

Impact of Municipal Regulations on SMMEs

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My government and I are aware of the many obstacles that have prevailed against small business- historical injustices with prevented the majority of South Africans from gaining access to finance and other resources, restricted their access to major markets, and indeed, prevented millions of people from becoming entrepreneurs. These practices have resulted in what is now a very distorted economy, in which so many small businesses and black businesses are confined to the margins of economic activity.

(Message from Former President Nelson Mandela, in "The President's Conference on Small Business" brochure, 1995)

Glossary

OECD	–	Organisation for Economic Co-operation and Development
SMME	–	Small, Medium and Micro Enterprise
LED	–	Local Economic Development
GEM	–	Growth Entrepreneurship Monitor
IMFO	–	The Institute of Municipal Finance Officers
MFMA	–	Municipal Finance Management Act
PPPA	–	Procurement Policy Act
SCM	–	Supply Chain Management
CFO	–	Chief Financial Officer
EDU	–	Enterprise Deregulation Unit
RR	–	Regulatory Reform
CBO	–	Congressional Budget Officer
OMB	–	Office for Management and Budget
PRA	–	Paper Reduction Act
MTEF	–	Medium Term Expenditure Framework

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Abstract

The regulatory impact of municipalities on small enterprise is inextricably linked to their developmental and service delivery roles. The ultimate impact of regulations is a function of a particular municipality's capacity to implement transformation. While uneven enforcement may be as a result of capacity constraints, municipalities may often choose to implement certain regulations selectively. This is especially true in relation to informal trading where businesses are exposed to an unpredictable environment. A general lack of information about municipal regulations and their enforcement was also discerned among the small businesses interviewed.

The four categories of micro, very small, small and medium enterprise are vastly different in terms of turnover, assets and number of employees. Regulations therefore impact very differently on each of the categories and consequently customised and targeted interventions are recommended. The most significant distinctions are as follows:

- *Micro survivalist and micro non-survivalist businesses* also classified as the informal sector. This category requires a specialised focus through **standardised regulations and transparent and predictable service delivery arrangements**. Where possible, targeted support for certain, highly viable micro businesses could **assist them in becoming formalised** and graduate to the very small status.
- *Very small businesses* are on the threshold of becoming more established, small or medium enterprises. They are already formalised which means that the initial regulatory barrier posed through licensing and zoning applications has been crossed. This category requires municipal support in the form of **business advice, training and reliable** provision of utilities.
- *Small and medium enterprises* stand to gain significantly from **effective supply chain management policies of municipalities that rely on unbundling of larger projects, capacity building of businesses and regular monitoring and evaluation of the regulatory environment**.

A range of recommendations is offered in the paper. Recommendations to enhance the municipal regulatory role include **improved consultation with local businesses regarding new and existing policies** (especially where uncertainty exists such as property rates valuation and the provision of electricity), consultation with national departments to iron out apparent contradictions between different policy objectives vis-à-vis local small

enterprise, establishment of a regulatory impact assessment (RIA) unit within the LED offices of more capacitated municipalities and launching of business incubators and empowerment zones as vehicles to ease regulatory and taxation burdens.

Even as municipalities aim to be proactive in the business promotion arena, both provincial and national departments also regard this as their core activity. Therefore, potential exists for increased co-ordination and alignment among the three spheres around business encouragement. In their support capacity, municipalities could invest in advisory centres for micro and very small businesses and facilitate technical training of business owners and employees. The administrative burden from regulatory compliance could be reduced through direct assistance in filling out forms when start-ups register for municipal services or apply for licences/permits. Business support services can be decentralised and made more accessible through one-stop shops located in disadvantaged communities and various suburbs of large towns and metros. A specialised business service and liaison function should be established in municipalities to keep them constantly abreast of, and in contact with, business needs is recommended. This would also link with the RIA unit and aid in regular monitoring of the effects of municipal regulations and policies.

Municipalities can assist SMMEs immensely through their service delivery activities primarily by maintaining the operating environment of businesses and preventing disruptions and service breakdowns. Other steps include consistency and clarity in policy implementation, focus on customer care and prompt handling of complaints to help relieve the administrative burden of following up, correct billing of accounts and investment in GIS-based IT systems to assist in the above functions. Furthermore, the deposits required for the registration of municipal services could be lowered for small and very small businesses. Municipalities could also utilise unbundling of big contracts to involve SMMEs, provide incentives to larger businesses to sub-contract to SMMEs and arrange for shorter payment cycles since SMMEs have limited access to credit and are more reliant on regular payments for their cash flow management. Stronger co-ordination between different departments of municipalities, especially between licensing authorities and business support services could benefit also small businesses.

To give effect to the above recommendations, the organisational culture of municipalities might need to transform on many accounts. Municipal departments would need to actively support the objectives of regulatory reform.

Further, more detailed research is recommended for “informal trading” and “business licensing”. Areas of enquiry for informal trading include the optimum level of regulation, extent of subsidy for provision of services and zoning/location of informal traders. Standardisation and simplification of licensing procedures requires further attention, in accordance with various business or industry sectors.

Part 1: Introduction

1.1 Background

A recent study of regulatory compliance costs conducted by SBP and funded by the United Kingdom Department for International Development states that local government regulations contribute 6 per cent to the recurring compliance costs incurred by businesses in South Africa (SBP, 2005). The figure varies for different firm sizes and can go up to 12 per cent for small and medium firms (turnover under R1m). Municipal regulations were ranked 9th in a list of the 14 “most time consuming, troublesome and costly regulations” (SBP, 2005).

Such figures should indicate that an impact assessment of municipal regulations and remedial action could generate relatively larger benefits for small businesses. However, the apparent higher ranking from smaller enterprises needs to be balanced against the meaningful proportions of smaller firms that confirmed that they were untroubled by regulations in general.¹ Such a perception among SMMEs may be linked to a laxity in enforcement of regulations by the relevant authorities, resulting in non-compliance. The threat of enforcement, however, is very real and exposes SMMEs to the whims of enforcement agencies.

Internationally, SMMEs are noted for their contribution to innovation and their ability to impact on growth. Small and medium-sized enterprises account for 60 to 70 per cent of jobs in most OECD (Organisation for Economic Co-operation and Development) countries; they also account for a disproportionately large share of new jobs (OECD, 1997). However, the OECD study notes that many start-ups do not survive for more than five years and fewer still develop into high-growth firms.

In South Africa, the small, micro and medium-sized economic (SMME) sector has been promoted since 1995 in order to meet national economic growth objectives. The Small Business Act was enacted in 1996 and subsequently institutions such as the National Small Business Council and Ntsika Enterprise Promotion Agency were established. Despite ongoing government initiatives such as the formal launching of the Small Enterprise Development Agency by the Department of Trade and Industry in 2004, the situation of

¹ As noted by Martin Nicole in his review of the Draft Research Paper: “Impact of Municipal Regulations on SMMEs” dated August 19, 2005

most SMMEs remains highly problematic and is further complicated by the existence of dual economies. It has been estimated that approximately 1 million businesses operate outside the formal economy in South Africa and about 1, 8 million people are employed in these informal businesses (SBP, 2005; Roux, T. and Klaaren, J., 2002).

Douglass North's Nobel-winning research highlights the impact of institutional infrastructure (such as the regulatory regime) on growth and development. Businesses and citizens in OECD countries have a common complaint that the amount and complexity of government formalities and paperwork generate unnecessary regulatory burdens, also known as "red tape" (OECD Observer, 2003). Such red tape has extensive costs and has been noted to impede innovation, create unnecessary barriers to investment, trade and economic efficiency and may threaten the legitimacy of regulation (OECD Observer, 2003). In recognition of the unintended outcomes of regulation, some national departments in South Africa have set up monitoring and evaluation directorates to assess the potential impact of new legislation. However, no dedicated institution exists to ensure the overall effectiveness and efficiency of regulations in South Africa (Roux and Klaaren, 2002).

This paper looks beyond regulatory compliance costs for businesses, to include a whole range of interactions between SMMEs and municipalities, including local economic development. Municipal policies regulate utility charges, procurement, land-use in the municipal area, spatial zoning and environmental standards, among others. The regulations, in turn, are based on national legislation or guidelines and may in some cases draw from best practice principles.

The contributors to this paper, AFReC (Pty) Ltd, MCA, and BEES Development Organisation bring their respective expertise to address the multifaceted nature of local government regulatory impact on SMMEs.² Considering the vast array of municipal by-laws and the myriad ways in which they can impact SMMEs, the researchers first developed an integrated conceptual framework for evaluating the regulatory impact of local government on SMMEs.

2 AFReC specialises in public finance, MCA are experts in policy and economic development and spatial planning while BEES have extensive experience in innovation, capacity building and programme management in small enterprise and local economic development.

1.2 Report Structure

The report is presented in six parts. The conceptual framework is captured in the second part of this paper and situates municipal regulations within an overarching national and provincial policy and legislative framework (see section 2.2 Overarching Legislative Framework). The conceptual framework also addresses the developmental role of municipalities as introduced in the White Paper on Local Government of 1998 and later formalised through the Municipal Systems Act of 2000 (see Section 2.3 The Developmental Role of Local Government). The umbrella term SMME in the South African context is explored as part of the conceptual framework (see Section 2.4 Unpacking SMMEs). A synthesis captures the pertinent arguments made in the different sections of the conceptual framework.

Linked to the conceptual framework but captured in a separate part is a discussion on local economic development and small businesses (see Part 3: LED and small enterprise). **The Local Economic Development (LED) strategies of municipalities have the potential to shape the business environment for SMMEs.** However, the success of LED initiatives is inextricably linked to national and provincial initiatives. Implementation of LED policies is also influenced by the financial and non-financial bylaws in place. The cumulative impact of the developmental efforts of all three spheres of government on SMMEs is presented as an integrated framework (see Figure 3.1 Integrated Regulatory Environment).

The fourth and fifth parts of this paper present the research and analysis of municipal regulations. Both financial and non-financial municipal regulations were investigated. The rationale for such an approach is offered in Section 1.3 Research Methodology. Recommendations arising from the review and analysis of policies are summarised at the end of parts four and five.

Final conclusions and recommendations are presented in part six of the paper. They draw from the analyses of both financial and non-financial policies, as well as from survey results (captured in Appendix 2). The conclusions and recommendations also link with the conceptual framework and the issues discussed under LED and SMMEs. These collaborative efforts can then be used to inform local and national government in planning and development issues. By unravelling the existing and potential impact that municipalities' mainstream activities have on SMMEs, the dynamic role that SMMEs can play in South Africa's economic development may eventually be realised.

1.3 Research Methodology

The purpose of this research is to review the impact of municipal regulation on SMMEs as well as to suggest areas where regulatory reform may be required in order to reduce the impact and the costs of compliance.

In this context, regulations may be broadly defined as rules and standards imposed and managed by municipalities to control the function and operation of business within its area of jurisdiction. Regulations include parliamentary/national legislation, rules, standards, orders and codes of practice issued by different spheres of government using powers created by legislation, rules issued by other institutions to which government has delegated relevant powers, and rules imposed on bodies by their own governance structures (self-regulation).

The activity of creating and enforcing these rules and standards is called 'regulation'. Governments regulate the activities of individual citizens, and different branches of government regulate each other. In modern states, though, most regulation is made up of the rules put in place and systems set up by governments to regulate or influence the activities of businesses.³ Over the last two decades concern over regulations has risen. Unwieldy practices in OECD countries have been noted to have direct and indirect discriminatory effects on SMMEs (OECD Observer, 2004). A study conducted by Science Technology Industry (STI) in 1999 reminds us that the balance between a regulatory environment that alleviates the compliance burden on smaller firms and achievement of valid policy objectives can be rather precarious.

While it is understood that regulations will always have a cumulative impact on businesses, for purpose of analysis, regulations have been defined under two broad categories: economic and social. Economic regulation is designed to alter the ways in which markets work. It does this by creating rules about what prices can be charged, influencing the number of firms in an industry, or trying to influence the way in which firms function (for example, by way of regulations governing company registrations or have set minimum standards). Social regulation is intended to protect public interest such as health, safety, the environment, public order, and social cohesion. Although social regulation aims to change non-economic behaviour, it often has major economic effects.

³ Regulations are made in an effort to solve social and political problems or to achieve policy objectives that unregulated markets may be unable to address (Counting the Cost of Red Tape: for business in South Africa, Strategic partners for business growth in Africa, June 2005).

Areas of research were aligned with the respective expertise of the research institutions involved in this paper with AFReC focusing primarily on the financial regulations and MCA focusing on the non-financial or planning and development regulations.

The analysis of municipal regulations includes the following:

1. Descriptions of municipal policies and regulations (pertinent legislation included)
2. Discussion on the impact of municipal policies and regulations on SMMEs in their area of jurisdiction
3. Examples of good practices drawn from actual policies
4. Recommendations for changes to the regulatory environment

It must be borne in mind that South African municipalities vary greatly in terms of reform capacity. Most policies studied as part of this research were sourced from urban municipalities, in particular metropolitan municipalities. Financial policies from low capacity municipalities (as per National Treasury definition) were in some cases difficult to access, and in others, absent. Even among the metros, a diversity of policies was identified.

While not much is known in particular of the local government regulatory impact on the SMME sector, it is assumed to influence SMMEs through multiple channels with short and medium term impacts. For instance, the SBP report (2005) has established that government regulations hinder SMME operations and their development trajectory through increased transaction costs. Other negative impacts of municipal regulation on SMMEs include white elephant projects, municipal staff with limited ability or understanding of the role of SMMEs and poverty alleviation and development.

Through their survey work, BEES investigated the most important regulatory constraints and their impact on SMMEs, with particular attention to previously disadvantaged individuals (PDIs). The survey focus was to gain the perspective of SMMEs on municipal by-laws and financial policies that impact on them. The survey also accommodates recommendations on how municipalities can improve their service delivery role. The questionnaire for survey work conducted by BEES with formal (registered) businesses and the survey results are appended to this paper (see Appendix 1: Interview Schedule and Appendix 2: Interview Results).

1.4 Survey Methodology

A study of the municipal and SMME interface was considered crucial to attain a greater understanding of what relevant information municipal officials need in order to assist SMMEs. A multidisciplinary team, comprised of SMME, LED and local government expertise, conducted research of municipal regulatory impacts through a carefully structured, purposive sample of 70 firms. A cross-section of firms was selected and analysed to cover the variation among SMMEs, with companies of varying size and a variety of operations. Interviews were conducted on a personal basis with a senior person in each firm. Such a person would generally have a significant overview of business operations. The firms selected were in metropolitan and medium sized towns.

No informal sector operators were included in the survey. An additional, different questionnaire would be required to do the informal sector justice. Moreover, most informal businesses lie outside of the regulatory net, either through non-compliance or lack of enforcement or both. Since this research paper focuses on the regulatory role of municipalities, a separate interview for informal businesses was considered beyond its scope.

Part 2: Conceptual Framework

2.1 Introduction

The problems and challenges that SMMEs face are multi-faceted and wide-ranging. Among the factors that inhibit SMME growth are inadequate business support services, inadequate access to finance and funding especially for emerging SMMEs and poor quality or absence of business premises or infrastructure (Madell and Adams, 2003). Inadequate institutional economic delivery vehicles to support and enhance SMME development particularly in poor areas have also been identified as a critical factor in addition to a restrictive legal and regulatory environment.

Local government contribution to all or some of the above factors varies considerably and may be direct or indirect. For example, municipalities are generally not in a position to advance loans to small enterprise. However, reducing some of the red tape around business licensing and registration could facilitate access to private loans for small business. Therefore, while municipal regulations are merely one of the elements that create the overall business environment for SMMEs, they may exacerbate or improve existing conditions that result from factors beyond their control.

This part of the research captures various facets of the regulatory environment for SMMEs vis-à-vis local government. Constitutional and legislative imperatives are addressed in Section 2.2 while Section 2.3 discusses the role of developmental local government. The role of municipalities as facilitators of infrastructure expansion and providers of basic services, in addition to their regulatory role, is recognised.

The umbrella term SMMEs is unpacked in Section 2.4. The objective is to better define an essential element with respect to which municipal regulations are being analysed. The process of graduation for SMMEs on a developmental continuum is also highlighted.

Finally, a synthesis of all the salient points condensed from the above discussions is presented in Section 2.5. These arguments link with the recommendations and conclusions offered in Part 6 of the paper.

2.2 Overarching Legislative Framework

The purpose of this study is to focus on the regulatory environment created through local government by-laws and policies and their impact on the establishment as well as growth of small enterprise. In the past, municipal regulations were actively used to discriminate against small black businesses.⁴ Local councils, both in urban and rural areas, promoted the interests of property owners, white farmers and white-owned big businesses. Competition from small businesses was aggressively discouraged and regulations were designed to give effect to discriminatory practices. In democratic South Africa, the local government sphere is made up of 284 municipalities, many of which result from the amalgamation of urban areas with neighbouring hinterland. As a result municipalities are saddled with outdated by-laws from previous jurisdictions. The need for substantive transformation in the local sphere was immense. The current constitutional and legal framework tries to address the need for municipalities to initiate and sustain reform in their jurisdictions.

Municipalities have a regulatory role conferred by the Constitution. In terms of the Constitution section 156(1), municipalities have the right to administer, through effective by-laws, matters listed in Part B of schedules 4 and 5 as well as those assigned to the municipality by national or provincial legislation (see annexure A). With regard to regulation, key means of exercising local government authority are defined in section 11 (3) of the Municipal Systems Act and include inter alia:

- Implementing applicable national and provincial legislation and its by-laws (MSA, section 11(3)(e));
- Imposing and recovering rates, taxes, levies, duties, service fees and surcharges on fees, including setting and implementing tariff, rates and tax and debt collection policies (MSA, section 11(3)(i));
- Promoting a safe and healthy environment (MSA, section 11(3)(l));
- Passing by-laws and taking decisions on matters listed in section 11(3) (MSA section 11(3)(m))

⁴ As noted by Martin Nicole in his review of the Draft Research Paper: "Impact of Municipal Regulations on SMMEs" dated August 19, 2005

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Municipalities thus have wide-ranging powers to administer the provisions of national and provincial government legislation as well as to regulate through their own by-laws. However, it is important to note that municipal by-laws for matters listed in Part B of schedules 4 and 5 are assigned to a municipality by national and provincial government, by agreement and subject to conditions (Constitution, 156 (4)). Therefore municipal regulations are directly or indirectly given effect through provisions of national (and in some cases provincial) legislation. For example, the section on revenue management of the Municipal Finance Management Act of 2003 governs a municipality's credit and debt control policies.

Much has been achieved in respect of the legislative framework to define the regulatory and developmental roles of local government. However, it must be noted that the implementation of a plethora of new legislation, especially from national government, has been quite onerous for municipalities.⁵ When analysing municipal regulations for this paper, the researchers have identified the complex overarching legislative framework within which municipal policies are formulated. Figure 1 represents some of the national and provincial legislation that impact municipal policies and includes municipal regulations that influence SMMEs.

⁵ Based on Martin Nicole's review of the Draft Research Paper: "Impact of Municipal Regulations on SMMEs" dated August 19, 2005

Figure 1: Overarching Legislative Framework



2.3 The Developmental Role of Local Government

Argentina, Brazil and Peru are selected due to their developing country status. Any study on regulatory best practice in the context of local government must take into account the developmental role of this sphere. This developmental role is especially relevant when regulations are being analysed in terms of SMMEs whose promotion is targeted as a key element in Government's strategy for employment creation and income generation.

Clarity on the broader policy framework surrounding the 'developmental role of municipalities' was provided by the White Paper on Local Government of 1998. The White Paper put forward four inter-related characteristics of developmental local government: maximising social development and economic growth, integrating and co-ordinating, democratising development, and leading and learning. It provides a framework within which municipalities must develop their own strategies for promoting social and economic development of communities. Developmental outcomes of local government identified in the White Paper include "the provision of household infrastructure and services; creation of liveable, integrated cities, towns and rural areas; local economic development;

and community empowerment and redistribution.” The Municipal Systems Act of 2000 (MSA) and the Municipal Planning and Performance Management Regulations of 2001, provided a comprehensive basis for the emerging system of integrated development planning proposed in the White Paper. As part of compliance with the above legislation municipalities drew up Local Economic Development Strategies and some established dedicated LED offices within their departments. More recently, as part of Project Consolidate, some municipalities have developed Service Charters. Service Charters commit them to continuous improvements in service delivery and to maintain specific service standards.

The White Paper makes reference to SMMEs when discussing how the national Department of Trade and Industry (DTI) could cooperate with local government towards achieving its developmental mandate. Business support service centres, LED pilot projects initiated by DTI or DPLG and spatial development initiatives are cited as areas where involvement of municipalities is encouraged. Most recently, the Intergovernmental Relations Framework Act (2005) provides a series of forums through which efforts of the three spheres of governments in relation to LED and business promotion may be harmonised.

In the light of renewed focus on SMMEs, the role of local government must include pro-active initiatives to promote SMME growth. This gives added merit to analysing the regulatory activities of different municipal departments in terms of whether they create a favourable business environment for SMMEs. The role of municipal LED strategies as a means of achieving such co-ordination also needs to be explored (see Section 3.3 Municipal LED and Business Support Strategies in Part 3).

2.4 Unpacking SMMEs

The National Small Business Amendment Act (NSBAA) (2004) categorises SMMEs according to the given taxonomy: micro, very small, small and medium. These categories are then linked to the sectors in which they operate such as retail, small-scale manufacturing, fishing or small-scale/backyard farming. For each sector, benchmarks are then set for each SMME category in terms of the number of employees, annual turnover and asset value.

For the purposes of this paper, we broadly adopt the legal definition of SMMEs as suggested in the NSBAA schedule (2004). Table 1 provides a summary of the NSBAA schedule⁶.

Table 1: Abridged version of NSBAA schedule (2004) in Annexure A

Type	Number of Employees (max.)	Annual Turnover (Rm) (max.)	Gross Asset Value (excl. fixed property, Rm) (max.)
Micro- Survivalist	0	Varying	0
Micro- Non Survivalist	5	0.2	0.1
Very Small	20	6	2
Small	50	32	6
Medium	200	64	23

An additional distinction appended to the NSBAA classification is that of survivalist enterprises, which would form part of the informal sector (Roux, 2002) and is a sub-component of the micro – enterprise category (Karungu et al, 2000) in terms of the NSBAA classification.

Micro- Survivalist

People who are unable to find a paid job or enter the economic sector of their choice carry out survivalist enterprises. The income generated normally fall short of the minimum income standard. An additional feature of survivalist enterprises is that they do not pay tax and are not registered as a company with reference to the applicable legislation (SAQA, 2003). The annual turnover of survivalists varies, but is below the VAT registration limit (Karungu, 2002). Survivalist enterprises typically do not employ anyone and feature significantly as enterprises in the informal sector (Roux, 2002). According to Roux (2002, p33) the defining characteristic of the informal sector is that "...it describes and encompasses value – added activity that is not recorded in official economic statistical databases"⁷. Typical examples of survivalist enterprises include hawkers, vendors and subsistence farmers (Roux, 2002).

⁶ The complete version of the NSBAA schedule is in Annexure A.

⁷ Refer to Devey et al (2004) for a good critique on the concept of an informal sector/economy.

Micro – Non-Survivalist

Micro, non-survivalist enterprises typically employ no more than 5 employees. They also form part of the informal sector, which means employment is generally without secure contract and enterprises are usually non-registered (Devey et al, 2004). According to NSBAA, annual turnover is no more than R200 000 as shown in Table 1, which is below the VAT registration value. The gross asset value of micro, non-survivalist enterprises is also no more than R100 000 as reflected in Table 1, which indicates a limited capital base.

Very Small

Very small enterprises employ no more than 20 employees, as reflected in table 1. They also operate in the formal market and have access to technology (Roux, 2002). Their annual turnover amongst the various sectors varies from R1m (Community, Social and Personal Services) to R6m (Commercial Agents and Allied Services) (NSBAA, 2004). Also, as Table 1 shows, gross asset value for small businesses can be no more than R2m.

Small

A small enterprise is a separate distinct entity, with less than 50 employees and which has a turnover of between R3m (Agriculture) and R32m (Wholesale Trade, Commercial Agents and Allied Services) (NSBAA, 2004). Small enterprises are likely to operate from business or industrial premises and generally are tax-registered and meet other formal tax registration requirements (White Paper, 1995). Small enterprises also have a managerial structure in place and there is some form of managerial level of co-ordination (Roux, 2002).

Medium

According to Table 1, medium enterprises employ up to 200 people and have an annual turnover of R64m. The gross asset value of medium enterprises varies between R3m (Catering, Accommodation and Other Trade) and R23m (Mining and Quarrying) (NSBAA, 2004). There is also further decentralisation of decision-making, a more complex management structure and increased division of labour. (Roux, 2002).

Table 2: Kind of Enterprise and Employment in South Africa (Ntsika, 1997 in Karungu et al, 2000)

Type	Number of firms	%	Number of Employees	%
Micro- Survivalist	184, 400	20	184,400	3
Micro- Non Survivalist	466, 100	51	848,549	11
Very Small	180, 000	20	1,068,431	14
Small	58, 851	7	1,225,972	17
Medium	11, 322	1	909,880	12
Large	6,017	1	3,159,931	43
Total	906, 690	100	7,397,163	100

Table 2 indicates that of the total number of firms in the country, around 900 000 fall within the SMME sector. This number represents approximately 99 per cent of all the total firms in South Africa⁸. Another interesting observation is that over 70 per cent of the total firms, are classified as micro (i.e. micro – survivalist + micro – non-survivalist), indicating the extent to which this SMME category dominates business enterprises in South Africa. Table 2 also shows that over 50 per cent of the proportion of employees occurs amongst the medium to large enterprises in South Africa. SMMEs as a category comprise 57 per cent of the total proportion of employees.

Table 2 therefore indicates that the vast majority of SMMEs are concentrated on the very lowest end. A nuanced approach for examining the SMMEs environment is perhaps justified, with micro – survivalist and non-survivalist enterprises possibly needing a different policy stance to small and medium enterprises. However, as Karungu et al (2000) contends, strategy formulation does not proceed in terms of the differences and distinctions of the SMME categories, but persists with the more generic expression of SMMEs. The White Paper on Small Business Promotion in South Africa (1995), however, stresses the need for an objective definition and classification of different types of small enterprises. The rationale being that public money should only be used for enterprises that really need it.

⁸ Although table 2 may be outdated by now, it is nevertheless quite useful for illustrative purposes. The total number of SMMEs have incidentally risen by 2002 to 1 079 627 (Roux, 2002, taken from Ntsika database), an increase of nearly 180 000 over a 5 year period.

Graduation

Central to the type of support provided to a certain category of SMME is the understanding that SMMEs have the potential to be on a developmental course. Two types of entrepreneurs are identified (see section 3.3 Issues Relating to Economic Development and SMMEs): those that are largely driven by necessity (informal/survivalist) and those that are driven by opportunity (formal). Therefore, an SMME may progress from being a micro-enterprise to a small or medium enterprise depending on various factors in its business environment including public sector regulatory practices. In fact, regulations must be assessed in terms of whether they offer disincentives to formal, entrepreneurial opportunity-driven businesses at the point of changeover from their current category of SMME to the next.

2.5 Synthesis of Conceptual Framework

The conceptual framework has outlined an array of concepts which the authors considered critical to the understanding of the problem statement. Following are the salient points that can be synthesised from the above discussions:

1. Significant strides have been made on the constitutional and legislative frameworks to effect large-scale transformation in the local government sphere. However, the policy lag between the enactment of laws and the drafting of municipal policies and the implementation lag between approval of well meaning policies and their effective implementation pose a major challenge.
2. Municipalities typically create and administer their own regulations within parameters determined by national or provincial government, or enforce regulations on behalf of other spheres.
3. The ultimate impact of regulations is a function of a particular municipality's capacity to implement reform. In addition, municipalities often choose to selectively implement certain regulations, also leading to widely varying regulatory impact.

4. Local governments have a developmental role conferred by the constitution. One of the key dimensions of that developmental role is its obligation to promote Local Economic Development (LED). Promoting SMMEs is one of the cornerstones of LED.
5. SMMEs are varied in terms of turnover, number of employees, level of formalisation and the sector in which they operate.
6. Regulation impacts on SMMEs differently and there are consequently different interventions required. The impact of municipal regulations on an individual business will vary according to its defining characteristics.

Part 3: LED and Small Enterprise

3.1 Introduction

The preceding conceptual framework introduced the developmental role of municipalities (see Section 2.3). The promotion of SMMEs was identified as a cornerstone of local economic development (LED). This part of the paper focuses on different aspects of LED with respect to the promotion of SMMEs.

LED initiatives shape the business environment for businesses in a municipality. Section 3.2 provides a theoretical background for the review of municipal LED and business support strategies. It presents the life cycle of municipal LED projects against a classical business development life cycle.

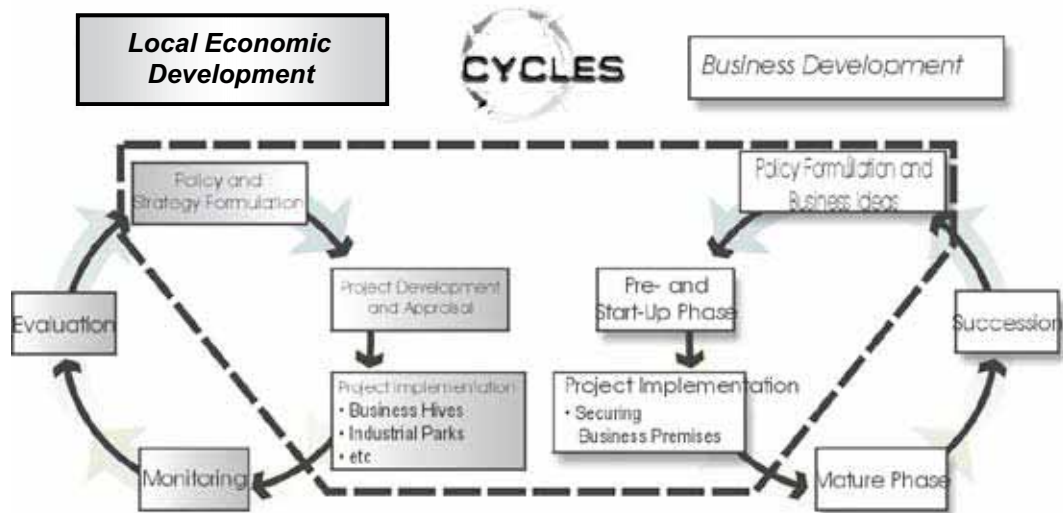
Section 3.3 lists various issues arising out of the interaction between public policy and initiatives and the varying needs of small enterprises. These issues have been identified through a literature survey of international case studies. The application of global best practices in a South African context is discussed.

Under Section 3.4, Municipal LED and Business Support Strategies of a few urban municipalities are investigated. Such strategies offer a powerful tool for reforming municipal support to SMMEs.

3.2 Economic Development and Business Cycles

This section focuses specifically on the interaction between municipal LED projects and the life cycle of SMMEs. Through a study of international experience a number of commonalities between the typical local economic development project cycle and a classic business development cycle have been identified (Madell and Adams, 2003). The following diagram captures the essence of these cycles.

Figure 2: Economic Development and Business Development Cycles



The LED project cycle represents local government initiatives undertaken to promote economic development. These may include implementation of LED strategies, physical and economic infrastructure for businesses and regulatory impact assessments. The Business Development cycle represents a typical business life cycle. Note that many survivalist businesses may never enter the mature phase.

Although local economic development processes and business cycles operate at different scales with varied implications, there are some commonalities when devising policies, strategies, programmes and projects. These phases with interactive processes are identified in Figure 2. It is critical that policy relating to LED reinforces and complements policies relating to business development. Recent policy directions have seen closer alignment. There is due emphasis on sustainable economic and business development responding to market conditions. Project development within the LED sphere, in particular within emerging areas, needs to be mindful of the needs of SMMEs during the start-up phases. For example, the need is not only for business advice and support but also for the provision of business infrastructure as this is generally inadequate in poor areas. Therefore, concurrent economic and physical infrastructure is needed both for start-ups and for businesses graduating into established, mature enterprises. One of the challenges faced by municipalities is the alignment of the LED project cycle with the business development cycle of SMMEs.

3.3 Issues Relating to Economic Development and SMMEs

This section outlines some of the key lessons derived from international findings on LED best practice. These lessons could help improve the effectiveness of LED initiatives in strengthening the SMME sector in South Africa.

Fostering Entrepreneurship

The presence of a critical mass of entrepreneurs is widely accepted as a pre-requisite for sustainable economic development. It is decidedly contestable whether entrepreneurship as a skill can be fostered in the members of a society. However, various deterrents to higher levels of entrepreneurial activity have been identified. While the Global Entrepreneurship Monitor (GEM) 2001 study identifies government regulatory burden as a major deterrent to entrepreneurs (Madell and Adams, 2003) it also highlights the need to making a distinction between business-owners within the informal and the formal sectors. Entrepreneurs in the informal sector are largely driven by necessity while those within the formal sector by opportunity. While formal businesses bear the burden of regulatory compliance, they are also more likely to benefit from targeted strategies.

Regulatory Reform⁹

Business Environment Simplification Task Force (BEST) of the European Commission (1998) made recommendations to identify administrative and regulatory barriers to an enterprise culture in Europe. BEST recommends that simplification and regulatory reform of public administration requires attention and support from the highest political level. Moreover, when the form and content of legislation (and municipal bylaws) is being determined, its impact on businesses must be factored in.

Regulatory reform needs to involve a diversity of professionals in addition to lawyers such as administrators, economists and statisticians (APEC-OECD Co-operative Initiative on Regulatory Reform, 2001). Tools identified to increase the quality of regulations include establishment of administrative simplification agencies and external committees. External committees could be established by government but include non-government representatives such as business chambers.

⁹ For more information on international and South African experience with regards to regulatory reform see Annexure B: Regulatory Reform Literature Review.

Many countries instituted regulatory review as part of regulatory reform. However, Roux and Klaaren (2002) have hypothesised that South Africa should not establish a regulatory review model along the lines of OECD countries. Reasons offered include the shortage of skilled professionals, the culture of bureaucracy and the non-readiness of South Africa's democratic institutions.

Decentralisation

There are particular market failure factors that impact on SMMEs and merit support from government because of their comparative weakness in the market and their relatively high unit cost of compliance with government regulations. A key concern of government would be in what form and through which vehicles this assistance takes place.

The trend internationally in countries such as the USA and Germany is to decentralise decision-making with regard to small business support to the local level (Madell and Adams, 2003). The knowledge of what enterprises require can be best generated at a local level. Municipalities are regarded as being closest to the community and therefore best placed to provide business support. Such support can come in the form of 'One-Stop Shops' that allow small businesses to acquire information about all administrative regulations and carry out administrative formalities. However, this does not imply that the role of central government should decline. For example, preliminary research such as this paper is best initiated at the national level as it indicates political will, and promotes comparability across municipalities.

Co-ordination of programmes/policies

The Growth Entrepreneurship Monitor (GEM) 2001 study highlights the need in countries with lower levels of entrepreneurship for government to ensure better co-ordination between programmes. At national level, Madell and Adams (2003) recommend rationalising the efforts of the departments of trade and industry and provincial and local government under a single umbrella for optimum impact on SMMEs. At local level, the interaction between national, provincial and municipal developmental initiatives could be investigated for improved alignment.

Multiple Service Providers

Gavron et al (1998) recommend that government focus should change from 'One Stop Shops' to 'First Stop Shops', which means delivering those services which are not provided elsewhere and referring businesses to the most appropriate provider whether public or

private. In the light that local authorities have limited resources, they can pursue active involvement of academic and training institutions and facilitate private-sector mentorship programmes.

World Bank's LED Primer (2003) advocates that not only business registration and taxation issues are reviewed but also how municipal staff deal with customers. The survey conducted as part of this study addresses the perceptions of business owners in how their municipality interacts with them.

Context specific solutions

Desktop based research and analysis of publicly accessible regulations and bylaws will help identify problems related to a generic understanding of the SMME sector. For example, the need to simplify and standardise procedures is a recommendation that would apply across all policies and bylaws. In practice, regulations are experienced by SMMEs in a highly specific local context. The survey conducted among business owners addresses this caveat of the research methodology by bringing in some context-specific information. The context in this case refers to a specific municipality with its peculiar socio-economic conditions as well as the services that local SMMEs could provide. Municipalities might need to conduct similar surveys in their jurisdictions in order to develop effective solutions.

Finally, the ease of entry into business in any municipality will depend upon a number of factors including access to venture capital, ease of business registration/licensing, access to economically vibrant premises and the presence of infrastructure or existing level of development in a municipal area.

Implementation Challenges

Lack of implementation remains the most glaring feature of economic projects and business development programmes in developing countries, including South Africa. In the Western Cape, it has been noted that the rate of SMME formation is very low, and that the rate of SMME failure is very high (Department of Economic Development and Tourism – Western Cape, 2004). This provides additional incentive for government to intervene and assist with SMME development through financial (loans, etc.) and non-financial (technical aid, etc.) means. A key issue has been whether government should provide finance directly or address the pathologies in the banking and financial services sector. Through the Red Door Initiative, the Western Cape provincial government has been advancing micro grants to SMMEs that meet minimum criteria.

Economic Infrastructure and Business Premises

Business incubators, industry clusters strategies and empowerment zones are among a range of strategies employed by governments to support SMMEs. Several such strategies have originated and achieved a relative degree of success in the USA. Arzeni (1998) notes that business incubators are “a popular instrument for stimulating entrepreneurship and local job creation by providing managed workspace for start-ups, pooling resources in terms of services, facilities and equipment and concentrating the supply of utilities geographically”. In the South African context, municipalities could conduct a thorough audit of existing physical utilities and economic resources before locating business incubators.

Partnerships and Outsourcing

SMMEs could benefit greatly from public private partnerships involving municipalities, academic institutions and other organs of civil society. Johnson et al (2000) identify the need for public sector agencies to become financially viable and to promote outsourcing, particularly with the implementation of new projects. In this regard, policies that guide municipal procurement of services from the private sector become relevant to this study, in terms of whether they encourage or promote SMME engagement on municipal projects.

In all likelihood, mutually beneficial partnerships could develop among different SMMEs that are providers to the same municipality. For example, EmpoweRisk is an SMME that supports public sector entities in financial, physical and operational risk management, occupational health and safety compliance as well as operational support of risk related activities. Tshwane municipality is an EmpoweRisk client and through the municipality, EmpoweRisk is supporting 20 other SMMEs in risk management and occupational safety compliance.

Monitoring of the Regulatory Environment

Ongoing evaluation of existing and new legislation and by-laws should ensure that the regulatory environment remains sensitive to the needs of enterprises. BEST recommends the establishment of organisation structures at national, provincial and municipal level such as Better Regulation Units (BRU) or Best Practice Units (BPU). Such units are recommended to ensure that the point of view of SMMEs be taken into account.

3.4 Municipal LED and Business Support Strategies

LED strategies and Business Support Policies form an essential part of the integrated business environment for SMMEs. They contribute to the cumulative impact of municipal regulations. This section discusses the defining characteristics of LED, includes a review of certain LED policies and offers recommendations.

Defining LED

The traditional responsibilities and powers of local government provide municipalities with a great deal of influence over communities' social and economic well-being. The Constitution promotes an even greater expansion of municipalities' role in the social and economic development of the people they serve (see Section 2.3 The Developmental Role of Local Government). South Africa is somewhat unique amongst other countries, in so far as local economic development (LED) is a mandatory activity within local government. In other countries, LED tends to be a voluntary activity of local government. National legislation governs local government's involvement in LED as discussed under Section 2.3.

The World Bank paper (2003) on LED accedes that LED encompasses many different disciplines, such as planning, economics and marketing. It also encompasses many local government functions including planning, infrastructure provision, real estate and finance. LED initiatives are recommended to include support for small enterprise (including informal and survivalist businesses) and encouragement of new enterprise.

LED is a holistic discipline and as such should interact with all local government strategies, policies and regulations. Appropriate structures and systems need to be in place, in order to ensure that LED informs all other municipal activities. In order to create an environment in which LED can therefore flourish, it is essential that a municipality (Mvula, 1999):

- Defines itself as an economic actor in the local economy with clout and leverage,
- Targets specific sectors for investment and economic growth,
- Ensures that the appropriate infrastructure and services are available for economic development,

- Provides support to SMMEs through capacity-building and training,
- Promotes and encourages local procurement,
- Simplifies regulations and by-laws in order to stimulate local economic development, and
- Encourages urban renewal.

Keeping in mind the above basic tenets of LED and business support activities of municipalities, a few policies relevant to the development and growth of SMMEs from specific South African municipalities are analysed.

Review and Assessment

The City of Cape Town's Business Support Policy (2003) acknowledges the importance of a supportive legal and regulatory environment that encourages the establishment and graduation of small businesses. Ease of access to this information is, however, questionable. The degree to which the Economic Development and Tourism Directorate of the City of Cape Town has managed to influence policies from other departments is not clear. On the other hand, Nelson Mandela Metropolitan Municipality gives little mention to SMMEs in its 2020 Citywide Economic Development Strategy beyond undertaking to involve this sector in the formulation of economic programmes. However, the same municipality undertakes several activities under Supply Chain Management that cater specifically for SMMEs. Clearly, there is a lack of communication across departments.

The eThekweni Informal Economy Policy acknowledges that the municipality has not been successful in engaging with street vendors and home-based workers. This is an important example of municipalities recognising the need for more effort on this front.

In an effort to provide support to local government in terms of local economic development, the Western Cape Government has started the Real Enterprise Development (RED) Initiative. The RED Door, as it is known, has been established in Cape Town, Drakenstein and the Overstrand Municipality so far. The objective of the RED Door Small Business Advice Centres is to provide support to entrepreneurs wanting to start or improve their businesses. SMMEs will be registered on the Western Cape Suppliers Database, provided with business information as well as skills development (Department of Economic Development and Tourism, 2004).

RED Door provides generic support to businesses. Proactive engagement with municipalities regarding their impact on SMMEs appears limited. Encouraging though, is that RED Door employees are willing to travel away from where the advice centres have been established. This should ensure that their services are available to emerging SMMEs over a larger area, instead of only being available to a select few in the main towns.

Recommendations

An analysis of LED strategies and of initiatives driven nationally and provincially suggests the need to improve communication at two levels. Firstly, municipal LED offices charged with achieving local economic development need to interact more closely with other municipal departments and vice versa. An LED office in isolation cannot achieve economic development, since the activities of all other departments affect the establishment, growth and graduation of SMMEs. The assessment of municipal regulatory impact on the local business environment could be incorporated as an LED office function. Recommendations based on assessment would have to be implemented across administrative departments and may face resistance from bureaucrats.

Secondly, the interface between the LED activities of municipalities and the business promotion initiatives from national and provincial departments needs to be resolved. The implementation of Municipal Business Support Strategies and Provincial Growth and Development Strategies could also achieve more if well integrated. From the perspective of an SMME, it is important that 'first stop shops' and integrated support mechanisms be employed. Emerging businesses do not have time or resources to chase different government departments and spheres. While such strategies do not regulate the business environment, they could serve as critical vehicles for addressing negative regulatory practices.

3.5 Summary

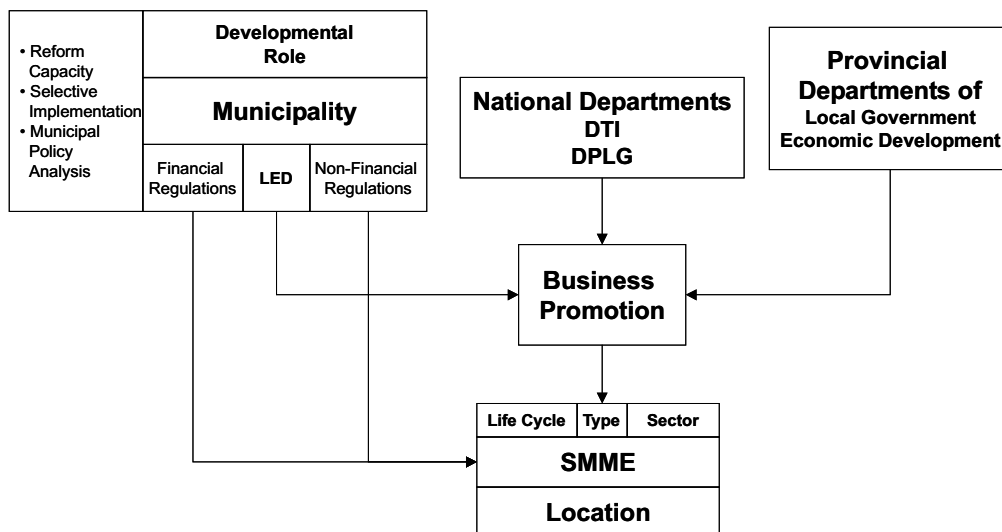
This part of the research has outlined various aspects of LED which the authors considered critical to understanding municipal regulatory impact on SMMEs. Several issues raised here relate to the conclusions and recommendations provided at the end of the paper (Part 6). Following are the salient points that can be summarised from the above discussions:

- The impact of municipal policies, LED initiatives and enforced regulations on an individual business will vary according to its stage of development.
- Strategies for promoting SMMEs must make a distinction between the needs of entrepreneurs in the formal and informal sectors.
- Regulatory reform requires the involvement of a range of professionals including administrators, lawyers, economists and statisticians.
- Certain vehicles for assisting SMMEs are best driven by national government. Others are more effective when initiated and implemented by municipalities.
- Alignment and co-ordination of developmental initiatives from different spheres of government is critical. This is especially true for emerging areas where timing can dictate success or failure.
- Municipalities can target their limited resources to core functions and involve specialised partners on programmes that assist SMMEs.
- Municipalities will need to engage actively with the SMME sector in their jurisdictions before devising context specific strategies.
- Implementation of support strategies will remain a challenge unless the impact of regulations and legislation is factored in and addressed.
- Business incubators and empowerment zones provide effective vehicles for easing regulatory and taxation burdens for SMMEs
- Municipal policies that guide procurement of services could promote SMME engagement on projects.

Impact of Municipal Regulations on SMMEs

- Legislative and operational definitions for the term LED abound. Nevertheless, initiation and implementation of successful LED projects remains problematic.
- The ability of municipalities to review their regulations and form appropriate LED strategies depends on their ability for policy analysis.
- High capacity municipalities could conduct ongoing monitoring and evaluation of their policies and by-laws. However, an organisational culture that resists change could hinder actual regulatory reform.
- While municipalities aim to be proactive in the business promotion arena, both provincial and national departments also regard this as their core activity. Figure 3 provides an overview of the challenges of co-operative service delivery in an intergovernmental configuration with constitutionally defined overlapping responsibilities.

Figure 3: Integrated Business Environment for SMMEs



In implementing its LED strategy a number of financial, planning and economic development regulations of municipalities are pertinent. Financial policies include user charges, property rates, credit control policies and the procurement policies of the municipality. These are explored in Part 4: Financial Regulations. More importantly, there are a number of non-financial regulations which impact on SMMEs. These include land use management, business licensing etc. These are discussed in Part 5: Non-financial Regulations.

Part 4: Financial Regulations

4.1 Introduction

Municipalities have a direct impact on SMMEs through their policies on property valuation, user charge collection and levies collection. Businesses bear not only the intended costs, which are the actual payments to municipalities for services, but also the unintended costs, including the time and effort required for tax administration. These costs are borne internally, by hiring a specialist who does the necessary paperwork or externally, by contracting accounting services. In either case, the red tape increases the cost of conducting business and must be minimised.

In addition to policies on the revenue side, municipalities also affect businesses through their expenditure-related policies. The municipality as a procurer of services has a direct impact on the growth of SMMEs through policies that regulate supply chain management, preferred procurement and credit control. Not all SMMEs are engaged in activities that allow them to become municipal providers. However, municipalities are major players in the local economy through their operating and capital expenditure. Therefore, an analysis of whether their policies promote or discourage SMME involvement is warranted.

4.2 Approach to Analysis

This section addresses municipal regulations that impact both on the revenue as well as expenditure side of municipal finance. The description includes references to national legislation and related documents arising out of other spheres of government, which regulate a municipal policy (for example, the Municipal Finance Management Act of 2003 regulates municipal credit control, debt collection etc). Recommendations for reform, therefore, consider the degree of freedom a municipality has over its own policies. The analysis also considers how a regulation is linked with other frameworks. For example, revenue collected through electricity surpluses impacts on tariffs charged for other municipal utilities; user charges are linked to presence of infrastructure and so on.

The most significant financial areas governed by municipal regulations that may impact on SMMEs include the following:

- Property Rates
- Levies and User Charges
- Debt Collection
- Debt and Credit Control
- Supply Chain Management

4.3 Property Rates

Property taxes or rates are charges or levies to owners of property and these charges normally relate to the fact that the property is owned, occupied, or being developed. It is important to note that the effects of property rates are both fiscal and regulatory. Fiscal effects refer to the impact that property rates have on the revenue-raising ability of government, and on the expenditure side to property owners. The rationale for the revenue-raising function of property rates is that government can charge property owners with at least the cost of providing the properties with a basket of services, such as refuse removal, electricity and water connections. In this case, it is prudent to refer to property rates rather than property taxes. If the level of rates are linked to the desire to redistribute income, then we could more readily refer to property taxes. In this paper, taxes and rates are used interchangeably.¹⁰

Regulatory effects refer to the impact that property rates have on encouraging property development by charging progressively less for developed properties and/or discouraging land speculation. It is not clear whether either of the two objectives is actually achieved. The regulatory function of property rates is also linked to social justification. Such a justification recognises government's prerogative to make the distribution of goods, services, income and wealth fairer (SBP, 2005).

¹⁰ See Annexure 1 for a further discussion on the linkage of property rates with the level of service provided to property owners.

This section includes an overview of the legislative background for the charging of property rates in South Africa. Final property rates' policies for most municipalities are currently not in place. Therefore the review and assessment section focuses on the national legislation and draft regulations in place. Property rates are a significant source of revenue for municipalities (refer Figure 4) and the debt control and collection policies of municipalities (see Section 4.6) are directed at property rates as well as user charges. Therefore, a discussion of property rates vis-à-vis their impact on SMMEs is imperative to this research.

Legislative Background

The Constitution (1996) provides the legal backing for local government to charge property taxes. According to Franzsen (1999), a property tax is a guaranteed source of revenue for local government if S 229 of the Constitution is read correctly. Additionally, provinces are prohibited from levying such a tax at provincial level, according to S 228 of the Constitution. The Act states in the preamble the need for local government to have access to a “sufficient” and “buoyant” source of revenue to fulfil its “developmental responsibilities.”

The Local Government: Municipal Property Rates Act (henceforth referred to as the PRA), No. 6 of 2004, introduces a uniform, national approach to rating property at local government level. It aims to introduce uniformity across the country concerning the assessment, charging, and collection of property rates. The Act, which is to be progressively implemented over the next five years, allows for property rating regulations to be transparent and open to public comment.¹¹

Review and Assessment

Paramount to addressing the extent of impact property rates have on SMME growth and formation, is to distinguish between the different types of firms and their respective stages in the business growth cycle (see Section 2.4 Unpacking SMMEs). Property Rates Policies of most municipalities are currently not in place.¹² We therefore analyse the existing legislation governing property rights in South Africa, including the PRA as well as the draft regulations issued by the department of provincial and local government.

11 As noted by Martin Nicole in his review of the Draft Research Paper: “Impact of Municipal Regulations on SMMEs” dated August 19, 2005

12 Draft Property Rates Policy for George was available and was referred to in this research.

During the drafting of the Municipal Property Rates Bill, there was considerable apprehension from the private sector that rates policies would lead to a reduction in investment and commercial viability in certain sectors. However, considerable care was taken to protect stakeholders that are sensitive to property rating. For example, Section 8 of the PRA determines that differential rates can be applied to certain properties, including agricultural and other business and commercial properties. Municipalities may, for example, in their rates' policies determine that properties of commercial viable sectors be charged less. This is of course subject to clauses on impermissible rates in the PRA (S 19).

While an SMME that owns property will be directly affected through actual payment of rates and transaction costs, those that rent properties are also affected. For example, the rent charged on a property is directly linked to the loan repayment on a property and the value of property rates. Therefore, even while interest rates have been coming down, rentals have been increasing as property rates, a buoyant source of municipal revenue, have been increasing.

In a hypothetical case of an entrepreneur who gains permission to start a small business from his residential property, some aspects of the PRA may be beneficial. For example, in terms of S 17(1)(h) of the PRA, the first R15000 of the market value of all residential properties and of all properties used for multiple purposes, provided one or more components of such properties are used for residential purposes, is exempt from the payment of rates. Such a provision can be highly beneficial at business formation stage when any additional funds are at a premium. Problems may be encountered once improvements are made to the property that would push the market value beyond the threshold value. Some municipalities may go beyond the minimum requirements of the PRA. For example, George Municipality sets the threshold at R40 000 in its draft Property Rates Policy (2004). The question is how heavy does the financial benefit described here weigh against any other supply side factors, such as private sector business support, access to start-up capital, etc.

Section 229 (2) of the Constitution states that “the power of a municipality to impose rates on property may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour” (Constitution, 1996). The PRA gives effect to this constitutional clause by allowing any local economic sector to complain to the Minister of Provincial and Local Government if it feels prejudiced by the municipal rates policy, but only after consulting the relevant municipality and South African Local Government Association (SALGA) (S 16 (3)). The Minister of Provincial and Local Government could intervene if he/she finds in favour of the complainant and asks the relevant municipality that a specific rate must be limited to an amount in the Rand (S 16(2-3)). These clauses will give small business, if properly organised, some form of guarantee that their case will be heard at higher levels of government.

Small-scale farmers or anyone that benefited from a land reform settlement stand to gain from the following arrangement: “A municipality may not levy a rate on a property belonging to a land reform beneficiary or his or her heir, provided that this exclusion lapses ten years from the date on which such beneficiary’s title was registered in the office of the Registrar of Deeds” (PRA: S 17(1)(g), 2004). This could prove to be a significant boost for the formation of SMMEs by land reform beneficiaries, and is not limited to agricultural practice.

Municipalities can discriminate amongst residential properties, but not between residential and non-residential properties. For example, S 19(1)(b) of the PRA allows the Minister of Provincial and Local Government, in concurrence with the Minister of Finance, to set the ratio between rates on residential properties and non-residential properties. Municipalities are therefore prevented from discriminating between residential and non-residential properties beyond the set “rates ratio limit” of 1:1 (Draft regulations: PRA, 2005).

Furthermore, although municipalities have been provided with the power to grant exemptions, rebates and reductions in terms of S 3 and S 15 of the PRA, “no municipality should grant exemptions, rebates and reductions in a manner that these are of a general application to the residential property category such that the prescribed ratio is practically rendered ineffective” (Draft regulations: PRA, 2005). Exemptions, rebates and reductions must only be granted to a specific category of owners within the residential property category as listed in S 15(2) of the PRA, such as indigent property owners and agricultural property owners who are bona fide farmers.

One avenue of further research on the impact of property rates is the case of properties used for multiple purposes. The PRA requires that the first R15 000 exclusion apply to

this particular type of property as a whole, not just the residential component of such a property, provided that one or more components of the property are used for residential purposes (Guidelines: PRA, 2005). Examples of properties used for multiple purposes are the following:

- Block of flats with businesses on the ground floor;
- Double storey building with a shop on the ground floor and the residential quarters on the top floor;
- Residential property with a spaza shop; and
- Farm that consists of the residential portion, a farm portion, factory portion and an unused land portion, etc.” (Guidelines: PRA. 2005)

On the negative side, if a small business owner or a potential market entrant has registered property with a market value higher than the threshold value described above, some clauses of the PRA may expose SMMEs to certain risks. S 27 (2) of the PRA states that a person is liable for paying rates whether or not that person has received a written account from the municipality. Here, the ‘constructive knowledge’ principle applies to rates payers, and although not an unfamiliar concept, may prove to be a source of dissatisfaction. Constructive knowledge in this regard simply means that it is expected that property owners familiarise themselves with any applicable legislation.

Section 102 of the Municipal Systems Act (Act No.32, 2000) states “that a municipality may consolidate any separate accounts of persons liable for payments to the municipality, and credit a payment by such a person against any account of that person.” A problematic situation could arise when user charges on water and electricity incurred by tenants are added to the property owner’s rate account. Small businesses renting from properties used for multiple purposes may be at risk when other tenants (residential or non-residential) run arrears, as this could result in discontinuation of municipal services.

Moreover, Section 28 of the PRA allows municipalities to recover property rates in arrears from tenants, occupiers and estate agents. The amount recoverable is limited to only the amount of rent or other money receivable by the owner. This clause may disadvantage small businesses when other tenants or the property owner run arrears.

Recommendations

The previous sections examined the basic rationale of property rates and the PRA's legislative requirements. The legislative impact of the PRA seems to be noteworthy for small and medium-sized enterprises, which are more likely to own property or rent from existing property owners. Survivalist firms most likely will not come in contact with the direct impact of property rates, as they typically operate from under-served informal settlements, or from informal marketplaces that do not fall under the direct control of local authorities, such as pavements and beaches. Property rates are invariably linked to the level of municipal services provided; therefore under-served areas are likely to not have to pay rates at all. Even if certain areas do receive municipal services, the value of the properties may most probably exempt them from rates. Survivalist firms may face secondary effects of property rates though, in that informal lease agreements may exist.

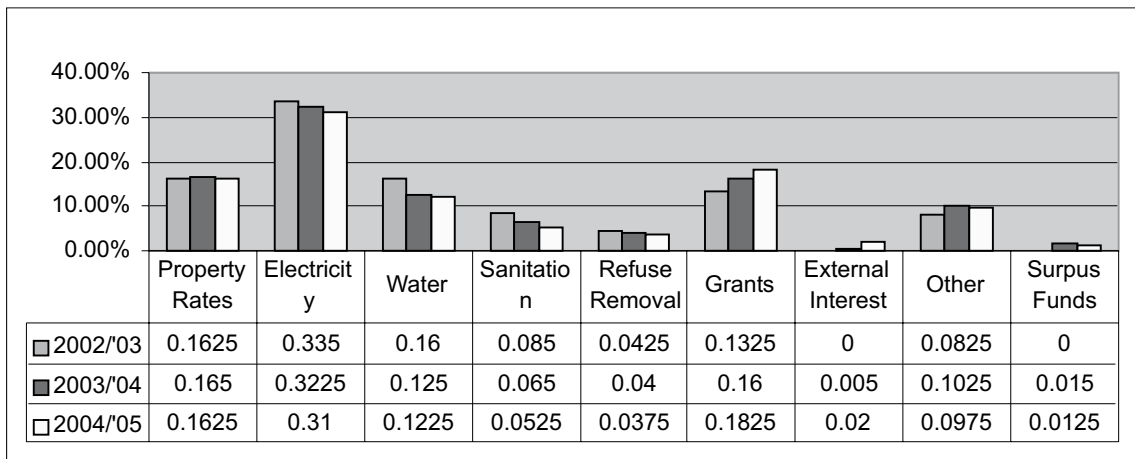
Initial research indicates that survivalist SMMEs do not identify property rates as impeding formation or growth by virtue of not being property owners. Start-up firms and individual entrepreneurs normally are also not hampered in the formation stage with the direct impact of property rates. Better-established SMMEs do, however, experience that property rates impact on their profit margins. This clearly impacts on the process of graduation of an SMME from micro to small to medium categories.

It is recommended that checks and balances that are available through the legislation be exercised. Municipalities might need to engage with SMMEs before finalising their property rates policies in order to ensure that reasonable levels of rates are put in place. In terms of potential risks from certain clauses of the Act, SMMEs might require assistance in understanding how such clauses specifically impact on them, especially if they want to formalise or grow.

4.4 Levies and User Charges

Enterprises of all sizes are directly impacted by the rates, tariffs and levies imposed by municipalities for the delivery of certain services. Due to the range of services provided by municipalities, the rates and tariffs faced by enterprises include tariffs for water, sanitation, refuse removal and electricity and regional service council (RSC) levies. Figure 4 indicates the different income categories for municipalities based on data from 6 metropolitan and 17 local municipalities. From the graph it is clear that user charges make up a significant source of revenue for municipalities and therefore have a direct impact on their financial position. Thus it is imperative to include policies that guide the levying of user charges in any discussion about the impact of local government regulation on small businesses.

Figure 4: Municipalities: Income per Category



Municipalities: = Metros (6) + group 1(Y > R500m, 3) + group 2(Y >R50m & <R500m, 8) + group 3(Y <R50m, 6)

Source: SALGA (2005) The report on the analysis of municipal budgets 2004/2005 financial year¹³

13 Information used in this report is primarily based on information contained in Appendix A Returns to National Treasury for the 2004/2005 financial year as submitted by the various Municipalities and information contained in the SALGA Report on the Analysis of Municipal Budgets for the 2003/2004 Financial Year. In this regard, it cannot be guaranteed that all the information used is accurate. Certain assumptions have been made on benchmarks believed to be appropriate for the purposes of this document. It is possible that information, which may change our interpretations contained in this report, may be missing or not accessible.

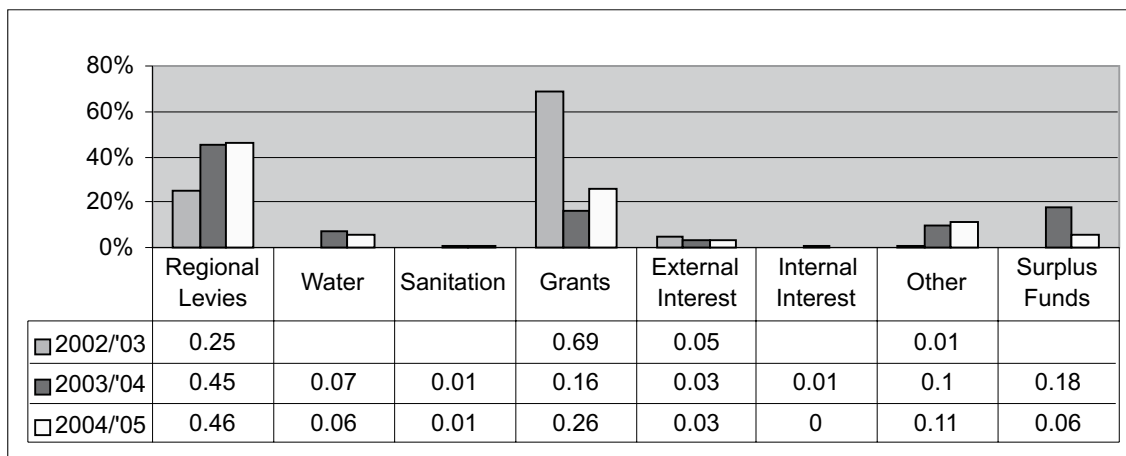
Impact of Municipal Regulations on SMMEs

This section includes a brief description of each of the various rates and tariffs imposed by municipalities followed by a qualitative discussion on how these may impact small businesses. Recommendations for improving the regulatory framework for levies and user charges are offered at the end of the section. The following discussion is pertinent for the next sections since municipal debt collection and control policies are directed at the collection of rates and user charges (see Sections 3.5 Debt Collection and 3.6 Debt and Credit Control).

RSC Levies

The Regional Services Council (RSC) levies consist of two components, a regional services levy and a regional establishment levy calculated on the payroll and turnover of businesses respectively. The RSC levy is an important source of revenue for metropolitan and district municipalities making up 9 per cent or R5.2 billion of total local government revenue in the 2003/04 municipal fiscal year (National Treasury Budget Review, 2005). Figure 4 captures the different income categories for a sample of 8 district municipalities indicating that RSC levies have been an important source of income for district municipalities who have used this to fund utility infrastructure, particularly in poor areas. Such infrastructure has benefited businesses, including small enterprises. For the medium term, however, infrastructure backlogs are to be addressed through the Municipal Infrastructure Grant, which came into effect on 1 July 2004.

Figure 5: District Municipalities: Income per Category



Source: SALGA (2005) The report on the analysis of municipal budgets 2004/2005 financial year¹⁴

Review and Assessment

The RSC levy was originally introduced to finance infrastructure development projects. The levy has been criticised for being an inefficient, inequitable and badly administered tax instrument. Neither of its components relates the tax burden to the ability to pay (Budget Review, 2005).

The impact of RSC levies on SMMEs is twofold: the financial burden of paying the levy, as well as the administrative burden of completing the required documentation. However, for most small businesses, the latter translates into an additional financial burden as they often choose to employ an outside professional to complete the required documentation. RSC levies are particularly onerous for small businesses, because they often suffer these burdens disproportionately. The growing criticism of this levy culminated in an announcement by the Minister of Finance during the 2005 budget speech that RSC levies would be abolished from 1 July 2006 and replaced with an alternative tax instrument. The National Treasury will request the Financial and Fiscal Commission to make recommendations during their 2006 submission.

¹⁴ Information used in this report is primarily based on information contained in Appendix A Returns to National Treasury for the 2004/2005 financial year as submitted by the various Municipalities and information contained in the SALGA Report on the Analysis of Municipal Budgets for the 2003/2004 Financial Year. In this regard, it cannot be guaranteed that all the information used is accurate. Certain assumptions have been made on benchmarks believed to be appropriate for the purposes of this document. It is possible that information, which may change our interpretations contained in this report, may be missing or not accessible.

Impact of Municipal Regulations on SMMEs

Of particular concern to SMMEs would be the nature of the alternative tax instrument and how that links with their ability to pay. RSC levies are essentially an “optional “ tax. SARS can audit firm’s PAYE or VAT disclosure. Municipalities have no such enforcement powers in respect of RSC levy disclosures. Uncertainty remains around what will replace RSC levies and whether the alternative will also be an “optional” tax. Currently, certain district municipalities who do not have major functions to perform also have access to RSC levies. SMMEs should be concerned about how these districts municipalities will raise their own revenue once the RSC levy is discontinued.

Electricity

The electricity sector is undergoing a major change as the Electricity Distribution Industry (EDI) Holdings (a state-owned company) amalgamate the electricity distribution assets of Eskom with those of the licensed municipal distributors. This amalgamation will result in the creation of six regional electricity distributors (REDs) across South Africa. The merger should eliminate the different tariff structures that currently exist between municipalities and Eskom. This process has encountered some difficulties since some municipalities currently make significant surpluses by purchasing electricity from Eskom and selling it to its various clients at a higher price. These surpluses are then used to subsidise other, less profitable, services. A review of Figure 3 supports the above argument since the income from sale of electricity outstrips income from sale of other services.

Although Cape Town has already launched the first RED, other issues, including the fact that participation of municipalities in the REDs is voluntary, have delayed the establishment of the other five REDs in the rest of the country.

A recent report released by the Department of Mineral and Energy Affairs¹⁵ has concluded that financial viability of the REDs requires significant price increases of around 50 per cent for domestic (conventional credit) customers, while prices to commercial, agricultural and industrial customers should generally remain at current levels (in real terms) or, in some cases, should initially decrease from the average tariffs currently charged by some municipal distributors.

¹⁵ Electricity Distribution Industry Restructuring Project, Department of Mineral and Energy Affairs, available at www.dme.gov.za

Review and Assessment

At the moment it is not clear how these changes will affect business or consumers. One clear way in which it will impact business owners is that municipalities will not be able to cross-subsidise the cost of other utilities through the surplus on electricity. Therefore, consumers, domestic as well as commercial, may witness increases to the charges for other utilities. Secondly, according to the report released by the Department of Mineral and Energy Affairs, different users of electricity will experience different impacts. It seems that formalised small businesses that have obtained the necessary licensing and are classified as commercial, industrial or agricultural consumers of energy will benefit from steady or reduced prices once the REDs have been established. However, those that operate from residential properties may experience higher tariffs. It would be necessary to investigate the rationale behind the assumption that financial viability of the REDS requires price increases for domestic users before recommending a case for SMMEs not classified as commercial, industrial or agricultural users.

There remains considerable uncertainty surrounding the entire restructuring process, with small businesses yet to see the impact of the RED on electricity tariffs. It also remains to be seen how the creation of the REDs will impact on the billing system of municipalities. Will the REDs send separate bills to electricity consumers, which may add to their administrative burden or will these bills be consolidated into municipal accounts?

Water

Cabinet recently announced the creation of a national water utility that will control all national dams and water pipelines and manage all water sales to the water boards in South Africa. Water boards were established in terms of the Water Services Act of 1997, which distinguishes between the primary and secondary activities of water boards. The primary activity of water boards is the provision of bulk water to municipalities and other bulk users. Secondary activities include the provision of water supply to consumers on behalf of poorer municipalities. Thus, the function of municipalities includes providing water to all users and developing water-services infrastructure to extend water services to rural areas and other previously disadvantaged areas. The annual setting or revision of water tariffs are based on municipal tariff policies which must comply with the Municipal Systems Act and the Water Services Act and conform to the draft water tariff guidelines provided by the Minister of Water Affairs and Forestry. Two White Papers – the Water Supply and Sanitation White Paper of 1994 and the National Water Policy White Paper of 1997 set out government's broad policy intentions with respect to the water sector.

Review and Assessment

The establishment of a national water utility does not affect the supply of water to consumers, which will remain the responsibility of municipalities. Most municipalities set their tariffs by distinguishing between different users of water in terms of consumer categories. In general the three categories used are: 'domestic', 'industrial and commercial' and 'other'. A review of Cape Town's consumptive water tariff policy reveals that domestic consumers are further distinguished between sub-categories: communal, controlled, full, unmetered and cluster. However, no such differentiation is available for industrial and commercial users indicating that no special provisions are currently made for small businesses. Current lack of focus on SMMEs in water tariff settings can be directly linked to national legislation (Water Services Act) and the two white papers. For example, the affordability and basic services provisos are accorded to poor households in urban areas and not to survivalist or micro enterprises. The manner in which a utility such as water is provided to consumers dictates that formalised SMMEs are clubbed together with large industries that operate on a completely different scale.

Recently, many parts of the country have experienced drought-like conditions, which have resulted in the imposition of water restrictions. Many municipalities have, however, granted special exemptions to water restrictions on an application only basis. These special exemptions would apply, for example, to businesses using water as a primary input into their revenue-generating activities and may add an additional administrative burden to them. Examples of such small businesses include roof cleaning services, car valet services, dry cleaners and community-centred gardening projects among others. The implications of the current arrangements for small businesses depend on where these businesses are located and the type of business an enterprise is involved in.

Recommendations

Rates and tariffs often have a disproportionately larger impact on the financial position of small businesses, because they have a smaller turnover and are less established than their larger counterparts. In addition, they have less access to cash flow financing and more volatility of sales.

Municipalities apply different tariff structures for domestic consumers of utilities and subsidise indigent users of basic services (including water, sanitation and electricity services) through their rates and tariff policies. However, the same is not applied to very small businesses, some of who may be in need of similar assistance from local governments (refer section 2.4 Unpacking SMMEs). It is clear that different categories

of SMMEs are not addressed by municipal policies governing service provision at the moment. SMMEs are not differentiated from larger industrial and commercial users and the fact that many of them operate from households is also not taken into account. Special attention to small businesses when setting tariffs could help municipalities in fulfilling their local economic development mandate. For example, attracting SMMEs through reduced user charges – coupled with other incentives – could encourage economic development in a specific area.

4.5 Debt Collection

Municipalities in South Africa are largely dependent on the collection of monies for the provision of various services to fund its developmental and service mandate (De Visser, 2001). Debt collection is, however, a sensitive matter in municipal governance with most South African municipalities having bad debt collection track records.

Review and Assessment

The City of Cape Town's Credit Control and Debt Collection Policy was approved by the City Council on the 31st of May 2005. The City charges interest on all outstanding amounts where receivers of services falls one month behind payment. Where defaulters are non-residential, debtors are required to furnish Council with the necessary financial documentation in order to negotiate settlements. In reaching such a negotiated settlement on debt, interest may be suspended by the council. An alternative method utilised by the City of Cape Town is to allocate 20 per cent to 50 per cent of the value of all units of electricity pre-purchased to the payment of municipal accounts in arrear. This is a good compromise, as municipalities must recover their costs while it allows SMMEs time to budget. The municipality may also institute reduced service levels until such time as all arrears are settled. In the event of a dispute, the administrative burden weighs heavily upon the SMMEs with considerable time and cost implications for small business owners.

The George Municipality's Draft Credit Control and Debt Collection Policy provides for the municipality to disconnect services in the event of service payments being one day overdue. This is in contradiction to the principles espoused in Section 97 of the Municipal Systems Act that states that defaulters should be allowed an extension of time for payment of services (De Visser, 2001). Where enforced, this particular clause of the George Municipality's Draft Credit Control and Debt Collection Policy could have catastrophic

consequences for small businesses experiencing initial cash flow problems. However, municipal insolvency needs to be balanced against small business support.

By the 19th of November 2003, business owed the Buffalo City Council over R52 million in arrears, having serious financial implications for the municipality's service delivery. By December of 2003 the municipality was threatening to cut services to those businesses in arrear. This crisis can be attributed to the lack of commitment on the part of municipalities to implement their credit control and debt collection policies stringently (South African Cities Network, 2003). The Buffalo City's Credit Control and Debt Control Policy, in a manner similar to other municipalities, list the various recourses that the municipality has when customers fall into arrears in the payment for services. This can, however, cause confusion since both this policy, and those of other municipalities, do not provide any indication of what sequence of events will be followed in collecting debt. It also provides no indication as to which recourse would be followed depending on the amount and time in arrears.

The Greater Tzaneen Municipality does, however, stipulate exactly what procedure will be followed in the event of customers falling into debt. This is a good practice as SMMEs will be able to plan their business cash flow while being fully aware of the consequences of non-payment. The following procedure adopted by Greater Tzaneen Municipality does not indicate the time lines associated with each event, but it is a step in the right direction:

- Issuing letter of demand
- Discontinuation of services
- Handing over to debt collectors or attorneys
- Handing over to credit bureau
- Attachment of assets

Recommendations

Municipalities need to follow specific procedures for implementing debt collection and management. The discussed policies leave the implementation of the policies to the discretion of the municipality and its council. Clear guidelines need to be developed and

disseminated to all stakeholders within the municipality in order to explain the manner in which the policy will be implemented, as well as the procedures to be followed before resorting to sale-in-execution. It is also important that such a policy be implemented consistently. Debt collection and management policies should also provide specifically for the needs of SMMEs, something currently not done in any of the debt control and management policies studied. For example, survivalist businesses with no corporate/legal status could have the owner's personal assets attached.

The increase in debt can be ascribed to a variety of reasons, chief amongst them being inaccurate billing, customer queries that aren't dealt with and where the service levels are not in line with what customers can afford (IMFO, 2003). Inadequate systems for debt management and credit control appear to be the order of the day in a number of municipalities across the country (South African Cities Network, 2005). Several IT and GIS based revenue management systems are now on the market and were exhibited at the recent IMFO Conference (15-17 August, 2005). Such systems incorporate billing systems and effective debt recovery as their core features. It would well be worth municipalities' time to survey the market for what product suits their purposes best. Several of these systems can be customised for specific municipalities and are developed and implemented by SMMEs. Municipalities could also use budget discussion forums more effectively in order to communicate debt collection policies with businesses in their areas of jurisdiction.

4.6 Debt and Credit Control

It is essential to the long-term sustainability of municipalities that all revenues due to it are collected. Appropriate credit control as well as debt collection mechanisms must therefore be developed and implemented. The Municipal Finance Management Act (S64) states that all municipalities must have an effective revenue collection system, in line with the municipal credit control and debt collection policy. Due largely to capacity and resource shortages within municipalities systems for effective implementation is often lacking. In order to attain compliance with all the relevant municipal regulations around credit control, SMMEs carry a disproportional burden. SMMEs face high compliance costs and extensive and complicated paperwork, whilst also having less managerial resources to devote to paperwork. It is often only the owner/manager who can address these issues at a great opportunity cost to the SMME (National Treasury, 2002).

Review and Assessment

Although Credit Control and Debt Collection Policies like the City of Cape Town Credit Control and Debt Collection Policy states that the policy will be implemented with “equity, fairness and consistency”, the perception amongst clients and businesses are often that this is far removed from reality. A case in point is Section 65 of the Municipal Finance Management Act (MFMA), which requires the accounting officer to ensure that the municipality make payments either electronically or by way of cheques and that payments by cash only be made for exceptional reasons. This section tends to favour businesses that are bank account holders and may create a disincentive among municipalities for doing business with certain categories of SMMEs such as very small businesses.

The Credit Control and Debt Collection Policy of the Greater Tzaneen Municipality, undertakes to provide clients with prompt billings on a monthly basis and also undertakes that meter reading will be accurate and read on a monthly basis where possible. Accurate billing and account information is an important method of motivating SMMEs to pay their accounts promptly.

The eThekweni Municipality through its Credit and Debt Collection Policy endeavours to ensure, where possible, to provide community members with paypoints for municipal fees within 10 kilometres of their residences. If this applies to SMMEs as well, it eases the pressures associated with having to spend significant amounts of time away from the emerging businesses and the costs involved with this. With more paypoints available, it furthermore means less queuing time for small business owners.

However, the administrative burden on small businesses in the registration process for services with municipalities are strenuous. The eThekweni Municipality as well as the City of Cape Town requires the following documentation for business applicants (eThekweni Municipality, 2005)(City of Cape Town, 2005):

- Certificate of business registration, with registration for municipal services not completed without either proof of registration or proof of exemption.
- Certified copy of ID
- Proof of personal surety
- Proof of ownership of property or the landlords’ consent or lease agreement.
- VAT registration number where applicable

Small businesses are also expected to pay a cash-deposit for the registration of water and electricity. There is also the threat of municipalities deciding at a latter stage of the SMME's existence that deposits paid for the connection of services were insufficient. The municipality then has the right to request that the deposit amount be increased unilaterally, and to include such an increase in the account presented to the SMME.

The George Municipality's Draft Credit Control and Debt Collection Policy stipulate that the municipality may introduce incentive schemes in order to promote prompt payment of accounts. The Draft Policy does, however, not specify what form such incentive schemes may take, beyond stating that payments may be made in the form of debit orders or stop orders. This should ease the administrative and time burden on SMMEs. However, to benefit from such an arrangement the SMME must have a bank account. So this practice does nothing for micro and very small SMMEs that operate on a strictly cash basis.

The municipality does, however, also reserve the right to increase deposits required for the registration of municipal services up to a maximum of three months of average consumption. For an SMME in its start-up phase, or a very small SMME on the threshold of graduating to small and later medium size, this is a sizable financial burden to carry. The manner in which the George Municipality determines the particular deposit required is illustrated in Table 3 and is connected with their debt collection system.

Table 3

	PAYMENT OF ARREARS
1 st default in any twelve month cycle:	25 per cent of outstanding amount plus current account. Balance over maximum of 3 months Deposit adjusted to 3 months consumption.
2 nd default in any twelve month cycle:	Full outstanding plus current account. No arrangements. Deposit adjusted to 3 months consumption.
3 rd default in any twelve month cycle:	Deposit adjusted to 3 months consumption. Weekly cash payments based on consumption plus contribution to increased deposit.

(George Municipality Draft Credit Control and Debt Collection Policy, August 2005)

Impact of Municipal Regulations on SMMEs

All of the policies studied for the purposes of this section state that persons, and therefore businesses, will only be supplied with information on the municipal credit control and debt collection policy upon request. Where persons or businesses are unaware of the existence of such policies it may have serious financial implications for SMMEs at a later stage. Greater assistance, therefore, needs to be provided for SMMEs to enable them to comply with all stipulations regarding credit control.

Recommendations

The administrative and cost burdens to register for services and to query accounts are quite considerable for small and emergent businesses. SMMEs cannot afford to appoint personnel to deal specifically with such issues; it is therefore essential that local government make compliance as standardised and simple as possible. By rigidly applying the procedures for registration, it provides obstacles in the movement of informal businesses to formalisation. The policy environment can therefore inhibit the formation of new SMMEs and their graduation. Ensuring compliance with all applicable stipulations of the policy can be a tremendously lengthy and onerous process (eThekweni Municipality, 2005). Municipalities need to be more proactive and assist SMMEs in firstly understanding municipal debt and credit control policies and thereafter, complying with them.

With regards to the minimum deposit required, municipalities could determine such amounts with respect to the ability of an SMME to pay, giving special consideration to start-ups as well as the financial status of the business-owner vis-à-vis the indigent status criteria.

It was observed that very few municipalities discuss payments to their creditors (service providers which could be SMMEs) in their credit control policies. Therefore, this issue is discussed under preferential procurement in the next section.

4.7 Supply Chain Management

S217 of the Constitution (1994) states “When an organ of the state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.” This section of the constitution allows for promotion of affirmative procurement practises that would give greater economic participation and empowerment to previously disadvantaged groups. The new procurement provisions in the MFMA (2003), Preferential Procurement Policy Act (2000) and the National Treasury regulations, intend to give substance to S 217 of the constitution with also a view to support Small, Medium and Micro Enterprises (SMMEs) especially through government procurement practises. However, does The Municipal Supply Chain Management (SCM) regulation (2005) (henceforth referred to as SCM regulation) and in particular, SCM policies of municipalities achieve this objective? A study of the municipal regulatory framework, with specific reference to SCM and the reviewing of five municipal policies indicate mixed results.

Regulatory Best Practise

There are always unintended costs and spin-offs to complying with regulation. Compliance costs are generally felt disproportionately more by small businesses (South African Foundation, 2003). Regulatory Best Practise (RBP) is an approach, which aims to minimise compliance costs (red tape), and administrative burden facing government agencies. From a RBP perspective, government should ensure obstacles such as business registration process, contract enforcement, tax and customs compliance are as simple as possible (SBP, 2003). Whether procurement practises of municipalities actually reduce transactions cost despite the stated intention to promote SMMEs requires careful scrutiny.

SCM Regulations

The SCM regulation has an interesting approach to encouraging SMME participation. Demand and supply measures are both utilised. For example on the demand side, municipalities are encouraged to procure goods and services from businesses in the local area before considering procurement from outside the municipal boundaries. On the supply side, municipalities must ensure that their supplier database of accredited service providers include small business participation. The SCM regulation ties small business

development with preferential procurement in a very strong way. This linkage is also emphasised in the White Paper on Local government (1998), which states that municipal purchasing should give preference to local suppliers and small enterprises, especially in the informal sector. It goes further by saying that procurement procedures should also be affirmative.

Preferential Procurement

The Preferential Procurement Policy Act that was introduced in 2000 requires each municipality to draft a preferential procurement policy. The policy must be implemented with a framework that follows a preference point system. The PPPA (2000) states that preferential points must be allocated to all tenders of PDI that comply with the specifications and conditions set out in the tender documents. Additionally the Black Economic Empowerment Act suggests that at least 50 per cent of state owned enterprises and government procurement should go to black companies and collective enterprises, and that 30 per cent of these enterprises should be SMMEs (Hugo et al, 2004). The preference point system is set out in Table 4.

Table 4

Preferential Point System: 80/20	Preferential Point System: 90/10
$P_s = 80 \left(1 - \frac{P_t - P_{\min}}{P_{\min}} \right)$	$P_s = 90 \left(1 - \frac{P_t - P_{\min}}{P_{\min}} \right)$
Ps = points scored for price of tender under consideration	Ps = points scored for price of tender under consideration
Pt = rand value of tender under consideration	Pt = rand value of tender under consideration
Pmin = rand value of lowest acceptable tender	Pmin = rand value of lowest acceptable tender

There are two categories of preference as indicated in Table 4. The 80:20 and 90:10 systems. The 80:20 system and 90:10 system implies that a maximum of 80 or 90 points are awarded to the tenderer who tenders the lowest price and proportionately fewer points awarded to those with higher prices. Either 20 or 10 points are then available for HDI equity ownership or other specific developmental goals (e.g. labour content, SMME status etc) specified in the respective municipal policies. The SCM regulation stipulates the usage of the 90:10 system in respect of procurement above R500 000 and the 80:20 system with contracts of a rand value up to R500 000. The immediate implication is

support for preferential procurement tends to be more emphasized with contracts with a rand value of less than R500 000.

Review and Assessment

Municipal policies generally abide by these regulatory stipulations, however, some variations were also observed. For example, George municipality apply the 80:20 principle for tenders and quotations with an estimated value between R6000 and R1 million and the 90:10 system for procurement contracts above R1 million. The municipalities surveyed, tended to comply broadly with the Procurement Policy Act (PPPA). In some cases such as Cape Town and Nelson Mandela municipalities, contracts were divided into various categories according to its rand value and preferential procurement goals would be specified for each of the categories. Another interesting observation with some municipalities is the HDI status of businesses in terms of its equity ownership are enumerated and categorised, with this being linked to preferential procurement goals, which is also in line with the Broad-Based Black Economic Empowerment Act. So for example, eThekweni awards preference points to businesses according to the level of equity ownership and SMME status, and the weightings may change according to the contract type. The evidence suggests that the larger municipalities such as Cape Town, eThekweni and Nelson Mandela have a better understanding of the way in which preferential procurement and SMME should be integrated. By identifying various segments of equity ownership and project categories, the larger municipalities acknowledge a differentiated approach to be the most suited for preferential procurement.

Payment Cycle

Small businesses have tight cash flow constraints therefore previous procurement practises of municipalities placed small businesses under strain with regular late payments for goods or services procured. The new Supply Chain Management (SCM) regulation requires municipalities to pay for goods and services within a month of being invoiced. No specific arrangement is made for SMMEs in this regard except a proviso, which states that if the Accounting Officer in consultation with the Chief Financial Officer (CFO) believes financial hardship will ensue, earlier payments can be made to the supplier. This is a general condition and would thus apply to all suppliers.

Review and Assessment

Some municipal policies (Umlalazi and George) make no specific mention of their municipality's payment cycle. There is thus no firm way to establish on what basis payment to suppliers will take place. To various degrees, the larger municipalities all link payment cycle arrangement with support for SMMEs. Nelson Mandela municipality meets the minimum regulatory requirements of a 30-day payment cycle, but goes further to state that payment will be made with minimum delay particularly for emerging contractors. Cape Town and eThekweni both go beyond the regulatory requirements by adopting reduced payment cycles (i.e. less than 30 days) to assist emerging contractors/suppliers, with eThekweni adopting a payment cycle of 14 days for the small and micro categories of SMMEs.¹⁶ To allow entry for small contractors, the large municipalities accept to incur the indirect project costs (such as sureties), which would otherwise be attributed to the small contractor. For example, Nelson Mandela municipality waves the security on small contracts (estimated at R120 000 or less) by underwriting the risk associated with the project.

Supplier Database

The SCM regulation requires each municipality to have a supplier database with a list of accredited prospective service providers. This list needs to be quarterly updated and once a year prospective providers need to be invited (via newspapers etc) to apply for evaluation and listing as service providers (AFReC notes/ National Treasury SCM regulation). The SCM regulation does not explicitly encourage SMME participation on this list of service providers, but what it does attempt to do is encourage competition amongst providers and promote the objectives of the BEE Act.

Review and Assessment

All the policies examined appear to meet the regulatory requirements of establishing a supplier database and linking it to BEE objectives. To various degrees, a linkage is also made to encourage local SMME participation. The requirement for being registered on the database is inter alia a tax clearance certificate issued by the South African Revenue Services and proof that all municipal rates and service charges have been paid. This information also needs to be provided on quotations submitted. For established businesses this information should be readily available and accessible, however, with

¹⁶ For all other contracts eThekweni has a 60 day payment cycle or 30 days with a 2.5 per cent payment discount.

micro and small enterprises, especially those starting up, this information may be unavailable and thus registration on the municipal supplier database cannot take place. Municipalities place all the associated costs of getting registered on the database with the vendor. For small businesses, this additional cost will negatively bias their chances of being registered, because this administrative cost may seem too high for them to incur and thus discourage them from seeking registration. From a policy perspective, the relationship between procurement and the supplier database is also quite interesting. The municipalities in general only accept tenders or quotations from service providers who have received accreditation and are listed on their database. However, eThekweni allows service providers, who are not listed on their database, to submit tenders and quotas as long as they become registered before the deadline for submission of the tender. Thus, this contingent arrangement creates more flexibility for small businesses not registered on the supplier database.

Advertising

The SCM regulation specifies that quotations should be made public through the municipal website or municipal notice board. No specific requirements of SMMEs are mentioned here. SMMEs, especially the micro and small enterprises could be disadvantaged if quotations are only specified by these two means as access to internet facility might not be readily available and the municipal notice board could be far from where SMMEs are trading.

Review and Assessment

Policies differ in terms of the emphasis they place on the means of advertising tenders. Umlalazi municipality omits this as a focus area altogether. The larger municipalities place more emphasis on advertising and the need to accommodate SMMEs. The greater ability of larger municipalities to advertise more widely may indicate a greater resource pool for such activities. Cape Town for example, mention they advertise their tenders in English, Afrikaans and Xhosa with the newspapers circulating in the Cape Metropolitan area. Nelson Mandela municipality has established a Tender Advice Office (TAO) specifically focusing on assisting SMMEs with information and help with the tender process. Their English-only advertising policy is balanced out by assistance that tenderers can receive from the TAO in either Xhosa or Afrikaans. Besides their website and notice board, George municipality also advertise their tenders (above R200 000) in commonly circulated newspapers or provincial newspapers. eThekweni also utilise additional means of advertising such as libraries, regional centres and wards, areas that are visible and more accessible for

SMMEs. Selecting the means of advertising tenders and quotations will thus play a large role in determining the level of SMME participation in the procurement process. The larger municipalities are taking the SCM regulation as a benchmark and finding their own ways to widen the net of participation opportunities for SMMEs.

Unbundling

Wary of the temptation to circumvent the more stringent tender requirements for larger projects, the SCM regulation is quite clear that the SCM policy must specify that goods or services may not be split into parts or items of a lesser value in order to avoid more stringent processes for requirements of a higher value (AFReC notes/SCM regulations, 2004). From an SMME perspective, this regulatory provision might mean certain projects are too large for them to tender for despite them having the capacity to perform some part of the larger project. By ensuring projects are not split up, SMMEs could be directly affected by making some projects beyond their reach.

Review and Assessment

The smaller municipalities do not really address this issue in their policies, however, Nelson Mandela and Cape Town municipalities have realised the direct implication this might have on SMMEs and have sought to provide a caveat to the above regulatory requirement. Nelson Mandela Municipality allows for procurement of goods and services to be offered in the smallest quantities without incurring unnecessary negative consequences. This policy provision is directly linked to targeted previously disadvantaged individuals and facilitating small business participation. Cape Town municipality also allows for unbundling of large projects into smaller contracts but state that unbundling cannot be allowed in order to circumvent the formal tender process.

Monitoring

The SCM regulation is quite specific about including in SCM policies a reporting and monitoring system that would monitor the implementation of the municipality's SCM policy.

Review and Assessment

Generally municipalities comply with the above regulatory requirements, especially on the reporting front, but few have set annual targets to monitor the success of meeting the

strategic goals and objectives listed in these SCM policies. Nelson Mandela municipality is one of the few that have set annual goals. However, with the adoption of the balanced scorecard, more municipalities will have to set goals and targets, especially with regard to preferential procurement and enterprise development. Nelson Mandela municipality for example, has set targets for preferential procurement until 2007/2008 for projects with rand value above and below R20 million respectively. Also enterprise development is a key focus of their balanced scorecard, with specific targets being set for projects more than and less than R20 million respectively. George and eThekweni municipalities omit to set any annual targets in their SCM policies. This might be to allow for flexibility in the face of changing circumstances and the initial SCM implementation challenges. On the whole, target setting has been quite clearly neglected in both the SCM regulation and policies, although increasingly more municipalities are beginning to realize the benefits of setting annual targets.

Recommendations

- By identifying various segments of equity ownership and project categories, the larger municipalities acknowledge a differentiated approach to be the most suited for preferential procurement.
- Municipalities – in partnership with other public sector business development agencies – need to take on the indirect costs of projects such as sureties and underwriting the risk to encourage more SMME participation. These contingent liabilities would have to be managed, disclosed in financial statements and appropriately targeted. Also regulations need to be more explicit with regard to having a shorter payment cycle for SMMEs.
- The SCM regulation needs to go further on the issue of advertising tenders and quotations if it wants greater SMME participation, especially amongst smaller municipalities. Waiving or lowering tender documentation payments (where these are required) for small businesses should also be considered.
- More needs to be done from the municipalities' side to address how SMMEs can get involved in larger projects and at the same time minimise unintended costs related to this.

- Create explicit targets that specify goals and objects directed at SMME growth and support and monitor these on an annual basis. This would then make reporting on the progress of SCM implementation by the Accounting Officer a much more accurate and worthwhile process.

4.8 Summary of Recommendations

Table 5 captures the recommendations offered under each of the policies analysed in the above discussions:

Table 5

Area of analysis	Recommendations
Property Rates	<ul style="list-style-type: none"> • Great opportunity exists for engagement with different categories of SMMEs before municipalities finalise their property rates' policies • SMMEs need to become aware of clauses in the Property Rates Act that may carry potential risk for them
Levies and User Charges	<ul style="list-style-type: none"> • In the light of current uncertainty around RSC levies and electricity provision, municipalities could publicise potential impacts to businesses • The alternative tax instrument to RSC levies can factor in the impact to different categories of SMMEs • Reduced user charges could attract SMMEs to a specific area and encourage economic development
Debt Collection	<ul style="list-style-type: none"> • Municipalities need to follow clear procedures for debt collection and management in a consistent manner • Municipalities could utilise budget discussion forums to communicate their policies more effectively among businesses and encouragement feedback • IT and GIS based systems could be invested in, specifically for targeted debt recovery and to improve transparency
Debt and Credit control	<ul style="list-style-type: none"> • Reduce the administrative burden on SMMEs related to registration for municipal services through direct assistance in compliance • Provide municipal pay points at minimum distances • Explore incentive schemes in order to promote prompt payment of accounts • Accurate billing and account information is an important method of motivating SMMEs to pay their accounts promptly and reducing follow-up administrative burden • Deposits required for the registration of municipal services could be adapted for very small and micro businesses
Supply Chain Management	<ul style="list-style-type: none"> • Municipalities could take on the indirect costs of projects such as sureties and underwriting of risk to encourage more SMME participation • More needs to be done from the municipalities' side to involve SMMEs in larger projects while at the same time minimise unintended costs • Establish shorter payment cycles for very small and small enterprise • Create explicit targets that specify goals and objects directed at SMME growth and support and monitor these on an annual basis

Part 5: Non-financial Regulations

5.1 Introduction

This section of the report specifically focuses on the impact of social/non-financial municipal regulation on SMMEs. Key aspects of non-financial regulation which impact on SMMEs have been identified as relating to:

- Land use management and controls, such as allocation of development rights, zoning, departures etc.
- Business licensing, including associated health and fire requirements.

Specifically in terms of business licensing, certain types of businesses are required in terms of the Business Act to apply for a business licence including:

- Item 1: sale or supply of meals or perishable foodstuffs,
- Item 2: provision of certain types of health facilities or entertainment and
- Item 3: hawking in meals or perishable foodstuffs.

Municipalities can have an impact on SMMEs through a range of non-financial regulatory mechanisms including the allocation of land use rights through zoning or consents; licensing business subject to certain prescribed conditions; as well as applying regulation around health, fire, and buildings. In this regard, businesses may bear costs related to application fees, which in some cases are not unsubstantial; less direct costs related to the time taken out to apply for the necessary permits and licences in order to comply with regulations; as well as costs related to capital and human resource investments necessary to meet with regulatory requirements. In addition, certain perhaps less evident “non-compliance costs” are encountered, particularly by the informal sector, where a number of opportunity costs may be encountered as businesses either intentionally or unintentionally remain outside existing regulatory framework.

Municipal regulations were actively used during the Apartheid era to restrict and curtail businesses in particular in townships. Black, Coloured and Indian residential areas were

planned as dormitory suburbs to ensure the growth and sustainability of white owned businesses in formal town centres and central business districts. The interests of white owned businesses were protected through local chambers of commerce and industry as well as the local municipality. Consequently, most townships do not have adequate business infrastructure, while overwhelming residential zoning prohibits business activities in townships.

Most of these restrictive land use legislation and by-laws are still in place today, and there are in addition, a plethora of new policies and laws further adding to the administrative burden of municipalities. Therefore, although some local municipalities have made significant strides to liberalise the regulatory environment for SMMEs, in most municipalities the situation has not changed. For example, although the City of Cape Town has reduced legislation impacting on street trading, most of the other municipalities in the Western Cape still retain the 'old' restrictions. In some municipalities they are still vigorously enforced, especially as far as street trading, business hours as well as operating from home are concerned. There are obviously some municipalities where, although the restrictions are still on the books, the lack of political will or capacity results in lack of enforcement and therefore reduces the impact of municipal regulations on SMMEs.

5.2 Approach to Analysis

This section reflects on key municipally administered regulations and their impact on SMMEs. Distinction has been drawn between:

- a) Land use regulation governing the type of use that is allowed on a particular parcel of land, which theoretically could have an impact on all forms of business and regulation around trading, environmental health and
- b) Community safety, which applies to particular types of SMMEs.

In addition, there are a number of miscellaneous municipally administered regulations that could have an impact on certain SMMEs.

A number of caveats to this research around the impact of municipally administered non-financial regulation should be borne in mind. Whilst certain by-laws relating to selected municipalities were considered, this review has not been comprehensive. It is rather

'issues based' and focuses on areas where there has been evidence that non-financial regulation has had a significant impact on SMMEs. Other municipally administered regulations¹⁷ (see under Section 5.6 Miscellaneous) may also impact on SMMEs though were regarded of lesser significance than those detailed in this part of the paper.

It should be noted that municipal non-financial regulations might vary between and even within municipalities depending on differences in by-laws, selective enforcement, approaches to and capacity for enforcement. In this regard, comparisons between municipalities are limited and an assessment of the capacity and ability of municipalities to enforce regulation (which has a direct impact on the relevance of the regulation) has not been undertaken.

The most significant 'generic' non-financial regulations that may impact on SMMEs by administering line functions include the following:

- Town Planning/ Land use management
- Business Licensing
- Informal Trading

¹⁷ See section under Miscellaneous

5.3 Town Planning / Land Use Management

Rights associated with the use of land allow businesses to operate legally. Zoning schemes are the regulatory framework indicating the permissible use rights for land according to zone. Depending on the zone, some business uses may operate as of right, other uses may be permitted with the consent of the municipality and certain uses would be prohibited and would entail a change in use rights or rezoning. Zoning schemes are the point of reference for municipal officials responsible for the enforcement of regulation and this directly impacts on operation of businesses.

Zoning schemes vary both between and within municipalities in a number of respects. They may vary in terms of the types of use and associated conditions related to a specific zone and may also vary in terms of their requirements linked to application procedures. These variations are as a result of the array of legislation that governs zoning schemes as well as the fact that schemes have been established by different municipalities that have now been amalgamated in terms of the new municipal demarcation process that began in the post 1994 era. Consequently different zoning schemes are, for instance, still in operation within the same municipality (e.g. there are approximately 22 zoning schemes still in force within the City of Cape Town). Other land use legislation such as the Less Formal Townships Establishment Act, Act 113 of 1991 as well as the Black Communities Development Act, Act 4 of 1984 (although defunct, the relevant zoning regulations are still in force), apply in a number of areas and generally reflect less onerous requirements in terms of a change in land use.¹⁸

Generally, zoning schemes are fairly rigid (many schemes were compiled during the 1960's and 1970's) and have reflected a broad scale separation of race and associated land uses with discreet areas for business, residential and industrial uses. In contrast, market forces are characterised by their dynamic nature. Business activity for instance has reflected new location dynamics such as a move towards decentralised suburban locations and in some cases towards business linked to places of residence in suburbs. Very often this has required a change in the use rights associated with property to allow for business use. As is noted in the following section this can place a burden on small

18 In the Western Cape for instance, the provisions of the Land Use Planning Ordinance do not apply in areas established under LEFTA. It should be noted that the Act also provides for possible exemption in these area from other legislation or regulation such as building regulations.

businesses, in particular in areas originally conceived as dormitory townships during the Apartheid era.

As a background to the review of the impact of regulation (in this case embodied by zoning schemes) it is necessary to briefly reflect on the purpose of zoning. Zoning schemes are a form of social regulation (as opposed to economic regulation) aimed at protecting the public interest. This form of regulation stems from the industrial revolution, whereby the role of government in regulating land use was recognised as important in terms of protecting the public (including access to light, avoiding offensive uses, e.g. noxious industry, from locating close to places of residence) from the unregulated impact of business activity. This role of zoning as protecting the public good has prevailed. The reason for noting this at this stage is to point out the fact that issues around land use are not 'politically neutral' as this form of regulation impacts both on individual property rights as well as the public interest. There is thus significant scope for 'contested terrain' adding to the fact that it is not necessarily an easy area to regulate. This is in particular a factor why businesses were not actively encouraged to locate in townships during the previous political dispensation.

In addition to zoning schemes, a range of sector specific land use policies¹⁹, usually forming part of a municipality's land use management system (LUMS) may have an impact on SMMEs. These include policies relating to:

- Residential business (Home based industries/businesses)
- Guesthouses/accommodation facilities
- Taverns and shebeens
- Adult entertainment

Review and Analysis

Although zoning schemes are a form of social regulation, they can result in economic costs to small business. In relation to the business development cycle (see Figure 3.1) it is noteworthy that this impact may be felt most significantly at critical points between the pre-establishment and start up phases and the project implementation phase. In the case

¹⁹ Generally present in an urban policy context

of small business seeking to enter the market (either starting up or 'formalising') this is at a point where resources may be severely constrained. In this context the following review identifies a number of issues and related costs that impact on small business and points to a significant 'duality' related to how these costs and impacts are felt.

It is argued that a 'duality' exists in the nature and application of land use management regulation in urban areas in South Africa. This 'duality' reflects a situation whereby significant variation is encountered in the application and enforcement of land use regulation between more established, historically better off areas as opposed to newer, historically poorer areas. Costs related to this form of regulation (zoning being one aspect) are thus not encountered in the same manner. Although to some extent a generalisation, actual evidence gathered as input to this paper seems to support this argument.

In wealthier areas, formal legislated procedures relating to land use management are generally followed. Costs associated with obtaining business rights to premises entail application fees, which can vary between municipalities and depending on the type of land use application. A survey of selected municipalities reflected that costs for a rezoning to business/industrial use could range from R620 to R6000.²⁰ More significant than these costs are 'compliance costs' related to the time that may be taken up either employing professionals to deal with the application and/or the opportunity cost related to the time taken internally in relation to understanding requirements, preparation and submission of the application and other tasks such as responding to objections. Added to this, the actual time period taken to gain the necessary permissions to start operating can be significant – this is especially the case in better off areas where local interest groups are often vigilant and people are more aware of their rights to object and appeal²¹ (See Box 1). Whilst in some cases, small businesses start to operate and then only begin the process of seeking the necessary land use permissions, which can be highly risky depending on the nature of the business. Although enforcement of land use regulation generally only takes place once a complaint from the public is received, it seems that complaints are more likely to emanate from better off areas. Fines and the risk of possible closure of enterprises are thus more likely in wealthier areas.

20 The higher costs are generally associated with metropolitan areas (such as Cape Town and eThekweni) whilst smaller category B municipalities generally reflect cheaper fees.

21 This is supported by evidence from Cape Town which reflects the fact that land use management issues are largely concentrated in the wealthier parts of the city which consume some 90 per cent of available land use person-power (Watson, 2001).

Box 1: Cumulative Impact of Regulatory Requirements

Beyond land use regulations a variety of other 'development related' regulations could impact on the development of a business site. Whilst perhaps more likely to impact on the development of a small or medium sized business (rather than micro or survivalist enterprises) the growing number of approval processes (above and beyond land use approval) that development applications may need to contend with have the potential to delay access to business premises significantly. There are critical problems of delay within land use management systems – often relatively simple applications take years to process. Contributing to this is the length of time associated with the land use approval process, which is often held up by objections and appeals (in terms of planning ordinances as well as the Municipal Systems Act) which demand high levels of municipal human resources to administer. In addition, apart from planning approval a development application may under certain conditions be required to submit an Environmental Impact Assessment (EIA) application, Heritage Impact Assessment (HIA) (which may be administered by the province rather than a municipality). These applications do not necessarily get processed in parallel, but most often follow sequentially.

Apart from the time taken to process applications, there is the potential for significant professional costs related to the team of experts that would be required to complete and monitor these applications. There is a widely held view that many of these requirements, whilst having the intention of protecting public resources such as the natural and cultural environment are often imposed on proposals where there is limited or no possible negative impact. Despite this the application process and related requirements remain onerous and approval process slow.

In 'poorer' urban areas, evidence suggests that although formal procedures relating to land use exist, they are often not adhered to or, if processed through the formal system, do not face the extent of opposition from community groups and other affected parties.²² In theory the costs of gaining land use approval may in nominal terms be less. However, it should be borne in mind that knowledge of land use regulation and requirements is not

²² Evidence from Cape Town reflects the fact that whilst applications from the poorer parts of the city are far fewer, they tend to attract fewer objections, and are of less concern to local councillors (Watson, 2001).

necessarily as entrenched in poorer areas. With moves to improve levels of adherence to land use regulation in these areas, particularly in the case of uses with a nuisance factor such as taverns and shebeens²³ (see Box 2), it is likely that requirements to obtain land use approvals will become stronger in areas where they have traditionally not been enforced. The issue in many 'township areas' is that due to past practices, limited opportunities were created for business opportunities.

Box 2: Enforcement of Land Use Regulation In George Municipality: Taverns and Shebeens

The George Municipality has made a concerted effort to shut down illegal and troublesome informal business undertakings. A particular focus has been on taverns and shebeens, with an official dedicated to closing illegal enterprises. Action is, however, generally only taken when complaints are received from the public, with a degree of leniency granted to informal business as it has been recognised that these form an important base for people's livelihoods. (Vrolik, J, pers comm. 2005).

The net result is that due to limited or inappropriately located business zoned sites, the burden of obtaining necessary land use approvals may be disproportionate in these areas as opposed to areas where business has traditionally been clustered and zonings have been allocated. Potentially land use regulation could threaten to stifle business development in township areas if it is more strictly enforced. It is therefore clear that land use is not an easy area to regulate. It involves addressing the developmental challenge of promoting business development as well as the need to protect the public from potentially harmful activity. There are, however a number of areas where regulation and processes may be improved to support small business development.

Land use regulations have, however, limited ability to change the Apartheid city. Focus on innovative land use policies and strategies would be more appropriate. In this regard, although most municipalities have new land use policies and strategies in place, these are generally not approved and do not necessary relate to land use regulations. The Land Use Management System (LUMS) of a municipality is meant to consolidate the myriad

²³ The City of Cape Town is for instance in the process of drafting a tavern and shebeen by-law which has specific regard for how these enterprises should be dealt with across the entire city.

of zoning schemes within its area of jurisdiction (dealing with most land use regulations) and relate this to land use policy and strategy. Most municipalities are, however, only consolidating their schemes and are not considering land use policy and strategy. The desirable approach from a small business perspective would be to ensure that land use regulations are subservient to approved land use policies. This, however, would impact on property rights 'enshrined' in the constitution.

Recommendations

In relation to issues identified, a number of broad areas for further research into addressing regulatory impacts are proposed.

In line with recent thinking around closer integration between forward planning (embodied by Spatial Development Frameworks and reflecting desirable land use outcomes) and land use management decision making (especially dealing with zoning which is not in line with the forward plan), it is proposed that means be investigated to ease the burden of land use applications on SMMEs.²⁴ Areas that could be investigated include:

- Mechanisms to implement 'blanket rezoning or consents' in areas where a forward plan may propose business use. This would effectively avoid the need for SMMEs to seek land use approval²⁵ when developing in 'business areas' as indicated by the forward plan.
- Mechanisms to avoid the lapsing of land use rights in areas where a forward plan is clear around business use in an area.

Alternative means of administering regulation could be researched. The idea of shifting control over neighbourhood planning issues from urban authorities to neighbourhood groups has been suggested as a means to regulate home based enterprises in low-income areas (Isandla Institute, 1999). 'Neighbourhood councils' could become development control agents and arbitrators in disputes ensuring that locally sensitive judgements can be arrived at. This may be a solution to addressing locally contentious uses such as taverns and shebeens, where in some areas, land use management and enforcement

²⁴ These mechanisms would be suited in particular to less developed 'township areas' where business development is desired and encouraged

²⁵ Or could significantly ease the burden of the process

has been ineffective in either promoting and 'legalising' business or ensuring that negative social impacts on residents are avoided.

Furthermore, means need to be investigated to simplify or shorten the approval process, especially where a number of applications are necessary. This may include investigation into more effectively reducing requirements to submit applications (such as EIAs) where there is effectively 'no issue'. It may also mean closer integration between environmental and land use approval processes. This could be achieved through the delegation of authority for environmental authorisations to capacitated municipalities.²⁶

Awareness of regulation and associated processes should also be an area to address. Especially where regulations are not well understood the need is often for support and facilitation rather than control and regulation. The benefits of obtaining necessary land use approvals need to be conveyed. This may assist both in understanding the need for regulation as well as areas where SMMEs can obtain benefit (e.g. the increased value of business zoned land once rezoning has occurred).

5.4 Business Licensing

The Business Licence is a document ('certificate of acceptability') issued to an entrepreneur looking to start his/her own business after the business has complied with all the requirements as set out within the Business Act No. 71 of 1991 and as Amended No. 186 of 1993. Business licensing is required for the legal operation of certain types of businesses and activities (identified below).

A number of line functions within municipalities may have an input into the granting of a business licence including town planning (related to zoning and potentially building regulation), environmental health and community safety (health requirements) and disaster management (relating to fire requirements). Business licensing of a business entity or individual economic activity is the mechanism/regulation through which government ensures that the safety, health and environment for all citizens and surroundings are protected during the operation of a business.

The process preceding the issuing of the business licence may entail inspections by various relevant authorities (including health and fire) before commencement of

²⁶ At present provinces general deal with environmental authorisation whilst municipalities deal with land use approval.

operations, based on the particular type of business activities to be offered. According to Schedule 1 in Section 2 of the Business Act, the businesses in respect of which a license is required are as follow:

- Item 1: Sale or supply of meals or perishable foodstuffs
- Item 2: Provision of certain types of health facilities
- Item 3: Hawking in meals or perishable foodstuffs.

The business licensing categories are further described in Table 6.

Table 6: Business Liscence Categories and Fees

CATEGORY	DESCRIPTION	APPLICATION FEE
SALE OR SUPPLY OF MEALS	Foodstuffs that are handled or prepared in the form of a meal	R25.00
HEALTH & ENTERTAINMENT		
BATHS OR SAUNAS	Gyms or health centres or premises that offer saunas or Turkish baths, etc.	R25.00
MASSAGE & INFRARED TREATMENT	Body masseuses or aromatherapy, etc	R25.00
ESCORT AGENCY	Providing the services of an escort	R25.00
DEVICES	Business premises with three or more electronic machines	R25.00
POOL, SNOOKER OR BILLIARD	Business premises with three or more tables	R25.00
NIGHTCLUB OR DISCOTHEQUE	Dancing, raves, etc.	R25.00
CINEMA OR THEATHRE	Shows, dinner theatre, bands, live shows, etc.	R25.00
ADULT PREMISES	Adult shops, etc.	R25.00
HAWKERS	Food that is prepared on site e.g. boerewors rolls, hamburgers or hot chips, etc.	R10.00

Source: City of Cape Town: Department of Health – Business Licensing Division, 2005

Impact of Municipal Regulations on SMMEs

With regard to business licensing, the national legislation broadly pertaining to this process is as follows:

- National Health Act (Act 63 of 1977)
- National Building Regulations and Building Standards Act 103 of 1977 as amended (in terms of which the National Building Regulations, SABS 0400 have been developed)
- Tobacco Products Control Amendment Act, Act 12 of 1999 and Tobacco Products Control Act (Act 83 of 1993)
- Various regulations made in terms of national legislation such as the Foodstuffs Cosmetics and Disinfectants Act (Act 54 of 1972)

In addition to national legislation, by-laws, which have relevance to the business licensing process, are in place in many municipalities (see Box 3).

Box 3: Municipal By-Laws dealing with Business Licensing

In terms of environmental health, for instance, the George municipal by-law on food regulations (No R918 dated 30 July 1999) relating to the general hygiene for food premises is in force. "This regulation refers to the new regulations governing general hygiene requirements for food premises and transport of food in terms of the Health Act, 1977 (Act No 63 of 1977). In terms of the regulations, the person in charge of each "food premises" is required to apply to his or her local authority for an inspection of the premises. If the premises comply with the expected standards a 'certificate of acceptability' is issued.

The 'Certificate of acceptability' is a certificate that confirms that all premises, which handle food or food supplements, have to be inspected by the health officials. This is to ensure that the premises conform to the health requirements concerning general hygiene and food handling. There is no charge for the first inspection and certificate. If further inspection to the premises is required, the regulations allow the local authority concerned to charge a levy fee. The certificate of acceptability is not transferable from premises to premises or person-to-person. When a certificate holder, catering company, etc. leaves or is replaced, the new manager is required to notify the local health authority in writing. The new manager has to apply for another inspection (at no charge) within thirty days of his or her appointment. This legislation came into effect from August 2000 (George Health Department, 2000)."

In addition to the inspection by health officials, fire officials generally inspect the premises identifying any fire risks, and identifying necessary precautions (fire extinguishers). These requirements are enforced in terms of the National Building Regulations in terms of the SABS 0400 code. Fines can be imposed on enterprises that do not address issues and can even be shut down.

The Application Process

Licensing may include the following authorities:

- The Planning Department of the local authority
- Health and Environmental Department
- The Fire Department
- SAPS (South African Police Services)
- National Liquor Board
- Legal authorities

The Planning Department of the local authority ensures that the business falls within the appropriate zoning, which would allow for the existing business use. This is the first step in obtaining a business license. In terms of the Business Act, Section (4) licensing authorities are required to issue a business licence unless in terms of section 4(a) '...the business premises do not comply with a requirement relating to town planning or the safety or health of the public of any law which applies to those premises'.²⁷ The Health and Environmental Department of the local authority also has the right to inspect business premises on the grounds as stated in Section 4 (b): '...any apparatus, equipment, storage space, working surface, structure, vehicle, conveyance or any other article or place used for or in connection with preparation, handling or sale of foodstuffs, does not comply with a requirement of a law relating to the health of the public'.²⁸ The planning and health functions, thus, have key responsibilities in terms of regulating certain SMMEs.

The local fire department also has a role to play in terms of licensing a business premises as they ensure that the premises does not in any way present a fire hazard and complies with safety regulations. An application for business license is submitted to the SAPS only in cases where the business premises would include activities of entertainment and alcohol. It is the duty of the SAPS to inspect the premises and then forward the application to the Liquor Board for review and approval. The legal authorities would only

²⁷ Applicable to Business referred to in item 1(1) or 2 of Schedule 1

²⁸ Applicable to Business referred to in item 1(1) or 3 (1) of Schedule 1

be involved in the process if applications are unsuccessful and applicants appeal. This could ultimately prolong the process with up to two years from initial application date.

Review and Assessment

Impact of time and bureaucratic processes

The average time taken from application to final approval of the business licence could range from 2 days (if the zoning is correct and the business complies), and could be extended to almost 18 months, depending on legal processes such as appeals. It should be noted that this timing is subject to the physical distance between municipal offices and other licensing authorities as each authority works with the original documentation and thus electronic systems are ineffective communication methods. Therefore, the process could still create problems and prolong communicative and logistical matters.

Impact of business licensing regulatory costs on SMMEs

In terms of complying with regulations, there are a number of costs incurred by SMMEs before operations. These include the following:

- Costs incurred due to planning regulations are significant costs incurred by SMMEs. These would typically include:
 - Application fees for building plans and zoning, which could cost up to R2000
 - Up to 1 per cent x sqm (square metres) levies on building costs
 - Capital contribution for bulk services which could cost up to R35 000
 - Professional fees for consultants – business plans which could cost up to R30 000
 - Time as cost factor for waiting on approvals.
 - In terms of hawkers, some municipal stands in strategic areas could cost up to R100/month and in some instances this is doubled in December during peak tourist periods.

It must be noted that cost calculations may vary from authority to authority.

Impact of Municipal Regulations on SMMEs

- Significant capital costs on **structural adjustments** and provisions are incurred by SMMEs in the entertainment industry due to regulations on noise pollution and air pollution as provided for by the Noise Act and Tobacco Act. E.g. some businesses such as discotheques and bars must have acoustic structures to comply with noise regulations as well as make provision, structurally for either smoking or non-smoking areas.
- As previously mentioned (Refer to Table 6), the costs incurred for the application of a **business licence**, is relatively not very significant. This could range from free (initially) to a maximum of R25 once off fees. Since July 2005, it was established that the same fee structure would apply for every municipality in the country and that no municipality could deviate from it.
- **Transport costs** from disadvantaged areas, often located far from government institutions and services, is a major factor for often-unemployed entrepreneurs looking to start up a business. These entrepreneurs often have to make many trips to and from these licensing departments, who often neglect the transport costs incurred. However, there are some municipalities who offer transport services from their offices, but this is not always the case.
- Other types of cost incurred by SMMEs are referred to as non-compliance costs, which could include:
 - Municipal penalties for non-compliance
 - Lack of exposure and free marketing through local institutions such as tourism bureaus due to non-compliance

However, due to institutional capacity problems and lack of effective enforcement from certain departments, it is difficult for municipalities to identify non-compliant SMMEs unless they receive complaints. Similarly it is difficult to enforce these penalties. It is therefore assumed that non-compliant costs incurred by SMMEs due to penalties are not very significant.

The direct loss of free exposure and marketing, which is offered by institutions such as local tourism bureaus are significant due to non-compliance of registration of SMMEs such as B&B's and tour operators. These institutions offer services such as individual brochure design and printing, marketing through call centres, listing on their websites and linkages with other role players in the market, which could indirectly benefit the SMME financially by broadening target markets and foreign disposable income. All of these benefits are

available for a relatively small registration fee that could amount to approximately R300 with a monthly administration fee of approximately R60-R100 per month for various sizes of tourism businesses. However, it must be noted that fee structures may vary.

Recommendations

- **Lowering of Fees:** The administrative fees for business registration are relatively low. However, as far as businesses that are located in townships are concerned, public sector assistance with the preparation of business plans needs to be increased further; consideration should be given to waiving contribution towards bulk services for business infrastructure and rapid approval processes should be explored for issuing business licenses.
- **Stronger Co-ordination:** Health Departments and similar licensing authorities should co-ordinate and liaise with support structures such as Business support agencies as their roles are of a complementary nature. In addition, the support centres, which provide training and support in terms of starting up of small business, should also make aspirant entrepreneurs aware of the regulations involved as well as any incentives that could be provided.
- **De-centralisation of services:** Satellite municipal facilities in disadvantaged communities, which are located far from centralised services, could lessen the transport cost burden that entrepreneurs incur when applying for business licensing and other services. In places where provincial or national support initiatives such as RED Door have been established, resources could be pooled.
- **Awareness:** The non-compliant nature of some SMMEs could be attributed to a perception of saving on extra, unnecessary costs that could be incurred. However, this perception could be altered if SMMEs were more aware of the benefits that they could be offered through marketing strategies and incentives provided by local authorities and institutions.
- **Law-enforcement divisions:** It is recommended that capacity problems in enforcement of regulations, in municipalities like George, could be addressed through the establishment of law enforcement divisions. These divisions could ensure that all businesses are equal before the law and, in the long run could be a major deterrent to corruption.

5.5 Informal Trading

In terms of the Business Act, Act 71 of 1991, local authorities are given powers to develop by-laws regarding the supervision, control or restriction of street vendors, peddlers and hawkers (see section 6A(1)). It identifies areas where the local authority may restrict trading.²⁹ Many municipalities have developed by-laws governing informal trading – trading regulation is one of the powers and functions of local authorities as reflected in schedule 4B of the Constitution.

Review and Analysis

Informal Trading Permits/Rentals:

Informal trading by-law can impact on a range of informal trading activities (including formal market sites, individual fixed trading sites and intersection trading). The most obvious (cost) implication of this type of regulation is the general requirement to obtain a trading permit or 'rental'.³⁰ A survey of permit costs for informal traders in Cape Town reflected that amounts charged ranged from R50-R200/month.³¹ These costs may be insignificant for traders with higher margins, but could have a significant impact on traders that fall within the survivalist category. Recent evidence in some municipalities has suggested that increases in the cost of these permits are either being considered (see Box 4) or have recently been implemented.³² An equitable means of calculating these charges remains a challenge particularly considering the differentiation in levels of exposure (and sizes of local markets) linked to various sites.

29 See Business Act section 6A(1)(a)(iii)

30 The term 'rental' is preferred in the City of Cape Town as this reduces the requirement for advertising in terms of the Business Act. The allocation of 'rentals' is a different and easier process (pers comm. Williamson, 2005)

31 The variation reflects the tariffs charged by various administrations (former local authorities) within the City of Cape Town and is linked to the level of exposure of certain areas.

32 Permits in George have recently doubled according to an interview with local informal traders.

Box 4: City of Cape Town – Tariffs and Cost Recovery.

The requirements of the Municipal Finance Management Act (MFMA) have resulted in the City of Cape Town reviewing their tariff structure and charges. The cleansing function in particular has been interested in recovering costs of solid waste collection mainly as a result of informal traders in certain areas. A calculation was done and the tariff per trading stall (based on full cost recovery) was worked out to be in the region of R600-R700/month. The idea was scrapped with the resolution being that a portion of 'rental' could be allocated to the cleansing function and the rest would be obtained through usual channels (rates income). There remains, however, significant debate regarding how to ensure that rentals are paid and an adequate level of service provided by local authorities to traders in terms of cleansing, security etc. The idea of forming section 21 companies linked to trading areas such as transport interchanges has been identified as a possibility. This would see informal traders as one of the potential tenants within an area contributing to a section 21 company which would allow for 'ring fencing' of income and other benefits associated with the collective management of trading areas. A differentiated tariff structure has also been suggested which would effectively allocate different charges based on different levels of service (e.g. availability of water, electricity, storage facilities) and location.

Month-to-month concessions

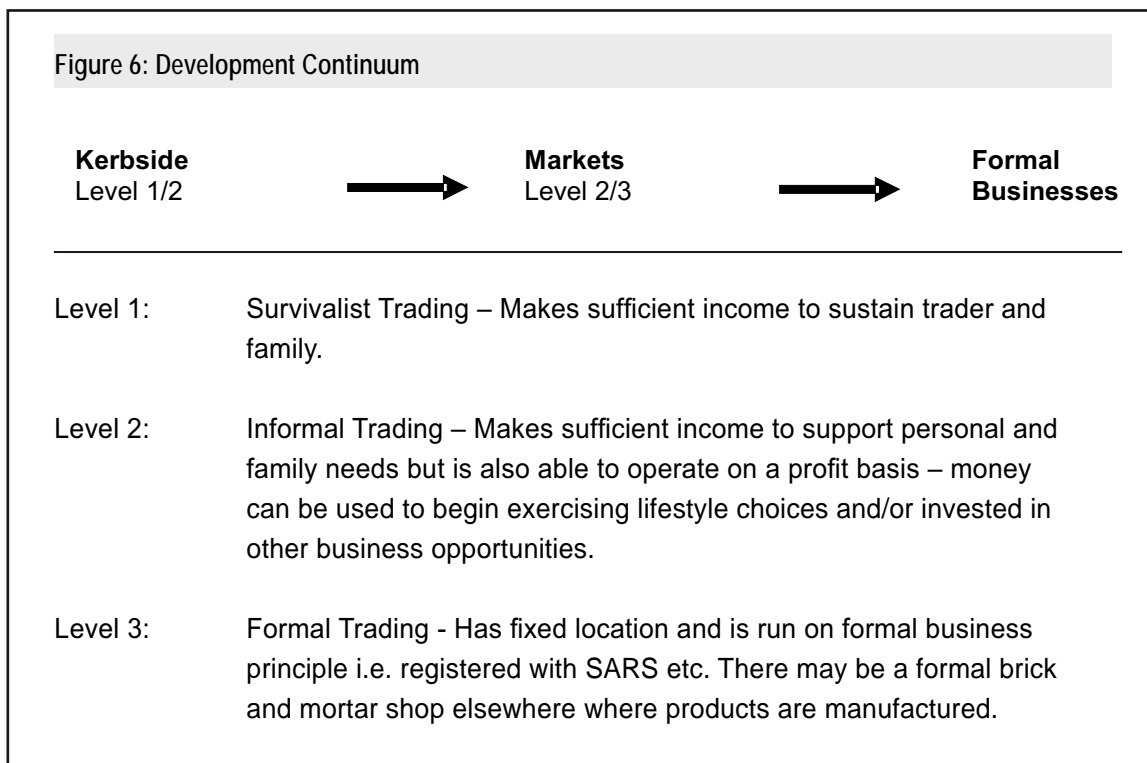
A less obvious, but potentially more serious impact on SMMEs associated with the allocation of informal trading permits is that systems associated with the regulation can become a significant obstacle to obtaining finance to upgrade these enterprises.³³ In certain municipalities, current policy is to issue informal trading permits on a monthly basis. In some cases traders have sought to upgrade (e.g. through moving from a trestle table and umbrella to a gazebo structure). Banks are, however, unwilling to grant loans based on a monthly concession. For a number of reasons there has been hesitancy to move toward an annual permit. This includes the fact that law enforcement officials have felt that, should there be contraventions, an annual permit would be more difficult to

³³ Pers Comm, Williamson 2005.

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revoke. Traders are also constrained in that an annual charge could become prohibitive if payment is required³⁴ up front (the charge could amount to over R2000). Bureaucratic systems are also not geared toward providing a letter assuring banks of the trading rights of the informal trader and there is not clarity regarding whether banks would accept this in order to grant loans.

This impact is potentially significant as it inhibits informal business and traders in particular from moving along the development continuum toward formalisation and growth of their enterprises (see Figure 6).



Source: City of Cape Town (2003)

Further to these impacts, it should be noted that informal trading by-laws are not the only form of regulation impacting on informal trading. With regard to street trading the provisions of the Road Traffic Act, Act 29 of 1989 as well as various traffic regulations

³⁴ It has been noted by the City of Cape Town that the finance department does not support having arrears on these permits as would be the case if payment was made in instalments.

and design standards related to roads can have an impact on the location and viability of informal trading (see Box 5).

Box 5: Impact of Road/Traffic Regulations - Princess Vlei Informal Fish Market

Up to the late nineties, a significant grouping of traders frequently sold fish on the side of Prince George's Drive close to the False Bay Coast in Cape Town. The informal market consisted of up to twelve traders who located on the side of the road and took advantage of the significant flow of passing traffic. At this point, the M5 (Prince George's Drive) was upgraded. Regulations, in this case engineering standards relating to the design of the road, prevented the location of informal trading within a specified distance from major intersections. Transport officials of the then South Peninsula Municipality were against informal trading on the side of the road. Embayments were proposed to accommodate the informal traders, however, again due to engineering design standards, this proposal was not supported by local traffic engineers. As a compromise market infrastructure was constructed some way off the main road, however, due to the fact that this market was less accessible (two sets of robots needed to be negotiated after which one needs to park and walk to the market) currently the number of traders has dwindled to one or two. (Vrolijk, J. Pers Comm, Williamson, 2005)

Fines and Confiscations

A further cost (regarded as a 'non compliance' cost) to informal traders is the threat of fines and confiscation. Whilst municipalities have tended toward a more facilitative approach, accommodating informal trade through demarcated bays, setting up trading areas on public space and even attempting to promote a greater mix of traders at markets ensuring that they are not monopolised by one player, the risk of fines and confiscation remains a threat to traders operating outside the regulatory framework. This is most common in areas that are also a focus of formal commercial activity such as CBDs and main streets. Action against informal traders by municipal law enforcement occurs mainly as a result of individual complaints by store-owners or pressure from organised business (e.g. through organisations linked to business improvement districts or BIDs). The survey results (Appendix 2) indicate that regulation of informal traders is requested by several of the interviewed formal businesses.

Confusion regarding relevant regulations

Furthermore, in the case of vendors that sell food to the public a business licence/certificate of acceptability is required and health regulations will apply (see also Section 4.4 Business Licensing). In this regard, research has pointed to the fact that there has been confusion amongst certain potential traders regarding what permissions are required to trade legally. There has been an instance (possibly more) where potential traders have obtained a business licence and subsequently invested in equipment only to find out that a trading permit is also required. In this case no space was available to trade (Vrolijk, J. Pers. comm. Williamson, 2005). This points to the fact that it is likely that informal traders are sometimes unaware of regulations pertaining to them as well as procedures for application to obtain the relevant permits.

Recommendations

New initiatives relating to the regulation of informal trade seem to suggest a move toward facilitation rather than purely control of business activity. Importantly these initiatives point to possibilities for overcoming some of the challenges identified. They contribute to the identification of a number of broad areas where intervention may be beneficial to traders.

Differentiated tariffs

It is suggested that effort should be made to address issues linked to tariffs or 'rentals' paid by informal traders. Altering regulation by, for instance, creating a system of differentiated tariffs could assist in reducing the burden on survivalists whilst levying a reasonable charge on informal enterprises that are operating at a higher economic level.³⁵ Furthermore, clarity seems to be needed around the impact of the MFMA for the setting of tariffs, as it is likely that informal trade will to some extent need to remain 'subsidised' by municipalities.

Management models for trading areas

Research could also be undertaken into the establishment of management bodies such as section 21 companies (that may for instance take control of collective management at transport interchanges and linked trading areas) to which trading associations could

³⁵ This has been proposed as part of the eThekweni Municipality Informal Economic Policy where 'management zoning' allows for flexible restriction, which will be linked to differentiated rentals for sites/permits.

belong. These institutional arrangements could assist in reducing burdens on council, allowing more efficient cost recovery and providing improved service to informal traders. The representation of informal trading on organisations linked to BIDs may also assist in mediating conflicts between themselves and formal business.

Removing conflict between regulations

It is also suggested that further research be undertaken into means of effectively dealing with inherent contradictions that may emerge from potentially conflicting regulation (see Box 6). This may include reviewing aspects of road engineering standards, particularly in areas where small business development is being promoted along movement or activity routes.

Streamline licensing processes

It is suggested that, at the municipal level, effort should be made to streamline the process of registration and application for permits and licensing (specifically when one or more permits are required). The City of Cape Town has suggested simplifying existing procedures and moving toward a one-stop centre (City of Cape Town, 2003).

Box 6: Potential Conflict between Traffic Regulations and the Business Act

Traffic regulations may reduce the opportunities for trading along road reserves, however, the Business Act (1991) states that:

‘Notwithstanding the provisions of any other law, a local authority may set apart by resolution and demarcate stands or areas for the purposes of the carrying on of the businesses of street vendor, peddler or hawker on any public road the ownership or management of which is vested in the local authority...’ (Section 6A(3)(b)(i))

Bearing this in mind it is possible that this could be interpreted as a provision that allows the ‘overruling’ of traffic regulations. This may in some cases result in positive outcomes for traders, however, clarity is needed with regard to how these two areas of regulation can reinforce each other so as not to impact negatively on traders.

5.6 Miscellaneous

A number of non-financial regulations administered by municipalities exist and have not specifically been reviewed in terms of their impact on small business. They include:

- Detailed parking regulations and requirements
- Advertising and signage regulations
- Building Regulations (established in terms of the National Building Regulations and Building Standards Act 103 of 1977)
- Air Pollution Regulations (in terms of the National Environmental Management: Air Quality Act, Act 39 of 2004)
- Municipal property regulation such as by-laws, which may relate to the leasing of public land (e.g. by informal markets)
- Regulations and policy around infrastructure provision
- Sector-specific land use policies although they have been mentioned in Section 4.3 Town Planning / Land Use Management.

Conclusions

In conclusion, it is evident that there are a number of regulatory costs, whether indirect or direct, incurred by start up SMMEs or SMMEs seeking to grow or 'formalise'. It is also important that one takes cognisance of the fact that SMME development represents a major hope in terms of addressing issues around joblessness and poverty in South Africa. Whilst it is necessary to ensure that negative impacts associated with business operation on the public at large is minimised (non-financial regulation is focussed on this), it is equally important to ensure that sufficient effort is applied to cutting the impact and costs on SMMEs through effectively administering regulation, ensuring information regarding regulation and requirements are easily accessible, and where possible and desirable from a public interest and business development perspective, strategically amending regulation.

It should be noted that, due to time constraints, justice could not be done to in-depth analyses and empirical information of each regulation and its effect on SMMEs. Therefore a further in-depth assessment is recommended for each relevant regulation impacting on SMMEs particularly those operating within our 'second economy' many of whose owners hail from previously disadvantaged backgrounds.

5.7 Summary of Recommendations

Table 7 captures the recommendations offered under each of the policies analysed in the above discussions:

Table 7

Area of analysis	Recommendations
Town Planning	<ul style="list-style-type: none"> Blanket rezoning or consent could be implemented in areas where a forward plan proposes business use Mechanisms could be explored that help avoid the lapsing of land use rights in proposed business use areas Investigate means of simplifying or shortening the approval process, especially where a number of applications are necessary Lack of awareness of regulation and associated processes among SMMEs should be addressed
Business Licensing	<ul style="list-style-type: none"> Businesses in townships need to be assisted in preparation of business plans Waiving of contributions towards bulk infrastructure could be exercised Need for stronger co-ordination between licensing authorities and support agencies Satellite municipal support services for business licensing could be established in disadvantaged communities Create awareness among SMMEs around benefits of compliance vis-à-vis the potential costs Establishment of law enforcement divisions are an option for municipalities that face serious problems when enforcing regulations
Informal Trading	<ul style="list-style-type: none"> Issues linked to tariffs or 'rentals' paid by informal traders need to be explored, especially for municipalities to maintain minimum level of services for informal traders Means of establishing section 21 companies for informal trading associations could be explored The process for registration and application for permits and licensing could be streamlined Level of regulating informal traders needs to be established and standardised across municipalities Further research needs to be undertaken to address inherent contradictions between regulations

Part 6: Recommendations and Conclusions

6.1 Introduction

This paper looked at a whole range of interactions between municipalities and SMMEs in order to assess the impact of municipal regulations on small enterprise. The conceptual framework delved into the legislative basis for the regulatory activities of municipalities. It underscored the developmental role of local government. It also presented different SMME categories as outlined in the National Small Business Amendment Act of 2004.

Flowing from the developmental role of municipalities, various pertinent dimensions of LED were also addressed. These include issues relating to policy formulation, project co-ordination and regulatory reform that underpin a municipality's developmental efforts. LED and Business Support strategies of different municipalities were analysed. This was in recognition of the harmony between the municipality's regulatory, service provision and business promotion roles in promoting SMMEs, and hence LED.

Finally, in the last two chapters, financial, planning and development-related regulations and by-laws administered by municipalities were reviewed. Recommendations were summarised for each of the chapters on financial and non-financial regulations.

The results of a survey conducted among a variety of SMMEs in four urban areas (see Appendix 2) provided insights into the perceptions that business owners/managers hold of their municipality's regulatory, developmental and service delivery roles.

This part of the report presents overarching conclusions derived from the conceptual framework, the analysis of developmental and regulatory roles of municipalities and the survey results.

Recommendations for municipalities to help achieve their complementary mandates of service delivery, economic development and regulation are also condensed from the analyses and survey results.

Finally, recommendations for further dedicated research are presented.

6.2 Conclusions

Based on the research and analysis conducted for this report, various conclusions may be derived. These are discussed below:

1. A differentiated approach to SMME categories

The four categories of micro, very small, small and medium enterprise are vastly different in terms of turnover, assets and number of employees. Regulations therefore impact very differently on each of the categories and consequently customised and targeted interventions are required. The most significant distinctions are as follows:

- *Micro survivalist and micro non-survivalist businesses* also classified as the informal sector. This category requires a specialised focus through standardised regulations and transparent and predictable service delivery arrangements. Where possible, targeted support for certain micro businesses could assist in them becoming formalised and graduate to the very small status.
- *Very small businesses* are on the threshold of becoming more established small or medium enterprise. They are already formalised which means that the initial regulatory barrier posed through licensing and zoning applications has been crossed. This category requires municipal support in the form of business advice, training and reliable provision of utilities.
- *Small and medium enterprises* stand to gain significantly from effective supply chain management policies of municipalities that rely on unbundling of larger projects, capacity building of businesses and regular monitoring and evaluation of the regulatory environment.

2. Policy implementation lag

The local governance framework has newly been put in place, and now needs to be consolidated and institutionalised within individual municipalities. There exists a lag between the enactment of framework policies and legislation at the national level and their implementation through by-laws at municipal level. The positive impacts that reform in national policy envisioned can be witnessed only after implementation has taken place. Municipalities may need clarity on apparent contradictions between different pieces of

legislation, and how to implement them. For example, Section 65 of the MFMA may create a disincentive among municipalities for doing business with very small businesses if they do not hold bank accounts. Identification of weaknesses in policy and its unintended outcomes is also delayed due to implementation lag, as are outcomes of changes to the policy framework. Conversely, bottlenecks which are currently perceived may be transient “teething problems”, mitigated once the legislation has been fully implemented.

3. Capacity constraints

The ultimate impact of regulations is a function of a particular municipality’s capacity to implement transformation on all fronts including regulatory, budgetary and revenue management reform. In particular, co-ordination across several departments within a municipality may be called for, as well as with other spheres of government and public entities. The achievement of developmental targets and delivery on Service Charters is also invariably linked to the capacity of a municipality.

4. Selective enforcement of regulations

While uneven enforcement may be as a result of capacity, municipalities may often choose to implement certain regulations selectively. This is especially true in relation to informal trading where businesses are exposed to an unpredictable environment. Regulatory impact also varies across different economic areas of jurisdiction in a municipality, linked to the presence of organised and vocal, social or business groups. Further research into the reasons for selective enforcement could inform improvements to the current regulatory environment.

5. Concurrent intergovernmental responsibilities

The three spheres of government have overlapping responsibilities in the business promotion arena. While municipalities develop and implement LED projects and offer business support services, national and provincial departments also regard this as their core activity. Therefore, potential exists for increased co-ordination and alignment to achieve maximum positive impact. The taxi industry especially is subject to an uneasy blend of national, provincial and local government regulations.³⁶ Already processes linking

36 As noted by Martin Nicole in his review of the Draft Research Paper: “Impact of Municipal Regulations on SMMEs” dated August 19, 2005

IDPs with Provincial Growth and Development Strategies are under way and should be enhanced.

6. Uncertainty and communication

Uncertainty exists around changes to electricity redistribution, property rates valuation and alternative tax instruments meant to replace RSC levies. A general lack of information about municipal regulations and their enforcement was also discerned among businesses interviewed. There appears to be definite room for improved communication channels between municipalities and SMMEs to identify specific issues and their possible solutions.

6.3 Recommendations for Municipalities

Municipalities face many challenges of delivering on their three distinct roles: regulatory, developmental and as providers of basic services. This research indicates that the regulatory aspect of a municipality's performance cannot be divorced from the remaining two areas, especially from the perspective of local small businesses. This section consolidates recommendations from the previous parts of this report, which focused on the review and analysis of specific regulations, as well as those generated through the interview of businesses.

Although analysis of the service delivery responsibility of municipalities is beyond the scope of this research, recommendations to enhance this area are included.

Regulatory Role

The research among businesses revealed that compliance with municipal by-laws, except for licensing requirements, is not perceived as a major constraint. This may be linked to the fact that formal businesses have already crossed the initial barrier posed by regulations. Moreover, it does not exclude the possibility that regulatory requirements from local government might be preventing start-ups from getting off the ground, or hindering micro businesses from becoming formalised. The following recommendations could help municipalities in enhancing their regulatory role, so that the burden from red tape to businesses across all SMME categories and start-ups is kept to a minimum.

Impact of Municipal Regulations on SMMEs

1. Guidelines pertaining to the informal sector need to be developed on a national level on issues such as level of regulation required, standardisation of regulation and service provision and streamlining of licences. Municipalities would need to collate information regarding their local informal economy in order to apply the national guidelines effectively. Public sector stance on the tension between formal and informal traders needs to be resolved as a matter of urgency.
2. Municipalities could help establish dedicated section 21 companies for informal traders and very small businesses. Such organisations could help in providing a united voice to these SMME categories during discussions around tariffs or rentals for informal traders, minimum level of services etc.
3. Municipalities can improve consultation with local businesses regarding new and existing policies. They can propagate information around by-laws and how they impact different categories of small enterprise. Especially when outdated by-laws such as zoning laws are being consolidated and new policies such as property rates are being drawn up, opportunity exists for wider consultation with SMMEs.
4. Processes for registration and application for permits could be streamlined for different sectors in which SMMEs operate. This would require greater co-ordination between different municipal departments.
5. Establishment of dedicated law enforcement divisions is an option for municipalities with capacity problems in enforcement of regulations.
6. Municipalities are recommended to consult with national departments to iron out apparent contradictions between different policy objectives vis-à-vis their impact on local small enterprise.
7. Municipalities (especially the more capacitated ones) could establish a regulatory impact assessment (RIA) unit within their LED office. Such a unit could conduct ongoing evaluation of existing and potential regulations in terms of how they influence various economic sectors in the local economy, including the different categories of SMMEs. Specialised checklists based on the one developed by OECD (see Annexure B: Regulatory Reform) will need to be drafted.

8. The RIA body would need to create a comprehensive list of all current regulations/by-laws that are administered by the municipality, ascertain the responsible municipal departments and establish communication channels to implement recommendations.
9. Municipalities could involve a range of local professionals including lawyers, economists, statisticians and business development practitioners in realising regulatory reform.
10. Business incubators and empowerment zones provide effective vehicles for easing regulatory and taxation burdens on certain categories of SMMEs. Municipalities would need to interact with other spheres of government before they can offer breaks on national taxes for a limited time period.

Business Support Role

Promoting SMMEs is critical for local economic development, a constitutional obligation for municipalities. Through this research, the authors came across various activities that municipalities could engage in to support local small businesses. Such activities go a step further in enhancing the business environment for SMMEs. They are important also because they complement the regulatory role discussed above.

1. Municipalities would need to distinguish between different categories of SMMEs that operate locally and develop suitable support strategies for them.
2. Any form of business support offered by municipalities must be co-ordinated or consolidated with similar services from other spheres of government available in the same area. Disjointed support activities dilute the overall impact and create barriers between the public sector and businesses.
3. Municipalities are recommended to involve specialised partners such as local universities, NGOs and trade organisations in support activities.
4. Adequate visible support for the development of micro businesses needs to be explored. Some of these businesses are extremely viable and are on the threshold of becoming formalised. The survey conducted as part of this research revealed a lack of micro-business-friendly approach to outsourcing and tendering among municipalities. This concern is

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linked to the presence of a marginalized second economy and needs to be addressed at national level.

5. Municipalities could invest in advisory centres for micro and very small businesses and facilitate technical support and training of business owners and employees.
6. A specialised business service and liaison function in municipalities to keep them constantly abreast of, and in contact with, business needs. This would also link with the RIA unit and aid in regular monitoring of the effects of municipal regulations and policies.
7. Business support services can be decentralised and made more accessible through one-stop shops located in disadvantaged communities and various suburbs of large towns and metros.
8. Budget discussion forums offer opportunities for municipalities to engage with local small businesses around their budget related policies for debt and credit control, user charges and consumer tariffs.
9. The administrative burden from regulatory compliance could be reduced through direct assistance in filling out forms when start-ups register for municipal services or apply for licences/permits. Such support services would need to be advertised extensively in order to have the desired level of utilisation.
10. Deposits required for the registration of municipal services could be lowered for micro and small businesses. These can be offered within designated empowerment zones.

Service Delivery Role

This section of recommendations focuses on the core responsibility of municipalities: the provision of a minimum standard of basic services to communities. Several businesses interviewed came up with recommendations around how municipalities can improve on this front and thereby enhance the physical environment within which businesses operate. Especially since businesses from all categories pay municipalities for services rendered,

they maintain certain expectations. Municipalities can also assist certain categories of SMMEs through their service delivery activities.

1. Municipalities need to become more conscientious about improving the operating environment of businesses. Most importantly, infrastructure maintenance is key to prevent disruptions and service breakdowns. Secondly, they need to maintain minimum levels of cleanliness and security in business districts and industrial areas. Business owners also mentioned improvements in road and traffic planning, visual aesthetics and effective advertising.
2. Consistency and clarity in policy implementation such as debt collection could help in improving relation with local businesses.
3. Customer care and prompt handling of complaints would help relieve the administrative burden of following up with municipal staff.
4. Correct billing of accounts would also reduce administrative time and cost for SMMEs and provide incentives for prompt payment.
5. Municipalities could invest in GIS-based IT systems to improve transparency on various functions such as valuation, revenue and debt management.
6. Deposits required for the registration of municipal services could be lowered for very small and micro businesses.
7. Municipalities could utilise unbundling of big contracts to involve SMMEs as well as provide incentives to larger businesses to sub-contract to SMMEs and build in skills transfers. However, systems will need to be in place to prevent fronting.
8. Shorter payment cycles are recommended since SMMEs have limited access to credit and are more reliant on regular payments for their cash flow management.
9. Operating budgets of municipalities could be disaggregated to verify which services are sourced from existing/past suppliers and whether these can become viable niches for SMMEs.

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10. The Integrated Development Plan of a municipality can take into account how different categories of SMMEs are prioritised through the operational and capital expenditure of municipal departments.

Transversal Issues

Although the recommendations above are segregated according to the different yet overlapping roles of local government, SMMEs are influenced by their cumulative impact. In addition, certain common factors have been identified for municipalities' attention. These are listed below.

1. There is a need for stronger co-ordination between different departments of municipalities, especially between licensing authorities and business support services.
2. Implementation of various recommendations offered above might face resistance from municipal departments. Organisational culture of municipalities might need to transform on many accounts. For instance, municipalities would need to accommodate SMMEs as preferred service providers, assist in removing bureaucratic hurdles for start-ups and improve the operating environment for informal traders.
3. Municipal departments would need to support the objectives of regulatory reform. Municipalities would need to create explicit targets aimed at SMME growth and support and monitor these on an annual basis, perhaps as part of the IDP (Integrated Development Plan) review process.

6.4 Recommendations for Further Research

1. **Informal Trading:** Regulation of this category of SMMEs needs specialised and detailed investigation. Areas of enquiry include the optimum level of regulation, extent of subsidy for provision of services and zoning/location of informal traders. Location of informal markets is controversial as it attracts the dissatisfaction of formal traders and yet adds vibrancy to the business environment.
2. **Business Licensing:** Standardisation and simplification of licensing procedures requires further attention. Means of simplifying or shortening approval processes, especially when a number of applications are required would advantage small businesses. Business licensing requirements in accordance with various business or industry sectors need to be collated and publicised among potential business owners.

Annexure A: Schedule from the National Business Amended Act (2004)

Column 1	Column 2	Column 3	Column 4	Column 5
Sector or sub-sector in accordance with the Standard Industrial Classification	Size of class	The total full-time equivalent of paid employees	Total turnover	Total gross asset value (fixed property excluded)
Agriculture	Medium	100	R 5 m	R 5 m
	Small	50	R 3 m	R 3 m
	Very small	10	R 0.50 m	R 0.50 m
	Micro	5	R 0.20 m	R 0.10 m
Mining and Quarrying	Medium	200	R 39 m	R 23 m
	Small	50	R 10 m	R 6 m
	Very small	20	R 4 m	R 2 m
	Micro	5	R 0.20 m	R 0.10 m
Manufacturing	Medium	200	R 51 m	R 19 m
	Small	50	R 13 m	R 5 m
	Very small	20	R 5 m	R 2 m
	Micro	5	R 0.20 m	R 0.10 m
Electricity, Gas and Water	Medium	200	R 51 m	R 19 m
	Small	50	R 13 m	R 5 m
	Very small	20	R 5.10 m	R 1.90 m
	Micro	5	R 0.20 m	R 0.10 m
Construction	Medium	200	R 26 m	R 5 m
	Small	50	R 6 m	R 1 m
	Very small	20	R 3 m	R 0.50 m
	Micro	5	R 0.20 m	R 0.10 m
Retail and Motor Trade and Repair Services	Medium	200	R 39 m	R 6 m
	Small	50	R 19 m	R 3 m
	Very small	20	R 4 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	R 64 m	R 10 m
	Small	50	R 32 m	R 5 m
	Very small	20	R 6 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m
Catering, Accommodation and other Trade	Medium	200	R 13 m	R 3 m
	Small	50	R 6 m	R 1 m
	Very small	20	R 5.10 m	R 1.90 m
	Micro	5	R 0.20 m	R 0.10 m
Transport, Storage and Communications	Medium	200	R 26 m	R 6 m
	Small	50	R 13 m	R 3 m
	Very small	20	R 3 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m
Finance and Business Services	Medium	200	R 26 m	R 5 m
	Small	50	R 13 m	R 3 m
	Very small	20	R 3 m	R 0.50 m
	Micro	5	R 0.20 m	R 0.10 m
Community, Social and Personal Services	Medium	200	R 13 m	R 6 m
	Small	50	R 6 m	R 3 m
	Very small	20	R 1 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m

Annexure B: Regulatory Reform Literature Review

International Experience

Many OECD countries have realised that SMMEs are crucial to their economies and have introduced various programmes to support them. Germany, Iceland, Japan and New Zealand dedicate more than 50 per cent of their entire public support programmes to SMMEs (Small Businesses, Job Creation and Growth: Facts, Obstacles and Best Practice).

These same countries have also realised the negative impact of poor regulation on SMMEs over the last two decades. The reform of regulatory systems has received increasing priority internationally.

In the early 1980's an attempt at deregulation began in the United States. This was followed by a period of "regulatory quality" and then policies shifted to "comprehensive regulatory management" or the establishment and maintenance of a range of state institutions to monitor the regulatory system (Roux and Klaaren, 2002).

In the Organisation for Economic Cooperation and Development (OECD) member states, regulatory reform is often documented as beginning in the 1990s with the establishment of the Public Management Committee (PUMA). As a result, the Council of the OECD adopted a 'Recommendation on Improving the Quality of Government Regulation'. This was meant to assist and encourage member states to ensure the quality and transparency of government regulations. A checklist was devised for regulatory decision-making (Roux and Klaaren, 2002).

The Checklist is comprised of ten questions:

1. Is the (regulatory) problem correctly identified?
2. Is government action justified?
3. Is regulation the best form of government action?
4. Is there a legal basis for regulation?
5. What is the appropriate level (or levels) of government for this action?
6. Do the benefits of regulation justify the costs?
7. Is the distribution of effects across society transparent?
8. Is the regulation clear, consistent, comprehensible, and accessible to users?
9. Have all interested parties had the opportunity to present their views?
10. How will compliance be achieved?

Source: Roux and Klaaren, 2002

Between 1990 and 2000, most OECD countries established institutions to conduct regulatory reviews. These institutions were tasked with the role of ensuring regulatory quality. According to STI (1999), since the adoption of the Business Environment Simplification Task Force (BEST) Action Plan by the EU in 1999, the business environment for small firms has been improved and start-ups have been facilitated.

In 1999, the OECD reported in “Regulatory Reform for Smaller Firms” that fostering a regulatory environment conducive to the establishment of small and medium-sized enterprises (SMMEs) was a high policy priority in OECD countries. However, in 2004, the OECD Observer noted that businesses and citizens in OECD countries were complaining about the amount of “red tape” or unnecessary regulatory burdens that need to be complied with. Extensive resources and time are devoted to complex government formalities and paperwork, filling out forms, applying for permits and licences and reporting business information.

The report by Crain and Hopkins on ‘The Impact of Regulatory Costs on Small Firms’, based on small businesses in the United States found that Americans spent \$843 billion in the year 2000 to comply with federal regulations. While all citizens and businesses share in the costs, the distribution of the costs is uneven with small businesses bearing the largest burden. Environmental regulations and tax compliance affect small businesses more than other businesses. However, other regulatory burdens are more evenly

distributed (including workplace rules, pricing constraints etc). Most importantly, Crain and Hopkins claimed that compared with an earlier study conducted in 1995, regulatory burdens continued to increase, with small businesses being affected the most.

In OECD countries, governments have been attempting to simplify the red tape by focusing on “smart tape” or quality regulation. This has been done by improving the efficiency of transactions, removing obsolete or contradictory provisions, providing guidelines on administrative regulations and introducing new ways in which to measure administrative regulations and to reduce their impact. Innovative thinking and information technology are used to administrate regulations more effectively (OECD Observer, 2004).

Four main trends for cutting red tape in government have been identified:

Gradual shift from an approach focused on easing administrative burdens after the event to one that recognises the need to ensure that unnecessary or unreasonable burdens are not implemented in the first place

- Simplification is usually a “bottom-up” approach (like business licence services, which initially serve specific needs but tend to cover additional information and transactions over time), but it has recently become a “top-down” initiative by governments and is increasingly integrated into broader reform programmes (for example, using government Web portals and the merger of one-stop shops)
- Market-based economics encourages simplification as policy makers take into account the notion that economic agents should be free to conduct their business unless public protection need is crucial
- The use of Information Technology reduces the need for paper shuffling and provides strong dynamics and increases pressure to reduce administrative burdens

Source: OECD Observer, 2004

Many countries have instituted regulation review as part of regulatory reform. For example Australia, an OECD member country, began regulatory reform in the late 1980s. According to Darrell Porter (APEC-OECD Workshop, 2001) Australian initiatives to reduce red tape

for businesses involved the three levels of Australian government: local, state and territory and the Commonwealth.

During the 1990s, states and territories engaged in business licence rationalisation and reduction programmes. Eventually, the focus has shifted from license reduction programmes to improving business information services. The Commonwealth Government established mechanisms to streamline business licensing and approval processes and merge similar licences into a single, 'common' licence. The Business Entry Point was also introduced to provide a single source of information from any level of government. This reduced the search costs for businesses and improved government services to business.

The United Kingdom underwent a number of changes to their regulation review practices over the last two decades. In 1985, the Department of Trade and Industry established the Enterprise Deregulation Unit (EDU). The EDU was originally responsible for reviewing new regulation and assessing the compliance costs that would be imposed on businesses. Their role (and their name) has changed over the years. Now, the Regulatory Impact Unit focuses on the impact of regulation on various bodies, with public participation by making use of the OECD Checklist (as referred to above).

According to Roux and Klaaren (2002) the United States carries out Regulatory Reform (RR) at the federal level through the Congressional Budget Office (CBO) and the Office for Management and Budget (OMB). These RR institutes provide technical support to government departments and other regulatory agencies in assessing the quality of proposed or existing regulation.

OECD Observer (2004) highlights methods used by three different countries to measure red tape or regulatory compliance. The United States has passed the Paperwork Reduction Act (PRA). The intention was to minimise the amount of paperwork required for federal agencies from small business, local government and other small entities. Agencies are required to demonstrate that the method they use for collecting information from the public is the most efficient.

The Netherlands makes use of the MISTRAL methodology to quantify the administrative compliance of laws and regulations. It functions in three stages- a) "data transfers" between business and authority are identified, b) the time involved in each "data transfer" and the level of expertise required is determined and finally c) MISTRAL computes the

above information to produce estimates for the administrative burden incurred by the complete transaction.

Norway measures and monitors the time spent on filling out forms and preparatory work for reporting obligations. Public authorities are obliged to co-ordinate their reporting requests to businesses. The Register of Reporting Obligations for Enterprises coordinates this exercise. Each public authority annually estimates and submits estimates to the Register.

South African Experience

The South African regulatory framework is noted in the SBP report (2005) as being “*wide-ranging and complex*”. The South African regulatory environment comprises legislation from 17 different departments with a complex regulatory environment due to the necessity to regulate across the dual economies in South Africa (SBP, 2005).

While governments across the world have begun paying increasing attention to the reform of their regulatory systems in the last two decades, South Africa has been less proactive (Roux and Klaaren, 2002). Since 1994, few laws have been repealed while many new laws have been passed and a few of the old laws have been adjusted. In addition to the national laws, local government bylaws have also been passed, contributing to the “*general sense of regulatory inflation*” (Roux and Klaaren, 2002).

The series of booklets on “Laws Affecting Small Business” have highlighted a number of issues around legislation that impact on small businesses. This includes inadequate access to justice for small business, dispossession of land, the rigidity of the labour market, lack of access to finance and licensing. One of the booklets notes that licensing reduces the number and variety of businesses and reduces consumer choice and results in increased costs to be borne by consumers.

Louw (1997) says that in South Africa, onerous compliance requirements may have prevented countless potential entrepreneurs from starting businesses. Aspects of the South African legal system and regulatory environment hinder rather than help small businesses.

Roux and Klaaren (2002) mention that some national government departments have set up monitoring and evaluation directorates to assess the impact of new policy frameworks

but that evidence does not suggest that the results and recommendations are used in the policy formation process.

Their research also mentions that to some extent, National Treasury, through the Medium Term Expenditure Framework (MTEF) has indirect control over the quality of proposed laws. Cabinet, the National Parliament and Provincial legislatures conduct a degree of regulatory review but no dedicated institution exists to ensure the overall effectiveness and efficiency of regulation in South Africa (Roux and Klaaren, 2002).

Until the SBP survey (2005), 'Counting the Cost of Red Tape', was conducted in South Africa, little was known about the impact of regulation on businesses and even less about the impact on small businesses. The SBP report (2005) makes note of four main types of regulatory costs. These are compliance costs, administrative costs, efficiency costs and non-compliance costs.

The SBP report mentions "Firms, particularly new start-ups, face a daunting and protracted process of form completion and reporting" (SBP 2005). The report mentions registration, tax returns, labour legislation, additional regulations, bargaining councils, sector-specific regulations, regulations from different spheres of government and the rate of regulation as problematic areas for business with regards to red tape. It also notes that although none of the requirements are unreasonable, their cumulative impact is large (SBP, 2005).

Through the SBP (2005) survey, it was found that South African firms experience regulation as a significant constraint on their growth and their plans to create more jobs. The majority of respondents believe it is possible to avoid compliance (through reducing employment, curtailing business growth and staying below regulatory thresholds). Furthermore, state interface is noted as the most important constraint on growth and within the category, regulatory compliance was noted as the single largest constraint. Some of the costs were attributable to the use of external professionals to help comply with regulations.

The informal sector is usually excluded from most of the regulatory system, but in South Africa the major cost of regulations to informal business is the costs of non-compliance and the efficiency costs of informality.

Regulatory Best Practice

Regulatory best practice as documented in the SBP report (2005), characterises five core principles:

- Proportionality: regulators should only intervene when necessary. Remedies should be appropriate to the problem and costs should be identified and minimised
- Accountability: regulators must be able to justify decisions and be subject to public scrutiny
- Consistency: government rules and standards must be harmonised, and implemented fairly
- Transparency: regulators should be open, and should keep regulations simple and user-friendly
- Targeting: regulations should be focused on the problem, and minimise side effects

In September of 2001, the first workshop for the APEC-OECD Co-operative Initiative on Regulatory Reform was held in Beijing, China. The aim of the workshop was to provide a forum for the exchange of experiences of good regulatory practices and concepts. It was decided that although a single recipe for a policy of regulation reform does not exist, common “ingredients” could be identified. These include the following:

- The success of regulatory reform depends on sustained political support from the highest level and needs to overcome local resistance
- Regulatory reform needs to not only involve lawyers but also use a multidisciplinary approach and involve administrators, economists and statisticians
- Regulatory reform is an ongoing process

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- Effective implementation needs to be guided by clearly set objectives and concrete goals to make the measurement and assessment of performance more feasible
- Countries need to create regulatory management capacities to merge general principles
- Reforms need to be participatory and involve not only a top-down approach but also engagement with the regulated parties needs to occur
- There is a widespread demand for managing and coordinating high quality regulatory principles across all spheres of government

The APEC-OECD workshop (September 2001) identified tools to help increase the quality of regulations. These are divided into three sections – tools concerning new regulation, tools concerning existing regulation and the importance of Information Technology. These tools are not meant to replace political choices but to support and sustain them by making regulatory decisions better informed, increase coherence with the general regulatory and administrative framework, reduce resistance to the proposed regulation and increase the ownership by consulted parties.

The OECD Observer (2004) recommends a number of instruments or measures that can be implemented to cut red tape. These are:

- Use of a “Single Purpose Entity”, to improve administrative regulations for businesses and SMMEs
- “Administrative Simplification Agencies”, to promote administrative simplification for all businesses and citizens
- “Regulatory Reform Agencies”, to integrate the promotion of administrative simplification policies in units or agencies responsible for broader regulatory quality management issues
- “External Committees”, to whom the red tape cutting effort is delegated. Such committees are usually established by government and made up of non-governmental representatives like business chambers etc.

“Single Purpose Entity” or one-stop shops have been established to allow small businesses to acquire information about all administrative regulations and carry out administrative formalities. Use of interactive Web sites have been made and strong accent on the removal, simplification and standardisation of regulation has promoted reform in line with SMME requirements (STI, 1999).

Daniel Brody (APEC-OECD Workshop, 2001), the Managing Director of the US Information Technology Office and representative of the Business and Industry Advisory Committee to the OECD advocates the use of an e-government to improve government’s transparency and efficiency. Brody recommends the use of e-commerce to drastically reduce the burden on SMMEs and generally promote entrepreneurship and economic growth.

Although the above measures have been successful, there are certain conditions under which they are most successful. A degree of political support and the use of short-term taskforces are advised to focus response to political priority.

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STI (1999) observes that although variations occur across countries, general recommendations for regulatory reform to improve the environment for SMMEs are:

- The regulatory reform process should be based on explicit understanding of the overall economic importance of the SMME sector
- Regulatory policy should be forward looking and part of a broader strategy to “foster a large and healthy community of SMMEs”(who said this?)
- Regulations should ensure an economic structure within which SMMEs, and in particular micro-enterprises, are given a fair opportunity to compete
- Mechanisms should be established to ensure SMME concerns are considered and debated in the regulatory process
- Attention should be given to regulations that affect flexibility for entrepreneurial activities, (as a major SMME advantage)
- All types of SMMEs, including those which are not technology-based, innovative or high growth, should be considered when vetting regulations and reviewing regulatory effects

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