



CORPORATE GOVERNANCE IN AFRICA CASE STUDY SERIES: NO 7

AN EXAMPLE OF THE TRANSITION FROM BEING BEE COMPLIANT TO BREAKING CORPORATE GOVERNANCE RULES

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Dumpinghead and the BEE

Thomas Dumpinghead looked excitedly at the certificate. The company he had helped build from a corner electrical outfit to a multimillion rand company had finally cracked the BEE nod after five years of trying. Billard (Pty) Ltd was now certified as a BBB/Level 5 contributor. He could now qualify to do business with the government and some of the bigger corporations which had insisted that unless he was BEE compliant, he could not do business with them anymore.

His management team and the Board of Directors had all put a great deal of time and effort into ensuring targets determined by various sectors were met. Meetings were held with various stakeholders during and after hours. Contracts and deals were concluded and signed to everyone's satisfaction.

'A good achievement indeed,' he said proudly to himself.

He was still admiring the certificate on the wall when Blessing Xulu, a former union rep and now their IR practitioner, disturbed him. 'These certificates are so meaningless they are not worth the paper they are written on. What they say about the company and where the company is are two different stories. Surely, this should form part of corporate governance and be audited as strictly as other managerial aspects. In fact I strongly suggest that it does,' Blessing said out loud as he left documentation for signing.

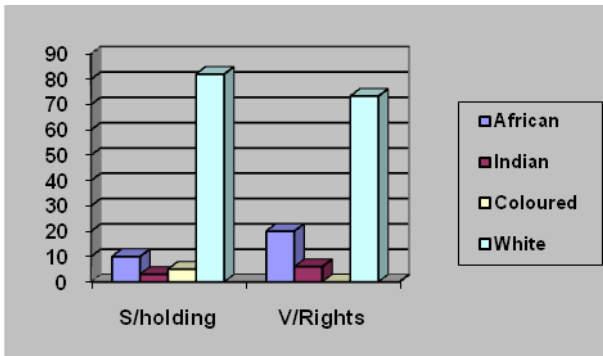
Thomas was caught off-guard. In their effort to be compliant with the BEE Act, had they broken some corporate governance rules? What procedures had been followed? What had not been followed?

Rate BBB/Level 5 contributor -- worth its weight in gold?

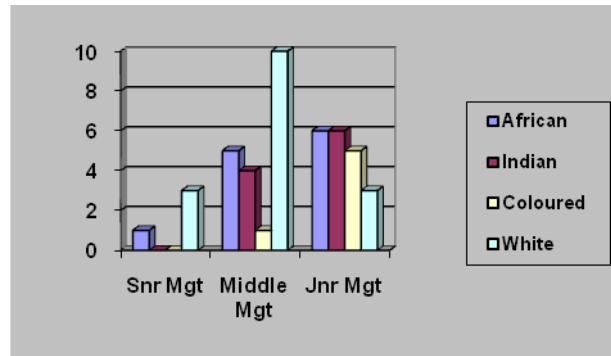
Blessing Xulu's presentation

Blessing Xulu was called to a special meeting to present his claims with facts. After much persuasion and encouragement from colleagues, he accepted. The following is a snapshot of his presentation.

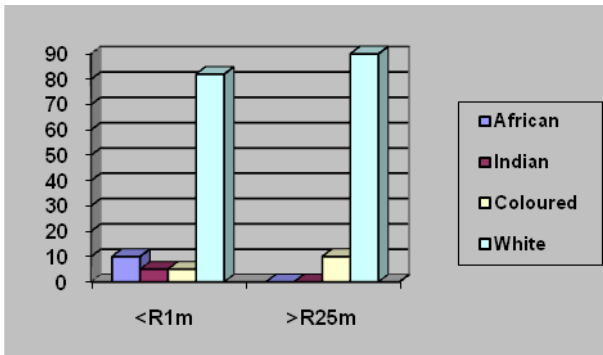
Figure: 1 A snapshot of the BEE at Billard (Pty) Ltd



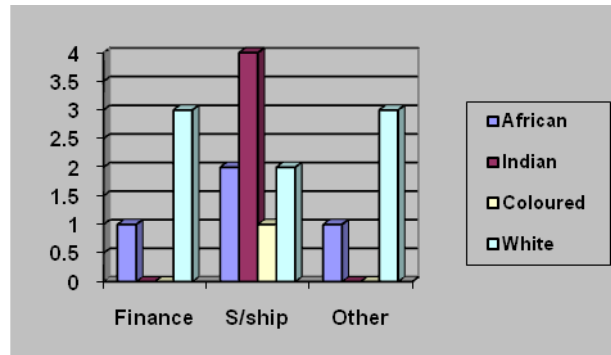
Shareholding & Voting Rights



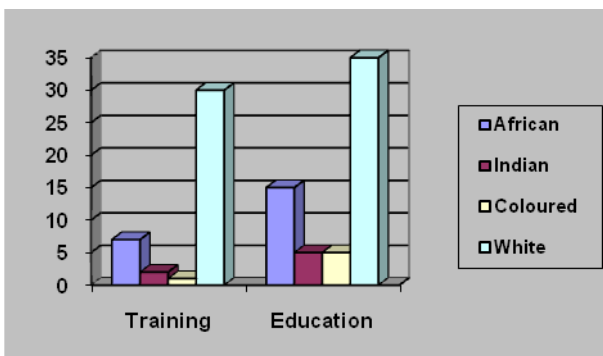
Management Structure



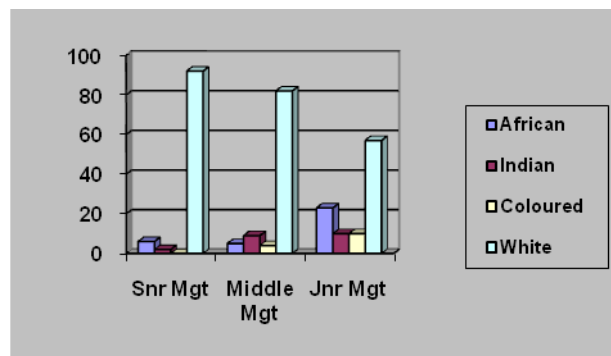
Percentage of BEE Procurement



Numbers of Enterprise Development



Percentage of HRD: Skills Development



Percentage of HRD: Employment Equity

From this presentation, the following major problems in Billard (Pty) Ltd were identified:

Direct Empowerment:

Equity ownership

- **The BEE business partners/shareholders**

When Billard made its intention known of wanting to sell 18% of its shares to a BEE partner, a number of reputable business owners sent forward their proposal, of which two were from an employee consortium. None of these were shortlisted; instead the relatively unknown Peo Ya Thakga won. Peo Ya Thakga was made up of five partners, two of whom had worked for the partners on junior projects. This smacked of tokenism, as these new partners were not independent and did not add any value to the company.

There were questions regarding how they had funded their purchase. Many believed that they had entered a 'buy now and pay later clause' which meant they had no minority protection normally offered to minority shareholders. This raised questions about their ownership.

- **Profiles of shareholders/BEE partners**

Some of the questions raised regarding the partners selected included:

- the true value they added to the organisation
- their independence as Board members
- whether they had the right profile, a good reputation and credibility
- their conflict of interests, in that they were also shareholders of one of Billard's competitors.

The partners (Peo Ya Thakga) comprised the following individuals:

	Background & Role	Education	Skills & Experience	Other Information
Mr Steve Thakga	Founder and Chair	Grade 11	Electrician	Former foreman for Jose Dunvar -- one of the shareholders of Billard.
Mr James Ndou	Co-founder	Grade 11	Accounts clerk	The son of Thomas Dumpinghead's gardener.
Mr Ndumiso Cele	Member/ Director	Grade 12 Business Management Certificate	Taxi operator	A friend of Steve Thakga.
Mr Hugh Booysen	Strategist financer	Engineering degree		An associate of Thomas Dumpinghead.
Mr Mdu Khoza	Unknown	BCom graduate	Internship consultancy	Strong entrepreneurial ambitions.

- **Management**

Appointment of directors as a result of the BEE deal

The functions of these directors were perceived by many as simply to 'rubber-stamp' decisions. It was clear that fiduciary responsibility was in the hands of others and that they could not engage the Board in stimulating debate but had simply to agree with whatever the other members decided. There were accusations of fronting.

Compensation (salaries and benefits) of BEE appointed directors

These directors did not receive payments and benefits similar to the other directors, selected outside the BEE contractor.

Board members and management/leadership

Name	Executive or non-executive	Position
Mr Thomas Dumpinghead	Executive	CEO
Mr Steve Thakga	Non-executive	Chairman
Mr Hugh Booysen	Non-executive	
Mr Roy Austen	Executive	Financial director
Mr Byron Corcoran	Executive	Commercial director
Mr Stuart Arderne	Executive	Engineering director
Mr Shaun Singma	Executive	HR director

Indirect Empowerment:

- **Preferential procurement**

The shareholders and directors were involved in the preferential procurement process even though a procurement committee had been established. The procurement/tender committee's responsibility was to ensure compliance with the following:

- Contracts of more than R5m went out to tender and were publicised in two newspapers in Zulu and English.
- The 80/20 system was to apply on the above tenders/contracts.
- Preference points were to be available on the tender document.
- All required documents were to be attached with the tender document.
- Only the procurement/tender committee was to award the contract or tender.

The audit committee was not allowed to audit the procurement and subcontracting procedures which resulted in a lack of uniformity in procurement documentation and procedure. Two major contracts worth R21m were awarded to a relation of the shareholders by Mr Thomas Dumpinghead.

- **Enterprise development**

The selection process of the suppliers who were to be financially assisted and mentored was defective. The only suppliers who had been offered assistance were linked to Peo ya Thakga, where for 2008 financial year Billard had spent R29m (with only R500,000 spent towards the black owned contractor.)

- **HR development**

Employment equity

Billard's employment equity was 60% below targets. All major components of the employment equity were below 50% as illustrated in the auditors rating certificate.

- **Skills development**

This was ignored even when major shortages occurred in the company and the industry.

In his conclusion, Blessing Xulu described Billard as a company that was all theory but no practice; as a firm that prided itself on its corporate governance yet failed to direct its BEE strategy within this governance. He mentioned his disappointment with the company's failure to align its BEE charter and scorecard with corporate governance and the increased BEE expenditure (see sustainability report below) that did not yield expected results.

Sustainable development report

Indicator	2006	2007	2008
Revenue (R`000)	90,547	143,710	166,437
Trading profit (R`000)	5,707	9,108	19,486
Employees	407	941	1,706
Total training spend (R`000)	10,774	10,483	18,543
Training spend per employee (R)	2,037	1,809	2,494
Lost time injury frequency rate	*	1.4	1.9
BEE procurement (R`000)	11,217	20,095	27,645
CSI spend (R`000)	1,564	2,544	2,997

Management's presentation

After Blessing Xulu had completed his presentation, the following summary of Billard's BEE scorecard was circulated for the Board to discuss further:

BEE Elements	Status/Rating		Target Score
BEE ownership	A	20.7	20
BEE management	D	3.4	10
Employment equity	D	4.6	15
Skills development	C	6.6	15
Preferential procurement	D	4.3	20
Enterprise development	B	10.8	15
Socio-economic development	A	5.0	5

BEE OWNERSHIP	20.7/20	SKILLS DEVELOPMENT	6.6/15
Voting rights	5.0	Skills development spend	18.5m
Economic interest	7.0	Skills development plan	Yes
Realisation	7.0	Adjusted skills spend as a percentage of leviabile payroll	1.2%
Bonus	1.2	Black delegates trained as percentage of workforce	35.0%
Continuing benefits	0.4	Black female delegates as percentage of black delegates trained	5.3%
Recognition for sale of asset	0.2	Learnerships as a percentage of total employees, adjusted for gender	1.4%
Percentage voting right	26.7%	Black learnerships as a percentage of total learnerships	40%
Percentage economic interest	26.7%	PREFERENTIAL PROCUREMENT	4.3/20
BEE MANAGEMENT	3.4/10	Preferential procurement plan	Yes
Board participation	1.9	Preferential procurement target	Yes
Top management participation	1.3	Total measured procurement	R27.6m
Bonus points	0.3	Excluded procurement	R19.5m
Voting rights by black directors on board adjusted for gender	27.3%	BEE compliant procurement	R 2.5m
EMPLOYMENT EQUITY	4.6/15	BEE procurement spend as a percentage of total measured procurement	9%
Total workforce analysed	1706	ENTERPRISE DEVELOPMENT	10.8/15
Black representation	45%	Enterprise development initiative	Yes
Black female representation	34%	Total quantifiable monetary investment in BEE entities development	R500 000
Adjusted black disabled	0.2%	Total investment spent	R29.5m
Adjusted black senior management	8.0%	SOCIAL DEVELOPMENT	5.0/5
Adjusted black middle management	18%	Social development initiatives	Yes
Black junior management	43%	Total social development spend	R27m
Employment equity plan	Yes		

Notes:**BEE ownership**

Peo Ya Thakga entered into a 'buy now and pay later clause' which is one of the most popular forms of financing used in major BEE deals. Peo ya Thakga acquired 25% shares of Billard worth R1.2 billion.

BEE management

The rating achieved is not far from target, with 70% achievement; progress will be made especially in top management.

Employment equity

Billard adopted an affirmative action policy as required by government to guide its recruitment processes in order to ensure a diversified workforce in 2006. Since the adoption of this policy, Billard had been able to attract competent employees with the right qualifications. Billard has developed and nurtured in-house candidates for promotion and further development. During the past five years, 20 employees had been promoted internally, not including PDI candidates.

Skills development

The company introduced leadership and skills development programmes in April 2006. The programme was named after the owner -- The Thomas Leadership-in-Action Programme. The aim was to develop Billard's managers, instilling in them the skills and related business acumen they would need to be leaders within a transformed society. The programme ran for the whole year starting from April, finishing in March of the following year. Participants in this programme -- which included two and three day sessions in mentoring, cases and workshops -- learnt from the experiences of world class business leaders, company executives and academics. The programme took one week in every quarter of the year, which meant one week away from work to attend it.

Preferential procurement

Inroads have been made with the structured approach followed. Tender documents need to be accompanied by a letter of resolution, company profile, company registration documents, a valid tax clearance certificate and a BBEE rating certificate. See below for the complete form and the procurement policy.

Enterprise development

This was a grey area that needed improvement and had been rated 10.8%. Billard intended to be involved in various initiatives contributing more to black enterprise development and saw subcontracting as a major technique to achieve set targets.

Socio-economic development

Billard sees Corporate Social Investment (CSI) as representing the values of both BEE and corporate governance. The company's major focus remains health and education and accepts that the needs in South Africa are far greater than the resources available, thus the need for this focused approach.

Issues of corporate governance

Audit Committees
Independence of Board members
Triple line reporting

Supplier Database Registration Form established by the Procurement Committee

Current Supplier Database Registration Form and Equity Ownership:

1. Business particulars

Name of the business: _____

Holding company: _____

Company registration number: _____

Business postal address: _____

Business physical address: _____

Telephone number: _____

Facsimile number: _____

Cellular phone number: _____

E-mail address: _____

Contact person: _____

2. Company banking details:

Account Holder: _____

Banking Institutions: _____

Branch: _____
 Branch Code: _____
 Account Number: _____

3. Type of business

- A. _____ Public Company LTD
- B. _____ Private Company (PTY) LTD
- C. _____ Close Corporation CC
- D. _____ Sole Proprietor
- E. _____ Trust

4. Products & Services

- A. _____ Finance & Business services
- B. _____ Mining & Quarrying
- C. _____ Transport, Storage & Communication
- D. _____ Catering & Accommodation
- E. _____ Agriculture & Forestry
- F. _____ Electricity, Gas & Water
- G. _____ Construction
- H. _____ Wholesale trade & Commercial agents
- I. _____ Retail, Motor trade & Repair services
- J. _____ Manufacturing

5. Ownership information

Name of business	Registration no.	Citizen	Capacity (Partner, Member etc.)	Ownership %	Gender (M/F)	Disability (Yes/No)	% of time devoted to the business	Race

6. Preference point claimed:

WHAT	POINTS	Yes/No
Company registering after 1994 election	5	
Equity ownership by women	5	
Equity ownership by disabled persons	3	
Skills & experience	4	
Total BBBEE compliance	3	

7. Previous Experience

List the last three (3) contracts awarded to you (the supplier).

Contract 1

Name of the Company: _____

Contact person : _____

Contact number: _____

Contract 2

Name of the Company: _____

Contact person : _____

Contact number: _____

Contract 3

Name of the Company: _____

Contact person : _____

Contact number: _____

SIGNATURE/S OF BIDDER/S

WITNESSES

1. _____

2. _____

Billard (PTY) LTD's Procurement Strategy & Policy

Policy statement

It is the policy of the Billard (PTY) LTD to procure technically and operationally suitable quality products and services at optimum total cost of ownership. As a leader in the industry and committed to the transformation of the country, Billard (PTY) LTD will promote preferential procurement to BBBEE and SMME companies without compromising competitive cost. Preference will be given to products bearing the SABS mark on grounds that conformity with the technical requirement is assured. Preference, but to a lesser extent, will be given to suppliers certified to SANS 9001/ISO 9001 by SANAS accredited (or SANAS recognised) certification bodies on grounds that their processes are adequately controlled.

Objectives

1. To consolidate total spending in order to achieve economies of scale.
2. To reduce the total cost of ownership of goods and services.
3. To set and meet internal BBBEE targets.
4. To provide internal customers with the value added services and the goods and services which they require to perform their functions.
5. To uphold SABS' value system, that is, Respect, Accountability, Fairness and Trust when procuring goods and services.

At the end of the presentations by Blessing Xulu and the management representative, the Board members were confused. Were there non-compliance issues as a result of the BEE deal or not?

Company background

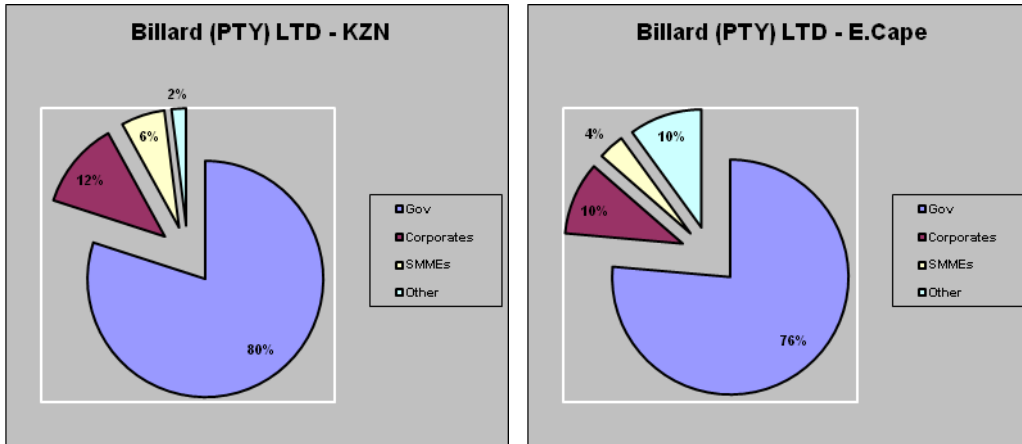
Mr Thomas Dumpinghead, the second son of well known South African mining billionaire Mr Dave Dumpinghead, started a company called Billard (Pty) Ltd five years after obtaining his BCom degree from the University of KwaZulu-Natal. The company began life as an electrical supplier shop in the Amanzimtoti area, 45 kilometres south of Durban. It expanded to an electrical engineering company two years later. The company consists of six qualified electrical engineers (two of whom are shareholders). The company employs 1,706 permanent employees and 711 temporary employees. It has offices in KwaZulu-Natal and the Eastern Cape. The KwaZulu-Natal branches include Durban (head office), Empangeni, Newcastle and Margate. The Eastern Cape has a branch in Port Elizabeth and East London.

The company's values according to Mr Dumpinghead are integrity, innovation, and customer satisfaction.

Products and services

The company offers consultancy services in electrical engineering to the private and public sector in two provinces of South Africa: Kwazulu-Natal and the Eastern Cape.

The company's customer base is made up mostly by the public sector: various municipalities and government departments with a number of parastatals such as Eskom, Transnet and South African Airways. (See figures below.)



Financials

Billard is a significant player in the engineering sector with revenue of over R160m. The company has Operating Income of R35m and NOI of R19m. Eighty percent of its margins are made up of government contracts and the balance from the private sector. (See below for abridged financial statements.)

Income Statement for the year ended 30 June 2006

	2008 R'000	2007 R'000
Revenue	66 437	143 710
Cost of sales	<u>22 025</u>	<u>22 488</u>
Gross profit	144 412	121 222
Other operating income	862	1 986
Operating, general & admin expenses	<u>109 845</u>	<u>102 856</u>
Direct Labour	31 217	30 615
Energy	12 845	11 986
Maintenance	15 591	17 539
Voltages/wires	9 990	8 919
Depreciations	20 410	20 557
Other operating expenses	19 792	13 240
Operating income before tax	35 429	20 352
Finance costs	<u>15 943</u>	<u>11 244</u>
Net income for the year	<u>19 486</u>	<u>9 108</u>

Balance Sheet as at 30 June 2006

	2008 R'000	2007 R'000
ASSETS		
Non-current assets		
Property, plant & equipment	213 543	237 118
Long-term debtor	<u>36 432</u>	<u>40 272</u>
Total non-current assets	<u>249 975</u>	<u>277 390</u>
Current assets		
Inventories	3 177	3 819
Staff loans	26	39
Trade & other receivables	38 026	23 726
Bank balances & cash	<u>48 125</u>	<u>13 779</u>
Total current assets	<u>89 354</u>	<u>41 363</u>
Total asset	<u>339 329</u>	<u>318 753</u>
EQUITY & LIABILITIES		
Reserves		
Retained Income	126 356	106 870
Maintenance & Insurance reserve	5 692	5 692
Insurance reserve	<u>2 807</u>	<u>2 656</u>
Total reserves	<u>134 855</u>	<u>115 218</u>
Non-current liabilities		
Interest-bearing borrowings	149 878	165 164
Provisions	<u>176</u>	<u>196</u>
Total non-current assets	<u>150 054</u>	<u>165 360</u>
Current liabilities		
Trade & other payables	34 763	22 608

Current portion interest-bearing borrowings	15 145	8 441
Current portion finance lease obligations	-	6 903
Provisions	28	31
Bank overdraft	<u>4 484</u>	<u>192</u>
Total current liabilities	<u>54 420</u>	<u>38 175</u>
Total equity & liabilities	<u>339 329</u>	<u>318 753</u>

Legislation -- BEE and Corporate Governance

The concept of BEE emerged in the early 1990s and initially sought to increase 'black' ownership of shares in major corporations. This focus changed when it was realised that BEE was seen as enriching a small number of well-connected people and doing nothing for the poor. A new concept of broad-based BEE emerged, encompassing in addition to shareholding, management representation, employment equity, skills development, preferential procurement, enterprise development and corporate social investment.

Corporate governance by definition refers to the manner in which an organisation is directed, and the laws and customs affecting that direction. It includes the laws governing the formation of companies; the bylaws established by the organisation itself, and the structure of the firm. Issues of fiduciary duty and accountability are often discussed within the framework of corporate governance.

In South Africa, the driving force behind the adoption and implementation of corporate governance principles has been the King Commission that produced the King I & II reports on corporate governance. Organisations of all sizes in South Africa are under pressure to develop and apply sound corporate governance principles and institute high ethical values for the benefit of investors, their stakeholders and the communities in which they operate.

Almost no connection has been made between BEE and corporate governance. This has contributed to a large number of BEE deals going awry and BEE losing value and credibility.

References

Corporate Governance and Equity Prices. Paul Gompers of Harvard and Andrew Metrick of the University of Pennsylvania's Wharton School 2007.

African Institute of Corporate Citizenship (www.aiccafrica.org).

Broad based BEE (www.empowerdex.co.za).