

Black Economic Empowerment

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SOUTH AFRICA

What is BBBEE and why is it important?



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**BLACK ECONOMIC EMPOWERMENT
ALERT**

What is BBBEE and why is it important?

South Africa is a country rich in diversity. This diversity extends not only to its natural environment but to its people and cultures. Apartheid subverted and stymied the development potential of this diversity by enabling laws and policies that oppressed and excluded the majority of its people, on the basis of racial classification, from effective political and economic participation.

When these laws and policies were dismantled, it became necessary to look at measures to address the (continuing) effect of these oppressive and exclusionary laws and policies on the majority of South Africans and ensure the effective participation by the majority of South Africans towards building an inclusive South African economy.

What is BBBEE and who does it apply to?

BBBEE means Broad-Based Black Economic Empowerment and is often simply referred to as "BEE" or "*Black Economic Empowerment*".

It is a legislatively mandated and regulated system of laws and policies aimed at promoting BBBEE in South Africa and thereby addressing the exclusion of the majority of Black South Africans from effectively participating in the formal economy under Apartheid.

Black South Africans are those who were previously classified (under Apartheid laws) as Africans, Coloureds and Indians.

The primary enabling legislation is the Broad-Based Black Economic Empowerment Act 53 of 2003 (BBBEE Act). As noted in the preamble to the BBBEE Act, the South African economy still excludes the vast majority of its people from ownership or productive assets and the possession of advanced skills and performs below its potential because of the low level of income earned and generated by the majority.

The objective of the BBBEE Act is to facilitate BBBEE. The BBBEE Act seeks to achieve this in a number of ways, including by achieving a substantial change in the racial composition of ownership and management structures and in skilled occupations of enterprises operating in South Africa. It also specifically seeks to promote the ownership and participation of Black woman, rural and local communities and workers in the South African economy.

The BBBEE Act applies to and is binding on all South African organs of state and public entities but does not oblige any private enterprise to undertake BBBEE. However, because under section 10 of the BBBEE Act all organs of state and public entities are required to apply BBBEE when, among other things, determining qualification criteria for the issuing of any licenses, concessions or other authorisations to conduct any regulated economic activity, BBBEE has become a business imperative for many businesses (and their suppliers) that conduct any licensed or similarly regulated economic activity in South Africa.

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Under the Codes of Good Practice on Broad-Based Black Economic Empowerment (Generic Codes), entities that have an annual turnover of R10 million or less can obtain an automatic (level 4) BBBEE recognition without having to comply with any of the BBBEE scorecard targets. These entities are referred to as exempted micro enterprises or EMEs. Sector-specific codes may, however, stipulate different turnover thresholds for EME qualification depending on sectoral characteristics.

What are the BBBEE Codes and BBBEE elements?

The objectives of the BBBEE Act are ostensibly manifested through the promulgation of BBBEE codes of good practice (BBBEE Codes) which set out the compliance rules and guidelines, interpretive principles and scorecards applicable to each of the measurable elements.

There are two categories of BBBEE Codes. The first is the Generic Codes which apply generally to all measurable entities and the second are sector BBBEE Codes (Sector Codes) which apply to certain sectors of the economy. Currently, there are 12 Sector Codes spanning various industries, including agriculture, construction, chartered accountancy, defence, financial services, forestry, information and communication technology (ICT), marketing, advertising and communications (MAC), property, tourism, transport and the legal sector. Sector Codes take precedence over the Generic Codes so BBBEE compliance for entities operating in a sector to which a Sector Code applies must apply that Sector Code and not the Generic Codes. The Generic Codes do retain residual application as many of the interpretive principles, methodologies and definitions contained in the Generic Codes also apply to Sector Codes.

All BBBEE Codes require assessment against targets set out in scorecards for five BBBEE elements: ownership, management control, skills development, enterprise and supplier development, and socio-economic development.

What are BBBEE recognition levels?

BBBEE recognition levels, or BBBEE status, are determined based on the overall score achieved by an enterprise under each of the BBBEE element scorecards.

There are eight levels of compliance, with level eight being the lowest and level one being the highest. A level one BBBEE recognition level means that your customer can claim 135% of the total procurement spend (with you) against the applicable targets in the enterprise and supplier development (ESD) scorecard and hence achieve optimal BBBEE scoring.

Why is BBBEE important?

BBBEE is not only an important policy tool in promoting economic and other forms of participation by Black South Africans in the South African economy, it also provides a distinct competitive advantage to private sector enterprises that achieve optimal BBBEE scoring.

Because compliance with the BBBEE Codes requires measurement against the BBBEE elements, which includes preferential procurement (part of the ESD element), enterprises are encouraged (incentivised) to contract with suppliers that have superior BBBEE recognition levels and, in so doing, optimise BBBEE scoring and hence achieve a competitive advantage.

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BBBEE compliance is also aimed at promoting the inclusion of small businesses like EMEs, and in particular Black-owned small businesses, so as to promote the development and growth of these kinds of entities that would otherwise not necessarily have had the opportunity to provide goods and services to larger more established business entities.

The evolution of BBBEE and in particular the introduction of Sector Codes has resulted in BBBEE compliance being fairly widespread throughout the South African economy. This has not only introduced a new competitive dynamic to doing business in South Africa, but has also placed BBBEE compliance as a key business imperative towards achieving success for a wide range of businesses.

BBBEE compliance is a feature of virtually all state and public entities' tenders for the acquisition of goods and services from the private sector or for otherwise doing business with the state or public entities. This has permeated the South African economy as suppliers to all these private sector entities now also have to ensure BBBEE compliance if they wish to retain their customers or seek new opportunities.

As there is also an emphasis on economic upliftment and socio-economic development, BBBEE compliance has a much broader socio-economic reach in South Africa though contributions made, for example, to NGOs and charities, as well as the inclusion of marginalised groups and communities in South Africa. Hence BBBEE compliance can also have an important impact on social cohesion and inclusion and promoting socially responsible behaviour.

What is the impact of BBBEE on South African companies?

If it is implemented holistically and in furtherance of the objects of the BBBEE Act, BBBEE can have a significant impact on South African companies that elect to comply, and this is not limited to competitive and commercial implications.

The impact of compliance with the all the BBBEE elements can impact the ownership and governance of companies; employment recruitment and retention strategies and policies, skills development of workers; relationships with suppliers and customers; and socio economic impact and reach of the business' activities. It has the potential to transform organisational culture, ideally for the better, by promoting inclusiveness and encouraging diversity.

Advantages of BBBEE

If properly and conscientiously implemented, BBBEE has a number of advantages. These include:

- Small business entities have a much lower compliance burden and hence the cost to implement BBBEE would usually not outweigh the potential benefits.

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- The potential benefits of diversity both in relation to ownership and governance as well as a diverse workforce that not only promotes social cohesion but also inclusivity and the opportunity to harness the benefits of diverse stakeholder engagement which can lead to enhanced reputation, increased productivity, reduced employment churn and better alignment between the interests of owners, managers and workers.
- Skills development can lead to improved productivity and employee satisfaction and generally increase moral and confidence, which can then also have a significant socio-economic impact outside of the business' immediate sphere of influence.
- Enhanced supplier diversity is also a significant benefit as this potentially opens up supply chain opportunities and reduces reliance on single or restricted supply arrangements, increased competition among suppliers, and the development of new supply and customer opportunities while also encouraging the development of small and specialised businesses.
- Enhanced business relationships with suppliers and customers as engagement increases, and with this comes a better understanding of your customers and suppliers of the market in which you operate.
- Better and enhanced competitive standing in the market as a result of enhanced BBBEE scoring, which also creates access to opportunities that may not have been previously available.

Disadvantages of BBBEE

Implementing BBBEE, especially for large companies (with an annual turnover of over R50 million), does, however, come with a number of challenges. These include:

- The cost of compliance for large entities can sometimes be significant.
- In the context of Black ownership transactions, it is often challenging to secure third-party finance for the acquisition of an equity interest, hence vendor-funded transactions are usually also considered and this sometimes means an additional cost and potential risk for the sellers.
- Complexity and interpretive issues persist in relation to the BBBEE Codes and there is currently very little common law (legal case law precedent), which does create some uncertainty and potential risk in relation to certain BBBEE initiatives/transactions/structures as these may subsequently be found wanting or otherwise lead to disputes. The consequences of non-compliance are significant, including criminal liability and significant fines (up to 10% of turnover).
- Because BBBEE is directed predominantly at benefiting Black people, it is sometimes perceived as exclusionary, which can potentially lead to stakeholder (which includes employees, shareholders, customers and suppliers) discontent and other challenges if not appropriately addressed.
- The BBBEE regulatory environment is complex and often requires specialist resources and assistance to navigate and advise on compliance and when dealing with regulators.



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How does BBBEE certification or verification work?

BBBEE certification or verification is undertaken by a BBBEE verification agent or professional. All BBBEE verification professionals are required to be accredited as such by the South African National Accreditation System (SANAS). Details of accredited BBBEE verification professionals can be found on the SANAS' website (www.sanas.co.za).

A verification professional will undertake an assessment of the compliance of an enterprise with the applicable requirements of the BBBEE Codes and determine the applicable scoring for each of the BBBEE elements and then also derive the applicable BBBEE recognition/status level based on the outcome of the overall scoring achieved.

A BBBEE verification certificate is then issued and is valid for a period of one year from the date of issue of the certificate.

Any enterprise that undertakes BBBEE and wishes to be recognised as BBBEE compliant must evidence this with a valid BBBEE verification certificate issued by a SANAS accredited BBBEE rating professional.

EMEs do not require a BBBEE verification certificate as they are exempt and only need to evidence by way of a sworn affidavit that they do not exceed the applicable revenue threshold (R10 million in the case of entities to which the Generic Codes apply). EMEs that are 51% or 100% Black owned can also evidence compliance via affidavit and do not require a BBBEE verification certificate.

QSEs (qualifying small enterprises) are entities with an annual turnover more than R10 million but below R50 million under the Generic Codes. There is a separate BBBEE scorecard for these entities and verification is usually

required, though QSEs that are 51% or 100% Black owned also do not require BBBEE verification certificates and can evidence compliance via a sworn affidavit.

Can a non-profit entity obtain BBBEE certification?

Yes, there is a specialised scorecard in the Generic Codes dealing with such entities and other entities that cannot be evaluated for Black ownership. This would also include higher education institutions (public universities) and even public entities, as ownership by the state cannot confer Black ownership.

Can a sole proprietor obtain BBBEE certification?

Yes, though if the turnover of the sole proprietor falls with the threshold for EMEs, the sole proprietor would be exempt and need only evidence this exemption through a sworn affidavit confirming their turnover.

Sole proprietors that do not qualify as EMEs would need to undergo BBBEE verification unless the sole proprietor is Black and qualifies as a QSE, in which case only a sworn affidavit is required to evidence compliance.

Does BBBEE apply to foreign entities?

No, BBBEE does not apply to non-South African entities. However, if a foreign entity has operations in South Africa, those operations could be subject to measurement under BBBEE.

Moreover, South African entities that own or operate businesses outside South Africa will only be assessed for BBBEE compliance in relation to their South African operations.

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

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