

Mini dissertation

IMPACT OF TAX LEGISLATION ON ECONOMIC GROWTH IN RELATION TO SMALL BUSINESS DEVELOPMENT IN SOUTH AFRICA.

by

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Submitted in partial fulfillment of the requirements for the degree

Masters Commercii (Taxation)

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

September 2008

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DEPARTMENT OF TAXATION

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Abstract

IMPACT OF TAX LEGISLATION ON ECONOMIC GROWTH IN RELATION TO SMALL BUSINESS DEVELOPMENT IN SOUTH AFRICA

by

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The overall purpose of this study was to explore whether tax legislation has an impact on economic growth in relation to small business development and whether the issues of economic growth, policies and strategies also impact the development of tax legislation.

The objectives focused on gaining an understanding of the economic policies and institutions related to small business development, the relationship between developments and changes in tax legislation with economic development strategies in South Africa and finally a critical analysis of the role that tax legislation played in stimulating or hampering economic growth in South Africa.

A brief historical exposition of the post apartheid era is given as well as highlighting the focus and emphasis on overhauling the whole economic and policy framework in place to accommodate initiatives creating a synergy between the first and second economy. The emphasis of Government in placing a policy and institutional framework in place that fosters employment creation and poverty alleviation is outlined. Furthermore, economic growth policies initiated by Government over time

ranging from RDP, GEAR and AsgiSA to the institutional frameworks and institutions set up by Government to accelerate the growth of small businesses as a way to create jobs and alleviate poverty is also explored and it is argued that despite the Government having good intentions, policy measures suffer from weak execution plans resulting from a general distrust of external agencies by SMMEs and the agencies inability to generate sufficient awareness of their existence and effectiveness. Furthermore, an exploration of tax legislation pertaining to small business is given.

The study concludes that several issues ranging from compliance costs to government interface issues are important obstacles in small business development.

In this study existing literature on tax legislation, small business development and economic growth policies was explored. The study also evaluated existing survey's and case studies on small business development and the business environment in South Africa constituted the units of analysis.

In concluding this study, the following recommendations are made:

- Government initiatives need to be publicized among the relevant target audiences.
- Removal of regulatory obstacles to the informal sector as it acts as a barrier to development by keeping a large, energetic, and entrepreneurial group of black South Africans out of the formal economy.
- Co-ordinate approach of government departments concerning development of SMME policy.
- Need for supportive environment for SMMES through initiatives such as free training and mentorship and funding the payroll agents for small business.
- Review of the Tendering process- service providers need company registration and tax clearance to be eligible for tendering therefore people end up registering many companies and in the process are disqualified as SBCs.

- Removal of limitations placed on SBC eligibility to more than one business as long as the total revenue of the businesses is less than R14 million.
- Offer more assistance to start-up or expansion businesses beyond the initial stage to a point where the business is successfully set up and all operating procedures are in place.

Opsomming

DIE IMPAK VAN BELASTINGWETGEWING OP EKONOMIESE GROEI MET BETREKKING TOT KLEINSAKE ONTWIKKELING IN SUID AFRIKA.

deur

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Die doel van die studie is om die invloed van belastingwetgewing op die ekonomiese groei van kleinsake-ontwikkeling te ondersoek en of ekonomiese groei, beleid en strategieë 'n impak het op die ontwikkeling van belastingwetgewing.

Die doelwitte van die studie het gefokus op die ekonomiese beleid en instellings rakende kleinsake-ontwikkeling, die verhouding tussen ontwikkelinge en veranderinge in belastingwetgewing in verband met ekonomiese ontwikkelingstrategieë in Suid-Afrika. 'n Kritiese analise is gedoen om die rol wat belasting speel in die bevordering of inperking van die ekonomiese groei in Suid-Afrika, te bepaal.

'n Geskiedkundige oorsig van die post-apartheid era is verskaf, en hoogtepunte is uitgelig rakende die fokus en klem van die vernuwing van die total ekonomiese en beleidsraamwerk wat in plek is om sinergistiese inisiatiewe tussen die eerste en tweede ekonomie te skep, te akkommodeer. Die klem wat die regering plaas op beleide om werkskepping te bevorder en armoede te beveg word uiteengesit. Verder word die ekonomiese beleide wat deur die regering ingestel is soos die RDP, GEAR en AsgiSA; en institusionele raamwerke en instellings om die groei van klein besighede te bevorder ten einde werk te skep en armoede te beveg, ook ondersoek. Die standpunt word ingeneem dat alhoewel die regering goeie

bedoelings het, die beleidsmaatstawwe swak uitgevoer word as gevolg van 'n algemene wantroue van SMMEs in agentskappe, asook die betrokke agentskappe se onvermoë om voldoende bewustheid van hul bestaan en doeltreffendheid te skep. 'n Ondersoek na die belastingwetgewing met betrekking tot kleinsake-ontwikkelings is ook gedoen.

Die studie kom tot die gevolgtrekking dat verskeie kwessies soos voldoeningsuitgawes en regeringskommunikasie kwessies belangrike hindernisse in kleinsake-ontwikkeling is.

In hierdie studie is bestaande literatuur oor belastingwetgewing, kleinsake-ontwikkeling en ekonomiese groei beleide ondersoek. Die studie het bestaande opnames en gevallestudies rakende kleinsake ontwikkeling en die besigheidsomgewing in Suid-Afrika gebruik as eenhede van analise.

In die afhandeling van die studie kan die volgende aanbevelings gemaak word:

- Regeringsprogramme en –inisiatiewe moet beter en meer geadverteer word by die relevant teikenmarkte.
- Regulasies wat die ontwikkeling in die informele sektor strem deurdat 'n groot groep energieke en ondernemende swart Suid-Afrikaners uit die formele ekonomie gehou word, moet verwyder word.
- Die benaderings van regeringsdepartemente rakende die ontwikkeling van beleide ten opsigte van SMMEs moet beter gekoördineer word.
- Die daarstelling van 'n ondersteunende omgewing vir SMMEs wat inisiatiewe soos gratis opleiding en mentorskap asook befondsing van salarisadministreerders vir klein besighede insluit.
- 'n Hersiening van tenderprosesse moet onderneem word. Diensverskaffers benodig besigheidsregistrasie en belastingtoegewings om in aanmerking te kom vir tenders en as gevolg daarvan registreer baie ondernemers verskeie besighede; wat hulle dan diskwalifiseer as KSO's.

- Die verwydering van beperking op 'n ondernemer wat meer as een besigheid het sodat hy steeds kan kwalifiseer as 'n KSO solank die totale jaarlikse omset van die besighede minder as R14 miljoen is.
- Die verskaffing van ekstra hulp aan nuwe en klein besighede afgesien van die aanvanklike stadium (naamlik befondsing) tot die punt waar sulke besighede suksesvol opgerig is en alle werksprosedures in plek is.

CHAPTER 1

CONTEXTUALISATION OF THE STUDY

1.1 Introduction

The aim of this chapter is to contextualize the study in general and attention will be given to the following:

- background to the study;
- identification of the research problem;
- goals and objectives of the study;
- research design;
- research methodology;
- potential value of the study; and
- structure of the dissertation.

1.2 Background to the study

Born out of a vision to eradicate the inequalities created by the previous Apartheid Regime, the African National Congress (ANC) Government since coming to power has embarked on a radical overhaul of the entire policy and institutional framework of this country, the economic sector being no different. Likewise, taxation legislation was developed and adapted to stimulate economic growth and development that in turn should aim toward employment creation. Thus, economic growth and development became an important focus for the South African Government since 1994 and various strategies, institutional arrangements and policy developments attest to this fact. Some developments specifically pertaining to small business development include the formation of core institutions to foster employment creation and entrepreneurship programmes such as Khula Enterprise Finance Ltd (Khula), Umsobomvu Youth Fund (UYF), National Empowerment Fund (NEF) and Small Enterprise Development Agency (SEDA).

The government in the past and current budget have put measures in place to reduce to cost of tax compliance for both businesses and individuals in an effort to incorporate the informal sector with the aim of achieving much greater participation in the formal economy (2006 Budget Review:14). Some typical examples include the exemption from stamp duties on lease agreements of fixed property if the rental contract is for a period of less than 5 years in an attempt to reduce the compliance burden for taxpayers entering into the lower value rental agreements, and the administrative burden on South African Revenue Services (SARS). Secondly, for small business corporations, the following amendments according to the Tax Guide for Small Business 2007/08(2007:26) came into effect for tax years ending on 1 April 2007:

- firms with an annual turnover of up to R14 million (increased from a level of R6 million) will qualify for the special graduated corporate tax regime;
- the taxable income threshold for the reduced corporate tax rate of 10 per cent will be increased from R250 000 to R300 000; and
- the small business income tax exemption threshold will be increased from R40 000 to R43 000.

However, with the budget for 2008 the small business income tax exemption threshold increased from R43 000 to 46 000. (Tax pocket guide 2008/09 2008:2)

As far as the Skills Development Levy (SDL) is concerned employers paying an annual remuneration of less than R500 000 are exempt from the payment of SDL. The Tax Pocket Guide for 2007/8 (SARS 2007:7) further highlights, that the Secondary Tax on Companies (STC) will be replaced by a dividend tax with the rate being reduced from 12,5% to 10% as well as broadening the tax base.

Another initiative implemented by Government to ease the movement of small businesses into the more formal mainstream of doing business was the tax amnesty which allowed SARS to waive taxes due by small businesses for years of assessment ending on or before 31 March 2006, where the turnover for the 2005 year of assessment did not exceed R5 million (2006 Budget Review: 75).

These developments in turn have had significant impacts on the ability of small businesses to grow, develop and hence create employment. It is therefore crucial to understand how these two factors – changes in tax legislation and economic growth policy and strategy influence each other to chart a way forward in terms of future tax legislation and business development in future.

The research problem will be identified and discussed in the section below.

1.3 Identification of research problem

The nature and extent of a reciprocal relationship between tax legislation and economic growth with particular reference to small business development needs further exploration and investigation.

1.4 Purpose, goal and objectives of the study

Babbie (1994:90-92) identifies 3 basic purposes or goals of social research in general: exploration (to explore a topic or provide a basic familiarity with a topic); description (to describe a situation, event, process); and explanation (to indicate causality between variables or events). The focus of this study is mainly on exploration and description, hence, the overall purpose here is to *explore* and *describe* the relationship between tax legislation and economic growth with particular reference to small business development.

According to Mouton (2001: 42) the research goal provides a broad indication of what researchers wish to attain in theoretical research. The goal of this research was twofold:

- to explore whether tax legislation has an impact on economic growth in relation to small business development; and
- whether economic growth policy and strategies have an impact on the development of tax legislation.

For any research to be successful proper identification of the research aims and objectives needs to be done. To achieve the above goal, the following objectives were set:

- to gain an understanding of economic policy and institutions related to small business creation in South Africa;
- to outline developments in tax legislation that has a direct impact on small business development;
- to critically explore the role of tax legislation in stimulating or hampering small business development in South Africa; and
- to, based on the above analysis, suggest possible new directions to be taken with regards to tax legislation and small business development in future.

The next section will discuss the methodology to be used in the study.

1.5 Research design and methodology

According to Mouton (2001:33) the goal of the research design is to plan the research project and to provide it with a specific structure in order to enhance the validity of the research findings. In choosing an applicable research design, Babbie and Mouton (2001:103) are of the opinion that the following questions should be asked:

- What type of study will you conduct to address the research problem as you have formulated?
- What kind of design will produce the evidence or data that you need to answer your research questions?

A qualitative approach was found to be most suitable for this study since the researcher aimed to increase the depth of understanding regarding tax legislation and its impact on economic growth and small business development. Wimmer and Dominick (1997:43-44), as well as Creswell (1994:94) indicate that qualitative research often focuses on:

- developing new hypotheses and theories;

- developing new and refining existing models;
- increasing the depth of understanding of a phenomenon; and
- pursuing new areas of interest.

Therefore, given the nature of the identified research problem, research questions, goals and objectives of this study; a qualitative research design in the form of a *literature review* and *desktop analysis* of policy frameworks was applied to achieve the aim and objectives of the study.

Mouton (2001:179-180) describes the procedure of a literature review as follows:

“Here you read a ‘sample’ of texts in order to come to an understanding of a specific domain of scholarship. The selection of sources is driven by the theoretical considerations, such as, the aim of study, the research questions, as well as pragmatic considerations (time-frame, level of study). It provides you with a good understanding of the issues and debates in the area that you are working in, current theoretical thinking and definitions, as well as previous studies and debates.”

The same author, however, also list certain shortcomings of literature reviews, namely: selectivity in selecting sources; misunderstanding of sources; and selective interpretation to suit one’s own view point (Mouton 2001:180).

Data are manifestations of, among other aspects, the reality, a phenomenon or problem that the researcher is investigating (Leedy 2001:78, 94). The author also distinguishes between primary and secondary data. Primary data, also known as new data, are collected via observations, interviews or focus groups, while secondary data already exists in the form of relevant literature, documents or reports. Since data in this study is collected by means of a literature review, the study of communication documents and records, the researcher will make use of secondary data sources

With this in mind this study firstly comprised an extensive literature review. Most of the sources selected as part of the literature review of this study were related

to tax legislation and economic growth policy frameworks as domains of scholarship. The researcher therefore investigated *existing literature* on economic growth policy frameworks, initiatives by Government and *existing relevant documentation and records* of tax legislation pertaining to economic growth and small business development in South Africa. The researcher furthermore undertook an analysis of the economic policies and legislative framework related to small business development.

1.6 Value of the study

The creation of employment through economic growth is one of the central goals of Government as it relates the Millennium Development Goal described as “The world's time-bound and quantified targets for addressing extreme poverty in its many dimensions-income poverty, hunger, disease, lack of adequate shelter, and exclusion-while promoting gender equality, education, and environmental sustainability. (www.unmillenniumproject.org/goals/index.htm).

This is achieved by creating and ensuring sustainable entrepreneurship activities that will culminate in job creation activities and inevitably economic growth. If the majority of the economically active population is able to create employment the issues of poverty and hunger are also indirectly solved.

The value of this study lies in the fact that by studying Government economic growth strategies and looking at the role of tax legislation in the broader arena the researcher is able to identify the strengths and weaknesses in the policy frameworks as well as the implementation processes thereof.

The researcher is therefore also able to provide guidelines for future developments in tax legislation and economic growth policy specifically aimed at small business development.

1.7 Definition of concepts

Tax legislation

Tax legislation is defined as legal rules that have been put in place to govern monitor and regulate taxes implemented by law.

Economic growth

Economic growth is defined as the increase in output per capita of a country over a long period of time. It is conventionally measured as the percent rate of increase in real gross domestic product (www.wikipedia.org)

Small business

The National Small Business Act of 1996, defines a 'small business as a separate and distinct business entity, including co-operative enterprises and non Governmental organizations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column 1 of the schedule (Department of Trade and Industry 2004:29).

1.8 Structure of the dissertation

The table below indicates the chapter outline of the dissertation:

Table 1: Chapter outline

CHAPTER	TOPIC
1	Methodology
2	Economic growth and development: an overview of the policy and institutional framework
3	An overview of Tax legislation pertaining to small business development
4	A critical assessment of the relationship between tax legislation and small business development strategies in South Africa
5	Recommendations and concluding remarks

1.9 Conclusion

In this chapter an overview has been given of the scientific approach that will be followed in this study. Important aspects such as the research problem, research questions, goals and objectives, research design, research methodology, etc have been highlighted.

In the following chapter an overview of the policy and institutional framework surrounding economic growth and development potential in South Africa will be explored.

CHAPTER 2

ECONOMIC GROWTH AND DEVELOPMENT: AN OVERVIEW OF THE POLICY AND INSTITUTIONAL FRAMEWORK

2.1 Introduction

This chapter focuses on exploring economic growth and development in South Africa. Attention is given to the following:

- background;
- historical background of South African economy;
- economic growth and development policies;
- the institutional support framework.

2.2 Background

Economic growth and development are central to the policies and institutional frameworks set up by any country if they want to compete competitively in the global markets. In this section the researcher intends to explore the concept of economic growth and the various elements that cannot be separated from this issue.

Thomas (1999:1) in an article for the Southern Africa Economic Summit states that generally there seems to be a consensus of the importance of the socio-economic conditions in explaining a country's economic performance. Reflections of socio-economic conditions are generally manifested in indicators of initial per capita income, life expectancy and primary education. Poorer countries tend to grow faster if they are able to take advantage of the technological advances of richer countries - this process often being referred to as convergence. But health and education also appear to be critical to the process of growth, representing a

long-term investment in human capital as well as contributing to the overall social wellbeing of a country (Thomas (1999:1).

It is further argued by Thomas (1999:2) that policy consistency is important, because most of the time economic instability has occurred as a result of inconsistencies in the macroeconomic policy framework. Such inconsistencies can represent a major disincentive to investment as they increase uncertainty. A compatible set of policies can be thought of as a configuration of monetary, fiscal, exchange rate and aid policies, which results in external balance. An inconsistency in the above mentioned areas can lead to currency volatility, low foreign direct investment (FDI) and low investor confidence which would impact directly on the economic growth potential of a country and inevitably employment creation potential.

Therefore, the quality of the institutional framework is especially important for encouraging private sector investment but also for ensuring that private sector activity is ultimately beneficial. Furthermore, Governments have an active role to play in creating an enabling environment for small- scale economic activity. This is an important element of broadening the set of economic opportunities available to the population. (Thomas 1999:2)

However, an improved social environment does not automatically follow from greater economic growth. It then falls on Governments to look for ways in which the wider population can enjoy gains from growth and how these gains can provide a basis for continued strong growth (Thomas 1999:3). In the context of economic liberalization, it is important to recognize that, in the short term, some sections of the population are likely to suffer in the pursuit of long-term growth. Trade liberalization, for example, can adversely affect employment in certain sectors of the economy as these economies are opened up to international competition. Governments need to consider complementary measures to offset the short-term adverse impact of liberalization on social development. This is a complex challenge facing many developing countries.

The above highlights the issues that Government needs to address in the quest for economic growth, development and competitiveness in global markets. It is important that the Government initiates complementary policies and institutional frameworks that will be of benefit to the wider population of South Africa. The next section will briefly touch on the historical background of the South African economy and the context in which it operates.

2.3 Historical background to South Africa's economy

Rodrik (2006:2) argues that even though the apartheid regime had begun to unravel in the 1980s, the majority of people remained deprived of basic political and economic freedoms. However, since its democratic transition in 1994 South Africa has undergone significant changes. Prior to that South African economy and polity had been dominated by a white minority.

The democratically elected Government led by the ANC however, managed to create a stable, peaceful, and racially balanced political regime with an exemplary record of civil liberties and political freedoms. Economic policy has been conducted in an equally exemplary manner, with South Africa turning itself into one of the emerging markets with the lowest risk spreads. While South Africa has instituted some innovative (and expensive) social transfer programs to address long-standing disparities, it has done so in the context of cautious fiscal and monetary policies which have kept inflation and public debt at low levels (Rodrik 2006:2).

Manuel (2007:1-14) states that after 1994 the new Government initiated various micro and macro adjustments with the Reconstruction and Development Programme (RDP) setting guidelines for Government expenditure in an effort to align spending to South Africa's poor majority. From 1996 to 2000, fiscal policy contributed to economic growth by lowering the financial cost of the budget deficit. The Government was then able to spend more money on social policies and permanently lowering the future cost of debt.

Alongside the set of fiscal and macroeconomic adjustments made in the early years, the opening up of trade policy played a critical role in providing impetus to investment and growth in productivity (Manuel 2007:1-14). The series of liberalizations of the exchange control environment, beginning with the elimination of the financial rand, have contributed to a robust two-way flow of capital into and out of the economy, demonstrated that South Africa was prepared for longer-term direct investment, and strengthened the flow of knowledge of all sorts into the economy.

A central factor in the strengthening performance of the economy has also been the structural decline in inflation since 1994. Trade policy and fiscal policy were important underlying contributors to lower inflation over the years. Monetary policy and its conduct was also critical, although as the economy became more exposed to international financial volatility the need to put in place a more appropriate monetary framework also grew. The inflation targeting framework developed between the National Treasury and the Reserve Bank in 1999 and announced in 2000, provided a more transparent policy with a clearer ordering of policy priorities and greater degrees of freedom to achieve them. A key element of the shift was that the exchange rate would be allowed to float – to adjust to external economic shocks and in doing so to create more stability for domestic interest rates and economic growth (Manuel 2007:1-14).

Even though South Africa has achieved remarkable strides in growing the economy of the country, Banerjee, Galiani, Levison and Woolard (2006:10) point out that the most worrying aspect of the economic performance are the disappointing high levels of unemployment. South Africa's unemployment rate today stands at 26 percent according to the narrow definition of who is unemployed, and at 40 percent if one includes discouraged workers. This is one of the highest rates of unemployment anywhere in the world. Furthermore, unemployment appears to have increased particularly rapidly since the democratic transition from a "low" of 13 percent in 1993. However, the lack of labor force surveys makes it difficult to know what the comparable unemployment

rates were in the 1980s. As would be expected, unemployment is heavily concentrated among the young, unskilled, and the black population. This poor record on employment represents not only an economic tragedy; it poses a significant threat to the stability and the eventual health of the South African democracy (Banerjee *et al* 2006:10).

2.4 Economic growth and development policies

Since 1994 the Government of South Africa has drafted and implemented various policies and institutional frameworks in an attempt to create economic growth for the country that would inevitably lead to the development and eradication of social ills faced by the majority.

The focus of this section will be on the Reconstruction and Development Programme (RDP) that was more people-driven focusing on the provision of basic needs. The next strategy of Growth, Employment and Redistribution (GEAR) set out to achieve the goals of the RDP by focusing on building the economy, creating employment and wealth redistribution. By achieving these aims the Government would indirectly address issues of poverty alleviation, social welfare and development of human resources.

The last section discusses the Accelerated and Shared Growth Initiative of South Africa (AsgiSA) which is the current focus of Government. The Government through the GEAR strategy has achieved recommendable growth in the economy but has been unable to achieve social targets and goals set out in the Millennium Development goals hence the need for a more accelerated growth initiative.

2.4.1 The Reconstruction and Development Programme

According to the White Paper on The Reconstruction and Development Programme (African National Congress 1994:7) the RDP is the policy framework that aimed to mobilize the people and country's resources in the movement towards a new democracy and the end of Apartheid. The policy instrument aimed at directing the progress of the transformation strategy towards an integrated and

coherent socio-economic progress. The programme further aimed to build a democratic, non-racial and non-sexist future and it represents a vision for the fundamental transformation of South Africa by developing stable institutions, participation by all groups, non-racial and non-sexist society and lastly by creating a sustainable and environmentally friendly growth and development path.

The White Paper outlines five key programmes that the RDP focuses on. The first one is meeting basic needs people which extends over a wide spectrum of issues including job creation, land, housing, water, sanitation, energy supplies, transport, nutrition, health care, the environment, social welfare and security. The second programme looks to human resource development to educate, train and empower people to achieve maximum capacity (African National Congress 1994:9).

Building the economy is the third key programme that focuses on readdressing the low levels of investment in productive enterprises, low productivity but incurring high costs. The poor majority of the people carry the burden of unemployment, bad housing, and poor health— in short of the poor performance of the economy (African National Congress 1994:10).

However the greatest challenge would be seen in implementing the RDP and this is the last key issue of the programme. The implementation objectives of the RDP are bold and innovative. They set out the procedures and the indicators through which the programme will mobilize the participation of the fullest range of social organizations and institutions (African National Congress 1994:10).

The Government realized that in order to achieve the goals set out in the RDP the country would need to achieve economic growth which would lead to employment creation and redistribution of wealth. Hence, the shift to a more economic based strategy which will be discussed in the next section.

2.4.2 Growth, Employment and Redistribution (GEAR)

To meet the goals set out by the RDP the Government had to implement an integrated economic strategy addressing issues of poverty, unemployment and inequality. GEAR promises poverty and inequality reduction via a surge in economic growth that would, in turn, increase employment creation and expenditure on service delivery to the poor. The growth engine in GEAR takes the form of a demand stimulus led by private sector investment (Department of Finance 1996:3).

The Department of Finance (1996:11) states that GEAR focuses on a number of strategies to reach its objectives. The most important being a conservative fiscal policy, public service restructuring and budgetary reforms to strengthen the redistributive thrust of expenditure as well as the elimination or scaling down of activities which cannot be provided to all, or which could be undertaken effectively by the private sector.

Low real interest rates and investor confidence are presented as the key determinants of private investment. Low inflation is an important requirement for higher economic growth, the creation of employment opportunities and a more equitable distribution of income. Low inflation would also build confidence and stimulate private sector investment.

Another critical policy thrust has been the expansion of market access through preferential trade arrangements with industrial countries and pursuit of regional economic integration. In the area of concessionary industrial finance, several schemes have been introduced by the Industrial Development Corporation (IDC) and the Regional Industrial Development Programme (RIDP) has been expanded to include a simplified scheme applicable to smaller enterprises (Department of Finance 1996:11).

The promotion of small, medium and micro enterprises (SMMEs) is a key element in the Government's strategy for employment creation and income generation reference in this strategy to "small enterprises", "small businesses" or

SMME's (small, medium and micro-enterprises), unless specifically demarcated, covers the full spectrum of business enterprises other than "large enterprises" or corporations and publicly owned enterprises. This includes categories known as micro-enterprises, survivalist enterprises, informal sector enterprises, and formal small and medium-sized enterprises (Department of Trade and Industry 2005:24).

Due to obstacles of the past, the SMME sector is severely under-developed. A major effort will be made to operationalise and implement the policies outlined in the White Paper on small business promotion. The relevant legislation has been revised and various programmes and institutions have been established to give effect to the strategy (Department of Finance 1996:14).

However, despite the strides that the GEAR strategy has achieved it is heavily criticized on the following issues:

- reliance on budget deficit reduction to kick-start growth and investment. The link between deficit reduction, lower interest rates and increased investment is dubious;
- reliance on FDI for growth and employment creation when the prospects for attracting FDI into South Africa are weak; and
- reliance on growth to create employment for the poor to reduce poverty. Studies on the causes of poverty illustrate that unemployment is a cause of poverty and unemployment is mostly structural and hence caused largely by a mismatch between the demand for labor and the nature of the skills of the unemployed poor (Department of Finance 1996:14).

2.4.3 Accelerated and shared growth initiative of South Africa (AsgiSA)

According to the AsgiSA 2006 Annual Report (The Presidency 2006:6) the Accelerated and Shared Growth Initiative of South Africa (AsgiSA) initiative originates from a commitment made by the ANC in its 2004 election manifesto to halve unemployment and poverty by 2014. Accomplishing this depends on achieving 6% economic growth per year by 2010. By 2004, economic growth had

exceeded the average 3% growth per year of the first 10 years of democracy. Yet the challenge remained to increase and sustain growth at levels sufficient to meet social targets. AsgiSA identified six 'binding constraints' – mitigating against achieving desired growth rates. The constraints are highlighted below:

- the relative volatility of the currency;
- the cost, efficiency and capacity of the national logistics system;
- shortages of suitably skilled labor and the spatial distortions of apartheid affecting low-skilled labor costs;
- barriers to entry, limits to competition and limited new investment opportunities;
- the regulatory environment and the burden on small and medium enterprises (SMEs); and
- deficiencies in state organization, capacity and leadership.

In order to address the key constraints identified the Government will target the categories focusing on the macro economy, infrastructural development, sector and industrial strategies, skills and education, the second economy and lastly public administration. The Government will endeavor to create a favorable investment climate and continue to reform trade and industrial policy (The Presidency 2006:8).

An examination of strategies initiated by Government highlights the issue of employment creation and the focus on small business enterprises as been a consistent goal found in the RDP, GEAR and AsgiSA policies and frameworks. The next section will explore the integrated small-enterprise strategy with special attention on the white paper on national strategy for the development and promotion of small business in South Africa. The section will further explore the various organizations and institutions that the Government has set up as support structures for small business development.

2.4.4 Institutional Support Framework

According to the report by the Government Communications and Information Systems (2006:78) South Africa has a significant small business sector with some two million small businesses representing 98% of all firms. Collectively, small businesses employ 55% of the country's labor force and contribute about 43% to the total wage bill. However, 87% of small businesses are survivalist enterprises with the great majority being black-owned and 41% owned by women. Survivalist enterprises are defined as businesses operating in the informal sector, undertaken by unemployed persons, usually with little capital investment, little income generated and very slim opportunities for growth (<http://www.etu.org.za/toolbox/docs/government/sbd.html>).

According to the Government Communications and Information Systems (2006:78) the Company Registration Index showed that the share of business held by small firms was increasing. In the 2006 calendar year alone, by the end of May 2006, the Companies and Intellectual Property Registration Office had recorded 19 050 company and 88 086 close corporation registrations. A private company is treated by law as a separate legal entity and must register as a taxpayer in its own right. It has a life separate from its owners with rights and duties of its own. A close corporation is defined as a company that is similar to a private company with the owners of close corporation as the members (Tax guide for small business 2007/08:3). This represented an annual increase of 2, 7% and 13, 7% respectively. Registrations of co-operatives totaled 4 843, representing an annual increase of 207%. A co-operative is defined as any association of persons registered in terms of section 27 of the Co-operatives Act, 1981 or section 7 of the co-operatives Act, 2005 (Tax guide for small business 2007/08:4). Overall, new registrations are in the business services, trade and financial sectors, followed by community, social services and construction industry.

Worldwide the importance of small business enterprises in the overall economic growth and development of any country's economy have been well documented. South Africa learns its lessons from countries like Brazil and Chile that have

successfully grown the small business sector for the benefit of the economy as well as creating employment opportunities and inevitably tackling the issue of poverty.

2.4.5 An Integrated Small-Enterprise Strategy

According to the White Paper on National Strategy for the development and promotion of small business in South Africa (Department of Trade and Industry 1995:4) Small, medium and micro-enterprises (SMMEs) represent an important vehicle to address the challenges of job creation, economic growth and equity in our country. Throughout the world one finds that SMMEs are playing a critical role in absorbing labor, penetrating new markets and generally expanding economies in creative and innovative ways. The strategy created an enabling environment for the accelerated growth of small enterprises following a history characterized by the dominance of large, capital intensive firms and the continued neglect of small enterprises.

The way forward for small business development over the next ten years is chartered by The Integrated Small Enterprise Development Strategy (i.e. 2005 to 2014). It is the result of a thorough process of review, consultation, research and refinement and also takes into account the changing economic context.

This process has built upon the successes of Government in macro-economic development and applies the experiences and lessons of the last ten years relating to small-enterprise promotion, while responding to the concerns raised by stakeholders within Government, the private sector, organized labor and civil society. In particular, the strategy aims to address Government's special development goals to improve equity in terms of race, gender and geographical location (Department of Trade and Industry 1995:4).

Subsequently the Government has set up various institutions and organizations to offer support to small business enterprises in an effort to eliminate the second economy and integrate small businesses into the first economy. The first economy is defined as an economy that is modern, integrated with the global

economy and produces the bulk of the country's wealth. On the other hand the second economy is defined as marginalized with characteristics like underdevelopment, isolation from the first or global economies, containing a large percentage of population including the urban and rural poor and lastly contributes little to the country's wealth (Goldman & Nel 2006:6) . The next section looks at the various organizations and their roles in the small business development initiative.

- **Small Enterprise Development Agency (SEDA)**

Developing small, medium and micro enterprises (SMMEs) has attracted increasing attention in South Africa in recent years, as an engine for general economic growth, and for employment creation and equity acceleration. The Department of Trade and Industry launched the Small Enterprise Development Agency (SEDA) in December 2004. SEDA, which provides non-financial support to small and medium enterprises (SMEs), was formed by merging the Ntsika Enterprise Promotion Agency and the National Manufacturing Advisory Centre. The agency aims to improve the department's geographical reach, achieve desired impact on small enterprises, provide a single access point for small enterprises and leverage resources in service delivery to all relevant stakeholders. The agency also seeks to optimize the usage of resources and align the Government's service -delivery strategy coherently (www.seda.org.za).

- **National Empowerment Fund (NEF)**

According to the Government Communications and Information Systems (2006:75) the NEF was established by the NEF Act, 1998 to promote and facilitate economic equality and transformation. The NEF leverages it's funding by setting up strategic alliances with other private-sector financial institutions to further increase funding for Black Economic Empowerment (BEE).

Operation takes place at different levels, providing finance and business support to rural women and fledgling entrepreneurs, and large-scale financial support to BEE groups. The fund's new products and services include the Group

Entrepreneurial Schemes Division (loans and equity finance to BEE SMEs from R250 000 to R10 million), Market Making (finance for larger BEE transactions in capital markets, warehousing and strategic projects) and BEE Retail Investment (promoting historically disadvantaged individuals' savings and access to listed equities through new product offerings in design phase).

The NEF partners business organizations focusing on serving women, deploying its resources to optimize the empowerment dividend of by providing pre- and post-investment management assistance. The NEF's funding comprises a hybrid of loans and equity, and is designed to lower the cost of capital for BEE participants. This approach to BEE funding is aimed at overcoming existing funders' traditional risk aversion (Government Communications and Information Systems 2006:75).

The table below highlights how the business has performed since its inception to 2007.

Table 2: Business performance since the inception of BEE

	Rand Invested	Number of Jobs	Existing Jobs	New Jobs	Rand per Job
Start-Up	R64,2m	817	3	814	R78,5k
Expansion	R40,1m	784	279	505	R51,2k
Acquisition Funding	R236,7m	2,519	1,492	1,027	R93,9k
Contracts	R19,8m	500	210	290	R39,6k
Rural & Community	R1,4m	12	0	12	R120,8k
Capital Market	R73,8	3,930	3,830	100	R18,8k
Liq & W/housing	R60,0m	542	362	180	R110,7k
Total Portfolio	R496,0m	9,104	6,176	2928	R54,5k

Source: NEF 2007 Annual Report

The table above highlights the business performance of the NEF since its inception. The business portfolio includes funding for start-ups, expansion and acquisition funding, the amount of money invested and the jobs created from the funding of the businesses (NEF 2007 Annual Report 2007:20).

- **Industrial Development Corporation (IDC)**

According to the IDC 2007 Annual Report the Industrial Development Corporation of South Africa Ltd (IDC) was established in 1940 to promote economic growth and industrial development in South Africa. In forming SMEs, the IDC has an increasingly important role in supporting and assisting with venture capital. The IDC has three operational and client-oriented divisions, namely Services Sectors, Industrial Sectors and Projects.

The IDC has facilitated the creation of a record of more than 33 000 direct jobs in South Africa with a further 3 900 in the rest of Africa as a result of funding activities. More than R5,9 billion in funding approvals are for 241 enterprises and 69% of the number of approvals relate to SMME's (IDC 2007 Annual Report).

- **Business Partners Limited**

Business Partners Limited is a specialist investment group, providing customized investment, mentorship and property-management services to SMEs in South Africa. In March 2006, Business Partners launched two new specialist investment funds, the Business Partners Empowerment Fund and the Business Partners entrepreneurial enterprises over the next five years (Government Communications and Information Systems 2006:77).

During its first 25 years of existence, Business Partners invested R6,9 billion into the country's SMEs. A further R6,6 billion was invested through Business Partners' three geographical investment funds, as well as through a number of specialist funds, some of which are joint ventures with Government bodies and other organizations. These include the Business Partners-Khula Start-Up Fund

and the Business Partners Umsobomvu Franchising Fund (Government Communications and Information Systems 2006:77).

- **Umsobomvu Youth Fund (UYF)**

UYF was established in January 2001 by the South African Government, and mandated to facilitate and promote the creation of jobs and skills development and transfer among young South African (ages 18 to 35), and fulfils its mandate by making strategic investments that facilitate opportunities for young people to acquire skills, to access job opportunities or pursue meaningful self-employment opportunities through various enterprise initiatives (www.youthportal.org.za).

The UYF is dedicated to investing in things that create opportunities for young people to acquire skills, find job opportunities or even start their own successful businesses. According to the UYF annual report for 2007 the organization's growth increased significantly from 2005 to 2007.

Table 3: UIF performance 2005-2007

Programme	2005/6 Performance	2006/7 Performance	Percentage of growth
Number of beneficiaries	13 087	15 139	16%
Number of SMME finance loans issued	6 600	21 383	224%
Number of Business Consultancy Vouchers issued	5 608	9 470	41%
Value of business opportunities	-	R183,7 million	-
Number of the South African Youth card members	46 494	73 512	58%
Number of Youth visiting Youth Advisory Centers	212 150	428 391	102%
Income from loans and investments	3 620 559	8 255 636	128%

Source: UYF 2007 Annual Report: 4

- **State-owned enterprises (SoEs)**

The Department of Public Enterprise is responsible for overseeing SoEs, to ensure that they facilitate economic growth by locating them in optimal industry structures and ensuring the efficiency of their operations and the economic effectiveness of their investment programmes. SoEs are further encouraged to play a leadership role in the economy in terms of corporate governance and the implementation of national policy and to catalyze sector and regional economic development opportunities (Government Communications and Information Systems 2006:77).

The SoEs include companies like Eskom, Transnet, Telkom, Council for Scientific and Industrial Research (CSIR), National party institute (NPI), and South African bureau of standards (SABS).

- **Expanded Public Works Programme (EPWP)**

The EPWP celebrated its first anniversary in April 2005. It is the largest job-creating initiative to be undertaken by Government. The EPWP is operational in all nine provinces. Projects include the construction of rural or low-volume roads, water and sanitation trenches and sidewalks.

In addition, Government will increase spending on the maintenance of schools, clinics and other Government buildings. EPWP projects will also be launched in the area of home-based care for people affected by HIV and AIDS, childcare projects, and in environmental projects like Land Care and clearing alien vegetation from river banks (Government Communications and Information Systems 2006:78).

In the year 2005/06 pilot programmes created 47 530 jobs with Kwazulu-Natal generating the most positions 30 647 jobs, followed by North West 6 325 jobs and the Western Cape 4 004 jobs (Government Communications and Information Systems 2006:78).

- **Khula Enterprise Finance Ltd**

Since its founding in 1996 Khula has managed to initiate, a number of loan schemes to increase access to finance for SMMEs through the use of Retail Financial Intermediaries (RFIs). These RFIs are SMME departments of commercial banks or accredited NGOs and are responsible for applying their own minimum lending criteria; the most basic is the provision of a business plan. The responsibility of risk assessment lies entirely with the RFIs. Khula is also responsible for administering a number of schemes mainly the Business Loan Scheme, Guarantee Schemes and Equity Funds (Government Communications and Information Systems 2006:79).

The 2007 financial year was noteworthy in several respects. Core business approvals rose significantly to record levels reaching R746 million, an increase from R462 million in 2006. Business loans approved with the assistance of mentorship services exceeded expectation with R108 million approved against 2006 approvals of R96 million, representing an increase of 13%. Statistics indicate that about 6,308 job opportunities have been created and that 84% of these involve full time employment and 37% female employment (Khula 2007 Annual Report 2007:17).

2.5 Assessing the effectiveness of South Africa's institutional support network

Little specific research has been done to assess the effectiveness of new and restructured institutions that are providing support to South Africa's SMMEs with indications showing that originally well-intended policy measures are suffering from suboptimal implementation (Berry, Von Blottnitz, Cassim, Rajaratnam and Van Seventer 2002:38). The heart of the problem lies with the general distrust of SMMEs of external agencies on the one hand, and the incapacity of support institutions to persuasively raise awareness about their existence and effectiveness on the other. Another problem that also needs attention is the poor co-ordination of service providers' that results in the replication of services, which results in the clustering of institutions in urban areas. This section explores these

general findings and some more specific ones regarding the particular institutions.

2.5.1 Insufficient outreach to SMMEs

Emerging and established SMMEs have shown to have little knowledge concerning the existence of SMME support initiatives. Only 57% of emerging SMMEs interviewed in Gauteng and 70% in the Western Cape never had contact with or even heard of any support institution (Berry et al 2002:39). Established SMMEs, by contrast, are embedded in a network of “traditional institutions”, such as the industrial councils and industry associations; however these traditional institutions are perceived by SMMEs to only lobby for large firms and largely on labour-related issues. The SMMEs lack of faith in the ability of Government to make interventions that would lead to an improved environment for small business contributes to SMMEs not looking for assistance from the DTI. However, it also seems that South African SMMEs have not developed a culture for making use of private consultants, because of the tendency to underestimate the usefulness of these services. (Berry *et al* 2002:39.)

2.5.2 Uneven distribution of services

Research of support institutions of manufacturing SMMEs in Western Cape and Gauteng provides ample evidence that no lack exist for SMMEs support services, but rather that there is an uneven spread of where, how and in which fields services are offered. More than a third of Gauteng’s SMME service providers, for example, are located in the Johannesburg magisterial district. General education and training, especially in ‘business skills,’ emerge as the most prominent areas of support offered, while specific needs such as legislation concerning SMME start-ups, have received little attention by both public and private support institutions. (Berry *et al* 2002:39.)

2.5.3 High cost of engaging in non-productive activities

SMME owner-managers do not have the time to search for adequate services providers because time spent on non-productive activities can be costly. Contact details and recommendations of specific service providers are available neither from entrepreneurial help lines, and referrals among local support institutions are rare. The telephone directory, the easiest accessible database of support institutions or directories prepared for the provincial SMME Desks (in Western Cape and Gauteng, for example), offers, little specification of the services offered and the hourly rate charged. Once a potentially suitable service provider is identified, it is extremely difficult to get hold of the 'right' person at the first phone call made. Hence, the search for support is more than often given up before reaching its target due to the time and effort required. (Berry *et al* 2002:40.)

2.5.4 Lengthy administration procedures and cessation of programmes

The main reasons why the DTI incentive schemes aimed at SMMEs have not been used extensively are the lack of information about their existence, red tape accompanying applications, and discouragement by dismal experiences of other applicants. This is for example true, in the particular case of the Competitiveness Fund, where firms are expected to identify their needs and provide a detailed analysis of how their performance will improve in the event that their proposed investment might be funded. Moreover, the requirements to qualify for and the components of certain schemes have changed several times over the past years without proper communication, which frustrates SMME owner-managers applying for these schemes (Berry *et al* 2002: 40).

2.6 Conclusion

The chapter has discussed various economic growth and development policies as well as the institutional frameworks directed at instigating growth in the small business sector. The chapter has explicitly highlighted the aims set out by each policy initiated by Government and also how the issues of economic growth,

employment creation and poverty alleviation are constant factors that need to be addressed.

The chapter also highlights how small business development has been identified as one of the ways to grow the economy, create employment opportunities, improve quality of life of and reduce poverty. However, it must be noted that while these measures have good intentions, policy measures suffer from suboptimal implementation resulting from general distrust of external agencies by SMMEs on the one hand, and the incapacity of support institutions to raise awareness about their existence and effectiveness, on the other.

CHAPTER 3

AN OVERVIEW OF TAX LEGISLATION PERTAINING TO SMALL BUSINESS DEVELOPMENT

3.1 Introduction

This chapter will explore the tax legislation pertaining to small business development in South Africa. Issues covered in the chapter are a brief description concerning the background of tax legislation, purpose of tax reforms, specific taxes that have a direct impact on small business development and lastly a roundup of the issues in the form of a conclusion. Attention will be given to the following:

- background;
- the purpose of tax reforms; and
- taxes pertaining to Small Business Development.

3.2 Background

Taxes that are levied on individuals and businesses contribute greatly to the economy as well as social development of the people in the country. The National Government levies taxes on income and profits in terms of the Income Tax Act, 1962 (Act No. 58 of 1962) and the Tax on Retirement Funds Act, 1996 (Act No. 38 of 1996). The taxation system in South Africa has evolved from a source-based income tax to a residence-based income tax system from 2001 (Taxation in South Africa 2006/07:1).

According to the Budget Review for 2006 (2006:63) South Africa over the years has implemented major tax reforms which have been in step with international tax reform trends. South Africa through the implementation of these international tax reforms has experienced prolific revenue collections which have allowed the Government to implement tax relief measures for individuals and companies.

The main focus of the tax policy framework has been to support the objectives of accelerated and shared economic growth through the promotion of long-term retirement savings, reducing the costs of tax compliance and the tax burden on all businesses, fostering small business development, boosting investment in research and development (R&D), supporting skills development and encouraging home ownership. Long term growth patterns are further reinforced by reducing the costs of tax compliance, broadening the tax base and lowering the tax burden on key economic activities (Budget Review 2006:63).

In a broad overview the Government seeks to:

- support economic growth, investment and job creation, business development and confidence;
- promote financial security of households and reducing their vulnerability through retirement reforms that encourage savings; and
- Support macroeconomic policy objectives.

It is quite explicit that the Government seeks to promote growth as well development of small business corporations in an effort to alleviate poverty through wealth and job creation. The next section seeks to highlight the main reasons of the tax reforms that were proposed in the 2005/06 financial year as they directly link up the relationship between small business development and the creation of an environment that is conducive for business through the implementation of attractive tax incentives.

3.2 The purpose of tax reforms

According to Chamberlain and Smith (2006:38-39) the 2005/06 financial year manifested a number of measures aimed at reducing the compliance cost of taxation and promoting the growth of small business. The announced changes are briefly highlighted under the following headings:

- decreasing the administrative burden;
- a stronger small business focus; and

- financial relief.

The next section discusses these measures one by one in an effort to give more clarity on the reasons for the reforms.

3.2.1 Decreasing the administrative burden

Discussed below are some of the ways that SARS will ensure that the administrative burden of tax compliance is reduced

- only one form will be required to register for all taxes, also Income Tax and VAT;
- implementation of the principle of *Voluntary Disclosure* was undertaken to ensure that small businesses not registered for tax or those that did not declare all income are given the opportunity of entering the tax system and rectifying income discrepancies without the threat of prosecution;
- a single customs declaration will be implemented, i.e. imports and exports are captured in one form;
- applications for tax clearance certificates can now be made online using the e-filing system;
- for firms with an annual turnover of less than R1 million, the VAT submission period is reduced from once every two months to once every four months from August 2005 onwards, i.e. from six to three times per annum;
- the Small Retailers' VAT package is introduced from April 2005 onwards. This package is a simplification of VAT accounting and is aimed at business registered for VAT with a turnover of less than R1 million that mainly function in the retail sector and do not have access to cash registers that can distinguish between zero-rated and standard-rated sales. The package includes a free set of pre-printed books that will help vendors keep track of stock purchases and daily sales. This change can thus be seen as directly targeting those small businesses in the greatest need of compliance cost reduction; and

- a single national call centre number will be established for all tax and customs queries. (Chamberlain and Smith 2006:38-39.)

3.2.2 A stronger small-business focus

SARS will adopt a more focused approach in terms of small business advancement by doing the following:

- SARS will be sending community tax helpers to support small businesses with tax issues such as registration, tax returns and other complexities;
- small business help desks will be made available for small businesses in the call centre and at SARS offices;
- a dedicated VAT information campaign will be undertaken; and
- accounting and payroll packages will be made available by SARS to small businesses. Small businesses can obtain the software from SARS or use dedicated computer kiosks in the SARS offices (Chamberlain and Smith 2006:38-39).

3.2.3 Financial relief

SARS in an effort to bring financial relief to various businesses has implemented the measures highlighted below:

- Abolishment of all regional social council (RSC) levies from July 2006. Replacement of the levy will be in the form of some other local council tax. A replacement income collection mechanism is still being considered;
- small businesses with an annual payroll of less than R500 000 are made exempt from paying Skills Development Levies from August 2005 onwards;
- the tax rate for close corporations and companies is decreased from 30% to 29% and then finally to 28%; and
- preferential tax treatment for Small Business Corporations (SBCs) is extended to include more service industries. The maximum annual turnover to qualify as a SBC increased from R5 million to R6 million to R14 million, while the tax brackets for this category of small businesses are broadened. In

3.4 Taxes pertaining to Small Business Development

The different types of taxes that have a direct correlation with small business development in South Africa are discussed in this section. The taxes discussed will include the Secondary Tax on Companies (STC), Small Business Corporations (SBCs), Capital Gains Tax (CGT) that was implemented on the 1st of October 2001, Value-Added Tax (VAT) that replaced sales tax, Skills Development levy (SDL) and lastly the tax amnesty levy initiated to integrate small businesses into the mainstream economy.

Secondary Tax on Companies (STC) will be discussed with the emphasis of highlighting the changes that have taken place over the years and the impact thereof on small business development.

3.4.1 Secondary Tax on Companies

McAllister (2006:13) states that the company rate of tax at the time of the introduction of STC was regarded as being too high in the context of the global economy. STC was introduced at a rate of 15% and the company rate was reduced from 48% to 40% for companies with tax years falling within the year ending 31 March 1994. However, about fourteen months later the rate was increased from 15% to 25% with effect from 22 June 1994, while the company rate was reduced from 40% to 35%.

The large increase in the rate of STC served as a strong disincentive for companies to distribute dividends and this had a negative impact on STC collections. It also prompted many companies to issue capitalization shares instead of cash dividends. For dividends declared on or after 14 March 1996 the rate of 25% was reduced to 12, 5% on the 1st of October 2007 the rate was reduced further to 10%. Clearly there is a fine dividing line between stimulating

growth through the retention of profits and the loss in tax revenue that results from fewer dividends being distributed (McAllister 2006:13).

The table below highlights the rates of the STC since its inception in 1993 to the current period. The rate currently stands at a much lower rate since it was introduced in 1993. The incentive for small businesses is that if they make use of cash dividends to the shareholders they are liable for less tax unlike if they go the route of company tax.

Table 4: Secondary Tax on Companies (STC)

From	Until	Rate
17/03/93	21/06/94	15%
22/06/64	13/03/96	25%
14/03/96	31/9/2007	12.5%
01/10/2007	To date	10%

Source: SARS Tax Rates/Duties/Levies 2006:1

The tax has been further reduced to 10% to broaden the tax base and has been renamed to a dividend tax even though it remains a tax on the company declaring the dividends. The next section discusses taxes levels of taxable income for Small Business Corporations and how a business can benefit from complying with the necessary requirements.

3.4.2 Small Business Corporations (SBCs)

Small businesses play a valuable role in stimulating economic activity, job creation, poverty alleviation and broadening development. According to the Tax Guide for Small Business (2006/07:29) the small business corporation regime allows two major concessions to companies and close corporations which comply with all of the following requirements:

- the shareholders or members must be natural persons (individuals) and must hold the entire shareholding/member's interest of the company/close corporation;

- shareholders or members may not hold any shares or interest in the equity of any other company [excluding shares in listed companies];
- the gross income of the corporation for the tax year may not exceed R14 million;
- not more than 20% of the total of all receipts and accruals (other than those of a capital nature) and all capital gains of the company/close corporation may consist collectively of investment income and income from rendering a personal service;
- the company/close corporation may not be an employment company (i.e. a labor broker without an exemption certificate or a personal service company); and
- the company, throughout the year of assessment employs at least four full-time employees who are on a full-time basis engaged in the business of the company of rendering that service. (Tax Guide for Small Business 2006/07:29.)

The impact of the SBC of the tax reforms is that the rate of tax on the taxable income of an SBC is considerably lower than the normal rate of tax for companies in general. A company pays tax at the rate of 28% on its taxable income, whilst an SBC will pay 0% tax on the first R46 000 of taxable income, 10% of the amount by which taxable income exceeds R46 001 and 28% of the amount by which taxable income exceeds R300 000. The table below highlights the expected rates (Tax Guide for Small Business 2006/07:29).

Table 5: Small Business Corporations

Tax years ending during the period	Normal Tax	From Taxable Income	To Taxable Income
01/04/00-31/03/02	15%	R1	R100 000
	30%	R100 001	and above
01/04/02-31/03/05	15%	R1	R150 000
	30%	R150 001	and above
01/04/05-31/03/06	0%	R1	R 35 000
	10%	R 35 001	R250 000
	29%	R250 001	and above
01/04/06-31/03/08	0%	R1	R 40 000
	10%	R 40 001	R300 000
	29%	R300 001	and above
01/04/08 to date	0%	R1	R 46 000
	10%	R 46 001	R300 000
	28%	R300 001	and above

Source: SARS Tax Rates/Duties/Levies 2006:4 and Tax Pocket Guide 2008/09

To ease the informal businesses into the more formalized and beneficial mainstream operations the Government decided to alleviate the non-compliance fears that had been stopping businesses from registering for tax by introducing a tax amnesty for businesses which will be discussed in the next section.

3.4.3 Tax Amnesty Levy

Although small businesses play a valuable economic and developmental role, many are historically marginalized. They have been excluded from the economic mainstream, operating informally and remaining outside the tax system. A growing understanding of the economic benefits of a more formal approach to doing business, of why it is necessary to pay tax, of the tax system's requirements, and of the risks of non-compliance have now led to greater willingness to enter the tax system (Tax Guide for Small Business 2006/07:25).

However, an obstacle to becoming tax compliant faced by these small businesses was the fear of the consequences of past non-compliance, which includes possible liability for additional tax. To mitigate this fear the Government

instigated a tax amnesty measure on the 1st of August 2006 to ensure the integration of small businesses into the formal business mainstream.

The Minister of Finance announced during the 2006 Budget that the Government would introduce a tax amnesty for small business with the purpose of:

- broadening the tax base;
- facilitating the normalization of the tax affairs of small businesses;
- increasing and improving the tax compliance culture; and
- facilitating participation in the taxi recapitalization program.

The percentage is determined on a sliding scale. No levy is payable on the first taxable income of R35 000 or less. However, the business is required to pay 2% for any taxable income above R35 000 but less than R100 000. If the taxable income exceeds R100 000 but does not exceed R250 000 the business will pay R1 300 plus an additional 3% of the amount above R100 000. An amount exceeding R250 000 but less than R500 000 sees the business paying R5 800 plus an additional 4% on the amount above R250 000. The business is required to pay R15 800 plus an additional 5% for any amount above R500 000 (SARS Tax Rates/Duties/Levies 2006:35).

Table 6: Tax Amnesty Levy

From	To	Levy (R)
Taxable Income (R)	Taxable Income (R)	
-	35 000	No levy payable
35 000	100 000	2% of the amount above 35 000
100 000	250 000	1 300 + 3% of the amount above 100 000
250 000	500 000	5 800 + 4% of the amount above 250 000
500 000	and above	15 800 + 5% of the amount above 500 000

Source: SARS Tax Rates/Duties/Levies 2006:35

3.4.4 Capital Gains Tax (CGT)

Capital gains tax (*CGT*) was implemented on 1 October 2001. It forms part of the income tax system and is a tax on capital gains made upon the disposal of assets from the date of implementation (Taxation in South Africa 2007:30).

In terms of the Income Tax Act, 1996 highlighted in Taxation in South Africa (2007:30) relief is provided to small business persons who, instead of providing for their retirement, have reinvested their resources in their businesses. A small business is defined as a business that has market value of all its assets at the date of selling the assets, or interest in the business, not exceeding R14 million.

The relief, which is available only to a natural person, permits him to disregard any capital gain on the disposal of:

- an 'active business asset' of a small business owned by him as a sole proprietor; or
- an interest in each of the 'active business assets' of a partnership qualifying as a small business upon his withdrawal from the partnership, to the extent of his interest in the partnership; or
- an entire direct interest, which consist of at least 10% of the equity qualifying as a 'small business', to the extent that the interest relates to the assets of that small business qualifying as 'active business assets'.

The sum of the amount that may be disregarded increased from R500 000 in 2001 to R750 000 in 2006 during a person's lifetime (Taxation in South Africa 2007:30). Meaning that although a person may qualify for the relief more than once during his lifetime, the total amount that may be disregarded may not exceed R750 000. However, as already highlighted above this relief will not be available if the total market value of all the active business assets of his small businesses exceeds R14 million.

Highlighted below are the inclusion rates and the effective rates of capital gains tax:

Table 7: Capital gains tax (CGT)

From	Until	Inclusion rate	Effective tax rate
01/10/2001	31/03/2005	50% of net capital gain	15%
01/04/2005	31/03/2008	50% of net capital gain	14,5%
01/04/2008	To date	50% of net capital gain	14%

Source: SARS Tax Rates/Duties/Levies 2006:22 and Tax Pocket Guide 2008/09

3.4.5 Value-added tax (VAT)

VAT is an indirect tax which is based on consumption in the economy. Revenue is raised for the Government by requiring certain traders (vendors) to register and to charge VAT on taxable supplies of goods or services. Vendors act as the agent of the Government in collecting the VAT charged on taxable transactions. Taxation in South Africa (2007:38) states that Value-added tax (VAT) is levied at a standard rate of 14% on all goods and services subject to certain exemptions, exceptions, deductions and adjustments provided for in the Value-Added Tax Act, 1991 (Act No. 89 of 1991). Under compulsory registration any person who carries on an enterprise and whose total value of taxable supplies (taxable turnover) exceeds, or is likely to exceed, R300 000 in any 12 month period, must register for VAT.

Table 8: Value Added Tax (VAT)

From	To date	Rate
30/09/1991	06/04/1993	10%
07/04/1993	To date	14%

Source: SARS Tax Rates/Duties/Levies 2006:14

3.4.6 Skills development levy (SDL)

An employer must pay SDL if the employer pays annual salaries, wages and other remuneration in excess of R500 000. Employers with an annual payroll of

R500 000 or less (whether registered for employees tax purposes with SARS or not) are therefore exempt from this levy (2007/08 Tax Pocket Guide 2007:10).

This levy (currently 1%) is used for the funding of education and training of employees. It is calculated as a percentage of a leviable amount, which is more or less equal to the earnings of the employees. The exemption for employers with an annual payroll for less than R500 000 is beneficial for small businesses as they are exempt from the levy (2007/08 Tax Pocket Guide 2007:10). The table below highlights the levy rate since its inception in 2000.

Table 9: Skills Development Levy

From	Until	Rate
01/04/2000	31/03/2001	0,5% of payroll
01/04/2001	To date	1 % of payroll
Exemption		R500 000 annual payroll or less

Source: SARS Tax Rates/Duties/Levies 2006:21

3.5 Proposed tax relief for Small Business 2008/09

Highlighted below are the proposed tax relief measures for small businesses in the 2008/09 financial year. The proposed relief explicitly highlights efforts by the government to ensure easier compliancy for small businesses as they are integrated into the mainstream economy (2008 Budget Review: 56):

- relief for personal income tax;
- corporate tax reduced from 29 to 28 per cent;
- removal of the secondary tax on companies (STC), to be replaced by a withholding dividend tax at shareholder level in 2009;
- simpler tax package for small businesses with an annual turnover up to R1 million;
- vat registration requirements threshold increased from an annual turnover of R300 000 to R1 million;

- incentives to encourage venture capital equity investments in small and medium-sized businesses;
- R5 billion in tax subsidies over the next three years to support the emerging industrial policy;
- a review of learnership allowances to encourage apprenticeships;
- measures to encourage private land owners to protect biodiversity; and
- the introduction of an electricity levy of 2 cents per kilowatt hour.

Table 10: Proposed presumptive tax for very small businesses

Turnover	Tax liability
0-R100 000	0%
R100 001-R300 000	2% of each R1 over R100 000
R300 001 –R500 000	R4 000 + 4% of the amount above R300 000
R500 001- R750 000	R12 000 + 5.5% of the amount above R500 000
R750 001-R1 000 000	R25 750 + 7.5% of the amount above R750 000

Source: 2008 Budget Review

According to the 2008 Budget Review (2008:63) the proposed turnover-based system will see small businesses having to deal with fewer problems in terms of tax compliance it does not however, excuse them from issues of tax liability.

3.6 Conclusion

The information given above highlights the reforms that South Africa has implemented over the last decade to increase economic growth, reduce tax burdens, administrative constrains, issues of tax compliance and integrating small businesses into the formal business operation arena. The Government has borrowed from international tax policies and this has paid off as manifested by

the buoyant revenue collections and the various relief measures that Government has been able to implement across the board.

The next chapter will explore the relationship between tax legislation and small business development strategies in South Africa. The chapter will review findings of previous studies carried out on small business development as well as issues related to tax legislation in respect to small business development.

CHAPTER 4

A CRITICAL ASSESSMENT OF THE RELATIONSHIP BETWEEN TAX LEGISLATION AND SMALL BUSINESS DEVELOPMENT STRATEGIES IN SOUTH AFRICA

4.1 Introduction

The focus of this chapter is on a critical assessment of the relationship between tax legislation and small business development strategies in South Africa. The chapter will assess the development policy frameworks initiated by the Government, the issue of tax legislation and its impact on small business development and inevitably economic growth. Attention will be given to the following sub-headings:

- background;
- small, micro and medium enterprises and the cost of tax compliance;
- findings of the 2004 SMMEs Survey;
- factors affecting SMMEs; and
- Critical assessment of issues affecting growth of SMMEs

4.2 Background

The promotion of the growth and development of small, micro and medium-sized enterprises (SMMEs) in South Africa fits into a framework of broad social and economic development goals. The White Paper on the National Strategy for the Development and Promotion of Small Business in South Africa (1995:4) advocates for a growth policy that focuses on expanding production and employment opportunities. The achievement of these goals will require the transformation of the small-enterprise sector justifying concerted policies of wider scope as well as the deliberate creation of an enabling environment.

In response to the challenges set out in the White Paper, certain Government organs were created to drive the National Small Business Strategy. The Centre for Small Business Promotion (CSBP) of the Department of Trade and Industry (DTI), Small Enterprise Development Agency (SEDA) formerly known as the Ntsika Enterprise Promotion Agency (Ntsika) and Khula Enterprise Finance were established. Further organizations have been created to give assistance to emerging entrepreneurs and small business operators wishing to expand and formalize their business operations. These organizations include Umsobomvu Youth Fund (UYF), National Empowerment Fund (NEF), Industrial Development Corporation (IDC) and Business Partners United. It is expected that SEDA and Khula will build the technical and financial capacity of non-financial and financial retail service providers (Berry *et al* 2002:35).

The DTI, together with the IDC, have introduced a number of specific programmes aimed at increasing the competitiveness of formal SMME manufacturers. There are, however, indications that despite their good intentions, these policy measures suffer from sub-optimal implementation due to a general distrust of external agencies by SMMEs on the one hand, and the incapacity of support institutions to persuasively raise awareness about their existence and effectiveness on the other (Berry *et al* 2002:35).

The next section focuses on one of the underlying objectives set out in the White Paper to support the framework for small business. The objective focuses on the issue of tax compliance costs as it explicitly fits into at least two objectives, namely creating an enabling environment for small enterprises and leveling the playing fields between big and small business.

4.3 Small, micro and medium enterprises (SMMEs) and the cost of tax compliance

It is estimated that approximately 5-7.5 per cent of all South Africans aged 18-65 are self-employed, while other Global Entrepreneurship Monitor estimates indicate that the owner-managed sector provides employment to 2.1 million

individuals. It is estimated that the number of SMMEs in South Africa ranges between 1.6 and 3 million. Of this total, it is further estimated that micro enterprises represent between 1.2 and 2.8 million businesses – between 69 per cent and 80 per cent of all SMMEs in South Africa (Orford, Herrington & Wood 2004: 3).

Although there are no conclusive figures concerning the size of the SMME sector in South Africa, a large proportion of the South African adult labor force generates its income through self-employment or through employment provided by the owners of small businesses. The economic importance of this sector is nested in its demand-generating ability, its income-generating potential and ability to act as driver of employment creation and human capital consolidation. A successful small business sector could also make a large contribution to black economic empowerment. Even if the SMME sector is unable to deliver the above economic and social benefits, developing countries should invest in SMMEs because they account for a large share of firms and employment (Berry *et al* 2002:13).

According to Chamberlain and Smith (2006:1), all over the world the cost of compliance with regulation is noted as a key inhibitor to SMME development. To remove this inhibitor Governments are realizing that, while regulation may be necessary, the cost of regulation should be monitored and controlled. This is particularly true for SMMEs that, due to their size, are more vulnerable to regulatory burden than larger firms. The focus is, therefore, to move to smart regulation rather than no regulation. Compliance with tax regulation is one area of regulation that is rated as a high burden. Recent studies in South Africa have confirmed that regulations and particularly tax compliance is an issue for SMMEs.

The next section focuses on a survey that was undertaken in 2004 surrounding issues that affect SMMEs in South Africa. These findings will bring to light whether measures implemented by Government in an effort to create a favorable business environment for SMMEs are successful.

4.4 Findings of the 2004 SMME Survey

Orford (2004:12) argues that despite commendable ideals and considerable effort the Government appears to be failing in its bid to promote small enterprises. According to the 2004 SME survey, 62% of all small and medium enterprises think the Government is failing in its efforts to promote small businesses.

These findings are consistent with the findings of the Global Entrepreneurship Monitor (GEM). Since 2001 the GEM study has interviewed nearly 200 experts on entrepreneurship in South Africa. These country experts are asked to identify strengths and weaknesses in the South Africa's enabling environment and to suggest ways in which entrepreneurship can be stimulated in South Africa.

Analysis of these interviews shows that taken together Government policies and programmes to support entrepreneurs are the second most frequently identified factor limiting entrepreneurial activity in South Africa. Furthermore, taken together recommendations concerning Government policies and programmes are the single most important category of recommendations made by the GEM country experts (Orford 2004:12).

Further analysis of the SME survey shows that poor communication is part of the problem. The survey found that 70% of SMEs felt that the Government communicates its incentives poorly or very poorly and 64% of SMEs felt that the Government communicates its legislation poorly or very poorly. Again this is consistent with research by GEM. For example, in a 2002 survey of small enterprises that had applied for finance, we found that more than half of the enterprises had not heard of Khula's loan facilities for small enterprises, even though this is one of Government's primary initiatives in this arena (Orford 2004:12).

However, problems run deeper than communications. In general, the findings of the SME survey support the view that the Government fails most where it is involved in the actual delivery of services rather than simply creating an enabling

environment (Orford 2004:12). For example, the survey finds that, while 41% of SMEs think that the impact of Government legislation is positive, 63% of SMEs think that the impact of general Government incentives is negative and 54% of SMEs think that the impact of SME support structures is negative.

These findings suggest two very important priorities for the Government. The first is for Government to improve the policy environment. Although the South African business environment is light years away from the horrors of doing business in some countries, there are considerable obstacles to starting and operating businesses. While not designed to specially target small enterprises, many aspects of legislation impose a very high burden on a small enterprises by diverting key resources, such as the entrepreneur's time, into non-productive activities (Orford 2004:12).

4.5 Factors affecting SMMEs

In November 2004, the Small Business Project (SBP) published a groundbreaking new report on regulatory compliance cost in South Africa. . The SBP study provides strong research-based evidence with which to take forward the discussion about how to achieve a regulatory environment that will be most conducive to the private sector's optimal performance, particularly for small and medium-sized businesses (SMEs).

Highlighted below are the findings that were documented after a study covering regulatory compliance costs from large corporations through SMEs to the informal sector was carried out. The cost of the time spent and professional fees paid to meet regulatory requirements; these compliance costs across the economy were estimated to amount to about R79bn a year – equivalent to 6.5% of GDP – a high ratio when compared to that in developed countries (Small Business Project 2004:17).

4.5.1 Factors inhibiting business growth

According to the report published by The Small Business Project (2004:17) a wide range of factors are perceived to limit growth. Of the constraints mentioned,

two stand out: weakness in the economy, or a lack of demand; and a range of factors resulting from the state's interface with business. These two factors are ahead by some way of the third and fourth: labor problems and affordable access to capital.

4.5.2 State interface-constraints on growth

The break-down of growth-inhibiting factors that arise from state interface are issues ranging from complexity of regulatory compliance to cost of registrations, compulsory affiliations, licenses, insurances etc. Expectations of BEE compliance criteria also come up as a significant factor. All these factors explicitly highlights that the cost of doing business in a country will have an effect on micro, small and medium businesses as they are expected to cover compliance costs and go through difficult and time consuming processes that they are not knowledgeable and confident about. (Small Business Project 2004: 17).

4.5.3 Constraints on increased employment

The patterns of responses on constraints on increased employment are summarized below. Again, a lack of confidence or demand in the economy attracted the most mention, followed by labor laws, and Government regulations in general. Some of the other factors, such as hiring and firing difficulties, employment equity, and various employment-related costs, are heavily influenced by Government actions. The responses generally give the impression that regulatory costs – of both the efficiency and compliance varieties – are an important reason why South African businesses are reluctant to hire more staff (Small Business Project 2004:18).

4.5.4 Ways of avoiding regulatory compliance

Further evidence about the efficiency costs of regulation comes from responses to one of the last questions in the survey. Respondents were asked what things could be done to avoid the cost of regulations. The largest group of respondents felt that nothing could be done; the second largest group felt that limiting the

number of employees would be a way to avoid regulatory compliance. Other respondents felt that limiting the size or revenue of the business would help avoid VAT. Lastly a sizable portion felt that engaging in tax aversion and avoiding VAT registration would be ways they would use to avoid regulatory compliance (Small Business Project 2004:18).

4.5.5 Most time-consuming and troublesome regulations

Businesses have to spend time learning which regulations apply to them, complying with them, and keeping up to date with changes. According to the survey that was carried out, VAT was cited in 19% of responses, and this, with other tax-related issues (PAYE and SARS together totaling 20% emerged as the most problematic regulations. Labor laws were mentioned in 12% of the responses, and SETA Sector Education and Training Authority and RSC Regional Service Council levies in 11%. No other issue attracted a significant mention in more than 5% of the responses (Small Business Project 2004: 19).

After exploring the findings reflected in various literatures and taking into account previous studies the following section looks at a critical assessment of various issues affecting the growth of SMMEs.

4.6 Critical assessment of issues affecting growth of SMMEs

4.6.1 Funding or tax compliance

Despite relatively intensive attempts at reducing regulatory compliance costs and more specific, tax compliance costs for SMMEs, no real impacts on SMME firm growth and start-up rates have been discernable. Determining whether tax compliance costs is a perceptual rather than real problem for SMMEs is important in, firstly, deciding how many resources to devote to compliance cost reduction and, secondly, for developing a successful approach to creating a more competitive regulatory environment (Chamberlain & Smith 2006:21).

4.6.2 Providing adequate support structures

Creating a generally supportive environment for SMMEs through initiatives such as free training and mentorship and funding the payroll agents for small business (such as in New Zealand) could prove more important for SMME growth than reducing compliance costs.

The conclusion gleaned from the SARS study after examining both the broader SMME policy environment and specifically tax and compliance cost issues is that it is not only tax issues that affect the growth and expansion of small business development but other development and infrastructural issues as well (Chamberlain & Smith 2006: 34).

4.6.3 Absence of a consistent definition of SMMEs and lack of co-ordination in Government policy

The literature revealed that there is no consistent definition for small business in South Africa, even between different Government departments. This has proved highly problematic in formulating coherent Government policy. A lack of co-ordination between Government departments is also increasing the time spent by small businesses on compliance. Business registration requirements are currently handled by 5 different Government offices and cannot be considered a co-coordinated process (Chamberlain & Smith 2006: 34)

4.6.4 Need to co-ordinate SMME policy amongst Government Departments

Despite the intentions encapsulated in the White Paper on the National Strategy for the Development and Promotion of Small Business in South Africa, SMME policy is not coordinated or aligned. In its simplest form this can be seen in the different SMME definitions used across Government departments. The result is duplicated and conflicting efforts and a loss of the synergy that could be achieved if, for example, SMME tax policy is aligned with DTI support initiatives.

Acknowledging this problem, the SARS study in Chamberlain and Smith (2006: 44) recommends the creation of a more co-coordinated approach to the

development of SMME policy. This includes establishment of an interdepartmental task team by SARS and Treasury to focus on “overall regulatory burdens affecting small businesses in general” and the possibility of establishment of a Small Business Ombudsman who would need to facilitate interaction between the task team and small business and represent the interests of small business (Chamberlain & Smith 2006: 44).

4.6.5 The regulatory environment

International evidence suggests that the regulatory environment has a major influence on the survival and growth of small and new businesses. According to the World Bank, regulatory reforms in developing countries could add as much as 1.4% to average annual GDP growth in these countries. Although South Africa has a relatively favorable regulatory environment there are areas where improvement to the regulatory environment could be made.

In particular, improvement in VAT tax and reductions in compliance costs could be achieved. The policy implication of this is that regulatory *reform* could contribute to higher enterprise formation and survival rates in South Africa. One way of achieving meaningful regulatory reform is to implement a regulatory impact assessment process. This would enable ongoing review of all legislation in order to determine the potential impact on small enterprises (Orford, Herrington & Wood 2004:42).

4.6.6 Regulatory obstacles to the informal sector

Although regulations are not largely enforced in the informal sector, the regulatory environment acts as a barrier to development by keeping a large, energetic, and entrepreneurial group of black South Africans out of the formal economy. From the perspective of informal operators, the regulatory environment is a cliff – they stand at the base, very aware of the advantages of reaching the higher ground, but equally aware that the cliff is too steep to be climbed (Orford *et al* 2004:51).

The study highlights that many SMMEs operators were well aware of the advantages of formalization. In the study they highlighted issues like less harassment, cheaper stock/inputs and credit, the possibility of Government aid and a better image for marketing and tenders. However despite highlighting the above mentioned advantages the operators also felt that there were huge disadvantages like taxes, cost in relation to rewards and red tape.

From a national economy perspective this results in a loss of tax revenue and lack of compliance with other important legislation. There are also costs to businesses that remain outside the formal economy. Informal businesses remain geographically dispersed and do not grow to their efficient size, thus reducing the number of productive jobs that they generate and diminishing the opportunities for growing out of poverty (Orford *et al* 2004:51).

4.6.7 Tax compliance burden as a measure to unlock the SMME market

Although important for long-term development, reducing the burden of tax compliance is unlikely to result in dramatic development of the SMME market in the short-term. It is more likely to be a catalyst or facilitator of development rather than a driver of growth. Drivers for growth will come from improvements in the general economic environment and demand conditions combined with initiatives to empower individuals to start their own businesses (Chamberlain & Smith 2006: 47).

On the other hand, the SBP study on cost of compliance in South Africa also highlights VAT and other tax issues as major concerns for businesses. This study surveyed 1 794 businesses of all sizes. The issue of VAT was cited in 19% of the responses and other tax-related issues like PAYE and SARS together totaling 20% emerged as the most troublesome and time-consuming set of regulations. This study estimated that on average the annual costs of regulatory compliance per firm were R105 174 for all sizes and sectors. These costs included the average estimated annual administrative, manpower, supervisory and

professional costs associated with regulatory compliance (Orford *et al* 2004:42).

4.7 Conclusion

A critical assessment of the relationship between tax legislation and small business development has been entered into by examining the factors surrounding the development policies and strategies set out to create an enabling environment for small business development. The chapter has examined various case studies carried out over the years and documented their findings in an effort to bring to light the relationship between tax legislation and small business development. The one factor that stands out in this relationship is the issue of cost of tax compliance and the regulatory framework in the business environment.

CHAPTER 5

CONCLUDING REMARKS ON THE STUDY AND RECOMMENDATIONS

5.1 Introduction

In this chapter the researcher makes concluding remarks on the study and recommendations.

Attention will be given to the following:

- revisiting the research problem
- revisiting the goal, research questions and objectives of the study
- evaluating the research design
- evaluating the research methodology
- recommendations
- a final word on the potential value of the study

5.2 Revisiting the research problem

This study focused on exploring and investigating the nature and extent of a reciprocal relationship between tax legislation and economic growth with particular reference to small business development.

This study was undertaken because of the importance of small business development in creating job opportunities and alleviating poverty. South Africa has not shown a positive picture in this regard as experienced by other countries in the world. Therefore, the question to be asked falls back on what are the constraints that hamper the successful operation of small business in South Africa, particularly as it pertains to employment creation. This study focused more on the issue of small business development in relation to tax legislation and compliance costs.

5.3 Revisiting the goal, research questions and objectives of the study

The overall purpose of this study was to explore whether tax legislation has an impact on economic growth in relation to small business development. Furthermore, the goal of the study was to establish whether the issues of economic growth, policies and strategies also impact the development of tax legislation.

The following objectives were identified towards a greater understanding of the stated research problem:

- to gain an understanding of economic policy and institutions related to small business creation in South Africa; (See Chapter 2)
- to outline developments in tax legislation that has a direct impact on small business development; (See Chapter 3)
- to critically explore the role of tax legislation in stimulating or hampering small business development in South Africa; and (See Chapter 4)
- to, based on the above analysis, suggest possible new directions to be taken with regards to tax legislation and small business development in future (See Chapter 5)

As highlighted above a chapter was devoted to the answering of each objective of the study. This approach provided a logical build-up towards addressing the stated research problem.

It is also argued that this dissertation was relatively successful in addressing the stated research problems, questions and objectives formulated for this study.

5.4 Summary and main arguments of the chapters

Chapter one lays the background of the whole study as it draws a map to be used in the navigation from one chapter to another until the final conclusion. The background and motivation of the study is highlighted in the chapter. A brief

exposition of the post apartheid era is given as well as highlighting the focus and emphasis on overhauling the whole economic and policy framework in place to accommodate initiatives creating a synergy between the first and second economy. The main argument put forth by the Government is that of placing policy and institutional framework in place that inevitably leads to employment creation and poverty alleviation.

Chapter two gives linkages on the economic growth policies initiated by Government over time ranging from RDP, GEAR and AsgiSA to the institutional frameworks and institutions set up by Government to accelerate the growth of small businesses as a way to create jobs and alleviate poverty. However, the main argument in this chapter is that despite the Government having good intentions, policy measures suffer from weak implementation plans resulting from a general distrust of external agencies by SMMEs and the agencies inability to generate sufficient awareness of their existence and effectiveness.

Chapter three is based on an exploration of tax legislation pertaining to small business development and how it has evolved overtime in order to create a more conducive environment for doing business. The chapter explores specific taxes that have a direct impact on small business development. The issues highlighted in the chapter provide the basis of the critical assessment that is to follow in the next chapter therefore plays a pivotal role.

Chapter four focuses on a critical assessment of the relationship between tax legislation and small business development. The findings of this chapter include critical assessment of the tax legislation as well as findings documented from previous surveys carried out on small business development and the business environment in which they operate. Several issues are highlighted ranging from issues such as compliance costs to Government interface issues. The issue of tax compliance comes up as one of the important factors acting as an obstacle in small business development but is not the only issue.

5.5 Evaluating the research design

5.5.1 The qualitative approach of the study

A qualitative approach was followed to pursue a relatively unexplored area of interest to increase the depth of understanding regarding the impact of tax legislation on small business development in particular and South African economic growth in general. It is concluded in this study that this research approach was suitable for addressing the research problem. However, the researcher acknowledges that the findings and conclusions of this study might have interpretational limits due to the researcher becoming an integral part of the study.

5.5.2 Evaluating the research methodology

In this study existing literature on tax legislation, small business development and economic growth policies was explored. The study also evaluated existing survey's and case studies on small business development and the business environment in South Africa constituted the units of analysis. The researcher did not experience any problem with regards to sources as the literature used provided sufficient material.

5.5.3 Recommendations

In concluding this study, the following recommendations are made:

- The initiatives that Government has in place to help SMMEs among the relevant target audiences must be publicized. (see section 3.2.1)
- Regulatory obstacles to the informal sector as it acts as a barrier to development by keeping a large, energetic, and entrepreneurial group of black South Africans out of the formal economy need to be removed. (see section 4.6.6)
- SMMEs policy needs to be coordinated amongst Government departments in order to create a more co-ordinated approach to the development of SMME policy. (see section 4.6.4)

- The need for a generally supportive environment for SMMES through initiatives such as free training and mentorship and funding the payroll agents for small business. (see section 4.6.2)
- Review of the Tendering process- service providers need company registration and tax clearance to be eligible for tendering therefore people end up registering many companies and in the process are disqualified as SBCs.
- Expansion on the limitations placed on SBC eligibility to more than one business as long as the total revenue of the businesses is less than R14 million. (see section 3.4)
- Offer more assistance to start-up or expansion businesses beyond the initial stage to a point where the business is successfully set up and all operating procedures are in place (see section 2.5.3).

5.6 CONCLUSION

The potential value of the study lays in the fact that knowledge small business development, tax legislation and the environment in which business operates has been evaluated and certain shortcomings highlighted. The study is important because it gives further in-depth understanding of the environment in which small business operates and this can be used to plan future development initiatives that address problems encountered in the past and device better ways of creating an environment conducive for business to flourish.

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