

Legal Factors Affecting the Establishment of Township SMMEs in South Africa: Are They Killing Small Businesses?

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Abstract

Small businesses are widely considered to be valuable assets for any economy. This sector contributes up to 20 percent of the South African economy and holds the key to improving the quality of life of residents who live in informal settlements, as small businesses have the ability to create jobs. It is therefore imperative for the government to implement strategies to assist South Africa's small, medium, and micro enterprise (SMME) owners with legal processes in order to create a more enabling operating environment in townships.

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I. Introduction

The term “township” is commonly used in South Africa to describe the underdeveloped and primarily urban or designated segregated urban living areas that were established during apartheid and were reserved for nonwhites (Africans, Coloreds, and Indians) in South Africa who worked in areas that were classified as white only (Pernegger and Godehart 2007, p. 2). These underdeveloped residential areas were established close to whites-only areas in order to supply the required workforce for the white areas—without having to integrate the living areas.

Although formal segregation ended with the new democracy in 1994, many township residents and businesses are denied effective access to basic public and social services, such as running water, electricity, public transport, medical care, and education. This state of affairs created its own problems as it exacerbated unemployment, resulting in higher crime and violence in these townships. Residents living in these settlements therefore find it extremely difficult to

participate in and gain access to the opportunities available in the social and economic environments of large South African cities due to limited personal finances, inadequate education, and excessively high transportation costs (Makakane 2014, p. 7).

Roughly 40 percent of South Africa's working-age citizens live in townships, and in 2018, the official unemployment rate stood at almost 28 percent (Stats SA 2018). Many of these citizens have realized that the formal sector in South Africa cannot provide enough employment opportunities for its growing labor force. For that reason, many job seekers have sought alternative ways to generate income for themselves and their families. Also, individuals that were retrenched or did not have the skills to apply for jobs in metropolitan cities started their own small businesses in their homes to support their families. Typical examples include selling grocery items and liquor from their garage or opening a beauty salon in their living room.

With this background in mind, the definition of small, medium, and micro enterprise (SMME) and the legal requirements these businesses should comply with to run a business in South Africa are discussed below.

II. Defining an SMME and the Legal Requirements to Run a Business in South Africa

In the South African context, the SMME sector consists of “small businesses [that] range from medium-sized enterprises, such as established traditional family businesses employing over a hundred people, to informal micro-enterprises” (Bureau for Economic Research 2016, pp. 9–13). This group also includes “formally registered, informal and non-VAT registered organizations” that include township SMME business owners (Bureau for Economic Research 2016, pp. 9–13).

As is the case in most countries, business owners must comply with a number of requirements to legally run a business in South Africa. These requirements include the registration of a business at the Companies and Intellectual Property Commission, South African Revenue Services, Department of Labor, Unemployment Insurance Fund (UIF), Employee Tax, and VAT Vendor (if applicable) (CIPC, n.d.). A brief discussion on each of these requirements follows.

A. Companies and Intellectual Property Commission (CIPC)

CIPC is a representative of the Department of Trade and Industry in South Africa and was established by the Companies Act (Act No. 71 of 2008) as a juristic person to work as a vital part of the state regarding the public administration, but as an institution outside the public service. According to CIPC, the commission's functions include the maintenance and registration of companies, co-operatives, and intellectual property rights (like trademarks, patents, designs, and copyright). It also includes the promotion of compliance, as well as the effective and efficient enforcement of applicable legislation.

B. South African Revenue Services (SARS)

All businesses regardless of size are obligated by law to pay tax. It is a legal requirement that a business register with SARS within sixty days of starting to operate. Business and legal entities registered with CIPC are registered automatically, except for sole proprietors or partners who need to register directly as provisional taxpayers.

C. Department of Labor

The Department of Labor publishes legislation that regulates labor practices and activities. It bears the responsibility that businesses operate under a conducive environment and adhere to legislation. In accordance with the Compensation for Occupational Injuries and Diseases Act, it is a legal requirement for a business to register when it employs one or more full-time employees in order to safeguard the rights of employees who are injured, contract a disease, or get killed as a result of their work.

The Unemployment Insurance Fund (UIF) gives short-term relief to workers when they become unemployed or when they can't work due to maternity leave, adoption leave, or illness. Employers and employees are responsible for contributions to the UIF and registration can be done at any SARS office or online.

D. Employee Tax

Any business with staff members who earn over a minimum amount per year must register the staff members for Pay as You Earn (PAYE). PAYE refers to the tax the employer deducts from the employee's pay. Furthermore, if the business payroll is more than a set amount per month, registration for the skills development levy

(SDL) is also required. The SDL funds are used to develop and improve employees' skills.

E. VAT Vendor

If a business's projected annual sales will exceed one million rand, the business must register for value-added tax (VAT). VAT is an indirect tax on the consumption of goods and services in the economy. VAT vendor registration can be done at any SARS office.

III. Complexity of Legal Aspects When Establishing Township SMMEs

Major challenges that SMME owners require assistance with include the registration of SMMEs with relevant bodies, drawing up and understanding contracts, and learning labor laws and safety regulations. However, it is an unfortunate reality that many township SMME owners might not have the basic industry-related knowledge or even a reliable infrastructure, such as access to telephone lines or the internet, to know where to seek advice with regard to these legal processes.

Characterizing a township SMME based on whether it is a startup or already well established impacts its level of compliance with policies and legislation. This legislative approach chosen by government is creating significant challenges for SMME development because of the diverse needs and characteristics of individual small businesses, not to mention the impact of the owner's industry-related skill and knowledge levels (Wise and Chiloane-Tsoka 2015, pp. 189–98). For example, the enormity of costs and complexities associated with labor legislation compliance and the tax system has been criticized repeatedly in the SMME sector because the majority of township business owners do not have the capacity to manage this area of their business correctly.

The legal aspects of starting a small business are generally not a top priority for a township SMME owner. Most business owners become so engrossed with the daily operations of their business, including winning clients and establishing a healthy cash flow, that legal compliance is not a priority.

IV. Aim and Methodology

The primary aim of the study was to examine the perceptions of SMMEs regarding factors that may impact their establishment,

success, and functioning in the township environment in contrast to businesses in industrial areas.

The study utilized an explorative design, with data being collected by well-trained fieldworkers by means of a survey questionnaire from various SMMEs across South Africa. The statistical package SPSS was used for analyzing the data after it was captured and cleaned. According to SEDA (2019), there were 2,550,000 SMMEs in South Africa in the first quarter of 2019. A total of 498 completed questionnaires were collected, which is a 4.39 percent margin of error at a 95 percent confidence level and 50 percent response distribution.

The total sample for the study consisted of 498 respondents ($n = 498$) with the majority being African ($n = 377$; 75.7 percent). In terms of gender, 299 respondents were male (60 percent) and 185 were female (37.1 percent).

A significant number of respondents ($n = 113$; 22.7 percent) indicated that they are involved in businesses that provide services. These services include mechanical, gardening, car washing, handyman, welding, upholstery, transport, dry cleaning, bookkeeping, printing, and communications. The other major type of business that respondents highlighted was in the food industry ($n = 78$; 15.7 percent).

The average number of employees per SMME in the study was 5.5, with the lowest number of employees indicated being zero (no employees, only the owner). The SMME with the highest number of employees indicated 103 employees (see table 3). 19.3 percent ($n = 96$) and 18.5 percent ($n = 92$) of respondents indicated that they employ “friends” and “family,” respectively. Those who employed workers “other” than friends and family (35.3 percent; $n = 176$) indicated that they employ qualified staff, community members (including neighbors), people who applied for the job (applicants), and whoever they could get.

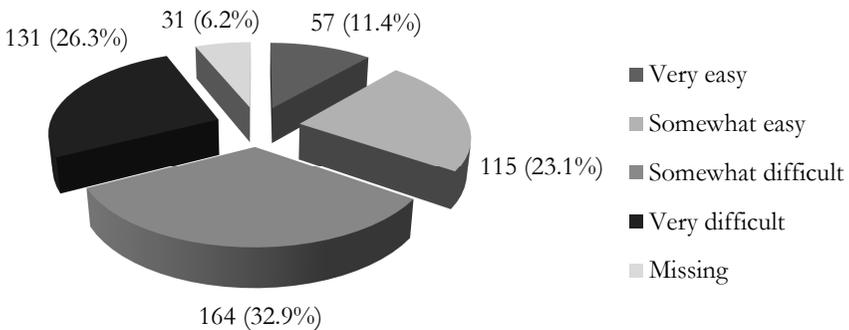
V. Findings and Results

Thematic analyses and basic descriptive statistics were utilized to identify the main themes stemming from the data, with frequencies and percentages being utilized to provide a graphic presentation of the data that served as a robust indication of the relevance or importance of the extracted themes. The results will be presented by examining the perceptions of respondents regarding the ease of legal processes to establish SMMEs.

A. Ease of Legal Processes to Establish SMMEs

To examine the perceptions of respondents regarding the ease of legal processes to establish SMMEs, respondents were required to indicate how easy or difficult the process is on a Likert scale ranging from 1 (“very easy”) to 4 (“very difficult”). Figure 1 breaks down respondents’ perceptions.

Figure 1. Ease of legal processes to establish SMMEs



The majority of respondents ($n = 164$; 32.9 percent) indicated that the legal process is somewhat difficult, with 26.3 percent ($n = 131$) of respondents indicating that the legal process is very difficult (see figure 1). In contrast, 11.4 percent ($n = 57$) and 23.1 percent ($n = 115$) of respondents indicated that they perceived the process to be “very easy” or “somewhat easy,” respectively (see figure 1). If the results are examined cumulatively, 59.2 percent ($n = 295$) of respondents found the process to be difficult, while only 24.5 percent ($n = 172$) perceived the legal process to establish an SMME as easy.

Table 1 breaks down the themes underlying the reasons put forward by respondents for indicating that the legal process was “very easy” or “somewhat easy.”

Table 1. Legal process to establish SMMEs: Easy

	<i>n</i>	Percentage
Very easy (<i>n</i> = 57)		
Assistance from government/organizations	5	8.8
Correct documentation	4	7.0
Easy access/information	3	5.3
No problems experienced	3	5.3
Simple/clear process	2	3.5
Assistance from the right people	2	3.5
Not a long process	2	3.5
Other	7	12.3
Missing	29	50.9
Somewhat easy (<i>n</i> = 115)		
Assistance from government/organizations	8	7.0
Simple/clear process	4	3.5
Assistance from the right people	4	3.5
Money/funds	3	2.6
Correct documentation	2	1.7
Follow correct procedure	2	1.7
Not a long process	2	1.7
Easy access/information	1	0.9
Other	8	7.0
Missing	82	71.3

Note: Several respondents indicated more than one element of support, thus total *n* > 498 and total percentage > 100 percent.

Respondents who indicated that the legal process to establish SMMEs is “very easy” highlighted that assistance from government or other organizations like SEDA makes the process easy (*n* = 5; 8.8 percent) and having the correct documentation or paperwork also makes the process easy (*n* = 4; 7.0 percent).

The main reason provided by respondents who indicated that the process is “somewhat easy” was assistance from government and organizations (*n* = 8; 7.0 percent). Further reasons included the

process being simple and clear ($n = 4$; 3.5 percent) and assistance from the right people making the process easier ($n = 4$; 3.5 percent).

Table 2 below shows the common reasons provided by respondents who indicated that the legal process to establish an SMME is “somewhat difficult” or “very difficult.”

Table 2. Legal process to establish SMMEs: Difficult

	<i>n</i>	Percentage
Somewhat difficult ($n = 164$)		
Lack of knowledge	27	16.5
Complicated documentation/process	20	12.2
Lack of funds	9	5.5
Long process	8	4.9
Crime/corruption	5	3.0
Lack of access in township	4	2.4
Inefficient service/support	2	1.2
Other	10	6.1
Missing	83	50.6
Very difficult ($n = 131$)		
Lack of knowledge	21	16.0
Lack of funds	11	8.4
Complicated documentation/process	10	7.6
Inefficient service/support	9	6.9
Long process	4	3.1
Lack of access in township	1	0.8
Other	14	10.7
Missing	62	47.3

Note: Several respondents indicated more than one element of support, thus total $n > 498$ and total percentage > 100 percent.

Lack of knowledge regarding the process emerged as the main theme for both groups, with 16.5 percent ($n = 27$) and 16.0 percent ($n = 21$) of respondents reporting this as a factor for the “somewhat difficult” and “very difficult” groups, respectively. Similarly, the complicated process and documentation required ($n = 20$, 12.2 percent for the “somewhat difficult” group, and $n = 10$, 7.6 percent

for the “very difficult” group) and a lack of funds to complete the process ($n = 9$, 5.5 percent for the “somewhat difficult” group and $n = 11$, 8.4 percent for the “very difficult” group) emerged as further main themes for each of the groupings (see table 2).

Further shared themes included the process taking too long ($n = 8$, 4.9 percent for the “somewhat difficult” group and $n = 4$, 3.1 percent for the “very difficult” group), inefficient service or support with the process ($n = 2$, 1.2 percent for the “somewhat difficult” group and $n = 9$, 6.9 percent for the “very difficult” group) and a lack of access to services and information in the township environment ($n = 4$, 2.4 percent for the “somewhat difficult” group and $n = 1$, 0.8 percent for the “very difficult” group) (see table 2).

VI. Discussion

From the data, it is evident that respondents perceive and experience difficulty with several factors that may impact the establishment, success, and functioning of their businesses.

The majority of participants perceive the legal process to establish an SMME as difficult, with factors such as the lack of knowledge regarding the legal process coupled with complicated documentation requirements and a lack of funds exacerbating the problem. While some respondents indicated that they found the process easy, the main theme elicited from the reasons for their responses centered on receiving assistance with the process from government or other organizations. Assistance with the legal process may thus represent a key consideration in alleviating the difficulty SMMEs experience with the legal process in establishing their businesses.

VII. Conclusion

Township SMMEs face a variety of factors that impact the business, ranging from the establishment of the business to its functioning and ultimate success. To address these factors that permeate the township business environment, greater assistance with the various processes, including the legal process to establish the business, is required, with a distinct focus on providing knowledge, information, training, and mentorship—as well as financial support and funding—to ultimately ensure that township SMMEs are not only legally established, but able to thrive.

It is recommended that an easy-to-understand pamphlet that illustrates and explains the legal process and requirements be

developed by government for distribution among SMME owners and prospective SMME owners.

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