



UNIVERSITY *of the*
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Evaluating the legal burden of Good Corporate Governance on Small and Medium Enterprises in South Africa in view of the Covid-19 pandemic

NAME: MOTSAMAI ATLEGANG
STUDENT NUMBER: 4119323
PROPOSED DEGREE: LLM IN MERCANTILE LAW
Supervisor: Prof RIEKIE WANDRAG
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RESEARCH PAPER SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE LLM DEGREE IN MERCANTILE LAW

DECLARATION

I, Atlegang Reuben Motsamai, declare that **Evaluating the legal burden of Good Corporate Governance on Small and Medium Enterprises in South Africa in view of the Covid-19 pandemic** is my own work, that it has not been submitted for any degree or examination at any other university, and that all the sources that I have used have been indicated and acknowledged by complete references.

Student: Atlegang Reuben Motsamai

Signature Motsamai Atlegang

Date 07 December 2021

Supervisor: Professor Riekie Wandrag

Signature



Date 8 /12/21



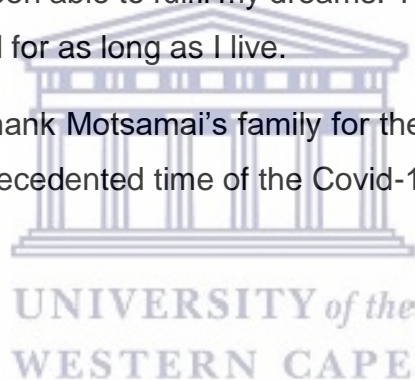
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I would like to thank God for giving me strength and courage to be able to complete my LLM degree. *'Have I not commanded you? Be strong and courageous. Do not be afraid; do not be discouraged, for the Lord your God will be with you wherever you go.'* (Joshua 1:9).

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ABBREVIATIONS

BBBEE	Broad Based Black Economic Empowerment
BCEA	Basic Conditions of Employment Act 75 of 1997
CEO	Chief Executive Officer
CPA	Criminal Procedure Act 51 of 1977
EEA	Employment Equity Act 55 of 1998
GDP	Gross Domestic Product
JSE	Johannesburg Stock Exchange
LRA	Labour Relations Act 66 of 1995
NDP	National Development Plan
NYDA	National Youth Development Agency
OECD	Organisation for Economic Co-operation and Development
PPE	Personal Protective Equipment
SA	South Africa
SARS	South African Revenue Services
SEDA	Small Enterprise Development Agency
SME	Small and Medium Enterprises
VAT	Value Added Tax



KEYWORDS

Corporate governance

Small and Medium Enterprises

Legislation

Regulations

Government

Covid-19 pandemic

Legal burden

King Report

Non-compliance

Economy

Unemployment

South Africa



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CHAPTER 1 INTRODUCTION

1.1 PROBLEM STATEMENT

In simple terms corporate governance can be defined as a system by which companies are directed and controlled by its board of directors.¹ Good Corporate Governance in a company is of prime importance as it ensure the effective running of the company, it also ensures that all the stakeholders of the organization follow appropriate and transparent decision-making processes and ensures that the best interest of all stakeholders are always considered and protected.² The G20/OECD Principles of Good Corporate Governance emphasise that the principle of good corporate governance includes compliance with the law.³ This research will focus on the legal burden of the good corporate governance principles imposed on small and medium enterprises in view of the Covid-19 pandemic.

It is important to note that there is no universally accepted definition of Small and Medium Enterprises.⁴ This is so because Small and Medium Enterprises differ in terms of their size, the number of employees, capital and sales.⁵ Each country in the world has its own definition of Small and Medium Enterprises based on their economic development.⁶ It is noteworthy to mention that in South Africa the term Small and Medium Enterprises is used interchangeably with the term Small Micro Macro and Medium Enterprises.⁷ In South Africa the definition of a small business or enterprise is provided for by section 1 of the National Small Business Amendment Act 29 of 2004 as

¹ Mongalo T 'The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa' (2003) 120 *SALJ* 173.

² 'Corporate Governance: Purpose, Examples, Structures and Benefits available at <https://youmatter.world/en/definition/corporate-governance-definition-purpose-and-benefits/> accessed on 27 April 2021.

³ OECD (2015) G20/OECD Principles of Corporate Governance available at <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> (accessed 12 May 2021).

⁴ Trybus M & Andrecka M 'Favouring Small and Medium Sized Enterprises with Directive 2014/24/EU?' (2017) 12 *European Procurement & Public Private Partnership Law Review* 226.

⁵ Le Fleur H *et al* 'Informal Small Meium And Micro Enterprises (SMME) Retailers in South Africa' 2014 *Skills Development for Economic Growth* 6.

⁶ Beyene A 'Enhancing the Competitiveness and Productivity of Small and Medium Scale Enterprises (SMEs) in Africa: An Analysis of Differential Roles of National Governments Through Improved Support Services' (2002) 27 *African Development* 133. (hereinafter Beyene 2002)

⁷ Fatoki O 'The impact of Entrepreneurial Resilience on the Success of Small and Medium Enterprises in South Africa' 2018 *Sustainability* 2.

“a separate and distinct business entity, together with its branches or subsidiaries, if any, including co-operative 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 1 of the schedule and [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.⁸

Summarily, the micro enterprises in South Africa have a maximum of five employees this includes *spaza* shops, the very small enterprises have a maximum of 20 workers, small enterprises have employees that are not more than 50 and the medium enterprises have employees that do not exceed 250 in number.⁹ The small and medium enterprises in South Africa find it difficult to succeed as a result of the stringent legal requirement imposed on them by the legal requirements *inter alia* labour laws and tax compliance regulations.¹⁰ This is the case because the majority of small and medium enterprises do not have the muscle to comply with the legal requirements.¹¹ The majority of small and medium enterprises lack financial stability and in most cases the majority of its owners have lower education level which makes it difficult for them to be able to comply with complex legal requirements.¹² Non-compliance with the law is bad corporate governance.¹³ For these reasons, it can then be said that the legal burden acts as an impediment against the success and growth of the small and medium enterprises in South Africa.¹⁴

Furthermore, the covid-19 lockdown regulations would serve as the best example, as the small and medium enterprises struggle to comply with the covid-19 regulations.¹⁵ The use of Personal Protective Equipment (PPE's) in the small and medium enterprises (hereinafter SMEs) was not always possible because of the fact that these

⁸ National Small Business Amendment Act 29 of 2004 s 1.

⁹ Fatoki O 'The Impact of Entrepreneurial Resilience on the Success of Small and Medium Enterprises in South Africa 2018 *Sustainability* 2.

¹⁰ Nieuwenhuizen C 'The effect of regulations and legislation on small, micro and medium enterprises in South Africa' 2019 *Development Southern Africa* 666.

¹¹ Abor J & Quartely P 'Issues in SME Development in Ghana and South Africa' 2010 *International Research Journal of Finance and Economics* 224.

¹² Ngek N B 'Determining high quality SMEs that significantly contribute to SME growth: regional evidence from South Africa' (2014) 12 *Problems and Perspectives in Management* 255.

¹³ OECD (2015) 13.

¹⁴ Beyene (2002) 134.

¹⁵ 'Reflections on the Impact of Covid-19 on small businesses (SMEs) in South Africa' 2020 *small business research specialists SBP* available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/Reflections-on-the-impact-of-COVID-19-on-small-businesses-SMEs-in-South-Africa-September-2020.pdf> (accessed on 28 April 2021).

enterprises do not make enough profit and buying PPE's would cost them.¹⁶ Social distancing was also an issue for the SMEs because some of their business premises are small and cannot accommodate a lot of people.¹⁷ For this reason, this research will evaluate the legal burden on small and medium enterprises in South Africa in view of the Covid-19 pandemic.

1.2 SIGNIFICANCE OF THE PROBLEM

SMEs in South Africa continue to struggle to cope with the legal burden imposed on them by the government which impedes the success and growth of SMEs.¹⁸ The challenges that SMEs face for compliance and the negative impacts of non-compliance is unbearable.¹⁹ This research will highlight the positive contribution made by the SMEs in the South African economy, its contribution on the reduction of the unemployment rate and also on its contribution to the GDP.²⁰ The legal burden of good corporate governance on SMEs discourages the establishment of SMEs which contributes to the high rate of unemployment and the declining economy.²¹ As a result, the marginalised members of the society are the ones to suffer the consequences thereof.

Without less stringent regulations or flexible legal requirements to ease the current existing legal burden on SMEs, the principles of good corporate governance would not be achieved. This is so, because the majority of the owners would resort to non-compliance with those legal requirements and non-compliance is bad corporate governance. For instance, tax evasion might be considered by the majority of SME owners as compliance with tax regulations is a burden to them.²² Of course, there are

¹⁶ Kalidas S, Magwentshu N & Rajagopaul 'How South African SMEs can survive and thrive post COVID-19 2020 *MicKinsey and Company* available at <https://www.mckinsey.com/featured-insights/middle-east-and-africa/how-south-african-smes-can-survive-and-thrive-post-covid-19#> (accessed on 29 April 2021).

¹⁷ Truter C 'Covid-19: The Impact on Businesses and Investments in South Africa' 2020 *Bowmans* available at <https://www.bowmanslaw.com/insights/mergers-and-acquisitions/covid-19-impact-on-businesses-and-investments-in-south-africa/> (accessed on 29 April 2021).

¹⁸ Abor J & Quartely P (2010) 224.

¹⁹ Abor J & Quartely P (2010) 224.

²⁰ Fatoki O 'The Impact of the Entrepreneurial Resilience on the Success of Small and Medium Enterprises in South Africa 2018 *Sustainability* 2.

²¹ Fatoki (2018) 2.

²² Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises' 2019 *Deloitte Africa Tax & Legal* available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed at 9 May 2021).

other factors that affect SMEs in South Africa such as; local economy, corruption, high crime rate, the cost of labour, lack of skills and experience.²³ Even if that is the case the regulatory burden has become the biggest inhibitor for business growth.²⁴ As a result, the legal burden is a major concern as the majority of SMEs find it difficult to comply with the regulatory requirements.²⁵ The cost of employment is unreasonably high as they do not have employees such as company secretary and attorneys or the internal capacity to attend to regulatory requirements and outsourcing such functions is onerously expensive.²⁶

1.3 RESEARCH PROBLEM

According to the research and report of University of the Western Cape, between 70 and 90 percent of Small businesses fail within 5 years of their establishment.²⁷ It is submitted, that the SMEs experience challenges which makes it difficult for them to be compliant with the law and as a result these enterprises end up suffering the negative impact of non-compliance.²⁸ For this reason, the purpose of good corporate governance practices cannot be realised.²⁹ The research paper will investigate how the SMEs are affected by the legal burden imposed on them by the regulations of the law. This is the overarching question that this paper seeks to answer, by *inter alia*, evaluating how the legal burden on SMEs can be minimized to avoid the negative impact such burden has on the aforementioned companies. The link between legal principles and the principle of good corporate governance will be drawn.

²³ Olawale F and Garwe D 'Obstacles to the growth of new SMEs in South Africa: A principal component analysis approach' (2010) 4 *African Journal of Business Management* 731-732.

²⁴ Niewenhuizen C (2019) 667.

²⁵ Leboea T S *The Factors Influencing SME Failure in South Africa* (Unpublished Master of Commerce in Development Finance Degree, University of Cape Town 2017) 73.

²⁶ Niewenhuizen C (2019) 670.

²⁷ Eva Financial Solutions 'South Africa: Why Do Small Business Fail?' 2019 available at <https://www.mondaq.com/southafrica/corporate-governance/869762/why-do-small-businesses-fail#:~:text=According%20to%20research%20and%20report,businesses%20fail%20with%205%20years> (accessed on 12 May 2021).

²⁸ Masutha M & Rogerson CM 'Small business incubators: An emerging phenomenon in South Africa's SMME economy' (2014) 25 *Urbania Izziv* 60.

²⁹ King IV Report on Corporate Governance for South Africa (2016) 59.

1.4 RESEARCH QUESTION

The research will evaluate the legal burden of good corporate governance on Small and Medium Enterprise in South Africa in view of the Covid-19 pandemic. In order to do this the research will discuss the following:

- The principle of good corporate governance in South Africa and the benefits of complying with the principle of good corporate governance.
- Why the legal burden on Small and medium enterprises should be reduced taking into account the positive contribution of these enterprises in the reduction of poverty and the economic growth.
- The legal burden on SMEs and the negative impact of non-compliance with the principle of good corporate governance. The latter will be discussed in view of section 332(1) of the CPA.

Discussing the abovementioned questions will assist this research to achieve its main goal of trying to draw a link that exist between the legal burden on SMEs and the principle of good corporate governance.

1.5 LIMITATION OF THE STUDY

It is submitted that there are many factors that affect SMEs in South Africa which includes but are not limited to; access to markets, lack of finances, poor infrastructure and high level of crime.³⁰ However, this research is limited to evaluating the legal burden of good corporate governance on SMEs. Therefore, it argues that it is important to make the law regulating corporate entities to be flexible in order to accommodate SMEs. This is important as SMEs play a major role in the economy of South Africa, in the creation of jobs and GDP.³¹ Furthermore, it can also be said that the legal burden in SMEs restrict potential entrepreneurs to start their own businesses in the country. The flexibility of the law in this regard will boost their confidence to establish their small businesses in South Africa.

³⁰ Chimucheka T 'Overview and Performance of the SMMEs Sector in South Africa' 2013 *Mediterranean Journal of Social Sciences* 786 789.

³¹ Ayyagari M, Beck T & Demirgüç-Kunt A 'Small and Medium Enterprises across the Globe' (2007) 29 *Small Business Economics* 415.

1.7 CHAPTER OUTLINE

Chapter one provided the research outline. From the onset, a general synopsis of the research topic was given to enable the reader to have a mind map of the research. The chapter also provided the problem statement, the significance of the problem, research question, limitation of the study, chapter outline and lastly the research methodology.

Chapter two discusses the benefits of good corporate governance and also the negative impacts of non-compliance with the principle of good corporate governance.

Chapter three discusses the current legal framework regulating the SMEs in South Africa. The link between the good corporate governance practices and the law will be drawn.

Chapter four discusses the role that Small and Medium Enterprises play in the South African economy. In this chapter the legal burden of good corporate governance on SMEs will be discussed.

Chapter Five provides conclusions and recommendations for the legal burden imposed on the SMEs. The recommendations are aimed at mitigating the negative impacts of the legal burden on SMEs, so as to encourage business establishments and growth which would benefit South Africa.

1.8 RESEARCH METHODOLOGY

This research study is a desktop-based study which will make use of primary and secondary sources. This includes books, journal articles and government publications. Moreover, legislation, international and foreign sources and lastly internet sources would be considered.

CHAPTER 2

THE PRINCIPLE OF GOOD CORPORATE GOVERNANCE IN SMEs

2.1 INTRODUCTION

This research paper seeks to evaluate the legal burden of good Corporate Governance on SMEs in South Africa in view of the Covid-19 pandemic. It is therefore important to provide a detailed discussion of the principle of good corporate governance. The author will therefore outline the benefits of the principle of good corporate governance for corporate entities with specific reference to SMEs. Furthermore, it is also important to highlight the relations between the principle of good corporate governance and SMEs. There are on-going debates as to whether corporate governance is also applicable to SMEs or is only limited to larger corporate entities.³² The question as to whether the principle of good Corporate Governance is applicable to the SMEs will be answered.

2.2 CORPORATE GOVERNANCE

It was earlier mentioned that corporate governance is usually defined as a system by which companies are directed and controlled by its board of directors.³³ The King IV report provides that governance is a way of supporting ethical and effective leadership by the corporate governing body in order to achieve the following outcomes: legitimacy, good performance, ethical culture and effective control.³⁴ Corporate governance entails a set of rules governing the relationship between a corporate's management, its board, shareholders and other stakeholders.³⁵ Cassim writes that Corporate Governance are those structural mechanisms and processes associated with management, decision-making and control in organisations.³⁶ It can therefore be said that corporate governance includes the set of all legal, cultural and institutional framework that determine what corporate entities can do, who controls them, the

³² Sibanda H, Sibanda K & Pooe D 'The impact of corporate governance on firm competitiveness and performance of Small and medium enterprises in South Africa: A case of Small and medium enterprise in Vanderbijlpark 2013 *Independent Research Journal in the Management Sciences* 11.

³³ Mongalo T 'The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa' (2003) 120 *SALJ* 173.

³⁴ King IV Report on Corporate Governance for South Africa (2016).

³⁵ Abdulla H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' 2009 *Middle Eastern Finance and Economics* 89.

³⁶ Cassim F et al *Contemporary Company Law* 2 ed (2021) 472.

exercise of such control, and how the risks and returns from the decisions and actions that were taken are allocated.³⁷

The G20/OECD states that Corporate Governance provides the structure through which the objectives of the company are set, and the means of achieving those objectives and monitoring performance are determined.³⁸ The principle of Corporate Governance in a corporate entity is of prime importance as it ensures that all the stakeholders of the organisation follow appropriate and transparent decision-making processes and ensure that the best interest of all stakeholders are always considered and protected.³⁹

2.3 THE ELEMENTS OF CORPORATE GOVERNANCE

There are a variety of elements of the principles of good corporate governance which includes; leadership, transparency, accountability, integrity and fairness.⁴⁰ There must be a capable and competent leadership to ensure that these principles of good corporate governance are adhered to.⁴¹ Effective leadership is important as every component of the corporate depends heavily on it.⁴² Effective leadership is vital in every type of corporate entity including in the SMEs. Leadership capacity is necessary for the growth and success of SMEs as these enterprises struggle to succeed. The owners of SMEs must have leadership capacity in order to make the SME functional and operational at all material times.

Secondly, transparency is also one of the important principles of good corporate governance.⁴³ It is important in the sense that all relevant stakeholders have to know and to be informed of any corporate's activities.⁴⁴ There must be openness and willingness by the corporate to furnish clear and true information to the stakeholders

³⁷ Davis G F 'New Directions in Corporate Governance' (2005) 31 *Annual Review of Sociology* 143.

³⁸ G20/OECD Principles of Corporate Governance (2015) 9.

³⁹ Pearse Trust 'The Core Principles of Good Corporate Governance' available at <https://www.pearse-trust.ie/blog/bid/108866/the-core-principles-of-good-corporate-governance> (accessed 02 June 2021).

⁴⁰ King IV Report on Corporate Governance for South Africa (2016).

⁴¹ Donaldson T & Preston L 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications' (1995) 20 *Academy of Management Review* 79.

⁴² Institute of Directors Southern Africa *King IV: Report on Corporate Governance for South Africa* (2016) 20.

⁴³ Deloitte 'King IV Bolder than ever' available at <https://www2.deloitte.com/za/en/pages/africa-centre-for-corporate-governance/articles/kingiv-report-on-corporate-governance.html> (accessed on 2 May 2021).

⁴⁴ Letza S, Sun X & Kirkbride J 'Shareholding Versus Stakeholding: a critical review of corporate governance (2004) 12 *Corporate Governance: An International Review* 249.

and to all shareholders.⁴⁵ Transparency is important as it causes stakeholders to be confident in the corporate entity, it ensures that all relevant stakeholders know and are informed of any corporate's activities.⁴⁶ For instance, financial documents should be disclosed and its figures should be truthful and accurate.⁴⁷ Similarly, the disclosure requirement is also applicable to the SMEs as this requirement is applicable to all corporate entities.⁴⁸ Be that as it may, this disclosure requirements cannot be expected to place administrative burdens or cost burdens which are unreasonable on enterprises,⁴⁹ in particular the SMEs. Moreover, these entities cannot disclose information that may impact negatively on their competitive advantage unless such disclosure is really necessary.⁵⁰

Thirdly, accountability is also of outmost importance.⁵¹ The board of directors have the responsibility and obligation to provide sufficient reasons and explanations for the company's actions.⁵² An owner/s of the SME or any person who makes a decision on its behalf on matters in relation to these entities must be accountable to the SME and to the regulators which includes the government and law officials.

Fourthly, the principle of fairness must always be upheld by the corporate's directors.⁵³ This includes equal and fair treatment for all its workers, shareholders and all the relevant stakeholders.⁵⁴ It is a challenge to apply this principle on SMEs as a result of the agency problem as in some instances there is no separation of duties between shareholders, directors, managers and employees. Due to the small size of these entities the owner in most cases undertakes all the duties.⁵⁵ Notwithstanding, the fact that SMEs experience an agency problem, the principle of fairness can still be

⁴⁵ Letza S, Sun X & Kirkbride J 'Shareholding Versus Stakeholding: a critical review of corporate governance (2004) 12 *Corporate Governance: An International Review* 243.

⁴⁶ Institute of Directors Southern Africa (2016) 22.

⁴⁷ Gevurtz F A 'The Role of Corporate Law in Preventing a Financial Crisis: Reflections on In re Citigroup Inc. Shareholder Derivate Litigation (2010) 23 *Global Business & Development Law Journal* 145.

⁴⁸ Institute of Directors Southern Africa (2016) 22.

⁴⁹ G20/OECD Principles of Corporate Governance 41.

⁵⁰ G20/OECD Principle of Corporate Governance 41.

⁵¹ Deloitte 'King IV Bolder than ever' available at <https://www2.deloitte.com/za/en/pages/africa-centre-for-corporate-governance/articles/kingiv-report-on-corporate-governance.html> (accessed on 2 May 2021).

⁵² Mongalo T 'The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa' 2003 *SALJ* 185.

⁵³ Companies Act 71 of 2008, s 76.

⁵⁴ Esser I & Delpont PA 'Shareholder protection Philosophy in terms of the Companies Act 71 of 2008' (2016) 79 *Journal of Contemporary Roman-Dutch Law* 1.

⁵⁵ Sibanda H, Sibanda K & Pooe D (2017) 1.

applicable by the owner of such entity by ensuring that he deals with all customers and suppliers fairly and provide equal treatment to all those he engages in business transactions with. In addition, directors or owners of the SMEs should have integrity and also act in accordance with their fiduciary duty.⁵⁶

The other fundamental element of corporate governance is the principle of discipline. The role of the board is to discipline those in senior management positions such as the CEO of the company.⁵⁷ Discipline is equally important for SMEs especially because the owner is also the director, the manager and also the worker, discipline is about the owners ability to hold himself accountable and to continue doing the work even if there is no one from the top management positions who directs and controls him. Discipline also means not to allow either internal and external forces to convince you that things cannot work for the best.⁵⁸ Avoiding people or circumstances which create doubt, lower your integrity or morals requires discipline.⁵⁹ The discipline that SMEs owners display have a strong impact on their stakeholders and clients.⁶⁰

Corporate entities by their nature experience risk,⁶¹ it is advisable that owners of SMEs have good risk management strategies in order to avoid or minimize the risk such enterprises might experience and ensure that the loss or harm that the enterprise might suffer as a result of such risk is well calculated. Risk management strategy is being able to circumvent the risk, being able to mitigate it or being able to eliminate it entirely. Risk management is of outmost importance for Small and Medium Enterprises, as these enterprises are small and some are at the survival stage and therefore cannot afford any loss especially of monetary value. For this reason, it is submitted that SMEs should have risk management strategies as they need it even more than the larger corporate entities because SMEs are disadvantaged and vulnerable.

⁵⁶ Companies Act 71 of 2008, s 76.

⁵⁷ Nicholson J G & Kiel C G 'Can Directors Impact Performance? A case-based test of three theories of corporate governance' (2007) 15(4) *Corporate governance* 602.

⁵⁸ The Online Resources for the Painting Industry 'The Case for Discipline in Small Business' available at <https://bloggingpainters.com/the-case-for-discipline-in-small-business/> (accessed 10 August 2021).

⁵⁹ The Online Resources for the Painting Industry 'The Case for Discipline in Small Business' available at <https://bloggingpainters.com/the-case-for-discipline-in-small-business/> (accessed 10 August 2021).

⁶⁰ The Online Resources for the Painting Industry 'The Case for Discipline in Small Business' available at <https://bloggingpainters.com/the-case-for-discipline-in-small-business/> (accessed 10 August 2021).

⁶¹ Kopel S *Guide to Business Law* 5th ed (2012) 828.

The principles of good corporate governance demands directors to uphold the law this includes ethical conduct, legislation and king reports.⁶² Principle 13 of the King IV Report requires companies to adhere to statutory obligation, disclose measures to mitigate non-compliance and disclose repeat non-compliances and sanctions imposed.⁶³ Corporate entities should comply with the law and this law includes the principle of good corporate governance, non-compliance with the law is not good corporate governance. It is therefore believed that the SMEs should comply with the King Reports III and IV on corporate governance principles and standards applicable to them in order to enjoy the benefits of good corporate governance,⁶⁴ such benefits will be discussed below.

2.4 THE BENEFITS OF CORPORATE GOVERNANCE

Corporate entities can enjoy many benefits of corporate governance by implementing the principles of good corporate governance in their business practices.⁶⁵ Corporate governance is applicable to all corporate entities whether private or public, big or medium or small, well established or early stage, they compete in an environment where the principle of corporate governance is the order of the day.⁶⁶ It is for these reasons, that a one-size-fits-all approach for all these different entities is not logically suitable and practically possible.⁶⁷ It is essential that companies implement corporate governance mechanisms and practices that are suitable for them.⁶⁸ The King IV report have the sectoral determination divided into specific categories of organisations in order to encourage the acceptability of corporate governance and ensures that corporate governance is fit for application across all sectors irrespective of the type of the organisation, size, complexities and resources.⁶⁹ In light of this it is argued that the sectoral determination is limited in application is it is only provided for in the King report and not in legislations governing corporate entities. The requirement provided by Principle 13 of King Report IV provides that companies are required to adhere to

⁶² King IV Report on Corporate Governance for South Africa (2016).

⁶³ King IV Report on Corporate Governance for South Africa (2016).

⁶⁴ Sibanda H, Sibanda K & Pooe D (2017) 9.

⁶⁵ Sibanda H, Sibanda K & Pooe D (2017) 9.

⁶⁶ Radebe MS 'The benefits of good corporate governance to small and medium enterprises (SMEs) in South Africa: A view on top 20 and bottom 20 JSE listed companies' (2017) 15(4) *Problems and Perspective in Management* 273.

⁶⁷ Institute of Directors Southern Africa (2016) 35.

⁶⁸ Du Plessis JJ et al *Principle of Contemporary Corporate Governance* (2005) 11.

⁶⁹ King IV Report of Corporate Governance (2016).

statutory obligations. This principle applies to all corporate entities and by statutory obligations it refers to all statutes which regulates and govern companies which includes tax legislations, labour legislations, National Minimum Wage Act and Companies Act. These aforementioned legislations do not provide for the sectoral determinations which will divide large corporate entities from SMEs. It is for this reason submitted that Principle 13 of King IV is not practical in application if SMEs are to be regulate and governed in the same manner as large corporate entities by statutes that also applies to SMEs.

The SMEs should incorporate the principle of corporate governance in their policies and practices as it will positively contribute to its growth, performance and give it a competitive advantage.⁷⁰ Some of these benefits may assist the corporate entity in ensuring that there is a better corporate governance behavior, better performance and development and also assist in preparing for any eventuality.⁷¹

2.4.1 Positive corporate behaviour

The benefit of a good corporate governance is that it encourages positive behaviour. It is in the best interest of the corporate that its directors uphold a good corporate governance culture as it encourages respect towards the management of the corporate and the rest of the organisation. A positive behaviour or attitude in a corporate is essential as it ensures that there is dedication, commitment and hard work in a company, it also ensures that there is a good working relationship amongst workers and amongst stakeholders. A positive attitude in a corporate also ensures that there is some internal control which will in turn ensure that there is certainty of the results. Further, positive attitude and behaviour is important as it create better relations with other stakeholders.⁷² This is important more especially to SMEs because these enterprises have a direct relationship with customers as they market their products at close contact to their prospective customers.

In addition, the principle of good corporate governance encourages corporate entities to have socially responsible behaviour.⁷³ The corporate's positive attitude towards the

⁷⁰ Radebe MS (2017) 273.

⁷¹ Claessens S 'Corporate Governance and Development' (2006) 21 *The World Bank Researcher Observer* 100.

⁷² Claessens S (2006) 107.

⁷³ Claessens S (2006) 108.

environment and giving back to the society for instance donating to social charity can create positive externalities in the form of better relationships with other stakeholders.⁷⁴ One may ask whether SMEs are also expected to have social responsible behaviour since it is costly and these entities are small and cannot afford to be socially responsible for instance not being able to donate money to charity organisations. It is not mandatory that giving back to the society should only be of monetary value. SMEs can physically contribute to the society for example by visiting schools and giving learners words of encouragement and hope. SMEs owners can also make themselves available by cleaning the premises of a public institution.

2.4.2 Reduce risk

The transparency element of the principle of corporate governance applied in corporates following good governance practices minimises the amount of risks of corruption and mismanagement such company should have suffered had they not applied the principle of transparency.⁷⁵ This is evident from the fact that many companies have suffered the consequences of fraud and corrupt practices.⁷⁶ Both the private sector and public sector have an obligation to fight corruption.⁷⁷ Good corporate governance practices can protect the company against fraud and company collapse by assisting the company to conduct its affairs with integrity and honesty.⁷⁸ Corporate governance reduces the risk of going for short-term gains that jeopardises the longer term viability of the corporate.⁷⁹ It can also be said that good corporate governance can reduce cost of capital as it would be able to foresee potential risks.⁸⁰ In view of the Covid-19 pandemic SME owners should ask themselves whether their SME will survive the risk of another global pandemic that affects businesses, and prepare themselves for the possibility of another global pandemic in order to avoid the challenges they experienced during the Covid-19 pandemic.

⁷⁴ Claessens S (2006) 108.

⁷⁵ Radebe MS (2017) 274.

⁷⁶ Fernando AC *Business Ethics and Corporate Governance* (2010) 202.

⁷⁷ Institute of directors in South Africa Guidance for Boards – *Governance challenges facing SMEs* (2020) 6.

⁷⁸ Hendrikse JW & Hendrickse LH *Corporate Governance Handbook Principles and practice* (2012) 104.

⁷⁹ Institution of Directors in South Africa (2020) 6.

⁸⁰ Rathod L 'Boardroom Best Practices: 6 Ways Boards Benefit From Good Corporate Governance' available at <https://diligent.com/en-gb/blog/6-ways-boards-benefit-from-good-corporate-governance/> (accessed 22 March 2021).

2.4.3 Sustainable growth

An SME that is guided by the principle of good corporate governance will be able to achieve the trust of the community and thus gaining success in the long run.⁸¹ Corporate governance in an SME is essential because it promotes better decision making, this is important because corporate entities make decisions at all material times. A corporate governance framework will enhance the decision making process that will benefit the corporate entity especially in ensuring that the decision maker look at the long as well as the short term effects which will contribute to the sustainable growth of the corporate.⁸² Corporate governance practices also attract talented directors and this helps with bringing new skills that would be of appreciable help to the corporate thereby, assisting with the comprehensive assessment of the sustainability of the organization.⁸³

2.4.4 Improved operational performance

Companies with effective corporate governance normally performs. Corporate governance can have a great impact on the internal operations of a company.⁸⁴ The main aspects of the internal operations include, *inter alia*, shareholder activism, transparency issues, strategic direction and financial expectation.⁸⁵ Effective corporate governance can add value by improving the performance of corporate entities, through more efficient management, better asset allocation, better labour regulations, or similar efficiency improvements.⁸⁶ Moreover, the need and benefits of the corporate governance enables better strategic planning, it reduces wastage as employees who are trained to follow good ethical practice will avoid excess wastage of company resources.⁸⁷ The ability of the SME to avoid unnecessary mistakes will result in good operational performance. Donors are more likely to provide financial assistance to SMEs where corporate governance principles are implemented and

⁸¹ Radebe MS (2017) 274.

⁸² Institution of Directors in South Africa (2020) 6.

⁸³ Rathod L 'Boardroom Best Practices: 6 Ways Boards Benefit From Good Corporate Governance' available at <https://diligent.com/en-gb/blog/6-ways-boards-benefit-from-good-corporate-governance/> (accessed 22 March 2021).

⁸⁴ Abor JY & Adjasi CKD (2007) 115.

⁸⁵ Abor JY & Adjasi CKD (2007) 115.

⁸⁶ Claessens S (2016) 103.

⁸⁷ Radebe MS (2017) 274.

practiced, this serves as an assurance that their money will be put to good use and will be properly managed.

2.4.5 Better succession planning

Many SMEs by their nature are typically the product of an individual's vision and drive.⁸⁸ It is necessary that the owner who is also the director in most cases consider who would replace him in the case of any eventuality such as death, illness or an accident.⁸⁹ Governance that focuses primarily on risk management and sustainability compel the founder to consider the issue of succession in good time and provide the framework for long-term sustainability even if he is no longer part of the corporate. If there are corporate governance guidance, policies, procedures, codes of conduct and so on in place, it will be easier for the business to continue being run as the founder would wish.⁹⁰

2.4.6 Higher firm valuation

The quality of corporate governance framework can also affect the cost of capital and firm valuation.⁹¹ A business governed in accordance with the principle of good corporate governance is more saleable and have higher value because it can prove its capacity and performance convincingly. The founder or owner of the SME can decide to sell it to the market for cash, but it might also be as part of a merger/ takeover with another company which the founder will be part of.⁹² In either event, a business operated in accordance with the principle of good corporate governance is a more attractive target and generates a higher valuation for the seller.⁹³

2.4.7 Builds confidence amongst stakeholders

The rights of stakeholders are recognised as part of the governance process by the principle of good corporate governance. These stakeholders play significant role in the corporation as these groups monitor, discipline, motivate, and affect management and

⁸⁸ Institute of Directors in South Africa (2020) 6.

⁸⁹ Institute of Directors in South Africa (2020) 6.

⁹⁰ Institute of Directors in South Africa (2020) 6.

⁹¹ Claessens S (2016) 102.

⁹² Institute of Directors in South Africa (2020) 5.

⁹³ Institute of Directors in South Africa (2020) 5.

the corporate in various ways.⁹⁴ Even the SMEs have stakeholders this includes its suppliers, customers, staff and all interested parties.⁹⁵ This group of stakeholders can increase as the business grows, and with time it will include investors, regulatory bodies, the local community and lenders and others.⁹⁶ All of this will build comfort in prospective stakeholders as they will be well convinced that the SME has implemented corporate governance principles and thus is planning to continue trading into the future. In addition to this, Corporate governance gives corporate reputation and recognition in the sense that it allows companies to gain the trust of the members of the society, investors and customers.⁹⁷ Such reputation can in turn be used as a marketing tool.⁹⁸

2.5 THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND SMEs

The concept of corporate governance has always been associated with larger corporates.⁹⁹ This is the case because of the existence of the agency problem in such companies.¹⁰⁰ The existence of agency theory is a problem because of the fact that owners of SMEs are the directors and managers and assume many other positions within the company (SME).¹⁰¹ In practice, SMEs tend to have a less pronounced separation of ownership and management than larger firms.¹⁰² Notwithstanding, the aforementioned argument the OECD provides accordingly that good corporate governance underpins market confidence, integrity and efficiency and hence promotes economic growth and financial stability.¹⁰³

The principle of good corporate governance ensures safeguards against mismanagement of funds, as it ensures that SMEs are well managed and therefore increase proper flow of financial capital.¹⁰⁴ Corporate governance can also increase Investment in the SME because it acts as a mechanism to attract and provide comfort

⁹⁴ Claessens S (2016) 107.

⁹⁵ Institute of Directors in South Africa (2020) 6.

⁹⁶ Institute of Directors in South Africa (2020) 6.

⁹⁷ Radebe MS (2017) 274.

⁹⁸ Institute of Directors in South Africa (2020) 6.

⁹⁹ Abor JY & Adjasi CKD (2014) 117.

¹⁰⁰ Sibanda H, Sibanda K & Pooe D (2017) 1.

¹⁰¹ Shezi M *SMEs corporate governance systems: status and effect on continuity* (unpublished MBA thesis, University of Pretoria 2013) 34.

¹⁰² Abor JY & Adjasi CKD (2014) 117.

¹⁰³ G20/OECD Principles of Corporate Governance (2015) 9.

¹⁰⁴ Corporate Governance 'Corporate Governance of Small and Medium Enterprises' available at https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/topics/sm/all+and+medium+enterprises (accessed 6 June 2021).

to potential investors that there is a high chance that their investment will bear returns through management and processes set in place by the corporate governance framework.¹⁰⁵ It can also be said that firm value or the corporate value is normally linked with the level of its corporate governance practice.¹⁰⁶ Corporate governance can take the SMEs from a survival stage incapable of growing past the abilities of its owners into becoming a company with factual and sustainable growth through improved competitiveness, firm performance and value.¹⁰⁷ Corporate governance is an essential key which unlocks the true value of a company regardless of its size.¹⁰⁸

In this country, some development agencies and the government are undertaking some efforts to encourage SMEs to comply with the principle of good corporate governance.¹⁰⁹ Some of the efforts include the promulgation of the King Report III in 2009,¹¹⁰ and also the King Report IV in 2016, which have incorporated some corporate governance principles and practices that accommodate SMEs.¹¹¹ Therefore, it is clear that good corporate governance principles are not only applicable to larger companies, but to all companies regardless of their size or extend of their operations. All companies can achieve benefits from establishing and implementing corporate governance systems.¹¹²

2.6 THE LEGAL FRAMEWORK OF CORPORATE GOVERNANCE IN SA

The corporate governance framework in South Africa includes; the common law, case law, regulations, the listing requirement of the JSE and both the South African and international codes of best practice.¹¹³ The primary source of company law in South Africa currently is the Companies Act of 2008.¹¹⁴ South Africa's corporate governance

¹⁰⁵ Radebe MS (2017) 274.

¹⁰⁶ Dzigba D 'Corporate Governance Practice among Small and Medium Scale Enterprises (SMEs) in Ghana; Impact on Access to Credit' (Unpublished MBA Thesis, School of Management, 2015) 15.

¹⁰⁷ Sibanda H, Sibanda K & Pooe D (2017) 1.

¹⁰⁸ Sibanda H, Sibanda K & Pooe D (2017) 1.

¹⁰⁹ Sibanda H, Sibanda K & Pooe D (2017) 2.

¹¹⁰ King III Report on Corporate Governance for South Africa (2009).

¹¹¹ King IV Report on Corporate Governance for South Africa (2016).

¹¹² Partner AJ 'Corporate governance for small-to-medium enterprises (SMEs)' available at <https://www.swaab.com.au/publication/corporate-governance-for-small-to-medium-enterprises-smes> (accessed 05 June 2021).

¹¹³ Naidoo R *Corporate Governance: An Essential Guide for South African Companies* 2 ed (2009) ch 3.

¹¹⁴ Companies Act 71 of 2008.

system is a hybrid system of law and its governance is guided by the common law.¹¹⁵ The company law and legal system of South Africa originated from British common law.¹¹⁶ From 1961 to 1994 South Africa was totally excluded from the global economy as a result of the apartheid system, South Africa was not part of the United Nations and therefore it was unable to participate on international organisations.¹¹⁷ The economic and trade sanctions were imposed against South Africa making it impossible if not difficult for South Africa to export and import goods and services to and from other countries.¹¹⁸ The sanctions imposed on South Africa affected the country's market as it did not have interaction with foreign capital markets, foreign corporate practices, laws and regulations.¹¹⁹ As a result, the South African corporate governance principles and practices did not conform to international standards.¹²⁰

South Africa joined international organisations and other countries started to have business relationships with the country after apartheid came to an end in 1994.¹²¹ As a result, there was a need for South Africa to incorporate sound corporate governance principles and practices in their legal system.¹²² South Africa has a unitary type of board structure, in which the board of directors manages the company and thus can delegate management functions to any directors, committee officers and employees.¹²³ The South African board structure is provided for in all King Reports that contain the code of corporate governance and the king codes influence the governance practices of many companies in South Africa.¹²⁴

The first King Report is the King I report on corporate governance which was published in 1994, it served as a reference for legislators in the development of legal and

¹¹⁵ William J & Yanis K 'Corporate Governance and Directors Duties in South Africa: A Review of Corporate Governance Trends' available at <https://uk.practicallaw.thossonreuters.com> (accessed 1 April 2021).

¹¹⁶ Strydom H et al *International Law* (2016) 47.

¹¹⁷ Strydom H et al (2016) 47.

¹¹⁸ Strydom H et al (2016) 47

¹¹⁹ Afolabi A 'Examining Corporate Governance Practices in Nigeria and South African Firms' (2015) 3 *European Journal of Accounting Auditing and Finance Research* 12.

¹²⁰ Afolabi A (2015) 12.

¹²¹ Afolabi A (2015) 12.

¹²² Afolabi A (2015) 12.

¹²³ William J & Yanis K 'Corporate Governance and Directors Duties in South Africa: A Review of Corporate Governance Trends' available at <https://uk.practicallaw.thossonreuters.com> (accessed 1 April 2021).

¹²⁴ Olson J F 'South African moves to a global model of corporate governance but with important national variations' 2010 *Acta Juridica* 233.

regulatory frameworks for corporate governance.¹²⁵ This King report recommended that all stakeholders should be part of the corporate governance practices of corporate entities.¹²⁶ It provided standards of conduct for boards and directors of companies listed on the Johannesburg Stock Exchange (JSE) such as financial, non-financial and state-owned companies. The King I Report of Corporate Governance included the following aspects of corporate governance; the composition, role and guidance on the category of board of directors, and it also covered the determination and disclosure of directors' remuneration, requirements for effective auditing and balance of annual reporting.

In March 2002 the King II Report was published by the King Committee. King II was a review of the King I Report as there was a need to include both the local and international developments on King Reports of Corporate Governance. South Africa like many other developing countries have a huge responsibility when developing corporate governance, in the sense that they are not only limited to considering the issues of corporate collapse and accounting practices but they have a broader responsibility of also considering the effects of corporate governance reforms on the economy of the country and on the economy globally and balance a locally acceptable and relevant corporate governance strategy with the need to meet international expectations.¹²⁷ King II Report showed that there is a clear link between economic and societal goal and such link must be considered at all material times when developing corporate governance frameworks in South Africa.¹²⁸ It can therefore be said that the King II report was a move from a shareholder approach to the stakeholder approach which embraced the environmental, economic and social aspects of a company's activities.¹²⁹ King II Report introduced new sections of risk management, the role of the corporate board and sustainability.¹³⁰

King III Report of corporate governance practice was published in September 2009. This code of corporate governance practices came with a fundamental move from a

¹²⁵ Afolabi A (2002) 15.

¹²⁶ King I Report of Corporate Governance for South Africa 1996.

¹²⁷ Andrew W 'Theorising South Africa's Corporate Governance' (2006) 68(4) *Journal of Business Ethics* 435.

¹²⁸ Afolabi A (2015) 15.

¹²⁹ Olson J F (2010) 222.

¹³⁰ Afolabi A (2015) 15.

'comply or explain' approach to a principle based on 'apply or explain' approach.¹³¹ The principle of 'comply or explain' approach of the King II Report was an approach that sought to enforce compliance and impose sanctions for non-compliance, it recognised that the 'one-size-fits-all' approach in corporate governance is not possible.¹³² King III Report is founded on the 'apply or explain' approach which simply means that companies and its directors must apply the principles outlined in King III report, if not applied they must explain their reasons as to why King III was not followed.¹³³ It is however important to take into cognisance the fact that some of the corporate practices are incorporated into the Companies Act and therefore failure to apply them might cause the company to suffer legal consequences of non-compliance.¹³⁴ In addition to that, King III also makes provision for corporate principles (in accordance with the Act) which are mandatory and others are peremptory hence the word 'must' and 'should' is used to distinguish this because of this reason companies cannot decide not to apply them because consequences might follow for non-compliance.¹³⁵

The King IV Report was published in November 2016 because of significant corporate governance and regulatory changes both locally and internationally.¹³⁶ The King IV Code lays out the theory, values, practices and results which serve as the benchmark for corporate governance in South Africa. King IV Report adopted an 'apply and explain' explain approach different from the 'apply or explain' approach of King III Report. The 'apply and explain' approach of the King IV report is important because it encourages organisations to apply principles of corporate governance by helping organisations realise the benefits of corporate governance.¹³⁷ Put differently, this approach makes organisations realise that corporate governance would not be in

¹³¹ Afolabi A (2015) 15.

¹³² Naidoo R (2009) 35.

¹³³ King III Report on Corporate Governance for South Africa 2009.

¹³⁴ Companies Act 71 of 2008.

¹³⁵ Naidoo R (2009) 35.

¹³⁶ King IV Report on Corporate Governance for South Africa 2016.

¹³⁷ Natesan P & du Plessis P 'Why King IV's "apply and explain" is so important' available at <https://www.iodsa.co.za/news/438882/Why-King-IVs-apply-and-explain-is-so-important.htm> (accessed 16 August 2021).

existence, or worth of implementation, if it did not have positive outcomes for organisations and their bottom line.¹³⁸

King Code IV provides seventeen principles as a guideline for Organisations to implement good corporate governance practices.¹³⁹ These principles are divided into four categories; principles for entities ethical cultures, performance, and value creation and lastly principles for trust, good reputation and legitimacy.¹⁴⁰ Unlike King III, King IV provides for sector supplements that provides guidance that apply specifically to certain categories of organisations and sectors. These sector supplements include; pension funds, public sector organisations and entities, non-profit organisations and SMEs.¹⁴¹ It is important to emphasise that the use of the aforementioned principles by corporations is voluntary except and it is not legally binding except for JSE listed companies, however, that does not mean that there will be no legal consequences to entities that does not comply with corporate governance principles because the courts can in a particular circumstance take corporate governance principles in consideration when making a verdict.¹⁴²

It is even stated in the King IV Report that a court will consider principles of King IV when evaluating what is regarded as practice on a case by case basis.¹⁴³ It is therefore clear that SMEs that do not comply with principles of corporate governance end up suffering the consequences of non-compliance. In the case of *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ),¹⁴⁴ the matter of importance is whether the board was mindful of and indeed applied principles of corporate governance in coming to their decision of suspending the respondent. It was said that the central issue of corporate governance is the accountability of senior management and the board of a company because of the extensive powers vested in them.¹⁴⁵ The court said that the public sector should try and apply the appropriate principles of corporate governance as recommended by the King Report on Corporate

¹³⁸ Natesan P & du Plessis P 'Why King IV's "apply and explain" is so important' available at <https://www.iodsa.co.za/news/438882/Why-King-IVs-apply-and-explain-is-so-important.htm> (accessed 16 August 2021).

¹³⁹ King IV Report on Corporate Governance for South Africa 2016.

¹⁴⁰ King IV Report on Corporate Governance for South Africa 2016.

¹⁴¹ King IV Report on Corporate Governance for South Africa 2016.

¹⁴² King IV Report on Corporate Governance for South Africa 2016.

¹⁴³ King IV Report on Corporate Governance for South Africa 2016.

¹⁴⁴ *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) para 28.

¹⁴⁵ *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) para 28.

Governance for South Africa 2002.¹⁴⁶ The court emphasised that the conduct of public enterprises must be measured against the relevant principles of the Code and must adhere to best practices.¹⁴⁷ Summarily, the court approved certain basic principles of corporate governance relying heavily on King Reports, which includes, the principle of integrity,¹⁴⁸ effective leadership,¹⁴⁹ ethical behaviour,¹⁵⁰ accountability and responsibility.¹⁵¹ Based on these principles of corporate governance the court ruled that the suspension of the CEO in a public enterprises which is primarily directed to the observation of the principles of good corporate governance and best practices must show adherence to the aforementioned principles of corporate governance.¹⁵²

For this reason, it is submitted that SMEs must comply with the corporate governance principle because it is the law and non-compliance with the law is not good corporate governance. However, it must be stated that SMEs themselves differ in terms of growth, size and complexity of the business. There must be some form of assistance that should be provided to SMEs to be compliant. Corporate governance practices recommended by the King Codes are part of the JSE listing requirements making it mandatory for listed companies to comply with King codes principles and practices which leads to the implementation of 'apply and explain' approach in companies.¹⁵³

2.7 CONCLUSION

It is clear that corporate governance is not only applicable to larger corporate entities. SMEs can also incorporate and implement corporate governance principles in their business practices. SMEs can enjoy the benefits of corporate governance such as sustainable growth, improved operational performance, better succession planning, higher firm valuation, builds stakeholders' confidence and reduce risk.¹⁵⁴ It is clear from the above extracted information, that corporate governance is of utmost importance and makes an invaluable contribution to the success of any corporation. It is therefore submitted that SMEs must be provided with some form of assistance so

¹⁴⁶ *Mpofu* case para 29.

¹⁴⁷ *Mpofu* case para 29.

¹⁴⁸ *Mpofu* case para 64.

¹⁴⁹ *Mpofu* case para 60.

¹⁵⁰ *Mpofu* case para 64.

¹⁵¹ *Mpofu* case para 30.

¹⁵² *Mpofu* case para 42.

¹⁵³ Naidoo R (2009) 36.

¹⁵⁴ Radebe M S (2017) 274.

that they can easily comply with good corporate governance practices without experiencing difficulties. Compliance with principles of good corporate governance must be prioritised because non-compliance thereof is non-compliance with the law, this includes compliance with labour law, tax law, minimum wage and protection of personal information law, and non-compliance with the law is bad corporate governance. It will be incorrect to suggest that good corporate governance exist independently and outside the confines of the law because corporate governance is the law. The next chapter will deal with the legal framework regulating small and medium enterprise in South Africa. It will further deal with the question as to why SME have to comply with regulations and the link between corporate governance and the law.



CHAPTER 3

THE LEGAL FRAMEWORK REGULATING SMALL AND MEDIUM ENTERPRISES IN SOUTH AFRICA

3.1 INTRODUCTION

Laws and regulations are important and necessary to govern and regulate businesses and firms.¹⁵⁵ It is against this background that the research argues that some regulations are good but others are just difficult for SMEs to comply with.¹⁵⁶ The definition of SMEs constitutes a very broad range of firms, some of which includes formally registered, informal and non-VAT registered organisations.¹⁵⁷ This chapter will discuss the legal framework of the SMEs in South Africa. This will be discussed in view of international regulations, national regulations and municipal regulations. Further, it will also discuss the importance of regulations on SMEs and whether there is a link between corporate governance and the law.

3.2 INTERNATIONAL REGULATIONS GOVERNING SMEs

It is important to briefly discuss the international regulations governing SMEs because South African regulations on SMEs need to meet international standards. The South African's policy makers can consider international experience when adopting regulatory response to promote economic and employment growth.¹⁵⁸ Section 232 of the constitution provides that customary international law is law in the Republic provided that such law is consistent with the constitution or an Act of parliament.¹⁵⁹ All laws and regulations in South Africa including SME laws and regulations should meet the international law standards unless the international law is not consistent with the Constitution of the Republic of South Africa. For instance, Principle 1 of the United Nations Global Compact's principles provides that businesses should support and

¹⁵⁵ Christensen J D, Hegazy F & Van Zyl J 'The Cost of Red Tape. An assessment of Administrative Barriers and Regulations for SMEs in South Africa' 2016 *International Labour Organisation* 8.

¹⁵⁶ Christensen J D, Hegazy F & Van Zyl J (2016) 8.

¹⁵⁷ Bureau for Economic Research (2006) 'The Small, Medium and Micro Enterprise Sector of South Africa' SEDA available at <http://www.seda.org.za/Publications/Publications/The%20Small,%20Medium%20and%20Micro%20Enterprise%20Sector%20of%20South%20Africa%20Commissioned%20by%20Seda.pdf> (accessed on 16 June 2021).

¹⁵⁸ Trade and Industrial Policy Strategies (2002) 'The Economics of SMMES in South Africa' available at <https://www.tips.org.za/research-archive/trade-and-industry/item/204-the-economics-of-smmes-in-south-africa> (accessed 05 August 2021).

¹⁵⁹ Constitution of the Republic of South Africa, 1996 s 232.

respect the protection of internationally proclaimed human rights.¹⁶⁰ In essence, both large and small businesses have a duty to respect and protect human rights that are universal provided for in the Universal Declaration of Human Rights¹⁶¹ and also individual rights as embodied in the Bill of Rights.¹⁶²

The G20/OECD provides for Corporate governance principles for all companies, large and small. It goes further to appreciate and recognise the fact that some of its principles may not be appropriate for smaller companies, it gives policy makers a choice to raise awareness of good corporate governance for all companies, including smaller companies and unlisted companies if they so wish to do so.¹⁶³ The OECD SME ministerial conference of 2018 on improving the business environment for SMEs through effective regulations provides recommendations for policy makers of nations. One of the recommendations provided is that countries should strengthen the integrity and transparency of the public sector, and to conduct regulatory impact analysis to enhance the effectiveness of regulation and assess its implications for SMEs.¹⁶⁴ South African policy makers need to consider the OECD principles when promulgating their national laws regarding SMEs regulations.

3.3 SOUTH AFRICAN REGULATIONS GOVERNING SMEs

It is important to provide a detailed discussion of the national regulations governing SMEs in South Africa as this research seeks to evaluate the legal burden of good corporate governance on SMEs in South Africa. Section 8 (2) of the Constitution provides that a provision of the Bill of Rights binds a natural and juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right.¹⁶⁵ In addition, section 7 subsection (a) of the Companies Act provides that the purpose of the Companies Act is to promote compliance with the Bill of rights as provided for in the Constitution of the Republic, in its application to company law.¹⁶⁶

¹⁶⁰ United Nations Global Compact's ten principle available at <https://www.unglobalcompact.org/what-is-gc/mission/principles> (accessed 16 June 2021).

¹⁶¹ Universal Declaration of Human Rights (1948) available at <https://www.un.org/en/about-us/universal-declaration-of-human-rights> (accessed 03 September 2021).

¹⁶² Constitution of the Republic of South Africa, 1996 ch 2.

¹⁶³ G20/OECD 'Principle of Corporate Governance' (2015) 9.

¹⁶⁴ OECD 'Improving the business environment for SMEs through effective regulation' (2018) 8.

¹⁶⁵ Constitution of the Republic of South Africa, 1996 s 8(2).

¹⁶⁶ Companies Act 71 of 2008 s 7(a).

As compared to many other developing countries, the contributions of SMEs in South African economic growth and employment is low. The inability of SMEs to contribute meaningfully to the economy and employment creation in South Africa is often linked with the racial discrimination in education, income and economic empowerment inherited from the apartheid regime.¹⁶⁷ For many years the South African government has invested an excessive amount of initiatives with the aim of supporting and growing the SME sector in order to redress the injustices of the past.¹⁶⁸ The policies for South Africa's small businesses was initially influenced by the White Paper on National Strategy on the Development and Promotion of Small Business in South Africa of 1995. The White Paper provided, *inter alia*, the need for the Government to create an enabling legal framework, affordable physical infrastructure and to improve access to finances for SMEs.¹⁶⁹ In 1996 the National Small Business Act was then promulgated to regulate small businesses in South Africa.¹⁷⁰ The Broad Based Black Economic Empowerment was then considered to be part of the SMEs sector to assist in empowering and developing Small Businesses especially black owned as a means to redress the injustices of the past and give black entrepreneurs opportunities to grow their businesses. The objectives of the 1995 White Paper were incorporated into the Integrated Small Business Development Strategy for 2004 to 2005. The strategy is based on the 3 fundamental principles which are (i) the reduction of regulatory burden on SMEs, (ii) creating local demands for SMME products or services and (iii) increasing financial and non-financial support.

3.3.1 The National Small Business Act

The National Small Business Act 102 of 1996 was adopted for the establishment of the National Small Business Council and the Ntsika Enterprise Promotion Agency; and to provide guidelines for organs of state in order to promote small businesses in South Africa; and to provide for matters incidental thereto.¹⁷¹ It was further adopted to deal with the establishment of Small Enterprise Development Agency and outlines its

¹⁶⁷ Trade and Industrial Policy Strategies (2002) 5.

¹⁶⁸ Ramukumba T 'Overcoming SMES Challenges Through Critical Success Factors: A Case of SMES in the Western Cape Province, South Africa' (2014) 16 *Economic and Business Review* 22.

¹⁶⁹ Ramukumba T (2014) 22.

¹⁷⁰ National Small Business Act 102 of 1996.

¹⁷¹ National Small Business Act 102 of 1996.

activities in a very broad terms.¹⁷² It was amended in 2003 and 2004. The National Small Business Amendment Act of 2004 was repealed for the purpose of repealing all the Ntsika Enterprise Promotions Agency provisions in order to provide for the establishment of the Small Enterprises Development Agency.¹⁷³ It also includes provisions that ensures that the Ntsika Enterprise Promotion Agency, the National Manufacturing Advisory Centre and any other Institutions relevant to the Agency is established.¹⁷⁴ Therefore, the main objective of the National Small Business Act is to provide for the Small Enterprise Development Agency and to provide for matters that relates to its operations functions and governance.¹⁷⁵

The objectives of the Small Business Development Agency (i) to provide for the design and implementation development support programmes; (iii) to promote a service delivery network that increases the contribution of small enterprises to the South African economy, the creation of jobs and equity; strengthen the capacity of service providers to support SMEs and encourage SMEs to successfully compete at the national and international level; and to promote economic growth.¹⁷⁶ The Act introduced the formation of the Small Business Councils.¹⁷⁷

3.3.2 National Small Business Council

The establishment of the National Small Business Council is embodied in chapter 2 of the Act. The NSBC was established as a juristic person with all the rights and duties of juristic persons. The functions of the Council are provided for in section 3(1) of the Act which are to represent and promote the interest of small business; and to advise the national, provincial and local spheres of government on social and economic policy that promotes the development of small business.¹⁷⁸ Section 4 of the very same Act provides for the Constitution of the Council, it provides for, *inter alia*, the composition of the Council, a provincial council for each province, the criteria for the appointment and procedures for the members, the appointment of any alternate member to act, the

¹⁷² Department of Small Business Development 'Comparative Analysis of SMME Legislation from Eight Countries to the National Small Business Act No 102 of 1996, as amended in 2003 and 2004. Final Report.

¹⁷³ National Small Business Amendment Act 29 of 2004.

¹⁷⁴ Act 29 of 2004.

¹⁷⁵ Act 29 of 2004, Preamble.

¹⁷⁶ Act 29 of 2004, s 9A.

¹⁷⁷ Act 29 of 2004, s 11.

¹⁷⁸ Act 102 of 1996, s 3(1).

election of office bearers of the council and provincial council, a two year tenure for members of the council and provincial council, the circumstances and manner for the termination of membership, the establishment and function of committees, the co-opting as a member of any person to assist the council, rules for the convening and conducting of meetings, the voting rights of the members of council and lastly the provision of administrative personnel employed by the council to assist.¹⁷⁹

3.3.3 Labour Regulations and Legislations on SMEs

Labour laws play an essential role in promoting economic development, productivity and equity.¹⁸⁰ It is important to split labour laws into specific areas, such as employment protection legislation, industrial relations and minimum wages in order to obtain meaningful evidence of their impact on economic growth.¹⁸¹ The south African labour law is well developed and finds application in businesses of all sizes.¹⁸² It is crucial to ensure that labour laws and regulations are made available to SMEs from an efficiency point of view.¹⁸³ This research evaluates the legal burden of corporate governance on SMEs in South Africa. The King IV Report on corporate governance provides that there is a link between good governance and compliance with the law. It is therefore essential to investigate whether labour legislations act as a legal barrier to the growth and development of SMEs, how compliance with these legislations or non-compliance with them works for SMEs or against good corporate governance in the SMEs sector.

It goes without saying, that labour law is one of the important branches of South Africa's legal system. Compliance with labour laws is of paramount importance because it promotes good corporate governance of local business which includes SMEs.¹⁸⁴ The South African government is in a very difficult situation that needs a balancing act to be made. On the one hand, there are laws of general application that applies to all sectors of employment, regardless of the size of the enterprise and on the other hand, the importance of the SMEs that is supposed to create jobs and

¹⁷⁹ Act 102 of 1996, s 4.

¹⁸⁰ International Labour Conference Report IV (2015) 42

¹⁸¹ International Labour Conference Report IV (2015) 42.

¹⁸² Christensen J D, Hegazy F & Van Zyl J (2016) 25.

¹⁸³ Christensen J D, Hegazy F & Van Zyl J (2016) 25.

¹⁸⁴ Thomas A & Luvhengo NE 'Labour Legislation Compliance within the Small – Enterprise Sector' (2020) 43 *African Journal of Employee Relations* 6.

therefore there is a need to protect this sector from struggling to comply with the legal burden so that it can precisely achieve its objective of job creation.¹⁸⁵

3.3.3.1 Labour Relations Act 66 of 1995

The LRA was promulgated to address the injustices of the apartheid labour relations system where black employees were marginalised and subjected to unfair labour practices.¹⁸⁶ The LRA was promulgated to give effect to the Constitutional provisions of labour relations rights which provides for the rights of both workers and employers.¹⁸⁷ In South Africa, the LRA provides for the following rights; the right not to be dismissed unfairly, unfair labour practices, the right to bargain collectively, the right to freedom of association and other labour related rights.¹⁸⁸

With regard to a right against unfair dismissal, section 186 of the LRA provides every employee the right to fair labour practices.¹⁸⁹ This aforementioned section does not provide a distinction between employees of large enterprises and those of small enterprises. For this reason, owners of small enterprises or rather SMEs find the procedure regarding dismissals to be an administrative burden. Hence, legislators deemed it necessary to cure this defect by including Schedule 8 in the LRA which allows small enterprises to follow a simple disciplinary procedure before dismissals can take place.¹⁹⁰

Collective bargaining is applicable to both larger and small enterprises, however, it is always a difficult process to apply collective bargaining in the small enterprise sector.¹⁹¹ Even if that is the case, the LRA has a clear objective to make provision for small enterprises in South Africa's collective bargaining framework. The collective bargaining power is essential to individual workers as workers can make their voice heard by bargaining collectively. For instance, workers can engage in a strike action to demand equal pay¹⁹² and also by demanding collectively that certain group or race of people who were previously disadvantaged to be considered for managerial

¹⁸⁵ Thomas A & Luvhengo N E (2020) 8.

¹⁸⁶ Thomas A & Luvhengo N E (2020) 9.

¹⁸⁷ Constitution of the Republic of South Africa, 1996, s 23.

¹⁸⁸ Labour Relations Act 66 of 1995.

¹⁸⁹ Act 66 of 1996 s 186.

¹⁹⁰ Thomas A & Luvhengo N E (2020) 15.

¹⁹¹ Thomas A & Luvhengo N E (2020) 17.

¹⁹² Benjamin P & Cheadle H 'South African Labour Law Mapping the Changes – Part 2: The History of Labour Law and its Institutions (2020) 41 *ILJ* 36.

positions in order to redress the historical injustices of the past.¹⁹³ The main purpose of collective bargaining is to regulate the terms and conditions of employment at the workplace.¹⁹⁴ By bargaining collectively with the management, labour organisations seek to give effect to its legitimate expectations that wages and other working conditions should guarantee a stable and adequate form of existence so as to be compatible with the physical integrity and moral dignity of all individuals, and also that jobs should be secured.¹⁹⁵ However, SMEs requires a different bargaining system, it is said that when protecting the rights and interests of workers through collective bargaining, trade unions finds it difficult to represent employees the best way possible because demanding more benefits for employees increases the cost of labour and therefore production cost.¹⁹⁶ The collective bargaining is more burdensome to SMEs hence there is a need for a new collective bargaining system.¹⁹⁷ Thomas and Luvhengo submit that the strike can have devastating economic consequences for organisations and may even destroy small enterprises, parties must have other ways of dealing with matters of mutual interests, such as salary adjustments.¹⁹⁸ The definition of an essential service as provided for in the LRA must be extended to include SMEs.¹⁹⁹ Thomas and Luvhengo argues that if the sector is categorised as essential service for the purpose of strike action, the right to strike will be limited.²⁰⁰ Strikes should be considered as a last resort in the SMEs sector.²⁰¹

3.3.3.2 Basic Conditions of Employment Act 75 of 1997

The BCEA was also promulgated to give effect to and regulate fair labour practices as enshrined in the Constitution.²⁰² The BCEA regulates employment conditions such as minimum notice period, maximum working hours, sick leave and minimum vacation.²⁰³ Section 29 of the BCEA provides that an employer must supply an employee, when the employee commences employment, with some particulars which includes; name and address of the employer; the name and occupation of the employee, or a brief

¹⁹³ Benjamin P & Cheadle H (2020) 34.

¹⁹⁴ Steenkamp A, Stelzner S & Badenhorst N 'The Right to Bargain Collectively' (2004) 25 *ILJ* 945.

¹⁹⁵ Steenkamp A, Stelzner S & Badenhorst N (2004) 945.

¹⁹⁶ Thomas A & Luvhengo L E (2020) 14.

¹⁹⁷ Thomas A & Luvhengo L E (2020) 14.

¹⁹⁸ Thomas A & Luvhengo L E (2020) 17.

¹⁹⁹ Thomas A & Luvhengo L E (2020) 17.

²⁰⁰ Thomas A & Luvhengo L E (2020) 17.

²⁰¹ Thomas A & Luvhengo L E (2020) 17.

²⁰² Basic Conditions of Employment Act 75 of 1997.

²⁰³ Act 75 of 1997.

description of the work for which the employee is employed .etc.²⁰⁴ Notwithstanding this requirement of section 29 of the BCEA, South African law does not attach a mandatory legal requirement to have a written employment contract, a verbal agreement will still be valid and enforceable if the parties agree to the contractual essentials.²⁰⁵ For this reason, small enterprises don't have to have written particulars of employment that serve as a written contract. SMEs owners can enter into a verbal employment agreement that serve as a written contract.²⁰⁶ As long as there is a verbal contract that exist between the employer and employees an agreement that an employee will provide services and the employer will pay for such services, therefore section 29 of the BCEA is indirectly complied with.²⁰⁷ However, this is not advisable because in practice verbal contracts are difficult to prove, there is no tangible evidence to show that a contract was entered into and on what terms. It is for this reasons that this research recommends for auditors in places where there is SMEs presence because these auditors will be able to assist SMEs with matters that are legal in nature.

3.3.3.3 Employment Equity Act 55 of 1998

The South African Employment Equity Act will continue to be relevant necessarily to overcome the historical discrimination and a vehicle for transformation and addressing inequality in the employment context. The Employment Equity Act was promulgated in order to achieve equity in the workplace by prohibiting unfair discrimination and by requiring the implementation of affirmative action measures to ensure the equitable representation of designated people in all the occupation categories in the workplace.²⁰⁸ The Employment Equity Act was enacted primarily to give effect to the constitutional imperative of the right to equality.²⁰⁹

Section 6(1) of the aforementioned Act provides that no person may unfairly discriminate, directly or indirectly against an employee, in any employment policy or practice' on one or more grounds which includes gender, race, disability. etc.²¹⁰ it is imperative to emphasise that the achievement of equality in the employment context

²⁰⁴ Act 75 of 1997, s 29.

²⁰⁵ Thomas A & Luvhengo L E (2020) 17.

²⁰⁶ Thomas A & Luvhengo LE (2020) 17.

²⁰⁷ Thomas A & Luvhengo LE (2020) 17.

²⁰⁸ Benjamin P & Cheadle H (2020) 33.

²⁰⁹ Du Toit D 'The Evolution of the Concept of "Unfair Discrimination" in South African Labour Law' (2006) 27 *ILJ* 1312.

²¹⁰ Act 55 of 1998, s 6(1).

should be achieved by promoting equal opportunity and fair treatment through eliminating unfair discrimination.²¹¹ The EEA provides that employers with 50 or more employees must develop and an employment equity plan.²¹² It is submitted that the EEA discriminates against small enterprises as it only applies to employers that employs 50 or more employees. It is argued that enterprises with less than 50 employees must also be accommodated in the EEA. For instance, there are employees in the SMEs sector who were previously discriminated and there is a need to give these employees some form of preference in order to address injustices of the past and also to ensure that there is equitable representation at the workplace. Put differently, it cannot be correct that in an enterprise of 45 employees, for argument sake, with senior or managerial positions occupied by all men or occupied by only a certain race of people. It is therefore submitted that EEA should accommodate SMEs because it is believed that affirmative action is also needed in the SMEs sector for the purpose of occupational representation in senior position and high salary level. It is a legal burden on those SMEs employees to be empowered and developed into becoming the best versions of themselves.

3.3.3.4 National Minimum Wage

Businesses in South Africa are required by law to pay the minimum wage amount for labour.²¹³ Section 32 and 33 of the BCEA deals with payment of remuneration and information about remuneration respectively by an employer to an employee.²¹⁴ section 15 (1) of the Minimum wage Act provides that an employer or an employers' organisation registered in terms of section 96 of the LRA or any other law may apply to be exempted from paying employees the national minimum wage.²¹⁵ This is also applicable to SMEs, they are not automatically excluded from this section, they can only be exempted by means of an application.²¹⁶ SMEs must be automatically exempted from compliance with the minimum wage requirement of the aforementioned Act for a certain period of time so that they can focus on establishing their entities and also learn about laws and regulations governing SMEs. It is submitted

²¹¹ Act 55 of 1998.

²¹² Act 55 of 1998.

²¹³ Christensen J D, Hegazy F & Van Zyl J (2016) 8.

²¹⁴ Act 75 of 1997 s 32 & 33.

²¹⁵ National Minimum Wage Act 9 of 2018, s 15(1).

²¹⁶ Thomas A & Luvhengo L E (2020) 19.

that SMEs especially new ones must be granted an automatic exemption for a certain reasonable period of time from their date of registration in order to well position themselves. The fact that the legislature included exemptions in the Act is a clear indication that the legislature recognise and appreciate that some entity may not be able to comply and exemption might be required. It is for this reason submitted that due to the challenges facing SMEs they should be granted an automatic exemption, the exemption must not be based on application because SMEs owners do not know the law, they are not legal experts and outsourcing such functions is onerously extensive. Automatic exemption will automatically apply to SMEs without them having to undergo the trouble of having to apply. Applying for exemption is time consuming and expensive.

3.3.4 Local government on the regulation of SMEs in South Africa

Municipal regulations include regulations pertaining to service delivery, specific acts and regulations of local municipalities, laws governing incompetency and accountability of municipal officials.²¹⁷ Local governments can play a significant role in developing SMEs more especially those in poor areas by assisting SMEs to deal with the restrictive legal and regulatory environment.²¹⁸

Section 156 of the Constitution provides that a municipality has an executive authority in respect of, and has the right to administer (a) the local government matters listed in part B of schedule 4 and part B listed in schedule 5; (b) and any other matter assigned to it by the national or provincial legislation.²¹⁹ Section 11(3)(i) Municipal System Act provides that imposing and recovering rates, taxes, levies, duties, service fees and surcharges on fees, including settling and implementing tariff, rates and tax and debt collection policies. It is clear that municipal regulations are directly or indirectly given effect through provision of national and provincial legislation.²²⁰

It is impossible to separate the regulatory impact of the municipalities on SMEs from their developmental and service delivery roles.²²¹ It is unfortunate, that the objectives

²¹⁷ Christensen J D, Hegazy F & Van Zyl J (2016) 16.

²¹⁸ Development Policy Research Unit (2006) 'The Impact of Municipal Regulations on SMMEs' available at http://www.dpru.uct.ac.za/sites/default/files/image_tool/images/36/DPRU%20WP06-107.pdf (accessed 23 August 2020).

²¹⁹ Constitution of the Republic of South Africa, 1996 section 156(1)(a) & (b).

²²⁰ Development Policy Research Unit (2006) 7.

²²¹ Development Policy Research Unit (2006) 7.

of the municipal regulations and other laws cannot achieve its objective because of corruption and crime.²²² SMEs owners are expected to pay bribes before they could be awarded municipal contracts or tenders and as a results being unfair on those who uphold the principles of good corporate governance particularly the one of integrity.²²³ Shava found that many potential small or emerging black company firms end up not succeeding because of corruption in municipalities.²²⁴

3.3.5 Broad Based Black Economic Empowerment (BBBEE)

Black economic empowerment is defined by the Department of Trade and Industry as an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa.²²⁵ There was a need for the South African government to promulgate the BBBEE Act in order to overcome social injustices of the past and such injustices are affecting SMEs development and growth.²²⁶ The BBBEE Act was to promote economic transformation in order to enable meaningful participation of black people in the South African economy.²²⁷ Its strategy is to increase the number of black people in senior executive positions and also increasing the number of high salary levels for black people within qualifying BBBEE companies.²²⁸ The intention of this Act was to ensure that entities who wish to meet qualifying criteria for licences or concessions, supply goods or services to any organ of state or public entity, acquire state-owned enterprises and enter public-private partnerships would have to demonstrate their commitment to Black Economic Empowerment.²²⁹

The BBBEE policies increases access to infrastructure, economic participation, skills and training of small business institutions.²³⁰ The SMEs do not only make a positive contribution to the economy of South Africa, they also act as a key driver for

²²² Bardhan P 'Corruption and Development: A Review of Issues' (1997) 35(3) *Journal of Economic Literature* 1322.

²²³ Bardhan P (1997) 1322.

²²⁴ Shava E 'Black Economic Empowerment in South Africa: Challenges and Prospects' (2016) 8 (6) *Journal of Economics and Behaviour Studies* 167.

²²⁵ Broad-Based Black Economic Empowerment Act 53 of 2003, Preamble.

²²⁶ Pike A, Puchert J, & Chinyamurindi WT 'Analysing the future of Broad-Based Black Economic Empowerment through the lens of small and medium enterprises' (2018) *Independent Research Journal in the Management Sciences* 2.

²²⁷ Act 53 of 2003, s 2 (a).

²²⁸ Shava E (2016) 161.

²²⁹ Shava E (2016) 161.

²³⁰ Act 53 of 2003, s 2 (a) & (h).

empowering historically disadvantaged groups through BBBEE.²³¹ In South Africa it is a requirement that all qualifying companies comply with the BBBEE Act and the South African government will only show support to those who are complying with the BBBEE.²³² Pike and others found that the main influence BBBEE had on SMEs was an increase in tender corruption.²³³ They further found that the BBBEE Act should be restructured to eliminate tender corruption so that it can equally benefit all individuals in South Africa.²³⁴ For this reason, it is argued that failure for the BBEE Act to eliminate corruption affects SMEs that are capable from benefiting from the government tenders to be able to benefit so that they can grow and mature. This acts as a burden to SMEs that upholds principle of corporate governance by not engaging in corrupt activities. It is submitted that BBBEE Act must contain a specific provision which addresses corruption and provides the consequences thereof, by doing so it will be easy to hold government officials and SME owners that benefit from corrupt tenders in the name of BBBEE accountable by enforcing the specific provision in the BBBEE that expressly deals with corruption.

3.3.6 Covid-19 regulations in South Africa

South Africa like many other countries around the world have put measures in place to support small businesses in order to survive the specific circumstances the small businesses face during this unprecedented time of the covid-19 pandemic.²³⁵ During the time of a pandemic the first priority that governments have committed themselves to is public health and they introduced policy measures to mitigate the economic impact of the coronavirus outbreak on business.²³⁶ South Africa like many other countries have introduced policy measures which include easing constraints of liquidity

²³¹ Pike A, Puchert J, & Chinyamurindi W T (2018) 2.

²³² Pike A, Puchert J, & Chinyamurindi W T (2018) 2.

²³³ Pike A, Puchert J, & Chinyamurindi W T (2018) 6.

²³⁴ Pike A, Puchert J, & Chinyamurindi W T (2018) 8.

²³⁵ Zeidy A I 'Economic Impact of Covid-19 on Micro, Small and Medium Enterprises (MSMEs) in Africa and Policy Options for Mitigation' *COMESA Monetary Institute Report 2020* available at <https://www.tralac.org/documents/resources/covid-19/regional/4049-economic-impact-of-covid-19-on-msmes-in-africa-and-policy-options-for-mitigation-comesa-special-report-august-2020/file.html> (accessed 27 April 2021).

²³⁶ Small Business Research Specialists SBP 'Reflections on the impact of COVID-19 on small businesses (SMEs) in South Africa' 2020 available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/Reflections-on-the-impact-of-COVID-19-on-small-businesses-SMEs-in-South-Africa-September-2020.pdf> accessed on 28 April 2021.

on SMEs by some tax relief, social security payments, reduction of debt payments and rent payments and utility payments.²³⁷

The South African government has a responsibility to enhance the national entrepreneurial culture by promoting programs that prioritises SMEs.²³⁸ In South Africa the department of small business development published directions in the government gazette in order to assist micro and small businesses trading in permitted services, to comply with the covid-19 regulations.²³⁹ These directions provides amongst other things that all formal and informal small business are required to comply with the covid-19 measure at the workplace.²⁴⁰ It also provides that all formal and informal small businesses must not allow any person to enter its premises without a face mask and lastly but not least, it also provides that employers of small businesses gives employees face masks and provide them with transport during the national state of disaster.²⁴¹ All covid-19 regulations exist in order to save lives of people, and ensures that small businesses do not suffer the grave negative consequences of the pandemic and continue to exist even beyond the pandemic, for this reason SMEs must comply with the covid-19 regulation, if not they will suffer legal consequences for non-compliance.

The covid-19 pandemic is an unprecedented worldwide crisis, affecting human health and economic welfare across the globe.²⁴² Even if it is clear that covid-19 affected all nations of the world, the economic earthquake unleashed by the covid-19 does not affect all similarly. SMEs suffered great harm due to few or no resources at their disposal to survive the storm, SMEs have been vulnerable to the negative

²³⁷ Zeidy A I 'Economic Impact of Covid-19 on Micro, Small and Medium Enterprises (MSMEs) in Africa and Policy Options for Mitigation' *COMESA Monetary Institute Report 2020* available at <https://www.tralac.org/documents/resources/covid-19/regional/4049-economic-impact-of-covid-19-on-msmes-in-africa-and-policy-options-for-mitigation-comesa-special-report-august-2020/file.html> (accessed 27 April 2021).

²³⁸ Zeidy A I 'Economic Impact of Covid-19 on Micro, Small and Medium Enterprises (MSMEs) in Africa and Policy Options for Mitigation' *COMESA Monetary Institute Report 2020* available at <https://www.tralac.org/documents/resources/covid-19/regional/4049-economic-impact-of-covid-19-on-msmes-in-africa-and-policy-options-for-mitigation-comesa-special-report-august-2020/file.html> (accessed 27 April 2021).

²³⁹ Disaster Management Regulations in GN 480 GG 43258 of 29 April 2020.

²⁴⁰ Disaster Management Regulations in GN 480 GG 43258 of 29 April 2020.

²⁴¹ Disasters Management Regulations in GN 480 GG 43258 of 29 April 2020.

²⁴² Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 4.

consequences of the crisis.²⁴³ The Survey Report by the NYDA on the Impact of covid-19 on Small Medium and Micro Enterprises since lockdown shows that in 2020 the pandemic has strongly affected 88 percent of the respondents out of 1000 businesses assessed in 100 days.²⁴⁴ The survey provides the challenges that SMEs encountered as a result of the covid-19 pandemic. The results show that 26 percent of the respondents indicated lack of generating income, 22 percent of the respondent indicated cash flow challenges, and 16 percent of the respondent indicated that they were unable to generate sales.²⁴⁵

SMEs were affected especially those that do not have resources such as resources that will assist them to reach and communicate with clients. During lockdown consumers reduced their frequency of visiting physical stores, it was found by the small business research specialists on the reflections on the impact of covid-19 on small businesses (SMEs) in South Africa that 37 percent of South African consumers increased their online shopping activity.²⁴⁶ SMEs in South Africa were already experiencing challenges with an economy under degeneration, covid-19 is putting additional pressure on SMEs. Having to comply with covid-19 regulation is a legal burden for SMEs because these enterprises do not have enough resources to be able to afford Personal PPE as owners depend on profit to survive and it is also a difficult for SMEs to comply with social distancing requirement as they normally have small business premises.²⁴⁷ It was recently found by the Auditor-general that there was corruption involved on the PPE tenders.²⁴⁸ It is argued that failure of the law to hold those involved in the PPE corruption negatively affect SMEs that should have rightfully benefitted had the PPE tenders not awarded through corrupt means.

²⁴³ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 4.

²⁴⁴ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 5.

²⁴⁵ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 5.

²⁴⁶ 'Reflections on the Impact of Covid-19 on small businesses (SMEs) in South Africa' 2020 *small business research specialists SBP* available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/Reflections-on-the-impact-of-COVID-19-on-small-businesses-SMEs-in-South-Africa-September-2020.pdf> accessed on 28 April 2021.

²⁴⁷ Truter C 'Covid-19: The Impact on Businesses and Investments in South Africa' 2020 *Bowmans* available at <https://www.bowmanslaw.com/insights/mergers-and-acquisitions/covid-19-impact-on-businesses-and-investments-in-south-africa/> accessed on 29 April 2021.

²⁴⁸ Auditor General *First Special Report 2020 – First Special Report on the financial management of government's Covid-19 initiatives* (2020) 17-18.

3.4 THE IMPORTANCE AND BENEFITS OF REGULATIONS ON SMEs

Compliance with the law is important because it is to ensure that a company meet its legal obligations which are necessary to protect the health, safety and welfare of people.²⁴⁹ The regulations are important as they are meant to protect citizens against harmful and dangerous products within a country. The way a certain business entity makes and sells their products and services might fall under the objectives of a government agency, such as a restaurant being mandated to meet health department guidelines in order to ensure that restaurants do not serve harmful products or food for human consumption.²⁵⁰

Further, regulations are important to ensure that injustices of the past do not repeat themselves. Employment Equity and Affirmative Action policies are necessary to overcome historical discrimination and a vehicle for transformation and addressing inequality in the employment context.²⁵¹ Taking into consideration that the purpose of the Employment Equity Act in South Africa is to redress the disadvantages in employment suffered by the designated groups in order to ensure their equitable representation in all occupational categories and salary levels in the workplace.²⁵²

The benefits of businesses being compliant with the regulation is that it protects the business against unnecessary legal problems. It reduces the risk of lawsuits, fines, penalties and the risk of business shutdown. It is not in the best interest of the company especially small business such as SMEs to be facing costly sanctions as it will suffer financial risk.

Furthermore, it is important to emphasise that legal rules and regulations are in existence to assist companies more than to destroy them. For instance, laws dealing with harassment and discrimination can assist the company to create a better working environment for the company's employees which can result in more worker

²⁴⁹ Milano S 'Importance of Compliance in Business' 2018 available at <https://smallbusiness.chron.com/importance-compliance-business-71173.html> (accessed 15 September 2021).

²⁵⁰ Milano S 'Importance of Compliance in Business' 2018 available at <https://smallbusiness.chron.com/importance-compliance-business-71173.html> (accessed 15 September 2021).

²⁵¹ Employment Equity Act 55 of 1998.

²⁵² Dupper O 'Affirmative Action and Substantive Equality: The South African Experience' (2002) 14(2) *South African Mercantile Law Journal* 289.

productivity.²⁵³ Adhering to regulations pertaining to safety and regulations at the work place can help in preventing human injuries, fires or building destruction which might harm the company's profitability.²⁵⁴ It is advisable for SMEs to comply with the law because the government and private companies are less reluctant to do business with enterprise that adhere to the legal regulations as compared to those who are not unless there is corruption or crime involved.

3.5 THE LINK BETWEEN THE LAW AND CORPORATE GOVERNANCE

The OECD (2015) states that effective corporate governance requires a sound legal, regulatory and institutional framework that those who participates on the market can rely on when they establish their private contractual relations.²⁵⁵ In addition, the International Corporate Governance Network of 2009 emphasises the need for companies to adhere to all applicable laws of the jurisdictions in which they operate.²⁵⁶ De La Harpe and others write that good governance can assist countries to respect their human rights obligations and by doing that good governance can be used as a potentially enabling framework for promoting human rights.²⁵⁷ It is also part of the recommendations of the Institution of Directors Southern Africa that the governing body of an organisation should ensure that a corporate citizen upholds its responsibilities which includes ensuring compliance with the South African Constitution , the law, leading standards, and adherence to organisation own policies and codes of conduct.²⁵⁸ This serves as proof that a link between good corporate governance and the law exist.

Essentially, section 7 (a) of the Companies Act provides that the purpose of the Act is to promote compliance with the Bill of Rights as provided for in the constitution, in the application of company law.²⁵⁹ In addition, section 7 (b)(iii) of the same Act provides further that its purpose is to promote the development of the South African economy

²⁵³ Milano S 'Importance of Compliance in Business' 2018 available at <https://smallbusiness.chron.com/importance-compliance-business-71173.html> (accessed 15 September 2021).

²⁵⁴ Milano S 'Importance of Compliance in Business' 2018 available at <https://smallbusiness.chron.com/importance-compliance-business-71173.html> (accessed 15 September 2021).

²⁵⁵ G20/OECD 'Principle of Corporate Governance' (2015) 13.

²⁵⁶ International Corporate Governance Network (2009) 16.

²⁵⁷ De La Harpe S, Rijken C & Roos R 'Good Governance' (2008) 11(2) *Potchefstroom Electronic Law Journal* 9.

²⁵⁸ Institute of Directors of Southern Africa (2016) 45.

²⁵⁹ Act 71 of 2008 s 7 (a).

by encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social economic life of the nation.²⁶⁰

The law which includes legislation apply to all business entities including SMEs and therefore these enterprises cannot opt for non-compliance, but they can have strategies in place to accommodate legislation.²⁶¹ The stakeholder theory of corporate governance is inclusive of employees,²⁶² therefore corporate entities that have employees should comply with the law that regulates the employer and employee relationship such as the LRA, EEA and BCEA. Even if principles of corporate governance are not legally binding and are voluntary, this should not be interpreted to mean that legal consequences will not arise from non-compliance²⁶³ as courts can take them into account when making decisions. Therefore, corporate governance can influence the court to come at a particular conclusion because judgements of the courts are sources of the law and are binding precedence. In the case of *Mbethe V United Manganese of Kalahari (Pty) LTD 2017 (67) ZASCA 503 (SCA)*, It was submitted that the purpose of the companies Act as outlined in section 7 of the Act which provides for the compliance with the Bill of rights, as well as encouraging transparency and high standards of corporate governance and the efficient and responsible management of companies must be considered when interpreting section 165.²⁶⁴

It is clear that the court can take into account the standard of corporate governance and its principles such as transparency when dealing with corporate related matters and the decision thereof might be mandatory for companies to comply with because the judgements of the courts is the law and is binding to either affected parties and/or to all members of the society. For instance, in the case of *South African Broadcasting Corporation Ltd v Mpofo* [2009] 4 All SA 169 (GSJ), as discussed in para 2.6 of chapter 2 where the court approved principles of corporate governance relying on the King Reports on Corporate Governance for South Africa and its decision was primarily

²⁶⁰ Act 71 of 2008 s 7 (b)(iii).

²⁶¹ Thomas A & Luvhengo E (2020) 5.

²⁶² Abdullah H & Valentine B (2009) 91.

²⁶³ Harduth N & Sampson L 'A Review of the King IV Report on Corporate Governance' 2016 *Werksman Attorneys* 25.

²⁶⁴ *Mbethe V United Manganese of Kalahari (Pty) LTD 2017 (67) ZASCA 503 (SCA)* para 12.

based on corporate governance principles.²⁶⁵ Also in the case of *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* 2015 (6) 338 (WCC), the Court held that the meeting of the respondent which sought to suspend the applicant as an employee was in violation of corporate governance principles and was declared invalid and of no force and effect.²⁶⁶ This research submits that compliance with the law requires compliance with corporate governance and the opposite is also true. The legal burden of good corporate governance will be discussed in the next chapter.

3.6 CONCLUSION

Compliance with the law including legislation and government policies is a fundamental element of good corporate governance. It is important for South African SMEs to fully comply with the law because the purpose of the regulation is to protect the state, the employees and the private sector including small businesses in terms of the production of goods and services and against unfair treatment experienced by either parties.²⁶⁷ In order for SMEs to comply with the laws and policies that regulates the SME sector in South Africa, it is important that SMEs owners familiarise themselves with the regulations that governs this sector.²⁶⁸ It is clear, that there is a link between corporate governance as discussed in chapter 2 and the law, and the two cannot operate in isolation. Corporate governance demands compliance with the law and the law stress out the need to be compliant with principles of corporate governance. This is proved by the fact that even if the principles of corporate governance are voluntary and not mandatory, it is still possible for an entity to suffer legal consequences of non-compliance with the principles of corporate governance.²⁶⁹

The next chapter will deal with the challenges that SMEs encounters as imposed by the legal burden of corporate governance on SMEs. It will seek to prove that the government through its legal framework and policies which mainly focuses on providing financial support to SMEs and avoiding the fact that the legal regulations

²⁶⁵ *Mpofu* case para 29.

²⁶⁶ *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* 2015 (6) 338 (WCC) pg 40.

²⁶⁷ Zwane T *The Impact of Regulation on Small Businesses in the Republic of South Africa* (unpublished Masters in Economics thesis, University of Johannesburg, 2009) 24.

²⁶⁸ Zwane T (2009) 70.

²⁶⁹ Harduth N & Sampson L 'A Review of the King IV Report on Corporate Governance' 2016 *Werksman Attorneys* 25.

that SMEs are mandated to comply with for the purpose of being compliant with the principle of corporate governance act as a burden on SMEs.



CHAPTER 4

THE LEGAL BURDEN OF GOOD CORPORATE GOVERNANCE ON SMALL AND MEDIUM ENTERPRISES

4.1 INTRODUCTION

It can be said that laws and regulations are not an issue, the issue is whether the compliance cost and the administrative burden imposed by such laws and regulations act as an impediment against business growth and development in South Africa. This chapter will evaluate the legal burden of corporate governance on SMEs. It is important to firstly deal with the importance of SMEs in South Africa in order to be able to answer the question as to whether it is worthy that legal burden on them be removed or minimised to avoid its grave effect on SMEs.

4.2 THE ROLE OF SMEs IN SOUTH AFRICA

According to the OECD 2017 policy on enhancing the contribution of SMEs in a global and digitalised Economy SMEs are the main sources of employment, they create an average of 70 percent of jobs and are major contributors to value creation internationally.²⁷⁰ Further, SMEs contribute up to 45 percent of the total employment and 33 percent of GDP in emerging economies.²⁷¹ SMEs makes a significant contribution in the economy of South Africa in terms of poverty alleviation, job creation and to ensure that the nation becomes prosperous.²⁷² The SME Growth Index of 2013 found that SMMEs on a high growth path recorded 52 percent increase of employment in the previous two years.²⁷³ The SMEs contributes significantly to the economic growth and economic development, this is so because of the fact that SMEs are used as a vehicle by which the low income earners in the South African society gain access to economic opportunities.²⁷⁴ The Bureau for Economic Research found that provinces in South Africa with larger economies have the highest number of formal SMEs.²⁷⁵

²⁷⁰ OECD 'Enhancing the contributions of SMEs in a Global and Digitalised Economy' (2017) 6.

²⁷¹ OECD 'Enhancing the contributions of SMEs in a Global and Digitalised Economy' (2017) 6.

²⁷² Chimucheka T 'Overview and Performance of the SMMEs Sector in South Africa' 2013 *Mediterranean Journal of Social Science* 784.

²⁷³ SME Growth Index 'Growth & Competitiveness for Small Business in South Africa' (2014) 12.

²⁷⁴ Chimucheka T (2013) 785.

²⁷⁵ Bureau for Economic Research (2016) 32.

The South African government had throughout the years shown an increased interest in developing the SMEs sector because of their potential in contributing to economic growth and employment creation,²⁷⁶ hence a new Ministry of Small Business Development was established in 2014 which aimed to facilitate the promotion and development of small businesses in South Africa.²⁷⁷ Statistics SA 2021 released the official unemployment statistics which shows that the unemployment in South Africa increased by 1.8 percentage points to 34.4 percent in the second quarter of 2021 as compared to the first quarter of 2021.²⁷⁸ The National Development Plan 2030 provides that at least 41 percent of the people aged between 15 to 64 will be employed and it aimed to increase this number to 52 percent by 2020. Clearly, this aim is not achieved considering the 2021 unemployment rate statistics in South Africa.²⁷⁹ The NDP 2030 further provides that small and medium-sized enterprises will be at the center of employment creation in South Africa and that 90 percent of employment will be created in small and expanding enterprises.²⁸⁰ In order to achieve this aim something out of the ordinary must be considered.

With regard to the issue of poverty it goes without saying that poverty is a pandemic that affects the entire global community, it is said that poverty is significantly higher in developing countries than in developed countries and in this regard the South African government has identified SMEs as a key to poverty alleviation.²⁸¹ The Bureau for Economic Research found that SMEs in the informal sector provide a living for many people in the country.²⁸² In South Africa the SMEs sector provides job opportunities to young people and SMEs also pay tax which is then utilised for service delivery. There are many other contributions made by the SMEs sector for example the SMEs activities that are directly benefiting the local governments including the empowerment of local communities.²⁸³ In addition, SMMEs are expected to reduce the high level of income inequalities that still exist in South Africa.²⁸⁴ The government of South Africa

²⁷⁶ Chimucheka T (2013) 784.

²⁷⁷ Bureau for Economic Research (2016) 32.

²⁷⁸ Statistics South Africa *Quarterly Labour Force Survey: 2021 Quarter 2* (2021) 13.

²⁷⁹ Statistics South Africa *Quarterly Labour Force Survey: 2021 Quarter 2* (2021) 13.

²⁸⁰ National Development Plan (2030) 119.

²⁸¹ Chimucheka T (2013) 785.

²⁸² Bureau for Economic Research (2016) 32.

²⁸³ Chimucheka T (2013) 785.

²⁸⁴ OECD 'Enhancing the contributions of SMEs in a Global and Digitalised Economy' (2017) 5.

had focused primarily on the development of SMMEs in communities that were previously disadvantaged.²⁸⁵

4.3 THE LEGAL BURDEN OF CORPORATE GOVERNANCE ON SMEs

It is recognised internationally that it is costly and difficult to comply with the regulation that are applicable to corporate entities which acts as a burden on businesses particularly the SMEs and constrict their ability to grow.²⁸⁶ Principle 13 of the King IV Report provides that companies should adhere to statutory obligations, disclose measures to mitigate non-compliance and disclose repeat non-compliances and sanctions imposed.²⁸⁷ Corporate entities including SMEs' should comply with the law, non-compliance therewith is not good corporate governance. Corporate governance principles must benefit and be to the advantage of SMEs, and not act as an impediment against the growth and success of SMEs.

4.3.1 The BBBEE compliance burden on SMEs

Pike and others argue that the concept of social justice, SMEs and BBBEE are interconnected with each other because of the fact that the reason for the promulgation of the BBBEE legislation was to overcome the social injustices of the past which are now affecting SMEs in the South African economy.²⁸⁸ BBBEE has failed to meet its expectations as poverty and inequalities in South African communities are on the rise despite the government's commitment in empowering small and medium enterprises and emerging black companies.²⁸⁹ BBBEE fails to meet its purpose because of the high level of corruption in municipalities which led to the enrichment of unscrupulous businessmen, politicians and relatives benefitting from their corruption, nepotism and favouritism.²⁹⁰ The manipulation of the procurement system by corrupt government officials act as an impediment for SMEs that upholds the principle of corporate governance to fairly benefit from the BBBEE system.²⁹¹ Municipal officials do not comply with the principle of good corporate governance which includes ,amongst others, transparency, social accountability and monitoring BEE procurement

²⁸⁵ Chimucheka T (2013) 785.

²⁸⁶ SME Growth Index 'Growth & Competitiveness for Small Business in South Africa' (2014) 20.

²⁸⁷ King IV Report on Corporate Governance for South Africa (2016).

²⁸⁸ Pike A, Puchert J & Chinyamurindi W T (2018) 2.

²⁸⁹ Shava E (2016) 161-170.

²⁹⁰ Shava E (2016) 164.

²⁹¹ Shava E (2016) 167.

structures.²⁹² Most importantly is the lack of accountability in the local government which negatively affects the growth and success of SME which indirectly affects the purpose of the BBBEE of benefitting the historically marginalized group of people.²⁹³ BBBEE did not do much in assisting back South African because of the tendering system which only seems to benefit the few minority of SMEs particularly those that do not comply with principles of corporate governance such as the principle of fairness, integrity and the regulations (BBBEE Act) as they are securing tenders through corrupt means and those that uphold corporate governance principles end-up not benefitting from the BBBEE as they are not prepared to secure government contracts through corrupt means.²⁹⁴

There is a need for good ethical conduct of government officials at the municipality level to exercise good corporate governance as a way of redressing past injustices and stimulate community livelihoods.²⁹⁵ It is submitted, that failure to exercise corporate governance principles by municipalities in enforcing the BBBEE regulations to ensure that well deserving SMEs benefit is a legal burden to SMEs that are complying with the corporate governance principles. The current BBBEE Act imposes direct obstacles on SMEs in South Africa.²⁹⁶ The corporate government principle that requires SMEs to comply with regulations disadvantage SMEs that are compliant as they unfairly compete with SMEs that are corrupt.

4.3.2 Labour law compliance burden on SMEs

Labour law is also seen as a key inhibitor of SMEs growth and success.²⁹⁷ Compliance with labour law legislation affects small enterprises more than it affects large enterprises.²⁹⁸ Luvhengo and Thomas found that owners of small enterprises experience labour laws as burdensome, and their forced implementation affects corporate governance negatively.²⁹⁹ Small enterprises are not able to comply with labour law especially with regard to leave, hours of work, payment of the bargaining council's minimum wages, remuneration for work on weekends and public holidays

²⁹² Shava E (2016) 165.

²⁹³ Shava E (2016) 165.

²⁹⁴ Pike A, Puchert J, & Chinyamurindi WT (2018) 6.

²⁹⁵ Shava E (2016) 167.

²⁹⁶ Pike A, Puchert J & Chinyamurindi T W (2018) 1.

²⁹⁷ Nieuwenhuizen C (2019) 670.

²⁹⁸ Luvhengo N E & Thomas A (2020) 3.

²⁹⁹ Luvhengo N E & Thomas A (2020) 1.

and contributions to employee pension and unemployment funds.³⁰⁰ The reasons which leads SMEs not to be able to comply with labour law are shortages of financial and administrative resources.³⁰¹

For instance, the National Minimum Wage Act provides that an employer or an employers' organization that is registered in terms of the LRA may apply for exemption from paying the national minimum wage, and there is no automatic exclusion for small enterprises either.³⁰² These research submit that this is a burden on SMEs as they do not enjoy automatic exclusion from paying employees minimum wage. Small enterprises should be completely excluded from the minimum wage requirement and should be allowed to pay the lower minimum wage depending on its turnover and assets.³⁰³ The current national minimum wage provides exemption for domestic workers, farm workers and workers employed on an expanded public works programme.³⁰⁴ If small enterprises are to pay the minimum wage their profits would be negatively affected.³⁰⁵

Based on the SMEs turnover compliance with labour law requirements is one of the impediments to their growth because of the fact that the cost of compliance is onerously expensive as they do not have employees such as attorneys or labour experts, and they also do not have the internal capacity to attend to these matters and it is expensive to outsource such functions.³⁰⁶ South Africa was ranked 47 of 138 countries in the Global Competitiveness Report of 2017 due to restrictive labour regulations which was indicated amongst others as the most problematic factor for doing business in South Africa.³⁰⁷ It is therefore clear, that the South African Labour legislations act as a burden to the success of SME and prevent employment creation.³⁰⁸ Notwithstanding the burden SMEs experience, it is compulsory for all enterprises to adhere to the law including labour related legislation, they do not have an option of non-compliance.³⁰⁹

³⁰⁰ Luvhengo N E & Thomas A (2020) 4.

³⁰¹ Luvhengo N E & Thomas A (2020) 4.

³⁰² Luvhengo N E & Thomas A (2020) 18.

³⁰³ Luvhengo N E & Thomas A (2020) 13.

³⁰⁴ Luvhengo N E & Thomas A (2020) 13.

³⁰⁵ Luvhengo N E & Thomas A (2020) 13.

³⁰⁶ Nieuwenhuizen C (2019) 3.

³⁰⁷ Schwab K 'The Global Competitiveness Report' (2017) 324.

³⁰⁸ Nieuwenhuizen C (2019) 5.

³⁰⁹ Luvhengo N E & Thomas A (2020) 5.

4.3.3 Tax compliance burden on SMEs

High costs of tax compliance fall disproportionately on small enterprises.³¹⁰ Given a substantial fixed cost component to tax regulatory requirements and compliance cost.³¹¹ Small enterprises are at a disadvantage as compared to their large counterparts with regard to tax requirements.³¹² Delays and unpredictability around refunds of Value Added Tax payments, often as a result of audits affects SMEs negatively.³¹³ Due to the importance of VAT refunds for small businesses, delays can have a significant impact on cash flow more especially when they are unpredictable making it extremely difficult to plan around them.

High tax compliance cost can exacerbate the lack of resources and lead to cash flow constraints often experienced in the early stages of business development, and may act as a deterrent to formalisation of the business.³¹⁴ According to Nieuwenhuizen the stringent and burdensome tax regulations encourage many small enterprises to remain informal because remaining informal reduces their operational cost, increases their wealth by not complying with government regulations and through tax avoidance.³¹⁵ The National Development Plan 2030 envisages a tax incentive to employers to reduce the initial cost of hiring young labour-market entrants.³¹⁶ It is submitted that such tax incentive should be implemented to SMEs that grow and employ people this will help in encouraging SMEs to hire people.

The taxpayer level of education and the costs of compliance is a significant challenge for SMEs because they do not have the employee resources and internal capacity to do tax related matters in order to timeously and fully comply with all their tax obligations.³¹⁷ Outsourcing such functions is expensive and will significantly add to the

³¹⁰ OECD 'Enhancing the Contributions of SMEs in A Global and Digitalised Economy' (2017) 15.

³¹¹ OECD 'Enhancing the Contributions of SMEs in A Global and Digitalised Economy' (2017) 15.

³¹² OECD (2017) 15.

³¹³ Trade & Industrial Policy Strategies 'Regulatory Burdens on Small Business: Options for Improvement' (2017) 6.

³¹⁴ OECD (2017) 15.

³¹⁵ Nieuwenhuizen C (2019) 9.

³¹⁶ National Development Plan (2030) 30.

³¹⁷ Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises (SMEs)' Deloitte available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed on 10 October 2021).

cost of doing business for SMEs.³¹⁸ Tax compliance act as a burden for SMEs, however, SMEs are have to comply with the tax regulations non-compliance therewith will be a bad corporate governance and will suffer the consequences of non-compliance which are non-compliance penalties imposed by SARS.³¹⁹

4.3.4 Protection of Personal Information Act 4 of 2013 (POPI Act) burden on SMEs

The South African government deemed it necessary to promulgate the POPI Act in order to give effect to the constitutional right of privacy.³²⁰ Such a right is a fundamental right and it can only be limited or violated if such is justified by the limitation clause.³²¹ It is important to mention that improvements can be made on the POPI Act to accommodate micro, small and medium enterprises by allowing such enterprises to be automatically exempted from compliance as the costs of compliance is onerously high for these enterprises. It is argued that it should not be to the discretion of the Information Regulator in terms of section 37 of the Act to exempt these enterprises,³²² due to the fact that the Information regulator may choose not to exempt them. It is submitted that because of the size or the nature of these enterprise they should be awarded an automatic exemption. This provision increases the cost of compliance for SMEs.

4.3.5 Covid-19 regulation burden on SMEs

The current covid-19 pandemic crisis is adversely affecting human beings across the African continent and there is a high possibility that it might leave a serious unforgettable impact on the SMEs of the continent.³²³ The Survey Report by the NYDA

³¹⁸ Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises (SMEs)' Deloitte available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed on 10 October 2021).

³¹⁹ Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed on 10 October 2021).

³²⁰ Constitution of the Republic of South Africa, 1996, s 14.

³²¹ Constitution of the Republic of South Africa, 1996, s 36.

³²² Protection of Personal Information Act 4 of 2013, s 37.

³²³ Kalidas S, Magwentshu N & Rajagopaul A 'How South African SMES can survive and thrive post COVID-19' McKinsey & Company 10 July 2020 available at <https://www.mckinsey.com/featured->

on the impact of covid-19 on Small Medium and Micro Enterprises since lockdown found that the covid-19 pandemic has strongly affected approximately 88 SMEs that took part in the survey.³²⁴ In the survey over 32 percent of the respondents in the tourism, manufacturing, services, agriculture and arts sector have indicated that they have already retrenched their staff and at least those who did not yet effect retrenchments they have placed their staff on rotation and are paying them less salaries.³²⁵ In one thousand businesses survey conducted by NYDA in 100 days it was found that 43 percent of businesses had temporarily closed down due to the Covid-19 pandemic.³²⁶ Respondents that had temporarily closed down indicated that the main reason that led to closures were reductions in demand and that they were concerned about their employees' health.³²⁷ Companies that are not registered with national authorities are mostly SMEs and they normally do not have financial capacity to sustain themselves when operations are shut down.³²⁸ The survey found further that informal enterprises are 32 percent more likely to be pushed by the pandemic towards impoverishment.³²⁹

The South African SMEs were battling with the economy that was under degeneration, the covid-19 added more pressure on their operations.³³⁰ Lockdown regulations have resulted in revenues of many SMEs falling and the majority being forced to cut on business spending to survive.³³¹ Some of the feedback from the respondent regarding the impact of covid-19 on its employees was that the covid-19 had a negative effect

[insights/middle-east-and-africa/how-south-african-smes-can-survive-and-thrive-post-covid-19](https://www.mckinsey.com/featured-insights/middle-east-and-africa/how-south-african-smes-can-survive-and-thrive-post-covid-19)
(accessed 9 September 2021).

³²⁴ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 5.

³²⁵ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 6.

³²⁶ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 10.

³²⁷ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 10.

³²⁸ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 6.

³²⁹ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 6.

³³⁰ Kalidas S, Magwentshu N & Rajagopaul A 'How South African SMES can survive and thrive post COVID-19' *McKinsey & Company* 10 July 2020 available at <https://www.mckinsey.com/featured-insights/middle-east-and-africa/how-south-african-smes-can-survive-and-thrive-post-covid-19>
(accessed 9 September 2021).

³³¹ Kalidas S, Magwentshu N & Rajagopaul A 'How South African SMES can survive and thrive post COVID-19' *McKinsey & Company* 10 July 2020 available at <https://www.mckinsey.com/featured-insights/middle-east-and-africa/how-south-african-smes-can-survive-and-thrive-post-covid-19>
(accessed 9 September 2021).

as the respondents could not get clients because of social distancing and the other respondent indicated that he could not access clients because of regulations.³³² In addition, another respondent indicated that he was unable to pay salaries and some employees have not been able to return to work.³³³

In June 2020 the Department of Employment and Labour issued the Government Notice in the Government Gazette which amongst other things provides that: employers with 10 employees or less than that must ensure that they arrange the workplace in such a way that employees can be at least 1 meters away from each other while executing their duties or if not practically possible have physical barriers in place that will separate employees to prevent the possible transmission of covid-19; give employees cloth masks, give them hand sanitizers, soap and clean water to wash their hands and disinfect their workstation; and also ensure that their workstations are disinfected on a regular basis.³³⁴ It is for these reasons submitted that the majority of small enterprises with ten or less employees lack the capacity to be complaint with the covid-19 regulations. It is difficult if not impossible for small enterprises to comply with social distancing since their premises does not have sufficient space as compared to large enterprises. Also having to provide personal protective equipment for their employee and having to disinfect their place of work regularly is expensive, time consuming and also affects the normal operation of the company which leads to loss of profit. Therefore, the covid-19 lockdown regulation act as a legal burden for SMEs to operate as effectively as they do under normal circumstances. All corporate entities must comply with the covid-19 lockdown regulations as it is good corporate governance to do so.

Moreover, the Auditor-general compiled a report on the multi-billion rand covid-19 relief package and how the covid-19 relief package was spent by various government departments.³³⁵ The report accentuated that there are inadequate controls to ensure the receipt and payment of PPE at the levels of quality and price ordered.³³⁶ Corruption

³³² Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 18.

³³³ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 18.

³³⁴ Employment and Labour Regulation in GN 639 GG 43400 of 4 June 2020, reg 46.

³³⁵ Auditor General *First Special Report 2020 – First Special Report on the financial management of government's Covid-19 initiatives* (2020) 1 – 168.

³³⁶ Auditor General *First Special Report 2020 – First Special Report on the financial management of government's Covid-19 initiatives* (2020) 17-18.

negatively affects SMEs as some of them could have been beneficiaries of the government tender system in order for them to be able to contribute to job creation, livelihoods as well as to the economic growth of the country in general.³³⁷ Instead only few people especially those who are corrupt benefitted from PPE tenders and that prevents service delivery.³³⁸ Failure of the law to hold people accountable for corruption and mismanagement of funds with regard to PPE tenders is a legal burden of corporate governance on SMEs that are compliant with corporate governance principles of integrity and accountability.

4.4 THE LEGAL CONSEQUENCES OF NON-COMPLIANCE WITH THE LEGAL BURDEN OF CORPORATE GOVERNANCE REQUIREMENT OF COMPLIANCE WITH THE LAW

It is necessary for entities to be compliant with the legal requirement of compliance with corporate governance, if not they will suffer the risk of experiencing legal consequences for non-compliance. Corporates that do not comply with their legal duty to obey and act in accordance with corporate governance principles may face consequences which includes fines, legal action that could lead to imprisonment and a court order to close their corporate operations this of course will depend on the nature and the seriousness of transgression.³³⁹

4.4.1 Non-Compliance with covid-19 regulation

Non-compliance with Covid-19 pandemic regulations lead to the contravention of the Disaster Management Act 57 of 2002.³⁴⁰ The aforementioned Act was adopted primarily to focus on preventing or reducing the risk of disasters, mitigating the severity of disasters, emergency preparedness, rapid and effective response to disasters and post-disaster recovery.³⁴¹ Section 60 (2) Act provides that anyone convicted of an

³³⁷ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 23.

³³⁸ Department of Small Business Development *National Youth Development Agency Survey Report 2020 – Impact of Covid-19 on Small Medium and Micro Enterprises Since Lockdown* (2020) 23.

³³⁹ GO LEGAL 'Don't be penalised for COVID-19 non-compliance' 19 August 2020 available at <https://www.golegal.co.za/covid-19-non-compliance/> (accessed 24 October 2021).

³⁴⁰ Disaster Management Act 57 of 2002.

³⁴¹ Act 57 of 2002, Preamble.

offence in terms of the Act is liable on conviction for a fine or to imprisonment not exceeding six months or both a fine and such imprisonment.³⁴²

Employers must adhere to covid-19 regulations in order to protect their employees and other stakeholders may face consequences of imprisonment or fine. Corporate entities that were found to be in breach of the covid-19 regulations and directives as issued by the Department of Employment and Labour regarding covid-19 compliance have been receiving correction notices, compliance orders and even prohibition orders.³⁴³

Companies have a legal duty to ensure their strict compliance with the covid-19 regulations and other relevant Acts, but the majority are still not taking precautions seriously enough or are avoiding them entirely. The Department of Employment and Labour Inspectors responding to whistle-blowers complaints, found that in the public sector compliance with covid-19 prevention requirements was only 47 percent and in the private sector 57 percent.³⁴⁴

4.4.2 Non Compliance with the law in general in view of section 332 of the Criminal Procedure Act 51 of 1977

Section 332 of the Criminal Procedure Act 51 of 1977 (hereinafter CPA) generally deals with the criminal liability of corporate entities for any criminal activity.³⁴⁵ Criminal liability can be defined to mean holding a corporate entity criminally liable for crimes that the corporate has committed or for crimes that have been committed in endeavouring to further the interests of the corporate entity.³⁴⁶ The aforementioned Act does not only limit its application on homicide, but it includes all other crimes that a corporate entity is capable of committing.³⁴⁷

³⁴² Act 57 of 2002, s 60.

³⁴³ GO LEGAL 'Don't be penalised for COVID-19 non-compliance' 19 August 2020 available at <https://www.golegal.co.za/covid-19-non-compliance/> (accessed 24 October 2021).

³⁴⁴ GO LEGAL 'Don't be penalised for COVID-19 non-compliance' 19 August 2020 available at <https://www.golegal.co.za/covid-19-non-compliance/> (accessed 24 October 2021).

³⁴⁵ Act 51 of 1977, s 332.

³⁴⁶ Farisani DM 'Corporate Criminal Liability in South Africa: What does History Tell Us About the Reverse Onus Provision' (2017) 23 (1) *Fundamina* 3.

³⁴⁷ Nana NC 'Corporate Criminal Liability in South Africa: The Need to Look Beyond Vicarious Liability' (2011) 55 (1) *Journal of African Law* 90.

The South African Criminal Procedure Act creates a broader scope for corporate criminal liability.³⁴⁸ Section 332 (1) of the CPA provides that an employee's criminal liability for any wrongful act or omission committed in the exercising of his powers or performance of his duties can be imputed to the company.³⁴⁹ The reference to 'director' or 'servant' made by the aforementioned Act suggests that the status or rank of such employee is irrelevant.³⁵⁰ Whether such servant is acting outside the scope of his employment duties is immaterial, what must be proven is that the servant is furthering or endeavouring to further the interest of the company.³⁵¹ The liability of the corporate entity as provided for in section 332(1) covers all acts performed by all the directors and servants of the corporation in the workplace or in a place that is presumed to be the workplace during working hours or during those times that are presumed to be working hours.³⁵² Section 332 (2)(c) of the Act provides that a fine is the criminal sanctions that may be imposed on a corporate offender.³⁵³ However, it is important to note that the Act is also applicable to non-incorporated entities such as partnerships, associations etc.

Nana argues that section 332 imputes vicarious criminal liability on the corporate entity for all types of offences irrespective of whether the element of mens rea can be proven and this stands against the general rule of not imposing criminal liability for the crime committed by another party.³⁵⁴ Nana further argues that the conviction granted on this basis is unfair and will lead to a grave injustice.³⁵⁵ It is on this basis that this research therefore submits that section 332 of the CPA acts as an impediment on the growth and development of SMEs. It was mentioned early in this research that SMEs don't have the internal capacity to deal with this difficult matters of the law and outsourcing such functions is onerously expensive. Further, considering the fact that SMEs have a lower turnover as compared to large corporate entities, it is submitted that holding

³⁴⁸ Nwafor AO 'Corporate Criminal Responsibility: A Comparative Analysis' (2013) 57 (1) *Journal of African Law* 103.

³⁴⁹ Act 51 of 1977, s 332(1)(a) & (b).

³⁵⁰ Nwafor AO 'Corporate Criminal Responsibility: A Comparative Analysis' (2013) 57 (1) *Journal of African Law* 104.

³⁵¹ Act 51 of 1977, s 332(1).

³⁵² Nana NC 'Corporate Criminal Liability in South Africa: The Need to Look Beyond Vicarious Liability' (2011) 55 (1) *Journal of African Law* 96.

³⁵³ Act 51 of 1977, s 332 (2)(c).

³⁵⁴ Nana NC 'Corporate Criminal Liability in South Africa: The Need to Look Beyond Vicarious Liability' (2011) 55 (1) *Journal of African Law* 96.

³⁵⁵ Nana NC 'Corporate Criminal Liability in South Africa: The Need to Look Beyond Vicarious Liability' (2011) 55 (1) *Journal of African Law* 103.

SMEs criminally liable for the crimes committed by its servants is unfair because these are entities of which its directors have lower level of education and cannot understand these difficult concept of the law. Further, it can also be said that not holding SMEs criminally liable for the crimes committed will be unfair to the victims of crimes committed by SMEs or their employees. Hence, the research submits that auditors be appointed in every area of SMEs operations to assist SMEs with legal matters to ensure compliance.

4.5 CONCLUSION

This chapter discussed the role of the SMEs in South Africa. It found that SMEs make a significant contribution to the creation of jobs, they also contribute to the economy and the GDP of the country. However, it was established that even though the South African government throughout the years have tried to assist SMEs to grow and develop, such efforts did not bear any positive results as the SMEs are still failing and many cannot reach the maturity stage. It is submitted that the legal requirement of the corporate governance that requires SMEs to be compliant with the law is a legal burden to SMEs as these enterprises are very small and they do not have the internal capacity such as lawyers and auditors to deal with difficult legal concepts. Compliance with labour laws, tax laws, BBBEE laws and covid-19 regulations impede the growth and success of these entities.

The chapter further highlighted that corruption, nepotism and favouritism when it comes to the awarding of tenders to SMEs is a legal burden to SMEs that are upholding the corporate governance principles such as the principle of accountability, integrity and fairness. It is submitted that these SMEs that upholds the principles of corporate governance end-up suffering the consequences of upholding principles of corporate governance as they are unable to secure government tenders and therefore end-up not making profit. In addition, the covid-19 pandemic made matters worse for SMEs as these are small enterprise that lack finances to buy PPEs during this difficult times of the pandemic. The majority of these enterprises rely heavily on their profit for survival and also corruption on the PPE tenders affected SMEs that could not benefit fairly from such government tenders.³⁵⁶

³⁵⁶ Auditor General *First Special Report 2020 – First Special Report on the financial management of government’s Covid-19 initiatives* (2020) 1 – 168.

Notwithstanding, the legal burden of the corporate governance of compliance with the law as discussed this research encourages all SMEs to comply with the law as compliance is necessary and all corporate entities including SMEs must comply. The research is pleading with the government to try and reduce the legal burden on the SMEs. It goes without saying, that the government with its initiatives and creating institutions that makes funding available to SMEs, SMEs still fails to survive and grow. It is for the reason that this research submits that the legal burden on SMEs could be one of the reasons for their failure. The next chapter will briefly summarise conclusions from previous chapters, it will also provide for recommendations and lastly final thoughts will be presented thereafter.



CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

SMEs in South Africa play a vital role in employment creation and the economy of the country and therefore South Africa should not be lagging behind when it comes to addressing the challenges that these enterprises encounter in complying with the legal burden imposed by the regulations. South Africa should limit or minimise the legal burden on SMEs as matter of urgency if these enterprises are to survive and reach the maturity stage.

5.2. CONCLUSIONS

The principles of good corporate governance demand directors to uphold the law this includes ethical conduct, legislation and king reports.³⁵⁷ Principle 13 of King IV report requires companies to adhere to statutory obligation, disclose measures to mitigate non-compliance and disclose repeat non-compliances and sanctions imposed.³⁵⁸ Corporate entities should comply with the law, non-compliance with the law is not good corporate governance. There is a clear link between the law and corporate governance. This research established that corporate governance is the law and therefore all corporate entities including SMEs must comply with it.³⁵⁹ The research established that non-compliance with the corporate governance principle is non-compliance with the law and therefore those that do not comply will suffer legal consequences.³⁶⁰

The corporate governance principles which includes leadership, accountability, transparency, integrity and fairness are applicable to SMEs.³⁶¹ SMEs like many large companies can also enjoy the benefits of corporate governance if well implemented in their establishments.³⁶² SMEs must comply with all laws applicable to juristic persons more especially corporate entities. However, it is submitted that a one-size-fit-all approach is not practically possible. Therefore, the law that is applicable to corporate

³⁵⁷ King IV Report on Corporate Governance for South Africa (2016).

³⁵⁸ King IV Report on Corporate Governance for South Africa (2016).

³⁵⁹ Chapter 3 para 3.5.

³⁶⁰ Chapter 3 para 3.5.

³⁶¹ Chapter 2 para 2.3.

³⁶² Chapter 2 para 2.4.

entities must be revisited in order to accommodate SMEs. These laws as discussed in chapter 3 para 3.3 include, municipality regulations, BBBEE regulation, Labour laws, tax laws and Covid-19 regulations.³⁶³ It was found that throughout the years the government has tried to support SMEs to grow and develop through establishing institutions that will make initiatives and funding available towards the development of SMEs, it seems as if such efforts are not adequate in assisting SMEs succeed. The research submits that the legal burden of good corporate governance is one of the contributing factors to the failure of SMEs. SMEs should enjoy some exceptions from having to comply with some of the stringent legal regulation. The research is pleading with the government to minimise or reduce the legal burden of corporate governance on SMEs by revisiting laws that regulates corporate entities in South Africa.

5.3 RECOMMENDATIONS

It is therefore recommended that a national sectoral determination is considered to be put in place which provides that SMEs with a certain turnover are automatically exempted from compliance with certain laws and that every legislation or provision in every legislation that seeks to benefit SMEs and providing that SMEs must apply to be exempted from compliance must be revisited. It is submitted that, it cannot be correct that SMEs can only be exempted from compliance by application. It was found by many authors that owners of SMEs have lower level of education,³⁶⁴ it is on this basis that it is argued that SMEs owners do not have legal knowledge and cannot understand and interpret difficult legal concepts. In this regard SMEs will have to outsource legal services and outsourcing such legal services is onerously expensive.³⁶⁵

Even if, SMEs can apply for a certain exemption as provided by a certain legislation, the process of applying for such exemption is lengthy as relevant parties need to make proper determination as to whether such exemption must be granted or not. For instance, section 15 of the Minimum Wage Act 9 of 2018 provides that an employer or an employer's organisation may apply for exemption from paying the minimum wage.³⁶⁶ It is submitted that SMEs especially those that are newly established should

³⁶³ Chapter 3 para 3.3.

³⁶⁴ Chapter 3 para 3.3.

³⁶⁵ Chapter 4 para 4.3.2.

³⁶⁶ Chapter 3 para 3.3.3.4.

be exempted for a certain period of time. The aforementioned section provides that the granting of such exemption should not be longer than a year,³⁶⁷ this is welcomed by the research by considering the fact that there is a need for a minimum age which will assist the country to eradicate poverty. As long as such exemption is not granted by application. It can be provided that SMEs that are less than one-year-old or for whatever period the legislature deemed it necessary must enjoy the automatic exemption from compliance in terms of section 15 of the aforementioned Act. It is clear that the legislature by including exemptions for minimum wage compliance knew or ought to have known that some corporate entities or employer or employer's organisation in terms of the Act would find it difficult if not impossible to be able to comply with the minimum wage requirement. It is submitted that SMEs by their nature and size need exemption for a reasonable period of time and to say that they must apply is unnecessary. It is unnecessary for legislatures to include in legislation that SMEs or those that cannot comply because it is clear that these enterprises are small and in most instances finds it difficult to comply.

Niewenhuizen submits that labour law must be revisited as it is the source of severe problems for small enterprises especially when it comes to increasing or reducing workforces by these enterprises.³⁶⁸ Luvhengo and Thomas also provides that labour laws that are less onerous must be established small enterprises as it is difficult for these enterprises to comply with labour laws that are currently stringent and, by implication, to uphold the corporate governance principles.³⁶⁹ Labour laws must be tailored in a manner that will protect employees and also to promote legal compliance of employers.³⁷⁰

With regard to tax compliance Scholtz and Gravenorst write that the cost of tax compliance and tax education is a significant challenge in South African SMEs because of the fact that these enterprises lack the necessary staff resources and skills to timeously and fully comply with tax matters.³⁷¹ The resources that have to be put in

³⁶⁷ Minimum Wage Act 9 of 2018, s 15 (2).

³⁶⁸ Chapter 4 para 4.3.2.

³⁶⁹ Luvhengo NE & Thomas A (2020) 19.

³⁷⁰ Chapter 4 para 4.3.2.

³⁷¹ Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises (SMEs)' Deloitte available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed on 10 October 2021).

place in order to comply with tax rules and the high fines or penalties for non-compliance with tax regulations is onerously expensive.³⁷² SMEs should be exempted from complying with these regulations for a certain period of time from the period of their registration. This period will be of appreciable help to SMEs as it will be used to learn about corporate regulations which include tax regulations while they work on establishing and growing their business without any burden of having to comply while they just established their business and lacking experience and knowledge of the laws that regulates corporate entities. This will encourage SMEs that are not registered to register their business establishment and after the period of exemptions lapses they will automatically qualify to pay tax and they will not have any excuse as to why they could not comply with any regulations.

Further, it is also recommended that the South African government and SME development organisations adopt simplified corporate governance principles and standards that are exclusive to SMEs considering that its owners don't have adequate education, this will improve compliance.³⁷³ It will further assist in creating a desire for SMEs to compete, improving their competitiveness and enhance their growth and sustainability in the long run.³⁷⁴

Furthermore, SME managers and owners would have to undergo some form of training and education about the importance of complying with the principles and practices of good corporate governance.³⁷⁵ This can be achieved by establishing SME corporate governance workshops and also conferences to provide adequate training.³⁷⁶ This will assist in ensuring that SMEs comply with the law which includes complying with principles of good corporate governance. In addition, there can be some mentorship provided to the newly established or failing SMEs by the SMEs that have succeeded in exceeding the survivalist stage and also those that have successfully complied with the principle of good corporate governance and grew from

³⁷² Scholtz A & Gravenorst C 'The tax compliance burden for small and medium term enterprises (SMEs)' Deloitte available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/AntheaScholtz_ClaudiaGravenorst_The_tax_compliance_burden_for_small_and_medium_term_enterprises.pdf (accessed on 10 October 2021).

³⁷³ Sibanda H, Sinda K & Pooe D (2017) 9.

³⁷⁴ Sibanda H, Sinda K & Pooe D (2017) 9.

³⁷⁵ Sibanda H, Sinda K & Pooe D (2017) 9.

³⁷⁶ Sibanda H, Sinda K & Pooe D (2017) 10.

it. The government must establish a corporate governance fund specifically set aside for those SMEs that find it costly to practice good corporate governance.³⁷⁷

Lastly, it is then submitted by this research that auditors should be appointed by the government specifically for SMEs operation in each and every district or area where there is an existence of SMEs. This will contribute significantly to the development, growth and success of SMEs. These auditors will equally ensure that there is compliance of the law because compliance with the law is good corporate governance. The duties of the appointed auditors in this regard will include but not limited to ensuring that there is tax compliance, labour law compliance and that there is good administration. Further, the auditor will be able to identify SMEs that need exemption in terms of specific provisions of law and duly assist those SMEs to apply for such exemption.

5.4 FINAL THOUGHTS

Minister Lindiwe Zulu's speech at the UWC's Chancellor's roundtable on the 12 of November 2014 titled "Should universities invigorate small development in SA", it mentioned challenges that small business face which include the lack of access to finance, low skills resources and most importantly the unfavourable regulatory and policy environment that these enterprises are exposed to.³⁷⁸ The main purpose of this study was to focus on evaluating the legal burden of good corporate governance on SMEs in South Africa in view of the covid-19 pandemic. Throughout the years the South African government has established a lot of initiatives with the aim of supporting and growing the SME sector and establishing institutions that provides financial assistance to SMEs in order to redress the injustices of the past.³⁷⁹ Notwithstanding the effort made by the government in assisting SMEs this research found that SMEs continue to fail. It is for this reason that it is submitted that the regulations that govern and regulate corporate entities in general and SMEs in particular must be considered. It is believed that SMEs continue to fail because of the legal burden of having to comply with the principles of good corporate governance.

³⁷⁷ Sibanda H, Sinda K & Poee D (2017) 9.

³⁷⁸ University of the Western Cape 'Should universities invigorate small business development in SA?' available at <https://www.uwc.ac.za/news-and-announcements/events/should-universities-invigorate-small-business-development-in-sa-4257> (accessed on 07 November 2021).

³⁷⁹ Ramukumba T 'Overcoming SMES Challenges Through Critical Success Factors: A Case of SMES in the Western Cape Province, South Africa' (2014) 16 *Economic and Business Review* 22.

The SME sector in South Africa has experienced some challenges with the legal regulations imposed on them.³⁸⁰ The policy makers also find it difficult to regulate SMEs as this includes very small corporate entities and some are even informal.³⁸¹ It was found that corporate governance is also applicable to SMEs and is not only limited to larger corporate entities.³⁸² SMEs can also benefit from compliance with corporate governance principles such as fairness, accountability, integrity, transparency and disclosure.³⁸³ There is a link between corporate governance and the law, it is clear that the two are inter-connected and cannot operate in isolation. Because of this link the research argued that non-compliance with the law is not a good corporate governance and therefore compliance with the law is necessary. Good corporate governance is very fundamental to all corporate entities or organisation and if well implemented corporate scandals, fraud, civil and criminal liability of the company could be prevented.³⁸⁴ Corporate entities would not suffer consequences of non-compliance.

In conclusion, it is important to emphasise that SMEs in the South African economy makes a significant contribution and its compliance with the law is crucial as the principle of good corporate governance demands compliance with the law.³⁸⁵ Thus, in order to ensure that SMEs remain compliant the flexibility of the law in this regard is necessary, the law should take into account the challenges faced by this sector and not impose harsher legal restrictions.³⁸⁶ This will encourage establishments of new SMEs and the success of existing SMEs in South Africa.

³⁸⁰ Nieuwenhuizen C (2019) 667.

³⁸¹ Nieuwenhuizen C (2019) 667.

³⁸² Sibanda H, Sibanda K & Poee D (2013) 11.

³⁸³ Radebe MS (2017) 274.

³⁸⁴ Radebe MS (2017) 272.

³⁸⁵ King IV Report on Corporate Governance for South Africa (2016).

³⁸⁶ Beyene A (2002) 134.

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