

WHAT IS THE END GAME FOR BBEE?

Over the past 12 years of democracy, Broad Based BEE has undergone a significant transformation. Initially, at the dawn of the new South Africa, 'Black Empowerment' was a loosely defined philosophy, which was focussed on black ownership of the economy. Some companies pursued empowerment initiatives in this loose framework partly because they saw the writing on the wall and partly because they believed it was the right thing to do. As we moved forward it became clear that Black Empowerment was not only about ownership but really required a far broader approach in order to benefit the ordinary man in the street – hence Broad-based BEE. Companies which had started on their initiatives found it easy to modify these to suit the new thinking. However, some saw BEE as a cost and were reluctant to pursue initiatives until 'forced' to do so. As a result, we have seen a philosophy develop into regulation in the form of the Department of Trade and Industry's Codes of Good Practice - which requires clear action on seven elements for companies with a turnover greater than R 35 million.

The most important aspect of the Gazetting of the Codes of Good Practice is that it provides certainty in respect of implementation and measurement of BBEE. Additionally, the Codes require that the various sector charters like the Financial Sector Charter which were negotiated in the absence of such clear direction, will have to be brought in line with the Codes of Good Practice in order to reduce the complexity of the entire system. One of the biggest drivers of BEE into the Private Sector is through Preferential Procurement by State Owned Enterprises (SOEs), however a recent review these procurement policies has revealed various deviations from the Codes in terms of measuring the BEE status of suppliers – requiring suppliers to spend efforts addressing each measurement system in turn. This will need to be urgently addressed if SOEs are to assist in reducing the costs of and uncertainty in BEE compliance.

With the reduction in uncertainty and therefore cost to achieve BEE, we expect to see a flurry of activity in the BEE space, moving forward. We envisage that BEE related merger and acquisition activity will continue over the next few months as companies who were waiting for certainty feel comfortable moving ahead. Furthermore, many transactions that were done historically may need to be restructured moderately to achieve maximum score on the balanced scorecard. Sectors which have had less incentive to undertake BEE initiatives such as the retail, manufacturing and tourism sectors will come under increasing pressure to transform as Government finds ways to leverage not only procurement requirements, but licensing requirements, public perception and investor activism through the Public Investment Corporation. We will see significant investment into various sectors such as ICT, Paper and packaging and wine and spirits on the back of the greater certainty that has been provided by the Codes as many sectors have been holding back due to the Codes not being finalised.

Additionally, we expect to see far more focussed activity on Broad-based elements such as Employment Equity, Skills Development and BEE Enterprise Development in order to improve Preferential Procurement scores.

In the medium term, we are watching with interest the formation of focussed BEE companies such as Exxaro, Mvelaphada and Brimstone which will rival the large multinationals for access to resources and compete effectively as a result of their BEE status, but increasingly through their operational involvement. Similar to the Afrikaner empowerment process that resulted in large listed companies like Sanlam and ABSA, Black Empowerment will also create large corporations that will hold their own on a global platform. Sectors expecting high growth over the next 5 to 10 years, such as construction, manufacturing and new technology areas such as bio-fuels are ripe for leadership from big-scale black corporate entrepreneurs.

That doesn't mean that traditional companies are doomed! The Dot com boom and subsequent crash highlighted that traditional companies which can transform rapidly are more likely to succeed than new companies which make their sole competence the new technology (or in this case, the new regulation). Ultimately, companies need to bring competitive operational skills to a market opportunity of uncertain duration created by a regulatory construct. This is evidenced in Malaysia, where the native Bumipatra found themselves out-competed in industries where they had become complacent as a result of regulation protecting their interests.

Most traditional companies will achieve BEE through the sale of a portion of equity in the existing entity to black shareholders. This has created companies such as Shanduka and numerous smaller BEE companies who have portfolios of minority investments in diverse industries. These players could consolidate to become the next major diversified financial services players as significant passive investors. Alternatively, a less exuberant market than we've had over the last 3 years will require that black conglomerates focus their portfolio investments on industries they can add value to, resulting in an 'all change' as groups refocus their portfolios and swap assets between them. Before this happens, BEE groups will need to decide which role they want to play - passive portfolio manager or active operational owner - and which sector or core competence to focus on or face losing out in a now globally competitive market.


Finally, there are those Black entrepreneurs who concluded their BEE transaction some three to five year ago and as a result of significant economic growth, are showing signs of real wealth accumulation to varying degrees and are itching to 'cash out'. The question that needs to be asked here is what happens to this new found wealth? There are basically two scenarios: The first is that this new found wealth is spent on the proverbial lifestyle assets like cars and houses. This is not entirely bad as we've seen the ability of consumer spending to stimulate the economy. However, if Mr. Manual's speech encouraging longer term savings is to be respected, the second and preferred scenario is that this wealth is re-invested into the establishment of new black owned and managed entrepreneurial enterprises. This will create long term and sustainable wealth for generations to come and allow people to become operationally involved in building businesses as true entrepreneurs. Government's massive infrastructure investment program and its preferential procurement policies should be no small incentive for black entrepreneurs to reinvest their new-found wealth in the creation of businesses with the capacity to deliver to Government's requirements.

Finally, the ultimate in crystal ball gazing, what do we see as the end game of BBBEE? Is it that black people 'own 25% of the JSE' (an impossible metric to quantify and ultimately meaningless as most investment in the JSE is indirect held through pension funds); or is it the emergence of historically black owned, managed and controlled enterprises that are listed on the JSE; or is it that we have a significant portion of our population living middle class lifestyles with wealth created indirectly through investments on the JSE? In our view it must be a combination of all of this and more. BBBEE regulation - as a key means for Government to align private and public sector activities to the broader economic development strategy - must address the skills backlog, reduce poverty and unemployment and create a class of black people who have sufficient income not only to live decent lifestyles, but save enough to create long term wealth in black hands. This should be the end game. It will clearly take several generations to eradicate the legacy of apartheid education and address issues of rural and township poverty. However, in the end game, BEE regulation will no longer be required when the market naturally takes up the challenge of involving all of its citizens in productive activity, without the need to force the mending of an economic, skills and cultural divide created through years of separating the country along racial lines.

Whatever the end game is, we should all be aiming to do our bit to achieve the end game as this will lead to a new South Africa that will be economically prosperous for all its people both black and white.

KEITH WEBB, AJAY LALU AND ALANA BOND

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