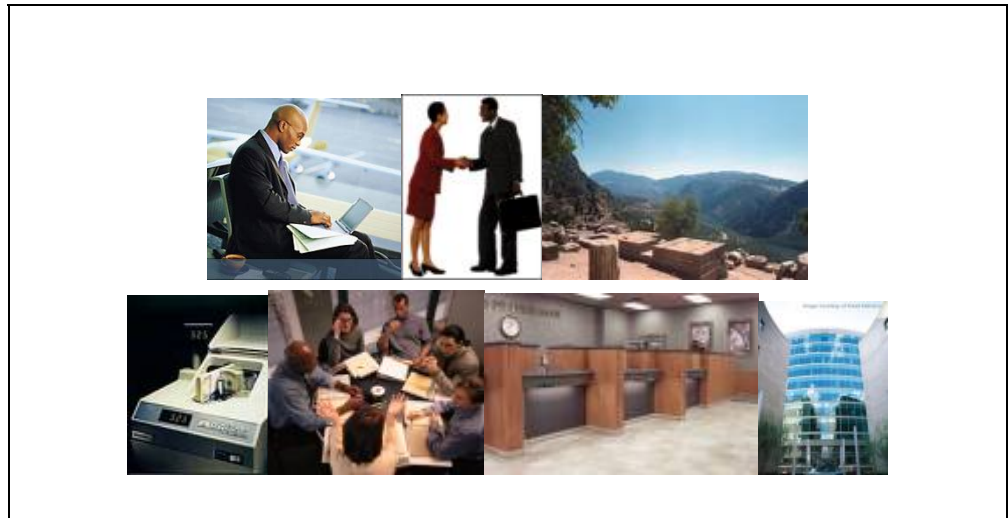




## IMPACT OF BEE IMPLEMENTATION ON PROFIT MARGIN AND PRODUCTIVITY



### AN EMPOWERDEX REPORT

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## ■ 1. Introduction

What are the costs of Broad-Based Black Economic Empowerment? Many companies have raised concerns over BEE implementation, as it adds “a notable and unnecessary cost burden” on businesses.

To address this, Empowerdex have compared the BEE status and the net profit margins of 99 JSE listed industrial companies over the last three years. The results show the concerns over the cost of BEE implementation to be unfounded.

Given the inherent bias against change, the so-called BEE costs are often perceived rather than real. For instance, many people use the hiring black management or staffs, who perform little or no function, as one of the potential cost of BEE. Not realizing that these perceived costs relates to the specific behaviours and practices the BEE rules is trying to stamp out.

Further, a sectoral comparison of the average BEE score against the productivity statistics provided by National Productivity Institute further shows that maintaining or increasing BEE score does not negatively affect the overall productivity of an industry.

There are no doubts that implementing BEE means changing people’s behaviour, which will surely bring discomfort to some people. However, our results illustrate that implementing true broad-based BEE not only address the economic imbalance in our society, but can result in significantly higher profit growth for a company.

## ■ 2. Methodology

To measure the effects of BEE on the costs and productivity of a company, Empowerdex relied on the following methodology.

### *2.1. Impact of BEE on Profit Margin*

To measure the impact of BEE on Net Profit Margin, Empowerdex compares uses the BEE status of JSE listed industrial companies (exclude Resources and Financial Services). The BEE score used is based on the annual Empowerdex/FM Top Empowerment Company Survey for March 2006 and March 2005.

The team uses the financial data as provided by INET Bridge for the net profit and turnover data for all companies for 2003, 2004 and 2005 financial periods.

A total Sample of 99 Companies, was selected for this sample (all companies without a BEE score or without a three year profit history were excluded from the data).

The companies are further divided into 9 sub-sectors:

- Basic Industries (including Construction)
- Food & Beverage
- General Industrials
- Health and Pharmaceuticals
- IT, Telecommunication and Media
- Retail
- Services
- Tourism and Leisure
- Transport

The team evaluates the costs of implementing BEE initiatives (as evidenced when it achieves a higher BEE score) by classifying companies into four quartiles. The average net profit margin over the three year preceding the score is then analyzed to measure the cost impact of a company's decision to achieve and maintain a high BEE score.

## 2.2. Impact of BEE on Productivity

To evaluate the impact of BEE on productivity, Empowerdex compared average BEE status in each sector to the productivity statistics as provided by the 2005 NPI report. The team studied the two key comparisons between BEE score and Overall Productivity, as well as between Employment Equity score and Labour Productivity.

## ■ 3. Results

### 3.1. Impact on Net Profit Margin

A study of the Net Profit Margin of the four BEE-ranked quartiles provides a very interesting analysis. The top two quartiles, by BEE score, improve their profit margin by a higher-than-average 34.5 per cent and 40.7 per cent respectively, while both bottom quartiles, improve their profit margin by less than the general average.

The improvements in profit margins were used as every company begin with different profit margins as baselines. The profit margins for the 3 years preceding BEE score are used to capture the potential longer term cost of BEE implementation.

Groups by BEE Score	Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
Top Quartile	25	58.92	7.0%	6.4%	9.4%	34.49%
Second Quartile	25	33.66	6.8%	8.5%	9.5%	40.70%
Third Quartile	25	13.35	7.6%	7.5%	8.5%	12.63%
Fourth Quartile	24	3.19	7.5%	7.8%	9.4%	26.06%
<b>Total Sample</b>	<b>99</b>	<b>27.35</b>	<b>7.3%</b>	<b>7.6%</b>	<b>9.3%</b>	<b>27.77%</b>

The result shows that companies who have implemented Broad-based BEE enjoyed a higher improvement in Profit Margin from 2003 to 2005.

If BEE is costly for companies to implement, we should have expected the opposite. That is, improvement in profit margin should slower or negative when a company maintains high BEE score.

### 3.2. Sector Comparison

To remove the impact, we look at impact of BEE on Profit Margin in Each sector. We have classified every sector into three equal sized groups; High BEE scorers, medium BEE scorers and low BEE scorers.

The result further confirms our finding over the general sample, that is, High BEE Scorers also have the greatest improvements in profit

margin over the last two years. This once again negates the concern over the “excessive” cost of BEE.

There are only one exception, out of the nine sectors (Basic Industries and Construction), where the low BEE scorers seem to be performing better.

Further, the sectors with the highest difference in the BEE score of High BEE scorers and low BEE scorers, seems to also have the highest difference in Profit Margin Growth rate as well.

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	46.98	6.3%	5.6%	7.0%	11.3%
Medium BEE Scorers	17.12	3.4%	1.9%	2.0%	-41.7%
Low BEE Scorers	3.91	7.1%	8.7%	7.4%	3.9%

The high BEE scorers in the Basic Industries & Construction sector improved their profit margin by 11.3 per cent. This compared favorably with the sharp decline for medium BEE scorers and small increase for the low BEE scorers. Government’s infrastructure and construction contracts are expected to further widen this gap.

#### FOOD & BEVERAGE

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	46.05	6.7%	6.4%	6.5%	-2.8%
Medium BEE Scorers	19.46	5.1%	5.9%	7.6%	50.6%
Low BEE Scorers	3.17	10.3%	6.2%	5.0%	-52.0%

The low BEE scorers in the Food & Beverage sector suffered a significant decline in their profit margin. The high BEE scorers maintained a relatively stable profit margin, while the medium scorers significantly improved their profit margins. In the sector, the three lowest BEE scorers also suffered significant deterioration in profit margins over this period.

#### HEALTH & PHARMACEUTICALS

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	31.74	14.8%	16.8%	17.2%	16.2%
Medium BEE Scorers	29.29	10.9%	9.6%	10.7%	-2.3%
Low BEE Scorers	8.20	12.9%	12.7%	13.3%	3.2%

The Health & Pharmaceutical sector demonstrate the same “High BEE Scorer = Higher profit margin growth phenomenon”. Although the lowest BEE scorers also improved their profit margin, this is only a fifth of the improvement enjoyed by the top BEE scorers.

**GENERAL INDUSTRIAL**

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	46.13	7.0%	6.5%	14.2%	104.2%
Medium BEE Scorers	19.96	7.2%	10.8%	12.1%	68.8%
Low BEE Scorers	4.65	5.7%	6.9%	8.6%	52.0%

General industrial companies supplies mainly to government and large corporate, both considers BEE status during procurement. The doubling of margin improvements for High BEE scorers in this sector is definitely not surprising.

**IT, TELECOMMUNICATION AND MEDIA**

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	60.78	6.7%	8.0%	9.5%	41.1%
Medium BEE Scorers	25.79	8.7%	8.2%	9.2%	6.1%
Low BEE Scorers	3.19	10.2%	8.1%	8.4%	-17.4%

The companies IT, Telecom and Media sector also count Government and Large Corporate as their main customers. Profit Margin of High BEE scorer in this sector is also significantly higher than their peers. The competitiveness of this sector means that the low BEE scorers suffered deterioration in their profit margins.

**RETAIL**

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	46.47	5.0%	6.4%	7.6%	51.5%
Medium BEE Scorers	13.59	8.2%	9.1%	10.3%	25.2%
Low BEE Scorers	2.33	5.5%	5.0%	6.2%	12.0%

Surprising, the companies in the retail sector, which are not subjected directly with preferential procurement, also show significant cost advantages to High BEE scorers.

This confirms two assumptions. Firstly, margin improvement as a result of BEE does not only arise from turnover increases and new business opportunities. Secondly, companies voluntarily implement BEE can derive cost advantages as a result of BEE implementation (the costs of implementation is minimal when compared to their benefits).

**SERVICES**

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	63.24	3.9%	5.0%	5.0%	28.3%
Medium BEE Scorers	38.76	8.9%	5.8%	14.0%	57.6%
Low BEE Scorers	11.67	7.5%	7.6%	7.9%	5.4%

Another sector relying on Government and large corporate clientele, so not surprising to see the higher average BEE score and also the higher profit margins for both High BEE scorers and Medium BEE scorers.

## TOURISM & LEISURE

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	66.73	2.2%	8.2%	8.8%	308.1%
Medium BEE Scorers	29.39	22.7%	23.9%	25.9%	14.2%
Low BEE Scorers	5.42	13.4%	12.3%	14.6%	9.3%

As a result of the gaming industry, which has higher BEE status than other tourism sector businesses due to their licensing conditions, and their high profit margin improvements over the last three years, the sector has the highest difference in profit growth between High BEE scorers and low BEE scorers. The profit margin of the High BEE scorers did start from a much lower base.

## TRANSPORT

Number of Companies	Average BEE Score	2003 Profit Margin	2004 Profit Margin	2005 Profit Margin	Growth in Profit Margin (2003-2005)
High BEE Scorers	42.14	3.7%	4.5%	4.8%	29.5%
Medium BEE Scorers	24.79	4.0%	3.7%	3.8%	-6.1%
Low BEE Scorers	2.13	5.6%	9.6%	6.8%	20.6%

In the transport sector, the differences in the improvements in profit margin between the different BEE-ranked groups are much smaller. Although the positive relationship between High BEE scorer and higher profit margin growth is still evident.

The study of the sectors reveals the same truth we have found from evaluating the entire sample, that is, increasing and maintaining a good broad-based BEE score have little or no impact on the profit margin.

In almost all of the cases, the profit margins of High BEE scorers are higher than those of the Low BEE scorers within the same industry. This further shatters the myth that BEE implementation is costly for businesses.

■ **4. Inherent Bias to Black Economic Empowerment**

Why do companies still think BEE implementation to be costly? I think we can trace this into the different biases and perceptions which the companies have against BEE.

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 consortiums 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

As we have shown in the table, the "perceived cost" of BEE arises as a result of people's inherent bias against change, or the lack of understanding around BEE.

In almost all cases, the perceived cost of BEE relates to window-dressing or fronting practices which the Codes is trying to stamp out. Many companies have shown that implementing sustainable BEE related profits significantly increase profit margin and decrease costs.



## ■ 5. Impact of BEE and Employment Equity on Productivity

Lastly, a comparison of the average BEE score to the real output index as published by the National Productivity Institute (NPI) shows very little linkage between BEE status and productivity.

Further, the average employment equity score (which measures representation at junior, middle and senior manager level) does not correlate with the changes in labour productivity.

What we can conclude, is that there are no conclusive evidence that BEE implementation or employment equity affect the real and labour output of an industry.

Sector	Number of Companies	BEE Score 2005	Real Output Index
Finance, insurance, real estate & business services	54	32.00	3.8
Construction	7	29.88	6.3
Mining & quarrying	22	27.45	4.2
Agriculture, forestry & fishing	7	23.06	1.2
Wholesale and retail trade, catering & accommodation	29	22.45	6.5
Manufacturing	6	19.34	2.6
Transport, storage & communication	13	18.65	5.5

Sector	Number of Companies	Employment Equity Score 2005	Labour Productivity Index
Agriculture, forestry & fishing	7	4.86	3.1
Transport, storage & communication	13	3.88	5.3
Wholesale and retail trade, catering & accommodation	29	3.38	6.0
Construction	7	3.03	12.8
Finance, insurance, real estate & business services	54	2.88	4.3
Manufacturing	6	2.86	2.7
Mining & quarrying	22	2.83	2.4