

# ENTERPRISE-WIDE RISK MANAGEMENT

The NEF's mandate requires it to operate in a high risk environment i.e. funding individuals that have minimal own contribution that would normally not qualify for loans from financial institutions. In light of the high risk environment that the NEF operates in, a strong risk management process is required in order for the NEF to be sustainable and deliver on its mandate. The NEF staff and management have a strong culture of risk awareness. Risk management is the responsibility of all staff at the NEF. The NEF adopts an enterprise-wide approach to risk management. An enterprise-wide approach requires the NEF to cover all risks: strategic, operational, financial, market, credit, people and reputational risks.

As per the King III report, the Board of the NEF is responsible for the governance of risk within the NEF. To assist the Board in discharging its responsibilities regarding risk management, the Board has established a separate Risk and Portfolio Management Committee (RPMC) to review the risk management progress within the NEF, the effectiveness of risk management activities, key risks facing the NEF, responses to address these key risks and monitor the performance of the NEF's portfolio.

## Overview of 2015/16

The volatile international and local economic conditions have increased the risks under which businesses operate. The businesses funded by the NEF are more vulnerable to any external shocks and are not as resilient as established businesses. Volatile international and local economies have had a negative impact on the performance of these businesses. This has resulted in an increase in defaults and impairments for the NEF.

Recapitalisation of the NEF has remained a material issue on the Board's agenda. Whilst a few initiatives have been embarked on, none have been finalised yet to allow us to reduce this risk.

All other forms of risks have been adequately contained during the year. The management of people and reputational risks are unpacked in the Human Capital and Stakeholder Engagement sections respectively.

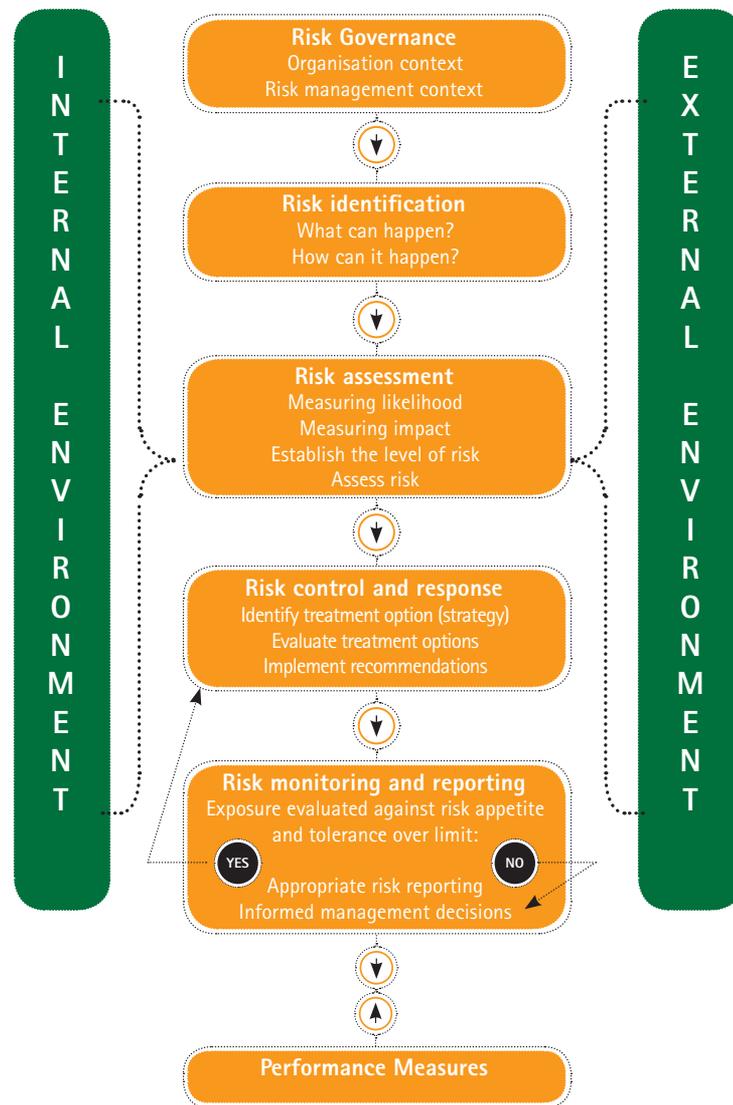
## Focus areas for 2015/16

During the past financial year our focus was on enhancing our Risk Management Framework, completion of Risk assessments, tracking of Key Risk Indicators (KRI's) continuing with discussions on Risk Appetite and Risk Tolerance with relevant Board committees, and working on developing a comprehensive approach to deal with Business Continuity.

## Risk Management Framework

The NEF's Risk Management Framework is based on COSO, Institute of Risk Management Standards of South Africa (IRMSA) Code of Practice and PFMA & Treasury Regulations. The ERM (Enterprise-wide risk management) methodology of the NEF consists of the following interrelated components: internal environment, objective setting, risk identification, risk assessment, risk control and response, risk monitoring and reporting, and risk performance measurement. These components are derived from best practice with respect to ERM governance.

The diagram below outlines the components of the ERM processes followed.



### NEF Risk Management Framework (continued)

The Framework is continuously benchmarked against best practice such as the International Standard on Risk Management (ISO 31000) and King III and where required relevant changes are made to the Framework.

The Risk Management Framework was reviewed and updated during the current year and the updated Framework was approved by the NEF Board of Trustees.

### Key Risk Indicators

We have also developed a Key Risk Reporting Dashboard and Key Risk Indicators (KRI's) which we use to proactively identify, respond to and report on and track Key risks and any emerging risks.

The tracking of KRI's confirmed challenges being experienced by clients due to tough economic conditions. This has resulted in proactive interventions being instituted by management. The portion of the portfolio that received additional moratorium was at 26% as at the end of December 2015 indicating that clients were experiencing challenges. The impairments ratio increased from 19% in the previous financial year to 24% for the year ending March 2016, due to tough market conditions

The tracking of KRI's had also raised concerns regarding the portion of the portfolio that collections are raised on. This is primarily due to instruments used to fund transactions such as equity, shareholders loans and preference shares. These instruments are used in certain instances where clients funded by the NEF have limited own contribution. This percentage was at 21% as at 31 December 2015 but has improved to 32.7% as at 31 March 2016. Management is continuing to focus on this area, as it impacts on the cash flows of the NEF.

The rand value of funds collected in the last two quarters of the year was approximately R400 million. This was mainly due to certain transaction exits and partial exits from the Strategic Projects Fund. This accounted for approximately 75% of cash collected for the financial year ending March 2016. Management are actively pursuing opportunities to exit transactions where possible.

### Risk Appetite and Risk Tolerance

Defining an effective risk appetite statement is a critical component of a sound risk management framework. During the financial year, various possible risk appetite statements as well as various scenarios regarding the NEF's Risk Bearing Capacity were presented to the RPMC. The lack of clarity regarding the NEF's recapitalisation however made this a difficult task to perform. Until clarity regarding the recapitalisation process is obtained, it will be difficult to determine the acceptable level of risk to be taken by the NEF. Should the future funding come through borrowings, the level of risk that the NEF will be able to take on will be less than what it can take if the NEF were to receive grant income.

### Business Continuity

The NEF identified a need to implement a formal Business Continuity process. During the financial year a formal process to deal with Business Continuity was developed and approved by the RPMC. The Business Continuity process will provide guidance to the organisation as to what needs to happen in the event of a disaster. The IT disaster recovery plan was also updated and approved by RPMC. The plans are in the process of being implemented and tested.



### NEF Risk Assessment Process

The risk assessment process results in the output of the risk universe of the NEF. The key risks are identified from the risk universe. The risk assessment exercise is completed on an annual basis and the divisional risk registers are updated thrice a year to identify any emerging risks and track progress of identified actions.

### Our Material Issues

Our material issues are issues that we believe could adversely impact our viability as a sustainable DFI, and our ability to discharge our mandate or influence decisions of the Board of Trustees and its Stakeholders. They represent our primary risks which are identified through our on-going stakeholder engagements, both internal and external, as well as through the impact of external environment factors. Management of these material issues is critical to enable the NEF to achieve its strategic objectives and mandate, and to remain sustainable.

The process of identifying and assessing potential material matters is a responsibility of the Board of Trustees through its sub-committees and internal committees. We identified and prioritised five material matters for the NEF and these we believe will remain relevant for the foreseeable future.

1. Recapitalisation risk
2. Credit risk/Asset quality
3. Market risk
4. People risk
5. Reputation risk

Material issue/Risk	Implications of material issue	Mitigating controls	KPA affected
<p><b>Recapitalisation Risk</b></p> <p>The lack of adequate capitalisation of the NEF to fund future growth of the NEF</p>	<p>The lack of clarity regarding the shape and form of the recapitalisation of the NEF will negatively impact on various areas of the NEF's business i.e. staff morale will be negatively impacted by the uncertainty regarding the recapitalisation of the NEF.</p> <p>In the past, this uncertainty led to an increase in resignations. Lack of adequate capitalisation of the NEF to fund transactions will also lead to a moratorium in funding new transactions, which was introduced previously when the NEF's cash reserves were low.</p> <p>This had a negative impact on the reputation of the NEF and it took some time for the market to have confidence in the NEF.</p>	<p>The Business combination process with the IDC has been approved and will need to be implemented to ensure the future sustainability of the NEF.</p> <p>In the interim, various engagements are being held with public entities such as IDC, PIC etc. to secure interim funding.</p> <p>The NEF is also focussing on exiting transactions where possible, resulting in improvements in cash collections.</p>	<p>Provide finance to business ventures established and managed by black people</p> <p>Support the participation of black women in the economy.</p> <p>Facilitate investment across all provinces in South Africa</p>

Material issue/Risk	Implications of material issue	Mitigating controls	KPA affected
<b>Credit Risk / Asset quality</b> The risk that poor quality of transactions are funded and increasing number of clients are in distress due to tough economic conditions	The NEF has robust screening and due diligence processes, which assists in ensuring that poor quality transactions are not funded. The tough international and local economic conditions have however negatively impacted on the NEF's portfolio. This has resulted in an increase in impairments for the financial year.	The closer monitoring of transactions is resulting in transactions that need quicker interventions being identified early. These transactions are transferred to the TWR, which will implement measures to assist businesses that are struggling.  The pricing of certain struggling clients has also been reviewed to assist them during this difficult economic climate.  Mentorship support is also provided to clients who are experiencing challenges during this period.	Provide finance to business ventures established and managed by black people. Establish the NEF as a sustainable DFI Invest in black empowered businesses that have high employment creating opportunities
<b>Market Risk</b> Changes in Macro economic conditions negatively impacting on the NEF's client base	The volatile international and local economic condition is negatively impacting on the NEF's client base, which is not as resilient as established businesses in dealing with external shocks.  The significant decline in the share price of MTN has also negatively impacted on the NEF's balance sheet for the financial year. The NEF has eroded approximately R700 million from its balance sheet mainly due to the decline in share price of MTN.	Post Investment unit is closely monitoring clients and identifying clients that require assistance sooner i.e. clients that need to be transferred to our TWR for specific interventions.  The pricing of certain struggling clients has also been reviewed to assist them during this difficult economic climate.	Invest in black empowered businesses that have high employment creating opportunities Support the participation of black women in the economy.
<b>People Risk</b> Increased uncertainty with regards to implementation of the business combination process leading to staff resignations	The increased uncertainty with regard to implementation of the business combination process and recapitalisation will negatively impact on staff morale and may lead to an increase in resignations. Management engages staff on a regular basis regarding the business combination process. Further clarity will however need to be obtained from stakeholders regarding the status of the business combination process and feedback will need to be provided to staff	Performance management process which engages employees three times a year  A remuneration framework that is benchmarked against other institutions	All KPAs are affected
<b>Reputation Risk</b> The risk that the NEF's brand is negatively impacted by media coverage	During the financial year the NEF had not received any significant negative media coverage. The delay in resolving the recapitalisation issue will possibly lead to a re-introduction of a moratorium on funding new transactions. This will negatively impact on the reputation of the NEF.	On-going engagements are held with stakeholders and the media to ensure that stakeholders and media understand the NEF's role. Actions are also being put in place to deal with findings of the Brand Audit done in 2015.	Establish the NEF as a sustainable DFI

## Credit Risk Management

Credit Risk is defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The NEF's Credit Risk Management (CRM) forms part of the key organisational risks as it relates to the core business of the NEF. CRM focusses on ensuring that the funds are invested to viable and credit worthy enterprises, this in turn also ensures that the liquidity risk and sustainability of the NEF are adequately mitigated and managed.

### Credit risk management roles and responsibilities

The management and control of this risk is a collective responsibility and forms an integral part of all the relevant teams. The following is an overview of the processes which are in place to ensure adequate management and control of the credit risk throughout the life of each transaction:

### Screening and Analysis

- Undertake desktop analysis to ensure an application meets the NEF's mandate and funding criteria.

### Investment Team

- Identify risks and any mitigating measures on each transaction reviewed and conclude on viability of such transaction.

- Conduct an entrepreneurial assessment of the project sponsor(s).
- Perform adequate financial, technical and legal due diligence investigations to confirm existence of mitigating measures and viability.
- Structure transactions in a manner that will reduce the credit risk to an acceptable level.
- Prepare an investment approval report that is factual and assists the investment committees in making informed decisions.

### Investment Committees

- Study investment approval reports to ensure that all risks have been adequately addressed.
- Make objective decision on the basis on commercial viability and acceptable risk exposure.

### Credit Risk Division

- Thoroughly study investment approval reports prepared by the investment teams.
- Perform an independent assessment of credit risk for each transaction, and
- Support the approval committee by providing an independent and objective opinion on viability of the evaluated transaction with regards to the level of credit risk.



**Business Sector:**  
Manufacturing

**Core Business:**  
Drilling Rigs and  
Aerial Platforms

**Jobs:**  
95

### Investee Profile:

## uMnotho Fund Smith Capital (Pty) Ltd.

The National Empowerment Fund funded Isipho Capital Engineering to acquire a 100% interest in Smith Capital Equipment, a company that manufactures aerial platforms, commonly known as cherry pickers and used to reach elevated structures such as streetlights, as well as drilling rigs used in mining exploration and installation of pylons and street poles.

With 42 years' experience, Smith Capital is a household name in the aerial platform market through its own brand, Superlift™ as well as its Hotline branded drilling rigs. The company also installs premium brands of aerial platforms and truck-mounted cranes from leading multinational companies around the globe. Isipho Capital owns 65% of the company while 35% is owned by staff and management.

### Post Investment Unit (portfolio management)

- Providing mentorship in areas in which the NEF investees lack adequate experience and skills and capacity to successfully run the business for which funding was provided.
- Providing continuous monitoring to ensure that the investees adhere to the business plan or address emerging investees' internal risks that have a potential of affecting their liquidity and ability to repay NEF loan.
- Following up on slow paying investees and collecting on outstanding debts promptly.

### Legal Unit

- Perform an independent legal due diligence for each transaction.
- Draft, negotiate and conclude legal documents with investees and other external stakeholders where relevant, e.g. suppliers
- Following up on investees transferred to the Legal Unit as a result of failure by investees to honour their obligations after all the turnaround options have been exhausted.
- Acting on securities or collateral and recovering some or all debts from investees failing to honour their debt obligations.
- Litigating on behalf of the NEF against investees to ensure all possible avenues are exhausted to ensure invested funds are collected or recovered.

### Turnaround, Workouts and Restructure Unit (TWR)

- Providing specialist service and intensive monitoring of investments experiencing cash flow or liquidity challenges and similar other challenges affecting debt repayment.
- This involves analysing causes of challenges, restructuring of business operations to ease the cash flow constraints and devising turnaround strategies.

### Fraud Risk Management

Fraud is defined as the unlawful and intentional misrepresentation or act which can lead to actual or potential disadvantage to another individual or group.

Fraud prevention forms part of the risk management process at the NEF. The following measures are in place to address the fraud risk at the NEF:

- Strong governance structures, such as the Audit committee and Social & ethics committee, that provide oversight over Fraud matters.
- Strong control environment subject to audit by our Internal Audit division.
- Code of Conduct and Conflict of Interest policy that form part of the NEF policies and serve to guide employees with regard to acceptable behaviour. The Code of Conduct and Conflict of Interest policy were reviewed during the year.
- During the completion of risk assessment with the various business units any new fraud risks are identified and monitored.



“Small businesses play a vital role in job creation, contributing to a skilled workforce, facilitating broader ownership, responding rapidly to market demands and increasing overall production. Because of this, Small Medium and Micro Enterprises (SMMEs) tend to be more effective in driving economic development than bigger businesses.”

*The Hon. Deputy President Mr Cyril Ramaphosa at the Shanduka Black Umbrellas National Development Awards, Sandton Johannesburg, 24 June 2015*

- Fraud awareness workshops are conducted annually to remind employees of the code of conduct and also to discuss case studies of fraud that were previously perpetrated at the NEF.
- A Fraud/Whistleblower program managed by Deloitte in collaboration with the Risk Division of the NEF is also used as a confidential means of reporting fraudulent activities perpetrated by employees and NEF investees. A need has been identified to increase the level of awareness of the Fraud hotline and additional fraud awareness sessions will be held in the new financial year.
- Fraud investigations are conducted by the Risk Division for each reported matter. This is sometimes performed using external forensic companies.
- Litigation and laying of criminal charges are carried out by the legal division following recommendations by the Post Investment unit and Risk Division. All litigation matters are approved by the Portfolio Management Committee (PMC).

The following are highlights relating to fraud risk management:

#### Fraud workshop

A Fraud awareness session was conducted with regional staff and communication regarding cybercrime was sent to all staff. A need was identified to increase the level of fraud awareness amongst staff, including raising awareness regarding the increasing risk relating to cybercrime. Fraud awareness and cybersecurity sessions are planned for the first quarter of the new financial year.

#### Fraud Tip-offs

The Risk Division received and followed up on three tip-off matters during the financial year. One matter related to material breaches by a client. This was reported to the NEF legal department who acted promptly and the NEF managed to recover all funds due. The other two matters related to Phishing attempts which were detected and no losses were suffered by the NEF.

#### Looking ahead:

- Closely monitor risk trends arising from macroeconomic uncertainty.
- Further enhance collection programmes to ensure appropriate management of investees in financial difficulty.
- Continue to focus on improvements to data sources and models/analytics to improve the portfolio risk profile, risk measurement, and risk-adjusted returns.
- Continue to improve internal risk measurement models and processes as part of the portfolio enhancement process.

#### Board's view on effectiveness of the NEF's Risk Management process

The Board through the Audit Committee provides assurance over the risk management process at the NEF. An independent review is performed on the risk management process on an annual basis by Internal Audit.



**Business Sector:**  
Electronics  
Manufacturing

**Core Business:**  
Television screens  
manufacturing

**Jobs:**  
100

#### Investee Profile:

### uMnotho Fund

### Stylco Group:

Stylco Empowerment (Pty) Ltd ("Stylco Empowerment") is a majority youth-owned company (i.e. 75%), with the balance of equity being owned by Stylco (Pty) Ltd ("Stylco"), their technical partner. Stylco has alliance partners, Universal Exports Group, based in Hong Kong and China. Stylco manufactures and distributes many well-renowned brands under license. Stylco Empowerment has listed with Pick 'n Pay for the delivery of the Pick 'n Pay branded products (AIM), which it has exclusivity in manufacturing.