Funding structure efficiency and empowerment success: A Broad Based Economic Empowerment Study

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DECLARATION

I Emuron Plaatjies, hereby declare that this research proposal is my own original work and that all sources have been accurately reported and acknowledged, and that this document has not previously in its entirety or in part been submitted at any university in order to obtain academic qualification.

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PREFACE AND ACKNOWLEDGEMENTS

I would like to thank God for his guidance and inspiration and for providing me with strength throughout the duration of this research report. A heartfelt thank you goes to my family and friends who has supported me. I would also like to express my sincere gratitude to Dr Thabang Mokoaleli-Mokoteli for availing herself and agreeing to assist me in this journey. Your assistance was much appreciated.

This report is dedicated to three special friends who lost their lives at very young ages. Nadine van Wyk, Bradley Dyker and Samantha van Wyk challenged me when we were still in Primary and High School to always strive for the best and to always give my best. .

ABSTRACT

Black Economic Empowerment ("BEE") or Broad Based Black Economic Empowerment (BBBEE) is an important socio economic tool that the South African government established to achieve its transformational objectives. BBBEE is meant to assist in growing the economy, decrease economic and other social inequalities and to introduce more black people in the mainstream economy of South Africa. The transformation strategies such as BBBEE and employment equity seek to redress economic imbalances created by the previous apartheid regime. BBBEE as an implemented policy has contributed in levelling the playing field by creating vast opportunities for the previously disadvantaged. Positive spin offs that have been realised in an effort to address economic and social imbalances are discussed in the paper

The paper seeks to demonstrate the progress made in South Africa by the BBBEE act and the efforts of corporate South Africa. It further highlights successes of BBBEE deals implemented recently and analyse how these empowerment deals were structured. Chapter 4 focuses on the analysis of specific BBBEE investments with reference to specific landmark broad based deals concluded in the recent past. The efficiency of the funding structures of these BBBEE deals is also analysed. Finally chapter 5 concludes by providing an overview of the findings in analysing the efficiency of BBBEE funding structures.

LIST OF ACRONYMS

AFS	**Annual Financial Statements**
BBBEE	**Broad Based Black Economic Empowerment**
BEE	**Black Economic Empowerment**
BEE ACT	**Black Economic Empowerment Act 53 of 2003**
DFI	**Development Financing Institution**
CAR	**Cumulative Abnormal Returns**
CAGR	**Compound Abnormal Growth Rate**
DTI	**Department of Trade and Industry**
GDP	**Gross Domestic Product**
GEAR	**Growth Employment And Redistribution Strategy**
IDC	**Industrial Development Corporation**
JSE	**Johannesburg Stock Exchange**
LBO	**Leverage Buy Out**
MBO	**Management Buy Out**
MIH	**Multichoice International Holdings**
MCSAH	**Multichoice South Africa Holdings**
NEF	**National Empowerment Fund**
PIC	**Public Investment Corporation**
RDP	**Reconstruction and Development Plan**
ROA	**Return on Assets**
ROE	**Return On Equity**
PN	**Puthuma Nathi**
VSA	**Vodacom South Africa**
WY	**Welkom Yizani**
YY	**Yebo Yethu**

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CHAPTER 1

1.1 Introduction

The dawn of democracy in South Africa in 1994 signaled an important phase for many marginalised South Africans. To this marginalized constituency this change meant the total dismantling of the old order and the reversal of socio-economic and political domination of a minority group to an era of shared growth and development. Black Economic Empowerment (BEE) was one of the vehicles needed and used to ensure that African people's freedom was not symbolic but was realised in all segments of society, including the economy. The major issues the new democratic government faced was amongst other things poverty, high levels of unemployment, a largely under skilled work force and the fact that the majority of the population was significantly uneducated.

1.2 Background

The introduction of the Black Economic Empowerment (BEE) programme in the post-1994 era is part of the new democratic government strategy of integrating the increasing number of previously excluded individuals to participate into the mainstream of the economy. Initially, the new government used the Reconstruction and Development Programme (RDP) as a South Africa's transformation plan that would address the socioeconomic ills that were brought by the previous apartheid system. The domination of business activities by white business and the exclusion of black people and women from the mainstream of economic activity were sources of great concern for the reconstruction and development process. A central objective of the RDP was to deracialise business ownership and control completely through focused BEE policies. These policies were aimed at making it easier for black people to gain access to capital for business development. The democratic government was obliged to ensure that no discrimination occurs in financial institutions. State and parastatal institutions were to provide capital for the attainment of BEE objectives. The democratic government also introduced tendering out procedures to facilitate BEE. Training and education, meaningful ownership participation was identified as priorities.

The first wave of BEE deals (often referred to as narrow BEE) concluded from 1994 to 2003 were found to be narrow and innefective as there was no BEE legislation in place then. Over this period, BEE attracted a lot of criticism as the deals were not broad based but enriched only a few politically connected black elites. For instance, in 2003, 60% of the empowerment deals amounting to R25.3 billion went to the companies of only two black businessmen (Kovacevic 2007). Kovacevic (2007) further argued that although BEE professes to promote the meaningful participation of black people in the economy, it actually fosters a political cronyism that benefits only a few elite. A majority of the deals done during this time focused only on the transfer of ownership where private companies would identify strategic partners and enter into BEE deals with them. These partners mostly played no role in the day to day running of the business and had little or no control as most of their shares had little voting power.

BEE is a restructuring and affirmative measure aimed at ensuring that the previously marginalised are placed at the centre of the economy. Therefore BEE is broader than procurement and ownership. Unfortunately with its good intentions BEE also has many drawbacks including crony capitalism and the empowerment of only a select few.

All of the above criticisms and other research undertaken by policy makers together with business gave rise to Broad Based Black Economic Empowerment (BBBEE). The BBBEE act 53 of 2003 was promulgated on 9 January 2004. The broad based policy focus on more than just mere direct empowerment through ownership. Other objective includes skills development, enterprise development, development and promotion of people with disabilities and women and children empowerment. One of the biggest obstacles to the ownership objective of BBBEE and also BEE as a whole is the availability of capital to buy into existing business or to start a new venture to benefit through the preferential procurement aspect.

BBBEE is currently under the spotlight for various reasons. BBBEE is still seen as a failure by many with little evidence of successful broad-based deals that have been concluded in recent years. Amendments have been made to the initial act implemented in 2003 twice, in 2007 and recently in 2011/2012. The focus of the amendments relates to fraudulent empowerment credentials, fronting and the linking of BEE to other government economic growth strategies. Government is currently emphasising that empowerment efforts should result in the promotion of a culture of venturing into new territories, operational excellence and risk taking. Focus on businesses and industries that result in significant job creation and addressing socio economic challenges. Furthermore, there should be symbiotic relationship between the public and the private sector and amongst private sector players, and large and small enterprises to unlock opportunities.

Business ventures need funding to commence and sustain operational activities and financing of empowerment deals and empowered businesses however has proven to be quite problematic. Many BEE deals concluded in the past have failed and the funding strategy used has been highlighted as one of the reasons for their failure. The failure had unintended consequences such as increased financing cost for future deals, no real empowerment for the intended benefactors, and significant decrease of value for the firms that pursued black empowerment.

This study seeks to analyse the efficiency of the different funding models used to facilitate BBBEE deals to create value for black people as defined and intended. Taking into consideration other factors, this research shows whether the benefits (returns) outweigh the costs (financing cost) incurred for putting together the BBBEE transaction. The study focuses on broad based empowerment deals that invited the broader public (individuals, groups of black investors, schools, churches etc) to subscribe for shares and the use of an employee empowerment scheme to achieve empowerment. The financial performance of both the empowerment firm and investors will be analysed.

1.3 Problem Statement

Terreblanch (2002) argues that although private and public institutions have implemented BEE in a variety of forms, it has yet to bring about increased black participation in the economy. He further highlights a lack of participation of the broader population in BEE. In the year 2003, in their BEE strategy report, the Department of Trade and Industry (DTI) stated that it remains critical that effective and sustainable funding structures be put in place. The problem is that, we know and understand the funding models used to finance BEE transactions (see Oyowole, 1996 and Nhlapo, 2008) but we do not know how efficient and sustainable these funding models are and the reason why they are seen by many as a source of BEE deals' failure. The research is required to unpack whether the problem lies with the structure of the funding model or elsewhere. Taking into consideration other factors, this research can show whether the benefits (returns) outweigh the costs incurred for putting together BEE transactions using various funding models.

1.4 Research Objectives

The study will be guided by the following specific research objectives:

- To establish whether the mixed financing structures used in recent BBBEE deals are efficient.
- To assess whether common South Africans who participated in BBBEE deals are empowered.

1.5 Research Questions

- Does the short and long term return of the recently mixed funded BBBEE deals exceed the finance cost incurred to facilitate the empowerment deals?
- How effective are the funding structures /mixed of funding used by the firms who invited the broader public to participate in the BBBEE deals?
- Are the participants of the BBBEE economically better off and empowered?

1.6 Gap and significance of the study

Sartorius and Botha (2008) found that less than 25% of equity is eventually transferred to empowerment partners and that the primary source of funding for empowerment transactions were third party funding. Ward and Muller (2008) looked at the long term impact of BEE companies following the announcement of BEE ownership transactions. Researchers (e.g. Nhlapo 2008,) have only looked at the reasons why early BEE funding models failed. Research has been done on the evolution and innovation of funding structures', the efficiency of structures used during the first and second wave of BEE deals, and whether the funding inefficiencies identified during the first phase were addressed when second wave of deals were implemented. Andrews (2008) investigated whether BEE is a growth catalyst and recommended that BEE specifically targets the middle and bottom end of the economy. Research was also undertaken to identify and evaluate the major challenges faced when structuring empowerment deals. No research evidence could be found on whether the recent uses of mixed funding structures are efficient. Research has also not been undertaken to establish whether the BBBEE deals created the economic empowerment for the broader population it sought benefit.

This study will prove to be important and useful for policy makers, finance students and companies who intend to do empowerment transactions in future. Future users will be able to use the study to improve empowerment deal structuring based on this assessment of the importance of funding structures to the success of empowerment deals. Students and academics can use the study to identify areas for further study or to substantiate and compliment their studies. Firms can also use the study to identify important features that could enhance successful implementation of empowerment deals. The study can also be used as publicity by the firms being studied.

1.7 Structure of Thesis

The thesis is structured as follows. Chapter 2 deals comprehensively with literature review of BEE research that has been undertaken. The use of different and innovative funding structures is discussed as well as entrepreneurial finance in South Africa. It aims at gaining a deeper understanding of BEE for the chosen subject and act as the foundation for conducting research. Chapter 3 discusses the research methodology used. Chapter 4 presents the results of the study and Chapter 5 discuss the findings and conclude the thesis.

Chapter Summary

This chapter serves as the introduction to the thesis regarding efficacy of the funding structures used to finance BEE transactions in order to address the issues identified above. The chapter is organised as follows: Section 1.2 presents the background to the study. Section 1.3 presents the problem statement. Section 1.4 provides the research objectives. Section 1.5 presents the research questions. Section 1.6 presents the research gap and the significance of the study. Section 1.7 presents the structure of the thesis

CHAPTER 2 LITERATURE REVIEW

2.1 Introduction

The objective of this chapter is to give a literature review on BBE, Entrepreneurial financing and Corporate funding determinants and to define the types of empowerment funding models that has been used. In analysing the different models, one will be able to identify advantages and disadvantages; similarities as well as limitations ,restrictions and contradictions amongst the BEE funding models that are commonly used in South Africa. The chapter is organised as follows: Section 2.2 present the overview of BEE. Section 2.3 discusses entrepreneurial financing. Section 2.4 discusses corporate funding determinants and section 2.5 discusses firm funding and capital structure. Section 2.6 discusses funding structures used in previous deals and section 2.7 presents an overview of BEE research undertaken previously.

2.2 Overview of BEE

In the post-apartheid era, the new government that came to power in 1994 was faced with huge economic inequalities, pervasive poverty and high levels of unemployment. The social and economic implications of the previous laws of apartheid excluded the majority of South African people, mainly black people, from the mainstream of the economy. To address inequalities, combat poverty and reduce unemployment, government promulgated empowerment legislation and policies in the form of the Employment Equity Act (Act 55 of 1998), Skills Development Levy Act (Act 9 of 1999) and Preferential Procurement Policy Framework Act (Act 5 of 2000) and encouraged the development of BEE charters for all sectors to support the empowerment and transformation of the economy. Key to this transformation has been the Broad Based Black Economic Empowerment (BBBEE) programme. The effort to include black people in the economy is in line with Mikhail Bakunin (1870) who argues “Political Freedom without economic equality is pretence, a fraud, a lie; and the workers [people] want no lying.

BEE is considered as one of the key drivers of economic activity with more than half of privately owned businesses expected to change ownership within the next decade. The question that however remains unanswered per Kritzinger (2004) is whether broad based economic empowerment will bear the fruits for the intended beneficiaries and more importantly are financing models used in BEE transactions efficient and appropriate.

The face of the JSE has been on a gradual transformation path. Anecdotal evidence shows that BEE has made relative inroads to the extent that currently 21% of listed companies are black owned.

2.3 Entrepreneurial Finance

Entrepreneurship in South Africa is not as prominent as politics and the country's mineral resources. Many experts (e.g., Ojah and Mokoteli (2010), Makina et al., (2004)) indicated that entrepreneurship is one of the biggest drivers of economic activity, growth and job creation. Entrepreneurship can be effective and meaningfully reduce poverty as well as close the gap between the rich and poor in the country (Makina and Malobola, 2004).

The most competitive nations are believed to be those that have the highest level of entrepreneurial activity. Entrepreneurial activities need funding to prosper. Entrepreneurs need to know that financiers would be willing to back their ventures financially without charging them exorbitant fees. Funding is believed to be one of the biggest obstacles to start-up ventures in South Africa. Ojah and Mokoteli (2010) found important causes of relative poor entrepreneurial funding in SA to be amongst other factors the lack of appreciation for the link between SA's first and second economy, the incorrect emphasis by government which favours entrepreneurial finance over developmental micro financing; the inappropriate business oriented lending designs of finance agencies and the lack of emphasis on micro savings. Ojah and Mokoteli (2010) also recommend possible solutions to the problems identified. The solutions are increased venture capital and angel financing, increased capital leases and trade credit and a more developmental focused microfinance scheme strategy. The BeeCom report (2000) reported that South Africa does not have a venture capital market, which has played an influential role in stimulating entrepreneurship internationally.

2.4 Corporate Funding determinants

BEE transactions may be viewed as unique corporate finance deals unlike most business deals, but BEE transactions are subject to conventional corporate finance decision considerations. The transactions are unique because the objective of the deals is not solely to maximise shareholder wealth or other conventional finance objectives such as growth or owner exit strategies but rather to transform the ownership status of firms. The maximization of shareholder wealth, can however not be ignored because deals are done to economically empower the intended beneficiaries.

The other more important factor that contributes to the uniqueness BBBEE deals is the lack of financial and other resources that are required by the intended beneficiaries to be economically empowered by the deals. Mokoteli and Ojah (2013) argue that BEE transactions are akin to spin-offs and ownership restructuring. They argue that although BEE companies are not directly spun off from existing companies, the relationship between them ends up like that of a parent and a subsidiary.

Business ventures are financed either through equity or debt or a combinationtherof. Besides the cost of funding, researchers such as Andani, Al Hassan (2012) and Mutenheri & Green (2002) found that capital structure determinants among listed companies include: size, profitability, growth, and asset maturity structure and non-debt tax shields. Adnani & Al Hassan (2012) found that, size, maturity structure and non-debt tax shields have been found to be related positively and significantly to total debt ratio. Profitability and growth are negatively and significantly related to total debt ratio amongst listed companies.

On the other hand for non-listed companies, the Adnani & Al Hassan (2012) found size, liquidity and non-debt tax shields to have significant and positive relationships with capital structure while profitability and maturity structure are negatively and significantly related to total debt ratio.

It is important as deduced from the above discussion that BBBEE deals cannot be structured without considering the fundamentals of corporate finance and the conventional corporate finance determinants. Wealth creation for the intended beneficiaries is the objective of these deals, it is therefore important that all the fundamental considerations of corporate finance be taken into account when deals are structured.

2.5 Firm Funding and Capital Structure

Various studies have been performed on optimal capital structures. Miller and Modigliani (1958) is perhaps the most cited in this regard. They argue that both capital structure and dividend policy are largely “irrelevant” in the sense that they have no significant, predictable effects on corporate market values. The agency and signalling theories (Manos, 2001) on the other hand suggest that dividend payments could lead to overall increase in firm value. Other theories such as transactional cost and tax theories state that dividend payments reduce shareholders wealth and should not be paid but the cash should be invested in other projects. These theories are particularly interesting for BEE transactions because several BEE transactions are indirectly financed by dividends. Therefore dividend policies play an important role for many firms wishing to conclude empowerment transactions as they are a major determinant in the repayment rate of debts.

According to Mutenheri and Green (2002) the main variables suggested by theory which are usually thought to influence a company's capital structure are derived from four main strands of literature. These theories have been the subject of research by amongst others (Frank and Goyal, 2002; Bharat, Pasquariello and Wu, 2008). First, asymmetric information theory states that debt is preferred over equity when firms' source funding because a debt issuance may signal management's confidence regarding the firms' profitability prospects. Second, pecking order theory posits that firms prefer internal to external finance because the cost of financing increases with asymmetric information. External equity issues are therefore seen as the last resort when firms' source funding. Third is agency theory which state that increased leverage imposes financial discipline on management and the asset substitution effect which posts that as debt to equity ratio increases management has stronger incentive to undertake risky project as shareholders wealth would be maximised significantly should the project be successful. Fourth is transactions costs theory which states that transaction cost has an impact on market timing and that firms may prefer the use of debt over equity due to the direct cost involved in equity issuances. Last is the issue of taxation. Thus, firms may prefer debt over equity because of the tax shield that debt may offer.

Firms therefore, consider a number of determinants when deciding how to finance in particular long term business transactions such as mergers and acquisitions and other long term projects. Empowerment transactions are very unique in that the targeted beneficiaries are not very well capitalised and therefore need financing in one form or another to become equity holders of the company that seeks black economic empowerment. Empowerment partners (individuals and organisations) in most circumstances have no choice but to access debt funding to facilitate participation in empowerment transactions. This can be complicated further due to the fact that the empowerment partners may have little to no collateral. This may significantly drive up the cost of capital as the absence of collateral increase the risk profile of the lenders and may further force firms to deviate from their target capital structures and conventional capital structure theories. Firms may be forced to use more equity, or other hybrid financially engineered instruments for funding purposes, that may alter their capital structures.

2.6 BEE transactions and funding models used

The lack of capital and collateral required by BEE investors to fund BEE transactions as mentioned above pose a significant challenge to all stakeholders. Government has introduced various initiatives to accelerate and promote BEE. To this end they have established finance providers such as the National Empowerment Fund (NEF) to assist with the financing and structuring of BEE deals. The mandate of the Industrial development Corporation (IDC) also has a huge focus on BEE activity.

2.2.1 BEE first wave: 1994-2002

South Africans irrespective of race or gender could finally participate in the mainstream economy because of the demise of apartheid. A significant drive to ensure participation of black people in the financial markets, big mining houses and other industries were kick started by the private corporations and the newly elected democratic government. The emphasis of these transactions was to ensure black participation at ownership level only and did not include other elements of empowerment such as effective and sustained management, skills transfer, and development of young black talent and creation of other black businesses. Nhlapo (2008) comprehensively describes the various funding instruments and models used to finance the first wave of BEE deals. She also shed some light on the probable causes of the failures of the transactions, the role that the type of funding played and discuss the evolution of funding during the second phase of BEE deals (BBBEE).

2.6.1.1 Special Purpose Vehicle

Van der Nest (2004) defines an SPV as a special purpose company established by a 'BEE-company', with the objective to facilitate the purchase of an equity stake in a 'target company'. According to the BEE Commission report (2001), the target company can either be a company listed on the Johannesburg Securities Exchange or a private company, interested in selling an equity stake to empowerment partners

Government Agencies, the Public Investment Corporation local and international through various initiatives provide funding to Special Purpose Vehicles (SPVs) which in turn provides black people with capital to acquire shares. The funding provided to the SPV's is generally guaranteed by the company seeking BEE credentials through the empowerment transaction.

The BEE company raises the required means to fund the deal either through a 100% loan from financiers such as the NEF, IDC or commercial banks. BEE companies in the past also made use of preference shares, or a combination of loans and preference shares with varying repayment and redemption terms. Various structuring methods were used to finance SPVs. For example, mezzanine debt, vendor financing, notional loans and senior debt instruments were common. In most instances no equity was required. Where equity was not required then the money would be borrowed in most cases. During the first phase of BEE transactions in the late 1990s, black investors were typically funded by third parties utilising SPVs. Oyewole (1996) summarises the other three main funding methods employed during the first phase in black economic empowerment transactions as shown below.

2.6.1.2 Equity participation without economic facilitation

The black empowerment investor acquires shares in the listed company, by forming a SPV which is funded by corporate investors. The corporate investors hold low-voting class B shares in the SPV while voting control will be ceded to the black empowerment investors through class A voting shares.

2.6.1.3 Equity participation at a discount

Shares in listed or private companies are sold to the black empowered investor at a discount to the fair value. The discount becomes a benefit to the black partner and enables or facilitates the transaction. Discounts varied in size. These shares would frequently have limitations and restrictions on dividends and tradability for a set period of time.

2.6.1.4 Put option granted by existing shareholders

The black investor is offered shares in the hosting company in which the purchase consideration is funded by a financial institution through a loan. The debt is guaranteed by a put option against the existing shareholders in the hosting company. The black partner owns ordinary shares in an established SPV. The bank then provides funding to the SPV through buying preference shares in the SPV. The money raised will then be used to subscribe for the portion of the offered shares in the hosting company. In the event that the black partner is unable to redeem the preference shares, the bank may sell the preference shares that it holds in the SPV to the existing shareholders in terms of the put option arrangement.

2.6.1.5 Failures of the First Phase Models

According to Business Map (1999), the first phase of BEE implementation came to an abrupt halt with the Asian crises of 1998. The crisis revealed some problems that affect the sustainability of the BEE financing models, which formed the foundation of most of BEE transactions during the 1990's. BusinessMap (1999) identified the extremely high levels of gearing as a core weakness in the initial BEE financial models. Instead of using access to finance, to build an asset base, most BEE transactions accumulated debt via the SPV's structures used at the time. The high dependence of these deals on debt was cited as one of the main causes of failures. Financial institutions and other providers of capital, play a crucial role in determining the pace and success of black economic empowerment.

Some of the disadvantages of the first wave models that led to failures of the BEE deals and not meeting BEE objectives include: One, the funding structures were mostly developed to be successful only in bull stock market situation, and not in a bear market. Two, preference shares used do not normally carry voting rights and therefore black partners do not take part in company strategic decisions. Three, these preference shares form part of contractual obligation and therefore cannot be easily traded (BEE shares are locked in for a specific period). Therefore, there was a lack of flexibility and liquidity on SPV structures. Four, dividend policies of the host companies were not aligned to ensure that the SPV's or BEE companies receive cash on a regular basis to service and redeem debt. Five, limited restrictions with regards to whether shares could be encumbered by target beneficiaries were in place. This could lead to beneficiaries encumbering their shares to finance otherwise unaffordable lifestyles.

2.2.2 BEE second wave: 2003 - current

The failures of the first wave of BEE deals placed pressure on all stakeholders to innovate and come up with new transaction structures that will be less sensitive to financing cost, more effectively geared and have a bigger impact on the broader economy, particularly the middle to low end of the economy. The highly geared BEE structures complicated the economic empowerment of black people.

In order to promote BEE activity, the government decided to reward BEE deals that successfully transfer economic benefits to previously disadvantaged groups. Government therefore, started to reward businesses with empowerment credentials by giving them preference to government tenders and other government business opportunities. Many however, argue that this just increased fronting and corruption.

In this second wave of BEE, funding structures evolved slightly as stakeholders attempted to curb the problems encountered with the initial wave of deals. This meant the new structures may have become more elaborate and complex because they combined debt, equity and hybrid instruments (such as deferred shares, options and preference shares). These complex and elaborate structures may hinder the ordinary black people to participate in these deals because it is difficult to understand them.

The focus is to develop and implement innovative financing structures that will ensure efficiency, sustainability and specifically envisage to pursuing the ideals of black economic empowerment. The acquisition of equity, for the BEE deals may now be vendor-financed call options driven as well as other more conventional methods of funding involving third party financing. These BBBEE funding models are discussed in detail below

2.6.2.1 Third Party Finance

The most common type of funding for any transaction during the second wave of BEE is third party loans which involve bank loans or loans from other financial service providers. These finance providers wants to reduce their risk as much as possible by requiring collateral, sureties or guarantees. Should loans be without guarantees or collateral it is normally more expensive due to the perceived increased risk.

There are other various structures that are considered by financiers on offering finance, but the most favoured are the leveraged buy-outs (LBOs) and preference share structures. An LBO is the purchase of equity or other assets using significantly more borrowed money (debt) than owners' funds (equity).The debt effectively serves as a lever to increase returns. The targeted assets or equity is in most cases used as security for the loans. On the other hand, BEE companies issue preference shares to purchase equity stakes or other assets in host companies. The BEE Company depend on dividend payments from the target company (parent companies) to ensure that it meets its day to day operational cost and more importantly service financing cost. Preference shares are still very popular funding instruments because of the flexibility that it provides. Preference dividends may be accumulated, and therefore reduces the risk of default. Preference shares may also be converted into ordinary shares and may carry voting rights or structured to carry voting rights in case of defaults.

2.6.2.2 Vendor Finance

Vendor companies facilitate BEE transactions through providing loan guarantees, price discounts, or internal notional vendor financing at or below market rates to BEE investors. This type of financing lowers the risk of the investment as it may increase investor confidence.

Regardless of the transaction structure, there is almost always a requirement from the financiers that the vendor facilitate the raising of finance for the BEE partner. Whichever structure is selected, and even if no vendor finance is provided, financiers tend to look for some form of guarantee from the vendor. Most financiers are risk averse and require some form of security on loans granted, which in most cases the BEE partners cannot provide.

Vendor finance companies are regarded necessary to enable deal makers to negotiate lower interest rates. High inflation coupled with the fact that black investors lack assets to pledge as security for borrowings results in financing that require high returns. This in turn necessitates that the BEE investor must earn a high return on investment to be able to make loan repayments. Examples of empowerment transaction that used vendor finance include amongst others Imperial and Alexander Forbes.

The funding models discussed above have the following characteristics in common. One, the hosting company mostly facilitates the BEE deal. The BEE company experiences benefits if the share price or earnings grow. Two, the real equity transfer only occurs once debt is redeemed and all limitations and restrictions are lifted. Three, the equity interest in the hosting company may be diluted because of the inability of the black partner to pay back the loan and because black people require access to cash and therefore sell the share in the open market should all the restrictions be lifted

2.7 BEE research

Previous research on BEE has investigated different aspects of BEE transactions. An Empowerdex (2005) study could not find any evidence that suggest that BEE negatively influence business confidence or foreign direct investment levels. Andrews (2008) looked at whether BEE is a growth catalyst or not and listed recommendations that could lead to BEE being a growth catalyst. Andrews (2008) recommended amongst other things that government should emphasise that deals are conducted with new entrants and government should focus on building pools of young talented skilled black professionals and should focus its BEE policy at the middle and bottom of the economy. Fauconnier and Mathur-Helm (2008) found that there is an increased focus on ensuring genuine and sustainable broad-based BEE in South Africa, especially with regards to implementing suitable funding structures that are not superficial fronting arrangements.

Muller & Ward (2010) examined the long-term impact on the share prices of listed companies after announcements are made relating to black empowerment deals. Their study found a positive cumulative abnormal return of around 10% after the first year. They also found evidence suggesting that the positive result is confined to smaller companies, with market capitalisation of less than R3,5bn, whilst larger companies experience a marginally negative cumulative abnormal return. Their results also showed that those companies which made BEE announcements prior to May 2005 ('first phase') did somewhat worse than those who followed.

Strydom et al (2009) argues that if BEE transactions are perceived by the market to represent an increase in the future earnings potential of the firm or a reduction in the riskiness of future earnings then the announcement of a BEE transaction should result in an increase in a firm's share price. They found that there is not a particular association between BEE transactions and negative abnormal returns. They found that in a limited number of cases that BEE transactions are associated with positive abnormal returns. Furthermore they suggest that the reaction may be related to firm specific and/or transaction specific characteristics.

Ferreira and De Villiers (2011) investigated whether an association exists between a firm's black economic empowerment (BEE) score and its share returns. Their study focused on the relationship between an entity's BEE score, as opposed to a BEE deal announcement, and the entity's market performance. Their analysis showed a significant, negative association between a firm's BEE score and its share returns.

Chapter Summary

The importance of BEE is clearly evident from the discussions above. The South African government together with the business fraternity is continually studying ways in which to improve BEE. The big hindrance to BEE is unfortunately the scarcity of capital and skills amongst black people. This hindrance is magnified by the absence of a venture capital market in SA and the relatively small developmental finance that's available. The relative failures of developmental finance initiatives introduced by the government have also contributed to the failure of past BEE deals. There is, however, success stories and companies constantly attempt to use innovative ways to fund empowerment deals. A limited number of firms has since 2003 entered into Broad Based transactions that involved the broader South African public (South Africans at the bottom and middle of the economy), including stokvels (traditional mechanism used by black south Africans that pool funds) and other black organisations such as churches, variety of black societies and black investment groups. The next chapter presents the methods and methodologies used in this research.

CHAPTER 3 RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods and methodology adopted in this research. Market measures are used to establish whether these specific transactions have created value for the participants who invested in the deals. Accounting based measures are used to establish whether the funding methods used play a significant role to ensure the success of deals. The chapter is organized as follows. Section 3.2 explains the data requirements and the sources of data. Section 3.3 discusses the design of the research and the chapter summary summarises the chapter.

3.2 Data and data sources

The purpose of this research is to establish whether ordinary Black South Africans were empowered by recently implemented BBBEE deals and whether the funding models played a significant role in ensuring the success of the deals. To achieve this, five deals of three JSE listed companies that were concluded between 2006 and 2010 are studied. The transactions were selected because of the following reasons. First, they were all concluded just before or after the 2008 global financial crisis that affected liquidity of financial markets globally. Second, these transactions all invited ordinary South Africans to participate in the transactions, which made them truly broad based. Lastly, these transactions were IPO-like, in the sense that shares were sold to the public and these shares were eventually listed once the empowerment period of the various transactions end. The companies selected are MTN (MTN Zakhele), Vodacom (Yebo Yethu) Media 24, a Naspers subsidiary (Welkom Yizani) and Multichoice – A subsidiary of Naspers (Phuthuma Nathi 1 and 2). The Naspers and Vodacom deals were principally done through unlisted wholly owned subsidiaries.

Data was collected from *Bloomberg*, Equity Express, MTN Zakhele and from other sources such as company websites and the published annual financial statements of the companies that were studied. Information was also obtained from public company records other than the annual financial statements and organisations that specifically track the share performance of the specific empowerment organisations.

Required data consists of prospectuses provided to investors during road shows, presentations done by the companies explaining the specifics of the empowerment transactions and if possible specific funding agreements and term sheets so as to clearly understand the funding mechanisms and terms underlying the deals. The performance of the share prices of the listed empowering companies over a specific period was obtained from sources such as the Equity Express and *Bloomberg*. Dividends declared and paid by the specific companies were obtained from the abovementioned sources and also from published Annual Financial Statements.

3.3 Research design

The deals being studied pursue economic empowerment by transferring ownership of the companies to previously disadvantaged individuals at a fraction of the true value of the shares. This is done by the empowering companies financing a majority share of the purchase price. True empowerment would therefore only be achieved if economic value is created and the debts incurred to facilitate the transactions repaid. The returns created need to be sufficient enough to ensure that debts are repaid and the net asset value of each participant is increased as a result of participating in the scheme.

In considering whether the funding method used was efficient and whether the economic empowerment objective was obtained or not, the following factors were taken into consideration:

- The market returns created by the deals. This assessment is done by making a direct comparison between the cost incurred and the total returns earned on the investment. The research, therefore, investigates the value appreciation of the shareholders of the empowered shares since inception of the deal until 7 March 2014.
- The dividends that were earned during the period.
- The extents to which loans and other financing have been repaid are also investigated. An efficient funding structure would be one that brought about economic returns for investors and changed the demographics of the shareholding of the target company.

3.3.1 Assessing value creation via market measure

Cumulative abnormal returns (CAR) are calculated to assess whether value was created for shareholders who participated in the deals. The JSE all-share index is used as a market benchmark. Compound annual growth rates (CAGR) for the market and the specific companies are also calculated and compared to assess the performance of the deals versus that of the market.

3.3.2 Accounting Measures and funding structures

Funding structures are very important because the deals are highly geared and debt levels have a significant impact on the value of any company. In assessing the appropriateness and efficiency of the funding structures, we use various accounting measures. We look at the dividend received per ordinary share for each of the BBBEE companies. We need to emphasise that the dividend per share in this regard refers to ordinary dividends received from the holding companies by the BBBEE company per BBBEE shareholder. We look at the year on year debt per share, the debt equity ratio of the BBBEE company from implementation date till the end of the last available financial year as well as the return on equity (ROE) for each of the holding companies since implementation till the end of the last financial year. We analyse the year on year values for the outstanding debt per share for each BBBEE company, we analyse the dividend payment pattern and ROE of the holding companies. ROE’s are used to assess the performance and profitability of the holding companies because not all the holding companies are listed and ROE is the best alternative measure and is easy to calculate.

Chapter Summary

This chapter outlined the sources of data and how the data was analysed to establish whether the funding structures used in BEE transactions enhance or destroy value for BEE beneficiaries. The next chapter presents the results and findings from the research.

CHAPTER 4 PRESENTATION OF RESULTS

4.1 Introduction

The objective of this chapter is to provide the results from the analysis of five BBBEE deals namely MTN Zakhele, Phuthuma Nathi 1 and 2, Welkom Yizani and Yebo Yethu. The chapter is organised as follows: Section 4.2 presents description of the deals. Section 4.3 presents the market performance for each of the deals, section 4.4 deals with the debt aspects of the deals and accounting performance of holding companies.

4.2 Description of deals

4.2.1 The structure of the MTN Zakhele deal

Table 1 below provides a summary of key information regarding the MTN Zakhele deal. The deal was implemented in November 2010 and runs until November 2016. Zakhele is a deal done by JSE listed, MTN limited, who, in conjunction with the PIC sold 4% of MTN limited to MTN Zakhele. MTN Zakhele is therefore, an investment vehicle holding 4% of MTN limited. The shareholding in MTN limited is Zakhele's sole asset. The 4% holding carry full voting rights and is eligible to receive dividends from MTN limited like all other ordinary shareholders. The shareholders are allowed to trade their shares on an over- the-counter platform after an initial three year lock in period, and after the 6 year empowerment term all limitations and restrictions will be lifted. It is expected that Zakhele shares will be converted into MTN Limited shares after the 6 year empowerment term. Shareholders will only be allowed to sell their shares to black people or black groups with similar or better BBBEE status than themselves after the initial three years. Dividends received by MTN Zakhele from MTN, should first be applied to pay operating cost and taxes, than to pay dividends to preference shareholders, to redeem preference shares and other debt and after all these obligations are met, only then can ordinary dividends be declared and paid to ordinary shareholders.

Table 1 – MTN Zakhele deal

Key Deal information	
Total Deal Value	R8.2bn
Inception date	24/11/2010
Limited trade commencement	24/11/2013
Empowerment Term	6 years
Deal expiry	24/11/2016
Issue Price	R 20

MTN Zakhele raised the funds to buy the shares via an initial public offering, exclusively for black people and black groups. Other sources of funding include a donation from MTN, notional vendor financing from MTN and the issuance of preference shares.

Table 2, Panel A below shows that R1.6 billion was raised from issuing 80 900 000 ordinary shares to the black public R2.1 billion was raised from a preference share issue and R3.2 billion was provided by MTN in the form of notional vendor financing. MTN donated R1.2 billion to complete the funding requirements. Table 2 Panel B, gives an overview of how the funds raised were utilised. Thirty three million shares were bought from the PIC and about forty two million shares were bought from MTN in two tranches. The “A” preference shares are redeemable after 6 years and carried a fixed dividend rate until April 30, 2013. From 1 May 2013 the dividend rate has been 77% of prime. The “B” preference shares have a dividend rate of 88% of prime and are redeemable at any time during the empowerment period or at the end of the six year empowerment period. Table 2 also shows how highly geared the transaction is. The notional vendor financing and the preference shares constitute 65% of the total transaction value and owners’ equity only contributed 20%.

Table 2- Funding of MTN Zakheke deal

Panel A		
Source of funds	**ZAR'000**	**Share Quantities '000**
Equity raised Zakhele IPO	1618000	80.90
Class A BIC Preference shares	1440000	
Class B BIC Preference shares	720	
MTN Donation	1294000	
Notional Vendor Financing	3214000	
Total funds raised	8286000	
Panel B		
Use of funds	**ZAR'000**	**Share Quantities '000**
Issue cost	189	
PIC sale Shares	3589000	3300.
MTN tranche 1	3214000	2900
MTN tranche 2	1294000	1200.
Total funds used	8286	

4.2.2 The structure of the Phuthuma Nathi deal

Table 3 below contains key information regarding the two Phuthuma Nathi empowerment deals. Phuthuma Nathi (PN) consists of 2 empowerment transactions (PN1 and PN 2) that were concluded by a subsidiary of JSE listed Naspers Limited called Multichoice International Holdings (MIH). MIH through its wholly owned subsidiary Multichoice South Africa Holdings (MCSAH) issued 45000 000 ordinary shares to Phuthuma Nathi (PN1) Limited and 22500 000 ordinary shares to Phuthuma Nathi 2 (PN2) limited at R50 a share. PN1 and PN2 combined own 20% of MCSAH. The empowerment term of both transactions is ten years. During the first 5 years, trading of PN shares was not allowed. The locked trade period ended after 5 years, which allowed investors to trade their shares with other black investors that had similar or better BEE credentials. The shares held by both PN1 and PN2 carry voting rights and are eligible to receive dividends. Dividends received by PN1 and PN2 from MCSAH, should first be applied to pay the operational cost and taxes of the organisations and only 20% may be paid to ordinary shareholders of PN. The rest of the dividends should be used to pay preference dividends and redeem preference debt

Table 3- Phutuma Nathi deals

Key Deal information	Phuthuma Nathi 1	Phuthuma Nathi 2
Total Deal Value	2.2bn	R1.1bn
Inception date	01/12/2006	01/03/2007
Limited trade commencement	01/12/2011	01/03/2012
Empowerment Term	10 years	10 years
Deal expiry	1/12/2016	01/03/2017
Issue Price	R 10	R 10

Table 4 below shows how funds were raised and how the funds were utilised. The combined cost of purchasing the MCSAH shares was R3.3 billion as can be seen from panel B in table 4 below. Panel A shows that R675 million was raised from an equity offer to the black shareholders (67.5million shares at R10 a share) and R2.7 billion was raised via a preference share issue.

Table 4- Funding of Phuthuma Nathi deal

Panel A		
Source of funds	**ZAR'000**	**Share Quantities '000**
Equity raised PN1	450000	45.000
Preference Shares	180000	180.000
Equity raised PN2	225000	22.500
Preference Shares PN2	900000	90.000
Total funds raised	3375000	
Panel B		
Use of funds	**ZAR'000**	**Share Quantities '000**
MCSAH Shares (PN2)	2250	45.000
MCSAH Shares (PN1)	1125	22.500
Total funds used	3375	

4.2.3 The structure of the Welkom Yizani deal

Table 5 below contains key information regarding the Welkom Yizani (WY) empowerment deal. The deal was initiated and implemented by Naspers limited through its wholly owned subsidiary Media 24 Holdings Limited.

The deal was concluded in December 2006 and is expected to run through to December 2018. The deal initially had an empowerment term of 10 years, but the term has been extended by two years. Media24 issued 14 600 000 shares to Welkom Yizani (WY) at R50 a share. The Media 24 shares held by Welkom Yizani carry full voting rights and are eligible to receive dividends. Dividends received by WY from Media 24, should first be applied to pay the operational cost and taxes of the organisation and only 20% may be paid to ordinary shareholders of WY. The rest should be used to pay preference dividends and redeem preference debt

Table 5 - Welkom Yizani deal

Key Deal information	
Total Deal Value	R730m
Inception date	08/12/2006
Limited trade commencement	08/12/2013
Empowerment Term	12 years
Deal expiry	08/12/2018
Issue Price	R 10

Table 6 below illustrates the quantum of funds raised, the sources of the funds and how the funds were utilised. R146 million was raised by Welkom Yizani via an equity offering to the qualifying black shareholders. 14.6 million Ordinary shares were issued at R10 a share. R584 million was raised via a preference share issue to Naspers Limited. The preference shares are redeemable over the empowerment term and the dividends are linked to prime.

Table 6 Sources and uses of Welkom Yizani deal funds

Source of funds	ZAR'000	Share Quantities'000
Equity raised WY	146000	14600
Preference Shares	584000	584000
Total funds raised	730000	
Use of funds	**ZAR'000**	**Share Quantities'000**
Media 24	730000	14600
Total funds used	730000	

4.2.4 The structure of the Yebo Yethu deal

Table 7 below shows key information about the Yebo Yethu empowerment transaction. The deal was concluded and implemented by the JSE listed Vodacom Group Limited, through its subsidiary Vodacom South Africa (VSA) on the 1st of July 2008.The empowerment term of the deal is 10 years. The deal had a 5 year trade restriction that ended in February 2014. Yebo Yethu purchased a 3.44% stake in VSA. Yebo Yethu subscribed for 7200 000 VSA ordinary shares and 82 800 000 VSA “A” ordinary shares. The total cost of the 3.44% to Yebo Yethu was R2.25 billion The VSA ordinary shares carry full voting rights and are eligible for dividends. The VSA A ordinary shareholders will only be eligible to receive dividends once the outstanding notional vendor finance balance is settled.

Table 7- Yebo Yethu deal

Key Deal information	
Total Deal Value (public component)	R2.25bn
Inception date	01/07/2008
Limited trade commencement	03/02/2014
Empowerment Term	10 years
Deal expiry	08/12/2018
Issue Price	R 25

Table 8, Panel A below shows how Yebo Yethu raised funding to acquire the VSA ordinary shares. Yebo Yethu offered 14 400 000 ordinary shares to qualifying black South African individuals and groups at R25 a share. VSA donated shares worth R225 million and VSA provided Yebo Yethu with notional vendor financing of R1.6 billion. The R585 million raised via the equity offering and the donation from VSA was utilised to acquire 7.2 million VSA ordinary shares. Table 8, Panel B, shows that the notional vendor financing was utilised to acquire 82.8 million VSA A ordinary shares. Yebo Yethu owns 3.44% of the issued VSA shares but the black public (individuals and groups) only owns 55% of Yebo Yethu.

Table 8 Sources and uses of Yebo Yethu deal funds

Panel A		
Source of funds	**ZAR'000**	**Share Quantities'000**
Equity raised YY IPO	3 60 000	14400
Notional Vendor Finance	1 665 000	
VSA Donation	225 000	
Total raised	**2 250 000**	
Panel B		
Use of funds	**ZAR'000**	**Share Quantities'000**
VSA ordinary	585 000	7.20
VSA A	1 665 000	82.80
Total Applied	2250	

4.2.5 Deal Summary

There are many similarities and also a few differences in the deals under investigation. Being BBBEE deals, it is not surprising that all the companies issued shares to black South Africans only, or groups of black South Africans and BBBEE qualifying organisations. All the deals have a restriction period during which shares were not allowed to trade, followed by a limiting trading period, during which shares may only be traded with BBBEE qualifying individuals and organisations. All the deals were highly geared, with the majority of the funding being provided by parent companies. MTN Zakhele is the only deal that had an external debt component. MTN Zakhele is also the only deal with an empowerment term of less than 10 years. The MTN Zakhele and Yebo Yethu deals were both beneficiaries of generous discounts. PN1, PN2 and Welkom Yizani used only a mixture of preference shares and equity for funding. MTN Zakhele however, used a mixture of notional vendor financing, preference shares, equity and the discount element. Yebo Yethu used only notional vendor financing, equity and a discount element.

4.3 Market Performance

Table 8 -11 below illustrate the performance of the BBBEE share price since the initial public offering. The cumulative return is calculated for the period between initial offering (the implementation date) and the average trade price on the 1st day the share became eligible for trading. Returns are also calculated for the period from first trading date till March 7 2014.

4.3.1 Performance of MTN Zakhele

Table 8, Panel A, below shows that the Zakhele deal created abnormal returns during the locked trade period as the value of the share appreciated 350%. It also shows that during the same period the returns on the share outperformed the market by 306%.The returns for Zakhele subsequent to the trade restriction being lifted is 0.35% and it underperforms relative to the market. The total returns for Zakhele since implementation is 350% and it outperforms the market over the same period by 299%.

Table 8 Performance of MTN Zakhele

Panel A

	Trade Date	Avg Price	Div Adj Price	R%	Alsi	Rm%	CAR
IPO Price	2010/11/24	20	20		31112.490		
initial trade	2013/11/25	90	90	3.5	44552.512	0.431982	3.0680
Last Trade	2014/03/07	93.03	93.03	0.0035599	47786.770	0.072594	(0.0690)
				3.5035599		0.504576	2.9990

Panel B

	Mtnz	Alsi	diff	Mtnz	Alsi	diff
IPO Price	20.000	31112.490		20.000	31112.490	
Trade Price	90.000	44552.512		93.030	47786.770	
Years	3.047	3.047		3.331	3.331	
CAGR	0.638	0.125	0.513	0.587	0.138	0.449

Table 8 Panel B shows that, the Compound Annual Growth Rate (CAGR) from inception till 1st day of trading for the deal is 64% which is 51% better than the market. The CAGR since inception till 7 March 2014 is 58.7% and outperforms the market by 45%.

4.3.2 Performance of Phuthuma Nathi 1 and 2

Table 9, Panel A, below shows that the PN1 deal, created abnormal returns during the locked trade period. The value of the share appreciated 221% and during the same period the returns on the share outperformed the market by 185%.The cumulative return since the deal was implemented is 431% and appears to be outperforming the market over the same period by 350%.

Table 9 Performance of PN1

Panel A

PN1	Trade Date	Avg Price	Div Adj Price	R%	Market	Rm%	CAR
IPO Price	01/12/2006	10	10		24070.920		
initial trade	2011/12/08	30	32.14	2.21	32760.170	0.3609854	1.85301
Last Trade	2014/03/07	96.08	99.57	2.10	47786.770	0.4586850	1.63932
				4.31		0.8196704	3.49234

Panel B

	PN1	Alsi	diff	PN2	Alsi	diff
IPO Price	10.000	24070.920		10.000	24070.920	
Trade Price	30.000	32760.170		99.570	47786.770	
Years	5.092	5.092		7.369	7.369	
CAGR	0.241	0.062	0.178	0.366	0.098	0.268

Table 9, Panel B shows that The CAGR for PN1 during the locked period is 24% which is 17% better than the market. The CAGR subsequent to the locked period is even better than during the locked period and outperforms the market by 27%.

Table 10, Panel A shows that the PN2 deal, created abnormal returns during the locked trade period. The value of the share appreciated 286% and during the same period the returns on the share outperformed the market by 257%.The cumulative return since the deal was implemented is 447% and appears to be outperforming the market over the same period by 370%.

Table 10 Performance of PN2

Panel A							
PN2	Trade Date	Avg Price	Div Adj Price	R%	Market	Rm%	CAR
IPO Price	2007/03/01	10	10		25336.6		
initial trade	2011/12/08	36.5	38.64	2.86	32760.2	0.29300	2.57100
Last Trade	2014/03/07	97.1	100.61	1.60	47786.8	0.45869	1.14509
				4.47		0.75168	3.71609

Panel B	PN2	Alsi	diff	PN2	Alsi	diff
IPO Price	10.000	25336.580		10.000	25336.580	
Trade Price	36.500	32760.170		100.610	47786.770	
Years	4.842	4.842		7.119	7.119	
CAGR	0.307	0.055	0.252	0.383	0.093	0.290

Table 10, Panel B above shows that the CAGR for PN2 is 31% which is 25% better than the market for the PN2 locked period. The CAGR since inception till 7 March 2014 is period is better than during the locked period and outperforms the market by 29%.

4.3.3 Performance of Welkom Yizani

Table 11 below shows Welkom Yizani did not produce abnormal returns during the locked trade period. The value of the share appreciated 67% and during the same period the returns on the share underperformed relative to the market. Market returns were 20% better over the same period. The share lost value in the period since trading commenced. The share dropped 35% whilst the market gained 6% over the same period. The cumulative return for the period since the deal was implemented is 32% and has underperformed relative to the market. The market appears to have outperformed the share by 63%.

Table 11 Performance of Welkom Yizani

Panel A							
WY	Trade Date	Avg Price	Div Adj Price	R%	Market	Rm%	CAR
IPO Price	2006/12/08	10	10		23760.590		
initial trade	2013/12/09	15.5	16.77	0.677	44732.422	0.8826310	(0.2056)
Last Trade	2014/03/07	10	10.82	(0.3548)	47786.770	0.0682804	(0.4231)
				0.3221998		0.9509114	(0.6287)

Panel B	WY	Alsi	diff	WY	Alsi	diff
IPO Price	10.000	23760.590		10.000	23760.590	
Trade Price	15.500	44732.422		10.820	47786.770	
Years	7.106	7.106		7.350	7.350	
CAGR	0.064	0.093	(0.030)	0.011	0.100	(0.089)

Table 11, Panel B show that the CAGR for WY is 6% during the locked period versus the 9% by the market over the same period. The CAGR since implementation till 7 March 2014 underperforms relative to the market. The market's CAGR is greater at 9% versus the 3% of Welkom Yizani.

4.3.4 Performance of Yebo Yethu

Table 12, Panel A shows that the Yebo Yethu deal created abnormal returns during the locked trade period. The share appreciated 92% and during the same period the returns on the share outperformed the market by 42%. The returns since trading are marginally better than the market. The cumulative return for the period is however still 94% and appears to be outperforming the market over the same period by 38%.

Table 12 Performance of Yebo Yethu

Panel A

	Trade Date	Avg Price	Div Adj Price	R%	Market	Rm%	CAR
IPO Price	2008/07/01	25			30003.76		
initial trade	2014/02/03	48	52.43	0.920	44956.91	0.498376	0.42162
Last Trade	2014/03/07	48.825	48.825	0.017	47786.77	0.062946	(0.04576)
				0.937		0.561322	0.37587

Panel B

	YY	**Alsi**	**diff**	**YY**	**Alsi**	**diff**
IPO Price	25.000	30003.760		25.000	30003.760	
Trade Price	48.000	44956.910		48.825	47786.770	
Years	5.675	5.675		5.764	5.764	
CAGR	0.122	0.074	0.048	0.123	0.084	0.039

The CAGR for the Yebo Yethu deal during the locked period is 12% versus a 5% for the market. The CAGR for Yebo Yethu outperforms the market by 4% over the period since inception till 7 March 2014.

4.3.5 Comparative performance of the deals

Table 12 below illustrates the mean returns of the individual deals since inception. The standard deviation and mean of the respective deals give us more insight into the risk and return relationships. Zakhele has the highest standard deviation, which can be interpreted as a high risk relative to the other investments. However taking into consideration the total cumulative abnormal return of Zakhele since inception, the risk investors took was handsomely rewarded. Yebo Yethu has the second highest standard deviation as can be seen from the table above, but also returned 94% since inception of the deal.

Table 12 Comparative descriptive statistics of the five BEE deals

Statistic Measure	Zakhele	PN1	PN2	WY	YY
Mean	0.136	0.009	0.008	0.007	0.039
Variance	0.453	0.005	0.009	0.014	0.034
Standard deviation	0.673	0.071	0.094	0.120	0.185
Coefficient of Variance	4.941	7.841	12.206	17.902	4.725

Puthuma Nathi 1 and 2 appears to be relatively low risk investments, judging by the standard deviation calculated above. Welkom Yizani standard deviation makes it the third riskiest deal and from the returns calculated, the Welkom Yizani deal performed the worst out of the 5 deals. The coefficient of variance, measures the risk return trade off. The lower the calculated coefficient variation the better is your risk return trade off. Zakhele and Yebo Yethu therefore offers the best risk return trade-offs and Welkom Yizani the worst.

4.4 Accounting performance & Debt profile

This section looks into the funding methods used and the funding profile of each deal to date. We also look at the accounting performance of each BBBEE company and the holding companies of each deal. Section 4.2 above give a background of each deal and briefly summarises how funds were raised and utilised. Table 13 below provides a summary of each deal and some specifics around the financing used. In summary, the table shows that the interest rates for all the deals were linked to the prime interest rate.All the deals used either preference shares or notional vendor financing or a combination of the two. The finance providers for every deal were the ultimate holding company.

Table 13 – Type of financing on five BEE deals analysed

Deal	Instrument A	Instrument B	Interest rate	Finance Provider
Zakhele	Preference Shares	Notional Vendor Finance	Prime linked	MTN ltd & External Investors
Puthuma Nathi1	Preference Shares	N/A	Prime linked	Naspers
Puthuma Nathi2	Preference Shares	N/A	Prime linked	Naspers
Welkom Yizani	Preference Shares	N/A	Prime linked	Naspers
Yebo Yethu	Notional Vendor Finance	N/A	Prime linked	Vodacom SA

Table 14 below provides a summary of the debt equity ratios for the respective deals. Looking at the ratios calculated in the table, it is clear that the deals were highly geared at implementation.

Table 14 – Debt ratios of BEE deals at implementation

Deal	Debt	Equity	D/E ratio
Zakhele	5374	1618	3.3
PN1	1800	450	4
PN2	900	225	4
WY	584	146	4
YY	1665	360	4.6

Table 15 below illustrates the debt equity ratio for each deal at each year end. The objective of the year on year debt equity ratio is to analyse the impact of outstanding debt on the market and accounting performance of each deal.

Table 15 – Debt ratios of BEE deals at implementation

D/E ratios	2007	2008	2009	2010	2011	2012	2013
Zakhele				1.031	0.875	0.650	
Puthuma Nathi1	4.680	3.880	3.558	2.915	1.955	0.927	0.408
Puthuma Nathi2	4.005	3.382	3.112	2.583	1.756	0.826	0.349
Welkom Yizani	4.530	9.566	-50.272	3.497	3.615	5.111	1.904
Yebo Yethu			3.803	4.075	4.606	4.079	2.609

Table 15 above shows that the gearing for each of the deals reduced with time. The debt ratio for Zakhele reduced from 1.03:1 to 0.65:1, both the Puthuma Nathi deals reduced from 4:1 to 0.4:1.Welkom Yizani reduced from 4.5:1, to 1.9:1 and Yebo Yethu reduced from 3.8:1 to 2.6:1. Further investigation is however, needed to establish what the underlying cause for the reduction in gearing is.

Table 16 below gives an indication of outstanding debt per ordinary share for each BBBEE company at the end of their respective financial years. This is the outstanding rand amount for each ordinary share in issue.

Table 16 – Per share reduction in debt overtime

Debt per Share	2007	2008	2009	2010	2011	2012	2013
Zakhele				66.04	65.97	62.81	
Puthuma Nathi1	41.20	43.74	46.84	48.54	44.73	30.45	18.36
Puthuma Nathi	40.01	42.46	45.41	47.01	43.07	28.61	16.41
Welkom Yizani	41.07	44.02	47.56	26.90	27.78	28.39	28.86
Yebo YethuY			234.80	232.04	234.15	235.90	163.98

Table 16 above indicates that debt per share for each of the deals has reduced with time. Zakhele's debt reduced by 5%, PN1 and PN2 by 55% and 59% respectively, Welkom Yizani by 29% and Yebo Yethu by 30%.This may lead one to think the debt is being repaid. However, further analysis is required to establish whether the debt per share reduced due to repayments of debt or because of other reasons.Dividends are the main source of income for each of the BBBEE companies as they are all investment holding companies. The accounting performance of the holding companies is therefore of paramount importance for the BBBEE companies, because their share in the holding company is their only asset. Companies pay dividends out of profits, a profitable company therefore, is more likely to pay dividends than a company that does not consistently make profits. This therefore leads us to Table 17

Table 17 – Annual return on equity

ROE	2007	2008	2009	2010	2011	2012	2013
MTN				20.16	25.82	23.28	25.84
MCSAH	2.26	0.46	0.41	0.37	0.40	0.59	0.65
Media24	0.26	0.08	0.34	0.19	0.34	(0.19)	(0.08)
Naspers	14.15	12.89	17.59	9.69	14.15	6.56	11.94
Vodacom			47.91	30.24	56.16	59.48	66.06

Table 17 contains the annual return on equity for each of the holding companies. MTN, Vodacom and Multichoice South Africa Holdings all have consistent positive return on equity numbers. Media 24 is more inconsistent than the other 3 companies and also has negative returns for their financial years ending 2012 and 2013.The ROE for Naspers, the holding company of both Media 24 and Multichoice, also appears to be more inconsistent than MTN and Vodacom. A deeper look into the accounting profits of the four holding companies reveals good growth in profits for MTN, Vodacom and Multichoice. Media 24 on the other hand made losses in the 2012 and 2013 financial years.

Table 18 below provides a univariate analysis of the equity returns. The statistics calculated in the table positively corroborates the statistics calculated on the market returns of the BBBEE companies under section 4.3.5. MTN and Vodacom have relatively high risk return trade-offs. Multichoice has the third highest with Media 24 the lowest. Naspers is included because it is the ultimate holding company of Multichoice and Media 24

Table 18 – Univariate analysis of return on equity

Company	Mean	Var	Std dev
MTN	23.78	5.45	2.34
MCSAH	0.73	0.39	0.63
Media24	0.13	0.03	0.19
Naspers	12.42	10.70	3.27
Vodacom	51.97	152.27	12.39

Table 19 below provides a summary of dividends received by the BBBEE companies from the assets they hold. We looked at the dividends received to establish whether dividends received would enable debt servicing and debt repayment and redemption.

Table 19 – Total annual dividends per share received by Empowerment Shareholders

Company	2007	2008	2009	2010	2011	2012	2013
Zakhele				0.63	5.79	7.42	
Puthuma Nathi1	2.17	2.31	2.67	8.00	17.78	14.82	13.33
Puthuma Nathi2	2.17	2.31	2.67	8.00	17.78	14.80	13.33
Welkom Yizani	1.54	1.70	1.70	1.03	1.28	1.41	1.45
Yebo Yethu			9.17	26.33	21.09	21.78	35.96

Table 19 shows that four of the companies paid dividends at an increasing rate per annum. Zakhele's dividend received increased by a 1000% over the 3 years, Puthuma Nathi by 500% and Yebo Yethu 300%.This can be seen as evidence that the holding companies were committed to the success of the BBBEE deals, and therefore aligned their dividend policies accordingly.

Welkom Yizani's dividends received are more consistent at around or less than R1,50 per share per annum with dividends for one year being as little as R1 per share. From the dividend received per share, we can therefore see why Zakhele, Puthuma Nathi and Yebo Yethu were able to reduce their debt levels considerably.

Table16 shows that that, the debt for Welkom Yizani reduced from R40 per share to R28 per share. This is interesting considering dividends received by Welkom Yizani were relatively low, the inconsistency in the performance of Media 24 and the fact that Media 24's ROE information reveals losses in the last two financial years. According to the 2010 AFS of Welkom Yizani, Naspers wrote of R330 M with of preference share debt to assist the Welkom Yizani shareholders. A press release regarding the assistance states that the assistance was needed due to a down turn in the media industry caused by the global economic recession.

Another key aspect is the relative low interest environment that the South African economy finds itself in. Interest rates have been at record lows over the last couple of years. The repo rate reached a record low of 5% in recent years. This ensured relative low interest expenses that assisted the performance of the deals. The low interest rates also meant more disposable income for consumers, which meant consumers could spend more on pay TV, and communication cost.

Chapter Summary

The analysis shows that all five deals were financed mainly by the holding companies of the BBBEE companies or the parent companies of the holding companies. The importance of profitable holding companies was also highlighted, because the BBBEE companies rely heavily on dividends to service and repay debt. Outstanding debt levels are very important as debt has a direct impact on company value. Our analysis also shows the importance of dividend policies of holding companies. The low interest rate environment we also found very important as the deals were highly geared.

CHAPTER 5 DISCUSSION AND CONCLUSION

5.1 Introduction

The objective of this chapter is to discuss the results of the research and provide the conclusion of the study. The chapter is organised as follows: Section 5.2 presents the results discussion. Section 5.3 provides the conclusion of the study and section 5.4 deals with recommendation for further study.

5.2 Results Discussion

To assess the efficiency of the deals, we first establish whether the deals had brought about economic value for the black shareholders that participated in the deals. We establish that four of the deals have created relatively good value as all these deals outperformed the market since inception. These returns created serves to answer Kritzinger (2004), who asked whether the intended beneficiaries of broad based empowerment will bear the intended fruits of the transactions and the BBBEE policy. This finding is also in line with previous research by Muller &Ward (2010) that found abnormal returns created by BEE deals. This is further corroborated by Strydom et al (2009) who found positive returns on a selected number of BEE deals with certain firm specific characteristics.

We then analysed what the factors were that had an impact on the success of the deals. We analysed the mixture of debt and equity funding, we identified whether the funders were internal or external companies and identified key features of the debt structures. Whilst performing the analysis we noticed that majority of the deals had preference shares as part of their debt structure. Only Yebo Yethu didn't have preference shares and we also noticed that the Yebo Yethu and Zakhele deals had a discount component and a vendor financing component. All the deals also had resulted in an investment company being formed (SPV), who held shares in the company implementing empowerment and seeking to transfer shareholding to black South Africans All these BEE funding mechanisms and structures are in line with the funding of BEE studies per Nhlapo (2008)..

Historically BEE deals were criticised for being too narrow, for not transferring ownership to black people (Santorius & Botha 2008, Nhlapo 2008) and the failures of deals were blamed on the high level of debt (Nhlapo 2008, Business Map 1999). We find that although all the deals we analysed were highly leveraged, the leverage assisted in maximizing the returns on investments.

We find that although the funding structures play a crucial role that they do not necessarily determine the failure or success of the empowerment deals as suggested by Nhlapo (2008) and Business Map 1999. We find the capital structures of the deals studied to be in line with capital structure studies by Frank and Goyal, (2003); Bharat, Pasquariello and Wu, (2008), who found that debt is preferred over equity due to the confidence signal it carries and because debt is relatively cheaper finance. We found that the performance of the empowering companies is a more important factor in determining the success of empowerment deals. We also found that the majority of the funding on the deals was internal funding, as most of the empowering companies used their internal funds to fund the deals. This corroborates the pecking order of finance theory (Franck and Goyal, 2003) that states that internal financing is preferred to external financing. The internal funding also played a crucial role in ensuring that the Welkom Yizani deal stays on track to reach its empowerment imperative. Naspers the parent company of Media 24, the empowering company, waived a big component of outstanding debt and accrued preference dividends. Management also send a confidence signal to the market by waiving debt. This would have been almost impossible or much more complicated if the debt providers were external financial institutions. Another important aspect was the discount provided by empowering companies on the MTN Zakhele and the Yebo Yethu deal. This discount signalled management's confidence in the deals and also lifted the NAV of the BBBEE companies. Another important aspect we found was the dividend policy of the holding companies. Dividends are crucial because it is the sole income of the empowered companies and it enables empowered companies to pay interest and redeem debt.

5.3 Conclusion of the study

The objective of the study was to assess the efficiency of funding structures used in BBBEE deals. In conclusion, we found that although funding structures do play a very important role, it does not necessarily negatively affect the performance of the deals. Efficient funding structures are important; however the performance of the holding company and the dividend policies of the company play a bigger and more crucial role in the success of BBBEE deals. We therefore encourage more companies to do similar broad based empowerment deals, and to use internal funding as much as it possibly can. Companies seeking empowerment should also focus on the growth and profitability of the empowering company and should ensure that dividend policies are aligned with its empowerment objective.

5.4 Recommendations for further study

A number of concepts in the study can be explored and studied further

- More broad-based empowerment deals could be included and a broader sample with companies from more industries
- A study could be done once the empowerment term for all the deals had come to an end to identify whether the empowering companies maintained their empowerment status and whether shareholders value grew more
- Tax efficiency of the structure of BBBEE deals could be studied
- Surveys could be done to establish whether the shareholders feel empowered and whether they would participate in such schemes' again
- The impact of the BBBEE deals on the share returns and profitability of the empowering companies can be studied

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