Black Economic Disempowerment (BED)

The case of the blind giant and the black investors' ghetto

By Gordon Young

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GORDON YOUNG refers to the recent decision of government to stop black investors from selling Burger King to a foreign private investor. He explains how the BEE regulations, because of their narrow concentration on black ownership, effectively hamper black investors from getting the full economic benefit from BEE policies.

The South African state has rightly devoted much attention to economic empowerment of black people who were prevented by the apartheid laws from accumulating capital, and indeed deprived of their capital in many instances by expropriation, over a very long period.

But our state is not very capable. It is certainly large and has considerable power, but sometimes it fails to see the wood for the trees. Well-intentioned policies get switched onto the wrong track. You may liken it to a blind giant destroying quite as much as it creates as its great clumsy feet trample on the very people it is trying to help. Its brain is slow and sometimes the neurons fuse and produce abnormal reactions.

The recent decision of the Competition Commission to bar the sale, by Grand Parade Investments, of Burger King to a foreign private equity fund (Wasserman, 2021) is just such a case of the blind giant at work. But it has served providentially to bring to the fore a key issue in the BEE terrain. What's it for? What is the real purpose of BEE?

For background, Grand Parade is 68% owned by BEE investors, including over 5,000 retail black investors with fewer than 10,000 shares each – mainly small investors who live on the Cape Flats and make Grand Parade genuinely broad-based.

When its application to the Competition Commission was rejected, therefore, and the price of Grand Parade shares dropped, these small black investors were the ones to suffer. The resultant furore caused the competition authorities to backpedal furiously and wiser counsel prevailed. The sale has now been approved, with but a tiny fig leaf to cover the Competition Commission's nakedness – a supplier to Burger King will be separated and it will be black owned.

The rejection of this deal, had wiser counsel not prevailed, would have created a precedent which would have continued to affect Grand Parade as well as every other black investor, since it seemed to mean that no sale would be approved unless the buyer was at least as empowered as the seller. Grand Parade, therefore, would have had to find a buyer that was 68% black-owned, or close, before it could sell Burger King, and this rule would surely be applied to every other instance where a black-owned company tried to sell an asset. The Competition authorities have not given any indication that they no longer promote this policy.

Obviously, the number of buyers who qualify as 68% black-owned is tiny, and those who want to buy a burger chain may be non-existent. This would have reduced the value of Burger King by a substantial amount, as Grand Parade would have had to reduce its price substantially to make it attractive to the few buyers who do qualify.

Did the Competition Commission have the slightest idea of what it almost did here? Had it succeeded, it

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would have cemented into competition practice a black discount on sales of assets, thereby only enforcing an existing consequence of the BEE Codes – a case of the Law of Unintended Consequences.

Let me explain.

Companies are encouraged by the BEE Codes to have 25% plus one black ownership, and indeed this is mandatory where government licences are required, or in transactions with government. The requirement in practice has risen to 50% plus one in many instances since state-owned enterprises and certain government departments tend to ignore the BEE Codes and apply their own Codes. This lack of central government discipline could itself be the subject of a long article, but is left aside here.

Companies selling these stakes to black investors naturally want to do it only once – it's costly – so the black investors are invariably compelled to agree to sell their shares only to other black investors. That keeps the company's BEE rating intact.

But what does it do for the black investors? It creates a segregated pool, or black investors' ghetto, where only black investors may buy. This pool is obviously still today a rather small sub-set of the overall market. And the smaller the pool of buyers, the lower the price. This imposes a discount on almost all black assets acquired under the BEE Codes.

To illustrate, Sasol was trading in October 2021 at R265 per share. Its BEE share, known as Solbe1, was trading at R157, a discount of 40.8%. These two shares are identical in all respects except one. They have the same voting rights and dividend rights. But Solbe1 may be owned only by black persons. Hence the discount. Great when you want to buy, but not so great when you want to sell.

Most of the traded BEE shares, such as Vodacom Yebo Yethu, trade at large discounts to intrinsic value and 50%, in my estimate, is typical. One or two such shares are trading closer to fair value, such as MTN Futhi, because you cannot repress those traders' instincts when they think they see a bargain. But amongst most black-owned assets, acquired under the rules of the BEE Codes and not listed or otherwise tradeable, the discount is vast.

It is difficult enough to sell a minority stake in any unlisted company; try doing it when the buyers must have the same or better BEE rating as you, the seller.

It is true that the Codes allow sales to non-black buyers in some cases, but only 40% of black ownership may be so counted (i.e., 10% out of the required 25%). And most companies simply forbid any such sales, particularly where they have provided vendor finance. Who can blame them when the BEE rating is so critical to their business?

The problem, like so many of our problems, is that the wood has not been seen for the trees. The state, our blind giant, does try to do the right thing, but often gets confused. In this case, his poor feeble brain has »

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fixed on ownership as the objective, when the correct objective is actually empowerment, specifically *empowerment through the accumulation of capital*. Ownership is surely the means to the end, not the end itself. Through ownership, black investors, large and small, are able to accumulate capital. Ownership is the means to the end being capital accumulation which is empowerment.

But the black investors' discount deprives them of the full value of their capital. It is not easy to say how much capital is locked up in the black investors' ghetto, but it must run to many tens of billions of rands even if the figure of 50% is used. But my experience is that the discount is probably larger on average.

Now imagine if the black discount were abolished, as it could be by the stroke of a pen. Vast amounts of capital would be released to black investors to do with as they pleased. Sounds empowering, doesn't it? To invest in their own businesses just for example, or to rotate into a sector more attractive to them. There would be *R683 million extra capital in black hands in the case of the Sasol Solbe1 shares alone* and that is one of the smaller schemes. It is difficult to calculate the value of the black discount in another prominent example, the case of MultiChoice, because their BEE

scheme, Phuthuma Nathi, holds shares only in the unlisted but very profitable local operation, but it is probably more than R1 billion. And there are hundreds more BEE deals out there which would be repriced favourably.

The state would have to take a bold decision here of course. Ownership would have to take a back seat to capital accumulation. The state would have to fixate less on the simplistic percentage of shares owned by black people, as it does today, and encourage and indeed celebrate the accumulation of capital by black people instead.

A simple way of doing it would be to alter the Codes to permit companies to retain their ownership ratings even if the black investors sold their shares, provided certain conditions had been met. For example, it could be required that any finance would have been repaid, and the shares retained for a further five years after that. The black investor is not here being required to sell, only to have the right to sell to the highest bidder.

What will be the result? Black investors will be able to escape the black investors' ghetto. Companies will have done what they have been asked to do, which is provide the means for black people to accumulate capital. A very large uplift in the value of black-owned investments will occur overnight, with probably very positive overall impacts for the economy. Money trapped in old BEE schemes will be released. Black individuals and companies will have liquid capital at their disposal to invest in new ventures and expand their existing ventures.

Sure, the black ownership of many companies will drop as measured by percentage shareholding. So what, actually? Is black ownership to be seen merely as a statistic, or a means to the accumulation of capital? Only a blind giant would say, "What I want is that black people own 25% of all companies. I don't care if they never reap the benefits, as long as that statistic is observable." But that is what our blind giant is saying.

Of course no-one ever intended, when the BEE Codes were conceived, that there should be a black investors' ghetto, which reeks of apartheid and discrimination. To be fair, it is a symptom of the success of the Codes in enabling black investors to accumulate capital on a large scale. But it is past time to end this unintended consequence and free up that large portion trapped by the rules.

REFERENCE

Wasserman, H. 2021. "Sale of Burger King South Africa blocked over lack of black ownership accreditation," News24.com. 01 June. Available at https://www.news24.com/fin24/companies/sale-of-burger-king-south-africa-blocked-over-lack-of-black-ownership-20210601

ENDNOTE

1. "BEE Codes" is shorthand for the revised Broad-Based Black Economic Empowerment (B-BBEE) Codes of Good Practice issued in terms of the Broad-Based Black Economic Empowerment Act No. 53 of 2003, as amended. See the website of the B-BBEE Commission, available at https://www.bbbeecommission.co.za/b-bbee-codes-of-good-practice/ NA