Why BEE deals fail and is there a better way?

By Brian Rainier, issued by Pula Capital Partners

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The graveyard of BEE deals is huge and this is sad.

Based on an examination of many of these deals over the past 15 years or so, I think the reasons are fairly simple as to why many of them have failed and they tend to share similar characteristics.

Typically, the reality has been that the BEE partner has had to borrow money to buy their stake and the business has not earned dividends sufficiently so that they could pay for it.

The deal simply breaks down because one of three things happen:

1. The value of the equity was priced too high;
2. The cost of debt to fund the deal was too high;
3. The business didn't perform i.e. didn't do and/or grow well enough to provide sufficient dividends to help the partner repay the debt.

And so ultimately the BEE partner could not service the debt and so never actually acquired/paid for the stake.

The consequences of this were that either the bank (funder) landed up with the stake, or the deal was just scrapped, leaving both the seller and the BEE partner feeling pretty disappointed about the whole engagement...

Furthermore, the sellers often complain that the BEE partner promised it would be able to help grow the business, and therefore the value and/or cost of funding would be covered.

Deconstructing this a bit further, we could suggest that:

Both sellers and BEE buyer were being too optimistic – the sellers in their valuation and the buyers in their expectation of the value they could add...

So, how to fix this? In services industries such as marketing and advertising a BEE strategy as described below is particularly well suited.

First of all – get realistic about value... How, you may ask?

Well, stripping out a fair bit of the historic value before doing the deal is a good start, then set a fair price: recognise that with the right partner growing the size of the pie, as the old cliché goes, this could grow the size of your slice even bigger in the end...

Then – cut the banks out of the equation – they can add 10-20% to costs of funding and do you really want them as your partner in the end?

As the seller, fund the deal yourself…make it a fair interest rate on the reduced valuation (remember you may have taken a fair chunk of the value out already)...

But be very selective of your BEE partner – make sure that in addition to them enhancing your BEE score – and this should in itself help you grow, that they can add sufficient value that together you can produce sufficient dividend for them to pay for their stake over time...

First prize is a BEE company who has operational capacity and client base that can demonstrate how together you can grow your business.

If you would like to find out more about the new B-BBEE codes and how to do a fair deal, why not join Empowerdex and Pula Partners' complimentary Breakfast Seminar on 25 April in Cape Town?

(http://www.pulapartners.co.za/news/bee-breakfast-seminar/).

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