THE IMPACT OF ECONOMIC DOWNTURN ON BLACK ECONOMIC EMPOWERMENT AND BANKS

by

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DECLARATION:

In accordance with Rule G4.6.3, I hereby declare that the above-mentioned treatise is my own work and that it has not previously been submitted for assessment to another university or for another qualification.

SIGNATURE:  ......................................................

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ABSTRACT

The purpose of this treatise is to ascertain the impact of economic downturn on Black Economic Empowerment (BEE) and Banks. This has been sparked by the huge speculations in the market as to what will happen to BEE and how will the banks cope in general with the impact of this scourge. It is imperative to understand the influence of the 2008+ economic downturn on socio-economic reconstruction and development in South Africa and the black economic empowerment and its funding mechanisms. The treatise has two phases the, namely the theoretical phase and a bit of narrative phase.

In the theoretical phase the research study interrogates what the literature review reveals about the economic downturn, BEE as well as performances of different banks across the world. This shows the economic impact that the banks have had to endure during the economic downturn. This resulted in stock markets losing their value. The dividend earners were significantly affected including a sizeable number of BEE companies. The BEE companies are perceived to be too reliant on debt on to finance their deals and this treatise will look at various options of financing a BEE deal and what is deem to the most suited financing structure.

The narrative phase involves semi-structured interviews that were conducted in order to ascertain the real impact that South African were faced with and how they have managed to steer clear of the turbulent waters. This also looked at how the BEE consultant views the current occurrences in the market.
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CHAPTER 1

1.1 BACKGROUND TO BLACK ECONOMIC EMPOWERMENT AND THE ECONOMIC DOWNTURN

Since the change from a minority Apartheid Government to a democratically elected ANC Government in 1994, the South African economy has been faced with the challenges of global re-integration, following a period of economic isolation due to international sanctions that were implemented as the result of an inequitable and racially privileged micro-economic policy at the time. To achieve the current objective of sustainable economic growth, productivity and competitiveness, and economic redistribution, the establishment of small business and medium size private enterprises have been actively promoted by Government. With the further goal to empower historically disadvantage population groups to manage and own an equitable share of corporate South Africa, the policy of Black Economic Empowerment (BEE) was introduced and prioritise. According to Jack (2008), this proved an excellent means of bringing those persons who were never previously involved in the formal economy to participate. These BEE deals are mainly funded by the big four corporate banks in South Africa. At the time when the BEE structures were planned, the 2008 global economic downturn could not have been anticipated.

According to Isa (2007), Black Economic Empowerment (BEE) is a government managed social and economic development programme intended to improve the inclusion of Black African, Indian, Coloured and Chinese people (in summary referred to as Black) into the mainstream economy. Legislation was promulgated through the BEE act of 1995. It allows companies in South Africa to achieve recognition for involving Black people in all levels of business. The first attempt at BEE is now referred to as “narrow BEE”, which measured the percentage of ownership held by
black people in a particular company. This strategy led to a small number of privileged black people benefiting economically and politically to the exclusion of the masses and has since been referred to as “enrichment of the few”.

Monana (2006), states that Government subsequently realised that the policy of BEE was not achieving its goal of being inclusive to the majority of the previously disadvantaged. Broad Based Black Economic Empowerment (BBBEE) was developed to address this shortcoming. The new strategy not only measures black peoples’ involvement at the ownership level of businesses, but also promotes the involvement of black people in the areas of management control, employment equity, skills development, work procurement and enterprise development. When BBBEE was conceptualised, no one could foresee the impact that the economic downturn would have on these BBBEE ventures.

According to Gwartney & Stroup (1983), an economic slowdown is a reduction in economic activity over a sustained period of time, or a business cycle contraction. Production measured by Gross Domestic Product (GDP), employment, investment spending, capacity utilisation, household incomes and business profits all tend to fall during an economic downturn.

Bloomberg (2008), states that the 2008+ local economic downturn has been largely influenced by the United States of America. The United States housing market correction and the subprime mortgage crisis have significantly contributed to the subsequent global economic downturn. The 2008/2009 downturn in the USA economy has seen private consumption fall for the first time in nearly 20 years. This indicated the severity of the economic downturn, which consequently has been termed a recession.
The issue of consumer confidence is being low, and Americans remaining reluctant to spend money, has impacted negatively on America’s trading partners. As the world’s largest economy, a slowdown in the USA economy has an indirect impact on the macro world economy.

1.2 PROBLEM STATEMENT

The 2008+ economic downturn has had a huge impact on the South African Banks and especially on its BEE ventures that had been concluded prior to the downturn (Jack; 2008). The severity of the economic downturn is witnessed by large organisations retrenching workers and, most significantly, by the weakening of share values. The companies which lost most of their equity due to the weakening of shares were predominantly BEE companies. This posed a significant amount of risk to the South African banks, as in most cases the banks have been the main funders of such BEE deals.

The Banks were holding onto BEE company share certificates as part security. It becomes difficult to manage the risk when the share prices of these companies had been devalued. As these companies default on their loan repayments, the Banks’ exposure is at risk of rising to uncontrollable levels, depending on the banks’ involvement in these BEE deals. Jack (2008) confirmed that the way the BEE funding deals were structured would have an impact on the banks’ impairments, however if the funding was astutely done the banks will still stand to benefit a great deal.

In light of the above, the study problem can thus be defined as follows:
How did the 2008+ global economic meltdown, with specific reference to the recession in South Africa, influence the business of existing BEE companies and what impact did
these effects have on the main funders, the corporate banking system, and how can one address prevalent shortcomings to the existing system? Therefore the overall study problem is “What is the impact of the economic downturn on BEE and Banks”?

1.3 RESEARCH OBJECTIVE

The primary objective of this study is to ascertain the impact of the economic downturn on South African banks and their BEE ventures, and to explore potential measures of intervention by both the private sector and government in the form of new strategic funding opportunities and/or monetary rescue packages respectively, in the event of such banks not being able to honour its contractual commitments to said BEE companies.

In addition to the above mentioned primary objective, the following secondary objectives will be explored:

- to ascertain the effectiveness of BEE funding,
- to assess the risk exposure of the banks to BEE ventures, and
- to ascertain the sustainability of BEE deals.

1.4 DELIMITATION OF RESEARCH

According to Collis and Hussey (2003), delimitation explains how the scope of a study is focused in one particular area.

This study will be limited to researching the four major South African banks with BEE exposure, doing business in the geographical area of the province of Gauteng.

1.4.1 The major banks

This research will focus on three of the four South Africa’s major stake holding banks, which have entered into BEE deals, prior to the economic downturn, involving bank
project funding and administrative support of independent, outside BEE registered companies. These banks are ABSA, Nedbank and Rand Merchant Bank (RMB). This is purely based on the high profile transactions deals that the big four have been involved in. A BEE consultant will also be interviewed to give his views on the BEE transactions.

1.4.2 Geographic Delimitations
The research will be limited to the Gauteng Province, where the above three banks have their head offices in Johannesburg and Sandton and where most BEE experts seem to reside.

1.5 KEY ASSUMPTIONS
It is assumed that:

- The interconnected global sub-prime lending rate crises, which started in the USA and developed into a global recession, directly affects South Africa, due to its earlier historic macro-economic market isolation and it being accepted globally as a major economic player in Africa.
- The policy concept of sustainable BEE does not accommodate for large market fluctuations.
- South African based enterprises and institutions are the sole financiers of Black Economic Empowerment deals in the country.

1.6 RESEARCH DESIGN
Research design constitutes the blue print for collection, measurement and analysis of data; it forms the plan and structure of the research investigation to obtain appropriate answers to the research questions (Cooper & Emroy, 14:1995).
Research methodology forms the foundation of any research project, as it directs the entire research endeavour (Leedy, 4:1997). The researcher must review the literature to become familiar with existing published work. Such efforts allow the researcher to ensure that their research questions have not been previously answered, identify gaps in the literature and note possible research methods for their own studies (Passmore, Dobbie, Parchman & Tysinger, and 286:2002).

1.6.1 Research methodology

The research methodology followed will comprise a single case study where semi-structured interviews will be conducted.

1.6.2 Literature review and empirical study

In order to solve the main problem and sub-problems stated, a literature review will be conducted and an empirical study will be undertaken.

The empirical study will consist of:

(a) Interview questions

Questions will form a basis of gathering information by being asked during semi-structured interviews. All questions will be prepared in advance in the form of an interview schedule.

(b) Semi-structured interviews

Semi-structured interviews will be conducted with the independent Black Economic Empowerment experts and also get an opinion of corporate bankers from the four major banks.

(c) Measuring instrument

The semi-structured interviews will be recorded and findings written as a narrative. The objective here is to determine how the South African Banks have been
impacted by economic downturn, especially those who have financed the BEE deals.

(d) Sample

The sample will consist of independent Black Economic Empowerment experts. A representative from each of the four major banks will be approached in his/her capacity as corporate bankers who are directly involved with the structuring of Black Economic Empowerment deals.

1.7 TERMINOLOGY

For the purpose of this study, the terminology listed below shall mean the following:

(i) Black Economic Empowerment

South Africa’s policy of Black Economic Empowerment (BEE) is not simply a moral initiative to redress the racial discrimination and economic inequalities of the past. It is a pragmatic social engineering and sustainable economic growth strategy that aims to realise the country’s full economic development potential (Isa; 2007).

(ii) Equity

Ownership in the form of common stock or preferred stock (Jack; 2008).

(iii) Special Purpose Vehicle

A corporate subsidiary company designed to serve as a counter party for swaps and other credit sensitive derivative instruments (Siegel; 2008).

(iv) Mezzanine Financing

A hybrid form of debt and equity financing that is typically used to finance existing companies. Mezzanine financing is basically debt capital that gives the lender the right to an ownership or equity interest in the company if and when the
loan is not paid back in time. It is generally subordinated to the debt provided by senior lenders such as banks and venture capital companies (Jack; 2008).

Since mezzanine financing is usually provided to the borrower quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of loan is normally aggressively priced, with the lender seeking a return in the 20-30 percent range.

(v) Interest Rate

It is the percentage calculated cost of borrowing money, forming the agreed upon rate at which interest is paid by the borrower for the use of money that he/she has borrowed from the lender.

(vi) Shares

It is a unit of account for various financial instruments including stock.

(vii) Profit

It is positive gain from an investment or business operation after subtracting all the expenses.

(viii) Economic downturn

It is a slowdown in economic activity over a sustained period of time, also referred to as a business cycle contraction (Fouche; 2003).

1.8 STUDY OUTLINE

The study will be divided into five chapters.

Chapter One outlines the scope of the study, states the research problem, defines the research objectives, notes the key study assumptions made, plans the research methodology, limits and focuses the study material and then proposes the subsequent chapter headings of the following treatise.
Chapter Two will provide a literature overview of the economic downturn under consideration and Black Economic Empowerment at large. This chapter will focus on global recession, stock recession, sub-prime lending and the property market.

Chapter Three will outline a general overview of Black Economic Empowerment, including Broad Based Economic Empowerment.

Chapter Four will outline the research methodology, which includes the research paradigm, sampling design and measuring instruments.

Chapter five will present and discuss the study results obtained.

Chapter Six will consist of conclusions and recommendations.

1.9 SUMMARY

This chapter, Chapter One, introduced the research problem and sub-problems to be investigated. Delimitations of the research project were established and listed. The chapter lists the key assumptions identified in related to the study and explains the research methodology to follow therein.

Chapter Two will provide a literature overview of the Economic downturn under review, which will include research material on sub-prime, recession of stock, perception on stock, and the property market.
CHAPTER 2

FACTORS THAT INFLUENCE ECONOMIC DOWNTURN AND SOME OF ITS EFFECTS

2.1 INTRODUCTION

This section researches and tabulates the macro and micro economic factors that influenced the global and local economic downturn of 2008+ and how BEE companies and their corporate funders in South Africa were affected by the downturn.

This chapter presents the relevant literature search on economic downturn. It examines some of the factors that influence economic downturn. The data presented focuses on how the current economic downturn started, its probable causes and effects. Subjects covered include sub-prime lending, global recession, stock market price indexes, as well as the consequent market perception on the profitability of banks and stocks.

According to Lim (2008), recession or economic downturn is regarded as a slowdown in economic activity over a sustained and specified period of time, also referred to as a business cycle contraction. During a recession, many macro-economic indicators vary in a similar manner. Economic indicators such as production (as measured by Gross Domestic Product (GDP)), employment, investment spending, capacity utilisation, household incomes and business profits tend to fall during recessions.

According to Lim (2008), in 1975 Julius Shiskin suggested several economic indicators that can identify a recession. These indicators included the rule of experiencing two successive quarterly declines in GDP (negative real economic growth). Lim (2008) further mentions that some economists prefer a more robust definition for recession, as measured by a 1.5 percent rise in unemployment within a 12 months period. The Oxford English Dictionary (2001) defines “recession” as a temporary economic decline during
which trade and industrial activity are reduced. According to Hazelhurst (2009), the South African economy shrank by 6.4 percent in the first quarter of 2009. This is the sharpest decline since the third quarter of 1984, when there was a contraction of 6.5 percent. The above figure represents a quarterly change which has been seasonally adjusted and annualised. This decline far exceeded the worst expectation of most economists, who predicted maximum four percent shrinkage. Consequently, economists prompted the National Treasury Director General, Mr. Lesetja Kganyago, to state that South African would be fortunate if the economy achieve zero growth for the year as a whole.

Hazelhurst (2009) argues that the above figure of 6.4% comes after a contraction of 1.8 percent in the previous quarter, confirming that the economy is in recession due to two consecutive quarters of shrinkage, as per definition. This recession follows a four consecutive quarters growth period and is the first recession recorded in South Africa since 1992. The Gross Domestic Product (GDP) figures that were released by Statistics South Africa in the first quarter of 2009 showed a contraction of 23 percent in mining and agriculture, a 15.5 percent decline in manufacturing and a 0.5 percent decline in the services sector. According to Kemp (2009), what was particularly worrisome was the fact that the weakness in the mining and manufacturing sectors has spread to the services sector, which makes up more than 60 percent of the economy. He further states that another factor contributing to the worse than expected outcome was the disappointing performance of agriculture, which had done well in previous quarters.

Because of this poor financial outlook, the Congress of South Africa Trade Unions (COSATU) called for a cut of two basis points to the prime lending rate, as managed by the Reserve Bank. According to Hazlehurst (2009), the National Treasury Director General, revised his expectations of zero growth for the year, during the February budget,
to a, 1.2 percent growth forecast. At the same time, he stated that the global economic conditions had worsened since the earlier prediction. The international Monetary Fund has revised its global growth forecast for 2009 from 0.5 percent to a negative 1.3 percent. He further stated that job losses in South Africa would be unavoidable due to the expected contraction of the economy. This would have a chain reaction of negative impact on both revenue tax collection and consequent service delivery by the government.

2.2 GLOBAL RECESSION
According to the International Monetary Fund (IMF) there is no commonly accepted definition of a global recession. The IMF regards periods when global growth is less than three percent to be a global recession. The IMF estimates that global recessions seem to occur at eight to ten year cycles. During what the IMF terms the past three global recessions of the last three decades, global per capita output growth was zero or negative. Economists at the IMF estimate that the current global slowdown would represent a global recession of three percent or less growth.

2.3 STOCK MARKET AND RECESSION
Bingham and Charron (2008) are of the opinion that some recessions have been anticipated by stock market declines. Siegel (2008) mentions that since 1948 ten recessions were preceded by stock market declines of greater than 10 percent. The real estate market also usually weakens before a recession. However real estate declines can last much longer than the recession itself. Since business is very hard to predict, Siegel (2008) argues that it is not possible to take advantage of economic cycles for the timing of investments.
Experience has shown that during an economic downturn, high yield stocks in the form of fast moving consumer goods, such as pharmaceuticals and tobacco, tend to hold up better against external pressures than most other stocks. However, when the economy starts to recover after the market has bottomed out, growth stocks tend to recover relatively faster. There is significant disagreement about how health care and utilities stocks tend to recover. Diversifying share portfolios among different international stock markets may provide some safety buffer. It is a further imperative to note that economies that are closely correlated to that of the United States of America may also be affected by a recession in the United States.

Siegel (2008) states that there is a view termed the *halfway rule*, according to which investors start discounting an economic recovery about halfway through the recession. According to the US treasury, looking at 16 recorded recessions in the United States since 1919, the average length of those recessions has been approximately 13 months. It further indicates that recent recessions have comparatively been shorter on average. Thus, if the 2008 recession followed the above average trend, the downturn in the stock market should have bottomed out around November of 2008.

According to Richardson (2008), recent history has shown that investors anticipate a recession to depress stock prices. The sooner people move out of the anticipatory stage, stock prices would stabilise. Stovall (2008) mentioned that stock market performance studies were performed during the last 11 recessions by the National Bureau of Economic Research (NBER), going back to 1945. It was found that the Standard and Poor’s 500 which is a basket of 500 stocks that are widely held. It is weighted by the market value. This index fell by 26 percent on average from the months leading up to the recession to the recession low. The over all study analysis showed that between the
official starting and ending dates of those recessions, the Standard and Poor’s 500 held relatively steady, gaining just below one percent. In the most recent recession, from March 2001 to November 2001, stocks tumbled by around eight percent. In comparison, during the severe recession of November 1973 to March 1975, the Standard and Poor’s 500 lost nearly a quarter of its value.

2.4 IMPACT OF RECESSION PERCEPTION ON STOCKS

According to Isa (2009), stocks dipped for a third session as investors dumped financial and retail shares on worries about the economy and the local unit of steel giant ArcelorMittal South Africa slumped after reporting lower earnings. The top 40 index fell 0.75 percent to 21 245.76 points, while the all share index softened 0.75 percent to 23589.29 points. Reuters and Bloomberg (2008) argue that the banks and retailers have run ahead of themselves in terms of earnings. The recession is not going to go away overnight.

Although Isa (2009) figures showed that inflation and credit growth had braked more than expected, it failed to buoy banks and retailers. Amalgamated Banks of South Africa (Absa) dropped 2.8 percent to 113.75 cents while FirstRand fell 3.26 percent to 14.70 cents. Clothing retailer Foschini fell as much as 2 percent. It closed down 0.33 percent at 57.06 cents. ArcelorMittal skidded to 97.50 cents which was 3.42 percent lower after reporting an interim headline loss per share of 1.90 cents per share, hit by a stronger rand to the US dollar. BHP Billiton, the world’s largest mining company, retreated 1.7 percent to 195.55 cents.

Bloomberg (2008) further reported that Anglo American fell 1.7 percent to 235.99 cents. Copper had its greatest retreat in three weeks on the New York and London exchanges,
sliding as much as 2.4 percent to 5 395 dollars (R42 180) per ton, as swelling inventories fanned the concern that prices might rise beyond the point of reflecting real demand. Ellie Holdings fell for a fifth day, sliding 0.8 percent to 1.22 cents. The earnings per share, excluding one time items, of the manufacturer of satellite-television equipment, dropped to 26.42 cents from 30.60 cents during the previous year. The company indicated that it would not pay an annual dividend as it focused on growth, a policy it has had since its listing in September 2007. Mutual & Federal Insurance sank 2.7 percent to 16.20 cents, its steepest decline in two weeks. Sasol, the world’s biggest maker of motor fuel from coal, slumped 1.7 percent, to end the day on 267.75 cents.

The above share prices weaknesses indicate the level of impact that the economic downturn had on the stock markets, not only in South Africa but around the world. The previous years’ stock prices were used as benchmark to compare movement. This illustrates the damning effect that stocks have been affected and the loss of value by companies and shareholders in these commodities.

2.5 IMPACT OF SUB-PRIME LENDING

Many analysts believed that the credit crunch that is being experienced globally was instigated in the United States. Mortgage banking (2008) defines Sub-prime as near prime, non prime and second chance lending are loans that are made available to the riskiest category of consumers and are typically from separate market from prime loans. It is stated that the credit crisis that began in the mortgage industry now threatens the nation’s (USA) financial system as a whole. The crisis was fuelled by rising delinquencies and falling house prices, aggregate write downs based on global holdings which originated in the United States, securitised mortgages, as well as consumer and corporate debt that have risen to 1.4 trillion dollars.
According to an International Monetary Fund report (2008), mortgagers are feeling the pain from an avalanche of foreclosures. In April 2008, Credit Suisse Group, based in Zurich, estimated that the total foreclosures could reach 6.5 million by the end of year 2012, of which 2.7 million of those are subprime loans. The Mortgagers Bankers Association (MBA) reported in September that during the second quarter of 2008, both the rate of foreclosures and the percentage of loans in the process of foreclosure set new records. The USA national foreclosure numbers continue to be driven by the hardest hit states, continuing to get worse. The MBA survey found that the foreclosures starts rate for subprime adjustable rate mortgages (ARM) in California had hit 9.5 percent and in Florida the rate was 9.1 percent, roughly double the national median rate for such loans. According to the MBA report (2008) many industries observers believed that they are at the start of a long downhill slide.

Bingham and Charron (2008) are of the opinion that the challenge for lenders is to identify loans that are in danger of going south, this means that loans that are in danger of not being paid as the crisis plays itself out over the next few years and then to decide which homeowners can be saved from default and to find ways of effectively helping them. They further state that some Attorney Generals from several states have recently pursued the adoption of similar strategies. This may act as a model for mortgage servicers in going forward.

Mortgage banking (2008), states that a host of factors from ARM, reset to a family illness may tip the scales on whether a homeowner is able and willing to make his or her monthly mortgage payments. This is a defining factor on making a full recovery of what was borrowed. Predictive analytics can help lenders understand which key factors most effectively quantify the health of loans in their portfolios. Through predictive analytics, lenders can identify different combinations of borrowers’ traits such as income, overall
debt, property location and lifestyle. This will provide a tremendous insight as to why loans have already begun the slide to foreclosure. These factors may signal that other borrowers are headed for trouble in the future.

Before the subprime crisis, collections were generally a minor concern for mortgage lenders (Mortgage Banking 2008). In most cases borrowers would have made a substantial down payment on the home, an investment that motivated them to do all they could to avoid foreclosure. With real estate prices rising, most cash strapped homeowners could sell their properties at a profit or at least without incurring further losses. If a borrower did default the lender could sell the property with relative ease and not end up holding a dreaded real estate owned property.

According to Mortgage Banking (2008), the pre-collections process in the past was typically based on a set formula and simple rules. A lender usually monitored loan-to-value (LTV) ratios for signs of stress. However little attention was paid to which type of loan products and which loans demanded the most attention. This was especially true for loans sold to investors various tranches of mortgage backed securities (MBS). The subprime collapse changed the calculus, as ARM reset and real estate prices plunged many homeowners found them being weighted down by their loans, leading to more foreclosures. In addition, with secondary market interest and access to capital markets being severely restricted, mortgage lenders found themselves stuck with a vast number of new loans on their books.

Bingham and Charron (2008) state that in small numbers foreclosures are manageable, but when they come in waves the strain and the cost are enormous. The institution must hire an attorney to file paperwork in accordance with state laws. If a homeowner walks away from his/her loan obligation, an increasingly common occurrence as many have no
equity in their homes, the property must be secured. Security has become a huge concern as vandals increasingly strip homes of high priced copper and other valuable material and content.

Putting the property on the market for resale means the mortgagee must engage a real estate company at a commission. Finally there are costs of closing the transaction and transferring the property to new owners, should the institution be lucky enough to find one. All of these expenses accrue to the former owner, leaving the financial institution to write cheques to pay these expenses. Along with lost interest payments and penalties, any equity that does remain can quickly evaporate. Financial institutions are experiencing tremendous financial burden associated with foreclosures as well as accumulating Real Estate owned portfolios, motivating them to find desirable alternatives to foreclosures. They state that pre-collection involves an intervention process and the development of a treatment strategy based on a simple set of rules, applied uniformly across the customer base. It further states that overdue payments are often the trigger for a lender to take action. How late the payments are commonly made can be a key variable. Some borrowers may routinely pay late because of the timing of their paycheques, in which case the lender can anticipate the delay and is able to collect additional fees. However, if such a late payment goes from 30 days owing to 60 days past due, the pre-collection operation may swing into action.

North Edge (2008), states that borrowers are prioritised for intervention, based on the risk of foreclosure. Such an approach is reactionary and resource intensive. It makes no distinction regarding the past history of the borrower or the experience, knowledge or skill of the people handling the account. Thus it leads to blanket treatment of customers and an inefficient use of lender personnel and resources. In short, it is totally inadequate in today’s environment.
North Edge (2008), further states that in the past the accounts would have gone from 30 to 60 to 90 days overdue before the lender would initiate a foreclosure. Now however, many loans go straight from 30 days late to “jingle mail”. The borrower simply walks away from the house and mails the keys to the lender, without giving the lender an opportunity to intervene. Mortgage banking (2008) states that predictive analytics can help prevent such adverse outcomes, by raising a warning very early on regarding customers who are at the highest risk of foreclosure. By combining powerful analytical models with non-traditional, publicly available, data elements, as well as by making other critical changes to the focus of the pre-collections organisation, mortgage servicers can do a far better job of prioritising treatment actions for loans already in default.

2.5.1 House Price Index of a South African Bank (Standard Bank)

Mokopanele (2009), states that one of the indicators that are utilised to measure the impact of recession is the house price index. During the recession property prices dropped, causing a lot of homeowners to be stuck with the properties they have, as selling them becomes difficult. According to Mokopanele (2009), the Standard Bank median house price index declined 4.9 percent year on year 2008 to 2009. This is a steeper rate of contraction when compared with a year previous, indicating a slowing economy. The recession, the level of household income and debt, as well as the medium-term outlook were such that a clear and quick improvement in the housing market was unlikely. In real terms, using its estimates of the consumer price index to deflate the nominal house price, the decline in real house prices came to about 12 percent.

Mokopanele (2009), further stated that the decrease in the growth rate showed that the median value of the residential property financed by Standard Bank was 523 000 rand. Times continuing to be tough, the latest statistics reflect a rising number of insolvencies
and liquidations, while banks have reported significant increases in bad debt. Households owe banks an astounding 1.2 trillion rand, of which the greater part (82 percent) represents mortgage advances. Adding to the existing woes experienced by the property market, about a third of South Africans have impaired credit records, being more than three months in arrears.

Mokopanele (2009) is of the opinion that the latest national accounts data confirmed that the slowdown in the economy had been spearheaded by a substantial decline in household consumption expenditure. A decline of 4.9 percent in real household consumption was reported for the first quarter of 2009. The consumer cutback in spending was made worse by a steep decline of 4.5 percent in disposable personal real income of households, in the last quarter. Botha (2008) stated that the contraction in house prices had been aggravated by industry wide-loan-to-value restrictions.

The First National Bank reported that more than half of applications it received for home loans were declined, due to a combination of excessive debt, high living cost or poor credit records. It also stated that financing residential property remains an active business.

2.5.2 Recession Impact on Property Prices in South Africa

Cokayne and Bloomberg (2009) state that house prices fell the most in 23 years, dropping 4.4 percent from June 2008. They further state that according to Absa Group, average middle segment house prices are now back to levels last seen in mid-2007, while prices adjusted for inflation are at their lowest level since mid-2005. Absa’s latest house price index shows that the nominal middle segment housing process was 42 700 rand lower in the last month, when compared with the peak of 967 300 rand in 2008.
According to Cokayne and Bloomberg (2009), the Absa index shows that prices have fallen by 4.4 percent year on year, to a value of 924 600 rand, which is the biggest drop in nominal house prices since May 1986. Isa (2009) states that, after adjustment for inflation, house prices dropped by 11.1 percent year on year in May 2009, compared with 10.9 percent in April 2009. This is the biggest real year on year price decline since September 1992. She further confirms that South Africa is in its first recession in 17 years, pushing up unemployment, slowing consumer spending and depressing house prices.

The South African Reserve Bank has cut its benchmark interest rate five times since dropping it to 7.5 percent, late in 2008 to help revive the economy. Nominal house prices fell by an average of 2.9 percent year on year during the first half of 2009, compared with a growth of 6.5 percent in the same period during 2007. Cokayne and Bloomberg (2009) note that Absa forecasted a 3.5 percent decline in nominal house prices for 2009, compared with a growth of 3.7 percent in 2008. They further predicted that real house prices would drop by 12 percent, the second consecutive year of lower real house prices.

According to Isa (2009,) Absa’s house price index is based on the average cost of a home taken from the mortgage applications it has received.

According to a construction report by Rawson Developers (2009), sales of holiday homes have come almost to a standstill in the Cape Peninsula and many of the people who bought in boom times are now defaulting on bond commitments. The report further states that the problem has reached alarming proportions along the Cape West Coast. In today’s difficult economy, with people cutting back on spending, the first thing to go is the holiday home. Owners of second homes, who used to be able to subsidise their monthly bond payments through short term rentals, are finding that there are very few takers these days.
Isa (2009) also mentions that “the weekend away” is often the first thing to be cut from an austere budget. Hotels and Bed and Breakfast establishments are well down on turnover. Houses are flooding the “for sale” market and some very attractive buys are available. She also argues that the lucky sellers are those that are able to accept substantially lower offers and the less fortunate sellers are those who still owe the bank far more than they can recoup through the sale. In the worst cases, owners have lost not only their holiday homes but also their primary residences, because these were put up as the security.

A construction report of (2009) by Rawson Developers states that the top four banks have repossessed many west coast properties during this year and developers have experienced hard times. Often the developers would complete the initial infrastructure, such as boundary walls and guard gates. The show house and the services for one or more phases would be completed, only to find that buyers are not materialising. The report further states that its ambition is to develop and expand the west coast on account of its long term potential. However, because of the current economic climate, this ambition had to be shelved. It also further reveals that house prices held up well, averaging nearly two million rand, probably because the middle and upper income buyers can afford to ride out the recession. It is imperative to note that the property market is stable however the buyers are limited due to banks tightening their lending criteria.

According to Kemp (2009), the slump in the personal home market has also expanded to the commercial property market. He is of the view that even when recovery commences in the commercial market, it is going to be a lot slower than expected. Vacancies are up, debt and funding pose a major challenge, building costs remain high and, to make
matters worse, rent is softening because of high vacancy levels. The recession had caught the property industry off guard with retailers reeling from falling consumer spending and some are closing shop. Furthermore, a tight monetary policy environment is adding to the industry’s challenges. High levels of inflation and household debt, as well as declining consumer and business confidence are not making matters any easier.

Data from the South African Property Owners Association and South African Council of Shopping Centres showed that trading densities for all shopping centres declined by 12.5 percent year on year March 2009, representing the sharpest decline in 69 months of recorded history. The decline affects all types of centres, except for super regional centres of a size larger than 100 000 square metres. Community size centres of less than 5 000 square metres continue to be particularly hard hit. Their trading density ended 15.3 percent down for the first quarter of 2009, compared to the same period last year. These centres were negatively affected as a result of their inability to attract shoppers.

According to Mokopane (2009), super-regional centres recorded a positive growth of 6.2 percent annually, up to March 2009, highlighting the defensive nature of larger centres. In contrast, the trading density growth of community sized centres had been negative for the past seven months. Regional centres, those bigger than 60 000 square metres and small centres both recorded a decline in annual trading density growth, ending down 2.2 percent and 3 percent respectively. He further states that there was now (2009) excess space available in the commercial property market, but only a few tenants for the taking.

With the economy in trouble, most centres will find it difficult to fill vacancies.

Mokopane (2009) suggests that few new commercial developments would take place in the near future, because of the dramatic slowdown in the economy. He further states that recovery would depend on how deep and long the recession would be. He also argues
that even though individuals bemoan banks’ tight lending policies, banks are under enormous pressure to preserve adequate capital and liquidity. He also mentions that even though the prime lending rate has come down, banks are charging increased margins. Previously, most people could get prime minus two, compared to prime plus two currently. This means that the cost of debt has risen.

2.6 RECESSION IMPACT ON SOUTH AFRICAN COMPANIES

Dlamini (2009) states that Transnet, the South African transport parastatal, announced that the economic recession had affected its volumes. This key source of the group’s profitability and growth had recorded a double digit decline. He further states that, disappointingly, Transnet’s volumes had declined by about 12.4 percent during the year 2008. The economic slowdown was more pronounced in the general freight and container business, where volumes decreased by 19 percent and 12 percent respectively. It was expected for volumes to remain weak due to the ongoing financial hardship.

Mokopanelo (2009) states that for many years container ships have provided South Africans with virtually everything that we use, for example our cars, trucks, buses, trains, televisions, shoes, computers, clothing, washing machines etc. However, the container shipping industry ground to a sudden halt in the latter part of 2008, as consumers stopped buying many categories of goods. The shipping industry is currently floundering, with empty ships anchored kilometres offshore, waiting for better days. Crews remain trapped on these ships, often too far out at sea for a shore visit, while many are uncertain whether their contracts will be renewed. More than 150 million containers are lying idle on wharfs, mainly in Asia which are awaiting to be shipped to South Africa.
2.7 FACTORY AND MINING SLOWDOWN IN SOUTH AFRICA

Isa (2009) states that factory output declined by 17.1 percent in the last year up to May 2009, while mining output plunged by 14.5 percent. Official data suggests that there is little relief in sight for the economy’s two most embattled sectors. She mentions that uncertainty over prospects for a recovery in global trade and a huge local electricity tariff hike will weigh heavily on both sectors in the short term, thereby tarnishing South Africa’s growth outlook. Manufacturing has plunged by a record 22.1 percent in the first quarter of this year, making it the main culprit behind a 6.4 percent contraction in the economy as a whole, which represents its steepest fall in a quarter of a century.

Kemp (2009) states that although the overall pace of contraction appears to be less negative, as compared to Europeans counterparts, South Africa is still a long way from where manufacturing could make a meaningful contribution to the overall economic growth. Mining also shrank by a record 33 percent in the first quarter of 2009. He further states that recently released data showed that the sector continued to shrink up to 10.5 percent over the last five months of this year, which was viewed with some alarm. According to Isa (2009), the extent of the fall in mining output was the worst since early 2008, when power outages forced the sector to shut down for several days.

Isa (2009) is of the opinion that the combined factory and mining output accounts for a fifth of South Africa’s economy, which has slid into its first recession for 17 years. Manufacturing comprises 15 percent of the above, with mining making up the remaining 5 percent. Yet, in terms of its overall importance for the South African economy, mining rates much higher than would appear at first glance. Mineral products account for about half of South Africa’s exports, while mining companies account for more than a third of the capital of the Johannesburg Stock Exchange (JSE). The sector also provides more than half a million jobs.
Thus, mining is crucial to the health of South Africa’s economy, which needs large foreign capital inflows to finance local investments. None the less, the industry has been in steady decline since 2006, due to infrastructure constraints, power shortages and volatility in the rand exchange rate. The rand’s rally of more than 16 percent against both the dollar and the euro in 2009 does not bode well for either mining or manufacturing, as it makes local exports less competitive globally. A 31 percent jump in electricity tariffs, effective from July 2009, will create a further challenge, as it will increase operating costs in both sectors. It is anticipated that the underlying trend in manufacturing production will remain weak, as both local and global economic conditions remain depressed.

Isa (2009), further states that production, related to sectors supplying the local market, might even moderate further. The reason given is that consumers are likely to remain cautious, as unemployment rises, disposable income falls and debt levels remain high. Manufacturing sectors, which rely on investment, are also likely to experience further weakness, as private sector investment falls. Isa (2009) is of the opinion that in the first five months of 2009, factory output has fallen by 15.7 percent compared with a rise of 3.1 percent during the same period in 2008.

Isa (2009), states that Kevin Lings, a Stanlib economist, is hopeful that two consecutive months of improvements in South Africa’s purchasing managers’ index (PMI), a key health gauge for the sector, would feed into factory output. The PMI index appears to have reached a bottom turning point, while at the same time global PMI readings have started to improve. PMI survey measures sales orders and expectations among buyers of factory supplies. In South Africa the overall PMI index has been below 50, the cut off point between contraction and expansion, for more than a year.
According to Isa (2009), the PMI reading has edged up from a record low of 35.6 percent in April, rising to 37.3 percent in May and 37.9 percent in June. Another positive sign is that the business expectations component of the PMI has risen above the 50 level for two months in a row. Similar surveys in Europe and the US also show an easing in the pace of contraction of factory output.

According to Mpofu (2009), Absa Capital is of the opinion that South Africa’s manufacturing sector is by no means out of the woods yet, with all 10 sectors having contracted in 2008 as compared with the same period in 2008. It is believed that it is going to be a long time before the manufacturing sector will be able to enjoy positive year on year growth rates again. Isa (2009) states that along with significant pressure on other sectors of the economy, notably mining and retail sales, the gross domestic product (GDP) should also suffer. Absa expects GDP to shrink by 2 to 3 percent in the second quarter of 2009 and by 2 percent over the whole year.

2.8 RECESSION IMPACT ON EMPLOYMENT

Isa (2009) states that the formal economy shed 179 000 jobs in the first quarter of 2009, as the fallout from South Africa’s first recession in 17 years took its toll. Employment in the non-farm sector was 2.1 percent down compared to the fourth quarter of 2008, with the retail and wholesale trades having been hit the hardest, followed by financial services, manufacturing and construction. She is of the opinion that the job losses reflect a labour market in distress and warns that the economy could shed up to 400 000 jobs this year, as companies cut costs with global and local demand waning.

She further states that the private sector is bleeding jobs. Job losses are very broad-ranging with white collar workers also under pressure, indicating that the global
recession has finally spilt over into South Africa. Seasonal effects would have contributed to the fall in jobs in the first quarter as employment normally rises in the final quarter. Statistics South Africa’s Quarterly Employment Survey of 2008 showed that employment fell by 1 percent compared with the same quarter last year – the first annual fall in six years.

Mpofu (2009) states that jobs are a lagging indicator, which means that the severe 6.4 percent contraction in the economic output in the first quarter could mean more second quarter retrenchments. The data reflects a labour market in distress, with a reduced formal workforce. He further asserts that communities should brace themselves for a cold period ahead with a lower income growth and further losses in employment.

A Statistics South Africa survey showed that the wholesale and retail trade shed 66 000 jobs in the first quarter. Financial services lost 43 000 jobs, manufacturing 29 000 and construction 19 000. The mining sector, which has been hit hardest by the waning global demand for commodities, shed 18 000 jobs. The data tallies with economic trends during the first quarter, when financial services (by far the biggest sector) contracted for the first time since 1993. Mining and manufacturing both shrank at record rates, while retail sales fell for the fourth quarter running. The first quarter is a seasonally bad period every year. Isa (2009) is of the opinion that the economy will shrink by 1.5 percent this year, marking this as South Africa’s first real recession since 1992. She further predicts an even steeper 2.4 percent contraction in 2009 due to the retreat in consumer spending, the economy’s main growth engine.

According Mpofu (2009), the Labour Force Survey (LFS) showed that the formal nonfarm sector shed 88 000 jobs in the first three months of this year, while the informal sector lost 96000 jobs. The LFS is a survey of households, carried out throughout the
quarter, while companies respond to the Quarterly Employment Survey (QES) at the end of April. It may be that some of the job losses will be picked up in the second quarter by the LFS. It is important not to be hung up on quarterly results. Jack (2009) pointed out that in the existing economic climate, it was not likely that the government would achieve its goal of creating 500 000 job opportunities by the end of this year. To achieve its aim of halving unemployment by 2014, 700 000 jobs had to be created each year till then. The QES showed that earnings in the business sector fell by 5.5 percent in the first quarter, but this could largely reflect bonuses paid at the end of last year, which were still at 10 percent.

He further states that despite expectations of the economy starting to recover from the global financial crisis, consumers are still keeping their wallets closed. Consequently, it is hard to keep a restaurant business going. More and more customers are downgrading, opting to eat in rather than out, or simply choosing a cheaper food outlet. He states that according to the restaurant associations of SA, at least 1 400 restaurants, coffee shops and take-away outlets closed down nationally last year, due to financial stress. This year (2008) alone, between 600 and 700 eateries have already closed down. Restaurants are expensive to operate. It is certainly no longer an easy business to run. Auctioneers have reported an increase in the number of restaurants and coffee shops undergoing forced sales. Several high-profile Cape Town restaurants have closed down during 2008.

Mpofu (2009) further states that although restaurants nationwide are under pressure, the Western Cape, a region internationally famous for its cuisine, has suffered more, due to its greater sensitivity and exposure to the macro economic climate. It was noted that there has been a dramatic increase in the number of restaurants being sold or liquidated in this area. In 2007, at least 90 restaurants in the Western Cape alone were closed down and
last year that number rose to 104. It all boils down to the simple fact that people are struggling financially and eating out has become a luxury. General suggestion: deal with specific industries separately. You were talking about major industry and now all of a sudden we are restaurants. Break them up, give them separate sub-headings. This will make it much easier to follow.

2.9 METHODS OF REDUCING DEBT

Kemp (2009) states that for the first time since Harry Truman was in the White House, Americans are paying back debts, a phenomenon that just might help to keep interest rates low, as the Treasury sells a record 2 trillion dollars of bonds and unemployment boosts US savings. While the proportion of consumers without jobs rose to 9.5 percent last month, household borrowing fell to 128 percent of the family’s after tax income in the first quarter of 2009, from a record 133 percent in the same period a year earlier: the total debt of individuals, non-financial firms and government grew at a 4.3 percent slower pace at the start of the year; down from a 9.9 percent peak in the fourth quarter.

According to Cokayne & Bloomberg (2008), consumer credit in the USA fell at an annual 1.6 percent rate in May to 2.5 trillion dollars. The United States intend to sell 1.1 trillion dollars of treasury bills by the end of the year, on top of the first half’s sales worth 963 billion dollars. While the treasury steps up borrowing, corporations are rushing to cut indebtedness. According to Bloomberg (2009), about 190 billion dollars have been raised in secondary share sales from April to June.

2.10 BANKS FACE CHALLENGING TIMES

The South Africa Economy Overview (2005) states that South African banking regulations rank amongst the best in the world and the banking sector of South Africa has been ranked globally among the top ten. There are five mutual banks, twelve foreign
controlled banks and fifty five locally controlled banks. Leading institutions in the world have announced their intention to enter the South African banking sector through potential mergers and acquisitions. Barclays Bank has entered the South African market in 2005 by acquiring control of Absa Bank.

According to Isa (2009), the banking sector had recently faced a tough 12-18 months, as lending slowed and bad loans rose. Notwithstanding, the financial system remained sound with no threats of any local banks collapsing. It seems that South African Bank have weathered the worst of the global crisis. So far, no local banks are expecting to show a loss. Notwithstanding the global turmoil, the local banking sector has come through and remains stable. It is generally expected that South African Banks would still have another 12-18 tough months ahead.

The collapse last year of the global giant Lehman Brothers would have exposed any local weaknesses in the banking system. She further states that the figures that were released by the Registrar of Banks showed that impaired advances in the banking sector rose to 115.12 billion rand or 5.1 percent of gross loans and advances. In the same period, the pace of growth in loans and advances in the banking sector stands at 49.8 percent.

She further states that capital controls helped to protect the South African’s banking sector, but the main reason for its resilience was due to sound regulatory measures. The overall capital adequacy ratio of local banks, a key measure of their ability to withstand losses, rose to 13.5 percent at the end of April, up from 11.8 percent in January last year. She further states that the banking system had been strengthened by a five year overhaul of its risk management, corporate governance and capital adequacy, as based on and complying to Basel 2 guidelines which are the recommendations on banking laws and laws regulations issued by the Basel committee.
In the diagram below, Ernst and Young depict the recessionary impact on South African banks. It shows the market value of the banks before and during the recessional period.

**SOUTH AFRICAN BANKS MARKET VALUE (R)**

Source: Nedbank Report: Fig 1

**2.11 BANKS’S PROFITABILITY**

According to West (2009), the Nedbank Group’s headline earnings for the last six months of 2009 were expected to be 32 to 37 percent lower than the 719 cents a share reported in the previous corresponding period. Nedbank joins the other big three banks in South Africa which expect to report lower earnings 2009 due to the recession, following the global financial crisis. He further argues that Absa Bank had expected its headline earnings per share to fall 25 to 30 percent in six months. The subsequent fall in results was attributed to rising impairments, losses relating to single stock futures, a contradiction of interest margins and a reduction in the value of investment portfolios.
West (2009) states that Standard Bank does not expect to meet its 2009 year’s earnings during this financial year. In the first four months of the year, impairments had risen by 72 percent on the previous year and normalised headline earnings had fallen by 14 percent to 4.1 billion rand. He further states that First Rand expects its earnings per share for 2009 to be 30 to 35 percent lower, since its operations were affected by much the same factors as the other banks. All the banks have had to revise their earnings forecasts due to the deteriorating economy. The First Rand group, which expects to release its annual results in the middle of September, expects that the economy would remain relatively subdued, but that the effects of the lowered interest rates would begin to affect the group performance late this year or early next year.

The comparison of South African banks and global banks, in terms of market value, has been significant. The recessionary impact on the South African banks has been moderate as compared to the world’s banking system. According to an Ernst and Young report (2008), the Royal Bank of Scotland and Citigroup have been adversely affected by the recession. Both banks’ market value was reduced by more than 60 percent. In most cases, the overseas banks had to be rescued through government intervention in the form of monetary bailouts. The closure of Lehman Brothers, one of the biggest and oldest banks in the USA, has put a lot of pressure on the other banks.

The diagram below shows the value of overseas banks before the recession and their value during the recession.
2.12 RECESSION ON SMALL MEDIUM ENTERPRISES (SME)

Timm (2009) states that more business owners are being turned away by banks, as the effects of the credit crunch linger on, although the banks state that they are still open for business. Since the start of the credit crunch last year, the percentage of applications for finance from business owners that Absa approved dropped from 70 to 60 percent, while at Nedbank the rate of approval dived from about 55 to 40 percent of all applications.

He further states that Absa Small Business, which lends to businesses with an annual turnover of up to 10 million rand, has tightened its lending criteria by putting new measures in place, such as a stress test. In this test, the bank looks at what contracts an applicant might have in place and whether the business would be able to stay afloat for three to six months in the case of losing these contracts. Absa is the leading bank when it comes to handing out Khula backed guarantees, but for the past eight to nine months the bank had limited its Khula based business exposure, particularly in the case of start-
up businesses. Start up business makes up half of the bank’s business, which is related to the government agency’s guarantee scheme.

He states that Absa had seen an upswing in bad debt, something it hadn’t seen in five years, resulting in a large number of cases being referred to the legal department. Actual impairments raised for 2008 came to 4.07 percent of the total advances book. For 2009, the bank projects this ratio will rise to 4.53 percent. The bank had also set up a forum where business owners can have applications that were turned down by business managers or relationship managers of the bank, reviewed. This is also linked to the recession because when times are tough you have to reinvent yourself.

According to Timm (2009), Nedbank Small Business Services had experienced a 40 percent drop in applications from businesses accessing finance for the first time. He further suggests that entrepreneurs have become quite cautious about taking on any new debt, which stands the chance of not being repaid.

2.13 MOODY’S OUTLOOK ON SOUTH AFRICAN BANKS

According to Isa (2009), the international financial rating agency Moody’s has changed its outlook on the bank financial strength rating (BFSR) related to South African banks, due to the deteriorating economic conditions. The rating agency stated that the South African economy proved to be quite resilient to the global crisis, but weakening macroeconomic conditions, including an estimated decline in gross domestic product of 2 percent this year, were exerting pressure on the banking sector’s financial fundamentals and on the banks’ asset quality and profit indicators.

The sector’s ratio of impaired loans to gross loan and advances increased to 5.4 percent in May last year, up from 2 percent in January. Profitability had been hurt by increased
provisions, lower interest margins and slower balance sheet growth. Moody’s predicted a possible downgrade in the long term, related to the global and local currency deposit ratings of Standard and Absa banks, in light of the rating agency’s global review of systemic support indicators for banking systems. The above Moody’s review will look at the extent to which SA’s ability to provide support to its banking system is converging with the government’s own debt capacity.

The South African government had shown strong focus on preserving a robust banking system. Given that the local currency deposit ceiling was four notches higher than the government debt rating. The ability support indicator that converged with the government’s debt rating would result in lower rating uplift due to systemic support, although the potential effect on the two South African banks was likely to be contained to one notch.

2.14 BLACK ECONOMIC EMPOWERMENT (BEE)

De Wet (2005) states that the majority of South Africa’s citizens generate and earn a low level of income and this leads to South Africa’s economy performing below its potential. In order to increase the effective participation of the previously disadvantaged and majority Black population in the country’s formal economy, further steps such as Black Economic Empowerment (BEE) had to be taken. The stability and the prosperity of the economy in the future could have and would have been undermined to the detriment of not only Black people but the whole of South Africa, irrespective of race, if BEE had not been not introduced.

Broad Based Empowerment Act, 2003 (Act No. 53 of 2003), hereafter referred to as the Act, or the Broad Based Empowerment Act, promotes the achievement of the
constitutional right to equality, as well as the aim to increase broad-based and effective participation of historically disadvantaged persons (prioritising the black community) in the economy, in the effort to promote a higher growth rate, to increase employment and to achieve a more equitable income distribution. The Act also establishes a national policy on broad-based black economic empowerment in order to promote the economic unity of the nation, as well as to protect a common integrated market and to promote equal opportunity and access to government services.

2.14.1 The Definition of Black Economic Empowerment

What is Black Economic Empowerment (BEE) and the further defined Broad-Based Black Economic Empowerment (BBBEE)? There are various definitions of Black Economic Empowerment, better known as BEE. The following definition was adopted by the Black Economic Empowerment Commission (2001). It defines BEE as an integrated and coherent socio-economic process. BEE is located within the context of the country’s national transformation programme, namely the Reconstruction and Development Programme (RDP). The aim of BEE is to redress the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa’s financial and economic resources to the majority of its citizens. BEE seeks to ensure broader and meaningful participation in the economy by black people, who represents the majority of South African citizens, in order to achieve sustainable development and prosperity.

According to the BEE Executive Summary (2001), BEE was adopted at the Growth and Development Summit (GDS), including strategies to ensure the broad and equitable ownership of productive assets and resources, to increase the levels of employment in the formal economy, to increase household incomes, to expand literacy and skills
development and to extend basic services to historically disadvantaged communities. “The Growth and Development Summit took the view that BEE should benefit all socio-economically marginalized persons, including women, youth, people with disabilities and those living in rural areas.”

According to De Wet (2005), Government consulted with various interest groups in South Africa, in order to formalise the BBBEE program of the government, which was promulgated into the Broad Based Empowerment Act, 2003 (Act No. 53 of 2003). The Broad Based Black Economic Empowerment Act extended or broadened the concept of BEE into the Broad Based Black Economic Empowerment (BBBEE) program. Broad-Based Black Economic Empowerment is defined as the economic empowerment of all black people (which is all encompassing), as well as women, workers, youth, people with disabilities and people living in rural areas, through the implementation of diverse but integrated socio-economic strategies that include, but are not limited to:

a) Increasing the amount of black people that manage, own and control enterprises and productive assets;

b) Facilitating ownership and management of enterprises and productive assets by communities, workers, cooperative and other collective enterprises;

c) Human resource and skills development;

d) Achieving equitable representation in all occupational categories and levels in the workforce;

e) Preferential procurement; and

f) Investment in enterprises that are owned and manage by black people.

De Wet (2005) also mentions that Black Economic Empowerment can be described as a method that aims at increasing the number of black persons that participate in and manage the South African economy. This involves economic ownership by previously
disadvantaged individuals and implies economic interest, profit sharing and risk sharing, which include the sharing of cost and the creation of wealth.

Black economic empowerment is seen as an external factor that influences any entity that intends to do business in South Africa. An entity is defined as something with a distinct and independent existence (Jack; 2008). So, Black Economic Empowerment influences any independent existence such as and not limited to a company, close corporation, sport organisation and non-profit organisation. Furthermore, this external factor has a certain impact on the country and its enterprises. If Black Economic Empowerment is seen as an economic entity, the economic entity must, as with any external factor, adjust to be competitive in the market.

2.14.2 The BEE Objectives and its application

The Broad- Based Black Economic Empowerment Act embodies the following objectives in its goal to facilitate broad-based economic empowerment:

a) promoting economic transformation in order to enable meaningful participation of black people in the economy;

b) achieving a substantial change in the racial composition of ownership and management structures and in the skill occupation of existing and new enterprises;

c) increasing the extent to which communities, workers, cooperative and other collective enterprises own and manage existing and new enterprises and increasing the access to economic activities, infrastructure and skills training;

d) increasing the extent to which black women own and manage existing and new enterprises, and increasing their access to economic activities, infrastructure and skills training;
e) promoting investment programmes that lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity;
f) empowering rural and local communities by enabling access to economic activities, land, infrastructure, ownership and skill; and
g) promoting access to finance for black economic empowerment.

De Wet (2005) is of the opinion that Black Economic Empowerment is important and if applied correctly, the process will create jobs for many South Africans. Other advantages are expected to be rural development, urban renewal, poverty alleviation, measures to empower black women, skills training and management development, education, meaningful ownership and access to finance for households, while promoting best practice procedures and ethical conduct. Codes of Good Practice for Broad-Based Black Economic Empowerment were developed as guidelines for implementation. The BBBEE Codes of Good Practice are to be applied in the development, evaluation and monitoring of BEE charters, initiatives, transactions and other implementation mechanisms.

2.15 ECONOMIC REFORMS OF OTHER DEVELOPING COUNTRIES

2.15.1 Indian reforms

Politics (2005) states that in the 2004 Indian elections the Congress Party returned to power and formed an alliance government with the Communist Party of India and several regional parties. This newly formed alliance-partnership was named the United Progressive Alliance (UPA). Thus, the UPA forms the present ruling coalition of political parties in India.

India has a booming economy that is growing at a rapid speed. The Common Minimum Program (CMP) was developed by the United Progressive Alliance to extend and
improve the reform policies introduced by the government of 1971. The Common Minimum Program is the result of the Indian Economy fairing so well. According to Politics (2005) the UPA government released the common Minimum Program to assist the furtherance of India’s economy, which includes six basic principles for governance, namely:

- to preserve, protect and promote social harmony,
- to ensure that the economy grows at least 7-8 percent per year in a sustained manner and to generate employment so that each family is assured of a safe and viable livelihood,
- to enhance the welfare and well-being of farmers, farm labour and workers and give the assurance of security for their families,
- to empower women in all aspects of political, educational, economical and legal aspects of life,
- to provide for full equality of opportunity, and
- to unleash the creative energies of the people.

Common Minimum Program (2005), states that the CMP is applied to all sectors of India’s economy. Brief extracts of the various sectors and their corresponding implementation strategies will be explored.

1. Employment

The UPA Government enacted a National Employment Guarantee Act. This provides a legal guarantee of employment for at least 100 days.

2. Agriculture

The UPA Government will ensure that public investment in agricultural research and extension, rural infrastructure and irrigation is stepped up. The rural cooperative credit system will be revived. The UPA Government will introduce a special programme for
dry-land farming and watershed and wasteland development programmes will be taken up on a massive scale. The UPA administration will ensure the implementation of minimum wage laws for farm labourers. Government will make amendments to ensure the democratic, autonomous and professional functioning of cooperatives.

3. Education and Health

Funds will be raised for spending on education and 50 percent of moneys raised will be spent on primary and secondary schools. This will be done in phases. A national cooked nutritious mid-day meal scheme, funded mainly by the Central Government, will be introduced in primary and secondary schools. Public spending will be raised on health with focus on primary healthcare. Drugs considered as life saving will be made freely available at reasonable prices.

4. Women and Children

Legislation on domestic violence and gender discrimination will be enacted as well as programmes for the development of women and children. Complete legal equality for women in all spheres will be made a practical reality.

5. Food and nutritional security

A comprehensive medium-term strategy for food and nutritional security will be introduced, in the effort to move towards universal food security over time.

6. Social Harmony and Welfare of Minorities

A Place of Worship Act will be implemented into the Special Provisions Act, of 1992. A model will be enacted for comprehensive law to deal with communal violence. Amendments will be made to the Constitution to establish a Commission for Minority Educational Institutions that will provide direct affiliation for minority professional institutions
7. Labour
The UPA Government is committed to ensuring the welfare and wellbeing of all workers, particularly those in the unorganised (informal) sector who constitute 93 percent of the workforce. Social security, health insurance and other schemes will be expanded for these workers.

8. Public sector
A selective and strategic focus will be placed on creating a strong and effective public sector whose social objectives are met by its commercial functioning.

9. Fiscal policy
The Government commits itself to eliminate its revenue deficit by 2009, so as to release more resources for investments in social and physical infrastructure.

10. Economic reform
The commitment to economic reforms with a human face that stimulates growth, investment and employment will be reiterated. Further reforms are needed and will be introduced in agriculture, industry and services.

2.15.2 Malaysians reforms
Malaysia experienced the worst ever racial rioting in 1969 and the New Economic Policy was perceived as a means of preventing such outbreaks in the future. The Malaysian reforms can be likened to South Africa’s endeavours on redressing the ills of the past and ensuring that all communities have opportunities to participate in the national economy.

2.15.2.1 Definition of Bumiputra
History of Malaysia (2005) states that it is generally considered that all Malays are Bumiputra and that all Bumiputra are Malay. This is incorrect as there are non-Malays
who are declared as Bumiputra and similarly non-Muslims who are considered Bumiputra. The definition of Bumiputra clearly excludes ethnic Chinese, as well as non-Muslim Indians. Treatment of Bumiputras versus other races is built into the Malaysian Constitution.

Racial policies were a major key of the Prime Minister Mahathir bin Mohamad, who was prime minister from 1981 to 2003. His policies were disclosed in his book named “the Malay Dilemma”. The concept of Bumiputra was discussed. The term Bumiputra was created to collectively address the group described in article 153 of the Malaysian Constitution.

Article 153 of the Malaysian Constitution stipulated the following: ‘the Yang di-Pertuan Agong (The King of Malaysia) shall exercise his function in such a manner as may be necessary to safeguard the special position of the Malays to ensure the reservation of such proportion in the public service and of scholarship and other similar educational privileges or special facilities given by the Federal Government”.

2.15.2.2 The Malaysian New Economic Policy

Malaysian’s New Economic and National Unity (2005) states that the Malaysian New Economic Policy (NEP), also known as Dasar Ekonomi Baru (DEB) in Malay, was developed as a restructuring program. This policy was to be implemented from 1971 to 1990 through a series of four five-year plans. A Brief History of the Malaysian Economy before the New Economic Policy follows below. Malaysia began its first stage of Import Substitution Industrialisation (ISI) in 1960. The ISI consisted of high tariffs, with the purpose to promote domestic investments. Furthermore, the prices of fuel and utilities were set below market value in order to keep production costs down, while tax and interest rate incentives were offered to pioneering industries.
Bumiputra policy (2005), states that in 1970 there was a huge underclass of Bumiputras, whose economic conditions had remained largely unchanged under the ISL. In 1970, the Malaysian Government estimated that Bumiputras comprised roughly 2.4 percent of Malaysia’s economy, compared to 33 percent owned by other races and 63 percent in foreign ownership.

2.15.2.3 The Goals of the New Economic Policy

Bumiputra Policy (2005), states that the new economic policy had two objectives. One of the objectives was to eliminate poverty, particularly rural poverty, and the other objective was to eliminate the identification between race and economic function. An agriculture policy was used to tackle poverty, which resettled Malays on newly cleared farms. The agriculture policy also caused investments in rural infrastructure, as well as the creation of free trade zones in rural areas, which are used to create manufacturing jobs.

Poverty declined during the 70’s and the 80’s with the poorest rural villages in Malaysia being Sabah and Sarawak. The second part of the government policy was to transfer economic power to Malays. Prime Minister Mahathir expanded the number of secondary schools and universities throughout the country, as education was seen as a way to transfer the economic power to the Malays. As far as the economic restructuring is concerned, the initial target was to change the ratio of economic ownership in Malaysia as follows:

- from 63 to 30 percent Bumiputra from 2.4 to 30 percent,
- Malaysians from 33 to 40 percent, and
- Foreigner ownership.
History of Malaysia (2005), states that the above restructuring program aimed at redistributing the wealth of the country, through the change of ownership ratios of business enterprises by specifically targeted population groups. Economic growth was to be increased, mainly in the form of ISI. Industries were targeted and policies were built around the government incentives of 1975 to expand large-scale manufacturing industries and energy-intensive industries. Export incentives were initiated and at the same time the Heavy Industries Corporation of Malaysia (HICOM) was formed in order to assist the manufacturing of pig-iron, aluminium die casting, pulp and paper, steel, cement, motorcycle and heavy engineering.

2.15.2.4 New Economic Policy benchmarks

History of Malaysia (2005) states, that the distribution of wealth remains unequal under the NEP. In 1997, 70.2 percent of households in the bottom 40 percent income group were Bumiputra. 62.7 percent of households in the top 20 percent income bracket were non-Bumiputra. The NEP increased the national debt and economic inefficiencies due to dramatic government intervention, causing worry among private sector investors. The NEP was mostly accepted by the Malaysian Chinese as a necessary evil for cessation of Malay aggression. Occasional anti-Chinese rioting in Indonesia often drew stark contrast to their situation in Malaysia. The Chinese community generally moved away from the public sector and set up businesses in the private sector, where the actual impact of the NEP was one of convenience rather than an actual paradigm shift. The national wealth owned by the non-Bumiputra races has increased over time, beyond the 40 percent mark in spite of the policies implemented under the NEP. This however represents an aggregation of the non-Bumiputra population. Certain segments of the population live in direct poverty, particularly a large number of the Malaysian Indian population.
Malaysia and India are similar to South Africa in that all three countries have to deal with difficult past which meant that they had to undergo a period of reformation. These were done with the intention of normalising these societies and provide economic opportunities for its citizens.

2.16 BLACK ECONOMIC EMPOWERMENT FUNDING INSTRUMENTS

Kekana (2009) states that empowerment financing involving listed companies, faces a number of challenges. For the concept to be sustainable there is a need to introduce new ways of providing finance, which are less susceptible to challenges. The first challenge is that most transactions involve funding the acquisition of equity with debt because the empowerment companies have to borrow funds. Acquiring listed shares means dividends are received to repay the debt plus interest. He further states that the problem is that the dividend yield is often less than the rate of interest, which leaves a shortfall. With an unlisted company, it is possible to undertake a leveraged buy-out. The company being bought carries the debt and uses pre-tax cash flows instead of dividends to pay off the debt. He further states that this is what probate equity firms do, prompting several finance ministers to raise concerns about the industry, because the higher the interest the higher the profit and therefore the tax payable. As currently is the case, most transactions are under water with the value of the equities having plummeted as a result of the global economic crisis. The financier faces a lack of liquidity, because the money borrowed is stuck in the financing structure secured by shares that may be worth less for an undetermined time.

According to Kekana (2009), this is why some commentators say empowerment may be South Africa’s credit crisis, because funders have assets that are worth far less than what they will recoup if they were to dispose of them. He is of the view that empowerment
funding could be better used to build new economies or companies, because with most deals it is merely a transfer of financial assets from one holder to another without an increase in productivity. The challenge is an aspect of the duration of the funding. Due to a liquidity risk, funders tend to extend the financing period to between five and 10 years. However, the amount of dividends received may only allow for the debt to be paid off over 15 to 20 years, unless the share price increase rapidly, so it is possible to deem debt with partial disposal of shares. Empowerment players who want to cash in also don’t want to wait too long to do so. Hence in some cases it is necessary to obtain refinancing once the initial deal structure matures.

Kekana (2009) states that finally, the financial instruments that fund empowerment are not tradable, which worsens the liquidity risk. There is no mechanism that makes it possible for funders to lay off the debt with another investor. What should be done to address these challenges is a priority problem. He is of the view that there are four financial mechanisms that possibly could fund empowerment sustainably. Firstly, the use of listed and therefore tradable corporate bonds should be investigated, issued by the company being acquired or the empowerment company. Secondly, call options should be looked at. This is a right, but not an obligation, by the holder to acquire shares at a fixed price in a company at a future date. An option exercised at any time is called an American option and one exercised on a fixed date is called a European option. The holder has to pay a premium on the price of such shares, instead of the listed price. Thirdly, share instalments should be assessed. The instalments represent the payment of a portion of the share price with an obligation to pay off the balance at a future date. Fourthly, a further financial instrument to consider is collateralised debt obligations.
These are a pool of assets of which pieces are sold to investors. The South African marker is not fully matured in dealing with these instruments and some may argue that this is why it is not finding itself part of the global credit crisis. Arguably, the failure of the US marker has more to do with lack of regulation, which led the financial marker players to clothe bad credit with derivatives and to gear themselves to the hilt by using undisclosed, off-balance-sheet financing structures. Typically, listed empowerment deals in South Africa entail blue-chip stocks based on strong fundamentals. Regulations will need to catch up with such instruments and the JSE and Bond Market exchange will need to promote them. The companies act may have to be changed to accommodate them.

2.17 BLACK ECONOMIC EMPOWERMENT (BEE) FUNDING

Theobald (2007) states that this year there will be a radical shift in the financing of BEE deals, thanks to an amendment to the Companies Act, which will make it possible for companies to play a much greater role in financing their BEE partner's acquisition of a stake. Much of the advanced financial engineering that investment bankers have planned during the past few years will be cast aside. This will be the dominant issue for empowerment deal making in 2007.

Dealmakers’ attention will also be caught by two other trends, namely:

First, the strong performance of many companies' shares, which has left BEE partners in a much stronger financial position. Consequently, many are looking to refinance their empowerment deals to bring down the cost of funding.

Second, a new stage of BEE deal making has arrived, a second phase in which BEE investors are trading stakes between themselves, requiring new financing in the process.
He further suggests that an imminent legislative amendment will revise section 38 of the Companies Act, to allow for companies to directly finance the acquisition of stakes in their businesses by BEE consortiums. Until now, transactions have been financed by external parties, usually the banks on a non-recourse basis. Section 38 has forbidden companies from lending or guaranteeing loans to be used to purchase their own shares. He also mentioned that a section was adopted from English law, with the intent to protect creditors. However, allowing companies to finance purchases of their equity can improve the value of the company by effectively increasing leverage. It has been recognised that banning such financing is a blunt instrument. If companies are solvent and liquid, there is no reason such should be prevented. In South Africa, this section has been particularly irksome because of the pressure on companies to introduce black shareholders. So the amendment, which comes as part of an amendment bill affecting various sections of the Companies Act, both brings South Africa into line with the rest of the world and smoothes a big wrinkle in the financing of empowerment shareholders.

He points out that the liquidity and solvency wording applies throughout the lifetime of the transaction, which could be many years. Until now, the majority of deals were financed by funders, usually banks, on a non-recourse basis. So an investment in a company was financed by a bank, the costs of that finance was borne by dividend flows from the investment, and the empowerment partner was the technical owner. In practice, the restriction on financing by the vending company was skirted through various complex structures, usually involving subsidiary companies and preference-share funding mechanisms.

Theobald (2007) laments that these structures depended on two things for their sustainability, sufficient cash flow from the investment and appreciation in the value of the underlying equity, so giving the empowerment partner a genuine asset after the
capital is repaid. It was often a tall hurdle when cash flows did not materialise or the shares performed poorly, resulting in such deals falling apart. The banks were left holding the shares, which formed the only security they usually had. In practice though, the banks usually also had a claim on the vendor company, usually via its holding company, in order to skirt section 38. However, with section 38 amended, two things become possible. One is that vending companies will be able to finance empowerment shareholders directly. That leaves the banks out of the picture, which can cut the cost of finance to the empowerment partner. It also aligns the incentives of all the parties.

The company needs to deliver a dividend cash flow to maintain its own financing. Alternatively, the vending company can issue guarantees to the lending bank. It is felt that this will lessen the cash strain on the vending company and will also cut the risk faced by the bank. Both strategies will have one major benefit over previous nonrecourse funding models: they will lower the cost of the financing. This will make it easier to conclude empowerment deals and will make more of them sustainable (all else being equal). That is good news for those sectors which have lagged in empowerment deal making, such as the retail sector. At the same time, for those which have gone well down the road in transferring ownership, it offers a cheap refinancing option.

Theobald (2007) further states that the stellar performances of most JSE-listed companies, many empowerment investors have hit huge hikes. With their assets having performed strongly, the way is now open for original funding structures to be recast, recognising the improvement in the value of underlying security. However, the opposite still holds true for the current economic crisis, that the share price of most of the empowerment deals took a knock which resulted in major losses for some of the banks in South Africa. He is of the opinion that deals done with various tiered structures can now
be refinanced to eliminate more expensive funding instruments. He further states that riskier deals have been done with financing at an effective cost of 17 percent. Now they can be done for around 10 percent. Plus, the vending company can be introduced as one of the funders. It adds up to a significant boom for existing empowerment investors, who now have the opportunity to restructure the funding of their investments, while cutting finance costs along the way.

Theobald (2007), states that while doing the above, empowerment investors have also taken advantage of other opportunities made possible by the accumulation of genuine assets - the rationalisation of their investment portfolios into focused competences. If empowerment investment firms went on an asset grab during the first phase of empowerment, they are now developing themselves into focused value-adding firms. He states that it is like what South Africa went through in the mid-1990s when all the conglomerates unbundled and focused on core areas. Now you will see the BEE companies focusing. This is helped by a strong mergers and acquisitions market environment. He further predicts empowerment firms to swap assets among themselves, as they choose to focus on particular sectors, for example Mvelaphanda in resources, Sekunjalo in medicine and foods, and HCI in gaming and leisure.

Though many such investors are tied up in contractual terms and conditions by the vending company, such as lock-in periods, they can be loosened if the transaction involves a sale by one Empowerment Company to another. From the perspective of vendors, it will be worth doing if they gain a value-adding specialist rather than a general empowerment investor.
2.18 CREDIT CRUNCH ON EMPOWERMENT BUDGET

Singh (2009) states that this year is going to be as tumultuous for the economy as expected. Two questions are posed. Firstly, from a black economic empowerment (BEE) perspective, what are the key issues that need to be addressed this year? The African National Congress (ANC) election manifesto has already confirmed that the BEE legislation will not be changed, but more emphasis will be put on the elements that affect employment, that is the human capital element of BEE. Thus, secondly, what are the challenges that companies will face in implementing their BEE strategies in the ownership and human capital areas this year?

In terms of ownership, the first challenge is that black people, due to their lack of capital, have to raise funds from third party financiers or the company itself, to buy into most of their shareholding. Deals signed in 2007 and early last year involved black people paying a premium, because the market values of companies were at their highest. The bottom line is that these investors overpaid for their stakes.

Singh (2009) is of the view that increasing interest rates put more pressure on the repayment of loans by the BEE partners, which caused deals to run out of money. The credit crunch that broke last September further eroded confidence within the banking system, with the result that banks are still reluctant to lend even to each other, let alone to the general public. This means that third party funding for BEE deals has dried up considerably over the past four months. Funding provided by the company doing the deal or provided by its shareholders is easier to manage, because the parties can renegotiate and re-price the transaction. The negative side is that the company has to write down the loan and recognise a loss in its books in the current financial year. He further states that BEE partners face losing their shares to the third party financier because of their inability to repay their loans.
The third party financier has to write down the value of the shares in its books and take a loss. Banks that took put-options against the company can exercise them and get their money back, which means the company's cash flow would be negatively affected and losses would accrue. In general, current deals face the risk of not generating enough cash flows from the company to pay off the debt. Future deals face a risk of a lack of funding to conclude the deal. Given these factors, the general level of black ownership of South African companies is set to decrease. Singh (2009) mentions that the positive side of this equation is that there may be an opportunity for black shareholders to acquire additional shares in the company at a low but realistic price.

Furthermore, the credit crunch may result in an increase in the proportion of BEE deals that are financed by the vendor. On the human capital side, the risk of people emigrating could jeopardise the management element of the BEE codes. According to Theobald (2007), there are reports indicating a trend of more qualified black people, especially Indians and coloureds, considering emigrating. The emigration trend may have an adverse effect on the pool of people available to choose directors from. However, the risk may not be as pervasive as some commentators make it out to be, because of the difficulties in securing jobs overseas and adjusting to a different standard of living.

He further states that the biggest challenge faced by companies is their contribution to employment equity targets in the wake of the job losses being seen locally and internationally. It will require a delicate juggling act by companies to be able to meet the targets set out in the BEE codes. This is a fine balance that involves ensuring that the company survives in the harsh economic realities, while achieving its BEE targets. Skills development budgets seem to be the first items to be trimmed by struggling companies. This means that the target of spending 3 percent of the total payroll on developing the
skills of black staff may be unachievable for most companies. Therefore, there is a risk of skills development continuing to take a back seat for a majority of companies in South Africa, who have always seen it as a form of indirect taxation.

2.19 BLACK ECONOMIC EMPOWERMENT STRUCTURE
Homann (2009) indicates that there are numerous designs for BEE participation, but they tend to be variations on two basic themes, namely buying shares in an existing company or establishing a new company, which is leveraged to facilitate the entry of black partners. The share purchase option is becoming a rarity. The leveraged New Co platform has become increasingly popular over the last five years and could eventually hold total sway. He further stipulates that the advantages and disadvantages of the two designs explain the trend to new friendly company formations.

2.19.1 The Share Purchase method
In the following BEE case study, discussed by Homann (2009), the shareholders of ABC (Pty) Ltd sell a 25 percent stake to black partner BEE Co. The deal might be sweetened through vendor finance or a discounted valuation on the company. The BEE consortium pays for equity with debt (usually a preference share loan). Dividends to the new stakeholders service the loan. On the face of it, higher company earnings in recent years and strong dividend streams seem to suggest that returns will be sufficient to service debt. However, buoyant earnings push up valuations, lifting the price of entry.

Homann (2009) further states that experience shows it is difficult to keep dividends fat enough for long enough to service interest and pay back the loan. Serial refinancing is needed. Meanwhile, the major shareholder may become restive. Constantly pumping cash out of the business as dividends depletes the funds available for investment in new
capacity and product development. It may also impede a business’s ability to spend heavily in training and fast-tracking of HDI employees, creating potential for conflict between different sets of BEE beneficiaries.

The structure has the advantage of simplicity but it is inefficient and banks generally do not advance loans to fund the purchase of shares in a private company. If things go wrong, they stand last in line to collect their debt. Furthermore, some would-be BEE owners are hesitant to take on large personal liabilities.

The share purchase structure does not always fail, but it is almost impossible to execute unless the BEE investor has substantial unencumbered assets. It also often leads to the reversal of the BEE deal in the event that the dividend flow is insufficient to meet the loan payments.

Studies show that smart gearing can lead to the same result on a more sustainable basis. A less onerous alternative is available in the New Company method below.

2.19.2 The New Company alternative

The business of ABC (Pty) Ltd, a company valued at 100 million rand, is sold to New Co, a structure created to enable easier entry by Bee Co. A bank provides R50 million in senior debt (secured by company assets and cash flows). BEE Co pays in 12.5 million rand (25 percent of the unfunded portion of the transaction). The owners of ABC (Pty) Ltd therefore receive 62.5 million rand in cash and retain a stake worth 37.5 million rand in New Co. Cash flow from the business (not from individuals) services the bank debt of R50 million. When all arrangements are concluded and all debts are cleared, the original owner has 75 percent of the company that has been strengthened by its new BEE profile. Black partners own the remainder.
This approach brings an efficient, well-established leveraged buy-out structure to the realms of BEE ownership. The BEE owners may have taken personal loans to generate their 12.5 million rand stake, but the loan is for only half the amount required under the initial model. Because the black owners sit with only half the debt they might have taken on (i.e. they have leveraged their investment), their returns as 25 percent equity owners are sufficient to retain a significant shareholding in the New Co.

The majority shareholder receives 62.5 million, versus the 25 million rand he would have received under a share sale. The bank is comfortable with the arrangement as its loan is secured. It is now first in line for repayment in the event of business failure.

Thus, to conclude, an interested Private Business entity may enter into discussions with various potential black partners to establish BEE credentials, none of whom could necessarily afford to pay cash for 25 percent of the business and who might find it difficult to obtain a loan or else find the repayment levels too onerous. Discussions fall flat and the owner becomes disillusioned with BEE talks that always stall when he says ‘show me your money’. According to Homann (2009) the New Co alternative provides a solution that more and more private companies are starting to explore.

2.20 CHALLENGES OF BROAD BASED BLACK ECONOMIC EMPOWERMENT (BBBEE)

Makholwa (2009) states that leading empowerment proponents have expressed reservations about whether Broad Based Black Economic Empowerment (BBBEE) deals would have any meaningful effects on the upliftment of individuals. He further states that the Black Management Forum president, Mr. Jimmy Manyi, observed that while his organisation welcomed broad-based black empowerment in terms of ownership, it has noted that some companies abused it. The distribution of a few rands to black employees will not achieve the desired outcomes.
He is of the opinion that it should be about the balance sheet, not an income statement. The Spar Group announced that 1 percent of its share capital, worth one billion rand, would be made available for purchase by the company’s employees and franchises, which were between 75 and 85 percent black owned. Earlier, SABMiller announced a six billion rand empowerment deal, which would result in 10 percent of its local subsidiary being placed in the hands of the company’s black employees and customers (liquor retailers).

Makholwa (2009) further states that these deals bode well for black equity ownership with regard to broad-based empowerment, stakeholders and communities. Broadening the ownership beneficiaries is the right thing to do, but the concern is whether these employees can be real agents of transformation. In assessing these empowerment transactions, it is needed to look at the impact they will have on individual beneficiaries, both now and over time.

2.21 SAFEGUARDING BEE DEALS FROM RECESSION

Monama (2009) states that the Industrial Development Corporation during the course of 2009 will fund a deal to sell 26 percent equity in its fertiliser making operation, Foskor, to a broad section of black investors, including workers, at a significant discount. It further states that the structure of the deal is excellent. Even if the markets would turn for the worse when Foskor gets to be listed, the deal should remain sustainable. It states that the empowerment partners are locked into the deal for nine years. Because there is no bank funding, they can restructure the deal until it works within the lock-in period.

On the other hand, if the markets outperform the assumptions made in concluding the deal, the empowerment partners would be able to settle their debt and reduce the repayment or lock-in period.
The deal is expected to be viable because Foskor provides fertilisers, a strategic input in food production and the bio-fuel industries. Monama claims that IDC, as a state-owned financier, believes in empowerment and it should do its best to ensure that empowerment remains locked in for a very long time, should the company face challenges as we have at the moment in the global economy. He believes that there will be a significant return when and if the market conditions improve. He expects the BEE partners to be substantially enriched when the structure matures in nine years.

He states that data from the deals that the IDC has previously funded show that on average black investors end up owning 5 percent in a 15 percent transaction, which after the repayment period tends to perform well. He further states that BEE investors must be involved in running businesses if the economy is to be transformed.

Monama (2009) is of the opinion that even though some black people have made money, the economy has not been transformed. It remains in white hands and in fact, if you look at the JSE, black South Africans are much worse off than they were 10 years ago in terms of empowerment. A lot of the companies failed and black investors had to hand over their shares to the banks. Empowerment deals must be done to transform the companies themselves, for them to be worthwhile. Black people must be strategically involved in these businesses.

According to Monama (2009), the IDC chief executive, Mr. Geoffrey Qhena, states that the decision to sell a share of Foskor to black people is in line with one of the IDC’s core objectives of broadening economic participation and facilitating industry development. The high level of interest from strategic business partners and broad-based groupings highlights the strength of Foskor as a business and the attractiveness of its shares as a broad-based BEE investment. Monama (2009) further states that depending on market
conditions, Foskor may list on the JSE sometime in 2009. If it does, the acquisition price will be based on Foskor’s initial public offering price. If it is not listed in 2009 an independent valuation will be undertaken to price the transaction. The IDC will fund the entire consortium. This follows legal changes that allow companies to fund the purchase of their own shares through third parties.

Monama 2009, further states that the deal constitutes four components, where (a) 12 empowered companies will comprise the Manyoro consortium, which will own 15 percent of Foskor; (b) the remaining 11 percent will be held in two special-purpose vehicles, the Phalaborwa community trust and the Richards Bay community trust; and (c) others will own 5 percent. The remaining 6 percent will be held by Foskor’s 2 000 employees.

2.22 BLACK ECONOMIC EMPOWERMENT CHALLENGES

De Lange (2009), states that the levels of debt that have been incurred to achieve the objectives of black economic empowerment are becoming unsustainable in the current financial crisis. Unease in this regard permeates the entire economy, but it is particularly serious in the mining industry. In fact, this is where the boil could burst at any minute. The first indications of something being seriously amiss were given at the annual Mining Indaba in Cape Town.

De Lange (2009) is of the opinion that the Government needs to assist BEE deals funded by debt, because the country's banks simply cannot carry this indebtedness. In most of these transactions, credit was advanced on the basis of future earnings, future dividends, or future share prices, but all these sources of income have dried up since the global credit crisis began to take its toll in September last year. He further states that the year
2009 will be BEE’s (black economic empowerment's) year of truth in the mining industry. He states that the term ‘toxic assets’ can be applied to the BEE debts. He warned that banks have since remained quiet regarding the indebtedness of BEE transactions.

Major players in the mining industry have even more disquieting things to say during informal discussions. According to de Lange, at the minerals department (DME), a crisis that no-one knows how to handle is looming regarding the funding of BEE transactions that have dried up, with creditors wanting their money back. Government, which virtually forced banks to finance BEE transactions, will have to accept responsibility, but the National Treasury is not interested. The infrastructure development programme itself will be exerting too much pressure on the fiscal budget. Some banks have apparently already converted the debt they advanced into shares and have taken over control of certain new mines. The chief executive of a coal company tells the story of how a banking group approached his company with a request for it to consider buying such mines from the bank.

De Lange (2009) is of the view that the Mineral and Petroleum Resources Development Act, which regulates the mining industry's BEE prescriptions and demands, together with the Mining Charter, contain certain weak points and obscurities. During the 2002 charter negotiations, it was agreed to publish within five years a 'Codes of Good Practice', aimed at obviating these legislated ambiguities and weaknesses, in consultation with the industry.

According to Jack (2009), the Code of Good Practice was published in April 2009, with the stipulation that BEE partners' 26 percent shareholding in mining companies should be
debt-free within two years from 2015. or the mining company concerned would not receive recognition for a BEE transaction. This is a mean way of extricating one's responsibility from the debt crisis, and entirely inconsistent with the Act. At its worst, it is futile nationalisation of mining assets.

SA Mining Development Association (Samda), which is regarded as the junior or black chamber of mining, expressed serious discontent. Some rather derogatory things were said about the DME. According to City Press, Samda’s chairman, claimed that the association had previously even recommended to the DME that BEE companies should get guidelines about the possible dilution of the 26 percent shareholding, so that these companies could gain access to funding in the current difficult market conditions. He remarked that BEE had assumed a strong ideological and emotional character rather than being a neutral economic growth strategy, as it was meant to be. Any criticism of Government’s way of doing things is regarded as high treason against the economy, which could again unleash the economic disaster which followed the leak of the Mining Charter in 2001. This is also why the banks are keeping quiet about the unserviced debt of BEE mining deals.

2.23 SUMMARY

This chapter looked at most of the economic facets that were affected by the economic slowdown. Isa (2007) is of the view that each country’s economic crisis does impact on its neighbours. The United States of America’s economic decline has had a major impact on the world’s economy. The subprime lending fiasco resulted in most US citizens taking up a lot of credit which they were unable to repay. The non payment resulted in most companies and banks being unable to receive what they are being owed by the citizens.
This has resulted in the tightening of lending criteria, which had an impact on spending. The decline of the home loan market, which is regarded as a creator of wealth by many, had a major impact on the South African housing market. This has caused major havoc among first time property buyers, as they have to face a double edged sword in terms of declining property prices on top of rising interest rates, which have impacted on people’s affordability.

The impact of the economic downturn on major overseas was illustrated in this chapter. The Royal Banks of Scotland (RBS) value declined significantly from 120 billion dollar organisation to just 4.6 billion dollar company. This is a significant drop in size of any company. This change the face of banking in the United Kingdom. This did not only affect the banks in the United Kingdom the United States Bank also felt it as the economic downturn led to the demise of the Lehman brothers.

Various developing countries have adopted similar mechanism in order to address the ills of their social and economic history. The Malaysian system is similar to South Africa’s BEE system, which aims at redressing imbalances of the past. It is imperative to note that, in any society, in order to be uplifted the prevailing social ills have to be addressed.

**Chapter three** will provide a general overview of Black Economic Empowerment in South Africa and how its funding and promulgation have influenced the business patterns of South African Banks.
CHAPTER 3

A GENERAL OVERVIEW OF BLACK ECONOMIC EMPOWERMENT WITH REGARDS TO SOUTH AFRICAN BANKS (FINANCIAL INSTITUTIONS)

3.1 INTRODUCTION

The South African economy was in dire need of being reformed post-1994. This led to the birth of Black Economic Empowerment, which was an attempt to ensure that the previously disadvantaged communities enter the main stream economy and meaningfully participate in it. Brown (2006), states that South African banks are working out how to structure and finance the Black Economic Empowerment (BEE) deals, especially deals that will be altering the ownership structure of the country’s financial services industry. Under South Africa’s voluntary Financial Sector Charter, direct black ownership in financial institutions should reach 10 percent by 2010.

3.2 THE STRUCTURE OF STANDARD BANK BEE DEALS

In July, the Standard Bank Group announced plans to sell a 10 percent interest in its South African banking operations to three BEE groups. The deal is worth about 4.3 billion rand. Standard Bank’s sale offer followed deals by Absa and Investec, as well as BEE deals in other sectors such as mining and telecommunications. The country’s total requirement for BEE financing could exceed 75 billion rand. Brown (2006) mentions that there is no regulation of BEE templates for South African companies to follow. Different deals use different combinations of structural options, equity and debt.

In mining sector deals, for example, third party lenders to BEE groups often take a view on future commodity prices and provide project finance-style debt. Banks have used quasi-vendor finance structures to help pay for their BEE deals. In any empowerment deal, for repayment of debt used by BEE groups to acquire shares, one of two things
needs to happen. Either the lenders to the BEE group rely on operating cash flows from the target company for repayment of their debt, or where there is no recourse to the target’s balance sheet, they rely on the BEE group’s proportionate share of the target’s ordinary dividends and the target’s share price appreciation, with lenders relying on the BEE group selling enough of its shares in the target for redemption of outstanding debt.

According to Brown (2006), Standard Bank has three BEE investors. A consortium formed by investment companies Shanduka Group, founded by former ANC Secretary General Cyril Ramaphosa, and Safika, of which Standard Bank is the largest shareholder. Standard Bank’s 2,500 black managers own 2.9 percent of Safika. The third BEE group comprises regional business and community organizations. Brown further mentions that the Standard Bank deal is a funded transaction rather than an options deal. The new shareholders get their shares on day one and the dividend flow is used to repay the debt. It is quite a simple structure. Standard Bank’s BEE structure is a two stage deal. First, Standard Bank creates three subsidiary companies and capitalizes them, using preference shares while they are still owned by the bank. The subsidiaries can buy shares from Standard Bank Shareholders. Standard Bank then sells ordinary equity in the subsidiaries to its BEE partners. Neither of these steps contravenes the South African Companies Act, which prohibits one company helping another to buy its shares.

Maloney (2007), states that the deal allows the BEE shareholders 20 years to pay for their stake. However, he is of the opinion that the BEE shareholders should clear their debts sooner. He mentions that standard Bank expects the redemptions to occur in about 17 years, although that assumes there is no appreciation in the share price, which is conservative. He further mentions that at the end of 2010, the performance of financial services institutions in South Africa will be reviewed under the Financial Sector Charter.
After this, if Standard Bank’s share price has risen, the BEE shareholders can sell some shares and use the proceeds to pay back part of their debt.

The interest rate charged on the preference share funding is 8.5 percent, which is relatively high even by current South African Standards. That is why Standard Bank asked its shareholders to sell their shares in the new subsidiaries at a discount. He is of the opinion that nobody doubts the moral motives behind BEE transactions. However, individual deals have been criticized, either for not delivering the true benefits of share ownerships to blacks, or saddling BEE groups with long-term debt.

3.3 ABSA BEE DEAL STRUCTURE

Marvin (2008) mentions that ABSA’s BEE deal structure, which was unveiled in April 2004, also involves the subscription of 10 percent of the group’s enlarged share capital by broad based BEE groups and black employees. The black shareholders’ interests are held by a special purpose investment vehicle, New Company, which has to raise 146.3 million rand to fund its share subscription. According to Brown, holders can subscribe for ordinary Absa shares between three to five percent after getting options. He is of the opinion that ABSA transactions have been criticized for not offering real ownership from day one, According to Brown, ABSA does not believe that is so. He further states that Absa believes that its deal provides for full voting and economic rights for the option holders from day one. Although it is an options structure, it has the key features of real ownership.

He mentions that critics of Absa’s deal also say that delivering empowerment depends on a significant rise in Absa’s share price. If the share price falls, an option deal unwinds. Absa recognizes that there is a risk in its chosen method. In practice, when the deal was first negotiated, the Absa share price stood at around 37 rand. By the time it was signed
the strike price was already below the market price. Looking at analysts’ reports, Absa remains very confident of where the share price will be in the next three to five year window. On day one, the option was in money, bringing real material benefits.

Brown (2006) is of the view that the big challenge is to keep diluted shareholders happy that they are not losing out to the new empowerment shareholders. To do this, Absa came up with an option formula. Note that of the remaining three big banks in South Africa, First Rand Group and Nedcor are the two large banking groups that have yet to announce details of their BEE programmes. Investec announced a BEE deal in May 2003, with black investors buying over 25 percent of the lender in a deal funded by the issue of 5.6 million new shares (Brown, 2006).

3.4 THE MECHANICS AND CONSEQUENCES OF BEE DEALS

BEE deals from leading insurers and asset managers, in particular old Mutual, are keenly awaited. Although the financial sector charter is voluntary, any banks that choose not to sign up would risk missing out on lucrative public sector mandates, including future privatizations. The South African market is dominated by government-owned institutions that are more likely to procure services from empowered banks.

Jack (2008), states that from 2003 to 2007 the market prices of listed shares have increased considerably, along with the number of BEE deals. A potential problem could arise with some deals, if the entry was at a high price. This could result in the value paid for the stakes being at a long-term peak, even after taking BEE discounts into consideration. In reality, some BEE deals were overpriced, which means that the amount owing on the acquisition is higher than the current value of the BEE stake. This decreases the net equity value of the black shareholder's stake in the company as there is no accumulation of capital gains.
He further mentions that in the early stages of leveraged BEE deals, the bulk of the loan repayments, which rely on dividends, go to pay off the interest. Therefore an increase in interest rates, assuming that the repayment is the same, will decrease the portion that goes to cover the capital amount outstanding on the loan. The implication is that it will now take much longer to repay the capital amount of the loan. When the market cools down and share prices decrease, it will also decrease the net equity value of the black investors. So the key to increasing the net equity value is to repay the loans faster or rely on the share price to increase.

Isa (2009), states that Makalani Holding was welcomed to the JSE listings in 2005 and quickly earned a following from fans of Rand Merchant Bank. Now the 2.7 billion rand company that provides mezzanine finance to BEE deals is gradually winding itself up, one of dozens of companies trading on the JSE under a cloud. Makalani’s mandate was to gear up shareholders funds and lend to empowerment players wanting to do deals. The stock market route has highlighted that the JSE is riddled with companies apparently on a road to nowhere. Isa (2007) further states that a good percentage of listed BEE companies are sustaining losses, some consistently year after year. Others have few or questionable assets and a lot of debt and virtually all their share prices are down heavily on the year.

According to Isa (2007), this was done with the full backing of Rand Merchant Bank. The sheen lasted until the global credit crisis hit equity values and credit spread, when the Reserve Bank started lifting rates. Makalani provided mezzanine finance for numerous BEE deals. Isa mentions that in good financial times Makalani thought it would be able to leverage its strong fundamentals to deliver increasingly positive returns to investors. Although lower equity values could damage the asset value, it means that
deals in the future would be more affordable. Higher interest rates were also welcomed. According to Isa, due to the economic downturn Makalani issued a statement that the company will not make any new investments other than those already contractually entered. Assets will be allowed to mature or be realised in an orderly manner and capital will be returned to unit holders as investments are realised or redeemed. This was an indication that the financial backing that Makalani had received was beginning to dry and its financial institution partner was not prepared to take any further risks.

3.5 PERFORMANCE OF THE BEE COMPANIES

Isa (2009) is of the opinion that nearly every black empowerment deal of the past two years is well under water, but so far not one of those indebted to Makalani has defaulted. The number of single debtors accounts for more than 15 percent of Makalani’s assets. Still, in a portfolio of 2.5 billion rand, there are some substantial exposures, for example 190 million rand for Servest/Safika, 135.2 million rand for Gautrain/Bombela, 159.8 million rand for Emira, and 162 million rand for Nafhold and 113.2 million rand for Sandown Motors, which recently built a Taj Mahal to show off its Mercedes Benz.

Isa further mentions that the Makalani’s share was illiquid and traded at a discount to net asset value. Rand Merchant Bank has relinquished control of Makman, the management company that controls the company. Partly because of 118 million rand write-down of the equity exposure, headline earnings in the six months to December 2008 fell to 88 cents from 416 cents in 2007. At 6770 cents, the share is at a 37 percent discount to the reduced net asset value of 10697 cents. It might offer good gains for those prepared to wait out the winding down process. Most of the small companies were listed on high hopes that they will do well. Now those hopes have been dashed. Mining exploration companies, particularly those in the platinum and diamond arenas have been particularly hard hit. Shareholders can expect some to delist or crash. Isa is of the opinion that some
big money is going to be made when some of these companies recover. However the challenge would be to spot those with potential.

Jack (2008) mentions that the head of Johannesburg Stock Exchange is of the view that it would be no favour to the shareholders of small struggling companies to suspend or delist them. Some of these companies could be turned around, others could be taken over. This is going to be tough for these small companies, as they need financial assistance to run their day to day activities. With all financial institution hesitant to finance any of these companies, the future looks bleak. Jack looks at a few companies that were financed by Makalan Holding. AH Vest, formerly All-Joy, recently announced a loss of 10.2 million rand for 2008. This is a company that had its sights on becoming another Tiger Brands, based on a tomato sauce brand that attempted to imitate Tiger’s brand. Andulela was already looking poorly when it raised 100 million rand of new equity. It spent 450 million rand on a platinum prospect, just as the metal plummeted. The share is down by 94 percent on its listing price.

3.6 OLD MUTUAL BEE DEAL SCARE
Jack (2008) states that Old Mutual’s black economic empowerment deal is hair-raisingly close to being out of money, raising for the first time in years the possibility (albeit in the somewhat distant future) of a major BEE deal failing. In fact, technically the deal was out of money for most days of the last week of April 2008 and only the recent international turnaround in financial services stocks put the deal back in the money. Yet Old Mutual’s major BEE partners, Wiphold and Brimstone, both proclaim themselves to be still fully supportive of the transaction, which they say is not in as bad a shape as it might seem.
The problem for the BEE partners, and for Old Mutual itself, is that the company's international profile has meant that it has taken the full brunt of the international onslaught of negative investor sentiment against financial services groups. Jack further states that Old Mutual's share price, has just about halved over the past 15 months and is currently trading at 1520 cents, after reaching a record of 2673 cents in February 2007.

In April 2005, Old Mutual, Nedbank and Mutual & Federal entered simultaneously into transactions with several consortia, including Wiphold, a new-generation empowerment company called Sphere, Brimstone, and a consortium called Mtha-we-Mpumelelo, a coalition of black business people spearheaded by Bulelani Ngcuka and Sipho Pityana. On the Old Mutual side, the 7.2 billion rand transaction for 12.75 percent of Old Mutual's stock was done at a price of 1485 cents. With financing costs included, it would be surprising if the deal was currently showing any upside.

According to Jack (2008), Brimstone is confident that the deal would ultimately work out, pointing out that it is a ten-year deal, and that the transaction was now only currently in its third year. However with over-aggressive lending against their home-loan books and the downturn in the housing market, first world banks were having to take big write-downs and Nedbank was not immune to this problem, which tends to affect the capacity to raise capital to finance these BEE deal.

3.7 BEE DEALS PERFORMANCE ON BANKS

Jack (2008) is of the opinion that BEE deals that were underwater because of underperforming stock markets were going to affect the balance sheets of all local banks. He further states that because the stock markets have been battered recently, deals that were linked to share price performance would scare BEE partners away, leaving banks with stock that had lost half of its value. According to Jack (2008), this view was largely
based on a Business Report from corporate finance experts, stating that global market turmoil had affected deals struck in all the major business sectors.

Imperial, MTN, Barloworld, Sasol and Old Mutual have been identified as high-profile companies whose BEE deals were either already in distress or were headed for trouble (Jack, 2008). Jack further mentions that two deals were reportedly to be already under water, involving Sasol and Old Mutual. He is of the opinion that because local retail banks put third-party debt in their deals, BEE transactions, such as those conducted by Standard Bank, Absa and Nedbank, could be derailed. The major threat to banks involved in the BEE deals is that security was now lower than loan value, because equity prices had fallen, leaving banks to impair those loans. This is where the impact on banks’ balance sheets is going to be. South Africa’s top four banks have recently reported heavy increases in their impairment charges.

3.8 INTEREST RATES ON BEE DEALS

Jack (2008) states that the second wave of BEE deals involves black people using debt to purchase minority stakes, mostly limited to 26 percent, in existing white businesses. He further describes this wave as the biggest leveraged buyout of the South African economy, using debt that depends on bullish markets, supported by low interest rates and rising economic growth. This round of BEE can be described as a leveraged buyout of the South African economy. The third wave of BEE comprises black people who start their own businesses from scratch and grow them organically or through acquisitions. Within this wave the black owners live and die by their business. The impact of interest rates is similar for businesses in both BEE scenarios above.

He further states that a typical second wave BEE deal involves a black buyer purchasing 25.1 percent of a company, using a bank loan or vendor financing to fund the acquisition.
If the buyer has collateral to back the loan, then the risk to the bank is decreased and the
finance charges will be lower. However, in the average deal the black buyer may not
have adequate collateral to cover the outstanding loan should a downturn in business
cause the borrower to default on repayments, transferring more risk to the bank. In order
to compensate the bank for the greater risk taken, the finance charges will be higher. The
lender could even take a percentage of the profits that the black buyer makes, if he or she
sells his/her shares.

Jack (2008), states that the financing mechanisms of the second wave of BEE utilise
special purpose vehicles (SPVs). These initially linked the payment of the debt to the
price of the shares, but they have subsequently been replaced by SPVs linked to dividend
flows. The critical variables of the financing of BEE deals are still the cost of financing
and the security required, along with the terms attached to that security. Due to the lack
of financial capital in the hands of black people, debt is a critical form of capital to fund
broad-based BEE.

There is now a great expectation for black people to become involved in the investments
they make through BEE deals. Passive ownership of shares is now frowned upon. There
is a rise in shareholder activism, which encourages the broad base of shareholders to take
an active interest in how their voting rights are used to drive change within companies.
Employee share ownership schemes, which include both black and white employees, are
increasingly being used as BEE vehicles. Jack (2008) is of the opinion that in most BEE
situations the power to affect these two courses does not lie with the black partners,
especially if they do not have significant assets.

In a nutshell, the interest rate increases will have a negative impact on businesses and
deals that are highly leveraged. BEE companies in the third wave would feel the impact
of rate hikes if they have borrowed money to finance their working capital needs. There will be more pressure on their cash flow, which means they will need to maximise their cash reserves. A possible way to mitigate this cash flow crunch would be to follow the enterprise development element of the codes of good practice on broad-based BEE.

Instead of just relying on the banks for working capital, BEE companies could negotiate better payment terms from their suppliers and quicker payments from their customers. The suppliers and customers then score points for enterprise development, depending on the level of support given. This ensures that companies that are deemed to be BEE complaint are looked at favourably by their business partners and government. Jack further states that when companies provide interest-free or low-interest loans to black businesses, they are doing business with the differential between the prime interest rate and the actual rate of interest charged. So, with the prime rate increasing, more benefit will accrue to both the black company in the form of saved interest, and to the contributing company for their enterprise development contribution.

3.9 SUMMARY
This chapter focused on the general overview of black economic empowerment. It has also looked at how different banks have structured their black economic deals. The focus on BEE structure was purely based on what mix did they use to finance their BEE transactions. When Standard Bank announced that they will be selling a 10 percent of their interest in South African banking operations to three BEE groups this attracted a lot of interest in the market.

The concern that was raised is that the BEE companies have 20 years to pay for their stake. ABSA also introduced its BEE deal structure which also involves the subscription
of 10 percent of the group’s enlarged share capital by broad based BEE groups and black employees. ABSA deal is viewed as not being offering real ownership. There are certain criteria that ABSA BEE transaction would have to meet to ensure it benefits it’s shareholders.

The tough economic environment led to Old Mutual BEE deal being close to be out of money. This deal was technically out of money most days of the last week. Only the recent international turnaround in financial services stock put the deal back on the money. The problem for the BEE partners and for Old Mutual itself, is that the company’s international profile has meant that it has taken the full brunt of the international onslaught of the negative investor sentiment against financial services group.

The performance of the BEE companies has been reviewed, as well as the influence of the interest rate on both the banks and the BEE companies.

Chapter Four will discuss the methodology used in the case study.
CHAPTER 4
RESEARCH DESIGN

4.1 INTRODUCTION
This chapter discusses the methodologies followed in gathering, processing, analysing and interpreting data collected from four similar but separate case studies of three major South African lending banks and one BEE company.

The aim of this chapter is to discuss the research design for this research study. The literature review (Chapter 2) revealed that banks faced challenging times during the economic downturn. Banks are major funders of BEE deals. Consequently, the economic downturn reduced BEE funding by the banks. Moreover, banks are exposed to risk when funding BEE transactions. The literature review further reveals concerns about the debt portion of BEE transactions. This chapter will formulate ways in which the research objectives can be achieved.

4.2 RESEARCH DESIGN
Research design provides a framework for collection and analysis of data. A choice of research reflects decisions about the priority being given to a range of dimensions of the research process (Bryman & Bell 259:2007).

The study framework has been broken up into the following categories:

- The research methodology and its rationale;
- The research data and its collection method;
- The research narrative;
- The data analysis and interpretation; and
- The reliability, validity and generalisability of the research study.
4.3 RESEARCH METHODOLOGY

Research methodology is a technique for collecting data (Bryman & Bell 259:2007). Research methodology has two primary functions, to control and dictate the acquisition of data; and to correlate the data after its acquisition and to extract meaning from it (Leedy & Ormond 6:2005). Primarily, there are two distinct approaches that inform the gathering of data in any research project, namely the qualitative approach and the quantitative approach (Babbie and Mouton, 2001).

Qualitative forms of investigation tend to recognise the importance of the subjective, experiential ‘lifeworld’ of human beings. Such reflection is the province of phenomenology reports (Babbie & Mouton 2001; Blanche & Durrheim, 1999). Gilbert (1993) notes that qualitative methodologies provide avenues that could lead to the discovery of these deeper levels of meaning. This kind of research draws on data collection methods such as participant observation, in-depth interviews and/or focus groups (Jennings, 2001). As a consequence of its underlying paradigm, qualitative research is subjective, since it relies on the texts and discourses of participants and involves small numbers of participants in the research process, as a result of gathering in-depth information (Gilbert, 1993; Sekaan, 1992)

A quantitative research approach is grounded in the positivist social sciences paradigm, which primarily reflects the scientific method of the natural sciences (Creswell, 1994). A quantitative methodology abstracts data from the participants into statistical presentations rather than textual pictures of the phenomenon. The entire research process is objectively construed and the findings are usually representative of the population being studied. The main strengths of the quantitative approach lie in its precision and control (Babbie & Mouton, 2001). Furthermore, hypotheses are tested
through a deductive approach, and the use of quantitative data permits statistical analysis (Welman & Kruger, 2001). One of the limitations of quantitative research, as reported by critics, is that many researchers are concerned that the scientific quantitative approach denigrates human individuality and the ability to think, (Massey, 2003).

According to Collis and Hussey (2003), the two main research methodologies, identified above, can be linked to positivistic and phenomenological study approaches, or to a combination of both. These approaches include:

- **Surveys** – involve selecting a representative and unbiased sample of subjects drawn from the group you wish to study;

- **Experimental studies** – are done in a carefully controlled and structured environments and enable the casual relationship of phenomena to be identified and analysed;

- **Longitudinal studies** – These are studies over an extended period to observe the effect that time has on the situation and observe and collect primary data of these changes;

- **Cross-sectional studies** – is a study involving different organizations or groups of people to look at similarities or differences between them at any one particular time;

- **Case studies** – offer an opportunity to study a particular subject, e.g. one organization or group of people;

- **Action research** – involves an intervention by a researcher to influence change in any given situation and to monitor and evaluate the results;

- **Ethnography (participant observation)** – is described as participant observation and this is where the researcher becomes a working member of the group or situation to be observed;
- Participative enquiry – is about research within one’s own group or organization and involves the active involvement and cooperation of people who you would normally work and associate with on a daily basis;
- Feminist perspective – focuses on knowledge grounded in female experiences and is of benefit to everyone, but particularly women;
- Grounded theory – reverses approaches in research that collected data in order to test the validity of theoretical propositions, in favour of an approach that emphasizes the generation of theory from data (Collis and Hussey 2003).

4.3.1 CASE STUDY

A case study research method is an empirical inquiry that investigates a contemporary phenomenon within its real life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used (Yin, 23:1984). The research object in a case study is often a program, an entity, a person, or a group of people (Soy; 1997). For the purpose of this research study the research object is an impact of economic downturn on banks and BEE deals.

Yin (2003) and Burns (1994), suggest the following types of case studies:
- The critical case – the researcher has clearly specified hypotheses;
- The revelatory case a researcher has an opportunity to observe and analyse a phenomenon previously inaccessible to scientific investigation;
- The representative or typical case seeks to explore a case that exemplifies an everyday situation or form of organisation;
- The longitudinal case – this case is concerned with how a situation changes over time;
- The historical case – traces the development of an organisation or system over time;
- The observational case – distinguished by being based primarily on visual observation;
- The clinical case study – related to workers’ health or accidents and customer liability.

Case studies can be single or multiple-case designs, where a multiple design must follow a replication rather than sampling logic. When no other cases are available for replication, the researcher is limited to single-case design (Tellis; 1997). According to Yin (1994), single case studies are used to confirm or challenge a theory or to represent an extreme case. Single cases are ideal for revelatory cases where an observer may have access to a phenomenon that was previously inaccessible.

A frequent criticism of a case study methodology is that its dependence on a single case renders it incapable of providing general conclusion (Tellis; 1997). Yin (1993) considered the case study methodology “microscopic” because it lacked a sufficient number of cases. However, according to Flyvbjerg (2004), one of the foremost proponents of case study research, one can often generalise on the basis of a single case, and the case study may be central to scientific development via generalization, as a supplement or an alternative to other methods. The case study is useful for both generating and testing a hypothesis but is not limited to such.

Soy (1997) suggests six steps for organising and conducting case study research successfully, namely;

1. Determine and define the research question;
2. Select the cases and determine data gathering and analysis techniques;
3. Prepare to collect the data;
4. Collect data in the field;
5. Evaluate and analyse the data; and
6. Prepare the report.

For the purpose of this research study, a single case study will be used. The researcher will use a qualitative approach. There will be a questionnaire drawn which will assist in uncovering the experts views on black economic empowerment, economic downturn and how it should be dealt with.

4.4 METHODOLOGY RATIONALE

This research study includes a case study. This is considered appropriate because:

- All the Big 4 banks had to deal with changing BEE legislation;
- The selection of this particular bank is pragmatic, as the researcher is a senior manager of this bank and hence has ready access to the source;
- A single case study offers a manageable data collection task.

Moreover, the:

- Nature of the study requires the exploration below the presenting surface of this issue;
- Information required was also based on respondents’ opinions; perceptions and attitudes, which would be difficult and impractical to observe unobtrusively.

4.5 RESEARCH DATA

Data are those facts that any particular situation affords or gives information or impressions to an observer (Leedy, 96:1997).
4.5.1 Population
A population are all the study objects or study units that are the focus of the research project (Babbie & Jennings; 2001). For the purpose of this study the population is all the South African commercial banks which are financiers of BEE deals.

4.5.2 Sample
Fridah (2000) describes sampling as the act, process or technique of selecting a suitable sample or representative part of a population for the purpose of determining parameters or characteristics of the whole population. According to Struwig and Stead (111:2001), there are several alternative ways of sampling and these can be grouped into probability and non-probability sampling techniques.

In probability sampling the researcher has a significant measure of control over who is selected and on the selection methods for choosing them (Blaxter, Hughes & Tight, 2001). The main methods of probability sampling are:

- Simple Random Sampling;
- Systematic Sampling;
- Stratified Sampling;
- Cluster Sampling (Blaxter et.al, 2001).

In non-probability sampling the researcher has little initial control over the choice of who is represented for selection, or where controlled selection of participants is not a critical factor (Blaxter et.al, 2001). The main methods of non-probability sampling are:

- Convenience Sampling;
- Voluntary Sampling;
- Purposive Sampling;
- Snowball Sampling;
- Event Sampling;
• Time Sampling (Blaxter et.al, 2001).

For the purpose of this research study, a non-probability sampling method forms the basis for the data collection, as the study focuses on one sample only.

4.6 DATA COLLECTION

There are two types of data, primary data which are often most valid, most illuminating and most truth manifesting, and secondary data which are derived not from the truth itself, but from the primary data instead (Leedy, 96:1997).

Primary data are original data collected by the researcher for the purpose of his/her own study at hand (Welman & Kruger, 147:2001). Primary data can be collected in the following ways:

• One-to-one interviews;
• Focus groups interviews;
• Participant observation;
• A questionnaire survey;
• Diaries;
• Case studies
• Critical incidents; and
• Portfolios.

Secondary data are information collected by individuals or agencies and institutions other than the researcher himself/herself (Welman & Kruger, 147:2001). Secondary data can be collected in the following ways:

• Books, newspapers and magazines;
• Journals, periodicals, abstracts, indexes and directories;
• Research reports and conference papers;
• Market reports and Annual reports;
• Internal records of organizations;
• CD-ROMS;
• On-line databases;
• Internet;
• Videos and Broadcasts.

Triangulation refers to the application and combination of several research methodologies in the study of the same phenomenon (Bogdan & Biklen, 2006). By combining multiple observers, theories, methods, and empirical materials, researchers can hope to overcome the weakness or intrinsic biases and the problems that come from single method, single-observer and single-theory studies. The purpose of triangulation in qualitative research is to increase the credibility and validity of the results (Stringer, 2007).

Denzin (1989) identified four basic types of triangulation:

• Data triangulation: involves time, space, and persons
• Investigator triangulation: involves multiple researchers in an investigation
• Theory triangulation: involves using more than one theoretical scheme in the interpretation of the phenomenon
• Methodological triangulation: involves using more than one method to gather data, such as interviews, observations, questionnaires, and documents.

For the purpose of this study the methodological triangulation will be used. There will be an observation of the market performance by the researcher. A questionnaire will be drawn in order to conduct interviews with the Banks’ representatives and BEE expert. This form of triangulation is best suited for the research that will be conducted.
4.6.1 Semi-structured interviews

This technique is used to collect qualitative data by setting up a situation (the interview) that allows a respondent the time and scope to talk about their opinions on a particular subject. The focus of the interview is decided by the researcher and there may be areas that the researcher is interested in exploring. The objective is to understand the respondent’s point of view rather than make generalisations about behaviour (FAO.com; 2008).

A semi-structured interview is conducted with a fairly open framework which allows for focused, conversational, two way communication. They can be used both to give and receive information (FAO.com; 2008). The researcher tries to build a rapport with the respondent and the interview is like a conversation.

The strengths of a semi-structured interview are that:

- There is a positive rapport between the interviewer and the interviewee;
- It is a very simple, efficient and practical way of getting data about things that cannot be easily observed, like feelings and emotions;
- It has high validity, in that people are able to talk about something in detail and depth. The meanings behind an action may be revealed as the interviewee is able to speak for themselves with little direction from the interviewer;
- It is a platform to discuss and clarify complex questions and issues. The interviewer can probe areas suggested by the respondent’s answers, picking up information that had either not occurred to the interviewer or of which the interviewer had no prior knowledge;
- It prevents pre-judgement, as the problem of the researcher predetermining what will or will not be discussed in the interview is solved;
- It is easy to record the interview (video/audio tapes) (FAO.com; 2008).
Semi-structure interviews have some weaknesses, such as:

- They depend on the skill of the interviewer;
- The interviewer may give out unconscious signals or cues that guide the respondent to give answers expected by the interviewer;
- They are time consuming and sometimes expensive;
- They are not very reliable as it is difficult to exactly repeat a semi-structured interview. Respondents may be asked different questions (non-standardised) and samples tend to be small;
- They make it difficult to analyse the depth of qualitative information such as deciding what is and what is not relevant;
- They may not be valid because of lying respondents (FAO.com; 2008).

Semi-structured interviews have major benefits as they are less intrusive to those being interviewed and often the information obtained from them will provide not just answers but the reasons for the answers (FAO.com; 2008). It is important to conduct the semi-structured interview correctly. Hence, researchers follow some standard guidelines when conducting semi-structured interviews.

**4.6.2 Guidelines for semi-structured interviews**

Fontana and Frey (1994) refer to interviewing as 'the art of science'. There is certainly much of art in the process of obtaining sound data through the interview. Many of the factors that contribute to the quality interview, however, can be developed through careful attention to a range of skills, such as careful listening and responding, as well as skill in the development of rapport and empathy.

According to Zorn (2008) the following are some suggestions for designing such interviews:
• Carefully plan the interview, even though it is to be only semi-structured;

• If it is your first interview with the interviewee, provide an overview of your purpose, your intended uses for the interview data, and the measures you’ve taken to protect confidentiality and anonymity. Also, discuss and get permission for tape recording or note-taking;

• If it is your first interview with the person, ask a few background questions first, such as the interviewee’s job title, responsibilities and time with the organisation. These often provide necessary information and serve to “warm up” the interviewee; that is, they’re easy to answer and allow the interviewee to get in the interviewing mindset;

• Focus on developing rapport and establishing a relaxed, comfortable climate. Be aware of your nonverbal communication: e.g., smiles, seating position, open/closed body posture, eye contact. In general, be yourself (authentic), positive about the interview, and confident;

• Prepare, and save until later in the interview, questions on specific facts or other items of interest;

• Use probes carefully to get more in-depth answers or to follow up on points of interest;

• Sometimes silence is the best probe. Being silent once interviewees pause can encourage them to continue;

• Also, you may want to avoid interrupting a good story and instead make a note to probe a particular point later in the interview;

• Think carefully about how to end the interview. It’s often a good idea to ask “Is there anything else you’d like to tell me?” near the end. This can be especially powerful if done once the tape recorder is turned off;
• It’s also often a good idea to ask if you can contact the interviewee later in case you have additional questions;

• Immediately after the interview, take time to test your recorder to see if you recorded the whole interview.

The usefulness of the data which is collected using a semi-structured interview is determined by the quality of interview questions.

4.6.3 Interview questions

The questions should be relevant to the purpose of the research and the answers should lead to the research objective. If the answers do not lead to the objective, the researcher did not ask the relevant questions. Further questions may be developed with the intention of making the interviewee reveal more information. The preparation of a questionnaire should be done with the following in mind:

• the research problem, this will decide the framework of questions;

• questions should not be personal as they might offend the interviewee;

• questions should be easily understood; and

• questions should be given all possible options.

The general rule of thumb for constructing interview questions is that the researcher should always bear in mind the research question and sub-problems (Bryman & Bell, 259:2007). There are two kinds of question formats, namely, open questions and closed question. For the purpose of this research, mainly open questions will be used. With an open question respondents are asked a question and can reply as they wish. With a closed question they are presented with a set of fixed alternatives from which they have to choose an appropriate answer.

The wording of the questions will not necessarily be the same for all respondents. According to Zorn (2008), the following should be considered when constructing
interview questions: make sure the interview questions are clear; the questions that focus on the topic of interest should be broad, open-ended questions that allow the interviewee latitude in constructing an answer. For questions of the semi-structure interviews of this research study, see the interview schedule at Annexure 3. An important factor in research interviews is an outline of questions.

4.6.4 An outline of questions
A researcher can get the most out of a semi-structured interview by posing several different types of questions. According to (Bryman & Bell, 264:2007), some prominent types of questions are:

- Personal factual questions – about the age, gender, education, employment status, income of the respondent;
- Questions about normative standard and values;
- Questions about knowledge.

4.7 RESEARCH NARRATIVE
Heikkinen (2002) states that in Latin, the noun “narrario” means narrative or a story and the verb “narrare” to tell or narrate. Moen (2006) states that a narrative is a story that tells a sequence of events that is significant for the narrator or his or her audience. Soy (1997) is of the view that case studies report the data in a way that transforms a complex issue into one that can be understood, allowing the reader to question and examine the study and reach an understanding independent of the researcher. For the purpose of this study, a research narrative will form the basis of presenting, analysing and interpreting the collected data.
4.8 DATA ANALYSIS AND INTERPRETATION

Welman & Kruger (1994), state that data analysis of mainly statistical techniques helps the researcher to investigate variables and their effect, relationship and patterns.

According to Saunders and Thornhill (1997), for quantitative data, the research analysis is conducted through the usage of diagrams and statistics, but for qualitative data the analysis is conducted through the use of conceptualisation. For the purpose of this research study, a qualitative data analysis will be carried out. Analysing qualitative data is essentially a simple process. It consists of three parts:

- Noticing
- Collecting; and
- Thinking about interesting things (Seidel; 1998).

Jorgenson (1989) states that qualitative data analysis is the breaking up, separating, or disassembling of research materials into pieces, parts, elements, or units. With facts broken down into manageable pieces, the researcher sorts and sifts them, searching for types, classes, sequences, processes, pattern or wholes. The aim of this process is to assemble or reconstruct the data in a meaningful or comprehensible fashion. The qualitative data analysis process can be:

- Iterative and Progressive;
- Recursive; and/or
- Holographic (Jorgensen, 1989)

Yin (1994) suggests a strategy of relying on theoretical proposition of study and then analysing the evidence, based on those propositions. For the purpose of this study, the researcher uses this strategy as he will use the findings of the empirical study and compare that to the literature review part of the study. According to Wellman & Kruger (1997), content analysis involves examining systematically the contents of personal documents and mass media material in order to report them in quantitative way.
4.9 RELIABILITY, VALIDITY AND GENERALISABILITY

It is generally agreed that good data collection methods must be reliable and valid. Babbie (1995) describes reliability as a condition in which the same result will be achieved whenever the same technique is repeated to do the same study. Reliability is usually concerned with stability over time (Caramines & Richard; 1979). It is important to test the reliability before the validity is examined. Specificity contributes to reliability (Summerhill & Taylor; 2006). The researcher ensured reliability by keeping the anonymity and confidentiality of the respondents.

According to Welman and Kriger (2001), validity is a mechanism that ensures that the process implemented to collect data has collected the intended data successfully. Validity refers to the extent to which an empirical measure adequately reflects the real meaning of the subject under investigation (Babbie & Mouton, 2001). According to Struwig & Stead (2001), validity comprises external and internal validity for research design:

- **External validity** – refers to the extent to which one can generalize the results of a study to other populations;
- **Internal validity** – refers to the extent to which conclusions which are free from bias, can be formulated.

External validity concerns whether the results could be applied to other contexts or situations and to what extent this might be possible. In quantitative studies the representativeness of the sample is the key issue in generalizing about a larger population (Smallbone & Quinton, 2006).

Cooper and Schindler (2003:231-236) subdivide internal validity into three types:
1. Content validity – does the measuring instrument represent the definition of what is to be researched?

2. Criterion validity – how good is the measuring instrument when compared to other instruments if results are compared?

3. Construct validity – to what degree do different measurement indicators correspond to results from these indicators?

The validity of a sample depends on two considerations, namely (1) accuracy and (2) precision. Accuracy is the degree to which bias is absent from the sample (Cooper & Schindler, 2003:181). The researcher ensures validity by:

- Doing an intensive reading on how in-depth interviews are done;
- Explaining the purpose of the study very clearly to the interviewees.

4.10 SUMMARY

This chapter gave a detailed account of the case study, primary and secondary data, semi-structured interviews and guidelines for semi structured interviews. The research design provides a framework for collection of data. A research choice determines which framework is utilised in the research.

The research methodology is technique that is used for collecting data. Research methodology has two primary functions, to control and dictate the acquisition of data. Primarily there are two distinct approaches that inform the gathering of data in any research project and these are qualitative and quantitative approach. For the purpose of this study a qualitative approach will be utilised.
A case study research method is an empirical inquiry that investigates a contemporary phenomenon within its real life context. The research object in a case study is often a program an entity, a person or a group of people.

Data research is those facts that any particular situation affords or gives information or impression to an observer. These involve population which are all the study units that are the focus of the research as well as sampling which is selecting a suitable representatives from the population for the purpose of determining parameters.

The researcher will have to choose a certain sample that will be used for the research.

There are various data collection methods and these are primary data and secondary data. This study will make use of both primary and secondary data. The interviews will be one method that will be used to gather data.

It has also given an analysis of interview questions and qualitative data analysis process. The next chapter will present and discuss results of the semi-structured interviews.
CHAPTER 5

PRESENTATION AND DISCUSSIONS OF THE INTERVIEWS’ RESULTS

5.1 INTRODUCTION

The pilot study that was conducted by the researcher’s bank about economic downturn proved to be inconclusive. As the results were only based on the bank’s customers rather than the industry customers. This would have provided a bigger sample and much more conclusive results. Therefore the assumptions that were derived from the pilot study were disregarded and the researcher opted to consult industry wide. This is to eliminate any perceptions and aimed at getting a truer reflection of the impact of the economic downturn on BEE and Banks

The purpose of this chapter is to present and discuss the results of the four interviews which the researcher held with staff from the three major banks and one BEE consultant. The interviewees held prominent positions in their banks, one is the BEE manager, another is a capital investment manager responsible for drawing up financial structures for BEE deals, and the last one holds a position of Debt Manager in a BEE portfolio. The last interviewee is a BEE expert that is widely known and respected in the market for his expertise in BEE. The reason for interviewing these individuals was for their specialist knowledge in this field and the fact that they work with BEE from opposing ends. The names of the interviewees were not recorded due to their respective requests to remain anonymous.

The researcher has gathered notes during the semi-structured interviewees and made some recordings, for the purpose of referencing and reliability, in order to correctly collate what was said during the interview. The direct quotes from the interviewees will
be recorded in italics. The discussion of the results of the semi-structured interviews was performed by analysing the above note and recorded narratives

5.2 PRESENTATION OF THE NARRATIVE

For the purpose of the following narrative presentation, the raw data of the four independent case studies was separately organised, analysed and interpreted, to be coordinated and to be integrated into a coherent single narrative structure, for the purpose of overall comparison and discussion.

5.2.1 Introduction

The current economic downturn has a major impact on the employment market of South Africa. Isa (2009) is of the view that more than 200 000 jobs were lost from South African industries during mid 2008 and the first quarter of 2009. All sectors were affected, with the car manufacturing industry being the hardest hit. Jack (2008), states that the economic slowdown has resulted in South African banks and most of their BEE deals being adversely affected. Most banks started tightening their credit policies. Singh (2008) mentions this means that it has become difficult to access credit if you are an average person on the street. BEE companies started losing out on dividend payments, as shares started losing value on the stock market. This problem was further exacerbated by tumbling property values across South Africa. It became evident that the economic downturn was going to last longer than what was initially predicted by most analysts.

Isa (2009) is of the view that the closure of Lehman Brothers in America shifted the focus to South Africa, especially from the public perspective, to determine whether they able to weather the economic storm. Most analysts refer to BEE as the “sub-prime” of
South Africa. Bloomberg (2008) is of the opinion that the current economic slowdown in South Africa was influenced by the United States of America’s sub-prime lending fiasco.

The resultant local slowdown hit the financial institutions hardest, as consumers and companies became reluctant to increase their credit facilities. This has had a negative impact on financial institutions as impairments started soaring and most companies defaulted on the debt obligations. The situation started to squeeze the profit margins of the financial institutions. The decline of credit demand and the reluctance of major companies to spend, forced some of the financial institutions to lay off some of their workforce in order to reduce the burden on their bottom lines. The retail sections of all the major banks suffered heavy losses, as consumers are heavily indebted and not spending. There was also a huge increase in house repossession by the financial institutions, which further affected their bottom lines.

Monana (2009) is of the view that BEE companies are experiencing tough times as the economic downturn has weaken their stock value, resulting in lower dividends or no dividends at all being paid. This has had a huge impact on the BEE companies’ cash flows, forcing them to default on their debts. Such defaults affected the financial institutions, starting to experience losses in their BEE portfolios. These losses would have a huge impact on their mid-term financial results.

The following section deals with the interviewees from different banks and one BEE consultant. The aim is to get different perspective from the different banks as well as a BEE expert. These diverse views will help to put the BEE conundrum into perspective and help to answer the research question.
5.2.1.1 Personal questions for interviewees

This section looked at the personal aspect of the interviewee in order to ascertain their level of knowledge and skill. It also looked at the tenure with their employees.

**Interviewee 1** (Absa Bank)

The interviewee has been a senior bank official with ABSA bank for the last 4 years, in its capital investment division. Prior to that, he worked for three years as a corporate banker, specialising in structured finance involving BEE funding.

**Interviewee 2** (Nedbank)

Interviewee 2 is with Nedbank. He has worked for 25 years in different departments. He is currently working for the bank’s corporate division as a BEE manager. He’s been a BEE manager for nine years and during this period he has overseen the Wiphold venture and various other BEE business partnership deals.

**Interviewee 3** Rand Merchant Bank (RMB)

The interviewee is with Rand Merchant Bank (RMB), which forms First National Bank’s corporate division. The interviewee has been with RMB for 19 years as a financial structuring manager overseeing BEE financing. He has been overseeing BEE financing for the past eleven years.

**Interviewee 4** (Thembeka BEE Consulting)

This interviewee is a BEE consultant at Thembeka BEE Consulting. He has been working for this company for 10 years. He specialises in BEE financing through major corporate. He is involved with the planning of financing structures and with decisions regarding its suitability within the target industry. He has been in this role for nine
years. He has vast experience in the structuring of BEE operating structures and funding deals.

5.2.1.2 Responses about impact of downturn on banks and BEE deals

The individual responses of the four interviewees on questions about BEE bank exposure, BEE sustainability and themselves are recorded below. The questions in this section were focusing on understanding the impact that economic has had on BEE and Banks

Interviewee 1 (Absa bank)

“The institution I worked for was severely impacted by the economic downturn. The organisation’s published midyear results showed that we have made a 47 million rand loss over that period. This is mainly due to impairments and non-performing loans on the corporate side. Our lending business suffered severely, especially our home loans section, which made a 200 million rand loss.

The only way to survive this situation is to reduce the cost of running the business. The cost cutting measures have already started by consolidating 2 departments into one and by retrenching some staff

Credit tightening has severely affected the bank and caused a lot of distress for the customers as no one seems to qualify for credit any longer. Credit scoring criteria suggest that these customers are over stretched, which further exacerbates their situation as most customers use new or restructured debt to get out of existing debt problems”.

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Interviewee 2 (Nedbank)

“The organisation was impacted, as the results are indicating that the organization will be making a loss for this trading period. The tough economic conditions have made it difficult for consumers to qualify for credit, which has a negative impact on the organization’s Net Interest Income (NII). The number of customers who have defaulted on paying their loans has contributed to the poor results of this trading period. Corporate management has been talking about cutting costs and one way of doing so is to reduce staff. The bank has been severely impacted by the economic downturn, and has become cautious about who it should lend to, as many of its customers are currently unable to meet their credit commitments”.

Interviewee 3 (RMB)

“The bank suffered a largely reduced profit. This is due to the economic slowdown. Loss of external jobs has directly impacted the number of people that meet the credit criteria of the bank. This has reduced its potential market by half. The changing of credit scoring did not help matters. The credit approval rate plummeted to 30 percent from the beginning of 2008 to mid 2009. This definitely is a sign of how the credit appetite has reduced since the start of the economic downturn. Lenders are forced to be risk averse because of the heavy losses that are being forecasted. The bank has already retrenched call centre and outbound sales staff. There are talks of further staff cuts. The bank has been severely impacted. Fewer customers bothered to apply for credit. This will further reduce the profit for this year, as revenue generated from loans surpasses the revenue generated from fees”.

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Interviewee 4 (Thembeka BEE consulting)

The interviewee has observed with interest how the banks and BEE companies have been hard hit by the economic meltdown.

“It is currently difficult for banks to handle the downturn, as a year or two before the downturn; the banks were offering credit to their customers without thinking of the future consequence. During the economic downturn that strategy caught up with them, as many customers started to default. This forced the banks to look at other options of curbing cost and thus preserving revenue.

On the other hand, BEE companies were so reliant on their dividend payments to boost their cash flow that once this revenue flow started to be affected due to poor stock performance, many BEE companies started to default, and this was another blow that banks had to deal with. Companies that were highly financed by debt really battled to keep up with their payments.

In future, banks and BEE companies have to be careful about what financial structure they choose to finance BEE deals with. Profitability of the major four banks was reduced drastically and this is attributed to the economic downturn. Some of the BEE companies also suffered major losses depending on which industry they trade in”.

5.2.1.3 Responses about BEE funding

This section dealt with questions around the mechanism of BEE funding and ascertaining which of these methods is or are effective in sustaining the company

Interviewee 1 (Absa bank)

“There are various options that are available to a customer when they choose to finance a BEE deal. The following three have been popular in the market during the last five years.
(i) Special purpose Vehicle (SPV) which is where third party financing is utilised to purchase shares within the company, with the provision that the BEE investor’s equity will be held as security.

(ii) Equity transfers of new shares at a discount to a BEE investor or consortium resulting in a dilution effect on the value of the original shareholders equity and adverse potential tax implications.

(iii) Mezzanine financing whereby lenders offer unsecured debt. However, this finance vehicle comes with high interest rates and if payment defaults occur, the lender has the right to convert the debt into equity in the company.

Mezzanine financing has proven to be popular despite its high interest rate and risk factor, as it provides the borrower with quick liquidity. Interest rate hikes are very risky for deals that have used mezzanine financing. However, it does provide a liquidity relief to the company. It has to note that with interest rate volatility, it makes a very risky form of financing.

Successful BEE funding would comprise a structure that does not put the company under severe financial strain when it has to pay back the loan. The deal has to be structured to suit the company’s affordability, as exorbitant repayment terms might be detrimental to it”.

Interviewee 2 (Nedbank)

Various mechanisms are used to finance some of the BEE deals in the market, as listed below:

(i) Conventional debt funding, which is based on the premise that cash flows or dividend flows will enable the BEE investor to service the debt. The risk taken by the lender is that of the cash flow failing to materialise.
(ii) Gearing, with equity sweeteners to lenders whereby a market related interest rate is placed on the loan, coupled with a sweetener for lenders, so that they are able to benefit from the upside share price of the company if the share price traded above its initial price at the commencement of the deal.

(iii) Vendor Finance, where normally a passive investor will sell shares to the BEE investors on a deferred payment basis over a period of time.

(iv) Preference shares, which provide lenders with option of partaking in the company.

(v) Mezzanine finance, which is a hybrid between debt and equity and is very expensive as the borrower is not required to provide security.

Mezzanine financing might possibly be the best option, as it provides the necessary finance quicker. It has to be noted that it is very pricey. During an interest rate hike, this kind of financing can prove difficult for a company to keep up with its debt repayments. Any debt has to be structured according to the company’s requirements in order for it to cope with repayments.

Any method of financing has its pitfalls. It is difficult to state categorically that mezzanine financing is the best form of financing, It is relatively expensive and when markets turn volatile, it might turn costly. Any financing method should be decided based on the company’s long-term growth strategy, as too much debt can cripple its current performance and too much equity can likewise affect its performance.

**Interviewee 3 (RMB)**

“*There are two ways of financing BEE deals, that is (1) through equity and (2) through debt. However, these two types are broken down even further, as follows:*

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(i) Share buy backs where the parent company buys back shares through a subsidiary which can then be issued to the BEE investor, with potential tax benefits.

(ii) Convertible debentures, which are issued to benefit the lender, by the BEE investor, and which will come into play if capital or interest payments are not met or if the market value of the acquisition falls below a certain level.

(iii) Revenue stripping, which enables the vendor to acquire all or part of the BEE investor’s share of production or dividend stream.

(iv) Asset based financing, which occurs when a BEE investor acquires separate assets, especially in the case where assets have separate cash flows.

(v) Mezzanine financing, which is a combination of debt and equity. The lender does not do any due diligence and no collateral is required. The borrower receives the money and the interest is payable. It is the most expensive form of debt.

Mezzanine financing has become the most popular form of BEE financing in recent times. This is due to the fact that most BEE companies cannot or do not have collateral and therefore they will resort to pay the high interest rate in order to access financing. An alternative to mezzanine financing will be equity financing (in the case of public companies). It is one of the preferred methods of financing, as it eliminates debt and the cash which the public has used to buy shares is ploughed back into the company. There is no interest, therefore the only concern that the company has is to ensure that it performs and meets the expectations of the new shareholders.

Successful financing depends on the borrower’s requirements. Any financing that does add value to the company and does not drain its resources is good for that company. Finance structuring plays a major role in the company’s success. It is important to balance debt with equity, as too much debt might not be good for the company,
especially if interest rates are hiked successively at each quarter of the year. This will result in an unmanageable and an unaffordable debt”.

**Interviewee 4** (Thembeka BEE consulting)

According to the interviewee, the most popular methods of financing are:

(i) *Equity transfer*, which is where shares are offered at a discount to the new investors. This is the most popular form currently. A lot of companies are inviting the public to buy shares in its business. Telkom started this by selling shares to previously disadvantage South Africans and other companies followed suit. Recently, Sasol came up with its Inzalo share scheme.

(ii) *Mezzanine financing*, which involves a bit of both equity and debt. Some borrowers prefer this method as it not complicated and it does not require them to raise collateral. The borrowers pay exorbitant interest rates. This is because of the risk associated with this type of financing.

(iii) *Conventional debt funding*, which is purely based on affordability, where the cash flow or dividend flow is presumed to be sufficient to cover the debt servicing.

It was reiterated that despite the high interest rate and risk in defaulting payments, mezzanine financing provides the borrower with cash injection, hence its attractiveness. Borrowers want a fair deal, with reasonable and affordable repayments. Structuring of the deal has a major influence on how the company performs. The BEE companies should be advised to learn which methods work for them. The interviewee has seen a lot of companies that fail not because they are intrinsically bad, but because of their bad decision making in choosing an appropriate financial deal.
5.2.1.4 Response about bank risk exposure to BEE

This category of questions looked at how the banks have responded to the economic downturn challenges. It has looked at what policies if there were any that were changed to mitigate risk.

**Interviewee 1** (Absa bank)

“The bank’s BEE portfolio book is worth between 21 and 30 million rand. Much of this book is in distress, with as much as 40 percent of this book showing signs of strain. Almost 20 percent of the above has already been classified as bad debt and the signs are that more will follow.

Most companies have taken more debt than they could handle and this has increased their repayments. The change in interest rate has definitely made a major impact. As the interest rate started to hike, it became more evident that most companies could not handle the pressure.

The financing of BEE deals has been difficult. It is regarded as a very risky business. This is due to a number of reasons. In most instances, the directors of these companies have never had any prior business exposure and this limits their decision making ability on crucial business matters. Most of these companies battle to produce their financial statements and when they do, they are riddled with many discrepancies.

In the past, when the bank has financed a BEE company, it used to request collateral. In some forms this was provided in terms of share certificates that the bank then hold. This has proved a futile exercise, as some of these shares have devalued to such an extent...
that they are worthless in the market place and the bank is stuck with them, without being able to recoup the money so owed.

Banks should be prudent as to who they lend money to. It’s important that proper due diligence is performed on prospective BEE companies, to ensure appropriate mitigation of potential risk. A proper screening of all the prospect borrowers will stand banks in good stead. Most high profile deals were done with some degree of due diligence, however have more being done, some deals might never been financed.

The banks are well regulated and this has to some degree protected them from some irresponsible lending and unscrupulous customers. The legislations such as FICA and NCA have put a certain level of control and structure into the banking business”.

**Interviewee 2** (Nedbank)

“Our BEE book is worth more than 40 million rand. There are some clients who are taking severe strain, numbering roughly 15 percent of BEE customers. Each time the bank reviews this book, the number changes. The bank is experiencing high volumes of bad debts, with the current figure sitting at more than 30 percent of the book. Various factors are responsible for the non performing loans, such as lack of foresight from decision makers, the inability of the company to afford the debt due to change in market and trading condition, and interest rate increases, which make debt more expensive to service.

BEE deals have been very difficult to finance as some of them take a couple of months for decisions to be made. This is due to the complex nature of some of these deals and the large risk that the financial institutions have to carry. This leads to countless delays as the bank wants to make sure that all is fine and everything meets the set requirements.
In most cases the bank requires collateral from the borrower, however this is determined by the structure of the deal and the amount of security required. The nature of the business also plays a part in determining the type and amount of collateral. This depends on what the company has in terms of assets. Some companies cede policies and some attach their properties. This gives the bank a sense of comfort should something go wrong with the deal.

Credit assessors look at the company’s profile related to its standing in the market and its financial position. The quality of BEE leadership is looked at. This plays a major role in the success and failure of the company. Should the company fail to honour its obligation; the lender can lay a claim on what has been ceded to it. Banking legislation plays a major role in regulating banks and lending criteria. It is difficult for corporate clients, as they do not fall under NCA national credit act that governs the criteria that the banks have to follow before lending to the customers and consequently the banks have to be more cautious in following their own internal processes”.

**Interviewee 3 (RMB)**

“We have a BEE transaction book worth almost 100 million rand. Due to the economic downturn, this book has deteriorated badly, resulting in it being diligently controlled by the bank. The company is currently experiencing difficulties with 20 percent of this book and close to 40 percent is experiencing bad debt. The market conditions are not favourable to some of these companies, especially those involved in the financial sector. These companies are struggling to service their debts due to their dependency on a single revenue stream.”
Since 2008, when interest rates started to climb, the bank forecasted that most companies would default as it would become more difficult to keep up their debt payments. It is important to consider certain steps before considering lending. These steps include a proper due diligence of the industry the company is operating in and the possible risk of funding. The volatility of the particular industry has to be taken into account, as well as company management and the business potential of the company. Once these factors have been considered then a deliberation on what decision should be taken can be made.

It is very risky financing BEE companies, as more often than not, they tend to fail. This is because some of these companies do not follow basic business principles. This leads to them making inappropriate choices which affect their growth opportunities. Many choose to invest in areas that are already market saturated, which hamper their progress.

Legislation is playing a major role in ensuring that banks lend responsibly. Providing collateral is part of the contractual conditions, However, the collateral provided of late tends to be insufficient. Consequently, the bank had to amend its contracts in a quest to ensure that it is adequately covered should any unforeseen circumstances emerge. The recent poor performance of some stock on the JSE has meant that those share certificates held as collateral have become meaningless, forcing the lender to review such clauses in the contract”.

Interviewee 4 (Thembeka BEE consulting)

“All four major banks have BEE portfolios which vary according to the size of the bank. Nedbank has the smallest of the BEE book, with Standard Bank and ABSA leading the pack.
All banks suffer to some degree due to non performing loans that in most cases went on to become bad debts.

**From the very onset, BEE financing was a risky business.** In most cases the banks fail to base their decisions on the risk exposure of the borrower, which is dependent on their financial standing, management of the venture and on the nature of the industry. These factors play a significant role in risk assessment, debt mix and the maturity structure of lender debt. Limited BEE investor capital also results in financial institutions bearing the risk associated with a BEE transaction. As BEE groups and funders of BEE transaction are aware, the return profile of the investment is asymmetrical. The funder assumes all the downside risk, while sharing the upside potential with BEE groups, primarily brought on by the BEE group’s lack of capital. With risk being a critical factor in the lending of capital by financial institutions, it goes without saying that non financial factors also play a significant role in the decision to lend.

Borrowers of capital are often rated by the quality of the applicant as a potential debtor, as well as on their probability of defaulting on the loan. The interviewee recommends that, although BEE investors often rank low in qualifying ratings, a new hybrid rating model should be developed, which takes into account factors such as business risk, legal risk and quality of management when assessing and monitoring the risk of new deals.

Most financial institutions use relationship lending where a decision for a financial intermediary is based on the premise that to provide such a service, such as lending of capital to a company, depends on borrower specific information collected over time and

This chapter presents a brief summary of the research outcomes, conclusions and recommendations.
High profile names and the standing of the responsible person representing the borrower in society have become synonymous with BEE. This could be the reason that some of the BEE deals being financed are bearing the names of high profile individuals such as Cyril Ramaphosa, Tokyo Sexwale and Saki Macozoma to mention just a few. Should the borrower fail to deliver on its debt obligation, the financial institution can attach whatever asset that the company has in its name to secure the outstanding debt, in order to recover the money from the company”.

5.2.1.5 Responses on the sustainability of BEE deals

This section look at the sustainability of BEE and it also look at the financing model that was used in a BEE company

**Interviewee 1** (Absa bank)

“Most BEE deals can be sustainable, depending on the industry they are in and the way they are structured. The company that continues to meet its financial obligations and be able to pay out dividends to its shareholders is considered successful under these circumstances.

The finance structure is crucial in the company’s existence as it can determine its success or failure. Should a company choose more debt, this can be detrimental to it as it might not be able to service it during times of turmoil. Market condition and the decision making of the company’s management can influence the success and sustainability of the BEE company.

Partnerships play a huge role in BEE sustainability. The intervention of IDC in the Foskor deal is the pure example of how a partnership can lead to success. Partnerships
lend support to the company that is besieged and help to pull it through rough times. Government institutions can be utilised as potential partners, IDC should be more involved in financing some of the BEE deals, as this will alleviate pressure on the private sector financial institutions. Land bank can also play a major role in assisting small BEE deals”.

Interviewee 2 (Nedbank)

“Any transaction can be sustainable, depending on how it is managed. It is crucial that leadership understands the levers that drive the company and its transaction. The finance structure chosen has a direct influence on the performance of the company, which can directly attract new investors or force them out.

The Nedbank Eyethu deal is perceived to be the best current deal in the market. However, there are different views in the market on this. The lock-in period on BEE deals could make such deals less appealing, as the shareholders have to wait for a stipulated period of time to lapse before they could exercise their rights in the shares they own.

Thus, the success of any BEE deal lies on how it is driven and controlled by its management. The prevailing market conditions and market perceptions are influencing factors on the performance and the sustainability of the company. Partnerships enhance BEE deals as the bigger corporate partners act as guides to their smaller business partners. This was the case when Absa collaborated with the taxi associations and helped them to steer their business model.
Furthermore, government institutions have a major role to play in assisting the up and coming BEE companies. The Development Bank of South Africa and Independent Development Corporations have a huge role to play in developing rural BEE companies in reaching a development level on par with their counterparts in the urban areas”.

**Interviewee 3 (RMB)**

“BEE deals can be sustainable. However, market conditions play a major role in determining their success. Avusa is one example of a successful BEE deal, realising that the old Johnic was already a successful entity prior to its unbundling. This is the outcome of a favourable market condition influence. The same can be said of BEE mining deals, as these depend directly on the performance of the local currency (Rand). If the rand strengthens the industry suffers, as its core business trade relies on exports.

The successful transaction is the one that is able to pay back its investors and to keep afloat in difficult times. The management of the company and the decisions it makes are the leading factors in business’s sustainability. It is important to invest in correct vehicles and the timing thereof. The financing structure plays a major role in ensuring that the company has a chance of success. A cumbersome financing structure can lead to confusion. Companies must keep it simple and most importantly affordable.

Partnerships form a key factor in the success of most businesses. The partnering of Shanduka Investments with Absa is one such example. Wiphold partnering with Nedbank is another example. Companies realise that they cannot succeed on their own. It has been observed that some Government institutions are beginning to fund BEE companies. However, lack of skills and corruption allegations are affecting progress.
BEE will be the beneficiary when Government institutions realised that they have a serious role to play in this market. This will improve funding and broaden BEE to other industries that might not be viewed as viable by the private sector financial institutions”.

**Interviewee 4** (Thembeka BEE consulting)

“A specific concern related to BEE is the risk that any black owned company can obtain an equity stake in a bigger BEE deal, which will dispose such equity position as soon as a profit can be made. This may result in mere enrichment rather than empowerment and capacity development, nullifying the real purpose of the BEE equity participation objective.

This is a challenge that BEE is faced with. However, apart from this most deals are sustainable and can function. Mvelaphanda is a prime example of a successful BEE venture that continues to grow in leaps and bounds, even in challenging times.

A successful BEE deal is the one that continues to grow and expand its reach of empowerment to different communities. The Royal Bofokeng deal is one that comes to mind, where the entire community is set to benefit from the proceeds of the BEE deal that it has signed. This will result in an empowered and self sustaining community.

Financial structuring has a major impact on the company’s BEE deal. Therefore, it is important that companies choose wisely when they decide on a financing method”.

**5.3 DISCUSSION: ANALYSIS OF THE NARRATIVE**

The analysis of the narrative will categorise and discuss the findings of the research interviews under two sub-headings or themes, namely:
1. The general impact of the economic downturn, and

2. The dimensions of Black Economic Empowerment (BEE)

5.3.1 The general impact of the economic downturn

The researcher observed that with the challenges faced by the overseas banks due to the global economic downturn, the market value of the Royal Bank of Scotland (which is regarded as one of the biggest banks in the world) shrank from a 120 billion dollars to 4.6 billion dollars. It was generally expected that the South African banks will follow suit. Fortunately, the four South Africa banks did not experience as much market stress as their overseas counterparts. The researcher also noted that Standard Bank, which is one of the biggest banks in South Africa, moved from being valued at 125 billion rand to 117 billion rand. It is evident from these figures that South African Banks were not as hard hit as their overseas counterparts. The writer is of the opinion that this is partly due to the stringent controls that are governing South African Banks. A lot of new legislation was introduced to bring about the necessary controls required in the banking industry. Such legislation includes the National Credit Act.

The researcher is of the opinion that the new legislations that were introduced coupled with the economic downturn made it difficult for SMME to get funding from the financial institutions. This was due to the number of defaults that the financial institutions were experiencing, resulting in non-performing loans on their books. This has forced most of these financial institutions to change their qualifying lending scorecards. Monana (2009), states that when SMMEs started to experience financial difficulty, many people that were employed in this sector were also affected. Nedbank and Absa SMME loan books were not badly affected, as they claim that they follow a stringent screening process before offering loans to their clients. Because of the economic downturn there was huge reluctance from people starting up new ventures, as
they knew that they were going to have problems in accessing credit. Most analysts predicted that the economy would be revived by the SMME sector.

The researcher noted that the indications were clear that the economic downturn has had an impact on how financial institutions view and process credit applications. Singh (2008) is of the view that businesses that were most impacted by the change of rules were the small BEE companies who were yet to establish themselves in the market. These became too risky for the financial institutions to finance and hence the development of special purpose vehicles (SPV) to finance these new deals.

The larger BEE partner (SPV) accepts the loan on behalf of the smaller BEE alliance company, which allows the BEE company to be indirectly financed by the financial institution. Thus, the BEE partner stands security, which reduces the risk to the banks should the BEE company defaults on its loan repayments.

Singh (2008) further states that this form of deal is good for the financial institutions as it reduces their risk exposure. However, the BEE companies seem to be getting the shorter end of the stick as there is no transfer of ownership. This approach has raised a lot of questions from different government and societal sectors about many BEE transactions that have taken BEE companies as partners lacking real power. Debt financing has had a crippling effect on most of the deals that were financed by long term loans.

There has been a call from prominent role players for the government to get involved in order to save some of the drowning deals. The BEE legislation has been docked with many controversies, especially the one of fronting (where previously advantage individuals use the details of a previously disadvantaged person in order to get
business). This has prompted many people calling for the legislation to be refined and for the government to be more involved in the supervising of some of the deals. In many BEE deals, companies were listed with great expectations of making money. However, because of the changes in the economic landscape, many of these companies were now folding.

Isa (2008) states that many listed companies had their shares devalued. The economic downturn has resulted in the public losing faith in these companies and hence their foreclosure. One significant impact that this has had on financial institutions, were the millions of rand worth of outstanding loans yet to be settled. This will have to come off the bottom line of financial institutions. All four major South African Banks reported some reductions in their profitability. The reduction in profits vary from bank to bank, Nedbank reported a 45 percent reduction. First National Bank also reported similar financial results. This is an indication of how the economic downturn has negatively impacted the performance of financial institutions.

5.3.2 Banks and Economic Downturn

The researcher observed that during the economic downturn, the first impact experienced by the local financial institutions primarily started with the bank’s home loan books. This is where banks make most of their profit and when this line does not perform it gives a clear indication of how much strain the banks are experiencing. Bloomberg (2008), states that the homes that were being repossessed by the banks in 2008, show that households could not keep up with the repayments of their debts. The losses that were experienced in home loans could not be recovered in other areas, as is normally the case during non recessionary periods. These non performing loans, coupled with BEE loans, have almost crippled the financial institutions in South Africa.
5.4 BANKING REGULATION SANITY CHECK

Theobald (2007) suggested that because of the sound banking regulation system in South Africa, the local banks still remain functional notwithstanding the global economic downturn. It is imperative to note that the market value of South African banks have, from 2007 to 2009, declined marginally as compared to global financial institutions. Absa market value, which was 89 billion rand in 2007, dropped to 68 billion rand in 2009. The market value of First Rand Group, worth 125 billion rand in 2007, dropped to 80 billion rand in 2009. Nedbank dropped from 80 billion rand to 44 billion rand. These figures indicate the severe impact that the economic downturn has had on South African banks.

The researcher is of the view that the above local results are in complete contrast to the European banking situation. The market value of Citigroup, which was regarded as the biggest USA based bank in 2007 with the market value of 255 billion dollars, drastically dropped to 19 billion dollars in 2009. This bank is almost on the brink of collapse. HBSC, which was regarded as the biggest UK based bank in 2007, had a then market value of 215 billion dollars. By 2009, its market value had shrunk to 97 billion dollars. Another big USA based bank, JP Morgan, was also hard hit when its market value dropped from 165 billion to 85 billion dollars. This is an indication of how severe the global banks were affected by the economic downturn. The public tends to lose faith when major blue-chip financial houses are performing at the low levels at which these major banks are currently performing. Because of the globally integrated business of banks trading with banks, the situation became difficult to control, as no bank wanted to take guarantees from its counterpart.
This complicated matters even further and it stalled major contracts that were supposed to take place. Most South African banks are reluctant to deal with their overseas counterparts due to insufficient guarantees and lack of trust that the South African banks have for their overseas counterpart. This does not only impact the Banks, the import and the export industry has also been hard hit due to the overseas banks being unable to honour big payments.

The interview revealed that Nedbank’s BEE deals are worth approximately 11 billion rand. The exposure to these deals stood at 16.7 percent in 2009 and it is likely to increase as the economic strain continues. The Nedbank book varies in terms of its type of financing, making use of both debt and preference shares funding.

5.4.1 Measures Taken to Bring in Some Control

The interview revealed that due to the major cash flow problems being experience by the BEE companies, Nedbank started to see an increase in the number of its non-performing loans. This is due to the number of BEE companies waiting for dividends to be paid before they service their debts. This is the result of a domino effect that was caused by the slide of the stock market, which caused most listed companies not to declare dividends, having a major impact on Nedbank’s BEE portfolio. Most Nedbank facilitated BEE deals were servicing their debt from dividend proceeds. Due to the oversight by Nedbank of not having stringent policies of BEE lending, the bank’s BEE division has decided to require collateral from either the BEE company’s partner or the BEE company itself. This policy was introduced to reduce the level of risk exposure to the Bank. Nedbank further focuses on the cash flow of the BEE companies in order to ensure that the company that requires funding will be able to honour its repayment obligation.
Jack (2008) states that Standard Bank has followed the same route as Nedbank by introducing stringent measures of assessing BEE Company’s cash flow before loans are granted. The BEE losses have contributed to the bank’s reduced profitability in 2009. The announcement of the bank’s impairment results accounted for about 66 percent of its book, which have had major impact on the bank’s profit. Standard Bank has been a major player in BEE financing and the economic downturn forced the bank to rethink its involvement in certain BEE deals. Standard Bank, due to pressure in the property market and the decline in the number of applications that were coming through from the origination channel, decided to cancel the contracts it had with the mortgage originators. This channel was costing the bank a fortune, as it was paying commission to the channel for the applications it was bringing in.

5.4.2 Dealing with Home loan Market Challenges
Theobald (2007) states that after some deliberation with the originators, Standard Bank decided to review its position with the origination channel. It has signed contracts with three selected mortgage originators after an eight month hiatus in which it stopped using the sector to source new business. A combination of fewer loan applications, its own more aggressive stance toward originators and a recessionary environment saw the group grant mortgages worth only 7.3 billion rand in the first six months of 2008, compared with 36 billion rand worth in the same period of 2007. However, Standard Bank appears to have taken a more conciliatory approach to originators, but only those prepared to do business on its terms. Theobald (2008) further states that the bust up between the banking industry and originators was inevitable and happened at the end 2008 when the credit crunch reached crisis proportions and lenders called time-out on an industry it believed had become too powerful in the pricing dynamic between it and its clients.
While other banks appear to have been more open to sign new deals, Standard Bank held out longer than its peers and recently announced it had invited South Africa’s five biggest mortgage originators to submit sealed confidential proposals on how their relationships might continue. Standard Bank chose to sign contracts with Betta Bond and Bond Choice. A sixth uninvited proposal from a smaller player, Multinet, was also accepted, as the bank liked the terms it offered. However, noticeable by its exclusion is ooba, South Africa’s biggest originator. It submitted a proposal that wasn’t accepted.

There is a notion that the origination channel does not offer a valuable proposition to the banking industry. Banks are of the opinion that the originators were taking much of the margin that they believed they are entitled to, off the table. The cost of mortgage originators was out of step with the value they were providing.

The researcher is of the view that banks have moved from being price takers to price makers, with which they feel comfortable and have become much more aggressive in the way they price risk. All banks have tightened up on their pricing as financial institutions seek to put a more realistic figure on risk, after half a decade over exuberant lending practices. Standard Bank received 70 percent fewer applications for mortgage finance in the first six months of 2009 than it did in the corresponding period of 2008. However, the aggressive interest rate cuts since December 2008 are starting to feed through into the real economy and though still sluggish during the third quarter of 2008, there seems to be a slight improvement.

The financial performance of the various banks’ mortgage divisions in the first half 2009, tell a story of a much more difficult environment than any of the banks had become used to. There have been significant increases in bad debts as deals done with
clients over recent years turned sour and as property prices declined in an environment where 108 percent mortgages were the norm, in anticipation of ever increasing property prices.

5.5 DIMENSIONS OF BLACK ECONOMIC EMPOWERMENT (BEE)

Jack (2008) is of the view that in South Africa the BEE phenomenon has just taken off and most of the BEE deals were financed using different structures. There are various financing methods used to finance these BEE deals. Debt is most commonly used as most financial institutions in South Africa strive to involve themselves in BEE deals, in one way or another. Another reason for using debt was that South Africa was experiencing low interest rates, which made it cheaper to finance business through debt. Furthermore, financial institutions derived indirect benefits from debt financing.

Monana (2008), states that points are gained based on the extent of a financial institution’s involvement in BEE deals. Most financial institutions have a scorecard that measures their involvement in BEE transactions. This indirectly put pressure on managers to rule in favour of these transactions in order for them to look good in their scorecards. In some cases, due diligences were not performed properly and deals were financed according to an individual applicant’s standing in the community, whether politically or socially.

The researcher is of the view that due to some of the BEE companies owing too much money to the financial institutions, affordability was becoming a big challenge. When the South Africa Reserve Bank started with the interest rate hikes in late 2007 and early 2008, signs of discomfort started showing as most of the BEE companies started closing. Those that remained in existence started experiencing cash flow challenges.
This was due to the fact that it was no longer cheap to finance business operations through debt.

The interviews have revealed that in most instances where equity has been used to finance BEE deals, people were invited to buy shares in specific companies, temporarily injecting cash into the company. This has been the case with Sasol where the public was invited to buy shares. When the economic downturn started in South Africa the share value started to drop. When the share price dropped, most companies stopped paying out dividends. This put a lot of pressure on BEE companies who were relying on these dividends to ease their cash flow problems. The financial institutions were also hard hit by the drop of share prices.

Isa (2008) is of the opinion that at the time when the agreements were entered into with budding BEE companies, no one had foreseen that the share price would dip. Most financial institutions opted to take some of these shares as collateral. The impact of the downturn resulted in most of financial institutions holding on to share certificates that have no value at all. When the Sasol/Inzalo shares scheme started losing value, most of the BEE companies who had bought into the scheme experienced major cash flow challenges, due to the lack of dividend payments. When the Old Mutual BEE deal was reported to be out of money, it caused a wide spread panic and forced many financial institutions to review their BEE financing policies. However, when these deals were not able to make money it was not entirely the banks’ fault. A lot can be attributed to how these deals are structured. One of the challenges of the BEE deals is that the investors wait up to 10 years before they can access their investment. This is directly impacting on the day to day running of these BEE companies.

5.6 PARTNERSHIPS IN FINANCING BEE DEALS.
Isa (2008), states that the partnership between Absa and IDC in funding the taxi deal to the tune of 300 million rand has been commendable. This equitably spread the risk to all the stakeholders. IDC will carry 50 percent of losses incurred through the financing of this scheme. This gives Absa a sense of comfort that even if the client defaults, at least the total exposure is drastically reduced. The finance scheme promotes BEE, SMMEs, entrepreneurial development and taxi recapitalisation, all of which are principles that will contribute immensely to the economic development of the country and increase employment opportunities for the unemployed.

5.7 BEE FROM A STOCK PERSEPTIVE

Theobald (2007), states that when MTN shares were made available to the public through the Asonge black economic empowerment (BEE) scheme in 2007, they were oversubscribed by just 13 percent. A year later, Sasol's Inzalo scheme and Vodacom's YeboYethu scheme offers were each three times oversubscribed. Asonge investors were rewarded with one bonus share for every 10 held shares. Investors would have bought the share at 80 rand. MTN's share price was 12635 cents. Those who bought Telkom shares at the time have seen their investment recouped in dividends alone. Black investors who kept their shares until 2005 received one bonus share for every five. And they received almost as much as they originally paid for their Shares when Telkom sold its stake in Vodacom.

Sasol shares fell victim to the commodity price slump, at about the same time that it initiated its BEE scheme. This serves as an important reality check, as it was widely expected that these shares would not be impacted by the adverse economy, due to Sasol’s profile and the industry it is involve in. This experience illustrates that the enthusiasm for share schemes is not always matched by performance. In 2008 Sasol offered black investors 7.8 billion worth of shares at 11 percent discount.
The researcher is of the view that this was South Africa's largest empowerment transaction to date. But Sasol's stock dropped below the discounted price in the middle of 2008. These meant investors could buy Sasol shares on the market at a greater discount than offered to the BEE deal and not be bound by the two-year lock-in period. In the first and the second quarter of 2009, Sasol's share price was 292.3 cents, still 20 percent lower than the discounted 366 cents. Rather than being truly broad-based, share schemes appeal to the middle classes. The emphasis should be on building a savings culture in South Africa rather than selling shares at a discount to historically disadvantaged South Africans who can afford them. National Treasury issued retail bonds which can be purchased from the Post Office, which are low risk savings vehicles that are not dependent on the markets. This makes them the ideal starting point for new investors.

The researcher is of the opinion that the get-rich-quick approach taken by BEE share schemes is likely to cause a double whammy of resentment. In the case of Sasol, the public will resent the fact that BEE shares are worth less than ordinary shares, and the company's ordinary shareholders will resent having to foot the bill for shares that are now under the water. Sasol's experience also means that retail investors will think twice before investing in similar schemes in the future. Both Spar and SAB Miller have initiated schemes that will benefit their employees only. If the schemes were open to the public, they could have suffered a similar fate as Sasol. Some analysts believe that these shares would have been severely undersubscribed.

Isa (2008) is of the view that share schemes may have been a bit misguided, ultimately attracting subscribers from the relatively uninformed and unsophisticated public, many
of whom are unable to carry out a proper financial analysis before they participate. Selling BEE shares to people who eventually never benefit from them, while claiming to have the required percentage of black ownership in the company, is abusing the intent of black empowerment legislation for self gain. Had the outcome of all share schemes been positive, this view may have been different. But it is clear that for any investor, the buying of shares carries an inherent risk. The National Empowerment Fund, which distributed Asonge shares, is tasked with empowering ordinary people. It has been fortunate with the performance of MTN, but if institutions like it want to promote broad-based BEE, they will have to look beyond a quick-cash approach.

5.8 SUMMARY

In this chapter the results of the semi structured interviews with 4 interviewee narratives were reported. These interviewees consist of three bank employees from there of the four major banks as well as BEE expert from the BEE firm. There was a range of questions that was posed to the interviewees ranging from the form of BEE financing to sustainability of this financing methods.

There has been a consensus among the interviewees that too much debt will have dire consequences on the BEE deal and this might have an impact on the sustainability of the deal. Mezzanine financing seem to be the choice of the interviewee as a sensible form of financing as it involves both debt and equity.

The analysis of the narratives was discussed in 2 themes, namely the general impact of the economic downturn and the dimensions of Black Economic Empowerment. The chapter also analysed the partnerships that ABSA has formed with BEE companies especially the taxi deals. The wide perceptions that BEE share offer are the best in the
market. The decline of the Sasol share value dispels these perceptions as these shares lost so much value and invariably became worthless.

The Telkom shares proved to be a success in the market as the investors of this share scheme were handsomely rewarded. This at times is contrast to Isa’s view that some of the target market of the share scheme are unsophisticated and do not understand the mechanics of the share schemes. There are many success stories of the share investors, the MTN share scheme that has been recently introduced attracted a lot of interest. This is in the footsteps of the Vodacom share scheme called Yebo-Yes.

In the next chapter, chapter six, the summary, conclusions and recommendations will be presented.
CHAPTER 6
CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION
This chapter presents a brief summary of the research outcomes, conclusions and recommendations.

In chapter five the researcher discussed the findings of the semi-structured interviews conducted. The aim of chapter six is to correlate the data from the literature review with results of the semi structured interviews, in order to answer the sub-problems and thereby eventually the main problem.

The aim of chapter five was to confirm the main findings of the literature search then analyse the prioritised data and interpret it. The purpose of this chapter is to summarise the findings, deductions and viewpoints arising from the discussion with the interviewees concerning the impact of the economic downturn on banks and BEE deals. This chapter will consist of the following:

- briefly discuss the purpose of the study,
- restate the main problem and sub problem,
- briefly discuss the findings of the literature review, and
- briefly discuss the findings of the empirical study.

The summary will provide conclusions and recommendations.

6.2 PURPOSE OF THE RESEARCH
The purpose of this research was to ascertain the impact of the economic downturn on South African banks and their BEE funded deals.

The interest in the study took place when the researcher realised that certain BEE businesses were facing tough times. This was compounded by the banks reluctance to lend. This has put a huge squeeze in market as all these forces were occurring simultaneously. The economic downturn seems to be the cause of the banks reluctance to attract credit. Most BEE companies started to fold due to economic hardships and banks started retrenching along with other industries, who were feeling the strain of the downturn. The job losses in South Africa reached great proportions at the beginning of 2009. Analysts were not sure how long the economic downturn would last. Some analysts refer to the downturn as being one of the worst in history and it can continue unabated.

When the financial institutions presented their results, all four of the major South African banks researched either indicated a loss or a decline in earnings. This also impacted on the stock market as most stocks started market reluctance to invest in stocks that are making losses was felt especially by the small companies. The debt that was owed to the banks was either not paid on a timely basis or not paid at all, again putting a massive strain on banks’ performance.

6.3 RESEARCH PROBLEM

The main problem was stated as:

To ascertain the impact of Economic downturn on South African Banks and BEE deals.

The sub-problems which had to be solved in order to solve the main problem were stated as:

- to ascertain the effectiveness of BEE funding;
to assess the risk exposure of banks to BEE; and

- to ascertain the sustainability of BEE deals

The first and the second sub-problems were addressed in chapter two. The third sub-problem was dealt with in chapter three.

6.4 RESULTS OF THE LITERATURE REVIEW

The researcher is of the view that the economic downturn is perceived to have started in the United States due to its sub-prime lending rates. This has caused a major panic in the states as the debt levels overcame the income levels. This meant that US citizens owed more than they earn. This resulted in consumers being unable to spend and this brought the United States economy to a standstill. Because the United States is a major global economic player, this problem affected the entire world. The only economy that was left unscathed was that of China.

Siegel (2008), states that the economic downturn had a huge impact on the developed markets, causing widespread global panic. The researcher is of the opinion that the closure of Lehman Brothers indicates the enormity of the challenge that this economic downturn caused. Internationally, the stock markets were hugely impacted as many shares were devalued. In South Africa, the BEE shares especially became worthless.

This had a huge impact on companies who were relying on dividends to provide adequate cash flow to settle their debt obligations. In South Africa, Sasol is a good example of a BEE scheme that did not take off very well. Investors in the scheme lost money as the share price reduced. From a BEE perspective, funding equity with debt leaves a razor-thin margin for error. It is further challenging when the beneficiary of the asset has no security.
Bringham & Charron (2008) is of the view that the economic downturn resulted in a number of business sectors suffering a loss of revenue due to customers’ reluctance to spend. There were massive job losses due to the economic downturn, as trading conditions were not conducive and companies decided to let some of their employees go. The economic downturn also led to a decline in the property market, which has had a negative impact on the banks. This resulted in many financial institutions tightening their lending criteria.

Bloomberg (2008), states that the negative impact of this was felt by smaller BEE companies and ordinary consumers who were not able to access the loans that they required. The funding structure of the BEE deal plays a major role in determining its success or failure. Many companies are set up based on a debt which has to be serviced, the higher the debt the higher the service interest and this leads to squeezed margins. This is a major reason why most of the BEE companies battle to stay afloat. This also impacts on the small business sector, as most of the BEE companies tend to trade with SMME companies that provide employment to a certain number of employees in the community. Financial institutions have come up with sophisticated financial structures and forms of ownership.

Singh (2008) states that vendors that are unsympathetic to BEE deals tend to impose unreasonably steep prices on empowerment transaction. Crucial to any solid BEE deal is the correct valuation of the asset to the buyers.

6.5 RESULTS OF THE EMPIRICAL STUDY

The economic downturn affected all major banks’ profitability in 2008 and 2009. These banks showed a decline in earnings of over 40 percent. The banks debt exposure was as
high as 38 percent in some instances, as most customers were battling to repay their
debt. The South African banks weathered the storm better than its overseas counterparts.

It was established that the financial structure that a BEE company chooses will have a
direct impact on its success. This is due to the level of rising interest and dwindling
share prices. Companies that are using less debt have a better chance of succeeding than
those who are using a lot of debt. There has to be a correct balance between debt and
equity in the finance structure that the company chooses. Mezzanine financing proved
to be popular. This is due to its less onerous share prices and the fact that there is no
collateral required. However, the borrower has to brace himself against high interest rate
payments.

Equity financing has proven a popular choice, as most BEE deals seem to be following
this trend. The banks are exposed due to BEE companies not being able to sufficiently
service their debt. Companies that were relying on dividend payments to service debt
found it hard to cope during the economic downturn, as their cash flow were drying up
making it difficult to continue doing business.

The market condition determines the sustainability of the BEE companies. All
companies have a chance to succeed as long they are properly managed and lead. The
structure chosen to finance the deal will determine the company’s performance.
Favourable market conditions have an impact on BEE companies achieving
commendable results. Partnerships form the cornerstone of black economic success, as
it transfers skills and knowledge that contribute immensely to the sustainability of Black
Economic Empowerment ventures.
RECOMMENDATIONS

It is imperative that the government gets more involved in BEE dealings in order to assist the small companies that might not have the expertise to succeed. Government institutions, like IDC, should be more involved in the financing of BEE deals. Most of the start-up companies that would like to be involved in the mainstream business do not meet all the criteria that are set by the financial institutions. In some cases viable deals loose out due to the lack of understanding from financial institutions. The financial institutions tend to focus on mining and fishing deals, and they tend to neglect businesses that are perceived not to be viable by them.

There should be a limit as to how much equity can be financed through debt. Most of the companies that went under could have survived if they were limited to the number of shares they could affordably purchase via debt. When a company is saved from going under, it is not only the company that has been saved livelihoods are also saved as employees tend to keep their jobs. There should be a wide drive of consumer education, especially those that intend to re-enter the stock market and be involved in purchasing BEE shares. The Sasol share plunge should have provided some valuable lessons to potential investors, namely that the get-rich-quick schemes do not always work and therefore a level of insight is required before an investor makes a decision. The BEE learning path has been painful and many BEE transactions have collapsed. Financial institutions and the Government institutions should draw up an agreement as to which deals will be suitable for which sector. This will alleviate the burden that the financial institutions are feeling at the moment.

Banks have to follow stringent affordability policies and have to perform proper due diligences when financing major BEE deals. The banks should avoid financing deals
involving an influential person that does not know anything about the business. BEE deals, when properly financed and managed, provide livelihoods to a number of families and hence it is imperative that financiers do proper diligences in order to preserve these companies and to give them a chance to succeed. Partnerships should be encouraged, as they will always provide guidance to smaller and less experienced companies, providing them with a chance to succeed.

Since Sasol’s share price loss about 37 percent of its initial value on the Inzalo offer, the better option would have been a private equity-leveraged model where a portion of the existing business is sold to a new entity. This structure ends up financing the deal from the cash flow of the business rather than through dividends. This creates real value for BEE shareholders who can proactively participate in the business, while the balance sheet is not affected.

It is imperative that when a financial institutions looks at financing a BEE company, it should consider some key planning phases. These are:

- Strategic analysis of the BEE requirements,
- Selection of the BEE consortium,
- Structuring of the transaction,
- Makeup of the Company (management), and
- Funding structure

These phases ensure that a financial institution has enough information about the company before it commits to a loan that it might not be able to repay.

The Malaysian and Indian reforms can be utilised to enhance South Africa’s already existing reform plan. The Malaysian has taken key critical objectives like education and farming to ensure that the country will be sustainable for a long time. Education plays a
key role in any developing countries and South Africa needs to pay attention to this. Both countries have ensured that there are tight policies that govern the participation of the larger population in the mainstream economy. This reduces tension and fears. India has greatly focus on education with great success and hence the skill that is being imported from India by the developed world.

CONCLUSIONS

Banks and BEE companies have to exercise caution, as the economic downturn is still continuing to date, and there are signs that it is still going to last a little while longer. The credit drive from the banks during the boom time has contributed immensely to the current problem where consumers find themselves with bank offered credit, without these banks having performed any proper prior credit checks them, which was now backfiring badly.

The offering of Home Loans at lower rates has had huge impact on the banks’ impairment, as these customers were the first and hardest hit when the interest rates were increased. In a way banks encouraged consumers to live beyond their means and now this has affected their profitability. This is one of the reasons why banks are suffering major impairments on their home loan books and on vehicle financing, which has lead to massive repossession of both these assets.

On the other hand, the lax credit processes related to BEE deals have had a huge impact on losses in the banks’ books. The devaluing of shares affected the repayment of the BEE loans, as most companies were depended on dividend payment for their cash flows and now that these shares were not worth much it made it difficult for them to have an adequate source of income, as trading conditions were not as favourable.
The issuing of shares by the companies to the public have resulted in a lot of communities wanting to learn more about share schemes and how they will benefit in the long run. This remarkable interest in share schemes allow communities that have never thought of share schemes to participate freely. Telkom share schemes success allowed other companies to follow suit. This captured an untap market for the BEE companies who wanted to comply with the BEE legislation.

The failure of the Sasol shares to ignite the market raised a lot of concerns from the market and potential scheme participants. This raised awareness of the communities as they realised that the share schemes are not bullet proof. The perception of treating shares scheme as get rich quick scheme seem to be on the decline.

The economic downturn has resulted in a lot of changes especially in how the banks conduct their business. The credit policies that were previously in use before the economic downturn were put aside for new policies that would assist in mitigating risk for the banks. This assisted the banks in turning the tide. The new screening measures for credit customers were improved. Credit became tight and people could not afford to access credit and this resulted in most retailers sales declining as people became reluctant to spend.
LIST OF REFERENCES


Zorn, T. 2008. *Designing and conducting semi-structured interview for research.* Paper prepared for Waikato Management School,
ANNEXURE 1

RESEARCH QUESTIONNAIRE

1. Biographical questions

Which institution do you work for?

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How long have you been working for them?

☐ 0 - 3 years ☐ 4 - 7 years ☐ 8 to 10 years ☐ 11 ≥ years

What is your current role/and position in the organisation?

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How long have you been employed in this role?

☐ 0 - 3 years ☐ 4 to 7 years ☐ 8 to 10 years ☐ 11 ≥ years

2. Impact of Economic downturn on Banks & BEE deals

Please tick ☑ on your chosen answer

Was your Institution impacted by the Economic downturn?

☐ Yes ☐ No

How has the tightening of credit impacted your institution?

☐ Severely ☐ Moderately ☐ Mild ☐ No Impact

If “Moderate” or “Severely” explain what measure were taken by your institution to minimise the impact?

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Has Economic downturn alter your institution perspectives on BEE?

☐ Yes ☐ No

If the answer is Yes How?

Beside BEE what other factors of the downturn have impacted your institution?

What can be done, if anything to prevent these factors from reoccurring?

Considering the impact of the economic downturn is your institution financially sound at present?

☐ Yes ☐ No

Explain your answer

Did the finance of BEE deals impact your institution bottom line?

☐ Yes ☐ No
Explain your answer…………………………………………………………………………………………

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What has been learnt, if anything, from the economic downturn by your institution?

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3. To ascertain impact of BEE funding

What funding mechanisms are available when financing BEE deals?

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Which one of the mechanism does your institution favour and why?

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How sustainable is this preferred method during turbulent economic cycle?

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How do you determine a successful BEE funding instrument?

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In your personal opinion, which is currently the best BEE deal in the market and why?
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Does the structuring of a particular deal play a role in the success of the business?

☐ Yes ☐ No

Explain your answer?
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4. **To ascertain risk exposure of Banks to BEE**

How much is the institution’s BEE credit portfolio worth? \((R)\) billion

☐ 1-10 ☐ 11-20 ☐ 21-30 ☐ 31-40

How much of this book is in distress due to the economic downturn?

☐ 0–5% ☐ 6-10% ☐ 11-15% ☐ 16-20% ☐ 21-30%

How much of this book has been listed as bad debt?
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In your opinion, what could be the cause for non performing loans?
Does interest rate fluctuation play a role in hindering servicing of a debt?

☐ Yes ☐ No

If the answer to the above is “yes,” explain how?

How is your institution dealing with impairments?

Do you consider financing of a BEE deal risky?

☐ Yes ☐ No

If the answer to the above question is “yes”, explain why?

In your opinion, are there any special factors that should be taken into account by lending institutions before extending loans to BEE companies?

☐ Yes ☐ No

If the answer to the above question is “yes,” explain why?

What recourse do banks have to their disposal, should BEE company not honour their loan obligations?
Is there a way that lending institution can reduce their exposure to risk?

☐ Yes ☐ No

In your view, can Banks refuse to finance BEE deals?

☐ Yes ☐ No

Explain your answer

Has the legislation play a role in mitigating some of the above risk?

☐ Yes ☐ No

Has your institution changed it lending criteria to BEE clients, as a result of economic downturn?

☐ Yes ☐ No

If the answer to the above question is “yes”, explain why?

How have these BEE companies been servicing their debt?
Did your institution require collateral?

☐ Yes ☐ No

If the answer to the above question is “yes” has it been sufficient to cover the debt?

5. To ascertain the sustainability of BEE deals in tough economic climate

In your opinion, are BEE deals sustainable?

☐ Yes ☐ No

Explain your answer.

What are the signs of a sustainable BEE deal and/or company?

Does choosing a certain financing structure have an impact on success of BEE sustainability?

☐ Yes ☐ No

If the answer is “yes”, explain how.

What should be the reason for this sustainability?
Do you think partnership can be utilised to improve sustainability?

☐ Yes ☐ No

If the answer is “yes” explain how.................................................................

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Can government institutions be utilised to support BEE?

☐ Yes ☐ No

Explain your answer.........................................................................................

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