Section Three

Challenges and Prospects for Inclusive Empowerment: Workers, Empowerment Transactions and the Informal Economy

Gambling on the Share Price:

Re-Embedding Production and Operational Involvement in B-BBEE

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Background and context

Black Economic Empowerment (BEE) deals in private sector listed entities, which involve equity transfer interests, have historically been structured through the use of third-party debt and variables beyond the control of empowerment beneficiaries (see Chapters 3 and 4 in this volume). These two elements in BEE deal structures determine the transaction's success or failure (Fubu, 2019). Some prominent variables include underlying assets, share prices, interest rates and firm-level dividend policies. This chapter examines how the design, financing and composition of BEE deals determine whether these transactions contribute to the socioeconomic policy goals articulated in Broad-Based Black Economic Empowerment (B-BBEE) legislation.

The chapter departs from many prior B-BBEE analyses, which have focused on class formation, governance and its bureaucratic application (largely procedural). Much of the analysis has also investigated how B-BBEE has been instrumentalised and operationalised through employment equity (recruitment), procurement and technical codes (Codes of Good Practice) (see Ponte et al., 2007; Cargill, 2010). There is recognition that BBEE is not just about ownership but also skills, procurement, and enterprise and supplier development. However, as Jenny Cargill in her book *Trick or Treat* correctly observes: 'black shareholding is still the main gauge by which a company may qualify for preferential procurement and enterprise development' (2010: 58). It is on this basis, and because of the socioeconomic dimensions inherent in the pursuit of black shareholding, that this chapter focuses on the structuring of deals aimed at facilitating such ownership.

However, BEE deals do not happen in a vacuum and they influence (and are influenced by) corporate strategy. In the last few decades corporate strategy has been shaped by the impact of financialisaton in various sectors (Ashman et al., 2011; Epstein, 2005; see Chapter 5 in this volume)**.** Epstein (2005) defines financialisaton as the increasing role of financial motives, markets, actors and institutions in the functioning of domestic and international economies. This trend can also be observed in the evolution of BEE deals, which have been influenced by risk-based incentives placed before vendors, beneficiaries, third party lenders and transaction advisors. Black entrepreneurs are particularly vulnerable to financialisaton because they lack capital. Furthermore, Von Holdt (2018) points out that BEE deals coincide with a key characteristic of financialisaton: disembedding accumulation from production and geographic location (Von Holdt, 2018). BEE has happened in sectors where the influences of financialisaton and state power are most apparent. Deals have largely occurred in sectors in which the dominant firms are state-owned companies (energy, transport, etc.) BEE has also been prevalent in sectors in which revenues are heavily reliant on state contracts through procurement (construction and many service sectors) and rents (i.e. the mining and ICT sectors, through the provision of licensing).

Many have used this evidence to argue that BEE has reinforced South Africa's economic dependency on the finance-led minerals-energy complex (MEC) (Fine, 2008; Gqubule, 2006, Southall, 2007). Fine (2008: 3) suggests that this has also made it 'relatively easy to accommodate incorporation of BEE as minority enrichment, since this can be promoted through access to the financial system' (Fine, 2008: 3). This chapter's discussion considers whether contemporary BEE transactions have followed suit. Put differently, do these deals display design features that substantiate perceptions of B-BBEE as a project focused on elite proxies rather than a broad-base of beneficiaries? Furthermore, how do we design empowerment deals so that they help to diversify South Africa's industrial base and market structures? 'Market structure' in this chapter refers to the characteristics, features, institutions and power relations inherent in key product and service markets in South Africa's economy.

The chapter argues that the incentives B-BBEE provided, through the Codes of Good Practice and industry charters, encouraged the acquisition of equity in target firms using third-party debt. This third-party debt, in a high interest rate environment, exposed broad-based beneficiaries to a series of variables beyond their control (share price movements, interest rates and dividend policy). Moreover, this deal finance model complemented the impulses of financialisaton, which disembed transformation from operational business participation and the real economy. These deals create limited structural reform, and consequently entrench existing market structures in South Africa. The chapter's evidence illustrates that successful deals place operational and business concerns at the centre of deal design. These two elements were prioritised as key markers of success rather than narrow financial gains and imperatives. The main emphasis in this chapter is on the centrality of deal design in attaining B-BBEE socioeconomic objectives and pursuing market structure transformation. It fortifies the conclusions articulated in Chapters 3, 4 and 5, which argue for disembedding BEE from financialisaton or exchange.

Methodology

This chapter acknowledges that BEE takes place at multiple levels across society. However, it only examines prominent deals involving listed businesses for two important reasons. First, South Africa's developed tertiary sector, especially the deep capital and financial markets, have ensured that large-scale empowerment deals mostly take place within listed entities. Second, as Gqubule suggests, listed companies have 'better disclosure than non-listed companies, which by and large are impossible to monitor' (2006: 103). The chapter discusses various BEE deal structures using case studies of various companies as the basis for its approach. These empowerment transactions are discussed within the broader context of financialisaton and BEE policy evolution throughout the post-apartheid era. The five case studies were chosen because they reflect sector trends in BEE-related economic activity over the past 25 years.

The chapter commences with an overview of early BEE transactions. It analyses deal structure design in order determine how past transactions shape future B-BBEE deals. Then the chapter proceeds to examine various company case studies. There are three main themes that are explored in the company case study analysis: structural change, operational involvement and broad-base beneficiary participation.

Early BEE financing: from SPVs to vendor finance

Black Economic Empowerment is about how to use economic rents (procurement, licensing and regulation) to ensure black involvement in the mainstream economy. Has this been achieved? Economist Duma Gqubule seems to think not. Gqubule suggests in his 2006 book, *Making Mistakes* *and Righting Wrongs,* that most of the economic rents of capital reform (through BEE) have been captured by white capital. He attributes this to how these deals were structured and the influence of macroeconomic policy on payoffs to black shareholders. Many of the early deals were funded through Special Purpose Vehicles (SPVs). These financing mechanisms involved the creation of a vehicle which would be used to purchase a stake in the target company. Third party financiers would provide black groups with finance to purchase the stake (usually at a discount to market price), and the SPV would then issue A shares (with voting rights or political control but limited 'economic interest') and non-voting B shares with the lion's share of economic interest in the SPV.

The black consortium in this case would receive most of the 'political' A shares, and the B shares would be a combination of equity and debt, often extended to the non-voting financiers. The equity component in the B shares would give financiers access to some of the 'equity upside' (appreciation in the underlying share price of the target company: between 50 per cent and 90 per cent) and the interest on the debt provided to black groups would be 'rolled over three or five years'; the black investors would be expected to pay the debt and any accumulated interest (Gqubule, 2006: 117). The debt to be paid would require an internal rate of return for the vehicle, in excess of 20 per cent in some instances. As can be seen, if the rate of return implied by movements in the share price of the target company was less than the interest rate on the debt extended to the SPV after three or five years, the financiers would take back the shares. This happened in many instances in the early deals, as illustrated by the Johnnic and NEC case studies discussed in the subsequent sections of this chapter.

Chapter 3 in this publication discusses the effect of macroeconomic policy choices on BEE policy objectives aimed at capital reform. The chapter focuses on three essential macroeconomic dimensions: GDP, monetary and fiscal policy. This account highlights economic growth trends and approaches to inflation targeting, which raises a pertinent question about the use of interest rates. It is crucial to expand on this discussion because of the positive correlation between output growth and equity prices. For example, between 1996 and 2003, it was virtually impossible for black investors to achieve the hurdle rates that would justify the debt used to acquire stakes in target companies – national growth was sitting below 3 per cent and real returns on the Johannesburg Stock Exchange (JSE) were at 2 per cent per annum. However, what made things worse, certainly for black investors who started off with no capital, was the monetary policy approach of inflation targeting, which involved using prime lending rates to rein in inflationary expectations (Chapter 3 in this publication; Gqubule, 2006). This had major implications for the terms on which funding is extended to black investors. Gqubule (2006) suggests that a high interest rate and low growth environment presented very few opportunities for black consortiums to generate capital (Gqubule, 2006: 104).

Many of the SPV deals crumbled in the face of the 1998 Asian Financial Crisis (Chabane et al., 2006; Gqubule, 2006). A case in point was the ANC-linked investment holdings company Thebe, and their investment, initially into two homeland building societies and Citizen Bank (renamed to FBC Fidelity). FBC took a big knock through the decline of the Malaysian-controlled New Republic Bank during the Asian crisis, which prompted a major sell-off of their shares. Vusi Khanyile, formerly of Thebe, recounted in Cargill's book (2010: 7) the sad tale of the bank's demise: '… we drafted a term sheet, but it required Treasury support. They told us that if the banks aren't strong enough to survive on their own, they must go'. The bank was later brought out of curatorship by the Nedcor group (later renamed Nedbank in 2005).

The challenges cited above, coupled with minimal levels of operational control by black shareholders, compelled government to reform BEE policy in the early 2000s (Butler, 2007; Chabane et al., 2006). This process eventually produced the B-BBEE Act in 2003: No 53 of 2003, which brought into play the role of worker, community and other public group equity in post-apartheid empowerment corporate strategies. This also influenced deal structure and finance significantly. The policy shifts in BEE post-

2003, as Cargill (2010) observes, coincided with a bull market: Price earnings multiples[1] on the JSE All Share Index were in the 15–18 band between 2003 and 2008. This trend had two crucial implications. First, it led to an increase in deal activity, with R350 billion going into BEE deals between 2004 and 2008 (compared to R30 billion in disclosed deals between 1996 and 1998). Second, in this context of high asset prices, when asset values reversed, many of the BEE deals in question – funded largely through debt – went into the red as debt levels outstripped the value of the underlying assets.

'Lock-ins' – the golden handcuffs

One of the features from the SPV days that remains is the use of lock-ins to ensure that target companies retain their black shareholding and empowered status. The Codes of Good Practice and industry-level charters incentivised corporations to maintain their black ownership for significant periods, as this would secure public procurement benefits or operating licenses. However, the longevity of such black ownership would only come into question if black shareholders sold their shares. The implicit assumption was that they would not. Mzi Khumalo proved these assumptions wrong.

Khumalo, a former Robben Island prisoner and ANC activist, received a 7 per cent stake in Harmony Gold in 2001 through a broad-based consortium. Harmony would not only later realise that the broad-based consortium consisted solely of Khumalo, they would later find out that he had sold his stake, and left Harmony 'without an empowerment partner at all' (Cargill, 2010: 39). In 2005 Khumalo, through Metallon Ventures, acquired shares in Basil Read (at a discount) and sold these eight months later, leaving the construction group 14 per cent whiter and Khumalo R70 million richer before debt service costs. This experience undoubtedly made the companies giving the equity, and some of their associates in the banks, much wiser. These entities ended up moving to create lock-ins or what Cargill (2010: 39) calls 'golden handcuffs'. These were aimed at ensuring that companies did not wake up one day empowered and the next day not empowered. This concern around the durability of empowerment credentials has also been a key feature of the contemporary '*once empowered, always empowered'* debate in the mining sector.

The other more contemporary reason for the continued use of lock-ins is the gazetting of B-BBEE Codes of Good Practice in 2007 as a 'regulatory instrument' (Cargill 2010: 236). They did not create legal obligations (except in the case of the mining sector). But the state has used its procurement decisions as the mechanism to encourage compliance with the codes. In the case of the lock-ins, the B-BBEE codes require firms to consider exercisable voting rights, economic interest, realisation points and bonus points (for involving new black entrants, broad-based schemes and co-operatives) (Cargill 2010: 238).

The points achieved (when compliance targets are met – see Table 9.1 below) are measured on a continuous basis, and if a deal is unwound, the points are lost to the target firm. This has incentivised firms to structure deals in a manner that ensures that they retain the ownership points implied by their black shareholding (especially in instances where there is broad-based participation) for as long as the Codes remain in force. Khumalo's exploits heightened criticism levelled at BEE, as many stated that it was empowering the same few elite empowerment groups and individuals. Aspiring BEE corporates responded to this criticism with the development of consortia, including a wide cross-section of community, women, youth and worker groups.

[1] **Price Earnings Ratios** are what investors are willing to pay for a 'rand of earnings', it is a measure used to evaluate the relative attractiveness of a firm's stock price as compared to its current earnings.

Ownership element of B-BBEE codes

Table 9.1

OWNERSHIP		Weighting Points	Compliance Target
Voting Rights	Exercisable Voting Rights in the Entity in the hands of Black people	4	25% + 1 Vote
	Exercisable Voting Rights in the Entity in the hands of Black women	2	10%
Economic Interest	Economic Interest in the Entity to which Black People are Entitled	4	25%
	Economic Interest in the Entity to which Black women are entitled	2	10%
	Economic Interest of any of the following Black Natural People in the Measured Entity 1. Black Designated groups; 2. Black participants in Employee Share Ownership Programmes; 3.Black People in Broad based Ownership Schemes; 4. Black Participants in Co-operatives	3	3%
	New Entrants	2	2%
Realisation Points	Net Value	8	Refer to Annexure C
Total		25	

Source: Association of B-BBEE Professionals (2019)

Introducing the 'broad-base' – The story of the National Empowerment Consortium (NEC)

One of the main aims of introducing BEE was not only to cosmetically change the face of corporate South Africa, but also alter its underlying structure as a concentrated, minerals reliant, racialised and cheap energy/labour dependent economy. Viewed in this way, the envisaged de-concentration of the South African economy presented an opportunity for an aspirant black capitalist class to benefit from the sale of non-core assets through unbundling; but it also framed the path that BEE would follow in later years. In November 1996, the *Mail & Guardian* newspaper ran a story about the country's (then) most significant black empowerment deal involving the National Empowerment Consortium (NEC) acquiring media company Johnnic.

Seventy-six members came together to form this consortium, which was divided into two groupings: business and trade unions. It had an additional retail vehicle of 32 000 individual black shareholders. This 'mega-consortium' provided a blueprint for future 'broad-based' groupings (Cargill, 2010: 128). The Johnnic deal was structured in ways that allowed for black ownership and influence on the strategic direction of the diversified firm, with interests in brewing, entertainment, media, gambling, telecommunications and property. The first tranche of shares was sold at a 7 per cent discount to the share price, and the board of Johnnic would be enlarged to 20 members in order to allow the consortium to appoint half of the board, including the chairman. Former trade unionist and ANC secretary-general (and now President of South Africa) Cyril Ramaphosa became chairman of the Johnnic board in this way.

Armed with a boot-load of good assets – as former Anglo executive Michael Spicer observed – the NEC went about not only taking 'paper ownership' but assuming an operational role in driving the direction of the entity. Former NUM staffer, consortium member and non-executive director at Johnnic, Irene Charnley, grew concerned with the limited involvement of many NEC members in the 'real decisions' about the underlying investment. She aired her concerns in the following words: 'having an empowerment presence on a board does little good for black South Africans. You don't have much influence on strategy, hiring practices or company culture' (Hill & Farkus, 2006).

It was a common sentiment, not unique to broad-based deals. What was unique to the NEC, however, and would later be its undoing, were the dynamics inherent in large groups – conflicting agendas and bickering. In a context like that, when challenges arise, many partners decide to exit. For example, by October 1999, Cyril Ramaphosa would be very guarded in responding to Irish journalist, Padraig O'Malley, about his reasons for leaving NAIL (one of the prominent NEC members) (O'Malley, 1999):

O'Malley: … why did you leave NAIL?

Ramaphosa: Oh, ho, why did I leave that? I wasn't happy there.

O'Malley: Because?

Ramaphosa: I wasn't happy with the strategic approach.

O'Malley: The approach as an entity that had a corporate strategy as distinct from an entity that had a black empowerment strategy?

Ramaphosa: Well, black empowerment strategy, both, both in the end – corporate and black empowerment

Differences in strategy aside, there were also structural challenges related to how the consortia had been developed and their investment strategies. Both these factors would later determine the success or failure of the NEC. The Johnnic deal was financed through third party debt, which could only be paid through dividends and share price appreciation. The latter did not happen and, by 2001, the Johnnic shares were trading at two-year lows. Whereas in April 2000 the share had been trading at R70 (reaching R94.40 on 7 June of the same year), by February 2003, less than three years later, it was trading just above R50 a piece – well below the minimum value required to meet the original funding costs. This was surprising because Johnnic had undertaken two things that most corporate finance textbooks suggest lead to share price and shareholder value appreciation: share buy-backs and the disposal of non-core assets.

In September 2001, the Johnnic investors had approved the buy-back of 20 per cent of the firm's shares. The firm traded at a discount relative to its net asset value, and in an attempt to narrow the discount they undertook to buy back the company's shares. In February 2002, Chief Operating Officer Jacob Modise would assert that the disposal of non-core assets which had started in 2000 had yielded in excess of R430 million for Johnnic. These tactical manoeuvres were not enough to save the new Johnnic owners from the inevitable outcome of a gamble on any variable (least of all the share price). Losing the exchange value of whatever shares are held in the target company and secured at great leverage by the empowerment consortium was the one eventuality many consortium members feared most. The NEC's lesson would come in the telecommunications sector.

Having received a boot-load of good assets in 1996, the entity sought to create strategic alignment in a diverse portfolio through the disposal of marginal assets. By the time the interim results were announced for the year ending 31 December 1997, Johnnic had disposed of its stake in carmaker Toyota South Africa. Its net asset value (NAV)[2] in June 1997 stood at R71.66 a share, by the end of that year it had declined by over R10 to R61.63. When one considers that the empowerment consortium and the black public entered this deal at R50 a piece, any NAV above that would allow for an upswing that could pay the debt and hopefully, on liquidation, if there were to be anything left, a realisation of

[2] **Net asset value** is the value of the difference between a company's assets and liabilities, divided across the number of shares it has in issue. It is a measure that captures the 'per-share' value of a company and is often compared to a firm's share price.

a capital gain. However, by 2001 the share price fell beneath R50 and this had negative implications for debt repayment and capital gains.

Prior to that, there had been an acquisition of a further 18.5 per cent interest in MTN Holdings from Cable and Wireless South Africa. Johnnic, through M-Cell, already had an interest in MTN and would highlight the strategic synergies in a SENS[3] announcement which stated (Sharenet, 2001):

> The acquisition forms part of the strategic restructuring process and represents an opportunity for Johnnic to increase its interest in MTN Holdings which has been identified as a core asset in the new media and communications group and in which Johnnic already holds a significant interest through M-Cell Limited.

The NEC managed to negotiate a roll-over of the funding of its stake in Johnnic to the end of 2003. By February 2003 many of the original NEC members had forfeited the shares in Johnnic to the funders that had financed them due to weak share price performance. Unsurprisingly then, the same funders would vote for the unbundling of Johnnic's shares in MTN for two reasons. First, it would give them access to MTN shares (a decision they would later appreciate). Second, they would still hold assets in a Johnnic Communications (Johncom) structure that included some lucrative property, gambling, hospitality and media assets. However, it meant a full exit from MTN by Johnnic in 2004, and the subsequent departure of the original NEC members from the deal.

The deal led to the later emergence of a black-controlled and operated new entrant, MTN, in a relatively new industry; notwithstanding MTN's current regulatory woes in its West African operations, it remains an African corporate giant. It is a pity that many of the early NEC members were compelled by weak share price performance to sell early. This was driven largely by the fact that deals of that era were structured for bullish markets. In the absence of strong share price performance, not even share buy-backs or consistent dividends would make these equity stakes held by the consortia a sustainable investment (Ryan, 2006).

Below I examine if subsequent deals retained some key features of the NEC deal design, and to what extent they have departed from the original deal design approaches. Then I proceed to discuss a few contemporary deals in order to draw out some innovative shifts in deal structuring. It specifically assesses these deals' impact on the broad stakeholder base and underlying market structure.

The evolution of BEE deals – similar faces and different experiences

The new era of deals responded to the failures of the early 1990s deal design and to recommendations from the BEE Commission's report (2001). These deals included the use of call options (allowing black investors to access target company shares at a predetermined price by a certain date); vendor financing (where the target company finances the acquisition of its own shares by a black group); and third-party finance, often facilitated by the target company through the use of guarantees or upfront capital considerations.

This chapter considers the case of two deals within the financial sector: SANLAM's 2004 deal with the Ubuntu Botho consortium and ABSA's 2005 deal with the Batho Bonke consortium. This choice is attributable to the dominant role in gross value added of the financial services sector during the period under discussion, which was driven by rises in credit extension, residential construction and household

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[3] **SENS** is the Johannesburg Stock Exchange's news service that announces company developments such as mergers, takeovers, rights offer and results *inter alia.*

consumption (Mohamed, 2010: 159). Viewed in this way, the financial services sector has been crucial for the sectoral composition of output in South Africa and to the post-apartheid market structure.

Two different stories within the same financial services sector – the SANLAM and ABSA deals

Keeping up with the Motsepe's – SANLAM and Ubuntu Botho

In 2004, Sanlam announced that it would sell an 8 per cent stake to the Ubuntu Botho empowerment consortium. If certain targets of performance were met, a further 4 per cent of shares would be transferred to the consortium. By December 2006, the Ubuntu Botho consortium had a 9.8 per cent stake in Sanlam. The consortium was made up of 18 investment entities, including the investment vehicles of public sector unions such as SADTU and NEHAWU (see Chapter 11). It also included women's groups like the Abafazi Basadi Ubuntu Botho Investments Company. According to the Sanlam 2004 Annual Results Presentation, the deal 'included the transfer of 56.5 million treasury shares to the Sanlam Ubuntu-Botho Community Development Trust, to establish its stake in Ubuntu Botho' (Sanlam, 2004: 7). The deal also included the transfer of A deferred shares issued to the consortium, 'which qualified for conversion into ordinary shares based on Sanlam's business flows for the year' (Sanlam, 2004: 10).

In 2007, three years after the deal was struck, Ubuntu Botho (UB) was able to pay a R50 million special dividend to over 800 shareholders as well as the Development Trust. This, as Verhoef (2018: 320) suggests, was informed by the 'favourable financial position of UB's book', which 'led Sanlam to offer UB an early payment of dividends on the Sanlam shares in (UB's) portfolio'. The strong performance of the Sanlam share and the high dividends implied by UB's shares in Sanlam justified an early payment to UB shareholders. This took place despite the strict conditions placed on UB regarding the sale of Sanlam shares and dividend payments. By 31 December 2013, the shareholding had grown to 14 per cent through a combination of share buy-backs and the reclassification of 6.5 million deferred shares to ordinary shares. What about this deal made it different from the earlier deals and the experience of the NEC-Johnnic deal discussed earlier?

First, Patrice Motsepe contributed R200 million towards the deal through a personal family vehicle, Sizanani Helpmekaar Trust (which owned 55 per cent of Ubuntu Botho). This was a significant departure from the earlier deals solely financed through third-party debt. Motsepe was able to do this due to the payoffs received from investments in the mining sector and personal resources. This meant that this deal was not subject to a long process of equity transfer or reliance on strong share price performance and dividends to service debt. The alternative deal structure shifted the balance of power in material ways. Second, and more importantly, the business relationship between UB and Sanlam was linked to the performance of the underlying business – Sanlam, rather than any other exogenously determined variable such as the share price, interest rates or exchange rates.

The over 50 million A 'deferred' shares would only vest in UB if the company was able to ensure 765 cents accumulated value per deferred share. This was calculated based on a formula linking the 'quantum and profitability of South Africa-sourced new business volume growth in Sanlam' (Verhoef, 2018: 321). Put simply, UB would only be able to convert the deferred shares if their involvement in Sanlam's business ensured that the firm was able to source new work. In this way, Sanlam would put to work the wide and broad-based consortium in pursuit of new business. The bulk of new business volume would emerge from individuals and groups in the low-end and entry-level market (who by and large were from the same communities as many UB shareholders), through Sanlam Sky (the rebranded name of African Life Assurance). In the process, Sanlam would – in the heady days of the 2007–8 crisis – launch MiWay; establish Sanlam UK Ltd, and make investments in emerging markets like India, Nigeria, Malawi and Uganda. Luckily for UB shareholders, it also had a strong enough balance sheet and cash flow position to pay dividends at the height of the financial crisis.

These new businesses, with their attendant volume rises, would prompt Sanlam chair Johan van Zyl to observe, in 2018, that, ‘at least half of Sanlam’s entire bottom line is generated by businesses which have either been bought or created in the past 15 years’ (Van Zyl in Cranston, 2018). This view acknowledged that in a transitional society much of Sanlam’s future earnings would be from new acquisitions and initiatives. This success would not have been possible if Sanlam had kept its focus on its traditional Afrikaner middle market.

Ubuntu Botho participation did not only allow the firm to comply with legislation; but also facilitated a strategic shift and operational focus away from its core Afrikaans middle market towards a black, entry-level mass market. In the face of growing competition in the financial services sector, this may have been a masterstroke. Ubuntu Botho’s shareholders had created more than R15 billion in value from an initial R1.3 billion investment, with the share price increasing from R7.50 in 2004 to R52 in 2014 when the deal unwound. Unencumbered by debt, they were poised to take a greater stake in the operations of Sanlam and, by 2018, the UB consortium held a controlling stake in Sanlam Investment Managers (SIM) and, in its second deal with Sanlam, would emerge as the largest sole shareholder in the company. The firm which was started to bankroll Afrikaner empowerment in 1918 was now proffering a different experience of BEE implementation.

ABSA’s Batho Bonke Deal

ABSA went into a BEE deal in 2004 having learned significantly from earlier experiences of BEE deal design. The principles behind the deal reflected the need for participants to immediately be able to add meaningful value to ABSA; another important principle was that new ownership should be broad-based. The Batho Bonke consortium emerged from these principles and consisted of Sexwale’s Mvelaphanda Holdings; Yard Capital; Nthobi Angel; community trusts; an employee share scheme; individual businesspersons and NGOs (See Table 9.2 below). The recruitment process also involved roping in former ANC activists such as Mkhuseli Jack, James Ngculu and former Black Business Council chair David Moshapalo as regional coordinators to mobilise consortium members at a provincial level.

The Batho Bonke Consortium

Table 9.2

Consortium Member	**Ownership Stake in Consortium**
Nine Regional Groupings	27%
Mvelaphanda Holdings – *Tokyo Sexwale*	20%
ABSA Grouping – *Employees, select historically disadvantaged South Africans (HDSAs)*	15.7%
Other Broad-Based Groupings	13.3%
Yard Capital – *Leslie Maasdorp*	10%
Nthobi Angel	10%

Black Women's Grouping	4%

Source: (Sharenet, 2004)

ABSA would create a new class of shares (redeemable option-holding shares with a R2 par value) aimed at benefitting more than 1.17 million beneficiaries (McKune, 2012). Over 73 million of these shares would be issued to the consortium and another 7.3 million would be issued to an employee trust (Sharenet, 2004). This consideration, at the cost of R146.3 million, would be financed by third parties (Sharenet, 2004). The consortium would have a right to nominate one director to the ABSA board for each 5 per cent shareholding in the firm. This deal would eventually provide Batho Bonke with 10 per cent of ABSA's share capital. In 2004 Reg Rumney from empowerment advisory firm BusinessMap suggested that the deal design exhibited classic SPV characteristics, which would only unlock real value for shareholders once the share lock-up ends (Rumney, 2008). In this case, after a three-year period, the consortium could exercise their options and convert their preference shares to ordinary ABSA shares.

The deal was financed in two ways. The consortium put up R7.3 million and the remainder came from Sanlam. The consortium's share was financed by Sexwale's Mvelaphanda Holdings. In September 2005 Mvelaphanda Group would acquire a further stake in the Batho Bonke group, which would allow it a slightly larger stake in ABSA. This was largely in response to efforts by British bank Barclays to take control of ABSA, which led to rapid rises in ABSA's share price. When Barclays acquired ABSA in 2005 the Batho Bonke consortium had the rights to exercise options to acquire its 10 per cent stake in ABSA at a strike price of between R48–R69 a share when the lock-in expired in 2007. The Barclays acquisition pushed up the ABSA share price to just shy of R100. By 2007, Batho Bonke was considering exercising the options it had in the company now owned by Barclays. Former CEO of Mvelaphanda, Yolanda Cuba, suggested in a news report at the time that Mvelaphanda wanted UBS to advise them on the timing of the exercise (Mvelaphanda, 2009). The reason for this was that the consortium could exercise its options to exchange the stock for ordinary shares from July 2007 through to June 2009. However, a lot could happen to the share price in that period.

At the start of the strike period in July 2007, the share price was trading at R125.85 a piece, which was almost three times the share price of R48.056 attained in June 2004. The spectacular rise in the ABSA share price motivated the consortium to 'time the market correctly' and make the most money. They could do this, because of the shorter lock-in period that this deal had, but also because timing the market right would mean paying off the debt and realising value more quickly. There were also downside risks. By the time the 2007–8 financial crisis hit South African markets, the share price of ABSA hovered in the R70–R95 band for most of 2008 and the early parts of 2009.

In June 2009 Batho Bonke decided to exercise their share options, and this happened in two related parts. The first involved a repurchase by ABSA of half of their shares from the consortium (Mvelaphanda, 2009). This meant the cancellation of 49.9 per cent or 36.5 million worth of option-holding and redeemable preference shares. Second, the consortium then indicated to ABSA that they would exercise the remaining 50.1 per cent and acquire 36.5 million ABSA ordinary shares. This would be done through R818 million (to purchase 11.97 million shares) of the R988 million received from the ABSA repurchase; the remainder (24.68 million shares) would be provided through a three-month back-up funding facility extended to Batho Bonke for R1.68 billion (Mvelaphanda, 2009). This was done through ABSA acquiring and subscribing to Batho Bonke preference shares (Mvelaphanda, 2009).

Strong share price performance meant that the Batho Bonke group was able to conclude and raise third-party funding, which allowed it to finance its purchase of 36 649 300 ABSA ordinary shares to the tune of R1.68 billion and effectively pay back the ABSA back up facility from September 2009.

Raising this finance allowed Batho Bonke an effective 5.1 per cent shareholding in ABSA and paved the way for the winding down of the deal in 2012 (Sharenet, 2009).

By March 2012 ABSA was trading at R153.21 per share. This highlights the importance of share price movements (which are largely driven by exogenous market sentiment) to the value of the payoff to shareholders. Unlike the Sanlam deal, the Batho Bonke deal was subject to the vagaries of the market, largely due to its SPV characteristics and the focus on dividend payments and equity upside. Sexwale's Mvelaphanda had learned by then the financier's trick and, in putting the consortium's initial R7.3 million skin in the game, had structured the payment of this initial contribution, in typical SPV fashion (McKune, 2012). As McKune (2012) suggests, the payment of this R7.3 million was structured in a way that suggested that whichever was higher of the following two scenarios would accrue to Sexwale's Mvelaphanda:

- **Payment of Loan:** The loan plus interest at prime plus 5 per cent assuming compounded monthly interest, which by 2012 would amount to R28 million payable to Mvelaphanda
- **'Equity Upside'**: An upside of 25 per cent of the value realised by Batho Bonke members. This calculated on the R2.2 billion value realised by the consortium (after debt). This equity upside would have given Mvelaphanda a repayment of close to R300 million according to McKune (2012), a windfall compared to the R7.3 million provided upfront (by 2012, the 25 per cent upside was reduced to 12.5 per cent)

The Batho Bonke example also underscores the limitation of even a good share price trajectory in the presence of debt. Despite good share price movements, deal participants' benefit was limited due to financing of involvement, by Mvelaphanda and Sanlam initially, and later by other third-party financiers. Moreover, the Batho Bonke and Ubuntu Botho examples indicate the importance of selecting which variables deal performance will be reliant on**.**

In the case of Ubuntu Botho, the deal pivoted around the performance of the underlying business and the generation of new business volumes, rather than on an exogenously determined share price and interest rate movements. In the case of initial capital contribution, both deals had initial 'skin in the game'. In the Sanlam case, it was Motsepe putting forward the initial capital and, in the ABSA case, Mvelaphanda used the SPV approach to put up Batho Bonke's initial contribution, and in so doing may have doomed the consortium to an early death, as many participants (including Sexwale's own comrades like Mathews Phosa) expressed dissatisfaction with the impact that the Mvelaphanda loan repayments had on the final payoff to the more than one million beneficiaries of the scheme.

The nexus between operational performance, share price performance and financing is linked to our earlier discussions on financialisaton and its impact on disembedding accumulation from production (Von Holdt, 2018). In many ways, recent deals (as discussed below) have tried to re-embed operational dynamics (which management teams can at least control) back in the deal mix. This has been in pursuit of a different social, economic and market structure outcome. The chapter discusses a few recent examples below.

Emerging practices in broad-based deal design

This chapter has discussed that there are key features in the old model of BEE which were revisited in the 2000s, and many of which remain to this day. Among the features that have shifted from the early deals is the requirement to be broad-based. New features also include the role of the target firm as both a facilitator of finance (through guarantees) and, in the case of vendor financing, directly funding the deals. Some of the features that remain include the 'lock-ins', which effectively make many of the deals illiquid for black investors.

In this final discussion the chapter considers two deals in sectors outside the MEC complex. The section goes beyond the deals in the MEC complex to underscore not only key structural shifts in the South African economy to wean it of its reliance on these sectors, but to also understand what role, if any, BEE can continue to play in diversifying and transforming the South African market structure. The focus is on Barloworld's Khula Sizwe deal (logistics, automotive and equipment sector). Then the chapter examines an industry key for the fourth industrial revolution and future economic prospects: the telecommunications sector. The analysis focuses on Vodacom's *YeboYethu* deal. Unlike the auto, logistics and equipment sectors, the telecommunications sector is subject to state licensing, giving the government considerable leverage and encouraging deal activity in the sector.

Barloworld Khula Sizwe

Barloworld began in 1902 from a thousand pound loan by Major Ernest Barlow. The company initially sold woollen goods, blankets and coats from Durban and later expanded to sell engineering supplies. Like many South African firms with international reach (Barlow Rand had already acquired foreign businesses by the 1980s), the firm unbundled its non-core businesses between 1993 and 1994 and rebranded as Barlow Limited. In 2000 it changed its name once again to 'Barloworld' and, after multiple disposals of non-core assets, focused its attention on three revenue drivers: equipment, automotive and logistics. Barloworld first entered a BEE deal in 2008. The deal transferred 10 per cent of the entire company's global operations into black ownership. This was exactly the amount required in the ownership element of the B-BBEE Codes to receive bonus points for the involvement of black new entrants in the enterprise.

If one strips out the international operations, this amounted to 29 per cent of its domestic operations (Rumney, 2008). The financing mix mirrored the shifts in the second phase of BEE referred to earlier. The deal was financed through a mix of cash donations, financing from Barloworld, and own contributions on the part of strategic partners and community groups (Rumney, 2008). The deal was struck after significant pressure from the Public Investment Corporation (PIC) on Barloworld to transform and involved a wide array of strategic black partners (including Hixonia Nyasulu's Ayavuna and Sipho Pityana's Izingwe Capital), employees, an educational trust and a community group.

The funding structure included a R1.5 billion term loan guaranteed by Barloworld to ensure competitive cost of capital; a R40.4 million equity contribution from the strategic black partners; a R4.5 million equity contribution from community groups; and a Barloworld-facilitated contribution of R504 million on behalf of black managers and the education trust (Van der Merwe, 2008). The deal closed with R281 million worth of shares vesting to over 11 000 staff and 2 million shares issued to close-out the deal for the strategic black partners. How the deal unfolded beyond this is beyond the scope of this discussion. However, it is worth mentioning that, according to the current Group Executive for Human Capital, Tantaswa Fubu, the underperformance of the deal in the final analysis was largely due to its performance being linked to the performance of the Barloworld share price, rather than any operational performance indicators. This is what the new Khula Sizwe scheme sought to remedy.

In 2019, close on 11 years after the first deal, Barloworld announced the Khula Sizwe scheme as the earlier deal unwound. According to Fubu, this deal was structured with 'strong principles around deal design' (Fubu, 2019). The three main principles for the deal were that it first had to be 'the least dilutive' deal structure; second, it had to be broad-based; and third, the longevity of the deal had to ensure value transfer for BEE shareholders and stem the frequency of such deals.

The deal exhibited two elements worth discussion. The first was the role it envisaged for the Barloworld Empowerment Foundation and the Property Company (PropCo). Regarding the latter, the Khula Sizwe transaction envisaged the sale of its operating property portfolio to a black owned consortium, Main Street. Fubu described the process as one that would not be shareholder 'dilutive' (Fubu, 2018):

> Those properties have been identified and they are worth R2.8 billion. From that figure, there is a 5 per cent discount being given to the black property company. The property company will then buy the properties, and Barloworld will then enter into a sale and lease agreement with the black company. The black company on the other hand is getting into a financing agreement with an external finance house for 80 per cent loan to value. That R2.2 billion goes straight to Barloworld, and the beneficiaries of the property company being the employee trust, the management trust and the black public.

Regarding the Foundation, it would be a 3 per cent shareholder in Barloworld, holding this stake directly. The Foundation, to avoid dilution, would be consolidated into Barloworld and therefore the shares it had in the firm would be deemed as treasury shares. The work of the foundation, Fubu suggested, would be largely financed through dividend flows, which the firm has begun to model (Fubu, 2018):

> We expect by the first year that there will R30 million in dividends flowing to the Foundation, whose work will be focused on education, youth empowerment and poverty alleviation, with 60 per cent black females as beneficiaries.

The deal also carried features very similar to other deals, even the earlier ones such as the Johnnic-NEC tie up. One of these features was open retail-level access to shares for members of the black public. A key structural feature in the design of the Barloworld Khula Sizwe scheme that requires mention is the focus on disembedding value realisation from share price movements. Fubu suggested this was a key consideration in how Barloworld designed the deal, especially as it relates to the Property Company (PropCo) (Fubu, 2018):

> Barloworld will lease back the property from the PropCo, and over 10 years pay rental to the company. This money will be used to settle the 80 per cent loan. In our modelling, we envisage value coming through from the sixth year because of the large amount borrowed. Whatever value the PropCo derives, will have to buy Barloworld shares, so by the time they acquire those shares, they will not be encumbered.

The deal, aside from pursuit of a broad base of participants, is also focused on shareholder value maximisation, a key and consistent feature in the literature on financialisaton. However, the way in which the shares are acquired introduces some interesting features. The deal consists of a mix of 'free carry' treasury shares for the Foundation, more favourable credit terms and a focus on operational, rather than solely board-level, involvement of empowerment partners. The transfer of cash-generative assets like a property portfolio with predictable rental cash flows is not only better than value-based share-price volatility but also incentivises the retention of unencumbered stakes in the target firm. Below this chapter considers the most recent BEE deal in the telecommunications sector, entered into by Vodacom.

Vodacom YeboYethu

The telecommunications sector and its rapid development in South Africa was intimately tied to key political and social shifts characteristic of a society in transition. The negotiations at the Congress for a Democratic South Africa (CODESA) became the stage for a tense debate between the ANC and its alliance partner COSATU, and the National Party government over the licensing of cellular spectrum. This after the National Party government unilaterally awarded network licenses to Vodacom and MTN (Gqubule, 2006: 107). A compromise was reached that ensured that MTN would make 30 per cent of its equity available for black shareholders and Vodacom would make 5 per cent available and provide opportunities downstream.

Vodacom, then partly owned by Vodafone and Telkom, was always going to be operating in a sector influenced by state policy. The duty to license spectrum rests with the government (and its agencies) and Vodacom would later recognise the commercial importance of empowerment in its Integrated Report (Vodacom, 2008: 3):

> Vodacom drives Black Economic Empowerment (BEE) participation vigorously in order to leverage economic opportunities and potential within the South African business arena. Underlining our commitment to the draft ICT Sector Code on BEE, management was tasked to submit proposals to the Vodacom Group Board for equity participation by suitable BEE entities.

These suitable entities came in the form of Royal Bafokeng Holdings and Thebe Investment Corporation. Royal Bafokeng Holdings is an investment vehicle of a traditional community in the North West. Thebe is the ANC-linked investment vehicle that had achieved considerable success by 2008. The first iteration of the ICT sector codes set a 30 per cent equity target or an ‘equivalent’ black ownership stake worth R7.5 billion or more (Gedye, 2005). Unsurprisingly, the value of this first deal was to the tune of R7.5 billion. As it is with compliance, just enough to meet the Codes and no more.

The first YeboYethu deal was structured to provide marginal but not at all insignificant ownership stakes in Vodacom’s South Africa business to Thebe (0.84 per cent); Royal Bafokeng (1.9 per cent); and the YeboYethu Company (3.44 per cent) (holding the stakes of the black public and Vodacom’s employee stock ownership programme (ESOP). The remaining over 90 per cent in equity was retained by the Vodacom Group.

One feature of this deal, which distinguishes it from some of those discussed earlier, is the arms-length relationship embedded in the deal design. YeboYethu members (the black public and employee share scheme) were, as current chief executive Shameel Joosub described, ‘one level removed’ from listed Vodacom, although their dividends and payment of the vendor-facilitated finance was determined by developments in Vodacom at ‘group-level’ (Joosub, 2018). This created a ‘buffer’, quite like the first Barloworld deal, between the ‘selected’ and ‘suitable’ BEE vehicles and the ‘broad-base’ (workers and the black public). The financing for the deal for the black public in this instance came in the form of a 10 per cent discount; 16 per cent ‘skin in the game’ stake was offered to any member of the black public for a of R2500 retail deposit, plus 74 per cent vendor financing.

Unlike some of the examples we’ve discussed, this deal yielded some value for the ‘black public’ as Joosub later recounted (Joosub, 2018):

> If you invested R2500 in 2008, it is now worth more than R16 000. A close to six-point-seven times growth in value. so, it's R7.5 billion of value, which is 'net' after debt. So, this is real value that has been achieved.

The 'replacement deal' was announced by Vodacom in 2018 as it unwound the first Yebo Yethu deal, with a special dividend and a stake in the new scheme. The deal had the same actors (Yebo Yethu, black public and employees, Thebe, Royal Bafokeng and Vodacom). The deal, valued at R17.5 billion, allows current black shareholders to invest R4.5 billion in the new deal, with a discount from Vodacom and a remainder of R10.5 billion funded at just over two thirds of the prime interest rate. This is in stark contrast to the deals of the early nineties and their 20 per cent + cost of capital in a high interest rate environment.

The other key feature of the deal was that it would bring black players closer to the 'action' when it came to Vodacom, the listed global entity, rather than the local unlisted operations. This is important as it not only gives black shareholders access to the value embedded in the Vodacom share reflecting its international operations as well but also makes for more convenient market price discovery.

This deal had one similar feature to the Barloworld deal discussed above, which is instructive. It allowed black shareholders to be exposed to the tradable and 'liquid' listed Vodacom Group, at a discount and at a cost of capital more favourable than would have been seen in the 1990s. In retaining the first set of shareholders and carving out a stake for employees and the black public, the deal is as 'broad-based' as many of the earlier deals. However, unlike the Barloworld deal, it is not tied to a cash generative operational asset (like property) and is therefore subject to macroeconomic shifts (interest rates), a weak share price and other factors beyond the control of broad-based parties. In this regard, only time will tell whether it will face the same vulnerabilities.

Concluding remarks

By the time that the ill-fated Sasol Inzalo deal (launched in 2008) unwound, Sasol executive Bongani Nqwababa would note in an interview that the key lesson learned from the deal was that underlying business performance is a better variable to follow than exogenously influenced share price movements. He said that 'by changing the scheme to make sure it is based on underlying business performance rather than the share performance which has all manner of exogenous factors …', there was greater prospect for value realisation by all stakeholders (Nqwababa, 2018). This is what was patently clear in the deals that have ensured not only value realisation but longevity of participation. The Sanlam Ubuntu Botho partnership is one such example.

This chapter contends that the outcomes of BEE transactions are not only influenced by the financing and composition of deals. On the contrary, it suggests that key features of deal design, if they are to achieve the objectives of B-BBEE, need to re-embed operational and production-related measures of involvement and support. This will lead to a shift in the demographic and structural features of capital in South Africa. In many ways, if both public policies and corporate strategies are determined to leverage B-BBEE in the national interest, a return to what Marxists refer to as the 'sphere of production' rather than the 'sphere of exchange' is what is needed. Many of the earlier deals were structured for a sunny day or bullish markets. It is welcome therefore that the structuring of many contemporary deals aims to re-embed firm-level operational and production considerations, rather than share price movements, in deal design. This change came about as a result of the lessons learned from the experience of the NEC, Vodacom's first YeboYethu and other earlier deals.

In so doing, the recent deals also confront the moniker given to black participants of 'paper tigers', by ensuring operational involvement of BEE partners. Policy will have to respond to the illiquid nature of these investments, guaranteed by extensive lock-in periods, which prevent participants from liquidating their positions or, if they do, obliging them to sell these stakes to black players. It will, as the B-BBEE Commission has also started to do, consider the vehicles that facilitate broad-based participation, and whether these facilitate effective ownership, involvement and control. In the absence of this, form will trump the substance of these deals and make ever louder the calls for newer, more inclusive and least costly deals.

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