

**An Analysis of the Risks and Opportunities Inherent in PDI Beneficiary Trusts
as Vehicles of Broad Based Black Economic Empowerment**

Research commissioned by

Tshikululu Social Investments

From

Feedback Research and Analytics

Directors: GG Gomwe (chairman), AH Arnott (non-executive), NB Gxumisa (non-executive), TW Henry,
P Rungasamy (non-executive)

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1. Introduction

Community Trusts are increasingly popular as a vehicle for driving Broad Based Black Economic Empowerment (BBBEE). However, there is very limited documented knowledge on the frequency of their use, their fitness for the purpose of furthering BBBEE goals, or the factors that enable and constrain their effectiveness.

Anecdotal evidence suggests that the realization of the developmental objectives described in the BBBEE Codes of Good Practice persistently eludes Community Trusts and that even the immediate outcome for private enterprise – meeting the Ownership target obligation – is inherently problematic. Considering the importance of BBBEE to the nation-building project, and the prominent controversies concerning its implementation, it is clear that an evidence base to confirm or contest assumptions about the utility of trust vehicles in realizing BBBEE objectives is sorely needed.

Tshikululu Social Investments has commissioned an in-depth study to investigate the role and effectiveness of community trusts in Black Economic Empowerment transactions.

The study is a product of Tshikululu's commitment to acting as a bridge between the needs of the social and formal economic sectors through thought leadership on the role of the private sector in development. The research focuses in particular on a policy impact analysis of the Codes of Good Practice and the BBBEE scorecard.

While the views and conclusions contained in this study do not necessarily reflect those of Tshikululu, who owns the copyright to this work, it is shared with interested parties to encourage debate around and further study into the subject.

Any reference to this work must include acknowledgement of Tshikululu Social Investments. The authors are members of the Feedback Research & Analytics team that conducted the study.

2. Executive Summary

2.1. The Purpose of the Research Assignment

The broad aim of the study can be specified in 4 objectives:

- To quantify the frequency of Trusts in BBBEE transactions
- To explore the role of Trust vehicles in BBBEE
- To document the factors that constrain or enable the success of Trust vehicles
- To distil lessons learned and make recommendations towards optimising the utility of Trust vehicles in realizing BBBEE objectives

2.2. Learning from the Literature

Corporate sponsored Foundations and PDI Beneficiary Trusts have their genesis in the broader social movements of 19th century United States and United Kingdom, that also witnessed the birth of modern civil society. As such they have contributed to social reform and acted as a cultural force that modernized philanthropy and vitalized aspects of modern society that we now take for granted, such as tertiary education and modern medicine (Chernow, 2002).

In its contemporary guise the PDI Beneficiary Trust has proved useful as a vehicle for channeling funding for development, administering development programmes and empowering the victims of underdevelopment. It represents the manifestation of a current discourse which holds that business and industry should build society and communities, not only by creating employment and paying taxes, but also by directly funding the establishment of schools, hospitals and other critical infrastructure; the growth of local economies and small business enterprises; the protection and promotion of the interests and rights of marginalised peoples; and other obligations more readily attributed to the state first, and civil society next. This notion that social responsibility is part of best practice for business is complemented by a conviction in development theory that communities should take ownership of their own upliftment.

In South Africa PDI Beneficiary Trusts are employed in a grander nation building project which consciously subscribes to the idea that development must be the responsibility of all sectors of society. As findings further on demonstrate PDI Beneficiary Trusts are a ubiquitous mechanism for the private sector to meet its transformation obligations through BEE, as well as to contribute directly to development and social welfare.

In the theory of common pool resources the literature offers a theoretical framework for not only the analysis of the utility of PDI Beneficiary Trusts to social transformation and development through BEE transactions, but also to developing workable models for the successful operation of these Trusts.

2.3. The Occurrence of PDI Beneficiary Trusts in BEE Transactions

Figure 1 shows that there has been a significant increase in the number of documented BEE transactions over time, with a leveling off occurring from 2006 to 2008.

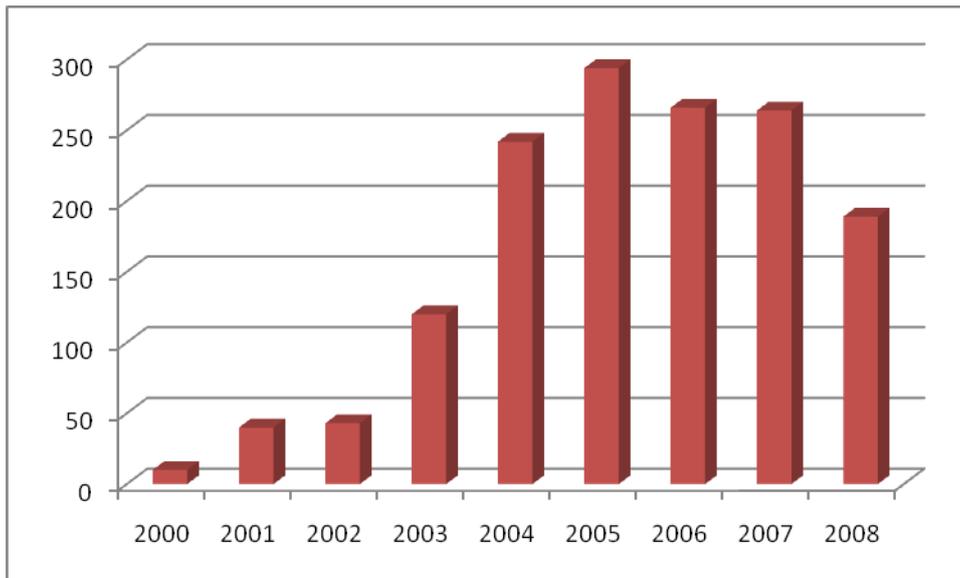


Figure 1: Number of BEE transactions 2000 to 2008

Figure 2 demonstrates that the number of Trust entities included in BEE transactions has been increasing over time.

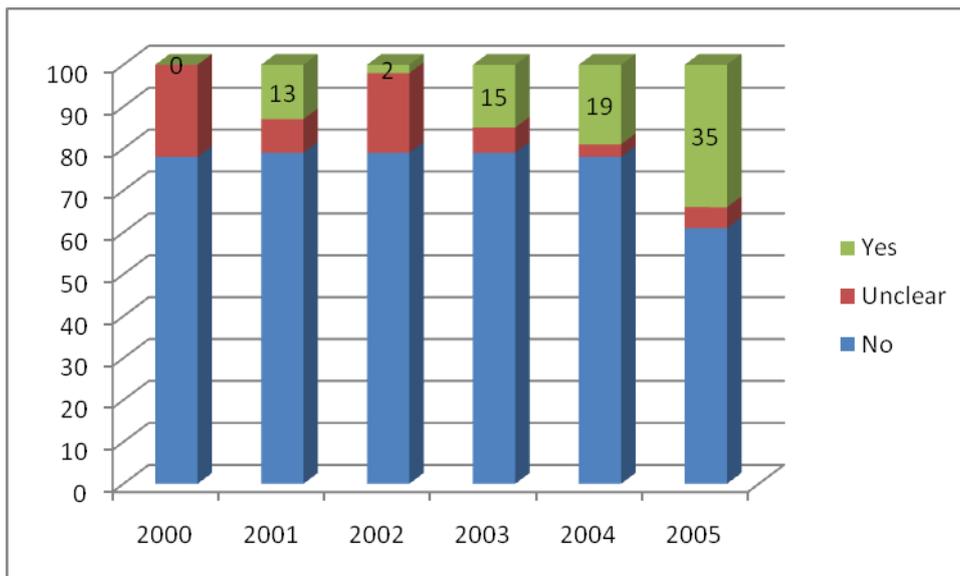


Figure 2: Proportion of BEE transactions including trust entities 2000 to 2005

Qualitative data from press reports on BEE transactions for 2009 suggest that Trust vehicles are ubiquitous in the larger BEE transactions and increasing in popularity across all deals.

2.4. An Initial Typology of Trusts in BEE Transactions

An initial review of the content of the Empowerdex database of BEE transactions, supplemented with additional research, suggests that there are a number of different types of PDI Beneficiary Trusts that can be distinguished. An initial typology in this regard follows.

- Type 1: The Corporate Social Investment function of a private enterprise, whether constituted as an independent Foundation or simply a department or function within the business, often includes the term ‘Community Trust’ or the word ‘Trust’ in its name, and manages a Trust vehicle through which funds are channeled.
- Type 2: Entities that are founded by members of communities as a vehicle for raising and channeling resources from donors for development interventions, or for managing commonly owned existing resources. In both cases these are often labeled ‘Community Trusts’.
- Type 3: Not-for-profit entities describing themselves as ‘Community Trusts’ that are involved in development work, but that have their roots in general civil society rather than in the private sector or a specific localized community.
- Type 4: Entities specifically constituted for the purposes of broadening the empowerment base of a particular BEE transaction. These would include Trust vehicles benefitting a community or Workers Trusts designed to benefit employees.

2.5. The Trouble with Trusts

Problems with Extending Ownership through Trusts

The BBBEE Codes of Good Practice directly addresses the use of Trusts as a mechanism for implementing Broad Based Black Economic Empowerment. In anticipation of trusts being utilised to game the system, the codes institute the flow through principle. The flow through principle states that the criteria for ownership – unrestricted voting rights and direct control over economic benefits - must ultimately rest in natural persons. The implications of the flow through principle significantly problematise the use of trusts to extend ownership to a broader base in the following ways:

- A mechanism needs to be instituted to ensure that the control over economic benefits accruing to the intended beneficiaries is in the hands of those beneficiaries, in practice. This implies that legitimate representatives of a defined beneficiary community that qualifies as previously disadvantaged conveys decisions from the community to the board of trustees governing the trust, at the very least. Ultimately, the will of the beneficiary community in terms of the deployment of their economic benefits must be reflected in the operations of the trust. This is an inordinately difficult outcome to secure, as is detailed in the section that follows.
- A mechanism needs to be instituted to ensure that the voting rights inherent in the shareholding vested in the beneficiary community are exercised whenever the occasion for a shareholder vote arises. The important nuance to emphasise here is that this provision is not a reference to voting on decisions of the trust; it is in reference to the business of the sponsoring enterprise.

Simply stated the sponsoring enterprise needs to take care that the ownership control rightfully vested in the natural persons the Trust represents is exercised by those persons. Overt negligence in this regard could result in the scorecard points for ownership not being awarded. Even unintentional negligence however may carry substantial risk, including reputational risk.

Persistent Challenges to Trust Success

Successful community trusts appear to be an exception rather than the rule. The persistent challenges undermining their efficacy include:

1. Defining Beneficiary Parameters

In establishing a Community Trust it becomes crucial to appropriately define who the beneficiary community is. This is especially important if the sponsoring enterprise intends to promote broad based empowerment through the Trust vehicle. In order to maximize their scorecard performance the company needs to guarantee that the representatives of a qualifying beneficiary community exercise unrestricted voting rights as shareholders in the sponsoring enterprise and that the community itself has unrestricted access to economic benefits of ownership. Without a clearly defined 'community' neither of these benefits can be guaranteed.

Clearly delineating a beneficiary community is no simple matter however. By what criteria should they be defined? If by geographic location, how do you propose to manage groups who identify themselves as distinct from their neighbours within the same area (e.g. migrant labour versus indigenous peoples)? If by shared identity, then whose identifying criteria do you use, what local intelligence must you access to do so appropriately, at which level of shared identity do you draw the line and how will you manage the local prejudices and related social injustices between groupings within a broader shared identity? If by local authority structures how do you identify, engage and accommodate the needs of outsiders?

In the more successful examples of Community Trusts a common element tends to be the fact that a community identity has been mobilised around an asset such as land ownership or mineral rights. That asset has been leveraged to secure equity in a business enterprise, so the community brings something to the table. The community is often already being served by a legitimate representative body such as a "property association" that is often rooted in traditional authority structures.

In contrast however, the emerging trend is for Community Trust to be established at the initiative of the sponsoring private enterprise. Equity in the enterprise becomes the asset and a sale needs to be financed. More often than not, and perhaps most problematically, there is no obvious beneficiary community and no existing community mobilisation factors to take advantage of. The need for expertise and models to address these challenges could not be more self-evident.

2. Ensuring Appropriate Representivity

PDI Beneficiary Trusts may choose to select representatives from the beneficiary community for inclusion on the board of trustees in order to facilitate transparent and representative decision making. This however raises concerns about who classifies as a true, adequate representative, what special interests they are advocating, and are they to be managers of expectations or must their expectations be managed?

The injudicious appointment of beneficiary representatives to the board of trustees introduces a legion of risks that threaten effective governance, strategic planning and ultimately operational efficacy of trusts. For the sake of legitimacy and the furthering of empowerment, beneficiary representation is critical. If beneficiaries are excluded as representatives from the board of trustees, companies run the reputational risk of being seen to be gaming the scorecard system. They need to decide if and how they will access the community intelligence to optimise their development expenditure and maximise the goodwill return.

3. The Fragility of Community Institutions

However a PDI Beneficiary Trust chooses to manage the governance question, it will have to engage with formal community structures at some point. Either the Trust will have to find and work with

existing structures, or it will have to facilitate their establishment. But community institutions are fragile entities. They tend to be voluntary; and individuals' commitment therefore involves a personal cost; they tend to have low levels of capacity and an inconveniently high turnover rate; further community institutions are subject to persistent and often inscrutable patterns of local politics. Dealing with such fragility is highly risky business and introducing a new institution or a set of new obligations into existing institutions and structure can be costly.

4. Operating a Community Trust

In the few examples observed, the emphasis in establishment of Community Trust tends to be on the legal constituting of the vehicle in the context of the BEE deal. However, equal attention needs to be devoted to how the entity will operate for beneficiaries to realise benefit. Operational issues that need to be considered include: governance, administration, issues concerning the implementing of development projects (such as informed project design, project implementation, project management, contractor management, monitoring, evaluation and reporting), stakeholder consultation and transparent, constant communication.

5. Managing Impact and Preserving Relationships

The possibility of accessing resources impacts *social arrangements*: newly constituted PDI Beneficiary Trusts are likely introducing matters for contention and conflict across existing institutions. The possibility of accessing resources also impacts *expectations*: beneficiaries will always expect results long before the income generating asset can produce them. Therefore, the management of resources necessitates the management of relationships between at least the following stakeholders: benefactor, beneficiary community, trustees, administrators, implementing contractors, local authorities, traditional authorities, and community leadership.

2.6. Conclusion

While social inclusion is a worthy and critical transformational objective, economic emancipation requires direct ownership of wealth creating assets. The BBEE Codes of Good Practice are adequate for driving private enterprise towards broadening black economic empowerment through efforts to nurture enterprise development and implementing preferential procurement practices. However the structure and mechanisms of the code continue to bias traditional empowerment when it comes to the ownership criteria. The single viable vehicle addressed in the codes for broadening the ownership base – community trusts - is difficult to implement and the current scorecard does not sufficiently incentivise business to go to the trouble. Our research suggests that private enterprise has yet to realise just how challenging PDI Beneficiary Trusts are.

It must be stated in defence of PDI Beneficiary Trusts that they currently represent the only credible solution to extending enterprise ownership to a broader base. If they are implemented with due dedication and care they are the most effective way of honouring the spirit of BBEE, providing previously disadvantaged individuals with the prospect of not just social inclusion, but economic emancipation.

2.7. Recommendations

A Planning and Implementation Model

- The legal constitution of trusts is a relatively simple matter and their inclusion in BEE deal structures also appears to be adequately considered and expertly executed. What is omitted is the proper planning of trust operations. It is therefore recommended that adequate resources be

devoted to planning Trust operations, more so than the legalities involved in Trust establishment or deal structures, both of which are inevitably well attended to.

- From evidence emerging in this exploratory study it appears that applying a systematic model to the establishment of PDI Beneficiary Trust should be recommended. The development of the Trust Vehicle should proceed broadly through 4 stages:
 - i. The legal constitution of the entity
 - ii. The planning and engagement phase during which informed planning will occur, culminating in the introduction of the Trust to beneficiary communities and their early participation
 - iii. The pre-operational phase during which the operational systems are formalised, beneficiary representatives are appropriately capacitated and an initial portfolio of projects planned with beneficiary input
 - iv. The operational phase during which pilot projects are launched using a revenue stream supplemented for example by CSI funding. The supplementary funding is phased out as the dividend stream from the beneficiary asset comes online
- The injudicious appointment of beneficiary representatives on to the board of trustees introduces a legion of risks that threaten effective governance, strategic planning and ultimately operational efficacy of trusts. For the sake of legitimacy and the furthering of empowerment beneficiary representation is critical. However it is recommended that the timing of beneficiary inclusion be thoroughly considered. It is certainly not the most immediate executable in the establishment of a PDI Beneficiary Trust.
- The findings demonstrate that many of the risks threatening the success of Trusts are rooted in poor communication between stakeholders. Interviewees repeatedly indicate that in their experience that a workable strategy has been to include existing and legitimate community based entities in a formal consultative mechanism. The mechanism, such as a broad forum, needs to be resourced, meet consistently, its proceedings documented and it must foster consequential participation. It is recommended that in all processes to establish PDI Beneficiary Trusts a formal consultative mechanism is established and that if legitimate community representative entities do not already exist that time be taken to assist in their formation.
- It is recommended that all sponsors of the establishment of PDI Beneficiary Trusts make the commitment to appointing and paying for the service of trust administrators. The extent to which this indispensable component is reluctantly acknowledged and poorly funded is alarming, while the interview evidence suggests that the operational failure of trusts is to a significant degree (and possibly primarily) attributable to inexpert administration.
- It is recommended that all business processes and procedures of the PDI Beneficiary Trust - especially those relevant to applying for funds, awarding funds, planning projects, appointing contractors, M&E and reporting – be formalised before the official activation of the trust.
- It is recommended that M&E be a formal embedded procedure and that the function be provided by a third party that is and is perceived as independent. The M&E function is as important for accountability as the financial audit function and the service provider should not be invested in the interests of any particular stakeholder involved with the trust.

2.8. Critical Prerequisites for Ensuring Success

Two critical risks to success were persistently highlighted by the key informants. Their importance seems worth emphasizing by focusing on associated recommendations in a separate section.

PDI Trust Vehicles that are dependent on a revenue stream from dividends for funds are especially vulnerable in the initial years of their operation. In addition to having no resources for operating expenses or the implementation of interventions, they are often locked in to a loan repayment agreement for the purchase of their equity in the sponsoring enterprise. It is strongly recommended that the sponsoring enterprise facilitate access to resources for the beneficiary community and their representative structures to tie them over during the period preceding the payment of equity. A dormant trust cannot suddenly come on line when dividends become available, nor can the goodwill of stakeholders be sustained over years of promise alone.

It is recommended that the conventional practice for the PDI Beneficiary Trust be that a clear, agreed and documented plan for how the money will be spent is concluded before money becomes available. This applies to all stages of the establishment of the trust vehicle – legal constitution; planning and engagement; pre-operational and operational. The inevitable contest over resources must be resolved before the resources are available to prevent deadlocks in extending the economic benefits to intended beneficiaries.

2.9. Empowering Beneficiaries

The research suggests that the success of the Trust is to a large extent dependent on the capacity of beneficiaries and beneficiary representatives to participate consequentially in the business of the Trust. While it is crucial that the Benefactor facilitate the development of capacity, provision needs to be balanced with a commitment to preserving the independence of the beneficiaries. The Benefactor needs to avoid conflicts of interest and ensure that the beneficiaries are not beholden to the sponsoring enterprise. In the interest of empowering stakeholders it is recommended that:

- A relationship is facilitated between the beneficiary community and not-for-profit independent advisors. There are a number of NGOs that provide such services to communities and community based organisations.
- A thorough work study should be conducted to identify the skills needed for beneficiary representatives to participate consequentially in the governance and operations of the Trust, and identify the skills gap. A work study may not be necessary in every situation as a number of not-for-profits that service the CBO sector provide standardised and widely applicable skills development programmes.
- Funds should be provided for a training programme to bridge the skills gap identified in the work study. It is important that the training programme be instituted as a repeated intervention to mitigate the effect of skills attrition. One of the observable consequences of the skills shortage in South Africa is that disadvantaged individuals trained in the not-for-profit sector become mobile and move on to exploit more attractive job opportunities in the labour market.

2.10. Managing Stakeholder Relationships

In order to ensure the successful implementation of the Trust and sustain developmental impact it is recommended that:

- The launch of the Trust should be timed judiciously. Announcing a Trust initiative prematurely will precipitate unmanageable expectations as benefits are anticipated long before they can be delivered. The marketing of the Trust should be delayed, possibly to the end of the pre-operational phase. Although the beneficiary community will already have been engaged and there will already be widespread awareness it is critical that the reputational reward reaped by the sponsoring enterprise be seen to be commensurate with the manifest level of social investment and current benefit experienced by the beneficiary community.
- Apply the art of stakeholder consultation. Engage more than is thought necessary but not enough to fall into stakeholder paralysis.
- Institute formal reporting mechanism between beneficiary representatives and the beneficiary community if they do not already exist. Despite their best intentions, without a formal channel for engaging the beneficiary community their representatives are unlikely to fulfil this function consistently and adequately.
- Have an accessible community based presence (open an office)
- Be clear, transparent and specific about what is intended to be achieved, and the timeline is for achieving it. Planning for long-term impacts is development best practice, but it may prove unwise to promise grand impacts projected a decade from now.

2.11. Further Research

The knowledge gap pertaining to PDI Beneficiary Trusts in the context of BEE and particularly broad based empowerment is remarkable.

The quantitative investigation into PDI Beneficiary Trusts could continue with:

- An investigation into the occurrence of PDI Beneficiary Trusts according to the initial typology presented in this paper.
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- A documenting of the value of BEE transactions including PDI Beneficiary Trusts, as well as the value of the stake assigned to PDI Beneficiary Trusts.
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This descriptive statistical study would involve the updating and maintenance of a detailed database which currently does not exist.

A critical contribution to knowledge on PDI Beneficiary Trusts would be a more comprehensive investigation into their current operating status. It is hypothesized, based on the qualitative data collected during this current study, that PDI Beneficiary Trusts are under-performing operationally. Although these databases recording BEE transactions exist, a comprehensive picture of the extent to which BEE has transformed the market place cannot be concluded without a review of smaller enterprises. This could prove a fruitful area of research.

3. Introduction to the Research

3.1. The Need for Research into PDI Beneficiary Trusts

'Community Trusts' are increasingly popular as a vehicle for driving Broad Based Black Economic Empowerment (BBBEE). However, there is very limited documented knowledge on the frequency of their use, their fitness for the purpose of furthering BBBEE goals, or the factors that enable and constrain their effectiveness. Anecdotal evidence suggests that the realization of the developmental objectives described in the BBBEE Codes of Good Practice persistently eludes 'Community Trusts' and that even the immediate outcome for private enterprise – meeting the Ownership target obligation – is inherently problematic. Considering the importance of BBBEE to the nation building project, and the prominent controversies concerning its implementation, it is clear that an evidence base to confirm or contest assumptions about the utility of trust vehicles in realizing BBBEE objectives is sorely needed.

3.2. Illustrating Trust Inclusive BEE Transactions

The largest BEE transaction concluded in 2009 involved South African Breweries and it involves a number of Trust vehicles in its structure. The Trusts are being used to ring-fence and manage assets for beneficiaries including employees, tavern owners, and a corporate foundation responsible for corporate social investment. The following description is based largely on the report of the deal in the Mail & Guardian of December 2009.

In 2009 SABMiller entered into a R6-billion black economic empowerment scheme that was touted as one of the "broadest-based" yet in South Africa. The empowerment transaction aims to ensure the loyalty of the small tavern owners and is designed to help speed up the process of legalizing the country's many shebeens, so that SAB can supply them directly with beer^[1]. It is estimated that this deal will cost R1,8-billion – almost a third of the entire R6-billion transfer of shares to black shareholders.

The vision is that in 10 years' time tavern and shebeen owners, employees and a charitable foundation will own part of the company's local South African operation, called SA Breweries (SAB). After 10 years they will then swap the shares in this unlisted company for shares in the listed SABMiller, which operates globally (a public limited company). Even though full ownership of the shares is expected to pass through over a 10 year period, the beneficiaries will receive a portion of the dividends from the first year.

Any licensed tavern owner, and those who have applied for licences, are eligible to apply for the scheme. Dividends will be used to pay for the equity but a key difference is the way in which these shares will be allocated to employees, the SAB Foundation and about 50 000 licensed shebeen and tavern operators. "How much the BEE participants will get depends on the value of SABMiller (and therefore SAB) after 10 years and on the dividends paid annually to them" (Rumney, 2009). The

^[1] Reg Rumney (2009). *Big Deal: Broadest-based BEE deal to date*. Mail and Guardian, Aug 28, 2009.

value of the SABMiller shares at that time will depend largely on the SAB share price and on interest rates.

Further, an employee share-ownership scheme will allow SAB to put shares into a trust and employees will have voting rights. Shares will also be available to black people or to 51% black-owned companies that are: liquor retailers with a valid licence; customers of ABI, the soft drinks division of SAB; and applicants or legal entities who can provide evidence that a liquor license application has been lodged. Their shares will be held by a "retailer investment entity" on behalf of the retailers for 10 years. Participating retailers will also have voting rights via a Director of the investment entity.

A key part of the deal is the establishment of a permanent SAB Foundation for community social investment. The SAB Foundation will focus on supporting entrepreneurship development, especially among women and the youth in rural areas, and will target "historically disadvantaged South Africans".

3.3. Purpose and Methodology

Delineating the Subject of Analysis

Trusts are legal entities governed by a common legal framework represented in a specific set of laws that include:

- Constitution of the Republic of South Africa, Act 108 of 1996 (as amended)
- Companies Act 61 of 1973 (as amended)
- Non-Profit Organisations Act 71 of 1997 (as amended) ("NPO Act")
- Trust Property Control Act 57 of 1988 ("TPCA")
- Income Tax Act 58 of 1962 (as amended) ("ITA")
- Value Added Tax Act 89 of 1991 ("VATA")
- Revenue Laws Amendment Act 20 of 2006

The same legal framework covers Section 21 Companies and Public Benefit Organisations. Each of these legal persons is commonly associated with philanthropic endeavors aimed at promoting the social development of disadvantaged beneficiaries. However the legal classification is of limited utility because it does not adequately distinguish between the various purposes Trusts are established to serve, and it is just such a distinction which is necessary for this study.

'Community Trust' is a term employed to refer to a number of different entities with varying purposes. The Corporate Social Investment function of a private enterprise, whether constituted as an independent Foundation or simply a department or function within the business, often includes the term 'Community Trust' or the word 'Trust' in its name. There are also entities that are founded by members of communities as a vehicle for raising and channeling resources from donors for development interventions, or for managing commonly owned existing resources, and in both cases these are often labeled 'Community Trusts'. Similarly there are a number of not-for-profit entities describing themselves as 'Community Trusts' that are involved in development work, but that have their roots in general civil society rather than in the private sector or a specific localized community. There are also instances of vehicles termed 'Trusts' that participate in BEE transactions but are intended to economically benefit a select group of individuals. The latter are, in effect, vehicles for private business interests rather than entities furthering broad development objectives.

As a result of the wide appropriation of the term 'Community Trusts' it became necessary to better delineate the nature of the entity that the analysis of data is intended to apply to. The subject of analysis would be legal but not natural persons that:

- Are specifically constituted or, alternatively, are included in a transaction, for the purpose of improving the BBBEE score of a private enterprise on the BBBEE scorecard published in the "BEE Codes of Good Practice"
- Is purportedly intended as a vehicle to economically benefit a broad but delineated base of previously disadvantaged individuals through the ownership of equity in a private enterprise, the earning of dividends from that equity and the spending of dividend revenue on development initiatives

In addition to the employment of the term 'Community Trust' and 'Trust' in diverse ways, there are additional legal vehicles that conform to the preceding description and therefore need to be considered. For example a number of BEE transactions have included 'Workers Trusts' as vehicles to further economic empowerment on a broader basis. Not only do they fulfill a similar function but 'Workers Trusts' are also legally proximate to 'Community Trusts.' The term 'Community Trust' was replaced with the more descriptive and, for the purposes of this investigation, more precise 'PDI Beneficiary Trust'.

While the focus of the study would be to understand the role and functioning of PDI Beneficiary Trusts that fit the defining description proposed above, some latitude was applied in the entities which qualified as objects of analysis. For example interview respondents included a board member from the Khayalitsha Community Trust, which is not a legal person constituted for the purposes of benefitting from a BBBEE transaction, but rather a NFP whose function it is to channel development funding on behalf of its local community. The research team would argue that the lessons learned in the founding, management and operating of Khayalitsha Community Trust are relevant to PDI Beneficiary Trusts that are the focus of this study. Similarly the institutional knowledge earned by Royal Bafokeng Holdings is relevant to the management of common pool resources in PDI Beneficiary Trusts, and consequently RBH was approached to contribute to the research.

The research team would further argue that the inclusion of a range of entities similar to those intended as the subject of study allowed for the emergence of the typology of PDI Beneficiary Trusts which is already a useful finding in itself.

3.4. The Research Methodology and Limitations

The nature of the research dictated a mixture of data collection and analysis methods.

The Literature Review

The literature review presented the opportunity to review potential theoretical frameworks for understanding PDI Beneficiary Trusts within the developmental context of South Africa and the policy context of BEE. Consequently the literature considered included publications on the historical and current role of trust vehicles in furthering social development, theory concerning the management of commonly owned resources, as well as general research focused on BEE and BBBEE. An attempt was also undertaken to gather whatever had already been documented and that might be of value in

terms of PDI Beneficiary Trusts in the context of BBBEE, although as suspected there was no literature at that level of specificity.

The literature was subjected to a content review, integration and interpretation according to generally accepted academic practice.

The Policy Review

A policy analysis of the “BBBEE Codes of Good Practice” was conducted to determine the contribution that trust vehicles could potentially make to the BBBEE performance of private enterprises. The analysis is primarily technical, focusing on the implications of the policy and its provisions as they currently stand and consequently offering an assessment of the potential effectiveness of the regulatory dispensation in incentivizing broad based empowerment through trusts.

The Quantitative Study

A descriptive quantitative analysis was initiated into the structure of all BEE deals concluded from January 2000 to February 2009. The results would provide trend data on the occurrence of trusts as an element of BEE transactions. The Empowerdex database of BEE transactions covering the period was purchased and the content coded to distinguish between deals that included Trust vehicles and those that did not. The current research does not distinguish between types of Trusts according to the typology proposed in this study because the database records do not contain sufficient distinguishing information. The database was also incomplete in terms of recording the entities involved in transactions and consequently some of the findings do not cover the entire period being scrutinized. The omissions however were supplemented with plausible expert opinion from researchers in the field that aligns with the empirical evidence available.

The Qualitative Study

A qualitative analysis was completed on data from in-depth interviews conducted with a panel of 15 key informants. Key informants were defined as individuals with extensive experience in the establishment and management of community trusts, preferably in the context of BEE. Interviews were guided by a semi-structured interview schedule but the interviews were kept open, in accordance with the exploratory nature of the research. The data was subjected to close content analysis with the emphasis being on extracting themes that responded to the research questions. Of particular interest was the documenting of persistent challenges to the effective operation of trusts in fulfilling their developmental purposes and strategies to address those challenges.

4. PDI Beneficiary Trusts in the Research Literature

Trusts as vehicles for corporate or private philanthropy have a long history. Similarly, as community based entities founded to channel donor funding and development initiatives, the operations and activities of trust vehicles have been documented. However in the context of BBBEE – as legal entities that manage and spend dividend revenue on development initiatives that benefit groupings of previously disadvantaged individuals – Trusts do not feature in academic literature. Consequently no direct theoretical framework has been formulated within which to conduct the analysis of the functions and functioning of PDI Beneficiary Trusts. Considering their increasing importance this dearth of knowledge is unexpected and represents an opportunity for consequential research and thought leadership.

This literature review considers the history, evolving roles and broader impacts of Community Trusts and similar entities on society, while problematising the institutional role that Trusts have assumed or are expected to assume in development and social welfare in South Africa. It also nominates the theory of managing common pool resources as a useful framework for investigating the utility of Trusts in the context of BBBEE.

4.1. Philanthropy and Social Reform

The Genesis of Corporate Philanthropy and Modern Civil Society

By the end of the 19th century, the industrial revolution and the colonial adventures of the West had yielded substantial economic rewards. However the resulting socio-economic inequalities were vividly foregrounded in the urban slum areas and amongst immigrant population groups in both Europe and North America. Civil welfare organisations grew as rapidly as capitalism to address these social inequalities (Bartlett, 1928: 336). Colonialism especially initiated a growth in charities as Europeans became exposed to the perceived “primitiveness” of the “natives.” The “civilising” project was vigorously championed by Mission Societies with arguably more ardor than the state organs responsible for administration of the colonies. At home Charity Organisations and networks of charities complimented the endeavors of local the Missions.

The first legal Charity Organisation Society was started in London in the late 1800s and many of its associates supported causes that found international support in the globalising world of the time. Much of their funding was received from philanthropic individuals or from corporate donations. These organisations were staffed for the most part by citizen volunteers and their activities mobilized a visible, vocal and often influential set that began lobbying policy makers and holding their elected representatives to account. Charity Organisations became mechanisms for enacting democracy and made notable contributions in the popular reform. For example, in the “early 1800s, U.S. and European bodies such as the British and Foreign Anti-Slavery Society were driving forces behind government action on the slave trade” and eventually helped to end the gruesome practice (Simmons, 1998: 84).

For reasons such as these, Lindeman (1988) suggests that the rise of modern capitalism was a positive development for social justice, especially in the United Kingdom and the United States, precipitating the establishment of Charitable Societies and Foundations that championed human rights, furthered social development and defined a role of civil organizations in society. However he goes on to explain the advent of modern civil society in the United States as a consequence of cultural rather than political factors:

“The Foundation was a natural, evolutionary consequence of two forces operating within the pattern of American ‘capitalism’, namely (a) huge fortunes which could not possibly be used in consumption, however conspicuous and wasteful, by the possessors, and, (b) the enthusiastic acceptance of the principle of organisation. The foundation is a manifestation of collectivism expressing itself on a purely practical level. If business and industry demand rigid forms of organisation, why not philanthropy?” (Lindeman, 1988: 7).

Foundations and Trust may not be unique American constructions, but the early 1900s saw them develop into social forces in the United States. They became vehicles for disposing of large accumulations of surplus wealth, perhaps in appeasement of the Protestant conscience which prized charity as much as the vaunted work ethic. Lindeman estimates that in the early 1900s Foundations and Trusts contributed roughly 5-15% of all of philanthropic expenditure in the United States of America. Perhaps more significantly, Lindeman (1988: 9) suggests that foundations represent a progressive cultural phenomenon, especially in the context of the zeitgeist in which they emerged. A foundation by definition is described as a “private legal agency established for the purpose of receiving and appropriating funds without profit or recompense to itself” (Lindeman, 1988: 10). In essence, a foundation cannot benefit private interests.

The Ideology of Corporate Philanthropy

Corporate sponsored PDI Beneficiary Trusts were conceptualized in the early 1900s and grew to popularity in the developing nations, like South Africa, during the late 1980s. The growth in corporate sponsored Trust activity was originally rooted in an ideological discourse, favoring an orthodox capitalism and influenced by the Christian ethic of charity, which conceived a role for excess capital in addressing challenges of community welfare. The early discourse has evolved to be characterized by the following principles:

- Private business has a need to distribute excess capital accumulation in the most tax-effective manner. The applicability of this factor in the South African context is limited because tax benefits related to social investment remains limited to Public Benefit Organisations, and then only those operating in specific categories.
- Corporate social investment is now regarded as part of good, responsible business practice. Best practice principles demand that business and industry are not purely motivated by capital accumulation but that they also “give back” to society in some manner.
- Social development ideology is currently dominated by the notion that “community-ownership” or “buy-in”, facilitated through community wide participation processes, is crucial to the success and sustainability of any upliftment initiative.

The formalizing of corporate social responsibility is justifiably considered a positive development. In South Africa it affirms the cross-sectoral nature of the nation building project. At a macro level however it can be argued that the mainstreaming of this discourse signals a shifting of responsibility for social development and social welfare across sectors and institutions that is problematic. As will be seen in subsequent sections of this review the less interventionist role of the state necessitates supplementary intervention from the private sector and civil society that is critical, ameliorative but most likely inadequate to the greater development challenge (Beney, 2007).

4.2. The Global Development Project

Development is a complex term. For this reason Ferguson argues that when evaluating development it is politically naive to begin by simply asking if aid programs really help the poor (Ferguson, 1990: 12). One should be careful not to focus solely on the ‘development industry’. A focus on individual aid programs or on the industry itself distracts from an understanding of what development means in different contexts. According to Ferguson, the term development is used, in growing popularity from the 1970s onwards, to define the desire for a “better quality of life” or “standard of living”, and refers to “the reduction or amelioration of poverty and material want” (Ferguson, 1990: 15). As he puts it, the directionality implied in this usage of the word development “is no longer historical, but moral. ‘Development’ is no longer a movement in history, but an activity, a social program, a war on poverty on a global scale” (Ferguson, 1990: 15 italics mine).

In the aftermath of the Depression and World War 2 western states became economically more interventionist and assumed the responsibility for social welfare. However the reach of the state was gradually diluted under successive Republican administrations in the US and Conservative governments in the UK, while events such as the mini collapse of the stock market in 1981 and trends such as the growing debt of many developing nations provided justification for the neo-liberal agenda. The Washington Consensus - a phrase coined by John Williamson in 1987 in reference to a macroeconomic framework based on a specific set of economic policy prescriptions - came to dominate global governance. The model set of neo-liberal policies favored lenient state controls of private sector interests, the growth of capital through free trade and increased competition. Ideologically the Washington Consensus invoked an untested faith in market forces to not only self-regulate market behavior, but to ultimately drive social development to the benefit of most, if not all. In some ways neo-liberalism re-asserted the orthodox capitalism of the gilded age. Certainly, by similar mechanisms, it recreated conditions that would necessitate the redirection of private resources to address development imperatives.

Essentially, the driving rationale behind the Washington Consensus is that social growth and “development” is attained through economic change, fueled by an open market. Adopted as modus operandi by institutions like the World Bank, the International Monetary Fund, and the U.S. Treasury Department, these recommended policies constituted a standard reform package for crisis-stricken countries (Cypher, 1998: 47). Through these institutions the ideology of economic liberalisation was exported to independent African states along with required structural adjustments and large financial loans from the “developed” world. A significant consequence of this process, ideologically and institutionally, is that the responsibility for social welfare and development began to shift from state institutions to primarily civil society. However the retreat of the state has not only precipitated the rise of reformism through civil society, it has also necessarily precipitated a reassertion of the direct involvement of the private sector in social development through social investment funding, ring-fenced in Trusts, and disbursed by corporate sponsored Foundations.

4.3. Development in the South African Context

Key Features of the Policy Environment

In South Africa, post 1994 state legislation has aimed at policy designs that address the historical inequalities resulting from colonialism and apartheid. These laws actively promote the so called “development” of previously disadvantaged individuals and communities. For instance, new laws have restored rights to land and tenure; have defined unfair discrimination; and have “introduced specific active measures to overcome the distortions in the labour market” (DTI, 2008:4). Some of the

legislation includes for example the Promotion of Equality and Prevention of Unfair Discrimination Act; the Employment Equity Act; the National Empowerment Fund Act; and the Preferential Procurement Policy Framework Act.

The government has implemented various policies, strategies and programmes targeting underdevelopment, such as the Urban Renewal Programme; Integrated Sustainable Rural Development Programme; the Tourism Transformation Strategy; and the National Small Business Development Promotion Programme (DTI, 2008:4). However a key policy watershed was precipitated under the Mbeki administration when GEAR was adopted as the macro-economic policy, in favor of the less neo-liberal friendly RDP. Although the nation building project always called for collaboration across public, civil and private sectors, the greater reliance on markets to drive social development and transformation would increase social expectations on private sector resources to be directly devoted to development objectives.

Government's strategy therefore calls on a partnership of state and private interests (including for-profit and not-for-profit entities) to bring about social change and positive, sustainable development. It is in this broader policy context that BBBEE needs to be understood.

Broad Based Black Economic Empowerment

The Broad-Based Black Economic Empowerment Act of 2003¹ exemplifies government's attempts to redress structural inequalities embedded in South African society. It outlines the criteria by which the degree of social transformation in private sector entities will be assessed. These criteria cover:

- Direct empowerment through ownership and control of enterprises and assets.
- Management at senior level.
- Human resource development and employment equity.
- Indirect empowerment through:
 - preferential procurement,
 - enterprise development, and
 - corporate social investment (a residual and open-ended category)

These expansive criteria, extending well beyond ownership and employment equity, reflect the 'broad-based' nature of the policy initiative. It is broad-based by virtue of the aspects of covered in the assessment criteria. However the term 'broad-based' is often used to refer to the reach of the policy's impact, as illustrated in this statement in DTI literature when describing the purpose of BBBEE:

“to situate black economic empowerment within the context of a broader national empowerment strategy ... focused on historically disadvantaged people, and particularly black people, women, youth, the disabled, and rural communities” (DTI, 2008: 10).

The policy is therefore broad-based by virtue of the fact that it is intended to benefit all, not just a few, of the previously disadvantaged South Africans.

¹ <http://www.acts.co.za/bbe2003/index.htm>

To ensure that transformation occurs, government for the most part has not resorted to direct legislation to enforce BBBEE, but has instead favored indirect mechanisms such as the awarding of tenders and licenses to operate.

Although redress is discussed as a moral imperative, Black Economic Empowerment (BEE) is characterized as a pragmatic growth strategy intended to realise the country's full economic potential by enabling previously disadvantaged peoples (African, Indian and Coloured people, as well as females and those with disabilities) to participate meaningfully in the economy². The Department of Trade and Industry's (DTI) Broad-Based Black Economic Empowerment (BBBEE) strategy states that South Africa requires an economy that can meet the needs of its citizens (people and enterprises) in a sustainable manner. In order to achieve this, the economy needs to "build on the full potential of all persons and communities across the length and breadth of this country" (DTI, 2008: 10). The DTI points out that "No economy can grow by excluding any part of its people, and an economy that is not growing cannot integrate all of its citizens in a meaningful way" (DTI, 2008:4). Black economic empowerment is thus an important policy instrument aimed at broadening the economic base of the country – and through this, stimulating further economic growth and creating employment.

Aside from pressure for private companies to comply with BBBEE policies, there is also a growing local and global pressure on large companies to directly benefit the communities in which they operate. Contemporary corporate governance principles advocate for a Corporate Social Investment (CSI) that is not peripheral to business activities but rather at the core. Resultantly, many South African corporations have developed CSI units, foundations or trusts that target specially defined communities, or address a specific need within a community or within the country (such as HIV prevention, or early childhood nutrition). Corporate social investment has boomed locally since the end of apartheid and the growth of corporate sponsored foundations and trusts is on the increase.

It is at the confluence of BBBEE, CSI and Development that PDI Beneficiary Trusts emerge and play a potential high value but currently problematic role in the nation building project.

4.4. A Theoretical Framework for Understanding PDI Beneficiary Trusts

Defining Trusts

The applicable literature refers to 'Community Trusts' while this research posits the term PDI Beneficiary Trusts in order to include entities such as Workers Trusts that perform a similar function in the context of BEE transactions. However the literature on 'Community Trusts' offers concepts that are appropriate to the formulation of a theory on PDI Beneficiary Trusts.

PDI Beneficiary Trusts are legally constituted entities funded by donations made for educational, charitable, or other benevolent purposes in favor of a defined beneficiary group. The assets (funds and/or income generating resources) are managed by a board of trustees. There may be one trustee or, as is more often the case, several trustees.

Lindeman offers a definition of Trusts that emphasizes the role of beneficiaries in the founding of the entity and the administration of its resources:

² <http://www.southafrica.info/business/trends/empowerment/bee.htm>

“A community trust is merely a device which makes it possible for a group of citizens in any community to create trust funds for educational, benevolent, and charitable purposes; the principal investment is placed under the administration of a selected financial institution and the expenditures are controlled by a local committee” (Lindeman, 1988:11).

South Africa’s National Treasury Toolkit for Tourism provides a similar definition with the added element of localizing the beneficiary community:

“not-for-profit trust created in terms of applicable law by volunteer members for the purpose of channeling the proceeds of various activities and investments for the common good of persons ordinarily resident within a specific town, village or settlement” (National Treasury Toolkit for Tourism, 2005: 3).

PDI Beneficiary Trusts are often formally owned and are intended to be managed to some extent by the community of beneficiaries that they benefit. In the context of a BEE transaction, defining the community of beneficiaries is a prerequisite for any claims of ownership and management participation to be credible. Defining the community of beneficiaries sensibly however can prove problematic. It may for example encompass the legal or non-legal citizens within a certain geographic location, such as a township; or it may include population categories, such as South African black females between the ages of 18 and 30 born and living in Gauteng Province.

The Functions of a PDI Beneficiary Trust

Fuert’s definition of Community Foundations relies heavily on his conception of the function of such entities:

“independent philanthropic organization working in a specific geographic area which, over time, build up a permanent collection of endowed funds contributed by many donors; provide services to those donors; make grants and undertake community leadership activities to address a wide variety of current and long-term needs in its service area” (Feurt, 1999: 24).

Such Foundations encourage community philanthropy and promote social entrepreneurship.

Feurt (1999: 4) lays out five distinct but interrelated functions a community foundation that it performs in service to its community. In this case, these functions can be applied to PDI Beneficiary Trusts as well:

1. Resource Development

A community trust mobilises, attracts, pools and manages financial resources for the current and long-term benefit of a local/defined community. It ordinarily receives donations from a single donor: either an individual or a company. A community trust’s primary aim is to build a permanent, continually growing asset base to serve the community into the future.

2. Financial Stewardship

A community trust acts a guardian of donated funds, investing and overseeing their safe-keeping. The trust follows sound investment principles, and takes independent, professional advice on managing the invested funds.

3. Donor Service

A community trust offers flexible, cost-effective services to the donor, tailored to its interests and giving capacity. The donor can give an unrestricted contribution which can be used by the community trust members for any community need or set up funds which are designated for particular purposes or organisations they wish to help. Donations can include cash, securities, property and in-kind services.

4. Grantmaking and Programme Support

Using interest income from invested assets, a community trust makes grants and operates programmes to address a wide variety of local needs in its community. The trust should take a holistic view of local development. As such its grantmaking and programme support can cover areas such as health and human services, education, the environment, economic development, and arts and culture. These priorities are established by monitoring local conditions, analysing gaps in services and funding, and responding to changing needs.

5. Community Leadership

A community trust provides leadership on pervasive community problems by serving as a facilitator, convenor, catalyst and broker. As a neutral body, it can facilitate joint action with other trusts or foundations, stimulate public-private partnerships, and bring local projects to the attention of national and international grantmakers.

In the current historical context, a functional perspective would assign Foundations and Trusts the role of supplementing society's quality of life by funding arts and culture, education, entrepreneurship, newspapers/literature, poverty upliftment initiatives, health care and research, etc. Further they invest in infrastructure and often pay salaries, maintaining employment. As such, Foundations and Trusts are culture shaping entities, birthed out of an overflow of capital accumulation.

Kuhlase argues that in order to “contribute to sustainable development, poverty reduction, peace building and social cohesion” meaningful, cross-/multi-sectoral partnerships, where PDI Beneficiary Trusts are at the center of an alliance between civil society, private and public sectors need to be developed. Because, Community Foundations or Trusts have ‘soft’ power, they “are well positioned to take the lead in forging mutually beneficial partnerships” between these three sectors (Kuhlase, 2005: 3). This cross-sectoral development dispensation assumes unique characteristics in South Africa, the most important, arguably, being the transfer of the ownership of wealth generating assets from the private sector to PDI Beneficiary Trusts.

Feurt (1999: 5) also suggests characteristics of community foundations that distinguish them from other non-profit organizations, distinctions that may prove useful in conceptualizing PDI Beneficiary Trusts as they emerge in BEE transactions.

- *Independent.* A community foundation is a separate legally-recognised entity, operated exclusively for charitable purposes, and is independent from control or influence by other organisations, government or donors.
- *Geographically-focused.* A community foundation concentrates on a specific geographic area, typically a city or a town

- *Knowledgeable.* A community foundation has in-depth knowledge about the geographic area it serves, including needs, opportunities, people and institutions.
- *Inclusive.* A community foundation involves all types of local citizens and institutions in its activities (e.g., on its governing board and advisory committees, as donors, as grant and programme beneficiaries, etc.).
- *Permanent.* Endowed funds provide the community foundation with the ability to plan ahead and address long-term issues in the community, offer donors the opportunity for their donations to make a difference for years into the future, and provide financial sustainability for the community foundation and its beneficiaries.
- *Innovative.* A community foundation continuously seeks out new ideas and approaches in working with donors, nonprofits and the community at large.
- *Flexible.* A community foundation accepts various forms of assets from all types of donors and addresses a wide spectrum of community interests and needs.
- *Accountable.* A community foundation has open and transparent policies and practices concerning all aspects of its operations, and informs the general public and donors about its purposes, activities and financial status on a regular basis.

Source: Feurt S. 1999. International Perspective: Models, Experience and Best Practice in Bertelsmann Foundation ed. Community Foundations in Civil Society.

The Theory of Common-Pool Resources

The joint ownership of a collective resource and its management in a participatory manner is challenging, because collective resource pools, otherwise known as common-pool resources, relies on establishing and exercising communal agreement, while avoiding the undue influence of individual interests and preferences. Understanding how communities deal with common-pool resources is vital to developing functional and useful PDI Beneficiary Trusts, especially in the context of BEE transactions.

Initially common-pool resources referred to natural or man-made resource systems that are sufficiently large as to make it difficult (but not impossible) to exclude potential beneficiaries from obtaining benefits from their use (Ostrom, 1999). Common Property Resources (CPR's) are somewhat similar but "they involve public goods that can be privately consumed and once consumed, they disappear. While it is in everyone's interest to ensure that the public good is preserved, everyone has an incentive to overuse that good" (Ostrom, 1999: 4).

Common-pool resources often include natural resources such as irrigation systems (water), fisheries, grazing land, or forests (Ostrom, 1999: 4). However, one can also use this definition to refer to financial common-pools, such as funds placed in a trust vehicle. The fund is managed collectively through a board of elected representatives and constitutes a resource that can be utilized by the prescribed community. Respective policy makers need to recognize the local self-organisation, independent decision making capabilities of the board of trustees as well as respecting their own resource use practices. If organizational structures determining how the board of trustees must

distribute the funds do not exist, chaos can ensue and the collective funds are at risk of being either depleted (due to “overharvesting”) or being underutilized and of no benefit to anyone.

In order to determine how individuals who generally do not know each other behave towards a common-pool resource Ostrom proposes using Game theory. “Game theory is a useful theoretical tool for representing a simplified, core social dilemma facing a set of individuals sharing a commons. Game theorists assume that individuals base decisions on immediate returns to self” (Ostrom, 2008: 2). In other words, individuals who do not know each other often over-utilize a common resource because they believe, either that it won’t ever be depleted, or because they simply do not regard the needs of others. This may lead to what is commonly termed “overharvesting”. Deforestation and excessive ocean fishing provide a clear example of rampant overharvesting (Berkes et al. 2006 and Ostrom 2008: 2).

However, by allowing participants to engage in face-to-face communication in which they can discuss how best to use the resource, enables them to reduce overharvesting substantially (Ostrom and Walker 1991). Some theories predicts that when given a chance to communicate, most subjects first try to figure out what is the best joint strategy; then try to build a group identity and to follow the agreed-upon strategy – increasing their joint payoffs (Ostrom 2008: 2). Subjects that communicate well and have developed structures in place are also more likely to punish others who continue to overharvest (Ostrom et al. 1992).

In some settings and under certain circumstances individuals “may develop broader sets of preferences than just their own immediate material well being—and they may actually do better as a result of their broader preferences” (Ostrom, 2008: 10). Individuals also subconsciously weigh up the “costs and benefits of following a norm” that they feel they must or must not do (Ostrom, 2008: 11). For instance some individuals may learn to adopt and use norms of trust and reciprocity – especially when a common resource is at stake. Further, although an individual may cooperate because of their own norms and values, he/she may also learn that the “reputation of others increases trust” and that “their own efforts to initiate reciprocity and cooperation will lead to higher cooperation and net benefits” (Ostrom, 2008:13).

This understanding that in certain contexts people’s individual and social behaviour differs is useful when combined with the knowledge that in order to ensure communal structuring of communal-pool resource use, individuals need to communicate. In other words, before developing a community trust the members, beneficiaries and selected/elected trustees need to communicate the parameters of use of the given resource (funds).

Corporate sponsored Foundations and PDI Beneficiary Trusts have their genesis in the broader social movements of the 19th century that also witnessed the birth of modern civil society. As such they have contributed to social reform and acted as a cultural force that modernized philanthropy and vitalized aspects of modern society that we now take for granted, such as tertiary education and modern medicine (Chernow, 2002).

In its contemporary guise the PDI Beneficiary Trust has proved useful as a vehicle for channeling funding for development, administering development programmes and empowering the victims of underdevelopment. It represents the manifestation of a current discourse which holds that business and industry should build society and communities, not only by creating employment and paying taxes, but also by directly funding the establishment of schools, hospitals and other critical

infrastructure; the growth of local economies and small business enterprises; the protection and promotion of the interests and rights of marginalised peoples; and other obligations more readily attributed to the state first, and civil society next. This notion that social responsibility is part of best practice for business is complemented by a conviction in development theory that communities should take ownership of their own development and upliftment.

However PDI Beneficiary Trusts also represent a problematic shifting of responsibility for development and social welfare from the state to private and civil institutions, precipitated by a contested ideology, which maintains that sustainable development is best achieved through trade activities in a free market.

In South Africa PDI Beneficiary Trusts are employed in a grander nation building project which consciously subscribes to the idea that development must be the responsibility of all sectors of society. As findings further on demonstrate PDI Beneficiary Trusts are a ubiquitous mechanism for the private sector to meet its transformation obligations through BEE, as well as to contribute directly to development and social welfare. In the theory of common pool resources the literature offers a theoretical framework for not only the analysis of the utility of PDI Beneficiary Trusts to social transformation and development through BEE transactions, but also to developing workable models for the successful operation of these Trusts. The theoretical framework is the most valuable contribution to this study of the literature review.

5. The Occurrence of PDI Beneficiary Trusts in BBBEE Transactions

5.1. Additional Details on Methodology

The Data Cleaning, Collation and Analysis Process

Quantitative data illustrating the frequency of trust vehicles in BEE transactions is not readily available. To address this knowledge deficit a database of all BEE transactions concluded between January 2000 and February 2009 was purchased from Empowerdex. The content of the database was reviewed and coded based on patterns emerging from the content. The codes were then subjected to basic descriptive analyses to produce the findings that follow in the results section.

Description of the Data

Each database record includes the name of the company relinquishing a stake in the BEE transaction and indicates whether the stake is in the company or a company asset; the database indicates whether the company or asset is listed; the name of the BEE party or the BEE consortium, deliberately distinguishing between the two; the date of the conclusion of the deal; an indication of whether the deal represents an acquisition, sale or a joint venture; the size of the BEE portion in percentage, as well as the value of the stake in ZAR; the value of the concluded deal. The database includes a field that provides basic details on the deal structure, specifically the parties in the BEE consortium where it applies, and the proportions of the BEE stake assigned to each party. It is this latter field that is of particular interest to the research because it would have some indication of whether a Trust vehicle is included in the deal structure.

Limitations of the Data

In reviewing the database it became evident that the listing of BEE transactions was not exhaustive. The research team added records to the database for the 2007 and 2008 listings. Numerous fields were not complete for every record, specifically those related to the size or value of the transaction. The column indicating whether the transaction remains current was also not consistently updated.

The most significant limitation is that the field providing information on the participants in consortium deals contains only basic data, and the data is only complete up to 2005. The consequence is that the research team had to initiate a process of supplementing the database content with details on participating entities (where these were omitted), and deal structures. Even where this field is complete, no clarifying detail on the Trust parties is provided, necessitating that the team do additional data gathering to ensure that Trusts involved are not vehicles benefitting private interests.

Supplementing the database content is an onerous undertaking, but the process will continue to completion. What is already evident is that there is an increase in BEE transactions that include a Trust vehicle, with the frequency of such vehicles apparently peaking in the 2007 to 2008 financial year. In addition a typology of PDI Beneficiary Trusts is also beginning to emerge, an early version of which is presented here.

5.2. Results

Quantitative Description on Occurrence of Trusts

Although the data is incomplete the number of BEE transactions recorded suggests that the trends demonstrated in this analysis are reliably indicative of the basic trends in BEE transaction involving the South African private sector.

Figure 1 shows that there has been a significant increase in the number of documented BEE transactions over time, with a leveling off occurring from 2006 to 2008. The turn in trend may be attributable to a number of factors:

- As BEE obligations are met by the prominent companies active in the South African Market place one would expect the number of transactions to even out and begin to keep pace with the growth rate of the economy, which would dictate the growth of companies, the number of new entries and therefore the number of BEE transactions necessary to comply with the Codes of Good Practice.
- The global credit crisis: BEE transactions require financing and available financing diminished considerably during the period. Certainly the significance of the turn in the trend is not particularly noteworthy prior to 2008.
- The database is constituted from publicly announced transactions, which would limit the data to transactions deemed newsworthy by the press. It is fair to suggest that over time transactions of medium size become less publishable in the light of the larger transactions that have preceded them.

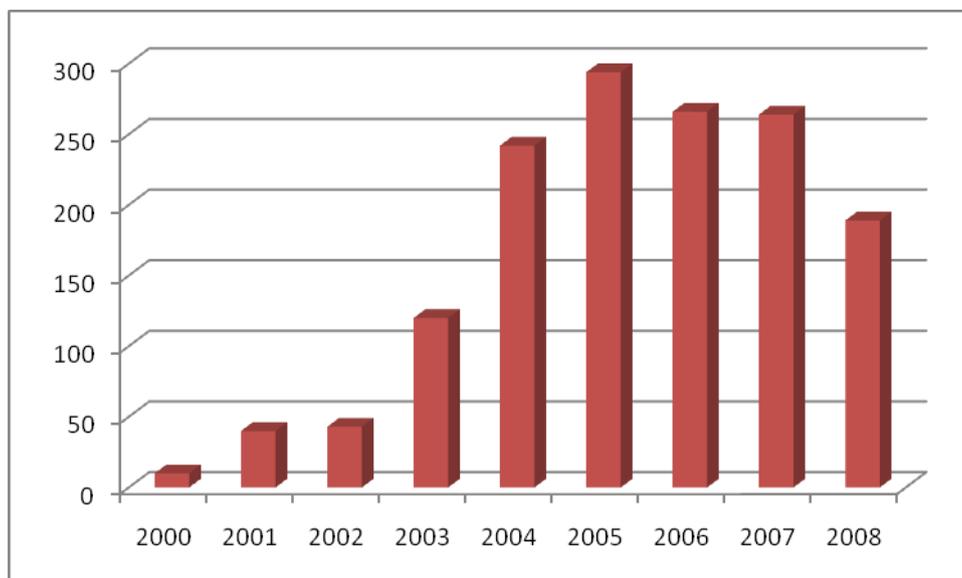


Figure 3: Number of BEE transactions 2000 to 2008

Unfortunately the database is not complete to 2009 in terms of the details of entities involved in consortium type BEE transactions. However, figure 2 demonstrates quite emphatically that the number of Trust entities included in BEE transactions has been increasing over time. The “unclear” category denotes transactions where the details of the nature of the parties involved suggest that Trust entities were involved, but the data in the database does not confirm this conclusively. Even if the “unclear” category were to be omitted, the trend for inclusion of entities, denoted by the “yes” category, remains evident.

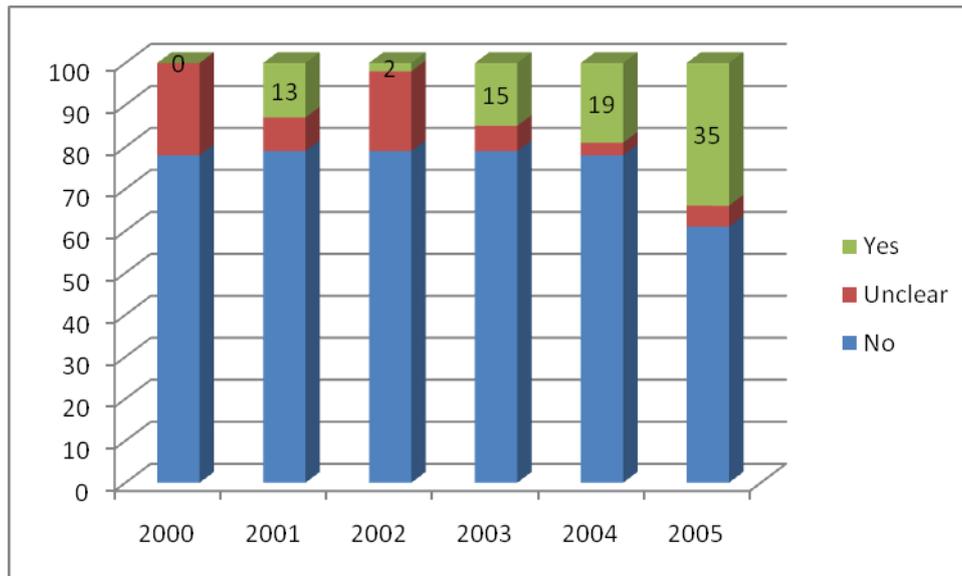


Figure 4: Proportion of BEE transactions including trust entities 2000 to 2005

Non-Quantitative Update on the Occurrence of Trusts

Even without the complete data for 2006 to 2008 it is evident that the inclusion of Trust vehicles in order to broaden the base of ownership in BEE transactions is becoming the norm, certainly in the bigger deals being concluded. Reg Rumney reporting in the Mail & Guardian at the end of 2009 points out that:

“The top three big BEE deals this year all have a broad-based component and all are vendor-financed, that is, financed by the companies doing the deals . . . There remains an element of narrow-based empowerment in these deals. Manyoro, for example, is led by former Robben Island prisoner Peter-Paul Ngwenya, who is executive chairperson of Makana Energy Consortium, one of the “strategic black business partners. But, none of the deals involves high-profile BEE personalities or political high-flyers.”

The ubiquity of Trust vehicles in the larger BEE transactions and their increasing popularity across all deals makes it imperative that the utility of PDI Beneficiary Trusts in the achievement of BBEE objectives be assessed.

5.3. An Initial Typology of Trusts in BEE Transactions

Categories of Trusts

For the purposes of this research PDI Beneficiary Trusts are legal but not natural persons that:

- Are specifically constituted or, alternatively, are included in a transaction, for the purpose of improving the BBEE score of a private enterprise on the BBEE scorecard published in the “BEE Codes of Good Practice”
- Is purportedly intended as a vehicle to economically benefit a broad but delineated base of previously disadvantaged individuals through the ownership of equity in a private enterprise, the earning of dividends from that equity and the spending of dividend revenue on development initiatives.

An initial review of the content of the database, supplemented with additional research, suggest that there are a number of different types of PDI Beneficiary Trusts can be distinguished. An initial typology in this regard follows.

- Type 1: The Corporate Social Investment function of a private enterprise, whether constituted as an independent Foundation or simply a department or function within the business, often includes the term ‘Community Trust’ or the word ‘Trust’ in its name.
- Type 2: Entities that are founded by members of communities as a vehicle for raising and channeling resources from donors for development interventions, or for managing commonly owned existing resources, and in both cases these are often labeled ‘Community Trusts’.
- Type 3: Not-for-profit entities describing themselves as ‘Community Trusts’ that are involved in development work, but that have their roots in general civil society rather than in the private sector or a specific localized community.
- Type 4: Entities specifically constituted for the purposes of broadening the empowerment base of a particular BEE transaction. These would include Trust vehicles benefitting a community and Workers Trusts designed to benefit employees.

There are also instances of vehicles termed ‘Trusts’ that participate in BEE transactions but are intended to economically benefit a select group of individuals. The latter are, in effect, vehicles for private business interests rather than entities furthering broad development objectives and as such are excluded from the typology.

Examples of Trust Types

Type1: CSI Functions of Private Companies - Volkswagen Community Trust³

Established as early as 1987, the Volkswagen Community Trust addresses key socio-economic factors within Volkswagen’s surrounding community of the Nelson Mandela metropolitan district in the Eastern Cape. It focuses specifically on education, youth development and job creation. Volkswagen has marketed its strategy by indicating that it has had a long history of community involvement and investment in local communities. The company spends roughly around R16 million each year on various projects, especially in training and skills development.

The trust’s rational is to “assist communities in their development, focusing on self-development and sustainability”. The Volkswagen Trust is a self-funding trust that invests the returns made on a capital base in the local community. The Board of Trustee members are “drawn from employee representatives, management and the Uitenhage community” (DTI, 2003: 26).

The trust’s priority investment area is a bursary programme offering approximately 500 bursaries over the past five years. The beneficiaries have studied towards qualifications in areas such as Engineering, Finance, Commerce, Computer Studies, Science, Technology and Business Studies. More than 50 percent of these recipients are Black females

³<http://www.vw.co.za/about/citizenship/community-development>
http://www.vwct.co.za/Pages_Partners.htm

According to Volkswagen South Africa's website, its trust supports a wide range of local organisations to help "raise the next generation of South Africans". The Volkswagen Community Trust has partnered with the following community-based organisations:

- Betheli Christian Centre
- Edward Cook Feeding
- Sophamakama Community Based Development
- Khanya Development Foundation
- New Life Pregnancy Crisis Centre
- Masibambane African Action Group
- Jerusalem Ministries

Volkswagen of South Africa has also taken "ownership" of two cottages in two different children's homes, namely SOS Children's Village and Oosterland Youth.

BHP Billiton Development Trust⁴

BHP Billiton Community Development Trust was developed because the company feels that it is a way to show that it takes its responsibilities as a good corporate citizen seriously. The BHP Billiton Development Trust co-ordinates and manages the company's CSI activities. Since 2000 the Trust contributed over R310 million to various community projects across South Africa. BHP Billiton contributes 2% of pre-tax profits to corporate social investment initiatives.

One of the company's flagship community initiatives is the Dreamfields soccer initiative. This aims to "enhance the development of underprivileged communities in South Africa through soccer by building soccer fields, the provision of soccer equipment as well as staging events and tournaments that initiate and enhance ongoing soccer activities in a sustainable manner".

The BHP Billiton Development Trust funds and supports a number of community projects, with a strong focus on education. The Ingwe Colliery runs a Saturday School Programme. Further the trust supports a number of environmental programmes, including a greening project called Umhlaba-Isizwe, which is being implemented in rural communities that are situated in areas rich in biodiversity or are ecologically sensitive, such as Richards Bay.

Mutual & Federal Community Trust⁵

Mutual & Federal Community Trust is one of Mutual & Federal's four black economic empowerment initiatives that receive a portion of over 11% of the company which is allocated to direct black ownership. The four key BEE components of Mutual & Federal's and their share percentages are:

- Staff and Management – 6.14%.
- *Black Business Partners* – the WIPHOLD consortium (women's empowerment group) with 3.5% and Mtha-we-Mpumelelo ("Mtha") with 0.5%.

⁴http://www.bestcompaniestoworkfor.co.za/Company%20profiles/BEST%20EMP_BHP%20BILLITON.pdf

⁵<http://www.oldmutual.co.za/Documents/BEE%20Deal/Mutual%20and%20Federal%20Press%20Release.pdf>

- *Mutual & Federal Black Broker Trust* – 0.5%. Established to provide or secure finance to black people wishing to develop broker businesses.
- *Mutual & Federal Community Trust* - 0.5%. Established to provide meaningful benefit to selected community and charitable projects.

Mutual & Federal’s CSI programme focuses its “financial assistance on 26 established and recognised organisations that work towards improving social stability, quality of life and developing economic stability”. Donations are reviewed annually and budgets allocated according to perceived needs. They profess to have a continuous, measurable programme that benefits thousands of disadvantaged South Africans, conservation, education and rescue institutions. Primary areas supported are:

- Education
- Health and Welfare
- Road Traffic Safety
- Crime Prevention
- Conservation & the Environment

Strict guidelines ensure that CSI initiatives remain focused and benefit as many people as the budget will allow. To ensure these objectives are met, each request is thoroughly assessed and investigated before financial assistance is granted.

Type 2: Community Managed Development Vehicles

Khayelitsha Community Trust⁶

The Khayelitsha Community Trust (KCT) was established by the City of Cape Town in 2003 in collaboration with Rand Merchant Bank (RMB). This case provides an example of how provincial government can participate with private donors to develop a trust that benefits a broadly defined geographic community.

The Khayelitsha Community Trust aims to facilitate the development of the Khayelitsha Business District (KBD) by securing the necessary private sector funding to initiate the first phase in the development process (Khayelitsha Community Trust, 2006). The financial plan for phase 1 of the KBD development provided for a total development cost (private and public funding) of approximately R 415 million. R 265 million of this has been sourced to provide for the following approved commercial projects:

- Retail centre
- Residential (comprising 1200 units)
- Municipal offices
- Service station
- Sport facilities,
- Residential units,
- A bus and taxi terminus,

⁶ <http://www.kctrust.org/> (site not yet operational)

- Landscaping, public spaces and greening
- Bulk services, road and other infrastructure

The development of the Khayelitsha Business District (KBD) is closely aligned to the City of Cape Town's strategic focus areas as expressed in the City's Integrated Development Plan (IDP) because it provides for the initial appointment of empowerment consultants including the appointment of:

- A contractor for the upgrade of the bulk electricity supply
- A consultant to provide a revised development plan for the KBD
- A consultant to investigate and make strategy proposals for integrated CBD Management

The Khayelitsha Business District is being developed adjacent to the Khayelitsha rail station. As such it will provide a transport interchange hub where entrepreneurship can be encouraged. The housing development nearby will also facilitate the improved mobility and accessibility for the people of Khayelitsha to community facilities and economic opportunities. Further the aim of the project is to build strong communities that offer various public facilities in support of health and social development.

Type 3: Community Independent NFP Funds

James 1:27 Trust

Started as a trust to facilitate the development of a technological platform that will service organisations reaching out to children orphaned through the secondary effects of HIV and AIDS, the James 1:27 Trust is an example of a new generation not-for-profit community trust. The trust is managed by a board of representatives from various civil society institutions and private sector organisations and the members are appointed on four year trusteeships. The community trust funds are derived from charitable donations made by individuals and private corporations willing to contribute towards the trust's cause. The James 1:27 Trust does not serve a geographical community but rather, its target population is orphans and vulnerable children in South Africa.

6. The Contribution of Trusts to BBBEE Performance

Overall, and despite the public emphasis on broad based empowerment, the BBBEE codes of good practice continue to favour narrow over broad-based BEE. Although the scorecard does incentivise the distribution of economic benefit through black ownership in an enterprise, it does not prefer broad based empowerment and because broad based ownership is a complicated business there seems little reason for companies to select the onerous route. Nevertheless a trust vehicle can contribute to the Direct Empowerment score on the scorecard.

It is important to recognise that the policy of Black Economic Empowerment, although emphasising the extension of the ownership base of private enterprises to previously disadvantaged individuals, is characterised by its formulators as primarily a developmental policy. Ownership of private enterprise is one of a number of empowerment objectives that the policy sets out to achieve. Together with a set of complementary objectives, the entirety of BEE policy is intended to provide previously disadvantaged individuals in South Africa with the opportunity to access and participate in the mainstream economy and improve their prospects. The complementary objectives are clearly reflected in the scorecard presented in the BBBEE Codes of Good Practice, published by the Department of Trade and Industry, and reproduced here in Table 1.

Table 1: BBBEE Scorecard Categories and Points Distribution

| ELEMENT | WEIGHTED POINTS |
|----------------------------|------------------|
| Ownership | 20 |
| Management Control | 10 |
| Employment Equity | 15 |
| Skills Development | 15 |
| Preferential Procurement | 20 |
| Enterprise Development | 15 |
| Socio-Economic Development | 5 |
| | TOTAL 100 POINTS |

Source: DTI. (2006). *Codes of Good Practice for B-BBEE*. Available at <http://www.thedti.gov.za/bee/Inside.pdf>

Despite its developmental emphasis BEE has been criticised for creating an advantaged elite while failing to address the plight of the severely disempowered to any satisfactory degree. The general thrust of the critique is aptly captured by Robert Southall in his article in the journal *Review of African Political Economy*:

“BEE has also become highly controversial, critics arguing variously that it serves as a block to foreign investment, encourages a re-racialisation of the political economy, and promotes the growth of a small but remarkably wealthy politically connected 'empowerment' elite.”

There is more than sufficient evidence to demonstrate that BEE has had a transformational impact on South African society. At the same time it is equally clear that economic disempowerment persists.

While it would be unreasonable to attribute economic inequality to the failure of a single policy, a case can be made for the complicity of that policy in perpetuating economic inequality. Further, the flaw in the policy is fundamentally ideological. Cumulatively the categories in the scorecard imply that economic empowerment is linked to social opportunity, as well as private ownership in enterprises. The developmental emphasis of the scorecard, with its inclusion of measures of social opportunity, is more explicit when illustrated in Table 2.

Table 2: Distribution of Scorecard Points across Ownership and Social Inclusion Categories

| Ownership | Indirect Ownership | Social Inclusion |
|-----------------|--------------------------|----------------------------|
| Ownership | Preferential Procurement | Management Control |
| | | Employment Equity |
| | Enterprise Development | Skills Development |
| | | Socio-Economic Development |
| Total Points 20 | Total Points 35 | Total Points 45 |

This is a dilution of the core prerequisite for economic emancipation which remains ownership of wealth generating assets. Provided this position is accepted then it can be argued that the 45 points assigned to social inclusion, which are clearly to the benefit of a broad base of previously disadvantaged individuals, reflect a very expansive conception of empowerment but do not directly address economic emancipation.

6.1. Control over Wealth Generating Assets

What then of the remaining 55 points that do address economic emancipation? Is this slight quantitative bias in the mechanism sufficient to drive the redistribution of benefits of business ownership to a broader base? While preferential procurement and enterprise development hold significant promise, the ownership category remains excruciatingly problematic for the broad based ideal of black economic empowerment.

Preferential Procurement and Enterprise Development

Promoting enterprise development through enterprise development initiatives and procurement spend is one of the mechanisms accommodated in the BEE scorecard. It promotes ownership by PDIs, although not conventionally resulting in ownership of equity in the sponsoring enterprise. It is further plausible to hypothesise that such initiatives have a more direct growth effect on the economy because it is not merely a transfer of existing economic benefit but generative of new enterprise. However the incentive for driving enterprise development is limited: it only accounts for 10% of scorecard points available (although in combination with a preferential procurement strategy the sponsoring enterprise could realise up to 30% of scorecard points); it does not contribute to the sponsoring enterprises' ownership score; the enterprise development function is managed and its performance measured according to frameworks that generally are incapable of tolerating the inevitably high failure rate of the new enterprises in their portfolio.

Ownership

In order for ownership to be recognised and points assigned, two criteria need to be met:

- Ownership in an enterprise must include unrestricted voting rights in the governance of the enterprise in question. By way of illustration, if a previously disadvantaged person is said to own 26% share in a business, then she or he must control 26% of the voting power.
- Ownership in an enterprise must include direct control over the economic benefits that ownership implies. By way of illustration, if a business pays a dividend to shareholders then the previously disadvantaged individual must receive the dividend payout due to a shareholder holding the amount equity that he or she does.

Broad Based Share Issues

Broad based share issues such as those launched by Sasol and MTN in recent years have intended to broaden the base of ownership by offering equity to as wide a qualifying public as possible. The advantage of this solution is that it meets the ownership criteria outlined in the Codes of Good Practice without any qualification. However the strategy has been beset with its own unique and apparently intractable problems. There is often a dilution of value for existing shareholders and, coupled with a race exclusive issue, these share launches inevitably involve some reputational backlash. It has also been speculated that the ring-fencing by race criteria is constitutionally dubious and that there may be legal resource for incorrigibles, though in our current cultural climate the risk is muted.

Of greater significance is the fact that artificial arrangements have to be made to combat an inexorable law of capital accretion i.e. that equity flows to concentrations of equity. Lock-in periods constraining the sale of equity are instituted but as has been repeatedly, and sometimes dramatically, demonstrated such provisions are very difficult to police. It is suspected that black ownership through such share issues is ultimately diluted as beneficiaries cash in or are exploited by seasoned market operators.

Community Trusts

Consequently PDI Beneficiary Trusts are emerging as a popular response to the increasing emphasis on BBBEE. However there is very little documented research on the role of trust vehicles in the context of BEE. Neither the extent to which BEE outcomes are realised through such arrangements nor the factors that enable or constrain their efficacy are widely known. Anecdotal evidence suggests that the challenges associated with implementing a PDI Beneficiary Trust are significant and that many companies are sitting on a reputational time bomb as their trust vehicles appear poised to fail.

6.2. The Trouble with Trusts

Problems with Extending Ownership through Trusts

The BBBEE Codes of Good Practice directly addresses the use of trusts as a mechanism for implementing broad based black economic empowerment. In anticipation of trusts being utilised to game the system, the codes institute the flow through principle. The flow through principle states that the criteria for ownership – unrestricted voting rights and direct control over economic benefits - must ultimately rest in natural persons. The implications of the flow through principle significantly problematise the use of trusts to extend ownership to a broader base in the following ways:

- A mechanism needs to be instituted to ensure that the control over economic benefits accruing to the intended beneficiaries, is in the hands of those beneficiaries, in practice. This implies that legitimate representatives of a defined beneficiary community that qualifies as previously disadvantaged conveys decisions from the community to the board of trustees governing the

trust, at the very least. Ultimately, the will of the beneficiary community in terms of the deployment of their economic benefits must be reflected in the operations of the trust. This is an inordinately difficult outcome to secure, as is detailed in the section that follows.

- A mechanism needs to be instituted to ensure that the voting rights inherent in the shareholding vested in the beneficiary community are exercised whenever the occasion for a shareholder vote arises. The important nuance to emphasise here is that this provision is not a reference to voting on decisions of the trust; it is in reference to the business of the sponsoring enterprise.

Simply stated the sponsoring enterprise needs to take care that the ownership control rightfully vested in the natural persons the trust represents is exercised by those persons. Overt negligence in this regard will result in the scorecard points for ownership not being awarded. Even unintentional negligence however may carry substantial risk, including reputational risk.

6.3. Conclusion on the Analysis of BBEE Policy

While social inclusion is a worthy and critical transformational objective, economic emancipation requires direct ownership of wealth creating assets. The BBEE Codes of Good Practice are adequate for driving private enterprise towards broadening black economic empowerment through efforts to nurture enterprise development and implementing preferential procurement practices. However the structure and mechanisms of the code continue to bias traditional empowerment when it comes to the ownership criteria. The single viable vehicle addressed in the codes for broadening the ownership base – community trusts - is difficult to implement and the current scorecard does not sufficiently incentivise business to go to the trouble. Our research suggests that private enterprise has yet to realise just how challenging community trusts are. Once the risk is made evident the frequency of their inclusion in BEE transactions is likely to decrease.

It must be stated in defence of community trusts that they currently represent the only viable solution to extending enterprise ownership to a broader base. If they are implemented with due dedication and care they are the most effective way of honouring the spirit of BBEE, providing previously disadvantaged individuals with the prospect of not just social inclusion, but economic emancipation.

6.4. Recommendations on Maximising the Potential Contribution of Trusts to BBEE

It is to be expected that the current policy document and scorecard will stand for some time. If the scorecard were ever to be revised to better favour efforts at ensuring broad based ownership however, the following two recommendations might be considered:

- In addition to the current ownership point's category, the code could create an additional point's category that sets criteria for broad based ownership. This may include exclusionary criteria that awards the points for BBEE ownership only if the natural persons fall within certain income brackets. A means test solution such as those used by the Department of Social Development to manage access to grants could be considered.
- The code could be more explicit about the structure, operations and qualifying beneficiaries of 'community trusts.' It could also describe mechanisms that trusts need to put in place in order to ensure that ownership rights (unrestricted voting rights and control over economic benefits) are satisfactorily exercised.

In terms of the management of Trusts:

Mechanisms need to be instituted in the operations of Trusts to ensure that the risks associated with the access to economic benefits and exercising of voting rights are appropriately managed.

7. Persistent Challenges of PDI Beneficiary Trusts

A number of challenges constraining the efficacy of PDI Beneficiary Trusts were persistently reported by key informants, as well as related factors that best enable them. The responses of interviewees are arranged here in 5 themes: defining beneficiary parameters, the representation of beneficiaries in decision-making, the fragility of community based institutions, operating a PDI Beneficiary Trust, mitigating the negative impacts of establishing a trust including the disruption of existing functional relationships.

7.1. The Structure of BEE Transactions and the Typology of Trusts

BEE transactions are generally speaking financed deals in which equity in an enterprise is sold to one or a number of black owned juristic entities. The sale of equity improves the ownership rating of the seller against the ownership criteria on the BBBEE scorecard. The fact that the deal is financed, either among the transacting parties or by a third party (e.g. an investment bank), means that a loan must be repaid by the black owned entities, conventionally from the dividends disbursed to them by virtue of the equity they now own in the seller.

The financed nature of these transactions has important implications for a Trust which might be included in the deal: because the Trust is repaying a loan with the dividends it earns from its equity stake, there is very little capital available to start development initiatives during the narrow repayment period. In fact there is often not even sufficient capital to fund the establishment of the Trusts operational processes in anticipation of its immanent function as a development funder. This paucity of capital in the early years of the Trust's existence presents a significant risk to its envisioned success.

For one particular type of Trust vehicle this risk is its defining characteristic exacerbates the effect of all the other risks reported by the key informants. Trusts that are established specifically for inclusion in a particular BEE transaction have no autonomous asset to contribute. The Trust purchases the asset – the equity stake in the sponsoring enterprise – with a loan that it must repay in conditions stipulated in the deal structure. These Deal-Specific Trusts are especially vulnerable to risk in their early years.

In contrast some Trusts control an asset that they use to transact the deal with. For example the beneficiary community might own land or mineral rights that it exchanges for cash and equity in a joint enterprise. In such cases the Trust vehicle may have been in existence some time prior to the transacting of the BEE deal. In other cases the Trust may have been established for the purpose of assigning ownership of the beneficiary asset to a juristic person for the purpose of transacting the deal. In either case the Trust has the advantage of offering an essential asset which it can leverage to ensure an immediate revenue stream that isn't diverted to finance a debt obligation. The Deal-Independent Trusts are apparently more resilient to the risks reported by key informants.

7.2. Defining Beneficiary Parameters

The trust deed must define the beneficiaries and the proportion of their entitlement to receive distributions.

In establishing a PDI Beneficiary Trust it becomes crucial to appropriately define who the beneficiary community is. It is also a rule for trusts in the BBBEE Codes of Good Practice and therefore especially important if the sponsoring enterprise intends promoting broad based empowerment

through the trust vehicle. In order to maximize their scorecard performance the company needs to guarantee that the representatives of a qualifying beneficiary community exercise unrestricted voting rights as shareholders in the sponsoring enterprise and that the community itself has unrestricted access to economic benefits of ownership. Without a clearly defined 'community' neither of these benefits can be guaranteed.

Clearly delineating a beneficiary community is no simple matter however. By what criteria should they be defined? If by geographic location, how do you propose to manage groups who identify themselves as distinct from their neighbors within the same area (e.g. migrant labor versus indigenous peoples)? If by shared identity, then whose identifying criteria do you use, what local intelligence must you access to do so appropriately, at which level of shared identity do you draw the line and how will you manage the local prejudices and related social injustices between groupings within a broader shared identity? If by local authority structures how do you identify, engage and accommodate the needs of outsiders?

In the more successful examples of PDI Beneficiary Trusts a common element tends to be the fact that a community identity has been mobilised around an asset such as land ownership or mineral rights. That asset has been leveraged to secure equity in a business enterprise, so the community brings something to the table. The community is often already being served by a legitimate representative body such as a "property association" that is often rooted in traditional authority structures. In contrast however, the emerging trend is for PDI Beneficiary Trusts to be established at the initiative of the sponsoring private enterprise. Equity in the enterprise becomes the asset and a sale needs to be financed. More often than not, and perhaps most problematically, there is no obvious beneficiary community and no existing community mobilisation factors to take advantage of. The need for expertise and models to address these challenges could not be more self-evident.

7.3. Ensuring Appropriate Representivity

"You will elicit politics; you cannot spread patronage wide enough to avoid it."

Although not explicitly stated as a rule governing the use of trusts in the 'Codes of Good Practice' it appears implicit in the general principles governing voting rights and unrestricted access to economic benefit that members of the beneficiary communities be represented on the board of trustees. In addition, with the trust functioning as the vehicle for a broad based ownership scheme the relevant rules in the Codes of Good Practice might be applicable. At the least they might function as a guideline. The rules state that 'at least 50% of the fiduciaries of the scheme must be black people and at least 25% must be women.'

The inclusion of beneficiary representatives on the board of trustees is no simple matter, as key informants repeatedly point out. There are four critical considerations in this regard.

- **Legitimacy:** The beneficiary representatives need to be regarded as legitimate by the trust beneficiaries they represent in order to ensure that board decisions are not unreasonably contested. Legitimacy is complicated by the cultural heterogeneity of the beneficiary community and any special interests that may be current. If the legitimacy of representatives is dubious, progress of the Trust's development is at significant risk.

- **Special Interests:** Beneficiary representatives tend to advocate specific interests in the proposals they make, inputs they give and decisions they take at board level. It is important to determine to what extent those are general interests of the beneficiaries they represent or special interests of particular groupings within the wider beneficiary community.
- **Wants and Needs:** It is a popular misconception that a beneficiary community is inevitably best placed to determine its development needs. This is only partly true. People commonly confuse what they need with what they want and the development context is no exception. It is important that all trustees are privy to critical information and expert advice, including beneficiary representatives. In addition a mechanism must be implemented to ensure that the beneficiary representatives are clearly communicating the inputs informing decisions to their constituents.
- **Management of Expectations:** Introducing the possibility of resources and accruing benefits in disadvantaged communities mobilises and augments expectations. Unmet expectations represent a substantial risk for the sponsoring enterprise. The financed structure of many BBEE transactions and the long cycles characterising the implementation of impactful interventions dictate that substantive benefits to the beneficiaries will become apparent over the medium to long-term. Beneficiary expectations will have to be managed and it is important that the beneficiary representatives appointed or elected to the board of trustees are allies in this task. Provided the sponsoring enterprise is measured in its undertakings to beneficiaries, and that its board representatives are reflecting this attitude, then the equanimity of beneficiary representatives on the board business is a function of personality. This must be considered when board appointments are made or representatives elected.

If the PDI Beneficiary Trust is merely a vehicle for corporate social investment or similar, it would be possible to avoid the complications associated with accommodating beneficiary representatives on the board of trustees. However there are reputational risks associated with that alternative. Certainly the goodwill return intended from investment in development might be compromised by deciding to exclude the beneficiaries from trust governance. In addition the community intelligence necessary to optimise development spend will be absent or at least significantly curtailed. If the trust vehicle is intended to drive broad based ownership however, exclusion of beneficiary representatives is not an option.

7.4. The Fragility of Community Institutions

Regardless of whether trust governance is inclusive or exclusive of beneficiary representatives, there is no effective way of consistently interacting consequentially with the entire beneficiary community, and at some point in the process formal community structures must be engaged with. Engagement with formal, legitimate community representation is so crucial that if the institutions do not exist, the sponsoring private enterprise will be compelled to facilitate their establishment.

A key risk to anticipate is the fragility of community institutions and the implications for trust operations. Key informants consistently identify the following factors that contribute to this fragility:

- **The Cost of Volunteerism:** Community institutions and community driven initiatives in disadvantaged communities are usually resource poor. Their functioning depends on the voluntary commitment of community members. Despite the remarkable level of resourcefulness displayed by community members in these situations, any cost associated with participation is

personally incurred and persistent costs in the context are usually not sustainable. Furthermore, introducing a new institution or a set of new obligations into existing institutions also introduces costs.

- **Capacity:** Community institutions and community driven initiatives in disadvantage communities are usually under-resourced in terms of skills. As the operational demands become more complex the institutions are less likely to be in a position to meet them. A common deficit is the absence of financial management skills, which in turn makes sustained access to donor funding a problematic prospect.
- **Personnel Turnover:** The demands of volunteerism exact a price and there is often a high turnover rate of personnel in community institutions. Consistency in the interaction and communication with intended beneficiaries is often severely undermined as a result. Rapport has to be re-established, consensus repeatedly revisited, commitments re-affirmed and actions reassigned. The implementation of Trust interventions is consequently delayed, with all the associated complications in the management of beneficiary expectations.
- **Special Interests:** Community institutions are subject to persistent and often inscrutable patterns of local politics. Dealing with special interests while furthering the general beneficiary interests is a necessity that must be prepared for. A judicious selection of institutions to engage with may mitigate this problem to some extent, but care must be taken to ensure that the legitimacy of the process is not undermined.

7.5. Operating a Community Trust

“Some people have the wrong impression. It’s as if helping them register a Section 21 is what we’re talking about. That’s nothing; that’s easy. There’s a lot more to it. If you don’t acknowledge that, the thing is doomed from the start.”

The exploratory research indicates that a common error in the establishment of PDI Beneficiary Trusts is that, while a great deal of attention is devoted to the legal constitution of the entity including the drafting of Trust deeds, comparatively little attention is given to the operational design. At least equal care needs to be taken in devising the processes and procedures by which the entity will facilitate the realisation of developmental benefits for its defined beneficiaries.

A pre-operational phase should be provided for in the establishment of a Trust during which the operational systems are formalised, beneficiary representatives are appropriately capacitated and an initial portfolio of projects planned with beneficiary input. The specific operational issues that need to be prepared for during the pre-operational phase are:

- **Governance:** Legitimate beneficiary representatives are elected or appointed to the Board of Trustees. If necessary these representatives should be appropriately capacitated to participate consequentially in board business. The deeds of the Trust might be revisited and finalised during this period and any additional governance mechanisms to ensure that unrestricted voting rights and economic benefits for beneficiaries are both guaranteed can also be instituted.
- **Administration:** The secretariat function of the Trust needs to be planned and provided for, as do the financial management procedures and any additional administrative functions. In addition

- **Implementation:** The operational procedures for implementing development projects need to be established and formalised. It is essential that these be instituted before projects are launched in order to ensure propriety in the selection and funding of projects, as well as to enhance project success. The basic implementation procedures that need to be formalised are:
 - i. Project selection
 - ii. Project design
 - iii. Project management, including contractor management
 - iv. Monitoring, evaluation and reporting

- **Beneficiary Relationship Management:** A persistent risk reported by key informants is the potential fall-out from poor communications with the general beneficiary community. Deliberate mechanisms need to be implemented to communicate Trust decisions and activities to beneficiaries, to obtain and incorporate their feedback on decisions and activities, and to ensure their participation in the decision-making processes of the Trust.

7.6. Managing Impact and Preserving Relationships

“Decide how the money is going to be spent before it is in the bank.”

Introducing the possibility of substantial resources into an impoverished community will inevitably impact on existing social arrangements. Together with benefits the Trust will very likely be introducing matters for contention and conflict across existing community institutions and relationships. The possibility of resources will also raise expectations and it seems - from the reports of key informants - that beneficiaries will always expect results long before the income generating asset can produce them. There is an ethical obligation in the part of those establishing the Trust to anticipate, prepare for, mitigate and manage these unintended negative consequences.

The management of resources necessitates the management of relationships between at least the following stakeholders:

- Benefactor
- Beneficiary community
- Trustees
- Administrators
- Implementing contractors
- Local authorities
- Traditional authorities
- Other community leadership

The effective management of these relationships and the prevention or resolution of conflict requires a specialized skill set and in some cases formal procedures. This function is usually not anticipated or planned for. It most often emerges out of crises that may strain relationships irrevocably and in some instances cause development initiatives to founder irretrievably.

Three important findings emerge from the interviews with key informants that should be attended to:

- Decisions on the use of existing funding are potentially vehemently contested. In contrast planning expenditure of funds not yet received tends to proceed more smoothly. When combined with formalized operational procedures such as project selection, as well as administrative procedures for managing financial obligations, unreasonable conflict over resources are largely avoided.
- The ability of the Trust to act responsively and with legitimacy in the eyes of the beneficiary community is severely undermined when the Trust has no community base. In instances where the Trust is serving a geographically localized community key informants tend to agree that a local office is a requirement.
- Even with the best of intentions it is unlikely that beneficiary representatives on the Board of Trustees can be relied upon to communicate consistently and effectively with the community they represent. It is necessary to institute formal mechanisms to ensure that the beneficiaries remain informed and are able to participate in the activities of the Trust.

8. Conclusion

This study set out to provide an initial exploratory review into the role and functioning of PDI Beneficiary Trusts in BEE Transactions. Four objectives of the research were specified, namely:

- To quantify the frequency of trusts in BBBEE transactions
- To explore the role of trust vehicles in BBBEE
- To document the factors that constrain or enable the success of trust vehicles
- To distil lessons learned and make recommendations towards optimising the utility of trust vehicles in realizing BBBEE objectives

It is evident that in an attempt to broaden the empowerment base of BEE transactions larger enterprises are inevitably including Trusts within the structures of these deals, and the frequency of the inclusion of Trusts in documented deals since 2007 is almost ubiquitous. The Trusts are intended to benefit either generalized groups of previously disadvantaged individuals with no locality parameter, specific communities in proximity to business operations, or groupings of enterprise insiders such as employees or clients.

Enterprises are confronted with significant challenges when including Trusts. The first set of difficulties are technical and related to the stipulations in the Codes of Good Practice. Mechanisms need to be instituted to ensure that control over economic benefits are vested in the intended beneficiaries and that voting rights vested in beneficiaries by virtue of the shareholding assigned to the Trust are exercised. It is not clear that these requirements are adequately provided for in the structuring of Trusts.

The second set of difficulties relate to the effective operating of Trusts after the BEE transaction is concluded. It would appear that the constitution of Trusts and their function within the structure of the BEE deal enjoys emphasis, whereas the operating of Trusts business is not adequately planned for or resourced. It is evident that a useful model for ensuring the successful operating of Trusts is needed. A significant gap in the knowledge related to Trusts in BEE transactions is a comprehensive review of the extent to which these vehicles are in fact functional post-deal, and realizing empowerment objectives. This study, which suggests that Trusts are in all likelihood underperforming in this regard, offers an initial basis for furthering this direction of inquiry.

9. Recommendations

9.1. A Planning and Implementation Model

The legal constitution of trusts is a relatively simple matter and their inclusion in BEE deal structures also appears to be adequately considered and expertly executed. What is omitted is the proper planning of trust operations. It is therefore recommended that the adequate resources be devoted to planning trust operations, more so than the legalities involved in trust establishment or deal structures, both of which are inevitably well attended to.

From evidence emerging in this exploratory study it appears that applying a systematic model to the establishment of PDI Beneficiary Trust should be recommended. The development of the Trust Vehicle should proceed broadly through 4 stages:

- The legal constitution of the entity
- The planning and engagement phase during which informed planning will occur, culminating in the introduction of the Trust to beneficiary communities and their early participation
- The pre-operational phase during which the operational systems are formalised, beneficiary representatives are appropriately capacitated and an initial portfolio of projects planned with beneficiary input
- The operational phase during which pilot projects are launched using a revenue stream supplemented for example by CSI funding. The supplementary funding is phased out as the dividend stream from the beneficiary asset comes online

The injudicious appointment of beneficiary representatives on to the board of trustees introduces a legion of risks that threaten effective governance, strategic planning and ultimately operational efficacy of trusts. For the sake of legitimacy and the furthering of empowerment beneficiary representation is critical. However it is recommended that the timing of beneficiary inclusion be thoroughly considered. It is certainly not the most immediate executable in the establishment of a PDI Beneficiary Trust.

The findings demonstrate that many of the risks threatening the success of trusts are rooted in poor communication between stakeholders. Interviewees repeatedly indicate that in their experience that a workable strategy has been to include existing and legitimate community based entities in a formal consultative mechanism. The mechanism, such as a broad forum, needs to be resourced, meet consistently, its proceedings documented and it must foster consequential participation. It is recommended that in all processes to establish PDI Beneficiary Trusts a formal consultative mechanism is established and that if legitimate community representative entities do not already exist that time be taken to assist in their formation.

It is recommended that all sponsors of the establishment of PDI Beneficiary Trusts make the commitment to appointing and paying for the service of trust administrators. The extent to which this indispensable component is reluctantly acknowledged and poorly funded is alarming, while the

interview evidence suggests that the operational failure of trusts is to a significant degree (and possibly primarily) attributable to inexpert administration.

It is recommended that all business processes and procedures of the PDI Beneficiary Trust - especially those relevant to applying for funds, awarding funds, planning projects, appointing contractors, M&E and reporting – be formalised before the official activation of the trust.

It is recommended that M&E be a formal embedded procedure and that the function be provided by a third party that is and is perceived as independent. The M&E function is as important for accountability as the financial audit function and the service provider should not be invested in the interests of any particular stakeholder involved with the trust.

9.2. Critical Prerequisites for Ensuring Success

Two critical risks to success were persistently highlighted by the key informants. Their importance seems worth emphasizing by focusing on associated recommendations in a separate section.

PDI Trust Vehicles that are dependent on a revenue stream from dividends for funds are especially vulnerable in the initial years of their operation. In addition to having no resources for operating expenses or the implementation of interventions, they are often locked in to a loan repayment agreement for the purchase of their equity in the sponsoring enterprise. It is strongly recommended that the sponsoring enterprise facilitate access to resources for the beneficiary community and their representative structures to tie them over during the period preceding the payment of equity. A dormant trust cannot suddenly come on line when dividends become available, nor can the goodwill of stakeholders be sustained over years of promise alone.

It is recommended that the conventional practice for the PDI Beneficiary Trust be that a clear, agreed and documented plan for how the money will be spent is concluded before money becomes available. This applies to all stages of the establishment of the trust vehicle – legal constitution; planning and engagement; pre-operational and operational. The inevitable contest over resources must be resolved before the resources are available to prevent deadlocks in extending the economic benefits to intended beneficiaries.

9.3. Empowering Beneficiaries

The research suggests that the success of the Trust is to a large extent dependent on the capacity of beneficiaries and beneficiary representatives to participate consequentially in the business of the Trust. While it is crucial that the Benefactor facilitate the development of capacity, provision needs to be balanced with a commitment to preserving the independence of the beneficiaries. The Benefactor needs to avoid conflicts of interest and ensure that the beneficiaries are not beholden to the sponsoring enterprise. In the interest of empowering stakeholders it is recommended that:

- A relationship is facilitated between the beneficiary community and not-for-profit independent advisors. There are a number of NGOs that provide such services to communities and community based organisations.
- A thorough work study should be conducted to identify the skills needed for beneficiary representatives to participate consequentially in the governance and operations of the Trust, and identify the skills gap. A work study may not be necessary in every situation as a number of not-

for-profits that service the CBO sector provide standardised and widely applicable skills development programmes.

- Funds should be provided for a training programme to bridge the skills gap identified in the work study. It is important that the training programme be instituted as a repeated intervention to mitigate the effect of skills attrition. One of the observable consequences of the skills shortage in South Africa is that disadvantaged individuals trained in the not-for-profit sector become mobile and move on to exploit more attractive job opportunities in the labour market.

9.4. Managing Stakeholder Relationships

In order to ensure the successful implementation of the Trust and sustain developmental impact it is recommended that:

- The launch of the Trust should be timed judiciously. Announcing a Trust initiative prematurely will precipitate unmanageable expectations as benefits are anticipated long before they can be delivered. The marketing of the Trust should be delayed, possibly to the end of the pre-operational phase. Although the beneficiary community will already have been engaged and there will already be widespread awareness it is critical that the reputational reward reaped by the sponsoring enterprise be seen to be commensurate with the manifest level of social investment and current benefit experienced by the beneficiary community.
- Apply the art of stakeholder consultation. Engage more than is thought necessary but not enough to fall into stakeholder paralysis.
- Institute formal reporting mechanism between beneficiary representatives and the beneficiary community if they do not already exist. Despite their best intentions, without a formal channel for engaging the beneficiary community their representatives are unlikely to fulfil this function consistently and adequately.
- Have an accessible community based presence (open an office)
- Be clear, transparent and specific about what is intended to be achieved, and the timeline is for achieving it. Planning for long-term impacts is development best practice, but it may prove unwise to promise grand impacts projected a decade from now.

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