

Financial Solutions for
Business Owners

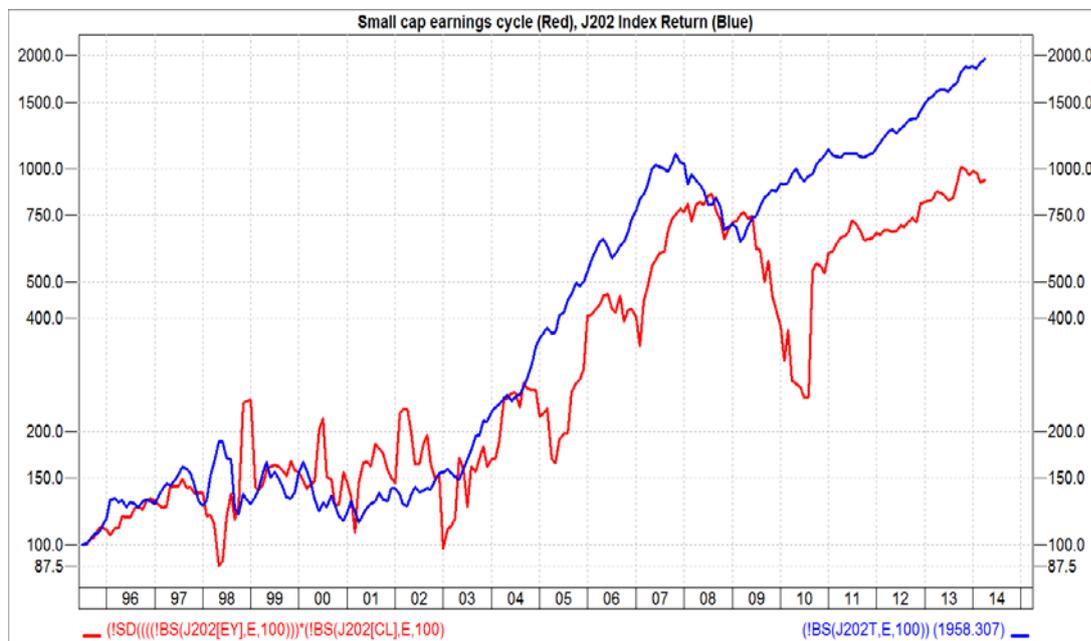


Pravin Gordhan promotes SME development

From the mid-1990s to the Great Recession, South Africa’s small and medium enterprises (SME’s) recorded strong earnings momentum, which was reflected in robust gains in total returns of the JSE’s small business index.

SME’s are relatively sensitive to the domestic demand cycle and some are highly geared thereto. Hence, the economic backdrop of the business cycle upswing from September 1999 to November 2007 was ideal for SME’s. As South Africa reduced tariff barriers and opened trade with the rest of the world, a marked improvement in domestic productivity sparked a private sector investment boom and overall GDP (Gross Domestic Product) growth. Meanwhile, a sharp decline in the level of government debt and a downward shift in inflation were accompanied by a decrease in interest rates – an ideal environment for SME’s.

Small cap stocks earnings and return



Source: I Net

The post-recession environment has been markedly different. Productivity growth is weak and government is dissaving. Given a slowdown in foreign capital inflows, reflected in the sharp

depreciation of the Rand, the onus has fallen on the private sector to save more. Hence, private sector demand (household consumption and fixed investment) growth has been curtailed.

Not only are SME's operating in a slow domestic demand growth environment, but interest rates have now also started to increase as the Reserve Bank raised its repo rate by 50 bp in January 2014.

The outlook for interest rates is currently strongly tied with prospects for the currency. South Africa is a small, open economy and the Reserve Bank is right to be concerned with the potential feed-through effect from Rand weakness to domestic inflation.

However, all we can currently say about the Rand is that we believe it is cheap and should appreciate at some point. That does not mean that the currency cannot fall further in the near term. We simply do not know, given the vagaries of global capital flows. That leaves the outlook for interest rates highly uncertain.

Still, one-off interest rate hiking cycles are rare and real short-term interest rates are at low levels. At some point we would expect real short-term rates to increase. Given the above, SME's are facing an environment that has become more challenging, to say the least. This is critical for the employment outlook. The Treasury noted in 2013 SME's account for some 55% of employment in South Africa. Hence, Minister Pravin Gordhan's increased focus on promoting small business development in South Africa.

From the National Treasury's 2014 Budget Review it appears as though the focus of the fiscal authorities is shifting from lowering tax rates for SME's to issues such as the funding of small business activity. Indeed, the Budget for 2014 contains proposals to enhance access to finance through the promotion of venture capital with emphasis on small businesses and junior mining companies.

The Treasury's proposals on the venture capital company regime listed in its Budget Review 2014 include:

- Making deductions permanent if investments are held for a specific period of time
- Allowing transferability of tax benefits when investors dispose of their holdings
- Increasing the total asset limit for qualifying investee companies from R20m to R50m (and from R300m to R500m in the case of junior mining companies)
- Waiving capital gains tax on disposal of assets and expanding the permitted business forms

Also, under consideration is tax relief for organisations promoting small business development through grants.

SME's face numerous constraints. Over and above a moderate domestic demand growth environment and increasing interest rates, they must cope with a lack of skilled artisans, infrastructure constraints, bureaucratic red tape and a lack of funding.

But, we can say government recognises this and is, at least, making a concerted effort to address the latter through not only the latest tax proposals contained in Budget 2014, but also through formerly introduced measures, including the introduction of funding support through the Industrial Development Corporation, the Department of Trade and Industry and the Small Enterprise Financing Agency.

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