COVER STORY

Teetering on the tightrope
union investment companies

Has Cosatu formulated a proper model to ensure accountability of union investment companies? Cosatu's CEC approached **Naledi** to conduct an assessment of these companies so as to inform a coordinated and coherent approach. What did the preliminary results of the report reveal?

During the early 1990s, as it became clear that a majority ANC government would soon rule the country, two sides were pitted against each other during the so-called 'Great Economic Debate'. On the one side were the liberation movements and the progressive unions arguing for direct state intervention and redistribution for growth. On the other side were white political parties and captains of industry arguing for market-based solutions.

Fearing socialism, some captains of industry put forward more interventionist proposals (for example, the Old Mutual Scenarios) and other alternatives to nationalisation such as Black Economic Empowerment (BEE). This was the context in which Sanlam, in 1993, sold 10% of its shares to a black consortium called Methold, led by Ntatho Motlana in a transaction worth R140m. The transaction kicked off the first wave of corporate BEE.

Initially transactions were somewhat 'altruistic', with big business arguing that it was in the interests of creating a stable transition. Around the same time, Vodacom approached many Cosatu-affiliated unions offering them a stake in its proposed new cellular network. A few years later the same unions were offered the opportunity to participate in the consortia being set up to take advantage of the new dispensation in the casino industry. These two events sparked an intense debate amongst the Cosatu unions. Sactwu was the first to resolve the issue and decided to participate while Num followed this example a few years later.

Sactwu and Num were the first to establish union investment companies entering at the early stage of the cycle, together with New Africa Investments (Nail), Real Africa Investments and Thebe Investments. It is probably not a co-incidence that they are today the largest union investment companies accounting for more than 90% of the assets of all investment companies.

Sactwu and Num took advantage of opportunities in the regulated telecommunications and casino industries on extremely favourable terms. For example, Hoskens Consolidated Investments (HCI) – which was controlled by Sactwu Investment Company (SIC) and Num's Mineworkers Investment Company (MIC) – eventually exited the Vodacom investment in 2001 and received R1,5bn - having contributed a fraction of the amount in the original investment.

PERFORMANCE OF BEE COMPANIES

The performance of Cosatu union investment companies should be analysed within the context of the performance of all BEE companies and the country's overall macroeconomic environment.

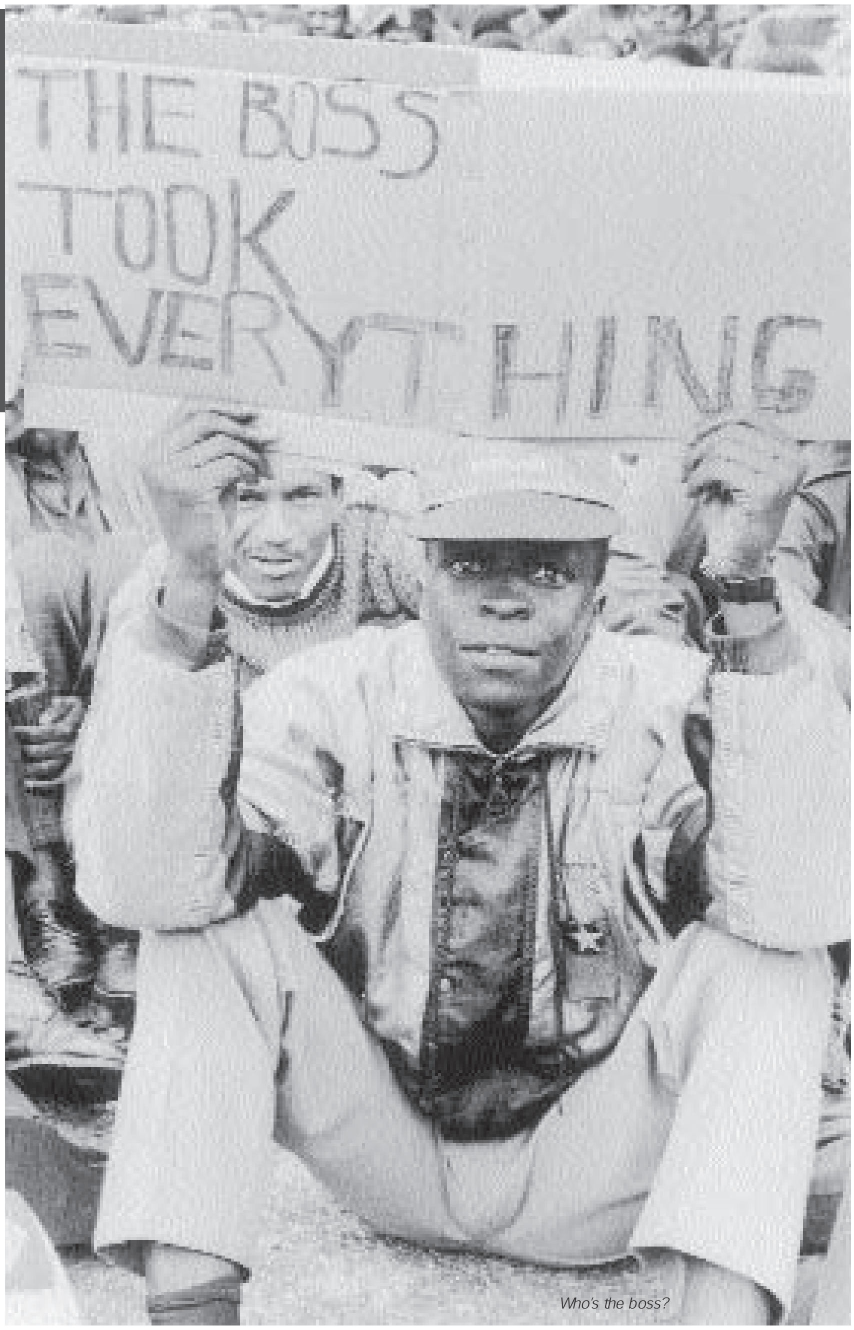
Over the past 12 years, hundreds of BEE transactions have delivered direct black ownership worth about 1,5% of the JSE Securities Exchange's total market capitalisation. In other words, the project has generally been a failure. There are numerous factors that contributed towards this situation, for example faulty funding structures which depended on rising share prices and usurious lending by financial institutions.

However, perhaps a more important factor behind the failure of the corporate BEE project thus far has been at the macroeconomic level. Real interest rates have averaged close to 11% since 1994, while economic growth has averaged about 3%. Gross Domestic Expenditure has been much lower than 3%, with exports sustaining the economy as the rand depreciated from about R3,50 in 1994 to R13,85 in December 2001. The gold price recovered from a low of $250 in 1999 following an accord in which G7 central banks agreed to control the sales of gold reserves. The gold price has been in an upward phase since then. The appreciation of the rand since 2002 has resulted in a sharp reversal of the fortunes of export industries, including mining, with growth now being sustained by the non-traded sector. This has created somewhat improved prospects for BEE companies operating in the domestic market.

Unpacking the 1,5% direct black ownership, it becomes clear that the bulk of the above figure was created in the mining sector by those companies that managed to accumulate value ahead of the turning point in the gold market. These include African Rainbow Minerals and those that fortuitously borrowed money just before 1999, Mvelaphanda and Metallon. These companies benefited from significant rises in share prices between 1999 and 2002. Since then, the cycle has turned with Mvelaphanda's share price having lost about 60% from earlier peaks. Elsewhere, significant financial value was created in the regulated sectors – telecommunications, mining and radio – that spawned the development of new industries and phenomenal growth in share prices. A few companies managed to create significant value by getting the timing right during the so-called 'irrationally exuberant' late 1990s – ahead of the stock market crash of 1997/98, which brought an end to the first wave of BEE. For example, HCI made a R700m profit in less than two years on the back of investments in former IT high-fliers Datatec and Softline, which were sold just before the market crash.

THE BEGINNING

Sactwu was the first union to establish an investment company, way before the others, which were formed during 1995-7 – potentially the worst economic period since 1990 for companies to be established. The SIC was launched in 1993 (however, Sactwu Investment Company was incorporated in 1988 with a loan from Frame to buy a factory). Whilst the economic climate was not the best for these investment companies, the mid-1990s period did however, offer the advantage of growing corporate and political interest in BEE, with increasing pressure on white-owned companies to better position themselves in regard to the democratic state. It was a period where there was more likelihood of preferential deals being offered



Who's the boss?

When formed and start-up capital

Investment Company	Date of incorporation	Start-Up Capital
Ceppwawu Investment Company	2001	R500 000 loan from the union
Sactwu Investment Company (SIC)	1988	Loan from Frame Group
Sadtu Investment Holdings	2000	R7m loan
Numsa Investment Company	1997	R300 000 loan
Mineworkers Investment Company (MIC)	1995	R 3m loan
Communication Workers Investment Company	1996	None
Popcru Investment Holdings	1998	R1,5m funding from Popcru
Nehawu Investment Company	1997	Advance of R3m from Southern Life

Investment Company	CEO	Board chairman	Union position
Ceppwawu Investment Company	D. Thomas	M. Buthelezi	Former GS of union
Sactwu Investment Company (SIC)	J. Copelyn	NOBs	NOBs
Sadtu Investment Holdings	N. Mbethe *	M. Maluleke	Current treasurer
Numsa Investment Company	T. Kgobe	S. Nondwangu	Current GS
Mineworkers Investment Company (MIC)	P. Nkuna	C. Moni	Current vice president
Communication Workers Investment Company	R. Monyokolo	J. Chauke	Current president
Popcru Investment Holdings	G. Rockman	T. Matsane	Current treasurer
Nehawu Investment Company	B. Tshabalala	C. Mevelase	No current union position

* Since the publication of this report, Mr Mbethe has left the investment company.

by such white-owned companies in exchange for such image-management positioning.

Unions starting investment companies were generally provided start-up capital in the form of once-off loans or regular payments into an investment account. Thus unions were, apart from giving their valuable trademark, directly sponsoring the formation of these investment entities, and often subsidising them through discounted interest rates, to act in the interests of their members.

WHY WERE INVESTMENT COMPANIES FORMED?

The reasons given for their establishment provides some of the basis for the tensions, which play themselves out in the daily lives of the union investment companies. The objectives expressed in interviews and in policy documents are both to generate a return to the union and/or members (and their families) as well as to pursue objectives that aim to create social capital, be it in the form of jobs or alternative forms of ownership.

Interviews revealed that the companies continuously have to balance the competing objectives of generating a return to their shareholders while pursuing Cosatu resolutions on investments. Both objectives can be pursued simultaneously. Nevertheless, from the nature of the majority of the investments it would appear that the primary objective is generating return. This is a dynamic tension that cannot, in all likelihood, ever be eradicated, but can be managed better.

WHO RUNS THESE COMPANIES?

For the most part both the senior executive positions and boards are occupied and controlled by former or current trade unionists. All the CEOs and chairmen are male.

INVESTMENT STRATEGY

Research revealed that when investment companies were formed they had an explicit policy of investing in certain sectors identified as being strategic. However, as the companies developed and more opportunities become available, they tended to drift from this original focus and began to invest wherever the opportunities presented themselves.

Some chose to focus outside of their sector to avoid possible conflicts of interest (for example, Numsa) while others have sought to make investments in the sectors in which they organise, with a view to having a progressive impact on the sector (for example Sihold and Nehawu Investment Company). With the advent of BEE Charters there has been an increasing tendency for union investment companies to pursue opportunities in those sectors simply because they are there. Accordingly, there is very little to suggest that there is a uniform approach to this issue. Similarly, it is impossible to conclude that either approach is the right way to go. Ceppwawu investment within their sector has been a considerable success, while SIC's and MIC's forays into media have been equally successful. In general, investments by union investment companies are across all sectors with some level of concentration in media and financial services.

The two best established, SIC and MIC, have pursued a more clearly articulated investment strategy. In the case of the latter it is clear that the initial strategy was opportunistic, but the company is now using its asset base to drive a clearer strategy. By far the overwhelming number of investments made by investment companies has been

Net Asset Value of investment companies

Investment Company management	Approximate value of assets under
Ceppwawu Investment Company	R50-70m
Sactwu Investment Company (SIC)	R1.3bn
Sadtu Investment Holdings	R100m
Numsa Investment Company	R150m
Mineworkers Investment Company (MIC)	R350-R500m
Communication Workers Investment Company	Negative
Popcru Investment Holdings	R56m
Nehawu Investment Company (NIC)	CEO is unable to put a figure to NAV at this stage. It is complicated by SPV deals as well as weak accounting in the earlier years of NIC's establishment. This is currently being resolved by the CEO in conjunction with new auditors.

into existing companies and not 'greenfield' operations – new developments. There are, however, exceptions with SIC and Popcru having invested in greenfields operations. In addition to the purchase of assets, a number of investment companies generate operating income by either selling membership databases or allowing for the direct marketing of financial service products to the union membership base. In return, they receive commission on the sale of these products, which serves to provide the company with operating income.

VALUE CREATION

The ultimate criteria by which one judges the success of a company is its economic success – its ability to build net asset value and to deliver returns to it shareholders. The very public failures of Saccawu Investment Company and Union Alliance Holdings coupled with the considerable dilution of value that was experienced by some investment companies during the late 1990s has left a lingering perception that they are, generally, unsuccessful. Research conducted for this report, reveals that like any collection of companies some have succeeded while others have been less successful – the most obvious of these being those that went bankrupt and were closed down.

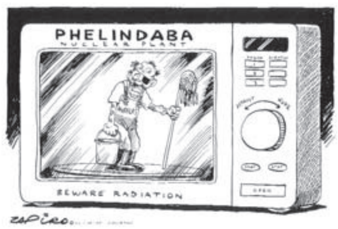
SIC stands out as the leading investment company, currently having about R1.3bn worth of assets under its management. MIC is the second largest with an asset value of between R350 and R500m.

A comparison between the start-up capital and current asset value reveals that these companies, at least those that survived, have in most cases vastly increased in value. However, it is important to note that, with the exception of SIC and MIC, the majority of the trade union investment companies are actually small to medium-size businesses. Of strategic concern is the fact that one or two economically valuable assets often drive these valuations but where the company may not necessarily have direct control over the direction taken by the business. This fact also militates against the extent to which these companies are able to drive more social capital objectives within the companies in which they have equity stakes.

CORPORATE GOVERNANCE

Our review of corporate governance has been to assess the extent to which formal processes of corporate governance are in place. As such it cannot be taken to be a qualitative assessment of the functioning of these mechanisms as that was beyond the scope of this report. That said, without exception, the basic mechanisms of corporate governance appeared to be in place.

Importantly only two of the companies reviewed had ever had their audits qualified. In both instances the qualification arose from the presence of unsecured loans on their balance sheet rather than because of any substantial failure in corporate governance. All of the companies that were interviewed had up-to-date audits that were performed by well-established audit companies.



TRADE UNION CONTROL

In all cases the investment companies are solely owned by a Fund or Trust established by the union. There have been one or two cases where there were other shareholders involved when the company was set up but those shares have subsequently been bought back.

The clearest form of trade union control is expressed by the presence of current trade unionists on the boards of investment companies. Nehawu is the only union that does not have current (but it has got previous) unionists on the board. The assumption is that if key office bearers and officials were on the board they would ensure that the company represents the union's interests. Further, the companies are often run not by professional managers but by former unionists and it might be argued that this recruitment strategy is aimed at ensuring that the ethos of Cosatu unions drives operational and investment decisions.

All the CEOs stated that they had to submit regular written and verbal reports on the performance of the investment companies to the governing structures of the union. Popcru Investment Holdings has gone as far as to establish a call centre which, amongst other purposes, will be able to respond to queries regarding it's investment activities.

Not all the unions had investment policies or resolutions that had been adopted by their congress. Nonetheless, most respondents were able to articulate a set of guiding principles. These guiding principles while common to some of the unions are not necessarily true for the entire sector.

BENEFICIARIES

Most of the companies interviewed claimed to have provided some return to their beneficiaries who fall into two broad categories, namely where the union is allowed to be a direct beneficiary of the investments and those instances where this is prohibited. The distinction is of profound strategic importance for unions, in the sense that it has long been a principle of democratic unions that they should never become 'independent' (financially or otherwise) of their members. This does not mean that the union should, necessarily, never be allowed to receive a direct return from the investment company, but would require that such a return was used for specific projects and not recurrent expenditure (such as salaries and overheads).

OVERALL PERFORMANCE

Given the nature of this review process, the researchers were unable to make conclusive statements about the financial performance and governance practices of the investment companies. Research did, however, reveal that by and large they are relatively small companies that appear to have most of the requisite corporate governance controls and practices in place. While most started out with a clearly articulated investment strategy this has, if not entirely abandoned, been deviated from in the face of the difficulty of realising these objectives with constrained resources, while simultaneously being tantalised with opportunities that have sometimes fallen outside the strategy. There exists a dynamic tension between developing a company that generates consistent and meaningful returns to the shareholders and one that pursues the objectives of Cosatu's 1998 Central Committee resolutions.

HOW UNIONISTS VIEW INVESTMENT COMPANIES

The unionists interviewed shared two broad categories of reasons for establishing an investment company. These were:

- The desire to have a progressive impact on the companies which they controlled or on the sector/economy through the companies they controlled. Perhaps the most successful of such examples has been Ceppwawu Investment Company's role in Aspen Pharmaceuticals which now produces antiretroviral generics.
- The ability to generate returns to better the lives of their members. In this instance most of the investment companies have given returns to union members in the form of bursaries for their children or other forms of support.

But have they pursued a union agenda? As stated above, most investment companies have given some form of financial return back to their union. So to that extent it may be argued that most unions have made progress on the second founding rationale of generating returns that could go towards member benefits. Progress on the first rationale of progressive impact on companies or economic transformation is a more complicated question to answer. In this regard, the more qualitative objectives outlined in Cosatu resolutions include those relating to job creation; social ownership; the advancement of workers' rights; and the diversification of patterns of ownership

While most of the companies will point to job creation, very few have invested in new developments, except for those mentioned above. Therefore, it would appear unlikely that most have contributed to the creation of new jobs, and that many of the claimed employment creation is in fact already existing employment. That said, it would be difficult to insist that they pursue a strategy of solely investing in greenfield operations, given both the risk associated with such investments and the need to generate stable returns for shareholders.

Nevertheless, there is clearly a dynamic tension between the imperative to build an asset base, generate returns and pursue the social objectives (which may require accepting lower short-term returns). This is not to say that the objectives are completely contrary to one another and that the companies and their boards do not strive to balance the two. However, in the interviews with the CEOs, it was clear that the imperative to generate returns constituted the primary driver, with the boards often having to provide a stronger social (let alone socialist) strategic input. The over-riding sense that emerges from the interviews is of a series of companies that are broadly aware of the need to pursue social objectives through their investment decisions, but that they do not strongly differentiate themselves on this basis.

Are unionists aware of the activities and strategies of their investment companies? The results were mixed with some individuals having an intimate and detailed understanding of the operations, while others simply are too over-burdened by their union responsibilities to provide effective oversight to the company's operations.

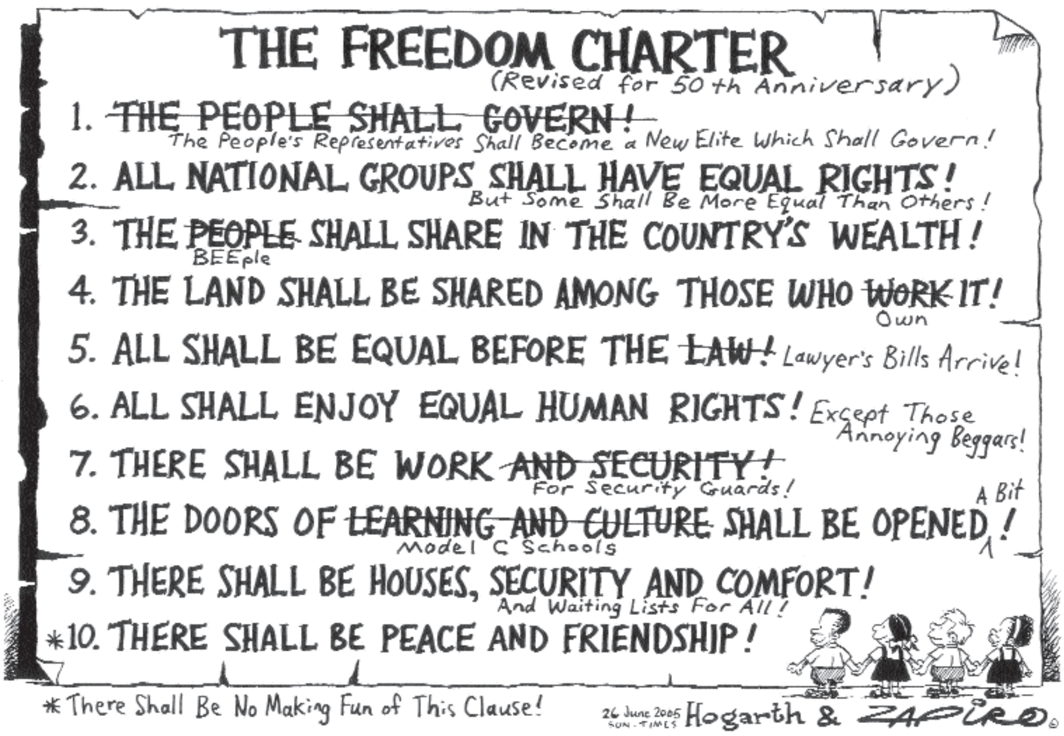
On the basis of the evidence, can it be said that union investment companies pursue a union agenda? Insofar as the Cosatu 1998 Central Committee resolutions are concerned, the answer would appear to be: 'Not really'.

The technical capacity of most unions to relate to the investment companies appears very limited, and hence results in inadequate substantive oversight. This relates to the general deficit in technical capacity within unions. If Cosatu and its affiliates intend to use investment companies strategically and effectively, then capacity within the unions to oversee investment company issues must be built. Failure to do this will guarantee poor oversight of the investment companies, in practice, and expose the union movement to grave financial, socio-political and reputational risks.

KEY RECOMMENDATIONS

What can be done to address existing problems in union investment companies? The following constitute some technical recommendations:

- *Ranking union investment companies*: Cosatu could institute a system of ranking these companies as there are substantial differences between them not only in terms of their value but how they operate. This is necessary so that they are not all tarred with the same brush. The results of such a ranking system would be made public so as to promote greater disclosure and transparency regarding the extent to which companies are accountable, performing and operating in the interests of workers. The criteria for ranking these companies could include the following: how they communicate with union members; board performance; benefits to union members; profitability; growth in net asset value; measuring increase in new jobs in companies invested in and investment in labour intensive sectors. This project could be overseen by Cosatu's Investment Council and would require it to establish a clear set of indices; obtain information on a regular basis to enable assessment; and publish an ongoing report. Such a report would serve both a monitoring function and stimulating public debate about the successes and failures of union investment companies. Such a process could also be used to promote guidelines on corporate governance.
- *Investment Charter*: Related to various industry and corporate governance initiatives, Cosatu could adopt an Investment Charter that specified the need for certain strategies to be pursued by investment companies in instances where they have a board seat or controlling interest in companies that they represent. An Investment Charter may be an appropriate vehicle to give expression to the principles enunciated in various Cosatu and affiliate resolutions pertaining to trade union investment companies. For example, advancing the objective on social ownership might be



expressed in the Investment Charter as an obligation to give first option in any outsourcing processes to worker collectives that may be established to run said operation.

- *Develop a distribution strategy.* While the investment companies have stated objectives in terms of pursuing social objectives, there is little substantial difference between their patterns of investment and that of any other 'Socially Responsible Investment' vehicle. Indeed, it may be argued that the latter have more stringent investment criteria. The key differentiator currently lies in the distribution of profits, which in this case goes either to union members or to the union itself. Accordingly, it is worth considering developing a set of broad guidelines for the distribution of profits.
- *Coordination of investments.* The review revealed that, with the exception of a few clusters of investments, much of union investment company investment is fragmented across the economy. There may be a role for Cosatu to lobby for the concentration of such investment in strategic sectors of the economy. While such a role would need to be sensitive to the need of the investment company to generate a return to their shareholders, such a coordinated approach to investment may in fact enable a more effective furtherance of the transformation of the economy than the fragmented approach currently allows for. This coordination would require that the Investment Council function effectively. Moreover, it would require that union-influenced pension and provident funds be actively brought into this coordination process.

CONCLUSION

The story of union investment companies is a fascinating one. They have built assets in excess of R2bn which represents a substantial gain for the labour movement in the sense that it represents the beginning of a consolidation of economic and financial power that they previously did not have. Yet in other ways this is an unremarkable story of a group of companies. Some have succeeded, some failed and others are mediocre. Some have been real innovators, while others have been more conventional. They have struggled to get corporate governance right and have made poor investment decisions. In short, there is little - other than that they carry the trademark of the unions - that compels us to name these companies better or worse than any other collection of companies.

Interestingly it appears that the key area of differentiation currently lies not in the manner or type of investments made, but in the distribution of profits from said investments. This is striking in the context of the fact that most Cosatu resolutions deal with the former and not the latter. Certainly both the lack of a 'union agenda' in the investment strategies and consistency in distribution of profits should be addressed.

This review is inevitably limited by the access to documentation and people as well as the nature of the enquiry. The lack of disclosure to documents (even on a confidential/edited basis), while expected of normal unlisted companies, seemed out of place for union investment companies (and, indeed, affiliated unions) responding to a Cosatu CEC mandated assessment project. This lack of disclosure and substantive information sharing is another crucial deficit that must be addressed and hence placed certain limitations on assessing their success. LB

This is an edited version of a draft report on union investment companies compiled by Naledi.