

## RESEARCH REPORT

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# **STRUCTURES FOR BLACK ECONOMIC EMPOWERMENT IN SOUTH AFRICA**

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# CHAPTER ONE

## INTRODUCTION

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As at 1994:

- less than 3% of South African managers or executives were black;
- less than 2% of shares listed on the Johannesburg Stock Exchange belonged to black business;
- blacks owned only 2% of shares in non-listed companies  
(Godsell, 1994:1)

Apartheid has assisted "whites" in South Africa to virtually own the country and everything that is in it, both legally and territorially. It is immediately obvious that the past exclusion of blacks from active participation in business, either through a deliberate policy of apartheid or the side effects of that policy, created the situation referred to above.

The proposed research report will examine the process of black economic empowerment as it has manifested itself in South Africa -identifying the problems and challenges, possible solutions and the structures for meaningfully empowering blacks. The research report will take the form of a detailed literature review.

Black economic empowerment is a generic term embracing a broad inventory of relevant elements which help to define the process:

- control of JSE listed companies;
- effective representation in all business, industrial and professional associations (aside from "blacks only" bodies);
- access to business finance for own ventures and for equity participation;
- participation by blacks in franchise operations;
- opportunities for share ownership;
- scope for profit sharing, employee share ownership and/or employee (management) buy-outs;
- access to appropriate business, managerial and entrepreneurial training;
- affirmative action in corporate employment, management and control; and
- access to business apprenticeships or traineeships and mentor-support programmes. (Godsell, 1994:2-3)

Established white business has, to some extent, taken the initiative started by the acquisition by Methold (an investment company formed and owned by black businessmen) of a 10% stake in Metropolitan Life from Sankorp. This research report will seek to look to the future rather than dwell on the past. Accordingly, a study of the historical causes which have resulted in blacks not being meaningful participants in the economic and business wealth and processes of South Africa will not be entered into as this is unlikely to add value. The objective will be to identify business structures and initiatives which will facilitate the process of black economic empowerment in order to provide a blueprint to South African companies and institutions that are considering an empowerment initiative.

Chapter 2 identifies some of the key problems facing meaningful black economic empowerment in South Africa. Chapter 3 analyses the three most successful corporate empowerment transactions to date in the private sector. This analysis is performed on the basis that the most demonstrable activity in the area of black empowerment in South Africa over the last two years has certainly been in the private sector. Chapter 4 examines specific vehicles or mechanisms which are consistently identified and have been harnessed in order to promote and achieve empowerment. One of the constraining factors identified in Chapter 2 as an obstacle in the path of meaningful empowerment is the scarcity of black capital resources. Resulting from this, various sophisticated financial engineering solutions have been devised to facilitate, in particular, the equity participation by black empowerment groupings in transactions. Chapter 5 analyses several typical financial engineering solutions. Chapter 6 concludes the literature review.

## CHAPTER TWO

### Problems and challenges facing meaningful black economic empowerment

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The business and economic playing field in South Africa was not equal for a long period of South African history. At this point in the history of South Africa very little will be gained by analysing the cause of the uneven playing field (one does not need to look beyond the National Party's sustained policy of apartheid from 1948 - 1990 to find the answers) but rather it is sought to discuss current challenges facing future empowerment.

This chapter aims to identify the major challenges facing real black economic empowerment (without attempting to provide a theoretical framework for addressing the problem) in order to provide a context for analysing the structure and mechanisms aimed at overcoming the challenges to allow for meaningful empowerment. The specific structures and mechanisms developed will be analysed in detail in later chapters.

Some of the immense challenges facing meaningful black empowerment have been identified as follows:

- i) a grossly undereducated black populous.  
(Sasol Limited, 1993:31)
- ii) a scarcity of black capital resources.  
(Levin, 1994:3; Nyati, 1993:85)
- iii) a lack of adequate managerial, technical and administrative skills among some managers.  
(Riley, 1993:62)
- iv) major corporations in South Africa are controlled by whites who are generally perceived to be unwilling to relinquish power voluntarily. (Mbatha, 1993:57)

These assertions are analysed in more detail:

## 1. A GROSSLY UNDEREDUCATED BLACK POPULOUS

There is clearly an urgent need to create more wealth in South Africa. A significant obstacle in the way of wealth creation is the gross lack of education, from a pre-school to postgraduate level.

The following table summarises claimed levels of education among black adults aged 16 and over (as %) as at 1990:

	%
No formal schooling	24
Some primary schooling	32
Primary school completed	10
Some high schooling	27
High school completed	5
Post matric education	2
	<hr/> 100 <hr/>

Source: South African Institute of Race Relations, Race Relations Survey, 1992.

Knowledge and skills are perceived to be the most vital tools for creating economic wealth. A review of the economic success stories of wealthy first world nations such as the United States, Germany, Japan, Norway and Sweden reveals one common denominator: technological prowess (Sasol Limited, 1993: 31).

The specific challenge facing the empowerment process is to provide the education and skills required to allow the black sector of the community to participate meaningfully in the mainstream of the economy. It is far beyond the scope of this research report to attempt to provide a theoretical framework for addressing the problem. The aim is simply to identify the major challenges in

order to provide some sort of context for the development of structures and mechanisms aimed at meaningful empowerment.

## **2. SCARCITY OF BLACK CAPITAL RESOURCES**

Professor Michael Katz of Edward, Nathan & Friedland says that "black economic empowerment means many things: meaningful black representation on boards of companies and meaningful black share ownership. To speak about blacks in venture capital and all of that is essentially inappropriate. There has got to be meaningful ownership in major South African listed companies." (Quoted by Levin, 1994: 3)

The significant challenge to all corporate finance theories is how to achieve "meaningful ownership" without serious capital resources. The fundamental issue is the problem of finding capital in a disadvantaged sector.

Shaheem Samsodien of Goldman Judin & Werner reiterates that the availability of black capital is always going to be a problem due to historical considerations (Levin, 1994: 3). He identifies one massive potential source of black capital as workers' provident funds. The latter part of the 1980's saw the proliferation of provident funds to which black workers contributed their retirement funding. This has resulted in a massive pool of black savings, which are currently managed by professional portfolio managers where the primary objective is to earn a market related return on the funds. Transactions of a black economic empowerment nature, which often implies an element of gratuity on behalf of the investor, are not likely to earn market related returns. The challenge facing the investment community is to channel black provident fund savings into appropriate investments so as to create black ownership of substantial assets.

The mobilisation of the savings of black individuals for the transfer of ownership of assets was used very successfully in the two flagship black economic empowerment groupings to date, the Real Africa Group and New Africa

Investments Group. Both of these transactions will be analysed in detail in Chapter 3.

At a micro-enterprise level, Nyati (1993: 85) makes the point that as black (people) were, until recently, barred from owning land, property could not be used as a form of collateral for loans from banks or other financial institutions. This hampered the ability of black entrepreneurs to raise capital in the formal banking sector.

### **3. LACK OF ADEQUATE MANAGERIAL, TECHNICAL AND ADMINISTRATIVE SKILLS**

Riley (1993: 62) concludes in her paper that lack of skills is one of the most hampering constraints limiting the development of black enterprises. In South Africa, the provision of skills needs to be addressed both in the overall context of restructuring the South African education system as well as in the business marketplace. Black individuals need to be educated, starting at a primary level, so that management, technical and administrative skills may be developed at a tertiary level or through vocational and occupational training.

Black entrepreneurs, surveyed by Riley (1993: 35-53), identified the principal internal constraint that adversely affected their business success as being the lack of the abovementioned skills. Deregulation that has begun to create a climate in South Africa where black business and businessmen can prosper needs to be accompanied by measures that directly eliminate this constraint.

### **4. MAJOR CORPORATIONS IN SOUTH AFRICA ARE CONTROLLED BY WHITES WHO ARE GENERALLY PERCEIVED TO BE UNWILLING TO RELINQUISH POWER VOLUNTARILY**

Mbatia (1993: 57) puts forward the view that the major corporations in South Africa, through an accident of history, are owned and controlled by whites. As at 1994, less than 2% of shares listed on the Johannesburg Stock Exchange

belonged to black business (Godsell, 1994:1). He argues that whites have the power in these corporations and won't voluntarily relinquish that power. This is presented as the reason for blacks not being appointed to positions of real power and authority within white controlled organisations.

Mabuza's (Mabuza, 1993: 15) point is that while the (previous) government had been willing to accept that it had made mistakes with its legislation and was ready to correct it, "white business continually beats its breast about the inequities and injustices of the system, but does nothing about it." The author is of the view that the economy as a whole has long been controlled and manipulated to keep blacks in subjection. The challenge identified for large white-controlled businesses is to contract out as much as possible of their needs to small black businesses as the start of an initiative by white corporations to relinquish control.

The specific structures and mechanisms developed to address these challenges as well as the initiatives taken by San'korp in relinquishing control of Metropolitan Life and by Southern Life in relinquishing control of African Life to black groupings (both analysed in detail in Chapter 3 of this report) will be analysed in the report in the context of the viewpoints presented by these authors.

## CHAPTER THREE

### Analysis of successful Black Economic Empowerment transactions to date

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#### 1. INTRODUCTION

This chapter analyses, in detail, the three most prominent black economic empowerment transactions involving the transfer of control of listed companies to black groupings.

According to Mabuza (1996), the most demonstrable activity in the area of black economic empowerment in South Africa over the last two years has certainly been in the private sector. In response to the growth of black economic empowerment initiatives and as part of the process, a number of black investor groups have been established to participate in transactions that will result from these initiatives. Mabuza's view is that, significantly, "the two most successful and most publicised black empowerment groupings at present (i.e. May 1996), Real Africa Group and New Africa Investments Group, were both founded initially on initiatives taken by established white business."

McNulty and Rushton (1994: 91) commented on the listing of the New Africa Investments Group that "numerous financial and industrial institutions were created and expanded this century to foster Afrikaner economic empowerment. When New Africa Investments... is floated on the JSE later this year, it will be designed as a vehicle to do much the same job but should achieve its aims more rapidly". The authors compare the listing of New Africa Investments to the initiatives taken earlier in South Africa to promote Afrikaner empowerment and cite Sanlam and Federale Volksbeleggings as specific examples of this.

McGregor (1996: 5) also reviews the transfer by Sanlam (through Sankorp) of control of Metropolitan Life to New Africa Investments in the context of Afrikaner empowerment. He writes (1996: 5) "The catalyst throughout the rise of Afrikaner power, to a large degree, has been Sanlam. Black businessmen are demonstrating the same determination (as Afrikaner businessmen) and it is no

surprise that the institution which has responded most rapidly to their need for financial aid has been Sanlam. This is no coincidence. In its early days, Sanlam went through similar, although far less severe, deprivation and exclusion from the mainstream of the economy. Its empathy with black empowerment is evident in the way it has been first to see opportunities."

The change of control in the shareholding base of African Life Assurance Company and the creation of the Real Africa Group has been described as a "text book model of ownership transfer" (Levin, 1994: 3) in that it mobilised the savings base of black individuals for the purchase of a controlling stake in a listed company.

During February 1995, Anglo American Corporation of South Africa Limited and De Beers Consolidated Mines Limited announced that one of its subsidiaries, Johannesburg Consolidated Investment Company Limited ("JCI") was to be restructured. In a circular dated 24 February 1995 sent to shareholders of JCI the rationale for the restructuring was stated as follows: "Black South Africans should be given every encouragement to participate meaningfully in mining and industrial finance groups." Following this announcement, control of Johnnic (one of the companies into which JCI was split) finally passed to the National Empowerment Consortium, a group of black investors as per a joint announcement issued by Anglo American and The National Empowerment Consortium dated 28 August 1996. The transaction was described as the "largest black economic empowerment deal ever in South Africa" (Sikhakhane<sup>(1)</sup>, 1996).

This chapter will examine the establishment and the structuring of the three black controlled groupings referred to above i.e. Real Africa, New Africa Investments and Johnnic. The analysis will be based on publicly available information, circulars to shareholders and prospective shareholders, press announcements and press commentaries.

According to McGregor (1996:5), with the transfer of control of Johnnic (and the empowerment transactions already concluded), the black community now controls almost 9% of the market capitalisation of the JSE and its rate of increase of control, from 1991 to 1996, has been far greater than that of any other group in the past 40 years. Sikhakhane<sup>(2)</sup> (1996:6) comments that the acquisition of Johnnic by a black consortium would increase more than sevenfold the market value of listed companies in which black investor groups

have joint control or can exercise significant influence. According to Sikhakhane, prior to the transfer of control of Johnnic to black groupings, black investor groups had joint control or could exercise significant influence over 15 companies listed on the JSE with a combined market capitalisation (at 13 August 1996) of R13,1 billion. This represented 1,2 percent of the JSE's market capitalisation - the total of all the shares of listed companies multiplied by each companies' share price. Sikhakhane calculates that the Johnnic deal lifted this amount to more than R96 billion, or 8,7 percent of the JSE's market capitalisation at the time.

The following table sets out an analysis of the R96 billion on a company by company basis. The above figure (i.e. R96 billion) are not measures of economic interest or the value of the equity owned by each of the black investor groups. It simply adds up the total value of all companies listed on the JSE in which black investor groups are able to exercise joint control or significant influence. Significant influence is defined as the ability to appoint a representative to the company's board of directors and thus being able to influence the company's future direction.

Johnnic	R8 003,7 million	Nail	R1 046,0 million
Bevcon	R11 414,8 million	RAH	R717,4 million
SA Breweries	R40 171,6 million	RAIL	R343,2 million
CNA Gallo	R1 419,7 million	Kilimanjaro	R67,3 million
Omnikor	R4 567,6 million	Plessey	R1 425,6 million
Premier	R5 062,8 million	Ocfish	R546,2 million
Metropolitan Life	R4 755,7 million	Persbel	R525,0 million
MIH	R5 785,7 million	Perskor	R1 274,4 million
Times Media Ltd	R993,2 million	Motolink	R276,2 million
Toyota	R1 187,5 million	MacMed	R250,5 million
CTP	R1 509,3 million	Mathomo	R72,2 million
M-Net	R1 220,1 million	Citizen Bank	R56,5 million
M-Cell	R1 951,5 million		
African Life	R1 215,7 million		
Corporate Africa	R496,3 million	<b>Total</b>	<b>R96 355,7 million</b>

Source: Business Report 13 August 1996, page 6

Efrat concludes (1997:3) that (subsequent to the transfer of control of listed companies into black hands) "for the first time, one can start talking about a meaningful presence of black - controlled companies on the JSE, some of which enjoy, if not blue-chip, then near blue-chip status."

The deals will be analysed in terms of the following:

- rationale
- group structure
- salient details of the transaction
- parties to the transaction
- spread of shareholders
- source of capital / finance
- voting power / control
- price at which transaction occurred
- funds raised.

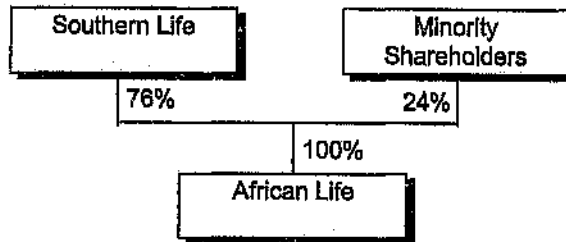
## **2. ANALYSIS OF GROUPINGS**

### **2.1. The Real Africa Group**

#### **2.1.1. Background to the transaction**

It was announced on 2 February 1994 (Real Africa Holdings Limited - Prospectus 1995: 13) that a consortium of black business people, led by Mr Donald Ncube, a director of Anglo American Corporation, had succeeded in obtaining the right from The Southern Life Association Limited ("Southern Life") to purchase 51% of the issued share capital of African Life Assurance Company Limited ("African Life"). Both African Life and Southern Life are life assurance companies listed on The Johannesburg Stock Exchange ("the JSE"). The announcement followed more than a year of negotiations between the consortium and Southern Life.

The shareholding structure before the transaction is shown below:



Southern Life undertook to sell 51% of African Life's equity to Real Africa Investments (Pty) Ltd ("RAI"), an investment holding company, and certain trade union aligned provident funds (collectively referred to as "the Acquisition Group") to enable the latter to acquire 51% of African Life. In terms of their constitution, the provident funds are required to invest in listed companies and thus could not invest directly in RAI. Accordingly, the provident funds purchased African Life shares directly and ceded their voting rights in respect of the African Life shares purchased to RAI.

A broad spectrum of interest groups and organisations within the black community subscribed for shares in RAI. RAI, in turn, utilised the funds received from its shareholders to purchase African Life shares from Southern Life. The African Life transaction was the first whereby control of a listed company passed to a black controlled grouping. (Real Africa Holdings Limited - Prospectus, 1995: 30).

**2.1.2. Salient features of the transaction.** Following intensive negotiations between the black consortium and Southern Life, details of the transaction were announced in the media (Joint Announcement by African Life Assurance Company Limited and

The Southern Life Association Limited, 1994). Salient details are as follows:

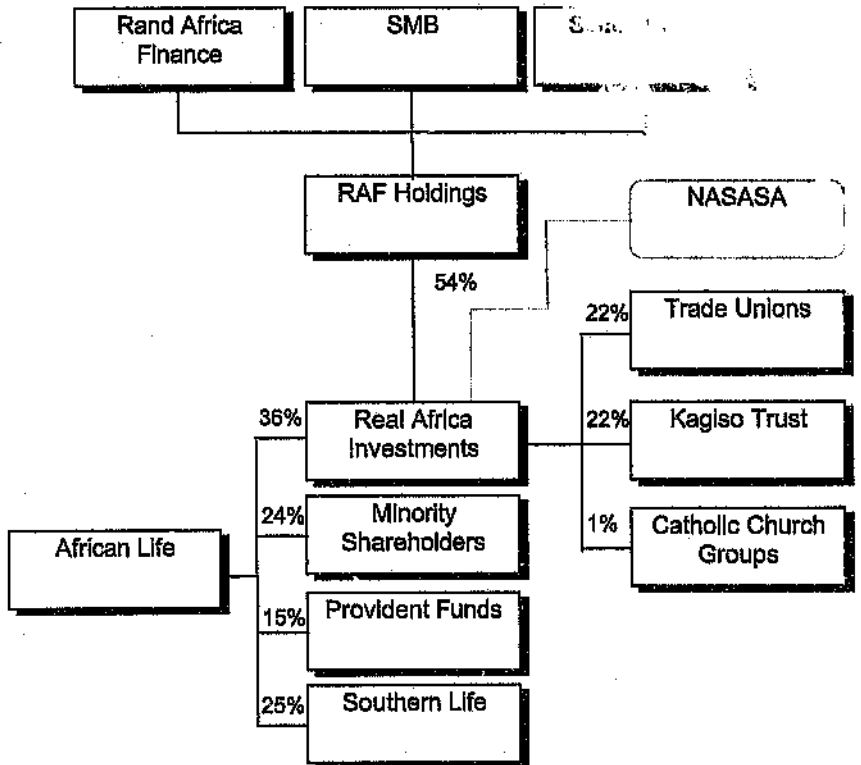
- The transaction was based on a price of R4,70 per African Life share which was the market price of African Life as quoted on the JSE on 19 November 1993, the day when agreement in principle was reached. This translated into a total purchase price payable by the Acquisition Group of R162,8 million.
  
- Southern Life, however, facilitated the transaction by investing indirectly into RAI an amount of R41,7 million at an effective premium of R24,3 million. By investing at a premium, Southern Life reduced the amount needed to be raised by the Acquisition Group to R138,5 million. By investing in RAI, the new holding company of African Life, Southern Life demonstrated two important facets which may become general characteristics of black economic empowerment transactions:
  - The formation of a strategic relationship with RAI, being a vehicle aimed at further black economic enablement ventures. This is further backed up by Southern Life retaining 25% of the equity in African Life directly.
  
  - An element of facilitation by "white" business. The premium at which Southern Life invested in the transaction reduced the amount needed to be raised by the Acquisition Group (R138,5 million) to an effective R4,00 per African Life share. This represents a 15% discount to a market value of R4,70. This gratuitous discount effectively given

by Southern Life facilitated the transfer of control of a listed company to a black grouping.

- In addition to the remaining R138,5 million to be raised by the Acquisition Group to fund the purchase of 51% of African Life, 10 cents per African Life share acquired (i.e. R3,5 million) was raised. This amount was retained by RAI and was used to capitalise RAI for working capital purposes. This fixed RAI's total capital requirement at R142 million.
- The Acquisition Group was granted until 31 May 1996 to raise the required R142 million. In order for the transaction to become unconditional, 51% of 51% of African Life had to be paid for by 31 May 1994. It was announced on 2 May 1994 (Joint Announcement by The Southern Life Association Limited and Real Africa Investments (Pty) Limited, 1994) that the transaction had become unconditional in that the Acquisition Group had been successful in paying for at least 51% of 51% of African Life before 31 May 1994.
- Once the deal became unconditional, voting rights in respect of the remaining balance of African Life shares not paid for by the Acquisition Group (i.e. up to 51%) were ceded to RAI to enable RAI to take effective voting control of 51% of African Life.
- Southern Life retained beneficial ownership of that portion of the 51% not acquired prior to 31 May 1994 and released the shares against future payment.

### 2.1.3. Participants in the transaction

A broad spectrum of trade unions, trade union provident funds, church groups and interest groups within the black community participated in the transaction by subscribing for shares in RAI or acquiring shares directly in African Life in conjunction with RAI (Mabuza, 1996). The group structure at the time of the transaction was as follows:



(Source: Vosloo, 1994: 2)

At the time of the transaction, the shareholding in RAI comprised the following parties:

- **Rand Africa Finance (Pty) Ltd ("Rand Africa Finance")**

Rand Africa Finance is an investment holding company formed by the consortium of black business people which acquired the right to purchase 51% of African Life from Southern Life. The consortium members and shareholders in Rand Africa Finance comprise:

- Mr Don Ncube
- Mr Jethro Mbau
- Dr Oscar Dhlomo
- Mr Mutie Mogase
- Mr Parthabsing Bodasing
- Dr Ellen Blekie

- **Standard Merchant Bank Limited ("SMB")**

SMB is the merchant bank in The Standard Bank Group which has been involved, both as financier and with SMB as merchant banker, with RAI since its formation. SMB participated in the transaction by investing in RAF Holdings which in turn invested in RAI.

- **Southern Life**

Southern Life is a large life insurer, listed on the JSE. Its controlling shareholder is Anglo American Corporation of South Africa Limited ("Anglo American"). Anglo American is credited as taking the initiative in the process of black economic empowerment through the sale by Southern Life of a controlling stake in African Life.

- **RAF Holdings (Pty) Ltd ("RAF Holdings")**

The interests of Rand Africa Finance, SMB and Southern Life were consolidated in RAF Holdings, an investment holding company. The three shareholders of RAF Holdings, namely Rand Africa Finance, SMB and Southern Life have entered into a voting pool arrangement which gives Rand Africa Finance, the black owned investment company, control of RAF Holdings, even though SMB and Southern Life each hold 41% beneficially in RAF Holdings.

(Real Africa Holdings Limited - Prospectus, 1995: 9).

The significant feature of this arrangement is that the black business consortium, while lacking the financial muscle of the established white corporates, has effective control of the group. This has developed as an essential characteristic of black economic empowerment type transactions, which, together with the use of pyramid companies, is seen as one of the foremost means of overcoming one of the major problems facing meaningful empowerment, that of the scarcity of black capital resources.

- **National Stokvels Association of South Africa ("Nasasa")**

Nasasa is a national association incorporated in terms of Section 21 of the Companies Act to act as the umbrella organisation for stokvel societies. A stokvel is effectively an informal savings "club" or "mini-bank" operating mainly in rural black communities throughout South Africa. Nasasa manages approximately R1,5 billion of savings from the black community and has approximately 150 000 members (Mabuza, 1996). The stokvel associations were identified as ideal participants in black economic empowerment transactions for the following reasons:

- their savings base represents real savings of the broader black community and as such are a significant source of black capital; and
- their wide membership ensures a very broad shareholder base at the grassroots community level which significantly adds to the credibility and representivity of black economic empowerment vehicles.

(Mabuza, 1996).

At the time of the transfer of control to the RAI grouping, Nasasa had an option to invest in RAI. They became a shareholder in RAI at a later stage once their option had been exercised.

- **Trade unions**

The New Africa Investments Limited ("NAIL") and Corporate Africa Limited transactions witnessed the first significant involvement by the formal trade union movement in mainstream business groupings. The trade unions (like the stokvels) were recognised as possessing two very essential elements which would make the trade unions particularly suitable as participants in black economic empowerment transactions:

- access to capital
- representivity through a broad membership

(Mabuza 1996)

The participation in RAI was spearheaded by the Southern African Clothing and Textile Workers Union ("SACTWU"), the third largest union affiliated to the Congress of South African Trade Unions ("COSATU"). SACTWU invested in RAI through an investment holding company owned by SACTWU. The

objective of the union owned investment holding company is to invest members' contributions in viable commercial investments with a view to generating superior returns to members. The last 2 years has seen the union movements become substantial investors in large South African businesses, including RAI, NAIL and Mobile Telephone Networks (Pty) Ltd ("MTN"). (Mabuza, 1996).

- **Kagiso Trust**

Kagiso Trust is a developmental aid agency which initially participated in the African Life transaction in order to promote the whole process of black economic empowerment. With the anticipated listing of RAI, Kagiso Trust's role as a developmental agency had been fulfilled and consequently an appropriate party was found to replace them. Kagiso Trust also wished to concentrate on smaller direct investments that required less funding.

- **Catholic Church Groups**

The following church organisations acquired a small direct stake in RAI:

- Southern African Catholic Bishops' Conference
- The Catholic Diocese of Johannesburg
- Marist Brothers

Like the trade unions, the formal church movement was identified as having two significant assets:

- funding; and
- representivity through a broad membership base.

The church groupings also enhanced the credibility of the shareholder base of RAI and provided the opportunity for the "man in the street" i.e. church members, to participate indirectly in a major black business grouping.

- **Provident Funds**

The following trade union aligned provident funds invested in the transaction by buying African Life shares directly:

- Industrial Council for the Clothing Industry (Transvaal)
- Industrial Council for the Knitting Industry (Transvaal)
- Industrial Council for the Clothing Industry (OFS and N. Cape)
- Industrial Council for the Clothing Industry (Natal)
- Frame Group Provident Fund
- Nictex Provident Fund
- Metal Industries Provident Fund
- Mine Workers Provident Fund

(Real Africa Holdings Limited - Prospectus, 1995: 7-9)

At the time of the transaction, the Acquisition Group was seen as representing some of the foremost black business people in South Africa who had teamed up with credible black institutions that represented an estimated 1,2 million people from all spheres of the black community who held an indirect investment in African Life.

(Real Africa Holdings Limited - Annual Financial Statements 1995: 4)

#### **2.1.4. Formation of the Real Africa Group**

RAI was conceptualised and structured at the outset to facilitate the formation of an industrial grouping that could play a leading role in the process of black economic empowerment (Real Africa Holdings Limited - Annual Financial Statements 1995: 4). RAI was constituted as the vehicle in which the controlling interests of the black groups, supported by Southern Life and SMB, were consolidated. RAI was incorporated initially to hold an investment in African Life, with the intention of becoming a leading investment company based on sound commercial principles. (Real Africa Holdings Limited - Prospectus, 1995: 13).

Subsequent to the acquisition of a controlling stake in African Life, RAI was converted to a public company, Real Africa Investments Limited, and constituted as the pyramid controlling company of its then wholly owned subsidiary, Real Africa Holdings Limited ("Real Africa Holdings"). The intention is for RAI to retain control of Real Africa Holdings, the investment holding vehicle.

Subsequent to the African Life transaction, Real Africa Holdings finalised 4 further acquisitions:

- a 20% shareholding in NSA Investments Limited ("NSA Investments");
- an effective 13% shareholding in Oceana Fishing Group Limited ("Oceana");
- a 2,08% shareholding in MTN; and

- a 30% shareholding in Lifecare Group Holdings Limited ("Lifecare").  
(Real Africa Holdings Limited - Prospectus, 1995: 18, Real Africa Holdings Limited - Annual Financial Statements 1995: 6).

As an investment holding company focused on black economic empowerment initiatives, Real Africa Holdings aims at taking sole or joint control of assets that meet its investment criteria. It has sought alliances with select "white" parties by way of taking strategic shareholdings in such companies. Real Africa Holdings has the long term vision of having core investments in the following sectors:

- financial services
- food
- telecommunications
- mineral resources
- health care
- tourism

In selecting investment targets in the above sectors, the company applies investment criteria which are focused on cash generative businesses which have significant growth potential and possess strong management infrastructures. The board of directors of Real Africa Holdings is focused on working pro-actively with the management of its group companies to add value and enhance their ability to generate superior returns to shareholders.

(Real Africa Holdings - Prospectus, 1995: 14).

### 2.1.5. Structuring of the acquisitions

- **NSA Investments**

NSA Investments is a listed investment trust which invests in businesses, both listed and unlisted, which it is believed possess superior potential.

It was announced on 31 October 1994 that NSA Investments and RAI had agreed to form a strategic alliance, in terms of which NSA Investments acquired 20% of RAI and Real Africa Holdings acquired 20% of NSA Investments. NSA Investments effectively subscribed for shares in RAI which were settled by the issue of NSA Investments' ordinary shares and options to RAI. RAI in turn renounced the NSA Investments' ordinary shares and options to Real Africa Holdings for the issue of shares in Real Africa Holdings.

In addition to acquiring a highly rated and tightly held asset, Real Africa Holdings also acquired access to NSA Investments' proven management expertise to assist it in evaluating the many opportunities presented to it, thus addressing one of the significant challenges and constraints facing empowerment as identified by Riley (Riley, 1993: 62) i.e. a lack of skills. (Real Africa Holdings Limited - Prospectus, 1995: 31).

- **Oceana**

Oceana is an investment holding company with interests in fishing, canning, cold storage, trading and shipping. The group was founded in 1918 and is generally regarded as the major inshore fishing operation in South Africa. It was listed on the JSE in 1947.

(Real Africa Holdings Limited - Prospectus, 1995: 16).

Agreement was reached on 9 December 1994 in terms whereof Tiger Oats Limited ("Tiger Oats"), which previously owned 70,1% of Oceana, placed 52% of the issued share capital of Oceana into a holding company and offered 50% of the shares in the holding company to the Oceana Acquisition Group, a group comprising Real Africa Holdings, businessmen, trade unions, employees and other stakeholders involved in Oceana's operations. The investment in Oceana amounted to a strategic partnership between Tiger Oats and the Real Africa Group as the leading party in the Oceana Acquisition Group.

(Real Africa Holdings Limited - Prospectus, 1995: 30).

The purchase price was agreed at R26 per Oceana share, which was the prevailing market price when agreement in principle was reached. The Oceana Acquisition Group was required to raise 50% of the purchase consideration within a 3 months period and were allowed a further 6 months to raise the remainder. The purchase price for the outstanding balance was increased by a factor of 7% per annum (Real Africa Holdings Limited - Prospectus, 1995: 30). The structuring of the transaction, which effectively allowed for payment

on terms at a favourable interest rate (i.e. 7%) was understood to be a form of facilitation offered by Tiger Oats in order to broaden the shareholder base of Oceana. It also provided another example of the voluntary relinquishment of control by a white corporation to a black controlled grouping, viewed in the context of Mbatha's claim (Mbatha, 1993: 57) that white corporations are unwilling to relinquish control (to black groupings) voluntarily.

The desire by Oceana and its shareholders to involve the broader black / coloured community in the ownership of Oceana is generally regarded as a defensive strategy. Oceana's fishing activities are directed mainly at quota species: as the allocation of quotas becomes more politicised and more representative of the broader spectrum of South Africa's society, the correct shareholder base will be a critical element in order to protect existing quotas and benefit from future allocation of quotas.

- **MTN**

MTN is one of the two local companies to be awarded a licence to operate a cellular telephone network in South Africa. SACTWU offered Real Africa Holdings an opportunity to acquire part of the indirect stake that it held in MTN. The investment in MTN was viewed as a source of significant revenue flows for Real Africa Holdings in the future. It was also seen as a strategic link up between Real Africa Holdings, a company strongly identified with black empowerment initiatives, and the broad black shareholder base of MTN with its established legitimacy and substantial networking ability.

(Real Africa Holdings Limited - Prospectus, 1995: 17).

- **Lifecare**

Lifecare is presently the largest privately owned health care group in South Africa with 16 000 beds. It owns or manages 41 health care facilities throughout the country, mostly under contract with the government and municipal health care authorities and is engaged in the provision of medical care for all population groups in South Africa. Real Africa Holdings acquired a 30% shareholding in Lifecare, effective from 1 April 1995, and an option to acquire a further 15% interest in Lifecare. The purchase consideration payable to the vendors for the acquisition was settled by Real Africa Holdings in cash.

Lifecare is perceived as having been at the forefront of community based health care initiatives, demand for which is expected to grow significantly over the next few years in response to the government's RDP objectives. Significant synergies are expected with other companies within the Real Africa Holdings group. (Real Africa Holdings Limited - Circular to shareholders, 1995:5).

#### **2.1.6. Listing of the Real Africa Group**

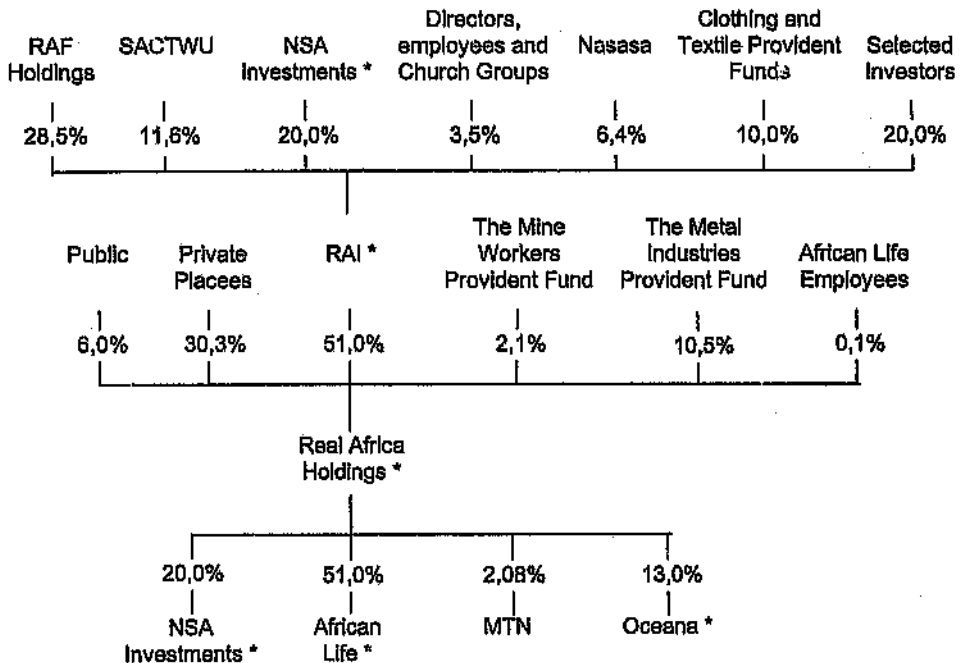
Real Africa Holdings required approximately R124 million in order to fund its outstanding commitments in respect of the African Life, Oceana, NSA Investments, and MTN acquisitions. (The interest in Lifecare was acquired after listing.) In addition, Real Africa Holdings wished to retain cash of approximately R76 million, bringing the total funding requirement raised on listing by Real Africa Holdings to R200 million.

(Real Africa Holdings Limited - Prospectus, 1995: 18-19).

Furthermore, it was understood that in order to establish itself as a leading vehicle in the process of black economic empowerment a company needs to have a legitimate, resilient shareholder structure as well as access to significant resources. The listing of Real Africa Holdings and its holding company, RAI, was perceived as giving the group not only the widest possible representative shareholder base but also providing it with the capital base to actively pursue its investment objectives. A listed group was seen as having the critical mass necessary to take advantage of the various asset acquisitions opportunities that would result from the process of black economic empowerment gaining momentum.

(Real Africa Holdings Limited - Prospectus, 1995: 17).

Real Africa Holdings and RAI were listed on 22 March 1995. In order to ensure that the shareholder base of the group was as wide and as representative as possible, a preferential offer of shares was made prior to the listing to members of Enterprise Investment Forum (a grouping of black business people administered by African Life), African Life employees and policyholders and employees of Oceana. Institutions were offered shares for subscription by way of a private placing and members of the general public were offered shares by way of a public offer. The group structure following the listing was as follows:



\* Listed on the JSE.

(Real Africa Holdings Limited - Prospectus, 1995: 13-14).

## **2.2. New Africa Investments Group**

The acquisition in May 1993 of a 10% stake in Metropolitan Life Limited ("Metlife") from Sankorp Limited ("Sankorp") by an investment company formed and controlled by black businessmen represented the first initiative taken by an established white business in the sphere of black economic empowerment. (Mabuza, 1996)

Metlife is a registered life assurer that was listed on the JSE in 1986. It transacts individual life and employee benefit business and is currently South Africa's seventh largest life assurer in terms of total assets. Metlife's business focuses on professional people, businesses and salaried employees. Some 92% of new business is sourced from the black community, as a result of which Metlife was earmarked by Sankorp as the subject of a black empowerment transaction.

(Mabuza, 1996, New Africa Investments Limited - Pre-listing Statement, 1994: 9)

### **2.2.1. Formation of the New Africa Investments / Corporate Africa Group**

New Africa Investments Limited ("NAIL") was incorporated as a public company on 10 May 1993, under the name Metlife Investment Holdings Limited. On 23 August 1994 the company changed its name to New Africa Investments Limited ("NAIL").

NAIL was incorporated to acquire 10% of the issued ordinary share capital of Metlife from Sankorp with the specific objective of promoting black economic empowerment. The purchase consideration was R20 per Metlife share and was based on the average price at which Metlife's shares had traded on the JSE during the three-month period preceding the date on which agreement in principle was reached with NAIL's financier.

(Metlife Investment Holdings Limited - Circular to Shareholders, 1994: 7).

The Industrial Development Corporation of South Africa Limited ("IDC") financed the acquisition of the Metlife shares by NAIL. The IDC provided R137 million to NAIL, equal to the purchase consideration payable for the Metlife shares. The IDC also undertook to provide NAIL with an additional R4 million to finance the costs of marketing the ordinary shares in NAIL. In exchange for the finance provided by the IDC, the IDC received the right to subscribe for 141 million shares in NAIL at a price of R1 per share. In terms of prospectuses issued during the course of 1993 and 1994 the IDC renounced and offered its right to subscribe for the 141 million NAIL shares to as wide a base as possible of members of the black community (New Africa Investments Limited - Pre-listing Statement, 1994: 11). This method of financing, whereby an institution buys shares and effectively holds them until they are taken up and paid for by their ultimate owners, is referred to as "warehousing" and has been identified as an important mechanism whereby white institutions can facilitate black empowerment transactions. (Mabuza, 1996)

During June 1994, Corporate Africa Limited ("Corporate Africa") disposed of its entire interest in Prosper Africa Limited ("Prosper Africa"), a company which effectively carries on the business of the Sowetan newspaper and also has a stake in MTN, to NAIL in exchange for an issue of NAIL shares. In addition, Corporate Africa also acquired additional shares in NAIL from the IDC for cash, resulting in Corporate Africa becoming the controlling shareholder of NAIL, with 51% of its issued ordinary share capital.

(Corporate Africa Limited - Pre-listing Statement, 1994: 1).

The NAIL / Corporate Africa Group has a strong commitment to black economic advancement based on the principle of constructive black-led business partnerships with industry leaders and leading enterprises. The group's objective will be to create shareholder wealth by maintaining a prominent position in the South African financial services industry, media and communications industries and positioning itself to take advantage of the opportunity to acquire select assets which will arise as South Africa's major industrial conglomerates and foreign investors provide opportunities to emerging black business.

(New Africa Investments Limited - Pre-listing Statement, 1994: 15)

#### **2.2.2. Participants in and background to the transaction**

Sankorp is generally credited with initiating the sale of an initial 10% stake in Metlife to a black controlled business grouping, with the stated view of promoting black economic empowerment (Mabuza, 1996). On 13 May 1993 Sankorp, Sanlam's industrial investment company, together with Metlife and the IDC, first announced details of the transaction. These institutions stated that they "believed it to be imperative that a broader spectrum of the South African population be given the opportunity to participate in the economy." (Metlife Investment Holdings Limited - Circular to Shareholders, 1994:7). Metlife was identified as a suitable vehicle for an empowerment transaction, given that over 90% of its new business is sourced from the black community. The participation of strategic shareholders in Metlife, through NAIL, was believed to hold significant growth opportunities for Metlife. (Metlife Investment Holdings Limited - Circular to Shareholders, 1994: 9).

Corporate Africa, led by Dr Nthato Motlana, spearheaded the acquisition of 10% of Metlife from Sankorp. Corporate Africa is an investment holding company controlled by a group of prominent black business people, headed by Dr Motlana. The directors of Corporate Africa at the date of the acquisition of 10% of Metlife were as follows:

- Dr Motlana (Chairman)
- Dr E J Mabuza
- Mr F A Sonn
- Mr J Sandler
- Mr P Gama
- Dr S Motsuenyane

Corporate Africa is ultimately controlled by black individuals through a combination of companies and family trusts. The largest individual (i.e. non-institutional) shareholder is Dr Motlana and his family. Various institutional investors subscribed for shares in Corporate Africa in order to raise sufficient cash to enable Corporate Africa to acquire its controlling shareholding in NAIL.

(New Africa Investments Limited - Pre-listing Statement, 1994: 8).

**Other significant shareholders in NAIL are:**

- Sefalana Employee Benefits Organisation ("SEBO"), an organisation which provides a wide range of social security and retirement benefits to more than 150 000 primarily black employees in the North West province of South Africa;

- National Council of Trade Unions ("NACTU"). NACTU is a trade union organisation which represents trade unions with a membership base in excess of 350 000 members. NACTU itself, as well as pension and provident funds of trade unions belonging to the NACTU grouping of trade unions invested in NAIL;
- Metlife staff. As part of the objective of creating as wide a shareholder base as possible, the IDC offered staff of Metlife the opportunity of subscribing for NAIL shares. (Corporate Africa's Limited - Pre-listing Statement, 1994: 13-14).

### **2.2.3. Additional acquisitions**

#### **2.2.3.1. Purchase of an additional 20% of Metlife**

At the time of the initial purchase of 10% of Metlife by NAIL from Sankorp, an agreement was entered into between, inter alia, Sankorp, Sanlam and NAIL in terms of which a five year call option was granted by Sankorp to NAIL to acquire a further 20% of Metlife from Sankorp.

NAIL exercised its call option on 9 June 1994 in terms of which it acquired an additional 20% of Metlife's ordinary share capital from Sankorp for a total consideration of R426,4 million. The purchase consideration was settled partly by the issue of NAIL shares to Sankorp and partly by cash. NAIL raised the cash needed to pay Sankorp by issuing Corporate Africa with additional shares. This consolidated NAIL, with its 30% shareholding, as the single largest shareholder of Metlife and represented effective control of Metlife by NAIL.

(New Africa Investments Limited - Pre-listing Statement, 1994: 12)

### **2.2.3.2. Purchase of Prosper Africa**

With effect from 9 June 1994 NAIL acquired the entire issued share capital of and claims against Prosper Africa from Corporate Africa for a total consideration of R84,5 million, settled by way of an issue of shares to Corporate Africa (New Africa Investments Limited - Pre-listing Statement, 1994: 12). Prosper Africa is an investment holding company whose investment assets are a 7,1% effective interest in MTN and a 52,5% effective interest in New Africa Publications Limited ("NAP"). The business of NAP is the publication of the Sowetan newspaper.

(New Africa Investments Limited - Pre-listing Statement, 1994: 7).

The Sowetan was first published in 1981 and is now the leading daily newspaper in South Africa in terms of circulation. It has primarily a black readership and is the fastest growing newspaper in South Africa. The Sowetan is generally perceived to be politically independent, although it reflects general black political aspirations. The editor, Aggrey Klaaste, initiated the "Nation Building" theme in 1988, which in simple terms embodies black empowerment. The profile of the Sowetan was thus viewed as complimenting perfectly the black economic empowerment principles on which NAIL was formed.

(Metliffe Investment Holdings Limited - Circular to Shareholders, 1994. ).

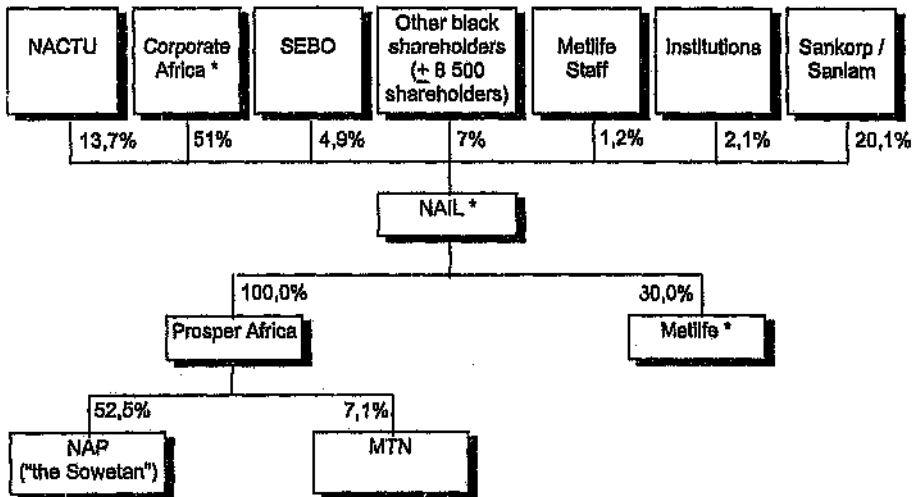
#### **2.2.4. Listing of NAIL and Corporate Africa**

In order to firmly establish the NAIL / Corporate Africa group as a substantial vehicle for black economic empowerment opportunities and in order to facilitate access to NAIL and Corporate Africa's equity, it was decided to list both companies. Accordingly, NAIL was listed in the Industrial Holdings sector of the JSE on 29 August 1994 while Corporate Africa was listed as its pyramid holding company in the same sector on 11 October 1994.

In so doing, NAIL became the first newly listed company of significant size to be controlled by black shareholders. It also saw the creation of a group, firmly established on black economic empowerment principles, with assets in excess of R7 billion under its control and with the critical mass to attract foreign capital investment and other asset acquisition opportunities as the process of black economic empowerment gathers momentum. The structuring of the group's investments, i.e. in Metlife, the Sowetan and MTN, all companies with strong and established management expertise, combined the principle of black-led business partnerships with industry leaders at the operating level.

Following the offers made by the IDC in prospectuses issued during 1993 and 1994 to members of the black community to subscribe for shares in NAIL, NAIL was listed with a shareholder base of approximately 8 500 black individuals giving the company a meaningful spread of shareholders on the JSE. Together with other parties, the shareholders of NAIL represent a significant range of interest groups and people from the black community (Metlife Investment Holdings Limited - Circular to Shareholders, 1994: 9). The simplified group structure of NAIL

and Corporate Africa at the date of listing Corporate Africa was as follows:



\* Listed on the JSE.

(Metlife Investment Holdings Limited - Circular to Shareholders, 1994: 13, New Africa Investments Limited - Pre-listing Statement, 1994: 7, Corporate Africa Limited - Pre-listing Statement, 1994: 5).

### 2.3. Johnnies Industrial Corporation Limited ("Johnnic")

In a circular dated 24 February 1995 sent to shareholders of Johannesburg Consolidated Investment Company, Limited ("JCI"), details of the restructuring of JCI were announced. Briefly, the restructuring of JCI involved the separation of JCI's business into three distinct groupings, each with a listed holding company:

- a platinum mining house (Amplats), holding JCI's platinum and unlisted diamond investments;

- a mining finance house (JCI Limited), holding JCI's interests in gold, coal, ferrochrome and base metals; and
- an industrial finance company ("Johnnic"), holding JCI's interests in the property, media, motor, food, beverages and other sectors.

The rationale for restructuring is presented on pages 7 - 8 of the above circular. The factors which influenced the decision of the board of JCI to restructure JCI are stated, Inter alia, as follows:

"Black South Africans should be given every encouragement to participate meaningfully in mining and industrial finance groups, and this should prove to be of significant benefit to all parties including the managements and present shareholders in such entities. Groups of a meaningful and viable size should thus be created as a first step towards the important objectives of encouraging black involvement in terms of equity ownership and broad representation."

At the date of the circular, Anglo American Corporation of South Africa Limited and De Beers Consolidated Mines Limited (collectively referred to as "Anglo American"), jointly owned 48,3% of JCI. The circular clearly sets out the intention of Anglo American to dispose of its shareholdings in Johnnic and JCI Limited to "appropriate new shareholders" (pg 8). Paragraph 3 on Page 8 sets out the perceived opportunities and benefits of restructuring as follows:

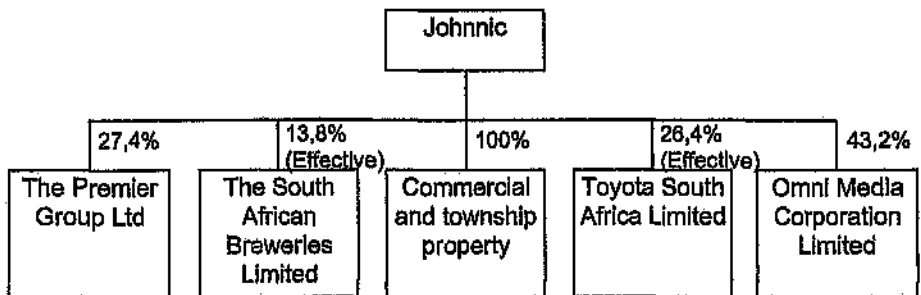
"The merits and opportunities that arise from the restructuring can be categorised as those that accrue specifically from the participation of black South Africans in the business and, more generally, those that make good business sense.

Black participation, through the influence of ownership and board representation, and, in time, through management, offers a number of

attractions. First, it should enable Johnnic and JCI Limited to align themselves more easily with the new social and political structures in South Africa and to adapt more readily to the changes that are occurring in the new society. Second, the potential credibility that black participation brings and new cultural values should accelerate growth and provide new opportunities for the companies in South Africa and Africa. Third, a broad base of black shareholders, many of whom may be represented through investments by black trade unions, savings societies and business organisations, should bring with them the opportunities for closer and more sympathetic business relationships. Finally, it should attract new investors who are eager to support the companies and contribute to their success."

At the time of writing of this report only the transfer of control of Anglo American's stake in Johnnic had been finalised so it is this part of the transaction that will be analysed in detail in this report.

The summarised group structure of Johnnic, after the restructuring, is as follows:



to Vermeulen, (1996: 1) "In SA's biggest black empowerment deal, Anglo American and the National Empowerment Consortium ("NEC") have signed an agreement for Anglo to sell most of its 47,7% stake in the Industrial group Johnnic to NEC over the next 18 months. The agreement, under negotiation for more than two years, was finalised ..... yesterday." According to Sikhakhane<sup>(1)</sup> (1996:1) "The National Empowerment Consortium, a group of black investors, finally bought control of Johnnic yesterday in the largest black economic empowerment deal ever in South Africa."

Anglo American and The National Empowerment Consortium issued a joint announcement dated 28 August 1996 which appeared in, *Inter alia*, *Financial Mail* (6 September 1996, pg 86 - 87). The following is an extract from this announcement:

"Anglo American Corporation of South Africa Limited ("the Corporation") and The National Empowerment Consortium ("the NEC") announce that agreement has been reached for the NEC to acquire a significant shareholding in Johnnic from the Corporation and De Beers Consolidated Mines Limited ("De Beers") which together hold 71 917 807 shares in Johnnic, representing 47,4% of its issued share capital. The NEC is a consortium comprising black-controlled business organisations and trade unions.

The agreement is subject to the fulfilment of certain suspensive conditions, including the issue of a ruling to be sought from the Securities Regulation Panel that it will not be necessary for the NEC to make a comparable offer to the other shareholders of Johnnic should the NEC acquire 35% or more of the issued share capital of Johnnic.

If the suspensive conditions are fulfilled:

- with effect from 1 July 1996 the NEC will purchase an initial shareholding of at least 30 352 000 shares representing 20% of Johnnic's Issued share capital. The price of this initial purchase will be R50 per Johnnic share. The price per share excludes the capitalisation award and / or final dividend payable to shareholders in respect of the year ended 30 June 1996;
- the NEC will have an option to purchase additional Johnnic shares to take its shareholding up to 35% of Johnnic's issued share capital determined as at 29 July 1996. The period of this option is 18 months and the price of the shares under option will be the volume weighted average price over the 60 trading days calculated at a date 7 days prior to the date of exercise of the option, discounted by 5%;
- a maximum of 9 105 800 Johnnic shares representing 6% of Johnnic's issued share capital determined as at 29 July 1996 will be made available by way of a retail offering by the NEC to smaller NEC members and others within the black community over a period of 4 months after fulfilment of the suspensive conditions at the same price as the initial purchase above with assistance from designated financiers and with a put option against the Corporation;
- the Corporation and the NEC will each contribute shares to a voting pool comprising 35% of Johnnic's issued share capital determined as at 29 July 1996, and will enter into a voting pool arrangement in respect of these shares. This arrangement provides inter alia that:

- the NEC will be entitled to control the voting rights in respect of all shares in the voting pool;
  - the Corporation will have certain minority protection rights; and
  - the Johnnic shares in the voting pool will be subject to reciprocal pre-emptive rights;
- the NEC will have a right of first refusal for a period of five years in respect of Johnnic shares which have not been contributed to the voting pool or sold under the retail offering by the Corporation and De Beers; and
  - the board of directors of Johnnic will be reconstituted to comprise 20 members of whom 10 members will be nominated by the NEC.

The agreement provides that the NEC will have a 60 day exclusivity period ending on 28 October 1996 during which it will conduct a due diligence investigation into the affairs of Johnnic. During that period it will also finalise the funding required for the purchase of the initial tranche of Johnnic shares.

The transaction meets the criteria of the Corporation for black economic empowerment in that the NEC represents a broad spectrum of black interests who support those who have assumed the leadership role in the NEC. The agreement entered into between the parties also provides the framework for black involvement in Johnnic by way of equity ownership, board representation and participation in management.

The NEC has entered into the transaction as it provides a significant opportunity for previously economically disenfranchised South Africans to participate in a meaningful way in the South African economy. The

combination of black business and labour groupings in the NEC will further the objectives of black economic empowerment”.

Following the announcement dated 28 August 1996, a second joint announcement by Anglo American and the NEC was published on 1 November 1996 which appeared in, inter alia, Business Report (1 November 1996, page 7). Salient features of the joint announcement are as follows:

- the suspensive conditions relating to the acquisition by the NEC of a significant shareholding in Johnnic had been fulfilled. These conditions included:
  - the finalisation of the funding required by the NEC to purchase Johnnic shares; and
  - a ruling being granted by the Securities Regulation Panel that it was not necessary for the NEC to make a comparable offer to the other shareholders of Johnnic;
- the NEC had purchased 53 117 200 shares in Johnnic, representing 35% of the issued share capital of Johnnic as at 29 July 1996, at a cash consideration of R50 per share. As the NEC had acquired 35% of Johnnic, there was no need for Anglo to participate in the voting pool;
- In addition to the Johnnic shares purchased by the NEC, a maximum of 9 105 800 Johnnic shares representing approximately 6% of Johnnic's issued share capital would be made available by way of a retail offering to smaller NEC members and other persons within the black community over a period of four months at a price of R50 per share;

- the NEC has the right of first refusal for a period of five years in respect of Johnnic shares not taken up in the retail offering together with the Johnnic shares retained by Anglo American; and
- the board of directors of Johnnic will be reconstituted to comprise twenty members of which ten would be NEC appointees.

Details of the membership and funding of the NEC are provided in a paid announcement issued by DLJ Pleiade Investment Corporation (Pty) Limited, which appeared in, inter alia, Business Day (page 8) on 1 November 1996:

The NEC represented a grouping of 23 member constituents, made up of business and labour units who had established themselves as a unified bidding consortium in order to negotiate with Anglo American for its stake in Johnnic. The NEC represents a broad spectrum of black business groupings, trade unions and trade union provident funds. Major constituents of the NEC are as follows:

- **Business**
  - Siphumele Investments Limited, a Western Cape based investment company;
  - Nozala Investments (Pty) Limited, a womens' investment company;
  - New Africa Investments Limited;
  - World Wide Africa Investment Holdings Limited, an established black owned investment holding company.
- **Labour**
  - National Union of Mineworkers;
  - SA Commercial Catering and Allied Workers' Union;
  - Food and Allied Workers' Union;
  - SA Railway and Harbour Workers' Union;

- SA Clothing and Textile Workers' Union;
- Mineworkers Investment Company (Pty) Limited;
- SACTWU Investments Group (Pty) Limited;
- Building, Construction and Allied Workers Union.

Individual members of the NEC were required to secure funding for their allocated stakes. In general, funding was provided by banks, pension funds and other financial institutions using the Johnnic shares as security for the funding obtained. A range of leading South African financial institutions provided funding to NEC members for their Johnnic shares. Participating institutions included the following:

- ABSA Bank Limited;
- Eskom Pension and Provident Fund;
- Old Mutual;
- Standard Bank;
- SANLAM;
- The Transnet Pension Fund;
- Community Growth Fund; and
- Metropolitan Life.

Cargill (1996:11) comments on the Johnnic deal as follows: "The Johnnic deal illustrates well that there are many facets to making empowerment meaningful, and that, certainly, empowerment is not concluded along with the deal. The new black buyers carry a responsibility to give substance to the empowerment objectives which underpin such initiatives.

She comments further on the use of a consortium as the bidding vehicle. She sees the use of consortiums by black business as a feature of black empowerment today. The reason for this is firstly that black companies on their own lack financial muscle and need to operate as a consortium in order to expand their muscle and secondly to ensure a broad spread of black groupings.

### 3. CONCLUSION

The transactions analysed in this chapter appear to have the following common success elements:

- Initiative taken by large, established "white" owned corporates;
- A degree of facilitation by the previous controlling shareholder;
- Credible black entrepreneur leadership;
- Sophisticated financial structuring;
- Effective harnessing of black capital resources;
- Broad based acquisition groupings with correctly structured shareholdings; and
- Suitable acquisition target companies which would benefit from black shareholder participation.

## CHAPTER FOUR

### Examination of viable mechanisms to aid empowerment

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A review of the literature reveals several vehicles or mechanisms which are consistently identified and indeed, harnessed, in order to achieve the objectives of empowerment. These mechanisms or initiatives have been identified as enabling mechanisms in literature emanating from both the public and private sector and from governmental and non-governmental organisations and agencies. The following generic terms have been used in the context of being an enabling mechanism in the process of empowerment:

- privatisation (Menaker 1996, Shabalala 1995);
- joint ventures (Quebeka 1994, Nkonyeni 1994, Dow 1994);
- franchising (Rodkin 1996, Nelson 1996, Baloyi 1994);
- equity ownership (Ramaphosa 1996, Nkonyeni 1994, Lusengo 1993, Godsell 1994, Alberts et al 1994).
- facilitation by the Johannesburg Stock Exchange (Galli 1994, The Johannesburg Stock Exchange Listings Requirements)

#### 1. PRIVATISATION

The South African Pocket Oxford Dictionary defines privatisation as "the transfer from State to private ownership".

Menaker (1996: 36, 37) clearly identifies privatisation as one of the major tools at the disposal of government to enhance black economic empowerment. She also comments on the apparent swing of government from a proposed policy of nationalisation to one of privatisation. She writes (pg 36) "just five years ago, Nelson Mandela's African National Congress chilled South Africa's private sector with talk of nationalisation. Many of the ANC's leaders in exile, educated in communist bloc or leftist Western Institutions, believed that nationalising South Africa's major industries would prove a powerful tool for bringing

its core economy under the control of the black majority. They also agreed with the South African Communist Party that nationalisation would help correct the great disparities of income and opportunity in white-run South Africa once the apartheid regime had been consigned to history."

She refers to the ANC, once it had come into power, as having "changed its tune" to the extent that the Mandela government is seen as being far more committed than its predecessors to liberating the economy by:

- privatising state-owned industries;
- lowering tariffs and subsidies;
- promoting competition.

Simultaneously, the Mandela government is intent on seeking its ambitious social goals. It is in this context that the government will seek to carry out its privatisation policies. Menaker (pg 36) thus summarises the government's objectives as "keeping the sale of state assets in the context of an overall economic restructuring that will help empower black business while improving efficiencies." The specific challenge facing government with regard to privatisation is seen as the unloading of state "behemoths while helping to make blacks an economic force".

On 7 February 1996, the National Framework Agreement ("NFA") was signed. Parties to the NFA are:

- Government of National Unity ("GNU");
- Federation of South African Labour Unions;
- Congress of South African Trade Unions;
- National Council of Trade Unions.

The NFA represents an accord between government and organised labour to establish an agreed process, based on stated objectives and principles, between the parties in regard to the restructuring of certain

state assets. The NFA defines privatisation as the "policy of converting public ownership of an asset to the private sector or permitting the performance of a certain activity, hitherto carried out by a state owned enterprise, by a private sector business".

The NFA sets out 13 guiding principles for restructuring. Of particular relevance are the following:

- **Labour**

Organised labour in general and employees of the relevant public enterprises should participate in policy formulation and implementation. The ultimate aim of restructuring is to improve the quality of life of all South Africans. Therefore, the underlying approach of the parties is that restructuring should not occur at the expense of the workers in state enterprises. Every effort should be made to retain employment.

- **Historically disadvantaged groups**

Restructuring must redistribute wealth, boost the small and medium enterprise sector, have sustainable affirmative action implications and facilitate genuine black economic empowerment. The capacity of the historically disadvantaged communities to participate and benefit fully in the restructuring programmes should be ascertained and enhanced.

The NFA thus places on record the GNU's recognition that privatisation, or the restructuring of state assets, in the context of a partnership with organised labour, has as one of its fundamental objectives, the facilitation of black economic empowerment.

The theoretical concept of privatisation as a tool to aid empowerment appears fairly well accepted. To be useful, however, the theoretical concept has to be translated into practice. While this is certainly not going to happen immediately, Menaker (1996: 37) provides some examples of how this could take place:

- **Telkom.** The South African telecommunications parastatal is seeking a strategic equity partner to purchase a stake of up to 20% in Telkom, with the goal of attracting foreign capital and technological expertise. Menaker (1996: 37) quotes Ronald Roberts of lawyers Moseneke & Partners as saying that in the case of Telkom, "a phone is more empowering than a share" consequently, a strategic equity partner that speeds up service to poor blacks does more to empower blacks than a public share auction of the entire company.
- **Aventura,** the state resorts company, is small enough for a possible sale to a black entrepreneur, or for a joint venture between a white backer and black management.
- **Eskom.** The parastatal electricity supplier is regarded as a strategic asset that might well stay in state hands but could encourage small, black-run businesses among its subcontractors. In other cases, shares distributed to poor (black) people after a mass education programme could provide collateral for homes or education loans.

- **Government contracts.** Granting more government contracts to small business could play a substantial role in bringing blacks into the economic mainstream. Menaker (1996: 37) quotes Loren Braithwaite of Msele Corporate & Merchant Bank as follows: "Look at how much contracting the government does. If black business could get even 20% of that a year, that would be real empowerment."
- **Land reform.** Another version of privatisation could be land reform, designed to return property seized under the apartheid regime. State-owned land could become restitution for black property owners forcibly removed from previously "whites-only areas".

Professor S R Shabalala, Deputy Director-General and Head of the Office for Public Enterprises, (1995: 17) presents his view that in the South African situation, privatisation has to be crafted to become a national instrument or technique for empowering and promoting African economic freedom and participation in the restructuring and democratising process of the economy. It must be politically, technically and economically efficient and effective. In his paper (pages 25 - 29), Shabalala explores possible empowerment techniques which can be partially facilitated through privatisation. He breaks down categories of persons to be empowered into:

- employees of state enterprises;
- entrepreneurs;
- the general public from disadvantaged communities.

He identifies the following techniques that can be used to promote economic empowerment of blacks through partial or full privatisation of state (owned) shares:

- 1) employee share ownership programmes;

- ii) the private sale of shares through a competitive bidding process to avoid competition and favouritism;
- iii) selling of assets of the state-owned enterprise by, effectively, liquidating the company and thereby wiping out its outstanding debts. The assets can then be repackaged for sale to black investors, but for a lower price than the value prior to liquidation;
- iv) the creation of a National Saving Trust. Under this scheme, the government would transfer to the trust, free of charge, certain shares which it owns which are being, or will be, privatised. The intermediary trust would manage securities that are allocated to them and use the income to fund community development programmes;
- v) the public offering of shares to better organised and financed segments of the disadvantaged communities;
- vi) specific decisions and measures by the government to use its political empowerment to promote black economic empowerment in the private and public sectors;
- vii) employment and placement of blacks in positions of power in state-owned enterprises so that decisions taken in these organisations are empowering to blacks;
- viii) the re-orientation of business activities of state-owned enterprises so as to promote entrepreneurship within the black community and to provide training and development opportunities for black managers and technical professionals;
- ix) assistance to be provided to facilitate equity ownership of state enterprises by blacks.

Shabalala (1995: 18) comments that in order to optimise the restructuring and privatisation process as means of facilitating empowerment, economic development strategies and programmes should be formulated and be made national strategies and programmes.

## 2. JOINT VENTURES

Qubeka (1994: 1) presents the view that "the new disposition in South Africa necessarily must incorporate rapid black economic empowerment and it is clear that the skills required for this purpose are simply not sufficiently available." He argues that in order to address this situation, reliance will need to be placed largely on what he refers to as the "corporate world" (1994: 2), on the basis that they are better equipped to understand what needs to be done.

Four avenues (1994: 4) are presented as methods whereby the corporate world can address both the skills and the finance shortage which currently inhibits black empowerment:

- donations / sponsorships;
- mentorships;
- secondment of skills and experience;
- joint business ventures.

Qubeka (1994: 4) dismisses the donation / sponsorship route on the basis that it is susceptible to mis-appropriation (i.e. black enrichment instead of black economic empowerment) but also denies blacks the opportunity to learn from those who have the skills and experience. Mentorship and the secondment of skills and experience are both recognised as successful methods, however, the establishment of joint ventures with corporate partners is identified as the method most able to achieve real black empowerment.

The author sets out (1994: 6) three objectives or principles which should be considered in structuring any black economic empowerment joint venture arrangement:

- skills need to be conveyed to blacks to permit blacks to gain the experience needed to run businesses on their own or in partnership with others;
- it is preferable for blacks to have a majority stakeholding in the joint venture structure and to expand this stake as experience is gained;
- in view of the problems faced by black entrepreneurs in securing finance, assistance must be provided – and either through existing financial institutions or by the joint venture partner.

A critical element to be recorded in the joint venture agreement relates to the financing of the venture and here the author repeats (1994: 6) what has emerged as a common trend in empowerment deals to date i.e. that of facilitation by (white) joint venture partners. In this regard, two essential considerations relating to the financing of joint ventures are set out (1994: 7):

- It is assumed that the black joint venture partners will be financed by their (white) partners or that finance will have been obtained with the assistance of their partners. In order for the joint venture arrangement to actually promote black empowerment, Qubeka asserts that it is necessary that the interest rate payable by the black partners on the loan finance be subsidised i.e. that interest be charged at a rate lower than a prevailing market rate. This would imply that the joint venture partner either foregoes a portion of interest income (where the joint venture partner has financed the deal) or actually "tops up" the interest paid by the black partner to the financial institution which has advanced the loan.

- The repayment on the loan should be linked to profit flows or dividend declarations out of the joint venture, allowing the black entrepreneur to effectively service and repay the loan out of the proceeds of the joint venture. This particular financing arrangement would appear to be a "softer" option than financing terms normally available commercially and would act as a facilitating mechanism for black entrepreneurs entering into joint venture arrangements.

The author (1994: 8) addresses the potential conflict arising from the stated objective of giving the black partner the majority shareholding in the joint venture while the finance for the joint venture is made available or is guaranteed by the minority (white) partner. This is overcome by giving the minority partner a majority vote until such time as the finance is repaid or the guarantee falls away.

Qubeka concludes by defining (1994:8-9) several characteristics necessary to ensure that the joint venture meets its specified overall objective of promoting black empowerment:

- all partners in the joint venture must share the same vision and commitment to black economic empowerment;
- the exercise must be genuine and must avoid the situation of blacks fronting for whites. Instead of the prevalent present situation where blacks are placed in staff jobs such as Human Resources, Public Affairs, Communications, etc., they should be placed in decision making line jobs where they can acquire the requisite skills and experience. Attached to this is the condition that people appointed to decision making positions are properly equipped for the position;

- the assistance provided to black joint venture partners must not be in the nature of welfare or charity even though there may be a social responsibility motivation, all parties should derive some form of commercial gain from the association;
- the black joint venture partners want to see a transfer of skills to them. Coupled to this is the necessity for the white corporate partner to realise that they have a responsibility to assist their black partner to assume their proper role in the economy;
- a drop in standards, because of the involvement of black partners, should not be tolerated, firstly because it is not in the interests of the economy and secondly, because the black entrepreneur should not be seen as an inferior partner or a liability;
- the joint venture agreement should be in the nature of a long term partnership to avoid allegations of either or both partners "making a fast buck" and then withdrawing.

Nkonyeni (1994: 8) expands the joint venture concept further by identifying tripartite partnership opportunities involving black South Africans, white South African business and foreign interests as an important item in the inventory of relevant elements in the process of black economic empowerment. The author sees the main thrust of this tripartite model as being the facilitation and provision of intensive and holistic training by white owned South African businesses and foreign enterprises to their black partners. Nkonyeni provides as an example the initiatives currently being undertaken by NAFCOG in creating, developing and upgrading a data base which covers the full spectrum of black business activities with a view to playing the role of match maker in tripartite relationships involving black South Africans, (experienced) white-owned / controlled enterprises and foreign players.

Dow (1994: 2) presents both the African Life deal and the Metliffe deal as specific examples of two successful local joint ventures between existing white controlled groupings and black South African entrepreneurs. Dow sets out the criteria which he believes are necessary in order to establish a successful joint venture:

- high public profile transactions;
- credible and suitably qualified black entrepreneurs;
- the assets that are the subject of the joint venture to be of a high quality and to be managed by quality management;
- the white joint venture partners to be of a high quality;
- the joint venture transaction must be commercially justifiable;
- the focus of the joint venture should be on the partnership between the black entrepreneurs and established white business.

According to Dow (1994: 2), the objectives of such joint ventures should be to:

- establish black controlled groups;
- achieve a critical mass;
- attract positive local and international market reaction.

### 3. **FRANCHISING**

The South African Pocket Oxford Dictionary defines franchising as "the authorization to sell a company's goods etc. in a particular area" or "the right or privilege granted to a person or corporation."

Franchising has been popularly identified as a viable tool to aid black empowerment (Rodkin 1996, Nelson 1996, Baloyi 1994).

Rodkin (1996), who is franchise division head of Kessel Feinstein Consulting, is of the view that franchising is directly linked to black economic empowerment in a number of specific areas:

- Franchising allows big business wanting to downsize and create opportunities within the organisation to sell ownership of branches and small business franchises to management. This allows the man in the street access to enter the business world at an entrepreneurial level.
- Franchises are a good medium for the transfer of business skills to previously disadvantaged entrepreneurs. Banks are more likely to grant start-up finance to a franchisee than a person wanting to start an untried small business. From a financier's point of view, funding a franchise is a commercial proposition as the franchised business is usually a proven concept and the franchisee is trained and supported by his franchisor. In support of this argument, Rodkin quotes US statistics which indicate that while 80% of non-franchise small businesses fail, only 10% of franchised small businesses fail.
- As more and more disposable income comes into the hands of black South Africans, so many of the International franchisors entering the South African market are looking for black franchisees in touch with the need of black consumers.
- In the parastatal arena, functions such as cleaning and catering are being outsourced by the parastatal to franchisees with a high representation of people from previously underprivileged communities.
- Franchising is an ideal business mechanism for aiding the black entrepreneur in the transfer of skills. It provides tried and tested businesses, brand names, training, business procedures and products, all of which can be transferred within a short time.

According to Nelson (1996), black empowerment cannot be advanced by way of handouts. Real empowerment means giving individuals the ability to generate wealth and create employment via the transfer of skills. Franchising is identified as an excellent way of transferring skills. Nelson believes that it is skills

transfer, rather than the availability of capital, which is the critical factor in the creation of new business and empowerment opportunities. He states that capital will follow the successful transfer of skills needed to create new business opportunities and that franchising has a vital role to play in passing on management and business skills, particularly to previously disadvantaged South Africans.

Baloyi (1994: 2) presents, based on her own research, that the most appropriate definition for economic empowerment is "a strategic investment aimed at enhancing economic performance and sustained profitability through the provision of opportunity and the development of skills and resources." According to Baloyi (1994: 2), economic empowerment is based on four cornerstones:

- education and development;
- employee participation;
- affirmative action;
- investment in business development.

Based on what Baloyi views as a necessarily holistic approach to economic empowerment, she specifies franchising as a particular strategy which meets the four criteria set out above. She continues (1994: 7) that, given South Africa's historical perspective, the franchisor is almost always white and the franchisee black. Of concern to the author is how to get the franchisee to be economically empowered to the point where franchising can assist in meeting the objectives of empowerment. Baloyi presents (1994: 7-10) five success factors necessary to make franchising a tool for real economic empowerment.

- **Independence**

The black franchisee should enjoy sufficient independence from the franchisor to ensure that the franchisee is actually empowered and does not merely become a small black business fronting for large white businesses.

- **Financial growth**

The focus of the franchisee should be on financial growth in the short and long term so that the franchisee is not financially dependent on the franchisor. The financial growth pattern should empower the franchisee as well as be profitable to the franchisor.

- **Capacity building**

Franchising should ensure capacity building at all levels. It is essential that the franchisor is socially responsible and ensures that the franchisee is properly trained and skilled.

- **Mutual benefit**

The franchise arrangement must avoid a "big brother" relationship or what is referred to as "high tech fronting". The franchise should be mutually beneficial to both franchisee and franchisor in monetary terms.

- **Infrastructural flexibility**

The franchise arrangement needs to provide a certain amount of latitude in the way that the franchisee conducts business in the context of the development of black entrepreneurs. To be an effective tool for economic empowerment, the franchisor should allow for flexibility, whilst safeguarding the name behind the franchise. In the South African context, the franchisor must, in particular, recognise the need to uplift the small and medium sized (black) entrepreneur to allow the latter to develop into strong members of the business community.

#### 4. EQUITY OWNERSHIP

The South African Pocket Oxford Dictionary defines equity as the "value of the shares issued by a company" and ownership as "have as property; possess." Equity ownership may thus be defined as possessing shares in a company.

Equity ownership has been identified as the key component of black economic empowerment by various writers (Ramaphosa 1996, Nkonyeni 1994, Lusengo 1993, Godsell 1994, Alberts et al 1994).

Ramaphosa (1996: 16) is of the view that the South African economy is increasingly moving towards a system in which wealth is created through (the ownership) of capital assets. The ownership of capital assets such as equity is identified as the key element in the accumulation of wealth. Ramaphosa believes that the majority of the population that do not own capital should be provided with means of achieving substantial equity ownership. Two areas identified by Ramaphosa as facilitating equity ownership are:

- **Unbundling**

Unbundling transactions by large conglomerates provide the opportunity to disadvantaged communities to take up substantial stakes in the South African economy.

- **Commitment by financial institutions**

Financial institutions need to be committed to rectifying distortions in the South African economy. Banks need to develop their capacity for assessing risks in the emerging black markets and view the funding of black business as a legitimate and profitable transaction between private sector institutions rather than a social responsibility exercise.

According to Godsell (1994: 1), "an expansion of ownership of the South African economy can only be achieved by giving people the opportunity to gain control of wealth, and then to use that wealth to create more."

Lusengo (1993: 43) states that "various forms of transactions, which result in a change of ownership of a company, are opportunities to embed the principles of black economic empowerment in companies". He explains that leveraged buy-outs (LBO's) and management buy-outs (MBO's) are two practical ways of contributing to black economic empowerment. An LBO is defined as "the acquisition of a company using debt to leverage the purchase price and using the cashflow of the company to repay the debt." An MBO is an LBO where the management, or a consortium consisting of management and employees, is the buyer of the company. Lusengo believes that the MBO in particular has proved an attractive vehicle for management and employees to create wealth through equity participation - owning shares - in their company. They apply their skills and expertise to repaying the debt incurred in acquiring the company. Lusengo is of the view that a heavy load of debt is a significant spur to creativity and productivity. From the point of view of enhancing black economic empowerment, Lusengo believes that a consortium of employees and management (who are now owners or part-owners of the company) can implement strategies to this end. He cites, as examples:

- The adoption of a strategy to implement affirmative action;
- The establishment of trust funds to give employees financial assistance with health, education and housing;
- the active involvement with social upliftment programmes; and
- the formulation of guidelines for employment creation.

According to Alberts et. al (1994: 1), "black economic empowerment ... models under discussion agree that growth must underpin sustainable development. The process must be about the creation and distribution of new wealth and the expansion of ownership." The authors are of the view that in order for a real restructuring of ownership to be achieved, the commitment of three key role players is required:

- government
- labour
- business

The authors believe that the role of business will be guided to a large degree by self interest and a drive towards global competitiveness. Without the ownership base being broadened, there is little incentive for productivity or constructive participation in the economy. Alberts et. al (1994: 1) state that business must also view the creation of a dynamic black business sector within the context of genuine socio-economic transformation and national survival. The role of business is analysed into two specific areas:

- **Facilitative**

The role of business here is specified in terms of changing traditional business attitudes and approaches, identifying and encouraging opportunities for economic empowerment, and doing business with black entrepreneurs and businessmen.

- **Interventionist**

The role of business in this area is to assist in the mobilisation of capital through investment and equity transfer.

Alberts et. al (1994: 2 - 14) propose two specific options or models which have the specific objective of broadening equity ownership by black South Africans. These are:

- The Community Growth Fund Model; and
- Employee Share Option Schemes.

- **The Community Growth Fund ("CGF") Model**

The Community Growth Fund is a unit trust launched by trade unions in June 1992 in order to direct members' (largely black) retirement fund savings into "socially-responsible" companies and thus into long-term social upliftment.

The CGF grew out of unions' concerns that their own members savings in provident funds and elsewhere were not succeeding in creating jobs or improving social conditions. The funds of seven trade unions are currently invested through the CGF.

- National Union of Mineworkers;
- Paper, Printing, Wood and Allied Workers' Union;
- Transport and General Workers' Union;
- Construction and Allied Workers' Union;
- National Union of Food, Wine, Spirits and Allied Workers;
- Transport and Allied Workers' Union;
- Metal and Electrical Workers' Union of South Africa.

The CGF is owned by the Community Growth Management Company which is jointly controlled by fund managers Syfrets and Unity. The CGF invests only in companies that are judged socially responsible and successful against the following weighted criteria:

- employment creation;
- Industrial relations practice;
- conditions of employment;
- training;
- gender equality;
- environmental policy;
- worker participation;
- social spending;
- racial equality policies.

According to Alberts et al (1994: 7), "the CGF affords the opportunity to participate actively in the economy. The unions themselves recognise that the CGF represents a first step in empowering workers."

- **Employee Share Option Schemes ("ESOPS")**

Alberts et al (1994: 5) identify ESOPS as a model of equity ownership which allows (black) workers direct access to a company's equity. Jardine (1996: 2) expands on this concept by explaining: "within the context of the democratisation of South Africa, increasing focus is placed on the tightly controlled white dominated corporate sector. Two central issues can be identified:

- the widening of the controlling structure; and
- the implementation of the process of black empowerment.

Jardine (1996: 2) believes that ESOPS allows for the allocation of a significant portion of the issued share capital of the company which can widen the controlling structure of a company while simultaneously facilitating black empowerment.

Brown (1996:1) reviews ESOPS, especially within the fishing industry, in the context of black economic empowerment. According to Brown, ESOPS offer a means to further black economic empowerment. The implementation of ESOPS in South African companies is still generally limited, other than in one sector, the fishing industry. Brown (1996: 1) sets out the reasons for this as follows "The reason would seem to relate to the peculiarities of that (i.e. the fishing) sector, where the black shareholders fall into three groupings: organised full-time workers, seasonal workers, and unorganised, individual black fishermen, who have found it difficult to mount an organised campaign in support of their interests. The ESOPS offer an efficient means for the major fishing companies to incorporate all these groupings under one black empowerment mechanism and by so doing, hopefully relieve mounting political pressure as the outdated quota allocation system is reviewed."

Brown (1996: 1) is of the view that ESOPS may well find a place within the government's privatisation initiatives, with worker and trade union support being secured partly by offering workers a share in the state companies and utilities which have been identified, at least in part, for sale. The experience gained in the fishing industry could provide important lessons for greater things to come.

Brown (1996: 1-2) sets out a brief overview of the South African companies which have chosen to implement ESOPS:

- **Oceana Fishing**

Oceana Fishing was the first company to implement such a scheme. In December 1994, Reef Africa Holdings Limited ("RAH") bought a joint controlling stake in Oceana Fishing from Tiger Oats. As part of the deal, each employee was offered 500 shares at R2,55 per share, the price of which RAH bought Oceana Fishing shares. More than 90% of Oceana's 2 500 employees have taken up their options, which represents 3,5% of

Oceana Fishing's total share capital. In addition, Cosatu's affiliated food trade union, FAWU, exchanged its existing stake in Oceana Fishing for a 2% stake in RAH. To assist employees in taking up their options, 10 year loans are available, interest free over the first five years. Employees have the option to repay the loan in full after five years, by instalments or at the end of the tenth year.

- **Sea Harvest**

In January 1996, Sea Harvest embarked on the first phase of the implementation of its share option scheme by offering its employees 500 shares each at a discounted price to the market price. The loan facility is the same as that in place for Oceana Fishing employees. The first offer was 85% subscribed by Sea Harvest's 3 500 employees. The first phase of the scheme comprised 1,2% of the company's total equity.

In the second phase of the scheme, announced in November 1996 (Hasenfuss: 1996:1) employees are being offered an additional 7,5% of the company. Louis Penzhorn, the Managing Director of Sea Harvest, is of the view that an employee share option scheme "provides the ideal balance between broadening participation and ensuring the economic use of existing assets and the preservation of jobs." In the second phase of the scheme, employees are being offered 2 000 shares each at a 23% discount to the then ruling market value. 95% of Sea Harvest's employees have elected to take up the offer. Sea Harvest would provide interest free loans to employees to finance the purchase of the shares over five years. Penzhorn comments further that Sea Harvest's share scheme was the "perfect form of gain-sharing and an important move, considering that the company's value adding processes depended heavily on the skills of the workforce." Penzhorn continues that the scheme provides "a real incentive for employees to do things better, which leads to bigger dividends and profits and ultimately translates into a higher share price."

- **Premier Fishing**

Premier Fishing, a division of Premier Food, has adopted a slightly different scheme. Whereas Oceana Fishing and Sea Harvest are both listed on the JSE, Premier Fishing is an unlisted company. During 1995,

it restructured its local fishing interests into a separate subsidiary, Premier Fishing SA, and created a share trust that allows employees a direct 20% stake in this new company. Its 1 100 employees paid one cent per share, which were valued in April 1996 at R2,92 per share. Employees are offered 800 shares plus 120 shares for every year of service. At this stage, Premier's share scheme goes further than the others, insofar as providing the highest proportion of equity for employees, and having employee participation at management level.

Brown comments (1996: 2) that all ESOPS implemented to date in the fishing sector share common features:

- employees can repay their loans out of dividends
- the schemes apply to both permanent and seasonal employees
- the schemes have the blessing of the relevant trade union, FAWU, after consultation with FAWU.

Brown concludes (1996: 2) that the fishing industry's ESOPS still carry many of the "problems" associated with similar share participation schemes that have tended to make them unpopular among the trade unions. For example:

- Perhaps barring Premier Fishing, the equity is small and hence insignificant in terms of control. In Oceana Fishing's case, the total scheme comprises 3,5% of Oceana's equity, the same proportion as management's share option scheme. Employees can attend the annual general meeting of their respective companies, but with limited equity shares, ESOPS do not qualify as the kind of empowerment that offers a measure of control.
- In the early days of black unionism in South Africa, share schemes were considered by unions as a crude attempt by employers to "buy off" their workers. While FAWU is not claiming this, it is questioning the motives of the companies at a time when blacks are gaining greater access to the economy. FAWU, therefore, wants to see ESOPS extended to include increased involvement by workers in company decision-making.

- **M-Net's Phuthuma Share Scheme**

During 1995, M-Net embarked on a much publicised scheme which placed 10% of M-Net's equity in the hands of historically disadvantaged South Africans, with the stated objective of assisting in the process of black economic empowerment. Full details of the scheme are contained in a booklet entitled "M-Net's Phuthuma Share Scheme" which was issued in April 1996. All references in this sub-section are to that booklet. The forward (pg 2) sets out the objective of the scheme as follows: "to assist in the economic empowerment of historically disadvantaged communities in South Africa" (defined on page 2 as Black, Coloured and Indian South Africans).

The objectives of the scheme are set out in more detail on page 3 of the booklet:

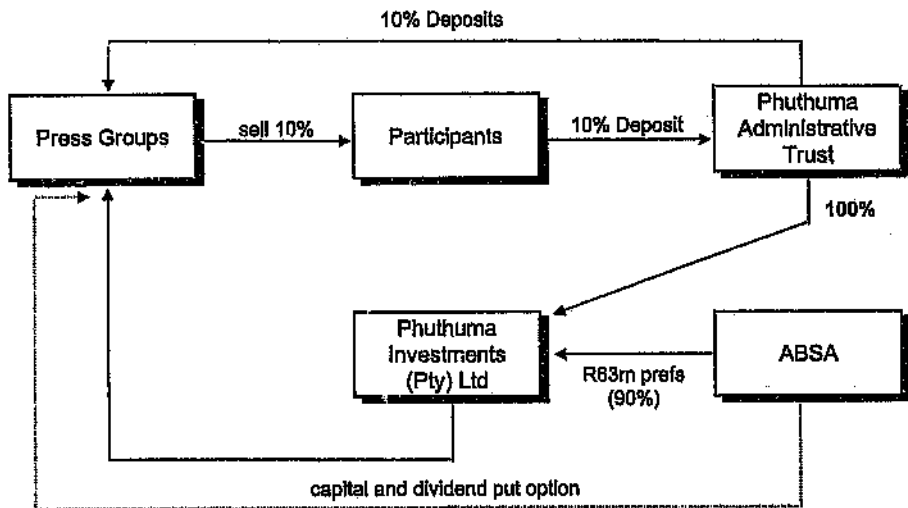
M-Net believes that there is a growing demand for a meaningful participation of the black community in the management, ownership and control of organisations. M-Net has long been active in the area of black career advancement. It sought to match this in the area of equity ownership as well. It was in response to these views that the major original M-Net shareholders agreed to divest some of their M-Net shares and provide the impetus for the birth of Phuthuma. The choice of the word "Phuthuma" is explained as follows (pg 3): "Phuthuma is a Zulu word which means "hurry up, get going". It captures a sense of urgency."

To ensure meaningful economic empowerment, M-Net wished its scheme to extend share ownership to ordinary black South Africans, including the most deprived. This raised the problems of affordability and risk. Given the acute shortage of black capital, the offer could not lightly be put at the risk ordinarily implied by stock market investment. To purchase 10% of M-Net would cost R70 million. A funding mechanism was needed and one of the stated objectives of the scheme was to protect participants from losses caused by a drop in market value.

The mechanics of the scheme are presented in detail on Page 5 of the booklet:

- South Africans belonging to historically disadvantaged groups were publicly invited to purchase 10% of the equity of M-Net. The groups referred to were blacks in the widest sense - Africans, Indians and Coloureds. This represents all those unable to vote before 1994.
- The share price was based on the prevailing market price of M-Net shares. Applicants had to pay a deposit of 10% of the purchase price in cash with their applications. They incurred a debt for the balance, repayable at the end of three years.
- The shares were sold directly to the participants. Having been given three years to pay, their shares were pledged to the major original shareholders and dividends ceded for three years. Ownership will then pass directly to the participants.
- The major original shareholders sold their claims against the participants to a newly-incorporated company, Phuthuma Investments (Pty) Limited which acted as a special purpose vehicle for the issuing of preference shares to ABSA Corporate and Merchant Bank - the financiers.
- The major shareholders granted the preference shareholders a put option on the outstanding balance of the preference shares as well as any dividends in areas and/or defaults upon dividend payments by M-Net. In terms of the put option, the major original shareholders undertook to buy back the shares at a price of R2,50 per share if after the three year period, the share price for some reason dropped below this level.
- The coupon rate of the preference shares would be recalculated at the expiry of each year and the new coupon rate would reflect the effect of the arrear dividend.

- The administrative function was controlled by the Phuthuma Share Trust, which owns 100% of Phuthuma Investments (Pty) Limited, and which will receive the M-NET dividends on the shares annually. These will be used to service the preference share dividend with ABSA Corporate and Merchant Bank.
- On the third anniversary of the scheme, the preference shares will be redeemed at the issue price thereof plus any outstanding preference dividends. The redemption will be funded by the payment of outstanding indebtedness by each participant, a refinancing mechanism to be arranged at that stage, the exercise of the put option against the major original shareholders, or the sale of sufficient M-Net shares in the market.
- The structure is diagrammatically set out below:



The process and design of the Phuthuma scheme are presented on page 7 of the booklet:

M-Net was legally prohibited from holding a rights offer of new shares in which only historically disadvantaged people could participate. The Stock Exchange Act prescribes that a rights offer of new shares has to be made to all existing shareholders.

For the scheme to conform to these provisions, existing shares had to be used. The major original shareholders, holding 65% of the equity, were the source.

It was realised that a significant portion of the target market had not owned shares before and were therefore on unfamiliar terrain. It was therefore critical that black shareholders participating in a scheme of this nature be protected from serious capital loss in the event of a general stock market retreat or some other contingency.

As mentioned earlier, the major shareholders agreed to grant a put option to the bank, which effectively protects the applicants from capital losses.

M-Net insisted that the offer should also bring people who had never owned shares on board as owners. Affordability was the key. That is why participants were permitted to buy shares against a deposit of only 10%, with the 90% balance being payable at the end of the three-year period. The shares were priced at R2,50, the prevailing market price. M-Net's shareholders considered making the shares available against no deposit, but felt it was important that participants should indicate commitment and exposure to risk by laying out some hard cash. The 10% deposit required made it possible for anyone with R25 to subscribe for the minimum of 100 shares.

M-Net staff, as well as the trustees, were excluded from Phuthuma. All M-Net staff members in service had already participated in a staff share option scheme in November 1994.

It was necessary for the scheme to extend over three years, because the trust was based on preference shares. Dividends on preference shares are not taxable as interest in terms of section 8E of the Income Tax Act, if the shares are redeemed after three years and one day.

The legality of the scheme is addressed on page 8. From the outset, M-Net was quite candid that the Phuthuma scheme was designed to be in the interests of black economic empowerment. By definition, whites were excluded and this was controversial. With regard to the constitutionality of the scheme, senior counsel advised M-Net that because it was a private offer of existing shares made on behalf of their owners i.e. the original M-Net shareholders, confining ownership to "historically disadvantaged groups" was not unconstitutional.

M-Net summarises the outcome of the scheme on page 22 - 23 of the booklet as follows:

- Approximately 7 800 individuals and organisations participated in the Phuthuma scheme and in so doing, an additional 7 800 new black shareholders became owners of JSE listed M-Net shares.
- The offer was 35% over-subscribed. A total of 28 million M-NET shares were offered on the basis that individuals could subscribe for no more than 500 000 shares and organisations for no more than 3 million shares, with the stated objective being to give preference to small applications. Accordingly, all applications for up to 20 000 shares received their full allocation. Those who applied for more than 20 000 received the first 20 000 and 53,5% of the balance. Altogether, 97% of the applicants received their full allocation.

## **5. FACILITATION BY THE JOHANNESBURG STOCK EXCHANGE**

Galli (1994:1) reports that the Johannesburg Stock Exchange ("JSE") has recently announced the creation of a new sector on its main board to allow for the listing of vehicles "designed to bolster black empowerment and the reconstruction and development process". Galli quotes the JSE President Roy Andersen as saying that "the exchange had been looking at the role it could play in reconstruction and development and had come up with the idea of a new main board sector which probably would be known as the reconstruction and development sector. Our goal is to create vehicles that can raise capital to be lent to emerging black entrepreneurs or groups involved in the reconstruction of

the country. This would provide a pool of capital for emerging and small black business".

The Johannesburg Stock Exchange Listings Requirements issued during May 1995 contained new listings requirements which became effective on 1 July 1995. During September 1995, the first set of amendments, which became effective on 10 October 1995, was issued. One of these amendments contained provisions relating to the Industrial - Development Stage sector, which is what the sector previously referred to as the reconstruction and development sector was finally called.

In terms of paragraph 4.25 of The Johannesburg Stock Exchange Listings Requirements, a company seeking a listing on the Main Board of the JSE must satisfy the following criteria, inter alia:

- i) a permanent capital base of at least R2 million
- ii) a satisfactory profit history for the preceding three financial years, the last of which reported an audited profit of at least R1 million before taxation.

In terms of paragraph 14.16 of The Johannesburg Stock Exchange Listings Requirements, a company seeking a listing on the Industrial-Development Stage sector needs to comply with all the criteria for a Main Board listing, except for the following:

- i) the company should have a permanent capital base of at least R20 million
- ii) a profit history is not necessary, but the applicant should provide a forecast of future profits/losses during and at least one year after completion of the development stage
- iii) at the beginning of the prospectus or pre-listing statement there must be a warning, in bold letters, that the applicant is still in the development stage and that it does not have a profit history which meets the criteria for a Main Board listing.

In terms of paragraph 14.17(a), a company that is listed on the Industrial-Development Stage sector and which has produced a satisfactory profit history for three consecutive financial years (at least R1 million before tax in the last year), may apply for a transfer of its listing to the Main Board.

Galli (1994:1) comments that by doing away with the need for detailed past company profit history, the JSE has facilitated the use of vehicles which can raise capital to be utilised by emerging black groupings and entrepreneurs.

## CHAPTER FIVE

### Financial Engineering

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As referred to in Chapter 2, resulting from the scarcity of black capital resources, corporate finance practitioners have been presented with numerous opportunities for creative financial engineering solutions. It would appear that most of the merchant banks, stockbrokers and financial institutions have devised several methods of financing, in particular, the equity participation by black empowerment groupings in transactions. The various structuring methods employed in black economic empowerment transactions by the Corporate Finance Division of Standard Corporate and Merchant Bank are summarised in an internal document entitled "Proposal regarding a black economic empowerment fund" prepared by Funke Oyewole and dated 26 August 1996.

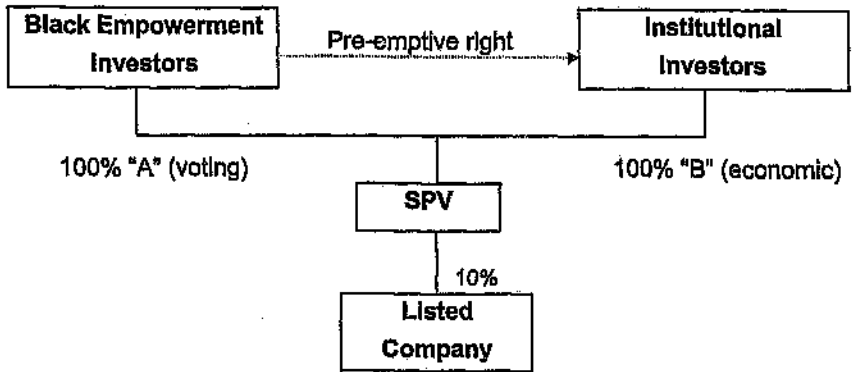
The document sets out 3 typical structures which have been used by Standard Corporate and Merchant Bank to introduce black empowerment groupings into various listed and unlisted companies:

- equity participation with no economic facilitation;
- equity participation at a discount; and
- put option granted by existing shareholders.

These structures are analysed in more detail.

i) **Equity participation with no economic facilitation**

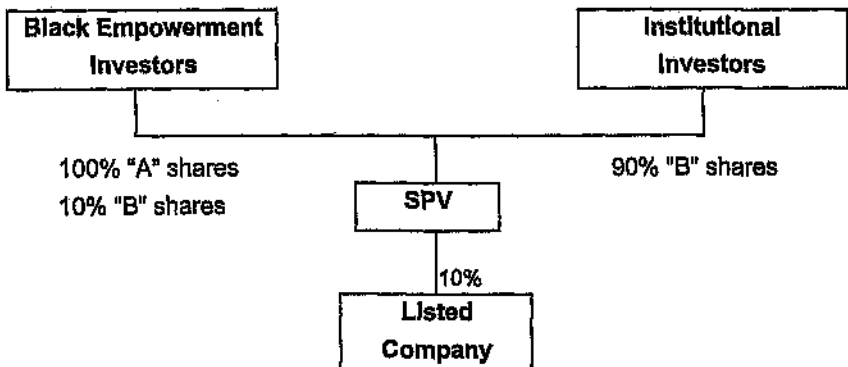
In this case, the black empowerment investors acquire, for example, a 10% interest in a listed company, through a special purpose vehicle ("SPV") which is entirely funded by institutional investors who take on low-voting Class "B" shares in the SPV. Voting control is ceded to the black empowerment investors through Class "A" voting shares. The structure is represented diagrammatically as follows:



The situation envisaged under this structure is that the black empowerment investors would be able, over time as the black empowerment company grows, to exercise their pre-emptive rights over the institutional investors' shares at the future market price of the listed shares. There is therefore no economic facilitation in the transaction as the shares in the listed company are effectively owned by the institutional investors until the black empowerment investors have sufficient cash to acquire the institutional investors' Class "B" shares. The expectation is that other business opportunities would flow to the black empowerment investors which would enable them, over time, to acquire the Class "B" shares.

ii) **Equity participation at a discount**

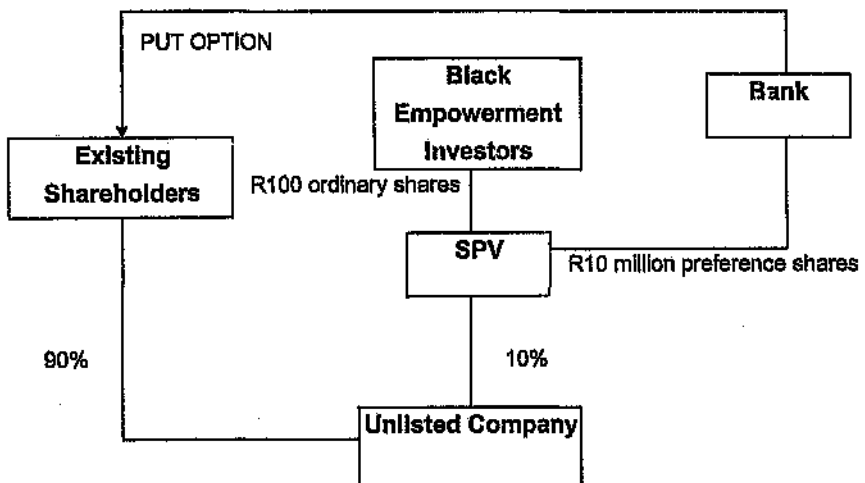
under this scenario, the shares in the listed company are sold to the black empowerment investors at a 10% discount to the ruling market price. The full benefit of the discount is given to the black empowerment investors at the outset through their 10% shareholding in the Class "B" shares. The structure is represented diagrammatically as follows:



The black empowerment investors may or may not have a pre-emptive right on the remainder (90%) of the Class "B" shares held by the institutional investor, but in any event, unlike in i), they are guaranteed to own at least a 1% direct stake (ie 10% of 10%) in the listed company. This stake of 1% equates to the discount given by the original seller of the shares and effectively gives the black empowerment investors free shares in the listed company. This structure thus relies, to a certain extent, on economic facilitation by an existing shareholder.

iii) **Put option granted by existing shareholders**

Under this scenario, black empowerment investors are offered shares, typically in an unlisted company. The purchase consideration is funded by a bank whose debt is guaranteed by a put option against the existing shareholders in the unlisted company. This structure is represented diagrammatically as follows:



The above structure assumes that the existing shareholders in an unlisted company would like to introduce black empowerment investors as a 10% shareholder in the unlisted company, for strategic reasons. The purchase consideration is R10 million. An SPV is established with the black empowerment investors owning all of the ordinary shares in the SPV (say R100). The bank provides all the funding to the SPV in the form of preference shares which, in turn, is used to subscribe for 10% of the shares in the unlisted company. At the end of say, three years,

should the black empowerment investors, through the SPV, be unable to redeem the preference shares (the debt owing to the bank), the bank can sell those preference shares to the existing shareholders in the unlisted company in terms of the put option. The existing shareholders, who are assumed to be of sufficient size and standing so as to meet the bank's normal credit requirements, have thus facilitated the participation of the black empowerment investors by accepting the put option which effectively guarantees the bank's debt.

## CHAPTER SIX

### Conclusion

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The depth of references in the literature to black economic empowerment topics would clearly seem to imply that corporate South Africa is coming to accept black empowerment as both an economic and social necessity. As a result, it would appear that there will be no lack of investment opportunities presented to black entrepreneurs. The literature also reveals that a central issue in the debate around black empowerment is still likely to be how to finance black participation in the economy. The race is on among financial engineers to find the most creative ways to bring blacks with limited resources into the economic mainstream. It appears, that as a result of the limited pool of appropriately educated black executives, the black empowerment initiatives undertaken to date have been with a small number of consortiums led by prominent individuals.

The government seems to have endorsed the view that the political liberalisation of South Africa must be followed by economic empowerment of the previously disadvantaged peoples of South Africa in order to ensure that the capitalistic model of society becomes firmly entrenched within the country. Responding to this, the government has already demonstrated that it will support the process by those means at its disposal.

The overall purpose of this literature review was to provide a detailed analysis of the successful empowerment transactions to date as well as the vehicles, mechanisms, structures and initiatives employed to enhance black empowerment. The objective was to provide a blueprint of elements which contribute to successful, meaningful empowerment. The most important elements may be summarised as follows:

- The major constraints and challenges facing black empowerment, namely lack of education and skills need to be addressed.
- Major South African corporates need to relinquish control of assets and take the initiative by embarking on transactions with the stated objective of black empowerment. Linked to this, suitable acquisition companies which would benefit from black shareholder participation and an empowerment transaction need to be identified.
- A degree of facilitation e.g. the sale of shares at a discount, is often necessary by the previous controlling shareholder.

- Credible black entrepreneurs are needed to lead the empowerment groupings.
- Acquisition groups need to be broad based and the shareholdings thereof structured correctly.
- Pools of black capital resources need to be identified e.g. stokvels, church groups and trade unions, and harnessed effectively.
- Sophisticated financial structuring with regard to voting power and control issues needs to be employed.
- Several viable mechanisms have been developed and identified in both the public and private sector and from government which are aimed specifically at creating empowerment. These include the transfer of ownership of State assets into private hands, joint venture arrangements, franchising agreements and ownership of company shares by black shareholders. The Johannesburg Stock Exchange has created a specific sector to allow for the listing of vehicles designed to bolster black empowerment. This sector needs to be utilised fully as an available tool to create black controlled listed companies.
- Numerous creative financial engineering solutions have been developed to allow, in particular, for equity participation by black groupings in transactions. These financing structures need to be utilised fully in structuring empowerment transactions.

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