

# **BEE Cause**

**this is serious....**



Newsletter: May 2017

## **Industry Update**

As we approach the middle of 2017, it might be a good moment just to stop and take stock of what has happened so far this year.

We have seen the release of the Amended Forest Sector Code. It is now added to the growing list of Sector Codes that have concluded their revisions to align with the Amended B-BBEE Codes gazetted in 2013. (Yes, you read that right, 2013). At present, we have Sector Codes in Tourism, Media, Advertising and Communications (MAC) and ICT that have been gazetted. The Construction, Transport, Property, Financial, Agri-BEE and CA Sectors have drafts that were released for public comment, some as far back as October 2015. They have yet to be finalised, but the informal feedback is that most of them will be released shortly.

We also have not yet seen the final Verification Manual, a critically important document that guides the verification industry on how they should measure compliance. The draft has been around since November 2015, and the lack of clear guidance on some of the requirements is a serious concern. Perhaps the book on Radical Economic Transformation should have a chapter in about speeding up transformation by signing off on the legislation that governs it. Just saying.

Our prediction from last year came true and each new Sector Code now comes with the "damned if you didn't" clause, effectively making the Sector Code retrospective to the last financial year you have not yet been verified on. This effectively means that companies with a financial year at the end of December 2016 or February 2017 would be measured for their next verification on a Sector Code that may not yet have been gazetted. The fact that this flies against the principles established in terms of effective dates, seems not to be a consideration.

There are still companies that are using EME Certificates issued in terms of the Amended Codes, even though everyone that matters is on record stating that they are invalid. What is happening now is that these companies that were either knowingly or unknowingly taken for a ride by whomever issued these invalid certificates, is nicely making it their clients problem. Our clients are forced to discard up to 25% of BEE certificates from their suppliers because they were invalidly issued.

QSE ownership fronting has been blocked, sort of. Some of the popular scams that have been going around since the Amended Codes came to life, include the use of the "Modified Flow Through" Principle to elevate a company with an effective 26% ownership to become a 51% Black Owned Level 2 Company that is exempt from complying with the Codes. The B-BBEE Commissioner is on record saying that it is a misinterpretation of the Amended Codes to allow this and anyone that advises clients to do this should end up in jail. Unfortunately this will not have the desired effect yet, because the entire document is called a "non-binding guide". Only the Minister may change the Codes, and that appears not to be a priority.

Will we see a revamp to the Amended Codes? Apparently there are some rumours flying around that a complete revamp of the Codes is on the cards. According to this, we may see a complete revision of the Codes before the end of 2017. This will apparently clear up all the confusion, close the loopholes, define the grey areas and provide the missing bits.

In the meantime, we urge the leadership of businesses to engage with the Codes, flawed as they may be, to implement transformation that is real, cost effective and in the interest of your bottom line. Denial is only a solution if you are in politics, or in love.

## Black business credibility hit by fake BEE, says Gestalt



A wave of BEE fronting schemes is causing 'collateral damage' among genuinely empowered black businesses, says Gestalt, a leading BEE consultancy.

Two types of black business fall victim to fronting cynicism, according to Gestalt Group CEO Deon Oberholzer.

The first is the small scale start-up led by a black entrepreneur, using his/her skills and capital to build a business. The second is the mid-scale business with genuine 51% or more ownership by a black proprietor in partnership with white associates.

Oberholzer explains: "Government is to be saluted for simplifying BEE processes for micro-enterprises. A Black sole proprietor with an annual turnover of less than R10 million simply has to swear an affidavit to this effect to obtain exempt status and a Level 1 ranking or Level 2 if between 51% and 100% Black.

"It's quick and easy. Perhaps too quick and too easy. The temptation for white business to put sham ownership structures together has seen a wave of businesses all claiming exemption with no structural oversight. This creates credibility issues for legitimate players in this space.

"Black partners in bigger enterprises face similar problems. They may run a genuine partnership and legitimately own a 51% stake. However, so many structures now create the appearance of black majority ownership that it is difficult to decide if you are dealing with true or sham empowerment."

Black owners are becoming increasingly frustrated by the situation.

"They are honest contributors to empowerment," notes Oberholzer, "but face growing scepticism; so much so, they believe the onus is on them to provide an extra layer of assurance around their status.

"We therefore see demand for an intermediate form of BEE recognition – more formal than an affidavit but less costly and time-consuming

## Construction codes can fix BEE inertia



The envisaged construction sector BEE codes have the potential to re-energise transformation while creating a platform for strategic growth at wide-awake building firms and contractors.

The 'thumbs-up' comes from Gestalt, a leading BEE Consultancy.

Gestalt Group CEO Deon Oberholzer applauds new provisions in the sector council's recently published draft codes that enable small and medium sized industry players to improve their BEE status by committing resources to skills development and supply chain development.

The general principle is that Exempt Micro Enterprises that are not at least 51% Black owned are stuck at a Level 4 with no option but to comply will all elements of the QSE Scorecard if they want to improve their BEE compliance.

It does come with a sting, warns Oberholzer. EMEs that do nothing about BEE might drop to a Level 5.

Oberholzer notes: "An exempt micro-enterprise (EME) or black-owned QSE can improve up to two levels by making full use of their opportunities. Even one step up can massively improve the competitiveness of construction firms and sub-contractors.

"The sector council tackles transformation apathy and inertia head on. Other sectors should carefully scrutinize these provisions as they could be usefully applied in many industries."

"Policymakers seek ongoing change. In practice, many businesses stick at one level and assume there is no chance of improvement, perhaps because of ownership constraints. Transformation stalls because opportunities for another step up are lacking – but not in the planned construction sector dispensation."

Typical examples, he says, are the black-white partnership in which a black entrepreneur has a 51% stake. This often results in Level 2 empowerment status. Level 1 is generally perceived as the monopoly of firms with 100%

than full accreditation.”

Supply chain distribution is one area where widespread fronting is suspected, says Oberholzer. This concerns both business-to-business customers and policymakers. On the surface, new exempt Black Owned Companies appear to be emerging in all value chains, but the ability to separate the real black owned companies from the shams is challenging.

“Preferential procurement through a company with a black ‘wrapper’ has the potential to become a major problem,” he says. “Government is impatient with the rate of real change and efforts to deflect transformation in this way will be severely dealt with.”

The Broad-Based Black Economic Empowerment Act, as amended in 2013, says fronting can be prosecuted as fraud, with the BEE Commissioner empowered to fine or prosecute offenders. The maximum jail term is 10 years while a juristic person faces a maximum fine of 10% of annual turnover.

Oberholzer warns: “If fronting becomes so commonplace that BEE is discredited and undermined, offenders can expect the Commissioner to engage in salutary sentencing. Playing games with the letter and spirit of the law will not be tolerated.

“Some smart operators may get away with it for now, but for how long?”

## More About Gestalt

Gestalt is a BEE Strategy and economic empowerment consultancy. Gestalt owns Veri-Com, a Level 2 B-BBEE SANAS Accredited Agency. Deon Oberholzer, the group CEO is on the board of ABP (Association of BEE Professionals)

black ownership. Under the construction sector’s planned codes, the Level 2 firm might reach Level1 by energetic action to develop suppliers and staff, without further changes in equity.

Similar possibilities apply further down the scale. For instance, a white-owned EME may be stuck at Level 4 and assume further progress is impossible without a majority black partner. Under the envisaged sector codes, a step up becomes feasible, giving new life to transformation in that business and across its suppliers.

Says Oberholzer: “The envisaged construction sector dispensation looks beyond point verification to a more dynamic environment where ongoing empowerment is rewarded.”

“However, strategic business consultancy services may be necessary to enable a firm to fully realize these opportunities.”

“Today, construction businesses need a BEE profile simply to get into the queue for contracts. Companies intent on growth have to get to the front of that queue. Well-informed, properly structured utilization of the new codes could provide the competitive edge they’re looking for.”

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