

SOUTH AFRICA

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Key Data Points (as at end-December 2023, unless otherwise stated)

Total population	63,212,384
National currency and exchange rate	Rand (ZAR), ZAR18.27 per USD1
GDP and growth rate	ZAR6.97 trillion, 0.6% (nominal and real)
Annual average inflation	6%
Unemployment rate	31.9%
Total government debt outstanding	ZAR4.7 trillion (excl. contingent liabilities)
Public debt to GDP ratio	73.4% (government)
Primary stock exchange	Johannesburg Stock Exchange
Number of publicly listed companies	273
Equity market capitalisation (total and % of GDP)	ZAR19.5 trillion, 348.3%
Mutual fund assets under management	ZAR1.48 trillion

Sources: Statistics South Africa; South African Reserve Bank; National Treasury of South Africa; Johannesburg Stock Exchange; Association for Savings and Investment South Africa.

1. Introduction and Context

A nation rich in history and natural resources, South Africa is characterized by its diversity and dynamism. Since the end of apartheid in the 1990s, the country has undergone significant economic and social transformation. Despite its progress, South Africa continues to grapple with a complex interplay of economic challenges, social disparities, and political dynamics.

On the macroeconomic front, the country has demonstrated steady growth in recent years, with an average GDP growth rate of 1.8% annually between 2010 and 2023. This growth has been accompanied by relatively stable inflation, which has hovered between 4% and 5% each year, indicative of a degree of economic stability.

Structurally, South Africa is well positioned for international trade, engaging with key markets such as China, the United States, Germany, and the United Kingdom. It is home to eight commercial ports, which enhance its trading capabilities and make it a leader in trade and foreign exchange activities on the continent. Trade alone has accounted for approximately 25% of South Africa's GDP.

Despite improvements in the population's literacy rate, disparities in education and access to opportunities persist, particularly in rural areas. The emergence of a small but growing middle class in South Africa signifies a positive development. Challenges remain, however, because a substantial portion of the population continues to live in poverty (approximately 30% below the national poverty line in 2020). Additionally, unemployment rates stood at around 33.3% in 2023, exacerbating the issue of income inequality in the country, which had a Gini coefficient of 0.63 in 2023.⁶² These challenges are compounded by limited infrastructure and insufficient funding for SMEs and households.

Retail participation in the capital markets has grown in recent years, as a result of strengthened financial literacy, increased job opportunities, rising income, and a wider range of investment products. Retail investors are exposed to market volatility and financial scams, however, given a lack of in-depth knowledge and experience to make informed investment decisions.

2. Raising Funds in the Public Markets

It is well understood that local capital markets cannot develop without sound and stable macroeconomic frameworks and a legal environment that protects investor property rights. With these in place, the financial infrastructure needed for securities trading, settlements, legal and regulatory enforcement, credit ratings, market conduct, monitoring, and reporting can follow. It is crucial for regular disclosures and securities listing rules to be standardised across

⁶²Data from African Development Bank, "South Africa Economic Outlook" (2023), www.afdb.org/en/countries/southern-africa/south-africa/south-africa-economic-outlook.

companies. The development of markets tends to be a gradual and interactive process. South Africa's capital market is considered advanced relative to its counterparts elsewhere in Africa. More work is needed, however, to grow and diversify it. With a Gini coefficient of 0.63, an effective unemployment rate of 41.9%, and a 72-member cabinet, South Africa also faces extreme levels of inequality, unemployment, and bureaucratic burden, thus inhibiting rapid capital formation.

In South Africa, one can raise bond and equity capital from the public on the Johannesburg Stock Exchange (JSE), among other much smaller exchanges. It is the largest stock exchange by market capitalisation in Africa and the 16th largest in the world. Formed in 1887, the JSE joined the World Federation of Exchanges in 1963. In the early 1990s, it was upgraded to a fully electronic trading system, offering trading, clearing, and surveillance for equities, bonds, commodities, and their respective derivatives. Generally, the exchange is open to all participants (domestic and international) that can meet the requirements, which are aligned with international best practice. The exchange is regulated by the Financial Sector Conduct Authority (FSCA), which is modelled on the twin peaks framework adopted by the United Kingdom. As a result, its regulation, compliance, and dispute resolution operations are analogous. As the regulator, the FSCA specifies the governance and arbitration rules for financial markets' service providers and consumers.

Currently, the South African Reserve Bank—the central bank of South Africa—implements inflation targeting to maintain a consumer price level between 3% and 6%. In addition, the National Treasury promotes a set of fiscal policies aiming at a primary budget surplus. Although these efforts manage to stabilize some macroeconomic variables, high unemployment, slow economic growth, and relatively high national debt pose challenges to further stability. Therefore, the composite credit rating for South African sovereign debt is BB–, two levels below investment grade.

Fundraising Processes

The process to raise equity and bond capital requires appointing a sponsor, a corporate adviser, a legal adviser, an accountant, transfer secretaries, a public relations consultant, and in the case of minerals companies, a technical adviser. The appointment of these roles can be undertaken by one or more agents. The platform STRATE must be used for clearing and settlement of dematerialised securities. Additionally, local legislation requires at least three nonexecutive board members, one of which must be designated as the chair.

The sponsor's main responsibilities include ensuring that the company meets the listing requirements and that directors know their responsibilities and obligations as directors of a listed company, submitting the listing documentation to the JSE, and serving as a liaison between the JSE and the company. The corporate adviser counsels the company on the method of listing, marketing, the size and terms of the offer, and the timing and pricing of the offer. The legal adviser

assists with drafting the listing documentation to ensure compliance with all legal requirements. The JSE requires an accredited independent accountant to report in the prospectus (i.e., the prelisting statement) on the profits of the company over the previous three years and the financial position of the company over the previous three years. Transfer secretaries are responsible for setting up the company's register of members, issuing share certificates, the registration of transfers, and mailing company circulars. Companies must be approved as STRATE eligible in terms of the Central Securities Depository Rules. Public relations consultants are used to promote the image of the company before a listing. For basic resources companies, the JSE requires the prospectus or prelisting statement to contain a technical adviser's report on the company and its exploration and mining activities. Among other requirements, the listing must meet the basic criteria of value exceeding ZAR50 million (~USD2.9 million), at least 25 million shares being issued, and at least 20% of equity held by the public. A dedicated public exchange, AltX, is run by the JSE for listings of smaller entities, which must still comply with this listing process, with additional requirements that increase transparency.

In addition, the following are permitted to list on the JSE with minor adjustments to the previously listed criteria: special purpose acquisition companies that facilitate capital raising to acquire assets and construct a viable listed company; green bonds that raise investment for green infrastructure, technologies, and services; and fast-tracked secondary listings for companies already listed on the Australia Stock Exchange, London Stock Exchange, New York Stock Exchange, and Toronto Stock Exchange.

Striking a Balance in Listing Processes

Each step in the listing process incurs costs, many of which are fixed. For large issuers, these costs are not significant barriers to listing, but such costs can be material for small enterprises that issue relatively smaller tickets. For example, these mandatory direct and indirect governance costs can amount to around ZAR12 million per annum for a small and simple company. Although the listing process is transparent and market size is not a key issue, a company must set aside at least ZAR12 million per year from net income to maintain a listing. Recall that access to private loans from the banking system is a relatively cheaper and simpler alternative with lower levels of governance requirements.

Discussions around simplifying the listing processes are ongoing. It is hard to strike the right balance between enhancing market competitiveness and investor protection because it is equally important to uphold public interest, international regulatory alignment, and integrity of the exchange. A medium-term solution at the micro level would be to increase the supply of the previously mentioned service providers and agents in order to promote price competition. At the macro level, a low economic growth rate (significantly below potential), public debt crowding out, historically high real rates, and fiscal dominance are headwinds to private sector capital formation, especially by younger and smaller industries. Low real growth extinguishes the key benefits of a public listing.

In theory, with regulated and mature local pension funds, asset managers, banks, and intermediary brokers, public access and investment in listed debt, equity, and its variations should be well serviced. In practice, however, small to medium listings experience illiquidity and much lower analyst coverage or no coverage at all. Risk premiums tend to be inversely correlated with size in South Africa. Here, too, an increase in the supply of analysts and trading can reduce the risk premium and increase valuation. South Africa follows the global trend in delisting from public markets. Low liquidity, high costs of listing compliance, and low aggregate growth have accelerated this trend.

SME Financing

The development of South Africa's capital markets has been a key driver of socioeconomic growth, providing access to finance for businesses and infrastructure projects. The JSE is one of the largest and most sophisticated stock exchanges in Africa, playing a predominant role in mobilising domestic and foreign capital. To help SMEs, which often struggle to access affordable funding, the government has implemented various initiatives to support SME financing, such as the Small Enterprise Development Agency and the National Credit Regulator.

Yet these efforts have been insufficient to meet the growing demand for SME financing, constraining the growth potential of SMEs in South Africa. According to the Organisation for Economic Co-operation and Development (OECD), contributing factors to low access to SME financing include

- the lack of suitable formal finance products available to small enterprises,
- stringent lending requirements,
- the lack of readily available credit information,
- the perceived riskiness of small enterprise finance, and
- the apparent lack of appropriate assets available to small enterprises for the purposes of collateral (OECD 2022).

All these issues reduce the availability—and therefore increase the cost—of credit for small enterprises.

Infrastructure Financing

Infrastructure development is another critical area for South Africa's economic progress. The country has made significant investments in transportation, energy, and telecommunications infrastructure, but challenges remain in terms of efficiency, maintenance, and equitable access.

Public investment is being prioritised through upscaling the use of public-private partnerships and new institutional arrangements that will bring in private funding to improve infrastructure delivery. Following a review of the PPP regulatory framework, the government is implementing reforms to improve

effective governance, risk management (against perceived country/market risk), and the alignment of interests between the public and private sectors.

According to the National Treasury (2024), the key elements of the reforms are as follows:

- Consolidate the financing, preparation, and planning arrangements for large projects in a single entity to bring in private sector finance and expertise.
- Increase the use of PPPs to deliver infrastructure projects.
- Reduce fragmentation and duplication across spheres of government.

Total infrastructure investment planned by the South African government over the next three years amounts to ZAR943.8 billion.

The Impact of COVID-19 on Fundraising

The trend of delisting and the scarcity of new listings continued during the COVID-19 pandemic. On average, about 16 new equity listings took place each year in South Africa between 2010 and 2019, but starting in 2020, the average decreased to about 6. The average pace of equity delisting increased from about 6 per year to 16 per year during the same periods. Turnover and value have increased year on year since 2000, except for during the 2008 and 2020 crisis periods. In 2000, there were 616 listed equity counters, compared with 292 in 2023. In contrast, the bond markets have grown year on year since 2003 in terms of issues, value, and turnover. Much of this bond market growth can be attributed to the government increasing its debt stock and structured product notes being listed on exchange.

The structural decline in interest rates from peak to trough cycles has not resulted in growth in new capital formation on the exchange. Since 2000, aggregate growth has declined from around 3.5% to 2.0% in 2010 and to 1.0% in 2020. Further research is required to determine why capital formation through capital markets in South Africa is slowing dramatically. Preference for lower risk premiums and interest rates in developed markets are key contributors. Nevertheless, intermediaries, including the JSE, can improve company disclosures, access to information, and analyst coverage and promote the advantages of going public to the investors of South Africa. Compared with developed markets such as the United States, the efforts in South Africa are deficient even though the costs of such efforts are not particularly high. Lastly, higher risk aversion among investors also explains weakened capital formation in South Africa.

3. Debt

According to the National Treasury's (2024) budget review, the government's budget deficit narrowed during the past year. The consolidated budget deficit is projected to narrow from 4.9% of GDP in 2023-24 to 3.3% by the end

of the 2024 medium-term expenditure framework period. As a result, the gross borrowing requirement declined from a projected ZAR484.5 billion to ZAR387.9 billion in 2023, or 5.8% of GDP.

Eskom, a public energy utility, is South Africa's largest state-owned enterprise. Over the next three years, the government will service ZAR184.4 billion of Eskom's debt (capital repayments and interest payments), and in 2025–26, it will take over up to ZAR70 billion of Eskom's debt, with strict conditions. As a result, the gross borrowing requirement will increase from ZAR515.6 billion in 2023–24 to ZAR555 billion in 2025–26. Any guaranteed debt that is settled as part of the debt relief arrangement will reduce the state's guarantee exposure to Eskom. By the financial year 2025–26, this exposure is expected to decline by ZAR118.9 billion.

Gross debt stock is projected to increase from ZAR4.73 trillion in 2022–23 to ZAR5.84 trillion in 2025–26. Debt is expected to stabilise at 73.6% of GDP in 2025–26, compared with the 2022 Medium Term Budget Policy Statement projection of stabilisation at 71.4% of GDP in 2022–23. Debt as a share of GDP is expected to decline thereafter. Contingent liabilities are set to decline from ZAR1.07 trillion in 2022–23 to ZAR904.1 billion in 2025–26.

During the past year, rising inflation, interest rates, and risk aversion have led to more difficult global and domestic financing conditions. Nevertheless, South Africa's deep capital markets and its improved fiscal and debt position have helped cushion against rising risks associated with tightening monetary policy and a slowing global economy. Moreover, South Africa's foreign debt remains a relatively small share of its overall borrowing. In 2022, the key credit rating agencies (Fitch Ratings, Moody's Ratings, and S&P Global Ratings) indicated an improved outlook for South Africa's sovereign credit ratings for these reasons, although concerns over power cuts, a high debt burden, and significant fiscal risks remained. Those concerns explain why Scope Ratings downgraded South Africa's credit rating in late 2023 (Scope Ratings GmbH 2023).

The government continues to work with the private sector to develop South Africa's capital markets and ensure a diversified portfolio of instruments to meet its borrowing needs. In 2023–24, the government successfully introduced a new floating-rate note and a domestic rand-denominated sukuk (Islamic bond). In 2024–25, the gross borrowing requirement will be financed through domestic short- and long-term loans, foreign currency-denominated instruments, and cash balances (National Treasury 2024). In addition, the government will continue to explore innovative ways to raise funds through climate financing and related initiatives. See **Exhibit 42** for details.

The National Treasury has argued that the yield curve has shifted higher, as illustrated by the difference between the January 2022 and January 2023 curves, averaging 68 bps (see **Exhibit 43**). Higher yields indicate higher borrowing costs across maturities, especially for long-term bonds. This yield curve shift reflects

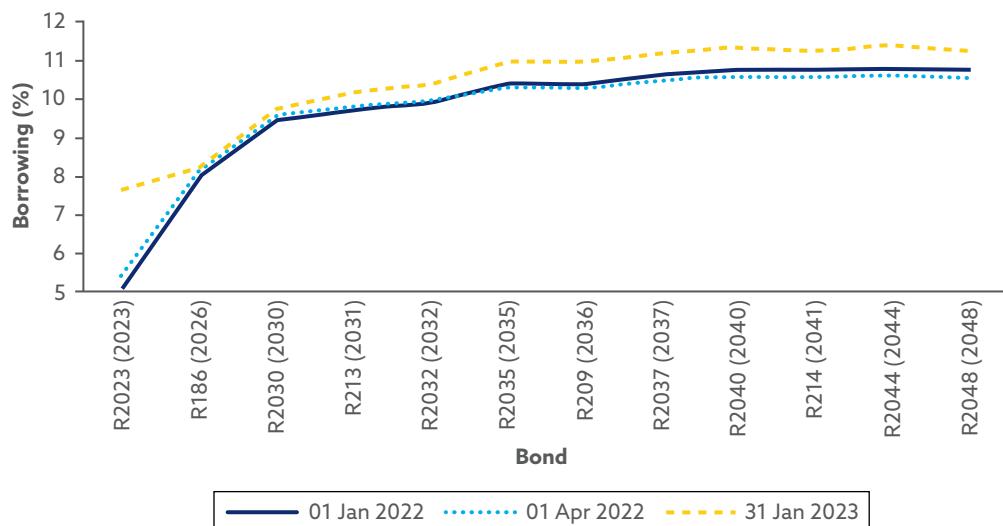
Exhibit 42. Performance Estimates for 2023-24 and 2024-25 Against Strategic Portfolio Risk Benchmarks

Description	Benchmark Range or Limit	2023-24	2024-25
		Estimates	
Treasury bills as a percentage of domestic debt ^a	15.0	11.8	12.5
Long-term debt maturing in 5 years as a percentage of bonds	25.0	15.4	20.0
Inflation-linked bonds as a percentage of domestic debt	20-25	21.8	19.3
Foreign debt as a percentage of total debt	15.0	10.6	10.8
Weighted term-to-maturity of fixed-rate bonds and treasury bills (years)	10-14	10.5	9.7
Weighted term-to-maturity of inflation-linked bonds (years)	14-17	13.7	14.7
Other indicators (weighted average)			
Term-to-maturity of total debt (years)		11.2	10.7
Term-to-maturity of foreign debt (years)		12.8	12.1

^aExcludes borrowing from the Corporation for Public Deposits and retail savings bonds.

Source: National Treasury (2024). The National Treasury estimated that in 2023-24, domestic long-term borrowing increased to ZAR329.9 billion and averaged ZAR349.5 billion over the medium term.

Exhibit 43. South African Domestic Borrowing



Source: National Treasury (2024).

Exhibit 44. Foreign Currency Commitments and Financing (USD millions)

	2022-23	2023-24	2024-25	2025-26	2026-27
	Outcome	Estimate	Medium-Term Estimates		
Opening Balance	5,925	7,119	4,590	2,172	1,030
Commitments	-3,009	-4,945	-4,420	-5,643	-4,705
Redemption	-1,000	-2,493	-2,141	-3,224	-2,146
Interest	-1,177	-1,643	-1,514	-1,645	-1,780
Departments	-832	-809	-765	-774	-779
Financing	4,203	2,417	2,002	4,501	5,001
Loans	4,131	2,412	2,000	4,500	5,000
Purchases	-	-	-	-	-
Interest	72	5	2	1	1
Closing Balance	7,119	4,590	2,172	1,030	1,327

Source: National Treasury (2024).

the lingering effects of COVID-19, the ongoing Russia–Ukraine war, monetary policy tightening to combat persistent inflation, and the impact of prolonged power cuts.

International Borrowing

The South African government borrows in foreign currency—mainly US dollars and euros—to meet its foreign currency commitments, as illustrated in **Exhibit 44**. It will continue to explore financing instruments that offer concessional loan terms to support its developmental objectives.

Debt Service Costs

Debt service costs are determined by debt stock, new borrowing, and macroeconomic variables, such as interest, inflation, and exchange rates. As a share of GDP, debt service costs in South Africa are projected to average 4.9% over the medium term, and as a share of government revenue, they are projected to increase from 18% in 2022-23 to 19.8% in 2025-26 (see **Exhibit 45**). Although the projected debt service costs may seem manageable at present, the treasury should approach fiscal policy with caution, taking into account long-term sustainability for the country. Strategies that enhance revenue generation, improve fiscal discipline, and potentially restructure existing debt to support rather than hinder economic growth should be prioritized. Such strategies are particularly relevant in light of a tight monetary environment, which debt service costs depend on.

Exhibit 45. National Debt Service Cost (ZAR millions)

	2021-22	2022-23		2023-24	2024-25	2025-26
	Outcome	Budget	Revised	Medium-Term Estimates		
Domestic Loans	250,503	277,693	284,874	317,018	340,566	372,327
Short term	22,096	23,454	30,385	40,473	41,522	43,851
Long term	228,407	254,239	254,489	276,545	299,044	328,476
Foreign Loans	17,568	24,113	22,283	23,442	22,274	24,747
Total	268,072	301,806	307,157	340,460	362,840	397,074
<i>As a percentage of:</i>						
GDP	4.3	4.7	4.6	4.9	4.9	5.0
Expenditure	14.2	15.3	15.3	16.7	17.0	17.5
Revenue	17.1	19.0	18.0	19.4	19.4	19.8

Source: National Treasury (2024).

State-Owned Entities

According to the National Treasury, Eskom accounts for 85.3% of total SOE debt guarantee exposure (see **Exhibit 46**).

Corporate Debt Market

There are only 42 nonbank bond issuers in the South African listed credit market. Combined, these companies have approximately ZAR170 billion of listed debt outstanding, compared with the ZAR459 billion issued by banks and government's total issued debt of around ZAR3.3 trillion.

According to Satish Gosai of Camissa Asset Management, in a corporate credit market of a small size (relative to the overall savings), security prices tend to be sensitive to changes in demand. During the past five years, primary issue demand has been substantially higher than company issue size (as shown in **Exhibit 47**). This higher demand has led to higher-clearing bond prices and lower credit risk premiums at issue and thereafter in the secondary market.

According to Philip Bradford, Chief Investment Officer at PMX Asset Management, there is enormous demand and not enough supply in the South African credit market, which has driven spreads tighter and tighter. A large part of this demand has come from local short-term interest-bearing and multiasset income funds, as these unit trust categories have seen substantially increased uptake. As **Exhibit 48** shows, the combined assets under management (AUM) in these categories nearly tripled from 2015 to 2022.

Exhibit 46. Guarantee Exposure of SOE (ZAR billions)

	2020-21		2021-22		2022-23	
	Guarantee	Exposure ^a	Guarantee	Exposure ^a	Guarantee	Exposure ^a
Public Institutions	581.6	384.7	559.9	395.3	478.5	396.1
Eskom	350.0	298.3	350.0	313.0	350.0	337.8
SANRAL	37.9	37.4	37.9	42.0	37.9	28.6
Trans-Caledon Tunnel Authority	43.0	13.2	25.0	9.6	25.0	8.7
South African Airways	19.1	6.7	19.1	2.8	19.1	0.3
Land and Agricultural Bank of South Africa	9.6	2.4	9.6	1.9	8.1	0.4
Development Bank of Southern Africa	10.0	4.9	9.9	5.2	9.9	5.5
Transnet	3.5	3.8	3.5	3.8	3.5	3.8
Denel	6.9	3.4	3.4	3.5	3.4	0.3
South African Express	0.2	0.0	0.0	0.0	0.0	0.0
Industrial Development Corporation	0.5	0.1	0.5	0.1	0.5	0.1
South African Reserve Bank ^b	100.0	13.7	100.0	12.8	20.0	10.0
Independent power producers	200.2	176.7	200.2	165.7	208.5	187.1
Public-private partnerships^c	8.0	8.0	7.9	7.9	7.1	7.1

^aTotal amount of borrowing, adjustments to inflation-linked bonds as a result of inflation rate changes, and accrued interest.

^bIn April 2022, the minister approved the reduction of the loan guarantee scheme to ZAR20 billion.

^cThese amounts include only national and provincial PPP agreements.

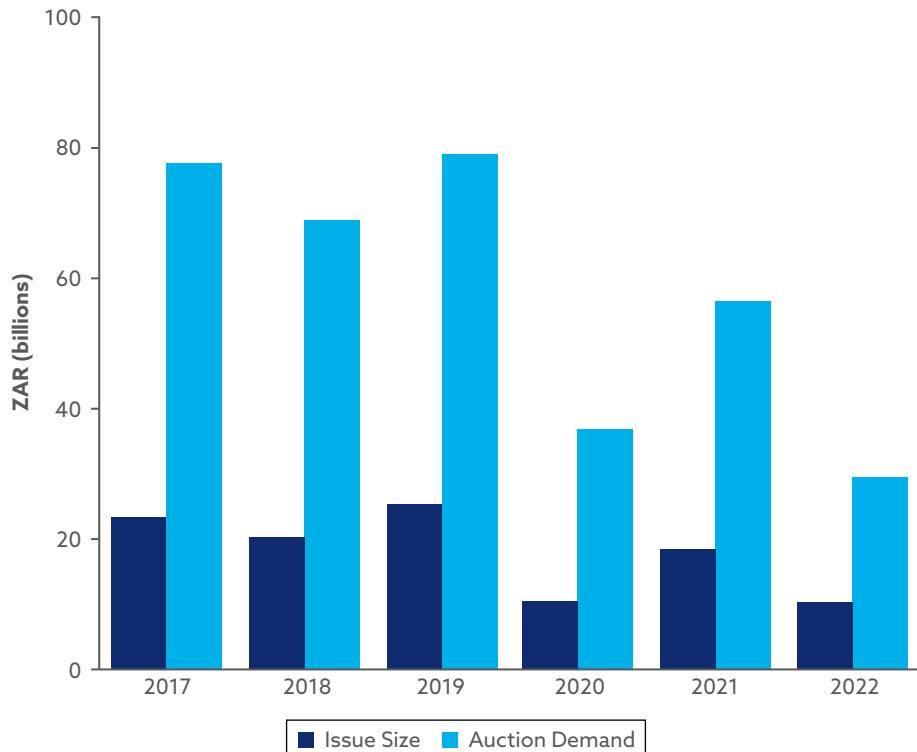
Source: National Treasury (2024).

The South African corporate credit market is small and illiquid. Most fund managers buy corporate bonds at initial auction and hold them to maturity. The primary investors in South African corporate bonds are local institutional investors, and most corporate bonds issued are denominated in South African rand.

The main corporate bond issuers (excluding banks) are listed in **Exhibit 49**.

It is worth noting that corporate credit has experienced a rebound, reversing the significant contraction in 2020. The recovery could be attributed to a variety of factors, including increased demand for working capital and a renewed focus on investment needs (South African Reserve Bank 2023).

Exhibit 47. Issue Size and Auction Demand in South Africa, 2017–2022



Sources: ABSA, Standard Bank, and research by Camissa Asset Management (<https://citywire.com/za/news/just-how-big-is-the-risk-in-the-local-credit-market/a2410379>).

Exhibit 48. AUM in South Africa's Unit Trust

Local Unit of Trust Growth				
Category	December 2015		December 2022	
	Number of Funds	AUM (ZAR bn)	Number of Funds	AUM (ZAR bn)
SA interest-bearing short term	48	86.4	52	271.8
SA multi-asset income	95	119.8	138	284.6

Source: Association for Savings & Investment South Africa, www.asisa.org.za/media/df0nvgwf/20221231-asisa-cis-statistics-1-holdings.xlsx.

4. Raising Funds in the Private Markets

Background on Private Markets in South Africa

The definition of alternative assets is broad and includes real assets, real estate, and, increasingly, new asset classes, such as cryptocurrencies. For the purposes of this publication, we limit the scope to private equity and private debt, the private markets' analogue to traditional investments.

Exhibit 49. Profile of the Main Corporate Bond Issuers in South Africa

Company Name	Industry	Approximate Market Capitalisation (ZAR billions, October 2024)	
AECI Limited	Chemicals and Explosives	10.43	
Barloworld Limited	Industrial Equipment and Services	16.03	
Bidvest Group	Diversified Investments	99.40	
Discovery Limited	Financial Services	122.19	
The Foschini Group (Supergroup)		Retail	50.78
Kap Industrial Holdings	Diversified Investments	8.53	
Mercedes-Benz South Africa	Automotive	Part of the global Daimler AG	
MTN Group	Telecommunications	166.97	
Northam Platinum Holdings	Mining	58.25	
Pan African Resources	Mining	18.60	
Woolworths Holdings	Retail	65.25	

Source: Data from JSE, via Reuters decision-support system.

Allocating to alternative investments and its many strategies requires a level of investor sophistication. Private credit managers follow wide-ranging strategies that span the debt-to-equity risk spectrum. Some strategies, such as direct lending, assume pure credit risks, while others, such as special situations investing, contain significant equity risk, despite being labelled debt investments. In addition, private assets are difficult to value and involve subjective inputs, often with significant information asymmetry between managers and investors. Therefore, investors need to be discerning about investment risks and suitability in relation to investment objectives. Given its fairly developed financial system, South Africa has a range of expertise to support private market investing. Organisations such as Financial Sector Deepening Africa (FSD Africa) and the Southern Africa Venture Capital and Private Equity Association (SAVCA) play pivotal roles in fostering a vibrant ecosystem.

Investors have the option to customize private investments through limited partnerships or segregated funds or to access a diversified pool of assets through standardized investments, such as funds of funds and closed-end investment companies. The former option may be suitable for larger investors with adequate resources, expertise, and a desire to retain some control over the investment strategy. However, smaller pension funds that lack the resources and scale may opt for the latter. Examples of some of the larger pension funds in South Africa include the pension fund (USD119.4 billion), the Eskom Pension and Provident Fund (USD9.7 billion), Central Retirement Annuity Fund

Exhibit 50. Major Pension Funds and Corresponding Asset Holdings in South Africa

Major Pension Funds in South Africa	Asset Holdings (USD billions)
Government Employees Pension Fund	119
Eskom Pension and Provident Fund	9.7
Central Retirement Annuity Fund	7.27
South African Retirement Annuity Fund	7.1
Sentinel Retirement Fund	6

Source: Financial Sector Conduct Authority (South Africa), "2022 Retirement Funds Statistical Report," www.fsca.co.za/Annual%20Reports/2022%20Pensions%20Statistical%20Report%20Publication.pdf.

(USD7.27 billion), South African Retirement Annuity Fund (USD7.1 billion), and Sentinel Retirement Fund (USD6 billion). **Exhibit 50** provides more detail.

Although it boasts a substantial asset base of approximately USD500 billion, the pension fund industry in South Africa is characterized by a dual nature of concentration and fragmentation:

- *High concentration at the top:* The top five pension funds account for roughly 30% of the total assets.
- *Long tail of small funds:* The industry comprises a large number of smaller funds, with approximately 2,000 active funds currently operating from more than 10,000 companies.
- *Government consolidation efforts:* The South African government aims to consolidate the industry, reducing the number of funds to between 100 and 200 to enhance efficiency and effectiveness.

Private Credit Investing in South Africa

According to data from FSD Africa (2022), between 2015 and 2021, the South African private debt market was the most active in Africa, with USD7.7 billion in transactions. This rapid expansion of nonbank private credit follows tighter regulations for banks after the global financial crisis, resulting in reduced funding to SMEs.

There is a strong overlap in sector exposure between private equity and private credit funding because of the complementary nature of these two funding methods. It is estimated that 21% of South African private equity firms also offer private credit funding, compared with 31% globally. This private credit gap between local and international private equity firms suggests that there is significant scope for private credit growth in South Africa. Local players have noted the international growth in private credit and expect significant growth in the South African private credit market in coming years.

The changes in regulations, particularly Regulation 28 of the Pension Fund Act (regulating asset class concentrations by setting limits for retirement funds), create opportunities to grow the asset class. The regulatory limit for alternative assets, including private equity and private credit, rose from 10% to 15%. SAVCA found that 53% of pension funds allocated less than 1% to private credit, including 24% that have no private credit allocations at all.

Private Equity Investing in South Africa

South African private equity firms manage ZAR206.2 billion in AUM (up 20% since 2017), including ZAR39.5 billion in undrawn commitments. The main sectors that benefitted from private equity investments are infrastructure (20.4%), energy (14.5%), and telecommunications (10.7%). The variability in sector exposure is driven by thematic trends in the economy. For instance, energy sector investments responded to recent government policy actions (for example, Section 12B in the Income Tax Act) aimed at attracting private sector investments into the energy sector to address the country's current energy crisis.

South African private equity funds mainly raise funds locally (69% of AUM), with the balance from foreign investors (31%). The main contributors to foreign investments are Europe (67% total, of which the United Kingdom accounts for 18%) and the United States (27%).

Pensions and endowments are the main investors in private equity, contributing more than two-thirds over the last three years. The recent increase in the regulatory asset allocation limits for global assets under Regulation 28 are likely to result in reduced investment—at least in the short term—for local assets, including private equity. This reduction may be partially offset by the increase in asset allocation limits for alternative assets.

Other significant investors in the private equity market include government development funds, international aid agencies, and DFIs (23%), insurance companies (19%), banks (7%), and private equity funds of funds (4%).

South African private equity firms consistently lag global peers in offering ancillary services. Most PE managers also offer private credit (21% locally versus 31% for global peers), real estate (5% locally versus 8% globally), venture capital (3% locally versus 13% globally), and real assets (3% locally versus 8% globally). The significant underperformance in venture capital may indicate a need to attract a more diverse pool of funders who can tolerate higher levels of risk.

Exhibit 51 provides insight into the segmental focus of the largest managers in the market. The best alternative managers, offering differentiated strategies, tend to be capacity constrained. To avoid negatively affecting investment returns, fund managers may limit the number of investors and/or capital into their funds.

Exhibit 51. Most Active PE Players in South Africa, 2018–2023

	Number of Investments	AUM (USD bn)	Median Deal Size	Exits
ARC Investments	15	0.9	11.4	3
Ethos Private Equity	11	1.7	74.2	1
Medu Capital	10	NA	11.9	0
Apis Partners	10	0.8	21.5	2
Growth Capital Partners	9	NA	1.3	0
The Carlyle Group	9	400	110.9	1
Crossfin Technology	9	NA	30.3	2
Old Mutual Investment Group	8	4.8	25.6	3
Fledge Capital	8	NA	9.1	3
Khulasande Capital	6	NA	9.8	1

Note: NA = not available.

Source: David Stevenson, "The 10 Most Active PE Investors in South Africa," Pitchbook (28 March 2023), <https://pitchbook.com/news/articles/top-pe-investors-south-africa>.

Managers' investment philosophy and strategic focus tend to drive portfolio construction. Whereas established players, such as Ethos and Carlyle, have large median deal sizes (focusing on the top end of the market), the emergence of new managers targeting smaller transaction sizes is to be encouraged. This dynamic creates diversified sources of funding for mid-sized companies and, in turn, promotes broader economic participation and growth.

Is Investing in Private Markets the Answer?

The capital markets, both private and public, are part of the financial services ecosystem. Rather than competing with each other, they are complementary offerings with a potential for stronger linkages. For instance, a review of JSE company press releases from 2019 indicates that 8 out of 33 companies that delisted from the JSE involved financial sponsors (i.e., private equity companies). In these cases, mainly smaller-capitalisation companies that did not see the benefit of maintaining a listing, the companies resorted to private equity funds. As the JSE (2022) noted, small and medium-sized companies have seen a decline in the benefits of being listed, alongside a number of structural changes in the savings industry:

There has been a reduction in institutional interest in small and medium-sized companies. In particular, the transition of most pension funds from defined benefit to defined contribution has substantially lessened their ability to invest in illiquid stocks.

Activity during the 2019 to 2022 period was driven by smaller PE funds and Black Economic Empowerment players as “providers of liquidity.” During the same period, there were three investment exits through stock market listings by private equity firms. This shift reflects broader trends in the investment community, where risk aversion has grown and the focus has shifted towards more liquid, established investments. The private capital markets have become “seekers of liquidity” in these transactions and turned to the public capital market.

As institutional interest wanes and investment patterns change, the JSE, being the biggest public investment market in South Africa, recognized the need for stronger private capital markets and introduced JSE Private Placements (JPP, a wholly owned subsidiary) in 2021. The platform is intended to “connect private companies and issuers directly to investors, enabling private capital formation,” given it is difficult and expensive for small and medium-sized companies to raise capital on the JSE. Initiatives such as the JPP can reduce the cost and burden of compliance, while mobilising additional funding targeted at SMEs.

Expanding Access to Capital for SMEs

Similarly, the growth in private equity and private debt funds has expanded the pool of available capital for SMEs—particularly in underserved segments—and should be encouraged. Although established private equity players have large transaction size as entry points, much like traditional lenders, this excludes a large section of the SME market. For instance, the Ethos Mid Market Fund targets investments between ZAR100 million and ZAR350 million (approximately USD6 million to USD18 million). The effort by large fund managers to reach smaller firms is laudable. Because of this commitment to smaller firms, private markets serve as alternative financing sources that offer a crucial lifeline to smaller businesses.

Smaller Fund Managers, Bigger Impact

Smaller private equity firms, such as Growth Capital Partners, which has a median transaction size of USD1.3 million, play a pivotal role in bridging this financing gap. By targeting smaller transaction sizes, these firms offer much promise for impactful investing that caters to the specific needs of SMEs in South Africa. Similarly, in the private credit space, Aluwani Capital Partners is also making a significant impact by casting a net wider than the traditional targets for private credit. These funds can help businesses overcome capital constraints and achieve their growth objectives. As more players enter this space with a commitment to supporting SMEs, the ripple effects will not only stimulate economic growth but also foster job creation and innovations in the long term.

5. The Challenges to Capital Market Formation

The dynamics of South Africa's capital markets are deeply influenced by the country's legacy of social inequality, which manifests in several critical areas:

- Limited pools of private capital
- Dominance by five institutions in the banking sector
- Low levels of disposable income, leading to low savings rates
- High risk aversion in the banking and formal finance sectors
- Economy driven by small and informal enterprises
- Low economic diversification
- Low-tech financial solutions for small and informal businesses

These challenges create substantial barriers for small and young enterprises to secure capital needed for growth, leading to a high rate of corporate failures. Research from the University of the Western Cape⁶³ highlights an alarming statistic: South Africa's overall startup failure rate ranges from 70% to 80% within the first five years. Furthermore, only about 1% of startups manage to grow large enough to employ 10 or more individuals. This lack of growth is of particular concern because it limits the capacity and potential of SMEs to reduce the country's persistently high unemployment rate, which has hovered around 34% over time.

The interplay of these factors not only reinforces the low credit ratings assigned to small enterprises—critical players in the South African economy—but also perpetuates a cycle of capital starvation that stifles job creation and capital accumulation.

Exhibit 52 draws on World Bank estimates for GDP and surveys of bank penetration.

The Rank column in the exhibit indicates a global rank for gross domestic product, C-Score is the percentage market share of the jurisdiction's five biggest banks, and B-Score is the percentage of respondents aged 15 years and older who have a bank account with a formal institution. The sample was selected to show South Africa against the world's leading economies, as well as rivals for size. Iran and Hong Kong SAR (ranked 40 and 41, respectively) are excluded for lack of bank concentration estimates (Iran) and unique market dynamics (Hong Kong SAR).

South Africa's banking concentration is striking because it has the highest ranking in the sample, with the top banks dominating the entire sector.

⁶³Research from University of the Western Cape (n.d.), "How Can South African Entrepreneurs Succeed?": <https://www.uwc.ac.za/news-and-announcements/news/how-can-south-african-entrepreneurs-succeed-897>.

Exhibit 52. Financial Concentration and Inclusion by Jurisdiction

Rank	Jurisdiction	GDP (current USD, millions)	C-Score	B-Score
1	United States	25,462,700	49.7%	95.0%
2	China	17,963,171	54.2%	88.7%
3	Japan	4,231,141	63.6%	98.5%
5	India	3,385,090	53.4%	77.3%
8	Russia	2,240,422	69.8%	88.7%
11	Brazil	1,920,096	79.4%	83.6%
16	Indonesia	1,319,100	57.1%	50.0%
30	Nigeria	477,386	74.4%	45.1%
31	Egypt	476,748	84.0%	26.1%
34	Bangladesh	460,201	35.2%	37.7%
35	Vietnam	408,802	48.3%	
36	Malaysia	406,306	70.1%	88.2%
37	South Africa	405,870	99.3%	84.1%
38	Philippines	404,284	67.3%	46.0%
39	Denmark	395,404	89.9%	100.0%
42	Colombia	343,939	90.2%	55.9%
	Average score		67.9%	71.0%

Sources: World Bank Group's Global Findex Database 2021; World Bank Group's Global GDP Indicator from 2023, <https://openknowledge.worldbank.org/bitstream/handle/10986/37578/9781464818974.pdf>.

This resulting reduced competition retards the customisation of investment products for nontraditional customers and segments. In Exhibit 52, South Africa's B-Score of 84.1% is higher than the sample average of 71%. Although this statistic shows that the country has a higher-than-average rate of banked respondents, these are largely retail consumers, not business banking customers.

The gap between South Africa's B-Score and C-Score suggests potential for reform. Banks could expand their services to underserved businesses without the need to first develop a base of banking-savvy clients. However, the complexities involved between commercial and retail banking products and the related gap between retail and institutional credit risk suggest that banks may not rush to coax their business-owner clients to bring their businesses on board.

Research by the UNCTAD (2022) has identified low economic diversification as a hurdle to growth. Africa's heavy dependence on commodity exports,

which represent over 60% of total merchandise exports in 45 of its 54 countries, positions it as one of the least diversified regions globally. This lack of diversification makes the continent highly vulnerable to global commodity price shocks, hindering sustainable growth and development opportunities. The crippling effect of sector concentration is seen in capital formation, where South African investors look offshore for investment diversification. The concentration aversion is amplified by South African investors' and consumers' perception of the rand as a "weak" currency, set upon a long-term trend of devaluation against the US dollar. Thus, dollar-denominated assets are perceived as doubly effective in offsetting concentration risk.

Statistics from the South African Reserve Bank show increased offshore investment by nonbanking institutions and retail investors in South Africa. This trend is driven by the quest for diversity described previously, coupled with the perception of South Africa as a dangerous, unstable place. This perception leads to "over-insurance," which takes the form of maximal offshore allocation, at the expense of local capital-consumptive companies. At the informal end of offshore investment, South Africa's sophisticated economic system and nascent financial forensic capacity allow more capital flight than the reserve bank's regulated prudential limits allow.

Data from the South African Chamber of Commerce and Industry show business confidence pegged in a narrow range from January 2016 through May 2023 (see **Exhibit 53**). There has been volatility on the downside only, with sharp spikes triggered by local political crises and the onset of the COVID-19 lockdown. The upside has seen only mean-reverting recoveries from the crises. This picture is consistent with corporate managers maintaining a cautious rating of local risk. With this mindset, investment in local industries is constrained by the policy

Exhibit 53. Business Confidence Index in South Africa, January 2016–May 2023



Source: South African Chamber of Commerce and Industry, Q2 2023 (<https://sacci.org.za>).

of self-insuring, preserving excess cash as a buffer against future crises. The risk-averse maintenance of "lazy balance sheets" presents a challenge to capital formation (granting that, technically, idle cash on a balance sheet is "capital").

Although South African financial markets are sophisticated by global standards, the provision of sophisticated financial solutions is currently a preserve of larger corporates. As a result, small and medium-sized enterprises—constituting the major employers—are deprived of capital-enhancing solutions. Research by the Center for Strategic and International Studies (CSIS) provides examples of this problem.⁶⁴ CSIS specifically targets blended finance models, which combine commercial credit with grants and concessionary finance. Increasingly, such finance is used to great effect by the South African government and major non-banking institutions. Blended models have the potential to draw commercial investors to the MSME sector, providing working capital that would stem the high attrition rate of smaller companies.

On the demand side, the lack of sophistication among small business owners contributes to the limited access to capital. Historically, about half of all small South African businesses keep no formal records, obviating credit scoring through financial statements. Research by McKinsey⁶⁵ has identified the demand for loan collateral as a further impeding factor. South Africa's unusual wealth concentration and history of red lining by commercial banks means that MSME are largely unable to offer collateral assets to match the loan requirement. The McKinsey research further identifies fragmentation as a hidden impediment.

A banking sector respondent mentioned that the costs of screening companies with a turnover under USD0.5 million were prohibitive and that therefore these companies were routinely denied loan capital. According to statistics from SME South Africa, more than 70% of small businesses fall under this threshold. Moreover, minority borrowers may have demographic differences that affect the modelling of their likelihood of default. Credit scoring models that do not consider these differences systematically underrate bankable members of these groups. This problem has a relatively significant impact in South Africa, where traditional scoring models are not derived from observation of default among the unbanked corporate majority.

6. Possible Solutions to Accelerate Capital Market Formation and Policy Recommendations

A number of structural and qualitative barriers and challenges to the development of local private capital markets have been highlighted and articulated in the previous sections. The purpose of this section is to explore

⁶⁴See CSIS, "Supporting Small and Medium Enterprises in Sub-Saharan Africa Through Blended Finance" (July 2021), www.csis.org/analysis/supporting-small-and-medium-enterprises-sub-saharan-africa-through-blended-finance.

⁶⁵See McKinsey & Co., "A Credit Lifeline: How Banks Can Serve SMEs in South Africa Better" (11 December 2020), www.mckinsey.com/featured-insights/middle-east-and-africa/a-credit-lifeline-how-banks-can-serve-smes-in-south-africa-better.

potential policy recommendations and approaches to address some of these identified barriers and challenges hindering the development of private capital markets and allow retail savers, regulators, various private market players, financial intermediaries, and other local and international stakeholders to help support the sustainable development of South Africa's private capital markets, complementing and building on the relatively well-established public markets.

The South African public equity markets relative to the rest of the continent are significant, relatively well established, and sophisticated, with the JSE, for instance, representing more than half (USD1.36 trillion) of the roughly USD2 trillion market capitalisation of the 25 African public equity market exchanges, according to the African Securities Exchange Association. The private equity capital markets, however, are at significantly lower levels of relative development, accessibility, and standardisation, all of which can be improved to attract retail and local or foreign investors.

On the debt side, the South African local public bond market is significant but remains dominated by securities issued by the South African central government, local government, municipalities, public enterprises, and other major corporations taking up the bulk of debt issuances, crowding out and leaving very little room for the private debt and equity markets to develop and support SMEs, for example.

Further, private capital markets have historically been limited to mostly institutional domestic sources and overseas investors, via foreign direct investment or other overseas development assistance interventions.

Harnessing Retail Domestic Investors

A source that has largely been overlooked, however, is harnessing retail domestic investors, including overseas remittances by African migrant workers that could be used to create an annuity income for their intended recipients, while supporting private capital market formation through providing patient and long-term funding for various productive sectors of the local economy. Remittances can offer a dual benefit. They can gradually lessen the financial burden of the African diaspora sending money home every month by creating recurring income sources via dividends and other investment distributions. This process can simultaneously support private capital market formation. To fully harness the potential of African migrant workers' remittances, more local market research and investigation will be necessary to inform financial and fit-for-purpose product innovation by banks and private credit and equity players in this space.

According to the World Bank, in 2021, more than USD590 billion in inflows from remittances were received in the global south from the global north, considerably more than overseas development assistance (USD180 billion) and private capital from private investors (USD400 million). Currently, more than 80% of remittances are going into recurring expenditure, with less than 20%

going into savings that could, in turn, be channelled into private capital market formation initiatives. With additional research, insights, and innovation, more of the inflows could be channelled into such initiatives, which would make a significant impact on the development of the local markets and thus the availability of patient long-term capital for both SME funding and infrastructure projects that are currently starved of capital. Additional research on South Africa's and the region's share of these overseas remittances by the diaspora, as well as on their nature and dynamics, should be conducted. Such research should explore innovative ways these inflows can be leveraged into supporting local private capital markets for the equity and debt funding of SMEs, as well as other economy-building infrastructure development projects for the benefit of society overall.

Tax Compliance and the Informal Economy

Tax compliance in the informal economy that employs the majority of workers in South Africa remains a concern. One important and promising proposal is to introduce a universal basic income (UBI) with a tax incentive that covers everyone, including those between the ages of 18 and 60 years, who is not currently covered. This UBI tax incentive would encourage tax compliance by requiring all potential recipients to register with the South African Revenue Service before receiving the tax incentive. This incentive would tie in support for SMEs, many of which operate as sole proprietors initially, with increased tax compliance and revenue collection over time as private capital market formation, increased tax compliance in the informal economy, and SME-driven economic growth gain momentum. The tax incentive would work via the current primary, secondary, and tertiary rebate system, wherein all citizens would be required to aggregate their UBI entitlement or grant to any tax rebate claimed.

The net effect of this proposal would be that only those not in any income-generating activity, whether in the formal or informal sector, would be able to claim their full grant. Similarly, any active economic activity that generates taxable income would result in a tax rebate claim that would be netted off the UBI payment, automatically creating a system that incentivizes net UBI recipients to transition from net grant receivers to tax contributors without a need for means testing over time. This approach takes care of the poverty reduction elements of universal social security while keeping an eye on affordability. It also supports the formalisation of the informal sector and eventually private capital market formation.

Addressing the Structural Need for Skilled Professionals

To further develop the informal sector and, in particular, SMEs, the scarcity of skills, including corporate governance skills, needs to be addressed in order for both small and large companies to scale up production in South Africa. Skills deficits, whether in marketing, finance, audit, or tax planning, are curtailing capital formation, listings, and related corporate finance activity that underpins private market capital formation.

Incentivising the Mobilisation of Domestic Savings through Taxation and Widening the Scope of Possible Investment Solutions

On the venture capital and private equity side, the government should be commended for coming up with innovative policy initiatives, such as Sections 12J and 12B of the South African income tax act, to mobilise domestic savings to support private equity funding from private individuals and corporations. These initiatives provide individual taxpayers and SMEs an additional asset class to invest in, beyond the traditional asset classes held within the institutionalised savings industry (such as equities and bonds).

The Section 12J tax incentive, originally introduced in 2009 before expiring in 2021, resulted in more than ZAR13 billion that went to fund various SMEs. According to the interim Section 12J venture capital association, the initiative was on track to at least create jobs at a cheaper cost compared with other government-sponsored job creation initiatives, such as the Industrial Development Corporation. All these incentives, however, require tax compliance and an increasing tax base. Therefore, they are linked to the UBI tax incentive, which could encourage economic activity in the SME and informal sector and increase financial literacy and capital mobilisation. This could lead to innovative solutions, such as 12B venture capital, and ultimately higher tax revenue collection because market systems with increased compliance work better.

The 12J incentives ended, and the 12B incentive—specifically targeting the energy sector—replaced them. The 12B incentive targets the energy sector to address the country's crippling energy shortages, and it has the stated intention of funding renewable energy infrastructure projects through providing tax incentives to taxpayers. The government could consider introducing or extending the tax incentive to other sectors, supporting SMEs currently starved of funding to unleash their potential to contribute to South Africa's sustainable development and that of the continent as a whole. In addition, the government could explore interventions to reach a wider spectrum of investors, such as initiatives to encourage registered financial advisers and financial institutions to distribute 12B venture capital vehicles, to multiply the intended impact.

However, more research on both the positives and negatives of these initiatives over long trial periods will be required to assess their net effect on the economy broadly, tax collection, and the growth and development of SMEs themselves, and thereby on job creation, reduction in poverty, and inclusive growth for the development of society overall.

Other potential policy recommendations are as follows:

- Digitalised assets and distributed ledger technology platforms could be used to improve the transparency of information, automation, and distribution systems in the process and could also serve as infrastructure for the formation of private capital markets.
- Support of regional trade and linkages of SMEs underpinned by the UN SDGs, the African Union's Agenda 2063 vision, and the National Development Plan, as well as the African Continental Free Trade Area, would encourage cross-border trade between SMEs across the region. This represents another opportunity to support private capital market formation and could be tied with new payment systems that do not require foreign currency between SMEs.
- Other technologies could be used, such as fintech solutions to facilitate capital movement in the economy and cross-border transfers.
- A proposal around supporting financial literacy and inclusion initiatives could be introduced to support higher domestic discretionary savings, which would go towards supporting private capital market development and formation.
- Blended finance models should be explored to tap into the efficiency of the private sector with a developmental mandate of various DFIs, such as SEFA, IDC, and NEF.

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