

South Africa's Economic Transformation
A Strategy for Broad-Based Black Economic
Empowerment

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INTRODUCTION - THE TRANSFORMATION IMPERATIVE

- 1.1 Our country needs an economy that can meet the needs of all our economic citizens – our people and their enterprises – in a sustainable manner. This will only be possible if our economy builds on the full potential of all persons and communities across the length and breadth of this country. Government's objective is to achieve this vision of an adaptive economy characterised by growth, employment and equity by 2014.
- 1.2 Apartheid systematically and purposefully restricted the majority of South Africans from meaningful participation in the economy. The assets of millions of people were directly and indirectly destroyed and access to skills and to self-employment was racially restricted. The accumulation process under Apartheid confined the creation of wealth to a racial minority and imposed underdevelopment on black communities. The result is an economic structure that today, in essence, still excludes the vast majority of South Africans. It is crucial to understand the magnitude of what took place in our past in order to understand why we need to act together as a nation to bring about an economic transformation in the interest of all.
- 1.3 The basic vision of an economy that meets the needs of the people in a more equitable manner goes back to the Freedom Charter of 1955. This was refined and developed in the contemporary context in the Reconstruction and Development Programme (1994). Subsequently, government has outlined broad economic strategies to transform the economy by 2014. These strategies include the Microeconomic Reform Strategy and a range of specific strategies such as the Integrated Manufacturing Strategy and the National Research and Development Strategy.
- 1.4 The period since 1994 has seen the South African economy undergo profound restructuring. Ten years of consistent economic growth has been recorded. Macroeconomic stabilisation has largely been achieved, providing a platform for accelerating the growth rate. The economy has become increasingly integrated into global markets and has become a successful exporter of manufactured goods and value-added services. South Africa is now able to position itself as an advanced manufacturing economy.
- 1.5 Despite the economic successes and a plethora of state policy, strategy and programme interventions aimed at overcoming economic disparities, entrenched inequalities continue to

characterise the economy and act as a deterrent to growth, economic development, employment creation and poverty eradication. Vast racial and gender inequalities in the distribution of and access to wealth, income, skills and employment persist. As a consequence, our economy continues to perform below its potential.

- 1.6 Societies characterised by racially or ethnically defined wealth disparities are not likely to be socially and politically stable, particularly as economic growth can easily exacerbate the inequalities. Therefore the medium- to long-term sustainability of such unequal economies is vulnerable. Accordingly, in South Africa, the socio-political and moral imperative to affect a redress to racial discrimination is also an imperative dictated by the need to develop a sustainable growth path.
- 1.7 South Africa's integration into the global economy means that it is exposed to both the positive and negative forces that constitute the process of globalisation. Globalisation can further entrench existing inequalities and further marginalize those on the periphery. Increased inequality and uneven development is a real danger for all economies, both developing and industrialised. In South Africa, however, inequality and uneven development has an extremely strong racial character and represents a threat to our young democracy. An economic transformation strategy must therefore form part of government's strategic approach to globalisation to ensure that we benefit from these processes and not suffer its deleterious effects. More than just an economic imperative, the deracialisation and engendering of our economy is a moral requirement in keeping with the values and principles of equity enshrined in our constitution.
- 1.8 Progress has been recorded in undoing the legacy of the past, however, the extent to which this economic success has been shared by all of our people is still inadequate for the requirements of a stable and prospering society. The time is right for the introduction of a comprehensive and focused strategy for broad-based black economic empowerment.
- 1.9 Black economic empowerment is already an unfolding process in our economy. This document however outlines the more comprehensive and focussed strategy that is now needed and adds impetus to the process by providing greater clarity and certainty. The document begins with an analysis of the legacy of dispossession and disempowerment that characterised our economic development until 1994. It is essential that we understand this in order to understand what

actions are needed for success. The steps taken to overcome this legacy since 1994 are examined and lessons from this experience are extracted.

- 1.10 This strategy document is the outcome of an extensive consultation process within government and with the private sector. It is informed by contributions of the Black Economic Empowerment Commission as well as the views of the President's Black Business and Big Business working groups. The Trade and Industry Chamber of the National Economic Development and Labour Council have also considered the matter and their inputs have been incorporated into the document.
- 1.11 The essence of the new strategy can be briefly stated as follows. The strategy consists of a policy statement and a statement of the policy instruments that the government will consistently and predictably use. These include the formalisation of partnerships and 'charters' with the private sector; the use of a 'balanced scorecard' approach to gauging success; and an Act that allows for the formalisation of guidelines and codes and the establishment of an Advisory Council. Several of these instruments are elaborated on in appendices to the strategy. In addition new financial support measures are introduced and existing financial support is better aligned with the strategy. In general there is now considerable information available to all as to the policy intention and approach of the government.
- 1.12 Copies of the Broad-Based Black Economic Empowerment Strategy can be obtained from **the dti's** website (www.thedti.gov.za) or from **the dti's** offices in Pretoria and Cape Town, as well as the provincial departments of economic development, or call **the dti's** Customer Contact Centre on 0861 843 384. **The dti** encourages all interested parties to provide comments on this strategy, and to participate in any parliamentary hearings that will be convened on this important public policy matter. All contributions will receive serious consideration and the document will be refined accordingly in order that it can be formally published when the enabling legislation is passed later this year.

OVERCOMING THE ECONOMIC LEGACY OF APARTHEID

2.1 Introduction

- 2.1.1 The South African economy is performing well given its Apartheid and colonial legacy and the current global downturn. South Africa has enjoyed 10 years of consistent growth. Much has been achieved since 1994. Unfortunately, the extent to which this growth has been shared equitably amongst all South Africans is not as yet adequate to the requirements of a stable, integrated and prospering society. Accordingly we need to take further collective actions in order to achieve our objectives. Further, growth can only be accelerated and sustained if all South Africans are meaningfully integrated into the economy.
- 2.1.2 We need to continue to advance our economic transformation. This chapter argues for the State to actively lead the development and implementation of a focused and coherent strategy to achieve broad-based black economic empowerment and the deracialisation of the South African economy.

2.2 The legacy of Apartheid

- 2.2.1 The Black Economic Empowerment strategy is a necessary government intervention to address the systematic exclusion of the majority of South Africans from full participation in the economy. The defining feature of Apartheid was the use of race to restrict and severely control access to the economy by black persons. The accumulation process was one of restricted wealth creation and imposed underdevelopment of black communities to ensure that they were, in the main, suppliers of cheap labour. The underdevelopment of black South Africans took the form of a progressive destruction of productive assets; deliberate denial of access to skills and jobs; and the undermining of self-employment and entrepreneurship. In combination these policies restricted and suppressed wealth and skill endowments in black communities thereby structurally inhibiting their participation in a legislatively deracialised economy. It is a testimony to the vitality of black society that they have managed to achieve what has been achieved.
- 2.2.2 The structured exclusion of black people from economic power began in the late 1800s with the first dispossession of land and continued throughout the twentieth century with the first

Mines and Works Act, 1911, the Land Act of 1913, and the raft of Apartheid laws enacted after 1948.

2.2.3 The impact of this systematic disempowerment not only resulted in a landless black majority with restricted access to skills development, but also deliberately prohibited black people from generating self-employment and entrepreneurship. South Africans were systematically deprived of viable business opportunities in the following ways:

- Apartheid confined the majority of African people to homeland areas, which were not only the poorest in terms of living conditions, infrastructure and business opportunities, but also lacked a dynamic business infrastructure and environment.
- Racially segregated areas enforced through the Group Areas Act not only uprooted millions from their places of residence, but also led to large capital losses and virtually destroyed the fabric of black small enterprises.
- The drastic curtailment of property ownership rights of black persons made it impossible for them to acquire assets that could serve as collateral for loan financing; it also excluded black persons from the long-run process of capital accrual and growth.

2.2.4 A job reservation policy was reinforced by a vastly inferior education system and this had devastating effects on skills and the positions that the majority of workers obtained in the labour market. Only a small minority gained access to higher education. Technological and professional careers were made less attainable by chronic inadequacies in the teaching of mathematics and sciences in black schools. Millions of adult South Africans had been particularly poorly equipped for a modernising industrial and commercial economy. When the economy adjusted in the 1990s to re-enter global markets and became more competitive the harsh reality has been the displacement of these same poorly equipped black workers. This has had a severe distorting effect on income distribution, the levels of effective demand for goods and services in the economy and the ability of displaced and retrenched workers to generate self-employment.

2.2.5 The economic, political and social marginalisation of black South Africans led to significant structural distortions in the South African economy. These distortions eventually resulted in a crisis in the economy, which started during the early 1970s, when growth rates deteriorated sharply. From the mid-1970s the South African economy entered a long-term period of decline

with the average annual growth in real GDP per capita falling to zero between 1970 and 1979 and hovering around 3.4% between 1980 and 1989. High levels of unemployment; highly unequal distribution of income and low levels of growth and investment became deeply entrenched during this crisis. When other developing economies with similar endowments to those of South Africa were growing, we were stagnating and slowing down with further adverse effects on the participation of black persons in the economy.

2.2.6 South Africa's first democratic government was elected into office in 1994 with a clear mandate to redress the inequalities of the past in every sphere: political, social and economic. The legislation that has been enacted, as well as the policies and programmes introduced and implemented since 1994, has sought to fulfil this mandate. Much has been accomplished in each sphere and, at this juncture, the economic transformation of our country is truly underway and has started to pay dividends to our people. While much has been achieved, the extent to which the majority of black people participate meaningfully in our economy remains far too limited and it is necessary to introduce a coherent and focused strategy for broad-based black economic empowerment.

2.3 Dismantling Apartheid, stabilising the economy and extending basic services

2.3.1 In 1994, the democratic government inherited an economy in deep structural crisis, trapped in a low-growth equilibrium, economic exclusion and underdevelopment. Government has over the past nine years set about redressing this legacy of disempowerment and fundamentally transforming the country's political, social and economic landscape.

2.3.2 South Africa's new Constitution enshrined the right of all South Africans to equality and provided for specific measures to be taken to redress historical imbalances. New legislation aimed at dismantling the machinery of Apartheid and transforming society in all areas, from education to the arts, from health care to the justice system was enacted. The Reconstruction and Development Programme (RDP) set out a comprehensive plan for mobilising all South Africans towards the final eradication of Apartheid and the building of a new democratic, non-racial and non-sexist society and economy. In accordance with the priorities of the RDP, the Budget was reoriented towards meeting the needs of the poor and redressing years of unequal spending on education, health care, and social security between race groups.

2.3.3 Simultaneously, the South African economy has also undergone profound restructuring. Ten years of consistent economic growth has been recorded. Macroeconomic stabilisation has been achieved providing a platform for accelerating the growth rate. Many microeconomic reforms have been implemented. Our economy has become increasingly integrated into global markets and has become a successful exporter of manufactured goods and value-added services. South Africa is now able to position itself as an advanced manufacturing economy.

2.4 Deracialising the South African Economy and laying the foundation for Black Economic Empowerment

2.4.1 Since 1994 government embarked upon a comprehensive programme to provide a legislative framework for the transformation of our economy. New laws have restored rights to land and tenure; have proscribed unfair discrimination; and introduced specific active measures to overcome the distortions in the labour market as well as provide new economic opportunities to historically disadvantaged persons.

2.4.2 Some of the legislation introduced includes: The Promotion of Equality and Prevention of Unfair Discrimination Act, Extension of Security of Tenure Act, Restitution of Land Rights Act, Employment Equity Act, National Empowerment Fund Act, Competition Act, Telecommunications Act, Preferential Procurement Policy Framework Act, and the Minerals and Petroleum Development Act.

2.4.3 In addition, government has implemented various policies, strategies and programmes aimed at overcoming economic inequalities and underdevelopment including the Integrated Human Resources Development Strategy, Urban Renewal Programme, Integrated Sustainable Rural Development Programme, the Tourism Transformation Strategy, the Strategic Sector Plan for Agriculture and the National Small Business Development Promotion Programme.

It is worth reviewing some of these measures in more detail to understand government's efforts to facilitate the deracialisation of the South African economy.

2.4.4 Legislative measures

2.4.4.1 In addition to the many new laws enacted since 1994 to dismantle the Apartheid machinery, enshrine the basic human rights of all South Africans, and tackle inequality in specific areas, government also enacted specific legislation to address economic inequalities in our country.

2.4.4.2 In 1995, a national strategy for the development and promotion of small business in South Africa was tabled in Parliament. The creation of new black-owned and –controlled enterprises was seen as a key component of the strategy. The National Small Business Act was introduced in 1996 to provide an enabling environment for SMMEs and to establish several institutions to provide financial and other support to entrepreneurs. These institutions, Khula and Ntsika, have targeted substantial proportions of their programmes to black entrepreneurs.

2.4.4.3 In 1997, government issued a green paper on public sector procurement reform. This policy document recognised that government, as the largest buyer of goods and services in the economy, had the responsibility to leverage this purchasing power in support of its economic policy objectives of black economic empowerment, small enterprise development, and labour-intensive construction. Mechanisms were introduced to give effect to a preferential procurement policy:

- The tendering process was made more accessible to black people
- Tenders were 'unbundled' into smaller tenders to allow smaller enterprises to tender for work
- A point system was introduced to award tenders on the basis of the combination of price and preference for targeted groups

This latter mechanism was given legislative force with the enactment of the Preferential Procurement Act in 2000.

2.4.4.4 In 1998 important pieces of legislation were enacted that address specific elements of the black economic empowerment challenge. One of the core objectives of the Competition Act, 1998, was to increase the numbers of historically disadvantaged persons with an ownership stake in the economy. Indeed, the preamble to this Act recognises that competition law had to specifically address the excessive concentration of ownership and control of the economy, and

the unjust restrictions on the full participation of black people in the economy that arose from the various Apartheid laws. Thus, the Act allows for exemptions from the provisions on anti-competitive practices where such practices promote the ability of black-owned and –controlled enterprises to become competitive.

2.4.4.5 The second important law introduced in 1998 was the Employment Equity Act that outlawed all forms of unfair discrimination at work and required all enterprises employing more than 50 employees to take affirmative action to bring about a representative spread of designated groups in all occupations and organisational levels within defined time periods.

2.4.4.6 Also in 1998, government created the **National Empowerment Fund**, a trust to hold equity stakes in state-owned enterprises and other private enterprises on behalf of historically disadvantaged persons. The NEF Corporation, established in terms of the NEF Act, 1998, was tasked with managing the trust in order to:

- Provide historically disadvantaged persons with the opportunity to, directly and indirectly, acquire shares
- Encourage and promote savings, investment and meaningful economic participation by historically disadvantaged persons
- Promote and support business ventures pioneered and run by historically disadvantaged persons

2.5 Financial support from government for BEE

2.5.1 Government has also reoriented many of its incentives and enterprise support measures to promote black economic empowerment. Included in this support are the offerings of **the dti** and its various agencies, including Ntsika, Khula and the Industrial Development Corporation (IDC). In the 2002/3 financial year, total government support to BEE enterprises amounted to R2.2bn.

2.5.2 Khula has also made an important contribution to empowerment and small business development. Amongst other things it has approved facilities of R1,3 billion. Of these,

- 79% were to BEEs
- 56% to women-owned enterprises

- 71% to urban enterprises
- 29% to rural enterprises.

2.5.3 An examination of the role of the IDC provides important insights in more proactive project financing of empowerment enterprises. The IDC has played an important role in financing BEE transactions. The IDC's involvement with BEE funding commenced in the early nineties when the IDC secured the inclusion of HDPs in companies such as National Sorghum Breweries, NAIL and MTN. Since 1990, the IDC has financed over 690 empowerment deals worth over R6.6 billion. Increase in empowerment funding rose from three deals in 1990 to peak of 191 deals in 2002 representing about 37% of the total number of approvals.

2.5.4 Over the past five years to December 2002, there was an increase in empowerment funding from 14% of the total number in 1998 (R56.4 million) to 39% (worth (R1.2 billion) in first six months of 2002/2003. The sectoral spread of the IDC's empowerment financing over the period has been wide, with the manufacturing sector taking the biggest share followed by communications, mining and quarrying and retail and wholesale trade. Within the manufacturing sector the main areas of funding were within chemicals, food products, metals, clothing and textiles and forest products.

2.5.5 In its business execution, the IDC considers the development impact of BEE in terms of job creation, SME development and regional development. Of all BEE approvals in the period 1990 – 2002, 78% (worth R4.71billion) of the number of approvals came from high impact sectors compared to only 4% (worth R0.23 billion) that came from the low impact sectors.

2.6 Achievements and Lessons Learned

2.6.1 A central objective of the Reconstruction and Development Programme was to deracialise business ownership and control completely, "through focused policies of black economic empowerment".¹ Government's approach was to situate black economic empowerment within the context of a broader national empowerment strategy that focused on historically disadvantaged people, and particularly black people, women, youth, the disabled, and rural communities. Whilst gains were made within the public sector, the overall approach to black economic empowerment lacked focus and an overarching strategic framework. Nevertheless,

¹ The Reconstruction and Development Programme, point 4.4.6.3., p93, 1994

a process of black economic empowerment started to emerge in the mid-1990s to achieve this objective.

- 2.6.2 The private sector embarked on several BEE initiatives in the 1990s. In 1993, Sanlam sold 10% of its stake in Metropolitan Life to a black-owned consortium. This was followed by a spell of similar transactions where equity stakes in enterprises, many of them listed on the JSE, were sold to black investors.
- 2.6.3 Broad based empowerment was, however, hampered by the low levels of initial capital endowment of the black business community. This resulted in a financing process that was highly geared and often dependent on problematic corporate structures. Financing consortia, or 'special purpose vehicles' were utilised to compensate for the lack of capital by prospective owners leading to the new BEE enterprises behaving more like investment funds and conglomerate corporate structures. New black owners were left highly indebted as financial and equity markets experienced considerable volatility globally in 1997. Further, black owners were still removed from the management and operations of these enterprises. The stock market crash in 1998 exposed the weaknesses in this approach and the number of these transactions fell sharply.
- 2.6.4 This 'generation of empowerment deals' had many difficulties but are not to be dismissed as having no impact. They provided a high profile to empowerment and brought forth a new generation of business leaders. However, there was more limited success in bringing about a substantial increase in the number of black people owning, controlling and managing significant and important parts of the economy (such as manufacturing, for example). This has to be taken into account in the more focused strategy and the provision of more innovative funding mechanisms. Further, the current phase of globalisation tends to exacerbate the marginalisation of those who lack assets, skills and access to markets. Government's strategy for broad-based black economic empowerment looks beyond the redress of past imbalances to situating BEE as a powerful tool to broaden the country's economic base and accelerate growth, job creation and poverty eradication.
- 2.6.5 Every piece of legislation enacted, every policy and programme introduced and implemented since 1994 has sought to redress the legacy of Apartheid. While much has been accomplished to deracialise the economy and put in place the foundations for sustainable empowerment

processes, the extent to which the majority of black people participate meaningfully in our economy has to be accelerated.

2.6.6 At times, the impact of the many initiatives that have been taken since 1994 has tended to be diffused. What has been lacking is a comprehensive black economic empowerment strategy that pulls together the various elements of government's transformation programme in a more coherent and focused way. We have suffered from the lack of a common definition and understanding of what was meant by black economic empowerment. Black economic empowerment has come to mean both everything and nothing at the same time. For black economic empowerment to be a programme of delivery in a meaningful sense it has to be more precisely defined. There is also a need to co-ordinate and focus the efforts in this area to a greater degree.

2.6.7 The absence of a strong and coherent voice for business and in particular black business has also been a weakness in that the business community has not played a coordinated leadership role in what is an essential process for the long-term security of business. Even in the area of small and medium business the divisions and weaknesses of long-standing black business organisations has not helped matters.

2.7 Conclusion

2.7.1 The systematic dispossession and disempowerment of black people that has defined South Africa for so long requires an equally systematic response from government in order to achieve redress, particularly in the context of globalisation and the need for accelerated economic growth to eradicate poverty in our country. Since 1994 the government has taken many steps to transform the economy and has set the foundation for a focused strategy of broad-based black economic empowerment.

A STRATEGY FOR BROAD-BASED BLACK ECONOMIC EMPOWERMENT

3.1 Introduction

- 3.1.1 In the previous chapter it was established that South Africa needs a focused BEE strategy to achieve the broad-based economic empowerment of black persons in our country. This will facilitate growth, development and stability in our economy. This chapter sets out the core components of such a strategy in order to provide greater clarity and a measure of certainty to the process of BEE currently unfolding.
- 3.1.2 This chapter will outline government's approach to the definition and measurement of BEE as well as the policy instruments that will be utilised to achieve our objectives. The strategy also emphasises the importance of a partnership approach to achieving BEE and as such the document specifically addresses the question of sector charters and partnerships. The financing of BEE is also discussed and the financial instruments are spelt out in the attached appendices.

3.2 Defining Broad Based Black Economic Empowerment

- 3.2.1 The challenge in defining black economic empowerment is to find the appropriate balance between a very broad definition and an overly narrow one. To define BEE too broadly equates BEE with economic development and transformation in general. The strategy is then commensurate with the totality of government's programme of reconstruction and development. To define BEE too narrowly limits it to a set of transactions transferring corporate assets from white to black ownership.
- 3.2.2 Accordingly, government defines BEE as an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities.
- 3.2.3 The BEE process will therefore include elements of human resource development, employment equity, enterprise development, preferential procurement, as well as investment, ownership and control of enterprises and economic assets.

3.3 Policy objectives of BEE

The successful implementation of the BEE strategy will be evaluated against the following policy objectives:

- A substantial increase in the number of black people who have **ownership and control** of existing and new enterprises
- A substantial increase in the number of black people who have **ownership and control** of existing and new enterprises in the priority sectors of the economy that government has identified in its microeconomic reform strategy²
- A significant increase in the number of new **black enterprises, black-empowered enterprises and black-engendered enterprises**
- A significant increase in number of black people in **executive and senior management** of enterprises
- An increasing proportion of the ownership and management of economic activities vested in **community and broad-based enterprises** (such as trade unions, employee trusts, and other collective enterprises) and **cooperatives**
- Increased ownership of land and other productive assets, improved access to infrastructure, increased acquisition of skills, and increased participation in productive economic activities in **under-developed areas** including the 13 nodal areas identified in the Urban Renewal Programme and the Integrated Sustainable Rural Development Programme.
- Accelerated and shared **economic growth**
- Increased **income levels** of black persons and a reduction of income inequalities between and within race groups.

² These sectors include agriculture and agro-processing, mining, minerals and metals beneficiation, clothing and textiles, automobiles and components, aerospace, information and communication technology sector, chemicals, cultural industries including media, film, music and crafts, as well as high value-added services.

3.4 Key principles

The strategy is underpinned by three key principles.

3.4.1 Black Economic Empowerment is broad based

Societies that are characterised by racial or ethnically defined wealth disparities are not likely to be socially and politically stable. The process of BEE seeks to accelerate the deracialisation of the South African economy and fast track the re-entry of historically marginalised communities into the mainstream of the economy.

3.4.2 Black Economic Empowerment is an inclusive process

A more equitable economy will benefit all South Africans, individuals and enterprises. The process of BEE is an inclusive one, and all enterprises operating within South Africa can, and indeed should, participate in this process. This strategy will be implemented throughout all sectors of the economy and is not limited only to those enterprises that derive income from government procurement or those where the sector is regulated by government.

3.4.3 Black Economic Empowerment is part of our growth strategy

3.4.3.1 Economic growth, development and BEE are complementary and related processes. Government's approach is that BEE must be an inclusive process and not an exclusive process. No economy can grow by excluding any part of its people and an economy that is not growing cannot integrate all of its citizens in a meaningful way. As such this strategy stresses a BEE process that is associated with growth, development and enterprise development, and not merely the redistribution of existing wealth.

3.4.3.2 New, inclusive patterns of wealth accumulation must come from both existing economic activity and new economic activity. Thus we need higher levels of investment that generates a substantial amount of new economic activities. At the same time, ownership patterns must change.

3.4.3.3 An effective and successful process of BEE and accelerated economic growth are mutually reinforcing objectives. The absence of shared economic growth will continue to generate a lower rate of growth as it will continue to restrict levels of demand in the economy, in turn reducing the multiplier effects of investment and the accelerator effects of higher levels of domestic consumption.

3.4.3.4 The deracialisation of our economy is geared towards enhancing the economic growth of the country. In accordance with this principle, BEE will be pursued in such a way as to ensure that where ownership is transferred the proceeds from the sale of assets are reinvested in the South African economy.

3.4.3.5 In order to grow our economy, more enterprises are needed to produce value-added goods and services, to attract investment, to employ more of our people in productive activities. Thus, a core component of the BEE strategy is the creation and nurturing of new enterprises undertaking new forms of economic and value adding activities. We seek in BEE a new vitality in our economy by facilitating new entrants to all aspects of the economy.

3.5 Policy instruments to achieve BEE

3.5.1 Government will utilise a number of policy instruments to achieve its objectives in respect of BEE. These include legislation and regulation, preferential procurement, institutional support, financial and other incentive schemes. In addition, government will be seeking partnerships with the private sector to accelerate the BEE process.

3.5.2 Legislation

Government will introduce into Parliament a Broad-Based Black Economic Empowerment Bill to establish an enabling framework for the promotion of BEE in South Africa. In particular, the legislation will allow the Minister of Trade and Industry to issue guidelines and codes of good practice on BEE, as well as establish a BEE Council to advise the President on the implementation of BEE and related matters.

3.5.3 Regulation

Government will utilise various regulatory means to achieve its BEE objectives.

3.5.3.1 Government will use a 'balanced scorecard' to measure progress made in achieving BEE by enterprises and sectors. The use of a common scorecard by different stakeholders provides a basic framework against which to benchmark the BEE process in different enterprises and sectors. The scorecard will measure three core elements of BEE:

- Direct empowerment through ownership and control of enterprises and assets.
- Human resource development and employment equity.
- Indirect empowerment through preferential procurement and enterprise development.

3.5.3.2 The scorecard also allows government departments, state-owned enterprises, and other public agencies, to align their own procurement practices and individual BEE strategies. The scorecard also facilitates the process of setting measurable targets for BEE.

3.5.3.3 The scorecard will be issued as a Code of Good Practice in terms of the forthcoming enabling legislation. The code will allow for a measure of flexibility in order that it can be adapted to the particular circumstances of specific sectors or enterprises, while at the same time bringing a measure of standardisation to the definition and measurement of BEE.

In particular, government will apply BEE criteria, as set out in the scorecard, whenever it:

- grants a licence to engage in a specific regulated economic activity, for example, gambling or mining
- grants a concession to a private enterprise to operate an asset or enterprise on behalf of the state
- sells an asset or a state-owned enterprise
- enters into a public-private partnership
- engages in any economic activity.

3.5.4 Restructuring of state-owned enterprises

The promotion of broad-based economic empowerment is one of the key objectives of government's policy on restructuring state-owned enterprises. BEE can be achieved through the transfer or sale of an equity stake in a state-owned enterprise (SOE) to black enterprises. Initial public offerings of shares in state owned enterprises (SOEs) can be utilised to promote ownership by black people individually, or by community and broad-based enterprises, through setting aside discounted shares. Worker and community ownership and management of SOEs is another option that is available to government to pursue BEE. In addition, preferential procurement by SOEs, employment equity, sub-contracting, and management development are other means through which the restructuring of SOEs will contribute towards achieving BEE objectives.

3.5.5 Preferential procurement by government

Preferential procurement is an effective instrument to promote BEE in our economy. Government is reviewing its preferential procurement policy in order to enhance its impact on BEE. In addition to increasing the levels of preference to black-owned and black-empowered enterprises, clear targets have been set. A final target will be set once research on existing levels of black procurement has been completed.

In support of increased procurement by Black-owned firms (as defined in Appendix D), government will expand its supplier development programmes to ensure that more black enterprises are created and are able to meet the requirements of purchasers in the public sector.

The enabling legislation on BEE will provide that all government departments, state-owned enterprises and public agencies must take into account any code of practice issues in terms of the legislation in determining and implementing their preferential procurement policy.

3.5.5 Institutional support and a BEE Advisory Council

3.5.6.1 A strong, coherent and effective voice of black business is an important part of ensuring that this strategy meets its objectives. The development of such a voice requires the development and integration of strong business organisations, especially black business organisations, as well as capacity building amongst community and civil society structures. It is essential that black business is effectively represented on and participates in the various economic advisory bodies and councils that form part of South Africa's institutions of social dialogue. In particular, a strong black business presence is needed in the National Economic Development and Labour Council, the various Sector Education and Training Councils, and the various Export Councils. Government will support initiatives in this regard.

3.5.6.2 In addition, government will establish a BEE Advisory Council to advise on the implementation of the BEE Strategy. The Minister will establish this council to advise the President on BEE and to:

- review progress in achieving BEE
- provide advice, in the light of experience, on new programmes and instruments to achieve the agreed objectives of BEE
- promote partnerships to enhance the implementation of BEE
- advise on sector and enterprise charters
- advise on codes of practice and guidelines

Such advice can be incorporated in codes of good practice that the Minister of Trade and Industry can issue in terms of the Broad Based Black Economic Empowerment legislation.

3.5.6.3 It is envisaged that the Council will comprise of 19 members who will hold office for a three-year term. This will include four Cabinet Ministers. The remaining 15 members of the Council will be appointed by the President.

3.5.7 Partnerships and Charters

3.5.7.1 Government will pursue its BEE objectives through two categories of instruments. The first set of interventions relates to the use of various government instruments to promote BEE such as procurement, regulation, financing, and institutional support. These have been outlined above. The second set of instruments is the forging of partnerships with the private sector.

3.5.7.2 Government recognises that its BEE strategy will not be effective if government acts alone without the support of the private sector. Partnerships between government and the private sector, including trade unions and community-based organisations, represent a key vehicle for the formulation and implementation of BEE programmes at different levels and in different sectors of our economy.

3.5.7.3 Partnerships refer to structured collaboration between government and the private sector for the sustainable achievement of BEE. Government will actively seek the establishment of innovative partnerships with the private sector, built around the specific circumstances of different sectors and enterprises. The complexity of different sectors and enterprises requires a flexible approach that allows sectors/ enterprises to determine the form and manner in which it will contribute to BEE within the broad parameters outlined in the legislation.

3.5.7.4 Sector- and enterprise-based charters are one of the forms that such partnerships could take. Such charters would need to include specific mechanisms to achieve BEE objectives in that sector or enterprise in a comprehensive and appropriate manner, as well as provide measurement indicators and targets.

3.5.7.5 It is not expected that every sector and every enterprise will develop empowerment charters. However, those sectors and enterprises that continuously engage government in contracts, or are regulated by government, will be strongly encouraged to develop charters that set specific BEE targets and outline concrete plans to achieve these targets.

3.5.7.6 In other sectors, voluntary compliance with the strategy and in particular, the implementation of the scorecard approach will be encouraged, especially in the sectors that government has identified as having significant potential for future growth. Government will seek to conclude enterprise charters with key corporates in the priority sectors to inject momentum into the BEE process. BEE will only be achieved when enterprises voluntarily develop, as part of their overall corporate strategy, clear plans to achieve BEE. An important element in this regard is the creation and development of new black-owned enterprises.

3.5.7.7 Government will launch an extensive outreach campaign for medium and smaller enterprises, to encourage the adoption of the scorecard approach across the country.

3.5.7.8 Government will issue a Code of Good Practice outlining in detail the core elements that should be incorporated into sector- and enterprise-based charters. Wherever possible, charters should incorporate the following:

- the BEE challenges in that sector/ enterprise
- the sector's/ enterprise's vision for achieving BEE targets and timetables
- the specific mechanisms to be used to achieve BEE targets including financing instruments, skills development and employment equity, preferential procurement, and enterprise development, as well as any additional mechanisms appropriate to the specific sector/ enterprise
- an assessment of the financing required to fund BEE transactions
- the institutional and management mechanisms that will co-ordinate, facilitate, monitor and evaluate the implementation of the charter

Government will measure all charters against the balanced scorecard explained above and elaborated upon in appendix A.

3.6 Finance for BEE

3.6.1 The financing of BEE is strategically important for the economy. BEE will not have the desired effect if it does not include a credible financing component. The absence of financing would generate two problems: the first problem is that the extent of BEE will be limited as there will not be enough financial support and the BEE that does occur will not be broad-based; the second problem is that investment funds will be diverted into asset transfers and with the danger of a flow of funds out of the economy from the sellers of assets. Both outcomes are socially, economically and politically dangerous.

3.6.2 In an economy where the rate of saving and investment is still too low for our developmental needs and where our ability to attract foreign saving is dependent on our growth and overall economic environment it is clear that any financing strategy should not jeopardise domestic or foreign sources of saving or investment. In short BEE has to be part of our overall growth strategy.

3.6.3 The following must be taken into account in the financing of BEE:

- **Maintaining macroeconomic balance** – this means that we cannot finance BEE by taking on excessive debt or large scale deficit financing or by assuming excessive sovereign contingent liability.
- **Increasing the growth rate** – we need to ensure that the rate of investment rises. This means that we have to remain attractive to domestic and international investors. It is also essential therefore those who are sellers of assets reinvest in the economy. This second factor will require an economy capable of higher rates of growth.
- **Intensifying economic transformation** – this means ensuring that we increase the levels of employment and participation in the economy and that economic benefits are shared more equitably across the geographic dimension and by all social groups. This means more access to all forms of social service and infrastructure for all citizens. BEE in this area is particularly important.
- **Diversifying the size and type of enterprise** – the financing strategy has to take particular care to ensure that all forms of enterprise have access to finance. This is a particularly acute problem for small, medium and micro enterprises (SMMEs) and also for new forms of enterprise such as cooperatives.
- **Commercial risk must remain with the private sector** – the State will facilitate access to capital and collateral – both structural problems for the black community – but it will not assume commercial risk. This must remain with the enterprises and the entrepreneurs and investors. This is crucial both from the point of view of the macroeconomic stability of the economy but more important it will improve the quality of enterprise development and therefore the competitiveness of the economy.

3.6.4 Taken together it is clear that we have to ensure the financing of BEE within the parameters of the existing macroeconomic and microeconomic reform strategies. If we do not do this then BEE will only create a small wealthy black elite in a low growth economy that is likely to be less globally competitive. The question that arises is whether it is possible to pursue our sound policies and still provide for a financing strategy that will make a significant impact on the rate

of effective BEE. It is quite conceivable to do this effectively if we improve mechanisms of coordination and introduce innovative financing structures.

3.6.5 Financing Mechanisms

3.6.5.1 Government has already proposed setting aside R10 billion over the next five years to support the BEE process. This will in part be financed from the extraordinary proceeds of the exchange control measures announced in the 2003/4 Budget Speech. A new mandate for the National Empowerment Fund, and a review of the roles of other development finance and support institutions, to ensure that these resources are effectively and efficiently employed, will be developed by **the dti** and National Treasury. Financing mechanisms will be varied and will include guarantees, grants, incentive schemes, loan and equity financing. A market making facility is being considered in order to prevent undesirable ring fencing and therefore an illiquid situation for BEE assets. This is likely to be limited to more strategic areas.

3.6.5.2 **Grants and incentives – the dti** currently provides a range of grants and other incentives to enterprises. The department will seek to coordinate such financing with other programmes in order to maximise its BEE impact. New schemes, and amendments to existing schemes, are also being considered in support of BEE, including supplier development, micro-enterprise development, support for skills development, and the acquisition and development of new technology.

3.6.5.3 **State-Facilitated Lending** – The focus here is again on small- and medium-sized enterprises. Government has set up lending facilities and also provided for underwriting and risk sharing. Khula is the main facility in this regard. However, a number of problems have arisen over the last five years. A distinction is now being made between micro-enterprises and small and medium enterprises and a new initiative for an apex fund for micro-lending will be established. In addition work is being done to add a retail component to Khula.

3.6.5.4 **Project Financing** – the public sector can play a very important role in ensuring BEE in new project development. The key institution here is the IDC. The IDC also deals extensively with SME projects and has a specific BEE policy approach. However, in public sector led projects such as those in Transnet and Eskom or new entities like iGas and Petrosa significant BEE can be achieved. The new portfolio of PPPs is also a place for effecting BEE.

3.6.5.5 Venture Capital – government will facilitate specific venture capital projects in particular sectors.

3.6.5.6 Targeted Investment – government will provide inducements to finance empowerment ventures. The implementation of the mining charter is a case in point. Other programs include investment in the various SDIs and the rural and urban nodes.

3.7 The IDC's role in financing Black Economic Empowerment

3.7.1 In order to strengthen the IDC's fundamental BEE funding practices and mandate, a new BEE policy was accepted in 2002. This policy was intended to further create an enabling environment for the IDC to play a catalytic role in the recovery of the SA economy through the transfer of ownership, management and control to black people. The policy highlights the IDC as one of government's implementing agents in sustaining economic and industrial development and job creation in South Africa by including the majority of people in the mainstream economy.

3.7.2 In support of its BEE policy position, the IDC has formulated strategies with the objective of aligning this with the overall IDC operational strategy, balancing the growing BEE book and support system, ensuring ownership and retention of assets by BEE parties post-IDC funding, spreading of funding between equities and loans, new and existing BEE companies, startups, expansions and acquisitions, thereby maintaining a balanced investment portfolio. These include:

- Encouragement of the IDC's involvement in transactions that relate to government incentives in their various permutations
- Involvement of the IDC BEE funding in sectors of strategic importance prioritised by government such as agriculture, tourism and mining
- Supporting of government projects at local, provincial and national levels
- Monitoring and control where there is focused and specialised structured skills transfer to assist BEE companies throughout their operations
- Proactive encouragement of its clients on aspects relating to the BEE initiatives
- Opening of communication channels with identified BEE stakeholders as well as obtaining feedback on BEE activities and other issues from external entities such as **the dti**

- Co-financing BEE activities with other financing agencies

3.7.3 The IDC will remain at the forefront of BEE by continuing to proactively seek opportunities aimed at creating an enabling environment for the empowerment process in order to yield high developmental and financial returns. Through the growing array of its BEE support initiatives the IDC will:

- Endeavour to partner with other role players to facilitate empowerment investment within the Mining sector
- Manage and disburse the funds from the European Investment Bank on funding for empowerment projects
- Continue its role of facilitating and financing empowerment projects in disadvantaged rural areas
- Act as the deal arranger for all strategic government deals. In doing this they would enter various partnerships with the private sector.

THE WAY FORWARD

- 4.1 The purpose of this strategy document is to provide clarity and certainty about government's approach to broad-based black economic empowerment. The strategy also represents a call to action by all sectors of our society and economy to take active steps to contribute towards the process of empowerment.
- 4.2 The draft legislation referred to in the document will shortly be gazetted to allow for public comments. In terms of that legislation the Minister of Trade and Industry will be able to issue codes of good practice. Accordingly the drafts that are set out in this document are now open for public comment. It is therefore important for interested parties to make their views known. This should be done through **the dti**.
- 4.3 A task team will shortly be established to prepare for the convening of the advisory council once the enabling legislation is enacted. The Task Team will also assist in making contact with interested parties and in assisting with the processing of the legislation. A joint task team of **the dti** and National Treasury is working on specific options for financing BEE. A six-month deadline has been set for the first recommendations to be considered by Cabinet. Parliament has expressed an interest in calling public hearings on the subject of broad-based black economic empowerment and **the dti** and the Task Team would support a process of parliamentary hearings on such an important matter of public policy.
- 4.4 As the process of refining and implementing this strategy unfolds, **the dti** will continue to seek the opinion and advice of relevant stakeholders and role-players. The department will also rely on these stakeholders to assist it in monitoring and evaluating progress made in achieving the economic transformation of our nation through a broad-based black economic empowerment strategy.

APPENDIX A

A BALANCED SCORECARD FOR BROAD-BASED BLACK ECONOMIC EMPOWERMENT

Introduction

To achieve our BEE objectives we need to have a consistency of approach, appropriate flexibility to respond to different economic and enterprise conditions and the ability to measure our progress. The negotiations around the Mining Charter developed a useful and pragmatic approach to these needs that will now be applied more generally.

Government will use a 'balanced scorecard' to measure progress made in achieving BEE by enterprises and sectors. The use of a common scorecard by different stakeholders provides a basic framework against which to benchmark the BEE process in different enterprises and sectors. The scorecard also allows government departments, state-owned enterprises, and other public agencies, to align their own procurement practices and individual BEE strategies. The scorecard further facilitates the process of setting measurable targets for BEE, for BEE ratings and other measurement purpose.

The scorecard allows for a measure of flexibility in order that it can be adapted to the particular circumstances of specific sectors or enterprises, while at the same time bring a measure of standardisation to the definition and measurement of BEE.

Core components of BEE

This scorecard will measure three core elements of BEE:

- direct empowerment through ownership and control of enterprises and assets
- human resource development and employment equity
- indirect empowerment through preferential procurement and enterprise development

Direct empowerment

The process of BEE must result in an increase in the ownership and control of the economy by black persons. This means that a significant proportion of black people's ownership of assets and

enterprises must be a controlling interest, reflecting genuine participation in decision-making at board, executive management and operations levels, and the assumption of real risk.

In the scorecard, direct empowerment focuses on ownership of enterprises and assets through shares and other instruments that provide the holder thereof with voting rights and economic benefits such as dividends or interest payments.

Control means:

- The right or the ability to direct or otherwise control the majority of the votes attaching to the shareholder's issued shares.
- The right or ability to appoint or remove directors holding a majority of voting rights at meetings of the board of directors of that shareholder.
- The right to control the management of that shareholder.

This emphasis on control does not detract from the important role that passive ownership of assets through pension and provident funds, unit trusts, and other collective investment schemes, can play in BEE. However, passive ownership by black people is in itself not sufficient to bring about a real transformation of our economy. Without active participation in managing worker-owned funds, and similar investment instruments, investors have very little control over the direction of investment decisions made by fund managers. Passive ownership of enterprises can also lead to a form of 'fronting' and this needs to be guarded against.

Human resource development and employment equity

This component of the scorecard focuses on the development of the employees of an enterprise or sector as well as employment equity. Enterprises are required to comply with the provisions of the Employment Equity Act to bring about an equitable representation of black persons in all occupations and at all levels of the organisation over a period of time. The involvement of black persons in operational, professional cadres and executive decision-making is a critical aspect of BEE. Given the legacy of systematic labour market discrimination and inferior education, accelerated skills and advanced professional skill development is also important.

Indirect empowerment

In order to grow our economy, more enterprises are needed to produce value-added goods and services, to attract investment, and to employ more of our people in productive activities. Thus, a core component of the BEE strategy is the creation and nurturing of new enterprises by black people. Preferential procurement by both the State and the private sector is an effective and efficient instrument to drive BEE as it provides emerging black enterprises with opportunities to expand their output. The scorecard, therefore, includes a preferential procurement element.

A second element of indirect empowerment is enterprise development. This can take two forms:

- investment in black-owned and –empowered enterprises
- joint ventures with black-owned and –empowered enterprises that result in substantive skills transfer

Investment in black-owned and –empowered enterprises is a crucial step in the provision of financial and intellectual capital to such enterprises. The key elements to be taken into account when making these types of investment are: there must be real economic benefit flowing to the recipient enterprise to enable it to be set up and run on a sustainable basis. Effectively there must be resultant operational capacity from the investment into the enterprise; and there must be active participation by black people in the recipient enterprise.

Joint ventures with black enterprises may involve processes such as outsourcing parts of the established enterprise's projects, or by jointly contracting for certain projects that will result in a transfer of skills to the black enterprise. The measure of the effectiveness of joint ventures is whether or not the black enterprise is able to perform the core elements of the joint projects on a stand-alone basis without compromising the competitive advantage contributed by either enterprise.

The residual 10% in the scorecard

In order to allow sectors and enterprises to tailor the scorecard to the circumstances peculiar to that sector/ enterprise, a residual 10% of the scorecard is left to sectors and enterprises to determine. Government encourages sectors and enterprises to consider including some of the following in their scorecards:

- infrastructural support to suppliers and other enterprises in the same area or community
- labour-intensive production and construction methods
- beneficiation
- investment and support to enterprises operating in rural communities and the geographic areas identified in government's integrated sustainable rural development programme and urban renewal programme
- investment in the social wage of employees (for example, housing, transport, and health care)

The BEE scorecard

Core component of BEE	Indicators	Conversion Factor	Raw Score	Weighting	Total Score
Direct empowerment score					
Equity Ownership	% share of economic benefits	2		20%	
Management	% black persons in executive management and/ or executive board and board committees	2		10%	
Human resource development and employment equity score					
Employment equity	Weighted employment equity analysis	2		10%	
Skills development	Skills development expenditure as a proportion of total payroll	2		20%	
Indirect empowerment score					
Preferential procurement	Procurement from black-owned and empowered enterprises as a proportion of total procurement	20		20%	
Enterprise development	Investment in black-owned and empowered enterprises as a proportion of total assets	20		10%	
Residual 10%					
To be determined by sector/ enterprise				10%	
Total Score out of 100%					

Indicators

The indicators outlined in the scorecard are provided as a guide. In practice, enterprises and sectors may use these ratios, analysis tables or mini-scorecards to provide the most accurate reflection of progress in each of the core components of BEE.

Conversion factor

The conversion factor enables the scorecard to reflect progress made against the specific BEE targets that enterprises and sectors have established. Targets will be set at sectoral level where sector charters have been agreed. With regard to enterprises codes of good practice will be issued on appropriate benchmarks or targets. The targets set out in the Mining Charter will be used as guide.

By way of illustration, the conversion factor in this scorecard is calculated as 100/target ratio. For example, if an enterprise established a target for procurement of 5%, i.e. black-owned and empowered enterprises will provide 5% of total procurement, then the component factor for preferential procurement will be 100/5, which is equal to 20. When that enterprise achieves this target it will receive a score of 5% times 20, 100%, for achieving its target. If the enterprise only procures 3% from black enterprises in the first year, it will receive a score of 3% times 20, or 60%.

Core component of BEE	Indicators	Conversion Factor	Raw Score	Weighting	Total Score
Preferential procurement	Procurement from black-owned and empowered enterprises as a proportion of total procurement Year 1- 3% Year 2-5%	Target is 5% of procurement in 3 years Conversion factor = 100/5 = 20	3% x 20 = 60% 5% x 20 = 100%	20% 60% x 20%	12%

Weighting

The weighting of each component reflects the relative importance that government places thereon. The six core components of BEE are weighted to bring the scorecard to a maximum of 100%. The weightings total 100 in order to bring the scorecard to a standardised maximum score.

Total score

The total score will be calculated by the sum of the individual component scores and will be reflected as a score out of 100 percent.

Ranking enterprises using the scorecard

Using the scorecard as a guide, government will rank and categorise enterprises for the purposes of preferential procurement, regulation and granting of licences, restructuring of state-owned enterprises, financing and other kinds of support. The precise weighting and score will depend on the actual transaction and will be adjusted according to the economic, commercial and financial situation.

Government will use the total score to rank enterprises according to their progress in achieving black economic empowerment:

- Total score of **91%** and above – **excellent** contributor to broad-based BEE
- Total score of **65% to 90.9%** - **good** contributor to broad-based BEE
- Total score of **40% to 64.9%** - **satisfactory** contributor to broad-based BEE
- Total score of **below 40%** - **limited** contributor to broad-based BEE

These rankings will be used to guide the direction of government support towards its BEE objectives. Preferential procurement policies and the qualifying criteria for government incentives and support schemes will be reviewed and, where appropriate amended, on a case-by-case basis, to reflect these rankings.

Government will also encourage the private sector to develop similar ranking systems in sector and enterprise charters and to use these rankings in their procurement systems.

APPENDIX B

DRAFT REGULATIONS GOVERNING THE FUNCTIONING AND ESTABLISHMENT OF THE BLACK ECONOMIC EMPOWERMENT ADVISORY COUNCIL

Terms of Reference

1. Establishment

- 1.1 The Council will be established in terms of the Broad Based Black Economic Empowerment Bill. In order to allow for change as we proceed and learn, the composition, structure and purpose of the Council will be set out in a Council constitution determined by the Minister of Trade and Industry and will not be incorporated in the Act.

2. Function of the BEE Advisory Council

The BEE Advisory Council, hereafter referred to as the "Council" will support the President by:

- 2.1.1 Providing advice on Government's BEE Strategy;
- 2.1.2 Providing advice on the implementation of the BEE Act; and
- 2.1.3 Executing any other function as requested by the President from time to time

3. Composition of the Council

- 3.1 The Council will consist of a chairperson and no more than 19 members;
- 3.2 The Council will be chaired by the President;
- 3.3 The members will include:
- i. Four Cabinet Ministers with respective Directors-General as alternates;
 - ii. 15 other Councillors incorporating a mix of trade unions, academia, business, community based organisations and other appropriate constituencies as decided by the President.
- 3.4 Council members will be appointed by the President.
- 3.5 Council members will serve a minimum term of 3 years, and 1 month's notice must be given in writing in the event of resignation.

4. Disqualification of Councillors

- 4.1 A person may not be appointed or continue as a Councillor if such person:
- i. is an unrehabilitated insolvent;
 - ii. is of unsound mind, or is subject to an order of a competent court declaring such person to be mentally ill or mentally disordered;
 - iii. has at any time been removed from an office of trust on account of misconduct.
- 4.2 A person who is subject to a disqualification contemplated in subsection (i) may be nominated for appointment and may be appointed as a trustee if at the time of such appointment he or she is no longer subject to that disqualification.

5. Powers of the Council

- 5.1 The Council will be advisory in nature;
- 5.2 The Council may create sub-committees to deal with specific matters as and when required;
- 5.3 The Council may co-opt experts to serve on or advise sub-committees as contemplated in 5.2 above.

6. Administration

- 6.1 The secretariat of the Council will be located in **the dti**.
- 6.2 **the dti** will provide a budget for the Council.
- 6.3 The Council will meet at least twice a year.

Council members will not be remunerated (except for disbursement costs).

APPENDIX C

DEFINITIONS OF BLACK EMPOWERMENT ENTITIES

The following categories of BEE enterprises are proposed as a guide to enable preferencing and targeted support, especially in the area of the government procurement. These would form the basis of a code of practice.

1. A “black enterprise” is one that is 50,1% owned by black people and where there is substantial management control. Ownership refers to economic interest while management refers to the membership of any board or similar governing body of the enterprise.
2. A “black empowered enterprise” is one that is at least 25,1% owned by black people and where there is substantial management control. Ownership refers to economic interests. Management refers to executive directors. This is whether the black enterprise has control or not.
3. A “black woman-owned enterprise” is one with at least 25,1% representation of black women within the black equity and management portion.
4. A “Community or broad-based enterprise” has an empowerment shareholder who represents a broad base of members such as a local community or where the benefits support a target group for example black women, people living with disabilities, the youth and workers. Shares are held via direct equity, non-profit organisations and trusts. Benefits from the shareholding should in a measurable sense be directed towards the upliftment of the community, through job creation, welfare, skills development, entrepreneurship and human rights. At the same time, directors and management of groups should significantly comprise black people. These arrangements are appropriate in situations where the activities or operations of an enterprise or industry directly impact on a community or are located in a community, or may benefit a community. Notable examples would be large

industrial projects, mining and tourism. Other instances, which do assist in broadening the shareholder base, would be employee share ownership schemes; these are a viable empowerment shareholder option. In this and other circumstances, these arrangements should not detract from the ability of the shareholder to exercise significant influence or control over the operations of the business.

5. A “cooperative or collective enterprise” is an autonomous association of persons who voluntarily join together to meet their economic, social and cultural needs and aspirations through the formation of a jointly owned enterprise and democratically controlled enterprise³.

³ This is a universally accepted definition (used by the International Labour Organisation [ILO] and International Co-operative Alliance [ICA]) and is applied as a legal definition in many countries promoting co-operatives. Co-operatives have also been identified as a particularly accessible and attractive mechanism for drawing people into productive activity. The government will design a co-operative support programme and complementary legislation. Co-operative arrangements must extend to all sectors, especially manufacturing.

APPENDIX D

ALIGNING THE CURRENT SUPPORT MEASURES WITH THE BROAD-BASED BLACK ECONOMIC EMPOWERMENT STRATEGY

1. Background

A number of studies, reviews and consultative processes commissioned by **the dti** and allied organisations over the past 5 years to address black owned small and medium enterprises have uncovered systemic constraints that, individually or in combination undermine their growth and development. Access to finance has been identified as the core problem. **The dti** SMME Finance Reference Group Report confirms that "...in surveys among small enterprises all over the world, access to finance comes out as one of the most urgently felt needs."

The criticism of post –1995 support for small business in South Africa centres around the difficulties that individual, mainly black-owned and controlled businesses experience in their efforts to get start-up finance or funds for the establishment and expansion of their businesses.

Rural communities, particularly black women are denied access to affordable financial services. Most still cannot open bank accounts. Furthermore, millions of black people are unable to access any form of credit. The financial sector remains geared to meet the needs of the minority section of the population and urban areas. The poor in general, and small and medium-sized enterprises in particular, have not been able to secure sufficient funding from the formal financial sector. Despite numerous attempts to address this problem, by both government and the private sector, access to funding remains a major challenge.

This problem results from a combination of low levels of wealth and asset holding by the majority of economic citizens and a risk-averse financial system. Lack of land and low agricultural development amongst rural people also means a low cash capacity amongst the majority of black families. The financial institutions need collateral or cash revenue streams that can quickly repay loans.

Commercial banks have a low level of outreach and service provision in poor rural areas and small towns. Even where there are banks, they are clustered in towns that only partially serve the rural areas. They basically cater for affluent urban communities. Some of them have argued against providing banking services to rural areas simply because they claim that transaction costs make it

prohibitive to do business in rural areas. As such transaction costs have been cited as the most significant reason why low-income earners have been ignored by commercial banks.

South Africa has a relatively large venture capital market with over R25 billion available for investment. However this is mostly targeted at large “safe” investments. Funding available for start-up and risk capital for Small and Medium Enterprises (SMEs) is estimated at R1-R2 billion. It would be concluded that the amounts of venture capital accessible to BEEs would be a minor percentage of the R1-R2 billion precisely because of red lining and the view of financial institutions that BEEs constitute a higher financial risk.

Regrettably even those organisations that have specific development and empowerment agendas remain risk averse and prescribe as an imperative prerequisite that prospective entrepreneurs make own financial contributions to the intended businesses. For instance the Khula Equity Fund requires that the promoter of a business concept make financial contribution of between 15% to 20% of investment cost, while the National Empowerment Fund “will invest only where the HDPs are making a *significant* commitment of their own resources (financial, skills, etc).”

Current and past incentives, whether offered in the form of investment grants, tax allowances or matching grants, by **the dti** through The Enterprise Organisation, a division of **the dti**, can only be accessed after an entrepreneur has invested and brought the business into operation or if the entrepreneur can contribute a matching amount. To date the number of BEEs who access **the dti** incentives is still unacceptably low.

This limited access can be attributed to the following factors:

- 80% to 90% of applications for **the dti** incentives are submitted by consultants, who have limited links or accessibility to black entrepreneurs;
- BEEs have limited knowledge of government policies and enterprise support measures; and
- distribution channels are limited.

Some of **the dti** incentives available to BEEs are discussed below.

2. Small Medium Enterprise Development Programme Manufacturing

The Small, Medium Enterprise Development Programme (SMEDP) is a cash incentive to encourage local investment in manufacturing, high value agriculture, agro-processing, aquaculture, biotechnology, tourism, and information and communication technology. The incentive is available to new or expansion projects.

2.1 Requirements

Local and foreign legal entities i.e. companies, closed corporations, co-operatives, sole proprietorships and partnerships, will be assisted to a total investment amount of R100 million to acquire land and buildings, machinery, commercial vehicles and equipment for new projects or the expansion of existing projects related to manufacturing, high value agriculture, agro-processing, aquaculture, agro-processing, biotechnology, tourism, information and communication technology investment.

2.2 Objectives

- Create wealth, generate employment
- Develop entrepreneurship, promote empowerment
- Utilise raw local material
- Promote sustainability of recipient projects
- Reduce investment cost for small and medium investors
- Promote foreign investment

2.3 Projects

- Business located in South Africa
- New projects or expansion of existing projects
- Business able to demonstrate a minimum of 35% increased investment in machinery and equipment at cost as determined in the base year.
- Business classified as manufacturing as per standard identification codes (SIC)

2.4 Benefits

- A tax-free cash grant for two years based on the costs of the investment in land and building, machinery, equipment and commercial vehicles
- Additional cash grant to enterprise for third year, provided ratio of human resource remuneration expressed into manufacturing cost is a minimum of 30%
- A maximum incentive of R3 050 000 per annum for enterprises with investment in qualifying assets.

Levels of investments	cumulative grant (as a % of investment)
First R0 – R5million	10% p.a
Above R5 – R5million	6% p.a
Above R15 – R30 million	4% p.a
Above R30 – R50 million	3% p.a
Above R50 – R75 million	2% p.a
Above R75 – 100million	1% p.a

3. Black Business Supplier Development Programme

The Black Business Supplier Development Programme (BBSDP) is an 80:20 cost sharing cash grant incentive scheme, which offer support to Black owned enterprises in South Africa. The scheme provides such firms with access to business development services that assist them to improve their core competency upgrade managerial capabilities and restructure to become more competitive.

3.1 Who qualifies?

- Firms that are majority black-owned (fifty plus one share) and have a significant representation of black managers on their management team.
- Firms with a maximum annual turnover of companies that can qualify for BBSDP grants will be limited to R12million per annum.
- A key criterion for eligibility is that the firm must have a minimum trading history of one year.
- Companies accessing the scheme will also be required to comply to commercial regulatory requirements applicable to their areas of business e.g. Registration with CIPRO and SARS

3.2 Aims of the incentive

- The BBSDP is aimed at fast tracking existing SME's that exhibit a good potential for growth into the main stream of the formal economy.
- The a BBSDP is aimed at growing black owned enterprises by fostering linkages between black SME's and the corporate and public sector enterprises.
- The BBSDP complement current affirmative procurement and outsourcing initiatives of corporate and public sector enterprises.
- It is intended that the capacity of grant recipient firms successfully compete for corporate and public sector tenders and outsourcing opportunities.

4.1 Requirements

- Foreign investors who hold at least 50% of the shares in the relevant company
- Business engaged in manufacturing
- New, qualifying investments
- Registered incorporate legal businesses in South Africa
- Businesses qualifying for small, medium enterprises development programmes.

5. Proposed amendments to current State Grants

5.1 Background

In order to improve BEE utilisation of existing grants, a number of amendments have been proposed. The approach adopted in the delivery of enterprise support products represents a fundamental shift relative to the traditional structuring and implementation methodology. The approach, shifting from rigidity to flexibility, presents government with new challenges.

5.2 Proposed amendments to the tax based incentives

The dti and Treasury task team of Government will review tax-based incentives with a view to increasing their accessibility to Black-owned firms.

5.3 Proposed amendments Small Medium Enterprise Development Programme

BEE's currently face difficulty in attaining the mandatory 10% equity requirement to qualify for the SMEDP incentive. The equity requirement will be made more flexible for BEE applicants.

Key concerns around the success of BEE projects are commercial viability, business skills, growth potential and technology transfer. It is proposed that the SMEDP programme be amended to allow for Joint Venture applications where one of the Joint Venture partners will be an established business and another will be a BEE company. It is proposed that the current concessions in the SMEDP programme to facilitate participation by Historically Disadvantaged Individuals should apply to such joint venture applications. The proposal will facilitate business linkages, improve commercial viability of projects, facilitate skills transfer and will contribute to the achievement of the Government's BEE policy.

5.4 Support Programme for Industrial Innovation

The Support Programme for Industrial Innovation (SPII) provides reimbursive financial support for the development of innovative products and processes. Initial capital requirements for such development may be prohibitive. It is suggested that up to 20% of approved project funding be provided upfront and that at least 20% of the SPII budget be earmarked for BEE participants.

5.5 Export Marketing Investment Assistance

The problem facing BEE participants is that their products and processes are not export ready. The Export Marketing Investment Assistance (EMIA) Scheme is being reviewed and the programme will be made more flexible and focused by introducing training programmes for companies to become export ready. A budget of R 10m will be allocated for training to improve export readiness. In addition 20% of the EMIA budget will be allocated to BEEs.

5.6 Sector Partnership Fund – Linkage Programme

Government identified the need for big business to enter into business linkages with SMEs, with a specific focus on BEE enterprises. The current objectives of the Sector Partnership Fund (SPF) will be expanded to facilitate upstream and downstream business linkages between existing businesses, with a proven track record, and BEE enterprises.

This will facilitate improved commercial viability, growth, competitiveness, productivity and skills transfer to BEE companies participating in a specific industry sector.

It is further proposed that the mandate of the SPF be extended to provide financial support to Chambers of Business in order to build a strong and co-ordinated chamber movement in South Africa. In so doing we enhance the integration of BEEs into mainstream business.

6. New financial incentives for BEE enterprises

6.1 The Empowerment Investment Grant

In order to deal with the chasm created by the limitation of Black Owned Small and Medium Enterprises (BOSMEs) to access finance, an Empowerment Investment Grant (EIG) is proposed. The grant seeks to address constraints brought about by the fact that programmes such as the SMEDP and its predecessor, the SMMDP, are disbursed after the entrepreneur has procured the qualifying assets and has commenced production, inhibits accessibility by entrepreneurs challenged by limited access to finance.

The proposed grant shall be extended to qualifying entities as owner's contribution to investment cost for new investments, expansions or acquisitions of majority shares by Black entrepreneurs. The grant will be complemented by loan finance sourced from financial institutions, which may be guaranteed by Khula. The EIG may also complement entrepreneurs who can raise their own finance, which is not adequate to provide for a healthy gearing relative to the interest payable on the loan.

6.1.2 Objectives of the Proposed EIG

The Programme would be aligned and consistent with governments strategic economic priorities as set out in the Integrated Manufacturing Strategy and would be advised by the Broad-based Black Economic Empowerment Strategy to effectively deal with " ...the exclusion of black people and women from the mainstream of economic activity." In this regard, its implementation will be aligned towards and seek to achieve the following strategic objectives:

- Generation of opportunities for the growth and development of BOSMEs with a special focus on enterprises owned by black women, the youth and the disabled;

- Integration of BOSMEs with the mainstream industry with regard to trading — providing goods and services to the attractive mainstream markets as well as association — membership of mainstream business associations; and
- Integration of the HDI owned SMMEs with the mainstream financial institutions with regard to capability to leverage finance through the “normal” means rather than extraordinary interventions.

6.1.3 Implementation Process

Operational methodology or implementation shall not be an open-to-business practice, as is the case currently, but a proactive method wherein **the dti** shall take the initiative to select and target projects that deserve intervention (evidenced by proven viability and a potential for the additional desired socio-economic benefits to materialise due to extending assistance to the enterprise).

In order that assisted BOSMEs achieve optimum growth and development the programme shall be implemented in conjunction with other complementary enterprise support services / instruments offered by The Enterprise Organisation, the Council of Trade and Industry Institutions, public enterprises, other government departments, Non-Governmental Organisations as well as the private sector. For this purpose the nurturing or primary contacts with candidate enterprises shall include a comprehensive audit of enterprises' support requirements / needs for achievement of optimum growth and development. *Inter alia*, the audit shall take into account whether or not each candidate enterprise would require support, including the specific nature of needs, in respect of the following:

- Human Resources Development programme intended to achieve expertise, proficiency / competency in Business Management;
- Financial Support Needs;
- Business Development and marketing skills;
- Accessing Information relevant to the enterprise's development needs;
- Compliance with relevant laws, international and / or national standards;
- Accessing markets;
- Intervention to improvement of productivity and / or competitiveness.

There shall be a board to adjudicate applications. The Board shall assign an accredited and duly authorised mentor, preferably drawn from **the dti's** pool of agencies or individuals accredited by the South African Institute of Business Advisors. Each mentor will be assigned a maximum number of twenty projects in a specific industry sector or geographic area. The functions of the mentors shall be:

- To provide assistance to entrepreneurs as set out in "TEO's Guidelines on Agents";
- To nurture potential projects;
- Carrying out comprehensive audits, evaluation and analyses of enterprises' support requirements;
- To identify cost effective solutions, support services and suited enterprise support service providers;
- Packaging, liaising with the so identified enterprise support service providers making arrangements to ensure delivery of enterprise support solutions, including assistance in the process of applying for the investment grant contemplated hereby;
- Mentoring approved projects and providing any after care service incidental thereto;
- Monitoring, compiling and submitting progress and performance reports to the Board respecting each project under their respective portfolios;
- In the case of projects that prove to be non-viable during the term of assistance under the proposed EIG, to advise the Board with immediate effect upon concluding that the facts and circumstances are as such;
- To implement the exit procedures to be set out in the "Exit Strategy for non-viable projects under the proposed EIG".

In order to mitigate the risk of extending the grant to non-viable projects the following process (a detailed procedure relating to the process shall be developed if the proposed grant is approved) shall be followed:

- Projects, whose viability has not been proven, shall be subjected to a feasibility / viability study at the cost of the entrepreneur.
- Should the conclusions of the study be negative the application shall be rejected forthwith upon submission of the study report.
- Should the conclusions of the study be positive the application may be approved, depending on whether or not there is, precedent to disbursing the grant, a requirement to deal with other support

needs of the enterprise (including the loan approval by the bank, loan approval by the bank and Guarantee approval by Khula or proof of ability to provide own contribution by the entrepreneur).

- In the case of such needs the mentor will deal with the matter accordingly and on conclusion of the process, provided the Board is satisfied, the application may be approved.
- Following the approval, for the purpose of mitigating exposure again, the first instalment shall be transferred to the banking account of the enterprise.
- The so transferred amount shall be used to pay for the approved cost items and the handling of the transactions shall involve the banker, the mentor and the entrepreneur. Subsequent instalments shall be dealt with in an identical manner.
- Whenever possible each project shall be subjected to an incubation process. The incubation may be real time, where suitable facilities are available or virtual in the case where suitable facilities are not found. Virtual incubation refers to location of a small-scale pilot operation outside a site established for the purpose of incubation, however such pilot operation being subjected to the same intensity of care and monitoring.
- Projects that prove viability shall be advanced to a full-scale operation and those that do not shall be terminated forthwith upon concluding that the facts and circumstances are as such.

6.1.4 Critical Success Factors

6.1.4.1 Distribution channels and capacity

Establishment of a distribution channels that are suitably structured as well as appropriately resourced i.r.o human resources capacity and expertise to provide all enterprise support services needed by the targeted market segments is critical to the successful achievement of the strategic objectives and focus of the programme. This is critical in-so-far-as it is detrimental to the accessibility of the product and complementary services to the target segment, achievement of an outreach in scale and depth, which will make a nation wide geographic coverage and impact. In order to mitigate cost of expansion of distribution channels, **the dti** contemplates taking advantage of channels established by allied organisations such as Khula, Ntsika, the National Association of Manufacturing Advice Centres, the

Business Referral and Information Network, the Local Business Support Centres, other organisations that are part of the “Enterprise Support Industry”, as well as provincial and local government structures.

6.1.4.2 Impact monitoring—researching profiles and enterprise support needs

Ability to provide effective enterprise support demands a solid knowledge of the target segments, of structural problems and trends in the different economic sectors and of challenges created by the changes and the dynamic nature of the business environment. Such knowledge needs must be based on systematic research and the dissemination, absorption and interpretation of the research results, together with lessons of international “best practices” for application in strategy formulation and implementation.

In order that the envisaged product achieves the desired impact, with the success achieved in a cost effective manner, The Enterprise Organisation shall be complemented by other institutions within **the dti** and the “Enterprise Support Industry” and shall retain own expertise capacity to:

- Continuously research profiles and trends within BOSMEs, advise organisational strategy, operational plans and programme implementation;
- Provide information on competitors and benchmark against best practices;
- Provide information on generic and specific nature of support needs that will achieve optimum impact in respect of growth needs of client enterprises, achievement of strategic objectives and favourable externalities; and
- Provide information for feedback to policy, product development, principals and cabinet.

It is contemplated that this will constitute a component of the Product and Systems Development structure of TEO – and will have such clout as to be the think tank that informs/ advises the strategic direction of TEO. Provision for such capacity and expertise must be made.

6.2 Micro Enterprise Support Programme

Micro Enterprises are mostly faced with a shortage of start up capital. A new incentive programme is under consideration to enable qualifying Micro Enterprises to obtain the necessary funds to start and / or develop businesses. We are suggesting that a pilot programme be introduced allocating R 50m to this initiative over a period of two years.

6.3 Bridging Finance

Enterprises experience cash flow constraints during the first years of operation. In this regard TEO, in conjunction with Khula, will investigate the possibility of setting up a bridging finance vehicle to assist BEE enterprises to address this particular problem.