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# THE REAL ECONOMY BULLETIN

TRENDS, DEVELOPMENTS AND DATA

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## SPECIAL EDITION: THE STATE OF SMALL BUSINESS IN SOUTH AFRICA

### SMALL BUSINESS AND INDUSTRIAL POLICY

Small business is often seen as a key potential driver of job creation, equality and innovation in South Africa. The National Development Plan argues that small business can open new opportunities to create jobs as well as be a route to economic empowerment. (NPC, 2011:123). In manufacturing, small business accounts for only a tenth of revenue, but a fifth of employment.

In the event, small business provides 55% of formal employment, compared to 40% from large companies (the other 5% of workers do not know the size of their employer). But the available evidence shows virtually no increase in the number of small businesses since 2008, and only relatively slow employment growth. South Africa continues to have low levels of small business compared to other middle-income economies.

This Special Edition of The Real Economy Bulletin first reviews the state of small business in South Africa and its evolution over the past decade. It then summarises the findings from two TIPS studies into policy related to small business: proposals around how it should be defined in legislation, which in turn affects who benefits from state support; and a review of regulatory obstacles and burdens that arise from national legislation.

### SMALL BUSINESS IN SOUTH AFRICA

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

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Over the past 10 years, however, the number of employers and self-employed people has barely budged, while the numbers they employ, their incomes and the structure of production have stagnated.

The limited scope of small business in South Africa resulted from draconian apartheid legislation, which shaped exclusionary systems across the economy. But those laws were ended more than two decades ago. A key question is why small business since then has grown so slowly, and remains far behind the level found in peer economies.

This review of the state of small business in South Africa analyses major indicators and trends among the self-employed and small-scale employers, focusing on their impact on employment, distribution by industry and region, earnings, education levels and race and gender. The findings suggest that:

- Formal small business is growing more slowly than large-scale companies, which contributes to slower job creation and likely limits diversification and innovation; and
- Informal business has grown more rapidly, but remains low-income, precarious and mainly survivalist.

The next section briefly reviews some methodological issues. It is followed by an assessment of job creation by small business, which is benchmarked with peer economies; the number of small businesses; formal and informal business; earnings; the distribution between industries and by region; demography and education.

#### **A statistical profile of small business from Statistics South Africa Labour Market Dynamics**

- ◆ **Formal small businesses in 2015: 670 000, down from 707 000 in 2008**
- ◆ **Informal small businesses: 1.5 million, virtually unchanged from 2008**
- ◆ **Total small businesses: 2.2 million**
- ◆ **Employment in small formal businesses in 2015: 5.8 million**
- ◆ **Employment in large businesses: 3.6 million**
- ◆ **Main sectors: Retail, construction and business services**
- ◆ **Main provinces: Gauteng, Western Cape and KZN (mostly in the metros)**
- ◆ **Income for formal employers and self-employed: R8000 – R12 000 a month**
- ◆ **Income for informal employers and self-employed: R2000 – R4000**
- ◆ **51% of formal small and microenterprises are white owned, down from 62% in 2002**
- ◆ **Women own 24% of formal and 40% of informal small business**

### **The analytical approach**

Analysis of small business should consider the significant differences between formal and informal enterprises. Compared to informal business, formal small and micro enterprises typically have more capital, relatively advanced technologies, more employees and higher incomes. Self-employed people in the formal sector are mostly professionals or artisans, with significant skills and above-average incomes. In contrast, most self-employed people in the informal sector live with precarious and low earnings, and high failure rates.

This assessment relies primarily on analysis of Statistics South Africa's Labour Markets Dynamics (LMD) database series, which runs from 2008 to 2015. The LMD permits analysis of small business because it distinguishes between wage workers, employers and the self-employed. The analysis separates the self-employed, employers with under 49 workers, and employers with 50 or more workers. From the standpoint of the National Small Business Act of 1996 (NBSA), that means that, for employment levels, the analysis covers micro and small employers, since medium employers have over 50 workers. The data do not provide figures on turnover, but by this measure self-employed people in the formal sector would often be classed as small rather than micro.

The LMD is an annual consolidation of Statistics South Africa's Quarterly Labour Force Survey (QLFS), a household survey with 60 000 respondents. In 2015, the LMD included 3 689 employers and 7 074 self-employed/own-account workers, excluding domestic workers. These are significant samples, but they become less reliable if divided on too many dimensions. That is a problem for enterprises with 20 or more workers, where the sample was only 344 respondents in 2015. Moreover, a change in weighting in 2015 saw a significant jump in overall employment and in the number of employers and self-employed people.

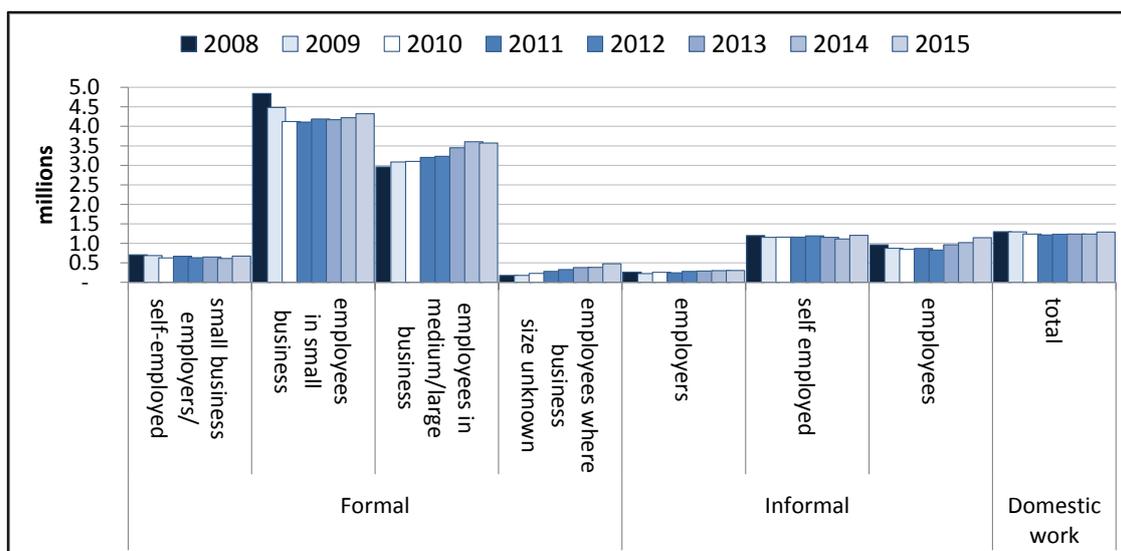
## Employment

As Graph 1 shows, from 2008 to 2015 small business was the largest source of employment in South Africa. In 2015, there were 710 000 small business owners who employed a total of 4,3 million people. In contrast, medium to large companies (with 50 or more employees each) employed 3,6 million people. In addition, over half a million formal workers said they did not know how many people were employed in their companies. A total of 1,5 million people worked in the informal sector, of whom 1,2 million were self-employed, 300 000 were employers, and 1,1 million were employees.

The number of jobs in small formal business climbed only slowly. It fell by 14% from 2008 to 2010, in the aftermath of the global financial crisis. Small business accounted for virtually all the positions lost by the private formal sector in this period. Then, from 2010 to 2015, employment by small formal businesses grew less rapidly than larger employers in every year except in 2015. The number of workers and employers who said they worked in small business increased by a total of 7% from 2010 to 2015, while those who said they worked in medium and large companies climbed by 15%. For comparison, the working-age population rose by 9% in this period.

This picture is not much affected by the rising share of workers who said they do not know the size of their company. Even if we arbitrarily assume all these workers were in small businesses, the number of employed people in formal small enterprise would still have increased by only 10% from 2010 to 2015. That is still a slower rate of expansion than for employment in larger companies.

**Graph 1. Private employment by sector and size of enterprise, 2008 to 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics electronic databases for relevant years. Series on main work, type of work, and number of employees. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za).

Informal employment climbed even more slowly than private formal employment from 2008 to 2015. Its 6% growth from 2010 to 2015 was only enough to overcome the decline in informal employment from 2008 to 2010.

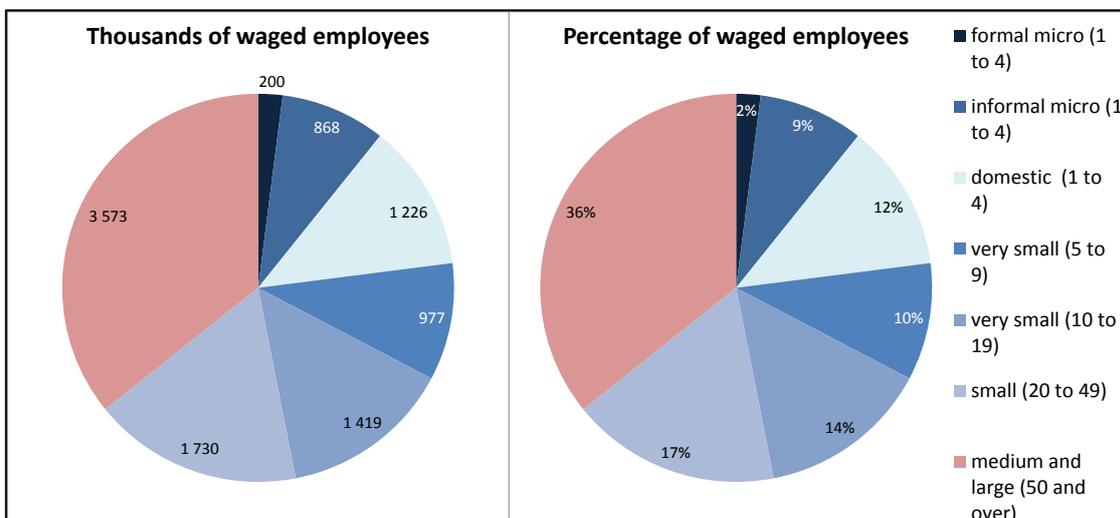
Slow job creation by formal small business meant that its share in private formal employment dropped from 64% in 2008 to 55% in 2015. Informal employment fell from 18% of total private employment (including domestic work) to 17% in the same period.

Formal small business generated the bulk of wage employment. As Graph 2 shows, in 2015 in the private sector, formal companies with 20 to 49 workers accounted for 17% of wage employment; very small formal businesses with five to 19 workers for 22%; and formal self-employment contributed 2%. Informal microenterprises contributed only 9% of total employment.

While small formal business in South Africa makes a significant contribution to employment, small business as a whole remains underdeveloped by international standards. In South Africa, less than 20% of all employed people are self-employed or employers. In contrast, the norm for upper middle-income economies, excluding China, is around 40%.

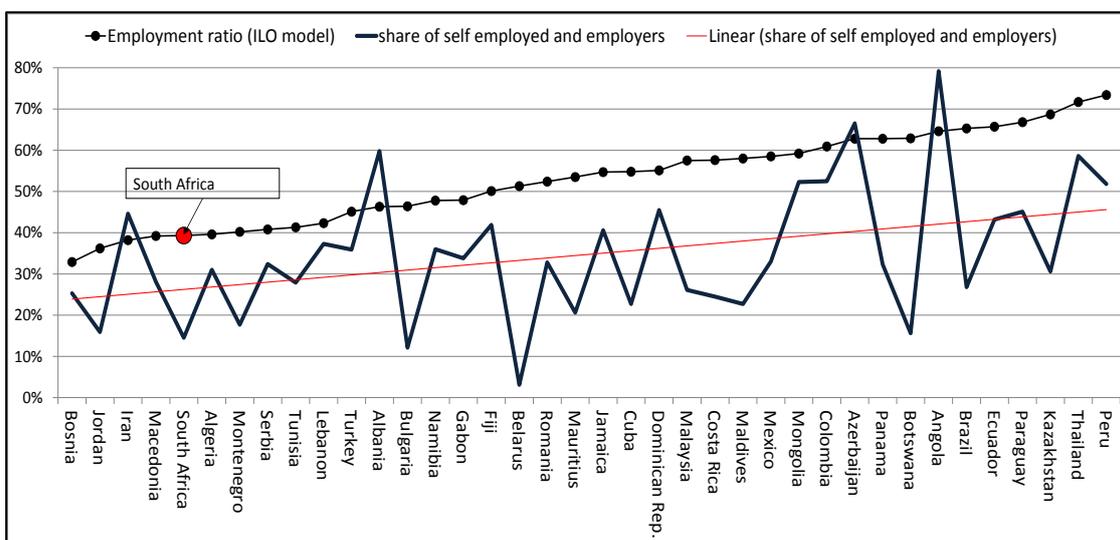
The evidence suggests that the lower the share of self-employment, the lower the level of employment overall, measured in the ratio of employment to working age population. Only 40% of South African adults have income-generating work, compared to almost 60% in other upper-middle-income economies excluding China (Graph 3).

**Graph 2. Waged employees in the private formal and informal sectors by size of enterprise (in terms of number of workers employed, in brackets), 2015 (a)**



Note: (a) Excludes workers who do not know the size of their firm. There were 595 000 such workers in the formal sector, and 314 000 in the informal sector. Source: Calculated from Statistics South Africa. Labour Market Dynamics Survey, 2015. Electronic database. Series on sector, type of employment, main work and number of workers. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

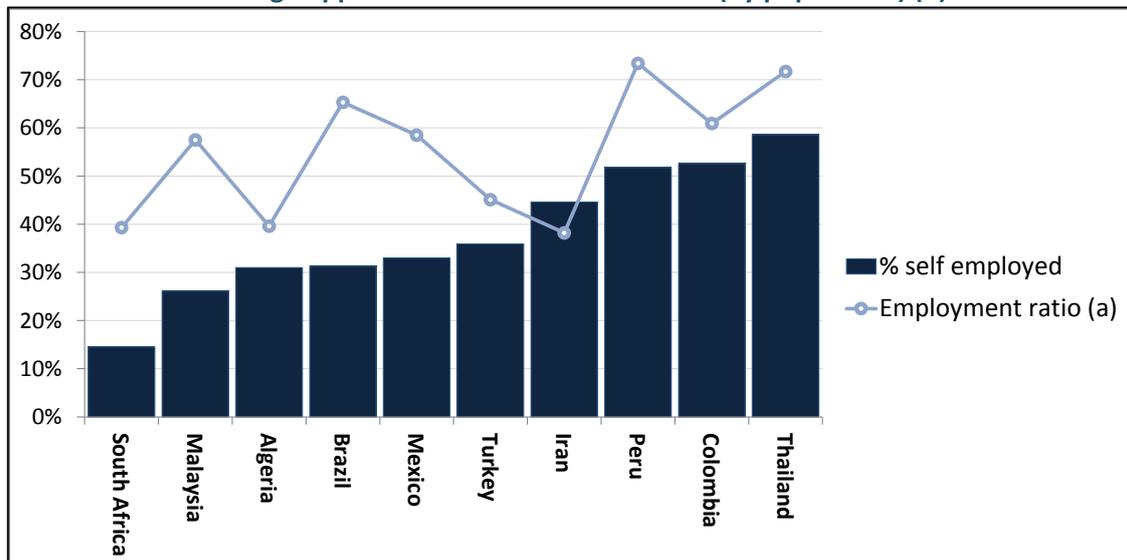
**Graph 3. Share of employees in employment, employment ratio (a) and linear trend for share of employees in employment (b)**



Notes: (a) Share of employed in all working age adults. (b) Latest year from 2007 to 2013; most in 2010 to 2013. Source: Calculated from World Bank. World Development Indicators. Electronic database. Series on Wage and salaried workers, total (% of total employed) and Employment to population ratio 15+, modelled ILO estimate. Downloaded from [www.worldbank.org](http://www.worldbank.org) in June 2016.

A similar picture emerges if we compare South Africa with the 10 countries that account for 80% of the population of the upper-middle-income economies (Graph 4).

**Graph 4. The employment ratio (a) compared to the share of self-employed in employment for large upper-middle-income economies (by population) (b)**



Notes: (a) Share of employed in all working age adults (b) Latest year from 2007 to 2013; most in 2010 to 2013. Source: World Bank. World Development Indicators. Electronic database. Series on Wage and salaried workers, total (% of total employed) and Employment to population ratio 15+, modelled ILO estimate. Downloaded from [www.worldbank.org](http://www.worldbank.org) in June 2016.

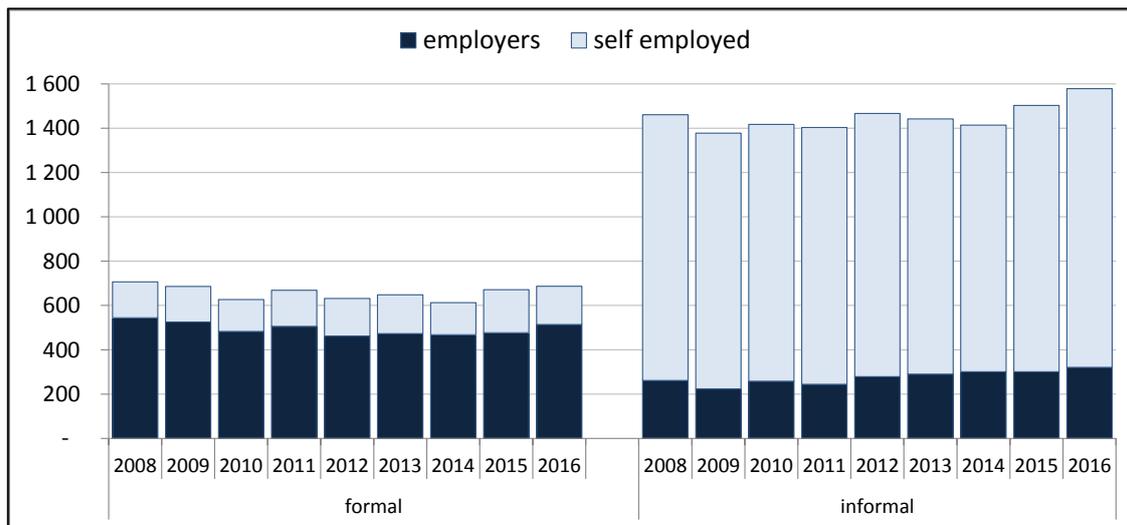
In short, the low share of self-employment in South Africa appears to be a significant factor behind persistently low levels of employment overall. In other developing economies, a substantial share of the population earns a livelihood from family businesses in agriculture and retail. Those systems of production and the associated market institutions were systemically suppressed under apartheid. Measures to achieve that end included blocking black people in general, and Africans in particular, from conducting small-scale production and trade, including through restrictions on land ownership and on access to credit, formal education and training, and infrastructure. As a result, democratic South Africa started out with a smaller class of established small business than its peers.

In other countries, small-scale entrepreneurs could build on long-standing family assets, market connections and customers; in South Africa, they often started without these advantages. Moreover, large companies and government agencies often have procurement systems designed to acquire goods on a scale beyond the scope of small businesses, while major providers of business services and credit focus on established clients. In response to these challenges, the state established a range of institutions to support small businesses, but – as the sections above show – growth in small business has nonetheless been limited over the past 20 years.

## How many small businesses are there?

In 2016, the Quarterly Labour Force Surveys found 690 000 formal small businesses and 1,6 million informal ones.<sup>1</sup> The LMD data suggest that formal small business had not fully recovered from the slew of closures following the 2008/9 global financial crisis. From 2008 to 2010, the number of formal small businesses dropped by 11%, or 80 000 enterprises; from 2010 to 2016, around 60 000 new firms emerged. For the informal sector, the picture is less dire, with 3% losses from 2008 to 2010 and 11% growth since then (Graph 5). As noted, however, in contrast to formal small businesses, most informal enterprise is essentially survivalist, generating low incomes and only limited employment.

**Graph 5. The number of formal and other small and micro businesses, 2008 to 2016 (a)**



*Note: (a) Self-employed here means small businesses with no waged employees. Figures for 2016 are average for the four quarters, since the 2016 LMD has not yet been published. Source: For 2008 to 2015, calculated from Statistics South Africa. Labour Market Dynamics databases for relevant years. Series on number of employees, main work, type of work and sector. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in relevant years. For 2016, calculated from Statistics South Africa. Quarterly Labour Force Survey. Electronic databases for Quarters 1 to 4 for 2016. Series on main work, type of work, number of employees and sector.*

The LMD figures for small business numbers align reasonably well with most other studies, with the exception of FinScope and Quantec (See Table 1).

Definitions of small business and methodologies differ somewhat across these analyses, although several rely on the labour force surveys that underlie the LMD.

<sup>1</sup> Figures are average of the quarterly reports for the year, which is the method utilised for the LMD. The LMD 2016 has not yet been published. See Statistics South Africa. Quarterly Labour Force Survey. Electronic databases for Quarters 1 to 4 for 2016. Series on main work, type of work, number of employees and sectors, including agriculture in formal and informal sectors.

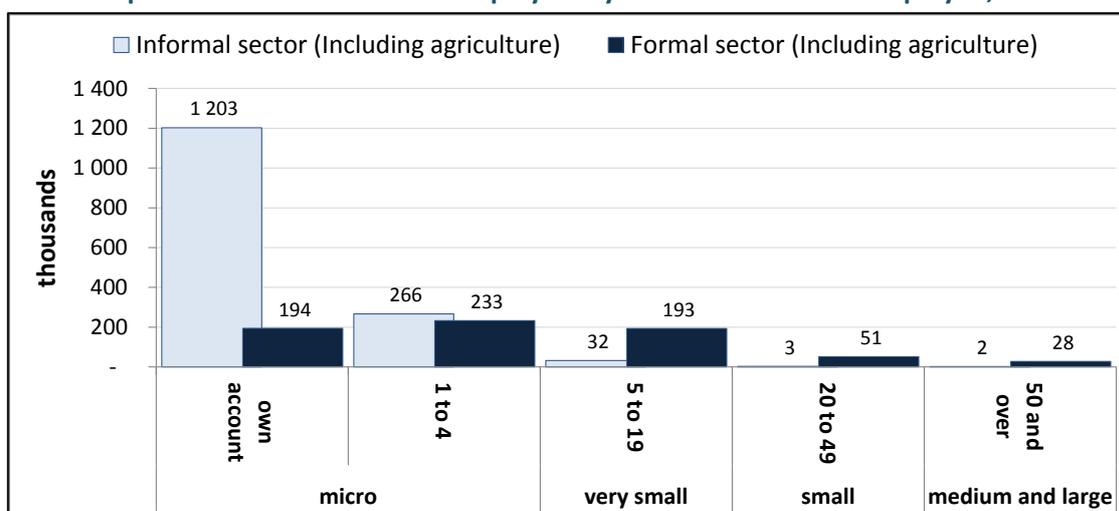
**Table 1. Findings on the number of small businesses in South Africa**

Study	Findings
LMD (2015)	2,2 million total, of which 663 000 were formal and 1,5 million informal.
SARS (2015)	650 000 companies registered for tax with taxable income between R250 000 and R20 million.
Bureau for Economic Research (2016)	2,25 million based on the Quarterly Labour Force Survey for the second quarter of 2015.
The Department of Trade and Industry (the dti) (2008)	2,26 million SMMEs in South Africa in 2007, of which more than 75% operated in the informal sector.
Finmark Trust (2010) FinScope Small Business Survey	5,58 million small business owners in South Africa owning 5,98 million small businesses.
Quantec (downloaded in 2017)	4 million informal employers and employees, up from 3 million in 2008.

### Formal and informal

Well over half of employers were in the formal sector, while most informal producers were self-employed. In 2015, the formal sector had 477 000 employers and 194 000 own-account workers. In contrast, the informal sector had 1,2 million self-employed workers but only 300 000 employers (Graph 6).

**Graph 6. Formal and informal employers by number of workers employed, 2015**



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

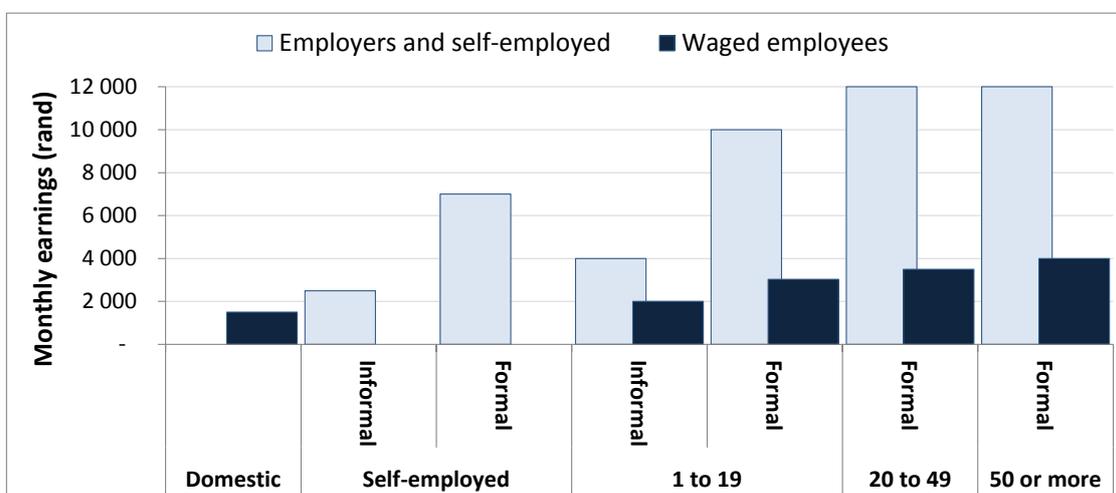
The LMD asks a number of questions around taxes, levies and registration to distinguish between formal and informal enterprises, but the main criterion is whether enterprises are registered for VAT. In 2014, VAT registration was legally required for enterprises with at least R1 million in turnover. Almost 680 000 were registered in 2014/5, but only 420 000 actually paid VAT. Statistics South Africa includes the minibus taxi industry in the informal sector.

## Earnings

Both employers and employees in the formal sector typically earned more than those in the informal sector. Self-employed people in the informal sector generally earned less than waged employees in formal jobs. Median earnings for formal employers were more than twice as high as for wage workers, but in the informal sector there was much less difference between employers and employees. On the whole, earnings for employers and the self-employed declined with the size of enterprise.

Graph 7 shows that in 2015 formal-sector earnings for employers and the self-employed ranged between R8 000 and R12 000 a month for micro and small enterprise. Informal employers had a median income of R4 000 a month, while the informal self-employed earned just over half as much.

**Graph 7. Median monthly earnings for the self-employed, employers and employees by sector and size, 2015**



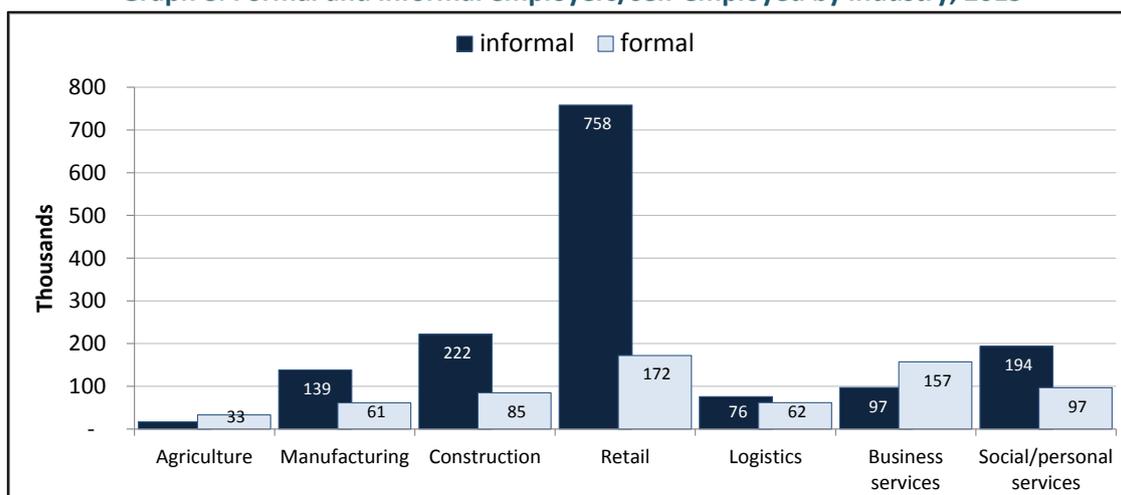
Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees, main work, sector and employer and employee monthly earnings. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

## Industries

Most small enterprises are found in trade, construction and business services. Around half of formal micro and small entrepreneurs are in business services and retail. Small formal enterprises have a significant presence in construction. In contrast, in the informal sector the self-employed are overwhelmingly in retail, while employers are principally in retail and construction. In both the formal and informal sector, just under 10% of small businesses are in manufacturing (Graph 8).

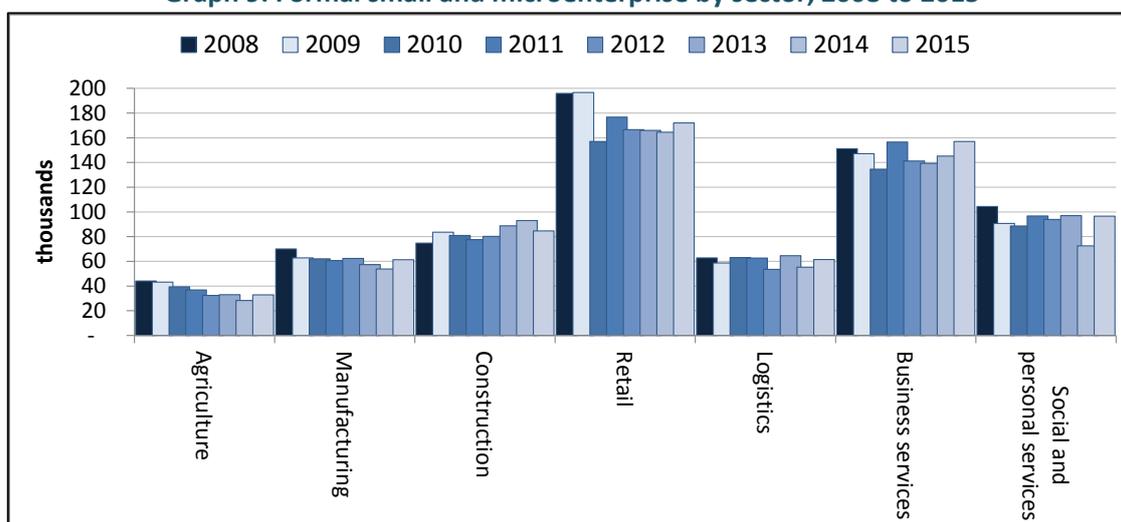
In terms of small formal enterprises, the number in agriculture and manufacturing has tended to decline, while construction and business services saw some growth. Other sectors reportedly saw fluctuating numbers without a clear trend from 2010. Retail accounted for most of the sharp decline in numbers from 2008 to 2010, but then stabilised (Graph 9).

**Graph 8. Formal and informal employers/self-employed by industry, 2015**



Notes: (a) Statistics South Africa categorises minibus taxis as informal. Source: Calculated from Statistics South Africa. Labour Market Dynamics database for 2015. Series on number of employees, main work, sector and industry. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

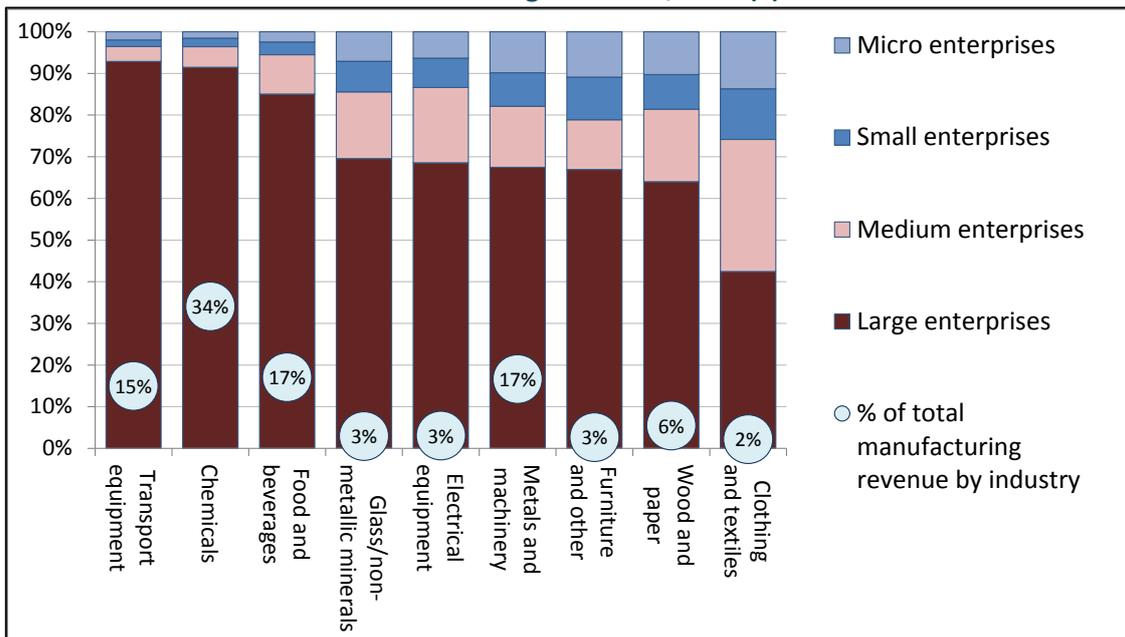
**Graph 9. Formal small and microenterprise by sector, 2008 to 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database for relevant years. Series on number of employees, sector (including agriculture in formal and informal sectors), main work and industry. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

The sample in manufacturing is too small to permit an analysis of the number of small businesses by industry. Some information is, however, available from Statistics South Africa's 2014 financial survey of manufacturing companies, which draws on a sample of 15 500 enterprises. It found that, in manufacturing, small and micro businesses provided a third of employment but had less than 10% of revenue. (StatsSA 2016:32) By industry, the share of small businesses in manufacturing revenue ranged from 4% in the dominant chemicals and auto industries to 19% in the much smaller industries of wood and paper and 26% in clothing (Graph 10).

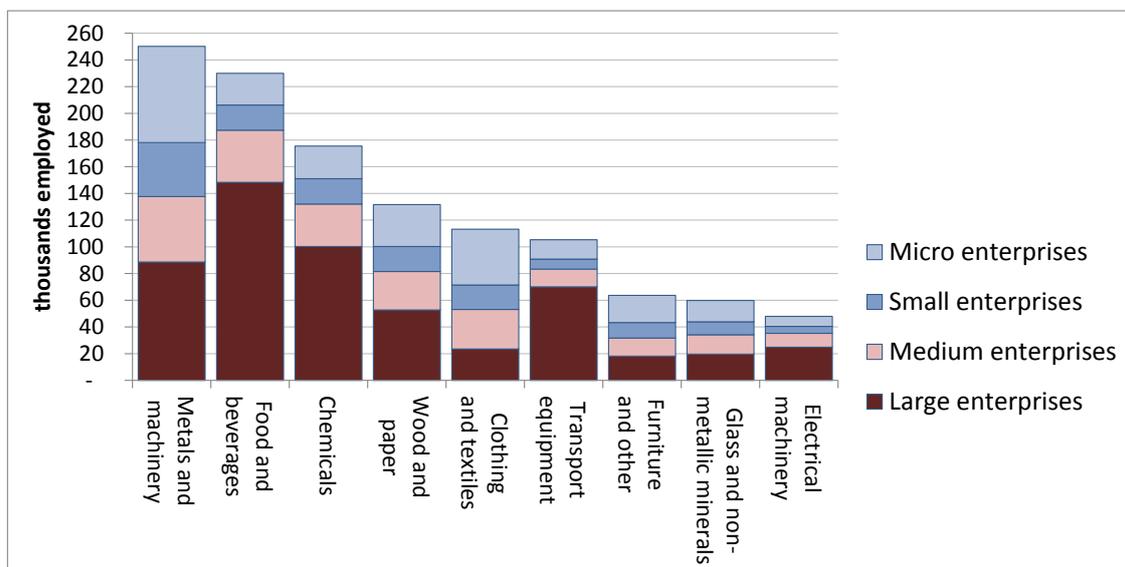
**Graph 10. Share of revenues by size of enterprise in formal manufacturing industries, 2014 (a)**



Notes: (a) Microenterprises defined as having a turnover of under R22,5 million; small as R22,5 million to R58,5 million; medium as R58,5 million to R229,5 million. Source: Calculated from Statistics South Africa. 2016. Manufacturing Industry: Financial, 2014. Pretoria. Page 32. Table 8.

While small businesses generated only a small share of manufacturing revenue outside of clothing, they were more important for employment. The share of jobs in small business ranged from around half in clothing, metals and machinery, and furniture, to a fifth in food and auto (Graph 11).

**Graph 11. Employment by size of company in manufacturing industries, 2014 (a)**



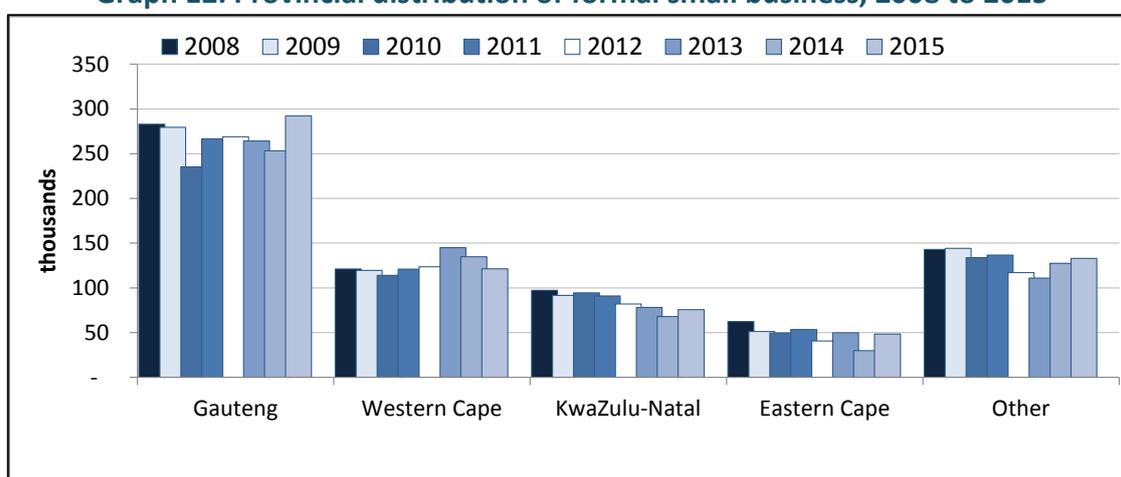
Notes: (a) Micro enterprises defined as having a turnover of under R22,5 million; small as R22,5 million to R58,5 million; medium as R58,5 million to R229,5 million. Source: Calculated from Statistics South Africa. 2016. Manufacturing Industry: Financial, 2014. Pretoria. Page 58. Table 18.

## Geographic distribution

The spatial distribution of small business has continued to mirror patterns set up under apartheid, with most clustered around economic centres. In 2015, micro and small formal enterprises were found disproportionately in Gauteng, the Western Cape and KwaZulu-Natal. In contrast, Limpopo and Mpumalanga had a relatively high proportion of informal employers. This mainly reflected the limited number of formal small businesses found in the impoverished former so-called “homeland” regions.

Since 2008, Gauteng has accounted for around 40% of formal small enterprise, although only about 25% of the working-age population. The Western Cape held a fifth of small business and a ninth of the population. These proportions were reversed in the rest of the country. KwaZulu-Natal had just over a tenth of small business and a fifth of the population. The other provinces taken together held a fifth of all small business and two fifths of the working age population. The shares of KwaZulu-Natal and the Eastern Cape have tended to decline over the past eight years (Graph 12).

**Graph 12. Provincial distribution of formal small business, 2008 to 2015**

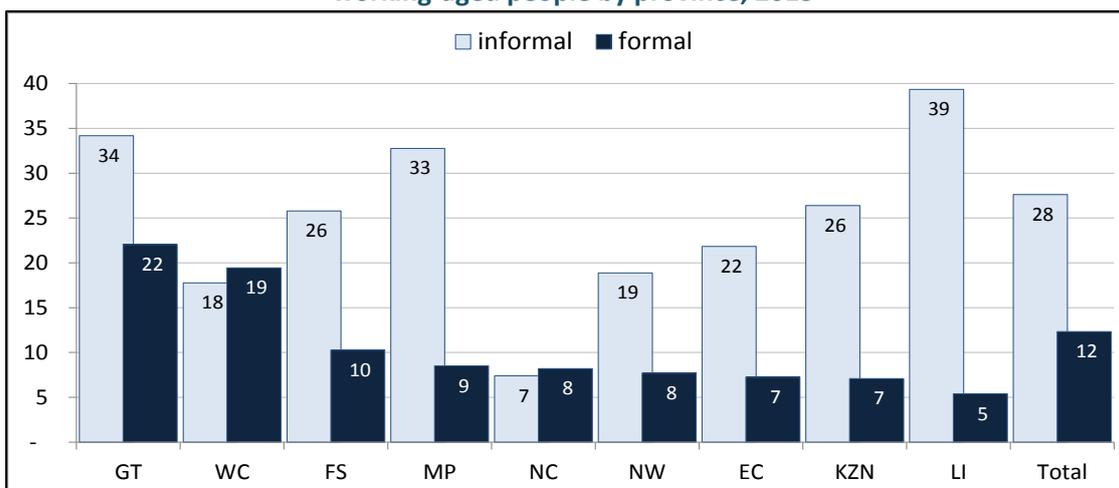


Source: Calculated from Statistics South Africa. Labour Market Dynamics databases for relevant years. Series on number of employees, main work and province. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in relevant years.

The number of formal and informal businesses per thousand working-aged people in each province underscores the regional discrepancies. In Gauteng and the Western Cape, there were around 20 formal businesses for each thousand working-aged people. In the rest of the country, the figure ranged between five and 10. In contrast, the number of informal businesses per thousand working-aged was highest in Limpopo, at 39, followed by Gauteng at 34 and Mpumalanga at 33 (Graph 13).

As discussed in the subsection Formal and Informal (page 8), most informal businesses were microenterprises with no employees and low incomes.

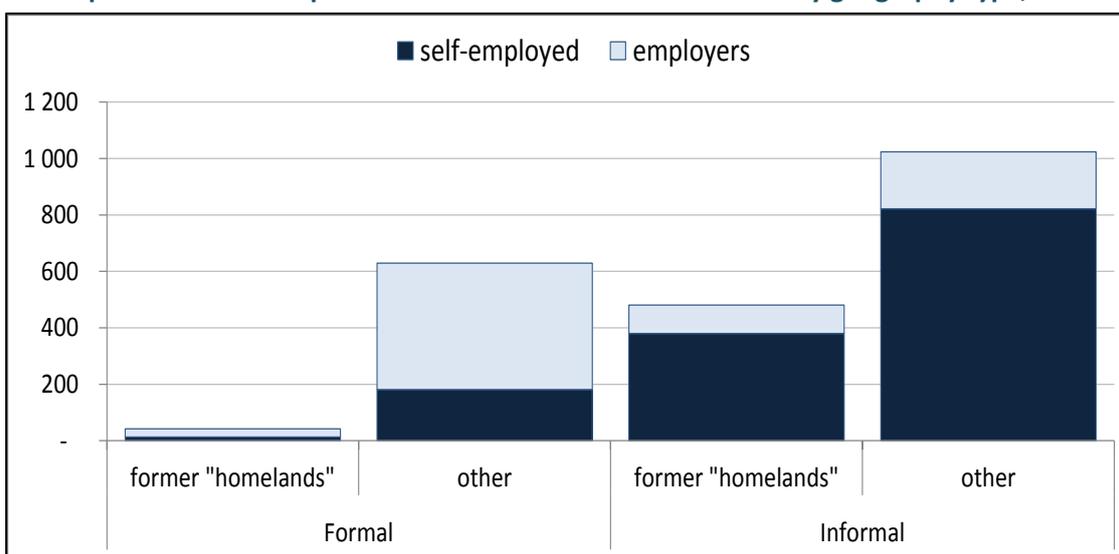
**Graph 13. Number of private formal and informal businesses per thousand working-aged people by province, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database 2015. Series on number of employees, main work, sector and province. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

The provincial distribution of formal and informal enterprise mainly reflected the legacies of apartheid. Formal private enterprise was under-represented in the former “homeland” regions, with more than 25% of the population but just over 15% of total employment. These areas housed around 6% of formal small enterprise, but over a quarter of informal businesses. For every thousand working-aged people in the former “homeland” areas, there were 43 informal businesses and only four formal ones. In contrast, in the rest of the country, for every thousand inhabitants there were 26 formal and 40 informal businesses (Graph 14).

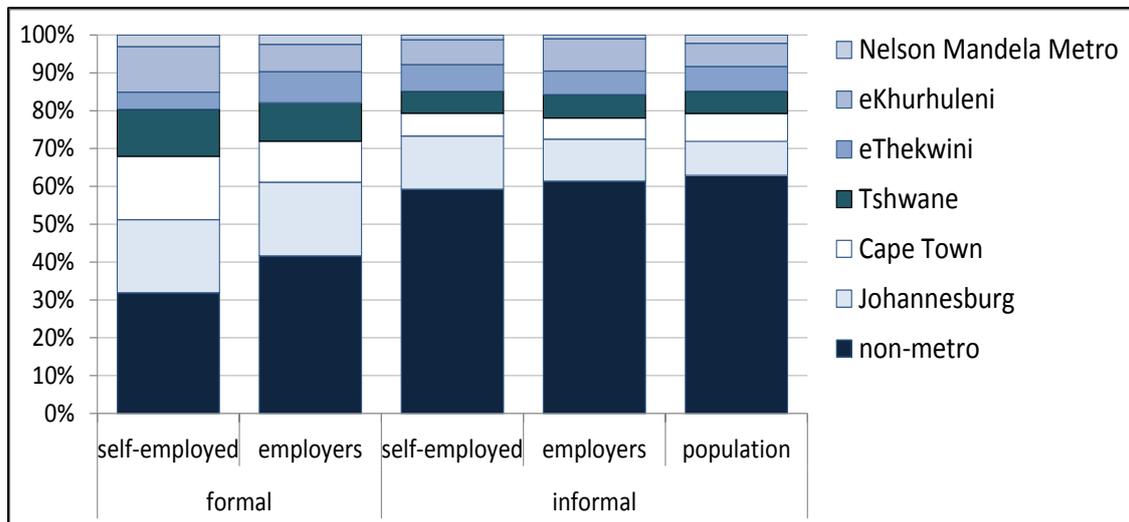
**Graph 14. Number of private informal and formal businesses by geography type, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database 2015. Series on number of employees, main work, sector and geography. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

As Graph 15 shows private formal employers and self-employed people were disproportionately located in the metro areas, particularly Johannesburg and Cape Town. As a group, the metros accounted for over two thirds of formal employers and the self-employed. In contrast, informal employment and self-employment was more proportional to the population.

**Graph 15. Distribution of private formal and informal small business by metro and non-metro areas, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database 2015. Series on number of employees, main work, sector and metros. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

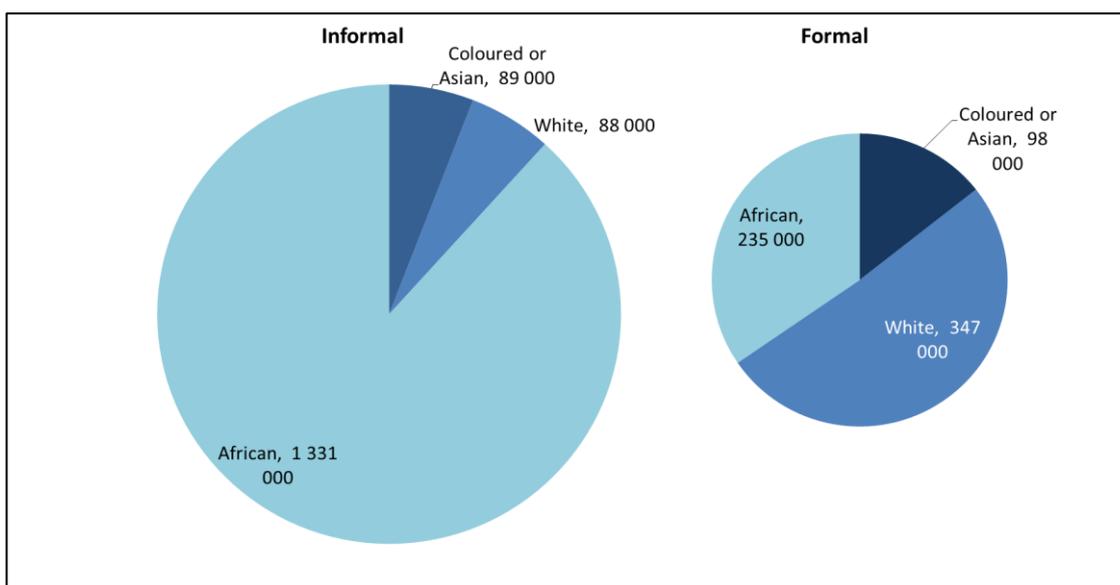
## Demography

In 2015, half of the owners of small formal business were white, although most informal entrepreneurs were black. Given South Africa's history of exclusion based on race and gender, the unrepresentative nature of ownership has important implications for the regulation of small business. On the one hand, it means that most formal enterprise do not benefit from state efforts to reduce barriers to black entrepreneurs, and may even bear a cost from them. On the other hand, mobilising government support proves more difficult when most of the direct beneficiaries belong to an historically privileged group.

Black people owned 49% of small formal businesses in 2015, but 94% of informal enterprise. The share of white-owned firms in small formal business dropped from 62% in 2002<sup>2</sup> to 57% in 2008 and 51% in 2015. The number of white-owned firms fell from 420 000 in 2008 to 360 000 in 2015 (Graph 16).

<sup>2</sup> Calculated from Statistics South Africa. Labour Force Survey. September 2002. Electronic database. Series on sector, type of employment, number of workers and population group. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in March 2015.

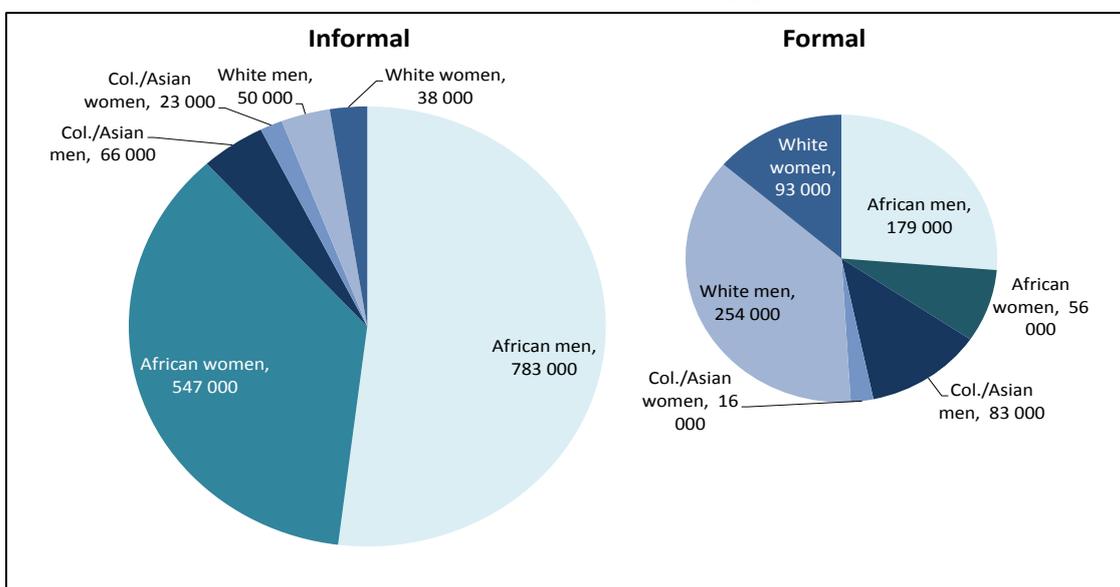
**Graph 16. Ownership of small business by race, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database 2015. Series on number of employees, main work, sector and population group. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

Women made up 40% of informal-sector entrepreneurs but only 26% in the formal sector in 2015. Among women, racial differences were pronounced. There were 10 times as many African women business owners in the informal sector – over half a million – than in the formal sector. In contrast, there were close to 100 000 white women formal entrepreneurs, compared to just under 40 000 informal ones (Graph 17).

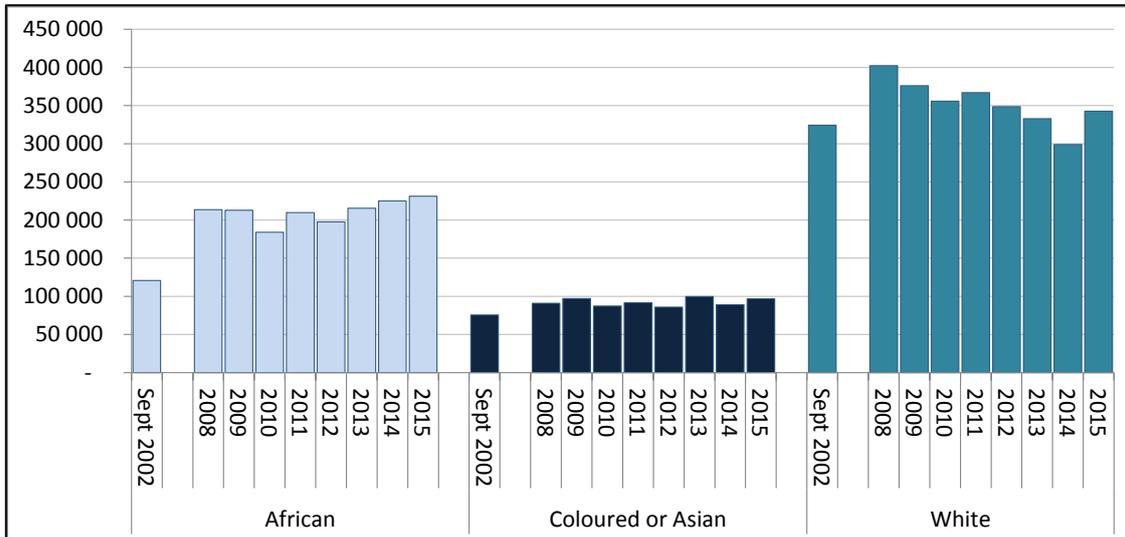
**Graph 17. Formal and informal small business by gender and race, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics database 2015. Series on number of employees, main work, sector, population group and gender. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

Since 2008, there has been a sharp decline in the number of white men with small formal businesses, and a gradual increase in the share of black women and men (Graph 18).

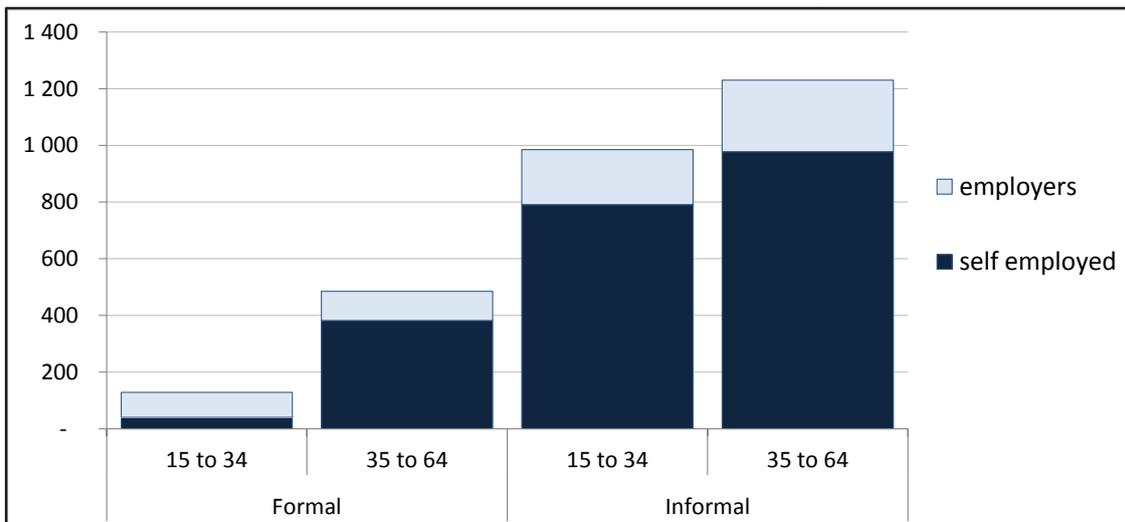
**Graph 18. Number of employers and self-employed in the formal sector by race and gender, 2008 to 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics databases for relevant years. Series on number of employees, sector, main work, gender and population group. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in relevant years.

Young people are less likely to become entrepreneurs, mostly because they lack the assets, experience and networks required for success. As a percentage of all employed people, young people under 35 accounted for around 40% of waged employment outside of domestic work, compared to between 15% and 20% of formal business owners and a third of informal business owners. Young employers and self-employed people were more commonly found in the informal sector and micro enterprise. If they were business owners, they were most likely to have an informal microenterprise with no employees (Graph 19).

**Graph 19. Employers and the self-employed by age, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics Survey, 2015. Electronic database. Series on sector, type of employment, number of workers and age. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

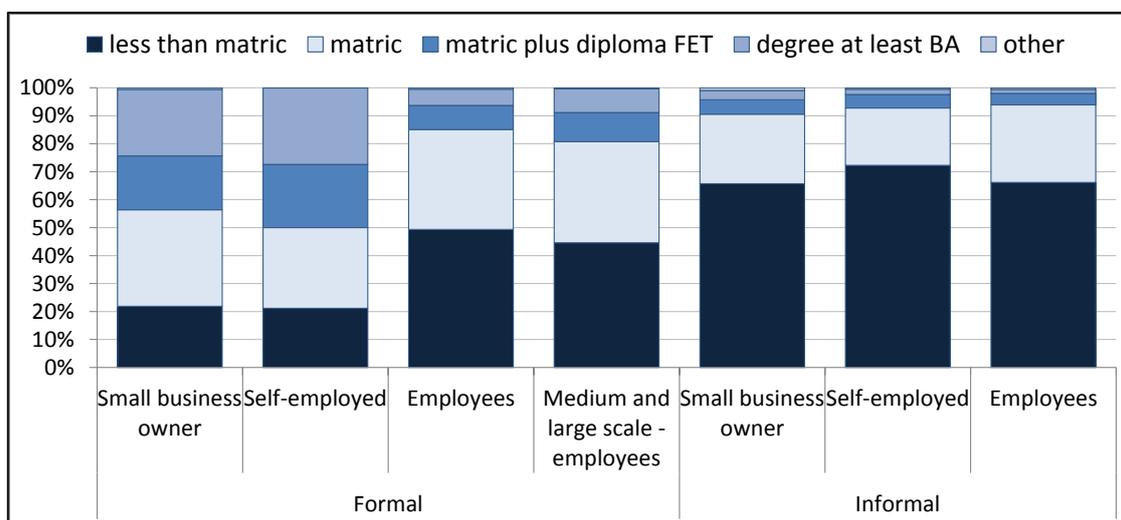
## Education of small business employers and employees

As Graph 20 shows, formal employers and self-employed people often had high levels of formal education. In contrast, informal employers and self-employed people had less certified education than formal employees, and almost the same education as informal wage workers.

Around half of formal businesspeople had some post-secondary education, and a third had matric in 2015. Self-employed people in the formal sector were slightly more likely than employers to have a degree, reflecting the fact that they were often professionals.

For both self-employed people and wage workers in the informal sector, around 70% did not have matric. Among private formal employees, just over 15% had post-secondary qualifications, 36% had matric, and 47% had not completed secondary school. In contrast, amongst informal employers, around 5% had a degree or a diploma, and around 25% had matric.

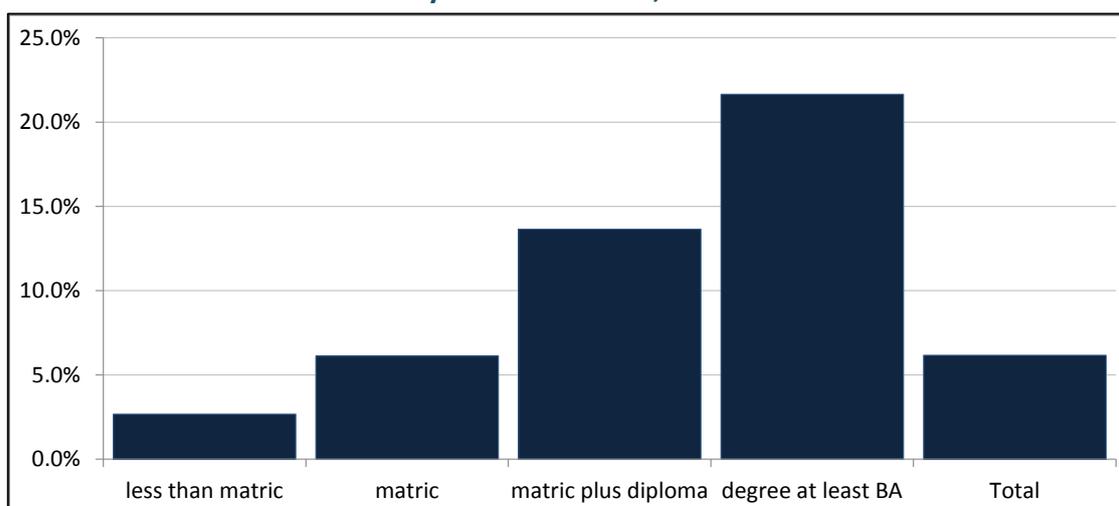
**Graph 20. Education status of employers, self-employed people and private-sector employees in formal and informal enterprise, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics Survey, 2015. Electronic database. Series on sector, type of employment, number of workers and education. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

The likelihood of owning a small formal business increased with education level. Over one in five people with a degree owned a small business, compared to more than one in 10 with a post-secondary diploma, but fewer than one in 20 for individuals who had matric or less.

**Graph 21. Employers and self-employed as percentage of total by education level, 2015**



Source: Calculated from Statistics South Africa. Labour Market Dynamics Survey, 2015. Electronic database. Series on sector, type of employment, number of workers and education. Downloaded from Nesstar facility at [www.statssa.gov.za](http://www.statssa.gov.za) in February 2017.

## Conclusions

The data suggest that, contrary to national policy aims, small formal business in South Africa has seen a modest decline in numbers since 2008, while informal employment has remained essentially unchanged. Furthermore, small business remains concentrated in retail and to a lesser extent construction and business services, with only limited diversification into manufacturing, with formal firms mostly found in the main economic centres. Looking at race and gender, the ownership of small formal business has become more representative but still lags far behind the national population. That in itself makes it more difficult to develop and implement strong policies to support small business.

## THE DEFINITION OF SMALL BUSINESS

Because government policy is to support small business, it is important to define what that means. The definition should enable identification of beneficiaries for state support, for instance through funding, tax concessions and procurement. At the same time, it should be easy to administer for both the businesses themselves and for government officials.

Development of an official definition for small business began in 1995 in the *White Paper on National Strategy for the Development and Promotion of Small Business in South Africa*. The small business sector was understood as being highly diverse with issues and growth prospects varying widely across its different segments. Given the financial and organisational constraints faced by government, the White Paper conceptualised that a definition and classification of different types of small enterprises would be needed to inform the disbursement of government support.

The White Paper provided an initial broad classification of small businesses across four categories: survivalist activities, microenterprises, small enterprises and medium-sized enterprises. It used the general term “small business” and the abbreviation “SMMEs” to

define the diversity of small business. Each category adopted by the White Paper was defined by the features detailed in Table 2.

**Table 2. Types of small businesses**

Type	Broad description
<b>Survivalist enterprises</b>	<b>Survivalist enterprises</b> are business activities by individuals who are unable to secure a paid job or enter into the economic sector of their choice. No capital is invested, little to no skills training is required and these enterprises have very limited opportunities for growth into a viable, registered business. Poverty and the need to provide basic sustenance are the main drivers for establishing this category of enterprises. It was suggested that survivalist enterprises cannot be viewed as sustainable microenterprises, even though some may eventually achieve such a position.
<b>Microenterprises</b>	<b>Microenterprises</b> are very small businesses that often have only one owner, some family member involvement and a maximum of two paid employees. They usually lack in formality in terms of business licences, value-added tax (VAT) registration, business premises, operating permits and accounting systems. Most of them have a limited capital base and basic technical and business skills among those that operate the business. Nevertheless, a significant number of micro businesses are presumed viable enough to advance into small businesses. Due to the similarities in some of the business obstacles faced by survivalist and microenterprises, they are often combined by government support agencies.
<b>Small enterprises</b>	<b>Small enterprises</b> constitute the majority of established business, with employment levels ranging between five and 50 individuals. These businesses would usually be owner-managed or directly controlled by an owner-community (i.e. a cooperative). They are likely to conduct operations from a business or industrial premise, be tax registered, and fulfil other formal registration requirements. Classification of assets and liabilities varies, given the broad differences across business sectors such as construction, manufacturing, retailing and professional services.
<b>Medium enterprises</b>	<b>Medium enterprises</b> constitute a category of businesses between small and big business. They are significant enterprises with strong capabilities; they are viewed as owner/manager controlled, although there may be more complexity to the shareholding. Employment of 200 people and capital assets (excluding property) of about R5 million are perceived as the maximum thresholds.

The White Paper recognised that further stratification of small businesses would be required from the broad categories in Table 2 to guide government support. It indicated that the stratification of enterprises by race, gender and disability of the owner might also be needed to reverse imbalances created by apartheid. The White Paper called for “the dti [Department of Trade and Industry] to create a mechanism to identify different types of enterprises based on sectoral, size and developmental criteria,” to extend this broad categorisation.

The distinctions between SMMEs provided by the White Paper formed the basis of the official definition in the NBSA. The Act’s definition specified that small businesses are:

“...a separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one owner or more, including its branches or subsidiaries, if any, and is predominantly carried on in any sector or sub-sector of the economy”.

The NSBA further differentiated SMMEs by Standard Industrial Classification (SIC) sector or sub-sector and by classifying SMMEs according to key indicators, including the total full-time equivalent of paid employees, the total turnover, and the total gross asset value (excluding fixed property). All the figures were provided in 1996 rand, which were revised in 2003 to take inflation into account. The full schedule is shown in Table 3.

**Table 3. Schedule of the small business definition in the National Small Business Act as updated in 2003**

SIC classification	Size or class of enterprise	Total full-time equivalent of paid employees	Total annual turnover	Total gross asset value (excluding fixed property)
<b>Agriculture</b>	Medium	100	R 5 m	R 5 m
	Small	50	R 3 m	R 3 m
	Very Small	10	R 0.5 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Mining and Quarrying</b>	Medium	200	R39 m	R23 m
	Small	50	R 10 m	R 6 m
	Very Small	20	R 4 m	R 2 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Manufacturing</b>	Medium	200	R51 m	R19 m
	Small	50	R13 m	R 5 m
	Very Small	20	R 5 m	R 2 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Electricity, Gas and Water</b>	Medium	200	R51 m	R19 m
	Small	50	R13 m	R 5 m
	Very Small	20	R 5.1 m	R 1.9 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Construction</b>	Medium	200	R26 m	R 5 m
	Small	50	R 6 m	R 1 m
	Very Small	20	R 3 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Retail and Motor Trade and Repair Services</b>	Medium	200	R39 m	R 6 m
	Small	50	R19 m	R 3 m
	Very Small	20	R 4 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Wholesale trade, Commercial Agents and Allied Services</b>	Medium	200	R64 m	R 10 m
	Small	50	R32 m	R 5 m
	Very Small	20	R 6 m	R 0.6 m
	Micro	5	R 2m	R 0.1 m
<b>Catering, Accommodation and other Trade</b>	Medium	200	R13 m	R 3 m
	Small	50	R 6 m	R 1 m
	Very Small	20	R 5.1 m	R 1.9 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Transport, Storage and Communications</b>	Medium	200	R26 m	R 6 m
	Small	50	R13 m	R 3 m
	Very Small	20	R 3 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m
<b>Finance and Business Services</b>	Medium	200	R26 m	R 5 m
	Small	50	R13 m	R 3 m
	Very Small	20	R 3 m	R 0.5 m
	Micro	5	R 0.2 m	R 0.1 m

SIC classification	Size or class of enterprise	Total full-time equivalent of paid employees	Total annual turnover	Total gross asset value (excluding fixed property)
<b>Community, Social and Personal Services</b>	Medium	200	R13 m	R 6 m
	Small	50	R 6 m	R 3 m
	Very Small	20	R 1 m	R 0.6 m
	Micro	5	R 0.2 m	R 0.1 m

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

TIPS conducted a review of the official definition of small business. It concluded that the definition required amendment for the following reasons:

- The definition was not consistent with international practice, which favours a simpler formula.
- The definition had not been adopted by other government departments or by SMMEs themselves.
- The definition sector thresholds had not been systematically updated for inflation and therefore did not reflect the current realities of SMMEs. From 2003 to 2016, consumer prices more than doubled and the GDP climbed by a total of 43%.

To understand international practice, TIPS conducted a study of definitions of small business by multilateral institutions, such as the World Bank and OECD; regions such as the European Union; and individual countries. This benchmarking exercise determined that there was no broadly accepted international best-practice definition of small business. It also found, however, that the most common practice is to use employment levels to define small business. Although there is significant variation between international references, most prefer a simple cross-cutting figure for employees (e.g. less than 250 employees) to a more complex sectoral definition.

TIPS also reviewed the policies and legislation adopted by government agencies in order to assess the extent to which the Act's definition had been adopted within the state. The Act's definition is used by the Department of Small Business Development (DSBD) and its agencies as well as the Small Enterprise Development Agency (SEDA) and Small Enterprise Funding Agency (SEFA) to target financial and non-financial support measures to small business. However, there has been only limited adoption of the definition by other departments.

A summary of the definitions of small business across different legal statutes is provided in Table 4.

**Table 4. Summary of the legal statutes and definition of small business**

Type of Legislation	Threshold/ exemption	Basis for defining SMMEs		
		Employees	Turn-over	NSBA Definition *
<b>Companies Act No. 71 of 2008</b>		-	-	-
<b>Cooperatives Act No. 14 of 2005</b>	Minimum 5 people to register a co-operative	-	-	-
<b>Basic Conditions of Employment Act 75 of 1997</b>	Applicable if more than 10 employees	Yes	-	-
<b>Labour Relations Act 66 Of 1995</b>	-	-	-	-
<b>Employment Equity Act 55 of 1998</b>	Applicable if more than 50 employees	Yes	-	-
<b>Skills Development Act 97 of 1998</b>	R500 000 salary bill	-	Yes	-
<b>Broad-Based Economic Empowerment Act 53 of 2003</b>	Exempted Micro-Enterprise if less than R10 million turnover Qualifying Small Enterprise if R10 million but less than R50 million	-	Yes	-
<b>Sector Charters (B-BBEE)</b>		-	Yes	-
<b>Income Tax Act 58 of 1962</b>	R1 million turnover per annum for Turnover Tax R20 million turnover for a Small Business Corporation (SBC)	-	Yes	-
<b>Value-Added Tax Act 89 of 1991</b>	R1 million turnover threshold	-	Yes	-
<b>National Credit Act 34 of 2005</b>	NSBA definition	-	-	Yes
<b>Preferential Procurement Policy Framework Act 5 of 2000</b>	NSBA definition	-	-	Yes

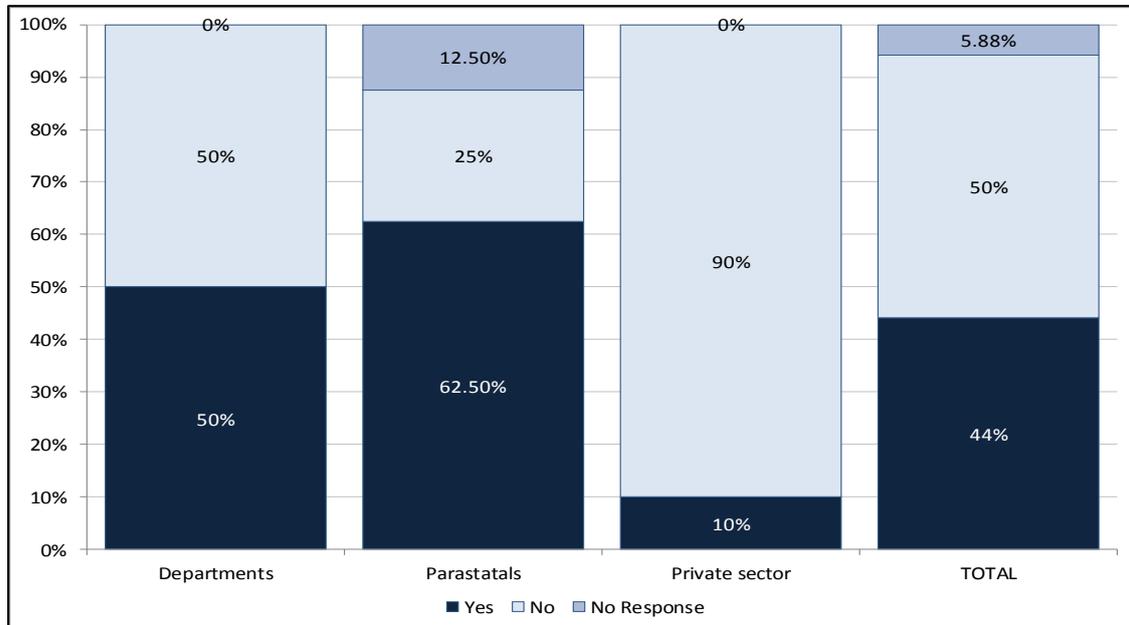
\* This would include the combination of Employees, Turnover and Gross Asset Value (by sector)

Table 4 shows that while some laws use the Act's definition, alternatives are introduced in labour legislation, tax legislation and some Broad-Based Black Economic Empowerment (B-BBEE) Charters. The use of different indicators may be justified by context, such as labour legislation using employment while the transformation and tax legislation use turnover.

All three categories of legislation use thresholds to prescribe exemptions from compliance of certain aspects of the legislation. This reality suggests that the misalignment of thresholds between small business definitions imposes an administrative burden on small businesses because they need to prove separately to each regulatory agency that they qualify for an exemption. For instance, it is not clear why an information technology company with two to three permanent staff and R5 million turnover is exempt from B-BBEE and Basic Conditions of Employment obligations but may be required to pay the skills development levy (assuming at least R500 000 salary bill) and does not qualify for turnover tax.

Feedback from business also demonstrates limited adoption of the Act’s definition. A survey of prospective SMME definition users conducted in a 2009 review of the NSBA found that the private sector was the least likely to use the NSBA definition, followed by parastatals and government departments, as shown in the Graph 22.

**Graph 22. Results of 2009 survey of National Small Business Act review**



Most private-sector respondents said they did not use the NSBA definition as they preferred to apply definitions from other government agencies and national departments. Several challenged the use of the Act’s definition because they experienced a wide variety of eligibility criteria that were unrelated to the official small business definition. The survey also found that users of the NSBA commonly use turnover and employment (27%) or turnover only (27%) to determine the class and size of the enterprise they are dealing with.

In 2017, TIPS conducted focus group discussions with stakeholders on the SMME definition. Findings from these consultations align with previous reviews, pointing to the need to update the Act’s thresholds and harmonise the SMME definition across departments.

Finally, the NSBA definition is out of date, although it was updated in 2003 for inflation. International best practice suggests that thresholds should be updated at least every five to seven years to reflect the realities of small businesses. Consultation with Statistics South Africa officials suggested that the NSBA definition has been used to report on sector trends in the economy. However, officials cautioned that use of the Act’s thresholds required factor adjustments to represent a more accurate reflection of the distribution of different sizes of businesses in the economy – the current thresholds are too low even when adjusted for inflation.

In sum, the evidence converged on the need to update the NSBA thresholds for SMMEs. However, that would not guarantee an increase in adoption and uptake of the definition.

To develop a more appropriate and useful definition requires an understanding of the factors that would improve the adoption of the NSBA definition. These factors include:

- The purpose of the definition, which is above all to improve the targeting of state support without imposing unnecessary administrative burdens on small businesses;
- Ensuring that the definition assists state programmes to fulfil transformation objectives; and
- Distinguishing appropriately between formal and informal enterprise.

From this standpoint, a simpler definition would likely prove more useful, with fewer categories and indicators. When necessary, state agencies and departments could then add further criteria.

For these reasons, TIPS recommends the following.

1. The NSBA definition should be amended:
  - To update the thresholds with Statistics South Africa data that are more accurate and based on company surveys;
  - To consolidate the sectors to reduce the complexity of the definition;
  - To reduce the indicators to two, namely employment and turnover; and
  - To remove the “very small” category but retain the micro, small and medium categories.
2. The NSBA should be amended:
  - To include the informal sector definition provided in the National Informal Business Upliftment Strategy; and
  - To provide guidelines on how to apply the definition in practice.
3. A process should be initiated between the DSBD, the **dti**, National Treasury, Statistics South Africa and the Department of Labour to harmonise the SMME definitions across these key departments.

## **REDUCING REGULATORY BURDENS ON SMALL BUSINESS**

At the request of the DSBD and the Department of Performance Monitoring and Evaluation (DPME), TIPS conducted a study on the regulatory burdens for small business arising from national laws and requirements. The research project aimed:

- To identify viable changes in national rules and systems to reduce the regulatory burden on small business; and
- To indicate the main costs, benefits and risks to other stakeholders of the proposed changes.

As a precursor to the project, a literature review was conducted on the main studies of red tape for small business, including public, private and academic studies (See Appendix 1). The literature suggests that small business owners typically cite structural issues such as economic conditions, access to finance, access to markets and skills as their main challenges. However, they also refer to onerous regulations and government bureaucracy as a secondary problem.

The literature review established that studies on regulatory burdens typically:

- Centre on surveys of small business or SMME experts;
- Identify and, in some cases, seek to quantify regulatory areas that business owners see as a burden; but
- Provide only general conclusions rather than proposing specific amendments to rules or procedures that cause problems for small business.

By extension, the main benefit of these studies for policymaking is to identify areas of concern for regulatory reform. They do not, however, provide sufficient detail to guide a reform process. Moreover, they do not indicate trade-offs that might follow from reforms, especially when they would affect stakeholders other than small business.

The TIPS project sought to develop specific, practical options to reduce burdens on small business in areas that earlier studies identified as problematic. To this end, it developed and tested a methodology to review and assess regulatory burdens. The study applied the methodology to four regulatory areas:

1. Reporting and registration requirements, with a focus on national laws, especially around taxation, labour laws and the Companies and Intellectual Property Commission (CIPC);
2. State procurement procedures as they affect small business;
3. The construction industry, which is subject to sector-specific regulation by both national and municipal government; and
4. B-BBEE compliance.

The next section outlines the methodology developed to analyse regulatory burdens on small business. The following sections outline the main findings and proposals arising from the study. The full study will be available [on](#) the TIPS website from October 2017.

## Methodology

The methodology used to analyse the regulatory burden on small business aimed to generate specific proposals for legislative reform. It involved three phases: a textual analysis of the relevant rules to develop hypotheses around the burden on small business; testing the hypotheses against the available qualitative and quantitative evidence; and on that basis the development and systematic evaluation of options for reform. The process draws on the approach of the Socio-Economic Impact Assessment System (SEIAS), adopted by Cabinet for assessing new laws and regulations.

### Textual analysis

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

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

The SEIAS methodology points to two basic kinds of costs.

On the one hand, there are administrative burdens, which are the core of red tape as commonly understood. These costs include both the initial effort of setting up systems to comply with new requirements, and the on-going administrative burdens associated with

compliance, such as submitting tax forms. Reforms to reduce unnecessary administrative burdens are typically relatively uncontroversial, although they may impose costs on agencies that are asked to re-tool their systems, upgrade their technologies, or reduce their ambitions especially around information collection.

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

Starting with a textual analysis ensured that the arguments for the research were specific enough to guide practical reforms. They guided the research toward clauses and requirements that could impose burdens on small business, for instance around the provision of information; timeframes for decision-making; and changes in their production processes, for instance to meet procurement requirements. In itself, this kind of analysis proved useful in defining more clearly where regulatory burdens arose for small businesses.

### **Qualitative and quantitative research**

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

In assessing the actual costs and benefits for small business, researchers had to take into account the reality that small businesses are diffuse, diverse and numerous. As the analysis in the sub-section Employment (page 3) notes, they vary widely in their resourcing, requirements and regulatory context. Moreover, entrepreneurs are typically crucial for the day-to-day operations of their businesses, and cannot take much time out for interviews and workshops with researchers. Unlike big business, most do not have staff to delegate for this purpose.

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

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

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

In addition to qualitative evidence, an effort was made to assess findings against the available data where possible. The most important statistics are transactional and collected by the relevant agencies. Mostly they related to how many small businesses use procedures designed to support them and to the time required for compliance and turnaround.

### **Policy options**

The final phase of the methodology involved identifying and testing options for reform. To that end, in line with both the SEIAS and standard Regulatory Impact Assessment methods, three options were developed and analysed for each set of rules and procedures studied. The options involved different combinations of regulatory reform and other measures to reduce the impact of existing rules. For each option, the costs, benefits and risks to small business and other stakeholders were reviewed. On that basis, a preferred option was identified.

The identification of options aimed to compel innovative thinking by requiring evaluation of a broad range of alternative reforms. As a result, some of the options analysed were controversial. In this context, it was important to indicate the costs, benefits and risks for stakeholders besides small business, both inside and outside of government. This approach ensured that the proposals were more realistic as well as indicating which groups would have to be engaged for successful implementation of reforms.

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

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

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

### **The SEIAS approach**

The methodology used in this study was based in the SEIAS approach. This section outlines some of its key elements.

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

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

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

In evaluating measures, SEIAS requires consideration of the costs, benefits and risks to different social groups. This approach is grounded in the understanding that laws and procedures do not affect all citizens in the same way.

The aim is to understand potential or actual contestation around the measures, as well as to identify unintended consequences.

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

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

For the TIPS study on regulations for small business, utilisation of the SEIAS approach required the following:

- The aims of the rules and procedures, and what social problem they are trying to solve, were analysed to indicate both beneficiaries and cost-bearers.
- The costs and benefits to small business were extrapolated from the text to some degree using approaches developed for regulatory impact assessments. Because the rules and procedures being analysed had already been implemented, however, the findings provided hypotheses that could be tested against actual experience.
- To develop realistic proposals for change, policymakers need to understand the costs and benefits of the existing regulatory system, not only for small business, but also for other stakeholders. This approach generates an understanding of the likely opposition and possible win-win compromises. For the TIPS study, the main stakeholders were broadly small business; other businesses; relevant government agencies; and workers and communities.
- As in the SEIAS process, it proved useful to describe costs and benefits to different groups in qualitative terms, even if they could not be quantified.
- In assessing options, it proved important to include risks as well as the anticipated benefits and costs to the affected groups.

In summary, for each area reviewed:

- The analysis started by explaining the importance of the particular set of rules and procedures analysed, and where relevant the main debates.
- The second sub-section reviewed the logic of the rules and their inherent theory of change, and the implications for small business. In this context, it identified the assumptions underlying the theory of change inherent to the legislation. If these assumptions do not hold, then the legislation will likely have unintended consequences.
- The third section assessed the administrative and, when relevant, the inherent costs for small business based on the textual analysis and associated evidence.
- The final section proposed and evaluated three options for mitigating the burdens on small business, and indicated which one seemed preferable.

## Registration and reporting

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

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

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

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

### Company and co-operatives registration

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

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

Company registration in South Africa is governed by the Companies Act of 2008. In section 185, the Companies Act mandates the CIPC to register enterprises and to maintain a central database of company records in South Africa.

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

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

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

There is an overlap between CIPC and SARS reporting requirements for certain types of businesses. By extension, there is a strong case for integration, which will not undermine indicators of sound corporate governance in reporting businesses. The fees for the Annual

Returns could be levied as part of normal tax assessment and then transferred to the CIPC.

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

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

A second challenge around CIPC reporting emerges from the Co-operatives Development Act. The Co-operatives Development Act provides specifically for the formation and registration of the different types of co-operatives (primary, secondary and tertiary). The need for separate legislation arose because government aimed to use the registration process to provide co-operatives with incentives and to ensure they abided by co-op norms especially in terms of internal democracy and book-keeping.

Unlike other small enterprise, most co-ops are required to submit audited financial statements. That imposes a considerable additional expense. In contrast, the Companies Act only requires enterprises above specified thresholds to submit audited statements. The Cooperatives Act permits exemptions where the cost of audits would be prohibitive, but no detailed guidelines have been provided, and in practice exemptions are rare.

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

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

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

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

Engagement on these proposals would require interaction with the CIPC and SARS, as well as their oversight departments – respectively the dti and National Treasury. Responsibility for co-ops has been transferred from the dti to the DSBD, which presumably is now also responsible for the Cooperatives Development Act.

## Taxation

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

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

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

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

SARS reports that in 2015/6, the average turnaround time for VAT refunds was 33 working days, although SARS's target was 21. That said, over half of refunds were paid within 48 hours (up from 3% 10 years earlier) and two thirds within 14 working days. But some were delayed over three months.

Small business informants argued that the main cause of delayed VAT refunds was that businesses were being put under audit. The SARS turnaround times for audits run between three and 12 months. SARS reports, however, found that the delays were mainly due to inflated claims when VAT returns were not properly filled out. SARS contends that VAT fraud constitutes a key risk for its operations, with sole-traders seen as particularly challenging.

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

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

Under the tax regime for small business, the law provides a differentiated tax system. National Treasury and SARS have long sought ways to minimise administrative costs without reducing revenues. A survey has found that the median small business requires up to eight full working days a year to comply with the full panoply of tax requirements, including company income tax, VAT and administration of Pay-As-You-Earn taxes on employees (see University of Pretoria 2015).

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

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

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

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

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

### **Labour registration: The skills levy, the Compensation Fund and Private Employment Agencies (PEA)**

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

Informants directed the study toward three issues:

- The difficulties involved in accessing the benefits of the skills development levy;
- The risk assessment process for Compensation for Occupational Injuries and Diseases Act (COIDA); and
- The procedures for obtaining Private Employment Agency certificates.

The Skills Development Act prescribes that businesses with a salary bill of over R500 000 a year pay 1% as a skills levy. However, evidence suggests that only 37% of small businesses

that pay the skills levy can access funds from their Sector Education and Training Authority (SETA) for training. Only companies that pay less than R500 000 for employees – which effectively means they have from one to 10 workers<sup>3</sup> – are exempt from the levy.

Various factors explain why small business find it hard to access SETA funds. First, to claim the funds, businesses must have a skills plan. Small businesses often lack the capacity to comply with the requirements for skills planning. Second, SETA training seeks to ensure workers' skills are transferable and can support certification. It may therefore require considerable technical proficiency, which may seem unnecessary and excessively time-consuming to small employers. For instance, accredited learnerships take at least a year. That may seem excessive to small businesses, which would prefer shorter internships.

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

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

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

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

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

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

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<sup>3</sup> In full-time equivalent terms, based on 2015 figures for median wages from the LMD.

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

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

Representatives of the employment agencies' business association, the Federation of African Professional Staffing Organisations (APSO) argue that, as a result, some private employment agencies end up operating illegally. It is estimated that 3 000 enterprises operate as employment agencies, but many are unlicensed. In effect, the unnecessarily slow and arduous registration process means that many agencies do not comply with any standards.

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

## **State procurement**

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

In an effort to prevent corruption and improve value for money, the procurement laws aim to ensure that state agencies must buy the lowest-cost product that meets quality requirements, regardless of who supplies it. To achieve that end, supply-chain procedures are regulated tightly. Regulations detail requirements around the kinds of information suppliers must provide as well as defining procurement models for different tender sizes.

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

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

- Delays in payments, with around 2,5% of the value of spending on goods and services at national level, and almost 25% at provincial level, paid more than 30 days after invoicing;

- The ban on up-front payment on tenders, which may shut out small businesses with limited liquidity; and
- The lack of regulation to protect subcontractors on government tenders, which can lead to abuses such as delayed or non-existent payments; demands for delivery beyond the original agreement; and exploitative terms.

The preferred options recommended are:

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

## Construction

The construction industry has a relatively large share of small businesses. Many small contractors argue, however, that they find it difficult to get state contracts. The TIPS study included a section on the Construction Industry Development Board (CIDB) Act, which is a sector-specific law aimed at facilitating access to government tenders for small construction contractors.

The Act establishes an oversight body, in the form of the Board, to implement an integrated strategy for the reconstruction, growth and development of the construction industry. Specifically:

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

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

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

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

Informants were mostly concerned that there seemed to be little payback to compensate for the effort of registering. Specifically, government tenders were still hard to get, which meant that the administrative costs loomed large. The CIDB itself estimates that the 650 enterprises on the highest two levels of its ranking account for 80% of the value of all tenders, out of a total of 150 000 registered (mostly on level 1) in 2016.

In the event, the TIPS study found that the number of companies registered for smaller construction contracts at the CIDB far outstripped the actual number of tenders. Judging by an assessment of construction contracts gazetted by the Gauteng Department of Public Works from 2013 to 2015, there would be around 2000 companies registered with the CIDB for each contract that was larger than R650 000 but smaller than R6,5 million. For every tender valued at under R6,5 million issued by the Gauteng Department of Public Works, there would be 61 enterprises per tender in the eligible group, and in value terms, the tenders averaged only R50 000 per enterprise per year. Similar findings emerged from an analysis of tenders by the Department of Public Works.

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

### **Broad-Based Black Economic Empowerment**

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

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

The research was unable to quantify the substantive cost of B-BBEE for white-owned enterprises, or the benefits to black-owned or empowered businesses.

In terms of certification, the preferred options are:

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

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## Appendix

AREAS	Bureau for Economic Research (2016)	BUSA (2014)	Davis Tax Committee (2016)	GEM (2016) National Expert Study	International Labour Organization (2016)	SBP (2015) SME Growth Index	WEF (2015) Global Competitiveness Index
Access to finance	X	X	X	X	X		
Access to markets	X		X	X			
Burdensome regulations (national and Municipal by-laws)	X	X	X	X	X	X	
Crime	X						
Economic conditions		X			X	X	X
Education and skills	X	X		X		X	X
Entrepreneurial culture				X	X		
Environmental regulations					X		
ICT					X		
Infrastructure	X			X	X		X
Labour market (cost of labour and regulations)	X	X				X	X
Procurement (late payments)			X			X	
Property and land ownership					X		
Research and development	X			X			
Sector specific issues							
Taxation			X	X		X	
Trade practises					X		