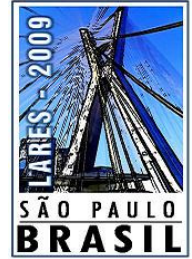




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## The Transformation of the South African Built Environment – An Institutional Approach LARES 2009, São Paulo, Brazil

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### ABSTRACT

This paper develops the proposition that the characteristic of the South African built environment can largely be explained by the economic and social institutional framework that continues to characterise this market. The proposition is developed within the context of the Institutional Economics literature, and demonstrates the relevance of this theoretical framework in explaining the present and future trajectory of the South African built environment – the construction and property sectors. While recent public and private sector policies and interventions, have attempted to alter the players, in the South African economy, there is growing evidence, and concern, that a significant institutional “lock in” continues to perpetuate historical market outcomes. There is also a growing realisation that government intervention may not have been successful in changing the institutional framework and structure of the South African built environment. This suggests that when strong institutional “lock in” exists, public sector interventions that attempt to alter market institutional arrangements should target different echelons of the institutional hierarchy.

### 1. INTRODUCTION

This paper primarily considers the institutional changes, and related policy interventions that have influenced the South African built environment since 1994. While there is widespread agreement that BEE (Black Economic Empowerment) is an essential part of redressing the legacy of apartheid, the impact that such policy interventions have had on the structure of the property market, remains disappointing. It can be argued that BEE interventions have primarily benefitted a small group of politically well connected individuals, and has not had a significant impact in broadening property ownership and transformation of the construction sector.

The paper suggests that institutional economics provides a useful theoretical approach to clarify the path that the South African property and construction sectors have taken in the post-apartheid era. In the past decade, public sector driven Black Economic Empowerment (BEE) interventions promoted by government at national level have been significant, and include

legislation, as well direct procurement driven interventions. There is however, a growing concern that these policy interventions have shown limited success in altering the institutional framework and economic behaviour of participants in the South African Built Environment. This perceived failure is encouraging government and certain interest groups to promote new approaches to accelerate institutional change.

## **2. THE THEORETICAL BACKGROUND**

The institutional approach provides a useful paradigm that explains the influence that social and economic rules and regulations have on the structure of a market. From an economic perspective, the institutional approach is based on the premise that the behaviour of market participants is influenced by formal and informal rules and regulations. A central theme of New Institutional Economics (NIE) is that markets are developed by human activity, and therefore, reflect the power and interests within society. A change in power relationships can therefore result in new market institutions and a change in economic behaviour and economic outcomes.

The path that institutional change takes remains an important point of contention. While it is tempting to think that institutional change results in optimum socioeconomic outcomes, there is a growing understanding why this may not be the case. North (1990) emphasizes that institutional transformation is always influenced by some level of path-dependence. Path Dependence is based on the proposition that an institutional framework is influenced by socioeconomic drivers that define the trajectory that institutional change takes. The trajectory may result in non-optimal outcomes.

Mahoney (2000) identifies three explanations of path dependence—namely the utilitarian, functional and power centered explanations. The utilitarian explanation is largely based on the proposition that institutions are reproduced because potential benefits are outweighed by the costs. North (1990) emphasizes that increasing returns associated with a particular institutional framework provides disincentives for institutional change – even if such a change could result in greater efficiencies. The functional approach suggests that an institutional framework will continue to exist as long as it serves a broader system and socioeconomic outcomes. It can be argued that property institutions in the apartheid years continued to exist because they were an integral part of a broader political system. In turn, the collapse of apartheid required the transformation of the property institutional environment as it no longer served a functional role. The power centered approach suggests that an institution can persist even when most individuals or groups prefer to change it. It exists provided the elite that benefits from the existing arrangement has sufficient strength to promote its reproduction (Mahoney 2000).

From a policy perspective, the challenge therefore, often lies in developing market interventions that can fundamentally alter the parameters that delineate the institutional “path” of a market. The important challenge for policy makers in South Africa has been to devise interventions that can promote the racial transformation of the promoter sector. The South African case study also suggests that attempting to change the institutional framework of a market requires interventions targeted at different levels of the institutional hierarchy.

Keogh & D’Arcy (1999), suggest that the property institutional framework can be explained in terms of an institutional hierarchy. The property market comprises a three tier institutional framework. First, the property market exists within an institutional framework defined by

political, social, economic and legal rules and conventions. This includes constitutional arrangements and the legislative environment. At the next level, the property market itself is considered as an institution with a range of characteristics which describe its structure and determine its scope and function. Finally, at the third level, comprise organizations that function in the property market – namely property owning companies, professional service providers and property associations.

*Figure 1: Institutional Explanation of Property Development*



*(Source: Guy and Henneberry, 2002)*

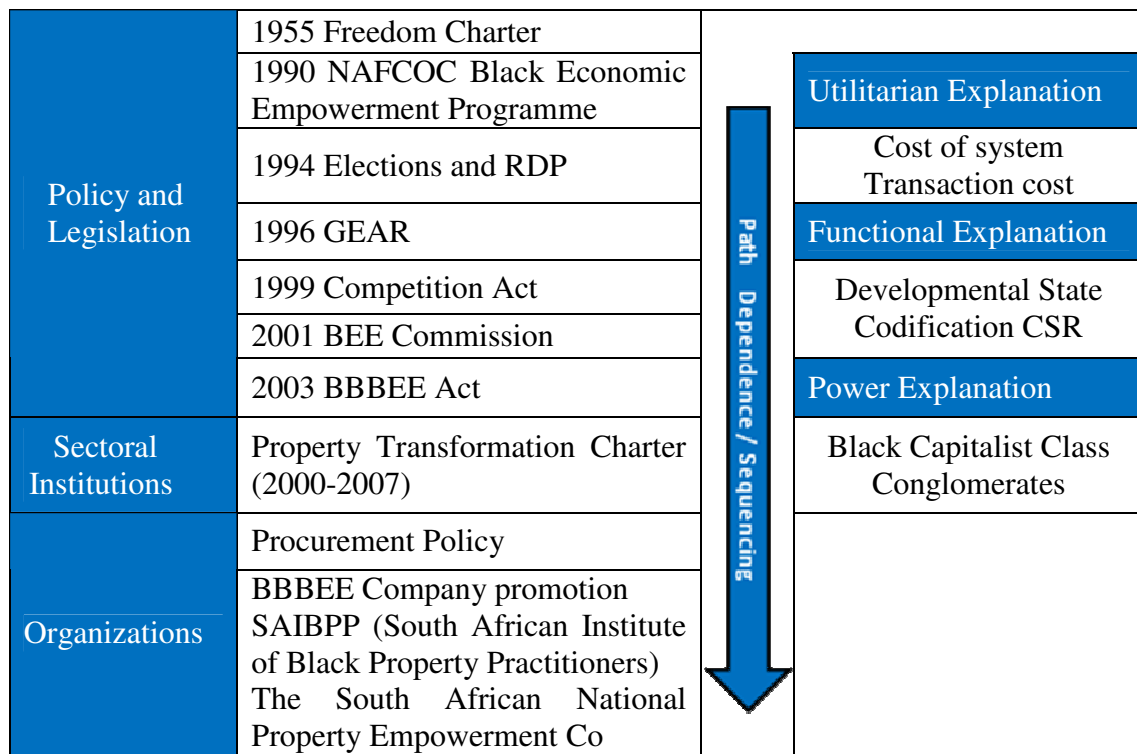
The hierarchy of institutions that make up the Built Environment influence each other in numerous different ways. A top down approach suggests that the legislative environment influences the characteristics of the property market and the organisations that interact within this market. But there is always the possibility that the drivers of path dependence and institutional lock-in may reduce the trickledown effect of such interventions.

Yet, it can also be argued that the path of institutional change can also be effected through a bottom-up approach - underpinned by the decisions that property market organisations and interest groups desire. This may ultimately influence the sectoral institutional framework and the legislative environment. For the policy maker the challenge lies in identifying the level of the institutional hierarchy that offers the best opportunity to alter the path of institutional change.

Taking a historical perspective, apartheid legislation, which dominated the policy and legislative environment, had a profound impact on the structure of the South African built environment. The apartheid system determined, on a racial basis, the organisations in the built environment as well as the interactions that existed between players. These interactions also promoted relations that excluded black interest groups from the sector, and as a result, few black owned companies existed at the organisational level.

The hierarchy of property institutional interventions in the South African property market is illustrated in diagram 2. It largely builds on diagram 1 and depicts interventions that have occurred at the Policy/Legislative, Sectoral and Organisational levels. It also shows that with time the South African Black Economic Empowerment intervention environment has moved from the Legislative/Policy environment, to the building and supporting of property organisations.

*Figure 2: BEE Institutional Hierarchy and The Property Sector*



Although the initial BEE interventions occurred at the legislative level, by 2000 there was growing evidence that BEE legislation attempted to redress property ownership was not having the desired effect. The view was that the required results would only be achieved through interventions at the sectoral level of the institutional hierarchy. This resulted in the negotiation of sectoral transformation charters. More recently, procurement policies have attempt support new organizations in the sector.

### **3. THE HISTORICAL BACKGROUND OF BLACK ECONOMIC EMPOWERMENT**

South Africa's policy of racial spatial segregation can historically be retraced to the 1913 Land Act which divided the country on racial lines. This was followed by the Groups Area Act in 1952 which furthered legislated where blacks could and could not own properties.

The apartheid system also promoted a type of - *volkskapitalism* , from the mid 1950s – leading to the promotion of a white property owning class. In the mining sector, Afrikaans controlled only 1 percent of the sector in 1949. By 1960 the figure had moved to 22 percent. The apartheid state therefore, used the legislative environment to foster a particular economic structure.

By the late the 1980's economic sanctions and a changing political environment reduced the legitimacy of the institutional framework which in turn resulted in a "Break" in the institutional path. In 1994 the first democratic elections created an opportunity for the South African economy and property market to shift the institutional framework in a new direction.

Since 1994, South Africa has embarked on a number of programmes aimed at empowering groups of individuals who were negatively affected by the previous system of apartheid – such interactions are better known as BEE or Black Economic Empowerment interventions. The policy was largely based on the premise that the future democratic process of the country would be compromised if some emphasis was not placed on redressing the inequalities of the past. The BEE policy was based on broader policy documents such as the Reconstruction Development Programme (RDP), and the GEAR – Growth Employment and Redistribution (GEAR – 1996) policy. In 1998 the transformation policy was strengthened with more targeted interventions which included the Employment Equity Act (1998), followed by the BBEE act (2003) (Broad Based Black Economic Empowerment).

As suggested by Ponte et al, (2007), South Africa's Black Economic Empowerment policy can be divided into three phases;

#### **3.1 Phase 1 from RDP To BEE Commission**

In the early period the focus was on the RDP programme and the GEAR policy. There was a general view that government intervention should not harm business practices. In this initial phase government lacked a coherent BEE policy. By 2001 government initiated the BEE commission. The final commission report released in July 2001 made clear that the state had to play a more active role in economic transformation, and that policy had to develop a greater understanding of the processes associated with it. A suggestion was that the BEE process should be codified in a manner that sectors and organisations could benchmark their BEE status. By 2001 there was a growing understanding that institutional "lock in" was substantial and that this could only be altered through agreed codes negotiated at the sectoral level of the institutional hierarchy.

#### **3.2 Phase 2 from the Early Industry Charters to Broad Based BEE and Codes (2000-06)**

The shift towards sectoral institutional interventions was accelerated through the negotiation of sectoral transformation charters. In 2000 the Petroleum and Liquid Fuels (P&LF) sector adopted a transformation charter calling for a 25% transfer of equity to black investors. This was followed by the mining charter which called for 26% equity transfer. The mining charter also identified seven pillars of broad based black economic Empowerment - namely equity /

ownership. Human resource, development, employment equity, beneficiation, housing, affirmative procurement, and community development. The Mining charter also accompanied a 'scorecard' listing five and ten year targets for the industry.

The later charters were published in the wake of the release of the Department of Trade and Industry (DTI) strategy document on BEE in march 2003 ((DTI, 2003) , the passing of the 2003 BB-BEE act , and the Department of Trade and Industry code of good practice (DTI 2005). To a degree, the BBEE act provided the legislative environment that pushed change at the sectoral institutional level. The DTI agreed code of good practice also started to play a role in promoting new organizations through the creation of a chain of compliance. The emphasis moving towards procurement, training and the promotion of black owned property companies in the sector.

The DTI code of good practice promotes the transformation of the industry through the following objectives;

1. Direct empowerment and management. The extent to which historically disadvantaged South African own shares or have access to economic benefits, dividends payments, and the proportion of historically disadvantaged South Africans that have access to positions in senior levels of management.
2. Human resource development and employment equity enterprises are required to comply with employment equity and skills development legislation to bring about improved human resource development and an equitable representation of HDSA at all levels.
3. Indirect Empowerment. The creation and nurturing of new enterprises by HDSAs with particular emphasis on preferential procurement and enterprise development.
4. Miscellaneous sector –specific issues; in order to allow sectors and enterprises to tailor the score card to their needs.

In conclusion, South Africa's black Economic Empowerment policy has attempted to alter an institutional dependency path. Although the initial interventions occurred at a policy level, it has become that interventions at this level would not be effective in addressing the institutional "lock-in" that existed. From a policy perspective this has resulted in policy instruments that have focused increasingly on the sectoral and organizational institutional hierarchical levels.

#### **4. BEE AND PROPERTY TRANSFORMATION CHARTER**

Although the emphasis of land reform and redistribution has always received high priority by the ANC and the SA government since 1994, the transformation of the built environment and the property market in particular accelerated after 2003.

The catalyst that encouraged discussions around the property charter was primarily the Broad Based Black Economic Empowerment Act (2003). The Board Based Economic Empowerment Act (2003) emphasized the need to promote the achievement of the constitutional right to equality, increase broad based and effective participation of black people in the economy and promote a higher growth rate, increased employment and more equitable income distribution; it also focused on establishing a national policy on broad based Black Economic Empowerment so as to promote the economic unity of the nation, protect the common market, and promote equal opportunity and equal access to government services,

The initial discussions in the property sector encompassed a number of interest groups including the South African Property Owners Association (SAPOA), The Estate Agencies Board (EAAB), The South African Institute of Black Property Practitioners (SAIBBP), The Women's Property Network (WPN) and the National Department of public Works. The Property Transformation Charter was gazetted by government on 4 October 2007.

The agreement underlines some of the challenges facing the property sector and emphasizes the following;

- That due to apartheid legislation , blacks have generally been denied access to the property market;
- Despite legislative interventions , the transformation of the sector has generally been slow;
- The South African property sector is dominated by certain large enterprises;
- Employment in the property sector continues to be underrepresented by blacks and females;
- The investment in skills is inadequate;
- Preferential procurement has been implemented in sufficiently;
- Enterprise development;
- Lack of investment in under-resourced areas;
- A view that administrative and other procedures are cumbersome.

The charter largely responds to section 12 of the BBBEE Act which encourages sectors to develop Transformation Charters. The charter applies to the South African property sector, and in particular to all enterprises engaged in property ownerships or the provision of property services, also includes practitioners and enterprises involved in property development. The property transformation charter encapsulates two critical components. These are the Charter council and the sector agreed scorecard.

- To consider the executive structure with adequate capacity;
- To oversee and monitor the implementation of the charter;
- To receive and approve enterprise annual BBEE reports;
- To issue guidance notes on the interpretation and application of the charter;
- To prepare an annual report on progress in implementing the charter; and
- To liaise with and report to the BEE Advisory Council on transformation of the sector.

The scorecard provides the targets that the sector wishes to achieve over a five year period. They are summarized in Tab 1.

*Table 1: Property Sector Score Card*

<b>1. Employment Equity (Target)</b>	<b>5 Year Target</b>
Black People in senior Management	30%
Black Women in senior Management	15%
Black people in Middle Management	37.5%
Black Women in Middle Management	20%
Black people in Junior Management	40%
Black women in Junior Management	20%

<b>2. Skills Development</b>	
% of payroll per annum on skills development	1.5%
% of staff learnerships for black people	2.5%
% of staff in mentorships for black people	2.5%
Compliance with the skills Development Act No. 97 of 1998	
<b>3. Procurement</b>	
Eligible procurement spend on BBEE	70%
Eligible procurement spend on property services enterprises with a BBEE status level one to level four	40%
<b>4. Enterprise Development</b>	
% of net profit before tax on monetary enterprise development	3%
% of profit before taxation on non –monetary enterprise development	2%
% disposal to level one to level four BBEE enterprises over a five year period	35%
<b>5. % Economic Interests held by black people and 25% plus one vote participation by black people in voting rights</b>	
economic interests held by black women and participation by black women in voting rights	10%
participation in ownership by broad based ownership schemes	2.5%
<b>6. Control</b>	
black people at board level	40%
of black women at board level	20%
black people at top management level	40%
<b>7. Development</b>	
Development investment in under –resourced areas as a % of total annual investments.	10%
<b>8. Corporate Social Responsibility</b>	
Spending on:	
- Education	
- Environment	
- Arts and Culture	
- Health care ( HIV and AIDS awareness)	
- Sport	
- Job Creation	
	1% of net profit to be spent on CSI.
<b>9. Gender Transformation</b>	
- Devise appropriate Programmes	
- Target skills development	

## 5. CONCLUSION

The Property Transformation Charter therefore intervenes in the property market by promoting black property ownership, skills development, procurement and enterprise development, gender transformation, and the development areas that have been neglected in the past.

Although legislation played an important role in initiating discussions around the Property Transformation Charter, the scorecard was negotiated within the property sector and thus may largely be seen as an intervention that has occurred directly in the sectoral and organizational hierarchical spheres of the institutional environment.

But, the progress in transforming the transformation of the industry continues to be slow and there are increasing pressures to initiate certain new initiatives accelerate the process.

Moreover, in recent months the Department of Public Works has become more circumspect in determining who it wishes to interact with. At present the department will only undertake long term leases with companies that have at least a 40% black property ownership. Government is



also actively promoting a procurement policy that offers, facility management, property management and development activities to black owned companies. Thus, government procurement policy is increasingly being used as a tool to directly promote organisations that have the correct Black Economic Empowerment credentials in the in the property sector.

In May 2009 an initiative saw the creation of a Property Transformation Coalition (a coalition of various black organisations), comprising black owned property interest. The main aim of this coalition being to “accelerate the transformation process”. Added to this initiative is the proposed creation of the South African National Property Empowerment Company (SANPEC).

The company is expected to facilitate the acquisition of properties by black investors, support the activities of the of the property transformation charter, provide a broad accelerated and promote the holistic transformation of the South African property market.

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