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## List of Acronyms

ANC	African National Congress
BBSDP	Black Business Supplier Development Programme
BEE	Black Economic Empowerment (BEE)
BEECom	Black Economic Empowerment Commission
BOSMEs	Black-Owned Small and Medium Enterprises
CBO	Community-Based Organisation
CBPWP	Community-Based Public Works Programme
Cosatu	Congress of South African Trade Unions
CPPP	Community Public Private Sector Partnership
CR	Community Reinvestment
CRA	Community Reinvestment Act
CSIR	Council for Scientific and Industrial Research
DACST	Department of Arts, Culture, Science and Technology
DBSA	Development Bank of Southern Africa
DEAT	Department of Environmental Affairs and Tourism
DFI	Development Finance Institutions
DLA	Department of Land Affairs
DME	Department of Minerals and Energy
DoE	Department of Education
DoH	Department of Housing
DoL	Department of Labour
DPLG	Department of Provincial and Local Government
DPSA	Department of Public Service and Administration
DPW	Department of Public Works
DWAF	Department of Water Affairs and Forestry
EAP	Economically Active Population
EDSA	Entrepreneurial Development Southern Africa
EIG	Empowerment Investment Grant
EMIA	Export Marketing and Investment Assistance
ESC	Entrepreneurial Support Centre
ESOP	Employee Share Ownership Programme
FIG	Foreign Investment Grant
GDP	Gross Domestic Product
GEAR	Growth, Employment and Redistribution
HBDC	Highveld Business Development Centre
HDIs	Historically Disadvantaged Individuals
HDPs	Historically Disadvantaged Persons
HDPs	Historically Disadvantaged Persons
HEDC	Highveld Entrepreneurial Development Centre
HRD	Human Resources Development
ICT	Information and Communication Technology
ICTs	Information and Communication Technologies
IDC	Industrial Development Corporation

IDRC	Independent Development Research Centre
IDT	Independent Development Trust
IDU	Investment Development Unit
IDZ	Industrial Development Zone
IMS	Integrated Manufacturing Strategy
ISRDS	Integrated Sustainable Rural Development Strategy
LBSC	Local Business Service Centre
LED	Local Economic Development
MAC	Manufacturing Advice Centre
MAP	Manufacturing Advice Programme
MFI	Micro-Finance Industry
MFRC	Micro-Finance Regulatory Council
MTEF	Medium-Term Expenditure Framework
NAFCOC	National African Federated Chamber of Commerce
NEDLAC	National Economic Development and Labour Council
NEF	National Empowerment Fund
NGOs	Non-governmental organisations
PII	Partnership in Industrial Innovation
PPFA	Preferential Procurement Framework Act
PPP	Public Private Partnerships
R&D	Research and Development
RDP	Reconstruction and Development Programme
RFI	Retail Finance Institutions
RIDP	Regional Industrial Development Programme
SADC	Southern African Development Community
SARS	South African Revenue Service
SDIs	Spatial Development Initiatives
SICs	Standard Identification Codes
SME	Small and Medium Enterprise
SMEDP	Small and Medium Enterprise Development Programme
SMME	Small, Micro and Medium Enterprise
SOE	State-Owned Enterprise
SPF	Sector Partnership Fund
SPII	Support Programme for Industrial Innovation
SPV	Special Purpose Vehicle
SR	Social Responsibility
TDI	Targeted Development Investment
TEO	The Enterprise Organisation
<b>the dti</b>	The Department of Trade and Industry
TIDP	Trade and Industrial Development Programme
URP	Urban Renewal Programme

Notes

**INTRODUCTION - THE TRANSFORMATION IMPERATIVE**

- 1.1 Our country requires 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 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). The need to effect redress in the interests of equity is also embodied in our Constitution. 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 broad range 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 full potential.
- 1.6 Societies characterised by entrenched gender inequality or racially or ethnically defined wealth disparities are not likely to be socially and politically stable, particularly as economic growth can easily exacerbate these 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 redress racial discrimination is also an imperative dictated by the need for sustainable growth.
- 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 marginalise those on the periphery. Increased inequality and uneven development poses a real danger for all economies, both developing and industrialised. In South Africa, however, inequality and uneven development have extremely strong racial characteristics, which represent a threat to our young democracy. Therefore,



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**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 yet adequate for the requirements of a stable, integrated and prosperous society. Accordingly, we need to take additional 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 Broad-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 on 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 race-based economy. The fact that black communities had little access to technical and scientific teaching and learning further exacerbated the obstacles in our rapidly developing industrialisation process. It is a testimony to the vitality of black society that so much have been achieved in so short a space of time.

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 20th 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 for black learners and this had devastating effects on skills, particularly technical and science skills, with the resultant impact on 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 were deliberately under-equipped for 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 severely 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 persons 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. While other developing economies with endowments similar 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 in 1994 with a clear mandate to redress the inequalities of the past in every sphere: political, social and economic. This mandate is embodied in the Constitution. The legislation that has been enacted, as well as the policies and programmes introduced and implemented since 1994, have sought to fulfil this mandate. Much has been accomplished in each sphere and, at this juncture, the economic transformation of our country is truly under way 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 re-oriented towards meeting the needs of the poor and redressing years of unequal, race-based spending on education, health care, and social security.

2.3.3 Simultaneously, the South African economy has also undergone profound restructuring. Macroeconomic stabilisation has been achieved, providing a

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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 Broad-Based 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 black-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 small, medium and micro-enterprises (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 at 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 broad-based 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 addressed specific elements of the broad-based 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 fifty 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 re-oriented many of its incentives and enterprise support measures to promote broad-based black economic empowerment. Special efforts were made to increase public awareness of available incentives and enterprise support. The decentralisation of resources was expedited through the active participation of local and provincial government.

2.5.2 A total of R2,2 billion was allocated to fund BEE initiatives for the 2002/2003 financial year. Included in this support were offerings of **the dti** and its various agencies, including Ntsika, Khula and the Industrial Development Corporation (IDC); as well as offerings from the Land Bank, the Development Bank of Southern Africa and other financial development institutions. The Isibaya Fund contributed an amount of R321 million and the Umsombomvu Fund contributed R461 million. In addition, the DBSA has contributed R1.4 billion to the revenue of low income households between 2000 and 2002.

2.5.3 There is little doubt that these measures have leveraged private sector funds to support BEE. This is an important point in that quite clearly it cannot and will not be the State alone that finances BEE. The bulk of the funding is likely to come from the private sector with State funds acting as facilitator.

2.5.4 Khula has also made important contributions 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.

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- 2.5.5 An examination of the role of the IDC provides critical insights on proactive project financing of empowerment. The IDC has played a leading role in financing BEE transactions. The organisation's involvement with BEE funding commenced in the early 1990s when the IDC secured the inclusion of Historically Disadvantaged Persons in companies such as National Sorghum Breweries, NAIL and MTN. Since 1990, the IDC has financed over 690 empowerment deals worth more than R6.6 billion. Increase in empowerment funding rose from three deals in 1990 to a peak of 191 deals in 2002, representing about 37% of the total number of approvals.
- 2.5.6 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 the 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. In the manufacturing sector, the main areas of funding were within chemicals, food products, metals, clothing and textiles and forest products.
- 2.5.7 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 during the period 1990 – 2002, 78% (worth R4.71 billion) of the number of approvals came from high impact sectors compared to only 4% (worth R0.23 billion) from low impact sectors.
- 2.5.8 It is evident that there are now considerable state resources going into BEE and this strategy document and the measures it announces will significantly increase these resources. No purpose is served by attempting to divert more funds into the BEE process as the commercial and practical imperatives of successful BEE limits the amount of funds that can be absorbed into viable and sustainable projects at any one time.

**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".<sup>1</sup> 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, 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 dependant 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

<sup>1</sup> The Reconstruction and Development Programme, point 4.4.6.3., p93, 1994



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**A STRATEGY FOR BROAD-BASED BLACK ECONOMIC EMPOWERMENT**

**3.1 Introduction**

3.1.1 In the previous chapter it had been established that South Africa needs a focused BEE strategy to achieve the broad-based economic empowerment of black persons - a generic term, which means indigenous Africans, Coloureds and Indians - 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 which is 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 Thus BEE process will 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 strategy<sup>2</sup>,
- 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,**

<sup>2</sup> 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.

- 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 **co-operatives**
- 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.

### 3.4 Key principles

The strategy is underpinned by four 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 associated with good governance.

A fundamental part of our economic reform and transformation is improving the quality and transparency of all economic activity. Accordingly, BEE must be associated with and ensure the highest standards of corporate governance. Concerted efforts will be made to ensure that the quality of corporate boards and governance is improved.

#### 3.4.4 Black Economic Empowerment is part of our growth strategy.

##### 3.4.4.1 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.

##### 3.4.4.2 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.

##### 3.4.4.3 An effective and successful process of BEE and accelerated economic growth are mutually reinforcing objectives. The absence of shared economic growth will

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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.

3.4.4.4 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.

3.4.4.5 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 seek 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 Advisory 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 scorecard (or charter) 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 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. Clear targets will be set to increase the levels of preference to black-owned and black-empowered enterprises. The final target will be set once research on existing levels of black empowerment procurement has been completed.

In support of increased procurement by black-owned firms (as defined in Appendix B), 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.

#### 3.5.6 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 Authorities, 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 of Trade and Industry 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,

**Notes**

- 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 be comprised of 19 members who will hold office for a three-year term. Of the members, four will be Cabinet Ministers and the remaining 15 members 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 relates to the use of various government tools to promote BEE, such as procurement, regulation, financing, and institutional support. These have been outlined above. The second set 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 each 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 form 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 spirit of this strategy and, in particular, the implementation of the scorecard approach will be encouraged, especially in 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 For those medium and smaller enterprises, government will launch an extensive outreach campaign 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 this process is strategically important for the economy. It is understood that BEE must have a credible financing component in order to proceed. The absence of this component would generate two problems: the first is that the extent of BEE will be limited as there will not be enough financial support and the occurrence will not be broad-based; secondly, 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 BEE cannot be financed 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. Thus, it is also essential for those who are sellers of assets to 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. In this area, BEE 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 consideration for SMMEs and also for new forms of enterprise such as co-operatives,
  - **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, the entrepreneurs and investors. This is crucial from the point of view of the macroeconomic stability of the economy but more importantly it will improve the quality of enterprise development and, therefore, the competitiveness of the economy.

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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 made a commitment to set aside finance to support the Broad-Based BEE process. A new mandate for the NEF 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 thus an illiquid situation for BEE assets. This is likely to be limited to more strategic areas. The Employment and Investment Cluster of Directors-General will convene a meeting of development and parastatal institutions to discuss further improvement to the accessing of financial and other support by black-owned firms.

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 again is on small- and medium-sized enterprises. Government has created lending facilities and has also provided for underwriting and risk sharing. Khula is the primary 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 also 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 programmes include investment in the various Strategic Development Initiatives 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



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**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 for 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 comment. 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. Therefore, it is important for interested parties to make their views known. This should be done through **the dti**.
- 4.3 A task team will be established shortly 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 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. **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 in monitoring and evaluating progress made in achieving the economic transformation of our nation through a broad-based black economic empowerment strategy.



Horizontal lines for taking notes.

**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 provided 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 where sector-specific charters are developed, the terms set out in those charters will apply. 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 so 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.

**Core components of BEE**

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.

**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 persons’ 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.

**Notes**

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 black-empowered enterprises,
- Joint ventures with black-owned and black-empowered enterprises that result in substantive skills transfer.

Investment in black-owned and black-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 that 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 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 their circumstances, 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
<b>Direct empowerment score</b>					
Equity Ownership	% share of economic benefits			20%	
Management	% black persons in executive management and/ or executive board and board committees			10%	
<b>Human resource development and employment equity score</b>					
Employment equity	Weighted employment equity analysis			10%	
Skills development	Skills development expenditure as a proportion of total payroll			20%	
<b>Indirect empowerment score</b>					
Preferential procurement	Procurement from black-owned and empowered enterprises as a proportion of total procurement			20%	
Enterprise development	Investment in black-owned and empowered enterprises as a proportion of total assets			10%	
<b>Residual 10%</b>					
To be determined by sector/ enterprise				10%	
<b>Total Score out of 100%</b>					

### 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 the 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%.

**Notes**

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	Target is 5 % of procurement in 3 years		20%	
		Conversion factor :			
	Year 1 - 3%	100/5 = 20	3% x 20 = 60%	60% x 20%	12%
	Year 2 - 5%		5% x 20 = 100%		

**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%.

**Ranking enterprises using the scorecard**

Using the scorecard as a guide, government will rank and categorise enterprises for the purposes of preferential procurement, 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 broad-based black economic empowerment. The following are samples of categories for preferencing:

- Total score of **65% and above** – **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.





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**APPENDIX C**  
**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. Fifteen 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.



Notes

**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 five 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 black-controlled businesses experience in their efforts to acquire 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 of these women still cannot open bank accounts. Furthermore, millions of black persons 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 those in 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. 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 mostly cater for affluent urban communities. Some of them have argued against providing banking services to rural areas simply because of the 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 to 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 contributes 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:

- Of the applications for incentives to **the dti**, 80% to 90% 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

**Notes**

Above R30 – R50 million	3% p.a
Above R50 – R75 million	2% p.a
Above R75 – 100 million	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 offers 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 (50 plus one share) and have a significant representation of black managers on their management team,
- Firms with a maximum annual turnover of R12 million per annum can qualify for BBSDP grants,
- 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 with 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,
- 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 to successfully compete for corporate and public sector tenders and outsourcing opportunities is enhanced.

**3.3 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.

**4. Proposed amendments to current State Grants**

**4.1 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.

**4.2 Proposed amendments to the tax based incentives**

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

### 4.3 Proposed amendments to Small Medium Enterprise Development Programme

BEEs 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 (HDIs) should apply to such joint-venture applications. The proposal will facilitate business linkages, improve commercial viability of projects, facilitate skills transfer and contribute to the achievement of the government's BEE policy.

### 4.4 Support Programme for Industrial Innovation

The Support Programme for Industrial Innovation (SPII) provides financial support in the form of reimbursement 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.

### 4.5 Export and Marketing Investment Assistance

The problem facing the majority of BEE participants is that their products and processes are not export ready. The Export and Marketing Investment Assistance (EMIA) Scheme is being reviewed. The programme will be made more flexible and focused by introducing training programmes for companies to help them become export ready. A budget of R10 million will be allocated for training to improve export readiness. In addition, 20% of the EMIA budget will be allocated to BEEs.

### 4.6 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 business chambers in order to build a strong and co-ordinated chamber movement in South Africa. This will enhance the integration of BEEs into mainstream business.

## 5. New financial incentives for BEE enterprises

### 5.1 The Empowerment Investment Grant

The Empowerment Investment Grant (EIG) is proposed, to assist Black-Owned Small and Medium Enterprises (BOSMEs) who have difficulty in accessing 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.

**Notes**

**5.1.1 Objectives of the Proposed EIG**

The programme would be aligned and consistent with government's 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 persons 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 people living with disabilities,
- Integration of BOSMEs into the mainstream industry with regard to trading - providing goods and services to the attractive mainstream markets as well as - membership of mainstream business associations,
- Integration of the HDI-owned SMMEs into the mainstream financial institutions with regard to capability to leverage finance through the "normal" means rather than extraordinary interventions.

**5.1.2 Implementation Process**

Implementation of EIG will be done proactively whereby **the dti** will select and target specific projects.

In order that assisted BOSMEs achieve optimum growth and development the programme will be implemented in conjunction with other complementary enterprise support services / instruments offered by TEO, the Council of Trade and Industry Institutions, public enterprises, other government departments, Non-Governmental Organisations, as well as the private sector. As part of the selection, comprehensive audits of the enterprises' support requirements and needs for achievement of optimum growth and development will be done. Among others, the audit will identify needs in the following areas:

- Human Resources development programmes 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 20 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 analysis of enterprises' support requirements,
- To identify cost effective solutions, support services and suited enterprise support service providers,
- Liase 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,
- Mentor approved projects and providing any incidental aftercare service,
- Monitor, compile and submit progress and performance reports to the board in respect of 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 verifying the facts and circumstances,
- 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 a similar 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 cases 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 warrant it.

**5.1.3 Critical Success Factors**

**5.1.3.1 Distribution channels and capacity**

Establishment of distribution channels that are suitably structured as well as appropriately resourced in respect of human resource 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 insofar as it is detrimental to the accessibility of the product and complementary services to the target segment and achievement of an outreach in scale and depth, which will make a nationwide 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.

**Notes**

**5.1.3.2 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, 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 practice 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,
- 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 The Enterprise Organisation – and will have such clout as to be the think tank that informs and advises the strategic direction of The Enterprise Organisation. Provision for such capacity and expertise must be made.

**5.2 Micro Enterprise Support Programme**

Most micro enterprises face a shortage of start up capital. In order to address this a new incentive programme is to be piloted over a two-year period. An amount of R50 million is to be allocated to this programme aimed at enabling qualifying micro enterprises to obtain the necessary funds to start and/or develop businesses.

**5.3 Bridging Finance**

Enterprises experience cash flow constraints during the first year 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.



