

## SUMMARY OF THE CHANGES TO THE CODES OF GOOD PRACTICE

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After Cabinet approved the final BEE Codes of Good Practice, the DTI publicly launched the Codes in a detailed briefing session at the end of last year. While the detailed codes will only be published in late January 2007, here is a summary of key changes.

Overall, the Codes will not satisfy all stakeholders, but its robust nature ensures a fair document that all companies will be able to implement. Unfortunately, attempts to make the Codes workable for all have resulted in the complexity being reduced only slightly. **Gender Recognition Factors** are a new feature which have reduced the number of indicators by combining those pertaining to black men versus black women. Other simplifications have come at the cost of **removing the easier to achieve indicators** such as appointing transformation champions and having BEE policies and plans in place. Additionally, concessions allowing the **high water-mark principle** in ownership, allowing the inclusion of **indirect ownership**, and allowing multi-nationals the option to use **equity equivalents** still need to be thought through clearly and are (for better or worse) open to interpretation.

On **Ownership**, the use of **employee share ownership schemes** has been **capped at 40%** of the BEE component (i.e. 10% of ownership) in order to discourage abuse of these schemes. The DTI recognized the benefit of well constructed employee share schemes, but admitted they had seen too many poorly set up schemes where the beneficiaries were unclear. The **high water-mark principle** allows **ownership points to be maintained after sale** by black partners, and will be based on the **net value created in black hands**. To qualify, black owners must have their stake for **at least 3 years** and there must be a level of **BEE transformation** within the company. Additionally, black shareholding arising from sale or loss of shares can contribute **no more than 40%** of the ownership points.

**Indirect ownership** is a similar concept where companies largely held on the JSE or held through pension and investment funds can recognize **up to 40%** of their ownership points through indirect black ownership. **Black private equity funds** will be recognized as 'black owners' if more than **50% of voting rights and economic interest** are held by and accrue to black people and the **fund manager** is also a black owned company.

In our view, the most important shift in emphasis in the broad-based elements of the codes has been the encouragement of **real empowerment through Enterprise Development**, supported (as previously) by encouraging Preferential Procurement from new BEE enterprises. The **weighting** for Enterprise Development has been increased from **10 to 15%** and **Industry specific contributions** have been included in under Enterprise Development. The DTI is also encouraging what has previously been a neglected element of the scorecard by making it easier to achieve – the **target** for Enterprise Development has been **significantly reduced to**

**3% of NPAT from 5% of EBITDA.** A control has been put in place should companies abuse the NPAT metric and this is set at **0.375% of turnover**. The DTI made it clear that it was **not** a case of using the higher of the two i.e. NPAT would be the primary metric and turnover only as a check.

To further encourage smaller enterprises in South Africa and simplify the application of the Codes, **Exempt Micro Enterprises (EMEs) automatically score Level 4 BEE.** EMEs are defined as those with a **turnover of R5m or below**. Additionally, **Qualifying Small Enterprises (QSEs)** with a turnover of between **R5m and R35m** can select **four of seven simplified scorecard** elements, each with a **weighting of 25%**. This means that the full BEE Codes only apply to companies with turnovers greater than R35m. **By volume, these companies make up approx. 2% of the registered companies in South Africa which generate approx. 60% of GDP, putting paid to the argument that BEE will be a significant tax on smaller companies and to the economy as a whole.**

**Preferential procurement** has been made easier as 100% of company's imports can be excluded under specific circumstances, but we advise awaiting the detail before making significant judgment calls. **Procurement targets of 20% of spend** from companies more than **50% black owned** or **30% black women owned** have been added with a **weighting of 5** encouraging real empowerment as mentioned above. Requirements to **procure from QSEs and EMEs** have been maintained at **15% of spend** (double counting with the above is allowed), but with a **weighting reduced from 5 to 3**. **Interim 5 year targets** have been set of **approximately 60%** of the 10 year targets, to make it easier for companies to achieve a good initial score.

On **Management, Employment Equity** and **Skills Development**, the changes are as expected with the **weighting for Employment Equity** being increased to **15%** (from 10%) and **Skills Development** being reduced to **15%** (from 20%). As mentioned above, the gender recognition factor applies to each level and **interim 5 year targets apply**. **Companies would be well advised to take advantage of the increased score in the first 5 years, but plan for a 10 year target so as not to incur a drop in BEE score in year 6.**

Most of the decreased weighting in **Skills Development** came from **removing the 6 'bonus points'** for having a BEE strategy, Skills Development Facilitator etc. That said, the DTI has made it simpler to calculate the Skills Development score by **removing** the distinction between training for **core skills versus general skills**. The targets for Skills Development remain at **3% of payroll**, apparently benchmarking well with international standards in developing countries. **Learnerships** are still **encouraged** through a **Learning programme matrix**, however, the detail of such a programme is not yet available. It is our understanding that this should **reduce reliance on** a bureaucratic **SETA system** to achieve the goals of Skills Development.

**Socio-Economic Development** has had industry specific initiatives removed and the **weighting reduced to 5 points**. Additionally, **targets** have been **reduced** from 1.5% of NPAT to **1% of NPAT**, with a check using 0.125% of turnover. As with Enterprise Development, the primary metric is NPAT.


Finally, the rating agency system is in the process of being finalized, with accredited **rating agents expected by April 2007**. The DTI is working with the other Government departments to

**align the BEE Codes with other related legislation** such as employment equity which should minimize the administrative burden on companies. As such, **Preferential Procurement requirements** of government departments and parastatals should be **aligned**. **Sector charters** are expected to move ahead and will need to be **significantly aligned with the Codes** also to simplify BEE across sectors.

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