



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

by Feedback Research and Analytics

Part One

PDI Beneficiary Trusts – Background and definitions

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

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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.

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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.

Preamble

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.

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’. Mission societies vigorously championed the ‘civilising’ project with arguably more ardour than the state organs responsible for administration of the colonies. At home, charity organisations and networks of charities complimented the endeavours of the local 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 because 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 trusts 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 that prized charity as much as the vaunted work ethic. Lindeman estimates that in the early 1900s foundations and trusts contributed roughly 5 to 15% of all of philanthropic expenditure in the United States. 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 conceptualised 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, favouring 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 characterised 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; and

 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 formalising 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).

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).

In the aftermath of the Depression and World War II, 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 favoured 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 not only to self-regulate market behaviour, but ultimately to 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, fuelled 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.

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 favour 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:

1. Direct empowerment through ownership and control of enterprises and assets;
2. Management at senior level;
3. Human resource development and employment equity; and
4. 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.

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

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

licenses to operate.

Although redress is discussed as a moral imperative, Black Economic Empowerment (BEE) is characterised 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 benefit the communities in which they operate directly. Contemporary corporate governance principles advocate for 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.

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 favour of a defined beneficiary group. A board of trustees manages the assets (funds and/or income generating resources). There may be one trustee or, as is more often the case, several trustees.

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

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

“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:

“A not-for-profit trust created in terms of applicable law by volunteer members for the purpose of channelling 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 as a guardian of donated funds, investing and overseeing their safekeeping. 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 that can be used by the community trust members for any community need, or set up funds that 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, 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 centre of an alliance between civil society, private and public sectors need to be developed. As 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 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 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 (CPRs) 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 utilised 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 organisational 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 “over-harvesting”) 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-utilise 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 ‘over-harvesting’. Deforestation and excessive ocean fishing provide a clear example of rampant over-harvesting (Berkes et al. 2006 and Ostrom 2008: 2).

However, allowing participants to engage in face-to-face communication in which they can discuss how best to use the resource enables them to reduce over-harvesting substantially (Ostrom and Walker 1991). Some theories predict 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 who communicate well and who have developed structures in place are also more likely to punish others who continue to over-harvest (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).

The 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).

Learning from the Literature

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 channelling 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 by paying taxes. These should be supplemented 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.