BLACK ECONOMIC EMPOWERMENT FUNDING EFFICIENCY: A SOUTH AFRICAN PERSPECTIVE

THANDI SUSAN NHLAPO

Dissertation submitted in partial fulfilment of the requirements for the degree of MASTER IN BUSINESS ADMINISTRATION MANAGEMENT (MBA) at the NORTH WEST UNIVERSITY

Study Leader: Prof Ines Nel
POTCHEFSTROOM
March 2008

ABSTRACT

The South African government, in an attempt to accelerate economic growth and development, promulgated Black Economic Empowerment legislation. Immediately thereafter, a number of BEE transactions were concluded. Yet the success reported on these transactions has not been as successful as anticipated in supporting the BEE objectives. Such failures were associated amongst others with the funding models used. The challenge has been to implement structures and funding models that will be able to fund black partners requiring 100% loans.

Unfortunately, such funding is exposed to factors such as interest rates, cash flow and share price performance. One of the possible solutions to support the BEE funding models has been to reduce the cost of capital through low interest rates (using vendor finance) and reducing the price of the assets through discount offered on the shares. In order to identify possible solutions, different types of models were assessed, to determine the efficiency of these models, including vendor finance, derivatives, third party finance and performance based models. Secondly the sustainability of the BEE transactions was determined. The study attempts to look at better ways to fund the BEE transactions and ensure that funding models support the overall BEE objectives.

ACKNOWLEDGEMENTS

I wish to thank the following individuals who played a role in the betterment of the dissertation:

- Firstly God, for always being my greatest supporter and being the provider of strength for me to complete the dissertation

- My family for understanding and being patient with me always.

- My previous employer for providing funding to study MBA

- Prof Ines Nel, for believing in me, supporting me and being patient

- Lastly, my best friend for her words of encouragement

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

For the purpose of this study, the following definitions and abbreviations have been adopted:

ANC	African National Congress
BEE	Black Economic Empowerment
BBBEE Act	Broad Based Black Economic Empowerment Act 53 of 2003
BEECom	BEE Commission
The Codes	The Codes of Good Practice
BEFM	Black Empowerment Financial Models
CHARTERS	Sector Transformation Charters
DFI	National Development Finance
DTI	Department of Trade and Industry
FIRST WAVE	Phase One (1994 – 2003) of BEE Funding
HDI	Historically Disadvantaged Individuals
ICT	Information and Communications Technology
IDC	Industrial Development Corporation
JSE	Johannesburg Stock Exchange
NPAT	Net Profit After Tax

NEF	National Empowerment Fund
PDI	Previously Disadvantaged Individuals
SDA	Skills Development Act 97 of 1998
SETA	Sector Education Training Authority
SECOND WAVE	Phase Two (after 2003) of BEE Funding
SMME	Small to Medium and Micro-Enterprise
SPV	Special Purpose Vehicle
SPE	Special Purpose Entities
The Codes	The Codes of Good Practice

Table of Figures

Table of Tables

CHAPTER 1: NATURE AND SCOPE OF STUDY

1.1 Introduction

The attainment of political liberalization has increased the need to focus more attention on social challenges. Since 1994, certain critical economic and social challenges remain unresolved (Antonites, 2003:1) such as unemployment, poverty, and inequality, as well as policies and practices that excluded the majority from participating in the mainstream economy. According to the Statistics South Africa (2008:10), the level of unemployment remains high even though it has declined in recent periods. For example, unemployment rate during September 2007 was recorded to be around 23.0 percent.

The introduction of the Black Economic Empowerment (BEE) programme in the post-1994 era is part of the new democratic government strategy of integrating the increasing number of previously excluded individuals to participate into the mainstream of the economy. The main objective of the BBBEE Act (Act 53 of 2003) is to ensure that South African enterprises achieve certain predetermined empowerment targets in terms of various existing legislations and to developed transformation charters. These include transformation charters from different sectors such as Mining, Liquid Fuels, Financial Services and Information and Communication Technology. Specifically, the targets are aim at increasing overall ownership by BEE-certified enterprises to a quarter of the private economy within a period of ten years.

The rapid proliferation of empowerment legislation, coupled with looming empowerment deadlines and the need to achieve empowerment targets, has precipitated a flurry of empowerment-related deals. Despite all these BEE transaction deals, according to Wu (2004:3), blacks still own only 1.6% of stocks listed on the Johannesburg Stock Exchange (JSE), which represents an insignificant real transfer of economic benefits to previously disadvantaged groups. Several articles have been circulated, speculating on the main factors that prohibit considerable progress of the BEE programme from meeting its key objectives. Some of the key challenges the programme are faced with have centred on the complex funding structures and models to finance BEE transactions.

1.2 Background and importance of the study

According to Timmons and Spinelli (2004:37), entrepreneurial activity is an essential prerequisite for economic growth, development, social well–being and political stability. De Klerk (2006:6) has argued for a broad measurement of success relating to BEE deals, which include a substantial increase in ownership and control of existing and new enterprises, in addition to a significant increase in the number of new black enterprises, black-empowered enterprises and black-engendered enterprises.

The main challenge however is that BEE deals are faced with funding constraints due to the fact that it is not considered a corrective policy instrument but a normal commercial transaction without in-built concessions that will support BEE objectives (Taljaard, 2004:28). As a result, the majority of the BEE deals are exposed to general commercially used risk evaluation method and market conditions; for example, risk includes amongst others high interest rate charges. In particular, interest rates have tended to exacerbate the challenges faced by BEE transactions by raising the cost of third party finance to black investors. As a result, constraints around BEE funding models have been instrumental in shaping the way BEE transactions are financed and structured. These challenges have also put government under pressure to review its overall BEE approach and strategy.

1.3 Problem statement

The shortage of so called "black capital" is the key obstacle to a successful BEE programme (Cargill, 2005:22). Black businesspeople are often forced to borrow 100% from third parties to finance BEE transactions, which may lead to high levels of financing costs. Specifically, the lack of collateral and equity contribution may result in BEE transactions having to use high-debt that attract high-risk financial structures, increasing the vulnerability of BEE transactions specifically during economic downturn. According to Cargill (2005, 23), BEE partners rely heavily on dividend payment and share price growth to service and repay debt. However, in most cases company earnings are insufficient to cover interest and capital repayments leading to the sale of the BEE partner's shares during the financing term. The threat of highly geared funding structures has been evident in empowerment initiatives such as Nail and Johnnic. These empowerment initiatives failed to transfer economic benefit and equity to previously disadvantaged individuals. As a result some transactions had to be refinanced.

In response to the funding challenges confronting the way in which empowerment deals have been financed, new funding models and structures such as vendor finance, performance-based funding, third party finance, and derivative instruments have been developed. However, further analysis is still required to understand the effectiveness of the new generation of transactions using new funding models and whether it would be sustainable. The challenge of establishing mutually beneficial funding structures and models remains a pivotal aspect for most BEE transactions.

1.4 Objective of the study

The main objective of the study is as to:
Investigate whether the funding models used to finance BEE transactions are efficient for the creation of sustainable BEE transactions.

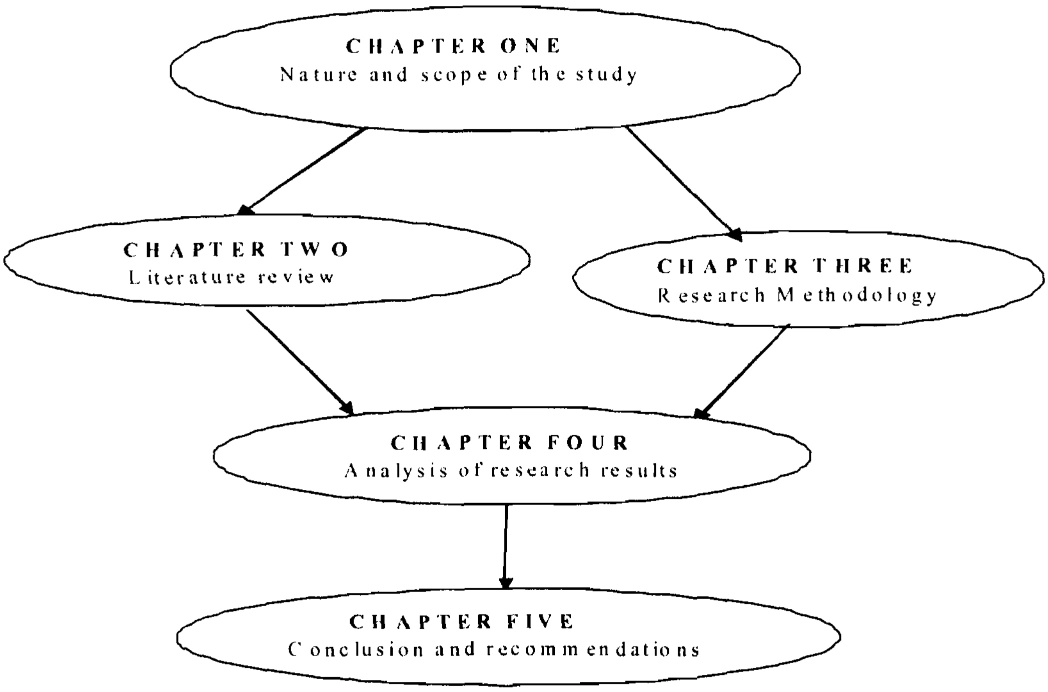
The sub Objectives are to:

i. To assess whether BEE models used support BEE objectives
ii. To define different types of BEE funding models/ structures used during the first and second phase

1.5 Layout of the study

The study follows a logical progression to build up to the specific research problem. The investigation starts with a thorough and broad literature review based on black economic empowerment and the assessment of efficiency on funding models used to finance BEE. Then it designs the research instrument and concludes by presenting the research findings and recommendations.

Figure 1.1 Layout of the study



1.5.1 A brief overview of the study

Chapter 2 deals comprehensively with literature review of BEE funding models used during the first and second phase. Black Economic Empowerment concept in the South African context. It aims at gaining a deeper understanding of BEE for the chosen subject and act as the foundation for conducting research.

Chapter 3 focuses on gathering of data and empirical investigation on the data obtained from a selected group of BEE partners, consultants and funding institutions.

Chapter 4 will focus on the interpretation of empirical results by means of qualitative and quantitative analysis. The results will be integrated into the concepts identified during the literature review to develop a structured approach in the analysis of funding models.
Chapter 5 will provide the concluding overview attempting to make the reader understand the funding models used in South Africa. The findings in chapter 4 will be discussed in relation to the research objectives, the shortcomings of the study and the recommendations that focus on addressing the identified obstacles, provide summary research and conclusions on the research of efficiency in BEE funding models.

1.6 Limitation of the study

The research study deals with the assessment of the effectiveness of the BEE funding models and is limited to experiences within the South African context. Data collected will include journals, previously researched articles and the broader BEE body of knowledge. Where information is not available reasonable assumptions will be made.

1.7 Conclusion

Economic transformation and empowerment in South Africa has been viewed as the critical strategy in addressing the imbalances of the past and accelerate economic growth. This has led to the development of empowerment legislations and BEE targets through sector charters. With all these mechanisms in place, South Africa has seen an increase in the number of BEE transactions; yet very few of these have survived. Lack of capital and collateral required by BEE partners is seen as a major obstacle that continues to hinder the success of BEE transactions. Government has been required to come up with BEE funding models that will be used for BEE transactions whilst supporting BEE objectives.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

Prior to discussing Black Economic Empowerment (BEE) funding models, one needs to understand the meaning and origin and objectives of the BEE in the South African context. In the post-apartheid era, the new government that came to power in 1994 has been faced by huge economic inequalities, persistent poverty and high levels of unemployment. The social and economic implications of the previous laws of apartheid excluded the majority of South African people, mainly black people, from the mainstream of the economy.

To address inequalities, combat poverty and reduce unemployment, government promulgated empowerment legislation and policies in the form of Employment Equity Act (Act 55 of 1998), Skills Development Levy Act (Act 9 of 1999) and Preferential Procurement Policy Framework Act (Act 5 of 2000) and encouraged the development of BEE charters for all sectors to support the empowerment and transformation of the economy. Key to this transformation has been the Black Economic Empowerment (BEE) programme. South Africa adopted the same concept of empowerment that has been used widely in other countries such as the USA, India, Canada and Malaysia.

The objective of this chapter is to give a literature review on Black Economic Empowerment and to define the types of empowerment funding models that were used during the first and second phase of BEE implementation. In analysing the different models, one will be able to identify advantages and disadvantages; similarities as well as restrictions and contradictions amongst the BEE funding models that are commonly used in South Africa.

2.2 Definition of Black Economic Empowerment

Black economic empowerment is defined as a multi-layered, multi-pronged strategy that requires achievement at a higher level while simultaneously contributing to the development of disadvantaged individuals and groups (De Witt, 2003: 36). This definition now behoves government and the private sector to jointly formulate an integrated government driven strategy. BEE strategy is aimed at substantially increasing black ownership at all levels in the economy. The strategy tries to redress the imbalances of the past by transferring more ownership, management and control of South Africa's financial and economic resources to the majority of its citizens. It also aims to ensure broader and meaningful participation in the economy by previously disadvantaged people (BEE Commission report, 2001:2).The strategy should embrace the key components of Black Economic Empowerment governed by the Broad-Based Economic Empowerment Act (Act 53 of 2003).

The above definition has been adopted in establishing the BEE Act which regulates the objectives of BEE, the establishment of the BEE Advisory Council, the BEE strategy to be formulated by the DTI, the sector transformation charters and the financing of BEE transactions (Strydom, 2006:1). The principal objective of the BEE Act is to redress the apartheid induced economic inequalities and disparities by:

i. Promoting economic transformation in order to enable meaningful participation of black people in the mainstream economy; and
ii. Achieving a substantial change in the racial make up and composition of ownership and management structures of existing and new enterprises.

One can identify distinct principles that constitute the foundation of the Strategy document:

i. BEE should drive economic growth and development.
ii. BEE entries should promote the highest standard of corporate governance.
iii. BEE activities should include all the sectors (private, public and non governmental); and
iv. BEE should accelerate the incorporation of historically disadvantaged into mainstream economy. The document also spells out BEE targets and timeframes and also describes the meaning of various forms of black ownership and control.

2.2.1 Distinguishing features of black enterprises

In terms of the BEE commission report (2005:5), the following is the definition of black economic empowerment companies:

i. A black company is one which is 50.1% owned by black persons and where there is substantial management control by black people. Ownership refers to economic interest while management refers to the membership of any board or similar governing body of the enterprise.
ii. A black empowered company is at least 25.1% owned by black persons and where there is substantial management control by black people. Ownership refers to economic interests, while management refers to executive directors.

iii. A black woman owned enterprise is one with at least 25.1% representation of black women within the black equity and management portion.

The code explains the approach to be adopted by the government in the measurement of BEE compliance. The strategy and the BEE Act clearly articulate the government's current policy on BEE.

2.2.2 Shortcomings of the first phase BEE implementation

During the first phase of BEE implementation between 1994 and 2003, emphasis on BEE was largely on equity transfer. Hence there was a flood influx of BEE transactions. Government was criticized for empowering the few elites. BusinessMap report (2000:15) highlighted the following as the shortcomings after the first five years of black empowerment:

i. Empowerment has been too narrow, only focused on corporate ownership and control.

ii. BEE benefited only a limited pool of beneficiaries, hence the critique of "enrichment of the few".

iii. A number of beneficiaries have shares in more than one company and hold director's positions in a number of companies.

iv. Since empowerment is premised on acquisition, there has been lack of organic growth in wealth and therefore lacked the necessary sustainability over time.

v. Too little attention has been paid in transforming corporations and transferring skills.

vi. Most black shareholders were not taking part in the running of the business and thus unable to understand the operations of these companies, with strategic decisions still in the hands of white people.

vii. Venture capital was not made available to black businesses. Hence, the use of complicated funding structures that were introduced to help black shareholders without capital to acquire large amounts of shares. More emphasis fell on transferring control of major corporations to inexperienced black companies, with the old control structures remaining intact.

viii. The distortions of or deviations from business principles and practices were extreme. In order to accommodate BEE, certain business rules and regulations such as company law and tax law had to be contravened.

ix. In an attempt to give previously disadvantaged individuals access to the business sector, financiers and established white-owned companies paid less attention to the conditions and requirements which prevail in any regular investment. Risk-taking, reporting mechanisms and performance linked remuneration played little role in the corporate-related BEE arena; and

x. Government has been the primary motivator for empowerment related investments and has forced companies to enter into equity relationships with black groups by specifying empowerment conditions for state contracts, licenses or quotas, While government has used its buying power to encourage commitments to training and affirmative action, as well as small enterprise and community development, its own approach to empowerment has been *ad hoc and* without a coherent strategic framework. This led to increase in fronting tactics rather than buy-in and proper implementation by the corporate.

Given these failures and criticism, the government strategy was seen as a failure in meeting the envisaged objective of poverty alleviation and reducing unemployment. In the late 1990s, the government began a review of where the country was heading with the BEE programmes in place. The true meaning of BEE was debated; with the aim of ensuring that the process followed will include economic benefits in the economy to previously disadvantaged people rather than simply transferring assets only.

The DTI revised the Black Empowerment Act, to address the shortfalls and challenges of the first phase implementation of BEE. The Broad Based Black Economic Empowerment Act which aims to extend BEE to a significantly broader base of enterprises and individuals was introduced. The broad based approach does not only consider equity and ownership but include other elements of direct empowerment, indirect empowerment and human resource development and putting emphasis on including women and people with disabilities to be part of empowerment.

2.3 Broad Based Black Economic Empowerment (BBBEE)

Government saw the need to change its strategy and focus more on broad based empowerment. During the ANC National Conference held in Stellenbosch in 2002, the essence of the BEE was re-examined (BEE Commission report, 2002:3). Where after current government BEE policy document was put forward "as a comprehensive black economic empowerment strategy that draws together the various elements of government's transformation programme in a more coherent and focused way" (department of trade and industry, 2003: 11). The emphasis was to look at the concept of BEE in a broader and more inclusive context.

The Broad Based Black Economic Empowerment Act (Act 53 of 2003) was introduced to serve as the legal roadmap towards achieving a fair and equitable right of participation in the economy. The Act provides various guidelines and a legal foundation for the transformation of companies.

The purpose of the Act is to facilitate black economic empowerment ('BEE') by increasing participation in the economy by all previously disadvantaged people – including women, workers, youth, people with disabilities and people living in rural areas, through diverse but integrated socio-economic strategies. These strategies include affirmative action (or 'employment equity'), skills development, encouragement of small black business through targeted procurement polices, social investment, ownership and management structures. The broad based concept began to emerge strongly with the introduction of the Codes of Good Practice and the BEE Scorecard.

2.3.1 Transformation Charters

Transformation charters were introduced and drafted by representative bodies of specific sectors or industries. The sector charters served as evidence of the commitment by all stakeholders to promote BEE in the applicable sector (De Klerk, 2006:11). Sector representative bodies are responsible amongst others for approving and confirming BEE ratings and annual audits of institution. In short, sector representative's bodies regulate the charter that touches most aspects of the SA business landscape.

Since the beginning of 2004, a number of sector transformation charters have been drafted and signed which included the Energy and Liquid Petroleum Charter, the Mining Charter, and Financial Sector Charter (Luiz and Van Der Linde, 2006:407). According to the BBBEE Act (Act 53 of 2003), Transformation charters must be published and promoted by the Minister of Trade and Industry once evaluated and confirmed to have met the objectives of the BBBEE Act (Department of trade and industry, 2005: 3). The codes of good practice on section 9, statement 010 provides guidelines for the development and gazetting of sector transformation charters. Several of these charters were drafted prior to the release of the BBBEE Act, promulgated in April 2004 and Codes of Good Practice (Codes), issued by the Department of Trade and Industry in December 2004.

2.3.2 BBBEE Codes of Good Practice

In accordance with the terms of BBBEE Act, the Department of Trade and Industry has published Codes of Good Practice to guide the BBBEE processes of organisations and companies. The Codes will ensure that BBBEE work properly and consistently within all industries, giving clearer direction of what is required for empowerment credentials. The Codes provide detail on the measurement of the different components of BEE, the desired nature and structure of sectoral BEE charters and charter processes and the acceptable BBBEE scorecard's weighting and targets on each element. (De Klerk, 2006: 9)

2.3.3 Measuring BEE Performance

According to Brown (2004:35-37) It is imperative to have effective monitoring to review empowerment performance. However, in the context of low levels of reporting, inconsistent standards and methodologies as well as inadequate systems to monitor, measuring progress is almost impossible. Until recently, agencies were rating empowerment performance according to their own interpretation of empowerment benchmarks, however with the new codes of good practice and generic scorecard introduced by the department of trade and industry, verification is now based on the same standard of reporting.

The scorecard measures and weights each element of empowerment to assess progress in meeting the set targets. Based on the total score of the seven elements, the company can be viewed as empowered and classified between level 1 – 8.
Small Micro Medium Enterprises with a turnover of less than R5 million are exempted from being BBBEE rated, and automatically qualify as BEE, level 4 (Luiz and Van der Linde, 2006: 405). To some extent the scorecard is expected to reduce the problem of "fronting" and creates a more level playing field. Although there are different sector charters, each industry is required to comply with the Codes of Good Practice. Companies that meet the above BEE requirements will be considered for government procurement, public-private partnerships, sale of state-owned enterprises, when licenses are applied for, and for any other relevant economic activity (Tucker, 2003:1).

2.3.4 BEE Scorecard

Each industry is expected to measure compliance to BBBEE based on industry charter. In the absence of the charter, a generic scorecard is used. The balanced scorecard developed by the department of trade and industry will be used to measure compliance in each of the below stated elements. Each element has a rating to ensure proper and standardized way of reporting compliance. The rating is based on the sum of all elements with an allocated weighting of 100 percent (De Klerk, 2006: 9).

2.4 Elements of BBBEE on Generic Scorecard

The generic scorecard has seven elements discussed as follows: But for the purposes of this paper, focus will be specifically on the ownership element.

2.4.1 Management

The introduction of the management element into broad based empowerment will provide previously disadvantaged individuals access to manage and benefit from economic activities / resources of the company. Management control is exercised through the governing bodies of an enterprise and is normally measured at two levels:

(i) Board of directors, where the determination of strategies, policies and direction of the economic activities and resources is made. According to Codes of Good Practice, companies are expected to have black participation including women at board level appointed by the board.

(ii) Executive management or highest executive body after the board of directors or equivalent structure, which is entrusted with the day-to-day management of the entity's economic activities and resources. Previously disadvantaged individuals including women and people with disabilities should be actively involved in carrying out the day-to-day management of a company.

The generic scorecard requires companies to have at least 40% of top management (executive and non executive level) being previously disadvantaged individuals (women count for extra 20%). The ownership element weights 20% on the scorecard. Based on the requirement of this element, companies have a challenge of not only transferring shareholding to previously disadvantaged but to involve them in decision making.

Figure 2.1: Top Empowerment Companies 2004 – Management

MANAGEMENT						
Rank	Overall	Top 5 companies	Sector	Board %	Top executive (black %)	Management Score%
1	34	Primedia	Media	68,8	60,0	10,0
2	31	Johnnic Holdings	Properties	83,3	100,0	10,0
3	19	Datacentrix Holdings	Information Technology	55,6	50,0	9,2
4	21	LA Group	Retail	71,4	100,0	9,0
5	5	Telkom	Information Technology	81,8	100,0	9,0
Source: Financial Mail Survey, 30 April 2004						

According to the Commission for Employment Equity report (2004: 5) there has been limited improvement with regard to equitable representation of previously disadvantaged individuals. It is noted that within the key decision making positions, legislators, top and senior positions, Blacks (Africans, Coloureds, and Indians) account for 37.6%, 23% and 27.3% respectively. Black directors control of the total market capitalisation of the JSE still remain low at only 4, 55% on a one-director-one-vote basis (McGregor, 2006: 6). Yet despite all these criticisms, some companies have been regarded as a success in transforming their organisations and meeting management targets. Figure 2.4.1 gives an overview of the accomplishments with regard to management during the first phase (1994 – 2003).

2.4.2 Skills Development

The skills development component is part of broad based black economic empowerment and weighs 20% on the generic scorecard (Dekker, 2004:10). Between 1995 and 2002 there have been changes in the occupational composition of employment which varied between population groups.

The African group has had an increase in the share of semi skilled workers (from 54% to 61%), while skilled workers have remained at 5% during this period (Burger and Rulof, 2004). Based on the above statistics, South Africa seems not to have a sufficient pool of trained and skilled black people and women to fill empowerment positions. Thus proper strategies and mechanisms are required to improve the transferring of both technical and management skills through developing core competencies that will enable participation of previously disadvantaged individuals in the mainstream of the economy.

During the first phase, the following companies were rated amongst the best that achieved the skills development objectives as set out by the Skill Development Act.

Figure 2.2: Top Empowerment Companies 2004 – Skills Development

SKILLS DEVELOPMENT								
Rank	Overall ranking	Top 5 companies	Sector	Skills spend %	Learnership	Learnership as % employees	Score %	BEE score 2006 (%)
1	49	Foschini	Retail	4,1	121	3,0	20,0	**42,67**
2	37	African Bank Investments	Financials	3,0	122	4,6	20,0	**46,89**
3	33	SABMiller	Food & Beverages	6,0	460	7,8	20,0	**49,66**
4	28	AngloGold Ashanti	Resources	4,3	N/A	4,3	20,0	**53,63**
5	24	Enviroserv Holdings	Services	3,8	109	11,2	20,0	**54,51**

Source: Financial Mail Survey, 30 April 2004

The Skills Development Act (Act 97/1998), National Skills Development Strategy and Skills Development Levies Act (Act 9/1999) are some of the legislative frameworks provided by the government to address the skills shortage in the South African economy. According to Benjamin and Barry (2002:1) the Skills Development Act and the Skills Development Levies have various functions, namely to create a framework for the development of skills in workplaces, to improve the skills of the South African workforce, and to integrate skills development strategies within the National Qualifications Framework. Skills Development Act (Act 97/1998) provides for the establishment of learnerships and for the conclusion of learnership agreements. The Skills Development Levies Act (Act 9/1999) obliges all employers to give attention to the training and education of employees and to contribute 1%

of payroll to the Sectoral Education and Training Authority (SETA). All South African institutions are required to comply with these acts.

2.4.3 Employment Equity

The Labour Market Commission Report (1996:138-139) describes employment equity as a way of getting the labour market to be both non-discriminatory and socially equitable. This will be achieved through fair and equitable representation of all races in all occupational categories and levels within the workplace. The Employment Equity Act (Act 55/1998) was implemented with the purpose of promoting equal employment opportunity and the fair treatment of people.

The above definition is promoted through the elimination of unfair discrimination and implementation of affirmative action measures. The Employment Equity Act forms part of the elements within broad based black economic empowerment and should be incorporated into the various transformation charters to work congruently with the BBBEE Act. This commits government bodies and private sector organisations to increase the participation of black South Africans and women in senior, middle and junior management in different employment categories. In practice, experience has shown that not all individuals are equally enthusiastic about the transformation that needs to take place within companies and that this might also affect commitment levels. Some of the concerns are highlighted by Jordaan (2002:28) who is of the opinion that whites will experience reverse discrimination when black workers are given preference. While Mahanyele (1993, 9-13) seems to differ and believes that organisations only talk about Employment Equity (EE) but blacks still do not have enough opportunities for self-actualisation. Müller and Roodt (1998:27) research found that women seem to have fewer opportunities; thus were more negative than men about affirmative action.

Even though the government strategy gave emphasis on addressing the imbalances in the workplace, much still has not been achieved to alleviate a great number of these. According to the 7th Commission of Employment Equity Annual report (2007: 5-8), blacks (African, Coloureds, Indians) represent 87.2% of the economically active population. Mahanyele (1993:8) reflects the frustration that organizations only pay lip service to EE, but deny blacks opportunities.

The following companies were rated successfully in implementing employment equity and achieving the set targets as per scorecard requirement (see figure 2.3).

Figure 2.3: Top Empowerment Companies 2004 – Employment Equity

EMPLOYMENT EQUITY										
Rank	Overall rank	Top 5 companies	Sector	Senior mgt %	Senior mgt % (black women)	Middle mgt %	Middle mgt % (black women)	Junior mgt %	Total staff %	**Total EE % score**
1	2	The Don Group	Tourism	66,7	66,7	80,0	40,0	93,6	92,0	**10,0**
2	1	Sekunjalo Investments	General Industrials	89,5	10,5	70,6	20,6	71,1	93,9	**9,1**
3	18	Brimstone Investment	Financials	53,0	21,0	55,0	18,0	93,0	97,0	**9,1**
4	4	Enaleni Pharma	Health &Pharma	42,9	14,3	77,8	11,1	96,2	94,0	**8,6**
5	31	Johnnic Holdings	Properties	100,0	50,0	71,4	0,0	61,5	71,7	**8,6**

Source: Financial Mail Survey, 30 April 2004

2.4.4 Preferential Procurement

Preferential procurement refers to the acquisition of goods and services from companies complying with BEE requirements. The establishment of Preferential Procurement Act (Act 5 of 2000) gave effect to section 217(3) of the Constitution by providing a framework for the implementation of the procurement policy. The section gives provision to organs of state for implementing a procurement policy providing for categories of preference in the allocation of contracts and the protection or advancement of persons or categories of persons disadvantaged by unfair discrimination. Preferential procurement is a measure designed to widen market access for all black owned and black empowered enterprises into the mainstream economy. However the government has not been sufficiently well organised and co-ordinated to ensure a systematic implementation of the programmes for preferential procurement; and a great deal of work still has to be done (Chalmers, 2001:6).

According to generic scorecard requirements and codes of good practise, companies compliance level on preferential procurement will be measured based on the total amount spend with the BBBEE compliant suppliers. The percentage amount of procurement spends on BBBEE compliant suppliers depend on the BBBEE level of that particular supplier. The BBBEE scorecard rank suppliers according to contribution levels 1 to 8, which should be verified by broad based BEE verification agencies (Balshaw *et al*, 2005: 129). Companies that procure from suppliers that are rated level 1-4, will be able to record on the scorecard, preferential procurement spend of between 135%-100%. Procuring from suppliers that are rated level 5 – 8, means companies will only enter a portion (between 80% -10%) of what has been procured. The intention of classifying empowerment through levels is to encourage companies to transform in all levels as much as possible. Preferential procurement is thus considered as the tool to encourage and force businesses to participate in black economic empowerment initiatives. Preferential procurement has the potential to force the supply chain to include the empowered businesses, it is envisaged that it might have a multiplier effect in boosting empowerment. The 2005 average ratio of purchases from black suppliers was 3 percent of total private sector spending, and only 10 percent of spending in government departments (Mbabane, 2006). This is also supported by an analysis conducted on the top 100 JSE-listed companies in 1992 and 1997 which shows that there were low levels of interest in buying from black owned businesses (Empowerdex, 1998). Despite all the challenges of the first phase implementation of BEE, the following companies were rated as being progressive in achieving the set targets of preferential procurement at the beginning of the second phase.

Figure 2.4: Top Empowerment Companies 2004 – Preferential Procurement

PREFERENTIAL PROCUREMENT					
Rank	Overall	Top 5 companies	Sector	Spend %	Procurement % score
1	52	Command Holdings	Services	70,0	**20,0**
2	7	Adcorp Holdings	Services	67,0	**19,1**
3	5	Telkom	Information Technology	61,9	**17,7**
4	6	Mustek	Information Technology	56,5	**16,2**
5	11	Phumelela Gaming & Leisure	Tourism	55,2	**15,8**
Source: Financial Mail Survey, 30 April 2004					

2.4.5 Enterprise Development

During the budget speech, Minister of Finance, Trevor Manuel (2005: 5) singled out the importance of Small to Medium and Micro Enterprises (SMME's) in alleviating poverty and reducing unemployment. SMME's in the South African context, encompass a very broad range of businesses, from established traditional family businesses and medium sized enterprises (employing over hundred people), down to survivalist self employed from the poorest layers of the population (informal micro – enterprises). The SMMEs are characterised by small size (Cronje *et al*, 2003:492) and previously disadvantaged survivalist businesses (Berry *et al*, 2002:1).

SMMEs are reported to be the largest employer and contributors to the economy of South Africa, (Ntsika, 2000). Thus Berry *et al,* (2002:4) argue that within the South African context, SMMEs have the potential to generate employment and upgrade human capital. According to the Department of Trade and Industry (2003:19), the SMME sector was responsible for about 50% of formal employment and contributes nearly 37% of the country's GDP. However, Visagie (1997:660) noted that the South African SMMEs did not have the required technology especially in terms of information technology to enable them to react proactively. As such, the ability to compete favourably with international counterparts was in serious doubt. Hence SMME's needed support in terms of finance and resources.

Enterprise development was introduced to look at an investment made by cooperation in SMMEs that are owned and managed by previously disadvantaged individuals, and to ensure that BEE programmes contribute to growth and therefore are not exclusively about the redistribution of assets and income. According to Janisch (2006:24), the spectrum for enterprise development contributions is broad. The real criterion is that the contribution should result in the recipient enterprise becoming a sustainable entity in the long term. Thus, donating companies are allowed to claim points on the BEE scorecard for both enterprise development and corporate social investment. Support provided to the SMME's could also involve monetary and non-monetary type and as a result does not have to be purely financial. Additionally, it could take the form of skills transfer or a donation of machinery or equipment that will assist the recipient in getting off the ground, including mentoring, preferential credit terms, provision of guarantees, use of infrastructure for free and/or any other initiative to enhance BEE businesses.

2.4.6 Residual/Corporate Social Investment/Industry Specific

The residual element allows other factors that may accelerate BEE to be taken into account and to be included at the discretion of the specific sector or entity. Corporate social investment looks at facilitating community and worker ownership of enterprises and productive assets. Unlike the other elements which are generic, corporate social investment is industry specific and varies from one industry charter to the next. It usually includes some form of corporate social investment and/or an industry specific initiative, such as the payment of levies to an industry body to promote sector growth and development of the society/community.

Sectors and enterprises are encouraged to consider some BEE initiatives such as infrastructure support to suppliers or enterprises; labour-intensive production and construction methods; investment and support to enterprises operating in rural communities and geographic areas identified in government's integrated sustainable rural development programme and urban renewal programme; and investment in the social wage of employees (for example, housing transport, and health care). All the elements discussed above form part of the broad-based black economic empowerment. For the purpose of this research, more emphasis will be put on ownership and funding models used to acquire equity within white owned corporations.

2.4.7 Ownership

According to the majority of transformation charters signed by major sectors, the overall ownership targets for BEE imply that a quarter of the private economy should be owned by black South Africans within a decade. The definition of ownership has changed over the years and there has been a notable evolution in the Department of Trade and Industry's concept of measuring ownership. According to Empowerdex (2005:7) during the first phase of BEE implementation, many BEE transactions boasted a high percentage of legal black ownership, yet in September 2004 the actual economic benefits accruing to black shareholders was only 3.3% of all companies listed on the JSE. Thus even though there has been an increase in the number of BEE transactions in terms of value, the true transfer of ownership (economic benefits) has been significantly low.

The introduction of the new codes of good practice by the Department of Trade and Industry added Code 100 to include the concept of voting rights and economic interest on ownership. According to Marais and Coetzee (2006:504) the strategy for Broad-Based Black Economic Empowerment identified the focus on direct economic empowerment of black people as the "ownership of enterprises and assets through shares and other instruments that provide the holder thereof with voting rights and economic benefits, such as dividends or interest payments" Voting rights afford the shareholder the right to determine strategic and operational policies of an enterprise, while economic interests result in the rebuilding and accumulation of wealth by black people. Economic interest includes, but is not limited to, a shareholder's entitlement to receive dividends. Economic interest is effectively a return on investment and is measured by quantifying what the black shareholder gets in return for holding shares in a company. Economic benefits may come in the form of annual dividend payments (large listed company) or profit share (small enterprise).

The codes of good practice issued by the Minister of Trade and Industry in terms of section 9 of the BEE Act extended the interpretation and definition of broad-based BEE and provided indicators to measure the level of Broad-Based BEE in an entity. The codes determine the weighting associated with each of the indicators and set targets for the indicators. Ownership is still considered important in the process empowerment and carries a weighting of 20% in the generic scorecard (Mason and Watkins, 2005:2).

To ensure that the objectives of BEE are not being circumvented through complex funding structures (first phase funding), benefits to BEE beneficiaries are calculated using the flow-through principle, which traces the level of BEE participation at every tier of the ownership chain, implying that black people must fully own the shares within the company or consortium to score the maximum points on the ownership component. Companies that can prove to have allocated equity with economic benefits and voting rights to black people and have removed restrictions or barriers that will help the participant to achieve debt-free ownership will be rewarded in the scorecard. Penalties will be incurred when economic benefits are delayed. The latter was introduced as an incentive to help decrease the levels of debt carried by black partners and to encourage companies to help BEE partners to settle such debt.

Only the above definition of ownership will be considered in evaluating black ownership within company. The inclusion of economic interest is an attempt to measure the real monetary benefits of black ownership. Such requirement encourages companies to put in place supporting mechanisms that will assist black partners to acquire funding without using complex and expensive funding structures.

Figure 2.5, shows the top 5 companies that have been successful in transferring equity to previously disadvantaged individuals during the first phase of BEE implementation.

Figure 2.5: Top Empowerment Companies 2004 - Ownership

OWNERSHIP						
Rank	Overall Rank	Top 5 companies	Sector	Economic Interest %	Black women %	Ownership Score %
1	16	Paracon Holdings	Information Technology	26,5	25,0	19,0
2	6	Mustek	Information Technology	30,0	12,5	**18,0**
3	8	GijimaAST	Information Technology	40,8	15,3	**18,0**
4	10	Bytes Technology Group	Information Technology	27,0	13,5	**18,0**
5	13	Bidvest	Services	25,3	16,6	**18,0**
Source: Empowerdex, Financial Mail Survey, 30 April 2004						

2.5 Funding Strategy

Either commercial or government third party financiers are used for the financing of BEE transactions. The government has provided substantial start-up capital to support black businesses through the Department of Trade and Industry and its various agencies, including Ntsika, Khula and the Industrial Development Corporation (IDC). According to Department of trade and industry (2003: 10), a total of R2.2 billion was allocated from these sources to fund BEE initiatives for the 2002/3 financial year alone. In particular, the Industrial Development Corporation kick-started the BEE programme in 1993 by facilitating R137 million worth of acquisitions by black investors in New Africa Investments Ltd.

2.5.1 Government Funding Structures

In 1998, the government created the National Empowerment Fund (NEF) – a trust that holds equity stakes in state-owned enterprises and other private enterprises on behalf of historically disadvantaged individuals (HDI). The aim of the NEF is to overcome the perceived risk associated with BEE financing, showing that it is possible to successfully finance BEE businesses. The following are some of the government third party empowerment financiers in South Africa.

2.5.1.1 Industrial Development Corporation

The Industrial Development Corporation (IDC) is a self-financing national development finance institution (DFI). The IDC's original objective was to contribute to economic growth and industrial development. Since 2001 it has included empowerment as one of its objectives of financing activities. The IDC funds Small Medium Enterprises in two ways: directly, through strategic business units focusing on specific sectors, and indirectly, through its wholesale division which makes funds available to external fund managers. Depending on the type of fund, the IDC's funds have different selection criteria ranging from growth objectives to sector development, job creation, empowerment and poverty alleviation (IDC Annual Report, 2002: 26).

2.5.1.2 National Empowerment Fund

The National Empowerment Fund (NEF) is a state-owned provider of empowerment finance. It was established in 2001 as part of department of trade and industry's group of development finance agencies. National Empowerment Fund was created by the National Empowerment Fund Act (Act 105 of 1998) and forms part of the department of trade and industry's group of development finance agencies. It has a BEE focus in that its aim is to promote economic participation of previously disadvantaged individuals (PDIs) and has a mandate to facilitate successful and sustainable black economic empowerment through finance and investment activities. According to Monkman (2003:2), the NEF has three main product offerings:

i. ***Private Equity***, which provides acquisition and enterprise finance in the form of equity, quasi-equity and debt to support empowerment focusing on transactions requiring funding between R25 million and R200 million.

ii. ***Venture Capital,*** which provides seed money, early stage, start-up, expansion and acquisition capital to entrepreneurs in the form of debt, equity and quasi-equity; and

iii. ***Investment Services*** are also offered which focus on design and packaging of mass empowerment products, which seek to address participation of PDIs in financial markets, with emphasis on the development of mass empowerment investment and savings products supported by targeted programmes of investor.

2.5.1.3 Public Investment Corporation (PIC)

The Public Investment Corporation (PIC) manages and invests funds on behalf of public sector entities such as Government Employees Pension Fund, the Associated Institution Pension Fund, the Compensation Commissioner and the Unemployment Insurance Fund. PIC provided more than R2bn for the MTN, Investec and Gold Fields transactions.

2.5.2 Commercial Banks

Commercial banks are frequently used as source of finance for BEE transactions. In South Africa, the largest commercial banks are the Amalgamated Banks of South Africa (ABSA), First National Bank, Nedbank and Standard Bank. The funds provided are in the form of debt financing, and as such require some tangible guarantee or collateral, which is defined as an asset with inherent value. According to Hirsch and Peters (2002:363), collateral can be in the form of business assets (entrepreneurs' house, car, land, stock or bonds). In general, banks have three main loan products – overdrafts, term loans and mortgages. In addition, the banks all have subsidiaries or partners who can assist with asset finance (such as leasing and hire purchase). There are also special equity funds set up by the banks to invest in small black – owned enterprises that do not have enough collateral for term loans (First National Bank's Progress Fund and ABSA's incubator fund). According to Schoombee in Rwigema and Venter (2004:393), conventional banks regard financing of BEE and SMME ventures as high risk endeavours.

2.6 Types of Funding Models

The lack of capital and collateral required by BEE investors to fund BEE transactions still pose a challenge even with the new empowerment initiatives. As a result, the broad based empowerment has included promoting access to finance for black economic empowerment transactions as one of the key objectives.

2.6.1 First Phase BEE Models

The first phase of BEE marked the entry of black people into the mainstream economy, either through SME's or acquisition of strategic stakes from the big corporate that were previously owned, controlled or managed by whites. The emphasis of these transactions was to ensure black control only and did not include other elements of empowerment such as management and transfer of skills. The following were regarded as part of the first phase BEE funding models.

2.6.1.1 Special Purpose Vehicle

According to Van der Nest (2004:18) an SPV is a special purpose company established by a 'BEE-company', with a view to facilitate the purchase of an equity stake in a 'target company'. According to the BEE Commission report (2001:19), the target company can either be a company listed on JSE Securities Exchange SA or a private company, interested in selling an equity stake to a black partner. Special Purpose Vehicles (SPVs), are also known as Special Purpose Entities (SPEs), have a single-purpose and separate legal structures created by corporations (Competition News, 2004:7).
Financial institutions provided funding to Special Purpose Vehicles (SPV's) which enabled black people without capital to acquire shares in the target company (Batchelor & Dunne, 1999).

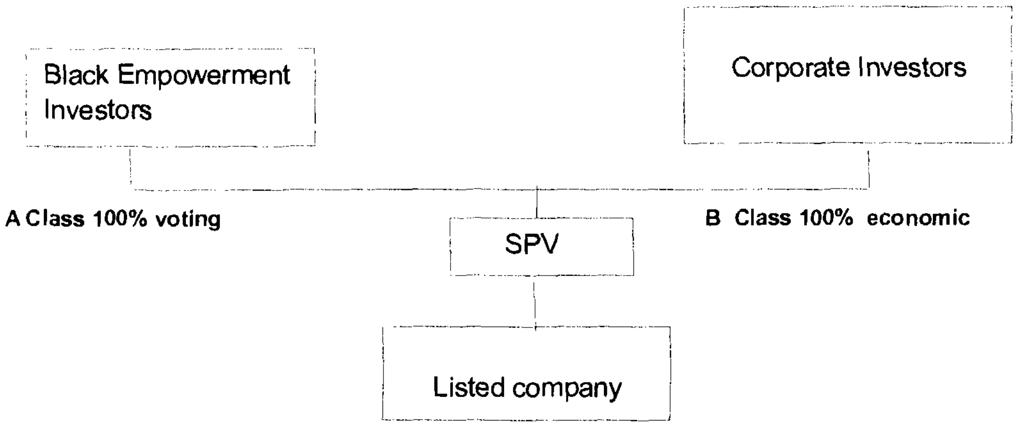
The BEE Company raises the required means to fund the deal either through a 100% loan from the financiers, in return issuing preference shares of the SPV to the financiers. The BEE Company holds 100% of the ordinary shares in the SPV and therefore controls the votes. The preference shares are redeemable in three to five years, and entitle the financier to a determined dividend rate from the SPV, normally expressed as a percentage of the prime lending rate. The capital raised would then be used by the SPV to acquire the relevant equity for the black investor in the target company. Dividend income received from the equity investment would be used by the SPV to pay the preference dividends and to redeem the preference shares at the end of term.

Various structuring methods were used to finance SPV's; for example, debt instruments funding equity structures were common place with only minimal or no equity participation. Frequently, multiple SPV's were created, and assets sold back and forth among themselves and/or the sponsor that gives life to these entities. During the first phase of BEE transactions in the late 1990s, black investors were typically funded by third parties utilising SPVs.
Oyewole (1996:12) summarises the other three main funding methods employed during the first phase in black economic empowerment transactions.

i. Equity participation without economic facilitation

In this option, the black empowerment investor acquires shares in the listed company, by forming a SPV, which is funded by corporate investors. The corporate investors hold low-voting class B shares in the SPV, while voting control will be ceded to the black empowerment investors through class A voting shares. For example, if the black empowerment investor acquires 25% in the listed company through a SPV, the structure will be as depicted in the diagram, below:

Figure 2.6: Equity participation



In this structure there is no immediate economic benefit to the black empowered investor because the corporate investor owns the shares in the listed company until the black investors have sufficient cash to pay and acquire the Class B shares. This structure is created under the assumption that the company will grow in order for the black empowered partner to be able to exercise his anticipatory rights over the corporate investors shares.

ii. Equity participation at a discount

This structure requires that the shares in the listed company be sold to the black empowered investor at a discount to the ruling market price. The discount becomes a benefit to the black partner through percentage shareholding in Class B shares. The black investor may or may not have an anticipatory right on the remainder of the Class B shares held by the corporate investor. The black investor is though guaranteed to own a direct stake, which is the portion of the discount in the listed company. For example the black investor will acquire 25% B Class shares at a discount of 10% in the listed company. Therefore the black partner is guaranteed an effective and direct interest of at least 2.5% in the shareholding of the listed company. The latter may be regarded as shares received free of charge.

iii. Put option granted by existing shareholders

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

2.6.1.2 Failures of the First Phase Models

According to BusinessMap (1999:7), the first phase of BEE implementation came to an abrupt halt with the Asian crises of 1998. The crisis revealed the unsustainable nature of the BEE financing models, which formed the foundation of most of BEE transactions during the 1990's. BusinessMap (1999:11) identified the extremely high levels of gearing as a core weakness in the initial BEE financial models. Instead of using access to finance, to build an asset base, most BEE transactions accumulated debt via the SPV's structures used at the time. The cause of failure was purely the high dependence of these deals on debt. It is obvious that financial institutions and other providers of capital, played a crucial role during this period in determining the pace and success of black economic empowerment. It is therefore not surprising that the equity market crash of 1998, affected many black owned companies listed on JSE such as Nail very negatively.

The following are amongst some of the disadvantages of the first wave models that led to failures of the BEE deals and not meeting BEE objectives:

i. Funding structures are mostly developed to be successful only in bull stock market situation, thus limiting success.

ii. Preference shares used do not normally carry voting rights and therefore black partners do not take part in company strategic decisions; and

iii. Preference shares form part of contractual obligation and therefore cannot be easily traded (BEE shares are locked in for a specific period). Therefore there is lack of flexibility and liquidity on SPV structures.

2.6.2 Second Phase BEE Models

The second phase of BEE has resulted in increased expectations that South Africa will succeed in transforming ownership of the economy. Success depends on the ability of financial institutions and established companies to develop innovative funding models and identify a second generation of black entrepreneurs - many of whom may have developed hard, technical skills, to take BEE to the next level. Many black South Africans found it hard to accumulate economic wealth using highly geared structures in BEE transactions during the first 10 years of empowerment deals (Jack, 2005).

It can be argued that the government should reward BEE deals that successfully transfer economic benefits to previously disadvantaged groups. The latter will ensure that government has a mechanism through which it can promote BEE activity. To achieve BEE goals government has incorporated a BEE scorecard system to keep track of and monitor the success of BEE within companies. Successful and compliance to BEE targets is recognised and rewarded by giving it access to government and business contracts as stipulated in industry charters and BEE legislation.

BEE sounds like a solution to an empowerment of previously disadvantaged people. Yet based on the above problems of funding identified during the first phase, new structures have been recently introduced for the new wave of BEE. Even so, these newly introduced structures may still be seen as elaborate and complex, because it combines debt, equity and hybrid instruments (such as deferred shares, options and preference shares). The focus is to develop and implement innovative financing structures that will ensure efficiency, sustainability and specifically suit the needs of BEE transactions. The acquisition of equity, for the BEE deals may now be vendor-financed call options driven as well as other more conventional methods of funding involving third party financing. These funding models are discussed in detail below.

2.6.2.1 Derivatives (Options)

A call option gives the right but not an obligation to the investor to buy a share or specified quantity of an asset at an agreed fixed price at some time in the future. For example, the option gives the right to buy 100 shares in the hosting company for R130 (the strike price) on a particular day. If on that day the shares are trading for R120, it is unlikely that the person will exercise the option because the person will make a loss of R10. However, if on that day the shares are trading for R140, it is likely that the option holder will exercise the option. The person will be able to buy the shares at R130 and sell on the market for R140, thereby making a profit of R10 on every share.

The advantage of options is that it gives an opportunity to profit from price movements in the underlying asset or share whether up or down for a fraction of the price of the asset or share.

However, it should be recalled that although options in particular offer a relatively cheap way to get exposure to shares, one does not become a shareholder of the underlying share by holding an option, and therefore one does not receive the dividends paid to shareholders. In the case of black empowerment, an option becomes a grant by the hosting company to an empowerment company to acquire shares in the hosting company at a predetermined price within an agreed period. The strike price of the call option is the funding obligation faced by the BEE Company in the transaction. In cases where the BEE Company has the right to settle any obligations prior to the settlement date, the call option held by the BEE Company would be an American call option. Companies such as ABSA and Bidvest have used the call option for empowerment transactions.

Traditionally, BEE transactions are valued from an accounting view-point, employing valuation techniques such as value-added calculations, net asset value calculations, discounted cash flow analysis and other similar accounting techniques. Yet for the valuation of a call option, Black Scholes option valuation model is normally used, which is a departure from the usual accounting methodologies.

2.6.2.2 Third Party Finance

The majority of the equity financiers require substantial capital protection from the borrower for protection when one is unable to make repayment. The lender normally requires collateral or guarantee from the hosting corporate. If the borrower does not have a guarantee, the transaction is regarded as high risk, and then the lender will charge high interest rates to cover such risk.

There are other various structures that are considered by financiers on offering finance, but the most favoured are the leveraged buy-outs (LBOs) and preference share structures.

i. Leverage Buy Outs (LBOs)

In this format, the business is bought from the vendor by a newly established entity, which is empowered at ownership level. The assets of the business are used as collateral to partly or fully raise the finance required for the purchase. This is beneficial to the financiers as assets are used as security and there is direct access to the cash flows of the business. However, if not structured appropriately, this format may have significant cost implications such as capital gains tax, which will be discussed in detail later in the chapter.

ii. Preference Shares

In using this structure, the financier subscribes for preference shares in a BEE company for cash. In turn, the BEE Company acquires shares in a company in need of BEE (target company) using cash received from the financier as payment for preference shares. The preference shares will be convertible to ordinary shares when the BEE Company defaults on payment. The BEE Company depend on dividend payments from the target company to enable payment for the preferred dividends and redeeming the preference shares. The financier does not have direct access to the cash flows of the hosting company but has the underlying shares as security. Preference shares are still very popular funding instruments. Standard Bank and Liberty Life are amongst the largest BEE deals announced to date and have financed BEE transactions through the issue of preference shares.

2.6.2.3 Vendor Finance

Vendor companies facilitate BEE transactions, through providing loan guarantees, price discounts, or internal vendor financing at below market rates, to BEE investors to acquire shares from established business (Cargill, 2005:23). This type of transaction allows the financiers to have confidence in the company and regard the transaction as low risk.

Regardless of the transaction structure, there is almost always a requirement from the financiers that the vendor facilitate the raising of finance for the BEE partner. Whichever structure is selected, and even if no vendor finance is provided, financiers tend to look for some form of guarantee from the vendor. According to Le Roux (quoted by Financial Mail, 2006), most financiers are risk averse and require some form of security on loans granted, which in most cases the BEE partners cannot provide

Vendor finance companies are regarded necessary to enable deal makers to negotiate lower interest rates. Gqubule (2003) highlighted that empowerment can't work without vendor finance especially when interest rates are high. High inflation, coupled with the fact that black investors lack assets to pledge as security for borrowings, results in financing that require high return rates. This in turn necessitates that the BEE investor must earn a high return on investment to be able to make loan repayments. Examples of empowerment transaction that used vendor finance include amongst others Imperial and Alexander Forbes.

2.7 Shared Characteristics of Funding Models Discussed

The funding models discussed above have the following characteristics in common:

i. The hosting company mostly facilitates the BEE deal.
ii. The BEE Company experiences benefits if the share price or earnings grows.
iii. The real equity transfer will only happen after the final loan repayment which might take a long time especially in cases where interest rates paid are high and the expected return of the hosting company is low. The equity interest in the hosting company may be diluted because of the inability of the black partner to pay back the loan.
iv. The capital contribution by the BEE partners is limited; and
v. Contradiction to the tax laws and section 38 of the Companies Act (discussed in more details on section 2.9).

2.8 Number of BEE Transactions to date

The research organisation Business Map Foundation has estimated that since 1994 to 2005, about R150 billion worth of BEE deals have been concluded (BusinessMap, 2006). The total value of BEE deals reached a record high of R56.2bn in 2005 compared to R49.9bn in 2004 and R42.2bn in 2003. An annual mergers & acquisitions survey shows that between 1995 and 2005, BEE deals increased from 23 to 238 (Ernst & Young's, 2006).

Figure 2.7: BEE volumes and values (1995 – 2005)

Year	Number of transactions	Value (Rbn)
1995	23	12.4
1996	45	7
1997	52	8.3
1998	111	21.2
1999	132	23.1
2000	126	28
2001	101	25.1
2002	104	12.4
2003	189	42.2
2004	243	49.9
2005	238	56.2

Source: 15th Ernst & Young Mergers and Acquisitions: 2005

2.9 Restriction on the Funding Models

The funding structures are neither perfect nor without challenges. The complexity of these deals and funding structure means that the parties involved are often at risk of contravening the company law by prohibiting a company to give any type of financial assistance related to the purchase of or subscription for its shares, or shares in its holding company. The parties are also at risk of incurring substantial upfront and future tax costs.

2.9.1 Section 38 of the Companies Act

According to Section 38 of the Companies Act (Act 61/1973), companies may not grant any form of security over assets, or issue any surety or guarantee, or otherwise provide financial assistance in connection with the acquisition of issued shares or the shares of the holding company. Holding companies are, however, not prohibited from providing financial assistance for the purposes of, or in connection with the purchase of, or subscription for, shares in a subsidiary company. In addition to voiding a prohibited transaction, a contravention of section 38 constitutes a criminal offence. As is evident, the impact of section 38 is far ranging, and it is vital to ensure that any acquisition finance package does not fall foul of its provisions.

Section 38 however, does not pose an absolute barrier to BEE transactions. Parties are not prohibited from structuring affairs in such a way so as to avoid the application of this section, as long as such restructuring is not seen as a disguise for providing financial assistance. It may, however, force BEE transactions to be more complex, and consequently more costly. In many cases the BEE partner will acquire shares indirectly in the company through a special purpose vehicle ("SPV"). An external financier will provide the SPV with the necessary funding for the acquisition of the shares in the company, and consequently require the BEE partner's shareholding in the SPV to be held as security for the SPV's obligations. Due to the greater risk such a structure imposes, it has been suggested that section 38 be reviewed to accommodate BEE, especially with regard to the introduction of share buy-backs and associated capital adequacy rules into the Companies Act.

2.9.2 Secondary Tax on Companies (STC)

A broad-based BEE restructuring could result in significant tax consequences for the company in terms of the provisions of the Income Tax Act. Government's objectives in the Empowerment Act do not seem to complement the current tax regime. The tax legislation is harsh on the shifting assets within the same group as it taxes them at market value even though the transfer is between two wholly owned subsidiaries at book value. Transferring at market value may result both in income tax and in capital gains tax.

However, the legislation does provide for certain exemptions such as the transference of assets between companies within a group of companies where group ownership in terms of equity share capital is at the 75% threshold of ownership. The company would, therefore, have to restrict any transfer of its assets to 25% of its share capital. Above this level, companies could be liable for either income tax or capital gains tax, provided that the market value of the assets in question is higher than book value. Yet the strategy document and the transformation charters currently envisage ownership levels in excess of 25%.

It is clear from the above example that current tax legislation is not user friendly towards the facilitation of BEE activities. To assist with achieving the goals set in the Empowerment Act, there is clearly a need to reform certain elements of the tax law to be BEE friendly. Proposed changes set out in this year's budget speech include the re-categorisation of redeemable preference shares as debt (which will result in dividends paid being fully taxable), and the re-categorisation of compulsory convertible debentures into equity (which will result in interest paid no longer being treated as deductible). The proposed changes will most likely increase the cost of funding for BEE transactions. Prior to this proposed re-categorisation, many BEE transactions relied on the tax benefits traditionally accruing to the mentioned instruments. It appears that no tax concessions will be provided and will become more difficult to implement and achieve the objectives of the Empowerment Act.

2.9.3 Capital Gains Tax (CGT)

Tax structuring plays a significant role in private equity transactions in South Africa. Tax considerations include: the form of investment enterprise to be used; the possibility of a taxable recoupment arising in a sale of business transaction; the deductibility of interest on debt financing; the re-characterization (for tax purposes) of equity as debt where preference share funding is used in certain circumstances; and, generally, capital gains tax (CGT) consequences. Consideration should also be given to ensuring efficient transaction structuring so as to minimize transfer and stamp duties, which may be substantial in large transactions. Special tax exemptions (including CGT and transfer duty exemptions) apply to share-for-share transactions and intra-group transactions.

2.10 Conclusion

After implementation of the first phase of black economic empowerment, government policies and legislations were questioned whether it adequately addressed the apartheid legacy and whether it has been successful in achieving qualitative change to alleviate poverty and benefit all South Africans. Key conclusions therefore are:

i. Government has revamped its empowerment programme by developing Broad-Based Black Economic Empowerment (BBBEE) and, mainly to ensure equitable transfer of ownership, management and control of the economy.

ii. The use of BBBEE scorecard has not been very successful due to the fact that limited skilled black people are available to take up highly skilled and managerial positions; and

iii. Due to lack of access to capital by people, early BEE-initiatives failed to ensure that significant control of companies in which black people acquired equity stake was fully transferred. More importantly, black empowerment suffered in its early stages from the development of artificial control tools such as convoluted pyramid company structures and the issuance of low voting N-shares to investors ensuring that ownership did not dilute control of the company.

In charting a way forward, the challenge is to ensure that black companies without capital are able to acquire equity or provide substantial guarantee to funders. As a result, new funding models had to be developed so BEE partners are not encumbered by the need for collateral, which amongst others, have included vendor finance, derivatives and third party finance. To ensure that the new funding structures support the BEE objectives, the South African government has provided the legislative environment for funding the BEE transactions.

Indeed, the future and success of BEE transactions will depend greatly on the display of commitment by all parties engaged in transaction, rather than on relying too much on the government action. Companies offering empowerment opportunities need to embrace transformation whilst empowered partners have to add critical value to the company. According to Rupert (2005:14), the empowerment programme should be perceived as encouraging handovers, but for the BEE partner to contribute at least half the finance as a condition to being assisted to obtain the other half. This approach will ensure that BEE partners are part of the acquired business and committed to its long-term success.

The next chapter presents and explains the research design as well as the methodology used to accomplish the objectives of the study.

CHAPTER 3: RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

According to Saunders, Lewis and Thornhill (2003:2), the term "methodology" refers to the theory of how research should be undertaken. Methodology is practically focussed on the specific ways (methods) used to understand the world better. Welman and Kruger (2001:2) state that the research process involves the application of various methods and techniques in order to create scientifically obtained knowledge by using objectives, methods and procedures. The purpose of this chapter is to provide a clear and detailed description of the method applied to the study. It will explain the research design, the unit of analysis of the study, the instruments used for data collection and the procedures followed, and lastly, data analysis.

3.2 Research Process

A descriptive study is one that attempts to explain the characteristics of the population by examining the samples of that population (Glatthorn, 1998:75). Descriptive study will make use of both quantitative and qualitative research methods. Creswell (2003: 211) defines this research method as mixed approach which implies that the researcher collects both quantitative and qualitative data either in phases (sequentially) or that they gather it at the same time (concurrently).

The empirical study will attempt to assess the efficiency of BEE funding models or structures in South Africa. The goal of the study is to develop an understanding of the impact that funding models have on the success of BEE transactions and BEE objectives in general.

3.2.1 Approach

The mixed approach that has been selected for this research will ensure a comprehensive and in-depth understanding and analysis of the problem under investigation, i.e. the challenges associated with the implementation of BEE and using BEE funding models in the South African context. Data will be gathered from self–administered face to face or telephonic interviews.

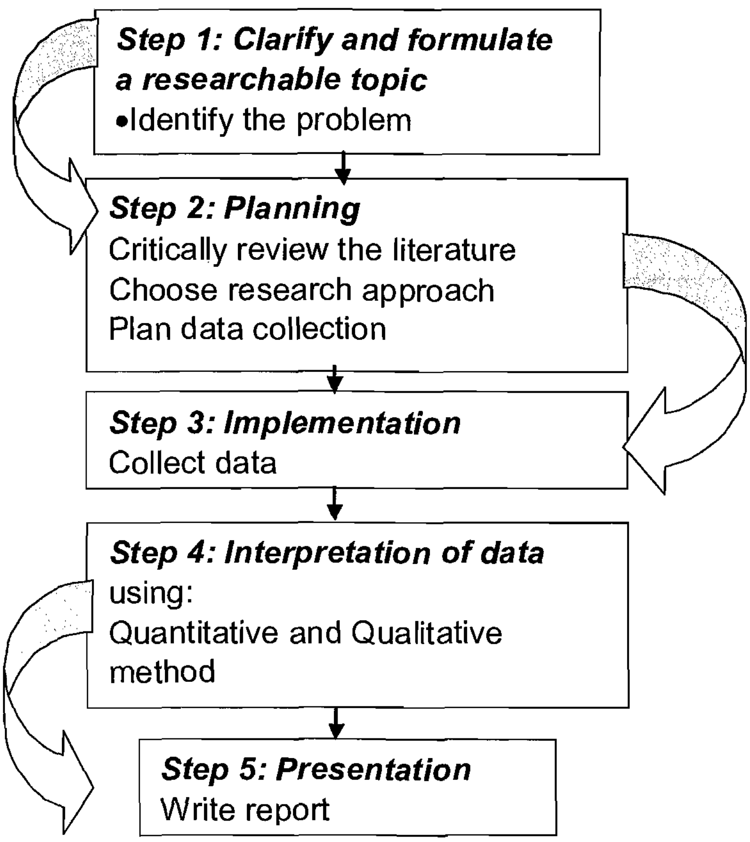
3.2.2 Rationale for selecting a mixed approach

The benefit of using a mixed approach, in this research is, firstly, as Miles and Huberman (1994:1) correctly observe, "With qualitative data, one is able to preserve chronological flow, see precisely which events led to which consequences, and drive fruitful explanations". Secondly, because it focuses on meaning qualitative research will enable the researcher to gain deeper insight into the contextual issues surrounding the implementation of BBBEE in South Africa.

3.2.3 Research Model

To come to a conclusion with an understanding of the problem identified, the researcher must be able to adapt a model relevant to this particular study the research process undertaken in this study is outlined in the stages below.

Figure 3.1: Research Process Model



Source: Mark Saunders, Philip Lewis and Andrian Thornhill (2003:7)

3.2.3.1 Clarifying and formulating a researchable topic

In Step 1, the topic selected was "The efficiency of BEE funding" because of its relevance to South African economy and its impact to the society at large.

3.2.3.2 Planning

In Step 2, literature review is undertaken to understand the theory formulated on this topic. The research approach selected is an empirical study with a combination of both qualitative and quantitative study. Data relating to financial performance of black empowered and listed companies were collected. A questionnaire was designed as a framework for telephonic and face-to-face interviews. Not all questions are applicable to all the companies interviewed. The questions are designed to stimulate discussion and to uncover unique approaches used by the different empowered companies, funders and BEE experts/ consultants in structuring BEE transactions. Therefore, the questionnaire has a combination of multi choice and open ended questions. Five BEE transactions were selected and analysed as part of the research to ascertain support of the data collected.

3.2.3.3 Implementation

Steps 3, Questionnaires were handed, faxed or e-mailed to the selected persons. Data was collected primarily through meeting with organizations that are in Johannesburg and conducting face to face, telephonic and e-mail interviews. The interviews ranged between 30 minutes and one hour depending on the relevant information that the interviewee could provide. Data reasonably represent all identified sources.

3.2.3.4 Collecting, analysis and interpretation of data

In step 4, the completed questionnaire was collected from the selected sample. All the data collected, analysed and interpreted to establish the views of the selected sample.

3.2.3.5 Presentation

After data has been interpreted, a report will be formulated and presented with conclusion and recommendations.

Stage 1

The research problem to be investigated was formulated. This followed an introductory part that examined the background to the problem.

Stage 2

A detailed literature review was undertaken on the implementation of BEE, revelation that led to broad based approach, the commitment of businesses through targets set on sector charters, tools introduced by government to measure implementation of BEE, assessment of different BEE funding models used for BEE transactions and success thereof.

Stage 3

Based on the problem statement and the review of related literature, the hypotheses to be tested will be formulated. These hypotheses test the entrepreneur's challenges, obstacles and needs for accessing finance and improving management skills, which are usually cited as reasons for business failures.

Stage 4

The questionnaire will be distributed to BEE partners, empowered companies, funders BEE authors and consultants.

Stage 5

A measuring instrument will be developed. An interview schedule that consists of a combination of structured multiple choice questions and open ended questions will be compiled and tested on the sample of 50. The interview schedule will be completed through conducting face to face and over the phone interviews.

Stage 6

Quantitative statistical analysis and qualitative analysis of the responses gathered the interviews will be done and findings will be reported in Chapter 4.

3.2.4 Literature study

Review of Black Economic Empowerment funding models meaning, objectives, implementation strategy and its impact of black economic empowerment within the South African context will be researched. A thorough literature study will be done on funding models used to finance black economic empowerment. The purpose is to determine the efficiency of BEE funding models in financing BEE transactions through evaluating the success of each funding model used.

3.2.5 Empirical study

A questionnaire was developed to determine and assess efficiency of different BEE funding models. The questionnaire was distributed to a selected sample of 80 people, only 50 responded. The respondents included people who were involved in BEE transactions and funding such as employees of black empowered companies, funding institutions and BEE consultants. The information collected from all the parties was analysed, interpreted and reported.

The research findings represent information from interviews of the selected sample. The results are primarily qualitative and designed to demonstrate the different techniques and views within the South African industry context.

The questionnaire compiled is based on the information collected from reference books, newspaper articles, Internet and journals.

3.3 Research Methodology

This section explains the research methodology and approach underpinning the study; the techniques that will be employed in the data collection and analysis processes and potential limitations of the study.

3.3.1 Assumptions of the study

The efficient BEE funding model results in the achievement of the BEE objectives and the sustainability of the BEE transaction in the long term.

3.3.2 The sampling framework

Cooper and Schindler (2001:170) describe a sample as “a list of elements in the population from which the sample is actually drawn”. According to Sekeran (1992:226) a source of concern when using a framework to provide a listing of each population relates to the fact that it may not always be current and updated document. Hence although the sampling framework may be available as in the case of companies' database, there is no guarantee that the list is fully comprehensive.

In such cases the researcher has to make a choice between trying to obtain an updated sampling framework, uses the sampling framework as is, or discard the framework and use a different framework. Sekeran (1992:226) argues that trying to obtain an updated or a new sampling frame does not guarantee that the new frame will give an accurate listing of all the elements for the reasons stated above. Given the high birth and attrition rate in the BEE deals, it is possible that the list may not be complete hence biases could arise between the opinions of the sample frame and the population.

3.3.3 Sampling techniques used

Various techniques are available for selecting a sample to be analysed. These techniques are generally grouped into two main categories (each having different sampling strategies) namely, probability sampling and non–probability sampling. The choice of the method and strategy is normally influenced by the extent of generalisability desired, the availability of time and other resources, and the purpose for which the study is done (Sekeran, 1992:229).

This study will use simple random sampling because it has the advantage of being the representative of the population in the sense that it does not favour one unit of analysis (individual or subpopulation) over another. According to Welman and Kruger (2001:55) the chance of choosing a bias sample is remote when using this technique.

3.3.4 Data collection method

According to Cooper and Schindler (2001:295) there are really only two alternatives used to gather primary data. One method involves observing conditions, behaviour, events, people, or processes while the other method has to do with communicating with people. The choice of the method however depends on the purpose and the nature of the study. The study will employ the communication approach where the instrument comprises interview schedules, structured in a multiple choice format that will be completed by the interviewer according to the respondent's choice and circumstance.

The framework requires identifying the behavioural dimensions, facets or properties denoted by the concept and then categorising these into observable and measurable elements.

3.3.5 Style of the interview schedule

The face to face interview method will be used and as indicated above, in most cases respondents will be asked to choose what is applicable to their BEE experience or ideas.

From the literature in chapter 2, it became apparent that access to finance or ability to provide collateral is the determining factor in BEE transactions using different types of funding models. The questionnaire was therefore divided into two sections. Section A and B are a combination of both closed (multiple questions) and open ended questions. Section A determines the profile of the interviewee. Section B, tries to establish which BEE funding models is most preferred and the sustainability of BEE transactions. The interviewers are simply expected to mark with an 'X' in the space containing the applicable response.

3.3.6 Testing the interview schedule

As indicated earlier, the research process involves the designing of the interview questions. These questions originate from the initial research question, objectives and literature survey. The primary interview schedule will be administered to 50 respondents. The language employed that has been deemed satisfactory. It was found that most respondents feared information about BEE transactions may not be kept confidential and were unwilling to give answers to financial matters. In order to overcome this, questions on financial matters were kept to the bare minimum in the final instrument.

3.3.7 Data preparation

Once interview schedules have been returned, it will be prepared for analysis. This involves editing, handling blank responses, coding and processing.

i. Editing or cleaning refers to the checking of data for any errors and incomplete information.
ii. Data coding, according to Terre Blanche and Durrheim (2002:98), coding involves applying a set of rules to transform information from one form to another. This involves converting the interview schedule into numeric form in order to allow for quantitative

analysis. Once the interview schedules are collected and edited, responses will be transferred into the column titled "for office use only"; and

iii. The data will be analysed using the statistical software Moonstats which has the capacity to perform the necessary statistical calculations.

3.3.8 Statistical procedures and treatment for analysis

The primary purpose of collecting data in research is to answer research questions. But for research questions to be answered, data collected has to be interpreted. In other words, it has to be explained and given meaning. However, before this can be done the data has to be analysed. In quantitative research, data analysis is normally used to refer to the process of breaking down of collected data into constituent parts in order to obtain answers to research questions. In other words, data involves the process of reducing data into intelligible and interpretable form so that the relations of the research problems can be studied, tested, and conclusions drawn (De Vos *et al,* 2002:223). Therefore data analysis basically involves summarising data. There are two types of presenting data: descriptive statistics and inferential statistics.

3.3.9 Descriptive statistics

Descriptive statistics is used to describe characteristics of a population or sample. Thus it is logical to say that descriptive analysis is the first stage in data analysis and aims at describing data by investigating the distribution of scores on each variable. In other words, descriptive analysis allows the researcher to present data in a manner that is easily interpretable. Descriptive statistics to be used in the present study will include frequency counts, mean scores, standard deviations and cross tabulations. Frequencies are defined by Kerlinger (1986:127) as the number of objects in sets or subsets. More simply, the number of observations and the standard deviation is the square root of the variance around the mean, in other words, how well the mean represents the data (Field, 2005:6).

3.4 Conclusion

This chapter provided a description of the methodology applied to this study. It began by providing an overview of the research process by indicating various stages. Firstly, the research questions were posed followed by the formulation of various hypotheses to be tested. This was followed by a description of the sampling process, which included defining the population, deciding the appropriate sampling design, and deciding on the required sample size. The measuring instrument used was also clearly specified and finally the type of data analysis was also clearly specified. The next chapter reports on the findings of empirical investigation.

CHAPTER 4: DATA PRESENTATION AND ANALYSIS

4.1 Introduction

The purpose of this chapter is to provide the results of the empirical study which focused on assessing the effectiveness of BEE finance. It focuses on summarising and interpreting the research findings and descriptive statistics, based on the responses from the respondents who participated in the surveys. Although a lot of survey questionnaires were sent out to the prospective respondents, only 50 survey results that were received from the respondents were usable.

The first section of this chapter reports on the demographic profile of the sample which provides the respondent's exposure to BEE and BEE funding models. The second section provides information on the efficiency and effectiveness of BEE funding models based on respondents. The sample structure is described in terms of consultant for BEE transaction; employee of a BEE empowered company, owner or shareholder in a BEE company and employee of a financial institution financing BEE companies.

4.2 Measurements

In order to carry out the analysis of the research, mean and standard deviation were calculated for each question on section 2. To measure the efficiency of any BEE models, the following assumptions were made:

i. BEE transactions must be able to transfer full equity acquired to previously disadvantaged individuals, without dilution.
ii. The asset acquired must be able to service debt raised until that asset is fully owned by the previously disadvantaged individuals.
iii. The return on the acquired asset must exceed the total cost of capital including all transactions costs incurred. Thus the share price must outperform the rate at which interest is increasing.
iv. The asset acquired must be able to transfer economic benefits to the BEE partners; and
v. The BEE model must be able to support BEE objectives.

4.3 Survey results

The following research results presented are based on the questionnaire analysis of 50 respondents. The questionnaire has section 1 (demographics) and section 2 (efficiency of BEE funding models). For the purpose of analysis, the respondents were divided into two groups representing first phase and second phase.

4.3.1 Section 1: Demographics

The demographics of the research comprises of respondents with different BEE background and exposure of BEE funding models.

Figure 4.1: Respondents demographics

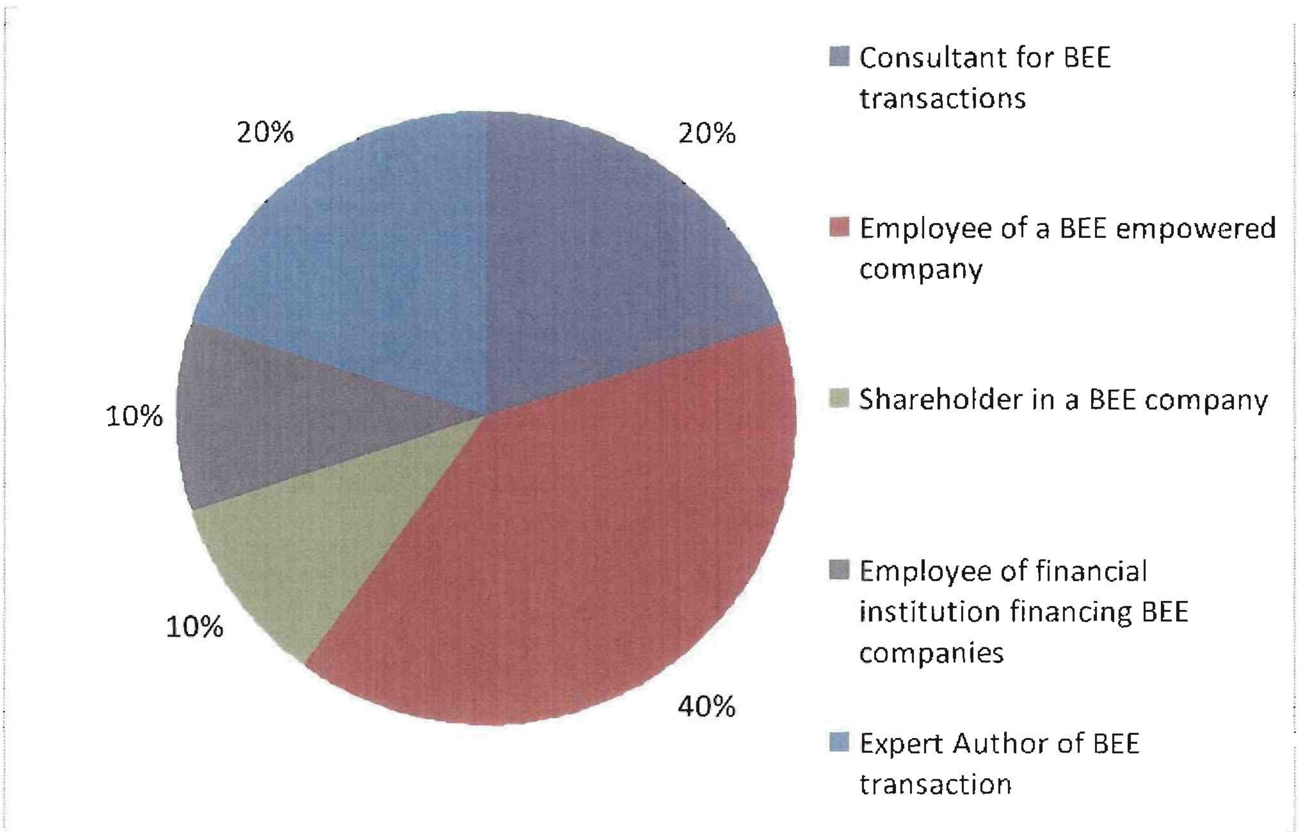
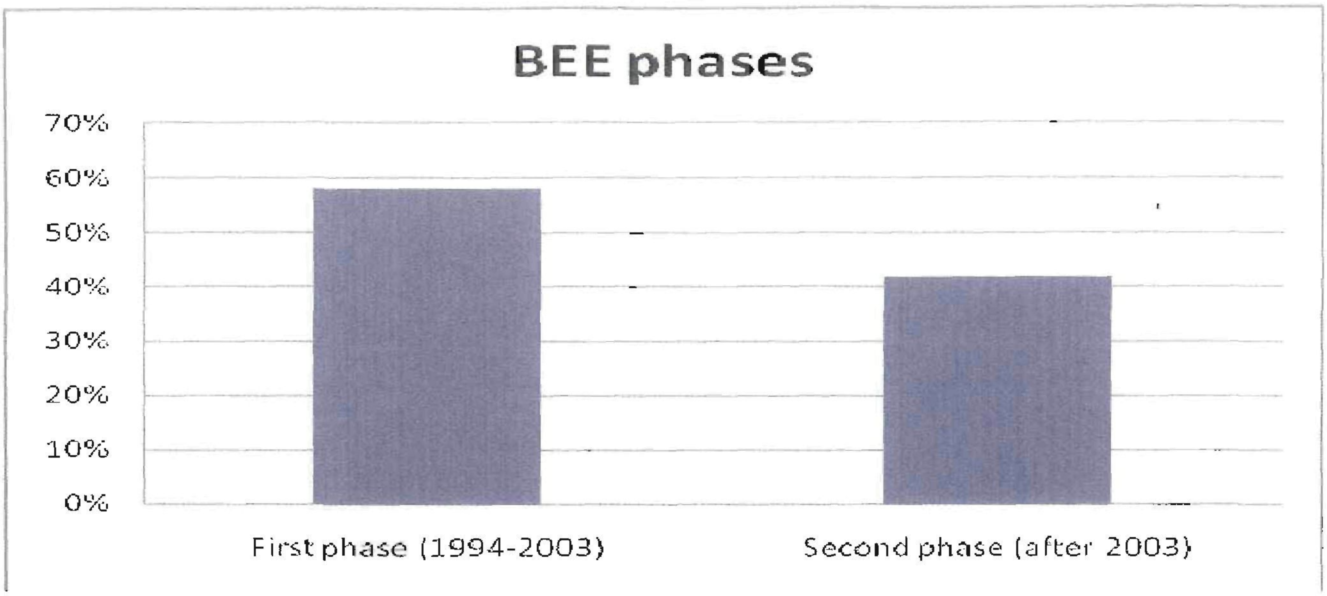


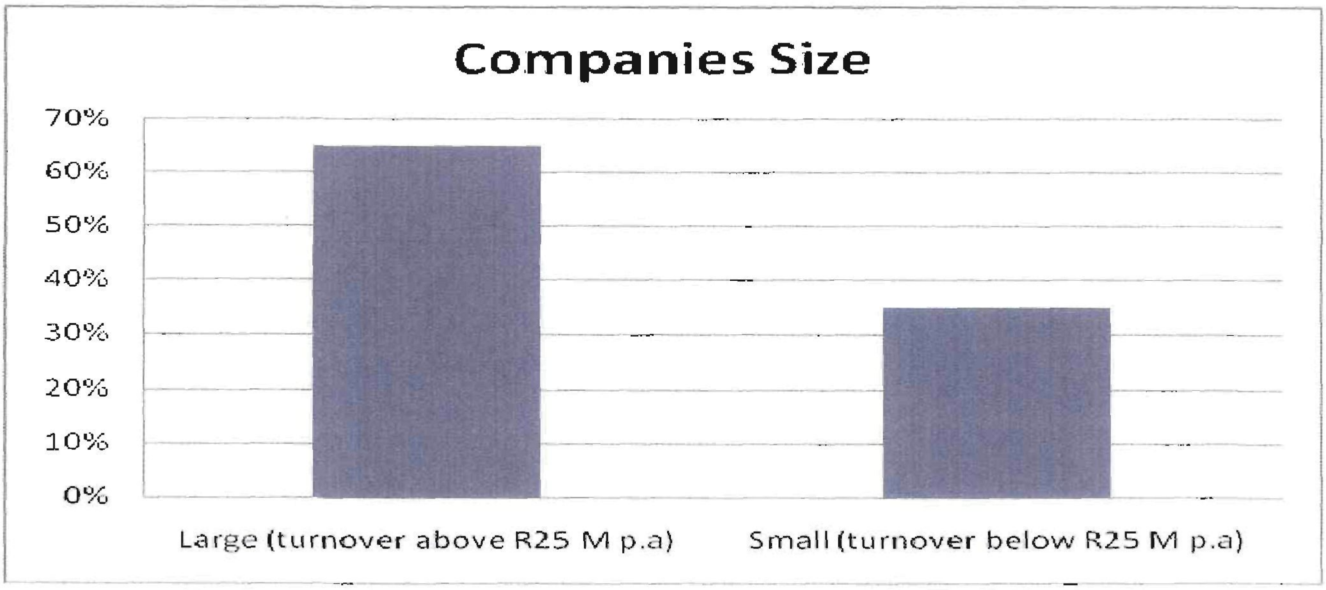
Figure 4.1 indicates that the greatest number of respondents were employees of the BEE empowered company (40%) followed by the consultants for BEE transactions (20%) and expert author of BEE transactions with (20%). The employees of BEE empowered company and shareholder of BEE companies both were at (10%)

Figure 4.2: BEE phases



In section 1 of the questionnaire the phase of the BEE funding models were fragmented into two phases, the first phase (1994 -2003) and second phase (post 2003). According to the results from the population the first phase (1994-2003) has a representation which is 42% and the respondents from the second phase (after 2003) represent 58% of the population.

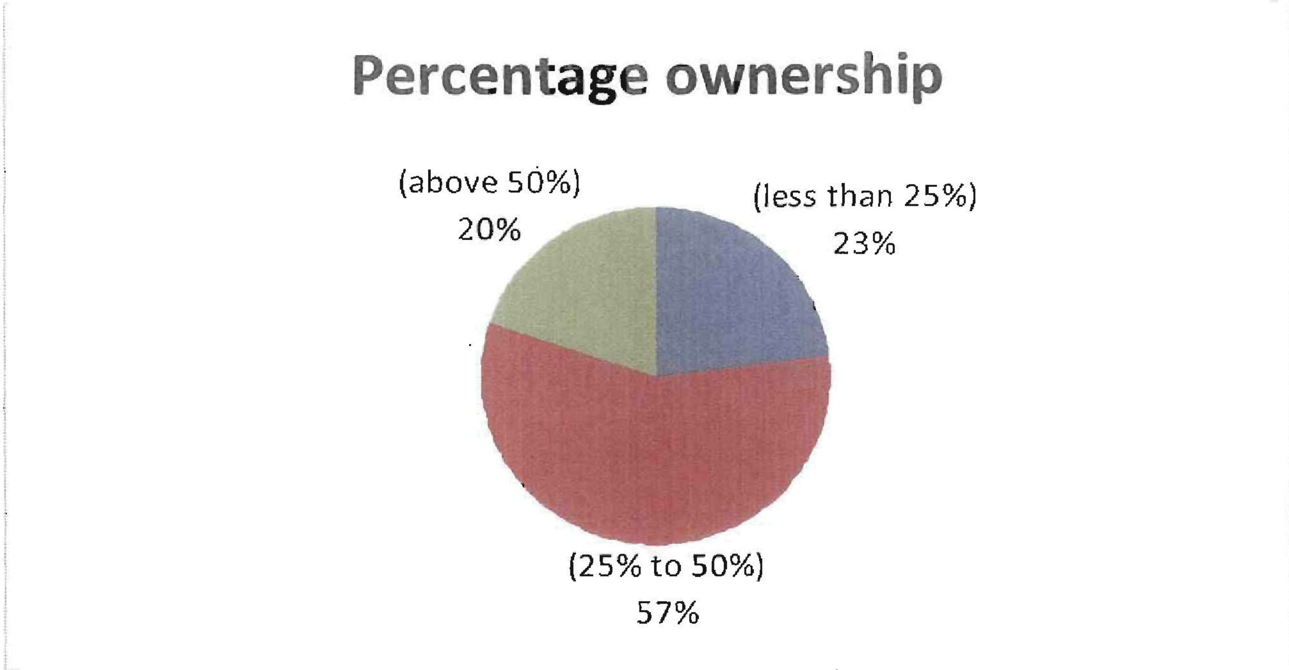
Figure 4.3: Company sizes involved in BEE



For the purpose of size, BEE transactions were split into large size (turnover above R25 m per annum) and small size (turnover below R25 m per annum). It was important for the researcher to know whether the respondents have been exposed to large or small BEE transactions in order to find out the cause and effect of the conditions surrounding the transaction. According to the results the small size constituted 65% and the large size was represented by 35% of the respondents.

The other factor to be considered was the percentage of the ownership acquired by the BEE parties in the BEE transaction.

Figure 4.4: Percentage of BEE ownership



For the purpose of this research, the researcher needs to understand what percentage of equity was acquired by the BEE partner to be able to determine whether it was affordable and the level of exposure to future interest rate fluctuation. The research results revealed twenty three percent of respondents had been involved in transactions that have a 25% BEE ownership. While fifty seven percent were involved in BEE transactions that have ownership of 25% to 50%. The rest of respondents (twenty percent) had been exposed to BEE transactions of above 50% BEE ownership.

4.3.2 Section 2: Efficiency of BEE funding models

The efficiency of the funding model is a measure to determine whether the BEE funding models supports the BEE objectives and sustainability of BEE transactions.

Table 4.1: Achieving BEE objectives

	FIRST PHASE GROUP			SECOND PHASE GROUP		
Question A:	Mean	Std Deviation	No of respondents	Mean	Std Deviation	No of respondents
Question 1	1.33	0.48	21	3.72	0.45	29
Question 2	1.71	0.46	20	2.90	0.45	28
Question 3	1.90	0.54	21	2.90	0.72	29
Question 4	1.48	0.51	21	2.93	0.77	29
Question 5	1.76	0.70	21	2.79	0.84	20
Question 6	2.72	0.83	19	2.83	0.90	29
Question 7	2.19	0.51	21	3.07	0.76	27
Question 8	1.52	0.58	21	2.86	3.55	20
Question 9	3.05	0.60	20	0.63	0.59	21

In this part of the questionnaire the questions posed to the respondents were sourced from the part of the literature that covers achieving BEE objectives which include the economic benefit and the poverty alleviation effect that the BEE transactions have on the communities in the South African context. From the responses 21 were from the first phase group and 29 from the second phase group.

Respondents when asked about whether the BEE funding models were/ are effective in supporting the achievement of BEE objectives which are (i) transferring of ownership and economic benefits to PDI's broader community, (ii) positively contributing to transformation, (iii) encouraging sustainable economic growth and wealth as well as reducing unemployment and poverty. Based on the mean of between 2.79 to 3.72 and standard deviation of between 0.45 to 0.9, second phase group seems to agree. While the first phase group with the mean of 1.33 to 2.52 and standard deviation of between 0.46 to 0.83 seems to be in disagreement.

About eighty six percent of respondents from the second phase group and only 18% from the first phase group are positive that the second phase BEE funding models are better than the first phase models. An overwhelming 82% from the first phase is still sceptical that the BEE funding models will work.

Table 4.2: Sustainability of the BEE transactions

	FIRST PHASE GROUP			SECOND PHASE GROUP		
Question B:	Mean	Std Deviation	No of respondents	Mean	Std Deviation	No of respondents
Question 1	3.10	0.77	19	3.38	0.80	28
Question 2	1.67	0.66	21	3.10	0.49	29
Question 3	3.24	0.77	21	2.07	0.62	29
Question 4	3.19	0.51	21	1.86	0.80	29
Question 5	2.05	0.80	21	2.03	0.52	29
Question 6	3.14	0.48	21	3.21	0.82	29
Question 7	3.10	1.22	20	3.24	0.62	29
Question 8	3.24	1.00	19	1.93	0.74	29
Question 9	3.10	0.89	21	3.00	0.59	28
Question 10	3.14	0.57	21	2.93	0.85	29
Question 11	1.71	0.96	21	2.10	0.84	29
Question 12	3.19	0.75	17	3.21	1.14	27
Question 13	3.19	0.51	21	2.03	0.56	29
Question 14	3.05	0.50	19	3.38	0.82	29
Question 15	3.24	0.87	20	3.10	0.62	29
Question 16	3.14	0.55	21	3.34	0.67	28
Question 17	3.14	0.56	21	3.03	0.67	28
Question 18	3.33	0.64	21	3.07	0.73	29
Question 19	3.10	0.64	21	3.34	1.00	29

From the table it can be observed that most of the respondents in the first phase group and second phase group overwhelmingly agree with the statements made about the BEE in that period of time in place. The questions range from the transaction costs, finance models costs and the benefit of the BEE. At a mean of between 3.04 and 3.3, standard deviation of 0.47 and 1.22, first phase group agree that the BEE transactions using BEE funding models are not sustainable and efficient because of high transaction costs and interest rates. The first phase group also agree that BEE transactions have a low chance of survival because of the funding structures used that depend on dividends paid, share price performance and interest rates. While the second phase group at a mean of between 1.86 and 2.1, standard deviation of 0.52 and 0.84, seems in disagreement with the above notion that BEE transaction are not sustainable and efficient. However with mean of between 2.93 and 3.38, standard deviation of 0.49 and 1.15 this group seems to agree that the structure of BEE funding models will allow BEE transactions to survive if share price grows faster than the interest rates charged, specifically if the company declares adequate dividends. Both groups are in disagreement that the value added by the BEE partner can be quantified. Also both disagree that the discount offered on BEE shares is sufficient to guarantee a sustainable share in a company to BEE partner.

Table 4.3: Characteristics of BEE funding models

	FIRST PHASE GROUP			SECOND PHASE GROUP		
Question C:	Mean	Std Deviation	No of respondents	Mean	Std Deviation	No of respondents
Question 1	3.71	0.46	21	2.90	0.67	28
Question 2			21			29
Question 3	3.14	0.48	20	3.17	0.73	29
Question 4	3.05	0.67	18	3.10	0.66	27
Question 5	3.62	0.67	21	2.52	0.62	25

With the mean of between of 3.7, standard deviation of 0.46 and mean of 2.9, standard deviation of 0.31, both respondents from the first phase and second phase highly agrees that the majority of BEE transactions use special funding models because most BEE partner does not have capital or collateral. Respondents also agree that commercial banks always require collateral and guarantee for funding provided to BEE transactions. According to the first phase and second phase group, banks see BEE funding as high risk.

Table 4.4: Structure of BEE funding models

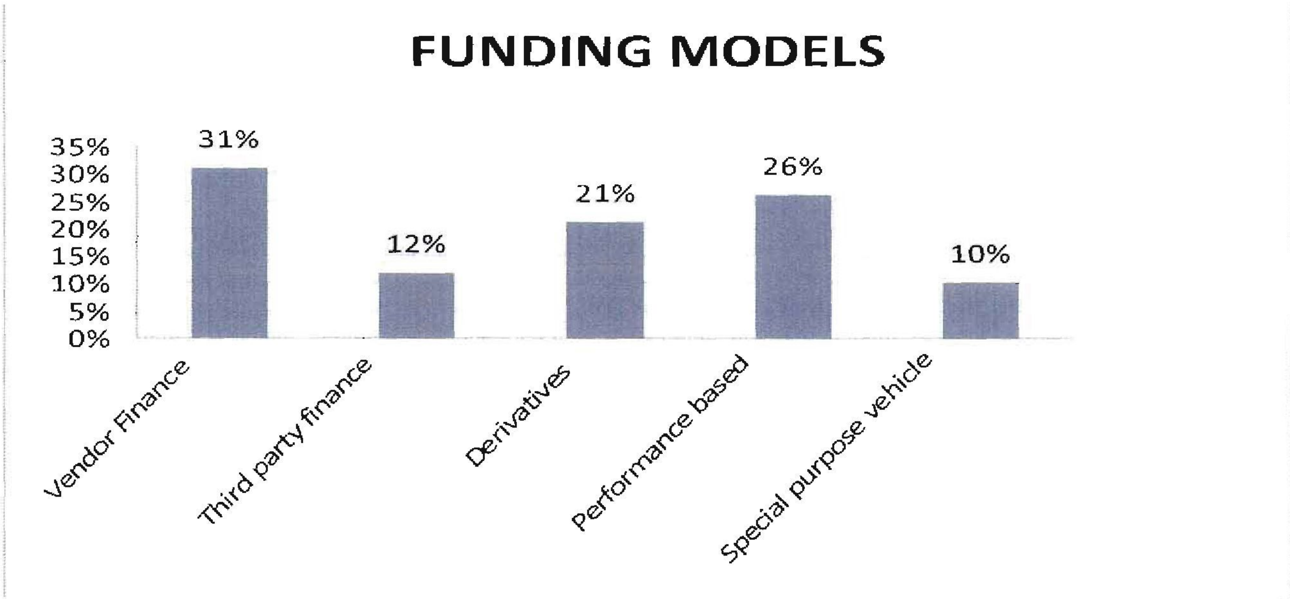
	FIRST PHASE GROUP			SECOND PHASE GROUP		
Question D:	Mean	Std Deviation	No of respondents	Mean	Std Deviation	No of respondents
Question 1	3.71	0.59	21	1.72	0.83	29
Question 2	3.19	0.92	21	2.24	0.59	29
Question 3	3.43	0.88	21	1.41	0.99	29
Question 4	3.48	0.58	21	1.48	0.63	28
Question 5	3.19	0.72	21	1.83	0.63	29
Question 6	3.19	0.58	20	3.07	0.63	27
Question 7	1.57	0.56	21	2.31	0.49	29

The first phase group with a mean of between 3.19 and 3.71 and standard deviation of between 0.58 and 0.92 believes that BEE funding models in general uses complicated structures that are ineffective in transferring shares acquired by the BEE partners, therefore the survival rate of BEE transactions is very minimal. Meanwhile respondents from second phase disagree by a mean of between 1.72 to 2.48 and standard deviation of 0.59. Yet both respondents from the second phase and first phase do agree that models and structure used to fund BEE transactions attracts higher interest rates than normal transaction. Both groups are also in disagreement with the statement that government has adequate structures to support BEE initiatives.

4.3 Funding models

The funding models/structures which were apparently widely used through the spectrum by the respondents are vendor finance, third party finance, derivatives, performance based and special purpose vehicle. The results from the survey indicate that the mostly used method of funding is vendor finance with thirty two percent of the respondents favouring it, then performance based is second at twenty six percent, in the third place is derivatives which is at (twenty two percent). The last two methods which do not seem to be favoured by the respondents are third party finance as the fourth favourite at twelve percent and lastly special purpose vehicle at ten percent.

Figure 4.9: Types of BEE funding models



4.4 Interview results

Nearly fifty four percent of people interviewed believed that BEE funding models have not been successful in supporting BEE transactions to achieve BEE objectives because there is no concession from the funding models to recognise inefficiency of the past. Normal banking criteria still apply and are punitive to the BEE partners. While sixty six percent sees BEE funding models as a failure because of large amounts required to acquire equity and therefore more exposure to fluctuating interest rates and other unpredictable variables. The other thirty eight percent do not regard using BEE transaction as a true empowerment initiative but as an enrichment scheme, thus irrespective of funding models used, there will still be poverty, high level of employment and very few will see the economic benefits of the

BEE transactions. About fourteen percent think BEE transactions have so far been successful in achieving BEE objectives because a number of people benefited from these transactions and there has been millionaires/billionaires that were made.

All people interviewed regard vendor finance, third party finance, derivatives, performance based and SPV as the only funding models and structures commonly used to fund BEE transactions.

Nearly fifty two percent think commercial banks will only invest in a BEE transaction if the business is viable and has sufficient assets that can absorb the cost of debt or act as guarantee, therefore irrespective of whether the transaction is BEE or not, the risk will be the same. Supported by sixteen percent that says banks use shares or equity funded as collateral, therefore there is no high risk involved, if the BEE partner is unable to service the loan, the bank will acquire those shares. While an overwhelming seventy two percent says commercial banks sees BEE partners as high risk because they do not have collateral.

Then sixty two percent of those that think BEE transactions are regarded as high risk thought the solution in reducing such risk will be to offer higher discounts on shares and equity acquired by the BEE partners. Adequate discount offered will reduce the price of these assets. Approximately forty eight percent supported this by further saying BEE partners should be offered the first ten percent stake for free, which can then be regarded as collateral to reduce risk. Thirty four percent said BEE partners should be offered smaller equity within the target companies to reduce the pressure of requiring large amounts of funding which is not affordable.

About sixty four percent of respondents believed company's share performance determines the ability of the BEE partner to service loan obligations. Supported by a further sixteen percent that sees economic conditions have a direct impact on company's performance and thus being a contributing factor. Twelve percent said dividends paid will determine whether the BEE partner can fulfil loan obligations or not. While nearly eighteen percent said interest rates were the highest factor in determining the ability of the BEE partner to service the loan obligation.

Approximately twenty eight percent of respondents said, discount offered reduces the price of an asset, thus reduce the value of the company. While fifty eight percent said the discount offered is very minimal, thus does not have much impact on a company's value. A further ten percent said most of the BEE shares are overvalued, not even the discount offered will have much impact.

Nearly fifty percent believes that no value has been added by the BEE transactions to the target company, while twenty two percent said even if value has been added it cannot be quantified. Ten percent believes that BEE transactions should not be expected to add value because it is not concluded as commercial transactions but as a political and legal requirement. Lastly eighteen percent think BEE transactions have added value through preferential procurement and being able to discover new markets. If value added by the BEE transaction were to be quantified, sixty percent of respondents think evaluation should be done on each contract work awarded. Twelve percent think value added by BEE transactions should never be quantified because their purpose is not to add value but to comply with empowerment legislations. Value can be quantified through doing a financial and economic analysis, such as returns on investments and job opportunities created. Further supported by twenty percent that said through cost and benefit analysis, the net benefits or losses can be quantified. The process will involve quantifying all costs of BEE transaction (cost of debt, legal costs, and overheads) and benefits (tenders and business received based on the BEE status of the company).

Almost forty percent said the second wave models are better because based on the past lessons learned about BEE funding, BEE partners are now wise and better at selecting a model that will best suite the structure of the BEE transaction and the target company. Eleven percent said the guidance offered by the scorecard and Codes, defines requirements that have to be met by the new funding models, thus avoid inefficiencies that were caused by the first wave models. Guidance offered by the Codes seems to have clarified a lot of issues. About twenty two percent were unsure of whether the second wave models will be better since it is based on the same conditions of funding without collateral and nineteen percent said the models were still fairly new to decide.

Seventy percent of respondents believed that the lack of funding or collateral affects the sustainability of BEE transactions. Fifty two percent said without collateral, huge amounts of funding cannot be afforded by the BEE partner. Forty two percent said funding without collateral exposes the BEE partner to high interest rates, thus minimising the chance of the deal being sustainable. Another twenty four percent said irrespective of whether the BEE partner can provide collateral or not, huge amounts of funding required will still expose the BEE partner and sustainability is dependant on company performance.

Only thirty eight percent believes share percentage is diluted because BEE partners do not have collateral. To raise collateral it seems BEE partners need to sell part of their shares and use proceeds as collateral. Thirty six percent said the need to sell shares is caused by complicated structures that were used to fund most of the BEE transactions. Nearly eighteen percent said the inability of the BEE partner to pay back the loan, meant the bank will have to acquire BEE shares which were put forward as collateral.

About fifty six percent of respondents think irrespective of which ever funding model is used for BEE transactions, the survival of the BEE transaction depend on performance of the company/shares. While twenty two percent believes that all funding models will be efficient if it is able to transfer economic benefits to BEE investors. Yet twelve percent said that as long as BEE transactions are exposed to high interest rates and high transaction costs, BEE transactions cannot be efficient.

To insure sustainability of BEE transactions, thirty two percent said there must be a radical shift in the BEE structure. A funding model must not be dependent on the loan to value relative to the share price, but must be linked to cash generating abilities of the company. Forty two percent said that BEE transactions must be treated as an empowerment requirement. Thus should be offered more financial support through discount on share price and low interest rates to reduce the burden of huge amounts of debt.

About twelve percent said BEE partners must be offered minimal shares that can be paid within a short period of time. Eight percent believed sustainability of BEE transactions does not only depend on ownership but on other empowerment elements such as involvement of BEE partners into strategic and operations of the business. An overwhelming seventy eight percent believe the current structures that the government have are not effective in supporting BEE transactions.

In the next chapter attention is focused on the conclusion and recommendations of the study.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This paper has analysed the funding of BEE through available research, interviews, and analysis of research results from the selected sample. In the process of understanding Black Economic Empowerment in South Africa and its development, the origin and evolution of BEE from narrow based approach to broad based was discussed. The following conclusion and recommendation are made based on the literature review and research.

5.2 Summary overview of the study

Chapter 1 presented the background to the research, followed by the problem definition and research objectives. This chapter was concluded with the research structure and discussion on the chapter layout.

Chapter 2 presented the literature review regarding the origin and evolution of Black Economic Empowerment in South Africa, the definition and strategy. Two phase of empowerment, first phase (1994 -2003) and second phase (post 2003) were discussed. The funding models used to finance BEE transactions during the two phases were analysed. According to the literature research, the government promulgated numerous empowerment policies and regulations. The government also developed its BEE strategy and encouraged sector or industry charters. The charters were regarded as a show of industry commitment towards achieving BEE targets and support of BEE initiatives. The first phase proved to have been characterized by narrow based empowerment that focused more on ownership and empowered only few individuals. This period saw an influx of BEE transactions, yet few of these transactions were successful in transferring economic benefits to previously disadvantaged individuals (PDI's). During this period, the special purpose vehicle was the most used structure.

Based on the failures of the first phase period, the government changed its strategy and introduced a broader based approach of empowerment which included other elements, namely management, skills development, employment equity, preferential procurement and enterprise development. These elements are assessed and measured based on the weighting and point system allocated as per the generic scorecard. Only companies that comply with the scorecard requirements will be regarded as empowered companies. Even with the broader approach, the government is still faced with the dilemma of funding.

The funding structure for most BEE equity transactions is an attempt to acquire equity with 100% debt and without collateral, which is an inherently difficult task. Hence the main purpose of this paper was to establish how is the BEE fraternity dealing with this mammoth challenge and assess the efficiency and effectiveness of BEE funding models used for all the BEE transactions. The second phase BEE funding models, such as vendor finance, performance based, derivatives and third party finance were critically discussed in this chapter.

Chapter 3 focused on the empirical research phase. The empirical study consisted of primary data collected from an explorative structured face to face interviews and a questionnaire.

Chapter 4 provided a discussion of the results obtained from the empirical investigation conducted on the problems of accessing the effectiveness of BEE funding models. Descriptive statistical analysis, which included mean and standard deviation, was predominately used in the presentation of results.

Chapter 5, the final phase and the component of the research study, aimed at applying the information obtained from the literature study as background to provide a solution to the problems of BEE funding models.

The primary and secondary objectives discussed in chapter 1 have been met. The study has shown that the problem of BEE funding models used during the first and second phase include the following:

i. Black investors lack capital and collateral thus requiring 100% funding
ii. High interest rates required on the financing of BEE transactions; and
iii. BEE transactions use funding models that highly depend on share performance, dividends and cash flow.

The above problems show that the funding models success and sustainability depends highly on factors that are beyond the control of BEE partners.

The study has also given a broader understanding of BEE and its objectives, including discussion on first phase and second phase. BEE funding models used during both phases were discussed and critically analysed. The research also highlighted the problems in funding BEE transactions from both the first phase and second phase.

5.3 Shortcomings of the study

Several shortcomings were identified during the study. There has not been much documented research on the problems of BEE funding in South Africa. The new funding models have just been recently implemented; therefore it's still at an early stage and difficult to assess the performance of these transactions.

Secondly, one of the initial aims of the study was to explore from financial institutions and companies what problems they encountered in financing BEE transactions and the performance of the current BEE companies. However, this objective could not materialize because of non disclosure issues. Therefore the financial performance was excluded from the final result generation.

Lastly, the sample used for this research was smaller because only people with reasonable exposure and understanding of BEE and BEE funding models were selected.

5.4 Key findings and recommendations

The government has developed empowerment policies and numerous funding structures such as Khula and the IDC to support BEE initiatives. Yet according to research it seems as if people don't think government is doing enough to support BEE initiatives. It is therefore recommended that government should establish an independent agency that will evaluate the effectiveness of the BEE government structures.

Based on past lessons learnt from the first phase BEE funding models, there has been developments with new funding models introduced for the second phase BEE transactions. With the introduction of vendor finance, more BEE companies may be able to reduce the cost of capital that is used for the purchase BEE shares. Such intervention will reduce the burden of debt and high interest payments.

Yet based on the literature review and research, interest rates charged on BEE investments are still highlighted as one of the issues that affect the success of BEE transactions. BEE transactions are still perceived to be exposed to high interest rates because financiers regard such transactions as commercial and not as a legal obligation. An option to control and lower interest rates charged on BEE transactions is for government to structure the funding policy, forcing lower than prime rate on BEE transactions. Government could also consider subsidizing the cost of interest rates on BEE transactions. Another option is to provide companies that assist BEE investors to pay lower interest rates the opportunity to receive more points on the scorecard.

According to research done, the discount offered to BEE transactions on share purchases is not adequate or enough to lower the burden of finance. Therefore there is an opportunity for government to provide guidelines and minimum rates that can be applied by companies when offering discount on BEE shares. Companies that offer higher discounts on the BEE shares may gain points on the scorecard to encourage higher discounts.

There are high costs incurred for BEE transactions such as transaction costs, cost of capital and discount offered. Most of these costs cannot be quantified because, until recently companies did not keep records, to show the total costs of putting together BEE transactions. Therefore it is difficult to quantify the financial losses and gains that come with the BEE transactions. Even so, it has been evident that companies loose a lot of money on transaction costs and discounts given to BEE companies, especially if the BEE transaction fails completely or fail to obtain government tenders.
Such failures have created perceptions that BEE is not a value adding activity.
Thus companies should structure the BEE transactions by linking equity interest to performance. This will ensure that these transactions also add value to the company.

The industry charters as discussed in Chapter 2, requires that most companies within respective industries transfer at least 25% of equity to black people within ten years. Such targets have put a lot of pressure to the transformation process, resulting in a lot of inefficiencies, such as complex structures that are not effective and refunding of the shares because of increasing interest rates and poor returns. The Charters needs to be reviewed and BEE companies be given equity that is affordable, the rest can be acquired in small portions once the other investments have matured and made profits.

Nearly forty three percent of the BEE partners interviewed did not understand the type of funding structures used by companies, therefore were unable to access whether the transaction would survive with the companies' financial projections.

The ability of the BEE investor to correctly evaluate the assets of the business purchased plays a crucial part in determining the benefits of investing in that company, and whether the black investor will be able to meet the loan obligations. Most BEE funding models used depend on share price performance, free cash flow generation, achievements of performance targets and the discounts given at the inception of the transaction. All of these will determine the success of the BEE transaction and if not applied correctly and not achieved will cause the transaction to fail.

During the research it emerged that the majority of respondents interviewed preferred vendor finance because it reduces the cost of finance for BEE investors. In such situations, the target company is able to finance the deal or give guarantees on behalf of the black shareholders. In this regard companies have to be aware of the conditions of section 28 of Companies Act (discussed in 2.7.1). To assist black economic empowerment companies, it is proposed that the government relax section 28 only to accommodate BEE transactions.

According to the research done, cash flow and financial projections are amongst the issues that have an impact on the ability of the BEE investor to service the loan obligations. On calculating the financial projections to determine the future performance of the company, future projects and cash requirements should be considered. Management should also note that BEE transactions may require a company not to be involved in large investments that will require large cash injection. Thus there may be a trade off between growth and loan obligation. Companies should have strategies in place to ensure that both requirements can be met without compromising the other.

5.5 Further research

Further research that can be conducted includes the following:

i. Research can be undertaken to determine the efficiency of the new funding models by assessing the financial performance of the BEE transactions prior and after the empowerment. Taking into consideration other factors, assessment can show whether the benefits (returns) outweighs the costs incurred for putting together the BEE transaction.

ii. Review on whether financial institutions are doing enough to finance BEE transactions. Also whether it's more risky to finance BEE transactions as compared to any normal transaction.

iii. Further research can be done on comparing the different types of funding models used to determine which funding model will best suite any type of BEE transaction.

5.6 Conclusion

Based on the failures of the first phase highlighted on literature review and on the research. It can be concluded that the funding models (SPV's) used during the first phase were not effective in meeting the BEE objectives. These structures failed to transfer ownership without dilution or economic benefits to previously disadvantaged individuals. It also incurred high costs through complicated structures. The first phase BEE SPV's did not transfer economic benefits or add value to the target companies. Huge discounts offered by the target companies to BEE, did not ensure the transfer of equity to black people but led to undervaluation of the shares and diluted the BEE shareholding to financiers and other white investors.

The second wave deals are characterised mostly by vendor finance. Although it is still early to assess the effectiveness of the second phase models. So far vendor finance has proven to be most popular and efficient to some level. This model seems to be able to reduce cost of capital because of guarantees offered by the hosting company to the BEE partner. Yet it may be more risky, for the target company if the BEE company defaults on payments. Even though the interest rates have been lowered because of the guarantee, the BEE company is still exposed to the country's prime rate fluctuations. Thus the company's rate of return performance has to be better than the interest rate fluctuations for the transaction to remain efficient. The target company should have adequate resources (profitability and cash flow) to be able to undertake the BEE loan obligation. This indicates that funding BEE transactions will always be a difficult and challenging initiative for the government unless interest rates and discount offered on the BEE shares can be controlled to reduce the price of the acquired BEE assets or shares.

Bibliography

Ackermann, P.L.S.; Meyer, P.G. 2007. The identification of credit risk mitigation factors in lending to black economic empowerment (BEE) companies in South Africa: research article. Available: Southern African Business Review. Vol. 11. Date of access: 11 Jan. 2008. 40p.

Anon. 2003. African National Congress: ANC today. Opening the doors of Black Economic Empowerment. http:/www.anc.org.za.Date of access: 14 Sept. 2006.

Anon. 2005. Broadening the base: black economic empowerment: strategic executive report. 3rd Edition. Human Capital Management. p. 12-16.

Anon. 2006. Black economic empowerment: business strategy. 3rd edition. Human Capital Management. p. 47-49.

Antonites, A. J. 2003. An action learning approach to entrepreneurial creativity, innovation and opportunity finding. Pretoria: University of Pretoria (Unpublished Thesis - D Com). 150p.

Balshaw, et al. 2005. *Cracking Broad-Based Black Economic Empowerment: Codes and Scorecard unpacked.* Human and Rousseau, Cape Town.

Batchelor, P. and Dunne, P. 1999. TIPS Annual Forum, Industrial Participation, Investment and Growth: The Case of South Africa's Defence Related Industry.

BEE Commission. 2001a. BEEC Black Economic Empowerment project, Draft Report. p. 19-21.

BEECom. 2001b. Black Economic Empowerment Report. Johannesburg: Skotaville.

Benjamin, P and Barry, B. 2002. *Skills Development Handbook* at 1; Jacqueline Church & Joan Church 'Education' in: WA Joubert (founding ed) *The Law of South Africa* Reissue. Vol 8. Part 2.

Berry, A. von Blottnitz, M. Cassim, R. Kesper, A. Rajarathnam, B. and Seventer, D. 2002. The economics of SMME in South Africa. TIPS Report.

Brown, A. 2004.Black Ownership: Risk or Opportunity. Measuring empowerment ownership.

BusinessMap. 2000. Empowerment Guidelines for Investors: Mapping state requirements and investor experiences. Empowerment Guidelines.

BusinessMap. 1998. Innovation in Empowerment Financing. http://www.businessmap.org.za. Date of access: 2 Mar. 2007.

BusinessMap. 2001. Empowerment Report 2001: better outcomes. Johannesburg: BusinessMap Foundation.

Cargill, J. 1997. Quarterly Review: Black Economic Empowerment. *BusinessMap*: 6 Nov. 200p.

Cargill, J. 1998. New Policy Direction in South Africa. *BusinessMap*.

Cargill, J. 2000. Empowerment 2000: New Direction. *BusinessMap*: April. p. 10 – 17.

Cargill, J. 2001. Empowerment 2001: Better Outcomes. *BusinessMap*: 200, Nov.

Cargill, J. 2005. Black corporate ownership: Complex codes can impede Change. S. Brown (ed.), *Conflict and Governance: Economic Transformation Audit 2005.* Cape Town, Institute for Justice and Reconciliation.

Cargill, J.1999. Empowerment 1999: A Moving experience. *BusinessMap*. 176 p.

Chalmers, R. 2001. Markets value information. Business Day:11 Feb. 6p.

Coetzee, L and Marais, F. 2006. The determination of black ownership in companies for the purpose of black economic empowerment (part 2). Vol 27, Issue 3. Obiter. p. 502-538.

Commission for Employment Equity. 2005. Annual Report 2004/2005. http://www.labour.gov.za. Date of access: 12 Jan . 2008.

Commission for Employment Equity. 2007. Annual Report 2006/2007. http://www.labour.gov.za. Date of access: 12 Jan. 2008.

Cooper, D.R. and Schindler, P.S. 2001. Business Research Methods. 7th edition. Boston: Mc – Graw Hill.

Cooper, D.R. and Schindler, P.S. 2003. Business Research Methods. 8th edition. Boston: Mc – Grew Hill.

Creswell, J.W. 2003. Research design; qualitative, quantitative, and mixed methods approaches, 2nd edition. Thousand Oaks, CA: Sage Publications, Inc.

Cronje, G.J.J. du Toit, G.S. Motlatla, M. D. C. 2003. Introduction to Business Management. 5th edition. Cape Town, Oxford University Press.

De Klerk, F.W. 2006. The FW De Klerk Foundation: Transformation and Black Economic Empowerment in South Africa. http://www.fwdklerk.org.za.Date of access: 27 Nov. 2007.

De Vos, A.S. Strydom, H. Fouche, C.B. and Delport, C.S.L. 2002. Research at grass roots: For the social sciences professionals and human services professions. 2nd edition. Pretoria: Van Schaik.

De Witt, D. 2003. Black economic empowerment: Hand-outs of business sense. HR Future, Feb. 2003.

Dekker, C. 2004. The way to BEE, a guide to broad-based black economic empowerment in South Africa. http://www.cliffedekker.com. Date of access: 07 Feb. 2008.

Department of Trade and Industry. 1998. National Empowerment Fund Act No. 105. Government Gazette. www.dti.gov.za. Date of access: 20 Sept. 2006.

Department of Trade and Industry. 1999. The Sector Transformation Charters. http://www.dti.gov.za/bee/beecharters. Date of Access: 13 Feb. 2007.

Department of Trade and Industry. 2000. Petroleum and Liquid Fuels Charter. http://www.dti.org.za. Date of access: 12 Nov. 2006.

Department of Trade and Industry. 2002. Industrial Development Corporation: Annual Report. http://www.dti.gov.za. Date of access: 13 Jun. 2007.

Department of Trade and Industry. 2003. Broad Based Black Economic Empowerment Bill. http://www.dti.gov.za. Date of access: 22 Oct. 2006.

Department of Trade and Industry. 2003. South African Economic Transformation: A strategy For Broad Based Black Economic Empowerment. http://www.dti.gov.za. Date of access: 22 Oct. 2006.

Department of Trade and Industry. 2007. The Codes of Good Practice. http://www.department of trade and industry.gov.za/bee/beecodes. Date of access: 26 Jan. 2007.

Employment Equity Commission. 2004. Annual Report. www.dti.gov.za Date of access: 13 June. 2007.

Empowerdex. 2003. Transformation Catalyst: Quantifying the Economic Impact of the Financial Services Charters. http://www.empowerdex.co.za. Date of access: 2 Sept. 2006.

Empowerdex. 2003. Transformation Catalyst: Quantifying the Economic Impact of the Financial Services Charters. Date access: 2 Sept. 2006. 3-12p.

Empowerdex. 2003. Pioneers, Powers and Pundits: Influential and powerful Directors on the JSE, Empowerdex. Date of access: 9 Jan. 2007.

Empowerdex. 2005. Empowerment partnerships: *New Agenda*, No. 20, 4th Quarter. p. 27-31.

Empowerdex. 2006. Draft codes accelerate BEE for Listed firms. *Business Report*: 2 Mar.

Ernst & Young. 2005. 15th Mergers and Acquisitions: A review of activity for the year 2005. http://www.southafrica.info/public_services/citizens/travelkit-bee.htm. Date of access: 11 Oct. 2007.

Field, A. 2005. Discovering statistics using SPSS. Sage: Thousand Oaks.

Financial Sector Charter Council. 2006. 2005 BEE performance report: Reporting form, scorecard and guidance note. Date access: 12 Aug.2006. p. 1-51.

Fisher, R. 2003. Driving government BEE policy: Moneyweb. http://www.moneyweb.co.za. Date of access: 9 Apr. 2007.

Glattorn, A.A. 1998. Writing the winning dissertation. A step-by step guide. Thousand oaks, CA: Sage Publication.

Goldberg, J. 2006. Update on broad-based black economic empowerment: legal and management. Vol 14, Issue 8. Civil Engineering: Aug. 26p.

Gqubule, D. 1999. Time to Take Stock: *Financial Mail*: 7, 4 Jun.

Gqubule, D. 2003. Capitalising Capitalists without Capital: Black Economic Charters Supplement *.Leadership Magazine: 20, 14 Sept.*

Gqubule, D. 2006. Making Mistakes Righting Wrongs, Insights into Black Economic Empowerment: The True Meaning of BEE. Johannesburg, Janathan Ball Publishers. 251p.

Gqubule, T. 2006. Top Empowerment Companies: Its time to step up the tempo. *Financial Mail*: 78, 10 March.

Henning, Du Plessis, Delport, De Koker and Pretorius. 2001. *Korporatiewe Reg.3rd* edition. p. 224-225.

Hirsch, R.D. and Peters, M.P. 2002. Entrepreneurship. 5th edition. London. The McGraw – Hill Companies.

Huysamen, G.K. 1997. Parallels between qualitative research and sequentially performed quantitative research. South African Journal of Psychology, Vol. 27, No.1. p. 1 - 8.

Jacobs, J. 2007. A broad-based approach: black economic empowerment. Vol 32, Issue 3. IMIESA. Mar. 2007. p. 47-55.

Janisch, P. 2006b. BEE and South Africa's growth strategy: black economic empowerment .Vol 14, Issue 2. Civil Engineering. Feb. 2006. p. 38-39.

Janisch, P. 2006a. A practical application of enterprise development and corporate social investment: black economic empowerment. Vol 14, Issue 4. Civil Engineering, Apr. 2006. p. 23-24.

Janse van Rensburg, K; Roodt, G. 2005. The perceptions of Employment Equity and Black Economic Empowerment as predictors of organisation-related commitment. Vol 3, Issue 3. SA Journal of Human Resource Management. p. 49-60.

Jordaan, J. 2002. Employment equity can mean money in the bank. HR Future, April. 2002. p. 28-31.

Kerlinger, F.N. 1986. Foundations of behavioural research. 3rd edition. CBS College Publishing: New York.

Levin, J.L. 2006. Considering the Legitimacy of Government measures to introduce Black Economic Empowerment Legislation analyses. Vol 18, Issue 4. SA Mercantile Law Journal. p. 388-392.

Luiz, S and Van der Linde, K. 2006. Broad-Based Black Economic Empowerment: some challenges in measuring ownership of companies. Vol 18, Issue 4.SA Mercantile Law Journal. p. 405-417.

Mabuza, E. 1996. Black Economic Empowerment: The South African experience, Business Round Table Conference, Sun City. 2 May. 1997.

Mahanyele, M. 1993. Black Economic Empowerment underpinning post apartheid era. Human Resource Management, Oct. 1993. p. 8-13.

Manuel, T. 2005. Budget speech. http://www.info.gov.za/speeches/2005 Date of access: 11 Jan. 2006.

Marais, F and Coetzee, L. 2006. The determination of black ownership in companies for the purpose of black economic empowerment (part 1). Vol 27, Issue 1.Obiter. p. 111-127.

Martins, N. 1999. Questionnaire on employment equity in association with Ernest and Young. Unpublished document. Johannesburg: Organisational Diagnostics.

Matseke K. 2005. Actis Africa. Financial Mail. www.financialmail.co.za. Date of access: 11 Feb. 2007.

Matuna, J.M. 1996. Excessive job mobility among black managers. Johannesburg: University of the Witwatersrand (Unpublished master's thesis).

Mbabane,L.2006. BEE equity in listed firms lags: Business Report. http://www.busrep.co.za. Date accessed: 23 Aug. 2006.

Mbeki, M. 2003. Empowerment Enriches Only a Selected Few. *Business Day*: 5 Jun. 2003.

McGregor A. 2007. Analysis of South Afircan business in Africa. Who owns whom.

Metcalfe, M. 2006 .Making sense of Black Economic Empowerment.

Miles, M.B and Huberman, A.M .1994. *Qualitative Data Analysis.* London, Sage.

Monkman, D. 2003. A review of the department of trade and industry's SME assistance programmes: Finmark Trust. http://www.cmfnet.org.za Date of access: 01 Apr. 2007.

Müller, S.M. and Roodt, G. 1998. The relationship between employees' attitudes against affirmative action and their work involvement: An explorative study). Journal of Industrial Psychology, 24 (1). p. 26-32.

Netswera, F.G. 2001. Perceptions of Johannesburg small business operators about their small business support systems. Vol 32, Issue. South African Journal of Business Management, Dec. 2001. p. 31-37.

Ntsika. 2002. State of Small Business in South Africa: Annual Review. Ntsika Enterprise Promotion Agency. Pretoria.

Ntsika. 1998. State of Small Business in South Africa: Annual Review. Ntsika Enterprise Promotion Agency. Pretoria.

Ntsika. 2000. State of Small Business in South Africa: Annual Review. Ntsika Enterprise Promotion Agency. Pretoria.

Oyewole, F. 1996. Proposal regarding a black economic empowerment fund, Standard Corporate and Merchant Bank unpublished document. 26 Aug.

Pretorius, Delport, Havenga and Vermaas.1999.*South African Company Law through the Cases.* 6th edition.

Primos, L. 1994. Searching for gold: The challenge for affirmative action recruitment. People Dynamics. p. 32-35.

Radebe, S. 2006. Top Empowerment Companies: A tool to assess real effects of BEE. *Financial Mail*: 7, 10 Mar. 2006.

Republic of South Africa. 1998. Employment Equity Act 55 of 1998. Pretoria: Government Printer.

Republic of South Africa. 2003. South Africa's Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment. Pretoria: Government Printer.

Republic of South Africa. 1998. Skills Development Act 97 of 1998. Pretoria: Government Printer.

Republic of South Africa. 1999. Skills Development Levies Act 9 of 1999. Pretoria: Government Printer.

Republic of South Africa. 2004. Broad-Based Black Economic Empowerment Act, 2003 Government Gazette, Republic of South Africa, vol. 463, Cape Town. No. 25899. 9 Jan. 2004. 45p.

Rwigema, H. and Venter, R. 2004. Advanced Entrepreneurship. Oxford University Press. Cape Town.

Saunders, M. Lewis, P. and Thornhill, A. 2000. Research Methods for Business Students. 2nd edition. Harlow: Pretence Hall.

Saunders, M. Lewis, P. and Thornhill, A. 2003. Research Methods for Business Students. 3rd edition. Harlow: Pretence Hall.

Sekeran, U. 1992. Research Methods for Business: A Skill Building Approach. 2nd edition. New York: Wiley.

South Africa. 1998. National Empowerment Fund Act No. 105. Government Gazette: http://wwwdti.gov.za. Date of access: 20 Sept. 2006.

South Africa. 1998. National Empowerment Fund Act: Act No 105. Vol 402. Government Gazette, 19589, 11 Dec.

South Africa. 2000. Preferential Procurement Policy Framework Act: Act No 5. Vol 416. Government Gazette, 20854.

South Africa. 2003. Broad Based Economic Act .Act No 53, Vol. 463. Government Gazette, 25899, 9 Jan. 2004.

South Africa. 2004. National Small Business Amendment Act: Act No 29. Vol 474. Government Gazette, 27101, 15 Dec. 2004.

Strydom, P.D. 2006. Black Economic Empowerment in South Africa. http://www.sabusinesshub.co.za. Date of access: 13 May .2007.

Sutcliffe, J. 2007. Black economic empowerment: empowerment in SA paying healthy dividends: business strategy. 4th edition. Human Capital Management. 26p.

Taljaard, A. 2004. BEE in melting pot: a banker's view. Finance week: 30, Aug.

Terre Blanche, M. and Durrheim, K. 2002. Research in practice: Applied methods for the social sciences. Cape Town: UCT Press.

Timmons, J.A. Spinelli, S. 2004. New venture creation: Entrepreneurship for the 21st century. 6th edition. Irwin/McGraw – Hill. Boston.

Tredoux, C. and Durrheim, K. 2002. Numbers, Hypotheses and Conclusions: A course in Statistics for Social Sciences. Cape Town: UCT Press.

Tucker, C. 2003. Summary of BEE in South Africa. http://www.bowman.co.za/Pressroom/Publications/Pub_BEE. Date of access: 12 Nov. 2007.

Van der Nest, D. 2004. The impact of BEE on the management of small companies in S.A. Johannesburg. RAU (Mini Dissertation – M.B.A).

Van Jaarsveld, M. 2005. Black economic empowerment and skills development: a success in many ways. Vol 17, Issue 3. SA Mercantile Law Journal. p. 261-275.

Van Zyl, B. and Roodt, G. 2003. Female perceptions on employment equity: Is the glass ceiling cracking. SA Journal of Human Resource Management, 1 (2). p. 13-20.

Verhoef, G. 2003. The invisible hand: the roots of black economic empowerment, Sankorp and societal change in South Africa, 1985-2000. Vol 28, Issue 1. Journal for Contemporary History. June. p. 27-47.

Verhoef, G. 2004. Economic empowerment and performance: strategies. Vol 29, Issue 2. Journal for Contemporary History. p. 92-118.

Visagie, J.C. 1997. SMMEs challenges in reconstructing South Africa. Management decisions, Vol. 35. p. 656 -663.

Vosloo, C. 1994. Listing of Real Africa: Standard Corporate and Merchant Bank.1 Aug.

Walbrugh, A. and Roodt, G. 2003. Different age groups' response to employment equity practices. SA Journal of Human Resource Management, 1 (2). p. 28-39.

Watkins, G. and Mason, G. 2005. The role of HR in facilitating Black Economic Empowerment. http://www.workinfo.com. Date of access: 22 June .2007.

Welman, J.C. and Kruger, S.J. 2001. Research Methodology. 2nd edition. Cape Town: Oxford University Press.

Wu, C. 2004. Top Empowerment Companies: The year sets the tone. Financial Mail: 3, 30 Apr.

APPENDIX A: MULTIPLE CHOICE QUESTIONNAIRE

Section 1: General information

Choose one of the following with an X

1. Please state the capacity in which you are answering questionnaire (you may select more than one)

Consultant for BEE transactions	
Employee of a BEE empowered company	
Owner or shareholder in a BEE company	
Employee of financial institution financing BEE companies	
Expert Author about BEE transaction	
Other (specify)...	

2) The period in which the BEE transaction was concluded

First phase (1994 – 2003)	
Second phase (after 2003)	

3) Size of the target company :

Large (turnover above R25 million p.a)	
Small (turnover below R25 million p.a)	

4) Percentage of ownership acquired by the BEE partner/s from the t company

Less than 25%	
Between 25% and 50%	
50% plus	

Choose the most appropriate answer based on your exposure to BEE transactions. Mark with x.

Section 2: Effectiveness of BEE Funding models

A: ACHIEVING BEE OBJECTIVES	**Strongly Disagree**	**Dis agree**	**Agree**	**Strongly Agree**
1. As per definition of ownership on broad based black economic empowerment "DEPARTMENT OF TRADE AND INDUSTRY codes", BEE transactions have been able to transfer economic benefits to previously disadvantaged individuals (PDI's).				
2. BEE transactions contributed positively to transformation and sustainable economic growth in South Africa.				
3. BEE transactions were successful in supporting the BEE objectives of reducing unemployment and eliminating poverty in S.A.				
4. BEE transactions are able distribute benefits to broader community and majority of South African PDI's as oppose too few elites.				
5. BEE models used are supportive of BEE transactions.				
6. BEE funding models used to fund BEE transactions will or have created sustainable wealth for PDI's.				
7. BEE funding models are able to encourage empowerment through transfer of ownership to PDI's.				
8. The newly applied funding models used during the second phase are much better than those used during first phase.				
B: SUSTAINABILITY AND EFFICIENCY OF THE BEE DEAL	**Strongly Disagree**	**Dis agree**	**Agree**	**Strongly Agree**
1. BEE funding model will be regarded efficient if benefits of BEE transactions exceeds total costs of putting together BEE transactions				
2. The BEE funding models that are currently used will ensure sustainability of BEE transactions				
3. Funding models used to finance BEE transactions are more costly than normal transactions				
4. Most BEE funding models used to finance BEE transactions attracts higher interest rates.				
5. The discount offered by the target company on the shares acquired is generally sufficient to enable the BEE partners to				

buy the shares.				
6. Discount offered on BEE shares underestimate the value of company's shares.				
7. The total cost of putting together a BEE transaction is normally higher than other commercial transactions				
8. Using BEE funding models to finance BEE transactions will have a negative impact on cash flow.				
9. BEE transactions have a limited future growth because of high funds required to service debt.				
10. BEE transactions add value to the target company through preferential procurement and positive returns.				
11. Value and benefits added by having BEE partner can be easily quantified.				
12. Financial institutions have been able to generate superior returns on capital invested in BEE transactions because high interest rates required				
13. Most BEE transactions do not have a chance to survive because of incorrect (underestimated) future projections made.				
14. Most BEE transactions survival depends on the ability of the BEE partner to service loan repayment.				
15. Whichever BEE funding model is used, the BEE partner will benefit from the BEE transaction, only if share price grows faster than interest rates.				
16. BEE funding models are used to fund transactions that have a political and legislative imperative (compliance issue) rather than a commercial imperative.				
17. For the BEE transaction to survive, the target company must be able to pay sufficient dividends to enable BEE partners to service loan and interest repayments.				
18. BEE partners will experience real economic benefits once the debt has been paid up.				
19. Most funding structures perform successfully on bull markets and worse when interest rates rise faster than returns.				
C: CHARACTERISTIC OF BEE FUNDING MODEL	**Strongly Disagree**	**Dis agree**	**Agree**	**Strongly Agree**
1. A majority of BEE transactions use special funding models because most BEE partner/s does not have capital or				

collateral.				
2. The most efficient BEE funding model/ structure used for BEE transactions funding.				
a) Vendor Finance- The Hosting Company *(company selling shares)* provides finance or collateral for a BEE partner to buy shares.				
b) Third Party Finance - Finance provided by a financial institution (e.g. banks) or government funding				
c) Derivatives – e.g. Option - The holder obtains an option to buy shares in the BEE Company within a certain time period.				
d) Performance based: Shares provided based on performance of the BEE.				
e) Special Purpose Vehicle - Separate legal structures used to acquire shares in the target company.				
3. Most funding structures are successful in supporting BEE objectives of including previously disadvantaged individual into mainstream of economy.				
4. BEE partners will experience real economic benefits once the debt has been paid up.				
5. The ability of the BEE partner to service loan repayment in any of the funding models is determined by future financial projection.				
6. The success of BEE transaction depends on the performance of share price of the company in which the BEE partner has acquired stake.				
7. Commercial banks require collateral or guarantee for funding provided.				
8. Commercial banks normally regard BEE as higher risk.				
D: STRUCTURE OF BEE FUNDING MODELS	**Strongly Disagree**	**Dis agree**	**Agree**	**Strongly Agree**
1. Most BEE funding models uses complicated structures; therefore the survival rate of BEE transactions is very minimal.				
2. BEE funding models creates an ineffective transfer of BEE shares allocated to BEE partners.				
3. BEE funding models used have complicated structures that dilute BEE shares acquired and fail to transfer real economic benefits.				

4. First phase funding models have highly geared structure accumulate more debt and less asset base.				
5. First phase funding models have separate structures with all risk born by the funders and no risk or responsibility taken by the BEE partners and target company.				
6. BEE transactions financed through vendor finance attract less interest rate.				
7. Government funding structures are adequate to support BEE initiatives.				

APPENDIX B: BEE SCORECARD

THE SCORECARD

Empowerment factor	Indicator	Compliance target	Scorecard points Total:100
Ownership	Voting rights held by blacks	25% + 1 vote	3
	Voting rights held by black women	10%	2
	Economic interest held by blacks	25%	4
	Economic interest held by black women	10%	2
	Economic interest held by other black groups (including staff)	2,5%	1
	Ownership fulfilment		1
	Ownership net value		7
	Total ownership points		20
	Bonus points – involvement by new black entrants	10%	2
	Bonus points – involvement by other black groups (including staff)	10%	1
Management control	Board: voting rights of black directors, half to be black women	50%	3
	Board: number of black executive directors, half to be black women	50%	2
	Senior management: number of black managers	40%	3
	Other top management: number of black managers	40%	2
	Total management points		10
	Bonus points - black independent nonexecutive directors	40%	1
Employment equity	Black top managers as % of total top management	43% (years 0-5) 60% (years 6-10)	5
	Black middle managers as % of total middle management	63% (years 0-5) 75% (years 6-10)	4
	Black junior managers as % of total junior management	68% (years 0-5) 80% (years 6-10)	4
	Black disabled staff as % of all employees	2% (years 0-5) 3% (years 6-10)	2
	Total employment equity points		15
Skills development	Skills development spend for black staff as % of training levy	3%	6
	Skills development spend for black disabled staff as % of training levy	0,3%	3
	Number of black staff in training as % of total employees	5%	6
	Total skills development points		15
BEE procurement	BEE procurement as % of total procurement	50% (years 0-5) 70% (years 6-10)	12
	BEE SME procurement as % of total procurement	10% (years 0-5) 15% (years 6-10)	3
	BEE procurement as % of total from 50% black-owned or 30% black-owned women–owned suppliers	15% (years 0-5) 20% (years 6-10)	5
	Total BEE procurement points		20
Enterprise development	Qualifying spending	3% of taxed profits	15
	Total enterprise development points		15
Socioeconomic development	Qualifying spending	1% of taxed profits	15
	Total enterprise development points		15

The scorecard for smaller enterprises is on the *FM* website at www.fm.co.za

Source: DTI

Financial Mail Top Empowerment Companies (TEC), 30 March 2007