



# Clear the road for empowerment deals

Lessons from the establishment of Exxaro Limited can help designers of future Broad-based Black Economic Empowerment transactions to chart a route that bypasses common obstacles.

by Anna-May Fauconnier and Babita Mathur-Helm

South Africa's Broad-based Black Economic Empowerment (BBBEE) Act provides a comprehensive legal framework for transforming the country's economy equitably. Yet it is not backed by equally comprehensive guidelines on how to implement empowerment transactions in practice. The Act gives directives for the journey to be undertaken and emphasises the objectives transformation should achieve, but is short on

details that would signpost the manner in which such transformation should take place.

BBBEE transactions are fraught with challenges and problems. Sadly, the paths taken by many of the early ventures have not been documented in the public domain. As a result, prospective transactions are likely to run into the same obstacles as their predecessors and to repeat the same mistakes. Published studies on empowerment deals are

scarce, and mostly focus on specific issues rather than on the full process. What is still lacking is something of a roadmap that can provide direction to key actors in the structuring of a new transaction.

Given the difficulties of the business environment, the high expectations of government and society are not easily met. And what is found in practice is that the success rate of empowerment transactions is relatively low. Although anecdotal »

evidence suggests some common problems that could contribute to the failure of such deals, there seems to be no empirical research to substantiate these claims.

The lack of published resources – and hence the uncertainties that designers of empowerment transactions face – motivated a research project at the University of Stellenbosch Business School (USB). A major empowerment transaction in the South African mining industry, namely the Kumba Resources deal that led to the establishment of Exxaro Limited, was used as a case study. The aim was to examine the execution of the transaction in a comprehensive way in order to provide a broad framework of lessons.

The USB study found that BBBEE transactions have to grapple with challenges on a wide front. Among the most important are finding sustainable funding, securing suitable investors, merging the various cultures, dealing with fronting, and ensuring management and leadership succession. The investigation also showed that deals of this nature are prone to certain malpractices that may impede the achievement of the intended objectives. The outcome of the research is a seven-point approach that can guide designers of future transactions in anticipating and planning for difficulties they are likely to encounter along the way.

**Tips from those who made the journey**

The interviews revealed that certain aspects of the Kumba Resources deal and the establishment of Exxaro Limited as a new company went well, and that there were mechanisms instituted that served the process successfully. Role-players criticised

**TRACING THE EXXARO JOURNEY**

The investigation aimed to explore the hands-on experiences of the leaders and decision-makers in the formation of Exxaro Limited, one of South Africa’s biggest black-owned and black-managed companies.

In-depth interviews were conducted with eleven prominent role-players. The sample was carefully chosen to be representative of the complexity of the total process. A semi-structured approach was followed in order to cover certain themes believed to be important in this context, but also to probe further issues through open-ended discussions.

Seven themes were selected as a result of what had been found in past studies and other literature relevant to the topic. These themes helped to focus the interviews around a set of pertinent questions as a basis for a meaningful and constructive discussion:

- What were the main challenges encountered during the transaction?
- What processes and methods were used to overcome challenges?
- What sustainability issues were faced during a transaction of this magnitude?
- What were the positive aspects and things that went well during the transaction?
- What are the current issues being faced after the conclusion of the deal?
- What future challenges are there for the newly formed company?
- What alternative ways could have been used to address the challenges of the transaction?

it should be embarked on with a certain level of insight into the dynamics of such processes. Based on the valuable experience of leaders who lived through the formation of a major empowerment company, a seven-point approach can be presented to guide people who find themselves central to putting together future deals.

**Signposts for sustainable empowerment transactions**

**1 Enter the process with a pro-active mindset**

Anticipate that it will be a challenging process and that stumbling blocks can be encountered in

This will include aspects such as:

- An innovative and competitive funding structure that can sustain the creation of further value for shareholders, especially Black Economic Empowerment (BEE) partners. Designers must be alert to financial manoeuvres that may later turn out to favour certain shareholders ahead of the sustainability of the company.
- A sound asset base that can sustain the profitability and, importantly, also the cash-flow needs of the new company.
- Realistic pricing of assets.
- Provisional funding for the early stages.
- Consideration of the market cycle. Beware when the deal is structured at the time of a boom, which inevitably will be followed by less prosperous times. The structure must be robust enough to survive the downward cycles.

**3 Select the BEE partners carefully**

The selection of BEE partners should be considered thoroughly beforehand. It is important to take cognisance of a number of factors:

- A limited number of BEE partners is preferable. Too many partners can make the process unwieldy to manage.
- Follow a transparent process for the selection of BEE partners.
- Conduct an in-depth due diligence of potential partners to ensure that they have the necessary

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some areas, however, and noted elements that could have been handled more effectively. All in all, there were numerous contributions that designers of prospective empowerment deals can learn from.

The findings of the research make it clear that a BBBEE transaction should be approached with a great deal of care and preparation. In essence,

unexpected places. These problems can best be mitigated by designing a process with a better chance of running smoothly and of avoiding potential pitfalls, and by managing the process with great awareness of the unfolding dynamics.

**2 Structure the deal wisely**

Make sure that the deal is financially well designed.



competence, realistic expectations and, as far as possible, aligned views about each party's contribution to the success of the undertaking.

- There should be at least one BEE partner with hands-on experience in the industry concerned and the capability to take the lead in managing the newly formed company.
- Partners should have shared value systems about business ethics and corporate governance.

#### 4 Avoid dominance by the lead company

The lead company is in a relatively strong position and, perhaps not unreasonably, may have its own agenda that it wants to impose. This delicate situation must be addressed upfront to ensure that it does not threaten to derail the process at a later stage.

#### 5 Manage the process and different interests in a balanced way

The study showed that a well-structured process of managing the transaction goes a long way towards ensuring a successful transition. The following aspects will assist role-players to overcome some of the potential challenges:

- Upfront alignment of the diverse interests of the parties to the deal.
- A thorough study of the background of each partner to gain an understanding of the expectations and requirements of each.
- Curbing expectations to what would be realistic in the context of the transaction.
- Fostering a spirit of transparency and trust from the start.
- Establishing a steering committee that can form the backbone of the process.

- Holding regular discussion sessions and meetings.
- Ensuring ongoing engagement of all parties.
- Instituting mechanisms to keep all parties informed of relevant information and decisions.
- Making sure that all partners have competent advisory capacity at their disposal throughout the formation phases.
- Instituting mechanisms to make sure that government, an important stakeholder, is kept abreast of major decisions and the progress of the deal.

**Designers should never lose sight of the overall broad-based empowerment aim of the transaction, even in the planning phases**

#### 6 Ensure that there is adequate changeover and future leadership

The company in transformation needs to be managed competently. Designers of the process have to put the necessary mechanisms in place to ensure that this will happen, not only during the establishment or changeover phase but also when the new company is fully up and running – and beyond. Designing for effective company leadership should include:

- Well-defined management structures.
- Effective initial and changeover leadership.
- Short-term succession planning, i.e. directly after changeover.
- Longer-term succession planning.
- Having leadership training in place from the outset to assist new leaders in, for example, merging people from different cultures, and maintaining the company ethos and approach to governance.
- Making sure that the right quality of leaders is at board level to instil confidence, especially in the market for attracting future investment.

#### 7 Manage and sustain the empowerment nature of the deal

Designers should never lose sight of the overall broad-based empowerment aim of the transaction, even in the planning phases. It is crucial that aspects such as the following should always be on their agenda:

- Ensuring a lengthy lock-in period for BEE partners.
- Making sure that the empowerment status of the new company is truly broad-based, that it includes aspects of gender empowerment and community upliftment, and that it does not merely focus on enriching an elitist few.
- Gaining a thorough understanding of legislation and the applicable industry charters as far as BBBEE is concerned to make sure that ongoing decision-making complies with the relevant stipulations.

These guidelines consolidate the intricacies of a challenging process. Though they do not introduce a major change of direction, these pointers may smooth the way for future transactions. ■



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This study was conducted by Anna-May Fauconnier as her MBA research project at the University of Stellenbosch Business School (USB), under the supervision of Dr Babita Mathur-Helm. The research report, *Black economic empowerment in the South African mining industry: A case study of Exxaro Ltd*, was presented in December 2007. The research was subsequently published under the same title by A Fauconnier and B Mathur-Helm in the *South African Journal of Business Management*, Vol 39(4).



**Write to us:** Can you suggest areas of BBBEE, from the beneficiaries' perspective, that need improvement and further research?  
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