



# BROAD-BASED BLACK ECONOMIC EMPOWERMENT

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### Introduction

Black Economic Empowerment (BEE) is a process driven by Government through legislation and policy, which aims to remedy historical racial imbalances and achieve economic transformation by increasing the number of black people who participate in the mainstream South African economy. BEE is fundamental to economic activity in South Africa and encourages the opening up of the economy to those previously excluded by the system of apartheid through a mix of economic persuasion and incentive.

### The Foundations of BEE

The Constitution of the Republic of South Africa, 1996 (Constitution), provides a constitutional mandate for BEE, as it authorises measures aimed at advancing categories of persons disadvantaged by unfair discrimination.

Government's strategy to promote BEE was outlined by the Department of Trade and Industry in 2003 (BEE Strategy). The underlying principle is the use of State purchasing and regulatory power to increase participation by black people in the South African economy by giving recognition and preference to enterprises which contribute to BEE.

The BEE Strategy proposed that BEE be measured across seven aspects (or "elements") to promote BEE at all levels of the economy on the basis of "Broad-Based" BEE, (B-BBEE) rather than only on the basis of the ownership and management control aspects of an enterprise. The seven elements were: employment equity, skills development, preferential procurement, enterprise development, socio-economic development, ownership and management control.

The Strategy also proposed a rule-based BEE system to ensure consistency and certainty in the application and measurement of contributions made by an enterprise to BEE, across all industries. The BEE Strategy thus paved the way for legislation to promote BEE.

### The Broad-Based Black Economic Empowerment Act

The Broad-Based Black Economic Empowerment Act, No. 53 of 2003 (B-BBEE Act), was promulgated in April 2004. It does not set any targets for BEE but rather provides a framework for the implementation of BEE initiatives and for the Minister of Trade and Industry (Minister) to publish Codes of Good Practice (Generic Codes).

The Generic Codes, among other things:

- define key terms and concepts relating to BEE (such as the definition of "black people");
- specify the elements of an enterprise which will be measured;
- spell out the method for measuring each element of BEE;
- specify the targets against which enterprises' BEE contributions are assessed; and
- provide for the independent verification of the B-BBEE status of an enterprise measured against the scorecard.

Section 10 of the B-BBEE Act also provides that every organ of State (eg provincial and national Government departments) and public entity (eg Armscor, Eskom, and the South African Broadcasting Corporation) must take into account and, as far as reasonably possible, apply the Generic Codes in:

- determining qualification criteria for the issuing of licences, concessions or authorisations in terms of any law;
- developing and implementing a preferential procurement policy;
- determining qualification criteria for the sale of State-owned enterprises; and
- developing criteria for entering into partnerships with the private sector.

Therefore, enterprises that require licences, concessions or authorisations from the State, wish to provide goods and services to organs of State or public entities, wish to acquire State-owned enterprises or wish to enter into partnerships with the State, must provide evidence of their B-BBEE status as measured under the Generic Codes.

It is important to note that the Generic Codes themselves simply provide a means for determining an enterprise's B-BBEE status. The manner in which organs of State and public entities apply the Generic Codes will be found in legislation applicable to them (eg in relation to tenders, the Preferential Procurement Policy Framework Act, No. 5 of 2000, and its regulations) and in the policies and guidelines issued by them. It is therefore important for investors to determine how organs of State and public entities with whom they wish to conduct business will apply the Generic Codes.

### **The Broad-Based Black Economic Empowerment Amendment Act**

The Broad-Based Black Economic Empowerment Amendment Act, No. 46 of 2013 (B-BBEE Amendment Act) was gazetted on 27 January 2014. The B-BBEE Amendment Act is still to be proclaimed into law by the President.

In many respects, the B-BBEE Amendment Act aims to clarify and expand on issues that are already covered in the B-BBEE Act. Salient features include:

- the definition of "black people" is now aligned with the Generic Codes and the determinative date of 27 April 1994;
- the definition of "Broad-Based Black Economic Empowerment" has been expanded to mean the viable economic empowerment of all black people in particular women, workers, youth, people with disabilities and people living in rural areas, through diverse but integrated socio-economic strategies. The emphasis in the new definition is on the continued viability of BEE;
- fronting, which was previously dealt with in terms of the Department of Trade and Industry's (DTI's) guidelines is now incorporated, defined and specifically targeted in the B-BBEE Amendment Act. The penalties associated with the fronting practices of window dressing, benefit diversion and opportunistic intermediaries are now punishable by penalties of up to 10 years in prison, or up to 10% of an enterprise's annual turnover. In addition to the possibility that any contract or authorisation awarded by an organ of State or public entity may be cancelled, a person and/or entity convicted of fronting will be blacklisted and prohibited from contracting or transacting with any organ of State and/or public entity for a period of 10 years. The B-BBEE Amendment Act further introduces an obligation on B-BBEE verification professionals, procurement officers and officials of organs of State and public entities to report instances of fronting;
- the B-BBEE Amendment Act establishes a B-BBEE Commission whose main aims include promoting adherence to B-BBEE, good governance and accountability in the implementation of B-BBEE and B-BBEE advocacy. The B-BBEE Commission is also empowered to receive and on its own initiative investigate complaints;
- the B-BBEE Amendment Act introduces a new provision which states that to the extent of any conflict between the provisions of the B-BBEE Amendment Act when it is passed into law and any other law (excluding the Constitution) in force immediately prior to the date of commencement of the B-BBEE Amendment Act, the provisions of the B-BBEE Amendment Act will prevail if the conflict specifically relates to a matter dealt with in the B-BBEE Amendment Act. This is the so-called "trumping provision". The B-BBEE Amendment Act provides for a one-year transition period to allow for the statutory alignment as contemplated in this new provision;
- the B-BBEE Amendment Act clarifies that enterprises in a sector in which Sector Codes have been gazetted may only be measured for compliance in accordance with that Sector Code;
- the B-BBEE Amendment Act introduces reporting obligations both on private enterprise as well as on all organs of State, State-owned enterprises and all spheres of Government to monitor compliance with B-BBEE; and
- the B-BBEE Amendment Act further permits the Minister to allow organs of State and public entities to set criteria for procurement and other economic activities that exceed those set in the Generic Codes.

### **The Generic Codes**

The Generic Codes came into effect on 9 February 2007. They apply to all enterprises with a turnover of at least ZAR 5 million per year. Enterprises with an annual turnover of less than ZAR 5 million, referred to as "Exempted Micro-Enterprises" (EMEs), are generally granted a specified B-BBEE status.

Enterprises with an annual turnover of between ZAR 5 million and ZAR 35 million, referred to in the Generic Codes as "Qualifying Small Enterprises" (QSE), can elect to be measured on any four of the seven BEE elements.

Private enterprises are not obliged by law to meet the targets specified in the Generic Codes. However, in so far as they seek a licence, concession, contract or partnership agreement with any organ of State or public entity, they may be prejudiced by their failure to ensure that their B-BBEE status is at least as good as that of others also seeking those benefits. This is because B-BBEE status is one of the factors which will be taken into account in deciding whether or not to award the benefit being sought.

There is also a trickle-down effect, by which entities that need not otherwise be BEE compliant by virtue of their reliance on organs of State or public enterprises are pressured by market forces to do so. The procurement element of BEE encourages an enterprise to direct money spent on procuring goods and services to enterprises which have good BEE credentials, because this improves its own B-BBEE status. The commercial pressure to implement BEE is therefore trickled down to entities which do not themselves seek any such licence, concession or contract, but must compete for business with other entities that may have a better B-BBEE status.

The Generic Codes add substance to the seven elements of B-BBEE identified in the BEE Strategy. They describe the seven elements as follows:

- ownership: assesses the proportion of voting rights and economic rights held by black people as a percentage of the total voting and economic rights held in the enterprise by its “owners”;
- management control: assesses the black members of the board of directors (and the proportion of the voting rights they hold) and the participation of black people in the “top management” of the enterprise;
- employment equity: assesses the number of black employees in an enterprise’s senior, middle and junior management and encourages initiatives to achieve equity in the workplace in line with the spirit and intent of the Employment Equity Act, No. 55 of 1998;
- skills development: assesses the extent to which enterprises implement initiatives designed to promote the development of core competencies of black employees;
- preferential procurement: assesses the extent to which enterprises buy from black suppliers and service providers;
- enterprise development: assesses the extent to which enterprises implement initiatives intended to assist and accelerate the development of other enterprises that meet the BEE compliance requirements set out for enterprise development; and
- socio-economic development: assesses the contributions by enterprises to corporate social investment initiatives, recognised socio-economic development initiatives and sector specific programmes.

In terms of the Generic Scorecard, a measured enterprise is awarded points out of a possible score of 100 (although it is possible to earn bonus points, therefore theoretically, an enterprise can achieve more than 100 out of 100).

The respective weightings (ie points out of 100) of the seven elements are set out in the Generic Scorecard as follows:

| Element                    | Weighting |
|----------------------------|-----------|
| Ownership                  | 20        |
| Management control         | 10        |
| Employment equity          | 15        |
| Skills development         | 15        |
| Preferential procurement   | 20        |
| Enterprise development     | 15        |
| Socio-economic development | 5         |

There is a scorecard for each element, which sets out the “indicators” or sub-elements against which an enterprise will be measured. The combined scores obtained from the scorecards for the seven elements comprise the score achieved in terms of the Generic Scorecard.

### B-BBEE Status

The number of points an enterprise scores against the Generic Scorecard will be converted into a “B-BBEE status level”. It is this B-BBEE status level which will then be recorded on the certificate prepared by the verification agency.

On the same table, the B-BBEE status level is convertible to a “B-BBEE procurement recognition level”, which a customer of the measured enterprise will use to determine its own BEE procurement spend:

| B-BBEE status             | Points on the Generic Scorecard | B-BBEE procurement recognition level |
|---------------------------|---------------------------------|--------------------------------------|
| Level one contributor     | at least 100                    | 135%                                 |
| Level two contributor     | at least 85, but less than 100  | 125%                                 |
| Level three contributor   | at least 75, but less than 85   | 110%                                 |
| Level four contributor    | at least 65, but less than 75   | 100%                                 |
| Level five contributor    | at least 55, but less than 65   | 80%                                  |
| Level six contributor     | at least 45, but less than 55   | 60%                                  |
| Level seven contributor   | at least 40, but less than 45   | 50%                                  |
| Level eight contributor   | at least 30, but less than 40   | 10%                                  |
| Non-compliant contributor | less than 30 points             | 0%                                   |

The following two examples illustrate how B-BBEE status and B-BBEE procurement recognition levels may affect enterprises and investments in South Africa:

- in a privatisation exercise, a Government department may decide that only purchasers with a B-BBEE status of level four or above will be considered for the purchase of a particular State-owned enterprise; and
- a customer faced with quotes to supply a particular service from two competing enterprises may choose the one with the better B-BBEE status because by doing so it will enhance its own B-BBEE status (through the increased recognition awarded to it in terms of the procurement element scorecard). For example if the customer purchases from a level three contributor, ZAR 1 for every ZAR 1 spent will count as BEE procurement spend, whereas if it purchases from a level seven contributor, only 50c of every ZAR 1 spent will count as BEE procurement spend.

### The Ownership Scorecard

| Category | Ownership indicator  | Weighting points | Compliance target |
|----------|--|------------------|-------------------|
| 1        | Voting rights:   |                  |                   |
|          | Exercisable voting rights in the enterprise in the hands of black people   | 3                |                   |
|          | Exercisable voting rights in the enterprise in the hands of black women  | 2                |                   |
| 2        | Economic interest:   |                  |                   |
|          | Economic interest of black people in the enterprise  | 4                | 25%               |
|          | Economic interest of black women in the enterprise   | 2                | 10%               |
|          | Economic interest of the following black natural people in the enterprise: <ul style="list-style-type: none"> <li>• black designated groups</li> <li>• black participants in employee ownership schemes</li> <li>• black beneficiaries of broad-based ownership schemes</li> <li>• black participants in cooperatives</li> </ul> | 1                | 2.5%              |
| 3        | Realisation points   |                  |                   |
|          | Ownership fulfilment   | 1                |                   |
|          | Net value  | 7                |                   |
| 4        | Bonus points   |                  |                   |
|          | Involvement in the ownership of the enterprise by black new entrants   | 2                | 10%               |
|          | Involvement in the ownership of the enterprise of black participants in employee ownership schemes, broad-based ownership schemes or cooperatives  | 1                | 10%               |

Thus, an enterprise can score 20 points (or, if bonus points are attained, 23 points) in terms of the Ownership Scorecard. Of those 20 points, two points are awarded for ensuring that 10% of the exercisable voting rights in the enterprise are in the hands of black women. By way of example, if only 5% of the exercisable voting rights in the enterprise are in the hands of black women, the enterprise will be awarded only one point (as it is only halfway towards meeting the target).

In turn, the Generic Codes specify the formula to be used (in certain instances, more than one formula must be applied) in order to calculate the points scored by the measured enterprise in respect of each of the indicators. Ultimately, the number of points scored for each of the indicators will be tallied and the total will comprise the number of points scored by the measured enterprise in respect of that element.

### **Multinational Enterprises and Equity Equivalents**

The Generic Codes recognise that a “multinational business” (defined as a measured entity with a business in South Africa and elsewhere, which maintains its international headquarters outside South Africa) may not be able to dispose of equity to South Africans.

Provision is therefore made in the Generic Codes for multinational businesses who qualify for the dispensation to obtain points for the ownership element through “Equity Equivalents”. Primarily, the multinational will be awarded ownership points for establishing and implementing programmes (defined as “Equity Equivalent Programmes”) aimed at encouraging participation in the South African economy by black people and approved by the Minister.

Equity Equivalent Programmes may include programmes that support the Accelerated and Shared Growth Initiative for South Africa, the Joint Initiative for Priority Skills, and the National Skills Development Strategy. Equity Equivalent Programmes may also include programmes that promote enterprise creation in respect of cooperatives that are:

- more than 50% owned by black people;
- more than 30% owned by black women; or
- more than 50% owned by members of black designated groups (defined as black people who are unemployed, youth, disabled or who live in rural or underdeveloped areas).

Any other programmes that promote socio-economic advancement or contribute to the overall socio-economic development of South Africa may also qualify as Equity Equivalent Programmes.

Equity Equivalent contributions made in this manner are measurable against the value of the multinational’s operations in South Africa. The Equity Equivalent element has a weighting of 20 points in terms of the Generic Scorecard.

A foreign multinational may choose from two different targets: either 25% of the value of its South African operations or 4% of total revenue of its South African operations determined annually or over a 10-year period. The multinational may choose to make a once-off contribution towards its Equity Equivalent Programme or do so over an extended period of up to 10 years.

The Generic Codes also indicate that a foreign multinational may score points on the ownership element through equity held in the offshore enterprise by South Africans who are black people. An example would be a multinational enterprise listed on the London Stock Exchange, which can demonstrate that some of its shares are held by black South Africans, or for the benefit of black South Africans (for example, by an institutionalised shareholder such as a pension fund).

In such cases, the shares held in the multinational entity offshore may be considered in the ownership calculation relevant to the local subsidiary of the multinational enterprise. There are a number of difficulties associated with this provision, so investors are urged to obtain advice before adopting this route.

## Revised Generic Codes

The DTI gazetted revised Generic Codes on 11 October 2013 (Revised Generic Codes). Salient features include the facts that:

- under the Revised Generic Codes, enterprises have been given a transitional period starting on 11 October 2013 to 30 April 2015 to align their affairs with the Revised Generic Codes' requirements. During this transitional period, enterprises may elect to be measured either in terms of the Generic Scorecard under the Revised Generic Codes or the Generic Codes. However, enterprises governed by sector-specific codes will continue to be measured in terms of those Sector Codes;
- the Generic Scorecard in the Revised Generic Codes provides that all enterprises will be measured in terms of five B-BBEE elements, being ownership, management control, skills development, enterprise and supplier development and socio-economic development;
- the Revised Generic Codes introduce the following sub-minimum targets for three priority elements, namely ownership, skills development and enterprise and supplier development:
  - 40% of net value points for ownership, net value being one of the measurements for ownership which looks at the extent to which shares held by black shareholders are free from encumbrance;
  - 40% of the total weighting points for skills development; and
  - 40% for each of preferential procurement, enterprise development and supplier development;
- large entities must comply with all three priority elements, while QSEs must comply with at least two of the three priority elements, one of which being the ownership priority element. The Revised Generic Codes provide for the downgrading of the B-BBEE status level of both large entities and QSEs by one level in the event that the above targets are not met. Large companies will find in any event that the more stringent targets in the Revised Generic Codes are likely to have a negative impact on current B-BBEE ratings, even without the additional one level downgrading that has been introduced;
- another significant change brought about by the Revised Generic Codes is the increased threshold in points required to achieve a better B-BBEE status. For example, a company currently needs 65 points to achieve a level four B-BBEE status (and 100% procurement recognition level). Under the Revised Generic Codes, a company would need at least 80 points to achieve that same status; and
- the thresholds for enterprises to qualify as EMEs, QSEs or large entities, are as follows:
  - EME increased from ZAR 5 million to ZAR 10 million;
  - QSE increased from ZAR 5 million - ZAR 35 million to ZAR 10 million - ZAR 50 million; and
  - large entities increased to ZAR 50 million and above.

## Verification Agencies

Provision has been made for the B-BBEE status of enterprises to be measured by verification agencies. Verification agencies are accredited by the South African National Accreditation Systems Agency (SANAS) and/or the Independent Regulatory Board of Auditors (IRBA) and are required to observe certain guidelines in the B-BBEE verification process.

## Industry and Sector Charters

Certain industries have developed charters that provide for BEE targets for those particular industries. This has been achieved through industry bodies, negotiations with Government and as a consequence of legislation.

Under Section 12 of the Generic Codes, these charters can be recognised either as "Transformation Charters", in which case only the participants in that industry are bound to them or as "Sector Codes", in which case organs of State and public bodies are obliged to apply them in the same manner as the Generic Codes.

Once Industry Charters are adopted and subject to the procedures set out in the Generic Codes they can be submitted for gazetting in terms of Section 9(5) of the B-BBEE Act as amended. At this stage, the Draft Industry Codes remain open for public comment and are only finalised once they are gazetted in terms of Section 9(1) of the B-BBEE Act as amended.

## Sector Charters Gazetted in terms of the B-BBEE Act

Once gazetted, charters become Sector Codes which apply in priority to the Generic Codes in the relevant industries. Presently, the transformation efforts of the following industries are assessed with reference to the Sector Codes:

### Agricultural sector charter

This code aims to take account of the unique challenges facing this sector by, among other things, dividing the ownership element into two sections where participants are given the option of pursuing their empowerment objectives either through “General Ownership” or “Agricultural Land Ownership” or both, all in support of Government’s Land Reform Programme which aims to transfer 30% of commercial agricultural land to black people by 2014. This code became effective on 28 December 2012.

### Chartered accountancy sector charter

This code seeks to increase the number of black people, and especially black women, in the profession of chartered accountancy. The sector has committed to 32.5% black ownership of chartered accountancy firms by the end of 2016. It became effective on 10 May 2011.

### Construction sector charter

This code applies to all enterprises which are involved in the creation, expansion and/or maintenance of fixed assets related to residential or non-residential buildings, infrastructure or any other form of construction works in South Africa.

The code sets out the framework for measuring BEE in the construction sector, envisaging a transformation period of seven years. At the end of the seven years, the code aims to achieve a target of 30% black ownership in the sector. This code became effective on 5 June 2009.

A Construction Charter Council was established to oversee and monitor the implementation of the Construction Sector Code.

### Financial sector charter

This code is aligned to the Generic Codes, but also regulates issues of access to financial services and empowerment financing. The aim of including these additional elements is to encourage the financial sector to implement initiatives to make financial services accessible to the previously unbanked and under-served population of South Africa.

It is also intended to encourage the provision of affordable housing, financing of black SMMEs and agricultural activities and investing in various forms of infrastructure that create the necessary platform to grow the economy. Given the additional elements, the weightings applicable to most of the Generic Scorecard elements have been changed.

Separate ownership scorecards are provided for local measured entities and local branches of foreign banks. In addition, an ownership fulfillment target will apply to economic interest as a result of direct or indirect B-BBEE ownership in excess of 15%. This code became effective on 26 November 2012.

### Forestry sector charter

This code applies to all enterprises involved in commercial forestry and the first level processing of wood products. It includes the following sub-sectors: growers, forestry contractors, fibre, sawmilling, pole and charcoal.

The code aims to attain 30% black ownership within the forest sector within a period of 10 years. In respect of the other elements, the forest sector has aligned itself with the provisions of the Generic Codes. The code encourages and incentivises BEE compliant procurement, ownership and job creation within the sector. This code became effective on 12 June 2009.

### Information and communications technology sector charter

This code is aligned to the Generic Codes. There is, however, a marked difference between the weightings allocated to a number of elements in this code compared with the Generic Codes.



In terms of this code, the participants in the industry have committed to transferring 30% ownership (as opposed to the 25% target set out in the Generic Codes) to black people. An interesting innovation regarding the black shareholding target states that despite the percentage black shareholding in an information, communications and telecommunications company, if the Rand value of the total BEE stake in that company is in excess of ZAR 7.5 billion, then the company will be considered to be compliant with the black shareholding target in the scorecard.

In the case of listed companies the prescribed minimum float of 20% is excluded from the computation of the target. Therefore, the target for black shareholding in a listed company is calculated as 30% of 80%, which translates to 24%. However, this relaxation for listed companies is subject to black shareholders maintaining voting rights of 25.1%. This code became effective on 6 June 2012.

### **Integrated transport sector charter**

This code contains sub-codes relating to eight sub-sectors: bus commuter and coach services, taxis, road freight, public transport, maritime transport and services, forwarding and clearing, rail and domestic aviation.

The code aims to fast-track the development of efficient transportation, freight and logistics sectors within the economy. It became effective on 21 August 2009.

### **Mining and liquid fuels sector charters**

The Mining Charter was promulgated on 13 August 2004 in terms of Section 100(2)(a) of the Mineral and Petroleum Resources Development Act, No. 28 of 2002. It was revised on 10 September 2010.

The Liquid Fuels Charter was published as Schedule 1 to the Petroleum Products Act, No. 120 of 1977, when the Petroleum Products Amendment Act, No. 58 of 2003, was assented to on 20 April 2004.

Because the Mining and Liquid Fuels Charters were published in terms of entirely different Acts, there are many differences between the Mining and Liquid Fuels Charters and the Generic Codes. The major difference is the target for empowerment – whereas the Generic Codes focus on “black people”, both the Mining and Liquid Fuels Charters still refer to the empowerment of “historically disadvantaged South Africans”. The revision of the Mining Charter has added further confusion by requiring that the empowerment of such groups must be representative of the South African population.

In addition to the revision of the Mining Charter being legislatively problematic, the revised version has introduced much confusion regarding the question of whether enterprises in the downstream mining industry (eg non-mining companies which act as suppliers to the mining industry) can be measured against the Generic Codes for empowerment purposes. Although the correct view must be that they can (the Mining Charter having been specifically designed with mining companies in mind), non-mining enterprises in the mining industry are often required to demonstrate compliance against both standards – those imposed by the Mining Charter and those imposed by the Generic Codes.

### **Property sector charter**

This code seeks to transform the property owning patterns in the South African economy and applies to the residential and commercial property industry. All enterprises engaged in property ownership, leasing, management, sales and valuation are governed by the code.

The terms of the code are similar to those in the Generic Codes, although the property owning companies' ownership scores are measured more leniently in relation to the realisation points (the encumbered percentage of black ownership is not required to reach 100%, but only 50%, within 10 years). This code became effective on 1 June 2012.

### **Tourism sector charter**

This code applies to entities providing accommodation, hospitality or travel services. The code is based on the Generic Codes, but has differing weighting points, targets and definitions.

The code aims to attain a target of 30% black ownership within the sector by 2019 and became effective on 22 May 2009.

## Conclusion

The measures that potential investors in South Africa should implement to attain a particular B-BBEE status will depend on the nature of the likely business relationship with organs of State and public entities, as well as with private entities that will assess the B-BBEE status of the proposed business for their own procurement scorecards. Any BEE initiatives that are implemented should follow the measurement principles, definitions and scoring system provided for in the applicable Sector Codes.