INTUITION

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# Formalising the Informal Economy – SA's Silver Bullet?

*"You can go to Switzerland where everything works but there are no opportunities, or work within the South African market where not everything works but there are lots of opportunities" (Gerrie Fourie – Capitec CEO). In 2019, I was fortunate enough to go on a Township Immersion tour through the streets of Soweto and Alexandra. The aim was to lift the lid on the opportunities within the SA informal sector, a sector which had long since been ignored within the official GDP statistics. What we witnessed was a hive of small business activity and a buzz of energetic entrepreneurism in its purest form. The illusion given by many highways which often physically bifurcate the haves and the have-nots has since proved to be just that, whilst the reality is that our worlds are very much intertwined. This article will combine recent insights from township 'guru', GG Alcock, with our own views including the various companies in which we have chosen to invest within our 'Supported Consumer' theme, to illustrate and re-iterate this growing and exciting South African opportunity.*

Nick Rogers

Let's begin with SA's biggest issue, near-record levels of unemployment. In mid-2019, the unemployment rate was dire at 27%. However, post-Covid-19, the official figure has soared to 33.9%. "Indlela Iyaziwa Abayihambile" ("The road is known by those who have travelled it") is quoted on GG Adcock's website. He is the author of "KasiNomics" (Township Economics) and for 19 years has been running KasiNomics Events PTY Ltd, specialising in the informal mass market. In his mind, the real unemployment figure is 12%. How can this be? According to his calculations, the informal spaza sector is worth R160 billion, fast-food R90 billion, the taxi industry R50 billion, traditional herbal medicines R18 billion and hair salons R10 billion. Furthermore, R25 billion is generated from spaza rentals and a further R20 billion from back-room rentals. Yet very few employees within these industries receive official pay slips, and hence fall outside of the formal sector employment numbers. According to Investec, the informal sector accounts for an estimated 17% of South Africa's total employment. Whichever number you choose to settle on, the official unemployment figure needs context, and the reality is far more positive thanks to the resilience of the informal sector.

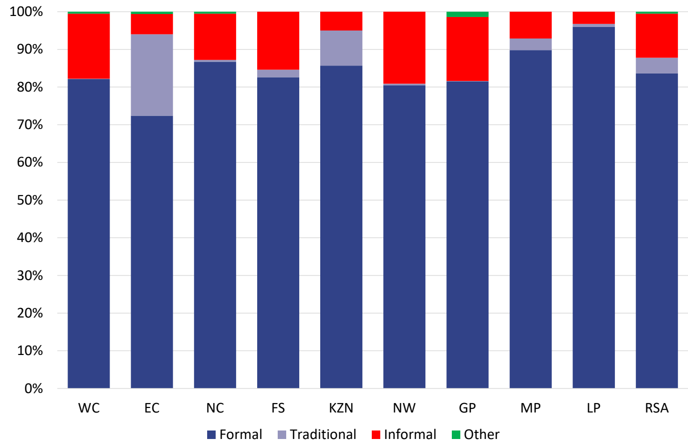
**SPEED READ**

- **SA's real unemployment rate is closer to 12% (including the informal sector) v 33.9% (formal sector only) according to GG Alcock.**
- **Shoprite has transformed its Money Market account into a fully transactional bank account to compete with Capitec.**
- **The SA government spends R365 billion on social welfare grants per year across 46% of the population. This underpins informal spending.**
- **According to GG Alcock, the informal spaza sector is worth R160 billion, fast-food R90 billion, the taxi industry R50 billion, traditional herbal medicines R18 billion and hair salons R10 billion. Furthermore, R25 billion is generated from spaza rentals and a further R20 billion from back-room rentals.**

That begs the question of what will underpin the above expenditure over the medium term given that the local economy is under huge pressure? The answer has two parts. Firstly, since most reading this article will be registered with SARS, tax revenue is the primary source via the Social Grant system. South Africa now pays grants to more than 46% of the population! The Department of Social Development estimate that 96,6% (R684 billion) of its budget over the next three years will go towards financing social grants. The second underpin is the growing black middle class which does not seem to fit the narrative at first glance. On the 20th of September, the UCT Liberty Institute of Strategic Marketing released its "2022 Black Middle Class Report." (This report defines the middle class as those households earning over R22,000 per month). It states that this group consists of 3.4 million people or

7% of South Africa's black African population, who have a combined spending power of R400 billion per year. GG Alcock highlighted that many of these "black diamonds" are currently living within or in new developments adjacent to townships and consequently spend a portion of their disposable money within the informal sector.

**COMPOSITION OF SA HOUSING MARKET**




*The percentage of households that lived in formal, informal and traditional dwellings by province in 2021.*

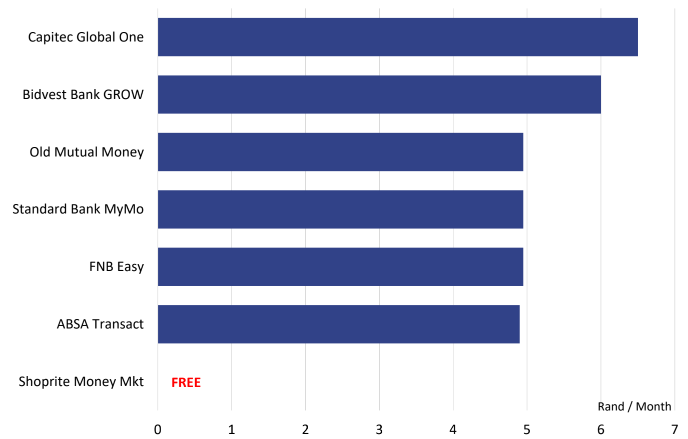
Surely the middle class would choose to move out of the townships and into more formal dwellings? Interestingly, in the 2021 SA Household Survey, 83.6% of SA households were already classified as formal. Single-occupant households had grown to account for 23.3% of housing demand and 75% of households had between 1-4 dwellers (historically 6-8). Why is this important? Alcock points out that the majority of the township or informal population already lives in a formal household and demand for these houses is growing faster than the population. That is good for the construction materials retailers like SPAR's Build it who service the 'bakkie-brigade'. Since the Covid-19 lockdowns, there has been a rise in the number of black middle class people choosing to leave more affluent suburbs and move back to the townships where they can save on rent (to free up resources for spending on other categories, such as vehicles and appliances), enjoy better social lives and be close to family. Townships should no longer be seen as 'informal settlements' where poor black people live, but rather as potential economic hubs. The private sector has woken up to this fact and the competitive landscape is heating up, especially within the financial services, telecoms and retail sectors.

According to GG Alcock, despite 80% of South Africans having a bank account, 70% of all retail payment volumes and 89% of the transactions in the informal economy remain cash based. This means that:

1. SARS are missing out on a sizeable chunk of tax receipts at a time when the government coffers are under pressure, and
2. The biggest potential value un-lock lies in converting this informal cash society into cashless via digital innovation and inclusion.

Why is there the need to formalise this economy? The informal economy includes thousands of small and medium enterprises (SMEs) which are the lifeblood of the SA economy. This is backed up by global management consulting firm, McKinsey and Company, who state that "SMEs represent more than 98% of businesses, employ between 50% and 60% of the country's workforce across all sectors, and are responsible for a quarter of job growth in the private sector". Most SMEs are township-based and unable to access or do not qualify for funding from the formal banking sector. Without this funding, they are unable to grow their businesses, create jobs or participate meaningfully in the economy. The National Development Plan forecasts that by 2030, SMEs will generate 90% of new jobs required in SA. However, this relies heavily on public-private partnerships, a reduction in red tape and access to affordable funding.

**COMPARISON OF BANKING FEES**




*Shoprite has transformed its Money Market account into a fully transactional bank account aimed at the informal sector. Importantly, it carries no monthly fee.*

Over the past few years, we have incorporated various themes in our top-down analysis. Below is a selection of companies that Harvard House believes will benefit from the 'Supported Consumer' theme:

1. Capitec is now the 3rd largest bank in SA - despite it only being founded in 2001 - thanks to its focus on the informal sector. It has 19 million active clients including 10.8 million on its digital platform. Insurance operations contribute 33% of Capitec's net profit. Back in 2019, everyone we asked had a Capitec bank

account, illustrating their dominance.

2. Standard Bank, ABSA and FirstRand are now all on board and expanding their market share within the informal sector but essentially playing catch-up.
3. Sanlam has underwritten Capitec's Funeral and Credit Life policies, issuing millions of policies. It will now partner with Allianz across sub-Saharan Africa now that Capitec has been granted its own underwriting license for life insurance.
4. Shoprite is the largest listed retailer thanks to its low-price model aimed at the lower-income consumer, mainly through its Usave business (which includes Usave Ekasi, a shop within a container placed in townships.) Its new transactional bank account is an exciting growth lever for future profits.
5. The Foschini Group acquired JET (which focusses on the Low LSM market) from the Edcon Group in 2020 for just R480 million. That acquisition is already reaping rewards.
6. Mr Price has always been a value-focused retailer but recently entrenched it's position through the acquisition of low-end retailer Power Fashion. It has also recently launched an entry-level life insurance product where customers can get up to R200,000 life cover with no waiting period.
7. Various REITs, notably Fairvest and Vukile, own malls located near townships and in rural areas.
8. Remgro is playing a big part in democratising internet access across SA. Remgro-owned Vumatel provides affordable, uncapped fibre to low-income areas like Mitchells Plain and Alexandra where there is potential to bring fast internet to 4 million new homes.
9. MTN and Vodacom are both integral in facilitating the digital/online world which is empowering township entrepreneurs and students alike. For example, WhatsApp and Facebook are used extensively since they are both trusted platforms. Mobile money and Fintech are massive growth areas as this vast cash economy transitions to a cashless system.
10. AVI is our preferred food producer and I personally witnessed many of its products like Bakers biscuits, Trinco, Five Roses, Rooibos and Frisco in spaza shops across Soweto and Alexandria.
11. Transaction Capital owns the largest taxi fleet in SA. Its partnership with the banks is being replaced with an in-house, unsecured vehicle financing unit using SA Taxi's database to check creditworthiness and boost sales in the lower-end car market via its WeBuyCars platform.

In conclusion, for our country to be prosperous, we must ensure that entrepreneurs and SMEs within the township environment are economically included. This will boost employment, enabling more South Africans to become self-sufficient and rely less on social grants, which in turn will reduce the pressure on the tax base as revenue is re-directed towards growth initiatives. There are endless opportunities for more interaction between our parallel economies to join forces at a time when every unit of economic growth is crucial and every side-hustle a potential future employer in the formal economy.


*Shoprite's Usave Ekasi brand, a shop within a container placed in townships to compete directly with the spazas as the formal sector seek to gain market share in the township economy.*

The world and financial markets have lurched from one crisis to the next over the past few years.

Will 2023 be any different?

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**Topic: The World in 2023**

| **Natal Midlands** | |
|---|---|
| Date: | 24th of November 2022 |
| Venue: | Oasis Conference Centre, 72 Main Road, Howick |
| Morning Time: | 10am for 10.30am |
| Evening Time: | 5.30pm for 6pm |

| **Johannesburg** | |
|---|---|
| Date: | 6th of December 2022 |
| Venue: | Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham |
| Time: | 7am for 7.30am |

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