



TRADE & INDUSTRIAL POLICY STRATEGIES

FINAL REPORT
REGULATORY BURDENS ON SMALL BUSINESS:
OPTIONS FOR IMPROVEMENT

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Trade & Industrial
Policy Strategies
(TIPS) is a research
organisation that
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ABBREVIATIONS

AFS	Annual Financial Statements
APSO	Federation of African Professional Staffing Organisations
BBBEE	Broad-Based Black Economic Empowerment Act No. 53 of 2003
BBC	Black Business Council
BCEA	Basic Conditions of Employment Act
BUSA	Business Unity South Africa
CC	Close Corporation
CCMA	Commission for Conciliation, Mediation and Arbitration
COIDA	Compensation for Occupational Injuries and Diseases Act No. 130 of 1993
CIDB	Construction Industry Development Board
CIPC	Companies and Intellectual Property Commission
CSI	Corporate Social Investment
DHET	Department of Higher Education and Training
DOL	Department of Labour
DPME	Department of Planning, Monitoring and Evaluation
DSBD	Department of Small Business Development
DTC	Davis Tax Commission
dti (the)	Department of Trade and Industry
EDD	Economic Development Department
EEA	Employment Equity Act
EESE	Enabling Environment for Sustainable Enterprise
EME	Exempted Micro-Enterprise
EPP	University of Cape Town Employment Promotion Programme
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
ILO	International Labour Organization
LMD	Labour Market Dynamics (Statistics South Africa publication)
LRA	Labour Relations Act No. 66 of 1995
MFMA	Municipal Finance Management Act of 2003
MOI	Memorandum of Incorporation
NCA	National Credit Act No. 34 of 2005
NPO	Non-Profit Company
NSBA	National Small Business Act No. 102 of 1996
OHSA	Occupational Health and Safety Act (OHSA) No. 85 of 1993
PEA	Private Employment Agency
PPPFA	Preferential Procurement Policy Framework Act No. 5 of 2000
PFMA	Public Finance Management Act of 1999
QSE	Qualifying Small Enterprise
RIA	Regulatory Impact Assessment
SAQA	South African Qualifications Authority
SARS	South African Revenue Service
SBC	Small Business Corporation
SDL	Skills Development Levy

SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SEIAS	Socio-Economic Impact Assessment System
SETA	Sector Education and Training Authority
SME	Small and Medium Enterprises
SMME	Small, Medium and Micro Enterprises
SOC	State Owned Company
SBC	Small Business Corporation
SBP	Small Business Project
STC	Secondary Tax on Companies
TIPS	Trade & Industry Policy Strategies
UIF	Unemployment Insurance Fund
UK	United Kingdom
US	United States
VAT	Value-Added Tax
WEF	World Economic Forum

EXECUTIVE SUMMARY

1. BACKGROUND AND AIMS

Compared to peer economies, small business accounts for a relatively limited share of the South African economy. World Bank data show that in South Africa less than 20% of all employed people are employers or self-employed. In contrast, the norm for upper middle income economies, excluding China, is around 40%. Self-employment tends to be mostly in smallholder agriculture, retail trade and food services.

The limited share of small business in South African society was entrenched under apartheid. Before 1994, government policies deliberately suppressed black small enterprise in a variety of ways; through restrictions on land ownership, city centres, financial services and education, and licencing requirements.

As a result of these measures, democratic South Africa did not inherit a large pool of small enterprises or the institutions and regulatory frameworks required to stimulate small businesses. The available data suggests that the transition to democracy has produced very limited growth in the small business sector. The data from 2008 to 2015, which are the most reliable statistics, shows that the number of small formal businesses remained virtually unchanged at around 600 000 during in this period.

Regulations impose costs on small business, through administrative requirements and as a result of their policy aims, for instance by requiring improved conditions for workers and imposing taxes. That said, alleviating unnecessary regulatory burdens will not by itself remedy the structural constraints that small businesses face. These constraints include the lack of appropriate market institutions; inadequate access to finance, assets and infrastructure; and skills shortages. In other words, reducing the regulatory burden is necessary but not sufficient to promote growth in small business.

In order to assist in improving the regulatory environment for small business, the Department of Performance, Monitoring and Evaluation (DPME) and Department of Small Business Development (DSBD) requested the Employment Promotion Programme (EPP) to contract Trade and Industrial Policy Strategies (TIPS) to conduct a study on the national regulatory burdens on small business. The broad objectives of the research project are:

1. To identify practical and viable ways to reduce the effective costs of legislation and regulations for small businesses, and
2. To understand broader stakeholder and departmental positions on relevant laws and regulations.

Specifically, TIPS was tasked:

- To research the administrative burden on small business,
- On that basis, to identify viable changes in rules and systems in order to reduce the regulatory burden on small business, and

- To indicate the main costs, benefits and risks to other stakeholders of the proposed changes.

The study was assisted by inputs from the DSBD and EPP Steering Committees. In this context, it was agreed that the study would address four regulatory areas:

1. Reporting and registration requirements, with a focus on national laws, especially around taxation, labour laws and the Companies and Intellectual Property Commission (CIPC);
2. State procurement procedures, which militate against small business in a variety of ways, ranging from the large scale of many contracts to rules against up-front payments;
3. The construction industry, which is subject to sector-specific regulation by both national and municipal government; and
4. Broad-Based Black Economic Empowerment (BBBEE) compliance, which may simultaneously burden smaller white-owned producers and reduce barriers to entry for new black-owned businesses.

2. SCOPE AND METHODOLOGY

The effects of regulations on small business vary depending on their size, sector, formalisation and regional location. The research used Statistics South Africa's Labour Market Dynamics data to map out formal and informal enterprise, differentiated by size, in terms of their number, industrial distribution, income and human capital.

According to these data,

- There were just over two million formal and informal small businesses in South Africa in 2014. Informal micro enterprise comprised the majority in numbers, but the 700 000 formal enterprises dominated employment and production. Most informal businesses were small and precarious; only one in five had any employees at all.
- The majority of formal small businesses were in retail and construction, and they were disproportionately located in the metros.
- The median earnings for formal employers came to R12 000 a month in 2015, more than twice as high as the median pay for formal wage workers. In contrast, in the informal sector the median income for employers was R4000 a month and for the self-employed it was just R2000, little more than the pay of informal employees.
- In terms of demographics and human capital, less than half of formal small businesses were black owned; formal employers and self-employed people were relatively well educated; and young entrepreneurs comprised only a fifth of formal business owners.

The study does not extend to municipal regulations and requirements, which are subject to a separate process within government. National legislation does not usually directly affect informal self-employed people. It may however have some implications for larger informal businesses both because compliance may constitute a barrier to entry in some markets and

through the labour laws, which apply to all employers. For these reasons, the study concentrated on formal business of all sizes, as well as informal employers where relevant.

Existing research into the regulatory burden on small business has tended to focus on identifying, and in some cases attempting to quantify, the compliance burden in broad regulatory areas. Relatively few studies seek to propose specific reforms to either the legal requirements or procedures.

A number of surveys of business owners identify the functions of the state that they see as imposing the greatest burdens. The findings generally point to taxes, protections for labour, and government bureaucracy as the costliest cross cutting regulatory constraints.

These studies provide a useful frame for understanding regulatory issues and prioritising areas for reform. They do not, however, generate the detail needed for practical regulatory reforms. Moreover, the areas listed often conflate structural factors such as the nature of the financial market with regulatory issues such as the nature of tax and labour laws.

Studies that seek to quantify overall regulatory costs do not share a common methodology. Still, in most cases the quantification is linearly additive. That is, these studies typically aggregate time and resources spent in an activity without differentiating between once-off implementation costs, on-going compliance costs and costs that are integral to the desired outcome. Most rely on self-reporting by business owners about the time and cost of compliance, as well as sometimes rather adventurous assumptions about the amount of foregone income.

More fundamentally, the studies generally do not explore whether the cost burdens on small business are offset by benefits to other stakeholders. Identifying and successfully negotiating reforms, however, requires an understanding of the impacts on other groups.

The review of existing work on regulatory burdens for small business pointed to the importance of developing a methodology that would generate more specific reforms, and indicate their viability in political-economic terms. For this reason, the study here adopted a four-part methodology.

- 1) In each area reviewed, the study started with a detailed textual analysis of the laws and regulations in order to identify the likely costs, benefits and risks for small businesses and other stakeholders. The assessment pointed to a set of core hypotheses about how specific requirements would impact on small business. For this analysis, the study distinguishes between administrative costs, whether initial once-off requirements or on-going burdens, and costs that are integral to the aims of the law, such as paying tax, maintaining minimum labour standards, or bringing in black investors.
- 2) The study then undertook an empirical test of the arguments derived from the textual analysis. To this end, it utilised both qualitative and quantitative information. The main sources were individual and group interviews with small business owners and officials, analysis of implementation systems and procedures, and reports on key outcomes and outputs such as turnaround times and figures for compliance with specific requirements.
- 3) Based on the validated arguments about each regulatory area, the study then indicates a set of remedial options, which are tested using the Socio-Economic Impact Assessment System (SEIAS) approach. The SEIAS approach requires (a) evaluation of alternative options, one of which should not require a legal amendment; (b) assessment of costs

and benefits to different stakeholders; and (c) evaluation of risks. Using this approach should permit improvements in the preferred measure through mitigation of risks by maximising the net benefits. It should also assist in understanding of the likely impact on all stakeholders, and by extension the broader viability and desirability of the proposed reforms.

- 4) Finally, for each proposal the study indicates the relevant departments and agencies that must be engaged in order to implement the proposed reforms.

3. CORE FINDINGS AND PROPOSALS

3.1. Registration and reporting

Requirements to register with and report information to state agencies form the core of red tape as commonly understood. These kinds of obligations arise from many laws and regulations because the state has an interest in identifying relevant businesses and knowing information about them, in particular for the purposes of:

- Determining legal status and liability in contracts,
- Levying taxes and rates,
- Providing targeted infrastructure and other services to businesses, and where relevant ensuring payment for them, and

Ensuring adherence to standards, especially in terms of the environment, labour and consumer safety – in effect, in order to ensure internalisation of externalities for businesses.

This section focuses on three main groups of laws, which constitute the minimum to which all formal enterprises, irrespective of industry, have to conform. The areas are:

- The Companies Act and the Cooperatives Development Act as administered by the Companies and Intellectual Property Commission (CIPC), which falls under the Department of Trade and Industry (dti)
- Tax legislation administered by the South African Revenue Services (SARS), and
- Labour registration administered by the Department of Labour and its agencies.

3.1.1. Company and co-operatives registration

The two most significant issues that emerged from the analysis of burdens pertaining to company and cooperatives registration were:

- Annual Returns for companies, and
- Compulsory audits for cooperatives.

Small businesses argue that the Annual Returns required by the CIPC are onerous because they do not have a fixed date, but must be filed on the anniversary of a company's original registration; include information that is also covered in tax returns; and can lead to deregistration if the relevant deadlines are missed.

The CIPC argues that Annual Returns are important for ensuring good governance of registered companies. In addition, although fees from annual returns are not particularly high, taken together they contribute just over half of the CIPC's budget.

Assessment of the costs, benefits and risks of various possibilities for reducing the regulatory burden of Annual Returns indicates that the preferred option is to integrate CIPC Annual Returns with SARS.

There is an overlap between CIPC and SARS reporting requirements for certain types of businesses, therefore there is a strong case for integration, which will not undermine indicators of sound corporate governance in reporting businesses. The fees for the Annual Returns could be levied as part of normal tax assessment and then transferred to the CIPC.

The main challenge is that both SARS and the CIPC have capacity constraints in maintaining their databases. It would be important to manage and fund the transfer to the new system and the interface between SARS and the CIPC in order to secure both CIPC revenues and the integrity of the registry. The cost of the transfer should be assessed before finalisation of the proposed reform.

Under this proposal, inactive or dormant companies would still file their Annual Returns with CIPC, since they do not pay tax. They would have to provide evidence of dormancy (such as a bank statement with no transactions) and could be enabled to file Annual Returns free or at a minimal fee.

A second challenge around CIPC reporting is that under the Co-operatives Development Act, most co-ops are required to submit audited financial statements. That imposes a considerable expense, which does not apply to any other small enterprise. This is in contrast to the Company's Act which has specified thresholds over which enterprises are required to submit audited annual financial statements. The Cooperatives Act permits exemptions where the cost of audits would be prohibitive, but no detailed guidelines have been provided.

The analysis found that the preferred option to reduce the burden on co-ops would be:

- To clarify the exemption criteria,
- To amend the law such that audits are only required when a cooperative reaches a particular threshold, which could be harmonised with the Public Interest Score in the Companies Act, and
- To explore ways to improve bookkeeping at co-ops, for instance through incubators or assistance from sefa.

A policy to interpret the exemption criteria could effectively make the audit a specific requirement for larger co-ops rather than a default for all of them. For instance, an audit would be required where:

- The costs would not affect the financial sustainability of the co-operative, based on bright-line criteria such as a specific share of the audit in revenues; and
- The co-operative is unable to provide any financial records.

Engagement on these proposals would require interaction with the CIPC and SARS, as well as their oversight departments – respectively the dti and the National Treasury.

Responsibility for co-ops has been transferred from the dti to the DSBD, which presumably is now also responsible for the Cooperatives Development Act.

3.1.2. Taxation

With regards to tax administration, a number of issues arise. The most important are:

- Delays and unpredictability around refunds of Value Added Tax (VAT) payments, often as a result of audits; and
- Shortcomings in the income tax regime established for small business.

VAT refunds tend to be larger relative to turnover for smaller businesses than for larger ones. For businesses with under R1 million in turnover, VAT refunds totalled almost R4 billion in 2015/6. That equalled over 95% of their VAT payments and 7% of their aggregate turnover. For businesses with R1 million to R10 million turnover, VAT refunds totalled R10 billion, equal to a quarter of their VAT payments and 1,3% of turnover. Businesses with over R10 billion turnover had almost R150 billion in refunds, with was equal to 60% of their VAT payments and 1,4% of their turnover.

Given the importance of VAT refunds for small businesses, delays can have a significant impact on cash flow. This is especially true when they are unpredictable, making it more difficult to plan around them.

SARS reports that in 2015/6, the average turnaround time for VAT refunds was 33 working days, although SARS's target was 21. Although over half of refunds were paid within 48 hours (up from 3% ten years earlier) and two thirds within 14 working days, some were delayed over three months. SARS reports found that the delays were mainly due to inflated claims where VAT returns were not properly filled out. For informants, the main cause of delayed VAT refunds was that businesses were being put under audits, which was adding to the delay as SARS turnaround times for audits are between three and 12 months. SARS argues that VAT fraud was a key risk for its operations, with sole-traders seen as particularly challenging in this regard.

To address the challenges faced by small business, the preferred option is for small businesses to receive a mandatory refund after a specified period (for instance 90 days), even if they are still under audit. This measure would both improve predictability and cash flow for small businesses affected by audits, and incentive SARS to avoid unnecessary delays in audits and refunds. If an audit took more than the specified time, SARS could withhold later refunds if it uncovered excess payments.

The main risk is that other taxpayers would lobby for the same benefit. SARS would have to create clear criteria to prioritise audits according to size in order to avoid charges of discrimination.

In terms of the tax regime for small business, South Africa has adopted an approach of having a differentiated tax system for small business. National Treasury and SARS have long sought ways to reduce administrative costs without reducing revenues. Research indicates that the median small business requires the equivalent of over eight full working days a year to comply with the full panoply of tax requirements, including company income tax, VAT and administration of Pay-As-You-Earn taxes on employees.

Businesses with taxable earnings below R1 million pay around 4% of total company income tax, although they constitute 94% of all company taxpayers. They account for around 80% of companies that pay VAT, but contribute just 15% of VAT revenue. Businesses with taxable earnings of R1 million to R10 million account for 5% of income-tax payments but 12% of income-tax payers. In terms of VAT, they contribute 23% of payments but constitute only 15% of taxpayers. Companies with over R10 million in profits account for 1% of income-tax payers and 3% of VAT payers, but pay 84% of company income tax and 62% of VAT.

In 2009, SARS introduced the turnover tax regime to simplify the filing process. Under this regime, micro businesses with turnover under R1 million a year pay a percentage of turnover, rather than filing separately for income, VAT, capital gains and dividends tax. The maximum rate was initially 6%, but it was reduced to 3% in 2015.

SARS sees the turnover tax regime as a regime that reduces administrative costs for small business but diverts some of the savings into tax revenues. However, the regime has not had the expected support from small businesses. Informants perceive that the system does not reduce their tax costs and in some cases may even increase them relative to the normal requirements. This was particularly likely in the case of the original 6% maximum rate, which would likely end up with a higher bill unless taxable income was equal to at least 20% of turnover. As noted, the average margin on turnover for small business was around 10% in 2015.

The preferred option is to ensure that the rate charged under the Turnover Tax is always lower than the rate under other tax regimes. This would require monitoring the actual tax paid compared to turnover for micro enterprise under the recently introduced 3% rate. In effect, the turnover tax regime would shift from aiming solely to reduce administrative burdens to a commitment to avoiding higher taxation in return.

SARS and National Treasury would have to establish a system to monitor the impact of the turnover tax. They would also have to agree with this approach.

National Treasury is in the process of reviewing the tax regime for small businesses. DSBD should coordinate with National Treasury on this as a joint task team.

3.1.3. Labour registration: UIF, the Compensation Fund and the skills levy

The labour laws function in part by delegating administrative functions to employers. These functions appear when employers are required to register workers for unemployment and compensation insurance and for the skills levy as well as for the PAYE. From the standpoint of society, these requirements impose costs on both employers and employees in return for a variety of benefits that, ultimately, support a more productive and cohesive society.

Informants directed the study toward three issues:

- The difficulties involved in accessing the benefits of the skills development levy,
- The risk assessment process for COIDA, and
- The procedures for obtaining Private Employment Agency certificates.

The Skills Development Act prescribes that businesses with a salary bill of over R500 000 a year must pay 1% as a skills levy. However, evidence suggests that only 37% of small businesses that pay the skills levy are able to access funds for training. Only companies that pay less than R500 000 for employees – which effectively means they have from one to ten workers¹ – are exempt from the levy.

Various factors explain this lack of access. First, small business may find it difficult to claim from their Sector Education and Training Authorities (SETAs) because they cannot comply with requirements for skills planning due to a lack of capacity. Second, SETA training seeks to ensure workers' skills are transferable and can support certification. It may therefore require considerable technical proficiency, which may seem unnecessary and excessively time-consuming to small employers. Accredited learnerships require at least a year, which may seem excessive to small businesses, which would prefer shorter internships.

Proposals to reform the skills system to meet the needs of small employers generally focus on ensuring more flexible, focused and short-term training that would effectively do less to raise sectoral skill levels but would reduce the cost to employers. If this trade-off is accepted, then National Treasury and the Department of Higher Education and Training (DHET) could increase the threshold for small business. DHET could also introduce more flexible requirements for training for small business employees, with shorter modules that are less tied to accreditation and human capital development.

These modifications essentially aim to enhance training to benefit small businesses. That contrasts with the existing aims of the skills system, which are primarily to improve career mobility for workers and meet sector skills needs. There would therefore likely be some opposition from unions and policymakers in the skills field.

The Compensation Fund functions as an insurance fund, with legally required payments through the employer. Informants raised concerns around delays and arbitrary risk assessments (which affect the amounts levied from employers). At the same time, the Fund is clearly over-charging members, with an annual surplus that is more than equal to its total pay-outs. In 2016/17, it budgeted for investment revenue at R11 billion, revenue from assessments of businesses at R8 billion, but payments for compensation at just R4 billion. That means it would generate a surplus of R13 billion, which it planned to re-invest.

The Fund has only around 480 000 registered companies, even though almost all private employers outside of mining are legally required to join. It seems likely that many smaller businesses are not members at all, which means they do not pay but also that they do not benefit from the insurance provided to workers.

The preferred options for improving services from the Compensation Fund for smaller employers include:

- Reviewing the amounts paid by small business especially in light of the current large and unnecessary surplus, and
- Establishing an appeals system with short and efficient turnaround times for appealing against risk assessments.

¹ In full-time equivalent terms, based on 2015 pay figures from the LMD.

There would likely be opposition from the Compensation Fund to proposals that it should reduce assessments, although it might be more amenable to establishment of an appeals system on risk allocation. In addition, some unions might argue that the Fund should raise benefits rather than cutting levies on employers.

Finally, informants from the employment agencies argued that the procedures for obtaining a Private Employment Agency (PEA) certificate are unnecessarily onerous and long drawn out. They require paper letters from Department of Labour regional offices for good standing on UIF and COIDA, which may take over a year to obtain, as well as site visits by inspectors.

Representatives of the employment agencies' business association, the Federation of African Professional Staffing Organisations (APSO) argue that as a result a number of private employment agencies end up operating illegally. It is estimated that 3000 enterprises operate as employment agencies, but many are unlicensed. In effect, the unnecessarily slow and arduous registration process means that many agencies do not comply with any standards.

It is proposed that the letters on COIDA and the UIF be digitised and allocated a short turnaround time, and site inspections be randomised rather than a pre-condition for registration. Implementing these options will require that the Department of Labour develop the appropriate capacity to issue the letters more rapidly, and that its inspectorates are able to undertake random inspections sufficiently often to maintain standards.

3.2. State procurement

State procurement of goods and services accounts for around a tenth of the GDP. Small businesses, however, often argue that they are restricted from supplier opportunities created by government procurement in part because of inappropriate regulatory frameworks that impose excessive burdens.

In an effort to prevent corruption and improve value for money, the procurement laws aim to ensure that state agencies must buy the lowest-cost product that meets quality requirements, regardless of who supplies it. In order to achieve that end, supply-chain procedures are regulated tightly. Regulations detail requirements around the kinds of information required from suppliers in order to legitimise supplier agreements and the way in which procurement is managed depending on the size of tender.

A number of measures have been instituted recently by government in order to promote new suppliers and local procurement. They include providing points for preferential procurement; the designation of some strategic products for local procurement; the requirement that government pay suppliers within 30 days of invoicing; and the BBEE Codes, which include some incentives for local and small suppliers.

In practice, procurement legislation places considerable burdens on suppliers, which appear particularly onerous for smaller producers. They include:

- Delays in payments, with around 2,5% of the value of spending on goods and services at national level and almost 25% at provincial level, paid more than 30 days after invoicing;
- The ban on up-front payment on tenders, which may shut out small businesses with limited liquidity; and

- The lack of regulation to protect subcontractors on government tenders, which can lead to abuses such as delayed or non-existent payments; demands for delivery beyond the original agreement; and exploitative terms.

The preferred options recommended in this report are:

- To supplement the timeline for payments with set timeframes for disputes and appeals;
- To permit up-front payments of up to 25% in contracts with small business; and
- To develop and enforce a Code of Good Practice for subcontracting.

3.3. Construction

The construction industry has a disproportionate share of small businesses. Many small contractors argue however that they find it difficult to break into formal production. This is due to in part difficult sector specific regulations and general challenges in accessing tenders from government entities. This study has a section focused on the CIDB Act, which is a sector specific regulation aimed at facilitating access to government tenders for small construction contractors.

The CIDB Act provides for the establishment of the CIDB in order to implement an integrated strategy for the reconstruction, growth and development of the construction industry. Specifically,

- Businesses that want to bid for government construction tenders are required to register with the CIDB and, for larger tenders, to demonstrate appropriate competency.
- Government departments are expected to take the CIDB rating into account in construction tender processes.
- The CIDB provides some mentoring and support for emerging construction businesses so that they can gradually improve their competencies and bid for larger tenders.

Registration with the CIDB requires extensive documentation and is only paper based, which imposes significant costs in terms of time. Moreover, contractors have to demonstrate their capacity to manage contracts in financial and technical terms, which is often difficult. For instance, for a small business to qualify for contracts valued at up to R6,5 million, it has to demonstrate adequate financial capacity through one of the following:

- It has had turnover of at least R3,3 million in one of the past five years;
- It completed a contract worth R1,6 million in the past five years; or
- It has access to R700 000 in capital.

In effect, the need to meet capital requirements generates a vicious cycle: contractors cannot accumulate capital because they do not get tenders, but then they cannot get tenders because they have not accumulated capital. The situation ultimately arises because, as noted in the discussion on procurement, government agencies may not provide up-front financing.

Informants were mostly concerned that there seemed to be little payback to compensate for the effort of registering. Specifically, government tenders were still hard to get, which meant that the administrative costs loomed large. The CIDB itself estimates that the 650

enterprises on levels 8 and 9 account for 80% of the value of all tenders, out of a total of 150 000 registered (mostly on level 1) in 2016.

The lack of access to tenders could be addressed in part by requiring specified levels of subcontracting on larger tenders combined with regulations to ensure minimum standards for subcontractors. There should however be an effective mechanism to enable contractors to appeal against the requirement where an integrated process is technically imperative.

3.4. Broad-Based Black Economic Empowerment

The Broad-Based Black Economic Empowerment Act of 2003 support black-owned business, most of which is small, both by ensuring a preference in government procurement and by incentivising large businesses to support black-owned suppliers. At the same time, it may impose costs on white-owned small business, at least when they are competing with black-owned or empowered enterprises.

The **dti** has sought to reduce the burden on micro and black-owned small enterprise of obtaining a certificate of BBBEE compliance by permitting them to provide an affidavit. In contrast, larger businesses and white-owned small business must get a formal certification, which can prove costly and time consuming. Verification agencies are largely unregulated, and the amount of time required and the cost of a certificate varies widely.

The research was unable to quantify the substantive cost of BBBEE for white-owned enterprises, or the benefits to black-owned or empowered businesses. In terms of certification, the preferred options are:

- The National Treasury should be requested to issue a directive requiring procurement officers to accept affidavits for qualifying small enterprises, and the DSBD should set up a hotline for complaints on the issue.
- The **dti** should be requested to issue regulations on the amount of time and cost of certification, and all verification agencies should be publishing a list of fees according to specified criteria (for instance, the size of the enterprise and its sector).

REGULATORY BURDENS ON SMALL BUSINESS: OPTIONS FOR IMPROVEMENT

1. AIMS AND DELIVERABLES

At the request of the Department of Planning, Monitoring and Evaluation (DPME) and Department of Small Business Development (DSBD), the Employment Promotion Programme (EPP) contracted Trade & Industrial Policy Strategies (TIPS)² to assist in developing measures to reduce the regulatory burden on small business. Specifically, TIPS was tasked:

- To research the administrative burden on small business,
- On that basis, to identify specific, practical changes in rules and systems in order to reduce the regulatory burden on small business, and
- To indicate the main costs, benefits and risks to other stakeholders of the proposed options.

It is however not feasible to analyse and propose amendments to all regulations that affect small business in one project. For this reason, the project also aimed to develop and test a methodology that would enable on-going work within government to review regulatory burdens for small business with a view to identifying specific interventions to reduce them.

While addressing the regulatory burden on small business is important, it is not sufficient as it does not address all of the underlying structural constraints that they face. These constraints include inadequate access to finance, assets and infrastructure; the lack of appropriate market institutions; and skills shortages. From this standpoint, the proposals arising from this study should support growth in small business, but they will not by themselves unlock growth.

The study was assisted by inputs from the DSBD and EPP Steering Committees. In this context, it was agreed that the study would focus on four areas:

- Registration and reporting under tax, company registration and labour laws;
- State procurement;
- Construction; and
- Broad-Based Black Economic Empowerment (BBBEE).

It was agreed that the project would provide five deliverables:

1. An inception report
2. A draft research report, which includes a literature review on the existing research on the regulatory burdens on small business in South Africa and outlines the proposed research framework

² For a description of TIPS, see Annexure A.

3. A progress report, that includes a textual analysis of the relevant laws and regulations
4. A draft final report that would be circulated for comment to the DSBD and the EPP Steering Committee
5. A final report, with findings, recommendations and a set of briefing notes on options.

This study, which constitutes the final deliverable, starts with a brief assessment of the extent and nature of small business, which sets the context and motivation. It then reviews existing studies on small business in South Africa and indicates how this research takes them forward, and outlines the methodology used. Section five to eight, which constitutes the bulk of the study, provides an in-depth analysis of the four main regulatory areas, with respective proposals for regulatory reform. The final section provides a summary of the options and findings from the study.

2. PROBLEM STATEMENT: THE SMALL BUSINESS SHORTFALL IN SOUTH AFRICA

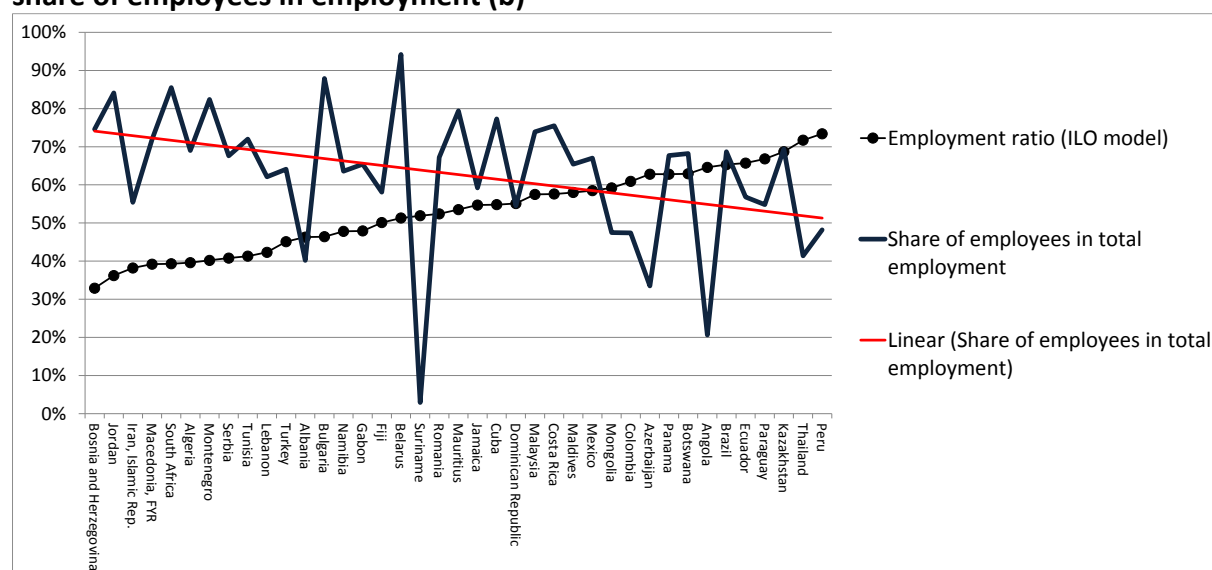
South Africa has an unusually low share of employers and self-employed people in the labour force, and a relatively low share of working age adults in employment at all. That in itself is a major factor behind high joblessness and the associated inequality and economic exclusion.

This chapter first reviews why the relatively small share of small business in the economy poses a broader challenge for social and economic development. It then outlines trends in the development and nature of small business in South Africa.

2.1. The implications of limited small business

In South Africa, less than 20% of all employed people are self-employed (an individual working independently with no employees) and employers. In contrast, the norm for upper middle income economies, excluding China, is around 40%. The evidence suggests that the lower the share of self-employment is related to the lower the level of employment overall, measured in the ratio of employment to working age population. Only 40% of South African adults have income-generating work, compared to almost 60% in other upper-middle-income economies excluding China.

Figure 1. Share of employees in employment, employment ratio (a) and linear trend for share of employees in employment (b)

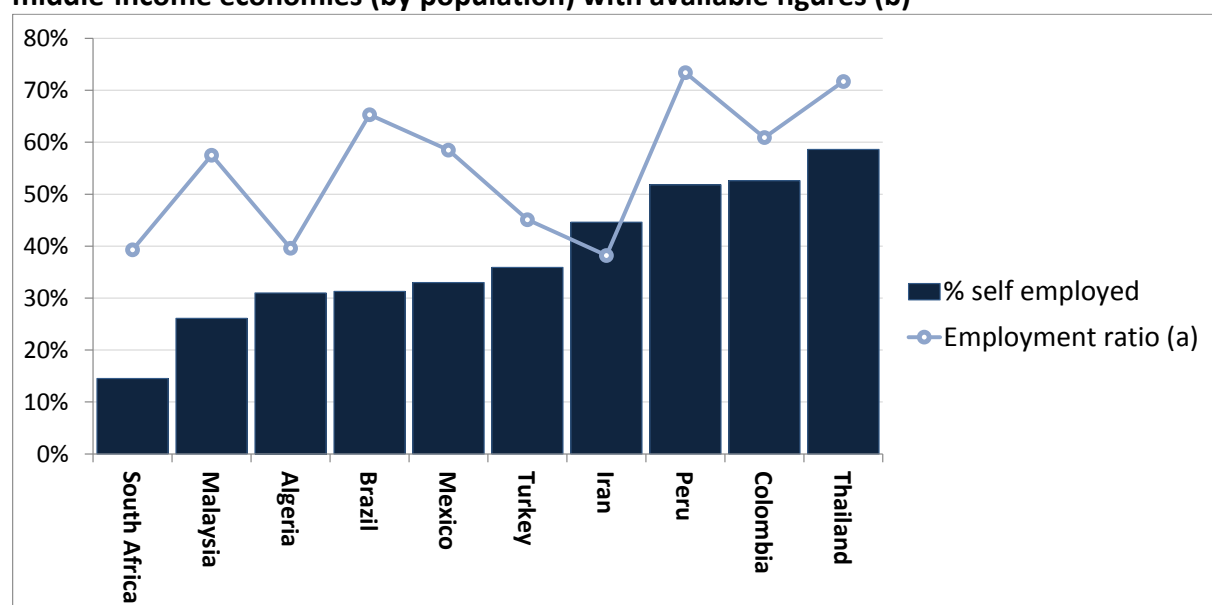


Source: World Bank. World Development Indicators. Electronic database. Series on Wage and salaried workers, total (% of total employed) and Employment to population ratio 15+, modelled ILO estimate. Downloaded from www.worldbank.org in June 2016.

Notes: (a) Share of employed in all working age adults. (b) Latest year from 2007 to 2013; most in 2010 to 2013.

A similar picture emerges if we compare South Africa with the ten countries that account for 80% of the population of the upper-middle-income economies.

Figure 2. Share of employees in employment and employment ratio (a) for largest upper-middle-income economies (by population) with available figures (b)



Source: World Bank. World Development Indicators. Electronic database. Series on Wage and salaried workers, total (% of total employed) and Employment to population ratio 15+, modelled ILO estimate. Downloaded from www.worldbank.org in June 2016.

Notes: (a) Share of employed in all working age adults (b) Latest year from 2007 to 2013; most in 2010 to 2013.

Historically, the shortfall in small business and self-employment in South Africa derives directly from apartheid. Apartheid laws suppressed small business in a number of ways, which can be summarised – rather schematically – as follows.

- During apartheid, black people in general and Africans in particular were largely prevented from conducting small-scale production and trade. They were also prevented from owning most kinds of land, most notoriously for farming but also retail and industrial sites in economic centres; had only limited access to credit; often did not receive key infrastructure such as roads, electricity and piped water; and faced myriad legal obstacles to economic activity.
- The suppression of small black-owned business was made possible in part by the strength of the mining sector. On the one hand, mining tended to attract skilled people and encourage contestation around the sharing of rents, rather than investment in new kinds of production. On the other, it laid the basis for a state industrialisation policy from the 1920s that generally focused support on large formal and energy-intensive ore and coal refineries and metals-based industries.
- Under apartheid, work organisation was generally designed to generate European incomes for owners and senior managers. The resulting workplaces tended to depend on a few highly skilled (and well-paid) individuals combined with low skill levels for most workers. Expectations of high incomes for owners and entrepreneurs have persisted into democracy, affecting investors' risk appetite and the kinds of enterprise they will support as well as staffing levels and work organisation.

These factors above meant that democratic South Africa started out with a smaller class of established small business than its peers. In other countries, small-scale entrepreneurs could build on long-standing family business assets, market connections and customers. A vast amount South African entrepreneurs often started without these advantages.

Moreover, in South Africa the institutions to support small businesses, in general but especially for black entrepreneurs, are variable and often simply absent. Large companies and government agencies often have procurement systems designed to acquire goods on a scale beyond the scope of small businesses; major providers of business services and credit focus on established clients; and emerging black entrepreneurs themselves often do not have social networks that can provide advice, contacts or financial support.

In this context, this study focuses on whether the current regulatory framework continues to impose unnecessary or inappropriate burdens on small business. Addressing these burdens will not in itself re-shape exclusionary economic systems. However, it should improve the environment for small business to a certain extent.

2.2. The extent and nature of small business in SA

The effects of regulations on small business vary depending on their size, sector, formalisation, regional location and ownership. To contextualise the regulatory analysis to follow, this section maps the small business landscape in South Africa. It reviews trends in the number of small businesses and their differentiation by size, industry, demography,

earnings, location and human capital. The analysis draws primarily from Statistics South Africa's Labour Market Dynamics (LMD) database, which starts in 2008.³

2.2.1. Categories and data sources

The 1996 Small Business Act categorises medium, small and micro enterprise according to employment size, turnover and asset value, with slight variations by sector. The publicly available transactional data on small business turnover and asset value, however, do not distinguish systematically by industry and tend to leave out the informal sector altogether. In contrast, the LMD provides information on the industry, income, location and formalisation of employers and the self-employed according to the number employed. It is therefore used here to indicate key characteristics of different business groups.

The LMD employment categories are similar, although not identical, to those in the current Small Business Act. For most of this analysis, the sizes used will be self-employed; one to 19 employees; 20 to 49; and 50 or more. These categories correspond reasonably well to the Act's categories of micro (zero to five employees) and very small (six to 20); small (21 to 50); and medium (50 to 100 or 200, depending on the sector) and large.

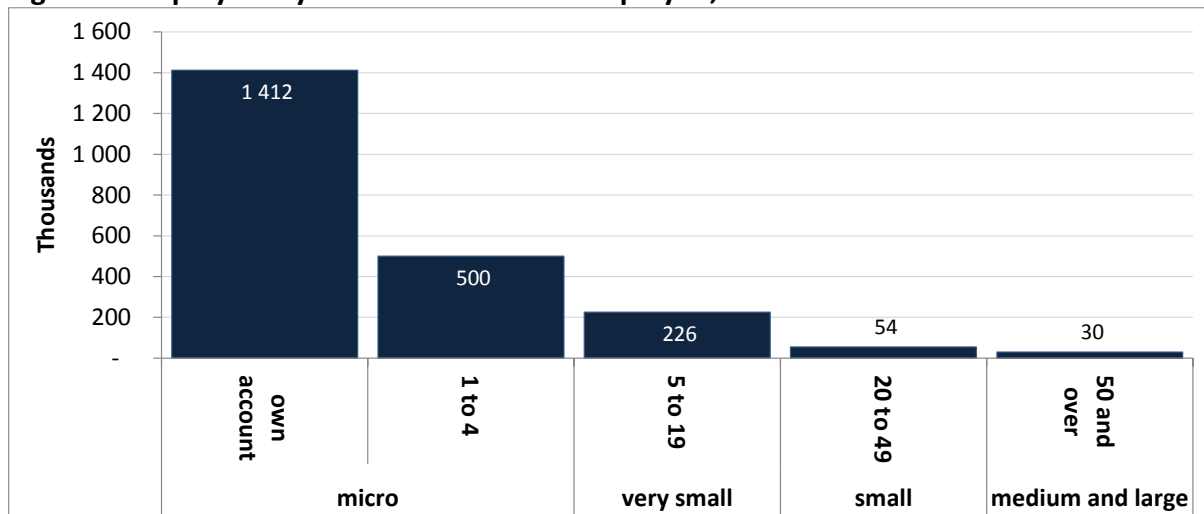
2.2.2. The number of small business and employment

The 2015 LMD found around 1,2 million self-employed people (also called "own-account" workers) and 830 000 employers with under 50 employees. These figures are reasonably well aligned with SARS data for company income tax, which reported a total of 702 000 companies registered for tax. Of these, almost 650 000 had taxable income between – R250 000 and R20 million.

In 2015, two thirds of businesspeople were self-employed, while almost a quarter employed fewer than five workers. One in ten employed between five and 19 workers, which would rate them as very small under the **dti** definition. Just 3% of all employers had more than 20 employees.

³ The LMD is an annual consolidation of Statistics South Africa's Quarterly Labour Force Survey, which is a household survey with 60 000 respondents. In 2015, the LMD included 3689 employers and 7074 self-employed/own account workers, excluding domestic workers. While these are significant samples, they become less reliable if divided on too many dimensions. That is particularly a problem for medium and large enterprises, where the samples become small.

Figure 3. Employers by number of workers employed, 2015



Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees and main work. Downloaded from Nesstar facility at www.statssa.gov.za in February 2017.

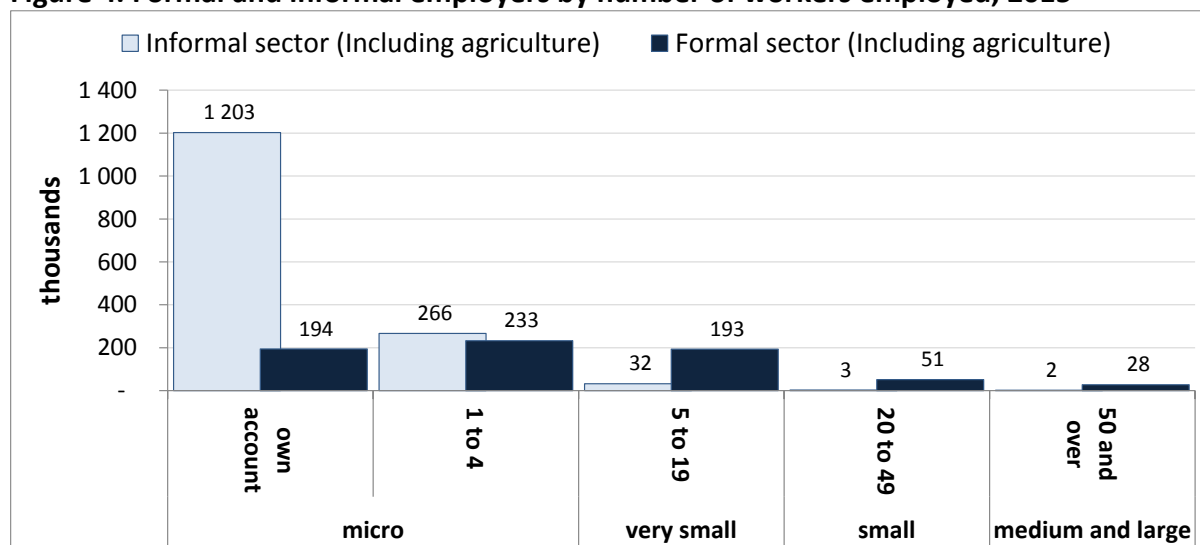
2.2.3. Formal and informal small business

In terms of the regulatory impact, informal enterprises generally are less affected by most national laws, such as tax, company registration and BBBEE. If they have employees, however, they are bound by the labour laws.

The vast majority of small employers were in the formal sector, while most informal enterprise had no employees. The formal sector had 500 000 employers (including commercial farmers) and 190 000 own-account workers. The informal sector contained 1,2 million self-employed workers but only 300 000 employers. In other words, the formal sector contributed over 60% of all employers, but less than 15% of the self-employed. In contrast, informal, domestic and small-scale farming accounted for 85% of the self-employed but under 40% of employers.

Self-employed workers made up one in four of formal businesses, but four out of five informal enterprises. Employers with up to 19 employees constituted two thirds of formal enterprise, but only a fifth of informal businesses.

Figure 4. Formal and informal employers by number of workers employed, 2015



Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees and main work. Downloaded from Nesstar facility at www.statssa.gov.za in February 2017.

While the vast majority of small businesses were informal micro enterprise, larger formal producers dominated employment and production. Formal small and micro enterprise, with fewer than 50 workers each, employed 4,3 million workers in 2015, while medium and large enterprise (excluding the public sector) provided jobs for a further 3,6 million. In contrast, the informal sector had 870 000 wage workers – far less than the number of informal self-employed. In addition, there were 1,3 million domestic employees.

With the exception of labour regulations, national regulations have a limited effect on informal micro enterprise, but they have significant impacts on all sizes of formal business. The remainder of this analysis will therefore focus on:

- Formal entrepreneurs, distinguishing the self-employed, micro and small employers, and medium and large employers; and
- Informal employers with up to 19 employees, excluding larger enterprises because the numbers are not statistically significant.

2.2.4. Small business by industry

According to the LMD, the bulk of small enterprises are found in trade, construction and business services. Around half of formal micro and very small entrepreneurs are in business services and retail. Small formal enterprises have a significant presence in construction. In contrast, informal employers are concentrated in construction and retail, with almost none in business services. In both the formal and informal sector, just under 10% of small business are in manufacturing. The heat-map below indicates the percentage of enterprises in the sample by sector, industry and size.

Table 1. Formal and informal employers/self-employed by industry and size, 2015

Sector	Formal			Informal	Total
	Self-employed	1 to 19	20 to 49	1 to 19	
Agriculture	1%	6%	15%	2%	4%
Mining	0%	0%	0%	0%	0%
Manufacturing	9%	9%	7%	8%	9%
Construction	6%	15%	19%	41%	21%
Logistics	13%	9%	4%	5%	8%
Trade	25%	26%	25%	28%	26%
Business services	30%	21%	19%	4%	17%
Community services	17%	14%	10%	12%	14%
<i>Total</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>
Number	194 000	426 000	51 000	298 000	969 000

Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees, main work, sector and industry. Downloaded from Nesstar facility at www.statssa.gov.za in February 2017.

Virtually all commercial agriculture ranks as small or micro enterprise. The survey finds no small business in mining.⁴

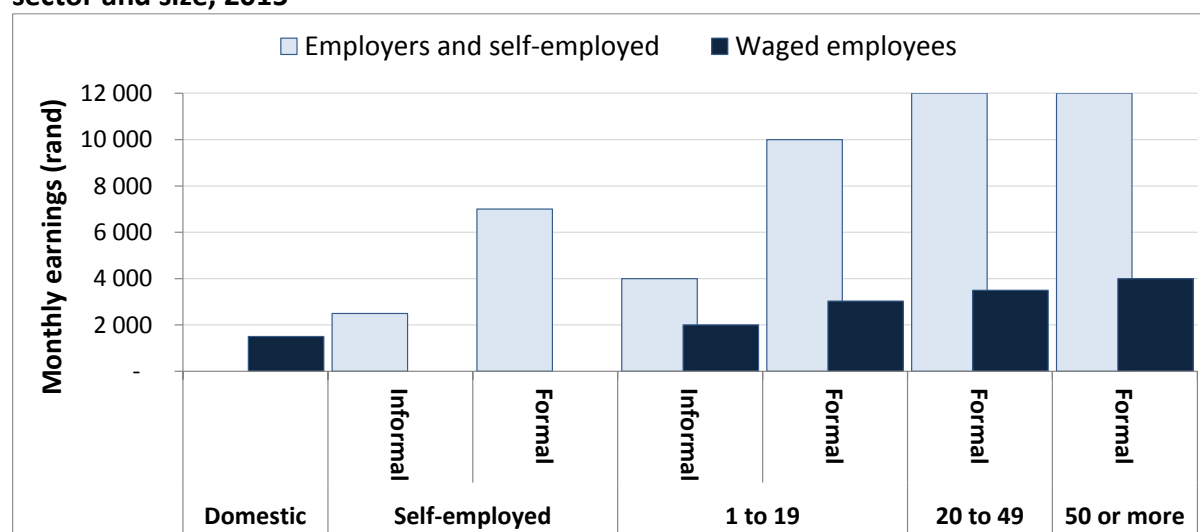
2.2.5. Earnings

Median earnings of employers and the self-employed, as reported by respondents in the survey, generally declined with the size of enterprise. They were substantially lower across informal business than in the formal sector; self-employed people in the informal sector generally earned less than waged employees in formal jobs. Median earnings for formal employers were more than twice as high as for wage workers, but in the informal sector there was much less difference between employers and employees.

Error! Reference source not found. below shows that in 2015 formal-sector earnings for business owners with micro and small enterprise ranged between R8000 and R12 000 a month. Informal employers had a median income of R4000 a month, while the informal self-employed earned just over half as much.

⁴ However, small business may play an auxiliary role in the mining value chain, providing repairs, after-service, ICT, office support and so on.

Figure 5. Median monthly earnings for the self-employed, employers and employees by sector and size, 2015



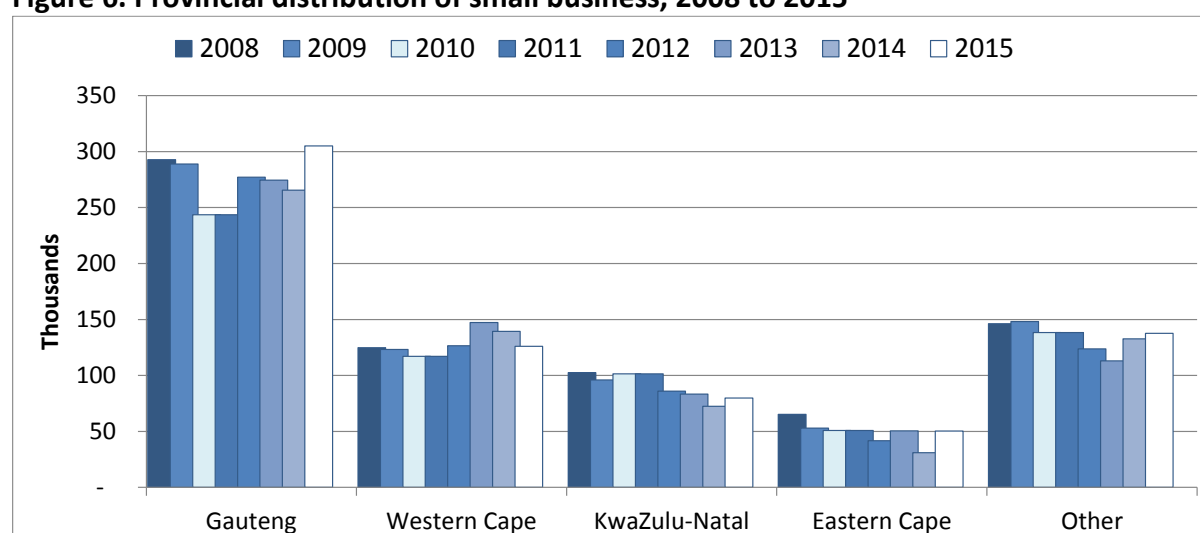
Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees, main work, sector and employer and employee monthly earnings. Downloaded from Nesstar facility at www.statssa.gov.za in February 2017.

2.2.6. Provincial distribution

Micro and small formal enterprises were found disproportionately in Gauteng, the Western Cape and KwaZulu-Natal. In contrast, Limpopo and Mpumalanga had a relatively large proportion of informal employers.

From 2008, Gauteng has accounted for two fifths of small enterprise, compared to around a quarter of the working-age population. The Western Cape held a fifth of small business and a ninth of the population, while KwaZulu-Natal had just over a tenth of small business and a fifth of the population. The other provinces taken together held a fifth of all small business and two fifths of the working age population. The shares of KwaZulu-Natal and, even more markedly, the Eastern Cape have tended to decline over the past eight years.

Figure 6. Provincial distribution of small business, 2008 to 2015



Source: Calculated from Statistics South Africa. Labour Market Dynamics databases for relevant years. Series on number of employees, main work and province. Downloaded from Nesstar facility at www.statssa.gov.za in relevant years.

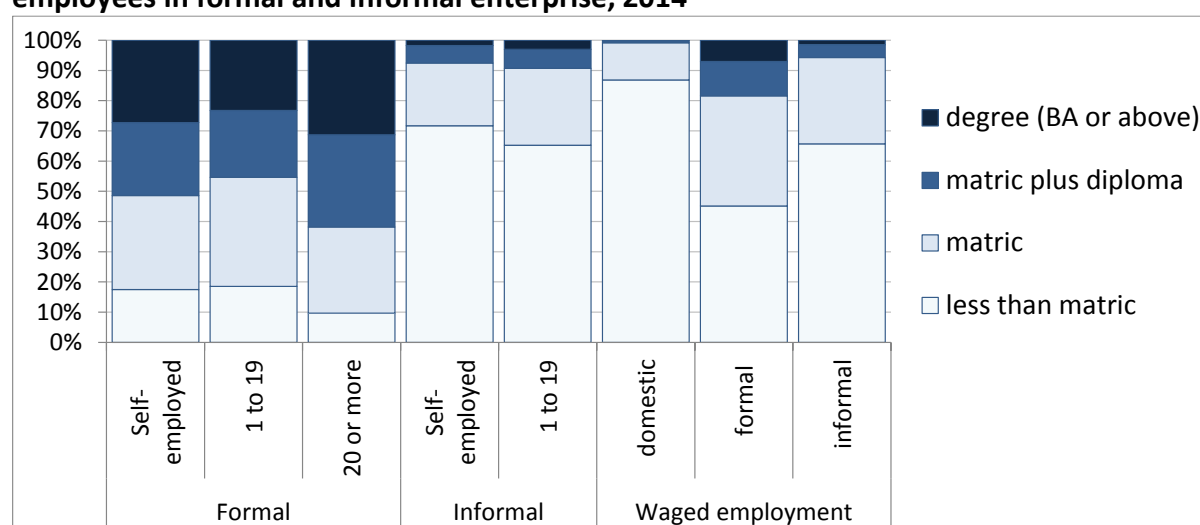
The provincial distribution of formal and informal enterprise largely reflected the legacies of apartheid. Formal private enterprise was under-represented in the former homeland regions, which hold 30% of the population but provide just over 15% of total employment. These areas housed around 6% of formal small business, but a more or less proportional share of informal enterprise. For every thousand people in the former homeland areas, there were 43 informal businesses but just four formal ones. In contrast, in the rest of the country, for every thousand inhabitants there were 40 informal businesses but 26 formal ones.

2.2.7. Human capital

As Figure 7 shows, formal employers and self-employed people often had high levels of formal education. In contrast, informal employers and self-employed people had less certified education than formal employees, and almost the same education as informal wage workers.

Around half of formal businesspeople had some post-secondary education, and a third had matric in 2015. Amongst private formal employees, just under 20% had post-secondary qualifications, 36% had matric, and 45% had not completed secondary school. In contrast, amongst informal employers, under 10% had a degree or a diploma, and around 25% had matric. For both self-employed people and wage workers in the informal sector, around 70% did not have matric.

Figure 7. Education status of employers, self-employed people and private-sector employees in formal and informal enterprise, 2014



Source: Calculated from Statistics South Africa. Labour Market Dynamics Survey, 2014. Electronic databases in SPSS format. Downloaded from www.statssa.gov.za.

2.2.8. Demography

Half of small formal enterprises were white-owned in 2015. The figure had fallen from around two thirds a decade earlier. More detail on ownership by race and gender is provided in Section 8 on broad-based black economic empowerment.

Given South Africa's history of exclusion based on race and gender, the unrepresentative nature of ownership has important implications for the regulation of small business. On the one hand, it means that most formal enterprise do not benefit from state efforts to reduce barriers to black entrepreneurs, and may even bear a cost from them. On the other hand,

mobilising government support may prove more difficult when the majority of direct beneficiaries belong to an historically privileged group.

Youth under 35 made up less than one in five formal entrepreneurs and one in three in the informal sector, but around half of all wage workers.

2.3. Implications for research

Generally, the LMD data show that there is a diversity of small business in South Africa. By extension, the analysis of regulatory burdens will have to take into account the divergence between groups, amongst others in terms of industry, size, demography and education levels.

Except for labour laws, national legislation does not apply to informal enterprise, by definition. The laws, however, affect micro as well as small and medium formal enterprise. The studies of priority areas will therefore analyse the impacts on all formal enterprise, irrespective of size, as well as informal employers.

Analysis of enterprises by race and gender also point to the importance of understanding trade-offs in regulatory burdens for existing and potential enterprise. In particular, laws to promote greater black representation in ownership and procurement may benefit emerging black-owned enterprise but burden existing white-owned producers.

3. EXISTING RESEARCH ON THE REGULATORY BURDEN IN SOUTH AFRICA

Research on small business constraints in South Africa spans public, private and academic studies. Studies have sought to identify constraints to small business growth and development, quantify the cost of regulatory burdens and propose remedies to alleviate the structural and regulatory burdens on small business. They have, however, generally focused on costing the regulatory burden, rather than on analysing how changes to specific laws and regulations could reduce the burdens on small business. As a result, studies typically point to areas where regulatory reform would reduce the burdens on small business, but do not indicate specific changes to rules or procedures.

3.1. Overall surveys of constraints on small business

A number of overall surveys of constraints on small business point to the importance of regulatory burdens, although they also indicate structural constraints. Structural constraints are defined here as the legacy of apartheid laws combined with the concentrated market structure typical of the inherited economy. Structural factors may arise without and indeed despite state efforts, for instance as a result of inequalities in ownership of capital, land and other assets; the nature of market institutions; the allocation of skills and access to education; and the way that established networks within business function. In contrast, the regulatory burden arises narrowly from the way that laws and regulations affect business.

A challenge with the overall reviews of regulatory burdens is that they require a vast amount of survey data in order to essentially end up listing broad areas that impinge on small business development, without much detail to guide remedial action. The areas listed often conflate structural and regulatory factors. This issue is most prominently demonstrated by international studies on constraints on small business that benchmark South Africa against other countries, such as the World Economic Forum (WEF) Global

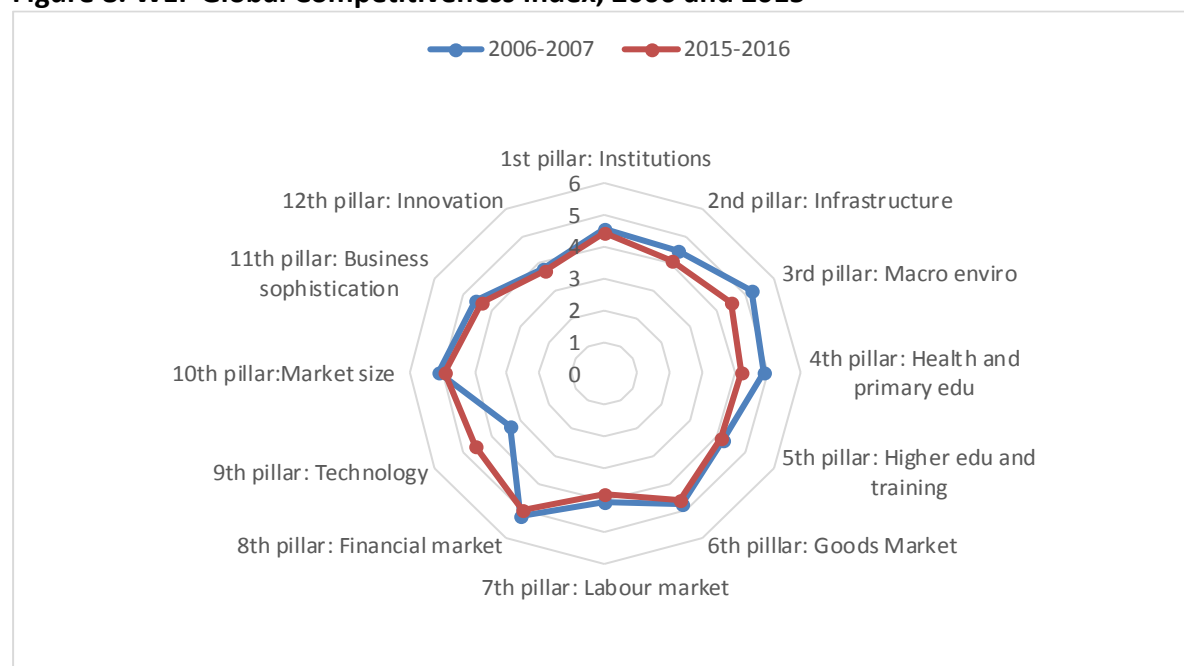
Competitiveness Index and the Global Entrepreneurship Monitor (GEM) National Expert Survey (NES).

The WEF's Global Competitiveness Report ranks countries based on an index that integrates the macroeconomic and micro/firm level aspects of competitiveness into a single indicator. The index is compiled using an executive opinion survey and by assessing publicly available articles and reports. It comprises of 12 pillars, namely: institutions, infrastructure, a stable macroeconomic framework, good health and primary education, higher education and training, an efficient goods markets, an efficient labour market, developed financial markets, the ability to harness the benefits of existing technologies, market size, sophisticated production processes and innovation.

South Africa achieved an overall score of 4,4 and was ranked 49th out of 140 countries in the 2015/16 WEF Global Competitiveness Index. That is a relative decline from the 2006 result of an overall score of 4,5 score and a ranking of 35th.

The 2015 results indicated that South Africa ranked highly according to its innovation, goods and financial market efficiency and infrastructure. However, the country was ranked low in terms of health and education, corruption and government regulation, crime and labour market flexibility.

Figure 8. WEF Global Competitiveness Index, 2006 and 2015



Source: World Economic Forum (2016) Downloaded from http://www3.weforum.org/docs/gcr/2015-2016/GCI_Dataset_2006-2015.xlsx in September 2016

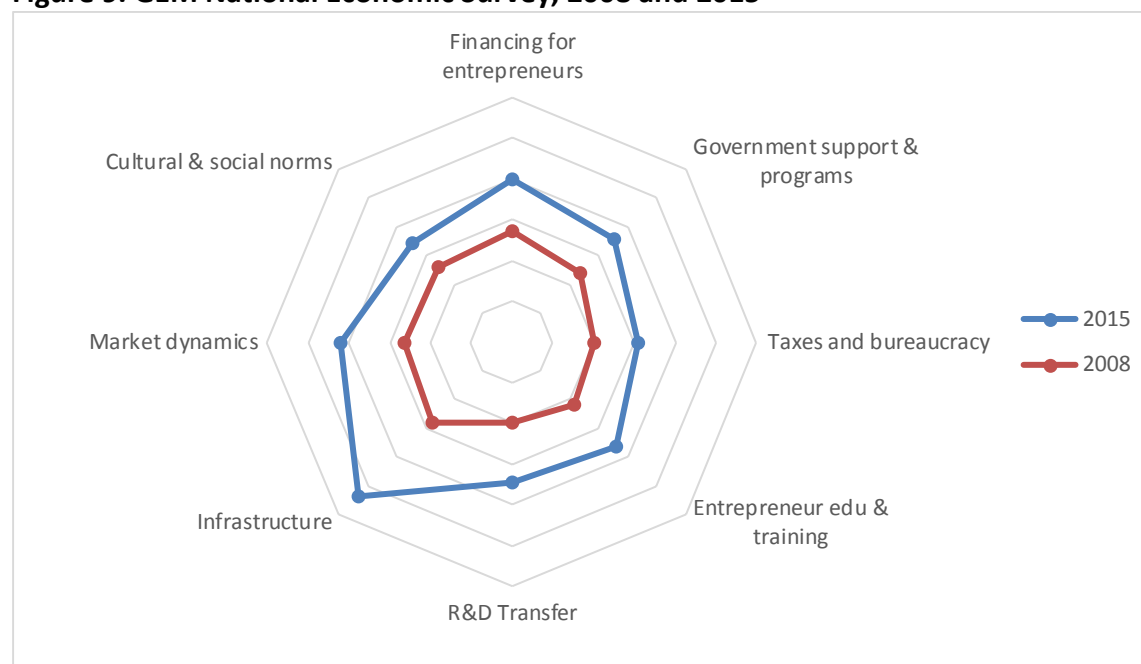
GEM was established in 1999 as a joint project between Babson College (USA) and the London Business School (UK). The aim was to consider why some countries are more “entrepreneurial” than others. GEM is currently one of the most prominent entrepreneurship research databases.

The GEM National Experts Survey captures expert judgements on specific national conditions pertaining to entrepreneurship. In contrast to the WEF Global Competitiveness Index which evaluates the economy as a whole, the GEM Survey focuses on factors or conditions that affect new business creation. The factors studied include: entrepreneurial

financing, government policy, government entrepreneurship support programs, the quality of entrepreneurship education within the education system, R&D transfer, commercial and legal infrastructure, entry regulation, market dynamism, physical infrastructure and cultural and social norms.

The GEM Survey found that the conditions for new businesses in South Africa improved from 2008 to 2015. The experts surveyed contended that South Africa has good infrastructure and a quality banking system, but that major constraints include poor education, government bureaucracy, crime and labour laws.

Figure 9. GEM National Economic Survey, 2008 and 2015

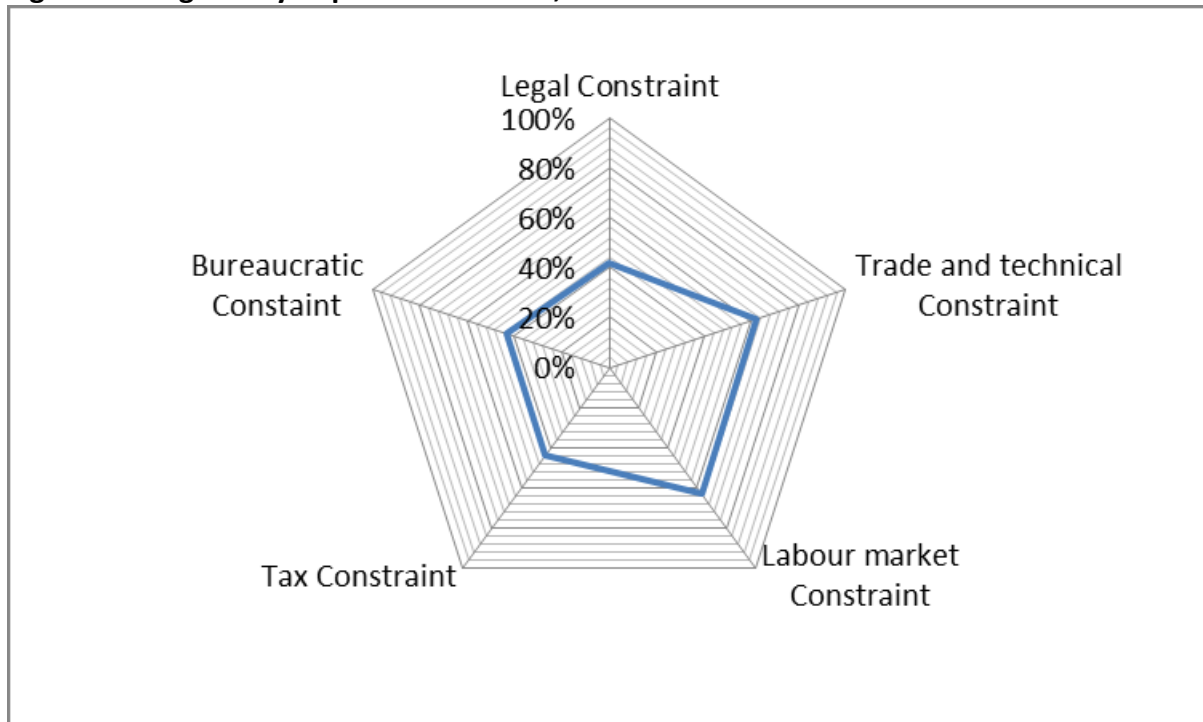


Source: Global Entrepreneurship Monitor (2016) Downloaded from <http://www.gemconsortium.org/data/sets> in September 2016

In addition to these international benchmarking studies, there have been a number of national efforts to identify how regulations affect small business in South Africa. Examples of these studies include the Economic Development Department's (EDD) Regulatory Impediments Index (EDD, 2012) and the Small Business Project (SBP) 2012 small business Growth Index (SBP, 2013).

The 2012 Regulatory Impediments Index was commissioned by EDD and derived from a survey covering 107 small business spread throughout South Africa. As demonstrated in the illustration below, the survey found that labour market constraints tend to be the most important indicator that limits business success. It was reported that small businesses found the existing labour laws to be too complex and punitive and that the complexity of dismissal procedures, specifically, renders the labour market inflexible (which in turn leads to repressive labour costs). The second most important factor was reported as trade and technical constraints. Small business pointed to burdensome procedures required for compliance to standards and specifications. Respondents indicated that they struggled with a lack of information on how to comply with trade and technical standards set by government.

Figure 10. Regulatory Impediments Index, 2012



Source: Economic Development Department (2012)

The findings of the Regulatory Impediments Index were echoed in the small business Growth Index. The small business Growth Index is a longitudinal study tracking a sample of 500 small business in manufacturing, business services and tourism from 2011 to 2013. It correlates small business constraints on whether the small business was growing or not in this period, as measured by increased employment.

Some 58% of the panel's responses cited structural issues such as lack of skills, burdensome regulations, local economic conditions, a lack of finance and the cost of labour as inhibiting the growth of their firms. When asked to identify primary sources of regulatory burdens in 2013, 26% of panellists responded that SARS inefficiencies were the key issue. This included problems with paying refunds, resolving disputes and difficulties in obtaining tax clearance certificates were cited as a source of frustration. A further 19% of respondents raised labour regulation as a burden. Issues with labour regulations included problems relating to bargaining councils, the Commission for Conciliation, Mediation and Arbitration (CCMA), Workman's Compensation and so on. Finally, issues with municipal by-laws were also raised.

Overall, the key challenge to the overall surveys on regulatory burdens on small business is that they require a significant amount of survey data to identify broad areas that impinge on small business development. While that is an important first step, further research is required to prioritise specific constraints and to indicate concrete legal and procedural reforms. Furthermore, on a conceptual level, these surveys conflate structural factors such as the nature of the financial market with regulatory issues such as the nature of tax and labour laws.

That said, the overall survey literature does indicate that labour laws, tax laws and government bureaucracy in general constitute the most burdensome regulatory constraints on small business.

3.2. Quantifying the regulatory burden

A number of studies have taken the regulatory burden issue further by attempting to quantify the cost of regulatory burdens to small business. The small business Growth Index, for instance, found that red tape for firms employing less than 50 employees can account for between 4% and 8% of turnover. The study reported that enterprises spent on average 75 hours a month dealing with red tape, or an equivalent of eight working days. Similarly, the SBP (2005) estimated that the total tax compliance costs for formal firms amounted to R20 billion in 2004. Another organisation, Upstart Business Strategies (2004), estimated that the total Value-Added Tax (VAT) compliance cost for small business ranges between R6000 and R8000 annually.

There is no standard methodology for quantifying regulatory costs for small businesses. Still, a challenge with the literature on this topic is that the quantification is generally linearly additive. Studies aggregate time or resources spent in an activity without differentiating between once-off implementation costs, on-going compliance costs and costs that are integral to the desired outcome. In addition, not enough consideration is put on whether cost burdens on small business may be offset by gains made by other stakeholders.

A further challenge with these studies is that they generally only indicate the overall burden, without exploring the specific factors that contribute to it. As a result, it is difficult for policymakers to identify which procedures or requirements should be modified to reduce the regulatory burden.

3.3. Proposed reforms

Lastly, some studies propose remedies to address the burden on small business in South Africa. The studies which focus on a specific sector or an area of regulation tend to generate the most useful recommendations for the purposes of the current project. Given that government bureaucracy in general, labour law and tax law were provided as the most burdensome, the literature review will assess studies that have proposed reforms to those regulations.

3.3.1. Permits, registrations and reporting

It has been found that the time costs of obtaining operating licenses and permits may be more onerous on small businesses than the actual financial cost (SBP, 2014). The time required to deal with regulations as well as the cost of consultants to assist with compliance is reported as severe. Furthermore, amendments to regulations are often unpredictable,

Government's response to these challenges was captured in the Department of Trade and Industry (2005) Review of Ten Years of Small Business Support in South Africa 1994 – 2004⁵ ("10-year Review") which made the following recommendations pertaining to reducing the administrative burdens on small business:

- Simplify regulations;
- Identify high priority regulations; and

⁵ The 10 Year Review synthesised recommendations from a number of previous studies on the regulatory burden.

- Set up a mechanism for regulatory impact assessments.

At national level it was also proposed that an inter-departmental consultative committee should be established to focus on small enterprise issues in order to help to accelerate progress and assess the potential impact of new legislation on small enterprises.

Following on these findings, the state initiated a number of measures to reduce the regulatory burden on small enterprise. In 2007, the government began to require Regulatory Impact Assessments (RIA) for new legislation and major regulations. RIA was not however implemented consistently. In 2014, the RIA process was replaced by the Socio-Economic Impact Assessment System (SEIAS), which has a focus on assessing costs and benefits of new regulation on a wider group of stakeholders, as well as identifying risks and proposing mitigation strategies for them. In addition, the CIPC initiated an online registration process for new business and SARS introduced a single registration process initiative. Both of these innovations aimed to reduce bureaucracy in registration and reporting.

The research into the burden on small business of registration and reporting requirements could usefully be extended by:

- Establishing a more comprehensive list of the remaining requirements, at least at national level, taking into account the reforms and other changes in the regulatory framework, with proposals on how they can be consolidated and simplified; and
- An assessment of whether technical support would enable small business to reduce the burden of compliance.

3.3.2. Labour laws

As the broader surveys analysed in section 3.1 indicated, South Africa's labour market conditions have been consistently characterised by surveys of small business as burdensome on the ability of small business to create employment. Labour relations in South Africa are defined primarily by the Labour Relations Act (LRA), the Basic Conditions and Employment Act (BCEA), the Employment Equity Act (EEA) and the Occupational Health and Safety Act (OHSA). For small business, critical issues are

- The extension of Bargaining Council agreements,
- The time required for dispute settlement procedures,
- The procedural requirements for disciplinary and productivity dismissals (retrenchments are substantially easier and faster), and
- The minimum standards set in the BCEA around wage determinations, paid leave, overtime and retrenchment pay.

The 1995 White Paper on National Strategy for the Development and Promotion of Small Business in South Africa ("the White Paper") acknowledged the perceived tension between the interests of employers and labour, particularly for small business where employers may need lower wage costs in order to compete with larger enterprises. It was also acknowledged that institutions governing labour relations are viewed as increasing the cost of labour and lowering the competitiveness of small business.

The White Paper, however, firmly asserted that established labour laws were in place in the interests of equity and that employers and workers should seek a more participatory and collaborative relationship. The White Paper proposed regulated flexibility of the labour market and simplicity in the collective bargaining process. Instead of exemptions from collective agreements or creating a dual labour system, the White Paper recommended that industrial councils should rather become more representative of all constituents in an industry, including small business. The White Paper affirmed the need for basic standards in the treatment of labour even if enterprises operate outside of collective bargaining regimes.

The Presidency's Ten Year Review reaffirmed the continuing tension between small-scale entrepreneurs on the one hand, who often view minimum labour standards as costly and detrimental to competitiveness, and workers on the other hand, who seek improved remuneration levels and general employment conditions. The 10-Year Review noted that more inclusive negotiations systems would alleviate some of these contradictions, but they could also lead to slower negotiation processes. Moreover, in practice large businesses often have more capacity for negotiations and therefore effectively determine the outcomes.

A paper by Rankin in the 2005/6 National Regulatory Review for Small Businesses commissioned by Presidency investigated the specific impacts of the LRA on small business. The paper found that the concept of regulated flexibility in labour relations had not taken full effect. The paper argued that both hiring and disciplinary measures short of dismissals should be regulated by collective bargaining or structured worker participation processes rather than going through the courts, and that the procedural requirements for dismissals by small business should be simplified. It also argued that basic conditions of employment should be negotiated at sectoral level rather than being subject to national legislation.

A paper by Benjamin and Gruel in the 2005/6 Regulatory Review attempted to assess the efficiency of CCMA processes. This analysis was not definitive regarding the efficacy of CCMA procedures but did raise two points: 1) that there are stark variations in patterns of dispute referrals and determinations on the basis of sectors and regions, and 2) that the CCMA was not living up to its envisaged mandate of providing a simplified, non-legalistic, non-jurisdictional dispute resolution mechanism and the rising level of *in limine* and rescission applications⁶ was indicative of this. An analysis conducted by the Small Business Project (SBP, 2013) showed that firms employing less than 50 employees spent 11 staff days on average per case at the CCMA.

In summary, the existing research indicates that there is an ongoing tension between affirming the rights of workers and mitigating the regulatory burden on small business. The state has been firm that a dual labour market is not desirable. A more detailed analysis would help determine how the burden on small business can be reduced without undermining workers' rights and job security.

3.3.3. Taxation

The White Paper deemed the differentiation of South Africa's tax rates and other incentives an important tool to promote small enterprises. It asserted that a reduction in the tax burden on small business would encourage reinvestment of profits, ultimately encouraging

⁶ Applications to have the award or ruling dismissed on legal technical grounds or grounds of substance.

growth. The White Paper deferred to the Katz Commission on Tax Reform, which was underway in 1994, to formulate recommendations on this matter. The Katz Commission in turn proposed turnover thresholds for company tax and VAT registration that would immunise small businesses from the tax burden. This differentiated tax regime has held ever since; the floor for VAT registration is now R1 million.

More recently, the Davis Tax Commission (DTC 2014, 2016) was mandated to assess South Africa's tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability. The Commission has published an analysis of the impact of taxes on small business. In particular, it reviewed the turnover tax thresholds and compulsory VAT registration thresholds and affirmed its satisfaction with them as they stand. It was noted that the VAT registration thresholds compare favourably to international standards and there does not appear to be any justification for raising it further.

The Commission went further to note that enterprises had the flexibility of registering as a sole trader or a small business corporation in terms of the Income Tax Act in order to be subjected to differentiated taxation. In addition, the position of a taxpayer vis-a-vis the threshold is reviewed annually, so that small business that experience a fall in turnover would automatically be exempt.

The Commission has raised concerns with the tax system for registered small business corporations. It is argued that it has become ineffective as it largely benefits service-related small business (such as financial, education, real estate, medical and veterinary services). In contrast, the system was intended to benefit emerging businesses or to assist ailing enterprises in an assessed loss position. Similarly, the Commission proposed reforms to the Skills Development Levy, arguing that it has effectively benefited larger companies at the cost of small business, because small business typically do not claim funding back for skills development. With regard to incentives, the Commission noted the tax deductions for small business funding entities and for venture capital companies.

The Commission did not however comprehensively address the challenges that micro businesses or cooperatives may face in regard to tax administration. Typically, micro businesses struggle with registration and keeping up to date with tax payments. The Commission only noted that the South African Revenue Service (SARS) has recently established 138 small business desks at branches countrywide to service taxpayers who operate small and micro enterprises and that further initiatives for these enterprises were part the SARS strategy.

In sum, the analysis by the Davis Tax Commission suggested that that, with the exception of a few parts of the tax codes, the taxation system has been reformed substantially to reduce the burden on small businesses. The Commission noted improvements that have been made with regard to making tax compliance more accessible but acknowledged that more work can be done on assessing the taxation burdens on micro-businesses and cooperatives.

3.4. Conclusions and implications for research

In conclusion, the studies on small business regulatory burdens have sought to identify constraints to small business growth and development, quantify the cost of regulatory burdens and propose fairly broad remedies to alleviate the structural and regulatory burdens on small business. The studies point to the following key findings:

- While regulatory burdens are significant for small business, they are not in themselves determinant. By extension, to grow the sector requires measures to address the fundamental structural barriers to small business as well as ensuring a more supportive regulatory framework.
- The studies have focused on analysing the overall extent of regulatory burdens, either by quantifying the cost to small business or by benchmarking South Africa against other countries. The result is that they generally do not indicate the specific rules or procedures that should be changed. From that standpoint, a key contribution of this project is to point to concrete and practical reforms.
- Most of the surveys rely almost exclusively on surveys of entrepreneurs and managers. As a result, they do not provide much insight into the motivation behind regulations that impose burdens on small business. That means that they do not generally clarify the trade-offs involved in reforms. But understanding those trade-offs is critical for a realistic and viable reform strategy.

The main regulatory burdens identified are unnecessarily time-consuming registration and reporting procedures; labour laws; and taxation. Some studies quantify the costs of regulation in general, but the costs are treated as linearly additive, without differentiating between implementation costs, compliance costs and costs arising from the desired outcomes of the regulation. Lastly, the studies that propose more specific remedies tend to be those that focus on a single sector or area of regulation.

This review of existing research on the regulatory burdens on small business in South Africa indicates the need for more in-depth analysis of individual areas of regulation, as opposed to a broad overview. Furthermore, the effects of the regulations on different categories of small business will diverge, depending largely on size, legal status and industry. Finally, for the analysis of laws and regulations to point to practical reforms, it is important that the research methodology help to assess the effects of specific requirements and procedures. These issues are explored in the remainder of this paper.

4. METHODOLOGY

The review of existing literature showed that most analysis of regulatory burdens is typically:

- Based on surveys of small business,
- Identifies and in some cases seeks to quantify regulatory areas that business owners see as a burden, but
- Provides mostly general, impressionistic conclusions about the specific elements of the rules or procedures that cause problems for small business.

As a result, the main benefit of these studies is to identify areas of concern for regulatory reform. But they do not provide guidance for officials about specific changes in rules and procedures that would help. Moreover, they do not indicate trade-offs that might follow from reforms, especially where they would affect stakeholders other than small business. As

a result, they do not assist in finding win-win solutions that have a realistic change of bringing about changes.

To build on existing research, therefore, this project focuses on developing specific, practical options to reduce burdens on small business in areas that have been identified as problematic. It adopts a methodology rooted in standard impact assessment methodology, as articulated in particular in the Socio-Economic Impact Assessment System (SEIAS) adopted by Cabinet for reviewing proposed laws and regulations.

4.1. Outline of the methodology

The methodology used here has three phases for analysing the impact of specific rules and systems with a view to reform. It starts with a textual analysis of the relevant rules in order to develop hypotheses around the burden on small business; tests the hypotheses against the available qualitative and quantitative evidence; and on that basis develops and systematically evaluates options for reform.

4.1.1. Textual analysis

The process starts with a textual analysis of relevant rules and procedures in order

- To identify the aims of the legislation and the underlying theory of change
- To develop hypotheses around the likely burdens for small business.

The SEIAS methodology points to two basic kinds of costs.

On the one hand, there are administrative burdens, which are the core of “red tape” as commonly understood. These costs include both the initial effort of setting up systems to comply and the on-going administrative burdens associated with compliance, such as submitting tax forms. Reforms to reduce unnecessary administrative burdens are typically relatively uncontroversial in society as a whole, although they may impose costs on agencies that are asked to re-tool their systems, upgrade their technologies, or reduce their ambitions especially around data collection.

On the other hand, every law imposes costs on some groups in order to achieve benefits for others. Labour laws protect workers from employers; taxes impose burdens on the relatively well off to fund social needs of various kinds. Reforms that aims to reduce these kinds of integral costs on small businesses will likely encounter opposition from the beneficiaries of the current order.

4.1.2. Qualitative and quantitative research

In the second phase of the process, the hypotheses derived from the textual analysis are tested against the available evidence. The aim is both to assess whether the hypotheses themselves identify genuine costs and benefits from the existing rules and procedures, and to see if there were gaps in the analysis. Both a qualitative and, where possible, a quantitative analysis is undertaken.

In assessing the actual costs and benefits for small business, researchers have to take into account the reality that small businesses are diffuse, diverse and numerous. As the analysis in Section 2.2 notes, they vary widely in terms of their resourcing, requirements and regulatory context. Moreover, entrepreneurs are typically crucial for the day-to-day operations of their businesses, and cannot take much time out for interviews and

workshops on policies. Unlike big business, moreover, most do not have staff to delegate for this purpose.

The qualitative assessment in this study relies on interviews with key informants rather than a survey. Survey results are typically too vague and general to support the kind of detailed understanding required for practical reforms. In contrast, interviews with key informants – that is, people with every-day experience in the administration of the rules – can help in finding specific solutions.

The key informant interviews, in part with assistance from Business Unity South Africa (BUSA) and the Black Business Council (BBC), included:

- Small businesses themselves
- Business associations of small businesses and relevant industries
- Agencies that work with small businesses such as incubators and advocacy groups
- Representatives of organised business
- Officials from relevant departments and agencies

Appendix 2 provides a list of key informants for this study.

In addition to qualitative evidence, an effort was made to assess findings against the available data where possible. The available statistics relate primarily to outcomes – indicating mostly whether efforts to shape the laws to assist small business have succeeded – and to procedures, especially around the time required for compliance and turnaround.

4.1.3. Policy options

The final phase of the methodology involves identifying and testing options for reform. To that end, in line with both the SEIAS and standard Regulatory Impact Assessment methods, three options are developed and analysed for each set of rules and procedures studied.

The options methodology aims to compel innovative thinking by requiring evaluation of a broad range of alternative reforms. As a result, some of the options analysed will be controversial.

The options essentially involve different combinations of regulatory reform and other measures to reduce the impact of existing rules. For each option, the costs, benefits and risks to small business and other stakeholders are briefly presented. On that basis, a preferred option is identified.

To assist in taking the preferred options forward, the study identifies key next steps, in particular

- Whether more detailed research is still required, and
- The affected departments and stakeholders.

A briefing note is provided separately on each option in order to support engagements around the proposed reforms.

4.2. The SEIAS approach

The methodology utilised in this study is based in the SEIAS approach. This section therefore outlines some of its key elements.

SEIAS aims, not to prevent regulations, but to improve them. To this end, it promotes an objective analysis that includes an evaluation of potential unintended consequences and unnecessary costs.

SEIAS adopts a problem-solving methodology. That means that, for any specific measure, policymakers should clearly identify

- The socio-economic problem being addressed,
- Its main causes, which are effectively targeted by the intervention, and
- The theory of change that follows from this analysis – that is, just how the proposed measures should resolve the socio-economic problem addressed.

In evaluating measures, SEIAS requires consideration of the costs, benefits and risks to different social groups. This approach is grounded in the understanding that laws and procedures do not affect all citizens in the same way. The aim is to understand potential or actual contestation around the measures, as well as to identify unintended consequences.

Often policymakers cannot quantify the costs, benefits and risks of specific measures, but they can describe what social groups may be affected and how they would be impacted. This in itself often points to options for improvement. By the same token, SEIAS analyses often can only be tested against logic and through consultation with the stakeholders affected by a measure. Since stakeholder inputs are inevitably more or less biased, whatever data is available should be utilised to check them.

Finally, the SEIAS methodology requires that the proposed options for change should push the envelope. The aim is to ensure that policymakers are not captured early in the process by particular solutions, shutting out alternatives without analysis. As noted above, this means that some options will be controversial.

For the present study, utilisation of the SEIAS approach requires the following.

- The aims of the rules and procedures analysed, and in particular, what social problem they are trying to solve, should be analysed in order to indicate both beneficiaries and cost-bearers.
- The costs and benefits to small business can be extrapolated from the text to some degree utilising approaches developed for regulatory impact assessments. Because the rules and procedures being analysed have already been implemented, however, the findings become hypotheses that can be tested against actual experience.
- To develop realistic proposals for change, policymakers need to understand the costs and benefits of the existing regulatory system, not only for small business, but also for other stakeholders. This approach generates an understanding of the likely opposition and possible win-win compromises. For this study, the main stakeholders are broadly small business; other businesses; relevant government agencies; and workers and communities.

- As in the SEIAS process, it proves useful to describe costs and benefits to different groups in qualitative terms, even if they cannot be quantified.
- In assessing options, it is important to take into account risks as well as the anticipated benefits and costs to the affected groups.

In sum, for each area studied in sections 6 to 10 below:

- The analysis starts by explaining the importance of the particular set of rules and procedures analysed, and where relevant the main debates.
- The second sub-section reviews the logic of the rules and their inherent theory of change, and the implications for small business. In this context, it identifies the assumptions underlying the theory of change inherent to the legislation. If these assumptions do not hold, then the legislation will likely have unintended consequences.
- The third section assesses the administrative and where relevant the inherent costs for small business based on the textual analysis and associated evidence.
- The final section proposes and evaluates three options for mitigating the burdens on small business, and indicates which one seems preferable.

4.3. Scope

This study aims to analyse the impact of laws on small business. That requires some common definition of small business, although it can be fairly broad.

As discussed in Section 2.2, small businesses diverge broadly in size, operations and relationship to different laws. For the purposes of this study, it is important to be clear both about the definition of small business used and about the factors that may affect the burdens imposed by specific regulations.

The National Small Business Act (1996) uses employment, turnover and assets to define small business by sector. As Table 2 shows, the criteria vary widely, largely because the definition aimed, not to identify small business for the economy as a whole, but rather to encompass the smallest businesses in each industry. Because the scale of companies varies widely between industries, the result was a fairly wide scope especially for small and medium businesses.

Table 2. Definition of small business by class from the National Small Business Act (1996)

Size	Number of employees (a)	Turnover	Assets (b)
Medium	100 to 200	R5 mn. to R64 mn.	R3 mn. to R23 mn.
Small	50	R3 mn. to R32 mn.	R1 mn. to R6 mn.
Very Small	10	R0.5 mn. to R6 mn.	R0.5 mn. to R2 mn.
Micro	5	R0.2 mn.	R0.1 mn.

Notes: (a) Expressed in full-time equivalents. (b) Excludes fixed property.

Appendix 4 gives the full set of definitions by industry. The Act is currently being reviewed, however, which may lead to some changes in the definition.

For the purposes of this study, the figures for number of employees guided the mapping of small businesses. But it was not applied rigidly to informants or in analysing the impact of

laws, except where the law itself includes a definition as in the case of BBBEE. The main focus has been on small and very small business.

The Act does not take into account differences between formal and informal business. In the event, for this study that becomes a critical factor. In the three cases where the scope is defined by specific laws – that is, registration and reporting; BBBEE; and procurement – the impact assessment focuses on formal small business, as informal business by definition is not affected by the regulatory burdens identified. In the case of construction, all small business is included but informants were mostly drawn from small formal enterprises.

5. REGISTRATION AND REPORTING

5.1. Importance for small business

Requirements to register with and report information to state agencies form the core of red tape as commonly understood. These kinds of obligations arise from many laws and regulations because the state has an interest in identifying relevant businesses and knowing information about them, in particular for the purposes of:

- Determining legal status and liability in contracts,
- Levying taxes and rates,
- Providing targeted infrastructure and other services to businesses, and where relevant ensuring payment for them, and
- Ensuring adherence to standards, especially in terms of the environment, labour and consumer safety – in effect, in order to ensure internalisation of externalities for businesses.

In some instances, small businesses obtain benefits from these laws and regulations directly, as in the case of securing legal status and obtaining infrastructure. In other instances, businesses benefit indirectly, through greater social cohesion and reduced conflict with labour, consumers and communities. Still, in most cases businesses see the immediate costs but have only vague and general understanding of possible benefits. In these instances, even if administrative costs are reduced to the minimum, businesspeople often argue that they are excessive since they do not perceive the off-setting benefits.

Evaluations of the cost of registration and reporting requirements often dovetail with a broader view of the role of the state. Thus, free-market proponents are disposed to view any administrative cost as excessive, because they do not see much in the way of benefits from state regulation. In contrast, proponents of industrial policy as well as environmental, consumer and labour protection generally argue that the benefits outweigh the administrative burden, although they may agree that some red tape could be reduced.

Assessing the impact of registration and reporting is often difficult because studies are rarely able to track how much actual time and funding businesses use. Instead, most studies depend on self-reporting by business owners. That may over-emphasise the amount of time required, both because respondents see the whole exercise as an unnecessary burden and because people with the worst experiences are the most vocal.

The most recent efforts to quantify the cost of reporting and registration are over a decade old. The Small Business Project put the burden at up to R20 billion annually in aggregate. (SBP, 2005) Upstart Business Strategies came to an estimate of between R6000 and R8000 per individual enterprise per year. (Upstart Business Strategies, 2004)

In practice, informants for this study typically see the registration and reporting requirements as an annoyance and a cost, but not as a determinant of their success and failure. While the analysis generates proposals to re-engineer some processes, they will not provide a big boost to the operations of most of small businesses.

This section focuses on three main groups of laws, which constitute the minimum to which all formal enterprises, irrespective of industry, would have to conform. The areas identified include:

- The Companies Act and the Cooperatives Act as administered by the Companies and Intellectual Property Commission (CIPC),
- Tax legislation administered by the South African Revenue Services (SARS), and
- Labour registration administered by the Department of Labour (DOL).

A schedule of the relevant laws is provided in Table 3 below. This section analyses each area in turn.

Table 3. Reporting and registration requirements for formal small business

Area	Requirements	Responsible state agency	Acts
Registration and reporting for companies and cooperatives	Registration with CIPC	Companies and Intellectual Property Commission (CIPC)	Companies Act No. 71 of 2008 Cooperatives Act No. 14 of 2005
Tax payments and administration of payroll taxes for employees	Registration Regular payments with associated reporting on income, turnover and payroll	South African Revenue Service (SARS)	Income Tax Act No. 58 of 1962 Value-Added Tax Act No. 89 of 1991 Customs and Excise Act No.91 of 1964 Tax Administration Laws Amendment Act No. 21 of 2012 Tax Administration Act No. 28 of 2011 Tax Administration Laws Amendment Act No. 39 of 2013
Labour laws	Register for Unemployment Insurance Fund (UIF), Compensation Fund and relevant Sector Education and Training Authority (SETA) Pay relevant fees and levies May receive refund for approved training expenditures	Department of Labour; UIF Commission; Compensation Commission; SETAs	Unemployment Insurance Contributions Act No. 4 of 2002 Skills Development Act No. 97 of 1998 Compensation for Occupational Injuries and Diseases Act No. 61 of 1997 Occupational Health and Safety Act No. 29 of 1996

5.2. CIPC registration and reporting

The registration of enterprises and regulation of their governance forms an integral part of the regulatory framework for formal business. Registration establishes ownership of

businesses, provides model governance structures for different types of ownership, and secures a legal status for entering into contracts.

5.1.1. The legal framework

Company registration in South Africa is governed by the Companies Act of 2008. The purpose of the Companies Act is stated in section 7 as *inter alia* to promote the development of the South African economy by:

- encouraging entrepreneurship and enterprise efficiency;
- creating flexibility and simplicity in the formation and maintenance of companies; and
- encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation.

The Companies Act provides for the legal registration of enterprises and establishes minimum requirements for governance structures for different types. The registration of cooperatives is provided for by the Cooperatives Act of 2005. As discussed below, the registration and reporting requirements for co-operatives are more onerous than for other business types.

In section 185, the Companies Act mandates the CIPC to register enterprises and to maintain a central database of company records in South Africa. The institution also monitors compliance to governance standards, including regular reports to affirm continued existence and provide up-to-date contact details. Businesses that exist as sole proprietors and partnerships are covered by Common Law rather than the Companies Act.

Enterprises are required to register with the CIPC in one of the available forms of incorporation, and to file an Annual Return to confirm their continued existence. Some forms of ownership are subject to more onerous governance standards such as the preparation of Annual Financial Statements (AFS) and annual audits.

The Co-operatives Development Act provides specifically for the formation and registration of the different types of co-operatives (primary, secondary and tertiary) in section 6, the establishment of a Co-operatives Advisory Board⁷ in section 85, the dissolution of co-operatives and related matters. The need for a separate legislation arose because government aimed to use the registration process to institutionalise and provide incentives to co-operatives and to ensure they abided by co-op norms especially in terms of internal democracy and book-keeping.

5.1.2. Aims and theory of change

Legal registration addresses the lack of obvious property rights and governance structures for many modern enterprises. Providing companies and co-ops with legal status helps ensure certainty of ownership rights, which is important for the enterprise, its investors and its customers. Similarly, identifying minimum governance standards under which an enterprise can operate facilitates accountability and transparency to the benefit of shareholders or members as well as other stakeholders. Table 4 indicates the main

⁷ We have not found any evidence to suggest that the Co-operatives Advisory Board exists.

beneficiaries and cost bearers from the problems that the Companies Act and Cooperatives Act seeks to alleviate.

Table 4. The logic of the Companies Act and the Co-operatives Act

The socio-economic problem	Who benefits from the problem?	Who loses from the problem?	Measures to address the problem
If enterprises do not have clear legal status, they cannot enter into legal agreements including for credit.	Producers who do not need legal status to operate, for instance informal enterprise and sole proprietors.	Enterprises and their partners who cannot use legal dispute settlement systems Economy as a whole, as enterprises unable to grow beyond a certain point	Enable registration according to broad models with well-defined liability and contact details
If ownership of shared or intangible assets is poorly defined, fraud and theft becomes possible	Fraudsters and wheeler-dealers	Investors who may lose access to their holdings	Registration defines who is responsible for property rights in the enterprise, with identification check
Enterprises may not reveal important information to investors, employees or customers	Management and sometimes investors	Stakeholders that make wrong decisions or suffer in other ways because of lack of information	Registration leads to requirements around governance, especially reporting on ownership and accounts
The state aims to support co-ops as a way to promote economic opportunities for the poor and promote social solidarity, but it cannot easily identify genuine co-ops	Enterprises that aim fraudulently to benefit from calling themselves co-ops Co-ops that do not require or want state assistances	Co-ops that could benefit from state assistance but cannot easily prove they meet key criteria (especially in terms of co-op governance structures and integrity)	Require co-ops to register with a democratic constitution and proof of sound financial accounting

The implicit theory of change behind legal registration is that formal registration encourages entrepreneurship by providing a legal status to producers and investors. This is derived from the principle that clearly defined property rights enable formal economic activity. The key steps to achieving this end state are:

1. Companies and co-ops obtain formal registration and maintain up-to-date information through their Annual Returns.
2. Based on these inputs, the CIPC maintains a reliable database of information on enterprises, which identifies a unique name, ownership and contact details.
3. Companies are able to engage in legal contracts and investors are safeguarded against fraud and theft by outsiders or managers.
4. Companies gain access to new investors, opportunities and services, enabling growth and economic expansion.

The theory of change suggests that most businesses, especially those with substantial outside investors, have a built-in incentive to register. However, as detailed below, the law also imposes penalties for companies that engage in fraudulent registrations or do not comply with reporting requirements.

The implicit assumptions underpinning the theory of change are that:

1. The legal status provided by registration provides real benefits for entrepreneurs by securing their ownership and enabling them to take advantage of more economic opportunities, and
2. The costs of registration and maintaining records do not outweigh the benefits because they are administratively straightforward.

5.1.3. The costs of registration and reporting

a. Company registration

Small enterprises typically register with the CIPC as co-operatives and private companies rather than as public companies.⁸ Each type of enterprise has its own form of incorporation.

Table 5. Company types and forms of incorporation

Type	Definition	Form of incorporation
Private Companies "Pty Ltd"	A private company trades for profit. It may not offer its shares to the public and the transferability of its securities is restricted.	One or more persons may incorporate a profit company.
Co-operatives	A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.	A co-op may be incorporated by a minimum of five persons in the case of a primary co-op; a minimum of two or more primary co-ops in the case of a secondary co-op; or a minimum of two or more secondary co-ops in the case of a tertiary co-operative.

Source: CIPC (2016). The Companies Act 2008 at a Glance. Pretoria.

A standard company registration for a private company is derived from section 14 of the Companies Act. It entails submission of the following documents:

1. Memorandum of Incorporation (MOI)
2. Notice of Incorporation
3. Supporting documents, including certified copies of identification for all indicated initial directors and incorporators; a power of attorney; and a valid name reservation document, if desired.

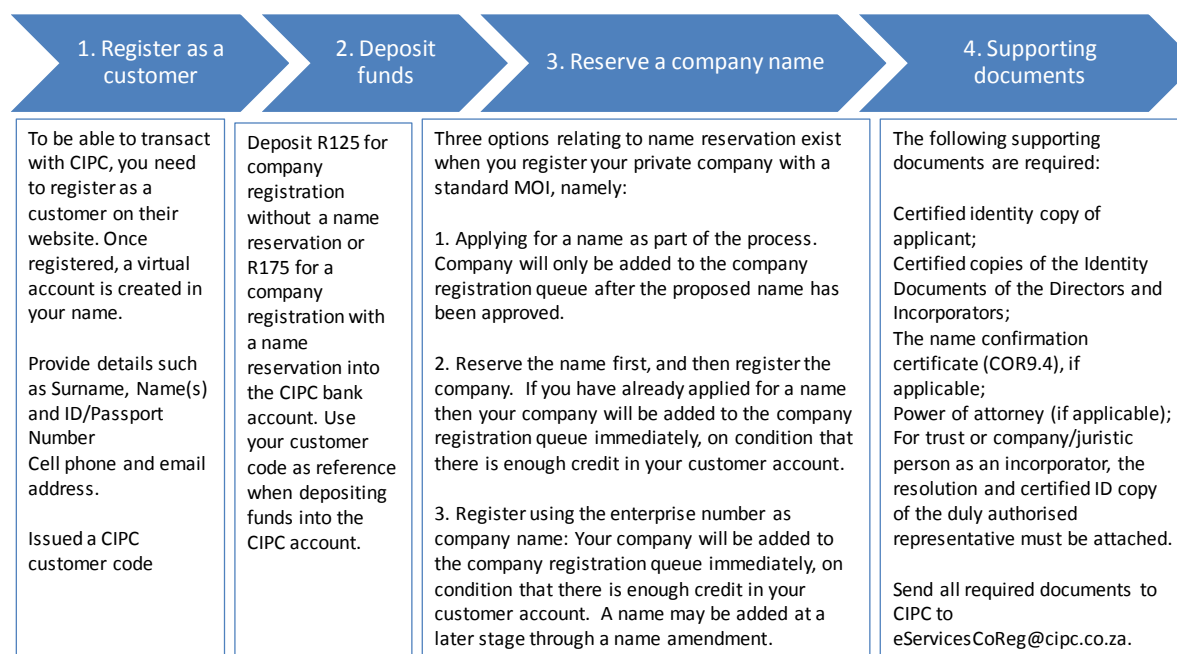
A standard company registration for a private company costs R125. It is optional to register a name when registering a company. If the initial name reservation application is not approved, the applicants will need to apply for new names. Applicants may apply for between one and four names during each application process. Each name reservation application costs R50.

A company can be registered manually or electronically. Manual applications can be processed at the CIPC offices in Pretoria by: completing the forms and then e-mailing them to the CIPC, or by logging the detail of the registration on the CIPC website (as diagrammed in Figure 11 below) and then printing and e-mailing the forms for final processing. The CIPC

⁸ After the implementation of the Companies Act (Act 71 of 2008) no new closed corporations can be registered and no conversions from companies to closed corporations will be allowed. However, the existing closed corporations will be maintained.

also has fully automated company registrations (immediate and without paper work) whereby the customer may register the new company via any of the four major banks (ABSA, Standard Bank, Nedbank or FNB), an intermediary that has access to the fully automated suit of services or one of the CIPC self-service terminals in Gauteng, the Western Cape, Northern Cape or KwaZulu-Natal. By extension, company registration is also subject to the indirect costs of transportation and/or internet costs to access any of these channels.

Figure 11. Illustration of online company reporting process



Source: CIPC (2016) Registering Your Company.

The predecessor to the CIPC was notorious for lengthy delays in registering new companies, averaging over 25 days and sometimes lasting for months. Virtually all informants agreed, however, that the current CIPC turnaround time is fast.

For a registered private company with a Standard Memorandum of Incorporation, the average turnaround time is now three working days from date of date of the submission of the supporting documentation. Other kinds of application process may take longer, with ten to 15 days required for physical applications.

Every company must lodge an Annual Return to the CIPC within 30 business days of the anniversary of its incorporation date. The Annual Return updates company details (contact details and business description) and discloses turnover. It must be submitted with audited financial statements, independently reviewed financial statements, or an accountability supplement. The kind of accounting required depends on the company category and its Public Interest Score, which in turn correlates largely with size.

Regulations 28 and 30 under the Act basically require that smaller companies (which typically have a Public Interest Score below 100) must at least submit an annual financial supplement which essentially confirms that the company is keeping accounting records and identifies the employee who is responsible for the task.

The Annual Returns form is only available online, and lodgement is instantaneous. Failure to submit Annual Returns over three years will result in the automatic deregistration of the company. According to CIPC officials, this penalty is only advanced in very exceptional cases

for large non-compliant companies, and therefore generally does not apply to small business.

For companies with over R1 million in turnover, the fees for Annual Returns are higher than for the initial registration, although still fairly modest. The CIPC imposes penalties for late filing.

Table 6. CIPC annual return fee schedule

Annual turnover	Filing within 30 business days of due date	Filing more than 30 days after due data
Less than R 1 mn.	R100	R150
R1 mn. but less than R10 mn.	R450	R600
R10 mn. But less than R25 mn.	R2000	R2500
R25 mn. or more	R3000	R4000
Re-instalment application	n.a.	R200

Source: CIPC (2016) Information Guide: Relationship between Annual Returns, Deregistration's and Reinstatements.

b. Co-operative registration

Registration for co-operatives is significantly more burdensome than for other governance models in terms of the required paperwork, the turnaround time and the cost.

A co-op's registration for application must be submitted on the prescribed form and must be accompanied by:

- the constitution of the co-operative, signed by the founder members;
- a list of the founder members;
- a list of the directors; and
- the prescribed fee of R215 or proof of payment thereof (CIPC, 2016).

By extension, before registering members must hold a formation meeting to decide on their common purpose as well as the co-op's nature (that is, primary, secondary or tertiary) and type (service, producer or marketing, for instance). The meeting has to adopt the constitution and elect the first directors. The constitution must ensure the implementation of democratic principles in line with co-operative practice, as laid out in the Co-operatives Act.

The registration forms for cooperative applications can be downloaded from the CIPC website although a co-operative may only be registered manually. The CIPC reports that the standard turnaround time for finalising a co-operative registration was two days in 2015/6, down from 18 days reported for four years earlier.

Upon registration, a co-operative must appoint an auditor unless an exemption has been obtained. Section 55 of the Cooperative Act provides that the registrar may exempt a co-operative from compliance to the audit if:

- the costs of an annual audit would materially affect the financial sustainability of the co-operative;
- the co-operative has maintained and is able to prepare annual financial records; and
- there is some assurance that the interests of members will be adequately protected in regard to the size and kind of co-operative.

In practice, the Act has been interpreted to mean that virtually every registered co-operative must provide audited statements to the CIPC.

In terms of the Co-operatives Act, a registered co-operative must also keep the following at its offices (CIPC, 2016c):

1. Its Constitution, including any amendments thereto.
2. The minutes of General Meetings in a Minute Book.
3. The minutes of meetings of the Board of Directors in a Minute book.
4. A List of Members / Register of Members setting out:
 - a. the name and address of each member.
 - b. the date on which each member became a member.
 - c. if applicable, the date on which a person's membership was terminated.
5. The amount of any membership fees paid, the number of membership shares owned and the number and amount of member loans.
6. A Register of Directors setting out:
 - a. the name, address and identity number of each director, including former directors.
 - b. the date on which such directors became or ceased to be directors.
 - c. the name and address of any other co-operative, company or close corporation where both present and former directors are, or were, directors or members.
7. Adequate Accounting Records, including records reflecting the transactions between each member and the co-operative for the purpose of calculating the patronage proportion.

A co-operative must hold its first annual general meeting within 18 months of its registration. It must hold subsequent annual general meetings within six months after the end of the preceding financial year.

5.1.4. Assessment of costs and benefits for small enterprises

This section first assesses the costs and benefits of registration for companies and co-operatives, and then the processes around Annual Returns.

Table 7. Summary of administrative and compliance costs for a company

Company	Private companies "Pty Ltd"	Co-operatives
Registration	Notice of Incorporation Memorandum of Incorporation	Constitution of the co-operative A list of the founder members A list of the directors
Annual Returns	Annual return must be filed within 30 business days after the anniversary of the date of incorporation.	Auditor's report and Annual Financial Statements (AFS)

Company	Private companies “Pty Ltd”	Co-operatives
Annual financial Statements	Financial statements must be prepared within six months of the financial year end.	The auditor’s report and the AFS must be approved at the Annual General Meeting (AGM) and signed by the chairperson of that meeting. The Board of Directors must send a copy of the AFS to the CIPC within 15 days after it has been approved and signed.
Is an audit necessary?	Yes, if the company holds assets for another party in excess of R5 million; or the public interest score ⁹ is 350 or more; or the public interest score is 100 or more and the annual financial statements are internally compiled; or it is required by the Memorandum of Incorporation or by a shareholders’ or director’s resolution or in terms of an agreement.	An audit of the affairs of a co-operative must be conducted annually in respect of each financial year, unless the co-operative applies for a waiver because of the cost.
Is AGM Required?	Only if specified in Memorandum of Incorporation	Yes, the annual general meeting must consider approval of the auditor’s report and financial statements
Minimum directors	1	5
Minimum members	1	5
Keeping company records	Yes	Yes

Source: CIPC (2016) The Companies Act 2008 at a Glance

a. *Registration of companies*

Assessment of registration processes and registration fees for companies indicates that they do not pose a significant administrative burden on small business, while they bring substantial benefits. The registration costs of R125 are about 3% of informal employers’ monthly earnings and the accessibility of registration via self-service terminals and banks makes it highly accessible for entrepreneurs from every part of the country. In contrast to five years ago, turnaround time is quick.

The ease of access is demonstrated by the fact that new company registrations have been on the increase despite poor macroeconomic conditions. The CIPC reports that 2016 was the highest number of new company registration since the establishment of the commission (CIPC, 2016b). The evidence suggests that digitisation has improved efficiency and access, given that 95% of the CIPC new company registrations were made online in 2016.

⁹ The public interest score calculation method is explained in Appendix

Figure 12. CIPC registration statistics, 2008 to 2016



Source: CIPC (2016) CIPC Annual Report 2015/2016

Registration for cooperatives is more burdensome. Cooperatives are only registered manually, the cost is slightly higher at R215 per new registration and the turnaround time is often longer.

b. Annual Returns

While most informants were happy with the CIPC's registration process, they found the requirements around Annual Returns unnecessarily burdensome. The main issues arose around the timing of the return and the duplication with tax requirements. In addition, a study by the **dti** found that the use of the internet as the sole way to file returns posed a significant challenge to many small businesses.

The benefits of the Annual Return are the following.

- It ensures the CIPC registry is up to date, with accurate contact and ownership details and including only functioning businesses. Given that a core aim of company registration is to ensure that ownership is properly recorded, ensuring a reliable register is worthwhile for the economy as a whole.
- It is the largest single source of revenue for the CIPC, generating R283 million or 52% of its total income in 2015/6. Since the CIPC is self-funding, this is important for its sustainability.

That said, the CIPC itself suggests that the Annual Returns process is flawed. It reported (CIPC 2016b, p.50) that only 50% of enterprises that were expected to file an Annual Return actually did so. Officials report that approximately 25 000 to 30 000 enterprises are referred to deregistration every month for failure to file. Low filing rates were also identified by the **dti** in 2015 through a study on obstacles to small business (the **dti**, 2009).

Officials claim that they deregister companies on an annual basis due to annual return non-compliance. Companies can find that, until they are reinstated, they are unable to undertake most formal business activities or tender for government contracts. CIPC officials report that about 25 000 to 30 000 companies and close corporations are referred for deregistration due to non-compliance with annual returns, every month. Of this number, some are deregistered and others ultimately submit annual returns.

Informants argued that tying the date of the Annual Return to the initial registration was confusing, and that the importance of filing was often not understood. Moreover, if companies change their contact information without informing the CIPC, they may not get reminders.

Informants also felt that the information in the Annual Return was similar, although much less detailed, than the requirements for tax filing. As a result, they felt that it was a duplicate effort and that the two processes should be aligned.

Other factors that contribute to the low Annual Return filing rate include:

- The difficulty of using the internet in order to file Annual Returns, which the CIPC underestimated. A **dti**-commissioned study (the **dti**, 2009) reported that 61% of respondents claimed that the use and cost of the internet were the most significant obstacle to filing an annual return.
- Dormant or inactive company owners may not understand their obligation or cannot afford to file an Annual Return.

Officials in the CIPC say they addressed some of the recommendations of the **dti** study by improving communication with enterprises regarding Annual Returns and sending out systematic reminders as well as increasing its educational drives and marketing campaigns to create more awareness regarding annual returns and the importance to file.

Officials also argue that filing rates are low because many of the newest registrations are by survivalist enterprises that are not a going concern. They cite research that has shown that about 80% of businesses fail within the first three years.

c. Co-operative registration

The registration of co-operatives declined by around a third in 2015/6, as indicated in Figure 12 above. The CIPC acknowledges that relative complexity of registering a new cooperative may be a factor in the decline, although it also notes the withdrawal of some government support measures. (CIPC, 2016b).

Overall, cooperatives have an extraordinarily high mortality rate. A 2010 study funded by the European Union found that only 2644 of the then 22 619 registered cooperatives were still functional. In other words, some 88% had not survived beyond a year or two. (Eising & Shenxane, 2011 in Wessels, 2016)

The requirement that all registered co-ops submit audited financial statements is perceived as the most burdensome and costly registration requirement. In contrast, only companies with a high public interest score or internal requirements have to submit audited statements to the CIPC.

In the event, many co-ops ignore the audit requirement, although it is not clear how many of these are actually registered. The **dti**'s 2009 baseline study found that almost all of the emerging co-operatives surveyed did not submit annual financial statements to the Registrar of Co-operatives, and only 4,72% had audit reports. (the **dti**, 2009)

Informants argued that the need to include original members in many filings posed an additional challenge. Since membership changes over time, this requirement can cause significant delays and costs.

The costs of registration for cooperatives need to be offset against the benefits. The evidence suggests that the high number of new registrations of cooperatives was previously driven by committed government support programmes, in the form of funding from sefa and departments such as the Departments of Agriculture, Education and Social Welfare (Wessels, 2016). Informants however argued that the benefits were scanty compared to the administrative burdens of registration, especially given the broader difficulty of sustaining new co-ops as an innovative form of ownership and control.

Finally, informants identified shortcomings in the CIPC call centre challenges as a broad challenge. The CIPC itself found that 60% of calls were abandoned in 2015/6, although the rate declined from over 90% in April 2015 to just over 50% in March 2016. The main reason was understaffing as well as reliance on poorly capacitated people. (CIPC 2016b, p. 48)

5.1.5. Options

The two most significant issues that emerged from the analysis of burdens pertaining to company and cooperatives registration were:

- Annual Returns for companies, and
- Compulsory audits for virtually all cooperatives.

d. Annual Returns

The following options were assessed to address the challenges around Annual Returns.

- Option 1: Increase awareness through DSBD and CIPC (outreach campaigns, more capacity to follow up and remind companies)
- Option 2: Integrate Annual Returns with SARS Annual Filing (CIPC filing only for dormant companies)
- Option 3: Eliminate Annual Returns (altogether or for companies below a threshold size)

Table 8 indicates the main costs, benefits and risks to the key stakeholders – small business, the DSBD, the CIPC and other stakeholders.

Table 8. Costs, benefits and risks of options to reform Annual Returns

Option	Small business	DSBD	Regulator (CIPC)	Other stakeholders
Option 1: Increase awareness through DSBD and CIPC	C: Non-filing companies will have to pay filing fee and accept admin burdens B: Avoid costs from being deregistered due to lack of knowledge about requirements R: Outreach fails to reach small businesses, which therefore may still be deregistered.	C: Additional work for sefa and sefa B: DSBD benefits from more accurate CIPC database and better environment for small business R: Outreach fails to achieve desired aims because doesn't have required scope or companies not filing due admin burdens	C: Additional work and cost to reach small business B: Increased revenues; a more accurate database R: As with DSBD	C: Opportunity cost as resources directed to outreach campaign (but small) B: Workers in small business benefit with their employers; other citizens benefit from stronger small-business sector R: As with DSBD

Option	Small business	DSBD	Regulator (CIPC)	Other stakeholders
Option 2: Integrate with SARS Annual Filing (CIPC filing only for dormant companies), with fees paid to CIPC through SARS	C: Filing fee will depend on arrangement between SARS and CIPC B: Reduced admin burdens for filing as well as benefits of remaining registered R: SARS and CIPC do not interface adequately, leading to delays or failure to file returns	C: None B: DSBD benefits from more accurate CIPC database and from better environment for small business R: Same as small business	C: Might have to provide some payment to SARS for its services; cost of database interface B: Increased revenues if filing increases above 50%; a more accurate database R: Same as small business	C: Opportunity cost for other citizens and companies if SARS invests significant resources into the system B: Workers in small business benefit with their employers; other citizens benefit from stronger small-business sector R: Failure of interface could affect efficiency in other SARS or CIPC functions
Option 3: Eliminate Annual Returns (altogether or below a size threshold)	C: None (but see risks) B: At least some small business could not have to file at all. R: Less reliable registration of small business could lead to fraud or theft and make it more difficult for small business to engage in the formal economy.	C: Less accurate CIPC database on small business would make targeted measures more difficult B: Some improvement in conditions for some small business at least in short run R: Worse database leads to increasing exclusion of small business from formal economy.	C: Substantial loss in revenue plus cost of amending the companies Act (section 33). B: Could result in increased compliance as can focus on larger companies, sustaining revenues R: Lower quality database.	C: If state has to support CIPC due to loss of revenues, then cost to other programmes; workers in small business lose if slower growth in long run B: In the short run, some benefit from stronger small-business sector for both workers and communities R: Same as for small business..

The assessment of costs, benefits and risks indicates that the preferred option is to integrate CIPC Annual Returns with SARS. Companies have to provide returns to SARS, and the state has an interest in sustaining that function, but the CIPC returns can integrate with it. The fees to the CIPC could be levied by SARS as part of normal tax assessment and then transferred to the CIPC.

The main challenge is that both SARS and the CIPC have capacity constraints in managing their databases. As noted in the table, it would be important to manage the transfer to the new system and the interface between SARS and the CIPC carefully in order to maintain both CIPC revenues and the integrity of the registry.

Inactive or dormant companies may still file their Annual Returns with CIPC, since they do not pay tax. They would have to provide evidence of dormancy (such as a bank statement with no transactions) and could be enabled to file Annual Returns at a minimal fee.

e. *Minimising the audit burden on co-operatives*

The following options were developed to reduce the burden on co-operatives of the audit requirement.

- Option 1: DSBD funds the audit through sefa
- Option 2: Policy directives or amendments clarify the exemption criteria to minimise the requirements to larger and better established co-ops.
- Option 3: Eliminate compulsory audits (some cooperatives would still have to undergo routine SARS audits and could institute them in any case if they wanted)

Table 9 summarises the main costs, benefits and risks to the key stakeholders

Table 9. Costs, benefits and risks of modifying compulsory audits for co-operatives

	Co-operatives	DSBD	Regulator (CIPC)	Other stakeholders
Option 1: DSBD funds the audit through sefa	C: No costs B: Free audit; improved financial management R: No risks	C: 14 000 co-ops registered in 2015/6. The cost of funding their audits would come to over R100 mn. B: Reduce the burden on co-ops without undermining financial management. R: Cost goes up as more co-ops register in order to benefit from free audit; co-ops fail despite free audit so money is wasted	C: No cost B: Less pushback when registering co-ops R: Increased number of cooperatives register to access the benefit, straining CIPC capacity	C: Opportunity cost for other government programmes B: Benefits to community from stronger co-op movement R: Pay for the audit but co-ops fail in any case for other reasons
Option 2: Clarify exemption criteria	C: More established and prosperous co-ops will still have to get an audit B: Cooperatives that qualify for exemption have lower costs R: Poor financial management won't be addressed	C: Effort to support development of new criteria together with CIPC B: More co-ops exempted from audit requirement R: Increased co-op failures for group that doesn't undergo audit	C: Effort to develop and implement new criteria B: Less pushback from co-ops R: Increased co-op failures due lack of audit	C: None B: More co-ops able to register R: Increased co-op failures due lack of audit

	Co-operatives	DSBD	Regulator (CIPC)	Other stakeholders
Option 3: Eliminate compulsory audits	C: No costs B: Relieved from audit requirement R: Lack of audits could result in poor financial management and higher failure rates	C: Effort to support elimination of requirement B: More co-ops register, improving capacity to target support R: Lack of audits could result in poor financial management and higher failure rates	C: Need to amend the Act. B: Could result in increased co-op registrations. R: Managing higher co-op registrations; potential for greater fraud amongst co-ops	C: Less work for audit companies. B: More co-ops register and prosper due to lower cost R: Increase fraud and failure in co-op sector

The preferred option combines elements of the three options assessed above. It would include the following.

- Clarification of the exemption criteria with clear guidelines especially in terms of the cost of the audit relative to turnover or some other relevant indicator.
- A change the law so that audits are only required when a cooperative reaches a particular threshold. The threshold can be harmonised with the Companies Act Public Interest Score.
- Development of other ways to improve bookkeeping at co-ops, for instance through incubators or assistance from sefa.

A policy to interpret the exemption criteria could effectively make the audit a specific requirement for larger co-ops rather than a default for all of them.

f. Stakeholder responses

In terms of the proposal on Annual Returns, potential contestation could arise:

- From SARS and the CIPC, which would have to find technical solutions to ensure an efficient interface, and
- From CIPC if the process reduced its fees from Annual Returns, which are critical for its budget.

The clarification of audit requirements for co-ops does not seem likely to cause much contestation, but would require considerable technical engagement to identify appropriate criteria for exemption from the audit requirement, as well as to amend the law to exclude smaller co-ops altogether. In addition, the DSBD would have to identify and support partners to work with co-ops to upgrade their bookkeeping practices.

5.3. Taxation

Taxation is both socially necessary and individually burdensome. This makes it particularly difficult to regulate, because taxpayers will push back even if administrative systems are highly efficient.

5.3.1. The legal framework

SARS is South Africa's tax collecting authority, established under the South African Revenue Services Act of 1997 as an autonomous agency. SARS is responsible for administering the

South African tax system and customs service. A number of laws regulate different aspects of the tax system, as listed in Table 3 above.

As soon as a taxpayer commences a business, whether as a sole proprietor, a partner in a partnership or a shareholder in a company, it is required to register for tax. Businesses must register for a number of taxes, although they may not have to pay anything, depending on whether they reach the relevant income or turnover thresholds. Specifically,

- The initial business tax registration is for income tax, but only around a quarter of the 700 000 registered businesses earned enough to pay anything in 2014;
- Companies with over R1 million in turnover have to register for Value-Added Tax (VAT), which they effectively collect from customers on behalf of the state; and
- Employers have to record and pay the Pay-As-You-Earn (PAYE) income tax on behalf of their employees.

Registered companies may pay tax continually through the year in the form of PAYE, VAT and other taxes. Income tax returns must be submitted manually or electronically by the annual deadline. The mechanism of charging, collecting and paying VAT to Government is based on self-assessment, allowing each business to determine its liability or refund of tax. In both cases, SARS reviews returns and can audit them, which may lead to higher tax payments.

Like most countries, South Africa imposes significant penalties for failing to register for tax. If a company does not register or provide regular returns, SARS can charge a penalty amount that depends on a taxpayer's taxable income, ranging from R250 up to R16 000 a month for each month of non-compliance.

5.3.2. Aims and theory of change

The registration requirements around taxation ultimately derive from the fundamental need for tax-funded public services to provide public goods for everyone and basic necessities for the poor. In that context, registration of businesses is required so that the tax authorities can ensure reasonably sound assessment and payment.

Table 10 indicates the main beneficiaries and cost bearers from the problems that the taxation legislation seeks to alleviate.

Table 10. The logic of the tax system

The socio-economic problem	Who benefits from the problem?	Who loses from the problem?	Measures to address the problem
The private sector cannot supply public goods or meet basic needs of impoverished people	People and companies who can afford to obtain basic services and infrastructure without state support or assistance, although the unit cost may be higher	People who cannot afford basic services and infrastructure without state support. Society as a whole to the extent that services are inefficient and under-consumed, leading for instance to higher-cost infrastructure, skills shortages and poor productivity due to ill health, amongst others	Fund public services through taxes that ideally reflect ability to pay; entail minimal administrative burdens; are not so high that they deter economic activity; and support efficient and effective delivery systems.

Companies will not pay tax unless the state can identify them and ensure compliance	Companies that evade tax.	People who need public services – ultimately most citizens.	Establishment of systems to ensure businesses are registered and required to report reasonably reliably on their income and turnover.
SARS cannot easily collect tax from employees and customers	Employees and customers who can evade tax.	People who need public services – ultimately most citizens.	Require businesses to record and pay PAYE and VAT to SARS.

The core theory of change around taxation and tax compliance is that if companies are registered for taxation, SARS will be able to monitor and enforce taxation both for the companies themselves and, through the companies, for their employees and customers. The key steps to achieving this end state are:

1. Requiring all businesses to register for tax, whether or not they are liable for any payments, with significant sanctions for failure to register.
2. Linking registration for tax with other business requirements, including CIPC registration, legal audits and eligibility for government tenders, and communicating the benefits of tax payments to taxpayers.
3. In response to this combination of carrots and sticks, most companies register for tax.

The assumptions underlying the theory of change are:

- Companies comply with tax laws in part because they see the value of state services in terms of both their own needs and the contribution to social cohesion and peace.
- The paperwork required to register for tax and maintain tax payments is not very onerous, and it is far less costly than the penalties for failing to comply.
- SARS has capacity to monitor tax returns and track down at least a substantial share of enterprises that should register but do not. The flip side of this assumption is that only small, often informal producers do not register for tax.

5.3.3. The costs of registration and reporting

As soon as a company commences a business, it is required to register with the local SARS office in order to obtain an income tax reference number. The company must register within 21 business days after the business has commenced operations. A company that registers with the CIPC is automatically registered as a taxpayer.

A company must register for VAT if:

- Its total turnover exceeds R1 million in any consecutive 12-month period (which would make it a “very small” business under the current legal categories) or
- It has entered into a written contractual commitment to provide taxable supplies worth more than R1 million over the following 12-month period.

To register under VAT, a business needs to submit the relevant form in person at the SARS branch nearest to its place of business. Sole proprietors have to come in themselves while other businesses may send a representative. Either type of business may also employ a registered tax practitioner to appear in person on their behalf.

When applying for registration, a business needs to provide the following attachments:

- Original letter from the enterprise's bank or a recent bank statement with the original bank stamp.
- Copy of identity document, driver's licence or passport of the vendor's representative.
- A recent copy of its municipal account or utility bill, or a CRA01 form.
- A recent copy of the residential municipal account or utility bill or a CRA01 form for the owner, a partner or the vendor's representative.
- A copy of financial information listed as sources under financial particulars.

If a business changes its address, it must notify SARS within 21 days.

Employers must deduct PAYE tax from their workers' remuneration every month, and pay the money to SARS within seven days of the end of the month. They must also issue employees' tax certificates (IRP5s) when they deduct PAYE, showing remuneration as well as PAYE and other deductions. An employer who cannot deduct PAYE for a valid reason must provide an IT3(a) certificate that indicates taxable benefits and remuneration.

SARS introduced eFiling in 2006 as a free online process for managing taxes. The first year it processed just 40 000 returns, but the figure now is well over ten million. Using eFiling, businesses can register, submit tax returns and make payments securely. As of 2016, payments could be made through the SARS eFiling system; electronic transfers; and in most major banks. In 2016, the system was extended to make it possible for businesses to share their tax clearance status with government agencies. SARS also announced it would no longer accept manual payments.

SARS has also established a simplified tax system for very small businesses as well as a special dispensation for Small Business Corporations (SBC).

For very small businesses, the turnover tax provides for a single tax on turnover, with three payment dates in the year, in place of VAT, income, capital gains, dividend and secondary tax. The aim is primarily to reduce the administrative burden, not the amount of tax paid.

The turnover tax is provided for in Schedule 6 of the Income Tax Act. It enables what it terms "micro-businesses," which have a qualifying turnover of no more than R1 million a year, to opt in to the system. If a qualifying enterprise opts out of the system, however, they may not be permitted to re-enter it.

The turnover tax rates that are applicable for the year of assessment ending on 28 February 2017 are detailed below. Until 2015, the maximum rate was 6%, which meant that some businesses would end up paying more in tax than they would under the normal dispensation. They would still, however, save on the paperwork involved in the normal tax regime.

Table 11. Turnover Tax Rates in 2016/7

Turnover	Rate of tax
0 - R335 000	0%
R335 001 - R500 000	1% of each R1 above R335 000
R500 001 - R750 000	R1 650 + 2% of the amount above R500 000
R750 001 and above	R6 650 + 3% of the amount above R750 000

Source: SARS (2016)

The following records must be kept for the turnover tax:

- Records of all amounts received;
- Records of dividends declared;
- A list of each asset with a cost price of more than R10 000 at the end of the year of assessment as well as of liabilities exceeding R10 000.

A small business may register as an SBC for tax purposes under schedule 12E of the Income Tax Act. An SBC is taxed on the basis of a progressive rate, and can write-off and depreciate assets at a faster rate than other businesses. To qualify as an SBC, private companies, close corporations and co-operatives need to comply with all of the following requirements:

- The owners (or members, for co-ops) must be actual people, not other companies, and they may not have equity investments in any larger company;
- The business's gross income may not exceed R20 million a year.
- No more than 20% of its receipts and accruals, and no capital gains, may derive from investment income or providing "personal services" as defined in the tax laws, and the business may not be a "personal service provider" as defined in the tax laws.

An SBC registers as a company and for income tax like other business. It can then register for VAT and PAYE, if necessary, through SARS eFiling or through a fast process at a SARS office, rather than completing the normal lengthier process. Registration for income tax, PAYE and VAT are completed in real time, with VAT possibly requiring an additional review step.

The SBC rates that are applicable for the year of assessment ending on 28 February 2017 are detailed below.

Table 12. SBC tax rates as of 2016

Taxable income	Rate of Tax
0 – R75 000	0% of taxable income
R75 001 – R365 000	7% of taxable income above R75 000
R365 001 – R550 000	R20 300 + 21% of taxable income above R365 000
R550 001 and above	R59 150 + 28% of taxable income above R550 000

Source: SARS (2016)

5.3.4. Assessment of costs and benefits for small enterprises

SARS has done a lot to reduce the administrative burden of taxation over the past ten years, including eFiling and improved coordination with the CIPC around company registration. The main concerns now arise around delays and a lack of transparency around VAT refunds and audits.

In 2012, a survey of small businesses (with turnover under R14 million) found that the median time reported for tax compliance was around 100 hours a year, or about one day a month. The average figure was substantially higher, at 255 hours a year, suggesting very large discrepancies within the sample. The study did not attempt to evaluate the accuracy of the businesses' reports. As Table 13 shows, PAYE and VAT required the largest amount of time, in part because they required more frequent submission of returns.

Table 13. Hours reportedly spent on tax compliance by small businesses in 2012

Tax	Median	Cleaned mean (a)	Actual mean
Pay-Aa-You-Earn	38	83	155
Value –Added Tax	31	99	284
Income Tax	29	70	209
Capital Gains Tax	-	3	18
Customs	-	1	14
Excise duties	-	0	6
Total	98	255	686

Notes: (a) The mean trimmed of 5% considered to be outliers. Source: Smulders *et al.* “Tax compliance costs for the small business sector in South Africa — establishing a baseline,” in *eJournal of Tax Research*. October. (X.2) p. 193

The finding that VAT imposes significant compliance cost was confirmed through the focus group discussions with small businesses. They argued in particular that late or delayed payment of VAT refunds is a significant challenge for their cash flow.

SARS targeted a turnaround time for VAT refunds of 21 working days in 2015/6, but actually required 33 days. Although two thirds of refunds were processed within 14 days, if a refund is audited the time can be lengthened to anywhere between three and 12 months. The problem is compounded by the lack of communication by SARS to small business about the progress of audits. As a result, businesses cannot plan for when they will receive their refunds. Recent evidence suggests that there has been an increase in complaints regarding delays of VAT refund payments and the tax ombuds has lodged an investigation.¹⁰

To understand the impact of delayed VAT refunds, the following table indicates the share of VAT refunds in turnover by size. For formal micro and very small enterprise as a group, VAT refunds more or less equalled their entire payments, or 5% of turnover. The figure dropped to 25% for small enterprises, with turnover up to R20 million, equal to around 1,5% of turnover. Delays and unpredictability in resources of this magnitude could obviously prove devastating for businesses.

Table 14. VAT refunds compared to payments and turnover by size of business, 2014/5

Turnover category	number of companies	R bns.			Refunds as % of	
		turnover	payments	refunds	VAT payments	Turnover
over R20 mn	43 500	10 089	227.1	-140.4	-62%	-1.4%
10 mn to 20 mn	29 000	408	17.6	-4.7	-27%	-1.1%
5 mn to 10 mn	43 000	303	14.9	-3.7	-25%	-1.2%
1 mn to 5 mn	139 000	337	20.0	-5.3	-26%	-1.6%
up to R1 mn	166 500	56	5.9	-5.6	-95%	-10.0%

Source: SARS. Tax Statistics: Value Added Tax. 2016. Excel spreadsheet. Downloaded from www.sars.gov.za in March 2017.

Manual registration for VAT also imposes a burden compared to the income tax. SARS has 53 offices countrywide. The standard turnaround time for company income tax is one working day and for a new registration ten working days, but VAT registration takes 21 days.

SARS is particularly sensitive to loosening governance standards as VAT represents the largest single target for fraudulent tax activity in South Africa. SARS reports that it has been

¹⁰ Business Day (2017) Pravin Gordhan urged to launch a probe into SARS for VAT refund delays. 28 February 2017; Business day (2017) Why the tax ombudsman wants to probe delayed refunds. 13 March 2017.

confronted with fraudulent VAT refund claims averaging approximately R2 billion a month (DTC, 2014 p. 47).

Small businesses informants also raised complaints about the compliance costs of obtaining tax clearance certificates when conducting business with the state. In late 2016, however, SARS introduced a system to provide clearances through eFiling, which should address this blockage.

The turnover tax system was expected to reduce the compliance costs for small business. In 2012, the median time spent on tax compliance for businesses using the turnover tax was just 30 hours, less than a third the time required for normal tax returns. The average time for the turnover tax system came to 67 hours, or just under two thirds the average required for other taxes. (Smulder *et al.*, 2012, p. 193)

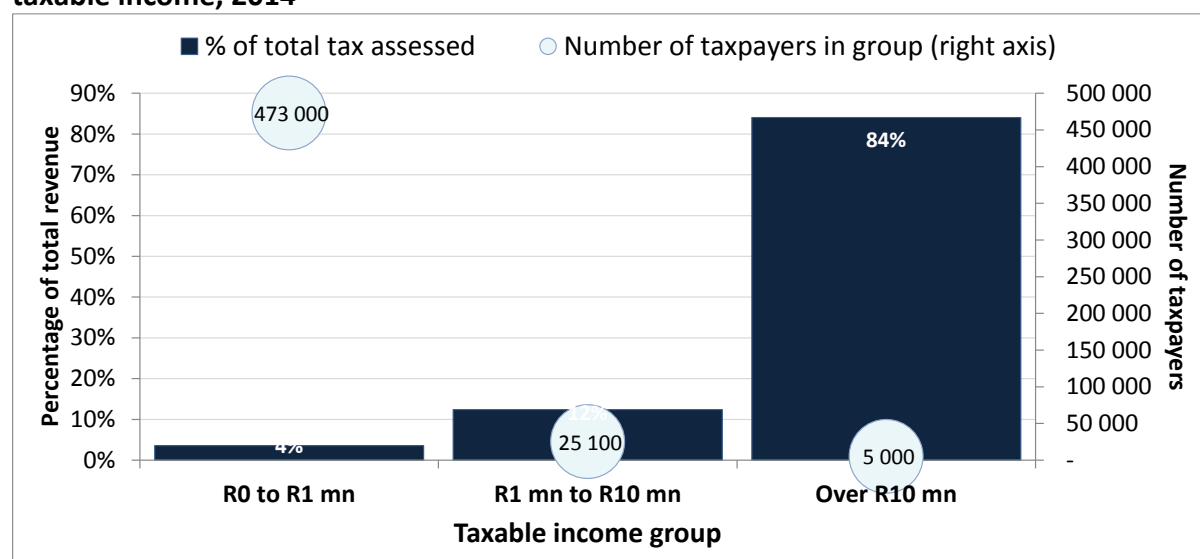
Nonetheless, SARS officials report only limited uptake of the turnover tax by small businesses. This low rate of sign up may be related to the relatively high tax rate at least until 2015, which offsets the reduced compliance costs. From SARS's standpoint, the aim is not to reduce taxation on small business, but to cut the administrative burden.

The SBC tax system was recently reviewed by the Davis Tax Commission (DTC, 2016). It argued that the tax benefits go primarily to service-related small businesses (such as financial, education real estate, medical and veterinary services). In contrast, the SBC was expected to assist start-ups and ailing businesses in an assessed loss position.

It should be noted that the tax system for small business imposes significant burdens on SARS as well. As the following figure shows, almost 500 000 micro enterprises pay some tax, but they account for only around 4% of tax revenue. They also contribute around 11% of VAT payments.¹¹ In the long run, SARS argues that getting small business into the tax net is important over time. In the short run, however, it must clearly spend a significant amount of time and capacity to register and audit small companies that pay very little, if anything, in tax.

¹¹ Calculated for VAT as companies with turnover of R10 million or less, which equates to around R1 million in pre-tax earnings assuming a margin of around 10%. That is the margin found in Statistics South Africa's Quarterly Financial Statistics in September 2016 for all small and micro enterprise.

Figure 13. Share in total tax assessed and number of tax-paying companies by value of taxable income, 2014



Source: Calculated from SARS. 2016. Company Tax Statistics. Excel spreadsheet. Table A3.3.1. Downloaded from www.sars.gov.za in March 2016.

5.3.5. Options

A number of issues emerge with regard to tax administration.¹² These issues include:

- Delays in obtaining VAT refunds, often as a result of audits; and
- The lack of take up for the tax regimes designed for small business.

The costs, benefits and risks of options are evaluated here.

a. VAT refunds

The following options were assessed to address the challenges around VAT refunds.

- Option 1: Change procedures to require SARS to report progress on audits on small business at least every 21 days
- Option 2: Change procedures to prioritise small business audits and refunds
- Option 3: Small businesses receive an automatic refund after a minimum period (e.g. 90 days)

Table 15 indicates the main costs, benefits and risks to the key stakeholders – small business, SARS and other stakeholders.

¹² Some of the tax administration issues have been addressed by the Davis Tax Committee (2016) Small and Medium Enterprises: Taxation Considerations, Second and Final Report, April 2016

Table 15 Costs, benefits and risks for VAT return issue

Delayed VAT refunds	Small business	SARS	Other stakeholders (workers and other companies)
Option 1: Change procedures to require SARS to report progress on audits on small business at least every 21 days	C: Delays may persist B: Will assist small business to plan for their cash flow and financial sustainability R: Communication may not provide useful information	C: Regular communications will require capacity B: Less complaints from small business R: Unable to keep to deadlines; incentive to avoid audits of small business	C: None B: Stronger small business sector helps grow society; may spill over into general improvement in SARS accountability around audits R: Larger businesses may be subjected to delays if small business prioritised
Option 2: Change procedures to prioritise small business audits and refunds	C: No costs B: Better cash flow R: No risks	C: Change auditing procedures to enable priority for small business B: Less complaints from small business R: May receive more complaints from other taxpayers who feel discriminated against	C: None B: General benefits of growing small business sector R: Unless SARS gets more capacity, may end up with greater delays for medium and large businesses
Option 3: Small businesses receive an automatic refund after a minimum period (e.g. 90 days)	C: No costs B: Guaranteed refund by 90 days R: May have to pay back when SARS completes audit, which could be disruptive	C: Cash flow pressure; cost of recovering refunds if audit shows were mistaken B: Less complaints from small business about audit process R: Lower net revenues from small business; greater fraud	C: No costs B: General benefits of growing small business sector R: SARS uses mandatory refund as a reason to prioritise small business refunds over other taxpayers

For VAT refunds, the preferred option is for small businesses to receive a mandatory refund after a certain period (e.g. 90 days) irrespective of an audit. The refund will assist with providing small business with cash flow and incentivising SARS to be more efficient in processing audits and refunds.

The main risks are that payments made before an audit is finalised may be difficult to recover, and that larger businesses end up with longer delays as SARS prioritises smaller ones. These risks would be mitigated if SARS sticks to the 90-day timeline for audits for small business.

b. Reforming income tax for small business

The following options were assessed to address the challenges around the income-tax regime for small businesses.

Option 1: Exempt micro businesses from income tax, but require formal micro-enterprise to register

Option 2: Fix the turnover tax regime (ensuring effective taxation on Turnover tax rate is equivalent or lower than income tax method, not just lowering the compliance cost)

Option 3: Guaranteed tax rebate for small businesses below specified size

Table 16 indicates the main costs, benefits and risks to the key stakeholders – small business, SARS and other stakeholders.

Table 16. Costs, benefits and risks for Income tax for small business

Income Tax for small business	Small business	SARS	Other stakeholders (workers and other companies)
Option 1: Exempt micro businesses from income tax, but require formal micro-enterprise to register	C: Still have cost of registration B: Will assist small business with cash flow and financial sustainability R: None	C: Determine a suitable threshold for exemption; amend the schedule Lower revenue: Companies with less than R1 mn turnover contribute R6,1 bn or 4% of CIT revenue B: Growth in small business and reduced admin costs for relatively little revenue R: Could affect tax morality in business; even formal micro enterprise, some of which are highly profitable, would end up paying less tax	C: 4% increase in company tax required to offset loss of revenue from micro business B: Stronger formal micro enterprise might have spill over effects R: Undermines tax morality; reduces redistribution as formal professionals might be exempt if threshold is up to R1 million
Option 2: Relaunch the turnover tax regime to communicate that lower rates now mean companies would not pay more tax	C: Register for turnover tax B: Better cash flow R: Less space for deductions could mean some businesses end up with higher tax	C: Communications drive; monitoring to ensure that in fact leads to lower taxes B: Incentivise small business to comply with tax registration; growth in small business; reduced admin costs for relatively little revenue R: May receive lower revenues	C: No costs B: Growth in micro enterprise has spill over effects R: If net revenue declines, end up with higher taxes
Option 3: Guaranteed tax rebate for small businesses below specified size	C: Register for income tax B: Better cash flow R: Refund delays could affect cash flow	C: Determine threshold; amend the schedule B: Incentivise small business to comply with tax registration; growth in small business; reduced admin costs for relatively little revenue R: Lower revenues from small business	C: Reduced revenue from small business leads to higher tax on others B: Growth in micro enterprise has spillover effects R: SARS uses mandatory refund, as a reason to prioritise small business refunds over other taxpayers

The preferred option is to improve communication around the Turnover Tax and monitor outcomes to ensure that it does not in fact entail higher tax payments. The system originally sought to incentivise participation on the basis of lower tax compliance costs, as opposed to lower effective taxes. Small business with high turnover but operational losses had an incentive to opt for the normal tax regime. The shift to a 3% rate two years ago aimed to address this problem, at least in part, by reducing the actual tax paid to no higher than the likely income tax. Improved communication of the new rates has to be bolstered by monitoring to enable further adjustments if required to avoid over-taxing micro enterprises.

c. Stakeholder responses

Providing automatic VAT refunds if audits take too long shifts the administrative burden from small business to SARS. As such, it would certainly run into a degree of opposition, especially given SARS's expressed concerns around VAT fraud. That said, although small businesses make up the vast majority of taxpaying companies, they account for only a very limited share of revenue. As such, it might be better for SARS to develop streamlined techniques for auditing them so that it can focus on the larger players where VAT fraud costs much more.

The Turnover Tax proposal would require some effort by SARS to re-launch the system with the new rate, and to monitor returns to ensure that it has the desired effect of avoiding over-taxation of small business. The DSBD could assist with the re-launch costs and with on-going communication to small business about the new dispensation.

5.4. Labour registration: UIF, the Compensation Fund and the skills levy

Labour laws generally seek to ensure that workers do not face dangerous or exploitative conditions. These laws have had a particularly substantial impact in South Africa because they sought explicitly to remedy abuses that had been normalised under apartheid.

In this context, employers are effectively required to help administer parts of the social security and skills development provisions – specifically the UIF, Compensation Fund and skills development systems. That in turn requires registration and reporting in each of these areas.

5.4.1. The legislation

All employers are required to register for the UIF, the Compensation Fund and the Skills Development Levy and make regular payments to them. The payments are governed by:

- The Unemployment Insurance Contributions Act of 2002
- The Compensation for Occupational Injuries and Diseases Act (COIDA) of 1993
- The Skills Development Act of 1998
- Various tax laws.

The UIF and the Compensation Fund are managed by Commissioners appointed by the Department of Labour, but have strong advisory boards with labour and employer representation. The skills levies are paid to Sector Education and Training Authorities (SETAs). They in turn pass some of the revenue on to the National Skills Fund, and are expected to use the rest to pay for accredited training by registered employers. SETAs have tripartite boards that appoint the executives.

SARS collects the UIF and skills levies and transfers them to the relevant authorities. Payments are made together with PAYE. In contrast, the Compensation Fund treats its payments as insurance premiums that it levies directly.

The payments from registered businesses are:

- For the UIF, 1% of payroll each from employers and workers for virtually all employees, although tax is only levied on an employee's earnings up to around R15 000 (as of 2016);

- For the Compensation Fund, an amount calculated based on payroll times the assessed risk factor by sector, but state employees are exempt; and
- For the skills levy, 1% of payroll for all employees outside of government and domestic work, and excluding employers who pay less than R500 000 in wages and salaries.

Section 13 of the Unemployment Insurance Contributions Act allows the UIF to impose interest on late payments or default equal to up to 10% of the amount owed. Labour inspectors may investigate employers' premises to confirm the returns are accurate. Section 17 permits a fine or maximum imprisonment of 12 months for illegally avoiding UIF payments.

5.4.2. Aims and theory of change

The UIF provides an insurance fund giving limited benefits to retrenched workers. It aims to address the externalities that arise from retrenchment, as employees who lose their jobs may otherwise become destitute. It was originally established before 1994 to serve non-African workers; since 1994 it has gradually extended to virtually all employees.

The Compensation Fund provides insurance against occupational injuries, diseases and death. Without this kind of insurance, workplace accidents or health problems could push workers into destitution and lead to costly legal processes against employers. As with the other levies, it originated to serve privileged workers but has since been extended to all private-sector employees. That said, in 2015 only 480 000 enterprises were registered with the Compensation Fund, out of over 700 000 formal and informal employers according to the LMD.

COIDA operates under a no-fault system. If an employee claims for compensation for an occupational injury or disease from the Compensation Fund, they cannot take the employer to court. On the other hand, if an employer fails to comply with the provisions of registration and an employee has an accident, the Director General of the Department of Labour may charge them with a fine, and some kinds of non-compliance constitute offences.

The skills system was fundamentally reformed in the 1990s in an effort to redress the inequalities in education and training that formed a pillar of apartheid. It aims:

- To provide more workers with certified, transferable skills; under apartheid, black workers generally could gain skills on the job, but without certification their skills benefited only their employer, not the broader sector, and did little to promote career mobility.
- To ensure that skills development resources benefited all workers, not just managers and professionals.
- To increase the funding of skills development across the formal sector.

Table 17. The logic behind the UIF, Compensation Fund and skills levy

Problem	Beneficiaries from the problem	Cost bearers of the problem
Retrenchment imposes costs on society, not just on the affected workers	Employers see costs of retrenchment as externalities	Retrenched workers and their families Society has to pay to support retrenched workers and their families
Workplace injuries and disease impose costs on society, not just workers and employers	Employers do not have to pay full cost of workplace ill health	Workers and their families in the case of workplace-based ill health Society has to support the affected workers and their families
Apartheid left South Africa with low skill levels, a lack of training and certification systems for ordinary workers, and inadequate employer spending on training	Employers do not have to provide certified training and pay for it	The economy grows more slowly and creates less employment due to the skills shortage Employers cannot tell if workers are skilled, so they have a smaller pool to choose from Workers without certified skills are locked into jobs

The theory of change applied to for the UIF, Compensation Fund and skills levy is comparable to the theory of change for taxation. That is, individuals will pay levies if there is a modest penalty combined with an understanding of the direct and indirect benefits of the schemes for employers and workers.

The theory of change for the UIF and skills levy involves the following specific steps:

- Employers are required to register with SARS to pay PAYE, with the normal penalties
- UIF and the skills levy are included in the PAYE registration and payments, with additional penalties for failure to register and pay the levies
- Employers comply because it is administratively easy if they are registered for PAYE, to avoid the penalties, and because they see the benefits of the schemes (that is, insurance for retrenched workers and refunds for accredited training)
- SARS transfers the skills levy to the relevant SETAs and the UIF payments to the UIF
- Workers can access the UIF if retrenched, and employers can obtain funds from the skills levy to pay for accredited training.

The assumptions are:

1. The benefits of the scheme to employers actually materialise
2. The benefits are proportionate to the administrative and financial costs.

For COIDA, employees are incentivised to register in order to avoid being sued for damages in case of an employee injury, disease or death. In addition, employees will encourage employers to register in order to have some form of financial insurance against work related illnesses, diseases and injuries. The key steps to achieving this end state are:

1. The Compensation Fund assesses the risks of occupational ill-health by industry
2. Enterprises are required to register with the Compensation Fund and pay annual assessment fees based on the assessed risks for their industry

3. In the event of an employee injury, disease or death, the enterprise reports to and claims from the Compensation Fund, and cannot be sued by employees who benefit
4. Employees obtain support for occupational diseases and injuries without requiring an individual lawsuit against the employer.

The implicit assumptions relating to this regulation are that the incentives and penalties provided by COIDA are a sufficient mechanism to encourage registration and compliance. That presumes that the cost of fees and paperwork for the Compensation Fund are not excessive, and that payments are reasonably prompt. It is also assumed that the Compensation Fund has the capacity to assess realistic fees and to ensure that employers register, in order to secure a sufficiently large pool of insured people.

5.4.3. The impact on smaller enterprises

a. The cost of implementation

UIF is administered by SARS on behalf of the Department of Labour. Where an employer is liable to pay UIF contribution, the employer must register with either SARS or the UIF office¹³ of the Department of Labour for the payment of the contributions. They must register all employees who work more than 24 hours in a month for UIF.

SARS also administers the skills levy for the Department of Higher Education and Training (DHET) and the SETAs. Employers have to register if they expect to pay total salaries over R500 000 a year. They have to select the SETA that matches their area of business – not always an easy task, since some enterprises fall between SETA scopes. The payment is made on the same form as the PAYE and UIF.

With a few exceptions, every employer must register for the Compensation Fund.¹⁴ For COIDA, employers must fill in a standard form at any labour centre or on the Department of Labour website, which hosts the Compensation Fund. They have to fill out the average number of employees and their estimated earnings. Employers send forms to the Department of Labour with a copy of a registration certificate from the Registrar of Companies (CIPC) if they are a company or closed corporation, or their ID document if they are sole owners of the business.

b. Administrative costs

The PAYE, skills levy and UIF amounts that are deducted or withheld must be paid by the employer to SARS on a monthly basis, by completing the Monthly Employer Declaration (EMP201) through SARS eFiling.

To claim for UIF, retrenched workers must apply for benefits at their nearest labour centre in person. Workers may not claim UIF if they resign or are dismissed for ill-discipline or low

¹³ An employer who is not required to register with SARS for employees' tax purposes can apply directly to the Department of Labour.

¹⁴ This excludes workers who are totally or partially disabled for less than 3 days; domestic workers; anyone receiving military training; members of the South African National Defence Force, or the South African Police Service; any worker guilty of wilful misconduct, unless they are seriously disabled or killed; anyone employed outside the RSA for 12 or more continuous months; and workers working mainly outside the RSA and only temporarily employed in the RSA.

productivity. They must be registered as work-seekers and take the necessary documents with them, which include:

- Bar-coded ID or passport;
- Banking details;
- Form UI-19 to show that you are no longer working for your employer; and
- Proof of registration as a work-seeker.

To claim SETA support for training, an enterprise needs to compile a Workplace Skills Plan. In return they can receive mandatory and discretionary grant repayments equal to half their annual skills levy contribution. If companies send their employees for training on accredited courses approved by their SETA, the SETA will pay the service provider directly.

According to the provisions of Section 82(1) of the COIDA, it is incumbent upon an employer to render a return of earnings before or on the 31st of March of each year. From April every year, the Compensation Fund sends employers notices of assessments that tell them how much to pay, depending on the industry to which they are assigned.

The notification process occurs throughout the year, and it is not possible to predict when employers will receive their notices. The date of the notice determines when employers must pay, making the process somewhat unpredictable. Typically, employers are required to pay within 30 days of when the notice was sent. Employers can pay by cheque, direct debit or internet banking. An employer that does not receive an assessment for a whole year is expected to contact the Compensation Fund to find out if there is a problem.

An employee needs to keep records of Compensation Fund payment for up to four years of the date of last entry. A health and safety representative will inspect the register, records or documentation maintained by the employee for compliance.

Employers must submit their claim to the Compensation Commissioner within seven days after an injury and 14 days of being notified of the diagnosis of a disease. Validated claims – the vast majority – are paid through the National Revenue Fund, which is later compensated by the Compensation Fund. In 2015/6, the Compensation Fund registered 129 000 claims and adjudicated 80% of them. A quarter of claims take two months to adjudicate. The Fund blamed the delays on slow computer systems and high vacancies in its provincial offices. (Compensation Fund 2016, pp. 42-43)

The Compensation Fund systems were computerised only a few years ago, and are still not fully on-line. In particular, the Fund does not have a computerised case management system that is integrated with the registration system. This situation led to significant delays and backlogs in 2013, which have since reportedly been largely overcome.

c. Costs that are integral to the desired outcome

The levies paid by employers are an integral cost to the desired outcome for funds as well as the skills levy. The total for the UIF and the skills levy equals 3% of payroll, with 1% of that paid by employees for the UIF.

The current regulations on the skills levy provide that t

In contrast, COIDA does not levy a flat amount. Instead, it bases its fees on the anticipated risk as well as workers' earnings.

COIDA has established over a hundred risk classes for employers based mostly on the type of industry, each with its own assessment tariff. If an employer has higher accident costs than others in the same subclass, the assessment tariff may be increased. If costs are lower, the rate may be reduced. The assessment system is currently lagging behind in the dates for new assessments.

The Compensation Commissioner may refund employers with a merit rebate if employers actively prevent accidents; employers moderate costs over a three-year cycle; and there are excess funds. In the event, as discussed in the following section, the Compensation Fund has an extraordinarily large surplus from payments.

5.4.4. Assessment of costs on small enterprises

Informants and other research raised concerns principally around the limited ability of small businesses to benefit from the skills levy; the unpredictability of COIDA risk assessments and the general overpayment built into the system; and the relatively onerous registration requirements for private employment agencies.

The current SETA refund system has been criticised for extracting funds from small business without providing them with appropriate training. This position was articulated by the Davis Tax Commission (2016) recently, but it has been a consistent concern from small business associations, as cited for instance in Fetola (2013). In this context, the main concerns arise about the low exemption ceiling and the high standards set for accredited training.

Companies have to pay the skills levy if they have a payroll of R500 000 or more. Based on 2015 rates, that would mean the number of employees could range from a single professional worker to around ten formal employees earning the median wage of R3500 a month. By extension, it would mean most micro-enterprises are expected to pay the skills levy.

Estimates suggest that only 37% of small businesses that pay the levy are receiving the training benefits. Only 10% of those small businesses claimed through the workplace skills plan, while the rest utilised SETA accredited training courses.

Various factors explain this situation.

First, many small businesses do not have capacity to comply with the requirements for workplace skills plan, which were designed essentially for relatively large enterprises. Amongst others, the workplace skills plan requires an enterprise to set up a consultative committee with employees and to have monitoring systems in place. But most small and micro businesses do not have a separate human-relations component, so that the burden falls on the owner or senior managers. Moreover, if they have only a handful of employees, the required committee becomes only a bureaucratic requirement.

The difficulty of developing a workplace skills plan has to be offset against the benefits. From 2016, the share of levies returned for an approved skills plan was reduced to 20%. For a company with a payroll of R500 000, that means a refund of R1000 – almost certainly less than the cost of developing the plan in the first place. Before 2016, the mandatory grant was half the levy, which would come to R5000 for a company with a payroll of R500 000. Again, that sum would not justify significant administrative effort.

Second, SETA-accredited training provides courses that fall within the South African Qualifications Authority (SAQA) framework. The aim is to enable employees to accumulate

credit toward a recognised certification. That in turn requires substantial time on theoretical understanding and transferable skills. For small businesses, however, this may be seen requiring a significant amount of lost time in return for theoretical benefits to the employee but only limited practical training to benefit the employer.

Third, accredited learnerships generally entail at least a year's commitment with specified theoretical as well as practical training. Small businesses with very limited staffing may find that this leads to disruption and undesirable rigidities. They may prefer shorter and more informal internships in order to maintain flexibility to respond to changing conditions and needs.

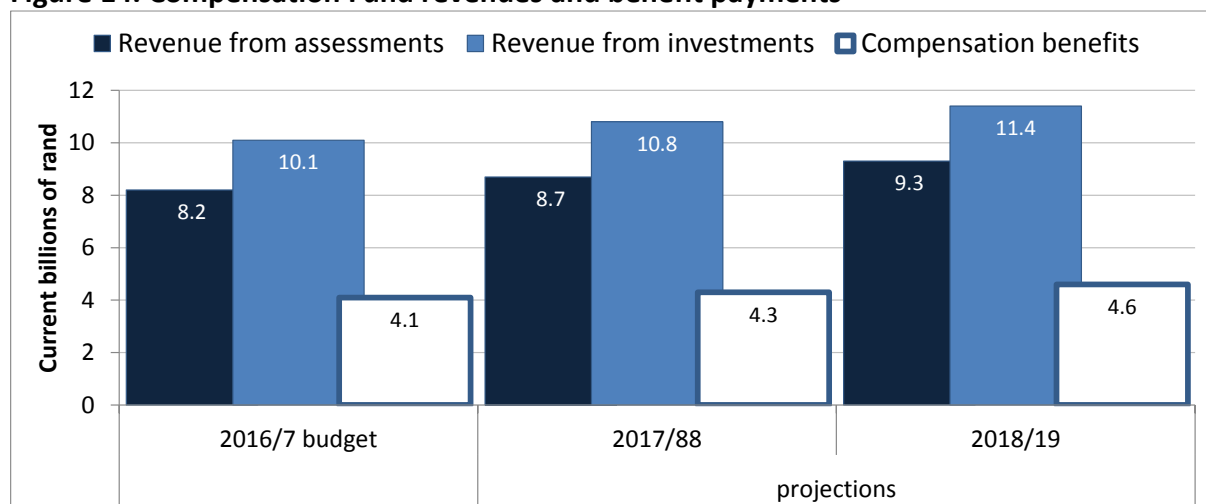
In terms of the Compensation Fund, the main issues relate to the risk assessment process and to the unjustifiably high levies.

As noted above, risk assessments have been delayed and unpredictable. Moreover, informants argue that

- companies that span more than one industry are inevitably assigned to the higher-risk, and higher-cost, category
- improvements in health and safety at sectoral level are not adequately reflected in assessment, in part because the assessments themselves are delayed, and
- it is difficult, time-consuming and often futile to appeal an inappropriate assessment.

The concerns around risk assessment underpin the evidence of considerable over-payment by companies. As the following table shows, the Compensation Fund has consistently received far more in assessed payments from employers than it has spent on employee needs. As a result, it has built up a substantial surplus, from which it now receives an income in excess of both payments from employers and payouts to employees. That means the surplus is likely to continue to grow for the foreseeable future. Its payouts are now around a fifth of its total income.

Figure 14. Compensation Fund revenues and benefit payments



Source: Department of Labour. Report to Parliamentary Labour Portfolio Committee on 17 May 2016. Downloaded from www.pmg.org.za in April 2017.

In effect, this situation means that COIDA has become a forced saving scheme for employers, both small and large. A similar argument applies to the UIF, which also has an

extraordinarily large annual surplus and investments worth well over R100 billion. (See Makgetla 2016)

Finally, representatives of private employment agencies have raised concerns around their specific registration requirements for UIF, the skills levy and COIDA. A representative of the Federation of African Professional Staffing Organisations (APSO), an industry association, brought these issues to our attention.

In order to register for as a formal employment for gain company, an enterprise requires a Private Employment Agency (PEA) certificate. That in turn requires that the enterprise undergo a site visit and submit:

- VAT registration
- Skills Development Levy registration
- Income Tax registration (and tax clearance certificate)
- Proof of payment of COIDA and UIF
- Letter of good standing from UIF and COIDA

The applications must be submitted by every branch of the employment agency, in person, at the nearest Department of Labour office. The site visit takes place following submission of the documents. APSO says that the Department of Labour has increasingly insisted on site audits for applications and renewals for PEA certificates. The site inspections cover amongst others the company letterhead, founding documents, a utility bill as well as compliance with the Basic Conditions of Employment Act, the Occupational Health and Safety Act and the Employment Equity Act. The inspector may also ask about the nature of employment services work conducted.

After the Department of Labour has issued a PEA certificate, the agency has to renew it every two years. It must also renew the certificate if it moves or makes a fundamental change to its operations.

APSO argues that the process is tedious and onerous for small enterprises in the industry. The Letters of Good Standing for UIF and COIDA, in particular, are managed through a paper-based system at regional Department of Labour offices. That leads to reported delays of up to 18 months.

APSO contends that the onerous registration process means a large number of enterprises to operate illegally, without the PEA certificate. It estimates that there are approximately 3000 companies operating in the industry, most of which may be unlicensed. APSO itself has only about 750 members.

5.4.5. Options

We here assess options to address:

- The failure of SETAs to provide support to small business in line with levy payments;
- The unpredictability and high level of COIDA payments; and
- The onerous procedures and delays with obtaining PEA certificate.

a. *The skills levy*

The following options have been considered for ensuring that small businesses benefit more from the skills levy system.

- Option 1: Raise the payroll threshold for payment of the skills levy, for instance to R1 million (equivalent to two or three professionals or up to 20 semi-skilled formal workers)
- Option 2: Develop a simplified workplace skills plan for small businesses
- Option 3: Develop specific modules and curricula for training for small businesses

Table 18. Costs, benefits and risks around the skills levy

	Small business	Department of Higher Education and Training	SETAs	Workers in small business
Option 1: Raise the payroll threshold for skills levy	C: Lose the chance of financing training through the ordinary SETA process B: Lower direct costs R: Small business may remain at lower skills level, and therefore less dynamic and competitive	C: Administrative effort to gazette new exemption level under the Act B: Fewer complaints from small business R: Small business may not access or invest in training	C: Reduced levy income and fewer constituents B: Do not have as much administrative burden and less pressure from small business R: None	C: Workers in small business may not get training or only unaccredited training B: If boost growth in small business, some spillover benefits R: Slower growth in small business due lower training, with negative spillovers
Option 2: Simplified Workplace Skills Plan for small business	C: Still have to complete skills plan to qualify B: Easier to qualify for skills levy refund R: Plan is still too onerous compared to benefits at 20% of levy	C: Develop simplified plan and negotiate acceptance by SETAs; communicate to small businesses B: Smaller businesses remain in skills system R: Could reduce funds from skills system that now finance other DHET programmes	C: Adoption of simplified form and more workplace plans submitted for processing B: Smaller businesses remain in skills system R: Worse training outcomes due lower quality plans	C: Worse training outcomes for workers in small business if permit unaccredited training B: Workers in small business are more likely to benefit from SETA financing R: As under costs
Option 3: Develop modules and curriculum for small business	C: Still have to meet application requirements B: More useful training R: Training may still be misaligned	C: Support for development of new modules B: Improve outcomes in terms of training R: As with small business	C: Development of new modules and identification of service providers B: Improve outcomes R: As with small business	C: End up with unaccredited training or training outside of SAQA B: Greater access to training R: As with small business

These options for reforming the skills system to meet the needs of small employers generally focus on ensuring more flexible, focused and short-term training that would

effectively do less to ensure accredited training but would reduce the cost to employers. If this trade-off is accepted, then the easiest option is for Treasury and the Department of Higher Education and Training to increase the levy threshold for small business, for instance to R1 million a year. Under the Act, the change need only be gazetted.

On the longer run, it would obviously be helpful if DHET and the SETAs introduced more flexible requirements for training for small business employees, with simplified requirements for workplace plans and shorter modules that are less tied to accreditation and human capital development. DSBD could usefully support development of these models.

b. The Compensation Fund

The options examined for the Compensation Fund payments are:

- Option 1: A payment holiday for micro, small and medium business
- Option 2: Establishment of a tripartite commission to review actuarial requirements and assessment systems for Compensation Fund
- Option 3: Establishment of a more effective and faster appeals and dispute settlement route for assessments.

Because the Compensation Fund already has such a large surplus, none of these proposals should affect pay-outs to workers. The analysis below therefore focuses only on the implications for larger businesses.

Table 19. Costs, benefits and risks of options for the Compensation Fund assessments

	Small business	Compensation Fund	Other stakeholders
Option 1: Payment holiday for micro, small and medium business	C: None B: Reduced costs R: None	C: Legal requirements (likely in form of reduced assessments rather than outright cancellation of payments); slower growth in assets B: Better macro-economic environment overall; improved alignment with mandate R: None (surplus is now so large that lower revenues should not have major impact in the absence of hyperinflation)	C: Risk pool would be smaller for business as a whole, which could lead Fund to increase assessments B: Growth in small business could have spill over effects R: As with Compensation Fund
Option 2: Commission to review actuarial requirements and assessment systems for Compensation Fund	C: Engagement with Commission B: Reduced assessments R: Commission is very slow and findings lead to higher assessments (seems unlikely)	C: Support for Commission B: Empirical test for basis of assessments; improvements in assessment systems R: Commission gets it wrong	C: Engagement with Commission B: More appropriate and responsive assessments for all businesses R: As with Competition Commission

	Small business	Compensation Fund	Other stakeholders
Option 3: More effective and faster appeals and dispute settlement route for assessments	C: No change in existing inefficient system for setting assessments B: May see improvements where assessments are inappropriate R: New system doesn't work well	C: Have to respond timeously to appeals and be more accountable about assessments; could lead to lower revenues and consequently slower growth in assets B: More satisfied constituencies and more appropriate assessments R: As with small business	For all business, the analysis for small business applies

The preferred option would provide for a limited payment holiday, say for two years, during which time a tripartite commission would review the actuarial basis of the Compensation Fund's assessments. This approach would ensure a longer-term solution to the problem of excessive surpluses. In addition to analysing the level of assessments, it should review the Compensation Fund's payment systems. Workers and healthcare workers contend that the existing benefit levels are inadequate and that payments are often delayed.

In addition, establishment of a more responsive appeals and dispute resolution system would assist in improving the legitimacy of the compensation assessment system while reducing inappropriate charges to companies. Such a system could for instance involve fixed turnaround times for responses to appeals and some possibility of independent arbitration.

c. PEA certificates

The following options were analysed to reduce the burden of obtaining a PEA certificate.

- Option 1: Exempt employment agencies that count as small businesses, and do site visits by exception
- Option 2: Set a standard turnaround times and time frames – for instance, if an inspection is not conducted in two weeks then certificate will be provided automatically
- Option 3: Digitise certification

Table 20. Costs, benefits and risks for PEA certificate options

	Small business	Department of Labour	Employees of employment agencies
Option 1: Conduct site visits after certification and only where some evidence of need	C: No additional costs, but other elements of registration remain B: Can have accreditation more rapidly R: Criteria that trigger inspection set very broadly	C: None B: Reduced inspection requirements R: Companies may use the opportunity to avoid regulation at the cost of their workers and customers; regional offices oppose change	C: None B: If more companies register, then workers' conditions would also improve R: More likely to be deprived of benefits or defrauded (not clear how big this risk is)

	Small business	Department of Labour	Employees of employment agencies
Option 2: Set standard turnaround times and time frames	C: No costs, but other costs of registration remain B: Can have accreditation more rapidly R: No risks	C: Determine time frames; change procedures to meet timeframes B: Greater compliance R: Regional office are unable to adhere to timeframes	C: None B: As above R: Lower quality inspections mean do not catch problems
Option 3: Digitise certification	C: Need to be able to use digital system B: Can have accreditation more rapidly R: Unreliable systems	C: Include in existing systems B: Reduced admin burden once new system is in place R: Regional offices see as a new burden	C: None B: As above R: No risks

From the assessment of costs, benefits and risks, the preferred options for reform include a combination of a digital solution for the Letter of Good Standing and shifting to selective rather than universal site visits.

d. Stakeholder responses

The modifications proposed for the skills levy contrast with the existing aims of the skills system, which are primarily to improve career mobility for workers and meet sector skills needs. There would therefore likely be significant opposition from unions and possibly from policymakers in the skills field.

In terms of the Compensation Fund, the tripartite board and the Commissioner will likely oppose any reduction in revenue, even though it is running a significant surplus. Experience suggests that the Department of Labour will tend to support the Compensation Fund unless the evidence around the surplus is clearly communicated. It is possible that unions will also oppose any reduction in the levy because they fear (wrongly) that it would necessitate cuts in benefits.

It is likely that the Compensation Fund would also oppose any effort to make the assessment process more accountable.

In terms of the PEA certificate, the regional offices of the Department of Labour may see the proposals as disruptive and unnecessary. In addition, most unionists see employment agencies as inherently linked to outsourcing and therefore exploitative. They might therefore also oppose any efforts to facilitate their registration.

6. PROCUREMENT

State procurement of goods and services accounts for around a tenth of the GDP.¹⁵ Small businesses, however, often argue that they are restricted from supplying all the spheres of

¹⁵ Calculated from South African Reserve Bank. Interactive data. Series on government procurement of goods and services and the GDP. Downloaded from www.resbank.gov.za in April 2017.

government in part because of inappropriate regulatory frameworks that impose excessive burdens. This section analyses both the administrative and the inherent costs associated with the rules and procedures governing national and provincial procurement.

6.1. The legal framework

The main procurement laws are the Public Finance Management Act of 1999 (PFMA), the Municipal Finance Management Act of 2003 (MFMA), and the Preferential Procurement Policy Framework Act of 2000 (PPPFA). The first two lay down procedures for all government procurement that aim to prevent corruption and ensure value for money. They are enforced through detailed and extensive regulations managed by the National Treasury. The PPPFA, in contrast, aims to ensure that government departments can take into account broader social and economic aims in their procurement processes.

In an effort to prevent corruption and improve value for money, the laws aim to ensure that state agencies purchase the lowest-cost goods and services that meet quality requirements, no matter which supplier provides it. To achieve that end, they tightly regulate supply-chain procedures, with detailed requirements around the kinds of information required from suppliers and how the procurement process is managed depending on the size of the tender involved.

The laws give some latitude in choosing options for procurement, and different state agencies interpret the regulations somewhat differently. Moreover, the rules allow for limited exceptions, for instance for emergency procurement, in order to allow local producers to match prices, or where there is a sole provider. Deviations are however generally discouraged, with often very strict definition of the acceptable arguments and evidence.

Key requirements for tendering include the following:

- In virtually all cases, procurement processes require a degree of competition, although the specific procedures vary by size. Smaller procurement processes can involve just getting competitive quotes, while larger processes require advertised tenders.
- Specific officials are required to take responsibility for tender processes, with the main administrative head – the Director General, in the case of departments – specifically responsible for any failures.
- The auditor general reports publicly to Parliament on any deviation from procedures, whether or not there is evidence of corruption, and the head of department is then required to explain to the relevant portfolio committee (and effectively the press).
- Expenditure must align with budgets unless a virement is obtained; large deviations must be approved by National Treasury and ultimately by Parliament.
- Suppliers must be registered for tax and supply contact details in the required format.
- Price and ability to meet criteria for the tender must account for at least 80% of any tender decision, with the remaining points reflecting efforts to promote other policy ends under the PPPFA. If a decision is made to use a higher-cost supplier, the procurement official should be able to justify their decision to the auditors in terms of either the quality of the supplies or preferential procurement considerations.

- Any deviation from procedures, for instance because there is only one viable supplier or because of urgency, must be justified formally. Generally, these deviations are discouraged except where the evidence of need or benefit is overwhelming.
- Contact between potential suppliers and procurement officials in designing tender specifications is strongly discouraged.
- Large tenders must be advertised in the government gazette and in newspapers, and are also accessible through a centralised website.
- Tenders submitted after the specified date must be rejected, no matter how strong they are.
- Tender decisions must be made by a panel comprising the potential users of the input and procurement officials. In other words, the potential users do not have the final say on which tender is approved.
- Payments must be made for deliverables, with no up-front payment allowed.

In order to promote new suppliers and local procurement, a number of measures have also been instituted. They include the following.

- In any procurement process, 20% of points for tenders below R100 million and 10% for larger tenders are set aside for preferential procurement. State agencies may choose the criteria for these points as long as they align with national priorities. Most utilise the points for small business and/or some form of black empowerment, either ownership alone or BBBEE levels as provided in the **dti** Codes. A few also require a degree of local procurement, in some cases defined as local to provinces or municipalities.
- National Treasury, together with the **dti**, has designated some strategic products for local procurement. Designated products currently include inputs for renewable energy; clothing; rolling stock and locomotives; and furniture, amongst others.
- Government departments are required to pay suppliers within 30 days of invoicing, although it is not clear if that means approved invoices or initial invoicing. Departments and provinces that report long delays in payment have been reported through the DPME to the Forum of South African Directors-General (FOSAD) and to Parliament, although this is not a regulatory requirement.
- The BBBEE Codes (a) provide some incentives for local producers, although they are limited and not comprehensive, and (b) incentives for larger suppliers to the state to procure from and support smaller black-owned suppliers. The BBBEE Codes are analysed separately in more detail in section 8.

Some of these measures are currently being reviewed. In particular, initial changes designed to promote subcontracting to small suppliers have been gazetted for comment. The longer-term proposals have not yet been published, but current discussions centre on changing the nature of the regulatory authority rather than immediate modifications to the current system.

6.2. Aims and theory of change

From 1994, large, predominantly white-owned companies and imports have generally dominated state procurement. That has undermined efforts to promote more representivity

and diversified producers. The challenge has been to integrate measures to address this problem in the context of the over-arching procurement laws, which are focused on preventing price overcharging, corruption and poor quality purchases, on the one hand, and avoiding excessive delays, on the other.

The issues around corruption, quality and delays impact disproportionately on poor households, who most depend on government services, and on businesses that are pushed out by corruption and lower quality producers.

Procurement from large suppliers and importers has tended to militate against smaller and black-owned business and local producers. These are not always the same group, as many importers are smaller than local producers. Moreover, the barriers to entry tend to be lower for importing agencies than for new producers, which means importing may attract more black-owned businesses.

Table 21 indicates the main beneficiaries and cost bearers from the problems identified around procurement.

Table 21. The problems that procurement laws seek to address, and their beneficiaries and cost bearers

Problem	Beneficiaries from the problem	Cost bearers of the problem
Corruption	Corrupt companies Corrupt procurement decision makers	Beneficiaries of state programmes, who are disproportionately poor Non-corrupt suppliers Taxpayers (who may end up paying more for less) Public sector employees, who may see lower job creation or job losses
High prices and/or poor quality	Suppliers of low-quality or over-priced products	Beneficiaries of state programmes, who are disproportionately poor Quality and lower-price suppliers (who may lose out due higher prices) Taxpayers (who end up paying more for less) Public sector employees, who have to work with shortages and worse quality products and get blamed for poor service
Delays in procurement	Procurement officials, who can prove they abide by the rules	Beneficiaries of state programmes, who are disproportionately poor Suppliers Taxpayers (who end up paying unused taxes) Public sector employees who face shortages of required products
Large companies dominate of procurement	Large and white-owned enterprises that have historically supplied state agencies Workers, beneficiaries and public-sector employees, at least in short run, if (a) suppliers produce locally and (b) they are able to supply at best price and quality Procurement officials, who don't have to change behaviour	Small business and black-owned companies that are unable to compete for state contracts Workers, beneficiaries and public-sector employees, if new suppliers would lead to higher quality, lower prices and reduced dependence on imports, and ultimately accelerated industrialisation, at least in the longer run

In terms of the theory of change, the procurement legislation aims to ensure that state procurement achieves value for money while, as a secondary aim, involving more small and black-owned suppliers. The extent to which imports figure in this end state is contested.

The legislation presumes the following steps will lead to achievement of the desired outcomes.

1. The National Treasury specifies procedures that balance the need to promote competitive tenders with some degree of preferential procurement.
2. Heads of department and state agencies ensure enforcement of the rules as required by law, and the Auditor General reports on any deviations.
3. Procurement officials abide by the rules in procuring goods and services.
4. Departments procure from more diverse suppliers while continuing to obtain quality, low-cost goods and services.

This theory of change implies a specific analysis of what could go wrong with procurement – specifically, that officials may be open to corruption or fail to ensure rigorous value for money, but also that smaller and black-owned enterprise may not be able to compete on price and quality grounds with more established suppliers. The specific assumptions in this regard are:

- Officials and suppliers will inherently be tempted to undertake corrupt processes. These temptations can be managed by bright-line rules that establish procedures based on unambiguous criteria for delivery and competitive pricing.
- Effective enforcement of the rules requires clear responsibility from the top down as well as monitoring by highly capacitated authorities like the Auditor General and National Treasury.
- If suppliers are not recorded properly and do not pay tax, they are more likely to engage in corrupt processes and to fail to meet tender requirements.
- Developing new suppliers and local procurement tends, in the short run, to involve higher costs and worse quality, which needs to be balanced against the potential impact on government services. For instance, it would be problematic to pay higher prices for medicine in order to support local suppliers since that could result in a higher burden of illness, even death, especially for poor families that depend on the public health system.
- Failure by state agencies to pay especially small suppliers on time can have disastrous consequences for the enterprises and may deter smaller producers from tendering.

In addition, the theory of change rests on assumptions about how implementation will work. The main assumptions are the following.

- The rules provide an appropriate balance between preferential procurement and the core aim of maintaining and improve state services.
- The rules are unambiguous, so that responsibilities and deviations can be identified and sanctioned.
- The public-service hierarchy, the Auditor General and the National Treasury have sufficient capacity to monitor implementation, and the potential punishments in terms of both labour relations and criminal sanctions are clear and sufficient to ensure the desired behaviour.

As discussed above, National Treasury itself has noted that some of these assumptions are not sufficient. In particular, it has argued that:

- The size of tenders may in itself be a barrier to entry for smaller suppliers. It has therefore published for comment draft regulations that will require that any contractor who wins a tender of over R30 million must subcontract at least at third to small business.
- The sanctions for failing to comply with requirements are inconsistent and often not applied.
- There is limited regulation of procurement procedures following the tender process, which means that suppliers may not live up to their obligations.
- The regulations are in practice sometimes ambiguous and very complex, and different state agencies do not always implement them in the same way.
- Departments sometimes use indicators other than the **dti**'s BBBEE ratings to allocate points for preferential procurement, including to define black ownership and empowerment.

6.3. Assessment of the costs to small businesses

In practice, the procurement legislation places considerable burdens on suppliers, which appear particularly onerous for smaller producers. They include the following.

6.3.1. The cost of implementation

1. Suppliers have to be formal (especially in terms of tax registration) and provide a physical address rather than a post office number.
2. Suppliers have to pro-actively find out about contracts and, where relevant, register for panels. Departments are not required to seek out smaller suppliers. While web-based products have improved access to information on tenders, they still require consistent monitoring by suppliers. That can impose a significant cost in itself.
3. Tendering may require small businesses to expend considerable resources on developing and presenting bids, and require that they know how to set budgets and margins. The costs are not recovered if the business does not get the tender.

6.3.2. Administrative costs

Although departments mostly claim to have paid on time, the perception from small businesses remains that there are often long delays, which put pressure on cash flow. It is not clear how this difference in perceptions arises.

According to the DPME, which monitors on-time payment of invoices, in 2016 national departments failed to pay for procurement worth around R300 million a month within 30 days. For provinces, the figure rose to almost R2 billion. The delayed payments affected around 10 000 invoices a month for the national departments, and 35 000 a month at provincial level. (DPME, 2016: Tables 3 and 7)

In value terms, the figures approximated 2,5% of spending on goods and services at national level, and almost 25% at provincial level.¹⁶

¹⁶ Calculated from South African Reserve Bank. Interactive dataset. Series on expenditure on goods and services by central government and by provincial governments. Downloaded in April 2017.

A relatively small number of state agencies accounted for the bulk of late payments. At the national level, Water and Sanitation accounted for a third of all late payments in June 2016, while Home Affairs, Rural Development and Defence accounted for another half. Each of these departments paid more than R40 million late. (DPME 2016, Table 2) In the provinces, Gauteng and the Eastern Cape were responsible for half of all invoices that were unpaid after 30 days in June 2016. (DPME 2016, Table 6)

The DPME cites the following factors in late payments:

- Contractual disputes, especially where suppliers were appointed without going through proper procedures and documentation or where deliverables are poorly defined.
- Inadequate staffing, tracking of invoices and poor attitudes in supply-chain management.
- Possible corruption, where officials want to be paid off to finalise an invoice.

Treasury officials argue that the 30-day requirement is unambiguous. The DPME's experience, however—like that of many informants from small business—is that the 30-day requirement only starts when an invoice is finalised. That may be some time after work is completed and the business has submitted an initial invoice, for instance because of disputes over the quality of work or because the invoice is not in the required form (See DPME 2016, pp. 10-11).

Department officials often dispute the quality of deliverables unnecessarily or ask for products beyond the tender requirements. This situation reflects, in part, the fear of audit queries combined with a lack of unambiguous rules to require approval of deliverables when they meet contractual requirements. Even if suppliers end up being paid, managing these disputes takes time and may add to costs.

Procurement rules forbid any initial payment. Small enterprises may not be able to carry the cost of the first phases of a project, however. As a rule, lenders do not consider a signed contract with the state sufficient security for commercial loans. This may result in part because of the potential for delays in finalisation and therefore payment, as noted above.

6.3.3. Costs and benefits that are integral to the desired outcome

The main benefit for small businesses from the procurement legislation are that small businesses, especially if black owned, should gain through greater demand due to preferential procurement points.

The costs include:

- To succeed in tendering, companies have to pay taxes, accept audits, and manage complex administrative procedures. In the end, they may experience delays in payments or even end up going without.
- The law does not require that state agencies include size in the preferential points. In practice, many departments focus on ownership rather than the size of suppliers or local value add. In these circumstances, white-owned small businesses in particular may not benefit from preferential procurement rules.

Tenders may be too large for smaller producers, or include criteria that new suppliers cannot meet. The rules do not mandate departments to design tenders pro-actively to reduce barriers to entry for smaller suppliers. Steps to that end could include, for instance, breaking tenders up into smaller components; minimising unnecessary quality criteria (for instance, design details that are not functional but effectively favour existing suppliers); and ensuring early deliverables to reduce cash flow problems.

The available evidence suggests that the number of tenders appropriate for small and micro enterprise is very small relative to the pool of eligible business. The National Treasury does not track figures for tenders by size. For this reason, the finalised gazetted tenders for the Gauteng Department of Public Works from 2013 to 2015 were analysed. They showed that:

- In 2015, 107 tenders were awarded, valued at R3,6 billion.
- 36 tenders were valued at under R6,5 million, which means small construction companies would have been eligible to bid. These tenders taken together were however worth only R108 million, or 3% of the total.
- From 2013 to 2015, the share of small business in the Departments' finalised tenders had fallen from 10% by value and had dropped from half of the total tenders.

Table 22. Gauteng Public Works finalised tenders by size, 2013 to 2015

Year	Share of value	Value	Share of number	Number of tenders
2013	10%	R132 mn	51%	50
2014	5%	R122 mn	36%	34
2015	3%	R108 mn	34%	36

Source: Gazetted tenders by Gauteng Public Works.

In Gauteng in 2015, using the CIDB ranking (which is discussed in more detail in section 7) there were around 2000 companies eligible to tender for construction contracts larger than R650 000 but smaller than R6,5 million. By extension, for every tender valued at under R6,5 million issued by the Gauteng Department of Public Works, there would be:

- 61 enterprises per tender in the eligible group, and
- In value terms, the tenders averaged only R50 000 per enterprise per year.

Challenges also arose over subcontracting on state tenders. Currently, government does not monitor the treatment of subcontractors. Small business informants argued that they often faced delayed or non-existent payments; demands for delivery beyond the original agreement; and exploitative terms.

The issue of subcontracting has become more urgent because, as noted above, Treasury has gazetted a proposal that successful tenderers for any contract over R30 million be required to subcontract a third of it by value. In effect, this proposal would delegate enforcement of preferential procurement and the development of small-scale tenders to larger private enterprise. If the subcontracting relationship is not regulated, however, the benefits to small business could be limited.

6.4. Options

We here assess options to address delays in payment; up-front payments; and the regulation of subcontracting.

6.4.1. Payment delays

Options for addressing payment delays include the following, all of which would apply only to micro and small suppliers:

- Option 1: Imposition of penalties for late payment – for instance 10% of the total invoice for payments delayed over 60 days without reasonable justification.
- Option 2: Clarify that the 30-day clock starts with the initial submission of an invoice, not when all disputes are finalised.
- Option 3: DSBD works to strengthen DPME unit on 30-day payments, including setting up a hotline.

Table 23. Options for minimising delays in payment to small business

	Small business	Client department or agency	DSBD/Treasury	Other stakeholders
Option 1: Imposition of penalties for late payment	C: None B: Fewer late payments and get an additional payment if payments are still delayed R: Departments pressure small contractors to relinquish claims or delay invoice in order to avoid penalties	C: Have to pay extra if cannot pay on time – could lead to acceptance of substandard work B: None R: Small businesses invoice very early, before normal finalisation of work, in order to start the clock in order to pressure clients to accept work	C: Would need to establish a dispute resolution system and criteria for fair and unfair delays B: More payments on time R: As with client departments	C: Penalties paid to small business reduce funds for other priorities B: Spillovers from small business growth R: As with client departments
Option 2: Clarify that the 30-day clock starts with the initial submission of an invoice, and acceptable reasons for delay, also with time frames	C: None B: Clarity about payment deadlines and turnaround times for disputes R: May still not be paid on time if disputes arise or contracting is faulty	C: Greater pressure to pay on time, which could lead to acceptance of substandard work B: Clarity around deadlines R: More invoices will be paid late because departments abuse the nominally acceptable reasons, e.g. contract and product disputes	C: Need to review regulation to clarify deadlines and set up dispute resolution system B: More timely payments R: As with client departments	C: None B: Spillovers from small business growth R: Risk that departments accept faulty products in order to finalise invoices on time

	Small business	Client department or agency	DSBD/Treasury	Other stakeholders
Option 3: Payment delay hotline at DSBD in cooperation with DPME unit	C: DSBD diverts resources to hotline rather than other forms of support B: Improves appeals and mediation process with clients R: May be afraid to use hotline because clients will refuse to contract them in future	C: May have to pay sooner than would otherwise B: Mediation system to assist in disputes with contractors R: Mediation is not handled well, leading to undesirable outcomes	C: DSBD would have to staff hotline and allocate capacity to work with DPME unit B: More timely payments R: Annoy either client departments or small businesses	C: Resources used for hotline rather than other purposes B: Spillovers from small business growth R: Risk that departments accept faulty products in order to finalise invoices on time

The preferred options are to clarify that the 30-day period starts with the initial submission of an invoice, even if it is faulty, and to set turnaround times for disputes on contracting, paperwork and finalisation of products after that date. It would also be necessary to set a date for when an initial invoice may be submitted – presumably, as a minimum, only after the deliverable has been provided, even if it has not yet been accepted. In effect a timeline would be instituted that could be subject to the audit process:

1. Submission of deliverable
2. Submission of invoice
3. Specified turnaround time for approval of deliverable added to 30 days
4. Finalisation of invoice within the timeframe (30 days plus turnaround time for deliverable), without adding time to the clock unless the contractor sends revised documentation after the deadline
5. Additional time added if there is a dispute over acceptance of the deliverable, with additional time added to the clock)
6. Payment of invoice within timeframe.

A hotline at the DSBD would likely also be of assistance, but it would be important to consult the DPME unit and the Chief Procurement Officer to ensure alignment and avoid duplicating efforts and forum shopping by small businesses.

6.4.2. Up-front payments

Options for up-front payments include the following, which would apply only to contracts for small business.

- Option 1: Permit up-front payment up to a maximum of 25% of value of contract.
- Option 2: Set up revolving fund with an appropriate agency, such as the IDC or sefa, which would cover initial costs for small suppliers
- Option 3: Encourage or require banks to provide loans to small businesses to cover up to 25% of contract amount.

The following table provides an assessment of the costs, benefits and risks of these options for the main stakeholders.

Table 24. Up-front payments: Analysis of costs, benefits and risks

	Small business	Client department or agency	Financing agency	Other stakeholders
Option 1: Permit up-front payment	C: None B: Able to bid for more contracts R: Take the up-front payment but unable to deliver, so end up in debt	C: None B: Able to procure from more small businesses R: Lose the up-front payment as contractor cannot deliver	n.a.	C: None B: Spillovers from growth in small business R: Loss of resources for other priorities if contractor cannot deliver
Option 2: Revolving fund for small suppliers to state	C: Interest on initial funds B: Able to bid for more contracts R: Take the up-front payment but unable to deliver, so end up in debt; excessive failures mean revolving fund fails	C: None B: Able to procure from more small businesses R: None (risk covered by guarantee fund)	C: Administration of fund; reserves against bad debts; initial funding B: Fees and possibly interest also R: Underestimate bad debts including due payment delays by clients	C: Financing agency uses funds for revolving fund rather than other purposes B: Spill overs from small business growth R: Cost to revolving fund (and ultimately state) if estimate risk wrong
Option 3: Encourage or require banks to provide loans to small businesses to cover up to 25% of contract amount.	C: Interest on funds (small business often pay close to 30% interest on commercial loans) B: Able to bid for more contracts C: Contract fails and end up with debt	C: None B: Able to procure from more small businesses R: None (risk covered by banks)	C: Administration of loans; reserves against bad debts; initial funding B: Interest and fees R: Underestimate bad debts, so make a loss	C: Banks use credit for small business, restricting loans to other borrowers B: Spill overs from small business growth R: If banks make losses on the scheme, it may affect customer service

The preferred option is that up-front payments up to 25% of the value of the contract be allowed for contracts worth under a ceiling, for instance R6,5 million. As noted earlier, the available evidence suggests that these contracts are a small percentage of total state procurement of goods and services. The losses would therefore be relatively small if delivery failed. The risk of loss could also be mitigated if Treasury or DSBD developed guidelines indicating when up-front payment were warranted, including what kind of information should be required from small contractors to prove their reliability and creditworthiness.

6.4.3. Regulation of subcontracting

To ensure that subcontracting relations are fair to small business, the following options were analysed.

- Option 1: Set up an easily accessible and low-cost dispute settlement panel.
- Option 2: Establish regulations on key areas of dispute (particularly timing of payments and the definition of work required) with a dispute-settlement process.
- Option 3: DSDB to establish a subcontracting hotline for small businesses.

Table 25. Subcontracting: Analysis of costs, benefits and risks for small businesses and other stakeholders

	Subcontractor (small business)	Contractor	DSBD	Other stakeholders
Option 1: Set up an easily accessible and low-cost dispute settlement panel.	C: Cost of dispute settlement B: Disputes resolved fairly without legal costs R: Dispute mechanism becomes costly and over-legalised; wrong decisions; no enforcement powers	C: Cost of dispute settlement; providing fair conditions for subcontractors B: Disputes resolved fairly and cheaply; more motivated subcontractors R: As with small business	C: Setting up and maintaining dispute settlement panel, including payment for arbitrators B: Enable small business to benefit from state procurement, especially given newly gazetted proposals on subcontracting R: Panel does not function; costs get out of hand	C: State resources go for panel rather than other priorities B: Spill overs from growth in small business R: As with DSBD
Option 2: Establish regulations on key areas of dispute (particularly timing of payments and the definition of work required) with a dispute-settlement process.	C: Cost of dispute settlement, where relevant B: Clear regulatory framework and dispute settlement process R: Limited enforcement mechanisms; inappropriate standards	C: Cost of dispute settlement; providing fair conditions for subcontractors B: Disputes resolved fairly and cheaply; more motivated subcontractors R: As with small business	C: Developing and monitoring standards; dispute settlement panel as above B: Enable small business to benefit from state procurement, especially given newly gazetted proposals on subcontracting R: Unable to monitor or enforce standards; panel does not function; costs get out of hand	C: State resources go to enforce standards rather than other priorities B: Spill overs from growth in small business R: As with DSBD
Option 3: DSDB to establish a subcontracting hotline for small businesses.	C: None B: Support from DSBD in disputes with contractors R: DSBD unable to resolve disputes in favour of small business	C: Cost of dispute settlement; providing fair conditions for subcontractors B: Mediation of disputes with small business; more motivated subcontractors R: DSBD supports small business even if they are in the wrong	C: Staffing hotline and following up on issues B: Enable small business to benefit from state procurement, especially given newly gazetted proposals on subcontracting R: Unable to resolve issues raised on hotline, which is a reputational risk	C: DSBD resources go to hotline rather than other initiatives B: Spillovers from growth in small business R: None

The optimal option would be to develop a Code of Good Practice for subcontracting by suppliers to the state, with a mediation and arbitration process to manage disputes. Developing the code and a panel of experts for dispute-resolution would, however, require substantial effort, expertise and resources. It would require support from Treasury as well as other relevant departments, notably the **dti**, as well as provincial governments.

6.4.4. Stakeholder responses

On the regulation of payment conditions, Treasury would have to play a leading role. Departmental supply-chain managers would also have to participate in order to develop realistic turnaround times. In any case, most departments will likely see stronger rules as yet another audit requirement.

In terms of up-front payments, Treasury has long held that they impose an unacceptable risk on the state. They might, however, be more amenable if the payments were limited to relatively small contracts. In addition, the supply-chain management in most departments would likely be unwilling to take a risk on this kind of payment unless DSBD communicated the importance of the process and assisted in developing risk-mitigation processes.

On subcontracting, there would certainly be a degree of resistance from the contractors themselves, since they would be required to uphold higher standards in their relations with subcontractors.

7. THE CONSTRUCTION INDUSTRY

As shown in section 2.2.4, construction is a major industry for small business. Many small businesspeople however argue that they find it difficult to get formal contracts, including through tenders with government entities. They also argue that programmes that are supposed to assist them, notably the establishment of the Construction Industry Development Board (CIDB) add to their regulatory burdens.

The construction industry is also regulated to protect consumers, workers and the environment. Many of these rules are imposed at municipal level, however. The national laws that affect construction include:

- The Construction Industry Development Board Act of 2000
- Housing Consumer Protection Measures Act of 1998
- Council for the Built Environment Act of 2000
- Quantity Surveying Profession Act of 2009
- Council for the Built Environment Act of 2000
- Engineering Profession Act of 2000
- The Architectural Profession Act of 2000
- Consumer Protection Act of 2008
- Environment Conservation Act of 1989
- National Environmental Management Act of 1998
- National Water Act of 1998
- Air Quality Act of 2004
- Waste Act of 2008

This section focuses on the CIDB Act, which is supposed amongst other functions to facilitate access to government tenders for small businesses.

7.1. The legal framework

The CIDB Act provides for the establishment of the CIDB in order to implement an integrated strategy for the reconstruction, growth and development of the construction industry. Specifically,

- Businesses that want to bid for government construction tenders are required to register with the CIDB and, for larger tenders, to demonstrate appropriate competency.
- Government departments are expected to take the CIDB rating into account in construction tender processes.
- The CIDB provides some mentoring and support for emerging construction businesses so that they can gradually improve their competencies and bid for larger tenders.

7.2. Aims and theory of change

The main problem addressed by the law or regulation is that (a) state agencies often could not tell which small contractors were competent, which meant they sometimes ended up with substandard products, and (b) historically large companies dominated state construction tenders.

Table 26 indicates the main beneficiaries and cost bearers from the problems that the CIDB Act seek to alleviate.

Table 26. The problems that the CIDB Act seeks to address, and their beneficiaries and cost bearers

Problem	Beneficiaries from the problem	Cost bearers of the problem	Measures
State agencies often unable to assess competency of contractors	Substandard tenderers who could not comply with new requirements	Government institutions/ National Treasury; competent contractors; users of substandard or delayed infrastructure	CIDB to assess competency of construction businesses that want to tender for state tenders
Small contractors not participating in state contracts	Large companies	Competent small contractors	Small contractors can get certification of competency and some mentoring from CIDB

The legislation presumes that the root cause of substandard delivery by small construction firms was that government clients could not adequately vet contractor's capabilities. As a result, they either did not award contracts to small businesses at all, or they contracted small businesses that did substandard work.

The legislation presumes the following steps will lead to achievement of the desired outcomes.

- CIDB will set up a system to assess and certify competency for different types of contract; that is, it will categorise and grade contractors according to capability to carry out public infrastructure projects.
- Government clients in construction procurement will be able to determine a contractor's ability to meet contract requirements based on their CIDB grade.

- Competent small and emerging contractors will be able to obtain state contracts.

The core assumptions in this theory of change are the following:

- 1) State agencies will comply with requirements in contracting (they will pay attention to the CIDB grade and they will not be corrupt or misguided in decision making).
- 2) The CIDB assessment is reliable.
- 3) The costs of registration and assessment are not excessive compared to benefits of being registered in the various grades.
- 4) Small enterprises can meet requirements at higher levels as they gain experience and if they are coached.

7.3. The regulatory requirements

Under the CIDB Act, the CIDB acts as a regulatory body for the construction industry. It is expected to determine and establish best practice, develop methods for monitoring and regulating company and industry performance, and register projects and contractors.

The Act also requires prospective construction contractors with government agencies to apply to the Register of Contractors with CIDB. Contractors are graded according to the size and complexity of construction project they are capable of completing. Grades range from 1 to 9. Grades are defined by the maximum tender allowable to contractors in the grade.

Table 27. Maximum value of contracts in the different grades

Grade	Tender value ceiling	Number in grade, 2016
1	R200 000	132 265
2	R650 000	2016
3	R2 000 000	5 588
4	R4 000 000	2 264
5	R6 500 000	2 809
6	R13 000 000	1 868
7	R40 000 000	2 078
8	R130 000 000	1 176
9	No limit	438

Source: CIDB. Annual Report 2015/16.

All public-sector construction clients are bound by the Act to use the Register of Contractors in construction procurement. Company that do not register are supposed to be excluded from public work. If they do not move up the registration grades, they will be barred from larger contracts.

The following table indicates the document required to register. For contracts above Grade 1 – that is, valued at over R200 000 – requirements with respects to competencies and resources gradually escalate.

Table 28. Requirements for application to CIDB registry, by grade

Requirements	Documentation required
Grade 1 (eligible for contracts up to R200 000)	
Enterprise Particulars	Close Corporation (latest CK1/CK2)
	Company: Certificate of Incorporation (CM1)/CoR 14.3; list of all active directors (CM29)/CoR 39; share certificates (must be originally certified by Commissioner of Oaths). The validity period of certification is three months; all name change certificates (CM9) (if applicable) Partnership (partnership agreement)
	Trust (a copy of the trust deed or JM21)
	Co-operatives – CR 10 (Certificate of Incorporation): list of all directors in a table format with their names, surnames, ID numbers, addresses and signed by all.
Principals and Ownership/Interest	Originally certified copies of Identity Documents (the validity period for certification is 3 months) (Must be certified by Commissioner of Oaths)
	For external Companies, originally notarised copy of passport
Tax Clearance Certificate	Valid and original Tax Clearance Certificate
Requirements for Registration in Electrical Engineering for EB class of works	Originally certified and signed copy of the enterprise's valid Electrical Contractor's Certificate (The validity period for certification is 3 months) (Must be certified by Commissioner of Oaths)
Proof of payment	Application fee payable for each class of work (R450.00)
Grade 2 to 9 applications	
Documents as for Grade 1	As above
Financial Requirements	A complete set of financial statements (compliant with IFRS or IFRS for small businesses) for two financial years immediately preceding the application including SARS VAT forms or stamped business bank statements for verification of turnover
	Public/Private company – as per the provision of Companies Act No. 71 of 2008 as amended
	Trust – as per the provision of Companies Act No. 71 of 2008 as amended
	Close Corporation – as per the provision of the Close Corporation Act No. 69 of 1984 as amended
	Partnership – as per the provision of Companies Act No. 71 of 2008 as amended
	Co-operatives – as per the provision of Co-op Act No. 14 of 2005 as amended
	Sole Traders – compiled by a Bookkeeper or Accounting Officer
Available Capital	Description and proof of financial sponsorship(s)
	Registered financial institution sponsorship or If sponsor is a not a financial institution please attach the sponsors latest set of financial statements (compliant with IFRS)
	Letter of sponsorship undertaking in the form of a member's resolution from a Close Corporation OR a board resolution from the sponsoring company
Track Record for each class of works applied for	Copy of letter of award on a letterhead of the client and addressed to contractor, signed and dated; Certificate of completion; and Final payment certificate indicating the contract value.
	Maintenance contractors must provide latest payment certificate and a confirmation letter from the client/consultant indicating the value of work done to date.
	Joint Venture agreement (if applicable);
	Sub-contract agreement and corresponding stamped bank statements.
	Private Sector Contract – Purchase Orders, Contract Agreement, Tax Invoices and corresponding stamped bank statements.
	Projects with more than one Class of Work – Submit a breakdown showing the value of each class of work applied for (breakdown must be on client's or consultant's letterhead and signed)
Transfer of Records	Particulars of change as per Regulations 11 (4), (4A) and (4B)

Requirements	Documentation required
Proof of payment	Administration in respect of each class of work applied for (R450 – R750) (fee dependent on contractor grading designation)
	Annual fees depend on contractor grade - for small business in levels 3 to 5, the maximum fee is R1750, but the fees top out at R55 000 for the largest contractors (able to take jobs worth over R130 million)

For small contractors to bid for contracts valued at up to R6,5 million, they would have to demonstrate adequate financial capacity through one of the following:

- they have had turnover of at least R3,3 million in one of the past five years;
- they completed a contract worth R1,6 million in the past five years; or
- they have R700 000 available in capital, some of which may belong to a “sponsor”.

Table 29 indicates the requirements for proving capacity at each CIDB grade above Grade 1. For financial capability, only one of the three types of proof listed must be supplied. Grade 1 does not have competency requirements except for electrical contractors.

Table 29. Requirements for proving competency for CIDB grades

Grade	Tender ceiling for grade	Financial capability (R mns) (a)			Professionals (number)	
		Best Annual Turnover in past 5 years	Largest Contract in past 5 years	Available Capital (assets plus sponsorship)	General/ civil engineering	Electrical/ mechanical / specialist
2	0.7		0.2			
3	2.0	1.0	0.5	0.1		
4	4.0	2.0	1.0	0.2		
5	6.5	3.3	1.6	0.7		
6	13.0	7.8	3.3	1.3	.	1
7	40.0	24.0	10.0	4.0	1	2
8	130.0	90.0	32.5	13.0	2	3
9	no limit	270.0	100.0	40.0	3	4

Note: (a) Applicants can use any one of the three columns. *Source:* CIDB. Tables for grading designation calculator. Downloaded from www.cidb.org.za in April 2017.

To make it easier for black-owned businesses to move up the grades, the CIDB Act defined the Potentially Emerging status. Under this programme, an enterprise that is owned, managed and controlled by historically disadvantaged persons may be contracted at a grade above their grade on the register. A public-sector agency may grant the larger contract to a potentially emerging enterprise, however, only if it has in place a structured support system to ensure that the contractor will succeed.

7.4. The impact on smaller enterprises

The impact of the CIDB Act on smaller enterprise varies substantially depending on the grading and therefore size of the enterprise.

7.4.1. Administrative costs

The system imposes significant administrative costs on small contractors who do work in the public sector. Even to enter into Grade 1, they have to:

- apply to the Register of Contractors with CIDB
- register under the Companies Act with CIPC

- acquire a tax clearance certificate
- produce financial statements.

Contractors then have to apply separately for each class of works (that is, type of construction such as electrical or general building) as well as each upgrade. To apply for larger contracts requires proof of competency.

They have to renew their applications every three years.

Applications have to be hand delivered or sent by post, which in itself requires time. The CIDB planned from 2015 to develop an on-line system.

7.4.2. Costs and benefits that are integral to the desired outcome

The benefits are:

- Small contractors become eligible for state contracts.
- Small contractors may benefit from Potentially Emerging status.

The costs are:

- Small contractors are required to maintain competencies to keep their rating, including both financial and professional capabilities if on Grade 2 or above.
- Small contractors are unable to apply for larger contracts than those for which they have qualified.

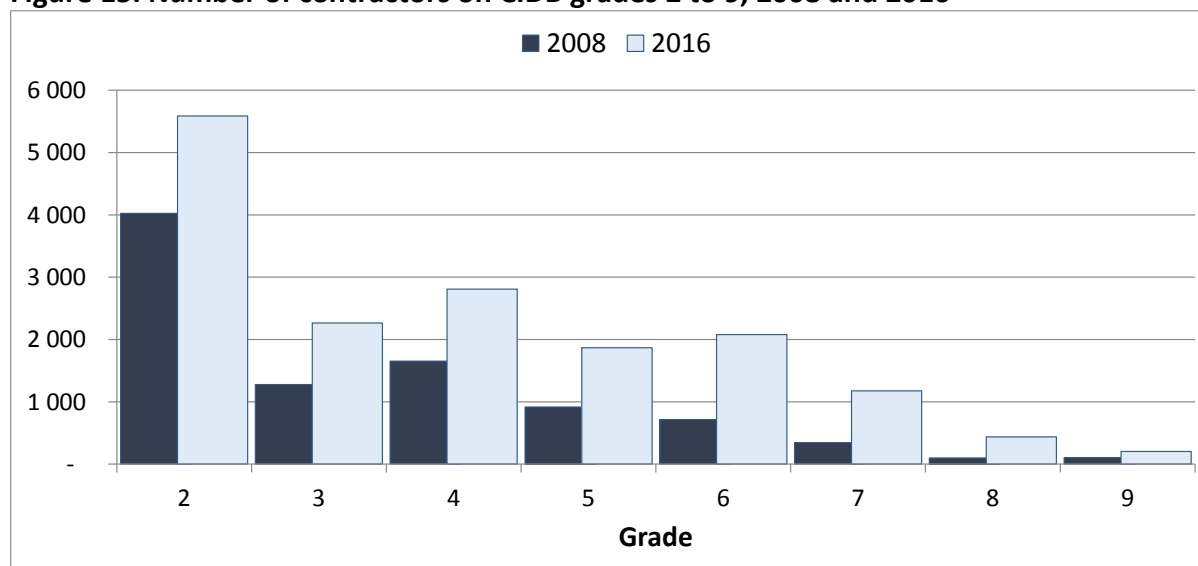
7.5. Assessment of costs and benefits for small business

Informants were mostly concerned that there seemed to be little payback for the effort to registering. Specifically, government tenders were still hard to get, which meant that the administrative costs loomed large.

The main benefit to small business is supposed to be that they get greater access to tenders as they move up the CIDB ladder. In the event, as discussed in section 6.3.3 above, the number of small tenders available is too limited to provide work for the vast majority of contractors registered with the CIDB at the lower levels. The CIDB itself estimates that the 650 enterprises on levels 8 and 9 account for 80% of the value of all tenders, out of a total of 150 000 registered (mostly on level 1) in 2016.

Furthermore, there has been only limited growth in the number of contractors on levels 2 to 9 in the CIDB ranking. As the following graph shows, the number of enterprises on grades 2 to 4 has grown only relatively slowly since 2008. In this period, the number of level one soared from 40 000 to 130 000, or more than three fold.

Figure 15. Number of contractors on CIDB grades 2 to 9, 2008 and 2016



Source: CIDB Annual Reports for relevant years.

A CIDB study found that in the year to the second quarter of 2015 alone, 5% of contractors on grade 1 moved up, as did 15% of contractors in grades 2 to 6.

The requirements for proving competency every three years is a significant administrative burden for small business. Informants argued that proving capital adequacy was particularly difficult, as it required both access to relatively large contracts in itself, and sound record keeping over the previous five years.

In this context, small contractors complain that proving available business capital, which is prerequisite for moving up the CIDB ladder, represents a serious challenge. In effect, it generates a vicious cycle: contractors cannot accumulate capital because they do not get tenders, but then they cannot get tenders because they have not accumulated capital. The situation ultimately arises because, as noted in section 6, government agencies cannot provide up-front financing.

The Potentially Emerging status was supposed to assist black-owned enterprises to overcome this hurdle. Informants said, however, that it is rarely utilised. Apparently this is because state agencies, and especially municipalities, are not prepared to provide the required support – and take the associated risks.

Furthermore, the CIDB is not designed to help most micro enterprise, but only businesses that can manage tenders worth at least R650 000.

7.6. Options

7.6.1. Assessment of options

The options analysed here focus primarily on the limited number of tenders available for small contractors. The CIDB plans to address the main administrative inefficiency – the lack of a web-based application system for upgrades – in the coming year. But if the benefits of registration are not enhanced, then a more efficient registration system will not be much help. The challenges around proving available capital and subcontracting could be addressed by the options proposed for managing up-front payments and regulating subcontracting contained in sections 6.4.2 and 6.4.3 above.

The options identified for increasing access to tenders for small construction firms are:

- Option 1: Establishing subcontracting requirements for construction tenders over R30 million, as proposed by the National Treasury, with increased protection for subcontractors.
- Option 2: Requiring that 10% of the value of all construction contracts go to contracts of R6,5 million or less.
- Option 3: Make government contracts worth over R30 million contingent on support for emerging suppliers as required in the BBBEE Act.

Table 30. Options for improving small contractors access to tenders

	Small contractors	Large contractors	State agencies	Other stakeholders
Option 1: Sub-contracting requirements for tenders	C: None B: Greater access to contracts, albeit indirectly R: Exploitation by contractors; still relatively limited opportunities	C: Required to subcontract part of project B: None R: Have to coordinate subcontracting in line with project requirements	C: May face higher bids to cover cost of subcontracting B: Bring in smaller contractors R: Reliance on sub-contracting leads to worse quality work and poor coordination on major projects	C: None B: Spill overs from growth in small business R: Reliance on subcontractors may lead to delays, higher costs and lower quality in state construction projects
Option 2: Requiring smaller tenders	C: None B: Greater access to contracts R: None	C: Greater competition from small contractors for smaller contracts B: None R: None	C: Have to design contracts to hold down size on a larger share than now the case (judging by Gauteng); have to supervise more contractors B: Bring in smaller contractors, which may be cheaper R: May break up projects inappropriately, leading to worse quality and higher costs; may ignore directive	C: Resources used to develop and monitor smaller contracts rather than other priorities B: Spill over from growth in small business R: Possibility of worse quality and higher costs in state projects

	Small contractors	Large contractors	State agencies	Other stakeholders
Option 3: Use BBBEE requirement to leverage support for sub-contractors	<p>C: White-owned small business may face tougher competition</p> <p>B: Greater access to contracts, albeit indirectly, for black-owned small business</p> <p>R: Exploitation by contractors; still relatively limited opportunities; may benefit large black-owned enterprise, not small firms</p>	<p>C: Required to support black-owned enterprise in a variety of ways</p> <p>B: More diverse suppliers should ultimately lead to greater dynamism</p> <p>R: Failure of new suppliers</p>	<p>C: Introduce BBBEE as consistent criterion in tendering and monitor enforcement</p> <p>B: More diverse suppliers should ultimately lead to greater dynamism</p> <p>R: Failure of new suppliers</p>	<p>C: Cost of bringing in new suppliers diverts resources from other priorities; workers in white-owned business may see job losses</p> <p>B: More diverse suppliers should lead to greater dynamism; job growth in black-owned business</p> <p>R: Failure of new suppliers</p>

The preferred option would be to require subcontracting on larger tenders combined with regulations to ensure minimum standards for subcontractors. More research is required to evaluate what percentage of large construction tenders are already subcontracted. There should also be a mechanism to enable contractors to appeal against the requirement where an integrated process is technically imperative.

As noted above, the measures proposed to extend the number of small tenders should be supplemented by:

- Enabling departments to provide up-front payments to qualified contractors equal to a set fraction of the total tender, and
- Establishing web-based systems for CIDB applications.

7.6.2. Stakeholder responses

Contractors will likely push back against efforts to set required levels of subcontracting. This will be particularly true if there is no system to enable appeals where the nature of project would make subcontracting particularly costly or hard to manage. In addition, small contractors would likely prefer an option that generates more contracts directly for them rather than having to rely on larger firms.

8. BROAD-BASED BLACK ECONOMIC EMPOWERMENT (BBBEE)

8.1. The justification for Broad-Based Black Economic Empowerment legislation

The policy of BBBEE should be a strong lever for enabling the growth and development of black owned small business. The codes aim in part to facilitate market access for black-owned small business by creating direct opportunities in government procurement and indirectly by imposing black representivity for white owned businesses.

Broad-Based Black Economic Empowerment (BBBEE) under the Broad-Based Black Economic Empowerment Act of 2003 broadly aims to address the exclusion of black people from the economy. It defines the problem as being the lack of black ownership and management of

enterprises, inadequate access to skills and promotions for black workers and failure of dominant companies to buy from black-owned companies.

BBBEE does not address the exclusion of the unemployed or issues pertaining to wage inequality directly. Moreover, over time it has reduced the emphasis on the lack of career pathing for most workers, reflected in reduced points for representivity in artisanal and supervisory positions.

In addition, the latest BBBEE Codes, which came into effect in 2016, seek to discourage state procurement of imports rather than local products. The problem has been twofold: first, state purchases of imports reduce the multiplier effect of government spending on jobs and growth; and second, it is often easier for emerging black entrepreneurs to import than to produce locally, while small manufacturers are often family-owned companies with relatively low profits, so they cannot easily bring in new black owners.

Table 31 indicates the main beneficiaries and cost bearers from the problems that the BBBEE Act and Codes seek to alleviate.

Table 31. The problems that BBBEE seeks to address, and their beneficiaries and cost bearers

Problem	Beneficiaries from the problem	Cost bearers of the problem
Lack of representivity in business ownership and control	Existing white owners (estimated at half of all formal employers) and managers in the short run	Potential black owners and managers Workers and citizens to the extent that lack of diversity leads to greater social conflict and slower growth
Lack of skilling and career pathing for workers	Existing skilled workers and managers (higher incomes and more power; do not have to disrupt existing work organisation)	Black workers who do not have access to skills or promotions
Failure to procure from black-owned companies, especially small business	Existing suppliers (including local producers) and their employees Supply chain managers (easier, often cheaper in medium term to work with existing suppliers)	Black-owned companies (including small business) and their employees Big business to the extent that suppliers are less competitive
State procurement of imports when local products available	Importers, whether black-owned or not, as well as foreign producers Government departments and NT, since do not have to disrupt procedures and may get goods cheaper or of better quality Citizens, if get better and cheaper government services	South African producers and workers Citizens, if growth is slower National Treasury if revenues go down due to slower growth and job creation as a result of limited industrialisation

8.2. What the BBBEE Codes require

Measures under the BBBEE Codes set out different requirements for micro, small and medium/large enterprises. Micro enterprises are defined as having under R10 million in turnover, and small as having between R10 million and R50 million.

The key measure in the BBBEE Act is to require state entities to take into account the BBBEE status of enterprises when providing any kind of licence as well as in procurement. In

practice, however, the requirement has only been applied consistently in the case of procurement, where it has largely determined the 10% to 20% of tender points that departments may use for preferential procurement.

The BBBEE Codes, which are issued as regulations under the Act, set the criteria for determining an enterprise's BBBEE status. As revised in 2013 and 2015, respectively, an enterprise's status requires:

- That the enterprise qualifies as an Empowering Supplier as defined in the Codes, and
- That it provides a certificate (or, for black-owned micro and small enterprise, an affidavit) that rates its fulfilment of BBBEE criteria.

To be an Empowering Supplier, an enterprise must:

1. Obey South African laws, including on taxes, company registration and labour, and
2. Unless it is a micro enterprise, meet some of the four following criteria (three for medium and large enterprises and one for small enterprise):
 - a. At least 25% of costs of sales excluding labour costs and depreciation must be procured from local producers or local suppliers in South Africa
 - b. 50% of net new jobs created are for black people.
 - c. "At least 25% transformation of raw material/beneficiation which include local manufacturing, production and/or assembly, and/or packaging." (The intent of this section appears fairly clear, although the wording is not precise.)
 - d. The enterprise spends at least 12 days a year in assisting black small business to "increase their operation or financial capacity."
3. In the service sector, 85% of remuneration must be paid to South Africans.

Private verification companies regulated by the South African National Accreditation System (SANAS) provide the BBBEE certification, but enterprises must pay for it. Certification distinguishes a number of levels, with Level 1 indicating the highest level of performance. Black-owned micro enterprise and small business need only provide an affidavit affirming their ownership status. Other small businesses and all medium and large businesses require a certificate.

BBBEE status depends on an enterprise's score against specific criteria in five areas, namely:

- Ownership: The share of black ownership
- Management control: The share of black people in management, measured separately for executive and other levels
- Skills: The funding of skills development beyond legal requirements
- Enterprise and supplier development: Support for black-owned enterprises, especially suppliers, with a target of procuring 15% of measured procurement spend from micro enterprise (as defined below)
- Social Development: essentially Corporate Social Investment (CSI) that benefits black people and communities

Enterprises must reach a specified minimum standard for ownership, management control, skills and enterprise development, or their overall score will be reduced by a level.

To reduce the burden on smaller enterprises, the Codes lay out separate requirements for micro enterprise and black-owned small business, to which it refers as Qualifying Small Enterprise (QSE) and Exempted Micro Enterprise (EME), respectively.

- QSEs and EMEs that are 51% or more black-owned qualify automatically as level 2 under the Codes, while those that are 100% black-owned qualify as level 1. Most larger enterprises are ranked at level 4 or below. By extension, black-owned QSEs and EMEs are effectively not required to achieve anything on other elements of BBBEE.
- EMEs that are not majority black-owned qualify as Level 4.
- EMEs and black-owned QSEs are automatically recognised as empowering suppliers, that is, in effect, local producers, even if in fact they are import agencies.
- QSEs that are not black-owned need only be certified on two areas, one of which must be ownership and the other either enterprise support or management control.
- As noted above, EMEs and black-owned QSEs can supply an affidavit rather than outside certification of their adherence to BBBEE standards.

8.3. The theory of change in the BBBEE Codes

The desired end state for the BBBEE Codes is a more demographically representative economy, especially in terms of ownership of enterprises but also in terms of management and employment compositions.

The key steps to achieving this end state are:

1. Enterprises are required to obtain certification of their Empowering Supplier and BBBEE status from a verification agency unless they are black-owned micro or small enterprise.
2. The state allocates benefits to enterprises (including procurement, licencing, etc.) based on BBBEE status.
3. In order to obtain state benefits, enterprises will progressively seek to meet and exceed the requirements in the BBBEE Codes.

The core assumptions in this theory of change are the following.

First, the theory of change implies a specific understanding of what is wrong with procurement – specifically that:

- The lack of representivity in ownership and management as well as the failure to promote black workers and to procure from black-owned small and micro enterprise largely reflect path dependency rather than the incentive structure facing existing enterprises, and
- State agencies do not take these issues into account consistently when dealing with enterprises because they lack the information needed to distinguish enterprises in terms of their degree of transformation.

It follows that the solutions embodied in the BBBEE Codes are expected to work because:

- Every enterprise has some relationship to the state, although in fact only procurement and mining licences have so far been significantly dependent on BBBEE status.
- Enterprises have the flexibility to find optimal solutions based on the scorecard approach.
- Enterprises will not all simply minimise compliance across the board but rather compete to improve performance.
- Certification agencies will resolve the information problem for state agencies without unduly burdening the state or imposing excessive costs on enterprises, and they will not be corruptible or inaccurate.

8.4. The impact on smaller enterprises

The impact of the BBBEE Codes on smaller enterprise varies substantially depending on whether enterprises are black owned or not, and on their size. The Codes aim to foster growth of smaller black-owned and empowered enterprise, in part by imposing both actual and opportunity costs on white formal enterprise of all sizes.

Analysis of Statistics South Africa's Labour Market Dynamics indicates that in 2015, around half of existing micro and small formal enterprises were black owned.

8.4.1. The cost of implementation

The cost of implementation differs if the small business is white or black owned as well as if it is small or micro.

EMEs and black-owned QSEs only have to supply an affidavit or CIPC certificate to be exempt from BBBEE certification. Both affidavits and CIPC certificates are free. Nonetheless, some verification agencies charge for BBBEE verification for EMEs, with reported fees running from R460 to R1037.

White-owned small enterprise and all medium enterprise have to:

- pay a verification agency, with the costs and effort varying significantly from agency to agency, and
- set up systems to generate information on BBBEE compliance, including amongst others employment, procurement and training by race.

Verification for QSEs can range from about R6 000 to R10 000, depending on the complexity of the enterprise. The process can span from two weeks to as much as three months.

All of these are estimates based on the verification agencies that list their rates and average verification times on their website. Most verification agencies, however, do not publish this information.

8.4.2. Administrative costs

Enterprises have to obtain annual certification, although the differentiation based on size and ownership is replicated.

Informants argued that changes in the BBBEE Codes in 2013 required significant shifts in both information systems and compliance. They saw the change as adding to uncertainty, although it formed part of a regular ten-year review process.

8.4.3. Costs and benefits that are integral to the desired outcome

The benefits are:

- Micro and small enterprises with high BBBEE rankings should benefit from increased procurement and support from larger private enterprise as well as improved conditions in competing for state procurement and licences.
- Small white-owned business would become more productive if they broadened the pool of skills and suppliers to become more representative. Research internationally indicates that more diverse companies perform better in the long run.

The costs are:

- White-owned small and micro enterprises could experience a loss of sales to both the public and private sector since they could not compete with black-owned small and micro enterprises for state benefits. They could also be hindered because they might not qualify as easily for licences and other benefits. Alternatively, they would have to meet the costs of significant changes to meet BBBEE criteria. A particular challenge is that many small white-owned companies are not profitable enough to attract black owners or managers.
- Local producers could lose out compared to small importers because of higher costs and because they are more likely to be white-owned. The reason for this is that it is easier to establish an import agency than to initiate local production. The Emerging Suppliers requirements for micro and small enterprises can be met by employing mostly black people or by assisting other micro and small enterprises, rather than through local production.

In the event, informants were reluctant to discuss the substantive costs for small business as opposed to administrative burdens, especially around verification. Increased research is required to understand the net impact on small business of achieving BBBEE targets.

8.5. Options

8.5.1. Assessment of options

The options here focus on managing the administrative costs of BBBEE requirements for small business. In particular,

- There is no guidance framework for pricing and time taken for verification
- Informants complain that state-owned companies and municipalities sometimes do not accept affidavits as evidence that the company is an EME.

The following options were proposed to ensure more transparency around verification costs.

- Option 1: The **dti** could publish guidelines for verification costs linked to the size and complexity of small businesses.
- Option 2: The **dti** could require that verification agencies publish their fees annually in an easily accessible form.
- Option 3: Verification could be undertaken as part of companies' financial audit.

Table 32. Costs, benefits and risks

	White-owned QSE (not relevant for black-owned QSE)	the dti	Verification agencies
Option 1: The dti to produce guidelines for verification costs	C: Still have to pay for verification B: Lower admin costs for BBBEE R: dti sets price too high or too low, leading to unnecessary costs or to shortage of agencies	C: Develop guidelines for pricing B: Reduce the cost of doing business for QSE R: Guidelines are too high or too low, leading to market exit or super profits at least in short run	C: May have to reduce prices B: Competition shifts to quality, rather than price R: Guidelines set prices too low, leading to market exit
Option 2: Require an annual fee list from verification agencies	C: Still have to pay for verification B: Able to find lowest cost provider R: Does not ensure quality; list fees are misleading	C: Develop regulation B: More efficient verification market R: Companies publish misleading lists	C: May have to reduce prices to compete B: More efficient market for verification R: May be unable to compete if transparency leads to lower prices
Option 3: Link verification through audit	C: Still have to undertake verification B: Reduced costs in terms of time and possibly fees R: None	C: Amend regulations B: Reduce the cost of doing business for QSE R: Audit companies do not take BBBEE requirements seriously	C: Increased competition from audit companies B: More efficient market as more competitive R: May be unable to compete with large audit companies, many of which are white-owned

The easiest option to implement is to require verification agencies to publish a fees list at least annually. Ideally they should also indicate how long they think the process will take. Publication of this kind of information should lead to more competitive and efficient outcomes in the verification market.

In terms of affidavits and CIPC certificates for EMES, the DSBD can undertake to:

- Publicise the template on its website as well as through seda and sefa,
- Ask National Treasury to issue a directive requiring that all state agencies accept affidavits for EME, in line with the BBBEE Codes, and
- Set up a hotline to support EMEs confronted with supply-chain managers who do not accept the affidavit.

8.5.2. Stakeholder responses

Verification agencies will certainly push back against regulation, even if it is only to require that they provide a public price list. The requirement is not however particularly onerous, so the measure should not lead to much contestation.

9. SUMMARY OF OPTIONS AND STAKEHOLDER ANALYSIS

This section summarises the options for reforming regulations that impose unnecessary costs on small business. In each case, the options derive from a longer analysis of alternatives, which is included in the relevant sections above. The likely response of key stakeholders is also summarised, in order to inform engagements going forward.

9.1. Company and co-operative registration

To simplify the filing of Annual Returns at the CIPC, it is proposed that

- The returns be integrated with the SARS filing, since most of the information is duplicated; and
- SARS levies the filing fees and transfers the funds to the CIPC.

The main stakeholders affected would be the CIPC and SARS. They would have to manage the technical challenges of marrying their databases, which would impose both resource and capacity burdens. In addition, the CIPC would have to be assured that it would not see revenue losses, since fees from Annual Returns contribute around half its budget.

To reduce the disproportionate audit burden on co-operatives, the exemption criteria in the Act should be clarified, including exempting smaller co-ops altogether. The exemption could set thresholds similar to those now provided for small business under the Companies Act, using the public interest score. In addition, it would be helpful if the DSBD worked with co-ops and support agencies to develop bookkeeping systems that are appropriate for co-ops.

The main burden of implementation would fall in the DSBD, which would have to clarify the criteria for audit requirements and find partners to assist in improving bookkeeping systems for co-ops.

9.2. Taxation

To make VAT refunds more predictable and reliable, it is proposed that SARS be required to make payments to small businesses no later than 90 days after submission, even if they are still undergoing an audit. Over-payments can then be captured from later tax payments, if required.

SARS is very concerned about the risk of VAT fraud, so they may argue that the audit should take precedence over small business cashflow. In the event, however, small business only accounts for around 15% of VAT revenue, so the proposed dispensation should not have much effect on revenues.

The turnover tax regime has not attracted many small businesses, despite the reduced administrative burden, because the rate was high compared to the normal tax system. The reduction of the rate in 2015 should however remedy that problem. It is therefore proposed that the new lower rates be publicised while returns are monitored to ensure that the turnover tax does not lead to higher payments than the mainstream system.

Publicity for the turnover tax and monitoring its impact would entail some costs. The DSBD could assist SARS in this regard.

9.3. Labour laws

The threshold for the skills levy should be increased to at least R1 million in payroll, and SETAs should be assisted to develop more appropriate training modules for small business.

This proposal will likely run into some opposition from unions and experts, including some in government, since they would object to measures that would lower training standards and potentially the amount employers spend on skills development.

The current system entails substantial overpayment to the Compensation Fund, reflected in a rapidly growing surplus. It is therefore proposed that there should be a limited holiday on contributions while a tri-partite commission develops a more reasonable actuarial basis for assessments as well as an efficient appeals system for employers and industries that think the assessment is too high.

The Compensation Commissioner and the board will likely object to measures that will reduce their revenues, despite the Fund's very large annual surplus and accumulation of assets. Unions may also oppose the proposal unless it is clear that, because of the high surplus, lower assessments will not affect benefits.

For private employment agencies, the Department of Labour should be encouraged to introduce a digital solution for the Letter of Good Standing required for the PEA certificate, and undertake only selective site visits.

Regional offices of the Department of Labour may see changes to the existing systems as disruptive and unnecessary. Moreover, unions generally see employment agencies as a mechanism to promote outsourcing, casualization, and lower employment standards, so they will not be sympathetic to these proposals.

9.4. Procurement

To address the still-pervasive problem of delays in paying invoices, the guidelines should set timeframes for additional steps in the payment process, including for disputes about products and contracts as well as the finalisation of documentation. The DSBD could also consider establishing a hotline aligned with the existing DPME Unit.

Treasury would have to regulate timeframes for payments, but the DSBD could assist in developing specific requirements. In this process, supply-chain managers from departments and provinces should be consulted carefully, since they are most familiar with realities on the ground and have to implement the new rules

Small businesses often cannot compete for tenders because they do not have enough liquidity to manage the initial phases of a contract. For this reason, procurement rules should be modified to allow up-front payment of up to 25% of contracts to small businesses. These contracts account for a relatively small share of total expenditure. Guidelines could be developed to mitigate risks, for instance by taking into account the suppliers' credit and contracting history and their assets.

Treasury and accounting officers will likely see up-front payments as too risky unless DSBD works with them to develop risk-mitigation strategies.

A Code of Good Practice with an efficient dispute-resolution system should be established to improve sub-contracting practices. Currently small businesses complain about delayed payments, or sometimes no payment at all, as well as project creep.

Contractors would likely push back against higher standards for sub-contractors, and might insist on higher prices to cover perceived increases in costs. The proposed code of good practice could build on work by DPW and CIDB around subcontracting in construction.

9.5. Construction

To improve the access of small business to state tenders, construction contracts should include a requirement that a significant share of larger tenders be subcontracted. These requirements should be complemented by regulations to ensure adequate protection for subcontractors.

Large contractors will likely push back. Their concerns might be mitigated if there is a system to exclude from the subcontracting requirements any projects that inherently require close integration and careful phasing.

9.6. BBBEE

Verification agency costs and practices are currently difficult to understand and poorly publicised. The **dti** should be asked to require that verification agencies publish a fees list every year. The agencies may object, but the requirement is not onerous, and it would significantly improve the efficiency and transparency of the market.

The BBBEE Codes now enable micro enterprises and black-owned small business to provide an affidavit rather than a full verification certificate, specifically in order to reduce their costs. The DSB should work with Treasury and the **dti** to publish this new dispensation, and consider setting up a hotline to support businesses who find that officials decline to recognise the affidavits.

This proposal will require some effort from Treasury and the **dti**, and coordination in particular with the BBBEE Commission. In addition, it will be important to work with supply-chain managers, including in municipalities and state-owned enterprises, to ensure that they understand that the Codes require acceptance of affidavits for the relevant small and micro businesses.

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Appendices

Appendix 1: TIPS profile

Trade & Industrial Policies Strategies (TIPS) is an independent, non-profit, economic research institution based in Pretoria, South Africa. It was established in 1996 to support economic policy development, with an emphasis on industrial policy, in South Africa and the region. Currently TIPS has three main areas of work: trade and industrial policy; inequality and economic inclusion; and sustainable growth.

TIPS's main objectives are to undertake in-depth economic analyses, especially at the industrial level; to provide quality research as the basis for improving industrial policy as well as broader economic development strategies; and to support an increasingly dynamic and evidence-based discourse on industrial policy and inclusive growth with academics, other researchers and stakeholders.

TIPS offers high quality quantitative and qualitative research, project management, dialogue facilitation, capacity building and knowledge sharing. TIPS undertakes commissioned research, as well as policy papers and think pieces around industrial policy and economic development.

TIPS has over 23 full-time staff and works with a network of expert researchers and institutional partners across South Africa and the world. Its activities are overseen by a Board of Directors comprising individuals involved in high-level policy formulation in South Africa.

TIPS is committed to the growth and development of future economic researchers and operates a substantial intern and young economist development programme.

Appendix 2: Consultation summary

Stakeholder Group	Official(s)	Department/ organisation	Date of consultation
Regulators/ Government institutions	Christa Klokow	Companies Intellectual Properties Commission (CIPC)	14 November 2016
	Narcizio Makwakwa	South African Revenue Services (SARS)	30 November 2016
	David De Jong	Co-operative Banks Development Agency - National Treasury	7 December 2016
	Mmathapelo Lechaba	Department of Labour – Unemployment Insurance Fund (UIF)	30 January 2017
	Salphy Komane	Office of the Chief Procurement Officer - National Treasury	19 January 2016
	Johan Lamprecht	National Treasury	09 February 2017
	Zodwa Ntuli	Broad-Based Black Economic Empowerment (BBBEE) Commission	07 March 2017
Small business associations	Workshop with Business Unity South Africa (BUSA) members	Members from the IT Association, APSO (African Professional Staffing Organisations), National Accommodation Association – South Africa (NAA-SA), Chamber of Mines, SEIFSA (Steel and Engineering Industries Federation of Southern Africa)	20 February 2017 and 21 February 2017
	Workshop with Black Business Council (BBC) members	Members from Foundation for African Business and Consumer Services (Fabcos), Black Management Forum (BMF), National Industrial Council (NIC), National African Federated Chamber of Commerce and Industry (NAFCOC), Gauteng Industrial Trading, WDB Investment Holdings, PPC, South African Women in Construction (SAWIC), SANCOC Provincial Hub and BBC-Built Environment	23 February 2017
Small business incubators/ Research institutes	Brendon Daroll	Small Business Project (SBP)	18 November 2016
	Peter Kypri	Raizcorp	29 November 2016
Construction Sector	Superintendent Bore and Officer Malima	Johannesburg Municipal Police Department	22 October 2016
	German Mphahlele	Construction Industry Development Board (CIBD)	28 November 2016
	Workshops with contractors	National Department of Public Works Incubator Programme	8 December 2016 and 12 December 2016

Stakeholder Group	Official(s)	Department/ organisation	Date of consultation
	Workshops with contractors	Department of Public Works/Vuk'Uphile Learnership Programme	21 February 2017 and 22 February 2017
	Senzo Xulu	seda Construction Incubator	20 February 2017
	Ms. Nthabiseng Mehale	National Home Builders Registration Council (NHBRC)	20 December 2016

Appendix 3: Calculation of the Public Interest Score

- A number of points equal to the average number of employees of the company during the financial year;
- one point for every R1 million (or portion thereof) in third party liability of the company, at the financial year end;
- one point for every R1 million (or portion thereof) in turnover during the financial year; and
- one point for every individual who, at the end of the financial year, is known by the company-
- in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or
- in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

Appendix 4: Schedule of the small business definition

Sectors or sub-sectors in accordance with the Standard Industrial Classification	Size or class of enterprise	Total full-time equivalent of paid employees	Total annual turnover	Total gross asset value (fixed property excluded)
Agriculture	Medium	100	R 5 m	R 5 m
	Small	50	R 3 m	R 3 m
	Very Small	10	R 0.5 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m
Mining and Quarrying	Medium	200	R39 m	R23 m
	Small	50	R 10 m	R 6 m
	Very Small	20	R 4 m	R 2 m
	Micro	5	R 0.2 m	R 0.1 m
Manufacturing	Medium	200	R51 m	R19 m
	Small	50	R13 m	R 5 m
	Very Small	20	R 5 m	R 2 m
	Micro	5	R 0.2 m	R 0.1 m
Electricity, Gas and Water	Medium	200	R51 m	R19 m
	Small	50	R13 m	R 5 m
	Very Small	20	R 5.1 m	R 1.9 m
	Micro	5	R 0.2 m	R 0.1 m
Construction	Medium	200	R26 m	R 5 m
	Small	50	R 6 m	R 1 m
	Very Small	20	R 3 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m
Retail and Motor Trade and Repair Services	Medium	200	R39 m	R 6 m
	Small	50	R19 m	R 3 m
	Very Small	20	R 4 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m
Wholesale trade, Commercial Agents and Allied Services	Medium	200	R64 m	R 10 m
	Small	50	R32 m	R 5 m
	Very Small	20	R 6 m	R 0.6 m
	Micro	5	R 2m	R 0.1 m
Catering, Accommodation and other Trade	Medium	200	R13 m	R 3 m
	Small	50	R 6 m	R 1 m
	Very Small	20	R 5.1 m	R 1.9 m
	Micro	5	R 0.2 m	R 0.1 m

Sectors or sub-sectors in accordance with the Standard Industrial Classification	Size or class of enterprise	Total full-time equivalent of paid employees	Total annual turnover	Total gross asset value (fixed property excluded)
Transport, Storage and Communications	Medium	200	R26 m	R 6 m
	Small	50	R13 m	R 3 m
	Very Small	20	R 3 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m
Finance and Business Services	Medium	200	R26 m	R 5 m
	Small	50	R13 m	R 3 m
	Very Small	20	R 3 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m
Community, Social and Personal Services	Medium	200	R13 m	R 6 m
	Small	50	R 6 m	R 3 m
	Very Small	20	R 1 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m

Source: The National Small Business Act No. 102 of 1996, as amended in 2003