SOUTH AFRICAN AGRICULTURE FINANCIAL RESTRUCTURING AND PRIVATIZATION PROGRAM (SARPP)

FINAL REPORT

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ACRONYMS

BEE	Black Economic Empowerment
BLCF	Business Linkage Challenge Fund
DfID	British Department for International Development
DLA	Department of Land Affairs
GEAR	Growth, Equity, and Redistribution Privatization Project
HDE	Historically Disadvantaged Employee
HDI	Historically Disadvantaged Individual
IDC	Industrial Development Corporation
IFC	International Finance Corporation
LRAD	Land Redistribution for Agricultural Development
MII	Mpumulanga Investment Initiative
SAFCOL	South African Forestry Company, Ltd.
SARPP	South Africa Agriculture Financial Restructuring and Privatization Program
SAWIT	South Africa Wine Industry Trust
TA	Technical Assistance
TEBA	The Employment Bureau for Africa (formerly a recruitment agency for the mining industry, that has been transformed into a services organization)
ZAR	South African Rand ($1 = ZAR 6, as of January 2006)

I. BACKGROUND AND INTRODUCTION

When the first democratically elected government came to power in South Africa, it inherited an economy with structural problems brought on by decades of apartheid with its insular and anticompetitive economic policies. A critical priority for the government was to address high levels of unemployment - a major cause of poverty, particularly among the historically disadvantaged. Acknowledging these economic weaknesses, the Government adopted a series of economic programs, policies and approaches to maintain and enhance stability while promoting more equitable patterns of growth. These programs have encouraged a more equitable asset distribution, opened markets, improved competitiveness at local, regional and international levels, and addressed high levels of unemployment. Two major elements of the Government's program for equitable growth have been the restructuring and privatization of state assets and addressing issues of land tenure and redistribution.

In May 2000, USAID/South Africa's Office of Sustainable Employment amended EMG's Growth, Equity, and Redistribution Privatization Project (GEAR) contract, to provide support to the implementation of restructuring of state owned assets. The purpose of this amendment was to extend privatization services to incorporate a focus on the restructuring of agricultural assets and enterprises. From then to the inception of SARPP in 2003, GEAR succeeded in assisting 41 historically disadvantaged groups to negotiate the acquisition of state-owned agricultural assets, concluded deals valued at over $55 million, and created approximately 10,000 jobs.

An evaluation of GEAR noted that the program had successfully achieved its objectives, and went on to make a number of recommendations:

- Expanding the agricultural restructuring/privatizations program to include deals whereby historically disadvantaged acquire agricultural assets form private owners on a "willing-buyer/willing-seller" basis.
- Increasing post-privatization support and the provision of entrepreneurship and business skills development by linking groups to resources such as retired executives, USAID and other donor agribusiness projects, and to established agribusinesses.
- Continuing to work with the Land Bank and IDC Agro-Industries Unit, while also encouraging and providing models for innovative methods to finance asset acquisition and rural finance in general.
- Developing the agricultural privatization database and ensuring its sustainability.

These recommendations were taken into consideration in the design of SARPP, and this report presents the SARPP scope of work, project objectives, documents the findings, and where relevant, highlights lessons learned and makes recommendations for additional assistance.

Scope of Work

The focus of the South African Agriculture Financial Restructuring and Privatization Program (SARPP) was to promote and facilitate the restructuring and/or privatization of state-owned agricultural assets, as well as the transfer of privately-owned agricultural assets on a "willing-buyer/willing-seller" basis to benefit historically disadvantaged groups and individuals. The achievement of these objectives is to increase ownership opportunities for the historically disadvantaged of rural assets that would result in more sustainable rural employment and black agribusiness growth. Thus, activities under this contract would be crucial to supporting USAID/South Africa's overall employment goal of increasing market-driven employment opportunities and its supporting objective of stimulating the growth of historically disadvantage commercial agribusiness. Performance was measured using the following indicators:

1) The number of employment opportunities created and/or preserved.
2) The number, type and value of transactions – or deals assisted by the project. Transactions may include sales contracts, government contracts, lease and lease-to-buy agreements, business partnerships, joint ventures equity deals, mergers and acquisition, privatizations and business financing.
3) The financing leveraged from grants, equity and debt (public or private).

The critical factors of the process were:

- Preparatory steps toward transactions were completed in a cost-effective and timely manner.
- Transparency was maintained through all stages of the transactions.
- Sales, other agreements, contracts, and legal documents met local and international standards and requirements.
- The capacity of South African government, private sector, financial intermediaries, and other institutions for designing and implementing transactions was increased.
- Restructured/privatized agribusiness enterprises received sufficient support to maintain financial viability and sustainable growth.

Specific Tasks

Project goals included identifying and assisting a minimum of 20 deals (restructuring or privatization) or transfers of the use and/or ownership of privately owned agricultural assets to historically disadvantaged groups of individuals. Concluded transactions were to result in not less than 1,500 jobs created, and a total sales value of ZAR 30 million.

The contractor technical assistance team assisted potential bidders for agricultural assets from the stage of deal evaluation through the bid process, and either identified or provided business support for the owners once the deal was completed. This assistance included:

- Assessing the costs and benefits of potential transactions employing various valuation methodologies.
- Providing assistance in developing privatization and acquisition strategies and options for financial and organizational restructuring.

- Developing ownership structures, which serve as models for restructuring/privatization and/or acquisition from private owners, as well as other new strategies for dispersing assets to rural historically disadvantaged.
- Providing assistance in identifying strategic partners.
- Assisting local investment firms, banks, or other financial intermediaries to strengthen their capacity to participate in restructuring/privatization activities, and the deals that transfer the use and/or ownership of privately owned agricultural assets.
- Providing expertise in commercial and investment banking, on legal and regulatory issues, business analysis, and negotiating strategies.
- Providing post-privatization or post-acquisition support to new owners, including the provision of technical assistance or linkages to providers of technical assistance in the areas of small and medium business development, marketing, financing and financial agreement, and other business skills.

II. PROJECT PERFORMANCE REVIEW

Over the life of SARPP, from October 2003 to December 2005, fifty-seven agricultural transactions were evaluated using the criteria developed during the Inception Plan:

- Is the business financially viable, with prospects for sustainable growth?
- Will the employees and/or Black Economic Empowerment (BEE) investor benefit from taking an equity position in the business?
- Will the equity funding in this business help create sustainable employment?
- Will it be possible to raise financing for this transaction?
- Is it possible to close this transaction within a reasonable amount of time (i.e., within the period of performance of the contract)?

If the criteria were met, the SARPP team commenced work. As transactions tended to change and evolve as they were developed, the final form of some transactions did not meet these criteria. SARPP reported these "red flag" transactions on a quarterly basis, to ensure that USAID was aware of the roadblocks encountered by the team.

Of the fifty-seven transactions evaluated, thirteen have been funded or approved for funding upon the completion of documentation within a few months from the end of the project. Total funding leveraged was close to ZAR 56.1 million. Nine hundred and eighty four (984) historically disadvantaged individuals became beneficial owners of agribusiness assets in their respective farming enterprises, and 892 new full-time equivalent employment opportunities were created.[1]

Issues and Constraints

There is a continuing need to improve and/or introduce corporate governance standards in the new employee trusts. SARPP attempted a variety of approaches to improve corporate governance, including:

- SARPP repeatedly requested the Institute of Directors (IOD) to develop a course for trustees of the employee trusts in the agricultural industry. Unlike the market for Managing Directors, which is the major focus of the IOD, trustee training is a grass roots market. SARPP attempted to facilitate the development of this grass roots training program in the mining sector, where large mining companies are in a position to pay for training development. The training could then potentially be cost effectively rolled out to other agricultural sectors.
- SARPP developed recommendations on how employees' trusts should be structured. Many lawyers have experience with trusts related to estate planning, rather than with employee trusts. Small-town lawyers were quite content to allow SARPP to present them with a trust template, based on which, they collect a fee for registering the trust in court. Large law firms

[1] Refer to Closed Transaction Summary Table.

were not comfortable taking SARPP recommendations to their clients – perhaps of their risk perception or policies related to the sources of legal documentation. In such cases, the establishment of the trust becomes the single longest phase in the transaction. SARPP recommended to large companies that they use a town lawyer in the location where the transaction is taking place to register the trust, rather than in-house attorneys or a law firm on retainer.

Traditionally, the SARPP approach was based on the "willing buyer/willing seller" concept, which, to date, has delivered 3.1 million hectares of land to Historically Disadvantaged Individuals (HDI). However, this pace will not meet the targets set by the South African Government for the transfer of 30% (24 million hectares) of land by 2014.

Recent *2005 Land Summit* took a non-binding decision that rejected the "willing buyer/willing seller" principle without recommending an alternative. The Minister was quoted as saying "…*Government must come up with another mechanism…that is not a simple thing*."[2] This, along with the failure to produce an Agricultural Charter, may cause more delays in the land redistribution process.

[2] Cape Times, August 1, 2005

III. LESSONS LEARNED

Lessons learned might be more aptly called "lessons not learned" or "insights" into the pre-conditions necessary for a successful project. These insights could then be used as the basis for evaluating whether the conditions necessary to achieve a successful project are present at inception, and provide insights for designing future projects.

There is a tremendous amount of good will among South Africa's farming community towards bringing the historically disadvantaged into equity positions in agriculture. SARPP found that throughout South Africa there were farmers who wanted to participate in the process of bringing the HDI into equity positions in agriculture, and wanted to discuss what they can do to participate in the process and to begin to make it happen. Despite the often negative press on the issue, many white farmers are actively seeking ways to move ahead, but are frustrated by a number of conditions that made progress slow and painfully difficult.

i) The Agricultural Charter needs to be signed and implemented.

Before many farmers will move ahead in bringing the historically disadvantaged in as partners in agriculture, they want to be sure they are proceeding in accordance with the government's intentions. They want to know the ground rules. There is a lot of talk about the "scorecard" for agriculture. The process of bringing in equity partners can take one to two years. Farmers want to know that they are doing the deal in accordance with government's objectives before they commit the time and energy necessary to close the deal. SARPP encountered many farmers who said, "*I am going to participate, but I want to wait until the Agricultural Charter is signed*." The Agricultural Charter needs to be signed and the scorecard defined as to how the percentage of land transferred will be measured.

There can be many approaches to the acquisition of land. Leasing with an option to buy, shareholding in a company that owns the land, and sharecropping are all viable routes to land acquisition. All of these options should receive credit on the agricultural scorecard. Farmers need to know that the government will approve these options before they proceed.

ii.) The Financial Charter needs to be implemented.

Although the banks have signed the Black Economic Empowerment (BEE) Charter undertaking to make more funds available for BEE transactions, and Khula Enterprise Finance has been providing funds for BEE transactions, funding for agriculture remains very difficult. Funding in the form of a grant is available from a government-funded Land Restitution and Development (LRAD) program, but the amount of the grant is dependent upon the financial resources an applicant can raise. Therefore, it is usually necessary to use both a commercial bank loan and a LRAD grant to fund land acquisitions and development. Most of the commercial banks, however, insist on either collateral, which an HDI farmer does not have enough of on his own, or a bank guarantee from the white farmer, into whose farm the HDI farmer is buying. Many white farmers are hesitant to guarantee the farming venture and from a practical perspective, a farming entity must be medium to large in scale to have the financial ability to provide such a guarantee. This makes most small farming operations unable to obtain financing to allow HDI farmers to own equity in the business.

The Financial Charter needs to be signed and the scorecard against which banks will be measured needs to be clearly defined. The few banks that are financing agricultural transactions that bring the historically disadvantaged in as equity partners, are currently skimming the most financially viable deals and still require personal guarantees. The signing of the Financial Charter, with an effective scorecard, will encourage the banks to think creatively and develop new means of financing beyond collateral or personal guarantees. Guarantee programs funded by donor agencies should be designed so as not to increase the cost of borrowing to the recipient.

iii.) A capital gains tax exemption for BEE agriculture transactions should be developed.

Capital Gains Tax (CGT) was first introduced in South Africa in October 2001. Most sales transactions will attract CGT ranging in the amount of 10% to 20% of the taxable gain. In the case of the sale of farmland and associated improvements, or shares in a company owning farming land and improvements, the amount of the tax can be substantial, and is seen as an additional cost of the transaction. The CGT rates are 10% in the case of an individual, 14.5% for a company and 20% if the taxable gain is made by a trust. Most family farms are held in trusts. Most "willing buyer/willing seller" transactions in farming will attract a 20% capital gains tax. This is a major deterrent to selling shares in the family farming business, particularly for small and medium sized farms. A capital gains tax exemption for farming sales to historically disadvantaged buyers over the next five to ten years would encourage farmers to move more quickly to bring in historically disadvantaged farming partners.

iv.) A communication and education outreach program should be developed targeted at older generation farmers and rural accountants.

The SARPP team found many instances of second and third generation farmers in family farms (the sons of farmers) wanting and excited about bringing in the employees of the farm as equity partners. These sons had grown up on the family farm. They have known the farm workers, their families and children since birth. These second and third generation farmers see bringing in employees as equity partners as risk mitigation for the future. The fathers, however, see this as a high-risk proposition to be avoided. As was stated earlier, most family farms are held in trusts. Before the son can proceed, the father must agree. Sons are not always the best people to convince their fathers, and fathers often ask the farm accountant for advice. Rural accountants are conservative by nature, and although many realize the inevitability of what the sons are advocating, SARPP found that accountants usually recommend that the transaction be delayed for a variety of reasons. The sons on these farms need help.

Any communication and education outreach program to target these reluctant players, needs to include older generation South African farmers who are have brought in employees as equity partners and are making it work. Hermanus Potgeiter in the Eastern Cape is one such person, and there are others. Workshops involving older generation farmers, and rural accountants that focus on the real day-to-day issues involved in making this transition happen can make a difference. Articles in Farmers' Weekly, Nufarmer and Farm Tech focusing on successes can also help. South Africa cannot assume that the change in thinking necessary for this transition will fold neatly into the allotted timeframe – the risks of failure are too high. Although South Africans need to be heavily involved in any outreach program, donor involvement in the design and implementation could help to assure objectivity.

v.) The change in ownership of small family farms – 50 hectares or less – will fundamentally change agriculture in South Africa.

Most small family farms in the 50 hectare or less category are just surviving. They exist because the land was paid for generations ago, the financial needs of the farming family are extremely modest, and often members of the family add non-farm income to the farm income. Adding any amount of debt to the financing of these farms negatively affects the financial stability, as will reducing the income to the farming family by sharing it with a new equity partner. Usually, these farms do not have a sufficient number of employees for an LRAD grant alone to allow the employees to buy into the farm. The operations of the farm are not sufficiently profitable for a commercial bank to lend funds to new equity partners with collateral, and the family farmer is not in a position to provide a bank guarantee. The only way these farms can change hands is for the farmer to sell out completely, and selling out completely only happens when the farmer wants to retire and his sons do not want to farm.

There should be further analysis into how these farms fit into the future of agriculture and ownership of agricultural land in South Africa. Can South Africa wait to allow these farms to change hands over time, or does another approach suited to these farms need to be developed?

IV. ADDITIONAL ASSISTANCE

It is evident that the SARPP project has identified sources of transactions, as well as a process and methodology that can deliver significant results in terms of the transfer of land ownership and agro-industrial assets. This pipeline of transactions, however, will not move until some of the issues identified above are addressed and resolved.

Of immediate concern, are seven projects that await imminent closure, i.e. within 3-6 months of project end date. Due to the ending of the contract, work on these transactions ceased, and there is reputational risk involved in not seeing projects through to completion given that a provider - client relationship has been established. This risk would extend to EMG as well as USAID. As a result, the following sustainability issues should be addressed by the CTO:

i) Transaction Closure

For those transactions that can be brought to successful closure in a reasonable amount of time, technical assistance resources should be sought and applied so that these transactions can be concluded. There are approximately seven transactions in this category (Section II) and the clients do not have the financial resources to purchase these services on the open market.

ii) Training in Trust Governance

Operating through a trust is a new experience for most of the beneficiaries, and may seem complex. Beneficiaries must have reasonable and realistic expectations, and must also understand their rights and responsibilities, which are circumscribed by the rules of the trust. They should know how and to whom to address problems and issues.

Trustees, on the other hand, must understand their fiduciary responsibilities, and must be qualified for the job. They are responsible for managing the trust's affairs and overseeing the interests of beneficiaries.

iii) Monitoring and Follow-up

The performance of the trusts should be monitored for several years to see if the model is working, and the trusts are delivering the claimed benefits, financial and otherwise. Some sample audits should be conducted to ascertain whether administrative costs are reasonable and whether dividend distributions have met expectations. The review should also determine how any special circumstances have been handled, e.g., issues of survivorship and employee terminations.

V. SUMMARY MATRICES

The following tables provide a summary of the project activities from inception to December 31, 2005. Transactions fall into one of three categories:

i.) **Closed:** transactions, which have been completed with ownership transferred and funding acquired.

ii.) **Active:** transactions, which have been qualified (i.e., which meet project criteria and an evaluation has been completed) but for various reasons have not moved to closure.

iii.) **Unqualified:** transactions, which met the willing-seller/willing-buyer criteria, but have not produced sufficient documentation or information to make a final assessment.

The matrices are designed to provide the necessary data for reporting against the Strategic Objective 9 (formerly Strategic Objective 5). In addition to the capital raised for farm/asset acquisition ("Funding Leveraged" column), the matrices track the level and change of historically disadvantaged employee ownership and employment. The measure used for employment is full time equivalent (FTE). This measure is used as the standard since some of the employment is seasonal, and working hours may differ.

Note: In order to be consistent with the specifications of SO9 (Increased Market-Driven Employment Created), new jobs created ("Net Change FTE" in the table below) were assumed to be derived from the dividends earned by the trust(s) in an accounting period divided by the annualized minimum wage in the agriculture sector (ZAR 1,000 per month).

Closed Transactions

Trans-action	Location	Sale Value (ZAR million)	Funding Leveraged (ZAR million)	HDE Owners	Non HDE Owners	HDE %	FTEs Begin	FTEs End	Net Change FTE	Closed Actual
1	KZN	0.55	0.80	12	2	40	12	12	0	Closed 2004
2	NW	1.24	1.59	24	0	100	0	24	24	Closed 2004
3	GP	1.65	6.51	51	0	100	51	70	19	Closed 2004
8	EC	8.23	8.16	71	1	74	71	148	77	Closed 2004
10	EC	5.32	4.18	23	1	75	23	40	17	Closed 2004
		16.98	21.24	181	4	N/A	157	294	137	N/A
11	EC	6.32	7.72	100	1	74	112.5	136	24	Sep 2005
16	EC	2.05	2.40	35	1	77	31.5	53.5	22	Sep 2005
38	EC	4.10	4.10	27	0	100		30	30	Sep 2005
		12.48	14.23	162	2	N/A	144	220	76	
5	KZN	11.50	4.50	50	1	40		560	560	Sep 2005
12	WC	1.85	2.15	25	1	74	15	51	36	Sep 2005
27				364	0	100	395	395	0	Sep 2005
48		5.19	3.00	40	1	73	40	60	20	Dec 2005
55		11.00	11.00	163	1	27	204	267	63	Dec 2005
		29.89	20.65	641	4	N/A	654	1,333	679	
		59.33	56.12	984	10	N/A	955	1,847	892	

Active Transactions

Trans-action	Location	Sale Value (ZAR million)	Funding Leveraged (ZAR million)	HDE Owners	Non HDE Owners	HDE %	Non Owner FTEs Begin	Non Owner FTEs End	Net Change FTE	Closed Estimate
4	GP	2.40	2.00	60	3	10	12	60	48	
6	MP	3.50	3.50	69	1	50	1,165	1,165	0	Mar 2006
7	MP	3.50	3.50	69	1	50	69	69	0	Mar 2006
9	EC	10.15	9.55	120	5	70	0			
13	KZN	7.50	7.50	70	2	2	70	70	0	Sep 2005
14	WC	5.43	5.43	46	1		26	26	0	Mar 2006
15	EC	6.30	1.50	52	2		51	51	0	Sep 2005
17	MP	2.60		62	1	40	60	62	2	Sep 2005
18	MP									Sep 2005
19	EC									Sep 2005
20	EC									Sep 2005
21	KZN			66	1		66	66	0	Mar 2006
22	WC									Mar 2006
23	GP									Sep 2005
24	LP									Mar 2006
25	LP									Mar 2006
26	NW	0.17	1.59	3	2	45				Sep 2005
49		6.50		100						Dec 2005
50		0.83		15						Dec 2005
51		0.74		8						Dec 2005
52		1.21		15						Dec 2005
53		7.09		100						Dec 2005
54		2.50	2.00	60						Dec 2005
56		1.26	1.00	30	1	30%				April 2006
57		2.17	1.00	32		100%				January 2006

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