Emerald Meditari Accountancy Research

JSE's BEE Segment and problems facing compliance with BBBEE ownership requirements

Journal:	*Meditari Accountancy Research*
Manuscript ID	MEDAR-02-2016-0033
Manuscript Type:	Research Paper
Keywords:	Broad-Based Black Economic Empowerment, JSE's BEE Board, BEE schemes, BEE shares

JSE's BEE Segment and problems facing compliance with BBBEE ownership requirements

Abstract

South Africa has been trying to redress the socio-economic consequences of the past. A significant policy in this regard is South Africa's Broad-Based Black Economic Empowerment (BBBEE) policies. To comply with one aspect of BBBEE, companies have issued BBBEE scheme shares to include those groups of people affected by Apartheid in the economic wealth of the company, and, South Africa. In 2011, to facilitate trading in these restricted shares, the Johannesburg Stock Exchange (JSE) introduced a Black Economic Empowerment (BEE) Segment on the Main Board. However, this segment did not flourish as expected. For the better part of 4 years it only had one company listed – Sasol.

Sasol Ltd's Sasol Inzalo Ltd (RF) shares were the first shares traded on the BEE segment (listing in 2011) until November 2015 when MTN listed their MTN Zakhele Ltd (RF) shares. The aim of this paper is to draw researchers' attention to this under-researched area, highlight some obstacles and suggest some areas for future research.

Keywords: Broad-Based Black Economic Empowerment; JSE's BEE Board, BEE schemes, BEE shares.

Table of contents

Contents

1. Introduction

Under Apartheid, certain race groups' participation in the economy was limited. In particular, they were prohibited from owning shares in companies. This resulted in the entire corporate sphere being dominated by white capital (Stanford University, 2016).

South Africa has changed dramatically post-Apartheid with the opening of the country to direct foreign investment (Gstraunthaler, 2010). In order to help alleviate some of the injustices of the past, the African National Congress (ANC), in power since 1994, initiated Broad-Based Black Economic Empowerment (BBBEE) legislation. This legislation aims to encourage socially responsible behavior by South African corporate entities that will enhance designated peoples'[1] participation in the South African economy (Teoh et al, 1999; Arya and Bassi, 2011; Industry, 2015).

While initially the BBBEE legislation was not punitive, recently the legislation has changed. Initially preference was given when awarding government contracts to those companies with a higher Black Economic Empowerment (BEE) score. Also, in order to qualify for incentives and assistance from the Department of Trade and Industry, black ownership will be a precondition. In order to increase a company's BEE score they would increase their use of designated suppliers and so the legislation would filter the desired effect of helping designated people and designated entities from big corporations to smaller ones. Now, irrespective of whether entities want to tender for lucrative government contracts or not, companies need to achieve certain scores in certain areas or face possible penalties (Paton, 2015; Werksmans, 2015)[2].

In order to comply with BBBEE, several companies have developed and issued BEE scheme shares to employees with the aim being two-fold. Firstly, to promote increased work ethic by linking employees' effort with company profits (Employee Share Ownership Centre, 2016) and, secondly, to increase BBBEE compliance and earn BEE points (Werksmans, 2015). These BEE deals are structured in a variety of ways. Section 2 discusses how these BEE scheme shares work.

2. Black Economic Empower deals

One of the BBBEE legislation's criteria looks at the ownership percentage of designated people in entities operating in South Africa. In order to achieve compliance with this element of the BEE scorecard, common methods include creating a separate class of shares or incorporating a separate special purpose entity (SPE) whose sole asset is shares in the operational company. In the former case, the shares would be sold to designated individuals / groups for cash. In the latter option, the SPE will obtain loans from the bank and / or the operational company and use those funds to buy ordinary shares in the operational company. Shares in the SPE are given to designated individuals / groups and the dividends that the SPE earns on the shares in the operational company are used to pay interest, capital and expenses of the SPE. Then, any remaining cash is used to declare dividends

[1] Designated groups means black people, women and people with disabilities who: (a) are citizens of the Republic of South Africa by birth or descent; or (b) became citizens of the Republic of South Africa by naturalization: (i) before 27 April 1994; or (ii) after 26 April 1994, who would have been entitled to acquire citizenship by naturalization prior to that date but were excluded by Apartheid policies (Africa, 2012).

[2] The purpose of this paper is not to give an explanation of the BBBEE Act, Codes or amendments thereto.

to the shareholders of the SPE, if any. At a specified date (e.g., 10 years) the SPE will sell as many of the shares it has in the operational company as is required to repay any outstanding debt and expenses. The remaining shares in the operational company will then either continue to be held by the SPE, with future dividends going to shareholders of the SPE, or those shares will be declared as a dividend in specie to the shareholders of the SPE.

These schemes are not without their drawbacks. Potentially, many employees benefiting from these schemes do not understand what it is they actually have. More importantly, these employees may want cash now; not in 10 years' time. Due to this, employees could simply sell their interests. This would result in some of the interests being taken up by non-empowered holders (non-BBBEE designated individuals / groups), detracting from a long-term empowerment objective. The BBBEE criteria are, arguably, no longer met as, again, there is not enough designated peoples' participation in the company. The BEE status of the company would therefore get diluted and the company's BEE score reduced (Ngcobo, 2010; Mathews, 2015a).

A method to overcome the above situation is to incorporate vesting conditions, or shareholder lock-in periods, into the shares. These would typically be between 3 and 10 years. This would only temporarily solve the problem because, after the vesting period, employees could sell the shares to whoever would buy them. Another method is to impose permanent restrictions on a class of shares via its terms and conditions. This would ensure the shares always remain in designated persons' hands but introduces other obstacles related to liquidity and pricing; this also creates legal complications for the issuing entity in terms of monitoring this and then clawing-back shares sold contrary to the legal terms and conditions.

When companies do issue BEE scheme shares, most are traded using Over-the-Counter (OTC) platforms (Mathews, 2015b). This makes trading difficult as buyers need to find sellers and *visa versa*. Also, at what price should the trade take place; is the trade guaranteed; who accepts credit risk; who can investors turn to if there are any issues; is insider trading regulated? These may introduce more discounting factors into share prices and volumes, thereby reducing the value-creation in designated peoples' hands.

Yet another complication is the Financial Services Board's (FSB) directive on public companies housing infrastructure to trade in their own shares OTC. The directive notifies companies that if they maintain a platform that facilitates trading, that meets the definition of an exchange[3] in the Financial Markets Act, 2012 (FMA), they will require a license to continue the exchange (FSB, 2015). Obtaining such a license is a lengthy and daunting task, and not the issuing company's main business.

Finally, a point of significant concern to shareholders, and potential investors, is the matter of 'once empowered, always empowered'. If a company issues shares to designated people and those people sell their shares immediately afterwards, is the company obliged to continue issuing these schemes and forcing shareholders to accept dilution after dilution? This question has been posed to the courts as the Chamber of Mines try to obtain some clarity on this matter. However, once a ruling has been obtained, the codes and regulations could simply be changed to obtain a specific end result.

[3] The FMA defines an exchange as "a person who constitutes, maintains and provides an infrastructure – (a) for bringing together buyers and sellers of securities; (b) for matching bids and offers for securities of multiple buyers and sellers; and (c) whereby a matched bid and offer for securities constitutes a transaction" (FSB, 2015).

Although changing these policies and regulations requires consultation, it does not necessarily require agreement (Mathews, 2015a; Paton, 2015).

3. BEE Segment of the JSE's Main Board

Sasol Ltd and the JSE have a possible solution for some of the challenges discussed previously. Sasol Ltd and the JSE began collaborating to launch a separate BEE segment on the Main Board on the JSE that is specifically designed for trading in BEE scheme shares. Sasol Ltd contributed 20% to the development costs of this platform and was the first to list on the BEE Segment in 2011 (Financial Mail, 2012).

An advantage of listing BEE scheme shares on the JSE is that those shares can remain on the Board indefinitely, thereby ensuring that that portion of equity in your firm is always held by designated people, without the issuer having to monitor who is buying the shares, to some extent (see verification options below). This eliminates some of the burdens related to attaining and maintaining the required percentage of equity ownership. However, leaving these BEE scheme shares on the JSE permanently may result in long-term discounts on these shares. That is, at least and until there are sufficient volumes participating in this JSE segment.

The JSE's BEE Segment is not without challenges. Initially, it is thought that the verification of persons/groups eligible for trading in a particular schemes' BEE shares was an issue. It required multiple levels of approval/verification which resulted in shareholders having to drive around to get all the required signatures, all during which the share price is changing. Part of the new regulations for the JSE's BEE Segment took this verification obligation away from the JSE and gave it to the respective company whose BEE shares are traded on the platform.

A designated person or group can become verified using one of two alternatives: BEE Contract or BEE verification agents. The BEE contract is a once-off contract that, once signed, allows that investor to trade freely in any BEE shares on the JSE's BEE Segment. It is a cumbersome contract and, amongst other provisions, indemnifies the JSE if the issuer of a particular share claws-back shares sold to an illegitimate person or group. The other method is to get verified through a verification agent. This is usually done by the respective issuers and, once done, does not allow that investor to trade in any shares on the JSE's BEE Segment, but only those of the issuer by which the investor has been verified.

Another limit of using the JSE's BEE Segment is that certain restrictions cannot be maintained and monitored by the JSE. For example, if a company has a restriction where no one person or group may hold more than 10% of the shares (to ensure broad-based participation), this restriction the JSE cannot enforce (Planting, 2013). The gender of the shareholders also cannot be restricted when trading on the JSE. With the recently updated codes, the concept of broad-based participation is becoming even more important.

Finally, the basic structure of these BEE deals may require creative thinking to redesign them. Perhaps there are better means of transferring value to designated people and increasing the transformation of our economy.

4. Conclusion and areas for future research

In light of the recent racial tensions involving the use of social media, accountancy academics can play a pivotal role in helping to shape South Africa's future by using both their technical skills and understanding of accounting, economics and policy to help corporates solve some key problems and improve the efficiency with which we redress the socio-economic legacy left by Apartheid. This paper has highlighted issues regarding compliance with equity ownership and provided some context as a base for accountancy academics to research this little studied area (cf Maroun and Jonker, 2014). The following are some suggested areas for future research:

- Are there better ways of structuring BEE schemes to transform more efficiently the South African economy and ensuring ore meaningful participation in the economy by economically disadvantaged groups?
- What are the arguments for and against the principle are of 'once empowered, always empowered'?
- Does a separate segment of the JSE's Main Board for a designated group only reinforce racial segregation? Is this a necessary compromise, and, if so, for how long should such a segment exist?
- Can this segment of the main board be structured better to (a) decrease transaction costs and (b) to reduce inefficiencies, with regards to the verification process and restrictions on shares?
- Do fortunate/wealthier people, who are in the same race categories as those of designated people, per the BBBEE legislation, have a philanthropic responsibility to actively trade in BEE scheme shares to: increase volumes / improve liquidity, improve prices and efficiency of BEE scheme shares?
- Are complex BEE schemes the best way to actively include financial uneducated employees in the South African economy? If not, what are other possible methods to achieve similar results but with more but-in and upskilling in the designated groups?
- What are the consequences of leaving BEE scheme shares permanently on the JSE's BEE Segment of the Main Board?

References

Africa, R. o. S. 2012. Employment Equity Amendment Bill.

Arya, B. & Bassi, B. 2011. Corporate social responsibility and broad-based black economic empowerment legislation in South Africa codes of good practice. *Business & Society,* 50 (4)**,** 674-695.

Employee Share Ownership Centre. 2016. *Employee share ownership: an introduction* [Online]. Employee Share Ownership Centre. Available: http://www.esopcentre.com/employee-share-ownership-an-introduction/ [Accessed 19 January 2016].

Financial Mail. 2012. *BEE Platform* [Online]. Financial Mail. Available: http://www.financialmail.co.za/scitech/software/2012/05/02/bee-platform [Accessed 16 January 2016].

FSB 2015. Proposed OTC Directive.

Gstraunthaler, T. 2010. Corporate Governance In South Africa: The Introduction Of King III And Reporting Practices At The JSE Alt-X. *Corporate Ownership and Control,* 7 (3)**,** 149.

Industry, D. o. T. a. 2015. *Board-Based Black Economic Empowerment* [Online]. Available: https://www.thedti.gov.za/economic_empowerment/bee.jsp [Accessed 7 January 2015].

Maroun, W. & Jonker, C. 2014. Critical and interpretive accounting, auditing and governance research in South Africa. *Southern African Journal of Accountability and Auditing Research,* 16**,** 51-62.

Mathews, C. 2015a. Mining and empowerment: Back to scratch. Financial Mail.

Mathews, C. 2015b. *Sasol Inzalo joins MTN Zakhele as it lists in empowerment segment of JSE* [Online]. BDLive. Available: http://www.bdlive.co.za/business/energy/2015/12/02/sasol-inzalo-joins-mtn-zakhele-as-it-lists-in-empowerment-segment-of-jse [Accessed 16 January 2016].

Ngcobo, S. 2010. *JSE's board for BEE firms is ludicrous* [Online]. MoneyWeb. Available: http://www.moneyweb.co.za/archive/jses-board-for-bee-firms-is-ludicrous/ [Accessed 16 January 2016].

Paton, C. 2015. *'Once empowered, always empowered' — BEE attention turns to endgame* [Online]. Business Day. Available: http://www.rdm.co.za/business/2015/07/21/once-empowered-always-empowered--bee-attention-turns-to-endgame [Accessed 29 January 2016].

Planting, S. 2013. *BEE share trading gathers momentum* [Online]. MoneyWeb. Available: http://www.moneyweb.co.za/archive/bee-share-trading-gathers-momentum/ [Accessed 16 January 2016].

Stanford University. 2016. *The History of Apartheid in South Africa* [Online]. Stanford University. Available: http://www-cs-students.stanford.edu/~cale/cs201/apartheid.hist.html [Accessed 15 January 2016].

Teoh, S. H., Welch, I. & Wazzan, C. P. 1999. The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*. *The Journal of Business,* 72 (1)**,** 35-89.

Werksmans 2015. Amendments to the BBBEE Act and the Codes explained.