

# FINANCIER

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New opportunities and higher revenues fuel a fresh boom in technology deals.

### Structural versus cyclical shifts

Historical patterns hint at the direction of M&A in 2007.

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The compulsion to build a global exchange platform.

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Opportunities in emerging markets

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The automotive sector

There is a worrying tendency among international investors to ignore the regional implications of an investment opportunity. They tend to look at the micro (the jurisdiction itself) and the macro (the world economy), but ignore the 'midcro' of what is happening within a sub-region. Europe is riddled with well-established local trade flows, which get obscured by consolidated EU statistics. The most obvious examples come from the continuing influence of the Russian Federation on its former vassal states, best illustrated by the recent fun and games with energy supplies.

But look at any region and you will find competing pressures. An investment in a business operating throughout the Balkan region must

take into account the fact that Serbia is heavily affected commercially by Russia, the Croatians look to Hungary or even Austria, and Bosnia has Islamic influences. The permutations are giddy, but they need to be worked through.

Your advisers must also have enough influence in their markets to be useful to you if there is a problem with your investment. Most of these countries have outmoded insolvency laws, although Romania and some others are notable exceptions. Almost none have effective restructuring regimes, which is much more worrying. In these circumstances, you will need streetwise and fearless professionals on your side and flying them in from a developed market won't work.

You must invest in your relationship with these local professionals every bit as diligently as you work at the business you have funded, because they will need a good reason to be robust on behalf of you, the 'outsider', when it is often far easier to shrug their shoulders and favour local stakeholders.

The bottom line is that New Europe and beyond will provide some great deals and some spectacular returns for the brave and for those prepared to do their homework. But just remember, you are investing in a country and its business customs, just as much as you are participating in a commercial enterprise. ■

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## MARKET FOCUS: SOUTH AFRICA

### The challenge of black economic empowerment in South Africa

BY MARC KEMP AND KOOS PRETORIUS

In South Africa, rumours of big buyouts by private equity funds are hardening into offers. Many of these involve overseas funds: Actis is involved in a ZAR7.5bn offer for Alexander Forbes, a financial services and risk adviser; Bain has offered ZAR25bn1 for Edcon, a retailer (the market is waiting to see how KKR or Blackstone, other rumoured bidders, will react); Citigroup and the CDC have set up a US\$200m Africa fund, most of which is expected to be invested in South Africa. As these funds deploy their capital, it is important for them to consider black economic empowerment (BEE).

BEE is a policy designed to transform South Africa's economy so that it better reflects the country's diverse population. The policy is reflected in the Broad-Based Black Economic Empowerment Act, the Codes of Good Practice issued under the Act, and numerous industry charters (such as the Financial Sector Charter). In short, companies operating in South Africa are measured on the degree to which they integrate previously disadvantaged individuals in the economy through equity ownership, directorships, employment, training and procurement. BEE is not legally compulsory for non-government organisations, but anyone wishing to do business in South Africa would be unwise to ignore it.

One of the more controversial aspects of BEE is the equity requirement. To score well on BEE a company is expected to allocate a percentage of its equity to black individuals. Private equity firms acquiring South African companies should take this into account when structuring and pricing their investments, fail-

ing which they could find themselves under pressure from customers or government to implement an equity sale at a time when they may prefer to focus on their strategy for increasing the value of their investment.

There was some hope that the equity requirement would be diluted for overseas companies investing in South Africa, by allowing those companies to earn 'equity equivalents'. Statement 103, issued by the Department of Trade and Industry, recognises equity equivalents, but does not go so far as to stipulate what they are or how they may be earned. In addition, only multinational businesses headquartered outside South Africa, which have a global policy requiring that local subsidiaries be wholly-owned, and which can demonstrate that they would suffer substantial commercial harm if they were to depart from that policy, may use equity equivalents. Unless they meet these criteria, overseas private equity firms need not apply.

A possible solution would be to invest in a club deal with a South African private equity firm which has the necessary BEE profile. The co-investor would contribute the necessary BEE ownership. Two immediate difficulties present themselves. The first is finding a suitable private equity firm (i.e., one that is black-owned or black-influenced). These do exist, but (and here is the second consideration) may charge a premium for their involvement, for example by negotiating a greater share in the investment by virtue of their inherent BEE value. The overseas firms presently trawling South Africa appear to have clubbed with South African firms. Actis, for example, has

bid for Alexander Forbes with Ethos, a well-established local firm.

Before decrying a policy that seems designed to deter foreign direct investment, aspiring investors should bear in mind the importance to South Africa of addressing apartheid's historical legacy. Creating a more equal society is imperative and, notwithstanding heavy criticism that it is enriching an elite rather than benefiting South Africans as a whole, BEE is directed to that end. They should also bear in mind that a good BEE profile has commercial value: it is necessary to win government tenders and contracts from businesses that in turn provide services to public organs (such as pension funds). The market takes these facts into account when pricing companies. The Public Investment Corporation, South Africa's biggest fund manager, recently made public its concerns about the pace of change at Barloworld, a listed South African company which has no black directors and has not implemented a BEE policy at group level. Barloworld's share price suffered almost immediately. At the time of writing, the PIC is turning its attention to JD Group, a listed furniture retailer with no black executives. Private equity firms with an eye on a lucrative exit would do well to embrace BEE: implementing a rushed empowerment transaction under pressure is likely to take management's eye off the ball, and listing an under-empowered company in South Africa no longer appears to be an option. ■

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