

Perceptions of Small, Medium and Micro Enterprise on the Implementation of the New Companies Act in South Africa



Professor G.E. Chiloane-Tsoka

Department of Business Management
College of Economic and Management Sciences



Synopsis

This lecture is on the perceptions of Small and Medium Enterprise (SMEs) owners regarding the implementation of the new companies Act. The research we conducted (Post Doctoral research Project funded by Unisa MSDP 2011-2012) indicated that most of the participants were not familiar with the companies Act and its compliance requirements. It further emerged that consultation and awareness made by the government or its agencies when they phased out Close Corporations was not intensified. It was found that there are different perceptions on the implementation in terms of qualifications levels. It is thus recommended that prior to the implementation of the Act, an in-depth consultation and awareness should have been conducted in order to achieve the objectives of the Act. Finally, it is recommended that sensitisation workshops be conducted among SMEs to ensure that the business owners have reasonable and sufficient understanding of the Act so that they are able to comply with its provisions unlike to be informed on the last moment that their business have been deregistered due to non-compliance.



Why was the research conducted

The research was conducted with the aim to determine the perception of SMEs with regard to the introduction of the new Companies Act No 71 of 2008.

It also assessed whether or not the Office of Compliance Property Enforcement (OCPE) will effectively educate small businesses in administrating their business .

Furthermore, an investigation was done to determine whether or not the introduction of the new Companies Act No 71 of 2008, in phasing out the Close Corporations, on balance, assists the small business sector.

Hypotheses were formulated and tested using t-test. The null hypothesis was rejected and alternative accepted

- New Companies Act empowers small businesses.
- Close Corporations play an important role in small businesses.
- The merger of CIPRO and CIPC (OCPE) will educate and administer potential SMEs as well as the current existing.



Introduction

- The adoption of the New Companies Act of 2008 came into effect on the 1st May 2011, as an amendment to replace the old companies Act N°61 of 1973.
- The new Act is envisaged to shape the landscape of the business environment in SA.
- The purpose of the Act is to minimize the cost of red tape and business rescue for companies in financial difficulties and tough penalties for Directors. Sections 29 and 30 of Act are rooted in the promotion of good governance and transparency in business.
- Outstandingly, SMEs contribute 42% of employment in the formal economy and an estimated 2 million informal businesses, while close corporations comprise 78 % of the total registered entities and are expanding at an annualised growth rate in excess of 20 % p.a. (Source: Intellectual property Database of SA). Within this context the question “**Why did government unify procedure?**” **becomes critical.**
- The study investigated the perceptions of Small, Medium and Micro Enterprise owners regarding the implementation of the new Act.
- The research employed structured questionnaires and interviews to collect data.
- Random Sample of 335 businesses in Gauteng, Limpopo, KZN, Western-Cape, North-West and Mpumalanga was selected. Of the total population, 236 questionnaires were returned. The response rate was 71%.



Why did government unify procedure becomes critical?



Background

- The new Companies Act N°71 of 2008 was signed into law by the then interim President Kgalema Motlhanthe in 2009. Kings III code of governance was the rationale behind the introduction of the new companies Act.
- The company Law was in dire need of a review; thus the purpose of the new Act was to repeal Companies Act N°61 of 1973 (South Africa, 1973) which was not relevant to the principles of clean governance and compatible with international best practices.

Some Flaws of Companies Act of 1973:

- The Act did not lay down a standard on insolvency and liquidation; also there was no inclusion of starting, growing, and dissolving of businesses.
- The small business did not form part of the regulation of the companies Act.
- The Act did not stipulate the responsibility of directors towards shareholders.
- The emphasis of the Act was in the procedure for running businesses within the context of the memorandum and articles of associations.
- One of the worst flaws, amongst others, was its rigidity and insistence on adherence to formalities even though these formalities served no purpose.



Background (Continued)

Reasons for the introduction of the New Companies Act:

- The new Act will simplify regulations for companies regardless of their nature, size, or form of incorporation. (Source Booysen, 2010).
- Sections 29 and 30 of the new Act put emphasis on the promotion of transparency as well as compliance with good governance.
- The regulatory compliance clause establishes tough penalties for Directors
- The Act will reduce the red tape of doing business in the country and make provisions for business rescue when facing financial difficulties (Rob, 2010).
- The new Act in section (74) allows director's flexibility to use some discretion and act otherwise.
- The Memorandum of Incorporation (MOI) stipulates that any decision voted at board meetings can be adopted as long as it is communicated to all directors either by fax or otherwise electronically to fast-track internal formalities.
- The New Act will benefit SMEs by improving their access to capital from financial institutions because of the tighter regulations and enforcement provisions, which was not the case before in the old companies Act (Source: Rob, 2010).
- Unifying procedures as well as regulating and reducing business red tape is viewed as a major decision on the side of government.



Background (Continued)

Some educational issues

- According to Global Entrepreneur Monitor (GEM) of 2011, South Africa's performance rate in terms of Total Entrepreneurial Activity (TEA) is 9.1% which is far below the average of comparable economies around the world. This has been attributed to the way in which the nation's educational sector has been regulated (Simri et al., 2012). Despite the educational budget being excessive, according to the 2011 Global Competitive Report, SMEs faces education backlog and has serious policy implications.
- The Global Competitive Report (2010/2011), among others, also shows that South Africa is ranked 130 out of 139 countries while the GEM report of 2010 indicates that majority of the owners of the SMEs are operating at a qualification of Grade 12 and below.
- A study by Djankov La Porta, Lopez-de-Silanes and Shleifer (2007:7), concurs with the above statement and they further agreed that the cost of registering a formal business in South Africa is comparatively high. It amounts to **0.366%** of the annual gross domestic product (GDP) per capita. In Canada it is **0.414%**, in New Zealand **0.004%** and in Chile **0.116%**.
- Small enterprises often face heavy costs in the process of preparing, filing and paying taxes in addition to the burden of tax payments which distracts business owners to complete the process.



Background (Continues)

How the SMEs perceive the New Act

- The SMEs are not aware of the Act provisions and this raises questions as to how they are going to comply with enforcement.
- Understanding the legalities and formalities of converting from SMEs to Propriety (Pty) and Close Corporations to Public Companies (Ltd) is an extra burden on the businesses.
- The phasing out of Close Corporations and compliance based on the new Companies Act requirements is perceived by the SMEs as a great obstacle in their business environment because Close Corporations were seen as a simple way to establish a business vehicle (Mashamaite, 2011). On the other hand CC has been used to “stay under the radar” and has been used to operate huge businesses specifically tailored to stay within CC definition. Steenekamp (2009) perceives that the Act will undoubtedly close down a lot of small businesses.
- SMEs are still struggling to understand the formalities of the tax submission requirements. The Act is viewed as an extra burden due to the fact that SMEs were still far from operating in a formalized business environment (Mashamaite, 2011).
- Tax administration issues also lead to incurrence of extra costs such as time and effort required for understanding the procedures, completion of tax activities, compiling receipts and recording information.



Methodology used

In this study the quantitative approach method was used in a form of a survey.

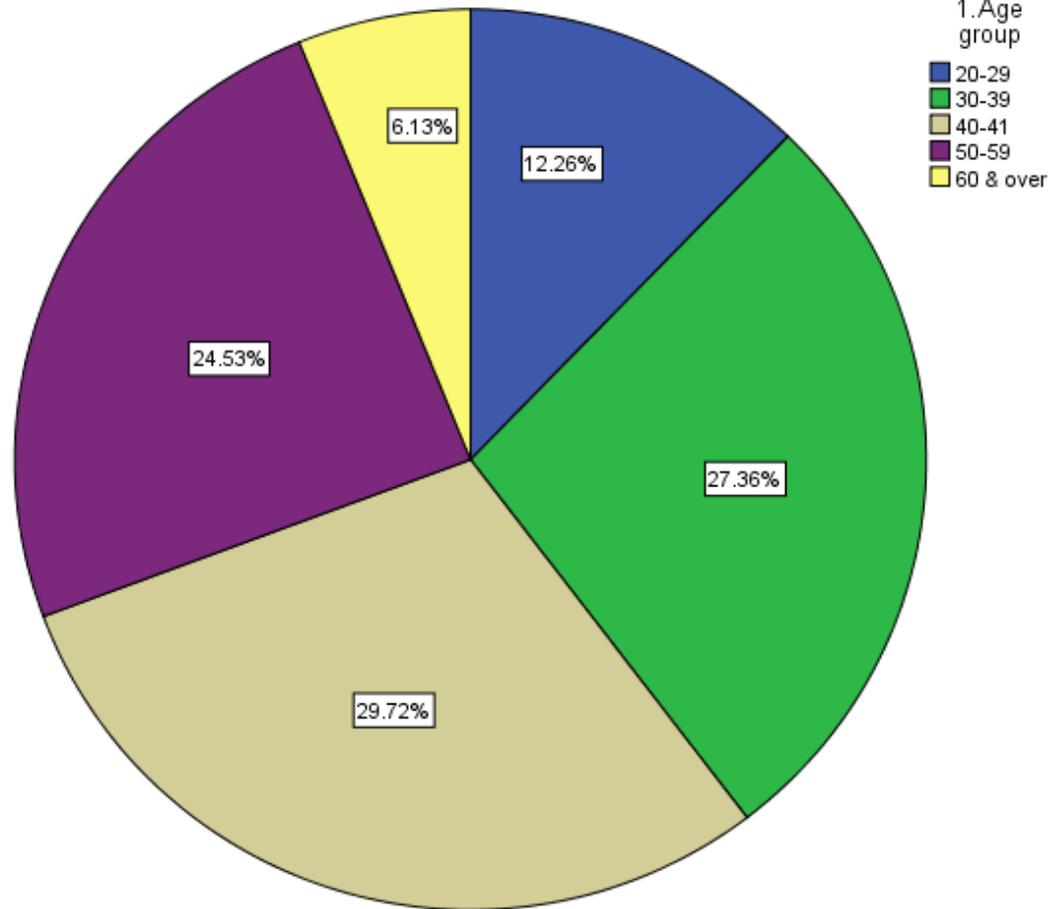
Sample Size

The random sample comprised of 335 businesses of all genders and races, as well as lawyers who have an understanding of why the Act was passed and the SMEs who were the main stakeholders. 236 returned the questionnaires and 99 did not. The response rate was 71% and 29% did not participate.



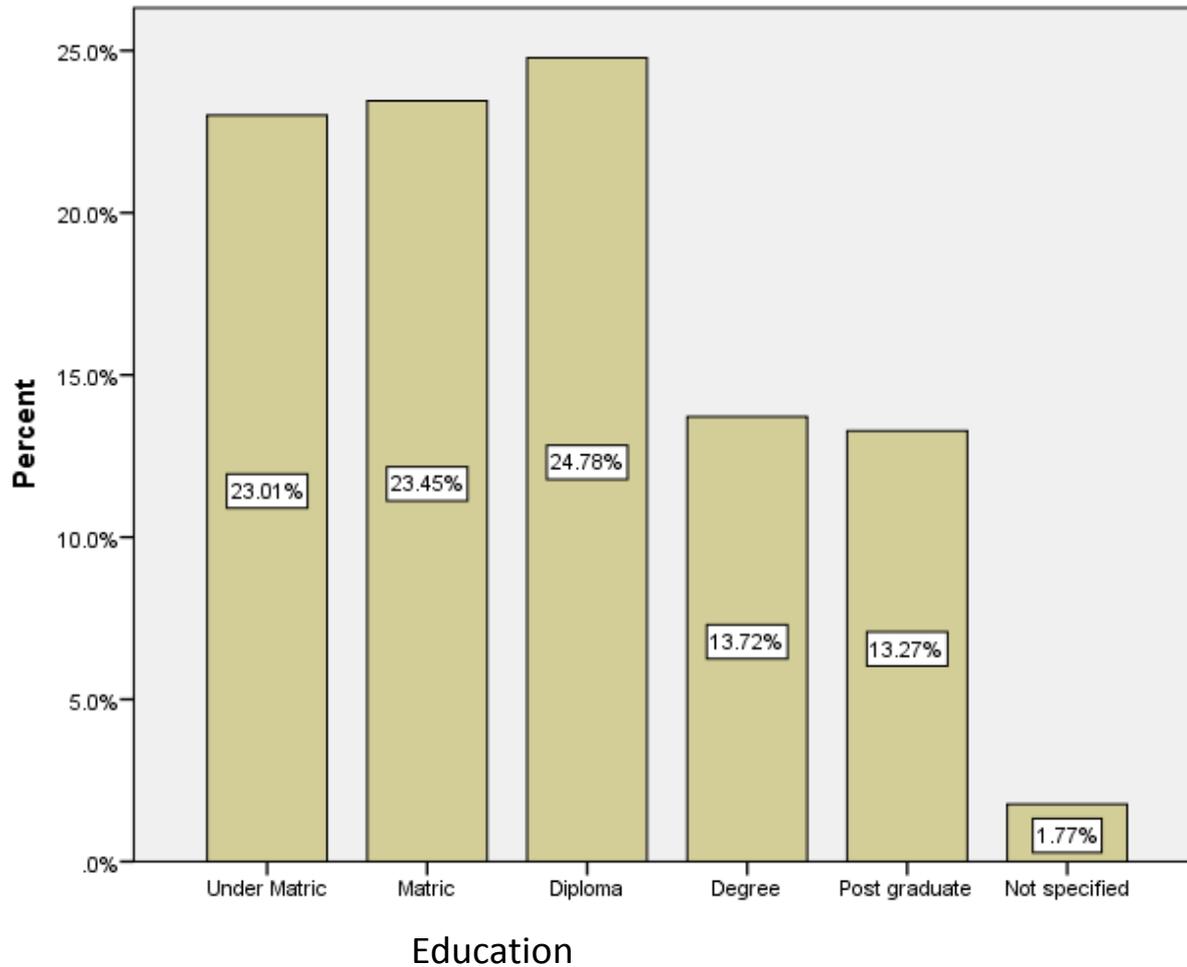
Findings

- **Demographics**



Findings (Continues)

- **Reports on Education**

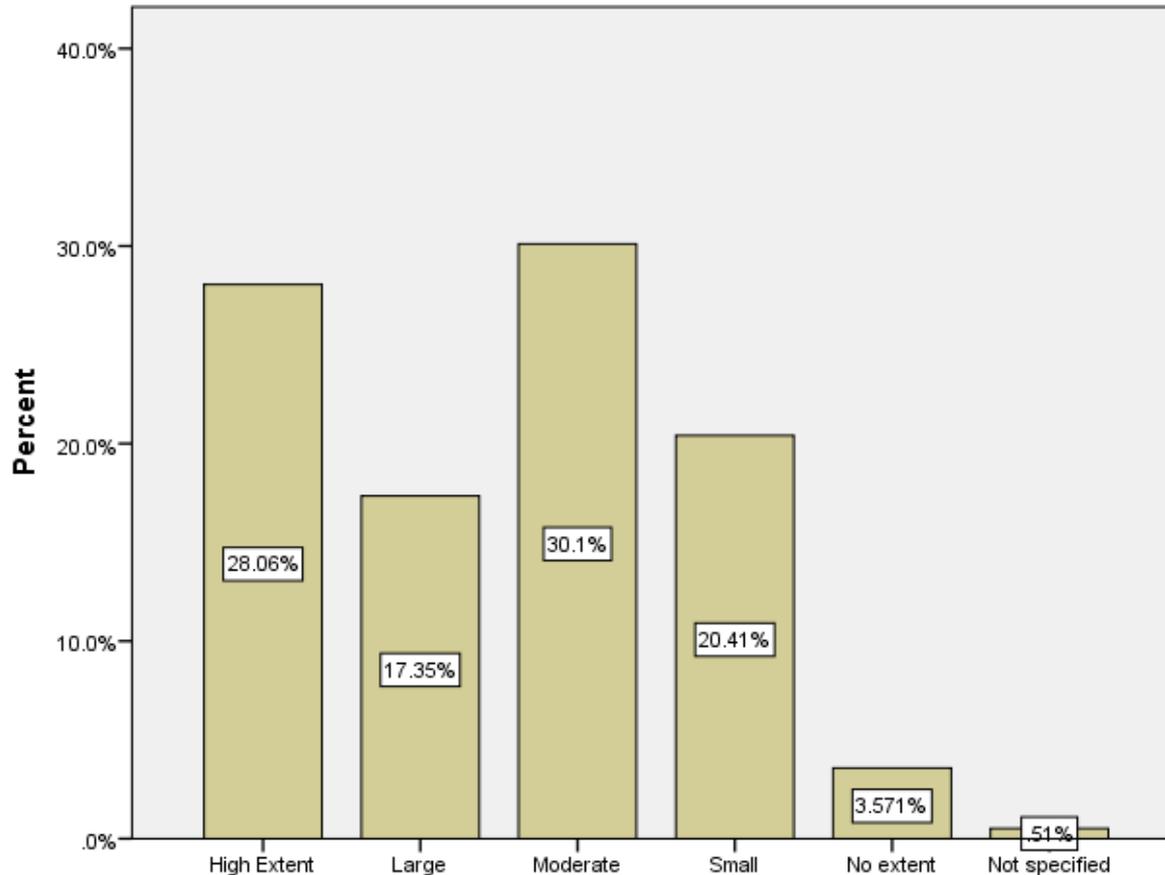


The result concurs with the report by GEM 2010. This confirms that almost 47% of SME participants have Matric and below.



Findings (Continues)

- **Reports on Understanding Tax Returns**



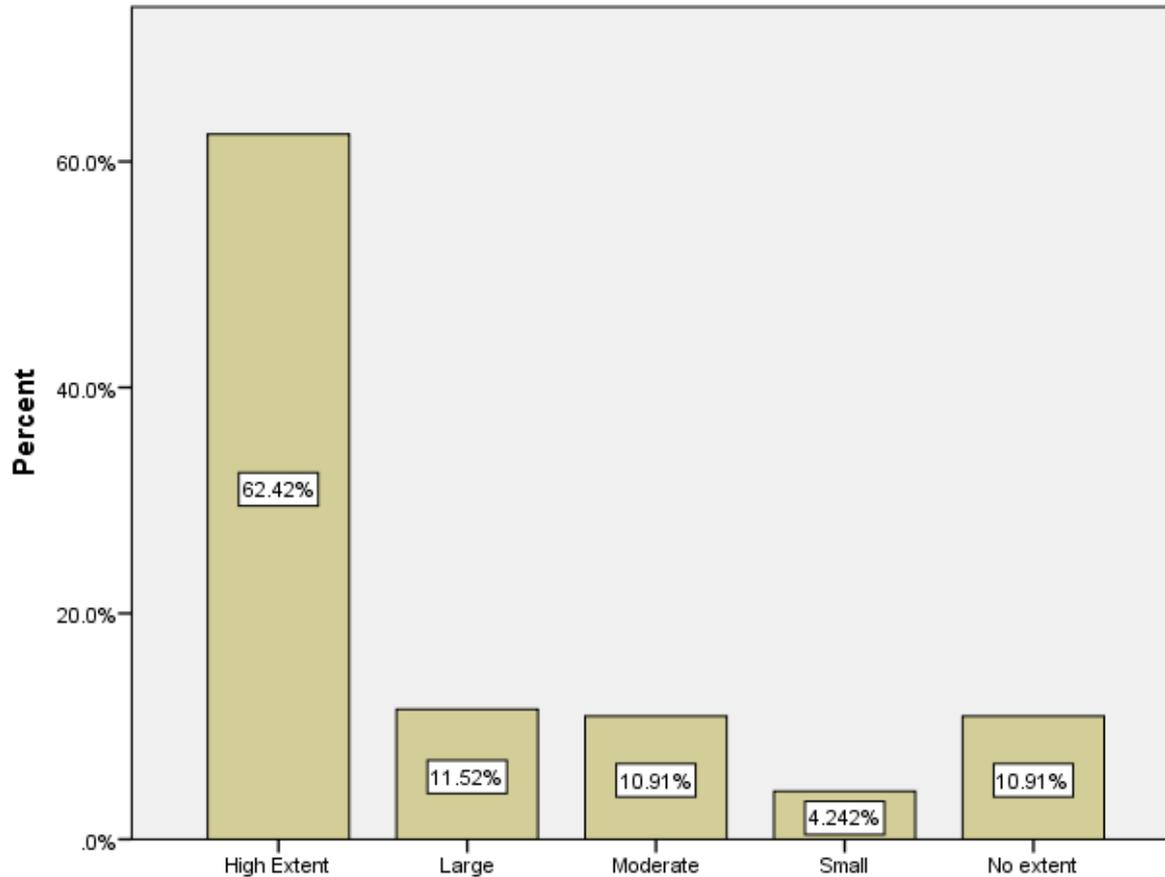
To what extent did you understand completing of tax returns

Concerning the extent to which research participant comprehended tax completion, 30.1% of them moderately understood, meanwhile 28.06% and 17.35% considerably had a grasp of what it meant to complete their taxes. The percentage which had difficulty in understanding tax completion issues was 20.41%. This small group of participants not being able to understand tax completion explains the educational backlog that is currently plaguing South African small business proprietors. This in actual fact would have further bearings on small business considering the phasing out of CCs to Ltd.



Findings (Continues)

- Reports on phasing out of the CC

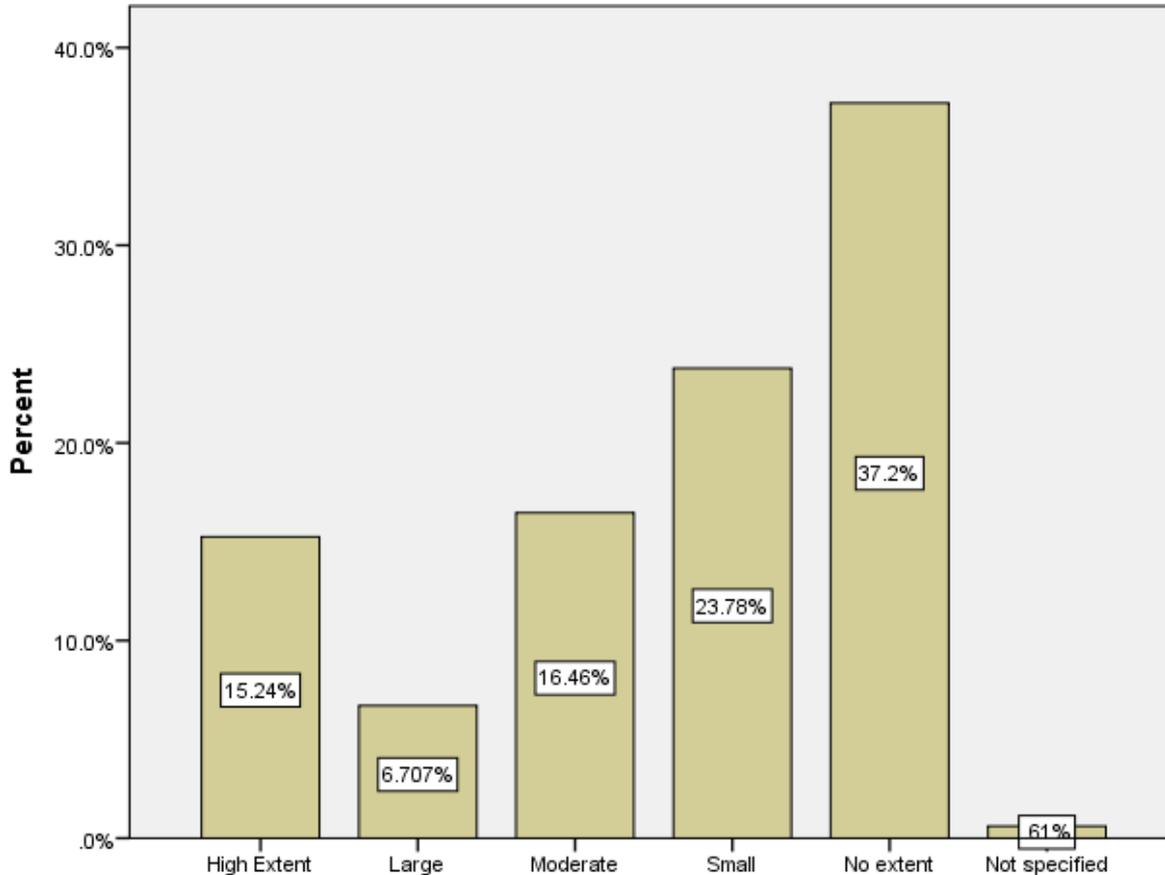


To what extent are you affected by the phasing out of CC?



Findings (Continues)

- **Reports on New Companies Act**



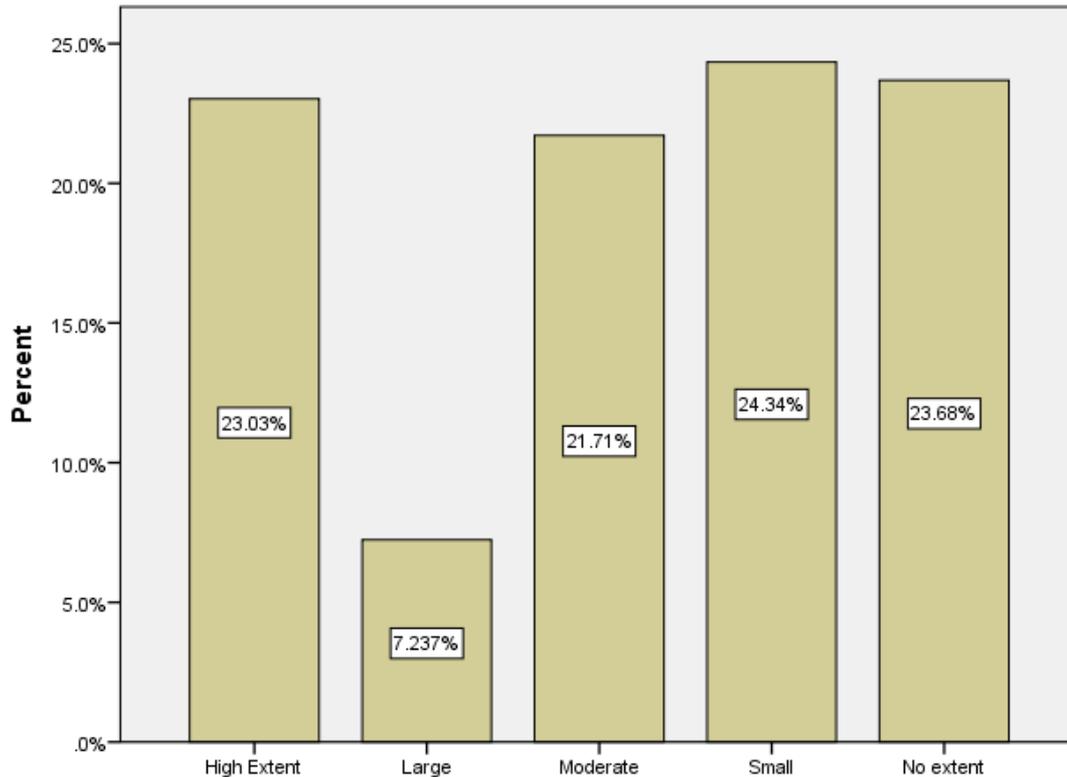
To what extent do you understand how the New Act operate?

The result concurs with the findings of the report by USAID/Financial Sector Program (FSP). SME's had very limited knowledge of the registration process and associated benefits of moving to formality.



Findings (Continues)

- **Reports on the Implication of the Act**



To what extent do you understand the implication of new business regulations in South Africa?

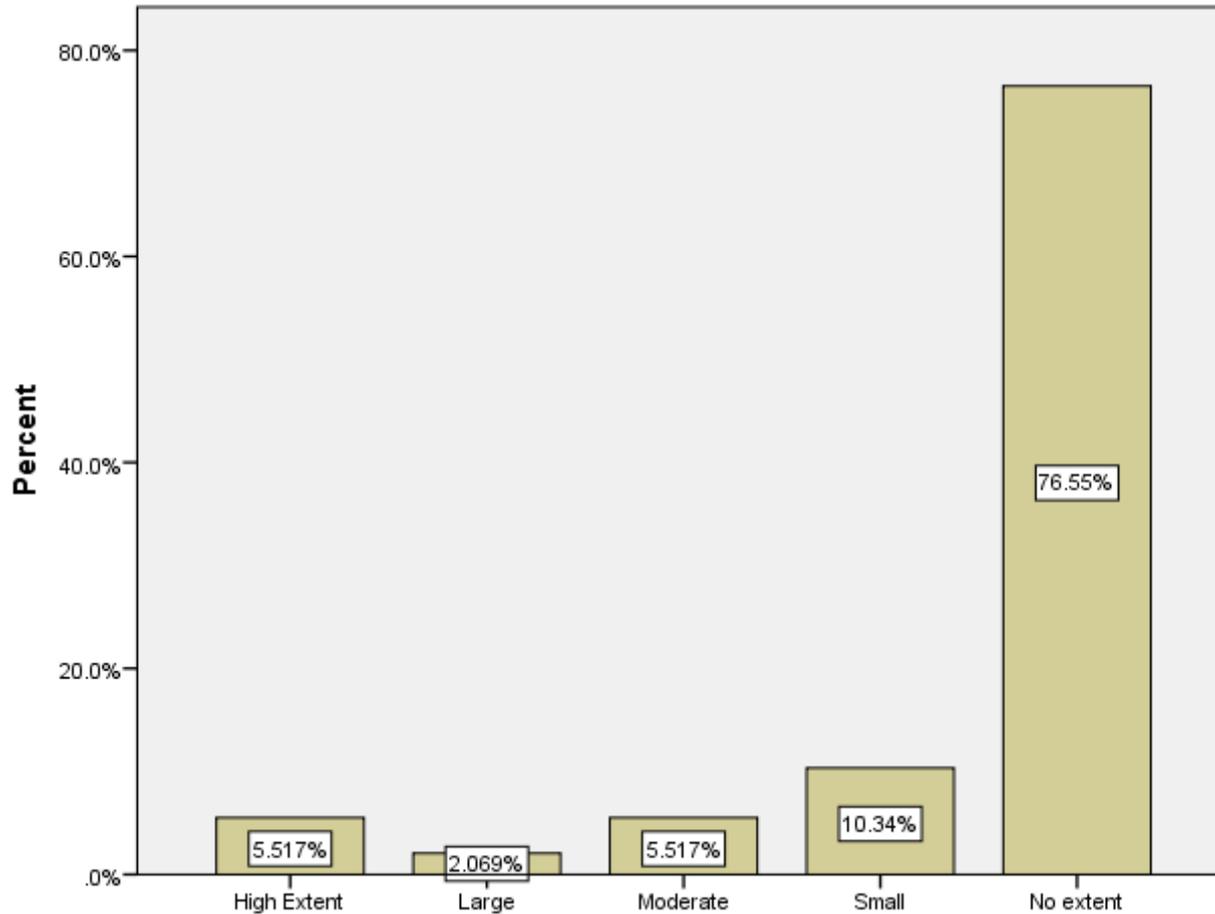
Perceptions about the Act

Regarding the extent to which participants understood the implication of new business regulations in South Africa, a small group with the highest score of 24.34% indicated that their capacity to understand the implication of new business regulations was minimal. Another 23.68% affirmed that they had virtually no understanding of the provisions of the Act. The fundamental issue among others is low educational level and lack of adequate information dissemination by government agencies such as local business service centres (LBSC).



Findings (Continues)

- **Reports on the Act's benefit to the SMEs**

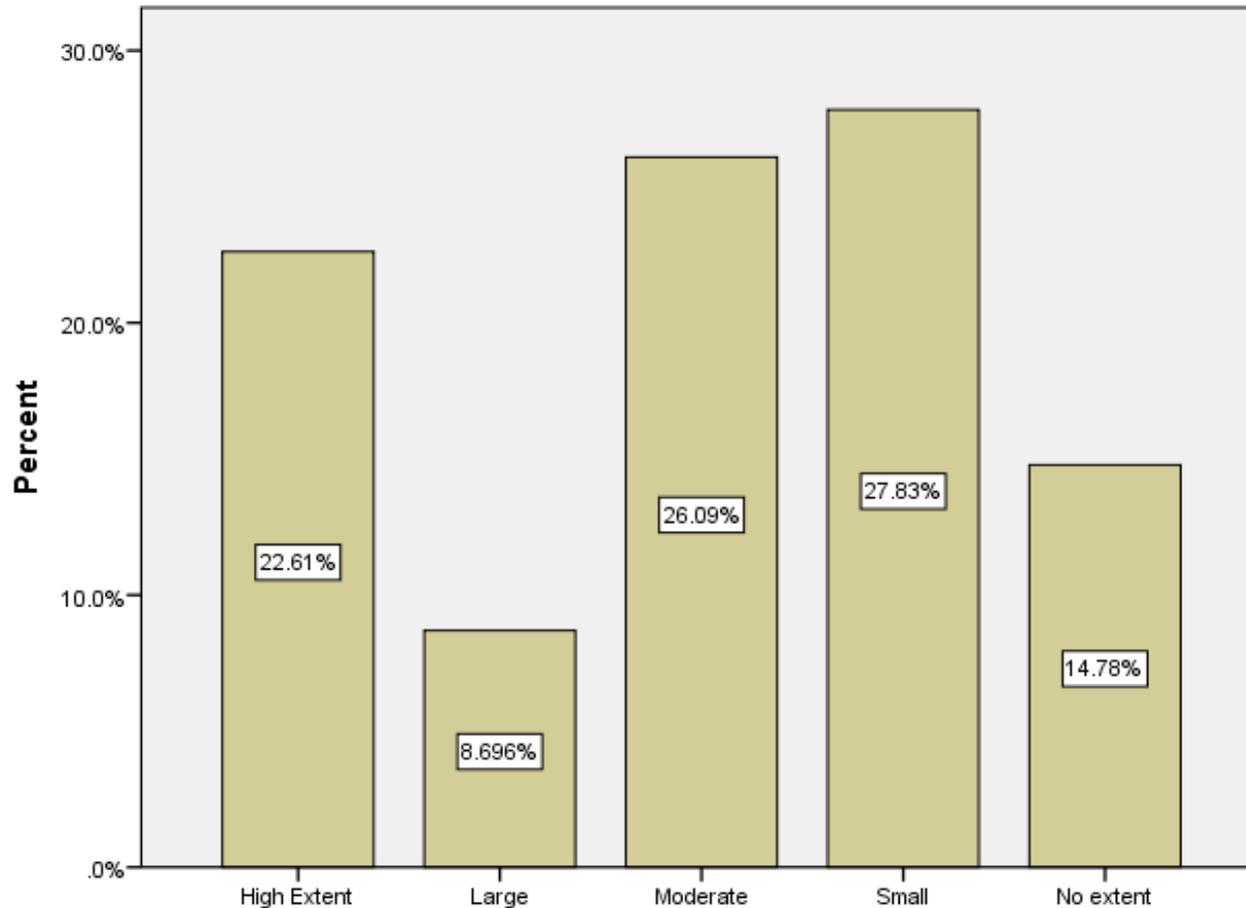


To what extent do you think the Act will be of benefit to SMEs?



Findings (Continues)

Reports on Office of Compliance Property Enforcement (OCPE)

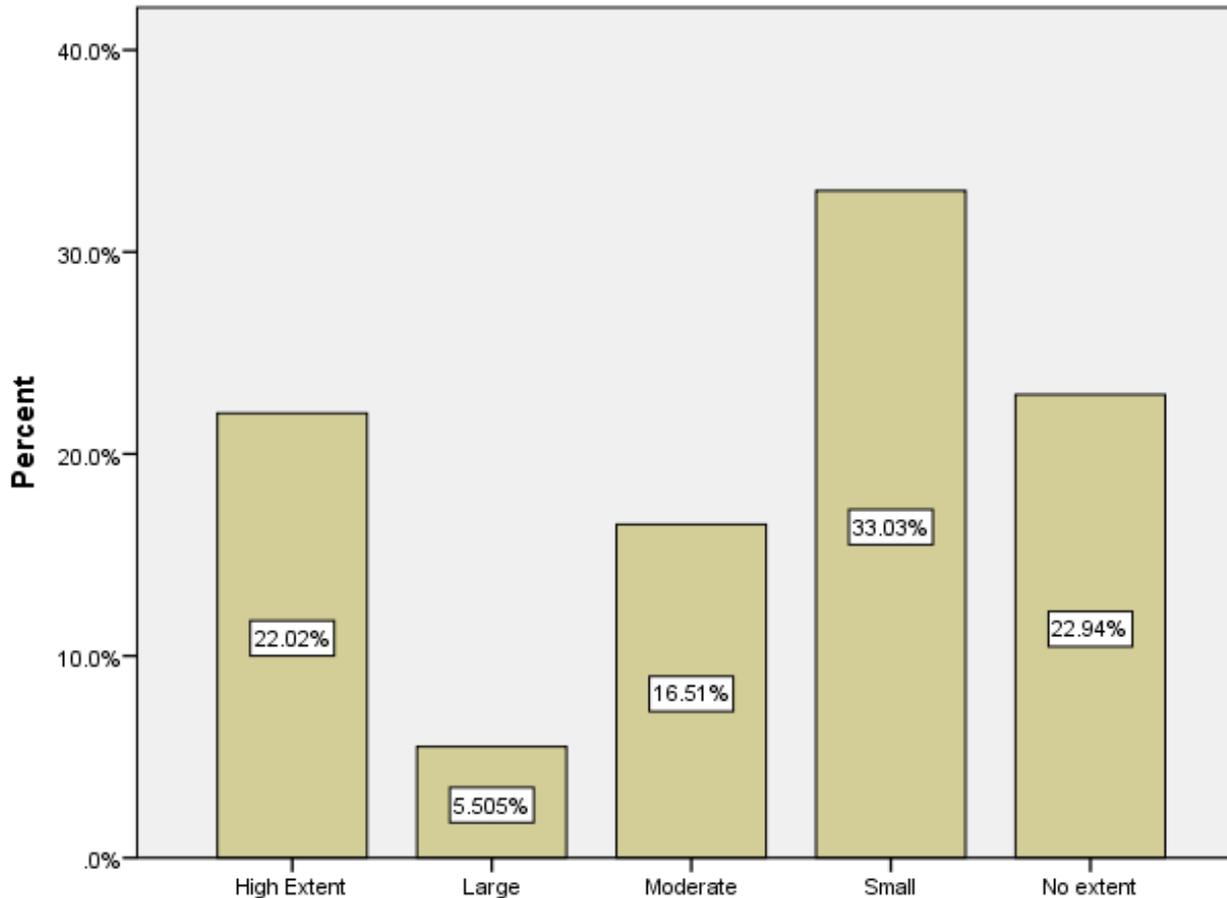


To what extent do you understand the enforcement requirements of running a business under OCPE?



Findings (Continues)

Reports on OCPE administrating personal liability of SMEs to Pty



CIPC will need to educate potential and current SMEs that the Companies Act provide for conversion flexibility from a personal liability company to a private company and eventually a public company, if desired.

To what extent do you agree the OCPE will educate SMEs in administrating personal liability company to private company?



ANALYSIS

- In this study I used SPSS to analyse data. Cross tabulations were used for provinces, and demographics. T-test was used to test the hypotheses.

The results revealed the following:

- Information about the new companies Act is not significantly known
- 68% of SMEs in Gauteng province were familiar with the Act as compared to 10% of Mpumalanga. This is accorded to the fact that many SMEs in Mpumalanga operate their businesses unregistered.
- Most participants got information dissemination via newspapers compared to other methods of information dissemination. These media were more effective than Local Business Service Centres - a structure established by government.
- SMEs lack information on how the Act will impact on their business.
- Majority of participants were in the age between 30-39 and 40-49
- Education had significance
- Provinces had significance
- Size of business no significance



Conclusions

- People with lower qualifications tend to comprehend the effect of the Act.
- Participants with higher qualifications appear to be at advantaged positions to understand the provision of the Act.
- Consultation and awareness made by the government or its agencies when the phasing out of CC was not sufficiently effective.
- Participants in Gauteng province were more informed about the companies Act than those operating in Mpumalanga.
- Many participants are aware of the implications associated with the compliance requirements.
- Finally, there is a theory and practice gap in the implementation of the new Act



Recommendations

- This study suggests that building capacities through the provision of workshops for SMEs owners is an imperative if the objectives of the Act are to be achieved.
- The workshops should assist SMEs owners to convert to Pty status and they should educate SMEs in terms of compliance if the introduction of the Act is to be effective.
- This study recommends mentoring and networks that will inform small business owners on the Act.
- The research also recommends a coherent monitoring and evaluation service by DTI to ensure that there are workshops taking place in all provinces.
- Consideration should be given to the effectiveness of Local Business Service Centres in their current form. They might be, for example, the platform for more effective workshops.
- Phasing out of CC was a major concern to most participants supporting the Steenkamp Report which considered the implementation of the new Act to be a significant risk to the growth of the economy in these sectors.
- This is why this study considers that the utmost assistance should be given to the SME sector in converting to the Pty format.



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Thank you
Merçi beaucoup
Siyabonga
Dankie

