

KNOWLEDGE IS POWER



THE DEFENCE SECTOR CODE



NPI Governance Consulting is a trusted B-BEE advisor to international investors as well as local and multinational organisations. The NPI Governance Consulting team consists of Israel Noko, Kelebogile Ntsimane, Thabo Somo, Thulisiwe Maguma, Tania Heyneke, Zaheera Khota and Mahali Molapo. Each provides B-BBEE advisory and consulting services with proven best practice in project management to secure the successful implementation of initiatives across all sectors. The NPI Team collectively has 70 years experience in the field of B-BBEE. NPI is a proud member of the UN Global Compact and is an advocate for sustainable economic growth and strategic transformation intelligence, with the premise of 'Pioneering Equitable Growth in Africa'. The King Corporate Governance Principles guide all implementation methodologies.

B-BBEE compliance has an impact on business and the economy as a whole. When it is sustainably and meaningfully implemented, it can provide organisations with healthy leverage in gaining and retaining business. However, for The Codes of Good Practice (The Codes), the measurement benchmark of B-BBEE, to be effective in their inclusive economic objective, it is imperative that organisations have an in-depth understanding of their expectations matched with a sustainable approach to drive their business. A chosen B-BBEE approach, be it a reactive or proactive one, will affect an organisation not only in financial terms, but in terms of their reputation and the overall benefits that a well developed and executed B-BBEE strategy can have.

The gazettement of a new or amended Code catapults both those operating in the B-BBEE arena and stakeholders affected by the gazette into a frenzy. As a gazette is published, the B-BBEE sector moves from Defcon 5 to Defcon 1. What's App messages go into overdrive, as those driving the B-BBEE sector come to terms with the expectations of a gazette. This frenzy stems from the Department of Trade and Industry (DTI) having mastered the art of publishing a gazette on a Friday afternoon.

Following a gazette, those operating in the B-BBEE arena in quick succession receive panicked calls: "What does this mean for us?"; "When does it become effective?"; or "How quickly can we implement the amendments of the gazette?". Slowly as the expectations and consequences of a published gazette filter through to organisations, those operating in the B-BBEE arena move from a high alert Defcon 1 down to Defcon 5. The process continues.

In this article, the NPI Governance Consulting Team will focus on the newly gazetted Defence Sector Code. This Code presents profound operational changes to encourage participation from 'Black' Designated Groups in the economy.

This article outlines the Defence Sector Code and will provide an overview of its origins, guiding structures and its ultimate expectations.

The Defence Sector Codes was gazetted on 18th November 2018 and immediately came into effect. Before the gazette, organisations operating within this sector were measured on the Generic Codes.

The core aim of this Sector Code is to secure effective participation of 'Black' People in the sector and the broader economy through promoting:

- > The participation of and growth of SMMEs;
- > The growth of technical innovation;
- > The growth of the sector as profitable and sustainable;
- > Local manufacturing capability for both the local and export market;
- > The acquisition, retention and transfer of critical, technical and scarce skills;
- > The protection of South Africa's Sovereign Capability in the sector;
- > Entrepreneurship, especially among 'Black' Designated Groups;
- > Entrepreneurship and new enterprises in the sector; and
- > Job creation.

The core aim of this Sector Code is to address the challenges hampering the growth and sustainability of the sector, which are identified as :

- > Declining local spending;
- > A declining economy;
- > The rising threat of socio-political instability as a result of economic exclusion and income inequality;
- > The exclusion of 'Black' Military Veterans from the economy;
- > The inability of businesses in the sector to meaningfully expand into the African continent;
- > Continued over-reliance on monopolies, oligopolies and foreign enterprises operating in the sector;
- > A lack of adequate protection and preferential access for local Defence manufacturers over the international competition; and
- > Regulatory constraints.

Scope of Application

The Defence Sector Code applies to all organisations who derive more than 50% of their annual turnover from operating in the sector. These include all national and provincial departments, organs-of-state, public and private enterprises providing Defence material and/or any other supplies, products or services to the Department of Defence and Military Veterans (DoD). This application extends to all DoD agencies irrespective of whether they procure from local or foreign organisations.

Compliance Reporting

All organisations falling into the ambit of this Sector Code must provide an annual report to the Charter Council. This submission is required within 12-months of the Gazette. The report must outline the progress of an organisation's transformation objectives and include an audited scorecard in line with SANAS requirements.

Threshold Eligibility

The financial thresholds for this Sector Code are broken down as follows:

Exempt Micro Enterprises (EMEs)	Less than R5m
Qualifying Small Enterprises (QSEs)	Between R5m and R50m
Generic Enterprises	More than R50m

Defence Sector Code Scorecard appears on page 36.

Unique features of the Defence Sector Code

The **Ownership** target is set at 35%, exceeding that of the Generic Codes. The implementation timeframe is over three years.

Localisation is a mechanism designed to increase the sector's global competitiveness and lay the path for sustainable growth. An annual target of 60% procurement of locally produced or manufactured products or services was set.

Foreign Enterprises are obliged to ensure that 75% of Defence Industrial Participation contracts are procured from local suppliers that are at least 25.1% 'Black'-owned and controlled. These contracts relate to the National Industrial Participation Programme introduced by the DTI.

A **Defence Industry Enterprise and Supplier Development Fund** will be established within one year of the Gazette. Except for EMEs, those in the ambit of this Sector Code must contribute 1% Net Profit After Tax (NPAT) to this fund to promote industry-specific Enterprise and Supplier Development initiatives, which include, however, are not limited to:

- > Funding 'Black'-owned organisations in the sector;
- > Initiatives that promote manufacturing;
- > Funding for innovative 'Black'-owned technology businesses that provide products and/or services relevant to the sector.
- > Promoting the development of intellectual property and exploitation thereof in collaboration with 'Black' People.
- > Promoting and funding the development, investment and transfer of sovereign and strategic capability to support 'Black'-owned organisations.
- > Supporting the growth of 'Black'-owned organisations to enable them to compete on an international scale to increase exports.

To promote the participation of 'Black' Military Veterans in the sector, the Management Control Scorecard encourages 30% representation. A 'Black' Military Veteran is defined as any 'Black' South African Citizen who:

- > Rendered military service to any Non-Statutory Military Organisations that engaged in South Africa's Liberation between 1960 and 1994;
- > Served in the Union Defence Force before 1961;
- > Became a member of the South African National Defence Force after 1994;
- > Completed his or her military training and no longer performs military service, and was not dishonourably discharged from the military organisation or force. The definition, however, does not exclude any person referred to above who could not complete his or her military training due to an injury sustained during military training, or a disease contracted or associated with military training.

A second notable aspect of the Defence Sector Code is the measured support for 'Black' Military Veterans, as virtually all elements of the scorecard, from board participation to dedicated Socio-Economic Development disbursements, include them.

This Sector Code places emphasis on developing, then supporting, local products and services across the value chain. By establishing a dedicated Enterprise and Supplier Development Fund with a commitment to Localisation, it is clear that this sector code intends to remove barriers to entry for small 'Black'-owned businesses in an industry that is both capital intensive and highly specialised. The value of Foreign Enterprises in the sector is paramount to its long-term sustainability and growth; this Sector Code encourages their participation in transforming the sector.

Source of Reference

Staatskoerant, Department of Trade and Industry (2018), Broad-Based Black Economic Empowerment Defence Sector Code of Good Practice in terms of Section 9

(1) of The Broad-Based Black Economic Empowerment Act 53 of 2003 as Amended by Act 46 of 2013. Available at: <https://www.thedti.gov.za/gazettes/42021.pdf>

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