



“Effect of Red Tape on small firms in South Africa”

SME Growth Index Thematic Paper

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Giving momentum to small and medium enterprises (SMEs) – that part of the business landscape recognised for its job creation potential – is inextricably linked with smoothing out the conditions under which they operate. In South Africa, this has long been recognised, at least rhetorically. The fact that this commitment has regularly been reaffirmed suggests that not much progress has been made in doing so. Central to this, in most of the public commentary, is “red tape”, the complex of laws, regulations and certifications which officialdom demands of businesses to permit them to operate legally. Is this really a brake on business or merely a smokescreen to disguise deeper inefficiencies?

Depending on one’s perspective, red tape can be viewed as a necessary system to protect consumers and ensure orderly commerce or an unproductive drain on time and resources for no discernible benefit. These views are not necessarily contradictory. Red tape does constrain economic activities and pose demands on business; but this is acceptable if it is linked to a rational and defensible social or other policy goal. Red tape, in other words, must seek to mediate optimal solutions.

The 19th century writer, Charles Dickens, satirised red tape in his novel *The Pickwick Papers*:

The Circumlocution Office was (as everybody knows without being told) the most important Department under Government. No public business of any kind could possibly be done at any time without the acquiescence of the Circumlocution Office. Its finger was in the largest public pie, and in the smallest public tart. It was equally impossible to do the plainest right and to undo the plainest wrong without the express authority of the Circumlocution Office. If another Gunpowder Plot had been discovered half an hour before the lighting of the match, nobody would have been justified in saving the parliament until there had been half a score of boards, half a bushel of minutes, several sacks of official memoranda, and a family-vault full of ungrammatical correspondence, on the part of the Circumlocution Office....

Numbers of people were lost in the Circumlocution Office. Unfortunates with wrongs, or with projects for the general welfare (and they had better have had wrongs at first, than have taken that bitter English recipe for certainly getting them), who in slow lapse of



time and agony had passed safely through other public departments; who, according to rule, had been bullied in this, over-reached by that, and evaded by the other; got referred at last to the Circumlocution Office, and never reappeared in the light of day. Boards sat upon them, secretaries minuted upon them, commissioners gabbled about them, clerks registered, entered, checked, and ticked them off, and they melted away....

This passage artfully sums up red tape at its most mendacious: essentially indulging and perpetuating itself, incomprehensible to outsiders and offering little benefit to those subject to it.

If there is a sincere commitment to encouraging business growth, then the costs to business must be rationally related to the importance of the outcomes that they seek to enforce. The prestigious news magazine, *The Economist* noted that “it is an irony of modern business that regulation, a concept designed to reduce risk by protecting the interests of corporates, customers and society at large, has itself become one of the most serious risks that companies face”.

The broad point made here, that regulatory issues often undermine firms’ ability simply to do business has actually been conceded, albeit indirectly, ever since South Africa’s political transition, and the first of the country’s extensive development agendas, the Reconstruction and Development Programme. Pledges to make the environment more conducive for SMEs have been a staple of subsequent plans, as have pledges to investigate the regulatory hurdles and appropriately reform them. The goal was to be a smoothly functioning environment within which SMEs would proliferate, blossom and steadily take on new staff, thereby progressively dealing with South Africa’s unemployment malaise.

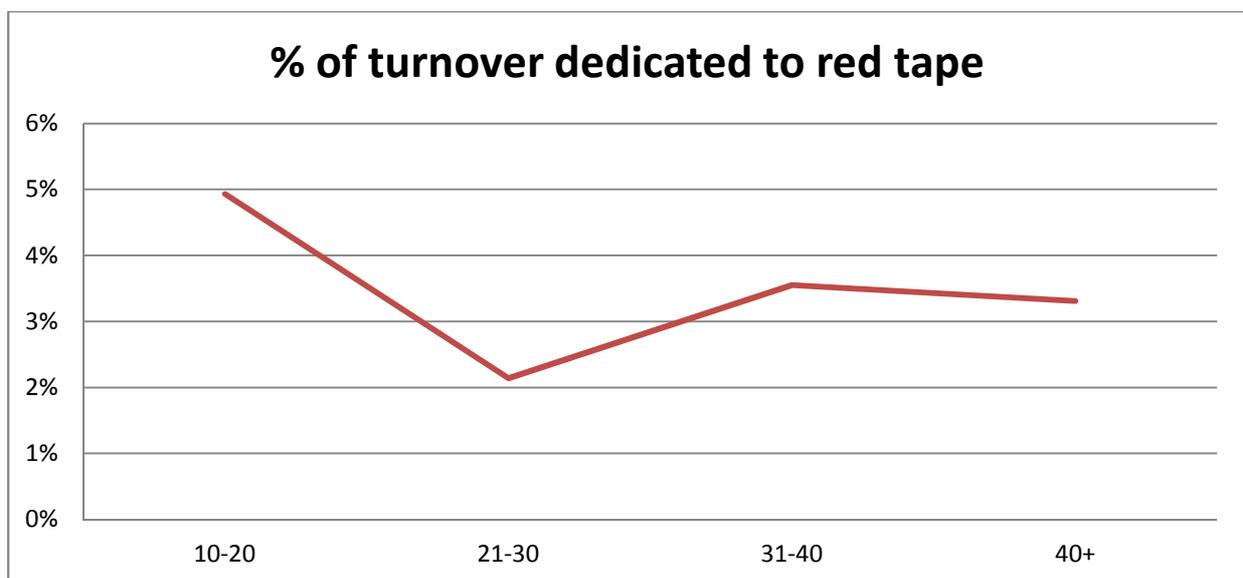
The current National Development Plan endorses this view by envisaging that “regulatory reform and support will boost mass entrepreneurship”.

The SME Growth Index provides an unmatched perspective on the country’s SMEs. It has canvassed matters germane to red tape extensively, particularly in the second round, conducted in 2012. Combining this with previous work done by SBP – notably the landmark study published in 2004, *Counting the Cost of Red Tape* – enables in-depth insights into the question



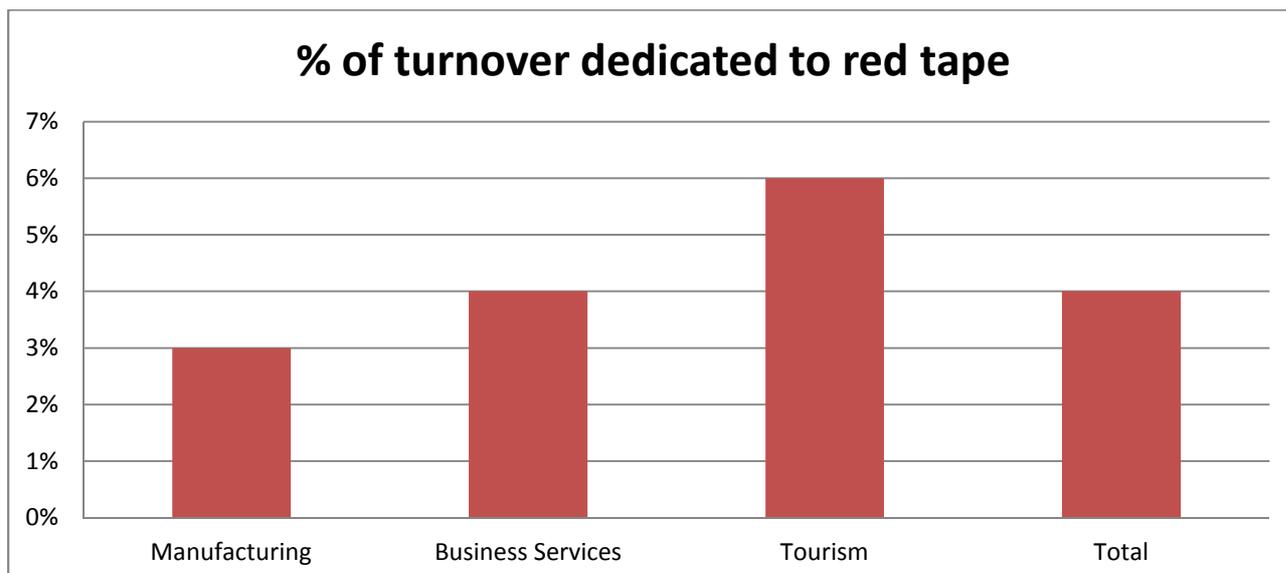
Quantifying red tape

In the second round of the SME Growth index, the panel reported spending an aggregate 4% of turnover on red tape. The trend showed that smaller firms were hardest hit by red tape were the smallest ones – those employing fewer than 21 people. At this level, some 5% of turnover was being committed to it. Larger firms had to commit a smaller proportion. For those employing more than 40 people, red tape accounted for some 3% of turnover. (In SBP’s 2004 study, the same trend was identified with a much broader sample.) Red tape is thus a highly regressive cost. This conclusion has been reached elsewhere in the world, too.



For firms employing fewer than 21 people, R1 in every R20 goes to red tape. Among those employing more than 40, the equivalent figure is R1 in every R33. But even the latter, lower, figure represents a considerable outlay. It should be noted that the overall fall in the proportion of turnover committed to red tape as the firm size (measured by staff numbers) still denotes growth of red tape costs in absolute terms. Although the relationship between employee numbers and turnover is not direct, larger firms will tend to operate with larger turnovers, and thus, progressively larger sums of money are being directed to red tape as firms grow in size.

Seen from the perspective of sector, tourism firms carried the greatest burden, committing some 6% of their turnover to red tape, while those in business services committed 4% and manufacturers 3%.



This disparity appears to be *partly* a function of the differential average size of the firms in the different sectors. Panellists in the tourism sector tend to be significantly smaller (both in turnover and employment) than those in other sectors.

Sector-specific red tape does, however, play a role. SBP highlighted the burden carried by tourism firms of all sizes in a report on the matter in 2006. In line with the question of size referred to above, tourism firms tend to be small, and even large firms in the industry tend to conduct their operations in smaller, localised broaches. Tourism firms, furthermore, are often required to obtain multiple authorisations for their business – liquor licences, health and safety permissions, statistical returns etc, as well as standard compliance issues in such areas as tax and labour. Overall, the study found that concerns around labour legislation and the tax regime to be the most problematic. This is in line with what the SME Growth Index

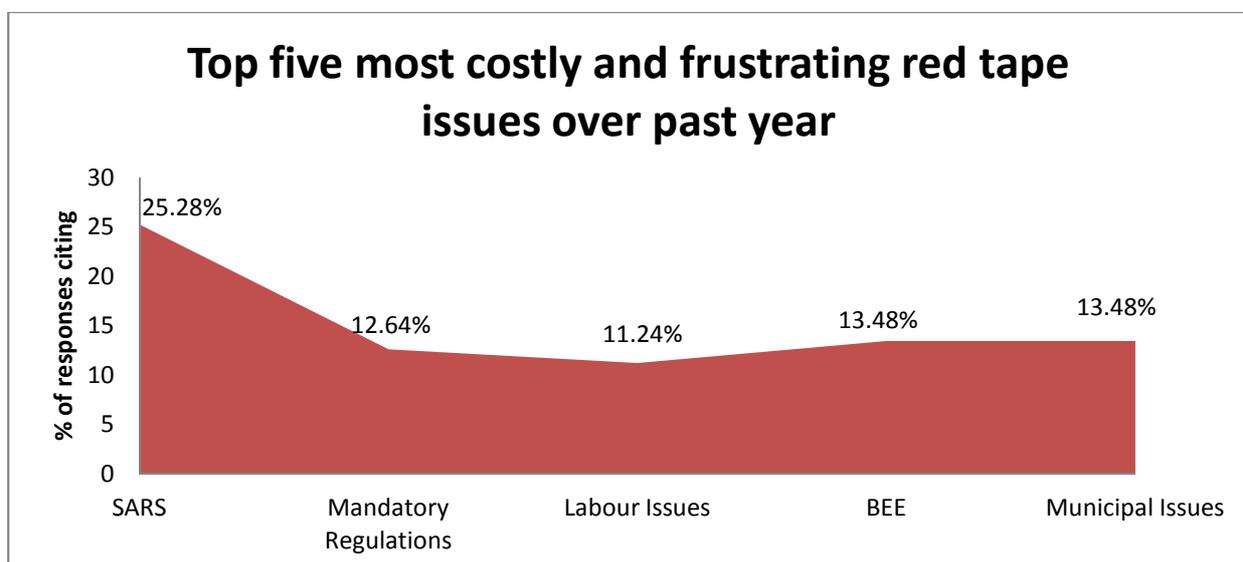
Business services panellists are similarly affected by the nature of what they do. This is especially so in view of the global financial crisis, which, has been widely interpreted (rightly or otherwise) as having arisen from a failure adequately to regulate the sector. Prime examples of the regulatory compliance burden would be the suite of examinations mandated by the Financial Services Board in terms of the Financial Advisory and Intermediary Services (FAIS) Act, and the responsibilities imposed by the Financial Intelligence Centres Act (FICA). In the coming year, government intends to introduce a so-called “twin peaks” model of regulation of the financial sector, which is explicitly aimed at discarding “light touch” regulation. Chief Executive Officer of Sanlam, Johan Van Zyl, voiced concern last year that increasing regulations were costing the life insurance sector “hundreds of millions of rands”, and were becoming a brake on the industry.



Overall experience of red tape

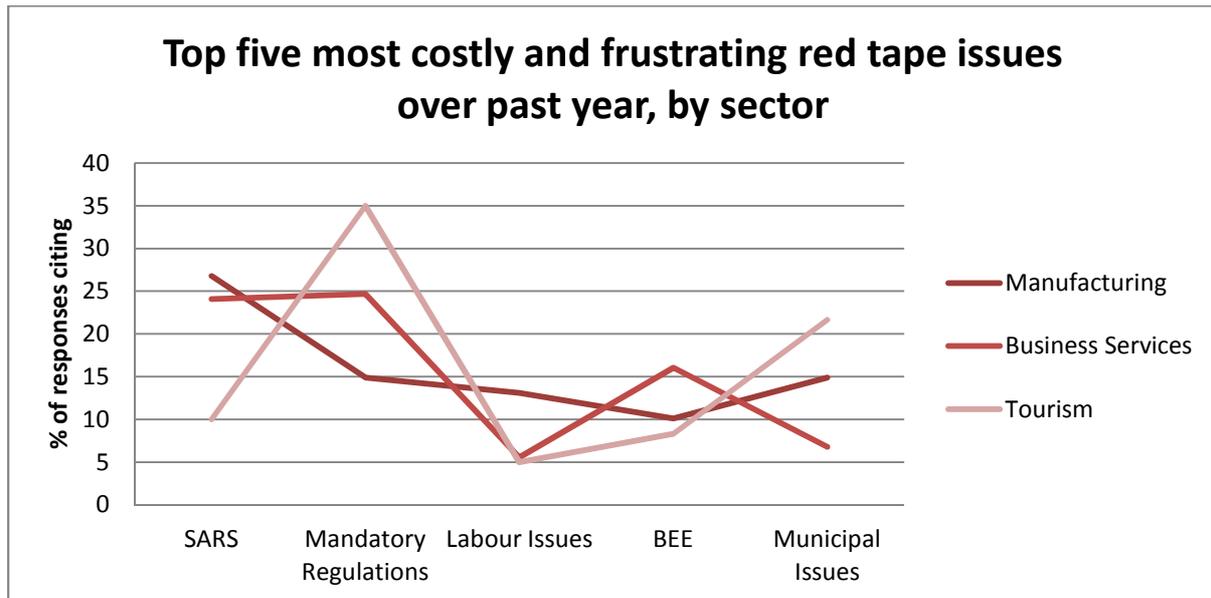
To gauge the specific concerns of SMEs in relation to the red tape burdens they confront, panellists were asked to comment the manner in which red tape was impacting on various facets of their operations.

An open-ended question was posed to the panellists, asking them to identify the most burdensome – in other words, the costliest and most frustrating red tape issues – that they have had to engage with over the past year. Each panellist could name up to three such issues.



Note: this figure records the proportion of responses; panellists may have made one, two or three responses, or may have made none.

Overall, five issues dominate the environment. These are SARS; mandatory regulations (those applicable to a particular sector, or to a particular aspect of the business); BEE; municipal issues; and labour issues. Together these accounted for over three quarters of the total number of responses, with SARS alone accounting for a quarter of the top five. Generic red tape, meaning that the entire business environment was viewed as overregulated and difficult to operate in, accounted for around 4% of the total, as did Workmen’s Compensation and the operation of the Consumer Protection Act. These three formed a second tier of visible but not particularly widespread concerns. No other accounted for as much as 3% of the total.



Note: this figure records the proportion of responses; panellists may have made one, two or three responses, or may have made none.

A wide range of concerns were raised about SARS. The panellists viewed SARS as administering a complex and constantly changing set of regulations. They also found that it was high-handed in its operations. One business services panellist commented that: “Just keeping up with them is a hassle. If they think you owe them money then they can just take it from your bank account.”

Case study 1:

A company focussed in health care evaluations for companies, with a staff complement of five people found its tax clearances expired in February 2012. In order to tender for work with institutional clients, a clearance certificate was a necessity. Attempts to obtain a new certificate from the local SARS office during 2012 proved frustrating and fruitless. The firm’s accountant made about 15 attempts to obtain one, each time costing the company some R1 000 in fees. Although the staff at SARS were polite and attempted to assist, the only document they could offer was a printout indicating that the attempt had been unsuccessful. They said that it appeared to be a “glitch” and would be remedied shortly. In the meantime, the prospect of firm failure loomed large as the means to tender for business were denied. After a lengthy period, the situation was finally resolved, after the query had apparently been escalated with intervention by a senior manager.

SARS was also not geared towards facilitating business, and addressing the needs of business taxpayers, as panellists reported that its employees were seldom able to provide satisfactory resolution of problems. A manufacturer said: “Inability to sort out queries. SARS staff are lazy and slow and inefficient.”



A significant proportion of the panel said that their primary concern with SARS was obtaining tax clearance certificates – just short of one in five responses concerning SARS *explicitly* mentioned this. “The protracted time and onerousness involved in getting tax clearance certificates”, to quote one panellist, were major frustrations. Tax clearance certificates are foundational documents for many transactions, signifying that they firm has met its obligations – or as one professional body describes it, “an essential part of certain businesses and a requirement when bidding for a tender”. One manufacturer described an experience thus: “SARS wanted information from us that was more than 12 years old – outside of prescription – they refused to give us a tax clearance without us giving them the information. We had to close production for a week to search through archives etc to find the relevant document”.

These problems were highlighted during 2012, when the revocation of a tax clearance certificate was struck down in the North Gauteng High Court, on the basis that it had been done “unlawfully” in doing so before hearing the affected person’s representations.

Case study 2:

A small business – employing four people, and with a turnover of about R2.5m a year – dealing in office supplies, conducts an estimated 30% of its business with government and other state agencies such as the IDC. To do this it requires tax clearance certificates. In March 2011, it was subjected to an audit for VAT for November and December 2010. The firm delivered the requested documents and received an acknowledgment for having done so. Two months later, in May, SARS rejected the firm’s input claims. Meanwhile, a revised demand for outstanding VAT was issued, calculated on data which excluded inputs for the relevant period. In August, the firm queried this and were told that the problem arose from the tardy capturing of the data. In other words, it was SARS’ fault, but it was unable to assist. To rectify the situation, an objection would need to be lodged – which in SARS own estimation could take months. It appeared that no one had dealt with the objection by November. Calls to the monitoring centre were unfruitful as no one was able to assist. Meanwhile the need for tax clearance certificates was becoming urgent, as the firm’s supply of them was dwindling – but according to SARS’ systems, it was unable to obtain them because they were not compliant. Eventually, the firm was able to trace the official working on the case. In February, the matter was finally resolved. The costs of this, in the estimation of the owner, came to around R50 000 in direct and opportunity costs, took around 100 hours, and involved dozens of phone calls. It also resulted in the loss of a R122 000 contract, for lack of a clearance certificate. SARS ultimately



refunded R500. The owner’s comment was that: “They (SARS) don’t care. Small business doesn’t have the resources to handle this. It needs one point of contact to solve this (sort of problem). This was not a huge problem.”

(Notably, SARS proved to be the most cited red tape concern for manufacturers, a sector more closely identified with labour matters.)

Mandatory regulations came in at around 12% of the total responses, with business services and tourism firms most affected – the former because of the extensive nature of the regulation, and the latter because of the multiple types of regulation to which they are subjected. For tourism firms, one response in three concerned mandatory regulations. Liquor licencing was the single most common issue raised, accounting for over 20% of the responses by tourism operators in this category.

Case Study 3

A firm in the manufacturing sector, employing some 125 people, is engaged in industrial minerals extraction and beneficiation. It is, on paper, exactly the sort of operation that ought to appeal to government in view its industrialisation aspirations. Yet it reports spending some 29% of its turnover on red tape. According to its Chairman, red tape costs are like breathing air: very few people are consciously aware of them. For companies involved in mining, there are two key pieces of legislation, these being the Mines Health and Safety Act and the Minerals and Petroleum Resources Development Act. These are placing a great deal of pressure on the industry, both from the point of view of the compliance they demand, and from that of implementation.

In the view of this firm, the governing legislation was introduced with little proper assessment of its consequences, and is being implemented by people with no background in or understanding of the mining industry. The latter point is arguably the more important. The use of Section 54 of the Mines Health and Safety Act to order a shut-down of production is particularly damaging. Although the power to do so serves a necessary purpose, it is being invoked out of all proportion to any benefits. Once shut down – as had happened to this firm four times over the past 3 years – it would typically take two days to a week to reopen operations. Mining inspectors approach their jobs with the mindset of “disenablers”. In one particularly petty instance, the firm’s mining operations were shut down because anti-septic cream in a first-aid box had expired. (The use of such “sledgehammer” tactics was raised by AngloGold Ashanti chairperson, Tito Mboweni, last year, when he said that they were “regulating the industry to death”.) An inspectorate with a background in the industry would



view its role as an enabling one, and would look at dealing with the problems it encountered without hamstringing the operations they were engaging with.

The approach of government more broadly is marked by hostility and various degrees of coercion, prompting the Chairman to characterise mining as a “retribution industry”. The mining industry is the only one required to submit to BEE strictures, on pain of losing licences. There is little differentiation in the treatment accorded between large and small firms (between say, a major platinum mine and a stone quarry). Requirements to consult with communities, to establish committees to enable employee involvement in the management of various aspects of the operations and so on are mandatory. This can mean that employees are absent from their work functions for days, which in turn means that costs accrue to the company. Mining executives spend as much as 40% of their time attending to regulatory matters. Larger organisations can absorb these costs, while smaller ones cannot.

The view of the firm is that while the mining industry is moving on and modernising, too much of government’s approach is weighted by ideology, and enforced by an uninformed and incapacitated bureaucracy. Mining fatalities, the Chairman pointed out, are lower than in the construction industry, which does not attract the same hostility. The upshot is that mining and mining-related work is not an attractive option. Mining products, such as talc, are more expensive to mine and sell in South Africa than they are to import. “Government has legislated the industry out of feasibility and sustainability.” Thus a potentially large generator of jobs and resources endowments worth around R3 trillion is lying fallow.

For business services, unsurprisingly, FAIS and FSB requirements accounted for the largest single group of replies in this category (around 38%), with panellists indicating that they were complex, “over regulated” and costly to comply with.

BEE concerns accounted for about 13% of the total responses. Business services found this to be the biggest problem, with 16% citing it (some 10% and 8% of manufacturing and tourism firms respectively cited BEE). The key issues raised were changes to the BEE regulations, their complexity, and to a lesser extent their rigidity. Panellists who raised BEE as a concern felt that the effort required of them, even of a purely administrative nature, was out of proportion to any benefits they would receive.



The SME Growth Index drew attention to this in its first round, noting that while a large proportion of its panel had BEE accreditation, there was extensive unhappiness about the process.

Municipal issues, at 13% of responses, attracted the same overall concern as BEE. Government has expressed concern about the underperformance of municipal governance. It should be noted that municipal government is not solely about quality of life, important though that is, but about the efficient operation of the economic infrastructure that firms have to use, typically that which they use most often. If it falters, the impact on business is likely to be immediate and profound. This impact will fall most heavily on those firms with fixed investments, and so the heightened concern of tourism operators (at 22%) and manufacturers (at 15%), against the lesser concerns of business services (7%), is to be expected.

Central in this area was the failure of municipalities to render accurate accounts or to provide reliable, cost effective services. The failure to do proper readings of firms’ utilities consumption is a big irritant. The impact has been both a direct cost burden and increased administrative demands, to the extent that some firms have hired staff specifically to deal with this, or have contracted outside consultants for the same purpose (this option is, however, unlikely to be viable for smaller or lower-turnover firms). A manufacturer remarked: “Have one staff member trying to resolve billings issues for the last 6 months. Lack of services, no water at least once a week. Regular electricity outages”.

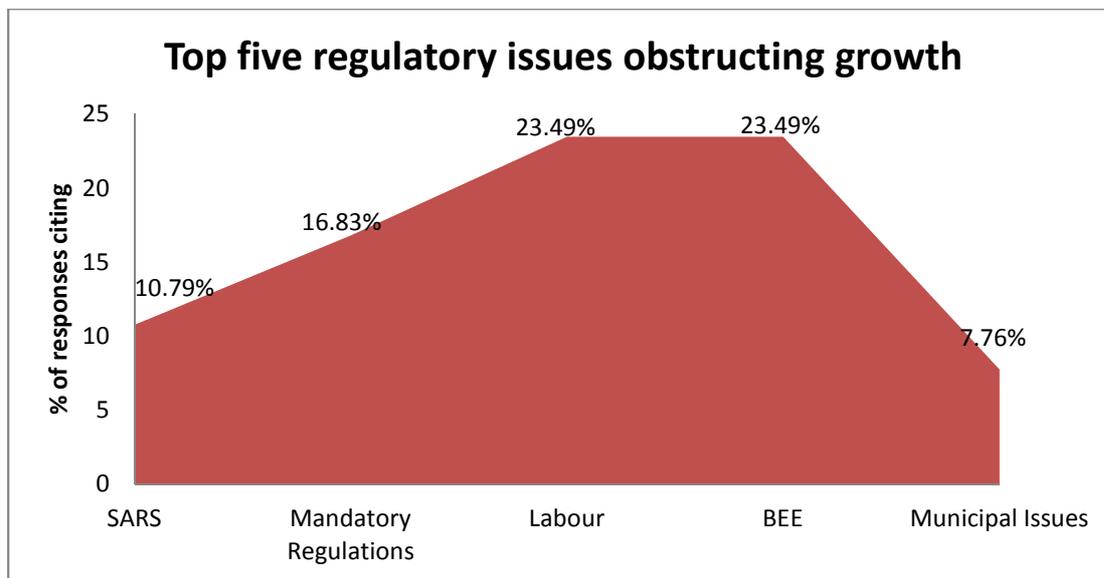
Around 11% of responses related to the labour market and its governing institutions. In this question, the labour market did not feature particularly prominently for either tourism or business services firms, with responses comprising 6% and 5% respectively. However, for manufacturers it was a significant matter, accounting for 13% of responses. These were dealt with fairly generally, but a palpable sense of dissatisfaction emerged about the perceived bias of the regime towards employees (this was notable in respect of panellists’ expressed views on the CCMA) – said one “inflexibility, firing staff and CCMA issues, collective bargaining agreements”. This was costing firms money, and also imposing opportunity costs in the time that needed to be spent on it.

Growth impact of red tape

The SME Growth Index is deliberately so named as it proceeds from the assumption that firm growth is a positive, something to be encouraged. If firms grow, the prospects exist for more profit (and therefore public revenue), more opportunities for linkages with others, and more employment. But firm growth is also a course of action that is chosen. To be successful in growth, firms must want to



do so, the opportunities to do so must be available and the environment must be conducive. This poses the question as to what might be done to create an environment for this to take place. With this in mind, an open-ended question was posed to panellists about *which aspects of the regulatory environment hampered their growth*. They could name up to three such issues.

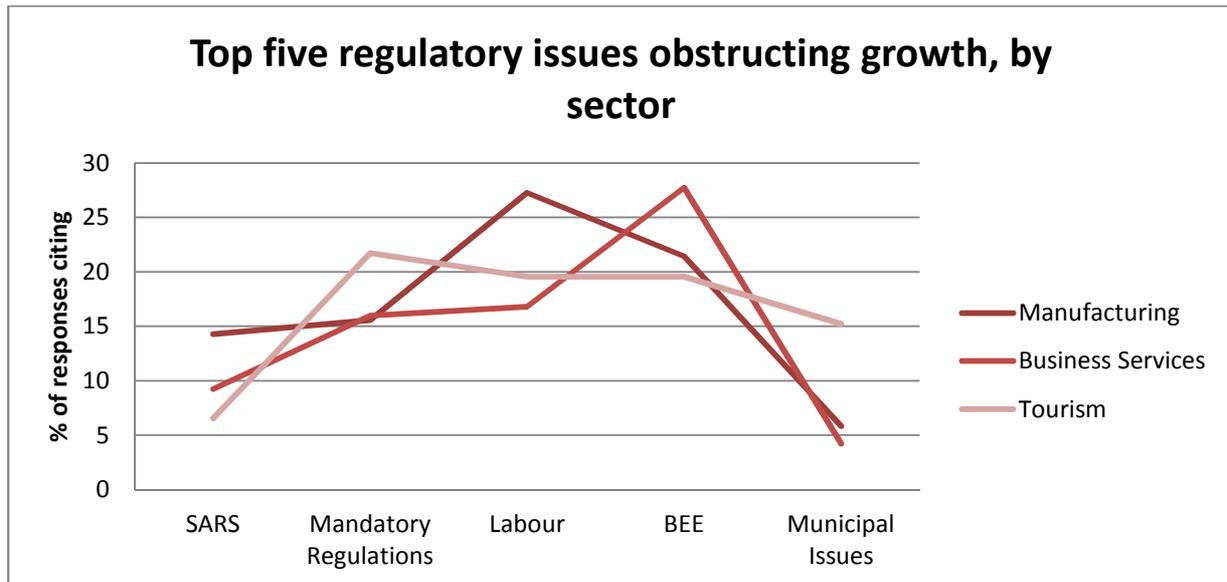


Note: This figure refers to the number of responses, and exceeds the number of panellists.

A little over 10% did not feel that regulatory matters were harming their growth. For the remainder, the frequently noted problems impacting on growth were BEE regulations; the labour regime; mandatory regulations; and SARS issues.

The two largest, BEE and labour regulations, each comprised 23% of the responses. BEE was felt to be cumbersome to administer, growing in its scope, and providing little benefit to the companies that attempted to participate; indeed, several of the panellists felt that it excluded them from business, particularly from government. It was also difficult to reconcile BEE requirements with family ownership. Labour regulations were likewise difficult to comply with and viewed as tilted towards employees. The difficulties involved in dismissing unsuitable employees was an especially problematic area – with a direct bearing on firms’ willingness to hire.

Mandatory regulations and SARS issues comprised 17% and 11% of responses respectively. These were then followed by some 8 other groups of responses, each comprising less than 10% of the total: CIPC; CPA; FAIS; loans, financing, NCR and FICA; municipal issues; tendering; regulatory uncertainty; and “other” (there were very few of this group).



Disaggregating the responses provides some insight into which regulatory areas are most keenly felt by the panellists according to their particular sectors.

Probably the most notable point is the spread of dissatisfaction with BEE. Although there is some variation, with some 28% of business services responses identifying this as a barrier as opposed to 21% of manufacturers and 20% of tourism firms, it was ranked as the first- or second-ranked barrier to growth by all sectors. BEE was identified in the 2011 as a source of deep unhappiness by the panel (interestingly, this was so across owners of all racial groups). During the course of 2012, there was much public discussion about changing the BEE codes – specifically the prospect of increasing their intrusiveness. Between the firms’ experiences and their expectations, BEE has evidently played a role in restraining SME growth.

Case study 4

A business services consultancy, dealing primarily with clients in the manufacturing and engineering industries, wished to enter into an empowerment deal. The company’s director was strongly supportive of the goals of the BEE initiative, believing that this was in the interests of the country at large and could also have benefits for the company. Three such attempts to do so have failed, imposing large costs on the firm.

The first attempt, in 2009, involved bringing on a shareholder, who brought 26% of the firm. He wished to be employed on a salary as well, but showed little interest in the operations, and used the firm’s resources to run his business interests elsewhere. After a while, the firm’s director concluded



that the arrangement was untenable, and fired him as an employee. As the relationship was breaking down, he demanded a payout with interest, so that he could divest himself of his responsibilities.

A second attempt, in 2010, involved a group of young businesspeople. They were confident that they would be able to bring business to the firm, and through commission earned on this business, would pay off the cost of buying a stake, this to take place over a two year period. However, they were, in the director’s words, “naïve” about their abilities, and were not able to bring any business – although having not taken salaries, the actual financial impact was limited. The contract was terminated before the two years were up.

The third attempt, in 2011, kicked off with a nine-month period of negotiations. The aspirant empowerment partner wanted a 50% shareholding, while the company was only offering 26%. Eventually acceding to the proposal, the company needed to buy out existing shareholders. This was profoundly alienating to people with whom the firm had established relationships. However, after the contracts were signed, it was revealed that aspirant partner did not have the funds to purchase the shares. Instead, a proposal was floated whereby a government-backed finance institution would make a loan to the company money to buy the shares. This would have entailed the director signing surety for the loan – although it appears that this arrangement was not entirely permissible, since a company may not borrow money to buy its own shares. In view of all of this, the deal came to appear increasingly unattractive. When the funds did not materialise by a specified deadline, the deal was cancelled.

Asked about current feelings towards BEE, the director said that it is not working. The broad intentions are correct, and it has considerable marketing value, but in its execution it is complex and risky. The director further stressed that in each case, all necessary care had been taken, through negotiations and due diligence studies, but these can offer only indifferent protection from the complexities of organisational and cultural change. Ultimately, it “defocussed” the company, imposing both direct and indirect costs. One example of these was that for the salary paid to the first partner, two staff members could have been engaged, servicing clients and making money. Another was that in the third attempt, the effort required to bring the prospective partner onboard resulted in a failure to look adequately for future business (indeed, it was hoped that this deal would bring new clients). The result in the latter case was that ultimately the firm had to downsize from 23 staff members to nine, and at one point serious consideration was given to liquidation. Government is felt to lack understanding of the difficulties of implementing BEE, and if amendments to the BEE codes



are implemented, this could prove a tipping point, beyond which many firms would cease trying. Firms wishing to enter into such deals should engage a professional BEE consultant, as there are “too many pitfalls”.

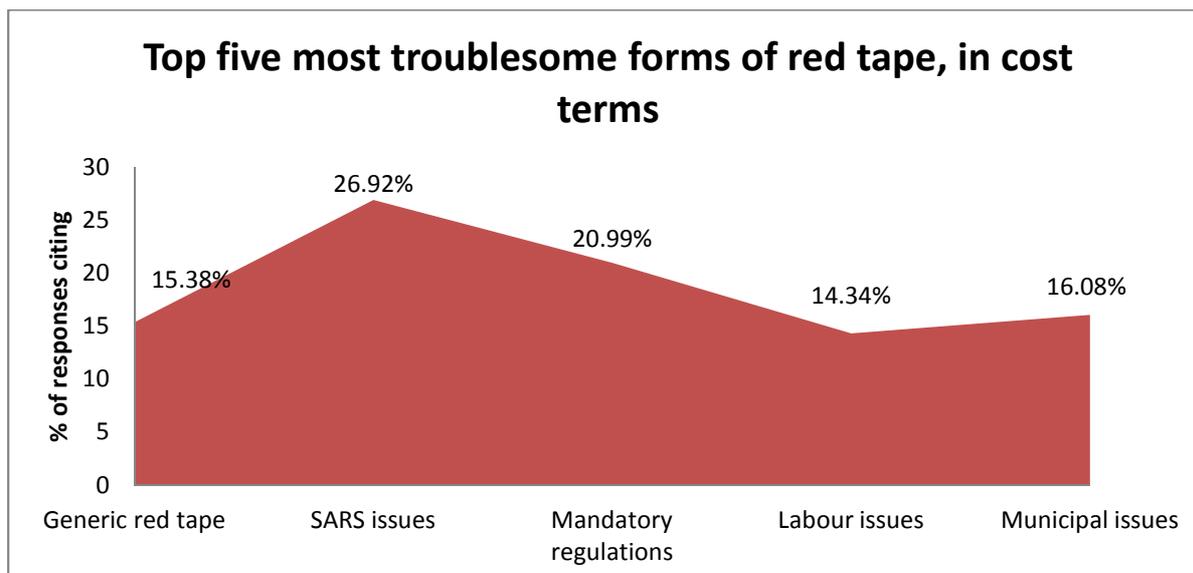
Concerns around labour issues had a similar prominence. They were the top-ranked factor for manufacturers (27% of responses), the second ranked for business services firms (17%) and were by a minute fraction in third place for business services (20%).

Mandatory regulations were most problematic for tourism operators – tourism panellists were more likely than those in other sectors to identify these as a barrier, and also ranked them more frequently than any other. This is unsurprising given the multiple requirements to which tourism operators are subjected (as discussed above).

It is perhaps surprising, given the heavily regulated nature of the sector, that mandatory regulations did not feature more prominently for business services panellists (although at 17% of responses from the sector, mandatory regulations very much in evidence, with the FAIS requirements being particularly frequently cited). This is probably explicable by factoring in the high levels of concern around BEE and labour issues. These impact in specific ways on the content of the work undertaken by business services. Business services firms need particular skills, which must often be vetted in terms of FSB regulations; these may be scarce and expensive. People unable to achieve the professional certification or render the level or competence required are protected (or at any rate perceived to be protected) by the labour regime. This imposes costs for additional training, or simply means they may not be able to serve productively. In other words, there is reason to believe that in relation to business services, specific sectoral regulation is probably described under other concepts.

How is red tape adding to costs?

Complementing what has already been presented, panellists were asked to identify areas of the regulatory environment that had been most troublesome *with a focus on the impact it was making on their expenses*. The open-ended format of the question enabled them to name as many issues as they chose – and provided a rich vein of qualitative commentary. These responses have been grouped into 14 broad groups. (These are broadly comparable, though not identical, to those in the figures above.)



Note: This figure refers to the number of responses, and exceeds the number of panellists. In classifying the panellists’ responses to the relevant question, multiple responses were frequently extracted. Panellists could therefore comment on any number of issues, and each one would be allocated to one of the categories identified here. Thus, a Panellist citing SARS issues and Municipal issues, would contribute one citation to each. However, where a Panellist discussed more than one matter germane to a single one of the categories, these were grouped together, as a single citation, for classification purposes. Thus, a Panellist who identified PAYE and VAT as troublesome would have contributed a single response to the SARS category.

Over 80% of respondents identified at least one aspect of red tape as “troublesome” in this respect, confirming the impact that red tape was having on firms’ expenditures.

Generic red tape featured relatively highly, at 15%. This indicates a significant level of concern about the environment as a whole, probably owing to continuous and multiple demands for compliance, As one panellist put it: “compliance as a whole is a huge issue – just too much”. Mandatory regulations included health and safety regulations, licencing regulations, sectoral, quality assurances, FAIS and FICA regulations and so on. In relation to both the generic and more specific types of red tape, Panellists identified not only the volume of work that this imposes on them, but also the problems of inefficient institutions tasked with processing it. For example, one panellist indicated that an error on the part of the liquor board created a problem that took over 2 years to remedy. Another felt that “dealing with all the regulations of the South African Marine Safety Authority is also onerous and frustrating, particularly as they lack industry knowledge and display an unwillingness to listen to the advice of established industry players”. One panellist said that theirs



was the only company with its particular offering and “because of this we do not get a clear guideline from the regulators as to compliance”.

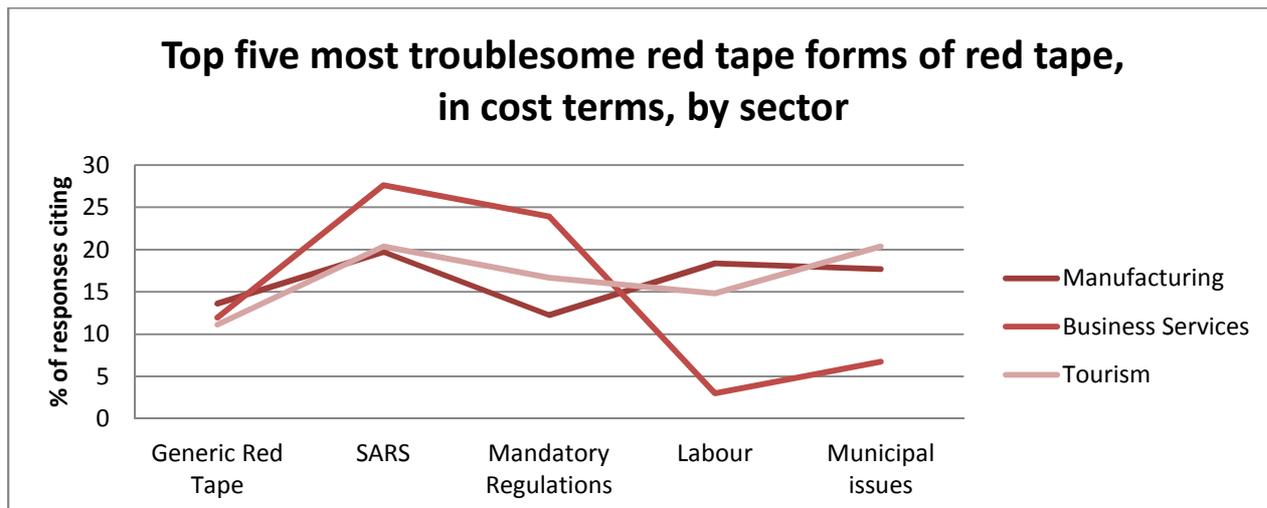
Issues relating to the South African Revenue Service were particularly common. Over a quarter of panellists expressing concerns about red tape named one or more SARS related issue, more than any other. Inefficiencies with SARS were imposing direct and opportunity costs on firms. Some reported lengthy periods of work to correct errors or deal with queries, placing a chokehold on cashflow. One panellist illustrated it thus: “SARS paperwork on us is not up to date, we have submitted the forms etc., but seems we have to do it over and over. This year they realized they hadn’t processed us 2006/7/8. I have all the docs stamped they received it but PAYE had to be resubmitted”.

Around 1 in 8 of the panellists who cited SARS as problematic explicitly mentioned problems with tax clearance certificates. It is, however, likely that a significant portion of the others experiences similar problems, but have reported as problems with the various component parts of the tax regime that feed into tax compliance, i.e. VAT, PAYE etc.

Municipal issues tended to be very broadly defined, incorporating concerns about the local regulatory environment (such as planning permission), as well as concerns about municipal accounts. Commented one: “The poor performance of local authorities. The high prices charged for rates and electricity, especially given the little returns seen in this regard.” Indeed, when asked about panellists’ concerns for future growth, municipal governance emerged as by far the most prominent concern, with 38% of the Panel citing it as their key concern.

Labour issues, at 14%, and BEE, at around 11%, tended to be commented on very generally. This suggests an overall dissatisfaction with the regimes. They were felt to be cumbersome and time consuming. In the case of labour legislation, there was evidence of frustration that the labour regime was not only difficult to operate in, but worked against the interests of employers.

Beyond these prominent issues are number of less frequently cited ones: workman’s compensation; FAIS issues; CPA; CIPC; FICA issues; Unemployment Insurance Fund; tendering issues; and Employment Equity. None of these were cited by as many as 5% of the Panel, although it is likely that in various combinations they weighed on the minds of panellists who identified generic red tape as a burden.



The figure above shows the responses categorised according to the responses predominating in the three sectors surveyed.

Unsurprisingly, the proportions identifying generic red tape as problematic were broadly comparable across sectors. Notable differences existed among most of the significant categories. Concerns about SARS were an exception of sorts. Although Business Services evidenced the greatest concern (28% of all responses from the sector, against 20% for both manufacturers and tourism firms), it was the most frequently named among all sectors, underlining the difficulties it is posing and across the SME community.

Labour issues weighed heavily on manufacturing, and to a significant extent on tourism. These sectors depend on the contribution of often unskilled workers (for this reason they are attractive to government as potential job creators). However, in the case of manufacturing, workers are often unionised, and their operations are governed by bargaining council agreements – these conditions can be onerous for SMEs. The CCMA – which the SME Growth index reported in its first round was viewed as being partial to employees – featured as a concern in several responses. Among tourism operators, the nature of their business, which often requires staff to work out of ordinary hours, and involves contract and part-time staff as part of overall staffing plans, are not congruent with labour regimes built around the assumption of permanently-employed workforces operating in standard working hours. Moreover, a labour dispute can make a crippling demand on the opportunities and resources of an establishment where the owner is also the manager.

Moreover, both manufacturing and tourism expressed particular concern about municipal governance. Given that these sectors involve fixed investments that are bound to particular local



economies, and depend on municipal performance in terms of maintaining services and infrastructure, this was to be expected. Business services firms are far less dependent on this, particularly with modern communications technology.

Business services tend to be more dependent on their human capital and their ability to manage information. As such, the “fixed” factors that manufacturing and tourism firms identified tends to rate rather lower. Neither labour nor municipal issues, for example, featured particularly highly.

Aside from concerns about SARS, mandatory regulations were most troublesome for business services firms. Given the extensive regulations to which firms dealing in finances are subject – notable FAIS – this is predictable. Business services firms also expressed considerable concern about BEE (which did not come out strongly in this inquiry), largely related to the need to gain accreditation to supply services to clients.

How is red tape unwinding?

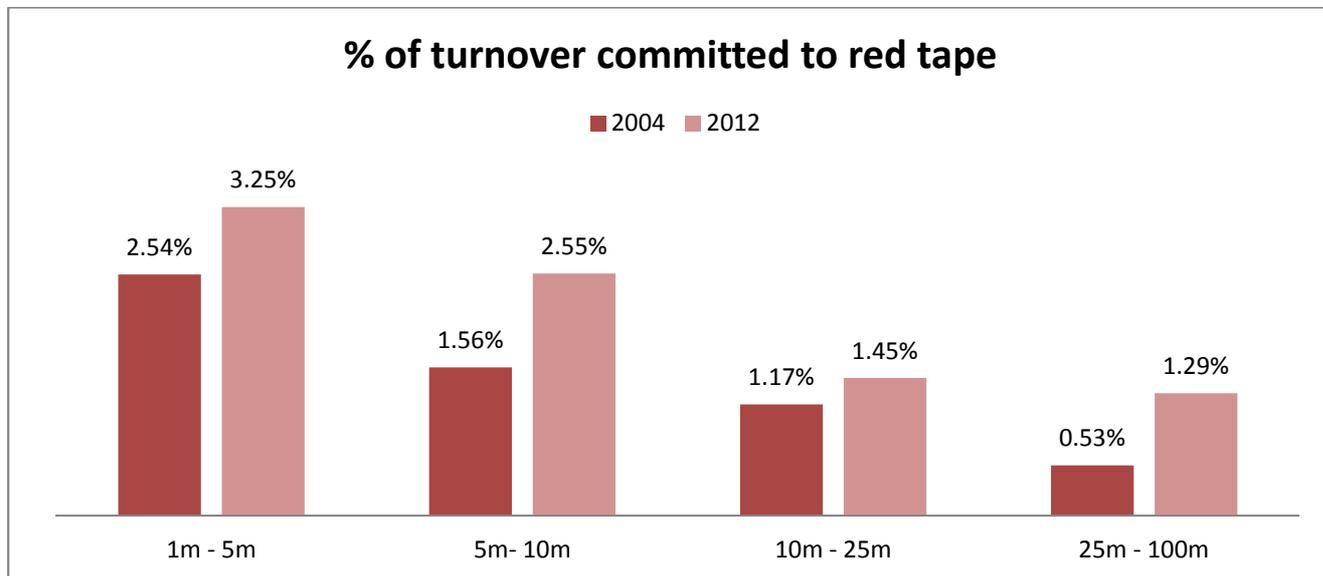
Is red tape becoming more or less of a problem? This is an important issue, since – as has been pointed out – reducing the regulatory burden has been a long-standing professed goal of government.

SBP’s study of red tape in 2004 estimated that the country was at that point spending some R79bn or 6.5% of GDP. No more recent research has been done on this matter, and it is impossible to conclude with any certainty whether or not this has changed. In the absence of any significant reform to the red tape regime, it is likely that this figure is still broadly applicable.

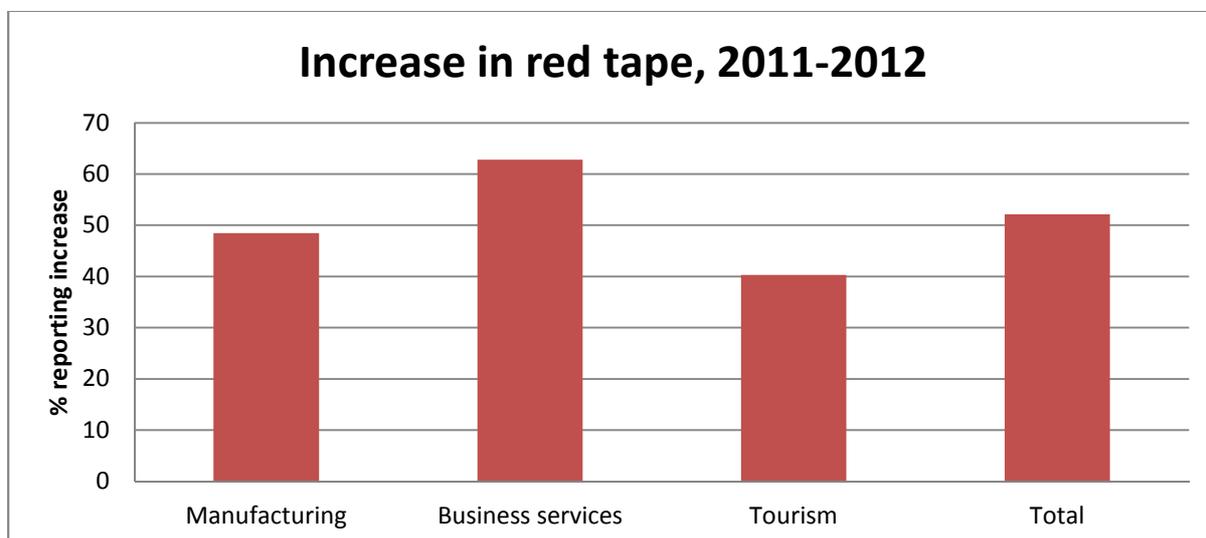
The same study put the cost of red tape at 2.8% of turnover across the South African economy. This is an aggregate figure, and incorporates firms both smaller and larger than those canvassed for the SME Growth Index. The largest firms accounted for a very large proportion of the total turnover considered, and spent significantly smaller proportions of their turnovers than their smaller counterparts. The figure of 2.8% is thus not strictly comparable to the 2012 figure of 4% for 2012 in relation to SMEs, and should be treated cautiously in inferring that the costs of red tape have risen. However, the 2004 study did agree with the SME Growth Index in the highly regressive nature of red tape.



It is possible to compare the red tape commitment by broad turnover band between the two studies (allowing for inflation). It strongly appears that the costs of red tape on the SME segment of the business has risen.

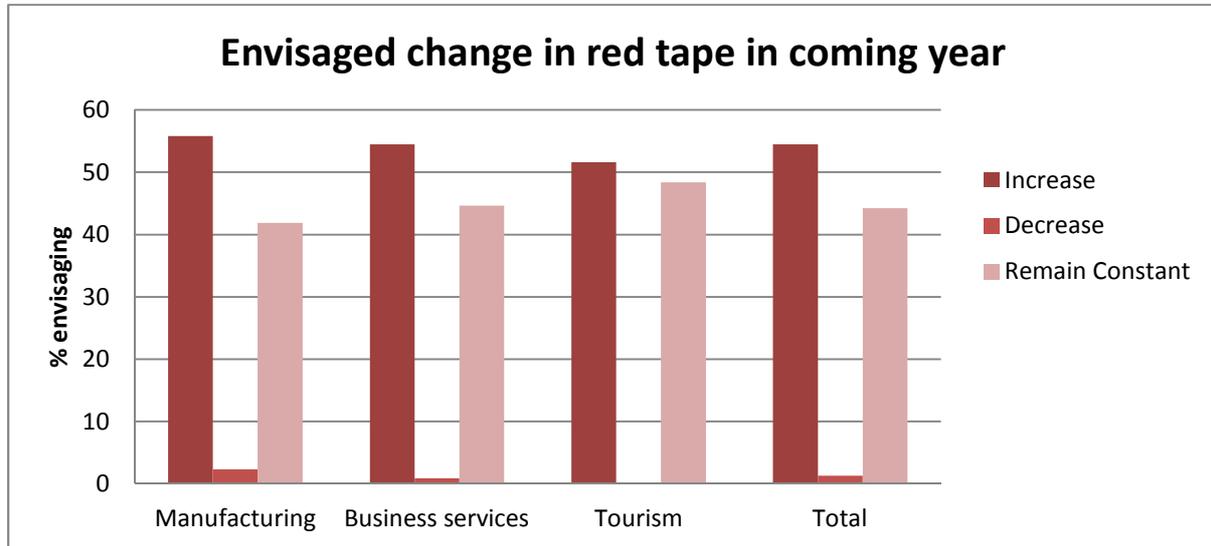


The SME Growth Index itself has highlighted some important observations and associated assumptions regarding the direction that the immediate regulatory environment was taking. In the 2012 survey, some 52% of panellists said that the official regulations that they had to comply with had increased. It was most acute among business services panellists. Tourism firms and those employing fewer than 21 people were least likely to report an increase, although this must be viewed against their already high level of exposure to red tape (certainly in relation to their expenditure). Not a single panellist in the entire sample said that there had been a decrease in red tape.

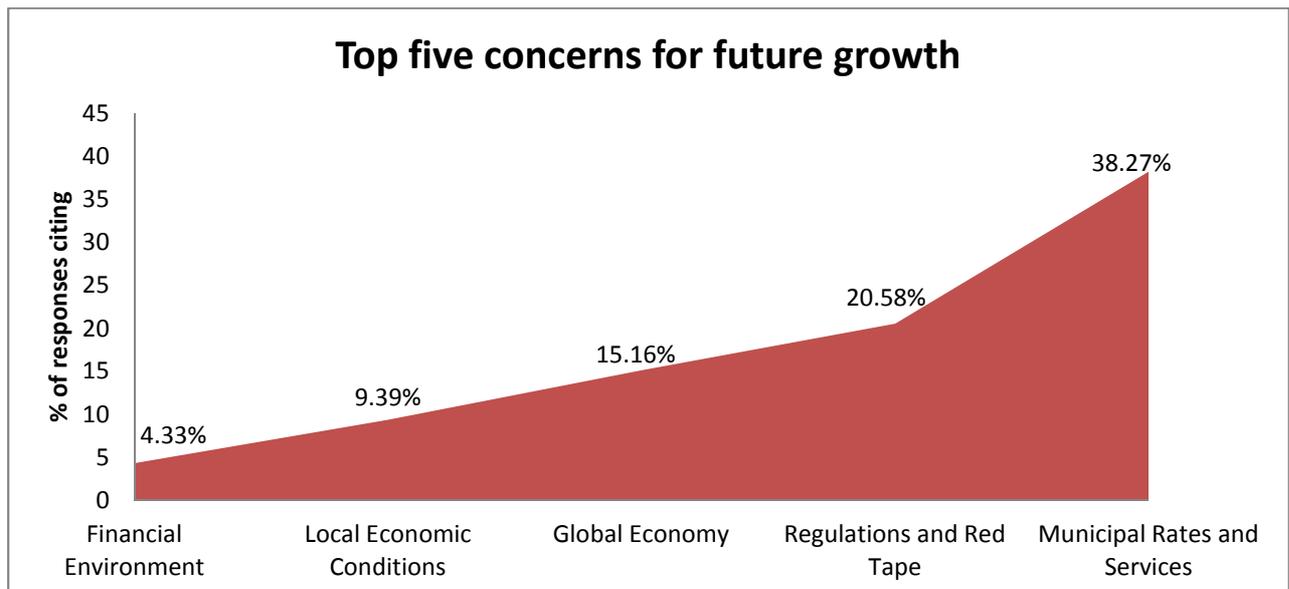




Looking forward, there is a palpable sense of pessimism. The clear expectation among the panel was for that there was no relief in sight. Some 54% believed that they would be subjected to a greater regulatory burden, while 44% believed it would remain constant. A miniscule proportion (a fraction over 1%) believed that it would decrease.



It is important to point out at this juncture that while red tape needs to be examined as a discrete factor, it operates along with all the various pressures that business. When asked to rank the factors obstructing growth – in other words, with an eye on the future – red tape featured as follows:





Red tape was the top concern for around one in five panellists. This is substantial, and illustrates that red tape is viewed as a key problem. But, illustrating that it is not the sole problem, it was outdone by municipal issues (at 38%, or close to two in five panellists). The global economy and local economic conditions accounted for 15% and 9%, or together for about one panellist in four.

Case study 4

Property developers and managers in Johannesburg have faced considerable difficulties in recent years as a result of administrative problems. This has been very publically exposed by media coverage of the city’s “billing crisis”.

Difficulties with rendering accounts in Johannesburg have been a long-standing problem. In recent years, this problem has been intimately linked to the changeover to the SAP computer revenue management system. This was accompanied, in the words of one executive, by a period of “major crisis”, during which his company repeatedly received incorrect statements or none at all. Between 2011 and 2013, the company submitted several queries. These dealt with incorrect amounts charged, missing rebates, excessive estimates, as well as the wrong tariffs levied – with, for example, residential properties charged commercial rates.

Associated with the challenges of a new system are concerns that the ability of staff to handle it has been lacking. One developer indicated that it was frustratingly difficult to get council to perform. When a problem or error arises, correcting it is a long and complicated affair. Excessive discretion, he noted, was not desirable, but it seemed that council staff were not able to negotiate processes when matters were urgent, for example, when a foreign investor needs assistance. In a similar vein, another developer described an experience in which municipal staff had, in two instances on one account, captured data incorrectly, punching in an extra zero onto the firm’s account (thereby increasing the amount owed tenfold). Although the fault originated with a council official, it became the responsibility of the property owner to resolve. The Joburg inner-city association of property owners and managing agents named JPOMA had even resorted to court action to compel the council to comply with the law in relation to terminating services. He also indicated that it was sometimes less of a problem to pay the incorrect accounts billed than to contest them, especially in the case of incorrect clearance certificates.

These problems have both direct and indirect consequences. The difficulty in establishing compliance manifests itself in problems with obtaining clearances necessary for property deals – this



imposes an effective tax on investments. There are also direct costs, such as the costs of court action cited above (costing around R1.5m). One developer indicated that his company had established a specialist unit to handle municipal matters, headed up by a chartered accountant, at considerable cost.

A further executive, heading up a firm that had previously directly been involved in property investments, reported that his firm now only invests through property funds. This allowed it to benefit from the property market, but to avoid much of the regulatory burden. However, funds tend not to invest in low income housing stock, preferring to finance shopping centres and office space. In this way, the regulatory environment undermines an important social need.

In Conclusion

Altogether the picture that emerges is that amid public rhetoric around the importance of SMEs, it is winding itself around the SME community, and is becoming a prominent element in retarding its growth to the detriment of the country and its developmental prospects.

The most obvious observation from the point of view of the SME community is that the regime is both extensive and complex. Aiming to achieve a sweep of social and economic goals, it is at present creating rather than alleviating problems.

To this must be added that there is a very definite sense that public servants lack understanding of the industries they are meant to engage with, or that they are unable to execute their responsibilities comes out in a number of responses. The prominent economist Chris Hart once phrased it memorably that “red tape must work”. This matches concerns expressed by government itself recently, notably in the National Planning Commission’s call for a “capable state”.

There are furthermore grounds to believe that the red tape burden is increasing. This is borne out in the available research. Equally important, it is reflected unambiguously in the perspectives of the panel, and its overall expectations for the future.

On the latter point, legislation emerging from the Department of Trade and Industry (with cabinet approval) posits a new regime for business regulation, along with extensive provisions for enforcement. The probability is that this will add to the burden. In a similar vein, ongoing debate



about new liquor licencing laws could see new and tougher burdens imposed on the tourism sector, interestingly further constricting an aspect of their operations that has come through clearly as a major problem.

Substantively, most problematic are overall is without doubt the tax system. This is perhaps somewhat counterintuitive, given the public image of SARS as an efficient and well-ordered institution. The experiences of the panel suggest otherwise. SARS is seen as inefficient, and largely indifferent to the legitimate concerns of businesses about its conduct.

Besides SARS, red tape concerns are centred on three other issues: mandatory regulations; labour market regulations; and municipal issues.

It is important to reiterate that red tape is not the *only* problem facing business; nor indeed is it identified as the single largest. But that it is a *key* problem is indisputable. And red tape is *uniquely* problematic in a number of ways.

Firstly, it is linked in many ways to other problems, which may not be seen as being primarily regulatory. Inefficiencies in municipal government, for example, manifest themselves not only in retarding the supply of utilities, but in throwing up obstacles to comply with necessary regulations around the sale of property or obtaining zoning permission. Thus, businesspeople probably deal with more red tape than either they realise or the SME Growth index reveals. The comment by one of the interviewees that red tape is like breathing air is apposite.

Secondly, it is a burden that in some way the country has chosen to bear. The regulatory regime is a matter of policy. This may be deliberate, in the sense that laws were consciously passed with the intention of imposing bureaucratic obstacles; or incidental, as in merely allowing legislation to accumulate with little thought of how it would interact with existing legislation, or indeed what its broad outcome would be. In South Africa, the regulatory regime is a combination of these two streams.

Since it emerges from the actions and choices of governments, red tape can be controlled, limited and streamlined. More than that, it should be understood that red tape is best tackled on a continuous basis. As systems and circumstances change, so too do the options available to make business function more efficiently. This is not a suggestion to dispense with regulation but to be prudent with it, both in terms of reaching a balanced between benefits and costs, and ensuring that



the human, organisational and financial resources are available for its efficient enforcement. As a minimal starting point, the country's red tape tangle calls out for laws to be tested through rigorous regulatory impact assessments.

In the current adverse economic environment, red tape is one brake on business that can be alleviated. Indeed, with few other options this is now a necessity.