South Africa

STARTUP ACT

POSITION PAPER – UPDATE SEPTEMBER 2021

"Entrepreneurship does not take place in a void, at random or under the general influence of homogenous economic conditions. It occurs in specific places that create the right conditions for it and within the context of a particular set of incentives, opportunities, and barriers."[1]

Preamble

The South African Start-up Act is (i) a proposed Economic Bill; (ii) which may be introduced as a stand-alone Act, or a set of proposed amendments to an existing Act (such as the National Small Enterprise Act); (iii) that outlines a set of provisions with which to support the ecosystem that supports the creation of high-growth enterprises; (iv) where such enterprises are in the formation, or early growth-phases, thus being considered start-ups; and (v) with the overarching purpose of accelerating socio-economic growth, development, competitiveness and the transformation of the South African economy through the increased involvement and impact of successful start-ups.

The proposed Act is (i) rooted in the National Development Plan which targets a radical increase in the role of small and medium size businesses in the national economy, (ii) echoes National Treasury's policy on Economic transformation, inclusive growth, and competitiveness, (iii) gives effect to the ANC's declarations that small enterprises need fair access to finance and market access, by removing barriers to entry, (iv) takes note of the Presidential Commission on the Fourth Industrial Revolution and the critical finding that "small enterprises have to be positioned for the commercialisation of home grown innovations and building these to global scale and relevance", and significantly, (v) builds on the fact that South Africa has a vibrant and globally recognised start-up ecosystem.

The purpose of the Act is therefore to outline ways in which to accelerate the success and contribution of start-ups and high-growth firms to the national economy, *by removing and/or reducing those burdens* that are keeping such firms from playing a larger role and having a greater impact in the national economy.

The Act is a call to the President of South Africa to unleash the growth and innovation embedded in our entrepreneurs and youth, by exempting qualifying new enterprises with a turnover of less than R100 million[2] from the limitations of existing policies and red-tape that constrain their growth and ability to contribute to job creation, and in doing so accelerate the social and economic spill over of such start-ups to the rest of South Africa.

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[1] Monitor Group. 2009. Paths to Prosperity, Promoting Entrepreneurship in the 21st Century, Pg 22.

[2] This is similar to the round yet bold figure of a "100MW" threshold amount announced by the President for local power generation without need for regulatory pre-approvals.

Two-prong approach

During stakeholder consultation, the two main options for introducing a new bill were discussed. This included the development of an omnibus of acts, meaning one Start-up Act that covers all existing regulations and provisions embedded in existing but diverse laws, so as to harmonise all the elements needed to achieve the objectives of the Start-up Act. This however will in all likelihood take a significant effort and could entail a lengthy development time.

The second option is to utilise an existing law, and introduce the desired components of the Start-up Act as an amendment to such a law. There appears to be a very realistic and appropriate opportunity to do so through the current call for amendments to the National Small Enterprise Act via the Draft National Small Enterprise Amendment Bill in 2021/22 (previously referred to as the Small Business Act or SBA). This may speed up the process by reducing efforts needed for public consultation and stakeholder buy-in, as the SBA is an existing act.

Call to action

The SA Start-up Act Position Paper is a call to action, addressed to the broader start-up community in South Africa – including start-ups and scale-ups, entrepreneurs, regulators and policy makers, as well as the investor community – to share their inputs and provide feedback as to the prioritisation of the applicable interventions proposed in this position paper.

PART 1: PRELIMINARY

1. **Title:** South African Start-up Act
2. **In the proposed Act, –**

"Fourth Industrial Revolution or 4IR" is a fusion of advances in artificial intelligence (AI), robotics, the Internet of Things (IoT), genetic engineering, quantum computing, and more. In South Africa it represents a new era of innovation in technology – one that's enhancing human-machine relationships, unlocking new market opportunities, and fuelling growth across the global economy.

"DSTI" is the National Department of Science, Technology and Innovation.

"high-growth start-up" is a new enterprise, be it for-gain or not-for-gain, and be it private, public, NPO or otherwise, and where the difference from other early stage businesses and entrepreneurial ventures is the intention to position and manage the start-up so as to achieve above-average growth.

"OECD" is the Organisation for Economic Co-operation and Development (OECD), an international organisation that works to build better policies for better lives. Its goal is to shape policies that foster prosperity, equality, opportunity and well being for all.

"Qualifying Start-up" is a business enterprise that meets a set of criteria outlined in the Start-up Act, and in doing so, become eligible to access a set of support measures, incentives and/or beneficial relaxations outlined within the SA Start-up Act.

"R&D 150% tax incentive" is an incentive from the South African government to incentivise private sector investment in Research and Development (R&D).

"R&D professional" is defined as someone that is directly employed on research and development activities.

"Research personnel" includes research and development personnel, which are all persons employed directly on research and development activities, as well as those providing direct services such as research and development managers, administrators and clerical staff.

"National Small Enterprise Act" refers to the South African National Small Enterprise Act of 1996 (and later amendments), which was previously known or referred to as the National Small Business Act (or SBA).

"small enterprise" means a separate and distinct business entity, together with its branches or subsidiaries if any, including cooperative enterprises, managed by one owner or more, predominantly carried on in any sector or subsector of the economy mentioned in column 1 of the Schedule[3] and classified as a micro, small or a medium enterprise by satisfying the criteria mentioned in columns 3 and 4 of the Schedule.

"SMME" is a small, medium or micro sized enterprise as defined in the National Small Enterprise Act of South Africa. The use of SMME has been replaced in amendments of the SBA to be referred to as small enterprises.

"start-up ecosystem" defined by the Start-up Commons[4] is a ring-fenced networked collection of entities, including physical and human actors, that collectively comprise the region, locale or grouping's capability in so far as seeding, creating, fostering, nurturing and sustaining high-growth start-up enterprises.

"start-up" is a team of entrepreneurial talent developing new innovations, in identifiable and investable form, in progress to validate and capture the value of the created innovation - with the ambition to grow fast with a scalable business model tailored for maximum impact."[5]

[3] Schedule of the Small Enterprise Definition as contained in the National Small Enterprise Act.
[4] https://www.startupcommons.org/what-is-startup-ecosystem.html
[5] https://www.startupcommons.org/what-is-a-startup.html

3. **Scope: -** The proposed bill shall apply to small enterprises that have been in business for five years or less, that meets and operates within a certain set of criteria outlined in the Bill.

SECTION 1: BACKGROUND TO THE DEVELOPMENT OF THE PROPOSED SA START-UP ACT

4. Context

Stimulating the establishment of, and leveraging new business enterprises, or so-called start-ups has emerged as a vital development policy in reshaping economic activity in many countries around the world[6]. Young firms account for about 20% of employment but create almost half of new jobs on average across OECD countries[7]. Many countries are heeding the OECD example by emphasising the role of start-ups in respective national development and economic policies.

This insight is not limited to South Africa as there has globally been increased attention given to the improvement of start-up ecosystems: boosting the collective network of players and interventions that enable the functioning of start-ups in any specific region. Examples of such improvements include increasing access to capital for early stage ventures, easing the regulatory burden on small enterprises, as well as creating a more amenable labour regime with which to ensure that start-ups have access to the necessary talent[8].

Several nations have already, and others are increasingly looking towards improving the legal systems, be it laws and regulations that influence the formation and expansion of start-up ecosystems[9]. Such interventions aim to introduce and/or enhance the laws that address the legislative, policy and/or regulatory prerequisites, and often shortcomings of a particular start-up ecosystem. In some countries, such interventions have taken the label of Start-up Acts.

Support outlined in Start-up Acts comprises a mixture of direct firm level support including access to finance and business advisory, as well as indirect support such an assortment of regulatory incentives. Additionally, support through Start-up Acts may focus on aspects related to regulation reform[10].

The 2014 SiMODiSA White Paper calls for private sector investment in SMEs, especially so-called high-growth small enterprises, with the latter defined as being fast-growing and dynamic businesses that have the potential of significant job creation and economic development.

Key stakeholders in the South African start-up ecosystem, many of which are represented in the Start-up Act Steering Committee, initiated a proposal to investigate the merits of introducing a special act in South African Law that speaks to the unique needs and objectives of growing and supporting the South African start-up ecosystem.

[6] Klenow, P J and H Li (2020). "Innovative Growth Accounting", in NBER Macroeconomics Annual 2020, Vol. 35, University of Chicago Press.
[7] "No Country for Young Firms?", Policy Note, Directorate for Science, Technology and Innovation Policy Note, June.
[8] "Supporting people and companies to deal with the COVID-19 virus: Options for an immediate employment and social-policy response", Tackling coronavirus (COVID-19) Contributing to a global effort.
[9] https://africaeurope-innovationpartnership.net/news/startup-acts-are-next-form-policy-innovation-africa
[10] "Start-up Acts and supporting entrepreneurship", dated 15 April 2021. Justin Hill, FCI Global Practice, World Bank Group.

5. **Origin**

The SA Start-up Act White Paper is a ground-up initiative and undertaking of the SA Start-up ecosystem. The initiative is coordinated by a Steering Committee that consists of organisations within the South African entrepreneurship ecosystem that have rallied together to advocate for the establishment of a Start-up Act in South Africa. These organisations include SiMODiSA (Secretariat), i4Policy, Endeavor South Africa, Silicon Cape, SAVCA, Loud Hailer and the Digital Collective Africa.

The research component of the Start-up Act position paper is funded and supported by the World Bank and a representative of the bank sits on the Steering Committee. The research considered local and global start-up acts and policies, and formed the basis for the assessment of the merits for promulgating for the introduction of a Start-up Act in South Africa.

6. **Development of the proposed Act**

The development of a South African Start-up Act Position Paper comprised of three main components, being (i) a review of available research, data, case studies and information about existing and planned start-up acts around the globe; (ii) public consultation with key players in the South African start-up ecosystem, to review research findings, and to supplement thinking based on insights from said key players; and (iii) the development of an SA Start-up Act position paper (this document) outlining the conclusion from the assignment in so far as the merits of promulgating a Start-up Act for South Africa.

7. **Why does South Africa need a Start-up Act?**

   a. ***Start-ups are integral to the transition to, and future state of the South African economy***

      i. South Africa is undergoing a transition from resource to knowledge as the main drivers of the economy.
      ii. The Services economy is the largest contributor to GDP, with this contribution growing faster than other sectors of the economy.
      iii. Start-ups are integral to both the transitioning from resource to knowledge, as well as the services economy.
      iv. Such start-ups have the potential to become high-growth enterprises, being enterprises underpinned by innovation, and that achieve above average outputs in terms of growth, job creation and socio-economic impact.
      v. The formation, growth and successful impact of such start-ups are a function of the combined eco-system that supports start-ups.
      vi. The status, health and expansion of the start-up ecosystem needs to be elevated, emphasised and prioritised within South African national economic policy, for its impact to grow exponentially, rather than organically, and in doing so play a meaningful role in addressing the objectives of the NDP in so far as economic transformation, inclusive growth, and competitiveness.

   b. ***Why focus on High-Growth potential firms?***

   The intention to focus on high-growth enterprises as opposed to new enterprises in general (e.g. entrepreneurial ventures, sole proprietors and other forms of small enterprises) is the objective to leverage such high-growth start-ups as instruments with which to boost the economy by increasing the taxable revenue base, fostering innovation and positively impacting on job creation. The vast majority of new business enterprises (thus micro or small start-ups in general) that exist beyond the first three years of operations do not grow. Rather is it the remaining balance comprised of a tiny portion of start-ups that are responsible for creating a disproportionate number of jobs[11]. This is the reason for the focus on high-growth start-ups, rather than small enterprises in general.

Policy makers are increasingly focusing on incentives and framework conditions that escalate the initiation, growth and success of high-growth enterprises. Such enterprises are seen as important drivers of economic growth, employment and social value. They offer potentially significant leveraged returns to government investment as their success creates further growth in the economy and overall supply chain. This growth is often correlated to a presence of innovation, which has resulted in a keen focus on identifying effective policy measures to foster innovation as a precursor to a fertile environment for high-growth and innovative small enterprises.[12]

EuroSTAT and OECD policy[13] defines high-growth enterprises as being fast-growing and dynamic businesses that have the potential of significant job creation and economic development[14].

Local policy makers, evident from a recent publication by the Economic Policy unit of the South African National Treasury, share these insights:

"There is growing awareness that there is a subset of firms in the economy—high-growth firms (HGFs)—that contribute disproportionately to net employment growth. These firms also contribute disproportionately to innovation and productivity growth. HGFs are broadly defined as the fastest growing firms in the economy and have been found to be responsible for a disproportionate contribution to net employment growth in developed countries (Shane 2009). HGFs are the most productive and innovative firms in their industries (Li and Rama 2013) and consistently create a disproportionately large share of new jobs at any given point in time across different countries."[15]

c. ***High-growth potential start-ups need to be a national imperative***
    i. A Start-up Act can be a made-to-measure implementation platform with which to give effect to the call in the National Development Plan for greater focus and support of the role of entrepreneurs in the South African economy; in doing so achieve exponential growth in the contribution of small enterprises to the South African GDP.
    ii. A Start-up Act can be a vital policy instrument in the quest to create socio-economic transformation.
    iii. A Start-up Act is purposed to spearhead economic development, growth and job creation.

[11] Calvino, F., C. Criscuolo and C. Menon (2015), "Cross-country evidence on start-up dynamics", OECD Science, Technology and Industry Working Papers, 2015/06, OECD Publishing, Paris. Last accessed in July 2021 from http://dx.doi.org/10.1787/5jrxtkb9mxtb-en. More or less 5% of new micro start-ups grow quickly in the first few years, but account for between 21% and 51% of total job creation from the sample group.
[12] 2014 SiMODiSA White Paper.
[13] Eurostat & OECD. 2007. Eurostat OECD Manual on Business Demography Statistics. OECD.
[14] SiMODiSA: Accelerating growth of small and medium enterprises in South Africa. Policy recommendations for enhancing the start-up/SME ecosystem in South Africa, 2014.
[15] Economic transformation, inclusive growth, and competitiveness: Towards an Economic Strategy for South Africa. Prepared by Economic Policy, National Treasury

iv. A Start-up Act will transcend ministries and overlapping policies impacting on small enterprises, if placed and coordinated within the Office of the President of South Africa.

d. ***South African law does not have a uniform definition for, or clear policy support for high-growth start-ups, including silence on the link between start-ups, high-growth firms and the NDP***

There is currently no single, articulated, uniform and aligned policy instrument in South Africa, that outlines a cohesive set of regulations, laws and policies aimed at accelerating the strength and impact of the SA start-up ecosystem, in so far as accelerating the formation and support of successful high-growth start-ups.

i. Existing policies are silent on the role and value of start-ups and high-growth firms in the South African economy.

ii. Lack of policy linkage and support for start-ups within the context of the NDP means that incentives and support for start-ups essential to achieve high-growth potential is either non-existent, or lost in the general discourse loosely grouped alongside everything resembling small enterprises, and tagged as SMEs. This despite overwhelming global evidence that only a small percentage of small enterprises referred to as high-growth firms, achieve the objectives of job creation, economic transformation and competitiveness.

iii. Policy certainty is further complicated through overlaps between the mandates of different ministries, not only those primarily responsible for policies impacting on small enterprises, as almost every government department has a priority demarcation for small enterprises. This leads to conflicting incentives and even contradictory objectives in so far as outlining the support for small enterprises that may or may trickle down as support for high-growth start-ups.

e. ***A Start-up Act can bridge the policy vacuum with which to accelerate the impact of start-ups within the objectives of the NDP***

A Start-up Act is a possible intervention with which to provide an agreed definition for a high-growth enterprise, relevant to delivering high-growth impact. This includes the need to formulate and articulate the following foundations from which to support and grow the SA start-up ecosystem:

i. Legal definitions for start-ups, start-up ecosystem and high-growth enterprises;

ii. Labelling (to distinguish from other labels such as small enterprises, tech(nology) enterprises, SMEs, entrepreneurial businesses and many others);

iii. Harmonisation of policies and acts that have direct bearing on start-ups; and

iv. Outline specific interventions that are needed to support qualifying start-ups with the potential to become high-growth firms.

f. ***A law holds more stature than policy***

Through law, the various objectives with which to support the start-up ecosystem can be consolidated through a legislated set of regulations that supersede political terms, changing policies and self-interest, while facilitating accountability.

8. Development Roadmap

1. First draft for Steering Committee inputs and review.
2. Second draft for stakeholders involved with the consultation process.
3. Draft Position Paper on Start-up Act published for circulation (this document).

4. Public workgroups for comments on the Position Paper.
5. Updates to Position Paper based on public comments received.
6. Development of a Green Paper (a first draft of the Start-up Act Policy drafted by the applicable Ministry).
7. Circulation of Green Paper for public comments.
8. Development of White Paper
9. First draft bill amendments drafted.

SECTION 2: PURPOSE OF THE SOUTH AFRICAN START-UP ACT

9. Socio-economic foundation

The contribution of small businesses to the national GDP has increased by almost 40% between 2013 and 2019, despite large businesses still dominating the economy. The South African start-up ecosystem is clearly growing and increasingly contributing to the national GDP[16]. The events of July 2021 in Kwazulu-Natal and Gauteng are a stark reminder that the country is at a critical crossroad in so far as socio and economic policy, with national unemployment and the impact of COVID-19 lying bare the failures of not attaining the objectives outlined in the National Development Plan. South Africa is missing out on the benefits to its economy from start-ups and high-growth enterprises by remaining slaves to a resource driven economy, and negating the opportunities embedded in our burgeoning services sectors.

South Africa can ill afford to wait patiently for the eventual trickling down effects from current levels of entrepreneurial activity, especially if these are reduced to organic growth at best. A 2019 World Bank report on the Digital Economy in South Africa cautioned that the country couldn't afford the status quo. The report highlighted recent successes in the form of globally recognised tech and start-up ecosystems, successful fund raising for digital ventures, as well as the reinvestment into the sector by an increasing number of up-and-coming South African digital entrepreneurs. But, it highlights various weaknesses in the South African policy and regulatory frameworks such as an insufficient supply of digital skills, inadequate access to funding, lack of ecosystem coordination, and inclusivity to name a few[17].

The report published by the Presidential Commission on the 4th Industrial Revolution[18] highlights the need for "strategies that place emphasis on leveraging and harnessing capabilities in the private sector to find scalable and profitable solutions that simultaneously unlock social and economic value". Small enterprises are earmarked to fill the void left by jobs made redundant through the 4IR, by using innovation and digitalisation to create new opportunities and drive economic renewal[19].

"The Fourth Industrial Revolution is about more than just technology-driven change; it is an opportunity to help everyone, including leaders, policy-makers and people from all income groups and nations, to harness converging technologies in order to create an inclusive, human-centred future. The real opportunity is to look beyond technology, and find ways to give the greatest number of people the ability to positively impact their families, organisations and communities[20]."

But the global economic revolution toward a more important role for start-ups is clearly happening also in South Africa. The Start-up Act has its objective to LEVERAGE this global movement, so that the full potential of South Africa and its people can be realised. South Africa was ranked 52nd in the 2020 StartupBlinks 3rd global start-up

[16] According to StatsSA, the contribution of small business to national GDP increased from 16% in 2013, to 22% in 2019, eating into the comparable share of large business, which has seen its share wane from 75% to 68% over the same period. "Three facts about small business turnover in South Africa". Last accessed from www.statssa.gov.za in July 2021.

[17] World Bank Group. 2019. South Africa Digital Economy Diagnostic. Washington, DC: World Bank. License: Creative Commons Attribution CC BY 3.0 IGO.

[18] Department Of Communications And Digital Technologies Notice 591 Of 2020

[19] https://www.weforum.org/agenda/2019/09/start-up-business-india-fourth-industrial-revolution/

[20] The World Economic Forum, last access in August 2021 from https://www.weforum.org/focus/fourth-industrial-revolution

ecosystem report. On the city rankings Johannesburg skyrocketed 88 spots to 160. Regionally in Africa, South Africa ranks number one.

A 2021 Endeavor impact report based on 28 South African Endeavor Entrepreneurs[21] demonstrates first-hand the impact of supporting and nurturing South African high-growth start-up entrepreneurs:

- Total revenues generated by the 28 companies amounted to R5.6bn in 2020, with average revenue of **R200m per year per business, representing an increase of R 2.7bn additional revenue** since 2017.
- More than **4,234 additional jobs created between** 2017 and 2020, 75% of which were black.
- The cost of jobs created in this way is estimated at R 5,000 per full time employment position, considerably lower than that required by the Jobs Fund (R70, 000 to R120, 000) and the Black Umbrellas initiative (R64, 000), both of which are considered to be exemplary initiatives that respectively focus on earlier stage and/or grassroots entrepreneurs, thus in general not primarily targeting high-growth entrepreneurs.

Investment into South African start-up enterprises is accelerating and increasingly attracting the attention of local and global early stage investors. This is apparent from the latest SAVCA Venture Capital survey report published in 2021:

- South African early stage fund managers concluded a record year of investments in 2020, despite a difficult trading year as a result of the global pandemic, investing R1.39bn into 122 entities; collectively managing an active portfolio of 841 deals amounting to R6.87bn.
- In the last five years, SA VC fund managers invested more than R5.6bn into early stage opportunities, up from R1.3bn in the preceding five-year period, capping off eight consecutive years of year-on-year growth in the total amount of capital allocated to early stage companies.
- The public sector is a major investor into start-up enterprises, holding 28.1% of all active portfolios by value of deals, amounting to R1.75bn.
- The appetite for investment into start-ups is not limited to South Africa, and our entrepreneurs have to compete for investor attention with other start-up ecosystems on the continent.
- Alarmingly though has South Africa lost ground to Nigeria with VC investment in dollar terms almost four times more in 2019 in Nigeria (USD 747 million) compared to South Africa (USD 202 million).

10. Objectives of the South African Start-up Act

The South African Start-up Act is an intervention that sets out to support calls for changes to national economic policy in so far as prioritising Reconstruction, Growth and Transformation, with the objective of building a new, inclusive economy[22]. Accordingly, the Start-up Act espouses the following principal high-level objectives, the details of which are expanded on in later sections:

1. Profoundly increase the contribution and impact of start-ups to the national GDP so as to address the growth objectives outlined in the National Development Plan.
2. Leverage and grow the existing start-up ecosystem so that more South African start-ups can experience high-growth phases and thereby become successful locally and globally.

[21] Endeavor SA Impact Report 2020, published in May 2021.
[22] Reconstruction, Growth and Transformation: Building a New, Inclusive Economy. A discussion Document prepared by the ANC's Economic Transformation Committee, dated 2020.

3. Do so in a way that patriotic and proud South African talented youth and entrepreneurs don't have to relinquish their South African ties as a consequence of experiencing start-up growth and success. The offshoring of firms, IP and people is often a prerequisite to attracting foreign investment, or scaling into global markets.
4. In other words, maximise the value and impact of SA start-ups and successful entrepreneurs for the benefit of South Africa and her people.

11. The Act is based on a mechanism of relaxation for start-ups that meet a set of qualifying criteria

A start-up ecosystem can benefit from a number of different interventions in so far as becoming more efficient in supporting these types of small enterprises. Many such interventions do not require policy changes or new laws. Access to market research, standardised term sheets, pre-approved local and foreign corporate structure best practices, as well as standardised accounting policies, are a few examples of non-policy interventions.

South African firms have benefited significantly from previous state-driven initiatives to support, supplement and grow the start-up ecosystem. These range from various funding interventions and start-up grants, the development of research infrastructure through the National System of Innovation, and tax incentives such as Section 12J. The proposed South African Start-up Act is therefore not a call for an institutional response, or a scheme for new support instruments.

The South African Start-up Act is a policy intervention that seeks to amend or adjust national policy where the latter, evident from research has been shown to impact negatively on start-up businesses and the start-up ecosystem as a whole, thus limiting the potential of start-ups to become high-growth firms.

The Start-up Act seeks to propose a set of relaxations and incentives within the context of said policy and legal environment. It does not intend to replace or propose to change the policy and legal environment as it pertains to South African companies as a whole, and does not preclude the above-mentioned non-policy interventions.

Eligibility for the benefits espoused in the proposed Start-up Act is premised on a potential beneficiary meeting a specified set of criteria.

12. Pillars of the South African Start-up ecosystem considered as relaxation interventions

The following are interventions that feature in start-up acts across the globe. These interventions were further gauged through a process of studying global start-up acts - some of which are in force, whilst others are still in development - as well as reviewing available research on the impact and range of start-up act provisions effective around the globe; the latter of which was made possible through the assistance of the World Bank. The identified interventions were sound-boarded with members of the South African start-up ecosystem, through a range of public engagements taking place in 2021.

The interventions can be grouped according to the main pillars of a start-up ecosystem[23], being:

i. Access to financial capital.
ii. Presence of a supporting entrepreneurial culture.
iii. Access to skilled talent.

[23] Review of the South African tech ecosystem commissions by Google and published by OC&C Strategy Consultants in 2018.

iv. Conducive regulations and the appropriate regulation of business activity relevant to start-ups.
v. Quality and depth of start-up networks.
vi. Supportive infrastructure.
vii. Local and global market access.

The proposed South African Start-up Act does not have to include provisions for each of the above pillars as not all areas of the SA start-up ecosystem requires interventions in law.

SECTION 3: CRITERIA WITH WHICH TO BE DEMARCATED AS A QUALIFYING START-UP

13. A qualifying start-up is defined as a limited company (including cooperatives), not listed, that meets the following requirements:

i. It is newly established or have been incorporated for less than five years;
ii. It has its operational entity based in South Africa;
iii. It has an annual turnover less than R100 million;
iv. It does not distribute its profits, and has not done so in the past;
v. Its mission statement concerns, predominantly or exclusively the development, production and commercialisation of innovative products or services, with a clear technological component, where innovative products or services are defined as per the OECD definition of innovation;
vi. It is not the result of a company merger or split-up, or of a business or branch transfer;
vii. It operates in a permissible sectors of the economy as outlined below; and
viii. Finally, it meets at least one of the three following high-growth related indicators:
   a. Research and development expenditure corresponds to at least 15% of the higher value between turnover and annual costs:
      i. Allowable R&D expenditure as defined per the existing DSTI R&D incentive;
      ii. Start-ups with applicable R&D expenditure needs to register digitally with DSTI for the R&D tax incentive and meet applicable criteria;
      iii. Self-assessment of applicable and qualifying criteria so as to automatically qualify without a DSTI administrative intervention;
      iv. In instances where the start-up turns profitable and thus is able to qualify for a tax credit based on the R&D tax incentive, the credit is automatically approved as long as the qualifying start-up met the rest of the qualifying start-up criteria.
   b. The total workforce includes at least one third qualified R&D professionals[24], with an R&D professional defined as someone that is directly employed on research and development activities; or
   c. The company is the owner or licensee of a registered patent (or it has filed an application for an industrial property right) or it owns original registered software.

14. Applicable industrial sectors relevant to the South African Start-up Act

A key lesson from the Section 12J tax incentive in South Africa is to consider ring fencing the Start-up Act by including industrial sector as a final criteria to be demarcated as a qualifying start-up company. However, the very nature of the business activity of most start-ups entails the digitalisation of the economy. This covers almost all sectors as the underlying drivers of technology and innovation form the basis on which start-ups disrupt and bring change to virtually every aspect of the economy. Compounding this is the fact that the sectors serviced by start-ups are dynamic and ever changing.

For this purpose, it is proposed that the Start-up Act explicitly lists all sectors, or business activities that will NOT be considered when assessing the criteria to be a qualifying start-up. Accordingly, a start-up will be

[24] OECD definition of research personnel: Research and development personnel includes all persons employed directly on research and development activities, as well as those providing direct services such as research and development managers, administrators and clerical staff.

deemed a qualifying start-up if it meets the applicable criteria outlined in Section 13 above, AND if it does NOT operate in any of the sectors listed below. Examples of excluded sectors to be considered include the following:

i. Trade in immovable property (with the exception of trade as a hotel or bed and breakfast owner).
ii. Trade in the banking, insurance, money lending and hire purchase financing sectors. This excludes the development of technology, solutions and products for the banking, insurance, money lending and hire purchase financing sectors.
iii. Operating in the financial sector as an advisory service, including but not limited to legal, tax advisory, stock broking, management consulting, auditing or accounting.
iv. Trade or operation in the gambling industry includes casinos and similar games of chance. This excludes the development of technology, solutions and products for the gambling and associated industry.
v. Trading or operating in the manufacture, buying, or selling of liquor, tobacco products, arms or munitions of any kind. This excludes the development of technology or solutions for the manufacture, buying or selling of liquor, tobacco products, arms or munitions.

SECTION 4: INTERVENTIONS PROPOSED IN THE SOUTH AFRICAN START-UP ACT

The set of interventions outlined below take the form of a relaxation, being a reduction in, or complete exemption from an existing regulation or policy applicable to South African based companies and/or commercial activities.

15. Relaxation window and scope

The South African Start-up Act calls for qualifying start-ups to be exempted for a set period of time (e.g. five years from date of company registration, or once turnover exceeds R100m) from the regulatory and associated burden of indicated existing policies, taxes and implications, through the stated provisions outlined below.

16. Relaxation 1: Provide tax breaks and incentives to encourage investment in Qualifying Start-ups

- ***Title:*** Venture Capital Companies and appropriate incentives to increase access to capital
- ***Start-up ecosystem pillar:*** (i) Access to financial capital

"SMME's must be allowed fair access to finance including through reform of private and public finance lending practices".[25] Accordingly, specific incentives need to be introduced to incentivise capital contributions to early stage funding entities that invest in qualifying start-ups in South Africa (e.g. Venture Capital Companies), especially given the absence of suitable public sector start-up funding, as well as virtually no funding from institutional funds towards the VC and early stage sector in SA.

The basis for qualifying as a VCC is its investment into a qualifying start-up. The definition of a qualifying start-up outlined in this document is subsequently the superseding qualification criteria for selection of investment candidates by the VCC (termed Qualifying Companies in the existing Section 12J tax incentive). The Start-up Act should additionally outline suitable administrative and regulatory preconditions addressing the legal form, operations and reporting requirements of the VCC, taken from the existing VCC dispensation outlined in the Section 12J tax incentive.

In line with the above, incorporate the aspects of the Section 12J tax incentive that contributed to the creation of jobs and investment in early state funding, if such funding leads to investment in a qualifying start-up. Furthermore, give similar tax benefits to corporate entities that contribute funding to investment vehicles that invest in qualifying start-ups.

- ***Title:*** Special tax dispensation for qualifying start-ups so as to increase availability of financial capital
- ***Start-up ecosystem pillar:*** (i) Access to financial capital

Simplify the registration for, and administration of PAYE and VAT for qualifying start-ups, and allow qualifying start-ups to reinvest such taxes that may become due whilst trading as a qualifying start-up, into the growth of the business.

Enable full tax exemption for capital gains accrued to an investor through its investment into a qualifying start-up.

[25] IBID.

17. Relaxation 2: Remove barriers that inhibit access to skilled talent

- ***Title:*** Employment flexibility and special skills visas
- ***Start-up ecosystem pillar:*** (iii) Access to skilled talent

Enable a more flexible employment regime that underpins the ability to appoint and dismiss without fear of CCMA penalties and pro-labour rulings, if such appointments are made by a qualifying start-up. Balance fairness through the availability of financial guarantees (such as for example a UIF benefit for dismissed employees from qualifying start-ups) to safeguard prospective start-up employees when facing dismissal, thereby ensuring that there remains an incentive to take up employment with a start-up. In doing so, create a level field for recruitment from start-ups in comparison to the salaries, benefits and labour law protections on offer from government and Corporate South Africa.

Automatic, fast-tracked and flexible immigration for access to, and continued retention of foreign talent, including foreign talent willing to invest in such South African business opportunities, if such recruitment and appointment is done by a qualifying start-up.

18. Relaxation 3: Remove inhibiting regulatory barriers that hampers globalisation and investment into qualifying start-ups

- ***Title:*** Address Exchange Control Limitations
- ***Start-up ecosystem pillar:*** (iv) Conducive regulations and the appropriate regulation of business activity relevant to start-ups

South African Exchange Control impacts start-ups mainly on two fronts, being the repatriation or offshore movement of South African intellectual property, and secondly limitations placed on the amounts of money moved offshore.

The Start-up Act calls for automatic approvals, and amnesty from current and future ExCon regulatory actions or pursuits against the start-up that may impact negatively on the legal status of the assets in questions; and through granting amnesty, maximise the portability, commercialisation and investment into South African intellectual property.

In addition to the above, the Start-up Act calls for the removal of limitations on, and automatic ExCon approval for the moment of money by a qualifying start-up to finance the expansion of its South African operations in other markets. This could include the offshore movement of money to cover the costs of employment in other markets as well as other working capital costs involved in setting up branches, offices and operations in other countries.

It is additionally proposed that the Start-up Act include the following two specific interventions in regards to ExCon:

- Extend permissible loop structures for start-ups and high-growth firms to allow them to raise international capital by creating a noncash-settled share swap at market value that would not require pre-approval from the South African Reserve Bank, but rather reporting after the transaction.

- IP transactions for exchange control purposes should be aligned to a reporting framework rather than the current pre-approval model. Such reporting should be done within 30 days of the transaction's effective date. Furthermore, transactions between unrelated parties should not require reporting or approval, as reporting would be included in the tax framework.

19. Relaxation 4: A qualifying start-up to be exempted from preferential procurement limitations

- ***Title:*** Automatic Level 1 BBBEE status for procurement and supply chain grading
- ***Start-up ecosystem pillar:*** (vii) Local and global market access

"Small enterprises must be allowed fair access to markets including through removing barriers to entry at wholesale and retail levels"[26]. The Start-up Act proposes automatic relaxation in the extent of BBBEE scrutiny **for the purposes of procurement and supply chain grading**, enabling quicker access to the supply chains of Corporate South Africa and the public sector. This will directly benefit qualifying start-ups by (i) radically increasing the opportunities for market access, (ii) without the restraints and costs intrinsic to obtaining and maintaining BBBEE points and schemes, as well as (iii) enabling capital raising from offshore investors without risking the loss of BBBEE status when local equity is taken up by non-South African investors.

This could be achieved through an amendment to the BBBEE codes, whereby an additional compliance level is introduced, similar to that for Exempted Micro Enterprises, such as "Exempted Start-up Enterprise", and where the status of this BBBEE level is that of a Level 1 BBBEE company. EME and QSE grading currently only enable Level 4 status. Start-ups consulted in the stakeholder sessions communicated losing out to large companies because they are (and can only go as far as) level four as they don't have the resources, enterprise development spending and other capabilities that many large enterprises use to "buy" their level one status.

Despite such relaxations in respect of BBBEE, the company is still obligated to pursue/maintain/ensure BBBEE compliance or risk losing all preferential privileges once the enterprise no longer qualifies as a start-up enterprise.

[26] Reconstruction, Growth and Transformation: Building a New, Inclusive Economy. A discussion Document prepared by the ANC's Economic Transformation Committee, dated 2020.

SECTION 5: OUTCOMES OF THE SOUTH AFRICAN START-UP ACT

20. In conclusion –

The South African Start-up Act is a call to the President of South Africa to unleash the growth and innovation embedded in our entrepreneurs and youth, by exempting qualifying new enterprises with a turnover of less than R100 million[27] from the limitations of existing policies and red-tape that constrain their growth and ability to contribute to job creation, and in doing so accelerate the social and economic spill over of such start-ups to the rest of South Africa.

The following outcomes are foreseen as the immediate impact of implementing the Act:

- Free qualifying start-ups from the compliance costs, inhibiting policies, and bureaucratic practices that prohibit South African domiciled start-ups from (i) attracting foreign investment and (ii) doing business internationally as a South African company.
- Give South African start-ups the opportunity to operate, attract and receive foreign investment and expand globally, without having to repatriate and/or give up their South African status.
- By removing the constraints that come with operating a South African start-up business, substantially increase the probability to achieve rapid growth by creating a growth platform based on (i) benefiting from being uniquely positioned in the South African market (i.e. local market insights, access to local talent, local cost benefits); (ii) being attractive to global investors, and (iii) operating globally as a South African business.
- Address the objectives of the NDP by adding significant momentum to the economic and social transformation of the South African economy, including its competiveness and ability to meet the needs of her citizens, as a direct result of the incentives and relaxations made possible through the South African Start-up Act.

[27] This is similar to the round yet bold figure of a "100MW" threshold amount announced by the President for local power generation without need for regulatory pre-approvals.