The viability of preferential procurement in the metals and engineering sector

by

L.L. MOKAKALA

21432775

BSc Engineering (Chemical)

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Supervisor: Prof R.A. Lotriet

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ABSTRACT

The objectives of this study were to evaluate the viability and sustainability of preferential procurement in the metals and engineering sector. Preferential procurement is one of the seven elements of Broad-Based-Black Economic Empowerment (BBBEE) and seeks to encourage companies to procure goods and services from black empowered suppliers.

The Broad-Based-Black Economic Empowerment Act was legislated in 2004 as an improvement on the previous Black Economic Empowerment (BEE). The objective of these legislations was to increase participation of previously disadvantaged groups in the mainstream economy. BEE was deemed to be narrow because it focused exclusively on ownership and management control. BBBEE was enacted to broaden the number of beneficiaries and included five other elements, namely: Employment Equity, Skills Development, Preferential Procurement, Enterprise Development and Socio-economic Development.

The two companies that engage in preferential procurement should benefit from the relationship and value should be created in the process. Companies should not procure from black suppliers for accumulating points on the generic scorecard. Black-owned suppliers should provide service and products of the highest quality standards that meet customer requirements.

The questionnaire that reflects on the objectives of this study was drafted and circulated to black-owned suppliers for completion. The suppliers were asked to comment on statements that reflect on capacity, profitability, working relationship and continuity. The results show that the SMMEs have capacity to perform according to specification of customers. The area of concern was the

difficulty for SMMEs to maintain the current preferential status. This is a risk that needs urgent attention. This needs further in-depth study and analysis.

Key words: black economic empowerment, broad-based-black economic empowerment, ownership, management control, employment equity, skills development, preferential procurement, enterprise development, socio-economic development, generic scorecard, historically disadvantaged individuals, historically disadvantaged South Africans, codes of good practice, SMMEs, fronting

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LIST OF ABBREVIATIONS

AA	Affirmative Action
ANC	African National Congress
BBBEE	Broad-Based-Black Economic Empowerment
BEE	Black Economic Empowerment
BMF	Black Management Forum
DA	Democratic Alliance
DME	Department of Minerals and Energy
DTI	Department of Trade and Industry
EE	Employment Equity
ESOP	Employee Share Ownership
GPA	Government Procurement Agreement
HAD	Historically Disadvantaged Individuals
HSDA	Historically Disadvantaged South Africans
IDC	Industrial Development Corporation
IPO	Initial Public Offering
JSE	Johannesburg Stock Exchange
MNEP	Malaysian New Economic Policy
MQA	Mines Qualification Authority
NAFCOC	National African Federated Chamber of Commerce (Nafcoc)
NEF	National Empowerment Fund
NWU	North-West University
RDP	Reconstruction and Development Programme
RTO	Reverse Take Over
SA	South Africa
SEIFSA	Steel and Engineering Industries Federation of South Africa
SMME	Small, Medium, Micro Enterprises
SPV	Special Purpose Vehicle

LIST OF ABBREVIATIONS (continued)

UCT	University of Cape Town
WEFA	Wharton Econometric Forecasting Associates

CHAPTER 1:
SCOPE AND NATURE OF THIS STUDY

1.1 INTRODUCTION

The African National Congress (ANC) held several meetings with the National African Federated Chamber of Commerce (Nafcoc) in 1986. Nafcoc, which was a representative organisation of black entrepreneurs in South Africa, had asked for a meeting with the then exiled ANC. This was because its members have been on the receiving end of harsh and violent treatment from the pugnacious youth. Many of their enterprises have been burned or looted and the rendering of the townships 'ungovernable' meant that the economy that sustained them has all but collapsed (Gevisser, 2007:538).

The Nafcoc delegation had arrived in Lusaka very hostile to the Freedom Charter's provision of nationalisation (ANC, 1988). The ANC propounded its stance on ideals enshrined in the Freedom Charter and informed the Nafcoc delegation that it is a supporter and not enemy of black business. The black businessmen were told that 'black business will be better off under an ANC government' (Karis & Gerhart, 1986:74). Far from stifling the market, the businessmen were told the ANC would create an environment for black business to thrive by ending monopoly capitalism and would implement Affirmative Action (AA) policies in favour of the disadvantaged majority.

This marked the first step towards the journey of Black Economic Empowerment (Hirsh, 2005:31). Black Economic Empowerment – or BEE, as it would be widely known – would be a hot topic among black businessmen in 1989. Nafcoc started to demand that 'tangible expression and meaning' be attached to the ideology of Black Economic Empowerment (ANC, 1989:22).

The ANC borrowed heavily from Malaysia's *bumiputra* programme, formulated to empower the majority by ensuring indigenous Malays participate in the mainstream economy. The *Bumiputra* programme intended to reduce the participation of the wealthy Chinese minority in the economy. Following the racial riots on 13 March 1969, the Malaysian government came up with the *bumiputra* programme, which was implemented in the early 1970s to diffuse inter-ethnic tensions (Stoever, 1985:89).

The programme was integrated into the Malaysian New Economic Policy (MNEP) and made provision for the following interventions:

- *Bumiputras* must own at least 30% of equity of companies listed on the Kuala Lumpur Stock Exchange (Bursa Saham Kuala Lumpur). This became one of the listing prerequisites.
- Companies submitting tenders for government projects must be *bumiputra* owned.
- Skills development was enhanced by selecting specific projects where indigenous Malays should participate.
- New housing development should ensure that a certain percentage is owned by the *bumiputra.*

These policies have succeeded in creating a significant urban Malay middle class but have been less effective in eradicating poverty among rural communities (Randall, 2001:86). The joint Nafcoc-ANC working group used the *bumiputra* programme as a guide in the quest to transform the South African economy. Nafcoc put forward what has now being called a '3-4-5-6' proposal.

This implied all South African companies listed on the Johannesburg Stock Exchange (JSE) should have 30% black people in the board of directors and black people should own 40% of the equity. It also went a step further. Nafcoc suggested that listed South African companies should source 50% of their procurement from black-owned suppliers and 60% of senior management should be blacks (Iheduru, 2004:61). This was far-reaching and radical because it was at a time when black ownership of the economy was less than a

percentile (Gqubule, 2006:100). This was the first time the fundamentals of BEE were spelled out (see: Chapter 2) and numerical targets proposed with specific time frames. The empowerment legislation is briefly introduced in the next section.

1.2 THE EMPOWERMENT LEGISLATION

Broad-Based-Black Economic Empowerment (BBBEE) – an improvement (Posel, 2006:74) on the previous initiative called BEE – is a form of economic empowerment that seeks to encourage broader participation of black business in the mainstream economy. This broader participation is waged from seven fronts, namely:

- Equity Ownership
- Management Control
- Employment Equity
- Skills Development
- Preferential Procurement
- Enterprise Development
- Socio-economic Development

On 9 February 2007, the Broad-Based Black Economic Empowerment Act (53/2003) was promulgated in the Government Gazette 29617. This was put in place to replace the original BEE Act. See Appendix 1 for the Broad-Based-Black Economic Empowerment Act. The transitional period between these two Acts was extended to 31 August 2008 after expiring on 9 February 2008. In the next section, the background of this study will be discussed.

1.3 BACKGROUND TO THE STUDY

"The aim of empowerment is to correct some of the distortions of the past and it therefore stretches over all spheres – from buying and investment to personnel and social investment. All these elements are important for the successful implementation of empowerment", said Johan van Zyl, CEO of Sanlam (Paton, 2004:15). This captures the intention and objective of BBBEE.

BBBEE is a necessary measure for the normalisation of South African society because of the emphasis it places on the socio-economic upliftment of previously disadvantaged people at the top of the agenda. "For generations, government policies seriously hobbled the ability of black South Africans to accumulate wealth and under these circumstances there can be no doubt about the need for special measures to promote wealth." (De Klerk, 2009:1) In this sense, it should be recognised that South Africa's (SA) industries' constructive commitment to BBBEE will contribute to the creation of a better society for all South Africans.

BBBEE will improve the buying power of the broader South African society, thereby expanding the markets and increasing demand of the products that are sold by SA's companies (Joffe, 2005:11). Broader participation by a wider spectrum of the society will result in a bigger pool of talented employees who will bring fresh ideas and better ways of doing things. This will result in increased operational efficiencies and will have a positive contribution on the bottom-line of companies involved.

This includes Small, Micro, Medium Enterprises ("SMMEs"), which play a very critical role in sustaining South Africa's economy by creating employment and overall economic contribution, which is not necessarily measured by official statistics. The success of SMMEs is directly linked with the economy's capacity to absorb unemployed people into the mainstream economy and thereby reducing SA's unemployment. According to Manuel

(2008:23), the government had identified the development of SMMEs as a government priority. This was shown by R500 million allocated to enhance development of SMMEs.

Increased economic activity, through awarding of contracts to SMMEs by SA's large companies is critical for the economic growth and sustainability of these small businesses (Klein, 2006:8). A successful two-way relationship between companies involved in this transaction will offer limitless opportunities and benefits that will be enjoyed by the society at large.

1.4 PROBLEM STATEMENT

One of the seven elements of BBBEE is preferential procurement, which encourages companies to procure services and products from companies owned by historically disadvantaged persons. This seeks to increase economic activity of these empowered companies and to build skills and expertise. These empowered companies should provide services or products of high quality and should have capacity to service these big companies.

The business relationship should be viable and sustainable. A symbiotic relationship should emerge where the two parties are extracting value from the relationship. Companies should not engage in the preferential procurement code of BBBEE for the sake of accumulating points on the balanced scorecard. This implementation of BBBEE is facing challenges such as fronting, finance, lack of skills and expertise and the lack of will from decision-makers. These challenges make it difficult to engage in a mutually beneficial preferential procurement relationship.

The consequences of a failed preferential procurement policy have wide-ranging ramifications for all stakeholders involved and these are not good for business. It is in everyone's interest to have successful implementation of preferential procurement. The objectives of this study are briefly discussed below.

1.5 RESEARCH OBJECTIVES

1.5.1 Primary objective

The primary objective of this study is to evaluate the viability of the preferential procurement code relating to BBBEE in the Metals and Engineering sector.

1.5.2 Secondary objectives

The following are the secondary objectives of this study:

- To evaluate the sustainability of preferential procurement relating to BBBEE.
- Identify obstacles to successful implementation of preferential procurement.
- Recommend interventions that can be considered for implementation to increase the probability of success with preferential procurement.

1.6 SCOPE OF STUDY

This study will focus on Code 500: Preferential Procurement, which encourages big business enterprises to outsource some of their contracts to companies owned or controlled by previously disadvantaged people. These companies that are awarded the contracts to service businesses will mostly fall under the SMME's definition as outlined by National Small Business Act No. 102 of 1996.

This study will be confined to SMMEs that deal with one of SA's Top 40 companies on the JSE Securities Exchange ("JSE") in the industrial metal and mining sector of our economy. The company constitutes a dominant market player in this sector. This study will focus on only one geographical location of this organisation, which has operations scattered all over the country. This chosen geographical are is the second biggest plant in the business portfolio and is where the researcher is based.

1.7 RESEARCH METHODOLOGY

This research, pertaining to the specific objectives, consists of two main phases, namely a literature review and an empirical study.

1.7.1 Phase 1: Literature review

In phase 1, a comprehensive literature review regarding the topic of interest is outlined. The sources that were consulted to develop a comprehensive and solid literature review are the following:

- Political documents from various commentators and political parties.
- All the legislation relating to BBBEE, all the codes, policies and strategies.
- Economics literature such as the financial media.
- Previous articles and debates on the subject.
- Internet.
- Published papers, journals and theses.
- Database search from North-West University (NWU) library

This literature will also concentrate on legislation and the migration from BEE to BBBEE. This chapter will seek to understand how they moved from BEE to BBBEE and what the reasons behind this were. The essence of deeper understanding will be the role of SMMEs in this code and how it affects them.

The goals and objectives of the preferential procurement code will be dissected and evaluated. The intentions of the propagators and writers of this code will be investigated and analysed. Any previous research that has been conducted on this topic will be assessed.

1.7.2 Phase 2: Empirical study

The empirical study consists of the drafting of the questionnaire as measuring instrument as well as structured and informal interviews. Statistical analysis will be performed in order to explain empirical results of the study.

1.7.2.1 Research design

The questionnaire will be designed based on the important issues identified in the literature review and interviews with knowledgeable people in the field of preferential procurement. These are the people dealing with this topic on a daily basis and are well-versed with the issues relating to successful implementation of preferential procurement.

The questionnaire developed contains statements/questions that will assist in achieving the primary and secondary objectives of this study. The questionnaire uses a Likert scale ratings from 1 to 5. The number 1 will represent 'Strongly Agree' and the number 5 representing 'Strongly Disagree'. The length of the questionnaire was limited to less than 40 questions in order to balance quality against quantity.

1.7.2.2 Participants

The number of BBBEE compliant companies on the database of Company XYZ is 1 092. These companies form the study population. From this population, a sample of 55 companies was asked to complete the questionnaire. Forty of these companies were recommended by the Preferential Procurement Manager and the remaining fifteen were identified by the researcher. In the end, only 21 companies responded. These responses are analysed in the study.

1.7.2.3 Data analysis

Statistical analysis of data was carried out using suitable statistical tools to manipulate and present the data. Graphs were also used to highlight the results. Descriptive statistics in the form of frequencies, mean, variance, standard deviation and percentages were calculated. Comparisons were made on the grounds of factors such as the size of the SMMEs.

1.8 LIMITATIONS OF THE STUDY/ANTICIPATED PROBLEMS

The greatest limitation of this study was the reluctance of the company to share information. This is because BBBEE is a sensitive subject and any company that is not complying will not want to reveal its non-compliance for all to see. This will offend important stakeholders like the government and has the ability to make life difficult for the non-complying company. The politics of BBBEE made this study a tricky angle to tackle.

To eliminate any problems emanating from this politically sensitive topic, the company in question was dealt with anonymously. From now on it will be referred to as 'Company XYZ'. Other limitations of this study are the following:

- Focus on one geographical area.
- Focus on one company in one sector.
- Time frame of 10 months to complete the study.

An important point that needs clarification is the contents of the questionnaire. The respondents had to fully understand each question and answer it honestly and truthfully. The questionnaire was designed in a manner which attempted to eliminate any ambiguity.

1.9 CHAPTER LAYOUT

The chapters in the mini-dissertation are presented as follows:

1.9.1 Chapter 1: Scope and Nature of the study

The study focuses on the preferential procurement code of BBBEE and the implementation of this in one of South Africa' s biggest companies. Due to the sensitivity of this, this company remains anonymous and is referred to as Company XYZ throughout this research. The study focuses on one operation, which is based in one geographical area of the country.

The objective of this study was to evaluate the viability and sustainability of preferential procurement within the context of Company XYZ in the Metals and Mining sector. The study also identified obstacles that hamper effective implementation of preferential procurement and recommend actions that can be implemented to enhance the success of preferential procurement.

1.9.2 Chapter 2: Preferential Procurement in South Africa

BBBEE is a policy that seeks to increase the participation of previously disadvantaged groups in the mainstream economy. One of the seven elements of BBBEE is preferential procurement that seeks to encourage companies to source their products or services from companies owned or controlled by previously disadvantaged individuals. The Preferential Procurement Policy Framework Act No. 5 was enacted in 2000 to be a framework that will facilitate preferential procurement.

Preferential procurement is strategically important because of the possibility to contribute towards job-creation, assist with transfer of skills and technology, development of entrepreneurial potential and ensuring diversity of suppliers. Implementation of this Act has faced challenges including fronting, lack of commitment, lack of capacity by the service

providers and insufficient funding. A successful preferential procurement requires buy-in from all the stakeholders involved and alignment with the company's strategic objectives.

1.9.3 Chapter 3: Empirical Study

The empirical study takes a qualitative approach to inquiry as a form of research. A questionnaire that measures the primary and secondary objectives was drafted. The questionnaire contained a combination of open-ended questions and questions with a Likert scale rating from 1 to 5. A population of 1 092 SMMEs that services Company XYZ was identified and a sample of 55 SMMEs was targeted. These were briefed on the contents of the questionnaires to eliminate interpretation errors. The filled questionnaires underwent a statistical analysis.

1.9.4 Chapter 4: Conclusions and Recommendations

The statistical analysis yielded the questionnaire results. These results are analysed and interpreted. One of the objectives of this study is to recommend actions that can be implemented to increase the success rate of preferential procurement. The results of the questionnaire are used as a base for recommendations that are put forward. Obstacles to successful implementation of preferential procurement are identified and outlined. Recommendations to increase the success rate of preferential procurement are advanced.

1.10 SUMMARY

Preferential procurement is important because of the value it can add to the economy through ensuring competitive diversity of suppliers that will contribute to the value adds on goods and services. This policy should not be viewed as another onerous piece of legislation that companies need to comply with. Companies should not implement this as a way of accumulating points on the scorecard but should ensure that genuine value is created in the process.

SMMEs that render this service should meet performance criteria and build healthy relationships with the customers. There is no doubt that challenges face effective implementation of preferential procurement but these are not insurmountable. BBBEE policy should be viewed within the broader context of developing and maintaining a stable society. In the following chapter, the concept of BBBEE will be discussed.

CHAPTER 2:
BROAD-BASED-BLACK ECONOMIC EMPOWERMENT IN SOUTH AFRICA

2.1 INTRODUCTION

Empowerment can be defined as a process of enhancing feelings for self-efficacy among organisational members by identifying conditions that foster powerlessness and removing them through formal organisational practices (Kappelman & Bryputok, 1995:23). Empowerment can be seen as an alternative development path that places emphasis on the improvement in the conditions of, and livelihood of, the excluded majority (Gunter, 2006:32). The Black Economic Empowerment legislation was enacted as a framework that will encourage broad participation of the previously disadvantaged group in the mainstream economy.

Broad Based Black Economic Empowerment was identified as an interventional policy that is necessary to de-racialise business ownership and ensure effective participation of black people and women in the mainstream economy (Ponte, 2006:7). This included special emphasis on tendering procedures, skills development and ownership, among others.

The Broad Based Black Economic Empowerment (BBBEE) Act No 53 of 2003 was promulgated on 9 February 2007 in order to act as a blueprint that makes it law to advance or promote the interests of previously disadvantaged individuals in participation of the mainstream economy. This chapter will focus on the broad BBBEE philosophy and will be narrowed down to Preferential Procurement. Driving forces that ensure successful implementation of Preferential Procurement are analysed and discussed. Once all aspects of Preferential Procurement has been discussed and understood, a questionnaire was drafted that is in line with the literature study and sought to measure the attainment of the objectives of this study.

2.2 THE LEGACY OF SOUTH AFRICA'S PREVIOUS POLITICAL SYSTEM

The majority of the South African population still needs to be incorporated into the mainstream economy. This is because they do not have partial or full ownership of the means of production and also lack the capacity to operate these assets (Madi, 2003:17). This is the legacy of our previous political system where race was used as a gate-keeper in order to access the resources that are used in the production of high-value products that are traded in the market (Nattrass, 1994:31).

This exclusion and lack of participation in the mainstream economy had negative ramifications to the economy of the country because only a few had access to income that is used to stimulate economic activity. The black people who had income were mostly in the low-income bracket and the impact on the economy was minimal (Fernsby, 1998:78). The lack of participation in the economy also ensured that the economy was not functioning at optimal point because the potential of all its human resources was not exploited to maximum value. High-calibre human resources were marginalised instead of honing their skills and making a positive contribution that is in line with their talents, capabilities and potential.

This exclusion created a huge inequality that is characterised by South Africa having one of the highest Gini co-efficients in the world. A Gini co-efficient is a measure of inequality within a society. This coefficient is a number between 0 and 1, where 0 corresponds with perfect equality (where everyone has the same income) and 1 corresponds with perfect inequality (where one person has all the income, and everyone else has zero income). South Africa has recorded a Gini co-efficient of 0.67 (Pressly, 2009:3). Commenting on this figure, Haroon Bhorat, an economics professor at University of Cape Town (UCT), told Parliament: "In the long run it is bad for growth. It is a threat to social stability and to growth itself." (Pressly, 2009:3).

The economy will be unable to grow because it is deprived of better ways of producing existing products, innovative business ideas, new products, access to fresh markets and other value adding initiatives that could have been spearheaded by the previously excluded individuals (Southall, 2004:67).

The slow pace of transformation in the South African economy (Makgetla, 2006:47) prompted the government to accept the fact that intervention is necessary if meaningful progress is to be achieved. This also has a direct bearing on the prosperity and stability of the society at large. Civil unrest is usually fostered by exclusions of enjoying economic benefits.

2.3 BLACK ECONOMIC EMPOWERMENT (BEE)

Black Economic Empowerment, or BEE as it was previously known, was a policy that was launched by the African National Congress-led government on assuming power in the middle of the 1990s. The aim of this policy was to redress the inequalities generated by the policy of apartheid (Mbeki, 2006:13). The policy sought to give economic opportunities to the previously disadvantaged people. In this context, previously disadvantaged means "Black, Coloured and Indian South Africans". White women are also included in this group.

The original BEE policy focused exclusively on black equity ownership and black management representation. A company was complying if it met the minimum criteria on ownership and representation. Using research figures gathered in South Africa's 1996 Census – Andrew Whiteford, an economist for Wharton Econometric Forecasting Associates (WEFA) – found that "the poorest 40% of the population, mainly blacks, earned about 3.8% of all income while the richest 10%, mainly whites, earned 52% of the country's income". This is the economic distortion that the BEE policy was meant to address. These figures show that the status quo is not sustainable in the long-term and can also have massive ramifications in terms of social stability of the country.

2.4 BEE TO BBBEE

BEE was deemed to be too narrow because it focused on equity ownership and management representation (Selaelo, 2007:17). As a result of this limited focus, it was a massive challenge to bring the majority in the mainstream economic arena. It was only benefiting those close to power. Few politically connected black shareholders got very rich quickly and with no effort while profit remained dependent on the existing white-controlled companies (Mbeki, 2008:10). An example of this is the Sanlam-NAIL initiative, which was brokered in 1993. NAIL was owned and controlled by high-profile political people such as Nthato Motlana and Saki Macozoma.

The fact that BEE only measures ownership and management representation meant its outcomes will be limited (Lund-Thomsen, 2005:33). This limitation ensures that BEE will have minimal impact on the society except those politically connected to the ruling party. Those close to the ruling party had the connections and access to the channels that will ensure funds to access equity ownership and to sit on the high tables of South Africa's big business. Therefore, the original model of equity ownership and management representation was heading for failure and it would be unfair to the country's poor not to amend the policy as it originally was (Selaelo, 2007:17). The government investigated a way of improving the BEE policy in order to make it broad-based and extend the different black people who can benefit from this initiative.

2.5 BROAD BASED BLACK ECONOMIC EMPOWERMENT (BBBEE)

The South African government launched what is now called Broad-Based Black Economic Empowerment (BBBEE) in December 2003. The goal of BBBEE is to distribute wealth to a wide spectrum of the South African society. Broad-Based Black Economic Empowerment is measured using seven pillars, each with a relative weighting (Department of Trade and Industry, 2004:27):

- **Direct Empowerment:**
    - Equity Ownership – 20%
    - Management – 10%

- **Indirect Empowerment:**
    - Employment Equity – 15%
    - Skills Development – 15%
    - Preferential Procurement – 20%
    - Enterprise Development – 15%
    - Socio-economic Development – 5%

As it can be seen from the above, the BBBEE legislation included other elements that were not in the original BEE policy. Unlike Narrow-Based Empowerment, Ownership and Management account for only 30% of the total contribution. The new beneficiaries of new BBBEE legislation included:

- Communities and other stakeholders (Socio-economic Development)
- Black-owned companies (Preferential Procurement and Enterprise Development)
- Employees (Skills Development and Employment Equity)

These different sub-sections of the Act are discussed below in Section 2.4.1.6

2.6 THE BBBEE ACT

The Constitution states that everyone is entitled to the right of equality and the BBBEE Act seeks to promote the advancement of this ideal. The Act also seeks to promote high employment rates through high economic growth that will be achieved through implementation of this initiative. A wide distribution of income across a wide spectrum of society will help reduce the inequalities that are presently witnessed in SA's society. *See* Appendix 1 for BBBEE Act.

2.6.1 Objectives of the BBBE Act

The objectives of the Act were incorporated in terms of the BBBEE Act (53/2007) (SA, 2007):

- Achieve increased participation of designated groups in the mainstream of the economy by enhancing transformation of the economy;
- Attain a more balance racial representation of designated groups in ownership and management of enterprises participating in the economy;
- Achieve meaningful participation of stakeholders (workers, communities and others) in ownership and management of new business and broadening of the skills and further access to economic activities and better infrastructure;
- Advance ownership and management of enterprises by black women and access to skills development;
- Investment of resources that will enhance broader participation in the economy by people from designated groups;
- Opening all access channels for skills development, better infrastructure, land and other economic activities to rural and local communities; and
- Assisting to finance the achievement of the above objectives.

The BBBEE Advisory Council will advise the State President of ways of achieving the above objectives.

2.6.2 Black Economic Empowerment Advisory Council

The Act makes provision for the establishment of the Advisory Council. The Council will be chaired by the State President and will compose other members of government, representatives of labour and business and other members who have been co-opted because of expertise that is brought onto the table (SA, 2007:3). The Council will facilitate and advise on ways of achieving objectives of the BBBEE Act. The mandate of this Council

is to advise on all issues that affect effective formulation and implementation of the BBBEE strategy.

2.6.3 BBBEE strategy

The Minister of Trade and Industry is tasked with issuing a strategy forBBBEE. This represents an action plan that dictates the direction the country is headed in as far as black economic empowerment is concerned. The strategy direction will be assisted by key action plans of how the objectives will be achieved. This strategy will be an integrated approach that involved all role-players and stakeholders (state, labour, business, NGOs, local communities, and more) that will spearhead all the parties in the same direction. The plan is on how the achievement of these objectives will also be integrated in the strategy. In line with the strategy, individual sectors will draft charters that will act as a blue-print to aid implementation of BBBEE (Jack, 2006:14).

The next section discusses the Mining Charter.

2.7 THE MINING CHARTER

Part of Company XYZ's operations is in the Mining Industry and this means that this chart is relevant in the context of this study. Individual industries will draw-up specific transformation charters provided that all the major stakeholders in that sector have participated in the drawing of the charter. The charter should advance the interests and attainment of the objectives of the Act. This means that the charter should not be in direct or indirect conflict with the spirit of the Act.

The South African Mining Industry developed the Mining Charter in 2002 as a plan that shows the objectives that need to be achieved in order to enhance BEE. The vision of the charter is for the mining industry to be a globally competitive industry that benefits all

South Africans. The charter aims for ownership of 26% by the historically disadvantaged groups in the mining sector within 10 years.

Many commentators warned against loss of investment due to negative consequences to the exploratory sector (Mitchell, 2004:12). This is because companies can lose patience with South African mining legislation and can choose to invest elsewhere instead of dealing with bureaucracy and legislation. The following subsections discuss key objectives of the Mining Charter.

2.6.1 Human Resource Development

In partnership with the Mines Qualification Authority ("MQA"), the Mining Industry commits to formulate a comprehensive skills strategy. This strategy will help to empower the personnel with the skills needed to participate in the Mining Industry. This will aid the smooth operation of the Mining Industry because the South African labour force is unable to produce enough skills needed by the mining sector. In addition to this, the Mining Industry will invest heavily in scholarships and bursaries in order to quadruple the number of registered learnerships.

2.6.2 Employment Equity

The Mining Industry will formulate Employment Equity ("EE") plans that will seek to improve the number of previously disadvantaged individuals in management positions. Specific focus will be placed on junior and middle management bands. The Mining Industry will aspire to achieve 40% of HDSA in five years' time. Needless to say, this was not achieved (*see* the Mining Charter in Appendix 2).

2.6.3 Mine Community and Rural Development

The Mining Industry undertook to formulate developmental plans in the communities where mining operation takes place. Infrastructure development projects will be prioritised and this will be inline with the triple bottom-line philosophy of the Mining Industry.

2.6.4 Housing and Living Conditions

The living conditions of hostel dwellers have long been a controversial topic in the political circles and the broad SA society. The Mining Industry has recognised this. The industry has pledged to work with the Department of Housing and Mine Health and Safety Council to improve the living conditions of hostel dwellers. These hostels will be converted into family units and home-ownership for mine employees will also be facilitated.

2.6.5 Procurement

The Mining Charter has divided procurement spend into the following categories:

- Capital goods.
- Services.
- Consumables.

Companies owned by Historically Disadvantaged Africans ("HSDA") will be given preferred supplier status and the Mining Industry has committed to progression of procurement to HSDA companies within a time frame of three to five years. This will also ensure that the HSDA provider adds genuine value. Other targets include encouraging existing suppliers to develop relationships with HDSA companies and to develop a consolidated database of HSDA companies.

2.6.6 Ownership and Joint Ventures

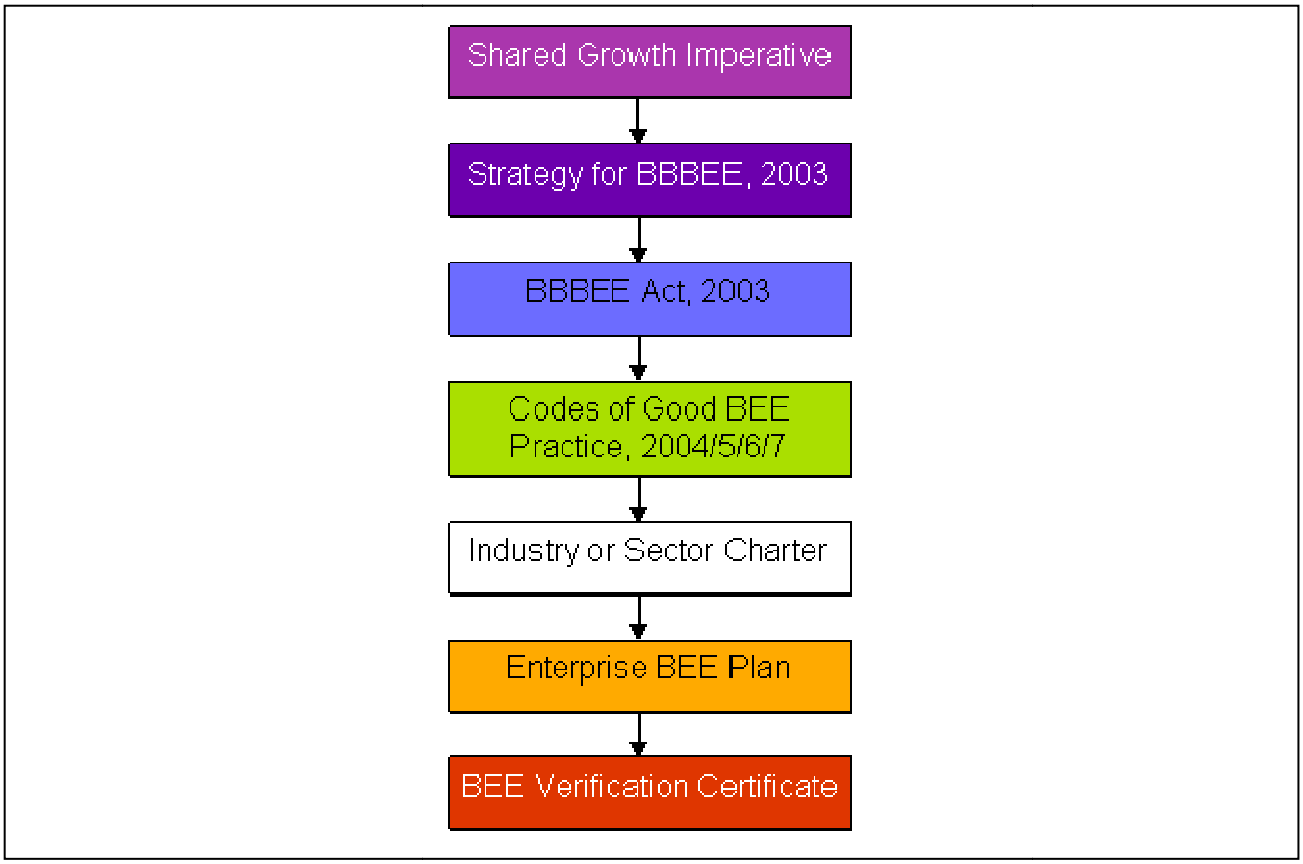
The charter aims for ownership of 26% by the historically disadvantage groups in the mining sector within 10 years. The Employee Share Ownership Scheme ("ESOP") will be one of the ways that the Mining Industry will consider in order to improve employee ownership in the industry. Strategic joint ventures will be pursued and this will result in skills transfer of the companies owned by HSDA. The Chamber of Mines has admitted that this target will not be met in 2012.

The Department of Minerals and Energy (DME), the Department of Trade and Industry (DTI) and the Chamber of Mines have reached an agreement that the Mining Charter will take precedence over the codes (Smith, 2005:43).

2.7 CODES OF GOOD PRACTICE

The BBBEE Act gave the Minister of Trade and Industry the powers to publish the codes and related regulations. Codes of Good Practice have been gazetted in February 2007 in order for the DTI to dispense with various sector charters, which have previously guided the empowerment regulatory framework. The charters can be re-aligned to conform to the new codes (Jones, 2007:2). The codes are guidelines that set the requirements that need to be fulfilled for a company to comply with that particular element (see Figure 2.1 below for different codes).

Figure 2.1: Flow Chart to achieve a BEE Verification Certificate



(Source: EconoBEE, 2008)

The codes give more expression to the broad-based generic scorecard and the scorecard for small enterprises, outlined procedures for calculating scores, recognition of charters and verification agencies (Jack, 2006:22). The most common response of industries or sectors of the economy to the BBBEE imperative has been to draft charters – stating the industry's unified interpretation of the codes and scorecard (Power, 2008:44). At the enterprise level, every business formulates its plan to comply with BBBEE in a way that promotes growth. A verification certificate will only be issued once a plan has been implemented.

The verification certificate is one of the important documents as it is an independent assessment of the company's empowerment credentials. The following points should be kept in mind when one's company is in pursuit of preferential status:

1. The verification certificate must be in agreement with the industry charters and if the company is operating in an industry without a charter, then the generic scorecard shall apply (*Please see 2.8 below*).
2. The charter can be negotiated with DTI and other stakeholders to remain as is or should be aligned with Codes of good practice.
3. If there is a clash between the charter and the Codes, then the Codes shall apply.
4. The Codes give expression to the bona fides of the BBBEE Act, which gives teeth to the Strategy for BBBEE.
5. The Strategy is government's plan for achievement of the shared growth imperative.

Above all things, one should make the spirit of BBBEE the beacon in structuring any BBBEE initiative – be it a transaction, employment equity intervention, corporate social investment, enterprise development or skills development undertaking (Sanchez, 2006:31).

This means that fulfilling the broader transformational agenda takes precedence over merely meeting the targets set in the scorecard. Failure to comply with BEE is not illegal but suicidal in terms of a company seeking new opportunities or even maintaining its status quo as the economic landscape seeks ways to transform.

One of the major objectives of codes of good practice is to stem the perpetuation of narrow-based empowerment. Vuyo Jack – co-director of the empowerment rating agency Empowerdex (2006:6) – welcomed the intervention as timely adding that, for example, ICT companies that concluded empowerment deals will be compelled to restructure those to ensure they comply with seven elements of the scorecard (Malala, 2006:74).

The codes of good practice also spell out the qualifying criteria for preferential purposes on procurement and other economic activities. The indicators are tabulated clearly (see table 2.1: section 2.4.1.2) and the weighting is clearly attached to these indicators. The codes also provide clarity on any other matters that are imperative in the achievement of objectives of the Act. The codes of good practice makes a clear distinction between black

men and black women in order to discern progress achieved with regard to emancipation of black women (SA, 2007:3).

The codes of good practice should be taken into consideration when a decision is to be made with regard to preferential procurement policy. The formulation and implementation of this policy should be integrated and married to the contents of the codes of good practice in order to achieve cohesion between the two (Power, 2008:44). Any organisation that desires to radically change ownership or partnership should also do so in line with codes of good practice.

The section below discusses the different codes of BBBEE.

2.7.1 Code 100: Measurement of Ownership

This refers to the ownership of the business by black people. The black people referred to in the ownership must have full voting rights and economic interest. Voting rights mean the levels at which black people participate in the formulation and execution of a company's strategy. Economic interest refers to the extent to which black people enjoy profits, dividends and other forms of wealth-accumulation. This should be due to ownership in the business enterprise.

2.7.2 Code 200: Measurement of Management Control

Management control refers to the extent to which black people plan, direct and control the resources and activities of the business enterprise. This is measured at two levels:

- Board of directors, which is entrusted with determining the strategic direction of the company.
- Executive Management, which is entrusted with day-to-day running of the company's activities.

2.7.3 Code 300: Measurement of the Employment Equity

The ultimate objective of this code is to have all sectors of South African society reflect the demographics of the country. This is done by promoting equal opportunity and fair treatment by eliminating unfair discrimination. Employment Equity ("EE") means implementing affirmative action measures in order to redress the disadvantages in employment experienced by black people as a result of exclusion by the previous system.

This codes guide companies on:

- The structure of the EE plan
- Process of constructing the plan
- The planning phase
- Developing the plan
- Monitoring and evaluating the Plan
- Affirmative action measure
- Dispute resolution
- Reporting

2.7.4 Code 400: Measurement of the Skills Development

This code refers to the training and empowering of black people to develop core and distinctive competencies to facilitate the ability to participate in the mainstream economy. Skills development should help to upgrade core and technical skills that will enable black people to participate in the wider economy in a meaningful manner.

2.7.5 Code 500: Measurement of the Preferential Procurement

The level of contributions made by Qualifying Small Enterprises will be the basis for entitlement to points on the QSE Preferential Procurement Scorecard. The following items will be taken into consideration for the calculations of Measured Procurement spend:

- Any services or products that make up the company's costs of sales in the Income Statement.
- Any services or goods that ensure day-to-day smooth running of a company's operations.
- Goods and services brought from a company that is a dominant player in its respective field.
- Any expenditure that is used for capital expansion projects.
- Any goods or products procured from state-owned enterprises.
- Payment as a result of a company using an independent contractor or a labour broker.
- Payment on behalf from a customer, where this is reflected in the customer's financial statements.
- Goods and services procured for the purpose of implementing the ideals of the seven BBBEE pillars.
- Services or products procured from subsidiaries or holding companies of the business enterprise being measured and the terms 'subsidiary' and 'holding company' to be interpreted in accordance with the Companies Act, 2008.
- Fund management costs for the administration of pension funds, provident funds, other post retirement funding schemes, medical aid schemes or insurance products (SA, 2006:3).

2.7.5.1 BBBEE Spend

To evaluate the BBBEE Procurement Spend, the total value of Procurement Items included in the calculation of Measured Procurement spend should be calculated. This figure is then multiplied by the BBBEE Procurement Recognition Level of the Supplier. BEE Procurement Spend will then be calculated as follows:

$$A = \Sigma (B \times C)$$

Where:

A is the calculated total value of the procurement spend

B is the value of the Procurement items include as per the above explanation

C is BBBBEE Procurement Recognition Level of each Supplier of the company being measured.

The score for a company being measured for preferential procurement contributions to BBBEE under the preferential procurement element shall be evaluated as follows:

$$A = B/C \times D$$

Where:

A is the calculated preferential procurement score for the business enterprise of interest

B is the total BBBEE Procurement Spend of the company being measured

C is the preferential procurement as discussed in earlier paragraphs

D is the weighting points

(SA, 2006:6)

2.7.6 Code 600: Measurement of the Enterprise Development

This element of BBBEE refers to the assistance that is being given to Small, Micro, and Medium Enterprises to be better positioned to be in a strong financial and operation position. This assistance can be in the form of coaching, mentoring or educating the SMMEs on how to run the business efficiently and effectively. This support includes financial assistance and business skills development. Non-monetary support is also emphasised in this element.

2.7.7 Code 700: Measurement of the Socio-Economic Development

This refers to the difference the company is making in the lives of the communities it operates in. This investment in the communities, which is usually referred to as Corporate Social Responsibility Initiative (CSI), is an indication of a company's bottom-line approach. In most cases, these CSI initiatives are infrastructure development projects.

In the next section, the generic scorecard that is used as a guide by DTI will be discussed.

2.8 THE GENERIC SCORECARD

The table below indicates the elements of the scorecard and the weighting assigned to each element.

Table 2.1: BBBEE Codes and the weighting

Element	Weighting	Code Series Reference
Ownership	20 points	100
Management Control	10 points	200
Employment Equity	15 points	300
Skills Development	15 points	400
Preferential Procurement	20 points	500
Enterprise Development	15 points	600
Socio-Economic Development	5 points	700

(Source: Department of Trade & Industry, 2004)

If a company is 100% black-owned, it will receive 20 points on the ownership element and if it is 25% black-owned it will received proportionate 5 points. Similarly, if a company spends half of its procurement spends on BBBEE empowered companies, it will receive 10 points. If a company is not involved in any corporate social responsibility projects, it will receive 0 points.

Companies will receive points per element depending on the level of progress that they have achieved on that element. The total number of points accumulated will be calculated. Depending on the total number of points, a company will be classified as "Level 4 contributor" or "Level 8 contributor" as guided by the table below:

Table 2.2: Compliance levels or BBBEE Ratings

Points	Compliance Points	Compliance Level
100 and more	135%	Level 1 Contributor
85 and less than 100	125%	Level 2 Contributor
75 and less than 85	110%	Level 3 Contributor
65 and less than 75	100%	Level 4 Contributor
55 and less than 65	80%	Level 5 Contributor
45 and less than 55	60%	Level 6 Contributor
40 and less than 45	50%	Level 7 Contributor
30 and less than 40	10%	Level 8 Contributor
Less than 30	0%	Non-compliant contributor

(Source: Department of Trade & Industry, 2004)

The above table is a generic scorecard that is used by the Department of Trade and Industry (DTI). However, sector-specific scorecards can be drafted but will need the approval of the DTI. This adds an element of flexibility to the process because a one-size-fit-all approach will not work across the board.

Now that the codes and charters have been discussed a comparison between the two can be made. The table in the next page tabulates the principles of the codes against the charter.

Table 2.3: Comparison of codes of good practices against BBBEE charters

Codes	Charter
Skills development as 3% investment	"Has the company offered every employee the opportunity to be literate and numerate by 2005 and are employees being trained?"
Employment target for women at 50%	Aims for 10% participation of women in mining by 2007
Seeks to ensure that fronting does not happen by requiring suppliers to meet a range of empowerment criteria (Singh, *et al.*, 2005:20)	Procure goods and services from black-owned or empowerment firms (Singh, *et al.*, 2005:20)

Source: Adapted from the Chamber of Mines

However, the charters have been ditched in favour of codes of good practice. Existing charters can be reviewed and transformed to be in line with codes of good practice. Charters were ditched in favour of codes of good practice because the codes guide companies on what action plans to follow to attain the objectives of the Act (SAMPPF, 2010).

2.9 PUBLIC PROCUREMENT

South Africa has the principles of procurement included in the supreme law of the land, the Constitution. The Constitution states that the following principles should be taken into consideration when buying goods or services:

- Fairness
- Equity
- Transparency

- Competitiveness
- Cost-effectiveness

These can be used as a guide and state-owned enterprises can go a step further. Before the apartheid system was dismantled in 1994, the state used to procure goods and services from large and mainly white companies (Van der Berg, 2005:41). Even though there have been suggestions to the contrary it is submitted that the word "procurement" (which heads the Procurement clause in the constitution) should be afforded a broad meaning: it refers to both the acquisition of goods or services and the selling and lending of assets (Bolton, 2008:784). If the word "procurement' is interpreted to mean goods and services only, then many state owned organs will still be doing business (in terms of trading assets) with white-owned companies.

The amount of funds that the government has for public expenditure is over R100 billion and therefore it is strategic to use this as leverage towards furthering the objectives of Preferential Procurement. Port Elizabeth Metro Procurement Manager, Vuyani Limba, has stated that the municipality has a policy which dictates that 40% of the monetary value of all municipal tenders should be consumed by empowered companies (Matavire, 2002:13).

Apart from the provisions in the Constitution (clause 217), there are other different legislations that are a support structure to the principles of the Constitution. The Public Finance Management Act No. 1 of 1999 (PFMA) regulates financial management. The Municipal Systems Act No 32 of 2000 and The Corruption Act No. 12 of 2004 are applicable to procurement procedures. The Corruption Act creates offences out of corrupt activities relating to tendering for state tenders.

A bidder who lost a tender has a constitutional right to challenge the procurement decision on the basis of procedural fairness, lawfulness and reasonableness. The aggrieved bidder has a right to information regarding a procurement decision. This information is easily accessed through Promotion of Access to the Information Act No. 2 of 2000, (PAIA), which makes access to information a constitutional right.

Before the dismantling of apartheid, the suppliers of goods and services to government were white-owned businesses. The state intends to use its financial clout to remedy past injustices. This applies to all layers of government (national, provincial and local). However, government owned parastatals such as Eskom and Transnet do not fall under the jurisdiction of the Procurement Act.

This is because these parastatals are involved with strategic development of the economy and should not be impeded in their quest to carry out their duties (Bolton, 2008:787). This appears to be hypocritical. This means that government recognises that preferential procurement will hamstring effective functioning of other companies.

There are companies that are bigger than Eskom and Transnet and who contribute more than these parastatals in terms of their contribution to the country's Gross Domestic Product (GDP). There is no thought given to what impediment obstacles these companies will come across. Government should show its bona fides and apply preferential procurement across the board and with no boundaries and limitations. This could undermine the credibility and the spirit of the implementation of this code.

In the case of *Fidelity Springbok Security Services Pty Ltd vs South African Post Office Ltd*, a court ruling was made that a parastatal (South African Post Office) could be regarded as an organ of state for the purposes of the Procurement Act (Frase, 2008:66). This should not be regarded as precedent. It has been made clear that parastatals are organs of state for purposes of the Constitution, but not for the Public Procurement Act No. 33 of 2006, because parastatals need flexibility in the implementation of their preferential procurement programs.

The Constitution should be regarded as the supreme law of the land. The Constitution's interpretation should rank above other laws including the Public Procurement Act No 33 of 2006. This means that the Constitution interpretation should supersede the Public Procurement Act . This point needs further clarification before it results in confusion.

Organs of state can request exemption from the Act but the Minister of Finance, the custodian of the Act, will have to grant it. This may, however, be granted only in the instances where it is in the interest of national security, or if the likely bidder is an international supplier or if it is in public interest (Bolton, 2008:787). However, a permanent exemption will not be granted because it will defeat the whole purpose of having a national framework for implementation of procurement policies.

The legislation makes provision for different methods of procurement:

- Petty cash;
- Verbal or written quotations;
- Written price quotations; and
- Competitive bidding.

The value of the contract influences the method of procurement depending on the level of the government. At national and provincial government levels, petty cash purchases are prescribed for contracts up to R2 000 and written or verbal contracts over R2 000 but less than R10 000 (Bolton, 2008:787). At local governments, the procurement methods are the same except that a written price quotation should be obtained for contracts over R10 000 but under R200 000 and tendering should be used for contracts above R200 000.

At local government level, a two-stage bidding process is used for large projects or projects that will run in excess of three years. An important point to emphasise is that being part of the designated group does not automatically mean one is entitled to preferential treatment. This was evident in *Cash Paymaster Services (Pty) Ltd vs The Province of the Eastern Cape.*

In this case, a contract was awarded for the payment of social pension and other welfare grants and the winning bidder was R200 million higher than the closest rival. In this case, the court held that:" Important as the RDP factors are, they are not to be regarded as the sole consideration or to be given such importance that at the end of the day they destroy

the economy and become counter-productive to that very noble purpose for which they were instituted. If tenders are to be awarded indiscriminately on the basis of RDP factors without due consideration for the cost to the country, then the inevitable result will be an impoverishment of the economy to such an extent that the very people that the RDP factors is intended to develop and empower will suffer the most and be impoverished even more at the end of the day." (Bolton, 2008:794).

In this case, the court called for a fresh tendering process and ruled that the extra R200 million was not commensurate to the benefits that will be obtained. This shows that values such as fairness, competitiveness and getting value for money be taken into consideration when a decision is made. In any way, the awarding of the contract to Cash Paymaster Services (Pty) Ltd violated the principles in the Constitution that serves as a guide for the public procurement system. It states clearly that it must be cost-effective and competitive. This clearly was not the case here.

The principles enshrined in the Constitution will also apply to companies in the private sector. The principle of fairness and equitability will apply in any company that cherishes good corporate governance. Transparency is the ability to be open and for everyone to see how the decisions are reached. A non-transparent company ends up in corporate scandals such as those experienced by Regal Treasury Bank in 2001. Running a competitive and cost-effective company is the cornerstone of a successful company in a dynamic market. As it can be seen, the principles of the Constitution that governs public procurement can be extended to private companies simply because those principles make good business sense.

South Africa is still not a member of the World Trade Organisation Government Procurement Agreement (GPA), whose sole purpose is to promote world trade by providing access to government business. South Africa's main trading partners have been exerting pressure for it to join the GPA.

Incorporation to the GPA would mean South African companies can compete for business in GPA member countries. However, this means South Africa will not have the power to apply for preference in awarding contracts on the basis of national policies namely to promote local business and encourage broad-based black economic empowerment (BBBEE). The restrictions are not absolute because considerable scope is provided for negotiation of exemptions and exclusions. However, it is a given that one cannot apply for exemptions all the time while local companies are enjoying business outside its borders.

2.10 THE PREFERENTIAL PROCUREMENT POLICY FRAMEWORK ACT OF 2000

2.10.1 The Charters on Preferential Procurement

According to Van der Merwe (2010:2), there is no charter for the Metals and Engineering sector despite it being an important component of the South African economy. The charters that are in place, such as the mining charter, put a heavy emphasis on preferential procurement. The Mining charter spells it out clearly that mining companies should give Historically Disadvantaged South Africans (HSDA) preferred supplier status and commit to progressively procure from HSDA.

The mining charter also urges the members to reflect on the genuine value added by the HSDA and encourage current suppliers to form partnerships with HSDA. The charter for the South African Petroleum and Liquid Fuels Industry drafted in 2000 travels the same path as the mining charter by encouraging adoption of supportive procurement policies to facilitate and leverage the growth of the companies of HSDAs. An examination of how a tender is adjudicated will be discussed in the next section.

2.10.2 Tender Evaluation System

The Act provides for preference in the procurement of government and state owned enterprises in favour of HSDAs and small, medium and micro-enterprise (SMMEs). According to the evaluation system for tenders, preferences are applicable to all tenders, irrespective of amount (Bolton, 2007:788). An 80/20 point system is applicable to tenders up to R500 000, while a 90/10 point system is applicable to tenders above R500 000. An example of how the 80/20 point system works is discussed as follows:

The Department of Education invites tenders for the provision of study materials. Company ABC, an empowered company, quotes the materials for R350 000. Company DEF, with no empowerment component, quotes the materials for R250 000. The contract is worth less than R500 000 and hence the preference point system will be used. The points awarded to Company ABC and Company DEF will be as follows:

Company DEF's tender:

Price: 80

Preference: 0

Total points: 80

Company ABC's tender:

$Ps = 80 (1-(Pt-Pmin)/Pmin))$

Where:

Ps = the points scored for price for the tender under consideration

Pt = rand value of the tender under consideration

Pmin = the rand value of the lowest acceptable tender

Therefore:

Ps = 80 (1-(R350 000 – R250 000)/R250 000))

= 48

Preference = 20

Total points = 68

The tender will be awarded to **B** because it scored the most points.

For the former, "80" focuses on price differences between bidders and 20 points are awarded based on the empowerment characteristics of the tender and for achieving the specified Reconstruction and RDP goals (Bolton, 2005:56). For tenders with a value above R500 000 a maximum of 10 points can be scored for the empowerment characteristics and for achieving the specified RDP goals. These goals can include the promotion of SMMEs, promotion of enterprise located in a specific province, region, municipality or rural area, the empowerment of the workforce through skills development, upliftment of communities (Thomas, 2006:14). The Minister of Finance is mandated with the implementation and monitoring of the procurement system.

Since 1996 a maximum of 11.1 percent preference has been allowed for HSDAs who tender for building and construction contracts administered by the Department of Public Works, while a maximum of 13.6% preference was allowed for equity ownership by HSDAs and women for contracts with a value up to R2 million (Ponte, 2007:62). For contracts over R2 million, no preferences are allowed. The initial implementation of preferential procurement will now be examined.

2.11 INITIAL STAGES OF PREFERENTIAL PROCUREMENT

Preferential procurement is a two-way relationship between a supplier and a customer. The customer could leverage its bargaining power to discipline a supplier to adhere to

certain practices and provisions, that is, BBBEE legislation or regulations (Pauw & Wolvaart, 2009:68). This depends on the balance of power between supplier and the buyer. For example, there was one case where one company indicated that preferential procurement has no impact because it is a monopoly supplier (Gunter, 2006:46).

In the initial stages, preferential procurement was not meticulously implemented. This means that suppliers were not punished for low scores on the generic scorecard. White-owned firms were still bidding and winning tenders from private sector and government-owned enterprises. However, there were isolated incidents where firms lost business due to lack of empowerment status.

The weak link in the BBBEE chain is how it impacts foreign-owned firms, because there is no clarity on how exactly the BBBEE legislation affects them. In addition, firms that supply highly technical input are shielded from BBBEE imperatives since competitive pressures are severely limited. However, there have been cases where some firms lost business to empowered competitors (Quentin, 2005:2). As preferential procurement is gradually being understood and implemented, some companies were denied business because of not being empowered. That was the first time that many companies realised the seriousness of being empowered.

There is growing pressure on firms to report BBBEE status. The charters in the construction sector that is under consideration will force industry players to address BBBEE. Where there is no charter endorsed or no codes of good practice published, as is the case for multi-national corporations, firms appear to adopt a wait-and-see approach rather than pro-actively engage in issues of empowerment, including employment equity and skills development.

Anecdotal evidence suggests that the Preferential Procurement Code of BBBEE is benefiting firms that provide non-essential services. There has been an increase in firms providing services than the one supplying goods. BBBEE firms are supplying services such as cleaning, security, catering and gardening. In the case of technical and material input

those sourced from BBBEE firms tend to be basic materials such as scrap metals input for a foundry. Firms have reported that in the metals sectors there are simply no independent BBBEE firms that have the capabilities to do research, design and engineering of intermediates (Mahomed & Roberts, 2006). Employees who worked in these disciplines have a good chance of starting a company and then rendering a service to their former employer.

2.12 EMPLOYER AND FORMER-EMPLOYEE PREFERENTIAL PROCUREMENT RELATIONSHIP

Another emerging trend is that of firms outsourcing support services to former employees. These employees know the exact requirements of their former employer. This puts them in a strong position to meet the former employer's performance requirements. Although the outsourcing of non-core activities to former employees from designated groups could aid black enterprise development, firms should be careful that these activities are not conducted in a manner that will undermine employer-employee relationships (Moodley, 2008:32). This also has the possibility to open the employer to a host of accusations such as nepotism.

2.13 INCORRECT INTERPRETATIONS OF PREFERENTIAL PROCUREMENT

There are some firms who claim to be 'empowered' and on closer scrutiny it is evident that this claim is based on spurious grounds. Some firms still do not understand exactly what does being 'empowered' means. There are three firms that claim to source in excess of 60% of technical/material input from BBBEE firms.

On closer inspection, these claims are based on incorrect interpretations. One is sourcing from ArcelorMittal and this is claimed as an empowerment transaction because ArcelorMittal is a black-owned company (Gunter, 2006:56). This is due to ownership by

Lakshmi Mittal, an Indian national who is regarded as black. Another firm is sourcing from Trident Steel, part of the Aveng industrial group, formerly part of the Anglovaal conglomerate and now controlled by institutional investors (Quentin, 2005:2). This raises serious questions about effective implementation of BBBEE since preferential procurement is an important part of the DTI's planned scorecard.

There is little difference between foreign companies and local companies in sourcing services and/or input from BBBEE suppliers. For foreign-owned firms the impact of the Preferential Procurement Policy Framework Act No. 5 of 2000, and the mining and petroleum charters, were reported as key considerations given the importance of the state-owned enterprise, mining and petroleum markets for these firms (Cohen, 2005:9). Procurement was viewed as a way to present a BBBEE image where ownership could not change.

Surprisingly, some state-owned enterprises are not doing well in sourcing inputs from BBBEE firms despite being governed by the Preferential Procurement Act. Reasons given for not sourcing inputs from BBBEE firms include the unavailability of competent BBBEE firms to supply highly technical inputs. Firms with a 25.1% or more black shareholding are sensitive about their empowerment profile as one of their competitive characteristics and also seek to maximize the apparent purchases they themselves make from BBBEE firms.

2.14 PREFERENTIAL PROCUREMENT TARGETS

In 2001, the ANC issued a policy statement which spelled out the targets for implementation of preferential procurement (ANC, 2001):

- At least 30% of private sector procurement should be companies that are owned or controlled by black people.
- At least 50% of state-owned enterprises and Government procurement (at all levels) should be black owned SMMEs.

- At least 40% of Government incentives to the private sector should go to companies controlled or owned by black people.
- At least 30% of long-term contracts and concessions within the public sector should incorporate black-owned companies and collective enterprises upfront.

The term 'black people' is defined as 'Africans, Coloureds ad Indians' and is limited to South African citizens only. Preferential Procurement is a way of broadening the beneficiaries of BBBEE. White women and disabled white women are not included in the definition of historically disadvantaged South Africans according to the BBBEE Act.

2.15 SA MINING PREFERENTIAL PROCUREMENT FORUM

The Mining sector has created the SA Mining Preferential Procurement Forum which is a system that ensures that a significant portion of its members' annual capital expenditure – approximately R31 billion – is spent on empowered companies. The forum also maintains a database of empowered companies that provides a wide-range of services and goods. The representatives of the Forum ensure that companies are truly empowered and conduct audits to verify empowerment credentials. Pierre Lourens – CEO of Impala Platinum's community development trust – and also chairman of the forum says, "We have decided to take the middle road when it comes to accreditation. We scrutinise documentation rather than taking the companies' word for it and we conduct site visits" (Paton, 2004:44). A brief outline of the importance of preferential procurement will be examined.

2.16 A SUCCESSFUL PREFERENTIAL PROCUREMENT PROGRAMME

The African National Congress (ANC, 2002:18) released a report which specified the four requirements for a successful Preferential Procurement Programme:

- Management must be committed to implementation of preferential procurement.

- Implementation of preferential procurement should complement the achievement of a company's strategic objectives.
- Implementation must boost growth of the country.
- Accreditation agencies should independently verify and endorse the empowerment credentials.

A new company culture has to emerge for BBBEE to be successful and 'all hands should be on deck' and it should be clear that it is 'business unusual'. SMMEs are often faced with a costly ultimatum of either transforming or losing their business (Booysen & Bouche, 2005a:46). Additionally, these authors point out that forcing SMMEs to give up control or sell will not be the best available option.

SMMEs should be careful when introducing an empowerment partner. A due diligence process should be followed and the following points should be taken into consideration to ensure that the right partner is chosen (Booysen & Bouche, 2005b:59):

- The chosen partner should have the skills and expertise to make a meaningful contribution at management and operational level.
- The chosen partner should have good understanding of the industry and the driving force behind the industry.
- The partner must bring strategic fits to the business and make a contribution towards competitive advantage.
- The partner must have capacity to assist in the transformation of the SMME.
- The partner must bring diversification opportunities, which can be used as an engine for growth and pursuit of new opportunities.

If these points are adhered to, SMMEs will have a very positive future in South African economy through long-term and sustainable relationships.

2.17 PHASES OF PREFERENTIAL PROCUREMENT

Mutual trust and respect play an important part in the corporate procurement process (Lusengo, 2007:43). As preferential procurement was gradually introduced, it went through various phases in the implementation stage.

2.17.1 'Dazed and Confused' Stage

Buyers have cemented relationships with the suppliers over many years of working together. These relationships were based on trust, mutual understanding and good customer service. When preferential procurement was implemented, this meant that white companies had to be ditched in favour of black empowered companies. This, coupled with the lack of clarity on how exactly preferential procurement works, resulted in buyers unsure of what to do. This was the 'dazed and confused' stage.

2.17.2 Database Stage

Companies were now in active search for black-empowered companies that can supply the required goods and services. This presented a problem because this information was not readily available. Business-savvy individuals realised that forming a database and selling it to companies looking for black empowered SMMEs could present business opportunities. This resulted in a consolidated database for black empowered companies. However, this phenomenon was not without problems. In a highly-paced market, one needs to constantly updated information in order for it to remain current. If this is not done, the information becomes invalid and meaningless.

2.17.3 Post-Database Stage

When the quality of information on the database created problems for companies, a migration to traditional buying tactics was done. This involved old ways of doing business

with suppliers. Tactics such as haggling, face-to-face negotiations, intuition and relationship based methods came into play. Classification of suppliers (*see next section*) relates to the definition of preferential procurement, whereby the classification of suppliers becomes vital when awarding an empowerment contract.

2.18 THE CLASSIFICATION OF SUPPLIERS

A 'black company' is the one that has black ownership of more than 50%. Please refer to *2.7.1 Code 100: Measurement of Ownership* for a definition of ownership in the context of BBBEE.

Table 2.4: Classifications, Rating and Benefits of BBBEE Companies

Classification	% Ownership	Rating	Benefits
Black Company	> 50%	A	15% price preference
Black Empowered Company	> 25.1% but less than 50%	B	15% price preference
Black Influenced Company	>5% but less than 25%	C	5% price preference
Engendered Company	>30% representation by women	D	5% price preference

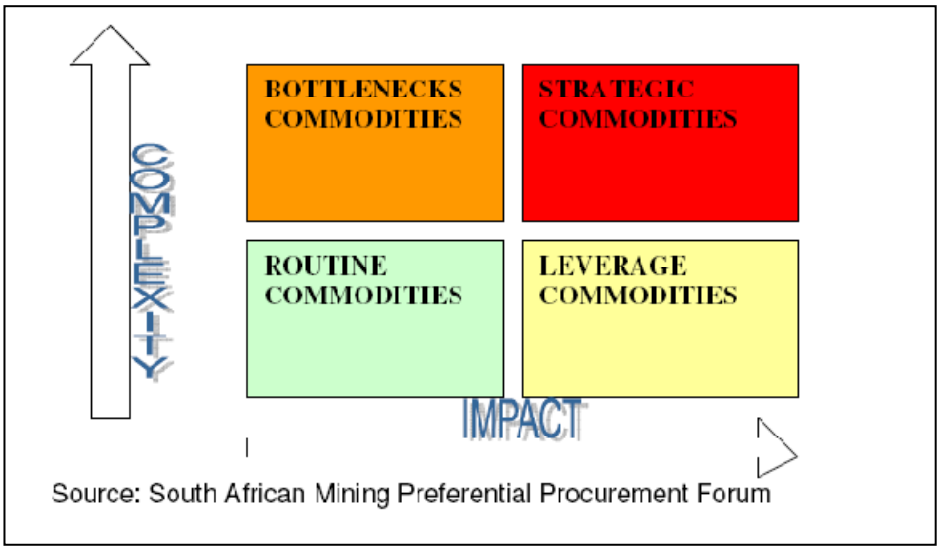
(Department of Trade and Industry, 2007)

The above table shows the benefits that accrue to a company depending on ownership and the extent of empowerment. A rating is then allocated to a company and this is used to guide the preferential procurement process.

2.19 CLASSIFICATION OF COMMODITIES SUPPLIED BY EMPOWERED COMPANIES

The South African Mining Preferential Procurement Forum (2007:12) has identified different types of commodities: bottlenecks, strategic, routine and leverage. These differ on complexities and impact on the operations. Each is discussed individually below.

Figure 2.2: Complexities and Impact of Different Commodities



Source: South African Mining Preferential Procurement Forum

2.19.1 Strategic Commodities

These are commodities that are very important for day-to-day running of the plant. If it is available or is broken, production will stop. These commodities are high in complexities and also high on impact. The consequences are high if there is a problem with this commodity. Example of this will be specialised machinery used in a production facility. A company will make sure that it finds the supplier for this commodity. Safety and quality will be important parameters in the decision to choose a particular supplier (Browning, 2006:22).

2.19.2 Routine Commodities

These are commodities that support the secondary activities of the business. The primary purpose of the business can continue without these. An example of this will be toilet paper. These commodities are low in complexity and also low on impact. A company does not have to waste a lot of time trying to find the right supplier for this commodity. Price will be an important factor here while quality will be a secondary consideration.

2.19.3 Leverage Commodities

These commodities are low in complexity and high on impact. An example of this will be personal protective equipment at the mine. It is not a complex product but the consequences of not having it can be severe. A worker can suffer an injury, or worse, a fatality can occur. The mine will make it top priority to find the right supplier for this commodity.

2.19.4 Bottleneck Commodities

These commodities are high in complexities but low in impact. This usually represents products or services that needs specialised expertise but are not necessary for day-to-day running of the plant. Price will be an important consideration in this commodity.

2.20 INITIAL EXPERIENCES WITH PREFERENTIAL PROCUREMENT

This section deals with the initial experiences Company XYZ went through in the initial stage of venturing into preferential procurement. The contents of this section were generated from a personal interview with the Preferential Procurement Manager of

Company XYZ. The Manager stated that Company XYZ was in a rush to implement preferential procurement.

The first problem was that many companies did not have a policy or a strategy to guide them in their implementation. This is problematic because it means companies do not have a sense of direction and just follow the letter of the Act. Lack of planning ended disastrously and that is why many companies ended up with, for example, sub-standard products or services because there were no systems in place.

One of the issues highlighted is the lack of knowledge and skills by potential suppliers. These people might be good with products or services that they are offering but have no business skills. This could mean, for example, that when a quote is submitted, it is not up-to-standard. Some of the suppliers do not know how to structure a quote and have no knowledge of the commercial environment (Louw, 2010:1). Some quotes were so low that the owner of the business did not realise that it did not make business sense. This means that new suppliers need to be developed in order to hone their business skills.

This meant that some suppliers are providing products and services at a loss. The sustainability of these suppliers can be threatened. One of the companies on the JSE Top 40 realised this and had to retrospectively review payments that it has been making to suppliers and to adjust this upwards. One of the interventions that this company implemented was to ensure speedy processing of invoices submitted by these companies. Normally, suppliers are paid 60 days after invoice submission. This company now pays SMMEs within 6 days of invoice submission. Speedy payment helps suppliers with liquidity and improves working capital. It has also collaborated with one of the banking institutions to help 'uneducated contractors'.

The companies that engage in a business relationship need to generate mutual understanding. This is why vendor audits are important. This audit helps to find out if the would-supplier has proper systems in place and if there is capacity to provide the needed service. Proper insights will be derived from these audits and one will also find out if the

potential supplier is complying with the law, for example, tax and workman's compensation.

Preferential procurement does not occur in a vacuum. This is why it is important to talk to suppliers that are not complying and engage them on this issue. Everyone needs to be on the same bus and singing from the same hymn sheet. This will create a bigger impact from the synergies involved and total value derived will be higher than the sum of the values that could be added by individual companies.

Companies also need to be trained and in order to know exactly what preferential procurement entails. Confusion still reigns and many companies' still view this as a threat. This training will clear the air and help to drive the threat out. Threatening companies will not help the cause of BBBEE. These experiences show why it is important for a company to have a policy that guides its action in implementation of preferential procurement.

2.21 PREFERENTIAL PROCUREMENT POLICY

A company that implements preferential procurement needs to have a policy in place. This policy should form the basis and the framework and can be used as a guide towards the implementation of preferential procurement in a business entity. The policy should be recognising that BBBEE is a business imperative that can be used to contribute to the development and growth of SMMEs. The policy should have objectives attached to it.

These objectives will include the establishment, monitoring and reporting of progress against annual targets in respect of goods and services that is procured from BBBEE vendors. This can be used as a two-way relationship. It can also be used to encourage non-BBBEE vendors to establish and implement BBBEE initiatives. The policy can provide a guideline of how to facilitate access of BBBEE vendors to procurement activities of the company concerned.

The procurement policy should stress the point that engaging in preferential procurement is in no way a compromise of the following:

- The expertise and experience of persons supplying services;
- The specifications and quality of goods to be supplied;
- Delivery reliability; and
- Pricing.

This policy will need to be drafted with maximum participation of all the role-players. A buy-in should be sought from everyone who will be involved in this value chain. The success or failure of this will be dependent on how well it is implemented and how motivated the personnel is to the cause. The policy should also be communicated to all prospective tenderers, BBBEE vendors and all other suppliers.

The policy should be governed by all statutory principles. It should complement these and should be drafted as a holistic document that encompasses all other facets of BBBEE. This is because preferential procurement does not exist in isolation but is just a small part of a bigger whole. The statutory regulation that should be kept in mind includes, but is not limited to:

- Employment Equity Act No. 55, 1998;
- Skills Development Act No. 97, 1998;
- Preferential Procurement Policy Framework Act No. 5 of 2000;
- Skills Levy Act No. 97, 1998;
- Broad-Based Black Economic Empowerment Act. 2003;
- Any accompanying regulations (Government Gazette No. 29617 dated 2007-02-09), as may be promulgated from time to time; and to the
- Code Services 500 "Measurement of Preferential Procurement Element of BBBEE".

The policy also needs to be integrated with all commercial policies of the company and ensures that it is integrated with other facets of the commercial systems of the company.

The personnel who are the authorised functionaries responsible for the procurement of goods and services will need to be trained and be well-versed with the spirit and letter of the document.

The policy needs to tabulate the order of preference for SMMEs. This means how does a black owned woman or black owned company fare against a company that has targeted sub-contractors and is outsourcing to a BBBEE beneficiary. How does a company being assisted with an applicable Enterprise Development initiative fare against a skills development transfer and mentoring situation? This means that BBBEE should have a multiplier effect on the economy.

The policy should state clearly on what basis will preference be given to BBBEE vendors and tender requirements that will need to be met (this will vary from tender to tender and should be stipulated in the tender document). A process should be communicated on how the decision will be arrived at. If a balance scorecard is used, it should be clearly communicated and how ratings will be calculated.

The successful tenderer will need to comply in all respects with the criteria provided. If this is required, the successful BBBEE tenderer will also have to comply with criteria such as technical evaluation. The rating will need to be in preference order as discussed above. The registration details for vendors and audit requirements should also be communicated. It should be stated what actions will be taken should a tender be based on falsified information. The generic scorecard (*see section 2.8*) should be comprehensive and include the following aspects:

- Ownership (broken down by voting rights, economic interest and others);
- Management Control (Board participation at top-manager level);
- Employment Equity (black employees);
- Skills Development;
- Preferential Procurement;
- Enterprise Development; and

- Socio-economic Development.

Most companies tend to use one of two ways to determine a supplier's status – either a complex questionnaire or insistence on a certificate from a rating agency. The first creates an administrative overhead for both supplier and purchaser and the second is a financial burden on suppliers, many of which are unable to afford services from rating firms' services (Janisch, 2005:8). The methods are viewed as threatening and a way to stifle the market.

2.22 CHALLENGES OF BBBEE

2.22.1 Fronting

Fronting is the use of people, names or objects to represent an ideal while masking an uncomfortable truth (Bonorchis, 2005:2). A recent high-profile example of fronting is Height Safety International. Meshak Mabalane, an employee of Height Safety International, was named a shareholder by the company in order to fabricate its BBBEE credentials (Rose, 2010:1). The company successfully secured lucrative contracts, among others, to build the façade of the 2010 World Cup flagship stadium, Soccer City near Soweto.

This phenomenon presents one of the biggest challenges facing BBBEE. Fronting is when one pretends that they are black-owned or have significant black management when it is not true. Basically, it is about falsifying one's BBBEE credentials. There have been many media stories where a security guard at the gate is named a 'director' when a company is bidding for business. As it turns out this security guard knows nothing about this and has nothing to do with the business operation except to open gates and search people coming in and out of the building.

This practice undermines the efficacy of BBBEE including the Preferential Procurement Policy Framework Act No. 5 of 2000. Companies are procuring goods and services from suppliers who are believed when BBBEE credentials are stated. This maintains the status

quo and does not aid development of companies owned or controlled by HDSA. The practice of fronting has been described as 'an act of terrorism against empowerment' (Ngcobo, 2003:2).

However, front is becoming more complex and sophisticated. A senior public official revealed that government is beginning to see 'advanced fronting' (Direko, 2010). This is what one can describe as black-on-black fronting: when a company is 100% black-male owned and it is pretending to be black-female owned in order to put itself in pole-position to land a lucrative contract. This is only one of the forms of advanced fronting. These company directors use the names of their wives, cousins and friends to mask the true credentials.

Government has begun to crack down on fronting and has promised to take strong punitive action against offenders. Former Gauteng Premier Mbazima Shilowa has stated that a contract that was awarded as a result of fronting should be considered as fraudulently acquired and punishable by law (Roberts, 2006:66). A firm has been charged with fraud after it was discovered that it secured a multi-million rand deal to supply sirens to the police service after it listed a black woman, who sells sweet and cakes from the backyard, as a 49% shareholder in the company (Roberts, 2006:67).

Former Minister of Public Works, Stella Sigcau, announced the introduction of a credit system to evaluate procurement contracts in a bid to stamp out the practices of fronting. Rating agencies also need to ensure that their clients have meaningful and tangible BBBEE credentials in accordance with BBBEE.

2.22.2 Other Obstacles to Preferential Procurement

Gunter (2006:58) has identified critical obstacles in the implementation of preferential procurement:

- One-man black companies winning government contracts and then 'subcontracting' other companies to do the job.
- Rent-a-black schemes to falsify empowerment credentials.
- Opportunistic dishonesty that exploits government's genuine desire to increase economic activity of black people.
- No buy-in or will from the decision-makers to implement preferential procurement policies.

All the above are detrimental towards the achievement of real empowerment and diminish the foundation for genuine transformation.

Companies need to feel that it is in their business interest to implement preferential procurement. It should be shown and understood how the business will reap benefits by implementing this. This will ensure sustainability of the business and help the business to do more than it is doing now. This is the only game in town. Companies need to do a thorough analysis of their industry landscape and will generate good understanding of driving forces behind the industry. It will also increase the understanding of the micro and macro environment of the business. This will help to make quality and well-informed decisions.

2.22.3 The Funding of BBBEE Transactions

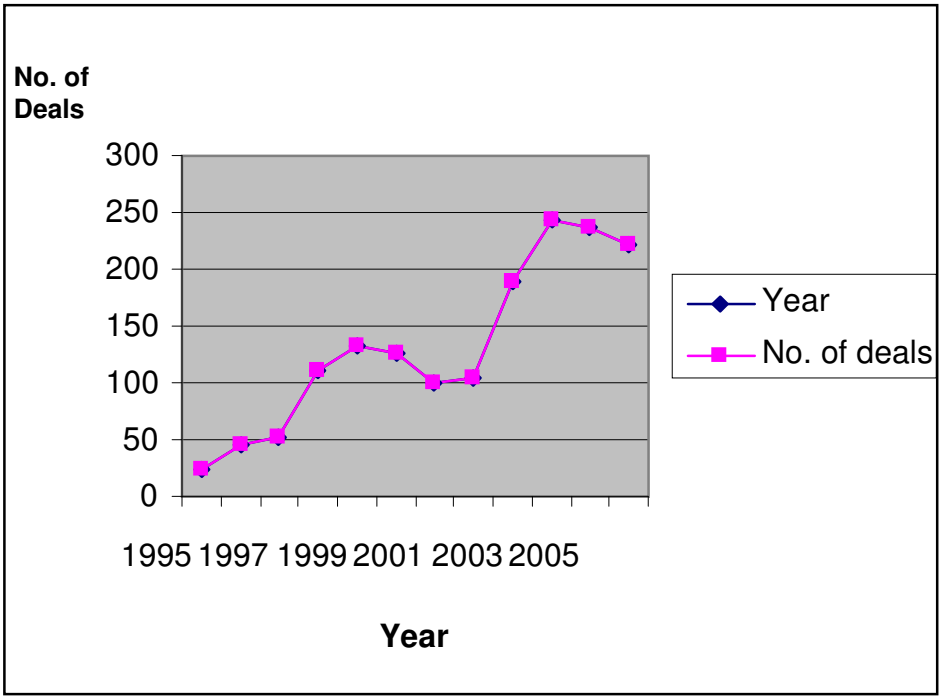
One of the challenges facing BBBEE transactions is funding, or lack thereof. According to Fauconnier and Mathur-Helm (2008:12), many deals have failed because of unsustainable funding. Radebe (2006:68) makes an example of the Johnnic deal that failed because of an inappropriate funding structure. The problem with this transaction is that it was based on expectations of an increase in the share price (Ngubane, 2009:76).

Several funding structures have been developed to deal with perceived lack of finance from black people (Burger et al., 2003:17). These include the following:

- Special Purpose Vehicle (SPV);
- Asset Securitisation;
- Convertible Debentures;
- Reverse-takeover of Initial Public Offering (IPO);
- Mergers;
- Employee Share ownership Schemes;
- Split-up of assets;
- Equity Financing;
- Deferred Shares;
- Vendor Financing; and
- Private Equity Partnerships.

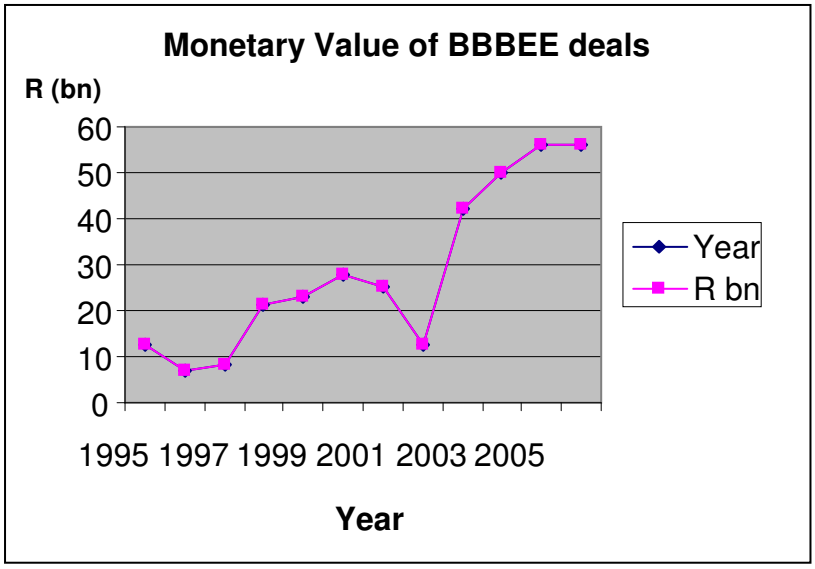
The first six will be discussed briefly and the research will not dwell into other finance structures. This is because BBBEE finance is a complex research topic on its own.

Figure 2.3: Number of BBBEE deals since 1995



The above graph shows that companies have been trying to close BBBEE deals. This is shown by an increase in the number of deals, except a slight dip in 2000.

Figure 2.4: Monetary Value of BBBEE deals since 1995



The graph on the last page shows that, except for a dip in 2003, the amount of money spent on BBBEE deals has been increasing steadily until 2006. This means that many companies are trying to comply with the BBBEE Act and are seeking to close deals with empowered partners. However, these deals are at ownership level and do not reflect the indirect empowerment elements of BBBEE. This means that it is still a great challenge to spread the benefits of BBBEE as wide as possible.

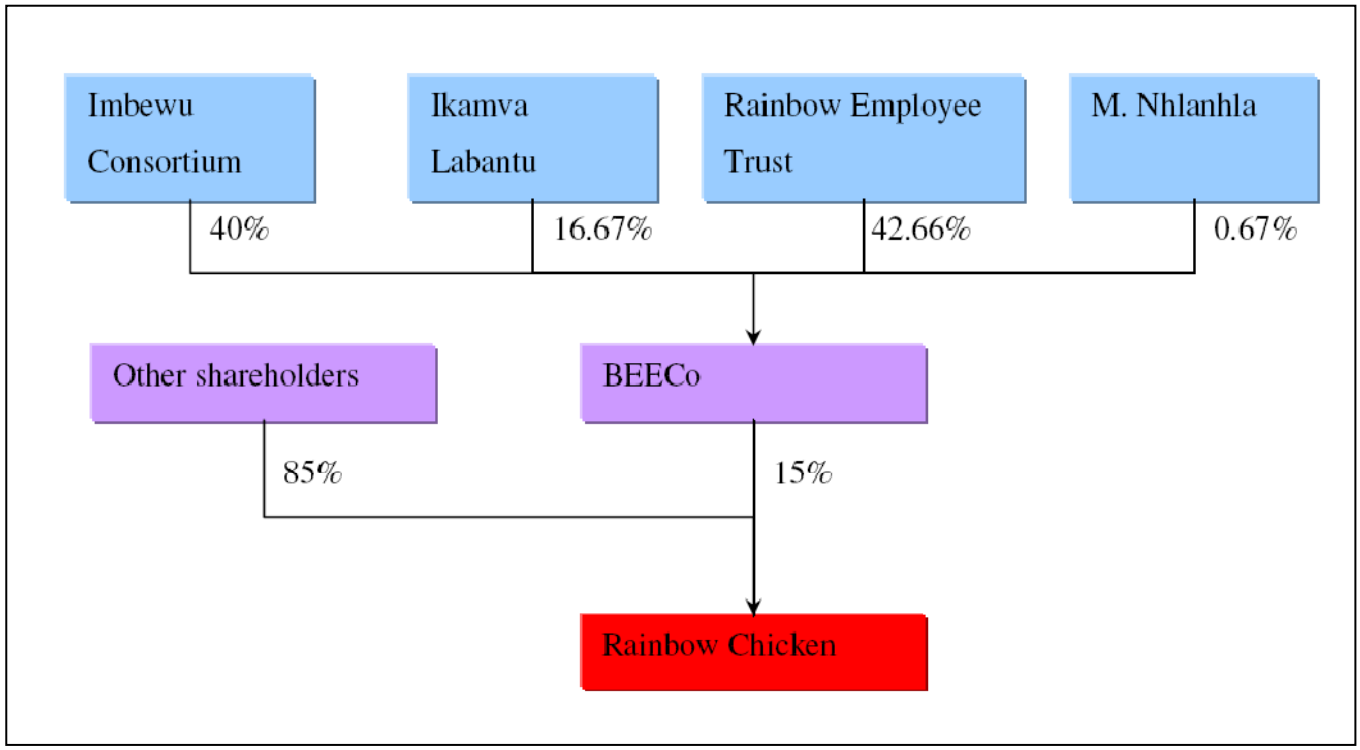
2.22.3.1 Special Purpose Vehicle (SPV)

Many BBBEE companies do not have funds to access equity in white-owned business enterprises. In general, there is no asset that can be used as surety to raise loans in order to finance a BBBEE transaction. The underlying logic of financing a transaction through debt is that the profit from the asset can be used to finance interest on the loan. Special Purpose Vehicle (SPV) finance structure is one method of ensuring that a BBBEE deal does not collapse because of the non-performance of the asset.

An example of this type of finance structure is the Bidvest-Dinatla deal. Arrangement was made that Bidvest's 15% deal with Dinatla gave voting rights to the empowerment shareholder, but ownership transfers only in three years, provided Bidvest's share price reach a price where it makes commercial sense for the BBBEE enterprise to exercise options allocated to it (Levitt, 2005:7). However, Bidvest can score points on the scorecard because of the 'conclusion' of this deal even if ownership has not been transferred.

Another example of an SPV deal is the acquisition of 15% of Rainbow Chickens by an SPV, called BEECo, which is owned by several institutions (Avery, 2008:11):

Figure 2.5: Typical Structures of SPV/Consortiums



The diagram above indicates a simplified drawing of the SPV structure

2.22.3.2 Asset Securitisation

This finance structure is used when a BBBEE company owns assets and wants to use the cash flows from these to acquire equity in another company. These assets owned by the BBBEE company will be thrown into a basket. The assets will then be moved to an SPV, which will issue equity to the BBBEE company. This separation of the original owner from the asset ensures that BBBEE investors in asset-back securities are not exposed to credit risks of the original owner. SPV, which was popular with regard to financing BBBBE deals, is no longer an attractive option for fund managers seeking to finance BBBEE transactions.

2.22.3.3 Convertible Debt or Convertible Debentures

This is a widely used finance structure when an asset that will be invested in will generate consistent and assured cash flows. Debentures or convertible preference shares can be issued to BBBEE enterprise and these can be converted to ordinary of preference shares at a given price at a future date (Levitt, 2005:9).

These are preferred when interest rates are high because the BBBEE company will pay low interest as compared with unconvertible debentures. A fixed rate is payable to debenture holders each year until maturity. If there is failure to pay interest or the principal loan amount, debenture holders can apply for liquidation of the enterprise and recoup the losses through the sale of assets.

2.22.3.4 Reverse takeovers (RTOs) or Initial Public Offerings (IPOs)

RTO is also similar to issuing shares to the public because the company becomes publicly traded. However, reverse take-overs are done through an existing "shell" company, generally a defunct or dormant corporation that has a previous life in public markets and its only asset is cash in the bank (Fauconnier & Mathur-Helm, 2008:12). This finance structure can have serious drawbacks especially past liabilities of the sheet from the previous life.

Funds can also be raised by a normal IPO process although this might not be the best method. This method does not represent a good exit point for companies that want to sell the shares. The listing expenses can be high and requirements for representation and warranties for profits can turn off many BBBEE enterprises. The shares are generally held in escrow for a fixed time period, meaning that the enterprise will not be able to access its newly found wealth any time soon as it will be embargoed from selling its shares for a period of time (Levitt, 2005:10). A public company has to fulfill certain requirements that a private company does not have to deal with. For a BBBEE enterprise not used to this, the challenges can be tedious and depressing.

2.22.3.5 Mergers

This is the case where a white-owned company merges with a black-owned company to form a black-empowered company. In 2007, African Legend Technologies merged with Datatec to form a new company called African Technology Indigo. Datatec owned 55% of the company while its empowered partner holds the remaining 45% (Datatec, 2006).

The advantage of this type of deal is that the two merging companies can create synergy that can be used to strengthen and improve the merged company's financial performance. The main disadvantage of this financing structure is that shareholders of these companies get high return in the beginning and are saddled with low returns in the long term (Negash, 2004: 31).

2.22.3.6 Employee Share Ownership Schemes (ESOPs)

In this funding structure, companies buy shares for employees by utilising internal cash flows or debt. Companies that have used this model include the recently announced BBBEE deal of ArcelorMittal and Sasol's Inzalo transaction, where 4% of the company was transferred to the employees and black managers (Sasol Limited, 2008).

According to Balshaw and Goldberg (2005:8), employee share ownership has the advantage of better retention and incentivisation of employees. Jack (2007:28) corroborates this by arguing that employees will have a vested interest in the company and will ensure that the business performance is enhanced and sustained. This structure also poses some risk. Employees leaving the company will cause cash drain on the company coffers because the shares have to be repurchased (Balshaw & Goldberg, 2005:8).

2.22.4 Government Affiliated Agencies

The government has mandated several institutions to, among other things, facilitate the funding of BBBEE transactions. This includes, but is not limited to:

- National Empowerment Fund (NEF);
- Industrial Development Fund (IDC); and
- Khula Enterprises.

Please see Bhakwira and Khumalo (2004:13) for detailed facts and figures on the performances of the above institutions with regard to financing of BBBEE deals.

2.23 DIVERGENCE BETWEEN PREFERENTIAL PROCUREMENT AND BBBEE POLICIES

The two above policies advance the interest of two different beneficiaries. The Preferential Procurement Policy Framework Act No. 5 of 2000 promotes the interest of Historically Disadvantaged Groups (HDG) where as BBBEE advances the interests of black people. HDG include white women where as BBBEE does not cater for this group. There is also an example of a black person who does not qualify as HDI in terms of the Preferential Procurement Policy Framework Act No. 5 of 2000. An example would be a black person who became a citizen by naturalisation after the commencement of the interim

Constitution, because the apartheid system barred him/her from doing so before that date (Marais & Coetzee, 2006:121).

The two Acts have guidelines that should be taken into consideration when a preferential procurement policy is implemented. Price has no bearing on the Broad-Based Black Economic Empowerment Act 53 of 2003where as it has a central focus on the Preferential Procurement Policy Framework Act No. 5 of 2000. There is a need to harmonise the BBBEE Act, codes of good practice issued by the DTI, Preferential Procurement Policy Framework Act No. 5 of 2000, provincial governments and state-owned enterprises' strategies on matters of procurement (Khaas, 2005:2). The different interpretations of beneficiaries needed to be closed because it opens the BBBEE to abuse.

2.24 CRITICISMS OF BBBEE

2.24.1 Moeletsi Mbeki

Moeletsi Mbeki, a prominent political commentator and analyst, has criticised the policy of BBBEE. Moeletsi argues that white businesses realised the possibility of the new government implementing radical economic policies such as nationalisation or high taxation of wealth gained during apartheid (Mbeki, 2009:9). This was not in white businesses' interests. To mitigate this risk, white business came up with a novel solution. It volunteered to transfer some of its assets to black leaders in return for the business environment being left as it is.

Moeletsi offers the example of Sanlam, when it created NAIL, and then transferred the control of one of its small subsidiaries, MetLife, to several ANC and PAC affiliated leaders. The device was used to split shares into a small package, dubbed high voting shares, which gave politicians who were funded by a loan from the Industrial Development Corporation (IDC), control of the company (Mbeki, 2009:9).

This new-formulated business relationship between old adversaries allowed white business to move primary listings from South Africa to London. Some of South Africa's companies – Anglo American Corporation, Dimension Data, Billiton, South African Breweries and Old Mutual – moved their primary listing to London.

Moeletsi Mbeki might not be entirely accurate. The primary listing of these companies may have been moved to London in order to attract extra capital that is needed to expand the business operations and be a global player. South African Breweries (SABMiller – after taking over the Miller Brewing Company in the United States) has executed an aggressive expansion strategy through acquisitions and to become the world's second biggest brewer by volume. Billiton was involved in mergers for expansion purposes and is now called BHP Biliton. Old Mutual has acquired some US and Scandinavian businesses and some of these acquisitions were not successful transactions. The situation deteriorated to such an extent that their highly acclaimed Chief Executive, Jim Sutcliffe, had to resign.

Speaking at the Gordon Institute Business School, GIBS, Moeletsi Mbeki summed up the contradiction by saying:"Who gets what share of state revenue between the black elite's private consumption and the poor people's welfare consumption; investment in social and physical infrastructure; payments to other claimants such as workers in the public sector. Competition between these claims on state revenue has become increasingly explosive. South Africa is, therefore, now entering a new phase of conflict – between the black political elite and the masses over how to distribute state revenue between them. This struggle is commonly referred to as a struggle over service delivery which, in a limited way, it is" (Mbeki, 2006:10).

Mbeki argues that if the objective of BBBEE was to create instant millionnaires who add no value to the economy, then it has succeeded. The interests of new black millionnaires and white business are the same. Both of them share the support for a migrant labour system and South Africa's continued reliance on mineral exports.

2.24.2 Solidarity

Trade Union Solidarity has worked with the Democratic Alliance (DA) to formulate proposals that can be used to amend the Employment Equity legislation. The joint statement says that both organisations support 'appropriate affirmative action' and are concerned about the way EE is implemented. The implementation of EE in its current form can cause divisions in SA's society and compromise fair treatment of employees.

Other concerns raised include:

- A sunset clause should be incorporated into the Act;
- Ensure that small business is not burned with regulatory framework by expanding the definition of a designated employer to 100 employees or more;
- Criteria such as disability, gender and race should be 'bonus' factors, but not decisive factors; and
- 'Born-free's' (after 1994) should be exempted from implementation of EE.

2.24.3 Business Concerns Over BBBEE

Business, through SEIFSA, has issued consolidated comments on BBBEE. Member companies mandated the business organisation to release the concerns with regard to BBBEE. While affirming its commitment to work with government to ensure BBBEE is a success, business highlighted its concerns about the legislation.

Business has raised the following concerns about BBBEE:

- Giving black people equity in the business;
- Lack of clarity on implementation of the scorecard in the government procurement process;
- Method of verification and certification on the scorecard;
- Token appointments of black people in crucial positions;

- Putting black people on training that adds no value to the business just to meet a quota on skills spends;
- Fronting;
- Throwing money away in the form of CSI initiatives; and
- Throwing money away in the name of Enterprise Development.

As Appendix 2 shows, these 'perceived costs' of BBBEE arise as a result of people's inherent bias against change, or the lack of understanding of BBBEE (Empowerdex, 2006:8). This report has shown that there is no relationship between a company's BBBEE status and profitability.

The issue of skills shortage has dominated the debates on BBBEE. Business is saying there are a limited number of skilled people from designated groups. Due to this, complying with EE (Employment Equity) will be difficult. Anecdotal evidences suggest there is a shortage of skilled personnel in South Africa. This has resulted in unqualified people appointed to crucial positions and then unable to perform to required standards. This has the capability of undermining economic growth and job-creation. Eskom is being used as an example of what happens when inexperienced people take over the reigns of strategic companies.

The issue of skills shortage has elicited a heated debate between business and the Black Management Forum (BMF). President of the BMF, Jimmy Manyi, has dismissed the skills shortage argument as 'urban legend'. Manyi argues business wants to maintain the status quo and is not looking hard enough. Manyi offers the example of the Reserve Bank's quest to fill one of the key positions at the bank. Tito Mboweni, governor of the bank at the time, has alluded to the fact that filling that position with a black person was impossible. Manyi boasted that through the intervention of BMF, the Reserve Bank was able to fill that position with a black woman. This further buttressed Manyi's argument that business is not working hard to develop and find skilled personnel.

2.25 CONCLUSION

All the role-players agree on the need for BBBEE and as a result preferential procurement. The economy's successful transformation is directly linked with the effective implementation of BBBEE. This is where the thorny issue lies. The debate of BBBEE centres on how can it be effectively implemented in order to empower the people who need it the most: the poor.

The transition from BEE and BBBEE did not have a significant contribution in ensuring that the broad-based part of BEE yields positive result. The BBBEE deals still focus heavily on ownership and little on the broad-based side. This is shown by the disgraceful BBBEE deal by ArcelorMittal South Africa.

Preferential procurement is an important component of BBBEE and is confronted by challenges such as lack of capacity and fronting. The government has indicated that fronting will be regarded as a criminal act and will be punishable by law. This is welcomed and it will discourage many companies from abusing the system.

Preferential procurement places an onus on the SMMEs that are rendering the service or product to provide acceptable quality of service. There should be value added in the value chain. Companies are in the business of improving the bottom-line and business relationships should be based on this premise. This is why it is important to measure the viability and sustainability of preferential procurement.

CHAPTER 3:
EMPIRICAL STUDY

3.1 INTRODUCTION

The study is intended to be an evaluation of the viability and sustainability of preferential procurement in the Metals and Engineering sector. This will be measured by using a questionnaire as a measuring instrument. The questionnaire, which was drafted by the researcher, contains statements that have a direct bearing on the objectives of the study.

In the first stage of this study, a comprehensive literature study was conducted to gain a broad and holistic understanding of BBBEE and preferential procurement. This was done in Chapter 2, which is titled broad-based black economic empowerment. This gave an in-depth understanding and identification of forces driving the success of BBBEE. The sources consulted to generate an understanding on the topic of interest included:

- Political documents from various commentators and political parties;
- All the legislation relating to BBBEE, all the codes, policies and strategies;
- Economics literature such as the financial media;
- Previous articles and debates on the subject;
- Internet;
- Published papers, journals and thesEs; and a
- Database search from North-West University (NWu) library.

The sensitivity of BBBEE makes it a very contested and controversial topic, which always results in debates. Perceptions of how BBBEE and preferential procurement are viewed will be influenced by an individual's background, experience and culture reflecting SA's diversity. To offset this type of bias, the researcher made a concerted approach to consult

a wide range of sources in order to gain a better overall understanding of the topic of interest.

The second stage of this research is the empirical investigation. This data were collected using a questionnaire that made statements which reflect on the attainment of the objectives of this study. The questionnaire consisted of a combination of the following type of questions:

- Five-point Likert scale (1 represented "Strongly Agree" and 5 represented " Strongly Disagree");
- Yes/No type questions; and
- Open-ended questions.

The respondents were encouraged, through the cover letter, to answer in an honest and truthful manner in order for the researcher to generate an accurate understanding of the present status with regard to implementation of preferential procurement. The confidentiality and anonymity of the responses were assured to the respondents. The unit of study was SMMEs conducting business with Company XYZ. Different research methodologies will be discussed briefly in the next section.

3.2 QUALITATIVE RESEARCH METHODOLOGIES

There are five qualitative types of approaches to research (Creswell, 2007:56). These five types are the following:

- Case Study Research;
- Grounded Theory Research;
- Phenomenological Research;
- Ethnographic Research; and
- Narrative Research.

3.2.1 Case Study research

The case study method has been a popular research methodology in the field of social science. This method is not intended to focus on the entire organisation but should refer to an event, an entity, an individual or a unit of analysis (Noor, 2008:1602). Case studies have been criticised by some as lacking scientific rigour and reliability and that generalisability is not addressed (Johnson, 1994:42). However, there are some strengths of the case study method. For example, it enables the researcher to gain a holistic view of a certain phenomenon or series of events and can provide a round picture since many sources of evidence were used (Gummesson, 1991:83).

3.2.2 Grounded Theory research

This method is a systematic qualitative research methodology that seeks to generate theory from data. During data collection, data usually are analysed concurrently. As the data are analysed, the researcher searches for a core variable, which will serve as the foundation for theory generation (Denzin, 1994:5). The core variable usually has some of the following characteristics:

- It recurs frequently; and
- It links various data.

The Grounded Theory method is seen as a reverse of traditional research methods. This is because it does not begin researching and developing a hypothesis. This method has been criticised for its status as a theory (and not practical application) and the distortions that arise from it because it is impossible to free the researcher entirely from pre-conceptions in the collection and analysis of data.

3.2.3 Phenomenological research

The goal of qualitative phenomenological research is to describe 'lived experience' of a phenomenon. Phenomenological methodology is concerned with studying real-life experiences of the subject of interest and 'bracketing' taken for granted assumptions and perceptions (Moustakas, 1994:56). This methodology's leans heavily on personal knowledge, subjectivity and emphasise the importance of personal perspective and interpretation. This is a powerful methodology for understanding subjective experience, gaining insights into people's motivations and actions, and cutting through the clutter of taken-for-granted assumptions and conventional wisdom (Lester, 1999:4).

3.2.4 Ethnographic research

Ethnography is a qualitative research method that is used by anthropologists to describe a culture. Culture has many definitions but usually consists of origins, values, roles, and material items associated with a particular group of people. Ethnographic research, therefore, attempts to fully describe a variety of aspects and norms of a cultural group to enhance understanding of the people being studied (Yin, 1993:35). Ethnography aims to describe the nature of those who are studied.

3.2.5 Narrative research

Narrative research consists of studies in which the primary data source is some type of subject provided narrative. An example of this will be a discourse between one or more people on a particular subject or a conversational storytelling (Mishler, 1995:25). Narrative studies are essentially of three types:

- The focus is upon the time between when the event occurred and the narrative in which it is discussed;

- The focus is upon strategies used to tell the story and/or the textual and structural elements of the narrative; and
- The function of the narrative is considered along with its contextual, cultural and political elements.

Regarding these three types, Hartley (1997:10) has suggested that more inclusive research strategies should combine these research types thereby furthering and strengthening developments in the field of narrative study.

3.3 RESEARCH DESIGN

The choice of which method to employ is dependent upon the nature of the research problem. The actual suitability of a research method derives from the nature of the social phenomena to be explored. From the brief analysis of different types of research methodologies, the phenomenological research method is appropriate for evaluating the viability and sustainability of preferential procurement in the Metals and Engineering sector.

The reasons for this suitability are the following (Smircich, 1980:491):

- The research study is evaluating 'lived experiences' of empowered companies;
- The study will rely on personal perspective and interpretations;
- The area of focus is controversial (highly subjective);
- The study will depend on the personal knowledge of people directly working in preferential procurement; and
- The study has limitless boundaries and seeks to challenge the take-for-granted assumption and conventional wisdom.

The statistical analysis was done with the help of North-West University's Statistical Consultation Services. The SPSS (2009) and Statistica (2009) packages were used for the analysis.

3.4 POPULATION DISTRIBUTION

Company XYZ receives a wide range of goods and services from SMMEs in different sectors of the economy. The researcher decided to have a broad range of SMMEs participating in the research and not to limit the study to SMMEs providing a specialised service or goods. This is because no additional benefits will be derived from focusing on one particular sector that is providing specialised services/goods to Company XYZ.

The population for this research is all BBBEE SMMEs that are doing business with Company XYZ. The number of BBBEE compliant SMMEs on the database of Company XYZ is 1 092. The levels of BBBEE compliance differ from one SMME to another. These form the study population. The study sample was identified from this population.

3.5 SAMPLE DESCRIPTION

The Preferential Procurement Manager provided a list of 40 SMMEs that are empowered and are providing a service to Company XYZ. This represents 3.7% of the total SMMEs on the database. These companies formed part of the sample in this study. The table on the next page tabulates the different sectors that SMMEs are conducting business in.

Table 3.1: Breakdown of SMME sectors in the study sample*

Type of Sector	Example of Business Offering	% of total procurement spend
Construction	Building	3.000
Labour	Supplying semi-skilled personnel	2.100
Supply of Stationery	Pens, paper, and more	0.020
Security Services	Security guards at the gates	0.100
Consulting Services	Consultants to perform EIA activities	0.300
Supply of raw materials	Cleaning chemicals	2.000
Courier services	Transporting letters/parcels from one place to another	0.015
Engineering services	Repairing coke oven door	4.000

* Please note that not everything is included in the above table and hence percentages won't add up to 100

On top of the 40 SMMEs provided by the Preferential Procurement Manager, the researcher went on site and identified an additional 15 empowered companies. This represented a 37.5% increase in the sample size. The sample size increased from 3.7% of the study population to 5% of the study population. The sample size increased was in order to boost the response rate. All 55 companies were approached and questionnaires were distributed.

The companies in the sample were called and briefed about the questionnaire. During the initial phone-call, the person positioned best to fill the questionnaire was identified. This is because some of the questions required someone with access to detailed information about the company. The researcher asked the respondents what kind of communication channel will be preferable between facsimile and electronic mail. The majority of these companies opted for electronic mail.

The number of SMMEs which responded was 21 and this represented a 38% response rate. The other companies did not respond in time. The resulting sample of 21 SMMEs was analysed. The researcher conducted a follow-up with SMMEs to find out reasons for not responding to the questionnaire. The SMMEs provided the following reasons:

- No time to fill the questionnaire;
- Not interested to participate in the research;
- The research will not add any value to the SMMEs;
- BBBEE is a waste of time;
- Fear of victimisation even if confidentiality was guaranteed; and
- The person best positioned to fill the questionnaire was not available by the closing date.

This low response rate can cause bias in the data. The sample is an availability sample and may not be representative of the population and therefore inferences to the population should be considered with caution.

3.6 RESEARCH INSTRUMENTS

3.6.1 The Questionnaire

The questionnaire that uses, among others, a 5-point Likert scale is the sole research instrument that is utilised to generate a database pertaining to the requirements of this study.

The questionnaire was formulated by the researcher. The formulation of the questionnaire was grounded from the literature study and attainment of research objectives. The questionnaire was accompanied by a cover-letter (*see* appendix 4 for cover-letter and the questionnaire). The purpose of the cover-letter was to formally invite the companies to participate in the research and to introduce the topic and the research objective to the

respondent. The cover-letter explained how the questionnaire should be completed. The cover-letter also assured respondents about the anonymity of the responses and encourages the respondents to fill the questionnaire in an honest and truthful manner.

The advantages and disadvantages (Kelly, 2003:261) of using a questionnaire as a research instrument are tabulated below:

Table 3.2: Advantages and disadvantages of using a questionnaire in research

Advantages	Disadvantages
Ability to cover a wide range of respondents	No control – respondents can choose not to reply and researcher is unable to influence this
Low labour costs	No quality data – researcher is unable to ask follow-up questions and probe further for clarity
Respondents cannot be coached to skew the quality of data	Researcher cannot pre-screen respondents to check if criteria/profile is met
Respondents can fill the questionnaire at any time that suits them	Respondents can tick quickly in order to finish as quickly as possible
	Research needs to follow-up and remind respondents to fill the questionnaire

The researcher is of the opinion that the impact of disadvantages has been minimised in order to boost the response rate and quality of data. This is because of the following reasons:

- The researcher kept a database of the sample and was constantly reminding and following up on the progress made towards completion of the questionnaire;

- The above intervention not only helped with boosting the response rate but also maintained good control over the sample; and
- The questionnaire was designed to be as clear and simple as possible in order to remove any chances of ambiguity.

This questionnaire developed contains issues that will assist in achieving the primary and secondary objectives of this study. The questionnaire uses Likert scale ratings from 1 to 5. The number 1 will represent 'Strongly Agree' and the number 5 representing 'Strongly Disagree'. Other measuring scales, such as yes/no questions were also included. Furthermore, some open-ended questions were asked to motivate the point of view on critical aspects related to the objectives of the study. The length of the questionnaire was limited to less than 40 questions in order to balance quality against quantity and to limit the questions to the essential aspects.

The questionnaire was divided into six sub-sections, namely:

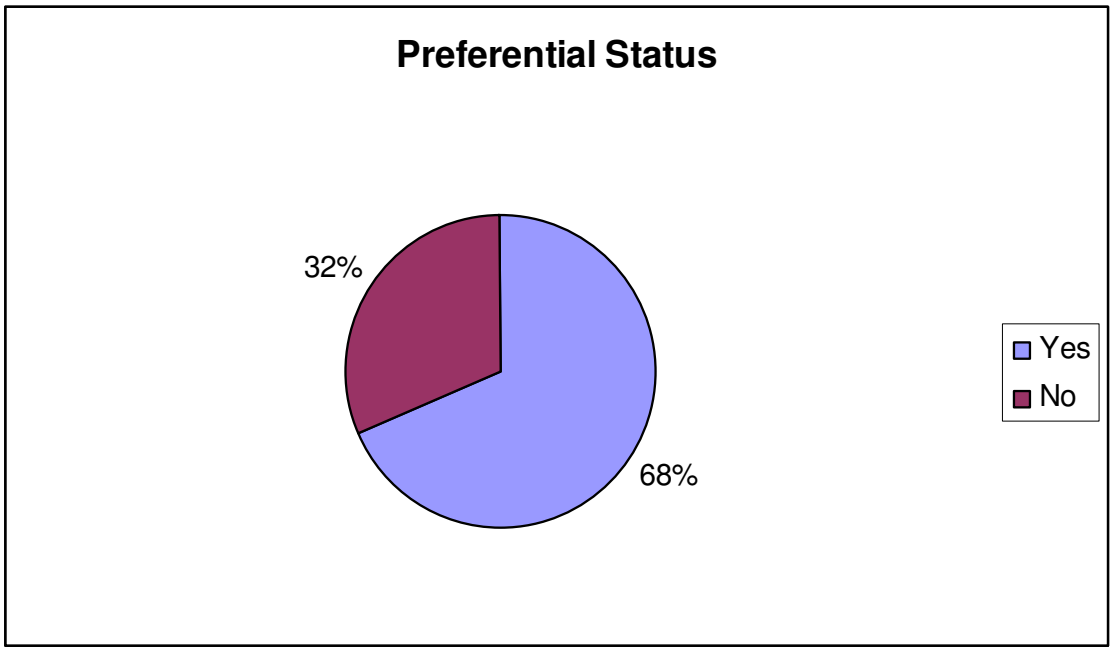
- Company Profile;
- Capacity;
- Profitability;
- Working Relationship;
- Continuity; and
- General.

The next section provides an analysis of the above sub-sections.

3.6.1.1 Company Profile

This section seeks to generate general company information. The first question asks if the SMME has preferential status. This is important because it is the focal point of this research. This research is aimed at empowered SMMEs that receive preferential procurement contracts. The researcher expects that all companies will have a preferential status because of the presence in Company XYZ's preferential procurement database.

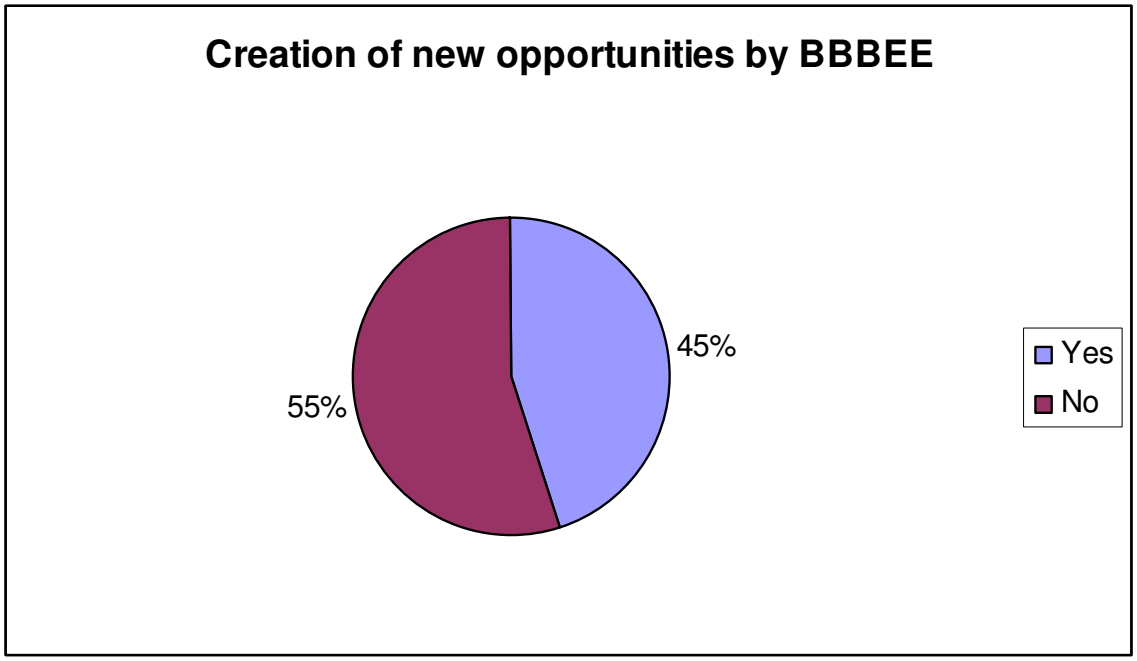
Figure 3.1: Results of whether respondents have preferential status



Two SMMEs did not answer this question. During the follow-up on the questionnaires with the SMMEs, the researcher discovered that this question was not properly understood by the respondents. One SMME did not know exactly want 'preferential status' means. Another company misconstrued it to imply that gains by the SMME will not have been on merit. The researcher received four phone calls from SMMEs seeking clarity on this question before completing the questionnaire.

The second question asks if the implementation of BBBEE, through preferential procurement, has created new business opportunities. The question is important in the context of BBBEE playing a critical role in stimulating growth and generating new business and jobs (Klein, 2006:8).

Figure 3.2: Creation of new business opportunities by BBBEE



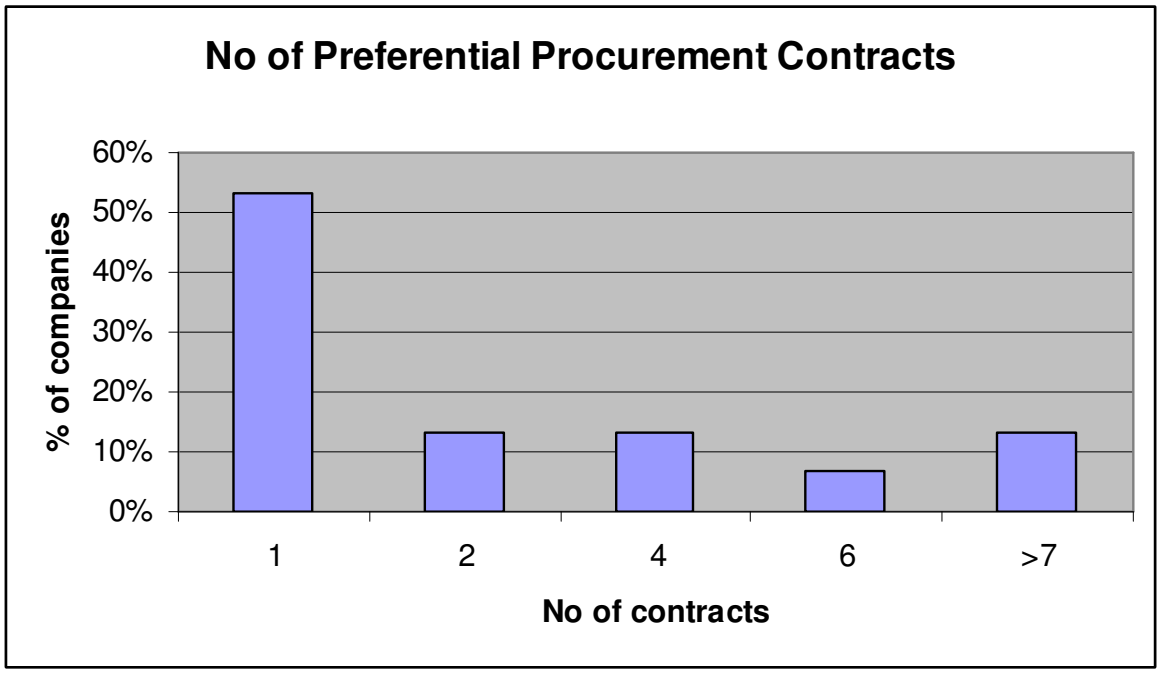
The secondary part of the second question asks the respondent to give clarity and explain how new opportunities have been created. This gives the respondent an opportunity to provide details to the primary question. Two companies motivated their answer to second question as follows:

- Preferential procurement has limited opportunities already present by restricting normal business if the rating is not high enough.
- Preferential procurement has increased opportunities by eliminating the competitors, who are not empowered.

Both of these findings have merit. If a 100% black-man owned company competes with a 100% black-woman owned company, all things being equal, it will lose because the latter generates more points on the scorecard. The second answer to the questionnaire is self-explanatory because unempowered companies are being kicked-out of the databases. These companies are usually experienced, possess a sound track record and this leaves a gap in the industry landscape. This increases opportunities for black-empowered companies.

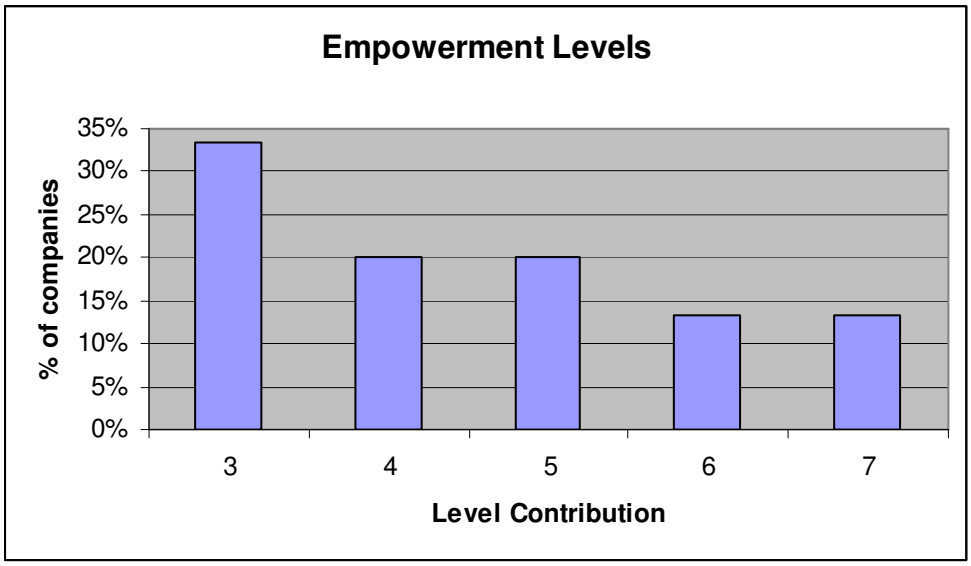
The third question asks how many preferential procurement contracts the SMMEs have. This will measure the extent to which the SMME has exploited the preferential procurement landscape.

Figure 3.3: Number of preferential contracts possessed by the SMMEs



The figure above shows that more than 50% of the SMMEs have only one contract and the rest have multiple preferential procurement contracts. The fourth question seeks to establish the SMME's score on the BBBEE scorecard. This will determine what level of contribution the SMME is at. The responses to this question will show the extent of empowerment among sampled companies.

Figure 3.4: Empowerment levels of sampled companies



A third of the sampled companies are level 3 empowered as indicated by the above graph. Please *see* Chapter 2 for the interpretation of the level contributions. The graph shows 25% of the SMMEs are still in the infancy stage of empowerment. This is characterised by level 6 and level 7 contributions. The SMMEs already have entrenched BBBEE credentials. This can be in the form of ownership, management, preferential procurement or the other four elements of BBBEE.

The fifth question asks about the service or product being rendered by the SMME. This will provide details on which sector of the economy the SMME participates in. The table on the next page shows a breakdown of services/products.

Table 3.3: Breakdown of services/product offered by sampled SMMEs

Service	%
Engineering services	24%
Supply of raw materials	5%
Maintenance	5%
Sells equipment	19%
Construction	10%
Transport	5%
Labour	10%
Manufacturing raw material	10%
Security services	10%
Cleaning services	5%

The sixth question seeks to determine how long the business has been operating. This will generate how much experience the SMME has in providing the service and product. It will also tell if the company has been started after the implementation of the BBBEE policy.

Table 3.4: Operating life of sampled SMMEs

Years	%
3 and 5	5.0
5 and 10	15.0
> 10	80.0

The above table shows that 80% of the sampled SMMEs have been operating for over 10 years. This means that these SMMEs have a solid track record of providing the service or product. The answer to this question will also provide insights on the sustainability of the SMMEs. The seventh question determines how long the SMME has been providing the service or product to Company XYZ. Responses to this question will yield information about how established the relationship between the two is.

Table 3.5: Years providing a service

Years	%
1	19.0
4	4.8
>5	76.2

The next two questions (8 and 9) focus on the number of people employed by the SMME. The eighth question asks the number of people employed by the SMME.

Table 3.6: Number of employees employed by the SMMEs

Employees	% of companies
5 - 50	66.7
>100	33.3

The above results show that in terms of number of employees, the majority of companies fall under the definition of SMMEs because two-thirds have employees between 5 and 50.

The ninth asks about the number of people employed on this specific preferential procurement contract. This will measure the magnitude of the impact on the SMME with regard to this specific contract.

Table 3.7: Employees working on this specific procurement contract

Employees	% of companies
1	26.3
5 to 10	15.8
11 to 30	26.3
31 to 50	5.3
> 50	26.3

The table above shows that a significant amount of the employees are working on this contract. This complements the answer one of the above question, which showed that the majority of these SMMEs have one preferential contract.

The last question asks about the location of the business.

Table 3.8: Headquarters of sampled companies

Headquarters	% of companies
Newcastle	40%
Vanderbijlpark	10%
Johannesburg	15%
Vereeniging	5%
Durban	10%
Bethal	5%
Meyerton	5%
Carletonville	5%
Alberton	5%

The majority of SMMEs are based in Newcastle. This was expected because it is where Company XYZ's operation of interest is based. This means local suppliers are in the majority with regard to the sample of this research.

3.6.1.2 The Capacity to Deliver

This subsections deals with the capacity of the SMME to provide quality services/products to Company XYZ. This is one of the most important aspects in any business relationship. The supplier must be able to deliver the quality specifications as detailed in the contract. Companies should not engage in preferential contracts for the sake of accumulating points on the BBBE scorecard.

The first question asks about the experience and skills possessed by the SMME to provide good service to Company XYZ. This will yield some information on the ability of the SMME to perform to acceptable levels.

Table 3.9: Experience and skills of SMMEs to deliver required service/products

Response Category	1	2	3	4	5	**Mean**	**Std dev**
%	81%	14%	5%	0%	0%	1.24	.539

The SMMEs that positively responded to the experience and skills question represented 85% of the total sample. Considering how long these companies have been in existence and providing the service, it is clear that the experience and skills have been developed over time.

The second question asks if the SMME had to recruit additional personnel and capital goods in order to build capacity to perform.

Table 3.10: Recruitment of additional personnel and acquiring of capital goods

Response Category	1	2	3	4	5	**Mean**	**Std dev**
%	38%	24%	14%	14%	10%	2.33	1.390

The majority of the SMMEs had to build capacity by recruiting personnel and acquiring additional capital goods. The third question will determine how many employees were recruited to build capacity. This will yield insights on how much impact the awarding of the contract had in generating employment opportunities. This will give an indication if the government policy has created a conducive atmosphere for job-creation.

Table 3.11: Additional Personnel recruited since procurement contract

Between	<5	6 & 10	11 & 30	31 & 50	>50
%	35%	40%	10%	5%	10%

This shows that employment was created in the process of winning the preferential procurement contract. However, employment was not enough to create a significant

amount of jobs. This is because SMMEs are reluctant to hire personnel immediately after securing a contract. This is due to SA's rigid labour laws. The fourth question determines how many days the SMME spend in training of employees. Training is one of the important ways of empowering employees and building capacity to provide a quality service/product.

Table 3.12: Actual training days

Between	<1	2 & 3	3 & 5	5 & 8	>8
%	15%	25%	15%	10%	35%

The above table shows that SMMEs are investing in training the employees. Over a third of SMMEs are above a world average of 7.5 days. This is impressive and could partly explain why these SMMEs feel confident about possessing the necessary skills and experience to provide a good service to Company XYZ.

The fifth question relating to capacity seeks to determine if the SMME experienced any difficulties in meeting the contractor requirements of Company XYZ after securing the contract. These requirements include:

- In good standing with the Compensation Fund;
- Tax statements in good order;
- Medical certificates of all personnel in order and up-to-date;
- A comprehensive Safety Plan is in place (including a risk assessment);
- Works plans and procedures in place;
- Emergency training (such as first aid and fire-fighting); and
- All legal appointments are in writing and signed by all parties.

The above highlights the requirements demanded by Company XYZ before a contract can be awarded and work can commence. A comprehensive list of requirements is given to the SMME prior to placing of the order for work to commence.

Table 3.13: Ability of SMMEs to comply with contractor requirements

Response Category	1	2	3	4	5	Mean	Std dev
%	14.3%	14.3%	14.3%	9.5	47.6	3.62	1.564

The responses show that over half had no problem with meeting the requirements. The mean of 3.62 shows that the majority of SMMEs are comfortable with meeting the contractor requirements as demanded by Company XYZ.

The sixth question relating to capacity asks if the customer has complained about the quality of service being rendered by the SMME. This will give an indication on the capacity of the SMME to perform and will give a yardstick on customer satisfaction.

Table 3.14: Customer complaints regarding services/products offered by SMMEs

Response Category	1	2	3	4	5	Mean	Std dev
%	9.5	0%	19%	9.5%	61.5%	4.14	3.15

Over two-thirds of SMMEs (62%) have never experienced a customer complaint. The fact that these companies are long-established (*see* table 3.5) and have the skills and experience to render the service or product manifests itself in low customer complaints. The seventh question asks about the funds and resources available to perform the required service. Too many times the SMME has been given business but has been unable to deliver on the mandate because of inadequate resources.

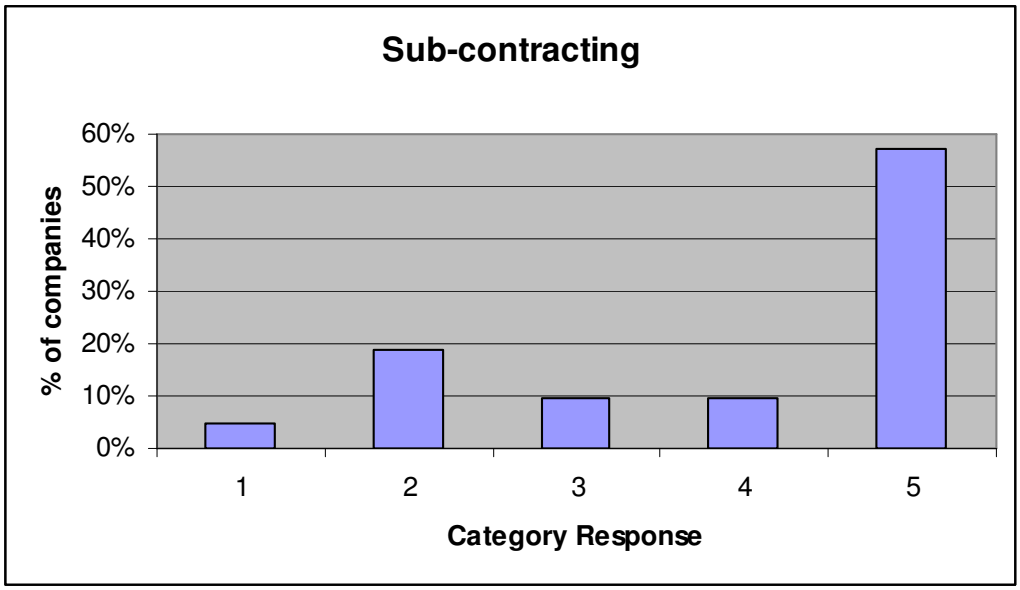
Table 3.15: Funds and resources needed to perform the service

Response Category	1	2	3	4	5	Mean	Std dev
%	66.7%	19%	4.8%	4.8%	4.8%	4.14	3.15

Almost 80% of the companies were confident funds and resources are not a problem in terms of performing according to the contract. The eighth question asks about the use of sub-contractors to execute a contract. SMMEs without capacity to perform tend to give the work to sub-contractors.

An empowered company gets a contract and then allocates a big portion to an established but un-empowered company. This does not result in skills transfer and the principal contractor is not empowered to perform in the future.

Figure 3.5: Subcontracting activities



The above graph shows that sub-contracting is not as widespread as originally thought. This can be because the SMMEs are established businesses with solid track records and skills to perform the required services.

3.6.1.3 Profitability

The first question relating to profitability asks the SMMEs if it is realising profits from its preferential procurement contract. Company XYZ has experienced unrealistic quotes from SMMEs with initial implementation of preferential procurement (*see* section 2.20). Managers of these SMMEs did not know how to quote on a tender and ended up with a contract that is not profitable. This is attributed to lack of skills and inability to conduct viability analysis.

Table 3.16: Profit generated from procurement contract

Response Category	1	2	3	4	5	Mean	Std dev
%	30%	40%	15%	0%	15%	2.3	1.342

The majority of SMMEs are generating profits from their contracts with Company XYZ. The number of SMMEs that are not realising a profit is three. The questionnaire did not make provision to uncover the reasons why SMMEs that are running at a loss are continuing the business relationship.

The second question relating to profitability asks about the availability of cash to meet financial obligations. Cash flow has been identified as one of the important measures of a company's financial position. A company may be profitable and possess a healthy balance sheet but without cash in the bank to meet day-to-day expenses, the company will struggle to survive.

Table 3.17: Cash flow of sampled SMMEs

Response Category	1	2	3	4	5	Mean	Std dev
%	55%	20%	20%	0%	5%	1.8	1.1

Only one SMME reported cash flow problems. This means the rest are SMMEs with cash available in the bank to meet the immediate expenses of the business.

The last question of profitability asked if the SMME's financial position has been improving owing to the service or product being rendered. This will determine if preferential procurement has provided a growth platform for the SMME. It will also be an indication if the SMME has been generating more business from Company XYZ.

Table 3.18: Improved financial position

Response Category	1	2	3	4	5	Mean	Std dev
%	25%	45%	25%	0%	5%	2.15	0.99

Only 5% responded that the financial position has not been improving and 25% of SMMEs were neutral on this issue. The rest of the SMMEs' financial position have been improving owing to the service or product being rendered.

3.6.1.4 Working Relationship

This sub-section deals with the working relationship between the SMMEs and Company XYZ. The first question deals with the ability of Company XYZ to pay on time for services rendered. It has been identified that one of the many challenges facing SMMEs is the inability of customers to pay on time. This put pressure on the SMMEs' cash flow and results in the inability to meet financial obligations on time.

Table 3.19: Customer XYZ paying on time for services rendered

Response Category	1	2	3	4	5	**Mean**	**Std dev**
%	95%	0%	0%	0%	5%	1.62	1.0

Only 5% of SMMEs felt that Company XYZ does not pay on time and 95% of SMMEs were satisfied. Company XYZ has indicated that it is giving preference to SMMEs as far as payment is concerned (*see* section 2.20). Company XYZ has eradicated the bureaucratic systems and procedures that used to prolong payment. This policy seems to be working judging by the responses to this question.

The second question of profitability asks if Company XYZ has provided all the necessary support to enable the SMME to function optimally. This support can come in the form of:

- The supply of resources;
- Equipping the SMME with the necessary skills; and
- Co-operation in creating a good working environment.

Table 3.20: Support by Company XYZ to the SMME

Response Category	1	2	3	4	5	**Mean**	**Std dev**
%	35%	25%	15%	15%	10%	2.4	1.4

Sixty percent of SMMEs felt that Company XYZ has provided the necessary support. The third question is an open ended question that asks the SMMEs what sort of additional support company XYZ should provide to the SMMEs to ensure optimal performance. The answers to this question can help Company XYZ to improve the way it conducts business with the SMMEs. This will provide an opportunity for Company XYZ to hear the views of its suppliers. The responses include:

- Additional guidance on Company XYZ procurement systems (which underwent modifications);
- Company XYZ's processes are cumbersome and tend to be administratively intense. This result in long lead times to get issues sorted out;
- Onerous safety requirements. There are many requirements to comply with and this is very challenging to small businesses;
- Earlier payment for services rendered; and
- Reliability of data will help stock modeling for the suppliers.

The fourth question asks if there is a good business relationship between the SMME and the Company XYZ. This will determine how comfortable the two parties are around each other and if there is synergy between the two parties involved in this transaction. It provides the SMME with the opportunity to motivate the response to the question.

All companies responded that there is a good relationship with Company XYZ. Companies attributed this to:

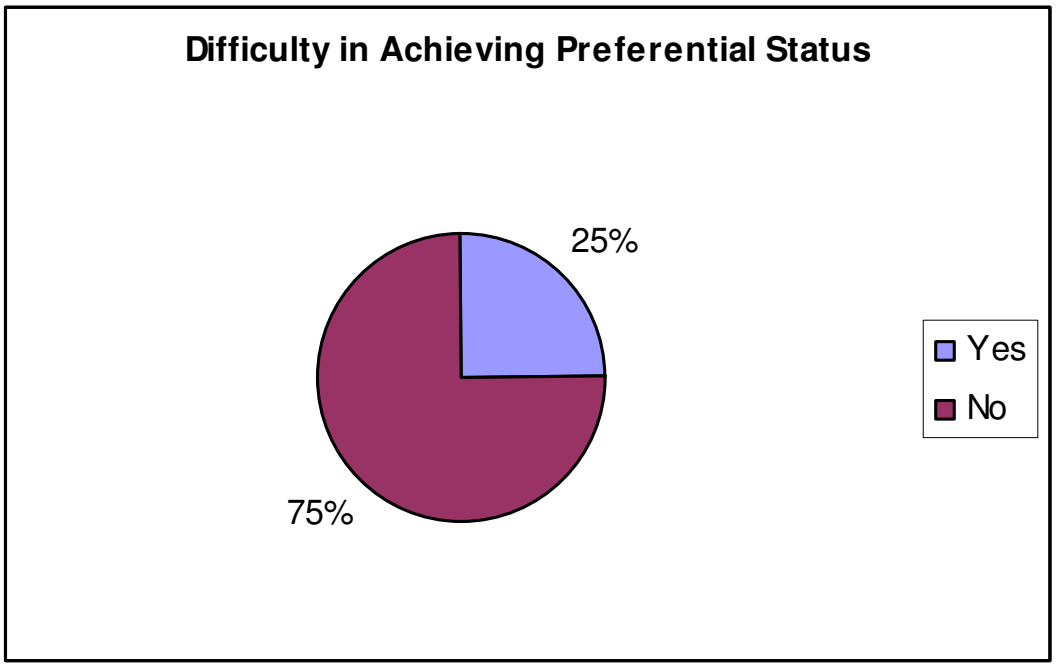
- Good communication;
- Good quality service being rendered;
- Interdependence on each other, despite bullying tactics from Company XYZ; and
- Long standing relationship and proximity to Company XYZ.

3.6.1.5 Continuity

This section intends to measure the sustainability of preferential procurement.

The first question relating to continuity asks about the difficulty in achieving the preferential status. Some SMMEs need to sell a portion of its equity to an empowered partner and appoint HDIs into management structure. The motivation will provide insights into the lengths the SMME had to go through to gain preferential status.

Figure 3.6: Difficulty in achieving Preferential Status

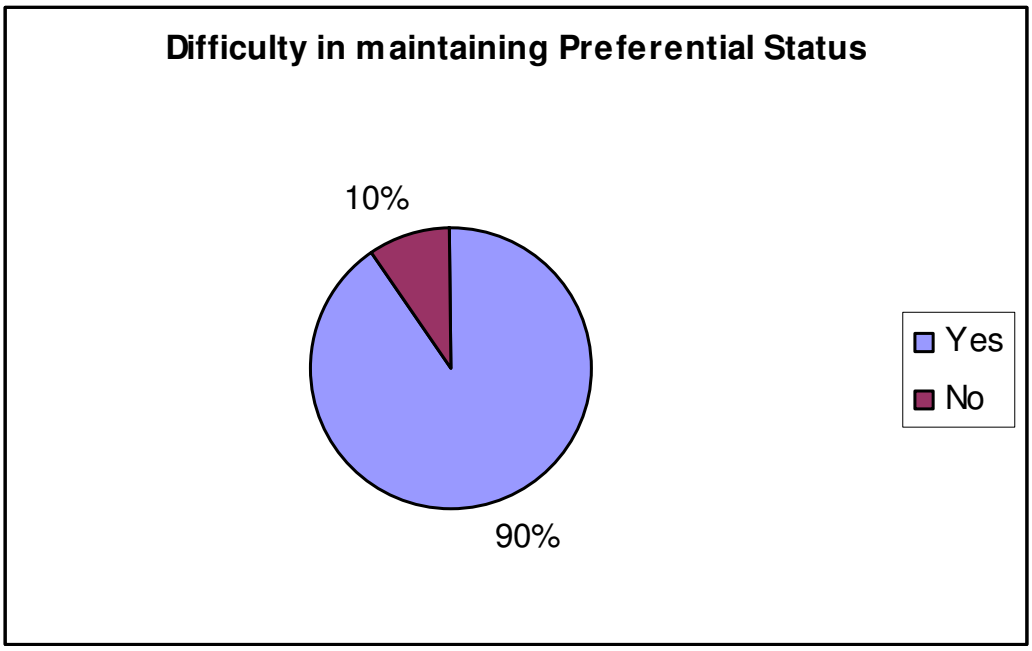


The SMMEs say it was not difficult to achieve this status. This could be because some of these companies started from scratch as black owned and hence automatically had 'preferential' status. The second question asks how difficult it is to maintain that status. This is important because for preferential procurement to be sustainable, the empowered SMMEs need to maintain the status. If this is not possible, sustainability of preferential procurement is threatened.

Responses on what the SMMEs did in order to achieve empowered status include:

- Utilising a consultant who made recommendations; and
- Finding a partner with experience in the field is difficult because it is an import industry.

Figure 3.7: Difficulty in maintaining Preferential Status



The number of SMMEs who found it difficult to maintain the preferential status is 19. This represents 90% of the sample. This 90% did not explain further why it is difficult to maintain preferential status. The two who did not find it difficult to maintain preferential status explained as follows:

- The preferential status is cherished and used as a marketing tool making it easy to maintain; and
- Legislative requirements are clear with respect to BBBEE and this is more structured and less stifling than the previous BEE process.

The third question asks whether the SMME has been gaining new customers over the past years. If the SMME has been gaining customers then it will give some indication of the sustainability of preferential procurement because of the opening of new opportunities.

Table 3.21: Gain in new customers since preferential procurement

Response Category	1	2	3	4	5	Mean	Std dev
%	28.6%	47.6%	19%	0%	4.8%	2.05	0.97

It should be emphasised that answers to this questionnaire are not isolated and will be compared and contextualised within answers given to other questions. Only one SMME said it did not gain new customers and four were neutral. The rest, which is the majority, have been gaining new customers. This can be attributed to the opportunities that are opened by the BBBEE landscape.

The fourth and the fifth questions ask about the length of this specific procurement contract and if the SMME will be interested in re-tendering for this contract. This will provide an indication on the interest of the SMME to continue providing the service/product to Company XYZ.

Table 3.22: Growth of the SMME's business

Response Category	1	2	3	4	5	Mean	Std dev
%	40%	45%	10%	0%	5%	1.85	0.99

The answer to this question resonates with the answer to the third question of this subsection. This is because a company that gains new customers will grow in the long run.

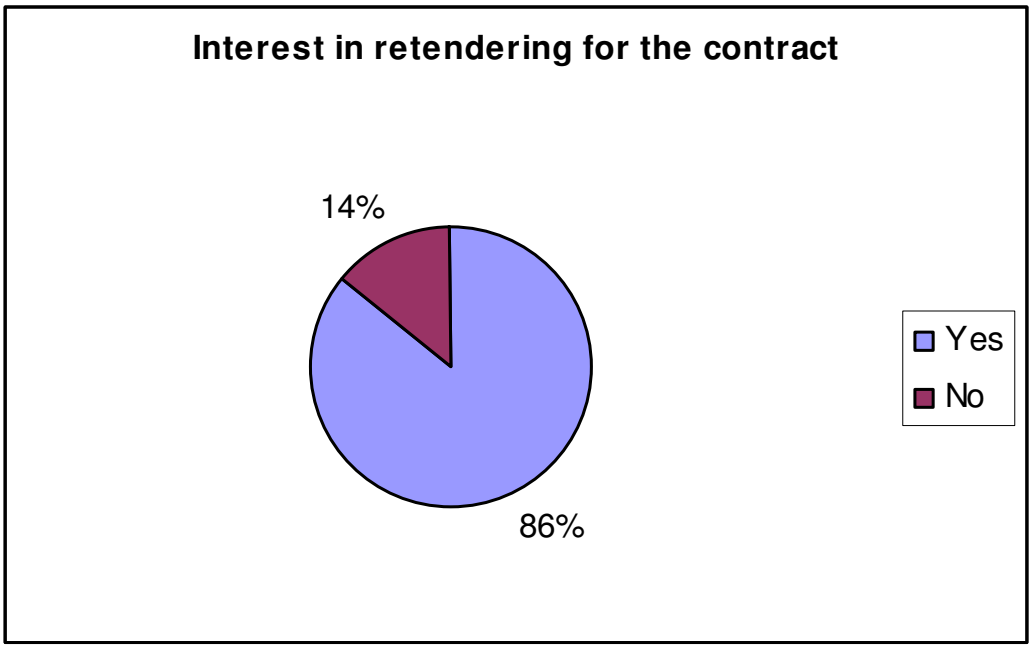
Table 3.23: Length of business relationship between SMME and Company XYZ

Response Category	1	2	3	4	5	Mean	Std dev
%	38.5%	7.7%	30.8%	0%	23.1%	2.62	1.6

The mean of 2.62 years for a contract indicated the short-term nature of these preferential procurement contracts. This could be attributed to a company who supplies raw materials or executing short-term tasks such as installing a valve in the plant. The short-term nature of the contracts is a threat to the sustainability of preferential procurement.

The sixth question asks about the interest of the SMME in re-tendering for the contract that it already has. This will give an indication of the sustainability of preferential procurement.

Figure 3.8: Interest in re-tendering for the contract



All SMMEs except three are interested in renewing the contract. These three that are not interested could possibly be those ones that indicated that they are running the business at a loss. This shows that the majority of the SMMEs are interested in a long-term and sustainable business relationship with Company XYZ.

The seventh question asks for a brief motivation on the previous question. The only SMME that provided motivation to this alluded to the fact that it needs to be an active business organisation. The desire to re-tender stems from the need to continue trading as a business.

The eighth question asks about the stability of the customer and the need for the product/service being offered by the SMME. This is because for a business relationship to be sustainable, the customer must continue to be in business and there must be a demand

for products or services offered by SMMEs. The number of SMMEs that answered this question positively is 75%.

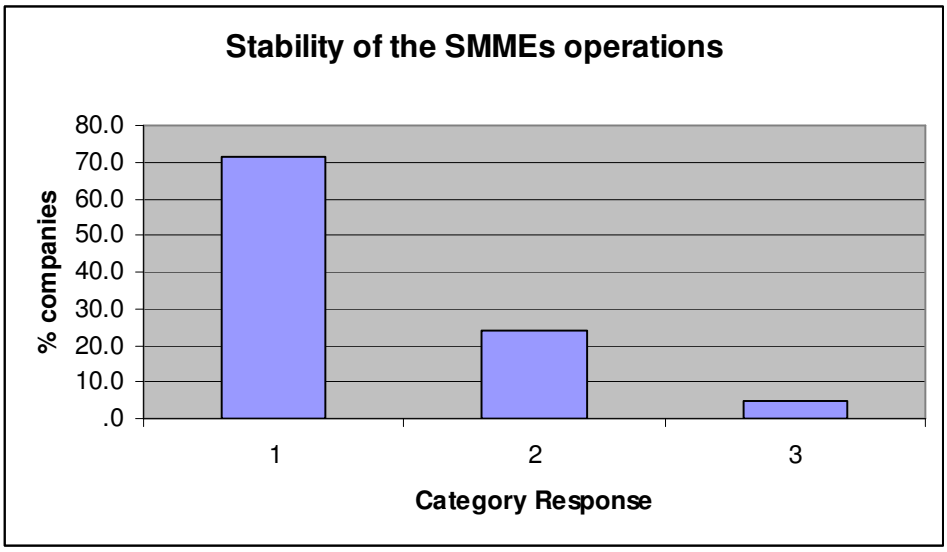
The ninth question asks about the working relationship between the SMME and the customer being a long-term relationship.

Table 3.24: Expectance of a long-term business relationship

Response Category	1	2	3	4	5	Mean	Std dev
%	71.4%	28.6%	0%	0%	0%	1.29	0.463

The tenth question of this sub-section asks about the position of the SMME with regard to its finances and stability of its operation. The answer to the question will provide the ability of the SMME to be a sustainable business that will continue to operate in the future.

Figure 3.9: The stability of the SMME operation to continue rendering the service



There is no SMME that stated that its operations and finances are not stable enough to continue rendering the service to Company XYZ.

3.6.1.6 Other Business Related Issues

This section provides an opportunity for respondents to express any other views over and above what was asked in the questionnaire.

The first question asks about the problems with regard to raising finance for the SMME. Finance has been identified as one of the challenges facing implementation of BBBE. The answer to this question will reveal if these SMME have experienced any difficulties in raising loans or other forms of finance to keep the business running. The SMMEs responded as follows:

- Not necessary because the business has a positive cash flow and in good books with the banks.
- Finance problem only if it is a huge capital project (above R5 million).
- If accounts are set up and invoices promptly processed, there will be no need for finance.

The second question asks about challenges and problems that SMMEs are facing. Respondents have been asked to be as honest as possible in order for the researcher to generate a holistic view of challenges facing SMMEs in dealing with customers and preferential procurement. The responses to this question were as follows:

- Input costs (labour and raw materials) keep rising and the customer resists supplier price increases;
- Shortage of skilled labour and rigid labour laws;
- Uncertainty in the economy leading to slow or subdued spending by customers;
- Get business at other sites of Company XYZ; and
- BBBEE companies regarded as a big risk because of the perception of inexperience.

The third question invites the respondents to elucidate on what can be done differently to improve the success of preferential procurement. These SMMEs are the ones dealing on the ground with preferential procurement and are better placed to provide insights and suggestions on what can be done to improve the probability of success with implementation of preferential procurement. The SMMEs responded as follows:

- Exposure to all departments of Company XYZ;
- More opportunities to tender;
- A good business relationship, that is fair to all the parties;
- Root out fronting; and
- Additional investments in training and development of BBBEE.

The fourth question asks about the advantages and disadvantages of BBBE to the business. Advantages mentioned are as follows:

- Redistribution of wealth (upliftment of previously disadvantaged groups);
- Preferential opportunities;
- Transfer of skills;
- SMMEs with high empowerment levels (level 3 and level 4) enjoy a bigger portion of the business landscape; and
- Moral imperative – the creation of a stable social environment. Therefore, the business can grow from strength to strength.

The disadvantages that were highlighted are as follows:

- Investment in training HDI and once empowered with the necessary skills, resignations are observed;
- Highly paid people from designated groups, who add little value to the company;
- A lower rating restricts business opportunities;
- Lack of skills;
- Fronting practice;

- Dealing with inexperienced people;
- Brain drain; and
- Companies without experience getting contracts and unable to deliver.

The fifth question seeks to determine what the main driver of success of the business is. In order words, what is the unique selling point that helped the SMME to get this specific preferential procurement contract from Company XYZ?

The answers to this question were as follows:

- Quality products and good customer service;
- Competitive pricing;
- Highly motivated staff;
- Expertise and marketing astuteness;
- Good stock control (always has what Company XYZ wants);and
- A solid track record and being safety-compliant.

The last question invites the respondent to express their views on anything that is deemed relevant but has not been asked by the researcher. The following were the responses to this question:

- Company XYZ should be transparent enough to provide details of how BBBEE is used and applied;
- Company XYZ wants true partnerships with key suppliers but does not want to compromise; and
- Company XYZ's middle management still biased towards the previously advantaged.

3.7 RELATIONSHIPS BETWEEN CHOSEN VARIABLES

In this section, the relationship between some chosen variables will be considered and depending on the statistics, conclusions can be made.

3.7.1 Cross tabulations

This is a statistical technique that uses two sets of tables to establish if an interdependent relationship exists between the two. In this case, the researcher wanted to determine if there is a relationship between having preferential status and the access to new opportunities created by BBBEE. This was done in order to evaluate if what happens in practice is in line with the theory that is often bandied around by experts. In theory, empowered businesses should receive more invitations to tenders as implementation of BBBEE gathers momentum and un-empowered SMMEs fall off the databases. This eliminates competitors and opens new opportunities.

The first pair of comparison was to determine if there is a relationship between preferential status (question 1) and the ability of BBBEE to create new opportunities (question 2) in the company profile section. This was done by using a two-way frequency table and Pearson's chi-squared test. The results of the two-way frequency table are the following:

Table 3.25: Two-way frequency table between preferential status and creation of new opportunities

Q1	Q2,1	Q2,2	Totals
1	8	5	13
Row %	61.54%	38.46%	
2	1	5	6
Row %	16.67%	83.30%	
Totals	9	10	19

The above table suggests that there is dependence between Q1 and Q2. As it can be seen, the SMMEs with preferential status have answered that BBBEE has created more opportunities for the business. The chi-square test evaluates if knowing the value of one variable can help with the estimation of another variable. Due to the non-random nature of the sample, the results of Pearson's chi-squared test for independence need to be

considered with caution. The effect size (phi coefficient) should rather be used. These values are presented in the table below.

Table 3.26: Chi-square table for question 1 and question 2

Statistic	Value	p
Pearson Chi-square	3.31	0.07
Phi for 2 X 2 table	0.4177	

Pearson's chi-squared test says the variables are statistically significant if $p<0.05$. In this case $p= 0.07$, which indicates that there is no statistically significant dependence. However, when a non-random sample is used, p-values are not really applicable. The effect size relevant for this analysis is that the phi-coefficient and should rather be used (Ellis & Steyn, 2003:51). The effect size relevant for this analysis is the phi-coefficient. The phi-coefficient, which is an effect size, will indicate if there is a practically significant dependence between preferential status and the creation of new opportunities.

The following ranges are indication of dependences for two variables:

If: phi = 0.1, small effect then no practically significant dependence
phi = 0.3, medium effect then practical visible dependence
phi = 0.5, large effect then practical significant dependence

For this data, phi =0.418 and is between medium effect and large effect. This means there is a practically significant dependence. The researcher can conclude that BBBEE has created new opportunities for companies with preferential status. Even if the dependence is not statistically significant, it is practically significant. This is because the p-values take the sample size into account to make generalisability to the population and a small sample was used here. Furthermore, generalisation based on p-values relies on the assumption that a random sample was used, which is not the case in this study.

The effect sizes, such as phi-coefficients, consider only the sample at hand and informs if the dependence is significant in practice for this particular sample (without trying to generalise about the entire population). The large effect size give an indication of dependence, which can be confirmed in future studies by using a bigger sample.

3.7.2 Correlations between data variables

The researcher studied correlations between the following pairs:

- Question14 and Question 29
- Question 14 and Question 19
- Question 21 and Question 29

The researcher wanted to evaluate if there is a relationship between training of employees and the growth of the SMMEs. In theory, a company which trains employees empowers the personnel with skills to be more competent and more efficient. Companies with distinct competencies are able to seize market opportunities and grow.

The researcher also wanted to ascertain if highly trained staff will result in more profits for the SMME. In theory, competent staff should bring effectiveness and efficiency in business processes. This reduces costs and drives efficiency .The last pair of interest to the research was to evaluate if growth of the SMME results in improved financial performance.

Spearman's rank order correlation co-efficient (**r**) was used. This measures the statistical dependence between two variables. The coefficient uses a monotonic function to evaluate how best the relationship between two variables can be described. This type of co-efficient is preferable because it does not rely on assumptions such as normality. The correlation coefficients can be interpreted as effect sizes indicating practically significant correlation.

According to Field (2009:170):

If:

r = ±0.1, small effect then no practical significant correlation

r = ± 0.3, medium effect then practically visible correlation

r = ± 0.5, large effect then practically significant correlation

In addition to the above, a p-value of less than 0.05 indicates a statistically significant correlation. For this data, p is greater than 0.05 for all three pairs and this means the correlations were not statistically significant. Once again, this p-value should be considered with caution, since a non-random sample was used.

The results for Spearman's rank order correlation co-efficient (r) are tabulated below:

Table 3.27: Correlations Coefficients relating to three different pairs of variables

Correlation	r	Practically significance
Q14 and Q29	-0.28	Practically visible
Q14 and Q19	0.04	None
Q21 and Q29	0.39	Practically significant

The following conclusions can be made from the above tables:

- Training of employees empowers the SMMEs to grow its business;
- There is no relationship between the number of days SMMEs spend on training its employees and the ability of the SMMEs to generate profit from preferential contracts; and
- The growth of SMMEs results in improved financial position.

3.7.3 Independent t-tests

The researcher looked at whether companies with or without preferential procurement status responded differently to questions 15, 18 and 29. This was to determine if the use of sub-contractors and the ability to meet Company XYZ's requirements is directly linked with whether an SMME has preferential status or not. The last pair was to evaluate if un-empowered SMMEs still grow in a business environment that is increasing the implementation of BBBEE. This is done by independent t-tests. The independent t-test becomes statistically significant if $p<0.05$. As mentioned before, emphasis should rather lie on effect sizes, measuring practical significance, because the sample was not randomly selected. The practical significance is evaluated using Cohen's d-value (Cohen, 1988:22):

If:

d =±0.2, small effect and no practical significant difference

d = ±0.5, medium effect and practically visible difference

d = 0.8, large effect and practically significant difference

Table 3.28: Cohen d-values for three pairs of variables

	YES: PREF STATUS	NO: PREF STATUS				
Q	**Mean 1**	**Mean 2**	**p**	**Stdev 1**	**Stdev 2**	**d**
15	3.769231	3.333333	0.588649	1.589227	1.632993	0.266932
18	4.307692	3.666667	0.357823	1.377474	1.366260	0.465363
29	2.083333	1.666667	0.420456	1.164500	0.516398	0.357807

The above table shows that there are no statistical differences that can be concluded. This is because the d-values are less than 0.8.

3.8 SUMMARY

The business enterprises that took part in this study fit the profile the researcher was looking for. These are black-empowered businesses, which also falls under the definition of SMMEs. These SMMEs have a solid-track record in providing the services and products to Company XYZ. The SMMEs possess the necessary experience and skills to perform the required services to acceptable standards.

This explains why the capacity to perform the required task or provide a required product to the customers is not a problem. This is fortified by a lack of customer complaints regarding the quality of service/product. The solid track record has cultivated a co-operative business relationship with the customer. However, the SMMEs expose the business model to a certain element of risk by relying on one customer. This is shown by the fact that over half of the surveyed SMMEs rely on business from Company XYZ.

The SMMEs have not experienced problems in achieving preferential status but have problems in maintaining that status. This has the potential to harm the sustainability of preferential procurement. The SMMEs are interested in continuing the business with Company XYZ. There is also an expectation that the business relationship will be long term.

There are some concerns from the SMMEs. This includes:

- Fronting;
- Lack of skills;
- Transparency on how preferential procurement is applied; and
- The system of Company XYZ is bureaucratic and this makes turn-around times high.

CHAPTER 4:
CONCLUSIONS AND RECOMMENDATIONS

4.1 INTRODUCTION

The purpose of this study was to evaluate the sustainability and viability of preferential procurement in the Metals and Engineering industry. A comprehensive literature review was conducted on preferential procurement. The literature review was used to design a questionnaire that reflects directly on the objectives of this study. The questionnaire yielded empirical findings that were presented in Chapter 3.

In this chapter, the study is concluded by noting the main findings and conclusions. The following parameters were considered in making the overall conclusions:

- Research title;
- Primary and secondary objectives; and the
- Findings of the empirical study.

This chapter will also focus on the relationships between certain chosen key variables and conclude on the nature of relationships between these variables. Recommendations regarding preferential procurement will also be presented in the last section of this chapter.

4.2 MAIN FINDINGS

The following section highlights the main finding of this study:

4.2.1 Company Profile

The following can be highlighted about the SMMEs' profile.

- BBBEE has either increased or limited opportunities depending on which side of the fence the SMMEs are in.
- Over half of the sampled SMMEs rely on one contract. This puts an SMME at risk because of reliance on one customer.
- Over 80% of SMMEs have been in business longer than ten years. This shows viable and sustainable businesses with solid track-records in providing the service or product to the customers.

4.2.2 Capacity

The following can be highlighted about the capacity to perform to required standards:

- All SMMEs that took part in this study have the experience and the skills to provide quality service or products to the customer.
- The SMMEs recognise the importance of training in achieving business objectives.
- In general, the SMMEs have not experienced customer complaints about the quality of the service or product.

4.2.3 Profitability

The following can be highlighted about profitability:

- The SMMEs possess the necessary financial skills to manage the day-to-day running of the business.

4.2.4 Working Relationship

The following can be highlighted about the working relationship:

- The entrenched business relationship has resulted in a co-operative working relationship between the customer and the supplier.

4.2.5 Continuity

The following can be highlighted about continuity:

- Achieving preferential status is not a problem but maintaining it presents problems to SMMEs.
- In general, the SMMEs want to see a long-standing business relationship.

4.2.6 Business Related Issues

The following can be highlighted about general open-ended questions:

- The SMMEs want greater transparency on how preferential procurement is applied.
- The SMMEs want training in order to understand procedures and systems of Company XYZ.
- The SMMEs are concerned about fronting and lack of skills.

4.3 CONCLUSIONS

The section makes conclusions based on the findings of empirical research.

4.3.1 Company Profile

The following conclusions can be made on the company profile:

- Preferential procurement is here to stay. The only reaction from non-compliant companies is to adapt or die. Company XYZ has issued a directive that non-compliant businesses will not be registered on the database in the future. Existing non-compliant companies have been given a grace period of two years to comply or be kicked-out of the database.
- Confusion regarding the meaning of the word 'preferential status' has compromised the accuracy of responses to question one.
- Whether BBBEE will create opportunities for an SMME will depend on the intensity of competition, empowerment rating levels and resource strengths of the SMME.
- A majority (just over 50%) of SMMEs has only one contract and it is with Company XYZ. This presents a risk to the SMME and will result in reduced bargaining power in negotiations with Company XYZ. This puts these SMMEs in a vulnerable position.
- There is an even distribution of empowerment levels (from level 3 to level 7) across the SMMEs surveyed.
- The biggest number of suppliers was providing engineering services. This was expected as Company XYZ is in the engineering sector.
- Eighty percent of sampled SMMEs have been operating for over 10 years and over 75% of the SMMEs have been providing the service for more than 5 years. This means these are companies with solid experience and a sound track record in providing products and services.
- Local suppliers dominate the research sample; that is, suppliers from the same immediate geographical area as Company XYZ.

4.3.2 Capacity to deliver according to performance standards

In this section relating to capacity issues, the following conclusions can be made:

- SMMEs have the necessary experience and skills to provide the services and products to Company XYZ.
- When SMMEs secured business, capacity had to be created by recruiting personnel and acquiring additional capital goods.
- The SMMEs take the development of employees seriously by investing in training.
- SMMEs perform according to acceptable levels in rendering the services and products to Company XYZ.
- SMMEs have no resources or funding difficulties in rendering the required services.
- Subcontracting is not a widely used practice in this research sample.

The findings of this section are that the SMMEs have the capacity to perform according to customer requirements. These SMMEs have a long track record of providing services, had virtually no customer complaints and possess the experience/skills/funds to provide the services.

4.3.3 Profitability

The following conclusions can be made with regard to profitability:

- In general, SMMEs realise profits from procurement contracts.
- In general, SMMEs have no cash flow problems and are highly liquid.
- The SMMEs' financial position have been improving due to the services or production being rendered. In other words, the SMMEs are better off as compared to the period prior to securing procurement contracts.

The SMMEs are reaping the financial benefits of engaging in the preferential procurement relationship with Company XYZ.

4.3.4 Working Relationship

The following can be concluded in this subsection:

- Company XYZ pays the SMMEs on time.
- Seventy-five percent of SMMEs were satisfied with the level of support received from Company XYZ. However, certain SMMEs pointed out that support in understanding Company XYZ's system/process will go a long-way in improving the relationship.
- All companies responded that there is a good working relationship with Company XYZ based on the long-standing business relationship and quality of service being rendered.

4.3.5 Continuity

This section attempts to measure the sustainability of preferential procurement in the Metals and Engineering sector. The following conclusions can be discerned from the findings of the empirical research:

- SMMEs did not experience any specific difficulties in achieving preferential status.
- SMMEs seem to have problems in maintaining preferential status.
- In general, SMMEs have been growing in terms of customers.
- There is a majority of short-term contracts between Company XYZ and SMMEs.
- All SMMEs (except 15%) are interested in re-tendering for the contracts.
- All SMMEs stated that Company XYZ's operations are stable and will always be in need of the service/product being rendered by the SMMEs.
- All SMMEs expect the business relationship to be long-term. This means as long as the SMME are black-empowered and providing good service to Company XYZ, there is high probability that the relationship will be long-term.

- All SMMEs stated that their operations and financial positions are strong enough to continue rendering the service or product to Company XYZ in the future.

4.4 EFFECT SIZE CORRELATIONS

The following conclusions can be made from the statistics about relationships between the variables:

- BBBEE has created new opportunities for companies with preferential status.
- Training of employees empowers the SMMEs to grow its business.
- There is no relationship between the number of days SMMEs spend on training its employees and the ability of the SMMEs to generate profit from preferential contracts.
- The growth of SMMEs results in an improved financial position.
- Preferential status has no direct bearing on whether SMMEs will meet Company XYZ's contractor management requirements or not.
- An SMME's preferential status does not mean the company will automatically grow going into the future.
- A d value of 0.465 indicates there is a practically visible difference with regard to the using of sub-contractors (*see* 3.7.3). Companies with preferential status are most likely to use sub-contractors to perform a job that was won through a tendering system.

4.5 CONTRIBUTIONS OF THE STUDY

4.5.1 Viability of preferential procurement

The findings of the empirical study make it clear that preferential procurement is viable, practical and sound. The SMMEs have been operating for a long time and have a solid track-record in providing the services and products to Company XYZ. All of them (except

one) have not experienced a complaint from Company XYZ about the quality of the product or service rendered. The SMMEs have capacity in the form of experience and skills to render the service required by Company XYZ. An overwhelming majority of SMMEs indicated quality products and services as the unique selling point for the products. This high quality of products/service from SMMEs has cultivated a good working relationship between Company XYZ and SMMEs.

4.5.2 Sustainability of preferential procurement

The SMMEs are confident about the long-term prospects of the business relationship between themselves and Company XYZ and have made it clear that a long-term business relationship is desired. There is also confidence on the inclination of Company XYZ to need products provided by the SMMEs. The financial stability and operational stability of the two parties are not in question. There are favourable conditions to declare that preferential procurement is sustainable, but these are not conclusive. An important negative aspect to sustainability is the findings that 90% of SMMEs declared that it difficult to maintain preferential status. This needs further research to uncover the driving force behind this response.

4.5.3 Obstacles to preferential procurement

The empirical findings have revealed the following obstacles:

- Black companies obtaining contracts and immediately selling the company.
- SMMEs train HDIs and once empowered with the skills, they leave the company.
- High paid people from designated groups, who add little value to the company, prevail.
- Lack of skills is prevalent.
- Fronting is a reality.
- SMMEs are dealing with inexperienced people from the customer's side.
- Companies without experience get contracts and are unable to deliver.

- Lack of commitment from decision-makers prevails.

4.6 RECOMMENDATIONS

4.6.1 Literature Review

The following actions are recommended based on the literature review:

- Regulations should be enacted that spell out clearly how BBBEE will apply or not apply to foreign-owned firms.
- The government should launch a massive educational driver to educate companies about BBBEE. There is still confusion and misunderstandings about exactly how BBBEE works.
- The government should launch a body that can advise non-complying companies on the procedure that should be followed when introducing a black partner. The government can develop a database of these black empowered companies.
- Companies should have a Preferential Procurement Policy that is integrated to the whole commercial policy and business strategy.
- Illiterate tenderers have no educational background on how to tender and to structure a quote. These entrepreneurs should be mentored to hone their business skills.
- Liquidity is a critical issue for SMMEs. Prompt payment for services rendered will help SMMEs to improve their cash flow management.
- Conduct vendor audits and investigate if the SMMEs have enough systems in place in order to provide the service that was tendered for.
- There needs to be convergence between the Preferential Procurement Framework and BBBEE. As it stands, the two policies advance the interests of two different groups (HDIs and black people respectively).
- Black-owned companies need to comply with all seven pillars of BBBEE and this should be taken into consideration when a preferential procurement contract is

awarded. Presently, black companies are of the perception that because of being 100% black-owned, there is no need to comply with other elements in the scorecard.

- The BEE Advisory Council needs to be actively engaging in the national discourse about BBBEE. There have been many burning issues with regard to BBBEE and the Council has not been providing strategic direction. These issues included the removal of white women as beneficiaries, extension of key deadlines to achieve targets and preferential procurement.
- An Anti-fronting Act should be enacted and companies should be prosecuted for engaging in this activity. Other corruption laws have not been used appropriately to clamp down on fronting. This is serious because it results in missed opportunities. No transformation, no skills transfer and the cost of doing business is driven up.
- Clamp-down of on one-man tenderpreuners who wins contracts and then sells them to companies who have the capacity to do the job. This tenderpreuner earns a fee for getting jobs for companies. Black companies and not black individuals should get preferential procurement contracts.
- Codes of good practice should encourage verification agencies to disclose information on fronting if it is detected.
- The government should get rid of transformation charters. Codes of good practice should cover everyone. Charters increase complexities and suppliers have to understand different charters for different industries. This increases the cost of doing business. Codes of good practice can be modified if there was anything unique to a particular industry instead of introducing a whole new charter as this caused more complexities for procurement officers.

4.6.2 Empirical Research

The following actions are recommended based on the finding of the empirical research:

- Company XYZ needs to educate the suppliers on how it applies the scorecard and implements preferential procurements.

- Many companies raised the issue of not understanding Company XYZ's systems that underwent a revamping recently.
- The perception of regarding BBBEE companies as a risk should be stopped immediately. The research findings have shown that these companies have a solid track-record of providing good/quality products to Company XYZ.
- SMMEs are collectively asking for more opportunities to tender in other contracts. Company XYZ should form one consolidated database of suppliers who can tender for jobs in other areas of Company XYZ's operations.
- Fronting has also been identified as the enemy in the responses from the questionnaire. Audits should be done on SMMEs that won contracts in order to verify their credentials. These should not be just paper-work but should also include site visits to get an accurate picture of the state of the SMMEs.
- Form a mini-team or small departments, whose sole function is to empower the SMMEs with skills needed to run a business. This will have two spin-offs: ensuring SMMEs have capacity to deliver against their contracts and earning points on the enterprise development element of BBBEE.
- A support structure is needed for SMMEs that are on the borderline or partially empowered, that is, level 7 or level 6, to point them in the right direction and nurse them during the infancy period of empowerment.

4.6.3 Suggested future research

Following the empirical research findings, the researcher would like to propose the following topics for future research:

- The viability of preferential procurement in the metals and engineering sector from Company XYZ's side. This is the same topic as this research study but it is flipped up-side down. It will be interesting to see if the findings of this future research will mirror the finding of this research.
- An alarming discovery from the research findings is that empowered companies find it difficult to maintain the preferential status. This requires detailed investigation on

the causes and what can be done to ameliorate the present status. This is important because it impacts on the sustainability of preferential procurement.

- Misunderstandings and misinterpretations of preferential procurement and BBBEE as a whole has been wide-spread. The literature findings also articulated big companies still struggling to understand the concept. Research on what can be done to eliminate these interpretation errors is recommended. All stakeholders should be identified and their inputs sought.
- Effective integration of the Broad-Based Black Economic Empowerment Act 53 of 2003 and Preferential Procurement Policy Framework Act No. 5 of 2000 in terms of objectives, beneficiaries, scorecards and strategies.
- Development of clear rules and sufficient systems of checks and balances to tackle fronting.
- How to effectively address the ownership measure of BBBEE to ensure that it equates to control and rights to dividends. This effective measure should ensure that not any black person qualifies and will ensure that companies do not use names of security guards or cleaners to falsify their empowerment credentials.
- Broaden the scope of the study to include companies on a national level to evaluate whether the finding are similar to the experiences of other industries.

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APPENDIX 1: THE BBBE ACT

Act No. 53, 2003 BROAD-BASED BLACK ECONOMIC EMPOWERMENT ACT, 2003

(English text signed by the President.)
(Assented to 7 January 2004.)

ACT

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.

PREAMBLE

WHEREAS under apartheid race was used to control access to South Africa's productive resources and access to skills;

WHEREAS South Africa's economy still excludes the vast majority of its people from ownership of productive assets and the possession of advanced skills;

WHEREAS South Africa's economy performs below its potential because of the low level of income earned and generated by the majority of its people;

AND WHEREAS, unless further steps are taken to increase the effective participation of the majority of South Africans in the economy, the stability and prosperity of the economy in the future may be undermined to the detriment of all South Africans, irrespective of race;

AND IN ORDER TO—

- promote the achievement of the constitutional right to equality, increase broad-based and effective participation of black people in the economy and promote a higher growth rate, increased employment and more equitable income distribution; and
- establish a national policy on broad-based black economic empowerment so as to promote the economic unity of the nation, protect the common market, and promote equal opportunity and equal access to government services.

BE IT ENACTED by the Parliament of the Republic of South Africa, as follows:—

ARRANGEMENT OF ACT

Sections

1. Definitions
2. Objectives of Act
3. Interpretation of Act
4. Establishment of Black Economic Empowerment Advisory Council
5. Functions of Council
6. Composition of Council and appointment of members
7. Constitution and rules of Council
8. Remuneration and reimbursement of expenses
9. Codes of good practice

10. Status of codes of good practice
11. Strategy for broad-based black economic empowerment
12. Transformation charters
13. Support services and funding of Council
14. Regulations
15. Short title and commencement

Definitions

1. In this Act, unless the context indicates otherwise—

"black people" is a generic term which means Africans, Coloureds and Indians;

"broad-based black economic empowerment" means the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to—

(a) increasing the number of black people that manage, own and control enterprises and productive assets;

(b) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;

(c) human resource and skills development;

(d) achieving equitable representation in all occupational categories and levels in the workforce;

(e) preferential procurement; and

(f) investment in enterprises that are owned or managed by black people;

"Council" means the Black Economic Empowerment Advisory Council established by section 4;

"members" means members of the Council;

"Minister" means the Minister of Trade and Industry;

"organ of state" means—

(a) a national or provincial department as defined in the Public Finance Management Act, 1999 (Act No. 1 of 1999);

(b) a municipality as contemplated in the Constitution;

(c) Parliament;

(d) a provincial legislature; and

(e) a constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999);

"prescribe" means prescribe by regulation;

"public entity" means a public entity listed in Schedule 2 or 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999);

"strategy" means a strategy for broad-based black economic empowerment issued in terms of section 11; and

"this Act" includes any code of good practice or regulation made under this Act.

Objectives of Act

2. The objectives of this Act are to facilitate broad-based black economic empowerment by—

(a) promoting economic transformation in order to enable meaningful participation of black people in the economy;

(b) achieving a substantial change in the racial composition of ownership and management structures and in the skilled occupations of existing and new enterprises;

(c) increasing the extent to which communities, workers, cooperatives and other collective enterprises own and manage existing and new enterprises and increasing their access to economic activities, infrastructure and skills training;

(d) increasing the extent to which black women own and manage existing and new enterprises, and increasing their access to economic activities, infrastructure and skills training;

(e) promoting investment programmes that lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity;

(f) empowering rural and local communities by enabling access to economic activities, land, infrastructure, ownership and skills; and

(g) promoting access to finance for black economic empowerment.

Interpretation of Act

3. Any person applying this Act must interpret its provisions so as—

(a) to give effect to its objectives; and

(b) to comply with the Constitution.

Establishment of Black Economic Empowerment Advisory Council

4. The Black Economic Empowerment Advisory Council is hereby established.

Functions of Council

5. The Council must—

(a) advise government on black economic empowerment;

(b) review progress in achieving black economic empowerment;

(c) advise on draft codes of good practice which the Minister intends publishing for comment in terms of section 9(5);

(d) advise on the development, amendment or replacement of the strategy referred to in section 11;

(e) if requested to do so, advise on draft transformation charters; and

(f) facilitate partnerships between organs of state and the private sector that will advance the objectives of this Act.

Composition of Council and appointment of members

6. (1) The Council consists of—

(a) the President, who is the chairperson of the Council;

(b) the Minister, with the Minister's Director-General as an alternate;

(c) three other Cabinet Ministers, appointed by the President, with their respective Directors-General as alternates;

(d) no fewer than 10 and no more than 15 other members appointed by the President.

(2) When appointing members in terms of subsection (1)*(d)*, the President shall have regard to the need for the Council—

(a) to have appropriate expertise;

(b) to represent different relevant constituencies including trade unions, business, community-based organisations and academics.

(3) In appointing members in terms of subsection (1)*(d)*, the President shall follow an appropriate consultative process.

(4) The President shall appoint a Cabinet Minister who is also a member of the Council to act as chairperson of the Council in the President's absence.

Constitution and rules of Council

7. (1) The Minister must establish a constitution for the Council.

(2) The Minister may amend the constitution of the Council from time to time, after consultation with the Council.

(3) The Council may, by resolution, and after consultation with the Minister, make rules to further regulate the proceedings of the Council.

Remuneration and reimbursement of expenses

8. Council members will not be remunerated for their services, but will be reimbursed for expenses incurred by them in carrying out their duties, as determined by the Minister, with the concurrence of the Minister of Finance.

Codes of good practice

9. (1) In order to promote the purposes of the Act, the Minister may by notice in the *Gazette* issue codes of good practice on black economic empowerment that may include—

(a) the further interpretation and definition of broad-based black economic empowerment and the interpretation and definition of different categories of black empowerment entities;

(b) qualification criteria for preferential purposes for procurement and other economic activities;

(c) indicators to measure broad-based black economic empowerment;

(d) the weighting to be attached to broad-based black economic empowerment indicators referred to in paragraph *(c)*;

(e) guidelines for stakeholders in the relevant sectors of the economy to draw up transformation charters for their sector; and

(f) any other matter necessary to achieve the objectives of this Act.

(2) A strategy issued by the Minister in terms of section 11 must be taken into account in preparing any code of good practice.

(3) A code of good practice issued in terms of subsection (1) may specify—

(a) targets consistent with the objectives of this Act; and

(b) the period within which those targets must be achieved.

(4) In order to promote the achievement of equality of women, as provided for in section 9(2) of the Constitution, a code of good practice issued in terms of subsection (1) and any targets specified in a code of good practice in terms of subsection (3), may distinguish between black men and black women.

(5) The Minister must, before issuing, replacing or amending a code of good practice in terms of subsection (1)—

(a) publish the draft code of good practice or amendment in the *Gazette* for public comment; and

(b) grant interested persons a period of at least 60 days to comment on the draft code of good practice or amendment, as the case may be.

Status of codes of good practice

10. Every organ of state and public entity must take into account and, as far as is reasonably possible, apply any relevant code of good practice issued in terms of this Act in—

(a) determining qualification criteria for the issuing of licences, concessions or other authorisations in terms of any law;

(b) developing and implementing a preferential procurement policy;

(c) determining qualification criteria for the sale of state-owned enterprises; and

(d) developing criteria for entering into partnerships with the private sector.

Strategy for broad-based black economic empowerment

11. (1) The Minister—

(a) must issue a strategy for broad-based black economic empowerment;

(b) may change or replace a strategy issued in terms of this section.

(2) A strategy in terms of this section must—

(a) provide for an integrated co-ordinated and uniform approach to broad-based black economic empowerment by all organs of state, public entities, the private sector, non-governmental organisations, local communities and other stakeholders;

(b) develop a plan for financing broad-based black economic empowerment;
(c) provide a system for organs of state, public entities and other enterprises to prepare broad-based black economic empowerment plans and to report on compliance with those plans; and
(d) be consistent with this Act.

Transformation charters

12. The Minister must publish in the *Gazette* for general information and promote a transformation charter for a particular sector of the economy, if the Minister is satisfied that the charter—
(a) has been developed by major stakeholders in that sector: and
(b) advances the objectives of this Act.

Support services and funding of Council

13. (1) The Department of Trade and Industry must provide the Council with the necessary support services and funding out of money appropriated by Parliament for that purpose.
(2) The funds referred to in subsection (1), must be utilised for—
(a) the establishment and operating costs of the Council: and
(b) the development and implementation of a communication plan on broad-based black economic empowerment.

Regulations

14. The Minister may make regulations with regard to any matter that it is necessary to prescribe in order to ensure the proper implementation of this Act.

Short title and commencement

15. This Act is called the Broad-Based Black Economic Empowerment Act, 2003, and comes into operation on a date to be determined by the President by proclamation in the *Gazette*.

APPENDIX 2: THE MINING CHARTER

ANNEXURE A: SCORECARD FOR THE BROAD BASED SOCIO-ECONOMIC EMPOWERMENT CHARTER FOR THE SOUTH AFRICAN MINING INDUSTRY

NOTES	DESCRIPTION	5 YEAR TARGET				10 YEAR TARGET
1	**Human Resource Development**					
	• Has the company offered every employee the opportunity to be functionally literate and numerate by the year 2005 and are employees being trained?	Yes		No		
	• Has the company implemented career paths for HDSA employees including skills development plans?	Yes		No		
	• Has the company developed systems through which empowerment groups can be mentored?	Yes		No		
2	**Employment Equity**					
	• Has the company published its employment equity plan and reported on its annual progress in meeting that plan?	Yes		No		
	• Has the company established a plan to achieve a target for HDSA participation in management of 40% within five years and is implementing the plan?					
	• Has the company identified a talent pool and is it fast tracking it?	Yes		No		
	• Has the company established a plan to achieve the target for women participation in mining of 10% within the five years and is implementing the plan*					
3	**Migrant Labour**					
	• Has the company subscribed to government and industry agreements to ensure non-discrimination against foreign migrant labour?	Yes		No		
4	**Mine community and rural development.**					
	• Has the company co-operated in the formulation of integrated development plans and is the company co-operating with government in the implementation of these plans for communities where mining takes place and for major labour sending areas? Has there been effort on the side of the company to engage the local mine community and major labour sending area communities? (Companies will be required to cite a pattern of consultation, indicate money expenditures and show a plan).	Yes		No		
5	**Housing and Living Conditions**					
	• For company provided housing has the mine, in consultation with stakeholders established measures for improving the standard of housing, including the upgrading of the hostels, conversion of hostels to family units and promoted home ownership options for mine employees? Companies will be required to indicate what they have done to improve housing and show a plan to progress the issue over time and is implementing the plan?	Yes		No		
	• For company provided nutrition has the mine established measures for improving the nutrition of mine employees? Companies will be required to indicate what they have done to improve nutrition and show a plan to progress the issue over time and is implementing the plan?	Yes		No		
6	**Procurement**					
	• Has the mining company given HDSA's preferred supplier status?	Yes		No		
	• Has the mining company identified current level of procurement from HDSA companies in terms of capital goods, consumables and services?	Yes		No		
	• Has the mining company indicated a commitment to a progression of procurement from HDSA companies over a 3 – 5 year time frame in terms of capital goods, consumables and services and to what extent has the commitment been implemented?	Yes		No		
7	**Ownership & Joint Ventures**					
	• Has the mining company achieved HDSA participation in terms of ownership for equity or attributable units of production of 15 percent in HDSA hands within 5-years and 26 percent in 10-years?	15%				26%
8	**Beneficiation**					
	• Has the mining company identified its current level of beneficiation?	Yes		No		
	• Has the mining company established its base line level of beneficiation and indicated the extent that this will have to be grown in order to qualify for an offset?	Yes		No		
9	**Reporting**					
	• Has the company reported on an annual basis its progress towards achieving its commitments in its annual report?	Yes		No		

APPENDIX 3: PERCEIVED COST OF DIFFERENT ELEMENTS OF BBBEE

Indicators	Description	Perceived Cost	Real situation	Real Benefits
Ownership	Selling equity stake to BEE investors or consortiums	Shares have to be "donated" to black investors	Black consoritums raises capital to pay for the stake in the company. In some instances, companies can voluntarily provide discounts or provide security to the debt.	According to the both the E&Y survey (on M&A) and KPMG/SAVCA, BEE has been driving significant corporate activities in SA
Management	Black representation on the board of directors and in top management	Company have to appoint black people into top management with little or no real value-add (Window-dress)	Many company follow their normal (and sometimes more stringent) appointment process to appoint black directors (especially black executive directors)	A diversified expand the opportunity available to the company by expanding and diversifying the combined network (Many existing black directors also had to overcome significant adversities of the past to get to where they are, and the experience provide them with significant value to add)
Employment Equity	Representation of black employees	Appointing black individuals to position for quota purposes rather than as a result of real advancement (window-dressing)	Appointing and advancing individuals on merit, eliminating the "glass ceiling" often faced by black candidates	More diversified workplace improves the effectiveness of teams
Skills Development	Investing in the skills development of black employees	Putting black employees through numerous soft-skill training to meet quota on skills spend	Requires company to invest in training which will develop the core skills of the black employees	Improvement of skillset of any employees result in greater productivity in the business
Preferential Procurement	Buying from black suppliers	Buying from a fronting entity or agency who have some BEE credential and charge a "comission" for colouring the transaction	Finding suppliers who are also committed towards investing in BEE, and buying from these companies	Some sectors (such as the banks) have found that a company can improve on cost savings while improving on preferential procurement
Enterprise Development	Investing and supporting black entrepreneurs	Company has to write out a cheque to a black business who need support	Enterprise development can become an effective tool to create or improve a company's upstream and downstream partners	Many companies have establish successful BEE companies who became significant business partners (either as a supplier or a customer)
Corporate Social Investment	Investing in the community	Company has to write out a cheque to charity	CSI requires a company and its employee to be involved in the community	Community involvement often improves a company's positioning in the community

APPENDIX 4: THE QUESTIONNAIRE

Dear Respondent,

I invite you to participate in a research project to study the viability of preferential procurement in the Metals and Engineering sector and then assess the sustainability of it thereof. Enclosed with this letter is a short questionnaire that solicits your views on business with ArcelorMittal. Your honest answers to these questions will allow us to improve the way business is conducted between yourself and the ArcelorMittal.

The questionnaire consists of statements that directly reflect on the objectives of the study. You are requested to mark the block which is appropriate to the statement made. The survey uses a 5-point Lickert scale as a measuring instrument. Number "1" is for ***strongly agree*** and Number "5" is for ***strongly disagree***.

I hope that the results of the survey will be useful for making recommendations that will address the problems identified and put interventions in place to improve the way business is conducted. Your response will be dealt with in a confidential manner and will not be shared with anyone outside my research group which consists of Professor Ronnie Lotriet and myself.

You are requested not to mention your organization name to maintain confidentiality of your response. I hope you will take the time to complete this questionnaire honestly and truthfully. Completed questionnaires can be faxed to 086 634 3815 or emailed to lethola.mokakala@arcelormittal.com. On request, feedback can be made available to all respondents

I thank you for taking the time out to participate in this research.

Yours Sincerely,

Lethola Mokakala,
MBA Student

PREFERENTIAL PROCUREMENT QUESTIONAIRRE

Company Details

1. Do you have preferential Status?

Yes (1)	No (2)

2. Did BBBEE create new opportunities for your business? If yes, motivate shortly…

Yes (1)	No (2)

-

1	Strongly Agree
2	Agree
3	Neutral
4	Disagree
5	Strongly disagree

3. How many preferential contracts does your business have?

1 (1)	2 (2)	3 (3)	4 (4)	5 (5)	6 (6)	>7

4. What is your score on the BBBEE scorecard?

1 (1)	2 (2)	3 (3)	4 (4)	5 (5)	6 (6)	7	(years)

5. What service or product are you rendering?.....

6. How long has the business been operating?

< 1 (1)	1 - 3 (2)	3 - 5 (3)	5 - 10 (4)	> 10 (5)	(years)

7. How long have you been providing this specific procurement service (Between yourself and Mittal?

1 (1)	2 (2)	3 (3)	4 (4)	5 (5)	(years)

8. What is the total number of people employed by the business?

<= 5 (1)	6 - 50 (2)	51-99 (3)	>100(4)

9. How many employees are working on this specific procurement service (Mittal contract)?

< 5 (1)	6 - 10 (2)	11 - 30 (3)	31 - 50 (4)	>50 (5)	Rands

10. Which town is the business headquartered?.....

Capacity					
11. Your company has the necessary experience and skills to render the service required by Mittal.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
12. Your company had to recruit additional personnel/ or capital goods (such as machines etc) to build capacity.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
13. If the company had to recruit personnel, how many employees were recruited to build capacity?	< 5 (1)	6 - 10 (2)	11 - 30 (3)	31 - 50 (4)	>50 (5)
14. How many days of training does each employee undergo per year?	<1	2- 3	3-5	5 - 8	>8
15. It was difficult to meet Mittal requirements as per contractor management guidelines.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
16. Mittal representatives have complained about the quality of service that the your company is rendering.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
17. Your company has the capital(funds) and resources needed to perform the required service.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
18. Your company has used sub-contractors because of lack of capacity to do the job.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
Profitability					
19. Your company is generating a profit from Mittal preferential procurement contracts.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
20. Your company has sufficient cash at all times to meet its financial obligations.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
21. Your company's financial position has been improving due to the service or product being offered	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)

Working Relationship					
22. Mittal always pays on time after service is rendered.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
23. Mittal has provided the company with all the neccesary support (resources, skills, co-operation etc) needed.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
24. What additional support can Mittal offer your business? Motivate shortly…					
25. There is a good business relationship between your company and Mittal. Please motivate your answer briefly…				Yes	No
Continuity					
26. It was difficult for your company to achieve preferential status. Motivate shortly…				Yes	No
27. It is difficult to maintain the company's preferential status. Motivate shortly…				Yes	No
28. The company has been gaining more customers over the past years.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
29. The company's business has been growing over the past years.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
30. How long is the length of the contract between the business and Mittal?	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
31. After the contract has lapsed, will your business be interested in re-tendering for the contract?				Yes	No

32. Please motivate the above answer briefly…					
31. Mittal's operation is stable and need the service or product the company is offering in the future.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
32. The working relationship between your business and Mittal is expected to be long-term.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)
33. Your company's operations and financial position is stable enough to continue rendering the service.	1 (1)	2 (2)	3 (3)	4 (4)	5 (5)

General

34. Is it problematic for your business to raise finance? Motivate briefly…

35. What are challenges/problems that the your business is facing? Please elaborate…

36. What can be done differently to improve the success of preferential procurement?

37. What are 3 most important pros and cons of BBBEE to your business?

38. What aspect of your operation is the main driver of success of the business? In order words, what is your unique selling point that helped you to get Mittal contract?

39 Any additional comments/observations that the company will want

to highlight?

APPENDIX 5: LETTER FROM LANGUAGE EDITOR



Tuesday, November 16, 2010

Mr L.L. MOKAKALA

21432775

Re: Letter of confirmation of language editing

The MBA mini-dissertation "*The viability of preferential procurement in the metals and engineering sector*" was language, technically and typographically edited. The sources and referencing technique applied was checked to comply with the specific Harvard technique as per North-West University prescriptions.

Antoinette Bisschoff
Officially approved language editor of the NWU