Tax and Other Incentives to Small, Medium, Micro Enterprises in South Africa

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DECLARATION

This research has not been previously accepted for any degree and is not being currently submitted in candidature for any other degree.

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SUMMARY

The promotion of Small, Medium and Micro enterprises (SMMEs) has been identified as key strategy of government for employment creation and income generation. For some time now small business owners had to fend for themselves. Small business was neglected and was in the main ignored by government. Since the 1994 democratic process the challenge for the new order has been to create an enabling environment for the small business sector of the economy. The historical neglect and the consequent policy vacuum has had to be re assessed. To this end the 1995 White Paper on a National Strategy for the development and Promotion of Small Business in South Africa was the first major effort by government to design a policy framework targeting the small business sector.

The promulgation of the Small Business Act in 1996 and the establishment of the Ntsika Enterprise Promotion agency under the aegis of the Department of Trade and Industry has attempted to provide direction and facilitate the provision of Non Financial support to the Small Business Sector. Various incentive schemes have been developed and put into operation together with a range of tax incentives to help promote Small Business. Eight years have passed since the promulgation of the Small Business Act and the perception that finance for SMMEs has been the greatest stumbling block to development. However the failure of the vast numbers of micro lending agencies have revealed that low levels of entrepreneurship has led to their demise.

The provision of meaningful positive incentives need to be measured and their effectiveness needs to be tested. This study will try and identify the incentives available.

Chapter One

Introduction

1.1 Background

"South Africa is a country of two nations.

One of these nations is white, relatively prosperous, regardless of gender or geographic dispersal. It has ready access to a developed economic, physical, educational, communication and other infrastructure....The second and larger nation of South Africa is black and poor, with the worst affected being women in the rural areas, the black rural population in general and the disabled. This nation lives under conditions of a grossly underdeveloped economic, physical, educational, communication and other infrastructure. This reality of two nations, underwritten by the perpetuation of the racial, gender and spatial disparities born of a very long period of colonial and apartheid white minority domination, constitutes the material base which reinforces the notion that, indeed, we are not one nation, but two nations And neither are we becoming one nation. Consequently, also, the objective of national reconciliation is not being realized" President Thabo Mbeki 1997

It is against this background that government has redoubled its efforts to try and bridge the vast gaps between the haves and the have nots.

"For decades, the SMME economy was largely ignored by policy makers and in the case of black – owned enterprises was actively discouraged by repressive measures. The challenge for the government since 1994 has been the creation of an enabling environment for the emergence of a sustainable segment of black – owned small business as a way of tackling basic inequalities in the country." Malcolm Ray – Enterprise Magazine November 2004(p13)

While the better organised large enterprise sector should be able to move towards the envisaged growth path with relatively limited support and prodding from government, the transformation of the small-enterprise sector requires and justifies concerted policies of wider scope as well as the deliberate creation of an enabling environment. Such initiatives need effective inputs from all segments of the economy and close co-operation between government and the private sector.

The ultimate goal is to make SMMEs equal partners in all the economic sectors, and to maximize the sector's contribution to the Reconstruction and Development Programme.

In this transformation process government is a facilitator and not an implementor. In fact, small-business support programmes are best implemented by institutions that most closely reflect the entrepreneurship and risk characteristics of small businesses themselves. Such institutions are typically small localised non-governmental organisations (NGOs), private consultancies, partnerships and companies.

In his contribution to the "State of Small Business in South Africa – Ntsika Annual Review of 2002" Professor *André Roux* of *Econometrix (Pty) Ltd.The Institute for Future Research, University of Stellenbosch stated that* 'SMMEs play a vital role in economic development by enabling people to meet their basic needs for survival. It has also been proven in many parts of the world that the SMME sector stimulates economic growth, redistributes wealth and creates jobs.

The latter is particularly important within the context of the reality that large corporations demand for labour does not rise in proportion to their growth.

SMMEs in South Africa have become an important target for policy makers because, *inter alia:*

- The labour-absorptive capacity of the small business sector is higher than that of other size-classes;
- The average capital cost of a job created in the SMME sector is lower than in the big business sector;
- They allow for more competitive markets;
- They can adapt more rapidly than larger organisations to changing tastes and trends;
- They often use local recycled resources;

- they provide opportunities for aspiring entrepreneurs, especially those who are unemployed, under-employed or retrenched;

- Workers at the smaller end of the scale often require limited or no skills or training: they learn skills on the job;

- Sub-contracting by large enterprises to SMMEs lends flexibility to production processes;

- They play a vital role in technical and other innovation.

State of Small Business in South Africa – Ntsika Annual Review of 2002 Professor *André Roux* of *Econometrix (Pty) Ltd.The Institute for Future Research, University of Stellenbosch*

1.2 The Objectives of this study

To analyze the contributions made by the government through its various agencies in creating an enabling environment for SMME growth and development in South Africa and to determine the level of incentives offered by the various agencies and the level of tax incentives that are presently being offered by the fiscus.

In order to have a greater understanding of some of the key considerations that stakeholders and policy makers need to take cognisance of when evaluating the SMME sector and formulating appropriate strategies the following questions need to be addressed:

- How are SMMEs classified?

- In which sectors are SMMEs making the most impact?
- What contribution is made by SMMEs to GDP and employment?
- What size enterprise is best suited to the respective sectors?
- What contribution is made by SMMEs to the economies of the nine provinces?
- At what rate are SMMEs growing?
- To what extent are SMMEs contributing to the ability of previously disadvantaged communities to gain access to economic activity?

1.3 Classification of institutions

In analyses of the SMME sector terminology and definitions – and therefore measurement - can be problematic. It is, often assumed that very small business organisations are, as a matter of course, located in the informal sector. Conversely, it is assumed that large businesses are, by definition, situated in the formal and encompasses any value-sector. These assumptions, based on "conventional wisdom", may, however, be flawed, since the defining property of the informal sector is that it describes adding economic activity that is not recorded in official economic statistical data-bases.

For the purposes of this report enterprises in South Africa have been divided into the following categories:

- Survivalist and single-person micro-enterprises (which may be deemed to be the equivalent of the informal sector)

- Medium and large enterprises (equivalent to the formal sector)

- Micro-enterprises employing one to four people, very small enterprises, and small enterprises (a mixture of formal and informal sector entities) and medium enterprises. In addition, the following qualitative criteria are relevant:

- In *survivalist enterprises* the income generated is less than the minimum income or poverty line, there are no paid employees, and asset value is minimal. Typical examples include vendors, hawkers and subsistence farmers.

These are activities by people unable to find a paid job or get into an economic sector of their choice. Income generated from these activities usually falls far short of even a minimum income standard, with little capital invested and virtually no skills training in the particular field and only limited opportunities for growth into a viable business. Poverty and the attempt to survive are the main characteristics of this category of enterprises. Support strategies should primarily help these people - a large percentage of whom are women to get out of this sector. Given the large number of people involved in survivalist activities, this constitutes a vast challenge.

- ***Micro-enterprises*** have a turnover less than the VAT registration limit and are not usually formally registered for tax or accounting purposes. For the purposes of this report micro-enterprises have been further defined into those enterprises in which the entrepreneur is the only employee, referred to as ***micro(0)***, and those enterprises that employ between one and four people, excluding the entrepreneur, referred to as ***micro(1-4)***.Micro businesses are very small businesses, often involving only the owner, some family member(s) and at the most one or two paid employees. They usually lack 'formality' in terms of business licenses, value-added tax (VAT) registration, formal business premises, operating permits and accounting procedures. Most of them have a limited capital base and only rudimentary technical or business skills among their operators. However, many micro-enterprises advance into viable small businesses. Earning levels of micro-enterprises differ widely, depending on the particular sector, the growth phase of the business and access to relevant support.

- ***Very small enterprises*** . Small enterprises constitute the bulk of the established businesses, with employment ranging between five and about 50. The enterprises will usually be owner-managed or directly controlled by the owner- community. They are likely to operate from business or industrial premises, be tax-registered and meet other formal registration requirements and operate in the formal market and have access to modern technology.

- In ***small enterprises*** a secondary co-coordinating managerial structure is in place and there is some form of managerial level co-ordination.

In ***medium enterprises*** there is further decentralisation of decision-making, a more complex management structure and increased division of labour. Medium enterprises constitute a category difficult to demarcate vis-à-vis the "small" and "big" business categories. It is still viewed as basically owner/manager-controlled, though the shareholding or community control base could be more complex. The employment of 200 persons and capital assets (excluding property) of about R5 million are often seen as the upper limit. The following Table outlines the criteria used in the classification of enterprises.

1	2	3	4	5
Sector or Sub Sector in accordance with SIC *	Size or Class	Total Full - time paid Employees	Total Annual Turnover Rands	Total Asset Value Rands
Manufacturing	Medium	200	40 million	15 million
	Small	50	10million	3.75 million
	Very Small	20	4 million	1.50 million
	Micro	5	0.15 million	0.10 million
Electricity,Gas and Water	Medium	200	40 million	15 million
	Small	50	10million	3.75 million
	Very Small	20	4 million	1.50 million
	Micro	5	0.15 million	0.10 million
Construction	Medium	200	20 million	4 million
	Small	50	5million	1 million
	Very Small	20	2 million	0.4 Million
	Micro	5	0.15 million	0.10 million
Retail and Motor trade and Repair Services	Medium	100	30 million	5 million
	Small	50	15 million	2.5 million
	Very Small	10	3 million	0.5 Million
	Micro	5	0.15 million	0.10 million
Wholesale Trade,	Medium	100	50 million	8 million
Commercial Agents	Small	50	25 million	4 million
and Allied Services	Very Small	10	5 million	0.5 Million
	Micro	5	0.15 million	0.10 million

* SIC Standard Industrial Classification
Source : National Small Business Act 1996

1	2	3	4	5
Sector or Sub Sector in accordance with SIC *	Size or Class	Total Full - time paid Employees	Total Annual Turnover Rands	Total Asset Value Rands
Catering, Accomodation and Other Trade	Medium	100	10 million	2 million
	Small	50	5 million	1 million
	Very Small	10	1 million	0.20 million
	Micro	5	0.15 million	0.10 million
Transport, Storage and Communications	Medium	100	20 million	5 million
	Small	50	10million	2.50 million
	Very Small	10	2 million	0.50 million
	Micro	5	0.15 million	0.10 million
Finance and Business Services	Medium	100	20 million	4 million
	Small	50	10 million	2 million
	Very Small	10	2 million	0.4 Million
	Micro	5	0.15 million	0.10 million
Community, Social and Personal Services	Medium	100	10 million	5 million
	Small	50	5 million	2.5 million
	Very Small	10	1 million	0.5 Million
	Micro	5	0.15 million	0.10 million

* SIC Standard Industrial Classification
Source : National Small Business Act 1996

1.4 Sectoral analysis

1.4.1 Contribution by Sector to GDP

While large enterprises generally dominate, in 2001 the contribution of SMMEs (excluding survivalist and micro(0) enterprises) to GDP was 36,1%, as opposed to 32,7% in 1995. SMMEs accounted for at least half of GDP in the agricultural and construction sectors, and more than 40% of GDP in the trade, catering and accommodation, as well as the transport, storage and communication sectors. Small enterprises are especially significant in the construction, trade, catering and communication, and transport, storage and communication sectors. The 15,7% contribution made by micro-enterprises to value added in the community, social, other personal services, finance and business services sectors is second only to the contribution made by large enterprises. – Ntsika State of Small Business in South Africa Annual Review – 2002.

1.4.2 Contribution to employment

According to the September 2002 Labour Force Survey (LFS) 11,03 million people were employed in South Africa out of an economically active population of 15,87 million. The labour market participation rate (the percentage of people of working age that is economically active) was 56,7%. Of those employed:

- 7,03 million (or 63,4%) were employed in the formal sector.

- 811 000 (or 7,4%) were employed in the commercial agricultural sector.

- 520 000 (or 4,7%) were employed in subsistence or small-scale agriculture.

- 1,7 million (or 15,4%) were engaged in informal sector activities.

- 875 000 (or 7,9%) were employed in domestic service.

In terms of the official (strict) definition, the unemployment rate in September 2002 was an estimated 30,5%, i.e. 4,84 million people were officially unemployed.

The LFS (2003) also provides a breakdown of employment in the formal and informal sectors by industry, there are discernible differences in the most important sources of employment, depending on whether one is examining the formal or informal sectors. In the formal sector, community services account for 24% of total employment, the manufacturing and trade sectors approximately 18% each, business services 12,2% and agriculture 10,3%. In the informal sector, however, private households account for one-third of employment (including domestic workers), the trade sectors for one-quarter, and agricultural sector for 17%.

Adapted from Stats SA, 2003

1.4.3 Employment in the formal and informal sectors by industry in 2002

SMMEs employed 68,2% of people employed in the private sector, as opposed to 44% in 1995 and 53,9% in 2001.

Small enterprises constitute the most significant SMME employer, (accounting for 21% of total SMME employment), followed by medium-sized (18% of total SMME employment) enterprises and micro(1-4) enterprises (17% of total SMME employment).

The growth in employment by SMMEs is considerably faster than the growth in the contribution by SMMEs to GDP. In 1995 the contribution of the SMME sector to employment in the private sector was 1,35 times greater than the contribution of the SMME sector to GDP; in 2001 this factor was 1,5. This implies a very high labour absorption capacity of SMMEs, and again highlights the job creation potential of the sector.

With the one exception of mining and quarrying, more than 50% of employment in the various private sectors is by SMMEs. Indeed, more than 80% of employment in the agriculture, forestry and fishing, construction, and retail trade sectors is provided by SMMEs.

Adapted from Stats S.A. 2003

For the private sector as a whole large enterprises constitute the largest single employer of people in the economy (accounting for 32%

of total employment), followed by small enterprises (14,3% of total employment). However, in some sectors an SMME size-class is the single largest employer of people (remembering that the large enterprise size-class does not, by definition, reside within the SMME sector).

In the case of construction, the survivalist and micro (1-4) enterprises are the two largest employers, and are responsible for almost 40% of employment in that sector. In the retail sector the two largest employers are the survivalist and micro (0) size-classes, which, between them, account for virtually 50% of all employment in that sector. The significance of, for instance, spaza shops is clear: retail employment in the survivalist size-class alone is 2,7 times bigger than in the large size-class (which, of course, is not an SMME).

– Ntsika State of Small Business in South Africa Annual Review – 2002.

As far as employment offered by the SMME sector is concerned:

- Micro and survivalist enterprises dominate in the construction retail trade and transport, storage and communications sectors;
- Small enterprises dominate in the mining and quarrying, wholesale trade, and catering and accommodation sectors;

- Medium enterprises dominate in the agriculture, forestry and fishing, manufacturing, finance and business services, and community, social and other personal services sectors; and

- Very small enterprises do not dominate in any sector.

Clearly, therefore, there is some relationship between size-class of enterprises and sector concentration:

- The smaller the enterprise size-class, the less significant (as an employer) that size-class tends to be in agriculture, forestry and fishing, manufacturing, finance & business services, and community, social & other personal services.

- Conversely, the smaller the enterprise size-class, the more significant (as an employer) that size-class is in construction and retail trade (including motor trade).

Possible explanations for these differences in concentration include the ease of entry/ barriers to entry to certain sectors, in the form of start-up costs, as well as training and infrastructure requirements and labour legislation constraints in some industries. The relative labour intensity dictates of an industry are also likely to play a role, as are the vigours and rigours imposed by international competitiveness.

1.4.4 Registrations of Close Corporations and Companies

The annual increase or decrease in the number of new registrations of companies can be used as a barometer of overall economic activity in a country. Moreover, as a rule of thumb one would assume that growth in new company registrations should translate into more entrepreneurial activity. It should, however, be borne in mind that some registrations may not have a bearing on future entrepreneurial activities, since they may occur for reasons related to tax purposes, or may be affected by mergers. Notwithstanding these caveats, it is assumed for the purpose of analysis that Pty Ltds (private companies) generally represent medium and large enterprises, while CCs (close corporations) represent small, very small and micro (1-4) enterprises. Compared to Pty Ltds growth in the registrations of new CCs has been less volatile since the mid-1990s. What is particularly encouraging is the 20% increase in new registrations of CCs in 2001 – an economically testing year, during which registrations of Pty Ltds were 20% lower than in the previous year. A further 13,3% growth in new CC registrations was recorded in 2002. Between 1990 and 2002 the annualised percentage increase in new CC registrations was 12,6%. By all accounts, therefore, SMME growth remains robust – even during times of economic sluggishness. This attests to a strong move towards entrepreneurship during the last decade, and supports the view that proactive development of the SMME sector is a key ingredient for economic growth in South Africa.

– Ntsika State of Small Business in South Africa Annual Review – 2002.

1.4.5 Provincial Analysis

The largest provinces in economic terms are Gauteng, KwaZulu-Natal and the Western Cape, which jointly account for 69% of South Africa's GDP. Together these three provinces house some 48% of the country's entire population. The smallest provinces, measured in accordance with GDP, are the Northern Cape, Limpopo Province and North West Province, which account for 10% of the country's GDP and 23% of the total population. These comparisons may, however, be misleading: for instance, KwaZulu-Natal's contribution to the country's GDP is, at 16%, the second highest, but its GDP per capita of R10 365 is some 20% lower than the national average. Likewise, the Eastern Cape has the fourth largest GDP, but its GDP per capita of R6 495 is the second lowest and some 50% lower than the national average. Therefore, it is probably more meaningful to use GDP per capita to compare the economic state of the nine provinces. Gauteng and the Western Cape are the only two provinces with a GDP per capita in excess of R20 000. These two provinces have other things in common as well:

- They are the only two provinces whose contribution to SA's GDP is greater than their share of the country's population.

- They are the two highest contributors to total employment. Jointly, they account for 56% of South Africa's employment.

- They are the only two provinces where more than 30% or more of their populations are employed (the national average is 17,2%).

The Eastern Cape and KwaZulu-Natal, which are responsible for 24,3% of South Africa's GDP and 37,3% of the country's population, account for 22,7% of total employment, while less than 12% of their respective populations are employed. This suggests that incomes are concentrated in the hands of a few.

Although the smallest province in terms of GDP, the Northern Cape, has the third highest GDP per capita (R13 230), while its contribution to national employment is proportionately higher than its contribution to GDP, and almost 20% of its population is employed. This is indicative of relative economic health.

It is clear from this discussion that there are substantial inter-provincial inequalities in terms of economic performance, job opportunities and poverty. This inequality is likely to be reflected in the incidence of SMME activity in the various provinces. Some 60% of all enterprises and approximately 70% of all SMMEs are concentrated in the three provinces with the largest GDPs, *viz* Gauteng, KwaZulu-Natal and the Western Cape. These three provinces are also responsible for virtually 70% of national employment.

The larger the provincial economy, the greater is the proportion of larger size-classes that fall in that province. More than 45% of all small, medium and large enterprises are, for instance, in Gauteng, again indicating that province's relative wealth. It is worth recalling the fact that small, medium and large enterprises collectively employ some 60% of employed people in South Africa, and that Gauteng accounts for almost 40% of total employment. More than 20% of South Africa's survivalist enterprises are found in each of Mpumalanga and the Limpopo Province. This fairly high ratio mirrors the relatively high rate of poverty in these provinces.

As described earlier, the Western Cape has one of the more healthy and robust provincial economies in South Africa – the percentage of the population employed is over 30%; its GDP per capita is the second highest, and its contribution to national GDP is high in comparison to its share of the national population. And yet only 12% of all large enterprises, and 16% of all medium enterprises are located in the Western Cape. This points toward the important and meaningful role that a strong SMME sector can play in establishing and maintaining an economically sound economy.

The SMME density per province (i.e. the number of enterprises within each class-size per 100 people) indicates the intensity of SMME economic activity by taking into account the size of each province in terms of its population. Gauteng has by far the highest SMME density of 7,8 – more than double the density of the second-placed province, the Western Cape (3,7). The relatively high SMME density recorded for the Northern Cape is interesting in the light of the fact that this province has the fewest number of SMME enterprises, and is indicative of the relative economic strength of this province. By contrast, the Limpopo Province has the lowest SMME density (together with North West), houses more than 12% of South Africa's population; its contribution to GDP is only 3%, and only 3% of its population is employed.

Ntsika Part 1 Annual Review 2002: Ntsika Enterprise Promotion Agency

1.4.6 Black empowerment and equitable growth

The SMME sector has been identified as a key cog in the advancement of entrepreneurship in South Africa as a means towards creating wealth and job opportunities. A particular focus, as articulated in the Department of Trade and Industry national small business policy framework, is the advancement of black people and women in the SMME sector as a means toward bringing about a narrowing of income and wealth gaps and facilitating growth in rural areas. The relatively high labour intensity of survivalist and micro-enterprises is of particular significance in this regard.

As the enterprise size-class increases, ownership by Africans, Asians and Coloureds declines. African, Asian and Coloured entrepreneurs are found mostly in the survivalist and micro-enterprises. Factors such as skills and or financing requirements have restricted the movement of African, Asian and Coloured entrepreneurs from moving into the Medium and larger sectors of the economy. This points to the need for concentrated skills training and reasonable access to "seed money".

Since some 60% of employment in the private sector is provided by small, medium and large enterprises (which also account for about

80% of the country's GDP), it is clear that economic power in South Africa is still largely in the hands of white entrepreneurs. In fact, if anything, this state of affairs worsened between 1996 and 1999, very small and unspecified enterprises increased proportionately between 1996 and 1999, while African, Asian and Coloured ownership of survivalist and micro-enterprises increased proportionately during the same period.

All told, there were 2,28 million people running at least one non-VAT registered business in South Africa in 2002. A breakdown of this figure reveals the following:

- Only 15% of these businesses employed people; i.e. 85% were either survivalist or micro(0) enterprises.

- 69,4% of these businesses were in the wholesale and retail trade sector.

- Only 4,4% of these businesses were run by whites; 2,2% were run by Asians; 3,7% by coloureds; and the overwhelming majority - 89,7% - by Africans.

- 60% of these businesses were run by females, while 56% were run by African females. A further breakdown of the people running at least one non-VAT registered business.

Female ownership in general, but African female ownership in particular, is dominant in the manufacturing, trade, community, social and personal sectors. These businesses account for 85% of all the non-VAT establishments under review. In addition, half of the African-owned businesses in the agriculture and financial and business services sectors are owned by females.

The predominance of female-owned businesses is a double-edged sword: The high prevalence of female entrepreneurship is to be welcomed; but most of this involvement is in the survivalist or micro-enterprise area of entrepreneurship – by definition, wealth and employment generated here is constrained.

In all provinces more than half of the African-owned establishments under review are owned by females. In two cases – Eastern Cape and Limpopo – three-quarters of African-owned businesses are owned by females. The lowest proportion of female African ownership is recorded in Gauteng. Again, the link between low levels of economic activity, continued poverty, high unemployment and a bias against previously disadvantaged communities is established."

State of Small Business in South Africa – Annual Review of 2002 Professor *André Roux* of *Econometrix (Pty) Ltd.The Institute for Future Research, University of Stellenbosch*

Chapter Two

Assessing The Institutional Support Network For SMMEs In South Africa

2.1 Introduction

Although little research has been undertaken to specifically assess the effectiveness of new and restructured institutions providing support to South Africa's SMMEs, there are indications that the originally well-intended policy measures suffer from sub-optimal implementation. General distrust to external agencies among SMMEs on the one hand, and the incapacity of support institutions to persuasively raise awareness about their existence and effectiveness on the other, are said to lie at the heart of the problem. Moreover, the poor co-ordination of service providers results in a replication of services, and clustering of institutions in urban areas.

This section details the programmes of the government and its agencies in implementing their polices.

The government and its agencies need to create an environment such that SMMES will accept responsibility for the operation, growth and progress of their enterprise.

Programmes will need to be developed and implemented at both the regional and local levels. Policies need to be developed not just for SMMEs, but need to be developed across sectors like manufacturing, tourism and construction.

Small businesses do not constitute an economic sector on its own. Therefore policies and programmes must be in tune across sectors both nationally, provincially and at local levels.

Programmes need to be developed that looks at redressing the wrongs of our apartheid past especially with respect to providing easier access to economic opportunities for women and the growth of small businesses in rural areas.

Micro-enterprises and survivalist activities are not always able to generate reasonably remunerated long-term jobs. Support for small businesses has to include steps to upgrade the skill level of SMME operators, strengthen the use of appropriate, modern technologies and boost the capacity to create long-term jobs.

Individually SMMEs may lack the skills and resources to stimulate economic growth, it must therefore be the task of either the public and or the private sector across the various sectors to provide business support strategies for small enterprises.

It is essential that small enterprises within sectors, industries and some regions or localities be assisted to network and there by overcome obstacles and jointly address development.

Larger organized and urbanized businesses have in the past enjoyed better marketing opportunities and regulations that favoured them, a support strategy for SMMEs will help to rectify some of the imbalances.

To this end the governments White Paper on Small Business identified the following ten key principles :

- The strategy is based on a joint vision for big, medium and small business in South Africa.

- All the segments of the small business sector - survivalist, micro-, small and medium enterprises - need attention.

- The business efficiency and competitiveness of the whole small enterprise sector has to be developed, with due recognition of social, financial and other compliance standards relevant to an internationally competitive economy.

- An integrated support strategy has to give attention to both the supply and demand side of small business activities.

- Black advancement in the enterprise sector is a key factor in all spheres of the strategy; special emphasis also falls on other marginalised or disadvantaged groups.

- The scarcity of public funds demands careful prioritization of support programmes and the skilful matching of different resources.

- Support policies will be sector-focused and targeted with application of public funds and full recognition of the market orientation of our economy.

- The institutional framework for small business support has to be restructured in order to reflect the evolving institutional diversity, the provincial thrust of policy implementation and effective bottom-up and top-down co-operation and co-ordination.

- Ultimate responsibility for the national strategy rests with the Department of Trade and Industry.

- The private enterprise sector, co-operatives, NGOs. business associations and foreign assistance programmes all have a critical role to play in an integrated small business strategy.

2.2 The Government Assistance to SMMEs

In terms of the Government White Paper on Small Businesses government will endeavour to streamline restrictive legislation.

2.2.1 Streamlining regulatory conditions

Inappropriate or unduly restrictive legislative and regulatory conditions are often viewed as critical constraints on the access of small enterprises into the business sector and as obstacles to their growth. Since government - at central, provincial, sub-regional and local level - is responsible for the legislative and regulatory framework and its ongoing adjustment, it is also its role to assure the appropriateness of these rules and regulations for the small-business sector.

All over the world, and certainly also in South Africa, there is discussion and frequently disagreement about the proper degree of regulation and deregulation in the business scene. Unduly strict regulations often harm small and, in particular, emergent enterprises and benefit the larger, established ones, whereas less regulation may lead to aggressive competition between market entrants, to the neglect of worker interests, or to health hazards and environmental destruction.

2.2.2 Transparency

Government regulations must be transparent and must be the product of a consultative process. All interest groups having a chance to state their interests and concerns, and with national economic growth and job creation being the main objective.

2.2.3 Co – Ordination

Encourage the Competition Board to take the necessary reform steps to prevent restrictive practices vis-à-vis small enterprises and to make the Competition Board more accessible to SMMEs. The DTI, in co-operation with the Competition Board, must monitor and, where possible or necessary, co- ordinate and assist the regulatory reform process, with particular emphasis on the following spheres:

- investigations by different central government departments and consultations with relevant stakeholders about the appropriateness of existing and proposed legislation and regulations in the fields of taxation, labour (including Industrial Council agreements), zoning and building controls, tendering procedures, training requirements, health and occupational conditions, etc., and how they can be made more suitable for small enterprises.

- investigations by the Competition Board about possible small business constraints inherent in our present competitive structure and how these could be overcome, either through legislative changes or a more proactive enforcement of the board's recommendations; in addition to the matters raised in section 4.1, attention will be given to the possible need for legislation to strengthen small enterprises in their access to raw materials and other inputs controlled by monopolistic suppliers.

- steps taken by provincial and local governments to reduce restrictive legislative and regulatory conditions. Through its support for Local Service Centres, the government will also assure that attention is given to these important issues at grassroots level and that close interaction is maintained between central government and grassroots needs. Furthermore, the DTI, in consultation with the SBDA and the Competition Board, will regularly review progress in this important sphere and its assessment by key players in the small business sector.

2.2.4 Legal Assistance

It is generally known that small enterprises often find it difficult, financially or for other reasons, to avail themselves of the due process of law in order to defend their interests. The government is committed to facilitate feasible avenues of legal assistance that could help level the legal playing fields for small enterprises, with particular attention to those disempowered in the past on the basis of race or gender.

2.2.5 Judicial Reform

The government will also support steps to reform the current small claims court system, with particular attention to:

- increasing the number of court outlet points.
- raising the level of claims falling within its jurisdiction (to about R30,000).
- integrating it more closely with the legal framework, thereby providing access to interdict procedures.
- enabling members of closed corporations to utilise the services of the small claims court.
- strengthening co-operation with the Department of Justice.

2.2.6 Simplification and Standardisation

Establishing a user-friendly environment also calls for the simplification and standardisation of documents. This includes:

- business registration and licensing.

- financial and loan applications.
- purchasing and sub-contracting (tender) document.
- export documentation and other commercial documents.
- registration of contracts at fair-trading boards.
- simplified tax return forms for small businesses.
- the collection of industrial data and other statistics.

2.2.7 Access to information and advice

Lack of access to appropriate, relevant and understandable information and advice is one of the most important problems of small enterprises, in particular micro-enterprises, survivalists and small start-up enterprises. Due to past discrimination and lack of opportunities this problem is most severe among black entrepreneurs. The significance of this constraint is recognised all over the world. In many of the more developed countries the bulk of government-funded assistance to the small business sector centres almost exclusively around these needs. In South Africa some progress has been made with the preparation of information material relevant for small enterprises and the dissemination of information and advice. Yet, to date the number of enterprises effectively reached remains small, compared to the vast number of people involved in self-employment in both urban and rural areas.

2.2.8 Information and Advice

As an operational principle, information and advice should be as focused and sector-orientated as possible and it should be supplied at grassroots level wherever this can be done. Responsibility for the preparation and dissemination of relevant material falls on all the agencies active in the SMME support sector, i.e. public, parastatal, private and NGO, operating at the national, provincial and in particular local as well as sectoral levels.

2.2.9 Local Service Centers

The DTI must accept responsibility for the dissemination of both data and information related to the national small-business scene, the strategy framework and the availability of support services all over the country.

- In order to facilitate the systematic spread of business-related information and advice, the establishment of a decentralised, country-wide network of Local Service Centres (LSCs) must be created. These will supply more than just information and advice, but financial assistance as well.

- As a rule the government will not be directly involved in the preparation or dissemination of information and advice. The bulk of this should be undertaken by private institutions, NGOs and self-help or group initiatives, with financial support as far as possible within the constraints of the budget - largely limited to information seekers unable to meet the cost of such services. Such support will primarily be channelled via the LSCs.

2.2.10 Mentorship

In many cases the passive availability of information and advice is not sufficient for the effective transfer of experience. Individuals operating as mentors and interacting regularly with advice seekers can be very effective, especially if the advice is focused, the mentor has extensive experience and is able to communicate effectively with entrepreneurs. A vigorous mentorship programme is to be implemented. Some are already working on a voluntary basis, some are funded through parastatals, NGOs or local authorities while others are provided as part of corporate social responsibility. An increasing number are directly or indirectly linked to normal business relations, i.e. they are supplier-driven, consultancy-driven or bank-linked, to mention a few. It is expected and hoped that these mentoring relationships, which often evolve into more comprehensive partnerships, will further expand, without the need for substantial financial support by the state. Where assistance is still necessary to help emergent enterprises or the survivalist segment, it will also be channelled through LSCs.

2.2.11 Statistics

Reliable statistical information is important for the small business sector, for small-enterprise support agencies and for the central as well as provincial governments to monitor policy effectiveness and facilitate forward planning. At present the statistical base is extremely poor with respect to most aspects of small-enterprise development in South Africa. The task to upgrade and regularly update relevant trends cannot be the responsibility of government alone. The most effective approach will need the co-operation of the following parties:

- The DTI via its relevant Small Business Advisory Bodies

- Central Statistical Services, who should collect as much of the relevant data as is possible within the framework of its resources and techniques.

2.3 Access to marketing and procurement

Small-enterprises usually regard market constraints and the inability to sell their products and services as one of the most serious obstacles to the starting of businesses and growth beyond mere subsistence level. This perception is paralleled by many studies - in South Africa and internationally - which view market access as a critical factor in business growth, in particular in the case of entrepreneurs from disadvantaged communities. Responsibility for steps to overcome this constraint falls upon many different groups, individual entrepreneurs and groups of small businesses, which have to compete with others for the same clients, local government and business associations, who should reconsider regulations hindering market access of newcomers, the established business community, who should practise what they preach by opening up competition rather than controlling markets, and public-sector departments as well as big enterprises, who should re-orientate procurement towards small-enterprise suppliers and subcontractors. The government must commit itself to facilitate this complex process in a number of ways:

- Consider steps which could include tax incentives, procurement quotas, voluntary commitments, etc., to motivate the big-business sector to systematically expand its links with small enterprises. In this respect sector-specific and localised efforts are likely to bear better results and minimise confrontation, compared to national rules or guidelines.

- Propagate and encourage the simplification of tender procedures among all public-sector and parastatal tender authorities, in order to make it easier for small enterprises to compete and eliminate gender bias.

- Adjust public procurement practices at central, provincial and local government levels, and by parastatals, in order to facilitate the granting of some proportion of contracts to black-owned or controlled enterprises, and encourage small-business tendering for such contracts.

- The Public Works Ministry and other government and/or provincial departments need to address the unemployment problem through labour-intensive construction, using the small-enterprise sector. Attention must be given, wherever practically possible, to the involvement of small and/or emergent subcontractors.

- The DTI must encourage co-operation between relevant departments as well as private-sector institutions and NGOs to reach SMMEs and to mobilise training and mentoring support for small contractors, so that they are able to tender successfully;

- Facilitate, where necessary the ability of small enterprises to meet the conditions of such contracts. This will be done primarily through the support of Local Service Centres and, in particular, business linkage programmes;

- Encourage the development of more appropriate small-enterprise export-support programmes, to either adapt, supplement or replace existing programmes which are largely tailored towards the needs of the bigger exporters. Such programmes could cover special finance schemes, exhibition facilities, new types of export trading houses, adjusted export credit-guarantee schemes, an expansion of the export marketing assistance scheme and special training efforts. They should be sector-specific and locally focused.

- All of the above steps will only be effective if small enterprises at the same time work hard to increase the quality of their goods and services, diversify their product range in response to changing market opportunities.

- Closely linked to marketing and supply problems of SMMEs are issues related to reasonable access to raw materials and quality services at affordable prices. There are many ways of addressing these problems, including bulk purchases by clusters of firms or through sector associations, assistance to individual firms via extension networks and the discouragement of supplier monopolies.

2.4 Access to finance

In surveys among small enterprises all over the world, access to finance comes out as one of the most urgently felt needs. This remains true even though other problem areas (like marketing, technical skills, poor product quality, weak management, etc.) often aggravate the financial position of small enterprises and hamper their access to funds.

The financial needs of different types of SMMEs vary widely, with access problems particularly severe in rural areas, among start-up micro-enterprises and among those owned or controlled by women as well as other formerly disempowered groups, and in certain higher-risk business categories.

The government is committed to strengthen the link between small enterprises and existing as well as evolving financial institutions, so that available funds are channelled to areas where they are most urgently needed. Areas for direct or indirect government and parastatal involvement in the financial sphere include the following.

2.4.1 Commercial banks

South Africa's commercial banks have in the past been reluctant to provide comprehensive services for the fragmented, risk-prone and geographically dispersed small-enterprise sector. This applies in particular to black emergent enterprises, where apartheid restrictions, forced removals, influx control, migrant labour and job reservation all militated against the gradual development of bank-client relations in both the urban and rural areas. It is only logical, therefore, that commercial banks have for long been reluctant to risk their clients funds through loans to and investments in black-owned or –controlled enterprises.

During recent years there are welcome signs that commercial banks are giving increasing attention to the needs of SMMEs, with many innovative financing schemes having been introduced to assist particular types of SMME clients. About a dozen former homeland development corporations (or their small business subsidiaries), the SBDC (now known as Business Partners) and a few other specialised lending institutions like Get Ahead, the Informal Business Enrichment Centre (IBEC),the Informal Business Training Trust (IBTT) and others, have over the years tried to fill part of the vacuum in SMME funding, with traditional schemes like gooi-goois and stokvels also playing a significant role. These institutions are essential for the type of loans where the risk and transactional costs are still too high for conventional commercial banking practice.

In addition support is envisaged along the following lines:

- initial start-up equity and overhead cost of these specialised agencies has to come from local or foreign donors or through a government (marketing) grant;

- concessionary (lower-interest) loan capital for on-lending has to be provided by local or international wholesale financing agencies (like the DBSA, the IDC or an evolving small-enterprise finance trust);

- commercial funding to supplement the other two sources, but at market-related interest rates; and

- ongoing subsidisation or matching grant finance for aftercare and other support services necessary to safeguard the portfolios and fulfil a developmental role.

2.4.2 Micro-enterprise finance

In addition to the above institutions, NGOs have over the past decade become increasingly involved in the supply of micro-loans and related services to micro- and survivalist enterprises. In the short run such schemes, which are highly significant for certain segments of the SMME sector (e.g. the rural and informal sector) are only sustainable with some grant funding and/or if the micro-loans are combined with other partially sponsored support services.

Government will continue to supplement other donor agencies' efforts to help micro-enterprise funding agencies. Much of this support is likely to be channelled along parastatal, provincial and local government levels and with interaction with the private sector. Major emphasis will also have to fall on capacity-building efforts and the supply of seed capital.

As detailed in the Government White Paper on Small Business it is the long-run vision of government that over the years the grant and concessionary funding share will decline and commercial funding of SMME-focused financing institutions will increase. In the meantime the scarcity of government resources demands careful targeting of such concessionary and grant funding

2.4.3 Venture finance

The creation of equity funds to address the equity needs of SMMEs should be private-sector-driven. The public sector will, however, assist in capitalising some of the funds targeted at disempowered entrepreneurs with viable business propositions. This could best happen via SMME-focused financing institutions.

2.4.4 Credit guarantees

In order to strengthen the commercialised funding of SMMEs, the government and relevant private institutions are developing an expanded and differentiated credit-guarantee system, which will be commercially run and jointly funded. Such a system also offers scope for targeted additional support to the disempowered, women and other categories of entrepreneurs.

2.4.5 Deposit-taking by lending NGOs

In order to strengthen their ability to mobilise funds for micro-loans and other programmes, government will look into the feasibility of an expansion of deposit-taking facilities towards approved NGOs.

2.4.6 Alternative collateral

Given the critical role collateral plays in the attraction of conventional bank credit, attention will be given to the recognition of other types of securities and collateral substitutes, especially in the rural areas where land is communally held and with respect to women entrepreneurs.

2.4.7 Information on access to finance

In as far as lack of knowledge about available financing programmes or the process of application constrains access for individual small enterprises, the proposed national network of service centres can also play a significant role. LSCs could also facilitate the establishment of special local lending programmes as a form of joint action between financial institutions, parastatals, NGOs and local authorities or community groups.

2.5 The physical infrastructure

The development and financing of business and industrial premises (shops, offices, factories, market stands, hawker shelter, etc.) and infrastructure facilities, including the supply of electricity, water, telecommunication connections, sewage, street lights, parking facilities, etc, is usually seen as the responsibility of either the private sector or local authorities, rather than the government.

Yet, due to the past neglect of the needs of black townships and emergent enterprises a serious backlog of even basic facilities has emerged in both rural and urban area. Special attention must be given to the supply of electricity to businesses, basic services and the road infrastructure in commercial and industrial areas, facilities for fresh produce and other markets, industrial incubator structures, telecommunications, postal delivery services and appropriate business zoning and planning processes. Recent political changes, the prospects of less violence and crime in the townships, and the gradual emergence of legitimate local authority structures have increased the chances for greater private-sector and local-authority involvement in the improvement of township business infrastructures. In addition, parastatals like Eskom and Transnet/Intersite and the regional development corporations are increasingly involved in this sphere, with funds solicited from wholesale financing institutions, regional governments or foreign sources.

- Much attention has recently been given to the need for industrial incubators (hives) and commercial premises at rentals affordable for emergent enterprises. These needs can be handled in different ways:

- The incubator (or industrial start-up premises), if not established through private enterprise, can be viewed as a variation of LSCs, for which structured support programmes can be developed.

- Existing suppliers of such accommodation, like the SBDC and the regional development corporations, have to consider the need for and justification of rental subsidies and the feasibility of such subsidisation within their own funding as well as other possible support programmes. The SBDC already has such a scheme, but this may need adjustments to strengthen its development impact.

- The DTI and/or provincial governments could investigate the scope for an affordable system of start-up rental subsidies with sliding scales of subsidisation for specific categories of emergent entrepreneurs (e.g. small manufacturers and rural hives). Such a scheme might also help motivate the private sector to construct more incubators and other small-business premises.

- Special attention has to be given to the planning and physical infrastructure needs of women entrepreneurs. This includes a flexible planning approach towards home-based enterprises, the provision of creche facilities close to businesses, and more public toilet facilities.

- In the rural areas and many of the resettlement villages there is often a critical shortage of built-up work spaces, combined with the lack of access to electricity, water and telephones.

- High crime rates and continuing violence are serious obstacles to small-business growth since they increase the risks for small enterprises and often cause major losses of stock, damage to buildings or reduced turnover. Attempts by central, provincial or local authorities and other agencies to help establish peace in the townships and decrease the crime rate should also be seen as important stimulants for SMME growth.

2.6 Training in entrepreneurship, skills and management

The acquisition of relevant vocational, technical and business skills is generally regarded as one of the critical factors for success in small enterprises. In addition, literacy and entrepreneurial awareness are seen as particularly important to enable people to advance from survivalist activities into larger and better earning enterprises. With the rapid expansion in the range and number of small enterprise all over the country, South Africa faces a daunting challenge in the sphere of small-business-orientated education and training. Responsibility for education, training and experience transfers rests on a wide range of institutions, including the central and provincial tiers of government, NGOs, parastatals and the private sector. During the past few years the range of training programmes made available for and relevant to small businesses has expanded considerably. In fact, a general lack of awareness about the spread of already existing facilities and what they offer the small-enterprise sector or those interested in a business career, constitutes one of the shortcomings of the whole training process.

Bearing in mind the diversity of SMMEs and the wide range of training suppliers, the governments sees the following challenges as core elements in a national training strategy for small enterprises.

- Knowledge about presently available training programmes has to be disseminated more effectively to reach entrepreneurs all over the country. Such information should also help match particular needs and specific training programmes. The planned national grid of LSCs should play a significant role in this process.

- School curricula and other school-related activities should give more scope for the inculcation of entrepreneurial attitudes and a general awareness about self-employment opportunities.

- All suppliers of training have to reconsider the nature, content and effectiveness of their programmes, taking into account the small-business environment in the different sectors of the economy and working closely with the business sector. Thus, training has to become far more sector-specific, focusing on the particular needs and practical problems of small enterprises. Different programmes will have to be developed for inter alia

- survivalist entrepreneurs lacking even basic literacy.

- micro-enterprises in rural areas, where language capabilities are critical for the absorption of experience.

- women entrepreneurs wanting to focus on particular issues and problem areas and needing particular time considerations to match home duties and training.

- business and skill needs in sectors like construction, manufacturing, small-scale agriculture, tourism, etc.

- self-employment problems experienced by the youth, where the emphasis will have to fall on awareness about opportunities and development paths. In addition, training should in general help to break with traditional gender roles in business and skill categories.

- Training programmes have to be modular, so that trainees can combine training from different institutions. Linked to this is the need for some accreditation of small business-related programmes, in order to protect trainees and allow training paths. A two-pronged strategy will have to be considered by the relevant institutions, after broad-based consultation.

- greater concern for SMME-related training needs and programmes in the activities of established industry training boards and

- the establishment of a new Informal-Business Training Board to give particular attention to training issues related to micro- and survivalist enterprises which are unlikely to be addressed by the levy-funded Industry Training Boards. This would include issues like certification, accreditation, matching grants and better co-ordination of these training efforts.

- The present incentives of different government departments have to be coordinated more effectively. This will have to include the manpower and skills development training programmes funded by the Department of Labour for the unemployed, the public works programme in the construction of roads and the agricultural development projects and others related to subcontracting preferences for emergent SMMEs.

- Serious attention has to be given to the staff training needs of SMME- support agencies, in order to expand their capacity to handle the challenges facing the implementation of the various projects. These tasks rest as much with the tertiary training institutions, including the small-business units attached to some universities, as it rests with the broader training community. Once again, the needs of rural areas and small, community-based NGOs trying to support micro- and survivalist enterprises have to be addressed proactively.

- Parallel to more training efforts it is necessary to expand applied research about problems, needs and development trends in South Africa's SMME sector, and about developments in Africa. These efforts should occur in close co-operation with tertiary education institutions, the business sector and relevant parastatals and government departments.

- In tandem with increased training there is also need for the rapid expansion of business-mentorship systems of the type developed in the past by the SBDC and the International Executive Service Corps (IESC), but also new approaches like small-industry extension workers. These schemes should include general, volunteer-type mentorships as well as sector- or industry-focused technical and business mentoring, with the cost shared by different stakeholders. The government will channel its support primarily via LSCs.

- Another important avenue for intensive experience exchange are business internships and traineeships for SMME managers at well-run enterprises. This approach, which is comparable to apprenticeships emphasised so much in other countries, also has to be expanded rapidly in South Africa, with particular focus on black and women entrepreneurs. Franchises, joint ventures and other types of partnership agreements can play a similar role and should also be expanded further in South Africa.

- Although the main thrust in all these spheres has to come from the private sector, government must accept the need for some support. In order to help co-ordinate initiatives and work out a new approach towards limited financial support for SMME-focused training.

2.7 Access to appropriate technology

Just like training, finance and business premises, technology is an important factor influencing the success of small enterprises, but not always accessible to them.

This applies to both ends of the technology spectrum, viz. sophisticated technology needed for the competitiveness of small enterprises in the modern manufacturing and services sectors, and "appropriate" technology for small enterprises operating in the labour-intensive, low-skill spheres. Both of these areas deserve more attention and may justify some government support. Over the past few years a number of institutions have started to focus on the technology needs of small enterprises, with the CSIR the most important parastatal. The DTIs Support Programme for Industrial Innovation can also be used for this purpose, as could research sponsored by the Foundation for Research Development (FRD) and more proactive work by the National Productivity Institute (NPI). Universities and technikons as well could give greater recognition to the SMME-related issues and technical research. In fact, the time seems ripe for a well propagated, multi-year programme, spearheaded by the CSIR, involving all the relevant bodies, both public and private, to systematically address small-enterprise needs in the field of appropriate technology. Much of this will, however, have to be implemented in the context of specific industry or sector programmes.

Financial commitments of the state will have to await the preparation of detailed proposals based on broad consultation. Significant resources may also be forthcoming via foreign donor programmes and private-sector involvement. At the grassroots level the proposed network of LSCs would seem to be the best channel to filter technology information through to individual small enterprises and to identify needs that warrant subsidised research. Even here the focus should, as far as possible, be sectoral, giving special attention to the particular economic structure and sector specialisation in each LSC neighbourhood. For example, in the rural areas a lot of emphasis will have to fall on product development and the introduction of low-cost state-of-the-art technology.

- At local authority and Regional Services Council (RSC) level the differentiation of rates and user charges could also be an instrument for the promotion of small enterprises.

- In the industrial sector the industrial-development incentives granted under the Regional Industrial Development Programme (RIDP) have for many years largely excluded small enterprises. More recently an adjusted set of simplified incentives (Small Enterprise RIDP/SRIDP) has been made available to smaller enterprises, without attracting vast numbers of applications. Where the RIDP is as a whole under reconsideration, the particular needs of small-scale manufacturers may call for a totally different application of funds available for that sector. The DTI is currently negotiating the transfer of the SRIDP allocation to the Directorate for the targeted assistance programme.

- The same remarks about the RIDP can apply to export incentives provided under GEIS and the EMA scheme to small-scale exporters. To reach a large number of SMMEs, a sector or niche-focused export-facilitation process may be far more economic than cash payments to a few applicants.

- Finally, direct funding supplied to accredited training institutions under the Department of Labour's unemployed training programme has been criticised on the same grounds. If channelled through provincial SMME desks, sector associations, regional development corporations or other sector-focused channels more effective use may be made of those funds. Government is interested to have all of these proposals and issues discussed in the relevant bodies.

The responsibility for support and assistance to medium, small, micro- and survivalist enterprises falls upon a wide range of organizations, associations or agencies. They include all levels of government, a whole range of parastatals, a large number of NGOs and community-based organisations (CBOs), the full spectrum of business associations, an increasing number of private institutions and several foreign donor agencies. The commitment to this national strategy and the degree of co-operation between all these organisations largely determines the effectiveness of our national small business-support system, which was seen as being critical for the rapid unfolding of the South African small-enterprise sector. The government has no intention to curtail this diversity of support agencies, but it has every intention to make sure that scarce public resources are channelled in the most effective way through this system.

Chapter Three

Constraints facing the SMME Sector

There can be no doubt that, compared to big business in South Africa and in other countries, small businesses face a wider range of constraints and problems and are less able to address the problems on their own, even in effectively functioning market economies. The constraints relate, among others, to the legal and regulatory environment confronting SMMEs, the access to markets, finance and business premises (at affordable rentals), the acquisition of skills and managerial expertise, access to appropriate technology, the quality of the business infrastructure in poverty areas and, in some cases, the tax burden. In the South African context the constraints have been particularly hard on entrepreneurs in rural areas and on women.

Generally speaking, the micro- and survivalist enterprises are far less able to face constraints linked to finance, market access and the acquisition of skills. On the other hand, some sectors like agriculture, construction and manufacturing confront small enterprises with a particularly wide range of problems, thus preventing easy access to these sectors by new enterprises or increasing the risk of those already in the sectors. Even among medium-sized enterprises, problems like international competition, technology transfer and skills training can constitute major growth obstacles. These differences are of critical importance for the national support strategy. They not only stress the need for some degree of public sector involvement, but also emphasise the need for explicit differentiation in the support framework.

In addition to sector-specific differences of constraints, the legacy of apartheid constitutes an important factor in the inability of black owned or controlled small enterprises to face business development constraints. For decades, if not centuries, the majority of South Africans were deprived of viable business opportunities in the following ways:

- Bantu Education restricted opportunities for the acquisition of technical and professional skills by black people.

- there was total absence of entrepreneurial education or sensitising for young people in a way that could encourage them to enter business and acquire a culture of entrepreneurship.

- apartheid confined the majority of the African people to homeland areas which were not only the poorest in terms of living standards and business opportunities, but also lacked a dynamic business environment.

- even outside the homelands the system of apartheid made it impossible for black would-be-entrepreneurs to participate in business apprenticeships and partnerships with more established(non-black-owned/controlled) enterprises.

- racially segregated residential areas, enforced through the Group Areas Act, not only uprooted millions from the places of residence and business, but also led to large capital losses and virtually destroyed the fabric of black small enterprises.

- segregation increased the distance between black residential and working areas, thereby increasing the cost and risk of conducting business.

- the drastic curtailment of property ownership rights of blacks made it impossible for them to acquire assets that could serve as collateral for loan financing; it also excluded blacks from the long-run process of capital accrual and growth through rising property values and share prices.

- apartheid left no real space for the business involvement of black women; marriage laws reduced women to unions with no contractual capacity at all; even though marriage laws have changed, customary law remains intact and there are cultural, behavioural and attitudinal constraints which affect women's participation in business, particularly in rural areas. There are also restrictions in terms of access to land.

An additional constraint to SMME growth is presented by labour legislation. Managers/owners may be reluctant to expand their labour forces for fear that they may then be exposed to employment and labour relations regulations, which are perceived to be costly and time-consuming as South Africa is perceived of having a very well organized and unionized work population.

In so far as this prevents low-wage competition, labour-intensive activity is discouraged in favour of capital-intensive enterprises. In this way, the job-creating potential of the SMME sector is not being fully realised. Moreover, in a globally competitive business world, characterised by trade liberalisation, relatively high wages for unskilled labour in South Africa result in jobs being effectively exported to low-wage countries.

Due to these processes, small business-support policies will for an considerable time also have to focus on the particular needs of black enterprises and ways to overcome the remaining consequences of that legacy. This does not imply that policies should only focus on black-owned or -controlled enterprises or business-infrastructure facilities in formerly black-reserved towns, but that policy differentiation will have to include affirmative elements.

Chapter Four
Access to Finance

"The challenge for us as government and its implementing agencies in respect of small business is to build on what has already been achieved and to begin to offer small enterprises packaged services and products to impact on key areas such as access to finance, training and mentorship and access to technology. Increased focus should be on target groups such as women and rural small business, and how to widen their participation in the mainstream economy. The path we have travelled since our democracy has been characterised by smooth and rough surfaces. The challenges we face as a country are enormous, government alone will not be able to deliver. We need everyone's commitment. Banks in particular must deliver on their commitment to lend to the historically disadvantaged communities particularly women who are known to be the best in terms of repayment of loans and they will be called to account when the integrated financing institution is operational." Source : Keynote Speech launch of Khula's Annual Report, Deputy Minister Lindiwe Hendricks 10 September 2002

The reluctance of financial institutions to advance loans or overdrafts to small business is not just based on the alleged conservatism of Anglo-Saxon bankers or racially-biased financiers. It is also the result of their experience with poorly motivated loan applications, the frequent lack of systematic business plans and realistic market assessments, the statistically verified high rate of small-business failures and irrecoverable collateral, and other co substantial financial resources will be needed to implement the proposed Government strategy - undoubtedly much more than the resources made available in the past, when SMME support reached only a small fraction of the small-business community.

4.1 Types of finance needed

- Start-up capital, which has the highest risk and is most difficult to fund through financial institutions.
- Buy-in finance, which relates to a partner joining a new venture.
- Franchise fees, which usually constitute substantial amounts in the start-up phase, but are regarded as less risky because of the franchisor's mentoring role.
- Early-growth finance, which has the advantage that the firm already exists and some performance records are available to assure financiers.
- Expansion/diversification finance, which is usually easier to arrange, since the firm has passed the start-up/consolidation phase.

Special Needs Finance including export finance, crisis or restructuring finance, funds to cover (un)expected tax commitments and funds to facilitate the incorporation of a black economic-empowerment (BEE) partner.

Exit Finance or Succession Funding :When small-business owners want to exit from their (lifelong) business (e.g. getting a family member to take over), they may want to utilise some of the capital tied up in the business for old age "pensions"

Group Loans and community projects :The supply of such funds has to come from properly structured schemes, with conventional and new types of financial institutions sometimes also playing significant roles (e.g. in the administration of funds).

Working capital : includes a whole range of sub-categories, such as raw material finance, import finance, funds to tie over seasonal fluctuations in output, debtor finance to cover delays in the payment by clients, and funds to cover major maintenance and small capital projects. Once again, closer scrutiny of these sub-categories reveals different time spans for the funding, different risk profiles and different relative volumes (compared to a firm's monthly turnover).

4.2 Finance Categories of small businesses

Financial categories can be spread over the three broad categories of enterprises as previously identified, Survival Enterprises, Micro Enterprises and ,Small and Medium Enterprises and demand for finance can be further be differentiated within each of the three categories according to the sector/industry/niche within which the small business operates.

We can also distinguish between urban and rural enterprises where the latter live in environments with very few banking facilities, and between relatively smaller as opposed to larger, more established firms within each sector (e.g. a one-person taxi as opposed to a ten-vehicle taxi service).

Finally, in all three categories – we have to take into account special needs of PDIs (Previously Disadvantaged Individuals) or needs linked to BEE (Black Economic Empowerment).The needs of disabled people and women must also always be taken into consideration.

4.2.1 Personal funding sources

Personal funds could be accessed in various ways. These funds are the most easily accessible :

- Utilising own savings, kept in the bank, in other financial or savings institutions or "under the mattress money"
- Relying on regular bank or credit-card overdraft facilities, and or Budget facilities on credit cards.
- Obtaining a loan, grant or "sleeping partner" capital share from a family member, relative or close- friend.
- The pooling of funds or direct labour inputs of friends in a capital generation process – e.g. the erection of a building for a dealer/workshop, etc. in a rural environment.
- The slow accumulation of funds through the channelling of part of a prospective entrepreneur's monthly salary payments into a

moonlighting business (e.g. the establishment of a clothing CMT business while still working at a factory).

Although non-glamorous, these different sources add up to very significant supplies of risk and start-up capital. We explicitly exclude here the mobilisation of funds through illegal or socially unacceptable ways, which would include gambling, theft, drug dealing and related syndicate activities. Some of the capital supplied by "informal money lenders" may originate in that supply segment.

4.2.2 Banking-related funds

The most obvious sources in this category are loans from regular *commercial banks* – the "Big Four" – with their hundreds of branches, as well as the specialised or *niche banks,* some of which concentrate on the financial needs of smaller enterprises.

In recognising their importance in the funding of small enterprises, we should at the same time realise that this market segment makes but a small contribution to the overall fee income and profitability-bottom-line of banks. Generally, banks find the risk, time frame and interest/fee-earning capacity of small-business loans relatively unattractive, compared to other client activities.

"Banks' lending criteria and credit processes are focused on collateral-based lending and companies that have solid track records," *says First National Bank small business division enterprise solutions CEO Duncan Randall.*

"They are not set up to assess risk in the [small business] sector or manage the portfolio risk."*as quoted in SPECIAL REPORT : SMALL*

BUSINESS REGULATION – by Paul Crankshaw (Financial Mail – 14th May 2004) (page 48-50)

4.2.3 Micro Finance

A second, growing category in this segment are the micro-finance suppliers, where two types have to be distinguished:

- *Conventional personal loan suppliers* (often referred to as "loan sharks", even when they operate perfectly legally within the guidelines of the Micro-Finance Regulatory Council) – of whom there are many in South Africa, including subsidiaries of foreign firms. These suppliers concentrate on personal, relatively short-term loans to (preferably) regular salary earners, with good security (in the form of an ID and salary printout showing the potential for a garnishing order), and a reasonable credit record, checked through an efficient industry-wide referral system. The bulk of these loans are for household needs and the balancing of income fluctuations, but a not entirely insignificant share of five to ten percent of the funds are utilised for business purposes (e.g. when overdrafts of bank clients exceed their limit) :

- *Specialised micro-finance loan suppliers* operating as NGOs, with accreditation by and/or support from Micro Finance Regulatory Council and foreign donors and grants from aid agencies.

4.2.4 Services

Services provided by business associations to SMMEs, either fully costed or subsidised from own funds (cross-subsidisation) or external support :

- The South African Chamber of Commerce (Sacob).
- the National African Federation of Chambers of Commerce (Nafcoc).

4.2.5 Local Authority Support

Local-authority services to or support for SMMEs, provided at cost, via rates and taxes, or in a subsidised form (cross-subsidisation or funded from external subsidies):

- Hawker stands, municipal hives, open markets, information centres. The funding could also be pooled between several local authorities or subregions.

4.2.6 Statutory Bodies

Parastatal or statutory bodies involved in SMME support (fully or ad hoc) :

- Use of own revolving funds/capital, e.g. the SBDC and regional development corporations.

- Functionally specialised associations offering services at cost or on a subsidised base (with funding from external sources or cross-subsidisation) e.g. Safto (export support), universities (training for SMMEs), CSIR.

4.2.7 Wholesale Funding Agencies

Wholesale funding agencies for SMME loans or other programmes:

- Concessionary loan finance (DBSA, IDC).

- Grant funds (IDT, Kagiso Trust).

These agencies can tap government funds as well as capital-market sources and foreign donor funds.

4.2.8 Provincial Governments

Provincial governments, funded from regional sources, loans or central-government transfers:

- Staffing of provincial SMME desks.

- Support for provincial/local development corporations.

- Provincial SMME-support programmes.

4.2.9 Foreign Assistance

Foreign technical or financial assistance (grant or loan):

- Government-to-government programmes or multilateral aid.
- Funding or assistance to other implementation agencies.
- Regional joint programmes (SADC).

4.2.10 Central government funding of SMME-support Programmes

- DTI.
- operating cost of Chief Directorate.
- NSBC operating cost.
- SBDA operating cost.
- Local Service Centre support.
- Finance Trust and Export support.
- Other programmes handled via SBDA.
- Direct or indirect funding of provincial support.

- Tax incentives.

- Other incentives (e.g. RIDP, Department of Labour, GEIS/EMA).

- Special RDP funds.

4.2.11 Leveraging programme funding

All over the world the shortage of public-sector funds to meet all the programme needs has led to innovative ways of leveraging available resources, i.e. mobilising other financial resources through the prudent use of state funds. Matching grants are the best-known examples. In that case state funds only become available if the implementing agency mobilises other financial sources. This could be direct contributions from the client entrepreneurs, cost-sharing contributions from other partners in the programme (e.g. big business in subcontracting support schemes) or joint sponsorship from other agencies. The range of combinations is virtually unlimited.

Aside from multiplying the resource input, matching grants and similar cost- sharing schemes have the advantage that they exert additional discipline on the programme managers; if others also have to contribute, state funds may be less easily misused.

Chapter Five

Tax Incentives

5.1 Introduction

Over many years representations have been made for the differential treatment of small enterprises in order to reduce their tax burden and facilitate the reinvestment of small-enterprise profits, which are often the only basis for new investments or the expansion of existing small enterprises.

For many years there have been representations for a lower rate of corporate taxes for small enterprises, comparable to the situation in the United States and in several other countries. An alternative to the above is the exemption of a minimum amount of profit from taxation, in order to encourage reinvestment. More generous depreciation allowances could have a similar effect to a tax-free profit level. Exemptions to or rebates from import duties on manufacturing inputs and capital equipment could be important to re-exporting small businesses (like boat builders) where significant cash flow is tied up in import duties.

With the cost of tax compliance often quite substantial for small enterprises, it has been suggested that higher write-offs could be granted for expenses incurred. The same has been suggested for training, research, technology transfer and export marketing expenses.

To stimulate subcontracting by larger firms and greater volumes of loans to small enterprises by the banking sector, tax incentives have also been proposed. This could similarly apply to profit-orientated research, consultancy, training and technology transfer institutions who are to be encouraged to shift their focus to SMME-related issues, even though those clients are not able to afford the same fees.

Tax incentives have also been suggested to help overcome the gender bias of larger firms and service establishments vis-a-vis SMMEs owned by women.

A different type of proposals relates to the normalisation of tax arrears of SMMEs, including those involved in VAT, income tax, import duty and other tax non-payments. As in the case of bond and rental arrears such steps can only be undertaken in a concerted way, with full acceptance of all tax dues after the moratorium. If managed successfully, such a normalisation might open the gate to far higher future levels of tax compliance, especially if the transition happens during an upward phase of the business cycle and coincides with other SMME support action. To strengthen future compliance, eligibility for all public-sector support would be made conditional to such compliance.

5.2 SMMEs and Small Business Corporations

5.2.1 Differences between SMMEs and SBCs

An 'SMME' is not the same as a 'small business corporation'. The former could be any 'person' while the latter is restricted to a close corporation or a private company. Both are subject to different provisions and requirements.

The Income Tax Act governs and defines a 'small business corporation' while SMMEs are governed by the National Small Business Act, 1996. Each has separate benefits administered by separate bodies.

The Income Tax Act provides special tax rates and accelerates allowances for SBCs while SMMEs benefit from certain amounts (grants) received being exempt from tax.

5.2.2 Definition of an SBC

(Section 12E of the Income Tax Act)

The company must meet **all** the requirements set out below, to be classified as a SBC.

The requirements are :

5.2.2.1 Ownership requirements

- It must be a close corporation or any company registered as a private company in terms of the Companies Act, 1973 Act No. 61 of 1973).

- Shareholders or members that are natural persons must hold the entire shareholding at all times during the tax year.

- The shares must be held for their own benefit and not as a nominee.

- None of the shareholders or members may at any time during the tax year hold any shares or have any interest in the equity of any other company or any unit portfolio. This includes a close corporation, a dormant company and a co-operative. It is proposed, where shareholders, have a minimal level of ownership in another company, such ownership does not disqualify the business from benefiting as a SBC.

5.2.2.2 Turnover requirements

The gross income may not exceed R3 million for years of assessment ending on or after 1 April 2002. The limit was previously not exceeding R1 million for the years of assessment commencing on or after 1 April 2000. The Budget proposals announced on 26 February 2003 increased the turnover requirement to R5 million. The R3 million limit means the gross income received or accrued for a full period of 12 months, i.e. a full tax year. If you commenced trading during a tax year, you must calculate the annual equivalent to determine whether your turnover would have exceeded R3 million had you traded for the full tax year. Gross income, referred to above, includes all exempt income, but excludes any capital gains.

5.2.2.3 Business activity requirements

- The company cannot be an employment company or a personal service company.

- Not more than 20 % of the gross income of the company may consist of investment income and/or income from the rendering of a personal service.

Investment income includes income from :

- Dividends, royalties, rentals, annuities, interest as contemplated in Section 24J of the Act (incurred and accrual of interest), any amount contemplated in Section 24K of the Act (amounts for interest rate agreements or interest rate 'swap' agreements) as well as any other income subject to the same treatment as income from money invested.

'Personal service' means any service in the field of :

- Accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsmanship, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate, research, secretarial services, sport, surveying, translation, valuation or veterinary science, which is performed personally by any person who holds an interest in the company or close corporation.

5.2.3 Tax benefits of an SBC

5.2.3.1 Lower tax rates

A small business corporation enjoys lower tax rates than other companies, which are taxed at 30% on all profits.

A small business corporation is taxed at a rate of 15 % on the first R100 000 of taxable income for tax years ending on for after 1st April 2002. The taxable income exceeding the first R100 000 or R150 000, whichever is relevant, is taxed at the normal company rate of 30%.

5.3 Tax investment incentives available for an SBC

The full cost of any asset used in a process of manufacture and brought into use for the first time on or after 1st April 2001 may be deducted in the tax year in which the asset is brought into use, e.g. if the SBC acquired a printing machine for R200 000 it can deduct the full cost against its income.

The allowance is not reduced if the asset is used for less than 12 months during the tax year. The asset does not need to be a new asset.

Such an asset will not qualify for a scrapping allowance in terms of Section 11(o) of the Act, e.g. when it becomes obsolete, as the full cost of an asset is deducted when brought into use for the first time.

5.3.1. Definitional amendments

The definition of a "small business corporation" ("SMME") contained in section 12E(4)(a) of the Income Tax Act, 58 of 1962 ("the ITA") has been amended, so that the maximum gross income earned for classification as a SMME has been extended from R1 000 000 (one million rand) to R3 000 000 (three million rand).

The amendment applies to any year of assessment ending on or after 1 April 2002. This amendment will enable more SMMEs to qualify for a lower rate of tax as well as obtaining the benefit of special capital allowances made available in section 12E of the ITA for qualifying machinery and plant for SMMEs.

5.3.2 Tax rates

- **Income tax rates**

The tax rates applicable to an SMME will be, for normal tax, at a rate of 15% (fifteen percent) on the first R150 000,00 (one hundred and fifty thousand rand) of its taxable income, and at a rate of 30% (thirty percent) on taxable income in excess of R150 000,00 (one hundred and fifty thousand rand). This means that the effective rate of tax on the first R150 000,00 (one hundred and fifty thousand rand) of taxable income derived by an SMME will be 24,4% (twenty four comma four percent).

- **Capital gains tax rates and secondary tax on companies.**

On taxable capital gains, the effective total rate of normal tax will be 15% (fifteen percent), calculated on an inclusion rate of 50% (fifty percent). Secondary tax on companies ("STC") will be 17,8% (seventeen comma eight percent) for the SMME whose taxable income, inclusive of the taxable capital gain, will not exceed R150 000,00 (one hundred and fifty thousand rand).

The reduced rate of tax will apply to tax years of assessment during the period of 12 (twelve) months ending on 31 March 2003 (section 5(2) of the ITA). The rates of tax are set out in Schedule 1 of the ITA.

Taxation Laws Amendment Act 30 of 2002 ("TLAA")

Year-end commencing after 1st April 2000 and ending before 1st April 2002		Year-end ending on or after 1st April 2002	
Taxable income	**Rate of tax**	**Taxable income**	**Rate of tax**
R 0 to R100 000	15 % of each R 1	R0 to R150 000	15% of each R 1
R100 000 +	R15 000 plus 30% of the amount over	R150 000 +	R22 500 plus 30% of the amount over
	R100 000		R150 000

5.3.3 COMPARISON OF TAX RATES

The effective tax saving of an SBC compared to any other company is illustrated as follows:

Comparison (Year end 28 Feb.2003)	Taxable Income	Tax rate	Tax payable
Small business corporation	500 000	150 000 x 15 % 350 000 x 30 %	R127 500
Normal company/CC	500 000	500 000 x 30 %	R150 000
Tax saving of SBC		R 22 500	

Source : Practical Tax Handbook for Small, Medium & Micro Enterprises

Antonie Goosen

Example

An SBC with a 28 February financial year acquires a printing machine costing R600 000 on 12 May 2003 and immediately brings the machine into use for manufacturing purposes. The gross income of the company *amounts to R1 500 000 for the 2004 tax year. The allowance (Section 12E) and tax payable is as follows :*

Small business corporation (SBC)		
GROSS INCOME	*1 500 000*	
SECTION 12 E ALLOWANCE	*600 000*	*(100 % x 600 000*
TAXABLE INCOME	*900 000*	*Assume no other expenses, etc.*
TAX CALCULATION	*22 500* *225 000*	*(150 000 x 15%)* *(750 000 x 30%)*
TOTAL TAX PAYABLE	*R247 500*	

Source : Practical Tax Handbook for Small, Medium & Micro Enterprises Antonie Goosen

Comparison with 'other' companies (not small business corporations)		
Gross income	*1 500 000*	
Section 12C allowance	*240 000*	*(40% x 600 000)*
Taxable income	*1 260 000*	*Assume no other expenses, etc.*
Tax calculation	*378 000*	*(1 260 000 x 30%)*
Total tax payable	*R378 000*	
Tax saving for small business corporation	*R 130 500*	*(378 000 – 247 500)*

Source : Practical Tax Handbook for Small, Medium & Micro Enterprises Antonie Goosen

5.4 Additional incentives for SBCs announced in the 2003 Budget

DOUBLE DEDUCTION OF 'START-UP' EXPENSES FOR SMALL BUSINESSES

A double deduction of the first R20 000 expenses initially incurred for a new business will be allowed. This will be limited to the first R20 000 of your allowable deductions. The start-up expenses will be ring-fenced against future income from the same business in which they arise. This means that you cannot offset these losses against other income received.

The SARS further proposes to :

- Clarify the tax rules surrounding the deductibility of start-up expenses

- Clarify the availability of VAT inputs during the start-up period; and

- Changes will be made to the tax treatment of pre- incorporation expenses as VAT input credits during the start-up period.

Tax relief for reinvesting the proceeds from the sale of your business assets.Tax relief has been provided for ordinary income and capital gains when the proceeds from the sale of moveable business assets are reinvested in other moveable assets within an 18 month period. This means you can defer the taxable income or gain from the asset sold over the life of the newly acquired asset. In other words, the profit or gain you make on such a disposal must be used to buy a new moveable asset, which in turn can be depreciated, providing you with further tax relief in that the profit or gain is not taxed.

Losses incurred on the sale of depreciable business assets are now deductible.

Currently you can only claim these losses where the business asset is scrapped (scrapping allowance), while in any other case the loss incurred will be of a capital nature, making it non-deductible from your income. It is proposed to delete the scrapping provisions and allow for losses incurred from the sale of devalued depreciable business assets with short useful lives. Thus, it is no longer necessary an asset first becomes 'obsolete' or you scrap the asset before becoming entitled to any loss incurred.

5.4.1 Allowances and advances to employees and office-holders (e.g. directors).

It is important for employers to be aware of the following amendments for purposes of ensuring that the correct "pay as you earn" ("PAYE") is deducted from their employees' salaries. Previously, entertainment allowances were excluded from an employee's gross income. Since the 2002 amendments, entertainment allowances must be included in an employee's gross income, except where the employee can prove that the amount received is reimbursive in nature and was *bona fide* for the purposes of entertaining clients on behalf of his or her employer.

5.4.2 Subsistence allowances

In terms of the amendments, certain amounts are deemed to be actually expended by an employee or the holder of an office ("the recipient") in respect of expenses incurred or to be incurred on accommodation, meals or incidental costs while, by reason of his/her duties of office or employment, he/she is obliged to spend at least one night away from his/her usual place of residence in the Republic. The amendments further permit an employer to grant to an employee, in addition to a salary, a fixed allowance of R3 600, (three thousand six hundred rand) per year to meet expenses incurred while travelling on business. Should it turn out that, for example, only R2 400 (two thousand four hundred rand) was actually laid out by the employee to meet the expenditure, the employee will suffer an inclusion of R1 200 (one thousand two hundred rand) (R3 600 (three thousand six hundred rand) less R2 400 (two thousand four hundred rand)) in his or her taxable income. The full subsistence allowance must be reflected on the employee's tax certificate.

5.4.3 Bursary – exempt from gross income

Section 10(1)(q) of the ITA exempts from normal tax any *bona fide* bursaries and scholarships granted to enable a person to study at a recognised educational or research institution. Special rules apply to awards granted by employers to employees or their relatives. A bursary or scholarship granted was not exempt if the remuneration derived by the relevant employee during a relevant year of assessment exceeded R50 000 (fifty thousand rand). In terms of the amendment, this amount has been increased to R60 000 (sixty thousand rand). Another circumstance restricting the exemption for a bursary is where the award exceeded R1 600 (one thousand six hundred rand) during the year of assessment. In terms of the amendment the amount has been increased from R1 600 (one thousand six hundred rand) to R2 000 (two thousand rand) per year.

5.4.4 Intellectual Property Deduction

Section 11(gA) of the ITA allows as a deduction from income, any expense incurred on the development or acquisition of certain incorporeal properties, such as expenses incurred in devising or developing an invention, a design, a trade mark, copyright, or property of similar nature. The amendment introduced increases the limit of the deduction of such expense from R3 000 (three thousand rand) to R5 000 (five thousand rand).

5.4.5 Learnership Agreements

A new section 12H of the ITA was introduced by the TLAA, which permits a deduction by an employer of a so-called "Learnership allowance" from income derived during any year of assessment. The deduction is available when, during a year of assessment, an employer or an associated institution, in the course of any trade carried on by him or her, enters into a registered learnership agreement with a learner, or a learner completes a registered learnership agreement entered into between the employer and the learner during the same year or any previous year, in the course of any trade carried on by the employer.

5.4.6 Secondary Tax on Companies (STC)

The amendment to section 64B(5)(c) of the ITA exempts a company from STC on capital profits distributed in the course of or in anticipation of the liquidation, winding-up or deregistration of the company. In order to qualify, a company must, within a period of 6 (six) months, take certain steps as may be prescribed by the Minister of Finance by regulation to liquidate, wind up or deregister itself. It expressly states in the amendment, however, that where a dividend is distributed in these circumstances and the company has not within 6 (six) months after the date on which the dividend was distributed taken steps prescribed by the Minister of Finance to liquidate, wind up or deregister, the exemption will not apply.

5.4.7 South African Revenue Service Amendment Act 46 of 2002

Expansion of SARS's objectives

Section 2 of the Act expands the objectives of the South African Revenue Service (hereafter "SARS") to include "control over the import, export, manufacture, movement, storage, or use of certain goods".

This extension of the objectives of SARS may have an impact on SMMEs that carry on business relating to the import, export, manufacture, movement, storage, or use of certain goods. Any changes to the controlling function of SARS in relation to these sectors should be carefully monitored by SMMEs engaging in business in these sectors.

5.4.8. Revenue Laws Amendment Act 74 of 2002

Transfer Duty

Insofar as SMMEs are involved in purchasing property held in a trust, company or closed corporation after 13 December 2002, section 2 of the Act will apply to the transaction and the SMME will not be able to avoid paying transfer duty on the acquisition of such property.

5.4.9 Disposal of Active Business Assets

The Eighth Schedule of the ITA paragraph 57 was introduced as a concession granted, subject to certain limitations, to small business persons who, on their retirement, dispose of "active business assets". The requirements are that the active business assets are used wholly and exclusively for business purposes.

This restriction precludes small business persons from enjoying any concessions in respect of immovable property used for business purposes on which that person resides. The amendment has relaxed this limitation in that any gain on property used partly for business and partly as residential purposes will, to the extent that that person uses the property for business, now qualify for the concession.

5.4.10 The impact of the 2003 Budget on SMMEs

- A double deduction has been proposed for the first R20 000,00 (twenty thousand rand) of costs incurred in the start-up of new businesses;

- The turnover limit of small businesses will be raised from R3 000 000,00 (three million rand) to R5 000 000,00 (five million rand);

- Small businesses will be subject to a 15% (fifteen percent) tax rate for the first R150 000,00 (one hundred and fifty thousand rand) of taxable income;

- Small businesses will be eligible for accelerated tax depreciation benefits;

- The tax law governing the deductibility of start-up expenses, including pre-production interest, will be amended to create a unified statutory regime. Start-up expenses generally will be allowed if incurred during a set period before business operations begin. These start-up expenses will further be ring-fenced against future income from the businesses in which they arise;

- Changes will be made to the tax treatment of pre-incorporation expenses as VAT input credits during the start-up period;

- Tax relief will be provided where business asset sale proceeds are reinvested within 18 (eighteen) months;

- An accelerated 4 (four) year write-off period will be provided for capital expenditure relating to research and development in the field of natural and applied science;

- A 20% (twenty percent) straight-line depreciation allowance will be provided over a 5 (five) year period for taxpayers engaged in refurbishing buildings within designated zones, and a 20% (twenty percent) write-off in the first year and a further 5% (five percent) a year for a further 16 (sixteen) years will be provided to taxpayers that engage in the construction of new buildings within a designated zone;

- The *ad valorem* excise duty on computer equipment will be abolished from 1 April 2003 in order to encourage technological advancement and improved competitiveness;

- The Siyaka administrative reforms that were implemented in KwaZulu-Natal in 2002 will be extended to the Western Cape and Gauteng .

- Given that the deductibility of start-up expenses affects the liquidity of small businesses,Government has taken the view that small businesses should not generate taxable income until their costs have been recovered.

5.5 Other Legislation affecting SMMEs

5.5.1 Financial Intelligence Centre Act 38 of 2001

The most important aspects of this act came into force on the 3rd February 2003.Some of the aspects that relate to SMMEs, is the reporting obligation contained in section 29 of the Act.

Any person who owns or manages a business or is employed by a business, such as a financial advisor or broker, and who either knows or suspects that the business has *inter alia* received or is about to receive the proceeds of unlawful activities or has been used or is about to be used in any way for money laundering, is required to report such information to the Financial Intelligence Centre.

The Act furthermore overrides any duty of secrecy or confidentiality that affects compliance by such persons or institution with the reporting obligation. Failure to report such information constitutes an offence in terms of section 52 of the Act.

SMMEs that conduct business as financial services advisors or brokers will accordingly be affected by these provisions and must be alert to the obligations imposed upon them by the Act.

5.5.2 Financial Advisory and Intermediary Services Act 37 of 2002

All the provisions of this Act except section 13(1)(a) came into effect on 8 March 2003. The Act is designed to regulate the rendering of certain financial advisory and intermediary services to clients in respect of financial products. Such financial products include, amongst others, securities and instruments, a participatory interest in a collective investment scheme, a long-term and short-term insurance contract or policy, and a deposit, as defined in the Banks Act 94 of 1990.

Financial services providers are regulated by a Registrar of Financial Service Providers. In order to conduct business, financial services providers must be issued with a licence by the Registrar, who must be satisfied that the applicant complies with the requirements for fit and proper financial services providers. An authorised financial services provider must maintain a register of representatives and key individuals of such representatives, which must be regularly updated and be available to the Registrar for inspection purposes.

The Registrar is required to draft a code of conduct for authorised financial services providers for the purposes of ensuring that the clients being rendered financial services will be able to make informed decisions, and that their reasonable financial needs regarding financial products will be appropriately satisfied.

For such purposes, authorised financial services providers and their representatives are obliged, *inter alia*, to have and employ effectively the resources, procedures and appropriate technological systems for the proper performance of professional activities. This requirement could possibly hinder SMMEs conducting business as financial service providers in that many SMMEs lack the necessary capital to invest in such resources and appropriate technological systems.

In addition, the Act creates an Advisory Committee on Financial Service Providers, which is tasked with investigating and reporting or advising either the Minister of Finance or the Registrar of Financial Services Providers on any matter relating to financial services providers. This Committee has the potential to initiate the reform necessary to remedy some of the problems facing SMMEs which conduct business as retail finance intermediaries.

The Act also establishes the Office of the Ombud for Financial Services Providers, which is required to consider and dispose of complaints lodged against financial services providers by the public. The establishment of this Office as a watchdog over financial services providers introduces more effective regulation and management of the industry and could be used to address many of the concerns held by SMMEs in their capacity as clients of financial service providers, such as access to loan finance.

5.5.3 Financial Services Ombud Schemes Bill 13 of 2002

This Bill is designed to regulate the financial services industry through the recognition of voluntary ombud arrangements that exist in the industry. The Bill comes in the wake of a general recognition that client complaints are often directed at financial institutions that did not participate in an ombud arrangement, and that such complaints should be dealt with by a statutory ombud as established by legislation.

The financial institutions covered by the Bill include banks and mutual banks, collective investment schemes and management companies, and long-term and short-term insurers, although any other body or institution may also be declared a financial institution for the purposes of the Bill/ Act.

The main object of the Bill is therefore to provide for the statutory recognition of voluntary ombud schemes and to empower the Ombud for Financial Services Providers to act with statutory force. The Bill provides for the establishment of a Financial Services Ombud Schemes Committee to represent consumers, industry and others and which will be responsible for the application of the Act. This Committee will *inter alia* consider and grant or refuse applications for recognition of a voluntary ombud scheme.

The Bill envisages that the ombud of a voluntary arrangement will deal with complaints for a particular industry. However, the Committee will be empowered to entertain client complaints if those complaints cannot be accommodated by any of the ombuds in the voluntary arrangements.

This Bill will impact on SMMEs both in terms of representing their interests as financial services providers in a particular industry as well as in their capacity as consumers of financial services. The Final Report identified a number of key hindrances to the advancement of SMMEs as relating to financial services, most notably the lack of access to loan finance. Such voluntary ombud schemes as well as the Financial Services Ombud Schemes Committee will hopefully assist in providing SMMEs with a specialised and inexpensive forum in which to deal with their concerns.

5.5.4. Usury Amendment Bill 1 of 2003

This Bill provides for persons other than public service officials to be appointed as inspectors to inspect the activities of moneylenders, credit grantors and lessors. Consequently, it is proposed that the term "chief executive officer" be included into the provisions of the Act referring to the person having executive authority within an approved regulatory institution.

The chief executive officer is given the same powers as the Registrar of Insurance, including the delegation of such powers to inspectors who, once appointed, must be issued with appointment certificates. The powers of a chief executive officer include requesting any information from any moneylender, credit grantor or lessor.

The effect of this Bill is to subject those that conduct business as moneylenders, credit grantors or lessors to tighter controls through the appointment of more inspectors to monitor their activities. This, in turn, could alleviate some of the financial discrimination experienced by SMMEs in respect of securing capital loans.

5.5.5 Insurance Amendment Bill 52B of 2002

The Insurance Amendment Bill provides for amendments to the Long-term Insurance Act 52 of 1998 and the Short-term Insurance Act 53 of 1998 and is designed to update and consolidate the insurance industry's legislative framework in terms of internationally accepted principles and best practice.

The Bill proposes several amendments, including the regulation of advertising material related to insurance policies, allowing reinsurance companies in certain circumstances to conduct business directly with certain entities, the extension of the scope of misrepresentations by policyholders and the legal consequences thereof. The intention behind this section is to broaden the scope of the expression "representation" so as to include representations by means of positive acts committed by a policyholder as well as omissions such as the failure to disclose certain information. This section therefore extends the relative protection granted in the section to policyholders who are guilty of non-material inaccuracies.

Other amendments specific to the Long-term Insurance Act include the granting of an exemption to a long-term insurer from compliance with certain requirements of the Long-term Insurance Act when money is advanced (loaned) to a policyholder upon the security of a long-term policy taken out with that insurer, as well as the granting of an exemption to banks from the issuing of specific receipts in respect of long-term insurance premiums paid in cash.

The former amendment gives effect to the long-standing practice of the giving of policy loans, which has become a standard commercial feature and facility of long-term policies. This amendment is a welcome one for SMMEs in that it provides a further mechanism to enable SMME borrowers to provide collateral for the granting of loans. The latter amendment is designed to rectify current banking systems that do not make provision for a bank to state the names of the insurance company and the policyholder on receipts, resulting in a breach of the Act. The rationale behind this provision is to protect the less sophisticated part of the market where premiums are paid in cash to a person collecting it on a frequent basis. This will surely benefit SMME insurance brokerage companies that have as their clientele a "less sophisticated" sector of the market.

Finally, the Short-term Insurance Act has been amended, *inter alia*, to prohibit the use of the words "funeral" or "burial" in short-term policies and advertising materials. The rationale for this amendment lies in the fact that the assistance business, which provides for funeral and burial benefits, is one of the classes of long-term insurance business that only a registered long-term insurer may underwrite. These provisions will need to be heeded by SMMEs that operate as short-term insurers and advertise the service of providing funeral or burial policies, especially in rural areas.

5.5.6 Debt Collectors Act 114 of 1998

Certain provisions of this Act came into force on 7 February 2003, and others will come into effect on 11 August 2003. The Act sets up a system whereby no person shall act as a debt collector unless he or she is registered as a debt collector in terms of the Act, and in the case of a company or close corporation, if in addition to the company or close corporation itself, every director of the company and member of the corporation is registered as a debt collector. The Act establishes a Council for Debt Collectors that must issue a certificate of registration to every person registered as a debt collector. A registered debt collector is required to pay the Council the prescribed fees.

This Act may assist in allaying some of the fears that lenders hold with regard to inefficient debt recovery mechanisms available to them. In the Final Report it was found that debt recovery mechanisms are not effective, including weaknesses surrounding enforcement in the case of continued wilful non-payment. This Act may provide banks and other micro-lenders with renewed trust in a more regulated debt collection system, thereby benefiting SMMEs by advancing loan finance more readily.

This Act will also affect the many SMMEs that conduct business as debt collectors and for this reason they should familiarise themselves with the provisions of the Act. In effect, SMMEs will be subject to greater regulation and will have to abide a stricter code of conduct as set out in the Act.

5.5.7 Interest Rate increases for 2002

In terms of section 80(1)(a) and section 80(1)(b) of the Public Finance Management Act 1 of 1999 the Minister of Finance fixed the uniform interest rate applicable to loans granted out of a Revenue Fund and all other debts payable into a Revenue Fund as follows for the period under review:

At 14,5% (fourteen and a half percent) per annum with effect from 1 April 2002;

At 15,5% (fifteen and a half percent) per annum with effect from 1 July 2002; an

At 16,5% (sixteen and a half percent) per annum simple interest with effect from 1 October 2002.

The increase in the uniform interest rate directly affect the rate at which lenders lend money to the public. Accordingly, many SMMEs will have been hard hit by the three increases in the interest rate for the period under review.

5.5.8 Unemployment Insurance Contributions Act 4 of 2002

This Act will affect SMMEs that employ persons in excess of 24 (twenty four) hours a month and although the contribution by an SMME employer is limited to 1% (one percent) of employees' monthly salaries, the Act places an added administrative burden on SMMEs. It does,on the other hand, protect so-called "informal" labour prevalent in this sector, in that it provides them with unemployment benefits upon dismissal.

5.5.9. Basic Conditions of Employment Amendment Act 11 of 2002

This Act, which came into effect on 1 August 2002, amends the Basic Conditions of Employment Act 75 of 1997 in the following ways:

- *Overtime-* An employer may not require or permit an employee to work more than 10 (ten) hours overtime per week, except in accordance with a collective agreement. A collective agreement, however, may not require or permit an employee to work more than 12 (twelve) hours on any day, although it may increase the maximum permitted overtime to 15 (fifteen) hours a week. Such collective agreement, however, may not apply for more than 2 (two) months in any period of 12 (twelve) months.

- *Payment to benefit fund-* Should an employer deduct from an employee's remuneration any amount for payment to a benefit fund such as a pension, provident, retirement or medical aid fund, that employer must pay the amount to the fund within 7 (seven) days of the deduction being made.

- *Notice periods for termination of employment contract*- A contract of employment terminable at the instance of a party to the contract may be terminated only on notice of not less than:

- 1 (one) week if the employee has been employed for 6 (six) months or less;

- 2 (two) weeks, if the employee has been employed for more than6 (six) months but not more than 1 (one) year;

- 4 (four) weeks, if the employee: has been employed for 1 (one) year or more; or.

- is a farm worker or domestic worker who has been employed for more than 6 (six) months. A collective agreement may not permit a notice period shorter than that required by the above.

- *Definition of an employee* -The definition of when a person will be regarded as an employee has been expanded. It states, *inter alia*, that a person who works for, or renders services to, another person is presumed, until the contrary is proved, to be an employee, regardless of the form of the contract, if any one or more of the following factors is present:

- The manner in which the person works is subject to the control or direction of another person;

- The person's hours or work are subject to the control or direction of another person;

In the case of a person who works for an organisation, the person is a part of that organisation;

- The person has worked for that other person for an average of at least 40 (forty) hours per month over the last 3 (three) months;

- The person is economically dependent on the other person for whom that person works or renders services;

- The person is provided with tools of trade or work equipment by the other person; or

- The person only works for or renders services to one person.

The Act makes provision for the issuance of a code of good practice that must be taken into account in applying or interpreting any employment law.

SMMEs are likely to be affected by the provisions regarding restrictions on overtime. It is noted that the main labour-related problems experienced by small businesses include the lack of adequate flexibility, especially in relation to arrangements of working time.

Furthermore, the expansion of the definition of an employee could prove more onerous on SMMEs than on other employers, as the rights attaching to employees will restrict the necessary flexibility required by SMMEs to operate their businesses profitably.

5.5.10 Labour Relations Amendment Act 12 of 2002

This Act, which also came into effect on 1 August 2002, amends the Labour Relations Act 66 of 1995

Although the provisions of this act does not affect SMMEs directly the amendments apply to all employers, the effect of some of these provisions will weigh more heavily on SMMEs due to the added protection afforded to employees. The extension of the registered scope of bargaining councils to workers in the informal sector and domestic workers, for example, could prove to be more onerous on SMMEs who are more likely to contract with labourers from the informal sector. While this amendment signals necessary and encouraging protection of the rights of workers, this change could possibly deter SMMEs from utilising informal labour and hamper job creation amongst the informal sector in which there is the highest rate of unemployment.

5.5.11 Skills Development Regulations (published in GG 24967, Notice No 344 of 7 Mar 2003)

The introduction of these amendments to the regulations facilitates the position of SMME employers in the work place in that they afford such employers special SETA support with regard to acquiring grants in respect of employee skills development.

5.5.12 Land and Agricultural Development Bank Act 15 of 2002

This Act came into effect on 10 June 2002. Amongst other provisions this act includes:-

- Recognition that racially discriminatory practices and laws of the past and apartheid deprived historically disadvantaged people of land resulting in their exclusion from the agricultural sector and racially skewed patterns of ownership of land in South Africa; and

- Effecting a change in the patterns of land ownership by promoting greater participation in the agricultural sector by historically disadvantaged persons and an increase in ownership of agricultural land by such persons through the provision of appropriate financial services.

This Act will have a dramatic effect on SMMEs in the agricultural sector. It serves to address some of the major concerns of SMMEs in this sector relating to access to land and property ownership by historically disadvantaged communities. The establishment of the Land and Agricultural Development Bank serves to promote an effective outreach programme geared to reaching small-scale and emerging farmers which is controlled by a Board that must be appointed by the Minister responsible for agriculture.

5.5.13 Deeds Registries Amendment Bill 65B of 2002

This Bill seeks to amend the Deeds Registries Act 47 of 1937 by providing that where immovable property, a real right in immovable property, a bond or a notarial bond is registered in the name of a person who on the date of registration was a party to a marriage governed by the Recognition of Customary Marriages Act 120 of 1998, the Registrar of Deeds shall on the written application by the person concerned and the submission of the deed in question and of proof of the relevant facts, endorse the change in status and make a note to the effect that the said person is a party to a marriage in community of property. The section goes on to provide that in the case of an order of court envisaged in section 7(9) of the Recognition of Customary Marriages Act, the Registrar shall on submission of the relevant deed and court order and without the necessity for a written application, make the endorsement or note.

This amendment recognises the high levels of illiteracy amongst rural women (who are the target of this legislative amendment) and therefore dispenses with the need for a written application to effect the necessary endorsement or note. Furthermore, the effect of this amendment on rural women operating or wishing to commence operating an SMME is significant in that many of these women will struggle to raise the requisite collateral necessary for loan finance. This amendment will allow these women to put up as security their portion of the immovable property of the marriage, in turn affecting their ability to raise the necessary finance to start their own small businesses.

5.6 SARS SMME Information Gathering

5.6.1 Accounting Reference Group

In the 2004 Budget speech, the minister of finance, Mr. Trevor Manuel, stated:

> ***"In the past five years, a number of measures have been introduced to support small businesses. Reducing the regulatory burden on these businesses is a key element of Government's strategy for encouraging employment creation. A working group will be established this year to review the compliance burden on small businesses."***

In pursuing this undertaking, SARS Commissioner, Mr. Pravin Gordhan, initiated a process to identify practical ways to ease the tax administration and compliance costs in the SMME sector. Compliance costs vary with firm size, small business suffers most. This is largely because of their limited administrative resources, uncertain cash flows and limited clout in government. A large corporation may well be able to absorb these costs; small business is in a different position. This is also the area with the greatest degree of non-compliance. Said Mr.

Gordhan, 'We take SMMEs seriously and want to assist them and at the same time we want better compliance from them.'

Few SMMEs have the time and/or inclination to participate in public policy debates, many of they are too busy running their businesses. Fresh strategies are needed if their voice is to be incorporated in policy debates. Earlier this year, delegations of senior SARS managers and the Commissioner conducted visits to various SMMEs to assess levels of tax compliance and awareness among SMMEs as well as hear their concerns around tax compliance. These site visits have become a valuable tool to measure public perceptions of SARS and levels of tax awareness. More broadly, this direct engagement with these businesses will support the work of a special SMME Task Team which is in the process of being established by SARS and the national treasury. It fits into government's broader agenda of reducing compliance burdens and removing the regulatory barriers to the advancement of the SMME sector, given depth and weight by President Thabo Mbeki's recent announcements in his state of the nation speech.

Many enterprises use the services of intermediaries to see to their tax affairs. This meeting afforded SARS the opportunity to discuss how the project will impact on practitioners, as well as explore how these pivotal actors can inform and assist in the process. It is hoped that this investigation of the compliance constraints faced by SMMEs will inform how SARS redesigns the systems of interaction with them so that they can get on with the basic task of creating wealth and jobs, rather than filling out forms and standing in long queues. Importantly, there are savings for government too from a streamlined, simplified regulatory environment

5.6.2 Role Of Reference Groups

- To include the participation of all relevant parties thereby increasing the prospects for better compliance.

- The role of the accounting fraternity is critical due to its interaction with the SMMEs as accountants or tax consultants. In addition, because they understand the tax legislation they are well-located to advise SARS on the administration burden and compliance costs which the tax legislation creates for SMMEs.

- The accounting body is mainly focused on practical solutions that can be implemented to ease the burden for SMMEs and ultimately boost compliance of SMMEs.

- Structured dialogue with SARS to raise concerns regarding tax, administrative and legislative burdens, compliance costs and to propose solutions.

- Build relationships and foster partnerships between SMMEs and key stakeholders both in government and business.

5.6.3 Administrative burdens

- In the context of low literacy levels, the complexity of the legislation is particularly problematic (processes, procedures and policy). Complex terminology and jargon on forms and correspondence underlines this.

- The hassle factor of poor communication, inefficiencies, errors, lost documentation, sluggish response times, shoddy quality of queries and delays on the part of SARS is frustrating and costly in terms of professional fees.

- The high number of submissions, registration requirements for the numerous taxes, frequency and complexity of returns (particularly IT14) is onerous.

- In a society such as South Africa where a key challenge is to 'bank the unbanked', SARS' insistence on taxpayers having a bank account excludes a number of potential taxpayers. Compliance with SARS requirements in a cash only society is difficult.

- The bank requirement of having three separate cheques for the Skills development levy, UIF and PAYE raises the administrative and compliance.

- The maximum filing period of 7 months is not practical in the SMME environment.

- Locating the right SARS person to resolve queries/complaints is less swift than one might hope. In addition, SARS personnel at various contact centres are not sufficiently empowered to effect decisions.

- Getting duplicate IT14 and IT12 returns at SARS counters is an overly complex, time-consuming, stressful, tedious process.

- Lack of trust in the system of e-filing and fear of potential liability, combined with limited SMME access to e-filing, reduces the benefits of this approach.

- The lack of access to SARS client information and tax files is a problem for intermediaries.

- Many SMMEs do not know that they must submit returns by a certain date and therefore unintentionally end up being liable for interests and penalties charged by an unforgiving SARS.

5.6.4 Regulatory Environment Burdens

- VAT payment on invoice rather than receipt of payment creates cash flow problems for SMMEs. In addition, most SMMEs do not have an invoicing system.

- Unclear definition of SMME in terms of legislation causes confusion.

- South Africa has a complex regulatory framework incorporating SARS and other government departments. The cumulative impact of numerous regulatory requirements, not just the individual pieces, for example, the Skills Development Levy, complex labour laws, RSC levies, tax requirements and so on raises costs of compliance.

- These compliance costs have a disproportionate impact on SMMEs.

5.6.5 Compliance Cost Burdens

- Time required for filing, completing returns and dealing with SARS-related queries excessive and costly.

- Compliance costs consume real resources which have possible alternative more productive use in boosting SMMEs contribution to the economy. One estimate by Upstart Business Strategies of VAT compliance costs suggested it ran at some R8 441.

- Gaining the knowledge required to comply in such a complex environment is difficult. Many SMMEs choose to outsource this aspect but the cost in terms of professional fees and technology required is expensive.

- The potential alignment of GAAP with tax policy and legislation should be explored.

5.6.6 PROPOSED SOLUTIONS

The accounting reference group identified the following solutions :

5.6.6.1 Administrative Burdens Solutions

- The 12-month extension period for SMMEs to be retained.
- Dedicated SARS contact centre with specific SMME knowledge base. Having someone specific to complain to that understands the critical role of these enterprises in the broader economy, would be helpful to SMMEs.
- Intermediaries submitting returns via e-filing on behalf of clients should not be held legally responsible.
- Practitioners would be grateful for access to SARS client tax files, with 'read-only' status.
- SARS contact centre staff must be empowered and authorised to make decisions.
- The cost of compliance must be submitted as a tax rebate, not a deduction.
- SARS must embark on taxpayer education through the use of a simplified handbook/ "dummy guide". SARS staff themselves must be adequately sensitised and trained to deal with SMME

concerns and queries. As a whole, SARS personnel must be fully up to date and clear on what constitutes compliance.

- SARS should consider allowing one provisional tax payment in the first year of operation – rather than three - or waive interest and penalties during the early phases of an enterprise's life.

- Introduce a registration and orientation pack for new business owners outlining all relevant compliance and tax obligations.

- The introduction of a single registration process for all taxes.

- SARS could usefully consider approaches to widen the tax net and encourage those in the informal sector to formalise by registering. One approach might be a 'window period' for those who are not within the net to register and access the benefits of formalisation.

- Integrate SARS' taxpayer education initiatives with SETA activities in terms of SMMEs.

- Shift tax and accounting requirements for SMMEs to a cash basis to ease cash flow constraints experienced by many enterprises.

5.6.6.2 Regulatory Environment Solutions

- Identify existing regulations that inhibit the performance of SMMEs, and revamp them. Of specific concern, is the Companies Act which is currently under discussion.

- All legislation must be harmonised to ensure business growth and success.

- Create a common forum for SARS, DTI, and other related government departments to interact with each other and thereby ensure a more integrated understanding of the SMME environment and their concerns.

5.6.6.3 Compliance Costs Solutions

- Realistic thresholds for RSC levies should be considered. Alternatively, there should be provision for a once-off annual payment.

- Where SARS are responsible for errors, the taxpayer must be refunded and the problem (whether technical or system-related) resolved.

- Reduce the amount of paperwork and limit information requirements to the absolute minimum.

- Start using the private sector as a channel to educate SMMEs on their tax obligations. This could be done by insisting that those SMMEs that supply companies in terms of procurement are compliant and up to date with their tax obligations.

Chapter Six

SMMEs Support and Funders

6.1 The Industrial Development Corporation

The Industrial Development Corporation (IDC) is a self-financing national development finance institution whose primary objectives are to contribute to the generation of balanced, sustainable economic growth in Africa and to the economic empowerment of the South African population, thereby promoting the economic prosperity of all citizens. The IDC achieves this by promoting entrepreneurship through the building of competitive industries and enterprises based on sound business principles.

The IDC endeavours to provide risk capital to entrepreneurs engaging in a wide range of projects, ranging from agriculture to information and communication technology industries. In addition, the IDC attempts to identify and support new opportunities not yet addressed by the market. The IDC also sees the establishment of large resource-based projects as a cornerstone of development and a catalyst for the development of smaller industries.

Throughout the world it is accepted that one of the most effective methods of promoting economic growth is through the development of small and medium scale enterprises (SMMEs). Not only can SMMEs exploit niche opportunities in the market more effectively than large corporates, they are generally more labour-intensive and thereby more efficient in creating jobs.

6.1.2 IDC support to SMMEs

The value of IDC approvals towards SMMEs increased from 10% in 1996 to more than 40% in 2000. The lower figure of 19% recorded for 2001 is as a result of a large project approved during the period. When looking at the number of approvals to SMMEs compared to total approvals, this ratio changes to 80%. Through its financing activities over the past five years, the IDC created almost 55 000 direct jobs and generated R10 billion in export earnings through SME funding activities.

- The Small Business Monitor Vol. 1 Number 1 - 2003

The IDC's organisational structure is tailored towards generating in-depth knowledge in the industry in which the project operates. Strategic business units focus on providing finance within specific sectors in the economy.

The business units focused on the smaller business sector are:

- Agro – industries.
- Chemicals.
- Metal based products.
- Textiles.
- Wood, paper and other.

- Entrepreneurial mining.
- Tourism.
- Wholesale and bridging finance.
- Empowerment.
- Media and motion pictures.
- Techno industries.

By having each business unit focus on its sector within the economy, specialists in that sector are in the best position to evaluate applications for finance and provide guidance to applicants.

The IDC provides several financial products to entrepreneurs, structured to suit their needs. These include equity investments, quasi equity investment and commercial loans. With equity investments the IDC will provide finance to a company in return for a minority shareholding in that company. This shareholding should preferably be between 20% and 30%. Quasi equity investments are considered for small, privately owned ventures with a high risk profile, but with the potential to generate substantial profits and have a high development impact. Commercial loans are provided at competitive interest rates and repayment terms can be adjusted to fit the client's cash flow requirements. A contribution from the owner for the new project or expansion is required. The period of the loans ranges from five to ten years.

In 1999 the IDC implemented its "Strategy for Growth" plan. The main objective of this new approach is to maximise the IDC's developmental impact, while ensuring sufficient returns to remain financially independent.

6.1.3 Empowering entrepreneurs

The IDC is the biggest funder of medium-sized BEE deals in the country, so it plays a key role in broadening ownership and economic development.

"According to the IDC, between July and December 2002, 77% of the total value of approvals went to medium-sized enterprises. These resulted in the creation of 13 000 jobs." THE POWER OF GOVERNMENT SPENDING – *by Itumelemg Mahabane (Financial Mail, TOP EMPOWERMENT COMPANIES, 2004) (page 81-82)*

Since the early nineties the IDC has been at the forefront of funding empowerment deals. From humble beginnings as a pioneer in black economic empowerment (BEE) support to National Sorghum Breweries, NAIL and MTN, the IDC has increased its involvement in BEE to include all sectors of the economy.

Since 1997 the number of approvals to BEE firms increased from 9% of total approvals to 32% in 2001.

- The Dept. of Trade and Industry Annual Report -2001

The IDC sees a large similarity between the need for SME development and BEE funding. Generally, the smaller the transaction, the larger the percentage shareholding and managerial involvement by historically disadvantaged persons.

Two Strategic Business Units (SBUs) focus especially on the advancement of black economic empowerment. These are the Empowerment SBU and the Wholesale and Bridging Finance SBU. Together, these two business units co-ordinate the IDC's empowerment drive. These SBUs, which target 15% to 30% of their funding to BEE, play a notable role. They specifically support existing BEE companies requiring expansion capital and assist BEE companies to participate in green field projects.

The IDC's funding criteria and approach to BEE has changed over the past few years to cover a larger scope of funding, broaden the beneficiary base and reflect its flexible, non-prescriptive approach to BEE funding. The IDC is willing to fund take-overs of existing firms by black entrepreneurs and through its Wholesale and Bridging Finance SBU, provide finance to entrepreneurs through an intermediary. This last scheme has been extensively used to finance black participation in franchises.

The importance of SMEs in South Africa's economy cannot be overstated. The job creation ability and the roles these smaller companies play in black economic empowerment are invaluable. Over the past few years the IDC has realised this and extended its business to expand its assistance to SMEs. Even though it remains involved with the establishment of large projects,the IDC believes that these projects provide a stimulus for development and growth of small business.

6.2 Ntsika Enterprise Promotion Agency

Ntsika Enterprise Promotion Agency is an agency of the Department of Trade and Industry, duly incorporated as a public entity in terms of Section 9 of the National Small Business A c t 102 of 1996, mandated to provide non-financial support services to small, medium and micro enterprises (SMMEs).

6.2.1 Ntsika services

Ntsika facilitates non-financial support and business development services to SMMEs through a broad range of intermediary organisations, commonly known as Local Business Service Centres (LBSCs) and Tender Advice Centres (TACs).

Ntsika 's services include:

- SMME Training, Counselling and Advice.
- Market Development and Business Linkages.
- Programme Design, Research and Information.

In addition, Ntsika uses intermediary organisations such as Manufacturing Advice Centres, parastatal institutions such as SABS, CSIR, SAQI, and institutions such as Technikons and Universities to extend business development services to small, medium and micro enterprises (SMMEs). Ntsika further utilises the services of private companies and independent consultants to continue to play a crucial role in the provision on non-financial support and business development services to SMMEs.

Ntsika does not provide financial assistance, loans or grants to SMMEs for business start-ups or project development.

The vision of Ntsika is to be a leading and dynamic national agency that supports and develops a vibrant and thriving small, medium and micro enterprise sector.

The mission of Ntsika is to render an efficient and effective promotion and support service to the SMME sector through intermediary organisations and to contribute towards equitable economic growth in South Africa .

6.2.2 Strategic goals

Through an extensive consultative process driven by the broad spectrum of SMME needs, national imperatives and government priorities, the following strategic goals have been identified by Ntsika:

- To identify and develop SMMEs to service identified market opportunities.

- To identify and develop markets with the objective of increasing opportunities for SMMEs.

- To facilitate business linkages between SMMEs and identified market opportunities.

- To co-ordinate, conduct and provide research, information and expert advice regarding SMME development.

- To promote the products and services of Ntsika through interaction with a broad range of stakeholders with the objective of creating business opportunities for Ntsika.

Markets are imperative to the development and sustainability of enterprise. Interventions, therefore, are designed to assist SMMEs to take advantage of market opportunities in order to promote their viability. This approach ensures that support given to enterprise translates into increased economic growth. SMMEs are supported through the provision of training, information and technical assistance.

Ntsika pursues its strategic goals through integrated programmes in the following three functional areas:

6.2.2.1SMME Supplier Development

Supplier Development is aimed at developing potential entrepreneurs to be able to start up new ventures and to enhance the capacity of existing entrepreneurs, in the growth and expansion stage of the business life cycle, to service market opportunities.

The interventions under Supplier Development include the following:

- Training (skills and business development)
- Information and Referral
- Technical Assistance.
- Cocooning and Incubation.

6.2.2.2Market Development and Business Linkage

Market Development is aimed at identifying business opportunities for entrepreneurs and developing their procurement potential via access to a network of goods and services. Market development will include business linkage activities aimed at assisting SMMEs to access appropriate markets through linkages, partnership development and fostering sustainable business relationships beneficial to these suppliers.

The interventions under Market Development and Business Linkages include the following:

- Identification of Business Opportunities.
- Facilitation of Access to Markets.
- Business Linkages.

6.2.2.3Programme Design, Research and Information

This is aimed at coordinating and conducting research on SMME development, the provision of relevant SMME-related information and expert advice regarding SMME programme and strategy design.

The interventions under Programme Design, Research and Information include the following:

- SMME Programme Design Services.
- SMME Research.
- Production and dissemination of relevant information and material.

It is through unblocking opportunities for SMMEs and using a market development approach that the following objectives can be realised:

- Creating a net increase in the number of Small Businesses.
- Maximising the contributions of small businesses to employment.
- Increasing outputs on growth sectors to contribute to the GDP.
- Improving the competitiveness of the SMME sector.

6.3 Khula Enterprise Finance Ltd

Khula Enterprise Finance Limited is an agency of the Department of Trade and Industry established in 1996 to facilitate access to credit for SMMEs through various delivery mechanisms. These include commercial banks, retail financial intermediaries (RFIs) and micro credit outlets (MCOs).

Khula is a wholesale finance institution, which means that entrepreneurs do not get assistance directly from Khula but through various institutions named above.

An impact study done by the Bureau of Market Research in 2001 showed that more than 1,5 million people benefited directly or indirectly from Khula's assistance since 1996. This is a remarkable achievement considering the reluctance of the formal banking sector to lend to small businesses due to the perceived risk associated with that market.

It is Khula's mandate to facilitate access to finance to previously disadvantaged individuals (P D I 's) through the use of retail financial institutions.

6.3.1 Khula Start

Khula's entry-level programme targeted mainly at the micro/survivalist sectors. The product utilises group-lending methodology with loans being made available to groups of rural women in the survivalist and/or micro industry. These loans are provided through a broad range of intermediary organisations called Micro Credit Organisations (MCO's). The loans are primarily made to first-time borrowers who need small amounts of money to maintain their dependants through survivalist economic activities. Larger loans are provided by Retail Financial Intermediaries through the Micro Lending Programme. The methodologies and the average loan sizes vary between group loans of R600 to individual loans of up to R500 000. In most instances, the borrowers are not able to access finance through the commercial banks for a number of reasons.

In the above mentioned programmes, extensive donor-funded capacity building programmes are conducted. The programmes aim to build the longevity of the lending organisations to levels of financial self-sufficiency within a pre-determined period of time.

The Khula Start programme has significantly increased its outreach capacity since inception three years ago. Having reached a peak of 22 Micro Credit Organisations (MCOs) in seven of the nine provinces, Khula reviewed the Khula Starts resulting in a reduction to 19 outlets. As at March 2001, the programme had reached 3 441 groups with 15000 individual borrowers and an average loan size of R908. An amount of R12 674 078 has been disbursed to group members while an amount of R4.1 million was provided to 19 MCOs as lending capital since inception.

The programme has been in full operation for a period of over three years. Over this period, the scheme has developed 22 micro credit outlets, with a field staff of just over 100 people in seven of the nine provinces. There are no KhulaStarts in the Western and Northern Cape Provinces. Between April and June 2001, a review of the KhulaStarts was undertaken and many of the issues affecting KhulaStarts were identified and steps taken to assist the MCOs. It is therefore envisaged that the KhulaStarts will improve their impact from a more solid and sustainable base into the future.

6.3.2The Credit Guarantee Scheme

It was taken over by Khula from the Small Business Development Corporation (The Individual Guarantee Scheme) in 1996.

This Scheme aims to assist the more established entrepreneur wishing to acquire or expand a business, or to access a bank loan whilst not in a position to provide the necessary security or collateral. The bank, in such an instance, has the option of applying for alternative security available in the form of the Khula Credit Guarantee. The scheme is currently available through 11 commercial banks. ABSA and Standard Bank have been the major performers under the Scheme with both banks still writing over 70% of total applications.

Khula maintains three other guarantee products:

- Institutional.
- Portfolio.
- Individual Guarantees.

The latter two schemes are designed to address risk sharing with the private sector in the absence of commercial banks of the participant.

In addition, Khula currently warehouses specialised donor-funded guarantee schemes such as:

- The DANIDA Business-to-Business Programme.

  The Technology Transfer Guarantee Fund.

- The Rehabilitation Fund – A Kwa-Zulu Natal initiative to assist entrepreneurs who suffered financial loss as a result of political violence in KZN.

Underpinning the above products is the Thuso Mentorship Programme wherein Khula has established a network of experienced mentors, both individual and organisations, to assist clients in terms of pre- and post-loan support.

6.3.3 Thuso Mentorship Programme

The Thuso Mentorship programme provides both pre-loan support (i.e. business plan development and advisory service) and post-loan assistance (i.e. rescue services and "after care" or mentoring) to small and medium entrepreneurs applying for commercial bank loans. The main objective of the scheme is to stimulate and increase the utilisation of the Khula Credit Guarantee Scheme by commercial banks. The mentorship scheme provides practical training and "on-the-job" support to entrepreneurs. It is planned that the mentorship programme will be extended to cover the Retail Financial Intermediaries (RFI) and the Equity Fund.

6.3.4Loans Division

The objective of the loans division is to provide debt financing, seed loans to support operational costs and capacity building.

The loan size granted by these RFIs could range from R100 to as much as R 2 million (Franchise Fund) in certain cases. The current average loan size amongst all RFIs is approximately R 29 323.

- The main Objectives of the Loans Division are:
- To provide interest-bearing debt to RFIs for on-lending to SMME's .
- To cover the operational shortfall of emerging/start-up RFIs.
- To provide non-interest bearing debt to emerging/start-up RFIs for on-lending to SMME's.
- To provide human resource training and development, Board training, mentorship, management information systems and debtor management systems to emerging/start-up RFIs.

6.3.5Private Equity Funds Programme

The Equity Funds are aimed at the top end of the market to assist entrepreneurs to expand or initiate a business. The Fund becomes an equity partner in the business and an agreed exit/profit sharing strategy is determined.

6.3.6The Khula Equity Fund

The Khula Equity Fund is the consolidation of its regional equity funds initially established by Khula Enterprise Finance Limited (Khula), the leader sponsor. The Fund is aimed at ensuring equitable access to risk capital by small and medium enterprises (SMME's) throughout South Africa. In addition to ensuring equitable access to capital by SMME's, the other unique feature of the Fund is its flexibility to offer pre and post funding support and other relevant technical assistance to SMME's in their portfolio companies. This is really aimed at filling the capacity gap defined as lack of management experience and skills on the part of most SMME's to run ventures on sound business practice.

The strategic role and function of the Khula Equity Fund is to create a vehicle to deliver risk capital to emerging enterprises which will create wealth, asset ownership and employment opportunities in the previously marginalized communities of South Africa.

The Khula Fund will target those communities and managers from previously marginalized communities who will benefit from a transfer of ownership of existing business or the expansion or acquisition of an existing one. The Fund will also consider investment in joint ventures and new businesses that offer substantial job creation prospects and a fair return on capital investment.

There are many sustainable private equity funds that have been brought into existence as empowerment vehicles but the Khula Equity Fund is the only one offering:

- Equitable access: the Fund will strive to ensure equitable access to risk capital by SMME's throughout South Africa without compromising the viability of the Fund itself.

- Technical assistance to portfolio companies: in addition to equity capital, the Fund will also provide management expertise, advise and counseling, plus a network of resources useful to a growing company.

Khula Equity Fund was founded out of two incorporated entities in 1998 New Cape Equity Fund and MKN Equity Fund, both incorporated as limited liability companies with autonomous boards of directors under the South African Companies Act.

The appointed fund management of the Khula Equity Fund is Firm Capital (Pty) Ltd.

Portfolio companies in the Khula Equity Fund will be growth orientated, small and medium enterprises with the following characteristics:

- **Size of investment**: the initial investment in any company will range from R250 000 to R2 500 000.

- **Financial viability**: investment projects must exhibit, through realistic projections, valuation and exit plans, the potential for achieving its minimum hurdle rate of return of 25% IRR.

- **Regional**: projects will be based in the Republic of South Africa.

- **Innovation**: the Fund will tend to favour investment in businesses that have an innovative product or service.

- **Patient capital**: The Fund seeks longer-term (3-7 years) investments.

- **Ownership**: projects must be owned and managed by South African citizens.

- **Social benefits**: projects will result in ownership residing in or transferring to members of previously marginalized communities.

- **Industry diversification**: The Fund's investments will cover a broad range of businesses in a variety of industries. However, as a risk management tool, no more than 20% of the funds will be invested in any one industry.

- **Board representation**: The Fund will always require participation on the board of the investment.

- **Equity stake**: investments typically result in the fund owning a 26% to 49% minority share position depending on the valuation of the amount of capital sought.

6.4 The Small Medium Enterprise Development Programme (SMEDP)

The Small Medium Enterprise Development Programme (SMEDP) is a cash incentive for manufacturing, high value agriculture, agro-processing, aquaculture, agro-processing, biotechnology, tourism, and information and communication technology investments in South Africa.

The main objects of the programme are :

- Create wealth, generate employment.
- Develop entrepreneurship, promote empowerment.
- Utilise local raw material.
- Promote sustainability of recipient projects.
- Reduce investment cost for small and medium investors.
- Promote foreign investment.

The incentive is available to new or expansion projects:

- Local and Foreign firms will be assisted up to a total investment amount of R100 million in qualifying land and buildings, machinery, commercial vehicles and equipment in new projects or the expansion of existing projects.

- Legal entities, sole proprietors and partnerships engaged in manufacturing, high value agriculture, agro-processing, aquaculture, agro-processing, biotechnology, tourism, information and communication technology investments.

In the tourism sector the following criteria will be used to judge projects :

- Enterprises located in South Africa.

- New projects or expansion of existing projects.

- Businesses with a capacity expansion of at least 25% in accommodation and/or in qualifying assets (vehicles must be demonstrated).

- Providers of short-term accommodation, eg. hotels, bed and breakfast establishments, lodges and chalets.

- Tour operators serving tourists only.

- Business with funicular or private railways, aerial cableways, water transportation vehicles on dams, lakes and others.

- A tax-free cash grant for two years based on the cost of the investment in buildings, furniture, tourism equipment and vehicles.

- Additional cash grant for the third year to enterprises provided that the ratio of Human Resource remuneration expressed in terms of operational cost be a minimum of 30%.

- A maximum incentive of R3 050 000 per annum for enterprises with an investment in buildings, furniture, equipment and vehicles.

The following table reflects the levels of investment required to qualify for grants

Level of Investment	**Cumulative grant (As a % of investment)**
First R0 – R 5 million	10% p.a
Above R5 – R15 million	6% p.a
Above R15 – R30 million	4 % p.a
Above R30 – R50 million	3% p.a
Above R50 – R70 million	2% p.a
Above R75 – R100 million	1% p.a

In the manufacturing sector the grants are based on the following criteria:

- Businesses located in South Africa.
- New projects or expansion of existing projects.
- Businesses able to demonstrate a minimum of 35% increased investment in machinery and equipment at a cost as determined in the base year.
- Businesses classified as manufacturing per SIC.

6.5 Export Marketing & Investment Assistance

Trade & Investment South Africa (TISA) is responsible for the management of the Export Marketing & Investment Assistance Scheme (EMIA).

The purpose of assistance under the EMIA scheme is to partially compensate exporters for certain costs incurred in respect of activities aimed at developing export markets for South African products & services and to recruit new foreign direct investment into South Africa.

The key objectives of this scheme are:

- Developing and promoting exports from South Africa.

- Black Economic Empowerment (BEE) and Women Empowerment (WE).

- Small Medium & Micro Enterprise (SMME) development Geographic spread of economic activity.

- Competitiveness.

- Employment.

- Growth.

- Attracting Foreign Direct Investments (FDI) into South Africa.

- Encourage domestic investments.

This scheme is offered to the following enterprises :

- South African manufacturers, including SMMEs, PDIs and other owned businesses.

- South African export trading houses.

- South African commission agents representing at least three SMMEs or PDI owned businesses.

- South African Export Councils, Industry Associations and Joint Action Groups.

The scheme also provides assistance to South African exporters to introduce South African products to foreign markets by participating in suitable foreign exhibitions.This scheme applies to exhibitions in which South Africa participates officially by means of a National Pavilion.EMIA makes arrangements and bears the cost of space rental, construction and maintenance of stands, electricity and water charges as well as freight costs up to a maximum of three cubic meters or two tons per exhibitor.

Individual participation in Exhibitions is also provided to exporters to exhibit products at recognized international exhibitions abroad where EMIA does not provide for a National Pavilion.

Outward Selling Trade Missions also funded by EMIA, provide assistance to South African exporters who wish to make contact with foreign buyers with a view to concluding new export orders.

The Scheme also provides assistance to South African enterprises participating in Outward Investment Recruitment Missions with a view to encourage and attract foreign direct investment into South Africa.

Assistance is provided to organizers of Inward Buying Trade Missions to enable prospective buyers to make contact with South African exporters to conclude export orders. The mission must be organized by a qualifying organisation, export council, TISA or the department of trade and industry

Assistance is provided to organizers of inward investment missions to facilitate foreign direct investment in South Africa. The mission must be organized by a qualifying organisation, export council, TISA or the department of Trade and Industry.

Primary Market Research is also supported and exporters are partially compensated for costs incurred in developing new export markets.

The costs of registration of patents, trade marks and quality marks relating to costs incurred relating to registration of a product in a foreign market, such as patents, trade marks and quality marks.

Foreign Direct Investment Research Assistance is provided to persons for costs incurred in recruiting new Foreign Direct Investment into South Africa through personal contact by visiting potential investors in foreign countries.

Sector Specific Assistance is provided to Export councils, industry associations, and groups of enterprises (three or more) representing and aiming to develop a particular sector of industry. The objectives of proposed projects must be in line with TISA's objectives of developing new export markets, broadening the export base and increasing the participation of BEEs and SMMEs.

Exporter Readiness Assessment assistance is provided to exporters to determine their export readiness by means of a comprehensive export readiness assessment.

Exporter Training assistance is provided to exporters to enhance their skills and knowledge of the export process, thereby enabling them to achieve competitiveness in the global market.

Assistance is provided on the following basis:

- Travel (Economy class).
- Daily subsistence.
- Transport of samples for specific events.
- Development of marketing materials for specific events.
- Product registration, e.g. patent registration, quality marks.
- Cost of setting up and/or managing an exhibition.
- Cost of brochures.
- Cost of registration and tutorial fees for targeted or comprehensive export training programme.
- Costs of conducting a comprehensive export readiness assessment.

Key Criteria for Qualification to the scheme:

- Export/production performance of the applicant.
- Export/marketing competence of person visiting foreign country.

- Potential available/accessible production/export product capacity.

- Extent of export marketing planning.

- Type of product for export and local sales performance.

- Level of labour absorption, location and technological requirements.

- Industry in which the venture operates or is planned.

- Membership with an export council (not compulsory but preferable).

6.6 National Empowerment Fund Venture Capital

The Fund will provide equity and quasi-equity finance for economic empowerment transactions involving Historically Disadvantaged Persons (HDP's). HDP's are defined as those persons or categories of persons who, prior to the new democratic dispensation marked by the adopt on and coming into force of the Constitution of the Republic of South Africa Act, 1996 (Act no 108 of 1996), were disadvantaged by unfair discrimination on the basis of their race and includes juristic persons or associations owned and controlled by such persons.

The overall aim of the Fund is to promote the involvement of individuals and/or groups from historically disadvantaged backgrounds in business. The Fund will therefore favour those investments in which attractive combinations of the following elements are involved:

- Involvement of managers from HDP's, especially women, at senior operational level;
- Active presence of the HDP investors, including women at board level;
- Broader empowerment participation such as Employee Share Ownership Plans (ESOP's) are promoted;
- Joint ventures between HDP's and non-HDP's with the objective of skills and technology transfer.

Terms of the Fund's investments

- The Fund will only fund transactions where HDP's have an equity interest and are operationally involved, at senior management level, post the Fund's investment.
- The Fund's investment in individual enterprises will be between R3 million and R10 million.
- The Fund will only invest in unlisted companies.

- The Fund will seek minority stakes in the businesses (up to 49%). The Fund may take majority stakes in certain instances where there is a clear mechanism for reducing the stake to below 49% in the short term.

- The Fund will invest directly into the underlying operating business rather than in an investment holding company.

- The Fund's investment horizon will be for a period of three to seven years.

- The Fund will prefer exits that promote HDP ownership in investee companies.

- The Fund will not invest in companies whose employment, health and safety or environmental records and/or policies fall short of South African government or internationally acceptable standards.

- The Fund shall invest in South African companies conducting business predominantly within South Africa.

- Investee companies will be required to adopt progressive, though commercial, policies with regard to recruitment, training, etc.

- The Fund will not provide 100% debt financing.

- The Fund will not purchase shares from existing shareholders, where the business is not beyond cash flow break even.

- The Fund will not purchase shares on behalf of third parties (warehousing).

- The Fund will reserve the right to nominate at least one person to the board of directors of the investee company.

Chapter Seven

Conclusion

SMMEs in South Africa, as in many other developed and developing nations, continue to make a substantial and ever-increasing contribution to economic activity and employment. The avenues through which this contribution manifests itself include creativity, innovation and competitiveness, all of which are distinguishing attributes of SMMEs. Moreover, smaller enterprises in South Africa tend to be less capital-intensive than larger enterprises – a particularly useful reality in the light of the shortage of capital and surplus of labour that characterises the country.

The positive contribution made by the SMME sector is highlighted by the following:

- In 2001 the contribution of SMMEs (excluding survivalist and micro (0) enterprises) to GDP was 36,1%, as opposed to 32,7% in 1995. SMMEs accounted for at least half of GDP in the agricultural and construction sectors, and more than 40% of GDP in the trade, catering and accommodation, as well as the transport, storage and communication sectors.

- In 2002 SMMEs employed 68,2% of people employed in the private sector, as opposed to 44% in 1995 and 53,9% in 2001.

Small enterprises constitute the most significant SMME employer, accounting for 21% of total SMME employment. The growth in employment by SMMEs is considerably faster than the growth in the contribution by SMMEs to GDP. This implies a very high labour absorption capacity of SMMEs.

- Retail employment in the survivalist size-class alone is 2,7 times bigger than in the large size-class. The significance of, for instance, spaza shops is clear.

- 84% of all retail enterprises are survivalist or micro-enterprises. (Again, the significance of spaza shops is highlighted.)

Similarly, 63% of all catering and accommodation enterprises are survivalist or micro-enterprises. This is in all likelihood indicative of the large number of bed-and-breakfast establishments in the country

- SMME growth remains robust, even during times of economic sluggishness. This attests to a strong move towards entrepreneurship during the last decade, and supports the view that proactive development of the SMME sector is a key ingredient for economic growth in South Africa.

- The rapid increase in new registrations since the mid- to late-1990s in the trade, transport, construction and mining sectors indicates an expectation of significant economic activity within these sectors. The significant increase in the number of CC registrations in the trade sector is particularly encouraging, given the relatively large number of employment opportunities created by SMMEs operating in this sector; likewise for the construction industry.

However, although the increasing importance of the SMME sector is to be welcomed, there are still some areas of concern:

- *The smaller the enterprise size-class, the less significant* (as an employer) that size-class tends to be in agriculture, forestry and fishing, manufacturing, finance & business services, and community, social & other personal services. Conversely, the smaller the enterprise size-class, the more significant (as an employer) that size-class is in construction and retail trade (including motor trade). Possible explanations for these differences in concentration include the ease of entry/ barriers to entry to certain sectors in the form of start-up costs, as well as training and infrastructure requirements and labour legislation constraints in some industries.

The relative labour intensity dictates of an industry are also likely to play a role, as are the vigours and rigours imposed by international competitiveness. These differences need to be recognized when making policy decisions and providing support to SMMEs.

- There are still substantial inter-provincial inequalities in terms of economic performance, job opportunities and poverty. Some 60% of all enterprises and approximately 70% of all SMMEs are concentrated in the three provinces with the largest GGPs, *viz* Gauteng, KwaZulu-Natal and the Western Cape. These three provinces are also responsible for virtually 70% of national employment.

- A very clear and somewhat disturbing pattern emerges when ownership by population group is examined: As the enterprise size-class increases, the percentage that is owned by Africans, Asians and Coloureds declines. Thus, while African, Asian and Coloured entrepreneurs dominate ownership of survivalist and micro-enterprises, White entrepreneurs dominate in very small, small, medium and large enterprises. The under-representation of African, Asian and Coloured South Africans in large, medium, small and even very small enterprises calls into the question the success with which SMME growth is addressing the issues of black economic empowerment and equitable growth.

- Female ownership of all non-VAT establishments in general, but African female ownership in particular, is dominant in the manufacturing, trade, community, social and personal sectors.

(These businesses account for 85% of all the non-VAT establishments under review.) : Stats S.A. 2001

In addition, half of the African-owned businesses in the agriculture and financial and business services sectors are owned by females. The predominance of female-owned businesses is a double-edged sword: The high prevalence of female entrepreneurship is to be welcomed; but most of this involvement is in the survivalist or micro-enterprise area of entrepreneurship – by definition, wealth and employment generated here is constrained.

- Ownership constraints are particularly severe for entrepreneurs in rural areas and for women, who face their own unique set of deterrents, such as cultural and behavioral norms, and problems regarding access to land.

- In some instances labour legislation prevents low-wage competition, thereby discouraging labour intensive activity in favour of capital-intensive enterprises. In this way, the job-creating potential of the SMME sector is not being fully realised. Moreover, in a globally competitive business world, characterised by trade liberalisation, relatively high wages for unskilled labour in South Africa results in jobs being effectively exported to low-wage countries.

The SMME sector is indispensable in South Africa's quest for a higher economic growth path, which is, in turn, a prerequisite for employment creation, poverty alleviation and the narrowing of the wealth and income gap. This report highlights some of the constraints that stakeholders need to acknowledge and dilute in pursuit of the achievement of the true capacity and potential of the SMME sector.

Included amongst these constraints are the legal and regulatory environment, problems in gaining access to the market, finance and suitable business premises, difficulties in acquiring the needed skills and managerial expertise, obstacles in gaining access to appropriate resources and technology, inadequate infrastructure (especially in poverty and rural areas), bureaucratic hurdles, and restrictive labour legislation.

The need for concentrated (and appropriate) skills training and reasonable access to "seed money" is undeniable.

Whereas the 1995 strategy lumped together Small, Medium and Micro enterprises the Integrated Small Business Development Strategy in South Africa 2004 – 2014 suggests that Service institutions such as Ntsika should revise its focus on the promotion of opportunity entrepreneurship and view the SMME market as two entities the Small and Medium and the Small and Micro enterprises.

Ntsika must also address the problems of fragmentation, duplication and resource scarcity, while this may seem a tall order there seems to be no other way out of the historical logjam of SMME development.
The challenge facing Ntsika and other development agencies is not of finances only but a combination of the factors of entrepreneurship, labour and finance.

The divide between the two well defined economies in South Africa seem insurmountable, and while the alleviation of poverty is high on the agenda of the present government, the performance of the various agencies at the forefront of the governments efforts to assist SMMEs has not been optimal. By their own admission Ntsika of the Department of Trade and industry feels that their contribution has not been adequate." The fact is, we have been unable to make inroads at the micro level on a scale consistent with our 1996 objectives, our track records is therefore disappointing in that we have either not adequately trained large numbers of micro enterprises, or attracted the desired success rate of those we have worked with." Ntsika chief executive

Lefa Mallane as quoted in Enterprise Magazine Nov 2004 Vol 192(page 14)

The growth rates of the countries in the Indian Sub continent and Malaysia and Korea indicates that the vibrant SMME sector plays a dramatic role in the economy of these countries. With the dearth of information that is available further studies as to the similarity and differences that exist between the approach adopted by these countries as opposed to the approach adopted by the authorities in South Africa need to be investigated.

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