

The altered anatomy of an international transaction in South Africa-the impact of equity laws.

By:

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Introduction

The South African law of contract and international business transactions regime is steeped in the common law tradition. For many decades it has been business as usual with individuals/companies having liberty to enter into transactions or hire employees regardless of whether their actions are unfair or prejudice the native populations of the country. The facts of South Africa's history of economic inequality and the legacy it presents are well known and its effects will be discussed here. In an attempt to address this anomaly the post-apartheid government has made it a priority to enact a number of equity laws that mandate businesses in various sectors to have a certain percentage of their equity in the hands of black people. This situation behoves the questions whether or not these laws have a negative effect on international transactions in South Africa and whether or not changes should be made in this regard?

Legal and Political Background

The most well publicized legal interventions to South Africa's income and social inequality have come through the Reconstruction and Development Programme (RDP) of 1994 and Broad Based Black Economic Empowerment Act 53 of 2003¹ popularly known as "BEE".

Recent statistics provided by both the South African Institute of Race Relations², Statistics South Africa point to a renewed intensity in economic inequality in spite of fervent attempts to redress this anomaly. Palpable marginalization of black people remains in all key sectors of the economy³. Let us use the example of mining as a microcosm.⁴ Historically major mining houses had a monopoly over the mining industry. The official apartheid laws meant that black people and mining communities were excluded from participating in the mainstream of the economy. Post-apartheid the mining industry formally declared its intention to adopt a proactive strategy of change, to foster and encourage BEE and transformation at the tiers of ownership, employment equity, skills development and management⁵. Stakeholders in this industry stressed that it was imperative to address

¹ This came into effect on 9 January 2004

² Frans Cronje, Project Manager, South African Institute of Race Relations writing in the Business Day 28 November 2007

³ South Africa has a multifaceted economy but key sectors include mining, energy, tourism, agriculture and manufacturing in different specialties.

⁴ Darryl Levitt –*Structuring Black Economic Empowerment(BEE) Transactions in the Mining Sector in South Africa*-Working Paper from Fasken Matineau DuMollin LLP

⁵ supra

historical and social inequalities as stated by the Constitution of the Republic of South Africa⁶

The current framework and its effect on transactions.

The new framework basically means that there are a number of benefits that come with being an empowered company such as access to government funding and preferential procurement status. There are a variety of forms of BEE enterprises which have forever altered the anatomy of a typical South African transaction whether it involves local or external companies operating in the republic.⁷ They are as follows;

(a) Black Owned and Black Controlled Enterprise (b) Black Empowered Enterprise (c) Strategic Partnerships (d) Black Women-owned Enterprise (e) Broad-based Empowerment. The different categories indicate the different thresholds which qualify a company as being “empowered”.

Certainly a company doing business in South Africa cannot avoid its equity obligations under the BEE Act or a plethora of other laws dealing with employment equity.⁸ A company operating in South Africa therefore finds itself faced with a social responsibility in spite of its over-arching intention to make a profit. There have been comments comparing BEE Charter requirements to those of India in the 1970s⁹ during which period the socialist government feared that the country’s economy would be dictated by multinational companies. All MNCs were required to either sell 60 per cent of their equity to local investors or disinvest with the result that Coca-cola and IBM were forced to disinvest¹⁰. The issue becomes whether transacting in this environment is worth the effort and whether this has a negative impact on Foreign Direct Investment (FDI) in South Africa.

Based on constitutional principles and statistical figures I aim to prove that BEE laced transactions and companies are not a hindrance but rather a positive development for investment and the lofty aspirations of reducing poverty and inequality.

First, the South African empowerment charters are not nearly as severe as the Indian regulations of the 1970s. The main objective of South Africa’s equity laws is to reverse the inequalities of the past. The concerns over vagueness and lack of clarity and consistency with regard to BEE Charters and Regulations are obviously justified.

Second, global constitutional and international law principles point to a trend where the impunity of the past where businesses were able to conduct business and transact in a particular country regardless of the consequences for locals has been unequivocally

⁶ Act 208 of 1996

⁷ See note 4

⁸ E.g. the Employment Equity Act, 1998

⁹ www.southafrica.info/doing_business/investment-survey

¹⁰ Empowerdex Working paper-The Effects of Black Economic Empowerment (BEE) on Foreign Direct Investment (FDI) accessible at www.empowerdex.com

rejected¹¹. South Africa's business framework has generally been pro human rights post-apartheid to the point where there is an express prohibition on "sweat shops' and other violations of international labour law principles¹².

Third, despite the apparent perceived negativity surrounding BEE and its perceived negative effects on FDI the sheer volume of transactions on the South African business landscape continues to soar¹³. The most recent statistics available point to the fact that there has been a significant rise in transactions in all sectors. The value of mergers and acquisitions (M&A) involving South African companies climbed by R103-billion [Exchange rate is US\$1=R8] or 63%, from R165.5-billion in 2004 to R269.1-billion in 2005, according to Ernst & Young's 2006 review of Mergers & Acquisitions activity worldwide.

Crucially, according to Business Day South Africa's leading business daily newspaper, R57-billion of this was "inward investment" - an amount equal to the foreign direct investment (FDI) in South Africa of the previous five years combined - helping the country to edge past India for the first time ever in the FDI stakes. British bank Barclays bought a majority stake in South African bank Absa for close on £3-billion (around R30-billion) in 2005 - the biggest single foreign direct investment ever in the country.¹⁴

Not long afterwards, British communications giant Vodafone concluded a US\$2.4-billion (around R21-billion) deal that gave it an 84% stake (and 90% effective voting interest) in South African investment firm VenFin, and through this access to VenFin's 15% stake in South African mobile phone operator Vodacom.¹⁵

According to Ernst & Young, these two deals "potentially represent the beginning of a new era of investment [in South Africa] that should send strong signals of confidence to other potential investors." At the same time, the value of black empowerment (BEE) deals in South Africa reached their highest level ever - R56-billion - in 2005 even though the number of BEE transactions dipped slightly, from 243 in 2004 to 238 in 2005.

¹¹ Among others these conventions affirm the rights of individuals to a worthy livelihood;

CEDAW: Convention on the Elimination of All Forms of Discrimination against Women

CRC: Convention on the Rights of the Child

ICCPR: International Covenant on Civil and Political Rights

ICERD: International Convention on the Elimination of All forms of Racial Discrimination

ICESCR: International Covenant on Economic, Social and Cultural Rights

¹² Incorporated in the Labour Relations Act, 1995 and the Basic Conditions of Employment Act, 1998

¹³ Foreign Direct Investment Soars 5 April 2006 accessed on

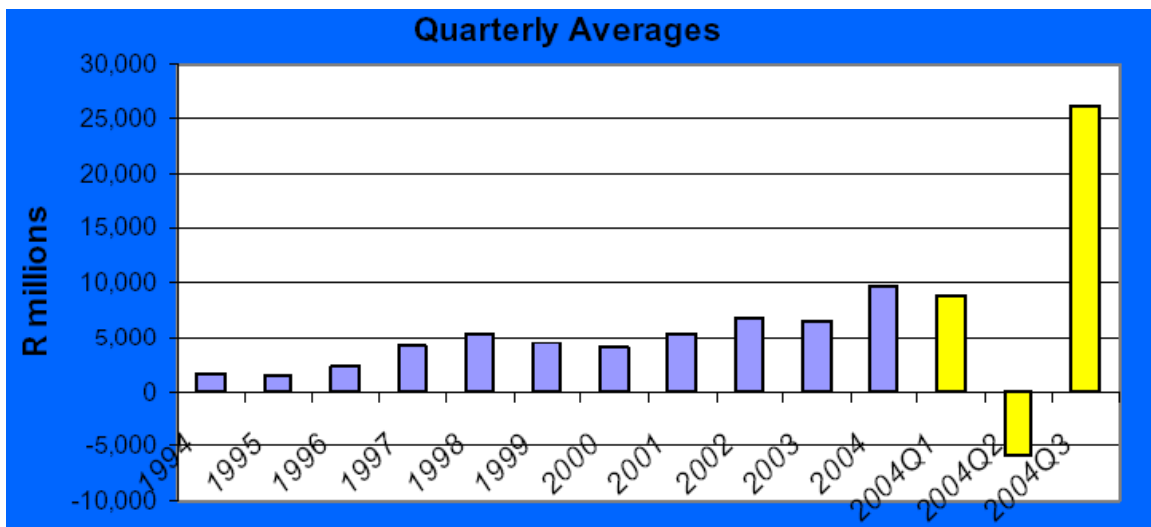
www.southafrica.info/doing_business/investment/fdi

¹⁴ As quoted on http://www.southafrica.info/doing_business/investment/fdi-m&a2006.htm

¹⁵ Ibid

According to Business Report, the biggest BEE deal of the year - and South Africa's biggest to date - was struck when resources giants Anglo American and Kumba Resources announced a R25.7-billion deal establishing the country's largest wholly black owned, controlled and managed company.¹⁶

The table below is illustrative of the positive trend



Fourth, a report released by McKinsey Global Institute in 2004 found that both the incentives used to attract foreign direct investment and the restrictions placed on it do not affect levels of foreign investment. McKinsey's studies show that the primary considerations of multinational companies (MNCs) when investing abroad are the following; quality of infrastructure and labour force, size and growth of the domestic market and the accessibility of the location. Thus FDI has a stronger correlation to business and economic confidence than the regulatory framework. Therefore the point is made that incentives such as costly tax breaks, import duty exemptions and other incentives do not necessarily work.

Conclusions

The advent of equity legislation regulating business in South Africa is not a development to be feared by the international business community or treated with suspicion and loathing. It is a welcome development which makes South Africa (Africa's largest economy) a very

¹⁶ Ibid

useful conduit for doing business with the rest of the African continent. Furthermore it affirms South Africa's constitutional transition as not just empty political rhetoric but as quantifiable in real terms that affect the poorest of the poor. Therefore the altering of the nature of a transaction to cater for marginalized communities is a step in the right direction to be emulated by other affected jurisdictions in countries with large income gaps.