Deutsche Securities
Member of the Deutsche Bank Group

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Retail Sector

No evidence to link share ratings with good corporate citizenship… yet

We assess in this report the key social and environmental issues durable goods and apparel retailers should be focusing on and whether their compliance (or lack of it) with "good corporate citizenship" has impacted share price performance. In doing so, we look at King 11, the recent Mining and Financial sector charters and the summit on sustainable development.

- Following the political transformation that has taken place in South Africa (SA), it is clear that economic transformation is lagging behind and government is determined to redress this. We believe this has elevated the need for SA corporates to embrace social responsibility in a manner that exceeds that of other countries. The prevalence of HIV/AIDS, and the challenges it brings adds further impetus to this need.
- Our analysis shows that durable goods and apparel retailers have over the past five years shown significant improvement in implementing and reporting on matters of transformation, social responsibility, healthcare, environmental issues and corporate governance.
- On a scale from one to 10, our scorecard shows that since 1998, the retailers have improved from 2.2 to 5.3. They have become better corporate citizens, but substantial further improvement is still required. Top scorer is Edcon (7.2), followed by Woolworths (6.6) and Truworths (6.0). Lagging are Foschini (4.5) and Mr Price (2.0), while JD Group and Ellerine are in the midrange.
- Unfortunately, for the five-year period under review, we were unable to conclude that there is a link between the shares' ratings and the level of compliance with good corporate citizenship.
- Over the longer term, we believe that share ratings, and hence share price performance, will be strongly influenced by good corporate citizenship. In fact, we believe the survival of companies in SA is inextricably linked to their ability to meet the social changes demanded by SA's transformation process.
- Our view is supported by a recent survey by CSR Europe, Deloitte and Euronext, which reveals that 52% of fund managers/analysts expect social and environmental performance to become a significant aspect of mainstream investing within the next three years. This survey included 388 fund managers and analysts in nine European countries.

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Why this report?

Invitation from the Asset Management Working Group

This research was produced on the basis of an invitation from the Asset Management Working Group (AMWG) of the United Nations Environment Programme Finance Initiative (UNEP FI) to:

- Identify the specific environmental and social issues likely to be material for company competitiveness and reputation in the durable good and apparel sectors.
- Identify and, as far as possible, quantify their potential impact on stock prices.

The AMWG includes the following 12 firms with combined assets under management of USD1.6 trillion:

Table 1: Asset management firms supporting the AMWG

Acuity Investment Management	Canada
BNP Paribas Asset Management	France
Calvert Group Ltd.	USA
Citigroup Asset Management	USA
Groupama Asset Management	France
Morley Fund Management	United Kingdom
Nikko Asset Management	Japan
Old Mutual Asset Management	South Africa
San Paolo IMI S.P.A. Asset Management	Italy
Storebrand Investments	Norway
ABN AMRO Bank N.V. Asset Management	Brazil
HSBC Asset Management Europe SA	Europe

Source: Asset Management Working Group

For more information visit: www.unepfi.net
Or contact Jacob Malthouse at: jacob.malthouse@unep.ch

Introduction

Objective is twofold

The objective of this report is twofold:

1. To identify environmental and social issues that are likely to shape the competitiveness of companies in the consumer durable and apparel sector.

2. To determine whether the level of disclosure and the management of the issues mentioned in 1. above impact share ratings.

Within SA we identified three formal developments likely to shape sustainability reporting and modify the manner in which business is conducted.

The first emanates from the **Global Reporting Initiative (GRI)** and the other two are SA specific developments – the **King Commission on Corporate Governance** and the various industry charters established by Government which are aimed at **Black Economic Empowerment (BEE)**. To highlight the importance of the latter issue, we have included the following two quotes.

"…the sole business of this government is transformation"

Nelson Mandela

"Economic growth, development and black economic empowerment are complimentary and related processes"

Thabo Mbeki

In addition to the latter, two other forces are also playing a role. The high prevalence of HIV/AIDs in SA and the increased focus of institutional investors on social and environmental issues.

The 5.1m people living with HIV/AIDS in SA is higher than in any other country in the world

According to UNaids, the 5.1m (c.11% of the population) people living with HIV/AIDS in SA is higher than in any other country in the world, indicating that SA companies have more to lose than their global peers by not recognising the problem.

Despite this, a recent Sanlam survey showed that only 78% of companies thought they were exposed to HIV/AIDS. The survey also found out that 50% of companies had no official AIDS policy, 68% did not offer voluntary testing or counselling, while 73% had not implemented healthcare provisions for AIDS. In our view, companies have no option but to develop comprehensive plans to address the social issues around HIV/AIDS.

Our sense is that far more focus is paid towards corporate governance

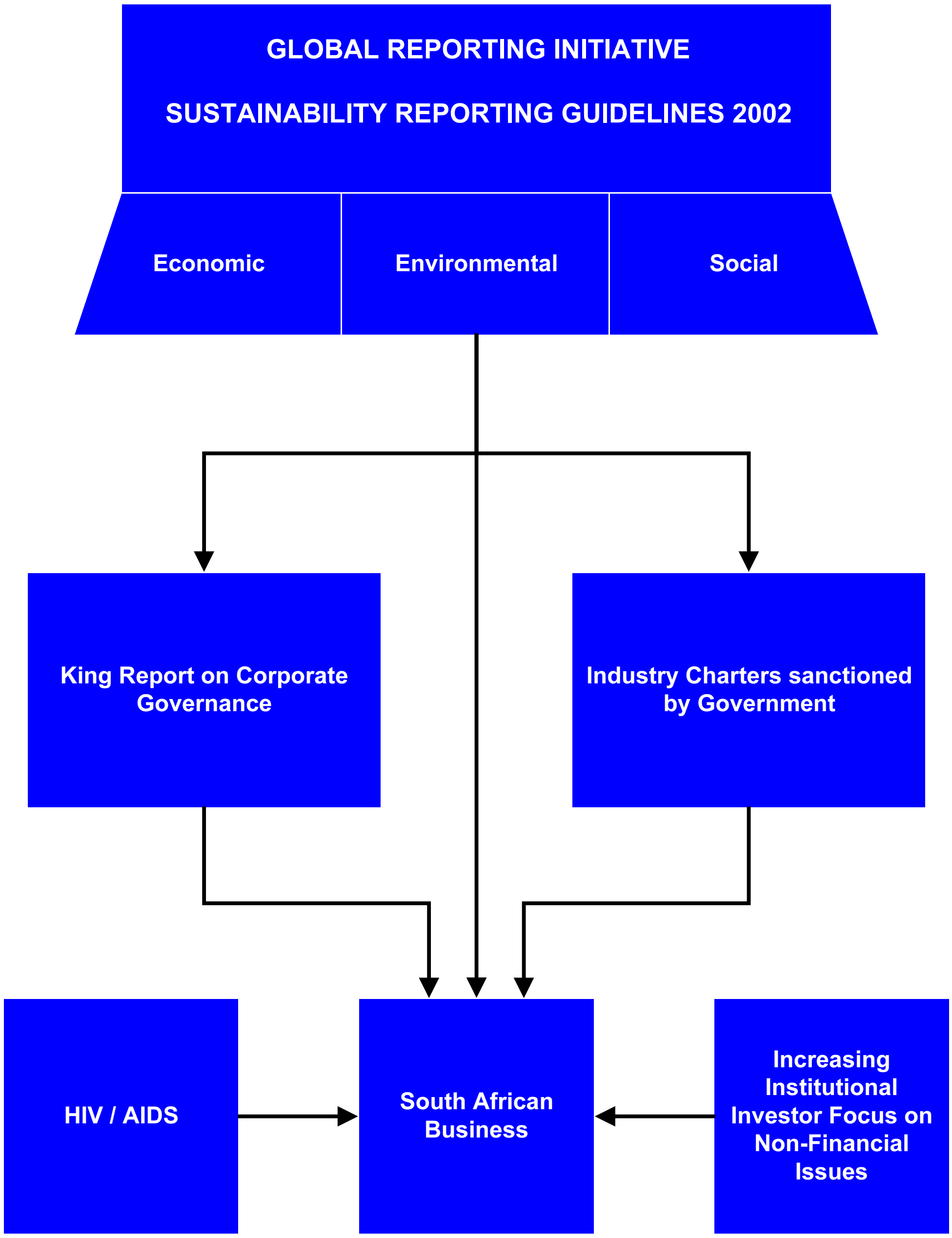
As far as SA institutional investors are concerned, our sense is that far more focus is paid towards corporate governance than to social and environmental issues. But we believe this will change. This is likely to driven by the recently established international trend to focus on these issues and pressure from government to support corporates embracing the transformation process.

Overall, we found that, over the past five years, most retailers have significantly improved their reporting of and compliance with corporate social responsibility issues. But, we were not able to observe a link between their ratings and level of compliance.

Framework

Figure 1 below shows the components of the framework likely to drive the development of corporate social responsibility.

Figure 1: **Framework showing drivers of corporate social responsibility**



Source: Deutsche Securities estimates

Global reporting initiative

The GRI Summit on Sustainable Development confirmed the structure for sustainable reporting

The Global Reporting Initiatives' (GRI's) Summit on Sustainable Development, held in SA in August 2002, confirmed the structure for sustainable reporting. The GRI is a long-term, multi stakeholder, international process whose mission is to develop and disseminate globally applicable *Sustainability Reporting Guidelines.*

These guidelines are for **voluntary** use by organisations and include three broad reporting categories - economic, environmental and social (the so-called triple bottom line) aspects of an organisations activities. The social category is further broken down into labour practices, human rights, society and product responsibility.

Greater accountability driven by recent corporate scandals?

One could argue that greater accountability has been driven by recent corporate scandals and the increasing focus that governments worldwide have adopted towards good corporate citizenship.

Among others, the GRI also includes the following reasons for the need to improve sustainability reporting: increasing globalisation, the global role of emerging markets, and financial markets' interest in sustainability reporting.

It is all good and well conceptually, but how does one ensure that organisations buy into the process. Implementing strategies to deliver sustainable growth does not come at zero economic cost. So what is the carrot for management to involve themselves - or alternatively, what is the stick?

In a recent panel interview with the CFA magazine, the question of how corporate governance (one aspect of sustainability reporting) should be progressed was asked. Warren Buffet, one of the panellists, responded:

> *"The only real way to get improvement in corporate governance is to have big investors demand it. A relatively small number of institutional investors who decided they would withhold their votes when they saw excessive compensation or poor performance, I think, could have a real impact on corporate governance, but I don't think legislation will."*

No choice?

Within the SA context we believe companies do not have a choice. In fact, their existence is dependent on embracing sustainable development.

SA specific developments

Driving sustainability reporting in SA are the King Report on Corporate Governance and the Mining and Financial Sector Charters designed by government to bring about economic transformation. Furthermore, initiatives have also been launched from certain quarters within the private sector, such as the Oppenheimer's Brenthurst Initiative.

Particularly important are the social issues

In our view, the transformation process in SA has elevated the need for compliance with sustainable development strategies beyond that of most other countries. **Particularly important are the social issues inextricably linked to the political and economic transformation processes.**

King report on Corporate Governance (King II)

Second King report released in March 2002

The second King report (King II), released in March 2002, is non-legislated code applicable to companies listed on the JSE Securities Exchange of SA, Financial Services sector companies and bodies that perform public functions.

All the above-mentioned organisations are encouraged to comply with the code. The code embodies seven characteristics of good corporate governance. One of those is Social Responsibility, which is defined as:

> *"A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues."*

Under the heading of Sustainability Reporting, King II identifies certain matters requiring specific mention. These include:

- A description of practices reflecting a commitment to reducing workplace accidents
- Strategies and plans to address and manage the potential impact of HIV/AIDS
- Reporting on environmental corporate governance including best practices that minimise environmental damage
- Policies defining social investment spending and in particular procurement and investment strategies aimed at enhancing BEE.
- Disclosure of human capital development, including progress in meeting employment equity targets and training and development initiatives. Separate disclosure of the progress achieved by women is also called for.

Virtually all companies in SA endorse King II and quote compliance, where possible

Through their annual financial statements, virtually all companies in SA endorse King II and quote compliance, where possible. In the past two years the retailers have substantially improved the reporting of non-financial issues and there is no doubt that King II has driven this. Nevertheless, as is evident from both our survey results incorporated in this report and that of KPMG's (also referred to in this report), much work is still to be done.

Government established charters

Government has already issued two industry charters aimed at driving BEE and transformation within SA

Government has already issued two industry charters aimed at driving BEE and transformation within SA. It is well accepted that these charters have come about because government is not happy with the pace of transformation. Ten years after SA's political transformation, economic and social transformation are still lagging and government is intent on redressing this.

The higher the score achieved by a company the more likely it will succeed in sustaining itself

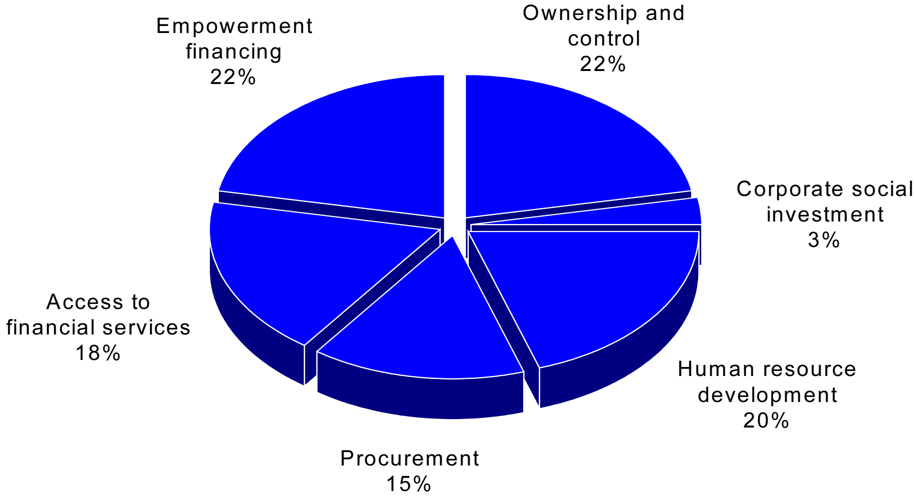
To elaborate, below we have extracted from the Financial Sector Charter the key issues management has been called to address in relation to the advancement of previously disadvantaged individuals:

- Ownership and control of companies
- Human resource development
- Procurement
- Corporate social investment
- Access to financial services *(specific to the financial organisations)*
- Empowerment financing *(specific to the financial organisations)*

For information purposes, *Figure 2* below shows the weighting that the Financial Service Charter attaches to the respective components. Ultimately, the higher the score achieved by a company the more likely it will succeed in gaining government and private sector business, and hence sustaining itself. Below, we expand on under "So why comply with a charter?".

A detailed discussion on how each component is scored is beyond the scope of this report, but in *Appendix A* we have provided a summarised version of certain of the scoring criteria, which could be a proxy for other sectors.

Figure 2: Category weighting for the Financial Services Charter



Source: Financial Service Charter

Is compliance voluntary?

The Financial Sector Charter is a voluntary charter

To date, only the Mining Charter embodies legislation that links mining rights with successful compliance with the charter. The Financial Sector Charter is a voluntary charter where no mention is made that banking licences are contingent on compliance with the charter.

Nevertheless, in essence we believe government is "legislating" an outcome. If the required outcome (transformation) is not achieved, mechanisms will be put in place to achieve it.

In our view, the vast majority of companies agree with the principle of transformation – but, as mentioned, adherence to the principle has not resulted in the required progress.

So why comply with a charter?

We believe the primary incentive for companies to sign up for a charter and comply is around **procurement**. Government's procurement policies in particular will favour companies that score well according to their charter. If a charter does not apply to a particular industry (and hence company), the decision defaults to a "black-influenced company".

The bottom line is that if you do not comply you are unlikely to secure government business

The bottom line is that if you do not comply you are unlikely to secure government business. **But there is another key reason to comply.** Companies will be able to enhance their procurement scores (and hence their overall BEE score) by procuring goods/services from other companies that themselves have high charter scores (or alternatively a significantly "black-influenced company").

This effectively means there is a virtuous circle driving "charter compliant" procurement throughout the economy. Companies seeking to enhance their BEE charter scores will seek out other high-scoring companies because this will boost their score and so the process continues. A poor-scoring company will soon find itself in the cold, which will probably threaten its existence.

What about the retail sector?

The leverage to drive transformation is obviously greatest in sectors with the greatest influence on the economy

Unsurprisingly, these first two charters cover the mining (issued late 2002) and financial sectors (issued October 2003). Together these sectors account for c.55% of the JSE's market cap. The leverage to drive transformation is obviously greatest in sectors with the greatest influence on the economy and where regulation is most entrenched. To our knowledge, no other charters are imminent but there is little doubt that more will follow.

In comparison with the mining and financial sectors, the retail sector only comprises 4% of the JSE's market cap. This is not to say that it will not attract government's attention. Ignoring market cap, total retail sector sales amount to c.R230bn, or 20% of SA's GDP.

Healthcare and the management of HIV/AIDS programmes to receive priority

Given the vast number of people employed in the sector, in our view the transformation will be focused more on employment equity, staff training and procurement policies. We also believe that healthcare and the management of HIV/AIDS programmes will receive priority.

How closely is government watching proceedings?

When Sasol recently filed documentation required by the US's Securities and Exchange Commission related to its secondary listing on the New York Stock Exchange (NYSE), it identified BEE as a risk to its business:

> *"there could be risks to shareholders that value may not be achieved in the case of black economic empowerment transactions."*
>
> and
>
> *"we cannot assure you that this participation will take place through transactions occurring at fair market terms and that this*

will not have a material adverse effect on our business, operating results, cash flows and financial condition".

In a five-page criticism, President Thabo Mbeki said that Sasol, and other companies that shared its mindset, would:

> *"have to outgrow an outdated mindset that has become entrenched as their own particular and peculiar corporate culture."*
>
> *"In the end, they (Sasol and others) will have to understand that black economic empowerment is in their interest, in like manner as the white population in our country, in general, is beginning to understand that democracy and non-racism guarantee them life, liberty and happiness," Mbeki* said.

From the above, it is clear that government is paying close attention to the manner in which companies subscribe to the principles embedded in the charters.

SA business initiatives

The Brenthurst Initiative

Active debate has taken place regarding the Oppenheimer family's recent proposal called the Brenthurst Initiative

Active debate has taken place regarding the Oppenheimer family's recent proposal called the Brenthurst Initiative. This proposal calls for a plan as to how government initiatives to accelerate BEE could, instead of inhibiting investment, become a tool to strengthen investor confidence – and so expand the SA economy for the benefit of all its people.

In fact in his Forward to the Brenthurst Initiative, President Thabo Mbeki states:

> *"One of the greatest challenges that faces our nation is to ensure that the economic fruits of our political transformation can be shared by everyone in society. How best to achieve this is an issue we all need to address."*

The Brenthurst Initiative envisaged rewarding companies that met transformation targets by way of tax breaks. Government seems to have quietly turned down this proposal. In the national treasury's medium-term budget policy statement, published in November, the following was stated:

> *"Tax incentives based on multifactor scorecard criteria, advocated by some commentators, are particularly hard to assess." It would require tax officials to make "discretionary judgments" or decisions based on "circumstantial considerations", which they are not qualified to do.*

Survey methodology

Constituents: Our survey incorporates five apparel retailers (Edcon, Foschini, Mr Price, Truworths and Woolworths) and two furniture retailers (Ellerine and JD Group).

Source of information: The source document for our analysis has been companies' annual financial statements (AFS). Our view is that AFS show the comprehensive financial performance of a company, and provide the best and most accountable medium (unless a separate sustainability report is published) for the disclosure of non-financial information.

It follows that a company lacking in its disclosure may be prejudiced by this evaluation technique

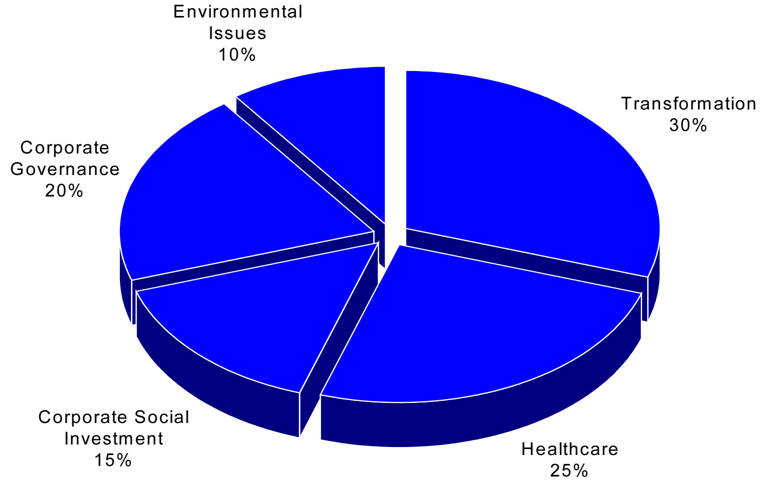
It follows that a company lacking in its disclosure may be prejudiced by this evaluation technique – for instance, if a company has a comprehensive environmental programme but fails to disclose it, we apply a score of nil. Thus, investors are only able to judge management on what has been clearly communicated to investors.

Period of review: We have reviewed the AFS for 1998 and 2003. But, as JD Group's 2003 AFS had not been published at the time of writing, we used the 2002 report, which may have disadvantaged its score.

We evaluated five core categories

Scoring mechanism: We evaluated five core categories that we believe embody the requirements for a sustainable business within the context of SA's future. These categories, which have been scored out of 10, are shown in *Figure 3* together with the weightings that we applied. Further, we discuss below how we evaluate each category (the scoring process is obviously a subjective one).

Figure 3: **Deutsche Bank's sustainable business categories and weightings**



Source: Deutsche Securities estimates

In our view, addressing social issues in SA requires a multifaceted approach

Elaborating on the categories chosen: In our view, addressing social issues in SA requires a multifaceted approach. To put social development into one box is too simplistic - the issues are inextricably linked to the whole transformation process taking place in the country. Accordingly, we have split and interwoven the social issues into three of the above-mentioned categories - transformation, healthcare and corporate social investment.

Environmental issues are clearly far more relevant for companies in the manufacturing sectors. Nevertheless, some important environmental issues still need to be considered - but the strong focus on social development is likely to draw attention away from the latter.

We have also addressed corporate governance in our overall analysis

We have also addressed corporate governance in our overall analysis. When investors assess financial information in an annual report, the corporate governance environment either adds to or takes away from the credibility of the results. We believe a similar through process applies to non-financial information.

Relative rather than absolute scores matter: Later in this report, we show the absolute social/environmental scores for the companies analysed *(see Figure 6).* Our scoring process sought to rank the relative performance of the companies, but an absolute score of say 60% does not necessarily "put a peg in the ground" as to a company's social/environmental status.

Key considerations for each category

Below we discuss in broad terms what we consider important issues within each category. In general, we believe that most industrial companies in SA will be exposed to similar social and environmental demands - apart from the obvious environmental issues peculiar to specific types of business.

One glaring social issue not addressed is transparency and fairness in the granting of credit products

One glaring corporate social issue not addressed by the durable goods/apparel retailers is transparency and fairness in the granting of credit products. In our view, this issue will gain increasing attention from government and any retailer that is seen to be less than transparent in its credit charges could be at risk.

In brief, our key considerations include:

Transformation (30% weighting)

- The amount of equity in the company held by historically disadvantaged individual (HDIs) – our scorecard has used a broad target of 25% of a company's equity as the benchmark. Of the latter amount, 10% should be held directly by empowerment partners. No companies met this criteria.
- The number of directors that are HDIs – we consider a minimum of 25% of board representation as the target benchmark.
- Progress in the area of employment equity (EE) - this includes disclosure of the number of black staff and woman in executive, senior and middle management positions. Targets and time-frames should be clear and quantified.
- Staff training programmes should be disclosed and, where possible, progress quantified.
- Procurement policies aimed specifically at supporting black business should be disclosed.

Healthcare (incorporating labour practices & safety) (20%)

- Flexible and comprehensive healthcare plan.
- A comprehensive HIV/AIDS strategy.
- HIV/AIDS counselling and education.
- The provision of antiretrovirals drugs to staff.
- Comprehensive reporting of HIV/AIDS-related issues, including prevalence levels among staff.
- The promotion of a safe working environment, including the provision of on-site medical assistance and the reporting of workplace accidents.

- Promotion of good employee and union relations, disclosure of minimum wage settlements and consideration of supplier labour practices.

Corporate social investment (15%)

- A well balanced social investment strategy that is preferably quantified.
- Ongoing and well developed community relationships.
- Job creation initiatives within the community.
- Bursary/scholarship schemes for both employees and the community.
- Transparent consumer credit policies.

Environment issues (10%)

- Comprehensive environmental plans that address issues such as recycling and pollution control.
- Auditing the compliance of all environmental plans.
- Ensuring that suppliers conform with environmental standards.
- Compliance with legislation aimed at reducing litter.

Corporate governance (25%)

- Shareholder treatment.
- Board independence.
- Information disclosure.
- Adherence to best business practice.
- Appropriate board incentivisation and performance management.

What have other surveys revealed?

As a precursor to discussing the results of the durable and apparel retailers, we show below extracts from KPMG's 2002 *"Survey on Sustainability Reporting in South Africa".*

This report analysed the state of sustainability reporting in the Top 100 companies in SA. The analysis focused on information disclosed in annual financial reports or separately published corporate social reports – but only four of the top 100 companies produced such separate reports.

KPMG's scorecard encompasses 127 questions across a range of topics

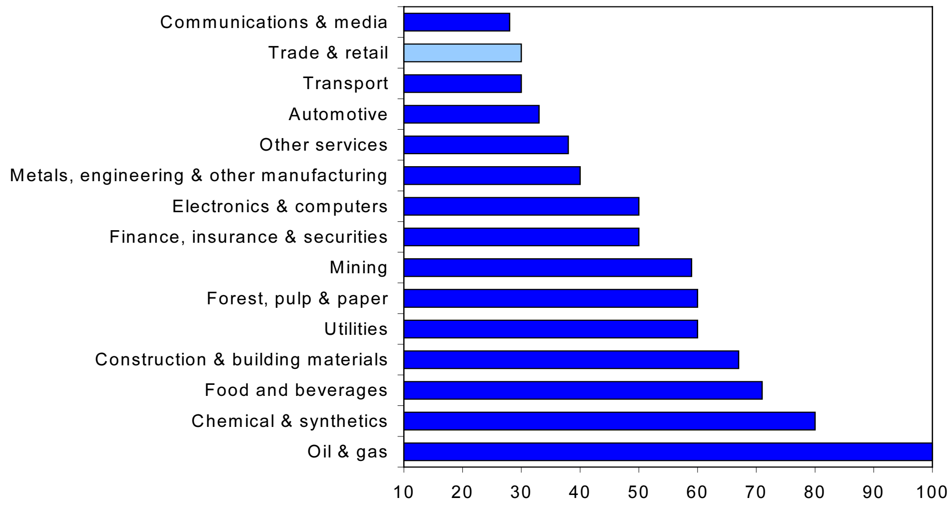
KPMG's scorecard encompasses 127 questions across a range of topics, including: financial management, eco-efficiency, sustainability management, operational performance, competence management, innovations, stakeholder management and product performance. Ultimately scores were summarised under the following five categories:

1. Code of conduct
2. Environmental
3. Social
4. Health and safety
5. Community

We highlight that the "Trade and Retail" sector came second from last and only achieved a score of 30%

Figure 4 shows the overall sector scores. We highlight that the "Trade and Retail" sector came second from last and only achieved a score of 30%, which is well below average. We are surprised at this poor result, but acknowledge that even if subjectivity of determining absolute scores results in an error, the relative sector score (assuming consistency in applying the scorecard across all sectors) is still very poor.

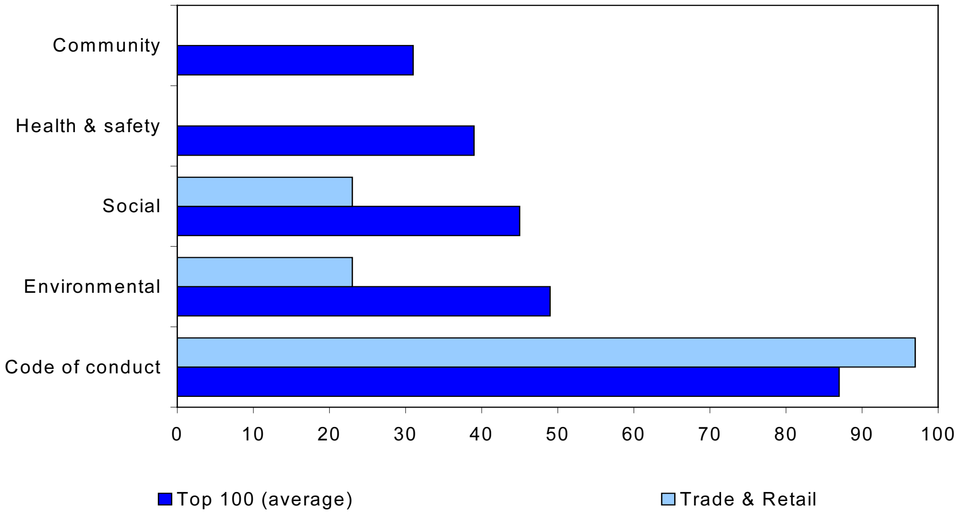
Figure 4: **% disclosure of sustainability issues by the Top 100 companies**



Source: KPMG

In F*igure 5* we show KPMG's category scores for the retail sector and the average of the Top 100 companies. As can be seen, the retail sector achieved no score for community and health and safety, which seems unduly harsh given that our analysis suggests that both these categories are addressed (whether superficially or not) by most of the retailers we reviewed.

Figure 5: % disclosure of sustainability issues by the retailers



Source: KPMG

The KPMG report concludes that for the Top 100 companies, the inclusion of sustainability issues in annual financial reports remains superficial, but that marginal improvement over prior years has been achieved. The report also suggests that the implementation of King II will see a more focused effort to improve sustainability reporting.

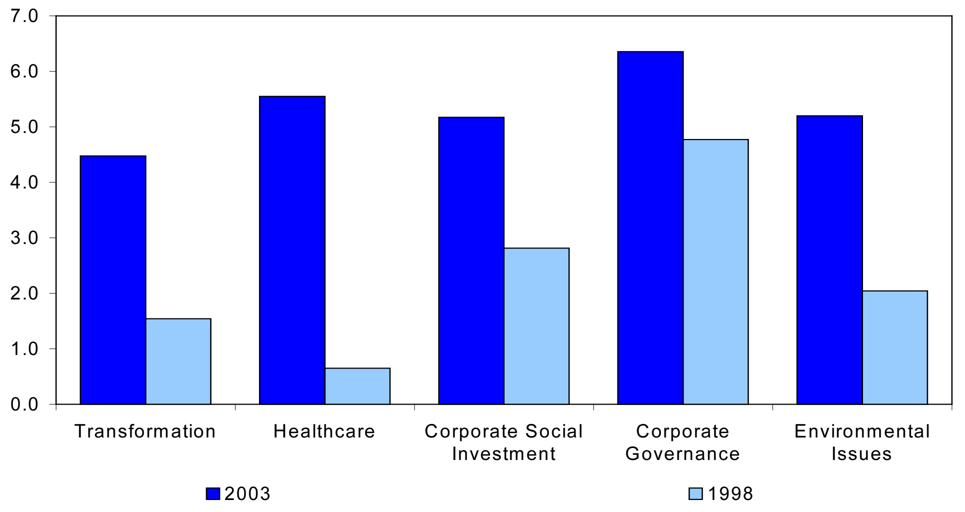
Our survey results

Based on our scorecard detailed above, *Figure 6* shows the results by category across all the companies surveyed. There was a marked improvement between 1998 and 2003. But, we believe the bulk of this improvement has been driven by the scramble to comply with the reporting guidelines as laid down in King II. *(For information purposes in Appendix B we show individual company scores by category).*

Main areas of improvement

Nevertheless, off a low base the main areas of improvement have been in the transformation healthcare and environmental categories – but significant room for improvement remains. As we expected, compliance corporate governance standards ranks the highest - clearly in recent years this issue received global attention and permeated most markets.

Figure 6: Category scores for durable and apparel retailers (out of 10)



Source: Deutsche Securities estimates

Linking share performance to the survey results

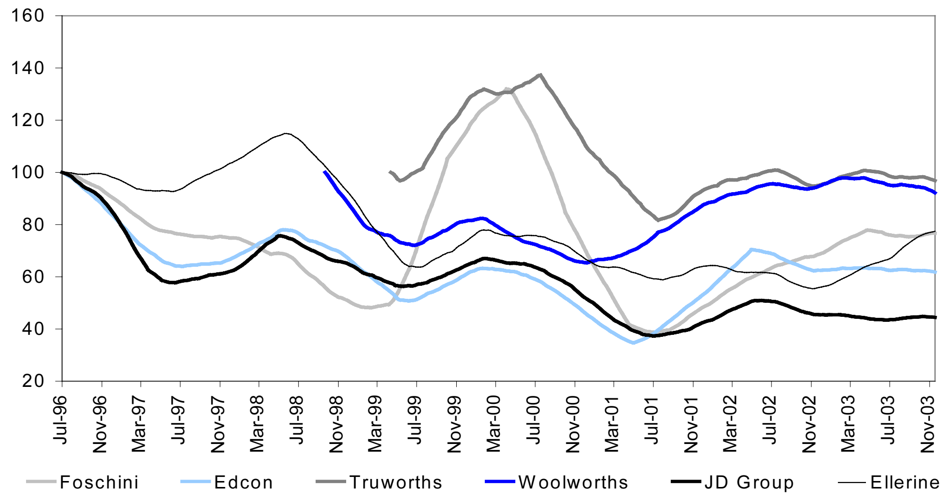
The key question is whether share prices benefited from the marked improvement in scores since 1998. Simplistically, a share price is a function of both earnings growth and the rating investors attach to the stock.

Investors usually attach a higher rating to the one presenting a lower risk profile

The rating of a stock can be determined by calculating the PE ratio or the Price/Book ratio. Assuming two almost identical companies (in terms of earnings etc), investors usually attach a higher rating to the one presenting a lower risk profile.

Clearly, better sustainable development characteristics should lower the risk profile of a stock. In theory, one could reasonably expect an improving score to be reflected by way of a higher rating for a particular stock.

Figure 7: PE ratios relative to the Findi index (based to 100)



Source: I-Net Bridge

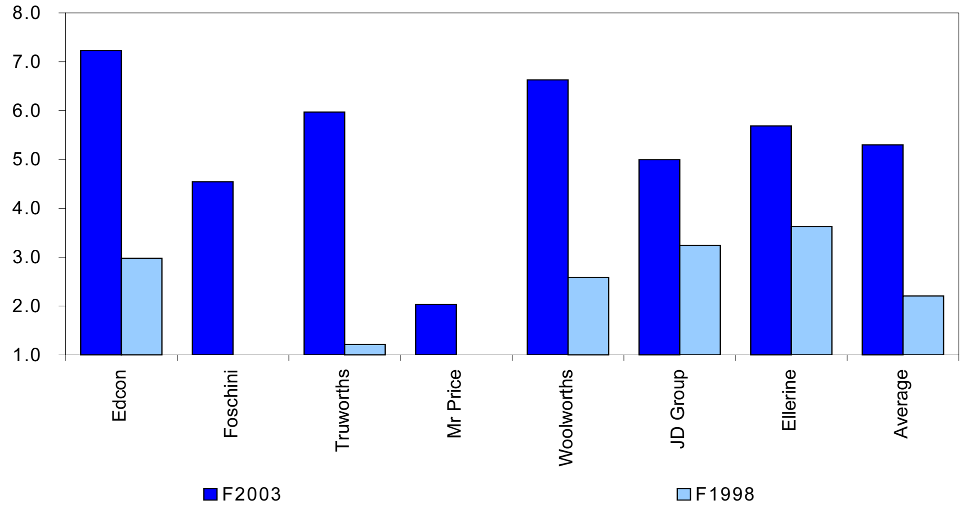
Note: Truworths and Woolworths were listed during the period under review

Clearly, the rating of the latter stocks is a function of a multitude of variables

Figure 7 shows that relative to the JSE Financial and Industrial Index (Findi), the above-mentioned stocks have not re-rated during the past five years despite the significant improvement in their scores. Clearly, the rating of the latter stocks is a function of a multitude of variables – interest rates, the retail landscape, disposable income, corporate governance, etc – at best, it is difficult to attribute changes in rating to any one factor.

Furthermore, who is to say that the average company in the Findi did not also improve its score at the same rate as the durable and apparel retailers. If the latter occurred, it makes sense for the relative ratings to be unchanged.

Figure 8: **Aggregated company scores across all categories**



Source: Company reports; Deutsche Securities estimates

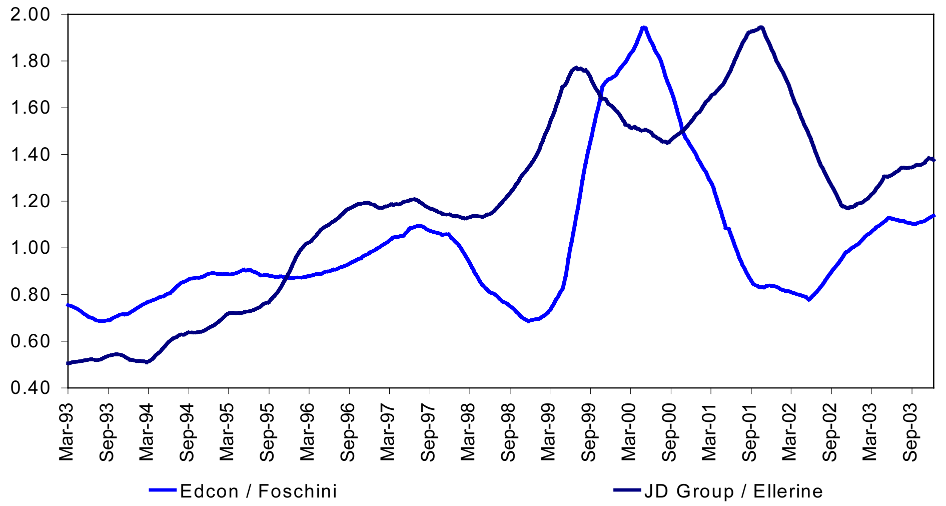
To avoid discarding our theory, we have taken the analysis one step further. In general, the rating of the durable and apparel retail stocks move together. This on its own means that the "noise" and distortions inherent in cross-sector relative evaluations can largely be avoided. The key is to try to understand why companies within the same sector attract different ratings.

We compared the performance of Edcon to Foschini and JD Group to Ellerine

Accordingly, we have compared the performance of Edcon to Foschini and JD Group to Ellerine. We have selected these pairs of companies because they have all been listed for many years, have similar customer bases and, in general, and are exposed to similar trading risks and opportunities.

As in *Figure 8*, not only is Edcon's score well above Foschini's, but the improvement over the past five years has also been better. From *Figure 9* it follows that apart from the anomaly of 2000, when Edcon experienced a big drop in earnings, the rating has remained much unchanged. The market does not appear to be rewarding Edcon for its materially higher score.

Figure 9: **PE relative ratings**

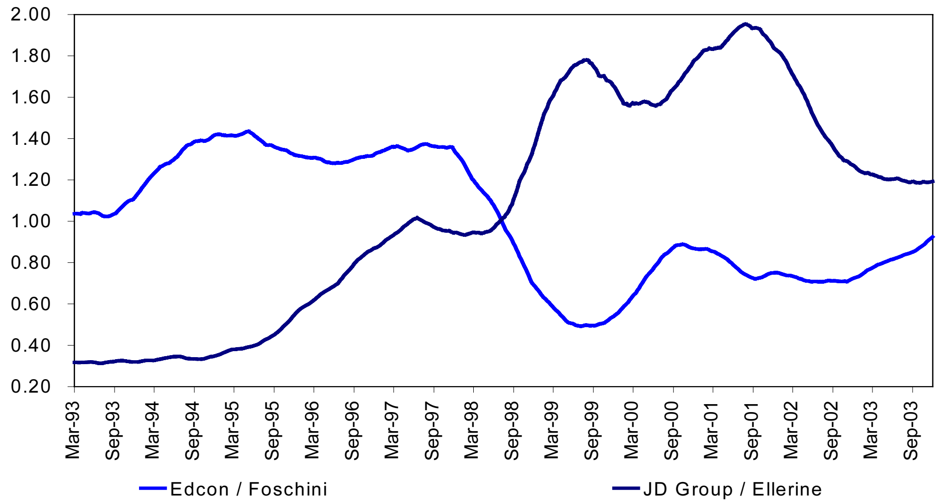


Source: I-Net Bridge; Company reports

The future growth opportunities for JD Group are more attractive than for Ellerine

The analysis of JD Group and Ellerine is more complicated. Ellerine achieves a higher score but this could be biased - as already highlighted, we had to base our scores for JD Group on its FY02 annual report because the FY03 report has not yet been released. In addition, the future growth opportunities for JD Group are more attractive than for Ellerine, and therefore a higher rating is probably deserved.

Figure 10: **Price/Book relative ratings**



Source: I-Net Bridge; Company reports

Given that earnings multiples can be distorted by different accounting policies and practices, we have also analysed the ratings on the basis of Price/Book ratios. Unfortunately, this methodology also shows no clear trend between the underlying scores of the respective companies and their ratings.

Re-rating driven by Edcon's operational improvements

In the case of Edcon and Foschini the Price/Book relative chart suggests a re-rating since 1998, but we believe this has been largely driven by Edcon's operational improvements.

Conclusion

Significant improvement over the past five years

The analysis shows that over the past five years, there has been a significant improvement by most companies in reporting compliance with key sustainable development issues. This improvement is encouraging even though it has probably largely been driven by the need to comply with the requirements of King II.

Unfortunately, the analysis is inconclusive with respect to linking share price performance with compliance. There are no clear trends showing that companies are awarded, through a re-rating, for better than average adherence to the principles of sustainable development.

Linked, in particular, to social changes the transformation process in SA demands

Even in the face of this analysis, over the longer term, our view is that share ratings and hence share price performance will be strongly influenced by the key issues we measured in our scorecard. In fact, our view is that the survival of companies in SA is inextricably linked, in particular, to the social changes the transformation process in SA demands.

Appendix A: Extracts from the Financial Service Charter scorecard

Below, as a proxy for what could be expected in say the retail sector, we highlight certain of the scoring criteria set for the Financial Sector Charter. We excluded two measures specific to the financial sector - the provision of empowerment financing and providing the broader population with access to financial services.

Without going into the detail, we highlight that the Financial Services Charter allocates 100 points among the various empowerment objectives. Specific targets for each category have been set and these will be rolled out in a phased approach up too 2014.

Ownership and control

Ownership

The target for black ownership at a holding company level is **25% by 2010**. Of this, a minimum of **10%** must be satisfied by **direct ownership** (12% of scorecard points), while the balance may be achieved through indirect ownership at group or subsidiary level (just two points available). Weighting of points is clearly heavily in favour of direct ownership, and there are a total of four additional points available if the full target is achieved through direct ownership.

Control

A minimum of **25%** black representation in **executive management** positions by 2008 (two points available). **4%** (part of the 25%) must be black women (one point available).

A minimum of **33%** black representation on the **board of directors** by 2008 (four points available). **11%** (part of the 33%) must be black women (one point available).

Procurement

To procure **50%** from BEE-accredited companies by **2008** and **70%** by **2014**. (15% of points available). "BEE-accredited" means either being recognised as such in terms of a recognised accreditation system or BEE charter scorecard, or alternatively, at least a "black-influenced company" (at least 5% black ownership, provided black people have participation in control).

That a sector charter potentially gives more alternatives to achieving a level of BEE-accreditation than simply direct ownership, leads us to believe that the Financial Sector Charter will create a ripple effect in the market, leading to other sectors following suit.

Human resource development

Employment equity

- A minimum of 40-50% black people in junior management positions by 2008 (4% of scorecard), of which one-third must be women (1% of scorecard).
- A minimum of 30% black people in middle management by 2008 (4% of scorecard), of which one-third must be women (1% of scorecard).
- A minimum of 20-25% black people in senior management positions by 2008 (4% of scorecard), of which one-third must be women (1% of scorecard).

Skills development

1.5% of **total basic payroll** on training of black employees (3% of scorecard).

4.5% of the SA labour force to comprise black matriculants in learnership programmes (2% of scorecard).

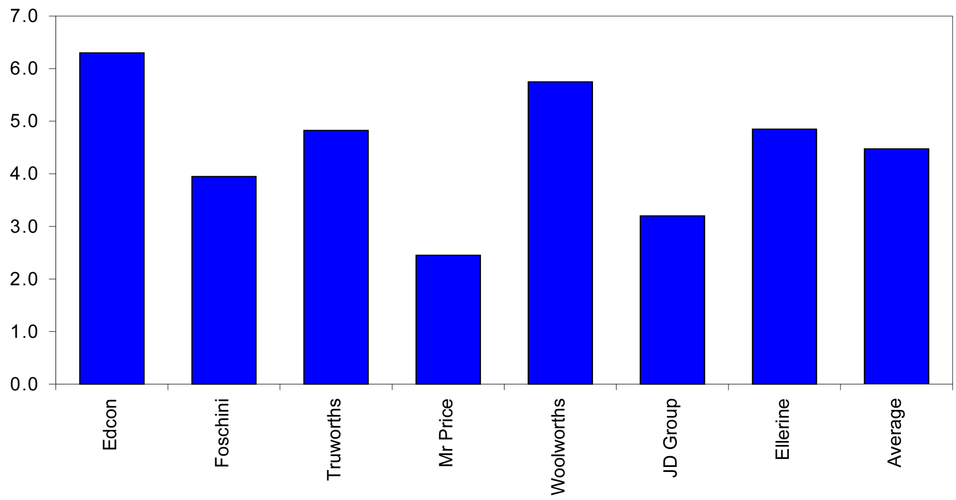
Corporate Social Investment

0.5% of **post-tax operating profits** per annum on corporate and social investment (CSI). (3% of scorecard)

Appendix B: Detailed category scores by company

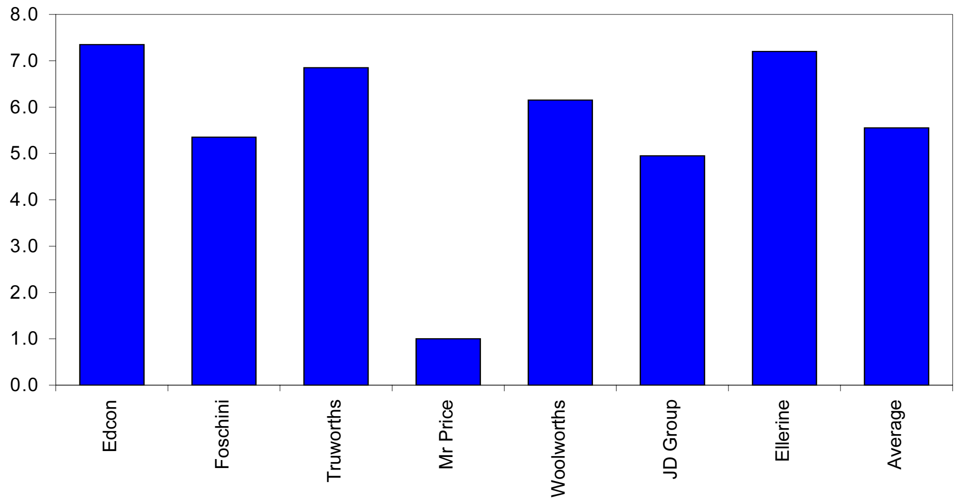
Below we show the individual category scores for each of the companies included in the survey.

Figure B1: **Transformation score for FY03 (out of 10)**



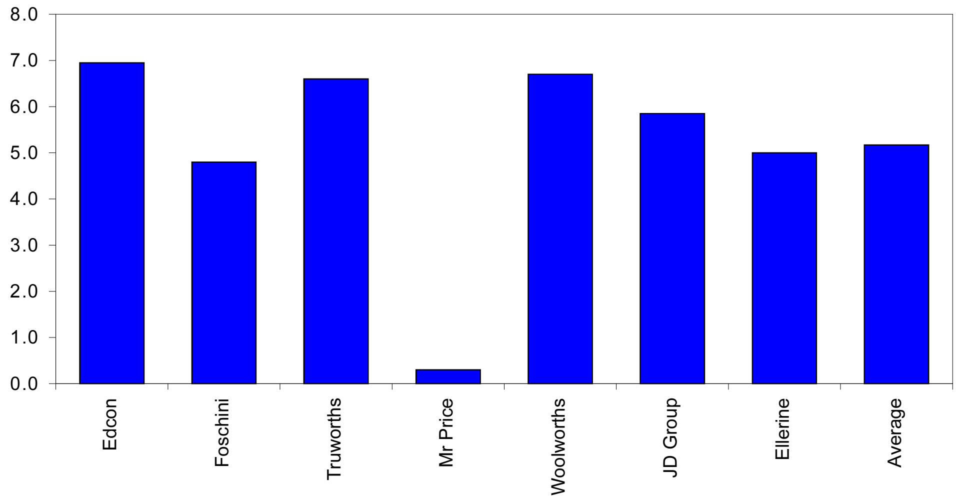
Source: Company annual financial statements, Deutsche Securities estimates

Figure B2: **Healthcare score for FY03 (out of 10)**



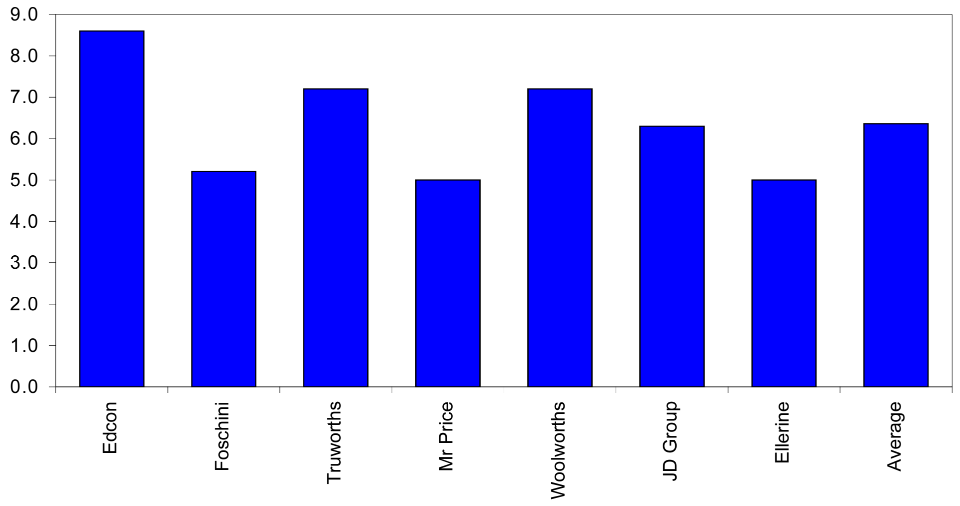
Source: Company annual financial statements, Deutsche Securities estimates

Figure B3: **Corporate social investment score for FY03 (out of 10)**



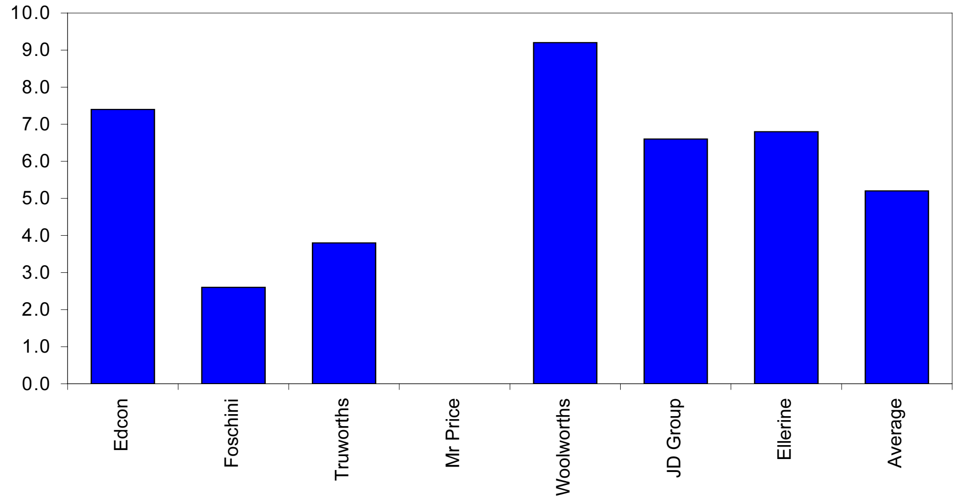
Source: Company annual financial statements, Deutsche Securities estimates

Figure B4: **Corporate governance score for FY03 (out of 10)**



Source: Company annual financial statements, Deutsche Securities estimates

Figure B5: **Environmental issues score for FY03 (out of 10)**



Source: Company annual financial statements, Deutsche Securities estimates

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Craig Sorour / Thathisihlalo Makunga

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