How Disinvesting Corporations Could Foster Economic Empowerment of Black South Africans

by Millard W. Arnold

For obvious reasons, majority rule is the issue on which black South Africans and all those who believe in a democratic alternative to apartheid have focused priority attention. A critical corollary priority not yet adequately addressed is the need for a strategy to achieve black empowerment in the country's economic mainstream. There are various mechanisms by which foreign corporations now withdrawing from South Africa in increasing numbers could assist toward this end. Two of these options warrant special attention at this time.

Scope of the Problem
As a consequence of apartheid, black business does not exist in any meaningful way in South Africa. It is estimated that black business contributes less than 1 percent to South Africa's annual GDP of over R200 billion. Although blacks account for nearly 80 percent of the population and 50 percent of the purchasing power in South Africa, they only have 2 percent of the assets and make up less than 4 percent of the managerial force. Indeed, one company — South African Breweries — is reputed to be capitalized at more than all the black businesses combined. There are no black insurance companies. South Africa's one black bank ranks 46th out of 60 in total assets and 41st out of 60 in total deposits.

None of this is surprising. Only in the past decade have black South Africans been permitted the opportunity to form companies legally, operate service industries, expand horizontally, and trade in the central business districts. After centuries of denial and neglect, a decade of limited opportunity is hardly sufficient to develop a proper base for strong economic growth.

The two essential ingredients necessary for major black economic empowerment — capital and expertise — are in extremely short supply among black South Africans. The expansion of black enterprise is, and will be, a painstakingly slow process. Real, sustainable, long-term growth is only possible through the gradual development of a vibrant business class and the accumulation of sufficient investment capital.
From Affirmative Action to Disinvestment

Many of the U.S. and other foreign-owned companies that have operated in South Africa pioneered affirmative action programs aimed at improving black working conditions, and more recently began to institute community development and social justice projects. By early 1988, largely in response to growing pressures from antiapartheid organizations and stockholders, but also to a downturn in South Africa's economic outlook, 155 U.S. companies had elected to terminate their direct operations. Most of the disinvesting companies withdrew in a fashion that permitted them to retain a niche in the marketplace. In a 1987 report by David Hauck of the Washington-based Investor Responsibility Research Center, it was noted that, by and large, companies that had terminated direct operations in South Africa did so in one of three ways: (1) by folding the business and selling off the assets; (2) by selling the business to a South African or European company; or (3) by selling to local managers through a management buyout. In each category, but particularly the latter two, an essential component of the sale is a licensing agreement that permits the disinvesting company to continue to sell its product in South Africa through the purchasing company.

Given the relative lack of blacks with expertise and financial muscle, and because so few companies had significant numbers of black managers, blacks were not parties to management buyout schemes, much less in a position to purchase the assets or the disinvesting company as a whole.

The Ford Model

In the latter part of 1986, as Hauck points out, a new method of withdrawal was devised whereby a foreign company establishes a trust to which is transferred the ownership and assets of its South African subsidiary. The trust is generally obligated to pay the parent company for the assets, but the payment period may not be fixed. Many of the trust agreements include an option for the parent company to repurchase its assets, thus leaving open the possibility of reestablishing a direct in-country investment position. The Ford Motor Company broke new ground by using the trust agreement option in a fashion that enabled black South Africans to gain significant control over a major economic entity.

In its disinvestment negotiations, Ford determined that both the black community and the company's employees should benefit from the transfer of assets and that the employees should have a say in future management of the company. Twenty-four percent of Ford's equity was vested in a trust, through which employees are to own shares of the company. The dividends of the trust do not go to the employees; rather, they are to be used for development projects nationwide. Through their share in the ownership of the company and guaranteed representation on the board of directors (two of the directors are black), all employees have a vote in management.

While the Ford formula advances the cause of black economic empowerment, it has its limitations. Seventy-six percent of the equity remains in the hands of whites. Although employees (through their stock ownership) now have a voice in company policy, that voice may be illusory. Two black members on the board of directors is an important step forward, but their influence will depend on the overall size of the board.

Why The First Priority Is Ownership

While trust arrangements can compensate for the two major impediments to black economic empowerment (lack of managerial experience and lack of adequate capital), there is another fundamental issue that must be addressed in any overall strategy.

When the issue of black empowerment is raised, it is usually implicitly understood that blacks should be in a position to assume managerial control of disinvesting companies or existing South African corporations. But the reality is that there simply is not enough black managerial expertise to go around. What also is often overlooked and may be infinitely more important is that ownership is much more meaningful than managerial control. After all, owners can always hire expert managers.

The purpose of black empowerment is to ensure that blacks benefit from corporate profit. The long-term best interests of black South Africans may not be served if managerial control of a vibrant, ongoing concern ultimately results in a diminution of profitability because of a lack of adequate managerial expertise. If there is no profit, there is very little that can be accomplished to further black economic growth.

The priority for blacks, therefore, should be ownership. By assuming ownership, blacks can have a decisive say in corporate policy, and be in a position to
achieve many of the social goals that the black community desires and believes the corporate community should promote.

Ownership in and of itself is no guarantee that management can be adequately supervised and no guarantee that profits will be realized. An ownership that knows nothing of the business is not in a position to develop or enforce corporate policy. Moreover, the ownership will remain at the mercy of management, which can have disastrous results. This was clearly demonstrated when the senior executives of the African Bank — the only black-owned South African financial institution — were charged with foreign exchange violations.

It is conceivable that South Africa can have both knowledgeable black ownership and competent black management. Indeed, it is implicit in the concept of black economic empowerment. Realistically speaking, however, there is just not enough of a broad-based black business class for that goal to be attained in the near future. In these circumstances, the urgent priority in maximizing black influence in the economic sphere is ownership.

The Pros and Cons of Options

(1) Charitable Trusts. One promising option in furthering black ownership is a nonprofit economic trust composed, at a minimum, of community leaders and those blacks (businessmen and others) who currently sit on the boards of directors of foreign and South African corporations. The mandate of the trust would be to utilize the assets at its disposal to develop managerial training programs; develop skill training for black entrepreneurs; assist in expanding black business opportunities; and aid in nationwide development projects. For those services, the trust would receive a commensurate portion of the dividends generated by the assets it holds. In addition, in those instances where the trust acquires a substantial portion of the equity in a disinvesting company, the trust would monitor the local management to ensure that it continues to support various affirmative action programs.

This approach is premised on the belief that sophisticated business knowledge, while limited, does exist in certain segments of the black community. By concentrating in one entity the best business skills in the black community, black South Africans can overcome the disadvantages that tend to limit their impact on large, multinational operations. With their diverse experience internationally and on boards of directors, they are the repository of the corporate culture in black South Africa, and are therefore in a position to provide the proper corporate guidance.

The trust would become the vehicle for black efforts to acquire controlling shares of disinvesting companies or more sizable percentages of the ownership of domestic South African companies. Moreover, given its composition, the trust's leadership would be in a position to combine ownership with management and oversee a disinvested company's senior executive staff. For those entities in which employees elect a stock-ownership plan, the trust, together with employee representatives, could serve on the board of directors. In addition, the trust could be an appealing vehicle to a disinvesting company seeking a black entity in which to vest some or all of its equity.

Should the trust enter the arena of leveraged buyouts, however, obtaining financing for the remainder of the purchase price not secured by the assets of the disinvesting firm could prove far more difficult. Although the composition and acumen of the trust and the proven profitability of the disinvesting company may be attractive, it is not clear that this combination would be enough to raise the capital necessary to acquire the substantial assets of many of the disinvesting corporations.

There are various ways in which this difficulty might be overcome. Conceivably the trust could borrow from the disinvesting parent on advantageous terms, enter into venture capital partnerships or joint venture agreements, or seek financing from abroad. In the latter regard, the Comprehensive Anti-Apartheid Act of 1986 expressly permits U.S. firms to lend money to black-owned businesses. This provision can be utilized to enable blacks to purchase the assets of disinvesting corporations. In addition, a venture capital fund patterned after the small business investment companies of the U.S. Small Business Administration could be established through an amalgam of corporate contributions or, if permitted, the seed capital for such a fund might be contributed by USAID. In any case, much more thought is needed to develop creative methods of financing black corporate buyouts.

Yet, whatever its merits, the trust option could face considerable difficulties within the black community. There is a strong belief that business — whether black or white — is inimical to the liberation struggle. Indeed, a variation on the theme that is proposed here is for a company to transfer its assets to a trust that includes an employee profit-sharing plan. It has been argued that offering employees bonuses under a profit-sharing formula would prove more attractive to union leaders and the rank and file. In fact, however, just the opposite seems to have been the case, at least until recently. As David Hauck notes, many union leaders have been decidedly cool to the idea of employee stock-ownership plans, pointing out that such schemes, "if confined to a relatively small number of companies, would divide the working class into those who own capital and those who do not. The ability of unions to carry out strikes for political objectives would be undermined because worker/owners in all likelihood would not participate in strikes for fear of jeopardizing the company's profits."

It is in this connection that the Ford trust arrangement is so important. Although the receiving trust was not composed of black business leaders, it included a profit-sharing plan and nonetheless won the endorsement of the Congress of South African Trade Unions.
(COSATU). This turn of events seems to suggest that opposition to this means of increasing the economic power base of black South Africans may be gradually diminishing. In light of the concerns of political and labor leaders, the idea of a charitable trust formed to promote the best interests of the black community may prove far more attractive and may become a key vehicle for accelerated economic growth.

(2) Industrial Worker Cooperatives. A second and equally viable option for black economic empowerment is a range of employee-ownership alternatives, in particular the democratic-based worker cooperative in which a substantial majority of the ownership is held by the employees and the board is elected on a one person, one vote basis.

The major difference between a worker cooperative and a share corporation, as David Ellerman of the Investment Cooperative Association has noted, is one of personal rights versus property rights. In theory, democratic worker-owned firms have all the strengths of traditional share corporations: strong management, adequate financing, and profitable markets. Unlike conventional corporations, voting and profit rights in a worker cooperative are personal rights that accrue to the employees of a company. Because these rights are personal and come with membership in the cooperative, they cannot be sold or transferred in the manner of a share corporation.

A company considering disinvestment might wish to explore with union officials the possibility of establishing a worker cooperative to acquire the assets and assume control of an ongoing, viable economic entity. The receptivity to such an approach may be greater than expected. In principle, the idea of worker ownership fits into COSATU's advocacy of workers' control. Although COSATU supports the idea in the abstract, it is hesitant about implementation for fear that it would be seen as an aspect of the government's attempt to create a black middle class with an investment in apartheid. COSATU is therefore concerned that any worker cooperative be democratic and controlled by individuals who share common political and economic objectives.

Because the fundamental strength of the worker cooperative is membership based on democratic principles, profits are distributed in an equitable manner (e.g., proportionate to pay or hours of work). The profit incentive remains, but it is now structurally assigned to the employees in such a way that they have meaningful control over their work lives.

Given the suspicion of traditional capitalist structures, an industrial or worker cooperative model could have substantial appeal to large numbers of black South Africans. Worker cooperatives tend to be more integrated into the local community, providing a form of solidarity, stability, and longevity to the work place that is lacking in other forms of ownership. Moreover, there are seemingly few legal hurdles to the establishment of worker cooperatives because South Africa's trust and pension laws provide a suitable legislative framework by which control of an existing or disinvesting corporation can be garnered.

In the evolving political and economic environment of South Africa, disinvestment to a worker cooperative with which the company retains a working relationship may prove, over the long run, to be a more attractive, creative, and profitable alternative than current disinvestment approaches.

A Beginning
This paper has explored only two potential devices for black economic empowerment. Other possibilities open for consideration are the South African government's recent commitment to privatize certain public-sector holdings, and various methods whereby the U.S. government, the U.S. private sector, foundations, and development organizations could focus more attention on black economic empowerment. A detailed exploration of these possibilities is warranted. In the final analysis, political liberation can only have meaning if there is true economic emancipation.