



OVERVIEW SUMMARY

MISMATCH BETWEEN SCORECARDS AND REALITY

BY COLIN ANTHONY

A box-ticking approach as well as outright fronting contribute to B-BBEE scores presenting a skewed representation of underlying transformation in the economy. Visions for the future include a switch in focus to measure outcomes rather than initiatives and building a bottom-up approach to transformation by placing more emphasis on supporting small businesses.

There is a strong element of frustration among people closely involved with broad-based black economic empowerment (B-BBEE). Many people interviewed for this report believe that while companies may perform well on the scorecard, that does not reflect the underlying reality.

In many of the articles on specific categories and sectors, interviewees raise the issue of the tick-box approach to doing just enough to score highly on the scorecard but without effecting any meaningful underlying transformation - although it's important to note that many companies do attempt to transform their businesses.

“In terms of whether companies are achieving the scorecard goal, yes they are,” says Lerato Ratsoma, MD of ratings agency Empowerdex. “There have been successes. But we are not where we want to be in terms of what the economy looks like. From the numbers in the research results we can see there has been improvement but in terms of a sustainable shift - we're probably not at the level we would have wanted to be.”

This is the first year we are conducting this research which we believe is the first attempt to measure the level of transformation across all industries to derive a B-BBEE scorecard for each sector and one national one, for “SA Inc”.

We managed to attain the scores of 3,154 businesses in our initial attempt. We will build on that year after year, tracking progress or otherwise in each scorecard element and each sector. The aim is to include as many businesses as possible to reflect the state of transformation in South Africa nationally. We believe this is an important endeavour.

The core issue is whether the scorecards accurately reflect the underlying transformation within the companies in each industry. Many of the people we spoke to reckon it does not, with box ticking presenting a superficial picture - scorecards might be up to scratch but underlying transformation is not happening in a meaningful way. Scorecard manipulation and outright fronting are far too common.

Transformation is happening, they believe, but too slowly. What is important, though, is that in many instances they know why and where it's going wrong, and often have ideas on how to fix things. Therein lies the true value of this report. It covers the five main scorecard elements, then focuses on the sector codes and issues specific to each sector are highlighted. The defence industry was excluded because we had too few companies from this sector in our database and could make no headway in getting any input from that sector.



On a broader level, there are strong calls for government to step in to assist the small business sector which has been devastated by Covid-1,9 along with suggestions for a structural shift towards measuring the outcomes of transformation initiatives rather than the initiatives themselves.

REGULATORY UNCERTAINTY

Areas where there appears to be regulatory conflict are raised in some instances but the most prevalent, which has caused much uncertainty in the market, relates to what appears to be the differing interpretation between the B-BBEE Commission and the B-BBEE codes on the issue of trusts.

The commission's concern is that the end-beneficiaries of certain types of "evergreen" trusts (eg, pupils of a school that receives trust funding) do not own shares and have no voting rights. B-BBEE Commissioner Zodwa Ntuli says the beneficiaries of a broad-based trust must be clearly identifiable and able to exercise voting rights; must receive the same economic benefits as other shareholders; and ultimately become the unencumbered owners of the shares in which they are invested. Those are confirmed in the B-BBEE Act and a Government Gazette amendment in 2013 states that black people may hold their rights of ownership in a measured entity as direct participants or as participants through some form of entity, including a trust.

Another problem is that such trusts are often used for fronting. In 2017, then trade and industry minister Rob Davies stated that more than half of the trusts registered as part of a B-BBEE ownership transaction had been found to be non-compliant.

The issue was seemingly cleared up in February this year when Trade, Industry and Competition Minister Ebrahim Patel stated: "Where the discussion has taken a little bit of reflection is evergreen schemes, where a shareholding is vested in perpetuity in hands of employees. There have been some questions as to whether that properly qualifies for BEE a rating in terms of the scorecard. I hold the firm view that it does."

SCORECARD ELEMENTS

Enterprise & supplier development holds the highest weighting on the scorecards of all sectors (between 34 and 42) but it is ownership, with weightings mostly around 25 points (but ranging from 20 for integrated transport to 30 for property) that stirs the most heated emotions.

The **ownership scores** in the Sanlam Gauge are relatively strong at 85.5% of target for all companies, the second-highest after socioeconomic development. Yet the target for most sectors is 25% black equity, meaning that 27 years into democracy, less than a quarter of the business sector is black-owned. Combined

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with frustrations that land reform has been slow, it's understandable that this stirs emotions as the majority of the population struggle to build any sort of asset ownership.

Even if ownership levels were much higher, however, the majority of the population still would not benefit. Cas Cavoodia, CEO of Business Unity SA, crystallises the issue: “The 25% to 30% of black ownership is not going to make much of a difference to the vast majority of people of this country who have no stake in the economy.”

Management scores are lowest across all sectors and all size categories, the research found, with companies generally meeting targets at junior management level but falling short in higher levels.

One common refrain is that skilled black personnel are in high demand so it is difficult both to hire them and retain them. Prejudice is raised as another factor. Companies are also accused of not doing enough to train and develop junior staff. One proposal to address this is to recruit people who have a willingness to learn, develop and grow and then be groomed for promotion, rather than focus only on recruiting already qualified people (*See management control article: page 26*).

Such a bottom-up approach would tie it in strongly with **skills development**, where there is a strong call for improved collaboration between businesses and the Sector Education & Training Authorities (Setas). A core issue is that Seta courses are unable to account for the varied needs of individual companies and much time has to be spent customising them (*See skills development article: page 30*).

Enterprise & supplier development (ESD) is considered crucial for overall economic growth because it focuses on developing the small business sector. A problem, however, is that some companies find it easier to put pressure on existing suppliers to change their ownership structures to become black-owned, rather than find and procure from small, black-owned enterprises. Finding ways to reduce existing barriers for big companies to procure from smaller companies, while increasing the incentives for them to do this, “would make the supplier pillar click,” says Greg McDonald of private equity firm Edge Growth, which has a strong focus on ESD (*See ESD article: page 32*).

SECTORS: THE ISSUES

Each sector also faces specific issues that inhibit transformation.

In the **financial sector**, we're told that there is insufficient scrutiny of the tier of companies below the big, listed financial services firms. There are more than 10,000 entities licensed to operate with many small entities like brokerages and one-man shop financial advisers. Most don't comply with the requirement to submit BEE reports annually to the Financial Sector Transformation Council.

One source says most of the big players are “very empowered” but “there's a long tail of tiny organisations, like financial intermediaries, that aren't. To get an accurate picture of the sector, he says, the data should be disaggregated.

There is also a call for asset consultants to be regulated more closely because they are “massive gatekeepers to the allocation of capital!” They are licensed by the Financial Sector Conduct Authority but are not required to report on transformation (*See financial sector article: page 59*).

In **construction**, the issue of conflicting regulation and legislation again raises its head. The South African Forum of Civil Engineering Contractors points out that sections of the Employment Equity Amendment Act clash with the Broad-Based Black Economic Empowerment Act. It says black-owned companies with turnover below R50m do not have employment equity measured for their scorecard in the sector code but are likely employing more than 50 people. As a result, these companies, through the Employment Equity Amendment Act, are now also required to conform to the industry targets (*See construction sector article: page 53*).

The policy environment in **mining**, of course, is also extremely problematic and has been inhibiting the sector's growth - as well as its important contribution to the economy. With the mining charter still subject to legal challenge, it is operating without any B-BBEE framework on which to measure transformation. Mining companies are thus being scored under the generic scorecard while having to adhere also to the Mining Charter Act (*See mining article: page 85*).

The **transport sector** is still operating according to the old codes before they were revised in 2013 and has seven scorecard elements. Consultants reckon this makes it easier for transport businesses to gain high scorecard points (See *transport article: page 72*).

An issue common to all sectors but particularly prevalent in the marketing, advertising & communication sector as well as **tourism**, is the need for more direct government support for small black businesses, outside of the ESD structure, because there are so many small players - many of which are black women, another target demographic for B-BBEE (See *tourism article: page 81*).

In tourism, black women make up about 70% of the workforce, according to Business Leadership SA. This sector was decimated by the initial hard lockdown restrictions and is one of the few still whose business activities remain curtailed, to an extent. Yet tourism is viewed as a game changer for the economy as it can create much-needed jobs and provide a range of entrepreneurial opportunities.

The Covid pandemic's decimation of tourism and other important sectors of the economy has led also to calls for flexibility in meeting scorecard requirements to accommodate prevailing market conditions. The difficulties for small operators are exacerbated by the complex detail of B-BBEE requirements. Mazars director Mohammed Khan says the lost revenue most businesses suffered from the lockdown restrictions made it more difficult to meet BEE targets but, despite their constrained positions, the B-BBEE targets have remained unchanged. "For most companies, their first priority right now is to ensure their survival and the ability to continue paying their employees."

Across all sectors, the lower levels of economic activity in the wake of the pandemic make it more difficult to meet scorecard requirements. Does a large company allocate 6% of its payroll to training or sacrifice the scorecard points so that it does not have to retrench as many people? And even if a company continues contributing the full 1% of net profit after tax to socioeconomic development, lower profits lead to lower contributions and therefore to fewer benefits for the end beneficiaries - but the same points on the scorecard.

The rigidity of the B-BBEE framework does not allow it to adapt to the extremely dire economic conditions where for many businesses, survival is the priority. These exacerbate the problems that were already bedeviling the country's transformation objectives.

TIME FOR A FRESH START

Moving beyond sector-specific issues, the overall strategy to transform South Africa's business landscape needs attention. As Aurelia Mbokazi writes in her article on ownership: "The general sentiment is that the policy needs an overhaul and business leaders have called on government to go back to the drawing board. They believe this is urgent, especially following the decimation of the nation's economy by Covid-19."

Empowerdex's Ratsoma believes we should move away from rules-based B-BBEE. "The current system is effective in measuring transformation in terms of the scorecard but it does not measure impact effectively. The scorecard approach, although useful, leads to a narrow view even on initiatives chosen. But it stifles creativity because whatever you come up with must be within the realm of the codes in that it must be measurable - which is not always possible to quantify within the ambit of the codes. Considering the output of initiatives, although harder to achieve, could be an option in the future."

Commissioner Ntuli also looks at the link between B-BBEE and its impact on society. Why is it, she asks, that compliance generally seems good yet we still have the related societal ills? For example, the Fees Must Fall campaign highlighted that hundreds of thousands of university students are without any higher education support yet skills development seems to be high in compliance. Who is getting this money? She also questions why so many SMEs are failing because they're unable to receive financing or get access to markets when ESD is so high in compliance.

"It's time we talk about meaningful B-BBEE," she says, "focusing on the actual initiatives being implemented and their impact and asking whether they are making a difference to society or are just for point scoring. The scorecard must be a true reflection of how we look like as a country in real terms. At this point, there is a disconnect."



DEBILITATING CORRUPTION

The call for more government support for small black businesses chimes with calls to drive transformation more from the bottom up. There is widespread belief that the focus should be on facilitating the development of small businesses into larger, influential players - but without the ever-debilitating element of corruption.

Since 1994, government has been grappling with policies that seek economic redress for those who were purposefully excluded from the economy during apartheid. In his first year as president, Nelson Mandela implemented the Reconstruction and Development Programme (RDP), whose main focus was on providing social services, particularly housing, water and electrification.

From the beginning, it was plagued by corruption, particularly in the RDP's mass housing development programme where "fronting" in some instances was extremely brazen, with "professional tenderers" applying for and winning tenders to develop housing then selling those to established construction players.

To tackle persistent inequality in the workplace, government policy evolved in 2001 into what was to be the framework of its transformation policies. The then BEE Commission had been tasked with, among others, developing a clear and coherent vision and strategy for BEE. In its 2001 Black Economic Empowerment Commission Report, it defined black economic empowerment as:

"An integrated and coherent socioeconomic process. It is located within the context of the country's national transformation programme, namely the RDP. It is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa's financial and economic resources to the majority of its citizens. It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity."

Implementation effectively began in 2003 but the format was immediately criticised for benefiting only a few "elite" members of society. To widen access to economic activity, the Codes of Good Practice of Broad-Based Black Economic Empowerment were gazetted in 2007 and revised in 2013. These set specific targets for businesses to meet on various criteria and the notorious scorecard was born.

The unscrupulous licked their lips and fronting exploded. Initially the corruption was initially crude - casual workers were made significant shareholders on paper, without their knowledge and without receiving any dividends or invitations to AGMs. As the authorities - mainly through the BEE Commission - clamped down on those, so more sophisticated forms of corrupting the system emerged.

A "fronting practice" is defined in the B-BBEE Amendment Act as "a transaction, arrangement or other act or conduct that directly or indirectly undermines the achievement of the objectives of the Act or the implementation of any of the provisions of this Act." In simple terms, fronting can be described as any act in which a business pretends to be more compliant than it actually is.

The B-BBEE Commission is investigating 426 cases of fronting out of a total of 822 cases received between June 2016 and September 2020. It believes it is under-resourced - yet another obstacle to effective transformation in South Africa.

THE WAY FORWARD

In boxing terms, SA has been pummelled in all parts of the body by corruption - from oxygen-sucking body blows to heavy shots to the head and some nasty below-the-belt stuff thrown in. Like the weary boxer in the late rounds, we cannot afford to drop our guard.

This report is designed to highlight obstacles to transformation as well as to stimulate and enrich the debate on the future strategy for South Africa in its quest for an inclusive, equal-opportunity economy. Whatever form it takes, strong monitoring and compliance must also be instituted.

The starting point of that quest, however, is provided by BUSA's Coovadia: "The debate we need to have is, what does a transformed South African economy look like?"



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