

BUSINESS BRIDGE FOR BUSINESS GROWTH[®]

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Budget breakthrough for small businesses

From the editor's desk

THIS EDITION of *Business Bridge for Business Growth* – the first for 2006 – brims with strategic information that will help you on your journey to success this year.

To begin, we look at the impact that the 2006–7 national budget will have on small businesses in South Africa. In last year's budget, the Minister of Finance, Trevor Manuel, announced tax relief of some R1.4 billion for small companies. This year's budget offers further relief worth R400 million. What does this mean for South Africa's entrepreneurs and small business owner-managers?

Business Bridge for Business Growth also looks more closely at the objectives of the Accelerated and Shared Growth Initiative South Africa, (ASGISA). ASGISA formed the nucleus of President Thabo Mbeki's state of the nation address, and is subject to continuing discussion and debate in the business arena. We explain the rationale for this new strategy, and assess its aim to achieve the higher rate of economic growth needed to

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SBP also publishes *Business Bridge for Business Growth* on its website, www.sbp.org.za, so you are able to print out a spare copy, or check out previous editions.

IN HIS budget speech in parliament on 15 February, Finance Minister Trevor Manuel noted that the South African economy had expanded by about 5 per cent last year, and that a similar pattern of continued growth was anticipated for the period ahead. Business confidence was strong, investment and employment creation had gained momentum, and inflation and interest rates remained moderate. State revenue for 2005–6 was expected to be about R41 billion more than anticipated, creating room for increased state expenditure as well as tax relief.

Looking back at the 2005–6 budget

Let's turn back the clock and briefly revisit the 2005–6 budget in respect of small businesses. Last year the turnover limit for companies to qualify as small

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Finance Minister Trevor Manuel ... his latest budget contains major concessions aimed at stimulating small businesses. Terry Shean / PictureNET Africa

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create jobs and reduce poverty. In particular, our in-depth article closely examines the impact of ASGISA on small businesses in South Africa.

Test your knowledge ... which province contains the most informal and formal firms in South Africa? How many small businesses are currently operating in South Africa? And are there more women entrepreneurs in the formal or the informal sector? Find the answers to these questions and more in this edition of *Business Bridge for Business Growth*.

'On the Ground' highlights the need for small businesses to have truckloads of entrepreneurial determination, as well as a strong backbone. The story of Iqbal Mohamed of AVH Projects in Springs on the East Rand provides a fascinating insight into the challenges of operating a small business, and raises issues that will resonate with many of our readers.

■ *Michelle Preiss*

Make yourself heard

Business Bridge for Business Growth is committed to hearing from our readers on issues affecting SMEs. Our questions to you in this issue are:

- What should the government do to create even greater tax relief for small business in South Africa?
- Will informal small businesses benefit by taking advantage of the tax amnesty and subsequent formalisation process, or is it more beneficial for such businesses to continue to operate on an informal basis?

Fax your answers to Michelle Preiss on (011) 486 0810, or e-mail michelle@sbp.org.za, and let's get the debate going! If you have a burning question, let us know, so that we can deal with it in a future issue. ■

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business companies (SBCs) was raised from R5 million to R6 million and the tax rate was reduced from 30% to 29%. And for the 2005/06 period government announced tax relief of R1.4 billion for small companies in a bid to stimulate the economy and create jobs.

At the same time the South African Revenue Service (SARS) agreed to help small businesses to become more tax-compliant by deploying 'tax helpers' to small business localities to help with tax registration, returns and business tax obligations.

The 2006–7 budget and small business

Back to the present. Manuel announced a number of adjustments – collectively worth R400 million – which are another step in the right direction for small businesses growth and development.

Tax adjustments

From 1 April 2006, the annual turnover threshold for qualifying as a SBC will be raised from R6 million to R14 million. This dramatic upward adjustment is a very significant move that allows many more small businesses with higher turnovers to qualify for tax relief.

Tax thresholds for SBCs, also effective from 1 April 2006 onwards, have been adjusted as follows:

- Businesses will pay no tax on the first R40 000 of taxable income. This threshold has been raised from R35 000 in 2005–6, providing additional relief for SBCs in this lower income bracket.
- Businesses will pay 10 per cent tax on taxable income between R40 000 and R300 000. In the 2005–6 budget this tax bracket included companies earning between R35 000 and R250 000.
- Businesses will now pay 29 per cent on taxable income in excess of R300 000. In the previous tax year, small business companies earning R250 000 were obliged to pay this tax rate, so this raised threshold also provides tax relief.

The bottom line of the 2006–7 budget is that, as a small business, you will pay less tax.

Tax amnesty

In his budget speech, Manuel stated: 'Although small businesses play a valuable economic and developmental role, many were historically marginalised. They were excluded from the economic mainstream, operated informally, and remained outside the tax system.' There is now light at the end of the tunnel for small businesses that have not formalised because they were concerned about penalties for past non-compliance.

According to SARS, its tax-broadening efforts and 'walkabouts' in informal business areas have shown that many small businesses are not registered, but would like to be. To encourage small businesses to enter the tax system voluntarily, SARS has proposed a tax amnesty for small businesses whose turnover does

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ASGISA – aiming to halve poverty and unemployment by 2014

IN RECENT months we have heard a lot about the Accelerated and Shared Growth Initiative South Africa (ASGISA). But what is it exactly? And how will it impact on you, the small business owner-manager?

ASGISA is the government's new blueprint for achieving 6 per cent economic growth. It has been developed in response to a number of economic constraints that we face as a country, including the skills shortage, and various challenges faced by SMEs. ASGISA emphasises partnerships with business, labour, and civil society. It will initially focus on initiatives to address challenges related to infrastructure, sectoral strategies, education and skills, the second economy, public administration, and macroeconomic issues.

Who is responsible for ASGISA?

The ASGISA initiative is led by Deputy President Phumzile Mlambo-Ngcuka. Her task force includes the ministers of Finance, Trade and Industry, and Public Enterprises; the premiers of Gauteng and the Eastern Cape, and the mayor of Johannesburg. Other ministers, senior government officials, representatives of organised business, and labour, religious, youth, and women leaders were included in the discussions. The government also consulted South African and international experts.

ASGISA's objectives and constraints

ASGISA's main objective is to halve unemployment and poverty by 2014. It identifies a number of constraints that have to be addressed to achieve this goal:

1. **The restrictive regulatory environment, and the burden on SMEs.** As an SME, you will be aware that some of your most serious challenges are created by the sub-optimal regulatory environment in which you operate. The administration of tax, the planning system, municipal regulations, the administration of labour law, and specific sectoral regulatory requirements combine to impact negatively on your development.



2. **The volatility of the rand.**
3. **The high cost, inefficiency, and low capacity of the national logistics and transport system.** It costs more to move goods around South Africa than it should. This is due to backlogs in infrastructure, investment, inadequate planning, and some market structures that do not encourage competition.
4. **A shortage of suitably skilled labour.** South Africa lacks sufficiently skilled professionals, managers, and artisans. The uneven quality of education in the past has contributed to this.
5. **Barriers to entry, limits to competition, and limited investment opportunities.** Competition law and industrial policies need to be strengthened to counteract these factors.
6. **Deficiencies in state organisation, capacity, and leadership.** Weaknesses in the way in which government is organised; in the capacity

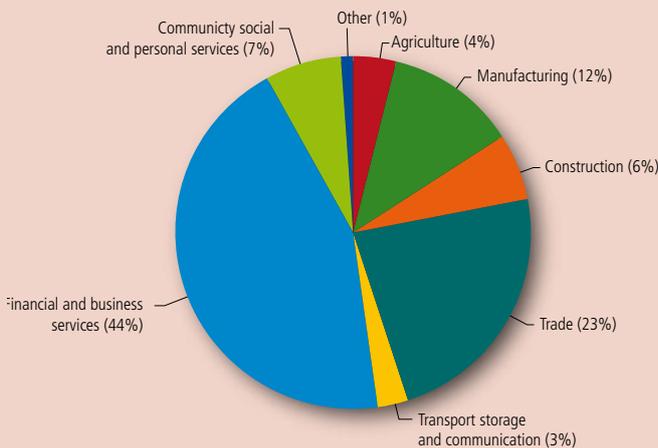
Tourists view giraffes in a private game reserve near the Kruger National Park ... ASGISA has identified tourism as one of the sectors with the greatest growth potential.
Naashon Zalk / PictureNET Africa

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Maintaining your competitive advantage

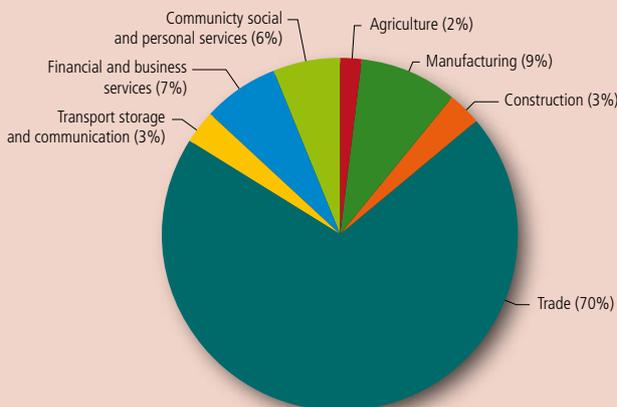
WE ALL have our heroes in the business world – inspiring and dedicated entrepreneurs who are so skilled at running their own business and managing their products that we believe they could ‘sell ice to an Eskimo’. There is enormous value in considering the underlying message of this well-known saying. Business development is shaped by two important elements. Strategic information about your business environment combined with shrewd product knowledge makes for growth and sustainability. To help you understand the marketplace in which you are operating, Business Bridge for Business Growth takes a look at one of these elements: the current SME business environment.

Figure 1: Formal businesses by economic sector, 2001



Source: Stats SA Integrated Business Register, 2004; Stats SESE Study, 2002

Figure 2: Informal businesses by economic sector, 2001



Source: Stats SA Integrated Business Register, 2004; Stats SESE Study, 2002.

Do you know that new company and cc registrations have increased steadily over the past 15 years?

According to the *Annual Review of Small Business, 2004*, published by the Department of Trade and Industry (dti) in late 2005, manufacturing, construction, and services were key contributors to South Africa’s strong economic performance in 2004. This buoyant performance led to an increase in the number of entrepreneurs entering both the informal and formal sectors.

The number of entrepreneurs in the formal sector grew from 506 000 in 2003 to 545 000 in 2004. So if you started a formal business in 2004, you were one of almost 40 000 new entrants to the marketplace.

If you entered the informal sector in 2004, you were one of about 68 000 new entrants. The informal sector grew by about 4,5 per cent between 2003 and 2004. If you were operating an informal construction, services or trade business in 2004, you will be interested to know that these sectors make up about 90 per cent of all informal enterprises in the country.

The dti *Review* also reports that the number of liquidations (especially of cc’s) is decreasing – another indication of a buoyant economy.

Main industries for formal and informal sectors

Figures 1 and 2 show that the industries in which formal small businesses operate are very different from those in which the informal sector is active.

As you can see, more than three quarters of

small businesses are involved in the services sector. The majority of formal businesses are involved in financial, business and professional services. Most informal businesses are involved in trade. This information could prove useful in identifying potential joint venture partners, or assessing the number of competitors in your sector or in other sectors.

The number of small businesses in South Africa

Based on a number of assumptions, the dti's Review estimates that about 2.75 to 3.35 million small businesses are operational – with about 1.1 million trading on an occasional basis

The locations of small business in South Africa

Considering Gauteng's status as South Africa's economic powerhouse, it's not surprising that the province is home to the largest number of informal and formal businesses in the country. About 46 per cent of formal and 25 per cent of informal enterprises operate from Gauteng. The Western Cape is the second-biggest province for formal businesses, and the second smallest for informal businesses. In Mpumalanga, Limpopo, the Eastern Cape, KwaZulu Natal, and North West, there are more informal than formal businesses.

Girl power

As you know, the government is advocating an increased role for women in our economy. The National Treasury is attempting to address this

objective through its Preferential Procurement Policy, which seeks to ensure that woman-owned businesses receive preference when tendering for government contracts. This has led to an increase in the number of enterprises owned by women in some previously male-dominated sectors, such as telecommunications and construction.

In 2001 the dti established the South African Women Entrepreneurs' Network which provides a strategy for fast-tracking support to women in addressing the challenges of establishing, strengthening and sustaining their enterprises.

Economically active women are probably as likely as men to engage in entrepreneurial activity. More female entrepreneurs are involved in the informal sector (47 per cent) than the formal sector (30 per cent).

The contribution of small businesses to employment and GDP

Do you know that SMEs tend to be more labour-intensive than larger firms? In South Africa, micro enterprises employ about one third of all workers, while micro, very small, and small businesses together account for about 71 per cent of employment.

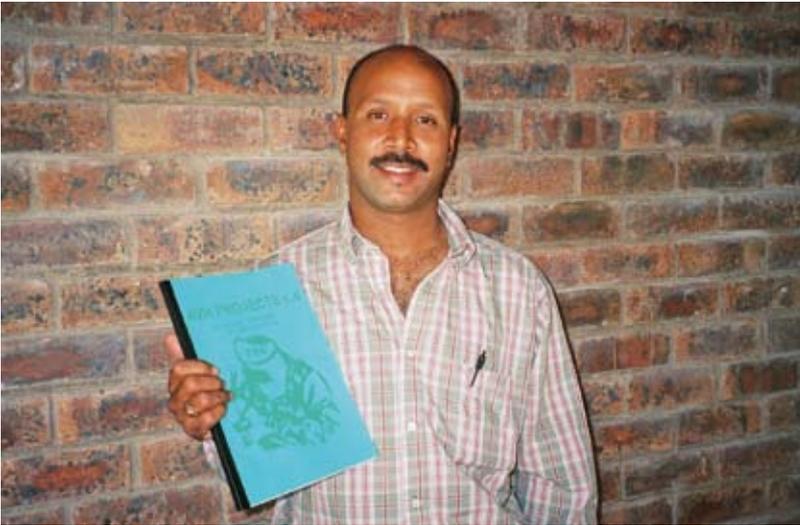
The dti *Review* also contains the following estimates of contribution to GDP in 2004:

■ Micro businesses	11 per cent
■ Very small businesses	15 per cent
■ Small businesses	14 per cent
■ Medium and large firms	60 per cent
■ Unspecified	1 per cent



SMEs networking at Business Bridge Steelpoort.

On the ground with Iqbal Mohamed of AVH Projects in Springs



*Entrepreneurial ambition
– Iqbal Mohamed of AVH
Projects.*

IQBAL Mohamed of AVH Projects cc is a dynamic example of entrepreneurial ambition. He is always willing to go beyond the call of duty in providing a superior customer service – even if this means being called out at 2 a.m. to repair a welding machine in the rain, or supplying customers with nuts and bolts late on a Sunday.

Based in Springs, AVH Projects is an industrial supply company distributing a wide range of well-known brands and makes of consumables and equipment in the engineering and industrial fields. It also repairs and supplies power tools, and undertakes fabricating work and small machining. In a savvy anticipation of the 2010 Soccer World Cup boom, the company has also acquired the distribution rights for a number of large lighting products – including floodlights – and Iqbal is currently working on a catalogue to showcase and market these products. 'Forward planning is vital,' he says, 'and the opportunities generated by 2010 are going to be huge.'

Business Bridge has played a significant role in improving Iqbal's operations. Says Iqbal: 'I have been attending Business Bridge meetings since 2004, and have learnt a lot about running a small

business thanks to the content of the meetings. It has benefited me to meet with other SMEs and explore common challenges and share ideas. I also enjoy the exposure that Business Bridge has brought to my business, as well as the insights I have gained into the SME environment in which I operate.'

Emerging South African entrepreneurs

An energetic participant in strategic discussions at Business Bridge meetings, Iqbal was nominated as the Business Bridge representative to attend the International Convention of Entrepreneurs (ICE) in 2005. ICE hosted a large number of South African SMEs, who discussed the challenges they face on a daily basis as 'second economy' players. One of the most hotly debated issues was access to finance, a need which Iqbal has experienced at first hand. 'Financially, the toughest period for AVH was when we started to market and sell our products,' he says. 'We had to buy COD for six months before we were able to open a 30-day purchasing account with suppliers. The banks refused to give us an overdraft – and the competition was tough'.

But Iqbal's hunger for success and customer service led to a steady increase in sales, as well as a solid reputation in the marketplace. Iqbal is prepared to do what it takes to achieve success, including forming joint ventures with other companies in order to benefit from their combined purchasing power.

As a proud BEE company, AVH's motto – 'although you may reach the treetops, keep aiming for the stars' – is echoed throughout the organisation. Iqbal maintains a positive state of mind at all times, be it while dealing with an enquiry or submitting a tender. He strongly believes that products and services must be of high quality, well-priced, and delivered on time. 'It is a combination of these factors' he says, 'that will contribute to your business having a positive reputation in the marketplace. Add hard work and honesty to this, and you're on your way to success.'

ASGISA – aiming to halve poverty and unemployment by 2014

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of key institutions, including some of those providing economic services; and poor policy development and implementation all impact negatively on the country's growth potential.

Bridging the gap between the first and second economies

Addressing constraint number 1 – the regulatory environment and the burden on SMEs – is crucial to bridging the gap between the first and second economy, or the formal and informal sectors. ASGISA forms part of the response to 'second economy' challenges by leveraging the forces of the first economy to address the second. This includes leveraging increased levels of public spending – especially on investment – to develop small businesses and broad-based empowerment. Other issues to be addressed include access to finance; preferential procurement; labour-intensive sectors; and regulation. The dti is developing a procedure through which 10 products will be set aside for procurement through smaller black-owned businesses.

Another key focus is sector-based. ASGISA has identified tourism and business process outsourcing as the sectors with the greatest potential for impact within a short time. Activities in this regard will include elements addressing the development goals

of the second economy.

Linking small businesses to opportunities deriving from the 2010 FIFA World Cup is another task for government. Infrastructure projects will be labour-intensive, where feasible. Women and the youth will receive special attention. Timely payment by government will be monitored by the dti.

Interventions to support small businesses

There are several interventions under ASGISA designed to support small businesses.

- To address the gap in loans between R10 000 and R250 000, Khula and Business Partners have partnered a R150 million fund for business loans of this size.
- A fund for women entrepreneurs established collaboratively by dti, Eskom, Umsobomvu, and the Women's Development Bank is being planned.
- The Financial Services Charter R5 billion commitment to small business loans is still to be finalised as a programme, but progress is expected soon.
- The roll-out of the Apex and Mafisa programmes for loans of less than R10 000 is to be accelerated.

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About SBP

SBP is an independent not-for-profit private sector development and research company, promoting strategic partnerships and a better policy, regulatory and operational environment for business growth in Africa. Our work combines research, advocacy, and practical business development programmes.

Originally known as the Small Business Project, SBP started life as a voluntary organisation in the early 1990s. In 1998 it was formally registered in South Africa as a Section 21 company.

Over the years, SBP has grown and diversified. Some of our projects have become self-sustaining and have been spun off to develop on their own. However, the development of small and medium-sized (SME) enterprises remains one of our main goals in South Africa and across the continent, as key to economic growth and job creation.

Through our Business Bridge programme, SBP empowers SMEs to enter the supply chain of large corporations in a mutually beneficial and sustainable way. In the process, SMEs can grow, generate profits, and create jobs.

Business Bridge is an informal business development forum for high-growth SMEs to get together on a regular basis to identify, discuss, and resolve real-time challenges and issues of mutual interest. It is a peer-networking tool leveraged to transfer skills, experience, and expertise from large companies to small companies. Even more important, it provides a platform for SME owner-managers to learn from one another.

In the policy field, SBP's broad objective is to provide research-based evidence to assist governments in Africa to make life easier for businesses so that business can do what it does best: that is, provide much-needed goods and services, and create wealth and jobs. ■

SME facts and figures

- Businesses with payrolls of less than R500 000 a year no longer have to pay the Skills Development Levy.
- As indicated in the Medium Term Budget Policy Statement in late 2005, government and public enterprise investment spending for April 2005 to March 2008 is expected to be about R370 billion. Of this, about 40 per cent will be spent by public enterprises, mostly Eskom (R84 billion) and Transnet (R47 billion). Most of the spending will be on power generation, power distribution, rail transport, harbours, and an oil pipeline. The general objective of this expenditure is to improve the availability and reliability of infrastructure services in response to rapidly growing demand.
- The Small Enterprise Development Agency (Seda) launched two offices in Durban in February 2006. One is the KwaZulu Natal provincial office, and the other is Seda eThekweni.
- BusinessMap Foundation, sponsored by the British High Commission, is launching a *BEE Guide to Investors in South Africa*. This website will be a simple and easy Guide to the South African Government's BEE Score Card and Legislation. The intention is to provide a one stop shop where all potential overseas investors or those who want an easily understood way to get on top of BEE can come for help. The site will also include an interactive ScoreCard which will allow companies to test their BEE credentials, as well as a set of Frequently Asked Questions.

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Another key second economy intervention is the Expanded Public Works Programme, which will be enlarged beyond its original targets.

Time will tell whether ASGISA will succeed in helping South Africa to meet the Millennium Development Goals of halving poverty and unemployment by 2014. We are interested in your views. How confident are you that these objectives will be achieved? And do you expect to benefit from these interventions? Fax your comments on ASGISA to Michelle Preiss on (011) 486 0810, or e-mail her at michelle@sbp.org.za

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not exceed R5 million and who have previously operated outside the system. In terms of the amnesty, SARS will waive all taxes owed up to 31 March 2004, subject to a non-disclosure penalty of 10 per cent of taxable income in 2005.

The amnesty process will be conducted in two phases. Phase 1 will focus on the taxi industry in order to encourage tax compliance in preparation for the recapitalisation programme, and will run from August 2006 to May 2007. Later this year, Phase 2 will extend the amnesty to other small businesses, including small-scale farmers.

According to SARS, the aim of the amnesty is not simply to get small businesses to pay taxes, but to allow businesses to see 'the benefits of moving into the formal economy'.

Warning !

The National Treasury has advised that small businesses that do not take advantage of this opportunity to enter the tax system voluntarily will be subjected to SARS enforcement activities, including additional taxes, interest, and prosecution.

The budget and the reduction of red tape

In the first edition of *Business Bridge for Business Growth*, we reported that red tape cost South African businesses R79 billion in 2004 – an amount equivalent to 6,5 per cent of GDP. As part of a government bid to cut red tape, Manuel announced that Regional Service Council (RSC) levies would be abolished as of 30 June 2006. This will provide significant direct tax relief to all businesses – including SMEs – by lowering the cost of job creation and reducing the monthly administrative burden.