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A path out of poverty: A South African perspective on the role of SMEs in CSR

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Abstract

The current rate of unemployment in South Africa poses a threat to sustainable development. A possible answer to the question of sustainable development might be found in adhering to the principles of corporate governance that include corporate social responsibility. This paper will examine the role that government has to play in the enforcement of CSR and determine whether or not government is doing enough to ensure that enterprises take up their social responsibility. Due to their immense economic contribution SMEs need to be socially responsible and adhere to the principles of good governance. This paper further discusses possible obstacles such as financial constraints and access to financial services that face SMEs in applying the principles of corporate governance. Recommendations to overcome the possible obstacles are also made. However, the argument is made that despite these obstacles, being socially responsible might add value to enterprise such as an enhanced reputation and improved financial performance.

1 Introduction

In post-apartheid South Africa, one of the biggest challenges facing the country is the improvement of the quality of life of historically disadvantaged South Africans through sustainable development. This sentiment is echoed in the preamble to the

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*Constitution of the Republic of South Africa*³ which clearly states that one of the reasons for adopting the new constitution is to improve the quality of life of all citizens. The implication of this statement is that the improvement of quality of life has received constitutional priority and is thus a constitutional commitment and not a mere ideological goal.⁴ This commitment is supported by the fact that the South African democracy is founded on the values of human dignity, equality and freedom.⁵ In terms of section 9(2) of the *Constitution* equality includes the full and equal enjoyment of all rights and freedoms and further makes reference to the fact that the achievement of equality *may* be promoted through *legislative and other measures* designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination.

The South African government has shown its commitment to eradicating the inequalities and injustices of the past and has since the enactment of the *Constitution* promulgated various pieces of legislation with the specific aim of improving the quality of life of millions of historically disadvantaged South Africans.⁶ Despite these attempts, it is however noteworthy that Statistics South Africa in their September 2005 labour force survey indicated that the unemployment rate among black Africans were 31.5%.⁷ These high rates of unemployment impacts negatively on the country's economic stability and poses a direct threat to poverty alleviation and ultimately sustainable development.

3 *Constitution of the Republic of South Africa*, 1996 (herein referred to as the *Constitution*).

4 Van der Walt 2004 *SAPR* 254.

5 S 7 of the *Constitution*.

6 These include, but are not limited to the following acts: *Employment Equity Act* 55 of 1998; *Promotion of Equality and Prevention of Unfair Discrimination Act* 4 of 2000; *Broad-Based Black Economic Empowerment Act* 53 of 2003.

7 Statistics South Africa 2005 HYPERLINK
www.statssa.gov.za/publications/P0210/P0210September2005.pdf 26 April.



A possible solution to the threat to sustainable development might be found in corporate governance. Corporate governance strives to attain a balance between economic and social goals as well as between individual and communal goals. One of the reasons for the growing importance of corporate governance is the fact that South African businesses, especially small and medium enterprises (SMEs) have in the past to a large extent neglected the social impact of their activities and have relied on the government to fulfill their fiduciary duty towards the community.⁸

Despite the fact that SMEs comprise a very significant component of the South African economy, it is commonly accepted that due to their size, they face different constraints and opportunities than their larger counterparts with respect to Corporate Social Responsibility (CSR). In future SMEs can potentially assume an important role in poverty alleviation through their CSR agendas and thus play a vital role in sustainable development.

From the abovementioned it is clear that we are confronted with the following questions:

- What are the responsibilities of the government in respect of the facilitation of CSR?
- What are the responsibilities of SMEs with regard to corporate governance and CSR?
- What are the obstacles that SMEs are being faced with in applying the principles of corporate governance?

⁸ In order to limit the scope of this paper it is important to take note of the fact that the SMME sector includes a wide range of enterprises and that there are major differences between for example medium-sized and very small or micro-enterprises. This paper will primarily focus on small and medium-enterprises and the acronym 'SME' will be used.



- Will SMEs benefit from practicing good corporate governance and CSR?

This paper will attempt to supply some answers to the abovementioned questions.

In order to have a better understanding of the questions at hand, it is important to define some key concepts. Throughout this paper, reference is being made to the following concepts: Corporate Social Responsibility (CSR), Small and Medium enterprises (SMEs), Sustainable development and corporate governance.

2 Defining key concepts

2.1 Corporate Social Responsibility

Although the concept of CSR has been developing for several decades, it is still impossible to provide a single acceptable definition of CSR. The concept of CSR has been described as “a fuzzy one with unclear boundaries and debatable legitimacy”.⁹

The European Commission provides the following definition:

Being socially responsible means not only fulfilling legal expectations but also going beyond compliance and investing ‘more’ into human capital, the environment and the relations with stakeholders.¹⁰

The World Business Council for Sustainable Development defines CSR as:

the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.¹¹

9 Lantos 2001 *Journal of Consumer Marketing* 595.

10 European Commission 2001 HYPERLINK
http://ec.europa.eu/comm/employment_social/soc-dial/csr/greenpaper_en.pdf 2
May.



Within the South African legislative framework, CSR¹² refers to:

an enterprise's contributions to society and community that are extraneous to its regular business activities.¹³

These contributions may include but are not limited to: Development Programmes for woman, youth, people living with disabilities; support of health and HIV/AIDS programmes in the community; education and training.¹⁴

From these definitions it seems clear that the aim of CSR is the improvement of the quality of life of communities by going beyond the normal business activities.

2.2 Small and Medium Enterprises

Despite the noteworthy contributions towards job creation, poverty alleviation and economic stability, to name but a few, there is no generally agreed definition for SMEs. When defining an enterprise as a small or medium enterprise the qualifying criteria that are currently being used includes annual turnover, number of employees and in some instances the annual balance sheet total.¹⁵ Within the South African context, the *National Small Enterprise Act*¹⁶ makes provision for four categories of enterprises within the different industry sectors. These categories are micro-; very small-; small- and medium enterprises.¹⁷ For example, an enterprise in the mining

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- 11 WBCSD 2002 HYPERLINK
<http://www.wbcd.org/DocRoot/IONYLirijYoHBDflunP5/csr2002.pdf> 2 May.
- 12 Although the definition refers to Corporate Social Investment (CSI) and not Corporate Social Responsibility (CSR), it will be accepted that, for purposes of this paper, these concepts have the same meaning.
- 13 Notice 2036 of 2005.
- 14 Notice 2036 of 2005.
- 15 For the EC definition of SMEs, see Jones and Tilley *Competitive Advantage in SMEs* 2.
- 16 102 of 1996.
- 17 Schedule 1 of the *National Small Enterprise Act*.



sector with 50 employees and an annual turnover of more than R10 million will according to the evaluating criteria be categorized as a small enterprise.¹⁸ Micro enterprises are those that employ less than 5 people and have an annual turnover of less than R150 000, whilst very small enterprises employ in some instances less than 10 people and have an annual turnover of less than R200 000, depending on the industry. As indicated above, this paper will mainly focus on small and medium enterprises, meaning enterprises with more than 10 people and an annual turnover of more than R200 000.

Besides the categories provided for in the *National Small Enterprise Act*, the South African Revenue Service (SARS) through section 12E of the *Income Tax Act*¹⁹ also provides a definition for a Small Business Corporation for tax purposes. A small business corporation is defined as a closed corporation or private company with a gross annual income of less than R6 million.²⁰ It is however important to note that this definition does not include sole proprietors or partnerships which might not be a very useful definition with regards to CSR and SMEs seen in the light that most SMEs are not corporations or companies,.

2.3 Sustainable development

Even after the 2002 World Summit on Sustainable Development, there is no formal definition for sustainable development. The concept of sustainable development might however be defined as

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- 18 Small enterprises constitute the bulk of South African established enterprises, with the number of employees ranging between five and about 50. These enterprises will usually be owned and managed by the same person. Medium enterprises might still be owner controlled although other shareholding structures might be in place and employ between 50 and 200 employees. Notice 213 of 1995.
- 19 58 of 1962.
- 20 The definition has several other requirements that need to be met in order to be classified as a small business corporation. These requirements however are not relevant to this paper.



development that meets the needs of the present without compromising the ability of future generations to meet their own needs²¹

The three essential requirements for sustainable development are: poverty eradication, changing unsustainable patterns of production and consumption and protecting and managing the natural resource base of economic and social development.²² As will be seen in paragraph 4, SMEs have an important role to play in especially poverty alleviation and will thus be an essential link in the chain of sustainable development.

2.4 Corporate governance

According to the Organisation for Economic Co-operation and Development (OECD) corporate governance involves

... a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.²³

The South African Department of Trade and Industry endorses the idea that corporate governance is concerned with:

holding the balance between economic and social goals with the result that corporate governance should be seen as the system by which organizations are or ought to be governed and controlled with the contribution of and for the benefit of all stakeholders, including shareholders, employees, creditors, suppliers and the society at large.²⁴

From this definition it seems clear that there is a link between corporate governance and CSR. CSR can be seen as one of the principles of corporate governance. This sentiment is echoed by the King II Report that indicates that the social aspects (that includes

21 United Nations HYPERLINK <http://www.un.org/issues/m-susdev.html> 4 May.

22 Strachan *et al* *The Plain Language Guide* 3.

23 Organisation for Economic Co-operation and Development 2004 HYPERLINK <http://www.oecd.org/dataoecd/32/18/31557724.pdf> 3 May.

24 Notice 1183 of 2004.



CSR) of a company's activities form part of what is commonly referred to as the 'triple-bottom line'.²⁵

3 The role of the state to facilitate CSR

As mentioned above, we are faced with the following question: What are the parameters – if any – of the responsibility of the state to facilitate CSR? It is common cause that CSR is becoming an increasingly important part of most governments' agendas for sustainable development and attaining the goal of poverty alleviation and government regulation is still seen as one of the most important drivers of CSR.²⁶ CSR has been described as a concept whereby enterprises decide to *voluntary* contribute to the upliftment of society.²⁷ Should CSR as a whole then be a voluntary process, it might be argued that the state has no role to play within the facilitation thereof. Advocates of legislative intervention highlights the failures of the present voluntary systems as one of the main reasons for the need of the state to play a more important role in the facilitation of CSR.²⁸ This article will however use the fact that the state has a role to play in the facilitation of CSR as a point of departure. Should CSR be totally voluntary, enterprises might not realize its important contribution to poverty alleviation, sustainable development and possibly financial benefits to the enterprise. This section will examine the role and responsibilities of government in the facilitation of CSR.

3.1 *The role and responsibilities of government in the facilitation of CSR.*

25 Institute of Directors *Executive Summary* 9. The 'triple-bottom line' can be described as a guideline used to judge a company's economic, environmental and social activities.

26 Hamann and Acutt 2003 *Development Southern Africa* 258.

27 European Commission 2001 HYPERLINK
http://ec.europa.eu/comm/employment_social/soc-dial/csr/greenpaper_en.pdf 2
May.

28 Cannon *Corporate Responsibility* 80.



As an introduction it should be noted that CSR should not be seen as substituting regulation or legislation concerning social rights. Furthermore it should not be seen as shifting the state's responsibility in respect of facilitating CSR to the private sector and thus 'privatising' their responsibilities.²⁹ In order to ensure an effective framework for CSR a regulatory foundation that promotes growth, employment and good governance is required whereby all participants have certainty about their rights and responsibilities. Regulation should be consistent, effective, transparent, fair and understandable.³⁰ An effective legislative framework for CSR will not only provide the 'rules for the game', but will also provide a level playing field on the basis of which socially responsible practices can not only be developed but also measured against.

3.2 The current legislative regulation of CSR

As already indicated, the government is under a constitutional obligation to protect, promote and fulfill the rights enshrined in the *Constitution*.³¹ Since CSR is also a human rights issue, it can be argued that government is under an obligation to facilitate it. However in post-apartheid South Africa, government has to a large extent neglected their constitutional duty in the sense that very little has been done to legislate the responsibilities that enterprises have towards their communities. It is also fair to state that the majority of South African enterprises have done very little to alleviate the need of the masses. It would seem as if enterprises are expecting that the government would take full responsibility for the social welfare of its citizens through legislation and systems of government welfare. On the other hand, government might only increase its regulatory power

29 Organisation for Economic Co-operation and Development 2004 HYPERLINK <http://www.oecd.org/dataoecd/32/18/31557724.pdf> 3 May.

30 Notice 1183 of 2004.

31 S 7 of the *Constitution*.



in the situation where self-regulation by industry insufficient and does not contribute towards the solution of the problem.³²

3.2.1 *Black Economic Empowerment*

The primary source of legislation pertaining to CSR is the Codes of Good Practice on Broad-Based Black Economic Empowerment drafted in terms of section 9 of the *Broad-Based Black Economic Empowerment Act*.³³ The main aim of the *BEE Act* is however not directly aimed at legislating CSR, but rather the creation of a legislative framework for the promotion of black economic empowerment and ultimately the effective participation of the majority of South Africans in the economy in order to create a stable economy through sustainable development. As a matter of fact, the act itself makes no reference to CSR, the only reference is found in the Codes of Good Practice.

The degree of compliance with the *BEE Act* is measured in terms of a generic BEE scorecard. This scorecard provides the criteria against which enterprises will be measured in order to determine whether the enterprise can be classified as a level one contributor or a non-compliant contributor.³⁴ The criteria against which an enterprise will be measured against include the level of black ownership and control, employment equity, skills development, preferential procurement and a residual element. It is within this

32 Hammers, Schwartz and Bisschop 2005 *StellLR* 307.

33 53 of 2003, commonly referred to as the *BEE Act*. It should however be mentioned that at the Codes of Good Practice are still only drafts and have to date not been enacted.

34 According to Notice 2036 of 2005 the BEE status of an enterprise might vary between a level one contributor, a contributor that scores 100 or more points, a level eight contributor that scores between 30 and 40 points and a non-compliant contributor which scores less than 30 points on the generic scorecard. The BEE recognition level of a level one contributor is 135 percent, whilst that of a non-compliant contributor is zero. Should an enterprise thus score less than 30 points on the generic scorecard it would not be rewarded for the steps taken and would not be recognized as a BEE contributor.



residual element that an enterprise's CSR efforts are measured. In terms of the scorecard, a measured enterprise that contributes three percent or more of its net profit after tax to development programs for woman, youth, people living with disabilities etc or support of health and HIV/AIDS programs in the community or education and training will score a maximum of ten points. Should the contributions be to the benefit of persons living in rural communities and or in the geographic areas identified in the government's integrated sustainable rural development program and urban renewal program, the measured enterprise will receive a bonus point.

Contributions made by enterprises, need not only be of a monetary nature. According to the Codes non-monetary contributions, like time spend by staff on for instance community training projects must be measured by quantifying the cost of time spend and determining the portion of the salaries that directly relate to the actual time spend by the staff in their CSR efforts.³⁵

Although these draft provisions will in the foreseeable future be enacted and thus have legislative force, it must be noted that the code does not make provision for any form of penalization of non-compliance. It would theoretically be possible for an enterprise to score enough points on the rest of the scorecard and take no notice of its social responsibility and still be regarded as an excellent contributor.³⁶

Industry sectors have in terms of section 12 of the *BEE Act* an opportunity to develop a Transformation Charter what constitute a framework and establishes the principles upon which BEE will be implemented within a specific sector. These charters will establish

35 Any travel or commuting time may not be included in the costs (Notice 2036 of 2005).

36 An excellent contributor being a level one contributor in terms of the draft Code.



transformation targets and in certain instances quantify the responsibilities of enterprises in that sector. The financial sector has recently drafted the Financial Sector Charter. Section 13 of the draft Charter requires that each financial institution contribute at least 0.5 percent per annum of post tax operating profits towards corporate social investment, which means projects aimed primarily at black groups, communities and individuals that have a strong developmental approach and contribute towards transformation. Similar charters are found in the mining- and agricultural industries. Once all these charters have been accepted and receive legal validity, a framework for the facilitation of CSR might be established.

These proposed provisions are the only provisions regarding the regulation of CSR within the South African legislative framework especially in the sector in which most SMEs function.

3.2.2 *JSE Socially Responsible Investment Index*

Although not regulated by law, the Johannesburg Stock Exchange (JSE) launched the first Socially Responsible Investment Index in May 2004 thus recognizing the steps that listed companies have taken towards fulfilling their social responsibility and the investments that they have made towards social development.³⁷ Companies listed on the JSE are *invited* to annually be assessed against the criteria of the SRI Index in order to identify to which extend the principles of the triple bottom line have been integrated into their business activities. Companies are assessed on their social sustainability with specific reference to the promotion of social upliftment, development and poverty alleviation.

Not ignoring the importance of the SRI Index it is important to note that the process of being assessed is a voluntary one and

37 Johannesburg Stock Exchange 2004 HYPERLINK <http://www.jse.co.za/sri/> 5 May.

