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A CRITICAL APPRAISAL OF THE MISAPPLICATIONS OF  
BLACK ECONOMIC EMPOWERMENT AND THE COMMON  
MISPERCEPTIONS THAT SURROUND IT

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This Research Project is submitted in partial fulfillment of the regulations for the LLB Degree at  
the College of Law and Management Studies, School of Law.

by

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**DECLARATION**

I, Prenisha Govender hereby declare that this project is an original piece of work which is made available for photocopying and for inter-library loan.

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## **ABSTRACT**

Broad-Based Black Economic Empowerment is a regulatory framework, which is unique to South Africa. This dissertation reflects upon the evolution of Broad-Based Black Economic Empowerment programme, from the commencement of apartheid to date. Broad-Based Black Economic Empowerment was implemented by government, with the objective of resolving the injustices created by the apartheid regime. Government seeks to achieve this objective by integrating the historically disadvantaged individuals within South Africa into the mainstream of the economy. However, the reality is that the implementation of the Black Economic Empowerment programme has not been entirely successful.

This dissertation is a critical analysis of the application of Broad-Based Black Economic Empowerment and related legislation. It aims to highlight the challenges faced by government in enforcing the Broad-Based Black Economic Empowerment programme, with a particular focus on the following issues: fronting, misrepresentations and common misperceptions. This dissertation begins by reflecting upon the historical context of South Africa toward democratization, secondly it analyses the current applicable legislation and explores the current issues.

This research shows that Broad-Based Black Economic Empowerment is essentially a work in progress programme as there is much room for improvement. Scholars have established that companies and other entities regularly circumvent the Act. Furthermore, many individuals misunderstand the programme and its purpose. The research concludes Broad-Based Black Economic Empowerment does have potential for success. In considering the approach taken by Malaysia, it is established that the key to overcome these major issues is education.

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## **LIST OF ABBREVIATIONS**

ANC – African National Congress

BEE – Black Economic Empowerment

B-BBEE – Broad-Based Black Economic Empowerment

BMF – Black Management Forum

Codes – Code of Good Practice

DTI – Department of Trade and Industry

EE – Employment Equity Act

ESME – Exempted Small and Micro Enterprises

GDP – Gross Domestic Product

GEAR – Growth Employment and Redistribution Strategy

HDI – Historically Disadvantaged Individuals

NEP – New Economic Policy

NGP – National Growth Path

NP – National Party

PFMA – Public Finance Management Act

RDP – Reconstruction and Development Programme

SEDA – Small Enterprise Development

SMME – Small Medium Micro Enterprises

SPV – Special Purpose Vehicle

QSE – Qualifying Small Enterprises

## **KEYWORDS**

Apartheid, economy, Historically Disadvantaged Individuals, Growth Employment and Redistribution Strategy, Reconstruction and Development Programme, Black Economic Empowerment, Broad-Based Black Economic Empowerment, Codes of Good Practice, scorecard, Affirmative Action, Employment Equity, skills development, companies, fronting, benefit diversion, window-dressing, opportunistic intermediaries, misrepresentation, misperceptions and procurement.

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## CHAPTER 1

### INTRODUCTION AND GENERAL BACKGROUND

#### **1 Introduction**

In order for one to understand the significance of Black Economic Empowerment (BEE), it is important to understand the history of South Africa. Pre-1994 the South African government sought to monopolize the country's economic resources through the apartheid regime.<sup>1</sup> As a result of apartheid there were severe inequalities between the majority and minority of the country. Consequently, the majority were politically, economically and socially excluded, therefore left to live in poverty-stricken conditions, with little or no opportunities to develop themselves.<sup>2</sup>

Generally, law has to evolve to meet the demands and changes within society. Upon the advent of democracy in 1994, the African National Congress (ANC) was faced with the challenge of redressing the past inequalities created by apartheid.<sup>3</sup> It began attempting to transform the economy through the Redistribution and Development Programme (RDP), the Growth Employment and Redistribution Strategy (GEAR), followed by BEE and a broader focus through Broad-Based Black Economic Empowerment (B-BBEE). Essentially, companies and other entities play an important role in transforming the economy. Instead of assisting in transforming the economy the companies constantly attempted to find loopholes to avoid complying with the BEE system. The circumvention of compliance is mainly done through practices such as fronting and misrepresentations. Effectively these practices are contrary to the spirit and purport of BEE and the advancements of the government.

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<sup>1</sup> S Ramlall 'Corporate social responsibility in post-apartheid South Africa'2012, SRJ 8(2) 270-271.

<sup>2</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006) ii.

<sup>3</sup> S Ramlall 'Corporate social responsibility in post-apartheid South Africa'2012, SRJ 8(2) 270-271

## **1.2 Problem Statement**

Entities, through misrepresentations and nonconformities, are deliberately exploiting the BEE system implemented by government. On the other hand, there are entities who innocently fail to comply with BEE based on their misperceptions. The failure of entities to comply with the BEE system, negatively affects the country's economic transformation, therefore these issues need to be exposed. Furthermore, the questions that need to be considered is whether the government has succeeded in preventing the non-compliance of the Act and what lessons can be taken from the Malaysian economic empowerment experience.

## **1.3 Literature Review**

The B-BBEE Amendment Act 46 of 2013 (the Act), was enacted in order to comply with the objectives of Section 9(2) of the Constitution which provides for 'legislative and other measures designed to protect and advance persons or categories of persons previously disadvantaged by unfair discrimination.'<sup>4</sup> Accordingly, BEE is a strategy, enforceable by the government with the objective of economic equality and introducing Black, Indian and Coloured individuals into the mainstream of the economy.<sup>5</sup> Jack and Harris state that the Act initiates a road map for achieving equal participation of all citizens in our economy, thus the main objectives of the Act are to provide meaningful participation by black citizens, through transformation of the racial composition in terms of management and ownership in the economy.<sup>6</sup> Esser and Dekker expand on the objective of BEE by providing that 'the South African B-BBEE Act, not only aims to correct racial imbalances, but also strives to promote social investment and the empowerment of the communities.'<sup>7</sup> In essence, if the programme is implemented correctly it will provide job creation, global competitiveness and economic growth.

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<sup>4</sup> s 9(2) Constitution of the Republic of South Africa, 1996

<sup>5</sup> F Marais & L Coetzee 'The determination of black ownership in companies for the purpose of Black Economic Empowerment' (2006) 27 *Obiter* 115.

<sup>6</sup> Jack & K Harris *Broad-Based BEE: The complete guide* 1ed (2007) 29.

<sup>7</sup> I Esser, A Dekker 'The Dynamics of Corporate Governance in South Africa: Broad Based Black Economic Empowerment and the Enhancement of Good Corporate Governance Principles' (2008) 23 *SA Merc LJ* 157- 169.

Generally, confusion arises about who the beneficiaries of the programme are. It has been established that beneficiaries are black citizens who were legally excluded in the past.<sup>8</sup> Another misunderstanding, which arises, is whether Chinese people are beneficiaries of the system. This issue has been clarified in the case of the *Chinese Association of South Africa and Others v Minister of Labour and Other*, where the court found that Chinese people are beneficiaries of BEE.<sup>9</sup> Apart from the B-BBEE Act<sup>10</sup>, related legislation subsequently implemented, such as the Employment Equity Act<sup>11</sup> and the Skills Development Act<sup>12</sup> to ensure equal opportunities and the development of Historically Disadvantaged Individuals (HDI's) in society. It is clear that government has taken dynamic steps through legislation to include HDI's in society.

However, the Black Economic Empowerment programme is not flawless. Fronting and other forms of misrepresentations are rampant as there is a lack of access to finance and there are HDI's in society.<sup>13</sup> Many scholars have identified fronting as an obstacle for government because fronting goes against the objectives of BEE. Nevertheless, prior to the release of the B-BBEE Amendment Act 46 of 2013, scholars have provided several views upon how the practice takes place and how it should be identified. For example Khomosto had given a more general definition of fronting and stated that 'fronting is a deliberate circumvention or attempted circumvention of the B-BBEE Act.'<sup>14</sup> Mynhardt has provided a more comprehensive understanding and stated that the practice takes place in the following manner: 'black and white individuals form a relationship solely to procure contracts as a result the black individual does not acquire a substantial educational or financial benefit; BEE companies are formed as an empowerment shell; and lastly black individuals are paid a fee for the use of their name by a company.'<sup>15</sup> Further, M'Paradzi is of the view that the practice is a 'superficial inclusion of

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<sup>8</sup> s 1 Employment Equity Act 55 of 1999

<sup>9</sup> *Chinese Association of South Africa and Others v Minister of Labour and Others* 2008 ZAGPHC 174

<sup>10</sup> Broad-Based Black Economic Employment Act 53 of 2003

<sup>11</sup> Employment Equity Act 55 of 1999

<sup>12</sup> Skills Development Act 97 of 1998

<sup>13</sup> Jack & K Harris *Broad- Based BEE: The complete guide led* (2007) 29.

<sup>14</sup> M Khomotso 'The end of fronting: B –BBEE' (2013) 13 *Without Prejudice* 58-59.

<sup>15</sup> A J Mynhardt *Investigation of Misrepresentations in Tender Documents* (unpublished Magsite Technologia, University of South Africa, 2011) 56.

HDI's, with not an actual transfer of wealth or control.'<sup>16</sup> It can take place by way of paper fronts; fictitious companies; fronts in joint ventures and front companies. Therefore, in effect government is defrauded.<sup>17</sup> It can be said that the general view is that fronting is a practice in which companies make unsubstantiated BBEE claims.

To address deliberate circumventions of the Act the B-BBEE Amendment Act 46 of 2013 was enacted. Accordingly, as outlined above many scholars have provided opinions on fronting, but in fact, they have not yet critically analyzed the statutory definition and the penalties in terms of the B-BBEE Amendment Act because it is new. This dissertation will critically analyze the practice of fronting which is defined in Section 1 as 'a transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of [the] Act or the implementation of any provisions of the Act.'<sup>18</sup> The practice can take place through window-dressing, benefit diversion or opportunistic intermediaries.<sup>19</sup>

Previously, fronting was only recognized under the common law as fraud. Thus, there were no statutory penalties.<sup>20</sup> Few, if any, scholars have considered whether the penalties are adequate to prevent the circumvention of the Act. Even though Butler went further in his discussion to explain that verification agencies and the public are encouraged to identify and report fronting, he did not discuss the penalties, which flow from fronting and other circumventions of the Act.<sup>21</sup> The penalty currently applicable is that; if an entity is found guilty of fronting or in contravention of the B-BBEE Amendment Act, it will be liable to a fine, which would not exceed 10 % of its annual turnover.<sup>22</sup> Furthermore, the Act provides that where a natural person is involved in said fronting, he or she will be liable to a fine or imprisonment of a maximum sentence of ten years. Accordingly, any person that is convicted of an offence in terms of the Act will be registered in the tender defaulters registry by the National Treasury, in other words blacklisted and precluded

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<sup>16</sup> A S M'Paradzi *BEE- Basis, evolution, evaluation: a critical appraisal of Black Economic Empowerment in South Africa* (unpublished Commercial Law thesis, University of Cape Town,2006) 65.

<sup>17</sup> Ibid.

<sup>18</sup> s 1 B-BBEE Amendment Act 46 of 2013

<sup>19</sup> Ibid.

<sup>20</sup> Jack & K Harris *Broad- Based BEE: The complete guide* 1ed (2007) 29.

<sup>21</sup> A Butler 'Black Economic Empowerment' (2004) 42 *JMAS*

<sup>22</sup> s 13M (3)(a) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

from entering into contracts with any organ of the state or public entity for a period of ten years.<sup>23</sup>

Apart from fronting and other abuses of the Act, many misperceptions surround BEE. As a result, these misperceptions cause individuals to evade compliance with the Act, which negatively affects their business.<sup>24</sup> Scholars have not yet comprehensively discussed this issue or clarified the misperceptions that arise. Some of these misperceptions are: that nationality has no relevance in B-BBEE; that B-BBEE is a merely a cost to a business; that it is solely based on ownership and finally that it has the effect of causing companies to no longer contribute to charities within society because of the socio-economic element. It is clear from the issues highlighted above that government continuously faces challenges in transforming the economy to represent the demographics of the country's population.

The general view has been that South Africa should look to countries such as Malaysia for guidance upon how to implement a successful economic empowerment programme and that the government should have begun B-BBEE by focusing on education.<sup>25</sup> Mandla supports this view because he states that in both countries, the majority were left out of the mainstream of the economy and therefore upon independence both countries 'faced the challenge of redressing the socio economic and political imbalances.'<sup>26</sup> Furthermore, Mputhi said that although Malaysia did face similar problems as South Africa, it was still able to create a new wealth for the majority without depriving the minority of its wealth. On the other hand, in the context of South Africa progress has been slow as a consequence of its unrealistic expectations. Therefore, it is suggested

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<sup>23</sup> s 13P (1) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

<sup>24</sup> 'BEE explained: An easy guide to understanding Broad Based Black Economic Empowerment' available at [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf), accessed on 18 September 2014.

<sup>25</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

<sup>26</sup> Ibid.

that South Africa should draw on the Malaysian model in seeking to implement further economic empowerment policies.<sup>27</sup>

To conclude, as mentioned above the implementation of the B-BBEE Amendment Act has been recent. A few scholars, if any have evaluated the statutory penalties for fronting and other contraventions of the Act. Therefore, this dissertation intends to shed light on the progress of government in implementing BEE and overcoming the challenges that have occurred to date. This dissertation aims to be of assistance to legal experts, companies and other entities with regard to the application of BEE, in particular it will provide clarifications and guidelines, whilst indicating how to detect and prevent non-conformities of the Act.

#### **1.4 Research Objectives**

The purpose of the dissertation is to identify the loopholes and misapplication by entities of the B-BBEE Act 53 of 2003 and critically analyze whether the penalties for the contravention of the Act are adequate. A further purpose is to highlight the common misperceptions that arise about the B-BBEE Act. To conclude, the dissertation will illustrate recommendations which were derived from the economic empowerment initiatives enforced by Malaysia.

#### **1.5 Methodology**

The research is desktop based. It will discuss the publications of accredited scholars and researchers. It draws on laws specifically from the *Constitution of the Republic of South Africa 1996*, *Companies Act 71 of 2008*, *Broad-Based Black Economic Empowerment Act 53 of 2003*, *Broad-Based Black Economic Empowerment Amendment Act 46 of 2013*, *Preferential Procurement Policy Framework Act 5 of 2000*, *Public Finance Management Act 29 of 1999*, *Employment Equity Act 55 of 1999* and the *Skills Development Act 97 of 1998*. Cases analyzed will include *Solidarity obo Bernard v South African Police Services 2014 (2) SA 1 (SCA)*, *Minister of Finance & another v Van Heerden 2004 (6) SA 121 (CC)*, *Chinese Association of South Africa and Others v Minister of Labour and Others 2008 ZAGPHC 174*, *Viking Pony*

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<sup>27</sup> M A Mphuthi *Black Economic Empowerment in South Africa: Evaluating progress since 1994* (unpublished Business Management thesis, Raand Afrikaans University, 1999) 29.

*Africa Pumps (Pty) LTD t/a Tricom v Hydro-Tech Systems (Pty) Ltd and another* 2010 ZACC 21 and *Peel and others v Hamon J&C Engineering (Pty) Ltd and others* 2013 (2) SA 331 (GSJ).

## **1.6 Outline of Chapters**

The next chapter reflects on the history of South Africa dating from pre-1994 to the post-1994 era. Firstly, the chapter will illustrate how the racial policies enforced during apartheid created obstacles for the democratic government. Secondly, the chapter seeks to discuss the steps taken by the government to rectify the imbalances of the past, through means such as RDP and GEAR. The chapter will conclude by emphasizing the link between the inequalities created by the past and the income disparities, which endure today.

Chapter 3 will focus on analyzing and providing guidance on the B-BBEE Act and related legislation. Furthermore, it will discuss the application of the Codes of Good Practice. To conclude, the chapter will clarify the beneficiaries of BEE.

Having considered the past and established an understanding of the current position in South Africa, chapter 4 will explain the manner in which entities intentionally exploit the BEE system, through fronting and other misrepresentations and conversely, it will explain how some entities innocently fail to comply with BEE due to misperceptions. Lastly, the chapter will examine the EE system implemented by Malaysia and identify what can be learned by South Africa.

The final chapter will conclude by reiterating the discussion as well as proposing recommendations for South Africa.



## CHAPTER 2

### A BRIEF HISTORY OF SOUTH AFRICA

#### **2 Introduction**

As already indicated above, there are three main purposes of this study. Firstly, it seeks to identify the loopholes and misuses of the B-BBEE Act. Secondly, it aims to highlight the common misperceptions that arise based on the B-BBEE Act and thirdly the study will discuss the EE initiative enforced by Malaysia, while providing recommendations for South Africa. The previous chapter framed the reasons for the study, while the purpose of this chapter is to discuss the relevant history of South Africa dating from the apartheid era to democratization. Furthermore, the chapter will discuss the central causes of the injustices that endure today.

#### **2.1 The Historical Development of South Africa**

The period from 1948 to 1979, symbolically marked the rise of apartheid as the National Party (NP) came into power.<sup>28</sup> The NP came into power with a vision of enforcing a racial policy that socially and economically excluded particular individuals of society. Thus, there was the implementation of apartheid, a system that consisted of racial laws and the segregation of different race groups.<sup>29</sup> Apartheid was subject to ‘various political and economic interests of the white community [and] it [had] emanated from the era of monopoly capitalism.’<sup>30</sup> Primarily, South Africa consisted of four major race groups that are White, Black, Indian and Coloured, of which three of these race groups, Black, Indian and Coloured, were affected by the racial system.<sup>31</sup>

As a result of the apartheid regime black individuals were forced to change their lifestyle, more specifically in respect of their residence and employment. Although, there was industrial growth in South Africa at the time, major problems had escalated over the years. Because of apartheid,

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<sup>28</sup> A E Loots ‘The evolution of development policy in South Africa: Lessons from the past and the way forward’ (1997) 12 *SAJH* 26-53.

<sup>29</sup> M Mariotii ‘Labour markets during apartheid in South Africa’ (2012) 65 *Economic History Review* 1100-1122.

<sup>30</sup> D T Mckinely ‘The real history and contemporary character of black economic empowerment’ available at <http://sacsis.org.za/site/article/600.1>, accessed on the 25 June 2014.

<sup>31</sup> M Mariotii ‘Labour markets during apartheid in South Africa’ (2012) 65 *Economic History Review* 1100-1122.

urbanization problems had developed because ‘steps had been taken to maintain the wages of [b]lacks at low levels, to deprive [b]lack communities of their land and to force them into reserves and locations where poor economic conditions prevailed.’<sup>32</sup> The development of black individuals was severely limited as ‘[d]uring this period, [their] economic development and development in general enjoyed a very low priority.’<sup>33</sup> On the other hand, opportunities had risen considerably for white citizens.<sup>34</sup> Thus, it was clear that ‘[a]partheid had perpetuated poverty and exacerbated income inequality in very obvious ways.’<sup>35</sup>

Additional legislation and policies had been implemented to deepen segregation and ‘disempower’<sup>36</sup> the black South Africans in the economy. In considering the restrictions placed by legislation, the Natives Law Amendment Act 54 of 1952 sought to place a restriction on permanent residence available to black people. Subsequently, the Bantu Education Act 47 of 1953 was enacted. The act racially separated education facilities, which resulted in black people given only the necessary skills so that they could procure menial or physical labouring jobs. The Bantu Education Act<sup>37</sup> was followed by the Extension of University Education Act 45 of 1959; the Act was implemented to separate tertiary educational facilities for people belonging to different race groups.<sup>38</sup> It is clear that the above-mentioned policies were enforced to exclude black people from any advantageous opportunities available in society.

Black citizens evidently had limited educational opportunities in comparison to white citizens. Butler identified that the ‘[e]ducation policy under apartheid was starkly inequitable in terms of how it treated people of different races.’ He stated that ‘the majority of state resources were diverted to schools in white areas while the population living in black areas was subjected to very low quality schooling.’<sup>39</sup> Because of this, the minority had lucrative opportunities available

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<sup>32</sup> A E Loots ‘The evolution of development policy in South Africa: Lessons from the past and the way forward’ (1997) 12 *SAJE* 26-53.

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.*

<sup>35</sup> J Seekings *Poverty and Inequality after apartheid* (Published LLM thesis University of Western Cape, 2007) 2.

<sup>36</sup> Disempower is defined as; to deprive of power, authority, or influence: make weak, ineffectual, or unimportant.

<sup>37</sup> Bantu Education Act 47 of 1953

<sup>38</sup> A Butler ‘Black Economic Empowerment’ (2004) 42 *JMAS* 1-30.

<sup>39</sup> A Butler ‘Black Economic Empowerment’ (2004) 42 *JMAS* 1-30.

for a good quality education.<sup>40</sup> Inevitably it can be argued that the past education inequalities in South Africa is the root of the high unemployment rate, as low skill levels often reinforce a cycle of poverty and inequality.<sup>41</sup>

Economically, new business opportunities were provided to black people with the intention of deepening the racial inequalities in society. The Bantustan Investment Corporation was formed to promote the economic development of blacks in a very limited way. The responsibility of granting small loans was given to a board of white directors to financially assist small businesses such as transportation, butcheries, hospitality, retail, controlled corporations and furniture manufacturers. Black entrepreneurs were restricted in respect of the type of businesses they conducted. To heighten these restrictions, black individuals were only permitted to attain artesian training and work in black designated areas, thus this effectively created limited job opportunities for black people.<sup>42</sup>

Loots argued that the restrictions placed on black individuals was because the aim of the NP was to keep them 'out of [w]hite urban areas and to restrict them to reserves and farms.'<sup>43</sup> Thus to achieve this goal, the Group Areas Act 41 of 1950 was enforced, in which Black, Indian and Coloured people were prohibited from operating businesses outside of their designated areas. Moreover, the government banned black individuals from trading on the outskirts of white areas, solely with the intention of protecting the interests of white businesses. As a result, white people benefited from the discriminatory policies and their businesses flourished extensively.<sup>44</sup> Hoffman stated, 'the South African government has admitted that, racially segregated areas enforced through the Group Areas Act not only uprooted millions from their places of residence but also lead to capital losses and virtually destroyed the fabric of black small enterprises.'<sup>45</sup> Therefore,

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<sup>40</sup> Ibid.

<sup>41</sup> M Liebbrant 'Employment and Inequality Outcomes in South Africa' available at <http://www.oecd.org/els/emp/45282868.pdf>, accessed on 7 July 2014.

<sup>42</sup> A Butler 'Black Economic Empowerment' (2004) 42 *JMAS* 1-30.

<sup>43</sup> A. E Loots 'The evolution of development policy in South Africa: Lessons from the past and the way forward' (1997) 12 *SAJEH* 26-53.

<sup>44</sup> A Butler 'Black Economic Empowerment' (2004) *JMAS* 42 1-30.

<sup>45</sup> E.A Hoffman 'A wolf in a sheep's clothing: Discrimination against the majority undermines equality, while continuing to benefit few under the guise of Black Economic Empowerment.' (2008) 87 *JIL* 87-115.

the whole structure of the Act was to limit access to employment opportunities by confining black people to specific homelands.<sup>46</sup>

Black individuals were used as labourers for industries such as mines, factories, and farms because it was more cost efficient for white businessmen. Evidently, although black individuals were given opportunities in the business sector, it was limited to the discretion of the Bantustan Investment Corporation and governmental policies. Butler illustrated that although the Bantu Investment Corporation awarded some black entrepreneurs capital it ‘provided three times as much capital to white-owned enterprises in the Bantustans.’<sup>47</sup> Therefore, the policies, which were enforced, had visibly undermined the rights and abilities of black workers. It was found that ‘not only were well-paying skilled jobs reserved for white workers, but blacks were excluded from participating in the statutory collective bargaining framework at the time namely, Industrial councils.’<sup>48</sup> Moreover, white businesses were allocated a list that contained permissible jobs for black people; in particular, the list excluded black people from acquiring managerial positions or any other positions that required technical training. Jack and Harris argue that this was the root to unemployment and poverty in black communities.<sup>49</sup> However, toward the 1990s there had been clear changes that gave rise to democratization.<sup>50</sup>

## **2.2 The End of Apartheid and the Rise of Democracy**

There are significant events, which took place in South Africa that essentially lead to democracy.<sup>51</sup> Noticeably, democracy in South Africa did not emerge spontaneously; it was achieved through years of struggle. The inception of South Africa’s transition toward democracy began in 1994, when South African held its first democratic election and ‘the newly elected South African government, the ANC was forced to consider constitutional issues in

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<sup>46</sup> Ibid.

<sup>47</sup> A Butler ‘Black Economic Empowerment’ (2004) 42 *JMAS* 1-30.

<sup>48</sup> ‘Employment and Inequality Outcomes in South Africa’ available at <http://www.oecd.org/els/emp/45282868.pdf> accessed on 7 July 2014.

<sup>49</sup> V Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 6.

<sup>50</sup> Democratization is defined as the transition to a more democratic political regime.

<sup>51</sup> Democracy is defined as a form of government in which citizens are allowed to participate equally directly or indirectly through an elected representative.

implementing necessary policies to assist previously disadvantaged groups while its new Constitution was being drafted.’<sup>52</sup>

The Constitution of the Republic of South Africa was adopted in 1996 and is primarily recognized as the cornerstone of democracy in South Africa. Once the Constitution was established, it marked the end of apartheid and the birth of democracy for our country. Hoffman highlights some of the main purposes of the Constitution;<sup>53</sup>

The South African Bill of Rights was enacted to ensure equality among citizens, which has been defined as including the full and equal enjoyment of all rights and freedoms, which may be achieved through legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination. Additionally, "the state may not unfairly discriminate directly or indirectly against anyone on one or more grounds, including race, gender, or sex."<sup>54</sup>

Due to nearly half, a century of apartheid the government was faced with the challenge of correcting the mistakes of the past. The majority did not have the opportunities, which had been afforded to the minority.<sup>55</sup> Will specifically emphasized, ‘the majority of South Africa were left out or confined to the margin of the country’s mainstream economy due to race.’<sup>56</sup> Therefore, it is clear that the income distribution was racially distorted and the government had ‘recognized the need to do more in order to promote racial equality among all citizens.’<sup>57</sup> Progressively, the government had begun to implement various policies and strategies in order to correct the imbalances of the past. Democratization naturally was accompanied by high hopes that income poverty and inequality would effectively be reduced.<sup>58</sup>

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<sup>52</sup> E.A Hoffman ‘A wolf in a sheep’s clothing: Discrimination against the majority undermines equality, while continuing to benefit few under the guise of Black Economic Empowerment.’ (2008) 87 *JIL* 87-115.

<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*

<sup>55</sup> E Will ‘Black Economic Empowerment and South Africa’ (2012) 294 *Contemporary Review* 200-208.

<sup>56</sup> *Ibid.*

<sup>57</sup> E.A Hoffman ‘A wolf in a sheep’s clothing: Discrimination against the majority undermines equality, while continuing to benefit few under the guise of Black Economic Empowerment.’ (2008) 87 *JIL* 87-115.

<sup>58</sup> J Seeking *Poverty and Inequality after apartheid* (Published LLM thesis University of Western Cape, 2007) 2.

### **2.3 The Reconstruction and Development Programme**

The ANC realized that it was required to take progressive steps in implementing an actual programme of government which goes beyond the Freedom Charter because ‘[e]very sphere of our society – economic, social, political, moral, cultural and environmental was confronted by serious problems.’<sup>59</sup> It was clear that every region of our country was directly affected by apartheid policies and subsequently the collapse of it. The way forward was to involve both the government and the people in order to identify the obstacles and needs of society and then for the government to implement realistic strategies to provide for these needs and overcome any obstacles that were identified.<sup>60</sup>

The government established the Reconstruction and Development Programme (RDP), which was seen as a progressive step toward overcoming the obstacles faced by the country. The government argued that, ‘addressing inequalities will expand markets at home, open markets abroad and create opportunities to promote representative ownership of the economy.’<sup>61</sup> As a whole, it was found that ‘[t]he income distribution in the country was severely racially distorted and ranked as one of the most unequal in the world.’<sup>62</sup> Thus, the government had an objective of addressing the greatest obstacle through the policy framework, RDP.<sup>63</sup> The White Paper on RDP provides that the function of the programme is to;

mobilize all our people and our country’s resources toward the final eradication of the results of apartheid. Its goal is to build a democratic, non-racial and non-sexist future and it represents a vision for the fundamental transformation of South Africa by, developing strong and stable democratic institutions, ensuring representivity and participation ensuring that our country

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<sup>59</sup> ‘The Reconstruction and Development Programme (RDP)’ available at <http://www.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm> accessed on the 15 May 2014.

<sup>60</sup> Ibid.

<sup>61</sup> *White Paper on The Reconstruction and Development Programme* (GN 1954 in GG 16085 of 23 November 1994)

<sup>62</sup> ‘The Reconstruction and Development Programme (RDP)’ available at <http://www.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm>, accessed on the 15 May 2014.

<sup>63</sup> ‘The Reconstruction and Development Programme (RDP)’ available at <http://www.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm>, accessed on the 15 May 2014.

becomes a fully democratic, non-racial and non-sexist society, creating a sustainable and environmentally friendly growth and development path.<sup>64</sup>

RDP was considered ‘an integrated programme, based on the people, that provides peace and security for all and builds the nation, links reconstruction and development and deepens democracy.’<sup>65</sup> In addition, five major policy programmes were linked to RDP and these include meeting basic needs, developing human resources, building the economy, democratizing the state and society, and lastly implementing the RDP.<sup>66</sup> The programme sought to lead growth in all parts of the economy, without compromising the interests of the future generation.<sup>67</sup>

However, Peterson argues that the realities signify a far more modest improvement than the government claims. It was clear that the government had encountered challenges to run the programme from the beginning, as there was a lack of spending capacity and the RDP was not feasible in terms of investment. As a result, government had realized that the RDP targets over a period of five years would be impossible to achieve due to the financial circumstances.<sup>68</sup> Furthermore, Mandela stated that due to the recognizable changes in the global market conditions, the government was required to replace RDP with a policy that was a macro-economic policy, the Growth Employment and Redistribution strategy (GEAR).<sup>69</sup>

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<sup>64</sup> *White Paper on The Reconstruction and Development Programme* (GN 1954 in GG 16085 of 23 November 1994)

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*

<sup>67</sup> ‘The Reconstruction and Development Programme (RDP)’ available at <http://www.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm>, accessed on the 15 May 2014.

<sup>68</sup> L Peterson *Post – Apartheid Southern Africa: Economic challenges and policies for the future* (1998).

<sup>69</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

## **2.4 The Growth Employment and Redistribution Strategy**

In early 1996, Deputy President Thabo Mbeki announced the government's plan to accelerate growth in the country by 'refrain[ing] from economic intervention and concentrat[ing] on the necessary adjustments that would create an optimal climate for private investments.'<sup>70</sup> The strategy GEAR, had 'stressed on the need for market-led growth, fiscal, monetary discipline and investor confidence.'<sup>71</sup> The mechanism in question was employment creation, by linking growth to poverty and inequality reduction or wealth redistribution.<sup>72</sup> Streak mentions 'GEAR promised to reduce poverty and inequality via a surge in economic growth' thus, growth should reduce poverty and inequalities. Further, she states 'poverty reduction in the GEAR strategy is quite clearly linked to job creation, with government investment in, and delivery of social and basic services to the poor playing a supporting role.'<sup>73</sup>

There have been several deliberations as to the success and failure of GEAR. The Congress of South African Trade Unions argued that 'GEAR has failed to deliver the promised economic and job growth or significant redistribution of income and socio-economic opportunities in favor of the poor.'<sup>74</sup> Furthermore, the ANC and leading economists acknowledged that GEAR had failed to reduce poverty and inequalities within the country.<sup>75</sup> However, Streak illustrates that GEAR improved prospects for the future. She emphasizes that foreign trade and investment markets had improved the environment for private sector investment, through lowering interest rates and reducing inflation. She argues that even though GEAR had substantial flaws and did not reach promised goals it can still be acknowledged as an accomplishment because there are more

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<sup>70</sup> W Visser *Shifting RDP into Gear: The ANC governments Dilemma in providing an equitable system of social security for the "new" South Africa* (unpublished LLM thesis, University of Stellenbosch, 2004)

<sup>71</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

<sup>72</sup> 'Poverty and Inequality in South Africa: Report prepared for the Office of the Executive Deputy President and the Inter-Ministerial Committee for Poverty and Inequality, Summary Report' available at <http://www.polity.org.za/polity/govdocs/reports/poverty.html>, accessed on 17 May 2014.

<sup>73</sup> J C Streak 'The Gear Legacy: did gear fail or move South Africa Forward in development' 2004, *DSA* 21(2) 1.

<sup>74</sup> R Knight 'South Africa: Economic Policy and Development' available at <http://richardknight.homestead.com/files/sisaeconomy.htm>, accessed on 17 May 2014.

<sup>75</sup> R Knight 'South Africa: Economic Policy and Development' available at <http://richardknight.homestead.com/files/sisaeconomy.htm>, accessed on 17 May 2014.



accessible resources that can be used for the benefit of poor individuals. Thus, public sector reform has developed adequately and the government now has the capacity to deliver services proficiently and effectively.<sup>76</sup>

It is evident that GEAR was based on private sector investment as oppose to being a people-orientated approach.<sup>77</sup> Visser stated that GEAR had ‘not lived up to the expectations of its planners to enhance growth, employment and redistribution.’<sup>78</sup> It can be argued that although GEAR failed to meet its targets, it did create improvements and awareness for the future of our country. Furthermore, Streak argues ‘GEAR has improved the private investment climate and produced better resource and institutional conditions for government to play a more active role in pushing future development.’<sup>79</sup> It is clear that RDP and GEAR essentially created the foundation for South Africa to move forward.

## **2.5 Conclusion**

It is clear from the discussion above that the South African economy bears a strong racial footprint. It can be established that the high aggregate of inequalities are primarily linked to the race income disparities of the country.<sup>80</sup> However, although the economic progress within South Africa has been slow, ‘the establishment of democracy ushered in a process of economic change.’<sup>81</sup>

It is submitted that this chapter has illustrated how the enforcement of apartheid prevented black citizens from taking advantage of available resources, land and employment opportunities, so that the interests of white citizens could be protected. It can be argued that this fundamentally led to the obstacles of inequality and poverty, making the country’s income distribution, one of the

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<sup>76</sup> J C Streak ‘The Gear Legacy: did gear fail or move South Africa forward in development’ 2004, *DSA* 21(2) 16.

<sup>77</sup> W Visser *Shifting RDP into Gear: The ANC governments Dilemma in providing an equitable system of social security for the “new” South Africa* (unpublished LLM thesis, University of Stellenbosch, 2004).

<sup>78</sup> Ibid.

<sup>79</sup> J C Streak ‘The Gear Legacy: did gear fail or move South Africa forward in development’ 2004, *Development Southern Africa* 21(2) 1.

<sup>80</sup> M Liebbrant ‘Employment and Inequality outcomes in South Africa’ available at <http://www.oecd.org/els/emp/45282868.pdf>, accessed on 30 July 2014.

<sup>81</sup> V Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 6.

most unequal in the world.<sup>82</sup> Generally, ‘critics claim that the economic power still resides amongst white corporate interests and the ANC rule represents merely an ‘elite transformation.’<sup>83</sup> Although, it is significant to consider the depths of history, it is important to consider South Africa’s focal economic development and the challenges, which our government faces today.

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<sup>82</sup> The Reconstruction and Development Programme (RDP) available at <http://www.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm>, accessed on the 15 May 2014.

<sup>83</sup> V Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 6.

## CHAPTER 3

### THE EVOLUTION OF BLACK ECONOMIC EMPOWERMENT

#### **3 Introduction**

The chapter above discussed a brief history of South Africa dating from apartheid to democratization and most importantly, the central causes and - responses to - the injustices, which still endure today. The following chapter will comprise of a discussion about the application of the various policies and strategies enforced by the government to curtail the racial inequalities within the country's economy. It is significant to understand how government sought to make BEE more effective through related legislation. Furthermore, the uncertainties and gaps within the Broad-Based Black Economic Empowerment Act 53 of 2003 will be addressed.

#### **3.1 The Significance of Economic Empowerment**

It is necessary to consider the important aspects of BEE. Jack and Harris use the following parable to explain this:

Consider the scenario of an athlete training for a race. The athlete favours his left leg and only trains that leg. The favoured leg gets so strong that it carries the other leg through the race at a marginally competitive level. In time the athlete came to realize that to compete at a higher level, both legs would need to be trained. The left leg had received training to the exclusion of the right leg for so long that merely training both legs will take too long. The athlete would be beyond prime competitiveness well before both legs were equally effective. To increase competitiveness, the athlete must now show preference to the right leg in training. The left leg could never be ignored or excluded, but the right leg must get preferential training in order to catch up with the left leg. Once both legs are equally strong, the athlete is able to compete at the highest level of the event.<sup>84</sup>

The parable points out that while white businesses are already able to compete at a higher level, black businesses need to be provided with preferential training and opportunities to reach the same level. Then South Africa will be able to compete at an international level as a whole.<sup>85</sup>

Post 1994 the government began to implement various policies, which assisted them in enforcing a newly developed 'nation building strategy' and transforming the economy. Deputy President Thabo Mbeki emphasized the importance of transformation a national address as follows:<sup>86</sup>

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<sup>84</sup> V Jack & K Harris *Make BEE work for you: A MANUAL FOR SMALL BUSINESSES* (2007) 7.

<sup>85</sup> Ibid.

As we approach, the end of the first decade of our new democracy the need for an economic transformation that brings about effective and significant black economic empowerment becomes more pressing. We believe that it is in the interests of all citizens that we succeed in this endeavor. Through a far-sighted partnership between all sectors of our society we can ensure a stable and growing economy that erases the inequities of the past and draws us all – irrespective of our race, sex or creed – into a more prosperous and equitable future.<sup>87</sup>

Three important imperatives have been identified to drive transformation.<sup>88</sup> The first imperative is a moral issue - in order to rectify the imbalances of the past, white businesses need to be willing to compensate black people by giving them preference in the economy. The second imperative is a social issue because our society is predominately identified in terms of a racial divide. For that reason, black people need to be developed and should no longer be segregated or connected to poverty. The third imperative is economic growth. The importance of labour and skills development needs to be realized so that South Africa can generate a stronger economy. Thus, it can be said that the main idea for driving transformation includes giving preference to black people but still giving white people the opportunity to have access to the available economic resources.<sup>89</sup>

Iheduru illustrated that although the South African society pre-1994 consisted of mainly black individuals, the white population still dominated the economy.<sup>90</sup> He argued that ‘if the most powerful social groups in the country (e.g. organized labor, local white businesses, foreign investors, and trading partners) support the emergence of the integration of black citizens into the economy there would be a move toward the emergence of a powerful black capitalist class and the establishment of a non-racial economy.’<sup>91</sup> Therefore, this could be achieved through BEE.

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<sup>86</sup> O.C Iheduru ‘Black economic power and nation-building in post- apartheid South Africa’ (2004) 42 *JMAS* 2.

<sup>87</sup> Ibid.

<sup>88</sup> V Jack & K Harris *Make BEE work for you: A MANUAL FOR SMALL BUSINESSES* (2007) 7-8.

<sup>89</sup> Ibid.

<sup>90</sup> O.C Iheduru ‘Black economic power and nation-building in post- apartheid South Africa’ (2004) 42 *JMAS* 3.

<sup>91</sup> Ibid.

### **3.2 Black Economic Empowerment**

This section discusses BEE a key towards transformation. The Department of Trade and Industry (DTI) has pointed out that, despite the developments and successes of our country during the post-1994 period, the racial divide between the rich and poor still remains. In effect, the economy could not grow by excluding certain of the country's citizens.<sup>92</sup> BEE was enforced as a strategy that 'focuses on the achievement of the economic equality of black people as a category of persons who were disadvantaged.'<sup>93</sup> Essentially, BEE emerged through three waves.<sup>94</sup>

The first wave was fixated on the 'black elite.' The 'black elite' comprised the 'politically, well-connected individuals and dynamic entrepreneurs' who sought to seize every economic opportunity presented before them. The climax of the first wave was when the first black company was listed on the Johannesburg Stock Exchange. The Company was The New Africa Investments Limited, which was chaired by Nthato Motlana, a dynamic black businessman who took the approach to acquire any asset which became accessible.<sup>95</sup>

A major issue which became clear during the first wave was that a majority of black people did not have sufficient startup capital. Thus, to deal with this issue the 'Special Purpose Vehicle' (SPV) was formed to financially assist black entrepreneurs. However, it was found that the SPV mechanism actually favoured white financiers as opposed to assisting black entrepreneurs with financial prospects. Consequently, many BEE companies and groups became unsuccessful due to a lack of capital and severe debts. Jack and Harris argue that although black people received ownership in certain instances during the first wave, they often acquired ownership without any control. Hence, it could be said that the first wave BEE initiatives were exclusively constructed on ownership contribution.<sup>96</sup>

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<sup>92</sup> Black Economic Empowerment available at

<http://www.southafrica.info/business/trends/empowerment/bee.htm#.VBmGwZSSxe8>, accessed on 20 August 2014.

<sup>93</sup> F Marais & L Coetzee 'The determination of black ownership in companies for the purpose of Black Economic Empowerment' (2006) 27 *Obiter* 115.

<sup>94</sup> V Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 7.

<sup>95</sup> *Ibid.*

<sup>96</sup> *Ibid.*p8

The second wave of BEE was centered on the ‘emergence of the black professional’ in 1997. The Black Management Forum (BMF) proposed that a BEE Commission should be formed. The motivation for this was ‘[t]he lack of common definitions, benchmarks and standards for BEE’<sup>97</sup> The BEE Commission created a new approach towards BEE and aimed to broadly focus on aspects such as ‘employment equity, skills development and preferential procurement’ as opposed to only focusing on ownership as in the first wave.’<sup>98</sup>

The mining industry took an important role in the second wave and was the first industry to broaden the aspects of BEE through the Mining Charter<sup>99</sup> in 2004. The Mining Charter had a major impact on the South African mining sector as it ‘sought to expand opportunities for historically disadvantaged persons to enter into the mining and mineral industry or benefit from the exploitation of the national mineral resources.’<sup>100</sup> The objectives of the Mining Charter are as follows:

Ownership schemes for historically disadvantaged South Africans (HDSA’s); participation in control and management for HDSA’s; development of management, scientific, engineering and other core skills in HDSA’s; procurement chains from operations with HDSA’s; and integrated socio-economic development for host communities, major labour-providing areas and areas that have become “ghost towns” because of the unintended consequences of mining.<sup>101</sup>

The investments made in the industry by BEE agreements had given black people the opportunity to take an active step and become involved in decision-making processes. However, although the wave generated a difference for the future South Africans there was still room for improvement through the third wave of BEE.<sup>102</sup>

During the third wave of BEE the economy flourished. It introduced the motion of the Preferential Procurement strategy, in which preference is given to HDI’s<sup>103</sup>. It is necessary to

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<sup>97</sup> V Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 10.

<sup>98</sup> *Ibid.*

<sup>99</sup> The Mining Charter is applicable to the South African mining industry. GN 1639 of GG 26661, 13/8/2014; 8

<sup>100</sup> GN 1639 of GG 26661, 13/8/2014; 6

<sup>101</sup> GN 1639 of GG 26661, 13/8/2014; 7

<sup>102</sup> *Ibid.* p11-12.

<sup>103</sup> *Ibid.* p10

understand the definition of this class of persons before going any further.<sup>104</sup> HDI's are defined as follows:

A South African citizen –

- (1) Who due to the apartheid policy that had been in place, had no franchise in national elections prior to the introduction of the Constitution of the Republic of South Africa, 1983 (Act 200 of 1983) ('the interim Constitution'); and/or
- (2) Who is a female and/or
- (3) Who has a disability:

Provided that a person who obtained South African citizenship on or after the coming into effect of the Constitution is deemed not to be an HDI.<sup>105</sup>

A ten-point plan in terms of the public sector procurement strategy was introduced by the Department of Public Works. The plan initiated the enforcement of the Preferential Procurement Policy Framework Act 5 of 2000 (PPPFA) and Preferential Procurement Regulations 2011 which provide guidelines on interpreting the framework.<sup>106</sup> According to the PPPFA an organ of the state should chose a specific goal in terms of their determined preferential policy. The goal must then be incorporated into their invitations to tender.<sup>107</sup> Furthermore, these goals must be 'measurable, quantifiable and monitored for compliance.'<sup>108</sup>

The framework established a procurement system that was based on point scoring parameters. The system involved two categories; which are known as the 90:10 and 80:20 rules. In terms of which 'the initial points are allocated to the cost and the latter points to empowerment. Thus, if a contract is valued over R500 000 the 90:10 rule would apply and if a contract is valued between R30 000 and R500 000 are evaluated using the 80:20 rule. The contract is then awarded to the tenderer that achieved the highest point system, except if in terms of the objective criteria, it is justifiable to award the tender to someone other than the person scoring the highest points.<sup>109</sup>

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<sup>104</sup> Reg 1 of the Preferential Procurement Regulations 2011.

<sup>105</sup> Ibid.

<sup>106</sup> Smallwood, N Ncunzana and F Emuze 'Preferential Procurement in the public sector: the case of Amouthole (2011) *JPDS* 18.

<sup>107</sup> s 2(1)(g) Preferential Procurement Policy Framework Act 5 of 2000

<sup>108</sup> s 2(2) Preferential Procurement Policy Framework Act 5 of 2000

<sup>109</sup> s 2(1) Preferential Procurement Policy Framework Act 5 of 2000 and S4(4) of the Preferential Procurement Regulations 2011.

The procurement system is essentially ‘the driving force behind the spread of BEE.’<sup>110</sup> Milovanovic says that the purpose of the system is ‘to benefit both public and private businesses, and promote transformation and development.’<sup>111</sup> Businesses should make purchases from BEE suppliers if they want to enter into contracts<sup>112</sup> with an organ of the state.<sup>113</sup> Furthermore, without preferential procurement there would be ‘no pressure upon businesses to adopt BEE, if they were not interacting directly with the government.’<sup>114</sup> It is important to note that there is no legal requirement to conform to BEE, though it would be in the best interest of a business to comply with BEE. As ‘the higher your supplier’s rating [is], the more of that spend you can claim.’<sup>115</sup> Preferential procurement in effect has a ‘trickle-down’ effect that can easily have a negative effect on non-complying BEE suppliers.<sup>116</sup>

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<sup>110</sup> ‘BEE Institute’ available at <http://beeinstitute.wordpress.com/understanding-bee/understanding-preferential-procurement/>, accessed on 18 September 2014.

<sup>111</sup> A Milovanovic ‘BBBEE empowerment meant to be sustainable and not slow’ available at <http://www.polity.org.za/article/bbbee-empowerment-meant-to-be-sustainable-not-slow-2010-09-03>, accessed on 18 September 2014.

<sup>112</sup> ‘BEE Institute’ available at <http://beeinstitute.wordpress.com/understanding-bee/understanding-preferential-procurement/>, accessed on 18 September 2014.

<sup>113</sup> s 1 Preferential Procurement Policy Framework Act 5 of 2000. “organ of state” means-

- ‘a) a national or provincial department as defined in the Public Finance Management Act, 1999 (Act No. 1 of 1999);
- b) a municipality as contemplated in the Constitution;
- c) a constitutional institution defined in the Public Finance Management Act, 1999 (Act No. 1 of 1999);
- d) Parliament;
- e) a provincial legislature;
- f) any other institution or category of institutions included in the definition of “organ of state” in section 239 of the Constitution and recognised by the Minister by notice in the Government Gazette as an institution or category of institutions to which this Act applies.’

<sup>114</sup> ‘BEE Institute’ available at <http://beeinstitute.wordpress.com/understanding-bee/understanding-preferential-procurement/>, accessed on 18 September 2014.

<sup>115</sup> ‘BEE explained: An easy guide to understanding Broad Based Black Economic Empowerment’ available at [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf), accessed on 18 September 2014.

<sup>116</sup> Ibid.



The question is whether BEE has changed the ‘free market system.’ A free market system, allows people to trade as they please without governmental intervention and regulation. The government plays a minimal role; hence, there is no limitation on businesses.<sup>117</sup> Often a misunderstanding arises that contracts and tenders are awarded solely based on a company’s BEE contribution. It is significant to understand that the government takes into account a number of factors when awarding contracts. These factors include; the price, quality, reliability, after-sales service, compatibility as well as the BEE contributions level.<sup>118</sup> The General Procurement Guidelines provide that ‘[p]rice alone is often not a reliable indicator and departments will not necessarily obtain the best value for money by accepting the lowest price offer that meets mandatory requirements. Best value for money means the best available outcome when all relevant costs and benefits over the procurement cycle are considered.’<sup>119</sup> Therefore, it is argued that the government had not created a stringent limitation on businesses and therefore entirely changed the free market system.

In relation to procurement, a set-aside mechanism was enforced to guarantee that the government’s procurement budget fundamentally favours BEE suppliers. When an invitation to tender goes out to the public a predetermined BEE contribution level will be stated on the invitation, all companies which acquired a BEE rating above the stated BEE contribution level is therefore entitled to bid for the tender. The contract would be awarded to the tender, which has most favorably satisfied the requirements.

The set-aside mechanism is considered to be fair and in line with the spirit, purport and objects of the Constitution.<sup>120</sup> Section 217(1) of the Constitution provides that ‘an organ of the state contracting for goods and services must do so under a system that is fair, equitable, transparent,

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<sup>117</sup> ‘Free market’ available at [http://www.princeton.edu/~achaney/tmve/wiki100k/docs/Free\\_market.html](http://www.princeton.edu/~achaney/tmve/wiki100k/docs/Free_market.html) , accessed on 21 August 2014.

<sup>118</sup> V Jack & K Harris *Make BEE work for you: A MANUAL FOR SMALL BUSINESSES* (2007) 7-8.

<sup>119</sup> ‘The Government of the Republic of South Africa General Procurement Guidelines’ available at <http://www.treasury.gov.za/legislation/pfma/supplychain/General%20Procurement%20Guidelines.pdf> , accessed on 18 September 2014.

<sup>120</sup> F Marais & L Coetzee ‘The determination of black ownership in companies for the purpose of Black Economic Empowerment’ (2006) 27 *Obiter* 111-127.

competitive and cost-effective.’<sup>121</sup> Additionally section 38(1) of the *Public Finance Management Act 29 of 1999* (PFMA) states that the accounting officer is responsible for ensuring compliance with section 217(1) of the Constitution.<sup>122</sup> Flowing from this requirement section 217(2) read with section 9(5) of the Constitution allows an organ of the state to enter into contracts, which are intended to protect, or advance historically disadvantages individuals.<sup>123</sup>

The Office of the Chief State Law Advisor was of the opinion that there is nothing in the PPPFA which specifically excludes individuals who are not BEE contributors to bid for tenders. Additionally, it emphasized that there are no specific minimum requirements for BEE contributions.<sup>124</sup> However, if there were an obligatory minimum contribution level ‘it would be contrary to the principles of fairness and equitability, as well as the principles of competitiveness and cost effectiveness.’<sup>125</sup> Furthermore, it was clear that it would be unconstitutional to exclude white tenderers to bid in the tender process. Therefore, authorities and accounting officers are obliged to give all suppliers the opportunity to bid for the tender.<sup>126</sup>

In summary, the third wave of BEE was the advent of Preferential Procurement, by enforcing BEE contributions through the preferential procurement strategy. Interestingly during this wave, larger businesses were not supportive of this strategy. It has been argued that there are three leading elements behind the growth of the economy during this time. These can be identified as enterprise development, preferential procurement and skills development. These elements were sought to be achieved through the Preferential Procurement Policy Framework Act 5 of 2000, Employment Equity 55 of 1999 Act and the Skills Development Act 97 of 1998.

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<sup>121</sup> s 217(1) Constitution of the Republic of South Africa, 1996

<sup>122</sup> s 38(1) of the Public Finance Management Act 29 of 1999

<sup>123</sup> s 217(2) Constitution of the Republic of South Africa, 1996

<sup>124</sup> Practice Note Number SCM 2 of 2006

<sup>125</sup> Ibid.

<sup>126</sup> Ibid.

### **3.3 The Employment Equity Act 55 of 1999**

As previously identified, another pillar of BEE is the *Employment Equity Act* (EE Act). The EE Act is important to consider because it is an essential part of BEE. It functions as an additional measure to integrate equality within the workplace. Thus the purpose of the act is to specifically ‘eliminate unfair discrimination’ and to enforce affirmative action measures.’<sup>127</sup> Section 15(1) of the EE Act highlights that ‘[a]ffirmative action measures are measures designed to ensure that suitably qualified people from designated groups have equal employment opportunities and are equitably represented in all occupational categories and levels in the workforce of a designated employer.’<sup>128</sup> Overall, the EE Act aims to promote equal opportunities and fairness in the work place. Most importantly, one of the purposes of the act is to redress the disadvantages created in the employment against designated groups.<sup>129</sup>

It is important to understand who falls within designated in groups terms of the EE Act. Designated groups are defined as follows;

black people, women and people with disabilities, who—

(a) are citizens of the Republic of south Africa by birth or descent; or

(b) became citizens of the Republic of South Africa by naturalisation—

(i) before 27 April 1994; or

(ii) after 26 April 1994 and who would have been entitled to acquire citizenship by naturalisation prior to that date but who were precluded by apartheid policies.<sup>130</sup>

The definition is significant because the beneficiaries of this act also include white women and white people with disabilities but does not include all employees.<sup>131</sup> In the case of *Solidarity obo*

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<sup>127</sup> s 2 Employment Equity Act 55 of 1998

<sup>128</sup> s 15(1) Employment Equity Act 55 of 1998

<sup>129</sup> s 2(1)(b) Employment Equity Act 55 of 1998

<sup>130</sup> s 1 Employment Equity Act 55 of 1998

<sup>131</sup> Employee is defined as any person other than an independent contractor who-

a) works for another person or for the State and who receives, or is entitled to receive, any remuneration; and

b) in any manner assists in carrying on or conducting the business of an employer,

and "employed" and "employment" have corresponding meanings;

*Bernard v South African Police Services*,<sup>132</sup> a white female captain applied for a promotion to a specialized SAPS unit for which she was found to be unsuccessful on two occasions. On both occasions it was recognized that she was the best candidate and as a result she outscored the best competing African male applicants. The applicant alleged that she was being subject to unfair discrimination on the basis of race.<sup>133</sup> She relied on the EE Act and the South African Police Services economic empowerment plan. The respondent raised that in the circumstances, if a white female was appointed for the position, the representative level of the superintendent would be negatively affected, and it would be contrary to economic empowerment. The labour court found in favour of the appellant but the labour appeal court found that there was no unfair discrimination present. However, the Supreme Court of Appeal held that in order to address the imbalances of the past, the process must be done fairly as the primary aim is to ensure that South Africa has a fully inclusive society. The appeal was upheld in this case.<sup>134</sup>

It is essential that companies have an active plan to meet employee's needs and employment equity. Section 5 of the EE Act obliges employers to promote equal opportunities in the working environment.<sup>135</sup> Furthermore, section 6 prohibits unfair discrimination<sup>136</sup> as Section 9 of the Constitution does.<sup>137</sup> In the case of *Minster of Finance & another v Van Heerden*, Moseneke J explained the importance of equality in our Constitution:

‘For good reason, the achievement of equality preoccupies our constitutional thinking. When our Constitution took root a decade ago, our society was deeply divided, vastly unequal and uncaring of human worth. Many of these stark social and economic disparities will persist for long to come. In effect, the commitment of the Preamble is to

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<sup>132</sup> *Solidarity obo Bernard v South African Police Services* 2014(2) SA 1 (SCA)

<sup>133</sup> s 6 (1) Employment Equity Act 55 of 1988 provides that ‘No person may unfairly discriminate, directly or indirectly, against an employee, in any employment policy or practice, on one or more grounds, including race, gender, sex, pregnancy, marital status, family responsibility, ethnic or social origin, colour, sexual orientation, age, disability, religion, HIV status, conscience, belief, political opinion, culture, language, birth or on any other arbitrary ground.’

<sup>134</sup> *Solidarity obo Bernard v South African Police Services* 2014(2) SA 1 (SCA)

<sup>135</sup> s 5 Employment Equity Act 55 of 1988

<sup>136</sup> s 6 Employment Equity Act 55 of 1988

<sup>137</sup> s 217(2) Constitution of the Republic of South Africa, 1996

restore and protect the equal worth of everyone; to heal the divisions of the past and to establish a caring and socially just society. In explicit terms, the Constitution commits our society to "improve the quality of life of all citizens and free the potential of each person."<sup>138</sup>

Therefore, to promote the constitutional right of equality and the objectives of BEE, the EE Act ensures the implementation of equality in the workplace and the promotion of economic development in the workplace.<sup>139</sup> Moreover, to ensure further develop of employees within the work place; the Skills Development Act<sup>140</sup> was enforced.

### **3.4 The Skills Development Act 97 of 1998**

While the EE Act is a pioneer to BEE, the *Skills Development Act* focuses on the development of education and the quality of life of employees within South Africa.<sup>141</sup> *The Skills Development Act* does not only concentrate on benefiting black people in society but it also focuses on improving skills of employees as a whole by encouraging proactive learning in the workplace.<sup>142</sup> The *Skills Development Levies Act 9 of 1999* was implemented to insure that companies participated in the educational development and training of their work force. The Skills Development Levies Act does this by allowing companies to claim money that they have spent on skills development.<sup>143</sup> It is clear that the above-mentioned Acts are all centered on the educational development of employees so they can pursue a proper livelihood and grow within entities. It is clear that government had sought to implement the BEE programme through related legislation. Nevertheless, to speed up the developmental progress of the country's majority the government realized that BEE needs to do something more to integrate the HDI's in society.

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<sup>138</sup> *Minister of Finance & another v Van Heerden 2004 (6) SA 121 (CC)*

<sup>139</sup> Preamble of the Employment Equity Act 55 of 1998

<sup>140</sup> Skills Development Act 97 of 1998

<sup>141</sup> s 2(1) Skills Development Act 97 of 1988

<sup>142</sup> s 2(1) (c) Skills Development Act 97 of 1988

<sup>143</sup> 'Skills Development Levy' available at <http://www.sars.gov.za/TaxTypes/SDL/Pages/default.aspx>, accessed on 19 September 2014.

### **3.5 The Introduction of the Broad-Based Black Economic Empowerment Act 53 of 2003**

From the above discussion, it was shown that BEE was effectively a narrow approach as it mainly concentrated on ownership and management. Thus, government realized that the narrow approach only empowered a few individuals because a majority of disadvantaged people in society was still left un-empowered. Ramlall illustrated that the narrow approach leads to the move toward B-BBEE, where black employees and black owned entities would reap benefits as well, as oppose to only black shareholders reaping benefits.<sup>144</sup>

The B-BBEE Act is acknowledged as a ‘latecomer to the scene of employment legislation.’<sup>145</sup> Marais and Coetzee describe the B-BBEE Act and the PPPF Act as ‘the cornerstone acts of government’s programme of using its own purchasing decisions to encourage the economic empowerment of black people.’<sup>146</sup> The objectives of the Act are closely linked to the definition<sup>147</sup>; accordingly, B-BBEE is defined as:

the economic empowerment of black people, including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include but are not restricted to –

- a) Increasing the number of black people that manage, own and control enterprises and productive assets;
- b) Facilitating ownership and management of enterprises and productive assets by communities, workers, co- operatives and other collective enterprises;
- c) Human resource and skills development;
- d) Achieving equitable representation in all occupational categories and levels in the workforce
- e) Preferential procurement; and
- f) Investment in enterprises that are owned or managed by black people.<sup>148</sup>

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<sup>144</sup> S Ramlall ‘Corporate social responsibility in post-apartheid South Africa’2012, *SRJ* 8(2) 270-271.

<sup>145</sup> F Marais & L Coetzee ‘The determination of black ownership in companies for the purpose of Black Economic Empowerment’ (2006) *27 Obiter* 115.

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> s 1 Broad-Based Black Economic Empowerment Act 53 of 2003.

The purpose of the Act is centered upon three basic themes ‘(a) the establishment of a legislative framework for the promotion of [BEE]; (b) the empowerment of the Minister of Trade and Industry to issue codes of good practice and to publish transformation charters; and (c) the establishment of a [BEE] Advisory Council.’<sup>149</sup> The codes of good practice and the transformation charters will be discussed later in this chapter. In considering the reason for the establishment of the Advisory Council, it was formed to monitor the progress of BEE, advise the President about transformation charters, the codes of good practices and any other developments or amendments of the BEE strategy that need to be implemented.<sup>150</sup>

### **3.6 Who are the Beneficiaries of Broad-Based Black Economic Empowerment?**

When considering who was initially intended to benefit from BEE, the answer would be ‘everyone’. Conversely, BEE provides preferential treatment to Black, Indian and Coloured citizens of the country, who were legally excluded in the past. At the start of the enforcement of BEE, there were recommendations that white people with disabilities and white females should be included as previously disadvantaged. Nevertheless, because of this, white business owners began to transfer their businesses onto their wives’ names. It was clear that the government did not agree with this practice.<sup>151</sup>

There have been debates as to whether white women should be included as beneficiaries of BEE. The reason for this argument is that there were many discriminatory practices against women as a whole; they were all denied training and technical skills in certain industries. Additionally there were many adverse consequences for businesses owned by women who were denied access to finance. On the other hand, there was previous legislation that existed against black women but there was not any legislation, which disempowered white women. An example would be the Job Reservation Act of 1954 where black women were not entitled to acquire certain jobs.

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<sup>149</sup> Broad-Based Black Economic Empowerment Act 53 of 2003

<sup>150</sup> s 5 Broad-Based Black Economic Empowerment Act 53 of 2003

<sup>151</sup> Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 46- 47.

However, it can be argued that the government has enacted additional legislation to correct the imbalances described above, such as the Employment Equity Act.<sup>152</sup> The approach settled upon is that the beneficiaries of BEE are black citizens excluded legally in the past.<sup>153</sup> It is important to understand whom the beneficiaries of BEE are, in order for a company to gain recognition and comply with BEE.

### **3.6.1 Clarity about the “People of Chinese Descent”**

Another enquiry, which often arises, is ‘where do Chinese people fit in?’ Previously there was a clear indication of the position of black and white people as beneficiaries of BEE but there was a failure to specify the position of Chinese people. The position, which remains today, is that Chinese descents also qualify as beneficiaries.<sup>154</sup> Many black companies and professional organization disagreed with the Pretoria High Court’s ruling in the case of the *Chinese Association of South Africa and Others v Minister of Labour and Other*<sup>155</sup>, therefore Chinese people were not previously disadvantaged by the apartheid regime as African, Coloured and Indian people were.<sup>156</sup> Contrary to this George van Niekerk, the representative of the Chinese Association of South Africa argued that although Chinese people weren’t excluded by the legislation, they were never sure of their status in society.<sup>157</sup> This ruling clears the position, which now regards Chinese people as beneficiaries of BEE.

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<sup>152</sup> Ibid.

<sup>153</sup> s 1 Employment Equity Act 55 of 1998

<sup>154</sup> BEE and Employment Equity: Birds of a different feather ‘available at [http://www.millers.co.za/NewsPublications/NewsArticle.aspx?CategoryID=1&articleId=247#.U\\_7iLsWSz84](http://www.millers.co.za/NewsPublications/NewsArticle.aspx?CategoryID=1&articleId=247#.U_7iLsWSz84) , accessed on 28 August 2014.

<sup>155</sup> *Chinese Association of South Africa and Others v Minister of Labour and Others* 2008 ZAGPHC 174

<sup>156</sup> ‘Black businesses rejects ‘coloured’ Chinese’ available at [http://www.iol.co.za/news/south-africa/black-business-rejects-coloured-chinese-1.406737#.U\\_7kSMWSz84](http://www.iol.co.za/news/south-africa/black-business-rejects-coloured-chinese-1.406737#.U_7kSMWSz84), accessed on 28 August 2014.

<sup>157</sup> B Mbola ‘Chinese South Africans qualify for BEE’ available at [http://www.southafrica.info/business/trends/empowerment/beeChinese-180608.htm#.U\\_7oicWSz84](http://www.southafrica.info/business/trends/empowerment/beeChinese-180608.htm#.U_7oicWSz84) , accessed on 28 August 2014.



### **3.6.2 The Main Categories of Black Economic Empowerment Beneficiaries**

As mentioned in the above paragraphs, the beneficiaries of BEE are essentially black people. Furthermore, the black population has been classified into four socio-economic levels, which include black citizens who are below the poverty line, those who are able to survive economically, the economically ready and the economically empowered individuals. The socio economic levels are represented in the form of a pyramid in which ‘below poverty line’, individuals are at the bottom, and ‘economically empowered’ individuals are at the top of the pyramid.<sup>158</sup>

The below poverty line individuals include black citizens who frequently struggle to acquire basic resources, to provide for their basic needs. Consequently, they are unable to acquire respectable training and skills to advance themselves, take advantage of business opportunities, and grow in the economy. At the economic level, people have adequate and established jobs but in order to progress they need additional training and skills. The crucial aspects for this group of citizens to move on to the next level are employment equity, skills development, and enterprise development. On the contrary, the economically ready individuals have the necessary skills and training but fail to obtain business prospects. The economically empowered people have the appropriate skills and resources but in addition, hereto, they are predominantly able to procure control, ownership and management of available resources.<sup>159</sup>

Nevertheless, there are fair amounts of black entrepreneurs who are beyond BEE. This means that they enter deals based on a free market basis because they have reached their ultimate capital achievement. One South Africa’s well-known black businessman, Mzi Khumalo has notified the public that he is not available for BEE deals any longer as he did not want to be a part of the BEE restrictions. Individuals are required to determine on their own when they are no longer candidates for BEE.<sup>160</sup>

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<sup>158</sup> Jack & K Harris *Broad- Based BEE: The complete guide* (2007) 57.

<sup>159</sup> Ibid. p57- 59.

<sup>160</sup> Ibid. p60

### **3.7 The Implementation of the Codes of Good Practice**

The B-BBEE Act in effect makes room for the development and enforcement of the Codes of Good Practice (Codes). The Act affords an outline for BEE whereas the Codes provide an understandable and detailed framework for the measurement of BEE.<sup>161</sup> The Codes provide indicators in order to measure BEE and the relevant weight that is attached to each indicator. In addition to this a criteria for preferential procurement is included in the code's.<sup>162</sup> Moreover, it assists decision makers in reporting economic decisions and implementing BEE initiatives. The Codes contain a scorecard, which allows enterprises to measure their BEE status and to set targets for themselves.<sup>163</sup> It is required that these 'Codes be considered by every government agency when dealing with matters of BEE.'<sup>164</sup>

The Codes were essentially published in two phases. The first phase dealt with the following aspects: 'a general outline and guideline of BBEE, ownership, management and control, transformation charters and verification agencies.'<sup>165</sup> The second phase of the codes solely focused on employment equity, skills development, preferential procurement, enterprise development and residual contributions as opposes to just ownership, management and control. Additionally, it specifically addressed multinationals as well as enterprisers, which fall below a certain turnover level or have a smaller number of employees.<sup>166</sup>

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<sup>161</sup> F Marais & L Coetzee 'The determination of black ownership in companies for the purpose of Black Economic Empowerment' (2006) 27 *Obiter* 111-127.

<sup>162</sup> s 9(1) Broad-Based Black Economic Empowerment Act 53 of 2003

<sup>163</sup> 'Background to, intention & application of the codes of good practices' available at [https://www.thedti.gov.za/economic\\_empowerment/docs/Inside.pdf](https://www.thedti.gov.za/economic_empowerment/docs/Inside.pdf), accessed on 4 September 2014.

<sup>164</sup> H Knoetze *An Analysis of the codes of good practice issued in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003* (Unpublished LLM thesis University of Free State 2006).

<sup>165</sup> Verification agencies monitor BEE compliance according to the BEE policy.

<sup>166</sup> H Knoetze *An Analysis of the codes of good practice issued in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003* (Unpublished LLM thesis University of Free State 2006).

The following table below represents a summary of the format of the codes and its contents.

<b>Code</b>	<b>Content</b>
Code 000	Provides a basic framework of the general principles of BBBEE and comprises of the generic scorecard and framework for measurement.
Code 100	Comprises the measurement of ownership.
Code 200	Comprises the measurement of management and control.
Code 300	Comprises the measurement of employment equity.
Code 400	Comprises the measurement of skills development.
Code 500	Comprises the measurement of preferential procurement.
Code 600	Includes the measurement of enterprise development, in which business contribute to BBBEE.
Code 700	Comprises the measurement of socio-economic development
Code 800	Considers the contribution level by small qualifying enterprises.

*Source: DTI*

The following table illustrates how BBBEE points are categorized.

<b>B-BBEE Status</b>	<b>Point Score</b>	<b>Recognition</b>
Level one contributor	100+	135%
Level two contributor	85-99	125%
Level three contributor	75-84	110%
Level four contributor	56-74	100%
Level five contributor	55-64	80%
Level six contributor	45-54	60%
Level seven contributor	40-44	50%
Level eight contributor	30-39	10%
Non-Compliant	Less than 30	0%

*Source: DTI*

The score, which an entity achieves, defines the contribution level of the entity. The levels range from a Level One contributor which is the highest and Non-Compliant contributor which is the lowest. The recognition level is the percentage of recognition, which a customer would acquire if they make purchases from a measured entity. In other words, a company that purchases goods and services from a BEE supplier would gain more recognition than from purchasing goods and services from a supplier, which is BEE non-compliant. An example would be, 'if a purchaser buys R100 worth of goods from a Level One contributor, they will include R135 in their preferential procurement scorecard. If a purchaser buys from a Level Eight contributor, they will only include 10% or R10 of the purchase price in their preferential procurement scorecard.'<sup>167</sup> Essentially the aim of an entity should be a Level One contributor and to achieve this they should

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<sup>167</sup> Jack & K Harris *Make BEE work for you: A MANUAL FOR SMALL BUSINESSES* (2007) 37.

preferably purchase goods and supply's from an entity who has achieved a good BBBEE score.<sup>168</sup>

### **3.8 The Development of the Qualifying Small Enterprises Codes**

DTI recognized that there was a need for Small Medium Micro Enterprises (SMME), which referred to Qualifying Small Enterprises (QSE's), to have their own set of codes. QSE's are defined as companies with an annual turnover between R5 million and R35 million. Those entities who earn less than R5 million automatically qualify as a level four BEE contributor and entities, which comprise of at least 50% of black people or black women, are awarded a level three-contributor status.<sup>169</sup>

It was established by the 'Small Enterprise Development Agency (SEDA) that small enterprises already contribute approximately 35% of the country's gross domestic product (GDP) and employ over half the number of people who work in the private sector.'<sup>170</sup> If small businesses were excluded from BEE it would negatively effect on economic transformation and in integration. Additionally, the President mentioned in a National Summit that it is an objective to focus on the 'National Growth Path (NGP) sectors of mining, agriculture, the green economy, tourism, infrastructure development and manufacturing.' In doing this, government endeavors to ease the burden of finance and capacity constraints which are placed on small businesses by requiring them to only comply with four out of the seven elements on the scorecard.<sup>171</sup>

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<sup>168</sup> Ibid.

<sup>169</sup> H Knoetze *An Analysis of the codes of good practice issued in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003* (Unpublished LLM thesis University of Free State 2006).

<sup>170</sup> H Knoetze *An Analysis of the codes of good practice issued in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003* (Unpublished LLM thesis University of Free State 2006)

<sup>171</sup> Ibid

### **3.9 Exempted Small & Micro Enterprises**

Companies with an annual turnover of less than R5 million and who have existed for a period of less than one year are recognized as Exempted Small & Micro Enterprises (ESME's). They are entitled to a level four-contributor status and a level three-contributor status where the enterprise is 50% owned by black people or black women. It is important to remember that in the circumstances where an ESME is awarded a contract that is over R5million but less than R35 million, the enterprise is required to comply with the QSE's scorecard.<sup>172</sup>

### **3.10 Transformation Charters**

Each industry has been given the opportunity to develop their own charters so that they could set their own targets according to their needs. In order for a transformation charter to be recognized, DTI had strict requirements to ensure that no one was prejudiced. Once all the requirements were complied with, the charter would be sent to the Minister of the Department of Trade and Industry for consideration and once the Minister is satisfied that all the requirements have been complied with he or she will gazette it. The process ensured that there would be not be any unfairness.

Marais and Coetzee identified two primary purposes of transformation charters. Firstly, the charters allow each sector to develop unique goals and methods to achieve these goals, which are in accordance with the B-BBEE Act.<sup>173</sup> Secondly, each sector is given an opportunity to develop a charter and to 'negotiate a variation of the generic BEE indicators and weightings in order to accommodate the unique circumstances of their sector.'<sup>174</sup> Marais and Coetzee illustrate that the charters 'materially depart from the methodology of the codes of good practice' and she states that the 'development of the codes create serious doubt [as to] whether charters still have a separate role to play in the empowerment framework.'<sup>175</sup>

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<sup>172</sup> 'Background to, intention & application of the Codes of Good practice' available at

[https://www.thedti.gov.za/economic\\_empowerment/docs/Inside.pdf](https://www.thedti.gov.za/economic_empowerment/docs/Inside.pdf), accessed on 4 September 2014.

<sup>173</sup> F Marais & L Coetzee 'The determination of black ownership in companies for the purpose of Black Economic Empowerment' (2006) 27 *Obiter* 115.

<sup>174</sup> *Ibid.*

<sup>175</sup> *Ibid.*

Transformation Charters were essentially a predecessor of Sector Charters. Although they are the same as Transformation Charters,<sup>176</sup> The adoption of Sector Charters by the Codes as opposed to Transformation Charters are required to be measured in terms of Sector Codes and not on the B-BBEE Codes of Good Practice.<sup>177</sup>

### **3.11 Conclusion**

From the discussion above it is clear that it is almost impossible to implement an effective strategy without providing a clear understanding and guidance to those who are affected by it. The government has acknowledged the injustices and found that by using policies and strategies they would be able to drive our economy toward transformation. Transformation began with a simple BEE strategy, followed by employment equity in the workplace, skills development and the implementation of the BBEE Act 53 of 2003 and the operation of the Codes of Good Practice.

BEE affects businesses from all sectors but they have a choice whether to either comply with it or not. The reality however is, that companies through misrepresentations and non-compliance are effectively exploiting the BEE system. While it is important to understand how the system functions in detail the focus of this study, which will be discussed in the next chapter, is to expose these issues and to illustrate how the failure upon companies to comply with the BEE system, negatively affects the country's economic progress.

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<sup>176</sup> 'B-BBEE Sector Charters' available at

[https://www.thedti.gov.za/economic\\_empowerment/bee\\_sector\\_charters.jsp](https://www.thedti.gov.za/economic_empowerment/bee_sector_charters.jsp), accessed on 21 September 2014.

<sup>177</sup> s 9(1) Broad-Based Black Economic 53 of 2003

## CHAPTER 4

### FRONTING AND OTHER MISREPRESENTATIONS

#### **4 Introduction**

Chapter 3 provided a detailed guideline and understanding upon the application of the B-BBEE, other Acts supporting BEE and the Codes of Good Practice. Nevertheless, as mentioned in the previous chapter the reality is that companies within South Africa are effectively exploiting the B- BBEE system, therefore the essence of the following chapter is to firstly, explain the concept of fronting and other misrepresentations that come about. Secondly, to reflect on the penalties which have been enforced and whether they are adequate. Thirdly, to clarify the common misperceptions about B-BBEE. Lastly, the chapter will consider the economic empowerment programme implemented by Malaysia and the lessons that can be learnt by South Africa.

#### **4.1 Fronting**

Commencing in 2010, the government encountered a problem of companies attempting to find loopholes to avoid complying with BEE. The most common practice is known as fronting, where companies make unsubstantial BEE claims. As a consequence of this practice, the government was forced to take steps to overcome the barrier created toward transformation, thus the B-BBEE Amendment Act 46 of 2013 was implemented. For a more comprehensive understanding of fronting, it is necessary to first define it in terms of the Act as ‘a transition, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of [the] act or the implementation of any of the provisions of [the] Act.’<sup>178</sup> Effectively fronting is challenging as it prevents any meaningful participation of black individuals in the mainstream of the economy and ultimately curtails the purpose of BEE.<sup>179</sup>

It is essential that companies assure that their transactions and practices do not represent fronting. Therefore, for the benefit of the public, the B-BBEE Amendment Act has specified ways in which fronting practices may occur. Fronting can occur through window dressing, where black individuals are brought into a company only for the purpose of ‘tokenism.’ In other words,

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<sup>178</sup> s 1 Broad-Based Black Economic Empowerment Amendment Act 46 of 2013.

<sup>179</sup> M Khomotso ‘The end of fronting: B –BBEE’ (2013) 13 *Without Prejudice* 58.



the black individual would neither participate in the central activities nor contribute in his or her stated areas or levels within the enterprise. Secondly, fronting may also take place through benefit division in which the 'B-BBEE status of an enterprise does not flow back to the people in the ratio as specified in the relevant legal documents.'<sup>180</sup> Opportunistic intermediaries in the context of fronting would include enterprises who conclude agreements that include suspicious limitations or restrictions upon the identity of the suppliers, service providers, clients or customers. Additionally, with regard to the business operations, there is no link to its resources and when considering the terms and conditions of the negotiated contracts, it is found to be unfair and unreasonable in the circumstance.<sup>181</sup>

It is argued by Mynardt that the following three core fronting indicators identified by the South African Engineering Association should be carefully considered:

- Black and white individuals form a relationship solely to procure contracts, as a result the black individual does not acquire a substantial education or financial benefit.
- BEE companies are formed as an 'empowerment shell'
- A company pays black individuals a fee for the use of their name.<sup>182</sup>

High risk indicators have been identified to include instances where:

- Black individuals are unaware of their position or their duties within the enterprise.
- Black individuals are paid lower than the market norm for their position.
- An enterprise that performs peripheral or marketing functions.
- An enterprise that outsources more of its core functions
- Any other practice that seeks to circumvent the Codes.<sup>183</sup>

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<sup>180</sup> 'Fronting' available at [https://www.theditgov.co.z/economic\\_empowerment/fronting.jsp](https://www.theditgov.co.z/economic_empowerment/fronting.jsp), accessed on 21 September 2014.

<sup>181</sup> Ibid.

<sup>182</sup> A J Mynhardt *Investigation of Misrepresentations in Tender Documents* (unpublished Magsite Technologia, University of South Africa, 2011) 56.

<sup>183</sup> 'Black Economic Empowerment Guide' available at [http://www.services.bowman.co.z/BEE\\_brochures-Ir.pdf](http://www.services.bowman.co.z/BEE_brochures-Ir.pdf) accessed on 28 September 2014.

Moderate indicators have been identified to include instances where:

- A black individual who is a shareholder, executive or part of management in the enterprise but has an inadequate knowledge of the enterprise
- There is no active participation by the black individual at a decision-making level
- The enterprise is found to be paying administration or management fees to someone without a B-BBEE status.
- Goods and services are acquired lower than the market rate.
- Loans are obtained at an excessive rate, which is not for the purposes of share acquisition.
- There are sharing agreements with a third party within the same industry for premises and infrastructure which is below the market value.<sup>184</sup>

An example of a fronting practice by a company is illustrated in the case of *Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd and Another*. In this case, the Constitutional Court dealt with the nature and the extent of an organ of the state to act when it awarded a tender based on fraudulent information provided by Viking Pony Africa Pumps (Pty) about their black shareholding. The applicant Viking Pony Africa Pumps (Pty) and the second respondent Hidro-Tech Systems (Pty) Ltd regularly competed for tenders to supply water and sewage treatment equipment. The tender in question dealt with supplying the City of Cape Town. As a result, Viking Pony Africa Pumps (Pty) was successful for more tenders than Hidro-Tech Systems (Pty) because black shareholders held 70% of the company's interest. Moreover it was found that the benefits were routed to their sister company, which was actually a white owned company.<sup>185</sup>

The second respondent argued that the shareholders were merely tokens and that the economic benefits did not flow back to the black individuals in question. Furthermore, the company acted as an opportunistic intermediary because the benefits flowed to its sister company. Both the High

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<sup>184</sup> 'Black Economic Empowerment Guide' available at <http://www.services.bowman.co.z/BEEbrochures-Ir.pdf>.

Accessed on 28 September 2014.

<sup>185</sup> *Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd and Another* (2010) ZACC 21

Court and the Supreme Court of appeal found in favour of the City. Viking appealed to the Constitutional Court, the court held that the City was meant to investigate the fraudulent information provided by the company and that tenders were required to declare that all information that is provided in their documents were correct, which did not happen in this case.<sup>186</sup> This case took place prior to the enactment of the B-BBEE Amendment Act thus it is clear that since fronting indicators are now clarified by the Act, it is easier for the public to recognize fronting and more importantly what practices should be avoided.

#### **4.2 A Misrepresentation of Facts**

It has been established that in most instances black individuals are merely used by entities to secure large government contracts as opposed to entities supporting the government's 10-year plan to improve the lives of HDI's in our country. Frequently, victims of fronting practices are unaware about their position in an entity because they innocently sign documents of which they are unaware of the true contents. There is therefore an abuse of black individuals status's because they receive no benefit as result of misrepresentations and fronting.<sup>187</sup>

The recent case of *Peel and others v Hamon J&C Engineering (Pty) Ltd and Others* is an example of a company entering into fraudulent shareholder agreement with black employees to improve its BEE status. According to the facts of the case, the first and second applicants were directors and shareholders of the first respondent, Hamon J&C Engineering a subsidiary of Harmon SA the second respondent, who were additionally both subsidiaries of the company Hamon & Cie (International South Africa) the third respondent. The two major shareholders were black women of which one was the company's cleaner and the other was a driver and a messenger. They were each sold 13% of shares in Hamon SA at a cost of R1. According to the evidence, when they had signed the share agreements, they were unaware of the contents of the documents and the witnesses. Additionally, it was found that they were not treated as shareholders nor did they participate in any of the decision-making processes of the company. The company's sole source of business was from public entities and non-governmental

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<sup>186</sup> *Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hydro-Tech Systems (Pty) Ltd and Another* (2010) ZACC 21

<sup>187</sup> A J Mynhardt *Investigation of Misrepresentations in Tender Documents* (unpublished Magsite Technologia, University of South Africa, 2011) 51.

companies. As a result of the company's favorable BEE status, they were awarded a lucrative tender from Eskom Holdings and conveniently six months after the agreements were concluded the shares were taken back from the two women.<sup>188</sup>

An application was made on the basis 163(1) of the Companies Act in which shareholders or directors of companies may apply for relief where their interests have been unfairly prejudiced or disregarded by an act, omission or business dealings of the company.<sup>189</sup> The applicants raised that the companies were engaging in inappropriate conduct in terms of exercising BEE and that their interests were prejudiced as the companies failed to take appropriate measures to remedy their conduct, they unfairly disregarded their interests. The court found in favour of the applicants on the basis that they were placed at serious business risk and were unfairly prejudiced by the companies' activities. The court granted the respondents a return of payment in terms of the value of the shares, subject to a deduction of wasted expenditure.<sup>190</sup>

What is significant about this case is that it shows how companies use their uneducated disadvantaged employees to disguise transaction in order to obtain BEE benefits. Another example of this practice is where a medical company called Mile Net Imports fronted one of its director's domestic workers for the purposes of obtaining BEE credentials. The practice is now specifically recognized as window dressing. The domestic worker in question was persuaded to sign documents, which she was informed were Unemployment Insurance Fund forms. Without her knowledge, according to the documents, she agreed to become a director and major shareholder of Mile Net Imports. Consequently, the company had won beneficial contracts and was recognized for their 'impressive' BEE status, which was in fact fraudulent. Due to the case being decided before the enactment of the B-BBEE Amendment Act, the Johannesburg high court had placed the company under liquidation for its fraudulent activities.<sup>191</sup> Today if the B-BBEE Amendment Act had to be applied such an entity would be liable for a fine.

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<sup>188</sup> *Peel and others v Hamon J&C Engineering (Pty) Ltd and Others* 2013(2) SA 331 (GSJ)

<sup>189</sup> s 163(1) Companies Act 71 of 2008

<sup>190</sup> *Ibid.*

<sup>191</sup> P Rampedi '160m fronting scam' available at <http://www.iol.co.za/the-star/r160m-fronting-scam-1.1302785#.VCEt8JSSxe8>, accessed on 21 September.

### **4.3 Reporting Fronting**

To prevent the above-mentioned practices, the DTI encourages the public, verification agencies and public officials to report fronting and other misrepresentations by entities. The process to reporting fronting is important and needs to be understood by the public thus; if fronting is detected, the measured entity must be notified of the suspected conduct and it will be required to submit representation within fourteen days of notification. If there is a failure upon the entity to provide a reasonable explanation, the fraud hotline or the DTI's B-BBEE unit must then be notified in writing.<sup>192</sup> The DTI will then consider the notification and may initiate an investigation based on the facts. Subsequently, the investigation commission upon its discretion has the power to hold a hearing, institute a restraint, or remedial relief.<sup>193</sup> Additionally, the Commission may refer the matter to the National Prosecuting Authority or the South African Police Services.<sup>194</sup> The Commission has the power to publish findings or recommendations.<sup>195</sup> However the commission cannot publish findings if the proceedings of judicial review were not initiated within the period allowed or completed, if the matter had been referred to the National Prosecuting Authority or the South African Police Services and the person or entity was not prosecuted or acquitted or finally, if the matter is pertaining to appeal or review.<sup>196</sup>

It is significant to consider the authority of the B-BBEE Commission as the Minister of Trade and Industry, Dr Rob Davies highlighted the role given to the commission:

the B-BBEE Commission [is] given the task of acting without fear or favour independently. It will also strengthen and foster collaboration between the public and private sector in order to promote and safeguard the objectives of B-BBEE. Over and above the Commission will ensure that BEE activities in the country are aligned.

When reflecting on the statutory process to reporting fronting, by the act allowing the publication of findings by commissioners, it encourages entities to refrain from contravening the act to avoid

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<sup>192</sup> Fronting' available at [https://www.thedti.gov.co.z/economic\\_empowerment/fronting.jsp](https://www.thedti.gov.co.z/economic_empowerment/fronting.jsp), accessed on 21 September 2014.

<sup>193</sup> s 13J(2) and (4) B-BBEE Amendment Act 46 of 2013

<sup>194</sup> s 13J(5) B-BBEE Amendment Act 46 of 2013

<sup>195</sup> s 13J(7)(a) B-BBEE Amendment Act 46 of 2013

<sup>196</sup> s 13J(7)(b) B-BBEE Amendment Act 46 of 2013

destroying their corporate image. It can be argued that now that investigations are presently done by an investigation commission, which is allowed to involve the National Prosecuting Authority, the South African Police Services or any regulatory authority that prohibits the conduct in question, the process is made stricter in order to prevent illegal contraventions of the Act. To substantiate this argument, Ngwenya states that these measures are now more effective to curtail and detect fronting or any other contraventions of the act.<sup>197</sup>

#### **4.4 Penalties for Fronting and Other Contraventions**

Prior to the enactment of the B-BBEE Amendment Act, fronting was recognized as fraud under the common law, there were no statutory penalties. Presently, an entity that is found guilty of fronting or in contravention of the B-BBEE Amendment Act will be liable to a fine, which would not exceed 10 % of its annual turnover. Additionally, the Act provides that where a natural person is involved, he or she will be liable to a fine or imprisonment of a maximum sentence of ten years.<sup>198</sup> Consequently, any person that is convicted of an offence in terms of the Act will be in the Register of Tender Defaulters by the National Treasury, in other words blacklisted and prohibited from entering into contracts with any organ of the state or public entity for a period of ten years.<sup>199</sup> In terms of a fraudulent entity and not a natural person, the court has discretion to place a restriction upon only the person who has contravened the act such as a member, shareholder, or director of the entity.<sup>200</sup>

Penalties for fronting and any other contraventions in terms of the Act are necessary because it negatively affects empowerment within the country, but the question is whether the penalties are adequate. Arguably, the penalties are sufficient, although there is only a 10 % fine placed upon guilty entities by the National Treasury, which would incur severe monetary loss and harm to its reputation, the entity is additionally blacklisted. More specifically, there would be a loss of business, especially for large businesses who derive their sole source of business from public funds. Moreover, other entities are inclined to avoid doing business with a blacklisted company.

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<sup>197</sup> F S Ngwenya *Successes and failures of BBBEE- a critical assessment* ( Unpublished thesis Masters of Business Administration, University of Stellenbosch, 2007)

<sup>198</sup> s 13M(3)(a) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

<sup>199</sup> s 13P (1) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

<sup>200</sup> s 13P (2) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

Ngwenya states that by criminalizing fronting the government has made significant progress because everyone will now understand the seriousness of the practice and the legislation will not be undermined.<sup>201</sup> Therefore, it can be said that although the B-BBEE Amendment Act is new, it addresses the problems that prevent compliance of BEE and provide adequate penalties.

#### **4.5 Common Misperceptions**

Several misperceptions within the corporate sector arise, which cause entities to make hasty decisions and innocently not comply with BEE. Often people have a perception that nationality does not count in terms of BEE, but the truth is that in order for a person to be a beneficiary of BEE they have to be a citizen by birth, descent or naturalization. It was found that due to ‘conflicting messages and ideas from uniformed, unreliable sources’ companies often make decisions, which negatively affect their business, and most often, they do not have proper transformation plans, which form part of the integral part of their business.<sup>202</sup> As well, foreign companies often regard BEE as a ‘cost’ of entering into business transactions with South Africa. Milovanovic states ‘BBBEE initiatives should be viewed as business opportunities, where organizations cooperate with partners who add value to the business, not a cost to be borne by existing shareholders.’<sup>203</sup>

The most common misperception that transpires is that BEE is solely based on black ownership and once a company is black owned it is empowered. However, BEE is much broader and in order to be empowered, entities need to perform in several areas such as ‘ownership, management and control, employment equity, skills development, preferential procurement,

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<sup>201</sup> F S Ngwenya *Successes and failures of BBBEE- a critical assessment* ( Unpublished thesis Masters of Business Administration, University of Stellenbosch, 2007)

<sup>202</sup> ‘BEE explained: An easy guide to understanding Broad Based Black Economic Empowerment’ available at [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf), accessed on 18 September 2014.

<sup>203</sup> A Milovanovic ‘BBBEE empowerment to be sustainable not slow’ available at <http://www.polity.org.za/article/bbbee-empowerment-meant-to-be-sustainable-not-slow-2010-09-03>, accessed on 30 September 2014.

enterprise development and socio-economic development as opposed to just ownership.’<sup>204</sup> Milovanovic says that the outcome of this will be to empower the majority of HDI in South Africa; hence, the intention is that not only would black shareholders benefit from the system but also black employees.<sup>205</sup>

Since BEE is more extensive than before, there has been a view that companies would no longer seek to support charities in terms of their corporate social responsibility. It is important to remember that BEE is actually ‘an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and seeks to create a just and equitable society.’<sup>206</sup> Esser and Dekker emphasizes that the vision of BEE was to promote social investment and the development of underprivileged communities.<sup>207</sup> Thus, the socio-economic development element in terms of BEE was not implemented with the intention to displace corporate social responsibility but rather to create a focus on HDI’s in society.<sup>208</sup> Ramlall provides that the government had enacted laws, which indirectly compel businesses to get involved in corporate social responsibility.<sup>209</sup> Additionally, Ngwenya’s view is that BEE imposes a moral obligation rather than a legal obligation upon companies to develop the under privileged and failure to comply will not result in criminal liability.<sup>210</sup> It is argued that even

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<sup>204</sup> ‘BEE explained: An easy guide to understanding Broad Based Black Economic Empowerment’ available at [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf), accessed on 18 September 2014.

<sup>205</sup> A Milovanovic ‘BBBEE empowerment to be sustainable not slow’ available at <http://www.polity.org.za/article/bbbee-empowerment-meant-to-be-sustainable-not-slow-2010-09-03>, accessed on 30 September 2014.

<sup>206</sup> ‘Clarification on the revised Broad-Based Black Economic Empowerment (B-BBEE) codes’ available at <http://www.gov.za/speeches/view.php?sid=32145>, accessed on 30 September 2014.

<sup>207</sup> I Esser and A Dekker ‘The dynamics of corporate governance in South Africa: broad based black economic empowerment and the enhancement of good corporate governance principles’ (2008) *JICLT* 3(3) 157-169.

<sup>208</sup> ‘Clarification on the revised Broad-Based Black Economic Empowerment (B-BBEE) codes’ available at <http://www.gov.za/speeches/view.php?sid=32145>, accessed on 30 September 2014.

<sup>209</sup> S Ramlall ‘Corporate social responsibility in post-apartheid South Africa’ 2012, *SRJ* 8(2) 270-271.

<sup>210</sup> F S Ngwenya *Successes and failures of BBBEE- a critical assessment* (Unpublished thesis Masters of Business Administration, University of Stellenbosch, 2007).



though the B-BBEE Act is in place, companies should continue with their corporate social responsibility while promoting economic empowerment.<sup>211</sup>

#### **4.6 The Malaysian Experience**

Internationally a lot of controversy surrounds the topic of economic empowerment for the reason that ‘the economic empowerment of previously disadvantaged people can be an important tool in improving their livelihoods and reducing poverty.’<sup>212</sup> As illustrated in the previous chapters, the need for economic empowerment in a country generally stems from the historical imbalances created by past practices within a country. Profoundly, the general focus of economic empowerment should be to allow the majority of a country to generate good jobs, improve their skills and eventually develop into entrepreneurs to improve their way of life and become economically active as oppose to only focusing on them acquiring shares in large companies to develop.<sup>213</sup> Therefore, the ultimate goal should be to ‘spread benefits of economic growth to the majority.’<sup>214</sup> Remarkably, a lot of attention surrounds South Africa for the implementation of economic empowerment through B-BBEE.<sup>215</sup>

South Africa is now in a similar position as Malaysia previously was and it has admitted that the country can learn numerous lessons from the sustainable economic programmes, enforced by Malaysia. Historically, Malaysia was under British rule and the population was divided into three groups, namely Chinese, Malay (Bumiputera) and Indian. The Chinese population held the minority and the Bumiputera were the majority and as a result of the policies which were enforced by the government, the Chinese were in control and the Bumiputera were left disadvantaged within the society and more specifically were denied opportunities in the mainstream of the economy. Therefore, there was a great inequality between the Bumiputera and

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<sup>211</sup> Clarification on the revised Broad-Based Black Economic Empowerment (B-BBEE) codes’ available at <http://www.gov.za/speeches/view.php?sid=32145>, accessed on 30 September 2014.

<sup>212</sup> A M Makwiramithi ‘ In the name of economic empowerment: A case for South Africa and Zimbabwe’ available at [http://www.consultancyafrica.com/index.php?option=com\\_content&view=article&id=674:in-the-name-of-economic-empowerment-a-case-for-south-africa-and-zimbabwe&catid=87:african-finance-a-economy&Itemid=294](http://www.consultancyafrica.com/index.php?option=com_content&view=article&id=674:in-the-name-of-economic-empowerment-a-case-for-south-africa-and-zimbabwe&catid=87:african-finance-a-economy&Itemid=294), accessed on 1 October 2014.

<sup>213</sup> Ibid.

<sup>214</sup> Ibid.

<sup>215</sup> Ibid.

Chinese population.<sup>216</sup> Furthermore, these inequities led to an outbreak of serious riots in 1969, which resulted in a state of emergency being declared. Subsequently, the government decided that in order to avoid further strife and protect the citizens of the country, a state policy had to be implemented to allow the Bumiputera citizens into the mainstream of the economy.<sup>217</sup> Mputhi argued that there was a mutual feeling amongst the people that ‘unless the position of the Bumiputra could be transformed, the Chinese and Indians will never be comfortable and secure in Malaysia and they would constantly fear the repeat of the 1969 riots.’<sup>218</sup> Additionally, M’Paradzi said that due to the imbalances in the economy created by the Chinese dominating skilled work and the Bumiputra being left ‘in the impoverished recess of unskilled work’ there was a need for a serious remedy.<sup>219</sup> As a result, the process toward change began when the National Consultative Council was established to ensure stability within the economy.<sup>220</sup>

Similar to South Africa, the Malaysian government had to develop many strategies to redress the imbalances of the past. Due to the previous inequalities in Malaysia, the ultimate concerns of the government were the low standard of education, the high unemployment and poverty rate within the country. The need to eliminate these challenges led to the implementation of the New Economic Policy (NEP). The objectives of NEP were to decrease the number of individuals living below poverty and to remedy inequalities.<sup>221</sup> More specifically, the approach was ‘to overcome the perceived socio-economic imbalances in society by giving preferential treatments to the Malays [Bumiputera] and other indigenous people.’<sup>222</sup> Once the aim of NEP was identified, many strategies were enforced to redistribute the income within the society for example, several institutions were formed with the objective of advancing Malay owned

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<sup>216</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

<sup>217</sup> M A Mphuthi *Black Economic Empowerment in South Africa: Evaluating progress since 1994* (unpublished Business Management thesis, Raand Afrikaans University, 1999).

<sup>218</sup> Ibid

<sup>219</sup> A S M’Paradzi *BEE- Basis, evolution, evaluation: a critical appraisal of Black Economic Empowerment in South Africa* (unpublished Commercial Law thesis, University of Cape Town, 2006).

<sup>220</sup> Ibid.

<sup>221</sup> Ibid.

<sup>222</sup> A H Roslan *Income Inequality, Poverty and Development Policy in Malaysia* (unpublished Economics Thesis, Universiti Utara Malaysia, 2003) 11.

businesses, additionally they were given preferential credit and opportunities to purchase shares in companies a price below par value.<sup>223</sup>

In the same way as South Africa, the Malaysian economic initiatives were grouped into ‘waves’. The first wave took place when the wealthy elite had prospered within the Malaysian economy. The second wave began when the impressive Bumiputera business class was created. Nevertheless, during this wave, the NEP programme was faced with the challenge of Chinese businessmen attempted to circumvent the system. This unethical practice is called ‘Ali Baba,’ it ensues when a Bumiputera Company acquires a contract through affirmative action in terms of the NEP programme and successively sub-contracts with Chinese Companies for a profit. This is recognized as a major challenge for South Africa. The Malaysian government estimated that it loses ‘\$3.3 [billion] a year on Ali Baba deals and abuses of the system.’<sup>224</sup> This makes one consider how much was exactly lost in South Africa through fronting. However, in spite of these shortcomings in Malaysia, the Bumiputera population could still able to be successfully transformed into the ‘urban working class, a middle professional class and a business capitalist class.’<sup>225</sup>

When one reflects upon how Malaysia fruitfully transformed its economy within a short period, it is clear that education was the key instrument to speeding up changes within the economy.<sup>226</sup> Mandla highlights that ‘education was regarded as a vehicle to modernize society and attain social goals as a way of achieving equal opportunities.’<sup>227</sup> By simply concentrating on education programmes as well as subjects such as science and technology, the Bumiputera population was able to grow and participate in the mainstream of the economy.<sup>228</sup> Additionally, Mandla argues that in the context of South Africa there should be a considerable focus on the development of

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<sup>223</sup> A S M’Paradzi *BEE- Basis, evolution, evaluation: a critical appraisal of Black Economic Empowerment in South Africa* (unpublished Commercial Law thesis, University of Cape Town, 2006).

<sup>224</sup> R Gardee ‘BEE lessons from Malaysia’ available at <http://www.moneyweb.co.za/moneyweb-empowerment/lessons-from-malaysia>, accessed on 7 October 2014.

<sup>225</sup> Ibid.

<sup>226</sup> Ibid.

<sup>227</sup> B Mandla *BEE and Malaysia’s NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

<sup>228</sup> Ibid.

skills and education because so far BEE in South Africa began by focusing on ownership as oppose to skills development and education.<sup>229</sup> Furthermore, Gardee also argues that the cause of this is a lack of communication between the education department and the DTI, therefore the education department focuses more on the pass rate of the number of matriculates as oppose to making sure that a majority of them are educated in subject areas such as math's, science and technology.<sup>230</sup>

The NEP policy was successfully in force for a period of twenty years. It is recognized as one of the most successful and effective economic empowerment initiatives in the world as it met its objectives and targets even though the minority was not content with the NEP programme and they tried to use the majority to gain benefits, the government was still able to overcome these challenges through educating its majority. It is clear that South Africa's BEE policy is similar to the Malaysian NEP policy thus Malaysia stands as an inspiration for a successful economic empowerment programme as there needs to be more spending on aspects of education and social services in rural areas as opposed to concentrating on ownership and control of the historically disadvantaged in society.<sup>231</sup> Thus, we can have a more progressive and advanced economic empowerment programme by educating the country's most important resource, its people. Nevertheless, it has been argued that B-BBEE is no longer sustainable in the current globalized world as there are always new challenges, which tend to emerge therefore to try to overcome this, the government needs to constantly explore and determine additional methods to achieve B-BBEE and its anticipated targets.

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<sup>229</sup> B Mandla *BEE and Malaysia's NEP: A Comparative Study* (unpublished LLM thesis, University of Stellenbosch, 2006).

<sup>230</sup> R Gardee 'BEE lessons from Malaysia' available at <http://www.moneyweb.co.za/moneyweb-empowerment/lessons-from-malaysia>, accessed on 7 October 2014.

<sup>231</sup> Ibid.

#### **4.7 Conclusion**

While South Africa is admirable for the implementation of B-BBEE, there is still room for improvement. Amongst the several challenges of BEE, the major challenge has been identified as fronting, in which companies intentionally exploit the BEE system. On the other hand, there are companies, which innocently fail to comply with BEE, based on their misperceptions. It is clear from the discussion above that the government has progressively, implemented the B-BBEE Amendment Act, hence provided statutory penalties, to prevent the exploitation of the BEE system. As illustrated South Africa has many similarities to Malaysia. It is found that in implementing its successful and commendable economic empowerment plan, Malaysia's key focus was to develop its disadvantaged individuals through education. It is established that there are many recommendations for the future that can be derived from Malaysia's EE programme, which will be discussed below.

## CHAPTER 5

### CONCLUSION

#### **5 Introduction**

Internationally, economic empowerment is generally a topical subject, more specifically in countries, which have undergone colonialism. In recent years, South Africa has been recognized for the advent of B-BBEE within the country. As a result, the model is constantly deliberated with regard to its successes and failures. Most importantly there is a constant emphasis on whether the targets through its implementation of the system will be met during a more globalized stage.

In general terms, companies and other entities play an important role in BEE as they essentially help the government to reach its targets and develop the economy. By companies and other entities participating in conduct such as fronting and other misrepresentations, South Africa's progress in this respect will be at a halt. Therefore, the focus of this study was to expose the loopholes and misuses that those companies and other entities participate in to avoid complying with the B-BBEE Act. More precisely the study highlighted deliberate fronting practices and clarified the common misperceptions that arise about the B-BBEE Act. Lastly, another aim was to suggest recommendations based on the EE initiatives enforced by Malaysia, while discussing the issue of Ali Baba within that country.

As shown throughout this dissertation, BEE is a significant part of South Africa's transformation process, of correcting the economic inequalities of the past. Chapter 3 provided guidance upon the application of the B-BBEE Act, other relevant legislation and the Codes of Good Practices. It is clear from the discussion that BEE affects businesses from all sectors. Government has realized that small, medium, micro-enterprises play a significant role in society, and to exclude these businesses, will negatively affect the transformation process. Thus, in these circumstances, if they comply with the requirements such entities will be awarded a level four-contributor status.<sup>232</sup> Additionally, to encourage compliance there was a conscientious development of

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<sup>232</sup> H Knoetze *An analysis of the Codes of Good Practice issued in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003* (Unpublished LLM thesis University of Free State 2006).

transformation charters and relevant sectors codes giving each industry an opportunity to set their own targets according to its needs.<sup>233</sup>

One of the main obstacles of BEE has been fronting, a practice which has been identified as one in which companies and other entities make unsubstantiated BEE claims. As discussed it could take place through window-dressing, benefit diversion or opportunistic intermediaries.<sup>234</sup> Additionally it has been emphasized that many black individuals are being used as fronts without their knowledge. Thus, their status is abused as they are unaware about their positions in a company nor do they receive any benefits as a result of it.<sup>235</sup>

To combat fronting, the government has implemented statutory penalties through the B-BBEE Amendment Act 46 of 2013. By including other organs of state in the investigation process, the process should be more effective in curtailing fronting and other contraventions of the Act. It is further submitted that the penalties are sufficient because in addition to a 10 % fine on the annual turnover of guilty entities; the entity is also blacklisted by the National Treasury.<sup>236</sup> In analyzing the effects of blacklisting, it is clear that blacklisting a business essentially negatively affects the business to incur monetary loss and harm its reputation.<sup>237</sup>

While there are deliberate contraventions of the B-BBEE Act, there is non-compliance due to uniformed conflicting messages surrounding B-BBEE. Some of the common misperceptions that arise are: that nationality has no relevance in B-BBEE; that B-BBEE is a merely a cost to a business; that it is solely based on ownership and finally that it has the effect of causing companies to no longer contribute to charities within society because of the socio- economic

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<sup>233</sup> F Marais & L Coetzee 'The determination of black ownership in companies for the purpose of Black Economic Empowerment' (2006) 27 *Obiter* 115.

<sup>234</sup> Fronting' available at [https://www.thedtigov.co.z/economic\\_empowerment/fronting.jsp](https://www.thedtigov.co.z/economic_empowerment/fronting.jsp), accessed on 21 September 2014.

<sup>235</sup> A J Mynhardt *Investigation of Misrepresentations in Tender Documents* (unpublished Magsite Technologia, University of South Africa, 2011) 51.

<sup>236</sup> S13(M)(3)(a) Broad-Based Black Economic Empowerment Amendment Act 46 of 2013

<sup>237</sup> A J Mynhardt *Investigation of Misrepresentations in Tender Documents* (unpublished Magsite Technologia, University of South Africa, 2011) 51.

element. It has been argued that BEE should rather be viewed as a benefit to a business and a contribution toward transforming and developing society.<sup>238</sup>

Similarly, to South Africa, Malaysia has also implemented a policy with the intention of transforming its economy in response to the imbalance of the past. Although, it has successfully implemented its NEP programme, it has also undergone challenges such as Ali Baba. Their government found that by educating the majority, they were able to overcome some of their challenges. Thus, as a suggestion, guidance should come from the Malaysian model.

Prior to the B-BBEE Amendment Act, the implementing of the BEE programme became an obstacle in the social context. Companies and other entities regularly evaded the B-BBEE Act. Additionally, many individuals misunderstand the BEE programme and its purposes. In considering the Malaysia model, it is clear that like South Africa, they had to overcome many obstacles, for example Ali Baba business practices. The Malaysian EE plan suggests that there is room for improvement in the programme. This research will further provide recommendations about the way forward, while considering the Malaysian model.

## **5.1 Recommendations**

As previously emphasized, in order for a country to alleviate poverty and improve the lives of the majority of citizens within the country, the economy needs to grow as a whole. Although many controversies surround B-BBEE in South Africa, it has created a pathway forward towards transformation.

It is clear from the discussion in chapter 4 that Malaysia's plan in concentrating on education through NEP sped up its economic transformation plan. As a way forward, it is argued South Africa should place more of a focus on educating the majority through proper education drives in schools, universities, programmes etc. and specifically focus on aspects such as science, technology and business management skills. Furthermore, in order to achieve this, preference should be given to skills development in terms of the programme and to encourage this more points should be awarded for training and educating unemployed individuals within society.

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<sup>238</sup> A Milovanovic 'B-BBEE to be sustainable not slow' available at <http://www.polity.org.za/article/bbbee-empowerment-meant-to-be-sustainable-not-slow-2010-09-03>, accessed on 30 September 2014



Additionally, to prevent the abuse of black individuals status's the government should educate them about their benefits, position in society and the abuses of the system which incur. By educating and empowering the HDI's in society, there would effectively be a reduction of poverty and crime within the country. In other words, it can be derived from the Malaysian economic empowerment model that education is the key to transformation and to overcome the main obstacles of the country. Accordingly, due to the constant changes internationally and entities attempting to find their way around compliance with B-BBEE, policy makers need to continuously explore ways to improve B-BBEE, while making it flexible to ensure compliance.

## **5.2 Contributions of the Study**

The study was essentially explorative in nature, it considered the B-BBEE legislation and related legislation. It took into account the loopholes which companies, and other entities participate in to effectively curtail compliance of the Act. Furthermore, the study investigated and clarified misperceptions, which occur. Thus, it effectively exposes the above-mentioned practices, which is important for South Africa to guard against the negative aspects that frustrate the integration of black individuals into the mainstream of the economy. It also sought to look to a foreign jurisdiction that has successfully implemented an economic empowerment initiative, which enabled it to provide a means to critically analyze the strengths and weaknesses of the South African programme and suggest ways of improving it. The study has made a significant contribution to the body of literature on B-BBEE as well as exposed aspects, which have not yet been comprehensively explored.

While South Africa had made significant progress over the past 20 years, there are still obstacles in empowering the majority of the country. The main recommendation is that South Africa should focus more on the educational development of HDI's in society. Further studies should explore how this may be done and should evaluate such developments. In a cultural and diverse society, equality is fundamental and getting BEE right is a crucial way to reach the promises of a newly democratic South Africa.

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