

B-BBEE CONSIDERATIONS AFTER Lockdown



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Data derived from research over the last 11 global recessions indicate that, on average, it takes 18 months for the economy to begin its recovery. However, the root of this global recession, caused through a pandemic and the subsequent economic cycle, is something not seen before.

In previous recessions, the world has continued to trade through the 18-month recovery period, thus struggled through them, which gives theory to the timeline. However, the economic cycle of this recession reduced the global GDP. One has to bear in mind that this recession is due to an event rather than underlying economic issues. Therefore, the recovery timeline for this global pandemic and the long-term impact thereof is difficult to predict. Nevertheless, there is hope for a rapid recovery as per a recent statement made by Jason Hamilton, a Director of First River Capital: "What we can, however, focus on is that it is an event-driven recession; hence the recovery and comeback should be quick, the question is just when"¹.

The roll-out of events that happened to trigger the National Disaster Act came about in quick succession with little notice. As organisations assess the collateral damage of our national lockdown, they will have to contemplate whether their B-BBEE Strategy and targets set before the lockdown still apply or whether they need to reassess them.

The risk of organisations not considering the impact of the lockdown on their B-BBEE Strategy or targets may well lead to a breach in contractual obligations, whereby penalties may become applicable or, worse still, the termination of contracts. Without any consideration, unforeseen Fronting Practices may emerge which, left undetected, could result in damage to an organisation's reputation. In a nutshell, the actual risk to an organisation depends on the steps they chose or chose not to take in reassessing their B-BBEE Strategy and targets².

This article will unpack areas to assess per element, whereby organisations can measure their B-BBEE Strategy and targets against the collateral damage brought about by these recent unprecedented times.

Generic Considerations

Organisations must reassess on which threshold they qualify to be measured. The reality is that a loss of annual turnover could see a Large Enterprise qualifying as a Qualifying Small Enterprise (QSE) or a QSE qualifying as an Exempt Micro Enterprise (EME). If this is the case, there would be a knock-on impact. The areas listed below are non-exhaustive.

- > The targets – for example, a Large Enterprise moving to a QSE means that the number of Priority Elements shifts from three to two before the Discounting Principle triggers.
- > Organisations may qualify for Enhanced Recognition.
- > The method of providing their B-BBEE Credentials might change from a SANAS accredited B-BBEE Certificate to an Affidavit.
- > Such a change in an organisation's financial threshold may qualify an organisation as a Supplier Development or Enterprise Development Beneficiary, with the accompanying benefits of assistance in the appropriate financial year.

Ownership Considerations

Today, due to such unprecedented times, there is no way an organisation can accurately forecast its value. The Net Value calculation on the Ownership scorecard links directly to an organisation's share price. A slump in an organisation's share price will most likely have a dire impact on the Ownership Scorecard, especially since it may lead to an organisation not making the sub-minimum 40% requirement.

Net Value Calculation

The Net Value calculation takes into account the value of B-BBEE Shareholders' equity and the acquisition debt, which is the amount incurred by the shareholders to acquire the equity. Generally, the Net Value calculation evaluates the decrease of the acquisition debt over ten years in sufficient proportions. Hence year-on-year the debt amount lowers, which translates into points on an Ownership Scorecard. However, suppose the lockdown has an impact on an organisation's share price. In that case, there will be a decrease in the portion of the acquisition of debt, which will affect an organisation's Ownership Scorecard. What are the unforeseen consequences of this happening?

- > The debt amount of 'Black' Shareholders, if payable through dividends, will not decrease, so there will be a shortfall in the repayment of such debt.
- > Contractual terms and conditions more often than not include a penalty or cancellation clause for such an occurrence; hence 'Black' Shareholders are at risk of being in breach of contract.

Net Value is calculated at the date of an organisation's B-BBEE Verification. Therefore, if there is a shortfall in the Net Value amount, remedial action can rectify the matter.

'Black' Shareholder Engagement

Shareholder engagement as to the value and distribution of dividends is essential, especially if the 'Black' Shareholders are employees. However, before doing this, an organisation must engage with its B-BBEE Rating Agency and provide evidence, in the form of its financial statements. Engagement with 'Black' Shareholders should include:

- > Managing the expectations of distribution values;
- > Providing evidence as well as the rationale behind it, in the case of a lower dividend or no distribution of the dividends; and
- > Taking cognisance of any concerns and, in the shortest timeframe possible, addressing them adequately.

"The risk of not considering the impact of the lockdown may well lead to a breach in contractual obligations."

To ensure good faith, it is vital to identify, then mitigate, any risk stemming from engagement with the shareholders. There must be no room for conspiracy theories or any opportunity for shareholders to allege Fronting Practice or misconduct².

As a result of the lockdown, the Master's Office and the Companies and Intellectual Property Commission (CIPC), amongst others, were temporarily closed. The result is that, upon reopening, there will be a backlog in applications. Therefore, a delay in the processing of such applications by the regulators can be expected. The potential impact as highlighted on page 12 could be:



- > In respect of trusts, an expected delay in registering new trusts or changes to the trustees, due to letters of authority being necessary, and any amendments to trust deeds; and
- > delays in relation to registering a new entity or a 'start-up' and amendments to the Memoranda of Incorporation for new share classes.

The administrative delays caused by the lockdown may interrupt the registration of B-BBEE Ownership transactions or prevent existing B-BBEE Shareholders from adhering to contractual obligations².

Management Control Considerations

Now more than ever, as organisations navigate the challenges of the lockdown, they stand to benefit from a solid Management Control Strategy. By the nature of the challenges facing organisations, each will have to evolve and adapt to find a 'new normal' through grit, determination and innovation. During lockdown level 5, approximately 36% of businesses laid off employees in the short-term. At lockdown level 4 this reduced to 26%.

Results published by Statistics South Africa on 29th September indicate that the number of employed people decreased by 2,2 million to 14,1 million in the second quarter of 2020 compared to the first. This unprecedented change is the largest quarter one to quarter two decline since the survey began in 2008.

In the context of the lockdown and the amendments to the Employment Equity Act (EEA) outlined on page 30, one cannot address Management Control without incorporating the Employment Equity (EE) requirements, as they inherently go hand-in-hand. Bear in mind that an organisation may not claim Management Control points without submitting a EE Report.

The detrimental impact of the nationwide lockdown has forced many organisations to consider retrenchment to stay afloat. However, cutting employees may be detrimental to their Management Control and EE outcomes which are measured as follows:

Management Control	Employment Equity
It measures the Executive and Top Management of an organisation at the time and date of a B-BBEE Verification.	It is measured as part of Management Control. Employment equity is a 'snap-shot' of an organisation's head-count at the time of a B-BBEE Verification.

Considerations for Employers contemplating retrenchment

The Notice to Designated Employers issued on 4th May 2020 (CEE Notice) by the Commission for Employment Equity (CEE) acknowledges the catastrophic impact of the lockdown on the economy, namely a decline in economic growth, job creation and retention. The CEE Notice reminds employers that, during the organisational restructuring or configuration processes, they remain bound by the relevant employment laws and are required to ensure that there is no unfair treatment or unfair discrimination in policies and practices.

The CEE Notice further states that "all Designated Employers are requested to strive not to reverse the previously attained transformation gains, including to, where reasonably practical, achieve their initially planned annual EE targets." Thus, in the face of the lockdown, employers remain cognisant of their obligations, particularly concerning workplace transformation. Two considerations arise from these obligations:

- > Can employers, when selecting employees for retrenchment, take into account the need to meet the targets set in their EE Plan?
- > What happens if the retrenchment impacts an employer's workforce to such an extent that an EE Plan is no longer viable?

Can EE goals be used as retrenchment selection criteria?

The method of selecting employees for retrenchment is an issue on which consulting parties must reach a consensus. The selection criteria must be on a basis that is fair and objective. EE considerations may fall within the ambit of 'fair and objective criteria'. The retrenchment code of "last in, first out" – the LIFO Principle, which is generally a fair and objective selection criterion, may undermine a B-BBEE Strategy or EE Plan. Therefore, a retrenchment process, now more than at any other time, must be a considered one.

In short, it appears that there is no absolute bar in using EE considerations for retrenchment and that the application of such a selection criterion could be defensible. A strict application of the generally accepted LIFO Principle as a selection criterion could either directly or indirectly be detrimental on the grounds of race or gender demographics in an organisation. Taking into account the controversial targets and requirements set out in section 15 of the EEA – as outlined on page 30 – an organisation may well be justified in applying EE criteria over the commonly used LIFO Principle

However, in applying EE targets as criteria for retrenchment, further justification may be necessary. For example, compliance with EE targets may be a requirement for an organisation to gain or retain business, otherwise it may be the criteria that allows them to operate in a specific sector. Therefore, it is necessary that an organisation's EE policy highlights the rationale by which the policy meets the requirements of the EEA itself.

Furthermore, the application of such a criterion would need to be fair and flexible. Organisations must mitigate the risk against claims by using EE targets in conjunction with the LIFO Principle and not as the only basis for retrenchment.

What happens if an organisation has already undertaken the retrenchment process and its EE targets are no longer realistic?

In this regard, the CEE Notice recognises that “amid all the organisational configuration processes ... it is inevitable that achieving the initially planned annual EE targets would not be unscathed.” If EE targets are no longer achievable due to retrenchments, organisations may amend their EE Plans to ensure that they are more realistic or relevant to their changing workforce. The CEE Notice endorses this and provides that “employers may consider reviewing and amending their EE Plans in consultation with the EE Consultative Forums, but must document all the reasons for the changes as prescribed in the Employment Equity Regulations, 2004.” Such consultation must align with section 16 read with section 17 of the EEA.

Despite the economic hardship provoked by the lockdown, employers must remain cognisant of their EE obligations, even if it means amending initially planned EE targets due to a reduction in their workforce. If an organisation uses their EE targets as selection criteria for retrenchment, a context-responsive approach that delicately balances the objects of compliance with EE targets and the interests of adversely affected employees is essential⁹.

Skills Development Considerations

As Skills Development by its nature brings people together, it has been the hardest hit by the lockdown, as training providers and SETAs closed their doors.

Globally, due to various lockdowns imposed, there has been a paralysis in education. Most affected is work-based learning.

Delays in Learners completing their courses and enrolling new Learners will have an impact on the Skills Development Scorecard. A knock-on consequence is that the lockdown will have a bearing on the Absorption targets, which removes the possibility of the Bonus Points on offer.

The Services SETA has put processes in place to address the issue of stipends for active Learners during the lockdown. Evidence of an active Learner must be in the form of the March 2020 attendance register.

Organisations that qualified as essential services during level 5 lockdown must provide attendance registers for Learners that worked throughout this period, as this will have an impact on their completion period. Payment for such Learners will be as per the normal process.

Learners who completed their Learnership in March 2020, or who are due to complete the programme during the lockdown period, will not be eligible for payment of stipends after the completion of their programme. Stipend payments for the month of May will be according to the March attendance register. Therefore, there is no need to submit an additional attendance register. The payment of all stipends will be on the last day of the month.

To ensure the compensation of a workforce during the lockdown, many organisations have applied to the UIF for relief. However, what is the impact of Learners, Interns or Apprentices receiving payment via the UIF Relief Fund?

The B-BBEE Commission has stated that claims for Learnerships, Internships and Apprenticeships must align with the requirements of Statement 300. Bear in mind that there is no way one can partially comply with the expectations of B-BBEE.

There is no doubt that the restrictions stemming from the national lockdown will have consequences for the annual plans and overall performance of many organisations. Therefore, organisations are encouraged to adjust their Skills Development Plans and, where possible, ensure the implementation of their initiatives to achieve their annual targets as set before lockdown.

The B-BBEE Commission is not authorised under the Act to grant any exceptions in implementing Skills Development initiatives due to the impact of the national lockdown. Subsequently, organisations can only claim the amount of the stipend paid directly to a Learner, Apprentice or Intern, as any payment made by the UIF is not a direct expense to an organisation. As such, organisations must secure the successful completion of Category B, C and D Programmes.

Further, Skills Development targets may be affected by the lockdown, as many organisations were forced to go through the retrenchment process to survive lockdown, as well as reduce salaries to those employees who remain employed. The reduced payroll could thus mean a reduced target for Skills Development Spend.

Recent advances in technology make distance learning, be it online or offline, an option, but not a long-term substitute for face-to-face teaching and practical skills training. In low- and middle-income countries many issues are impeding the wider and permanent diffusion of distance learning. These involve socio-economic and cultural aspects besides the limited ICT infrastructure that contributes to the digital divide. While new solutions for teaching and learning could bring much-needed innovation to education and training systems, the shifts we are seeing have the potential to exacerbate existing inequalities for those who already face disadvantages in trying to access and engage in learning.

The periods of restricted movement and lockdown present both challenges and a unique opportunity for education².

Enterprise & Supplier Development Considerations

Preferential Procurement

The consequence of organisations trading at low capacity or coming to a complete halt during lockdown is that there has been no or little procurement. Subsequently, there is a risk that organisations will have to relook the Preferential Procurement Recognition of their active suppliers to meet their Preferential Procurement target. Hence, emphasis should be on quality instead of quantity. Organisations will have to ascertain which suppliers will have the most value to offer on their Preferential Procurement Scorecard to counteract the effect of the lockdown.

Now more than ever, organisations must ensure that the suppliers they use have valid B-BBEE credentials. Another aspect to bear in mind is that many small businesses have adjusted their operating models to deliver on demand. Therefore, it may be advantageous for an organisation to analyse their suppliers, which could potentially allocate two or more points on their Preferential Procurement Scorecard. Thus, purchasing from QSEs or EMEs may be an avenue to counteract the impact of the lockdown.

“Now more than ever, organisations must ensure that their suppliers have valid B-BBEE credentials.”

Enterprise Development and Supplier Development

The lockdown has had a significant impact on small businesses, especially start-ups. Since the lockdown began, more than 70% of start-ups have had to terminate employment contracts, and in the worst cases close the business⁵.

Both Enterprise Development and Supplier Development targets are based on an organisation's Net Profit After Tax (NPAT). The initiatives used to achieve the spend targets are based on NPAT forecasts, with the actual initiatives implemented during the course of the Measurement Period. In the case of the lockdown decreasing NPAT, an organisation must review their initial forecasts and, where necessary, amend their planned initiatives. A review will ensure that an organisation's spend aligns with their actual turnover².

Another challenge through these trying times is that beneficiaries may default on loans. When giving a loan, an organisation has the full rights of recovery; however, this has to be clear in the terms and conditions. First and foremost, a loan must take the form of a debt instrument and not be a grant disguised as a loan.

Any loan made with the intention of not receiving repayment of the capital amount is not a loan but a grant, thus the claim must reflect this. Consequently, claiming a loan under Enterprise Development instead of a grant is Fronting Practice.

However, a solution is that, if a Beneficiary fails to repay a bona fide loan, an organisation may offer a Beneficiary a grant which will allow them to repay the loan, or an amendment of the contract to provide the beneficiary with a payment gap or reduced instalments. Otherwise, an organisation can write off the loan or follow the legal route based on the terms and conditions of the loan.

Furthermore, organisations may face cashflow constraints of their own during this time. Another option for consideration is to amend their Enterprise Development and Supplier Development Strategies to incorporate mentoring, coaching or training, rather than making large monetary contributions. To many Beneficiaries, having tangible support may be more valuable than a financial contribution.

Socio-Economic Development Considerations

The target for Socio-Economic Development is 1% of an organisation's NPAT. An organisation which has been hard hit by the lockdown, therefore running at a loss, may contribute a lesser amount based on the NPAT calculation. However, this might not always be the case, as the calculation based on the organisation's previous five-year calculations might result in a higher deemed profit rather than a lesser target amount. However, this depends on the industry norm percentage.

The calculation of NPAT targets under Enterprise Development, Supplier Development and Socio-Economic Development are as follows as per the Generic Codes. The NPAT or average target applies unless an organisation:

- > Did not make a profit over the past 12 months; or
- > Has shown, on average over the last five years, a net profit margin which is less than a quarter of the norm in the industry.

Under the Generic Codes for Large Enterprises using the NPAT calculation, targets are:

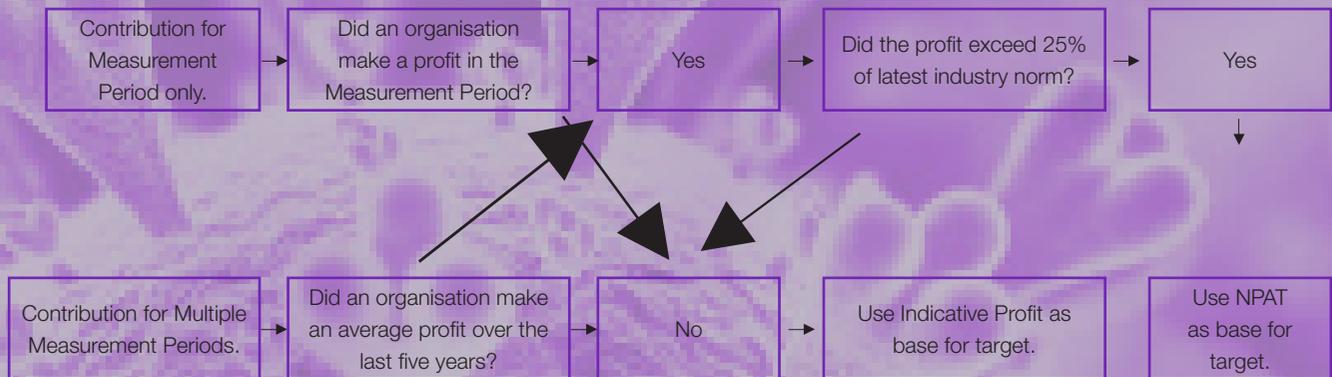
- > 1% of NPAT for Enterprise Development;
- > 2% of NPAT for Supplier Development;
- > 1% of NPAT for Socio-Economic Development.

When failing to utilise an organisation's NPAT, then each of the above must use the Indicative Profit Margin. This margin is the profit used in a previous year, where an organisation's profit margin is at least one-quarter of the industry norm. Unless otherwise indicated by a specific Sector Code, and in line with the B-BBEE verification principles and methodologies, the following is applicable:

- Step 1 |** Determine whether the contribution recognition claimed is for the Measurement Period only or whether it spans across multiple Measurement Periods.
- Step 2a |** If based on the Measurement Period only, compare the NPAT margin to the Industry Norm, which appears in the current StatsSA Quarterly Report⁶.
- Step 2b |** If based on multiple Measurement Periods, compare the average NPAT margin over the Measurement Periods used to the Industry Norm found in the latest StatsSA Quarterly Report⁶.
- Step 3 |** If the NPAT margin is 25% or more of the industry norm, said NPAT figure applies.
- Step 4 |** If the NPAT margin is less than 25% of the industry norm, the target becomes turnover based. Calculate Indicative Profit Margin - NPAT/Turnover. The NPAT figure used must be the most recent NPAT - not older than five years - which is at least 25% of the industry norm.
- Step 5a |** Slot Indicative Profit Margin into the formula element target $(1\% \text{ or } 2\%) \times \text{IPM (actual figure and not 25\% of IPM)} \times \text{Turnover} = \text{New Target}$.
- Step 5b |** If NPAT margin is less than 25% of the industry norm and is older than five years, the target becomes 25% of the latest industry norm.



Establishing the base for Enterprise & Supplier Development and Socio-Economic Development targets



Indicative profit:

Measurement Period Turnover x NPAT % of the last year, within the last five years, where the profit exceeded 25% of industry norm profit.

Target:

Indicative Profit or NPAT x 2% or 1% target as per the Codes.

In light of the lockdown, organisations have investigated whether a Socio-Economic Development contribution to the Solidarity Fund is a credible claim. The B-BBEE Commission clarified that the Solidarity Fund was established in response to the lockdown and not for the purposes of B-BBEE; therefore, such contributions do not qualify as a claim.

Organisations should reassess their available spend for this element, bearing in mind that these points on the scorecard are the easiest to achieve. However, taking into account that organisations will possibly have less to invest in this element, one must bear in mind that the Beneficiaries of this element, now more than ever, need such an investment.

To conclude, the B-BBEE Commission has clarified that there will be no reprieve in B-BBEE requirements in spite of the impact of the lockdown. In 2021 organisations will be measured on the basis of initiatives implemented during this year's Measurement Period. The instability of business operations, due to any changes caused by lockdown regulations, will force organisations to relook their B-BBEE Strategy roll-out to ensure they meet their overall annual target. Therefore, organisations are encouraged to re-evaluate their B-BBEE Strategy and the implementation thereof, based on the risk areas identified in each element.

Source of reference:

- <https://www.iol.co.za/business-report/economy/what-does-life-after-lockdown-look-like-for-business-45820946>
- <https://www.financialinstitutionslegalsnapshot.com/2020/04/10-things-to-know-about-bee-and-covid-19/>
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