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EMPLOYEE OWNERSHIP IN ZIMBABWE: Feasibility and Case Study Analysis

Final Report

U.S. Agency for International Development

Prepared for: USAID/Zimbabwe

Prepared by: The Services Group

Sponsored by: Private Enterprise Development Support Project III
Contract No. PCE-0026-Q-00-3031-00
Delivery Order No. 21
Prime Contractor: Coopers & Lybrand, L.L.P.

April 1995

Coopers &Lybrand

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ACRONYMS AND ABBREVIATIONS

AID	Agency for International Development
CDC	Commonwealth Development Corporation
CGC	Credit Guarantee Corporation of Zimbabwe
C&L	Coopers & Lybrand
CZI	Confederation of Zimbabwe Industries
EBO	Employee Buy-Out
ECP	Enhanced Credit Programme
ESAP	Economic Structural Adjustment Programme
ESOP	Employee Stock Ownership Plan
FCA	Foreign Currency Account
GDP	Gross Domestic Product
GOZ	Government of Zimbabwe
IBDC	Indigenous Business Development Centre
IDC	Industrial Development Corporation
IFC	International Finance Corporation
ILO	International Labor organization
IMF	International Monetary Fund
LPGP	Loan Portfolio Guarantee Program
MBO	Management Buy-Out
OPIC	Overseas Private Investment Corporation
PEDS	Private Enterprise Development Support
PW	Price Waterhouse
SAEDF	Southern African Enterprise Development Fund
TSG	The Services Group
USAID	United States Agency for International Development
VCCZ	Venture Capital Corporation of Zimbabwe
ZCTU	Zimbabwe Congress of Trade Unions
ZDB	Zimbabwe Development Bank
ZED	Zimbabwe Enterprise Development Project
ZESA	Zimbabwe Electricity Supply Authority
ZMDC	Zimbabwe Mine Development Company
ZNCC	Zimbabwe National Chamber of Commerce
ZSE	Zimbabwe Stock Exchange

TABLE OF CONTENTS

EXECUTIVE SUMMARY i

I. INTRODUCTION 1

II. POLICY AND INSTITUTIONAL FACTORS AFFECTING EMPLOYEE OWNERSHIP IN ZIMBABWE 2
- A. Current Employee Ownership 2
  - 1. Employee Ownership Trusts 2
  - 2. Direct Employee Share Ownership 2
  - 3. Employee and Management Buyouts 3
  - 4. Conclusions 4
- B. Overview of Economic Policy 4
- C. The Legal Framework for Business 5
  - 1. Business Formation 6
  - 2. Taxation 7
  - 3. Labor Policy 8
  - 4. Foreign Exchange Control 8
- D. Assessment of Financial Sector Potential 9
  - 1. Commercial Banks 9
  - 2. Merchant Banks 10
  - 3. The Stock Market 11
  - 4. Other Financial Institutions 11
  - 5. Potential for Credit Guarantee Schemes 12
- E. Policy and Institutional Requirements for Employee Ownership 13

III. THE PROPOSED ESOP STRUCTURE 15
- A. Structure 15
- B. Funding 15
- C. Tax Treatment of Contributions 16
- D. Tax Treatment of Employees 17
- E. External Financing 18
- F. Dilution 18
- G. Governance 19
- H. Motivation of Stakeholders 19
  - 1. Shareholders of Companies in Zimbabwe 19
  - 2. Employers 20
  - 3. Employees 20
  - 4. Government of Zimbabwe 21

C

TABLE OF CONTENTS (CONTINUED)

IV. CASE STUDY ANALYSES 22
- A. Introduction 22
  - 1. Delta Corporation 22
  - 2. Art Corporation 22
  - 3. Rio Tinto Zimbabwe 22
- B. Assumptions for the Case Study Model 23
- C. Case Study: Delta Corporation 26
  - 1. Company History 26
  - 2. Market Definition 26
  - 3. 1994 Financial Base 27
  - 4. Financial Projections 27
  - 5. Discussion of Results 30
  - 6. Economic Implications 30
- D. Case Study: Rio Tinto Zimbabwe Limited 32
  - 1. Company History 32
  - 2. Market Definition 32
  - 3. 1994 33
  - 4. ESOP Projections 35
  - 5. Conclusion 35
- E. Case Study: Art Corporation 36
  - 1. Company History 36
  - 2. Market Definition 37
  - 3. 1994 Financial Base 38
  - 4. Financial Projections 38
  - 5. Conclusion 40

V. SOCIAL AND ECONOMIC ANALYSIS 42
- A. Social Analysis 42
  - 1. Socio-Economic Characteristics 42
  - 2. Employment Factors 43
  - 3. Implementing ESOPs: Constraints and Benefits Identified 36
- B. Economic Analysis 44
  - 1. Microeconomic Implications 44
  - 2. Macroeconomic Implications 45

VI. CONCLUSIONS AND RECOMMENDATIONS 47
- A Conclusions 47
- B. General Recommendations 48
- C. Recommendations for USAID Interventions 49
  - 1. Continued Technical Assistance 49
  - 2. Proposed Scope of Work 50
  - 3. Development of ESOP Advisory Services 50
  - 4. Identify/Develop Sources of Equity Capital 52
  - 5. Recommendations for the Zimbabwe Enterprise Development Project Staffing and Design 53

d

TABLE OF CONTENTS (CONTINUED)

ANNEXES

A ZED Project Design Team
B List of Interviews
C Statement of Work
D Delta Case Study Model
E Rio Tinto Case Study Model
F Art Corporation Case Study Model
G Social Analysis

LIST OF TABLES

Table 1	Summary ESOP Results	viii
Table 4.1	Projected ESOP Transaction Cost	25
Table 4.2	Delta Corporation Limited Financial Summary	28
Table 4.3	Delta Corporation Limited Summary ESOP Results	31
Table 4.4	Rio Tinto Zimbabwe Financial Summary	34
Table 4.5	Rio Tinto Zimbabwe Summary ESOP Projections	36
Table 4.6	Art Corporation Limited Financial Summary	39
Table 4.7	Art Corporation Summary ESOP Projections	41
Table 5.1	Estimated Strategic Analysis of Tax Revenue Foregone	46

f

EXECUTIVE SUMMARY

PROJECT PURPOSE

This report has been prepared for USAID/Zimbabwe under the Private Enterprise Development Support (PEDS) project, in partial satisfaction of PIO/T 613-0232-3-30097. The purpose of the report is to provide USAID/Zimbabwe with technical and financial analysis related to increasing employee ownership of firms in Zimbabwe, and in particular the use of mechanisms such as the Employee Stock Ownership Plan (ESOP) which have been developed in the United States. This effort is intended to assist USAID/Zimbabwe to develop project activities which support its Strategic Objective #2: "increased black ownership and investment at all levels of the economy" and specifically to assist in the design of project elements for the Zimbabwe Enterprise Development (ZED) Project.

The project team consisted of three members with expertise in employee ownership schemes and business policy. The core team from Coopers & Lybrand/The Services Group was supported by specialists from the Regional Economic Development Services Office (REDSO) of USAID and AID/Washington. Financial experts from the Harare partnership of Price Waterhouse (PW) also worked with the team, and prepared a separate report which served as a guide for this analysis.

This report presents an analysis of the current climate for employee ownership in Zimbabwe, and then develops a proposed ESOP model. Three case studies explore the potential for ESOPs in three companies based on the assumptions of the proposed model. Alternative cases investigate the implications of various ESOP structures, using simple financial projections based on extrapolation of current performance. The three companies were Delta Corporation (conglomerate with government and public share ownership in beverages, hotels, distribution, retail); Rio Tinto Corporation (mining); and Art Corporation (paper and paper products). The proposed structure of the ESOPs in the case studies is based upon the expert advice provided by the team members with international experience in the development of ESOPs. Economic, financial and other assumptions were developed by the team after a process of consultation and analysis. The team developed a financial model for the case studies which generates projections based on the alternative ESOP structures, financial and economic assumptions, and other variables.

CURRENT EMPLOYEE OWNERSHIP

There is a significant, if limited, base of experience with employee ownership in Zimbabwe. To date, employee ownership has been structured following one of two general models: an employee trust, with a small shareholding spread broadly among employees; and various efforts to promote direct employee ownership, usually concentrated on management or a select group of employees.

Employee Ownership Trusts. There are 22 listed companies, or just over one-third of the total number of publicly traded firms on the Zimbabwe Stock Exchange (ZSE) with some type of employee ownership trust. Only three have employee ownership trusts with over 5 percent of total equity, and these were all in the 10-12 percent range. While the terms of participation and beneficial ownership of each trust are different, most constitute around 3 percent of the equity in the company. They tend to allocate shares either on the basis of tenure or on a simple eligibility status, without regard to salary or tenure. Most trusts hold shares beneficially but distribute dividends. The circumstances of the establishment of employee ownership trusts vary widely; some were set up as donations by the

company, some were purchases with external financing. Likewise, some had specific purposes and objectives, whereas others were created to improve morale and benefits to employees.

Direct employee ownership. The second major option involves various schemes to promote direct ownership by employees. The mechanisms vary, and include preferential terms for purchase, special allocations on new issues, and options for management and executives. There were 10 companies with new issues on the ZSE since 1980 which involved employee purchase programs at preferential terms. In general, these programs also accounted for a small portion of total equity, usually from 1 to 3 percent of total capital, although they may have accounted for a higher percentage of the new issue. Special allocations directly to individuals on issue have been rare, and in general were determined by specific factors in the issue and the individual. Issuing purchase options to management and executives has been relatively common. A total of 31 firms on the ZSE have defined management options plans, which are limited by the exchange's rules to 4 percent of issued share capital.

Employee Buy-Outs and Management Buy-outs (EBO/MBOs). EBO/MBOs have also been developed to a reasonable stage in Zimbabwe. Typically, these involve the sale of all or a substantial part of the equity of a firm to management and executives. The motivations for these transactions vary widely, including localization (the sale of assets by foreign investors to residents), retirement of existing shareholders, restructuring to improve competitiveness, etc. In contrast to employee share trusts, these transactions typically involve sophisticated financing provided by local merchant and commercial banks.

Conclusions from the experience to date. There are several results from this limited incidence of employee ownership in the country to date. First, only a handful of firms have established employee ownership trusts that constitute more than 3 percent of total shareholdings. At this low level, most parties consider the effort to be a token gesture, even though the shares are donated by the firm, and the dividends are usually paid out. Supporting this view is the lack of voting power exercised by employees on their beneficial share ownership. Second, ownership schemes such as EBO/MBOs targeted to a small number of senior employees, management and executives offer limited distributional benefits, in that they do not spread share ownership among lower income, indigenous employees. Third, there is little knowledge of the potential of broader employee ownership schemes, and further investigation in this area does not appear high on the agenda of most stakeholders. Last, among those companies with significant employee ownership plans, the results have been generally positive, with meaningful increases in income and wealth for long-term employees and the continuing support of management. This suggests the potential for broader application of ESOP schemes to support employee ownership.

THE LEGAL AND POLICY FRAMEWORK AFFECTING EMPLOYEE OWNERSHIP

For the first several years after independence, the Government of Zimbabwe was primarily concerned with implementing its socialist economic ideology, which included satisfying expectations of land and income redistribution and an enhanced role for state ownership. This resulted, for example, in the Government of Zimbabwe (GOZ) acquiring a significant equity position in the Delta Corporation, Zimbabwe's largest business group, and Zimpapers which owns the Herald and other newspaper properties. The two aforementioned examples were purchases from South African interests, which was also one of the early goals of the GOZ.

Government historically suspicious of business. A side-effect of the early process of political transformation and economic consolidation was a negative attitude toward local business formation and capital investment. This negative attitude spilled over into foreign investment as well. Even though the GOZ publicly sought direct foreign investment, the policies that were pursued were not attractive to foreign investment. The limits on repatriation of capital and dividends, regressive tax rates, distortionary exchange rate policies, restrictive labor policies, and the lack of export incentives all combined to create a poor investment climate in Zimbabwe.

As a consequence, Zimbabwe did not live up to early expectations: with its infrastructure, industrial base, and human and natural resources, Zimbabwe was expected to be a success story with export and investment-led growth. In the 1990s, the government embarked on a program of economic liberalization, facilitated by the Economic Structural Adjustment Program (ESAP) financed by the World Bank. The principal elements have included new investment incentives and regulations, a relaxation of foreign exchange controls, import liberalization and tariff reduction, and privatization of government owned companies. The general policy priority of indigenization continues, although the means to achieve it have shifted to less interventionist policies.

Legal framework. Zimbabwe has a highly organized and fairly efficient legal system with an independent judiciary. Property rights, including intellectual property, are generally observed and enforced. For the most part, the legislation affecting business formation and operation is silent on the issue of ESOPs and EBO/MBOs. The Labour Relations Act makes an incidental reference (sections 16 and 17 [3][m]) regarding a situation where a business entity may be closed or "transferred." There is no specific legislation governing trusts, which have thus far been the major vehicles for establishing employee ownership plans. Trusts are established under common law, following the British system, and are a suitable mechanism for this type of pass-through beneficial ownership. Their common law derivation provides flexibility in setting the terms of the operation of trusts without the prescriptive elements often found in legislation.

Companies Act. The Companies Act poses no real obstacles to the operation of ESOPs. In some countries, overly prescriptive companies laws have precluded many innovations in corporate structure; this does not appear to be the case for Zimbabwe. ESOPs could be formed by publicly listed companies, as well as in closely held and family-owned companies, provided there is share capital. Sole proprietorships and partnerships could not develop such schemes, given the absence of defined share capital.

The protection of minority ownership rights is an important aspect of companies law in terms of protection of ESOP interests. These rights typically include the ability to prevent outright dilution or other measures which would differentially affect the value of shares, particularly in favor of the holders of large blocs. Section 171 of the Companies Act provides for remedial proceedings and the intervention of the Minister of Justice at the request of shareholders.

Tax. The tax treatment of all the transactions associated with ESOPs can be critical to their appeal as financial instruments. This includes the tax treatment of company donations to employee share trusts or plans, taxation of interest earned on external financing of trust contributions, capital gains, dividends and corporate profits. The relatively high rate of corporate profits tax means that there will be a strong incentive associated with any means of tax reduction. Taxation of dividends affects the distribution of profits to ESOPs. Capital gains taxes discourage ESOP's in two ways. First, they discourage shareholders from selling shares to established ESOPs; second, they discriminate the returns received by ESOP-holders after its established. In both cases, selling shareholders would be

fully taxed for capital gains. Company donations are not tax deductible at the current time; this is otherwise a common feature of ESOPs.

The GOZ has not developed any tax incentives or policies specifically for ESOPs, or for the existing types of employee trusts. The issuing of shares to employee trusts is not normally tax deductible, unless it can qualify as a bonus or other form of compensation, or meet the regulatory requirements for a pension plan, which most existing trusts do not. While some employee ownership trusts have sought and been awarded tax concessions by obtaining a ruling that dividends payable to an employee ownership trust are non-taxable, this has not been consistently applied.

Labor Policy. Zimbabwe's labor policy, which is governed by the Manpower Planning and Development Act and the Labour Relations Act, is effectively aimed at maintaining artificially high levels of employment by removing owners' discretion in "right-sizing" the labor force through redundancies and other means. The GOZ requires the formation of workers committees and councils in each place of business, in addition to any unions that may participate in the collective bargaining process.

To the degree that companies are forced to maintain more workers than is otherwise justified, and "right-sizing" is made difficult by the rigid collective bargaining structures and protective labor regulations, the climate for ESOPs will not be favorable. In another context, for companies which are more capital-intensive with relatively few higher skilled workers, an ESOP may be more attractive as a means of reducing turnover and improving productivity.

Exchange control and capital restrictions. Rigid exchange controls, with allocation of foreign exchange by import licenses and a virtual ban on capital transfers, have been a hallmark of Zimbabwean economic policy since independence. These controls, to the degree that they limit foreign investors' ability to sell shares, even to local shareholders, affect the general climate for ESOPs. However, recent liberalizations have improved upon the previous intricate system of exchange controls designed to restrict repatriation of corporate profits, capital, and investment funds.

Under previous exchange control regulations, localization (sale of foreign-owned equity or assets to Zimbabweans) was encouraged through the potential to cash out via more lucrative arrangements than either the steep discount in the blocked funds switching procedures or the purchase of low-interest government bonds. In these arrangements, the local investors had to be approved (i.e., indigenous) and 5 percent of the equity had to be reserved for an employee ownership trust. This was potentially a valuable incentive, given the highly punitive nature of the exchange controls, however it appears not to have been utilized. With the recent liberalization of capital transactions, this particular incentive will no longer apply, but the general relaxation in capital controls will ease the sale of shares by foreign owners, including sales to employees.

Financial sector. The sophistication of the financial sector can be an important factor determining the viability of employee ownership plans. While ESOPs created by straight share donations do not require financing, this option will not always be the most attractive. External financing for ESOP purchases of blocs of shares can greatly facilitate the options in how ESOPs operate, and hence their appeal to both companies and employees.

Zimbabwe's financial sector is well developed relative to other countries in the region. Commercial banks are conservative in their lending practices, determined in part by high reserve requirements and liquidity rules, although some have been active in financing well-structured MBO deals. Merchant

banks have been more active, assuming the roles of financial advisors, arranging as well as providing capital. The Zimbabwe Stock Exchange has grown rapidly in recent years, with a recent opening to foreign portfolio investment and preferential rates of tax on dividends and capital gains for listed companies. In addition, there are a number of specialized financial institutions including venture capital, equity investment funds, development banks and two new regional investment funds supported by USAID and the IFC.

In the current high interest rate environment, with real interest rates at 10 percent, financing any transaction is constrained, and medium term credits are rare. Recent MBO/EBO/ESOP transactions have been difficult to finance due to high interest rates and limited sources of equity financing, which becomes even more critical in a high interest rate environment. However, some transactions are proceeding. A broad range of financing options exist in the Zimbabwe market: debt financing, bridge loans, equity finance, medium-term finance, and leasing instruments are all well developed. The environment is not good at the moment due to high financing costs, but the tools are in place when the market stabilizes. Employee ownership financing can also be made more attractive by ensuring its qualification for various credit guarantee programs, including those funded by USAID.

THE PROPOSED ESOP MODEL

The proposed ESOP structure was developed based on the general consensus of the project team on the critical features. It serves as the basis for the projections of the impact of adopting an ESOP, with several variations, which is examined in the three case studies. The essential points of this model, especially in terms of tax treatment and structure, are as follows.

Structure. The structure is assumed to be that of a trust, which holds the stock for employees for a defined period, suggested at 10 years. After this period, stock is transferred to the employee on an annual basis (i.e., he/she would receive the shares 10 years after they were contributed on his/her behalf to the trust.) An employee would have to meet a minimum service requirement of 2 years. If the employee left after 2 but prior to 10 years, he would still receive those shares after the 10-year period.

Funding. A variety of means could be used to fund the ESOP trust, including direct issuance of shares by the company and purchase of a bloc of shares with external financing. In the case of the latter, the trust could be leveraged, so that shares were purchased to fund a commitment to the ESOP over an extended period. In all cases, it is presumed that the company (or existing shareholders) would fund the issue or purchase of shares. In the case of external financing, the loan would be paid off by the general cash flow of the company. The employees would not purchase shares or repay loans directly or indirectly through dividends on their shares alone.

Tax provisions. Company contributions would be tax deductible, including principal repayments on loans taken out to fund purchases. This represents a significant departure from current tax treatment, which in general offers no tax deductions. In addition, the government may wish to consider a reduction or deferral of capital gains tax for the selling shareholders, in order to provide a differential incentive to sell shares to an ESOP trust.

Employees' tax liability would be deferred, but not reduced, under the recommended plan. Ideally, no taxable event would occur until the shares were sold and the employee received cash. At this point, the employee would pay capital gains tax, in essence on the full value of the sale as the shares were

acquired at zero basis. This also represents a departure from current practice, in which there is a tax liability at the point at which shares are transferred or fully vested.

External financing for the acquisition of shares would also receive preferential tax treatment. The measure proposed is to exempt 25 percent of interest income earned from ESOP transactions from income tax. This would give financial institutions an incentive to finance ESOPs, as well as possibly reducing slightly the cost of financing. In addition, the government may wish to consider a reduction or deferral of capital gains tax for the selling shareholders, in order to provide a differential incentive to sell shares to an ESOP trust.

Dilution. Under this plan there would necessarily be some dilution of existing shareholders' equity or share value, as the employees would not be paying for the shares. While the tax incentives would make up a part of this dilution, there would still be some effect. Offsetting this could be the value of the ESOP as an additional fringe benefit and the potential for productivity gains. (See below.)

Governance. The recommended model would differ from most existing employee ownership trusts in that shares would actually be transferred to the employees at some date. This would allow them direct control and the ability to cash out, as well as vote their stock. It will also be important for the ESOP trust to have effective representation on the Board of Directors, so that employee ownership has some meaning in the context of corporate governance.

Stakeholders. The motivations of shareholders, company management, the government, and employees, are important factors determining the success of any employee ownership program. Existing shareholders may be seeking means of divestiture, whole or partial, to accomplish localization, corporate restructuring, or assure smooth succession. There will be a variety of motivations which are favorable to employee ownership; with a differential tax incentive, these will become particularly attractive. Employers (management) may have fears of loss of control or imposition of additional restrictions on their decisionmaking, as has developed in the overall labor/management framework. This is not the objective. For the management, employee ownership becomes an additional fringe benefit, one which also may provide incentives to reduce turnover and improve morale and employee performance. The government has the major stake in promoting ESOPs, as it will stand to lose tax revenues through the granting of incentives. This must be balanced against the benefits of achieving more widespread employee ownership. Employees will receive an additional benefit; this may or may not take the place of other benefits or profit sharing programs which could be planned. In doing so they will also be taking on the risk associated with fluctuations in the value of the company's stock. While this has its positive elements, involving employees in the financial state of the company, it also represents a risk that few have experience with or might otherwise take on.

CASE STUDY ANALYSES

Three companies were chosen for the case studies. All are publicly quoted companies, with readily accessible financial information. The specific reasons for choosing these companies are as follows.

Delta Corporation is the biggest group of companies in the country in terms of both turnover and employment. It accounts for approximately 20 percent of the total market capitalization of the Zimbabwe Stock Exchange. The group has had an employee share trust established for almost five years. An additional reason for focussing on the group was the announcement in late January 1995, as work on the study was well under way, that government intended to divest its 36 percent

shareholding in the group via the Zimbabwe Development Corporation. It was suggested that such a disposal might also incorporate an indigenization element.

Rio Tinto Zimbabwe is a multinational, with some shares listed on the ZSE. For many years this mining group has had a profit-sharing scheme and the response to the survey questionnaire indicated some interest on the part of management in widening this to embrace employee ownership. Rio Tinto has, additionally, no significant debt-service obligations -- it is in fact a net earner of interest. Thus, its ability to take on additional borrowings is greater than that of many firms in Zimbabwe at the present time.

Art Corporation was the first quoted company, and possibly the first company in Zimbabwe, to set up an employee ownership trust, and is well known as an enlightened employer. The employee trust has now been in place over 13 years and its current shareholding of 11.81 percent constitutes the second highest percentage held by an employee trust of any quoted company in the country. Indeed, for a while, the trust held 15 percent of the company's shares. The Art Corporation scheme has served as a model for many other trusts in Zimbabwe. Additionally, Art has a large tax loss, due to recent difficult times which compelled the group to restructure over 1992 to 1994.

Alternative cases and scenarios. Four year profit and loss projections have been made based on the following cases and scenarios (for each case):

- **Base Case: no ESOP** or additional employee shareholding is undertaken. Financial results are projected based on an extrapolation of current performance.

- **Case 1: 5 percent donation.** The company simply donates an additional 5 percent of its shares to employees by an issue of further shares out of reserves. This attracts full tax relief on the cost of the shares, deemed to be at market value, in the year of donation, a concession not currently available. Additionally it is assumed that the donation is not taxable in the hands of the recipients.

- **Case 2: 20 percent ESOP.** The company borrows to finance the purchase by the ESOP of 20 percent of its existing shares. The sum is repayable over four years, this being the maximum time frame that financial institutions generally appear to find acceptable when funding such transactions. There is full tax relief for the annual interest and principal repayments, a departure from existing tax legislation which treats neither as allowable. Again the receipt of shares by the ESOP is assumed to be a non-taxable event.

- **Case 3: 5 percent ESOP.** The company borrows from the banks as in (2) above but in this case the ESOP purchases only an additional 5 percent of the shares.

In each of the cases, the following variations in interest rate and inflation assumptions are examined.

- Scenario a)Borrowing at 29.7 percent interest with 20 percent inflation.
- Scenario b) Constant prices (no inflation) with a real interest rate of 10 percent.
- Scenario c) For Delta only, the ESOP is financed by issuing 20 percent preference shares.

Table 1
Summary ESOP Results

DELTA CORPORATION		20% ESOP	5% ESOP	5% Donation
Transaction Cost		698.1m	174.5m	174.5m
Value of ESOP Shares after 4 Years		1,068.8m	260.7m	260.7m
Cost to Treasury	Scenario (a) Scenario (b) Scenario (c)	438.9m 365.3m 339.8m	110.7m 89.2m 83.9m	65.7m 65.5m 65.7m
Percent of Cost of Shares Borne by Treasury	Scenario (a) Scenario (b) Scenario (c)	63% 52% 49%	63% 51% 48%	38% 38% 38%
RIO TINTO ZIMBABWE		20% ESOP	5% ESOP	5% Donation
Transaction Cost		105.6m	26.4m	26.4m
Value of ESOP Shares after 4 Years		144.7m	35.3m	35.3m
Cost to Treasury	Scenario (a) Scenario (b)	69.1m 56.9m	17.0m 13.9m	10.3m 10.3m
Percent of Cost of Shares Borne by Treasury	Scenario (a) Scenario (b)	65% 54%	64% 53%	39% 39%
ART CORPORATION		20% ESOP	5% ESOP	5% Donation
Transaction Cost		27.7m	6.9m	6.9m
Value of ESOP Shares after 4 Years		35.2m	8.6m	8.6m
Cost to Treasury	Scenario (a) Scenario (b)	6.5m 2.4m	1.5m 0.6m	1.5m 0.3m
Percent of Cost of Shares Borne by Treasury	Scenario (a) Scenario (b)	24% 9%	22% 9%	22% 4%

In the case of a donation of shares, the reduction in tax is due to the cumulative effect of the changes in company tax and resident shareholders' (dividend) tax. In the case of a purchase of shares as a result of borrowing by the company, the reduction is due to both these elements and the tax relief accorded on interest which is only 75 percent taxable. Table 1 summarizes the results of the financial projections for the three cases.

Financial projections: Delta. With the 20 percent ESOP, be it financed by either borrowings or preference shares, considerable strains are placed on both the Treasury and company's ability to service these obligations, particularly in the initial two years. Where companies already are highly geared, it is unlikely that shareholders will be enthusiastic about increasing borrowings to fund an ESOP.

A donation of 5 percent shares has in each case a less severe impact on the Treasury than a loan to fund a 5 percent ESOP. In general there is a trade-off between the benefits to the company (and therefore, in the long-term, the shareholders) and the losses to the Treasury. While the banks stand to realize significant tax savings in the event of borrowing, thought needs to be given to making a preference share sufficiently attractive, given that the current scenario envisages no tax benefits to the future holders of such instruments.

Financial projections: Rio Tinto Zimbabwe. The results are comparable under both interest rate and inflation scenarios. By 1996 the 20 percent ESOP produced the highest profits for the company, with interest cover no lower than 3.25 times in the early years. Having no interest expense prior to the ESOP, and a low effective tax rate of 26 percent, the company is in a strong position to be able to sustain such an arrangement. In current price terms (Scenario A) the cost to the Treasury is a discounted Z$69.1 million, or just over 65 percent of the transaction cost. The 5 percent ESOP produces a better company performance than does the 5 percent donation, and interest and capital cover are more than adequate to service debt. The cost to the Treasury of a 5 percent ESOP is, however, almost half as much again as a 5 percent donation, which only has significant fiscal impact in the first year.

Rio Tinto, being a company with no current interest burden, can easily absorb the financial impact of an ESOP, although on a 20 percent ESOP debt service is an initial problem. However, such a move would incur considerable fiscal cost. In this specific case, from closer discussions with the management, the company is considering a small level of participation for executive staff rather than a wide-ranging ESOP.

Financial projections: Art Corporation. Because Art is in an assessed loss position for the first of the three years, the tax benefits the company would otherwise enjoy do not translate directly into better performance under the ESOP or donation scenarios. By 1997 the assessed losses have been fully utilized and the 20 percent ESOP produces marginally higher profits. Art already has considerable existing borrowings, and consequently interest cover only reaches levels above 3 times by 1996 as debt service falls.

The result of the above is that the relative cost to the Treasury of the transaction is low - Z$6.5 million in discounted lost revenue, or only 24 percent of the transaction cost. With no adjustment made for inflation, assessed losses are still not fully utilized by 1997, although assuming continued growth in 1998 the company would revert to paying tax in that year. With no increased tax benefit, the fiscal cost of the 20 percent ESOP is a mere Z$2.4 million.

In general Art does not appear to be a strong candidate for increased employee participation via a leveraged ESOP. The company already has signification employee ownership, at close to 12 percent, but it must be borne in mind that Art has just emerged from a restructuring exercise which successfully reduced debt, the level of which had grown dangerously high. Moreover, the advantages to the company of further increasing employee ownership are modest.

SOCIAL AND ECONOMIC IMPACT

Social Impact. Blacks, and black women in particular, are generally under-represented in the formal workforce, especially in the higher skilled positions. Both employers and workers have criticized the effectiveness of workers' committees and work councils, as either not representing workers' interests or being little more than a hindrance. Employees' direct purchase of shares in an non-subsidized ESOP scheme is probably not viable in generating broad-based participation. Due to their low income levels, lower level employees would face considerable financial difficulties if they were to make a financial contribution to an ESOP.

For women and blacks alike, there are no legal impediments to ownership of shares. Attitudes may present a problem, as a distinct "us" and "them" mentality permeates employee-manager/owner relations throughout the business community. Likewise, lack of information about ESOPs is likely to inhibit interest in the schemes and depress participation.

All permanent employees in the firms benefit from the proposed ESOP schemes. While the exact structure of ESOPs will be determined by the individual companies, the most democratic means will be to have equal shares issued regardless of the positions held and salaries earned. Other project benefits are anticipated to include: increased productivity; increased loyalty to the company; increased black participation in the economy; improved intra-company relationships; and increased economic independence for women.

Economic impact. The ESOP structure recommended is a straightforward redistribution of equity from owners and the government to employees. As a first effect, there will be no new wealth generated. The primary change that occurs is that employees are now entitled to dividends and would benefit from any capital gains resulting from an improvement of the company's net worth. By the same token, they now bear the risk of the shares falling in value should the change in financial performance be negative.

A potential second effect is that productivity increases will improve the financial performance of the company overall, meaning as well that increased growth would occur in the economy. Raising workers' awareness of their role as equity holders could solicit cost savings suggestions, reduce worker absenteeism, and improve customer relations. Empirical studies do find evidence of increased productivity through employee ownership, but those results are not very robust. The usual rule of thumb in terms of increased productivity is about 5 percent; there is a low but positive probability of this occurring if the ownership level is significant, i.e. around 20 percent.

As shareholders, employees will also be risk-takers. The value of their shares can rise or fall and this will be absorbed by all shareholders, including employees. Under an ESOP, the employee receives a dividend which could be analogous to a share in the profits and benefits from the contribution to increased shareholder value. In the Zimbabwean context, it is also clear that managerial control is as much a part of the indigenization debate as is ownership of equity.

A potential negative effect is the use of employee ownership to prevent corporate takeovers. While some may argue that takeover prevention is a positive factor, the record regarding employee ownership and takeover attempts in the U.S. has been mixed. In a significant number of cases, employee ownership has been used as a means to prevent meaningful restructuring of companies. In the end, this can be more harmful than the disruption that some unwarranted takeovers cause. Because takeovers often cause disruptions to patterned corporate behavior and result in layoffs, employees will usually vote their stock against a takeover proposal. Such opposition could slow the pace of change in the Zimbabwean economy, acting against what would otherwise be a healthy change of ownership.

In the various permutations of the structuring of ESOPs, it is clear that no one will be motivated to commit to an ESOP without having some incentives, most likely in the form of the tax deductions, exemptions and deferrals recommended above. Based on the scenarios modelled in the financial section of the case studies, a portion of the cost of the transfer would be borne by government in the form of foregone revenue. The lost revenues in the case studies reach up to 65 percent of the transaction cost, in discounted terms, and average around 50 percent. This does not take into effect the cost of the deferral of tax for the employees, and the potential benefit of capital gains tax relief or deferral for the selling shareholders. However, in the absence of ESOPs, these transactions may not take place, and consequently there would be no taxable events, other than normal corporate profits.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions. The following points are evident from the analysis conducted for this report.

On the general environment for employee ownership:

- Employee ownership is not new to Zimbabwe, and stakeholders are generally receptive to the concept;
- Employee ownership fits generally into the GOZ's indigenization policy;
- The legislative and tax environment does not cater specifically to ESOPs, although there are no prohibitions or definitive constraints; and,
- It is unlikely that ESOPs will be established in substantial numbers, and of a significant size unless there are positive incentives.

On the financial aspects of employee ownership:

- In the current economic environment characterized by inflation and high real interest rates, ESOPs will be very difficult to finance on conventional commercial terms;
- Highly leveraged firms will not be able to afford leveraged ESOPs; and,
- Commercial and merchant banks are likely to structure and finance MBOs and EBOs without any additional incentives and in spite of the current economic situation.

On the tax implications of ESOPs:

- Tax incentives should be given to entities financing ESOPs, companies establishing ESOPs, the selling shareholders, and the employee trust; and,

- These tax incentives are likely to be a significant cost to the GOZ, perhaps approximating the cost of the ESOP transactions over time.

On the most desirable ESOP Structure:

- The "employee trust" model has proved to be a workable vehicle for employee ownership plans, and can serve as an appropriate mechanism for expanded ESOPs;

- Employees should take ownership of the shares after a prescribed period of time; and,

- Share ownership will be financed by the company, not by direct employee contributions.

In spite of the challenging economic environment, the conclusion of the project team is that ESOPs are a viable option for the promotion of "indigenization," privatization, increased employee share ownership, and increased employee productivity. MBO/EBO transactions, by their nature, will continue to attract financing when the deals are attractive to financial institutions.

General Recommendations. There are a number of measures which will help facilitate and enhance the growth and development of employee stock ownership plans in Zimbabwe.

1 **Develop a Comprehensive ESOP Tax Model.** The work done by the C&L/TSG and Price Waterhouse teams resulted in a very preliminary model applicable to individual cases, which could not be refined and expanded due to time constraints. However, the modelling exercise did point out the complexity of ESOPs, and the necessity to produce a reliable model to estimate the tax effects because of the potentially large losses in tax revenues from the proposed incentives. More in-depth analysis would enable the GOZ to clearly evaluate the different tax incentives proposed, and weigh the potential benefits against their impact on the Treasury.

2 **Develop a Constituency Within the GOZ.** The early and rapid development of ESOPs will require a high level of cooperation between several ministries: e.g., Commerce, Finance, Labour and Justice. Legislation delineating the tax must be drafted or existing legislation amended. In addition to the relevant Ministers, influential members of Parliament should be consulted and informed so that any required legislation has support when it is debated in Cabinet and Parliament. The Attorney General's office should be involved in the process from inception. Understanding clearly the nature of the tax incentives will be an important factor in generating government support for this new initiative. In addition to the tax incentives, government support will also be shown by proceeding with the incorporation of ESOPs into privatization transactions. Generating this support will be facilitated by continuing technical assistance from USAID, which can be incorporated into the proposed project.

3 **Develop Support Within the Private Sector.** It is unlikely that this program, if adopted, will be successful if it is not completely embraced and supported by the private sector, including industry, trade and labor associations. Organizations such as the CZI and ZNCC should be brought into the process at an early stage. While they may not be as concerned as the government over the impact of the tax incentives, it is important that these stakeholders understand the mechanics of ESOPs.

4 **Implement Comprehensive Tax Incentives to Support ESOPs.** These tax incentives should include the following, as outlined earlier in the proposed model:

- Reduction or elimination of capital gains taxes on sales of shares to ESOP trusts;
- Treatment of ESOP donations as deductible expenses for corporate profits tax purposes;
- Elimination or deferral of personal income tax upon receipt of the shares;
- Reduction or elimination of estate tax where ESOPs are created;
- Deduction of principal payments for leveraged ESOP loans; and,
- Deduction of a portion of banks' interest earnings from ESOP loans.

The exact nature and extent of each of these measures will need to be worked out in deliberations with the government; however without a comprehensive approach it is unlikely that ESOPs will expand their role significantly. Once the incentives are agreed upon, the qualifying structures needed for ESOPs to be eligible will define a standard model.

5 **Link Privatization to ESOPs.** The government can take direct action to promote employee ownership by establishing an ESOP as part of a privatization transaction. In order to do so, the development of standard guidelines for ESOPs created out of privatization will be helpful. While doing so will reduce, commensurate with the ESOP share of equity, the proceeds to the Treasury from the share sale, it will expand by example the concept of employee ownership, which can have valuable demonstration effects.

6 **Utilize Loan Guarantee Programs to Stimulate Financing for ESOPs.** While the interest rate exclusion from taxable income may induce banks to finance ESOP transactions, there will be additional benefits from extending partial loan guarantees through existing programs. These guarantee programs should be evaluated for their suitability in supporting ESOPs, as well as the satisfaction of their own criteria. Once ESOPs are more established, the guarantee cover can be gradually reduced or otherwise phased out.

7 **Support the Establishment of an ESOP Trade Association.** A formal trade association, comprising professionals with an interest and expertise in services to ESOP companies, and the management and employees of companies with employee ownership trusts can be a focal point for the expansion of ESOPs in Zimbabwe. As the government and private sector organizations such as CZI evaluate the prospects for expanding ESOPs, there is a strong role for a separate trade association which could advance the concept, serve as vehicle for exchange of information, provide education and training, and make representations to the government on ESOPs and policies affecting employee ownership.

Recommendations for USAID Interventions. The following elements can be productive means for USAID to support the establishment of ESOPs in Zimbabwe.

- **Additional technical assistance.** It is clear from the results of this report that a significant amount of analysis needs to be done in order to develop and implement an employee ownership program in Zimbabwe. The Scope of Work for a follow-on consultancy should contain the following tasks:

  1 Develop a comprehensive tax model to explore the revenue impact of adopting the ESOP structure recommended.

2 Assist the government with additional technical analysis of ESOPs.

3 Assist the GOZ in amending existing legislation or preparing a separate bill to provide the incentive framework for ESOPs, as well as developing guidelines for incorporation of ESOPs into privatization deals.

4 Conduct workshops within GOZ, the financial services community and the private sector to explain the rationale, operations and financing of ESOPs and promote the concept.

5 Facilitate the establishment of an ESOP trade association.

- **Support the development of ESOP advisory services.** Employee-owned companies often require the assistance of lawyers, trustees, bankers, valuators (both of businesses and assets), scheme administrators, investment bankers, trainers, productivity consultants, public relations/communications experts and general employee ownership consultants who understand how to integrate the work of the other experts. The development of these services will be critical to the expansion of ESOPs in the country. While Zimbabwe already has a well developed infrastructure of private business services firms and professions, additional technical support from USAID, in the form of ESOP specialists, can be effective.

- **Identify/Develop Sources of Equity Capital.** Given the major constraint of lack of sufficient equity funds available for employee buy-outs, it is important to note that there are two potential sources of funds on the horizon that could provide substantial support in this area; the Zambezi Fund being coordinated by IFC, and the Southern Africa Enterprise Development Fund sponsored by USAID.

Recommendations for the Zimbabwe Enterprise Development Project Staffing and Design. If a project is developed around the report recommendations, several long-term functions should be considered:

- **Legal Advisor**
- **Financial Advisor**
- **Credit Specialist**
- **Training**

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Employee ownership has the potential to expand beyond its current limited role in Zimbabwe. Supporting increased employee ownership is consistent with USAID's strategic objectives, and represents an area where USAID support can be meaningfully and productively deployed. This report lays the groundwork for expanding USAID project activities to encourage broadened employee ownership. While a number of issues must be resolved, there can be significant benefits to the society and economy realized through extending the benefits of share ownership to a broad group of employees.

I. INTRODUCTION

This report has been prepared for USAID/Zimbabwe under the Private Enterprise Development Support (PEDS) project, in partial satisfaction of PIO/T 613-0232-3-30097. The purpose of the report is to provide USAID/Zimbabwe with technical and financial analysis related to increasing employee ownership of firms in Zimbabwe, and in particular the use of mechanisms such as the Employee Stock Ownership Plan (ESOP) which have been developed in the United States. The Scope of Work is attached as Annex C to this report. This effort is intended to assist USAID/Zimbabwe to develop project activities which support its Strategic Objective #2: "increased black ownership and investment at all levels of the economy" and specifically to assist in the design of project elements for the Zimbabwe Enterprise Development (ZED) Project.

The project team consisted of three members with expertise in employee ownership schemes and business policy. The core team, drawn from Coopers & Lybrand/The Services Group, was supported by specialists from the Regional Economic Development Services Office (REDSO) of USAID and AID/Washington. Financial experts from the Harare partnership of Price Waterhouse (PW) also worked with the team, and prepared a separate report which served as a guide for this analysis. (See Appendix A for a list of team members.)

The project activity commenced in late December, 1994, when Price Waterhouse was authorized to begin the process of information collection and research. Their preliminary findings, which were based on a survey, literature search and PW's institutional memory, provided the basis of review for the C&L/TSG team members upon their arrival in the country. Team members added to this base of information by conducting interviews with Government officials, corporate managers, and other stakeholders.

This report presents an analysis of the current climate for employee ownership in Zimbabwe, and then develops a proposed ESOP model. Three case studies explore the potential for ESOPs based on the assumptions of the proposed model. Alternative cases investigate the implications of various ESOP structures, using simple financial projections based on extrapolation of current performance. The three companies were Delta Corporation (conglomerate: beverages, hotels, distribution, retail); Rio Tinto Corporation (mining); and Art Corporation (paper and paper products). The proposed structure of the ESOPs in the case studies is based upon the expert advice provided by the team members with international experience in the development of ESOPs. Economic, financial and other assumptions were developed by the team after a process of consultation and analysis.

The team developed a financial model for the case studies which generates projections based on the alternative ESOP structures, financial and economic assumptions, and other variables. However, it should be noted that due to the compressed time-frame of this project effort, it was not possible to model all of the variables that are involved in a financial structure as complex as an ESOP. In particular, it was not possible to prepare detailed cash flows for each scenario. In some cases, final accounts for 1994/1995 and budgets for future years were not available.

The report contains a social and economic analysis of employee ownership, based on the previous analysis, and concludes with recommendations designed to assist USAID/Zimbabwe in continuing its efforts in support of employee ownership and the expansion of indigenous enterprise in Zimbabwe.

II. POLICY AND INSTITUTIONAL FACTORS AFFECTING EMPLOYEE OWNERSHIP IN ZIMBABWE

A. Current Employee Ownership[1]

There is a significant, if limited, base of experience with employee ownership in Zimbabwe. To date, employee ownership has been structured following one of two general models: an employee trust, with a small shareholding spread broadly among employees; and various efforts to promote direct employee ownership, usually concentrated on management or a select group of employees.

1. Employee Ownership Trusts

There are 22 listed companies, or just over one third of the total number of publicly traded firms on the Zimbabwe Stock Exchange (ZSE), with some type of employee ownership trust. Only three had employee ownership trusts with over 5 percent of total equity, and these were all in the 10-12 percent range. While the terms of participation and beneficial ownership of each is different, most constitute around 3 percent of the equity in the company. They tend to allocate shares on the basis of tenure or alternatively on a simple eligibility status, without regard to salary or tenure. Most trusts hold shares beneficially (i.e. the employee has a defined share in the trust, but does not vote the shares or ever receive them directly) but distribute dividends. The circumstances of the establishment of employee ownership trusts vary widely; some were set up as donations by the company and some were purchases with external financing. Likewise, some had specific purposes and objectives whereas others were done to improve morale and benefits to employees.

2. Direct Employee Share Ownership

The second major option involves various schemes to promote direct ownership by employees. The mechanisms vary, and include preferential terms for purchase, special allocations on new issues, and options for management and executives. There were 10 companies with new issues on the ZSE since 1980 which involved employee purchase programs at preferential terms. In general, these programs also accounted for a small portion of total equity, usually from 1 to 3 percent of total capital, although they may have accounted for a higher percentage of the new issue. Special allocations directly to individuals on issue have been rare, and in general were determined by specific factors in the issue and the individual. Issuing purchase options to management and executives has been relatively common. A total of 31 firms on the ZSE have defined management options plans, which are limited by the exchange's rules to 4 percent of issued share capital.

Beyond the listed companies on the ZSE, there is also anecdotal evidence of limited employee ownership. However, due to the lack of standard reporting of privately held firms, there is no readily available source on shareholdings. Most anecdotal evidence suggests that the privately held firms with employee ownership are very few.

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[1] This section is a summary only. It is based on the study by Price Waterhouse, "Background Paper on Employee Ownership in Zimbabwe," Third Draft Report, February, 1995. Additional details are contained in that report.

3. Employee and Management Buyouts

Employee Buy-Outs and Management Buy-outs (EBO/MBOs) have also been developed to a reasonable stage in Zimbabwe. Typically, these involve the sale of all or a substantial part of the equity of a firm to management and executives. The motivations for these transactions vary widely, including localization, retirement of existing shareholders, restructuring to improve competitiveness, etc. In contrast with employee share trusts, these transactions typically involve sophisticated financing provided by local merchant and commercial banks. In meetings with these financial institutions, some details and information of recent MBO/EBO transactions emerged.

- A Shell/BP subsidiary was sold to the Zimbabwe asphalt, road building and construction company, Bitcon. The transaction was structured as a buy-out by Bitcon and local management. The size of the transaction was Z$16 million and it was completed in 1994. Standard Chartered Merchant Bank was involved as an advisor to Shell/BP and helped structure the buy-out. Syfrets Merchant Bank provided some bridge financing until the equity components were put in place. Equity was put in by the International Finance Corporation (IFC), Continental, and a small management contribution. Bank financing was provided by Barclays Bank and Zimbank. An amount of lease financing was also included in the deal by UDC. This was an interesting transaction and is a good example of the different types of financing that exist in the Zimbabwe market; debt, equity, bridge, and lease financing.

- Highfield Bag Company - This transaction was the sale/spin-off of a division of TA Holdings. IFC participated by providing both loans and equity in the transaction. Zimbabwe Development Bank (ZDB) contributed a portion of medium term financing. Stanbic and Zimbank were also lenders, providing mainly working capital financing. The banks were heavily secured in the transaction since the gearing ratio was over 1:1 which is very high for Zimbabwe. The deal was also partly financed by the seller, but those loans have already been repaid by the company.

- Zimbabwe Bicycle Company was a management buy-out and a spin-off from TA Holdings. As in the Highfield Bag situation, IFC contributed debt and equity financing. Other debt/working capital financing was provided by Zimbank and Standard Chartered.

- The Lonrho subsidiary, Zambesi Coachworks is currently the subject of an MBO/EBO. The company makes bus bodies and trailers, and has a turnover of Z$18 million. Although not completed as yet, the framework of the financing includes management (Z$125,000), the Venture Capital Corporation of Zimbabwe (VCCZ) (Z$190,000, IFC (Z$450,000), and ZDB (tentative Z$300,000). Syfrets is the Merchant Bank involved in the transaction.

- Hubert Davies is not a recent transaction having been done in 1987, but is interesting in that it was a 100% employee buy-out. Barclays was the main financing party.

Other transactions came up in discussions, but for confidentiality and other reasons, less information was available beyond a broad framework of the transaction. Descriptions are as follows:

- A subsidiary of Courtaulds was spun-off and sold in an MBO. The transaction was financed by management, assisted by the fact that there was a substantial amount of cash in the company.

- Stainless Steel Castings was an MBO transaction which was financed by ZDB and Standard Chartered. Another division of the same group, Stainless Steel Industries, was an MBO financed by the Commercial Bank of Zimbabwe.

It is also instructive to look at transactions which were attempted but did not go through for various reasons. A few of them are described as follows:

- Pilkington Glass Zimbabwe was analyzed for a possible MBO. In the end, the company was acquired by PG Industries which raised the funds for the acquisition through a rights issue.

- Centralflex, a subsidiary of Carnaudmetalbox Zimbabwe Limited makes exhaust pipes and has the largest market share in Zimbabwe. An MBO offer was put together by management, but they lost out when a competitor company in Zimbabwe (Bosal Central Africa Ltd of Bulawayo) made a higher bid.

- Blackwood Hodge in Zimbabwe was an attempted management buy-in transaction. The deal fell apart when two of the four local partners to the bid dropped out.

- Sabi Mines Company - IFC worked for several months on an MBO of 42% of the shares of Sabi Mines which is owned by the Government-owned Zimbabwe Mines Development Company. Financing was to be provided to a local management group by IFC, FMO, Barclays, and others. It would have been the first locally owned and managed mining company in Zimbabwe. ZMDC withdrew their agreement to sell the shares, to the disappointment of IFC, the other financing parties, and the management participating in the bid.

4. Conclusions

There are several results from this limited incidence of employee ownership in the country. First, only a handful of firms have established employee ownership trusts that constitute more than 3 percent of total shareholdings. At this low level, most parties consider the effort to be a token gesture, even though the shares are donated by the firm, and the dividends are usually paid out. Supporting this view is the lack of voting power exercised by employees through their beneficial share ownership. Second, ownership schemes such as EBO/MBO's targeted to a small number of senior employees, management and executives offer limited distributional benefits in that they do not spread share ownership among lower income, indigenous employees. Third, there is little knowledge of the potential of broader employee ownership schemes, and investigation in this area does not appear high on the agenda of most stakeholders. Last, among those companies with significant employee ownership plans, the results have been generally positive, with meaningful increases in income and wealth for long-term employees and the continuing support of management. This suggests the potential for broader application of ESOP schemes to support employee ownership.

B. Overview of Economic Policy

For the first several years after independence, the Government of Zimbabwe was primarily concerned with implementing its socialist economic ideology, which included satisfying expectations of land and income redistribution and an enhanced role for state ownership. This resulted, for example, in the Government of Zimbabwe (GOZ) acquiring a significant equity position in the Delta Corporation,

Zimbabwe's largest business group, and Zimpapers which owns the Herald and other newspaper properties. The two aforementioned examples were purchases from South African interests, which was also one of the early goals of the GOZ.

Since independence, the GOZ has developed a parastatal sector of some forty parastatals, as compared to 25 to 30 parastatals controlled by the previous Government. It should be noted that rather than embarking on a new policy of state ownership and control, the GOZ in fact built upon the inherited structures from the previous regime. The parastatal sector comprises all of the principal infrastructure (electricity, telephone, postal service, airline) which are wholly-owned statutory organizations. However, the sector is actually a mixture of active and passive ownership. Some of the ownership is exercised through the Industrial Development Corporation, which is itself a wholly Government-owned company.

A side-effect of the early process of political transformation and economic consolidation was a negative attitude toward local business formation and capital investment. The criticism that indigenous Zimbabweans who wanted to start or expand private companies were "bourgeois capitalists" had a dampening effect on business formation and growth in the early 1980s.

The negative attitude toward local business formation spilled over into foreign investment as well. Even though the GOZ publicly sought direct foreign investment, the policies that were pursued were not at all attractive to foreign investment. The limits on repatriation of capital and dividends, repressive tax rates and constrained exchange rate policies, restrictive labor policies, and the lack of export incentives all combined to create a poor investment climate in Zimbabwe. American investors were concerned by the GOZ's reluctance to sign an agreement with the U.S. Overseas Private Investment Corporation (OPIC). The macro-economic policies pursued by the GOZ, which ignited inflationary pressures and depleted foreign currency reserves, exacerbated an already negative business climate.

As a consequence, Zimbabwe did not live up to the early expectations held by the international business community. With its infrastructure, industrial base, and human and natural resources, Zimbabwe was expected to be a success story with export and investment-led growth. In the 1990s, the government has embarked on a program of economic liberalization, facilitated by the Economic Structural Adjustment Program (ESAP) financed by the World Bank. The principal elements of these liberalizations have included new investment incentives and regulations, a relaxation of foreign exchange controls, import liberalization and tariff reduction, and privatization of government owned companies. The general policy priority of indigenization continues, although the means of achieving it have shifted to less interventionist policies.

C. The Legal Framework for Business

Zimbabwe has a highly organized and fairly efficient legal system with an independent judiciary. Property rights, including intellectual property, are generally observed and enforced. With the exception of the recent controversy over large commercial farms, the GOZ has not used expropriation as a tool.

The body of legislation relating to private sector business activities comprises:

- Companies Act (as amended by Act No. 6 of 1993)
- Insolvency Act

- Manpower Planning and Development Act
- Labor Relations Act
- Small Enterprise Development Corporation Act
- Emergency Powers Act
- Co-operative Societies Act
- Stock Exchange Act (Chapter 190)
- Pension and Provident Fund Act, 1976
- Income Tax Act
- Exchange Control Act

In general, the legislation is silent on the issue of ESOPs and EBO/MBOs. The Labour Relations Act makes an incidental reference (sections 16 and 17 [3][m]) to the situation where a business entity may be closed or "transferred."

There is no specific legislation governing trusts, which have thus far been the major vehicles for existing employee ownership plans. Trusts are established under common law, following the British system, and are a suitable mechanism for this type of pass-through beneficial ownership. Their common law derivation provides flexibility in setting the terms of the operation of trusts without the prescriptive elements often found in legislation. Trusts are registered by notarial deed with the Registrar of Deeds to give them recognition.

1. Business Formation

Zimbabwe law recognizes the standard types of business organization: corporations (limited liability companies); private business corporations (including sole proprietorships); and partnerships.

Except where specific licenses are required (e.g. mining, tour operators), the only requirement before establishing a business, other than proper incorporation, is the acquisition of a business license. The Zimbabwe Investment Centre, previously the arbiter of a complex investment approval process, has streamlined its registration procedures.

The Companies Act poses no real obstacles to the operation of ESOPs. In some countries, overly prescriptive companies laws have precluded many innovations in corporate structure; this does not appear to be the case for Zimbabwe. ESOPs could be formed with publicly listed companies, as well as with closely held and family-owned companies, provided there is share capital. Sole proprietorships and partnerships could not develop such schemes, given the absence of defined share capital.

The Companies Act does contain provisions (Section 58) limiting the ability of corporations to extend assistance to purchase shares in the company without prior approvals and proper procedures. These restrictions would potentially apply to ESOP financings and donations; however with proper precautions they need not be invoked. Indeed, to date they have not posed an obstacle for transfers or financings of employee share ownership trusts.

The protection of minority ownership rights is an important aspect of companies law for the protection of ESOP interests. These rights typically include the ability to prevent outright dilution or other measures which would differentially affect the value of shares, particularly in favor of the holders of large blocs. Section 171 of the Companies Act provides for remedial proceedings and the intervention of the Minister of Justice at the request of shareholders. The requirement is for at least 100 members or one-twentieth (5 percent) of the shareholders to file a complaint. While this would not cover many

of the existing employee trusts, which typically have less than 5 percent and may be counted as a single member with the character of a trust, more substantial ESOPs (such as are being discussed) would qualify. This provision would not necessarily protect other minority shareholders, whose interests could be affected by a principal shareholder and an ESOP.

2. Taxation

The system of business taxation is not complex, and the granting of exemptions does not appear to give GOZ officials wide latitude of discretion. Tax incentives are directed at export activity through export processing zones and investment activity undertaken at specific "growth points." The GOZ also offers accelerated depreciation for new investment under the "Special Initial Allowance." A further investment allowance is available if buildings are erected and utilized for the training of employees.

Basic tax rates are as follows:

- Corporate Tax: 40 percent (to be reduced to 37.5 percent in April 1995)
- Gross Dividends: 20 percent (non-listed companies)
  15 percent (listed companies)
- Capital Gains: 30 percent (non-listed companies)
  10 percent (securities of listed companies)
- Loss Carry-Forward: 6 years

The tax treatment of all the transactions associated with ESOPs can be critical to their appeal as financial instruments. This includes the tax treatment of company donations to employee share trusts or plans, taxation of interest earned on external financing of trust contributions, capital gains, dividends and corporate profits. The relatively high rates of corporate profits tax means that there will be a strong incentive associated with any means of tax reduction. This is reinforced by the relatively small number of exemptions and allowances available, as noted above. Taxation of dividends affects the distribution of profits to ESOPs. Capital gain taxes affect both the impact on the selling shareholders upon the establishment of the ESOP as well as for the employees once they sell the shares. In both cases, selling shareholders would be fully taxed for capital gains. Company donations are not tax deductible at the current time; a common feature of most ESOPs programs.

In the case of preferential interest rates on loans among affiliated parties, which could include company financing of ESOP share purchases, the government imputes interest at specified rates for tax purposes. These rates are set to tax the transactions at their true values; however the current rates are set at 10.5-14 percent; well below the market interest rates of over 30 percent. Until the imputed rates more closely match market rates, there is a (very minor) tax incentive for these types of loans, in that the income from the loans is not taxed at the full opportunity cost rate.

Although the GOZ has not developed any tax incentives or policies specifically for ESOPs, some employee ownership trusts have sought and been awarded tax concessions by obtaining a ruling that dividends payable to the trust which holds ESOP stock are non-taxable. This has not been consistently applied, and it appears that any new requests for such a ruling would not be granted.[2] The issuing of shares to employee trusts is not normally tax deductible, unless it can qualify as a bonus or other form of compensation, which most existing trusts do not. Alternatively, such donations of shares would be tax deductible if they qualified as pensions, however again, most employee trusts

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[2] Price Waterhouse, p. 60.

are not qualified as pensions under the provisions of the Pensions and Provident Funds Act. Indeed, it is likely that ESOPs would be overly complicated and burdened with regulatory compliance were they to be structured as pensions. To date this has not been common.

The lack of specific tax incentives for employee ownership trusts is not surprising in the absence of a specific initiative aimed at establishing more widespread employee ownership through the definition of qualifying plans. However, uniform tax treatment with some provisions for tax relief will be an important aspect of an expanded ESOP program.

3. Labor Policy

Zimbabwe's labor policy, which is governed by the Manpower Planning and Development Act and the Labour Relations Act, is effectively aimed at maintaining artificially high levels of employment by removing owners' discretion in "right-sizing" the labor force through redundancies and other means. The GOZ requires the formation of workers committees and councils in each place of business, in addition to any unions that may participate in the collective bargaining process.

The National Employment Council oversees the working conditions for each industry category. For example, the National Employment Councils develop minimum wage and conditions of service for all graded (non-salaried) employees working in various industries in Zimbabwe. The National Employment Council for a particular industry is composed of an employer organization specific to that industry and the relevant trade union.

At the company level, workers committees are formed as required by law. The workers committee is composed of representatives of the workers and negotiates with management as to certain matters pertaining to that specific enterprise, for example, safety issues. The workers committee can call a strike in certain instances. Each company also has a Works Council which is composed of 50 percent management and 50 percent Workers Committee members.

These policies, and the framework of labor-management relations they foster, create distortions and rigidities in the labor market, and may force the eventual substitution of capital for labor. They may also force wages to be kept lower than would be the case where labor is mobile and potentially more productive.

To the degree that companies are forced to maintain more workers than is otherwise justified, and "right-sizing" is made difficult by the rigid collective bargaining structures and protective labor regulations, the climate for ESOPs will not be favorable. In another context, for companies which are more capital-intensive with relatively few higher skilled workers, an ESOP may be more attractive as a means of reducing turnover and improving productivity.

4. Foreign Exchange Control

Rigid exchange controls, with allocation of foreign exchange by import licenses and a virtual ban on capital transfers, have been a hallmark of Zimbabwean economic policy since independence. These controls, to the degree that they limit foreign investors ability to sell shares, even to local shareholders, affects the general climate for ESOPs. However, recent liberalizations have improved upon the previous intricate system of exchange controls designed to restrict repatriation of corporate profits, capital, and investment funds.

Under the ESAP begun in 1992, the GOZ has focused on an export-led economy, with a more liberalized approach to prices and wages and foreign exchange. An inter-bank market has been created for the allocation of foreign currency and the determination of a market exchange rate. Any corporate body or individual, whether a Foreign Currency Account (FCA) holder or not, may buy and sell foreign currency through the inter-bank market. All private sector import requirements are funded through the inter-bank market, subject to a "negative list."

Foreign investors are permitted to invest on the ZSE. The purchase of shares by foreign investors on the ZSE is limited to an additional 25 percent of the total equity of the company over and above that held at 31 May 1993, and for a single investor to a maximum of 5 percent of the shares on offer. Investments on the ZSE will qualify for 100 percent dividend remittability rights, subject to the deduction of withholding tax. Disinvestment proceeds are fully remittable. Any amounts arising from capital appreciation are freely remittable after deduction of capital gains taxes.

Under previous exchange control regulations, localization (sale of foreign-owned equity or assets to Zimbabweans) was encouraged through the potential to cash out via more lucrative arrangements than either the steep discount in the blocked funds switching procedures or the purchase of low-interest government bonds. In these arrangements, the local investors had to be approved (i.e. indigenous) and 5 percent of the equity had to be reserved for an employee ownership trust.[3] This was potentially a valuable incentive, given the highly punitive nature of the exchange controls, however it appears not to have been utilized. With the recent liberalizations for capital transactions, this particular incentive will no longer apply, but the general relaxation in capital controls will ease the sale of shares by foreign owners, including sales to employees.

D. Assessment of Financial Sector Potential

The sophistication of the financial sector can be an important factor determining the viability of employee ownership plans. While ESOPs created by straight share donations do not require financing, this option will not always be the most attractive. External financing for ESOP purchases of blocs of shares can greatly facilitate the options in how ESOPs operate, and hence their appeal to both companies and employees.

In the current high interest rate environment, with nominal rates over 30 percent and real interest rates at 10 percent or more, financing any transaction is constrained, and medium term credits, let alone long term, are rare. Recent MBO/EBO/ESOP transactions have been difficult to finance due to high interest rates and limited sources of equity financing -- which become even more critical in a high interest rate environment. However, some transactions are being done. It is also important to note that a broad range of financing options exist in the Zimbabwe market. Debt financing, bridge loans, equity finance, medium term finance, and leasing instruments are available to construct an appropriate financing structure for MBO/EBO transactions. The environment is not good at the moment due to high financing costs, but the tools are in place when the market stabilizes.

1. Commercial Banks

There are currently five commercial banks operating in Zimbabwe; Standard Chartered Bank, Barclays Bank, Zimbank, Stanbic Bank, and Commercial Bank of Zimbabwe. They are traditional full service

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[3] Price Waterhouse, p. 62.

commercial banks offering a range of retail, wholesale, corporate and international trade finance services. Competition is somewhat limited and the banks are very conservative in their approach. They are still adjusting to the many changes in the banking and financial sector brought about by liberalization and reduction of the former highly controlled environment in which they operated for so many years. Foreign exchange controls have been relaxed as well as many Reserve Bank restrictions.

Banks are still constrained by the high reserve requirements and liquidity rules which take up a substantial portion of their balance sheets and restrict lending. In addition, high interest rates have negatively affected their clients with the result that loan loss provisions have increased substantially in the last two years. High rates have particularly impacted long-term financing and "deal" financing as these are normally higher risk transactions.

The approach to lending is conservative. The banks require low debt: equity ratios of 0.2 to 0.3 times, as opposed to the US where 1:1 is considered conservative, and 3:1 is not unheard of. In addition to conservative ratios, banks seek to insure strong collateral protection and security over the assets of the company.

Despite the constraints, banks are selectively financing well structured MBO/EBO transactions supported by sound and experienced management, and where there is sufficient equity in the deal to make the risk acceptable. In the list of MBO transactions noted above, a number were financed with equity of approximately 10 percent. These transactions, as well as the funding of ESOPs with loans paid by the company, involve lending on future cash flows. While MBOs typically will be secured by all assets of the company, the real security comes from the ability to generate sufficient cash flow from operations to service the substantial debt required to purchase the equity. In the case of ESOPs with external financing, the loans are also repaid out of cash flow, but the equity is almost always a minority position and will generally not carry the security of all the company's assets.

2. Merchant Banks

The merchant banks active in Zimbabwe are Standard Chartered Merchant Bank, First Merchant Bank, Merchant Bank of Central Africa, Syfrets Merchant Bank, and National Merchant Bank. The banks provide a wide range of merchant banking services including banking, foreign exchange, import/export finance, acceptances, letters of credit, corporate finance, and issuing and underwriting securities.

The merchant banks have been relatively active in MBO/EBO transactions, mainly providing corporate finance services and advising on the financing structure. They tend to act on behalf of the seller of the business rather than the buyer, although they sometimes assist the buyer in order to facilitate the sale.

The merchant banks are not as active as the commercial banks in providing loans to MBOs/EBOs. They do not have the diverse funding base that the commercial banks have, so their funding costs are higher and accordingly their loan charges are higher. They are not usually providers of medium term loans which is frequently what the buy-out transactions need. Their role is more as an "arranger."

They are interested to put together buy-out transactions. Fees are generated on the advisory business, some lending can be done, and there is potential for these companies to be floated on the stock exchange in the future. The merchant banks are well positioned to take the companies public, which is lucrative business for them.

In summary, the merchant banks are interested in this type of business and do compete with each other to act and advise on buy-out transactions. They are also looking at the upcoming privatization program as a source of opportunities. Syfrets and National Merchant Bank should be particularly well positioned to gain privatization business.

3. The Stock Market

The Zimbabwe Stock Exchange (ZSE) has developed and grown dramatically over the last three to four years. Its annual turnover volume has increased from Z$102 million in 1992, to Z$376 million in 1993, to Z$1,400 million in 1994.

Since opening the market to foreign investors, 63 percent of the turnover has come from overseas, mainly the U.S., U.K., and Asia. The net inflow of foreign investment through the exchange has been US$70 million. Total market capitalization now stands at Z$17 billion.

The stock market will become an important vehicle in broadening share ownership in Zimbabwe. The ZSE strongly promotes employee ownership and participation and has listing and new share issue rules which encourage employee ownership of shares. As noted above, taxation of dividends (15 vs. 20 percent) and capital gains (10 vs. 30 percent) is significantly lower for listed companies, comprising a tangible differential and incentive for public listing.

The functioning of a stock exchange is important for the operations of an ESOP for a number of reasons. By providing a secondary market for existing shareholders, it offers an immediate and neutral valuation of shares. It also provides an easy mechanism for cashing out of shares by employees, once they are vested with actual ownership, which, whether exercised or not, increases the attractiveness of share ownership. The operation of the exchange, and in particular the degree to which shareholders' interests are protected via disclosure and reporting requirements, also are important in broadening its appeal to parties, such as employee groups, who may not otherwise be informed shareholders.

The exchange is conducting an information campaign to increase awareness of the exchange, its activities, and role in the economy. Programs and policies which encourage employee ownership would be strongly supported by the ZSE as additional means of broadening share ownership.

4. Other Financial Institutions

Other financial institutions which have participated in the financing of buy-outs and will be important to the future development of these transactions include (i) equity and debt investors such as IFC, FMO, Proparco, and Commonwealth Development Corporation (CDC); (ii) venture capital firms including Venture Capital Corporation of Zimbabwe (VCCZ), Continental Capital (Finhold Group), and Hawk Ventures (Anglo American Group); and (iii) medium-term loan providers such as Zimbabwe Development Bank.

The existing equity and long term debt sources to finance employee ownership schemes are limited. It is a major constraint in the market. The need for equity is even greater in the current high interest rate environment.

The three venture capital firms in Zimbabwe have small portfolios and the amounts they can invest in a single transaction range from Z$1-2 million. VCCZ has a portfolio of Z$34 million spread over

33 projects. Continental Capital's portfolio stands at about Z$10 million, and Hawk Ventures portfolio of equity and loans is about Z$45 million, with a maximum of Z$1 million in equity per investment.

Zimbabwe Development Bank has participated in a number of MBOs involving asset disposals by large groups in favor of management or new investors. This area has become a priority sector, and their ability to provide medium- to long-term finance and some equity through the Zimbabwe Development Fund has been critical.

The availability of equity and quasi-equity to support ESOPs and buy-outs will have a great affect on the growth of employee ownership. It appears that the venture capital firms have largely been tapped out, although some further resources may be freed up as they exit successful investments currently in their portfolios.

New sources of equity funds are needed badly, and can perhaps be sourced through the Southern Africa Enterprise Development Fund (SAEDF) and the Zambesi Fund, which are not operational as yet. Suggestions and steps to be taken for companies to access these critical sources of equity capital will be covered later in the report.

5. Potential for Credit Guarantee Schemes

Partial risk sharing through credit guarantees under the Enhanced Credit Program (ECP) and/or the Loan Portfolio Guarantee Program (LPGP) can play an important role in facilitating debt financing in support of employee ownership plans.

Banks and merchant banks that we met with were positive about partial guarantee support under USAID credit programs. It would particularly assist those marginal transactions where asset cover ratios and collateral packages would fall just short of the banks' criterion. Credit guarantees could therefore increase the amount and number of deals that can be done. With a partial guarantee, financing terms could be improved since the risk parameters for the lending bank will be reduced.

The bank which seems to be the largest player in lending for buy-out transactions was very enthusiastic about a partial risk sharing programme. They expect to do at least five transactions per year. At an average cost of Z$10 million, that would be Z$50 million (US$6 million) of buy-out lending. Using those assumptions, ECP support could be US$3 million or more.

Financial markets should not be distorted by the provision of partial guarantees because the banks will be making the same rigorous evaluation of the viability of the project before agreeing to lend. They will still be sound transactions which are facilitated by the use of credit enhancement.

The ECP can be used in support of specific buy-out loan financing transactions and can cover larger size transactions, based on specific approval by the credit committee. ECP or LPGP can be used in a Loan Portfolio Guarantee structure in support of a number of smaller transactions. For example, as part of the Government's privatization program, state-owned companies are seeking to spin-off non-core businesses or activities in advance of the sale of the core business. These types of spin-offs frequently involve employee groups taking over certain activities or services. Each individual transaction would be relatively small, Z$1-2 million, and would be appropriate candidates for an LPGP structure. Banks would be spreading out their risk and transactions could be done without each individual deal needing approval.

The Credit Guarantee Corporation of Zimbabwe (CGC) could also be used, but they tend to concentrate on smaller guarantee transactions of Z$300-500 thousand and are for a maximum of three years. Also, each transaction needs to have specific approval. CGC provides 50 percent guarantees and have a program for women business owners which offers up to 65 percent guarantee protection to lending banks. The CGC would seem to be particularly well suited to small employee ownership, where for instance, a few employees take over a service from a company or a parastatal as part of a streamlining or out-sourcing process. At present they are not doing buy-out transactions with their guarantees, but they are scheduled to review the matter at their next Board meeting.

E. Policy and Institutional Requirements for Employee Ownership

The above analysis points out virtually no obstacles to employee ownership in Zimbabwe; this is supported by the fledgling schemes in existence. Rather, what is needed are additional incentives. To implement a strategy which significantly grows the level of employee ownership in Zimbabwe, several policy initiatives must be undertaken and various parties must be involved. Among the key employee ownership issues to be resolved are the development of tax incentives, loan guarantees, employee share participation guidelines for privatization, and a trade association to represent ESOP interests.

Tax incentives are the primary vehicle for making employee ownership plans more attractive. These may include the following, all of which are found in the U.S. tax treatment of ESOPs:

- capital gains deferral for selling shareholders, with qualified reinvestment of the sale proceeds;
- deferral of tax for employee shareholders, generally meaning no tax incidence upon the establishment or funding of the ESOP, even if by donation or direct funding from the company;
- exclusion of interest income for lenders to employee ownership trusts, generally a partial exclusion to make these loans more attractive to the banks and also lower cost to the ESOP; and
- deductions for companies to grant stock or otherwise fund stock purchases for employees.

This broad-based approach means that every private sector player may receive some form of preference to enable employee ownership to move forward. Employee share-holding systems are presently diverse in Zimbabwe. Some share ownership schemes involve trusts, others do not. Some systems allow employees to sell their shares when they leave their company, others do not. At present there is no coherent model that offers employers the option of a long term, significantly tax-advantaged plan to increase employee ownership. This is partly a result of the variety of motivations behind establishing employee ownership plans in the country. A second reason is that no unified effort has been made at the governmental level to put forward a plan or implement these types of tax concessions to significantly increase the level of employee ownership. Definition of what constitutes a qualifying plan for tax purposes will, as it has in other countries and with other financial instruments, help to standardize the form(s) of ESOPs, which will also facilitate their development. Care must also be taken not to make the definitions for tax purposes too restrictive, so as to pre-empt innovation and flexibility.

Loan guarantees for employee ownership lending may be essential to provide confidence to the banking community in Zimbabwe regarding the banks' participation in such loans. Such guarantees may not only provide the impetus for banks to learn more about employee ownership, but the banks may also complete transactions based on the encouragement offered by such loan guarantees. The

donor community may have to play the role of guarantor of last resort; this may be accomplished using existing loan guarantee programs such as the ECP and LPGP run by USAID.

Guidelines for privatization, in which the government would state a definitive position endorsing some share participation by employees in privatization transactions, will also be an important means of government support for employee ownership. These guidelines could set a standard structure for ESOPs, and a recommended share participation. While they would not be binding, these guidelines would provide the norm for privatizations, and with some effort by the responsible agencies arranging privatization deals, the exact nature of employee participation in each deal could be negotiated.

Discussion of the wide range of potential developments regarding employee ownership should involve a broad array of interest groups. In addition to government leaders and leaders of businesses which could become employee-owned, practitioners who have worked on past Zimbabwean share ownership schemes should be consulted. Furthermore, pressure groups and trade associations should play a significant role in the development of greater employee ownership in this country.

To this end, a **trade association** for employee ownership should be formed once the general direction for employee ownership policy is formulated. Such a trade association could help move Zimbabwe from being a country which uses employee ownership for limited purposes, to being one where employee ownership plays a significant role in addressing the country's broader political objectives of indigenization and black empowerment. To be successful the trade association should have at least the representation of advisors for ESOP transactions, and officials (including employee and management representatives) from companies with active ESOPs. Goals for the association would be to lobby for ESOP tax advantages, educate potential ESOP firms about employee ownership, and share experiences between ESOP companies and advisors about what works best to develop ESOPs to their full potential.

III. THE PROPOSED ESOP STRUCTURE

The proposed ESOP structure presented here was developed based on the general consensus of the project team on the critical needed features. It serves as the basis for the projections of the impact of adopting an ESOP, with several variations, which is examined in the three case studies in the following chapter.

A. Structure

The structure recommended for ESOPs is the employee ownership trust model. The trust would be tax exempt so that stock of a company purchased on behalf of an employee would not be taxed until distributed to the employee directly. It is suggested that stock which has been allocated to an employee within the trust be distributed to the employee from the trust after the stock has been held by the employee for a ten year period. This distribution of stock would be made to the employee even if he or she is not employed by the company at the end of the ten year period. Each year the employee would continue to receive those shares of company stock from the employee ownership trust account which have matured (held for ten years). This design would serve several purposes. First, the employee would actually receive the shares of stock -- unlike many programs in Zimbabwe which only distribute dividends but not actual shares. Second, employees would have access to stock when the cash is needed for education, housing, etc. instead of having to wait for retirement or termination of employment. Third, by having only a portion of stock available to employees in any one year, long term holding of shares of the company is achieved. Moreover, the employee with a substantial account balance in the trust will not be tempted to resign from the company in order to gain access to the stock in his or her account within the trust. Fourth, the necessary tax exemption legislation required from the Ministry of Finance for the employee ownership trust will be made more attractive to the government because the employees will be paying taxes on the distributions of stock made to them each year with only a ten year deferral. The employees will be able to sell their shares in the public market, or if not possible, then back to the company, and thus can obtain sufficient liquidity to pay the taxes due on the stock distribution.

If an employee leaves the company before ten years of employment are satisfied, the employee would still receive either the shares or the money for the shares at the same time as employees who stayed with the firm for the full ten years or more. The only stipulation would be that an employee work for the company for a full two years. If the employee left before reaching two years of employment, the stock of that employee would be redistributed among all other employees.

B. Funding

The purchase of the company stock by the employee ownership trust can be accomplished by borrowing funds from a financial institution, perhaps with a donor guarantee. To induce the bank to enter into this transaction, the Government of Zimbabwe would offer an exclusion from taxable income of 25 percent of the interest income earned by the bank in connection with the loan to the employees. The loan would be repaid by the employee ownership trust through the use of dividends paid on the entire share capital of Delta (including shares held by the trust) and through cash contributions made by the company to the trust which would be in the nature of a bonus and thus deductible by the employer. This tax deduction will require enabling legislation.

The current tax laws of Zimbabwe provide that the company could increase its employee stock ownership program in a variety of ways. First, a company could make further contributions of stock or cash from its treasury to the trust for the benefit of employees. To the extent cash is contributed to the trust, the cash would be utilized to purchase shares in the public market. Second, a company could issue such shares directly to employees as part of a bonus or profit-sharing program. Third, a company could issue options to employees to purchase its shares in the future. It should be noted that this discussion will focus on the use of stock in each of the structures set forth below. However, each of the structures may utilize stock of any subsidiaries at the discretion of the company.

The employee ownership trust may be leveraged so as to allow it to purchase a block of stock which is available to pre-fund the future years' benefit. This leveraged approach would have several advantages for the company. First, in the case of partial government ownership, such as with Delta, the borrowed funds would allow the Zimbabwean Government to liquidate some of its holdings and create a buyer for future sales of stock in the case of GOZ-owned shares. Second, by purchasing stock of the company in the public market in a large bloc, the stock could be purchased at current fair market value and, assuming that the stock value will increase in future years, will permit shares which are to be allocated to employees in future years as a benefit, to be purchased at a low price per share.

If a company wished to grant shares to employees directly, it could also structure such a transfer as a bonus so as to generate a deduction as a compensation expense. However, if long-term holding of stock is desired, it is unlikely that employees will hold stock long term especially since they will be taxed on the shares in the year in which they are received. This would convert the program into little more than a cash bonus program.

The company could also choose to issue options to purchase shares of the company's stock to its employees (probably at fair market value). However, no deduction would be generated by the option program for the company. More important, the concept of options would be difficult to convey to the employees and the administration of individual employee exercises could be unduly cumbersome.

In all of these options, it has been presumed that the company will essentially finance the acquisition of shares by employees: employees would not pay for the shares directly. In the case of shares issued directly to the ESOP, this will be a straight donation. Where blocs of stock are purchased with outside financing, the resulting loan is presumed to be repaid by the company, either in the form of pre-tax dividends, direct donation, or some other means. In essence, the company will be financing or donating the shares to the ESOP trust as an additional benefit. In the Social and Economic Analysis conducted for this study (see below and in Annex), it was clear that employees outside of management and executives could not afford to purchase shares, directly or via a trust, and would be disinclined to do so.

C. Tax Treatment of Contributions

In the case of an employee ownership trust, current law would not allow the company to take a deduction. At present, only traditional pension trusts which have been approved by the Registrar of Pensions and Providence are eligible to generate a tax deduction for the employer. However, it may be possible to structure the contribution of the company as a bonus so as to allow the company to deduct the value of the stock contributed or the cash contributed to the trust as a compensation expense. Ideally, the Government of Zimbabwe would enact the appropriate legislation to permit all companies with ESOPs to deduct any contribution of employer stock or cash made to an employee

ownership trust for the benefit of its employees. This may be accomplished through new legislation or regulation or by grafting the employee ownership trust on to the existing pension law so that contributions to the employee ownership trust would have the identical tax treatment as contributions to a pension trust, i.e. full deductibility for the corporation.

In order to induce a stockholder to sell stock to an employee ownership trust, the Government of Zimbabwe may also consider a tax deferral of capital gains which would otherwise be payable as a result of the sale. With this incentive, current stockholders would be encouraged to sell shares of stock to the employees. This option, an attractive feature of the U.S. ESOP tax advantages, has proven an effective incentive, generally accounting for a comparable tax benefit as the deductibility of contributions by the company.[4] In the Zimbabwean context, with many closely held companies facing succession problems, an additional incentive to sell at least a partial bloc of shares to employees could have a strong impact.

D. Tax Treatment of Employees

In the employee ownership trust structure under current law, the employee would incur a tax when shares are allocated to his or her account in the employee ownership trust. If the shares of the company's stock allocated to the employee are subject to forfeiture or vesting, the employee will incur tax on the fair market value of the shares in the year in which the shares are no longer subject to forfeiture. Consequently, subjecting the employee stock in the employee ownership trust to vesting only serves to increase the tax liability of the employee at a time when the shares are not yet available to him or her.

It is essential that shares of stock transferred to employees (either through the employee ownership trust or directly) be free from taxation until at least the point where such shares are actually made available to the employee, recommended here as a 10 year holding period. Preferably, the employee would not be liable for any tax until the shares are sold and cash generated. In this treatment, the employee would be liable for capital gains tax only on the sale. As his tax basis would be zero, this would be on the full value of the shares.

Alternatively, the employee could be liable for tax as normal income on the value of the shares at the point at which he receives a direct shareholding. This is less desirable as it will mean that the employee would have to raise cash to pay the additional tax; in most cases it can be presumed that this would mean the sale of at least some of his shareholding. In cases when the employee would otherwise continue to hold the shares, this acts against the objective of stimulating long-term shareholdings. The employee would be liable for capital gains on any subsequent sale after the transfer, however only on the increase in value since the transfer date. The net effect of this alternative would be a higher tax incidence for the employee, as the shares would be taxed as ordinary income on transfer, instead of at the capital gains rate at the date of sale.

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[4] This option, while recommended, was not incorporated into the case study financial models. In order to do so, assumptions regarding the cost basis of the selling shareholders would be necessary, and there was no basis for such assumptions.

E. External Financing

The sale of a bloc of stock to employees should not require a contribution from the employees because the average worker has neither disposable income nor personal savings. Therefore, except in cases of the issuance of shares directly to the ESOP trust, the sale will require third party financing from financial institutions in Zimbabwe, perhaps supported by donor guarantees. The financial institutions will analyze the transaction as if it were entering into business loans for the company. Consequently, the financial institutions will base their decisions to lend in connection with the employee ownership purchase, based upon the past performance of the company and financial projections prepared by management.

It is likely that financial institutions will be resistant to lend to an employee ownership trust since the trust will be an empty shell immediately prior to the transaction and no collateral will be available other than the stock of the company purchased with the loan proceeds. In other countries utilizing the employee ownership model, assets of the employer corporation may be used as collateral to secure the loan to the employee ownership trust. In order to attract financial institutions to enter into a loan transaction involving a sale to the employees, the Government of Zimbabwe should be encouraged to enact tax incentives to the financial institutions whereby 25 percent of the interest income received by the financial institutions in connection with the loan would be excluded from taxation, i.e., only 75 percent of the interest earned by the financial institutions would be taxable. In the U.S. this exclusion is 50 percent; however given the high nominal and real rates of interest in Zimbabwe, the costs in foregone tax revenues of an ESOP interest exclusion would be excessive. The 25 percent exclusion is considered to be reasonable.

Repayment of the loan from the employee ownership trust would come from two sources. First, dividends paid by the company on shares held in the trust would be applied to repay both principal and interest on the debt. Second, the company would make cash contributions to the employee ownership trust each year in an amount sufficient to allow the trust to amortise the debt, both principal and interest, to the financial institutions.

If the stock acquired with the proceeds of the loan to the employee ownership trust is used as collateral by the financial institutions, such stock would be released each year from pledge in proportion to the debt paid in that year as a percentage of total debt outstanding. For example, if four-year term loans were obtained to finance a purchase of stock on behalf of the employees, each year one fourth of the loan would be paid down and one fourth of that block of stock would be released from collateralization by the financial institutions and allocated to individual employees within the employee ownership trust.

Loan guarantees for employee ownership lending may be essential to provide confidence to the financial institutions in Zimbabwe regarding such loans. Such guarantees may not only provide the impetus for banks to learn more about employee ownership, but the banks may also complete transactions based on the encouragement offered by such loan guarantees. The donor community may have to play the role of guarantor of last resort.

F. Dilution

Unless the employees were to fund the purchase of shares held by the ESOP trust, there will inevitably be some dilution of share value, directly or indirectly. To some extent, this dilution will be

offset by the tax advantages. In the case where shares purchased by the employee ownership trust are bought on the secondary market, or where they are otherwise purchased at an assessed or appraised value, remaining stockholders would suffer no direct share dilution. However, the imposition of additional debt on the company would affect share value at least in the short term. The company would repay the debt from its general cash flow; this will affect the money available for distribution as regular dividends, and the interest burden would decrease net income.

The dilution of non-employee shareholders interests will only be partially offset by the tax benefits to the company, i.e. the reduction in taxable income of the donation or funding of share purchase. This will be equivalent to the marginal tax rate, or a maximum of 40 percent. The cost of funding an ESOP to the existing shareholders would also be offset in part by productivity gains emanating from employee ownership and the improved motivation of the employees. If there are no productivity gains and ESOP stock is made available to employees as a net increase in benefits, then non-ESOP shareholders and the government, via reduced tax revenues, will basically fund the employees share ownership plan.

G. Governance

The few employee ownership programs in existence in Zimbabwe have been criticized by some because the employees have not have had any influence over the company as a shareholder. Moreover, the shares held in trust are never actually distributed to the employee. In the structure recommended, employees will actually receive shares in the company ten years after the shares are allocated to the employee's account. The employee should also be entitled to vote the shares allocated in the trust to his or her account in order to make ownership "real."

It is important to have the employee ownership trust managed by an entity or individuals with undivided loyalty to the employees. Even if the trustee(s) is appointed by the board of directors of the company, which is common in many countries, the trustee(s) should be subject to strict fiduciary standards and operate solely for the benefit of the employee shareholders.

H. Motivation of Stakeholders

Because of their relative complexity and the requirement of a long-term commitment, ESOPs are only done in an environment where there is a substantial commitment on the part of one or more stakeholders. However, in Zimbabwe the Government has not taken an active role in ESOPs although in principle the GOZ supports the development of employee ownership schemes, particularly those involving "indigenous locals."

1. Shareholders of Companies in Zimbabwe

Shareholders of companies in Zimbabwe which are traded on the Zimbabwe Stock Exchange can obtain liquidity through the public market. However, many companies -- including very large ones -- are not listed on the Zimbabwe Stock Exchange and, consequently, those shareholders have difficulty in obtaining liquidity for their shares of stock absent selling to a third party buyer. The employee ownership concept can be used as a financing tool to permit a shareholder of a private company to sell significant blocks of shares at a full market price. This application may be particularly attractive to a shareholder who is approaching retirement age who desires to diversify his personal holdings.

For a variety of reasons, a sale to a third party may not be desirable either because there is no ready buyer or because the shareholder is not yet interested in relinquishing control of the company. The employee ownership trust can be structured as a ready buyer for a shareholder who wishes to so diversify. The price at which the shareholder can sell his or her shares to the employees will be determined by a qualified business appraiser thus insuring a fair price to both buyer and seller. By using third party financing, the employee ownership trust can purchase large blocks of shares limited only by the financing available. This transfer of ownership from a single shareholder or small group of shareholders also accomplishes the goal of transferring ownership to a larger segment of the population of Zimbabwe.

The additional debt placed on the company using third party financing will cause the company and thus the shareholders (including the employee ownership trust) to experience greater risk emanating from the pressure on the company to generate sufficient cash flow to amortize the debt. This risk is exacerbated by the high interest rates charged at the current time. In addition, the financial institution providing the financing is likely to collateralize all assets of the company and may seek additional security from the selling shareholders thus raising additional risk.

Because of this additional risk, it would be desirable to offer a shareholder an incentive to sell to the employees of the company. This could be accomplished by offering the shareholder an opportunity to defer the capital gains otherwise payable on the proceeds of the sale. As a condition to the tax deferral, the government of Zimbabwe could require that the sale proceeds received by a shareholder be reinvested in enterprises in Zimbabwe.

2. Employers

Companies in Zimbabwe are interested in tools to motivate employees which in turn would increase productivity and profits. The sale of shares to employees could be accomplished if coupled with an education program to demonstrate to employees that their collective efforts to generate profits for the company would translate to personal wealth in addition to wages.

The issue of control of the management of the corporation is often a source of confusion among employees who are new to employee ownership. Often the new employee owners believe that they have the right to make the kinds of decisions usually made by top management. It is important to provide an extensive educational process in conjunction with the onset of employee ownership to encourage the employees to become more involved in the welfare of the company in a productive manner so as to maximize his or her investment in the company's stock. However, it is important to have the company run by trained professional managers and to have workers continue to do their job within the company.

3. Employees

Most workers in Zimbabwe do not have the personal resources to purchase even a minimal amount of stock of a business including the business of the employer. Except in the case of the top tier of management, employees' personal resources are used exclusively to meet the needs of the family. Consequently, for most Zimbabweans, the only method by which an employee can own stock in a business will be if financing is provided or the stock is given outright.

If the employer reduces other benefits to the employee, such as eliminating an existing pension plan, the result will be that the employees' "savings for retirement" will be in a much riskier investment

because it is not diversified but rather is in a single investment. In addition, the employees' stock account in the employee stock ownership trust will be subject to the volatility of the company's business. Losses in share value can be discouraging to a workforce and education is needed to prepare employees of the cycles experienced in the market place.

4. Government of Zimbabwe

The greatest risk assumed is that of the government of Zimbabwe in that it is foregoing tax revenue on transactions which would otherwise be taxable. However, it should be pointed out that many of these transactions would not have taken place but for the incentives offered. For example, a stakeholder who is at retirement age might not sell his or her stock but merely allow the company to wind-down after his departure. Or, current shareholders would maintain ownership levels and thus not generate any capital gains taxes. Consequently, the alternatives to the sale to the employees might not generate tax revenue to the government.

IV. CASE STUDY ANALYSES

The Scope of Work required that the project team undertake and complete four case studies, utilizing companies drawn from the following categories: multinational; parastatal; local (ZSE listed); and local (non-listed). However, given the constraint of time, only three case studies are presented in this report. The fourth case study, of a parastatal company, will be conducted later and with the benefit of experience gained from producing the other case studies.

A. Introduction

Three companies were chosen for the case studies. All were public quoted companies, for which financial information is readily accessible. Specific reasons for choosing these companies were as follows.

1. Delta Corporation

This is the biggest group of companies in the country in terms of both turnover and employment. It accounts for approximately 20 percent of the total market capitalization of the Zimbabwe Stock Exchange. Delta was an early respondent to the Price Waterhouse questionnaire which was the basis for much of the information gathering of this study. The group has had an employee share trust established for almost five years. An additional reason for focussing on the group was the announcement in late January 1995, as work on the study was well under way, that the government intended to divest of its 36 percent shareholding in the group via the Zimbabwe Development Corporation. It was also suggested that such a disposal might also incorporate an indigenization exercise. It would therefore seem logical to assume that employees might be included among those groups who could acquire some of the state-owned shares, making Delta a model for the application of ESOPs in privatization transactions.

2. Art Corporation

Art was the first quoted company - and possibly the first of any company in Zimbabwe - to set up an employee ownership trust, and is well known as an enlightened employer. The employee trust has now been in place for over 13 years and its current shareholding of 11.81 percent constitutes the second highest percentage held by an employee trust of any quoted company in the country. Indeed, for a while, the trust held 15 percent of the company's shares. The Art scheme has served as a model for many other trusts in Zimbabwe. Art is also essentially a domestic company, with a focus on the domestic market.

Additionally, Art has a large tax loss, due to recent difficult times which compelled the group to restructure from 1992 to 1994. In examining fiscal impact it was thought worth using such a model, where losses to the treasury would be substantially deferred. The group, despite the recent restructuring, is still highly leveraged, and the impact of further borrowing was also considered worthy of scrutiny.

3. Rio Tinto Zimbabwe

Rio Tinto is a multinational, with some shares listed on the ZSE. For many years this mining group has had a profit-sharing scheme and the response to our questionnaire indicated some interest on the

part of management in widening this to embrace employee ownership. It was also felt useful to select a case study in the strategic mining sector where Zimbabwe enjoys a number of natural comparative advantages. Historically, the mining sector in Southern Africa, and in particular South Africa, has experimented with employee ownership. Rio Tinto has, additionally, no significant debt-service obligations - it is in fact a net earner of interest. Thus, its ability to take on additional borrowings is greater than that of many firms in Zimbabwe at the present time.

B. Assumptions for the Case Study Model

For each of the four years from 1995 in the case of Delta, whose year end is in March, and from 1994 in the case of Art and Rio Tinto, whose year ends are in December, profit and loss projections have been made on the assumption of each of the following cases and scenarios:

- **Base Case: no ESOP** or additional employee shareholding is undertaken. Financial results are projected based on an extrapolation of current performance.

- **Case 1: 5 percent donation.** The company simply donates an additional 5 percent of its shares to employees by an issuance of shares out of reserves. It is assumed that this attracts full tax relief on the cost of the shares, deemed to be at market value, in the year of donation, a concession not currently available. Additionally it is assumed that the donation is not taxable in the hands of the recipients. This treatment is a further departure from current practice. However loss of revenue by the Treasury in the latter event is not included in fiscal effects, since it is assumed that the donation would not have arisen without the fiscal incentive, and hence no actual revenues are lost.

- **Case 2: 20 percent ESOP.** The company borrows to finance the purchase by the ESOP of an additional 20 percent of its existing shares. The sum is repayable over four years, this being the maximum time frame that financial institutions generally appear to be comfortable with when funding such transactions. There is full tax relief for the annual interest and principal repayments, again a departure from existing tax legislation which treats neither as an allowable deduction. Again the receipt of shares by the ESOP is assumed to be a non-taxable event.

- **Case 3: 5 percent ESOP.** The company borrows from the banks as in (2) above but in this case the ESOP purchases only an additional 5 percent of the shares.

In each of the cases, the following variations in interest rate and inflation assumptions are examined:

- Scenario a) Borrowing at a slight discount to current market interest rate, i.e., 10 percent to 33 percent, giving an effective 29.7 percent interest. In this scenario, adjustments are made for annual inflation at a rate of 20 percent per annum, the current approximate rate.

- Scenario b) Projections are in constant terms, with borrowing at an interest rate of 10 percent, this being the approximate current "real" interest rate (i.e., excess of nominal interest rate over rate of inflation). No adjustments are made for inflation, and summary values, such as the total cost to the Treasury, are not discounted.

Finally, and in the case of Delta only, a third variation postulates the ESOP structure scenarios but in this case the method of finance is not borrowing, but the issue by the company of 20 percent preference shares. Tax treatment of the preference shares is again a departure from current practice in that the dividends and capital repayments are regarded as allowable deductions. Again, adjustments are made for annual inflation at 20 percent. The selection of 20 percent as a coupon rate reflects existing market trends today, given that under current legislation, dividends received on shares are not taxable in the hands of companies.

In each of these scenarios the costs to the Treasury in terms of reduced tax receipts against the base case are shown on a year by year basis. Dividends received on shares held by the ESOP are assumed to be exempt from the 15 percent withholding tax currently raised on all dividends paid to individuals by quoted companies. The level of company tax also rises or falls, depending upon the impact each year of the ESOP on profits, and therefore taxable income.

In the case of a donation of shares, the reduction in tax is due to the cumulative effect of the changes in company tax and resident shareholders' tax (tax on dividends). In the case of a purchase of shares as a result of borrowing by the company, the reduction is due to both the above elements and the tax relief accorded to the banks who are only taxable on only three-quarters of their interest income, a concession which would be a departure from current legislation. In the case of the financing of the transaction by the issue of preference shares for Delta, the loss to the Treasury is again due to the combination of changes in company tax and resident shareholders' tax. As preference share dividends, like any other form of dividend, are already exempt from taxation in the hands of companies, there is no impact upon the Treasury from the point of view of the tax position of the holder of the preference shares. The costs of the transactions are shown in Table 4.1.

Additionally the projections show the levels of interest cover in each case, together with the ratio of retained income to annual capital payments. This is a very crude indication of the company's ability to service its annual principal repayments and is not strictly accurate for a number of reasons: retained income is not the same as retained cash, and it is in any event likely that, with the company incurring further borrowings or issuing preference shares to finance an ESOP, dividend cover will have to be increased. We have, however, assumed a future constant dividend cover based on existing levels.

A summary of the change in taxation receipts against the base model is then given, allocating the increases or decreases against the various taxes. In each case the Treasury suffers a net loss. This benefit is then summarized on an annual percentage basis, allocated between shareholders, company and where applicable, banks.

The change against the base model in net dividends received by the outside, or non-ESOP shareholders, is also given in each case for each year.

The total loss to the Treasury, discounted back to 1994/1995 prices in the case of scenarios one and three, is summarized for each of the three events. This is set alongside the reduction in company tax, and tax paid by the banks.

Table 4.1
Projected ESOP Transaction Costs

Company and Case	Shares	Price	Value
DELTA			
5 percent donation and ESOP:	1,292,800 shares	@ Z$135	Z$174,528,000
20 percent ESOP:	5,171,200 shares	@ Z$135	Z$698,112,000
RIO TINTO			
5 percent donation and ESOP	1,123,050 shares	@ Z$23.50	Z$26,391,675
20 percent ESOP:	4,492,000 shares	@ Z$23.50	Z$105,566,700
ART			
5 percent donation and ESOP	12,582,550 shares	@ 55 cents	Z$6,920,403
20 percent ESOP	50,342,200 shares	@ 55 cents	Z$27,681,610

An attempt is made to show, at 1994/1995 prices, the increase in capital values of the shares as a result of the ESOPs. The assumption is made that the current share price will increase in value in real terms in proportion to the increases in productivity, which are assumed at 2 percent and 4.5 percent as noted above. The share price is also allowed to increase to the extent that each company enjoys real growth, which is at different rates for each company according to its individual circumstances. For each company there is only one set of increases, i.e., these are seen as independent of the hypothetical scenarios. The net increase in share values is set out insofar as it affects both ESOP shareholders and outside (i.e., non-ESOP) shareholders. For ESOP shareholders the figure stated is also the projected value after four years, expressed, at current prices, of the shares they will acquire through the ESOP. In each case it forms a substantial portion of the overall increase in the value of the shares of the entire company.

Finally, an additional inclusion is the total change in outside shareholders' dividends, which is the net loss of dividend income over the four year period, discounted where appropriate, to those shareholders who have seen a dilution of their shareholding as a result of the ESOP. It will be noted that net gains arise only in the case of the 5 percent donations (where there is a massive tax benefit in the year the donation is made and consequently a greater dividend pay-out than in the base case).

C. Case Study: Delta Corporation

1. Company History

Delta Corporation is the country's largest company, a conglomerate which owns businesses in such industries as consumer products, hotels, tourist services, breweries and other beverages. For many years the company has been known as Zimbabwe's leading firm. In fact, presently Delta has 3 times the turnover of the next largest Zimbabwean company. (See Table 4.2.) The employees own approximately 3 percent of company shares.

Delta shares have done particularly well exceeding the general rise in Zimbabwe share prices over the last several years. Since the original year of employee ownership, approximately 5 years ago, share prices have increased from Z$15 to Z$140 in January, 1995.

A major subsidiary of the firm is Zimbabwe Sun Limited which has holdings in the tourist industry. This company has an employee trust which holds 1.5 percent of the outstanding subsidiary shares. This holding was established in 1990 when the company was taken public. The employees, as partial owners, take some pride in their company, according to company sources.

While neither Delta nor its subsidiary Zimbabwe Sun have large employee holdings, the amounts of money some employees receive upon leaving the company are becoming sizeable. A Delta employee who remains with the company for the required 5 years receives 100 shares. Consequently, at recent, pre-split share prices, employees would receive Z$14,000. Although few departures have been prompted by a desire to receive this money, some concerns exist among Delta managers that good people will leave the company early to collect their shares.

Since the government owns approximately 35 percent of Delta's shares, opportunities for greater employee ownership may exist as part of a further privatization. Delta recently reported having 12,300 employees.

2. Market Definition

Delta Corporation is involved principally in the beer and soft drink industries. Through subsidiaries, it deals with hotels (Zimbabwe Sun Hotels), retail food, clothing and other goods (OK Bazaars and Bon Marche), and furniture (Bradlows, Homemakers, Pelhams, Furniture Discount Centre, and Everest Carpeting).

In its primary businesses, Delta Corporation has a tremendous amount of market power, including a near monopoly in its major product lines. It controls 80 to 95 percent of the beer market and about 85 percent of the soft drink market. ZimSun Hotels is one of the largest suppliers of hotel services in the country.

Delta is easily the largest firm in Zimbabwe. In 1994, the firm had turnover of Z$2,654 billion, which is about eight to ten percent of the GDP. With this volume of activity, the company is subject to very little competitive pressure. In its main lines of beer and soft drinks, there are some imports that it competes against, but these are too small to be any real competition.

During 1994, the firm had turnover per employee of Z$206,400, and average compensation to employees of Z$23,192. Thus, labor costs amounted to only about 11 percent of turnover. It is estimated that most of the line employees of the firm earn about Z$14,000 per year, with the upper management earning Z$180,000 to Z$190,000 per year.

In contrast to employee earnings, taxes, at about 19 percent of turnover, are the largest single expenditure of the company. Taxes represented 43 percent of value added by the company. This very large share of company volume going to the state would indicate that competitive pressures are small, and that the state is sharing significantly in the rewards of the dominance of these markets.

3. 1994 Financial Base

Use was made of September 1994 interim results. In discussions with the company's Group Treasurer, the view emerged that 10 percent real growth was a real possibility, with particular expansion in the tourism and retail fields where the group has sizeable and established market shares. This percentage was applied to future profits, with the interest burden pegged at existing levels. A more detailed rationale of the estimated March 1995 figures is given below.

1. According to the interim report to September 1994, turnover was Z$1,668 million. In the previous financial year the first half year's turnover represented 45 percent of annual sales (traditionally Christmas sees a surge in consumer retail spending and the tourism fields). The same ratio has therefore been applied to the current financial year.

2. Profit before interest in relation to turnover has varied between 10.5 percent (1991) to 15.6 percent (1994). In the current year the interim ratio was closer to 14 percent and a ratio of 15 percent was selected for the year as a whole.

3. The interest bill has been held at constant levels, assuming some moderation in rates and a peaking of debt in September 1994.

4. Effective tax rate taken as 24.4 percent, this being the average of the last four financial years. The effective rate at September 1994 was 24.8 percent.

5. The outside shareholders' interest was Z$16 million at September 1994. In September 1993 this constituted 38.9 percent of the final annual figure and therefore the same percentage was applied.

6. The amortization of the revaluation surplus was Z$17.4 million at September 1994. In the first half of the previous financial year this constituted 49 percent of the final annual figure and this figure was held constant.

7. Dividend cover has been traditionally two times, after taking the above amortization into account. It has been maintained at this level.

4. Financial Projections

The full tables showing the financial projections are shown in the Annex.

Table 4.2
DELTA CORPORATION LIMITED
Financial Summary

(Z$ million)

	Estimate[1]	Audited			
	31.3.1995	31.3.1994	31.3.1993	31.3.1992	31.3.1991
TURNOVER	3707	2654	2013	1681	1243
PROFIT BEFORE INTEREST & TAX	556	413	312	238	131
INTEREST	(129)	(125)	(90)	(19)	(7)
ASSOCIATE	3	3	2	3	2
PROFIT BEFORE TAX	430	291	224	222	126
TAX	(105)	(60)	(64)	(66)	(23)
PROFIT AFTER TAX	325	231	160	153	103
OUTSIDE SHAREHOLDERS	(41)	(18)	(9)	(20)	(12)
PROFIT ATTRIBUTABLE TO ORDINARY SHAREHOLDERS	284	213	151	136	91
AMORTIZATION OF REVALUATION SURPLUS	(36)	(38)	(29)	(23)	(6)
DIVIDENDS	(124)	(86)	(61)	(56)	(42)
RETAINED INCOME	124	89	61	57	43

[1] Figures based on interim results to September 1994.

[2] Profit attributable to ordinary shareholders increases by 33 percent over 1994. This agrees with Executive Chairman's interim statement that group attributable earnings for whole year will exceed last year by at least 30 percent.

Scenario a)

At close to the current high interest rates, a 20 percent ESOP achieves the greatest profitability for the company by 1996. A 20 percent ESOP would, however, cost the Treasury a discounted Z$438.9 million (just over 62 percent of the cost of the shares) and would seriously test the company's ability to service its debts, particularly in the first two years, where retained income is equal to or below capital payments. This despite the fact that in these two years the company would have an assessed loss and pay no tax. The 5 percent ESOP would produce a net effect on company performance which is slightly superior to that produced by the 5 percent donation from 1997 onwards. It also shows levels of interest and capital cover sufficient to give greater confidence that the debt could be serviced, even at the high interest rate indicated. However, the discounted cost to the Treasury is over one and a half times as great as that of a 5 percent donation.

The 5 percent donation results in a discounted cost to the Treasury of Z$65.7 million, all of the costs coming as a result of the one-off large tax concession in 1995, this being the sole tax benefit.

All three events produce a more profitable company than base case by 1997, the third year of the ESOP.

Scenario b)

With interest rates held at 10 percent in real terms, a 20 percent ESOP again produces the best results for the company by 1996. Interest cover is no longer a serious problem but capital repayments are very tight throughout and the cost to the Treasury is still a huge Z$365.3 million. The 5 percent ESOP produces slightly better results for the company than the 5 percent donation by 1996, but costs the Treasury over 36 percent more than the 5 percent donation.

An immediate improvement in company results arises by the end of the first year of the ESOP.

Scenario c)

Using preference shares as the financing instrument, a 20 percent ESOP again produces the best results for the company by 1996. However, servicing the capital repayments is only slightly less problematic than in scenario one. However, interest cover is no longer, a problem with no additional. interest charges arising. The fiscal cost is still a high Z$339.8 million, although this would be greatly reduced on the company tax side if neither preference dividends nor capital repayments were deductible.

With a 5 percent ESOP the company is again slightly better off by 1996 than with a 5 percent donation, a year earlier than in scenario a), although the fiscal cost of the former now fails to just under a third as high again as the latter.

- All three cases produce improved company results by the second year of the ESOP. Scenario c) sees an entire elimination of any interest received by banks as a result of the use of a preference share, rather than borrowings, to finance the ESOP.

Since there are no special fiscal concessions to the subscribers of preference shares - there being effectively none to make in the case of companies, who are already not taxable on dividends received - the question may be raised as to what incentives need to be offered to make such an instrument

attractive. This may necessitate, among other things, a higher coupon rate than the current base market one, which is around the 20 percent mark for a non-convertible redeemable preference share.

5. Discussion of Results

In considering a 20 percent ESOP, be it financed by either borrowings or preference shares, it is clear that considerable strains are placed on both the Treasury and company's ability to service these, particularly in the initial two years. Where companies already are highly leveraged, it is unlikely that shareholders will be enthusiastic about increasing borrowings, albeit temporarily, to fund an ESOP. Scenarios a) and c), which take into account inflation, show that the company earns slightly greater profits by 1998 when financing both 5 percent and 20 percent ESOPs through preference shares rather than through borrowings, and with substantially less damage to the Treasury. This arises because the company benefits from the lower coupon rate and fiscal concessions with no tax advantages accruing to the holder of the preference shares.

A donation of 5 percent has in each case a less severe impact on the Treasury than a loan to fund a 5 percent ESOP. In general there is a trade-off between the benefits to the company (and therefore, in the long-term, the shareholders) and the losses to the Treasury. Striking a balance between the two is crucial. While the banks stand to make significant tax savings in the event of borrowing, thought needs to be given to making a preference share sufficiently attractive, given that the current scenario envisages no tax benefits to the future holders of such instruments.

Table 4.3 summarizes the relationship between the fiscal costs, the original cost of the shares and the net capital benefit to the ESOP shareholders.

6. Economic Implications

There are significant distributional implications to an ESOP at Delta. This is a very large company, employing 12,860 employees in 1994, with a total payroll of Z$298 million. An ESOP for this company can easily affect the welfare of extended families in households containing as many as 100,000 Zimbabweans, perhaps as much as one percent of the population.

Moreover, the size of the program would add significant wealth to these households. At current market prices, a 5 percent ESOP would add Z$180 million to their net wealth, or about 60 percent of one year's earnings. A 20 percent ESOP would add Z$719 million, equal to 2.4 years of earnings. Although the average earnings of Delta employees place them well above the median income in Zimbabwe, this program nevertheless could have large distributional impacts. This is especially true if the benefits were limited to non-management employees, or were graduated in some way that lower paid employees received greater benefits.

Delta has an employee stock program now with 2.72 percent of the company stock. There is little evidence that it has had any impact on productivity. A senior manager has stated that an employee profit-sharing program is considered to have more impact on employee work habits. Profit sharing can amount to a one to three month bonus each year. However, it is impossible to predict what the impact of a larger ESOP would be.

Table 4.3
DELTA CORPORATION LIMITED
Summary ESOP Results
(Amounts in Z$ Millions)

	20 % ESOP	5 % ESOP	5 % DONATION
Cost of Shares	698.1m	174.5m	174.5m
Value of ESOP Shareholders' Shares after 4 Years	1,068.8m	260.7m	260.7m
Cost to Treasury:			
(a) Higher interest rate adjusted to current prices	438.9m	110.7m	65.7m
(b) Constant prices with 10 % real interest rate	365.3m	89.2m	65.5m
(c) Preference shares adjusted to current prices	339.8m	83.9m	65.7m
Percent of Cost of Shares Borne by Treasury:			
Scenario (a)	63%	63%	38%
Scenario (b)	52%	51%	38%
Scenario (c)	49%	48%	38%

The impact on taxes of the proposed ESOPs would be significant. In 1994, Delta paid Z$487 million in direct taxes and Z$60 million in taxes on earnings. Together, these amounted to about 4.3 percent of all tax revenues during the year. If the personal income taxes of Delta employees are added to this, the company could easily be responsible for 5 percent of all tax revenues.

Under the scenarios worked out in the financial modelling section at current interest rates, the tax concessions would be significant. With a 20 percent ESOP, the tax concessions are close to half of the company's 1994 tax payments. With such a large company, this one transaction would have a measurable effect on government tax revenues. Tax revenues for the 1994/95 year are forecast to be approximately Z$15.5 billion. In the first year, a 5 percent ESOP would reduce government revenues by 0.15 percent, and a 20 percent ESOP would require tax concessions equal to about 1.3 percent of all tax revenues.

In the scenarios, the concession on corporate income taxes is larger than the 1994 taxes paid, but company growth is projected to be large enough to use the entire concession. The major tax impact, however, comes from the relief on the principal. In the cases modeled here, the company essentially can count the 5 or 20 percent of the value of the company as an expense or a loss, reaping a commensurate tax gain. The third category of tax breaks, the interest deductibility for banks, is large because of the very high interest rates now in existence. This could drop significantly in future years.

Under the current interest rate scenarios, it can be seen that over the four years the total tax concessions can amount to from 50 to 100 percent of the ESOP program. There is a simple explanation of why total tax benefits are so large. For any given size program, the tax loss from the company donation will amount to about 40 percent of the share values. If the four years of non-taxable dividends are 5-10 percent of stock value each year, that is a tax loss of 20 to 40 percent of the share values. When the interest deductibility of ESOP financing is added, as well an any foregone capital gains, the total tax cost can potentially equal the entire transaction.

D. Case Study: Rio Tinto Zimbabwe Limited

1. Company History

Rio Tinto Zimbabwe Limited (Rio Tinto) aims to create natural resource-based business opportunities. An aspect of this creation is exploration activities. Historically, Rio Tinto's exploration efforts have been hampered by security problems, cash flow constraints and, increasingly as the technology progresses, the lack of relevant skills. Zimbabwe produces almost 50 mineral products. Although the company's exploration portfolio involves programs in diamonds, gold, coal and platinum, the strategy of Rio Tinto is not commodity driven but rather opportunity driven. The pursuit of opportunities is the guiding principle in the commodity make-up of the programs.

In 1993, the Rio Tinto Board of Directors approved a strategy of focusing on the mining and metallurgical activities of the Rio Tinto group. Consequently, Tinto Industries was sold during the 1993 year to FSI Holdings for Z$52 million.

A dividend of 40 cents per share was declared payable to shareholders in August 1993. A dividend of 80 cents per share was declared and payable to shareholders in April 1994.

Labor relations are said to be very good. The 1993 Report and Accounts of Rio Tinto reported having 2946 employees. Rio Tinto sponsors a profit-sharing bonus plan for employees excluding management and contributes 7 percent of profits annually. Employee compensation is in the top quartile for the Zimbabwean labor force. Labor agreements are renegotiated every year but the company is seeking to lengthen the contract period. Thus far, wage increases have not kept up with the rate of devaluation of the Zimbabwe dollar.

2. Market Definition

Rio Tinto's operations consist for the most part in the mining of gold which contributes as much as 75 percent of its profits. It is also involved in toll mining of nickel and copper as well as the development of coal reserves. Thus, its relevant markets are commodities and are global in scope. The markets are competitive and Rio Tinto must take its product prices as given, cannot influence them, and can only hope to boost its profit margins by being among the most efficient producers. It can currently sell as much gold as it can produce and it does have proven reserves of as much 7 years in some mines. Probable reserves are much higher.

Costs of gold production at most of its mines are currently among the world's lowest. Perhaps 10 percent of its production would be considered to be at very high unit costs. The state of the plant and equipment is said to be in good condition, with replacement being undertaken on a continuing basis. The cost of utilities is a small but substantial share of the costs of production - under 20 percent.

However, Rio Tinto has plans to bring its own plant on stream utilizing its coal reserves. This will happen in 1998-2000, outside the time period of this study. So, if the Zimbabwe Electricity Supply Authority (ZESA) is forced because of fiscal pressures to charge an economic rate for its electricity, it will impact negatively on profits. But this should not substantively alter the firm's economic outlook. Therefore, for the period covered by this exercise at least, it would be fair to say that Rio Tinto should remain an efficient producer.

Other factors which might impact negatively on the financial health of the company are within reasonable limits. The company considers itself to be environmentally responsible and does not anticipate any liability in that respect for the near future. For example, cyanide leaching is used only for the dumps and only in the refinery. The company does cover the costs of restoration in areas where mines are closed. It does have an internal health scheme which is voluntary and partly financed by worker contributions.

The price of gold is currently about US$382 per ounce and is forecast to remain stable. It is unlikely to breach the US$400 barrier as long as inflation in the major industrialized countries remains under control. Because economic activity is increasing in the developed world, industrial demand will maintain the strength of the market price. Rio Tinto refines nickel and copper and receives a flat fee which is tied to the U.S. inflation rate. The fee for 1995 will be adjusted upward by the 1994 rate of inflation in the United States. Within recent months, the price of nickel has increased by as much as 150 percent. Copper prices have also strengthened. These markets are clearly tied into the business cycle of the industrialized nations and industrial demand increased, prices have gone up.

It is reasonable to expect that over the next 4 years, continued strong demand will support high prices. Perhaps at slightly lower than current prices, if efforts by the Federal Reserve are successful in bringing the U.S. economy to a soft landing.

3. 1994 Financial Base

In the absence of budgeted information for the forthcoming years, and of finalized accounts for the 1994 year just ended, an estimate was made of the likely results for the latter year. (See Table 4.4.) The specific assumptions for 1994 are outlined further below. Conversations with the firm's Financial Director yielded the view that the next few years should see considerable growth for the company, with non-core businesses such as Sandawana Emerald Mine and Tinto Industries recently disposed of, and a reasonable outlook for gold over the next few years. (The holding company's view is that the price will remain within the US$370 - US$400 per ounce price range for the next four years). We have posited a growth of profit before and after tax of 7 percent per annum for the next four years. The assumptions on the final 1994 figures are:

1) A less profitable second half of year, due to weaker gold price, failure of the Zimbabwe dollar to weaken as expected, and disruptions to production for capital works. PBT at June was Z$65m, so a conservative estimate for year is Z$100m.

2) Tax applied at same effective rate as at interim, is 26 percent.

3) No further extraordinary items other than those at mid-year.

4) Dividend cover held at 2.3 times before extraordinary items - from discussions with company personnel this seems unlikely to drop, in spite of exchange control relaxations.

Table 4.4
RIO TINTO ZIMBABWE

Financial Summary

(All amounts in Z$ millions)

	(EST)	AUDITED			
	1994[5]	1993	1992	1991	1990
TURNOVER	400,0	392,9	363,6	274,5	181,3
PROFIT BEFORE INTEREST & TAX	100,0	64,2	56,5	55,4	20,4
INTEREST	-	1,3	9,7	5,1	3,7
PROFIT BEFORE TAX	100,0	62,9	46,8	50,3	16,7
TAX	26,0	15,2	6,4	13,6	1,1
PROFIT AFTER TAX	74,0	47,7	40,4	36,7	15,6
OUTSIDE SHAREHOLDERS	-	0,1	0,4	0,6	0,4
PROFIT ATTRIBUTABLE TO ORDINARY SHARE HOLDERS	74,0	47,6	40,0	36,1	15,2
EXTRAORDINARY ITEMS	(6.0)	20,3	0,5	-	2.5
PROFIT AFTER EXTRAORDINARY ITEMS	68,0	67,9	40,5	36,1	17,7
DIVIDENDS	30,0	27,0	15,7	15,7	6,7
RETAINED INCOME	38,0	40,9	24,8	20,4	11,0

[5] Figures based on interim results to June 1994.

4. ESOP Projections

The full financial projections are included in the Annex.

Scenario a)

By 1996 the 20 percent ESOP produces the highest profits for the company with the company's interest cover no lower than an initial 3.25 times. Having no interest expense prior to the ESOP, and a low effective tax rate of 26 percent, the company is in a strong position to be able to sustain such an arrangement. However the retained income/capital repayment ratio is only 1.3 times in the first year. The cost to the fiscus is a discounted Z$69.1 million, or just over 65 percent of the cost of the shares. Again the 5 percent financed ESOP produces a better company performance by 1996 than does the 5 percent donation, and interest and capital cover are more than adequate to service debt. The cost to the fiscus of a 5 percent ESOP is, however, more than half as much again as a 5 percent donation, which only has significant fiscal impact in the first year.

All three events produce improved company results over the base case by year three of the ESOP.

Scenario b)

Again the 20 percent ESOP produces the best results, this time by as early as 1995. Interest cover is comfortably high throughout but again capital repayments appear tight. The cost to the fiscus is Z$56.9 million. Again fiscal cost is higher with a 5 percent ESOP than a 5 percent donation, although the company itself is in a better position with the former by 1995.

It is significant that, with the low interest rates, the company produces better results than the base case in all three events by as early as the end of the first year of the ESOP.

5. Conclusion

Rio Tinto, being a company with no current interest burden, would appear to be a strong candidate for an ESOP, although on a 20 percent ESOP debt service is still potentially a sizeable problem. However such a move would incur considerable fiscal cost as the company has no assessed losses which might defer the impact on the fiscus.

Table 4.5 summarizes the relationship between the original cost of the shares, the fiscal costs, and the net capital benefit to the ESOP shareholders.

Table 4.5
RIO TINTO ZIMBABWE

Summary ESOP Projections

(All amounts in Z$ millions)

	20 % ESOP	5% ESOP	5% DONATION
Cost of Shares	105.6m	26.4m	26.4m
Value of ESOP Shareholders' Shares after 4 Years	144.7m	35.3m	35.3m
Cost to Treasury:			
(a) Higher interest rate adjusted to current prices	69.1m	17.0m	10.3m
(b) Constant prices with 10 % real interest rate	56.9m	13.9m	10.3m
Percent of Cost of Shares Borne by Treasury:			
Scenario (a)	65%	64%	39%
Scenario (b)	54%	53%	39%

E. Case Study: Art Corporation

1. Company History

Art Corporation was formed in 1906 and in 1951 became listed on the local stock exchange. In 1973, through a reverse takeover, Nedlaw Investment Trust Corporation acquired control of Art Corporation. Through this development the company broadened its main lines of business to include production of paper and stationery, light metal fabrication and plastic packaging. The company is highly integrated, owning: forest land where trees are harvested, pulp mills where the processing takes place and industrial plants where the paper is made into usable final products such as tissue and stationery.

Art Corporation is known as one of Zimbabwe's enlightened employers. During the time of independence mechanisms were established for stock to be owned by an employee trust. The total amount was to be 15 percent of Art Corporation's stock. Because of dilution, the trust now owns roughly 12 percent of the stock.

While Art Corporation has experienced financial difficulty in recent years, profitability returned in the last fiscal year. Both 1992 and 1993 were difficult as a result of the drought and the taking on of debt to build a new pulp mill. The interest on this short-term debt nearly overwhelmed the company as interest rates rose.

Fortunately for all shareholders, but especially for the employee shareholders whose jobs are also dependent on the success of the company, Art Corporation seems to have turned around financially. Among the factors which have contributed to the company's improved condition are the stronger economy and a financial restructuring.

Art Corporation recently reported having 3,400 employees.

2. Market Definition

Art Corporation is involved in the business of paper manufacture, converting operations, and plastics. The company restructured its operations after having suffered a major financial setback. The restructuring exercise involved the formation of a new class of preference shares, disposal of Z$100 million of Group assets and use of cheaper offshore loans.

Art has three paper mills; Kadoma Fine Paper Mill, Kadoma Tissue Mill, and the Mutare Board and Paper Mill. In conversion operations, it produces stationery, sheeting services tissues. The conversion operation is the largest paper converting factory in the country.

There are basically two groups that together constitute the paper industry in the country i.e., Artmail (being the largest) and the Hunyani Group. The industrial market structure is therefore oligopolistic (duopoly). The structure of Artmail is as presented below.

Net output of this subsector amounted to Z$214 million in 1991 against a gross national product of Z$18,964 million. Paper and paperboard imports in the same year amounted to Z$121 million and no exports were recorded.

Zimbabwe's paper industry is very small in world terms. In fact, out of the five continents, Africa is the smallest producer of paper and within Africa, South Africa is the largest producer. Zimbabwe produces only 100,000 tons per annum compared to South Africa which produces 2.1 million tons per annum.

The demand for paper is strongly correlated to economic performance, with high demand during booms and low demand in times of recession. During times of recession, the firm is forced to reduce capacity utilization and this pushes costs up and hence reduces profits. The position is worsened by a situation of excess supply that occurs on the international market with the large producers seeking to export (including to Zimbabwe) at low/dumping prices.

Generally, the situation tends to improve when there is an upturn in the world economy. The possibility of sub-sectoral growth based on exports is therefore limited, given the excess capacity prevailing in the international market. However, Art Corporation hopes to export fine paper to the regional market in the near future. The company also exported about 1,000 tons of tissue paper to Zambia, Malawi and South Africa.

The sequencing of the trade liberalization program had a negative impact on the company's performance. For example, with trade liberalization, paper is imported at a 10 percent import duty yet imported inputs for paper production have a duty of 20 percent levied against them. In addition, South Africa, which competes with Zimbabwe, offers a 15 percent to 20 percent export subsidy. The devaluation of the Zimbabwean dollar by 17 percent in 1994 was of some assistance with regards to

exports in the region. But at the same time, Zimbabwe's 9 percent export subsidy was withdrawn (to comply with the requirements of the General Agreement on Trade and Tariffs).

Shortage of water in Mutare forced the Mutare Board and Paper Mills to import water drills and this increased operational costs. In addition the cost of electricity went up by about 300 percent which pushed the electricity bill for Mutare Board and Paper Mills to over one million dollars.

The paper industry of Zimbabwe has good prospects particularly if there was to be a decrease in the interest rate. Art Corporation is highly leveraged. The corporation borrowed for expansion purposes when interest rates were low. Interest repayments are reducing net profits of the company.

Plastic operations are undertaken through Saltrama-Plastex which is the leading plastic packaging operation. It converts about 8,000 tons of raw plastic materials per annum. Saltrama is the only plastics recycling business in the country.

Art Corporation went through a difficult restructuring in 1993 as a result of reduced revenues and increased competition. The company had losses in 1992 and 1993. Dividends were suspended and 1,500 jobs were lost as a result of restructuring. The financial restructuring consisted of new preference shares (Z$98 million), a term loan (Z$60 million), and asset disposals (Z$100 million) for a total of Z$258 million. As a result of restructuring/losses, the company has an assessed loss of Z$184 million which it can carry forward up to 6 years. Since the company will not be paying tax in the next few years, the tax incentives relating to a 5 percent or 20 percent ESOP are not beneficial to Art Corporation.

Strategically, the company is concentrating on its core businesses of paper manufacturing, paper converting, and plastics. Peripheral businesses and services were disposed of including injection molding machinery, Wiroplastics Division, and vehicles and property.

3. 1994 Financial Base

In the absence of both budgeted information and finalized accounts for the 1994 year, use was made of interim June 1993 statements and the April 1993 rights issue document. Assumptions on the basis of which the 1994 figures shown in Table 4.6 were compiled are set out below, these largely mirror the group's own forecasts.

- Interest - Based on debt reductions in Annual Report
- Preference Share Dividends - Per redemption over 10 years
- Profit - Real growth of 5 percent per annum
- Profit Before Tax - Per forecast in Rights Issue Document
- Dividends - Z$0.03 per share as forecast in Rights Issue Document
- Dividend Cover - Assume 2.7 times
- Minority Shareholders - Increase at 5 percent per annum

4. Financial Projections

The full financial projections are included in the Annex.

Table 4.6
ART CORPORATION LIMITED

Financial Summary

(Z$ Million)

	Estimated 1994	1993	1992	1991
TURNOVER	400	277	271	241
PROFIT BEFORE INTEREST & TAX	60	28	20	46
INTEREST	31	72	27	-
PROFIT BEFORE TAX	29	(44)	(7)	46
TAX	-	-	-	-
PROFIT AFTER TAX	29	(44)	(7)	46
MINORITIES	4	4	2	6
PREFERRED DIVIDENDS	4,7	-	-	-
PROFIT TO ORDINARY SHARES	20,3	(48)	(9)	40
EXTRAORDINARY ITEMS	-	(10)	(13)	-
PROFIT AFTER EXTRAORDINARY ITEMS	20,3	(58)	(22)	40
ORDINARY DIVIDENDS	7,5	-	-	15,6
RETAINED INCOME	12,8	(58)	(22)	24,4

Scenario a)

Because Art is in an assessed loss position for the first of the three years, the tax benefits the company would have otherwise enjoyed do not translate into a better financial performance. By 1997 the assessed losses have been fully utilized and it will be seen that the 20 percent ESOP produces marginally higher profits. Until then the base case produces the second best results (exceeded only by those arising from the 5 percent donation) in each of the first three years of the ESOP.

Art already has considerable existing borrowings, although these are expected to fall over the period, and consequently interest cover only reaches levels above 3 times by 1996 with a 20 percent ESOP.

The result of the above is that the relative cost to the fiscus of the transaction is low - Z$6.5 million in discounted lost revenues, or only 24 percent of the cost of the shares in the case of the 20 percent ESOP.

A 5 percent ESOP costs the fiscus slightly less than a 5 percent donation and this time, significantly, produces lower profits, due to the tax benefits postponed as a result of the assessed loss.

Scenario b)

With no adjustments made for inflation, assessed losses are still not fully utilized by 1997, although assuming continued growth in 1998 the company would revert to paying tax in that year. With no increased tax benefit, fiscal cost of the 20 percent ESOP is a mere Z$2.4 million.

In this scenario the 5 percent donation produces slightly better results for the company in every year, as interest payments are zero throughout. This emphasizes the point that where a company has assessed losses, the financial benefits of ESOPs or donations are reduced.

5. Conclusion

In general Art does not appear to be a strong candidate for increased employee participation via a leveraged ESOP. The company already has significant employee ownership, at close to 12 percent, and Art has just emerged from a restructuring exercise which successfully reduced debt, the level of which had grown dangerously high. Given this background, it is not likely that the company's current shareholders would welcome an additional saddling of the company by further borrowings, a move which would take the company back along the path along which it has just recently come. Moreover, the advantages to the company in terms of bottom line benefits are only modest. On the other hand, the transaction is one that the fiscus could withstand without great pain and there is a potential sizeable increase in ESOP shareholders' share values which is well in excess of the fiscal costs.

Table 4.7 relates the fiscal costs to the costs of the shares and the net capital benefit to the ESOP shareholders.

Table 4.7
ART CORPORATION LIMITED

Summary ESOP Projections
(Amounts in Z$ Million)

	20% ESOP	5% ESOP	5% DONATION
Cost of Shares	27.7m	6.9m	6.9m
Value of ESOP Shareholders' Shares after 4 Years	35.2m	8.6m	8.6m
Cost to Treasury:			
(a) Higher interest rate adjusted to current prices	6.5m	1.5m	1.5m
(b) Constant prices with 10 % real interest rate	2.4m	0.6m	0.3m
Percent of Cost of Shares Borne by Treasury:			
Scenario (a)	24%	22%	22%
Scenario (b)	9%	9%	4%

V. SOCIAL AND ECONOMIC ANALYSIS

A. Social Analysis

As part of the investigations, the project's socio-economic environment was examined, focusing on those factors which represent constraints and opportunities toward participation in ESOPs. Key findings can be grouped into the following basic areas:

- General socio-economic characteristics;
- Employment factors; and
- Opportunities and constraints identified.

Each is discussed briefly below. The full report of the sociologist is appended to this document.[6]

1. Socio-Economic Characteristics

There is general agreement among stakeholders such as representatives of the CZI, the Zimbabwe Congress of Trade Unions (ZCTU), the Zimbabwe National Chamber of Commerce (ZNCC), and the Indigenous Business Development Centre (IBDC) that race and gender remain the main factors affecting access to formal sector employment. Black employees generally hold low-level, low-pay positions while their white counterparts, even though they may be small in number, occupy higher-level and higher-paying jobs in the professional and skilled category. Whites still largely dominate ownership and management of companies, although there has also been some effort to place blacks in management posts, as in the case of personnel management where positions are increasingly occupied by black men.

As is often the case, women are under-represented at all levels of the formal workforce, constituting 52 percent of the total population, but only 2 percent of formal sector employment. Women's participation is largely confined to secretarial and clerical posts in only a few industries. Firms engaged in heavy industry such as Rio Tinto, employ very few women in general. Black women in particular are under-represented. Women's formal sector promotion and advancement opportunities are still limited due to their low educational levels, and negative socio-cultural attitudes.

The effectiveness of organized efforts to involve employees in company decision making is questionable, according to the ZCTU, which argues that workers' committees and work councils have long stopped representing workers' interests and have increasingly become management instruments. Workers are sometimes represented on the trustee Board of firms that have Employee Trusts, although some critics state that such representatives are always men and are generally hand-picked by management, rather than representing an independent voice.

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[6] This analysis is based on general research on women in the formal sector of employment, interviews with managers from the Delta Corporation and Rio Tinto, and data emanating from firms' responses to a questionnaire on ESOPs and stakeholders' views and attitudes. Although various interviews with employees and managers at case study firms were intended to be conducted, clearance was not obtained prior to the conclusion of the field investigations.

The salary structure favors white employees and predictably, women's wages, especially those of black women, are lower than men's. Salaries are skewed dramatically in favor of management with unskilled positions gaining Z$640 monthly, versus, Z$7400 for average management slots at Rio Tinto, a 12:1 ration, and an even more drastic divergence at Delta of 16:1. Given the escalating costs of living under ESAP, low level income employees are finding it difficult to cope. Real wages for the formal sector have failed to keep pace with the cost of living expenses for low income families.[7] A 1991-1992 study in one of Harare's high density suburbs revealed an increase from 23 to 43 percent in the proportion of households living below the poverty between 1991 and 1992.

2. Employment Factors

Education is an essential pre-requisite for participation in formal sector employment. Education largely influences individual employment opportunities, salary, and to some extent, promotion prospects. Women's low educational levels and concentration in traditional female fields of study restrict their participation in the formal sector.

Likewise, stakeholders interviewed believe that race is one of the major determinants of formal sector employment and advancement. This trend is particularly marked in the case of black women. The National Manpower Survey (1981) revealed that although African women comprised 95.5 percent of the female population, they constituted only 39 percent of the trained female work force while European women who comprised 2.9 percent of the female population constituted 54 percent of the trained female workforce.

3. Implementing ESOPs: Constraints and Benefits Identified

Constraints. Employees' ability to purchase shares in an ESOP scheme is a formidable obstacle to generating broad-based participation, and is probably not viable. Due to their low income levels, lower level employees will face considerable financial difficulties if they have to make financial contribution to an ESOP. As recommended in this study, employee trusts whereby firms donate shares (or finance their transfer) to employees as a group or individuals are more appropriate for this category of employees.

For women and blacks alike, there are no legal impediments to ownership of shares, viewpoints that are echoed by policymakers. Attitudes may present a problem, as a distinct "us" and "them" mentality. permeates employee-manager/owner relations throughout the business community. Likewise, lack of information about ESOPs is likely to inhibit interest in the schemes and depress participation.

Benefits. As defined, all permanent employees in the firms will benefit from the proposed ESOP schemes. While the exact structure of ESOPs will be determined by the individual companies, the most democratic means will be to have equal shares issued regardless of the positions held and salaries earned. Other project benefits are anticipated to include: increased productivity; increased loyalty to the company; increased black participation in the economy; improved intra-company relationships; and increased economic independence for women.

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[7] Brand, Mupedziswa and Gumbo, Women Informal Sector Workers Under Structural Adjustment in Zimbabwe, Harare, January,1992.

B. Economic Analysis

1. Microeconomic Implications

Under the ESOP options recommended and used in the case studies, a sale or donation of shares to the employees under an ESOP, represents in economic terms, an exchange of assets. It transfers to the employees the rights to a share of the future value of the company. The current market value of shares is equal to the present value of the future economic stream that would accrue to that company. An ESOP then, is a straightforward redistribution of equity from owners and the government to the employees. As a first effect, there will be no new wealth generated. The primary change that occurs is that employees are now entitled to dividends and would benefit from any capital gains resulting from an improvement of the company's net worth. By the same token, they now bear the risk of the shares falling in value should the change in financial performance be negative. It does however, facilitate the political and social agenda of having increased indigenization. As ESOP plans are commonly structured, the employees do not incur a direct cost in paying for the shares. They are either donated or financed through the use of tax inducements. However, since the company will use a part of its cash flow to retire the debt, it means that these resources are not available for other purposes. It may mean less funds available for direct benefits such as increased wages or dividends. The cost to the employee is indirect but is nevertheless, a cost as well as an investment. The calculation is that the capital gains registered on the stock will be higher than the return on higher cash wages, for example.

A potential second effect is the increased growth that would occur in the economy as a result of higher productivity on the part of the employees. It is posited that having a stake in the company will motivate employees to better performance. Raising worker awareness of their role as equity holders could solicit cost savings suggestions, reduce worker absenteeism, and improve customer relations. Avis Car Rental Company is such an example. Empirical studies do find evidence of increased productivity but those results are not very robust. The usual rule of thumb in terms of increased productivity is about 5 percent and there is a low but positive probability of this occurring. For the purposes of the case studies, the following assumptions were made: in the case of the small ESOP of 5 percent, increases in productivity amount to 2 percent over the project period; for the large ESOP of 20 percent, the increase productivity amounts to 4.5 percent.

While productivity gains are a reasonable prospect for the individual company, they do not necessarily translate to the overall economy. In fact, unless employee ownership becomes very widespread in the economy, one cannot argue for economy-wide productivity gains. In the case of very large companies, such as Delta Corporation, with operations that are a significant share of the GDP, there may accrue a discernable gain. With turnover equal to about 10 percent of national GDP, a 1 percent productivity gain would l translate into a 0.1 percent gain for the overall economy.

As shareholders, employees will also be risk-takers. The value of their shares can rise or fall and this will be absorbed by all shareholders, including employees. Under an ESOP, the employee receives a dividend which as analogous to a share in the profits and also benefits from increased shareholder value. In the Zimbabwean context, it is also clear that managerial control is as much a part of the indigenization debate as is ownership of equity.

A potential negative effect is the use of employee ownership to prevent corporate takeovers. While some may argue that takeover prevention is a positive factor, the record regarding employee ownership and takeover attempts in the U.S. has been mixed. In a significant number of cases,

employee ownership has been used as a means to prevent meaningful restructuring of companies. In the end, this can be more harmful than the disruption that some takeovers cause. Because takeovers often cause disruptions to patterned corporate behavior and result in layoffs, employees will usually vote their stock against a takeover proposal. Such opposition could slow the pace of change in the Zimbabwean economy, acting against what would otherwise be a healthy change of ownership.

Market conditions in Zimbabwe can be characterized as being mostly oligopolistic[8], raising three issues. First, as the economy becomes more liberalized, there will be more competition. This means that some firms will be likely to do poorly and suffer losses in equity value, including workers' stock in the case of companies with ESOPs. Therefore these ESOPs will be riskier than if the markets in which these companies operate were already competitive. Second, it means that there is there is much scope for productivity gains. Third, care should be taken that no ESOPs are undertaken with companies that have some advantage in the market. In such cases, the existence of the ESOP may become a justification for maintaining that favored position for fear of negatively affecting the ESOP owners.

2. Macroeconomic Implications

The cost of the ESOP is related to the rate of interest, currently over 30 percent for prime borrowers. The prospects for a reduction in the nominal rate in the near future are related to fiscal and inflationary pressures. The Central Bank has a tight credit policy in force, attempting to control inflation (currently at about 20 percent, down from 23-24 percent). Financing large ESOPs will increase pressure on interest rates in an already tight credit market, although inflation may moderate if control of the money supply is maintained and the government is able to finance its spending without resorting to the Central Bank.

In the various permutations of the structuring of ESOPs, it is clear that no one will be motivated to commit to an ESOP without having some incentives, most likely in the form of the tax deductions, exemptions and deferrals recommended above. Based on the scenarios modeled in the financial section of the case studies, the cost of the transfer will be borne by government in the form of foregone revenue. In the case study analysis, the cost to the government reached 65 percent of the transaction cost after 4 years on a discounted basis. However, this does not include the additional tax foregone from the incentives of deferral of tax on the part of employees, nor the deferral or reduction of capital gains on the part of selling shareholders. Inclusion of these factors would increase the overall tax losses.

Table 5.1 presents a static estimate of the revenue that would be given up if ESOPs were to become a regular feature of the Zimbabwe economy. This estimate was derived to illustrate a worse case tax loss scenario. This estimate assumes that the total cost to the Treasury over 4 years would equal the transaction value, at 25 percent per year. Total quoted equity on the Zimbabwe Stock Exchange is about Z$16 billion. One can extrapolate that up to 5 times that amount would represent the total stock value of equity in the country. Assuming that up to 5 percent issue a 20 percent equity ESOP, revenue foregone would be Z$200 million or about 5.7 percent of estimated company tax revenue for 1994/95 in the Zimbabwe budget.

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[8] Study of Monopolies and Competition Policy in Zimbabwe' Implementing Policy Change. for USAID/Zimbabwe, Sept. 1992.

It is important to note that this is a static estimate. The absolute revenue foregone would increase each year as the stock of outstanding loans on issued ESOPs increase. There are two ways to decrease the loss in revenue: either by stretching out the repayment period or by having a reduction in the rate of interest. There are trade-offs to be made in the loan period -essentially lengthening the repayment period increases the risk that company losses could occur and increases the total amount of interest that would qualify for advantaged tax treatment.

Table 5.1

Estimated Static Analysis of Tax Revenue Foregone

ZSE Total Equity Quoted*	Z$16 billion
Estimated Total Equity with ESOP Potential	Z$80 billion
Estimated Annual ESOP Issues	Z$0.8 billion
Revenue foregone (25 percent of Issue value)	Z$0.2 billion
As a percent of 94/95 companies revenue**	5.7 percent

* Published Financial Gazette Jan/26/95

** Based on Estimates in the Financial Statements 1994; Min of Finance

VI. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

On the basis of the many interviews, literature review, and case study analysis, the team was able to draw the following general conclusions.

On the general environment for employee ownership:

- ESOPs are not new to Zimbabwe, and stakeholders are generally receptive to the concept;
- Employee ownership fits generally into the GOZ's indigenization policy;
- The legislative and tax environment does not cater specifically to ESOPs, although there are no prohibitions or definitive constraints; and,
- It is unlikely that ESOPs will be established in substantial numbers, and of a significant size unless there are positive incentives.

On the financial aspects of employee ownership:

- In the current economic environment characterized by inflation and high real interest rates, ESOPs will be very difficult to finance on conventional commercial terms;
- Highly leveraged firms will not be able to afford leveraged ESOPs; and,
- Commercial and merchant banks are likely to structure and finance MBOs and EBOs without any additional incentives and in spite of the current economic situation.

On the tax implications of ESOPs:

- Tax incentives should be given to entities financing ESOPs, companies establishing ESOPs, the selling shareholders, and the employee trust; and,
- These tax incentives are likely to be a significant cost to the GOZ, perhaps approximating the cost of the ESOP transactions over time.

On the most desirable ESOP Structure:

- The "employee trust" model has proven to be a workable vehicle for employee ownership plans, and can serve as an appropriate mechanism for expanded ESOPs;
- Employees should take ownership of the shares after a prescribed period of time; and,
- Share ownership will be financed by the company, not by direct employee contributions

In spite of the challenging economic environment, the conclusion of the project team is that ESOPs are a viable option for the promotion of "indigenization," privatization, increased employee share

ownership, and increased employee productivity. MBO/EBO transactions, because of their nature, will continue to attract financing when the deals are attractive to financial institutions.

B. General Recommendations

There are a number of measures which will help facilitate and enhance the growth and development of employee stock ownership plans in Zimbabwe. Most of these have been mentioned earlier in the report, either as part of the recommended ESOP structure, as part of the general analysis, or as an implication of the case studies.

Recommendation 1: Develop a Comprehensive ESOP Tax Model

The work done by the C&L/TSG and Price Waterhouse teams resulted in a very preliminary model applicable to individual cases, which could not be refined and expanded due to time constraints. However, the modeling exercise did point out the complexity of ESOPs, and the necessity to produce a reliable model to estimate the tax effects because of the potentially large losses in tax revenues from the proposed incentives. More in-depth analysis would enable the GOZ to clearly evaluate the different tax incentives proposed, and weigh the potential benefits against their impact on the Treasury.

Recommendation 2: Develop a Constituency Within the GOZ

The early and rapid development of ESOPs will require a high level of cooperation between several ministries: e.g., Commerce, Finance, Labour and Justice. Legislation delineating the tax must be drafted or existing legislation amended. In addition to the relevant Ministers, influential members of Parliament should be consulted and informed so that any required legislation has support when it is debated in Cabinet and Parliament. The Attorney General's office should be involved in the process from inception.

Understanding clearly the nature of the tax incentives will be an important factor in generating government support for this new initiative. In addition to the tax incentives, government support will also be shown by proceeding with the incorporation of ESOPs into privatization transactions. Generating this support will be facilitated by continuing technical assistance from USAID, which can be incorporated into the proposed project.

Recommendation 3: Develop Support Within the Private Sector

It is unlikely that this program, if adopted, will be successful if it is not completely embraced and supported by the private sector, including industry, trade and labor associations. Organizations such as the CZI and ZNCC should be brought into the process at an early stage. While they may not be as concerned as the government over the impact of the tax incentives, it is important that these stakeholders understand the mechanics of ESOPs.

Recommendation 4: Implement Comprehensive Tax Incentives to Support ESOPs

Tax incentives should include the following, as outlined earlier in the proposed model:

- Reduction or elimination of capital gains taxes on sales of shares to ESOP trusts;

- Treatment of ESOP donations as deductible expenses for corporate profits tax purposes;
- Elimination or deferral of personal income tax upon receipt of the shares;
- Reduction or elimination of estate tax where ESOPs are created;
- Deduction of principal payments for leveraged ESOP loans; and,
- Deduction of a portion of banks' interest earnings from ESOP loans.

The exact nature and extent of each of these measures will need to be worked out in deliberations with the government; however without a comprehensive approach it is unlikely that ESOPs will expand their role significantly. Once the incentives are agreed upon, the qualifying structures needed for ESOPs to be eligible will define a standard model. While the nature of the original purchase, transfer or issue of shares and the extent of the ESOP will differ, certain minimum qualifying criteria, such as the 2 year eligibility and 10 year holding period for shares prior to their transfer to employees, will define a "standard" qualifying ESOP.

Recommendation 5: Link Privatization to ESOPs

The government can take direct action to promote employee ownership by establishing an ESOP as part of a privatization transaction. In order to do so, the development of standard guidelines for ESOPs created out of privatization will be helpful. While doing so will reduce, commensurate with the ESOP share of equity, the proceeds to the Treasury from the share sale, it will expand by example the concept of employee ownership, which can have valuable demonstration effects. While an ESOP may also potentially complicate a privatization where it is a sale to another corporation, it should be more feasible where there is a public share issue on the ZSE.

Recommendation 6: Utilize Loan Guarantee Programs to Stimulate Financing for ESOPs

While the interest rate exclusion from taxable income may induce banks to finance ESOP transactions, there will be additional benefits from extending partial loan guarantees through existing programs. These guarantee programs should be evaluated for their suitability in supporting ESOPs, as well as the satisfaction of their own criteria. Once ESOPs are more established, the guarantee cover can be gradually reduced or otherwise phased out.

Recommendation 7: Support the Establishment of an ESOP Trade Association

A formal trade association, comprising professionals with an interest and expertise in services to ESOP companies, and the management and employees of companies with employee ownership trusts can be a focal point for the expansion of ESOPs in Zimbabwe. As the government and private sector organizations such as CZI evaluate the prospects for expanding ESOPs, there is a strong role for a separate trade association which could advance the concept, serve as vehicle for exchange of information, provide education and training, and make representations to the government on ESOPs and policies affecting employee ownership.

C. Recommendations for USAID Interventions

1. Continued Technical Assistance

In order to implement meaningful employee ownership in Zimbabwe, the Ministries must become educated in the concept of employee ownership and must do in-depth analysis of whether employee

ownership meets its national goals, both economic and social. This paper and additional technical assistance in the design of the Black Enterprise Project may serve as a starting point for that dialogue. USAID may serve as a liaison to bring in the expertise from the U.S. and other countries to share in great depth the experiences of other countries who have explored employee ownership concepts. This may be accomplished through a conference with various experts invited to speak, through exposure tours or workshops. Workshops could be designed for each area of specialty such as finance, business valuation and appraisal, legal, etc. Special workshops could also be held targeted to business enterprises to determine the level of interest among companies.

2. Proposed Scope of Work for Additional Consultants

It is clear from the results of this report that a significant amount of analysis needs to be done in order to develop and implement an employee ownership program in Zimbabwe that contains the following elements:

- minimal impact on GOZ tax revenues;
- adequate incentives for employers;
- sufficient size to elicit employee support and productivity gains; and
- no direct contribution from employees.

The Scope of Work for a follow-on consultancy should contain the following tasks:

Task 1: Expand and improve upon the work done by the C&L\TSG and PW on the ESOP financial model by developing a more comprehensive financial model whose primary objective is to quantify the revenue implications of the proposed tax incentives. The model should be applicable to individual companies, but also allow for some generalization about the tax implications.

Task 2: Assist the government with additional technical analysis of ESOPs. The goal will be to generate some consensus and build support within the government, using both the tax model and expanding the base of economic and other analysis in this report. The result should be an agreed incentive package. A comparable process should be pursued with representative private sector and labor organizations, in order to generate a broad consensus.

Task 3: After an incentive package is finalized from the previous tasks, assist the GOZ in amending existing legislation or preparing a separate bill to provide the incentive framework for ESOPs, as well as developing guidelines for incorporation of ESOPs into privatization deals.

Task 4: Conduct workshops within the GOZ, the financial services community and the private sector to explain the rationale, operations and financing of ESOPs, and to promote the concept.

Task 5: Facilitate the establishment of an ESOP trade association. If appropriate at this time, assist in the formation of an association by providing background materials on ESOPs, and comparative information from the ESOP association in the U.S.

3. Development of ESOP Advisory Services

Employee-owned companies often require the assistance of lawyers, trustees, bankers, valuators (both of businesses and assets), scheme administrators, investment bankers, trainers, productivity consultants, public relations/communications experts and general employee ownership consultants who

understand how to integrate the work of the other experts. The development of these services will be critical to the expansion of ESOPs in the country. While Zimbabwe already has a well developed infrastructure of private business services firms and professions, additional technical support from USAID, in the form of ESOP specialists, can be effective. The types of professional services to be supported will include the following.

Lawyers are needed to interpret existing law, document the employee ownership plan and to protect the rights of parties to the plan. Because of the complexity of employee ownership transactions, significant involvement of lawyers is usually required. Some transactions can be completed where lawyers are used simply in planning the transaction structure and to document the transaction structure.

Trustees play the role of protecting the employees' interests. Since many employees are not financially sophisticated, trustees can be used to represent employees, using their expertise to safeguard employee ownership plans from poor fiduciary decisions. Trustees can also be helpful to shelter selling shareholders from liability. This can be especially pertinent when the selling shareholders are also managers of the business who are adopting an employee ownership plan.

Bankers should do more than simply finance transactions on an asset-based formula. Since the employees' prospective company stock is usually pledged as collateral for employee ownership loans, bankers must understand the cash flow projections of firms. The bank must also understand how the employee-owned company plans to address the repurchase of employee and/or trust shares. If the bank is not active in helping the company plan for future obligations, the company and bank may face a defaulted loan to an employee ownership plan which can be even more awkward than a traditional loan.

Valuators are needed when either the company is privately held or when a loan is at least partly-based on asset values. Privately held stock must be valued to give sellers and employees a sense of the fair market value of the stock. Valuators should be able to judge the influence of various factors on stock value, including share values for competing firms, future cash flows, current profit, asset values, debt and other obligations. Property valuators must be able to value real estate, plant and/or equipment.

Administrators keep track of the accounts of employees. They must record the number of shares each employee holds. Dividends, share value, years of service, and (if applicable) the ability to diversify out of holding just employer stock may be documented. This field is highly technical and involves advanced computer programming in most countries.

Investment (merchant) bankers may play roles in large and complex transactions. Often privatizations, sales of public company stock and transactions where companies want experts to raise financing are candidates for investment banker involvement. In the United States a special class of advisors has developed which provides employee ownership investment banking expertise. This group often overlaps with the generalist employee ownership consultants mentioned below.

Trainers, productivity consultants, communication specialists and public relation experts provide technical inputs in their areas. It is usually not necessary to involve all of these advisors in the same transaction. Sometimes one advisor can play several of these roles, or the generalist employee ownership consultant can handle the required responsibilities.

The broader role of the generalist employee ownership consultant is to coordinate the transaction. With as many specialists as are required to complete a complex transaction, a coordinator is usually required. Transactions can many times be coordinated by a lawyer or an administration firm. This has become more readily accomplished as specialist lawyers and administrators have developed their practices to concentrate primarily on employee ownership.

4. Identify/Develop Sources of Equity Capital

Given the major constraint of lack of sufficient equity funds available for employee buy-outs, it is important to note that there are two potential sources of funds on the horizon that could provide substantial support in this area; the Zambesi Fund being coordinated by IFC, and the Southern Africa Enterprise Development Fund sponsored by AID. The Zambesi Fund is not operational as yet and is currently in a "draft discussion" mode.

- **Zambesi Fund:** Investments of the fund will be targeted to expansion stage equity financing, management buy-outs and buy-ins, localization of business ownership, and privatizations. The investment objective is to achieve medium- to long-term capital appreciation through equity and quasi-equity investments in growth businesses, which will make a positive contribution to overall economic growth and development.

  The average size of each investment is expected to be in the US$1-2 million range. The minimum size investment is US$1 million. The fund will provide equity and quasi-equity finance.

  The companies invested in will be expected to look to banks and other financial institutions for debt and working capital financing. The fund will concentrate on firms which are aimed at foreign currency generation. In Zimbabwe, one area to be explored is industries that are currently controlled by Industrial Development Corp (IDC) -- which is expected to be privatized.

  The Zambesi Fund will be looking for well thought out, soundly structured investment proposals in companies which are, or will be, managed by an experienced team.

  The starting point for investment consideration would be the submission of a detailed feasibility study and business plan for the proposal. If the proposal has merit, IFC analyzes and appraises the investment from a financial, technical and economic point of view. They look at the sponsorship, management and technical expertise of the company. Market and sales assumptions and financial projections are made. IFC vets the overall financial structure of the company including the sources and terms of other equity and debt financing.

- **Southern Africa Enterprise Development Fund (SAEDF):** The purpose of the fund is to provide financial services and investment resources to indigenous Small- and Medium-size Enterprises (SMEs) on a cost-effective and financially sound basis. The fund will be oriented to risk capital investments as the lack of access to risk capital continues to be a major impediment to business growth in the region.

  The fund will be investing in various forms of risk capital in intermediary institutions and operating companies which benefit the SME sector. It will have a number of investment options. The SAEDF will have a total capitalization of US$100 million, plus further support from AID in the initial years for the Fund's operating costs and a separate fund for related

technical assistance to investees. Fifty percent of the Fund's investments will be targeted for South Africa.

As part of its strategy, the fund can invest in larger intermediary financial institutions working with the SME sector. Potential investments could be small enterprise banks, leasing companies, venture capital funds, mortgage banks, investment trusts, non-governmental organizations or private volunteer organizations, and direct investments. The Fund will also have the ability to invest directly in companies, particularly those with appealing developmental impact potential. An employee buyout or large ESOP could be such an attractive investment for the Fund, also suitable for its mandate to take minority positions. The fund will give attention to opportunities including U.S. partners, through joint ventures or privatizations.

Specific investment criterion and application procedures have not been established as yet, but it is assumed they will be similar to U.S. venture capital models and IFC procedures.

- **Other avenues for expanding equity financing options in support of employee ownership.** There are a number of other potential sources of funds that will require additional research and evaluation.

  - Review the insurance and pension fund market in Zimbabwe to determine if a small portion of their investment portfolios could be placed in venture capital funds or direct equity investments in employee ownership transactions.

  - Analyze the possible use of "blocked funds" for equity investments that support employee ownership.

  - Pursue with the commercial banks and merchant banks the possibility of setting up a venture capital fund either individually or as a group. A couple of the banks raised this issue as part of their efforts to support a program of local and employee ownership.

  - Examine the possibility of setting up a "Privatization Fund" which would specifically invest in privatization transactions, perhaps with incentives attached.

5. Recommendations for the Zimbabwe Enterprise Development Project Staffing and Design

If a project is developed around the report recommendations, several long-term functions should be considered:

- **Legal Advisor.** The Legal Advisor would initially assist the GOZ to conceptualize and draft legislation which would enable and facilitate the development of ESOPs. The Advisor would also develop guidelines for employee and employer groups as they consider the ESOP mechanism. Finally, the Advisor would advise companies on legal strategies and implications. The Advisor may also conduct some training for local legal practitioners.

- **Financial Advisor.** The Financial Advisor would advise on ESOP structure and financing, i.e., donation versus leveraged ESOP or the issuance of preference shares. The Advisor would also participate in the training of stakeholders.

- **Credit Specialist.** This function may be handled by USAID. It is anticipated that AID credit or credit guarantee facilities will be utilized to provide the incentive for ESOP financing.

- **Training.** Given the complexity of employee stock ownership programs, there will be the need for training of participants and, for the future, practitioners, e.g. GOZ, trade and industry associations, attorneys, and accountants. Training is likely to be the subject of short-term interventions, managed by a long-term advisor.

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Employee ownership has the potential to expand beyond its current limited role in Zimbabwe. Supporting increased employee ownership is consistent with USAID's strategic objectives, and represents an area where USAID support can be meaningfully and productively deployed. This report lays the groundwork for expanding USAID project activities to encourage broadened employee ownership. While a number of issues must be resolved, there can be significant benefits to the society and economy realized through extending the benefits of share ownership to a broad group of employees.

ANNEX A

ANNEX A: ZED PROJECT DESIGN TEAM

Coopers & Lybrand/The Services Group

Jeffrey L. Jackson	Team Leader/Business Policy
John Hoffmire	ESOP Specialist (Financial)
Marilyn Marchetti	ESOP Specialist (Legal)

AID Washington (G/EM/EG/I)

Greg Fell	Credit Guarantee Specialist
Aaron Dannenberg	ECP Specialist

REDSO

Anthony Chan	Economist (Macro)
Larry Forgy	Economist (Micro)

Price Waterhouse

Williams Wells	Partner
Rob Carter	Lead Technical Member/Business Policy
Gray Neely	Corporate Finance
Graeme Fleming	Corporate Finance
Geoffrey Wood	Commercial Banking
Benson Zwizwai	Economist
Julian English	Tax Specialist/Financial Analyst
Mercy Dikito	Social Scientist

ANNEX B

ANNEX B: LIST OF INTERVIEWS

John Hoffmire

Art Corporation	Tony Barfoot, Advisor
World Bank	Kapil Kapoor, Economist
Delta Corporation	John Koumides, CFO
Zimbabwe Sun Corp.	M. Dean, CFO

Larry Forgy/Anthony Chan

American Embassy	Anthony Holmes, Economic officer
World Bank	Kapil Kapoor, Economist
Zimbabwe Sun Corp.	M. Dean, CFO
Delta Corporation	John Koumides, CFO
Economx	Mervyn Ellis, Consulting Economist
Ministry of Finance	Rudo Faranisi
Rio Tinto Corp.	CFO

Greg Fell

Standard Chartered Merchant Bank	Huw van Hoffen, Sr. Mgr.
	Emma Fundira, Manager
First Merchant Bank of Zimbabwe	Ray Feltoe, MD
IFC	Mwaghazi Mwachofi, Rep.
National Merchant Bank	William Nyemba, MD
Zimbabwe Development Bank	N.J. Makuvise, DGM
Syfrets Merchant Bank	Charles Dengedza, ED
ZSE/Edwards & Co.	Mark Tunmer, MD
Zimbank	Noel Lorimer, DGM
	Victor Chando, AGM
	T.N. Mundawarara Sr. Mgr
Hawk Ventures	E.G. Ngugama, Chairman
SEDCO	A.K. Mtshani, GM
	J.W. Nyamunda, DGM/O
	A.P.S. Sheridan, DGM
Credit Guarantee Corp.	A.G. Hatendi, AGM
Barclays Bank	David Hall, Director
Stanbic Bank	Ray Langmead, AGM
	Anthony Light, Sr. Mgr.
Barclays Bank, Small Business	Chris Tompson, Manager
Reserve Bank	Mr. Chikaura, Dpy. Gov.
	Mr. Tsatsa, Advisor

Marilyn Marchetti

Ministry of Finance	Rudo Faranisi, MIU
Attorney General	Diana Mandaza, Counsel

Jeffrey Jackson

Kudenga Associates	Elton Mangoma, Partner
National Merchant Bank	William Nyemba, MD
Ministry of Commerce	Owen Tshabangu
	E. Ndlovu, Permanent Secretary
Ministry of Finance	Permanent Secretary
Dairiboard	C. Millar, Chairman

ANNEX C

ANNEX C: STATEMENT OF WORK

NOTE: THIS DOCUMENT WAS RECEIVED BY FAX AND PORTIONS WERE ILLEGIBLE

Section One: Background

1 . USAID/Zimbabwe Private Sector Strategy

Access to and ownership of agricultural land was the primary reason for the war of liberation in Zimbabwe. After independence, a slow process of land acquisition and redistribution to blacks began.

For industrial assets, however, the new government had a different solution for black empowerment. The state was to acquire the commanding heights of the economy. Until the socialist state was built, private white ownership of industry was tolerated, but black ownership was actively discouraged and disparaged.

The GOZ's "socialism for blacks" policy began to erode in the mid-eighties, with the creation of the Small Enterprise Development Corporation (SEDCO)[1]. Most of SEDCO's loans to blacks were -- and are -- for small retail businesses.

With the implementation of the Economic Structural Adjustment Program (ESAP), the GOZ recognized the primary role of the private sector as the engine of development. They also realized that unless more was done to allow blacks to participate in the economy, it would end up even more heavily dominated by the minority white population. Since the early 1990's, blacks have been increasingly encouraged to enter the business sector at all levels. Unfortunately, many of the means which would encourage black entry into the economy have not been adopted.

In 1993, in response to the GOZ change in policy, USAID/Zimbabwe adopted Strategic Objective #2 ("SO#2").

"Increased Black Ownership and Investment at All Levels of the Economy"

SO#2 was adopted because the mission perceived that the Government of Zimbabwe (GOZ) would be reluctant to continue the pace of adjustment under the ESAP, unless there was more progress in increasing the share of black ownership and control of the economy. Experience in the agricultural sector in Zimbabwe has shown that if significant progress towards indigenization is not made with growth enhancing techniques, political pressures may be overwhelming to employ potentially anti-growth mechanisms such as nationalization, designation, and sector reservations.

Under SO#2, USAID will work with the public and private sector to promote growth enhancing means of black ownership. We have adapted the existing projects in the private sector portfolio, the Zimbabwe Manpower Development 11 (ZIMMAN) Training project and the Private Sector Housing project, to more clearly reflect this new strategic objective.

The Zimbabwe Business Development Project (ZBD), a pilot project authorized in 1991, has a special role to play in the development of Strategic Objective #2. Two components of ZBD -- "Implementation Support Research" and the Quick Response Fund", were designed in part to provide the analytical basis

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[1] Most of SEDCO's original capital base came from local currency generations of USAID CIP programs.

for new private sector project design. ZBD project funds will be used for this contract to explore the following components of future private sector projects. These are:

Component One. **Employee/Management Ownership.** This component will provide technical assistance/training and partial risk sharing to facilitate employee/management ownership of private and public sector enterprises.

Component Two. **Small and Micro Enterprise (SME)/black access to finance.** This component will provide technical assistance/training, and other interventions as needed to facilitate access by the larger and more dynamic end of the SME sector (e.g., 5-20 employees) to formal, quasi-formal, and informal sources of finance. Next to access to land, access to finance has been perhaps the most emotive part of the indigenization debate in Zimbabwe.

Component Three. **Business/Trade Association Support.** This component will work through and with the numerous Zimbabwean business and trade associations to help strengthen their programs, specifically those oriented towards increasing black ownership.

These new activities will complement -- and draw up on the resources of -- the other private sector programs of USAID/Zimbabwe already mentioned.

These new activities will also work directly with the programs of the USAID Initiative for Southern Africa (ISA), especially those that are directly related to promote black entrepreneurial development such as the Southern African Enterprise Development Fund (SAEDF). They will complement the more general economic development ISA activities such as the Regional Telecommunications Restructuring and Railways Restructuring programs.

II. Background on Component One: **Increasing Employee and Management Ownership in the Zimbabwean Economy.**

The analysis of Component One, Increased Employee Ownership, will be where the greatest level of effort will be expended under this contract.

The activity will address policy, information, and expertise related constraints in an integrated fashion to **increase** black ownership in the economy, in **a growth enhancing and sustainable** fashion. This will be done by introducing mechanisms to facilitate employee ownership that have proven in a variety of economic and political environments worldwide, adapted as necessary to the Zimbabwean environment.

GOZ policy after independence actually did encourage employee ownership where white owners were disinvesting from Zimbabwe, but these cases generally did not follow market principles. The employees' shares were held collectively, not individually. Employees were given an in appropriate say over corporate level decisions. Worse, party officials often interfered with board and management decisions. The result was that most of these employee-owned firms were not able to thrive or grow in a competitive economy.

More recently, the GOZ has shown a keener interest in employee ownership schemes, especially in the instances of divestiture of state holdings. In fact, an employee/management buyout mechanism has been approved for the Zimbabwe State Trading Corporation (ZSTC). If this occurs as envisioned, it will be the first full privatization of a statutory parastatal in Zimbabwe[2].

For its part, the private sector in Zimbabwe has stepped up corporate restructuring activities, which include the sale of non-core divisions or subsidiaries. This is in response to the increasingly competitive environment in many sectors in Zimbabwe, as key ESAP reforms are being implemented. In such instances, employee ownership schemes are considered, but in the current environment in Zimbabwe usually not the first choice.

In response to these changes in Zimbabwe, USAID will focus on the introduction of employee ownership schemes that have considerable financial incentives for seller and buyer. More specifically, the mechanism of Employee Stock Ownership Plans (ESOPS) will be introduced for private and public sector firms in Zimbabwe[3] .

- ESOPs will be used to help employees obtain a minority, non-controlling ownership share in their employers.

- ESOPs will also be used to help employees and managers gain a controlling interest in their employers firm, or in a division/subsidiary spun off from the firm, through employee buyouts (EBOs) or management buyouts (MBOs).

ESOP-based transactions will promote and facilitate sale of businesses from whites to blacks in a way that will stimulate, not retard, economic growth. In Zimbabwe, economic growth through enhanced employee ownership will occur for two primary reasons.

1 . Productivity gains will occur from employees having a greater stake in the success of their firm, because they are owners as well as workers. Worldwide experience has shown, however, that productivity gains from employee ownership are greatly enhanced if there is also concomitant worker empowerment on work-related issues such as quality control or reduction of waste.

2. The mobility of capital to its highest and best use will be increased. In many cases, the proceeds received by the seller will be reinvested at a higher economic rate of return than before.

In all cases, the employee ownership mechanisms contemplated will increase (or at least not decrease) private ownership of the Zimbabwean economy. Sales will be made at market value, strictly on a willing buyer/willing seller basis.

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[2] USAID/Zimbabwe is assisting ZSTC management to analyze a management buyout option.

[3] Definitions: Employee Stock Ownership Plans (ESOPs) provide all employees the opportunity to own shares in their employer. Because of their special tax advantages, ESOPs have numerous restrictions. (NOTE: REMAINDER OF FOOTNOTE NOT LEGIBLE)

In the United States, public policy strongly encourages sale of company shares to employees through the following tax incentives for ESOPS:

- Both interest and principal of loans used to finance an ESOP's acquisition of shares for employees can be repaid from pre-tax profits (if ESOP debt financed).

- Corporate contribution of company shares to qualified ESOP is deductible from corporate income tax (if ESOP is not leveraged).

- Dividend payments to shares held by qualified ESOPs are deductible from corporate income tax (dividend payments are normally not deductible).

- If owner sells at least 30 percent of company's stock to a qualified ESOP, any capital gains can be deferred indefinitely by a "roll over" to other types of investment, including an ordinary mutual fund.

- A bank may exclude 50 percent of interest income from corporate income tax, originating from loans made to finance qualifying employee stock purchases.

These financial incentives have had a twofold effect. First, ESOPs are the least expensive way for a firm to borrow money. Second, ESOPs are the best way that an owner can sell part or all of his/her firm.

I. Enhanced Access to Credit -- Loan Guarantees

Commercial banks and other financial institutions in Zimbabwe have little experience in assessing risk or structuring the finance for market-driven management and employee buyouts. While a number owners of firms have sold part or all of their holdings to employees, especially South Africans seeking to disinvest from Zimbabwe, these are special cases. Because of the punitive disinvestment regulations, the owner's equity was sold at a deep discount to the value of the firm (however measured), often as low as 20 cents on the dollar value of the assets. The banks, therefore, took little risk in financing the sale to the employees, because the value of the assets offered as collateral was worth for more than the amount of the loan.

In a more employee purchase situation in Zimbabwe -- the risks are considerable:

- With many leveraged buyouts, the only collateral available to the lender is corporate securities, sometimes with a guarantee by the corporation. The value of listed shares is subject to substantial fluctuation anywhere in the world, and this is especially true in Zimbabwe. The value and liquidity of shares of unlisted or thinly traded companies is even more problematic.

- Accounting standards and protection of minority shareholders are not up to U.S. and other developed country levels, further reducing the value of shares as collateral.

- Low profits or an adverse dividend policy could reduce cash flow below what is necessary to service a bank loan.

Lending for employee ownership may be encouraged by the provision of guarantees that would absorb a substantial portion of the risk of lending to employee ownership schemes. Donor funding for guarantees can be justified for an interim period before the legal environment has improved, and before banks have more experience with analyzing and structuring transactions.

The availability of loan guarantees could allow **more transactions** to occur, because they will provide banks with more confidence to make loans. The guarantees will make the transactions **more viable and this sustainable.** This is because the banks will be able to provide better terms -- because of lowered risk -- and so the cash repayment schedule will more manageable, especially in periods of unexpectedly low cash flows.

Proposed Implementation mechanism: At least two options will be explored for the implementation of credit guarantees; the G/PRE/I Enhanced Credit Program, and the Zimbabwean Credit Guarantee Corporation.

II. Enhanced Access to Equity Capital

Equity capital is an essential ingredient of MBOs/EBOs/MBIs. Additional equity capital, beyond what the employees can provide, can make a difference between a viable and a nonviable transaction. Additional equity capital will allow the new entity to attract additional debt finance on favorable terms, and in many cases the outside investors will bring specialized managerial and technical expertise.

Proposed Implementation mechanism: Component One will not directly provide equity capital for employee ownership. Rather, the new project activities will work to ensure that sound proposals are properly developed and presented to those institutions and individuals with investment capital. These will include *inter alia* the Southern Africa Enterprise Development Fund, as well as other international investment funds such as the International Finance Corporation (IFC) sponsored Zambezi Fund, and local venture capital funds such as Venture Capital Company of Zimbabwe (VCCZ) and Continental Capital.

III. Technical Assistance for Owners and Employees of Firms, and for Financial Institutions

As noted earlier, there is little relevant experience and expertise in Zimbabwe with the process of selling of divisions or companies to employees, and structuring employee ownership programs. The economic and policy environment conditions are not right. The tax code and restrictions on divestment discourage owners from selling part or all of their businesses. Parastatals, in fact, are proscribed by law from providing any shares to employees.

In the U.S., there are numerous firms that provide the necessary business advisory or financial services for employee ownership. In Zimbabwe, they have not developed because of the poor enabling environment and lack of demand.

Depending on the outcomes of the analyses, the types of services that may be required are specified below.

Owners of companies or divisions may need to be provided with technical assistance in a number of different areas, to help:

- Assess the costs and benefits of selling all or part of their company or division through EBO/MBO, MBI or ESOP mechanisms.
- Structure the transaction to maximize value to remaining shareholders.
- Develop a continuing business relationship with the former subsidiary or division so that needed products or services remain available at favorable terms.
- Establish the complex administrative systems required by ESOPS.
- Establish employee empowerment schemes proven to be necessary to maximize the productivity gains from employee ownership, which may include an appropriate employee information program.

Employees/managers who are buying a controlling interest in the company or division may need technical assistance, with three main objectives. First, to help them undertake a sober, professional, objective evaluation of the company or division that they are contemplating purchasing. In many instances, management in Zimbabwe has an unrealistically positive view of business prospects, based on out-of-date assumptions about privileges or protected markets. Second, if the deal looks favorable, to help them structure a transaction that provides the new firm with best chances of success, while protecting the interests of all employees. Third, to provide any support after the transaction is complete to ensure success.

Employee groups that wish to establish an Employee Stock Ownership Plan may need to be provided assistance in structuring the key aspects of ESOPS; viz., **participation, distribution, and limitation.**

Financial Institutions may need training or technical assistance to understand and analyze the risks of individual transactions, and to structure transactions advantageous to all parties.

Proposed Implementation mechanisms:

To the maximum extent possible, the technical assistance will be provided by or through locally based business advisory and financial services firms, to ensure the most rapid transfer of expertise. Initially, of course, specialized outside assistance from a variety of potential mechanisms will be considered, including the various volunteer services International Executive Services Corps (IESC), Free Market Development Advisors Program (FMDAP), Financial Sector Voluntary Cooperation (FSVC); USAID projects and IQCS; multilateral assistance groups such as African Project Development Fund (APDF); and our own ZIMMAN training project.

A fundamental principle of our new private sector activities will be that those who benefit financially from technical assistance will cover part of the costs. The cost-sharing principal is for two reasons. First, if one pays for assistance, it is valued more greatly and used more efficiently. Second, cost sharing can extend the resources of the program.

IV. Removing Policy, Regulatory, and Administrative Constraints

A number of policy, regulatory, and administrative constraints retard the spread of employee ownership in Zimbabwe. These include: high levels of taxation of ordinary income and capital gains, restrictions on sale of foreign investments made before independence, and the lack of a coherent and transparent privatization policy. Within government, the acceptance of employee ownership as an important goal is widespread. The experience and expertise necessary to analyze and remove the policy constraints, however, is largely absent.

Proposed Implementation mechanism: The GOZ making institutions and other key stakeholders will be assisted to work through the costs and benefits of changes necessary to make ESOP and EBO/MBO transactions a viable means of promoting black employee/management ownership. Assistance in implementation will also be provided. As above, a variety of potential mechanisms for delivery of this assistance will be explored.

Section Two: Scope of Services

Part One: ARTICLES

ARTICLE ONE - TITLE

Zimbabwe Business Development Project, Implementation Support Research, "Analysis of Employee Ownership Alternatives and Trade/Business Association support mechanisms"

ARTICLE TWO - OBJECTIVE

The objective of this contract is to provide the background technical information and analysis necessary for the development of new private sector project activities.

The contractor will be directing the work of a local contractor, as well as specialists that may be made available from REDSO/ESA, the Financial Sector Volunteer Corps, and the Enhanced Credit Program.

ARTICLE THREE - SCOPE OF WORK

Part One: Employee Ownership

The contractor shall analyze the feasibility of structuring, financing, and implementing ESOPs as a means of buying a minority, non-controlling interest in the company, and as a means for MBOs and EBOs. The contractor shall recommend the best means of introducing ESOPs in the Zimbabwean context.

The contractor will build on the work done by a local contractor, the results of which will be contained in a briefing paper (the scope of work for the local contractor will be provided).

Specific tasks are outlined below.

Task 1 Define the necessary ingredients for an employee ownership program in a developing country context (work to be undertaken in Washington, DC).

The contractor shall define the necessary ingredients for the introduction of ESOPs in a developing country context. This will include all relevant factors, but focus on the policy/regulatory/legal environment.

This task will rely heavily on the institutional expertise of the contractor, and require lime incremental effort beyond selected interviews and a review of the recent literature on employee ownership relevant to the developing country context.

Task 2 Define and Analyze the Policy, Legal and Regulatory Environment in Zimbabwe.

The contractor shall define and analyze the policy, legal and regulatory environment in Zimbabwe that will influence the structuring, financing, and operation of ESOPS. This should be based on the framework developed in Task 1.

In the sub-tasks to be undertaken, the contractor shall:

2-1 Analyze the policy, legal, and regulatory factors that would facilitate or otherwise impact on an employee ownership program in Zimbabwe. These shall include but not be limited to:

- Restrictions on disinvestment by foreign investors (percent ownership that can be held by management, e.g.) that reduce the value of a sale of a firm or division to employees.

- Securities and capital markets regulations (listing requirements, ability to issue voting/nonvoting shares, rights and protection of minority investors, etc.).

- Laws governing parastatals, public corporations, partnerships, sole proprietorships, and trusts.

- Financial accounting regulations and enforcement capabilities; quality and quantity of information provided.

2-2 Develop a criteria for prioritization of the policy issues identified and analyzed above, given the general requirements for employee ownership and the Zimbabwean environment. Use this criteria to prioritize the policy constraints to employee ownership.

2-3 Identify and analyze measures being taken by the GOZ to resolve the policy problems identified above, focusing on the higher priority policy/legislative/regulatory issues.

2-4 Analyze the views of the GOZ and ZANU-PF (either formal or informal) on employee ownership, including its use in the divestiture of state holdings in the economy. Special attention shall be placed on: the goals that may have been established for employee/management ownership and control; positive incentives (e.g., free or discounted shares, reserve shares/options, installment sales); and restrictions (e.g., reservation of a certain fraction of equity for non-management employees, requirement that certain companies must be sold via employee/management buyout.

2-5 Recommend means of supporting changes in the priority policy/legal/regulatory areas (expert advisors, exposure tours, workshops, etc) necessary for introduction of ESOPS. Preferably, these efforts would be coordinated if not championed by existing private and public sector organizations identified in the stakeholders/socio-economic analysis.

2-6 Develop a scope of work for further analyses required to address the policy/legal/regulatory consiraints to employee ownership. This SOW should address what legislative or other steps would be required to develop a viable mechanism for ESOPs (or similar mechanisms) in Zimbabwe.

Task 3 Develop Sample of Firms to be used for Case Studies

The case study firms will be a focal point for the analyses to follow. In the specific sub-tasks, the contractor shall:

3-1 Review the sample set of potential MBO/EBO/MBI and ESOP candidates developed by the local contractor, and select final candidates for case studies.

The case study firms will be firms where management, employees, or owners have indicated a strong interest in employee ownership, and, where in the judgement of the contractor a ESOP impractical for passive or controlling ownership. One or more of these case study firms may serve as pilots for implementation of the employee ownership activities (in fact, this may should be a motivation for a firm to agree to be used as a case study).

The sample set for case studies should include at least one company from each of the following categories:

- parastatal
- multinational
- larger local corporation/holding company
- sole proprietorship/smaller corporation

The case studies should explore:

- a leveraged ESOP used to buy minority, non-controlling interest in a firm
- a leveraged ESOP used in conjunction with an EBO/MBO to buy a division or subsidiary of a firm
- a leveraged ESOP used in conjunction with an EBO.MBO to buy a controlling interest in a firm

3-2 Develop framework for case study analyses, based on the overall requirements of this Scope of Work.

3-3 Review choice of firms and framework for analysis with USAID/Zimbabwe, and obtain approval before further work commences.

Task 4 Analyze Financing of Employee Ownership

The contractor shall analyze the financing of employee ownership, which will include an examination of risk sharing and other incentives that may be necessary to increase:

- Owners after-tax returns from a sale of ownership;
- Employees' ability to finance purchase; and
- Post-purchase after-tax cash flow of the firm.

In the following sub-tasks, the contractor shall:

4-1 Analyze the financial (debt and equity) needs of the case study firms, using the general knowledge of the financial requirements of ESOPs and MBOs/EBOs.

4-2 Analyze the availability of debt (short- to long-term loans, bonds) for the needs of the case study firms under current and likely future conditions. What institutions will likely provide debt finance? What would be the likely amount and structure of the credit received for the case study firm transactions (absolute amounts, degree of leveraging, interest rates, other relevant terms)? What would be required to obtain the necessary credit on reasonable terms from these institutions:

4-3 Analyze impact of partial risk sharing, through credit guarantees, on financing available to the case study firms. How will guarantees increase the amount of finance available, the number of deals that are bankable, the terms and conditions of finance, the viability of the deals from the creditors and the owners? What are the potentially distorting impacts on financial markets of using these mechanisms? What policy, legal, regulatory, institutional and other changes would be required to make credit guarantees successful? What are the pros and cons of using the Enhanced Credit Programme versus the Credit Guarantee Corporation of Zimbabwe?

4-4 Analyze other means for providing financial incentives for employee ownership, in terms of their compatibility with Zimbabwean law and custom, their ability to increase employee ownership in the Zimbabwean context. These incentives include but are not limited to:

Reduction of income tax rates in firms with a minimum amount of employee ownership.

Deferral of income taxes on ESOP shares received by employees as compensation, until they are cashed out of the ESOP plan.

Deduction of capital and interest repayments associated with ESOP loans and repurchase agreements on the part of corporations.

Tax credits for employee purchase of shares.

Deduction of dividends paid on ESOP shares, or for profit sharing.

Exclusion by financial institutions of interest earned on ESOP loans.

Deduction of or tax credits for ESOP related training expenses

4-5 Analyze the availability of equity or quasi-equity for the case study firms. Who are the most likely institutions with equity capital to invest: What would be likely terms from these institutions for the case study transactions?

4-6 Recommend steps to be taken by USAID, the GOZ, and firms to ensure sufficient **equity** capital will be available on reasonable terms. In particular, what will be required to ensure consideration by the Southern African Equity Development Fund and other external funds (Zambezi Fund, e.g.)?

4-7 Develop a SOW for further research or inquiry necessary to enhance the quality and quantity of finance available for employee ownership.

Task 5 Firm Level Assistance

The contractor shall:

5-1 Based on world-wide experience and an analysis of the case study firms, the contractor shall identify the type and quantity of outside business advisory and other services that will be required by:

employees/managers who are considering purchase of managing control of a company or division.

employee groups interested in evaluating and structuring ESOP mechanisms.

owners of companies or division who may be considering a sale of all or part of their company or a division of their company to their employees or management through an ESOP.

financial institutions who may be considering lending to ESOP deals.

5-2 Identify Zimbabwean sources of the business advisory services identified in the previous sub-task, and make an assessment of their quality, cost, availability, and other factors deemed relevant.

5-3 Assess the need for USAID assistance to: provide specialized outside assistance; increase the quality and quantity of services offered by local firms; provide cost-sharing for locally available services.

Create not-for-profit ESOP advocacy and membership organizations (e.g., an Employee-Owners Association).

5-4 Recommend the most appropriate modality for USAID assistance for the more important areas of need identified above.

5-5 Recommend practical means of cost sharing of the expenses of providing the necessary services relevant to the Zimbabwean context (e.g., pre-arranged success fees, collected by the financial institutions at the close of a successful transaction). Recommend uses for the revenues generated from cost sharing to further employee ownership (e.g., to increase the amount of guarantees given by financial institutions, or create a pool of risk capital through an endowment mechanism).

5-6 Develop a SOW for further analyses necessary to make the necessary expertise available on reasonable terms.

Task 6 Stakeholder Analysis

The contractor shall analyze the attitudes, issues, concerns held by key stakeholders visa vis the different aspects of employee ownership under investigation, as well as examine any specific programs by these stakeholders to promote employee ownership. A synopsis of the results of Task 2, the policy/legal/regulatory environmental analyses, should be reviewed with the stakeholders.

In the following sub-tasks, the contractor shall:

6-1 Interview the key stakeholders in employee ownership in Zimbabwe from the GOZ (the ministries of labour, Industry and Commerce, Finance, the Reserve Bank), and identify those individuals with a particular interest in employee ownership, especially those that are the advocates or implementers of measures that will support employee ownership.

6-2 Interview ZANU-PF (and if possible other parties); the unions; financial institutions and associations; and private sector leaders and associations officials Confederation of Zimbabwe Industries (CZI), Affirmative Action Group (AAG), Zimbabwe National Chamber of Commerce (ZNCC), and Indigenous Business Development Centre (IBDC).

Specifically identify the individuals that are activists or opponents (or may become activists or opponents) for the cause of employee ownership

6-3 Interview workers (including union representatives, worker council leaders), management, and owners in the case study firms.

6-4 Recommend the content and delivery mechanisms for information needed by the different categories of key stakeholders. Particular attention should be placed to those groups who may have significant reservations about employee ownership schemes (e.g., the unions), those with the authority to make employee ownership schemes happen (e.g. in the GOZ), and those who may... (NOTE: REMAINDER OF PARAGRAPH NOT LEGIBLE)

Task 7 Socio-economic analysis

7-1 The contractor shall develop the framework for a socio-economic analysis, appropriate for a USAID project paper. The contractor may receive guidance from a specialist from REDSO/ESA on specific USAID requirements and guidelines in this area.

The socio-economic analysis will be used to:

- Provide guidance in developing support activities in a manner appropriate to Zimbabwean labor relations and industrial culture.
- Provide an understanding of the differential impact of the employee ownership program on the employees/managers and their families (at a minimum, distinguish between male and female; and between unskilled, skilled, and management employees).
- Suggest means of mitigating any unintentional or adverse impact on employees.

The socioeconomic analysis framework will include a general description of the socio-cultural environment of the project at the corporate and people levels, as well as the distribution of benefits and burdens amongst the primary beneficiaries, the employees.

Questions/issues to be addressed in the framework include:

How will the risks and returns of employee earnings change in a company that has adopted an ESOP? an EBO? an MBO? leveraged or unleveraged?

What is the impact of the share valuation and share valuation procedures chosen on the employees?

How much would the employees' income increase over his/her period of employment through accumulation of employer's stock?

Will the Zimbabwean industrial culture allow the successful introduction of worker empowerment programs?

The framework for analysis should be approved by USAID/Zimbabwe before further work on this task is undertaken.

7-2 After consultation with USAID on what will be necessary for successful completion of the analysis, undertake a first order scoping of the questions in the socioeconomic impact framework, using the case study firms.

7-3 Recommend any mitigation measures required to compensate for perceived and real adverse impacts of employee ownership on stakeholders, particularly on certain categories of employees.

Task 8 Economic Analyses

The contractor shall:

8-1 Analyze macro- and micro-economic factors in Zimbabwe, in general, and relevant to the employee ownership component.

8-2 Analyze the economic impact of the initial proposals for employee ownership at the firm and national levels. The contractor will use the case study firms to explore the following areas, among others:

Use of sales proceeds by the sellers equity. Are the proceeds reinvested in the same business, put into other business, used for consumption, or repatriated out of Zimbabwe?

Impact on the financing and financial structure of the firm. This will include the cost and availability of capital, increased cash flow because of lower taxes, increased risk because of leveraged methods of achieving employee ownership, contingent liabilities from ESOP repurchase requirements.

Impact on productivity of firm.

Impact on corporate policy and governance from increased employee/management representation on board or board decisions.

Impact of the financial incentives on the short and longer-term revenue generating capability of the GOZ. For example, the short term loss from tax incentives contrasted against the long term benefits from productivity gains.

Impact on employment and income levels.

Part Two: INITIAL SCOPING OF BUSINESS/TRADE ASSOCIATION SUPPORT ACTIVITIES

The contractor shall:

Task 1 Review the list prepared by the local contractor of the business and trade associations, NGOs, and other non-government entities and select a short-list of the more promising ones for further analyses.

Task 2 Identify and analyze the likely impact of the current and planned activities of the short-listed entities.

Task 3 Further refine the short-list of organizations with highest potential programs that would further SO#2, and undertake a rapid assessment of their institutional strengths and weaknesses and other factors that may contribute to the success of their programs.

Task 4 Analyze the pros and cons of using the following organizations as implementing organizations in conjunction with a U.S. NGO or consulting firm: the Zimbabwean Association of Business Organizations (ZABO), the Confederation of Zimbabwean Industries (CZI), the Zimbabwean National Chamber of Commerce (ZNCC), and the Indigenous Business Development Centre (IBDC).

Task 5 Develop a SOW for further analyses necessary to develop the Business Association program component.

ARTICLE IV REPORTING REQUIREMENTS

The contractor team shall:

Develop a workplan with proposed modifications in the Scope of Work, staff assignments, timetables, and checkpoints for consultation with USAID within one week of signing contract.

Submit draft reports to USAID/Zimbabwe for question, comments and modifications. The contractor will produce final reports in hard copy and on diskettes in Word Perfect 5.1 (and graphics on Harvard Graphics) incorporating the input from USAID/Zimbabwe.

Submit a complete copy of interview notes, and complete copies of any materials collected while on this assignment.

ARTICLE V RELATIONSHIPS AND RESPONSIBILITIES

The Contractor will report to the Chief of the Program Development and Implementation Support Office, or a project officer designated by the Chief, for policy guidance. Technical guidance, administrative oversight, monitoring, and day-to-day liaison will be provided by the USAID/Zimbabwe Private Enterprise Officer and Private Sector Advisor.

The Contractor will work closely with and provide leadership and guidance to the Zimbabwean contractor firm(s) and the REDSO/ESA advisors. The Team Leader will have ultimate authority and responsibility for ensuring that the technical and administrative terms of the contract are fulfilled. The Team Leader will have ultimate authority over the technical and administrative aspects of the work produced by the local Zimbabwean contractor in support of this Contract. In the event of any disputes among or between the U.S. and the Zimbabwean contractor teams, the U.S. contractor Team Leader will resolve these disputes in consultation with USAID/Zimbabwe.

ARTICLE: VI SEQUENCING AND PERFORMANCE PERIOD

Date	Action/Milestone
1 December	Contract Signed
7 December	Workplan Submitted
15 December	Final Mobilization of Team, Work on Part One Task 1 commences in Washington.
9 January	Field Work Begins
30 January	First Draft Report Submitted
28 February	Final Draft Report Submitted

ARTICLE: VII CONTRACTOR TEAM QUALIFICATIONS AND LEVEL OF EFFORT

Team Leader/Business Policy specialist: Substantial experience directing the development of business support and policy programs in developing countries, likely only to be gained through 5-10 years experience. Substantial experience in southern Africa, with some of that in Zimbabwe strongly preferred. Ability to lead a large inter-disciplinary team from a variety of companies to complete tasks on a tight deadline.

Ability to motivate and direct the work of specialists, especially those with little development or African experience, towards the specific requirements of project design and ensuring adaption of input to the Zimbabwean context. Presence and communication skills to work with all players at all levels, from mid-

ranking civil servants to ministers, from union shop stewards to managing directors of the country's largest corporations. Outstanding conceptualization and writing skills.

ESOP specialist: An expert in all aspects of analyzing and structuring ESOPS, including their use in MBOs and ESOPS. Substantial experience in the adaption of the U.S. ESOP model to developing countries and for privatizations or divestitures. Experience in southern Africa and Zimbabwe preferred, at a minimum the sensitivity and ability to adapt input to developing country context.

MBO specialist: Substantial experience structuring MBOs and EBOs for companies ranging in size from sole proprietorships to medium-size corporations(for the U.S.) corporations. Must have hands-on familiarity with the use of ESOPs in MBOS. Experience in developing countries is preferred; at a minimum the sensitivity and capability to tailor input to the developing country context.

Credit Guarantee specialist: Substantial experience in analyzing and structuring credit guarantee programs in developing countries and preferably in southern Africa. Thorough understanding of the lessons from earlier USAID experience with credit guarantee programs. General understanding of the financial sector development in developing countries.

Social Scientist: Substantial experience analyzing the socioeconomic impact of business policy and business development programs on workers and their families. Prior experience with the analysis of the impacts of ESOPs and MBOs/EBOs, preferably in developing countries. Required to have an excellent grasp of economics and business policy (although not necessary advanced degrees in these areas). Must be able to function as an integral part of the team, and to direct the work of local social scientists and economists.

Business Association Specialist: Substantive experience designing and implementing programs of support to and through business associations, with some experience in southern Africa and preferably in Zimbabwe. Through understanding of the lessons learned from business association support programs. Will direct local contractor for the business association component.

ANNEX D

DELTA CASE STUDY MODEL

DELTA CORPORATION
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in Z$ Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1998 BASE	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE
PROFIT BEFORE INT. AND TAX	1,231,193	1,234,264	1,231,193	1,228,123	947,072	954,157	947,072	944,710	730,334	733,967	30,334	726,700	564,590	570,180	564,590	559,000
INTEREST	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000
ESOP INTEREST	0	51,835	12,959		0	103,670	25,917		0	155,504	38,876		0	207,339	51,835	0
TAX	292,870	203,184	270,234	292,011	213,377	81,001	185,557	212,716	152,737	0	119,733	151,720	36,553	0	68,177	105,000
PROFIT AFTER TAX	809,323	850,245	819,001	807,112	604,695	640,486	606,597	602,994	448,597	449,463	442,724	445,980	399,037	233,841	315,578	325,000
MINORITIES	90,077	90,077	90,077	90,077	69,290	69,290	69,290	69,290	53,300	53,300	53,300	53,300	41,000	41,000	41,000	41,000
PREF.DIVIDENDS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ATT.TO ORD S/HOLDERS	719,246	760,168	728,924	717,035	535,405	571,196	537,307	533,704	395,297	396,163	389,424	392,680	358,037	192,841	274,578	284,000
AMORT.REVAL.SURPLUS	(79,092)	(79,092)	(79,092)	(79,092)	(60,840)	(60,840)	(60,840)	(60,840)	(46,800)	(46,800)	(46,800)	(46,800)	(36,000)	(36,000)	(36,000)	(36,000)
ORD DIVIDENDS	320,077	340,538	324,916	318,972	237,282	255,178	238,234	236,432	174,248	174,681	171,312	172,940	161,019	78,420	119,289	124,000
RET.INC.	320,077	340,538	324,916	318,972	237,282	255,178	238,234	236,432	174,248	174,681	171,312	172,940	161,019	78,420	119,289	124,000
INTEREST COVER	9.54	6.83	8.67	9.52	7.34	4.10	6.11	7.32	5.66	2.58	4.35	5.63	4.38	1.70	3.12	4.33
RET INC/ANNUAL CAPITAL PAYMENTS		1.95	7.45			1.46	5.46			1.00	3.93			0.45	2.73	
ASSESSED LOSS										(57,697)				(112,047)		
ANNUAL PAYMENTS																
INTEREST		51,835	12,959			103,670	25,917			155,504	38,876			207,339	51,835	
PRINCIPAL		174,528	43,632			174,528	43,632			174,528	43,632			174,528	43,632	
ANNUAL TOTAL		226,363	56,591			278,198	69,549			330,032	82,508			381,867	95,467	
COST OF SHARES		698,112	174,528													

2

DELTA CORPORATION
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in Z$ Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP
SHAREHOLDERS TAX	2,235	6,981	1,545	1,652	4,843	1,517	1,111	4,979	1,529	(4,345)	9,190	1,601
COMPANY TAX	(859)	88,827	21,777	(661)	131,715	27,159	(1,017)	151,720	31,987	68,447	105,000	36,823
BANKS TAX ON INTEREST		5,183	1,296		10,367	2,592		15,550	3,888		20,734	5,183
TOTAL	1,376	100,992	24,618	991	146,925	31,267	94	172,250	37,403	64,102	134,923	43,608
CHANGE IN O/SIDE S/HOLDERS' DIVS	(12,663)	(39,560)	(8,756)	(9,362)	(27,446)	(8,594)	(6,293)	(28,216)	(8,665)	24,623	(52,074)	(9,074)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		7	6		3	5		3	4		7	4
COMPANY		88	88		90	87		88	86		78	84
BANKS		5	5		7	9		9	10		15	12

5% ESOP:		5% ESOP:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	110,737	INCREASE IN ESOP S/HOLDERS VALUE:	260,671	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A.:	94,941	INCREASE IN O/SIDE S/HOLDERS VALUE	1,462,181	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (27,330)
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	10,373	INCREASE IN TOTAL S/HOLDERS VALUE	1,722,852	
20% ESOP:		20% ESOP:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	438,940	INCREASE IN ESOP S/HOLDERS VALUE:	1,068,821	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A.:	374,306	INCREASE IN O/SIDE S/HOLDERS VALUE	1,024,011	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (117,541)
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	43,892	INCREASE IN TOTAL S/HOLDERS VALUE	2,092,831	
5% DONATION		5% DONATION:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	65,665	INCREASE IN ESOP S/HOLDERS VALUE:	260,671	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A.:	66,644	INCREASE IN O/SIDE S/HOLDERS VALUE	1,462,181	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS 5,549
		INCREASE IN TOTAL S/HOLDERS VALUE	1,722,852	

ASSUMPTIONS

1.RATE OF CO. TAX:40%,EFFECTIVE RATE ON PBI 28%,TAX RELIEF ON INTEREST 40%
2.INFLATION:20% PER ANNUM
3.RATE OF DIVIDEND WITHHOLDING TAX:15%-EMPLOYEE-HELD SHARES EXEMPT
4.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
5.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
6.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

7.MARKET INTEREST RATE:33%
8.NO TAX PAYABLE ON RECEIPT OF SHARES
9.TAX RELIEF ON INTEREST TO BUY SHARES
10.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
11.REAL GROWTH:10% PER ANNUM
12.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
13.P:E RATIO CONSTANT 13.75

DELTA CORPORATION
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in ZS Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1998 BASE	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE
PROFIT BEFORE INT. AND TAX	745,889	747,749	745,889	744,029	678,081	683,154	678,081	676,390	617,975	621,049	617,975	614,900	564,590	570,180	564,590	559,000
INTEREST	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000
ESOP INTEREST	0	17,453	4,363		0	34,906	8,726		0	52,358	13,090		0	69,811	17,453	0
TAX	157,089	80,817	137,891	156,568	138,117	55,763	117,174	137,644	121,300	31,406	98,612	120,440	36,553	10,192	81,930	105,000
PROFIT AFTER TAX	459,800	520,479	474,635	458,461	410,964	463,485	423,181	409,746	367,674	408,285	377,273	365,460	399,037	361,176	336,207	325,000
MINORITIES	54,571	54,571	54,571	54,571	49,610	49,610	49,610	49,610	45,100	45,100	45,100	45,100	41,000	41,000	41,000	41,000
PREF.DIVIDENDS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ATT.TO ORD S/HOLDERS	405,229	465,908	420,064	403,890	361,354	413,875	373,571	360,136	322,574	363,185	332,173	320,360	358,037	320,176	295,207	284,000
AMORT.REVAL.SURPLUS	(47,916)	(47,916)	(47,916)	(47,916)	(43,560)	(43,560)	(43,560)	(43,560)	(39,600)	(39,600)	(39,600)	(39,600)	(36,000)	(36,000)	(36,000)	(36,000)
ORD DIVIDENDS	178,657	208,996	186,074	177,987	159,897	185,158	165,005	158,288	141,487	161,792	146,287	140,380	161,019	142,088	129,604	124,000
RET.INC.	178,657	208,996	186,074	177,987	158,897	185,158	165,005	158,288	141,487	161,792	146,287	140,380	161,019	142,088	129,604	124,000
INTEREST COVER	5.78	5.11	5.59	5.77	5.26	4.17	4.92	5.24	4.79	3.42	4.35	4.77	4.38	2.87	3.86	4.33
RET INC/ANNUAL CAPITAL PAYMENTS		1.20	4.26			1.06	3.78			0.93	3.35			0.81	2.97	
ANNUAL PAYMENTS																
INTEREST		17,453	4,363			34,906	8,726			52,358	13,090			69,811	17,453	
PRINCIPAL		174,528	43,632			174,528	43,632			174,528	43,632			174,528	43,632	
ANNUAL TOTAL		191,981	47,995			209,434	52,358			226,886	56,722			244,339	61,085	
COST OF SHARES		698,112	174,528													

DELTA CORPORATION
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in Z$ Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP
SHAREHOLDERS TAX	1,239	1,618	182	1,100	1,524	230	895	1,642	211	(4,345)	1,549	131
COMPANY TAX	(520)	75,751	18,678	(473)	81,881	20,470	(860)	89,034	21,828	68,447	94,808	23,070
BANKS TAX ON INTEREST		1,745	436		3,491	873		5,236	1,309		6,981	1,745
TOTAL	719	79,115	19,296	627	86,896	21,573	35	95,912	23,349	64,102	103,338	24,947
CHANGE IN O/SIDE S/HOLDERS' DIVS	(7,024)	(9,171)	(1,034)	(6,236)	(8,638)	(1,303)	(5,072)	(9,304)	(1,197)	24,623	(8,780)	(745)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		2	1		2	1		2	1		1	1
COMPANY		96	97		94	95		93	93		92	92
BANKS		2	2		4	4		5	6		7	7

5% ESOP:		5% ESOP			
TOTAL LOSS TO FISCUS :	89,165	INCREASE IN ESOP S/HOLDERS VALUE:	260,671		
TOTAL REDUCTION OF CO.TAX :.	84,046	INCREASE IN O/SIDE S/HOLDERS VALUE	1,462,181	CHANGE IN O/SIDE S/HOLDERS DIVS:	(4,279)
TOTAL REDUCTION OF BANKS TAX :	3,467	INCREASE IN TOTAL S/HOLDERS VALUE	1,722,852		
20% ESOP:		20% ESOP:			
TOTAL LOSS TO FISCUS :	365,261	INCREASE IN ESOP S/HOLDERS VALUE:	1,068,821		
TOTAL REDUCTION OF CO.TAX :.	341,474	INCREASE IN O/SIDE S/HOLDERS VALUE	1,024,011	CHANGE IN O/SIDE S/HOLDERS DIVS:	(35,893)
TOTAL REDUCTION OF BANKS TAX :	13,869	INCREASE IN TOTAL S/HOLDERS VALUE	2,092,831		
5% DONATION		5% DONATION:			
TOTAL LOSS TO FISCUS :	65,483	INCREASE IN ESOP S/HOLDERS VALUE:	260,671		
TOTAL REDUCTION OF CO.TAX :.	66,593	INCREASE IN O/SIDE S/HOLDERS VALUE	1,462,181	CHANGE IN O/SIDE S/HOLDERS DIVS:	6,291
		INCREASE IN TOTAL S/HOLDERS VALUE	1,722,852		

ASSUMPTIONS

1.RATE OF CO. TAX:40%,EFFECTIVE RATE ON PBI 28%,TAX RELIEF ON INTEREST 40%
2.REAL GROWTH:10% PER ANNUM
3.RATE OF DIVIDEND WITHHOLDING TAX:15%-EMPLOYEE-HELD SHARES EXEMPT
4.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
5.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
6.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

7.INTEREST RATE:10%
8.NO TAX PAYABLE ON RECEIPT OF SHARES
9.TAX RELIEF ON INTEREST TO BUY SHARES
10.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
11.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
12.P:E RATIO CONSTANT 13.75

DELTA CORPORATION
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO C: DEAL FINANCED BY 20% PREFERENCE SHARE:
(Amounts in Z$ Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1998 BASE	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE
PROFIT BEFORE INT. AND TAX	1,231,193	1,234,264	1,231,193	1,228,123	947,072	954,157	947,072	944,710	730,334	733,967	730,334	726,700	564,590	570,180	564,590	559,000
INTEREST	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000	129,000
ESOP INTEREST	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
TAX	292,870	209,955	271,926	292,011	213,377	117,623	188,943	212,716	152,737	24,323	124,812	151,720	36,553	0	74,949	105,000
PROFIT AFTER TAX	809,323	895,308	830,267	807,112	604,695	707,534	629,129	602,994	448,597	580,644	476,521	445,980	399,037	441,180	360,641	325,000
MINORITIES	90,077	90,077	90,077	90,077	69,290	69,290	69,290	69,290	53,300	53,300	53,300	53,300	41,000	41,000	41,000	41,000
PREF.DIVIDENDS	0	34,906	8,726	0	0	69,811	17,453	0	0	104,717	26,179	0	0	139,622	34,906	0
ATT.TO ORD S/HOLDERS	719,246	770,326	731,463	717,035	535,405	568,432	542,386	533,704	395,297	422,627	397,042	392,680	358,037	260,558	284,735	284,000
AMORT.REVAL.SURPLUS	(79,092)	(79,092)	(79,092)	(79,092)	(60,840)	(60,840)	(60,840)	(60,840)	(46,800)	(46,800)	(46,800)	(46,800)	(36,000)	(36,000)	(36,000)	(36,000)
ORD DIVIDENDS	320,077	345,617	326,186	318,972	237,282	253,796	240,773	236,432	174,248	187,914	175,121	172,940	161,019	112,279	124,368	124,000
RET.INC.	320,077	345,617	326,186	318,972	237,282	253,796	240,773	236,432	174,248	187,914	175,121	172,940	161,019	112,279	124,368	124,000
INTEREST COVER	9.54	9.57	9.54	9.52	7.34	7.40	7.34	7.32	5.66	5.69	5.66	5.63	4.38	4.42	4.38	4.33
RET INC/ANNUAL CAPITAL PAYMENTS		1.98	7.48			1.45	5.52			1.08	4.01			0.64	2.85	
ASSESSED LOSS														(44,330)		
ANNUAL PAYMENTS																
PREFERENCE DIVIDENDS		34,906	8,726			69,811	17,453			104,717	26,179			139,622	34,906	
PRINCIPAL		174,528	43,632			174,528	43,632			174,528	43,632			174,528	43,632	
ANNUAL TOTAL		209,434	52,358			244,339	61,085			279,245	69,811			314,150	78,538	
COST OF SHARES		698,112	174,528													

DELTA CORPORATION
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO C: DEAL FINANCED BY 20% PREFERENCE SHARE:
(Amounts in Z$ Thousands)

	1998 5% DONATION	1998 20% ESOP	1998 5% ESOP	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP
SHAREHOLDERS RST	2,235	6,372	1,364	1,652	5,009	1,155	1,111	3,391	986	(4,345)	5,127	878
COMPANY TAX	(859)	82,055	20,084	(661)	95,093	23,773	(1,017)	127,397	26,908	68,447	105,000	30,051
TOTAL	1,376	88,427	21,449	991	100,102	24,928	94	130,788	27,894	64,102	110,127	30,929
CHANGE IN O/SIDE S/HOLDERS' DIVS	(12,663)	(36,106)	(7,731)	(9,362)	(28,386)	(6,543)	(6,293)	(19,218)	(5,589)	24,623	(29,050)	(4,973)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		7	6		5	5		3	4		5	3
COMPANY		93	94		95	95		97	96		95	97
BANKS		0	0		0	0		0	0		0	0

5% ESOP:
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM: 83,897
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:. 80,606

20% ESOP:
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM: 339,805
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:. 324,686

5% DONATION
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM: 65,665
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:. 66,644

5% ESOP
INCREASE IN ESOP S/HOLDERS VALUE: 260,671
INCREASE IN O/SIDE S/HOLDERS VALUE 1,462,181
INCREASE IN TOTAL S/HOLDERS VALUE 1,722,852
DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (18,648)

20% ESOP:
INCREASE IN ESOP S/HOLDERS VALUE: 1,068,821
INCREASE IN O/SIDE S/HOLDERS VALUE 1,024,011
INCREASE IN TOTAL S/HOLDERS VALUE 2,092,831
DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (85,673)

5% DONATION:
INCREASE IN ESOP S/HOLDERS VALUE: 260,671
INCREASE IN O/SIDE S/HOLDERS VALUE 1,462,181
INCREASE IN TOTAL S/HOLDERS VALUE 1,722,852
DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS 5,549

ASSUMPTIONS

1.RATE OF CO. TAX:40%,EFFECTIVE RATE ON PBI 28%,TAX RELIEF ON INTEREST 40%
2.REAL GROWTH:10% PER ANNUM
3.RATE OF DIVIDEND WITHHOLDING TAX:15%-EMPLOYEE-HELD SHARES EXEMPT
4. RATE OF INFLATION:20%
5.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
6.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

7.PREF.DIVIDEND RATE:20%
8.NO TAX PAYABLE ON RECEIPT OF SHARES
9.P:E RATIO CONSTANT 13.75

ANNEX E

RIO TINTO CASE STUDY MODEL

RIO TINTO ZIMBABWE
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP	1994 BASE
PROFIT BEFORE INT. AND TAX	205,350	205,862	205,350	204,838	161,693	162,903	161,693	161,290	127,635	128,270	127,635	127,000	101,000	102,000	101,000	100,000
INTEREST																
ESOP INTEREST	0	7,838	1,960	0	0	15,677	3,919	0	0	23,515	5,879	0	0	31,353	7,838	0
TAX	53,391	39,832	49,968	53,258	42,040	25,527	37,833	41,935	33,185	13,388	28,194	33,020	15,703	3,422	20,486	26,000
PROFIT AFTER TAX	151,959	158,192	153,423	151,580	119,653	121,699	119,941	119,355	94,450	91,367	93,562	93,980	85,297	67,225	72,676	74,000
MINORITIES	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
PREF.DIVIDENDS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ATT.TO ORD S/HOLDERS	151,959	158,192	153,423	151,580	119,653	121,699	119,941	119,355	94,450	91,367	93,562	93,980	85,297	67,225	72,676	74,000
EXTRAORDINARY ITEMS	0	0	0	0	0	0	0	0	0	0	0	0	(6,000)	(6,000)	(6,000)	(6,000)
ORD DIVIDENDS	67,041	69,791	67,686	66,874	52,788	53,691	52,915	52,656	41,669	40,309	41,277	41,462	34,984	27,011	29,416	30,000
RET.INC.	84,918	88,40[illegible]	85,736	84,707	66,865	68,008	67,026	66,698	52,781	51,058	52,285	52,518	44,313	34,214	37,260	38,000
INTEREST COVER		26.26	104.79			10.39	41.26			5.45	21.71			3.25	12.89	
RET INC/ANNUAL CAPITAL PAYMENTS		3.35	12.99			2.58	10.16			1.93	7.92			1.30	5.65	
ASSESSED LOSS																
ANNUAL PAYMENTS																
INTEREST		7,838	1,960			15,677	3,919			23,515	5,879			31,353	7,838	
PRINCIPAL		26,392	6,598			26,392	6,598			26,392	6,598			26,392	6,598	
ANNUAL TOTAL		34,230	8,558			42,068	10,517			49,907	12,477			57,745	14,436	
COST OF SHARES		105,567	26,392													

RIO TINTO ZIMBABWE
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP
SHAREHOLDERS TAX	478	1,656	386	376	1,456	358	281	1,382	337	(485)	1,259	308
COMPANY TAX	(133)	13,426	3,290	(105)	16,408	4,102	(165)	19,632	4,826	10,297	22,578	5,514
BANKS TAX ON INTEREST		784	196		1,568	392		2,351	588		3,135	784
TOTAL	345	15,866	3,872	271	19,431	4,852	116	23,366	5,751	9,811	26,972	6,607
CHANGE IN O/SIDE S/HOLDERS' DIVS	(2,707)	(9,385)	(2,186)	(2,132)	(8,248)	(2,029)	(1,595)	(7,832)	(1,911)	2,749	(7,133)	(1,747)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		10	10		7	7		6	6		5	5
COMPANY		85	85		84	85		84	84		84	83
BANKS		5	5		8	8		10	10		12	12

5% ESOP:		5% ESOP:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	17,009	INCREASE IN ESOP S/HOLDERS VALUE:	35,291	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	14,288	INCREASE IN O/SIDE S/HOLDERS VALUE	142,687	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (6,013)
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	1,659	INCREASE IN TOTAL S/HOLDERS VALUE	177,977	
20% ESOP:		20% ESOP:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	69,119	INCREASE IN ESOP S/HOLDERS VALUE:	144,701	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	58,102	INCREASE IN O/SIDE S/HOLDERS VALUE	50,970	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (24,819)
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	6,637	INCREASE IN TOTAL S/HOLDERS VALUE	195,671	
5% DONATION		5% DONATION:		
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	10,296	INCREASE IN ESOP S/HOLDERS VALUE:	35,291	
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	10,009	INCREASE IN O/SIDE S/HOLDERS VALUE	142,687	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (1,626)
		INCREASE IN TOTAL S/HOLDERS VALUE	177,977	

ASSUMPTIONS

1.RATE OF CO. TAX:40%,EFFECTIVE RATE ON PBI 26%,TAX RELIEF ON INTEREST 40%
2.INFLATION:20% PER ANNUM
3.RATE OF DIVIDEND WITHHOLDING TAX:15%
4.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
5.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
6.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

7.MARKET INTEREST RATE:33%
8.NO TAX PAYABLE ON RECEIPT OF SHARES
9.TAX RELIEF ON INTEREST TO BUY SHARES
10.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
11.REAL GROWTH:7% PER ANNUM
12.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
13.P:E RATIO CONSTANT 6.46

RIO TINTO ZIMBABWE
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP	1994 BASE
PROFIT BEFORE INT. AND TAX	122,811	123,117	122,811	122,504	114,776	115,635	114,776	114,490	107,535	108,070	107,535	107,000	101,000	102,000	101,000	100,000
INTEREST																
ESOP INTEREST	0	2,639	660	0	0	5,278	1,320	0	0	7,918	1,979	0	0	10,557	2,639	0
TAX	31,931	20,398	29,028	31,851	29,842	17,397	26,675	29,767	27,959	14,375	24,528	27,820	15,703	11,741	22,565	26,000
PROFIT AFTER TAX	90,880	100,080	93,123	90,653	84,934	92,959	86,782	84,723	79,576	85,778	81,027	79,180	85,297	79,703	75,796	74,000
MINORITIES	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
PREF.DIVIDENDS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ATT.TO ORD S/HOLDERS	90,880	100,080	93,123	90,653	84,934	92,959	86,782	84,723	79,576	85,778	81,027	79,180	85,297	79,703	75,796	74,000
EXTRAORDINARY ITEMS	0	0	0	0	0	0	0	0	0	0	0	0	(6,000)	(6,000)	(6,000)	(6,000)
ORD DIVIDENDS	40,094	44,153	41,084	39,994	37,471	41,012	38,286	37,378	35,107	37,843	35,747	34,932	34,984	32,516	30,792	30,000
RET.INC.	50,786	55,927	52,039	50,659	47,463	51,948	48,496	47,345	44,469	47,935	45,280	44,248	44,313	41,187	39,003	38,000
INTEREST COVER		46.65	186.14			21.91	86.98			13.65	54.33			9.66	38.27	
RET INC/ANNUAL CAPITAL PAYMENTS		2.12	7.89			1.97	7.35			1.82	6.86			1.56	5.91	
ASSESSED LOSS																
ANNUAL PAYMENTS																
INTEREST		2,639	660			5,278	1,320			7,918	1,979			10,557	2,639	
PRINCIPAL		26,392	6,598			26,392	6,598			26,392	6,598			26,392	6,598	
ANNUAL TOTAL		29,031	7,258			31,670	7,918			34,309	8,577			36,948	9,237	
COST OF SHARES		105,567	26,392													

RIO TINTO ZIMBABWE
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP
SHAREHOLDERS TAX	286	701	145	267	685	151	237	699	146	(485)	598	112
COMPANY TAX	(80)	11,453	2,823	(74)	12,370	3,093	(139)	13,445	3,292	10,297	14,259	3,435
BANKS TAX ON INTEREST		264	66		528	132		792	198		1,056	264
TOTAL	206	12,418	3,034	193	13,583	3,375	98	14,936	3,636	9,811	15,913	3,811
CHANGE IN O/SIDE S/HOLDERS' DIVS	(1,619)	(3,971)	(820)	(1,513)	(3,883)	(855)	(1,344)	(3,959)	(826)	2,749	(3,389)	(635)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		6	5		5	4		5	4		4	3
COMPANY		92	93		91	92		90	91		90	90
BANKS		2	2		4	4		5	5		7	7

5% ESOP:		5% ESOP:		
TOTAL LOSS TO FISCUS:	13,856	INCREASE IN ESOP S/HOLDERS VALUE:	35,291	
TOTAL REDUCTION OF CO.TAX: .	12,643	INCREASE IN O/SIDE S/HOLDERS VALUE	142,687	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (3,137)
TOTAL REDUCTION OF BANKS TAX:	660	INCREASE IN TOTAL S/HOLDERS VALUE	177,977	
20% ESOP:		20% ESOP:		
TOTAL LOSS TO FISCUS:	56,850	INCREASE IN ESOP S/HOLDERS VALUE:	144,701	
TOTAL REDUCTION OF CO.TAX: .	51,528	INCREASE IN O/SIDE S/HOLDERS VALUE	50,970	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (15,202)
TOTAL REDUCTION OF BANKS TAX:	2,639	INCREASE IN TOTAL S/HOLDERS VALUE	195,671	
5% DONATION		5% DONATION:		
TOTAL LOSS TO FISCUS:	10,308	INCREASE IN ESOP S/HOLDERS VALUE:	35,291	
TOTAL REDUCTION OF CO.TAX: .	10,004	INCREASE IN O/SIDE S/HOLDERS VALUE	142,687	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (1,726)
		INCREASE IN TOTAL S/HOLDERS VALUE	177,977	

ASSUMPTIONS

1.RATE OF CO. TAX:40%,EFFECTIVE RATE ON PBI 26%,TAX RELIEF ON INTEREST 40%
2.RATE OF DIVIDEND WITHHOLDING TAX:15%
3.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
4.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
5.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

6.INTEREST RATE:10%
7.NO TAX PAYABLE ON RECEIPT OF SHARES
8.TAX RELIEF ON INTEREST TO BUY SHARES
9.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
10.REAL GROWTH:7% PER ANNUM
11.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
12.P/E RATIO CONSTANT 6.46

ANNEX F

ART CORPORATION CASE STUDY MODEL

ART CORPORATION
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in ZS Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP	1994 BASE
PROFIT BEFORE INT. AND TAX	117,480	117,773	117,480	117,188	93,984	94,688	93,984	93,750	75,375	75,750	75,375	75,000	60,600	61,200	60,600	60,000
INTEREST	13,000	13,000	13,000	13,000	19,000	19,000	19,000	19,000	25,000	25,000	25,000	25,000	31,000	31,000	31,000	31,000
ESOP INTEREST	0	2,055	514	0	0	4,111	1,028	0	0	6,166	1,542	0	0	8,221	2,055	0
TAX	27,408	24,908	28,662	29,575	0	0	0	0	0	0	0	0	0	0	0	0
PROFIT AFTER TAX	77,073	77,810	75,[illegible]05	74,613	74,984	71,577	73,957	74,750	50,375	44,584	48,833	50,000	29,600	21,979	27,545	29,000
MINORITIES	7,813	7,813	7,813	7,813	6,250	6,250	6,250	6,250	5,000	5,000	5,000	5,000	4,000	4,000	4,000	4,000
PREF.DIVIDENDS	3,400	3,400	3,400	3,400	3,800	3,800	3,800	3,800	4,200	4,200	4,200	4,200	4,700	4,700	4,700	4,700
ATT.TO ORD S/HOLDERS	65,860	66,598	64,092	63,400	64,934	61,527	63,907	64,700	41,175	35,384	39,633	40,800	20,900	13,279	18,845	20,300
EXTRAORDINARY ITEMS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ORD DIVIDENDS	24,333	24,605	23,679	23,424	23,991	22,732	23,611	23,904	15,212	13,073	14,643	15,074	7,722	4,906	6,962	7,500
RET.INC.	41,528	41,993	40,413	39,976	40,944	38,795	40,296	40,796	25,963	22,311	24,991	25,726	13,178	8,373	11,882	12,800
INTEREST COVER	9.04	7.82	8.69	9.01	4.95	4.10	4.69	4.93	3.02	2.43	2.84	3.00	1.95	1.56	1.83	1.94
RET INC/ANNUAL CAPITAL PAYMENTS		6.07	23.36			5.61	23.29			3.22	14.44			1.21	6.87	
ASSESSED LOSS					(35,961)	(42,504)	(32,826)	(30,250)	(110,945)	(118,192)	(107,810)	(105,000)	(161,320)	(168,942)	(158,185)	(155,000)
ANNUAL PAYMENTS																
INTEREST		2,055	514			4,111	1,028			6,166	1,542			8,221	2,055	
PRINCIPAL		6,920	1,730			6,920	1,730			6,920	1,730			6,920	1,730	
ANNUAL TOTAL		8,976	2,244			11,031	2,758			13,086	3,272			15,142	3,785	
COST OF SHARES		27,682	6,920													

ART CORPORATION
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO A: BANK LENDS AT DISCOUNT OF 10% TO CURRENT MARKET INTEREST RATE:
(Amounts in ZS Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP
SHAREHOLDERS TAX	46	561	139	167	858	221	93	692	174	25	536	133
COMPANY TAX	2,167	4,667	912	0	0	0	0	0	0	0	0	0
BANKS TAX ON INTEREST		206	51		411	103		617	154		822	206
TOTAL	2,213	5,434	1,104	167	1,269	324	93	1,309	329	25	1,358	338
CHANGE IN O/SIDE S/HOLDERS' DIVS	(262)	(3,179)	(789)	(946)	(4,861)	(1,253)	(529)	(3,923)	(989)	(140)	(3,039)	(753)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		10	13		68	68		53	53		39	39
COMPANY		86	83		0	0		0	0		0	0
BANKS		4	5		32	32		47	47		61	61

5% ESOP:	
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	1,476
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	528
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	435
20% ESOP:	
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	6,475
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	2,701
TOTAL REDUCTION OF BANKS TAX DISCOUNTED AT 20%P.A.:	1,740
5% DONATION	
TOTAL LOSS TO FISCUS DISCOUNTED AT 20% PER ANNUM:	1,499
TOTAL REDUCTION OF CO.TAX DISCOUNTED AT 20% P.A:.	1,254

5% ESOP:			
INCREASE IN ESOP S/HOLDERS VALUE:	8,581		
INCREASE IN O/SIDE S/HOLDERS VALUE	24,634	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS	(2,903)
INCREASE IN TOTAL S/HOLDERS VALUE	33,215		
20% ESOP:			
INCREASE IN ESOP S/HOLDERS VALUE:	35,185		
INCREASE IN O/SIDE S/HOLDERS VALUE	10,209	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS	(11,523)
INCREASE IN TOTAL S/HOLDERS VALUE	45,394		
5% DONATION:			
INCREASE IN ESOP S/HOLDERS VALUE:	8,581		
INCREASE IN O/SIDE S/HOLDERS VALUE	24,634	DISCOUNTED CHANGE IN O/SIDE S/HOLDERS DIVIDENDS	(1,389)
INCREASE IN TOTAL S/HOLDERS VALUE	33,215		

ASSUMPTIONS
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1.RATE OF CO. TAX:40%,ASSESSED LOSSES DEFER TAX UNTIL 1997,EFFECTIVE RATE 40%
2.INFLATION:20% PER ANNUM
3.RATE OF DIVIDEND WITHHOLDING TAX:15%
4.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
5.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
6.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

7.MARKET INTEREST RATE:33%
8.NO TAX PAYABLE ON RECEIPT OF SHARES
9.TAX RELIEF ON INTEREST TO BUY SHARES
10.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
11.REAL GROWTH:5% PER ANNUM
12.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
13.P:E RATIO CONSTANT 13.75

ART CORPORATION
PROJECTED PROFIT AND LOSS ACCOUNTS AS A RESULT OF ESOPS
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1997 BASE	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1996 BASE	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1995 BASE	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP	1994 BASE
PROFIT BEFORE INT. AND TAX	69,631	69,805	69,631	69,458	66,315	66,812	66,315	66,150	63,315	63,630	63,315	63,000	60,600	61,200	60,600	60,000
INTEREST	13,000	13,000	13,000	13,000	19,000	19,000	19,000	19,000	25,000	25,000	25,000	25,000	31,000	31,000	31,000	31,000
ESOP INTEREST	0	692	173	0	0	1,384	346	0	0	2,076	519	0	0	2,768	692	0
TAX	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
PROFIT AFTER TAX	56,631	56,113	56,458	56,458	47,315	46,427	46,969	47,150	38,315	36,554	37,796	38,000	29,600	27,432	28,908	29,000
MINORITIES	4,631	4,531	4,631	4,631	4,410	4,410	4,410	4,410	4,200	4,200	4,200	4,200	4,000	4,000	4,000	4,000
PREF.DIVIDENDS	3,400	3,400	3,400	3,400	3,800	3,800	3,800	3,800	4,200	4,200	4,200	4,200	4,700	4,700	4,700	4,700
ATT.TO ORD S/HOLDERS	48,601	48,082	48,428	48,427	39,105	38,217	38,759	38,940	29,915	28,154	29,396	29,600	20,900	18,732	20,208	20,300
EXTRAORDINARY ITEMS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ORD DIVIDENDS	17,956	17,764	17,892	17,892	14,448	14,120	14,320	14,387	11,052	10,402	10,861	10,936	7,722	6,921	7,466	7,500
RET.INC.	30,645	30,318	30,536	30,535	24,658	24,098	24,439	24,553	18,863	17,752	18,535	18,664	13,178	11,811	12,742	12,800
INTEREST COVER	5.36	5.10	5.29	5.34	3.49	3.28	3.43	3.48	2.53	2.35	2.48	2.52	1.95	1.81	1.91	1.94
RET INC/ANNUAL CAPITAL PAYMENTS		4.38	17.65			3.48	14.13			2.57	10.71			1.71	7.36	
ASSESSED LOSS	(11,973)	(45,156)	(20,624)	(13,393)	(68,770)	(94,348)	(75,517)	(69,850)	(123,005)	(133,855)	(120,756)	(117,000)	(161,320)	(163,489)	(156,822)	(155,000)
ANNUAL PAYMENTS																
INTEREST		692	173			1,384	346			2,076	519			2,768	692	
PRINCIPAL		6,920	1,730			6,920	1,730			6,920	1,730			6,920	1,730	
ANNUAL TOTAL		7,612	1,903			8,304	2,076			8,997	2,249			9,689	2,422	
COST OF SHARES		27,682	6,920													

ART CORPORATION
OVERALL DECREASE(INCREASE) IN TAXATION RECEIPTS AGAINST BASE MODEL OF NO ESOP
SCENARIO B: CONSTANT PRICES WITH REAL INTEREST RATES AT 10%
(Amounts in Z$ Thousands)

	1997 5% DONATION	1997 20% ESOP	1997 5% ESOP	1996 5% DONATION	1996 20% ESOP	1996 5% ESOP	1995 5% DONATION	1995 20% ESOP	1995 5% ESOP	1994 5% DONATION	1994 20% ESOP	1994 5% ESOP
SHAREHOLDERS TAX	125	552	134	99	464	117	65	392	93	25	295	61
COMPANY TAX	0	0	0	0	0	0	C	0	0	0	0	C
BANKS TAX ON INTEREST		69	17		138	35		208	52		277	69
TOTAL	125	621	151	99	602	152	65	600	145	25	571	130
CHANGE IN O/SIDE S/HOLDERS' DIVS	(709)	(3,128)	(760)	(562)	(2,627)	(665)	(371)	(2,222)	(526)	(140)	(1,669)	(346)
BENEFITS CONFERRED:(%)												
SHAREHOLDERS		89	89		77	77		65	64		52	47
COMPANY		0	0		0	0		0	0		0	0
BANKS		11	11		3	23		35	36		48	53

5% ESOP:		5% ESOP:		
TOTAL LOSS TO FISCUS:	578	INCREASE IN ESOP S/HOLDERS VALUE:	8,581	
TOTAL REDUCTION OF CO.TAX: .	0	INCREASE IN O/SIDE S/HOLDERS VALUE	24,634	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (2,297)
TOTAL REDUCTION OF BANKS TAX:	173	INCREASE IN TOTAL S/HOLDERS VALUE	33,215	
20% ESOP:		20% ESOP:		
TOTAL LOSS TO FISCUS:	2,394	INCREASE IN ESOP S/HOLDERS VALUE:	35,185	
TOTAL REDUCTION OF CO.TAX: .	0	INCREASE IN O/SIDE S/HOLDERS VALUE	10,209	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (9,647)
TOTAL REDUCTION OF BANKS TAX:	692	INCREASE IN TOTAL S/HOLDERS VALUE	45,394	
5% DONATION		5% DONATION:		
TOTAL LOSS TO FISCUS:	314	INCREASE IN ESOP S/HOLDERS VALUE:	8,581	
TOTAL REDUCTION OF CO.TAX: .	0	INCREASE IN O/SIDE S/HOLDERS VALUE	24,634	CHANGE IN O/SIDE S/HOLDERS DIVIDENDS (1,781)
		INCREASE IN TOTAL S/HOLDERS VALUE	33,215	

ASSUMPTIONS
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1.RATE OF CO. TAX:40%
2.RATE OF DIVIDEND WITHHOLDING TAX:15%
3.TAX RELIEF ON PRINCIPAL REPAYMENTS SPREAD EQUALLY OVER 4 YEARS FOR COMPANY BORROWING
4.BANKS TAXABLE ON ONLY 75% OF INTEREST EARNED
5.PRODUCTIVITY GAINS PER ANNUM:

	5% ESOP	20% ESOP
YEAR 1	1.00%	2.00%
YEAR 2	0.50%	1.00%
YEAR 3	0.25%	1.00%
YEAR 4	0.25%	0.50%

6.INTEREST RATE:10%
7.NO TAX PAYABLE ON RECEIPT OF SHARES
8.TAX RELIEF ON INTEREST TO BUY SHARES
9.OVERALL LEVEL OF LENDING BY BANKS REMAINS UNCHANGED
10.REAL GROWTH:5% PER ANNUM
11.DONATION OF SHARES ATTRACTS FULL TAX RELIEF ON MARKET COST IN YEAR OF DONATION
12.P:E RATIO CONSTANT 13.75

ANNEX G

ANNEX G: SOCIAL ANALYSIS

A. Introduction

This socio-economic analysis looks at the project's socio-economic environment; factors affecting the project environment and the constraints and opportunities to participate in ESOPs.

Although the report was supposed to be based on interviews with employees and managers at case study firms, it was not possible to achieve this due to lack of prior clearance to interview employees and relevant managers at case study firms. This report is therefore based on general research findings on the situation of women in the formal sector of employment, 2 hour interviews with two managers from the case study firms, data emanating from firms' responses to a questionnaire on ESOPs and stakeholders' views and attitudes on ESOPs.

B. Project's Socio-Economic Environment

Participation Rates

Stakeholders such as ZCTU, ZNCC, IBDC believe that race and gender still remain the main factors affecting formal sector employment even though companies often deny this. Whites still largely dominate ownership and management of companies, although there has also been some effort to elevate blacks into management. Personnel positions, for instance, are increasingly being occupied by black managers, the majority of whom are men and this is also the position in the case study firms. Black employees largely occupy low-level, low-paying positions while their white counterparts, even though they may be small in number, occupy higher-level and higher-paying jobs in the professional and skilled category. Firm-specific statistical data was not available to substantiate this partly due to the confidential nature of salary matters as well as the sensitivity of racial issues in Zimbabwe at this moment in time. Qualitative information from stakeholders such as government, ZANU PF, ZCTU, ZNCC thus formed the basis of this observation.

Although women constitute 52% of the total population, female formal sector employment constitutes only 2% of the national population in comparison with 10% for men. In Delta Corporation for example, women constitute 10% of the labor force. At Rio Tinto, women constitute 5% of the work force.

Women's formal sector participation is characterized by a small proportion of women in the trained workforce, concentration in a few industries and their confinement to a limited range of jobs in the traditional female domain eg secretarial, clerical etc. Women's low participation levels at Rio Tinto is partly due to the nature of the firm's operations i.e. mining which is dependent on engineering expertise. Engineering as a field of study is essentially a male domain and it is quite likely that the few women who are at Rio Tinto are largely secretaries.

There are a few women in the professional and skilled categories, Women are largely confined to low-paying, low-level positions mainly in the unskilled and semi-skilled categories as well as casual workers. At Rio Tinto, 47% of the employees are in the unskilled category, 41% in the semi-skilled category and 12% in the skilled/managerial category. Although this data is not desegregated by gender, it is very probable that women's participation is mainly confined to lower level positions. Participation rates from Delta are not desegregated by level and it is also very probable that women's participation is at the low levels.

The Manpower Survey (1981) revealed inter-alia that there is a small percentage of women in the workforce and that African women constituted a very small proportion. The Labor Force Survey (1986/87) confirmed the same and found that women constituted 21% of all professional workers, 15% of all skilled workers and 11% of the semi-skilled workers. It also showed that women constituted 28% of formal sector employees and that they dominate the informal sector, i.e. 64% and agricultural labor force, 55%. Women's participation rates at Delta and Rio Tinto are thus way below the 1986/87 average women's participation rates.

The Labor Force Survey (1986/87) also showed that women tend to be concentrated in community and social services, commercial agriculture and in wholesale trade. The proportion of women to men is particularly low in manufacturing (16%) and Transport(8%). Approximately 20% of women in the formal sector are employed in service occupations. Clerical and sales combined account for 22% of female employees while production industries employ less than 10%.

Women's formal sector promotion and advancement opportunities are still limited due to their low educational levels, and negative socio-cultural attitudes that reinforce the myth of women as being weaker and dependent on men and hence not needing high paying jobs or high salaries.[1]

Race also continues to be a major factor in women's employment. There is a tendency to have white women dominating high paying secretarial, clerical and other jobs.

The Economic Structural Adjustment Programme is also likely to negatively impact on women employees more, for the experience of other Sub-Saharan countries including Benin, Ghana and Senegal indicates that retrenchments have mainly affected the sectors where women are concentrated in employment, (eg. social services, finance and real estate)[2]. Retrenchments often tend to be at the lowest levels among clerical, secretarial and in the unskilled labor categories which also happen to be the categories where women tend to concentrate. Under ESAP, new jobs are expected to be created mainly in the manufacturing sector. However women represent only 16% of the employees in this sector and will not benefit as much as their male counterparts. Statutory requirements for maternity. benefits for female employees often subtly prejudice women's employment opportunities.

Employee Participation in Decision Making

Workers' participation on relevant company matters is through the workers committees and works councils. Although these structures were strong in the early 1980's, their effectiveness seems to have been diluted. The Zimbabwe Congress of Trade Unions for instance argued that these bodies have long stopped representing workers interests and have increasingly become management instruments. It was not possible to check these perceptions with the workers committees themselves as well as with the workers that they represent. Management at one of the case study companies viewed these bodies as important structures for worker's participation.

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1 Betzart and Mwalo, (1986) The Situation of Women in Zimbabwe.

2 ILO, 1990. Structural Adjustment and its Socio-Economic Effects, Geneva.

In some companies which have employee trusts, there is an elected worker representative on the Trustee Board. In most cases, this representative is a man and this is also the situation with Delta. ZCTU, CZI and ZNCC confirmed this trend in Companies. The sensitivity of these worker representatives to gender issues is questionable given the socio-cultural environment in which they are brought up and operate. ZCTU also alleged that these worker representatives are largely hand picked by management or are elected into these positions through management's manipulation of the work force. ZCTU, ZNCC and CZI noted that the capacity of these employee representatives to comprehend the management issues is also rather limited due to, inter-alia, their low levels of education and limited business management expertise.

In the formal sector of employment, decision making still remains a male preserve and women's absence is very conspicuous. The Labor Force Survey, (1986/87) found that only 1% of the women are in the administrative/management field. In the Delta Corporation for instance, 1 out of the 6 Trustees is a woman, 1 out of the 10 Board members is a woman; the Corporation's top management is 100% male; and women comprise about 20% of the technical positions. The Works Council and Workers' Committees are 100% occupied by males.

The tendency for men to dominate decision making is not only peculiar to the case study company , but is reflective of the patriarchal nature and values of the Zimbabwean society as a whole and also resembles the set-up at household level. It also permeates all the important public institutions. For instance, in the public sector women constitute 16.7% of all parliamentarians, there are only 2 out of 16 women in ZANU PF Politburo - the Party's highest decision-making body, no female Cabinet Ministers, 1 Minister of State in the President's Office, 4 female Deputy Ministers, 4 female Ambassadors (against 29 males), 2 female Public Service Commissioners (against 3 males) and 2 out of 23 Permanent Secretaries.[3]

At the household level, men make most household decisions including on income utilization. Given this socio-cultural tendency by men to dominate decision making at all societal levels, most married women are likely to seek for their husbands consent regarding whether or not they can join an ESOP. if such schemes are optional. Men are also likely to decide on the use of ESOP dividend income.

Income Levels

The salary structure is largely in favor of white employees who largely control the economy. Although black men are disadvantaged, black women are disadvantaged even more. The National Manpower Survey (1981) and the Labor Force Survey (1986/87) showed inter-alia that women, especially black women's salaries, were lower than men's.

Even though the government has passed various legislative measure such as the Labor Relations Act which prohibits discrimination in recruitment, wages, training, promotion and advancement; Minimum Wages Act which stipulates the minimum scales of remuneration for people in the unskilled category and Equal Pay Regulations which enable men and women to get equal pay for equal work, there still does exist some subtle discrimination against women. Negative attitudes against women still largely prevail.

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[3] Ministry of National Affairs, 1994. The Zimbabwe National Report for the Fourth World Conference on Women.

The average monthly income for unskilled and semi-skilled category workers at Rio Tinto is $640 and $920 respectively while that for the skilled, management position is about $7400. At Delta, the average monthly salary for lower level employees is about $1000 while that for management/skilled positions is about $16000. These figures illustrate the wide salary gap that exists between low level employees and management.

Given the escalating costs of living under ESAP, low level income employees are finding it difficult to cope. As it was not possible to interview them, there is no case study-specific information on their expenditure pattern. The removal of Government subsidies on basic foods and the lifting of price controls has led to a sharp increase in the cost of goods and this has lead to a decline in real wages. Within the 1980-1991 period, food staffs represented about 54.9% of the budget of most low income households and these had increased nearly 6 times since 1980.[4]. Real wages for the formal sector have failed to keep pace with the cost of living expenses for low income families.[5] A 1991-1992 study in one of Harare's high density suburbs revealed that food, housing and transport alone constituted 53%, 10% and 7% of household expenditures respectively while the rest of the income is spent on education and remittances (6% each), transport, electricity and other (5% each), and 3% for health. The same study showed that there was a increase in the proportion of households living below the poverty datum line, 23% and 43% for 1991 and 1992 respectively. Mean monthly income in real terms declined by 23% for the top 25% of households while the bottom 25% suffered a decline of 55%. There was a 24% rise in male headed households living below the poverty datum line compared to 3% for female headed households. There were more female headed households living below the poverty datum line, 47% and 50% for 1991 and 1992 respectively compared to 20% and 44% for male headed households for the same periods respectively.[6]

The study also illustrated that the majority of low income households are experiencing real hardships as a result of ESAP.

Household Size

The average household size according to the 1992 census is about 5. Women who have attended secondary school are having significantly fewer children than women with no education i.e. 3.8 as opposed to 7.0 children.[7] Educated women often prefer compromises, i.e. smaller and healthier children and more economic activity outside the home. [8] Although there is no information relating

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[4] CSO Consumer Price Index for Lower Income Urban Families (released, 11/12/1991).

[5] Brand, Mupedziswa and Gumbo, Women Informal Sector Workers Under Structural Adjustment in Zimbabwe, Harare, January,1992.

[6] See Kanji and Jazdowska (1993) Summary Presentation of Findings on The Gender-Specific Effects Of ESAP on Households in Kambuzuma, Harare. p15,16,20.

[7] Zimbabwe Demographic and Heath Survey 1988, Summary Report.

[8] World Bank. Women in Development, Issues for Economic and Sector Analysis, Women in Development Division, WPS 269.p.vi

household size with income, high family sizes are generally associated with lowly educated-low income earners. Larger households are disproportionately impoverished by ESAP due to high dependency ratios.[9]

Household Composition

Although many households are comprised of husband, wife and children, the phenomenon of female heads of households is increasing in Zimbabwe. De-facto female heads of households are prevalent in the rural areas due to men's migration to towns. In the urban areas, there is likely to be a higher incidence of de-jure female headed households. According to the 1992 census, one third of all households in Zimbabwe are headed by women either in a de-facto or de-jure capacity. As there was limited in depth consultations at the company level, statistics on this phenomenon could not be ascertained from the case study firms. It can however be safely assumed that this phenomenon also exists at the case study firms.

C. Factors Affecting Employment

Education

Education is a most essential pre-requisite for participation in the formal sector of employment. Education largely influences one's employment opportunities, salary and to some extent one's promotion and advancement prospects.

Women's low educational levels impose restrictions on their participation in the formal sector. An analysis of the Ministry of Education 1979-1989[10] enrolment rates shows that although there was a 45 to 50 enrolment rate in favor of boys at primary school, there was a high drop out rate among girls, 33% compared to 27% for boys. At O and A level, girls numbers were 38% and 29% respectively in 1989. At University, women constituted 24% of the enrolment in 1990. At vocational and training colleges, women's participation rates were 44% in 1989 and 34% in 1990. The introduction of ESAP is likely to have even more adverse effects on girls educational opportunities for it is a well documented fact that households faced with economic hardships often withdraw daughters from school and would rather invest their limited resources in the education of sons. For example falling ratios of primary school enrolment were experienced in African countries with IMF or World Bank programmes in the period 1980-85, eg Ethiopia, Mozambique, Tanzania, Somalia and Kenya.[11]

Available data also reveals that girls fields of study are mainly in the traditional areas and that there are few girls who enter into the scientific technical areas as compared to boys. At both O and A Levels, very few girls, compared to boys, take science subjects and the trend continues to University

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[9] Kanji and Jazdowska 1993. op.cit p 20

[10] World Bank (1990). A review of Primary and Secondary Education, Volume I and Volume II.

[11] Abstracted from Commonwealth Secretariat, Report of a Commonwealth Expert Group on Women and Structural Adjustment, Table 3.5, p.82.

level. For example in 1990, the faculties of Arts, Social Science, Law and Medicine at the University of Zimbabwe had the highest female enrollment while men dominated engineering (97.3%). At vocational technical colleges, female students also dominated traditional fields of study in secretarial studies (87% in 1989 and 67% in 1990) and general development short courses (66% in 1989 and 63% in 1990).

Women's low educational levels and concentration in traditional female fields of studies limits their employment opportunity in industry.

Race

Stakeholders such as ZCTU, believe that race is one of the major determinants of formal sector employment as well as one's position within the organization. They allege that white employees often end up as black employees' supervisors after the black employees have been used to train them. The supersession of blacks by white juniors whom they will even have trained often results in much antagonism, ill-feelings, and racial conflict and tension among the affected parties. Black men are disadvantaged on race considerations; women, especially black women, are further disadvantaged by gender considerations. In the absence of company level interviews, it was not possible to confirm these allegations.

The National Manpower Survey (1981) vividly demonstrated the effect of racial factors in the employment of women especially black women. According to this survey, although African women comprised 95.5% of the female population, they constituted only 39% of the trained female work force while European women who comprised 2.9% of the female population constituted 54% of the workforce.[12] In the absence of subsequent Manpower surveys covering the post independence period, it is not possible to quantify the racial factor in employment.

Rio Tinto is a British multinational, while the major shareholder of Art Corporation is a white. Delta Corporation on the other hand is effectively controlled by the Government which has a 36%. shareholding. As there was no information gathered on the racial composition and racial dynamics of case study firms, it is not possible to comment on the nature of intra-firm racial issues.

Socio-Cultural Factors

Due to cultural considerations, some parents, particularly those in the rural areas may prefer to educate their sons as they believe that their sons are more likely to find a well paying job and to look after them in old age than a daughter who marries and benefits her husband.[13]

Within the work environment itself, socio-cultural factors shape attitudes regarding men and women's work, hiring practices as well as their salaries. Because of the belief that a women's place is in the home, company management (who are predominantly men) are often reluctant to hire women for

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[12] NMS 1981, Vol 3.

[13] World Bank op. cit. p 20.

untraditional women's jobs even if these women are well qualified.[14] Black women are even more disadvantaged than their white counterparts.

The cultural tendency to regard women as mothers and housewives who only enter paid employment to supplement the husband's income negatively affects their employment opportunities, salary and promotion and advancement prospects. Men, as the deemed bread-winners often receive more preference at work places and are also often placed in higher paying jobs as illustrated by the Labor Force Survey (1986/87) which showed the 1% women's occupation of administrative and managerial jobs.

Benefits

All permanent employees in the firms will benefit from the proposed ESOP. The exact nature of paying dividends however still needs to be further worked out so that it can equally benefit all employees. There seems to be two systems of dividend payment currently in operation at the present moment, namely:

- on the basis of one's salary and length of service;
- equal payments but with variations based on one's length of service. In Delta, each employee is entitled to 100 shares after completion of 5 years of service.

The method based on one's salary militates against lower level employees while the higher income employees benefit more. A more effective approach in terms of spreading the benefits is a system whereby employees are entitled to equal shares after a certain length of service to the company as is the case with Delta. Using this approach, both high and low level employees will have meaningful take-home benefits.

In general the project benefits can be anticipated to be:

- Increased Productivity.
- Economic benefits through the dividends that will accrue to the employees as shareholders. It is however still not clear whether married women will control this income given their lack of control of the decision making process at the household level.
- Increased loyalty to the company. It is possible that if the employees have a stake in the company, they can identify with the company. This of course depends on the level of stakeholding.
- From the point of view of promoting indigenization, ESOPs do promote black participation in the economy.

[14] ILO, Women's employment patterns, discrimination and promotion of equality in Africa, The case of Zimbabwe, JASPA,1986.p 31.

- Improved intra-company relationships as a result of reduced racial tension and improved working environment.
- Increased economic independence for women.
- Increased awareness/appreciation of the stock market and a motivation to purchase additional shares as individuals. Increased share ownership will increase employees control of decision making processes.

It must however be emphasized that these results can only be achieved if appropriate motivational packages are applied, hence the need to tailor-make incentives to the needs of men and women employees at different organizational levels It must also be emphasized that dividends must be sizeable so as to effect behavioral changes as well as meaningful changes in employees lives.

Economic incentives alone can however not lead to increased productivity. They should be linked to social rewards, (eg. appreciation, increased self-worth and image) a comprehensive skills training programme. Attention should also be paid to other business management aspects such as quality control and marketing.

D. Constraints and Opportunities to Participate in ESOPs

Finance

Due to their low income levels, lower level employees will face considerable financial difficulties if they have to make financial contribution to an ESOP. Employee trusts whereby firms donate shares to employees as a group or individuals may be appropriate for this category of employees. Most stakeholders viewed such current schemes as too small (2-5%) and also advised that they generally do not effect the requisite behavioral changes as employees' share dividends are too small.

Direct loans to employees create constraints for the lower level employees as it is difficult for them to access the banks and also have financial limitations regarding repayment due to their poor economic status. Women employees face even more difficulties in accessing banking finance due to socio-cultural and economic factors.

Women generally have no collateral needed by the commercial banks as most of them do not own properties in their own names. Family houses are mostly registered in husband's names, thus enabling husbands to use the houses as collateral while women cannot. Women are also inhibited from approaching commercial banks due to the cumbersome loan application procedures and this is further complicated by women's low educational levels and literacy rates, 60% compared to 74% for men. Their lack of confidence, partly due to low levels of education, the socialization processes (which emphasizes women's subordination) is also another impediment. The prevalence of males in commercial banks' decision making positions is also an inhibitive factor for most women. Most of these men mirror society's conservative views and values about men and women's roles in society and thus largely do not associate borrowing with women. It is in fact generally believed that most of them view lending money to women as risky business partly because of the tiny nature of women's projects, lack of track records, lack of collateral and limited managerial and technical skills. Evidence

from Commercial Banks, Agricultural Finance Corporation and other financial institutions however show a high repayment rate among women borrowers.

Women's inability to network with male bankers also disadvantages them. Due to socio-cultural factors, most women, for instance, do not belong to the sports clubs which are the basis for most networking by men. They are also largely unable to go for the "occasional drink" after work as most of them have to rush home to take care of their reproductive roles (i.e. family care roles). Thus their combination of both productive and reproductive roles often leaves them with little time for networking.

Socio-cultural norms and requirements stipulate that married women have to get husband's permission first in order to apply for a loan. Most women report that most husbands are reluctant to grant their wives this consent. Even though there is no legal basis for this, some bank officials also insist that married women have to get husband's written consent and also insist on male guarantors.[15] Due to these socio-cultural constraints, women are generally reluctant/afraid to borrow from commercial banks and most of them would rather borrow small amounts from relatives and friends. These small amounts however do not constitute adequate financing for purchasing of shares.

Although women face these gender-specific constraints emanating from the socio-cultural environment, there are however no legal impediments. The Legal Age of Majority Act (1982) makes all women and men over 18 years into legal majors who can enter into any contract in their own right. The Deeds Registration Act (1993) also empowers women to acquire shares or any property (movable or immovable) in their right.

At the policy level, there are also no impediments, for the government and the party support the policy of black and women's advancement. Attitudes however lag behind policy pronouncements and legal provisions.

Given the constraints that low level employees and women face, loans taken out by the firms as has been proposed by the team of consultants is socially sound as it saves the employees from the burdens of having to make direct loan applications to the banks, an environment that most of them are not familiar with. It also saves them from the collateral requirements since the company assets are used for this purpose. Most importantly, they do not have to pay. However, if the ESOP has to be financed by a loan which has to be paid back from the cash flow of the company, less benefits will be available to employees in the form of increased wages and other benefits.

Attitudes

Consultations with some of the stakeholders as well as with 2 case study managers indicated that there is a distinct employer-employee mentality which has developed over the years and that this mentality has largely been internalized by both employees and employers. This type of attitude may hinder some employees from participating in an ESOP. The ZANU PF political leadership and the two case study managers in fact indicated that employees, particularly the lower level employees are not in fact keen to buy own shares as individuals, partly due to this attitude problem. Lower level

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[15] One of the issues raise with President Mugabe at the **Meet The President Tour**, (Focussing On Gender and Human Rights) Harare International Conference Centre, 28th September, 1994.

employees are reported to be satisfied with their benefits. ZANU PF advised that in the 1980s, some employees in fact turned down offers to control companies. The Delta management advised that their low level employee have not enquired about the possibility of individual share ownership. Employees on the other hand were reported to be frequently enquiring about their dividends. Stakeholders such as ZCTU, ZNCC and CZI believe that inculcating a sense of ownership in employees who have been workers for their whole life may be difficult to achieve given the fact that these attitudes are a result of many years of socialization. In the absence of intra-company consultations, it was not possible to check these perceptions with the employees themselves.

Lack of Information

It is unlikely that many employees will be knowledgeable about ESOPS, how they operate vis-a-vis the stock market. Lack of knowledge about these matters may inhibit employee participation in the schemes.

The limited women's participation in decision making bodies such as in Boards, Management, Works Councils and Workers Committees also raises concerns about the effectiveness of such bodies in disseminating ESOP-related information to women.

Decision Making

The fact that socio-cultural norms require that men make all household decisions will necessitate that married women request their husbands for permission to participate in an ESOP. This may prove to be a hindrance to women's participation in ESOPs as there is no guarantee that husbands will endorse their wives' request to participate.

In terms of decision making regarding access and control to income from ESOPs, most husbands will control it. This is an issue which needs to be further probed at the company level.

The fact that decision-making at company level, Boards, management, works councils, workers committees, is predominantly male-dominated may result in the marginalization of women's gender needs and interests during the project design stage and all other project processes. Both men and women should be consulted and should participate in all project processes and this cannot be achieved if both men and women are not represented in decision-making positions.