



The [Flourishing] Entrepreneur:

A case for legislative intervention to support healthy SMME financial access in South Africa

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Supervisor : Dr Cheri-Leigh Young

Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the LL.M in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

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Abstract

This thesis presents human flourishing as the theoretical foundation from which to pursue social policy in the post-colony. Accepting this theoretical foundation, the purpose of this thesis is to reflect on the role and potential of small, micro and medium enterprises (SMMEs) in South Africa. Further, this thesis will consider in what manner the law can support the realisation of the potential of South African SMMEs.

The main value of this thesis is to illustrate the positive distributional impact that a human flourishing approach to legal intervention can have for a property system, which has the objective of supporting the realisation of the capabilities of persons in society. This value is illustrated in this thesis by analysing the relationship between the South African SMME and retail banking sectors.

This thesis has chosen to focus on the SMME sector because of the role identified for SMMEs in South Africa's growth strategy, the National Development Plan (NDP).¹ This role includes recognising SMMEs as being an entry point for previously excluded persons into the mainstream economy. A recent report by the Small Enterprise Development Agency (SEDA) highlights that the potential of SMMEs in South Africa remains unrealised.² The report identifies key barriers to SMME flourishing in South Africa. This thesis focuses on the following identified barriers

¹ National Planning Commission (NPC) 'National Development Plan 2030 – Our Future, Make It Work' (2012).

² Small Enterprise Development Agency (SEDA) 'Imbadi: Official Quarterly Publication – June 2016' (2016) Department of Small Business Development.

in the report: (i) the existing legal framework with respect to SMMEs; (ii) existing government agency support available to SMMEs; and (iii) the ability of SMMEs to access finance and credit.³

A primary finding in this thesis is existing credit structures in the retail banking sector are negatively biased towards the black population group. This has an adverse impact on black entrepreneurs. It is suggested in this thesis that this negative bias is a consequence of apartheid. Apartheid had the effect of regulating the access that black people had to the mainstream economy and their ability to acquire and accumulate property. Recognising that SMMEs have an identified role to play in South Africa's growth strategy,⁴ this thesis finds that legislative intervention in the retail banking sector is needed to overcome this negative bias and to support increased SMME access to finance and credit.

This thesis interprets the preamble to the Constitution,⁵ as well as the concept of transformative constitutionalism, as mandating a capabilities-approach to human development. It is for this reason that a property system with a distributional outcome that supports the realisation of the capabilities of persons in society is preferred by this thesis.

It is only once there is a real commitment of moving the majority of South Africans into the mainstream economy will inroads to tackling inequality and poverty be made.

³ Ibid at 2.

⁴ See note 1.

⁵ The Constitution of the Republic of South Africa, 1996.

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List of abbreviations and acronyms

BER	Bureau for Economic Research
BBSDP	Black Business Supplier Development Programme
CIS	Co-operative Incentive Scheme
DAFF	Department of Agriculture, Forestry and Fisheries
DED	Department of Economic Development
DST	Department of Science and Technology
DTI	Department of Trade and Industry
GDP	Gross Domestic Product
GNP	Gross National Product
IDC	Industrial Development Corporation
ISBDS	The Integrated Small Business Development Strategy in South Africa 2004 - 2014
MAFISA	Micro-Agricultural Financial Institute of South Africa
NEFCORP	National Empowerment Fund Corporation
NDP	National Development Plan
NIBUS	National Informal Business Upliftment Strategy
NPC	National Planning Commission
NSB	National Small Business Act 102 of 1996
NSBAC	National Small Business Advisory Council
NYDA	National Youth Development Agency
QLFS	Quarterly Labour Force Survey
RDP	Reconstruction and Development Programme
SA	South Africa

SAMAF	South African Micro-Finance Apex Fund
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SEIF	Shared Economic Infrastructure Facility
SMME	Small, Micro, and Medium Enterprise
SME	Small and Medium Enterprise
TIA	Technology Innovation Agency

Note: The term SMME and SME is used interchangeably in South Africa.

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CHAPTER ONE: INTRODUCTION

The story of South Africa's unequal society has been widely canvassed. However, little has changed since the dawn of democracy in 1994.⁶ Apartheid played an instrumental role in creating and entrenching an economic and social structure in South Africa, which has placed a disproportionate and undue burden on black South Africans.⁷ The Constitution of 1996⁸ recognises this unfortunate legacy. It envisions a legal framework that is transformative in order to address past injustices and promote the flourishing of all South Africans.⁹

This thesis analyses the relationship between the South African SMME and retail banking sectors to illustrate how existing legal interventions in the market place do not adequately support the transformative nature of the Constitution.¹⁰ This thesis proposes the use of human flourishing theory to inform legal intervention in the marketplace. Human flourishing theory is proposed and used, because in pursuing the advancement of the well-being of persons, the theory focuses on the development of a person's capabilities.¹¹ This thesis proposes that legal intervention which advances the development of a person's capabilities is to be preferred because such legal intervention would best align with the transformative nature of the South African Constitution.¹²

⁶ R M Carter and J May 'One kind of freedom: poverty dynamics in post-apartheid South Africa' (2001) 29 *World development* 12 1987-2006 at 1996 - 1999.

⁷ Ibid at 1997.

⁸ See note 5.

⁹ S Liebenberg and B Goldblatt 'The interrelationship between equality and socio-economic rights under South Africa's transformative constitution' (2007) 23 *South African Journal on Human Rights* 2 at 338.

¹⁰ See note 5.

¹¹ D B Rasmussen 'Human Flourishing and the appeal to Human Nature' (1999) 16 *Social Philosophy and Policy* 1.

¹² See note 5.

1.1. Background

In 1998, former President Thabo Mbeki, relying on the imagery captured by Disraeli's identification of English society in 1845 as comprising of 'Two Nations',¹³ characterised South Africa as being divided into 'two nations, the one black and the other white'.¹⁴ He stated:

'One of these nations is white, relatively prosperous, regardless of gender or geographical dispersal. It has ready access to a developed economic, physical, educational, communication and other infrastructure. This enables it to argue that, except for the persistence of gender discrimination against women, all members of this nation have the possibility of exercising their right to equal opportunity, and the development opportunities to which the Constitution of 1993 committed our country. The second and larger nation of South Africa is black and poor, with the worst-affected being women in the rural areas, the black rural population in general and the disabled. This nation lives under conditions of grossly underdeveloped economic, physical, educational, communication and other infrastructure. It has virtually no possibility of exercising what in reality amounts to a theoretical right to equal opportunity, that right being equal within this black nation only to the extent that it is equally capable of realisation.'¹⁵

It can be argued that this description of South Africa's two nation state still holds true today. South Africa recognises four population groups: black african (black), coloured, indian/asian (indian), and white.¹⁶ Between 1994 and 2014, the official unemployment rate in South Africa grew from 22 per cent to 25 per cent.¹⁷ The proportion of black workers who were part of the labour force grew from 63 per cent to 73 per cent.¹⁸ Further, this period recorded an uneven distribution of skills growth within population groups.¹⁹

¹³ D Benjamin 'Sybil, or The Two Nations' (1845) 74.

¹⁴ N Natress and J Seekings 'Two Nations? Race and Economic Inequality in South Africa Today' (2001) 130 *Daedalus* 1 at 46.

¹⁵ *Ibid* at 45.

¹⁶ Statistics South Africa 'Employment, Unemployment, Skills And Economic Growth' (23-07-2013) <http://www.statssa.gov.za/presentation/Stats%20SA%20presentation%20on%20skills%20and%20unemployment_16%20September.pdf> (accessed on 24-07-2016). The presentation relied on data from the 1994 October Household Survey and the 2014 Quarterly Labour Force Survey.

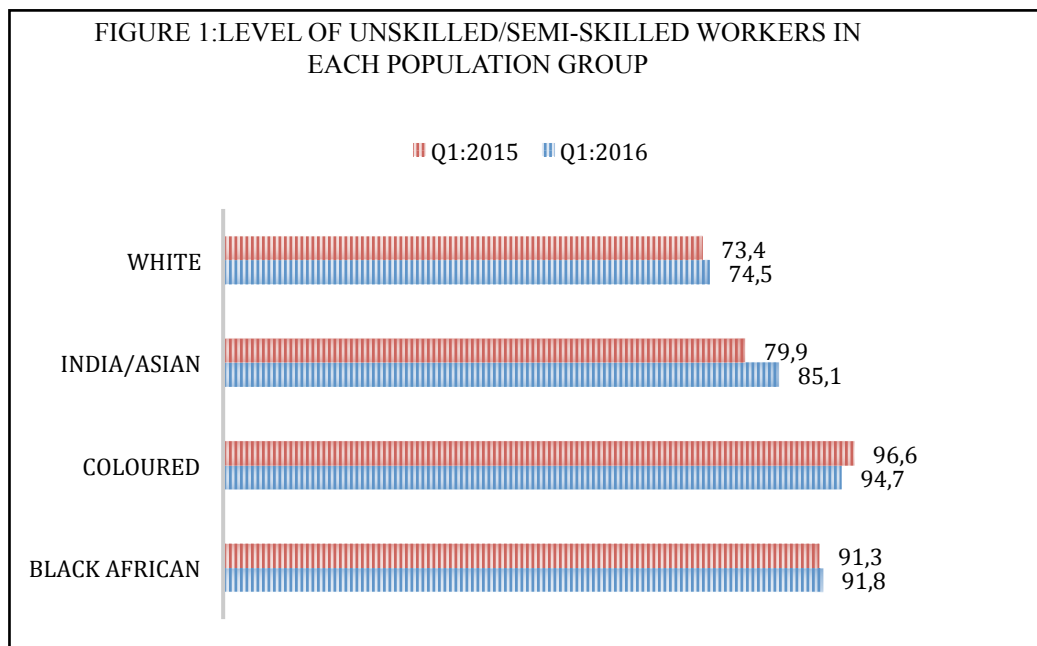
¹⁷ *Ibid* at 14.

¹⁸ *Ibid* at 15.

¹⁹ *Ibid* at 27.

As a proportion, the growth in skills within the black population group was much lower than in other groups.²⁰ Figure 1 is extracted from the Quarterly Labour Force Survey (QLFS) for the first quarter of 2016.²¹ The values presented in figure 1 must be understood in terms of the absolute size that each population group accounts for in the labour force.

Figure 1 highlights that the majority of unemployed persons fall into the unskilled or semi-skilled category and that this category has increased for most population groups. This is concerning because key sectors in South Africa's economy include the wholesale, retail and finance sectors.²² These sectors require semi-skilled to skilled labour.²³ If the objective is to include more people into the mainstream economy, then it would follow that more persons need to be receiving skills that can make them fully active economic participants.²⁴



²⁰ Ibid.

²¹ Statistics South Africa 'Quarterly Labour Force Survey - Quarter 2 2016' (28-07-2016) <<http://www.statssa.gov.za/publications/P0211/P02112ndQuarter2016.pdf>> (accessed on 05-03-2016) at 14.

²² A Banerjee, S Galiani, J Levinsohn, Z McLaren and I Woolard 'Why has unemployment risen in the new South Africa?' (2008) 16 *Economics of Transition* 4 at 723.

²³ Ibid.

²⁴ Ibid at 724.

Alternatively, as the Centre for Development and Enterprise²⁵ has suggested, it may not be necessary to change the sectoral composition of the labour force.²⁶ Rather, what is needed is the creation of jobs for the type of labour that we have available.²⁷ Regardless, what is clear is that there is currently a disconnect between labour supply and labour demand in South Africa, placing year on year, upward pressure on unemployment and positively contributing towards inequality and poverty in South Africa.²⁸

The economic structural exclusion of black people is a consequence of the apartheid enterprise. The well-publicised system of spatial segregation, job reservation and Bantu education created, and has supported, the exclusion of black people from the South African mainstream economy.²⁹ This exclusion has been embedded within the South African social system. Despite the legal reform introduced by the Constitution,³⁰ which includes the unique recognition of a justiciable Bill of Rights that has captured a broad range of socio-economic rights,³¹ the economic exclusion of black people persists. This can be illustrated in the negative bias towards black people in the composition of the low-skilled labour sector and unemployed.³² To bridge the growing economic divide within South African society, opportunities

²⁵ Centre for Development and Enterprise (CDE) 'Rethinking South Africa's Labour Market: Lessons from Brazil, India and Malaysia' (13-06-2013) <<http://www.cde.org.za/rethinking-south-africa-s-labour-market-lessons-from-brazil-india-and-malaysia>> (accessed on 20-08-2016).

²⁶ Ibid at 29.

²⁷ Ibid at 30.

²⁸ See note 16.

²⁹ See note 14 at 51.

³⁰ See note 5.

³¹ This is illustrated in the broad range of socio-economic rights provided for in the Constitution of the Republic of South Africa, 1996. See further: P De Vos 'Pious wishes or directly enforceable human rights: Social and economic rights in South Africa's 1996 Constitution' (1997) 13 *South African Journal on Human Rights* 67 at 69.

³² See note 21.

must be capitalised on that enable black people to access, and become active in, the mainstream economy.

The National Development Plan (NDP) is the product of the National Planning Commission (NPC).³³ The NDP has set the desired goals for South Africa for 2030 and identified the role(s) of key stakeholders in driving the change needed to achieve these goals.³⁴ At the heart of the NDP is the achievement of the elimination of inequality and poverty.³⁵ It is with this understanding that the NDP recognised the importance of small-scale entrepreneurship and the small, micro, and medium enterprise (SMME) sector. This sector presents an employment opportunity that can be leveraged to reduce the growing polarisation of South African society.³⁶ The NDP identifies SMMEs as an avenue to increase economic inclusiveness through increasing the economic participation of black people, women, the youth and persons with disabilities.³⁷

This recognition of the role of SMMEs is not unique to South Africa, but can be considered as an observable trend in developing markets.³⁸ However, South Africa's small scale entrepreneurship and SMME sector is underperforming when compared to its international counterparts.³⁹ A report commissioned by the Small Enterprise Development Agency (SEDA) highlight key challenges that inhibit the realisation of the potential of South African SMMEs. These challenges include access to finance and credit, poor infrastructure, low levels of research and development, onerous

³³ See note 1.

³⁴ Ibid at 49.

³⁵ Ibid at 41.

³⁶ Ibid at 117.

³⁷ Ibid.

³⁸ A Bouri, B Mark, D Magatte, K Randall, K Bailey, and S Keely 'Report on support to SMEs in developing countries through financial intermediaries' (2011) *Dalberg* at 7.

³⁹ Ibid at 11.

labour laws, an inadequately educated workforce, inefficient government bureaucracy, high levels of crime, and lack of access to markets.⁴⁰

1.2. Theoretical approaches to improving social welfare

The rhetoric surrounding South Africa's social policy is that social welfare in South Africa will only be enhanced once the great majority of black people are economically secure. This is evident in the approach of the NDP in focussing on promoting social outcomes that provide persons with economic security.⁴¹ However, there are a number of competing theories and approaches to tackling social welfare that do not necessarily only focus on economic factors and indices. These alternative approaches, it will be argued in this thesis, provide a better framework for determining the extent to which real progress is being made in terms of South Africa's transformative project. These alternative approaches are introduced below, and are more fully canvassed in chapters three and four of this thesis.

Nussbaum and Sen highlight that the pursuit and achievement of economic security should not be considered the exclusive factor that drives greater social welfare.⁴² The traditional or resource-based approach focuses on economic factors, namely, the provision of material resources to individuals, and encourages an equal distribution of resources.⁴³ Advances in social welfare under the traditional approach can be

⁴⁰ National Bureau for Economic Research 'The Small, Medium and Micro Enterprise Sector of South Africa' (2016) Commissioned by the Small Enterprise Development Agency 1 at 7.

⁴¹ See note 1.

⁴² A K Sen 'Rational Fools: A critique of the behavioral foundations of economic theory' (1977) 6 *Philosophy and Public Affairs* 4 at 323.

⁴³ M C Nussbaum 'Women and equality: The capabilities approach' (1999) 138 *International Labour Review* 3 at 228.

understood through concepts like Gross National Product (GNP), the Gini coefficient and child mortality measurements.⁴⁴

Nussbaum critiques the traditional approach. Nussbaum's critique is based on the following key attributes: (i) the nature of the composition of GNP per capita, (ii) the approach adopted in the composition of GNP per capita is distribution insensitive, (iii) the traditional approach does not provide a link between resource allocation and how persons convert those resources into functions, and (iv) the traditional approach assumes a base level of autonomy for all persons that in reality does not hold.⁴⁵ Each of the critiques is set out in more detail below.

The traditional approach assumes a general standard measurement for social welfare to be applied to all communities, despite it being common cause that different communities have different value systems.⁴⁶ For example, under the traditional approach a measurement that can be considered when determining whether social welfare is improving is Gross National Product (GNP) per capita.⁴⁷ GNP per capita is the calculation of a country's total production divided by the number of persons in the country. Higher levels of GNP per capita are regarded as an indicator of higher levels of social welfare.⁴⁸ However, the nature of this calculation is that it only considers measurable factors.⁴⁹

⁴⁴ Ibid at 232.

⁴⁵ Ibid at 228.

⁴⁶ Ibid at 230.

⁴⁷ P L Berger 'The Gross National Product' (1994) Policy 4 at 7.

⁴⁸ Ibid.

⁴⁹ See note 43 at 232.

Secondly, a measurement of GNP per capita provides an aggregate illustration of a community and therefore is insensitive to distribution.⁵⁰ This is because an aggregate illustration does not indicate who has the money in the economy, does not indicate what government has done for designated groups,⁵¹ or the nature of existing social classes and the differences between these classes.⁵² Nussbaum argues that to account for these areas of consideration, factors such as life expectancy, infant mortality, educational opportunities, health care, employment opportunities, land rights and political liberties would need to be included.⁵³

For Nussbaum, the reliance on indices in the traditional approach equates the achievement of progress with higher levels of access and/or a more 'equal' distribution of a resource.⁵⁴ However, this does not relate how a person may engage with available resources in a manner that supports their development and the exercise of their capabilities.⁵⁵

For example, to increase employment opportunities for women in the labour market, the government may decide to intervene by requiring that ten out of every twenty medical posts must be filled by women. The availability of the resource may be undermined where, despite ten posts being made available, the nature of the posts have not been adapted to accommodate the needs of women so as to enable them to take up the opportunity.

⁵⁰ Ibid.

⁵¹ Designated groups include youth, women, previously disadvantaged racial/ cultural groups and the disabled.

⁵² See note 43 at 232.

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ Ibid.

Accommodating for the specific gender-needs of women could include adjusting the terms of employment to account for the distinct employment needs of men and women, which may differ because of unique circumstances that may prevail for the latter, such as pregnancy. Nussbaum suggests that using an approach to social welfare that is premised on an equal distribution of resources will often have the outcome of: (i) not recognising the abovementioned example, and (ii) reproducing inequalities that are highly related to well-being.⁵⁶

Finally, Nussbaum critiques the traditional approach because it assumes that within society there exists a sufficient level of autonomy among members of the citizenry to engage in the resources made available and convert them into capabilities.⁵⁷ Therefore, building on the previous example, it is assumed that women have a level of autonomy that would give rise to a preference for economic independence and a job opportunity that would be at odds with the traditional homemaker role. Based on this assumption, where ten medical posts are made available, if they are not taken up, then this is done by choice. This conclusion would require an interrogation of what level of autonomy is considered sufficient to enable a fully informed choice. The traditional approach does not engage with such an interrogation.

Bruni⁵⁸ highlights that a traditional approach towards social welfare prioritises the achievement of higher levels of income, employment and wealth. The achievement of these factors would support greater levels of social welfare. However, studies of

⁵⁶ Ibid at 227.

⁵⁷ Ibid at 242.

⁵⁸ L Bruni 'Civil Happiness: economics and human flourishing in historical perspective' in *Happiness Again* (2006) ch 3.

post-war countries, that relied on a traditional approach to improving social welfare, have recorded at aggregate, relationships of constant or decreasing levels between wealth and self-reported individual happiness.⁵⁹ While there is evidence for a positive relationship between wealth and happiness at a point in time in a person's life cycle, the relationship is ambiguous for the entire life cycle.⁶⁰ Therefore, it may be that greater access and a more equitable distribution of resources does not necessarily improve individual happiness or encourage greater levels of social welfare.

An alternative to the traditional or resource-based approach is the capabilities-based approach to social welfare which has its roots in *eudaimonia*.⁶¹ *Eudaimonia* can be understood with reference to human flourishing theory, which proposes that it is the creation of an environment that allows for the realisation of the full potential of a person that would best support social welfare.⁶² The theory acknowledges that the advancement of economic security is often accompanied by positive changes within the material environment. These changes are desirable when the objective is to create an environment for flourishing, but economic security is not the only factor to be considered.⁶³

⁵⁹ E Easterlin 'Does economic growth improve human lot? Some empirical evidence' in P A Davis and M W Reder (eds) *National and Households in Economic Growth Essays in Honor of Moses Abramowitz* (1974).

⁶⁰ E Diener & M E P Seligman 'Beyond money: towards an economy of well being' (2003) *Psychological Science in the Public Interest* 5 at 13.

⁶¹ See note 11. When translated "*eudaimonia*" means 'happiness'.

⁶² *Ibid* at 11.

⁶³ *Ibid*.

1.3. Thesis structure

This thesis aims to contribute towards the opinions on how to improve the welfare of South Africans through the use of the law. Accordingly, this thesis, rejects the traditional approach (outlined above), and adopts human flourishing theory as the ideological base to inform how the law should be developed, for the purpose of increasing social welfare.

Thereafter, this thesis demonstrates, how this can be done by analysing the relationship between the SMME and retail banking sector, and proposing legal intervention to improve this relationship. This thesis explores the SMME sector within South Africa, paying particular attention to the current regulatory environment in terms of access to finance and credit, as experienced by SMMEs. With an appreciation of the potential role of SMMEs, this paper proposes legislative intervention that would provide for increased SMME access to finance and credit.

It is recognised that there is limited literature on human flourishing theory and specifically, on how the theory can be used for the purpose of developing law. Therefore, the discussion on human flourishing within this thesis is primarily based on the perspectives of Rasmussen,⁶⁴ and Alexander and Peñalver.⁶⁵

Chapter 2 of this thesis reflects on the current profile of South Africa's SMME sector. It focuses on the legal framework, existing government support programmes, and the current ability of SMMEs to access finance and credit.

⁶⁴ See note 11.

⁶⁵ G S Alexander and E M Peñalver 'An introduction to property theory' (2012).

Chapter 3 of this thesis introduces the theoretical framework, human flourishing. Specifically, it explores the theory of human flourishing at an individual level. Further, by relying on human flourishing theory, the chapter provides a brief assessment on how the apartheid legal system prevented South Africans from flourishing. Finally, the chapter suggests that the use of human flourishing theory in developing the law is appropriate given the transformative nature of the South African Constitution.⁶⁶

Chapter 4 explores human flourishing theory at a societal level. To better understand how human flourishing can influence the nature of legal intervention, the chapter supplements Rasmussen's human flourishing theory with Alexander and Peñalver's human flourishing theory for property systems. This chapter concludes the establishment of the theoretical framework.

Chapter 5 reflects on the relationship between the SMME and retail banking sectors by providing practical examples in support of this thesis herein, namely, human flourishing theory as the guiding model for law-making and specifically, market intervention in South Africa.

These examples will demonstrate how market intervention informed by human flourishing theory can support the broader developmental goals of society and support the flourishing of entrepreneurs at an individual level. These examples would include the provision of a legislative framework that: (i) creates a SMME

⁶⁶ See note 5.

financial services office within the Department of Small Business Development, (ii) establishes a SMME bank-depositors insurance, and (iii) empowers the Minister for Small Business Development or their designate to deal with all issues ancillary to the intervention.

Chapter 6 of this thesis acknowledges the imbalance of social power that makes it difficult for the legislative intervention proposed in this thesis to take place. However, it argues that the proposed legislative intervention into the SMME and retail banking sectors is needed in order to bring South Africa's growing two nation state together. This thesis is concluded by highlighting how legal intervention informed by human flourishing theory can support the realisation of transformative constitutionalism.

CHAPTER TWO: SOUTH AFRICA'S SMME SECTOR

2.1. Introduction

The National Development Plan recognises the SMME sector as part of the solution to the unemployment and inequality issues that permeate South Africa.⁶⁷ This recognised role of the SMME sector is not new: it predates democracy to the 1980s⁶⁸ and was formally adopted as early as the 1994 Reconstruction and Development Programme (RDP) white paper.⁶⁹ The RDP white paper called for the introduction of, and amendments to, existing legislation and regulations, so as to encourage SMME development and enable SMMEs to generate further opportunities for the broader economic network.⁷⁰

Government's identified role for SMMEs is for them to serve as an access point to the mainstream economy for supporting greater economic growth.⁷¹ Chapter two explores the measures that have been proposed by government to realise this identified role and analyses the extent to which these proposed measures have been actioned. Further, this chapter focuses on the legislative framework for SMMEs, the existing government support programmes and the nature of SMME access to finance and credit.

With respect to access to finance and credit, it is acknowledged that there are many different financial intermediaries and that the analysis should change for each

⁶⁷ See note 1.

⁶⁸ E Mahembe 'Literature review on small and medium enterprises' access to credit and support in South Africa' (2011) *Underhill Corporate Solutions. National Credit Regulator (NCR)* at 27.

⁶⁹ RSA 'White Paper on Reconstruction and Development' (1994), see specifically subchapter 3.10.

⁷⁰ C Darroll 'Current state of legislation in South Africa-a country overregulated and undergoverned?' (2013) *Africa Growth Agenda* 14 - 18.

⁷¹ See note 1.

category of financial intermediary. Therefore, this chapter focuses primarily on the role of the major South African retail banks in providing access to finance and credit. To guide the analysis of the role of retail banks, this thesis accepts that the banks are profit-driven financial intermediaries, whose institutional role includes directing the allocation of financial resources that are available within the South African economy.⁷²

Further, this chapter assumes a simple operational structure of a retail bank, which is to attract deposits that can then be used to issue loans, the issuance of which is a source of revenue for the bank.⁷³ This revenue is achieved through the costs that the bank levies on the issued loans.⁷⁴ With this understanding, for a bank to maximise revenue it must issue loans where there is a sufficient probability that performance on the loan agreement by the debtor will take place.⁷⁵ To maximise profit, banks seek to engage in a cost-efficient operations structure and to minimise their potential exposure to non-performing loans.⁷⁶

2.2. The state's approach to SMMEs

The Small Enterprise Development Agency (SEDA), an agency of the Department of Small Business Development (DSBD), identified the broad issues emerging in the second quarter of 2016, which act as barriers to SMME development. These include

⁷² A Franklin and A M Santomero 'What do financial intermediaries do?' (2001) 25 *Journal of Banking & Finance* 2 at 273.

⁷³ A Turner 'What do banks do? Why do credit booms and busts occur and what can public policy do about it' (2010) *The Future of Finance* 5 at 10 - 13.

⁷⁴ *Ibid* at 5.

⁷⁵ E Nikolaidou and S Vogiazas 'Credit risk determinants in Sub-Saharan banking systems: Evidence from five countries and lessons learnt from Central East and South East European countries' (2016) *Forthcoming in the Review of Development Finance Journal* at 15.

⁷⁶ *Ibid* at 18.

the lack of access to finance, labour laws, crime levels, low levels of research and development, an inadequately skilled labour force and lack of access to markets.⁷⁷

SEDA reaffirmed the role of SMMEs as being an entry point into the mainstream economy for many individuals located on the social periphery particularly, women, the youth and the disabled.⁷⁸ However, the agency also highlighted that, given the identified barriers, the potential of the sector remained unrealised. The barriers also contributed towards the high mortality rate of SMMEs, which was found to be three and a half years.⁷⁹

A few government support programmes have made use of a process of incubation to increase the longevity and sustainability of SMMEs. Incubation refers to the development of a SMME, under the guidance of a team of qualified experts, and usually in a controlled environment for at least a period of three months. However, there is insufficient capacity to provide all SMMEs, who stand to benefit from incubation processes, such direct and individualised support.⁸⁰

South Africa's small business policy has been primarily informed by the 1995 white paper on the National Strategy on the Development and Promotion of Small Business in South Africa ('1995 white paper').⁸¹ The 1995 white paper identified several areas where government could intervene to create a support framework for the SMME

⁷⁷ See note 2 at 2.

⁷⁸ Ibid at 2 - 3.

⁷⁹ Ibid at 5.

⁸⁰ Ibid.

⁸¹ RSA 'White Paper On National Strategy For The Development And Promotion Of Small Business In South Africa' (1995).

sector.⁸² While the intervention of government was regarded as unavoidable, the paper stressed that the approach to the SMME sector would not be ‘top-down’ and rather the private sector, NGOs and other interested stakeholders needed to guide the process.⁸³ Therefore, the identified areas for government intervention was limited to the creation of an enabling legal framework, the streamlining of the regulatory environment and access to finance.⁸⁴

The objectives and areas of focus in the 1995 white paper formed the basis of the government’s Integrated Small Business Development Strategy (‘ISBDS strategy’) for 2004 to 2014.⁸⁵ The vision of the ISBDS for the SMME sector was the creation of a competitive economic market, where businesses emerged and grew from small, to medium, to large enterprises.⁸⁶ The belief was that the emergence of new business would support the reintegration of those persons previously excluded from the mainstream economy into the mainstream economy.⁸⁷ This was seen as necessary if economic growth and poverty reduction was to take place in South Africa.⁸⁸

To advance this vision, the ISBDS strategy highlighted three strategic objectives, which are: (i) the promotion of entrepreneurship, (ii) the realisation of business potential through the creation of an environment that was conducive to do business

⁸² Ibid at Part 4.

⁸³ Ibid at Part 3.4.

⁸⁴ Ibid.

⁸⁵ Department of Trade and Industry (DTI) ‘The Integrated Small Business Development Strategy In South Africa 2004 – 2014’ (10-2013) <<http://www.dwaf.gov.za/war/documents/IntegratedSmallBusinessStrategyOct03.pdf>> (accessed on 06-05-2016) hereinafter referred to as “ISBDS”.

⁸⁶ Ibid at 17.

⁸⁷ Ibid at 16.

⁸⁸ Ibid at 7.

in, and (iii) the improvement of market competition to allow for new business opportunities.⁸⁹

Having provided an overview of how government has defined its relationship with the SMME sector, it is necessary to look at how this relationship has been legislatively crafted. In addition, the support that government has provided in growing the SMME sector should be investigated. Further, the opportunity arises to analyse whether this relationship has positively contributed towards SMME success, and in particular, SMME access to finance and credit. These issues are addressed in sections 2.2, 2.3 and 2.4 respectively.

2.3. The legal framework

The 1995 white paper recognised that the regulatory environment at the time would adversely impact SMME success by: (1) imposing onerous compliance standards on SMMEs,⁹⁰ (ii) favouring established enterprise and thereby making it difficult for SMMEs to compete, and (iii) acting as an entry barrier for entry.⁹¹ Therefore, the paper proposed that government work together with the competition authorities to review the appropriateness of regulations that would impact SMMEs.⁹² Where necessary, it is proposed that government intervene and carry out regulatory reform to enable the promotion of SMME growth.⁹³ The paper went as far as encouraging

⁸⁹ Ibid at 15.

⁹⁰ See note 81 at 38.

⁹¹ Ibid at 11.

⁹² Ibid at 33.

⁹³ Ibid.

legislative intervention to strengthen the ability of small enterprise to access raw material and other inputs controlled by monopolistic suppliers.⁹⁴

In addition to the 1995 white paper, the ISBDS strategy broadly contained three pillars: (i) increasing the supply of financial and non-financial support to small business, (ii) stimulating demand for SMME products and/or services, and (iii) reducing regulatory constraints.⁹⁵

For the purpose of creating an enabling legal framework, the 1995 white paper proposed the enactment of three pieces of legislation.⁹⁶ First, a National Small Business Act would provide the formal recognition of the government's involvement in the SMME sector, and define the main categories of SMMEs, as well as the statutory bodies for the SMME sector.⁹⁷

Second, recognising that market access was a barrier to SMME success, and while voluntary action by existing enterprise, NGOs and other market stakeholders would assist in overcoming this barrier, the 1995 white paper proposed legislative intervention. The intervention was proposed in the form of a Transaction and Procurement Act that would accelerate the process for market entry by SMMEs and provide certain conditions and principles to encourage the integration of SMMEs into the market.⁹⁸

⁹⁴ Ibid at 34.

⁹⁵ See note 85.

⁹⁶ See note 81 at 32.

⁹⁷ Ibid.

⁹⁸ Ibid at 33.

Finally, a Small Business Finance Act would encourage financial intermediaries to become more active in the SMME sector. In addition, it would facilitate deposit-taking by lender-NGOs, recognise non-conventional forms of security and widen the scope of specialised lending and investment firms focusing on the SMME sector.⁹⁹

In 1996, the National Small Business Act¹⁰⁰ (hereinafter the ‘Act’) was introduced and provided the legislative foundation to make inroads in supporting small business.

The Act defines ‘small business’ as meaning:

‘[A] separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column I of the Schedules which can be classified as a micro-, a very small, a small or a medium enterprise by satisfying the criteria mentioned in columns 3, 4 and 5 of the Schedule opposite the smallest relevant size or class as mentioned in column 2 of the Schedule.’¹⁰¹

The definition distinguishes between four categories of small business: micro-enterprise, very small enterprise, small enterprise and medium enterprise. However, commercial practice has included a fifth category, namely, survivalist enterprise.¹⁰²

A survivalist enterprise is one that provides an employment opportunity only for the entrepreneur.¹⁰³ The categories provided for in the Act emerge from specific threshold requirements with regard to ‘total full-time equivalent of paid employees’, ‘total annual turnover’ and ‘total gross asset value (fixed property excluded).¹⁰⁴

These thresholds are different for each sector or sub-sectors as classified by the Standard Industrial Classification.¹⁰⁵

⁹⁹ Ibid.

¹⁰⁰ Act 102 of 1996.

¹⁰¹ Ibid at Chapter 1.

¹⁰² See note 68 at 25.

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid at 26.

Table 1 sets out the three requirement threshold for classification of enterprise based on the Act.¹⁰⁶ Table 1 indicates that a firm in the agricultural sector, employing one hundred workers on a full-time basis, with an annual turnover of less than R 4, 000, 000, and a total gross asset value of less than R 4, 000, 000 (excluding fixed property), would be classified as a medium sized firm.

However, for a firm to be classified as medium-sized in the mining and quarrying sector, it would need to employ at least two hundred workers on a full-time basis, have an annual turnover of less than R 30, 000, 000 and have a total gross asset value of less than R 18, 000, 000 (excluding fixed property). This highlights that the classification of a firm as micro, small or medium will vary depending on the firm's sector or sub-sector.

Sector or sub-sector in accordance with industrial classification	Size or class	Total full-time equivalent of paid employees (less than)	Total annual turnover (less than) ¹⁰⁸	Total gross assets value (fixed property excluded) (less than)
Agriculture	Medium	100	R4	R4
	Small	50	R0.40	R2
	Micro	5		R0.15
Mining and quarrying	Medium	200	R30	R18
	Small	50	R7.50	R4.50
	Micro	5	R0.15	R0.15
Manufacturing	Medium	200	R40	R15
	Small	50	R0.40	R3.75
	Micro	5	R0.15	R0.10
Electricity, gas and water	Medium	200	R40	R15
	Small	50	R0.40	R3.75
	Micro	5	R0.15	R0.10
Construction	Medium	200	R20	R4
	Small	50	R5	R1
	Micro	5	R0.15	R0.10
Retail and motor trade and repair services	Medium	100	R30	R5
	Small	50	R15	R2.50
	Micro	10	R0.15	R0.10
Wholesale trade, commercial agents and	Medium	100	R50	R8
	Small	50	R25	R4

¹⁰⁶ Ibid.

¹⁰⁷ Source: Schedule 1 to the National Small Business Act of 1996 as amended in 2003 and 2004.

¹⁰⁸ The unit of measurement for columns 4 and 5 is in millions.

allied services	Micro	10	R0.15	R0.10
Catering, accommodation and other trade	Medium	100	R10	R2
	Small	50	R5	R1
	Micro	10	R0.15	R0.10
Transport, storage and communication	Medium	100	R20	R5
	Small	50	R10	R2.50
	Micro	10	R0.15	R0.10
Finance and business service	Medium	100	R20	R4
	Small	50	R10	R2
	Micro	10	R0.15	R0.10
Community, social and personal services	Medium	100	R10	R5
	Small	50	R5	R2.50
	Micro	10	R0.15	R0.10

The legal framework envisaged by the 1995 white paper and the ISBDS strategy has not been realised.¹⁰⁹ With exception to the National Small Business Act, no additional legislation directly targeting SMMEs has been enacted. While government does encourage procurement from SMMEs, there remains no Transaction and Procurement Act that specifically caters for SMMEs.¹¹⁰ Further, despite a call by the 1995 white paper for a Small Business Finance Act, as well as wide spread acknowledgement of the difficulty faced by SMMEs in accessing finance and credit,¹¹¹ there remains no such Act.

2.4. Existing government support

The nature of government support made available to realise government's vision for the SMME sector has arguably contributed towards increasing the bureaucratic hurdles for SMMEs to overcome. A complicated institutional matrix has been created for SMMEs to navigate.¹¹²

¹⁰⁹ See note 38 at 7.

¹¹⁰ See for example the Preferential Procurement Policy Framework Act 5 of 2000.

¹¹¹ See note 68 at 31. See further: D Kelley, S Singer and M Herrington 'Global Entrepreneurship Monitor 2015/2016 Global Report' (2016) < <http://www.gemconsortium.org/report>> (accessed on 10-02-2017); M A Turner, R Varghese, P Walker 'Information Sharing and SMME Financing in South Africa: A Survey of the Landscape' (2008) *Center for Competitive Credit, Policy and Economic Research Council*.

¹¹² See note 68 at 30.

Government's institutional framework to support SMMEs comprises six key departments, each with their own plethora of programmes. These include the Department of Trade and Industry, the Department of Economic Development, the Department of Science and Technology, the Presidency, the Department of Agriculture, Forestry and Fisheries, and the Department of Small Business Development.¹¹³

Government has attempted to centralise the support that it provides to SMMEs through the establishment of the Department of Small Business Development. This Department became effective in 2014 and operates closely with the Department of Trade and Industry.¹¹⁴ The vision for the Department of Small Business Development is to transform the economy through the integration of SMMEs and cooperatives into the mainstream economy.¹¹⁵

According to the memorandum of understanding between these two departments, the Department of Small Business Development has four strategic outcomes-orientated goals: (i) to support economic growth by facilitating the growth and development of SMMEs by relying on the investment of both the private and public sector, (ii) to advocate for a regulatory environment conducive to SMME growth and development, (iii) to facilitate the development of relationships between the SMME sector, spheres of government and the private sector, and (iv) to facilitate the transformation of the economy through integrating SMMEs and cooperatives into the mainstream economy, and ensuring their sustainability.¹¹⁶

¹¹³ See note 68.

¹¹⁴ Department of Trade and Industry (DTI) 'Annual Report 2014-2015' (2015).

¹¹⁵ Ibid at 49.

¹¹⁶ Ibid at 78.

However, despite the emergence of this department, key programmes exist that are spread across the six abovementioned departments. The key programmes from each department are set out below.¹¹⁷

The Department of Trade and Industry established the National Empowerment Fund, which is a national institution established by Act 105 of 1998. Its main objective is to provide both financial and non-financial assistance to black empowered business to increase the economic participation of black individuals in the mainstream economy.¹¹⁸ It provides business loans to businesses across sectors, ranging from R 250 000 to R 75 million.¹¹⁹

The Department of Economic Development established the Small Enterprise Finance Agency in 2012, as a result of a merger between Khula Finance Limited, the small business activities of the Industrial Development Corporation and the South African Micro-Finance Apex Fund.¹²⁰ There are two financing schemes available through the agency, namely, direct lending and wholesale lending. These schemes have sub-financing schemes depending on the nature of the applicant and the nature of the application.¹²¹ Applicants to the schemes can apply for loans ranging from R 50 000 up to R 5 million.¹²²

The Department of Science and Technology established the Technology Innovation Agency, which is a national institutional entity that serves to bring together different

¹¹⁷ See further note 68 at 27 – 30.

¹¹⁸ National Empowerment Fund (NEFCORP) (2016) <<http://www.nefcorp.co.za>> (accessed on 09-10-2016).

¹¹⁹ Ibid.

¹²⁰ Small Enterprise Finance Agency (SEFA) (2016) <<http://www.sefa.org.za>> (accessed on 09-10-2016).

¹²¹ Ibid.

¹²² Ibid.

stakeholders in the technology innovation arena, including research from higher institutions, science councils, the private sector, the public sector and SMMEs.¹²³ The Technology Innovation Agency has three funding schemes, including seed funding, technology development funding, and commercialisation support funding.¹²⁴ The access points to the funding schemes depends on the amount of funding requested, the progress made in technological development of the product/service, and whether the request for funding aligns with the stated objectives of the Technology Innovation Agency funding schemes.¹²⁵

The Presidency established the National Youth Development Agency (NYDA) through Act 54 of 2008, which is a government institution focused on South African youth.¹²⁶ The institution has several youth empowerment programmes that operate between national, provincial and local government as well as at the micro (individual), meso (local) and macro (provincial and national) level of South African society.¹²⁷

Initially, the agency made general financial loans available to youth entrepreneurs. However, the nature of financial assistance available has now changed into grant offerings.¹²⁸ Grant offerings do not have the onerous repayment terms that are included with general financial loans. These grant offerings are available to

¹²³ Technology Innovation Agency (TIA) (2016) <<http://www.tia.org.za>> (accessed on 09-10-2016).

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ National Youth Development Agency (NYDA) (2016) <<http://www.nyda.gov.za>> (accessed on 09-10-2016).

¹²⁷ Ibid.

¹²⁸ Ibid.

survivalist youth entrepreneurs individually or acting as a cooperative, and the grant value ranges from R 1 000 to R 100 000.¹²⁹

The Department of Agriculture, Forestry and Fisheries created the Micro-Agricultural Financial Institute of South Africa, which provides financial assistance to smallholder producers in the agriculture, fishery and forestry sectors.¹³⁰ Financial loans can be used for the purchase of small equipment, livestock, livestock medicines and production inputs.¹³¹ Applicants must be over the age of 21 and from a disadvantaged background. Loans less than R 25 000 are not securitised and the maximum loan amount is R 500 000.¹³² The repayment plan is based on 8 per cent per annum compounded and the repayment is determined on the applying enterprise's income cycle.¹³³

The Department of Small Business Development established the Small Enterprise Development Agency. The mandate of the agency is to implement government's small business strategy, design and implement a standard and common delivery network for small business, and to integrate government-funded agencies that support small business development.¹³⁴

In addition, the Department created the Black Business Supplier Development Programme, which is a cost-sharing initiative aimed at supporting the

¹²⁹ Ibid.

¹³⁰ Department of Agriculture, Forestry and Fisheries (DAFF) (2016) <<http://www.daff.gov.za>> (accessed on 09-10-2016).

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Small Enterprise Development Agency (SEDA) (2016) <<http://www.seda.org.za>> (accessed on 09-10-2016).

competitiveness and sustainability of black-owned small business.¹³⁵ The programme provides grants to the value of R1 000 000 for tools and machinery, and R200 000 for business development and human capital training.¹³⁶ The Co-operative Incentive Scheme was also created by the Department, which is aimed at increasing the competitiveness of cooperatives by lowering their operational costs. The programme provides grants to cooperatives that have at least five members who are historically disadvantaged individuals.¹³⁷

The Department of Small Business Development is also responsible for the Shared Economic Infrastructure Facility, which is a sub-programme of the Black Business Supplier Development Programme. The Shared Economic Infrastructure Facility provides the platform for public sector crowd investment in the informal economy, focusing on areas like townships, rural areas and the inner city.¹³⁸ It is aimed at supporting the objectives of the National Informal Business Upliftment Strategy.

The National Informal Business Upliftment Strategy targets entrepreneurs from designated groups (disabled persons, women, and youth) that operate within the informal economy.¹³⁹ The programme is limited to the retail, manufacturing, agricultural, construction and maintenance sectors.¹⁴⁰ The programme interventions include support provided from the Shared Economic Infrastructure Facility, skills

¹³⁵ Ibid.

¹³⁶ Department of Small Business Development (DSBD) (2016) <<http://www.dsbd.gov.za>> (accessed on 09-10-2016).

¹³⁷ Ibid.

¹³⁸ Ibid.

¹³⁹ Ibid.

¹⁴⁰ Ibid.

development with a focus on technical, computer and business skills, and organisational development support.¹⁴¹

These government programmes have been actioned to achieve the objective of the Integrated Small Business Development Strategy, to provide both financial and non-financial resources to SMMEs. However, three hurdles arise with respect to the full usage of these government programmes by SMMEs.¹⁴² First, there is ineffective communication about the existence of these programmes.¹⁴³ Therefore, those who may ordinarily take up participation do not do so because they are unaware of the programme.¹⁴⁴

Secondly, the criteria that an applicant needs to meet to qualify for assistance under any of the programmes are regarded as onerous by SMMEs.¹⁴⁵ Thirdly, a number of these programmes are only accessible once the business has been setup. Therefore, the entity is required to be operational for a period of time and, in certain circumstances, the entity is required to have a specific operations structure to qualify.¹⁴⁶

These hurdles contribute towards the under-utilisation of these programmes.¹⁴⁷ It is apparent the programmes made available by the Small Enterprise Development Agency respond more to the needs of established SMMEs as opposed to emerging

¹⁴¹ Ibid.

¹⁴² H Falkena, I Abedian, M Blottnitz, C Coovadia, G Davel, J Madungandaba, E Masilela, and S Rees 'SMEs' Access to Finance in South Africa, A Supply-Side Regulatory Review' (2001) *The Task Group of the policy Board for Financial Services and Regulation* <<http://www.treasury.gov.za/publications/>> (accessed on 22-10-2016).

¹⁴³ Ibid at 36.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid at 57.

¹⁴⁶ See note 142.

¹⁴⁷ See note 68 at 64.

SMMEs. Therefore, the programmes fail to respond adequately to, and address, the obstacles that were identified by the Small Enterprise Development Agency for emerging SMMEs.

2.5. Access to finance

Access to finance is globally recognised as a barrier to SMME success.¹⁴⁸ Given the complexity of the problem of SMME access to finance, this chapter's discussion on SMME access to finance will be dealt with in four parts: (i) the relationship between South Africa's commercial banking sector and SMMEs, (ii) Akerlof's 'Market for Lemons', (iii) The 'Missing Middle', and (iv) The operational structure of retail banks.

For most countries, access to finance and credit facilities is a function of the strength of the country's banking sector. The strength of a country's banking sector can be signalled by the depth of the coverage of financial institutions and the level of non-performing loans exhibited by the asset register of these financial institutions.¹⁴⁹

Non-performing loans refer to the circumstance where a debtor is unable to make good any part of their repayment plan including that part which contributes towards the principle amount.¹⁵⁰ The non-performance on loans decreases in times of

¹⁴⁸ See note 38 at 9.

¹⁴⁹ World Bank (2016) <<http://www.worldbank.org>> (accessed on 09-10-2016).

¹⁵⁰ Ibid.

increasing economic activity.¹⁵¹ This is regarded as a consequence of the positive effect that increasing economic activity has on employment in the economy.¹⁵²

2.5.1. The relationship between south africa's retail banking sector and SMMEs

South Africa's SMME and retail banking sectors have a complicated relationship. There are two reasons for this complicated relationship. First, the apartheid system adversely impacted the creation of banking relations between retail banks and black consumers.¹⁵³ Secondly, like in other developing jurisdictions, in South Africa, there is a general reluctance by financial intermediaries to provide SMMEs with finance.¹⁵⁴ These reasons contribute towards the persisting inability of SMMEs to access adequate finance and credit opportunities in South Africa.¹⁵⁵

The 1995 white paper highlighted that an impact of the forced removals, influx control, migrant labour and job reservation during apartheid was to displace many black South Africans, and place them at the periphery of the mainstream economy.¹⁵⁶ This had a direct consequence for the relationship, or rather the lack thereof, between retail banks and black consumers. Apartheid legislation prevented the space for client relations between black households and retail banks to emerge.¹⁵⁷

As a consequence, retail banks post-1994 did not have established client relations with black consumers, did not have a range of products that would respond to the

¹⁵¹ Ibid.

¹⁵² R Beck, P Jakubik and A Piloiu 'Non-Performing Loans: What Matters In Addition To The Economic Cycle?' (2013) at 15.

¹⁵³ See note 81 at 41.

¹⁵⁴ See note 38 at 9.

¹⁵⁵ See note 142 at 54.

¹⁵⁶ See note 81 at 41.

¹⁵⁷ Ibid.

banking needs of black households, and lacked an established infrastructure network that enabled the banks to access black households in rural areas.¹⁵⁸ The net effect was that retail banks did not have sufficient information on black consumers and given the risk that arises with information asymmetry, were reluctant to use existing client funds to make finance and credit facilities available to black enterprise.¹⁵⁹

Further, the 1995 white paper drew attention to how property relations in indigenous communities differed from those upon which the established South African retail banking sector were premised, and how, as a result, the retail banking sector was inadequately equipped to respond to the needs of black households.¹⁶⁰ In this context, with respect to accessing credit, a key difficulty that arose was the disqualification of a black credit applicant because of the inability to meet the bank's loan requirements for security. This inability arose because of the indigenous practice of communal ownership of assets and the limited extent to which women in indigenous settings could own assets.¹⁶¹

Given these difficulties, the 1995 white paper indicated that government would engage retail banks in being more proactive in developing banking relations with black people and black enterprise.¹⁶² In addition, government would stress the importance of affirmative action measures, as well as encourage and facilitate the realisation of SMME-focused financing institutions. Finally, government would

¹⁵⁸ Ibid.

¹⁵⁹ Ibid.

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

¹⁶² Ibid.

provide recognition for the non-conventional types of securities and security.¹⁶³ These objectives remain to be realised.¹⁶⁴

The finance market continues to regard SMME credit as risky. The reasons for this are set out below in sections 2.4.2, 2.4.3, and 2.4.4. As a result, financial intermediaries are generally reluctant to provide SMMEs with credit facilities. Black entrepreneurs face the additional task of having to overcome the abovementioned impact of apartheid on their relationship with retail banks. Consequently, black entrepreneurs find themselves in a credit market that flags them as not being creditworthy. Further, the continued inability for them to acquire credit with ease reinforces the idea that the black entrepreneur is not creditworthy.

2.5.2. Akerlof's 'Market for Lemons'

The risk that retail banks assign to SMME finance can be explained with reliance on Akerlof's 'Market for Lemons'.¹⁶⁵ Akerlof's 'Market for Lemons' captures the scenario where in a market there are two versions of a product – a higher quality version and a lower quality version.¹⁶⁶ Akerlof regards the lower quality version of the product as a lemon. The dilemma that arises is that, despite knowing that there are two versions of this product, a consumer does not have perfect information when they participate in the market for it.¹⁶⁷ Therefore, a lay person wanting to buy a bicycle enters the market for bicycles and is unable to distinguish between a higher quality bicycle and a lower quality bicycle.

¹⁶³ Ibid at 33.

¹⁶⁴ See notes 68 and 142.

¹⁶⁵ G Akerlof 'The Market For "Lemons": Quality Uncertainty and the Market Mechanism' (1995) in *Essential Readings in Economics* 175-188.

¹⁶⁶ Ibid at 178.

¹⁶⁷ Ibid at 179.

This information asymmetry has the effect of producing a product price that is not a fair representation of the quality of the goods. For example, to compensate a consumer for the potential circumstance where they purchase a lower quality version of the product they desire, the market price is lowered for the desired product. However, at the same time the market contains higher quality versions of the desired product. As a result, the market price is positively impacted to account for the existence of higher quality versions of the desired product. It is assumed that the final effect of these opposite price effects is indeterminate. As a consequence, the price paid for a randomly selected version of the desired product could be too high or too low.¹⁶⁸

Therefore, some consumers will gain a surplus.¹⁶⁹ This will take place where the consumer pays a price that does not sufficiently represent the quality of the product. This misrepresentation is the consequence of the presence of lower quality versions of the product in the product market. On the other hand, a consumer may lose a surplus, as a result of the consumer paying more for the goods than their actual worth relative to the quality of the thing.

Akerlof extends his demonstration of the ‘Market for Lemons’ to include the example of credit markets in developing countries. His illustration includes two examples that are the managing agency system and moneylenders.¹⁷⁰ The second example is relevant for the purpose of this thesis: it illustrates how the screening systems and onerous security conditions of established financial intermediaries can exclude SMMEs from accessing finance. This results in the SMME accessing

¹⁶⁸ Ibid at 181.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid at 182.

funding from a 'local money lender' under repayment terms that often contribute towards the failure of the SMME.¹⁷¹

To understand the position from which local moneylenders operate relative to other financial intermediaries, Akerlof reflected on the role of local moneylenders relative to 'big banks' and the 'middle man'. He found that the big banks in the central cities had lending rates of 6 per cent to 10 per cent, while the local money lender had lending rates of between 15 per cent to 50 per cent. The middle man tried to offer a competitive rate relative to that offered by the big banks and local money lenders.¹⁷²

In respect of big banks and the middle man, Akerlof found that lending took place where there existed sufficient means to enforce the loan contract, together with personal knowledge of the character of the borrower.¹⁷³ The local moneylender, by contrast to the big banks and the middle man, did not require security and/or personal knowledge of the borrower. Akerlof identified that the screening tools used by the big banks and middle man gave rise to a pool of credit applicants who were perceived as high risk by the big banks and middle man respectively.¹⁷⁴ As a result, they became the clients of the local moneylender. The onerous terms imposed by the local moneylender would support the financial failure of the endeavour pursued by the credit applicant.¹⁷⁵

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Ibid at 184.

¹⁷⁴ Ibid.

¹⁷⁵ Ibid.

Akerlof concludes that the effect is to produce a self-fulfilling prophecy:¹⁷⁶ without any reasonable alternative, the perceived high risk credit applicants approach a local moneylender and are subjected to borrowing terms that are too onerous for the credit applicant to realise. The unsuccessful credit applicant, now a client of the local moneylender, ultimately defaults.

Further, referencing Darling's interpretation of the village moneylender's power in an Indian village, Akerlof draws attention to unfortunate power imbalance that emerges between the village moneylender and the credit applicant who fails the credit requirements of the big banks:

‘It is only fair to remember that in the Indian village the money-lender is often the one thrifty person amongst a generally thriftless people; and that his method of business, though demoralising under modern conditions, suit the happy-go-lucky ways of the peasant. He is always accessible, even at night; dispenses without troublesome formalities, asks no inconvenient questions, advances promptly, and if interest is paid, does not press for repayment of principal. He keeps in close personal touch with his clients, and in many villages shares their occasions of weal or woe. With his intimate knowledge of those around him he is able, without serious risk, to finance those who would otherwise get no loan at all.’¹⁷⁷

Darling's description of the village moneylender's power reflects the outcome where South Africans fail to satisfy the strict screening tools employed by the major banks. Consequently, they have to accept unfavourable credit terms from unofficial credit providers to obtain the access to finance and credit that they require.¹⁷⁸

Applying Akerlof's 'Market for Lemons' to South Africa's SMME sector, it would suggest that SMME credit applicants, and specifically SMME credit applicants from

¹⁷⁶ Ibid at 187.

¹⁷⁷ Ibid.

¹⁷⁸ P Mashigo 'The debt spiral in the poor households in South Africa' (2006) *The International Indigenous Journal of Entrepreneurship, Advancement, Strategy, and Education*; P Q Siyongwan 'Informal moneylenders in the Limpopo, Gauteng and Eastern Cape Provinces of South Africa' (2004) 21 *Development Southern Africa* 5 851-866.

previously disadvantaged groups, if successful with their credit application would: (i) incur disadvantageous credit costs for the duration of the credit repayment period, and/or (ii) during the course of the credit repayment period, be unable to service their credit repayments, as the credit costs out pace the entrepreneurs return on investment.

2.5.3 The ‘Missing Middle’

A report by Dalberg looked at SMME access to credit and finance in developing countries, of which South Africa was part of the sample group of developing countries reviewed.¹⁷⁹ The report reflects the treatment of SMMEs accessing credit as akin to the understanding demonstrated by Akerlof’s ‘Market for Lemons’.¹⁸⁰ The report by Dalberg identifies a general financing gap with respect to SMMEs. This financing gap has been referred to as the “Missing Middle” of SME financing.¹⁸¹ This financing gap has arisen because of quality uncertainty of SMME borrowers and the inability for the borrowers to provide security to compensate for the quality uncertainty that the market assigns them.¹⁸²

Figure 2¹⁸³ is extracted from the report by Dalberg. The figure illustrates what is regarded as the ‘Missing Middle’ and segregates existing finance for enterprise into three bands: microfinance with an investment size that ranges from \$0 to \$ 25 000, the ‘Missing Middle’ with an investment size that ranges from \$ 25 000 to \$ 2 000

¹⁷⁹ See note 38.

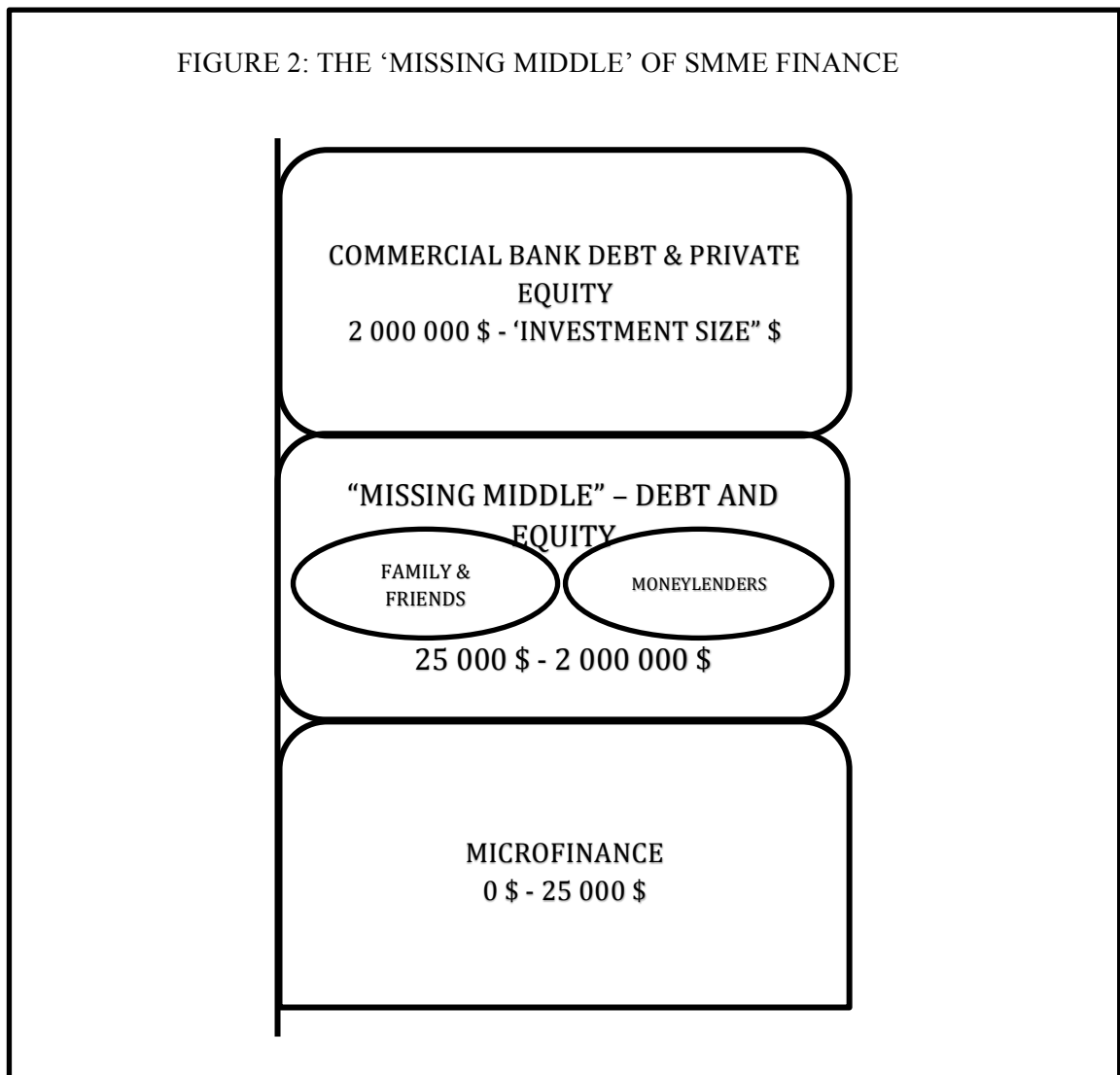
¹⁸⁰ See note 165.

¹⁸¹ See note 38 at 10.

¹⁸² See note 165.

¹⁸³ See note 38 at 11. The report looked at a number of developing countries and relied on dollars as the base currency.

000, and retail bank debt and private equity with an investment size that ranges from \$ 2 000 000 upwards.¹⁸⁴



The limits for each investment size band in Figure 2 are not an accurate reflection of the investment size bands for South Africa. However, a 2012 report by the South African National Credit Regulator (NCR)¹⁸⁵ confirms the existence of an investment

¹⁸⁴ Ibid.

¹⁸⁵ See note 68.

structure of this nature where a financing gap exists.¹⁸⁶ Further, the NCR has identified the same barriers to accessing SMME finance that were identified by Dalberg for developing markets.¹⁸⁷ However, access to finance as an obstacle to the flourishing of SMMEs is not unique to South Africa, as is discussed below.

While emerging enterprises have the option of accessing microfinance, the value of the available finance, as well as the nature of the loan terms, often do not make for sustainable funding for an emerging enterprise.¹⁸⁸ The value of the finance available through microlending often does not satisfy the amount required to sustain the enterprise in its initial years or is insufficient to fund the full entrepreneurial endeavour.¹⁸⁹

In addition, the risk profile of individuals seeking to start an SMME and the inability to provide security for finance made available through the market has the consequence of onerous terms in financing agreements.¹⁹⁰ The report found that retail banks in developing countries preferred established enterprise over emerging enterprise when the required financing was of an investment size equivalent to the upper band in Figure 2.¹⁹¹ The conclusion was locally confirmed in the conclusion reached by the NCR for South Africa.¹⁹²

The perceived higher risk profile of SMMEs has been emphasised because the nuanced nature of the SMME sector makes it difficult for banks to create standard

¹⁸⁶ Ibid at 52.

¹⁸⁷ See note 38 at 9.

¹⁸⁸ See note 68 at 52.

¹⁸⁹ Ibid.

¹⁹⁰ See note 38 at 17.

¹⁹¹ Ibid.

¹⁹² See note 68 at 52.

profiles to fairly assess the risk of an SMME. SMMEs are found in a range of economic sectors, at different stages of development, and with different resource capabilities.¹⁹³

Given the diverse nature of SMMEs there is difficulty in constructing a representative sample to assess risk.¹⁹⁴ In the context where the core markets of the retail banks already provide sufficient growth and return on investment to the retail banks, there exists little reason for retail banks to take on the associated financing risk with SMMEs.¹⁹⁵ Therefore, retail banks prefer their core markets where such generalised risk profiles are more easily identified.¹⁹⁶

The perceived higher risk and inability to fairly assess the financial risk of supporting an SMME can lead to an outcome where the SMME is faced with higher administrative costs, interest rates, and above normal requests for security.¹⁹⁷ The consequence is to reinforce the market failure of SMME lending because where lending does occur, it often operates in a manner that is unsustainable for the SMME.¹⁹⁸

Section 2.3.3 has reflected on the relationship between the SMME and retail banking sectors. It recognised that retail banks engage in a financial assessment of prospective debtors to assess the prospective debtor's credit worthiness. This assists the bank in appreciating the level of risk that the bank will be exposed to if they

¹⁹³ See note 142 at 24.

¹⁹⁴ See note 68 at 69.

¹⁹⁵ See note 75 at 22.

¹⁹⁶ Ibid.

¹⁹⁷ See note 142 at 8.

¹⁹⁸ See note 142 at 17, 55.

serviced the debtor.¹⁹⁹ In this circumstance, risk can be understood as the ability of the debtor to perform as per the financial arrangement with the financial institution.²⁰⁰ High rates of performing loans can provide evidence of healthy screening practices utilised by banks in the provision of finance and credit facilities.²⁰¹

A high rate of performing loans can be misleading in circumstances where financial institutions do not expose themselves sufficiently to risk.²⁰² Traditionally, a reduction in risk profile is associated with the ability of a debtor to provide sufficient security and/or the existence of a surety provider and/or the existence of a previous healthy credit record.²⁰³ However, the 1995 white paper noted that SMME owners often do not fall into any of these traditional categories that would support lower risk profiles.²⁰⁴

Further, the 1995 white paper noted SMME owners did not necessarily have available traditional forms of security.²⁰⁵ As a result, they often were, and according to the NCR Report, still are, disqualified from accessing credit.²⁰⁶ Therefore, traditional qualifications for risk management current screening tools and criteria used by financial institutions are not favourable for improving SMME access to finance.

¹⁹⁹ A N Berger and R De Young 'Problem loans and cost efficiency in retail banks' (1997) 21 *Journal of Banking & Finance* 6 849-870.

²⁰⁰ *Ibid* at 865.

²⁰¹ See note 75 at 25.

²⁰² *Ibid* at 14.

²⁰³ See note 81 at 13.

²⁰⁴ *Ibid*.

²⁰⁵ *Ibid*.

²⁰⁶ See note 68 at 44.

Piketty highlights that economic growth can in part be achieved with the redistribution of financial resources in the economy.²⁰⁷ The reports by Dalberg and the NCR indicate that greater access to financial resources would support the flourishing of entrepreneurs and SMMEs.²⁰⁸ However, as demonstrated in this section, traditional qualifications for risk management,²⁰⁹ and the risk profiles of financial intermediaries in South Africa's retail banking sector are at odds with the redistributive role that retail banks are to play in an unequal market economy.²¹⁰

2.5.4. The operational structure of retail banks

Retail banks are profit driven enterprises.²¹¹ Retail banks have two key and interrelated considerations for profit maximisation: (1) the minimisation of non-performing loans, and (2) the creation of a cost-efficient operations structure.²¹² The manner in which retail banks approach these considerations will have an impact on consumers. Further, it would follow that for effective market regulation to take place, the regulation would need to have an impact on the way retail banks approach the abovementioned two considerations.

Therefore, to understand these considerations this section relies on four hypotheses by Berger and de Young's.²¹³ These hypotheses analyse the behaviour between non-performing loans and the creation of a cost-efficient operations structure.²¹⁴ These

²⁰⁷ R G King and R Levine 'Finance, Entrepreneurship And Growth' (1993) 32 *Journal of Monetary Economics* 3 513-542.

²⁰⁸ See note 38 and 68.

²⁰⁹ See note 199 at 850.

²¹⁰ See note 75.

²¹¹ See note 73 and 199.

²¹² See note 75 at 11.

²¹³ See note 199 at 850.

²¹⁴ Ibid.

hypotheses are not mutually exclusive and each hypothesis implies a different non-linear relationship between non-performing loans and cost efficiency.²¹⁵

The ‘bad luck’ hypothesis argues that the debtor is no longer able to perform as a result of an exogenous factor.²¹⁶ This requires the bank to administer the problems that arise due to the non-performance of the loan. This would include additional monitoring of poor performing debtors, costs incurred in the seizing, maintaining and eventual disposal of the security provided by the non-performing debtor and additional measures to protect current high-performing loans.²¹⁷ The existence of the ‘bad luck’ hypothesis increases the bank’s costs resulting in lower levels of efficiency and profitability. Berger and de Young indicate that the ‘bad luck’ hypothesis is applicable to all banks.²¹⁸

Their second hypothesis is the ‘bad management’ hypothesis. This arises where subpar management evidenced through poor skills in credit scoring, an inability to appropriately appraise security pledged against loans, and ineffective monitoring of granted loans to ensure their performance, takes place. The ‘bad management’ hypothesis results in low cost efficiency.²¹⁹

Their third hypothesis is the ‘skimping’ hypothesis, which suggests that the reason for low cost efficiency is a preference for short-term return on loans.²²⁰ Under this hypothesis banks often under-invest in screening and monitoring tools that would

²¹⁵ Ibid at 851 - 854.

²¹⁶ Ibid.

²¹⁷ Ibid.

²¹⁸ Ibid.

²¹⁹ Ibid.

²²⁰ Ibid.

yield results more applicable for long term cost efficiency.²²¹ Therefore, in the long-term loan quality is often adversely impacted.²²² Further, the bank in the short term registers low operating expenses because of few resources allocated to screening loan customers, appraising security, and monitoring and controlling borrowers after loans are issued.²²³

Finally, Berger and de Young's fourth hypothesis is the 'moral hazard' hypothesis which illustrates a scenario where a bank has limited capital and, in an attempt to maximise returns, engages in risky lending.²²⁴ This, in the long term, translates into higher non-performing loans.²²⁵ While this hypothesis does not directly relate to cost efficiency, it can provide an alternative reason for non-performing loans. If in fact it is present in a scenario with any of the other hypotheses, it can have the effect of amplifying the effect of the other existing hypotheses.²²⁶

According to Nikolaidou and Vogiazas,²²⁷ the 'bad management' hypothesis dominates the relationship between non-performing loans and cost efficiency for South African banks.²²⁸ This can be illustrated in a preference by South African banks for investing in safer government instruments as opposed to issuing business loans, the issuance of which is found to have a positive relationship with non-performing loans.²²⁹

²²¹ Ibid.

²²² Ibid.

²²³ Ibid.

²²⁴ Ibid.

²²⁵ Ibid.

²²⁶ Ibid.

²²⁷ See note 75 at 3.

²²⁸ Ibid.

²²⁹ Ibid at 21.

The authors highlight that financial liberalisation, increases in cross-border activities and improved regulatory capacities have transformed the banking sector in Sub-Saharan Africa.²³⁰ Financial liberalisation refers to the implementation of financial reforms that support the operation of a country's financial sector as being separate from the authority of central government.²³¹ An economy that encourages financial liberalisation has independent financial institutions often signalled through the existence of a central bank.²³² Further, the financial sector is regulated based on the forces of the market in determining interest rates and the allocation of financial resources in the market.²³³

The South African banking sector is dominated by five banks that collectively have a 90% share of the market.²³⁴ The Competition Commission found that these banks do not operate as a cartel, but rather as oligopolists that maximise their profits by avoiding outright price competition where they can.²³⁵ These banks's assets are dominated by institutional deposits, while the level of household deposits remain low.²³⁶ Institutional deposits refer to deposits made by institutions like businesses or investment vehicles like mutual and pension funds. Household deposits refer to deposits made by individuals.²³⁷ This finding by the Competition Commission confirms the conclusion, in respect to the behaviour of South African banks, reached

²³⁰ Ibid at 26.

²³¹ J Hanson and S Ramachandran 'Financial Liberalization: What Went Right, What Went Wrong?' (1990) *World Bank, Economic Growth in the*.

²³² Ibid at 248.

²³³ Ibid at 252.

²³⁴ Competition Commission. 'Banking Enquiry Report to the Competition Commissioner.' Chapter 2: Market Power in the Provision of Personal Transaction Accounts (2017) <<http://www.compcom.co.za/banking-enquiry/>> (accessed on 16-10-2016).

²³⁵ Ibid.

²³⁶ Ibid.

²³⁷ World Bank (2016) <http://www.worldbank.org> (accessed on 05-02-2017).

by Nikolaidou and Vogiazas, namely, the presence of the ‘bad management’ hypothesis.

South African banks prefer government treasury bills that provide a lower and more certain yield, when compared to lending to individual households.²³⁸ This is preferred over the possibility of higher levels of non-performing loans that may arise through greater lending exposure to the individual households.²³⁹ Further, South African banks do not invest sufficiently in tools to screen, monitor and evaluate potential borrowers.²⁴⁰

As a result, in the context of a concentrated banking sector with low competition,²⁴¹ and given the negative relationship between lending rates and consumer borrowing,²⁴² there is a low availability of products to bank individual households.²⁴³ In particular, the current structure of the South African banking sector disincentivises the allocation of credit to SMMEs.

2.6. Concluding remarks

In conclusion, chapter two has highlighted the role of the 1995 white paper and the National Strategy on the Development and Promotion of Small Business in South Africa as being the foundation for South Africa’s approach to the SMME sector. The chapter focused on the nature of the legal framework supporting SMMEs and found that a number of proposed and desirable legislative interventions did not materialise.

²³⁸ See note 75.

²³⁹ Ibid.

²⁴⁰ See note 234 at 48.

²⁴¹ Ibid.

²⁴² See note 75.

²⁴³ See note 234 at 33.

Further, while there is a myriad of government sponsored programmes to support SMME development, the effect has been to create a support framework that is difficult for the emerging entrepreneur to navigate. Further, the programmes available have strong elements of duplicated efforts.

Access to finance is acknowledged as being key to enabling SMMEs to succeed, and in particular, the black entrepreneur to flourish. There is a common understanding that the financial means necessary to maximise economic opportunities must be made available. However, the reports by Dalberg and the National Credit Regulator highlight that there exists a financing gap with respect to SMME finance, though this is not unique to South Africa.

Reference to Akerlof's 'Market for Lemons' has illustrated the undesirable nature of investing in SMMEs given their perceived high risk and low return profile. Further, cross country research by Nikolaidou and Vogiazas indicate that the treatment of SMMEs by South African banks is not on par with the treatment of SMMEs by banks in other Sub-Saharan countries.²⁴⁴

The evidence presented by Nikolaidou and Vogiazas suggest that the financing gap experienced by SMMEs in South Africa is the result of the lemon's principle in operation. In addition, it is the consequence of the preference of South African banks for investments that exhibit relatively low returns in the short term and have low-growth, but are more stable over the long run.²⁴⁵

²⁴⁴ See note 75.

²⁴⁵ Ibid.

Therefore, given the existing levels of risk that South African banks expose themselves to, it is unlikely that the banking sector will experience a high level of non-performing loans in the long run.²⁴⁶ Further, the lending preference of retail banks has the effect of supporting the continuation of the concentrated nature of capital in the South African economy.²⁴⁷ A fair conclusion is that South African retail banks elect to forego their redistributive role with respect to financial resources in the economy, in the pursuit of stable returns and profit maximisation.

Recognising the role that SMMEs can play in bringing more South Africans into the mainstream economy, a more focused government strategy that centralises the various government programmes available to support SMMEs is needed. Arguably, there is a movement, albeit a slow movement, in this direction with the establishment of the Department of Small Business Development. Further, the identified financing gap that has been perpetuated by the behaviour of the major South African banks provides an opportunity for legislative intervention into the banking sector. Regulation could incentivise prudent risk taking that would support the reduction in the barriers faced by SMMEs when accessing finance.

Chapter three of this paper relies on the philosophy of human flourishing to begin establishing a theoretical framework that could inform legal intervention in the retail banking sector. This theoretical framework is finalised in chapter four. Chapter five demonstrates the use of this theoretical framework, to inform regulation in the retail banking sector, to encourage increased SMME access to finance and credit.

²⁴⁶ Ibid.

²⁴⁷ See note 234 at 26.

CHAPTER THREE: THEORETICAL FRAMEWORK – HUMAN FLOURISHMENT AT A SOCIETAL LEVEL

3.1 Introduction

Chapter three uses the theory of human flourishing to begin the development of a theoretical framework, which can be used to guide the creation of law for the purpose of regulation. In developing a theoretical framework, two perspectives of human flourishing are primarily relied upon: (1) Rasmussen's six characteristics of human flourishing, and (2) Alexander and Peñalver's human flourishing theory for society's property system. These two theories are relied upon because Rasmussen's theory targets human flourishing at the individual level while Alexander and Peñalver's theory targets human flourishing at the societal level. This chapter focusses on human flourishing at an individual level. Chapter four will focus on human flourishing at a societal level.

Chapter three and four propose that law should be used in a way to promote outcomes that enhance social welfare. These chapters challenge the traditional understanding that social-enhancing outcomes are to be understood by, for example, increasing rates of employment, lowering levels of poverty, closing the gap between the economic classes in society and increasing levels of GDP per capita.²⁴⁸ Rather, these chapters propose that the enhancement of social welfare should be understood as the creation of outcomes that enable all persons in a society to maximise their human potential.

²⁴⁸ R Easterlin 'Does economic growth improve human lot? Some empirical evidence' in P A Davis and M W Reder (eds) *Nation and Households in Economic Growth Essays in Honor of Moses Abromowitz* (1974); R Layard 'Rethinking the public economics: the implications of rivalry and habit' in L Bruni & P L Porta (eds) *Economics and Happiness: Framings of Analysis* (2005).

The maximisation of human potential is understood with reliance on the moral philosophies of *eudaimonia* and human flourishing, both of which are described below. This chapter first discusses how *eudaimonia* is considered to be the foundation for the moral philosophy of human flourishing.²⁴⁹ Reliance is placed on Aristotle's conception of *eudaimonia* in *Nicomachean Ethics* and *Eudemian Ethics* to lay the groundwork for understanding human flourishing.²⁵⁰ Secondly, this chapter considers what human flourishing means at an individual level. Rasmussen's six characteristics of human flourishing are presented with the purpose of indicating the manner in which flourishing can be achieved at an individual level.²⁵¹

Thirdly, it is demonstrated how the apartheid legal order undermined the flourishing of South African persons.²⁵² Finally, this chapter concludes by sourcing the authority for the use of human flourishing in informing the development of South Africa's legal framework in the preamble to the Constitution.²⁵³

3.2. *Eudaimonia* and human flourishing

Aristotle's moral philosophy on the human well-being recognises the unique nature of each person. It encourages reflection on the manner in which such uniqueness can be nurtured, made to flourish or leveraged for the purpose of counting a person as being *eudaimon*.²⁵⁴ Being *eudaimon* would mean that at an individual level, the

²⁴⁹ T Nagel 'Aristotle on Eudaimonia' (1972) 17 *Phronesis* 3.

²⁵⁰ *Ibid* at 252.

²⁵¹ *Ibid*.

²⁵² See chapter 3.5.

²⁵³ See note 5.

²⁵⁴ See note 249 at 253.

person has lived a full life.²⁵⁵ For the purposes of this thesis, it is accepted that having lived a full life is the natural objective of a person.²⁵⁶

A social policy with the objective of human flourishing would, at an individual level, have the consequence of promoting the maximisation of an individual's potential. Aristotle does not provide a clear notion of *eudaimonia* as two aspects make a generalised definition for *eudaimonia* difficult. The first is the inability to clearly distinguish between the constituent and necessary conditions for living a good life.²⁵⁷ The second is the interrelation between thought, purpose, emotion and perception.²⁵⁸

As mentioned above, the first aspect that contributes towards the inability of providing an exact definition for *eudaimonia* is the difficulty experienced in distinguishing between the constituent and necessary conditions for *eudaimonia* to be realised.²⁵⁹ The distinction between these conditions may vary slightly from person to person, given that *eudaimonia* is an inherently personal moral philosophy.²⁶⁰

However, broadly, the constituent conditions are those elements that collectively give content to living a good life.²⁶¹ The necessary conditions, by contrast, are those elements without which living a good life is not possible.²⁶² For example, where a good life is understood as comprising of good health, a person would need to have a diet that is sufficiently nutritious. In this consideration of a good life, the constituent

²⁵⁵ Ibid.

²⁵⁶ Ibid at 253.

²⁵⁷ Ibid at 254.

²⁵⁸ See note 65 at 80.

²⁵⁹ See note 249 at 253.

²⁶⁰ Ibid.

²⁶¹ Ibid.

²⁶² Ibid.

condition for a good life is good health and the necessary condition is a diet that is sufficiently nutritious.

However, while the constituent and necessary conditions for *eudaimonia* to be realised may vary slightly from one person to another, Aristotle does suggest that there are some constituent elements which all persons should possess. He provides the example of justice as being a constituent condition for *eudaimonia*.²⁶³ According to Aristotle, justice can be defined as being politically engaged, otherwise known as active citizenship in the South African context. This would require a person to participate in the political decision-making that will have an impact on the livelihood of the person.²⁶⁴ For Aristotle, being politically active in the community is important because the decisions of the politiek will have an impact on the person's *eudaimonia*, and thus their ability to live a good-life.²⁶⁵

The second difficulty experienced with positing an exact definition for *eudaimonia* is the interrelation between thought, purpose, emotion and perception. This interrelation is unique for each person.²⁶⁶ Aristotle identifies humans as a superior animal by virtue of their ability to employ rational thought.²⁶⁷ Rational thought enables a person to engage in action with thought, purpose, emotion and perception.²⁶⁸

²⁶³ Ibid.

²⁶⁴ Ibid.

²⁶⁵ Ibid.

²⁶⁶ Ibid; see note 11 at 31.

²⁶⁷ Ibid.

²⁶⁸ Ibid.

The difficulty that arises as a result of the interrelatedness between each person's thought, purpose, emotion and perception can be better understood with reference to the distinction between the *ergon* and *erga* of a person.²⁶⁹ The *ergon* of a person is a characteristic of a person that makes it what it is.²⁷⁰ It can be considered the potential of the person.²⁷¹ Whereas the *erga* of a person is a characteristic that is held in common among a group of persons.²⁷² Nagel indicates that the *ergon* of a person is the characteristic of a person which results through the unique relationship between the function of that person and the person's rational faculty.²⁷³

Function is understood as the capabilities of a person. The use of function in the singular is not intended to suggest that the capability of a person is restricted.²⁷⁴ Rational faculty is understood as the unique interrelation between thought, purpose, emotion and perception.²⁷⁵ All humans do not engage in the practical exercise of rational faculty in the same way.²⁷⁶

As a result of each person having their own unique system of rational faculty, the use of rational faculty by a person in the exercise of a person's functions will give rise to a unique potential.²⁷⁷ The exploitation of this potential results in a state of *eudaimonia*. Therefore, where a person's *ergon* can be successfully identified, and the necessary resources provided to exploit the *ergon*, a person will maximise their potential and achieve *eudaimonia*.

²⁶⁹ Ibid at 254.

²⁷⁰ Ibid.

²⁷¹ Ibid.

²⁷² Ibid.

²⁷³ Ibid.

²⁷⁴ See note 65 at 85.

²⁷⁵ Ibid.

²⁷⁶ Ibid.

²⁷⁷ Ibid.

However, the identification and exploitation of the *ergon* cannot be understood in isolation from the broader social system within which a person operates. The social system will have an impact on a person's potential and the ability of a person to maximise their potential. The socialisation of a person will impact the exercise of rational thought by that person.²⁷⁸ This will have an impact on that person's *ergon*.

In considering the manner in which a person may exercise their faculty of rational thought, it is necessary to include an understanding of the role that nurture and nature would have on the development of a person.²⁷⁹ As a result of the unique nature of the interrelatedness of nurture and nature that may form the collective space within which a person is placed, no two persons would exercise their faculty of rational thought in the exact same fashion.

Therefore, *eudaimonia* is where the individual's unique capacity is maximised.²⁸⁰ However, this maximisation does not take place by coincidence or luck, but is the result of the practical exercise of rational faculty and contemplation.²⁸¹ As a result, an independent event that is not the consequence of the functioning or malfunctioning of a person cannot be considered as determining *eudaimonia*: it is not brought about by the volition and autonomous direction of the person.²⁸²

For example, consider the scenario where a nurse, after having taken all the necessary health and safety precautions, contracts an infection while on duty. It is not that the nurse has malfunctioned, but rather that the effect of the infection is to cause

²⁷⁸ Ibid.

²⁷⁹ See note 65 at 84.

²⁸⁰ Ibid.

²⁸¹ See note 249 at 254.

²⁸² Ibid.

the nurse to malfunction. Therefore, this physical malfunction is regarded as an independent event and cannot be considered as part of the determination of the nurses's state of *eudaimonia*.

This can be contrasted against an alternative scenario, where a nurse intentionally does not follow the necessary health and safety precautions, and contracts the same infection. In the latter scenario, the malfunction brought about through the contraction of this infection is included in the determination of the nurses's state of *eudaimonia*. This is because the malfunctioning could have been avoided. The situation arose because of the nurse's exercise of free volition that resulted in the necessary health and safety precautions not being taken.

Further, Aristotle indicates that human flourishing is not to be determined at a static point in a person's life and should be differentiated from a mood or sensation that is momentary.²⁸³ Rather, human flourishing is a process that includes the acquisition of the requisite skills and resources to achieve human flourishing.²⁸⁴ The determination of human flourishing is not limited to one's innate abilities, but would include the dispositions that a person acquires over time as a consequence of the nurturing that a person receives from family, friends and community.²⁸⁵

In addition, for Aristotle, flourishing is to be determined with regard to what a person does with that which they have at their disposal. Therefore, virtues such as wealth and health are not to be considered ends in themselves. Instead, these virtues

²⁸³ Ibid.

²⁸⁴ Ibid.

²⁸⁵ See note 65 at 84.

hold instrumental value such that the manner in which they interact with the composite person will determine that person's level of well-being.²⁸⁶

In the context of property, Aristotle identifies the just property system as being one where the distribution of resources takes place on the basis of merit.²⁸⁷ Therefore, where society has persons of equal merit, the distribution of resources should be equal.²⁸⁸ However, where society has persons with different endowments of merit, those with superior merit should be entitled to more resources.²⁸⁹ Interestingly, Aristotle does not define what constitutes merit. Instead, he indicates that each community should be allowed to determine for itself what should be considered as merit.²⁹⁰

Within the South African context, it could be argued that the content given to merit is captured by the pursuit of capitalism. Consequently, the South African property system favours formulae that support a free market system and the protection of private property rights. However, the prioritisation of private property rights in a free market system over time can produce an unequal distribution of resources that cannot easily be contained by redistributive interventions.²⁹¹

Apartheid unjustly supported the concentration of the ownership of resources with white persons.²⁹² The resources required for the flourishing of black persons were

²⁸⁶ See note 65 at 87.

²⁸⁷ See note 65 at 105.

²⁸⁸ Ibid.

²⁸⁹ Ibid at 107.

²⁹⁰ Ibid.

²⁹¹ Ibid at 113; L Underkluffer 'The Idea of Property, Its Meaning and Power' (2003) 11 – 102.

²⁹² H Marais 'South Africa pushed to the limit' (2011) *The Political Economy of Change*.

not made available to black persons.²⁹³ Unfortunately, the effects of the apartheid merit system have been entrenched in South Africa's resource market.²⁹⁴ The current structure of the resource market prevents black persons from accessing those resources necessary for their flourishing.²⁹⁵ A demonstration of this is provided in chapter two with regards to the difficulty experienced by black SMMEs in accessing credit. The effect of South Africa's merit system is to continue to disadvantage black persons.

3.3. Human flourishing at an individual level

It is argued that the goal of human flourishing at an individual level can be advanced with reliance on Rasmussen's six characteristics that may further this goal: (i) objective, (ii) inclusive, (iii) individualised, (iv) agent-relative, (v) self-directed, and (vi) social.²⁹⁶

Sen and Nussbaum explain that the law has a role in facilitating the objective nature of flourishing by making opportunities available for a person to obtain certain crucial capabilities.²⁹⁷ The law can make available opportunities by regulating the allocation of resources with the purpose of enabling a person access to those resources necessary for their flourishing.

The objective characteristic of human flourishing is not limited to the natural endowments that a person may possess. Instead, it evaluates the extent to which

²⁹³ Ibid at 15.

²⁹⁴ Ibid at 140.

²⁹⁵ Ibid.

²⁹⁶ See note 11 at 3, 4.

²⁹⁷ Ibid.

those natural endowments can be optimised and enhanced.²⁹⁸ Part of optimising the natural endowments of a person require the provision of general basic needs, such as shelter. In addition, it requires filling the more subjective needs of a person based on their innate capabilities, such as being able to participate in their community's political life.²⁹⁹ Recognising that the nature of flourishing is unique to each person, the nature of these objective needs will vary from person to person.³⁰⁰

Therefore, the objective characteristic of human flourishing is understood in terms of the provision of that which is necessary to a person, to the extent required, to enable them to grow their natural endowments and capabilities, such that a person is able to maximise their potential.³⁰¹ However, the following qualification exists: given that a person may have what is required to maximise their potential, it still remains for that person to carry out actions or inactions that would result in the maximisation of their potential.³⁰² Therefore, it is this qualification that causes human flourishing to have an objective characteristic.

Human flourishing is considered inclusive in three aspects: time, virtue and activity.³⁰³ Human flourishing is not assessed with reference to a particular point in time or activity in the life cycle of a human being. The achievement of flourishing is assessed retrospectively, such that the entire life cycle is what determines whether or not flourishing is realised.³⁰⁴

²⁹⁸ Ibid.

²⁹⁹ Ibid.

³⁰⁰ Ibid.

³⁰¹ Ibid.

³⁰² Ibid.

³⁰³ Ibid at 4 - 6; T E Hill 'Happiness and Human Flourishment in Kant's Ethics' (1999) 16 *Social Philosophy and Policy* 1.

³⁰⁴ See note 11 at 4 - 6.

For example, if a person ‘achieves’ by creating and maintaining a profitable business in their twenties, this must not be interpreted in isolation, and without consideration, of how they distribute the proceeds of their business in their thirties. These events must be considered together. This collective, as opposed to isolated, consideration of events, equivalently activities, gives rise to human flourishing’s inclusive characteristic with respect to time and activity.³⁰⁵

The achievement of virtues like friendship, health and wealth can be considered symptomatic of flourishing, but are not determinative of flourishing.³⁰⁶ The virtues that a person possesses must be appreciated together with the vices that they may have.³⁰⁷ Further, the virtues and vices are assessed at an individual level with reference to the particularities of that person as opposed to a more objective assessment.³⁰⁸ This holistic appreciation of the human being makes flourishing inclusive with respect to virtue.

Human flourishing is individualised in that it recognises that there are both individuate and universal talents and potentialities.³⁰⁹ This characteristic reflects the aristotelean conception of *ergon* and *erga*, that which is unique to one of a category and that which is unique to all of a category respectively.³¹⁰ The actualisation of a person’s potential is a function of their circumstance and their individualised decision-making processes.³¹¹

³⁰⁵ Ibid.

³⁰⁶ Ibid at 26.

³⁰⁷ Ibid.

³⁰⁸ Ibid.

³⁰⁹ Ibid at 7.

³¹⁰ Ibid at 36; see subchapter 3.2.

³¹¹ Ibid.

Therefore, two people may have the same natural endowments and decision-making processes, but live in different circumstances. Recognising that the development of a person is a function of their circumstance, the actualised potential of these two people will be different. For their actualised potential to be the same, their development would need to not be a function of their circumstance. Therefore, they would need to be able to act in an impersonal manner, free from the consequences of their action or inaction.³¹²

Similarly, where two people have the same natural endowments and circumstances, these endowments and circumstances make it possible for them to actualise the same potential. However, the first person may have an individual decision-making process that does not place value on the actualisation of this potential. Instead, they may place a higher value on a different potential. In both circumstances, the realisation of these different potentials by these two people would mean that they both flourish, despite the nature of flourishing for each individual being different. Therefore, the natural endowments that a person may possess must be considered in the context of their circumstances, as well as their decision-making processes.³¹³

Accepting that human flourishing is inherently personal, the necessary conclusion is that flourishing is agent-relative.³¹⁴ It would be inaccurate to characterise human flourishing as agent-neutral as this would mean that consideration, for example, of the cultural, religious or general worldview of a person is not relevant to the determination of what would constitute flourishing for that person.³¹⁵ The pursuit

³¹² Ibid at 8.

³¹³ Ibid at 14.

³¹⁴ Ibid at 8.

³¹⁵ Ibid.

of human flourishing requires that those aspects must be considered.³¹⁶ These aspects form an intrinsic part of personhood and therefore contribute towards a person's unique nature.³¹⁷

The fifth characteristic of human flourishing requires that flourishing be self-directed.³¹⁸ This would require an agent to take responsibility for their own flourishing according to a form and content that is necessary and suitable to do so.³¹⁹ Aristotle indicates that self-direction requires an agent to use their faculty of rational thought and act voluntarily, independently and with free volition, without undue influence to bring about a desired outcome.³²⁰ The desired outcome is one which supports the individual flourishing of the agent.³²¹ A person should undertake actions or inactions in the pursuit of conscious self-interest that supports the realisation of that person's flourishing.³²² Therefore, a person cannot be forced to flourish and there exists no set formula for flourishing.

The sixth characteristic of human flourishing is that an individual's development should be social. In *Nicomachean Ethics*, Aristotle identifies a person as being capable of independence, though stating that people are by nature a 'social and political being.'³²³ Therefore, while a person may be self-sufficient, a person still requires the company of others.³²⁴ Aristotle acknowledges that there is an aspect of the development of a person that is independent to the innate abilities of that

³¹⁶ Ibid.

³¹⁷ Ibid.

³¹⁸ Ibid at 11.

³¹⁹ Ibid.

³²⁰ Ibid at 31.

³²¹ Ibid.

³²² Ibid.

³²³ See note 249.

³²⁴ See note 11 at 13, 32.

person.³²⁵ This social characteristic of human flourishing is often understated, with flourishing often being understood in terms of a purely personal project.³²⁶

The facts of social dependence and interdependence highlight that the flourishing of one human good is linked to the flourishing of another human good.³²⁷ However, Alexander and Peñalver highlight that the relationship that arises between human goods is not necessarily reciprocal.³²⁸ For example, a person may be dependent on another, but it is not necessary for this second person to be equally dependent on the first. The second person could well be dependent on a third person. Further, the level of dependency may vary from one relationship to another.

The natural evolution of the human good requires the human good to depend on third parties and be exposed to a social ordering.³²⁹ The socialisation of the human good is necessary to optimise the natural endowments that the human good may possess by way of emotional nurturing, or the provision of material resources.³³⁰ It is the social ordering within a community that will contribute towards the extent to which freedoms, capabilities, and the practical reason of the human good may be realised, exercised or challenged.³³¹

For example, consider access to higher education in the jurisdictions of South Africa and Germany. Chapter 29(1)(b) of the South African Constitution³³² affords everyone a right to further education, within the reasonable capabilities of the

³²⁵ Ibid.

³²⁶ Ibid.

³²⁷ Ibid.

³²⁸ See note 65.

³²⁹ See note 11 at 13, 32.

³³⁰ Ibid.

³³¹ Ibid.

³³² See note 5.

government. Article 35 of the German Constitution³³³ places a greater burden on the German state than their South African counterpart, by requiring the state to make available to each citizen an equal right to education in a vocation of their choice. There is no limitation on the realisation of the German article as there is in the South African provision.

Accepting that the economic contexts in Germany and South Africa are different, higher education is not free and easily accessible to every South African, whereas in Germany there are free tuition higher education institutions.³³⁴ Therefore, a person requiring higher education to be able to participate in their vocation of choice, having financial ability as their only personal constraint, would have a better opportunity to access higher education in Germany than in South Africa.

However, this contextualisation merely attempts a short account of what barriers to flourishing may exist in the framing of educational rights and the material provision of educational rights. There are a host of other social elements that may prevent flourishing, such as limited space within centres for higher education or social pressures that prevent one from accessing an opportunity even though it may be available.

³³³ B Law 'Basic Law for the Federal Republic of Germany' Parliamentary Council and the German Bundestag' (1949) <<http://www.bundestag.de/htdocs-e/info/gg.pdf>> (accessed on 02-02-2017).

³³⁴ K Bruckmeier and B U Wigger 'The effects of tuition fees on transition from high school to university in Germany' (2014) 14 *Economics of Education Review* at 4; G Wangenge-Ouma and N Cloete 'Financing higher education in South Africa: Public funding, non-governmental revenue and tuition fees' (2008) 22 *South African Journal of higher Education* 4 at 910,916.

With respect to social pressures, research by Keswell and Powell³³⁵ found a convex relationship between predicted wage and years of education.³³⁶ Therefore, returns to higher levels of education decreased up to grade 12 and thereafter began to increase.³³⁷ Further, the marginal rate of return to education was extremely high for tertiary education and small (approaching zero) for primary education.³³⁸

Accepting that the average cost of education for 12 years of schooling outweighs the return to education having received the 12 years of schooling, then convexity might lead to an incentive structure that is at odds with the acquisition of further schooling.³³⁹ Therefore, where flourishing is premised upon the realisation of higher levels of education, in the context highlighted by Keswell and Powell, the social structure is a barrier to flourishing.

The six characteristics of human flourishing articulated by Rasmussen assist in providing a more focused understanding of what human flourishing is and, by implication, how to go about realising human flourishing. Further, the nature of these characteristics indicate that they are interrelated and for human flourishing to be possible, these characteristics must exist simultaneously. Therefore, the non-existence of one of the characteristics would undermine the pursuit and achievement of human flourishing.

³³⁵ M Keswell and L Poswell 'Returns To Education In South Africa: A Retrospective Sensitivity Analysis Of The Available Evidence' (2004) 72 *South African Journal of Economics* 4.

³³⁶ *Ibid* at 9.

³³⁷ *Ibid* at 11.

³³⁸ *Ibid*.

³³⁹ *Ibid* at 12.

3.4. Human flourishing and apartheid

In pursuing a social welfare objective with the ideological base of human flourishing, it is necessary to analyse the extent to which progress has been made towards the creation of a flourishing environment before inviting further legislative intervention. In the South African context, a starting point for this analysis is a consideration of the role that apartheid had on the flourishing of South Africans. A thorough analysis of apartheid's effects is beyond the scope of this thesis. However, a brief commentary on the effects of apartheid legislation on human flourishing for South Africans would support the arguments put forward in this thesis.

The apartheid state relied on legal intervention in the social and economic structure through laws that included the Immorality Amendment Act,³⁴⁰ the Group Areas Act,³⁴¹ the Population Registration Act,³⁴² the Bantu Education Act,³⁴³ the Natives Taxation and Development Act,³⁴⁴ and the Native Building Workers Act.³⁴⁵ These are merely examples of pieces of legislation that formed part of the greater design of legislation relied upon by the apartheid government to promote and achieve intergenerational racial segregation.

An example of how apartheid legislation prevented black human flourishing can be made by analysing the effects of the Native Building Workers Act³⁴⁶ through

³⁴⁰ Act 21 of 1950.

³⁴¹ Act 41 of 1950.

³⁴² Act 30 of 1950.

³⁴³ Act 47 of 1953.

³⁴⁴ Act 38 of 1958.

³⁴⁵ Act 27 of 1951 hereinafter "Native Building Workers Act". The Mines and Works Act 25 of 1926 created the foundation for the wage and colour bars that was promoted by this Act.

³⁴⁶ *Ibid.*

reliance on Rasmussen's six characteristics of human flourishing: (i) objective, (ii) inclusive, (iii) individualised, (iv) agent-relative, (v) self-directed, and (vi) social.³⁴⁷

The Native Building Workers Act supported the system of job reservation and economic segregation that was introduced by South Africa's Union government in the early 19th century.³⁴⁸ The Native Building Workers Act had four objectives: (i) to promote the interests of white persons in the workplace by ensuring the continued reservation of certain jobs for white occupation in the building industry, (ii) to allow black and coloured people the previously denied ability to be trained as artisans in the building industry and, thereafter, take up occupation as an artisan, (iii) to regulate the number of black artisans that could fill skilled jobs, like bricklaying and carpentry, so as to ensure that they did not act as competition for white artisans, (iv) and to impose on those black artisans an offence for carrying out skilled jobs in areas for which they had no permission.³⁴⁹

The Native Building Workers Act created a quota of artisanal jobs that could be taken up by black and coloured people. Once the quota was filled, the effect of the Native Building Workers Act would be to deny and, in certain circumstances, penalise, those black and coloured persons who sought to be an artisan. This effect would be in conflict with the objective and social characteristics of human flourishing.

³⁴⁷ See note 11.

³⁴⁸ See legislation including the Masters and Servants Act of 1856, the Mines and Works Act 12 of 1911, the Natives (Urban Areas) Act 21 of 1923, the Industrial Conciliation Act 11 of 1924, the Rural Dealers Ordinance of 1924, the Minimum Wages Act of 1925, the Mines and Works Act (Colour Bar Act) 25 of 1926, the Liquor Bill Act of 1926, the Liquor Act of 1927, the Industrial Conciliation Act of 1930, the Native Service Contracts Act of 1932, the Industrial Conciliation Act 36 of 1937, the Pegging Act of 1943, the Industrial Conciliation (Natives) Bill 1947.

³⁴⁹ See note 345.

It would be in conflict because black and coloured individuals would not be able to pursue their artisanal trade of choice, and those who could, would be limited in their choice of artisanal trade.³⁵⁰ Further, the limitation on where black or coloured artisans could engage in their trade would be in conflict with the social characteristic of human flourishing.³⁵¹ This conflict would arise because the limitation is an unnatural restriction on the relationship that a black or coloured artisan could have with their natural surroundings.

However, reflecting on the objectives of the Native Building Workers Act and the manner in which it was operationalised, whilst having a detrimental effect on the black and coloured population groups, it created an exclusive and unrestricted environment in favour of white artisans.

Accepting the existence of the external constraints imposed by apartheid legislation like the Native Building Workers Act, even where a black or coloured person had the volition, self-direction and innate ability to pursue an artisanal trade, they would legally not be able to do so. The external effect would be to undermine and curb that volition, self-direction and innate ability that the black or coloured person may have possessed.

With respect to the black and coloured population groups, while the inclusive, individualised, agent-relative and self-directed characteristics of human flourishing may have been present, the environment was not one within which these characteristics could be fulfilled. Therefore, the effect of the Native Building

³⁵⁰ Ibid.

³⁵¹ Ibid.

Workers Act was to undermine the flourishing of black and coloured artisans while imposing external constraints that would support the flourishing of white artisans.

A social policy with the objective of realising human flourishing would support the maximisation of the capabilities and potential of persons in society. Human flourishing requires the furtherance of the individual interest, for the purpose of enhancing overall social welfare, to be placed at the centre of the legal framework.

While apartheid was primarily occupied with regulating the private sphere, it was not done in the individual interest or with the objective of enhancing overall social welfare. The apartheid system was designed to prevent black people from flourishing, commodify the black person to support the objectives of the apartheid state, and to ensure that these outcomes were intergenerational. As a consequence, the circumstance that has prevailed is Mbeki's 'two nations, the one black, the other white'.³⁵²

3.5. Human flourishing and the Constitution

Chaskalason CJ in *Pharmaceutical Manufacturers Association of South Africa and Another: In re Ex parte President of the Republic of South Africa and Others*³⁵³ affirmed that the Republic of South Africa is based on a system of constitutional sovereignty. The case also highlighted that the Constitution³⁵⁴ is the supreme law of South Africa, from which one system of law emerges and derives force.³⁵⁵ Further,

³⁵² See note 14.

³⁵³ 2000 (2) SA 674 at para 19.

³⁵⁴ See note 5.

³⁵⁵ See note 353.

Chaskalason CJ indicated that the Constitution³⁵⁶ is not only descriptive but is also prescriptive in its requirement in chapter 1 of the Constitution:³⁵⁷ the shaping of the South African legal system must take place to advance the founding values of the Constitution.³⁵⁸

De Vos indicates that the Constitution³⁵⁹ was written in response to the social, economic and political history of South Africa.³⁶⁰ He highlights the Constitutional Court's continued reference to the Constitution³⁶¹ as a transformative document,³⁶² committed to continuous social, economic, legal and political transformation.³⁶³

Langa CJ indicates that transformative constitutionalism connotes a large-scale social change that is more than reform, but less than, or different to, a revolution, that moves the country in a direction towards a democratic, participatory and egalitarian direction.³⁶⁴ The continuous nature of the transformative mandate of the Constitution³⁶⁵ requires that the emerging legal framework be one that is malleable and flexible. It must respond to the changing needs of society so as to be able to advance the achievement of the founding values of the Constitution.³⁶⁶

³⁵⁶ See note 5.

³⁵⁷ Ibid.

³⁵⁸ Ibid.

³⁵⁹ See note 5.

³⁶⁰ See note 31.

³⁶¹ Ibid; P Langa 'Transformative constitutionalism' (2006) 17 *Stellenbosch Law Review* at 351.

³⁶² See the cases of *Mkontwana v Nelson Mandela Metropolitan Municipality* 2005 (1) SA 539 (CC); *Soobramoney v Minister of Health (Kwa-Zulu Natal)* 1998 (1) SA 765 (CC) at para 8; *Investigating Directorate: Serious Economic Offences and Others v Hyundai Motor Distributors (Pty) Ltd and Others In re: Hyundai Motor Distributors (Pty) Ltd and Others v Smit NO and Others* 2001 (1) SA 545 (CC) at para 21.

³⁶³ See note 360.

³⁶⁴ See note 361.

³⁶⁵ See note 5.

³⁶⁶ Ibid.

Transformative constitutionalism places emphasis on the need to increase access to resources for all South Africans for the purpose of advancing human development. However, the Constitution³⁶⁷ takes having access to resources one step further and requires that access to resources include the ability to effectively use those resources. This narrative reflects a capabilities-approach to understanding human development.

For the purpose of this paper, there are three key characteristics of the transformative nature of the Constitution³⁶⁸ that are important in highlighting the capabilities-approach of the Constitution.³⁶⁹ (i) the provision of social rights and a substantive concept of equality, (ii) the provision of affirmative state duties, and (iii) the historical self-consciousness of the Constitution.³⁷⁰ These are set out below.

The Constitution³⁷¹ does not merely make available political freedoms, but recognises that the realisation of political freedoms requires access to social resources so that people can meaningfully exercise their rights.³⁷² The preamble introduces the need for resources to be made available to ‘improve the quality of life of all citizens and free the potential of each person...’.³⁷³ To redistribute resources to achieve this objective in the preamble, the law cannot be a neutral tool. Rather, it must be operationalised in a manner so as to advance the achievement of substantive equality.

³⁶⁷ The preamble and section 1 of the Constitution of the Republic of South Africa, 1996.

³⁶⁸ Ibid.

³⁶⁹ Ibid.

³⁷⁰ Ibid.

³⁷¹ Ibid.

³⁷² C Albertyn ‘Substantive equality and transformation in South Africa’ (2007) 23 *South African Journal on Human Rights* 2 at 255.

³⁷³ Ibid.

Albertyn³⁷⁴ argues that the advancement of substantive equality brings about the transformative process mandated by the Constitution.³⁷⁵ Substantive equality is something more than formal equality.³⁷⁶ A key differentiating factor is that formal equality is framed in terms of legal formalism and seeks to promote inclusivity by enabling access to the status quo. On the other hand, substantive equality adopts a contextual approach to claims and, as a consequence, is concerned with removing the structural conditions that promote and perpetuate inequality.³⁷⁷ Albertyn regards substantive equality as being transformative in keeping with the mandate of the Constitution.³⁷⁸

An example of substantive equality can be demonstrated with reference to sexual orientation claims. Formal equality would affirm the identity of gay and lesbian persons on an equal basis as heterosexual persons. A substantive equality approach would problematise dominant heterosexual norms and encourage the plurality of families and relationships.

For the purpose of this thesis, a formal equality approach would support the banking sector maintaining its' current approach to making credit facilities available. However, it would encourage new criteria for credit access to be developed to facilitate broader access by black persons. A substantive equality approach would interrogate the entire credit system and reimagine how it can be structured to respond

³⁷⁴ See note 372. See further: P De Vos 'Grootboom, the right of access to housing and substantive equality as contextual fairness' (2001) 17 *South African Journal of Human Rights* at 258; and S Fredman 'Providing equality: substantive equality and the positive duty to provide' (2005) 21 *South African Journal on Human Rights* 2 163-190.

³⁷⁵ See note 5.

³⁷⁶ See note 372.

³⁷⁷ Ibid.

³⁷⁸ See note 5 and 372.

to the needs of black persons; for example, by changing the content of collateral in credit transactions.

Reflecting on the jurisprudence of the Constitutional Court, Alertyn identifies four characteristics of substantive equality that have encouraged the development of the non-neutral role of law in South Africa: (i) emphasis on understanding inequality in its social and historic context;³⁷⁹ (ii) understanding the impact that the alleged inequality has on the complainant;³⁸⁰ (iii) the interrogation of existing norms to support the development of norms that recognise differences as being a positive attribute of society;³⁸¹ and (iv) an understanding of the purpose of the right in question, and the values informing that right, to appreciate how the right is a tool for the direct or indirect dismantling of systematic disadvantage or subordination.³⁸²

The non-neutral role of the law can also be understood in the context of the affirmative duties that the Bill of Rights in the Constitution³⁸³ places on the state.³⁸⁴

The state is not only required to refrain from unjustifiably and unreasonably interfering with the rights of individuals, but has a duty to ‘respect, protect, promote and fulfil the rights in the Bill of Rights’.³⁸⁵ According to Langa CJ, the state is ‘to assist people in authentically exercising and enjoying their constitutional rights, and to support individual self-realisation’.³⁸⁶

³⁷⁹ See note 372 at 7.

³⁸⁰ Ibid.

³⁸¹ Ibid.

³⁸² Ibid.

³⁸³ See note 5.

³⁸⁴ Ibid.

³⁸⁵ Chapter 7 (2) of the Constitution of the Republic of South Africa, 1996. See further: *Minister of Finance and Other v Van Heerden* 2004 (6) SA 121 (CC) para 24.

³⁸⁶ See note 361 at 154.

The recognition that the legal framework needs to be flexible and malleable, one that is open to continuous change, is affirmed by Langa CJ's reference to the historical self-conscious characteristic of the Constitution.³⁸⁷ This characteristic rejects the notion that the state and citizen enter into a timeless social contract that enables the continuance of the status quo. It also rejects the notion that this social contract is free from the interrogation of pre-existing hierarchies and distributions of social and economic power. Rather, the Constitution³⁸⁸ encourages the continuous interrogation of structures and distributions to ensure constant vigilance and responsiveness to the needs and problems of society.³⁸⁹

3.6. Concluding remarks

The post-colony legal system must be crafted on the basis of constitutional supremacy and under the mandate of transformative constitutionalism. At an individual level, transformative constitutionalism requires persons to not only have access to the resources necessary for their development, but to also be able to effectively use those resources. At a societal level, transformative constitutionalism includes social solidarity in the provision of resources to citizens as well as the ancillary assistance to effectively use those resources.

Chapter three has relied on Aristotle's theory of *eudaimonia* to broadly understand what human flourishing means. The chapter presented Rasmussen's theory of human flourishing to provide a systematic way of approaching the realisation of human flourishing at an individual level. Chapter four will present Alexander and

³⁸⁷ See note 5, most notable in the preamble and chapter 1 of the Constitution of the Republic of South Africa, 1996.

³⁸⁸ *Ibid.*

³⁸⁹ See note 361.

Peñalver's theory of human flourishing to understand how human flourishing can inform the structuring of society's property system to promote access to resources at an individual level.

CHAPTER FOUR: THEORETICAL FRAMEWORK – HUMAN FLOURISHMENT AT A SOCIETAL LEVEL

4.1. Introduction

Chapter two of this thesis discussed the relationship between the South African Small, Micro and Medium Enterprise (SMME) and banking sectors. The chapter illustrated how current banking behaviour in South Africa adversely impacts SMME access to credit. This thesis proposed that market regulation could be carried out to improve SMME access to credit. Chapter three of this thesis suggested that, for effective regulation to take place, the nature of the regulation should be informed by a theoretical framework that is reflective of the broader legal culture of South Africa. Therefore, acknowledging the importance of transformative constitutionalism, chapter three proposed the developmental theory of human flourishing as a suitable theory to inform regulation in South Africa's market economy.

Chapter three looked at the effect that the application of human flourishing theory would have on individual development. Insofar as the broader legal framework is concerned, chapter four will look at the nature of human flourishing theory from a societal perspective by relying on Alexander and Peñalver's application of the theory. Further, this chapter will suggest how Alexander and Peñalver's perspective can be used to guide regulation. Chapter six will use the theoretical framework established under chapters three and four to propose how the law, in response to the recognised barrier of accessing finance that SMMEs have experienced, can be used to regulate the South African banking sector.

In chapter one, this thesis highlighted the problem of adopting a generalised approach to law-making as being unable to respond adequately to the needs of the individual. This is the result of the design of laws taking place with a view of broader societal regulation. However, individuals are part of broader societies therefore successful law-making needs to account for both the individual and society. It is with this recognition that this chapter introduces an additional model of human flourishing theory: Alexander and Peñalver's human flourishing theory of property.

Alexander and Peñalver highlight that their human flourishing theory of property does not infuse morality and law.³⁹⁰ The purpose of the theory is to retain the instrumental role of the law and use it as a tool to create a more just society, in which there is opportunity for individuals to flourish.³⁹¹ However, the extent to which the law can be used as a tool is inherently constrained because of the importance that human flourishing theory places on individual autonomy. At the core of flourishing is the nurturing, enabling, advancement and preservation of individual autonomy.³⁹² Nussbaum and Sen argue that, even in circumstances where individual choice may give rise to individual harm, the law would not be able to intervene.³⁹³

4.2. Human flourishing at a societal level

Alexander and Peñalver's human flourishing theory of property has five characteristics: (i) to enforce moral obligations, (ii) to clarify social obligations, (iii) in limited circumstances, to draw upon its coercive nature to maintain a particular

³⁹⁰ See note 65.

³⁹¹ *Ibid* at 92.

³⁹² See note 11.

³⁹³ M C Nussbaum 'Capabilities and Human Rights' (1997) 66 *Fordham Law Review* at 273, 296.

social ordering, (iv) to intervene in the economic market place to advance a particular property objective that supports flourishing, and (vi) to preserve individual autonomy.³⁹⁴ These characteristics are explained below:

4.2.1. To enforce moral obligations

The use of a redistributive tax system illustrates how the law can be used to enforce moral obligations.³⁹⁵ The underlying motivation of this system is the enforcement of a moral obligation for persons who accumulate a surplus of resources to share that surplus with the organising governmental system. This enables the system to make resources available to persons in need, for their own development and pursuit of flourishing.³⁹⁶ The property system imposes a penalty where persons attempt to, or do not, contribute the defined amount from their surplus to the organising system.³⁹⁷

The evidence of a rigorous sliding scale tax system in South Africa provides evidence for the prioritisation of a redistributive model of growth.³⁹⁸ Further, it illustrates how the pursuit of policy that is premised on a redistributive model of growth informs a society's legal framework.³⁹⁹ In these circumstances, the impact of the law is not to give effect to the absolute nature of private property rights. Rather, the broader public interest is prioritised over the individual interest and, as a consequence, part of the individual interest is carved out, reducing the effectiveness of an absolute property right.

³⁹⁴ See note 65.

³⁹⁵ South African Revenue Services 'Tax Statistics 2015' (2015).

³⁹⁶ See note 65 at 95.

³⁹⁷ Ibid.

³⁹⁸ See note 14.

³⁹⁹ See note 65 at 95.

However, this impact on private property rights is not unique to the implementation of policy. For example, in the common law, it is well recognised that the holder of a private property right does not in fact possess an absolute right as understood in roman law.⁴⁰⁰ This is because a common limitation on the right is that it has to be exercised in a manner that does not constitute a nuisance for their neighbours.⁴⁰¹

4.2.2. To clarify social obligations

A model of property rights consists of holders of property rights and third parties. The law of property places importance on the holders of property rights and in particular, rights of ownership. In principle, the rights of ownership were absolute in nature.⁴⁰² Therefore, in a scenario where an ownership right is present, the rights of third parties would be determined relative to the ownership right.

Traditionally, the relationship between holders of ownership rights and third parties was typified as one of non-interference. The consequence being that third parties could not unduly interfere with the exercise of an ownership right.⁴⁰³ However, it was apparent that such a principle could not be maintained in its completeness because of the communal nature of society.⁴⁰⁴ Therefore, slight incursions on ownership rights, and more broadly property rights, were permissible where authorised by the law.⁴⁰⁵

⁴⁰⁰ P Birks 'The roman law concept of dominium and the idea of absolute ownership' (1985) 1 *Acta Juridica* at 1.

⁴⁰¹ See note 65 at 94.

⁴⁰² See note 400.

⁴⁰³ Ibid.

⁴⁰⁴ Ibid at 32.

⁴⁰⁵ Ibid.

An example of the use of law to clarify social obligations, and in effect maintain social order, is the Western Cape By-law Relating to Streets, Public Places and the Prevention of Noise Nuisances.⁴⁰⁶ The By-law⁴⁰⁷ provides in s3 that ‘No person shall in a public place permit noise from a private residence or business to be audible in a public place...’⁴⁰⁸

Upon application of this By-law,⁴⁰⁹ the owner of a stereo-system would not be able to use the stereo-system at a noise level in their household which would result in the noise from the stereo-system being audible beyond the confines of their household. Therefore, the extent to which ancillary rights of ownership like the rights of use and enjoyment can be exercised by the owner is limited by this By-law.⁴¹⁰ The effect of the By-law⁴¹¹ is to impose on the owner a social obligation due to third parties.

4.2.3. Maintaining the social order

There are circumstances where the independent coordination between members of society would not support the maintenance of social order, given the heterogenous composite nature of society. In these circumstances, legal intervention can clarify social obligations, enforce social obligations and promote social order.⁴¹²

This role of the law is visible, for example, in communities that have enterprises that produce negative externalities in the form of pollutants. Environmental legislation is

⁴⁰⁶ By-law Relating to Streets, Public Places and the Prevention of Noise Nuisances, 2007, Province of Western Cape GN 6469 28 September.

⁴⁰⁷ Ibid.

⁴⁰⁸ Ibid.

⁴⁰⁹ Ibid.

⁴¹⁰ Ibid.

⁴¹¹ Ibid.

⁴¹² M M Keys ‘Aquinas, Aristotle, and the promise of the common good’ (2006).

a response to the failed independent coordination between members of society, and attempts to define and reassign the cost of the negative externality, which would ordinarily fall onto the broader society, to the pollutant.⁴¹³ This clarifies the nature of the cost of the negative externality and who bears the responsibility of the cost thereof.

4.2.4. To intervene in the economic market place to promote human flourishing

A human flourishing theory of property law makes the social incursion on property rights greater. It imposes the obligation to promote the well-being of the community on the holder of property rights, as well as the nurturing of capabilities within the community to ensure the flourishing of the community.⁴¹⁴ Alexander and Peñalver identify this obligation to be less onerous in tightly-knit communities, and the obligation to be more onerous in communities that are structured around modern capitalism.⁴¹⁵

Alexander and Peñalver indicate that in circumstances of inequality and poverty, the state can legitimately intervene to require wealthy persons to contribute towards unwealthy persons in the community to promote flourishing.⁴¹⁶ This is because the needs of the community are prioritised over the property rights that persons may hold over surplus resources.⁴¹⁷

⁴¹³ J J Donohue III and J Heckman ‘Continuous Versus Episodic Change: The Impact of the Civil Rights Policy on the Economic Status of Blacks’ (1991) 29 *Journal of Economics Literature* at 1603, 1639.

⁴¹⁴ See note 65 at 98.

⁴¹⁵ Ibid.

⁴¹⁶ Ibid.

⁴¹⁷ Ibid

Aristotle provided the philosophical foundation for state intervention for the purpose of redistribution of resources.⁴¹⁸ However, for Aristotle, the extent to which the state could redistribute resources is limited to that which is necessary to ensure that each person has sufficient resources so as to flourish.⁴¹⁹ He regarded access to certain material resources for every person as a precursor to human flourishing.⁴²⁰

At this point, a distinction must be made between redistribution for the purposes of human flourishing and redistribution for the purpose of distributive justice.⁴²¹ Redistribution for human flourishing does not enquire into the merits of the prior distribution of property entitlements, nor does it seek to ensure an equal distribution of property entitlements between persons. Recognising that flourishing is determined through a capabilities-approach, the allocation or reallocation takes place to the extent necessary to realise the capabilities of each person.⁴²² This understanding of distribution reflects a model of comparative advantage, where each person receives that allocation of material resources necessary to carry out that activity which they can do more efficiently than any other activity.⁴²³

For example, consider the community of Cape Town with three community members. To flourish, Zethu must become a musician, Anna must become a carpenter and Layla must become a farmer. To be a musician, 9 units of resource X is needed, to be a carpenter 5 units of resource Y is needed and to be a farmer 8 units of resource Z is needed.

⁴¹⁸ Ibid.

⁴¹⁹ Ibid.

⁴²⁰ Ibid at 123.

⁴²¹ Ibid at 124.

⁴²² Ibid.

⁴²³ P R Krugman 'International economics: Theory and policy' (2008) 8ed.

Table 2, column 3 illustrates the initial distribution of resources after independent market interactions. Column 4 indicates the consequences of reallocation under a human flourishing theory of property. This would be for Anna, who has 10 units of resource X to reallocate 9 units to Zethu. This process would continue for each person until there is a final allocation of resources to allow each person to flourish. The final allocation of resources after redistribution is indicated in column 5. The final allocation would be an unequal distribution of existing resources. However, this allocation would be more ‘equitable’ because each person has the requisite allocation of the resource that they need to flourish.

Citizens of Cape Town	Allocation of resources required to flourish	Initial allocation of resources	Reallocation policy	Final allocation of resources
Zethu	9 X	10 Z	Reallocate 8 units to C	2Z, 9X
Anna	5 Y	10 X	Reallocate 9 units to A	1X, 5Y
Layla	8 Z	10 Y	Reallocate 5 units to B	5Y, 8Z

This can be contrasted against an example of distributive justice where the objective is to create an equal distribution of resources. Table 3 relies once more on the hypothetical scenario of Cape Town. The outcome is one where each person has an equal amount of each resource, but does not have the necessary amount of the resource they require to flourish.

Therefore, under a reallocation system of distributive justice, Zethu would receive 3.33 units of resource X, which is insufficient to allow him to become a musician. Overall the loss to society is greater, because Anna and Layla receive units of resource X that they do not require to flourish. Ideally, resources should be allocated in such a manner so as to support the flourishing of persons.

Citizens of Cape Town	Allocation of resources required to flourish	Initial allocation of resources	Reallocation policy	Final allocation of resources
Zethu	9 X	10 Z	Reallocate 3.33 units to B, reallocate 3.33 units to C	3.33 Z, 3.33 X, 3.33 Y
Anna	5 Y	10 X	Reallocate 3.33 units to A, reallocate 3.33 units to C	3.33 Z, 3.33 X, 3.33 Y
Layla	8 Z	10 Y	Reallocate 3.33 units to A, reallocate 3.33 units to B	3.33 Z, 3.33 X, 3.33 Y

4.2.5. To Preserve Individual Autonomy

A property system under a human flourishing construct still has to recognise the role of individual autonomy in flourishing.⁴²⁴ Therefore, even though a property system may make the necessary resources available to a person to enable them to flourish, the conversion of those resources into capabilities or functions that would reflect a movement towards flourishing, remains an individual choice.⁴²⁵ For example, drawing on the abovementioned scenario with Zethu, if the property system reallocated resources in the market so that Zethu received the 9 units of resource X required to become a musician, it would still be his responsibility to use those resources in the manner required to become a musician.

To understand the impact of redistributive models on autonomy, Blake draws a distinction between relative and absolute deprivation.⁴²⁶ He argues that where absolute deprivation exists, there is sufficient moral force for intervention to correct

⁴²⁴ See note 65 at 94.

⁴²⁵ Ibid.

⁴²⁶ M Blake 'Distributive justice, state coercion, and autonomy' (2001) 30 *Philosophy & public affairs* 3 257-296; J Raz 'The Morality of Freedom' (1986) ch 3 at 15.

the distributive imbalance.⁴²⁷ In the circumstance of absolute deprivation, the issue is not that a person has less resources than another. The issue is that the level of resources available to the deprived person is insufficient to support autonomous human agency.⁴²⁸ Therefore, a policy of redistribution has an empowerment role in that it seeks to make resources available to a person so that they can exercise autonomous human agency.⁴²⁹

However, in the circumstance of relative deprivation, the issue is that one person has less resources than another. Relative deprivation accepts that both persons have sufficient resources for decent human functioning, defined as being able to exercise autonomous human agency.⁴³⁰ The unequal distribution of resources is a signal that the deprivation in question could be remedied through a reallocation of resources.⁴³¹

In South Africa, there is a clear policy tension where legal intervention to redistribute resources, in either circumstance of relative or absolute deprivation, collides with the private interest to accumulate resources.⁴³² Private interest is a derivative of individual autonomy. Therefore, such legal intervention can be legitimised where the intervention draws a distinction between relative and absolute deprivation.

In the circumstance of absolute deprivation, some members of society do not have sufficient resources to enable decent human functioning. Therefore, intervention that

⁴²⁷ Ibid.

⁴²⁸ Ibid.

⁴²⁹ Ibid.

⁴³⁰ Ibid.

⁴³¹ Ibid.

⁴³² P De Vos 'Pious wishes or directly enforceable human rights: Social and economic rights in South Africa's 1996 Constitution' (1997) 13 *South African Journal on Human Rights* 67. The Constitution of the Republic of South Africa, 1996, seemingly provides scope for this collision to be overcome through the horizontal application of the Bill of Rights provided for in Chapter 8 of the Constitution.

reallocates surplus resources to the deprived members of society could be justified. Surplus resources are defined as those resources available to some persons above the minimum threshold required for decent human functioning.

However, in the circumstance of relative deprivation, a redistributive framework is more challenging where the preservation of individual autonomy is regarded as a priority. In this circumstance, all members of society have a minimum amount of resources to enable decent human functioning. A redistribution of resources from one person to another merely seeks to “even” the distribution. However, this redistribution may not have any moral justification and, rather, undermines the individual autonomy of the members of society.⁴³³

Accepting that circumstances of absolute deprivation would justify legal intervention to redistribute resources, it is then necessary to determine the minimum threshold of resources required by each person to sufficiently exercise individual autonomy. Therefore, appreciating the constraint of individual autonomy, the law: (i) makes available capabilities through the reallocation of resources in circumstances of absolute deprivation, (ii) cannot penalise where individual choice prevents the realisation of flourishing, (iii) and can intervene where individual choice adversely impacts the exercise of capabilities by third parties.

4.3. Conclusion

In understanding the role of human flourishing theory at a societal level, chapter four has relied on Alexander and Peñalver’s human flourishing theory of property.

⁴³³ See note 423.

The theory consists of five characteristics: (i) to enforce moral obligations, (ii) to clarify social obligations, (iii) in limited circumstances, to draw upon its coercive nature to maintain a particular social ordering, (iv) to intervene in the economic market place to advance a particular property objective that supports flourishing, and (vi) to preserve individual autonomy.

This chapter has suggested that effective market regulation must support distributive outcomes that allocate resources to individuals in a manner that ensures each individual receives that quantity, of that resource, required for that individual to flourish. Market regulation that has distributive outcomes, which include (i) the under-allocation of resource(s) and/or (ii) over-allocation of resource(s), will not be efficient and effective at promoting human flourishing at a societal or individual level.

Chapter two of this thesis highlighted the difficulty experienced by SMMEs in South Africa at accessing a much needed resource for their flourishing, namely, credit from retail banks. It has illustrated that the idea of ‘[T]he [Flourishing] Entrepreneur’ remains unrealised for many South African entrepreneurs because of inadequate credit facilities. Market intervention can, and should, take place to resolve this problem.

To establish a suitable theoretical framework of human flourishing to inform legal intervention this thesis began by first looking at human flourishing at an individual level in chapter three. Thereafter, in this chapter it looked at human flourishing at a societal level. At this stage, it is proposed that a holistic theoretical framework of

human flourishing has now been established for the purpose of informing legal intervention.

Chapter five of this thesis now relies on this theoretical framework to demonstrate how legal intervention informed by human flourishing theory can take place. Specifically, for the purpose of this thesis, how legal intervention in the SMME and retail banking sectors can take place to support the success of SMMEs.

CHAPTER FIVE: TOWARDS A FLOURISHING REGULATORY ENVIRONMENT

5.1. Introduction

Chapter five will provide practical examples in support of this thesis put forward, namely, human flourishing theory as the guiding model for law-making and specifically, market intervention in South Africa. These examples will demonstrate how market intervention informed by human flourishing theory can support the broader developmental goals of society and support the flourishing of entrepreneurs at an individual level. Further, chapter five will highlight how the model of law-making and market intervention proposed by this thesis supports transformative constitutionalism.

Efficiency within the market place has been traditionally characterised by allowing the market to allocate resources independently. Intervening in the free market has often been discouraged, because the effect of the intervention is regarded as being imprecise. Consequently, this can create negative externalities that contribute towards market inefficiency.⁴³⁴ However, despite the potential negative consequences of regulation, regulation can broadly provide (i) the framework for market stakeholders to interact, (ii) incentivise desirable behaviour by market stakeholders, and (iii) penalise undesirable behaviour.⁴³⁵

As discussed in chapter three, regulation in the market for South Africa must be understood within the broader framework of transformative constitutionalism, and

⁴³⁴ C McCrudden 'Regulation and deregulation: an introduction' in Regulation and Deregulation (1999) ch 1 3 – 12.

⁴³⁵ Ibid.

more specifically, with an appreciation of the existence of a broad justiciable Bill of Rights.⁴³⁶ Therefore, the balance between private property rights and broader social and economic interests needs to be struck.

As a consequence, it is necessary to constrain regulation so that it takes place only to the extent necessary.⁴³⁷ In fact, such an understanding of the reach of regulation can be understood with reliance on chapter 39 of the Constitution.⁴³⁸ The chapter requires that an interpretation of the Bill of Rights must take place in a manner that promotes the values that underlie an open and democratic society based on human dignity, equality and freedom.⁴³⁹ Further, the chapter requires that the development of the law must take place in a manner that promotes the spirit, purport and objects of the Bill of Rights.⁴⁴⁰

Theoretically, regulation will often take place where: (i) there is an absence of the right market structure that supports efficient capital formation; and/or (ii) the lack of an effective resource allocation system; and/or (iii) to encourage confidence in the market.⁴⁴¹ Further, regulation in the South African retail banking sector has to take place in light of its international legal obligations, which include the requirement that South African banks conduct their operations in a manner that adheres to the

⁴³⁶ C McCrudden 'Social Policy and Economic Regulators: Some Issues from the Reform of Utility Regulation' in Regulation and Deregulation (1999) ch 16 289 – 291.

⁴³⁷ Ibid.

⁴³⁸ See section 39 of the Constitution of the Republic of South Africa, 1996.

⁴³⁹ Ibid.

⁴⁴⁰ Ibid.

⁴⁴¹ C McCrudden 'Efficient regulation of the securities market' in Regulation and Deregulation (1999) ch 17 295 – 298.

principles of Basel III and, as a consequence, that South African legislation give effect to these principles to ensure local compliance.⁴⁴²

Basel III emerged soon after the Financial Crisis (FC) of 2009. It is motivated by the recognition of factors like: (i) risky lending practices by financial institutions; (ii) increased transnational trade; and (iii) greater financial market integration.⁴⁴³ These factors have the consequence of exposing local financial markets to external shocks. Further, these factors make it difficult for local financial markets to deal adequately with external shocks.⁴⁴⁴

The key objectives of Basel III are to increase the ability of local banks to withstand external shocks, improve the risk management and transparency of banking operations, and to strengthen the transparency and disclosure requirements of banks.⁴⁴⁵ These objectives are in part to be achieved through countries enacting legislation for their local banking sectors that increase the capital and liquidity requirements, in line with the formulae set out in Basel III, and to introduce new capital buffers.⁴⁴⁶ A capital buffer is the mandatory minimum amount of capital that a financial institution must hold. There are different types of capital buffers depending on the risk that the capital buffer is intended to support the financial institution in managing.

⁴⁴² Basel Committee on Banking Supervision 'International Regulatory Framework For Banks (Basel III)' (2010) *Bank for International Settlements*.

⁴⁴³ F Van Dyk 'Basel III: An Overview of the safer "safety net"' (2011) *Financial Markets Journal*.

⁴⁴⁴ Ibid.

⁴⁴⁵ Ibid.

⁴⁴⁶ Ibid.

Van Dyk highlights key impacts that Basel III would have on individual banks and, in general, on the financial system.⁴⁴⁷ For the purpose of this thesis, the noteworthy impacts on individual banks include reduced banking competition as weaker banks struggle to meet the increased capital and liquidity requirements.⁴⁴⁸ In addition, for the general financial system, Basel III requires more prudential lending to take place which may have the effect of reducing the overall lending available within the financial system.⁴⁴⁹

An objective of this thesis is to determine how human flourishing can inform how the law is used to intervene in the South African SMME and retail banking sectors to assist in the provision of healthy SMME access to finance and credit. Given the considerations outlined above, the following three factors must be considered in the context of legal intervention:

First, the intervention must take place within the constraints of the requirements imposed by Basel III. Secondly, as established in chapter four, market intervention should take place to advance a particular property objective that supports human flourishing. Therefore, the intervention should support a distribution of financial resources that responds to what is needed by SMMEs as opposed to ensuring that all SMMEs are assured an equitable access to resources.

Finally, as established in chapter three of this thesis, while intervention should encourage SMME access to financial resources, there should be a mechanism that supports the conversion of these financial resources into functions that will allow the

⁴⁴⁷ Ibid.

⁴⁴⁸ Ibid.

⁴⁴⁹ Ibid.

SMME to flourish. Therefore, increased SMME financial access should be coupled with increased skills development for the SMME entrepreneur.

The functioning of a market place is, in part, based on the nature of the property system in a particular jurisdiction. As a result, the proposed market interventions in the banking sector will rely on the five characteristics of a human flourishing property system as specified by Alexander and Peñalver: (i) to enforce moral obligations, (ii) to clarify social obligations, (iii) to maintain the social order, (iv) to intervene in the market place to promote human flourishing, and (v) to preserve individual autonomy.⁴⁵⁰

It is beyond the scope of this paper to enter into a discussion on moral obligations and to identify through that discussion the parameters that should be used to define moral obligations that would support market intervention. There is the possibility that the authority for such moral obligations is present in the Constitution.⁴⁵¹ In addition, moral obligations, specifically with respect to the market place, may be identified in the preamble to the Competition Act.⁴⁵² The preamble to the Act states:

‘The people of South Africa recognise:

That apartheid and other discriminatory laws and practices of the past resulted in excessive concentrations of ownership and control within the national economy, inadequate restraints against anti-competitive trade practices, and unjust restrictions on full and free participation in the economy by all South Africans.

That the economy must be open to greater ownership by a greater number of South Africans.

That credible competition law, and effective structures to administer that law, are necessary for an efficient functioning economy.

⁴⁵⁰ See note 65.

⁴⁵¹ See note 5.

⁴⁵² Competition Act 89 of 1998.

That an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focussed on development, will benefit all South Africans.

IN ORDER TO

Provide all South Africans equal opportunity to participate fairly in the national economy;

Achieve a more effective and efficient economy in South Africa;

Provide for markets in which consumers have access to, and can freely select, the quality and variety of goods and services they desire;

Create greater capability and an environment for South Africans to compete effectively in international markets;

Restrain particular trade practices, which undermine a competitive economy;

Regulate the transfer of economic ownership in keeping with the public interest;

Establish independent institutions to monitor economic competition; and

Give effect to the international law obligations of the Republic.⁴⁵³

Accepting these two sources of moral obligations, market intervention in the current context would take place to enforce the recognition of the inequality produced by apartheid, to provide for more equitable access where consumers can have access to, and freely select, the quality and variety of goods and services that they desire, to restrain certain commercial practices that undermines the competitive economy, and to encourage a more effective and efficient economy.

Market intervention would have an impact on existing rights and obligations in the market and would give rise to new rights and obligations in the market. Therefore, the legal framework supporting such an intervention would need to clarify the extent and effect of the emerging social obligation. In this circumstance, the intervention would impose a burden on certain parties to make available resources, so as to improve SMME access to finance and credit. The nature of such a burden may

⁴⁵³ Ibid.

adversely interfere with the naturally intended use of those resources. Therefore, this would infringe on the traditional notion of absolute ownership.

However, this infringement on the traditional notion of absolute ownership would be justifiable given the transformative nature of South Africa's Constitution⁴⁵⁴ and the developmental goals of the state. For such an infringement to be legitimate and enforceable in law, it must be in the form of a legislative enactment as opposed to self-help. A movement towards the latter has recently become more visible across the world with the occupations of key financial districts by activists.⁴⁵⁵ The role of the law in enforcing moral obligations and clarifying social obligations has become more relevant with growing levels of inequality, and the recognition thereof.⁴⁵⁶

5.2. Achieving flourishing at an individual level

To propose market intervention that would, at an individual level, have the effect of promoting human flourishing, reliance on Rasmussen's six characteristics of flourishing can take place.⁴⁵⁷ Thus, the relationship between a property system of human flourishing and the individual human flourishing of persons within that property system must be considered. Rasmussen's six characteristics, as discussed above are: (1) objective, (2) inclusive, (3) individualised (4) agent-relative, (5) self-directed, and (6) social.

⁴⁵⁴ See note 5.

⁴⁵⁵ For example the occupation of the Johannesburg Stock Exchange (JSE) in 2014 or the occupation of Wall Street in 2011. See further: C Calhoun 'Occupy Wall Street In Perspective' (2013) 64 *The British Journal of Sociology* 1 26 – 38.

⁴⁵⁶ See note 65.

⁴⁵⁷ See note 11

Market intervention should provide sufficient financial support to the SMME for it to break the period of incubation, cited by the Small Enterprise Development Agency as being on average three and half years.⁴⁵⁸ Thereafter, the SMME should be independent and financially sustainable. The financial access would need to be offered in a product range that responds to the financial needs of the SMME and the broader circumstance within which the SMME finds itself. This would provide a financial product range that satisfies Rasmussen's human flourishing characteristics (2), (3) and (4), namely: that flourishing is inclusive, individualised and agent-relative.

It would be inclusive and individualised because it responds to the needs and capabilities of the individual as opposed to imposing on the individual a standard form loan agreement that does not align with the individual's needs. Further, the product would be agent-relative as it would require the entrepreneur to convert the resources gained through accessing the financial product into capabilities that would support the flourishing of the entrepreneur.

The current vetting process used by banks would need to be enhanced to meet the needs of SMMEs. This enhancement must take into account the shortcomings in current banking practices identified by Nikolaidou and Vogiazas,⁴⁵⁹ and must include a continuous process of financial management education over the initial years of the operations of the SMME. Further, the mandatory period of financial education should address the recognised skills shortage within SMMEs and support more prudent business practices.

⁴⁵⁸ See chapter 2.

⁴⁵⁹ See note 75.

As a consequence, the individuals who are responsible for the operations of the SMME would be empowered to act independently. This empowerment would support the remaining characteristics of Rasmussen's human flourishing which include that flourishing is: (1) objective, (5) self-directed, and (6) social. The cumulative effect of these six characteristics is to give effect to the fifth characteristic of Alexander and Peñalver's property system of human flourishing, which is to preserve individual autonomy.⁴⁶⁰

The individual autonomy of the entrepreneur would be preserved as the market is mandated to respond to the needs of the entrepreneur, as opposed to imposing on the entrepreneur burdens, through, for example, standard form credit agreements, that he/she cannot manage. Further, greater financial education of the entrepreneur would improve their autonomous decision-making and support the development of their ability to convert financial resources into capabilities that support their flourishing.

Human flourishing would be objective if, through this intervention, the entrepreneur acquires the financial resources necessary for their flourishing. Further, accepting that the entrepreneur is in a position to convert financial resources into capabilities, human flourishing would be self-directed because it would be for the entrepreneur to convert the financial resources into capabilities. Finally, human flourishing would be social because it recognises that the relationship between the bank and the entrepreneur cannot be determined in isolation of the holistic nature of the entrepreneur.

⁴⁶⁰ See note 65.

5.3. Achieving flourishing at a societal level

Given the aforementioned discussions in chapters two to four, it is proposed that policy be created and enforced through a suitable legislative framework that: (i) creates a SMME financial services office within the Department of Small Business Development, (ii) establishes a SMME bank-depositors insurance, and (iii) empowers the Minister for Small Business Development or their designate to deal with all issues ancillary to the intervention.

The objectives for the SMME financial services office would be to investigate and establish a SMME lending annual target for identified banks to meet. The target for each bank will be determined according to a standardised formula. An individual target is preferred over a generalised target to avoid imposing an unfair target on banks that would hamper the individual bank's development. These targets would be revisable to account for changes in economic climate. Further, these targets would not be applicable to all registered retail banks. In the broader interest of banking stability, the office would investigate and implement a threshold test to be applied to registered banks, so as to identify banks that are sufficiently stable and, therefore, subject to meeting the SMME lending target. This threshold test could include consideration of the size of existing non-performing loans of the bank.

Further, the SMME financial services office will need to create a set of guidelines to be made publicly available which would include: (i) a definition for healthy SMME risk taking, (ii) a set of requirements to be used by banks to identify opportunities for healthy SMME risk taking, and (iii) a determination of criteria for when a bank can call-in on the SMME depositor's insurance for a non-performing loan.

However, it may not be sufficient to merely require targets to be met by each identified bank. To encourage banking behaviour that would support the realisation of the set targets, the SMME financial services office would establish a SMME bank-depositors insurance. The establishment of a depositors insurance will allow identified banks to call-in financial cover, to a limited extent, where the risk of SMME lending materialises. This sharing of risk between the private and public sector would hopefully reduce the current risk profile of SMMEs, as experienced by the banking sector. Therefore, the reduced risk exposure of banks would encourage behaviour that supports the meeting of targets.

It is proposed that part of the funding for the establishment of the insurance comes from the number of identified government financial programmes, such as the Technology Innovation Agency, National Empowerment Fund and the Small Enterprise Finance Agency, which were set out in chapter two of this thesis.⁴⁶¹ These government financial programmes could be consolidated and converted into a SMME bank-depositors insurance. A central consequence to the policy recommendation is that financial support to SMMEs would be administered only by retail banks.

Finally, it is necessary to recognise that insurance schemes create moral hazards. A moral hazard arises where a party receives compensation where a risk materialises that results in the party incurring a loss.⁴⁶² In such a circumstance, given the existence of the compensation, a party may be less inclined to take sufficient measures, or the ordinary measures that they would have taken if the compensation

⁴⁶¹ See chapter 2.3.

⁴⁶² S Shavell 'On moral hazard and insurance' (1979) *Foundations of Insurance Economics* 280-301.

did not exist, to avoid the materialisation of the risk that would give rise to the loss.⁴⁶³

In this context, there is an expectation that the existence of a SMME bank-depositors insurance could encourage unhealthy risk-taking by banks. Therefore, it is proposed that the SMME financial services office monitor the SMME lending behaviour of banks, to ensure that banks are operating in a manner to meet annual targets. Secondly, where banks exhibit lending behaviour to SMMEs that exposes them to unhealthy risk due to the existence of SMME depositors insurance, the bank should be made to bear the cost of the risk.

It is argued that while the abovementioned intervention would not result in perfect SMME access to finance and credit, these recommendations would promote an increase in access, which would be both economically healthy and sustainable. Through enhancing financial resource mobility in South Africa and improving support available to entrepreneurs, more people would have a direct access point to the mainstream economy. This would support the goal of overcoming South Africa's two nation state.

⁴⁶³ Ibid.

CHAPTER SIX: CONCLUSION

The 1994 Government of National Unity was not merely a political compromise. It represented the compromise between two opposing economic camps.⁴⁶⁴ The one camp was the neoliberal and established Afrikaans business that wanted South Africa to stand true to the Washington Consensus, so that the benefits from an open economy could be reaped by established local business.⁴⁶⁵ On the other end of the spectrum, there was the nationalist, black empowerment camp.⁴⁶⁶ The African National Congress, recognising that it needed to source capital to fund its ambitious Reconstruction and Development Programme conceded to the neoliberal camp, and engaged with the Bretton Woods institutions.⁴⁶⁷

While at the time engaging the neoliberal economic model seemed inevitable, twenty years later it has been difficult to move away from this model.⁴⁶⁸ The incompatibility of the free market with established enterprise, and the need to have greater redistribution mechanisms, has become more apparent and has fuelled growing social tensions.⁴⁶⁹ Apartheid's legacy of poverty and inequality remain, despite a justiciable Bill of Rights and the achievement of political freedom.

This thesis built on the government's recognition of SMMEs as an access point to the mainstream economy for many persons disadvantaged by apartheid. It acknowledged that this recognition is not innovative, but can be traced back to the early days of

⁴⁶⁴ A Habib and V Padayachee 'Economic policy and power relations in South Africa's transition to democracy' (2000) 28 *World Development* 2 245-263.

⁴⁶⁵ Ibid at 245.

⁴⁶⁶ Ibid at 249.

⁴⁶⁷ Ibid.

⁴⁶⁸ Ibid at 259.

⁴⁶⁹ Ibid.

democracy with the 1995 white paper on the National Strategy on the Development and Promotion of small business in South Africa. However, despite these key government commitments to the promotion of SMMEs, this thesis highlighted the finding by the Small Enterprise Development Agency that the potential of SMMEs in South Africa remains unrealised. The progress that has been made in the SMME sector is still well below that of South Africa's economic counterparts, and the barriers that were identified in the 1995 white paper to SMME success, remain today.

This thesis focussed on three key areas in identifying a role for the law to support the success of SMMEs. These areas included: (i) the legal framework, (ii) existing government programmes, and (iii) access to finance and credit.

Chapter two identified that, out of three proposed legislative interventions in the 1995 white paper, only one – the Small Business Act – has come to fruition. Reflecting on SEDA's highlighted barriers to SMME success, chapter two drew a parallel between the objectives of the proposed legislative interventions and the highlighted barriers. The chapter concluded that, had the desired legislative intervention been realised, the effect of the barriers experienced by SMMEs may have been alleviated, if not eradicated.

With regard to existing government programmes, this thesis identified a plethora of government programmes available to SMMEs. It recommended that the Department of Small Business Development focus on the consolidation of these programmes as

well as creating a greater awareness around the available government support to SMMEs.

Chapter two recognised that the current barrier to finance and credit, experienced by SMMEs, is not a new phenomenon and not unique to South Africa. Rather the barrier was first identified in the 1995 white paper and is a common barrier experienced by SMMEs in developing economies. Further, the chapter elaborated on the existing nature of the barrier to finance and credit. The chapter relied on Akerlof's 'Market for Lemons' to explain Dalberg and the National Credit Regulator's identified financing gap in access to finance and credit. The finding is that it is common for there to be an insufficient supply of the requisite credit for SMMEs in developing markets.

However, first, it is found that South African banks are not sufficiently incentivised to bank, in particular, make available credit, to SMMEs. First, apartheid adversely impacted the creation of black client relations and stagnated the growth of the banking network into black communities. Consequently, post-1994, many black South African's did not receive retail banking services. In addition, in accessing credit from established banks, black households were not positioned to be able to meet the traditional demands of security.

The consequence has been inadequate attempts, on the part of retail banks, to create banking products that are sufficiently accessible by black households. Further, it is found that the South African banking sector is dominated by five banks who collectively exert oligopolistic influence over the market, capturing part of the

consumer surplus that would ordinarily be available to consumers in a competitive outcome.

Secondly, accepting profit maximisation to be the objective of banks, and acknowledging the nature of their operations, albeit in a very rudimentary form, it is found that South African banks regard SMME finance as being high risk with real gains only in the long-term. To satisfy their short-term profit objectives, and to meet the onerous regulatory requirements, banks have a preference for more stable returns with low risk, even though the returns may be less than the return that the bank may receive from a successfully performed transaction with an SMME. These stable and low-risk returns were present in the market from established business as well as treasury bills. As a consequence, banks have not effectively been a tool to redistribute financial resources in the South African economy from concentrated areas to high growth areas. It is no wonder that Mbeki's "two nations, the one black and the other white" persists.⁴⁷⁰

A new model for enhancing social welfare is required. A model that directs the macro discourse with a strong reflection on what the implications are for the micro level. This thesis has highlighted that the resource-based approach to human development post-1994 has failed to enhance social welfare. This failure is the result of the approach insufficiently accounting for the individual and how the individual may relate to the resources that are made available to them.

⁴⁷⁰ See note 14.

An alternative approach to social welfare is proposed in chapter three, namely, a capabilities-based approach. This thesis found that the preamble of the Constitution⁴⁷¹ provides the space and, in fact, necessitates, the adoption of a capabilities-approach. A capabilities-approach does not require that each person receive the same amount of a resource. Instead, it requires that each person receive the amount of a resource required to enable them to flourish. The ‘enabling’ factor of a capabilities-approach explores the extent to which a person converts the resources made available to them into functions that reflect the pursuit of their potential.

With this understanding, three key aspects for a policy modelled on a capabilities-approach require clarification: (i) the manner in which a person’s potential is to be determined, (ii) the identification of what resources each person requires to achieve their potential, and (iii) how these resources can be converted into functions so as to reflect the pursuit of potential.

Recognising the dissatisfactory approach of the neoliberal model in accounting for the impact on the individual, which is premised on a resource-based approach, this thesis was conscious of trying to formulate a theoretical framework that responded to these three areas of clarification in consideration of both the individual (micro) and broader society (macro). Such a theoretical framework would be better equipped to inform this thesis’s proposed legal intervention in the market for finance and credit, in respect to the role played by the retail banking sector.

⁴⁷¹ See note 5.

Chapter three introduced the theoretical framework of human flourishing at an individual level. This was done with reliance on Rasmussen's six characteristics of human flourishing which are: (i) objective, (ii) inclusive, (iii) individualised, (iv) agent-relative, (v) self-directed, and (vi) social. Thereafter, chapter four relied on Alexander and Peñalver's human flourishing theory for property systems to account for human flourishing at a societal level. Their theory is premised on five characteristics, namely: (i) enforcing moral obligations, (ii) clarifying social obligations, (iii) maintaining the social order, (iv) intervening in the economic market place to promote human flourishing, and (v) promoting individual autonomy.

Relying on Rasmussen's six characteristics, this thesis reflected on the impact that apartheid legislation had on the development of South Africans. It found that the law created an environment that encouraged the flourishing of white individuals, whilst it equally created an environment that undermined the flourishing of black individuals. The effects in both circumstances were found to not be isolated to the period characterised as apartheid. Instead, given the systematic nature of apartheid, the contrasting effects of the apartheid law on the flourishing of white and black South Africans has persisted post-apartheid. The result of this is Mbeki's 'two nations, the one black and the other white'.

Chapter five of this thesis proposed legislative intervention to regulate SMME access to finance and credit in South Africa. It did so by building on the suggestion of a Small Business Finance Act in the 1995 white paper, while conscious of the ideological framework of human flourishing. However, it is acknowledged that

intervening in the retail banking sector is difficult because (i) the inherent operational structure of South African retail banks discourages making available access to finance and credit to SMMEs, (ii) SMME finance is perceived as risky, and (iii) while acknowledging that the market needs to be stimulated to increase SMME access to finance and credit, this is made difficult in light of the tighter regulation imposed by Basel III on bank-lending practices.

In supporting human flourishing at an individual level, this thesis has proposed that legal intervention take place to encourage banking behaviour which would result in the availability of banking products that respond directly to SMMEs. Further, these products should include continuous financial education for the borrowing entity for a minimum period of three and a half years. However, it is recognised that such outcomes at an individual level are only possible by changing the macro behaviour of the banking sector. Therefore, this thesis proposed that policy be created and enforced through a suitable legislative framework that: (i) creates a SMME financial services office within the Department of Small Business Development, (ii) establishes a SMME bank-depositors insurance, and (iii) empowers the Minister for Small Business Development or their designate to deal with all issues ancillary to the intervention.

It is recommended that further research investigates a formula that accounts for the individual circumstances of each bank and proposes a revisable annual target for SMME lending that each bank must satisfy. This way, the adverse impact of a generalised target that could hamper the bank's growth is avoided, while still ensuring that each bank contributes fully to enhancing SMME access to finance and

credit. In addition, it is recommended that further research explore whether it is more effective to reward banks for meeting SMME lending targets through, for example, tax rebates or to impose penalties on banks for unreasonably not meeting SMME lending targets, for example, through fines. The extent of the recommendation of this paper does not explore the consequences of non-compliance.

This thesis has argued that, through relying on a theory of human flourishing, the legal system can be used to increase social welfare and advance the achievement of the objectives in the Constitution.⁴⁷² Through reflecting on the South African SMME sector, access to finance and credit is identified as a barrier to SMME success in South Africa. This thesis then demonstrated how legal intervention, informed by a theory of human flourishing, in the retail banking sector could take place to enable greater access to finance and credit by SMMEs.

⁴⁷² See note 5.

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