SI MODISA
START-UP
INDUSTRY REPORT
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. SiMODiSA is an industry association committed to improving the state of South Africa’s entrepreneurship ecosystem of support. We aim to reduce fragmentation through collaboration and not competition. As key custodians of job creation in the South African economy, creating a community of support for small medium enterprises (SMEs) is essential and there are numerous factors that contribute towards success or failure.

Over the past four years, we have seen growth in the entrepreneurship ecosystem of support, and this is illustrated by the growing amount of incubators, accelerators, entrepreneurship activities and profiling of numerous emerging entrepreneurs evident in the media. Early stage investment into startups has received a slight boost, but to keep a sustainable momentum of growth, it is important to monitor and evaluate our efforts of support. How do we know that we are doing the right interventions and are they enough if levels of unemployment continue to rise and not decline given our inputs? Are we having enough engagements with small businesses to understand and articulate their needs? Are we doing enough customization of supplier and enterprise development programs to suit the individual enterprise, or are we promoting and applying a one size fits all approach?

An important question to ask is, what does a successful and thriving entrepreneurship ecosystem of support look like? As the fourth industrial revolution is upon us, how best do we use technology to create business efficiency and scale? What targets can we set in place, so that in the next four year review we can assess if we have hit the mark or if we have failed to progress startups from growth to acceleration. The following report is a high-level review of the results of certain policy recommendations made by SiMODiSA in its 2014 White Paper. The purpose is to inform SiMODiSA follow up actions and amendments to future policy recommendations. We hope that you will find the report insightful and we aim to continue to work closer with the public and private sector in progressing the state of support for entrepreneurs in South Africa.

Matsi Modise – SiMODiSA Vice-Chairperson
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SiMODiSA was started in 2014 by South African entrepreneurs as an industry led initiative to specifically address – and determine – what can be done to overcome the barriers that SMME’s and technology based start-ups face.

One of the first endeavours in 2014 was to develop - through an exhaustive consultative and research process - seven main policy recommendations to public and private stakeholders, aimed at enhancing the start-up ecosystem in South Africa.

**2014 SiMODiSA WHITE PAPER**

The SiMODiSA 2014 Policy research identified major constraints to the proliferation of high-growth start-ups in South Africa and encapsulated these in a number of problem statements. SiMODiSA then made seven policy recommendations to address each constraint.

**2014 RECOMMENDATIONS**

1. Address Exchange Control limitations.
2. Improve the Section 12J tax incentive for Venture Capital Companies.
3. Address the lack of uptake of government funded Intellectual Property (IP).
4. Pilot a public funding model for VC and SMME investing.
5. Increase the attractiveness of a SA Business visa.
6. Improve the labour market to respond to skills requirements of start-ups and SMMEs.
7. Make the R&D tax incentive relevant for start-ups and SMMEs.
It has been four years since the publication of the 2014 SiMODiSA White Paper. The South African start-up ecosystem has undergone a number of developments. It has experienced both positive (growth in numbers, success stories and recognition of the role of start-ups in the South African economy) and negative developments, such as dealing with the challenges related to a struggling economy and an uncertain political climate.

The 2018 SiMODiSA policy review intended to revisit the seven policy recommendations made in 2014, to determine the extent to which the recommendations have been implemented, and to what degree the start-up system has changed in so far as still necessitating said policy recommendations.

This is not an ecosystem analysis but rather a gap analysis based on the 2014 recommendations, with the purpose to determine the status quo of the ecosystem four years after publishing said policy recommendations.

**OBJECTIVES & APPROACH**

The review was conducted by assessing:
- Factual data outlining the 2018 status quo of aspects relevant to the policy recommendations.
- Perceptions amongst start-up founders and key stakeholders relating to the state of business relevant to each policy recommendation.

Information for this review was sourced through a combination of:
- An online survey of contributors to the 2014 research.
- The survey included key ecosystem stakeholders and start-up entrepreneurs.
- Interviews with major players.
- Desktop research.

**PARTICIPANTS IN THE 2018 REVIEW ARE REPRESENTATIVE OF**

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
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<tr>
<td>Investors</td>
<td></td>
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<td>Universities</td>
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<tr>
<td>Policy makers (e.g. Government &amp; NGO)</td>
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<tr>
<td>Support entities (e.g. Public or private Incubator, accelerator, co-creation hub)</td>
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<td>Advisors (e.g. Mentor, accountant, lawyer, consultant)</td>
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<tr>
<td>Start-ups (e.g. founder, start-up employee)</td>
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STATUS REVIEW OF SIMODISA 2014 POLICY RECOMMENDATIONS
EXCHANGE CONTROL

POINT OF DEPARTURE IN 2014
Exchange Control regulations were seen to be restricting the expansion options for SA start-ups as it introduced unnecessary complications to investors, and navigating this process for SA start-ups and investors was considered expensive and burdensome.

SiMODiSA POLICY RECOMMENDATION
Improve the Exchange Control regime to enhance business development and expansion in South Africa

SiMODiSA proposed a permissible loop structure to enable residents to domicile companies offshore in the form a Holding Company within an international market and a wholly owned South African Subsidiary, to attract international investors and access international markets.

2018 OUTLOOK
Recognised improvements have been made with more flexibility from the Regulator. Negative perception alone may act as a motivator for start-ups to consider offshoring IP from the start. Costs and overhead to start-ups remain barriers to growth and investment, despite reported improvements and an increase in ExCon approvals.

IMPACT OF EXCHANGE CONTROL ON BUSINESS ENVIRONMENT...

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

2018 GAP REVIEW ASSESSMENT
Need more certainty from Government in terms of the interaction between Treasury, SARS and SARB. Practical implications involving payment of offshore workers, contractors and suppliers remain a hindrance to efficiency and scalability.

Stakeholders are generally not aware of recent changes made or improvements to the ExCon framework. This may result in start-up business-decisions made on perceptions and lack of information.

IS THIS POLICY RECOMMENDATION STILL NECESSARY?
SECTION 12J VCC

POINT OF DEPARTURE IN 2014
SA’s Section 12J tax incentive and VCC offering has clear and well-intentioned objectives, and the policy establishes a strong regulatory framework that incorporates certain features of international best practice. However, this tax incentive has to date (2014) not put more risk capital into the businesses of SA start-ups.

SiMODiSA POLICY RECOMMENDATION
Increase the attractiveness of the Section 12J Venture Capital Company regime

SiMODiSA made two prior recommendations to National Treasury in regards to the enhancement of the VCC regime. The 2014 SiMODiSA Policy white paper includes more recommendations to further enhance the VCC regime, as the uptake (at that stage) of VCCs (formation of funds, fund raising and investment into qualifying companies) had not materialised as expected.

2018 OUTLOOK
Updates to date to the S12J tax incentive have contributed to significant uptake amongst investors in the last 3 tax years, leading to risk capital flowing to entrepreneurs. Regulatory concerns have been raised as to economic impact, and possible abuse by VCCs.

DO YOU AGREE THAT THE VCC REGIME HAS IMPROVED?

- Agreed: 62%
- Don’t agree: 18%
- Stayed the same: 13%
- Don’t know: 5%
- Other: 2%

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

- Don’t know: 46%
- No: 21%
- Yes: 33%

2018 GAP REVIEW ASSESSMENT
2018 saw another consultation by Treasury and SARS and included a submission by SiMODiSA. Stakeholders applauded both updated changes to the S12J tax incentive, and how this has stimulated VCC formation, fund raising and availability of risk capital to start-ups.

The major concern at present is to address regulatory concerns so as to secure the continuation of the S12J tax incentive and ensure investor certainty. The case remains to continuously enhance the incentive as per SiMODiSA and other stakeholder submissions, as well as coming up with other schemes to stimulate innovative risk capital and availability thereof to start-ups and entrepreneurs.

IS THIS POLICY RECOMMENDATION STILL NECESSARY?

- Other: 41%
- Yes, with amendments: 26%
- Yes: 12%
- Let’s see TLAB outcomes: 21%
POINT OF DEPARTURE IN 2014
The uptake of government funded IP by start-ups and the private sector in general is reported as very poor. Government funded IP commercialisation is regulated by the Intellectual Property from Publicly Funded Research & Development Act of 2008 (IPR-PFRD Act). Insufficient clarity and poor industry perception related to the IPR-PFRD Act reportedly exacerbate the unattractiveness of public funded IP, culminating in the low uptake.

SiMODiSA POLICY RECOMMENDATION
Increase the uptake of government funded IP

SiMODiSA made a number of recommendations in 2014 to address the above, including increasing public funding for IP development and commercialisation, improving clarity around the IPR-PFRD Act, and strengthening the Technology Transfer Offices (TTOs) at public funded research institutions that are responsible for increasing awareness of, and implementing the IPR-PFRD Act.

2018 OUTLOOK
Very little cases were reported of start-ups taking up, or private risk capital flowing to IP created with public funds. Indications are that the status quo in 2014 remains true in 2018.

IPR-PFRD ACT* HAS LED TO AN UPTAKE IN PUBLIC FUNDED IP

2018 GAP REVIEW ASSESSMENT
The IPR-PFRD Act is giving substantial certainty and regulatory guidance to the commercialisation of public funded IP. Additionally has government both invested in up-skilling and building capacity at TTOs, and increased grant funding for such commercialisation activities.

The challenge therefore is not the Act, but rather a combination of factors which includes the relative emergent nature of the support environment for commercialising public funded IP, such as lack of human capacity, experience, and insufficient support to assist start-ups to access public funded IP.

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

IS THIS POLICY RECOMMENDATION STILL NECESSARY?
POINTER OF DEPARTURE IN 2014
The ecosystem still exhibits a shortage of SMME and VC investors, and a consequent lack of adequate funding for many SMMEs. South Africa does not have a co-investment programme, being a platform that uses private investor capital to leverage government’s investment, accelerating the development of an entire SMME investment industry by addressing the market failures that hamper it.

SiMODISA POLICY RECOMMENDATION
Pilot a public funding model for Venture Capital and SMME funding

Pilot a government fund overseen by a programme manager who is responsible for the selection of, and distribution to, qualifying SMME and VC Fund Managers. The objective through such a pilot is to attract and increase private investment and private sector skills, talent and capital to develop the VC sector and related ecosystem broadly in South Africa, with a specific focus on SMMEs and VC Fund Managers.

2018 OUTLOOK
The SME Fund has since become operational, but the co-funding for SA VC type investors through a public VC fund-of-funds has not materialised as yet. New interventions by respectively the IDC, PIC and others are reportedly revisiting direct funding of VC type funds.

THE IMPLEMENTATION OF A PUBLIC VC MODEL HAS SHOWN ITS VALUE…

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

2018 GAP REVIEW ASSESSMENT
The formation of a fund-of-funds model has taken longer than expected. This has resulted in possible expectation gaps between the fund-of-funds management and existing VC fund managers. Original intentions of matching government and private sector funds appear not to be taking place.

The main challenge for having a working fund-of-fund approach appears to be finding a mutually beneficial balance between existing fund managers (skills, pipeline, experience, portfolios) and the specific mandates and key performance requirements of the fund managers that are ultimately held accountable for the deployment of such funds.
POINT OF DEPARTURE IN 2014
The attraction and retention of entrepreneurial talent to and in South Africa has significant potential to benefit the domestic economy. SA has a functional version of this concept in the Business Visa. However, the processing of applications is hamstrung by administrative inefficiencies, which makes the process difficult to anticipate and adds significant additional uncertainty for immigrants. Indeed, unpredictability is reported to be the major barrier restricting the supply of potential entrepreneurs, who are put off by the lack of clarity in the processing system.

SiMODiSA POLICY RECOMMENDATION
Increase the attractiveness of the SA Business Visa for international entrepreneurs

SiMODiSA proposed five specific recommendations so as to improve the relevance and effectiveness of the SA Business Visa.

2018 OUTLOOK
No visible changes have been made to the regulations and criteria specific to the SA Business Visa. The constraint on attracting foreign talent to South Africa remains a critical barrier.

IT’S EASIER FOR GLOBAL ENTREPRENEURS TO GET AN SA BUSINESS VISA...

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

IS THIS POLICY RECOMMENDATION STILL NECESSARY?

2018 GAP REVIEW ASSESSMENT
General views reported are exceptionally negative towards applying for, and the allocation of business visas for foreign entrepreneurs. The process seems to remain fraught with red-tape and delays. Added to this is a general perception that the South African economy is not open to foreign skills and entrepreneurs.

The time-cap of a 5 year Business Visa is similarly not seen as conducive to increased investment and start-up activity, as it places an automatic 5 year limit on business activity with substantial uncertainty of what to be expected after five years have run out.
POINT OF DEPARTURE IN 2014
South Africa labour market dynamics and the regulations governing them fundamentally discourage SMMEs from hiring new employees. The principal theme emerging from stakeholder feedback on barriers emerging from the SA labour market, further supported by academic research, relates to red tape surrounding the onerous dismissal procedures that apply locally.

SiMODiSA POLICY RECOMMENDATION
Improve the labour market to respond to skills requirements of start-ups and SMMEs

SiMODiSA proposed that a qualifying period be introduced into the Labour Relations Act for the first 12 months of an employee’s employment in an SMME; after the qualifying period, simpler dismissal procedures govern dismissal of employees from an SMME.

2018 OUTLOOK
No visible changes have been made to improve the labour market dynamics and regulations involving SMMEs. The amount of regulatory compliance including that for tenders and doing business with the state is adversely impacted by this. SA has not learned from other countries where sustained economic growth followed labour practices that encourage and prioritise SMMEs.

THE SA LABOUR MARKET FOR SME HAS IMPROVED...

HAS THIS POLICY RECOMMENDATION BEEN IMPLEMENTED?

2018 GAP REVIEW ASSESSMENT
Labour Act policies and regulations remain unsupportive of employment uptake by SMMEs and start-ups. The BBBEE Charter places more challenges than before, including workforce composition for small companies unless they are 51%+ black owned. This complicates an already difficult labour market for high-tech skills and the ability of a start-up to match skills to market opportunities, as start-ups are already reeling from severe costs and overhead from legal and regulatory compliance.

Stakeholders report that the SiMODiSA proposal regarding relaxation of employee protection will not necessarily improve the situation.
R&D TAX INCENTIVES FOR SMMES

POINT OF DEPARTURE IN 2014
The nature and implementation of the Research and Development (R&D) tax incentive does not speak to the stage, capacity or interests of startups and SMMEs in South Africa, resulting in limited relevance and low uptake of the incentive within this sector.

SiMODiSA POLICY RECOMMENDATION
Make the R&D tax incentive relevant for startups and SMEs

Enhance or supplement the provisions of the current R&D tax incentive in order to provide an immediate and upfront cash flow benefit for the startup or SMME; offer a simple and cost-effective application form and process without the need for costly advisors; have a rapid turnaround time on pre-approvals (within weeks); and stipulate clear and simple eligibility criteria to empower startups and SMMEs to test eligibility without needing costly advice.

2018 OUTLOOK
No visible changes have been reported for the R&D tax incentive so as to become relevant to those conducting pre-profitability development activity, and thus generally remains unappealing/unsuitable to SMMEs and start-ups.

UPTAKE OF R&D TAX INCENTIVES BY START-UPS HAS IMPROVED …

2018 GAP REVIEW ASSESSMENT
Start-ups are primarily involved with bringing new products and services to the market, implying R&D expenses before profitability (and thus taxable income) can be achieved. The tax incentive by nature discounts taxable income; without taxable income the tax incentive remains inappropriate for most start-ups.

Uptake is further hampered due to little awareness (or ambivalence) amongst start-ups of the process, benefits and timeframes related to the R&D tax incentive. A proposed amendment is to include an R&D Tax Credit for SMMEs whereby the SMME can sell the credit to a large business for cash (similar to the concept of a Carbon Credit).
ECOSYSTEM REVIEW WITHIN CONTEXT OF THE SIMODISA RECOMMENDATIONS
The global transactability of intellectual property rights remain costly and challenging for start-ups, not just South Africans. The local IP regime however appears to be stable with a slight improvement reported.

Respondents are generally negatively positioned towards the state of the South African education system as can be seen in the graph. This refers to the system as a whole, and not specifically to entrepreneurship education.

Recent expansions to the BBBEE charter are viewed as placing additional strain on the legal and regulatory compliance of start-ups.

Universities as catalysts of start-up activity have seen an improvement in the last few years. This is not related to spin-outs or technology transfer, but rather the production of skilled resources and graduates that are interested in pursuing careers in start-ups.
A deteriorating local currency and subsequent cost of global products and services are increasingly weighing on start-ups that are wanting to, or already accessing global supply chains.

The growth of the start-up support network including mentors, networks and events has seen an improvement. This is echoed in international recognition for local ecosystems and start-up support interventions.

Such growth is however placing additional demands on the availability of skilled and experienced employees.

Exchange Control is viewed less as an obstacle in comparison to previous years.

Access to venture capital, grants and angel funders are contributing to a positive sentiment related to funding available to start-ups.
Respondents are reporting an improvement in the culture of research and innovation, which is evident also in other metrics pointing towards the growth of the SA start-up ecosystem as a whole.

The same growth reported above is producing success stories, including access to start-up founders, employees and investors that have achieved local and global success.

A positive culture of entrepreneurship and self-employment is evident based on increases in the number of people employed fulltime in various aspects of the start-up ecosystem. This points towards start-ups shifting away from making a living on the fringes of the economy, increasingly becoming central to the development of the new economy.

Tolerance of risk and failure is reported on positively and is in contrast to the same perception in previous years.
Access to market for SA start-ups

Entrepreneurship education

Access to Venture Capital

Start-up events

Start-up at various stages

Foreign entrepreneurs locating to SA

5%  14%  81%  19%  7%

48%  48%  4%  4%  4%

81%  14%  5%  19%  7%

14%  60%  26%  18%  53%
The frequent selection of “Don’t know/no opinion” as to the implementation status of each of the seven SiMODiSA policy recommendations indicates a low awareness amongst the survey sample of specific actions flowing from said recommendations.

Despite negative sentiment in the questions in the general section, 73% of respondents believe that the South African start-up ecosystem has seen an improvement over the last two years.

A critical policy directive for SiMODiSA is the need to create awareness regarding the role and purported value of high-growth start-ups as opposed to SMMEs or normal start-ups. 84% of respondents are of the view that South African policy does not understand the role of high-growth start-ups.

South African economic development and policy makers may not be familiar with the difference in intent between the need for, and peculiarities of high-tech/high-growth start-ups, as opposed to supporting entrepreneurship in general.

More awareness raising, lobbying and information sharing is vital to ensure that the objective behind each policy recommendation specific to the support of high-tech/high-growth start-ups is appreciated, and is needed, over and above other SMME related policy interventions.
RECOMMENDATIONS FOR POLICY DEVELOPMENT AND UPDATES TO THE SIMODISA WHITE PAPER
<table>
<thead>
<tr>
<th>Policy recommendation</th>
<th>2018 gap analysis view</th>
<th>Priority * for intervention</th>
<th>Comments and/or updated recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange Control</td>
<td>Moderate improvement</td>
<td>Ranked 3rd</td>
<td>ExCon remains a hindrance but is not considered a fundamental impediment. Appease investor-concerns by creating awareness of best practices and successful cases. Lobby SARB to (i) share data on number of approvals vs. applications, and (ii) continuously work to reduce red-tape and costs for start-ups and investors.</td>
</tr>
<tr>
<td>Section 12J VCC</td>
<td>Substantial improvement</td>
<td>Ranked 4th</td>
<td>Monitor the outcome of the TLAB submissions and respond where necessary. Investigate other incentives with which to stimulate additional sources of, and practices involving start-up funding.</td>
</tr>
<tr>
<td>Uptake of public funded IP</td>
<td>No visible improvement</td>
<td>Ranked lowest for needing action</td>
<td>There is no evidence of draconian government interventions in public funded IP involving start-ups or the private sector, due to the IPR-FPFRD Act. Rather has the Act created certainty in terms of the framework for such transactions involving public funded IP. Yet, the uptake of public funded IP by start-ups remains a critical impediment to ensuring return on tax payer money, and currently does not feature in priority amongst start-ups or investors. The low uptake needs to be addressed through a separate policy directive involving DST/NIPMO/TIA as the current system does not show any cause to change.</td>
</tr>
<tr>
<td>Pilot a public model for VC</td>
<td>In development</td>
<td>Ranked 6th</td>
<td>The rollout, focus and priorities of the new SMME Fund is in the process of being established. Consider other pilots or raise awareness amongst other players that are looking into funding VCs.</td>
</tr>
<tr>
<td>SA Business Visa</td>
<td>Remains a constraint, no change from 2014</td>
<td>Ranked 5th</td>
<td>The SA Business Visa draws on the same negative and non-supportive state of the SA labour market regime for start-ups as discussed in the next point. Both needs to be addressed holistically.</td>
</tr>
<tr>
<td>Labour market for SA start-ups</td>
<td>Deteriorating</td>
<td>Ranked highest for needing action</td>
<td>Start-ups and SMEs are looked at as future providers of employment opportunities. However, evidence from the review and inputs from stakeholders clearly articulate that the opposite is true in South Africa, as the local labour market is not at all conducive to incentivise sustained employment opportunities by start-ups.</td>
</tr>
<tr>
<td>R&amp;D tax incentive for start-ups</td>
<td>No change from 2014</td>
<td>Ranked 2nd</td>
<td>The R&amp;D tax incentive is not suited to start-ups. Effective incentives are critical to stimulate start-up activity. R&amp;D tax credits for start-ups should be lobbied with Treasury separately from the current R&amp;D tax incentive.</td>
</tr>
</tbody>
</table>

* Rated by survey respondents: “If you had to choose ONE thing”
venture Solutions (www.venturesolutions.co.za), a South African innovation management and commercialisation consultancy conducted this survey on behalf of SiMODiSA. Venture Solutions is bound not to reveal any company or individual-specific detail. This report contains data in aggregate form only.