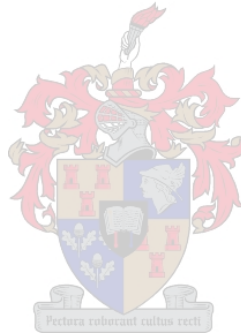


THE FUNDING OF BLACK ECONOMIC EMPOWERMENT IN SOUTH AFRICA

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at the University of Stellenbosch



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“Declaration

I, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature:

Date:”



Executive Summary

This study considers Black Economic Empowerment (BEE) in South Africa, and in particular, the various funding structures of Black Economic Empowerment transactions. Whilst these structures have a variety of forms, past experience has suggested some fundamental problems with the actual funding sources and structures.

Various definitions and interpretations of Black Economic Empowerment within the context of this paper are discussed. Two BEE strategies are identified, one of which namely, the creation of a broader, more sustainable group of black entrepreneurs for South Africa will be the focus of this paper. The issue of entrepreneurial empowerment will remain an ongoing theme throughout all chapters in this paper. The second BEE strategy, namely, poverty alleviation and employment creation is only briefly discussed although its importance is not underestimated. From the study it is concluded that BEE ought not be a strategy aimed at the enrichment of a select group of black elite. Lessons learnt from past failures are also highlighted.

A historical analysis of the provision of funding to historically disadvantaged people (HDP)¹ in South Africa is presented. The theme of inequality in providing access to finance for black entrepreneurs and small businesses is looked at in this context. The historical analysis starts with the early years in South Africa and then focuses on the period 1990 – 1999.

This report also provides a critical assessment of some of the biggest shortcomings of the pyramid structures and complex financial engineering of the first attempts of Black Economic Empowerment in the narrow sense of the word. It is established that the Special Purpose Vehicle funding structures of the late 1990s were a failure. Further, this study looks at current financing options and possible solutions. Some recent examples are also provided of BEE funding structures which seem to have worked. Traditional government institutions such as the Industrial Development Corporation, in particular, have also come a long way in developing more viable

¹ Note that HDP incorporates all disadvantaged groupings such as the Black, Indian, Coloured populations of South Africa. In historical terms it also includes the various tribes that existed in South Africa during the early years as well as those who were slaves.

funding in transactions with BEE companies. It is also noted that recent alternative financing structures by the private sector are addressing some of the key challenges of BEE such as ownership, control and the promotion of sustainable black businesses for the transformed South African economic landscape going forward. However, many obstacles remain with the potential sources of funding of BEE such as traditional banks and life insurers in South Africa who are still not more accessible to the poor. Fundamental problems have also been identified in the analysis of the Development Finance Institutions (DFIs) of government such as the National Empowerment Fund, Khula Enterprises and the Land Bank which are also anticipated to play a crucial role in the provision of financing for BEE over the coming years.

This study highlights the significant cost involved with the implementation of the BEE strategies. The single biggest challenge to the economic empowerment of the previously disadvantaged is access to funding. About the need for broad-based Black Economic Empowerment in South Africa, there is no dispute. But it is important that these costs are weighed against other sustainable development objectives. The private sector often seems to see BEE as a cost rather than an opportunity. But while the shortcomings of numerous empowerment initiatives, exacerbated by the 1998 stock market crash, may have caused the financial sector to get cold feet about these transactions, the sector can come up with some creative options that go beyond old problems. Therefore, the future role of government financed institutions together with the private sector remains critical in ensuring that these objectives are met.

In conclusion, the discussion on the funding of Black Economic Empowerment in South Africa must be seen within the context of the political and economic landscape of the 1990s and then in particular, the history of the past ten years.

Narrowly defined black economic empowerment has gained significant momentum in recent years due to the economic restructuring of the business sector which has been propelled by recent government legislation such as the Mining Charter, the Black Economic Empowerment Commission's recommendations, the Department of Trade and Industry's discussion documents and other legislation currently in the pipeline. However, the economic landscape still looks bleak. Real economic growth has been inadequate since large parts of our population are still unemployed. A significant

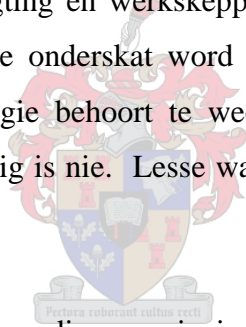
hurdle still facing our economy is the high degree of wealth inequality that exists. It is within this context that one should assess the many policy and funding initiatives that have been taken and the strategies proposed to redress historical imbalances in the country.

The paper itself is comprised of six parts. This executive summary only serves to provide a brief overview of the various areas covered in this study. Chapter One analyses the various definitions of the term Black Economic Empowerment, their relevance and the development of BEE in South Africa over the years. This leads to a discussion in Chapter Two on the problem statement, being the funding of BEE. Chapter Three is divided into seven sub-sections and provides a historical analysis of the funding obstacles facing black people since the early 1900s, then looks at developments of BEE since the early 1990s with a critical assessment of the failures of empowerment and the funding structures utilized during this period. Chapter Three also identifies various similarities and lessons learnt from examples of empowerment experiences in other countries. Chapter Four looks at the estimated size of the funding requirement and current sources of financing from the private and public sector. Certain conclusions are drawn from this overview. Chapter Five looks at the major risks facing the impact of BEE and the financing thereof in the future. Chapter Five also applies the criteria for appropriate funding of BEE to a recent BEE transaction in the form of a case study. Some possible solutions are also put forward in this section of the analysis. Chapter Six summarises and concludes.

Inleiding

Hierdie studie ondersoek Swart Ekonomiese Bemagtiging (SEB) in Suid-Afrika, en in die besonder die verskillende befondsingstrukture van Swart Ekonomiese Bemagtigingstransaksies. Hoewel hierdie strukture 'n verskeidenheid vorms mag hê, het ondervinding getoon dat daar wesenlike probleme is wat die werklike befondsingsbronne en -strukture betref.

Verskillende definisies en vertolkings van Swart Ekonomiese Bemagtiging binne die konteks van hierdie verhandeling word bespreek. Twee SEB-strategieë word geïdentifiseer, waarvan een, naamlik die daarstelling van 'n meer omvattende en meer volhoubare groep swart entrepreneurs vir Suid-Afrika, die fokuspunt van hierdie verhandeling sal wees. Die vraagstuk van entrepreneuriale bemagtiging sal 'n deurlopende tema in alle hoofstukke van hierdie verhandeling bly. Die tweede SEB-strategie, naamlik armoedeverligting en werkskepping word slegs vlugtig bespreek, alhoewel die belang daarvan nie onderskat word nie. 'n Gevolgtrekking van die studie is dat SEB nie 'n strategie behoort te wees wat op die verryking van 'n uitgesoekte swart elite-groep gerig is nie. Lesse wat uit mislukkinge van die verlede geleer is, word ook belig.



'n Geskiedkundige ontleding van die voorsiening van befondsing aan voorheen benadeelde mense in Suid-Afrika word gebied. Die tema van ongelykheid in die bied van toegang tot finansiering vir swart entrepreneurs en klein besighede word binne hierdie verband bekyk. Die geskiedkundige ontleding begin met die vroeë jare in Suid-Afrika en fokus vervolgens op die tydperk 1990 – 1999.

Hierdie verslag bied ook 'n kritiese evaluering van sommige van die grootste tekortkomings van die piramidestrukture en ingewikkelde finansiële geniëring van die eerste pogings tot Swart Ekonomiese Bemagtiging in die eng sin van die woord. Daar word bewys dat die Gespesialiseerde Voertuig-befondsingstrukture van die laat 1990's 'n mislukking was. Hierdie studie kyk boonop na huidige finansieringsopsies en moontlike oplossings. 'n Aantal onlangse voorbeelde van SEB-befondsingstrukture wat klaarblyklik suksesvol was, word ook gebied. Tradisionele regeringsinstansies, soos die Nywerheidsontwikkelingskorporasie in die besonder, het

ook heelwat vordering getoon wat die ontwikkeling van meer lewensvatbare befondsing in transaksies met SEB-maatskappy betref. Daar word ook gelet op die feit dat onlangse alternatiewe finansieringstrukture deur die privaat sektor sommige van die sleuteluitdagings van SEB, soos eienaarskap, die beheer en bevordering van volhoubare swart besighede vir die transformerende Suid-Afrikaanse ekonomiese landskap, aanspreek. Daar is egter steeds talle struikelblokke wat die potensiële befondsingsbronne van SEB betref, soos tradisionele banke en lewensversekeraars in Suid-Afrika wat steeds nie meer toeganklik vir die armes is nie. Wesentlike probleme is ook geïdentifiseer in die ontleding van die regering se Ontwikkelingsfinansieringsinstansies, soos die Nasionale Bemagtigingsfonds, Khula Enterprises en die Landbank, wat na verwagting ook 'n beslissende rol in die voorsiening van finansiering vir SEB in die komende jare sal speel.

Hierdie studie belig die aansienlike koste wat by die implementering van die SEB-strategieë betrokke is. Die grootste enkele uitdaging vir die ekonomiese bemagtiging van voorheen benadeeldes is toegang tot befondsing. Die behoefte aan omvattende Swart Ekonomiese Bemagtiging in Suid-Afrika word nie betwis nie. Maar dit is belangrik dat hierdie koste opgewees moet word teen ander volhoubare ontwikkelingsdoelwitte. Dit wil voorkom asof die privaat sektor SEB as 'n uitgawe eerder as 'n geleentheid beskou. Maar alhoewel die tekortkominge van talle bemagtigingsinisiatiewe, wat deur die ineenstorting van die aandelemark in 1998 vererger is, daartoe kon lei dat die finansiële sektor bra lugtig vir hierdie transaksies is, kan die sektor tog met skeppende opsies vorendag kom om ou probleme die hoof te bied. Die toekomstige rol van staatsgefinansierde instansies in samewerking met die privaat sektor bly dus deurslaggewend om te verseker dat hierdie doelwitte bereik word.

Kortom, die bespreking van die befondsing van Swart Ekonomiese Bemagtiging in Suid-Afrika moet gesien word binne die konteks van die politieke en ekonomiese landskap van die 1900's en die geskiedenis van die afgelope tien jaar in die besonder.

Eng gedefinieerde swart ekonomiese bemagtiging het in die laaste paar jaar aansienlike stukrag verkry danksy die ekonomiese herstrukturering van die sakesektor, wat verder aangedryf is deur onlangse regeringswetgewing soos die

Mynbouhandves, die aanbevelings van die Swart Ekonomiese Bemagtigingskommissie, die Departement van Handel en Nywerheid se samesprekingsdokumente en ander wetgewing wat tans beplan word. Die ekonomiese landskap lyk egter steeds allesbehalwe rooskleurig. Reële ekonomiese groei is onvoldoende aangesien groot gedeeltes van ons bevolking steeds werkloos is. 'n Betekenisvolle struikelblok wat ons ekonomie steeds in die gesig staar, is die groot mate van ongelyke welvaart wat bestaan. Dit is binne hierdie verband wat die talle beleids- en befondsingsinisiatiewe geëvalueer moet word wat onderneem is en strategieë wat voorgestel is om die geskiedkundige wanbalanse in die land aan te spreek.

Die verhandeling self bestaan uit ses afdelings. Hierdie inleiding dien slegs om 'n bondige oorsig te gee van die onderskeie temas wat in hierdie studie gedek word. Hoofstuk Een ontleed die verskillende definisies van die uitdrukking Swart Ekonomiese Bemagtiging, hul tersaaklikheid en die ontwikkeling van SEB in Suid-Afrika oor die jare. Dit gee aanleiding tot 'n bespreking in Hoofstuk Twee van die probleemstelling, naamlik die befondsing van SEB. Hoofstuk Drie is in sewe onderafdelings verdeel en bied 'n geskiedkundige ontleding van die befondsingstruikelblokke wat swart mense sedert die vroeë 1900's in die gesig staar, waarna dit ontwikkelings op die gebied van SEB sedert die vroeë 1990's ondersoek, met 'n kritiese evaluering van die mislukkinge van bemagtiging en die befondsingstrukture wat in hierdie tydperk toegepas is. Hoofstuk Drie identifiseer ook verskillende ooreenkomste tussen en lesse wat geleer is uit voorbeelde van bemagtigingsondervinding in ander lande. Hoofstuk Vier kyk na die geskatte omvang van die nodige befondsing, asook huidige bronne van finansiering uit die privaat en openbare sektor. Sekere gevolgtrekkings word aan die hand van hierdie oorsig gemaak. Hoofstuk Vyf belig die grootste risiko's wat die impak van SEB in die gesig staar, asook die toekomstige finansiering daarvan. Hoofstuk Vyf pas boonop die kriteria vir genoegsame befondsing vir SEB op 'n onlangse SEB-transaksie in die vorm van 'n gevallestudie toe. 'n Aantal moontlike oplossings word ook in hierdie afdeling van die ontleding gebied. Hoofstuk Ses vat saam en kom tot 'n slotsom

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1) Chapter One: Black Economic Empowerment in South Africa

‘When I speak of The Case for Equality I mean human equality; and that, of course, can only mean one thing: it means equality of income.’

George Bernard Shaw

a) Introduction

Over the years, poverty and income disparities in South Africa have continued to increase and the government has identified BEE as one of the critical solutions in solving these problems since coming into power in 1994. Before one can consider the funding requirements for BEE and potential problems surrounding the future financing of empowerment transactions, the concept of Black Economic Empowerment (BEE) in South Africa first needs to be understood. This chapter will consider various available definitions and interpretations of BEE which will enable a structured description of this particular concept for the purposes of this study. The origins and development of BEE in South Africa will also be discussed in chronological order.

The various interpretations of the concept of BEE in this chapter will reveal a great deal of confusion by government and the private sector in formulating and implementing BEE. It would seem that BEE has been interpreted to serve the self-interest of various groups. This confusion has resulted in two very different views on BEE, namely a narrow (top down) interpretation for BEE and on the other hand, a broad-based approach to BEE for South Africa. Although the ANC government seems to have accepted the broad approach to empowerment, it has failed in ensuring broad-based BEE in the true sense of the word. The result has been that BEE in its current form is still only dominated by a handful of black individuals. If South Africa is to achieve sustained growth, the country will have to bring millions of black people into the economy. The purpose of this chapter is to discuss the funding of BEE which is the result of a broad-based approach where the economic value-add of each black South African is increased on a sustainable basis. Finally, an appropriate definition and interpretation of BEE for the purposes particular to this paper, namely the funding of BEE in South Africa will be analysed and identified.

b) Defining BEE

The term 'Black Economic Empowerment' can be explained as follows. Firstly, economics can be defined as '...the study of how societies use scarce resources to produce valuable commodities and distribute them among different people' (Paul Samuelson, quoted in Mohr, P. and Fourie, L. (1996: 8). Secondly, the term 'to empower' in its most basic meaning, to give power to; to make able (Oxford Dictionary, 1990: 384). A definition of economic empowerment may thus be formulated as, a process, or act, whereby a society or a segment thereof, is given: 1) the power to access and use scarce resources; 2) the means and knowledge of how and what to produce. Economic empowerment is furthermore about economic involvement as opposed to economic marginalization as is the case of the eight million unemployed in South Africa. Thirdly, the term 'black' includes the African, Indian and Coloured population groups of South Africa.²

The diverse nature of BEE has meant that this phenomenon is not clearly defined and the various interpretations have led to a great deal of confusion about what the term BEE actually encompasses. Part of the problem is that government has historically provided no clear guidelines on BEE. This has caused various interest groups to assume an interpretation of BEE to suit their own particular interests at the cost of a broad-based approach to BEE. As a consequence, two distinct interpretations are given to the concept of BEE. First, there is the narrow definition that has been promoted by the corporate sector and financial institutions. The second, a far broader interpretation as defined by the Black Economic Empowerment Bill, has since been accepted by government. These two approaches will be discussed in detail. A third interpretation of BEE which will not be discussed in this paper, but deserves mention is an understanding of BEE which includes poverty alleviation which remains an integral part of BEE for South Africa in the future given the problematic income disparities.

The narrower approach to BEE (also referred as the top down approach) developed in the early 1990s with the first wave of deals by black business. This narrow definition

² As defined by the Black Economic Empowerment Bill, 2003 where 'black people' is defined as a generic term which means Africans, Coloureds and Indians.

traditionally focuses on the entry and transaction activities of black people in business, especially what is commonly referred to as BEE investment companies (BEEC, 2001: 1). In other words, it would evaluate the experiences and challenges faced in the establishment of companies such as New Africa Investments (Nail), Real Africa Investments (Rail) and Johnnic. One of the shortcomings of this interpretation of BEE is that it does not really encompass the experiences of small and medium businesses, the development of skills, the creation of a broader, sustainable group of black entrepreneurs and a strategy aimed at solving unemployment.

The minimalist approach to BEE or the so-called top down approach to empowerment views BEE largely as an entitlement and a mere transfer of assets to enrich only a few black South Africans (Iheduru, O.C. 1994: 86). This top down approach was also characterized by empowering a small section of the black elite, some of who had already been beneficiaries of the homelands policies of the apartheid era (Malala, J. 1995:25; Malunga, M. 1995:13). According to Dr Nthato Motlana, one of the best known advocates of the top down approach in the 1990s and former chairman of Nail, *'only through entrepreneurship, leadership and hard work will blacks inherit the economic kingdom. We do not want guilt offerings or hand-outs...We cannot wait decades to participate fully and effectively in the economic future of South Africa.'* (Smith, L. 1995b:65). In principle, this apparent broader approach to BEE is *'gives black business more flexibility; access to capital; allows it to operate in an open and transparent manner.'* (quoted in Smith, L. 1995c:66). The refrain of many proponents of this strategy is *'Don't give blacks a small business because they will fail; give them a big business and see them excel'* (Dr Nthato Motlana, quoted in Malunga, M. 1995:11-12). Although Dr Motlana's comment suited a broader approach to BEE, his implementation of BEE strategy to Nail provided extremely narrow. Therefore the irony of Dr Motlana's comments at the time, was that the BEE top down approach he was a strong proponent of in the 1990s, ended up being an effective hand-out by white business.

This wave of BEE also led to a complete failure of the growth of true black entrepreneurs and small businesses. The failure of the minimalist approach to BEE was reflected when in 1991 black corporations occupied only 30 (less than 2 percent) of the 2 550 directorships available in the top 100 companies listed on the JSE. By

May 1995, black people held 276 directorships, which was a significant increase from 120 directorships in 1993 (Pedder, S. 1995: 19). However, this number in relation to white directorships was still incredibly low.

The following quote is a good reflection of the minimalist approach, *'The same black faces have begun to crop up time after time on the boards of big white companies, mimicking the "clubbiness" of the white corporate world'* (Pedder, S. 1995:19). It seems that this is still the situation that prevails today.

The consequence has been an inadequate response to the limited inclusion of black people in all economic activities and no alleviation of poverty. The growth of the black middle class and the black business strata since 1994 has been spectacular (BEEC Report, 2001: 2). However, the problem is that there has only been a marginal increase in the number of black managers and real entrepreneurs in the private sector over the same period and barely any evidence of black people in controlling positions of capital, in the real sense of the word (with the exception of the public sector and parastatals). Therefore, the narrow definition of BEE can be translated into the notion that empowerment benefits only a small politically connected elite (Business Day, 5 June 2003: 5). The reason for this is that the narrow definition does not attempt to empower a broader-based group of black entrepreneurs in South Africa and encourage their skills development. Neither has it proven to have created employment on any large-scale.

This approach has received and is still receiving much criticism. One of its most negative consequences is that it seems to have been a contributor to the poor getting poorer and the rich getting richer since the new government came into power seven years ago (African Communist 1995:2). According to one critic, 'If at the end of five years, blacks in South Africa own a larger slice of the economy, this will be largely irrelevant if the change is simply the statistical result of a few Nthato Motlanas having become multi-millionaires' (Koch, E. 1997:44). Mangosuthu Buthelezi, Inkatha Freedom Party leader has also spoken somewhat scathingly about the 'black fat cats' and how out of touch they were with the realities of rural poverty and the need for broad-based empowerment (Sunday Independent, 31 August 2003: 7). There seems to be general agreement that between 1994 and 2000 only a handful of black business

people have been snapping up new business ventures (Business Day, 11 June 2003: 2). It can therefore be concluded that BEE had failed during this period since it did not create a sustainable culture of entrepreneurship. It also failed in that it did not help stem the poverty dilemma in South Africa.

More recent criticism of the narrow approach to BEE indicates that the perception that BEE has perhaps evolved to a broader strategy does not hold true. A recent statement by a well-respected political analyst received much media attention, 'We are not creating entrepreneurs,' Moeletsi Mbeki told a seminar at the University of Pretoria (Business Day, 11 June 2003: 2). He went on to say, 'We are taking political leaders and politically connected people and giving them assets which they don't know how to manage' (Star, 6 June 2003: 8). Professor Adam Habib of the University of Natal's school of development studies, says statistics indicate that black empowerment has indeed benefited an elite. Between 1991 and 1996 wealthy blacks grew from a mere 9% of the top earners in the South African population to 22%. At the same time unemployment increased from 34% to 36% of which 52% are African women (Business Day, 11 June 2003: 2). These figures seem to indicate that inequality and poverty has increased even though there are more blacks who are wealthier.

More recently, black business itself has also begun to criticize the government's BEE plan. The key point of criticism was the ownership targets being set in the various empowerment charters. The government has come under fire for forcing companies to put equity in black hands as a way of transforming and growing the economy (Cape Times, 5 September 2003: 6). The President's brother, Moeletsi Mbeki had the following to say, *'The government has yet to demonstrate how the acquisition of shares through forced sales by the original owners to black individuals will lead to economic and social development'* (Cape Times, 5 September 2003: 6). He goes on to add, *'In the case of listed companies, how is the transfer of shares from pension funds, foreign portfolio investors or hedge funds going to lead to economic development?'*

He said that it was government itself that was in dire need of empowerment because of its drastic lack of technical capacity. Moeletsi Mbeki's sentiments were also shared at the ANC black economic empowerment summit (4 September 2003) by Patrice

Motsepe, the executive chairman of African Rainbow Minerals, who said that history had shown that there was a significant body of black people who became successful entrepreneurs despite oppressive apartheid laws and before the advent of black economic empowerment legislation. He also said, '*...there is no proof that forcing white owners to sell equity will create value or be beneficial for the economy*' (Cape Times, 5 September 2003: 6).

As far as government is concerned, there also seems to be criticism from within. The Minister of Minerals and Energy, Phumzile Mlambo-Ngcuka, has insisted that empowerment policies cannot be limited to a small number of black business people (Business Day, 15 August 2003: 13). Here criticism of black business people appears justified. There are some black business people, who once they buy into established companies, have no concern about the issues of employment equity, affirmative procurement and in fact allow white management to do business as usual, which means excluding black people except at shareholder level.

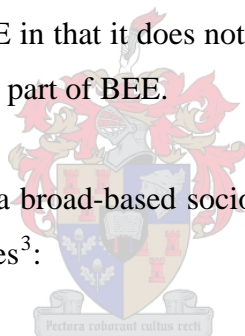
This minimalist approach which was characteristic of the first wave of BEE in the 1990s is rejected for the interpretation of BEE for the purposes of this paper since ultimately the risk is that over the longer term BEE transforms itself into a kind of crony capitalism as happened in Malaysia, with jobs and contracts only for the black elite (Cape Times, 19 May 2003: 16). Patrick Lawlor of the Cape Times, states, '*Black empowerment is an important priority and government is right to take it seriously and demand that the private sector does too. In any event there has to be some point....when it shelves the concept of BEE and rules that black business needs no further special help. Failure to do so may create the conditions for crony capitalism, a blight of the apartheid years, to take hold. Otherwise, these deals amount to little more than the rearranging the deck chairs on the Titanic*' (Cape Times, 19 May 2003: 16).

The narrower interpretation to BEE was blamed for the failure of empowerment in the 1990s. This led to government tasking the Black Economic Empowerment Commission to formulate a broader approach for BEE which will be discussed in detail in the following paragraphs of this chapter.

The Black Economic Empowerment Commission (BEEC) provides a broad definition of BEE as follows: *'An integrated and coherent socio-economic process, located in the context of national transformation that is aimed at redressing the imbalances of the past'* (BEEC Report, 2001: 2). According to this definition, BEE should be viewed within the broad scope of empowerment processes which include, amongst others, skills and management development, education, meaningful ownership, access to finance for households and for the purpose of conducting business and poverty alleviation (President Thabo Mbeki, ANC Today, 11-17 April 2003: 2).

The Liquid Fuels Charter provides a broader definition and scope of Black Economic Empowerment. This broader interpretation includes employment equity, skills and capacity building, ownership and equity participation, financing, procurement policies and the appropriate legislative and regulatory environment to facilitate the growth of the sector (ANC Today, 5-11 December 2003: 1). However, this charter still fails broad-based requirements of BEE in that it does not include the poverty alleviation of the majority of South Africans as part of BEE.

The focus of BEE is shifting to a broad-based socio-economic process, aimed at one or more of the following outcomes³:



- A substantial change in the racial composition of ownership and management of existing and new enterprises. For example, the Mining Charter (Act No.28 of 2002) calls for 26% BEE ownership by 2012 (Refer to Appendix A).
- An increasing share of the ownership, control and management of economic activities in the hands of historically disadvantaged communities, workers, collective enterprises and co-operatives.
- The management and staff of economic institutions and enterprises reflecting the racial composition of the population – for example, the Mining Charter calls for 40% of management to be black by 2007, with women representing 10% of total staff by 2007 (Annexure A, Mining Charter, Act No.28 of 2002); the Skills Development Act and Employment Equity Act also provide for this.

³'A Strategy for BEE', (the DTI) draft discussion document presented to Nedlac (National Economic Development and Labour Council) in September 2002

- Investment programmes that lead to broader and more meaningful participation in the economy by black people, in order to achieve sustainable development and general prosperity.

The broader definition of BEE argues that the fundamental crisis in our economy is that black people remain excluded from financial and economic resources. From the broader definitions of BEE provided by the BEEC and ANC, it would seem more appropriate that BEE encompasses more comprehensive strategies, which are aimed at the creation of a broader, more sustainable group of black entrepreneurs through the promotion of new opportunities for and an increase in the levels of participation of black people in ownership, management and control of economic activities in the large and SME businesses. The broader definitions also encompass a socio-economic element aimed at simultaneously addressing the dilemma of the eight million unemployed of South Africa. The problem is that government's broad-based interpretation of BEE does not address the issue of poverty alleviation at all. Mention is only made of an increase in the income levels of black persons and a reduction in income inequalities.

Government has come a long way in clarifying its definition of BEE as discussed above of a more broad-based approach. Previously the definition was far more rigid and interventionist. At the ANC's 51st Conference held in Stellenbosch in December 2002, government seemed to finally opt for a more measurable approach to empowerment (President's Opening Address at 51st National Conference, 16 December 2002: 16). This more measurable approach is evidenced in the subsequent National Strategy for Broad-Based Black Economic Empowerment document released by the Department of Trade and Industry which has been commissioned with the responsibility for BEE policy by government. In this document a framework for BEE is provided and various criteria are specified against which a company needs to be measured to assess whether it meets the various broad-based BEE requirements.

Black Economic Empowerment has been at the heart of the African National Congress' (ANC) policy guidelines since the early 1990s, and an integral part of the government's transformation programme since 1994. The two BEE strategies identified in this paper are reflected as follows: *'BEE is a moral, political, social and*

fundamentally economic requirement of this country's collective future. It is defined in its broadest sense as an integrated and coherent socio-economic process located in the context of the country's national transformation programme, the RDP. The benefits of such empowerment must be shared across society, and impact as widely as possible' (Discussion Document: Economic Transformation, No 16, August 2002 for ANC National Policy Conference: 19).

In January 2003, government's empowerment strategy document was adopted at a Cabinet Legkotla⁴. In his State of the Nation Address the following month, Mbeki sent a clear message that he will follow international best practice on empowerment policy despite the deep divisions that persist in SA. 'Growth he said (President Thabo Mbeki) will not be sacrificed for the sake of empowerment' (State of the Nation Address, Parliament, 14 February 2003: 11). President Mbeki is more of the view that: *'Economic growth, development and black economic empowerment are complimentary and related processes'* (State of the Nation Address, Parliament, 14 February 2003: 11). From this statement it would seem that economic growth remains the most important economic priority of government and that BEE will progress in a high growth economic environment.

What is interesting from President Mbeki's interpretation of BEE is that he goes on to mention the importance of economic growth for BEE by saying, 'Equally it follows that an economy that is not growing cannot integrate its citizens into that economy in a meaningful way.' He emphasizes this point even more when he says, 'the government will lay greatest stress on black economic empowerment that is associated with growth, development and enterprise development and not merely redistribution of existing wealth' (State of the Nation Address, President Thabo Mbeki, 14 February 2003: 11). The recent Brenthurst Initiative announced by the Oppenheimer Family also seems to be based on this underlying philosophical assumption that South Africa cannot have transformation without growth and the two should be seen as inextricably interlinked and in need of simultaneous implementation (Brenthurst Initiative, 5 August 2003: 12).

⁴ At least twice a year cabinet meets to discuss broad policy issues; these are Legkotlas.

The conceptualization from President Thabo Mbeki's statements made in his annual address to Parliament on 14 February 2003, that redistribution and economic growth are a single strategy and can be achieved simultaneously, is not necessarily accepted for the purposes of this paper as far as the interpretation of BEE is concerned. President Mbeki's approach effectively rejects the rigid separation of redistribution and growth, in contrast to the neo-classical economists (Edigheji, O.E. 1999: 15).

However, this view of President Mbeki that growth and redistribution are inextricably linked, might not be that clear given that the President in his weekly letter on the ANC Today website (week 22 August 2003 – 28 August 2003: 2) suggested a recognition that far greater state intervention would be needed in the future. President Mbeki debunked the theory that higher levels of growth would, in their own right, lead to a reduction in the levels of unemployment. He said, *'This is part of a proposition about an automatic so-called trickle-down effect that would allegedly impact on the "Third World economy" as a result of a stronger "First World economy". None of this is true adding that those who would benefit from increased growth were those working in the First World economy.'* Therefore, President Mbeki seems to be of the view that despite significant levels of growth being achieved in Third World economies, it will not necessarily lead to a direct reduction in the levels of poverty and unemployment. For South Africa, the government is faced with the risk that targeting high levels of growth will not solve our fundamental socio economic problems.

He goes on to say, *'To get to this point we will require sustained government intervention'* (ANC Today website, week 22 August 2003 – 28 August 2003: 2). This approach is more in line with that of Professor Sampie Terreblanche, author of *A History of Inequality in South Africa (2003)*, which proposes widespread state intervention in the economy to address poverty and unemployment. At a recent IDC BEE Conference (2 October 2003), Lionel October, also supported the more involved approach by government, *'government will play a key active role in ensuring that, together with the private sector, that BEE is accelerated.'*

The debate continues about the relationship between economic growth and BEE. What is important is that it remains uncertain if BEE will provide a means of

promoting sustainable economic growth for the economy, despite the fact that greater government intervention in the process of BEE could result in the particular BEE strategies succeeding. Black, P. (2002: 1157) also raises a critical question for the purposes of this paper and that is whether South Africa can actually afford a full-blown empowerment programme in the current environment. As he says, *'The country is involved in a titanic competitive battle to retain its existing export markets and penetrate new ones, which in turn requires higher levels of physical and human capital investment. Some of the proposed policies are bound to eat into our domestic savings, which are already too low to fund the required investments in physical and human capital'* (Black, 2002: 1157). From a strict growth perspective, we need to know what kind of human skills are needed and how they are likely to change over time – something about which the BEECOM (2001) is silent.

One of the four key principles underpinning government's broad-based BEE definition and strategy is that of economic growth, development and enterprise development, and not merely a redistribution of existing wealth (Department of Trade and Industry, March 2003: 13). New, inclusive patterns of wealth accumulation are needed from existing economic activity and new economic activity. This emphasizes that BEE, for the purposes of this paper is interpreted as, not just about the mere transfer of assets, but a sustainable process of effectively creating more entrepreneurs so as to meet one of the BEE strategies.

Gqubule, D. (1996:7) provides support to a more genuine, broader interpretation of BEE when he says, *'In these days of corporate largesse, it is important that the benefits of empowerment are spread as widely as possible to the black communities. By definition, reparations cannot be bestowed on a few individuals. This is especially so when black empowerment companies get deals, government contracts and licenses in the name of empowerment and benefit from state initiatives related to privatization and deregulation...'* (Duma Gqubule, in The Sunday Independent, 15 December, 1996: 7). This approach is very different from the minimalist approach followed towards BEE in the early 1990s which was discussed briefly in the earlier interpretation of the narrow approach to BEE and will again be discussed in greater depth in Chapter Four of this study.

Rudolf Gouws, economist at Rand Merchant Bank (cited in Enterprise Magazine, April 2003: 18) responds to the issues of growth related to BEE by saying that 'high economic growth rates are not the result of redistribution; rather, it was the other way around – economic growth created the scope for empowerment'. As The Minister of Trade and Industry, Alec Erwin says, 'if the economy is in white hands it will not grow; if it is in black hands it will not grow' (Enterprise Magazine, April 2003: 18). This is exactly the point which President Mbeki was trying to make in his State of the Nation Address in February this year which is that the success of BEE is dependent on good overall economic growth and that the black or white owners of large South African corporates will not individually be able to make the economy grow.

The Minister of Trade and Industry, Alec Erwin, contends that redistribution and empowerment are easier to achieve in a fast-growing economy. No economy, Erwin says, can meet its potential if any part of its citizens is not fully integrated into all aspects of that economy. Equally it follows that an economy that is not growing cannot integrate all its citizens into the mainstream in a meaningful way (Business Day, 15 April 2003: 1).

Indeed, in the case of Malaysia, mainstream economists have argued that the empowerment of the Bumiputra⁵ was fairly easily accomplished because of rapid growth. This is very different from the environment of lower growth which South Africa has been faced with since 1994 (Enterprise Magazine, April 2003: 18).

Clarity around government's definition and interpretation of BEE remains unclear despite government publishing its BEE strategy in March 2003 (Department of Trade and Industry, 2003) as well as the Broad-Based Black Economic Empowerment Bill. The challenge remains around the implementation of BEE initiatives since they still seem biased towards a narrower version of BEE in practice. Black business continues its aggressive flow of dealmaking with the same individuals becoming even wealthier. Although government's BEE policy appears broad in theory, there are few signs of an

⁵ The Bumiputra are the indigenous Malay people who were marginalised and had little ownership of the economy in the 1970s before the Malaysian government implemented a programme of economic empowerment.

emerging group of new black entrepreneurs or more socially oriented programmes aimed at skills development and poverty alleviation.

Government has also subsequently announced a task team to finalise legislation and liaise with the relevant interest groups (Business Day, 10 April 2003: 5). However, the exclusion of trade unions and community organizations in the team has been questioned by Cosatu.

However, some funding institutions which have made significant contributions to the funding of BEE already, such as the IDC (Industrial Development Corporation), have been of the opinion that the BEE Bill should be more prescriptive and allow for penalties to be introduced for institutions and organs of state which failed to meet their empowerment obligations (Business Day, 27 June 2003: 2). The Corporation has also called for the Bill to outline how monitoring and performance evaluation could be coordinated and institutionalized. But this heavy-handed approach does not seem to be part of the spirit of the Bill.

The Black Economic Empowerment Bill has also been criticized for its vagueness and lack of detail and makes no reference to related documentation such as the Department of Trade and Industry's broad-based strategy for BEE (Business Day, 20 June 2003: 11).

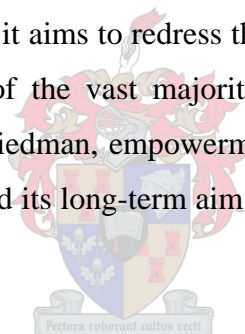
Therefore, a more detailed description of the term BEE is that of a concerted intervention to ensure that black people of South Africa are incorporated into the mainstream economy on a broad scale. Since the process of BEE is about enfranchising the HDP of South Africa it is valuable for the purposes of this study to question who have been the main beneficiaries of empowerment so far. A critical assessment of BEE in the analysis of the various definitions and interpretations reveals that the actual implementation of BEE has still failed despite efforts by government to enact broad-based BEE.

Thabo Mbeki's recent comments in the ANC Today (5-11 December 2003: 1) highlights the importance placed by government in using BEE as a strategy in addressing the dilemma of poverty and unemployment in South Africa, *'We have also*

recognised the fact that the interventions we have made and will make to provide social grants to the black poor will not solve the problem of poverty and underdevelopment. Mere common sense says that fundamentally to address this challenge, we have to focus on a number of objectives.'

A more academic definition of the broader approach to BEE is that derived from the work of Jowell, K. and Horwitz, F.M. (1997) (Horwitz, F.M. 1996: 3): '*Black economic empowerment is the process by which black South Africans will gain a representative share of the wealth generated by the South African economy.'*

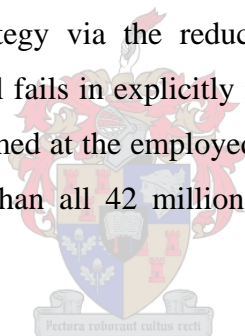
John Friedmann (1992), a professor of urban planning at the University of California, Los Angeles, provides an appropriate conceptual basis for an understanding of empowerment. He defines empowerment as an improvement in the conditions of life and livelihood of the excluded majority (Friedmann, J. 1992:12). Empowerment is an alternative development because it aims to redress the historical process of systematic disempowerment or exclusion of the vast majority of people from economic and political power. According to Friedman, empowerment aims to humanize the system that has shut out the majority, and its long-term aim is to fundamentally transform the whole of society.



This interpretation of economic empowerment seems appropriate since it is defined as a process to fundamentally transform the structures of a society, especially the social and economic structures. It's central objective is the improvement in the life and livelihood of the excluded majority. This Friedmann claims, is achieved not through handouts to individuals but through an increase in the productive access bases of the household (Friedmann, J. 1992:33). This includes access to skills development and training, employment opportunities, financial resources, and participation in social organizations. Friedmann correctly argues that successful empowerment requires a strong and proactive state. The reason for this is because a more interventionist government is required in a highly stratified economic community where there are significant income disparities so that it is accountable to all its citizens.

Against this conceptual framework, it would seem that government's recent more broad-based, but proactive approach to BEE would be suitable in terms of Friedmann

and Horwitz and Jowells' descriptions. The problem is that no reference is made to poverty and unemployment. Therefore, government's most recent and accepted definition of BEE policy which is described as follows, *'Empowerment in terms of the policy is defined as a broad-based process and the scorecard approach – covering ownership, management, employment equity, skills development, procurement, corporate social responsibility, investment and enterprise formation – developed in the mining charter has been adopted'* does not meet the requirements of broader empowerment in the true sense of the word (Department of Trade and Industry, 2003: 12). The definition adopted by government goes on to say that 'it needs to be an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities' (Department of Trade and Industry, 2003: 12). Emphasis needs to be placed on the importance of the reduction in poverty as a key BEE strategy via the reduction in income inequality. This interpretation of government still fails in explicitly including the poverty dilemma. It only views BEE as a strategy aimed at the employed, be it in the formal and informal sector of the economy, rather than all 42 million people that comprise the South African population.



Government has made it clear that there will be no stipulated targets in sectors, and aside from sectors identified by government as critical, it's up to industry players to set targets through voluntary associations (Leadership, Ray, M. 2003: 2). What is interesting is that the DTI Report on BEE, namely, A Strategy for Broad-Based Black Economic Empowerment (2003:12) emphasizes the objective of BEE of ensuring a substantial increase in the number of new black enterprises, black-empowered enterprises and black-engendered enterprises. This interpretation coincides with the first BEE strategy, which is the creation of a broad-based, sustainable entrepreneurship of black South Africans. However, the second strategy listed of BEE is not included, namely poverty alleviation. In this sense, the DTI Report on BEE is not really encompassing true broad-based empowerment.

This brings us to the efficiency case for a BEE strategy where Black (2002: 1155) states that such a strategy depends in part on whether it succeeds in alleviating

poverty and partly on the type of skills it is likely to promote. Black lends support to a strategy of 'growth through redistribution'. Apart from the old structuralist arguments that redistribution shifts demand towards labour intensive goods that have a low import content, there is another argument that redistribution could enhance the degree of social and political stability in a country. This strategy of 'growth through redistribution' is not necessarily accepted for the purposes of this paper given the seriousness of the poverty dilemma and the risk that economic growth will not solve this problem.

BEE can also be justified in terms of recent contributions to the 'new growth theory' (Romer, P. 1986: 94; Lucas, R.E.L. 1988:22; Stern, N.1991: 100). Adherents to this school have all called attention to the contribution that human resource development can make towards stimulating and reinforcing sustained economic growth (Black, P.A. 2002: 1156).

We are aware that the current approach to the funding of BEE still faces major challenges. But BEE will succeed with the transformation of the South African state, economy and society and the simultaneous rise of black entrepreneurs with meaningful eradication of poverty. In other words, all black South Africans should share the fruits of economic empowerment (Henderson, L.J.1993: 44).

The success of BEE will require not a minimalist state, but an active state that will articulate a clear vision of BEE and mobilize society around it. Government needs to find solutions via its BEE programme to resolve the lack of sufficient black entrepreneurs and the alleviation of the poverty crisis in South Africa.

The next section will look at a suitable interpretation and definition of BEE for the purposes of this paper.

c) An appropriate definition and interpretation for the purposes of this study

Black Economic Empowerment encompasses various strategies. The black population has become a highly stratified population group with a variety of characteristics, socio-economic conditions, developmental and educational needs. Any BEE

programme that aims to 'empower' all sections of the black population group, must consist of a variety of BEE strategies and these strategies must be focused on the 'empowerment' and/or development needs of all the different groups in the black community (Terreblanche, S.J. August 2003).

A list of different BEE strategies are as follows. Firstly, a strategy to promote black entrepreneurship, black ownership and black control which includes big and small businesses, that is, a strategy aimed at creating a broad black management or business group. Concurrently with this BEE strategy, a strategy to promote black entrepreneurial, educational and skills development. Secondly, a strategy for black empowerment resulting in poverty alleviation and job creation. Thirdly, a strategy that will enable the creation of a black middle class together with social security that will take place as the first two strategies are successfully achieved and implemented.

Therefore, in terms of this paper's definition and interpretation of BEE, the simultaneous empowerment of black people is seen as a collective and individual entity. Consequently, BEE-related companies should therefore be socially and politically rooted in the aim of empowering the black community at large. This interpretation is in accordance with John Friedmann's (1992) interpretation of BEE where BEE addresses the question of the improvement in the conditions of life and livelihood of the black population at large (Friedmann, J. 1992: 9). BEE cannot be addressed in isolation of the poverty and unemployment crisis facing South Africa. Therefore, the ANC government's broad-based definition of BEE still fails in covering one of the strategies of BEE since the Department of Trade and Industry Strategy Document for Broad-Based BEE (2003) does not include BEE as a strategy that will address the poverty dilemma. As mentioned previously, the Black Economic Empowerment Bill, does not either make explicit mention in its definition of BEE of poverty or unemployment as one of the strategies which BEE is likely to address (BEE Bill, 2003: 3).

This study will focus on the first strategy, namely, the promotion of BEE for the purpose of achieving broad-based entrepreneurial empowerment. Although this study will not cover the second BEE strategy, namely poverty alleviation and job creation, it needs to be emphasized that both BEE strategies encompass the concept BEE and

government has a responsibility in ensuring that both are successfully achieved. Government's use of BEE is aimed at targeting various strategies. This paper will primarily focus on BEE in the context of the promotion and creation of black entrepreneurship.

The reason for the funding of BEE being a problem will also be assessed in Chapter Two in the context of both BEE strategies, namely lack of access to financing for black entrepreneurs as well as virtually no access for the poor to financing via traditional institutions. It would appear, from the earlier definitions of BEE by the ANC government, that a broad-based approach to empowerment is also the more appropriate route in ensuring a more sustainable form of BEE. This is evidenced where the definition refers to the fact that the benefits of empowerment must be shared as widely as possible and thus not only with a select few (Discussion Document: Economic Transformation, No 16, August 2002 for ANC National Policy Conference: 19). The mention of a socio-economic process located in the RDP programme also covers poverty alleviation. However, the criticism in this study remains with the lack of implementation by government of this broader approach to BEE and the lack of using BEE as a strategy aimed at solving poverty and unemployment. Government itself has alluded to shortcoming on progress as far as the implementation of BEE is concerned: *'Five years after the arrival of the democratic order, we have not made much progress and may well be marching backward with regards to the de-racialisation of productive property. Clearly something is not right'* (President Thabo Mbeki, Black Management Forum National Conference, 1999: 3).

Friedmann, J. (1992:33) describes a more appropriate interpretation of broad-based BEE as individual and community empowerment being inseparable and integral objectives that can simultaneously be achieved. According to Friedmann, this strategy should include alternative investment strategies by the black community including workers and community group co-operatives, which aim to invest in the socio-economic activities within the black community that would uplift their living conditions and create jobs for the poor. Consequently, the development of black business is a means towards an end: the general empowerment of the black community.

Economic empowerment does not negate the need for a black entrepreneurial class. This remains one of the strategies for BEE to succeed. But it seeks appropriate mechanisms that incorporate it as one of the several BEE strategies to be mutually achieved. As already mentioned, black economic empowerment will be narrowly defined and discussed in the following paragraphs in the context of black entrepreneurship for the purposes of this study. An important rationale for the focus on black entrepreneurship as a driver of broad-based BEE is that entrepreneurial activity rates are of the lowest amongst blacks (GEM Survey 2002: 25).

As a point of departure, Schumpeter's (1951) explanation of the entrepreneur remains useful for examining entrepreneurship in the context of BEE for this paper. Schumpeter views entrepreneurship as bringing the radically new into the economic system. He literally views entrepreneurs as the province of bold individuals. For Schumpeter, the relative efficiency of an economic system depends not on how it 'administers existing structures' but on how well it generates innovation (Schumpeter, J. 1942: 84).

He goes on to say that entrepreneurs are effectively pillars of strength, symbols of legitimacy, role models. They provide the new ideas and new blood that refresh the 'bourgeois stratum'. He states that 'economically and sociologically, directly and indirectly, the bourgeoisie therefore depend on the entrepreneur (Schumpeter, J. 1942: 134). The applications of Schumpeter's definition of the entrepreneur to BEE in the context of the promotion of black entrepreneurship appears relevant for the purposes of this analysis.

In the context of the discussion on the promotion of entrepreneurial empowerment, the following two recommendations are made. Firstly, there is an increasing trend to look at black staff within companies as a component of the companies' BEE since there has been growing resentment among staff in some companies that have concluded black empowerment deals which has excluded them from future ownership structures. The concept of black empowerment where black staff are also the beneficiaries of the BEE transaction has a great deal of merit as far as the somewhat

broad based approach to BEE is concerned. Investec and MTN are cases in point (Business Day, 11 June 2003: 2).

Secondly, strategies should support individual entrepreneurs as well as social and collective capital. This broader interpretation views BEE as a more sustainable concept aimed at the creation of a broader group of black entrepreneurs for South Africa instead of, as in the past, giving politically connected individuals assets which they don't know how to manage (Business Day, 5 June 2003: 5).

The Financial Services Charter lends support to entrepreneurship when it says, *'Entrepreneurial development must be promoted and enhanced by supporting black entrepreneurs'* (Draft 12, 25 May 2003: 5). The Financial Sector Charter also makes specific provision for supporting black entrepreneurs: *'The financial sector will increase its support for entrepreneurs and black-owned businesses, (including black SMEs and cooperative and collective enterprises) through various initiatives, which may include: The establishment of effective black SME support structures and capacity, the promotion of the venture capital market and working in partnership with government to design innovative funding mechanisms that enable the financial sector to reach a broader segment of the population'* (17 October 2003: 10).



The focus of government's broad-based BEE strategy is particularly important as far the promotion of entrepreneurship via small and medium businesses (SMEs) is concerned. Government must place greater emphasis on preferential procurement as this will have far reaching implications for SME entrepreneurs. Of all the components of BEE it has the potential to best advance what government refers to as the economic rationale for empowerment which is the narrowing of economic inequalities in South Africa. This is particularly relevant given that a recent survey of business linkages in South Africa by Gestalt Corporate Engineers says, 'linking SMEs to (entrepreneurial) business opportunities in the supply, distribution and core business areas of large state-owned and private sector corporations is one of the best ways of stimulating them' (Business Day, 16 July 2003: 9).

These linkages will grow the number of capable black SME entrepreneurs. Promoting black SME entrepreneurs in this way will have a broader BEE impact and be far more

significant than a mere transfer of ownership of large corporates into black hands (Financial Services Charter, 17 October 2003: 8).

The Minister of Minerals and Energy, Phumzile Mlambo-Ngcuka, has also expressed support for the promotion of entrepreneurial empowerment, *'Efforts to expose the less known South African entrepreneurs of the future should continue. That can happen only if those who got there first are willing to be pathfinders, to search for and nurture unknown potential as they draw in partners through broad-based empowerment. We need to be careful of gatekeeping. We must understand that the government has an obligation to a broad-based constituency, and we have to serve every one of our people'* (Business Report, 6 August 2003: 16).

Due to our historical past, the issue of entrepreneurship remains a challenge. In a recent survey it was found that South Africa is less entrepreneurial than other developing countries. This is according to the 2002 Global Entrepreneurship Monitor (GEM) Survey led by the UCT Graduate School of Business, released at the United Nations in November 2002. This particular survey has found that South Africa is well below the average rate of entrepreneurial activity when compared to the thirty-six other countries taking part in the survey and ranks lowest of all developing countries including Chile, Brazil, Mexico, Argentina and Thailand (GEM 2002: 4). The results show that South Africa is in the bottom quartile of all countries on measures of opportunity entrepreneurship and new firm activity which are apparently critical gauges for economic growth potential. The reasons mentioned for these failures were that insufficient programmes are in place by government to encourage the development of start-up business and entrepreneurship (GEM Survey 2002:36).

According to Mike Herrington, the director of the UCT Centre for Innovation and Entrepreneurship at the Graduate School of Business, says, *'Equally concerning is the fact that South African start-ups have a low success rate compared with the majority of other countries surveyed. This indicates that although South Africa has long recognized the need to support entrepreneurship to boost economic growth and job creation, the existing policy interventions and programmes are simply not making enough of an impact'* (Business Day, 26 June 2003: 6).

Of particular relevance, is that the GEM Survey 2002 found that one of the greatest obstacles facing entrepreneurs in South Africa is ineffective financial support (GEM Survey 2002: 44). GEM also argues that a more targeted approach to promoting entrepreneurship could help boost South Africa's entrepreneurial performance by directing resources where they are most effective. It is here where institutions such as the formal financial services sector, the government funded institutions such as the IDC, NEF, Khula, to name but a few, must play a key role in the allocation of funding in a more effective manner for the promotion of black entrepreneurship. This type of funding will help breakdown the hostile environment among established business to the many 'unknown' potential entrepreneurs (GEM Survey 2002: 41).

Another constraint on potential entrepreneurship is lack of skills (Riley, R.1993:62). Black entrepreneurs surveyed by Riley (1993: 35-53), identified the principal internal constraint that adversely affected their business success as being the lack of adequate managerial, technical and administrative skills. This skills development is essential and must in future be funded through the IDC, NEF and private business.

The recent Broad-Based Black Economic Empowerment Bill has been amended to ensure that a broader spectrum of beneficiaries are targeted by the law such as people with disabilities, women, workers and people living in rural areas (BEE Bill, 2003: 3). This revision will help strengthen the broad-based character of the Bill so that large numbers of people and communities benefit and not only a small elite (Business Day, 21 August 2003: 4). The concept of broad-based black economic empowerment that is accepted for the purposes of this paper is, 'the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies' (Business Day, 21 August 2003: 4). However, this definition of the BEE Bill needs to be qualified to explicitly include the eight million poor and unemployed in South Africa for this particular study. Such a recommended approach and interpretation of BEE for the purposes of this paper would require a far more proactive role by government that emphatically addresses the poverty dilemma as well (Iheduru, O.C. 1995: 87). Economic resources cannot only be allocated to BEE as far as the employed are concerned. It is therefore imperative that BEE encompasses an even broader interpretation which specifically targets the inclusion of the poor into the economic

mainstream. Government's current broad-based interpretation does not deal with this problem.

Despite the broader interpretation provided by The Department of Trade and Industry's, namely, *'Empowerment in terms of the policy is defined as a broad-based process and the scorecard approach – covering ownership, management, employment equity, skills development, procurement, corporate social responsibility, investment and enterprise formation – developed in the mining charter has been adopted' ... it needs to be an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities'* (Department of Trade and Industry, 2003: 12), this definition does not meet even broader requirements such as job creation and poverty alleviation in terms of the BEE strategies appropriate for this paper.

The issue of government intervention in empowerment programmes is also discussed by Black (2002: 1156-1157) where he agrees that new growth theorists provide a strong justification for government intervention in these areas because it will create favourable conditions for private investment and growth. The continued reliance by the ANC on the market system to democratize the economy and enable BEE will not work because the South African economy is not an open economy with a level playing field for all participants given the political history of this country. Neither is the exclusive emphasis on a top down strategy a wise choice (Iheduru, O.C. 1995: 87). Malaysia provides a reasonably good example, where their approach was far more proactive and relied heavily on radical legislative interventions to transfer ownership to the black majority. In Malaysia, only a few Chinese controlled the economy to the exclusion of the indigenous Bumiputra. The government's intervention resulted in a massive shift: foreign and local Chinese investors had to set aside ownership stakes for the Bumiputra.

Based on the above, this study accepts that greater government intervention is needed in addressing the challenges facing the various BEE strategies.

This paper wishes to place great emphasis on the term entrepreneurship and enterprise development in the context of BEE. A great deal of emphasis will also be placed on black entrepreneurship in the historical analysis of funding in Chapter 4 as well as in the discussion of the IDC in Chapter 5. For example, the IDC has been one of the largest providers of finance to South African entrepreneurs in our history with financial support already beginning in the 1950s. The broad-based strategy of government seems to cover this point by emphasizing the term enterprise development and rejecting the mere redistribution of wealth which was characteristic of the minimalist strategy of BEE. The broad-based approach of government also means that it is government's responsibility to get more people involved in various sectors of the economy, such as the mining community. As Phumzile Mlambo-Ngcuka, recently had to say, *'If others get richer on their own that's fine, but our overriding responsibility is to spread the number of participants. Part of this (new legislation) is about moving away from fewer people who monopolise opportunities'* (Business Day, 9 September 2003: 5).

This paper therefore accepts a bottom-up approach to BEE which aims to promote a culture of enterprise rather than one of entitlement. A sustainable culture of entrepreneurship would help spur growth and would operate successfully in an environment where there is sufficient access by the state and private sector to capital. This culture of entrepreneurial empowerment will be further encouraged where the government has a targeted approach in ensuring the success of SMEs and the role of the banking sector in being more accessible to the poor and entrepreneurial class. In combination with these factors it is necessary that parastatals are well organized and strongly supported by government to provide the necessary entrepreneurial skills development and relevant financing instruments for the promotion of black business on a broader and more sustainable scale (Iheduru, O.C. 1998: 86).

Moeletsi Mbeki (Business Day, 5 June 2003: 5) correctly states, *'The transfer of white-owned or state assets will not build the economy. We are now seeing the mining charter ... and all sorts of other charters. But charters won't create entrepreneurs for SA.'* He seems more supportive of emphasis being placed on role of black entrepreneurship when he comments that blacks should, instead, be encouraged and supported to build their own assets from the ground up. Support is also given to the

view expressed by Adrian Macartney, a partner at Ernest & Young South Africa when he said, '*Most of the world's most successful corporations were started by entrepreneurial-minded people with vision and a lot of tenacity*' (Business Day, 26 June 2003: 7). He also goes on to cite Patrice Motsepe, the founder of ARMGold, as an ideal role model for aspiring South African entrepreneurs and recently won this year's South Africa's Best Entrepreneur Award.

At the black economic empowerment conference in Cape Town during May 2003, the interpretation of BEE was linked with that of entrepreneurship. At this particular conference, Minister of Finance, Trevor Manuel, had the following to say of entrepreneurship, '...we have created the door and shown the black entrepreneurs where it is' (Business Day, 23 May 2003: 2).

However, the broad-based interpretation of BEE, as accepted for the purposes of this study, has received some criticism from the trade unions. Their view is that far from being broad-based, the BEE policy's scorecard provides 60% of points just for black ownership and control and a mere 30% for broader measures of employment equity and skills development (Business Day, 8 August 2003:13).

Entrepreneurship in terms of the accepted definition of BEE for the purposes of this paper encompasses broader and more sustainable entrepreneurship than just getting more entrepreneurs into the Johannesburg Stock Exchange. Since this would hardly be a proposal that will bring substantial benefits to the majority of South Africans.

d) The development of BEE

Government's realization of the importance of BEE over the years has resulted in the formulation of various related legislation or policy documents which have played a role in influencing a formal interpretation and understanding of BEE. Table 1.1 illustrates this development in chronological order.

As Table 1.1 illustrates, black economic empowerment began with the Reconstruction and Development Programme (RDP) announced by the ANC government at the time of the 1994 elections. A central objective of the RDP was to deracialise business

ownership and control completely, ‘through focused policies of black economic empowerment.’⁶ The RDP set out the key developmental challenges for the new government, including the creation of jobs, human resource development, provision of infrastructure, changes in ownership patterns and the reduction of inequality in society (UBS Warburg, 26 November 2002: 14). The intent of the RDP already laid the foundations for a broader form of BEE, but unfortunately the implementation of BEE by government and black business in the early 1990s failed dismally in implementing the priorities of the RDP which aimed at re-orienting the government’s budget at meeting the needs of the poor (Department of Trade and Industry: A Strategy for Broad-Based Black Economic Empowerment, 2003: 7).

The imperatives of redressing social and economic inequalities were also reflected by the Constitution of the Republic of South Africa, Section 9 on Equality in the Bill of Rights.

As a reflection of government’s commitment to the process of empowerment it subsequently legislated a number of important acts, including the Employment Equity Act, the Skills Development Act and the Preferential Procurement Framework Act (refer to Table 1.1) since coming into power. These Acts aimed at ensuring greater income equality for the majority of the population and also great access to skills development and equality in the workplace.

Table 1.1 Development of BEE

Constitution of Republic of SA, 1992, Act No 200 of 1993	The Constitution emphasized the issue of equality in all spheres including economic equality which provided a starting point for the development of BEE
Reconstruction & Development Programme, 1994	First document of new government highlighting key developmental challenges for ruling ANC
Employment Equity Act, No 55 of 1998	Objective was to outlaw all forms of unfair discrimination at work.
The Skills Development Act, No 97 of 1998	Objective was for the promotion of skills development of employees in the private sector.
Preferential Procurement Policy Framework	This initial policy document aimed at ensuring that

⁶ The Reconstruction and Development Programme, point 4.4.6.3, pg 93, 1994.

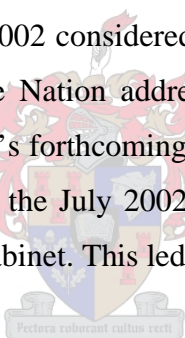
Act, No 5 of 2000	government, as the largest buyer of goods and services in the economy, had the responsibility of leveraging this purchasing power in support of its economic policy objectives of BEE.
The Integrated Human Resource Development Strategy, 2001	Aimed at enabling the provision of new economic opportunities to HDPs.
The Promotion of Equality and Unfair Discrimination Act, No 4 of 2000	Prescribed unfair discrimination.
National Small Business Act, No 102 of 1996	Enabled a national strategy for the development and promotion of small business in South Africa. This Act was introduced to provide an enabling environment for small, medium and micro-enterprises (SMMEs) and to establish several institutions to provide financial and other support to entrepreneurs.
National Empowerment Fund Act, No 105 of 1998	National Empowerment Fund was a trust to hold equity stakes in state-owned enterprises on behalf of HDPs.
The Integrated Sustainable Rural Development Programme, 2001	Aimed at overcoming underdevelopment in rural areas.
Charter for South African Petroleum & Liquid Fuels Industry, November 2000	First sector charter aimed at ensuring effective implementation of BEE in Petroleum & Fuels industry.
BEECOM Report, 2001	BEECOM was launched in 1997 as a structure reporting to the Black Business Council. It made its final recommendations to government on BEE in March 2001.
Mining Charter, October 2002	Sector charter aimed at redressing equalities within the Mining industry. This charter has its own particular scorecard against which companies in the mining industry need to comply.
DTI: A National Strategy for Broad-Based Empowerment, July 2003	Department of Trade & Industry launched government's broad-based BEE framework.
Financial Services Charter, October 2003	Sector charter providing a BEE framework for the entire financial services industry. The formulation of this charter followed a far more consultative process between government and the private sector.
Broad-Based Black Economic Empowerment Bill, 2003	Aimed at establishing a legislative framework for the promotion of BEE.

Source: Own Compilation of information in chronological order

The Cabinet Legkotla in January 2001 said that BEE is a key component of a sustainable growth path, which needs to be effectively supported, through integrated policies that significantly increase the economic contribution and productivity of all South Africans. This was reinforced in the President's State of the Nation Address in 2001 where BEE was cited as an indicator against which the performance of the country would be measured.

In March 2001 the Black Economic Empowerment Commission (BEECOM), submitted a report arguing for the adoption of an 'Integrated National BEE Strategy' to the government. Subsequently, the DTI was mandated through the Cabinet Cluster on Employment and Investment⁷ to co-ordinate the design of a National BEE Strategy. This strategy was to provide adequate policy and institutional support for the manner in which BEE is implemented.

The Cabinet Legkotla in January 2002 considered a draft of the National Strategy on BEE. The President's State of the Nation address in February 2002 referred once more in some detail to government's forthcoming BEE initiatives. Giving approval to the BEECOM Report in principle, the July 2002 Cabinet Legkotla asked for a final document to be submitted to the Cabinet. This led to the adoption of the government's BEE strategy in 2003.



More recently there has been pressure to accelerate black ownership following the Petroleum & Liquid Fuels Charter⁸, the BEE Commission Report, the Mining Charter, the Black Economic Empowerment Bill and more recently, the Financial Sector Charter and the Community Reinvestment Bill. The latter deals with broadening access to housing finance (Business Day, 4 June 2003:8). Cazenove (21 October 2002: 5) anticipates that various charters will be rolled out across the major sectors of the SA economy over the next few years. For example, the Financial Services Charter has been the latest sector charter to be released (17 October 2003) and various discussions are under way regarding charters for tourism, the building industry and telecommunications. One of the consequences of the Financial Services

⁷ This is a cluster of economics ministries, convened to improve planning and co-ordination in government.

⁸ These charters are documents that outline BEE programmes, guiding principles and targets within an industry. They are arrived at after detailed consultation with the particular industry.

Charter is that financial services companies will now be judged on empowerment according to a scorecard basis, much as is reflected in the department of trade and industry guidelines. A recent survey of remuneration in the financial services sector by Renwick Reward showed that black males comprised only three percent of senior management, six percent of middle management and six percent of junior management (Cape Times, 2 May 2003: 2). The Financial Services Charter places significant emphasis on staff training and development. It requires 20 – 25 percent of senior managers to be black employees by 2008, 30 percent of middle managers and 40 percent to 50 percent of junior managers (Financial Services Charter, 17 October 2003: 7).

This BEE-related legislation is likely to have significant effects on the economy and financial markets over the next ten years. Lionel October, Deputy Director-General of the Department of Trade and Industry, referred to all BEE-related documentation and legislation as ‘instruments’ when he said, *‘government will now deliberately and consistently use all instruments available to ensure BEE’* (IDC BEE Conference: 2 October 2003). He went on to clarify this by saying, *‘the first instrument is legislation and in the next few weeks we will have the BEE Act signed off by the President... the second instrument is the balanced scorecard which links the BEE legislation and charters’* (2 October 2003).

The BEE scorecard⁹ (Department of Trade and Industry, A Strategy for Broad-Based Black Economic Empowerment, 2003: 21) is going to be the central instrument which government will use in assessing and measuring BEE compliance. It will also be applied within the BEE charters. Lionel October states, ‘the scorecard is a critical piece in that it links the various parts of BEE’ (IDC BEE Conference, 2 October 2003). The scorecard stipulates various weightings to BEE criteria such as ownership, skills development and procurement are a few examples. The DTI scorecard criteria is

⁹ The balanced scorecard referred to in the DTI’s National Strategy for Broad-Based Black Economic Empowerment provides detail on the requirements that need to be met in measuring progress made in achieving BEE by enterprises in the economy. Where sector charters are developed, the terms set out in those charters will apply. Each sector charter will have its own scorecard. The use of a common scorecard by different stakeholders provides a basic framework against which to benchmark the BEE process in different enterprises and sectors. The scorecard also allows government departments to align their own procurement practices and individual BEE strategies (Department of Trade and Industry, National Strategy for Broad-Based Empowerment, Appendix A, 2003: 21).

illustrated in Table 5.2 and used as a benchmark in measuring Investec Limited's compliance to BEE in Chapter Five of this study. The problem in government using the scorecard approach in assessing BEE compliance is that it will result in BEE still being a narrow process where it will be twisted towards the upper income strata of the population since the scorecard does not cover all the BEE strategies as listed earlier in this chapter. For example, it makes no mention of one of the key BEE strategies, namely, poverty alleviation.

A vital point, however, as was revealed in the President's recent State of the Nation Address (14 February 2003:11), is that the government intends using negotiated charters rather than legislation to ensure reasonable BEE goals are met and that the private sector will be broadly responsible for implementation as the government does not have the capacity to deliver this itself. The Financial Services Charter provides an excellent example of a negotiated process by the captains of the private sector, NEDLAC and black business representative organizations.

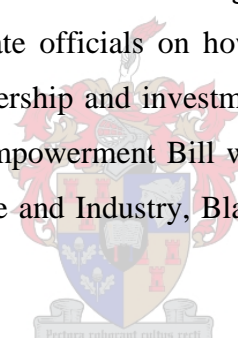
More recently, government has put forward the Black Economic Empowerment Bill to Parliament (Department of Trade and Industry, Broad Based Black Economic Empowerment Bill, 2003). This Bill provides its objectives, purpose and codes of practice for BEE. It is not prescriptive and provides the Minister of Trade and Industry with various powers to issue codes of practice on BEE (Business Day, 14 July 2003: 3). The Black Economic Empowerment Bill will thus provide an enabling framework for the empowerment initiatives being undertaken by the private sector (Business Day, 14 July 2003: 3). Lionel October added, 'The essence of government's BEE strategy is based on a partnership approach, in terms of which the state provides guidelines for the private sector but does not enforce targets or quotas' (Business Day, 14 July 2003: 3).

The Petroleum and Liquid Fuels Charter's approach to BEE is described as follows, *'The 25% ownership and control of all facets of the industry that the parties to this Charter are seeking to bring about over a ten year period means historically disadvantaged South Africans owning not less than 25% of the aggregate value...of the South African oil industry'* (Charter for the South African Petroleum and Liquid

Fuels Industry, November 2000: 15). This illustrates the targeted approach that the sector charters will prescribe for the various sectors of the economy.

e) Conclusion

It can be concluded that differing views remain as far as the interventionist as opposed to the non-prescriptive approach to empowerment is concerned. In an interview with Lionel October, it was said that the drafters of the BEE Bill had tried to accelerate empowerment without being prescriptive (Fisher, R. 2003: 1). However, from government's side, it seems that a more active role in promoting the acceleration of BEE will be required, particularly, as far as resolving unemployment in South Africa is concerned. This is contrary to the interventionist approach followed in Malaysia as mentioned in Chapter 3 of this study. The revised and accepted approach by our government would merely be to issue codes of good practice that would provide guidelines to companies and state officials on how to implement empowerment in areas such as procurement, ownership and investment strategies. This is indeed the spirit of the Black Economic Empowerment Bill which was recently put forward to Parliament (Department of Trade and Industry, Black Economic Empowerment Bill, June 2003).



However, much criticism remains of this Bill since many critics feel that the DTI, who is the body responsible for the formulation of BEE policy by government, that it was taking a limp-wristed and vague approach to the issue. At a recent IDC BEE Conference (2 October 2003), the same criticism was raised where the view was that nothing concrete and clear came out of all the BEE strategies proposed by the DTI.

Others feel that the proposed BEE Bill was trying to tie business up in so many rules and regulations that it could hobble small businesses (Business Report, 26 June 2003: 4). The Chamber of Business is concerned that such a bill would exacerbate an already highly regulated business environment and force compliance costs on small businesses that they would not be able to carry. For instance, small businesses might have to employ expensive experts to head-hunt black entrepreneurs with both the necessary skills and financial support or would have to invest heavily in the training and development of their own staff (Business Report, 26 June 2003: 4).

Cosatu, the labour federation, said it felt the BEE Bill's major shortcoming was its 'pursuit of a narrow empowerment agenda', which would mainly benefit a small elite of black, formal, urban and male-owned businesses (Business Report, 26 June 2003: 4).

Clearly, strong differences of opinion exist about the most appropriate definitions, interpretation and implementation of BEE for South Africa. The purpose of this paper is not to find solutions to these ongoing challenges for BEE policy, but to have selected the most appropriate definitions and interpretations for the purposes of the subject matter of this paper. As already mentioned, this paper accepts a broader interpretation of BEE which is comprised of three specific strategies all aimed at the improvement of the life and livelihood of the black population at large.

In conclusion, it is important to note that the issue of funding of BEE in terms of this paper will be interpreted in the context of the first BEE strategy, namely, the funding of black entrepreneurs in the private sector and small businesses via the government (for example the IDC, National Empowerment Fund, Khula and Development Bank of South Africa) and the financial services sector (for example banks and insurers via debt, equity, private equity financing). The second BEE strategy will also be addressed on the funding side in that the financial services sector has historically not provided adequate funding to the poor. Therefore this paper will provide a focused analysis of the funding of BEE and will not cover the funding of BEE as far as social grants or for the provision of land is concerned.

2) Chapter Two: The Funding of Black Economic Empowerment

a) Introduction

The financing of Black Economic Empowerment is strategically important for the economy in that for BEE to succeed it needs an efficient and credible financing mechanism. This problem remains pertinent in an economy where there is a major poverty crisis which has resulted in a continued low level of black participation in the economy. This problem is reflected in the highly inaccessible capital markets for a large part of the black population due to their unemployment that has resulted in a lack of funding. All indications are that there are relatively few enterprises in the small and medium range in the economy, thus limiting the potential growth benefits from a more competitive and vibrant SME sector. Furthermore, those black businesses that exist are active in the less skilled and capital intensive components.

This chapter will provide the motivation for the funding problem of BEE. This study wishes to emphasize that true broad-based empowerment requires increased access to skills, funding and other productive assets so for the implementation of BEE to succeed. The lack of access to funding for BEE will be the focus of this paper which covers all the BEE strategies mentioned in the accepted interpretation of empowerment for this study. Some of the reasons highlighted are the historical disparities that have existed where an arsenal of laws of prevented black people from having access to any form of sustainable income. This resulted in high levels of unemployment which led to a complete lack of access to capital by the traditional financial services sector of South Africa. This leads to a brief discussion on the various sources of funding being inefficient and unable to effectively allocated funds over time to help stimulated emerging black entrepreneurs. Funding in the context of the black entrepreneur in South Africa will be the primary focus for the purposes of the definition accepted of BEE as discussed in the previous chapter.

Various estimated amounts required for the financing of BEE will also be discussed so as to highlight the extent of the problem facing future progress of BEE for South Africa.

This chapter will conclude with emphasis placed on the role of government in the financing of BEE over the past few years. As this study will reveal in subsequent chapters, government and its various Development Finance Institutions (DFIs) are likely to play a critical role in the future funding of BEE for South Africa.

b) Why is financing such a problem in the context of BEE?

Financing is a problem due to the fact that after ten years of BEE and the enactment of hundreds of laws and policies designed to reverse the apartheid legacy and empower the black majority, there remains a lack of actual implementation of funding for BEE programmes. This study also reveals that the recent ownership targets stipulated by the various empowerment sector charters indicates that there might be a serious shortage of financing in meeting these prescribed targets over the next ten years.

The problem of BEE in its current form is that it has not really led to an improvement in the lives of the poor or led to the creation of a significant group of new South African entrepreneurs. Therefore, the implementation of effective broad-based programmes together with the allocation of sufficient financial resources remains a problem. A balanced scorecard of South Africa would show that the first wave of BEE delivered a modest increase in the black middle class. However, these gains were made in the context of rising levels of poverty as unemployment doubled to eight million people in 2003 and the numbers of the working poor have increased dramatically to more than four million people (Gqubule, D. 2003: 4).

The funding problem for the purposes of achieving BEE in South Africa is viewed as three-fold within the context of this study. The first problem regarding BEE funding is the fact that the majority of the population lacks access to capital given that traditional financial institutions are not accessible to the poor. As far as black entrepreneurship is concerned, results from the GEM Survey (2002: 32) reveal that lack of money for start-up and running costs is the most widespread problem facing informal black businesses. The second funding problem is that within the current framework for BEE it is envisaged that there will be a meaningful transfer of corporate ownership to empowerment entities with the sectoral charters setting the targets for BEE

ownership. Clearly these targets can only be said to have been met once the BEE entities have sourced and completed all funding attached to the equity ownership (Msibi, D. 2003: 32). Thirdly, the funding of BEE is a problem as a result of structural and organizational inefficiencies of potential sources of funding. A suitable example is the National Empowerment Fund which lacks the ability to allocate funds for BEE programmes effectively. The problems around these types of institutional sources of funding will be discussed in Chapter Four.

The history of Apartheid and Colonialism can be seen as one of the systematic destruction of productive assets owned by the black majority, with the aim of making black people completely reliant on the sale of labour. Rural people, who had built up a limited asset base before the advent of Colonialism, saw a progressive destruction of their productive assets (Department of Trade And Industry 2003: 5). A range of laws prevented black people from accessing land, capital and other inputs necessary for starting and running small businesses. Of particular relevance to this paper, it curtailed any progression of black entrepreneurship and large-scale contribution to the economy (Department of Trade And Industry 2003: 6)¹⁰. Rural communities were denied access to affordable financial services. Today, most can still not open a bank account, let alone obtain suitable financing for establishing small businesses. Furthermore, millions of black people are unable to access any form of credit because of black listings and market failures in the financial sector.¹¹

Efforts to support SMEs as far as funding goes, have focused on the micro level, with limited financial and non-financial support aimed at developing a vibrant small and medium sector with the potential to grow the economy and create jobs (BEEC, 2001: 19). In so far as extension of financial services in this area is concerned, little attention has been paid to the formal banking sector or to the creation of new institutions to deliver financial services on a massive scale.

In order to address the problem statement of this paper namely, the funding of BEE, the economic inequalities in South Africa first need to be assessed. Since in terms of

¹⁰ This information is sourced from comments made in the DTI BEE document, South Africa's Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment.

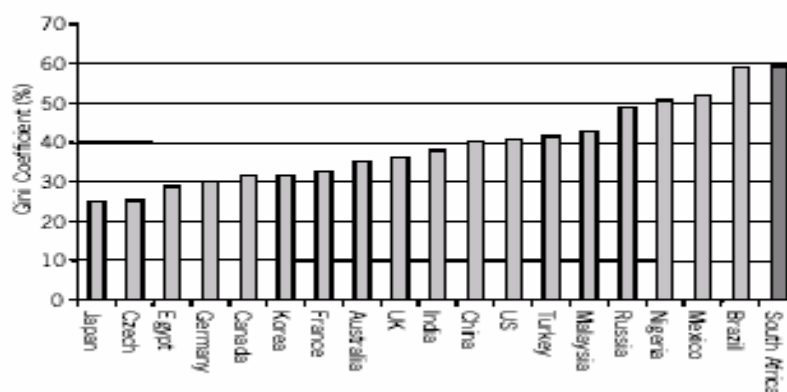
¹¹ A Historical Overview of Women Entrepreneurs in SA (Commission on Gender Equality, November 1999).

the broad-based definition of BEE which has been discussed earlier in this paper, economic equality, employment and income equality are a key component of BEE. Further, an assessment of the level of poverty and income inequality in South Africa is also important to determine the seriousness of providing access to financial services for the poor.

South Africa has one of the highest racially-based income inequalities. South Africa has one of the worst Gini coefficients in the world, with only a handful of economic minnows such as Nicaragua, Swaziland and Sierra Leone having a worse ratio (refer to Figure 2.1). Another way of showing this is the disparity ratio (refer to Figure 2.2) which shows the disparity of white per capital income compared to other races. It is also worth noting that the degree of income inequality among the black population has worsened over the last 10 years or so (van der Berg, S. 2001: 5). This trend is partly a reflection of the failure of past efforts to redistribute income and wealth in the country. Further, the challenging economic environment of South Africa over the past five years as well as the fact that global growth and equity markets have been dismal to say the least, have not helped attempts at solving the problem of unemployment and the redistribution of income in South Africa (Black, P.A. 2002: 1151).

Figure 2.1 Gini Coefficient¹²

Fig 2.3 Gini coefficient



Source: World Development Indicators 2001

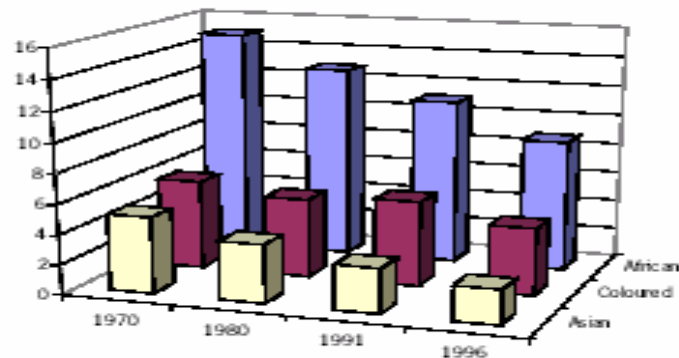
Although the disparity between white per capita incomes and those of other races has decreased over time, whites on average have 8.8 times higher income than blacks as at

¹² Both Figure 2.1 and 2.2 were shown in the Cazenove Report on BEE, dated 21 October 2002: 4.

1996 (Terreblanche, S.J., 2001:21). This is revealed in the disparity ratio shown in Figure 2.2. where white is classified under the title Asian and black is classified under the title African.

Figure 2.2 Disparity Ratio

Fig 2.4 Disparity ratio



Source: Winners & Losers WEFA

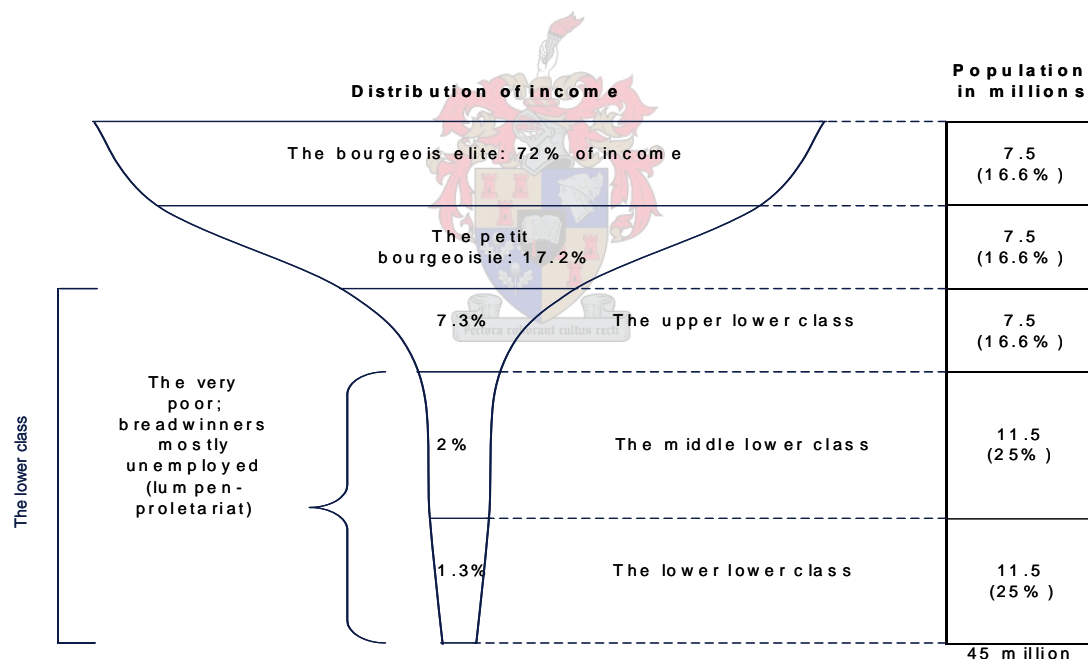
According to a release by Statistics South Africa (2000: 3), the share of the poorest 40% of households in the national income declined from 7.3% to 6.1% between 1995 and 2000. Hardest hit were African households, which saw a 19% drop in real income. As a result, the gap between white and black households widened by nearly a third over the same period. These numbers are further supported by Terreblanche, S.J. (9 October 2003: 1) who commented in a speech to the Black Management Forum that one of the most negative distributional shifts in South Africa have been the decline in income of the poorest 45% of blacks (around 18 million people) by almost 50% since 1974 until 1994 and by a further 10% since 1994 to the current period. Eight years after the political transition, changes in the distribution of socio-economic power have mainly benefited around 10 million blacks in the middle income group, and has hardly had any effect on the 22.5 million blacks in the middle lower and lower lower classes as illustrated in Figure 2.3 (Terreblanche, S.J. 2003: 35). With the official unemployment rate at 29.4% and the expanded rate at 41.2%¹³, job creation is one of South Africa's main priorities. South Africa's low rate of new firm creation by international standards, raises additional concern about the ability of our

¹³ Statistics South Africa – Labour Force Survey, February 2002: 3.

entrepreneurial sector to generate economic growth and create jobs (GEM Survey, 2002: 14).

The funding problem of today has been exacerbated due to a lack of funding and access to the available sources of funding over most of South Africa's economic history. For example, the task of delivering welfare and other services to the rural population was entrusted to traditional African authorities. When the Bantu system was implemented in the 1950s, the traditional authorities were transformed into paid bureaucracies. This facilitated the creation of an African elite that was inclined toward self-enrichment and disinclined to deliver services to those who needed them most (Terreblanche, S.J. 2003: 35).

Figure 2.3: South Africa's Highly Dispersed Class Society



Source: Terreblanche, S.J. 2003: 36

This paper is based on the premise that BEE will be a secular theme in South Africa with significant effects on the economy and financial markets. Against this trend, the issue of seeking viable funding structures for deals likely to flow from developments around BEE, will be the key theme of this paper.

The case for appropriate funding and funding mechanisms as sources for the development of BEE is critical if the implementation of BEE is to succeed so as to enable the promotion of broader black entrepreneurship as well as access of funding to the poor. The Financial Services Charter (17 October 2003: 5) identifies this problem in the context of one of the BEE strategies when it says, *'There have been an inadequate response... to the increasing demand for access to financial services... the sector has not effectively provided credit to entrepreneurs, particularly black businesses...there has been limited support for new black firms'*. Further, the banking sector has not been able to bring about any appropriate solution of providing financial services to the vast majority of South Africans.

The importance of the funding issue has been further expressed by Lionel October, at a recent IDC BEE Conference, *'the BEE financing issue is critical because you cannot implement the BEE charters without sufficient and effective financing... to have broad-based BEE you need an increase in the pool of financing otherwise you risk ending up with narrow-based empowerment'* (2 October 2003).

The Brenthurst Initiative recently announced by the Oppenheimer Family also highlights the importance of a resolution to the funding problem facing BEE. The Oppenheims have called on government to *'develop a comprehensive plan to promote all available sources of equity funding, as well as debt funding', adding that greater access to funds should promote more financially prudent deals'* (Brenthurst Initiative, 5 August 2003: 28).

This initiative also calls for new sources of black economic empowerment equity, such as employee share options programmes, mandated levels of savings, increased pension fund investments and incentives for private individual investment in empowerment vehicles (Brenthurst Initiative, 5 August 2003: 28-29). However, the funding proposals of the Brenthurst Initiative has also received criticism. Iraj Abedian, the chief economist at Standard Bank, feels that the funding of economic empowerment programmes is likely to prove challenging. In particular, he is opposed to the idea that emphasis is placed on legislating how much pension funds and the like should be set aside for black equity participation (Sunday Independent Business Report, 10 August 2003: 3). The plan for funding empowerment deals is one of three

tiers in the Brenthurst Initiative and is a reflection of the importance of this issue for BEE in the future (Brenthurst Initiative, 5 August 2003: 26).

One of the key sector charters dealing with the problem of the funding of BEE is the Financial Services Charter. This Charter will be the vehicle through which access to financial services for the poor will be addressed (Financial Services Charter, 17 October 2003: 9). It will also be a key source of funding for empowerment financing in South Africa over the next 10 years. In terms of the Financial Services Charter, the sector has committed itself to working in partnership with government and its DFIs (Development Finance Institutions) to mobilize resources for empowerment financing (Financial Services Charter, 17 October 2003: 10).

Government programmes overestimated the extent to which the private sector would participate in BEE. The market failures of the 1990s which caused the traditional banks to lose faith in supporting any BEE transactions, are amongst the major obstacles in allowing for meaningful funding of BEE. Further, inappropriate financial instruments which were dependent on a bull market led to a further failure of BEE during the 1990s (Black Economic Empowerment Commission Report, 2001:19). The funding mechanisms were also based on a mere transfer of assets, with no real risk-taking on the part of the BEE group and no meaningful participation of the BEE group in the operational side of the business.

Any form of development of BEE in recent years still excludes the vast majority from ownership of fixed assets and the possession of advanced skills that would enable the use of those assets that can facilitate the accumulation of wealth. This inequality in ownership is reflected by looking at the market capitalization of black-controlled firms as a percentage of the Johannesburg Stock Exchange (JSE) still only being around 2-3% (Business Map, 2002: 5). The number of black-controlled firms on the JSE is still only around 22 companies.

More recently, the government (in its Draft Strategy)¹⁴, while supporting the approach of the BEE Commission, stated that BEE should result in one or more of the outcomes

¹⁴ 'A Strategy for BEE', (the DTI) draft discussion document presented to Nedlac in September 2002

mentioned earlier in this paper. This paper will focus on one of these outcomes, namely, effective funding transactions which will help facilitate a substantial change in the racial composition of ownership, management and the control of existing and new enterprises. The effects of the Mining Charter to date, are already leading to the establishment of a number of new enterprises within this sector of our economy where the ownership, management and control is likely to lead to the transformation of many traditional mining houses in South Africa. The recent deals of Investec Bank Limited, African Vanguard Resources and Harmony as well as African Rainbow Minerals and Kumba are cases in point. However, further detail on current funding structures being utilized will be discussed in Chapter Four of this paper.

This leads to one of the primary reasons for this paper which is that the BEE experience in South Africa to date has not succeeded in meeting the government's broad-based objectives of BEE and a fundamental change in the racial composition of the ownership, management and control of various sectors of the economy. Neither have the funding mechanisms which has been in place, succeeded at meeting these objectives. It is also evident that neither has BEE succeeded at creating jobs for the poor. It has rather ended up being a case of asset transfers to a few black individuals and not true economic empowerment. The situation of the underclass is not only problematic, but has also become critical. The real household income of this group is almost 60% lower than what it was in 1974. According to a recent Human Rights Commission Report, 17 million people in South Africa live below the poverty line. This group is uneducated, unskilled and completely marginalized from mainstream economic activity with no indication of any significant job opportunities being created for this group over the past eight years (Terreblanche, S.J. 2003: 6).

In an economy where the rate of savings and investment is still too low for developmental needs and where the country's ability to attract foreign investment is dependent on growth and the economic environment, it is clear that any BEE financing strategy should not jeopardize domestic or foreign sources of saving or investment.

The current economic structure, which remains characterized by racially based income and social services inequalities, excludes the vast majority of the population

from ownership of fixed/productive assets and the possession of advanced skills that would facilitate the use of ownership and the accumulation of wealth.

Financial mechanisms are needed through which black people can build an asset and property base that generates income and reduces vulnerability to poverty on a massive scale. This can only be achieved by access to savings and credit and the creation of more black entrepreneurs. In order to put into perspective the issue of funding of Black Economic Empowerment, it is worth quoting Macartney of Ernest & Young South Africa when he says, *'..the biggest stumbling block for fledgling entrepreneurs is access to capital. Funding is the lifeblood of a business, but navigating potential capital structures and sources can be confusing and overwhelming'* (Business Day, 26 June 2003: 7).

This comment supports the challenging issue around BEE which is that of funding and a question mark for instance hangs over the R10 billion recently set aside for empowerment in Trevor Manuel's Budget Speech in February 2003. The issue of financing has become particularly relevant since two of the largest sectors of the South Africa economy have finalized their BEE charters, namely the mining and financial services sector which effectively means that South African corporate giants ranging from Anglo American to Standard Bank need to sell part of their businesses to black investors, fuelling demand for empowerment finance.

Various estimates as far as actual funding requirements for BEE ownership targets to be met have been raised. It must be noted that these estimates exclude funding required in terms of more inclusive BEE strategies discussed earlier such as funding needed to alleviate poverty. It is estimated that around R100 billion will be required just to meet the ownership targets specified in the current BEE sector charters (Empowerdex, 10 July 2003: 9). The problem is that only around R56 billion is available to fund the burgeoning demand for up to R100 billion in black empowerment deals from traditional funding sources such as banks, private equity, pension funds and development agencies, according to empowerment company Umbono (Business Day, 23 October 2003:1). This indicates a shortfall in South Africa's ability to fund empowerment, suggesting that banks and funders may need to commit more than they initially anticipated. The financial sector has already pledged

R79 billion as stipulated in the Financial Services Charter when it signed the charter on 17 October 2003. However, the study by Umbono states that the resources sector alone would require around R70 billion in funding, the financial sector another R50 billion and other sector a further R30 billion. Vuyo Jack, CEO of ratings agency Empowerdex, said there was 'definitely a shortfall in funding' (Business Day, 23 October 2003: 1).

However, one of the biggest problems facing the success of the implementation of all sector charters is the ability to provide sufficient empowerment financing to meet the various BEE ownership targets. According to the Financial Services Charter, it is estimated that the aggregate amount of new empowerment financing from the financial sector alone could exceed R75 billion (Financial Services Charter, 17 October 2003: 10).

The Financial Services Charter (17 October 2003: 5) mentions some of the key challenges facing the funding problem. Firstly, the inadequate response by the financial sector to the increasing demand for access to financial services by the majority of the population. Secondly, the sector has not effectively provided credit to entrepreneurs, particularly black businesses. Thirdly, there seems to be limited support for new black firms in the financial sector by government and the private sector. Fourthly, provision needs to be made for entrepreneurial development and be enhanced by supporting black entrepreneurs (Financial Services Charter, 17 October 2003: 5).

More recent developments in the BEE arena have also highlighted the funding problem. The implications of the Mining Charter (Act No.28, 2002, Annexure A), alone, in meeting the equity ownership requirements of 26% over the next 10 years, will mean that around R100 billion will have to be committed to BEE. With the financial services charter recently being finalized, estimates are around R25 billion to R50 billion if a direct equity ownership target of 15% is to be met (Financial Services Charter, 17 October 2003: 11). Financing is likely to become a critical issue in finding the sources of funds in South Africa to raise the necessary capital to meet these equity ownership requirements. The fact that the broad-based strategy of BEE as proposed by the department of trade and industry earlier this year, has placed a heavy weighting

in its BEE scorecard on ownership highlights the importance of this funding problem even more. As mentioned earlier, the Financial Sector Charter has committed itself, as a primary source of BEE funding, to provide empowerment financing of more than R75 billion (Financial Sector Charter, 17 October 2003: 10).

The recent Investec and Stanlib BEE transactions entailed a total of R1.16 billion being committed to meet a BEE equity ownership figure of 25 percent (Business Day, 16 May 2003: 1; Cape Times, 19 June 2003: 1). Funding of BEE deals in the case of some of the larger life assurers such as Old Mutual, for instance, will be much more challenging. For instance, if a BEE transaction were to be concluded with the asset management arm of Old Mutual (such as the case of the Stanlib transaction), then a 25% equity deal at Old Mutual Asset Managers would cost more than double the R350 million it cost Stanlib – a sum few empowerment players would be positioned to take on (Business Day, 19 June 2003: 11).

Malaysia had a similar experience where the indigenous people of Malaysia had little ownership of the economy and were marginalized. The Malaysian government subsequently implemented an empowerment programme similar to South Africa, but during the 1970s. The outcome has been that during Malaysia's transformative period a target of 30% ownership ended up in reality as 19% after thirty years. This example raises questions of whether the ownership targets can indeed be met from a practical perspective¹⁵. South Africa's experience in the last ten years indicates that its targets (as stipulated by the BEE sectoral charters thus far) will not be reached (Msibi, D. 2003: 32). The reason why South Africa's BEE equity targets may not be met within the time frames centers on the cost and terms of funding the equity transfers as well as implementation obstacles with the various sources of funding. This will be discussed in further detail in Chapter Four.

¹⁵ Malaysia is not the only example, but has been used in this study since the situation was relatively comparative to the South African BEE problem of today. Other examples include the transformation initiatives of the African Americans during the 1950s as will be discussed at the end of Chapter Three.

c) *The role of government in dealing with the financing problem*

The Department of Trade and Industry is currently looking at developing new mechanisms to improve access to finance and boost the resources of institutions such as the National Empowerment Fund and Khula Enterprise Finance so that they can extend their reach and offer finance to a great number of enterprises (Cape Times, 11 April 2003: 1). The funding problem by government DFIs¹⁶ is illustrated in the case of Khula which is the DTIs main initiative in small firm finance. At a recent IDC BEE Conference, Lionel October, made the following comment on the problems of the latter type of structures, *'The National Empowerment Fund is being revisited and it will play a critical role in ensuring broad-based empowerment financing for SMEs. We have had institutions which have not functioned well enough in granting sufficient loans to BEE businesses as they should have. This is currently being looked since these instruments we use will now need to be sharpened'* (2 October 2003). This statement reflects government's acknowledgement of the practical problems of financing related to BEE.

A recent survey by GEM revealed that only 9.3% of entrepreneurs whose loan applications were successful had benefited from Khula's services. This suggests that Khula's services are benefiting relatively few disadvantaged entrepreneurs (GEM Survey 2002: 41). In terms of the latter survey, the funding problem is further illustrated when it was revealed that one of the biggest obstacles facing entrepreneurs from obtaining general finance is lack of collateral.

The case for appropriate government intervention, and for concerted actions by the private sector due to the increased regulation & legislation by government for the promotion of BEE, could benefit the promotion of BEE in the economy over the longer term. The financing of this process of BEE is strategically important for the economy. Government acknowledges that it is understood that BEE requires suitable sources of financing and appropriate financing instruments in order to meet a broad-based strategy (Business Day, 10 April 2003: 11).

¹⁶ DFIs is Development Finance Institutions per the list of acronyms at the end of this study.

The absence of financing for the effective implementation of BEE in line with the accepted interpretation of BEE as identified in section (c) of Chapter One would generate two problems: the first is that the extent of BEE will be limited as there will not be enough financial support and; secondly, the likelihood of broad-based BEE will be far less probable since funds will not be allocated for the promotion of strategies such as black entrepreneurship and skills development (BEEC Report, 2001 :19).

Government, in its Draft Strategy¹⁷ stated that BEE should result in various outcomes, of which one of them, the provision of investment programmes that lead to broader and meaningful participation in the economy by black people, in order to achieve sustainable development and general prosperity, applies to this paper. Since without an effective role by financing and investment institutions such as the Industrial Development Corporation, the National Empowerment Fund, Khula and then the financial services sector (i.e. the private sector), BEE will fail.

Alec Erwin, had the following to say in a recent interview with Enterprise Magazine (April 2003: 18): *'In formulating the finance proposal, we were clear about the weakness of the recent experience of building an asset base for broad-based empowerment and the absence of financing measures. So the R10bn allocation announced by the finance minister would be leveraged in BEE through the National Empowerment Fund, but with a specific focus on the social dimension of redistribution.'*

While small business appears to support the above proposal, the policy is contentious since it is a departure from the BEECOM report which recommended a funding model based on a general target. This does beg the question whether the proposed redistribution formula, in the absence of an enforceable target, is adequate at dealing with the task at hand. Erwin maintains (April 2003: 18) that the debate on BEE policy has always been contentious.

¹⁷ 'A Strategy for BEE', (the DTI) draft discussion document presented to Nedlac in September 2002

Recent findings on the funding of BEE are interesting. The major drivers behind the growth in black business have been a range of public sector initiatives such as licensing and procurement policies. The government has also introduced numerous measures to enhance and improve access to finance and non-financial support to black entrepreneurs and households by restructuring existing government-related institutions and the creation of new ones. Government initiatives have however suffered from a lack of institutional support, poor co-ordination, insufficient focus, unclear mandates and insufficient outreach (Black Economic Empowerment Commission Report 2001: 19).

Recent findings show that government has been in the process of rationalizing a number of inefficient Bantustan Provincial Development Corporations (PDCs) - that provided housing, agriculture and economic development loans, in recent years (Black Economic Empowerment Report, 2001:19). Government has also refocused and restructured Apartheid-era DFIs such as the IDC, the Land Bank, the DBSA and the former Small Business Development Corporation (SBDC) (ANC Discussion Document, Number 16, August 2002: 20).

Recognising the vital role of SMEs in the economy, government has drafted a national strategy for the promotion of this sector. The National Small Business Act 1996 provided for the creation of four new institutions: Khula Enterprise Finance, Ntsika Enterprise Promotion Agency, the National Small Business Council and the Centre for Small Business Promotion with the DTI.¹⁸

More recently, government has also created three other institutions aimed at the funding of BEE, namely, the National Empowerment Fund (NEF), the Umsobomvu Trust and the Isibaya Fund.

Figures recorded in July 2000 showed that only a small percentage (less than 6%) of the total value of loans that have been extended by the IDC and the Land Bank have been advanced to black businesses (Refer to Table 2.1). However, more recently the

¹⁸ A White Paper on National Strategy for the Development and Promotion of Small Business in SA (20 March 1995). This Paper aims to address the problems associated with neglect of the SME sector by the Apartheid government.

IDC has made inroads as far as the numbers of loans being extended to BEE (IDC Annual Report, 2002), but there remains room for further improvement. The problem also still remains around the allocation of funds for the creation of more entrepreneurs rather than just providing financing to the same group of large BEE dealmakers already having gained significant wealth. Individuals such as Patrice Motsepe, Cyril Ramaphosa, Saki Makazoma, Bridgette Radebe and Mzi Khumalo are some examples of high profile black individuals driving a number of the largest BEE deals to benefit the companies which they are leading.

Table 2.1 Development Finance Institutions

DFI	Total Loan Book (Rm)	% of Loans to Black Business	Value of Loans to Black Business	Number of Loans to Black Business	Size of Loans (Average)	Loan Type
IDC	22940	5.9	1361	298	R4.6m	Debt & equity funding
Land Bank	14000	2.1	296	51761	R5700	Micro-finance
Umsobomvu Trust	1000	N/A	N/A	N/A	N/A	Debt & equity
Isibaya	6000	N/A	500	7	R71m	Debt & equity
NEF Ventures	200	N/A	N/A	N/A	N/A	Venture capital
Ithala	1 100	141	N/A	N/A	N/A	N/A
Khula Provincial Equity Funds	50	N/A	N/A	N/A	N/A	Private equity & venture capital
Khula RFI's	N/A	N/A	R130m	6000	R34 600	Debt capital
Development Bank of SA	11150	780	N/A	N/A	N/A	N/A
Business Partners	465	28	128	223	573 000	Debt & equity

Source: Black Economic Empowerment Commission Report, 2001: 20

There are numerous initiatives in the development finance arena. The problem is that there is little co-ordination as far as funding by government-related institutions goes, which leads to an overlapping of mandates and a delay by government in defining

new mandates for the various institutions mentioned earlier in this chapter (Business Day, 10 April 2003: 11). For example, the NEF has taken more than three years to get off the ground and has not succeeded on its implementation strategy. Funds still remain unallocated for the development of black entrepreneurs (Sunday Times Business Report, 10 August 2003: 2).

Many of the old and new initiatives appear institutionally weak. Most of the financial NGOs and development banks, particularly at provincial level, have extremely high cost structures, capacity constraints and limited outreach (Black Economic Empowerment Commission Report, 2001: 20). The PDC restructuring, for instance, have proven to be extremely difficult with cash-strapped organizations unable to effectively reposition and sustain themselves.¹⁹ The mandates of many of the DFIs have not either been clearly spelt out and are in many cases contradictory, for example, the need to be financially self-sustaining versus the need to meet development objectives.

Within the various DFIs, there has been little attention to developing sector-specific capacity in order to address the needs of entrepreneurs within particular industries. Non-financial service providers must have the appropriate skills and ability to move away from a 'one-size-fits-all' approach to delivering services towards a demand-driven model where the needs of the entrepreneurs are a priority.²⁰

No rigorous research has either been conducted to specifically assess the effectiveness of new and restructured institutions providing support to South Africa's SME economy. The IDC has been the only retail provider of support for black small and medium enterprises. The other government ventures intended to support this area of the economy have not yet gotten off the ground (BEECOM Report, 2001:20). The problems facing these DFIs are described in the BEECOM Report, 2001:21, *'While beginning to change, the (Khula) boards role has been focused mainly on the assuring Khula's financial performance rather than longer-term results for the SME sector. While Khula's mission is to facilitate the flow of credit to the high risk small business*

¹⁹ Mid-Term Evaluation of the National Strategy for the Development and Promotion of Small Business in SA prepared for the DTI (September 1999, 50).

²⁰ Mid-Term Evaluation of the National Strategy for the Development and Promotion of Small Business in SA prepared for the DTI (September 1999:42).

sector, it is simultaneously expected to operate according to conservative banking principles, maintain high loan recovery rates.'

The outcome has been that Khula has failed to win the support of all the commercial banks. The Khula Credit Guarantee Scheme, which guarantees up to 80% of loans granted by banks to SMEs, has achieved limited success in providing commercial bank loans to black entrepreneurs. Ntsika, another DFI, who is primary provider of non-financial support, has been riddled with management and institutional design problems ever since its inception.

The financing issue continues to remain one of the biggest obstacles to BEE in the future given that the mining sector charter alone requires an estimated R100 billion to meet the ownership requirements over the next ten years. Government has also recently indicated that it will be relying heavily on the private sector to help finance its new broad-based BEE strategy (Business Day, 10 April 2003: 11).

Lionel October told the portfolio committee on Trade and Industry that as government could only set aside R10 billion to fund BEE this year, it hoped the financial sector charter would come up with new and innovative ways to finance empowerment deals while also increasing black ownership (Business Day, 11 April 2003: 11). A recent example of a public-private partnership has been the Business Trust. This Trust announced at the growth and development summit (GDS) in June 2003 that it would commit more than R145 billion towards new capital investments in the next few years. A key focus of this initiative is also to take on young, unemployed people into learnerships (Business Day, 9 June 2003: 18). Experience elsewhere has shown that unless there was a real partnership with the private sector, sustainable empowerment was simply not possible. Portfolio Committee members expressed misgivings about how empowerment firms, especially those that were small and rural based, could access finance given the notorious unwillingness of banks to finance them in the past.

Given past failures, it seems that government is going to have to play a far more active role in the provision of loan finance to black firms via institutions such as the IDC, Khula, the NEF and the Development Bank of South Africa, to name but a few.

d) Conclusion

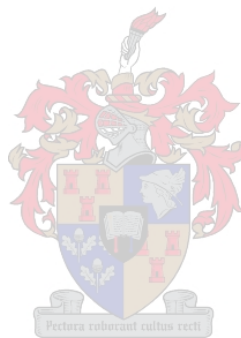
Various factors have been discussed in this chapter which have identified and motivated the funding problem of BEE. Government has provided limited institutional support, funding and non-financial, for the development of sustainable black businesses over recent years. Furthermore, there are no institutional mechanisms to facilitate broader ownership. Existing instruments such as procurement and licensing are doomed to fail in the absence of effective financial and non-financial support. Government resources over the past seven years have been ineffectively directed towards predominantly white and male SMEs rather than aimed at the promotion of meaningful and sustainable black business participation in the economy. The funding problem has been further exacerbated by the institutions responsible for allocating the funds by government for the purposes of BEE.

To a large extent, government's SME strategy overestimated the willingness of the private sector to participate in a partnership to promote entrepreneurship and to help drive this national empowerment imperative in a manner that truly benefits the majority of South Africans. In fact the banking sectors' approach to SMEs as well as sustainable BEE has been inadequate. Although a Financial Services Charter has finally been drafted, the implementation of the empowerment financing and the provision of access to financial services for the poor will be key. From recent sector charter developments as well as the enactment of the Black Economic Empowerment Bill, it would seem that government is likely to follow a more interventionist approach in ensuring the success of BEE over the next few years.

An analysis of South Africa's gini coefficient and disparity ratio provides further evidence of the problem of inequality in South Africa and the need for an implemented programme via financing to ensure progress as far as BEE is concerned. It can be concluded that there is indeed a strong case for a study being done on the subject matter of this paper and dealing with it as a problem statement.

Therefore, in the context of the above, Chapter Three of this paper will provide a historical analysis of funding by looking at the early funding of black entrepreneurs in

South Africa in the 1900s, as well as some of the failures of funding for BEE in the early 1990s. The subject of inequality will be a key theme in this part of the paper.



3) Chapter Three: A Historical Analysis of Funding

a) Introduction

The purpose of this chapter is to provide a historical analysis of the funding problem of the black South African population over time. This analysis also reveals the significant setback which this obstacle has had on the improvement of the economic well-being of black South Africans. Despite these obstacles, early accounts of black entrepreneurship will be discussed. Certain resemblances with the emergence of BEE will be drawn from the overview of the rise of Afrikaner empowerment in South Africa from the 1930s. However, it is also interesting to look at the post-Apartheid period in South Africa where opportunities for black people increased significantly in improving their economic livelihood. The judicial system in place in the 'old South Africa' protected the property rights of mainly white property owners, but Africans were systematically deprived of property rights and forbidden to own property in 87 percent of the country.

More importantly, the markets – and especially the labour market – were anything but free and competitive. For the greatest part of the last 150 years, most members of the black labour force have been powerless, impoverished, unskilled, and subject to repressive labour patterns. Part of the challenge for allowing for proper and sustainable forms of funding for BEE in South Africa over the next decade, will be to change the economic system to one that serves the interests of all 45 million South Africans whereby current power, capital, intellectual and human property will have to be fundamentally restructured. The funding issue is likely to be a critical factor in addressing part of this challenge.

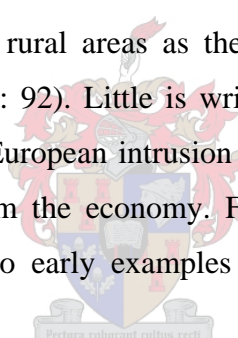
Part of the role of the state is to provide for a framework of broad-based empowerment where certain guidelines are set to enable that, over a reasonable period, the marginalized groups in South Africa are given the opportunity to become part of the mainstream. Hopefully, the recent BEE strategy of governments as well as the various sector charters being put in place will serve part of this objective.

This chapter will also analyse the black economic empowerment and funding models of the past which failed dismally and again led to an environment of inequality where only a few black people were economically enriched at the cost of the broader black population of South Africa who still remained impoverished. The reasons for some of these failures will also be discussed by using one of the first BEE companies to be established in South Africa, namely, New Africa Investments (Nail), as a case study.

Some international perspectives on empowerment will also be discussed with particular reference to Malaysia and the United States.

b) Early Accounts of Black Entrepreneurship

Accounts of black entrepreneurial activities in South Africa often suggest a 'lack of business socialisation' among Africans. Some even point to traditional sanctions against wealth accumulation in rural areas as the reason for the paucity of black entrepreneurs (Godsell, G. 1991: 92). Little is written on black economic activities between the period of the first European intrusion in 1652 and the late 19th century, when mining began to transform the economy. Farming production from 1800 to 1900 provides some insight into early examples of a culture of entrepreneurship amongst blacks.



One of the earliest threads of inequality in South Africa goes back to the 17th century upon Jan van Riebeeck's arrival at the Cape. It occurred when Van Riebeeck told the Khoikhoi leader, Harry the Strandloper, that there was not enough grazing land available for cattle for both the colonists and the Khoikhoi (Terreblanche, S.J. 2003: 154). In a famous extract Harry asked:

'It the country is too small, who has the greater right: the true owner or the foreign intruder? Van Riebeeck responded by saying, 'We have won this country in a just manner through a defensive war, and it is our intention to keep it.' As Terreblanche, (S.J. 2003: 155) puts it, this argument is seminal since it marked the beginning of a colonial process of land deprivation (effectively the equivalent of a lack of access to capital at the time) that continued for more than 250 years.

As far back as the 1800s, black people (the Khoikhoi, Mfengu, Thembu and all other tribes and disadvantaged groups) lacked access to capital, be it in the form of land or credit. The Ordinance of 1828 allowed the Khoikhoi the right to possess all forms of property, after having denied this them right, but by that time it was virtually impossible for them to become a significant force in farming (Muller, A. 1990: 57). Most of the land best suited to agricultural and pastoral activities had already passed into private ownership with productive farms fetching substantial prices. Few Khoikhoi had the financial resources needed to buy existing farms or to acquire vacant land. Moreover, they had little access to credit, as they could not furnish acceptable security for loans (Duly, L.C. 1972: 12). Indeed, existing farmers had a major advantage over newcomers, in that land had traditionally served as the main form of collateral security. To make matters worse, the government preferred not to make land grants to under-capitalised applicants, which meant that awards ended up going to the wealthier part of the population at the time which were in most instances the white population (Elphick, R; Giliomee, H. 1989: 35).

Cross-border trade which was legalized in 1824 provided another example of the natural entrepreneurship and talent of coloureds and blacks, in particular. These developments were very important to the economy of the Eastern Cape. The ivory trade, 'came to the rescue of the struggling community' of 1820 settlers whose agricultural endeavours had suffered from various misfortunes (Cory, G.E. 1926: 44). Ivory and many other products such as rubber from inland trade with blacks formed the bulk of the exports shipped from Port Elizabeth at the time. Both the colonialists and blacks were better off by this trade. These budding Xhosa and other black traders clearly had the potential to establish permanent trading stations from where they could supply merchandise to the local population in exchange for money. This would have happened if the Cape's traders had not been permitted in 1830 to settle beyond the colony's borders. These black traders were soon eliminated by virtue of their lack of access to regular wagon transport and to supplies of merchandise. Ultimately, the biggest obstacle once again, was a lack of access to finance for the black communities.

During the second half of the 19th century, the Mfengu tribe were known for their communal organizations and pastoralism which gave way to independent tillage

farming for the market. Their close contact with missionaries and traders hastened the commercialization in their ranks. As the Mfengu remained loyal to the Cape government during various wars, they were generously rewarded with land grants. A proclamation in 1858, for instance, permitted Africans to buy crown land at one pound an acre (Keegan, T. 1996: 12).

The development of a class of small freeholding African farmers was closely linked to the introduction of a qualified franchise system in the Cape in 1853. Two to ten acres of freehold land and house plots in villages enabled the owners to qualify for a vote in the Cape Parliament. This led to the expansion of African peasantry over the next 40 years in the Eastern Cape.

The rise of a relatively independent African peasantry in the Cape (and Natal) during the second half of the 19th century was an important and promising development. This meant that a significant number of Africans became landowners and independent farmers and therefore managed to escape the poverty caused by repressive labour practices over this period. The success of black entrepreneurship was seen specifically in the agricultural sector. During this period African peasants were able to participate in farming at a relatively successful level. Apart from their specialized knowledge of local conditions and methods, they tended to cultivate more intensively because of the growing scarcity of land. They were able to produce at a modest surplus which enabled them to participate in the exchange economy at the time on terms of their own without having to surrender land, security or cultural identity (Bundy, C. 1988: 113).

Often the black farmer would produce a surplus for sale when the white agriculturist could not. As J.W. Sauer, a Cape politician, put it in 1903: *'I am inclined to think that the Natives make rather more out of the land than do whites – though perhaps that is not a popular thing to say...'* (In Bundy, C. 1988: 113).

A similar conclusion is reached by Denoon (D.J.N. 1972: 87), who wrote of the nineteenth century that 'African peasants were more efficient and productive than white farmers.' Therefore, black entrepreneurship was very successful during this period despite their limited means to capital. These early accounts of black

entrepreneurship are proof of the enormous talent this large, unfortunate part of the South African population had, despite the many obstacles they faced.

The relative success of the African peasantry in the 1860s was firmly enough stated by the Natal Witness, which said: *'Perhaps the most striking feature in the Kafir character is his energy and industry as a farmer. Wherever he has lived beside a farmer, who is industrious, the Kafir has eagerly imitated him, has bought a plough and wagon, and has discovered that he also can obtain a large return in this way. The thousands of acres that have been ploughed by Kafirs, and the hundreds of wagons they possess, are conclusive proof of their readiness and fitness to become agriculturists'* (In Bundy, C. 1988: 174).²¹ Until the 1870s, blacks in Natal dominated sales of produce to the colony's markets (Lambert, J. 1988: 32).

One of the single biggest obstacles to further the flourishing black entrepreneurship was unfortunately the 1913 Natives Land Act which aimed at curtailing the possibilities open to peasant production, by preventing the accumulation of capital by Africans and at translating independent squatter-peasants into wage labourers (Bundy, C. 1988: 116).

The discovery of gold led to an almost immediate halt in the growth of African economic independence as far as land/agriculture goes (Terreblanche, S.J. 2003: 230). The Land Act of 1913, was really the turning point to this period of relative economic freedom enjoyed by some Africans. It is also interesting to note that African farmers were of the more successful producers of maize than their white counterparts during this period (Terreblanche, S.J. 2003: 242). Another hindrance to the success of African peasantry was their need for cash, which caused them to end up accepting depressed prices for their products and made it commercially less viable (Terreblanche, S.J. 2003: 206).

The same obstacles arose in Natal around 1845, where Africans were allowed to own land. The problem was that they were obliged to pay hut taxes, excise duties and other fees which meant that they needed access to the necessary capital to pay for these

²¹ To substantiate this point further, 'It must be remembered that most of the land in the colony is farmed by the Kafirs... who form the bulk of our farmers.' (In Natal Witness, 4 June 1872).

expenses (Terreblanche, S.J. 2003: 209). Despite these obstacles, Africans enjoyed a relative degree of economic independence during this period and proved successful at what they did. It was only when commercial farmers gained control of the Natal parliament that the state finally began to limit African alternatives to labouring for their white employers. What is of more significance during this particular period in Natal, was that African peasantry showed great progress and it became increasingly difficult for white farmers to compete with African agriculturists. As commercial white farmers gained decisive influence in the Natal government, the opportunities for Africans as far as land ownership and economic progression goes, came to a halt, as was the case in the Cape (Terreblanche, S.J. 2003: 210).

Another remarkable development during the 19th century was the transformation that was beginning to occur in black farming. It was revolutionary in that it involved a transition from subsistence-oriented to market-oriented production, as well as the adoption of totally new technologies (Muller, A: 1990: 111).

Even across the border of the colony, amongst the Xhosa, the expansion of agricultural production was the most significant development after 1835. The results of the commercialization of black farming were already apparent in the late 1830s, when traders began for the first time to purchase Xhosa maize and wheat for consumption in the Cape colony. Black farmers also began to acquire woolled sheep. After the middle of the 19th century blacks became responsible for a 'considerable quantity' of the wool exported through Eastern Cape ports (Beinart, W. 1982: 88). The success of blacks in commercial agriculture in the Cape was replicated elsewhere.

However, black commercial farming subsequently declined everywhere when an elite group of Christian (kholwa) families emerged who specialized in supplying colonial markets and who used the latest agricultural technology on their intensively cultivated holdings. This in retrospect is one of the great tragedies in South Africa's economic history. Dynamic entrepreneurship remained a very scarce resource and the entrepreneurial activities of the 'non-European' part of the population were of considerable significance to the South African economy over this period (Terreblanche, S.J. 2003: 231).

After the mineral revolution at the end of the 19th century, close symbiotic relationships were forged between the corporate sector and successive white governments. Those relationships were literally maintained for a century, from 1880 to 1990 (Terreblanche, S.J. 2003:239). It was these relationships which effectively obstructed the access of the greater part of the population to any form of capital accumulation, education or skills developments. As already mentioned, one of the saddest developments early in the 20th century was the introduction of the Land Act of 1913 which was enacted with the deliberate aim of forcing the black population into becoming a cheap and compliant labour force rather than having their own economic independence (Bundy, C. 1988: 214).

The obstacle of not having any access to funding due to the fact that black farmers were no longer able to own land is illustrated by a white farmer near Richmond,

‘That native’s earning power is not sufficient to enable him to pay his way...to pay his debts and his taxes. A man cannot live on nothing. When a man had cattle and land, like they had years ago, he could sell a beast and pay his rent; now they have no cattle and land...’ (In Bundy, C. 1988: 187).

c) *The rise of Afrikaner empowerment*

The period from 1934-1974 was of great significance for the Afrikaner. The higher growth rate over this period benefited the Afrikaners but more so by the preferential treatment they got such as the protection of jobs and good educational opportunities (Terreblanche, S.J. 2003: 298). Per capita income of whites increased at a higher rate than those of the black population groups and the distribution of income between whites and blacks was more unequal in 1974 than at the beginning of the century.

To understand why Sanlam pioneered BEE in the early 1990s, as will be discussed in the next part of this chapter, one has to take a brief look at the history relating to Afrikaner economic empowerment which has many close similarities to that of the black disadvantaged of today.

The Afrikaner, in pursuance of political freedom, was impoverished and isolated due to the Great Trek. The Anglo-Boer War (1899-1902), which occurred during the reign of Milner, was a severe setback to the Afrikaner people, both economically and politically. During this war, approximately 35 000 Afrikaners died, homes and properties were devastated and more than half of their agricultural stock was lost. The Depression followed after the war and was accompanied by one of the worst droughts in 50 years. This lasted until 1909 and caused many Afrikaners to leave their land and find work in the cities. The Anglo-Boer War however, crystallized the notion of Afrikaner nationalism. Afrikaners were largely rural dwellers in the latter part of the 19th century where most trade in the Cape was centralized amongst the English, Jewish and Malays (Terreblanche, S.J. 2003: 298). After the declaration of the Union of South Africa in 1910, Afrikaners sought to empower themselves economically and politically (Du Plessis, E.P. 1964: 22).

Six years after the declaration of the Union of South Africa, on 28 and 29 June 1916, the 'Kaaplandse Helpmekaarvereniging' was established, mainly to address the 'poor white' problem, the 'Afrikaanse Handelshuis Beperk' was also established to address the needs of farmers.

Santam, a short-term insurance company, was registered in 1918 with a share issue of 200 000 pounds. Sanlam the life insurance company was registered in the same year. Potgieter, D.J. (1970:203) notes, 'One of the most important events which eventually led to the breakthrough of the Afrikaner in the world of finance was the establishment of an insurance company, the Suid-Afrikaanse Nasionale Trust en Assurance Maatskappij, today known as Santam.' The formation of KWV (Ko-operatiewe Wijnbouwers Vereniging) in 1918 completed a year in which the Afrikaners were beginning to flex their economic muscle.

By 1920 the drought, which was largely responsible for the urbanisation of the Afrikaner, led to widespread unemployment. To overcome this crisis, unskilled Afrikaners were given jobs as labourers, however the problem of the 'poor white' remained and in 1932 unemployment of the Afrikaner population was around 17% (Du Plessis, E.P. 1964: 31).

The biggest catalyst in the process of the Afrikaner's well-being was the masterplan drawn up at the 'Eerste Ekonomiese Volkskongres' in 1939. This document formed the basis for the development of the Afrikaner on spiritual, cultural, scientific and technological fronts.

The establishment in 1940 of the 'Federale Volksbeleggings Beperk', the 'Federale Beleggings Korporasie' and the 'Afrikaanse Handelsinstituut' in 1944, placed the Afrikaner solidly on the road to recovery (Potgieter, D.J. 1970: 212). Companies such as Sasol (1950) which were established in 1950 with financing provided by the IDC, were further ambitious projects undertaken to entrench the Afrikaner economically. The IDC played a key role during the period from 1948 through to the 1970s in funding Afrikaner empowerment. Specific examples of funding by the IDC during this period of stellar growth of Afrikaner businesses include 'Ouma' rusks (1941), Forskor (1952), Soekor (1965). Refer to Appendix C for a detailed illustration of the history of the IDC's funding initiatives to date (IDC Annual Report, 2002: 2-3).

The phenomenal economic success of the Afrikaner can still be seen today by their influence in the banking industry, trust companies, insurance, print media and the industrial sector. The dilemma of the 'poor white' phenomenon amongst the Afrikaners was eliminated as a result of a great deal of government and parastatal support during this period (Terreblanche, S.J. 2003: 304).

However, in the mid-1980s a number of prominent Afrikaner businessman and academics realized that if the disadvantaged majority were disenfranchised economically and politically, South Africa would be heading for a major disaster. In an interview recorded by the media with Mr AS du Plessis of Sanlam in 1999, he stated that Sanlam executives realized that blacks needed a 'Federale Volksbeleggings Beperk' such as the Afrikaners had in 1939, to achieve economic prosperity. It was thus, that Sanlam in 1998, via its strategic investment arm, Sankorp, initiated the concept and process of black economic empowerment (Verhoef, G. 2002: 15).

The above historical summary of the Afrikaner disempowerment and rise to economic power in mainstream South Africa, bears many similarities to the history of black people in South Africa today. Both groups were largely excluded from the primary

economic activities of the country, albeit over different periods in the history of South Africa. However, there are also crucial differences between the Afrikaner experience and that of the black population of today. First, the state is much less powerful in relation to private business today. This is especially problematic given the scale of the empowerment challenge facing South Africa over the next decade; since it is one thing for a government to economically empower a couple of million Afrikaners. It is far more challenging to empower around 38.1 million black people today. Therefore, empowerment of the Afrikaner was more easily achieved. Afrikaners were never more than 12% of the total population, while Blacks have never been less than 80% of the population. This illustrates the scale of the challenge for empowerment of black South Africans over the next decade or more (Terreblanche, S.J. August 2003).

Secondly, Afrikaners in 1948 had the advantage of a major capital base in the form of land and were on average relatively more educated than the average black South African in 1994 i.e. access to finance and capital was relatively easy. Thirdly, empowerment today is taking place in an environment of far lower growth rates than the period 1948-1970 when the South African economy was growing at 5% per annum. In contrast, growth since the ANC came to power in 1994 has averaged just 2.5% and has not been accompanied by job creation, but by actual job losses (Terreblanche, S.J. 2003: 35). It is within this context that the empowerment experiences in the past 12 years in South Africa should be reviewed in this paper.

The rise of black economic empowerment in the early 1990s, with the initial help of large private sector institutions such as Sanlam and Anglo American, will be discussed in the case study in this chapter. The failures and lessons to be learnt from other countries will also be discussed.

d) Black Entrepreneurship During the 1970s and 1980s

These obstacles that blacks and other disadvantaged groups were faced with seemed to be the same for many years right through to the end of the apartheid era. Every

piece of legislation²² or any kind of social practice which excludes people from exercising free choice in the marketplace has two inevitable results: first, it terminates the advancement of the excluded group; and secondly, it would end up reducing total output (Abedian, I.; 1986: 3). Wide-ranging discriminatory legislation and practice led to the exclusion of South African blacks from meaningful participation in the economic system for many years. This inequality was a major setback for any form of economic development of blacks. Of importance is that the five major stumbling blocks that reduced the scope of business enterprise and which stifled their entrepreneurial spirit were: limited access to expanding integrated markets (due to racially segregated business premises); limited access to capital because of an inability to meet the collateral requirements of modern financial institutions; inadequate training and experience; inferior education and lack of proximity to large and dominating business centres.

Today, the limited access to capital remains an obstacle for real black advancement. The key challenge will be whether the process of Black Economic Empowerment will be able to resolve this. The problem is that with the above-mentioned obstacles having been in place for many decades, their economic consequences have manifested in a widespread incidence of poverty amongst South African blacks today. Davies, W.J. (1988:2) concludes this point by stating that, *'The relatively underdeveloped status of the black entrepreneurship in South Africa, and its apparent lack of competitiveness is thus due entirely to the exclusion from opportunities to gain experience, to take risks, to compete.'*

What is apparent from the above historical analysis of black economic activity is that despite the use of pass laws, segregated housing, job reservation, lack of any form of access to proper finance during the early years, the entrepreneurial drive of blacks continued. The advent of urbanization in South Africa created opportunities to provide ox wagons and horse carts – replaced later by taxis and buses – to transport workers from the newly established black townships to the cities (Iheduru, O.C. 1995:

²² Direct restrictions to black entrepreneurship were embodied in the following Acts, namely, the Land Act (1913), the Mines and Workers Act (1941), the Bantu Building Workers Act (1951), the Motor Transportation Amendment Act (1955), the Group Areas Act (1945). Source: Robinson, G. 1986: 104-114.

71). The problem was that even these types of businesses were prevented from developing to any size before the 1980s.

With the rise of the National Party in 1948, laws were enacted that continued until the mid-1970s that aimed to inhibit black participation in the economy. It has been noted that there were more than 500 laws and regulations that in one way or another impeded the involvement of the black community in the economy as owners and managers (Motsuenyane, A. 1989: 11).

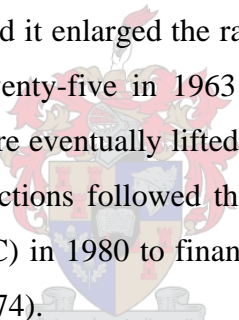
Although the stokvels (revolving financial and credit associations and other helping networks such as burial societies and womans' church organizations) blossomed in the townships during this period, they were generally not oriented to helping small businesses or to generating start-up capital. However, during the 1960s up until today this system remains one of the few real avenues to accessing capital for the poor (Bank, L. 1994: 34).

These factors help explain the 'lack of community status' and 'lack of business socialisation' amongst blacks in South Africa. Their exclusion from the economy continued unabated until the mid-1970s, when both the government and the private sector began to introduce reforms that resulted in genuine growth and advancement of black entrepreneurs, especially in the rural areas, by late 1989 (Terreblanche, S.J. 2003: 396). The Botha government made a series of concessions to blacks of which the abolition of discriminatory labour legislation in the late 1970s and early 1980s. This led to a strategic economic power shift that enabled the upper 20% of blacks to make enormous progress (Terreblanche, S.J. 2003: 396).

The homeland governments, despite their failings, were instrumental in creating a sizable class of entrepreneurs, since the Group Areas Act and other Apartheid laws prohibited white businesses from operating in black enclaves (Beinart, W. 1994: 65). Pretoria channeled large quantities of money into the homelands, emphasizing emerging social differentiation and diverting the ambition of African educated classes from major cities so that they would help to guide the journey toward separate development. This strategy of the mid-1970s was to build a large black middle class that would become a willing ally of the apartheid state and that would eventually

overshadow the radicalized urban political and youth leadership. The problem was that only a small black elite owned private property in the Bantustans. Blacks living outside the Bantustans were propertyless with more than 90 percent of Africans not owning property or having any real access to finance (Terreblanche, S.J. 2003: 397).

More specifically, the state revamped the Bantu Investment Corporation (BIC), created in 1959 to finance black businesses only in the homelands, in consonance with the theory of 'separate development' (Iheduru, O.C. 1994: 73). A number of legal and administrative changes were also made after 1976, such as the extension of property and ownership rights to urban blacks for a ninety-nine-year period in 1978; the right of blacks to register trade unions in 1979; and the abolition of the Bantu Education Act of 1953 in 1979, allowing blacks to hold apprenticeships and jobs in certain areas previously reserved for whites under the Industrial Conciliation Act of 1956 (Iheduru, O.C. 1994: 74). The state also amended harsh regulations that forbade company formation by blacks, and it enlarged the range of areas of permissible black business activities from only twenty-five in 1963 to fifty-two. All restrictions on business ownership by blacks were eventually lifted in the 1980s (Beinhart, W. 1994: 123). Further relaxation of restrictions followed the creation of the Small Business Development Corporation (SBDC) in 1980 to finance all small businesses on a non-racial basis (Iheduru, O.C. 1994: 74).



The private sector eventually started to show signs of stepping-in in the 1980s with the creation of the Urban Foundation, dedicated to improving the quality of life of urban blacks. The foundation initiated and supported housing, education, business and welfare projects in many black townships. By the late 1980s it began to encourage the government to hasten adjustments. As far as funding goes, it agreed to fund the SBDC by 50 percent and many white companies began to participate in the National African Federated Chamber of Commerce (NAFCOC) as associate members. In addition to paying higher membership fees, they also donated generously to various NAFCOC services aimed at assisting black entrepreneurs (Motsuenyane, A. 1989: 12). Some big companies also started to recruit blacks and train them for future private employment, while some, like Standard Bank, pioneered the creation of small business development initiatives to help finance many black entrepreneurs (Iheduru, O.C. 1994: 75). The result was that the income of the top 20 percent of African households

increased by 38 percent from 1975 to 1991, and by a further 15 percent from 1991 to 1996 (Terreblanche, S.J. 2003: 399).

These economic reforms and the deregulation of black entrepreneurship during the last thirty years have had tremendous consequences on the SA economy. An enlarged black middle class has been created, fundamentally transforming the entire system. In the 1980s the regime touted its rising number of black millionaires as an indication that things were not so bad for the black majority when compared with their white counterparts in black-ruled Africa (Burton, S. 1988: 23; Jones, J. 1989: 87).

At entrepreneurial level, blacks dominated the transport services in the townships, partially relieving transport difficulties with the proliferation of minibus taxis. Between 1970 and 1989, the number of these buses increased from 24 000 to 174 000; an estimated 80 000 of them operated without licenses. This phenomenal rise in the availability of automobiles reduced workplace travel time dramatically and opened up new markets in the townships and in the rural areas (Iheduru, O.C. 1994: 75). Taxis, which carried few black passengers in the 1970s, carried 30 percent of commuters in 1989 and over 40 percent by 1992. The black operators were eventually organized into an economically and politically important union called the Southern African Bus and Taxi Association, whose membership had reached 45 000 by late 1989 (Beinhart, W. 1994: 56; Khosa, M. 1990: 128).

By 1990, many blacks expected more rapid improvements to aid their economic positions. Unfortunately, as the problem statement in Chapter 2 has revealed, income disparities have only widened since the new government has been in power and funding still continues to remain a major problem.

e) Summary of Early Years of Empowerment

Despite the spectacular inroads that have been made by black entrepreneurs in recent years, the government's capacity to empower the black majority economically is still limited by a number of internal, external and structural factors. The obstacles caused by the Apartheid system and the failures of BEE through its lack of encouraging black entrepreneurship are largely to blame for the disappointing growth of more

entrepreneurs. Many black entrepreneurs, especially those with small enterprises, lack the representation and voice at a higher level on the issue of economic empowerment. The history of black political struggles and contemporary black politics have also contributed to both the division and the powerlessness of black entrepreneurs and their organizations. It appears that government has virtually surrendered empowerment programs to white businesses in an attempt to win their confidence (Malala, J. 1995: 56).

The economic reforms and deregulation of black business activities from 1976 to 1990 helped to create an emergent black middle class and entrepreneurs. New entrants have joined this class since 1990. Although various types of black entrepreneurs have made inroads into the mainstream economy, they still face enormous constraints of which a lack of access to capital is a primary obstacle (Iheduru, O.C. 1994: 76). The two contending strategies of BEE, the so-called minimalist and more broad-based approach, are part of the debate. As has been discussed, evidence thus far seems to suggest that a broader approach, but with institutionalised and active arrangements by the state might help spur the creation of true BEE of more black South Africans.

The next section of this chapter looks at some brief history and characteristics of BEE during the 1990s. The purpose of analyzing this period is to understand the reasons why BEE failed and the lessons to be learnt from these failures.

f) The First Wave of Black Economic Empowerment: 1990-1999

i) Introduction

A study of South African business history exposes some curious similarities between the Afrikaner business empowerment of the 1960s and the current BEE process, as already mentioned in the previous section of this chapter. The National Party of 1948 empowered the Afrikaans population of South Africa through the transformation of the civil service. A division within society became apparent and the separation of the Afrikaans Government and English controlled businesses ended only in the 1960s when Anglo American Corporation made one of its mining interests, General Mining, available for sale to an Afrikaans company, Afrikaans Mynbou. This sale marked the

beginning of significant participation of Afrikaners in South African business (Wilhelm, P. et al, 1997: 19).

In the early 1990s, the political changes in South Africa following the decision by the ruling National Party former President, FW de Klerk, to unbanned political organizations such as the ANC and the PAC as well as their leaders, were preceded by efforts of business to adapt to the changing global environment. Negotiations with respect to political transformation and the facilitation of the new black majority government, cannot solely be interpreted as a political process (Verhoef, G. 2002: 2).

The business community was instrumental in negotiating with government the re-entry of the South African economy into the global economy in the early 1990s. The changes that took place in the business community in post-Apartheid South Africa need to be understood in the context of international economic developments since the mid-1980s which displayed enhanced competition in a more powerful way than in the past. For the South African domestic economy that meant that it became imperative to utilize all resources optimally. These global economic developments impacted on the political environment in South Africa since one aspect of optimal resource utilization was the restructuring of control over resources and access to participation in the mainstream economy for the previously disadvantaged (Verhoef, G. 2002:2).

In hindsight, one of the probable shortcomings of the ANC-lead government at Kempton Park was the issue of negotiation on pushing for economic policy more geared to addressing the needs of the poor (Terreblanche, S.J. 2003:439). Since some of the work done by the Economic Trends Group of COSATU in the early 1990s in hindsight carried some weight in that its overriding theme was growth through redistribution, a formula 'in which redistribution acts as a spur to growth, and in which fruits of growth are redistributed to satisfy basic needs.' Although the document acknowledged the role of market forces, it stated that the market on its own would merely perpetuate inequalities, and that some government intervention was necessary to equalize opportunities (see Marais, H. 2001: 5).

The promise of the new government after 1994, that 'all can share equitablyin durable growth' was therefore misguided if we take into account the deeply

entrenched inequalities in socio-economic power and property between the elite and the impoverished majority. It is only now that we see the ANC government address the above problem through various indirect redistributive policies such as the BEE strategy document, Mining, Petroleum & Liquid Fuels and Financial Charters. Part of the problems of the early 1990s were that the ANC, in the negotiating process at Kempton Park, was simply not equipped enough to provide an innovative set of progressive ideas to put forward to business regarding the advancement of black business in a sustainable manner and hopefully the empowerment of all. Michie and Padayachee (1997:5) put it as follows: ‘...The more interventionist, Keynesian ideas and policy recommendations of MERG (December 1993) and the RDP (February 1994) came too late in the transition process to stop the ANC’s steady slide into neo-liberalism.’

The early years of BEE were characterized as follows: *‘There were assumptions that, once the conventional issues were sorted out, the dozing South African ‘economic giant’ would lumber to its feet and cart off to the land of promise. In short, the crisis was seen as primarily political, not economic... Redistribution was viewed as a political accessory that can be tagged onto the measures aimed at restoring economic growth; it was not seen as being integrally connected to – in fact part and parcel of – long-term sustainable growth’* (Morris, M. 1993:61).

It is worth noting and summarizing the various phases of Black Economic Empowerment in South Africa in the 1990s for the purpose of this section of the paper. The first phase was before 1991 when investors saw BEE as an exercise in social responsibility with the provision of study assistance to promising young black students (Metropolitan’s Raucall Scheme is an example), housing schemes and the development of small business (Verhoef, G. 2002:3).²³

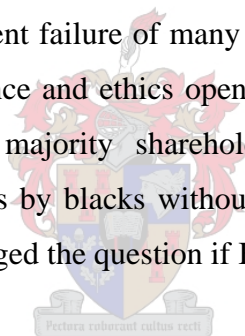
Between 1992 and late 1993, blacks and women gained representation at board level of the white-dominated companies, but was usually at non-executive director level. In 1994, black investors gained minority shareholding in various companies and were largely passive and also acted as fronts for procurement of government contracts.

²³ Sankorp Management: 1 April 1989:Confidential Report on Sankorp Social Involvement: 8.

The next phase of the early years of BEE was reflected between 1995 and 1996 when black business gained large holdings in traditional South African corporates. Joint ventures started and investment sentiment became more positive. The debate between enrichment and empowerment was sparked and trade unions became active in the investment market i.e. Hosken Consolidated Investments. Companies such as Real Africa Holdings (Rail), New Africa Capital (Nail), Johnnies Industrial Corporation (Johnnic) were characteristic of this period (BusinessMap, 2001:9).

In 1997 BEE centered around operating and holding company investments with the emphasis on adding value to the transaction. During 1998, the focus shifted to broader black economic issues, procurement policies and skills transfer.

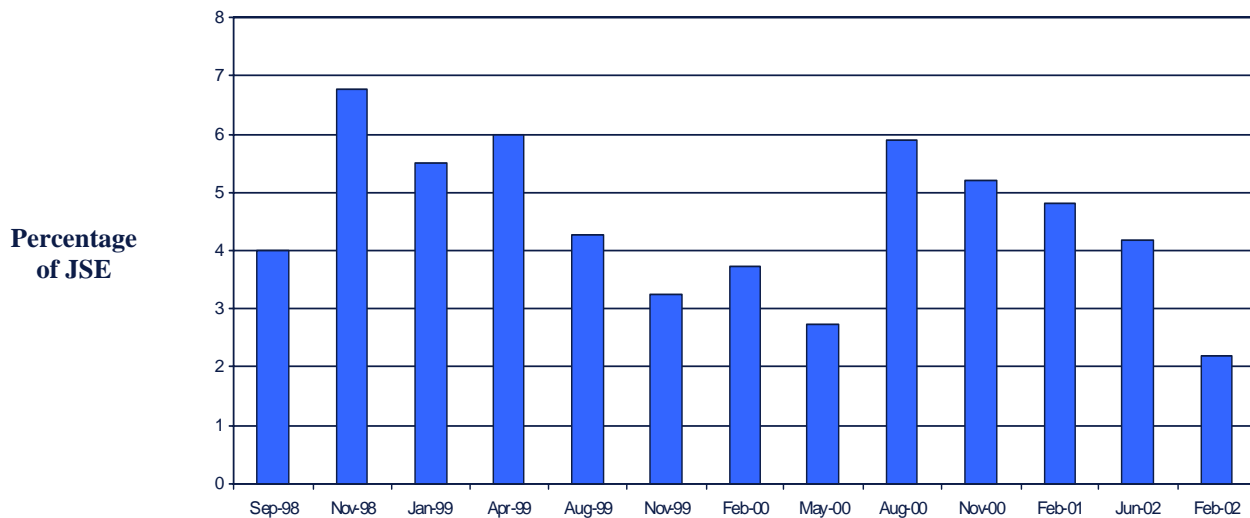
In 1999 with the collapse of equity markets due to the Asian crisis having occurred the year before and the subsequent failure of many of the listed BEE companies, the Nail saga on corporate governance and ethics opened the debate as to whether BEE was largely blacks obtaining majority shareholding in companies or whether operational control of companies by blacks without having majority ownership was the issue. The Nail saga also begged the question if BEE had not failed (BusinessMap, 2001:9).



J. Cargill, et al (1998:44) analysed BEE transactions over the above periods and came up with the following interesting statistics. During the first year of Nelson Mandela's reign, approximately 20 empowerment transactions had occurred. In 1998, an average of 20 a month were being recorded. During the period, affirmative action and training remained low-level concerns of board directors.

By November 1998, 26 Johannesburg Stock Exchange listed companies were black controlled, with a market capitalization of over R52 billion (about 4% of the total JSE market capitalization at the time). This compared to eleven companies in September 1995 with a market capitalization of R46 billion. However, what is interesting from Figure 3.1 is that since the market crash at the end of 1998, there has been a decline in size of many listed BEE companies up until February 2002.

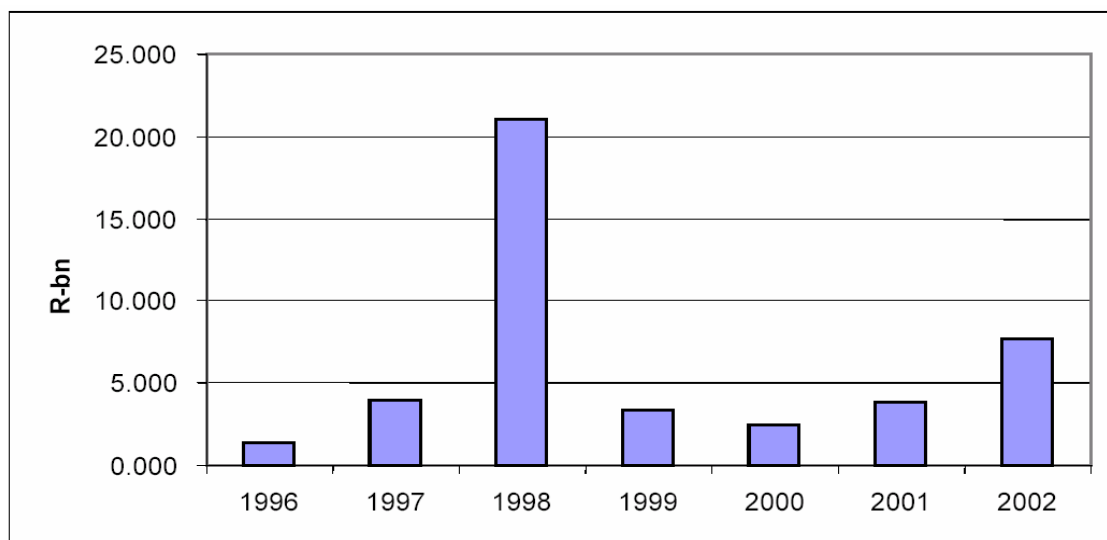
Figure 3.1 Market Capitalisation of BEE Companies as % of JSE



Source: BusinessMap

In addition to the 1998 figures mentioned in Figure 3.1, November 1998 was marked by a peak in the value of empowerment transactions. This peak in the value and market capitalization of BEE companies was due to high share prices for these companies prior to the emerging market collapse towards the end of 1998. The same declining trend followed thereafter where the value of empowerment transactions fell substantially as illustrated in Figure 3.2.

Figure 3.2 Value of BEE transactions peaks in November 1998

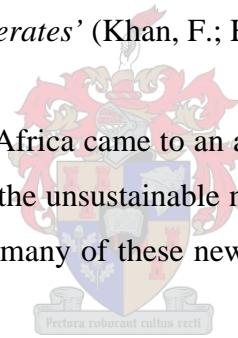


Source: BusinessMap

ii) *Reasons for the failure of BEE during the early years*

The key reasons for the failure of BEE during the early 1990s in South Africa is summarized in the text below. The narrow approach to empowerment during this period resulted in no real jobs being created or any broad, sustainable growth of black entrepreneurs. *'Despite the media hype of empowerment taking a slice of the white establishments' control over the commanding heights, the investment of billions of rands of black peoples' funds in forming pyramids, buying into existing companies, and engaging in joint ventures has not produced significant gains in employment of black workers or even a substantially larger number of black managers. Far from being focused on the goals of the RDP or some other such programme for black advancement for the working class in terms of housing, health, community development...black empowerment does not seem yet to equal the social responsibility programmes of existing conglomerates'* (Khan, F.; Hemson, D. 1997:19).

The first wave of BEE in South Africa came to an abrupt halt with the Asian crisis of 1998. This crisis really revealed the unsustainable nature of the BEE financing model which formed the foundation of many of these newly formed companies of the early 1990s (BusinessMap, 1999: 7).



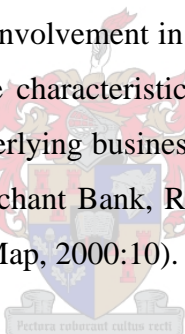
Black buyers into South Africa's corporate establishment during the 1990s were aptly described as 'capitalists without capital' (BusinessMap, 1999:12). As a result, financial institutions, the providers of capital, played a key role during this period in determining the pace and character of black economic empowerment (BEE). It is thus hardly surprising that when the equity markets crashed in 1998 many black listed companies, such as Nail, suffered the most. The core weakness in the financing model was the over-gearing of black companies. Instead of using their access to finance to build an asset base, most accumulated a debt base via the Special Purpose Vehicle financing (SPV) structure most prevalent at the time (BusinessMap, 1999:11).

In an interview with Fuad Cassim of the Public Investment Commissioners (PIC) in 2000, he had the following to say about the SPV funding model: *'The SPV approach*

did not lead to sustained and sustainable forms of empowerment. Instead it turned into a trap of debt and illiquidity.'

The problem was exacerbated when the black firms simply bought into as many businesses as they could. The financial vehicles they utilized ring-fenced each acquisition, which meant there was no downside risk being borne by the executives of Nail, for instance (BusinessMap, 1999:11). It was the financiers who bore all of the risk. In a bullish market, this scenario would most probably have worked, and was one of the reasons why a large number of black companies flourished before 1998 as evidenced by Figures 3.1 and 3.2 shown earlier.

This environment also caused few of these black businesses to see reason on focusing themselves or taking an active interest on an operational level in their underlying investments. Again, the Nail study provides a good example of this where the directors did not have operational involvement in the underlying businesses (Ngcobo, S. 1998:11). Further, Nail had the characteristics of a typical conglomerate with a whole range of investments in underlying businesses covering a range of sectors such as Metropolitan Life, African Merchant Bank, Radio Jacaranda. Such a strategy did not provide much focus (BusinessMap, 2000:10).



However, post the Nail saga of 1999, corporate black empowerment raised a number of key questions:

- i. Is ownership being distributed to the previously disadvantaged or simply a small black elite?
- ii. What is the capacity of the banks to continue to support high gearing of black empowerment groups?
- iii. Why are there so many non-blacks at board and senior management levels of black companies?

Political analyst Moeletsi Mbeki's more recent comments would provide an appropriate response to question one which is that government's black economic empowerment is not a model for creating entrepreneurs (in terms of the interpretation of BEE for this study), but is benefiting only a few blacks at the expense of the majority of the poor black population of South Africa (Business Day, 11 August

2003: 2). Addressing the economics department workshop on entrepreneurship at Rand Afrikaans University, he gave Nail and Rail as examples of such enrichment. He said, *'These companies were not seen in terms of networks, but rather as the creations of Nthato Motlana and Don Ncube respectively'* (Business Day, 11 August 2003: 2).

Moeletsi Mbeki feels that this is one of the reasons for the low level of entrepreneurship of black South Africans. He says, 'When you have a single class society, then the level of knowledge of everybody is the same, whereas in a network, you are in a differentiated society – with different levels of knowledge, different levels of access to capital...' (Business Day, 11 August 2003: 2).

Up until 2002, the investment community has remained largely sceptical of listed black companies such as Nail, Real Africa Holdings, Johnnic and many others, arguing that they are merely pyramid holding companies adding little value to underlying companies and assets (BusinessMap, 2000 :11). This minimalist approach to BEE, as will be discussed later in this part of the paper, was largely regarded as a failure.

Black ownership seemed to be distributed to a small black elite and no true broad-based empowerment in terms of the definition described in the beginning of this paper had been achieved. No significant creation of entrepreneurship had taken place and neither had the broad-based objectives in terms of the interpretation of BEE for the purposes of this paper been achieved.

The biggest challenge facing BEE after the failures of the 1990s was for the financial services sector to regain faith and capacity to continue to support the funding of future BEE transactions since the BEE deals of the 1990s were characterized by the financial services sector being an active funder of most of these large transactions. Almost without exception, the black consortiums of this period, had little money to put on the table. Creative financial engineering by merchant bankers, lawyers and stockbrokers enabled a few black individuals to control significant assets with relatively little capital outlay (BusinessMap, 2000:11). The dilemma facing a lot of the banks is the high-risk nature of financing black empowerment deals. During the first wave of

empowerment in the 1990s, many of the companies had little or no track record, mainly because of the historical exclusion of blacks from the mainstream economy; neither did they have much by way of assets to secure advances (Vermeulen, A. 1996: 53).

These were some of the biggest problems with so-called BEE in the early 1990s. Deals were being financed through soft loans or shares sold at a discount, with very fluid payback criteria. Nail will be discussed in the next part of this section as a short case study of one of the examples of BEE that had failed during this period and the flawed financing structures surrounding the creation of this company.

This period of failure of BEE during the 1990s was described by a previous Nail director, Dikgang Moseneke, *'Nail and other "first generation empowerment companies" went to market amid huge expectations, "bought into big companies and paid the price for that.' The lessons of the past year, he says, left many new black entrepreneurs with a deeper understanding that it is important to start at the bottom, grow, and go to the markets when the business is ready to add genuine value'* (Janette Bennet reporting in the Sunday Times, Business Times, 30 January 2000:17).



iii) Summary of Factors Contributing to Failure of BEE

A range of factors have been identified which contributed to the failure of BEE during the 1990s. These factors can be summarized as follows.

Firstly, past failures prompted a review by government, with a new effort at innovation now underway (for example, vendor financing structures).²⁴ To improve on the sustainability and effectiveness of BEE transactions, companies are designing funding vehicles, which include vendor finance, own contribution, private equity, development finance from government and commercial loans (Black Economic Empowerment Commission Report, 2001:27). This paper will discuss some of these options in the form of a case study in Chapter 5. Black companies are becoming more

²⁴ BEE Commission 'An Intergrated National BEE Strategy', March 2001

active in their investments, focusing on fewer industries and building synergies across various acquisitions (BusinessMap, 2001:29).

The established companies are accepting that a sustainable BEE initiative includes addressing all areas of BEE, and most importantly facilitating the effective participation of the black firms in the investment (Financial Mail, 9 May 2003:33). Recent innovative transactions and funding structures of BEE firms and traditional South African companies reveal that more effective BEE transactions are emerging in line with the recommendations of government in its Draft Strategy as presented by Nedlac in September 2002. The key challenge that remains is whether these innovative funding structures will actually lead to more sustainable, broad-based form of BEE for South Africa over the longer term.

Secondly, the analysis also reveals that whilst both the public and private sector have implemented BEE in varying forms since 1994, it has not yet brought about the expected increase in black participation in the economy (Terreblanche, S.J. 2003:423).

This leads to the subject of this study which is to provide a critical assessment of the actual funding structures which are and will be put in place to facilitate the BEE objectives of government. For government to meet the targeted approach of the BEE Commission and related industry charters and government scorecards, it remains critical for effective and sustainable funding structures to be put in place so that the failures of the early 1990s do not repeat themselves (Department of Trade And Industry, A Strategy for Broad-Based Empowerment, 2003:9-10).

The key challenge as will be discussed in the next section of this paper would thus be for appropriate funding structures to be created for empowerment transactions in South Africa. The proposed BEE strategy of government would then have the ultimate effect of boosting the longer term economy as a whole, with the subsequent creation of greater black entrepreneurship (Leadership Magazine, May 2003:62).

Thirdly, the analysis provided regarding the failure of the BEE model in the 1990s, also highlights, of the biggest challenges confronting BEE going forward, which is

funding. Early on, the black listed companies (so-called 'black chip shares') used multi-pyramid structures with preference shares and loan capital to fund the BEE equity. The case study has used Nail as an example.

The most favoured funding structure of the early to late 1990s was the special purpose vehicle (SPV). Essentially this structure involved splitting the economic value between the financier and the BEE company with the BEE company getting voting control. In a bullish market (as was the case before the Asian crisis), as in South Africa until mid-1998, the SPV structure tended to offer a win-win situation for both the financier and the BEE company. However, the problem came when the markets turned bearish in 1998 and the dividends from the underlying investment became insufficient to cover the debt preference hurdle rate, and as a result the balance had to be rolled over and added to the loan capital of the SPV. In many instances, the result was that the BEE equity gained had been significantly diluted. There have been more failures than successes due to such funding structures.

The problems of these failures were exacerbated by the fact that many of the first-generation type of BEE companies of the 1990s were black controlled, but not black owned (Financial Mail Supplement, 06/2000). This SPV model, was therefore fundamentally flawed in meeting one of the key objectives of the BEE Commission's targets of ensuring a sustainable transformation of ownership of private enterprises.

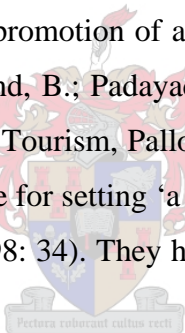
Fourthly, another key challenge which emerged after the failure of corporate BEE during the 1990s, was the limited participation of black companies (or their black executives) in key decision-making and in company operations (Brown, A. 2002:3).

In the past, BEE has not always been regarded as a value-adding activity given the failures of many BEE companies of the 1990s. This perception is a significant challenge facing BEE implementation. The crisis that had befallen numerous empowerment initiatives has resulted in intense scrutiny of the old empowerment approach and has led towards a new thinking on strategy and funding structures. It has also become apparent that for empowerment to succeed there must be a relatively high degree of involvement by the State, especially with regards to preferential access to public sector contracts, tenders and procurement (BusinessMap SA, 2001:33).

BEE is an evolving process, with different models of implementation – and thus necessarily uneven outcomes. For successful implementation of BEE, stakeholders (including South African companies and investors) must identify the shortcomings and appreciate the benefits (Brown, A. 2002: 4).

A lack of commitment to and understanding of BEE as described in the BEE Commissions' report will inhibit the country's ability to derive the best results possible. This has already contributed to the unsustainable nature of many of the BEE initiatives undertaken in the past. Companies have been driven simply by the need to get government business, and not by the objective of integrating BEE with the bottom-line beyond more immediate objectives (Edigheji, O.E. 1999: 14).

Fifthly, the biggest failure of BEE in the 1990s which is mirrored in so-called 'BEE companies' such as Nail, was the promotion of a new class of wealthy and powerful African movers and shakers (Freund, B.; Padayachee, V. 1998: 56). A leading ANC intellectual and former Minister of Tourism, Pallo Jordan, bestowed on this emerging black bourgeoisie as the prime hope for setting 'a new agenda for corporate social and civil responsibility' (Jordan, P. 1998: 34). They have therefore been labelled patriotic bourgeoisie.



In the words of Eskom chairman at the time, Mr Reuel Khoza, they must bring more than their 'blackness' to the table. And that means more skills and operational involvement which was not the case with Nail. The directors were not involved in the operational side of the underlying businesses such as Metropolitan Life, African Merchant Bank (Gqubule, D. 1999: 17). There was no element of entrepreneurship.

In conclusion, the BEE of the 1990s, has been described as the minimalist approach (Madi, P.M. 1997: 57; Edigheji, O.E. 1999: 5) which occurs every time a group of black persons acquire share certificates in previously white-owned companies or secures an equity stake in government-initiated businesses. In other words, the minimalist approach defines BEE in terms of share acquisitions by the black business

class in previously white-owned businesses.²⁵ Often, these transactions also take the form of ‘fronting’ where the ‘deals’ entered with government by black consortia, act as fronts for white foreign capital.

Strydom, M. (1997: 4) writing in the Star Business Report (10 October 1997) captured this as follows: *‘the white establishment uses black faces to gain access to the new government and often pays the blacks in the form of shares in their companies....so at the end of the day, it is a handful of black people that are being enriched.’*

According to the president at the time of the Micro Business Chamber, Lawrence Mavundla (cited in the Business Report, 6 November 1996:18), it is only about 300 people, who are already filthy rich that are benefiting from such deals. Consequently, he concluded that economic empowerment is a sham.

From a funding perspective, 99% of the economic interest would accrue to the financial institutions that provided the actual funding to start many of these businesses, with only around 1% of the economic interest accruing to the black shareholders (BusinessMap 1999: 11). Would it therefore be morally correct for such a group to be endowed with true empowerment credentials (and the benefits that accrue from them) when 99% of the economic benefits go back to the institutions? Is this, as discussed above, not just a sophisticated form of fronting, giving an appearance of black control to what is essentially a white company? The problem of BEE during the 1990s was also that empowerment companies were started in the form of mini-conglomerates. This was against the trend of many mainstream companies which unbundling their conglomerate structures at the time. However, the market was prepared to overlook the lack of focus and holding structures of many empowerment companies because they were perceived to bring something else (Gqubule, D. 1999: 17). It is for this reason that many of these BEE companies of the 1990s are being asked to clean up their equity structures (Ernest & Young: Review of Merger and Acquisition Activity, 1998).

²⁵ The minimalists do not take into account whether the black equity stake is in the minority or not. Thus companies where blacks acquire less than one percent shareholding have been labelled as BEE companies. Can this really be the case? The answer appears to be no if one accepts Friedmann’s definitions of empowerment (refer to the introductory section above).

iv) Nail as a Case Study

(iv)(a) Overview

As already mentioned, the 1990s were marked by the rise of a number of BEE initiatives, with the private sector leading the way through ownership strategies, small business support, employment equity and skills development. One of the primary business drivers of establishing closer links with Black leaders in business was Sankorp, the investment management company responsible for the strategic investments of Sanlam (Verhoef, G. 2002:2). Sankorp management realized that with the changing economic environment, that unless large numbers of blacks enter higher employment categories, the South African economy would be forced to a standstill as a result of a managerial shortage.²⁶

It was also acknowledged that there were certain major structural inequalities in the South African labour market: there was a low proportion of Black people in professional and semi-professional employment categories by 1985. Only 4.8% of black employees were employed as professionals or semi-professionals, while South Africa was experiencing a serious shortage of skilled labour.²⁷ While a strategy of negotiation had not yet been accepted by politicians, Sankorp decided early in 1987 to seek meaningful contact with Black business leaders (Sankorp Management, 18 August 1986).

The result was that Sankorp identified effective participation by blacks in the mainstream economy as an especially emotional area of frustration. Black people were frustrated by their limited access to effective economic power as owners and co-owners of factors of production ie land, capital entrepreneurship and natural resources. Anglo American repeated it's initiative of the sixties when in 1996 it unbundled one of its Mining Houses, JCI, for sale to a black controlled consortium. This was the second largest BEE deal of the early 1990s (Verhoef, G. 2002: 8).

²⁶Sankorp Management: Confidential. Preliminary Action Plan for Effective Linking with Black Leaders, 18 August 1986.

²⁷ Sankorp Management: Confidential Report, Blacks in the Market Place, 30 July 1986: 7.

(iv)(b) Background to the Establishment of Nail

It is worth giving specific attention to the case of Sankorp/Sanlam and the rise of Nail since Sanlam as one of the original bastions of Afrikaner empowerment was ironically the pioneer in South Africa in the early 1990s of so-called 'Black Economic Empowerment' characteristic of this period. This case study is also particularly relevant when looking at the provision of financing by one of the largest financial services institutions in South Africa at the time.

Sankorp argued that it could make a unique contribution to facilitate effective Black participation in the South African economy by forming alliances with black people. In the black community this strategy came to be referred to as 'Black Economic Empowerment.'²⁸ The business history of the mobilization of Afrikaner capital to establish Sanlam in 1918, provided the background to Sankorp's BEE initiatives. It took more than four decades for Afrikaner economic power to really manifest itself. It was generally accepted that the acquisition of General Mining had been a quantum leap in Afrikaner economic empowerment.²⁹ For BEE to succeed, it was similarly going to require a quantum leap.

During the transitional period, the first BEE transaction was when Sankorp in 1991 decided to initiate a deal using its life assurance company, Metropolitan Life (Metlife). Metlife was a suitable vehicle for the first BEE deal for Sanlam since by 1986, 50% of all new business of Metlife originated from black people and 30% from coloured people (BusinessMap, 1999: 12).

In 1993 the first BEE transaction in South Africa was announced when Sanlam sold 10% of its stake in Metropolitan Life to a black consortium called Methold. The new company obtained R135m financing from the IDC to buy the Metlife shares. The problem with this transaction arose when a pyramid of holding structures controlled by dr Nthato Motlana had mobilized Black capital: Corporate Africa Holdings was owned 55% by Motlana and Sons and 38% by various trusts representing prominent

²⁸ Sankorp Management: 1 April 1989: Confidential Report on Sankorp Social Involvement, pg 8.

²⁹ See G. Verhoef: 'The Development of Diversified Conglomerates: Federale Volksbeleggings – a case study', in Journal of Contemporary History, vol. No, 19.

black people (Cookson, M.J. 1999: 21). Methold also ended up exercising a call option to acquire another 20% of Sankorp's direct shareholding in Metlife. In July 1994 Methold's name was changed to New Africa Investments Limited (Nail) and was listed on the JSE in August of the same year. Part of the fundamental problem with the Nail financing model already revealed itself here when the Financial Mail at the time ironically enough commented on the 'beauty' of this transaction being that dr Motlana maintained control over Corporate Africa without having to put in more capital (Financial Mail, 22 July 1994: 11). This control structure which was exercised over Nail is illustrated in Appendix B.

(iv)(c) The Structural Financing Deficiencies of the Nail Model

After the establishment of Nail, the private sector began a sustained period of deal-making where at a point 'black chip' shares, as they were referred to, had increased from 0.3% of participation on the JSE to more than 10% from the period 1995-1998 (Financial Mail, 3/7/98:60). A meteoric growth in a short space of time. The problem was that the transactions which facilitated the rise of these so-called BEE companies at the time did not result in the 'controllers of a traditional enterprise who helped finance a new acquisition, to surrender control or ownership of that company' (Barr, Gerson, J. and Kantor, B. 1995: 66).

Financing generated to fund the purchase of a number of diverse listed operating companies from Sanlam by Nail was raised by established companies, share issues and debt instruments (BusinessMap, 2000:10). On the financing side of this particular deal at the time, it is important to note that it was Sankorp who facilitated the structured deal of access to finance, share transfers and direct control over a further 20% of Metlife via Nail (Verhoef, G. 2002:16).

Control of Nail had eventually been secured through a pyramid structure synonymous with many holding, conglomerate-type companies in South Africa at the time (Refer to Appendix B for a more detailed illustration).

The Nail experience also illustrates the lack of experience of many of the black directors on the operational and business side. For instance, one of Nail's subsidiaries,

Metlife, had a management team which consisted of six white men with the executive directors on the holding company level, dr Motlana, Sandler et al not involved in the operational business of Metlife (Verhoef, G. 2002:19).

Control structures also became increasingly distorted as the company's market capitalization grew. However, the issues which toppled market tolerance to Nail and ultimately the performance of the share price was related to corporate governance where a bid by the executive directors to exercise share options connected to one of the subsidiaries (African Merchant Bank), when these share options were actually intended for Nail shareholders rather than the directors (BusinessMap, 2000: 10).

The process of securing control of a company without owning a majority of the shareholding is done through a complicated web of holding companies and cross holdings, as was the case with Nail (BusinessMap, 1999: 17). Kantor (B, 1998:72) mentions that the mechanism used is to form a holding company whose assets consist of 50% or more holding in an operational company (Refer to Figure 3.3 below). Voting control of the subsidiary is sustained, provided the holding company's ownership exceeds 50% majority required, while the balance of the ownership in the subsidiary is sold off to investors to generate finance.

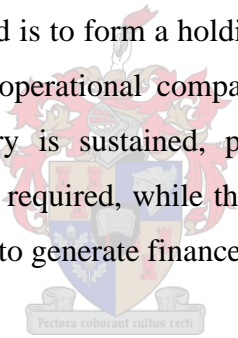
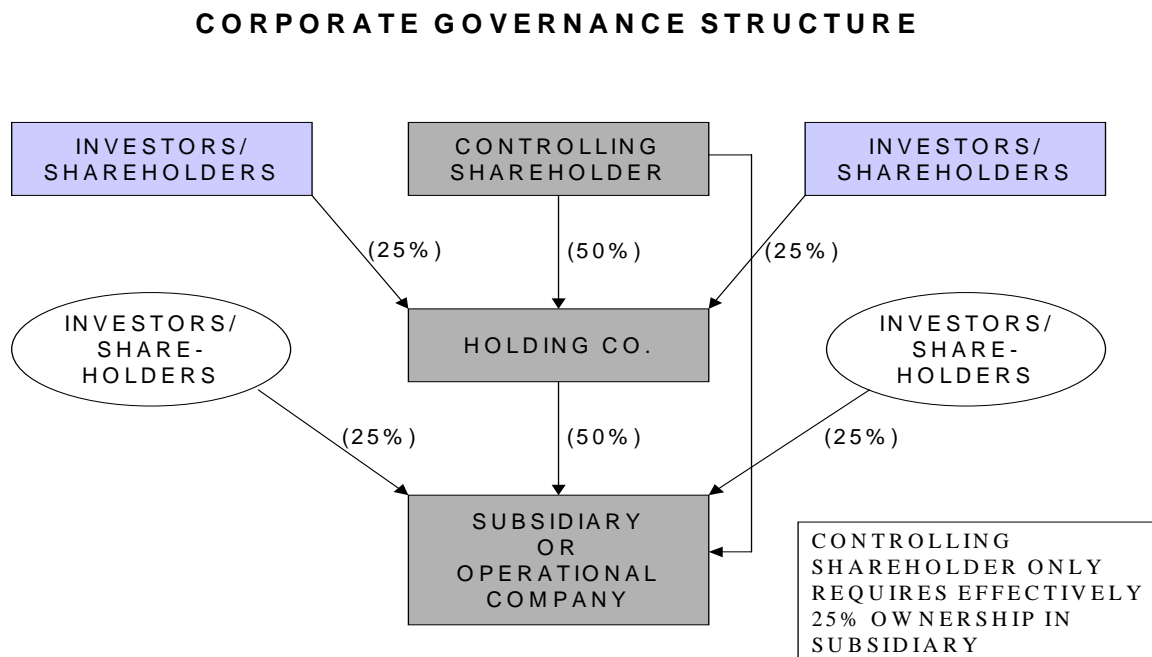


Figure 3.3



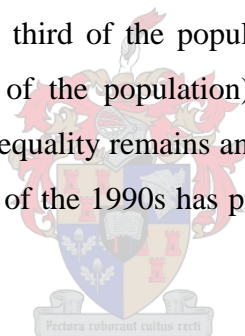
Source: Own Illustration

As holding company layers are increased within the pyramid structure, the ownership percentage in the operational company is reduced, but still the holding company maintains full control. Control should not be confused with ownership and despite BEE controlling about 6-10% of the JSE market capitalization, its ownership is far below this figure (BusinessMap, 2002: 46).

The problem at Nail, for instance, was that although the pyramid structure effectively gave the four directors control of 55% of the company, there was no real operational control over the underlying businesses (BusinessMap, 2000:24). The criticism as well was that this structure led to the enrichment of but a few prominent black directors, but not real empowerment since at operational level black people were not really involved in the running of the underlying businesses and neither were any skills being developed or entrepreneurs created by the black directors of Nail (Financial Mail, 4 June 1999:11).

The failure of Nail reflected one of the biggest disappointments for the effective development of BEE in South Africa in the early years of the new government, which was the restriction of empowerment to a privileged minority and in so doing it resulted in the neglect of more urgent matters such as more sustainable economic empowerment and upliftment of the poor (Terreblanche, S.J. 2003: 419).

Further criticism of the model of BEE financing provided during this period is that it had not generated any real 'trickle-down' effect to narrow the income gap and alleviate poverty. Although there has been a relatively large transfer of income through the national budget over the past eight years and also some transfer of ownership in the private sector, it has not been significant enough to really make a difference to the lives of the poor in South Africa (Terreblanche, S.J. 2003: 65). The resultant failures of the BEE models of the 1990s have also magnified the highly unequal distribution of socio-economic power, property, and opportunities between the upper class (comprising one third of the population) and the middle and lower classes (comprising 50 percent of the population). A new black elite has indeed emerged, but the huge income inequality remains and the efficient transfer and access to capital for the BEE structures of the 1990s has proven ineffective (Financial Mail, 4 June 1999:11).



A paper presented by African Merchant Bank (1998) mentions that a key issue which emerging empowerment groups need to deal with is funding, as in most instances the groups do not have sufficient financing of their own (BusinessMap, 1999:15). As a result, during the 1990s black groups sought funding to finance their transactions via SPV's. When funding transactions of this nature take place, control and economic value are separated through the SPV mechanism (BusinessMap, 1999:11). The empowerment group maintains organizational control, while the economic value of the company is split between the empowerment group and the financing institution. This is exactly the financing model chosen by Sankorp in the case of Nail where Sankorp made use of preference shares in providing finance to Nail (Refer to Appendix B).

The problem is that the risks associated with SPV funding structures are greater than mere investments in a listed share, due to the lack of liquidity within the structure, the longer investment term and the loss of voting control (BusinessMap, 1999:11).

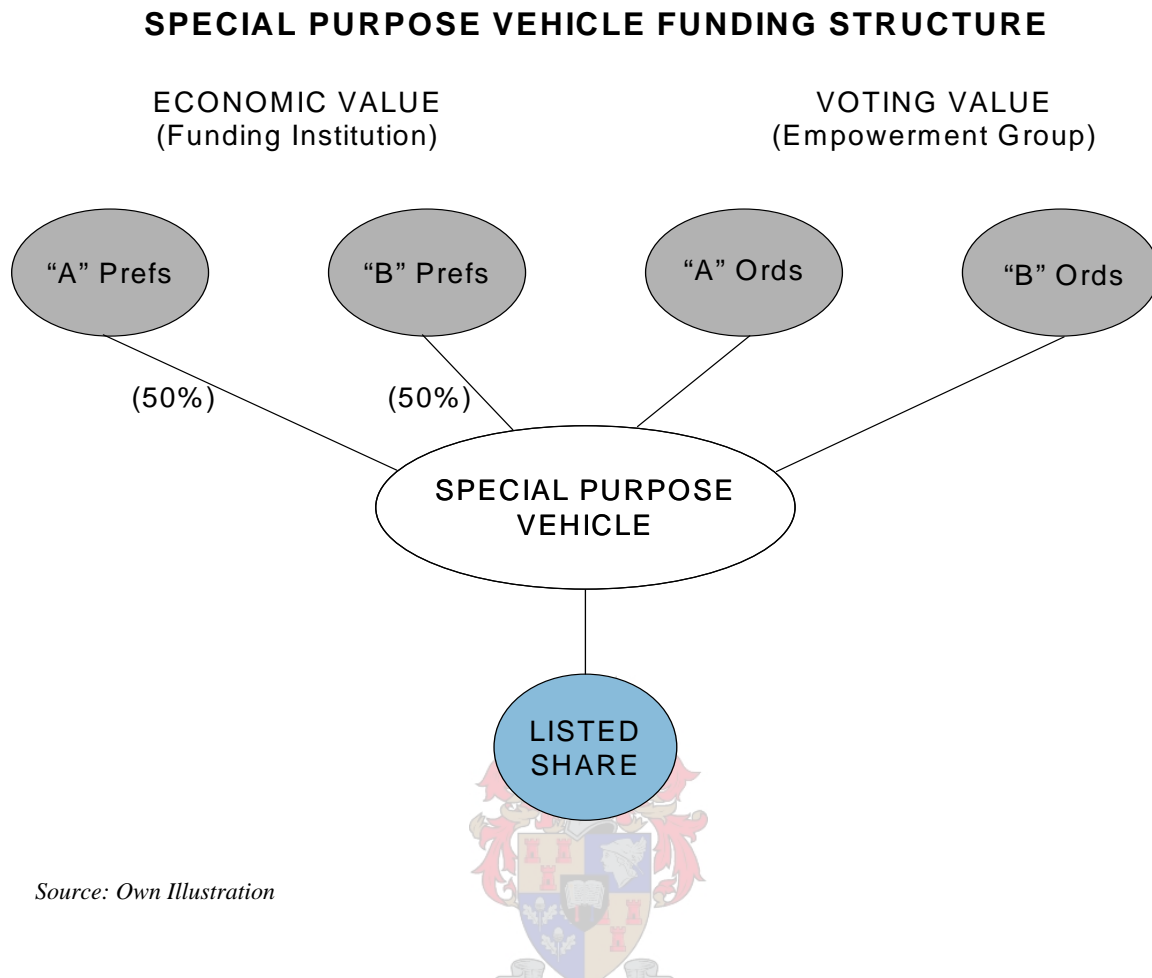
Further, black businesses established via the SPV structure, did not have to bear any of the risk (BusinessMap 1999:11). It was the financial institution which provided the finance and also bore the business risk. Some conclusions to be drawn from the 1990s, was therefore not access to finance for these BEE companies which were being formed, but rather the model of financing chosen was inadequate in providing a sustainable business model (BusinessMap, 1999:13).

This financing structure (the Special Purpose Vehicle-type of structure used) fuelled a high rate of acquisitions and dealmaking over this period, but with little attention of really adding value to investments or to create businesses for the long-term (BusinessMap 2000:9).

There is no doubt that the financing model at the time seemed acceptable given that black companies were given the opportunity to invest, without risking capital and with the promise of a return in three to five years. The fundamental problem with this model was revealed when the markets crashed in 1998 when the prospect of future returns which could have helped to build the capital base for black business, simply dissipated.

Figure 3.4 assists in the further explanation of the popular SPV funding mechanism at the time and the platform regarding control, ownership and returns.

Figure 3.4



What Figure 3.4 attempts to illustrate is the flawed mechanism of using preference shares as a debt instrument as in the case of Nail. Total funding is represented in the 'A' and 'B' Prefs, and are held solely by the financing institution, for example, Sankorp. The 'A' Prefs represent 50% of the funding and the remaining 50% are represented by the 'B' Prefs. The returns to the funding institution are derived from the 'A' and 'B' Prefs. Returns on the 'A' Prefs are the same as the returns on the listed shares of the BEE company, for example Nail which is listed on the Johannesburg Stock Exchange. But the returns on the 'B' Prefs are 10% real and payable at the end of five years. The funding institution requires collateral in the form of 30% of the listed shares for the 'A' Prefs, and 70% of the listed shares for the 'B' Prefs (Refer to Appendix B for further details of the Nail funding mechanism and also an illustration of the actual pyramid structure which Nail used).

The explanation of how this funding mechanism works, therefore also illustrates that the financing institution ie a bank or life assurer sacrifices a portion of the upside return on the investment and bears the full downside risk should the investment deteriorate. It is exactly this component of the funding mechanism that ended up creating huge problems when the markets turned in South Africa with the Asian crisis in 1998 and most of the BEE listed investment lost massive amounts of value. The financing institutions ended up bearing most of the losses (BusinessMap, 1999:12).

In summary, the Special Purpose Vehicle model had certain fundamental disadvantages which had a major impact on the future of the financing of BEE (BusinessMap, 1999:16). These key disadvantages can be summarized as follows:

- The funding structures are reliant on a bull stock market
- Due to virtually no risk on the part of the empowerment group, there is little incentive for them to take responsibility if circumstances turn against them.
- A lack of flexibility and liquidity associated with the SPV structures. Preference shares are not easily traded as they form part of a contractual agreement with at least a three year 'lock-in' period.
- Cession of voting rights. As in the case of Nail where preference shares were used which did not carry any voting rights and the financial institution had no influence on strategic decisions.

If the empowerment group believes that they have reached their target in terms of performance and no longer require funding, they are still bound to the funding structures.

The question today is how to ensure that the negative consequences of SPVs, or related types of financial engineering do not perpetuate in the 'second wave of BEE' post 1999. This particular matter will be discussed in Chapter Four of this paper which looks at funding options and possible solutions.

g) An International Perspective on Empowerment

The purpose of this section is to provide an international perspective on the matter of empowerment and the funding thereof and thereafter to draw some similarities and differences to the current South African experience.

(i) Malaysia and the East Asian Countries

The Black Economic Empowerment program as currently proposed by the South African government has a remarkable precedent in the New Economic Policy (NEP) that was introduced in Malaysia in 1970. Faaland, J. et al (1990: 30) states that, 'After 1970, the state, led by a younger generation of Malay leaders, took a highly interventionist role in the economy under the banner of the New Economic Policy. This policy was introduced to accelerate the transfer of wealth to Malays, and to prevent the erosion of their already established political position.'

Faaland, J. et al's (1990:30) further comments bear striking semblance to the current South African position, 'Targets were set so that by 1990 Malay corporate ownership would be 30 percent, non-Malay 40 percent and foreign 30 percent (in contrast to 2 percent, 38 percent and 60 percent respectively in 1970).'

The outcome of this targeted approach aimed at transforming the Malaysian economic landscape was the creation of a Malay bourgeoisie rather than the facilitation of the economic empowerment of all Malays. Income disparities are now greater within the Malay community than within any other ethnic group (Klitgaard, B. 1991: 32). As in South Africa, rich blacks have become richer and the poor are becoming poorer every day.

Table 3.1 compares some of the main elements of the South African and Malay policies.

Table 3.1 Comparison of Malaysia's NEP and South Africa's BEE³⁰**Table 1: Comparison of Malaysia's NEP and South Africa's BEE**

	Malaysia's NEP	South Africa's BEE
Background to development	Arose out of ethnic riots and social instability in 1969	Original ANC policy after disbandment. New focus seen as necessary to prevent social instability as seen in Zimbabwe
Key objective	Poverty eradication	Reducing income inequalities
Key elements	Affirmative action in employment and transferral of ownership	Affirmative action in employment, skills development, procurement and transferral in ownership
Equity ownership targets	30%	Ownership targets will be set on an industry basis. Current targets include 25% of mineral fuels and 26% of mining
Timeframe of targets	20 years	5-10 years

Source: Malaysia's Political Economy, Mining charter

Both the objectives and the main key elements of implementations appear broadly similar. For example, although South Africa has been characterized by social stability relative to the pre-1994 period, investors have historically expressed their doubts regarding the sustainability of this in light of the economic realities of the country. Population and income statistics also appear relatively similar. For instance, of a total population of some 22 million people, the Bumiputra constitute 57.6%, Chinese 25.6%, Indians 10.0% and non-citizens 6.3%. Yet some 65% of Bumiputra households lived in poverty, versus 39% of Indian households and only 26% of Chinese households (BusinessMap, 2001: 11).

There are, however, also differences between the two programmes. For example, while the key elements of Malaysia's NEP involved employment and ownership targets, the South African BEE program seems to be more holistic in its definition of employment equity, with skills development and transfer seen as part of the process (UBS Warburg Securities, November 2002: 3).

Another major difference from South Africa is that the NEP flowed from a national ideology which was adopted after the 1969 riots and contained a comprehensive programme of socially bargained, government led initiatives with specific targets for lessening racial inequality (BusinessMap, 2000: 42). In contrast, South Africa's BEE programme is a collection of initiatives developed separately by the private sector and various arms of government such as the Department of Trade and Industry. Another major difference is that the NEP took off in a high growth environment where Malaysia's GDP surged an average 7.3% per year between 1970-1995, largely due to

³⁰ This table was sourced from UBS Warburg Securities, November 2002: 3.

a domestic savings rate more than double South Africa's today (BusinessMap, 2000: 41). Although government, now in its broad-based definition of BEE acknowledges that it won't succeed without strong macro-economic growth, the savings rate in South Africa remains a major obstacle.

In Malaysia's case, Bumiputra (indigenous Malay people) ownership in the economy was estimated at 1.5% at the time of the introduction of the NEP in 1970. Despite rapid progress, a level of only 20% was achieved over the original timeframe of the policy. What is interesting to note was that the target of 30% was only achieved 28 years later after the introduction of the NEP (BusinessMap, 2000: 42). Although the starting level in South Africa is slightly higher and the target is somewhat lower than in the case of Malaysia, the timeframe over which these targets must be attained is significantly shorter, suggesting it may be an onerous target to achieve in the time envisaged (UBS Warburg Securities, 27 November 2002: 4).

Purely measured on the level of poverty reduction and ownership levels of the economy, the objectives of the NEP were achieved in Malaysia. We have already highlighted the evolution of Bumiputra ownership, while poverty levels fell from 49% when the NEP was introduced to 15% in 1989. Finally, Malaysia's strong economic growth rate suggests a general positive impact from the NEP implementation. (BusinessMap, 2000: 42).

However, like some observers such as Adam and Cavendish (1994) and Yoshihara (1998) have suggested that the implementation of the NEP actually hindered economic growth, notwithstanding the fact that Malaysia experienced rapid growth over this period. Some of the lessons to be learnt from the Malaysian experience was that while the NEP succeeded in creating a middle class in Malaysia it failed to create an entrepreneurial class (UBS Warburg Securities, 27 November 2002: 4). Wealth accumulation by Malaysians was rarely of a long-term nature with many Malays becoming passive investors cashing in on equity rights of government contracts. Further, as a result of the majority of university places being reserved for Bumiputras, the Chinese part of the population was increasingly forced to pursue their tertiary education outside of Malaysia with most of them never returning to take up productive positions in the Malaysian economy.

On the funding side, the experiences of Malaysia and some of the East Asian countries can also be valuable lessons for South Africa. For example, the Industrial Development Corporation has a generic approach in its programmes to promote black business (Edigheji, O.E. 1999: 15). Consequently, the state does not privilege a particular type of manufacturing nor has it created a focal point for the black business community. What this shows is that unlike some of the east Asian examples, South Africa's state intervention is neither selective nor targeted. It is hoped that the recent drafting of the Mining Charter, Petroleum & Liquid Fuels Charter, Financial Services Charter and a few others will be a step in this direction.

This generic approach to the funding for BEE in South Africa could perhaps be explained by the absence of coherent and effective industrial policy in the post-apartheid period (Fine, B. 1997:12), as well as the absence of an overall economic planning agency (Edigheji, O.E. 1999: 15). Since these factors proved to be crucial for the successful industrial and economic transformation of Korea, Taiwan and to a large extent, Malaysia (Wade, R. 1990; Evans, P. 1995; Campos, J.E. and Root, H.L. 1996). The Reconstruction and Development Programme (RDP) office could have played the role of super ministry where it's role would have been to create a unified economic vision and mobilize society around it. Unfortunately, it was given low status, headed by a junior minister and was subsequently closed down (Michie, J. and Padayachee. V., 1997:111).

However, there has been some recent criticism of the South African government's reliance on the Malaysian transformation model. The President's brother, Moeletsi Mbeki had the following to say, *'It is important for the government not to link the Malays with us. During the colonial era they collaborated with the British colonialists against the liberation movement in Malaysia made up largely of the Chinese, who are the main owners of business there'* (Cape Times, 5 September 2003: 6).

In conclusion, the most valuable lesson to be learnt from the Malaysian example is that in Malaysia the perceived negative effect on investment stemmed primarily from the cronyism that the NEP fostered (UBS Warburg Securities, 27 November 2002: 4). In effect, this boiled down to the enrichment of a few and not a wide scale benefit to

the masses. This experience in Malaysia has striking similarities to the early BEE model. There are indeed some among the South African black business community that would argue empowerment has led to the creation of a new rich entrepreneurial black class. This remains a risky option and there has been subsequent evidence in the last year or so that government has shifted the focus of BEE to encompass a broader view of its impact. This broader approach should hopefully assist in encouraging a deeper and more sustainable form of empowerment for South Africa.

(ii) United States

In the United States in the early 1970s, post the height of the Civil Rights movement, there was a conscious decision by President Richard Nixon and his administration to create a class of 'black capitalists', who could form a part of mainstream American capitalism (BusinessMap, 2000: 41). The stage had been set in 1964, with the passage of the Civil Rights Act, which enacted anti-discrimination legislation giving black people legal recourse in the event of racial discrimination. Special government structures were also set-up to facilitate black business development through the delivery of loans, grants and technical assistance to black entrepreneurs. At all levels of government procurement policies granted special preferences to black-owned businesses. This is very much in line with government's current procurement approach in South Africa (BusinessMap, 2000: 41).

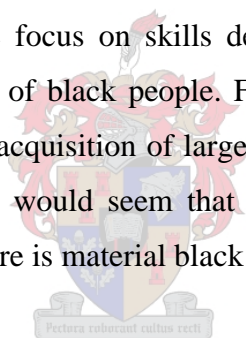
While such schemes were not without flaws, the US efforts as a whole had a material effect. During the 20 year period between 1972 and 1992, black owned businesses in the US grew from approximately 188 000 to 621 000. Of course the situation in the United States was significantly different from the current South African situation. First, like the Afrikaner example, US empowerment initiatives were focused on a minority rather than a majority. Secondly, the US was much richer so the fiscal resources of the state, were much greater in providing the assistance and support for the growth of black business. Thirdly, the US had a number of good black universities, producing a well-educated black managerial and entrepreneurial class (BusinessMap, 2000: 41).

It appears that still today, some 30 years after these various initiatives were put in place, the economic position of black people relative to white people in the United States remains unequal. This suggests that other measures are also needed to ensure that empowerment makes proper progress (BusinessMap, 2001: 45).

In summary some of the key lessons to be learnt from the Malaysian and US experiences are as follows (BusinessMap, 2000: 42). Time is needed for empowerment to succeed. For example, the empowerment of black people in the United States, the Afrikaner in post-war South Africa and the Bumiputra in Malaysia took at least two decades.

Further, education remains critical. South Africa today spends around 8% of GDP on education which is much more than the United States in the 1970s.

Another important lesson is the focus on skills development rather than the mere transfer of assets into the hands of black people. For example, the early 1990 BEE deals were characterized by the acquisition of large-scale assets by black owners via complex financing structures. It would seem that far more meaningful and broad-based BEE will be possible if there is material black operational involvement.



Lastly, economic growth remains a top priority since real empowerment in other countries has only taken place in an environment of strong economic growth. A recent speech made by our President Thabo Mbeki, reveals this as well, *'Economic growth, development and black economic empowerment are complimentary and related processes.'* (State of the Nation Address, Parliament, 14 February 2003: 11).

The GEAR strategy of 1996 has been criticized by some as not being able to allow for a 'trickle down' effect of an environment of high economic growth in resolving the above question (Terreblanche, S.J. 2003: 435). The inequalities not only of income, but also access to finance and job creation might not be solved via the growth priority of government. Perhaps focused programmes such as that of government's recent BEE strategy and industry charters for instance, might enable greater success of the so-called 'trickle-down' effect.

h) Conclusion

This chapter has provided a historical overview of access to funding for black South Africans during the past 150 years or more. Significant obstacles accessing financing have been identified as a problem in the development of broad-based involvement of blacks in the South African economy. The early years of BEE have also been analysed and the reasons for the failure of BEE during the early years of the ANC government coming into power have also been highlighted. Nail has been used as a case study in identifying the financing problems of the narrow approach to BEE as interpreted earlier in this study. Therefore, a great deal of criticism has subsequently been given to this minimalist approach to BEE since rather than seeking to fundamentally transform the corporate structure of South Africa, the emerging black business class have become comfortable with the status quo as long as transfer of assets and the level of deal-making has created BEE in their eyes.

As Simon Segal (1998: 66) rightly observed, most of the black operating companies of the 1990s cannot stand on their own and their contribution to job creation and skills development remains severely limited. Not only are the management and operational sides of these companies still under white control but these deals are being financed by white South African capital or foreign banks. A few examples illustrate this point. The Sunday Business Times (22 August 1999) reports that none of the directors of Wiphold Financial Services, for instance, that is being set-up by the company Women Investment Portfolio Holdings³¹ is black. They are all white males. In a similar report, the Financial Mail (20 August 1999) notes that the majority of the executive directors of two leading BEE companies, namely, African Life and Metropolitan Life are all white males. Blacks are relegated to token positions of non-executive directors.³² This approach to BEE therefore reinforces white control over the economy and provides marginal access to a few blacks into the ownership structure sector. In a telling conclusion, Segal notes, *'black economic empowerment is evolving into something that is not black, economic or empowering, but rather white, political and enriching.*

³¹ Wiphold is a black empowerment company led by women

³² Indeed, most of the so-called BEE companies of the 1990s were initiated by white consultants and investment bankers. They also end up constituting the management.

It has also failed to change racial mindsets, is vulnerable to JSE's performance...' (Segal, S. 1998: 66).

The result has been that the emerging black business class has depended on share acquisition through which it has become exposed to the global economy, which was subject to the volatility of the global financial economy. With the 1998 Asian financial crisis, BEE companies such as Nail lost over half of their share capital. Coupled with increased interest rates at the time, these firms ended up with repayment of loans via their SPV structures which were impossible (BusinessMap, 1999: 12).

A minimalist approach to BEE promotes the empowerment of a few black individuals and the disempowerment of the vast majority of the black population. This has resulted in the increased polarization of the black community, that has widened the gap between the rich and the poor within the broader population of South Africa. As Herman Giliommee noted, *'A huge gap has opened up between the top quintile of the blacks and the lowest two. There's a 60 times differential between the top 10% of blacks and the poorest 10%'* (Financial Mail, 29 November 1996: 6).

The risk to this minimalist approach as far as government goes, is that it leads to a state which is broadly supportive of the emerging black bourgeoisie but not overly proactive in the empowerment of the majority of the black population. Other critics such as Mbigi (L. 1996) correctly summarise the failure of BEE as both tragic and naïve and he consequently calls on 'black business people, professionals and managers to avoid this elite isolation and alienation' (Business Day, 28 November 1996: 13).

It can therefore be concluded, that the majority of the black population does not seem to have benefited from the early years of BEE in terms of improvement of their living conditions, through for example, job creation. In 1997, the Central Statistical Service reported that between December 1994 and March 1997, no new jobs had been created in the South African economy. Indeed, a total of 152 096 jobs have been lost in almost the same period, and by mid 1999, the figure of job losses was in the region of 500 000. In other words, whilst black equity participation is increasing and a few

black individuals enriched themselves, the number of unemployed has been increasing (Terreblanche, S.J. 2003: 35).

The early experiences of BEE in South Africa can indeed be regarded as a reflection of the minimalist approach to BEE. It therefore failed to meet the broader-based definition with entrepreneurship as a key focus. Cyril Ramaphosa, a major beneficiary of BEE during this period ironically concurs with the failure of BEE during the 1990s when he says, *'To define black economic empowerment only by the transfer of share ownership is short-sighted and skews the central thesis of South Africa's transformation'* (cited in Turok, B. 1999: 119).

This chapter has also made reference to some international perspectives on empowerment with particular reference to Malaysia, and the United States. These experiences have provided some useful comparatives and valuable lessons for the current development of BEE.



4) Chapter Four: Size of the Funding Requirement and Sources of Funding

a) Introduction

This chapter will provide various estimates of the current size of funding needed to meet empowerment targets over the next ten years in South Africa. The practical aspect of meeting these targets and their likely influence on the South African economy will also be discussed. The various potential sources of funding will then be considered given that these private and public sector institutions will have a major role to play in the provision of funding over the next few years. The capacity of these institutions to provide funding and their current shortcomings in meeting these funding requirements as proposed by the BEE sector charters will also be discussed. Certain conclusions will also be drawn.

b) Estimated Size of the Funding Requirement

Government has become a major role player in providing funding for BEE over the past few years, most notably from institutions such as the Industrial Development Corporation (IDC). Government has also begun to review the capacity of other institutions which it has classified as Development Finance Institutions (DFI's) (such as the National Empowerment Fund, Khula Enterprise Finance, the IDC, the Development Bank of South Africa, Post Bank, the PIC, the Umsobomvu Fund)³³, with a view towards enhancing their impact on BEE (Business Day, 14 August 2003: 1). These agencies as well as the financial services sector are likely to be critical sources of funding for BEE and for ensuring access to finance by small and medium-sized enterprises (Business Day, 10 April 2003: 5). The Financial Sector Charter (17 October 2003: 10) has also highlighted the critical role that DFI's are likely to play in mobilizing resources for empowerment financing over the next ten years.

In terms of the financing requirements of BEE charters and foreseeable BEE ownership initiatives, no quantified values have yet been arrived at. There is funding for BEE from government and private sector resources – the challenge is how best to

³³ These types of institutions are termed DFIs or Development Finance Institutions.

package and structure it. Some more recent examples of BEE transactions discussed in Chapter Five of this study will look at some of the funding options that are already being used in recent BEE initiatives post the failures of the 1990s as discussed previously. Appendix E also provides illustrative examples of the funding structures currently used.

Finance and funding structures have been a major area of review over the past few years, with previous funding structures seen as a source of failure of many of the BEE initiatives. However, the focus in BEE transactions has already shifted to a more innovative approach. South Africa has a globally recognized, sophisticated financial services sector built on the back of the mining sector and consolidated during the period of international isolation because of Apartheid policies. Financial institutions have begun to drive novel ways of funding BEE deals, new structures are emerging, and the sector has very recently finalized its own charter, which can be expected to address BEE funding streams and the implementation thereof (Financial Services Charter, 17 October 2003: 10).

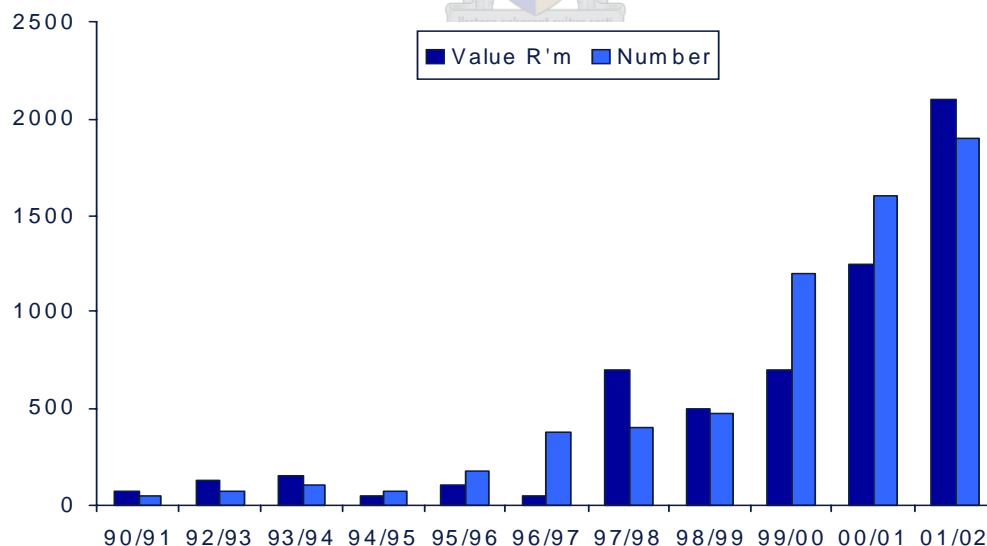
The emphasis is on structuring transactions in a manner that is affordable for all parties involved and enhances the ability of the BEE firm to meet the requirements as specified in the various charters. In the absence of good performance, pure debt-based funding will certainly result in dilution when capital is repaid (this was the case with the SPV-type of structures of the first wave of BEE in the 1990s). Hence the need to promote value addition and accelerated growth for the company as a whole (BusinessMap, 2001: 27). In line with this, ownership is combined with increasing levels of black influence, so that black shareholders, executives and senior management exercise greater influence over strategic financial decisions of the company (some examples of instances such as this will be discussed in Chapter Five, but Investec's recent empowerment deal is a case in point).

The role of institutional investors, estimated to hold a quarter of local shares, would be central role players in considering possible sources of financing. The Public Investment Commissioner (PIC), for example, which manages the government pension fund, owns around 5% of the JSE. The PIC is likely to become an important financier of many BEE deals (Financial Mail, 30 May 2003: 4).

There are currently various forms of other BEE funding such as vendor finance (off the balance sheet) and usually performance-linked, development finance from government institutions such as the IDC and then debt or equity finance from the commercial sector. With government's intention to restructure some of the parastatal-type of institutions such as Khula, the National Empowerment Fund (NEF) as well as The Development Bank of South Africa (DBSA), they are also likely go become valuable sources of BEE funding (BEE Commission, 2001: 5).

It is interesting to note from Figure 4.1, the increase in financing by the IDC towards BEE since 2000. In the last two years, in particular, there has been significant improvement and the allocation is likely to increase further as BEE unfolds (IDC Annual Reports, 2002). The National Empowerment Fund (NEF) has also launched a R200 million venture capital fund, and if we consider the shareholdings set aside for it by government state enterprises, it is estimated to hold between R10 billion to R20 billion worth of assets (UBS Warburg, November 2002: 11).

Figure 4.1 IDC's BEE Funding Performance Over the Past 12 Years



Source: IDC Annual Reports 2002

Another initiative that gives an indication of government's commitment to concessional BEE funding is the Risk Capital Facility (European Union, European Investment Bank and the IDC). This facility has an allocation of 50 million Euros and is aimed at acquiring equity in empowerment initiatives that meet more stringent BEE criteria (UBS Warburg, November 2002: 11).

Some of the current BEE charters – mining and petroleum & liquid fuels – provide for ownership targets of 26% and 25% respectively (Mining Charter, Act No. 28, 2002; Petroleum and Liquid Fuels Charter, November 2000). In the case of the mining industry, the charter also indicates that R100 billion worth of assets would be transferred over a five-year period and that it would represent 15% of the assets in the industry. These targets are likely to have a significant impact on the potential funding requirement and will lead to an increase in funding transactions in these particular sectors over the next few years.

In a research paper recently submitted by UBS Warburg Securities (November 2002: 11), it is estimated that the total funding requirement in the light of the above charters and the additional R100 billion highlighted in the mining charter, to be around R240 billion. Table 4.1 illustrates this estimated outcome more clearly. The table highlights the calculation of the non-mining domestic market capitalization of the JSE. Assuming an average of 25% BEE ownership target for this component of the market would then imply around a R140 billion funding requirement. Therefore, in conjunction with the R100 billion highlighted in the mining charter, the total funding requirement can be estimated at R240 billion.

The above estimate is however an understatement since there are large parts of the economy which are not listed. These mostly include areas where the parastatals are involved.

Table 4.1 Estimating domestic non-mining component of the JSE

Table 3: Estimating domestic non-mining component of the JSE market capitalisation

	R billion
JSE market capitalisation	1290
Less: Mining	533
Less: International stocks	141
Less: 50% of non-mining dual listed stocks	56
Non-mining domestic component of market	560
Assume 25% average BEE ownership target	140

Source: INET

**This data was obtained by a financial system called INET Bridge and was also published in UBS Warburg Document, 27 November 2002: 11*

A second approach would be to utilize national accounts data to arrive at an overall funding requirement for BEE ownership (UBS Warburg Securities, 27 November 2002: 12).

Table 4.2 uses the gross operating surplus in the economy as a starting point. By subtracting proxies for tax, depreciation and interest, we can derive an economy wide estimate of net earnings. Putting this net earnings estimate on an 8.8 times multiple (on the basis of a 20% liquidity discount to the JSE) would yield a proxy market capitalization for the economy of R1.6 trillion. Again, assuming an average 25% target for BEE ownership, this would then yield a R400 billion funding requirement.

Table 4.2: Estimating BEE funding requirement

Table 4: Estimating economy wide BEE funding requirement (1)

	R billion
Economy gross operating surplus	412
Less: tax charge (2)	62
Less: interest charge (3)	39
Less: depreciation	129
Economy net earnings	182
Implied economy "market capitalisation" using 8.8x PE (4)	1603
Assume average 25% BEE target	401

Source: SARB, UBS Warburg estimates

(1) Based on national accounts data for end of 2001

(2) Using 15% tax rate to gross earnings as implied by national accounts consolidated corporate income statement

(3) 13% interest rate on aggregate domestic corporate debt

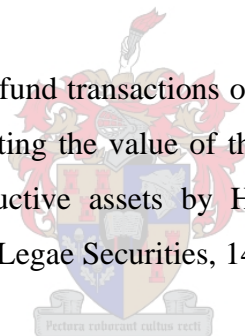
(4) A c20% liquidity discount on the current JSE PE of 11x

The two approaches above suggest a range for the potential BEE ownership funding requirement of R240 billion – R400 billion. This translates roughly into 25% - 40% of

GDP in 2002. It should be noted that such calculations are heavily dependent on assumptions made and could be subject to margin of error. For instance, it is possible that the 25% ownership target will not proceed very rapidly beyond the petroleum, liquid fuels, mining, technology, financials and tourism industries, due to the fact that government does not have significant leverage beyond these industries. Under such a scenario, the funding requirements would be below the range mentioned previously of R240 billion – R400 billion estimate used in this study.

The Oppenheimer Family have also recently launched the Brenthurst Initiative which encompasses the family's plan to transform the economy and highlights the challenges for empowerment funding (Sunday Independent, Business Report, 10 August 2003). This Initiative estimates that the required level of funding to achieve 26% black ownership in publicly quoted mining companies is over R220 billion (Brenthurst Initiative, 5 August 2003: 26).

In the case of mining, capital to fund transactions over a 10-year period, will have to be raised in an amount representing the value of the transactions necessary to bring about 26% ownership of productive assets by Historically Disadvantaged South Africans (HDSA's) in that time (Legae Securities, 14 July 2003: 10).



The overall cost of doing such transactions is roughly R150 billion at current valuations. The mining industry has committed itself to raising R100 billion of this figure, much of which will be sourced from the private sector and merely guaranteed by the companies. Miners are not about to become empowerment banks (Legae Securities, 14 July 2003: 10).

The Financial Services Charter has also been finalized and it has prescribed a 10% direct ownership target and a 15% indirect ownership target. Therefore, over and above the estimated funding requirements for the mining and petroleum and liquid fuels charters, there is also going to be a BEE funding requirement once the financial services charter is released. Table 4.3 provides a summary of the existing BEE ownership within the financial services sector, as well as the required funding to facilitate the transfer of equity ownership to HDSA shareholders. The analysis provides three ownership scenarios since this sensitivity analysis was done prior to the

Financial Services Charter being released, but remains useful in assessing the potential funding impact of the Charter.

Table 4.3 Required BEE Funding for the Financial Services Sector³⁴

Table 1: BEE Ownership	Banking	Insurance and Life Assurance	Other Financial Services	Total
Market Capitalisation	145,677	105,221	16,365	267,264
Current Shareholding				
Direct Shareholding	0.0%	0.0%	5.6%	0.3%
Indirect Shareholding	14.0%	8.86%	13.5%	12.2%
Direct BEE Holding (Rm)	0.0	0.0	920.0	920.0
Indirect BEE Holding (Rm)	20,339.0	10,881.9	1,281.9	32,502.8
Total Current BEE Holdings	20,339.0	10,881.9	2,201.9	33,422.8
Proposed Target 1	9115.0	11800.5	1595.2	22510.7
20% BEE Shareholding (Direct and Indirect)	9115.0	11800.5	1595.2	22510.7
Proposed Target 2	17856.3	17052.6	2308.6	37217.5
8.33% Direct BEE Shareholding	12139.3	8493.8	1001.3	21634.4
16.66% Indirect BEE Shareholding	5717.0	8558.8	1307.3	15583.1
Proposed Target 3	36419.4	26031.1	3272.4	65722.9
25% Direct BEE Shareholding	36419.4	26031.1	3272.4	65722.9

Source: Empowerdex, 10 July 2003: 6

The analysis in Table 4.3 shows that the required BEE funding for the financial services sector is estimated at between R22.5 billion to R65.7 billion over the next five to ten years depending on the final target set by the charter. As an indication of the quantum of the capital inflow required, R65 billion is sufficient to acquire an entity whose size is equivalent to the combined size of Old Mutual and Sanlam. From Table 4.3, it appears that Proposed Target 2 is very close to the targets that have been finalized in the Charter. Therefore, based on this analysis, it can be concluded that the financial services sector will require around R37 – R40 billion of funding to meet its direct and indirect ownership targets. Over and above this, the Financial Services Charter also states that it will be responsible for providing empowerment financing of more than R75 billion (Financial Services Charter, 17 October 2003: 10).

³⁴ All amounts reflected in this table are in rand billions.

Due to the significant size of the funding requirement and the insufficient capital base of most BEE investors, the market can expect various innovative financing structures developed to facilitate the transfer of ownership. The use of the various sources of funding to fund these transactions will also be interesting.

What these funding estimates do highlight is the important role which the funding issue is likely to play as BEE unfolds in ensuring that the targets of the various sectoral BEE charters are indeed met.

c) Sources of Funding for BEE

The potential sources of funding of Black Economic Empowerment transactions needs to be discussed since the funding of these projects will ultimately be facilitated by a number of public and private sources of funding. For the current empowerment ownership targets to be fulfilled, funding requirements are going to be extremely demanding on the existing institutional sources of funding in South Africa.

Therefore, there are considerable doubts concerning the capacity of private lenders to fund the necessary transactions required to meet empowerment Charter and non-Charter requirements. It does not seem alarmist to talk of an empowerment funding crisis (Legae Securities, 14 July 2003: 10).

Some of it will have to be raised through equity or the inevitable subsidising of assets. Even if the various BEE groups manage to raise some financing, they will still be dependent on receiving funding from government or traditional financial institutions given the extremely high ownership targets prescribed by the sector charters. Some innovative avenues of more targeted funding are being explored such as:

- Existing private equity and other initiatives like the New Africa Mining Fund, which amount to no more than R2 billion.
- Government has set aside R10 billion via the National Empowerment Fund (NEF), some of which will go to support smaller mining transactions

- The Industrial Development Corporation (IDC) has an asset base of around R28 billion and over a ten year period will contribute substantially.
- The Development Bank of Southern Africa (DBSA) could also be a possible participant.
- The traditional banking sector providing more financing to the broader population than in the past
- The use of the Public Investment Commissioners (PIC) as a source of funding

All the above speculation is still moot, but it can be said that an additional estimated amount of about R100 billion will have to be sourced and there are no other sources left other than private lenders and overseas investors. This figure only represents an amount needed to meet the ownership criteria in mining. This estimated requirement for funding in the mining sector will have to be repeated in respect of petroleum and liquid fuels where 25% ownership by HDSA's is also required in every segment of the industry value chain (Legae Securities, 14 July 2003: 11). A number of transactions have been completed which have contributed to improvements in meeting these criteria such as the cases of Total, Caltex and BP. However, it is at the current government asset level of Sasol, Petronet and PetroSA where the biggest deals still need to be undertaken. Sasol, for instance, is planning to do an empowerment deal in its liquid fuels business (Legae Securities, 14 July 2003: 12).

However, in other sectors funding pressures remain. Even if the ownership criteria is increased in financial services, for example, sector companies will still have to demonstrate that they have a significant portion of their assets under HDSA management.

Alec Erwin, Minister of Trade and Industry, recently commented during a debate in the National Assembly which had been dominated by concerns about the availability of financing to small and medium-sized black businesses. He said the broad-based policy on BEE had identified various sources of finance open to empowerment firms ranging from the IDC to the private sector and that, 'The amount of resources available potentially for empowerment is adequate' (Business Day, 15 April 2003: 5). This comment remains open to question. Currently, the primary sources of funding

include the financial services sector, private equity investment, the IDC, the NEF, the PIC and the small savings sector.

Each of the potential sources of BEE funding will be discussed in detail.

(i) Financial Services Sector

The next few years are likely to see significant demands on banks to fund empowerment deals in a range of sectors as companies comply in meeting the BEE ownership targets of sector-specific charters. The release of the Financial Services Charter on 17 October 2003 has also highlighted the significant role that this sector is likely to play in empowerment financing. In terms of the Charter, financial services are committing more than R75 billion to finance BEE (Financial Services Charter, 17 October 2003: 10).

Although banks have been active historically in helping fund empowerment deals in the past, there have been several such deals that have failed over the years (such as Nail which was discussed in a case study in chapter three). More recently, banks have begun finding more creative ways of lending to empowerment transactions. Such examples include enhanced terms of credit, or as participants in the actual deal where the bank becomes a shareholder in the transaction and not only financier. An example of this was with the delisting of the BEE investment bank, African Merchant Bank (AMB) where Investec ended up controlling the company where it had also provided the facility to finance and warehouse a large shareholding of AMB (Business Day, 15 July 2003: 26).

It also seems that banks in South Africa have learnt some lessons of the past failures and are also becoming increasingly interested in ensuring that the deals they get involved in fulfill broader social objectives. Graham Dempster, managing director of Nedbank's corporate banking division, says, 'People want broad-based empowerment' (Business Day, 15 July 2003: 26).

Other considerations for banks include ensuring that the new empowerment shareholder is actively involved in the management of the acquired business, at board

level and executive management level. The Financial Services Charter places great emphasis on black representation at all levels of the business. Banks have come under fire for an apparent reluctance to take on the risk of funding the empowerment deals. Dempster says, 'The biggest challenge is accessing the underlying cash flows to support the debt to fund the empowerment, particularly given the magnitude of most of these deals' (Business Day, 15 July 2003: 26). The most recent transaction in which Nedbank Corporate featured strongly was the Harmony and Armgold joint purchase of a R1.8 billion controlling stake in Avmin from Anglo American.

As was the case in the 1990s, the financial services sector remains one of the prime sources of funding for BEE. The recent finalisation of the Financial Services Charter is also likely to improve the role of the banking sector, in particular, in providing funding for BEE transactions since banks and life insurers will have to transform themselves as far as the issue of ownership is concerned and through that might in part also be the financiers of these deals (Cape Times, 2 May 2003: 2). An example is the recent BEE transaction announced by Investec where a consortium of black groups have acquired a 25.1% stake in the group. Investec itself provided 14% of the funding whilst the remainder was facilitated by the Public Investment Commissioners (PIC). This example will be discussed later as part of the case study. The significance of the Financial Services Charter is that it will stipulate the minimum targets for black participation in a sector where empowerment has only just begun to take route.

One of the biggest issues surrounding this charter is believed to be the amount of capital expenditure the financial sector intends to unlock over the next decade. In the Mining Charter, mining groups pledged to spend about R145 billion over the life of the charter. Mining and financial services are arguably the two largest sectors of the economy. The financial services sector has apparently pledged an estimated R75 billion (Business Day, 23 June 2003: 12) for empowerment financing. However, other analysis suggests a range of between R22 billion to R65 billion depending on the final outcome of the financial services charter ownership target (Empowerdex, 10 July 2003: 10).

Although most financial services groups have made substantial contributions by funding other empowerment deals and by creating dedicated investment funds,³⁵ they have remained slow in providing access to finance in the traditional or rural areas of empowerment. One of the most significant developments announced in the Financial Services Charter is the extension of financial services to the lower income market. Historically, this has been seen as one of the major obstacles to BEE which has been the provision of access to finance for the poor. The Charter states, *'the sector's ability to provide appropriate and effective access to financial services for a greater segment of the population must be substantially enhanced'* (Financial Services Charter, 17 October 2003: 5).

Stanlib and Investec's recent black empowerment deals involve shareholdings of just more than 25 percent, indicating that in the case of Investec, for instance, BEE equity ownership exceeds that prescribed by the Financial Services Charter (Business Day, 23 June 2003: 12). Ownership compliance in terms of the Charter remains key in meeting the requirements of the scorecard of the Financial Services Charter.

Table 4.4 looks at the current status of the financial services sectors as far as direct and indirect ownership is concerned. According to this research done by empowerment ratings agency Empowerdex, the sector as a whole is still far off the ownership targets, which should be reached by 2010. Direct empowerment shareholding accounts for only 0.3% of the sector while indirect shareholding accounts for 12.4% as illustrated in Table 4.4.

³⁵ Old Mutual, for instance, has about R1.9 billion (or 1 percent) of the assets of its SA life company invested in BEE-related activity. Sanlam's Development Fund, launched in 1996, has financed economic development projects worth more than R2.2 billion (Cape Times, 2 May 2003: 2).

Table 4.4 Current Status of the Financial Services Sector

Details	Insurance Sector	Other Financial Services	Banks	Total
Sample Size	15	20	6	41
Current Direct BEE Ownership	0%	1.7%	0%	0.3%
Current Indirect BEE Ownership	10.3%	12.1%	14%	12.4%
Value of Direct BEE investment	R23.5m	R1bn	R4m	R1.03bn
Value of Indirect BEE investment	R10.86bn	R7.32bn	R20.3bn	R38.5bn
Proposed Funding for direct BEE transactions	R10.62bn	R5.65bn	R14.5bn	R30.7bn
Required indirect BEE investment in financial services sector	R6.94bn	R2.18bn	R4bn	R13.4bn
Market Capitalisation	R105.2bn	R60.5bn	R145.4bn	R311.1bn

Source: Empowerdex 10 July 2003: 11

If we apply the ownership targets to current financial institutions, it is interesting to note that most of the large institutions only comply with the indirect ownership targets. One of the largest life assurers in South Africa, namely, Old Mutual does not comply with any of the direct or indirect ownership targets. Refer to Table 4.5 for further reference of financial institutions who do comply with the financial services charter ownership targets.

Table 4.5: Current Levels of Compliance with Ownership Targets

Ownership Target	Financial Institution
Full Compliance	AMB Private Equity, Cape Empowerment Trust, Brimstone
10% Direct BEE Ownership	Investec Bank Limited, Barnard Jacobs Mellet, Sanlam
15% Indirect BEE Ownership	New Africa Capital (Nail), Alexander Forbes, Remgro, Standard Bank

Source: Empowerdex 10 July 2003: 11

Moreover, the problem of funding remains a significant challenge as far as the majority of the South African population is concerned. Almost 60% of adults in South Africa lack a bank account (Business Day, 15 July 2003: 24). They are also restricted in accessing other types of financial services such as savings, insurance and credit, since all of these require a cost-efficient collection mechanism such as a debit order or a transaction account (Business Day, 23 May 2003: 11). ABSA bank executive director, Louis van Zeuner, estimates the total bottom end of the market at 11 million

to 14 million people, of which about 6 million are banked. The problem is that running a savings account each month can cost R30 a month in terms of fixed cost and is thus not affordable for many poor customers (Business Day, 15 July 2003: 24).

A recent study by Finmark Trust³⁶ provides clarity around the precise dimensions of the unbanked market of South Africa. It found that 4.5 million South Africans or 37% of the non-rural population are unbanked. They do not even have an ATM card or savings account (Cape Times, 2 May 2003: 2). They tend to be less educated, living in informal areas and would require assistance in their own languages to access financial services. Moreover, the study found that a further 37% of the population (4.4 million people) are partially banked, with only an ATM card or savings account but no other services. The survey covered a population of 12 million excluding those in deep rural areas of South Africa (Business Day, 15 July 2003: 24). Finmark found that the unbanked section of our population view a bank savings account as the best way to save money, but are inhibited by perceived high bank charges.

The basic bank account has traditionally been the backbone of the retail financial sector which has primarily serviced the upper end of the population. Unless the backbone is built and strengthened to cater for the broader population group, it will be much harder to expand access to other desirable financial services such as small business finance which has a vital role to play in South Africa's growth and development. Some recent estimates even suggest that there are already more cellphone users than bank account holders; according to a recent survey commissioned by FinMark Trust, 24% of the unbanked in urban areas have cellphones (Black Economic Empowerment Commission Report, 2001: 11). One can therefore conclude that there is still significant banking growth potential in the unbanked portion of the South African population.

This example illustrates the promise that new technologies available in the banking sector can do which remains at the heart of the banking challenge in South Africa: reducing costs and increasing the physical accessibility of mass banking services to

³⁶ Finmark Trust was established in March 2002 and is an independent trust controlled by five trustees from countries in Southern Africa. The study they did was titled, 'The demand for financial services by low income South Africans', Version 2, Author: David Porteus.

the poor (Sunday Independent, Business Report, 3 August 2003). Banks are addressing this by jointly implementing projects that would enable them to bank a much greater number of customers at the bottom end of the market with simple products. However, this would be far more costly for banks and therefore government would have to come in with a subsidy to cover part of the cost of expanding to areas of the poor (Business Day, 15 July 2003: 24).

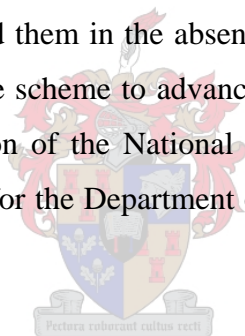
Without sustainable cost reduction 'banking the unbanked' will remain a major issue. Some suggestions in this regard are recent recommendations made by the Reserve Bank allowing for 'second tier' banks, a new institutional type of bank which will have lower capital requirements than first tier banks because they have a restricted activity profile (Business Day, 23 May 2003: 2).

One of the proposals that has come out of the Financial Services Charter process is that government should provide a small subsidy to cover the cost of a very basic, generic bank account that all the big retail banks could make available. Such an account would probably allow a customer one deposit and two withdrawals a month (Business Day, 15 July 2003: 24). A recent precedent for this type of subsidy was reached by the Eastern Cape Provincial government with Standard Bank and First National Bank where the province provides a R13,50 subsidy to help the banks provide accounts, particularly for pensioners (Business Day, 15 July 2003: 24). Now that the Charter has been finalized with great emphasis on the provision of access to finance for the poor, banks are contemplating a national savings account which will be a cheap product that will be created through a joint venture between the banks but offered through their networks with their own brands (Theobald, S.; Cranston, S.; Itumeleng, M. 2003: 26).

Another challenge facing the banking sector as source of funding for BEE and small business, was stated in the Black Economic Empowerment Commission Report (2001: 22), *'To a large extent, Government's SME strategy overestimated the willingness of the private sector to participate in a partnership to promote entrepreneurship and to help drive this national empowerment imperative in a manner that truly benefits the majority of our people. In fact the banking sectors' approach towards SME development has been hopelessly inadequate.'*

The five largest banks in South Africa presently hold over 80% of the market share. The banking environment itself has changed significantly, with a clear move towards the use of technology to enhance delivery, some banks have recently also formed partnerships with micro-lenders to access the unbanked sector (Black Economic Empowerment Commission Report, 2001: 22). An example of this is the partnership between African Bank and Standard Bank as well as Unifer and Absa Bank.

However, commercial banks continue to ineffectively support SME development (Sunday Independent, Business Report, 3 August 2003: 1). They site amongst a number of reasons, such as the risk (which raises the cost), the fact that it is not their prime business, that there is insufficient collateral and that it is not as profitable as other lending activities. For instance, the participation in the Khula Credit Gaurantee Scheme has been well below expectations with branch managers advancing loans to people who would have received them in the absence of a Gaurantee. In practice, it appears that banks have used the scheme to advance loans to white and male-owned businesses (Mid-Term Evaluation of the National Strategy for the Development of Small Business in SA prepared for the Department of Trade and Industry, September 1999: 42).



The recently released Financial Services Charter provides a possible solution to this problem where DFIs have been committed to provide more efficient finance to the poor (Financial Services Charter, 17 October 2003: 10).

In response to much criticism the Banking Council of South Africa (BCSA) and five major banks joined forces to establish Sizanani Advisory Services, the objective being to provide mentorship to the owners of start-up and expanding micro and very small businesses (SMEs). The Sizanani scheme is aimed at businesses which do not comply with normal banking requirements, and require finance of between R10 000 and R50 000 to establish or grow their enterprises.³⁷ The private sector has also launched SME support initiatives either in their individual capacities or as joint ventures. South

³⁷ The participating banks are ABSA, FBC Fidelity Bank, First National Bank, Nedcor and Standard Bank.

Africa's 220 largest companies spent R725 million on Corporate Social Investment during 1997/1998, with 15% going towards small business development.

The small and medium enterprise area remains a financing challenge for the major banks due to significant risk in this area of these businesses failing or having no track record. Opportunities to fund credible business people with credible business plans and the necessary skills to implement them are in short supply (Business Day, 15 July 2003: 25). In response to the banking sector's inadequate provision of financial services, the micro-finance industry has grown over the past six years following government relaxation of the Usury Act. According to the Black Economic Empowerment Commission's Report, the massive growth in this industry is a sign of the large demand for credit amongst those excluded from the formal banking system. The problem is that these micro-lenders contribute little to empowerment of individuals and tend to aggravate the spiral of dissaving in the economy (Black Economic Empowerment Commission Report, 2001: 22).

This has led to certain exemptions to the Usury Act and has been an important element in the proliferation of access to finance. However, these exemptions are not promoting growth of a more development-oriented micro finance sector and the rural population of South Africa, in particular, remain unbanked with limited access to capital. The funding issue therefore remains key to the provision of services to the poor by the formal banking sector (Black Economic Empowerment Commission Report, 2001: 22). This remains a great challenge given that between 60% and 80% of South Africa's economically active population remains unbanked (Draft Financial Services Charter, 2003:2).

The problem is that while the demand for banking services is growing in the low-income market, there has been a contraction of service provision for these communities within the traditional institutions (Cape Times, 2 May 2003: 2). To achieve international competitiveness and maintain market share in the local markets, the major retail banks have had to increase efficiency by closing unprofitable accounts and branches. It is clear that even with the use of modern technology, there are many communities and individuals who will remain out of reach of the conventional banks for many years to come (Banking Council, 2001). However, the recently released

Financial Services Charter states that the following requirements must be satisfied, *'the sector's ability to provide appropriate and effective access to financial services for a greater segment of the population must be substantially enhanced'* (Financial Services Charter, 17 October 2003: 5)

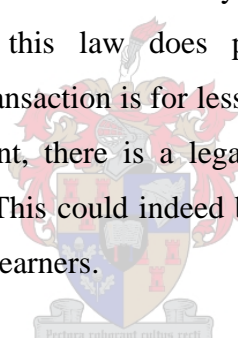
The Financial Services Charter goes on to define 'effective access' as 'being within a distance of 20 kilometers to the nearest service point at which first-order financial services can be undertaken, and includes ATM and other origination points...' and the charter also adds, 'structuring and describing financial products and services in a simple and easy to understand manner' (Financial Services Charter, 17 October 2003: 3).

However, despite the fact that the charter has indicated a commitment from the traditional financial services to provide access of finance to the poor, there remain significant challenges. For example, SME's whose financial needs are greater than those of the micro-enterprises and fall outside the loan sizes governed by the exemption to the Usury Act are not served by micro-lenders or the commercial banks, are also excluded. Loans for income generating purposes are not provided below a floor of around R35 000 – R50 000. This is despite evidence from South Africa that markets exist for loans as low as R50. Savings and transaction services are also not tailored to meet the needs of the poor, being inaccessible and high cost (Sunday Independent, Business Report, 3 August 2003: 1).

The conclusion to be drawn from the above is that *'most lending goes to sustaining people's livelihood rather than for the purpose of creating new jobs and little assistance is available to facilitate the conversion from a survivalist mode to an enterprise activity'* (Mid-Term Evaluation of the National Strategy for the Development and Promotion of Small Business in South Africa prepared for the Department of Trade and Industry, September, 1999: 42).

Research³⁸ indicates that there is a ‘missing middle’ in the case of loan advances of R35 000-R50 000 to R4 million, with the IDC, for instance tending to invest in larger BEE transactions. Venture capital is almost non-existent. It is therefore necessary to increase the number and outreach of enterprise loans below the R10 000 exemption ceiling, and then increase the finance in the middle range up to R4 million. Extending access to all forms of financial services in underdeveloped areas remains a major challenge for banks in South Africa (Black Economic Empowerment Commission Report, 2001: 23).

A further obstacle is that a recent survey conducted by banking group First National Bank has indicated that the previously unbanked may now be unbankable thanks to the introduction on 1 July 2003 of the law to fight money laundering and organized crime (Sunday Independent, 3 August 2003: 1). A person opening a new bank account must now provide their South African identity document and recent proof of residential address. However, this law does provide an exemption to these requirements if the account or transaction is for less than R5 000. But if someone just wants to open a savings account, there is a legal obligation to verify every new business or casual relationship. This could indeed be a stumbling block to extending financial services to low-income earners.



Experience in a range of low and middle-income countries shows that financial services which contribute to developmental objectives can be extended to the poorest of the poor on a non-concessionary basis. Some institutions which have met these objectives are credit co-operatives, Grameen Bank-type institutions and the stokvels rotating savings and credit organization. However, the problem with these types of institutions is that they have not reached a scale as yet to really impact on the country's financial systems (Black Economic Empowerment Commission Report, 2001: 23).

The South African financial services sector plays a significant role in the economy, and is regarded as highly sophisticated, and able to deliver a wide range of financing services. Over and above the basic services mentioned above, the banks' role in

³⁸ This is based on research done for the Mid-Term Evaluation of the National Strategy for the Development of Small Business in South Africa prepared for the DTI (September 1999).

financing growth and development has also come under the spotlight, as part of a political debate about what role the private sector should play in addressing South Africa's social and economic problems. The outcome of the Financial Services Charter is also expected to include these issues such as infrastructure finance or public-private partnerships as part of the empowerment scorecard (Business Day, 15 July: 25). Some banks have already made progress in this regard with FirstRand being a large shareholder in the Infrastructure Development Corporation which has lent more than R4 billion to municipalities which must deliver basic services.

As Nedlac has set up a useful framework within which to draft a charter, the various providers of financial services and capital are able to initiate BEE programmes. For now it seems as though government has endorsed the process and has expressed interest in being involved once the industry is able to present it with proposals.

What is relevant to this paper is that the increasing emphasis for the financial services industry will be on access to financial services and investment patterns (Business Report, 2 May 2003: 2). The consequences of this are likely to be good for BEE funding going forward. This means that in banking for instance, the industry will have to show some innovation and support for expanding funding services to BEE groups. The life industry will need to suggest some practical mechanisms of contributing an increasing portion of the value of assets under management to development-oriented, BEE and infrastructure investments (Cazenove, 2002: 5).

The only challenge in this regard is that the burden of financial risk on banks and insurers is likely to increase in order to meet the empowerment financing targets in terms of the Financial Services Charter and also in providing more access to financing for the poorer segment of the population. It is for this reason that the sector has asked government to play a role in accepting the increased risks faced in the targeted financing envisaged in light of the charter. A South African version of the successful American housing provider, Fannie Mae, is one possibility (Theobald, S.; Cranston, S.; Mahabane, I. 2003: 26).

Further, South Africa's challenge is to create a regulatory environment, together with pro-active partnerships that can facilitate the emergence of a diversity of financially

sustainable retail institutions that can constitute a stable tier of the financial services industry which services the poor on a large scale. In this context, institutional innovation and nurturing is required. South Africa's main advantage in this regard is that it is a comparatively advanced formal financial services industry, which has the capacity to develop innovative low cost solutions such as Standard Bank's E-bank offering (Black Economic Empowerment Commission Report, 2001: 24).

The Financial Services Charter which has been made public in October 2003, is expected to address many of the above challenges that have faced this sector over the years as far as BEE funding and access to the broader population is concerned. Government's decision to take a more active role in the process also reflects the imperative of transformation within this sector of the economy. It has been nine years since the country's advent to democracy and yet BEE in the financial services industry, arguably one of the few sectors that can claim to meet First World standards, has been slow (Business Report, 2 May 2003: 2).

Recent BEE-related announcements by the government have demonstrated that it feels it has waited long enough for the private sector to act. In his budget speech in February this year Trevor Manuel announced a R10 billion boost over five years for the funding of new BEE ventures and business operations (Business Day, 27 February 2003). The DTI has also appointed Lionel October as Deputy Director-General to focus on BEE and Telkom's listing at the beginning of March 2003 gave many black South Africans the opportunity to own shares through the Khulisa offer.

Although this sector has been slow in meeting some of the key BEE targets such as ownership, employment equity, they have made substantial contributions to funding both in the past and present. This is revealed by an increasing trend of creating dedicated investment funds with a specific social focus that are aimed at providing funding for a very particular purpose. Old Mutual, for instance, has about R1.9 billion, invested in BEE-related activity (Cape Times, 2 May 2003: 2). Sanlam's Development Fund, launched in 1996, has financed economic development projects worth more than R2.2 billion.

The Financial Services Charter has, in particular, made detailed reference to the issue of empowerment financing (17 October 2003: 10). For the purposes of this paper, this section of the Charter is of particular importance. The Charter states, *'All parties to the charter commit themselves to working in partnership with Government and its DFIs to mobilize resources for empowerment financing. The total amounts to be invested in BEE transaction financing and targeted investments... currently estimated to be the order of R2,000 bn.'*

The Charter also aims to determine the financial sector's capacity to finance BEE transactions and targeted investments. Based on preliminary calculations, it is estimated that the aggregate amount of new empowerment financing from the financial sector alone, could exceed R75 billion. Also to set the targets for the financial sector with respect to all four components of targeted investment such as infrastructure, low income housing, agricultural development and black SME development. The Charter also aims to set targets for the financial sector with respect to BEE financing (17 October 2003: 10).

The reason why paragraph nine on empowerment financing in the charter is key, is because it essentially commits all financial institutions in South Africa to fund empowerment deals across all sectors of the economy. Perhaps the most striking aspect of the 'empowerment financing' provisions in the charter is that its weighting on the charter's scorecard is a full 22% - the same as the weighting given to ownership and control – reflecting the priority given to the sector's role in funding South Africa's growth and development in years to come. Equally important is the wording of the empowerment financing clause in the charter which makes it clear that government also has a significant role to play in the provision of empowerment financing via its DFIs.

In order to alleviate the risks of poor financing models as was the case during the 1990s when BEE failed, the Financial Services Charter also stipulates, *'appropriate risk mitigating measures and risk sharing arrangements between Government and its DFIs on the one hand and the private sector on the other...to establish the institutional framework and financing models for the mobilization of the various resources'* (17 October 2003: 10).

The Charter is also in line with the broad-based definition of empowerment where initiatives aimed at achieving this broader interpretation of BEE will be promoted. The Financial Services Charter specifically interprets any references to BEE made in the charter as broad-based (17 October 2003: 2). Furthermore, in line with the interpretation of BEE in terms of this paper which focuses on the BEE of black entrepreneurs, the Financial Services Charter has placed significant emphasis on the fact that the sector has not effectively provided credit to entrepreneurs, particularly black businesses. This is reflected as follows, '*entrepreneurial development must be promoted and enhanced by supporting black entrepreneurs*' (17 October 2003: 5).

The Financial Services Charter has also made provision for a specific clause on enterprise development where the sector has now committed itself to improve the levels of assistance to BEE accredited companies and also supporting the establishment and growth of BEE companies within the sector. It also specifies that the sector will provide financial support to Black SME's (17 October 2003: 9).

Table 4.6 illustrates the estimated value of empowerment contributions from the Financial Services Charter through the various broad-based empowerment economic indicators provided in the Charter Scorecard. This analysis also accounts for the non-financial contributions made to the issues of BEE control, skills development and social development. This analysis provides estimates of the total empowerment contribution from the Financial Services Charter and also provides some practical insight into the impact of the application of the broad-based economic empowerment strategy.

Table 4.6 Summary of Likely BEE Benefits from Financial Services Charter³⁹

Factors	Minimum	Maximum
Ownership	22,400	65,700
BEE Control	47	102
Employment Equity	3,504	5,256
Skills Development	430	4,480
Affirmative Procurement	3,800	7,600
Targeted Investment	62,000	123,000
Social Development	180	350
Direct Empowerment Benefits	22,447	65,802
Broad-Based Empowerment Benefits	69,914	140,686
Total Benefits to Economic Empowerment	92,361	206,488

Source: Empowerdex, 10 July 2003: 19

The analysis in Table 4.6 is interesting since it illustrates the broader-based benefits expected from the financial services charter where more emphasis will be placed on the broad-based economic empowerment factors in comparison to the mining charter where the ownership target carried significant weight. Table 4.6 also highlights that although the transaction costs of direct empowerment benefits (ownership is an example of this) is much higher, it will provide only 24 percent of the empowerment benefits if complied with, while the broad-based factors are expected to contribute more than three quarters of the economic empowerment benefits in the financial services sector (Empowerdex, 10 July 2003: 19).

In total, the introduction of the financial services charter will result in the introduction of around R79 billion of economic benefits by the listed JSE financial services sectors towards economic empowerment. The sector has until June 2004 to establish the total amount that it will commit to financing BEE. However, for broad-based empowerment to succeed, the initiatives introduced by the sector need to have both economic substance and form.

³⁹ Note that all the amounts reflected in this table are in rand billions. Therefore, the maximum financial impact that ownership is likely to have on the financial services sector as a result of the charter is around R65.7 billion rand. This is the maximum rand cost or funding needed to meet the ownership requirement for BEE in this sector.

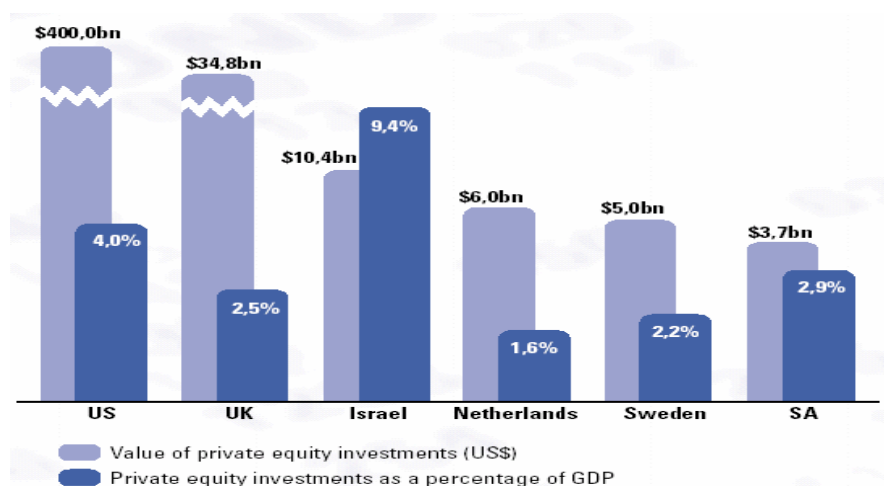
From the above, it is clear that the financial services sector is indeed aiming to become a major contributor to the funding of BEE over the next few years, but it is also clear there is still a long way to go, particularly as far as tackling the problem of providing access to funding for the unbanked population of South Africa is concerned. A workable partnership between government and the private sector will be key in ensuring the success of the implementation of the financial services charter since for it to work, major changes will be needed in the way government currently works with private sector financiers on projects aimed at growth and development.

(ii) Venture Capital Market & Private Equity

South Africa still has a relatively new private equity and venture capital market in absolute terms when the total value of private equity investments in each country is compared in absolute terms. Figure 4.2 reflects this where the value of private equity investments in South Africa is the lowest when compared to the United States or even Sweden. In the United States, approximately 5% of pension fund assets are invested in private equity/venture capital. The equivalent figure in South Africa is more like 1%.

However, as Figure 4.2 also illustrates that when comparing the size of private equity investment as a percentage of GDP, South Africa is not faring all that badly given that a large proportion of funds are invested in private equity as a percentage of South Africa's overall GDP.

Figure 4.2 Relative Size of International Private Equity Markets



Source: KPMG and SAVCA Private Equity and Venture Capital Survey - 2002

Although the private equity market has developed in South Africa to some extent (around R27.5 billion in funds under management) few of these funds invest in BEE (Black Economic Empowerment Commission Report, 2001: 24). A key issue in the venture capital industry is for the development of a vibrant venture capital market with the appropriate personnel with the skills to conclude and successfully monitor venture capital transactions.⁴⁰

According to Adrian Macartney, a partner at Ernst & Young South Africa, there is an urgent need for focused venture capital and private equity funding in South Africa to grow the local pool of fast growing, or rapid growth entrepreneurs. Macartney says that entrepreneurs are the backbone of the country's economic growth and job creation (Business Day, 26 June 2003: 7).

Venture capital and private equity funding is likely to play a critical role in the financing of black entrepreneurs for South Africa in the future. Venture capital funders, for instance, are better equipped to aid entrepreneurial growth because they understand the processes and sources of financing. In addition, they also have the ability to use their relationships with the business community to help match entrepreneurial companies with appropriate business opportunities. Macartney of Ernest & Young also points out that in addition to the provision of finance by the venture capitalist, they also play the role of mentor in supporting the entrepreneur with the set-up of systems and recruiting of the best people. He says, 'Entrepreneurs are often left to focus on their skills area and exploiting market opportunities' (Business Day, 26 June 2003: 7).

Various private equity funds in South Africa have recently turned attention to Mining Charter-linked deals. In a sign of things to come, Anglo American and Khula Enterprise Finance, the empowerment and business development arm of the department of trade and industry, recently formed a R40 million fund to facilitate

⁴⁰ Source: KPMG & SAVCA 1999 Private Equity Survey: In South Africa, the venture capital and private equity market is 1.5% of GDP which is far smaller than the US market where it comprises around 4.1% of GDP.

BEE access to the mining sector (Business Day, 10 April 2003: 11). The fund will be managed by the Khula Equity Fund Scheme. It expects to make about twelve investments of between R1 million and R5 million. The fund will focus on pre-feasibility studies, preparation of environmental management and mining licence applications. The idea is that once a mining prospect is proven and ready for development, other funders will be required to participate. *'The mining sector has not historically been an attractive sector for private equity players, but the advent of the mining charter may make this sector an attractive investment for BEE private equity funds'*. This is according to the KPMG/Savca (Southern African Venture Capital and Private Equity Association) survey on private equity and venture capital (2002: 24).

Private equity investors are likely to become key funders of BEE transactions over the next few years as various sector charters are finalized. BEE investment already accounts for a growing share of private equity funds, with information technology, services, retail and the manufacturing sectors being the preferred sectors.

Table 4.7 shows the cumulative value of BEE private equity transactions stood at R2.1 billion at the end of 2002 affecting 1 235 companies (KPMG/SAVCA Survey, 2002: 25).

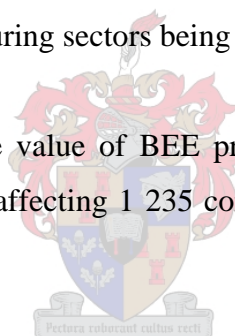


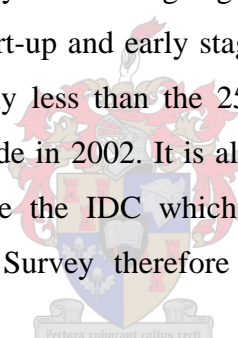
Table 4.7 BEE Private Equity Investments: Reported by Industry

	For the year 2001			For the year 2002			Cumulative as at 31 Dec 2002	
	Number	R m	% of total Rand	Number	R m	% of total Rand	Number	R m
Banks, fin serv, insurance	1	1	1%	3	6	1%	18	131
Telecoms	0	0	0%	2	1	—	7	218
Media	1	4	2%	2	1	—	7	78
Entertainment	26	13	7%	18	14	3%	128	51
Information Technology	0	0	0%	3	67	12%	10	123
Retail	81	34	20%	78	100	18%	487	175
Manufacturing	24	10	6%	26	182	32%	137	284
Services	22	13	7%	30	98	18%	148	433
Healthcare	6	83	47%	1	1	—	19	84
Infrastructure	4	1	1%	5	1	—	185	6
Other	18	15	9%	16	88	16%	89	573
Total	183	174	100%	184	559	100%	1 235	2 156

Source: KPMG and SAVCA Private Equity and Venture Capital Survey - 2002

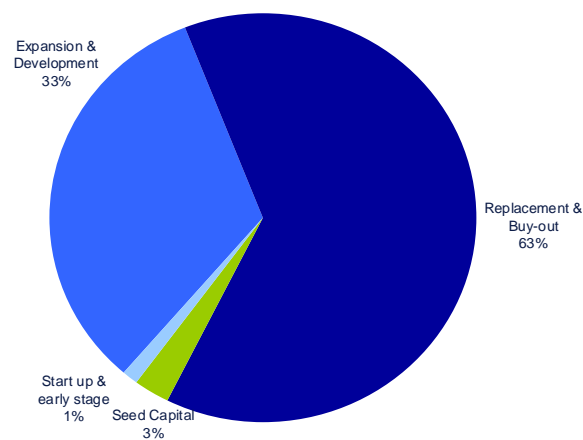
The KPMG/SAVCA Survey says empowerment investment is dominated by organizations such as Business Partners, which focuses on smaller transactions (Business Day, 10 April 2003: 11). Of the 39 fund managers included in the survey, nine percent have a mandate that specifically includes financing of BEE. However, this does not represent the full extent of private equity involvement in BEE transactions since many funds invest in BEE entities even though their mandates may not specifically mention this (KPMG/SAVCA Survey, 2002: 24). It is encouraging to note that of those funds under the survey, the value of investment in BEE entities in 2002 showed strong growth relative to the amount of BEE investment in 2001.

From Figure 4.3 below, it is evident that replacement and buy-outs⁴¹ are the most dominant stages for investment in BEE entities. This trend is constant with the broad transformation trend of the SA economy which is seeing established businesses gradually transferred to previously disadvantaged groups. It is interesting to note that the amount invested in seed, start-up and early stage comprises only 4% of the total investment which is significantly less than the 25% invested in this sub-sector in terms of overall investments made in 2002. It is also important to note that the BEE Private Equity statistics exclude the IDC which is obviously a significant BEE investor. The KPMG/SAVCA Survey therefore understates private equity BEE investments (2002: 25).



⁴¹ Replacement means when there are management changes within that company and buy-out means when there is a bid to buy part of the company, then it is deemed suitable for most BEE investors to partake in the management and ownership of that company.

Figure 4.3 Most Dominant Stages of investment in BEE entities



Source: KPMG and SAVCA Private Equity and Venture Capital Survey - 2002

A new, R100 million private equity fund has also been established to provide development venture capital to South Africa's youth. The fund, a public-private sector partnership between First National Bank, Momentum Life and Umsobomvu, was set up by the government to address youth unemployment. Umsobomvu Youth Fund (UYF) (Business Day, 26 June 2003: 7).

Various studies show that young South Africans, especially if they are black, have trouble securing funding even though they have sound business ideas (Business Day, Business Report, 10 April 2003). The rationale of this fund is to provide financing for South Africa's young entrepreneurs. This particular fund also aims to increase the rate at which it finances small medium and micro enterprises (SMMEs) focused around young black entrepreneurs since one of the shortcomings of the past have been the approval and implementation period for any BEE SME funding application with institutions such as the IDC, NEF for smaller types of funding transactions.

The Umsobomvu Youth Fund (UYF) has also established its Youth Entrepreneurship Programme, a multiple intervention model, to economically empower South African youth by providing them with access to finance as well as business development services (Business Day, 26 June 2003: 7). The UYF manager of Enterprise Finance, Roy Rajdhar, says UYF has ear-marked R500 million to entrepreneurial initiatives,

with R340 million set aside for Enterprise Funding and Micro Finance and R160 million to be channelled into Business Development Services. He goes on to say, 'Enterprise Funding is aimed at medium sized operations and comprises three funds, the Umsobomvu Business Partners Franchise Fund, the FNB-Momentum-UYF Progress Fund and the General Equity Fund' (Business Day, 26 June 2003: 7).

Business Partners, a South African specialized, added-value investment group, recognizes that entrepreneurs need much more than just funds since they need professional support services as well. One of the subsidiaries of Business Partners caters for services of this nature which provides for the business support and mentorship needs of entrepreneurs. This subsidiary fund raised R885 million when it was created in 1998 from a 2.5 percent levy from the proceeds of the Sanlam and Old Mutual demutualization. Most of the money, which has grown to over R1 billion because of interest, has still not been allocated as the fund has taken time to finalise its structure and seek partners (Business Day, Business Report, 7 July 2003: 13).

While banks assess loan applications on proof of assets or creditworthiness, UYF applicants will be assessed on the quality of their business plan; their technical competencies; operational capability; the plan's market potential and feasibility; the credentials of the owners; their involvement in the business and a demonstration of the owner's commitment. Equity financing has a number of advantages over debt, says Kekana. It is more gentle on the cash flow of young companies as opposed to debt's strict monthly repayment regimen (Business Day, Business Report, 7 July 2003: 13). *'It is a sustainable model, as profits are reinvested back into the fund, and it is in line with the best interest of the investors to ensure the small and medium enterprises succeed, as the return on investment is directly related to the SME's profit'* (Business Day, Business Report, 7 July 2003: 13).

Over the past year UYF has created two specialized SME funds aimed at leveraging the resources of its partners. The first of these, in partnership with FirstRand Bank and Momentum Life, is the R100 million Progress Fund, which provides finance ranging from R100 000 to R5 million to SMEs that have received procurement opportunities from the government and private sector (Business Day, Business Report, 7 July 2003: 13).

The second, in partnership with Business Partners, is the R125 million Franchise Fund, which provides funding ranging from R150 000 to R3 million to enterprises involved in a proven franchise opportunity. The private partners have contributed non-guaranteed capital of R20 million to the Progress Fund and R25 million to the Franchise Fund. The Progress Fund will take a minority stake in the business and a share of the profit, which will be ploughed back into the fund (Business Day, 26 June 2003: 7).

Kekana says the aim of both funds is to support black youth-empowered SMEs to develop sustainable, profitable businesses through funding and skills development. He adds, '*enterprises need more than capital but also ongoing assistance, particularly in areas such as marketing, equipment sourcing, strategic planning and financial controls*' (Business Day, Business Report, 7 July 2003: 13). What is interesting is that this kind of business support is seldom offered by debt providers whose primary concern is repayment of the loan rather than assistance to entrepreneurs.

The UYF is a development venture capital initiative which unlike traditional venture capital, which strives to maximize the return on investment, accepts a moderate internal rate of return and considers the positive economic impact the investment target makes on the local community as part of the return on investment. Without equity finance, entrepreneurs must finance their businesses through cash flows. This may involve paying suppliers late but selling at cash on delivery – a double burden on entrepreneurs funded through debt, who must service the interest while investing in fixed assets. 'This is unsustainable and delays growth and prevents new entrants', says Kekana (Business Day, Business Report, 7 July 2003: 13). This fund will hopefully aid in supporting black entrepreneurs in South Africa who struggle to getting funding from the traditional financing institutions.

(iii) The Industrial Development Corporation (IDC)

Although the IDC has a long history of providing funding to traditional Afrikaner establishment businesses from the 1940s up until the 1980s, it has become a key player regarding financing of BEE in recent years (Refer to Appendix C for a

historical summary of funding by the IDC since its inception). The IDC sees the promotion of black entrepreneurship in South Africa in coming years as a key priority (Business Day, 25 February 2003: 1). It has funded the very first black entrepreneurs in the cellphone industry and has been the longest standing funder of black entrepreneurship.

The importance of BEE as a key consideration to the IDC was stated by Khaya Ngqula, the chief executive of the IDC, *'Empowerment is a strategic focus of the IDC board. We took a decision that everything we do will be done with empowerment in mind and by which we will be measured'* (Business Day, 25 February 2003: 1).

He also had the following to say at a recent IDC Conference on BEE, *'We believe that the IDC is the best vehicle for the implementation of BEE... the IDC has been of the longest providers of finance to entrepreneurs in South Africa'* (Quote of a speech by the CEO at the IDC Conference on BEE in Johannesburg, 2 October 2003).

This has also been evidenced by the IDC's inclusion of historically disadvantaged groups in companies such as NAIL, MTN and National Sorghum Breweries in the early 1990s. In the most recent Annual Report of the IDC (2002), it is evident that this government institution has been one of the most successful funders of BEE. Since 1990, the IDC has financed approximately 625 black entrepreneurs, with a total of R5.6 billion having been approved for BEE transactions (Business Day, 25 February 2003: 2). What is also interesting is that over 90% of the BEE deals approved since 1990 were under R20 million in size, while 36% of the total value approved pertained to transactions of over R100 million. Since 1997, the number of approvals to empowerment firms by the IDC has risen significantly (IDC Annual Report, 2002).

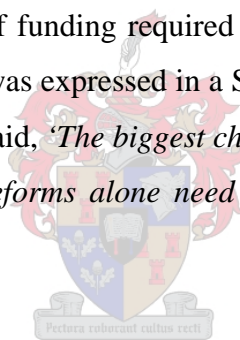
Figure 4.4 illustrates that for the financial year 2002/2003, R6.2 billion investment approvals were given involving 345 deals where this assisted in the creation of over 17 500 new jobs. Finance to BEE companies was 46% of the total number of approvals and 33% of total value of all IDC deals approved (IDC BEE Conference, 2 October 2003).

Figure 4.4: IDC Empowerment and Small Business Approvals



Source: IDC Annual Report, 2003

The challenge around the size of funding required given the large ownership targets prescribed by the BEE charters was expressed in a Survey by the Business Day on the IDC when the CEO of the IDC said, *'The biggest challenge for the IDC will be how to put funding together: Mining reforms alone need R100 billion'* (Business Day, 25 February 2003: 1).



In order to strengthen the IDC's fundamental BEE funding practices and mandate, a new BEE policy was accepted in 2002. This policy was intended to further create an enabling environment for the IDC to play a catalytic role in the recovery of the SA economy through the transfer of ownership, management and control to black people. This policy highlights the IDC as one of government's implementing agents in sustaining economic and industrial development and job creation. Moreover, the IDC is currently exploring various ways of raising finance. One possibility is to get empowerment bonds from the World Bank through the treasury with the assistance of the department of trade and industry (Business Day, 25 February 2003: 1).

In support of its BEE policy, the IDC has formulated strategies with the objective of aligning this with the overall strategy of the IDC. Some of these strategies include: involvement of the IDC in BEE funding in sectors of strategic importance prioritized

by government, such as mining, tourism and agriculture, and others such as the co-financing of BEE activities with other financing agencies.

The IDC has also played a major role in the provision of funding to the SME sector. The IDC provides funding to entrepreneurs in a wide range of projects, ranging from agriculture to information technology industries. Over the past two years alone, the IDC has approved R2.9 billion to approximately 700 SMEs and created almost 26 000 direct jobs (Cape Times, 5 September 2003: 7).

In the 2002 financial year, funding to SMEs generated R5.7 billion additional export earnings for the country (IDC Annual Reports, 2002). The main financing criteria is the ability of the business to make acceptable profits within a reasonable time but with high development impact. The applicant must be able to perform and the project must have strong cash flows (Cape Times. 5 September 2003: 7).

The issue of the promotion of black entrepreneurship also remains a key priority for the IDC. It has established an empowerment strategic business unit which aims to provide acquisition funding, develop and support emerging black entrepreneurs and facilitate the transfer of ownership and skills. This particular business unit assists these people to acquire shareholding or take-over business ventures through financial mechanisms such as management buy-ins or management buy-outs and so forth. Financing starts from R1 million to R250 million with average loans being in the R5 million range. In the past six months to the end of February 2003 alone, this Empowerment SBU has approved R300 million worth of loans (Business Day, 25 February 2003: 1).

Going forward, the IDC aims to establish a BEE Fund before the end of 2003 for deals of R120 million and more. Some of the areas of criticism from existing entrepreneurs who have applied for financing from the IDC, is the turnaround time for the approval of projects since in some cases it has been up to two years (IDC BEE Conference, 2 October 2003).

As far as the funding of BEE in particular is concerned, the IDC has a BEE Funding Policy document which provides the context and guiding principles for the funding of

BEE by black entrepreneurs applying to the IDC for financing (IDC BEE Funding Policy, 2003: 5). In this document the financing of black entrepreneurs is emphasized in both the vision and mission of the IDC, *'To be seen as the preferred provider of funding and support for emerging Black industrialists and entrepreneurs, whilst achieving attractive financial returns, transfer of ownership, skills and maximum development impact'* (IDC BEE Funding Policy, 2003: 4).

The IDC also stipulates that their approach towards BEE financing focuses on broad-based empowerment funding.

(iv) National Empowerment Fund (NEF)

On 11 December 1998, the National Empowerment Fund Act was signed into law. In terms of the Act, the objectives of the NEF are to provide HDP with the opportunity to acquire shares in State Owned Commercial Enterprises (SOEs) that are being restructured or in private business enterprises (Act No. 105, 1990: 3).

The NEF is another bold initiative taken by the government to promote HDP (Historically Disadvantaged People – hereafter referred to as black) owned businesses. Through the NEF, the government intends creating investment opportunities for black people that will generate income and capital growth. It aims to empower the black community through the sales of small amounts of shares to as a large number of black people as possible, rather than enriching only a few black individuals (Industrial Development Corporation, 1997). Three kinds of opportunities for black empowerment have been identified, that is, providing HDP's with the opportunity of directly or indirectly acquiring shares or an interest in state owned enterprises that are being restructured, or in private businesses. Secondly, the NEF also encourages savings, investment and economic participation by HDP's. Lastly, the purpose of the NEF is to promote and support business ventures pioneered and run by HDP's (National Empowerment Fund Act, No. 105, 1998: 3).

These would be achieved through a unit investment trust (Trust A) and direct investment (Trust B). In other words, Trust A and Trust B would accommodate the individuals and the black consortia respectively.

Shares would be made available to black business in state privatized companies, such as Telkom, before its listing. Here ten percent of Telkoms's shares are reported to be reserved for BEE purposes. Likewise, for Aventura and Eskom. These shares would be sold to the black community at discounted prices. The purpose of this is to spread ownership and ensure participation by as many people as possible. Although it is open to all race groups, Trust A would focus on the small black business person. These units would be distributed to the public through the post office, black-owned banks etc. The NEF is also aimed at broadening ownership and encouraging savings among the black people (Edigheji, O.E. 1999: 13). As a warehousing trust, it is proposed that Trust B would hold equity stakes in restructured parastatals until these are sold at competitive prices to black business groups.

Although the NEF has been relatively successful, challenges do remain. While the spending performance of some government-related funding institutions is on track, in others billions of rand remain unspent. In the case of the NEF, there was a time lag between announcing the fund and getting down to the actual implementation of the funding. However, government has also recognized these shortfalls, and the Minister of Finance in his recent Budget Speech, announced that the NEF would be the vehicle to spearhead government's project to assist with BEE where it would be mandated to ensure that resources allocated for empowerment are efficiently employed (Business Day, 27 February 2003: 9).

Although the NEF scheme aims to discourage early withdrawal, there is no mechanism to discourage 'fronting', that is, to ensure that the poor do not hold shares on behalf of rich individuals who might want to conceal their excessive capital accumulation (Edigheji, O.E. 1999:15). Furthermore, unlike the Malaysian ASN⁴² that specified that participants in its scheme could sell off their units only to the ASN, it is not clear how or through which means participants of the NEF would dispose of their shares. It is also difficult to understand why Trust A would be open to all race groups if the purpose of the NEF is to empower previously disadvantaged race groups. This is in contrast to the Malaysian case where participation in the ASN

⁴² ASN is the National Unit Trust

scheme was limited to the Bumiputras. Since Trust A aimed to accommodate the individual person, it would have been more appropriate to limit it to blacks.

However, it is envisaged that the state, through the NEF, will play major roles to promote black business via such trusts and act as the ultimate guarantor for the first three years of the minimum value of the individual investors unit. Additionally, the state will accept deferred payments of between seven and ten years for loans advanced to the trusts (Edigheji, O.E. 1999:16).

The above measures bear semblance to the Malaysian ASN. But the success of the ASN depended on a great deal of political will⁴³ by the Malay political elites to carry them through, in addition to a more favourable international economic climate. It is doubtful whether these conditions are present in the South African context.

Although it is proposed that the trusts mentioned earlier will also receive funding from 'investors and donors' (IDC, 1997: 9), there is no clarity as to whether these will be white or foreign investors and if so what their role would be. It is proposed that there should be an alliance between black professional firms and banks' and 'traditional institutions' in order to transfer skills and capacity (IDC, 1997: 9). While this is a welcome initiative, the government not only failed to spell out how it intends to attract the 'traditional institutions' to participate in such an alliance but it also failed to identify which type of investors it intends to attract. In other words, the proposal is silent on the incentives to attract 'traditional institutions' to participate in such an alliance.

Another shortcoming of the proposed NEF is the limitation of the government gaurantor's role to the first three years. Critics point out that this is ill-informed as it is unlikely that these trusts and the black investors would have matured after three years (Edigheji, O.E. 1999: 17).

⁴³ After the racial riot of 1969, the Malay political elite recognised that its legitimacy depended on its capacity to promote what Campos and Root (1996) refers to as Shared Growth, that is improving the living standard of ordinary Malays (or Bumis) and thereby creating a Malay entrepreneurial class, and expanding the economy. These were the principles encapsulated in the New Economic Policy (NEP) that came into effect in 1971. Since then the Malaysian political leadership has been resolute in its determination to achieve its set goals.

The third category of trust proposed is the Entrepreneurs Trust, known as Trust C. By this, Trust A (this is the unit investment trust which was described earlier in this section) will enter into partnership with various investors such as the IDC with the aim of contributing 'equity to viable but under-funded empowerment ventures' (IDC, 1997:9). As the Deputy Minister of Trade and Industry, Ms Mlambo-Ngcuka, at the time put it, Trust C is aimed to fast track the creation of excellent companies owned by blacks (Business Report, 28 May 1997: 3). From the forgoing analysis of the NEF scheme, it seems like government policies to promote BEE have been dominated by the minimalist approach to BEE and not the needs of the poor or a far more broader-based approach.

The Black Economic Empowerment Commission (BEEC) has the following recommendation to make about the NEF, *'The National Empowerment Fund, currently run by a board of Trustees, needs to be operationalised with a comprehensive investment strategy to unlock value. The objective of the NEF is to create wealth for the nation through investment in venture capital, private equity and listed investments, in the public and private sector. It is the intention of the NEF to be capitalized primarily through receiving shares of SOEs undergoing restructuring. It has received shares with a nominal value of about R2 billion, and may receive up to 10% of the shares of other SOEs, with a nominal value of between R10-20 billion, making it potentially one of the most significant investment entities in the South African financial markets'* (BEEC, 2001: 33).

From the above, for instance, an equity management fund is proposed which will provide venture capital to encourage entrepreneurship among historically disadvantaged groups (HDG) through joint ventures, management buy-outs, outsourcing and other forms of spin-offs.

Concern remains about the success of government supported institutions such as the NEF, particularly, given that the most recent chief executive of the NEF, Khanya Motshabi, has resigned. This is of particular concern given that the NEF was intended to be the vehicle in assisting in the funding of black enterprises and for the allocation of the government's recent R10 billion for BEE. 'Millionaires of millionaires' was the battle cry when the NEF idea was first mooted in 1996 (Sunday Independent,

Business Report, 10 August 2003: 3). The outlook of the NEF at this point looks bleak given that the R10 billion announced by the Finance Minister in his budget speech has still not been allocated.

Due to the above challenges facing government in the dedication of funds aimed at achieving government's development objectives, Parliament's Trade and Industry Committee has recently acknowledged that there needs to be a revamp of these organizations (Business Day, 20 March 2003: 1).

As already mentioned, the biggest problem is the fact that billions of rands remain unspent on projects ranging from poverty relief to black economic empowerment. More generally it could be said that the problem is not so much the lack of money for development as the ability to spend it effectively and efficiently. A lack of management capacity remains a significant problem for funding agencies and thereby leads to insufficient numbers of project managers to undertake the actual work (Business Day, 20 March 2003: 1).

In the case of the Umsobomvu Youth Fund and the National Empowerment Fund, there was a time lag between announcing the fund and then the actual implementation. A study by former University of the Witwatersrand academic Mark Swilling estimated that the NGO sector handled about R14 billion annually, which testifies to its importance in providing support in areas where government cannot reach (Business Day, 14 August 2003: 1).

Further, the department of trade and industry has announced that it will suspend funding to the NEF since this agency has struggled to fulfill its mandate since its establishment (Business Day, 14 August 2003: 1).

(v) Public Investment Commissioners (PIC)

The Public Investment Commissioners, the body that invests government pension funds, is laying the groundwork to become a leading investor in black economic empowerment ventures and infrastructure. It's biggest client, the Government Employees Pension Fund (GEPF) with assets of around R270 billion is developing a

new investment policy which it is believed will outline new guidelines on BEE. The PIC which manages the GEFP and other smaller government funds, is entrusted with funds to the value of R293 billion (Legae Securities, 14 July 2003: 4). Since its decision late last year to finance a deal by MTN staff and management to purchase government's 19% stake in the company, interest has been growing in the extent to which the PIC plans to involve itself in financing BEE in the future (Financial Mail, 14 February 2003: 48).

The current PIC empowerment investment approach is summarized in the latest annual report (2002: 4): *'Black economic empowerment will be supported by the Fund and the challenge will be to invest in sustainable broad-based empowerment initiatives, without compromising returns to the PIC's clients.'*

In 1999 the PIC Act was amended to allow the PIC to make investments that 'promoted social responsibility and infrastructure development.' A ceiling of 3.5% was placed on these investments where the PIC created the Isibaya Fund for this particular purpose (Legae Securities, 14 July 2003: 12).

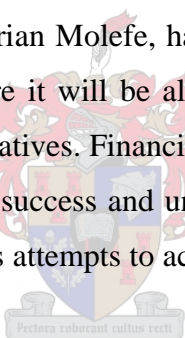
The most recent BEE deal of Investec, which will be discussed as a case study in Chapter Six, where a black consortium bought an effective 25.1% of the Group, had financing of R550 million provided by the PIC as well. This is the latest of the PIC funding efforts for the promotion of BEE (Business Day, 19 May 2003: 8).

It would seem that the above two financing transactions are not the last given the recent comments made by the previous PIC secretary, Ncedo Mlamla, on placing more emphasis on BEE and infrastructural development, 'the PIC would respond by honouring that mandate...My sense is that we will see that sooner rather than later' (Financial Mail, 14 February 2003: 48). Apparently, no capacity limitation has been set for future BEE transactions where the PIC will provide financing. Says previous PIC Secretary and CEO Mlamla: 'We are being approached to back many BEE deals and expect to finance many more as long as they make financial sense' (Financial Mail, 30 May 2003: 22). What is of concern to some fund managers is that this BEE drive of the PIC is, as yet, not backed by a coherent corporate finance policy guideline. What is of great significance as far as this paper is concerned, it that the

PIC's planned investment strategy going forward will include a number of key requirements for approval of BEE transactions such as extensive approval procedures and the borrowers putting up some risk capital (Financial Mail, 30 May 2003: 23).

These procedures were very much in evidence in the MTN and Investec deals. In the Investec transaction, the black groups apparently put up nearly R100 million of the total R810 million of the cost of the deal. A further requirement is likely to be that a portion of the repayments be secured, effectively through a corporate bond tied to dividends. Mlamla says that they are also working on co-financing strategies with development finance institutions like the IDC to spread their risk (Financial Mail, 30 May 2003: 23). Apparently these two transactions were both structured to limit the risk to the pension funds under the PIC's administration (Business Day, 19 May 2003: 8).

The newly appointed PIC CEO, Brian Molefe, has hinted at the investment mandate of the PIC being changed to where it will be allowed to become more involved in black economic empowerment initiatives. Financing of empowerment is often cited as one of the major constraints to its success and unlocking more funds could give it a solid underpinning in government's attempts to accelerate this process (Business Day, 27 June 2003: 1).



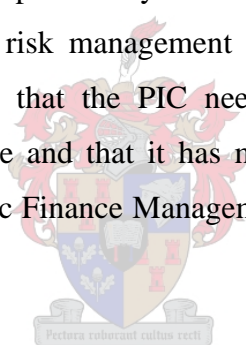
However, it seems that the PIC would tread carefully should their investment mandate be reviewed as its past experience of black empowerment financing through the Isibaya Fund was not particularly successful. The initial R506 million book value of the investments in this Fund had fallen by R304 million to a market value of R202 million (Business Day, 27 June 2003: 2).

Fund managers seem supportive of increased participation by the PIC in BEE transactions. Derrik Msibi of Old Mutual Asset Managers says: 'The PIC should be encouraged, given the dearth of financing of BEE deals.' Zenzo Lusengo, chairman of AMB Partners, agrees: 'Provided the transactions are commercially sound, there's nothing wrong with the PIC's role.' Although the PIC asserts that the transactions thus far have been at competitive market prices, it remains hard to tell given that most of the funding information is secret. This is not in itself unusual as many corporate

financiers don't release funding details, but more is at stake here given that the PIC is effectively taxpayer's money (Financial Mail, 30 May 2003: 23).

For this reason alone the PIC's investment strategy must define strict guidelines on how it is funding BEE deals and how much it is setting aside for this policy (Business Day, 19 May 2003:8). However, there has been some opposition to using the PIC as a funding tool for BEE. Asked what she thinks of the PIC strategy, Cosatu economist, Neva Makgetla says: 'Over my dead body. We are prepared to have union pensions backing developmental purposes, and where BEE overlaps with that, it's fine. What we don't support is using pensioner's funds to effect black corporate transformation' (Financial Mail, 30 May 2003: 23). Given that about 90% of the funds under PIC management belong to the GEPPF, the unions hold a powerful hand.

Further concern has also been expressed by SCOPA (Special Committee on Public Accounts) about the quality of risk management in the PIC. The auditor-general, Shauket Fakie, has commented that the PIC needs to ensure that a proper risk management plan is put in place and that it has met all the financial management principles laid down in the Public Finance Management Act (Cape Times, 14 August 2003: 15).



The chances are that the PIC is likely to be one of the key sources of funding of BEE in the years ahead. The PIC also has much more room to maneuver than it did a decade or so ago. Gone are the days of under-funded government pension funds during the apartheid years. Changes to the pension funds' contractual obligations and an improvement to South Africa's economy have changed the situation substantially. The obligations of the government pension funds now more or less match their financial resources. This is a dramatic change and a huge relief (Business Day, 19 May 2003: 8).

Already the GEPPF, through the PIC, has substantial investments in empowerment and socially responsible projects. GEPPF Head, Frans le Roux, says the amount stands at R3.361 billion. Investments other than the MTN deal include the N3 toll road, Lesiba Healthcare, Midi Television and PQ Africa Holdings. The PIC is also a substantial

member of the National Empowerment Consortium, through which it owns 6% of media and entertainment group Johnnic (Business Day, 22 May 2003: 4).

Further developments such as the above through the use of the PIC as a source of funding for BEE would hold great funding prospects. Even without a major policy change there is scope to almost triple empowerment and socially responsible investments. An amendment to the Government Employees Pension Law in 1999 stated that 3.5% of funds could be set aside for social investment. The PIC established the Isibaya Fund for this purpose in 1995, but has not come close to reaching the upper limit, which at present levels would be about R9 billion (Business Day, 22 May 2003: 4).

COSATU economist Neva Makgetla has responded critically to the above possible developments since the unions are more of the opinion that investing in BEE companies is not necessarily real development. 'We want jobs and income-earning opportunities for the poor' (Financial Mail, 30 May 2003: 23).

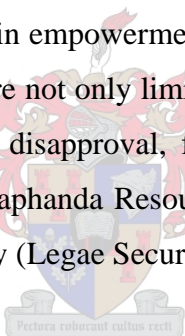
On the other hand, Empowerdex, a BEE research company, says in a study that the PIC constitutes an ideal vehicle to accelerate economic empowerment. 'PIC ownership provides more substantive economic benefits and potential control over economic resources to blacks than many of the existing BEE deals in the market' (Empowerdex, 10 July 2003: 12).

The issue around funding by the PIC has also brought into question whether retirement funds should be used to pay for social investment on a larger and more active level. Government has hinted that the more than R1 trillion in pension and long-term insurance funds is the first place everyone should look. One option that has been looked at is to create a special government bond that would aim to attract investment, particularly from retirement funds. Government could either use the money raised to fund expenditure on infrastructure or allocate it to a new agency. Another option would be to offer tax breaks for investments in infrastructure, which would render them more profitable (Financial Mail, 14 February 2003: 49). However, when it comes to investing in infrastructure or BEE using retirement funds, there are two key issues which need to be considered. The first is the return and sharing of risk,

and the second is timing (Business Day, 22 May 2003: 4). The custodians of these retirement funds after all have a responsibility in ensuring that members retire comfortably and an over-exposure to risky assets that are expensively priced could result in a negative cost to the retirement fund in which they invested.

It would seem that the use of the PIC as a vehicle for BEE investing is appropriate as long as the PIC ensures its exposure to ethical investment and black empowerment is modest, controlled and fair in application, criticism of its investment policy would be muted. A more recent statement by the newly appointed PIC Secretary, Mr Brian Molefe, is that 'we must be part of the national agenda of empowerment' seems to provide support for further initiatives in the future (Legae Securities, 14 July 2003: 13).

What is also interesting is that recent PIC funding activity has not only been about the PIC committing itself to investing in empowerment but that it has committed itself to funding empowerment deals that are not only limited to 'social investment' but also a broader commercial mandate. No disapproval, for instance, could be leveled at a decision to invest directly in Mvelaphanda Resources or to support the listing of the Royal Bafokeng resources company (Legae Securities, 14 July 2003: 15).



But if the PIC is to ultimately act as an empowerment bank, then the commercial rationale becomes more tenuous. Since it is not really the intention that the PIC to assume this role since there are already a number of funds and agencies dedicated to this function such as the IDC, the NEF and Khula. It would seem as though the PIC intends following a very cautious approach in its exposure to BEE investments (Business Day, 22 May 2003: 4).

A further funding challenge for the PIC as an empowerment banking institution is that equity acquired by the PIC for empowerment deal partners (Tiso or Peu in Investec's case) can either appreciate or depreciate in value. When shares appreciate, then the empowerment partners can pay off the loan since it is usually leveraged to the share price itself (Financial Mail, 30 May 2003: 14). In these circumstances, the PIC retains only the accumulated interest that has been paid at rates that one has to assume are commercially competitive. The result is that the PIC will during the time of having

granted the loan not receive the full benefits of share ownership, the dividends going to the empowerment partners to help pay off the loan. This only leaves the PIC in a marginally better position than had it invested in a money market instrument.

But should the Investec shares fall or future company dividends do not materialize, then the PIC is left with a diminished asset. This is the commercial downside which the PIC then faces in the case of acting as an active BEE funder.

It is difficult in such a scenario to talk of 'solid' returns and if this is the meaning of the PIC's commercial mandate which provides it with the authority to act outside the 3.5% of assets allocated to social investments, then deal funding has to be seriously reconsidered. However, if the commercial mandate means to capture deals that make financial sense then deal funding by the PIC is not inconsistent with the mandate provided potential deals are carefully scrutinized (Legae Securities, 14 July 2003: 16).

The Brenthurst Initiative launched by the Oppenheimer Family, has also suggested the use of the PIC funds in helping fund BEE (Brenthurst Initiative, 5 August 2003: 28). In conclusion, it does seem like the PIC is making progress in that it has already indicated that it will shortly be providing such guidelines which will include issues such as approval safeguards, indications of required levels of empowerment partner own risk capital and measures to secure at least most of the requisite repayments (Legae Securities, 14 July 2003: 17).

(vi) Small Savings Sector

Community savings and credit co-operatives are a significant business globally with an annual turnover in excess of US\$605 billion (Business Day, 21 August 2003: 3). These co-operatives, as a source of funding, have also gained momentum in South Africa in recent years. There are currently twenty-five co-operatives in South Africa with a membership of more than 14 000, boasting more than R20 million in savings, according to the Savings and Credit Co-operative League of South Africa, General Manager David de Jong.

The concept of promoting savings amongst communities is a worldwide phenomenon, as shown by the 36 901 savings and credit co-operatives with 112 million members. Of these co-operatives, 3 400 are in Africa, with a total of 2 million members, half of whom are in Kenya. De Jong says the concept is more than 100 years old in other parts of the world, whereas it took root only in 1994 in South Africa. In Canada, one in every three people belongs to a savings and credit co-operative according to De Jong of the Savings and Credit Co-operative League of South Africa. The South African Communist Party has recently said that it was forming its own savings and credit co-operative (Business Day, 21 August 2003: 3).

The Dora Tamana savings co-operative follows the Communist Party's campaign to get commercial banks to transform and diversify the financial sector to be more accessible to the poor and workers. The South African Municipal Workers' Union (Samwu) and the National Education, Health and Allied Workers' Union already have in place savings and credit co-operatives for their members.

The idea behind these types of co-operatives is to provide microlending to members and other people at more attractive rates than the commercial banks and to provide access to finance to those members who would struggle to obtain finance from the traditional banks. Says De Jong, *'There is a lot of potential for these in South Africa. So many people do not have access to financial services and communities must come together and help one another to form savings and credit co-operatives'* (Business Day, 21 August 2003: 3).

Legislation is currently being drafted by the National Treasury and the Reserve Bank to govern these types of traditional savings co-operatives in South Africa. In the meantime, savings and credit co-operatives are operating through an exemption to the Banks Act, according to Reserve Bank manager for legal services: bank supervision, Michael Blackbeard. Section 133 of the Act allows the Registrar of Banks, with the Finance Minister's approval to exempt institutions such as co-operatives from certain requirements that banks are subject to such as account statements and procedures.

According to Candice Jooste, customer communications officer with Teba Bank mentioned that these types of banks service the 'absolute end' of the markets, such as

mineworkers. She says, 'We want people that other banks do not want. We are basically a savings bank, but do provide short-term as well as long-term credit to our miners' (Business Day, 21 August 2003: 3).

According to a recent study done by the University of Cape Town Unilever Institute, formal market offerings were generally Eurocentric, inflexible and focused on individuals rather than groups (Business Day, 12 September 2003: 20). UCT Unilever Institute director, Professor John Simpson, presented the conclusions of the Institute's recent study – Stokvels: Making Social Cents? According to the Institute, stokvels owed their existence to being financially efficient and providing much-needed social support as they fitted into a community-focused culture which the traditional financial institutions do not seem to focus on. The Unilever Institute's research showed that almost one in two black adults were members of a stokvel. Based on conservative estimates by the FinMark Trust, about R5.6 billion was invested in stokvels annually and R8.4 billion in burial societies (Business Day, 12 September 2003: 20).

Examples of stokvels include a basic savings club where individuals made regular weekly, fortnightly or monthly contributions and received a lump sum on a rotational basis throughout the year or at year-end. Some stokvels also consisted of members of a family who grouped together to buy land or cars.

d) Conclusion

The sources of funding discussed in Chapter Four has provided some insight into the potential avenues of finance available for the funding of BEE. The structural problems of these private and public sector sources of funding have also been highlighted. One of the biggest challenges that can be drawn from the analysis of the various sources of funding is the estimated size of funding required to meet the BEE sector charter targets over the next ten years. These structures which are to act as the primary drivers of empowerment funding also have their own problems and related issues with financing. The practicalities around meeting the industry charters within the timeframe set need to be re-assessed in a realistic manner which does not place an unreasonable burden on the institutional sources of funding for BEE.

The role of the private sector, corporates in particular, in financing BEE is likely to increase. At a recent parliamentary briefing (Business Day, Business Report, 10 April 2003: 11) it was mentioned that government will be relying heavily on the private sector to help finance its new broad-based BEE strategy but intends for this to happen voluntarily. Lionel October has indicated that government could only set aside R10 billion to fund BEE this year, compared with the R100 billion committed in the mining sector charter. He also hoped that the outcome of the recent financial sector charter would come up with new and innovative ways to finance empowerment deals while also increasing black ownership.

At the same time, the IDC with its massive R28 billion asset base, would be expected to leverage venture capital, loan finance and equity empowerment deals. Experience elsewhere seems to show that unless there is 'a real partnership' with the private sector, sustainable empowerment was simply not possible. Committee members of parliament have broadly welcomed the new strategy but expressed misgivings about how empowerment firms, especially those that were small and rural based, could access finance given the notorious unwillingness of banks to finance them in the past (Business Day, Business Report, 10 April 2003: 11). They have also criticized plans to give a fairly prominent role to the NEF given its singular lack of progress and staffing problems over the past five years. But October said that the NEF's capacity problems were being addressed. He said that even though there had been some progress in empowerment in 1994, 'it is clear that many of those deals are unsustainable. Many of them are based on debt and many are linked to the share price, so if there is a problem on the stock market people can't repay their debt' (Business Day, Business Report, 10 April 2003: 11).

As far as funding by DFIs goes, it also appears that the problems of today were a result of an absence of coherent government policy during the early years of BEE to enable black business to gain effective access to funding. The IDC, for instance, has a generic approach in its programmes to promote black business (Edigheji, O.E. 1999: 15). Consequently, the state has not created a focal point for the black business community. What this seems to show is that, unlike the East Asian economies, South Africa's funding has neither been targeted nor selective in the past. Khan, F. and Hemson, D. (1997: 19) eloquently summed up the nature and effects of these

empowerment deals: *'Despite the media hype of empowerment taking a slice of the white establishment's control over the commanding heights, the investment of billions of rands of black peoples' funds in forming pyramids, buying into existing companies, and engaging in joint ventures has not produced significant gains in employment of black workers or even a substantially larger number of black managers. Far from being focused on the goals of the RDP or some other such programme for black advancement for the working class in terms of housing, health, community development....black empowerment does not seem yet to equal the social responsibility programmes of existing conglomerates. Certainly their investment is not in these fields.'*

More recently, based on the recommendations of the Brenthurst Initiative of the Oppenheimer Family, government has given the first sign that it will consider tax incentives for certain companies that fall in line with its black economic empowerment wishes (Business Day, 11 September 2003: 1). This is the first indication that government is starting to buy into the principle that tax breaks would encourage compliance with its empowerment ideals.

Lionel October said, 'If it is affordable, government will certainly look at tax incentives.' October said the incentives being considered would not be universal, but would apply, for example, to a company setting up industrial and development projects that required large-scale investment and would create a large number of jobs' (Business Day, 11 September 2003: 1).

It had become clear that because of the market failure, the state had to play a more direct role in the retail part of the provision of loan finance to small and black firms and that was why Khula Enterprises was examining entering the retail market.

5) Chapter Five: Risks, Criteria & Possible Solutions

a) Introduction

The purpose of this chapter is to identify some of the risks that could result as a consequence of the implementation of BEE in South Africa. Market reactive risk, foreign investor risk and the risk that the cost of BEE for the sources of funding have been identified. General guidelines for BEE will be discussed. Thereafter, specific criteria provided by the DTI scorecard, the BEEC Report and the IDC funding criteria document for a BEE benchmark and suitable financing of BEE transactions will also be discussed. A case study using the recent BEE transaction concluded by Investec Limited will apply these criteria practically. From this, possible solutions to the funding of BEE will be drawn.

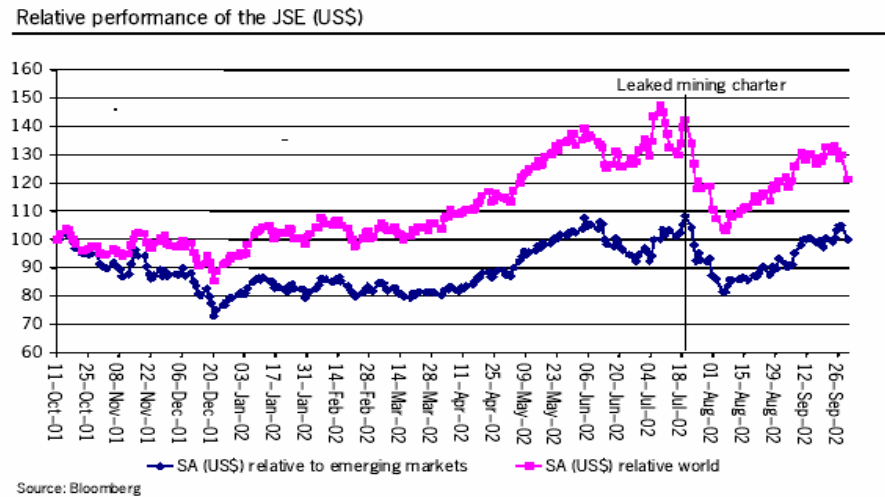
b) BEE Risks

The impact of BEE on the JSE (Johannesburg Stock Exchange) thus far has been profound. For instance, the announcement of the Mining Charter in 2002 led to a collapse of the stock market performance of listed resources companies as foreign investors sold their shares in these companies. In the seven days following the leaked mining charter, the JSE lost R99 billion of market capitalization and in the month following it underperformed developed markets and emerging markets by 15.3% and 7.1% respectively (refer to Figure 5.1 below).

This event highlighted the risks that the government's BEE charters are likely to pose, particularly on foreign investor interest in South Africa listed companies. The achievement of the ownership targets specified in the BEE sector charters is going to entail another cost in that the various public and private sources of funding are going to be the primary drivers of the financing of these BEE targets. Foreign banks have also recently lobbied with government that they be excluded from the ownership clause in the financial services charter. Further, uncertainty about the implementation of BEE, and what its effect is likely to be, has negatively affected US investors perceptions of investment in South Africa, according to a study prepared by Breakstone & Ruth for the Bank of New York (Business Day, 14 August 2003: 2).

This means that US investors may opt to buy shares in other emerging markets as they do not carry the perceived ‘empowerment charter’ risks as South Africa does.

Figure 5.1 Relative performance of the JSE



**Bloombergs is the financial database used to source this chart and was also published in a Cazenove Report in October 2002: 1.*

This weakness came from foreign selling of equities on fears of forced asset sales at a discount. There had been net foreign selling of equities in July, August and September 2002, which account for a third of the net foreign selling months since 1994 (Cazenove, October 2002: 1). This is despite a government press release saying that ‘any sale or transfer of ownership in the industry would take place in a transparent manner and for fair market value’. There is a perception that South African assets per se are more risky given our emerging market status. This is not helped by calls for 25%-26% of the JSE to be in black hands, with little debate about ownership and what that implies.

The leaked mining charter made the market realize that government was increasingly going to focus BEE on the issue of ownership. This in turn created the fear of value destruction and the concept of a BEE discount. Structurally, such a move would favour bonds over equities because country risk should be reduced, while companies rather than government will bear the cost. However, the second round effects of a weaker rand and higher inflation favour equities over bonds.

Another factor which is likely to have an impact on our market is the reaction of foreign investors to developments on BEE. As was highlighted earlier, foreign investors turned net sellers, which is negative on a flow of funds analysis. Table 5.1 shows foreign ownership on the JSE with foreign investors being large holders of our resource shares which is a risk for these companies. On a more positive note, the fact that many South African companies have been coming into their own internationally such as the recent US listings of Telkom, Sasol and Naspers, has led to South Africa being the eighth most active American Depositary Receipts market in the world in 2002 (Business Day, 14 August 2003: 2).

Table 5.1 Foreign ownership

Fig 5.3 Foreign ownership

Percentage	Jun 2001	Sep 2001	Dec 2001	Mar 2002	Jun 2002
Total foreign ownership	27.7	26.1	29.4	28.8	30.2
Resources (flat average)	25.6	23.7	20.3	20.4	22.0
Resources (weighted average)	37.4	36.3	36.4	35.0	37.8
Financials (flat average)	10.2	10.5	10.4	10.0	11.8
Financials (weighted average)	10.1	10.6	10.2	10.2	12.5
Industrials (flat average)	12.9	11.0	11.4	11.1	10.9
Industrials (weighted average)	26.3	23.5	29.5	26.1	25.7

Note: Sample group has been continually growing, hence time period comparison is not accurate

Source: Cazenove share register analysis service, covers > 70 companies c. 65% of market capitalisation

**This table was sourced from a Cazenove broker report titled 'Black Economic Empowerment' and dated 21 October 2002: 15*

The most difficult issue for the market to quantify is what cost will business have to bear due to BEE and how much discount needs to be applied. What is certain is that there will be costs with the likelihood that empowerment deals will be done at a discount to ensure compliance with charters. There might also be an opportunity cost on forgone growth opportunities as companies joint venture new projects.

On a theoretical basis we can calculate what additional equity risk premium or BEE discount is being priced into South African equities. Assuming a global risk free rate of 3% and an ERP of 3% for international markets. Using Gordon's dividend growth model this implies a fair value PER of 16.7x. A country risk premium of 2.5% is added on in line with current bond strips. This means a fair value PER for South African assets of 9.1x. We assume real growth of 3% and a dividend cover of 2x for

both countries. In a global bear market, equity risk premiums tend to rise but on a relative basis this should not have an impact (Cazenove, October 2002: 16).

$$P = \frac{D1}{k-g} \quad \text{Price = forward dividend divided by the cost of capital less growth}$$

Cost of Capital = risk free rate (rf) + equity risk premium (erp)

Dividend Yield (DY) = rf + erp – real growth Assume real rf + 3%, real growth = 3%

Refer to Appendix D for further explanations and details on the terminology and calculation.

The reality is that South Africa has had an average PER (Price Earnings Relative) of 10.9x over the past 30 years, which on the above calculation suggests that the long term real return required was 7.6%. Currently the SA market is on a 2003 forward PER of 8.3x, which should translate into a long term real return of 9%. This represents a 140 basis point increase in equity risk premium, or a 25% discount due to black economic empowerment (Cazenove, October 2002: 18).

One risk to the funding of BEE would be a weaker currency and higher inflation, which in turn leads to higher interest rates. The higher monetary base due to BEE financing will also impact inflation. As can be deduced from the above, no clear figures exist on what level of funding is required, but the JSE has a market capitalization of around R1.47 trillion, while South Africa's GDP is R0.98 trillion. It is therefore not improbably to see R100 billion worth of deals done in the next five years with a large portion of these being debt funded. In 1998, Business Map recorded more than R20 billion worth of BEE deals with the impact clearly seen in the spike in loans and advances by the banks. The risk facing current BEE developments is that banks suffered in the aftermath of the collapse of BEE post the Asian crisis of 1998, in terms of bad debts and the funding of BEE. High real rates are likely to add to the financing costs of BEE and highlight the discrepancy between government policies on BEE and growth and the implementation of a demanding inflation target.

c) Criteria for Effective BEE Financing & Transaction Models

Current black economic empowerment (BEE) transaction models will make it very difficult for companies to meet empowerment targets. Once funding and other costs are factored in, and the transaction has been wound up in five years, in many instances, the BEE partner is likely to be left with a shareholding of only between three percent and five percent. In the best case a shareholding of under ten percent might be achieved and in the worst case the result could be zero.

The recently published financial sector charter calls for financial services institutions to be 25 percent black-owned by 2010, of which 10 percent must be satisfied by way of direct ownership of black people, provided the company board is 33 percent black (Financial Services Charter, 17 October 2003: 11).

There are essentially four ways in the current environment to structure a BEE transaction. Refer to Appendix E for graphic illustrations of some of these financing models. Firstly, there is the classic deal model whereby an investor has funds and uses these to buy a percentage of the business. It is rare that the BEE partner will be able to put up all the funding, but there are some cases of BEE groups having to put up some of their own capital in an investment. An example of this is the recent deal between African Vanguard Resources and Harmony Mining. The BEE company borrowed R110 million from Nedbank and collected R30 million from various black sources ie R140 million was put forward by African Vanguard Resources in cash (Jones, L. 2003: 5). However, the application of this model is rare given that most BEE companies do not have sufficient financing and often make use of a loan provided by the target company.

Then there is the revenue contribution model where the BEE partner earns a stake in a company by bringing a new revenue stream to the business. This is most successful when applied to a small company, but tends to fail when applied to a large company. The reason is that to be a meaningful BEE stake, there is a 25 percent requirement. If a company produces R750 million it can be extremely difficult for the BEE partner to provide a revenue stream that grosses R250 million (Cape Times, Business Report, 20 November 2003: 2).

The third type of BEE transaction is where it is funded through various financing models as is illustrated in Appendix E. For example, in the first wave of empowerment, as discussed in Chapter Three, special purpose vehicles (SPV) were created and these were funded in order to make the investment. These types of SPV structures have subsequently fallen out of favour, given the fact that many BEE partners at the time exited with little or nothing. For a funded deal to be profitable, the circumstances need to be absolutely right. To begin with, the BEE partner must be able to buy in at a discount, and the value of the shares must grow exponentially. An example of this is the case of the Investec BEE transaction where the funding for the BEE consortium was provided by the PIC and the BEE consortium bought Investec shares at a very favourable market price at the time of the deal. This will be discussed in further detail in the case study.

On the other hand, an example of where the funding model can be a failure is the case of the empowerment consortium, Ucingo which was given a 3% stake in Telkom for R566 million in March 2001. The value of this debt has since ballooned to around R860 million with funding costs, yet the value of the investment is only worth around R540 million (Jones, L. 2003: 5). The problem is that the debt has become due and payable to the funders by the BEE consortium. The choices for Ucingo are either to hand over the equity to the funders or alternatively the funders need to find a way of rolling over the debt for this empowerment consortium. This more recent example is hardly new given that the market is littered with examples of empowerment transactions where funding has been provided to the BEE group which have failed when the share prices have fallen to below the price at which the deals were concluded. Other examples include African Harvest, Peregrine and the partnership between Worldwide Africa and Dimension Data at Plessey (Jones, L. 2003: 5).

Another example of the funded route for empowerment transacting is the trend to facilitate direct equity participation in black empowerment transactions via private equity funding. However, such transactions are generally done on a commercial basis with the financiers having to apply normal investment decision criteria before embarking on the transactions. The benefit of using private equity is that it allows access to operational cash flows rather than relying on rising share prices. The recent

de-listing of Fedics Limited by Ethos Private Equity is a notable example of the private equity funding of an empowerment transaction.

A pitfall of the third type of BEE transaction involves security. To buy a stake in the target company, the BEE partner often has to cede shares to the funder as security. This could result in the funder (a bank, private equity company or government) attaching the shares and exercising voting rights in the event of non-performance of the BEE party (BusinessMap 2001: 12). This could leave the company with a bank (or whomever the initial funder was) as shareholder, as opposed to a BEE partner. There are many examples of this, of which the much criticized Foodcorp/Pamodzi deal is one of the more recent where ABN Amro ended up with the shareholders' rights (Cape Times, Business Report, 20 November 2003: 2).

The fourth type of deal is where a company takes a view that there is a cost to doing a BEE transaction, and it thus prepared to allow a BEE partner to buy shares now and acquire the rights of a shareholder, but only pay for these rights in three or five years' time at today's value. For the BEE partner, this is most attractive as it will not be burdened with escalating debt. This entails the setting up of a number of specific performance targets for the empowerment company, whereby its equity participation is increased as each performance target is achieved (Cape Times, Business Report, 20 November 2003: 2). For example, an empowerment company will buy 10% equity in a corporate with an option to buy a further 10% to 20% in three years should it add value to the corporate in a measurable way. An example of this is the recent Bidvest BEE transaction. However, it must be noted that these types of transaction models often come with an equity-related cost of funding. Once this is factored in, the BEE shareholding is likely to be five percent or less and the firm will struggle to meet its BEE ownership targets.

Finally, there are hybrids of these approaches. The recent deal between African Rainbow Minerals (ARM), Harmony Gold and Anglovaal Mining is an example of such a hybrid empowerment model (Mahabane, I. 2003: 24).

Although the structure of each transaction is dependent on the characteristics of the company involved, the financial capability of the BEE party and the preference of the

vendors, there are certain key criteria that have to be considered when undertaking workable empowerment transactions. These are strong cash flows, good assets within the target company, the ability of the BEE partner to add sustainable value and a reasonable entry price for the BEE partner.

In addition, in a recent Discussion Document formulated by the Department of Trade and Industry (2003: 17), the following broad guidelines were put forward for the effective financing of BEE:

- **Maintaining macroeconomic balance:** This means that BEE cannot be financed by taking on excessive debt or large scale deficit financing or by assuming excessive sovereign contingent liability.
- **Increasing the growth rate:** The rate of investment needs to rise which means that South Africa needs to remain attractive to domestic and international investors. Thus, it is also essential for those who are sellers of assets to reinvest in the economy. This second factor will require an economy capable of higher rates of growth.
- **Intensifying economic transformation:** This means ensuring that the levels of employment and participation in the economy are increased and that economic benefits are shared more equitably across the geographic dimension and by all social groups. This means more access to all forms of social service and infrastructure for all citizens.
- **Diversifying the size and type of enterprise:** The financing strategy needs to take particular care to ensure that all forms of enterprise have access to finance.
- **Commercial risk must remain with the private sector:** The State will facilitate access to capital and collateral, but it will not assume commercial risk for these enterprises. This must remain with the enterprises, the entrepreneurs and the investors. This is crucial from the point of view of the macro-economic stability of the economy, but more importantly it is likely to improve the quality of enterprise development and therefore the competitiveness of the economy.

- Financing should not lead to the enrichment of a few: The financing of effective BEE needs to take place within the parameters of the existing macro-economic and micro-economic reform strategies. If this is not done then the risk is that BEE will only lead to a small wealthy black elite in a low growth economy that lacks competitiveness.

The key question still remains whether this broad-based approach of government can still provide for a financing strategy that will make a significant impact on the rate of effective BEE for the broader South Africa.

Stakeholders largely agree that empowerment should be linked to larger and more specific issues such as employment creation, skills transfer and the creation of sustainable black businesses for the longer term.

Overall, it is perhaps evident that the few significant empowerment transactions taking place currently are getting access to funding due to the backing received from the facilitating corporates and due to the fact that the underlying businesses are in stable sectors. An example of this is African Rainbow Minerals which listed around May 2002. This resource company is in a joint venture with traditional gold mining house Harmony. Due to the attractiveness of the gold price and the fact that this BEE company is in a joint venture with one of the biggest mining houses in the world, they were able to raise more than R300 million upon listing. Some traditional banks also backed them such as South Africa's BOE Merchant Bank and the Royal Bank of Canada (Miningweb, 2002:21). What is also interesting with this BEE company is that foreign investors provide the largest support base of this company with 29.7% of the company's shares owned by European investors, 15.4% by US investors and 10.8% by Canadians.

Smaller transactions, on the other hand, will have a greater chance of success if a joint venture or sub-contracting approach is used due to the inherent lower funding requirements. The IDC's primary focus has been on black development in recent years with financing for black firms starting at R1 million to R250 million with the average being at R5 million. This financing is structured either through strategic equity partnerships or through financial mechanisms such as leveraged buy-outs. The

IDC to date has done more empowerment funding than any other institution in the country (Business Report, 25 February 2003: 1-8). In the past six months alone it has approved R300 million worth of deals.

As discussed, government has made a commitment to set-aside finance to support a broad-based BEE process. The National Treasury and Department of Trade and Industry have been tasked to review the roles of development finance and support institutions as well as the National Empowerment Fund (NEF) to ensure that these resources are used in an effective manner.

Given the central role that the Department of Trade and Industry's balanced scorecard is likely to play in assessing the BEE compliance of companies, it is worth noting that equity ownership receives one of the highest scores. Therefore black ownership of companies will remain a key requirement.

The increase in the number of BEE transactions since 2001 does indicate a possible 'second wave' of BEE has emerged in the last two years as the market has expected government to introduce new legislation and charters in many sectors of the economy. Rising gold and platinum prices have also enabled three BEE companies in the mining sector, namely African Rainbow Minerals, Mvelaphanda and Simane to emerge. The key differences from the first phase of BEE in the 1990s, is that financial institutions that have returned to the market as funders of the next wave of BEE deals, have put forward new funding models that emphasized own contributions by BEE companies, and repayments that are tied to the operational performance of the target company which has to bear some of the risk (Gqubule, D. 2003: 16).

Despite the trend towards private equity as a source of funding, there has also been a resurgence of BEE transactions of listed JSE companies. African Rainbow Minerals (ARM) and Harmony announced a R20 billion merger this year, MTN's managers paid R4.8 billion for a 19 percent stake in the company. Mvelaphanda aims to acquire 15 percent of Gold Fields for R4.1 billion and as already mentioned in the case study, Tiso Capital and Peu Investments are leading a consortium that plans to buy 25 percent of Investec (Gqubule, D. 2003: 16).

It is disturbing to note that with the recent wave of BEE transactions as indicated in the previous paragraph, none of these transactions involves a private sector financial institution. ARM/Harmony required no outside funding, the PIC intends to finance the MTN and Investec deals and Mvelaphanda has not yet announced details of its funding structure, but is expected to raise a significant portion on the strength of its balance sheet alone. With financial institutions hesitant to get involved in such large transactions, except under onerous conditions, three trends are likely to emerge. First, target companies will be expected to facilitate transactions and allow BEE companies who they partner with to pay out of future profits. Secondly, most opportunities will end up consolidating around the few BEE companies that have gained critical mass over the past decade. Finally, the private sector financial institutions will be required that Government DFIs work in partnership with them and bear some of the transaction risk in entering such transactions since this has already been stipulated in the recent release of the Financial Services Charter (17 October 2003: 10).

An example of a more broad-based BEE transaction recently concluded has been that of Gold Fields and Mvelaphanda Resources. The director-general of the minerals and energy department, Sandile Nogxina, has welcomed this deal. At the announcement of this particular deal, Nogxina said there were concerns that established BEE companies were not doing enough to spread empowerment. He said, 'A concern we have is what have other established black economic empowerment companies done to empower their brethren?' (Business Day, 11 June 2003: 15).

This deal addresses broader-based concerns in that it will bring in other black economic empowerment players and pass on knowledge and skills. The new empowerment partners still have to be announced, but it has been agreed that a significant minority proportion of Gold Fields' assets will be sold to other empowerment groupings. Further, the fact that this BEE deal with Mvelaphanda results in Gold Fields selling 15% of its South African assets is in line with meeting the requirements of the mining charter which requires 15% of companies' mining assets to be held by empowerment groupings in five years, and this rises to 26% in ten years (Mining Charter, August 2002). Therefore, the development impact of a BEE transaction is also important in terms of the DTI scorecard requirements. What has made the Mvelaphanda business model commendable as far as broad-based

empowerment is concerned, is that the strategy is to co-invest with a number of broad-based empowerment groups at a subsidiary level. The groups include Umkhonto we Sizwe Military Veterans' Association (MKMVA), the Steve Biko Foundation, Cotlands, Johannesburg Child Welfare Society, Women's Development Bank and Widows of ANC Veterans (Gqubule, D. 2003:20).

Some practical examples of how these broad-based groups benefited from Mvelaphanda is the case of MKMVA where the organization participated in Mvelaphanda's acquisition of Northam. MKMVA has 46 000 members and converted its free Northam shares through the deal into a 4 percent stake in the company. In November 2002, the broad-based BEE groups were given the opportunity to sell their shares, which resulted in an R80 million payout to a number of groups such as MKMVA which have since used the funds to support a range of community projects (Gqubule, D. 2003: 20).

The recent BEE coal deal of Mmakau Mining, headed by Bridgette Radebe, wife of Public Enterprises Minister Jeff Radebe, should no longer qualify as an empowerment deal. Radebe is one of a handful of already wealthy black business people who continue to benefit from the government's black economic empowerment strategy (Business Day, 21 August 2003: 2). Mark Lowe, Democratic Alliance spokesman on trade and industry, had the following to say, *'Black economic empowerment is supposed to be about bringing new entrants into existing industries. It should be about assisting entrepreneurs to start new businesses that will broaden participation in the economy'* (Business Day, 21 August 2003: 2). Mmakau Mining is one of four BEE companies that have been awarded access to the export capacity of the Richards Bay Coal Terminal.

Another deal that has created significant BEE ownership is that between ARMgold and Harmony. By selling African Rainbow Minerals Gold (ARMgold), chairman Patrice Motsepe converts 100% control of a small gold company into a significant stake in a much larger company and has thus effectively had his company bought out (Business Day, 6 May 2003: 11).

By buying ARMgold, Harmony passes one of the most onerous stipulations of the new mining rights regime which is that of equity ownership. The questioning issue is whether this deal really adds value to the South African mining charter's attempts at creating a black mining industry. One could also ask if Anglo Gold should not rather get the BEE credit in the case of this transaction by selling a collection of Free State mines to ARMgold and Harmony ie is the sale of assets not at least as important for empowerment as the purchase of assets (Business Day, 6 May 2003: 11).

This question can be answered by looking at the mining charter and BEE scorecard. Both documents lay enormous stress on the achievement of ownership targets. However, it does seem from the recently released Financial Services Charter that empowerment financing by this sector as well as the role of skills development will start playing an increasingly important role.

This type of BEE transaction which is typical of most recent BEE deals (excluding Investec) raises concerns about current BEE implementation. It is questionable whether many of these 'second wave empowerment' BEE transactions comply with the definition and interpretation of broad-based empowerment as mentioned in Chapter 1 of this study. Since the main black shareholders of ARMgold are confined to a very small group: principally Motsepe himself and his politically well-connected family members (Motsepe's elder sister, Bridgette, is married to Public Enterprises Minister Jeff Radebe. His other sister, Tsepiso, is married to Johnnic chairman, Cyril Ramaphosa). This transaction seems to provide a case in point of BEE really only enriching a few rather than promoting sustainable, broader black entrepreneurship and the creation of jobs.

d) Applying BEE criteria to Case Studies – Investec Limited

Using Investec Limited as a case study in testing if the BEE transaction it announced in May 2003 actually meets the guidelines and criteria as specified in the BEEC Report and the broad-based strategy document of the Department of Trade and Industry where the BEE scorecard is stipulated. Further the recent financing guideline document issued by the IDC is also used as a measure of the effectiveness of the

Investec BEE transaction. Some of the Financial Services Charter guidelines will also be applied.

As a point of departure, the detail of the BEE transaction of Investec which was concluded in May 2003, will be discussed for background purposes. This transaction also provides an example of one of the financing models referred to in Appendix E, namely equity funding via capital-raising.

Earlier this year, black investors bought a 25% stake in Investec Limited, South Africa's fifth largest bank and the South African business of dual-listed Investec, in a deal valued at R1 billion. Black-owned groups, Peu Investment, Tiso Group, a broad-based Entrepreneurship Development Trust and an Employee Share Trust acquired this stake (Business Day, 16 May 2003:1). Tiso, with a 6.8% stake is headed by Fani Titi, while Peu (6.8%) is headed by Peter Malungani. The Entrepreneurship Development Trust (6.8%) will be governed by independent trustees on behalf of organizations accounting for 60% of its shareholders. The balance of the shares (4.7%) will be allocated at the discretion of Investec management to a trust for historically disadvantaged Investec employees. A graphic illustration of the transaction is provided in Figure 5.2.

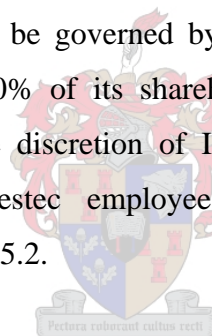
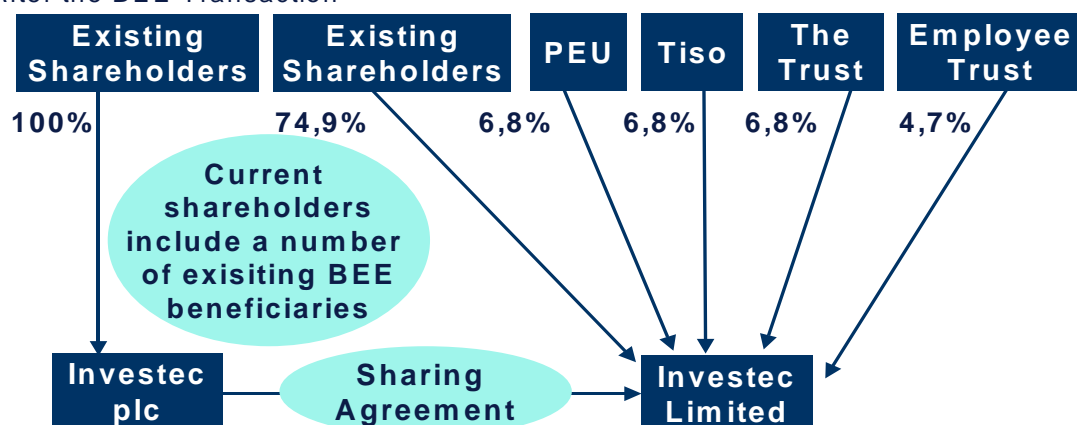


Figure 5.2 Structure of Investec Ltd after the BEE transaction

After the BEE Transaction -



Source: Investec Limited, March 2003 Financial Year-End Results

Fani Titi, the chief executive of Tiso and Peter Malungani, the chief executive of Peu, were already members of various Investec boards. Investec has also partnered Peu and

Tiso on a number of previous acquisitions (Cape Times, 16 May 2003: 1). Therefore, this relationship goes back five years where Investec management and directors already had operational experience of working with the BEE groups who were part of the recent transaction.

Investec's transaction is of particular significance relative to the peer group given that it is the first major financial institution to sell a substantial shareholding to black partners. For instance, Stanlib also announced a BEE transaction subsequent to Investec's announcement. But the primary difference is that Standard Bank is only selling 25.2% of its asset management business, Stanlib, and not of the entire banking group, as is the case with Investec. Standard Bank management have admitted that the primary rationale for their BEE transaction was aimed at retaining and growing Stanlib's asset management business (Cape Times, 19 June 2003: 1).

The R810 million funding of the empowerment partners, namely, Tiso, Peu and the Enterprise Development Trust, in the case of the Investec transaction came from the PIC (Sunday Times Business Times, 18 May 2003: 3). What makes this particular deal different from many others is that the empowerment partners have obtained independent funding and have not relied on the institution with whom they are doing the BEE transaction to raise the capital as well and carry the related risk. This transaction therefore differs from many of the BEE deals such as Nail, Rail, Johnnic and even the recent Stanlib deal where the empowerment partners carried no downside or funding risk and did not either obtain financing from the government pension fund, namely the PIC.

The funding details of the transaction are as follows. The balance of the R1 billion was raised via the following funding structure. Investec shares were acquired at R90 each and Investec at the same time issued 5.6 million new shares, raising around R504 million in the process (Sunday Times Business Times, 18 May 2003: 3). Assurances were given that the loans made by the PIC were at commercial rates, that payment had been structured over eight years and that even assuming a flat dividend and share price, the empowerment partners would still retain a 'significant residual shareholding.' Initially it appears as though the PIC had funded the entire deal, but later it emerged that Investec itself had put up 14% of the required finance as a sign of

good faith and that the empowerment parties had also introduced some risk capital (Legae Securities, 14 July 2003: 17).

The manner of funding between the Investec and Stanlib BEE deals also differs. In the case of Investec, the PIC was the primary funder, whilst in the case of the Stanlib transaction, it was Standard Bank and Liberty who put in the bulk of the funding. What is also interesting in the case of the Stanlib BEE deal is that the black consortium, Safika, is given an incentive to introduce new business mandates to Stanlib, since it will then allow for the rate paid for the funding by the banks to be reduced (Business Day, 19 June 2003: 1).

Investec's relationship with these parties goes a long way where Tiso for instance, was created in 2001 by Fani Titi and other black entrepreneurs with seed capital from Investec. This BEE company has a partnership with Kumba Resources as well and a 25% participation right in the Two Rivers platinum project. Investec holds 24% of Tiso, staff and management 56% and the public benefit organization Tiso Foundation holds 20% (Business Day, 16 May 2003: 4). Tiso seems to have more than proven itself as an operational business when its role as a private equity player in Nail, Kumba, Alstom and many other companies is evidenced. Tiso's emergence as a serious power broker on the corporate scene has as much to do with increasing deal flow as with the approach and strategy towards empowerment adopted by Fani Titi. It's his commercial orientation that enables him to walk away from deals if they are not strategic and focuses on operational and cash flow issues (Mahabane, I. 2003: 20).

Peu is an investment holding company headed by renowned entrepreneur, Peter Malungani. Peu is involved in financial services through a consultancy firm, Peu Capital and has a 10% interest in Capital Alliance.

Both Tiso and Peu are headed by black individuals who have solid experience and credentials as operational businessmen. Further, both are real entrepreneurs who have started their own businesses successfully. They are also far less high profile or politically connected than most of other black individuals who have relied on their political connections to get deals. The reason why the Investec BEE deal provides a good model is that it appears as though the corresponding spin-off for a broader

constituency seems to be the case. This transaction involves two real black entrepreneurs where it will generate benefits for all Investec shareholders by attracting significant future business for the asset management, corporate finance and other divisions across the Group (Business Times, 6 July 2003: 5). Better still, the entrepreneurs invested alongside a broad-based empowerment trust and designated black staff. This is in line with the Financial Services Charter which has as one of its key imperatives the promotion of entrepreneurial development and the provision of support to black entrepreneurs (Financial Services Charter, 17 October 2003: 5). The focus on entrepreneurial development also compliments the interpretation of BEE in terms of this paper, namely the promotion of black entrepreneurs.

The theme of entrepreneurship is central to Investec's empowerment strategy which is comprised of three tiers, namely, the creation of new entrepreneurial businesses, inspiring black entrepreneurs within Investec and developing black entrepreneurs in society (Theobald, S. 2003: 22). Therefore, the appointment of two entrepreneurs, Fani Titi and Peter Malungani of Peu on various Investec boards and as major BEE shareholders is in line with Investec's theme of entrepreneurship.

As far as the Investec deal goes, Tiso's Titi had the following to say, 'The transaction happens at Investec levels, so its not a deal of convenience that only targets part of Investec involved in parastatal or government business' (Sunday Times Business Times. 18 May 2003: 3). Again, this characterizes the deal from the Stanlib BEE deal.

Further, the deal means that Investec has qualified as an empowerment company under the department of trade and industry's guidelines.

The proposed Development Trust, will be governed by an independent board of trustees and is designed to promote entrepreneurial and leadership development. Cash flow generated by the trust will be distributed to organizations meeting the objectives of the trust (Cape Times, 16 May 2003: 1). The strong entrepreneurship theme has long been a characteristic of Investec as a business since it was established over 15 years ago. As Andy Leith, joint managing director for Investec South Africa says, '...we've taken a classic Investec entrepreneurial approach and applied it to empowerment' (Sunday Times Business Times, 18 May 2003: 3).

It does seem that post this deal, that Investec will meet the empowerment criteria set out by the department of trade and industry and has more than met the direct ownership target of 10% as specified by the Financial Services Charter (Financial Services Charter, 17 October 2003: 11). The combination of shareholding of Peu, Tiso and the Entrepreneurship Development Trust, would equate to 20.4% of Investec. Investec employees, predominantly black employees will hold 4.7% of the group through an employee trust.

Referring to the DTI's empowerment guidelines, Leith, says companies need to realize the guidelines are not about box-ticking. He says: 'You can't just tick one box, you have to tick them all' (Sunday Times Business Times, 18 May 2003: 3). He said Investec had consulted with government to check that its plans fitted within the broad empowerment framework. 'This transaction moves out of being Investec's black empowerment strategy and becomes part of our journey to sustainability in the new South Africa – we've taken a classic Investec entrepreneurial approach and applied it to empowerment' (Sunday Times Business Times, 18 May 2003: 3). Investec's BEE ownership figures were in line with the recommendations made by the BEE Commission, *'Black people (including businesses and collective enterprises) should hold at least 25% of the shares of companies listed on the Johannesburg Stock Exchange'* Black Economic Empowerment Commission Report (2001: 24).

What also sets this transaction apart from many other BEE transactions is that most of the deal was funded by the PIC. An eight year funding structure was designed to ensure that each new empowerment shareholder of Investec could retain unencumbered equity participation at the end of the funding period. The deal involved Investec issuing 5.6 million shares for cash. It would also seem that issuing shares at a price of R90 was very attractive for the BEE groups given that this is one of the lowest levels of the share price in recent years. The only criticism of the funding structure thus far is 'that it seems that the PIC is taking all the risk while a few black empowerment groups are set to benefit from what upside there is' (Business Report, 16 May 2003: 4). This was how one empowerment analyst described the recent BEE transaction of Investec saying that it looked like a great deal for all concerned except the commissioners and pensioners to whom the PIC is responsible.

However, following on recent announcements that the IDC was helping to fund Cell C and the PIC had also funded the acquisition from Transnet of a stake in MTN on behalf of MTN management, there are growing calls for these institutions to make public the terms and conditions of their funding arrangements (Business Report, 16 May 2003: 3). One empowerment analyst added that in this Investec transaction it seemed likely the PIC was creating a fixed interest investment which would generate certain returns but would still be exposed to loss of capital. He said, 'this seems like a subsidy from the PIC to a select group of people.'

Historically, what has also been positive about the Investec transaction is that Investec had never been part of the conventional empowerment vehicles of the 1990s, funded by institutions whose reliance on a rising share price was misplaced and which empowered a few.

Investec SA joint managing director, Andy Leith recalls, 'we were hammered for not participating in those deals, but just think of the billions written off by life companies.' He says for Investec it was a question of thinking hard about its core competencies, its successes and where it could add value to BEE on a sustainable basis, 'we were good at creating business platforms and backing entrepreneurs' (Sunday Times Business Times, 1 June 2003: 3).

He goes on to say: 'This informed our empowerment approach. Sustainability, not ownership became a recurring theme.' But Investec staff aspirations were a strong theme too. He says it was essential to align staff expectations upfront. The bank has energetically embraced employment equity and training is a big passion within Investec. 'Our senior black buys can work anywhere, not because they're black but because they are highly competent. It's about equipping people to build the country,' says Leith (Sunday Times Business Times, 1 June 2003:3). Leith has also emphasized that Investec's involvement of staff is deliberate and not decorative. Leith sees no point in lending Investec's name and balance sheet to empowerment outsiders when there is an enthusiastic body of black staff willing to transform the bank organically from within (Sunday Times Business Times, 18 May 2003: 3).

The involvement of staff in an empowerment trust is another defining feature of this BEE deal and provides a more broad-based approach to the transaction. What also makes this transaction unique from the rest is that for Investec, staff buy-in was critical. Black staff would probably have rebelled if Investec had sought to empower a group alongside Investec, rather as Standard Bank has with its Andisa Capital start-up. Andy Leith, joint managing director of Investec South Africa also felt that there was no point in lending Investec's name and balance sheet to empowerment outsiders when there is an enthusiastic body of black staff willing to transform and grow the bank organically from within (Sunday Times Business Times, 18 May 2003: 3).

The other beneficiary of the deal is the Development Trust which is designed to promote entrepreneurship and leadership development. Cash flow generated from the trust will be distributed to organizations meeting the objectives of the trust (Cape Times, 16 May 2003: 1).

As far as Investec's contribution to the broader society goes, it has also made some differentiating contributions. At the Cida City Campus, which operates from Investec's former Johannesburg CBD headquarters, the bank not only writes cheques, but its staff teach and sponsor pupils. These types of initiatives by Investec are in line with their emphasis on entrepreneurship as a form of creating sustainable BEE (Sunday Times Business Times, 1 June 2003: 2).

While the government appears to be in a hurry with its empowerment agenda, Investec's approach appears to recognize that creating sustainable empowerment takes time. That probably informed its decision not to appoint former politicians to help get ahead of its peers in the black business arena.

The Investec deal is also something new again as far as comparison to the peer group is concerned. Unlike Alexander Forbes where empowerment shareholders have taken 30% of the SA operations with Cyril Ramaphosa having led this transaction, Investec is selling its new shareholders an interest in its whole, global operation rather than just the SA arm. That is unusual because the deals done so far have tended to bring empowerment shareholders in on businesses where they could directly add value such as asset management where credentials really matter when it comes to pension fund

mandates. As Tiso CE, Fani Titi, put it the new shareholders will have input into all of Investec's businesses and not only where empowerment shareholding could be seen as beneficial (Business Day, 19 May 2003: 9).

However, this deal has drawn criticism especially from the trade unions. Many felt that details of the terms of the deal were scant. Critics do argue that the need for transparency around this deal is heightened because the GEPP is a defined benefit fund, meaning that it is the government and ultimately the taxpayers' money that is at risk if investment fail (Legae Securities, 14 July 2003: 17).

What critics fail to appreciate is that in complex transactions, where intermediary vehicles are utilized, deal information is usually at a premium, and funding information virtually non-existent. However, there are still shortcomings in that the PIC is still required at the very least to establish a set of rules comprising a strategy that governs funded transactions and to assure members and markets alike that the funding terms are commercially competitive, that empowerment partners share risks and that no asset subsidization is taking place.

The BEECOM 2001 has provided some valuable guidelines for testing the success of a BEE transaction (BEECOM Report 2001: 30). The rationale for this is that the BEE Commission believes that financial institutions and established business should ensure that future BEE transactions are guided by what is in the long-term national interest and in line with the broader definition of BEE. The factors recommended by the BEECOM and according to the Department of Trade and Industry BEE Scorecard as key components in a successful BEE transaction are listed on the left column. The Investec deals' success rating in meeting these is indicated on the right column of Table 5.2.

Table 5.2 Investec measured against prescribed BEE criteria

BEE Commission Criteria	Investec's	Comment
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	Rating	
1) Clearly defined objectives and alignment of interests	Good.	The BEE deal is very focused with a clear strategy and rationale.
2) Appropriate pricing	Good.	The deal was very attractively priced at R90 per share and was in line with the market price at the time.
3) Effective skills development beyond the BEE Act minimum requirements	Very good.	The Enterprise Development Trust is committed to the promotion of entrepreneurs and skills development. Investec has also been involved in a great deal of skills development in the community above the minimum requirements eg. Cida City Campus, Business Place, Staff.
4) Creative financing structures including claw-back and earn-in provisos	Reasonable.	The unique feature of the financing structure (vs other deals) was that the PIC was the primary funder and not Investec. However, not clear if there are any incentives built into the deal encouraging BEE partners to pay back the loan to the PIC within a shorter period as is the case with the Stanlib deal. However, BEE parties are partaking in the risk since they also made a contribution to the funding of the deal. Also selling part of the offshore business and not only the SA business.
5) Clearly defined and easily measurable growth targets	Good.	However, not much detail on the transaction is public.
6) Involvement of a focused, entrepreneurial BEE group that stands to lose more than it's reputation	Very good.	Investec deal is highly rated in this regard since a very focused BEE group, who are proven, successful entrepreneurs, in the same sector ie financial services.
7) Effective participation at the highest level of decision-making	Very good.	Titi of Tiso already serves on the Investec Bank board and Malungani of Peu is already on the Investec Group board.
8) Long-term commitment of both parties	Good.	Given that the BEE partners have already had a very long association and commitment with Investec, it seems unlikely that they are in for the short-term. They are also bearing significant risk themselves.

DTI Broad-Based BEE Scorecard⁴⁴		
1) Direct empowerment score a) Equity Ownership: 20% b) Management: 10%	Very good.	The first financial services BEE deal where 25.1% ownership is placed in black hands. The Investec BEE partners will be part of full operational control of the SA business.
2) Human resource development & employment equity score a) Employment Equity: 10% b) Skills Development: 20%	Good.	Investec has submitted its employment equity plan to the Department of Labour and is currently in line with the EE Act targets. Number of black staff in senior management positions have increase significantly in recent years. Investec has ongoing human resource development programmes.
3) Indirect empowerment score a) Preferential Procurement: 20% b) Enterprise Development: 10%	Reasonable.	Investec has been very proactive on enterprise development via the Cida City campus initiative as well as the Business Place in Johannesburg. These projects have also been in line with Investec's focus as a business on entrepreneurship. Improvements can still be made on preferential procurement.

Another criterium in determining the success of a BEE transaction is ensuring that it is broad-based and does not only lead to the enrichment of a few politically connected individuals. The Investec BEE deal has followed a more broad-based approach in allowing for a stakeholding by staff and then also the Enterprise Development Trust. Further, Investec South Africa's deal, also reflects the focus on entrepreneurship which is in line with one of the strategies of BEE as discussed in Chapter One of this study and which is part of the interpretation of BEE for the purposes of this paper. However, as far as the creation of jobs and the provision of more accessible finance to the poor is concerned, Investec still has progress to make.

As far as funding criteria is concerned, the IDC BEE Funding Policy Document provides some useful guidelines in their BEE funding criteria (2003: 7). Table 5.3 summaries the funding criteria and looks at the particular funding criteria required in the case of a BEE company wanting to acquire another business. Different funding

⁴⁴ Department of Trade and Industry, A Strategy for Broad-Based Empowerment (2003), Appendix A: 21.

criteria exist for a BEE company which wants to start-up a business or which wants to expand. However, the acquisition example has been used for the purposes of this paper so that the criteria can be tested against the case study of the Investec BEE transaction. Table 5.3 provides an interesting analysis.

Table 5.3 Investec measured against IDC BEE Funding Criteria

Criteria	Type of Transaction: Acquisition	Does the Investec BEE Deal meet these criteria?
Legal Entity	This business should be a company incorporated in South Africa, a close corporation or a sole proprietor.	Yes
Ownership	The applicant should at least be 50.1% owned by HDPs. The target company should be at least 25.1% or an equity interest that affords significant influence. At least 6% share by HDP employees.	Yes since the BEE consortium is 100% by HDP's ie Peu and Tiso whilst the target company is not 25.1% black owned, it will be so after the deal.
Management Control	HDP partner should have significant participation in the business.	Yes. Both the directors of Tiso and Peu have executive board representation on various levels of Investec Limited. The deal also entails that they will have operational decision-making in the business.
Contribution	The applicant must provide a minimum unencumbered equity contribution of 2.5%, depending on risk.	Yes, the applicant did meet this contribution requirement in the case of it's application to the PIC for funding.
Business Status	The business should have a proven trackrecord.	Both Tiso, Peu and Investec Limited have a proven trackrecord of more than five years.
Financial Performance	<ul style="list-style-type: none"> ✓ The target must provide satisfactory historical financial statements; ✓ Underlying assets; and/or ✓ Sureties/guarantees may be required; and/or ✓ Alternative assets. 	Yes.

Funding Facility	<ul style="list-style-type: none"> ✓ Equity finance of not more than 40%; and/or ✓ Quasi-equity; and/or ✓ Secured loans. 	Although the detail of the transaction is not revealed due to confidentiality clauses, it appears as though the financing was equity finance – so it would meet the IDC criteria.
Minimum Funding	R1 million	Yes.
Pricing	<ul style="list-style-type: none"> ✓ Prime-based interest on loans; and ✓ Pricing is based on development impact, risk and contributions. 	Yes. In the case of this transaction all that is clear that the equity finance was done at a market-related price plus prime, but in the case of the PIC who acted as financier in this deal it could be less than prime.
Terms	Up to seven years, depending on industry.	No, since the term of the Investec BEE deal is eight years.
Additional Information	<p>Exceptions:</p> <ul style="list-style-type: none"> ✓ Turnaround; and ✓ Refinancing 	Not applicable since the BEE group is not needing finance based on an existing finance arrangement or it is not the case where Investec is being acquired due to a turnaround situation.
Strategic Business Unit (SBU)	The various strategic business units for which BEE financing are offered are chemicals, textiles and allied industries etc.	No, since financial services is not covered.

Source: IDC Funding Policy Document (2003) and Own Additions

The findings from Table 5.3 suggest that the Investec BEE transaction has fared relatively well should the BEE consortium consisting of Peu and Tiso have applied to the IDC instead of the PIC for financing. These criteria of the IDC should be useful in measuring other BEE deals.

e) Possible Solutions

This study has revealed that the funding problem of BEE has a number of challenges as far as the actual capacity of the sources of funding are concerned as well as the access to capital for black entrepreneurs and the poor. These challenges are further exacerbated by the fact that the funding structures available do not necessarily guarantee a more sustainable and broad-based form of BEE.

From the analysis it therefore appears that there is no single solution to the current funding problem of BEE for South Africa. The IDC itself, has also acknowledged that there is no specific ideal future funding model (IDC BEE Conference, 2 October 2003). But, a few possible solutions will be discussed.

The Black Economic Empowerment Commission (BEECOM) believes that government should intervene in the financial sector to promote BEE. For instance, government should sell its current stake in Business Partners to raise funds for targeted support through existing structures. Government should direct more financial and human resources towards developing sustainable SMEs. Government should also provide incentives in stimulating the venture capital industry, extend current tax incentives for SMEs and encourage the development of co-operatives and retail schemes. It is expected that the Financial Services Charter will aim to help resolve the lack of access to financing via traditional financial institutions for the poor.

It is also proposed that government should seek advice from other developing countries to find successful models of financing the lower end of the market (such as the successful Grameen Bank model from Bangladesh). The provision of loan guarantees by Khula is unlikely to benefit those entrepreneurs who lack the knowledge and skills to be able to make a convincing loan application. Khula should rather offer loan guarantees through accredited micro-finance institutions (GEM Survey 2002: 49).

There is much debate around increased participation by the traditional banking sector to service the lower end of the small business market. The government should

stimulate competition between financial institutions by providing incentives for them to create access to finance for entrepreneurs through innovative schemes.

Another viable proposal by the BEECOM is the introduction of Community Re-investment (CR) legislation as part of a package of instruments to restructure the financial sector and to ensure affordable finance for households and entrepreneurs.⁴⁵

Another solution would be for the emphasis on the percentage of ownership to be replaced by what actual financial value accrues to the BEE investors. Secondly, longer time frames need to be set since the timeframe of ten years in the Mining Charter, Financial Services Draft Charter and the Petroleum and Liquid Fuels Charter seems too short. The Malaysian experience has shown that the targets were only met after thirty years. In tandem with this, the funding terms for the BEE companies need to be extended to a longer period as the IDC funding criteria also stipulates. Thirdly, the costs of funding need to be lowered.

Listed assets will be difficult to fund (for example equity stakes in Old Mutual) as investors are solely reliant on dividends. The private equity alternative as a source of funding and as a vehicle for funding needs to be seriously considered since the last ten years have proven that dividends are never sufficient to repay funding unless there is significant growth in the share price (Msibi, D. 2003: 32). Private equity transactions focus a lot more on direct cash flows from the business as a means of repaying some of the funding used to acquire the asset. Fortunately, one is also finding an increasing number of ingenious schemes for raising finance without straining the banking sector. Attempts have been made to access funding from the PIC. That money has already been created and accordingly the use of such debt should not be inflationary (Jammie, A. in Cazenove, 16 October 2003: 9). However, the supply of funding from this source is itself limited. Undue use of this avenue for funding empowerment could also impair the retirement benefits of public servants. In the end, other ways have to be found to fund empowerment which avoid the creation of new debt.

⁴⁵ It is interesting to note that the CRA was enacted in 1977 in the US as a third component of a legal framework that forbade discrimination in lending. CRA encouraged banks to provide services, including loans to low-income groups.

The guidelines for effective financing as provided by the Department of Trade and Industry's broad-based strategy for BEE is also useful for monitoring purposes of BEE deals that are funded such as the point that BEE does not lead to the enrichment of only a few (DTI, A Strategy for Broad-Based Empowerment, 2003: 18). The IDC has also recently announced at an IDC BEE Conference (2 October 2003) that it is going to have an accreditation method so as to prevent 'fronting' when BEE companies apply for financing from the IDC.

However, with the release of the Financial Services Charter in October 2003, it appears as though the financial institutions are going to play a vital role in empowerment financing in the future. It will also be interesting to monitor how this sector and Government DFIs will work together in mobilizing resources for financing from a practical perspective (Financial Services Charter, 17 October 2003: 10). It is also recommended that government establish a completely new DFI institutional framework that is clearly defined and aimed at a more practical solution to the implementation of BEE and the allocation of government funds to BEE than the current situation. More realistic targets also need to be prescribed for the various DFIs as far as the actual allocation of funds is concerned.

It is also recommended that a possible solution to more targeted funding of small businesses and smaller black entrepreneurs is the direction of more financial and human resources towards developing sustainable black businesses through far more active SME programmes that aim at extensive skills development. Also, the establishment of more aggressive tax incentives for black SMEs could also be a step in the right direction.

Future partnerships between government and the financial services sector, as highlighted in the Financial Services Charter is also likely to enable the provision of more broad-based funding to the poor.

The implications of the GEM Survey 2002 for black entrepreneurs is that South Africa needs to continue working towards creating a more entrepreneur-friendly climate according to the Entrepreneurial Framework Conditions such as government policy, financial support and access to physical infrastructure. A more conducive

climate and stronger business skills will go a long way to prolonging the life of start-ups to the point where they start and remain sustainable.



6) Chapter Six: Summary of Findings and Conclusion

This paper has analysed the funding of BEE through available research, current events and experiences which has laid the foundation for determining whether past and present funding structures will ensure longer term sustainability of emerging BEE businesses for South Africa.

This study has been approached in the context of the current economic and political landscape in South Africa. It has also taken into account recent developments as far as BEE is concerned.

Some of the findings of this study are that traditional financial institutions in South Africa have not been accessible to the poor, smaller emerging entrepreneurs and neither to black SMEs on a sufficient scale. Most of the models and structures of the past did not lead to the sustainable growth of black businesses in South Africa. Overall, government programmes in this regard are poorly executed, non-transparent and uncoordinated. There is also a general lack of awareness of government initiatives to support entrepreneurs because of poor promotion of initiatives and programmes. Many of the government-subsidized support centres, such as Local Business Service Centres have been unable to deliver anything meaningful to entrepreneurs. Further, the wholesale nature of Khula and Nitsika have been the root of many problems in the implementation of efficient financing for BEE.

Looking forward, the Financial Services Charter is likely to deal with this as well as government and the IDC, in particular, who have set aggressive funding targets for BEE over the next few years. The Financial Services Charter has provided a commitment from Government and the private sector to work in partnership so that resources can be mobilized for empowerment financing.

Examples used of the nature and character of the vast majority of empowerment initiatives up to now have still failed to demonstrate meaningful transformation. The risk also remains of empowerment deals have fallen short of contributing to economic growth and employment in any significant manner. Most empowerment deals represent a mere shuffling of the deck chairs resulting in the creation of a new or

crony elite. Wealth transfer in some manner or form is inevitable given the levels of inequity and inequality caused by the previous political system, but this transfer of ownership has failed to meet the broader-based empowerment objectives of recent BEE legislation. Some recent empowerment transactions look promising, but still have complicated financing structures which makes it challenging to determine whether real empowerment has taken place as far as voting control and financial interest is concerned.

The real issue at hand remains the application of empowerment policies to ensure effective funding in the future. The scope and scale of implementation and the extent to which beneficiaries are empowered via effective empowerment financing will be the next step. Although the financing question is directly related to the transfer of assets to result in a change in ownership of companies in South Africa as each BEE transaction is effected, the financing of these deals should also include actions and terms that fundamentally aim to transform the process by covering broader issues such as job creation, employment equity, skills development, proactive procurement and the creation of a larger group of black entrepreneurs for South Africa. In this regard, the shift in focus in recent months toward the notion of a scorecard in which skills development does indeed feature as one of the components which qualifies as a contributor to BEE within an organization is welcomed. While many companies appear to have bought in to the rationale for BEE, there is a continuing need to build the commitment of management and shareholders to embark on meaningful and sustainable BEE programmes. The Mining Charter (Act No.28, 2002) and other subsequent charters are in part aimed precisely at this, but it is also necessary for Black companies and potential BEE investors to pursue investment opportunities in a manner that realizes value for the company via sustainable fund structures (Brown, A. 2002:3).

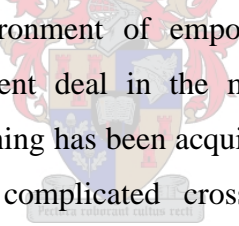
It seems unlikely, given the size of the funding requirement to meet sector charter targets, that these will be met in the timeframes set aside. Further, less emphasis should possibly be placed on the ownership requirement in the various BEE scorecards and more on the development impact that the funding of transactions are likely to have in ensuring more broad-based empowerment. The Financial Services Charter has hinted at a move in this direction where the weighting of empowerment

financing in the charter's scorecard is a full 22%, which is the same weighting given to control and ownership which is hopefully a reflection of the priority given to the sector's role in funding South Africa's growth and development.

One of the key macroeconomic challenges faced by empowerment initiatives during the next phase of BEE, which is the implementation phase, relates to the implications of the funding of such processes. The financial demands of funding BEE in the manner frequently envisaged by politicians and other interested parties are enormous and the macroeconomic implications potentially destructive if such initiatives are not pursued with appropriate circumspection. This view is based on concern expressed by a number of investors, economists and captains of industry about the more practical implications of the significant cost implications of BEE. In this regard, the Mining Charter appears to have set the tone for empowerment. This Charter proposes that 15% of the sector should be Black-owned within five years and 26% within ten years. It is in this respect that there are key concerns. The funding of BEE initiatives should not be gratuitous and instead should be market-related. However, if for example, such a principle were applied to transferring 25% of the market value of all listed companies on the JSE over the next ten years, it would translate into funding of 25% of the market capitalization of R1.7 trillion which is funding needed of over R400 billion in total. Although these calculations and the estimates mentioned in various parts of this paper are very crude, one very important reason for undertaking BEE is that, if successful, it ought to enhance political stability and via this economic progress in the longer term. Nevertheless, the risk of significantly higher inflation and through this lower economic growth is one possible outcome of the actual implementation of BEE over the next 10 years that needs to be guarded against. It is for this particular reason that one needs to emphasize that all BEE initiatives should have the imperative of value added from the process and not be seen as a process that has only ended up enriching a small group of South Africans.

Mention has also been made in this paper of past failures and likely successes as far as the structure of BEE deals is concerned. A key outcome from this analysis is that improvements and enhancements to past failures are in the process of being made. Given the transitional nature of BEE per se, there is no certainty that current improvements will ensure sustainable forms of BEE for South Africa going forward.

However, the BEE scorecard and various funding criteria will hopefully allow for a more structured and monitored approach in assessing the success or failure of an empowerment transaction. The establishment of a Charter Council aimed at monitoring the compliance of South African companies in meeting the scorecard requirements is a move in the right direction. Further, the Financial Services Charter also emphasizes the key role that Government DFIs are likely to play in providing empowerment financing which indicates a far more active role that Government is likely to play in ensuring that past failures do not repeat themselves. The Financial Services Charter also undertakes that the private sector and Government have until June 2004 to establish effective financing models for the mobilization of various resources. The establishment of effective financing models is key in ensuring that the newly empowered BEE company has the appropriate financing structure in place. Recent experiences as with the holding of Tiso in Kumba Resources where the BEE company was unable to service its debt provides a lesson to be learnt for similar companies.



Challenges in the current environment of empowerment financing undoubtedly remain. The largest empowerment deal in the mining sector has recently been announced where AngloVaal Mining has been acquired by Patrice Motsepe's African Rainbow Minerals through a complicated cross-holding share structure. This transaction has highlighted many of the practical loopholes in mining charter and other BEE charters. It is questionable whether this deal really meets BEE criteria and has raised critical issues such as what measuring stick should exactly be used when looking at each transaction on a deal for deal basis and what specific criteria need to be applied?

This paper has also highlighted the key role that the promotion of black entrepreneurship will play in achieving true broad-based BEE for South Africa. The problem is that findings highlight that there is a lack of effective community-based micro-finance infrastructure. Banks are not either in a position to service this sector profitably and remain risk averse to small business, especially businesses or entrepreneurs with no trackrecord, little business experience and no collateral. It is also highlighted that South Africa cannot rely on the banking system alone to solve the problem of poverty and finance for entrepreneurs. The role of government will be

key in the actual provision of funding for BEE and the implementation of the various BEE strategies identified in Chapter Three of this study. There is a lack of awareness and information about Khula and other DFIs. It is also found that there is a limited availability of micro-financing to rural and woman entrepreneurs by government. For the implementation of broad-based empowerment to succeed, government will also have to increase access and availability of support centres to assist in training, skills development and other forms of assistance over and above financing. There appears to be a lack of strategic thinking by the black business community on which sectors they should concentrate on to enhance their economic power, the quality of their investment and ultimately the creation of jobs for the majority of the black population. Therefore, the political and legal empowerment of black people since 1994 has not automatically translated into socio-economic empowerment (Terreblanche, S.J. 2003: 35). This explains the policy shift to socio-economic empowerment as described in the definition and interpretation in the introductory section of this paper.

The failure of black business in the 1990s to support the small and medium-sized enterprises has been another key weakness linked to lack of job creation since the rise of BEE. Moshapalo, head of the Black Business Council (BBC) adequately describes this failure, *'Many big black businesses that made it in listed companies have taken their money out of the country – to London and New York. Those that are still in the country are on their way. We now need to support the SMEs that are genuinely committed to staying and contributing to growth and development'* (Enterprise Magazine, April 2003: 19).

Recent statistics on access to finance of a large part of our population again highlights the problem around funding. Most of our population own no property not even household goods. They have no reserve funds at their disposal (Terreblanche, S.J. 2003: 35). In a recent article published in the Business Day, Business Report section (West, E. 2 May 2003: 2) it is estimated that about 17.2 million adult South Africans do not even have bank accounts, never mind the kind of savings products that might lead to a retirement free of dependence on the state. Although inroads have been made recently as far as the funding of empowerment deals by financial institutions is concerned, the challenge still remains to achieve a sustainable impact on the broader population.

Given that BEE is a relatively new and evolving process for South Africa, the success thereof is still uncertain. Government has finally laid the framework through various laws, charters and scorecards, and the implementation phase is likely to accelerate over the next ten years in South Africa. Only then, can the success of BEE and the funding thereof really be tested. This study has aimed to provide an analysis of the current challenges and experiences of the financing of BEE and tried to highlight some of the possible risks and also solutions for the future.



List of Definitions

- 1) BEE means black economic empowerment as defined by government in its strategy for broad-based black economic empowerment, subsequent legislation and codes of practice, means the economic empowerment of all black people, including women, workers, youth, people with disabilities and people living in rural areas, through diverse but integrated socio-economic strategies;
- 2) BEE transactions means all transactions for the acquisition, by black South Africans, of direct ownership or indirect ownership in an existing or new entity in the financial sector or any other sector of the economy; and joint ventures with, debt financing of or other form of credit extension to, and equity investments in BEE companies (other than SMEs);
- 3) Black companies means companies that are more than 50% owned and are controlled by black South Africans;
- 4) Black empowered companies means companies that are more than 25% owned and with substantial participation in management by black South Africans;
- 5) Black influenced companies mean companies that are between 5% and 25% owned with substantial participation in management by black South Africans;
- 6) Black People means all Africans, Coloureds and Indians who are South African citizens and includes black companies;
- 7) Black SME means a small or medium enterprise (with a turnover ranging from R500,000 per annum to R20 million per annum) which is a black company or a black empowered company;
- 8) Broad-based ownership is where an empowerment shareholder represents a broad base of members such as employees (to the extent that the options have actually been exercised), collectives and/or communities, or where the benefits support a target group, for example, black women, people living with disabilities, the youth and employees. Shares are held directly or indirectly through non-profit organizations and trusts. At the same time, directors and management of the groups should significantly comprise black people;
- 9) Development Finance Institutions or DFIs means finance entities created or funded by a tier of Government. These include, but are not limited to, the DBSA, IDC, Post Bank, NEF, Land Bank, Khula, NHFC, the PIC, the Umsobomvu Fund, and Provincial Development Corporations;

- 10) Direct ownership means ownership of an equity interest together with control over all of the voting rights attached to the equity interest;
- 11) Effective access means being within a distance of 20 kilometers to the nearest service point at which first-order retail financial services can be undertaken, and includes ATM and other origination points, except in the case of the products and services of the long term assurance industry, where effective access, including physical access will be in terms of the availability of these products and services, and in terms of proximity or accessibility if financial advisers to community-based infrastructure; and also being within a distance of 20 kilometers to the nearest accessible device at which an electronic (other than ATM) service can be undertaken; and appropriate and affordably priced products and services for effective take up by LSM 1-5; and structuring and describing financial products and services in a simple and easy to understand manner.
- 12) Empowerment financing means the provision of finance for or investment in:
- Targeted investment; and
 - BEE transactions;
- 13) Enterprise development means support for existing, or the fostering of, new black SMEs and BEE companies in the financial and other sectors of the economy;
- 14) Financial sector means all the financial institutions as defined in (15);
- 15) Financial institutions means banks, long-term insurers, short-term insurers, re-insurers, managers of collective investment schemes in securities, investment managers and other entities that manage funds on behalf of the public, including retirement funds and members of any exchange licensed to trade equities or financial instruments in this country;
- 16) Government financial institutions are development finance entities created or funded by all tiers of government. These include DBSA, IDC, PostBank, NEF, Land Bank, Khula and NHFC;
- 17) Indirect ownership occurs where an institution or other investor owns equity in a company on behalf of beneficiaries and there is no direct participation by the beneficiaries in the voting rights;

- 18) Targeted investment means debt financing of, or other form of credit extension to, or equity investment in South African projects in areas where gaps or backlogs in economic development and job creation have not been adequately addressed by financial institutions. It specifically means financing of or investment in:
- a) transformational infrastructure projects that support economic development in underdeveloped areas and contribute to equitable access to economic resources.
 - b) agricultural development involving integrated support for resource-poor farmers
 - c) low-income housing for households with a stable income in excess of R1,500 per month and less than R7,500 per month.
 - d) Black SMEs



List of Acronyms

ANC	African National Congress
ASN	National Unit Trust
BBC	Black Business Council
BBSDP	Black Business Supplier Development Programme
BEE	Black Economic Empowerment
BEEC	Black Economic Empowerment Commission
BEP	Black Equity Partner
BMF	Black Management Forum
BOSMEs	Black-Owned Small and Medium Enterprises
BSA	Business South Africa
CBO	Community-Based Organisation
COSATU	Congress of South African Trade Unions
CR	Community Reinvestment
CRA	Community Reinvestment Act
DBSA	Development Bank of South Africa
DFI	Development Finance Institution
DTI	Department of Trade and Industry
EAP	Economically Active Population
EDSA	Entrepreneurial Development Southern Africa
EMIA	Export Marketing and Investment Assistance
ESC	Entrepreneurial Support Centre
ESOP	Employee Share Ownership Initiative
FSB	Financial Services Board
GDS	Growth and Development Summit
GEM	Global Entrepreneurship Monitor
GEPF	Government Employees Pension Fund
GSB	Graduate School of Business
HDI	Historically Disadvantaged Individuals
HDPs	Historically Disadvantaged Persons
HEDC	Highveld Entrepreneurial Development Centre
HRD	Human Resources Development
IDC	Industrial Development Corporation
IDT	Independent Development Trust
IPO	Initial Public Offering
JOHNNIC	Johnnies Industrial Corporation
JSE	Johannesburg Stock Exchange
KEF	Khula Enterprise Finance Facility
LED	Local Economic Development
LOA	Life Offices Association
MFI	Micro-Finance Industry
MFRC	Micro-Finance Regulatory Council
MSEs	Micro and Small Enterprises
NAFCOC	National African Federated Chamber of Commerce
NAIL	New Africa Investments Limited
NEDLAC	National Economic Development and Labour Council

NEF	National Empowerment Fund
NGOs	Non-Governmental Organisations
NHFC	National Housing Finance Corporation
PDC	Provincial Development Corporation
PPP	Public Private Partnerships
PSBC	Provincial Small Business Council
RAIL	Real Africa Investments Limited
RDP	Reconstruction and Development Programme
RFI	Retail Finance Institutions
SACOB	South African Chamber of Business
SAVCA	Southern African Venture Capital and Private Equity Association
SBDC	Small Business Development Corporation
SBU	Strategic Business Unit
SME	Small and Medium Enterprises
SCOPA	Special Committee on Public Accounts
SOE	State-Owned Enterprise
SPV	Special Purpose Vehicle
SR	Social Responsibility
TDI	Targeted Development Investment
UYFC	Umsobomvu Youth Fund



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Appendix A

Table 3: Likely focus areas of BEE in industries over a 10-year period

	Ownership	EE and Skills development	Procurement	Corporate social/ community investment	Access to financial services and investment patterns	Beneficiation or diffusion and use of technology or extension of infrastructure	Government leverage over the industry
Liquid Fuels	 25%				NA		High
Mining	 26%				NA		High
Financial services	 20%						High
ICT	 30%				NA		Medium
Tourism	 30%				NA		Medium
Agri industry (incl. food processing and retail)	 15%				NA		Low
Manufacturing related (automotives, metals fabrication)	 15%				NA		Low
Transport and logistics	 30%				NA		Medium
Building and Construction	 15%				NA		High

Source: Andrea Brown

FIGURE 3: LIKELY FOCUS AREAS OF BEE IN INDUSTRIES OVER A 10-YEAR PERIOD

Appendix B

The Funding Mechanism for the Purchase of 10% and 20% in Metlife by Nail

The Funding Mechanism for the original 10% purchase of Metlife

10% of Metlife was acquired from Sankorp through the Methold vehicle in May 1994. The acquisition price of R137 million equated to R2 per Metlife share, calculated from the 40 day moving average. The acquisition was financed through an IDC loan. In exchange for the loan, the IDC received the right to subscribe for Methold ordinary shares at a price of R1 per share. In terms of the prospectuses, the IDC renounced its holding and offered its right to a wide spread of black shareholders in the community including Corporate Africa.

The Funding Mechanism for the Purchase of an Additional 20% of Metlife

The transaction to acquire the additional 20% of Metlife's ordinary share capital from Sankorp was financed as follows:

The issue to Corporate Africa of ordinary shares in Nail – R96 million

The issue of preference shares in Nail to Sankorp – R165 million

Cash in Nail (ex Corporate Africa for preference shares) – R165 million

Total – R426 million

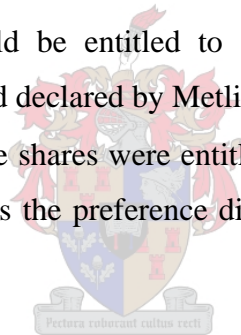
Preference shares by Nail to Sankorp, were issued in order for Nail to acquire a further 20% in Metlife, the salient terms of which are referred to below.

Details of the Sankorp Preference Shares

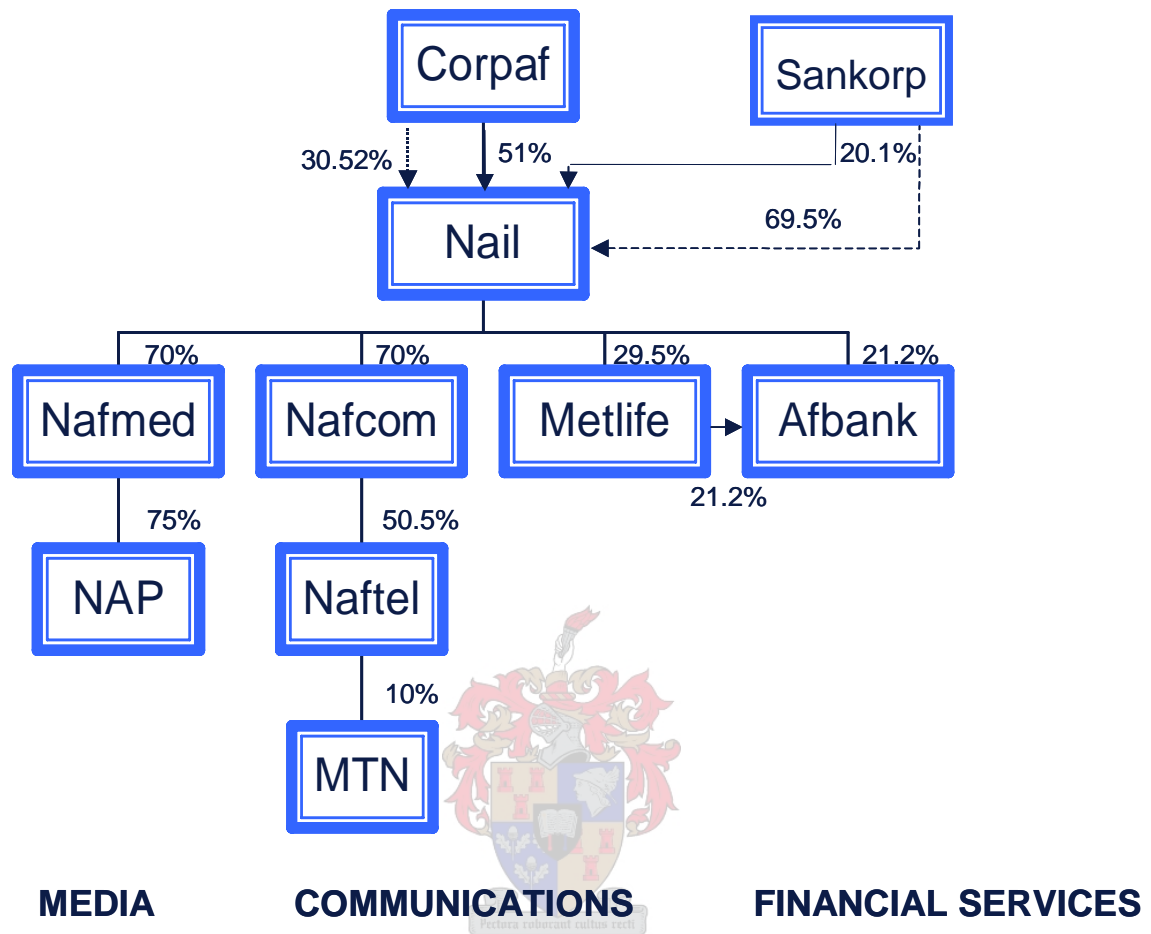
The detailed terms of the preference shares were as follows:

- The preference shares, of one class, were issued at a premium at 125.44 cents per share

- The preference shares were redeemable and convertible into ordinary shares at the option of the holder at any time after the expiry of three years following their issue
- With regard to the preference shares issued to Sankorp, it was agreed that they would not exercise their right of redemption/conversion until the fifth year, nor would any conversion by Sankorp increase its total ordinary shareholding in Nail above 30%. In addition, it was agreed that any conversion by other preference shareholders would not dilute Sankorp's total ordinary shareholding in Nail below 20%
- If not redeemed at the end of five years the preference shares would automatically convert into ordinary shares
- The conversion price of the preference shares would be directly linked to the Metlife share price on the JSE in the ratio of 25 preference shares to 1 Metlife share
- The preference shares would be entitled to a preferential dividend that was directly linked to the dividend declared by Metlife
- The holders of the preference shares were entitled to attend meeting but not vote at any meeting of Nail unless the preference dividends had not been paid in full within 14 days of due date



An illustration of the pyramid structure used to ensure that Corporate Africa retained control over Nail



Appendix C

Funding Initiatives of the IDC Since Inception

Milestones in Our History






The '40s

- Parliament passes the IDC Act to establish the Industrial Development Corporation with authorised share capital of £5 000 000 (±R730 000 000 in 2002 prices) (1940).
- The first loan granted to a small industry producing "Ouma" rusks. The value of the loan was £1 500 (±R220 000 in 2002 prices) (1941).
- Due to shortages of goods during World War II, the IDC Act is amended to enable the IDC to establish, as well as operate, industries (1942).
- The IDC's accounts show a profit for the year 1942/1943 (1943).
- The IDC buys its first motor car, a second hand Mercury Sedan (1945).
- The IDC played an integral role in the establishment of the textile and animal feeds industries in South Africa.

Approvals	
Total Number	130
Total Value	
• 1940's Prices	R16 million
• 2002 Prices	R1,2 billion
% of GFCF in SA	1,1%

The '50s

- Establishment of Sasol, and funded by the IDC (1950).
- Equity taken up in Sappi for the establishment of a kraft and wrapping paper mill in Natal (1951).
- South African Industrial Cellulose Corporation (Saiccor) set up to process wood and produce raw materials for the production of rayon. Saiccor later taken over by Sappi (1951).
- Foskor established to develop phosphate deposits at Phalaborwa and supply a domestic fertilizer industry (1952).
- The IDC fully endorses the "Buy South African" campaign (1953).
- Establishment of Phillips Carbon Black in Port Elizabeth to provide the rubber industry with this important raw material (1959).
- The IDC negotiates foreign loan to the value of \$8 500 000 from Chase Manhattan Bank (1959).
- Acquires an interest in Safmarine from a shipping company in the USA (1959).

Approvals	
Total Number	150
Total Value	
• 1950's Prices	R144 million
• 2002 Prices	R6,2 billion
% of GFCF in SA	2,5%

The '60s

- First "industrial estate" established in which industrialists could lease factory accommodation (1960).
- Export credit financing scheme set up to assist South African exporters (1962).
- Synthetic Rubber Company founded to produce rubber from raw materials obtained from Sasol (1962).
- Small Industries Division formed within the IDC to tend to the needs of smaller industrialists more effectively (1962).
- Sapekoe formed to develop tea estates (1963).
- Palabora Mining company founded to exploit copper deposits in Phalaborwa (1963).
- Formation of the South West African Water and Electricity Corporation for the development of the now Namibia's electricity and water resources (1964).
- Soekor registered with shareholding by the IDC and Sasol to search for oil in South Africa (1965).
- Financing of a submarine telecommunications cable between Europe and Cape Town (1965).
- Minerals Development Division established within the IDC to investigate and where applicable beneficiate mineral deposits in South Africa and provide finance to small mining ventures (1966).

Approvals	
Total Number	770
Total Value	
• 1960's Prices	R540 million
• 2002 Prices	R18,3 billion
% of GFCF in SA	4,7%

GFCF – Gross Fixed Capital Formation



The '70s

- Establishment of pilot plant for the reclamation of titanium minerals from beach sand at Richards Bay authorised – forerunner of Richards Bay Minerals (1972).
- A financing scheme for export development introduced (1973).
- The SA Government authorises the establishment of Sasol II (1975).
- Branch office of the IDC opened in Cape Town (1979).
- Construction of Atlantis Diesel Engines commences. Technical partners include Daimler Benz and Perkins (1979).
- The IDC commits itself to the establishment of the South African Micro-electronic Centre (later renamed South African Micro-electronic Systems) in co-operation with Siemens, the South African Post Office and the CSIR (1979).

Approvals

Total Number	1 300
Total Value	
• 1970's Prices	R2,5 billion
• 2002 Prices	R42,5 billion
% of GFCF in SA	5,4%



The '80s

- The IDC transfers its small industries assets to the newly formed Small Business Development Corporation, closing a nineteen year history of direct assistance to small industries (1981).
- Alusaf expansion, doubling its capacity, completed (1983).
- The IDC moves to its current offices in Sandton (1983).
- The IDC launches a venture capital scheme to assist entrepreneurs in manufacturing and marketing high technology products (1986).
- Development of a 40ha date plantation in the Northern Cape (1989).
- The IDC acquires a minority shareholding in Iscor (1988).

Approvals

• 1980's Prices	R6,1 billion
• 2002 Prices	R28,3 billion
% of GFCF in SA	3,1%

The '90s

- Algorax/Degussa project in Port Elizabeth for the manufacturing and export of automotive catalytic converters (1990).
- The IDC pays dividends of R1 billion to be channelled to the Development Bank of South Africa (DBSA) (1991-1992).



2000 to 2002

- Commitment of R600 million to support the tourism industry (1992).
- Columbus Stainless Steel joint venture formed along with Highveld Steel and Vanadium and Samancor (1993).
- Alusaf Hillside Smelter established (1993).
- Warehousing of Metropolitan Life shares for black economic empowerment group – New African Investments Limited (NAI) (1993).
- Financing for Anglo American's Namakwa Sands project on the West Coast approved (1993).
- Important role played in Uruguay Round of World Trade Organisation negotiations (1994).
- Loan finance provided to a number of black controlled consortia to take up shareholding in the first two cellular operators in South Africa (1994).
- The IDC's mandate extended to the entire SADC region (1997).
- Funding for the Mozambique Aluminium Smelter (MOZAL) approved (1998).
- Restructuring of the Corporation to increase its efficiency (1999).
- The share of the number of approvals to empowerment firms exceeds 20% for the first time (2000).
- Geographical mandate extended to entire African continent (2000).
- The Mozal expansion project to double the smelter's production capacity, was approved (2001).
- The restructuring of the South African steel industry initiated with the unbundling of Iscor into separate mining and steel companies and incorporation of Saldanha Steel into the steel producer (2001).
- African involvement is increased (2002).

Approvals

Total Number	1 440
Total Value	
• 2000's Prices	R16,0 billion
• 2002 Prices	R16,7 billion
% of GFCF in SA	5,5%

Approvals

Total Number	2 600
Total Value	
• 1990's Prices	R37,2 billion
• 2002 Prices	R56,4 billion
% of GFCF in SA	6,5%

Appendix D

Gordon's Dividend Growth Model

$$P = D_1 / (k - g)$$

P=Present value of future cash flows. In a perfectly efficient market this is the price.

D1=Forward dividend per share

$$k = \text{cost of capital} = r_f + \text{erp}$$

r_f =real risk free rate. We have used 3% as a global real cost of capital, in line with long term real returns from US bonds.

Erp=equity risk premium. We have used 3% as this solves for a theoretical PER of 16.7x, which is the 30 year average. It is also in line with ex ante surveys of 2.5% to 4%.

Country risk premium=2.5%. We add this to South Africa's cost of capital to reflect the higher country risk. This is calculated by subtracting US bond yields from the South African Yankee (US\$) denominated bond

G=real growth rate. We have used real GDP growth of 3% as a proxy for growth in corporate cash flows. This is probably too optimistic as in both the US and South Africa earnings have grown at less than GDP. Note we use real growth and real bond yields as this strips out inflation illusion as inflation should not impact the valuation.

We divide both side by P.

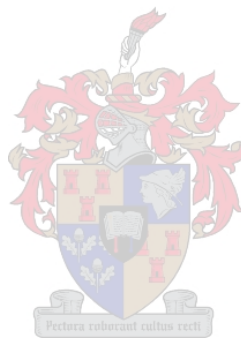
$$1 = DY / (k - g) \quad DY = \text{forward dividend yield}$$

$$k - g = DY$$

DY=3% in US and 5.5% in South Africa

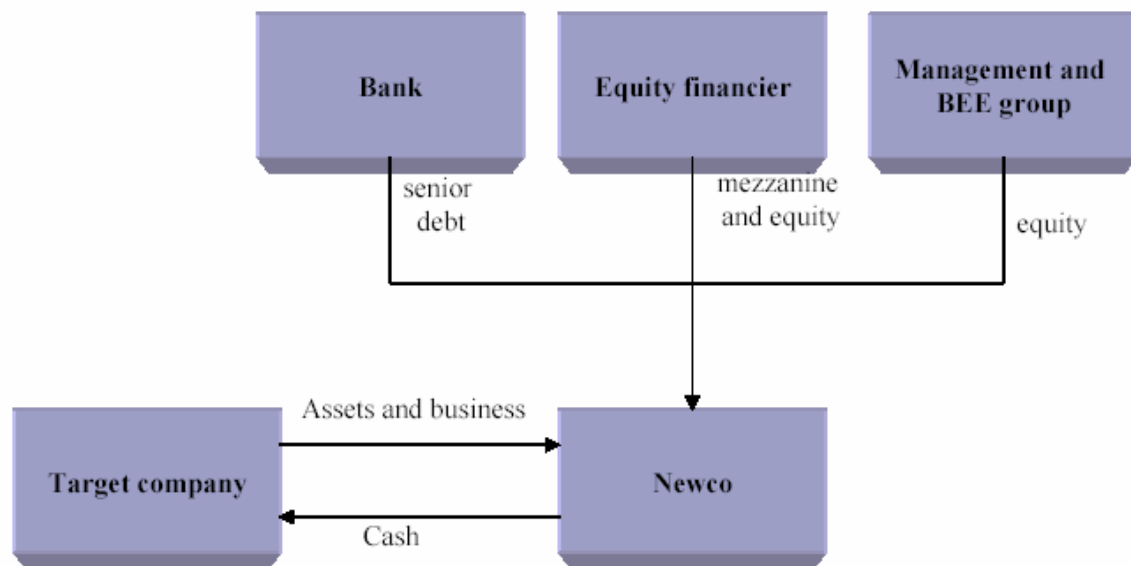
We then convert this to an earnings yield by multiplying by a dividend cover ratio of 2x.

EY=6% in US and 11% in South Africa. Inverting gives us a PER of 16.7x and 9.1x, respectively.

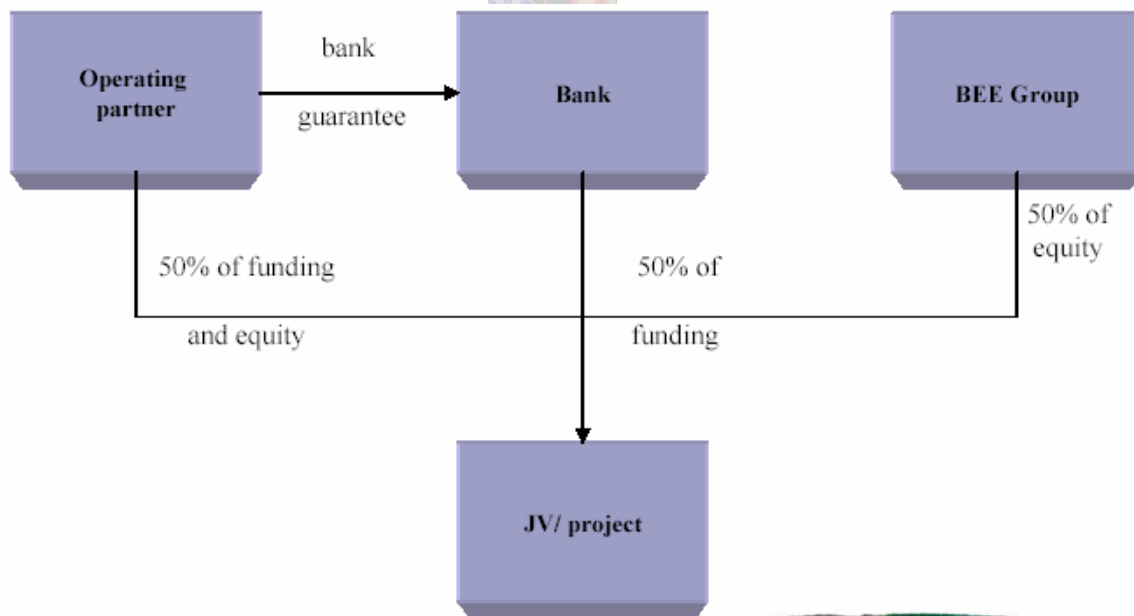


Appendix E

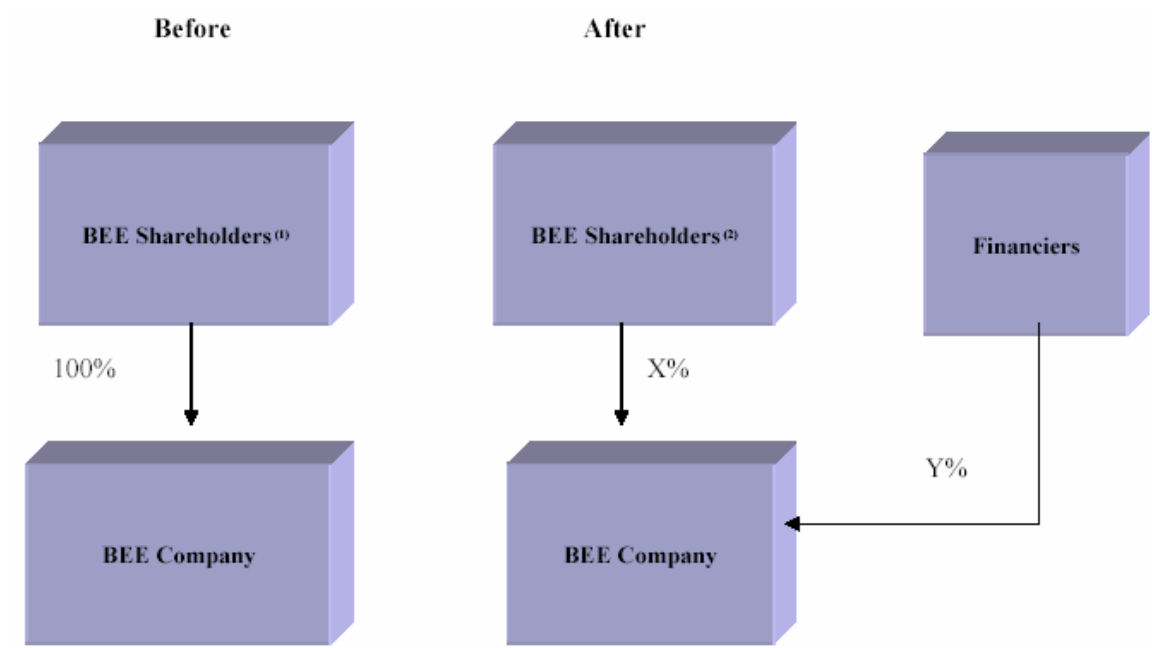
Structure of Financing: Debt Funding (LBO)



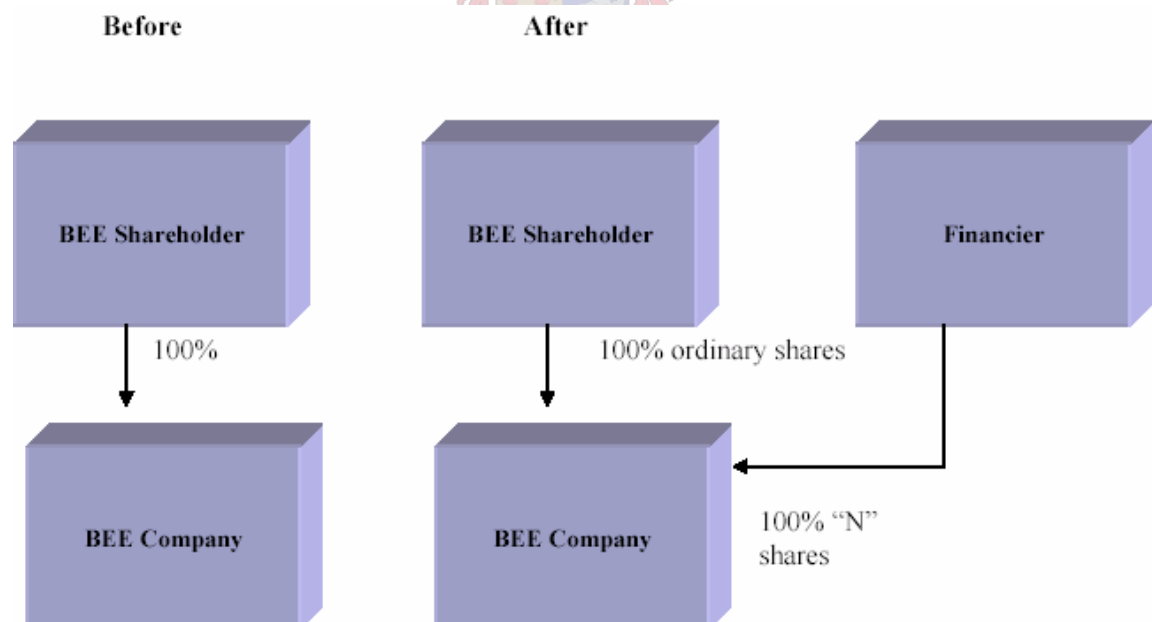
Structure of Financing: Project Debt



Structure of Financing: Equity (capital raising)



Structure of Financing: Equity (N Shares)



Structure of Financing: Special Purpose Vehicles (SPVs)

