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# COMMENTARY TO BE SUBMITTED ON PROPOSED BROAD-BASED BLACK ECONOMIC EMPOWERMENT CODES

## 1. INTRODUCTION:

- 1.1 The revised codes were published for public commentary on 5 October 2012 for the prescribed 60 day commentary period in terms of section 9(5) of the B/BBEE Act, Act 53 of 2003 (*“the Act”*).
- 1.2 In this letter, we wish to place our objections on record in the hope that same will positively impact on the finalization of the revised codes.

## 2. BEE OWNERSHIP:

- 2.1 It appears that the revised codes are a move away from Broad-Based BEE back to the dark ages of Narrow Based BEE. In the national growth path published by Minister Ebrahim Patel the following is stated in respect of government’s intended policy with regard to B/BBEE:

*“Government has adopted the position that black economic empowerment (BEE) should seek to empower all historically disadvantaged people rather than only a small group of black investors. To this end, it adopted the Broad-Based BEE Act which calls for expanded opportunities for workers and smaller enterprise as well as more representative ownership and management.*

*Current BEE provisions have, however, in many instances failed to ensure a broad-based approach, instead imposing significant cost on the economy without supporting employment creation or growth. The present BEE model remains excessively focussed on transactions that involved existing assets and benefit a relatively small number of individuals. The new growth path requires a much stronger focus on the broad-based elements of the BEE Regulations / ownership by communities and workers, increased skills development and career pathing for all working people, and support for small enterprise and co-ops- as well as new emphasis on procurement from local producers in order to support employment creation.*

*The following shortcomings have emerged in the implementation of BEE. First, ownership and senior management issues receive this proportionate emphasis. The unintended consequences of this trend include ‘fronting, speculation and tender abuse’. Second, the regulations do not adequately incentivise employment creation, support for small enterprises and local procurement. The preferential procurement regulations aggravate this situation by privileging ownership over local production. Finally, the broad-based BEE regulations penalize public entities*

*as suppliers. The democratic state owns public entities on behalf our people, yet the regulations do not count them as 'black empowered'.*

*A major rethink is needed of BEE framework and policy to achieve South Africa's developmental and growth goals. The DTI and EDD will work with the relevant government departments and the BBBEE Advisory Council to ensure:*

- (a) A substantial revision of the BBBEE codes to do more to incentivise employment creation; investment in new productive capacity by black entrepreneurs, including small businesses and co-ops (using among others stronger local procurement); skills development and employment equity, collective and other forms of broad-based ownership; and sector strategies to create jobs.*
- (b) Consistent implementation of broad-based (instead of narrow) BEE in all sectors, with a systematic assessment of the effects on the cost of capital and investment.*
- (c) Continuous monitoring and evaluation of the impact of broad-based BEE on overall equity, employment creation, support for new entrepreneurs, growth and innovation."*

3 It is submitted that the revised codes fails miserably in achieving the above stated objective of government to move towards a more broad-based approach to BBBEE. It would appear that it does exactly the opposite by adopting a more narrow-based approach towards BEE and specifically for the following reasons:

- 3.1 Rather than to de-emphasize the black ownership as the national growth plan suggests, the ownership element in the score card is awarded a further 5 points and its relative importance to the total BEE score card of a business is therefore increased.
- 3.2 With the new definitions of qualifying enterprise development contributions and qualifying local supply development beneficiaries which are now limited to black owned businesses, the amount of points attributable to contributions directly related to black ownership of business as increased from 23 points (23%) to 53 points (50.47%). (The 53 points represents the 23 points on ownership score card and the 28 points on enterprise and supply development score card related solely to black ownership.) More than 50% of the available points on the score card is therefore directly related to the black ownership of businesses. Rather than de-emphasizing black ownership it has become more than double as important under the revised codes as compared to the existing codes. It is a clear reversal towards a narrow-based approach towards BEE and is clearly not in alignment with the stated national objective adopted in the national growth plan.

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3.3 Whereas the above two points relate to the vertical application of the broad-based principle, i.e. black ownerships relative importance to the other elements of the score card, the following objection relates to the horizontal application of the broad-based principle which requires the promotion of participation of a broad-base of black beneficiaries within the ownership structures of businesses. The one additional point on the ownership score card related to broad-based ownership schemes, employee ownership schemes and co-ops is hardly an incentive for business to include these groupings in their ownership deals. If it was truly in keeping with the national growth plan one would have expected the relative weighting of this sub-category to increase significantly and not merely by one point. If we may, we would suggest that the weighting for this indicator be increased as well as the target for the indicator.

3.4 Probably the most telling provision in the revised codes with regard to the drafter's true intent in respect of the ownership score card, is to be found in the revised definition of 'Black New Entrants'. In terms of the current codes, a 'New Entrant' is an individual who at the time of entering into the BEE deal with the measured entity have not entered into prior BEE transactions with an aggregate value of more than R20 million. The revised codes now increases that threshold to R50 million. In doing so, it increases the longevity of the few fortunate black elite individuals who have been able to enter into BEE deals up to now and does so at the expense of the broad-base of beneficiaries, the national growth plan aims to intrude in the ownership structure of measured entities. It is submitted that this is directly in opposition to the stated intent in the national growth plan and directly in opposition to a horizontal broad-based approach to ownership. In our view, the broad-based agenda would be best served in the ownership score card by doing away with the category of new entrants' altogether and to reallocate those points for participation of broad-based ownership schemes, employee share scheme and co-opts. The beneficiaries of these groupings are almost without exception 'new entrants'.

#### **4 AN EXCLUSIONARY RATHER THAN INCLUSIVE APPROACH**

One of the core principles embodied in the existing codes that have ensured the participation and goodwill of corporate South-Africa has been the principle of 'Inclusivity' adopted by government in its formal strategy document related to B-BBEE. The principle is best explained in the Strategy document as follows:

*"Economic growth, development and BEE are complementary and related processes. Government's approach is that BEE must be an inclusive process and not an exclusive process. No economy can grow by excluding any part of its people and an economy that is not growing cannot integrate all of its citizens in a meaningful way. As such this strategy stresses a BEE process that is associated with growth, development and enterprise development, and not merely the redistribution of existing wealth."* (South

*Africa's Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment - 2003; p13)*"

This principle was well developed in the existing Codes through a '*stick and carrot*' approach to participation. Although there was no punitive measures for non-participation business would be less competitive in South Africa both out of a government procurement point of view as well as through the application of the preferential procurement element on the scorecard if they did not participate. This was the stick. On the other hand a traditionally 'white' business which chose to participate with the BEE program had access to various 'carrots' build into the Codes. Among these were the following:

- 4.1 The ability to participate on various levels of the BEE scorecard and not necessarily the ownership of the business. The ability to own a business is the very driving force behind new business development (entrepreneurial development). Take away the ability to solely own a business you take away a big part of the incentive for people to start businesses. In that regard it is worthwhile taking note of the latest census results which shows immense entrepreneurial activity amongst the white population groups in South Africa. These businesses are the primary avenue for job creation in South Africa and as such often make a significant contribution with regard to the other elements on the scorecard such as Employment Equity, Skills Development, Procurement, Enterprise Development and Socio Economic Development without necessarily addressing Ownership.
- 4.2 In line with the above thinking emerging businesses which were not more than 50% black owned but at least 25% black owned and did indeed participate on the other elements of the score to the extent that it was possible for them to achieve at least a level 6 contributor BEE status, were regarded as Category B Enterprise development beneficiaries. Although contributions to them in terms of the Enterprise Development Scorecard earned less recognition than the more than 50% black owned businesses, they were not excluded from benefitting as a recipient of Enterprise Development all together as is the case in the Revised Codes.
- 4.3 Through the cascading mechanism of the Preferential Procurement scorecard a white owned supplier was given a significant enough incentive to contribute to the other pillars of BEE apart from ownership as 15 points (75% of points) on the preferential procurement scorecard of its clients were based on the spending patterns of its clients directed at their suppliers' **broad-based** BEE scores. In other words its clients had a big enough incentive to procure from it and therefore it made sense for the supplier to participate with the BEE programme. Only 5 points (25%) was directed at a measured entities narrow based procurement practices. This incentivised white owned suppliers to participate in the BEE programme irrespective of their ownership status and lead to significant

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contributions towards the other elements of the scorecard over the last few years by these businesses. The Revised Codes on the other hand now only recognises 12 out of 25 points (48%) for broad-based procurement whereas narrow based procurement practices now earns a measured enterprise 13 out of 25 points (52%) of the preferential procurement points. The incentive for measured entities to procure in a broad-based manner has therefore decreased significantly. Together with the objective impossibility to meet some of the threshold requirements (see discussion below) and to actually achieve any material BEE status will leave white suppliers with no incentive to participate any further with the BEE programme. The inevitable consequence of this is that the black beneficiaries of the other elements of the scorecard which would have benefitted through the white suppliers contributions will in all likelihood no longer receive that benefit.

- 4.4 Contributions to charitable organisations under the Socio Economic Development element earned a 100% recognition as long as at least 75% of the value of the contribution benefited black people. The rationale behind this was to ensure that corporate South Africa's CSI spend was not redirected away to solely black charitable organisations. The thinking was that there was no sense in solving one social economic problem by creating another. That kind of incentive would have had untenable consequences such as for example the creation of 'black only' orphanages and welfare organisations. The Revised Codes now does away with this and only allows contribution to 100% black beneficiaries to count and thereby adopting an exclusionary approach. The provision that allowed proportionate recognition was also removed having the draconian effect that if a charitable has as little as 1% white beneficiaries that a measured entity would earn no recognition at all for any contributions towards it. This is just absurd.

## **5 APPLICATION OF NATIONAL RACIAL DEMOGRAPHIC TO MANAGEMENT CONTROL & SKILLS DEVELOPMENT SCORECARDS**

The exclusionary approach seen above now also takes a new form in the Revised Codes. In terms of the Revised Codes. Coloured and Indian people's contribution to the achievement of the targets under these elements are weighted according to their proportionate representation in the national demographic. This of course is a mere fraction of that of African people. In other words as far as these elements are concerned they are not as black as African people as a result of their proportionate under representation in the national demographic.

The formula's for applying this methodology are also irrational and will need to be revisited. It is unclear to which sub-categories they apply and they give rise to several anomalies such as that if all the employees were African female the business would only be able to ever score one sixth of the points for the category. This could not have been the intent.

Also, if the national demographic of Economically Active Populations (EAP) groups are to be used as per the Employment Equity Survey of the Department of Labour it needs to be noted that those figures includes non-South Africans and individuals that became South Africans only after 1994. In other words individuals that would not qualify as black by virtue of the Codes' definition of 'black'. Their inclusion in the population group for EAP measurement is material and by some estimates they represent as much as R10 mil people. This would dramatically skew the proportionate figures.

Our major concern with these provisions are not the technical application of the formulas but rather the principles they embody. These provisions can only serves to further divide South Africans along racial lines and in our view is unwise. They also are extremely prejudicial to businesses based in the Western Cape and Kwazulu Natal where Coloured and Indian people form a much larger proportion of the population.

They have much less of a resource pool to select their employees out of and this will impact their scoring negatively especially given the fact that Skills Development is a priority element and that businesses that do not score at least 40% of the targets in the Skills Development Scorecard would automatically be downgraded two levels. Given these dire consequences business in the Western Cape and Kwazulu Natal will be significantly less competitive than their counterparts in the other provinces of South Africa and this all at no fault of themselves. This in our view will impact on their fundamental right to freedom of trade as embodied in the Constitution. In our view is that these provisions, in addition to being divisive and exclusionary in nature, are unconstitutional. They must be removed from the Revised Codes.

#### 6. **AN ARBITRARY APPROACH TO TARGET SETTING AND GOAL POST SHIFTING**

The current Codes (Statement 004) requires sectors of the economy that wish to develop their own sectoral codes to furnish empirical research to substantiate any deviations in weightings or targets that they propose. However no empirical data is provided to substantiate the increase in targets and weightings which the Revised Codes now proposes. Indeed we do not believe that such empirical research exists and if it does it cannot be meaningful at this point in time in the life cycle of Broad-Based BEE for the following reasons.

- The B-BBEE Act 53 of 2003 only came into existence on 1 January 2004.
- The Codes, which contains the actual means of measuring B-BBEE were only gazetted three years later on 9 February 2007.
- It took the Dti a further two years to accredited the first verification agencies which occurred on 9 February 2009. This is the first date from which one can say that it was possible to empirically measure B-BBEE. The refusal to actually amend the plethora of technical and drafting errors in the existing codes, together with unofficial *ad hoc* interpretations that were often issued by the B-BBEE unit which often contradicted the actual legislation made it impossible for verification agencies to apply measurement

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consistently. It is important to note that the Revised Codes still fails to rectify these errors (*see discussion below on technical matters*). Any empirical research that might have been conducted to thus far is flawed on this basis alone.

- It took a further two and a half years to align the B-BBEE Codes with the Preferential Procurement Policy Framework Act 5 of 2000 with the gazetting of the 2011 PPPFA Regulation on 7 December 2011. This was the first date from which organs of state and public entities actually started applying the Broad-Based BEE Codes. Up to that date they were under official embargo by the Department of Finance (Treasury) to not apply the B-BBEE Codes when considering preferential procurement in tenders. A large portion of business only started aligning to the broad-based Codes at his point in time.
- During the years 2009 to 2011 South Africa also saw the gazetting of several sectoral Codes and businesses had to constantly realign themselves with different rules. To draw reliable conclusions from this period is therefore also not possible.
- The year 6 to 10 targets for Employment Equity and Preferential procurement only came into existence in February 2012. Already these targets have been increase in the Revised Codes. What possible empirical research could have taken place since February 2012 until the release of the Revised Codes that can warrant a further increase?

The increase in score thresholds to attain a particular BEE status level appears to be entirely arbitrary and designed to make it impossible for any business that does not score full marks for black ownership to achieve a significant B-BBEE Status level. The proportionate differences between B-BBEE levels also does not coincide with the proportionate points available in terms of the PPPFA 2011 Regulations for each B-BBEE Status Level.

Other arbitrary changes in targets and weightings include:

1. Top Managements target increases from 40% to 60%;
2. Skills Development Expenditure's target increase from 3% to 6%;
3. Preferential Procurement target's increase from 70%(*this target only came into operation in February 2012*) to 80%;
4. Preferential Procurement target for procurement from black owned businesses increases from 12% to 40%;
5. The significant decrease in weighted recognition on the Enterprise Development Matrix for almost all contributions.

All these changes is entirely unacceptable and in most cases unattainable, unless off course that was the intent? If so we caution government against this approach as it will seriously undermine the goodwill of business in South Africa.

In our view this revision of the Codes should have been used solely for the purpose of ironing out the technical and drafting errors in the existing Codes. In fact this is what it was held to be until about a year ago. None of the technical matters has however been addressed and these Revised Codes in its entirety represents a policy departure for government – even from its own formal policies to thus far on B-BBEE.

One cannot begin to compare apples with apples or for that matter the progress made by these business until measurement is done consistently, much less compile reliable research based on those results and certainly not in the short timeframe of measurement we have seen since 2009. The timing of these Revised Codes for the revision of policy is ill conceived and will do irreparable harm to the transformation efforts of government.

7. **CONCLUSION:**

7.1 It is submitted that the revised codes are moving away from broad-based approach in favour of a narrow-based approach and away from an inclusive approach towards an exclusive approach towards B/BBEE. As such it represents an absolute departure from the 2003 strategy of government as well as the recent national growth plan. In our view, the revised codes at best do lip service to the concept of broad-based economic empowerment and are almost a contradiction in terms. It would appear that the revised codes favour '*wealth distribution*' at the expense of wealth creation.

7.2 The revised codes are nothing but a disappointment and have the risk of acting as a death penalty for economic transformation in South Africa.

7.3 In view of the above, we cautioned the DTI not to proceed with the revised codes as planned and to address the impasse in the best interest of corporate South Africa.

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