

UNIVERSITY OF KWAZULU-NATAL

SCHOOL OF LAW

**An Analysis of the Broad-Based Black Economic Empowerment  
Policy and its Effects on Beneficiaries**

by

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This mini-dissertation is submitted in partial fulfillment of the  
requirements for the degree of Master of Laws in Business Law

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NOVEMBER 2019

## **DECLARATION**

I, Tasmia Dawood, do hereby declare that unless specifically indicated to the contrary in this text, this dissertation is my own original work and has not been submitted to any university in full or partial fulfillment of the academic requirements of any other degree or other qualification.

Signed at Pietermaritzburg on the 30<sup>th</sup> day of November 2019

Tasmia Dawood

“Electronic Signature”

## **DEDICATION**

This dissertation is dedicated to my parents, Bhilal and Sulochini Dawood, and my late grandfathers, Mahomed Shaik Dawood and Kisten Mandry.

## **ACKNOWLEDGEMENTS**

Firstly, I would like to thank the Almighty God for his guidance and strength to complete this dissertation.

Secondly, I would like to extend my sincere appreciation to the following people:

- To my supervisor, Dr Ernest Tenza for providing me with invaluable advice guidance, unwavering support, and insight throughout this dissertation.
- To my parents and sister for their constant love, support, and motivation.
- To my family and friends, for their support and having endless beliefs in my capabilities.

## **ABSTRACT**

Broad-Based Black Economic Empowerment (BBBEE) is one of the most controversial issues in the South African business sector. BBBEE is a fundamental conceptual constituent of the South African economy and the country as a whole, intended to encourage constitutionally directed diversion from the constricting practices of the past, especially those of the apartheid regime. This dissertation explores the route of the evolution of the BBBEE programme from the apartheid era. It was implemented by the government following the introduction of the democratic dispensation culminating with the enactment of the Constitution of 1996. The main objective of BBBEE was to correct and remedy the injustices of the apartheid era. The government sought, with the introduction of the Act, to bring the historically disadvantaged South African population into the mainstream of the economy. However, the implementation of BBBEE has not entirely achieved the intended result.

This dissertation analyses the challenges faced in its implementation, in the process exploring its impact and effect on small and medium-sized enterprises (SMMEs), its advantages and disadvantages, and the issue of ‘fronting’ in the business sector.

Despite becoming a constitutional democracy, South Africa still faces the same challenges that existed during the apartheid era, including economic and political challenges. The success of the BBBEE policy on balance remains largely to be realized. Therefore, the government must reconsider its transformation agenda and the adoption of the Broad BBBEE policy. Broad-Based Black Economic Empowerment is merely a work in progress that has the potential for improvement.

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## ABBREVIATIONS AND ACRONYMS

<b>BEE</b> .....	Black Economic Empowerment
<b>BBBEE</b> .....	Broad-Based Black Economic Empowerment
<b>SANNC</b> .....	South African Native National Congress
<b>SAP</b> .....	South African Party
<b>ANC</b> .....	African National Congress
<b>ANCYL</b> .....	African National Congress Youth League
<b>NP</b> .....	National Party
<b>RDP</b> .....	Reconstruction and Development Programme
<b>GEAR</b> .....	Growth, Employment and Redistribution Programme
<b>ASGIS</b> .....	Accelerated and Shared Growth Initiative for South Africa
<b>NGP</b> .....	New Growth Path
<b>SPV</b> .....	Special Purpose Vehicle
<b>SMEs</b> .....	Small and Medium Enterprises
<b>JSE</b> .....	Johannesburg Stock Exchange
<b>DTI</b> .....	Department of Trade and Industry
<b>HDI</b> .....	Historically disadvantaged individuals

## CHAPTER LAYOUT

This dissertation is divided into five chapters.

Chapter one explains the nature and scope of the study. It explains the rationale of the dissertation and reflects on the research questions discussed in this dissertation. This chapter enlightens the reader about the topic of the dissertation and the direction that the dissertation follows.

Chapter two outlines the historical background of South Africa while discussing the shift from the apartheid era to South Africa's independence in 1994. It provides more insight on the transition from Black Economic Empowerment to the Broad-Based Black Economic Empowerment policy. This chapter encompasses a brief overview of the Employment Equity Act 55 of 1998, the Skills Development Act 97 of 1998, and the seven pillars of Broad-Based Black Economic Empowerment.

Chapter three makes provision for the impact and the effects of Broad-Based Black Economic Empowerment; it specifically elaborates on the impact and effects of it on Small and Medium-Sized Enterprises and its effects on female-operated enterprises. The chapter includes an explanation for the challenges that Broad-Based Black Economic Empowerment enterprises encounter.

Chapter four reflects upon the advantages and disadvantages of Broad-Based Black Economic Empowerment and the issue of 'fronting' in South Africa. It explains fronting together with the procedure for reporting fronting practices and the penalties that enterprises may face should they engage in fronting practices.

Chapter five provides conclusions drawn from the study including recommendations that the government and enterprises could enforce which would ensure that Broad-Based Black Economic Empowerment accomplishes its initial aims and objectives.

# CHAPTER 1

## 1.1 Introduction and background

In the past, South Africa was governed by the system of apartheid, which excluded particular race groups from participation in the economy. The apartheid-era represented was the most cruelly unfair era of South African history. The majority, represented by black individuals, were treated indifferently as inferior members of society while white individuals were afforded the privileges attached to their highest ranking in society. Apartheid was a system that institutionalized racial segregation, characterized by a political culture based on white supremacy which in turn encouraged state repression of the black, Indian and coloured people. This system involved the segregation of public facilities and social events, and limited access to education and economic resources, which had an impact on the opportunities available to black people in South Africa.

However, with the introduction of the Constitution of 1996 with entrenched principles of democracy supported by a Bill of Rights, there has been enforcement of equal rights and equal opportunities for all races in South Africa. One such measure of enforcement is the Broad-Based Black Economic Empowerment (BBBEE) policy. This policy was introduced to address the discriminatory practices of the past and to provide a growth strategy to enable the country to achieve its economic potential. The priority of this policy is to distribute equal wealth across the large spectrum of previously disadvantaged racial groups. Black Economic Empowerment, more generally, is a growth strategy focused on South Africa's weakest link in the economy.

According to section 1 of the Broad-Based Black Economic Empowerment Act<sup>1</sup>, BBBEE 'means the viable economic empowerment of all black people in particular women, workers, youth, people with disabilities, and people living in rural areas, through diverse but integrated socio-economic strategies'.<sup>2</sup> The definition of BBBEE includes 'increasing the number of black people that manage, own and control enterprises and productive assets, facilitating ownership and management of enterprises and productive assets by communities, workers, co-operatives and other collective enterprises; human resource and skills development, achieving equitable representation in all occupational categories and levels in the workforce; preferential

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<sup>1</sup> Act 53 of 2003.

<sup>2</sup> Ibid (note 1).

procurement from enterprises that are owned or managed by black people and investment in enterprises that are owned or managed by black people'.<sup>3</sup> However, it is not limited to the above.

The Act provides for black people as the beneficiaries; however 'black people is a generic term which includes African, coloured and Indian people or who became citizens of the Republic of South Africa by naturalization before 27 April 1994 or on or after 27 April 1994 and who would have been entitled to acquire citizenship by naturalization before that date'.<sup>4</sup>

The Broad-Based Black Economic Empowerment Act<sup>5</sup> is controversial as it presupposes that several years of racism contributed towards the weakness of the economy. This Act was amended and the Broad-Based Black Economic Empowerment Amendment Act 46 of 2013 came into effect. The amendment act deals with 'fronting', the status of sector codes, institutes generic Black Economic Empowerment codes, and forms the Black Economic Empowerment Commission.<sup>6</sup> It serves as a guideline for the development of codes of good practice which give effect to various aspects and requirements of the policy.

BBBEE is regarded as a mainstream of economic transformation in South Africa, as it promotes the equal participation of all South African nationals in all spheres of the economy. However, its primary purpose was to increase the number of black individuals who owned and controlled businesses in the marketplace.<sup>7</sup> BBBEE has benefited many individuals and is regarded as the foundation of a sustainable, equitable, and prosperous society.<sup>8</sup> The numerous benefits include the employment of skilled labourers, entry into the global markets, a decrease in crime, and an increase in foreign investments. Therefore, it could be said that the policy provides equal opportunities to its beneficiaries.

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<sup>3</sup> BEE Act (note 1).

<sup>4</sup> Broad Based Black Economic Empowerment Amendment Act 46 of 2013.

<sup>5</sup> Ibid (note 1).

<sup>6</sup> V Pillay 'BEE Amendment Act and the draft codes of good practice' available at <http://www.cliffedekkerhofmeyr.com> accessed on 05 April 2019.

<sup>7</sup> E Shava 'Black Economic Empowerment in South Africa: Challenges and Prospects' (2017) 8(6) *Journal of Economics and Behavioral Studies* 161-170.

<sup>8</sup> Pillay supra (note 6)

## **1.2 Research objective**

The implementation of BBBEE is an essential element in the economic transformation of South Africa. It intended to increase the number of black individuals who own, control, and manage the country's economy. The main objective of this study is to focus on the BBBEE policy, addressing its past, present, and future positions, the advantages and disadvantages of the policy, and whether it has achieved its objectives, while determining whether it has benefitted the Black majority or not.

## **1.3 Rationale**

The reason for this study is based on many questions facing the economy, as many individuals continue to face hardships despite South Africa's having jettisoned apartheid regime and introduced democracy. Therefore, this study will examine the impact of the BBBEE policy in South Africa concerning particular provisions of the BBBEE Act and analysis of its effects on the beneficiaries.

## **1.4 Research questions**

1. What is the purpose of BBBEE and who are its beneficiaries?
2. Has it achieved its goals; if not what are the impediments to its implementation?

## **1.5 Research methodology**

This dissertation will follow a qualitative research method – a method of observation that gathers non-numerical data.

This will be desktop research and primary and secondary sources will be utilized. Legislation such as the 1996 Constitution, the Broad-Based Black Economic Empowerment Act 53 of 2003, and the Broad-Based Black Economic Empowerment Amendment Act 46 of 2013 will form the foundation of the research. Case law, journal articles, and books will provide deeper insight into BBBEE, and economic statistics will be taken into account to determine the effect on beneficiaries.

## **1.6 Literature review**

A literature review is essentially a summation of subject matter, primarily associated with academic orientated literature such as journal articles, theses, precedents, books, and numerous electronic references, including sources from websites and search engines. They are secondary sources as they do not reflect new or original work while forming the basis for research in every academic field. Since 1994, the South African government has introduced various policies, initiatives, and programmes aimed at economic reform and giving effect to the aims and objectives of addressing the economic imbalances and uneven development in South Africa. Various sources will be included in this dissertation; a few relevant works are as follows:

1. Pike A, Puchert J & Chinyamurindi WT ‘Analysing the future of Broad-Based Black Economic Empowerment through the lens of small and medium enterprises’ (2018) 18(1) *ActaCommercii* at 566.

This article seeks to analyze the future of BBBEE in South Africa together with the effect of the BBBEE policy on the South African economy by researching small and medium enterprises. Participants have revealed that BBBEE is resulting in economic strain and mixed economic outcomes and economic progression. The article provides an introduction to the history of South Africa and illustrates the reason for the enactment of the BBBEE policy.

Three particular themes are revealed in this study. First, research has shown that the South African economy is strongly impacted by the BBBEE legislation, as participants believe that BBBEE has created a stressful economic situation in which social injustices of the past were still rife. The second theme identified that BBBEE had impacted the economy and influenced the operation of industries in South Africa as there has been an increase in tender corruption together with an increase in the number of incompetent BBBEE owned industries. The last theme illustrated that participants believed that BBBEE needed restructuring, as legislation was required to eliminate tender corruption and equally benefit citizens in South Africa.

Although this article analyses the impacts of BEE and BBEEE on the South African economy and its effect on industries, it failed to show the effect on beneficiaries, specifically concerning the advantages and disadvantages of BBBEE. These factors are critically important to determine whether the policy has achieved its objectives.

- 2 Acemoglu D, Gelb S & Robinson JA *Black Economic Empowerment and economic performance in South Africa*. Non-technical policy brief (2007) Semantic Scholar.

This work lays out a framework for evaluating the impact of BEE on economic growth through its impact on political stability, firms' behaviour, performance, and economic growth. The paper adopts a historical overview of the phases of BEE (and BBBEE), discusses how the policy operates and addresses the question of the relationship between BEE and economic growth. The paper thereafter explains the various phases of the three phases of BEE, namely the uncoordinated policy phase, the big push to overcome the apartheid legacy phase, and the self-sustaining empowerment phase. The paper also provides an explanation of the various distortions BEE seeks to address and considers the factors that might assist in combating these issues. A particular question raised is whether BEE is good or bad for growth, but provides no clear answer as there are arguments both for and against. Despite taking into consideration the different phases of BEE, the work fails to delineate the impact of BEE on the economy and the future of the BBBEE in the South African economy.

- 3 Shava, E, 'Black Economic Empowerment in South Africa: Challenges and Prospects' (2016) 8(6) *Journal of Economics and Behavioral Studies* 161-170

This paper examines whether the BEE Act has created new economic opportunities for previously disadvantaged individuals and whether it has positively contributed to the poor South African communities. It deals with the claim that local government in the South African government is centered on the abuse and manipulation of the procurement systems by officials. The paper highlights several themes. First, it explains the existence of BBBEE in South Africa, especially in the context of local government, proposing that BBBEE is merely an initiative designed to empower previously disadvantaged individuals by granting them the opportunity of improving their lifestyle – attained by advancing ownership and management.

The paper discusses two theoretical perspectives on BEE; first, the organizational perspective, which considers relevant structures used to create the necessary

opportunities for black South Africans. The second perspective is referred to as the theory of social justice, encompassing a strategy that rectifies the socio-economic injustices of the past, by rewarding black entrepreneurs with the opportunity of obtaining business and government contracts. Thereafter, it explains the several structural pillars of BBBEE.

Despite identifying various advantages and disadvantages of BBBEE, the paper fails to specifically provide an in-depth discussion on each of these factors. It further fails to identify the impact of BBBEE on the South African economy.

4 *Viking Pony Africa Pumps (Pty) Ltd t/a Tricon Africa v Hidro-Tech Systems (Pty) Ltd* 2011 (1) SA 327 (CC)

The Constitutional Court was called upon, on appeal from the Supreme Court of Appeal, to consider when a duty arises on the state to investigate when an empowerment preference has been obtained by fraudulent means. Two companies competed for a tender at the local and provincial government level. The companies were *Viking Pony* (the appellant) and *Hidro-Tech* (the respondent). Many tenders had previously been granted to Viking Pony on account of its shareholding percentage of historically disadvantaged individuals (HDIs). Hidra-Tech received information that Viking Pony's HDI status was a pretense. Despite, the court recognizing that fronting had occurred, the employer (City of Cape Town) was found to be at fault for not having made the necessary scrutiny of the applicant's credentials. Mogoeng J held:

An organ of state can punish an offending tenderer only if a finding of prohibited conduct has been made. The Supreme Court of Appeal, . . . only found that the City breached its duty to investigate Hidro-Tech's allegations of fronting. The Supreme Court of Appeal order intended to do no more than direct the City to 'act against' Viking, by launching a proper and effective investigation against it. This is the only remedy which the facts of this case justify.

5 Commission for Employment Equity: Annual report, 2017-2018

This report evaluates and monitors the progress made with achieving the objectives of the Employment Equity Act 55 of 1998 to eliminate unfair discrimination and to enable the equal representation of employees in the workplace. The analysis is based on information submitted by employers. This report finds that a lack of equal representation at top-level management has a negative impact on the economic

growth of the country. Some companies fail to 'even out the playing field' by employing individuals of different racial groups, gender and disability. Therefore, various steps and programmes can be undertaken to provide equal opportunities in the workplace by recruiting, developing, and promoting individuals on a professional level.

## **1.7 Conclusion**

The wickedly cruel and unfair apartheid era in South African history is fundamental to understanding the purpose of BBBEE and how it operates; it is also important to understand South Africa's historical past to assess its transition to a democratic state and the enactment of the various legislative provisions to remedy past abuses and provide a meaningful definition to the word democracy. The inferior treatment endured by the various races leading to the segregation of public facilities and social events detrimentally impacted on opportunities available to the wider South African population. However, the enactment of the 1996 Constitution provided everyone, especially the previously disadvantaged, equal rights and opportunities. The following chapter provides a brief background to the relevant history and past practices, portraying the transition from a divided nation to a democratic union.

## CHAPTER 2

### A historical perspective and South Africa's independence

#### 2.1 Historical perspective

##### 2.1.1 *The pre-1994 era*

Under apartheid, racial segregation and white supremacy were at the center of South African government policy for more than 50 years, as various racist and discriminatory laws, projects, and practices were enacted to prevent the growth and the expansion of black businesses in South Africa. Policy deliberately excluded the majority population from the participation of the economy.

Segregation and discrimination had been in existence when the Union of South Africa was formed in 1910. The Union Constitution combined the Cape, Free State, Natal, and the Transvaal into a union 'that established boundaries of a single country'.<sup>9</sup> The South African Party served as the first government of South Africa and it obtained its legislative mandate from the number of colonies present in South Africa at the time. The primary objective of the government was to promote the interest of the white population despite the majority of the population being black. As a result, in 1913, a grouping of black individuals challenged the legislation that sought to place the minority group in skilled positions and the majority to perform unskilled labour. This grouping formed the South African Native National Congress (SANNC), which later became the African National Congress (ANC) in 1923.

The Land Act of 1913 served as the basis of territorial segregation as black South Africans were forced to live in specially allocated areas, which in turn restricted their movement. The legislation provided strict surveillance and control of so-called non-whites in white-only areas, by which black individuals were forced to carry 'passes'. The Broad-Based Black Economic Empowerment Act (BBBEE Act 53 of 2003) notes that 'black people is a generic term that includes Africans, Coloureds and Indians', and was extended to Chinese individuals.

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<sup>9</sup> N Moodley *The Evolution of Black Economic Empowerment in South Africa: A case study on New Africa Investments Limited* (MA dissertation University of KwaZulu-Natal, 2005)

The rise of the Afrikaner National Party in 1948 sought to physically separate the non-white population from the white population by law, and also purported to divide black South Africans along tribal lines to dissipate their political power. Under the governance of the National Party, a system of racial segregation and discrimination was entrenched, denying black people equal rights to freedom of movement, political representation, integrated housing, association or assembly, education and health care, and the right to vote.<sup>10</sup> This system served to prolong and intensify the system of slavery and colonialism that had existed under British rule.

During World War II, 'white labour was scarce and the industry needed workers'<sup>11</sup>, and therefore, black workers were employed and trained to expand the 'supply of skilled workers'.<sup>12</sup> The ANC protested and in 1944 the African National Congress Youth League (ANCYL) was created, led by many future political leaders and fighters for freedom and liberation from the apartheid dictatorship, including Nelson Mandela, Walter Sisulu, Ahmed Kathrada, and Oliver Tambo.

The minority population felt threatened by the move, claiming that the government was being too lenient towards the black population as these individuals were moving into the 'white' towns. As a result, the National Party government introduced a strict apartheid policy in 1948 which 'envisaged economic, political and social segregation between black and white people',<sup>13</sup> and aimed at distancing them from the white population.<sup>14</sup> This could only be achieved by way of 'geographical separation'<sup>15</sup> rigidly enforced by the Group Areas Act,<sup>16</sup>

During this period two separate educational systems were introduced, in which educational opportunities for black citizens were 'limited in comparison to that afforded to white citizens'.<sup>17</sup> Black South Africans were taught 'basic literacy skills which prepared them for manual labour'<sup>18</sup> and subjects such as mathematics and sciences were deliberately excluded from the black curriculum, together with the opportunity of furthering their education in the tertiary sector.

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<sup>10</sup> Republic of South Africa Constitution Act, 1961

<sup>11</sup> Pillay supra (note 6).

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> IP Govender 'A Critical Appraisal of the misapplications of Black Economic Empowerment and the common misconceptions that surround it' (LLM, University of KwaZulu-Natal, 2015).

<sup>15</sup> Ibid.

<sup>16</sup> Group Areas Act 41 of 1950

<sup>17</sup> P Govender supra (note 14)

<sup>18</sup> N Moodley supra (note 9).

The political/legislative label ‘Black’, as seen above, makes legislative reference to three racial groups, namely Blacks, Indians and Coloureds, all of whom were discriminated against.<sup>19</sup> They were deprived of necessities for daily living and denied the opportunity of expanding their businesses by the enactment of the ‘one-man business policy’<sup>2021</sup>, which prevented them from embarking on new business ventures. Several laws were enacted to strengthen the system of apartheid, including the Suppression of Communism Act 44 of 1950, Riotous Assemblies Act 17 of 1956, and the Internal Security Act 74 of 1982.

Suppression of black activists gain seeking liberty from the strict past laws and independence from the system in power was ruthlessly enforced for many years. However, in 1994 and after protracted negotiations South Africa became a democratic constitutional state.

### ***2.1.2 South Africa’s independence post-1994***

The general election of 1994 was the culmination of the long process of negotiations and represented the death of the apartheid regime.<sup>22</sup> The new Constitution (1996 Constitution) was founded, in terms of Chapter 1, on the values of freedom, human dignity equality, non-racism, non-sexism, the supremacy of the Constitution, and rule of law. This marked the beginning of democracy with the ‘promise of political and economic equality’.<sup>23</sup> Informed by the Constitution, the government ‘embarked on a process of transforming South Africa into a non-racial and democratic country’.<sup>24</sup>

‘South African society was based on inequality and discrimination in the legal, political and socio-economic spheres’.<sup>25</sup> As stated above, the apartheid legacy left many South Africans in poverty with limited access to education, employment and healthcare. In an attempt to redress these challenges, the government embarked on the Reconstruction and Development Programme (RDP) as the first step towards social transformation, forming part of the ‘election platform of

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<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> A Padayachee & A Desai ‘Post- Apartheid South Africa and the Crisis of Expectation’ available at <https://www.rozenbergquarterly.co.za> accessed on 20 August 2019

<sup>22</sup> A Padayachee & A Desai op cit (note 21)

<sup>23</sup> A Janse van Rensburg ‘The Constitutional Framework for Broad Based Black Economic Empowerment’ (Law doctorate, University of Free State, 2010)

<sup>24</sup> Moodley (note 9)

<sup>25</sup> Currie & De Waal *Bill of Rights Handbook* 6 ed (2013)

the ANC in the 1994 election'.<sup>26</sup> The primary objective of this programme was to alleviate poverty and address the numerous shortfalls in social services throughout South Africa. The White Paper on RDP provides that the programme sought to:

[M]obilize 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 becomes a fully democratic, non-racial and non-sexist society, creating a sustainable and environmentally friendly growth and development path.<sup>27</sup>

The policy developed five major policy programmes to assist South Africa's progress economically and socially, referred to as 'meeting the basics need of people, developing our human resources, building the economy, democratizing the state and society, and implementing the RDP'.<sup>28</sup>

The government was committed to developing a programme that would 'address the needs of the people without compromising the interest of future generations'.<sup>29</sup> It proposed that 'addressing inequalities would open markets at home and abroad and create opportunities to promote representative ownership of the economy'.<sup>30</sup> In this way, the government tackled the primary issues of poverty and deprivation. However, the government realized that 'RDP targets over a period of years would be impossible to achieve due to the financial circumstances'<sup>31</sup>; it, therefore, replaced the programme in 1996 with the Growth, Employment and Redistribution (GEAR) policy. With the introduction of GEAR, the government planned to increase the economic growth rate in the economy by 'refraining from economic intervention and concentrating on the necessary adjustments that would create an optimal climate for private investments'.<sup>32</sup> GEAR was introduced 'when the South African currency was weak and there

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<sup>26</sup> 'South Africa's key economic policies changes' available at <https://www.sahistory.org.za> accessed on 22 August 2019.

<sup>27</sup> 'White Paper on The Reconstruction and Development Programme' (GN 1954 in GG 16085 of 23 November 1994).

<sup>28</sup> P O'Malley, 'The Reconstruction and Development Programme' available at <https://www.omalley.nelsonmandela.org> accessed on 20 August 2019.

<sup>29</sup> A Padayachee & A Desai (note 21).

<sup>30</sup> 'RDP White Paper 1994 supra (note 27).

<sup>31</sup> L Peterson 'Post-Apartheid Southern Africa: Economic challenges and policies for the future' available at <https://www.sahistory.org.za>, accessed on 19 August 2019.

<sup>32</sup> W Visser *Shifting RDP into Gear: The ANC Government Dilemma in Providing an Equitable System of Social Security for the "New" South Africa* (unpublished LLM thesis, University of Stellenbosch, 2004)

was a lack of confidence in the country'<sup>33</sup> from local and international investors. Therefore, the GEAR strategy was regarded as a macro-economic stabilization programme, as it promoted 'market- and investor-friendly policies'<sup>34</sup> in which investors were assured that South Africa was in complete control of its economy. The main focus of GEAR entailed the accumulation of capital; therefore GEAR developed a plan that reflected an

'integrated economic strategy that would allow South Africa to successfully confront the related challenges of meeting basic needs, developing human resources and increasing participation in the democratic institutions of civil society'.<sup>35</sup>

The key elements of GEAR were the fiscal policy, monetary and exchange rate policy, trade, industrial and small enterprise policies, privatization, export-orientated growth, tax reduction, and low inflation.<sup>36</sup> These policies served as tools for economic expansion as a path to 'job creation and wider economic empowerment for the previously disadvantaged population'.<sup>37</sup> Despite the aims of the policy, GEAR failed to achieve 'increased socio-economic equality, job creation and economic growth'<sup>38</sup> and it was blamed for South Africa's low economic growth rate. Thus, in 2005 GEAR was replaced by the Accelerated and Shared Growth Initiative for South Africa (ASGISA).

ASGISA aimed to reduce poverty and halve unemployment. However, due to the uncertainty around the feasibility of the policy, it was replaced by the New Growth Path (NGP). The NGP aimed (unsuccessfully) to combat poverty, unemployment, and inequality. Hence the government introduced the National Development Plan (NDP), which serves as South Africa's 'long-term socio-economic development roadmap'.<sup>39</sup> This policy is regarded as the blueprint for eliminating poverty and attaining equality in South Africa by the year 2030. Despite all these policies and projects, it is clear that South Africa's struggle with poverty, equality, unemployment and economic growth persists.

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<sup>33</sup> Moodley supra (note 9).

<sup>34</sup> Moodley supra (note 9).

<sup>35</sup> 'GEAR: A macroeconomic strategy', 1996:1 available at <https://www.treasury.gov.za> accessed on 21 August 2019.

<sup>36</sup> Moodley supra (note 9).

<sup>37</sup> Ibid.

<sup>38</sup> SY Moyo *The impact of Broad-Based Black Economic Empowerment (BBBEE) on small enterprises* (Masters dissertation in Business Administration, North West University, 2009).

<sup>39</sup> Moyo (note 38).

## **2.2 The meaning of Black Economic Empowerment in the context of South Africa's economy**

After the transition from apartheid, the government evaluated the possibility of creating greater political equality;<sup>40</sup> however, it was not enough to 'unwind the inherited social and economic inequalities'.<sup>41</sup> Therefore, in an attempt to deal with the legacy of apartheid, direct intervention in the redistribution of assets and opportunities was deemed desirable,<sup>42</sup> and the main factor of this intervention became Black Economic Empowerment (BEE), introduced by the BEE Act 53 of 2003.

The BEE Commission had defined BEE as:

An integrated and coherent socio-economic process.

It is located within the context of the country's national transformation programme, namely the RDP (Reconstruction and Development Programme).

It is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa's financial and economic resources to the majority of the citizens.

It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity.<sup>43</sup>

## **2.3 BEE**

BEE had its origins when South Africa elected its first democratic government, accompanied by the institution of the Black Business Council that primarily aimed at 'shaping the economic policies'.<sup>44</sup> BEE served as an attempt to eradicate the inequalities of the past by providing policies that aimed at making more efficient means for black individuals to 'gain access to capital for business development',<sup>45</sup> as white business domination resulted in black individuals and black women, in particular, being excluded from the economic activity of the state. The

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<sup>40</sup> D Acemoglu, S Gelb & J A. Robinson *Black Economic Empowerment and Economic Performance in South Africa* (2007) (see p5 supra).

<sup>41</sup> Moodley (note 9).

<sup>42</sup> Ibid.

<sup>43</sup> BEE Commission Report, (2001) 2.

<sup>44</sup> S Y Moyo op cit (note 38)

<sup>45</sup> Moyo op cit (note 38).

Constitution<sup>46</sup> provides that every individual has the right to equality and the ‘element of equality is fulfilled by creating a basis for equal treatment’.<sup>47</sup>

The programme aimed at providing all people with economic privileges that were otherwise not available to black individuals. Therefore, the purpose of the act was to ‘establish a legislative framework for the promotion of black economic empowerment; to empower the Minister to issue codes of good practice and to publish transformation charters; to establish the Black Economic Empowerment Advisory Council; and to provide for matters connected therewith’,<sup>48</sup> in an attempt to provide the people of South Africa with an opportunity of enjoying the right to equality.

BEE emerged in three waves. The introductory wave focused on the ‘black elite’ (politically well-connected individuals and entrepreneurs who were prepared to seize every economic opportunity at their disposal).<sup>49</sup> However, the first wave encountered the problem of the black individuals’ lacking sufficient start-up capital. To combat this issue, the Special Purpose Vehicle (SPV) was formed to assist aspiring black entrepreneurs financially. Despite the SPV intervention, it failed to achieve positive results. Poor risk management and a misunderstanding of the risks of SPV usage caused a number of failures,<sup>50</sup> including failure to disclose massive losses, overstating earnings and embroidering of reports.<sup>51</sup>

The second wave of BEE targeted the emergence of black professionals in 1997, focusing on employment equity, skills development and preferential procurement. A dominant role was played by the mining industry as it broadened the aspects of BEE. Black individuals were granted the opportunity of being involved in the decision-making processes. Although this phase generated success, an improvement was required and sought by employing a third wave of BEE.

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<sup>46</sup> 1996 Constitution (note 10).

<sup>47</sup> A Van Steiger ‘Why does South Africa need BEE’ 2018 available at <https://www.nortonrosefulbright.com>, accessed on 28 August 2019.

<sup>48</sup> HM Knoetze *An analysis of the codes of good practice issued in terms of the Broad Based Black Economic Empowerment Act 53 of 2003* (LLM dissertation, University of Free State, 2006)

<sup>49</sup> S Ponte, et al. *To Bee or not to Bee? South Africa’s ‘Black Economic Empowerment’ (Bee), Corporate Governance and The State In The South*. DIIS Working Paper no 2006/27

<sup>50</sup> PwC ‘The next chapter: Creating an understanding of Special Purpose Vehicles’ (2011) *Financial Regulation* (available at <https://www.pwc.com> accessed on 14 September 2020).

<sup>51</sup> Knoetze (note 48).

The implementation of the third wave of BEE saw the flourishing of the economy together with the introduction of the preferential procurement strategy, which worked as a ‘driving force behind the spread of BEE’.<sup>52</sup> It identified preferential procurement, skills development, and enterprise development as the main elements that contributed to the growth of the economy.

With race being the dominant factor, the programme made way for various other measures such as socio-economic development, ownership, skills development, preferential procurement, management and employment preference. Therefore, the government enacted various pieces of legislation to avail economic opportunities to all South Africans. The legislation included the Employment Equity Act 55 of 1998, the Skills Development Act 97 of 1998, the Competition Act 89 of 1998, the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000, the Restitution of Land Rights Act 22 of 1994, the Extension of Security of Tenure Act 62 of 1997 and the National Empowerment Fund Act 105 of 1998. Despite the proliferation of BEE-initiative legislation, the two important acts that promoted the rationale of promoting democracy were the Employment Equity Act and the Skills Development Act.

#### **2.4 Broad-Based Black Economic Empowerment (BBBEE)**

The failure of BEE to accomplish the intended objectives of growth and equality led to the establishment of BBBEE – the economic empowerment of black people inclusive of women, workers, youth, people with disabilities, and people living in rural areas through equal but integrated socio-economic strategies that included, but were not limited to increasing:

- The number of black people who controlled, managed, and owned enterprises and productive assets;
- Facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;
- human resource and skills development;
- achieving equitable representation in all occupational categories and levels in the workforce;

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<sup>52</sup> P Govender *A Critical Appraisal of the Misapplications of Black Economic Empowerment and the Common Misconceptions that surround it* (Legal dissertation, College of Law and Management Studies, UKZN, 2015) supra (note 14)

- Preferential procurement and investment in enterprises that are owned or managed by black people.<sup>53</sup>

The Broad-Based Black Economic Empowerment Act<sup>54</sup> came into effect on 21 April 2004. Its main objective was to ‘transform South Africa’s economy to enable meaningful participation by black people, thereby changing the racial profile of companies’ owners, managers, and skilled professionals’.<sup>55</sup> Broad-based Black Economic Empowerment was a government policy explicitly aimed at redressing the economic imbalances of the past.

The inclusion of ‘Broad Based’ to BEE illustrates that the purpose of the programme is to benefit previously disadvantaged groups and not the selective group that had become the wealthy section of the black population. Whilst BBBEE is intended to benefit everyone, it provides preferential treatment to black, Indian and coloured citizens as having been excluded from the economic system of the past. Hence, specific emphasis is placed on black women, black youth, black employees, black individuals with disabilities, and black people living in rural areas.

The BEE Commission report (above) and the ‘BEE Strategy document culminated in the promulgation of the BBBEE Act in 2003’.<sup>56</sup> It is central to the South African government’s economic empowerment strategy.<sup>57</sup> The Act has three main 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>58</sup>

The Minister of Trade and Industry is authorized by section 9 of the Act<sup>59</sup> to issue codes of good practice. These codes provide details and specific methods for the implementation of the BEE programmes.<sup>60</sup> The codes operate through a scorecard, which allows enterprises to set targets and measure their BEE status. The objective of the codes is to ‘provide guidance and assistance

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<sup>53</sup> BBBEE Act (note 4).

<sup>54</sup> Ibid.

<sup>55</sup> HM Knoetze supra (note 48)

<sup>56</sup> Moodley supra (note 9)

<sup>57</sup> Ibid note 3

<sup>58</sup> Ibid note 3

<sup>59</sup> Ibid (note 3).

<sup>60</sup> Moodley (note 9).

to public and private corporations in their interpretation and implementation of the BBBEE Act,<sup>61</sup> together with facilitation and acceleration of the Act. The codes are of paramount importance as they must be taken into consideration by public entities when determining qualification criteria for ‘the issuing of licenses, concessions or other legal authorizations when developing and implementing preferential procurement policies, when determining qualification criteria for the sale of state-owned enterprises, and when entering into public-private partnerships’.<sup>62</sup>

#### ***2.4.1 The Seven Pillars of BBBEE***

A BBBEE scorecard used by the business sector measures the company’s contribution to economic growth. The scorecard is a ‘measurement tool of corporate compliance’ with BBBEE requirements. There are three main components to BBBEE, which are further divided into sub-components and referred to as the seven pillars of BEE. The three main components are direct empowerment, indirect empowerment and human resource development. Direct empowerment comprises the following pillars: equity ownership and management control; while indirect empowerment focuses on preferential procurement, enterprise development and social responsibility programmes. Human resource development entails skills development and employment equity.

##### *1. Employment equity*

This element is linked to jobs in businesses at all levels, inclusive of professional operations, executive, senior and middle management. This pillar deals with the representation of black employees in various job categories of a business. Employment equity and management control overlap to a certain extent and the main focus is to align the demographics of the business with the demographics of the country.

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<sup>61</sup> DN Ndou *Analysis of the implementation of Black Economic Empowerment: the case of TranUnion ITC* (Dissertation in Masters in Business Administration, UKZN, 2006).

<sup>62</sup> Ponte et al (note 49).

## *2. Skills development*

This pillar's focal point is the promotion of the leadership and development of black individuals, comprising of strategies, plans, and training programmes to assist black employees in developing their skills, which, in turn, facilitates their corporate advancement.

## *3. Equity ownership*

Equity ownership refers to company ownership, which is measured by the economic interest and voting rights in the company. Points are awarded to an organization based on the measured percentage of black ownership.

## *4. Management controls*

This element deals with the management of activities and resources of a company, applicable to the board of directors and top management. It entails the percentage of executive members who have decision-making power, including the formulation and implementation of various plans and strategies.

## *5. Social responsibility programmes*

This component deals with the Corporate Social Investment that businesses undertake in assisting charity organizations, non-profit organizations, and schools in the black community, leading to the upliftment and development of these communities.

## *6. Preferential procurement*

This pillar is based on the 'amount an organization spends on BEE supplies as the percentage of the total procurement'<sup>63</sup>, as the business receives points in accordance with the percentage procured from BEE suppliers.

## *7. Enterprise development*

This element looks at the amount of support and assistance given to small and medium enterprises (SMEs)<sup>64</sup> and it may take the form of financial management training, extended

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<sup>63</sup> S Mathiba 'Tell me something good: The impact of BBBEE on Corporate Governance in South Africa', available at <https://www.blackdiamondsmag.co.za>, accessed on 15 September 2019.

<sup>64</sup> BBBEE Act (note 4).

payment terms, or technical training. Incentives are granted for such assistance and support of black-owned companies.

## **2.5 Conclusion**

BBBEE is not merely imperative to redress the practices of the apartheid regime; it is also a pragmatic growth strategy used to attain South Africa's full potential by providing the black population with equal participation in the economic mainstream of the country and equal opportunities to all South African citizens. BBBEE has impacted greatly on its beneficiaries, especially in the 'promotion of small and medium-sized enterprises which is a key element in the government's strategy of addressing the imbalances of the past and to create employment and income generation'.<sup>65</sup> Therefore, the chapter to follow will discuss the impact of BBBEE on SMEs.

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<sup>65</sup> Moodley (note 9).

## CHAPTER 3

### The impact and effect of BBBEE

#### 3.1. Overview

After the election of 1994, the Government of National unity placed great emphasis on issues underlining economic growth and empowerment on the ‘agenda of in South Africa’.<sup>66</sup> In the face of high unemployment and underemployment, the government embarked upon a strategic route to generate sustainable economic growth and sustainability.

Unemployment in the country is much higher than it was at the end of the apartheid era, ‘as almost one-third of the labor force is out of work or they are discouraged’.<sup>67</sup> The current employment rate is 42.14 percent<sup>68</sup>, with approximately 10 231 000<sup>69</sup> people employed in the country. According to the World Bank, South Africa’s education system has left the young population unemployed, as they are not ‘equipped for a labor market that demands more skills’.<sup>70</sup>

The government promotes BBBEE in several ways; besides the enforcement of legislative measures, much emphasis is placed on the compatibility of a business to the principles of BBBEE when granting licenses, the awarding of state contracts, and financial and other assistance to businesses. Businesses must understand the concept of BBBEE and its impacts on businesses.

The BBBEE Act targets companies to be the drivers in the elimination of the past inequalities and seeks to force companies to establish BBBEE strategies. Should a company fall under the scope of the Act and fail to promptly comply with the prescribed black economic empowerment scorecard it will receive a poor BBBEE rating which will have a negative effect on its ability to do business in South Africa. ‘BBBEE is structured to ensure that it will have a “knock-on” effect

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<sup>66</sup> D van der Nest *The impact of Black Economic Empowerment on the management of small companies in South Africa* (Magister Commercii, Rand Afrikaans University, 2004).

<sup>67</sup> South Africa unemployment is worse now than at the end of apartheid, available at <https://www.businesstech.co.za>, accessed on 21 August 2020.

<sup>68</sup> <https://tradingeconomics.com/south-africa/employment-rate> accessed on 21 August 2020.

<sup>69</sup> <http://www.Statssa.gov.za> accessed on 22 August 2020.

<sup>70</sup> BBBEE Act (note 4).

throughout the business.<sup>71</sup> As the state and various companies conduct business with BBBEE compliant companies, a company will ‘lose out in competition if their company has a weak BBBEE rating’.<sup>72</sup> Hence, a BBBEE strategy must be one that will produce an ‘optimal rating, which will translate into better contracting opportunities’.<sup>73</sup>

A good BBBEE strategy encompasses an increase of black participation in all levels of the company, together with an increase in social capital in the form of black empowerment groups with new market opportunities and a favorable reputation within the black majority. Since the establishment of the BBBEE Act, there has been an increase in the number of black people who own and manage companies, providing a platform for black individuals to be heard encouraging companies to provide in-house training for their less-skilled employees. Hence, the company creates an opportunity of enhancing the ‘available skills within the company, whilst still complying with the Act’.<sup>74</sup>

### **3.2 Small and medium-sized enterprises (SMEs)**

SMEs play a vital role in the development of the economy, as they create more employment than big businesses; therefore, they are regarded as the driving force of economic growth. A BBBEE scorecard has an impact on SMEs, as they are dependent on contracts from large organizations for development and growth. The Black Economic Empowerment survey defined SMEs as organizations with an annual turnover of less than R35 million, which were not multinational, parastatal or Johannesburg Stock Exchange (JSE) listed companies.

However, banking institutions classify SMEs as enterprises with a turnover of less than R100 million. The National Small Business Act of 1996 provided a comprehensive definition of SMEs based on operations in the various sectors and sub-sectors in South Africa. In the past, there have been four main categories of such enterprises in South Africa as distinguished by turnover, employment and assets. These categories were micro-enterprises, very small enterprises, small enterprises and medium enterprises, however, due to a change in the law; very small enterprises no longer exist.

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<sup>71</sup> S Mathiba. ‘Tell me something good: The impact of BBBEE on Corporate Governance in South Africa’ available at <https://www.blackdiamondsmag.co.za>, accessed on 15 September 2019

<sup>72</sup> Mathiba supra (note 71).

<sup>73</sup> Ibid.

<sup>74</sup> BBBEE Act (note 4).

- a) Micro Enterprises: Also known as a micro-business. This category has a maximum of 10 employees. Its startup capital is a fairly small amount financed by microcredit. This type of business improves the quality of life for people as it provides goods and services to communities.
- b) Small Enterprises: Must have between 10 to 50 employees; these enterprises are more established in the business field with more complex business practices with a maximum turnover limit of R32 million.
- c) Medium Enterprises: Employ no more than 250 employees, with a maximum annual turnover of R64 million. This type of business has a complex structure and is managed by the owner with a few employees in managerial positions.

SMEs are regarded as the driving force that promotes economic growth and job creation in South Africa. The ‘Department of Trade and Industry (DTI) estimates that small and medium-sized businesses employ almost half of formally employed persons, and contribute between 52% to 57% of the country’s gross domestic product’.<sup>75</sup> As part of the DTI’s growth strategy focus is placed on ‘broadening participation, equity and access to redress for all economic citizens’,<sup>76</sup> particularly in the previously marginalized group. Therefore, SMEs are obliged to adhere to the BBBEE Act and be BBBEE compliant.

### **3.3 The impact and effect of BBBEE on enterprises**

#### ***3.3.1 The impact of BBBEE on SMEs***

An enterprise with annual total revenue of between R5 million and R35 million qualifies as a small enterprise – a collective of small and medium enterprises. A qualifying small enterprise is required to ‘select four of the seven elements for the purposes of measurement for BBBEE compliance under the qualifying small enterprise scorecard’.<sup>77</sup> However, should a qualifying small enterprise fail to select elements to determine its BBBEE measurement, four elements that produce the best scores will be used to determine the enterprise’s measurement.

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<sup>75</sup> H M Van Wyk *The impact on small and medium sized businesses in the Sedibeng region*, (Masters dissertation in Business Administration, North-West University, 2010)

<sup>76</sup> L P Krüger ‘The impact of black economic empowerment (BEE) on South African businesses: Focusing on ten dimensions of business performance’, (2011) 15(3) *South African Business Review* 207-233

<sup>77</sup> Moodley (note 9)

Compliance with BBBEE is regarded as a new obstacle for SMEs. Most of the hurdles are caused by the fact that every business is required to demonstrate their ‘empowerment credentials in relation to ownership, governance, human resource development, management and procurement’.<sup>78</sup> The DTI emphasizes the importance of companies complying with the legislative measures as a record of how the BBBEE scorecard contributes to social justice in South Africa. Whilst the BBBEE scorecard is a reality that all businesses have to face, SMEs feel weighed down and overwhelmed by the requirements with which they have to comply, and which are costly to implement. The cost outlay, however, does not provide businesses with great benefits and opportunities, producing mediocre results. Enterprises that comply with BBBEE practices are obliged to ‘obtain a BBBEE certificate that stands as proof of their BBBEE credentials, allowing them to apply for tender opportunities in the public sector of the SA economy’.<sup>79</sup>

A firm’s BBBEE compliance strategy emanates from the relationship between ‘a firm’s boundary choices and the BBBEE pressures it faces from its clients’.<sup>80</sup> Black ownership and management are not in itself sufficient to earn high BBBEE scores as suppliers earn points based on their skills development and procurement decisions, which implies an expectation on firms to alter their ‘value chain activities and choices’<sup>81</sup> to accommodate the BBBEE requirements of their suppliers. Businesses seek objectives within their strategic environment which results in the BBBEE policy altering the value chain preferences of their clients. Businesses are motivated to alter their boundaries based on clients’ preferences, which provides enterprises with a competitive advantage.

BBBEE is regarded as a competitive tool for businesses in South Africa, as its scorecard is vital in determining the tendering process for business from the government sector. Therefore, being BBBEE compliant provides businesses with a strategic tool to source business and remain in

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<sup>78</sup> Moodley supra (note 9).

<sup>79</sup> A Pike, J Puchert & WT Chinyamurindi, 2018, ‘Analysing the future of Broad-Based Black Economic Empowerment through the lens of small and medium enterprises’, (2018) 18(1), *Acta Commercii* available at <https://actacomercii.co.za>.

<sup>80</sup> K Mzilikazi ‘The impact of Broad Based Black Economic Empowerment compliance on profitability of companies listed in the Johannesburg Stock Exchange: a cross industry analysis’ (A research report Faculty of Commerce, Law and Management, Master of Management in Finance and Investments University of Witwatersrand, 2016)

<sup>81</sup> Mathiba supra (note 71).

business in the process of attaining the advantages of BBBEE. Hence, the growth of the economy plays a key role as businesses must invest in development, increase their productivity and make profits.

A strategy has been implemented to increase the number of black individuals who own and control new and existing enterprises; together with the increase in the number of black people in executive and senior management positions while ‘ensuring increased income levels of black individuals within qualifying BBBEE companies’.<sup>82</sup> Although the SME sector has been identified as the savior of the South African economy, the sector remains frustrated and pressured by BBBEE’s requirements and scorecard ratings, concluding that ‘BBBEE results in economic strain and mixed economic outcomes and progression’.<sup>83</sup>

A secondary impact of BBBEE on SMEs is an increase in the number of incompetent companies coupled with tender corruption which emanates from BBBEE companies being awarded tenders although they do not meet the criteria. Tender corruption is a major impediment of the BEE policy, hence this results in the majority of South Africans remaining out of the mainstream economy. Tender corruption is an ongoing issue within industries where there is also much incompetence in conducting projects and uncontrolled spending of tender capital.

Many companies perceive BBBEE as having caused the economy to move in a skewed direction instead of adhering to the aims and objectives of the legislation and overcoming the injustices of the past. As a result, BBBEE is claimed to have failed to achieve its desired objectives of poverty alleviation, the creation of employment opportunities and international competitiveness.<sup>84</sup>

### ***3.3.2 The effect of BBBEE on female operated businesses***

There has been a large increase in the number of women who own and operate businesses in South Africa. According to a study carried out by the Global Entrepreneurship Monitor, a higher percentage of female ‘entrepreneurs operate in the informal sector’<sup>85</sup>; with a higher share of ownership enjoyed by black women as opposed to other racial groups. BBBEE has provided the

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<sup>82</sup> Mzilikazi supra (note 80)

<sup>83</sup> Ibid.

<sup>84</sup> Ibid.

<sup>85</sup> B N O Irene ‘The Macroeconomic Landscape of Post-Apartheid South Africa: A Critical, Review of the Effect of the Broad-Based Black Economic Empowerment (BBBEE) Program on the Success of Female SMEs Operators’ (2017) (7)1 *Journal of Educational and social Research* 145-150

female population, previously ill-treated and neglected, with an opportunity to grow and participate in the growth of the economy. The Constitution and the BBEE Act have succeeded in ensuring the empowerment of females as major players in the economy.

### ***3.3.3 Challenges faced by Black Economic Empowerment SMEs***

BEE SMEs face various challenges such as lack of market information, lack of managerial skills, bad governance, lack of access to finance, a heavy regulatory burden, low-quality products, competition from large companies, and legal and administrative hindrances. However, the above is not a closed list as the challenges are inclusive of cultural factors, government policies, access to appropriate technology and entrepreneurial capacity. As a result, SMEs struggle to survive as they struggle to attain short-term profits rather than the growth of the enterprise and its long-term competitive advantage.

#### *a) Access to finance*

BEE SMEs lack the finance required to start trading and grow. This is regarded as a constraint on business growth. The credit processes of financial institutions are complex arising from the lending institution being cautious due to the risk involved. SMEs also experience difficulty in understanding the procedures and processes pertaining to loan applications (Haron et al, 2013).

In developing countries, banks do not provide SMEs with sufficient capital, therefore most enterprises rely on internal finance from family, friends, and contributions from the owners which are often inadequate for the growth and survival of SMEs. As a result, SMEs are forced to seek external finance to reduce the cash-flow problems.

#### *b) Managerial Skills*

Managerial competencies are ‘sets of knowledge, skills, behaviors, and attitudes that contribute to personal effectiveness’,<sup>86</sup> important for the survival and growth of SMEs as they support the performance of the enterprise. Lack of managerial skills is the main cause of SME failures, as SME owners and managers have very limited knowledge and experience, and lack ‘basic understanding of financial and accounting information and have serious problems with financial

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<sup>86</sup> F Olawale and D Garwe ‘Obstacles to the growth of new SMEs in South Africa: A principal component analysis approach’ *African Journal of Business Management* (2009) 4(5), 729-738, available at <http://www.academicjournals.org/AJBM> accessed on 20 September 2019.

planning literacy'.<sup>87</sup> In South Africa 'lack of education and training has reduced management capacity in firms'<sup>88</sup> and this is the cause of the low level of entrepreneurial creation and the high failure rate of new SMEs.

*c) Regulatory factors*

The regulations that govern the establishment of businesses are often conflicting and intricate as SMEs fail to comply with the regulations that are generally time-consuming and expensive. Non-compliance flows from an inability to understand the laws that govern them. 'The cost of regulation may impact on the growth of new SMEs'<sup>89</sup>, as SMEs have to obtain registration licenses and pay taxes (Hashi, 2001). Many SMEs believe that they 'do not get enough support from the government'.<sup>90</sup> However, they are not aware of the efforts carried out by the government to provide them with the necessary assistance.

*d) Technology*

It is of paramount importance that businesses invest in technology to enable them to keep up with the transition to information technology. SMEs face growth challenges in many developing countries due to the lack of technology and weakness in the business's technological capabilities. Despite the vast technological advancements conducted on a global spectrum, SMEs continue to be hindered by the lack of technological implementation. Without technology, businesses find it difficult to grow and compete in the markets. 'Technology plays a crucial role in the development of SMEs'<sup>91</sup> as it enables businesses to maximize their business opportunities. The use of technology also entails high cost as software and computer hardware 'need to be bought and installed',<sup>92</sup> all the more burdensome with the lack of necessary capital.

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<sup>87</sup> S Sitharam & M Hoque 'Factors affecting the performance of small and medium enterprises in KwaZulu-Natal, South Africa', *Problems and Perspectives in Management*,14(2) , 277-288, available at <https://www.researchgate.net>, accessed on 20 September 2019

<sup>88</sup> Olwale supra (note 86)

<sup>89</sup> Ibid.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

<sup>92</sup> Ibid.

#### *e) Competition*

Businesses are obliged to make strategic decisions to enhance business development in the face of a dynamic competitive ambience in which businesses are often forced to engage in a high risk to survive (Scarborough et al., 2009). Competitiveness is constant due to changing consumer needs and expectations and the various technological developments in the market. Although the competition amongst SMEs has always been rife, it has increased rapidly over the years, with SMEs having to develop competencies and skills to obtain a competitive advantage.

#### *f) Crime and corruption*

South African businesses are regarded as the ‘largest organized group suffering from crime and violence’<sup>93</sup>, as crime rates in South Africa are constantly increasing. The BBBEE Act<sup>94</sup> saw the introduction of the crime of fronting. A fronting practice includes a ‘transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives of this act’.<sup>95</sup> Some scholars argue that the reason for SME engagement in corruption, is often related to problems with regulatory compliance and bureaucracy.<sup>96</sup> In any event, corruption has a direct impact on a business's ability to grow and survive in the economy.

### **3.4 Conclusion**

An enterprise that falls under the scope of the BBBEE Act but fails to properly comply with the BBBEE scorecard, will receive a poor BBBEE rating, which will result in a negative impact on its ability to do business. SMEs in developing countries face many challenges; therefore, in an attempt to assist this sector, enterprises must realize their potential as an innovative and dynamic force, that must develop links in the business sector to ensure that the business becomes fully sustainable.

Despite the various challenges experienced by BBBEE enterprises, there are various advantages and disadvantages of BBBEE which will be discussed in the following chapter together with the issue of fronting.

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<sup>93</sup> Moodley (note 9).

<sup>94</sup> 46 of 2013

<sup>95</sup> Olawale (note 86).

<sup>96</sup> Ibid.

## CHAPTER 4

### The advantages and disadvantages of BBBEE

#### 4.1 Introduction

BBBEE policy is intended to redress the ‘socio-economic ills perpetrated by the former apartheid government’,<sup>97</sup> primarily to empower black South Africans who were excluded from the economic affairs of the country. According to the Department of Trade and Industry (DTI), BBBEE is a medium that promotes the development of human resources, skills development and provides equal employment opportunities to the black population. It is seen as a portal that enables economic transformation in a diverse spectrum through the reallocation of wealth in society and ensuring public participation of the inhabitants.

The South African Constitution ‘condemns all acts of gross economic disempowerment of non-white individuals during the apartheid era, and gives a leeway to the implementation’<sup>98</sup> of the policy, which is an essential and entrepreneurial strategy aimed at controlling and redistributing resources equally across all races. BBBEE is the primary source that drives the transformation of the economy. Therefore, businesses are obliged to comply with the BEE Act and ensure that they comply with the required scorecard. The scorecards measure the business's contribution to the economic growth of the country. Despite, being BBBEE compliant there are several advantages and disadvantages that businesses encounter, as discussed in this chapter.

The implementation of the BBBEE Act is a difficult process. Many businesses stand accused of contravening the law by deliberately misrepresenting facts concerning their compliance. One such misrepresentation is known as fronting.<sup>99</sup> Fronting is regarded as a loophole by which obligations set out in the BBBEE Act have been deliberately circumvented.

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<sup>97</sup> Pillay op cit (note 6).

<sup>98</sup> Ibid.

<sup>99</sup> ‘Fronting means a deliberate circumvention or attempted circumvention of the B-BBEE Act and the Codes. Fronting commonly involves reliance on data or claims of compliance based on misrepresentations of facts, whether made by the party claiming compliance or by any other person. Verification agencies, and /or procurement officers and relevant decision-makers may come across fronting indicators through their interactions with measured entities.’ ‘Fronting’ available at <http://www.thedti.gov.za>, accessed on 4 October 2019.

## **4.2 The advantages and disadvantages of BBBEE**

### ***4.2.1. The advantages of BBBEE***

Despite various challenges that businesses face, businesses can gain an advantageous edge from BBBEE. When businesses are rated by the BBBEE scorecard, they often receive good feedback reviews detailing their performance to national requirements and their vision for a sustainable strategy for the future, allowing them to envisage a clear plan for the future structure of their business. Upon receiving good ratings, businesses attain leverage, which enables them to negotiate and receive better discounts and to acquire materials at a cheaper rate as part of their preferential procurement process. Once businesses are rated, they ‘understand how to develop a strategy to increase’<sup>100</sup> their annual BBBEE rating. A BBBEE strategy is of paramount importance in a business and it should form part of the business's overall strategic plan. Businesses that are BBBEE compliant create new possibilities in the marketplace which broadens their business network.

When businesses focus on human resource development, enterprise development, and BBBEE, it creates a platform that demonstrates and highlights an enterprise's commitment towards educational, social, and economic developments in the community, thus creating job opportunities for society. In increasing and developing employees’ skills, businesses are perceived as enhancing fair and progressive employment practices, which acts as a competitive edge and demonstrates leadership in the industry. ‘BEE can also be a marketing tool’<sup>101</sup>. Businesses that are BBBEE compliant are regarded as being BEE empowered, gaining preferential business treatment.

### ***4.2.2 The disadvantages of BBBEE***

BBBEE attempts to eliminate the social and economic inequalities that black South Africans experience as a result of the apartheid regime. BBBEE was intended to eliminate such inequalities. However, businesses face various challenges and disadvantages as a result of BBBEE, the most crucial of which include the ownership structure and the cost of BBBEE.<sup>102</sup> The ‘disadvantages of BBBEE include an unfair emphasis on race in workers rather than

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<sup>100</sup> ‘Benefits of BBBEE’ available at <https://bempowered.net>, accessed on 10 October 2019

<sup>101</sup> Ibid.

<sup>102</sup> The top 10 challenges to BBBEE, available at <https://harrycurtisco.co.za> accessed on 15 September 2020.

qualifications and experience; and a shortage of essential skills due to the flight and unemployment of skilled workers, which result in a weakened economy'.<sup>103</sup>

Despite BEE contributing to the economic growth of approximately three percent annually, the South African Reserve Bank (SARB) has pronounced that it would take nearly 25 years to double this rate; however, it sets a target of seven percent per year for the efficient<sup>104</sup> functioning of the economy.

Although BBBEE policy accounts for equality in most genres of the economy, very few females occupy senior positions in industry, requiring measures to bridge this gap and promote and employ females in middle and senior positions.

Another disadvantage that businesses encounter is that compliance with the BBBEE Act and its codes of conduct places a costly and time-consuming administrative burden on businesses. Hence, many businesses regard BBBEE as a time-consuming and expensive process – serving as a disincentive. In addition, the implementation of BBBEE is often associated with persistent fraud, most evident in the procurement systems of municipalities in South Africa. Such fraud is also linked to corruption, which surfaces in the form of bribery, fraud, or dishonesty in the public sector. Therefore, public authorities encourage consultants and contractors to adopt an ethical decision-making strategy when selecting and executing contracts.<sup>105</sup> Corrupt practices are defined as a process of 'soliciting anything of value, receiving and offering gifts to officials in return for favours'.<sup>106</sup> There is evidence that corruption and fraud are two attributes that hinder governmental plans and procedures to redress social and economic inequalities and empower the disadvantaged population, serving as a disadvantage to the healthy functioning of BBBEE.

Critics of BBBEE argue that efforts should focus on bridging and developing the educational system of the country, 'freeing the labor market from excessive regulation, building international competitiveness and making the country more attractive to local and foreign investors'.<sup>107</sup>

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<sup>103</sup> 'What are the disadvantages of Black Economic Empowerment', available at <https://www.reference.com> accessed on 10 October 2019

<sup>104</sup> Ibid (note 102).

<sup>105</sup> Pillay op cit (note 6).

<sup>106</sup> Ibid.

<sup>107</sup> BEE Act (note 3).

Problems also ‘include active resistance by established businesses, insufficient financial resources, and fraud, including fronting by white businesses’.<sup>108</sup>

‘Fronting means a deliberate circumvention or attempted circumvention of the BBBEE Act and the Codes’.<sup>109</sup> It involves a reliance based on data or a company claiming to be BBBEE compliant based on a misrepresentation of facts. When businesses carry out fronting practices, they pretend to be more compliant with the BBBEE scorecards as opposed to their actual compliance; alternatively, they provide false information on their BBBEE compliance. According to the BBBEE commission fronting is contributing to the slow pace of economic transformation,<sup>110</sup> as it slows down the socio-economic result that BBBEE seeks to achieve. Fronting creates an artificial change as it leaves workers disempowered and disgruntled, as they do not participate in the bounty. ‘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>111</sup>

A good example of fronting surfaced in the case of *Viking Pony Africa Pumps (Pty) Ltd v Hydro-Tech Systems (Pty) Ltd and Another*,<sup>112</sup> in which the Constitutional Court considered the nature and the extent of the obligation of an organ of state ‘when it awarded a tender based on fraudulent information provided by *Viking Pony Africa Pumps (Pty) (Viking)* about their black shareholding’.<sup>113</sup> The applicant and the respondent had often competed for tenders to supply water and sewage treatment equipment to the City of Cape Town, the subject of the dispute. *Viking* was more successful in gaining the tenders due to its majority black shareholding of 70 percent; however, the benefits attained from this tender were passed down to its sister company which was a white-owned company. The City challenged the transaction as fraudulent.

‘The second respondent (Hydro-Tech Systems) argued that the shareholders were merely tokens and that the economic benefits did not flow back to the black individuals in question’.<sup>114</sup> The

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<sup>108</sup> Weaknesses in BEE Implementation available at <http://www.pholosong.co.za>, accessed on 10 October 2019

<sup>109</sup> ‘Fronting’ available at <http://www.thedti.gov.za> accessed on 10 October 2019

<sup>110</sup> ‘BEE fronting becoming more sophisticated, holding back transformation – commission’, available at <https://www.fin24.com/Economy/bee-front>, accessed on 10 October 2019

<sup>111</sup> Govender supra (note 14)

<sup>112</sup> (2010) ZACC 21

<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

company only acted as an opportunistic intermediary. The High Court and the Supreme Court of Appeal found in favour of the City, and *Viking* then appealed to the Constitutional Court, which held that the City of Cape Town was obliged to have investigated the fraudulent information that was provided by *Viking*, but failed to do so. This case was heard before the enactment of the BBBEE Amendment Act, whose ‘fronting indicators’ make it easier to recognize fronting practices.

Upon receiving a good BBBEE rating, companies are conferred with many benefits such as the ability to tender with large organizations, corporations, and the government and the ability to participate in preferential procurement. This progressively enhances the public image, attracting new clients and providing a competitive edge. BBBEE compliance is highly recommended as it is advantageous to a company, encouraging the obtaining of a BBBEE certificate. However, if a company fails to obtain the certificate the company may go to great lengths to obtain it, including engaging in dishonest means to obtain the ratings.

The practice of fronting is a loophole ‘by which the benefits conferred by the BBBEE Act have been conferred’.<sup>115</sup> Fronting is complex and multifarious and so difficult to curb. Therefore, in 2009 the DTI released a guideline to control fronting in South Africa. This guideline was followed by the Broad-Based Black Economic Empowerment Amendment Act 46 of 2013 which criminalized the practice of fronting. Enterprises are obliged to ensure that their practices and transactions do not represent fronting. ‘The BBBEE Amendment Act specifically prohibits fronting and if a company is found to be engaged in fronting, its scorecard may be disregarded and it could be listed in a database containing other window-dressers’.<sup>116</sup> Hence, the BBBEE Amendment Act<sup>117</sup> has identified ways in which fronting practices may occur.

According to the DTI, there are three types of fronting practices: window dressing, benefit diversion and opportunistic intermediaries.

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<sup>115</sup> A Sibanda ‘Weighing the cost of ‘BEE Fronting’ on best practices of corporate governance in South Africa’ 29(2) *Speculum Juris* 23-40 (2015)

<sup>116</sup> S Mathiba ‘Tell me something good: The impact of BBBEE on Corporate Governance in South Africa’, available at <https://www.blackdiamondsmag.co.za>, accessed on 15 September 2019.

<sup>117</sup> 46 of 2013.

- *Window-Dressing*

This practice includes instances in which black people are introduced or appointed by an enterprise based on tokenism and they may be discouraged from participating in the core activities of the business and discouraged ‘from substantially participating in the stated areas and/or levels of their participation’.<sup>118</sup>

- *Opportunistic intermediaries*

This practice involves enterprises contracting with each other to leverage the opportunistic intermediary’s BBBEE status, in circumstances where an agreement contains restrictions or limitations on the identity of the intermediary’s clients, suppliers, services providers, and customers and terms and conditions are not negotiated at arm’s length upon a fair and reasonable basis.

- *Benefit diversion*

Benefit diversion includes initiatives where economic benefits are received due to the BBBEE status of a business that is not provided to black people in the business in terms of the ratio that is specified in the legislation.

Fronting risk indicators play a vital role in determining the presence of a fronting practice. These risk indicators are of significance as they are utilized to prevent the circumvention of the BBBEE codes. There are eleven fronting risk indicators, summarised as follows:

- Black individuals at top-level management are not consistently involved in the strategic decision-making of a business;
- Black people are paid a significantly lower amount for carrying out similar roles as their non-black peers;
- Black individuals occupying positions as shareholders, executives, or managers are unaware or uncertain of their roles in the business due to no instructions being provided to them;

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<sup>118</sup> ‘Fronting’ available at <http://www.thedti.gov.za>, accessed on 10 October 2019.

- An enterprise that does not perform its core functions or relies on a third party to carry out its core functions;
- An enterprise that displays evidence of circumvention or attempted circumvention<sup>119</sup>;
- The enterprise fails to operate independently as it requires a third party, due to contractual obligation or a lack of technical or operational competence<sup>120</sup>;
- An enterprise purchases goods or services or obtains a loan that is not under a market-related rate from an entity or individual;
- An enterprise shares its ‘premises and infrastructure with a related person or with a shareholder with no BBBEE status or a third-party operating in the same industry where the cost of such premises and infrastructure is disproportionate to market-related costs’.<sup>121</sup>

In an attempt to prevent the practice of fronting, the DTI encourages verification agencies, public officials, and the public to report fronting and other misrepresentations to the DTI for investigation. Individuals may obtain a signed declaration from an entity or its clients which stipulates that the entity or client understands that if it is found to be carrying out a fronting practice then the entity may be reported to the DTI.

It is of paramount importance that the public understands the process of reporting fronting. If fronting is detected, the business must be notified of the conduct as it has a 14-day period to submit its representation. However, if the enterprise fails to provide a reasonable explanation, the DTI’s BBBEE unit or the fraud hotline must be notified in writing.<sup>122</sup> The DTI will consider and initiate an investigation based on the facts before it. If the DTI finds that the entity has engaged in any fronting practices the DTI may suspend or disregard the entity’s scorecard until the entity takes corrective action; alternatively, once the necessary processes are complete the DTI will keep a database of all companies that have committed fronting practices. Thereafter, the investigation committee may act on its discretion as it holds the power to grant remedial relief, to institute a restraint or hold a hearing.

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<sup>119</sup> See the definition of fronting (note 99 above)

<sup>120</sup> Ibid.

<sup>121</sup> Ibid.

<sup>122</sup> Ibid.

The process of reporting fronting encourages enterprises to ‘refrain from contravening the act to avoid destroying their corporate image’.<sup>123</sup> Due to investigations done by the investigation commission which allows for the involvement of the National Prosecuting Authority and the South African Police services, the process involved is much stricter as it is an attempt to prevent the illegal contravention of the Act.<sup>124</sup> As a result, these measures are more likely to combat and detect fronting or any such contravention listed in the Act.

Before the enactment of the BBBEE Amendment Act (2013), fronting was regarded as fraud under the common law. The current position is that if an enterprise is found guilty of carrying out fronting practices or conducting its business in contravention of the Act, the enterprise will be liable to a fine that does not exceed 10 percent of its annual turnover. The BBBEE Amendment Act also makes provision for imprisonment of up to 10 years or a fine. Such a person will be placed on the Register of Tender Defaulters by the National Treasury and ‘blacklisted and prohibited from entering into contracts with any organ of the state or public entity for 10 years’.<sup>125</sup> In the case of a fraudulent entity, the court may take action against the individual who has contravened the law. This individual could be a director, shareholder, or member of the enterprise.

Criminalizing fronting has forced individuals to appreciate the seriousness of this practice and serves to prevent them from undermining or acting contrary to the law. Therefore, the BBBEE Amendment Act specifically addresses the issues that prevent businesses from complying with BEE and makes provisions for adequate penalties.<sup>126</sup> The penalties under the BBBEE Amendment Act are severe and are likely to serve as an effective deterrent.

### **4.3 Conclusion**

The BEE policy has been implemented as an attempt to redress the socio-economic ills of the past and aims at empowering the previously disadvantaged population by promoting the development of skills development, human resources, and providing equal employment

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<sup>123</sup> Govender supra (note 14).

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

<sup>126</sup> Ibid.

opportunities for the previously disadvantaged population. However, there is still room for improvement.

Despite the advantages of BBBEE, there are equivalent disadvantages that hinder the success of the BBBEE policy and its growth. The central challenge faced by the BBBEE policy is the issue of fronting, intended to exploit the policy. As a result, the government has laid down strict penalties for businesses engaging in fronting practices.

Overall, the BBBEE policy, despite providing marginal improvement to the economy, continues to face hindrances. Therefore, the government needs to initiate and formulate new strategies that will assist and benefit the economy, businesses and improve the economic growth of the country.

## CHAPTER 5

### 5.1 Recommendations and Conclusion

Universally, economic empowerment is a topical issue, especially in countries that have been colonized. South Africa has been under the spotlight since the introduction of BEE culminating in the BBBEE framework. Its success or otherwise depends on whether companies comply with the policy or the law in general. As leading players in the development of the economy, companies and other entities play a leading role in assisting the government to reach its targets, particularly the alleviation of poverty and providing previously disadvantaged people with opportunities to enter into businesses or occupy positions previously reserved for white people.

The implementation of BBBEE has faced problems of fronting and other forms of misrepresentation which distort the policy's goal of redressing past inequalities and disadvantages. Businesses make unsubstantiated claims, involving black individuals being used as fronts without their knowledge, which results in an abuse of their status. As a result, progress towards economic growth is impeded. In an attempt to combat fronting, the government has enforced penalties contained in the BBBEE Amendment Act 46 of 2013.

However, the curbing of fronting has only been partially successful. Therefore, the government should provide mandatory guidelines and rules for businesses, including the requirement to include a full report to the government pertaining to the business of the employer together with an account of the various employees and the positions they hold in the company. This will guarantee that employees' positions are not abused. The government should also enforce stricter sanctions to discourage misrepresentation or fronting. These provisions should include:

- A business being deprived of benefits they receive from the government.
- If a tender is given to the business by the government and the business is found to be carrying out fronting practice, the tender will be immediately cancelled and it will be blacklisted.
- The business will be held accountable for a large monetary fine.

Twenty years since the fall of the apartheid regime and coming into place of a democratic government, the success of the BBBEE policy and programmes pertaining to the growth of the economy on an equitable basis is hardly visible. The government needs to actively monitor

companies to ensure that they implement BBBEE policy and programmes in compliance with the rules. Companies should be encouraged to properly implement these programmes, free of issues of window-dressing, benefit diversion and opportunistic intermediaries.

It is of paramount importance that the government reconsiders its transformation agenda and its adoption of the BBBEE policy. As shown above, the policy has failed to address the plight of females – illustrated by the paucity of successful female-operated enterprises in South Africa. Hence, policymakers are encouraged to incorporate the personal development and capacity building of female entrepreneurs in their processes.

In a country like South Africa where the rate of unemployment is very high, SMEs can play an important role in the development of the economy, as they are a platform through which many employment opportunities can be created. However, the implementation of the BBBEE policies has ‘not led to new opportunities, to an increase in turnover, new customers, innovative ideas by the new partner and does not help the business to acquire new contracts’.<sup>127</sup> As a result, many people perceive BBBEE as costly and time-consuming, as compliance with the Act and its codes of conduct place a great administrative burden on enterprises. SME owners and managers are encouraged to familiarise themselves with the requirements of BBBEE, particularly the codes of good conduct. Individuals are encouraged to formulate and enforce their strategies around BBBEE, considering that they have only to comply with four of the seven elements to be BBBEE compliant, providing enterprises a competitive edge.

Despite all the controversy, BBBEE has created a path for transformation as one of the strategies to drive economic growth in the country. Companies must implement BBBEE properly, in which event they will contribute to the alleviation of poverty and improve the lives of many individuals. The alleviation of poverty will relieve the state of the burden of providing welfare services to the poor as many more people will be able to build houses and provide for themselves and their families.

The scourge of poverty persists despite the various measures carried out by the government. Hence, the government should create institutional measures which ensure that poor individuals

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<sup>127</sup> SY Moyo ‘The impact of Broad-Based Black Economic Empowerment (BBBEE) on small enterprises’ supra (note 38)

and communities are provided with facilities in which children can be educated and adults can be taught skills that would allow them to attain employment. As a result, the rate of poverty and unemployment in the country would be reduced.

The future of South Africa requires the BBBEE policy as a primary measure to drive economic growth. However, growth will only be attained if the policy undergoes transformation. The transformation policy should encompass specific attention to the challenges and disadvantages set out in this study. In this event, the South African economy will achieve positive results together with the aims and objectives of the BBBEE policy.

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