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Corporate Governance in South Africa

A Hans-Böckler-Foundation research paper
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About this report

This report is the outcome of a literature review on the corporate ownership structure, corporate governance regime and pension fund sector in South Africa. It is the latest in a series of Hans-Böckler-Foundation -TUAC discussion papers including "Workers' Voice in Corporate Governance – A Trade Union Perspective" (2005), "World Bank Approach to Corporate Governance" (2006), "Corporate Governance in Sweden" (2008), "Pension Fund Investment in Private Equity" (2008) and "Corporate Governance in Brazil" (2010). As with the previous papers, the approach of this report has been to analyse the South African corporate governance system using the policy framework set out in the "Workers' Voice" report of 2005. It focuses on two complementary trade union approaches to addressing workers' rights in corporate governance: (i) worker participation and representation within the company (including rights to representation in the governing bodies), and (ii) the stewardship of workers' capital invested in equity *via* their savings in pension funds.

The paper is structured as follows. Section 1 reviews the corporate governance system that prevailed under the apartheid regime and provides the policy context for the transition to democracy and an open economy after 1994. Section 2 outlines the main features of the current corporate governance regime based on the new Companies Act implemented in July 2010. From there, Section 3 of the paper discusses the distribution of power within the financial sector, and in particular the pension fund industry. Finally, Section 4 describes the evolution of the black empowerment policy of transferring corporate ownership and management from the Afrikaner and Anglo-American elites to the black and coloured majority of the population.

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Introduction

1. Since the fall of apartheid in 1992, South Africa has made considerable progress in terms of political and human rights and can claim to have one of the most democratic systems and most vibrant civil societies of the global south. South Africa has ratified all eight ILO core conventions. According to the International Trade Union Confederation (ITUC) (2010), South African labour law protects workers' core rights, including the right to form and join a trade union without restriction and to seek redress in the courts for unfair dismissal. The right to strike is generally respected.

2. South Africa's economic and social development presents a mixed picture however. At face value, the economy has fared relatively well in the current global economic crisis. GDP grew at 3.1% in 2008 following four years of growth rates of above 5% annually. The financial sector in particular has proven to be far more "resilient" to the global credit crunch in 2008 than in OECD economies. According to the IMF (2008) and the OECD (2009a), the country has one of the largest and most "sophisticated" financial systems among emerging economies. It has a sizeable listed equity market as well as very active bond and derivatives markets. Success stories abound about South African financial and mining conglomerates expanding their businesses aggressively not only across the African continent, but also the OECD region and other emerging economies. At the other end of the spectrum, South Africa can also make claim to having a vibrant labour movement. The level of unionisation is high relative to other emerging economies. Today, there are over 3.1 million unionised workers out of a total workforce of 13.5 million, of which 9.72 million are in the formal economy (36% density). There are currently 261 trade unions, the vast majority of which are affiliated to one of the three national centres: COSATU (1.8 million workers), FEDUSA (0.55m) and NACTU (0.4m).

3. Taking a broader perspective however, it can be argued that economic growth and the expansion of the financial sector over the past decade have been achieved at the expense of a fair distribution of wealth creation within the society. Economic policy-making in the transition period of the 1990s was framed by two consecutive, but distinct programmes: a development-oriented Reconstruction Development Programme (RDP) from 1994-1996, followed by a much more market-oriented Growth Employment and Redistribution (GEAR) programme. Under GEAR, the country achieved its growth objective, but employment and redistribution were left at bay. In fact, almost twenty years after the end of apartheid the economy is far from being on a sustainable path. On the contrary, over this period South Africa experienced "premature de-industrialisation" and a "loss of manufacturing experience" across industries, with the engines of growth coming from "low value-added, low pay personal services" and demand based on debt-financed consumer spending (Baloyi and Pons-Vignon 2009). Furthermore, the national power crisis in 2009 exposed the country's inadequate public infrastructure that has persisted despite the surge in government investment over the past few years[1].

[1] This rose from 4.5% of GDP in 2005 to 9.7% in 2009 (Mboweni, 2009).

4. Social indicators for South Africa paint a bleak picture. Unemployment and informal employment remain high. More than half of the population lives below the country's poverty line – less than USD4 a day. Despite the democratic transition in the 1990s, the society remains racially divided between a rich white elite and a poor black majority, with a growing black middle class and growing number of black entrepreneurs. On average, a white South African earns more than seven times that of a black South African. A recent study by the OECD shows that income inequality has risen since the end of apartheid in 1994 (OECD 2010). A number of social factors are at play including the high incidence of HIV/AIDS, escalating crime rates and insecurity and increasing levels of xenophobic violence against immigrants.

5. This mixed picture of South Africa's social and economic development holds for its corporate governance regime: the way in which private companies are directed and controlled. On the one hand, the country has an advanced regulatory framework in which the rights and responsibilities of all core constituents – shareholders, creditors, workers and regulators – appear to be relatively well-balanced. While the ownership structure remains concentrated, considerable progress in broadening the ownership base has been achieved in the past 20 years. Conglomerates inherited from the apartheid era have been unbundled and their ownership structure has been diluted to some extent. Backed by a comprehensive labour regulatory framework – the Labour Relations Act of 1995 and the sector-wide bargaining councils – as well as the new Companies Act (2010), South African workers have, at least on paper, the right to participate in the corporate governance of their companies. Additionally, the South African corporate governance regime has gained international recognition for its relatively advanced practices with regard to environmental, social and governance (ESG) reporting, as seen in the recent decision to enforce sustainability reporting for all companies listed on the South African stock exchange. It is also unique in the adoption of its black economic empowerment policy, aimed at transferring corporate ownership and management from the Afrikaner and Anglo-American elites to black groups and black entrepreneurs.

6. Yet reforms in the South African corporate governance regime have had a very limited impact on the distribution of corporate and financial power in the economy. Boardrooms remain overly dominated by the white elite. The black empowerment policy has all too often led to the enrichment of the, mainly politically well-connected, few, while the economic engines of the country remain largely in the hands of the large conglomerates.

Transition and stabilisation in the 1990s

7. South Africa's oversized financial sector has its roots in the apartheid era and the excessive concentration of corporate ownership in the South African economy throughout the postwar era. Corporate power was concentrated in a few large mining groups – Gencor (now known as BHP Billiton), Anglo American, Gold Fields among others – which in turn were controlled by the fortunes of a handful of wealthy Anglo-American (not Afrikaner) families, such as the Oppenheimers, Ruperts, Gordons, Mennels and Hersovs. From the 1950s onwards, the apartheid regime adopted an active industrial policy that was based on the

development of state-owned enterprises (SOEs) in infrastructure and services. Corporate finance was equally concentrated in a handful of private and public institutions, the financial branches of the mining houses and large insurance companies – Old Mutual and Sanlam – and, on the public sector side, the Public Debt Commissions (later to become the Public Investment Corporations), which centralised asset management for government debt and financing.

8. The victory of the African National Congress (ANC) at the general elections in 1994, the first multi-party elections in South Africa, paved the way for the end of the apartheid regime. The founding economic policy framework, adopted in 1996, which led South Africa through the post-apartheid era, was the "Growth, Employment and Redistribution (GEAR)" strategy. GEAR was heavily criticised by the labour movement and other progressive forces – and with good reason. Ten years after its adoption, only one of the three objectives stated in its title, 'growth', can safely be concluded to have been achieved. And growth has been attained at the cost of employment and redistribution of wealth. Levels of inequality within society have actually increased compared with the apartheid era.

Corporate power under the apartheid regime

9. As political and economic sanctions against apartheid increased in the 1970s and 1980s, international trade and investment opportunities declined with a few notable exceptions – Israel or the Cape Verde islands. Private sector development was driven inward, with limited or no access to foreign corporate financing and investment. The sanctions regime against apartheid, far from preventing growth of the large mining houses, simply re-directed their growth. As Malherbe & Segal (2003) argue the "rational response" by the mining groups to the political isolation of the country "was to diversify domestically, rather than to specialise internationally". By the 1970s, "the area around Johannesburg had […] become the largest area of industrial activity south of Turin".

10. Given the predominant role of the mining houses, the corporate governance model under apartheid was classically highly concentrated. Using pyramid structures and the extensive use of non-voting shares, mining houses were able to raise money on stock markets while allowing the owners to retain control over the companies. As explained by Malherbe & Segal (2003), the common way to raise capital for the mining houses was through "sponsored listing" of new mining companies. Insurance companies and other institutional investors contributed fresh capital to these sponsored companies, while management remained under the control of the mining house. Other than equity financing, everything else was centralised by the holding company in order to access economies of scale across the group structure of the mining house: skills and capabilities in mining engineering, procurement policies, production processes etc. Related-party transactions were widespread. An on-going flow of transactions existed between the sponsored companies, the terms of which (provision of services, fees payable) were fixed by the parent mining house.

11. The system of sponsored listing ensured that mining houses and their controlling families could continue to raise equity financing without risking the dilution of corporate control. It also facilitated the development of an active market for listed equity. Founded in

1887 the Johannesburg Securities Exchange (JSE) is one of the oldest stock exchanges in the world. Market capitalisation relative to the country's GDP has consistently been higher than in other comparable emerging economies. The fact that South Africa is a common law jurisdiction also contributed to the growth of equity finance as did the presence of insurance companies in the role of very accommodating minority shareholders (La Porta et. al. 1997).

12. Malherbe & Segal (2003) argue that mining houses have generated a "self-perpetuating management elite" under which wealthy families kept ultimate control over the groups. As minority shareholders, South African pension funds and insurance companies held seats on the boards, but did not exercise effective monitoring. Baloyi and Pons-Vignon (2009) suggest a more mixed picture of the political economy under the mining houses. In the 1980s "capital controls meant that profits generated internally that were not illegally transferred abroad (see below) were confined to accumulation within the South African economy itself. This gave rise to intensified conglomeration across the economy and to the expansion of a huge and sophisticated financial system as cause and consequence of the internationally confined, but domestically spread". "Conglomerates" they argued, "have successfully pressed for their own strategy of corporate globalisation and financialisation and, first and foremost, the export of their domestic resources and control. This has governed the role played by the state in its macroeconomic policy, with policies more or less indistinguishable from those of orthodox IMF stabilisation policies being adopted to allow liberalisation of capital flows on favourable terms. Any prospect of a developmental state has been subordinated to such macroeconomic policy".

13. The pivotal role of the large mining houses in the economy was complemented by the apartheid regime's active industrial policy based on large SOEs operating in key sectors: Eskom (electricity), Telkom, Transnet (transportation), Denel (armament), Acsa (airports), Iscor (steel), SABC (media) among others. SOEs grew rapidly in the 1960-70s and accounted for 25% of the country's market capitalisation in 1990. "State corporations […] represented an accommodation across the economic power of the mining conglomerates and the political power of the Afrikaners" (Baloyi and Pons-Vignon 2009).

14. Unlike their private counterparts, SOEs relied extensively on debt-financing and in particular on the Public Debt Commissioners (PDC), which were established by one of the very first acts after the creation of the Union of South Africa in 1911. The Commissioners were nominated by the Minister of Finance and were fully integrated into the Treasury with close links to the South African central bank. As explained by Hendricks (2008), the PDC had the power to invest funds on behalf of public bodies. In effect they were the government's asset managers, ensuring capital allocation between government finances and the public sector pension funds and SOEs and investment programmes by the public administration. The PDC subsequently became the Public Investment Commissioners in 1984 – and then later the Public Investment Corporation (PIC) in 2004.

Labour law reforms

15. A wave of labour reforms took place in the years following the end of apartheid. The Labour Relations Act (LRA) of 1995 set the framework for industrial relations and collective

bargaining. As noted by Budlender (2009) the LRA "does not explicitly afford a right to collective bargaining but probably effectively accords enough rights to satisfy to the ILO definition and convention". It prohibits unfair dismissal and employment-at-will policies, and provides for rights for workers to redress by the court, compensation (ranging from 12 to 24 months remuneration) and reinstatement in the company. It also provides for the registration of trade unions and employer organisations and regulates collective bargaining process through the establishment of sector wide bargaining councils. The implementation of these councils has been quite uneven across the economy, however, with the high coverage in the clothing, textile, chemical, engineering and metal sectors, but low in others, including agriculture and household services.

16. The LRA also introduced the right to create "workplace forums" for representation of workers at company level along the same lines as European Works Councils. Under the scheme, management should consult workplace forums on all matters not covered by the prevailing collective agreement regarding *inter alia* restructuring and reorganization, training and education, pay-schemes, and grievance and disciplinary procedures. In practice, however, the creation and effective use of workplace forums have been very limited. It is argued that workplace forums met fierce resistance from employers, while they never benefited from active support from trade unions because no clear cut separation from collective bargaining activities was insured by law (Donnelly & Dunn 2006).

17. Other labour acts followed the LRA. The Basic Conditions of Employment Act of 1997 introduced working time limits of 45 hours per week. The Employment Equity Act of 1998 prohibited all forms of discrimination at work and required companies to promote women, as well as black and coloured employment. In addition to legislative reforms, unions and employers were given an enhanced role in the policy-making process. In 1994, the National Economic, Labour and Development Council (NEDLAC), was created to formalise tripartite dialogue between the government and social partners. NEDLAC includes the three national trade union centres, the employer federation and network of chambers of commerce (Business South Africa). The Council has authority over labour legislation; only in cases of disagreement between social partners can the government take the initiative. For Donnelly and Dunn (2006), NEDLAC was conceived to allow unions "to exchange industrial peace, support for government policy and wage restraint for more worker-friendly policies and initiatives around training, employment and welfare". Overall however, the authors argue that the South African industrial relations regulatory framework that was set up in the 1990s delivered mixed results: "it was arrayed in something old (bargaining councils), something new (NEDLAC) and something borrowed (workplace forums)" and developed into "multilayered institutions and processes".

Economic reforms, from the 'RDP' to the 'GEAR'

18. Following the elections in 1994, the coalition's economic policy framework was outlined in the Reconstruction and Development Programme (RDP)[2]. The RDP was to some extent focused on social security, employment and public services. But it also adopted a

[2] http://www.anc.org.za/rdp/rdp.html

prudent approach to trade liberalisation – that it should be conditioned on an employment objective – and had a strong regional dimension *vis a vis* neighbouring countries. Several of the RDP's measures related to the corporate governance of SOEs and financial institutions. "Civil society must be adequately represented on the boards" of SOEs, which should be fully accountable to parliament. SOEs should be supported and upheld, not privatised. The RDP also aimed to dismantle the mining houses by providing for stronger competition. Policies should be implemented "to reduce the gap between conglomerate control of a wide range of activities within the financial, mining and manufacturing sectors and sub-sectors, on the one hand, and the difficulties faced by small and micro enterprises in entering those sectors on the other".

19. The RDP had similar concerns in restructuring the financial sector, which it sought to reform with the primary objective of broadening access to financial services. "A handful of large financial institutions" the RDP document reads "all linked closely to the dominant conglomerates, centralise most of the country's financial assets. But they prove unable to serve most of the black community, especially women. Nor do they contribute significantly to the development of new sectors of the economy. Small informal-sector institutions meet some of the needs of the black community and micro enterprise". More generally, the RDP called for government action to "enhance accountability, access and transparency in the financial sector". Pension fund regulation in particular, should "ensure adequate representation for workers through the trade unions" and force regrouping of the pension schemes towards the creation of large industry-wide funds. Legislative reforms should target asset management companies "to make them more socially responsible". Importantly, for both the supervision of financial markets and for economic policy, the RDP included a fundamental reform of the governance of the South African Reserve Bank (SARB) "to ensure a board of directors that can better serve society as a whole", with mandatory representation of trade unions and civil society and clear accountability requirements *vis a vis* parliament

20. The RDP framework was replaced in 1996 by a much more market-oriented programme, GEAR, the priority of which was to ensure fiscal stabilisation[3]. The primary objective of GEAR was to ensure fiscal consolidation in the short-term and to reduce budget deficits. It set out commitments to controlling inflation and to ensuring, what it termed, wage

[3] This shift would come as no surprise when considering the composition of the team of experts that prepared the GEAR: of 17 the technical experts, of whom 16 were white, and 16 were men […] three worked at the Development Bank of South Africa, two at the World Bank, and two at the South African Reserve Bank (PADAYACHEE 1998). The reasons for the policy change from the RDP to the GEAR are perhaps also to be found in the pre-1994 informal negotiations between the ruling Afrikaner elite and the ANC leadership. Among these, the so-called "Mont Fleur Scenarios" appear to have had significant influence over the ANC leadership (GBN 2007). Between December 1991 and March 1992, 22 "prominent South Africans" including politicians, activists, academics, and businessmen from both the black majority and the Afrikaner engaged informal discussions on the various policy options for the forthcoming transition phase 1992–2002. Four scenarios were identified: "Ostrich" (no negotiated settlement, the country remaining under the rule of the Afrikaners), "Lame Duck" (political settlement is achieved but at the cost of a slow and uncertain process), "Icarus" (fast transition but at the cost of "unsustainable, populist economic policies"), and the preferred outcome "Flight of the Flamingos". In the latter scenario, policies observe "macro-economic constraints", investments grow and employment increases "once business is convinced that policies will remain consistent", "monetary and fiscal discipline" is a prerequisite while "further funding for social investments would have to be provided by economic growth" (GBN 2007). One may read the scenario exercise of 1991-92 as a (successful) attempt to shift the ANC away from the RDP framework which, it seems, was targeted by the "Icarus" scenario, toward free market-oriented and fiscal stabilisation policies.

moderation, gradual opening of financial markets and the removal of exchange controls and unconditional trade-related tariff reductions (following membership of the World Trade Organisation in 1996). Public finance management was reformed so as to increase the efficiency of management and fiscal control[4]. Rather than expanding the role of government and SOEs in the economy, GEAR prioritised privatisation. Most currency exchange controls were removed. Limits on the maximum exposure of domestic institutional investors and banks to foreign currencies and assets were relaxed. Today banks can hold up to 40% of their liabilities in foreign currency denominated securities and pension funds can hold up to 20% of their portfolio in foreign assets (see Annex 2).

21. As a result of the liberalisation of capital, since 1994, South Africa's current account has been in deficit for most years with a dramatic increase in the deficit experienced more recently (see Annex 1). Faced with current account imbalances, the SARB has prioritised protecting the national currency exchange rate, hence keeping the value of the RAND high, which in turn has required mobilising and increasing foreign exchange reserves. This resulted in a combination of restrictive monetary policy and relatively high interest rate levels (Plenderleith and Van Zyl 2005). Trade unions have repeatedly objected to the restrictive monetary policy of the SARB, and have called for a lowering of interest rates, so as to facilitate investment and employment creation. Protecting the Rand on the foreign exchange markets led to currency appreciation during the 1990s, which favoured the interests of the mining groups but resulted in a loss of competitiveness of the rest of the economy[5].

22. Regarding privatisation, the government took a rather cautious approach compared to other emerging economies (such as Brazil's "big bang" programme of privatisation in 1997-1998). The series of privatisations that took place between 1997 and 2003 labelled as the "French way" (Afeikhena 2004). First, the government engaged in the "corporatisation" of the SOEs (i.e. changing the legal status of the SOE to limited liability status and eliminating all government guarantees), then it proceeded with successive sales of stakes in the SOE. Privatisation was in many cases implemented through a block sale to a single or group of foreign or domestic investors, although the alternative method of initial public offerings (IPOs) on the stock market was also used. To reduce political opposition to privatisation, the government kept a minority stake in the newly privatised companies. In such cases, confidential shareholder agreements were negotiated by the government with the new private investors over the corporate strategy and objectives of privatised company. Importantly, the political acceptability of privatisation was greatly facilitated by the government's black

[4] A series of regulatory reforms and administration structuring took place. In 1997 the government tax collection service were consolidated and merged into a unique body, the South African Revenue Services (SARS) and tax rates were reduced. Financial management within government and reporting by public administrations were tightened following the adoption of the Public Finance Management Act of 1999 (PFMA). In 2000 several government finance departments were merged to create a unified National Treasury.

[5] The trade union union opposition also prompted a public debate on the constitutionality of the SARB. The Constitution stipulates that the SARB's mandate is to protect the national currency on the foreign exchange market and to create and preserve sustainable economic growth. Unions and COSATU in particular campaigned for bringing the SARB mandate in line with the latter, rather than the exchange rate stabilisation. The governance of the Bank was also central in the debate. The Constitution requires the bank's governance to be independent from government, yet at the same time it prescribes that it should remain in "regular consultation" with the Minister of Finance (LUDWIG 2008). While the RDP aimed at accountability to parliament, the GEAR programme was strict on the "independent" from government. Not only that the governor of the Bank in the last years of the Apartheid regime remained in office throughout most of the 1990.

empowerment policy. Part of the privatisation proceeds were transferred to a National Empowerment Fund aiming at financing venture and private equity funds that promoted black empowerment, while several black entrepreneurs and investment funds benefited from privatisation operations (see section below).

Unbundling and flight to London

23. Corporate ownership structure was also affected by the RDP and the GEAR programmes of reforms. Conglomerates needed to focus on shareholder value – and at the time it was widely acknowledged that the market capitalisation of diversified conglomerates was valued significantly below their net asset value. Conglomerates were therefore "unbundled". Groups retained ownership in mineral and extraction activities and divested from non-core activities. Accordingly the number of companies fell abruptly. The number of subsidiaries controlled by Anglo American, for example, went from 180 in 1986 to 56 in 2006. As reported by Chabane et. al. (2006), in 1994, 83 of the top 100 companies were owned or controlled by the top six conglomerates; by 2004 the number of companies controlled by these conglomerates had dropped to 47. The restructuring also translated into a dilution of ownership. According to Malherbe and Segal (2003), in 1989 only three of the top 20 listed companies by market capitalisation were widely held, whereas this had risen to nine by 1999. In 1989 the market value of companies controlled by pyramid structures was 12% of the total JSE market value. By 2000, that share had fallen to 6%. As shown in Annex 2, the ownership structure of largest capitalisations was diluted substantially after 1994.

24. A wave of migration of "blue chip" companies moving overseas in the late 1990s was another important driver in changing the corporate landscape, and was relatively common among emerging economies at that time. Both India and Brazil experienced similar flight of listed equity to New York, London or to offshore financial centres, but the scale of the trend in South Africa was unprecedented. The number of companies listed on the JSE fell from 732 in 1990 to 403 in 2004. National champions that migrated to London included two historical mining houses (Anglo American Corporation and BHP Billiton[6]), a food group (SABMiller), an insurance group (Old Mutual), several IT companies (PQ Holdings, Datatec, Didata) and an asset management group (Investec). Today dual listing in Johannesburg and in London has become common, as shown in Annex 2. Fifteen of the top 40 and six of the top 10 largest capitalisations listed on the JSE are also listed in London or New York, or in both London and New York.

25. For corporations, the justification for this re-location was the need to maintain the competitiveness of South African companies in the global market-place and the best way to do that, it is argued, is by lowering the cost of capital. The difference between South African and US interest rates in the past decade (see Annex 1) is taken as an indicator of the higher cost of debt finance for South African companies. "Diversification of corporate finance" should be promoted and companies should raise finance, be it debt or equity, where it is cheapest on the planet and not necessarily where their assets and activities are located

[6] Billiton, previously known as Gencor, listed on the LSE on 1997.

(Plenderleith & Van Zyl 2005)[7]. This argument explaining overseas listing in terms of the need to reduce the cost of capital is not entirely convincing, however. Others contend that the primary reason for listing overseas has been the internationalisation of South African conglomerates, which have engaged aggressive outward mergers and acquisition strategies. In fact offshore listing could well be seen as a sort of "re-colonisation" of South Africa. "With the election of the ANC and the dismantling of white power, white South Africans, especially English-speaking whites, have turned back to England." (Johnsons 2008 cited in Mohamed & Pons-Vignon 2008).

26. Yet, despite South Africa's reforms aimed at achieving more transparent ownership and less "entrenched" management, the outcome in terms of the distribution of corporate power in the economy is mixed. "Family-controlled business groups […] do not dominate the South African economy to the same extent as in the past, but they still play a very important role at the pinnacle of capitalism", contends Goldstein (2010). The institutional infrastructure of the country remains underdeveloped, the author argues, investors still "hold most companies in deep mistrust", and in effect "the governance of large corporations will remain in the hands of a few reputable business groups". In fact, South African business groups are able to maintain their pivotal role in the economy and reputation "insofar as they partly offset" the nation's structural gaps in public infrastructure and services, transfer of skills, and innovation. Family-controlled groups, Goldstein argues, "act as vehicles for building up knowledge capital for innovation across wide areas of the economy". At the same time these "business dynasties" have progressively delegated executive functions to professional managers in very much the same way as comparable groups in India, including the Tata conglomerate.

Current corporate governance regime

27. Following the end of apartheid, several corporate governance-related reforms took place to promote more transparent corporate ownership. Dual classes of shares and pyramid group companies were banned on the primary market. Legislation was enacted regarding insider trading, multiple directorships and director liability. More broadly, the Stock Exchanges Control Act (1995) greatly facilitated equity listing and trading. In 1999, the JSE shifted to electronic settlements and trading. In 2005, the whole trading system of the JSE was transferred to a London-based Securities Exchange Trading System, which enables traders from around the world to trade JSE securities. Self-regulation also played a role in modernising the corporate governance framework. The first version of the King Code on corporate governance was released in 1994, constituting at the time a real innovation for an emerging economy (the content of the code drew heavily on the UK's Cadbury Code, which had been published just two years earlier). Since then, the code of conduct has been revised in

[7] According to Investec, the cost of capital for an average South African company without debt in 2004 was about 15.5% (10% for the remuneration of debt[7] plus 5.5% remuneration on equity) as compared to 8.5% for a similar US company and 9% for a UK-based company (POWER 2005).

2002 (‘King II’) and in 2009 (‘King III’) and became a listing requirement of the JSE in 2010[8].

28. It is as late as 2010, however, that South Africa underwent a fundamental reform of its corporate law, with the adoption of the new Companies Act n°71 replacing the previous Act of 1971. What follows is an overview of the main provisions of the law and of other relevant regulations regarding key corporate governance issues: the organisation of the board of directors, the rights of shareholders and creditors, auditing and sustainability reporting and worker participation.

Organisation of the board of directors

29. Like the previous Act, the new Companies Act is not too prescriptive with regard to board nomination and organisation. Companies must have a board of directors consisting of at least three directors, half of which only must be elected by the shareholders, the remaining being appointed by any other party specified in the by-laws or memorandum of incorporation of the company (Sections 66, 69 & 70). On the other hand, the law gives shareholders the power to remove any director (s71). Removal requires the passing of an ordinary resolution (majority of voting rights) and needs to be justified either on the basis of incapacity or a breach of director’s duties. The law does not impose restrictions on the structure of the Board, such as the mandatory separation of the position of CEO and chair, or a minimum proportion of non-executive directors. The King code, on the other hand, does call for the separation of these two key board functions, as well as for the majority of non-executive directors to be independent from management. The JSE general listing requirement does not impose any such restriction with the exception of the ALTX listing segment – JSE’s market for SMEs and venture capital – which imposes a minimum of 25% of board membership filled by non-executive directors. Other sections of the law, however, have indirect implications for board composition. Whereas under the previous Act appointment of the audit committee was the responsibility of the Board, Section 94 of the new Act transfers this responsibility to the Annual General Meeting (AGM), with the additional requirement that members of the audit committee must not be non-executive directors.

30. The Act includes detailed and explicit definitions of directors’ duties (s76, 77). In addition to the general requirements to act “with care”, skill and diligence, “in good faith”, “for a proper purpose”, and “in the best interest of the company” (and not in the interest of the company’s shareholders specifically, as is the case in other common law jurisdictions), directors’ duties are extended to cover various disclosure requirements regarding situations of conflict of interest. Importantly, a director may not take part in the Board’s deliberation on an issue that would put him or her in a situation of conflict of interest.

31. Another important change in the new Act concerns the company’s and directors’ liabilities. Private companies in South Arica have legal personality both under criminal and

[8] Like other voluntary guidelines, the code had no enforcement power, and no measurement of compliance by listed and private companies has been made. For example a survey of the top 100 companies in 2004 has shown that “few of them comply fully” with the King II Report on corporate governance regarding employee-related disclosures (Faure and de Villiers 2004).

civil law. They and their directors and top management can be held liable for violations against their employees. Corporate and directors' liability was strengthened after 1994 notably with regard to occupational health and safety (Mine Health and Safety Act of 1996) and environmental protection (National Environmental Management Act of 1998). According to KPMG (2009) the new Act reduces the criminal liability of the company for core breaches (fraudulent behaviour, misleading information, reckless trading, etc.) but at the same time expands the scope of civil liabilities that may "give rise to numerous civil claims against directors and persons other than directors" as the Act comes into effect.

Shareholder and creditor rights

32. The basic task of the AGM of shareholders is to proceed with the election of (at least half of) the Board, appoint the external auditor and Board's audit committee and consider the company's reporting, including the directors' report, the audited financial statements, and the report by the audit committee. Any two shareholders may submit a resolution to the AGM (s65). Several sections of the new Act (s61, s62, s64) also include provisions to facilitate shareholder participation, including proxy voting for listed equity. A "special resolution", for which approval requires 75% of the voting rights, is needed for various key decisions: amendment to the by-laws, issuance of shares bearing more than 30% of voting rights, fundamental transactions involving the structure of the company (mergers, takeovers, sales of subsidiaries, etc). A special resolution is also needed for the approval of directors' remuneration, as well as for any loan or other form of financial assistance that benefits them. The Act also requires conformity of shareholder agreements with the company's by-laws.

33. On the other hand, the approval procedures for dividend and share buy-back programmes have been relaxed with new Act (s46). These can be approved by the Board without an AGM resolution, which was required before. On the other hand the new Act prescribes that any distribution to shareholders has to be conditional on certain solvency requirements (s48). This solvency test also applies to mergers and acquisitions (s113) as well as to financial transfers to subsidiaries (s44). With regard to takeovers, the new law incorporates provisions that were previously included in the code of the Securities Regulation Panel, now the Takeover Regulation Panel (TRP), which has an oversight role in relation to mergers and acquisitions. A shareholder that crosses the threshold of 35% of the voting rights is forced to a make an offer to all shareholders at the price of acquisition of the last share.

34. Creditor rights have also been affected by the introduction of a new credit default protection mechanism. The "business rescue provisions" of the new Act set the terms for management for financially distressed companies so as to avoid liquidation. The administration process can be triggered by the Board or by the judiciary upon request by shareholders, creditors, workers or trade unions. The provisions provide for more flexible legal management than was previously the case. According to Bowman (2009), the new provisions "could have far reaching implications" for creditor rights and their order in the ranking of claimants of the company. Indeed they considerably increase the powers of the administrator to re-negotiate contracts or cancel or suspend, either entirely or partially, any agreement (s136). Such enhanced flexibility may become of concern if indeed it would allow for claims by workers (payment of wages, other benefits) to be relegated in the ranking of

creditor rights. The administrator has, however, the obligation to inform and consult with the relevant worker representatives and trade unions within 10 days after being appointed (s148).

Auditing and ESG reporting

35. As noted above, it is the AGM that elects members of the audit committee, not the Board itself, with the obvious aim of ensuring independence of its members *vis a vis* the Board and top management (s94). Nominated by the audit committee, the auditor participates in the AGM in person and may intervene on all relevant topics. The auditor has to comply with conflict of interest-related provisions (s92). The same individual – although not necessarily his / her auditing firm – may not serve more than five years or deliver any other service to the company. Financial reporting standards are in line with those defined by the International Accounting Standards Board (IASB).

36. It is in the area of "sustainability reporting" that South Africa is distinctive. The JSE was the first stock exchange of an emerging economy to launch a socially responsible investment (SRI) index, which it did in 2004. For UNCTAD (2006) South Africa "stands out by a wide margin as a leader" in corporate reporting on non-financial performance, including environment, social and corporate governance (ESG). South African companies regularly score highly in the ISAR[9] survey, conducted by UNCTAD on the level and quality of reporting by 100 large companies in ten emerging economies. In 2008, the South African companies included in the sample[10] were "ahead of most other emerging market enterprises in disclosing corporate responsibility activities" (UNCTAD 2008, UNCTAD & EIRS 2008). They were said to have the "highest level of consistency", although the compliance gap was also higher. For UNCTAD, this high compliance gap is due to the fact that ESG disclosure requirements are more demanding in South Africa than in other emerging economies. King II already made key reference to ESG reporting and the latest King III version of the code has a dedicated chapter on "stakeholder relationship management", the requirements of which go beyond the usually minimal reference to corporate social responsibility that are found in other corporate governance codes. King III further recommends "integrated reporting" that combines regulated financial reporting with ESG disclosure (IOD 2009). Since March 2010, all companies listed on the JSE (450) are required to produce ESG reporting – or to explain why not.

37. There are a number of factors that explain the priority given to ESG reporting in South African corporate governance practices, which well above the level of other emerging and OECD countries. As shown in Annex 2, half of the top 40 largest companies produced a sustainability report in accordance with the Guidelines of the Global Reporting Initiative (GRI). One tentative explanation could be that, just as in the case of Brazil (TUAC 2010), the political acceptance of the private corporation in South African remains an issue. The roots of South African corporations are in the apartheid regime, which was characterised by weak corporate governance practices and excessive concentration of ownership and power.

[9] Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR).
[10] Anglo Platinum, Anglogold Ashanti, Firstrand, Gold Fields, Impala Platinum Holdings, MTN, Naspers N, Remgro, Sasol & Standard Bank.

Bringing in more socially and/or environmental progressive practices, or at least giving the appearance thereof, can be interpreted as a way to compensate for the otherwise highly unequal distribution of power and ownership in the private sector.

Worker participation

38. By law, workers have the right to information and consultation in the restructuring process of the company and any transactions that affect the company's structure. The LRA requires management to engage in consultation with trade unions under a specific written procedure before any decision on collective lay-offs may take place (s189). Issues for consultation must include a presentation by management on the mitigation of the restructuring programme for workers. The right of workers to continuity of employment conditions is protected in the context of a merger or takeover. Section 197 of the LRA requires that all the rights and obligations be transferred from the previous to the new employer in much the same way as the provisions of the European Acquired Rights Directive. As noted earlier, the LRA also recognises the right of workers to representation within the company in the form of workplace forums (see para. 16). In practice only a handful of such bodies have been established since 1995 and none has been created in the manufacturing sector. Because such forums require a 'union trigger' and employer compliance, their formation has been hampered by shared misgivings about co-determination and joint problem solving. Trade unions are concerned that forums might undermine their traditional role, if non-union representatives and managers collude to marginalize the union agenda. Many also worry that domestic bargaining can become weakened by forums encroaching on union bargaining territory. Equally, employers, perhaps in the Anglo-Saxon tradition, have not shown interest in developing such continental European-inspired worker participation mechanisms (Donnelly & Dunn 2006).

39. The new Act offers certain improvements for worker and trade union rights in the governance of the company. In particular, trade unions have the right to access financial statements, to initiate and participate in business rescue processes and to launch legal proceedings against the company or individual directors regarding issues falling within the scope of the Act. Malherbe & Segal (2003) report that while "some mining houses did study the concept of worker directors during the early 1990s, no such structural changes occurred", with the notable exception of Anglo Gold, which in 1999 appointed a trade union leader on to the Board of directors. Employee share schemes on the other hand are regulated by the new Act (s97).

Asset management and asset owners

40. "By many measures South Africa has the most sophisticated financial system of any [large emerging economy]" says the OECD (2009) and "even by advanced country standards". All key sectors and functions of the financial system are well developed: banks,

insurance companies and pension funds as asset owners, stock market and, more recently, bond, including securitisation, and derivatives markets.

The financial system

41. The current banking landscape is large and highly concentrated. In terms of assets four banks — the Amalgamated Bank of South Africa (ABSA), FirstRand Bank, Nedbank, and Standard Bank — account for almost 85% of total bank assets. Assets of the commercial banking sector alone are equivalent to 120% of the country's GDP. The current high level of concentration is a consequence of both the banking crisis in the early 2000s, which wiped out many small local banks and market liberalisation measures that have favoured mergers and acquisitions. Several foreign banks have also entered the South African market. In 2005 the British bank, Barclays, became the main shareholder of ABSA, and in 2007 the Chinese Industrial and Commercial Bank (ICBC), took a 20% stake in Standard Bank. The insurance sector is also large having gone through a similar restructuring and concentration process to that of the banking sector. Old Mutual and Sanlam, two leaders of the sector, were de-mutualised in the late 1990s and listed on the stock exchange. Today, assets owned by life insurance companies correspond to 80% of GDP and include a large proportion of pension funds assets. According to the IMF (2008), half of the total assets under management by South African insurance companies are with pension schemes. The bond market has also developed well. Like other emerging economies, the debt market in South Africa has historically been dominated by government bonds, but private issuance has risen rapidly and is fast becoming an important source of corporate finance[11]. Part of the success of the bond market is also due to the development of securitisation on one hand and derivatives and over-the-counter products on the other[12].

42. In terms of regulatory oversight, banks are supervised by the South African Reserve Bank (SARB) and are subject to prudential rules (capital adequacy ratios and risk management systems) that are in line with the current international Basel II Framework[13]. Outside banking supervision, the main financial supervisory authority is the Financial Services Board (FSB), which covers the stock exchange (JSE), the bond market (BESA), as well as all institutional investors: the asset management industry – both collective investment schemes and financial advisors – and the asset owners – pension funds and insurance companies. The enforcement powers of the FSB were expanded in the early 2000s following

[11] In 1996, the bond market was separated from the JSE and established as an independent body, the Bond Exchange of South Africa (BESA). In 2007 the BESA was de-mutualised. Today, BESA attracts more foreign investors than its sister equity market.

[12] As noted by the OECD (2009a) issuance of mortgage backed securities (MBS) and asset-backed securities (ABS) has been strong since 2001. The South African OTC market is also one the largest outside the OECD area. Indeed BESA serves as hosting platform for several privately organised OTC trading, notably insurance contracts to hedge against interest rate volatility (interest rate swaps and forward rate agreements).

[13] The supervisory framework has been expanded recently in the area of money laundering and terrorism financing. A Financial Intelligence Centre was created with the SARB and the JSE to monitor compliance with legislation on anti-money laundering and counter-terrorism financing. South African is an active member of the OECD-based Financial Action Task Force (FATF).

enactment of legislation[14]. As noted by the IMF (2008), the FSB has “clear authority to perform on-site examinations, to require reports, and to investigate misconduct and to impose penalties for violations of applicable laws”. Yet many FSB rules are implemented in the form of co-regulation with associated bodies. That is the case for listed equity, for which FSB supervision is supplemented by listing requirements set by the JSE for asset managers, for which the rules on disclosure and sales practices are co-regulated by the industry association, the Association of Collective Investments.

43. The larger part of the population has gained little benefit from the growth of the banking and insurance sectors. For the OECD (2009a) there is still progress to be made to ensure universal access to financial services. According to the IMF (2008) access to a bank account is characterised by “a major divide between salaried and non-salaried individuals”. Lending to SMEs remains limited and other services, beyond the provision of basic accounts, “lag far behind” for a large part of the population – notably savings and insurance products. Despite a recent increase, for low and medium income households, the proportion of the population with access to a bank account is below 45%.

44. Financial inclusion ranked among the key priorities of the ANC when it came to power in 1994. It was central to the RDP chapter on financial reform but then slipped down the list of priorities with the adoption of the GEAR policy framework. Efforts by the labour movement, together with civil society and small businesses, in the early 2000s to revive policy discussion on financial inclusion led to the creation of the Charter of the Financial Sector in 2004 under the auspices of NEDLAC. The Charter commits banks, insurance companies and brokers to attaining specific objectives with regard to the provision of financial services to households and access to bank accounts and insurance[15].

Pension funds

45. Just like its banking and insurance sectors, by OECD standards, South Africa has a sizeable and highly developed pension fund sector. Assets under management by pension funds exceeded R2tr in 2008 – equivalent to 57% of GDP and representing over a third of assets held by all institutional investors (OECD 2009a). As shown in Annex 3, the South African pension fund sector ranks among the largest relative to GDP of non-OECD countries.

46. With the exception of public sector pensions, which have their own regulatory Act, all pension funds are regulated by the Pension Funds Act n°24 (1956) and are supervised by the FSB. The two main collective investment vehicles for pensions are (i) the “privately administered funds” (which are equivalent to autonomous pension funds), and (ii) “underwritten funds” which consist exclusively of insurance products. With some 13,000 individual funds (of which 3,500 are pension funds and 9,900 insurance schemes) and 11.2

[14] the Securities Services Act (2004), the Collective Investment Schemes Control Act (2002) and the Financial Advisory and Intermediary Services Act (2002). It should be added that unlike the SARB, the FSB is directly accountable to the government – its board and senior staff are appointed by the ministry of finance.

[15] Beyond financial inclusion, the Charter also commits to black empowerment in the financial sectors with specific goals for employment of blacks and the support to black asset management and financial entrepreneurship – see following sections.

million members, the pension sector is excessively fragmented. While coverage in the formal sector is estimated to reach 60% according to the IMF (2008), it is heavily concentrated in the public sector where most of the pension rights are managed under one single fund, the Government Employee Pension Funds (GEPF). In reality only a fraction of the population, about 6%, is actually “self-sufficient” in terms of retirement income. For the vast majority of the population, access to decent retirement depends exclusively on tax-funded public social security and income-tested programmes (Hendricks 2008)[16].

47. Trade unions play a key role in the governance of pension funds. The pension law requires that half of the board of trustees is composed of worker representatives. For schemes that are drawn from collective bargaining, the worker trustees are nominated by the prevailing trade union. However, the fragmentation of the pension sector into many individual funds poses serious challenges to the sector. Many, including the IMF (2008) and the OECD, have called for consolidation of the pension industry into larger pension schemes. Such consolidation, it is argued, would help lower the cost of fees charged by the asset management industry and would strengthen risk management by – and the governance of – the funds. There is also a need for greater education of trustees. According to the IMF (2008) “the limited understanding by many trustees of their fiduciary responsibilities remains a major problem”.

48. In 2007, in response to these governance problems, the enforcement powers of the FSB were strengthened, including penalties for non-compliance, the right to remove trustees and to proceed with on-site visits without prior notice, while the fiduciary duties of trustees have been reviewed and codified. Financial sustainability of the funds is also under scrutiny. The FSB is currently engaged in a number of legal proceedings with employers regarding pension funds surpluses. According to press reports, some R30bn of surpluses are missing in the accounts of pension schemes[17]. In line with many OECD countries, the investment policy of pension funds has been de-regulated in the recent past. In 2008, the maximum exposure to assets held overseas increased from 15% to 20%. Yet quantitative restrictions remain important as shown in Annex 4. The FSB is currently working on new risk-based funding rules, which would adjust individual funding requirements according to the quality of governance of the pension funds and its exposure to risky assets.

The GEPF and the PIC

49. The fragmentation of the pension fund industry in the private sector contrasts with the high level of concentration in the public sector, which is dominated by the GEPF and its asset

[16] Most private sector pension funds are run as defined contribution schemes in which workers bear all the market risks: when the worker retires there is no guarantee by the employer regarding the level of the pension entitlements, which are determined by the financial performance of the fund during the accumulation phase. At the age of retirement pension entitlements are typically provided in the form of lump-sum payments (by opposition to life-long annuities), which means that workers bear at least part of the longevity risks. In many cases workers can cash-out their pension savings before retirement which weakens further the security of pension entitlements. About 11 million people benefit from these programmes in South Africa (HENDRICKS 2008).

[17] South Africa: Pension Fund Surplus Battle Rages On, 18 November 2009, http://allafrica.com/stories/printable/200911180639.html

management arm, the Public Investment Corporation (PIC). The public fund was created as a result of the merger of several public pension schemes in 1996 under a single Act (the Government Employees Pension Law). Today the GEPF is one of the largest pension schemes in the world with 1.37m members. Importantly it is still far from maturity – just about 18% of its members are retired – which means that the assets under management (approximately R800bn or $100bn in 2008) are expected to continue to rise continuously in the next decade.

50. In comparison with other South African pension funds, the GEPF's exposure to equity is relatively high. As shown in Annex 3, GEPF holdings in listed equity accounted for 53% of its total portfolio in 2008, compared with 27% on average among private pension funds. It holds minority stakes in a number of large South African Multinational Enterprises (MNEs). Similarly, PIC-held equities represent some 9-10% of the JSE market capitalisation[18]. 72% of its equity ownership is managed internally and 'passively' index-based, the remaining 28% is managed externally by a dozen South African asset managers (PIC 2009). PIC has increased its allocations to economically targeted investments under a single mandate, the Isabaya Fund (valued at R31bn in 2009)[19]. PIC targeted investments are also spent on BEE deals[20].

51. Given the importance of the GEPF as a shareholder in South African companies, the question of who controls its investment policy was politically sensitive. Under law, the GEPF Board's composition should have equal representation of employers and trade unions. It is only in 2005 however that the Board was created. Until then the fund was managed under the direct authority of the Ministry of Finance. Hendricks (2008) argues that the delay in the creation of the Board – and thereby the late introduction of union representation at the GEPF – was intended to facilitate the corporatisation of the PIC beforehand. The corporatisation indeed would precisely make the PIC independent from the GEPF. The change of status of the PIC from public body accountable to government to a limited liability corporation was opposed by the trade unions, and by COSATU in particular, who feared that the investment policy of the GEPF would be run along purely financial terms with little scope for integrating social, poverty-related and broader development goals (Hendricks 2008). For COSATU in particular, the corporatisation of the PIC was "inextricably linked to the broader processes of privatization and commercialization of state assets" (COSATU 2004a, quoted in Hendricks 2008).

Private equity

52. Private equity (PE) investment funds have historically played an important role in the South African economy. Assets under management by PE funds reached R100bn in 2008, of which a quarter was funded by foreign investors. South Africa ranks "11th as a private equity

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[18] PIC assets under management were valued at roughly R740bn (US$83bn) of which GEPF assets represented over 90% of its portfolio; other PIC clients include the Unemployment Insurance Fund, the Compensation Commissioners and the Associated Institutions Pension Fund (AIPF).

[19] This fund focuses on infrastructure projects such as the Gautrain, the high speed railway track between Johannesburg and Pretoria.

[20] Through fund-of-funds dedicated to debt financing of BEE leveraged buy-outs or through direct private equity investments in BEE transactions. Other than infrastructure and black empowerment, the PIC also runs a small SRI fund, the Community Property Fund, specialised in access to housing in townships and rural areas.

investment destination and 18th in terms of fund-raising activity on a global scale" (PWC 2007). The size of the sector reflects the number of significant buy-out and secondary buy-out transactions, which account for the majority of the deals, rather than smaller "start-ups" and venture capital funds (De Beer and Nhleko 2008). With the exception of a few big international firms, however – such as Bain Capital – the South African private equity industry is dominated by domestic firms such as Ethos and BRAIT. South African banks and insurance groups – which are allowed to develop proprietary investment activities – have also set up their own private equity house, such as Standard Bank, Sanlam and ABSA.

53. A key factor in the development of any private equity industry is the existence of a well-developed and diversified market for exiting from portfolio companies. The business model of private equity funds consists of short-term investments of 3 to 5 years in portfolio companies. Most of the revenues of the funds will come from the capital gains obtained from the re-sale of, or the "exit" from the company. Exit can take different forms: listing on the stock market through an IPO, block sale to another company, secondary buy-out sale to another private equity fund. Exiting through IPOs was facilitated by the creation by the JSE Development Capital Market in 1984 and the Venture Capital Market in 1989. Today, the main market for SMEs and mid-size private equity exiting through IPOs is the JSE's Alternative Exchange. Yet, even in South Africa's large listed equity market, historically the main route for private equity fund exits has been with trade sales, particularly in the public infrastructure and utilities sectors[21].

Black empowerment

54. A key task for the ANC government in the aftermath of apartheid was to rebalance corporate power and ownership in the economy away from the Afrikaner and Anglo-American elites to the black and coloured majority of the population. Such re-distribution of corporate power was no easy task. The spectrum of policy options was wide: from full-blown nationalisation of apartheid-era companies, to gradual adjustments based on self-regulation and voluntary corporate governance rules. In the end, reflecting perhaps the shift to the GEAR policy framework, a voluntary and market-driven approach was chosen in the form of the Black Economic Empowerment (BEE) policy. By creating incentives for black-owned and black-influenced companies, the BEE policy was intended to create a community of black entrepreneurs and business leaders, which would have a 'trickle- down' effect on the economy in the medium-term.

Leverage & financial engineering

55. The BEE process can be divided into two separate periods. During the first period BEE takeovers grew significantly. Malherbe & Segal (2003) report that listed companies

[21] For these sectors IPOs are not considered appropriate given the considerable amount of capital and debt financing that is needed for these types of investment and because of the "exposure to political risks" associated with public services requirements. (source: ft.com Private equity in Africa, January 14 2007).

under the control or significant influence of black owners grew from 1% of the JSE market in 1994 to 16.3% in 1999. Black influenced takeovers targeted companies of all sizes. The deals with the highest profile included the spinning-off of subsidiaries of large conglomerates (Sanlam's sale of Metlife, Anglo American of Johannesburg Consolidated Investment). At face value, the BEE policy was a success. However the *modus operandi* led to controversial outcomes.

56. The main criticism related to the excessive use of financial engineering. More than half of the BEE takeovers on the JSE in the second half of the 1990s were created *via* opaque "special purpose vehicles" (SPVs) and complex pyramid structures. In effect BEE takeovers were no less than leveraged buy-out operations, which are common to the private equity industry. As explained by Malherbe & Segal (2003) and Chabane et. al. (2006) a BEE takeover would typically involve four parties: i) the black empowerment group, including constituencies as diverse as individual entrepreneurs, community groups, and sometimes trade unions; ii) the target company; iii) a financial institution such as a bank or an asset manager; and iv) a holding company or an investment vehicle. The sequencing of the transaction was as follows:

- Shares of the target company would be offered to the investment vehicle at a below the market value price (typically a discount of -10% to -20% of the market value).
- To finance the purchase, the financial institution would then lend the required funds to the holding company and/or by non-voting shares in the holding equity.
- The collateral for the loan would be secured by the distribution of non-voting shares of the holding company to the lending financial institution.
- The majority of the equity of the holding group, and the voting rights in particular, would be issued to the empowerment group, cost free.
- The capital gains on the target company's equity, which in the 1990s were assumed to grow constantly, would be shared between the holding company and the lending financial institutions on a 50-50 basis (which would be enough to repay the latter's loan on a medium-term basis).

57. Having operated several BEE transactions consecutively, the holding company would eventually be listed on the JSE in order to raise new capital for another round of acquisitions. The listings of the holding groups typically consisted of the issuance of non-voting shares or setting up pyramid structures so as to guarantee that the black empowerment group would keep ultimate control over the holding group.

58. The BEE takeover model in the early days was not neutral from a corporate governance perspective. Because black majority control over the holding company could not be compromised, BEE transactions relied excessively on the issuance of non-voting shares and on pyramid structures. Creditors – banks and insurance groups – were bearing all the downside risks, while the control rights – the 'upside' risk – were with the black empowerments group, which itself did not assume any risk or debt. Accordingly it was "rational for the [empowerment] group to undertake very risky" investments. It also created incentives for the empowerment group to diversify the portfolio of the holding company (excessively) in many minority stakes with the result that it had little influence over the board of directors of the companies. The BEE thus delivered legal ownership by black empowerment groups but this did not materialise into effective black stewardship of the targeted companies. To make matters worse, BEE maintained the corporate governance

arrangements – dual class of shares, opaque pyramid structures – inherited from the apartheid era and the large mining houses. This perception is further supported by Bill Freund (2007) for which "it remains true that actual black influence as directors and as owners of South African companies remains very modest. [B]lack 'tycoons' and company directors are often dependent on large loans from the existing sources of finance which will not be repaid quickly or easily […]. Most of the black directors of listed companies are in fact non-executive".

A new framework in 2004

59. In response to the controversy and concern over the lack of transparency of BEE deals, the Broad-Based Economic Empowerment Act was adopted in 2003 with the objective "to end uncertainty over empowerment deals while boosting South Africa's economic growth" (DTI 2005). The Act came into effect in conjunction with the Charter of the Financial Sector, which set out specific black ownership and employment targets. Adoption of "Codes of Good Practice" for black economic empowerment (BEE) followed in 2005. These set precise criteria for defining black empowerment, including a scorecard and guidelines for certification for measuring broad-based BEE across all sectors of the economy. Specific BEE criteria related to shareholder ownership, management and control, employment equity, skills development, procurement policy and enterprise development. Sector specific codes were also drawn up. The BEE private equity code, for example, sets out the following terms:

— 50% plus one of voting rights in the limited partnership agreement of the private equity fund are held by a black people or empowerment groups;
— Over half of the capital gains generated at the resale of the portfolio company are distributed to black people or empowerment groups;
— The private equity firm itself is BEE-owned;
— Over a 10-year period, more than half of the portfolio of the public equity fund is invested in companies that have at least 25 per cent direct black ownership.

60. Overall, BEE transactions have remained controversial and fuelled suspicion of favouritism, related party transactions, if not outright cronyism. Some BEE transactions have exposed unhealthy relationships between government entities, political elites and black financial entrepreneurs. Hendricks (2008) cites the case of Telkom in 20005 as an example of governance failure in a BEE transaction[22]. More broadly, Hendricks points to the role of the PIC in black empowerment policy, which has served "to finance big business owned by blacks or huge deals in which black-owned firms purchase shares in big companies". Rather than effectively pursuing a small black entrepreneurship, Hendricks argues that the PIC debt financing support made the fortune of a few black individuals, such as Cyril Ramaphosa and Tokyo Sexwale (see Annex 5). For Bill Freund (2007) "the spectacular benefits accruing to a

[22] Elephant Consortium, a BEE investment group intended to take a 15.1% stake in Telkom. Lacking the necessary financing, the BEE group approached the PIC. The PIC then purchased the 15% stake in Telkom half of which were resold to the BEE group at a 15% discount compared to market value – and hence a 15% unrealised capital gains for the PIC with is a public body. COSATU's reaction was blunt, recalls Hendricks: "the hard earned money of the poor [invested in the PIC] has been used without their permission to facilitate a deal that will pour millions of Rands into the pockets of a few very rich people".

few hundred black families at the top largely linked to the ruling party but unconnected to the broader issues of equality and opportunity in South African society leave BEE as a policy attracting very limited enthusiasm from the bulk of the ANC's supporters". More recently, Vavi, head of the COSATU dismissed the "small right-wing tendency" within the ANC leadership which he said was led by "entrepreneurs" who extract private benefits from BEE deals[23]. For Goldstein (2010) the emphasis on building black "national champions" risks leading to a "worsening in distribution coefficients, without necessarily leading to faster economic growth", because of the "disconnection between a strategy of favoring the development of business groups to build a high-tech, high-wage, capital-intensive economy, and the combination of surplus labor and shortage of capital that characterizes the country".

61. Another distinct feature of the BBE policy has been its close linkages with the private equity industry. For de Beer & Nhleko (2008) "private equity has played a major role in broadening the scope for black people to participate in business activities". By the end of 2007, 69% of private equity assets qualified as being "black-influenced" that is with at least 5% black ownership, while BEE private equity deals per se accounted for R16.3bn in 2008, increasing by 38% compared with 2007[24]. There is some irony in this in so far as the very same South African private equity industry indirectly benefited from the apartheid boycott in 1980s when management buy-outs were the only exit available to foreign investors wishing to divest from South Africa (de Beer and Nhleko 2008).

Shareholder activism

62. Shareholder activism certainly is not rooted in South African tradition. Under the apartheid regime banks and insurance companies were satisfied with having a passive minority shareholder role in the mining houses. But even after 1994, Malherbe & Segal (2003) recall that the first versions of the King code "adopted a surprisingly sceptical stance to the role of institutional investors" highlighting the risk of insider trading problems and the assumption that they would be "reluctant to co-operate with one another". The authors point to "an unwillingness" of pension funds, insurance groups "to assume a powerful role in South African corporate life". Later on however, asset management accountability to asset owners, and to pension funds in particular, became a stand-alone policy issue for the ANC government. In a speech to the FEDUSA Congress in 2002, the Finance Minister Trevor Manuel stated that "[P]ension funds must hold their fund managers accountable. Pension fund trustees must be active guardians of their members' interests" (Hendricks 2008).

63. Over recent years, growing awareness of the importance of asset management accountability has resulted in the rise of BEE-oriented activism at the AGMs and in the boardrooms, but also within the asset management industry itself. In 2009 the PIC shifted several mandates that had been placed with the asset management branches of large insurance and banking groups (Old Mutual, Sanlam, Stanlib and Rand Merchant Bank) to black owned asset management firms[25]. The PIC's activism in favour of black empowerment also had an

[23] COSATU attacks Zuma's economic policy, ft.com March 7 2010.
[24] SA private equity breaks R100bn mark, 22 May 2009.
[25] National pension fund opts for positive engagement, Global Pensions | 23 Mar 2009.

impact on the boardroom. Under the leadership of CEO, Brian Molefe[26], the PIC developed an aggressive AGM policy to promote board diversity in JSE listed companies. In 2007, it was successful in bringing board change in Barloworld Co. and in Sasol Ltd to ensure black appointments and separation of the positions of CEO and Chair[27]. At that time Molefe argued that of the 33 executive directors in the top 10 firms in the country, only 3 were black (all in the same firm) and of the 92 executive directors in the top 20 firms, only 10 were black (cited in Hendricks 2008). Not much improvement has been achieved since. A study released in 2010 shows that blacks and women continue to be "grossly under-represented in all directorships and top executive leadership positions of JSE-listed companies". The study shows that of 269 CEO positions, blacks occupied 9% and whites 91% of the positions[28].

Pan-African investments

64. Recently, South African companies and investors increasingly are turning to African markets for their development as shown in the successful expansion on the African continent of the telecom group MTN and retail distribution group Shoprite. South African Government officials have been outspoken about the need to mobilise pension funds for pan-African investment. In 2005 President Thabo Mbeki said "we have this absurd situation that some of [the African pension funds'] money is invested in stock exchanges outside of the African Continent, because it is said that there is a lack of capacity to absorb these large volumes of capital here"[29]. As part of the NEPAD process in 2007 the African Development Bank launched the Pan-African Infrastructure Development Fund (PAIDF) with the South African government, the aim of which was to mobilise over USD1bn through the active contribution of South African pension funds[30].

65. South African banks and investment groups have moved aggressively "northbound" to take advantage of recent market openings in other African countries facing huge financing needs in agriculture, infrastructure and extraction. The JSE and the BESA are also active in promoting listed equity and debt, as well as improving stock exchange infrastructure across Africa, providing training and technical assistance within the framework of the SADC Stock Exchanges Committee. In October 2008, together with the British FTSE, the JSE launched the "All Africa 40 Index" including issuers from stock exchanges in Botswana, Egypt, Ivory Coast, Kenya, Mauritius, Morocco, Nigeria and Tunisia. In February 2009, the JSE created a trading platform, the Africa Board, to facilitate trading and settlements by foreign investors across African exchanges.

66. While South Africa remained by far the main destination of private equity deals in sub-Saharan African in 2008 (70% market share, USD2.9bn) that share is said to be "falling" in the future[31]. In 2003 Saudi billionaire Prince Alwaleed bin Talal set up Kingdom Zephyr, a private equity firm that manages two pan-African buy-out funds totalling USD600m in

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[26] Brian Molefe resigned from his position in 2010.
[27] Molefe quits as CEO of Africa's biggest fund manager, Global Pensions | 15 Mar 2010.
[28] Not enough black, female directors, study shows, Mail & Guardian, Mar 02 2010.
[29] <<http://www.dfa.gov.za/docs/speeches/2005/mbek0802.htm>>.
[30] Africa Confidential, January 2007.
[31] Ft.com African Private Equity Rebound Mooted, 3 March 2010.

committed capital[32]. The development of African and pan-African private equity funds is also supported by OECD-based government investment funds for private sector development in emerging and developing economies such as Proparco (France), DEG (Germany), and the CDC (UK). CDC, Proparco and their Belgian and Dutch counterparts (Bio & FMO respectively) are particularly active in Africa where they facilitate and contribute to the development of investment funds, as well as to infrastructure programmes and other business-development related initiative[33]. Sovereign wealth funds and state-owned investment banks from emerging economies are also reported to be "pouring money" into Africa. In 2007 the Industrial and Commercial Bank of China paid USD5.5bn for a 20% stake in Standard Bank, South Africa's largest bank[34].

Concluding remarks

67. The ownership structure of the private sector has been restructured and diversified in the past 15 years. South Africa is leading emerging economies in many key areas of corporate governance. The country has a well-developed and well diversified financial sector and equity and debt markets that are overseen by capable supervisory authorities. It has a sizeable pension fund and asset management and private equity sectors by OECD standards. Growth opportunities are boosted by the prospects of pan-African investment. The new Companies Act, which took effect in July 2010, appears to provide for a balanced distribution of rights and responsibilities between the core constituencies of the corporation: shareholders, workers, creditors, top management and regulators. Read together with labour legislation workers in South Africa have the right to intervene and indeed be represented in the governance of the company. The corporate governance framework is further enhanced by advanced initiatives in the area of sustainability and 'ESG' reporting and, importantly, by the national black economic empowerment policy aiming at increasing black-controlled and black-influenced corporate ownership and management.

68. Yet, some serious challenges remain. Despite the achievements of the BEE policy and the unbundling of the "mining houses" inherited from the apartheid era, corporate power in South Africa remains concentrated in the hands of a few. Boardroom diversity in particular is still something for the future. Many BEE transactions in the past far from democratising ownership have instead been mired in controversy and suspicions of cronyism.

69. Directing pension fund investments – workers' money – toward social goals could be considerably improved as well. Consolidation of the industry, particularly in the private sector, would not only could help improve coverage but could improve governance and risk management standards, thereby supporting the shift towards active and responsible investment strategies. The government seems to be concerned about the missing link between pension funds' investment and employment generation. In March this year Ebrahim Patel,

[32] <<http://www.kingdomzephyr.com/funds.html>>.
[33] A good example is Actis, and arms-length fund management unit that runs half of the CDC's investments in emerging economies. In 2008, CDC raised USD2,8bn in 2008 with pension funds and endowments alongside CDC's own capital commitment USD3.4bn http://www.cdcgroup.com/uploads/developmentreport2009.pdf
[34] Africa: New sources of finance energise economy, May 27 2008.

Minister for Economic Development, announced new plans for South Africa "to create financial instruments that will enable state and private pension funds to invest more in development projects", including "government development bonds" to develop infrastructure and promote labour-intensive industries[35].

70. Last but not least, the improvements made since the end of apartheid have failed to prevent a deepening of social and income inequalities across the economy over the past 15 years. The combination of provisions allowing sector-wide collective bargaining, the right to representation within companies and trade union access to economic policy-making through the NEDLAC should in theory have enabled the stakeholder approach to prevail and provided for a true democratisation of the private sector.

[35] South Africa Wants Pension Funds to Spur Development, March 05, 2010.

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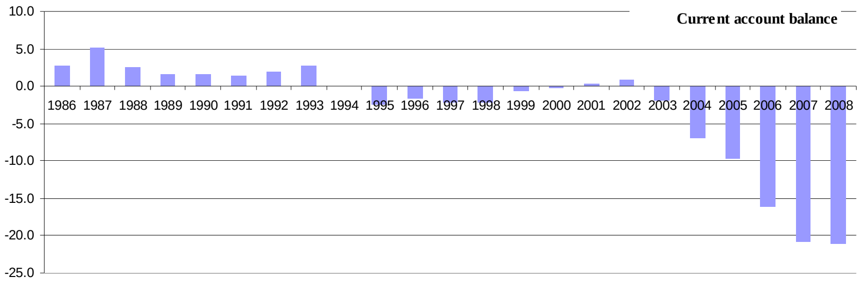
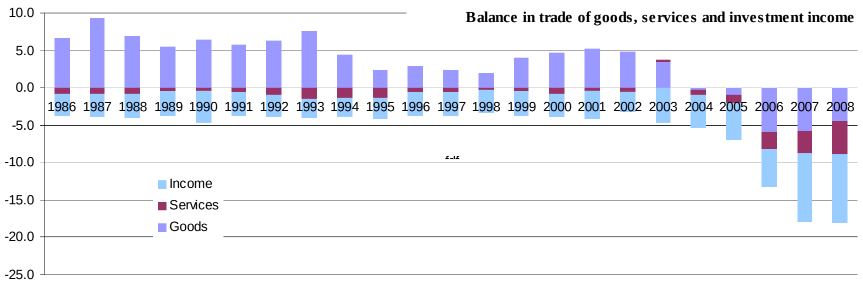
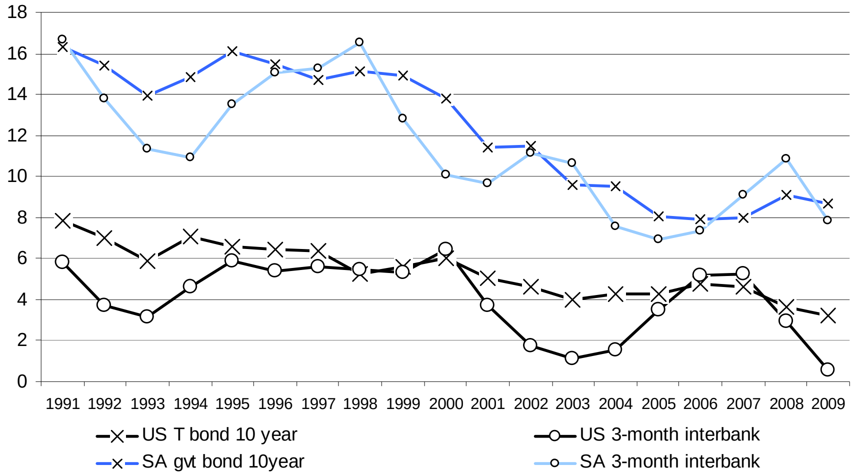
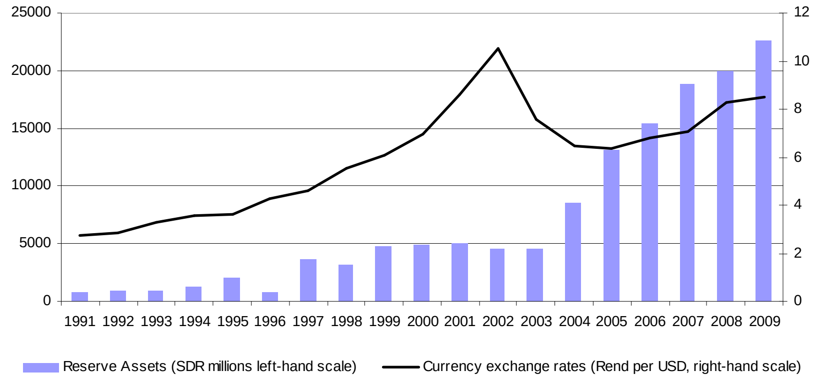
Annex

Annex 1: Macro economic figures (1986 -2009)









Annex 2a: Largest listed equity capitalisations (2009)

Rank	Company name	USDBn	Free Float	SRI index (X) & GRI compliance level (a, b, or c)	Dual listing in London or NY
1	BHP BILLITON PLC	67		X, a+	L
2	ANGLO AMERICAN PLC	48		X, a+	L
3	SABMILLER PLC	42	75.00%	X, b+	L
4	MTN GROUP LTD	27		X	
5	SASOL LTD	23		b+	NY
6	ANGLO PLATINUM LTD	22	40.00%	X, b+	L
7	STANDARD BANK GROUP LTD	22		X, b+	
8	COMPAGNIE FIN RICHEMONT	17			
9	IMPALA PLATINUM HLGS LD	15		X, b+	L
10	KUMBA IRON ORE LTD	15	30.00%	X, c+	
11	NASPERS LTD -N-	15			
12	FIRSTRAND LTD	13	75.00%	X	
13	ANGLOGOLD ASHANTI LTD	13		X, a+	L, NY
14	ABSA GROUP LIMITED	12	50.00%	X	
15	VODACOM GROUP LIMITED	10	30.00%	c	
16	OLD MUTUAL PLC	9		X	L
17	GOLD FIELDS LTD	8		X, b+	L, NY
18	NEDBANK GROUP LTD	8	50.00%	X, a+	
19	SANLAM LTD	7		X, b	
20	ARCELORMITTAL SA LTD	7	50.00%	X	
21	BIDVEST LTD ORD	6		X, b+	
22	REMGRO LTD	6		X	
23	EXXARO RESOURCES LTD	5	20.00%	X, b+	
24	SHOPRITE HLDGS LTD ORD	5			
25	LONMIN P L C	5	15.00%	X, b+	L
26	INVESTEC PLC/LTD	3		X, b	L
27	AFRICAN RAINBOW MINERALS	2	40.00%	X, c	L
28	RMB HOLDINGS LTD	5	75.00%		
29	LIBERTY INTERNATIONL PLC	5		X, b+	L
30	TIGER BRANDS LTD ORD	4	75.00%		
31	ASPEN PHARMACARE HLDGS.	4	75.00%		
32	HARMONY G M CO LTD	4		X, b+	L, NY
33	STEINHOFF INTERNTL HLDGS	4			
34	AFRICAN BANK INVESTMENTS	4		X	
35	REINET INVESTMENTS SCA	3			
36	MONDI PLC/LTD	3		X	L
37	GROWTHPOINT PROP LTD	2			
38	TRUWORTHS INTERNATIONAL	1		X	
39	PIK N PAY STORES LTD	3	50.00%	X	
40	REDEFINE PROPERTIES LTD	3			

Source: JSE website, March 2010, USD conversion based on 1ZAR = 0.130235USD

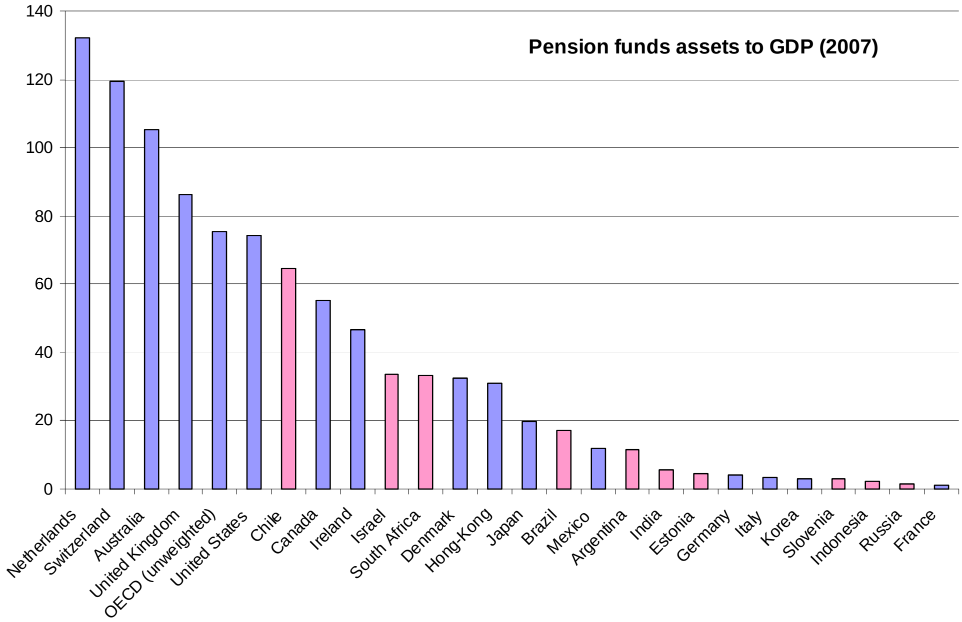
Annex 2b: Largest listed equity capitalisations (1986–2009)

% of total	1986	1990	1994	1998	2002	2006	2009
Anglo American	54.1	44.2	43.3	17.4	20.2	21	10.6
Sanlam	11.3	13.2	10.5	11.1	6.3	2.3	1.2
Standard Bank / Liberty Life	2.3	2.6	7.2	9.5	6.0	3.5	4.3
Rembrandt / Remgro	4.4	13.6	13	9.0	10	7.8	3.8
SA Mutual / Old Mutual	10.9	10.2	9.7	8.8	12.0	5.5	2.8
Sasol			1.7	2.2	3.8	4.6	4.6
SABMiller					4.0	5.7	5.9
Investec / Fedsure			0.4	3.3	1.9	1.2	0.8
Top 5 groups collectively	85.1					40.1	
Black-controlled groups				9.6	3.5	5.1	7.0
Foreign	6.1	2.1	2.2	3.9	10.1	20.8	33.1
Directors	8.1					6.7	
State						2.0	1.5

Source: GOLDSTEIN 2010 & CC 2009

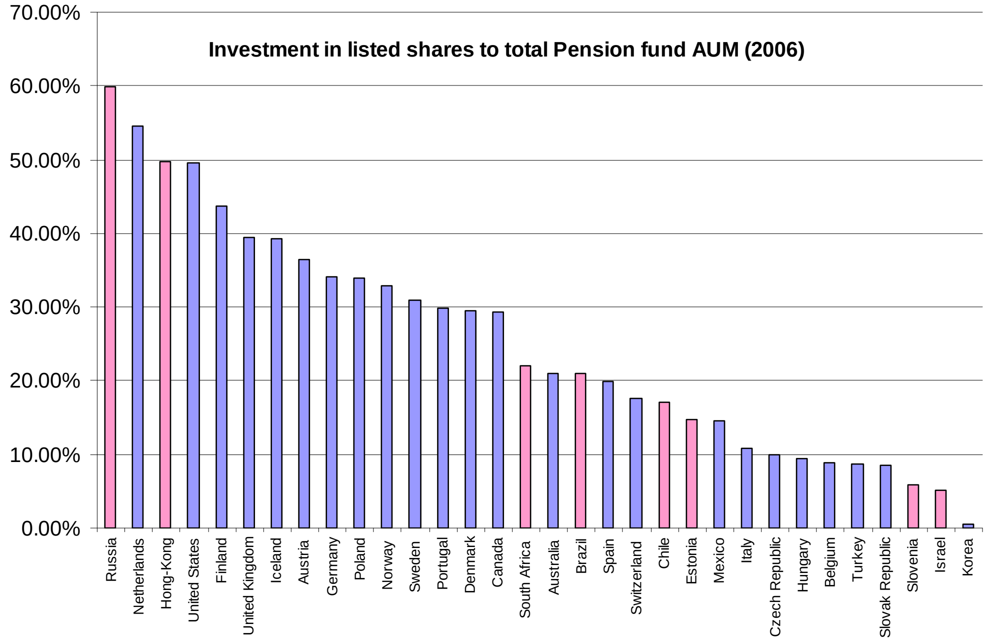
Annex 3: Size and asset allocation of South African pension funds

Size of the pension fund industry relative to GDP across the OECD & emerging economies



Source: OECD

Pension funds' exposure to listed equity in OECD and emerging economies



Source: OECD

Asset allocation of pension funds

Underwritten funds	
Insurance policies	100%
(Source FSB 2009)	

Private pension funds	
Cash and deposits, Loans (other than housing loans), Debentures	7.3%
Bills, bonds and securities	10.5%
JSE listed equities	27.3%
Foreign listed equities	4.9%
Insurance policies	36.9%
Collective investment schemes	9.7%
Investment in participating employer(s)	1.8%
Other	1.6%
(Source FSB 2009)	

GEPF	
Cash and deposits, etc.	7.9%
Bills, bonds and securities	33.8%
JSE listed equities	52.7%
Infrastructure, SRI & BEE funds	4.4%
Property	0.4%
Structured products & derivatives	0.8%
(Source: GEPF 2008)	

Annex 4: Pension fund investment regulation in an international comparison

Asset class	South Africa	Brazil (closed-end)	Sweden (IORP)	Anglo-American
Listed Equity	75% max.	35-45% max, 50% in *Novo Mercado* rated companies.	No limit if quoted	No limit (except conflicts of interest or employer-related
Unlisted equity	5% (for unlisted and listed SMEs)	20% max	10% max	
Real Estate	25%	8%	No limit	No limit except conflicts of interest or employer-related
Bonds	No limit for gvt bonds	No limit for gvt bonds 80% max for other bonds	No limit for gvt bonds 75% max for bonds issues by banks 50% max for corporate bonds 10% max for unquoted bonds (CDOs)	No limit, except conflicts of interest or employer-related
Retail funds	Not allowed	No limit on Brazilian funds	No limit (Max 5% for AP funds)	No limit
Private funds	Not allowed 5% on South African derivatives.	No limit on Brazilian funds	No limit (Max 5% for AP funds)	No limit
Loans	Housing loans to members limited to 95% of the fair value of the fund	10-15%		No limit, except conflicts of interest or employer-related
Bank deposits	20% limit per bank or mutual society	80%		No limit
Foreign assets	20%	Not allowed, except for 2-3% through retail funds and restricted to Brazilian Depositary Receipts within MERCOSUR	No limit (a part from currency exposure provision)	No limit
Investment in single issuer	10-15% for listed equity 20% for banks and insurance groups 5% in real estate projects	None for gvt bonds Max 30% for other classes 20% max (voting or non-voting)	5% max in shares, bonds and loans issued by a single company or real estate; 10% max in a single investment fund; 5% max in a single real estate investment.	Australia: Diversification principle Canada: 5-10% (30% of voting rights); UK: Diversification principle US: Diversification principle, exceptions for DC schemes
Self-investment / Conflicts of interest	5-10%	10% Max	5%-10% max	Australia : Max 5%; Canada: Max 10%; UK: 5%; US: Max 10%, exceptions for DC schemes

Source: OECD 2010b

Annex 5: Black empowerment investments

Black-controlled group, share of JSE market capitalisation

96-00	2001-2003	2004	2005	2006
7.4	4.2	6.3	5.8	5.1

Source: GOLDSTEIN 2010

Profiles of Cyril Ramaphosa & Tokyo Sexwale

	Cyril Ramaphosa	**Tokyo Sexwale**
Former political roles:	NUM general secretary (1982-91), MP and Chair Constitutional Assembly (1994-6), ANC SG (1991-4)	Robben Island inmate; Gauteng premier
Funding vehicle	Shanduka Ramaphosa (established in November 2000)	Mvelaphanda Investment Holdings (established in 1999, merged with Rebserve in 2004)
Holdings	Alexander Forbes (16%, bought April 2003), Bidvest (14.4%, July 2003), Standard Bank (1.2%, July 2004), Mondi Shanduka Newsprint (42%, August 2004), Mondi Packaging (40%, August 2004), Assore (11.74%, November 2005), Liberty Life (1.5%, November 2005), Downing, Reynard and Associates (unlisted, 25%, May 2006) Kangra Coal (unlisted 40%, July 2006)	Northam and Transhex from Remgro, ABSA (10% bought by a consortium led by Tokyo Sexwale), 70% stake of East Daggafontein
Directorships	Alexander Forbes, Bidvest (ch), MTN Group (ch), SABMiller, Standard Bank	Absa, Gold Fields, Mvelaphanda Group (ch), Mvelaphanda Resources (ch), Northam Platinum (ch), Trans Hex (ch)

Source: GOLDSTEIN 2010