

## Mining Indaba

EXXARO CEO, Mxolisi Mgojo

**Sustainable empowerment for black value creation and economic transformation**

Good afternoon ladies and gentlemen

It is an honour to be here at the *2017 Investing in Africa* Mining Indaba. It's been a positive start to the year, following a tumultuous 2016, which for us included the milestone achievement of EXXARO's 10<sup>th</sup> anniversary since its creation and listing on the JSE on the 28<sup>th</sup> of November. The anniversary also marked the coming to an end of the company's BEE ownership structure through the Mainstreet 333 consortium. As a result, we had to consider a replacement BEE structure. For EXXARO, empowerment through broad-based black ownership is a strategic imperative, alongside the other transformation pillars of the Mining Charter and BEE Codes of Good Practice.

I'm standing in front of you today as an EXXARO invitee, but will be speaking to you as a corporate citizen participating in the discourse on radical economic participation. You would have read in the media various perspectives on the restructuring of our black ownership structure, which will result in a reduction from a **gross** 50% to a **gross** 30% broad-based ownership level.

The concerns raised by commentators are not about EXXARO, but rather point towards larger unresolved issues in relation to transformation of economic ownership in the country. Our response and position is that we will

develop and lead this conversation in an attempt to collectively address these concerns, not only for EXXARO but for future empowerment transactions in the country. It is our contribution to powering the possibility of a better life for all in South Africa.

Our goal is to create sustainable black ownership, which reinforces the foundation of transformation, whilst adhering to the spirit and ambition of legislation. Investing in our country and the continent at large, and mining in particular, for long term sustainability is something that is very close to my heart. **But** will we go far enough to overcome our biggest societal challenges and achieve the kind of transformation we all so yearn for and desire?

I need not point out to you that the South African economy is one of the most unequal of the world's nations, registering close to 0.7 on the Gini co-efficient – a statistical scale where 0 represents all people having the same income and 1 indicates maximum inequality. **In other words, 1 is a situation where, one individual captures all the income in a country and the others have none.** South Africa's consistently high Gini coefficient indicates that a small group continues to earn more income than vast majority of the population combined. I also need not spell out to you the risks that such economic exclusion and inequality means for South Africa, and in particular in our mining communities, which are already hot beds for social and political unrest.

French economist Thomas Piketty made this point in the opening paragraph of the first chapter of his book, *Capital in the Twenty First Century*, by citing Marikana as an example of how extreme inequality leads to violence if not addressed.

### **Let me start by providing a brief historical perspective of BEE in South Africa.**

In order not to repeat such shocking tragedies it is worth reminding ourselves of the historical evolution of the South African economy, which has been predicated on the “domination, exploitation and marginalisation of the black majority”. This is a quote that comes directly from the BEE Commission Report of 2001, which was the first attempt at a blueprint for an empowerment policy framework.

The Commission was created against the backdrop of the so-called first wave of empowerment, which up to that point had been a programme set by traditional white business. That first wave of empowerment produced seminal companies like NAIL, established and led by Dr Ntatho Motlana, often considered a father of empowerment. That first wave also included the likes of Real Africa, led by one of South Africa’s great entrepreneurs, Don Ncube, and Johnnic Communications, whose restructuring became the vehicle that turned MTN into the global emerging market and telecoms champion it is today.

The problem, though, was that it was clear there was something shaky about empowerment as it was shaped then. The Black Management Forum knew this and pushed for the establishment of the Commission, so that black entrepreneurs, professionals and policy makers could be the drivers of a vision of sustainable empowerment.

In the report, the then Chairman of the Commission and now Deputy President of South Africa, Mr Cyril Ramaphosa said: “The BEECom report presents South Africa with an opportunity to break the cycle of under development and continued marginalisation of the black majority from the main stream economy.” The report itself defined BEE as an **“integrated and coherent socio-economic process that aimed 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. It sought to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity”**.

It is against the backdrop of these ideals that today I would like us to consider why we, as leaders of (1) some of the country’s largest employers, (2) policy makers and (3) value creators, should reassess current empowerment initiatives. We must honestly evaluate what has worked and what has not. The

question we must ask ourselves today is this: **Have we empowered those entrepreneurs and professionals to be the drivers of sustainable empowerment and economic transformation?** Only through honest reflection and debate can we hope to create new sustainable BEE structures that will benefit the people of our country well into the future.

**The challenges of BEE remain and there have certainly been numerous missed opportunities.**

One of the key challenges of the first wave of empowerment was that on the surface these entrepreneurs had built impressive looking black-owned and controlled conglomerates. However, many turned out to be unsustainable, controlled by the whims of financial markets and the understandable profit motives of the funders. Many of them collapsed under the suspect chemistry of their financial alchemy.

Unfortunately, we do not seem to have learnt the painful lesson of these collapses. **This may be largely because there are no easy answers.** Capital, of whatever nature, accumulates by allocating it to productive assets that provide a rate of return consistently higher than the cost of that capital. The challenge, of course, is that most black entrepreneurs had no capital and therefore most empowerment structures were designed to provide an equity return where there was no actual equity ownership.

**It was a recipe for tears and frustration and that is precisely the experience of BEE.**

There is a second related lesson that we seem to have forgotten: namely, that the BMF's call for a Commission for the empowerment of black people was about determining sustainable options. In designing legislation to effect BEE and in providing financial leverage in the absence of black capital and collateral, we inadvertently disempowered professionals and entrepreneurs, and made them subject to the very external forces that had brought down the first wave of empowerment.

Further, mining is cyclical. So if a transaction was structured at the bottom of the market, when commodity prices are low, and matured in an up-cycle, then as black shareholders you have hit the jackpot. You saw the value of your gross investment in the transaction rise over the years, thus allowing you to sell a partial or whole interest at a profit and pay off the debt after the lock-ups have expired.

**But**, if you were off on your timing and locked-in without any liquidity options, the chances of successful black value creation diminished exponentially. For many companies that concluded their empowerment transactions before the financial crash of 2008, the journey for the black shareholders has been

disheartening. Restrictive lock-up periods have frustrated black investors from reducing debt at opportune moments. Poor investment strategies, unintended legislative consequences and highly-encumbered deal structures have disenfranchised empowerment shareholders and destroyed value.

Over the eight years to January 2016, the JSE Resources 20 Index lost just over 70% of its value, before starting to recover. The casualties from poor mining BEE structures during this period are numerous, with significant value lost due to the inability to trade.

The companies that have survived understood the need to quickly create equity rather than perpetuate debt structures by focusing on a favourable capital structure. It is true that, in the main, their net ongoing shareholding in the traditional white companies in which they were invested reduced. However, they are still around today and they represent real, tangible net black wealth. Importantly, they represent institutional black capital formation. These are companies with senior black managers and black professionals, which are participating in the economy on their own terms. Among their ranks are African Rainbow Minerals, Kagiso Tiso Holding (KTH), Mineworkers Investment Company, Wiphold, Pembani and the Women's Development Bank (WDB), to name just a few.

What is common about all of these companies is that their black-owner managers were able to exercise independent commercial decisions, to restructure their empowerment structures, often with the result of lower equity representation in the original transactions but with the result that they became independent operational entities. Owners of the means of production, if you will, are now able to allocate capital to productive assets and grow their capital base. Some like ARM have been able to extend into financial services on a sustainable basis. KTH is a company that has grown strongly and is also a significant owner of media assets.

**We must learn from the past if we are to radically transform our economy and create hope for the next generation.**

It would be a crying shame if we continued to repeat the mistakes of the past as this will stifle our goal of radically transforming our economy and creating much needed hope for our children's future.

It is for this reason that the trajectory of black ownership must move towards less encumbered black equity shareholding at a significant – even if not majority – ownership level. Much work is going into finding the right balance between the size and level of black ownership with appropriate funding structures. Less rigid structures, that limit the cost and dilution to minority shareholders, will ensure that the business is more sustainable and able to



invest for future expansion. These more flexible and less geared structures are being designed to better enable black shareholders to maximize their returns, and end up with positive net equity position after equity facilitation and debt has been paid off.

By preserving net asset value, black investors will be better positioned to facilitate more empowerment and even market related transactions as well as reinvest in their businesses. Their companies will have larger capital reserves to invest in new projects for future growth. This means that more transactions will be sustainable in the long term, all the while also adhering to the national objectives of empowerment and transformation of the economy.

The conversation needs to move from rigid, reductive and restrictive ideas about fixed black equity in white companies. After all, are we really saying that we want a country where the demand is 30% or 40% black ownership regardless of the size of the company? Surely we can be more sophisticated than believing that an initial 26% black shareholding of a R6bn company must remain at 26% black shareholding of the same company that has grown to R100bn in value? What matters surely is the progress we make in the following key areas: -

- Over time, have we increased the enterprise or net asset value of black entities in the economy?

- Over time, have we increased the rate of corporatisation of BEE shareholding, converting black equity in traditionally white companies into independent black managed and controlled companies that are able to drive capital formation?
- And lastly, over time, the overall levels of black wealth better align with the demographics of the country

At the core of these issues are conversations that are deeply emotional and political on matters that are technically, economically and financially complex. Difficult trade-offs are needed to overcome funding constraints. Black business people and entrepreneurs who have set capital aside need to be encouraged to invest and reinvest in empowerment structures and the rest of the economy. They should, however, not be shackled or disadvantaged relative to other shareholders. Ultimately, they should be encouraged to build and be the major empowerment champions of this nation.

**To address these challenges, better co-operation is required between government, business and the whole financial services and investment sector to collaborate towards an honest intent of true empowerment which will achieve the ambitions I have outlined above.**

As a country, we must relook at policy interventions to ensure that these are not too restrictive for entrepreneurs and enterprising entities, thus stifling job creation; that they do not unintentionally create a permanent underclass or that they cripple our society and encourage corruption and fronting. We must agree on the purpose of economic transformation – **is it to create real wealth and value and for whom?** What is clear is that the debate cannot just be about regulatory compliance.

**As I conclude,** there is an urgent need for clarity on the goals of empowerment policy and legislation, particularly regarding the building of black wealth - we are confusing issues around the level of black control and ownership of the economy as a transformation imperative.

Policy must be enabling, rather than prescriptive, by acknowledging the milestone achievements in transforming our economy and addressing the remaining obstacles for further progress. The lessons of the past 24 years have shown that while we must remain ambitious in our transformation efforts for our economy, we must also be realistic, pragmatic and focus on achievable solutions. In addition, the country needs selfless, bold and visionary leadership who will maturely grasp with the difficulties of transformation but provide the required direction on wealth creation and efficient policy implementation for the creation of black industrialists and encourage broad-

based empowerment. **It's not a case of either one or the other.** This is a balancing act of short term needs and long term aspirations, shared risks and benefits, and critically also hard work and sacrifice. We must ensure that more black shareholders end up with high levels of net equity so that they are able to reinvest and create even more value for more people.

BEE is a national policy and fundamental tenant of transformation - it is right that citizens should have a say on how companies are embracing and promoting it. But it is incumbent on all of us to ensure that those conversations and those opinions should be informed, evidence-based and underlined by economic and financial reality, balanced with political aspiration and societal ambition.

I am saying that, yes by all means, let's talk about the evolution of BEE but let the conversation be less emotional and reactive and more measured, informed and constructive. We are at a defining moment in our history and the country's future depends on what we do now. Ultimately, we must achieve sustainable black ownership to ensure ongoing business development, economic growth and employment creation and social development for a better life for all in South Africa.

I've said this before, I want to be part of this conversation, as we find new solutions and create new paths into the next phase of economic transformation and sustainable ownership of the country's economy.

Thank you very much for listening

**END**