DRAFT SUBMISSION TO THE DTI – REVISED BBBEE CODES OF GOOD PRACTICE 2012

1. INTRODUCTION

In making this submission, The JSE has liaised with the authorised users that participate in its various markets. In addition, the JSE has worked closely with ASISA in formulating the response set out below.

The JSE is supportive of the intent of the revised generic code which in our understanding is to better align the BEE process with National priorities such as job creation. We are particularly pleased with the principle of prioritising the skills development and enterprise development components, as these issues are key to the pressing need to create sustainable, inclusive and employment centric growth in the economy.

We also welcome the opportunity to comment on the revised code, and trust that the inputs contained in this document will be read in the spirit that they are intended, which is to contribute to the development of BEE legislation that is in the broader interests of South African Society.

The JSE is however very concerned that there are a number of areas where the suggested changes in the code, will lead to unintended consequences that are not in the interests of the BEE process as a whole. These changes are on the whole also not practical for business to implement, and also introduce many uncertainties as to application. Much of the comment in section 3 and 4 below is provided in support of these concerns.

The JSE also supports the principle of alignment with other policy and legislation such as the Employment Equity Act, Skills Development Act and the PPPFA. *The proposed mechanisms for alignment are however not clear in certain areas and potentially severely problematic as well as anti-competitive.*

2. GENERAL COMMENTS

A Second draft for public comment?

The JSE is of the view that there are numerous important areas where the revised draft codes do not contain sufficient detail to allow for the provision of appropriate comments. These uncertainties predominantly relate to how QSE's will be measured as well as how the various sub-categories of black people, will be measured under Management and Employment Equity, as well as skills development.

We therefore strongly recommend that dti publishes a second draft of the codes (under section 9(5), for public comment, possibly for a shorter period of 30 days, before publishing the final code under section 9(1).

Transitional Period

The JSE is of the view that the revised codes represent a significant departure from the current framework. *We therefore strongly recommend that dti allows reporting institutions at least 12 months after publishing of the final gazette to migrate from measurement under the old codes, to measurement under the new codes.*

Impact on sector codes

The JSE and its members are currently subject to the financial sector code (FSC).

We therefore strongly recommend that dti allows sector councils at least 12 months after publishing of the final generic code gazette to re-negotiate alignment of the FSC to the new generic code. Following this we will recommend to our sector council that a further 12 months is allowed to migrate from the old FSC, which is aligned to the current generic code, to the new FSC, which will be aligned to the new generic code.

Broad Based versus Narrow based Empowerment

Rather than to de-emphasize black ownership as has been suggested by dti and various other government policy initiatives, more than half the points available on the scorecard now relate to ownership. These include the 25 points allocated to direct ownership as well as the 28 points based on the new definitions of '*Qualifying Enterprise Development Contributions*' and '*Qualifying Local Supplier Development Beneficiaries*' that will now effectively force corporate suppliers of enterprise development support to only finance black owned businesses. This is a clear reversal towards a Narrow based approach towards BEE and is clearly not in alignment with the stated intent.

Contributor levels

Significantly more points are now required to achieve each of the contributor levels. This change will not serve the nation's transformation agenda. *We thus believe that there is no motivation for changing the points required to achieve each contributor level*, especially as the requirements to achieve the points under each of the pillars, have also increased significantly. The revised contributor levels will also create much confusion especially in the transition period.

Priority elements

In line with our comments above, as well as our comments on the ownership pillar below, the *JSE strongly recommends that Supplier and Enterprise development as well as skills development are maintained as priority elements, but that ownership is no longer treated as a priority element.*

In addition to the above, we recommend that the non achievement of sub-min requirements under Supplier and Enterprise development as well as skills development, result in zero points being scored under the various line items that are measured under those scorecards. We thus do not support the move to penalise companies by 2 contributor levels as a result of *companies not being able to meet thresholds on the various elements, as this is overly punitive for companies who chose to focus their empowerment efforts, in other areas.*

IMPACT ON QSE's and EME's

The JSE supports the increased turnover thresholds suggested for EME's and QSE's. There is however **too little detail** provided in relation to the minimum requirements for QSE's. The ownership element should also not be compulsory.

Increased complexity and unclear application

Over the past number of years, various rating agencies have engaged with dti, on issues of interpretation and drafting errors in the current generic code. It is our understanding that very few of these issues have been resolved in the revised generic code.

We strongly recommend that dti formally engages with both ABVA and IRBA to resolve the above issues, prior to the release of the new code. This step is imperative to ensure the consistent interpretation of the legislation, across the economy.

3. PILLAR COMMENTS

NET VALUE AS A PRIORITY ELEMENT

While the JSE supports the continued inclusion of ownership as a pillar, the proposed amendments do not serve to further incentivize broad based ownership. In addition the assignment of priority status to the net value component cannot be supported.

Research performed on behalf of the JSE has clearly shown that significant economic interest in South Africa's largest businesses has been transferred to black hands over the past number of years. The vast bulk of this economic interest has not come from BEE deals.

Real wealth transfer has occurred as a result of dramatically increased black economic interest through various mandated investment schemes. This economic interest is also completely free from debt. The research results therefore do not support the continued prioritization of any aspect of this element, as *narrow based black ownership effectively incentivizes the transfer of wealth from the black middle class, who represent the vast bulk of participants in mandated schemes, to black capital.* In addition there is the very real danger that the SA taxpayer will end up having to part subsidize this wealth transfer, as by far the largest investor on the JSE, is a state underwritten pension scheme.

Foreign investors currently own in excess of 1/3 of the share capital traded on the JSE. These investors require regulatory certainty. If South Africa creates an environment where local (BEE) ownership requirements are constantly changing, this serves as a disincentive for foreign investors. Should these portfolio investors chose to exit our market in favour of other emerging markets, this will dramatically affect the value of the underlying listed stocks, *thereby placing a significant portion of the wealth that has been transferred to black hands, at risk.*

Based on the above, the JSE strongly recommends that the ownership aspect of the current generic code is maintained as is, in the revised generic code.

<u>MANAGEMENT</u>

RACIAL DEMOGRAPHY

The current calculation in terms of racial demographic representation on Employment Equity and Skills Development is structured in such a way that an entity will lose points if all races are not represented in their employee profile.

Regionally it is not possible to have exactly the right profile of demographics represented in employees due to the provincial demographics of the labour pool available to employers. It is also severely disruptive to family structures, etc when employers recruit employees from other provinces. The JSE thus proposes that the detailed calculation of the demographic representation is re-visited.

Also, if the national demographic of Economically Active Populations (EAP) groups are to be used as per the Employment Equity Survey of the Department of Labour it needs to be noted that those figures include non-South Africans and individuals that became South Africans only after 1994. In other words individuals that would not qualify as black by virtue of the Codes' definition of 'black'. Their inclusion in the population group for EAP measurement is material and by some estimates they represent as many as 10 million people. This would dramatically skew the proportionate figures.

It is thus proposed that the formula proposed in the codes is deleted. As an alternative we recommend that recognition in the form of bonus points should be given on the scorecard for over achievement on the employment of African black people, measured against EAP levels in the province of the measured entities primary domicile. <u>Please note that this recommendation also applies to the skills development scorecard.</u>

EMPLOYMENT EQUITY TARGETS

Further to the above we have also noted that gender equality is not appropriately incentivized in the proposed new scorecard for middle management and disabled employees. We also noted that Junior Managers, who represent the pipeline of talent for middle and senior management positions, will no longer be measured for scorecard purposes.

We accordingly make the following proposals:

- Measure Black female middle management employees as a separate line with separate targets in the proposed management scorecard. (1 point for black people and 1 point for black women with half the target for black females);

- Apply the same principle for black disabled employees; AND

- Provide for 2 bonus points under the scorecard for employers that exceed EAP targets for junior management.

SKILLS DEVELOPMENT

SKILLS DEVOPMENT TARGET AND THE LEARNING PROGRAMME MATRIX

ASISA performed a reasonability analysis on the proposed skills development spend target of 6% in the revised codes. dti is requested to consider the following:

- Assume that an employer spends 67% of its payroll on black staff
- Assume further that 75% of training spend on black employees is compliant spend per the revised learning programs matrix
- Assume that training spend is split equitably between black and non black employees

The above assumptions imply that employers would therefore now need to spend a total of 12% of payroll on training. (6%/67%/75%). This target compares to international norms of approximately 3% of payroll which in some instances is stretched to 5%.

Accordingly the JSE wishes to submit that the revised skills development spend target is simply impractical for business to implement, especially in the current economic climate. *We thus wish to recommend that the target is increased marginally to 4% of payroll, and that category F and G training, is retained as an important component of skills development.*

The removal of Category F and G programmes completely disregards the impact and role of informal instruction and workplace-based learning and experience that allows an individual to advance and progress within their career. In addition employees in modern organizations need to learn at the pace at which customer needs and business environments change to remain competitive, and formalised certified programmes do not lend themselves to rapidly changing environments. On the job, peer learning and the use of multimedia, such as online learning programmes are an integral part of learning, and by there very nature lend themselves to rapid skills transfer at low cost.

LEARNERSHIPS, INTERNSHIPS AND INTERNSHIPS AND THE BONUS POINTS

The JSE is fully supportive of the principle of incentivizing the creation of learnerships and apprenticeships as part of the skills development scorecard. We are however unable to evaluate the practicalities of the recommendations in the revised codes due to an absence of clear guidance on numerous issues including the terms for absorption, precise definitions of unemployed and a number of other issues.

We thus reserve our comments on this element and strongly recommend that additional guidance is provided by dti through another round of public comment on how sections 2.1.2 and 2.1.3 will be measured.

ENTERPRISE AND SUPPLIER DEVELOPMENT

VALUE ADDED SUPPLIERS

Value Added Supplier status is defined as a pre-requisite to qualify as a BEE qualifying supplier on a measured entities broad based scorecard. (Definition = Total salary bill + Net Profit before Tax should be more than 25% of Revenue).

According to various rating agencies, in excess of 60% of all suppliers are not value added suppliers. This is not because these suppliers do not want to employ people, it is simply a function of the nature of the suppliers business – i.e. certain businesses are capital intensive, technology intensive etc. This implies that any effort by these entities to comply with the B-BBEE codes is fruitless as this one item disqualifies them as being counted as BEE suppliers. In other words even a level 1, 100% black owned business will not receive any beneficial treatment by the market if it is not classified as a value added supplier.

We strongly suggest therefore that this change is not carried through in the final code. The current incentivisation for procurement from value added suppliers (the 20% multiple) could instead be increased to further support job creation.

PROCUREMENT FROM BLACK OWNED AND BLACK WOMEN OWNED BUSINESSES

While the JSE acknowledges that there is a systemic shortage of black owned and black women owned suppliers in the market, we are also of the view that the proposed changes to the scorecard elements proposed will not solve this problem. *We according recommend that the increased weighting recommended under these subsections is maintained in the draft, without the proposed increase in targets.* An increased weighting does indeed serve as an additional incentive to business to address this systemic shortage, but a corresponding increase in what are already stretch targets in this area, will actually have the opposite effect.

THE BENEFIT FACTOR MATRIX

The JSE would like to recommend that all forms of grant contributions are treated equally. The current factor matrix affords 100% recognition to monetary grant contributions but in kind grant contributions in the form of human resource capacity, only receive 60%

recognition. We thus strongly suggest that "in kind" contributions also receive 100% recognition.

The JSE has also noted that the maximum points that can be claimed for early payment has now been capped at 15%. We have also noted a parallel development not contained in the revised draft, that it is intended that only early payment to EME's will count. We submit that both businesses that fall within the QSE and EME' categories, are subject to cash flow constraints. *We thus accordingly recommend that only early payment to QSE's and EME's count under this element.* We further recommend that should this recommendation be adopted, that the 15% cap for early payment, will no longer be necessary.

SOCIO ECONOMIC DEVELOPMENT

There are a number of potentially adverse implications for business and civil society within the draft Codes.

The key problems are discussed below.

At present there are over 85 000 organisations formally registered as non-profit organisations (NPOs) by the Non-Profit Directorate in the Department of Social Development (DSD). The vast majority of these organisations are community-based organisations (CBOs) that provide a range of critical welfare and social development functions – often in partnership with government to millions of poor and marginalised people. Most organisations provide essential support in poor and marginalised communities across the length and breadth of South Africa. They work in critical poverty alleviation and developmental areas such as health, home-based care; education, childcare, child-headed households, care for the aged, disability, etc.

A large number of these are not in the business of facilitating "income generating activities". They do however help to build social capital and facilitate social cohesion. Without the contributions of these organisations of civil society, government's developmental programmes would be very significantly compromised. These organisations depend substantially on the contributions of the business sector. According to the latest Trialogue research, the corporate sector is currently the largest funder to the sector, providing approximately R7 billion over the 2011/12 financial year.

We thus strongly suggest that dti reconsiders the notion that only support of income generating activities, will count for SED points. The corporate sector remains committed to funding NGO's (often in the form of long term programs). Unfortunately corporate budgets for charity are limited, especially in the current economic climate. The changes proposed thus create a situation where corporates are forced to re-channel funding over time. This will clearly threaten the sustainability of the NGO sector.

We also strongly suggest that dti reconsiders the requirement that only funding that 100% benefits black people counts under the SED scorecard, as this is simply impractical and expensive to prove and measure. It is however quite easy to prove that beneficiaries of SED programs on the whole, are 75% black.

4. CONCLUSION

Unfortunately the vast bulk of the mechanisms proposed by DTI in the revised draft are simply impractical for business to implement. There are also numerous areas where insufficient detail has been provided to facilitate appropriate comment. Perhaps more importantly, we believe that should the revised codes be implemented in its current form, they will serve to inhibit the pace of transformation across the economy, instead of stimulating it.

We thus strongly suggest that dti incorporates the views of business, civil society, labour and other stakeholder groups in a revised draft which should again be gazetted under section 9(5), to allow for further public comment.