

The Impacts of Sector-Specific Policies and Regulations on the Growth of SMES in Eight Sectors of the South African Economy



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Abstract

The paper aims to identify the impacts of sector-specific policies and regulations on the growth of – and job creation by – SMEs in eight sectors of the South African economy. Where appropriate and, where possible, impacts are quantified. The aim is also to develop suggestions for policy changes and regulatory reforms which would reduce the regulatory cost burden on these SMEs and permit them to grow and take on workers more readily.

The paper contains descriptions of sector-specific policies and regulations in the eight selected sectors, qualitative assessment of the impacts of sector-specific policies and regulations on SMEs in the the selected sectors, quantitative assessment of these impacts and suggestions are made for policy changes and reforms to the sector-specific regulatory environments of the selected sectors.

The eight sectors are agri-processing, the automotive industry, clothing and textiles, financial services, information and communications technology (ICT), mining, pharmaceuticals and tourism.

Acknowledgements

This Working Paper is one in a series emanating from the SMME project, within the Employment Promotion Programme, which is aimed at Understanding the Regulatory Environment for Small Business in South Africa. The DPRU are the Programme Managers of this DFID funded project whose goal is to promote an enabling environment for employment creation in South Africa, and to contribute to the Government's goal of reducing unemployment.

Glossary

ASATA	–	Association of South African Travel Agents
DTI	–	Department of Trade and Industry
DCCS	–	Duty Credit Certificate Scheme
ICASA	–	Independent Communications Authority of South Africa
ICT	–	Information and Communications Technology
MCC	–	Medicines Control Council
MFRC	–	Micro Finance Regulatory Council
MIDP	–	Motor Industry Development Programme
NATIS	–	National Transport Information System
RCP	–	Road Carrier Permit
SABS	–	South African Bureau of Standards
SANAS	–	South African National Accreditation System
SAPC	–	South African Pharmacy Council
SATSA	–	Southern Africa Tourism Services Association
SME	–	Small and medium enterprises
TGCSA	–	Tourism Grading Council of South Africa
THETA	–	Tourism, Hospitality & Sport Education & Training Authority
VANS	–	Value-added network services

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1. Agri-Processing

In aggregate, food processing firms in South Africa have an annual turnover of R57 billion, employ 183,000 people and account for 2.4 per cent of total GDP. Agri-processing contributes 13 per cent of manufacturing employment and about 12 per cent of the manufacturing value.

Outline of Sector-Specific Regulations

Agri-processing has a complex regulatory environment. Agri-processing firms are subject to regulation by the national Department of Health, the national Department of Agriculture, the national Department of Environmental Affairs and Tourism, provincial departments of health and local authorities, the Perishable Products Export Control Board, the South African Bureau of Standards (SABS) and, indirectly, by the South African National Accreditation System (SANAS). Food retailers are one of a few types of retail operations that require specific licensing. Retailing premises are subject to inspections and are required to comply with guidelines for storage and display. It is also important to note that for each sub-sector there are usually a set of unique procedures and administrative requirements.

Further, firms in export supply chains are often – at least in theory – held to the regulatory standards of South Africa's developed country trading partners. These requirements are codified by the *Codex Alimentarius* commission, a joint body of the World Health Organisation and the Food and Agriculture Organisation, recently recognised by the World Trade Organisation as the international body that sets standards for the global food trade. South Africa has 18 *Codex Alimentarius* committees, involving the Departments of Agriculture, Health, Trade and Industry, the South African Bureau of Standards and the National Consumers Forum.

The key pieces of legislation affecting the food industry include:

The Foodstuffs, Cosmetics and Disinfectants Act, 1972 (Act 54 of 1972):

This Act governs the manufacture, sale and importation of foodstuffs, cosmetics and disinfectants from a safety/public health point of view and is administered by the Directorate: Food Control of the Department of Health and enforced by local authorities in their areas of jurisdiction. Import control is performed on behalf of the National Department by Provincial Departments of Health. The Act regulates foodstuffs as such as well as their labelling and advertising. It does not regulate hygiene provisions that relate to the handling and transport of food.

The Health Act, 1977 (Act 63 of 1977):

There are several sets of regulations promulgated under this Act that have direct relevance to food safety and are enforced by local authorities in their areas of jurisdiction. These include:

- Regulations Governing General Hygiene Requirements for Food Premises and the Transport of Food (G.N. No. R. 918 of 30 July 1999), which regulate hygiene provisions that relate to, amongst others, the handling and transport of food.
- Regulations Relating to Milking Sheds and the Transport of Milk (G.N. No.R. 1256 of 27 June 1986).
- Regulations Relating to Inspections and Investigations (G.N. No. R. 1128 of 24 May 1991), which provide for detention and seizures of food.
- Regulations Regarding Food and Water Vessels (G.N. No. R. 1575 of 10 September 1971), which aims to prevent the transmission of certain metals from containers to foodstuffs.
- General Regulations Promulgated in terms of the Public Health Act, 1919 (G.N. No. R.180 of 10 February 1967), which regulates transport of meat and meat products.

The Liquor Products Act (Act 60 of 1989)

This Act is administered by the Directorate: Food Safety and Quality Assurance of the Department of Agriculture. It sets up requirements for wines and spirits.

The Agricultural Products Standards Act, 1990 (Act 119 of 1990):

This Act controls and promotes specific product quality standards for the local market and for export purposes. It is administered and enforced by the Directorate: Food Safety and Quality Assurance in the Department of Agriculture. Assignees such as the Perishable Products Export Control Board (PPECB) are appointed and authorized to do physical inspections under the Act.

The Standards Act, 1993 (Act 29 of 1993):

This Act, administered by the SABS, creates compulsory specifications for canned meat and fish products and frozen sea foods.

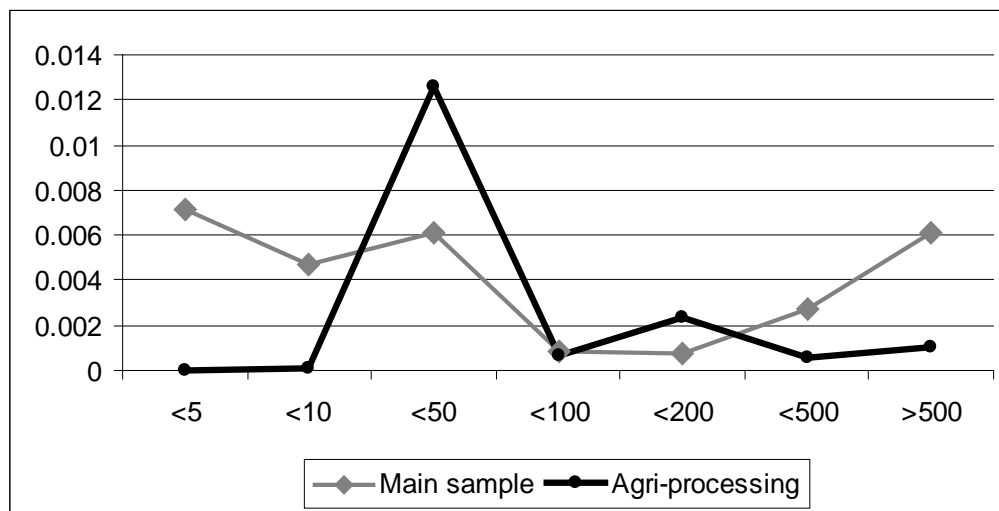
The Meat Safety Act (Act 40 of 2000):

This Act is administered by the Directorate: Food Safety and Quality Assurance in the Department of Agriculture and enforced by the Departments of Agriculture of the nine provinces. It regulates meat safety and hygiene standards in abattoirs and regulates the importation and exportation of unprocessed meat.

This regulatory environment has changed rapidly in the past ten years. Fifty new sets of regulations on foodstuffs have been issued since 1994.¹ In focus group discussions and interviews in 2004, firms reported that this rapid change has been a challenge in itself, since it requires firms not only to remain informed but also to engage in policy discussions.

¹ Based on information posted on: <http://www.doh.gov.za/docs/legislation-f.html>

Figure 1: Sector-Specific Regulatory Costs as a Percentage of Turnover: Firms in the Agri-Processing Sector vs. the Economy, by Number of Employees²



Given both the complexity of the regulatory environment for agri-processing, and its rate of change in the last decade, it is not surprising that 32 agri-processing firms³ surveyed reported that sector-specific regulations formed a larger proportion of their total regulatory costs (33 per cent) than they did for firms in any other sector, or for firms in the representative sample (21.6 per cent).

The details of this pattern of costs expressed as percentage of turnover and by number of employees, as in Figure 1, are perhaps more surprising. As with the main sample, sector-specific regulatory costs rise as firms become larger and, presumably, more complex and more visible to the regulatory authorities. However, they stay below costs in the main sample in all but two size categories, and are extremely low for agri-processors employing fewer than 10 people.⁴ This seems to suggest that SME agri-processors are not strongly affected by sector-specific regulations. Possible reasons for this are discussed below.

² The 2004 SBP survey was not designed with sector-specific regulations particularly in mind. For this reason, the data illustrated in Figures 1,4,6,7,9,11, 13 and 15 is likely to contain a small element of non-sector-specific costs.

³ The agri-processing sample included firms involved in meat processing, dairy, fruit and vegetable canning, grain milling, oils and general grocery manufacturing.

⁴ It is also noteworthy that in almost all size categories face lower overall regulatory costs than the average South African firm.

Agri-Processing SMES' Perceptions of Sector-Related Regulations

Figure 2: Relative Perceived Troublesomeness of Sector-Related Regulations

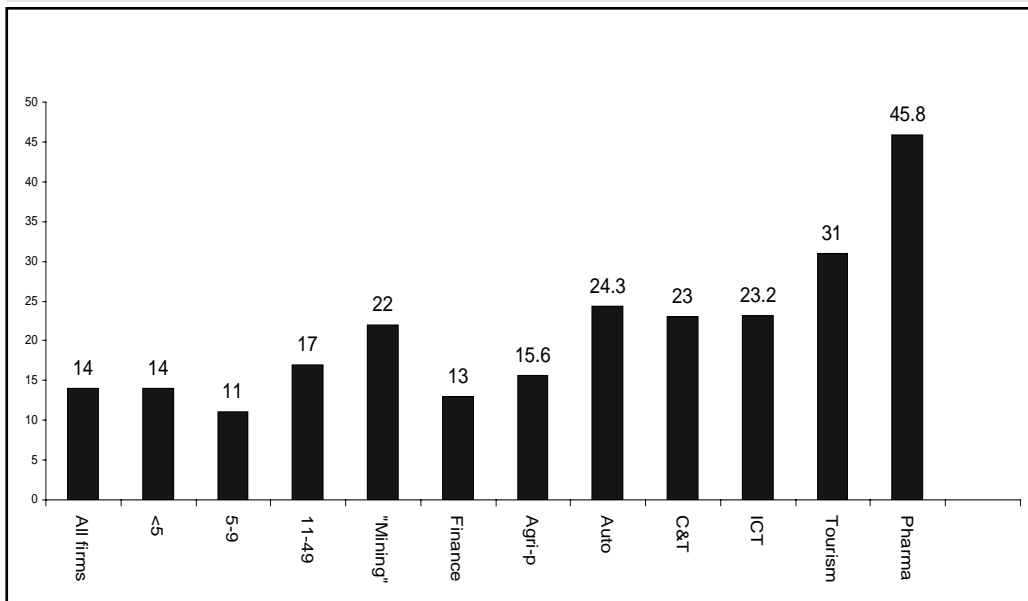
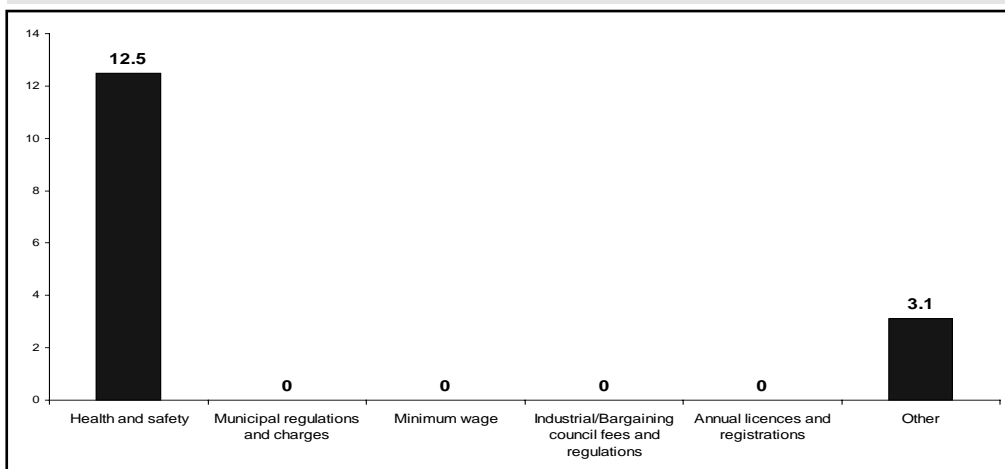


Figure 3: Perceived Troublesomeness of Types of Sector-Related Regulation in Agri-Processing



Figures 2 and 3 (and the analogous Figures 4 and 5) were generated by re-combining firms' responses in the 2004 survey on which regulations they perceived as most troublesome, so as to isolate those categories of regulation which tend to be more sector-specific. These are the 'health and safety,' 'municipal regulations and charges,' 'minimum wage,' 'industrial bargaining council,' 'annual licenses and registrations' and 'other' categories. (By way of context, VAT was mentioned as 'troublesome' by 29 per cent of respondents.)

These figures therefore give a sense of the *relative* perceived troublesomeness of sector-specific regulation and of the types of regulation which make up this burden. As can be seen, agri-processors perceive themselves to be less than averagely troubled by sector-specific regulations, and experience no significant trouble except from health and safety regulations.

The data do not permit us to isolate the perceptions of agri-processing SMEs. For these we turn to the results of a 2004 focus group and interviews in 2003 and 2005. Agri-processing SMEs reported:

- A sense of isolation from the regulatory environment: they did not know with any precision what the regulations governing their sector were; they did not know how to find out about these regulations; and they did not know when or by whom they would be inspected, or what would be required of them if they were to be inspected. They tended to be inclined to believe that they were unlikely to be inspected. As a result, they tended to report that compliance with regulations was, in practice, inexpensive
- A sense that larger firms use sector-specific regulations to reduce competition. For instance, sector and sub-sector specific requirements on food quality, content and labelling are perceived to be enforced by public officials only at the specific urging of larger firms looking to raise costs for their SME competitors and/or to protect the image of their own products.

Suggestions for Sector-Level Reforms

In the words of one focus group participant, 'enforcement is the weakest link' in the agri-processing sector. This is certainly the most likely explanation for the pattern of results seen here, in which all firms – and particularly SMEs – report relatively low sector-specific regulatory costs despite operating in a sector which is apparently very extensively regulated by a number of over-lapping authorities.

International experience and common sense both suggest that a simpler regulatory structure is likely to be easier to enforce. This is likely to have benefits for consumer safety – especially for the poorer consumers more likely to purchase their food from SMEs. There is also a considerable amount of qualitative evidence to suggest that larger firms are using the regulatory environment to reduce competition from SMEs. This may be undesirable, and should certainly be looked at more closely, to see, for instance, whether or not the benefits of this practice in terms of improved quality of goods outweigh its costs to consumers and to employment.

2. Automotive Industry

The automotive industry employs about 280 000 people. Of these 3 per cent work in tyre manufacturing, 12 per cent in assembly, 21 per cent in component manufacturing and 64 per cent in trade and services.

Outline of Sector-Specific Regulations

The most significant regulators of the automotive industry are SABS, which administers a complex system of automotive manufacturing and maintenance standards on behalf of the Minister of Trade and Industry; the Department of Transport, which regulates the motor trade under the National Road Traffic Act, 1996; the Department of Minerals and Energy, which regulates petrol stations under the Petroleum Products Act, 1977, as amended, and the Department of Trade and Industry (DTI), which administers the Motor Industry Development Programme (MIDP). The industry is also regulated by provincial Road Traffic Acts and by municipal by-laws.

The MIDP has been central to the expansion, diversification and export successes of the automotive manufacturing industry but, as will be seen below, it also generates significant regulatory costs for smaller firms in the sector.

The SABS standards system is highly elaborate, and changes rapidly with technological change. A division of SABS, Standards SA, operates a three tier system managing standards for the automotive sector. These are national compulsory specifications (VC), recommended practices (ARP) and rationalised user specifications (NRS).

The objective of compulsory specifications (VC) is to promote and maintain standardisation and quality where safety, health, consumer protection or the environment are concerned. Twenty compulsory specifications detailed by Standards SA apply directly to the automotive industry. Standards South Africa's recommended practices (ARP) are of a lower status than, and consequently do not take precedence over VC standards. Rationalised user specifications (NRS) are specifications created by organisations other than Standards SA. ARP or NRS specifications may be used by a technical committee when setting national standards. Standards SA have established a series of technical committees to consult stakeholders on formulating standards for various products. Nine committees relate to the automotive sector. In formulating standards, the technical committees guard against setting unique specification that could be used as a barrier to trade.

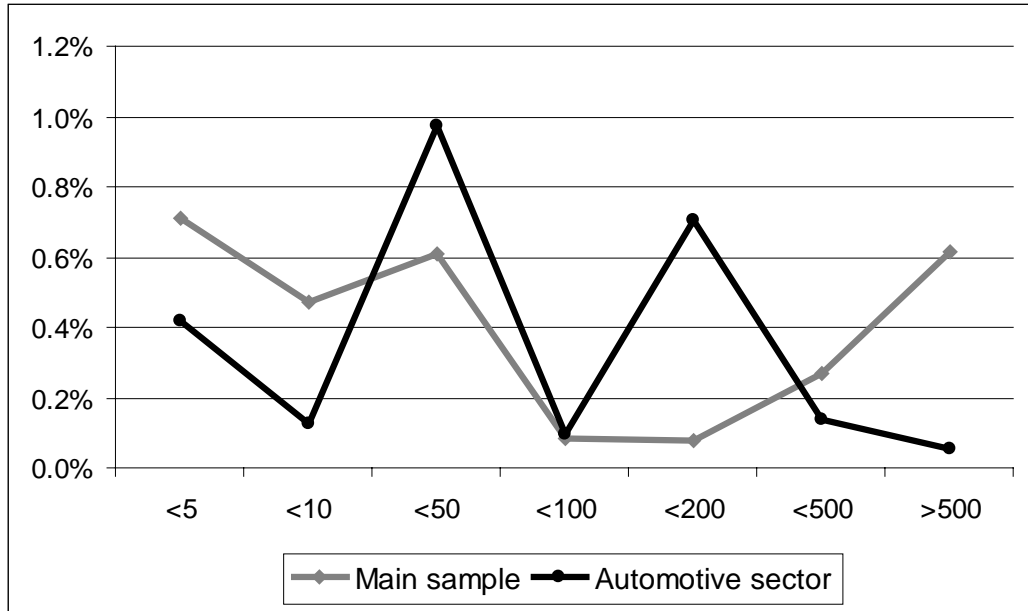
There are a series of levies associated with certifying that products meet the relevant standard products; these are paid to Standards SA and are used to finance the technical committees and enforcement.

The South African National Accreditation Service (SANAS) is responsible for accrediting organisations that carry out testing and inspections. This is particularly important for vehicle roadworthy certification, where private service providers carry out most of the actual enforcement.

Under the National Road Traffic Act, Regulation 70, 79, 80, 85, retail automotive firms require a Motor Trade Permit and Number and to register every vehicle distributed with the National Transport Information System (NATIS). Importers of used vehicles require a special permit; this regulation was introduced to control vehicle “dumping” and to protect local assemblers. The manufacturing of number plates also requires a separate registration under Regulation 49 of the National Road Traffic Act.

Manufacturers and importers of new vehicles require a specific registration under Regulations 39 and 46 of the Road Traffic Act on top of normal business registration. Additionally, under Regulation 41, for every new model to be sold in South Africa, firms must submit design and testing documentation to Standards SA (and sometimes a model of the vehicle itself) to demonstrate that it meets VC standards.

Figure 4: Sector-Specific Regulatory Costs as a Percentage of Turnover: Firms in the Automotive Sector Vs. the Economy, by Number of Employees



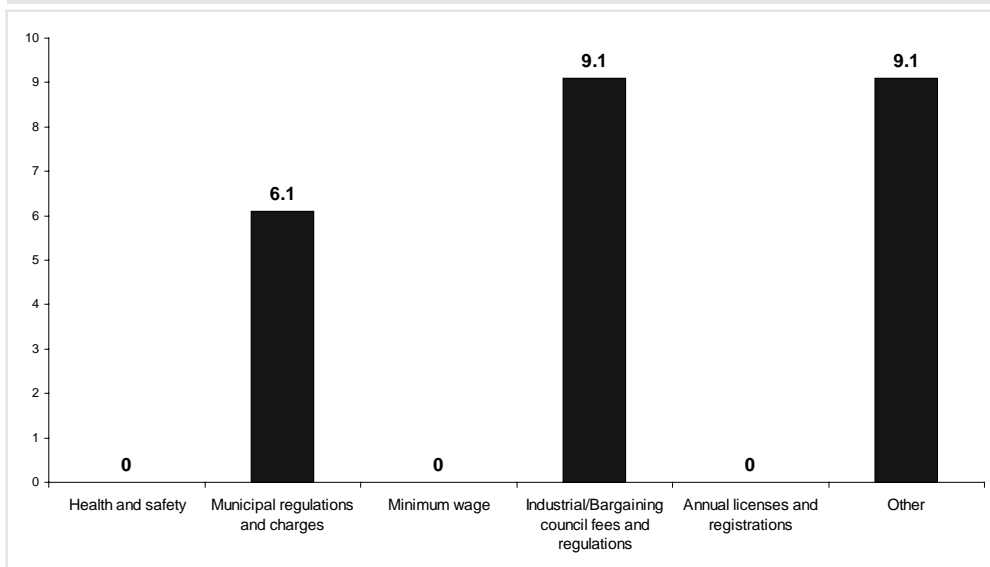
The 33 automotive sector firms⁵ surveyed reported that sector-specific regulations formed a relatively small proportion of their total regulatory costs (9 per cent).

Figure 4 shows the incidence of these costs by firm size. There are two distinct peaks – in the 10 to 50 employees and 200 to 500 employee size bands.

⁵ This included firms involved in service and retail, component manufacturing and vehicle assembly.

Automotive SMES' Perceptions of Sector-Specific Regulations

Figure 5: Perceived Troublesomeness of Types of Sector-Related Regulation in the Automotive Sector



Referring back to Figure 2, it can be seen that despite the fact that sector-specific costs form a relatively small proportion of their regulatory burden, automotive firms report perceiving sector-related regulations as a significantly greater burden than the average firm. This burden is perceived to derive equally from industrial council determinations and from 'other' – usually the most narrowly sector-specific – regulation. Municipal regulations were also perceived as troublesome, perhaps because local governments tend to regulate petrol stations and garages more closely than many other types of enterprise.

A 2004 focus group and the 2005 interviews revealed that two features of this sector's regulatory framework were particularly expensive and troublesome for SMEs: the MIDP and the related processes of SABS certification and National Transport Information System (NATIS) registration.

The benefits of the MIDP are not in doubt, but it also creates significant regulatory costs for smaller automotive firms seeking to enter the supply chain of the exporting manufacturers. Firms utilising the MIDP system are required to file 'Declaration of Origin' forms for all inputs and components. This form – the DA 190 declaration – is filed on a

quarterly basis at the Department of Trade and Industry. With over 20,000 components going into a single motor vehicle, the amount of time spent completing forms is significant. According to one participant in an SBP focus group with the industry, 'Every single item in the bill of materials of a component or car has to be traced "back to import" or to when it was "dug out of the ground" and DA190 declarations must be made at each point along the supply chain'. An additional complication is created by the fact that MIDP import credits are only valid for 12 months from date of issue.

The large manufacturers usually employ a team of people to manage the DA 190s received from suppliers and to submit their own forms to the Department of Trade and Industry. This is clearly a cost that is more acceptable to, and absorbed within, a large firm which is simultaneously enjoying major benefits from the MIDP. It is much less clear, however, that the MIDP burden is reasonable for smaller firms and firms that do not export, but which are required nonetheless to complete DA 190 forms for their clients. For a medium sized component manufacturer, it is common for managers to spend five days every quarter compiling the required documentation.

SMEs interviewed in 2005 reported that they perceived the SABS automotive product certification and NATIS systems to be slow, inconvenient and expensive. One SME reported that it had taken over a year to obtain SABS approval for a new model of trailer and that NATIS registration had required multiple trips to Pretoria. Another SME involved in transport reported that they employed a person full time to 'stand in queues at the Department of Transport.'

Suggestions for Sector-Level Reforms

An investigation of whether it is possible to reduce the reporting burdens imposed on SMEs by the MIDP is required.

It is also likely that a 'time and motion' study of SABS certification and NATIS registration for smaller equipment manufacturers and retailers would point to simplifications and other ways of reducing the regulatory burden that would be of significant benefit to SMEs in the automotive sector.

3. Clothing and Textiles

The clothing and textile industries are often considered separately. There are, however, enough similarities and linkages between the two to warrant a joint review of their regulatory environment.

Outline of Sector-Specific Regulations

The only significant sector-specific regulatory system that applies to the clothing and textiles industry is the DTI's Duty Credit Certificate Scheme (DCCS). The DCCS was due to expire at the end of March 2005. It has, however, been extended to March 2007, with modifications which may make it easier for SMEs to benefit from it. The quantitative and qualitative information discussed in this report were gathered before the 2005 changes.

In its 2004 form, the DCCS enabled clothing and textile exporters to earn import duty offsets. In order to qualify for the credits, companies had to enter a productivity monitoring scheme, as well as invest a minimum of 4 per cent of their wage bill on training. (Newspaper reports suggest that the performance assessments have since been discontinued and the training requirements modified.) DCCS credits are tradable within the industry. As a result, credits are usually earned by manufacturers who export, and in turn on-sell these to clothing importers.

Figure 6: Sector-Specific Regulatory Costs as a Percentage of Turnover: Firms in the Clothing and Apparel Sector Vs. the Economy, by Number of Employees

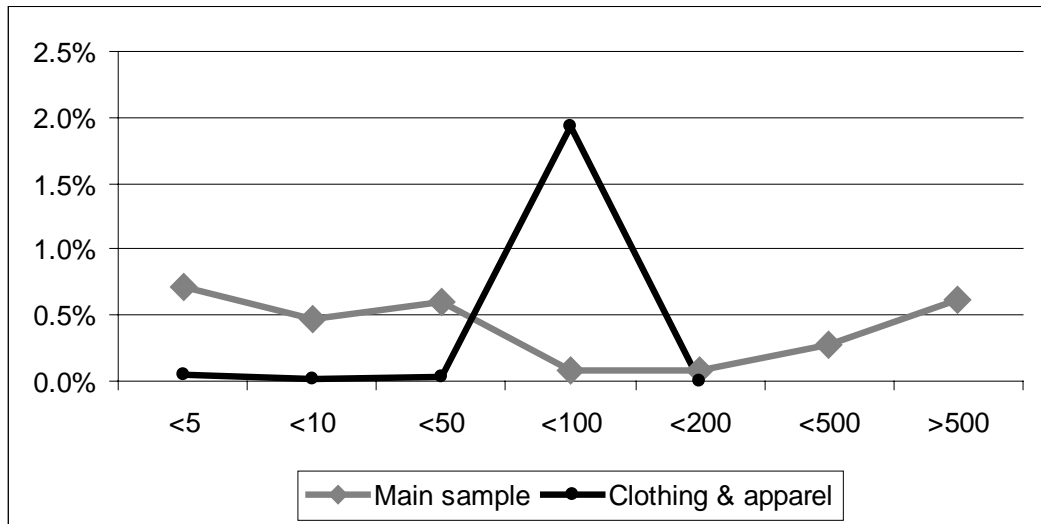
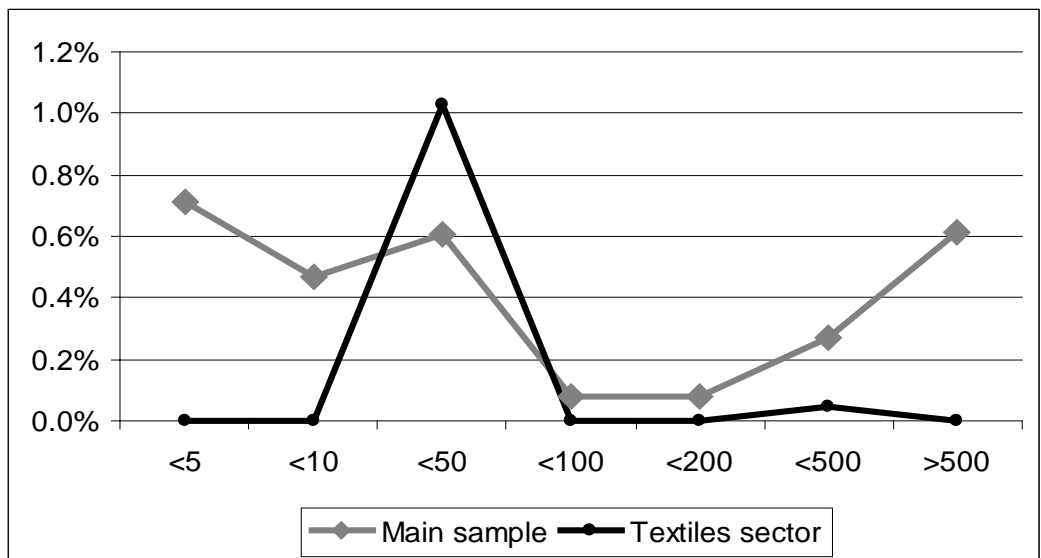


Figure 7: Sector-Specific Regulatory Costs as a Percentage of Turnover: Firms in the Textiles Sector Vs. the Economy, by Number of Employees

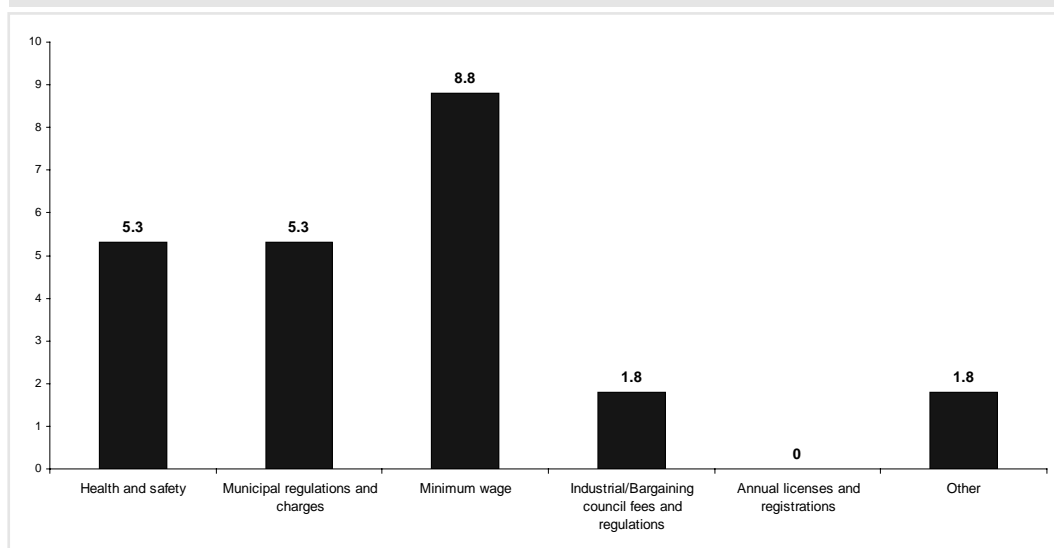


With two exceptions, the 58 firms in clothing and textiles had lower sector-specific regulatory costs than South African firms in general. In fact, sector-specific regulatory costs in the clothing and apparel industry are the lowest amongst all the sectors surveyed.

Sector-specific compliance costs for the textile industry are also much lower (less than half) than in the rest of the economy. SMEs in both sub-sectors seem to be almost completely unaffected by sector-specific regulations.

Clothing and Textiles SMES' Perceptions of Sector-Specific Regulations

Figure 8: Perceived Troublesomeness of Types of Sector-Related Regulation in the Clothing and Textiles Sector



Despite their low recorded sector-specific regulatory costs, clothing and textiles firms reported that sector-specific regulations made up a close-to-average proportion of their total regulatory costs, and reported themselves to be averagely troubled by sector-specific regulations. Two explanations for this seem plausible. First, given their detailed knowledge of their own sector and their relative ignorance of other sectors, it could be that managers are unlikely to perceive that their own firms are in fact less expensively regulated than other types of firms. Second, the SBP survey differentiated between minimum wage determinations and sector-specific regulations when asking for regulatory cost assessments. However, in this sector, which is under intense cost pressure from imports, minimum wages and conditions of employment are strongly perceived by managers to be a sector-specific problem.

Interviews (2003) and a focus group (2004) showed that larger clothing and textiles SMEs perceived that:

- The DCCS is difficult and expensive for SMEs to access and its

benefits are confined to the largest firms

- Minimum wages and conditions of employment agreed at the industry bargaining council have the effect of making larger and more visible SMEs less competitive and less likely to expand output and employment; and also of 'driving' production into ever-smaller 'cut, make and trim' SMEs which are able to ignore and evade bargaining council agreements.
- Regulations against illegal imports are very poorly enforced.

As might be expected from the quantitative results, very small clothing SMEs operating outside areas of union strength reported no sector-specific regulatory costs or problems.

Suggestions for Sector-Level Reforms

Further simplification of the DCCS to make it more accessible to SMEs may be required.

Larger SMEs called for more flexibility in conditions of employment, particularly concerning overtime.

Firms in the sector would very strongly support more effective implementation of the regulatory system against illegal imports.

4. Financial Services

At December 2004, the Micro Finance Regulatory Council (MFRC) had 1905 registered micro-lenders on its books. Of these, 1 488 were registered as close corporations and so are, presumably, SMEs. Some of the 287 private companies registered with the MFRC may also be SMEs.⁶ In October 2002, the MFRC estimated that around 30 per cent of micro-lenders were not registered with the MFRC.⁷

Outline of Sector-Specific Regulations

At the time of the survey, micro-lenders were regulated by the MFRC under its July 2002 rules, made in terms of the 1999 Exemption Notice to the Usury Act, 1968.

The 1999 exemption notice permitted micro-lenders to make loans of up to R10 000 for not longer than 36 months at rates of interest above the Usury Act limits but not exceeding 10 times the average prime overdraft rate.

Under the MFRC's July 2002 rules, micro-lenders were obliged to apply and pay for registration with the MFRC; re-register annually; inform the MFRC of any material changes to the ownership or status of the business; keep detailed accounts and records of the conditions of each loan made; make detailed financial reports to the MFRC every month on each loan made; and register each new loan made and each loan paid back with the MFRC within 2 business days of making the loan or ending the transaction.

Quarterly and annual statistical returns in a prescribed format were required, as were annual financial statements audited by a person approved by the MFRC. Registered micro-lenders were also subject to MFRC rules on reckless lending, which required that lenders 'shall, prior to entering a money-lending transaction with a borrower, consider the ability of the borrower to make the required payments... and still to meet his or her necessary living expenses.'⁸

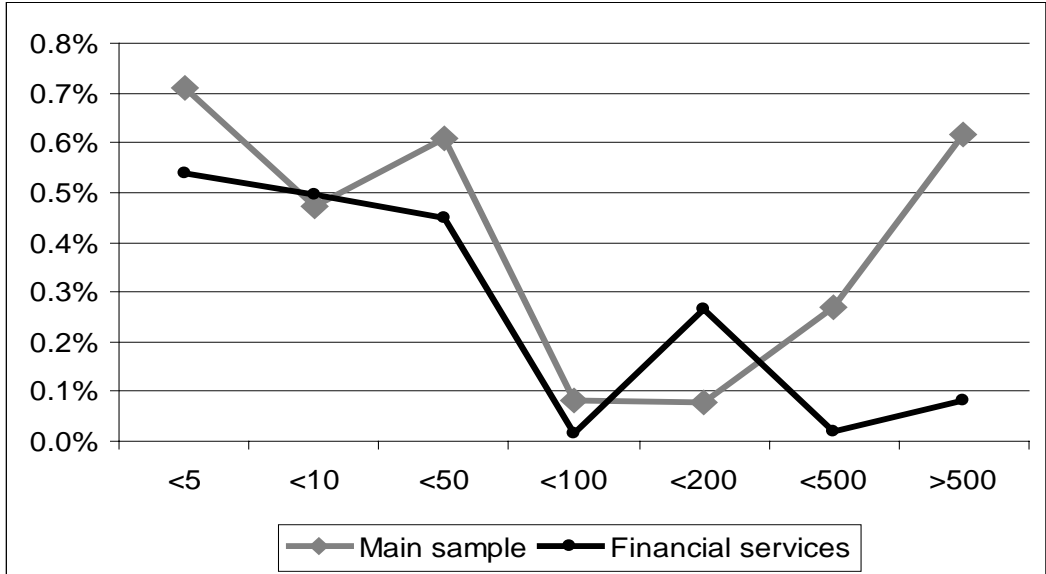
6 <http://www.mfrc.co.za/detail.php?s=95>, accessed August 2005

7 MFRC, Report on unregistered lenders, October 2002.

8 MFRC rules, July 2002, Rule 4.3

However, despite this demanding set of requirements, Figure 9 shows that a sample of 240 financial services including micro-finance SMEs did not face higher than average sector-specific regulatory costs.

Figure 9: Sector-specific Regulatory Costs as a Percentage of Turnover: Firms in the Financial Services Sector Vs. the Economy, by Number of Employees



Financial Services SMES' Perceptions of Sector-Specific Regulations

Possible reasons for this are suggested by a re-examination of the 2004 qualitative data and 2005 interviews and desktop research.

Figure 10: Perceived Troublesomeness of Types of Sector-Related Regulation in the Financial Services Sector

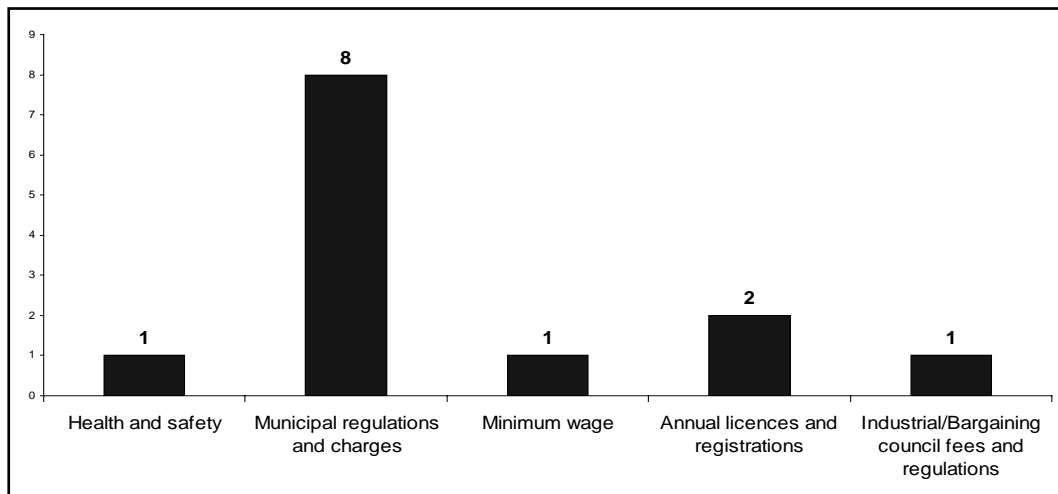


Figure 2 shows that financial services firms are the least 'troubled' of all South African businesses by regulation. Figure 10 shows that MFRC (and other financial sector) licenses and regulations were only mentioned as 'troublesome' by 2 per cent of respondents. One 2005 interviewee remarked that the MFRC 'was no trouble at all' to his micro-lending business, while giving the strong impression that he had not actually considered registration.

Suggestions for Sector-Level Reforms

SBP's data suggests the possibility that the MFRC may be underestimating the proportion of financial SMEs that operate without registration or oversight.

Effective ways of raising the level of regulatory compliance include simplification of registration and reporting requirements – and this should perhaps be considered here.

It may also be the case that the R10 000 maximum limit on Usury Act-exempt loans is too low and that micro-lenders therefore prefer the risks of illegality to the costs of not being able to make larger loans.

5. Information and Communications Technology

The two largest components of the ICT sector are telephony and value-added network services (VANS). The most common VANS service is providing internet access. The sector also includes retail provision of ICT goods and services. SMEs in the ICT sector tend to be retailers and small VANS or other ICT service providers.

Outline of Sector-Specific Regulations

The sector-specific regulatory environment of the ICT sector operates at two very distinct levels. Regulation of the major ICT providers (Telkom, the major mobile providers, Sentech and the other large IT firms) is undertaken by ICASA and the Department of Communications. The main effects of this slow and controversial regulatory process on SMEs have been through their cost structures rather than by way of specific regulations that apply to ICT SMEs.

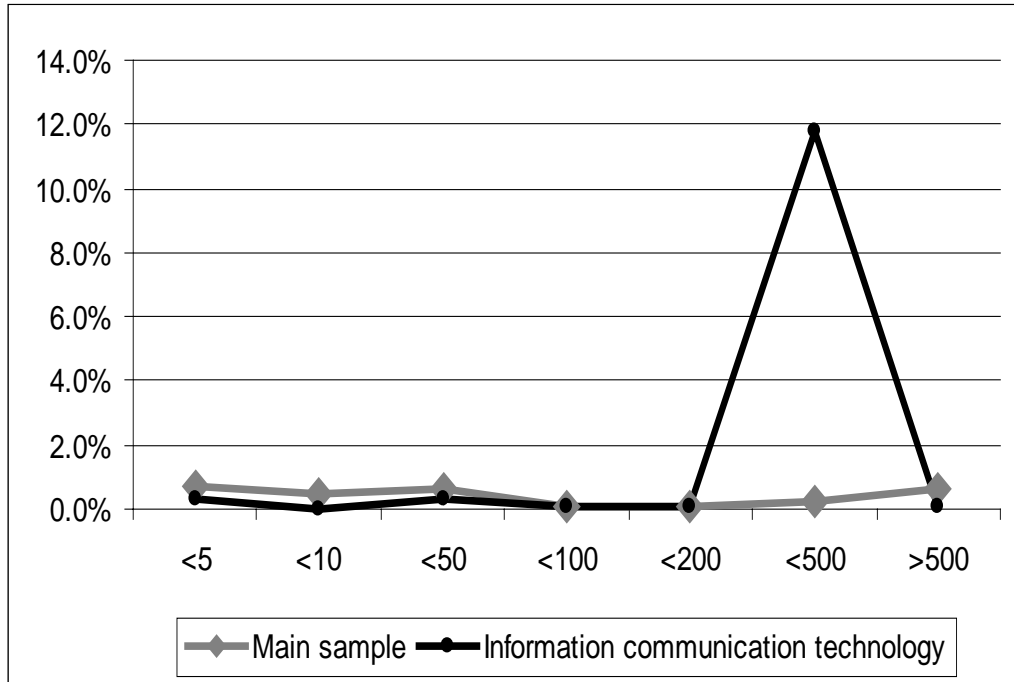
There has, however, also been a less well-known process of regulatory development in the sector, operating largely through the Department of Communications and Parliament rather than through ICASA, and this has direct impacts on SMEs.⁹ The relevant legislation is:

- The Electronic Communications and Transactions Act, 2002. Chapters in the Act on Cryptography and 'Protection of Critical Databases' appear to place heavy registration and reporting requirements on ICT SMEs
- Regulation 1241 of 2003 and Notice 837 of 2004 issued under the Telecommunications Act, 1996, which require small VANS providers to pay annual fees to ICASA and the Universal Service Fund
- The Regulation of Interception of Communications and Provision of Communication-Related Information Act, 2002, which requires small VANS to maintain infrastructure (or pay into an official fund that aims to cover the costs of leasing infrastructure) that will permit

⁹ The interpretations of the regulations in this section are based on input from industry experts (S & P Esselaar, Report on regulatory compliance costs in the ICT sector, October 2004) and therefore do not necessarily reflect the perceptions of SMEs.

undetectable monitoring by law enforcement authorities of their clients' communications; and also requires additional paperwork when opening an internet account for a client.

Figure 11: Sector-specific Regulatory Costs as a Percentage of Turnover: ICT Firms Vs. the Economy, by Number of Employees



Despite these regulations, sector-specific regulatory costs in the information and communication technology are reported to be generally slightly lower than in the rest of the economy. However, a single firm among the 40 survey claimed to have spent an amount equivalent to 50 per cent of turnover on professional and consulting fees in complying with sector-specific regulations. This is not implausible, if this firm were attempting to obtain an important ICT license from ICASA and/or the Department of Communications. If this observation is omitted the industry average drops to 0.23 per cent, which is significantly lower than in the rest of the economy. ICT firms reported incurring only 12 per cent of their total regulatory costs from sector-specific regulations, compared to 22 per cent for the representative sample of South African firms

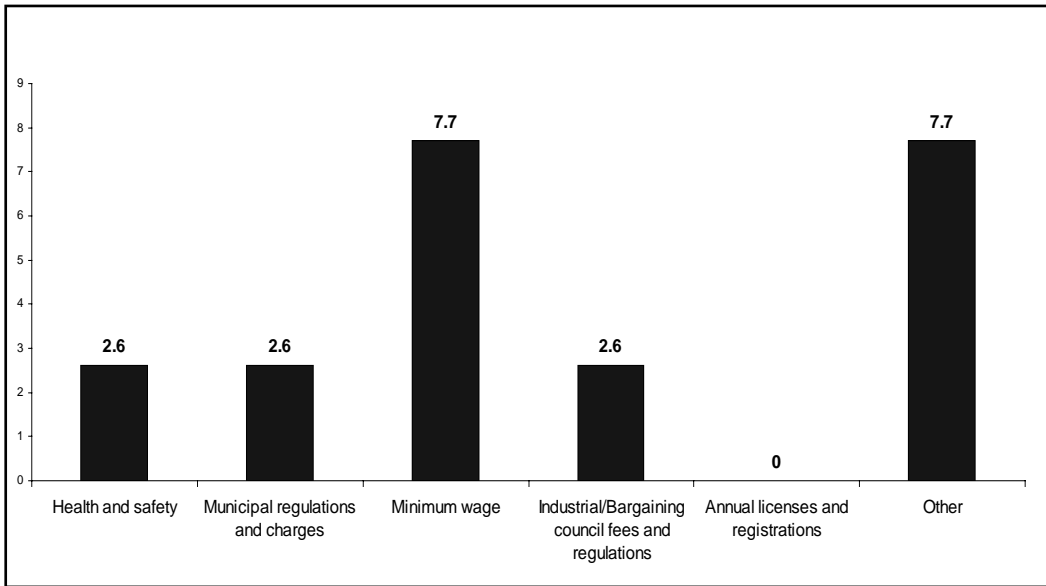
ICT SMEs' Perceptions of Sector-Specific Regulations

Since the 'other' category is likely to contain a large proportion of highly sector-specific regulatory costs, it is interesting that this category is so prominent in Figure 12. This, however, refers to the perceptions of ICT firms of all sizes.

For information on SMEs, we turn to a 2004 commissioned paper from an industry expert, and interviews in 2003 and 2005. These give the impression that ICT-sector SMEs have the following perceptions about sector-specific regulations:

- Most SMEs 'fly below the radar' of sector-specific regulations, but many are concerned that the costs of compliance would be crippling if it did become necessary to comply
- SMEs perceive the regulatory environment for ICT to be complex and internally contradictory
- SMEs or larger start-ups that are trying to win a major license or have other reasons for being fully compliant with the ICT-sector regulatory system face extraordinarily high regulatory costs as a proportion of their turnover

Figure 12: Perceived Troublesomeness of Types of Sector-Related Regulation in ICT Sector



Suggestions for Sector-Level Reforms

Several of the more demanding statutory requirements on SMEs in this sector to hold large quantities of information, maintain infrastructure and/or pay turnover levies should probably be reconsidered. It appears that these requirements may impose excessive burdens on SMEs and that, at least partly as a result, they tend to be ignored or evaded. Once again, it seems likely that a simpler regulatory system, focusing on what is essential and practically possible, would achieve a higher standard of compliance.

One interviewee raised the possibility that regulations defining the differences between various kinds of electrical and electronic technicians are unnecessarily restrictive. He reported that these regulations were a significant constraint on growing his business.

6. Mining

The very small sample of mining firms in the 2004 survey (7) makes it impossible to generate useful comparisons between sector-specific compliance costs in mining and firms in general. Useful 'troublesomeness' comparisons are also ruled out.

Mining SMEs' Perceptions of Sector-Specific Regulations

Nevertheless, interesting perceptions emerged from a focus group held in 2005 with a group of SMEs in Steelpoort, nearly all of which are service providers to the local platinum mines, and from 2005 interviews with sector experts and with small Johannesburg, Springs and Witbank-based mine services providers.

By far the most powerful perceptions emerging from these discussions and interviews related to the health and safety requirements enforced by large mining companies on their SME contractors. SMEs perceived that:

- Health and safety regulations in mining have been getting rapidly more complex and more expensive to comply with (often now approaching 30 per cent of a typical contract's value)
- Compulsory health and safety training – 'induction' – processes are often extremely elaborate and repetitive. One SME claimed that induction can take up to a week per contract; another suggested 3 days quarterly, yet another claimed that, in one extreme case, 2 hours of each work day on a short contract were spent receiving the same health and safety induction.
- It is not possible for SME contractors to fully recover the cost of these compliances from their corporate employers
- The increasing complexity and rigor of these regulations has not led to an increase in their actual level of safety
- Corporate mines' interpretations of these regulations vary considerably from one to the other. They often refuse to accept each others accreditations and therefore impose repeated unnecessary costs on SME contractors. SME contractors are obliged, for instance, to get different sets of health certificate 'red

cards' for their employees from each mine for which they work, in many cases even when mines are within the same group.

- The practice of requiring all the equipment used by contractors on-site to be assessed in advance for safety – 'tagged' – has been over-extended. One SME claimed, for instance, that shovels employed in fence construction were individually assessed for safety. Several other SMEs perceived that very extensive 'tagging' requirements are imposed on contractors by mine managers as a form of 'job creation' for retrenched former mine employees now working as tagging consultants.

SMEs also reported that they are obliged to compile very extensive 'contractor's packs' as a pre-condition for being awarded a contract, and that these documents are required to contain vast quantities of unnecessary detail about working methods, equipment and personnel. (One contractor's pack shown to an SBP researcher concerned the construction of a fence, and ran to roughly 600 pages.)

Suggestions for Sector-Level Reforms

Given the fact that the perceived increase in the complexity and rigor of safety regulations has been accompanied by a significantly declining trend in fatalities per million hours worked since 1988¹⁰, any proposed relaxations or simplifications of mine health and safety regulations to benefit SMEs should be approached with extreme caution.

However, there seems to be no good reason why the Department of Minerals and Energy, mining corporations, labour unions and SMEs should not work towards the standardisation across mining groups and mining regions of interpretations of the health and safety regulations, and therefore towards mutual recognition of each other's health and safety certifications for SME suppliers.

Contractors are always likely to complain that they cannot fully recover the cost of compliance from their corporate employers. However, interviewees also reported that one important reason why their 'margins are squeezed' is that mines do not explicitly state the level and

¹⁰ See Chamber of Mines, Mining safety performance statistics available at www.bullion.org.za, accessed August 2005

extent of health and safety compliance required of successful tenderers. As a result, SMEs fear that they will be under-bid by more cavalier or more inexperienced competitors. They also report being frequently 'surprised' mid-contract by new or unanticipated health and safety requirements. Mining houses and individual mines should take greater care to ensure that health and safety requirements are always clearly spelled out in invitations to tender and that requirements not change mid-contract unless absolutely necessary.

7. Pharmaceuticals

The pharmaceutical industry has sales of around R13 billion a year and accounts for 0.6 per cent of GDP. The private pharmaceutical sector employs about 41 500 people – around 19 500 in manufacturing, 4 500 in wholesale operations and at least 17 500 in community pharmacies.

Outline of Sector-Specific Regulations

The pharmaceutical sector is regulated by authorities created in the Medicines and Related Substances Act, 1997, as amended, 2002 and 2004; the Pharmacy Act, 1974, as amended 1997 and 2000. These authorities are the Medicines Control Council (MCC) and the South African Pharmacy Council. (SAPC) Both are ultimately responsible to the Minister of Health.

A comprehensive set of Regulations to the Medicines Act has been published, running to some 70 pages. In addition the MCC from time to time publish guidelines on matters of practice and interpretation of the Act. At present, for instance, a draft Code of Practice for the marketing of medicines (64 pages) has been published for public comment.

The MCC has 11 technical committees. These include the Clinical Committee, Pharmaceutical and Analytical Committee, Clinical Trials Committee, Scheduling Committee, Veterinary Committee, Pharmacovigilance Committee, Biological Committee, Complementary Medicines Committee, and African Traditional Medicines Committee.

There are two main types of sector-specific regulations: those applying to the manufacture of pharmaceuticals and those applying to retailing.

Under the Medicines Act, application for the licensing or registration of a medicinal product by the MCC requires completion of an MRF1 document and submission of all relevant data. The application includes 17 annexes, requiring complete information regarding the formulation of the medicine, the raw material specifications, final product specifications, analytical control procedures, method of manufacture, details of pharmacology, bioavailability and toxicity, safety and efficacy. This dossier is submitted to the MCC, and the evaluation process currently takes between two and three years. (It is anticipated that the backlog will be compounded by the 'call up' for listing of the approximately 13 000 complementary medicines available in South Africa and by the introduction of compulsory patient information leaflets and a pre-screening process as a new first stage of medicine registration.)

During this time, the company and the responsible pharmacists must remain registered, and thus incur expense without income. After evaluation and prior to the licensing for the product, the applicant is subject to a site inspection, paid for by the applicant. After the product is licensed, an annual retention fee is payable, and the product's license is re-evaluated every five years. Manufacturers must also adhere to regulations on labels, storage, batch control, and product complaint handling.

A manufacturer is required to conduct routine self compliance audits and present documentary evidence that these have taken place when audited by the inspectors of the MCC or the SA Pharmacy Council. Areas to be monitored include labelling, storage, batch release and authorisation, product complaint handling, lot control, batch tracking and validation of manufacturing processes and equipment .

Should there be changes to any process after the issuing of the product licence, amendments need to be submitted to the MCC for ratification or approval prior to implementation. These must be substantiated with the necessary evidence and documentation.

Before 2003, medicines manufactured in South Africa destined for sale on the export market only did not have to be registered in South Africa prior to manufacture and sale. Since that date, any medicine manufactured in South Africa, even if only for export, must be registered prior to it being made.

The inspectorate of the MCC conducts routine audits with each firm, including wholesalers/distributors (and licensed dispensing premises under the new amendments) being audited at least once every three years. Those with major non-compliance issues receive follow up audits should the corrective action following the audit report be deemed insufficient. Should compliance still not be achieved, the Inspectorate may close the facility until such time as it is satisfied that patient safety and adequate manufacturing practices are in place.

Most manufacturers have a regulatory department and/or employ a dedicated regulatory pharmacist. In addition, manufacturing firms will often need to hire regulatory consultants. In larger organisations, the costs involved in establishing and carrying such a person or department can be amortised over a wide basket of products, but the smaller entity will often devote a significant proportion of income towards maintaining their licences.

A retail pharmacy (referred to in the sector as a 'community pharmacy') must be licensed by the Department of Health, have facilities approved by the SAPC and be noted in a register held by the MCC. The license applies only to the specified location and individual. A new application is required if the business is to be relocated and a 'certificate of need' must now be obtained from the Department of Health. The registered pharmacists operating the pharmacy and their pharmacy assistants pay an annual re-registration fee to the SAPC.

Community pharmacies are required to keep records of all medicine transactions for products above Schedule 1. Sales of schedule 5 and 6 medicines – such as opiates – must be entered in a separate register and reconciled by the pharmacist quarterly. Records of prescriptions and purchase orders must be retained on the premises for a minimum of five years.

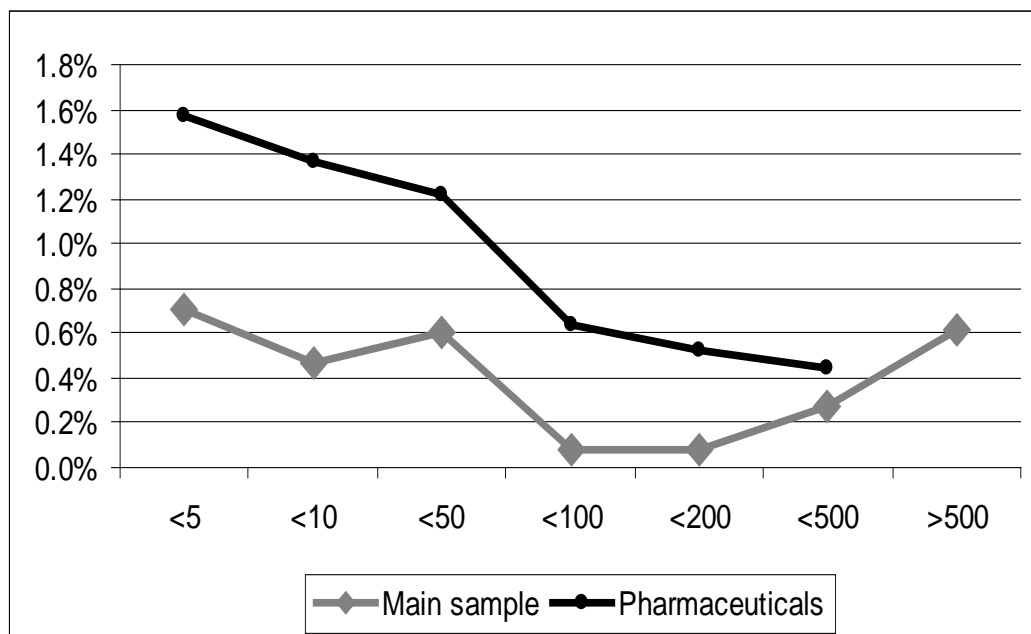
Manufacturers and retailers are required under the Medicines Act to generate documentation on their premises in the form of a Site Master File, containing floor plans and 'Standard Operating Procedures' for the specific manufacturing or retail operation.

Community pharmacies, manufacturers and distributors are also subject to regulations on medicines temperature control, which can create significant capital costs for smaller firms.

Mandatory community service for pharmacists was introduced as a condition of registration under the 2000 Pharmacy Amendment Act. Thus, in order to become registered as a practicing pharmacist, one must first do a year's internship followed by a year of community service prior to registration by the SA Pharmacy Council.

In April 2004, price control in the form of Medicines Act regulations was applied to the sector. The data below was gathered before this change.

Figure 13: Sector-specific Regulatory Costs as a Percentage of Turnover: Pharmaceutical Firms Vs. the Economy, by Number of Employees



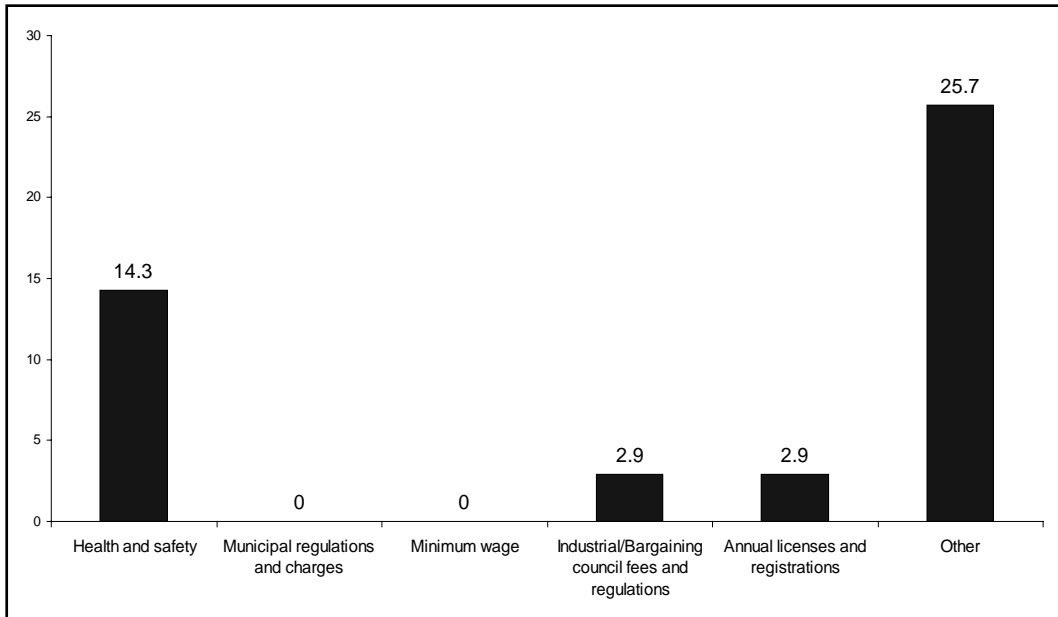
As Figure 13 shows, sector-specific regulatory costs for the pharmaceutical industry are higher for every employment band than for ‘average’ firms in the rest of the economy, and also higher than the other sectors considered in this report with the surprising exception of the tourism sector. Costs are regressively distributed across firms, as they are for the economy as a whole.

Since poor quality or incorrectly provided medicines pose grave risks, and since there are important social goals which a freer market in drugs may not be able to meet, it is no doubt appropriate that the sector should be properly regulated. However, it remains an open question whether smaller firms in the industry need to be so expensively regulated.

Pharmaceutical Firms' Perceptions of Sector-Specific Regulations

Referring back to Figure 2 we see that the 35 pharmaceutical firms in SBP's survey reported themselves as particularly 'troubled' by sector-specific regulations. Figure 14 shows that the bulk of this troublesomeness is perceived to derive from 'other' – largely sector-specific – regulation.

Figure 14: Perceived Troublesomeness of Types of Sector-Related Regulation in the Pharmaceuticals Sector



Research commissioned by SBP from an industry expert in 2004 did not reveal any pharmaceutical manufacturers that would qualify as SMEs.¹¹ It is perhaps an interesting finding in itself that despite repeated attempts, no community pharmacist in the Johannesburg area would agree to be interviewed for this project. For this reason, the suggestions for sector-level reform are entirely based on the work commissioned from the industry expert.

11 J Meekings, The cost of regulatory compliance in the South African pharmaceutical industry, October 2004

Suggestions for Sector-Level Reforms

Three obvious areas for reform are:

- Rationalising regulatory oversight of retail pharmacies, perhaps to a single body responsible for the routine licensing and inspection
- Modernising information storage requirements on retail pharmacies to permit electronic storage
- Taking steps to reduce delays and backlogs in medicine registration by the MCC. It may be appropriate, for instance, to consider delaying current plans to register complementary and alternative medicines until the conventional medicines backlog is reduced.

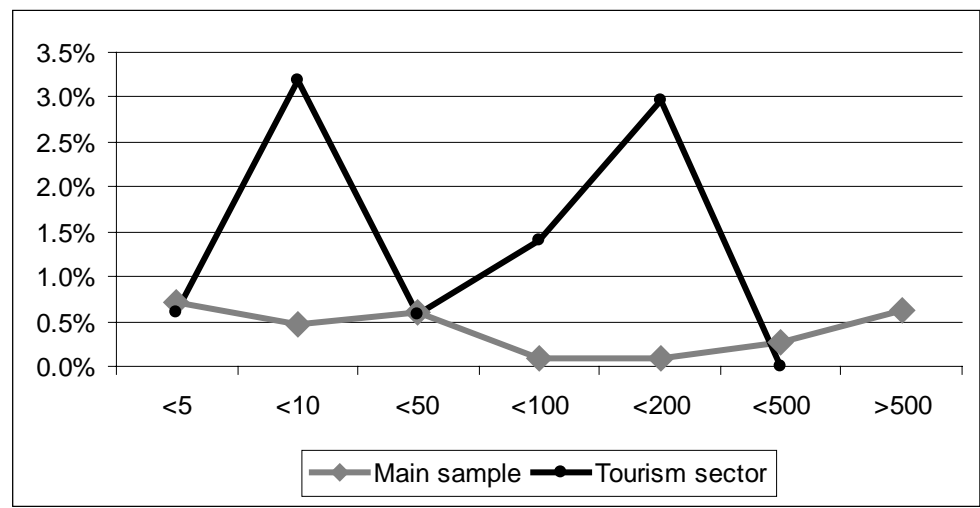
8. Tourism

In 2004, tourism employed around 512 000 people in South Africa – nearly 4,2 per cent of total employment. In 2003, foreign direct spending on tourism injected nearly R54 billion into the economy.

Outline of Sector-Specific Regulations

As Figure 15 shows, SBP’s sample of 42 firms in the tourism sector had a significantly heavier than average sector-specific regulatory burden. The average tourism firm spends more on sector-specific regulatory costs than does any other type of firm: three times as much as those in the rest of the economy. Tourism SMEs with between 5 and 10 employees report exceptionally high sector-specific regulatory costs, as do fairly large tourism firms.

Figure 15: Sector-specific Regulatory Costs as a Percentage of Turnover: Pharmaceutical Firms Vs. the Economy, by Number of Employees



There is something of a puzzle here. SBP’s desktop research in 2004-5 and SME interviews in 2005 uncovered only one set of compulsory national sector-specific regulations that apply to tourism SMEs *strictly in their capacity as tourism firms*. These are the 2001 Regulations issued under the Tourism Act, 1993, as amended, 2000. These regulations are fairly demanding. Registration as a tour guide is conditional upon formal proof of competence, which in turn requires tour guides to have a valid heavy-vehicle licence and to have undergone training – often rather rigorous, province-specific training

– accredited by the Tourism, Hospitality and Sport Education and Training Authority (THETA). Provincial tourism authorities have been created under provincial tourism Acts, but only the KwaZulu-Natal provincial government appears to have made regulations requiring that tourism firms within their jurisdiction be registered with the provincial tourism authority.

Tourism firms are also subject to several important – but not strictly compulsory – regulatory requirements. These include membership of the grading scheme run by the Tourism Grading Council of South Africa (TGCSA); administering and paying over the 1 per cent voluntary¹² levy on tourists to the Tourism Business Council of South Africa (TBCSA) to fund international marketing; and, where relevant, maintaining membership of industry associations such as the Southern Africa Tourism Services Association (SATSA) and the Association of South African Travel Agents (ASATA). It is likely that some of the costs of these voluntary registrations – which are, apparently, quite strongly enforced through peer pressure within the industry – are reflected in Figure 15

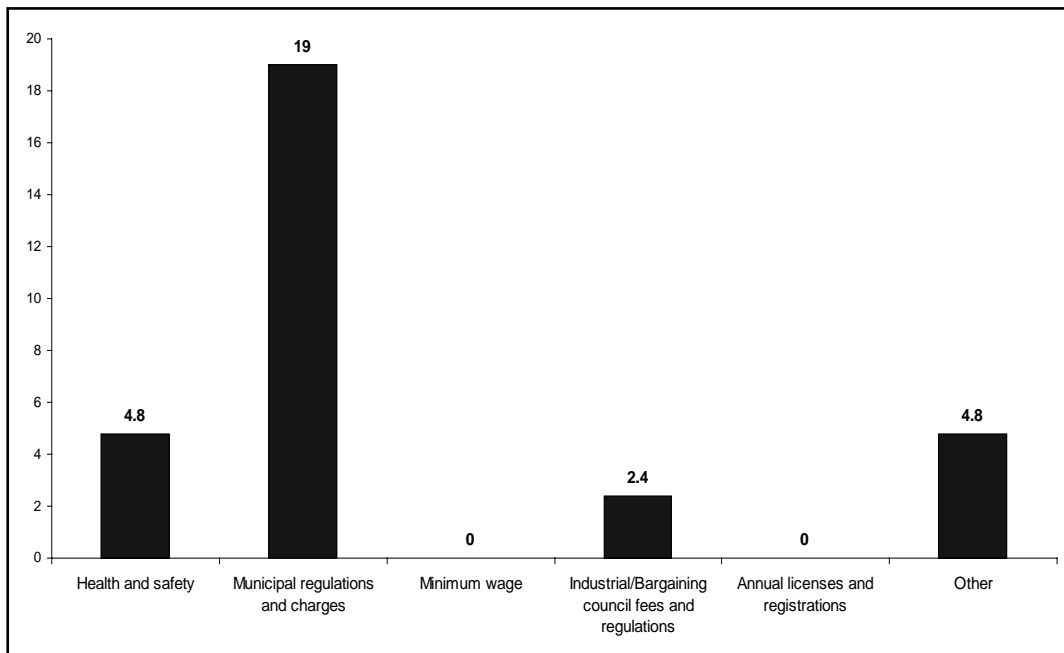
Nevertheless, it is highly implausible that a single set of national regulations on tour guides, one provincial registration requirement and some semi-voluntary association memberships could explain the reported pattern of unusually high regulatory costs

A more likely explanation of this pattern of costs is the fact that, in the ordinary course of their business, tourism firms tend to engage in a wide range of highly regulated activities – such as transport, catering and foreign exchange transactions – which are not strictly sector specific but which each entail significant regulatory costs. From the perspective of tourism firms, these regulations are perceived as sector-specific because they are an integral part of the everyday business of the tourism firm.

12 It is voluntary for firms to administer the pay over the levy to the TBCSA. Clients, it appears, are rarely if ever given the option.

Tourism SMEs' Perceptions of Sector-Specific Regulations

Figure 16: Perceived Troublesomeness of Types of Sector-Related Regulation in the Tourism Sector



Tourism firms of all sizes in the 2004 SBP sample perceived themselves to be more troubled by regulation than any other type of firm except pharmaceutical companies (Figure 2). They perceived municipal regulations as being responsible for the bulk of this difficulty (Figure 16.)

In 2005 interviews, tourism SMEs corroborated the perception that municipal regulations and charges (particularly municipal regulations on bus transport and other traffic issues) were troublesome to them, and also reported significant difficulty from the following regulations:

- The Department of Transport's Road Carrier Permit (RCP) regulations under the Road Transportation Act, 1977 as amended. These require every single application for a 3 year RCP to be published in the *Government Gazette* for comment. (This means that every bus on the road requires an RCP application to be published in the *Gazette*.) These applications are also, in the perception of one interviewee, subject to several other inordinate

delays. This interviewee reported that obtaining temporary 2-week RCPs for his SME's buses required the firm to employ a person full-time 'to stand in the queue at the Department of Transport.'

- While the 2001 regulations on tour guides were welcomed as a valuable form of quality control and skills development, long delays and inefficiencies were reported from THETA. One firm complained that the high required standard of knowledge and province-by-province specificity of the training were disproportionate to the requirements of the job.
- Regulations governing foreign exchange were perceived as cumbersome, and the costs of foreign exchange transactions as exorbitant
- South African visa requirements for nationals of neighboring countries were perceived as excessive
- One SME travel agent perceived ASATA's rules and inspections of members as having the effect of reducing the competitiveness of SMEs.

SBP Suggestions for Sector-Level Reforms

Investigation of ways to increase the efficiency of the tour guide regulations seem called for. Urgent action to remove the bottleneck created by the RCP regulations is undoubtedly required.

The major regulatory challenge facing tourism SMEs, however, seems to come from regulations that are not strictly specific to tourism narrowly defined. Rather, these regulations apply to firms that provide a range of personal services. This wider problem will require wider solutions, including systematic review of the regulatory environment for the services sector in general.

9. Modeling the Impact of Sector-Specific Regulation on Employment Growth¹³

The 2004 SBP survey asked firms to name factors that discouraged them from hiring more employees, and each firm was allowed three answers. This question was asked before the more detailed questions on regulations, so as not to bias respondents towards naming regulation as one of the constraints. A yes/no variable was derived from these answers that indicates whether a firm listed regulations as one of the three most important constraints on employment growth. This variable was created and used as the dependent variable in a probit regression in order to gauge what determines whether firms perceive regulation as being a constraint on employment growth.¹⁴

When estimating this regression while including all the different types of regulatory costs (expressed as a percentage of turnover) as explanatory variables, sector-specific regulatory costs showed up as the type of cost with the largest positive coefficient, which indicates that a marginal increase in this type of regulation was more discouraging of employment growth than any of the other kinds of compliance costs.

Table 1 presents a model in which we control for employment bands and sector, as well as including total recurring and sector-specific regulatory costs. Sector-specific costs have a positive and significant effect on the probability that a firm perceives regulation as constraining employment growth. Tourism also shows a significant positive effect.

13 This section reports on statistical analysis of the 2004 representative sample commissioned by SBP in August 2005 from Rulof Burger, Economics Department, Stellenbosch University

14 A similar regression was estimated on whether regulations were constraining firm growth, but the results were less conclusive.

Table 1: Probit Regression on whether Regulation is Perceived to Constrain Employment

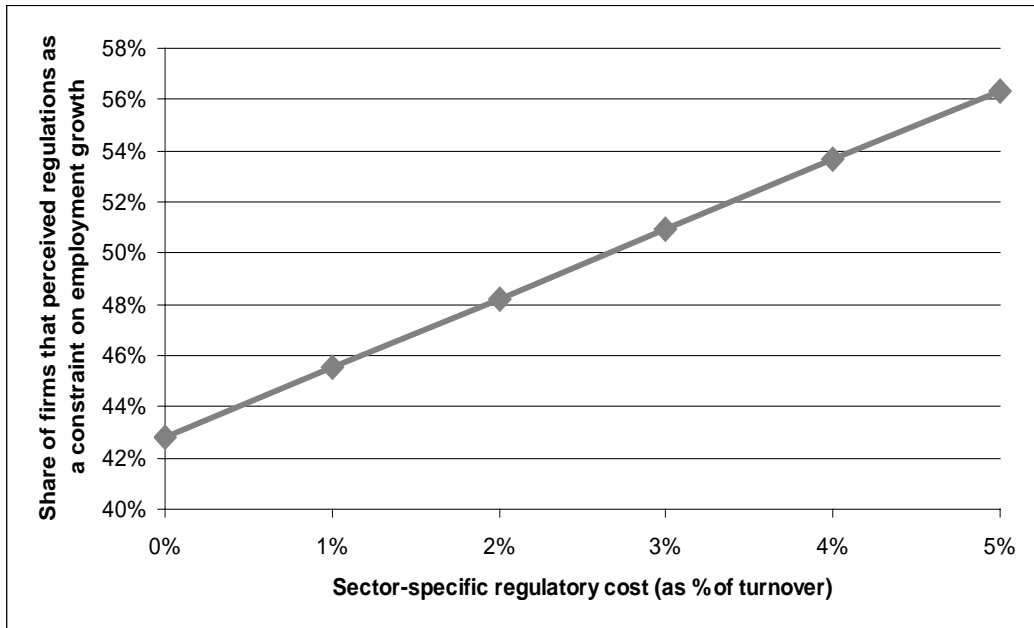
Dependent Variable: Regulation Perceived as Constraining Employment	
Observations	664
Employment bands:	
Between 5 and 10	0.286** (0.011)
Between 10 and 50	0.369* (0.061)
Between 50 and 100	0.354 (0.492)
Between 100 and 200	0.742 (0.299)
Between 200 and 500	0.697 (0.431)
More than 500	0.113 (0.893)
Recurring regulatory costs	-0.276 (0.170)
Sector-specific regulatory costs	7.079*** (0.007)
Tourism	1.583** (0.041)

Note: Value of standard errors in parenthesis. * Significant at 10 per cent, ** at 5 per cent and *** at 1 per cent levels.

Figure 17 demonstrates the simulated impact of a decrease in the sector-specific regulatory costs on the firm’s perception that regulations acted as a constraint on the firm’s employment growth. As the costs are decreased from 5 per cent to 0 per cent¹⁵ the probability that the firm will feel constrained by regulations to expand employment decreases from 56.3 per cent to 42.8 per cent.

15 Although the sector-specific regulatory costs for the average firm comprises only 0.6 per cent of turnover, approximately 2.5 per cent of firms experienced a burden exceeding 5 per cent.

Figure 17: Simulated Effect of a Decrease on Sector-Specific Regulatory Costs on Employment Growth



Regression analysis therefore shows that the level of sector-specific regulatory costs that a firm pays is an important determinant of whether this firm is discouraged by regulations from hiring more workers. All other things being equal, a decrease in these costs should therefore increase employment.

Unfortunately, the data does not allow us to infer the magnitude of employment growth that is at stake.

10. Concluding Remarks

Sector-specific regulations create some significant costs for SMEs, particularly in the automotive, pharmaceutical and tourism sectors. Percentages of turnover spent on sector-specific regulatory compliance may seem relatively small, but a small percentage of turnover will usually translate into a large percentage of profit.

Further, SMEs in all the sectors discussed in this report perceive sector-specific regulatory costs and burdens as constraints to growth and to employing more people. In fact, regression analysis suggests *that an increase in sector-specific regulatory costs is more discouraging of employment growth than an increase in any other kind of regulatory compliance cost*. It is clear, therefore, that the kinds of reforms to the sector-specific regulatory environment suggested in this report would stimulate employment.

However, most of the samples analysed in this report are too small to be representative – and the qualitative research discussed here was not deep enough to be definitive.

This paper has therefore established that changes to the sector-specific regulatory environment would often benefit SMEs, and has identified certain obvious candidates for abolition or reform. More complete and precise details about which sector-specific regulations to reform, about how exactly to change them, and about the likely costs and benefits of these reforms, can only emerge from deeper qualitative and quantitative research with larger sector samples. We strongly recommend that larger sector studies of this sort be undertaken in the sectors discussed here, but also in agriculture, fishing, construction and retail personal services.

As the case of tourism shows, it would often also be important to look closely at the regulatory environment from the point of view of expanding SMEs, rather than too narrowly by sector. At least in tourism – and almost certainly in other service sectors – what appears to matter is the *range* of regulations, each relating to apparently different sectors, that an SME is likely to encounter in its daily business. ‘Time and motion’ studies of the ways in which SMEs interact with the regulatory environment are likely to be a valuable tool here.

This report suggests that sector-specific regulations have very little impact on the behaviours and costs of SMEs in agri-processing and in the clothing and textiles sectors, and that ICT and financial services SMEs also often ignore, evade, or are simply unaware of sector-specific regulations. There are good social and economic reasons for wanting

SMEs in these sectors to be more compliant with certain sector-specific regulations. But they are only likely to become more compliant if the regulatory environment in these sectors is simplified to the point where both compliance and enforcement become realistic possibilities.

11. A Note on Sources

SBP made a commitment to interviewees and focus group participants that their identities would not be divulged. SMEs tend not co-operate with research except on this condition.

It is therefore not possible to provide the standard list of interviewees and focus group participants.

Focus groups

5 focus groups were held:

1. Agri-processing group, 9 participants, Johannesburg 26 July 2004
2. Automotive group, 8 participants, Johannesburg, 27 July 2004
3. Clothing and textiles group, 8 participants, Cape Town, 28 July 2004
4. Steelpoort group (including mining and construction SMEs), Steelpoort, Mpumalanga 11 July 2005
5. Springs group (including SMEs in manufacturing, mining, construction, ICT, financial services manufacturing), Springs, Gauteng, 2 August 2005

Interviews

A total of 45 in-depth interviews were undertaken.

23 interviews conducted with SMEs in February and March 2003 for an earlier project but exploring relevant issues were reanalysed for this report. This set of interviews included SMEs in agri-processing, clothing and textiles, ICT and mining.

22 interviews were conducted in August and October 2005 specifically for this project. SMEs in each sector discussed in this report were interviewed, except for Clothing and Textiles (covered by its own focus group) and pharmaceuticals. As remarked above, repeated efforts to secure interviews with community pharmacies failed. It was therefore necessary to rely on a paper commissioned from an industry expert to gather qualitative information on this sector.