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BLACK ECONOMIC EMPOWERMENT PROJECT

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# Devil's in the Detail

## How to assess transformation of ownership of the South African private sector

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SOUTHERN CENTRE FOR INEQUALITY STUDIES

## Introduction

An enormous amount of time and energy has been spent assessing the extent of transformation of South Africa's private sector. To date, the exercise has not moved much beyond squabbling over numbers. The complexity of measuring ownership, on the face of it a simple exercise, is only one reason for this. In addition, in focusing only on transformation of listed corporates, the debate has excluded an estimated two thirds of the private sector. Most important, business and government have talked past each other – the former primarily focused on regulatory compliance, the latter on substantive change.

The only point of consensus is that in the 26 years since South Africa achieved democracy and determined to address the exclusion of black South Africans from economic ownership during apartheid, the pace and extent of transformation of private sector ownership has been wholly inadequate.

The private sector has considerable incentive to transform its ownership – and to be seen to be doing so. Changing the racial profile of ownership is one of five key objectives of the guidelines and regulation providing Broad-Based Black Economic Empowerment (BBBEE)[1] targets for entities operating in South Africa. Transformation is required for winning business. It is perceived to reduce political vulnerability and to hold reputational advantage. Moreover, many business leaders see business and economic value in some degree of economic transformation.

The focus on quantifying black ownership of the South African private sector has yielded varied calculations of black ownership of listed companies. There is much less discussion of ownership of the much larger unlisted segment, partly owing to the limited data available. The result is a lack of clarity on steps to accelerate transformation of the total sector. There is clear need for a shared understanding of the objectives, targets and measurement framework of private sector ownership.

## Aim of this paper

This paper explores listed and unlisted equity ownership in the context of the distribution of South Africa's national wealth. It is intended to contribute to a shared understanding of private sector ownership: how South Africans hold equity, how equity wealth is distributed among South African households, and transformation of ownership of equity ownership. This includes the listed segment, a crucial part of the bigger picture, as well as unlisted business.

It also explores where ownership information is found and could be accessed in future.

The hope is that this assessment will contribute to a broader discussion on accelerating transformation.

## Building block

The focus of this paper is intentionally narrow. The distribution of ownership of the private sector is just one consideration in the broader framework of the total

1 The Broad-Based Black Economic Empowerment Act 53 of 2003 (as amended by Act 46 of 2013) establishes a legislative framework for the promotion of black economic empowerment and empowers the Minister of Trade & Industry to issue codes of good practice and to publish transformation charters. The generic *Codes of Good Practice on Broad-Based Black Economic Empowerment* were brought into effect in 2007 and amended in 2012.

transformation of South Africa's national wealth and (social and political) power dynamics. A shared understanding of equity ownership is a building block of a broader conversation about transformation levers and objectives.

The focus places this paper squarely within the minimalist definition of transformation, which holds that "the minimalist approach defines BEE in terms of development of black-owned businesses or creation of black business class" (Edigheji, 2005 citing Edigheji, 1999). That being said, it is intended as a component of a wider discussion on the goals, power dynamics and achievements of transformation in a broader sense. The intention is also to contribute to a study of the policy, regulatory and consensus-building amendments that may accelerate the pace of this broader view on transformation.

## Approach to this paper

- The paper starts with a view of the size and significance of the listed and unlisted components of South Africa's private sector.
- The second section considers what South Africa's national balance sheets tell us about equity ownership by the country's households.
- This is followed by an exploration of the elements of listed equity ownership, and their implications for distribution of wealth.
- The fourth part of this paper focuses on the complexities of assessing transformation in unlisted ownership.
- The final section draws from the above to identify policy, regulatory and consensus-building amendments that may improve assessment and acceleration of the transformation of private sector ownership.

## Out of scope

This paper focuses on the ownership pillar of the BEE scorecard. Transformation objectives and initiatives outside of equity ownership in the private sector are covered in other papers within this report.

The paper also does not attempt to find the "real" percentage of the private sector owned by black South Africans. There are existing assessments of listed equity ownership. And as will be outlined, there is insufficient data available to calculate black ownership of unlisted equity. Instead, the focus is on what underlies discussion around the main components of ownership, and what light a view on the country's national wealth sheds on these.

South Africa has five registered stock exchanges, the Johannesburg Stock Exchange (JSE) being the oldest (and the largest, by a range of metrics). Three South African exchanges target small companies or other structures. The remaining exchange, A2X Markets, is a trading venue to secondary list and trade shares. In this paper, listed equity discussions will refer predominantly to the JSE.

### Listed versus unlisted: why the focus on the total private sector?

There is no unanimous verdict on the value of private sector, nor on how to reach it. Commentators on transformation of its ownership have largely, either explicitly or implicitly, used the JSE equity market as a proxy for the listed and unlisted segments.

This is at least partly because of the quantitative information gap between the listed and unlisted sectors.

Clearly, focus on transformation of listed equity ownership is a crucial part of the discussion. However, the limited attention paid to progress of unlisted equity transformation may have inadvertently prompted a less than integrated approach to assessment, policy and practical focus of transformation of the private sector as a whole.

Routes to valuing listed companies often depend on looking years into the future to assess the value of the company. Approaches include forecasting future earnings, calculating the value of net assets and accepting as a guide the value suggested by what investors will pay for the shares. If the country's future growth is in doubt, this increases the perceived risk of private sector growth and reduces valuations.

What investors will pay for a company's share, called its market value, is generally accepted as a good determinant. This is also the approach used to determine portfolio value of South Africa's national balance sheets.

A company's market value (or market capitalisation) is generally calculated by multiplying its share price by the total number of its ordinary shares traded on a particular exchange. To reach the value of a total equity market, one can add the market capitalisations of all companies listed on a particular equity market that provides a value.

There is no such simple measure for valuing the unlisted segment, where companies publicise less data, complicating how to determine an aggregated value (Van Eeden, 2005). As a result, there is limited research on how to value the unlisted segment of the private sector, much less a commonly used framework for valuing the total South African private sector. Instead, the JSE is often used as a proxy for the full private sector.

However, there are several reasons why using JSE as a proxy for the private sector is not necessary and, moreover, distorts the picture.

First, at least one viable approach exists to valuing the total sector. Using listed market data, as well as private sector income tax paid to the South African Revenue Service (SARS), an earnings ratio can be generated from which to extrapolate a value for the full sector. This approach is posited by Aron, Muelbauer, Prinsloo (2007) in South Africa[2] and is cited as a benchmark approach by the Organisation for Economic Co-operation and Development[3] *(*OECD, 2009).

In a 2019 presentation, advisory firm Rothschild & Co follows this route, using private sector income tax and listed segment earnings data to create a framework to assess total private sector value. Using 2015/2016 corporate tax and company data, Rothschild calculates the ratio of tax paid to revenue generated for JSE-listed companies[4]. By applying this ratio[5] to total private sector corporate tax, Rothschild

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2 Aron, Muelbauer and Prinsloo suggest that a possible option would be to use "*a ratio relative to the share for listed companies*" (2007).

3 "This method proposes the use of a capitalisation ratio as the ratio of the stock exchange market capitalisation to "own funds at book value" calculated for the same set of listed companies. In constructing the capitalisation ratio under this method, stock market data for an individual country may be used when the stock market in that country is broad and trading volume is relatively high…" (OECD, 2009).

derives an implied value for the private sector. Listed companies, the firm estimates, make up only about a ***third*** of private sector value.

A second reason why including the unlisted segment is important relates to its rising relative importance as domestic company listings on the stock market decline in many regions. Globally, more companies are going 'unlisted' routes to fund business growth. Between 2000 and 2020, numbers of listed companies declined in most regions worldwide – with the notable exception of South East Asia where listing numbers increased significantly.

To illustrate: industry association the World Federation of Exchanges (WFE) reports that, from 2000 to 2020, the number of domestic companies listed on Nasdaq (US) dropped 43% to 2408; and on Deutsche Börse fell 41% to 438. Between 2006 and 2020, the number of domestic companies listed on the London Stock Exchange Group dropped 38% to 1979.[6] On the JSE, between 2000 and 2020 the number of listings of domestic companies fell 56% to 264.[7] Commentators on global listings suggest that this trend may relate to perceptions around the cost, regulatory complexity and disclosure requirements of being a listed entity. It simply does not make sense to focus exclusively on listed companies to assess the private sector.

A third reason to include the unlisted segment of the private sector in a study of black equity ownership is the focus on growing black ownership of unlisted businesses among a range of key private and public entities – Department of Trade & Industry, the National Empowerment Fund, various private equity funds, incubators and others among them who have well publicised initiatives to build black business ownership. The JSE clearly does not represent the extent of BBBEE ownership of the broader South African economy.

Fourth, the fact that we are starting to see assessments of ownership transformation across the private sector provides some of the data that has been missing from previous reviews of ownership of unlisted companies. The Broad-Based Black Economic Empowerment (BBBEE) Commission, a statutory agency, has, for example, since 2016 commissioned an annual assessment of transformation in South Africa across private and public sectors based on compliance documents it receives (BBBEE Commission, 2020). Were it to be publicised, data provided by companies tendering to provided goods and services could also shed light on ownership transformation of the unlisted segment. Other research studies are planned and such assessments for 'SA Inc' – one such a collaboration between Sanlam, KhumaloCo and Arena Holdings – enable a more accurate view on transformation of the private sector as a whole (Intellidex, 2020b).

## South Africa's national balances sheets and ownership of the private sector

4 For further information on this approach, see https://corporatefinanceinstitute.com/resources/knowledge/valuation/price-earnings-ratio/

5 Rothschild & Co notes that the impact of reducing the tax multiple to allow a discounted value for unlisted companies would be a lower total private sector value.

6 The London Stock Exchange acquired Borsa Italiana in 2006. Listings are therefore cited from this year to give a like for like comparison.

7 The number of total instruments traded on the JSE, which includes bonds, derivatives, etc, rose during the same period.

In addition to these reasons to build a clearer view of ownership across both listed and unlisted segments, a hugely insightful tool provides a means to improving a sector-wide understanding of equity ownership and distribution among South African households.

South Africa's national balance sheets present a view at a point in time of the country's "net worth", including the assets and liabilities of all sectors of the economy. A country's system of national accounts has two main components: a statement of flows during a period of time and a statement of the stock of economic objects at a point in time. Stocks are included in the national balance sheets and in the balance sheets of segments, including households, the private sector and government organisations.

For the purposes of this paper, the national household balance sheets provide several key parts of the puzzle.

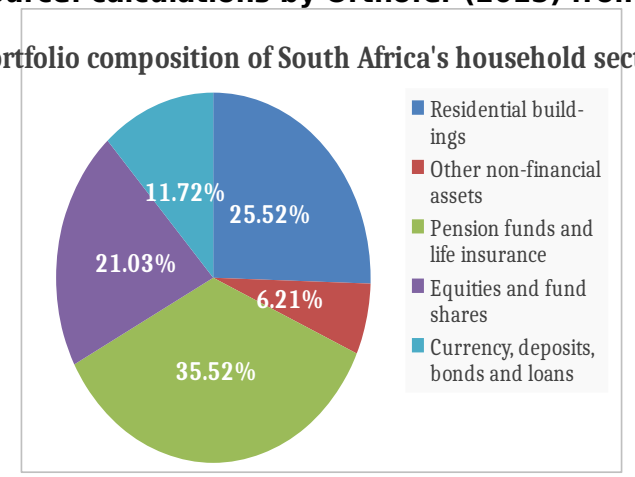
The balance sheets shed light on the extreme levels of inequality between value held by South Africa's wealthiest and poorest households.

While it is self-evident that South Africa's wealth distribution is eye-wateringly unequal, calculations, until fairly recently, have been difficult to do. However, work on the topic was accelerated following the work of French economist Thomas Piketty, with economist Anna Orthofer following a comparable approach to assess the distribution of wealth in South Africa (Orthofer, 2015; Orthofer, 2016b; Chatterjee, Czajka and Gethin, 2020). Orthofer's work is built on by a research team led by Aroop Chatterjee of the Southern Centre for Inequality Studies, among others.

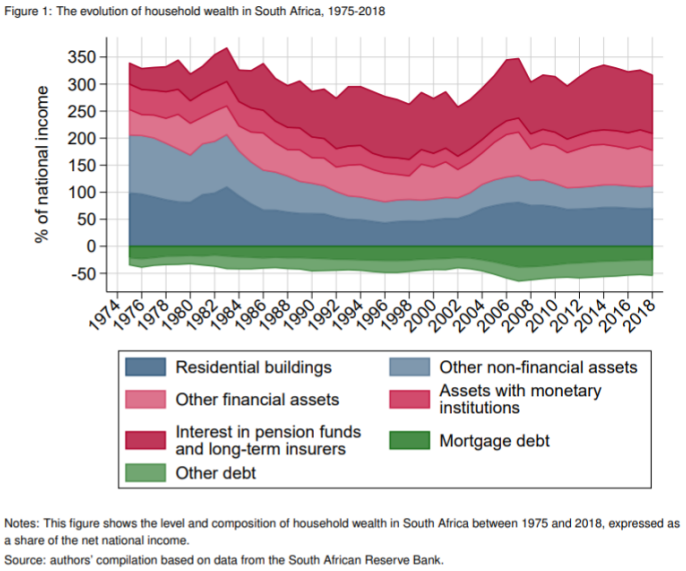
Using South Africa's national balance sheets and national living standards survey data (the National Income Dynamics Study) of 2010/2011, Orthofer found that the wealthiest 10% of the country's households own at least 90-95% of all wealth, with the next 40% of the population owning only 5-10% of all wealth. The poorest 50% of the population owns no measurable wealth at all (Orthofer, 2016a).

Another learning from the balance sheets is that equity is fairly significant in the composition of the country's household wealth: two thirds of household wealth is held in the form of financial assets, with wealth held through pension and life-insurance funds the single most important form of the household sector's private wealth.

**Portfolio composition of the household sector, 2010, in percent of total assets. Source: calculations by Orthofer (2015) from SARB database**

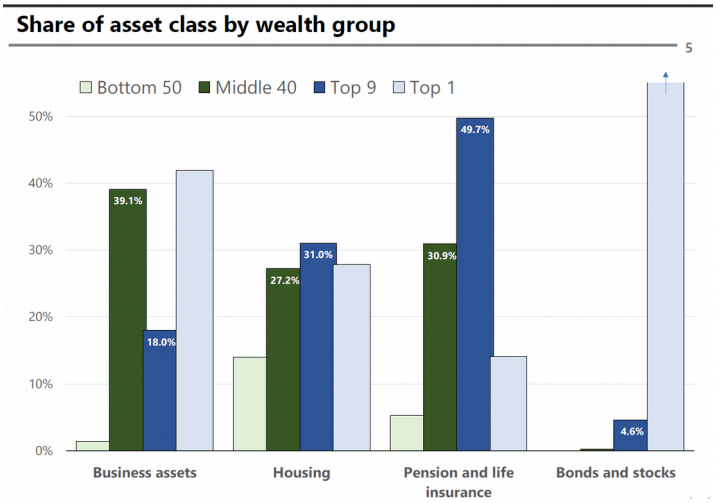


The dominance of financial assets in the portfolio composition of the household sector has been growing over an extended period. In a study on the distribution of personal wealth in South Africa, Chatterjee, Czajka and Gethin (2020) reflect the changing composition of household wealth between 1975 and 2018. This shows the growth of pension and life insurance to make up the biggest portion, with other financial assets (including equity, bonds and funds) growing less significantly to make up about 21%.




Source: Chatterjee, Czajka and Gethin (2020)

The balance sheets also enable down breakdown of ownership of financial assets by wealth brackets across South African households. The wealthiest 10% hold 95%+ of "stocks and bonds" – that is, directly held equity, bond and funds. The dominance of direct stocks and bonds holdings by a relatively small portion of households aligns with findings of JSE-commissioned research conducted by Alternative Prosperity into the breakdown by value of ownership of the largest 100 JSE-listed companies at a point in time.




Source: Sachs (2020) citing data from Chatterjee, Czajka and Gethin (2020)

Lastly, the household balance sheets enable some degree of comparison between the distribution of asset allocation of South African households and other countries. For example, the significance of financial assets in South Africa can be compared with the nine developed countries studied by Piketty, in which a significant portion of household wealth was made by residential houses (Orthofer, 2015 citing Piketty, 2013).

One anomaly regarding the household balance sheets may require further investigation. Business assets held by the household sector are valued in the 2018 household balance sheets at R497 billion (or 4.7% of national wealth)[8] – 13 times less than the implied value of R6.7 trillion suggested in the Rothschild & Co calculations based on 2015/6 tax data. Clearly given the nature of the calculations – and the two years between data points – there is room for variation between the two implied values. But there seems to be cause to identify the reasons for significant value differences. The possibility exists that wealth held in the form of unlisted equity is much more significant than the balance sheets suggest.

### An exploration of ownership of listed equity

The view on wealth distribution of South African households afforded by the national household balance sheets provides a meaningful part of the picture of listed equity ownership in South Africa, though not the full story.

For example, the balance sheets indicate that the wealth of half of South African households includes equity value held indirectly through mandated investments. On the behalf of the wealthier 50% of South African households, institutions manage a range of funds – including pension, life insurance, unit trust and others – holding roughly a third of the listed equity market.[9] These holdings give beneficiaries rights to wealth but not to control voting on the shares.

The balance sheets also demonstrate that South Africa's wealthiest 10% hold 90-95% of all South Africa's household wealth, including most of the value that the country's households hold in equities, bonds and funds.

While these points may play a role in thinking about listed equity ownership, they also indicate why policy aimed at reducing the wealth gap in South Africa should take account of the contexts of the country's richest and poorest households.

As one might expect, the household balance sheets do not reflect the large portion of value of equity held by foreign investors. This is accounted for elsewhere.

## The devil's in the detail

Although considerably greater clarity exists about the size and transformation of the listed segment of the private sector than the unlisted, anyone taking on the task of assessing ownership through going to shareholder records faces an onerous task.

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8 Data cited by Chatterjee (2020) estimated by combining available data sources from the South African Reserve Bank

9 Regulation 28 gives effect to Section 36(1)(bB) of the Pension Funds Act 1956, which provides that the Minister of Finance may make regulations limiting the amount and the extent to which a pension fund may invest in particular kinds or categories of assets. 75% of the value is required to be held in equity, with allocations to property, private equity, etc.

First, share ownership information is (mostly) not publicly available, to protect personal information of individuals. And where researchers gain access to shareholder data, they must look through the bulk "nominee" accounts used by stockbrokers handling the accounts of small individual investors to reduce the administrative complexity of managing many smaller clients.

Second, the sheer numbers of investors on the JSE, located worldwide, result in thousands of rows of share ownership data. Measurement of ownership is time-consuming and laborious. Complicating matters further is the fact that share register records do not include race, meaning that some black ownership calculations have used guesswork based on shareholder surnames to judge the race of investors.

Third, ownership of the large portion of the value of the 100 largest companies[10] held through institutions managing pension, life insurance, unit trust and other funds is recorded in the name of the institutions themselves. This means that in order to assess the race of the beneficiaries, the funds would need to disclose member data to enable cross-checking of this data against exchange ownership records. However, this is contrary to personal information protection regulations. Assessing ownership requires drilling down through the pension fund structure to see which individuals own or have rights to share value. The JSE-commissioned analysis follows this approach, which arguably yields the most complete view of listed equity wealth held by households.

Lastly, even assessing the race of participants in black economic empowerment (BEE) transactions is not a superficial exercise. BEE is measured at natural person level, by looking through the BEE ownership structures. Those transactions completed at listed entity level – where shares of a listed company are transferred to black individuals, or various trust and ownership structures in which black South Africans are beneficiaries – are more straightforward to assess. More complex is an alternative form of ownership recognised in the Codes of Good Practice[11] through which a company which sells an asset or SA subsidiary can claim BBBEE ownership points. In such cases, researchers estimate the value of the unlisted assets as a percentage of the total value of the company (Hofmeyr, 2019).

That said, a limited number of types of shareholding is publicly available.

For example, JSE-listed companies are required to disclose the names of investors holding large stakes of shares (5% or more) of each class of shares issued by the company. These shareholders are frequently institutional holders of shares on behalf of pension funds, collective investment funds, life insurance policy funds and the like. They can also include foreign investors, mostly institutions. And they can also include other major shareholders in the form of BBBEE companies and trusts.

Another example, the ownership impact of BBBEE transactions involving substantial share allocations of a company, is also made publicly available in transaction notices published through the JSE's Stock Exchange News Service. These transaction notices, the subject of intense public interest, are collated by data houses and can be obtained for use in calculation of black ownership.

Of all the thousands of investors, these shareholders make up a relatively small number. And the complexity of identifying any other investors is one source of the

10 The Top 100 companies make up about 85% of the total value (market capitalisation) of the equity market and are often used as a proxy for the whole equity market.

11 Statement 102 of the Codes of Good Practice on Broad-Based Black Economic Empowerment, 2013, relating to the sale of assets, equity instruments and other business.

disparities between different ownership assessments. Some assessments of black ownership, in fact, rely only on this publicly available information, often restricting the calculation to those groupings noted above.

**Not simply a binary affair**

As noted, the race of holders of the value of a large chunk of the value of the equity market is generally deemed indeterminable or irrelevant. Most assessments of ownership transformation of listed companies appear to agree on this – these groups do not feature as topics of debate – but are:

- Shares owned by the South African government

  An estimated 2% of the traded equity of the Top 100 is held by the South African government or by government's development finance institutions such as the IDC. In this instance, race is irrelevant. This figure excludes the value of equity held through the Government Employees Pension Fund on behalf of state employees, and managed by fund managers including the Public Investment Corporation. Most assessors simply remove this stake from the universe under consideration (denominator and numerator) – excluding it from calculations.

- Shares held by other listed companies

  Due to concentration of ownership of the business sector, large cross-holdings of shares exist between corporates where one company holds a stake in another. Cross-holdings are subtracted to avoid double-counting of those shares. In value terms, Alternative Prosperity found in its 2015/2016 report, cross-holdings and government-owned shares, combined, amounted to about 11% of the value of the Top 100 companies.

- Listed equity owned by foreign shareholders

  In an open economy such as South Africa, foreign investors are able to hold JSE-listed shares as are South African investors able to hold shares of companies listed on exchanges worldwide. Foreign shareholders held roughly a third of the value of Top 100 companies at the time of the 2015 ownership calculation, providing the country with a useful source of foreign investment. Racial classification of non-South Africans is generally deemed irrelevant. If foreign investors own shares, by definition they are unavailable to black or white South Africans. Following the approach laid down in the DTI Codes of Good Practise[1], shares held by foreign investors are often excluded from the universe of shares included in calculation.

- Unassessed shares

  As noted, analysis of race of shareholders is a complex task. By publication of the last JSE assessment, about 16% of the value of the Top 100 companies listed on the JSE had not been assessed. These shares were held by a range of small or mid-sized pension funds. Most commentators agree that attempting to attribute a race to owners of these shares would not be useful. These are generally excluded from the universe of shares when calculating black ownership of the JSE.

- Offshore operations of South African companies

In a globalised business environment, some of South Africa's largest companies have diversified geographically; their total values include assets in South Africa as well as elsewhere. Assessing black ownership of multinationals is complex in various respects. Multinational businesses are entitled to exclude from calculations the value of operations outside of South Africa. Many companies with offshore assets exclude the estimated value of foreign operations from the value used to estimate black ownership of the Top 100. That is, any contributions towards the ownership element of BBBEE made by multinational businesses or South African multinationals are measurable against the value of their operations in South Africa (Mahlaba, G, 2016).

**When is ownership really ownership?**

Shareholder rights, governed by the Listing Requirements and the Company's Act, include rights to economic value and control through voting.

The right of each shareholder to exercise his or her vote is one way in which even a small shareholder exercises some control over certain key decisions.

That's the theory, anyway. In practise, while it is true that direct shareholders have the right to vote, this is limited to their right to vote at the company's Annual General Meetings on governance issues, the appointment or retention of directors and remuneration of senior management. Strategy outside of major transactions is generally not voted on. Moreover, an investor will generally need to have a large direct holding of a company's equity (some commentators use 5% as an indicative number) to influence a company's strategic direction. There are rare exceptions to this – in key decisions requiring 75% of shares to be voted in favour, even a small investor can sway a decision.

A shareholder's economic right is the right to share in the company's profitability and gain from its stock price appreciation.

Debate on ownership arises in South Africa out of the significant place institutional investors have in the ownership of listed equity, and significant place that institutional holdings have in the household wealth of many South Africans.

An institutional investor is a company or organisation that invests money on behalf of clients or members. Beneficial owners are middle- and upper-income people, with the largest portion being the deferred incomes of workers who will be pensioners in the future. Hedge funds, pension funds, unit trust funds and endowments are examples of institutional investors. Institutional investors are a crucial component of the local equity market, providing capital to listed companies and a liquid market for the trading of shares and other financial instruments.

Mandated investments provide beneficiaries with economic rights of share ownership. The value of the pension fund grows or shrinks to the extent that its investments do the same. Households holding pension funds are accumulating wealth, but are not accumulating control in an investment sense. However, arguably control is not the object of the exercise in pension fund ownership – rather the aim is capital growth.

The DTI's Codes of Good Practise allow companies to include mandated investments in their black ownership calculations. The decision is left with the assessor.

If one's definition of ownership includes the right to control, then any ownership form that excludes this right is not regarded as "real" ownership. However, if – as is the

case with many financial market participants – the focus is almost entirely on economic rights, then there will be no debate about whether "non-voting" holdings should be included in the value of black ownership of listed equity. The answer will be, unquestionably, yes.

## The mandated shareholder debate

Shares held by institutions through pension funds and life insurance funds steal the limelight in the vociferous debates about black ownership of listed equity. Institutional funds – mostly retirement funds, long term insurance and collective investment schemes – accounted for 39% of the value of the stock exchange in 2015, according to research conducted for the JSE by Alternative Prosperity. Analysis of the rights vested in these funds indicates that about one third of these wealth stocks are owned by black South Africans (Thomas, 2017: 20)

As the country's household balance sheets indicate, pension and life insurance funds are a key mechanism for wealth accumulation among South Africans, with many South African households also beneficiaries of funds such as life insurance, unit trusts and others. Pension funds, collective investment schemes and long-term insurance make up 90% of institutional funds.

Although beneficiaries of retirement and life insurance policies receive the value accumulation of share ownership, beneficiaries do not hold shares directly and do not hold voting control, as discussed.

This is the source of a vociferous debate about whether pension fund value should be included in an assessment of the equity owned by black South Africans, with one's perspective related to how one defines equity "ownership".

## Snapshot of existing ownership calculations

Unsurprisingly, given that determining race of a fair portion of listed equity is not possible (see Not simply a binary affair above), a range of assessments of listed equity ownership exist. Assessment of black ownership of listed companies has produced varied results, underlying which are differing views about the objectives and priorities of transformation of the private sector.

One approach, aligning with the approach allowed by the DTI's Codes of Good Practice, focuses on the economic rights afforded by investment. That is, the focus is on wealth creation. For that reason, it includes direct and mandated investment, but generally excludes all the components where race is not possible to determine.

Another approach, focused on shares owned and controlled by black South Africans, generally estimates ownership through BBBEE deals reflecting on the share registers of listed companies and taking place at listed company level. This approach excludes mandated investments, where beneficiaries do not have voting rights. The equity value in the hands of investors, such as government or companies, is also excluded.

### Alternative Prosperity research

Probably the most granular and widely cited approach to calculation was followed by Alternative Prosperity in JSE-commissioned studies using an approach allowed by the DTI's Codes of Good Practice. This approach aligns with that used in the ownership pillar of the Black Economic Scorecard.

The focus was on the economic rights afforded by investment. Direct and mandated investment were included. In 2015, the JSE said[12] that 23% of the traded equity of the Top 100 was owned by black South Africans.[13] Of those, 13 percentage points were held through mandated funds and 10 percentage points directly or through BBBEE transactions.

About 16% of the value of the Top 100 was not researched.

Researchers drilled down to individual level by cross-checking share register records against other data such as certificates on BEE deals, pension fund, unit trust and life insurance policies data.

**Broad-Based Black Economic Empowerment (BBBEE) Commission calculation**

The BBBEE Commission, a department of the Department of Trade and Industry, conducts an annual assessment of transformation in South Africa across private and public sectors. Its report for the 2019 calendar year, published in 2020, was based on compliance reports from 150 JSE listed entities, 43 organs of state and 5 818 entities whose BBBEE certificates were provided to the commission. Using the public or private sector entity's own data as the basis of calculations, the approach excludes black ownership that the organisations may not be able to identify.

The Commission found that the overall level of black ownership in entities surveyed was 29% in 2019 (2018: 25%). Half the companies listed on the JSE, the Commission found, had less than 25% black ownership. (It is worth noting that there have been discrepancies between the Commission and a few organisations over the BBBEE impact of certain empowerment schemes or transactions (Cohen, 2020; Paton, 2020).

**National Empowerment Fund[14] study**

The National Empowerment Fund (NEF), which provides financial and non-financial support to black-owned and -managed businesses, based its research methodology on the approach followed by Who Owns Whom, which assesses black ownership of the JSE equity market as a proxy for the total private sector on the basis of ownership and control. Speaking at a 2015 panel discussion, the NEF focused on direct black equity control over the JSE's average market capitalisation of R11.6 trillion as at 19 Sept 2015 (for Listed Companies), standing at 3% (R349 billion) for shares directly held by black South Africans. The NEF cited Who Owns Whom & JSE market data, September 2015 as the source for this finding (Molepo, 2015).

**National Treasury's Ownership Monitor**

National Treasury-commissioned Ownership Monitor (Thomas, 2017) presents data on the ownership of South African companies listed on the JSE. This assessment focuses on four aspects of ownership: foreign ownership; ownership through South African institutional investors; major shareholdings; and black ownership. Research draws on

12 Through a research study by consultancy Alternative Prosperity whose findings the JSE published.
13 The research was released in 2015 and provided information on the breakdown of ownership at end 2013.
14 Established by the National Empowerment Fund Act No 105 of 1998, the National Empowerment Fund provides financial and non-financial support to black-owned and -managed businesses. It is governed by the Public Finance Management Act No 1 of 1991 (PFMA).

data from a variety of sources aimed at providing an overarching view of ownership of JSE-listed companies._

Exploration of unlisted equity

If deducing transformation of listed equity is complex, the unlisted business segment is even more difficult. Anecdotal information exists, however, transformation of unlisted business is under-researched and difficult to verify given the paucity of data that exists on its value or transformation. We are far from establishing the extent of transformation of ownership, which explains the use of the listed sector as a proxy for the private sector as a whole. However, the unlisted segment of the sector is a crucial part of the debate, as is the development of effective tools for acceleration of its transformation.

**Ownership of the unlisted sector**

The unlisted sector's significance is in its sheer size relative to the listed sector, the numbers it employs, its potential for growth, rising importance for capital raising (given the reducing numbers of companies listing on the equity market) and the fact that its less-concentrated ownership structures mean it is arguably easier for black entrepreneurs to achieve ownership and control of these entities.

So, how should we be thinking about ownership of unlisted equity in the context of South Africa's national wealth? This section focuses on what we do know, as well as which questions need to be answered in order to build an understanding of transformation of its ownership.

**What we know**

An unlisted company, held under private ownership, may issue stock and have shareholders, even though their shares do not trade on public exchanges. In general, the shares of these businesses are held by founders, founders' family and peers. They trade less and their valuations are more difficult to determine.

Because of how they are funded – by owner capital or bank debt – most unlisted businesses are owned by people, rather than by banks holding shares. Trade in shares is less frequent than on an exchange. The companies tend to operate in industrial sectors rather than financial services. From an empowerment perspective, this slows transformation, on the one hand, but makes the case for black industrialists all the more compelling, on the other.

Focus on the unlisted segment could have a greater impact on growing black private-sector ownership, based on its sheer size. Best available estimates put the unlisted segment at double the value of the listed segment (Rothschild presentation, 2019). This is reason for further research into effective policy tools to drive transformation of private sector ownership.

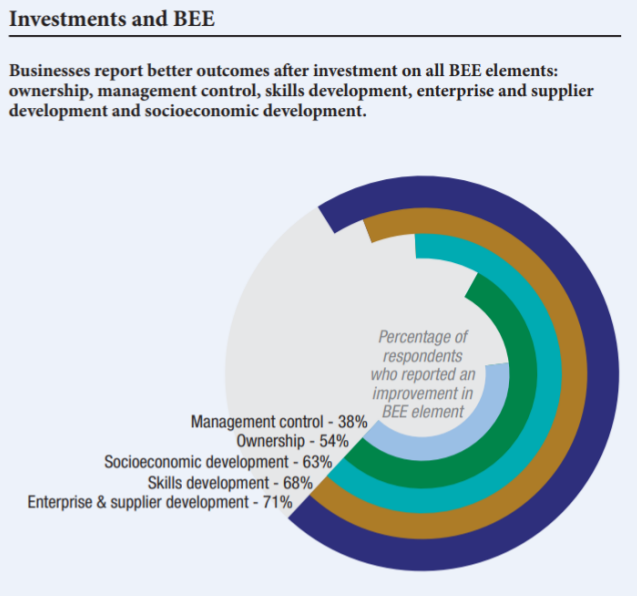
The clearest sector-wide view of ownership transformation is probably that provided by the BBBEE Commission research studies on private sector transformation. That research, says the Commission, puts ownership transformation across private and public sectors at 29% in 2019. There is no figure for unlisted entities alone.

This is not to say no information is available. For example, unlisted companies routinely provide information about equity ownership in standard competitive bidding documentation. Certain information is provided to the Companies and Intellectual Property Commission (CIPC). So far, companies have largely been responsible for disclosing information to the BBBEE Commission. It will be interesting to see whether that changes.

There is a fair degree of fire-power behind growing transformation in the segment. A range of organisations is focused on growing the number and prosperity of black-owned businesses in South Africa. These range from business incubators and private equity firms to state organisations and initiatives. In addition, Section 12J of the Income Tax Act, implemented in 2015, has been used to fund more than R5 billion worth of investment into small businesses in various sectors, enabling building of black-owned businesses, according to the 12J Association of South Africa (2021).

While each of these builds black-owned businesses in number and sustainability terms, there are no aggregate numbers available. A clearer nation-wide view of work underway in unlisted companies would be hugely beneficial to accelerating efforts. It would align with the Department of Trade and Industry Black Industrialist Policy, aimed at accelerating the growth and participation of black industrialists in the economy.

Support for ownership transformation of unlisted companies comes from a range of sources. A private equity sector-backed study conducted by research house Intellidex, for example, finds that 54% of investee businesses of private equity firms report better outcomes after investment in black ownership (Intellidex, 2020b).




Source: 27four (2020)

Notwithstanding the support for growing transformation of the unlisted segment, there are obstacles.

These include identifying investors and funding transactions. These present challenges particularly for smaller unlisted entities, according to a working paper on impacts and outcomes of the BBBEE policy by Neva Makgetla (2021) of Trade & Industrial Policy Strategies (TIPS). The paper reports that smaller enterprises “often find it difficult to identify or attract investors, since many have limited profits… Small

businesses said they could not easily find investors who were interested in participating in the company's operations rather than treating it as a purely financial investment" (p12, Magetla, 2021).

In this respect there have been suggestions that the Government Employees Pension Fund (GEPF) may be used to fund appropriate BEE transactions, through use of pension funds held on behalf of civil servants. Understandably, this attracts disagreement from those arguing that this could place pension funds of retired state employees at risk, given the primary role of the GEPF to protect the wealth of members and pensioners by safeguarding retirement benefits.

Unlisted family-owned businesses may be complex to value, with little distinction between personal and business expenses, or between management salary and dividends (Van Eeden, 2005). For the family, these businesses may be more than just an investment, bringing satisfaction of ownership and the ability for the family to want family welfare rather than profit maximisation. As the World Federation of Exchanges found in a 2015 research study on family-owned businesses, these entities may not wish to bring in outside shareholders (Cleary & Stefano, 2015). One wonders whether enforcing this would encourage growth of this sub-segment in South Africa.

**What we don't know**

Given the paucity of data available about the unlisted business sector, including the lack of a comprehensive source of information on racial composition of its ownership, the transformation of unlisted businesses is obviously an under-researched field.

Moreover, unlisted businesses are regarded as more complex to value than the listed sector in South Africa, because regulation does not require them to provide detailed disclosure (Van Eeden, 2015).

Nonetheless the unlisted segment of the private sector is crucial for the acceleration of total transformation of ownership. First, it is large. Second, its less-concentrated ownership structures mean it is arguably easier for black entrepreneurs to achieve ownership and control of these entities.

Further research on the unlisted segment is needed and to do this, the following is required:

- Estimate total value of South Africa's private sector by using other methods to generate a better understanding of the size of the sector and the relative significance of its different components. This is useful for research and policy setting purposes.
- Develop further ownership data sources for unlisted South African companies.
- Develop further assessment criteria and sources to enable, on a national level, further quantitative research on the role and ownership of small and medium enterprises in order to expand existing knowledge.
- Use the research and analysis noted above to develop and expand on policy tools to address high levels of ownership inequality.

Without a complementary research programme on unlisted equity ownership, there cannot be a full understanding of private equity ownership in South Africa.

Accelerating private sector transformation

Despite South Africa approaching three decades since the country achieved democracy, aims of transformation of private sector ownership remain unclear. While there is consensus on the broad aim – redistribution of ownership – there is limited agreement even on whether this references rights to wealth or rights to control. While there are views on how exactly each aim could be achieved, there is limited consensus.

However, the current distribution of assets in South African households – including segmentations of wealth bracket, race and asset class – provides, if it were needed, a clear and compelling set of reasons for reducing the inequality of asset ownership and, particularly, accelerating transformation.

The fact that a company's BBBEE status is a form of competitive advantage provides an opportunity to guide private sector behaviour towards substantive economic transformation, rather than compliance. BBBEE levels can influence procurement decisions, licencing and private sector procurement. That makes improving BBBEE scores a focus for companies, in order to take advantage of business opportunities.

But government, reliant on the private sector which includes white business, has been cautious in setting empowerment targets, given its commitment to achieving more rapid economic growth, but wary of the response of white business owners were they obliged to relinquish large ownership levels to black investors.

What then are levers to consider using to accelerate transformation of private sector ownership?

**Define equity ownership goals and metrics across the private sector**

All the uncertainty about ownership calculations makes it clear that clear definitions of the goal in the drive towards transformation of the private sector are required. In particular, further work is needed to develop an understanding of ownership of unlisted equity in South Africa.

Aims regarding control and management of private-sector assets could be extended across the listed and unlisted segments of the private sector, with a focus on metrics and targets to measure success (Business Unity South Africa, 2017).

In addition, there is a requirement for clear definitions of the desired outcome in the drive towards transformation of the private sector. The measurement of BBBEE in a particular entity needs to be recalibrated. There is a need for a consistent and credible measurement tool for equity ownership, using an agreed calculation methodology. This, in turn, can develop a clear and shared view on equity ownership in South Africa, a view shared by government, business and other key stakeholders, such as organised labour. This could include more focus on substantive transformation, value and influence (Business Unity South Africa, 2017).

**Incentivise transformation of the unlisted business segment, including through mechanisms that encourage new business growth**

The potential to add many small and growing businesses owned and controlled by black people is an obvious avenue through which to activate inclusive growth. The

trend in declining domestic equity listings is another reason to activate inclusive growth, were it needed.

Cross-stakeholder agreement is needed on more effective stimulus mechanisms for small business investment. This could take place in tandem, with a focus on integrating policy on stimulus of ownership transformation of listed and unlisted businesses.

Opportunities are required to drive inclusive economic participation in unlisted businesses. A focus on the creation of black businesses across the spectrum, from SMEs to large industrialists, could result in attention paid to the range of programmes mentioned in this paper. It could also include a review of the role played by the venture capital sector and possible measures to grow this.

The role of the unlisted segment could include the development of small, black-owned businesses which is a key objective of the BBBEE Scorecard's Enterprise Development pillar.

Another possible lever would be a relook at the impact and opportunities created through investor capital directed into SMEs through Section 12J investments – since 2015, an approximate R5.5 billion into more than 360 SMMEs across the country (12J Association, 2020).

A clearer nation-wide view of work underway in unlisted companies would be hugely beneficial to accelerating efforts. It would align with the Department of Trade and Industry Black Industrialist Policy, aimed at accelerating the growth and participation of black industrialists in the economy.

#### Enable monetising of equity investments

A solution should be found for the need for shareholders to monetise investments for continued economic participation and growth. The need to maintain the prescribed equity ownership targets should be an open topic of debate. Equally, there could be recognition of the impact of lock-in clauses on prohibiting beneficiaries from monetising their holdings.

#### Consider the use of mandated investments as a means to economic wealth transfer

Given the extreme levels of inequality in the value held by South Africa's wealthiest and poorest households, policy that takes account of the context of the country's richest and poorest households could recognise mandated investments as a mechanism for wealth accumulation. Given the role of pension assets in South Africa, a more comprehensive pension system would be effective in reducing wealth inequality (Thomas, 2017). This precludes a 'one size fits all' requirement for equity ownership.

Transfer of economic wealth to the 'middle 40%' and beyond should not be discounted. While economic control is a crucial aspect of private-sector ownership transformation, there is a place for the transfer of pension and life insurance fund wealth as a means to wealth accumulation.

## Conclusion

Assessing ownership transformation of the private sector was unlikely to yield a simple outcome.

The combination of arguments about measurement principles for business entities where ownership is clear, and inadequate data about the majority of business entities where ownership is unclear or unknown, has further slowed acceleration of transformation.

The JSE clearly does not represent the extent of BBBEE ownership of the broader South African economy. The unlisted segment could have a significant place in private sector transformation.

What is needed is a shift from squabbling over numbers to agreeing on a framework for accelerated transformation.

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