THE CENTRE FOR DEVELOPMENT AND ENTERPRISE

CDE IN DEPTH

ISSUE 4 / JANUARY 2007

Can black economic empowerment drive new growth?

CDE IN DEPTH provides South African decision-makers with detailed analyses, based on original research, of key national policy issues.

Series editor: Ann Bernstein

This edition is based on a workshop on Black Economic Empowerment and South Africa's growth prospects held on 7 September 2006. It has been summarised by Helene Perold and Associates, and edited by Dr Sandy Johnston, senior CDE associate.

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The Centre for Development and Enterprise
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Introduction

> *Black economic empowerment should be linked directly to the expansion of the economic base and the restructuring of society. Rather than being a cost, black economic empowerment should become the driver of new growth. – Kgalema Motlanthe, ANC secretary-general, ANC Today, 4–10 March 2005*

BLACK economic empowerment (BEE) is playing an increasingly prominent role in South Africa's economy and society, and is being widely debated by South Africans across the political spectrum.

Some believe BEE misguidedly perpetuates the racial classifications of the past; others that its benefits are too narrowly distributed, and still others that its targets are too modest, and its pace too slow.

A key issue is the link between BEE and economic growth

However, as Kgalema Motlanthe pointed out, a key issue is the link between BEE and economic growth. Ultimately the growth performance of the economy will determine the resources available for sustainable redistribution and transformation, and arguably the best contribution that BEE can make will be to contribute to new growth.

Against this background, CDE hosted a workshop aimed at stimulating the debate on the relationship between BEE and economic growth. Held on 7 September 2006, and attended by participants from business, government, and civil society, it was structured around four questions:

- What are the regulatory and cost implications of BEE?
- What progress has it made in the manufacturing sector?
- What is its impact on small and medium-sized enterprises?
- Does it contribute to widening entrepreneurship?

CDE commissioned papers from expert commentators on the first three questions, and invited a distinguished group of panelists from business and the media to discuss the fourth. This publication summarises the presentations, the panelists' contributions, and the general discussion.

Participants

Kosta Babich, *chairman,* Development Consultants of South Africa

Charmaine Bezuidenhout, *project officer,* Friedrich Naumann Foundation

William Blackie, *director: corporate finance,* Standard Bank

Robert Burgess, *deputy resident representative,* International Monetary Fund (IMF)

Stephen Dietrich, *head of finance,* De Beers Group

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Sandy Johnston, *senior associate,* CDE

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Emmanuel Lediga, *chairman,* Legae Securities

Leslie Maasdorp, *chairman,* Yard Capital

Matsatsi Marobe, *acting chief executive officer,* Tourism Business Council

Kreeson Naidoo, *intern,* Gauteng Provincial Government

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Shireen Omar, *researcher,* CDE

Bart Pennewaert, *first secretary,* Embassy of Belgium

Simon Ridley, *chief financial officer,* Standard Bank

Vincent Rousset, *director,* French Development Agency (AFD)

Reg Rumney, *journalist*

Jabulani Sikhakhane, *editor,* Business Report

Charles Simkins, *Helen Suzman Professor of Political Economy,* Wits University

Andrew Skudder, *executive – strategy,* Murray and Roberts Holdings Ltd

Anitha Soni, *chief executive officer,* ASA Tourism Services Group

Barrie Terblanche, *SME journalist*

Tumelo Tsutsube, *BEE co-ordinator,* PETROSA

Sandra Van Lingen, *chief executive,* British Chamber of Business in SA

Gerrit Van Schalkwyk, *senior advisor, economic affairs,* Embassy of the Netherlands

Keith Webb, *partner,* Bravura Equity Services

Growth and the costs of BEE across the economy[1]

***Reg Rumney** is an independent journalist. Previously he was executive director of the BusinessMap Foundation, a BEE think-tank, as well as a business and economics journalist for, among others, the SABC and the Mail & Guardian.*

AFTER South Africa's transition to democracy in 1994, the government increasingly introduced legislation on BEE, and by 2000 there were at least 24 laws or regulations that dealt with BEE requirements. However, these instruments were not well conceptualised, as they dealt mainly with the ownership of companies without clearly specifying what this meant.

We are now in an era of more structured BEE regulation, driven by the broad-based BEE Act and its attendant codes of good practice and sectoral BEE charters. There is a corresponding emphasis on BEE as a compliance issue, and an army of consultants has sprung up, dedicated to understanding the codes and charters and divining their implications for businesses. This means that BEE is increasingly likely to be seen as a form of tax, with only those who move early to comply receiving business advantages from BEE deals, and returns diminishing rapidly as compliance becomes general. This compliance reaches far and deep into the economy, as the codes and charters call on businesses to jump through a number of hoops. If their BEE scores are not high enough they will not be allowed to supply goods or services to companies that are complying with the codes or a charter; they will not qualify for government licenses; and they will not qualify to do business with government. They will also have to ensure that their suppliers comply with the codes or a charter. All these measures are expected - and meant – to create a cascade of compliance throughout the economy.

We are now in an era of more structured BEE regulation, driven by the Broad-Based BEE Act and its attendant codes of good practice and sectoral BEE charters

The cost of BEE transactions

The key points of departure in calculating the costs of BEE are the Codes of Good Practice on Broad-Based Black Economic Empowerment (broad-based BEE), which were published in two stages (November 2004 and December 2005) to give effect to the Broad-Based Black Economic Empowerment Act of 2003 (enacted in 2004). The government's strategy for broad-based BEE – on which the legislation and regulatory codes are based – effectively sets targets of 25 per cent black ownership across the economy by 2014. A structure for calculating the costs of trying to meet BEE targets is provided by the Balanced Scorecard, which was first outlined in the government's Broad-Based BEE strategy document (2003) and confirmed in the codes: the scorecard is a framework for measuring the BEE status of a given enterprise in terms of the legislation. It is balanced in the sense that it incorporates a number of elements, and generic in the sense that it applies across all sectors of the economy. It is also an essential element in the sector BEE charters drawn up by negotiation in different industries to give effect to the legislation and regulations.

Table 1: BEE generic score card (simplified)

Core components	BEE elements	Weighting
Direct empowerment	Ownership	20 per cent
	Management control	10 per cent
Human resources development	Employment equity	10 per cent
	Skills development	20 per cent
Indirect empowerment	Preferential procurement	20 per cent
	Enterprise development	10 per cent
	Residual element	10 per cent

Source: The BusinessMap Foundation[2]

Ownership

While the balanced scorecard de-emphasises ownership in some respects, equity transfer is unavoidable for all but small companies. In its annual Mergers & Acquisitions Review for 2005,[3] Ernst & Young notes that 'BEE deals come at a cost to existing shareholders, whether as a result of being asked to give up a portion of their existing holdings at a discount to market price, or as a result of the company funding the structures at below market rates'.

While the balanced scorecard de-emphasises ownership in some respects, equity transfer is unavoidable for all but small companies

The companies involved in 10 of the 31 deals included in the Ernst and Young study calculated and published the cost of their BEE transactions. These varied from 2,6 per cent of market capitalisation (the value of the company calculated by multiplying the total number of shares in issue by the ruling share price) for Nampak to 4,4 per cent for Pioneer Foods.

Based on these figures, if the average cost to companies of BEE transactions is taken as 3 per cent of market capitalisation, what would the cost be to the economy of every company listed on the JSE Securities Exchange effecting a BEE transaction?

The present market capitalisation of the JSE is around R3,9 trillion, 83,5 per cent of which is accounted for by the top 40 firms. If the non-South African assets of those top 40 firms which are listed in London and firms whose assets are entirely held elsewhere, such as Liberty International, as well as the sole black-owned company in the top 40, African Rainbow Minerals (ARM), are stripped out, this yields a market capitalisation of about R2,8 trillion.

Using this as the baseline figure, if every firm on the JSE entered into a BEE transaction, the total cost would be R85 billion. However, many other firms are not listed on the JSE, and some of them are quite large, so the total cost of BEE transactions by every eligible firm in the country would be far greater than that for listed firms alone.

As regards the amount of equity to be transferred to black partners, assuming that each deal involved transferring 25 percent of equity to a BEE partner, the total amount would be R711 billion for listed firms. As in the case of the cost calculation, this figure would be substantially higher, because many firms are not listed.

Employment equity and skills development

The direct costs of skills development will be up to seven per cent of the payroll, for a maximum of nine points on the generic score card. The other 11 points, making up the 20 per cent weighting, are awarded for contribution to learnerships and other forms of compliance, such as having a comprehensive BEE strategy.

By contrast, the costs of the employment equity component of BEE are very difficult to quantify, and the specific demands of the codes should not be seen in isolation from wider perspectives that motivate businesses to value diversity in employment, make full use of the potential range of talent in the country, and reflect its demography. Ironically, however, compliance with the codes can mean underutilising skilled whites which form a disproportionate part of the country's already narrow skills base, perhaps even causing it to shrink further through emigration.

Another potential cost is the salary premium – which can be as high as 40 per cent – for talented black people who might otherwise continue to job-hop. The research base for calculating the costs of underutilising white skills and the salary premium for in-demand skilled blacks is narrow. The issues are complex – both the erosion of skills through emigration and job-hopping have many causes. However, compliance with employment equity at the very least complicates and exacerbates the problems of skills shortages in an atmosphere of heightened growth expectations and continuing failures in both education and skills development.

Another potential cost is the salary premium – which can be as high as 40 per cent – for talented black people who might otherwise continue to job-hop

Preferential procurement

The 'sharp end' of the government's new broad-based BEE approach is preferential procurement. Through a cascade effect, it hopes to use its buying and licensing power to reach deep into the economy. If a company complies with a charter or measures itself by the codes, it needs to ensure that its suppliers contribute towards its own preferential procurement record. The BEE status of those suppliers will have to be verified; those suppliers will have to ensure that their suppliers are verified; and so on, with the government sanction of discretion in awarding contracts at the end of the verification line.

Under these circumstances, preferential procurement adds a BEE premium to the usual criteria of cost and quality. This is difficult to quantify, and will vary from supplier to supplier and procurer to procurer. However, the Preferential Procurement Framework Act gives an indication of the kind of 'rents' that can be secured through the premium for BEE credentials. All government departments and state-owned entities must abide by the act. Under its provisions BEE suppliers are allowed a 10 per cent price margin over non-BEE suppliers for amounts higher than R1 million, and 20 per cent for amounts less than R1 million.

Vuyo Jack, founder of the pioneering rating agency Empowerdex, has pointed out that some companies also have to bear the costs of finding suppliers who are BEE-compliant. 'In many cases,' he has noted, 'these business owners have to relinquish long-term contracts with suppliers they have dealt with for years, and they will have to pay a penalty for breaking that contract.'[4]

Enterprise development and the residual element

Both enterprise development and the residual element of the score card count for ten points, and both could be regarded as corporate social investment (CSI) expenditure. For enterprise development the compliance target is 5 per cent of earnings (before interest, tax, depreciation, and amortisation) to be spent on supporting the creation or development of black-owned businesses.

The target in the residual category is 1,5 per cent of after-tax profit spent on CSI, and 1,5 per cent spent on industry-specific initiatives as specified by a charter. A number of listed companies may already be spending these sorts of sums on CSI. A spur to spend will certainly not be harmful, although it appears that the target of the spending will now have to be racially defined.

Regulatory costs

While empowerment transactions are one-off costs, the costs of regulatory compliance will be continuous. The cost of being rated varies depending on company size.

Empowerdex charges between R5 000 and R20 000 to rate companies with a turnover of R100 million-R250 million. The rates for companies with turnovers of more than R250 million are negotiable. However, firms will have to pay far more if they have many suppliers which they need to rate in order to calculate their own status. Besides this, there is the cost of the consultants who are brought in to ensure that a company achieves the best score possible, a practice which, given the anxieties surrounding compliance and the hopes of reaping benefits in the marketplace, is increasingly common.

An important indirect cost that also needs to be considered is the time that managers spend on dealing with compliance

Indirect cost of regulation

An important indirect cost that also needs to be considered is the time that managers spend on dealing with compliance – not only the growing number of regulations, but also whole new sets of regulations.

The most damaging regulatory cost is that of fronting, a term that covers a variety of expedient practices to falsely claim BEE status. These can variously be seen as outright fraud, a lazy method of compliance, complying with the letter rather than the spirit of BEE regulation, or survival tactics for businesses that believe they cannot comply. Many members of the public are outraged by instances of fronting, especially when these are exposed in the media.

Fronting in its most egregious forms, such as using the names of low-level employees as directors without telling them, is easy to detect; other tactics are less straightforward. One example is the introduction of a black agency between a former all-white supplier and the procurer of goods. The agency is owned and managed by black people, yet all that has been added is a conduit. Is this fronting or not?

Fees paid to fronting agencies are also a cost. However, the worst damage fronting can inflict on BEE is the potential damage to its image, if white companies are widely seen to be bypassing the regulations and capturing the rents of empowerment.

The total cost to the economy

Estimates of the direct, quantifiable costs of compliance with the BEE codes are shown in table 2.

Table 2: Costs of compliance with BEE codes

BEE elements	Weighting	Cost of full compliance
Ownership	20 per cent	About 3 per cent of market capitalisation
Management control	10 per cent	Board fees, EE premium
Employment equity	10 per cent	Wage premium of up to of 40 per cent
Skills development	20 per cent	Around 7 per cent of payroll, plus other costs
Preferential procurement	20 per cent	Variable. Government procurement allows for up to 20 per cent premium on goods procured. Cost of finding new suppliers
Enterprise development	10 per cent	5 per cent of profit before interest, tax, depreciation and amortization (EBITDA)
Residual element	10 per cent	3 per cent of after-tax profit

Source: compiled by author

The economic costs range from direct spend on BEE equity transactions and the cost of tying up capital through these transactions to arguably less onerous and less contentious costs such as CSI and the salary premium attributable to affirmative action.

Issues arising from costs

Equity transactions are particularly problematic. While these may in some cases converge with broader corporate aims, they can also be seen increasingly as a tax.

Thus far there are at least two issues:

- Scarce savings may be diverted towards inflating merger and acquisition activity on the JSE instead of productive investment. This is a substantial amount of at least half a trillion rand.
- BEE investments are not normal business activity, but politically driven.

Moreover, the hidden flaw in the way in which equity transactions have been structured because of the lack of black capital is not fully understood. This may come back to haunt South Africa in future when it is discovered that the equity stakes of, say 25 per cent, are never transferred in full because of the onerous financing requirements, and the BEE parties either receive nothing unless they are exceptionally lucky and smart, or are forced to sell part of that 25 per cent, say 15 per cent, to own the remaining 10 per cent.

Moreover, the hidden flaw in the way in which equity transactions have been structured because of the lack of black capital is not fully understood

There are other costs that the government has tried to ameliorate, for instance by simplifying the score card of BEE requirements for small businesses so as not to try to impede this important part of the economy by discouraging new business and job creation. It has also exempted foreign investors from the ownership section of the score card as long as they contribute 'equity equivalents'. South Africa's record since 1994 of attracting foreign direct investment is not impressive when compared to those of other, similar, developing countries. The extent to which the deterrent effect of BEE has contributed to this is unknown. However, foreign investors have expressed guarded reservations, for instance in a survey conducted in 2005 as part of a study of the effect of the Trade, Development and Cooperation Agreement between South Africa and the European Union on foreign direct investment in this country.[5] The following quotations illustrate some of these concerns:

> 'Most of the interviewees understood the need for BEE, but they preferred being able to compensate for a lack of black-owned equity with racial transformation in other areas such as affirmative action to ensure employment equity.'
>
> 'Several interviewees cited policies on BEE as a concern, in particular the issue of transferring equity … There is either an actual discount, or shareholders will be required to subsidize the deal, most often through financing structures facilitated by the firm selling the equity.'
>
> 'Another issue often raised when discussing BEE was the need for clarity. Many investors said they were happy to comply with the country's policies but were unsure of the agreed requirements and confused by the co-existence of the good codes of practice and the sector-specific charters. One of the companies interviewed was forthright in saying they would not invest further in the country until the BEE policies were absolutely clear.'[6]

One potential cost that is difficult to quantify but could affect South Africa's growth prospects is the cost of its firms being forced to divert attention away from being globally competitive by the demands of racial transformation, while other emerging markets are concentrating on not being left behind in the global technological race.

The substantial costs of BEE must be weighed against its political and other benefits. There is no doubt that BEE is the trade-off for the new South African government having – initially at least – embraced free markets, including partial privatisation and liberalisation, in the face of trade union and other political pressures for nationalisation and other forms of state intervention. It can be seen as a means of preventing political instability in the context of endemic racial and income inequalities. As long as BEE delivers its intended benefits, it may continue to perform the task of effecting racial change in a non-destructive way.

The substantial costs of BEE must be weighed against its political and other benefits

But BEE holds not only political benefits, but some political dangers as well. The really damaging political costs would be if BEE, particularly BEE equity transactions, degenerated into an exercise in enrichment so patently unfair that populist pressure could force the ruling party into hasty redistributive moves by way of compensation. Recent events in Zimbabwe provide a warning. One version of events in that country is that the elite beneficiaries of narrowly based empowerment policies were forced to redistribute the country's only real asset, namely land owned by white farmers, to disgruntled supporters. Similarly, the failure of BEE to change the lives of anyone beyond a small new black elite might lead an embattled government to blame that failure on a minority which is still deeply resented by many among the previously disadvantaged majority. That would be a big cost indeed.

The economic impact of BEE on manufacturing firms[7]

__Charles Simkins__ is the Helen Suzman professor of political economy in the School of Economics and Business Sciences at the University of the Witwatersrand. He specialises in demography, poverty and income distribution, the labour market, and education financing.

IN 2005 manufacturing contributed R251,6 billion – or 18,6 per cent of total value added to the South African economy. In this context, 'value added' means the difference between a firm's sales revenue and the costs of raw materials. Estimates of the number of people in registered businesses employed by the manufacturing sector in the third quarter of 2005 range from 1 189 000 (Quarterly Survey of Employment and Earnings) to 1 404 938 (September 2005 Labour Force Survey).

Given the unmistakable importance of manufacturing to gross domestic product (GDP), employment and exports, it is essential to estimate – within the limits of available data – the impact of the various requirements of BEE on this sector of the economy.

Enterprises are classified into three categories in terms of broad-based BEE codes

Progress made thus far

There is only one industry charter in the manufacturing sector: the petroleum and liquid fuels industry charter, which sets a 25 per cent black ownership target by 2010. There are only five manufacturing firms among the top 200 of the Financial Mail's Top Black Empowerment Companies in 2006[8]. The top firm had a BEE score of 28,3 (slightly short of the 30 required for BEE compliance), and the remainder scored between 10,0 and 1,6. There is little specific to manufacturing in the government's BEE framework, and the legislative provisions have apparently had little effect on the sector as yet. At present, manufacturing seems almost untouched by broad-based BEE. But this initial judgement will be qualified in an important way at the end of this analysis.

Broad-based BEE requirements

Enterprises are classified into three categories in terms of broad-based BEE codes.

Exempt micro businesses, with a turnover of less than the VAT threshold (currently R300 000 a year); this category comprises 17 per cent of firms in the manufacturing sector, which contribute less than 0,1 per cent of total value added.

Qualifying small enterprises, with fewer than 50 employees and a turnover of less than R10 million a year; this category comprises 71 per cent of firms in the manufacturing sector, which contribute 15 per cent of value added.

Large firms that exceed the employment and turnover thresholds above; only 12 per cent of firms in the manufacturing sector fall in this category, but they contribute the great bulk of manufacturing output at 85 per cent.

Exempt enterprises do not have to comply with broad-based BEE requirements at all. Although both large firms and qualifying small firms are required to have their broad-based BEE scores verified once a year by an accredited agency, the score cards they are meant to use and the detailed criteria for large and qualifying small enterprises differ.

The criteria on the score cards for large firms, and the maximum number of points allocated to each criterion, are as follows:

1. 20 points for black ownership;
2. 10 points for black management control;
3. 10 points for employment equity;
4. 20 points for black skills development ;
5. 20 points for preferential procurement;
6. 10 points for enterprise development; and
7. 10 points for residual contribution.

Large firms are evaluated in terms of all seven criteria. Qualifying small firms may elect to be evaluated on five criteria, or on more than five. If they are evaluated on more than five, their total score is divided by 1,25.

Because large firms are responsible for the bulk of value added and employment in the manufacturing sector, this summary focuses primarily on the application of the requirements to large firms, although an impact assessment for small firms was also conducted for the larger study.

The seven BEE requirements listed above were analysed in order to estimate the state of the score card in ten years' time, as well as the costs of achieving acceptable scores within this time frame. These include expenditure to facilitate the acquisition of equity by black people, as well as expenditure on skills and enterprise development. These costs were calculated in terms of value added, and compliance costs were added to them.

Compliance costs

Broad-based BEE will impose two costs on manufacturing firms

Broad-based BEE will impose two costs on manufacturing firms. The first is the cost of the annual verification of their broad-based BEE status. For large firms, this is likely to be modest in relation to value added. The second is the cost of keeping new records. This burden is much more substantial. Broad-based BEE requires that detailed records be kept of the racial breakdown of ownership, management, employment, skills development, procurement, enterprise development, and corporate social investment. In its study entitled *Counting the Cost of Red Tape in South Africa* (2005), the Small Business Project (SBP) estimated that the cost of compliance with state regulations equalled 6,52 per cent of GDP. Keeping additional broad-based BEE records is likely to impose an additional cost of not less than 25 per cent of this figure, amounting to 1,6 per cent of value added.

The average large firm in ten years time

Supposing that the average firm makes a significant effort to meet all the criteria on the score card, the scores in 2015, as well as the costs of reaching those scores in terms of a proportion of value added, can be projected as follows:

1. 20.0 points for ownership;
2. 6.7 points for management;
3. 6.9 points for employment equity;
4. 14.1 points for skills development;
5. 18.6 point for preferential procurement;
6. 10.0 points for enterprise development; and
7. 7.0 points for residual contribution.

Increases in costs related to BEE will make manufacturing less competitive

This yields a total score of 82 points. This is premised on a substantial and comprehensive effort, so it is unlikely that many firms will achieve a higher score. In fact the tendency will probably be for a 'tail' to develop at the lower end of compliance. It should be possible for virtually all firms to accumulate the 30 points needed for minimal broad-based BEE compliance within ten years.

The estimates of the costs of achieving a score of 82 points, calculated as a percentage of value added, would then be 1,6 per cent for ownership, 1,5 per cent for skills development, 0.6 per cent for enterprise development, 0.2 per cent for residual contribution, and 1.6 per cent for compliance. This yields a total cost of 5.5 per cent of value added. (A similar exercise can also be performed with regard to qualifying small enterprises. The additional cost associated with meeting broad-based BEE at this level is 6.0 per cent of value added.)

Possible cost implications

- Some of the burden of this 5,5 per cent increase in costs in relation to value added may be passed on to labour in the form of lower wages and employment.
- If monetary policy continues to aim at pegging inflation at relatively low levels, it will be difficult for firms to shift the burden forward in the form of higher prices. Growing exposure to global competition has the same effect. Increases in costs related to BEE will therefore make manufacturing less competitive, a situation which will exert downward pressure on the South African currency until competitiveness is restored.

- The transfer of equity involves a purchase and a sale, where the purchase increases the demand for loanable funds and can therefore be expected to push up the interest rate. But what will the sellers of equity do? It defeats the purpose of broad-based BEE for white sellers of existing equity to purchase existing equity in other firms. There are four alternative destinations for the funds realised by sellers. The first is investment in new projects. These will be subject to broad-based BEE, but could absorb white equity investment. An illustrative calculation shows how much room there is for new equity investment by whites. Suppose the manufacturing sector grows at 4 per cent a year, and capital output ratios remain constant. Index manufacturing equity to 100 now, and suppose that white people own 87,5 per cent of it. Then there will be 148 units of capital in constant 2006 prices in 2016. If whites then own 75 per cent of it, they will have 111 units. If their investments achieve an average level of success, they could be expected to own 129 units of capital. So 24 units of the increase could be reinvested in manufacturing, while 18 would have to find a home elsewhere if the aims of broad-based BEE are not to be frustrated. The other three alternatives are: the purchase of government and corporate bonds, exerting downward pressure on interest rates; the purchase of individually held real estate; and the purchase of international equities and other assets, with adverse consequences for the capital account of the balance of payments. Each of these decisions has different macroeconomic effects, so the net effect will depend on the allocation of realised funds to the different asset classes.

Human capital implications

The projections implicitly demand a high and effective rate of human capital formation. The poor results from much of our school system – mediocre to poor literacy, and very poor numeracy – are therefore cause for considerable concern. The quality of schooling varies: it remains best in suburban schools, and poor in township and rural schools, though there are certainly exceptions in both cases to this generalisation. Poor school education creates a weak base for both higher education (important for the formation of professional skills) and training, thus paving the way for low productivity in the workplace.

The projections implicitly demand a high and effective rate of human capital formation

White employment in manufacturing has been estimated at 269 117 in 2005 and 255 500 in 2015, a drop of 5,0 per cent in a decade. The white population is decreasing, and is likely to go on doing so because of low fertility and moderate rates of emigration. Provided that the economy continues to grow at 4 per cent, there is enough room to accommodate black advancement at the pace indicated without creating much pressure on white employment.

An interesting baseline

A study recorded in the KPMG 2006 BEE Survey establishes a noteworthy baseline. KPMG asked large firms what their scores were in April 2006, as assessed by a verification agency or another verification process. The results for the average manufacturing firm were:

Table 3: BEE scores at large manufacturing firms, 2006	
Category	**Score/Points**
Ownership	2.0
Management control	3.2
Employment equity	5.0
Skills development	12.7
Preferential procurement	5.0
Enterprise development	2.8
Residual element	4.0
TOTAL	34.7

Source: author calculations from data in KPMG 2006 BEE survey, pp 6–8

To some extent, South African firms appear to have been moving fast in a BEE direction without knowing it

On average, large manufacturing firms in the survey had passed the 30-point milestone to be minimally BEE compliant. To some extent, therefore, South African firms appear to have been moving fast in a BEE direction without knowing it.

KPMG reports that 80 per cent of the respondents already had a BEE strategy in place. So the survey represents a point close to the beginning of the process, but not right at the beginning. Preferential procurement scores will rise once verification becomes widespread. For the rest, there will be more rapid movement the faster the economy grows. Public works programmes in the 1930s were at once made easier and rendered superfluous by rapid economic growth. It will be interesting to follow broad-based BEE with that historical experience in mind.

BEE and small and medium-sized enterprises: stimulating or stifling the sector?[9]

Barrie Terblanche is a former editor of the SMME publication BigNews for the Business Owner, and was named Africa SMME journalist of the year in 2003.

IT is conceivable that a grand scheme such as BEE will have both suppressive and stimulating effects, pushes and pulls, correcting and warping forces, and virtuous as well as vicious cycles. To estimate the overall effect is difficult, but a number of contributing factors can be identified.

Affirmative action and small business activity

Affirmative appointments in the public and private sectors are perhaps the most important way in which BEE stimulates small business in South Africa, albeit as an unintended consequence. This is so because affirmative appointments have led to many whites leaving the corporate and public sectors and starting their own businesses. They typically have skills, funds (from their pensions), and support from well-resourced families – key ingredients of successful business creation. Although they often have to accept an at least temporary drop in incomes, these white business owners are building up substantial amounts of capital. The result is white economic empowerment on a large scale.

Affirmative appointments have led to many whites leaving the corporate and public sectors and starting their own businesses.

As another unintended consequence, because of the huge demand for black skills in the public and corporate sector, many potential black entrepreneurs are sucked into these sectors instead. This is not necessarily bad, because large companies pay well and spend a lot on training and skills development. However, these corporate employees tend to spend their incomes on expensive lifestyles instead of accumulating capital.

In broad terms, then, there is a growing community of white business owners who are building up significant amounts of capital, and a community of potential black entrepreneurs who have been caught up in a corporate culture and therefore are not accumulating capital at nearly the same rate. Although the surge in small business creation by whites is good for economic growth and job creation, such mass white economic empowerment could cause even greater inequality. In 30 years' time, these little businesses may collectively be worth billions of rands.

Narrowly based BEE and black small business activity

Until now, one force above all has counteracted the movement of talented black entrepreneurs to the corporate sector: affirmative procurement. Under narrowly based empowerment, black businesses have been well placed to win contracts from government and some corporations. Some black entrepreneurs have therefore opted to start their own businesses despite major corporate career opportunities, because of the lucrative government tenders they could win as independent contractors.

Broad-based BEE and black small business activity

On the new broad-based BEE score card, black ownership has been watered down to about one fifth of the number of BEE points a company can score. The original advantage of black ownership under narrow-based empowerment has therefore been significantly weakened, which lessens the need to pull talented black people out of the corporate and public sectors.

Should the black ownership requirement be strengthened?

In order to avoid unequal growth in business ownership, BEE planners will have to strengthen the black ownership requirement. But this has a side-effect: as long as black ownership remains a major factor in winning contracts, white entrepreneurs will continue to seek black partners – an exercise that is energy-sapping, very expensive, and very risky. Apart from family businesses, small business owners are generally not good business partners; they tend to be egocentric, and their bossiness is unrestrained by the formal decision-making structures found in large organisations. BEE planners are therefore faced with a dilemma: if they strengthen the black ownership requirement, they will encourage white small business owners to form artificial, unsustainable partnerships. And if they weaken the black ownership requirement, they will discourage black entrepreneurs from starting their own businesses.

South Africa is about to become the first country in the world to impose a parallel system of accounting on its business sector

Enterprise development and small business

The enterprise development line item on the broad-based BEE score card is an exciting aspect of BEE. It allows companies to improve their BEE scores by helping to create room to develop small businesses, especially those involved in supply chains to large corporate businesses. What remains to be seen is whether this positive factor is enough to counter the negative effects of BEE on small businesses.

One possible drawback of this line item is the fact that it tends to be the preserve of corporations. Not many small businesses are able to help other small enterprises, which makes it difficult for them to accumulate points under this item.

The costs of BEE compliance and small business

South Africa is about to become the first country in the world to impose a parallel system of accounting on its business sector. Business will not only have to keep a set of financial books, but also a record of their BEE activities.

There are those who argue that all BEE score cards should be audited once a year, but the cost of this for small businesses, including close corporations as well as sole proprietors, who are presently exempted from annual financial audits, will be extremely high.

The government is likely to exempt small businesses from an annual BEE audit, and allow them to fill in their own score cards. But, even so, a proper self-assessment, which includes some kind of audit of one's supply chain, takes weeks, if not months, and involves a mountain of paperwork.

The problem with self-assessment

Small businesses are notoriously bad self-assessors. Most have mastered the art of padding their marketing material, and not showing a profit in their tax returns. If BEE self-assessment is not implemented with serious policing and sanctions such as the strong possibility of being charged with fraud if your self-assessed BEE score does not survive scrutiny, BEE scoring may become a form-filling joke.

Exempting small businesses from BEE scoring could be a solution to compliance problems, but the problem is where to peg the exemption

The problem with skills development

The skills development line item seems like an easy way for small businesses to earn BEE points. Small businesses are major trainers of workers because they cannot afford to employ skilled graduates. They hire off the street, and train on the job.

The problem is that this kind of training is informal, making it extremely difficult to report and verify. A few years after the implementation of the Skills Development System, the government had to exempt small businesses from the Skills Development Levy because of this.

Exempting micro businesses

Exempting small businesses from BEE scoring could be a solution to compliance problems, but the problem is where to peg the exemption. The current exemption level is equal to the VAT threshold of R300 000 a year, but is likely to move up to R1 million or R2 million as codes are adjusted.

Is this high enough? A business with a turnover of R2 million is still very small. Income is often so unstable that the owner tries to keep things light and manoeuvrable and not to create large, stable, and expensive administrative systems.

The less risky solution for economic growth would perhaps be to raise the threshold for exemption significantly to, say, 150 employees, the cut-off for the Employment Equity Act.

The problem of exemption

Any exemption will make some business owners try to qualify for it by restricting the size of their businesses – in this case, to avoid the annoyance of BEE scoring. In some instances this may result in businesses being split into two or more companies.

The case for staying under the radar screen becomes very strong when BEE compliance combine with other thresholds such as the Skills Development Levy, the Graduated Tax on Small Business Companies, Bargaining Council levies, and the Employment Equity Act.

Is BEE scoring really voluntary?

Even for businesses far outside the public and corporate realm, BEE scoring may not remain voluntary for long

The standard answer to the criticism that BEE will subject small businesses to unbearable red tape is that the law does not require any business to have a BEE score. It is entirely voluntary.

But for hundreds of thousands of businesses, it's Hobson's choice. When a major client tells a small business to produce a BEE score, it doesn't really have a choice but to comply.

The other concern is that even for businesses far outside the public and corporate realm, BEE scoring may not remain voluntary for long. For example, the retail sector will initially experience the least BEE pressures because it sells to the public. However, leases in shopping centres, permission for signage from municipalities, rezoning applications, and trading licences may all become subject to good BEE scores if requirements are tightened to reach ever further into the economy. It remains to be seen whether or not this would be a realistic option.

Panel discussion: empowering dealmakers, or fostering entrepreneurs?

Do present BEE policies do enough for real black entrepreneurs who take risks to build their own businesses, create jobs, and contribute to sustainable economic growth?

Panel members

Sandile Hlope is a director of KPMG, heads its BEE advisory unit, and is responsible for its annual BEE survey.

Leslie Maasdorp is chairman of Yard Capital, a director of ABSA and Fujitsu Services SA, and serves on the advisory board of Goldman Sachs International. Previously, as a deputy director general in the Department of Public Enterprises, he headed South Africa's privatisation programme.

Anitha Soni is chief executive officer of the ASA Tourism Service Group. She helped to draft the tourism White Paper for South Africa and tourism Green Paper for KwaZulu-Natal, and also to establish the Tourism Grading Council.

Jabulani Sikhakhane is the editor of *Business Report*. He has received several awards for financial journalism, and was a Nieman Fellow in 2001.

Leslie Maasdorp: Foster a culture of entrepreneurship

Besides HIV/AIDS, one of the biggest challenges facing South Africa today is reducing unemployment. BEE will not solve this problem. The government could only reach its objective to halve unemployment and poverty by 2014 by increasing the size of the economic 'cake'. The starting point in dealing with issues of BEE and entrepreneurship has to be in the context of broader economic growth.

Besides HIV/AIDS, one of the biggest challenges facing South Africa today is reducing unemployment. BEE will not solve this problem

BEE has caused some fundamental distortions. One of these is that BEE policies are inward-looking. Any forecast of the state of South Africa's economy in ten or 20 years' time must be done in the context of the global economy. The economies of Brazil, Russia, India, and China are growing at 6 to 10 per cent a year. What are the growth rates of the second-tier economies, and how are we positioned in this global landscape? If we fail to do this accurately, in five years' time most emerging markets would have overtaken us, because policy-makers tend to focus on domestic imperatives.

South Africa does not have a culture of celebrating entrepreneurship. Rather, distortions in BEE policies have resulted in the celebration of big business. Entrepreneurs who have built their own businesses without assistance or facilitation by black empowerment have gone unnoticed. A change in culture towards developing and celebrating entrepreneurs is vital. Barriers to entrepreneurial success still exist; they are often discussed, but have not yet been removed. Besides access to finance and a lack of skills, access to markets is a major impediment. South Africa is a very concentrated economy, dominated by large conglomerates, and it is often very difficult for small businesses to enter certain markets. Government attempts to help entrepreneurs via local business centres have not shown any tangible results.

Preferential procurement is one element of BEE that offers some hope for entrepreneurship. It offers the possibility of creating real opportunities for a new class of entrepreneurs over the next five to 10 years, with the large enterprises or established empowerment companies as major role players. For example, the Codes could prescribe that large companies (with a turnover of more than R500 million or R1 billion) which want to conclude an empowerment transaction should bring a new or emerging empowerment group into the deal. This could ensure an upward movement on the value chain of established companies, and a constant breeding of new players at the bottom.

In order to deal with the problem of unemployment, South Africa needs to focus more on entrepreneurship and deal with the obstacles that have blocked growth. Throughout the world, in both emerging and developed economies, most jobs are created in the SMME sector and not by large corporations. Paying more attention to this sector would go a long way towards reducing unemployment and poverty.

In order to deal with the problem of unemployment, South Africa needs to focus more on entrepreneurship and deal with the obstacles that have blocked growth

Anitha Soni: Focus on quality and enterprise co-operation

The tourism and manufacturing sectors share similar experiences, challenges, and opportunities. According to available figures, currently being verified in a baseline study commissioned by the BEE Council, the tourism industry is controlled by 31 large companies. This translates into about 65 per cent of tourism turnover. The remainder is fought over by SMMEs. These small enterprises operate in a fragmented subsector, and compete in a saturated market. Considering the potential benefits of the 2010 FIFA World Cup and the fact that, by its nature, tourism is a personalised type of business, it is important to create an environment that builds the entrepreneurial capacity of businesses in this sector.

While a number of training programmes are on offer to businesses in this sector, the rate of attrition is high, and the survival rate very low. The key factor in this respect is access to markets. In the tourism industry, access to markets is invariably affected by the quality of service offered by the enterprise – shoddy service drives tourists away from small enterprises. It is difficult for small enterprises to break into the crux of the tourism market because the markets lack confidence in dealing with them.

One way of addressing this shortcoming is for the sector to collaborate in order to consolidate, achieve high quality, and create sound transactional platforms. It is also important to look at good practices in the East. In Japan, for example, the major driver of small enterprises is incubators and co-operatives. In order to ensure that BEE in the tourism industry achieves the desired goals, conventional practices such as financing only from banks and constant supply-driven and sometimes irrelevant training should be replaced with quality service and co-operation among business enterprises.

Sandile Hlope: BEE policies are not designed to build entrepreneurs

To date BEE policy has been narrowly implemented, focusing solely on ownership. While the policy has created many deal-makers, and has enriched merchant bankers and a few others, any economic transformation is likely to result in a range of beneficiaries.

The government's narrowly based procurement policy has helped to create black SMMEs, as it has prompted some black people to leave the corporate sector and start their own businesses in order to take advantage of procurement opportunities. The question then becomes: how is a broad-based approach likely to affect this trend? Might the proliferation of black ownership actually be discouraging?

BEE policies are not really designed to build entrepreneurs. This is because enterprise development is but one of the components of the BEE score card that promotes entrepreneurship. Affirmative procurement under narrow BEE has helped until now, but we still have to see whether the broad-based approach will help to grow the number and diversity of entrepreneurs.

Jabulani Sikhakhane: BEE companies need to comply with the same empowerment regime

The BEE scorecard does nothing to apply pressure on black or BEE firms themselves to comply with its requirements

When a black man tells the world that white people are not doing enough to make him rich, what message is he sending to future generations of black South Africans? Is it that black people today are not capable of making money for themselves? The debate about BEE is too much about slicing up the economic cake equitably, and not about growing it. This is fed by an obsession with what percentage of the market value of companies listed on the JSE is in black hands, which side-tracks the government from focusing on issues that prevent black people from sowing business acorns that will grow into the oaks of tomorrow.

How do we as a country ensure that potential black entrepreneurs are not lured away from the difficult task of starting a business from scratch and building it into a financially viable – and job creating entity – by the allure of a quick buck associated with buying shares in existing companies? The problems faced by BEE investors pale into insignificance against the odds faced by entrepreneurs who grow the economy and create jobs.

Another point is that a major weakness of the BEE scorecard is that it does nothing to apply pressure on black or BEE firms themselves to comply with its requirements. If you can have Shanduka buy into Mondi, and then Mondi forces its suppliers to do empowerment deals, you could use that mechanism to force Shanduka to file a report every year indicating where and how they spend their money. Asking white-owned companies to comply with empowerment and excusing black-owned companies from it is counterproductive. If there is a cost to society for putting these empowerment policies in place, black companies also owe society, and need to give something back.

Key themes

Several themes emerged during the plenary sessions that followed the presentations and the panel discussion.

What are the benefits of BEE? Do they outweigh the costs of compliance?

How can one measure the benefits of BEE? This is important, because one needs to assess whether its benefits outweigh its costs.

Some of South Africa's leading companies estimate that they have spent R1 billion on BEE in recent years, and believe that, had they not done so, they would not be in business in five years' time. This seems to suggest that they view BEE as a normal cost of doing business in South Africa. Moreover, about half of the line items on the BEE score card do not involve additional expenditure; for example, companies worldwide invest in skills development, and spending 3–4 per cent of payroll on skills development is global best practice.

It is important to examine what South Africa's competitors are doing. Are elements of the BEE scorecard found in other countries?

One perspective is that the economic benefits of BEE are evident in most areas of the economy, which makes the cost of BEE irrelevant. Costs are never really looked at in isolation; in this situation a cost–benefit analysis is an appropriate way of approaching the debate.

Another perspective is that compliance can kill creativity. For example, in the early stages of BEE the deals mainly added value to the companies concerned, and the partners sought were able to convince shareholders whose shares were being diluted that the deal was not just a political gesture but a strategic business move. With regulation, however, the 'first mover' advantage rapidly disappears, as everyone does the same thing to comply with the score card. Companies come to regard compliance as something one has to bear with – just another tax, or a way of getting a 'licence'.

However, some participants suggested that too much attention was being focused on market capitalisation and the cost of equity transactions. While a lot of money is spent on leveraging these transactions, this money does not disappear; it returns to the existing shareholders for further investment. Although there is an element of a guarantee below prime that might be seen as a discount which current shareholders are paying for, the cash is going back into the economy. Furthermore, in many instances transaction costs are theoretical, since no cash is involved.

Is government passing responsibility for monitoring BEE compliance on to the private sector?

Some participants felt that, through the BEE score card, the government has effectively privatised the regulation of compliance with BEE policy. For example, private companies are responsible for ensuring that their suppliers comply with employment equity before they award tenders to them. This is a form of peer review which the government has put in place largely because the Department of Labour does not have the capacity to monitor the implementation of BEE provisions. This contrasts strongly with the situation in Canada, whose government has made available extensive resources to ensure that companies comply with its employment equity regulations – and this in a country where employment equity is a far smaller problem than in South Africa.

The move to 'privatise' the monitoring of compliance could be seen as part of a broader trend in South Africa. For example, the government seems to be shifting responsibility for human capital investment to the private sector. This could be attributed to the fact that the government has not yet found ways of addressing bottlenecks in the public education system, and contrasts with the situation in Malaysia which has invested massively in education through bursaries and opportunities to study abroad.

In essence, BEE is about economic transformation with political benefits – solving economic problems to improve political stability

Another perspective is that policing may not be enough to minimise non-compliance with statutory requirements. Business should rather demonstrate its goodwill, and play an active role in developing the country. For example, when a business provides meaningful training to black employees, this enhances the capacity of its personnel and increases productivity. This is easy to prove on a BEE scorecard, and has a long-term impact on the company's productivity.

The BEE score card and global competitiveness

It is important to examine what South Africa's competitors are doing. Are elements of the BEE scorecard found in other countries? For example, if AngloGold Ashanti operates in California, it would be subject to preferential procurement in that it would need to buy local, and this is part of its licence costs. But are its competitors subject to the same costs? In many instances they are not, thus placing a complying company at a disadvantage.

We also need to examine the way in which the score cards will be administered – will this process be riddled with delays, and impose unnecessary burdens on companies, or will it be efficient, and minimise the costs to companies? Are there systems in place that can be used effectively so that companies will appreciate the value of complying with BEE regulation? On the other hand, the costs of complying with the South African BEE score card are minimal compared with, for example, the United Nations global reporting initiative, which has 97 indicators. The costs of complying with that initiative are far higher, yet many South African companies subscribe to it.

The effects of BEE on economic growth

Around 80 per cent of the South African population is black, and only about nine per cent white. For the past 60 years the country's economy has been driven by this small minority and to achieve economic growth, this has to be changed. Global markets are about growth, size, and volumes. What BEE is trying to do is bring the 80 per cent on board.

For example, BEE has certainly changed South Africa's population dynamics, resulting in a boom in certain areas of the economy, such as the property sector. The housing market has grown not only because of the emerging middle class, but also because the dynamics of where people stay have changed. As a result, areas regarded as unsuited to development are booming, and people are buying houses in areas that don't even have schools. This shows what a political intervention can do for the economy. The fact is that more people can buy properties in areas previously inaccessible to them; this means a lot to the financial institutions, and also has implications for the construction industry. In addition, the rapid upward movement of large numbers of people through a range of income brackets creates attractive investment opportunities in this country. Although it is difficult to put a rand value on these benefits, the investment horizon has moved much further than previously thought possible. Lastly, key elements of the BEE score card are vital to growth: the accumulation of skills, capital, and the residual (productivity) are all factors that create economic growth. Furthermore, they may cost less than equity ownership, which has less impact on economic growth.

BEE should not replace the entrepreneurial spirit that still characterises enterprises in countries such as China and the United States

In essence, BEE is about economic transformation with political benefits – solving economic problems to improve political stability. The costs incurred are an investment in developing and growing the country's market share, increasing volumes, and widening participation. Nevertheless, due to slow transformation in some areas, the desired role of BEE as a key factor in economic growth has not yet been achieved. Its enterprise development component is one factor likely to bring about noticeable economic growth in the long term.

Why is manufacturing performing poorly with regard to BEE?

Manufacturing is one sector in which BEE can be effectively implemented, by developing the skills of workers through modest investments of time and finance. Manufacturing companies can train their employees in-house, develop their skills, and move them up through the ranks. Even if people do not acquire degrees, skills development in this sector makes a huge difference since people who are eager to learn can rise to high positions. In the services sector, by contrast, high-level training is required for an individual to move up the ladder. In manufacturing, the production and procurement processes are concrete, and the raw materials and finished goods are visible. This makes it possible for people to understand the BEE transactions in this sector.

One of the reasons why manufacturing has not seen substantial BEE activity is because of the cost pressures experienced in the 1990s; as a result, the sales function was delegated to an outside party (ie the retail sector). Since manufacturers are not first-level suppliers to government or other companies, they do not face much pressure to transform. In addition, the bulk of manufacturing activities are in steel, motor vehicles, and food. The major players in these fields are multinational companies that have not moved quickly with regard to transformation because they have not experienced any direct pressure from government. The government needs to find ways of putting pressure on these companies.

Do all the benefits of BEE transactions go to black people?

Most BEE transactions involve a medley of 'middlemen' including predominantly white banking institutions and legal firms which are among the major beneficiaries of these deals. BEE has also been criticised for its susceptibility to 'fronting', which the codes describe as any practice that circumvents BEE requirements. Economic transformation means transferring real power to black people rather than changing the face of management and share ownership while real power still vests with white managers at the operational level. This is not in the interest of meaningful equity or the long-term economic advancement of previously disadvantaged people.

BEE and media

The media have a duty to provide balanced reports and rigorous analyses of BEE transactions. The current trend in the print media in particular is not to report on all seven indicators contained in the Black Economic Empowerment Act of 2003; instead, the focus is mainly on one indicator, that of ownership. This shallow reporting makes it impossible for members of the public to assess other salient features of BEE deals, tends to obscure broader benefits of empowerment deals and to focus attention solely on the admittedly sometimes problematic issue of the 'usual suspects' benefiting from 'BEE deals'. Journalists should look at all seven indicators rather than labelling a transaction a 'BEE deal' on the basis of the ownership indicator only.

The growing trend of white people starting small businesses should not to be interpreted negatively

Factors that foster entrepreneurship in the context of BEE

BEE should not replace the entrepreneurial spirit that still characterises enterprises in countries such as China and the United States. The problem is that BEE does not promote modesty and hard work, and people seem to ignore the importance of starting small. When an individual starts a small company, and is part of its process of growth, he/she accumulates the capital bit by bit. The experience gained by Bill Gates when he started Microsoft in his parents' garage cannot be obtained at a business school – no MBA can impart those lessons. Those are the values that need to be encouraged, and people should know that there is nothing wrong with starting small and even failing in their endeavour to set up a successful company. This is all part of the entrepreneurial process.

There is also a key role for the education system. The biggest impediment to the growth of a small business is a lack of management skills (e.g. the management of cash flow), and BEE will not remedy this. These sorts of skills should be created by the public education system. The problem does not lie with tertiary education but with the schools system, which is largely dysfunctional. Schools do not produce people with the maths skills needed to run a small business.

Procurement is a key aspect that can benefit black companies. Afrikaners did not buy up English companies, or buy shares in those companies; instead, the National Party government used procurement to empower them. Similarly, procurement can strongly boost black enterprise. Steps should be taken to ensure that all black businesses are informed of tendering opportunities.

For example, in recent years a number of successful third-generation companies have developed through procurement in the IT sector. Many of these, such as Gijima AST, did not buy shares in white companies, but built themselves through procurement. In some cases, however, preferential procurement has not fully benefited black people. For example, if a white-owned company acquires a BEE partner, the procurers often do not see the need to do business with the black firm; they prefer to continue dealing with the people they know. Rather than continuing with business as usual, procurers should spend time and money on developing the BEE profile of their suppliers.

Is BEE fuelling white business control?

Entrepreneurship thrives in an environment in which government intervention and market forces are in balance

The growing trend of white people starting small businesses should not to be interpreted negatively. These are the people with the managerial skills and the money to take the country forward. In Malaysia, affirmative action was meant to promote indigenous Malaysian peole versus the dominant Chinese, but today the Chinese Malaysians still control the bulk of Malaysian capital because they went into new businesses. Therefore, in the long term we can anticipate that white entrepreneurs in South Africa will continue to own the bulk of capital and will continue to grow their businesses – but this is positive in terms of economic growth. One concern going forward is that fewer black entrepreneurs will be available to start their own businesses, because most talented black entrepreneurs will be tied up in BEE transactions.

Another concern is the skewed nature of the relationship between BEE firms and white managers. When a deal is made, the newly established entity depends on teamwork and shared responsibility. Although in many instances it is white managers who structure these transactions and earn the fees, the first people to be blamed when these deals fail are the black partners. Does this indicate persistent division? Do we really share the same values and vision for this country, or are we still as divided as we were when we started in 1994?

The role of equity ownership as a vehicle for entrepreneurship and BEE

To what extent is buying shares in an established company regarded as entrepreneurship? Can this form of business transaction stimulate the economy, and help to bring black people into the mainstream? This issue has to be approached in a dynamic way. Although trading shares can be seen as mere 'deal-making,' it can also foster entrepreneurship. When an individual buys shares, he/she risks capital, and contributes sweat equity. In some ways this qualifies him/her as an entrepreneur. Take, for example, the Batho Bonke deal with ABSA which create more than a million new shareholders: the deal itself may have been done or led by a few big names in empowerment, but in the end the benefits are spread much more widely. In the long term, these shareholders can use their investments to start their own businesses. Therefore, it is not appropriate to be dismissive of these landmark deals.

Does black business need special treatment to succeed in a competitive climate?

How can the government and established companies help black businesses to grow? Black businesses need all the support they can get due to the shortcomings inherent to this sub sector, including limited education and funding. Looking at the low rate of survival in the small enterprise sector, it is advisable that black entrepreneurs should focus on high growth sectors. Rather than entering a sector that is not growing, they should buy a stake in established white-owned businesses.

Furthermore, a commitment to enterprise development and preferential procurement by established businesses should not take place along the lines of corporate social responsibility. Established business should make concerted efforts to put systems in place that foster the capacity and development of black businesses. At the same time, black enterprises should not be cocooned from the harsh realities of business. They will ultimately have to compete in a global market, and in the long term it does not help them to be excessively protected.

Established business should make concerted efforts to put systems in place that foster the capacity and development of black businesses

Access to markets is a major challenge facing small enterprises, and being entrepreneurial means knowing what the market is looking for instead of crowding the market with more of the same service or product. Diversification is an important strategy for growth in a concentrated market. Rather than fighting over a dwindling market – as has been the case in the tourism sector, for example – emergent entrepreneurs should be creative and look for niches in high-growth areas. This can be done by aligning one's business with the demand side of the market.

BEE in relation to government support for small business

BEE should not be looked at in isolation of the wider policy environment. For example, the Department of Trade and Industry's small business development programmes are intended to provide support and to build managerial and other skills, but research has shown that these efforts have not been very effective thus far. Although there are some exceptions, such as the Manufacturing Advice Centre Programme, success is minimal and the impact of official government support -through the Small Enterprise Development Agency, for example – is negligible. Part of the problem lies in the provision of inappropriate support that has focused on unsustainable businesses characterised by a lack of market research. As a result, participants suggested that the Department of Trade and Industry should prioritise high-growth businesses that can serve as a vehicle for employment and equity.

BEE should not stifle competition

Entrepreneurship thrives in an environment in which government intervention and market forces are in balance. In order to facilitate economic growth, we should avoid a situation in which BEE detracts from the competitive environment. If the government wants to foster entrepreneurship, it has to re-regulate in a way that gives people opportunities to compete. It is not simply a question of whether BEE is doing enough for entrepreneurship; the question is what we are doing to change the regulations in the rest of the economy to allow entrepreneurship to flourish. For real entrepreneurs to succeed, the country should not create further hurdles. BEE charters that bring black people into the mainstream economy in ways that exchange active operational involvement for passive shareholding are not beneficial in the long term.

Participants raised concerns about the continuous cost of regulatory compliance

Although BEE is an important government policy, it is not a panacea for development. It is important to change people's perception that one does not have to work hard to succeed. People should not simply sit and wait for BEE deals to come through. This is one of the unintended consequences of BEE that retards growth and deters creativity among small and entrepreneurial enterprisers.

Summing up

MOST participants agreed that BEE was a political necessity to correct the persistent imbalances in economic participation in South Africa. Some also saw BEE as a trade-off for the country having – initially at least – embraced free markets, including partial privatisation and liberalisation, in the face of trade union and other political pressures for nationalisation and state intervention.

However, it was acknowledged that, thus far, narrowly based BEE had enriched only a minority, and policy guidelines were also criticised for not applying pressure on black or BEE firms themselves to comply or engage with the requirements of the score card. It was argued that black or BEE firms are not rated on enterprise development, skills development, or return on investments. Hopes expressed for broad-based BEE went beyond spreading the benefits of empowerment more widely to the potential for stimulating consumption and triggering economic growth.

While empowerment transactions were seen as once-off costs, participants raised concerns about the continuous cost of regulatory compliance, and the impact on efficiency of the time and cost involved in BEE verification. Furthermore, if estimates of BEE costs at about 5,5 per cent of value added were accurate, any attempt to shift this on to labour in the form of lower wages might depress consumer demand, and stifle domestic consumption. On the other hand, attempts to shift the costs forward in the form of higher prices were likely to make manufacturing less competitive – which could exert downward pressure on the South African currency until competitiveness was restored.

Participants raised concerns about the continuous cost of regulatory compliance

Participants discussed whether the funds raised for BEE share transfers reduced the money available for other transactions, but this view was not widely held. Rather, two anticipated macroeconomic effects were examined: an effect on the exchange rate, and the impact of equity transfer, particularly the question of where sellers of equity were likely to put their funds. Options include investment in new projects; the purchase of government and corporate bonds, exerting downward pressure on interest rates; the purchase of individually held real estate; and the purchase of international equities and other assets. Each of these decisions had a different macroeconomic effect, so the net effect would depend on the allocation of realized funds to the different asset classes.

On the question of BEE and small business development, it was suggested that the BEE culture in South Africa celebrated large corporate success stories and not the development of the country’s own entrepreneurs. Nevertheless, the value given to enterprise development on the BEE score card was commended as an exciting aspect of the policy. However large enterprises are more likely than small enterprises to have the resources and capacity to help small businesses. This might constrain the value of this aspect of the score card in the small business sector unless large enterprises took active steps to integrate small businesses with their value chains. The codes of good practice should prescribe to large companies seeking to engage in new empowerment deals that they should bring a new or emerging empowerment group into the deal. This could ensure an upward movement on the value chain of established companies, and a constant breeding of new players at the bottom.

Affirmative appointments in the public and corporate sectors are working to stimulate the small business sector, and therefore the economy, but this has taken the unanticipated form of many whites leaving government and large companies to start their own businesses. While affirmative procurement encourages black entrepreneurs to start their own businesses, the points awarded on the score card for black ownership is unlikely to persuade many black business people to leave large enterprises and the public sector and start their own small businesses. It was argued that the black ownership component of the score card should be strengthened if it were to serve as an incentive.

It was argued that BEE was inward-looking, and did little to make South Africa more globally competitive

It was also pointed out that barriers to entrepreneurial success still existed; these included difficulties in accessing finance, a lack of skills, and access to markets. South Africa remained a concentrated economy dominated by large conglomerates, and these barriers made it even more difficult for small businesses to enter certain markets.

Finally, on the question of whether BEE could contribute significantly to economic growth, it was argued that BEE was inward-looking and did little to make South Africa more globally competitive. There was a risk that, given increased BEE regulation, small businesses would try to remain below the compliance threshold, which would undermine their potential to contribute to economic growth. It was also suggested that BEE would not solve the problem of unemployment. The challenge for government to reach its objective of halving unemployment and poverty by 2014 could only be addressed by growing the size of the 'cake'. This would require a greater focus on entrepreneurship, and would depend on the government dealing with the obstacles that had impeded economic growth thus far.

Endnotes

1 This is a summary of a study commissioned by CDE from Reg Rumney. The full-length document is available from CDE.

2 <http://www.businessmap.org.za/documents.asp?DID=1442>

3 Dave Thayser (Ed), Mergers & Acquisitions, A Review of Activity for the Year 2005, 15th edition, Johannesburg: Ernst & Young, March 2006.

4 Daniel Bugan, BEE codes 'too expensive' to implement, say 56 per cent of businesses, www.businessowner.co.za, posted on Thursday 8 June 2006.

5 Foreign Direct Investment in Southern Africa: The Initial Impact of the Trade, Development and Co-operation Agreement between South Africa and the European Union, Lynne Thomas and Jonathan Leape, of Crefsa, London School of Economics, with Michel Hanouch and Reg Rumney, BusinessMap Foundation, Occasional Research Paper No 1, Regional Trade Facilitation Programme October 2005.

6 Ibid p A12.

7 This is a summary of a study commissioned by CDE from Charles Simkins. Copies of the full document are available from CDE.

8 *Financial Mail*, 10 March 2006.

9 This is a summary of a study commissioned by CDE from Barrie Terblanche. Copies of the full document are available from CDE.

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