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"Creating BUSINESS sense out of BEE"

CODE 100, STATEMENT 103: THE RECOGNITION OF THE EQUITY EQUIVALENTS FOR MULTINATIONALS

Introduction

The Minister of Trade and Industry, Mandisi Mpahlwa, gazetted the Department of Trade and Industry's Broad-based Black Economic Empowerment Codes of Good Practice under section 9 of the Broad-based Black Economic Empowerment Act (2003) on the 9th of February, 2006. These codes are now binding on the state and numerous state-owned entities (these are covered in schedules 2 and 3 of the Public Finance Management Act).

This document is a synopsis of the pertinent aspects of the statement. Detail is available from the codes themselves.

Don't forget that at all times the definition of black people remains: A generic term for Africans, Coloureds and Indians who

- are South African citizens by birth or descent;
- are South African citizens by naturalisation before 27th April, 1994;
- became South African citizens after 27th April, 1994, but who, but for the Apartheid policy that had been in place prior to that date, would have been entitled to acquire citizenship by naturalisation prior to that date.

An enterprise is defined as - a natural or a juristic person, or any form of co-operative, conducting a business, trade or profession in the Republic of South Africa. When we refer to companies we are effectively referring to an enterprise as defined.

Local operation: our term to describe the local multinational.

Defining a multinational

A multinational is a business with operations in South Africa. They must either:

1) have international head quarters outside of South Africa
2) have operations in other countries as well the country where it maintains its head quarters

The latter clause is obviously designed to deter companies setting up head quarters in another country to simply qualify as a multinational and therefore equity equivalents.

Equity Equivalents

An equity equivalent is a method for a multinational business to gain the equivalent number of points in the ownership section of the scorecard (20 points).

The value of the equity equivalent is measured against the value of the *South African operation*. The value contributed by non-South African operations to the local operation is expressly excluded.

Equity equivalent programme

1) The equity equivalent must take the form of a programme that is approved[1] by either:
   - a sectoral line ministry
   - a premier
   - other stakeholders in ANY government department, provincial government or local government
2) Any programme forming part of a sector code[2] is an approved programme.
3) Programmes should be sector specific; the minister (dti) may consider requests for other programmes.
4) Programmes may support government initiatives like ASGISA or JIPSA; or may benefit other enterprise development or socio-economic development beneficiaries.

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[1] The word "approved" is not expressly mentioned in the statement. The statement says the multinational must "consult" with the people or departments listed above, regarding their equity equivalent proposal. However the definitions contained in schedule 1 state programmes are "approved" by the minister.

[2] It is likely that this would be a code gazetted under section 9 of the BBBEE Act.

Applying for an equity equivalent programme

1) The multinational must prove that they are subject to a global practice.[3]
2) The application for the programme must contain
   - a complete description of the programme and its projected outcomes
   - qualification criteria for participation in the programme
   - timelines for implementation and delivery; milestones must be included
   - list of beneficiaries (types of beneficiaries are contained in section 3.7 of statement 103)
   - details of the sponsors of the programme

General rules about equity equivalent contributions

- Multinationals opting to implement an equity equivalent programme can only receive ownership points for that programme. In other words if they conduct any other type of programme to gain points under ownership (e.g. sale of assets under statement 102), the may not claim these points under ownership.
- Programmes that can qualify under enterprise development (code 600) or socio-economic development (code 700) cannot claim the points under those sections as well.

Measuring equity equivalent contributions

Contributions must equate to either:

- 25% of the value of the *South African operations* of the multinational.[4]
- 4% of the total annual revenue of the *South African operations* for the period of continued measurement (probably a ten year period).

[3] A global practice is a globally and uniformly applied practice of a multinational restricting alienation of equity or sale of the business in its regional operations. The practice must have existed before 9 January, 2003.

[4] This can be a lump sum upfront or can be made over a ten year period (10% in year one; 20% in year two; 40% over years three and four; 60% over years five and six; 80% over years seven and eight; the balance over year nine until the end of year ten).

Sales of equity instruments in non-South African enterprises

An example of this would be the sale of shares on an international bourse to black people. These are subject to:

1) The non-South African enterprise must be part of the chain of ownership between the South African operation and its multinational owner.
2) The transaction must comply with South African exchange control regulations.
3) The percentage of the value of the equity instruments can be measured against the value of local operation for the measurement of economic interest in terms of code 100.[5]
4) Voting rights in the local operation must be ceded to the buyers of these equity instruments in order to measure voting rights in terms of code 100.
5) The rights of ownership in the equity instruments are comparable to those in the local operation.

[5] In other words; if the local operation is valued at R100 then 25% would be measured at R25. This R25 can be realised in the equivalent of shares on an international bourse.

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Broad-based BEE (BBBEE) is one example. The Caird Group firmly believes in its responsibility to ensure that its clients have a firm understanding of the concept and that they are able to isolate and implement the business opportunities and efficiencies that reside within BBBEE.

Our BEE solutions combine well established methodologies with best practices that maximise the BBBEE implementation.

Contact the Caird Group

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CODE SERIES 100: THE MEASUREMENT OF THE OWNERSHIP ELEMENT OF BROAD-BASED BLACK ECONOMIC EMPOWERMENT

STATEMENT 103: THE RECOGNITION OF EQUITY EQUIVALENTS FOR MULTINATIONALS

Issued under section 9 of the Broad-Based Black Economic Empowerment Act of 2003

Arrangement of this statement

1 Objectives of this statement

The objectives of this statement are to:

1.1 define the means by which Multinationals may apply for recognition of Equity Equivalent Programmes;

1.2 specify how contributing towards the Ownership Element of B-BBEE by Multinationals is measurable;

2 Key Measurement Principles

Any Equity Equivalent Contributions towards the Ownership Element of B-BBEE made by Multinationals are measurable against the value of their operations in the Republic of South Africa.

3 Recognition of Equity Equivalent Programmes

3.1 The Minister may, approve certain Equity Equivalent Programmes after the Multinational has consulted with the sectoral line ministry. Premiers or other stakeholders in any government department, provincial government or local government with respect to their equity equivalent proposal.

3.2 Any Equity Equivalent Programme forming part of a Sector Code constitutes an approved programme.

3.3 Equity Equivalent Programmes are preferably Sector Specific, but the Minister may consider requests for approval of programmes that are not Sector Specific.

3.4 Equity Equivalent Programmes may involve:

3.4.1 programmes that support:

3.4.1.1 the Accelerated and Shared Growth Initiative for South Africa;

3.4.1.2 the Joint Initiative for Priority Skills;

3.4.1.3 the National Skills Development Strategy;

3.4.2 programmes that promote enterprise creation in respect of cooperatives that are:

3.4.2.1 more than 50% owned by black people; or

3.4.2.2 more than 30% owned by black women; or

3.4.2.3 more than 50% owned by members of black designated groups; ;

3.4.3 any other programmes that promote Socio-Economic advancement or contribute to the overall socio development of the Republic of South Africa.

3.5 Equity Equivalent Programmes must include:

3.5.1 a full description of programme objectives and projected outcomes;

3.5.2 qualification criteria for participation in the programme;

3.5.3 timelines for implementation and delivery with milestones against which progress is measurable; and

3.5.4 details about the sponsors of the programme.

3.6 Equity Equivalent Programmes are limited to Multinationals subject to a Global Practice.

3.7 Equity Equivalent Programmes may have any of the following as their beneficiaries:

3.7.1 enterprises in which:

3.7.1.1 black people hold more than 50% of the exercisable voting rights and more than 50% of the economic interest;

3.7.1.2 black women hold more than 30% of the exercisable voting rights and more than 30% of the economic interest; and

3.7.1.3 Black Designated Groups hold more than 50% of the exercisable voting rights and more than 50% of the economic interest; or

3.7.2 communities, natural persons or groups of natural persons where at least 75% of the beneficiaries are black people and the same percentage of economic value is derived by black people.

4 Measurement of Equity Equivalent Contributions on the Ownership Scorecard

4.1 The ownership score of a Multinational participating in an Equity Equivalent Programme is calculated in terms of paragraph 4.3. A Multinational participating in an Equity Equivalent Programme cannot receive any points for ownership under any statement in Code Series 100 other than this statement.

4.2 Contributions to Equity Equivalent Programmes are measured as actual contributions made using the general principle set out in code series 600 and 700 against any of the following targets:

4.2.1 25% of the value of the South African operations of the Multinational, determined using a Standard Valuation; or

4.2.2 4% of Total Revenue from its South African operations annually over the period of continued measurement;

4.3 The Ownership Score under an Equity Equivalent Programme using either of the targets in paragraphs 4.2 must be calculated in terms of Annexe 103(A).

5 Examples of Equity Equivalent Programmes

5.1 Enterprise creation:

5.1.1 If the equity equivalent contribution of a Multinational involves the creation of a new Enterprise:

5.1.1.1 the new Enterprise must qualify as a Value-Adding Enterprise;

5.1.1.2 the creation of the new Enterprise must comply with the requirements for a Qualifying Transaction as defined in statement 102;

5.1.1.3 the creation of the new Enterprise cannot contribute to the Multinational's score under Code series 600; and

5.1.1.4 the equity equivalent contribution must involve the provision of interest free loans, No-Gain Grants or Human Capital Investments to the new Enterprise equivalent in value to 50% of the new Enterprise's projected operational costs for the first 3 years following its establishement.

5.2 Investment in social advancement:

5.2.1 An equity equivalent contribution of a Multinational that involves enhanced Socio-Economic Development.

5.2.1.1 must comply fully with Code series 700; and

5.2.1.2 cannot form part of the Multinational's score under Code series 700.

6 Specific Rules on Multinationals

6.1 Any contributions towards the ownership Element of B-BB-BBEE made by Multinational Businesses or South African Multinationals are measurable against the value of their operations in the Republic of South Africa.

6.2 In calculating their ownership score, Multinational Businesses and South African Multinationals must apply the Exclusion Principle to any portion of the business value of their South African operations gained from non-South African sources. A Standard valuation method must be used to determine the value of the South African operations.

6.3 In calculating their ownership score, Multinational Businesses may recognise sales of Equity Instruments in non-South African Enterprises to black people, on the following basis:

6.3.1 the non-South African Enterprise must form part of the chain of ownership between the Multinational Business and its eventual holding company; and

6.3.2 the transaction must comply with South African exchange control requirements; and

6.3.3 the percentage of the value of the Equity Instruments sold to the value of the Multinational Business represents the recognisable black claim to Economic Interest; and

6.3.4 the percentage of Exercisable Voting Rights ceded to the buyers of the Equity Instruments in the Multinational Business represents the recognisable black right to Exercisable Voting Rights; and

6.3.5 the rights of ownership in the Equity Instruments are comparable to rights that would have accrued had the Equity Instrument B-BBEEn in the Multinational Business.

ANNEXE 103(A)

This formula is for determining the Ownership Score under an Equity Equivalent Programme using either of the targets in paragraph 5.2, where the contribution is made upfront on a once off basis.

$$A = \frac{B}{C} \text{ x}20$$

Where

A is ownership points of the Multinational in any year arising from its equity equivalent contribution

B is the value of contributions made

C is the financial value of the target of 4% of total revenue from its South African operations annually over the period of continued measurement;

This formula is for determining the Ownership Score under an Equity Equivalent Programme using either of the targets in paragraphs 5.2, where the contribution is made on an annual basis towards a ten year target is as follows:

$$A = \frac{B}{C} \text{ x} \left(\frac{1}{25\% \text{ x } D}\right) \text{ x } 20$$

Where

A is ownership points of the Multinational in any year arising from its equity equivalent contribution

B is the value of total contributions made prior to the date of measurement

C is the financial value of the target in paragraph 4.2.1.or the ten year value of contributions to be made over the life of this statement

D is the time-based graduation factor outlined below:

- 10% for the first year after the commencement of statement 000.
- 20% for the second year after the commencement of statement 000.
- 40% from the first day of the third year after the commencement date of statement 000 to the last day at the end of the fourth year after the commencement date of statement 000.
- 60% from the first day of the fifth year after the commencement date of statement 000 to the last day at the end of the sixth year after the commencement date of statement 000.
- 80% from the first day of the seventh year after the commencement date of statement 000 to the last day at the end of the eighth year after the commencement date of statement 000.
- 100% from the first day of the ninth year after the commencement date of statement 000 to the last day at the end of the tenth year after the commencement date of statement 000.