is often a lot less than that of the weather forecast.

The hidden dangers

In a climate of rising business confidence and low interest rates many businesses are now less risk averse than they might otherwise be. Some elect to terminate their credit insurance as they set sail on the rising tide of expansion

One aspect which is hardly assessed at all ... is personal information about key staff who own, manage or conduct the business of the applicant.

and growth. But the hidden dangers of the deep sea are never that far away. The cyclical nature of all things means that the surge of that rising tide carries in its wake all the folly of overheated retail consumption and a credit spending splurge which can soon drain away the waves of profit leaving the careless creditor high and dry.

So, if you don't want to be like the piggy whose house of straw was blown down by a huff and a puff of the big bad wolf, an overhaul of your credit management is a good idea:

- Do an audit to identify your weak points, and how they can be strengthened.
- Review and improve your credit application forms.
- Implement effective procedures to ensure your information stays up to date.
- Ensure that channels of communication between your sales team dealing with the customer and your credit management are open and active.
- Communicate more with your customers and get to know them better – this will not only improve business relationships, but also your ability to continuously assess their creditworthiness.

The better questions you ask, the better answers you get. And remember, you can never have enough knowledge.

Exchange controls: Just how relaxed

In his medium-term budget policy statement, Minister of Finance Trevor Manuel referred to the success of the gradual relaxation of exchange controls in South Africa since 1995 which he said had "facilitated the steady reintegration of South Africa with the global economy, while guarding against the macroeconomic risks of disruptive capital flows".

With each year and budget speech the gradual removal of the exchange controls continues through, as former Reserve Bank governor Chris Stals said, "the periodic lifting of limits and other administrative measures over a wide front to cover the corporate sector, institutional investors and private individuals".

It seems therefore that ultimately government's goal is to eradicate exchange controls in favour of a prudential reporting system.

In this article, ANDREW LEONTSINIS* gives a brief summary of the relaxations to the exchange control regulations which have already occurred.

For more than 40 years, South African residents were essentially prohibited from investing outside of South Africa.

With the political and social transformation since 1994 and the consequent lifting of sanctions, the South African Reserve Bank (SARB), which is responsible for the administration of exchange controls, and the Department of Finance began in 1995 to phase out exchange controls.

The early years

In 1995 there was considerable progress in relaxing exchange controls. On 13 March 1995 the dual currency system of the financial and commercial Rand was scrapped. In June of the same year a scheme enabled insurers and pension and mutual funds to expand part of their existing asset portfolios into foreign currency denominated investments. In addition, various mechanisms to lessen the administrative burden of exchange controls were introduced. For example, authorised foreign exchange dealers were given greater discretionary powers on exchange control applications without the necessity of prior reference to SARB. In addition, South African corporates were permitted to invest a total of R42 billion in foreign countries funded by share placements abroad and offshore borrowings.

What the budget speeches have said

The 1998/1999 national budget speech announced that, to assist corporates in their foreign cash management strategies, South African corporates could retain foreign currency earnings in the form of export proceeds and service receipts for a total of 180 days from the date of shipment or service.

South African corporates were entitled to make application for the transfer of up to R50 million in order to finance approved foreign investments and up to R250 million per project for approved new investments within the Southern African Development Community (SADC) other than to those countries in the Common Monetary Area (Namibia, Swaziland and Lesotho). Throughout the Common Monetary Area (CMA) there are no exchange control restrictions. All countries within the CMA apply similar exchange control measures.

In addition, in realising the advantages to regional economic development, dual listing of companies on the JSE and other SADC stock exchanges was permitted on application and

are we?

Finance Minister Trevor Manuel announcing further exchange control relaxations during his February 2004 budget speech. Will he go the whole hog during this year's budget presentation?

subject to the approval of the Minister of Finance and within the R250 million limit (supra).

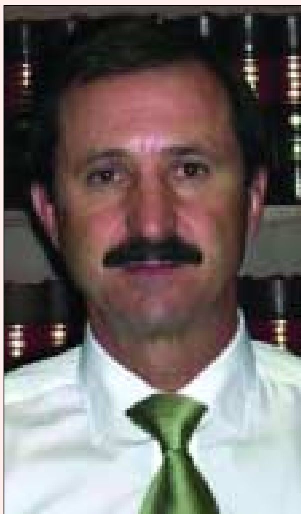
Also in 1998/1999, the restrictions on the opening and operation of customer foreign currency accounts with local authorised dealers by businesses making profits or commissions on foreign transactions were lifted subject to the 180-day limit for the repatriation of funds.

During the calendar year 1998 qualifying institutions were also permitted to invest offshore up to 5% of the net inflow of funds during 1997. Additionally an extra 10% of the net inflow of funds during the calendar year 1997 could be invested during 1998 in securities listed on stock exchanges in SADC countries other than those in the CMA. In 1999 these dispensations were once again renewed.

Investment policy extended

In 2000/2001, the existing corporate investment policy discussed above (see R250 million investments in countries outside the CMA but within SADC and up to R50 million per new investment elsewhere discussed above) was extended to allow corporates to apply to use part of their local cash holdings to finance up to 10% of approved new foreign investments where the investment cost exceeds the limits.

** The author, Andrew Leontsinis, is a partner in Bell Dewar & Hall Inc*



In 2001/2002, the amounts of R50 million and R250 million were increased to R500 million and R750 million respectively. Furthermore, the territory to which the latter amount applies was extended to Africa as a whole rather than merely SADC countries.

The budget speech also made provision for corporates wishing to invest abroad to apply to make use of corporate asset/share swaps to finance their investments.

South African corporates will now be allowed to utilise part of their local cash holdings to repay up to 10% of outstanding foreign debt raised to finance foreign investments, provided the foreign debt has been in existence for a minimum of two years.

Of significance, it was stated that "consideration (would) be given to requests by major corporates to establish primary listings offshore". The fairly recent listing of Sasol is an example of the fruit of such "consideration". In granting permission to list, there are a number of guidelines which are taken into account.

FDI in Africa increased

As a result of the Rand Commission of Enquiry into the rapid depreciation of the rand's exchange rate, no changes to exchange control regulations in the 2002 Budget speech were declared in 2002. However, in addition to noting the Rand Commission's support for the relaxation of exchange controls, Exchange Control circular D. 370 issued on 29 October 2002 increased the foreign direct investment in Africa allowance from R750 million to R2 billion. This is in line with both Nepad and Government's aim to expand investment in Africa.

In addition, in terms of the circular, the allowance for the use of South African funds includes "top-up" funding for expansions to existing approved African investments. The provision allowance for "top-ups" was extended to countries outside Africa in terms of Circular D 375 issued on 26 February 2003.

Circular D 375 also increased the allowance governing South African corporates' use of South African funds to finance new approved foreign direct investment outside Africa from R500 million to R1 billion. Furthermore, it was announced that repatriated dividends will qualify for an exchange control credit and re-export on application.

From the above, it is clear that the South African Government is taking South Africa's role as economic powerhouse in Africa seriously. Its past and present actions in lowering exchange controls demonstrate a concerted effort by Government to bring in foreign investment and further the South African economy.

More recent developments

Finance Minister Trevor Manuel announced in his February 2004 budget speech that foreign companies would be allowed to list on the Bond Exchange South Africa (BESA) and the JSE Securities Exchange (JSE) this year. Any foreign entity which seeks to list on the JSE or BESA will still be required to obtain approval from the Exchange Control Department of SARB. The minister has subsequently approved the necessary exchange control regulations enabling foreign companies to obtain secondary listings on the JSE; and BESA is in the process of finalising its proposals with exchange control. The objective is to allow foreign companies to raise debt and equity finance on the JSE and BESA and to promote inward investment and capital market development. South African private individuals will now be able to invest, without restriction, in inward listed instruments on South African exchanges (circular 443).

SARB's circular 441 dated 17 September 2004 stipulates the rules relating to inward listings by foreign entities on the South African exchanges. These rules favour foreign companies that are "African" (which means that the company will be domiciled in South Africa or have most of its activities in South Africa) as they will allow individuals and institutional investors to invest new

funds (taken from existing foreign investment allowances) in such listings.

Corporate shareholders, however, may be allowed to accept shares as acquisition currency in respect of acquisition issues and to exercise their rights in terms of a rights offer. The exchange control policy reform enabling inward listings will not result in a revision or relaxation of existing exchange control limits on private individuals or institutional investors, apart from institutional investors now being able to invest an additional 5% of their total retail assets, in African inward listed securities.

If a company's shares need to be reclassified from "African" to "foreign" for purposes of exchange control limits, then institutional investors are required to rebalance their portfolios within 12 months.

JSE indices

The rules state that only African companies obtaining an inward listing should be included in the JSE's indices – the JSE has been encouraged to develop an index that includes such African companies and to develop an index that includes only South African companies that cater for institutional investors with a South African-only mandate.

Benefits of inward listing include attracting foreign direct investment into our economy, growth in market capitalisation and liquidity of South Africa's capital markets, increased support for the Nepad initiative and support for exchange control goals of increasing foreign investment diversification through domestic channels.

An "inward" listing may well be an advantage to companies with South African ventures as it will allow them to raise money in South Africa. Some have expressed a concern that very few foreign companies will be attracted to "inward" listing particularly given the numerous restrictions on investments by South African investors.

Initial inward listings should involve only non-derivative equity instruments.

In terms of these rules, foreign companies would be entitled to use their shares as acquisition currency. South African institutional and individual shareholders will be given 12 months to realign their portfolios should they be in excess of their exchange control foreign exposure limits. Corporate shareholders will also be given 12 months to dispose of such shares.

Exchange Control will allow corporates to retain such shares if there will be benefits to the continued financial involvement of the South African corporate in the business or assets acquired and the alignment of interests in the extraction of the maximum value from the consolidated company.

Escrow account

Capital raised by inward listed companies through an initial public offering should be in terms of the Prospectus of the company, and recorded in an escrow account with the JSE. This capital should be deployed not later than one month after being raised or recorded in the escrow account.

The 2004 budget speech also confirms the limits for companies' allowed use of South African funds to finance approved foreign direct investment at R2 billion per project for investment in Africa and R1 billion for projects elsewhere, but increases the percentage of the excess cost that can be funded from South Africa from 10% to 20%. In addition, in an effort to improve access to domestic credit in financing investment in South Africa or domestic working capital requirements, foreign companies or foreign-owned South African companies may now borrow locally up to 300% of the total shareholders' investment.

The most recent circular on exchange control (numbered 443) and dated 26 October 2004, briefly describes the further steps in exchange control liberalisation announced by the Minister of Finance in his medium-term budget policy statement.

FDI controls abolished

It is apparent from the circular that exchange control limits on new outward foreign direct investments by South African corporates have been abolished, enabling South African companies to compete effectively in the global arena. However, SARB's Exchange Control Department will still call for an application in order to monitor such investments and also to ensure compliance with existing foreign direct investment criteria. Outflows relating to sizeable foreign investments may be spread over a period of time by SARB in order to mitigate and manage potential impacts on the foreign exchange market.

In addition, South African corporates may keep foreign dividends offshore and those repatriated to South Africa after 26 October 2004 may be transferred offshore again at any time for any purpose.

Looking ahead

A government task team has been appointed to draft recommendations on a broad cautionary regulatory framework, including foreign asset limits. The task team will make recommendations to the Minister, to address in his next budget speech. Perhaps this year exchange controls will become a thing of the past – we can but wait and see.

Last year, exchange control limits on new outward foreign direct investments by South African corporates were abolished.

Will exchange control disappear altogether this year?

World markets update

The following credit classifications were recently updated.
For information regarding other countries, please contact Credit Guarantee.

KEY – Political risks: 1 = low, 2 = medium, 3 = high
Commercial risks: A = low, B = medium, C = high

AFRICA

ANGOLA

Rating: 3C

Angola now fights a war against poverty, severe malnutrition, poor education, lack of basic human rights and the scourge of HIV/Aids. The end of the civil war has opened up new opportunities for Angolans and the international donor community to come together to affect real and lasting political, economic and social development. Addressing immediate humanitarian and emergency needs is critical to national reconciliation, resettlement and reintegration if Angola is to move towards a stable democracy with good governance and economic prosperity. Oil production and the supporting activities are vital to the economy, contributing 45% of GDP and more than half of exports. An improvement in relations with the IMF looks likely, although an agreement on a full programme which would eventually lead to debt relief is still some way off. Economic performance will remain well below potential due to weak physical and human infrastructure, poor economic policy and rampant corruption. Angola will also need to continue mortgaging future oil production as collateral in order to attract substantial inflows of foreign direct investment. Spending pressures will increase as elections planned for 2005 or 2006 approach, but government will be eager to demonstrate success in economic reform. Greater state control of the diamond sector and its long-term growth will spur the economy, helping to improve the lives of Angolans. Angola's diamond sector will provide a larger contribution to the state budget in the long-term, create secure employment for Angolans and help to improve Angola's credibility at the international level.

BOTSWANA

Rating: 1B

In October 2004 President Festus Mogae of the Botswana Democratic Party (BDP) won the general elections, giving him a second five-year term in office. Botswana is among the continent's most stable countries, is relatively free of corruption and has a good human rights accord. Through fiscal discipline and sound management, Botswana has transformed itself from one of the poorest countries in the world to a middle-income country. Sovereign credit ratings continue to place Botswana ahead of many developing countries, which reflect the strong external position of the country and the pursuit of a development strategy that has successfully balanced the provision of social services with prudent fiscal and monetary

How we rate them

Country classifications are based on a numeric and alphabetic basis associated with each country, with the numeric indicator showing the political rating of the country and the alphabet indicating the commercial risk.These range from 1 to 3 on the political rating with 1 being your lowest risk and 3 the highest. Likewise the A, B and C are relevant to the commercial rating – A being the lowest and C being the highest risk.

Usually the two ratings are closely linked because the political rating of a country will impact directly on its commercial rating.

Factors taken into account when assigning ratings include the following:

Political rating

Assessing political and economic conditions and stability:

- Environment
- Economic policies
- Forex reserves – ability to generate
- Rule of law
- Access to legal system
- Banking and commercial infrastructure
- Past history as trading partner
- Utilising various sources of information such as D & B, Moody's, S+P, various publications, Internet, Berne Union, ICIA, PASA, IMF, World Bank, etc
- Negotiating country limits with reinsurers
- Country reports prepared by Credit Guarantee's economic researchers
- Credit Guarantee's country underwriting committee.

Commercial rating

Commercial ratings are based on the financial strength of buyers in a particular country as well as their ability to repay amounts within terms afforded:

- Underwriting experience of other credit insurers on buyers in a particular market.
- Number of insolvencies/ liquidations in a country.
- Access to funds for buyers in the market.
- Reliable credit information from the respective market.
- Trade references within markets.
- Global and domestic industry trends and their impact on a market.

management over the years. A large share of Botswana's external debt is concessional in nature where the general government gross interest expenditure accounts for less than 1% of government revenues, which is a much lower figure than most other countries. The public sector also holds net external assets predominantly in the form of foreign exchange reserves, large enough to cover two years of imports of goods and services. Botswana is facing a major challenge of eradicating health threats (malaria, tuberculosis and HIV), which continue to affect the productivity of the Batswana adversely. The increase in labour productivity is one of the critical factors for improving long-term economic growth and as a vehicle for sustainable and diversified development. Given Botswana's strong trade links with SA, the value of the rand is a key determinant of the pula's value. Diamond mining is the most important source of income in Botswana, accounting for 77% of export earnings and 90% of foreign direct investment.

KENYA

Rating: 3C

The president and his ruling National Rainbow Coalition (NARC) have committed themselves to extensive reforms in an attempt to revive the country's ailing economy. Efforts to win the war against corruption have not eased, giving country observers renewed confidence in the new political regime. Donors and potential investors have expressed concerns that power struggles and political infighting could undermine any reform efforts. The Economist Intelligence Unit warns that economic expansion remains sensitive to political uncertainty, higher public transport fares, caution in the disbursement of pledged funds and strong global oil prices. Members of government are urging government to permit the imports of genetically modified seed to spur cotton growing to replace tobacco, which is expected to limit the damage to farmers if the proposed anti-tobacco legislation is passed. Kenya produces only 20 000 bales of cotton annually – 100 000 bales fewer than required. Kenya is characterised as the regional hub for trade and finance in East Africa but its development initiatives were curbed after it fell prey to corruption, especially in the judiciary. The extension of the third-country sourcing of fabric by the US Senate to 2007 and the extension of the Africa Growth and Opportunity Act (Agoa) to 2015 will place the textile sector in good stead. Kenya risks losing about $619m in annual revenue following controversial Economic Partnership Agreements with the EU which came into force on 1 January 2005.

MALAWI

Rating: 3C

On 5 February 2005 President Bingu Wa Mutharika resigned from the ruling United Democratic Party (UDF), blaming party members for condoning political graft and for blocking his drive to end corruption. Mutharika will continue as president, but his resignation from the ruling UDF was seen as an indictment of the previous regime led by former president and party head Bakili Muluzi. (Credit Guarantee is monitoring the situation and remains on cover.) The economy is dependent upon substantial inflows of economic assistance from the Bretton Woods Institutions. The IMF has stated that the economic situation in Malawi remains precarious. An assessment conducted in 2004 noted that the aftershocks of a severe drought led to acute food shortages and increased the country's vulnerability. Reductions in government services and a lower-value tobacco crop will cause GDP to retract in 2005. Malawi's financing requirements continue to rely on external and domestic borrowing. Debt relief under the Heavily Indebted Poor Countries

(HIPC) initiative will be responsible for the reduction of debt between 2004 and 2005. The economy is predominantly agricultural which accounts for 40% of GDP and over 80% of export revenue. The central bank frequently intervenes in the foreign exchange market to maintain the kwacha's stability but has no targeted exchange rate.

MOZAMBIQUE

Rating: 3C

Presidential elections were held in December 2004, ending the 18-year rule of outgoing president Joaquím Alberto Chissano. The ruling party's presidential candidate, Armando Guebuza, was declared the winner of the elections. Bureaucratic barriers continue to affect the competitiveness of the country and of companies. Growth in 2005 will be accelerated by the first full year operation of the gas pipeline and the expanded aluminium smelter. It will also be supported by the anticipated increase in private investment in ports and railways. However, the economy is perceived to be faltering in its traditional sectors such as agriculture and fisheries, which reduces the purchasing power of the rural poor. Favourable weather conditions will ensure that inflation remains in single digits. Mozambique's tea industry has been severely damaged by the collapse of the bridge over the Incise River, which has brought tea exports to a halt. Exporters of unprocessed cashew nuts have been negatively affected by the fall in the US dollar.

NAMIBIA

Rating: 2B

In November 2004 Hifikepunye Pohamba won the presidential election by a comfortable 76% majority. A disorderly land reform process would pose the greatest threat to political risk. One of the major causes of the deterioration in the country's economic and social rights is government's inability to manage state resources in a restricted and sustainable manner. The economy is closely linked to South Africa with the Namibian dollar pegged to the South African rand, therefore there is little external risk emanating from Namibia having low foreign exchange reserves. Namibia is on the brink of a food crisis that can be averted only through the proper management of its land reform policy. Resettlement without government support would be detrimental to national development. If government does not clarify its procedures for expropriating land from commercial farmers, investment and confidence throughout the economy could be hit. High oil prices, strong domestic demand and a credit boom constitute key risks to the inflationary outlook and any further cuts in the interest rate. In an attempt to speed up GDP growth, government has identified foreign direct investment (FDI) as a crucial element in Namibia's development. The country remains vulnerable to exogenous shocks due to agriculture, fishing and mineral extraction being the main resources. Growth will be supported by an expansion in offshore diamond mining, a rebound in fishing and processed fish output and strong performance by the construction sector. The main economic challenges facing government is to reduce the public sector budget deficit, reform the civil service, create

new jobs by attracting inward investment, improve efficiency and sustainability of social sector spending and use resources more efficiently.

NIGERIA

Rating: 3C

According to Transparency International, a Berlin-based anti-sleaze watchdog, Nigeria was named the world's second-most corrupt country. Its sizeable oil revenues (90% of forex earnings) are still squandered by its 36 state governments and 774 local governments. Despite some progress with economic reform, the contraction in growth is due to the expected fall in oil and gas production while government's failure to curb expenditure will sustain high inflation. Nigeria's external debt is a major obstacle to the country's overall development. The president is optimistic that sooner or later creditors will heed his appeal for debt relief, but promises to try to pay them in the interim. Approximately 4m people are expected to die of Aids by 2008 and employers are already feeling the loss of skilled workers, especially in the textile garments and tailoring sector. Loss of productivity, disruptions in the production process at factory level and loss of time spent on specialist training are on the rise. The Lagos Chamber of Commerce and Industry expressed concern over government's poverty reduction strategy, stressing that the programme failed to touch the root of poverty problems in Nigeria, noting that recent estimates measure 70% of the population living in abject poverty. Wider implications were escalating crime and pressure on internal security.

TANZANIA

Rating: 3C

Tanzania is a stable country in a volatile region, progressing on a path of democratic governance and market-based economic reform and growth. It remains one of the poorest countries in the world, heavily reliant on foreign aid, with many of its people living below the World Bank poverty line. The economy is heavily reliant on agriculture which accounts for about half of GDP, provides 85% of exports and employs 80% of the workforce. The World Bank, the International Monetary Fund (IMF) and bilateral donors have provided funds to rehabilitate Tanzania's out-of-date economic infrastructure and to alleviate poverty. The national economy has generally continued to improve in recent years, with substantial achievements in sustaining macroeconomic stability, following successful implementation of rigorous economic reforms. The key to sustained economic growth will be the diversification of the economy, better infrastructure and improved agricultural performance. Tanzania offers tremendous opportunities for investors as it is endowed with an abundance of natural resources, a wide base for raw materials supply from local source, political stability, good market policy, excellent geographical location in the East Africa region and excellent tourist attractions. Poverty will be overcome only with further reform, as structural constraints including weak marketing institutions, poor rural infrastructure and a shortage of credit and agricultural inputs, continue to limit growth. Inflation will be affected by the increases in food prices, a fallback in oil prices and the maintenance of fiscal discipline. The country has continued to receive external debt relief under the enhanced HIPC Initiative. The budget deficit will continue to be financed largely through external borrowing.

UGANDA

Rating: 3C

Uganda's democracy lacks viable political opposition and has an overly strong executive branch. The country's progress towards a vigorous and representative multi-party democracy requires permitting political parties to operate freely and constructively, as well as building institutions and systems that can check and correct abuse of authority and corruption. Armed conflict in northern Uganda and the spread of attacks on civilians in eastern Uganda by the Lord's Resistance Army (LRA) have displaced more than 1,4m people, creating Uganda's worse humanitarian crisis in 17 years. Continued conflict and insecurity causes more than $100m per year in lost production. Up to 700 000 people in northeastern Uganda are threatened by hunger due to acute food shortages caused by crop failures following a prolonged drought. If government does not check the rate at which food commodities are being exported Uganda will face a food shortage in March 2005. The country has a stable economic environment typified by single-digit inflation rates that have encouraged private investment both foreign and local. The Central Bank will continue to intervene in the currency market to smooth fluctuations. Low export receipts are hampering the country's ability to service its growing external debt. The Heavily Indebted Poor Countries (HIPC) initiative has failed to deliver debt sustainability due to slower export growth and rising debt. On 1 January 2005 a deal to eliminate import tariffs between Tanzania, Kenya and Uganda came into force, marking the first major step towards integrating the East African nations into a single economic and investment block.

ZAMBIA

Rating: 3C

Zambia has fallen from being a major copper producer and potentially one of the continent's richest countries to one ridden with mismanagement, debt and disease. The country has taken steps towards privatisation and budgetary reform, but growth remains below the necessary 5% to 7% which can reduce poverty significantly. It is hoped that a surge in the volume of non-traditional exports and good performance of the agricultural and tourism sectors would boost growth. Government is determined to reduce its domestic borrowing requirement and ensure that inflation retracts to single digits within two years by lessening the money in circulation to induce an increase in savings. Despite the praises that accompanied attaining the Highly Indebted Poor Countries (HIPC) initiative's completion point, many observers claim that Zambia, like other third world countries, needs much more than debt relief to return to prosperity and development.

ZIMBABWE

Rating: ZZ (off cover)

Zimbabwe was once the world's third largest source of tobacco but the economy has been marred by economic turmoil including an unsustainable fiscal deficit (estimated at 5,8% of GDP for 2005), an overvalued exchange rate, escalating famine and recession. The economy has shrunk nearly 30% since 1999 with an unemployment rate of 70% and acute shortages of fuel and foreign exchange. Macroeconomic stability will take a long time to restore given government's cur-

rent economic policies and political chaos. The country still holds the record for the highest inflation in the world. The mining sector is gearing to emerge as the country's top performer. Studies revealed that Zimbabwe has the largest undeveloped near-surface reserve of platinum globally. Mining currently contributes 4% of GDP and generates 30% of forex. Researchers fear that in the run-up to the March 2005 elections there will be manipulation of food or of people's fear of hunger to force them to vote for the ruling party. Government ignored requests to avoid seizing land protected by international accords and is targeting a big German-linked timber company as well as sugar and citrus estates.

MIDDLE EAST

U A E / DUBAI

Rating: 2B

Sheikh Khalifa bin Zayed was elected as the new president of the UAE on 3 November 2004. The UAE has a federation with specific powers delegated to the UAE Federal Government and other powers reserved for member emirates. The UAE, particularly Dubai, has emerged on the back of its oil industry and has successfully diversified its economy since 2000 into thriving manufacturing, finance, information technology and tourism sectors. The late president used oil money to modernise the country and turn it into a key economic player by allowing for the construction of motorways, luxury hotels and free trade zones so as to attract multinationals. By 2010, the national currencies of all the Gulf States are expected to disappear in favour of a single common regional currency. The current pegging of their currencies to the US dollar has enabled them to maintain low inflation and boost their standard of living. The UAE has one of the most open and highly competitive banking industries in the Middle East. Dubai prides itself on having the largest free trade zone in the Middle East with its port of Jebel Ali as well as the IT free-trade area Dubai Internet City.

NORTH AMERICA

U S A

Rating: 1A

On 2 November 2004 George W Bush was reelected as president for a second term in office and has increased his margin of support in both houses of the Congress. The dollar slide that began in 2002 is likely to continue if the current-account deficit reaches a new record and US capital outflows increase. In effect, the deeper the trade deficit, the more the US economy goes into debt. The dollar's current weakness stems from the US' "twin deficits" due to overspending by the federal government and overspending by consumers on foreign goods, especially from China. To narrow the shortfall, either the dollar must slide or interest rates on US investments must increase to lure investors. High-energy prices pose a risk to the economy – especially if they cause consumers and businesses to become extremely cautious and cut back on spending and investment. Although it is a large net debtor, it does not have to make net payments of interest and dividends to the rest of the world. Instead, the US still enjoys a net inflow of investment income as it earns a higher average return on its foreign assets than it pays on its liabilities. Returns on foreign direct investment and equities are higher abroad than at home and the US has benefited from unusually low interest rates on its borrowing in recent years. However, as interest rates increase and net foreign debt mounts, net investment income is likely to turn negative in 2005. This will swell the current-account deficit and exert an increasing drag on the economy. After a period of near-deflation, price pressures in the US are clearly starting to increase. Long-term problems include inadequate investment in economic infrastructure, rapidly rising medical and pension costs of an aging population, sizable trade and budget deficits and stagnation of family income in the lower economic groups.

Compiled and researched by Melanie Da Luz
Economic researcher, Credit Guarantee
January 2005

Credit Guarantee's AA rating reaffirmed

International rating agency Global Credit Rating (GCR) has reaffirmed Credit Guarantee's claims paying ability rating of AA (double A). The rating signifies a very high claims paying ability with strong protection factors. Risk is modest, but may vary slightly over time due to economic and/or underwriting conditions.

"Credit Guarantee is a credit risk insurer, covering domestic and export credit risks," says Credit Guarantee chief executive Mike Truter. "We were established specifically to protect exporters against the all too common risk of non-payment and over the past 48 years, have built up an information gathering network of enviable proportions with the largest database of company information on the African continent."

Marc Joffe, senior analyst at GCR, stated that the ratings were supported by the company's experienced management team, which adopts a conservative approach to underwriting credit risk insurance, supported by extensive credit intelligence.

"The increased shareholding of the group's majority shareholder, Mutual & Federal, the second largest insurer in the South African short term insurance industry, was favourably considered," said Joffe.

The company's balance sheet was "well structured" with the high solvency margin supported by a blue-chip equity portfolio (58% of the investment portfolio) and liquid investments (32%). "Notwithstanding this, the investment portfolio is exposed to the performance of relatively few counters."

Beyond the audit horizon

SA gets serious about legislating for good corporate governance

Unannounced as it may have been, South Africa is about to get its own version of Sarbanes-Oxley. This US statute, which became law in 2002, is a household name in global financial circles, and is seen as a model for changing the world of securities for the better, permanently.

Sarbanes-Oxley – in full: the Public Company Accounting Reform and Investor Protection Act – followed hot on the heels of the December 2001 bankruptcy of Enron, the energy trading-cum-technology company that disgraced corporate America, and most of the world, for that matter.

There are notable overlaps between Sarbanes-Oxley and the Draft Auditing Profession Bill, 2004, that the South African government released in December last year. The Bill is open for discussion until February this year, after which it is all but certain to become law.

Like Sarbanes-Oxley, the Bill is aimed at taking steps to restore public confidence in the capital market system, and in the accounting and auditing profession. Inspired by high-profile corporate collapses like Enron, finance minister Trevor Manuel, in his 2002 Budget speech, referred to weak or non-existent governance structures, the fiduciary responsibility of directors, negligent and sometimes reckless management, ineffective auditing, independence of auditors and conflicts of interest arising from inadequate separation between auditing and consultancy.

There had been some spectacular failures in South Africa as well, including Macmed, Leisurenet, Regal Treasury and Unifer, and, in 2004, CS Holdings. Manuel said that as finance minister he was responsible for legislation governing the audit profession.

The Draft Auditing Profession Bill traces its roots back to the early 1990s. Its release recently was accompanied by proposed amendments to the Companies Act 1973. The latter Act is universally recognised as being hopelessly out of date, and is earmarked for replace-ment. It will likely include the final results of another piece of draft legislation, yet to be released, the Financial Reporting Bill.

The Draft Auditing Profession Bill contains a critical new oversight provision. The Bill says that government, represented by the National Treasury, "should perform an oversight function with regard to the operations, decisions, and objectives of the Independent Regulatory Board for Auditors (IRBA)." The latter board, which is set to replace the Public Accountants' and Auditors' Board, will enjoy enhanced powers.

In broad terms, the regulatory structure envisaged by the Bill follows that of Sarbanes-Oxley. As an executive body, the IRBA, comprising a majority of non-auditors, is given a great deal of self-regulatory power and is overseen by a government structure. The structure is designed to reinforce the independence of auditors, which lies at the heart of the Bill.

New York attorney-general Eliot Spitzer announcing prosecution of several high-flying insurance companies for widespread corruption... "South Africa desperately needs the likes of him".

The Bill is also determined to preface laws that "facilitate swift and appropriate actions to rectify a situation in the event that circumstances give rise to an undermining of the independence of an auditor." And the Bill also wants to introduce measures that ensure that potential conflicts of interest between auditors and their clients are minimised.

Leonard Brem, senior partner at Grant Thornton, said the proposed structure of the IRBA is to be welcomed as being a regulator that deals with issues on an ongoing

basis, "a far more flexible and far more sensible kind of approach."

Auditors everywhere have been compromised slowly but surely over the past half-century, under pressure from clients chasing the eternal next buck. Brem argues that the process is being reversed; "huge amounts of additional work are going to be done over the next few years."

It is estimated that the average audit time will now require about 40% more working hours than before. "There's going to be a lot of focus on fraud, specifically management fraud, on internal controls, on planning, on understanding," Brem says.

"Those are things that are happening quite outside of this Bill, and I think the attitude which the Treasury is taking is 'let that happen.' It's already happening. We don't need to be heavy-handed."

Those who have had time to study the Bill are concerned that while heavy penalties – up to a decade behind bars – lie in store for errant auditors, other parties that may be part of a conspiracy are not even mentioned. Neither the Bill nor any other piece of legislation defines the misleading of an auditor as a criminal offence.

There is little doubt that the Bill will be amended according to the quality and quantity of public comment that flows in the next few months. It is clear, however, that as fine as the final legislation may be, the human element will remain a huge element of subsequent success or failure. To take another page from the US securities book, South Africa appears to be one of many countries that desperately needs the likes of the New York State Attorney General, Eliot Spitzer.

In the wake of the Enron debacle, Spitzer sued most of Wall Street's top investment banks over conflicts of interest, including the corruption of investment analysts. Last year, Spitzer targeted the mutual funds industry, and has achieved settlements running into billions of dollars. This year, he has targeted certain insurance brokers and insurers, where once again settlements and promises are already taking shape.

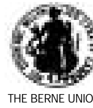
Spitzer's basic technique is to sue for civil fraud (backed up with lots of hard evidence), and to seek damages and promises of reform.

In South Africa, successes in the field of punishing breaches of corporate governance are as rare as hen's teeth. In one example, Annette van der Laan, the ex-CEO of technology group CS Holdings, was a chartered accountant who wielded massive influence over the company's presented accounts.

Despite accounting irregularities, neither van der Laan nor any other party directly involved in the CS Holdings debacle has ever been charged for anything. On that basis, there is no particular reason to name the auditors who allowed rotten CS Holdings accounts to be published.

– Barry Sergeant, Moneyweb

CREDIT GUARANTEE



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