

APPLICATION OF THE BBEE CODES OF GOOD PRACTICE

With the Gazetting of the final BEE Codes comes clarity on how to implement BEE initiatives. However, as a new piece of regulation, there are several issues companies should understand more fully before jumping in at the deep end.

As we know, the Codes are a balanced scorecard which allows companies to score points along 7 elements. Balanced scorecards are well understood in the corporate world as a means of comparing performance amongst vastly different entities. Balanced scorecards allow some level of fairness in that companies will do well on elements which are aligned with their core focus, and less well in other elements. Where companies go wrong however is in considering each element separately – rather than looking for opportunities to optimise across the elements. This means that companies have no understanding as to which initiatives are the ones to focus on in order to maximise their BEE score by gaining points under several elements. The Codes create a natural incentive process to optimise your BBEE score by for example procuring from a new BEE company set up as an Enterprise Development initiative which allows for 1.2 times your procurement spend to be included under Preferential Procurement.

In the Ownership element, Equity equivalents is a concession made to multinationals operating in South Africa who have a global policy of not selling equity in the local markets in which they operate. As an alternative to selling equity, companies can invest the equivalent of 25,1% of the value of their company over 10 years in an 'equity equivalents' program. As this is a significant cash investment, companies would need to consider that the expected return on this investment should be at least equal to, if not greater than, the return on investment in their existing company. If this is not the case, multinational companies should seriously consider selling 25,1% of the equity in their local operations and reinvesting the proceeds into their business at existing internal rate of return. When undertaking such an equity sale to a BEE party, companies should be aware that score is not purely a proportion of the target 25.1% BEE ownership. Many transactions lose out on 'Net Value' points which are created to track the Net Value in the BEE partner's hands. Numerous BEE SPV structures are sub-optimal as they did not factor the aggressive timing of the Codes into their repayment schedules. Some leveraged structures are better suited to achieving these points from day one thus scoring much higher.

Indirect ownership was the corresponding concession given to local companies, where large portions of their equity are held by institutional investors such as pension funds. The Codes allow this indirect institutional ownership to be treated in two ways – either to be excluded up to a maximum of 40%, or to be investigated to determine the ultimate economic benefit in black

hands through this institutional investment. As the Codes stand currently most listed companies that have operating subsidiaries will not benefit from the exclusion principle of indirect ownership and as such would still need to do a 25,1% BEE deal. If however the listed company is the operating entity then these companies would benefit from the exclusion principle. This in our view does not make any sense and companies should be aware of these complexities before spending large amounts of time calculating indirect ownership.

South Africa has been historically bad at developing skills – evidenced in the fact that only around 7% of the population between the ages of 45 and 65 have tertiary education (Govt Census 2001) – compared with more than 20% for developed countries. Additionally, when attempting to reach BEE requirements at Board levels, only 35% of the already scarce senior talent pool is black, making it seemingly tough for private sector companies to achieve their BEE targets in senior management of 40% and Board Directors of 50%. This is compounded by the preferred employment path for this black senior executive talent being Government, the State Owned Enterprises or the alluring opportunities of entering in the BEE deal-making space. This should not be an excuse though, as experience has shown that not all successful senior management have tertiary education, but have risen through the ranks based on their team and leadership skills. Companies should be creating the right environment to attract senior black talent with these leadership skills for the long term through creating the right environment for them to add value to the organisation. Too often, the black Transformation or HR Director is given the task of ‘transforming the company’, but not given any resources or budget to do so, nor given much time in the operational Board meetings to raise transformation issues.

Fortunately, things are rapidly changing at the younger levels, with 62% of 25 to 45 year old tertiary educated people in South Africa being black. This puts the onus on companies to attract new graduates and retain strong performers so that over the target period, these skills could be grown in the organisation. The most over-used and expensive solution, particularly for black talent, is to pay more to attract and retain. A better approach again is to provide for softer issues such as creating the right development opportunities, career path and training/mentorship for young folk and creating the right environment to support success.

In the Preferential Procurement element, it might come as a surprise that many companies do not have the centralised procurement systems allowing for easy determination of suppliers’ BEE status or enterprise size of these suppliers. As a consequence, many face a relative mine-field when approaching preferential procurement and trying to determine their BEE spend. This is compounded by a new rating system which is not fully in place yet and the frequent excuse heard is “there is no rating system, therefore I cannot proceed” and “I can’t rate myself until my suppliers have been rated”. To prevent the syndrome of the snake chasing its tail and no progress being made, procurement managers need to focus on the top 20% of their suppliers who invariably provide 80% of their procurement spend and use a conservative estimate of their score as an interim measure to at least get some traction.

As a second leg to their preferential procurement efforts, companies should put in place sustainable Enterprise Development schemes which grow their BEE suppliers so that they can procure from them efficiently. To support this activity, the BEE Enterprise Development

element directly encourages established companies to spend 3% of their net profit after tax on starting up new black businesses.


In our experience, we believe that the Codes incentivise the combination of the three ingredients critical to the creation of a sustainable business. The first is having access to the market and a potential set clients who have a need for a product or service and are willing to pay for it (through preferential procurement). Initial venture funding is provided through Enterprise Development which allows set up or expansion of the business. The final requirement is sufficient skills and experience to, not only provide the product/service, but also to set up and manage a growing business, which will require the services of an enterprise support and incubation program. Again, the DTI incentivise this as all costs to set this up can be considered as BEE enterprise development spend.

The Socio-economic Development element is typically well understood by companies. For best practice, however companies should seek ways for their programmes to be recognised as tax deductible through sponsoring registered charities. Additionally, companies should align this programme to the long term interest of their business. For example, IT companies should be sponsoring computers in schools as this is where their next generation of customers and potential staff will come from. It is encouraging to see that Minister Manual announced in his 2007 Budget Speech that up to 10% of taxable income can be deducted up from the 5% threshold previously.

Finally, to achieve scores on all of the above elements sometimes requires little more than recognising the efforts currently underway and providing sufficient audit trail to show the time or money spent on these. As a result, companies need to change their information systems to capture all monetary and non-monetary contributions to BEE.

KEITH WEBB, AJAY LALU AND ALANA BOND

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