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BEE ALERT

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IN THIS ISSUE

REVISED BROAD-BASED BLACK ECONOMIC EMPOWERMENT CODES OF GOOD PRACTICE

On 5 October 2012, the Revised Codes of Good Practice were published in the Government Gazette, for public comment. Interested parties have 60 days (until 4 December 2012) within which to submit comments to the DTI on these revised codes.

The revised codes seek to introduce a number of key changes to the Broad-Based Black Economic Empowerment Codes of Good Practice published in February 2007. They contain many minor changes and attempts to address certain inconsistencies and interpretive difficulties encountered under the original codes.

In this alert we focus only on certain key proposed changes.

Proposed revised Elements of B-BBEE of the Generic Scorecard

The revised codes propose merging the elements of Management Control and Employment Equity into a single element referred to only as Management Control, and the elements of Preferential Procurement and Enterprise Development into a single element referred to as Enterprise and Supplier Development. Instead of seven elements currently provided for, the revised codes propose just five elements. These are weighted as follows:

Element	Weighting	New code series
Ownership	25 **[up from 20]**	100 (as before)
Management Control	15 **[up from 10, but incorporates Employment Equity]**	200 (revised)
Skills Development	20 **[up from 15]**	300 (revised)
Enterprise and Supplier Development	40 **[up from 35, which is currently the combined total for Preferential Procurement and Enterprise Development]**	400 (revised)
Socio-Economic Development	5 **[as before]**	500 (revised)

Revised thresholds for contributor status scoring

The proposed qualification points for each of the B-BBEE contributor status levels are:

B-BBEE contributor status	Qualification	B-BBEE recognition level
Level One Contributor	$\geq$ 100 points on the G/Scorecard **[as before]**	135%
Level Two Contributor	$\geq$ 95 but $<$ 100 points on the G/Scorecard **[up 10 points]**	125%
Level Three Contributor	$\geq$ 90 but $<$ 95 points on the G/Scorecard **[up 15 points]**	110%
Level Four Contributor	$\geq$ 80 but $<$ 90 points on the G/Scorecard **[up 25 points]**	100%
Level Five Contributor	$\geq$ 75 but $<$ 80 points on the G/Scorecard **[up 20 points]**	80%
Level Six Contributor	$\geq$ 70 but $<$ 75 points on the G/Scorecard **[up 25 points]**	60%
Level Seven Contributor	$\geq$ 55 but $<$ 70 points on the G/Scorecard **[up 15 points]**	50%
Level Eight Contributor	$\geq$ 40 but $<$ 55 points on the G/Scorecard **[up 10 points]**	10%
Non-compliant Contributor	$<$ 40 points on the G/Scorecard **[up 10 points]**	0%

continued

Under the revised codes, enterprises are likely to find it more difficult to achieve and, possibly, retain their current (and perhaps, favourable) B-BBEE contributor status ratings.

NEW CONCEPT: MINIMUM THRESHOLD REQUIREMENTS FOR OWNERSHIP, SKILLS DEVELOPMENT AND ENTERPRISE AND SUPPLIER DEVELOPMENT

Ownership, Skills Development and Enterprise and Supplier Development are regarded as priority elements. Certain minimum compliance targets are proposed for these elements:

- A non-compliance penalty for large enterprises: If they fail to meet the minimum thresholds for any of the proposed priority elements, their B-BBEE contributor status will be downgraded by two levels.
- A non-compliance penalty for qualifying small enterprises (QSEs): If they fail to meet the minimum thresholds for Ownership and any one of the proposed Skills Development and Enterprise and Supplier Development priority elements, their B-BBEE contributor status will be reduced by one level.

The minimum thresholds for the priority elements are:

- **Ownership** - a measured entity must achieve a minimum of 40% of the annual "Net Value" targets set out in paragraph 4 of the current Annexure 100(C) to Code Series 100 of the codes.

This annexure was originally intended to encourage the achievement of debt free 25% black equity in enterprises, graduated over a period of 10 years. Traditionally, much attention has been paid to structuring and funding B-BBEE transactions in a way that achieves the specified graduated net value targets on this section of the Ownership element to allow a measured enterprise to score optimally over 10 years.

Less attention has been given to the equity component of B-BBEE transactions. Once the initial acquisition debt associated with the deal has been retired, the measured entity will still be required to comply with minimum threshold of 40% of the target of 25% for economic interest held by black people. In such circumstances or where a measured entity has concluded a debt-free black equity transaction, in order to avoid the penalty, the measured entity must have concluded at least a 10% black equity deal. Of course, the threshold aside, in order to score optimally in terms of the Ownership scorecard, measured enterprises that have not yet concluded full 25% black equity deals should give consideration to increasing the ownership participation of black people.

The proposed imposition of a penalty for the failure to achieve the minimum threshold in respect of Ownership will have the effect of:

  - Compelling firms that have either not yet done black equity deals or not yet achieved the targeted 25% equity deal, to consider doing so now in order to meet the targeted minimum of 40% of the specified net value levels.
  - Compelling firms that have concluded funded black equity deals to ensure that the funding is retired at a rate which adequately achieves the targeted minimum of 40% of the net value levels specified for measured entities.

- **Skills Development** - a measured entity must achieve a minimum of 40% of the targets set out in the Skills Development scorecard. These targets have also been adjusted and new concepts introduced for measuring and determining compliance (see below).
- **Enterprise and Supplier Development** - a measured entity must achieve a minimum of 40% of the following targets set out in the Enterprise and Supplier Development scorecard:
  - paragraph 2.1.1 (a target of 80% [currently 70%] for B-BBEE procurement spend, based on the B-BBEE recognition levels as a percentage of total measured procurement spend);
  - paragraph 2.2.1 (a target of 2% of NPAT for annual value of all Supplier Development Contributions made by the measured entity. This is a new concept; there is no equivalent concept under the current codes); and
  - paragraph 2.2.2 (a target of 1% of NPAT on the annual value of Enterprise Development contributions and sector specific programmes made by the measured entity).

Notably, despite the proposed revised codes stipulating that these penalties will apply to QSEs, no minimum thresholds are stipulated for QSEs and no revised QSE scorecard is provided. This oversight will need to be addressed in the final revisions.

OTHER REVISIONS

Ownership

Concerning the measurement principles for Ownership, the revised codes state that a measured entity applying the modified flow through principle cannot benefit from the exclusion principle and a measured entity using the exclusion principle to mandated investments cannot benefit from the modified flow through principle.

The measurement of the B-BBEE status of private equity funds has been clarified and expanded on. In particular, the B-BBEE status of a private equity fund will be measured in relation to the fund manager and not the fund itself, as is currently described in the codes.

The requirements of the current codes relating to private equity investments have been criticised for being practically difficult to comply with as, among other things, these investments are recognised only if they are made into existing black-owned enterprises. The revised codes attempt to address this situation by allowing the private equity fund manager to facilitate direct black shareholding when entering into the transaction if the target company does not meet the required 25% black shareholding.

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It is further proposed that private equity fund managers should be allowed to achieve the target of investing 50% of the funds under management into 25% black-owned companies over nine years. The target can be incrementally achieved, starting at 5% in year one. However, the nine year period starts on the date the current codes commenced, which was 9 February 2007. This means that more than five years will already have elapsed by the time the revised codes come into effect. So new private equity investments will lose a large portion of the benefit they could have derived from the staggered compliance threshold period.

Management

The Management Control scorecard proposes to measure as separate criteria the exercisable voting rights of black board members, black female board members, executive black board members and black female executive board members.

The concept of the Adjusted Recognition for Gender will be done away with. The measurement categories currently included in the Employment Equity scorecard will be moved to the Management Control scorecard and only the top management and senior management criteria will measure the black females employed within those categories.

The proposed changes also include a requirement that, for Management Control scoring purposes, account must be taken of the different racial sub groups (ie Africans, Coloureds and Indians). The revised codes provide that "for scoring purposes the targets should be broken down into specific criteria according to the different race sub groups within the definition of black in accordance with the Employment Equity Act requirements on equitable representation and weighted accordingly." It is not clear precisely what is meant here and how, and on what basis, the requirements on "equitable representation" should be determined, nor how these are to be weighted. There is no weighting provided for in the revised codes.

A new formula has then been introduced for calculating Management Control scoring. The formula requires the racial sub groups to be used in the calculation. Besides the fact that the formula seems to contain a number of errors, it also seems to be premised on the fact that there are or will be weighting targets for each of the racial sub groups. Since no such weighting targets have been proposed, its application could lead to anomalous results.

Skills Development

The revised codes propose amending the Skills Development scorecard by removing the concept of the Adjusted Recognition for Gender. There are no sub categories in the scorecard measuring the percentage of black females in the different skills development criteria.

The total number of points on this scorecard has been adjusted to 25 from the current 15 points, and all the compliance targets are adjusted. Additional elements are introduced including so called apprenticeships and internships. Points are also offered for the number of unemployed black people participating in learnerships, apprenticeships and internships. Five additional bonus points have been created for the number of black people absorbed at the end of learnership programmes.

As mentioned earlier, the Skills Development Element is a priority element, so a minimum compliance of 40% of the indicated targets must be achieved in order to avoid a downgrading of the B-BBEE status level of a measured entity.

Like the Management Control scorecard, the Skills Development scorecard also requires the relevant targets to be further broken down into racial sub categories. Similar wording is used in referring to the weighting of the different racial sub groups. Again, no weighting is given for these racial sub groups. A similar formula to that in the Management Control scorecard is provided, which again takes into account the racial sub groups, and again, the same anomalous results prevail.

Enterprise and Supplier Development

The new Enterprise and Supplier Development scorecard proposes to increase the targets for the measurement criteria currently contained in the Preferential Procurement scorecard of the existing codes. In amalgamating the Enterprise Development scorecard into this new Enterprise and Supplier Development scorecard, the target has been split into 2% of NPAT for annual value of all Supplier Development contributions made by the measured entity, and 1% of NPAT for annual value of all Enterprise Development contributions and sector specific programmes made.

Points can now be claimed for B-BBEE procurement spend only if the spend is on Value Adding Suppliers and EMEs. Value Adding Suppliers are entities that are VAT vendors and whose net profit before tax summed with its total labour cost, exceeds 25% of its total revenue. Essentially, this encompasses large employers and highly profitable businesses.

Enterprise Development and Supplier Development now are two separate concepts. Enterprise Development is similar to the concept in the current codes. Supplier Development is a new concept. It is aimed at local supplier development and attracts the lion's share of the points on offer.

As a priority element, Enterprise and Supplier Development must achieve 40% of the applicable targets to avoid the penalty B-BBEE status downgrade.

Measured entities are now obliged to develop an Enterprise and Supplier Development plan for qualifying beneficiaries, failing which they will not be able to score points on this scorecard. The plan must include clear objectives, priority interventions, key performance indicators and a concise implementation plan with clearly articulated milestones.

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There is also a new list of examples of Enterprise and Supplier Development contributions and, importantly, it will no longer be possible to exclude imported goods and services from total measured procurement spend (TMPS) as provided for in the current codes.

Socio Economic Development

The new Socio Economic Development scorecard retains the existing compliance target of 1% of NPAT and five weighting points. But it removes the requirement to apply an indicative profit margin where the measured entity does not make a profit. Also, Socio Economic Development contributions must now benefit black people 100% whereas currently the codes provide that in order to be fully recognised, at least 75% of the value of these contributions must benefit black people.

- **Start-ups, EMEs and QSEs**

The revised codes propose changing the turnover thresholds for the classification measured enterprises as follows:

- the threshold for exempt micro enterprises (EMEs) will be changed from an annual turnover of R5 million to R10 million;
- the threshold for QSEs will be changed from an annual turnover of between R5 million and R35 million to between R10 million and R50 million; and
- the threshold for large enterprises will be changed from an annual turnover of more than R35 million to more than R50 million.

EMEs that are 50% black-owned will now qualify for a level two B-BBEE contributor status (currently they qualify for a level three contributor status), while EMEs that are 100% black-owned will qualify for a level one B-BBEE contributor status. The same principles apply to so called start-up enterprises.

QSEs will no longer be able to choose only four of the (current) seven elements on the QSE scorecard for B-BBEE measurement purposes. They will now be measured in terms of all five of the proposed elements on the QSE scorecard. But, as previously indicated, no revised QSE scorecard has been published.

If you need advice on the provisions of the revised codes or in making submissions to the DTI on the revised codes, please do not hesitate to contact us.

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