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SMES and black economic empowerment in South Africa

Nina Kupzig
Ruhr-Universität Bochum

Abstract

Black Economic Empowerment (BEE) is a South African policy that aims to decrease racial inequality and incentivises firms to train, hire, promote and transfer ownership to black people. However, the policy struggles to reach its goals. This article investigates the firm-level determinants of BEE compliance of small and medium-sized enterprises (SMEs) to understand the challenges towards BEE adoption for SMEs. Considering the BEE certification decision and the BEE compliance level, the results show that, e.g., firm location, age, industry, owner and manager characteristics, and firm size are significantly associated with BEE compliance.

1. Introduction

South Africa experienced institutionalised racial discrimination during Apartheid, leading to persistent racial inequality. Broad-Based Black Economic Empowerment (B-BBEE) – a policy enacted in 2003 and that I refer to as Black Economic Empowerment (BEE) for the sake of brevity – aims to reduce racial inequality by economically empowering black[1] people (South African Government, 2003). The policy incentivises firms to train, hire, promote, and transfer ownership to black people. Participating firms receive annual BEE certificates measuring their empowerment. While participation is voluntary for non-listed firms, participation is tied to benefits in public tenders and licensing processes, as well as advantages in obtaining private contracts. The latter is driven by the policy's so-called trickle-down effect which incentivises participating firms to choose BEE-certified suppliers.[2]

Much criticism of the policy exists. For example, the B-BBEE Commission (2022) finds many malpractices (e.g., fraudulent certificates). Smaller firms complain they need to transfer ownership to get certified – something many family-owned businesses are reluctant to do.[3] Moreover, many listed firms obliged to get BEE certificates are not certified (B-BBEE Commission, 2018). Thus, the policy struggles to transform the South African economy.

This paper uses the World Bank Enterprise Survey (WBES) from South Africa from 2020 to investigate firm-level determinants of BEE implementation for small and medium-sized enterprises (SMEs). To the best of my knowledge, I am the first to use a large, representative dataset on SMEs that includes firm and BEE characteristics, allowing such an analysis. My findings may indicate the most challenging policy areas toward a higher BEE adoption rate for SMEs. As SMEs constitute a significant share of the South African economy (Kongolo, 2010), their adoption of BEE is key to transforming the South African economy.

This paper contributes to the literature on BEE implementation, which needs to be distinguished from the much larger literature on the effects of BEE on firms' success (e.g., Akinsomi et al., 2016; Busse et al., 2023; Duffett et al., 2009; van der Merwe and Ferreira, 2014; Vilakazi and Ponte, 2022; Ward and Muller, 2010). Existing work on BEE implementation often employs qualitative approaches using literature reviews, case studies of single firms, or interviews (e.g., Amoah, 2023; Bracking, 2019; Dlamini, 2014; Fauconnier and Mathur-Helm, 2008; Musabayana and Mutambara, 2022; Pike et al., 2018). Seldomly, it uses quantitative approaches although these studies lack data on firm characteristics and the data often show a selection bias (e.g., B-BBEE Commission, 2018, 2019, 2020). The findings of these studies on BEE adoption include the identification of challenges associated with corruption, fronting, and poor policy implementation (e.g., Bracking, 2019; Amoah, 2023; Pike et al., 2018). Further, the reports of the B-BBEE Commission (2018, 2019, 2020) analyse the national status of BEE implementation, showing, e.g., low black ownership and sectoral differences.

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[1] The definition of black follows the B-BBEE Amendment Act (2013), which includes Africans, Coloureds and Indians who are South African citizens by descent, birth or naturalisation.
[2] For more information on the measurement system and governmental incentives, see Chapter 2 of Busse et al. (2023).
[3] Criticism stems from an unofficial interview with a South African employer association in 2022.

2. The BEE Policy

The BEE policy consists of scorecards containing measurement criteria for firms' empowerment, e.g., in ownership, management control, or skills development (Department of Trade and Industry, 2019). Over time, the measurement has been adjusted, and industry-specific scorecards have emerged, slightly diverting from the generic scorecard. Certified firms receive BEE levels ranging from 1 (good) to 9 (non-compliant). Large enterprises are certified through the full scorecard, which is costly in terms of preparation and rating agencies. Smaller firms may be certified in a simplified manner. Following the 2019 Generic Scorecard, the thresholds for simplified certification are ZAR 10 to 50 million (Qualifying Small Enterprises (QSEs)) and below ZAR 10 million annual sales (Exempted Micro-Enterprises (EMEs)). QSEs may be certified like large enterprises or receive level 1 if they are 100% black-owned or level 2 if they are 51% black-owned. They only need an affidavit for the latter two, reducing costs. Using an affidavit, EMEs receive level 1 or 2 like QSEs or level 4 regardless of ownership structure. Seldomly, industry-specific scorecards use different thresholds (e.g., tourism charter) or additional rules (e.g., construction charter).

3. Theoretical Background

Firms' decision to participate in BEE may be viewed as an investment decision, meaning a firm should theoretically weigh the benefits of the BEE certification against the associated costs. As such, the decision may be influenced by many factors. These may be linked to factors regarding the benefits of participating in BEE and factors influencing the associated certification costs. Besides these two channels, decision-makers characteristics may additionally play a role as they broadly impact the decision-maker's judgment regarding potential benefits and costs (Qureshi et al., 2012). The following paragraphs identify factors that may influence a firm's BEE decision in one of these three channels and that can be found in the WBES. Figure 1 summarises the theoretical framework.[4]

	Cost side	Benefit side	Behavioural bias
Firm level	Firm size Firm age Existing quality certification Financial situation	Government contracts Industry affiliation	Firm location
Manager/Owner level	Foreign ownership		Manager experience Gender of owner Ownership structure Manager's trust in courts

Figure 1: Theoretical framework of the BEE decision

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[4] Please note that the WBES does not include information on manager's or owners' race - which I assume to be the decision-makers in firms. However, this variable potentially affects the BEE decision via its effect on actual certification costs or behavioural aspects resulting in a potential omitted variable bias.

On the cost side, I have identified the following potentially important characteristics: (1) firm size, (2) firm age, (3) the firm's experience in certification processes, (4) the firm's financial situation, and (5) whether a firm has a foreign owner. In detail, firm size measured by turnover is linked to the type of certification process a firm must undergo. While the certification process is very complex for firms classified as large, EMEs and, most often, QSEs have a much lighter certification process, reducing the associated cost (see Chapter 2). Thus, EMEs and QSEs are expected to get more often and better certified. Regarding firm age, firms found after 2003 – the year BEE was formally implemented – could consider the BEE policy in their business strategy when founding the firm. Older firms, instead, needed to incorporate BEE in their already existing business idea. Thus, firms found before 2003 are expected to get less often and possibly worse certificated than younger firms. The experience in certification processes may positively influence the decision to get another certificate like the BEE certificate. Thus, I expect that the experience in the certification process positively affects the BEE decision. Further, the certification process is associated with some costs, although much lower for EMEs. Thus, having financial obstacles may negatively affect the BEE decision. Lastly, foreign owners do not qualify as black in the BEE context regardless of their ethnicity, making it often more expensive to get certified.

On the benefit side, I have identified the following variables: (6) the firm's ties to the government measured by government contracts and (7) its industry affiliation. As the government is obliged to consider BEE performance when allocating tenders, having a government contract should positively affect the BEE variables. Industry affiliation may be important as the level of interaction with the government (e.g., public tenders or licenses) differs from industry to industry, resulting in higher or lower incentives for BEE. The construction sector, e.g., is largely known to rely more on tenders than the retail sector.

On the decision-maker level, the following aspects may influence the BEE decision: (8) manager experience, (9) gender of the owner, (10) ownership structure and (11) manager's trust in courts. While the first three are generally known to cause behavioural biases in investment decisions, e.g., via differences in risk perceptions (e.g., Schaltenbrand et al., 2018; Ayaa and Peprah, 2021), the latter two may additionally play a role in the context of BEE. Firstly, Acemoglu et al. (2007) hypothesised that family-owned firms are less likely to transfer ownership to black entities, making the owner structure an important variable as a large share of SMEs with only one owner is probably family-owned. Secondly, the BEE certification process is highly prone to fraud – especially for EMEs and QSEs, as their cheap certification method may yield high fraud opportunities (BusinessTech, 2016). This is why the decision-makers' beliefs in the system influencing their perception of getting caught are important. In addition, the firms' regional (12) location may play a role as South African regions have different racial compositions most likely leading to differences in BEE sentiments.

4. Data and Empirical Strategy

I use the World Bank (2020) Enterprise Survey from South Africa from 2020. The WBES is a firm-level survey of a representative sample of an economy's private sector and contains an expansive array of economic data (World Bank, 2024). The survey conducted in 2020 in South Africa is the most recent South African survey and contains information on firms' BEE certification.[5]

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[5] Please note that the WBES 2007 from South Africa (the next available survey before 2020) also contains some BEE variables. However, these do not align with the BEE certificate and cannot be linked reasonably to the 2020 BEE variables.

To the best of my knowledge, the WBES is the only nationally representative survey that combines BEE and firm characteristics. Further, it contains a large number of SMEs making it, suitable for investigating this subsample. However, because the survey was conducted in 2020, I must consider that Covid may have affected the variable measurement and the sample. Fortunately, most used variables (e.g., industry affiliation or firm's location) seldom change over time, making it less likely that Covid affected them. Further, I run a robustness check including only firms with a fiscal year ending before 31 March 2020, at the beginning of the first South African Covid lockdown, yielding similar results.[6] Unfortunately, using the WBES interview dates for this robustness check is impossible because less than 50 SMEs were interviewed before the lockdown.

The WBES dataset is restricted to SMEs (≤250 workers). The definition of SMEs does not align with the classification of EMEs, QSEs, and large enterprises based on the BEE policy. Thus, SMEs may be certified as any of these. For the largest estimation sample, Figures 2 and 3 show firms' location and industry affiliation, and Table 1 presents the summary statistics of key variables. The sample contains SMEs from four different provinces, e.g., Gauteng, Western Cape, KwaZulu-Natal and Eastern Cape. The presented industries are diverse, with most firms coming from the Wholesale & Retail and the IT sector. As Table 1 shows, most SMEs qualify as EMEs (70%), followed by QSEs (19%) and lastly large enterprises (10%). Only 49% of SMEs in the sample are BEE certified, and the most dominant channel is the ownership dimension, as 78% of the certified firms state that this is the most important BEE subdimension for them.

To study the determinants of BEE implementation, I run the following regression

$$BEE_i = \alpha + \beta'F_i + \gamma'Region_i + \delta'Industry_i + \varepsilon_i \qquad (1)$$

with BEE_i being the compliance status (whether they are BEE-certified (=1) or not (=0)) or compliance level (recoded to 1 (non-compliant) and 9 (good) for easier interpretation). F_i contains all variables listed under "Firm characteristics" from Table 1. Firm location and industry are included, too. For the compliance status, I employ a probit model and a linear probability model (LPM) that is estimated on the full sample of SMEs. For the compliance level, I use an ordinary least squares (OLS) regression and an ordered probit model that are estimated on a reduced sample only containing certified firms. The OLS model is employed for easy comparison and interpretation while the ordered-probit model is the theoretical appropriate model. All chosen estimators do not investigate causality but associations. Causal investigations require suitable instruments, which is impossible given the many variables of interest.

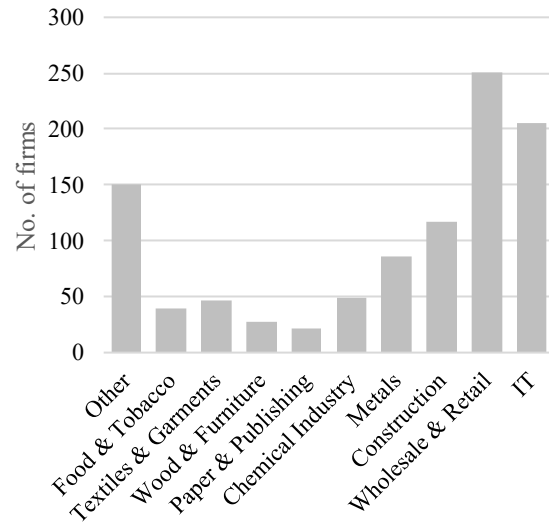[6] Results are available on request.

Figure 2: Firm Locations

Figure 3: Industry Prevalence
Note: Similar industries are grouped.

Table 1. Key Variables

	Count	Mean	Description
Firm Characteristics			
EME	994	0.70	1 if EME, 0 otherwise
QSE	994	0.19	1 if QSE, 0 otherwise
Large Enterprises	994	0.10	1 if Large, 0 otherwise
Found after 2003	994	0.39	1 if found after 2003, 0 otherwise
Government Contract	994	0.02	1 if attempted/secured gov. contract, 0 otherwise
Quality Certification	994	0.06	1 if firm has quality certificate, 0 otherwise
Foreign Owner	994	0.01	1 if foreigner owns ≥10%, 0 otherwise
Female Owner	994	0.11	1 if at least 1 female owner, 0 otherwise
Government-owned	994	0.00	1 if government-owned, 0 otherwise
Largest Owner	994	96.30	Percentage share of largest owner
Manager Experience	994	15.75	Manager experience in years
Financial Access	994	0.22	1 if financial access at least moderate obstacle, 0 otherwise
Trust in Courts	994	0.49	1 if at least moderate trust in courts, 0 otherwise
BEE Variables			
BEE compliance	994	0.49	1 if BEE-certified, 0 otherwise
BEE level (recoded)	454	7.49	BEE level from 1 (non-compliant) to 9 (good)
Ownership	477	0.78	1 if Ownership is most used subdimension, 0 otherwise
Management Control	477	0.12	1 if Man. Contr. is most used subdimension, 0 otherwise
Skills Development	477	0.09	1 if Skills Dev. is most used subdimension, 0 otherwise

Note: The subdimensions are not used in statistical analyses and are merely presented to understand how firms implement BEE. The definition of EMEs, QSEs, and large enterprises follows the generic scorecard with which most firms must comply. The key variables BEE compliance and BEE level are also referred to as status and level.

5. Results

Table 2 depicts the determinants of BEE compliance status and level. The results are robust to excluding variables and changing manager experience and the share of the largest owner to binary variables. Multicollinearity is always low, with a variance inflation factor close to 1.

Columns 1 and 2 show the results for BEE compliance status using the LPM and the Probit model. Columns 3 and 4 depict the results for the compliance level using OLS and the Ordered Probit model. While the LPM and the Probit model for the status variables have matching results, the Ordered Probit model shows weak deviations from the OLS for the compliance level.

Regarding the BEE status, I find the following results for variables potentially affecting a firm's cost. I do not find significant differences in firm size. Thus, the reduced certification costs do not lead to significantly more certificates for EMEs and QSEs than large enterprises, although they probably prevent them from getting less often certified. As expected, I find that financial obstacles are associated with a lower probability of getting certified while an existing quality certification in the company increases the probability of getting certified. Further, I do not find significant effects for the variable foreign ownership. This could be due to the low variation in the sample. For the factors potentially increasing a firm's benefit from BEE, I only find significant effects for the construction sector. Meaning that construction firms are more likely to get certified than firms from other sectors. Regarding behavioural aspects, firms with managers trusting the court systems, experienced managers, and male owners are less often certified. The first finding may be seen as weak evidence for the criticism that the cheap certification method for EMEs and QSEs yields indeed high opportunities for fraud (BusinessTech, 2016). Further, the results show regional differences. Regarding the ownership structure of firms, I do not find any significant differences, possibly due to the low variance in the sample.

For the BEE level, two cost side variables have significant coefficients. Firstly, large enterprises are less well-certified than EMEs. This finding aligns with the descriptive statistics from the B-BBEE Commission's reports (2018, 2019, 2020) and unsurprising, as large enterprises are complexly certified and may receive BEE levels lower than 4 (the lowest level for EMEs).[7] Secondly, older firms get worse certified than younger firms. For the factors potentially increasing a firm's benefit from BEE, I find that government contracts correlate only non-robustly with the BEE level as their significance disappears in the Probit estimation. For the industry affiliation, I find correlations for the metal sector, the food & tobacco sector and the construction sector. Although, the food & tobacco sector has a non-robust relationship. The finding for the construction sector, which has simultaneously significantly more and better BEE certificates, aligns with the descriptive statistics presented in the B-BBEE Commission's reports (2018, 2019, 2020) that show that the submitted BEE certificates in the construction sector are relatively well certified. A potential reason for this is that the construction sector is known to rely on public tenders. As public tenders are seldom in my sample, this finding may suggest that the policy's trickle-down effect works in this sector, pressuring even those firms that do not directly interact with the government.

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[7] Note that a robustness check without large enterprises to avoid bias from including those complexly certified firms yields similar results. Results are available on request.

Table 2. Determinants of BEE

	(1) Status	(2) Status	(3) Level	(4) Level
Cost side				
QSE	-0.158	-0.062	0.117	0.105
	(-1.42)	(-1.42)	(0.63)	(0.79)
Large Enterprises	0.063	0.023	-0.676**	-0.388**
	(0.46)	(0.43)	(-2.40)	(-2.31)
Found after 2003	-0.001	-0.001	0.354**	0.265**
	(-0.02)	(-0.03)	(2.21)	(2.37)
Financial Access	-0.291***	-0.112***	-0.053	-0.049
	(-2.65)	(-2.66)	(-0.25)	(-0.31)
Quality Certification	0.390**	0.150**	-0.346	-0.145
	(2.20)	(2.27)	(-0.96)	(-0.72)
Foreign Owner	0.390	0.134	0.550	0.542
	(0.79)	(0.81)	(0.99)	(0.81)
Benefit side				
Government Contract	0.369	0.143	0.654*	0.501
	(1.30)	(1.32)	(1.69)	(1.48)
Other Industries	-0.012	-0.005	-0.195	-0.103
	(-0.09)	(-0.09)	(-0.73)	(-0.62)
Food & Tobacco	0.076	0.029	-1.116*	-0.459
	(0.35)	(0.34)	(-1.67)	(-1.39)
Textiles & Garment	-0.116	-0.045	-0.244	-0.135
	(-0.56)	(-0.56)	(-0.60)	(-0.53)
Wood & Furniture	-0.096	-0.036	0.120	0.083
	(-0.39)	(-0.38)	(0.27)	(0.25)
Paper & Publishing	0.280	0.109	0.048	0.072
	(0.97)	(0.98)	(0.10)	(0.20)
Chemical Industry	0.113	0.045	-0.179	-0.132
	(0.56)	(0.58)	(-0.51)	(-0.61)
Metals	0.087	0.034	0.571**	0.332*
	(0.54)	(0.52)	(2.18)	(1.78)
Construction	0.306**	0.119**	0.513**	0.407**
	(2.09)	(2.09)	(2.25)	(2.46)
IT	-0.171	-0.066	0.045	0.086
	(-1.34)	(-1.33)	(0.17)	(0.45)
Behavioural bias				
Female Owner	0.354**	0.138**	-0.049	0.017
	(2.48)	(2.50)	(-0.17)	(0.09)
Largest Owner	-0.000	-0.000	0.000	0.001
	(-0.13)	(-0.12)	(0.09)	(0.20)
Manager Experience	-0.008**	-0.003**	-0.012	-0.012**
	(-2.07)	(-2.06)	(-1.55)	(-2.31)
Trust in Courts	-0.202**	-0.078**	-0.174	-0.104
	(-2.28)	(-2.28)	(-1.08)	(-0.94)
Eastern Cape	-0.040	-0.017	0.106	0.152
	(-0.31)	(-0.33)	(0.40)	(0.84)
KwaZulu-Natal	-0.191*	-0.075*	0.244	0.193
	(-1.67)	(-1.67)	(1.19)	(1.31)
Western Cape	-0.233**	-0.090**	0.155	0.050
	(-2.05)	(-2.05)	(0.68)	(0.35)
Estimator	Probit	LPM	OLS	Ordered Probit
Observations	994	994	454	454

Note: t-values from heteroscedastic standard errors in parentheses, *p<0.1 **p<0.05 ***p<0.01. Comparison groups for size=EME, region=Gauteng, industry=Wholesale/Retail. Columns (1), (2) and (3) include a constant and Column (4) includes a constant for each BEE level. Columns (3) and (4) are estimated on the reduced subsample only containing certified firm.

Overall, variables connected to behavioural aspects only affect the decision to get BEE certified, not the BEE level. In contrast, variables related to the benefit side of BEE are more closely associated with the BEE level and not the BEE status. Cost side variables affect the BEE status and the BEE level, although the significant variables do not overlap. These differences indicate that the decision to get BEE certified and the effort to improve the BEE level may have different drivers. The found associations align with the theoretical background presented in Chapter 3.

6. Policy Implication

Based on these findings, the following three policy implications may be drawn. First, this paper finds that only 49% of SMEs are BEE-certified, although many have low associated costs as they qualify as EMEs or QSEs. This low adoption rate may indicate that SMEs need stronger incentives to participate in BEE. This hypothesis aligns with Dlamini (2014), who finds that only 55.8% of the 120 participating business owners from Richards Bay agree that BEE positively effects their business. Hence, increasing associated benefits such as tax incentives or penalty payments may improve BEE adoption.

Second, the findings show that firms with financial obstacles are getting less often certified highlighting the need for cheap certification options for small firms. However, the currently implemented certification methods that already reduce costs for firms with low turnover yield large room for fraud. Thus, I recommend the introduction of random checks by the B-BBEE Commission based on a central, public database of BEE-certified firms - like the one introduced by the B-BBEE Commission (2023). While increasing costs for the government, this adjustment may reduce fraud while keeping the certification process for SMEs cheap.

Lastly, the policy review in this paper showed that EMEs and QSEs must (practically) transfer ownership to black people to receive high BEE levels. Giving them other options, e.g., through (subsidised) investments in black workers' skills development, may increase the policy's acceptance and reduce fraud further. Further, investments in skills development may yield sustainable, long-term benefits, possibly resulting in a natural shift in ownership structures.

7. Conclusion

This paper analyses the determinants of BEE compliance of SMEs in South Africa. It shows that certain firm characteristics are significantly associated with BEE compliance and that the decision to get BEE certified may have different drivers than the effort to improve the certification result. Overall, the paper finds that there is still considerable potential to adjust the policy to improve adoption. Suggested changes include higher participation incentives, controls to fight fraud and more diverse BEE options for smaller SMEs.

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