

# The power of three

Together, governments, entrepreneurs and corporations can spur growth across the G20

The EY G20 Entrepreneurship Barometer 2013

## Country profiles

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# South Africa at a glance



**Cheryl-Jane Kujenga**  
Strategic Growth Markets  
Leader, Africa, EY



**Yunus Naidoo**  
Government & Public Sector  
Leader, South Africa, EY

## A solid base for entrepreneurs will be at risk without reform

### Key facts

Overall Barometer ranking	<b>Quartile 2</b>
Population	<b>51 million</b>
GNI per capita (PPP)	<b>US\$11,190</b>
GDP growth	<b>2.5%</b>
Exports as % GDP	<b>28.8%</b>

Source: The World Bank, 2012

Among rapid-growth G20 countries, only South Africa achieves an overall barometer ranking of either Quartile 1 or Quartile 2 in the EY G20 Entrepreneurship Barometer 2013. Along with other rapid-growth economies, South Africa presents both strong opportunities and barriers to success for local entrepreneurs.

This contrast is seen throughout the entrepreneurial ecosystem. For example, while access to funding is certainly available within South Africa's sophisticated financial services sector, it is not cheap, nor is it always accessible enough for entrepreneurs. The South African press heaps praise on entrepreneurs and young people are encouraged to pursue their own enterprises, but at the same time there is a more limited culture of innovation, with little breakthrough research and development emerging from the country's universities. Local ventures are bound by restrictive labor laws, but regulators have developed world class tax and business start-up procedures.<sup>1</sup>

South Africa would benefit from (further) reform of its education system, particularly in the so-called "STEM" subjects: sciences, technology, engineering and mathematics. Without

improvements, it could lose its long-held lead within Africa in fields such as ICT, biotechnology and medicine. The redeeming features of the education sector are the rise of cheap independent schools. In addition, local entrepreneurs point to improvements in the availability of mentoring and informal support networks, showing encouraging signs of progress.

South Africa's future depends heavily on the Government addressing the above issues, allowing new enterprises to seize the clear opportunities available to them. The key question relates back to the pace and likelihood of change, and whether the existing momentum can be sustained – or even added to.

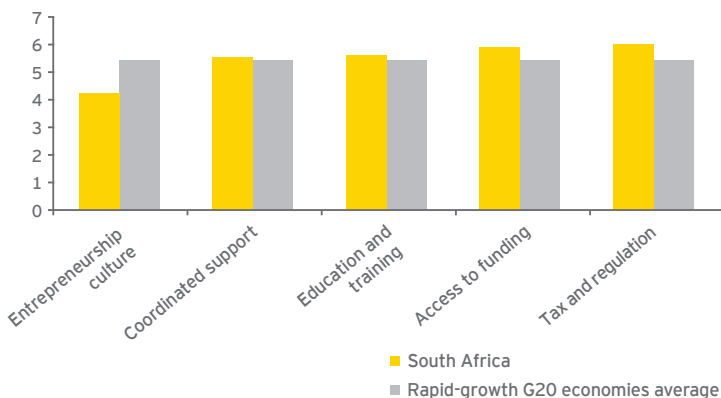
<sup>1</sup> N Turton and M Herrington, *Global Entrepreneurship Monitor: 2012 South Africa Report* (The UCT Centre for Innovation and Entrepreneurship, 2012).

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South Africa's pillar scores compared to rapid-growth G20 economies average



Source: EY G20 Entrepreneurship Barometer 2013

## South Africa: a land of extremes

The overall environment for South African entrepreneurs is one of relative extremes. It is relatively quick and cheap to start a new business, but getting the necessary registrations and compliance in place is difficult. Furthermore, it is expensive and onerous to hire and fire new workers. Similarly, there is a burgeoning middle class of consumers providing rich opportunities, but also a vast pool of unemployed workers, creating a sharply divided market. These extremes are observable across many aspects of the overall environment for entrepreneurs locally.

<sup>2</sup> SAccess, *Supporting the EU access to South Africa's research and innovation Programmes* (SAccess, 2013).

<sup>3</sup> "Youth unemployment: Generation jobless" *The Economist website*, economist.com, accessed 23 June 2013.

<sup>4</sup> Economist Intelligence Unit, *Africa: open for business – The potential, challenges and risks* (The Economist Intelligence Unit Limited, 2012).

<sup>5</sup> E Penfold, *Create entrepreneurs instead of tenderpreneurs* (Transformation Audit, 2012).

## SWOT analysis

### Strengths

- ▶ Low cost of business start-up – the sixth lowest in the G20 and cheapest among rapid-growth markets.
- ▶ Societal attitudes towards entrepreneurship are favorable – media attention is high, and entrepreneurship is seen as a positive career choice.
- ▶ Private equity investment remains strong relative to most G20 markets.

### Weaknesses

- ▶ Secondary school and tertiary education needs to improve dramatically to support more advanced entrepreneurship.
- ▶ South Africa is lacking the research and innovation institutions needed to generate a high volume of new patents that have commercial potential.<sup>2</sup>
- ▶ Hiring and firing is difficult and expensive in South Africa, discouraging new enterprises and keeping small businesses from growing larger.<sup>3</sup>

### Opportunities<sup>4</sup>

- ▶ South Africa benefits from a growing, urbanizing and modernizing stream of "new consumers." Entrepreneurs can use simple strategies like price and convenience to serve these markets, reducing the need to innovate.
- ▶ The country has a mature and profitable financial sector. Entrepreneurs enjoy world-class innovation, technology and competition in the financial marketplace.
- ▶ South Africa is a gateway into other thriving African markets.

### Threats

- ▶ From the top down, corruption is rife in South Africa. As much as entrepreneurship is lauded, locals also speak of "tenderpreneurship" – where Government tenders are awarded to companies with strong political connections.<sup>5</sup>
- ▶ High levels of crime affect all businesses in South Africa. This already deters many entrepreneurs, particularly in retail and cash-based industries.
- ▶ There is a risk that there will be growing social unrest if the rate of unemployment is not tackled more successfully.

## What to watch for

### Widespread educational reform needs to be a key priority

Studies have shown a positive correlation between the number of early-stage entrepreneurs and the level of education attained.<sup>6</sup> This backdrop makes the relatively weak state of South Africa's education system a concern. In fact, according to the World Economic Forum's latest Global Competitiveness Report, South Africa's inadequately educated workforce is the single most problematic factor for doing business in the country. Out of the 144 countries in the study South Africa ranks 132nd for the quality of primary education and 143rd for the quality of math and science education.<sup>7</sup>

Widespread reform of South Africa's education system is clearly needed. Educational solutions that focus on developing entrepreneurial skills and attitudes would also help to boost the country's growth potential. That said, much of the work needs to be done at a basic level, for example through improvements to areas like teacher training, administration and infrastructure. In the short term, few South African children will receive a quality education. According to the Government itself, 80% of all state schools are classed as "failing," and as with many things in South Africa, there is an increasing reliance on the independent sector, where the quality of education is far higher.<sup>8</sup> The number of independent schools has grown by 75% in the past decade, although their fees put them well out of reach for the vast majority of South African children.

In addition to the need to improve basic education, a greater focus on entrepreneur training and business skills is also needed. The Global Entrepreneurship Monitor suggests the introduction of entrepreneurship education as a compulsory subject in primary and secondary schools in South Africa, and also notes that business studies (as a subject at school) correlates positively with entrepreneurial aspirations.

**80%** of South African state schools are classed as "failing"

<sup>6</sup> N Turton and M Herrington, *Global Entrepreneurship Monitor: 2012 South Africa Report* (The UCT Centre for Innovation and Entrepreneurship, 2012).

<sup>7</sup> K Schwab, *The Global Competitiveness Report 2012-2013* (World Economic Forum Insight Report, 2013).

<sup>8</sup> "South Africa education crisis fuels state school exodus," *BBC News website*, [bbc.co.uk](http://bbc.co.uk), accessed 10 July 2013.

## How the government is helping

### Ithubalentsha Micro-Enterprise Program

This program provides training and mentorship on several important facets of a micro-enterprise, such as finance, market linkages and business opportunities. Young entrepreneurs can also access start-up loans ranging from ZAR1,000 (US\$100) to ZAR100,000 (US\$10,000). The program also involves experienced entrepreneurs, business consultants, managers and retired professionals to teach, motivate and inspire new entrepreneurs.

Launch date: 2012

Most relevant pillars: access to funding, entrepreneurship culture

The number of independent schools has grown by

**75%**

in the past decade

## Tourism Enterprise Partnership

South Africa's Tourism Enterprise Partnership (TEP) is one of the most successful public-private partnerships in South Africa. Its objective is to promote small enterprises involved in the tourism business through mentorship, skills development and financial assistance. The partnership is funded by the National Department of Tourism and the private sector, and it has a development agenda, which includes job creation, new product development, increased profitability and more participation of black-owned tourism enterprises. Since inception the TEP has helped create more than 65,000 jobs in small businesses.

Launch date: 2000

Most relevant pillars: **access to funding, entrepreneurship culture**

## Incubation Support Program

The Incubation Support Program (ISP) supports the development of small business incubators in South Africa. The program provides funding to incubators with the hope that over time they become self-sufficient by building revenue through their services and investments. The ISP will operate for 10 years (to 2022) and plans to establish 250 new incubators by 2015 through a public-private partnership model.

Launch date: 2012

Most relevant pillars: **access to funding, entrepreneurship culture, coordinated support**

### Key insight: bolstering South Africa's entrepreneurial environment

*Lance Fanaroff, joint CEO, Integr8 Group, South Africa*

*Integr8 Group is a South African ICT management and managed services company. Setup in 2001, it has grown to become the largest privately-owned ICT company in the country. In February 2013, it was acquired by Business Connexion Group. Lance Fanaroff is Co-CEO of the Group Companies.*

"It's no secret that unemployment is a huge problem in South Africa. And one of the keys to dealing with this is to increase the number of entrepreneurs who can create new jobs. I think the Government needs to focus more attention on increasing the number of entrepreneurs and the numbers of new businesses.

"More needs to be invested into developing entrepreneurship across the country, with a more coordinated focus. At the

moment, different Government departments are often working in isolation, as opposed to joining together in an integrated way. Making sure the entire service offering operates as an integrated unit as opposed to a whole lot of different units with their own goals and agendas would be hugely helpful.

"Education is another priority issue in South Africa. Skilled employees are necessary for the development of high-growth businesses. We need a much more focused effort on education at every level in South Africa: junior education, tertiary education, university education as well as developing general high-level skills. I think there is great potential for online training, which could be boosted with more connectivity to schools in rural areas."



# Access to funding

Pillar ranking: 6

79%

of local entrepreneurs surveyed think that it is difficult to access funding, with not a single person saying they find it "very easy"

## A strong baseline, but access to funding remains limited

Access to funding	South Africa	G20 average	Period
<b>IPO market activity</b>			
IPO amount invested (% of GDP)	0.19	0.22	2009-11 average
<b>Access to credit</b>			
Domestic credit to private sector (% of GDP)	146.3	99.0	2008-10 average
Venture capital availability (Scale of 1=impossible to 7=very easy)	3.0	3.0	2009-11 average
M&A deal value (% of GDP)	3.9	3.4	2010-12 average

Sources: The World Bank, Dealogic, IMF, World Economic Forum

Seventy-nine percent of local entrepreneurs say that access to funding is difficult for them. Added to this, many believe that funding conditions are deteriorating further, whether in terms of bank lending, angel investors or initial public offerings. More positively, though, some 69% of local entrepreneurs surveyed have seen an improvement in microfinance, while 53% also report improvements in the availability of Government funding. Both sources of funding are viewed by survey respondents as vital for accelerating growth in entrepreneurship.

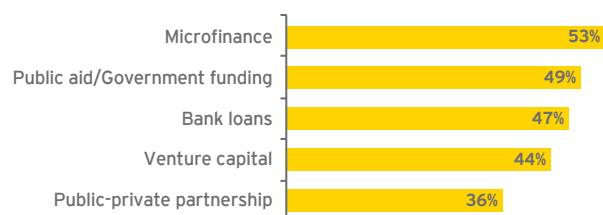
Microfinance in particular is ideal for millions of poor, unskilled and unemployed South Africans who, despite their disadvantages, often have the talent to develop successful businesses. Local entrepreneurs point to microfinance as a key funding instrument for the long-term growth of entrepreneurship locally.

Merger and acquisition (M&A) deal activity in South Africa was on the rise through the early 2000s, but has slowed since the financial crisis. But the country still has a very high rate of M&A investment relative to national GDP. Similarly, while venture

capital availability is better than the average for rapid-growth economies, sentiment in the survey is considerably worse than average, which impacts its performance.

Overall, South Africa has a highly mature financial sector, and many believe there is enough funding in the marketplace. However, funds are not made easily available to entrepreneurs, and much of the capital is often too expensive, which limits the growth of promising ventures.<sup>9</sup> To help counter this, many entrepreneurs look to the government. When asked which form of funding could make the biggest difference in improving the long-term growth of entrepreneurship, entrepreneurs cite public aid and Government lending as a key priority. This highlights the role that the Government will need to play in supporting entrepreneurship, to complement the country's financial services sector.

Entrepreneurs' view on the top five access to funding instruments aiding entrepreneurship



Source: EY G20 Entrepreneurship Barometer 2013

53% of local entrepreneurs surveyed think that Government funding is becoming more accessible

<sup>9</sup> N Turton and M Herrington, *Global Entrepreneurship Monitor: 2012 South Africa Report* (The UCT Centre for Innovation and Entrepreneurship, 2012).

# 70%

of local entrepreneurs feel that South African culture is supportive of entrepreneurship, which is significantly above average for rapid-growth markets

## Entrepreneurship culture

Pillar ranking: 14

### A supportive culture, although R&D inputs are falling

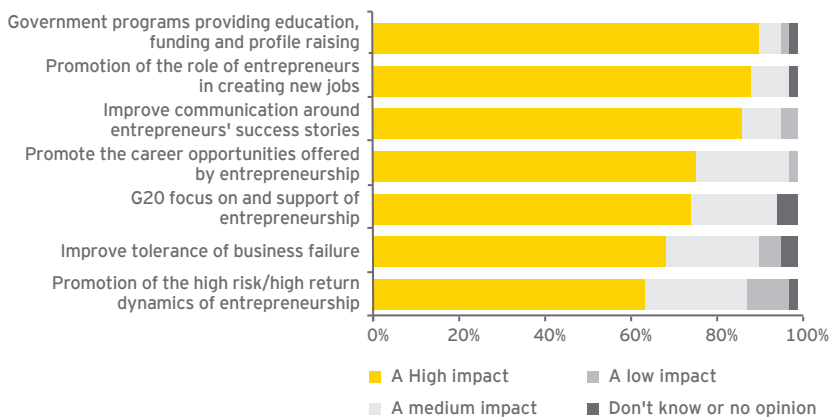
Entrepreneurship culture	South Africa	G20 average	Period
R&D spending (% of GDP)	0.9	1.6	2007-09 average
Scientific and technical journal articles (per 10,000 people)	0.6	3.3	2007-09 average
Cost of resolving insolvency (% of estate)	18.0	11.8	2010-12 average

Source: The World Bank

South Africa's business environment and culture raises challenges for local entrepreneurs. The country's performance overall is weighed down by below-average scores on innovation metrics, such as the number of scientific and engineering articles published, spending on research and development (R&D) and the number of researchers in this area. Patent applications, which provide another measure of innovation activity, fell by 24% in South Africa between 2008 and 2011.<sup>10</sup> This implies that South Africa's research institutions are unlikely to produce a large number of innovations with a commercial application in the near term, a fact that undermines prospects for the country's innovation-led start-ups.

Despite these weaknesses, South Africa's entrepreneurs believe their culture encourages entrepreneurship: 70% of those surveyed believed this. It is possible that a high level of media attention on entrepreneurs and entrepreneurship being seen as a strong career choice, rather than academic, corporate or institutional strengths, have fuelled this impression. Still, exceptionally high proportions of local entrepreneurs indicated that various measures – from promoting their role as job creators, to getting more start-up success stories publicized – could have a strong impact on cultural perspectives of entrepreneurship.

Entrepreneurs view as to which factors will have the highest impact on entrepreneurship culture



Source: EY G20 Entrepreneurship Barometer 2013

### Patent applications in South Africa fell by 24% between 2008 and 2011

<sup>10</sup> "Patent applications, residents," *The World Bank website*, data.worldbank.org, accessed 26 June 2013.

# Tax and regulation

Pillar ranking: 5

At **2.2%**

of income per capita, the cost of starting a business in South Africa is just under a quarter of the G20 average of 9.4% (2010-12 average)

## Tough labor rules are blunting entrepreneurial growth

Tax and regulation	South Africa	G20 average	Period
<b>Ease of starting a business</b>			
Start-up procedures (number)	5.3	7.6	2010-12 average
Time to start a business (days)	20	22	2010-12 average
Cost to start a business (% of income per capita)	2.2	9.4	2010-12 average
Paid-in minimum capital to start a business (% of income per capita)	0.0	17.9	2010-12 average
<b>Business regulations</b>			
Time spent on tax issues (hours)	200	347	2010-12 average
<b>Labor market rigidity</b>			
Cost of firing (weeks of wages)	80	50	2007-09 average
Labor and tax contributions (% of commercial profits)	4.1	24.0	2012
<b>Taxation</b>			
Total tax rate (taxes and mandatory contributions borne by the business expressed as a share of commercial profit)	33.3	49.7	2012
Indirect tax rate (taxes collected by the company and remitted to the tax authorities)	14.0	14.2	2012

Source: The World Bank

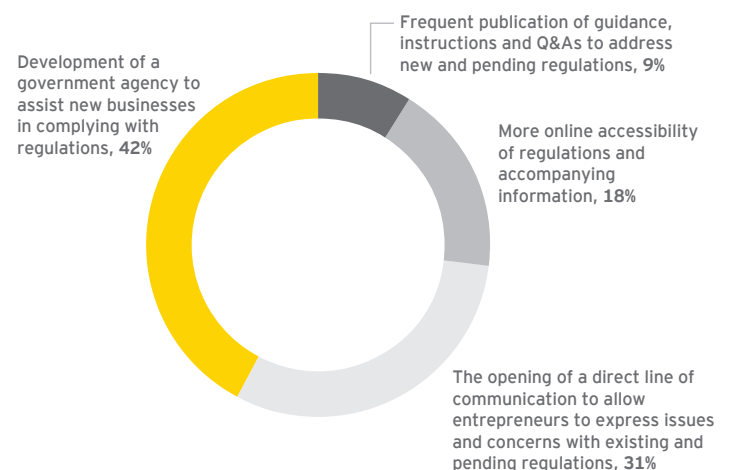
South Africa has strong start-up and taxation compliance procedures, in contrast to other members of the so-called “BRICS club” of rapid-growth markets. In terms of tax and regulation, the country puts in a good performance against both mature and rapid-growth G20 economies. Although difficulties and bureaucracy remain, it is relatively easy, quick and cheap to start a business, and the time spent on taxes is in line with mature economies, making this a relative strength for the country’s entrepreneurial ecosystem. Nevertheless, local entrepreneurs are still keen for greater support in complying with regulations, and 42% point to the need for an agency to assist in this area.

A bigger challenge emerges when companies move beyond the start-up phase. The cost of firing workers is a notable detractor, and highlights the ongoing need for labor-law reform in the country. Out of the 144 countries tracked by the World Economic Forum, South Africa is 143rd on hiring and firing practices, 140th for flexibility of wage determination and last on the measure of cooperation in labor-employer relations.<sup>11</sup>

From a regulatory perspective this is the most worrying feature of the South African economy for entrepreneurs. New businesses cannot afford to comply with these burdensome labor laws, and

many businesses will remain small or fall into the informal sector to avoid them. Regulatory reforms or tax credits could relatively easily help ease hiring terms, especially for the previously unemployed or for young workers, while incentivizing firms to hire more freely.

### Preferred single initiative to improve regulation



Source: EY G20 Entrepreneurship Barometer 2013

<sup>11</sup> K Schwab, *The Global Competitiveness Report 2012-13* (World Economic Forum Insight Report, 2013).



# Education and training

Pillar ranking: 11

# 93%

of local entrepreneurs surveyed agree that students need access to specific training to become entrepreneurs

## Sustained spending, but limited outcomes

Education and training	South Africa	G20 average	Period
Public spending on education (% of GDP)	5.5	4.8	2008-10 average
Secondary school enrollment (total enrollment expressed as a percentage of the population of official secondary education age)	93.5	95.0	2008-10 average
Tertiary enrollment (total enrollment expressed as a percentage of the total population of the five-year age group following on from secondary school leaving)	35.0	53.5	2008-10 average

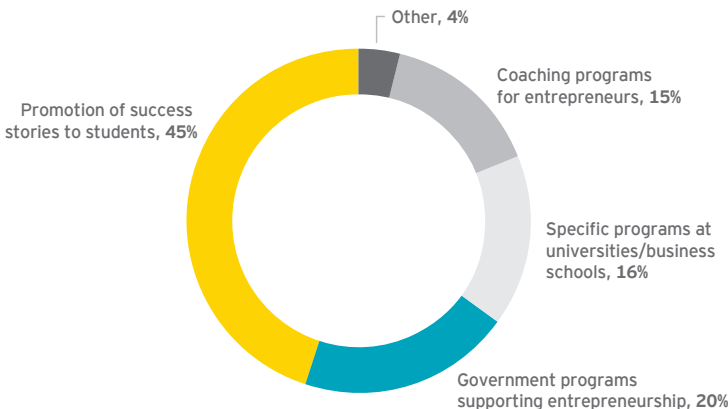
Source: The World Bank

South Africa spends more on education (as a percentage of GDP) than most G20 countries and significantly more than most other rapid-growth economies. However, South Africa's education system is in clear need of reform, which raises difficult questions about how effectively education funding is being deployed.

The country has low tertiary education enrollment and a low proportion of the workforce educated to a degree level. This means many of the more advanced entrepreneurial ventures simply don't have access to the skills they need to thrive. Furthermore, at a more general level, entrepreneurs clearly believe that more could be done to improve the public's view of entrepreneurship in the country. About one in two respondents pointed to the need for more efforts to promote success stories about South Africa's entrepreneurs, as a key measure for achieving this.

In the shorter term, though, more could be done to bolster informal learning and training schemes in order to help bridge at least some of the gap. There are encouraging signs, based on the sentiment from our survey, that the private sector is helping to pick up the slack here. For example, through stronger corporate engagement with start-ups; 62% of those polled think access to such schemes has improved in recent years, compared with 36% across the G20 overall.

Entrepreneurs' view as to what would improve student perception of entrepreneurship as a career path



Source: EY G20 Entrepreneurship Barometer 2013

At 35.0%, the level of tertiary education enrollment in South Africa is significantly below the G20 average of 53.5%

# Coordinated support

Pillar ranking: 8

69%

of local entrepreneurs currently use informal support and mentoring from other entrepreneurs compared to the G20 average of only 40%

## Stronger support networks are needed

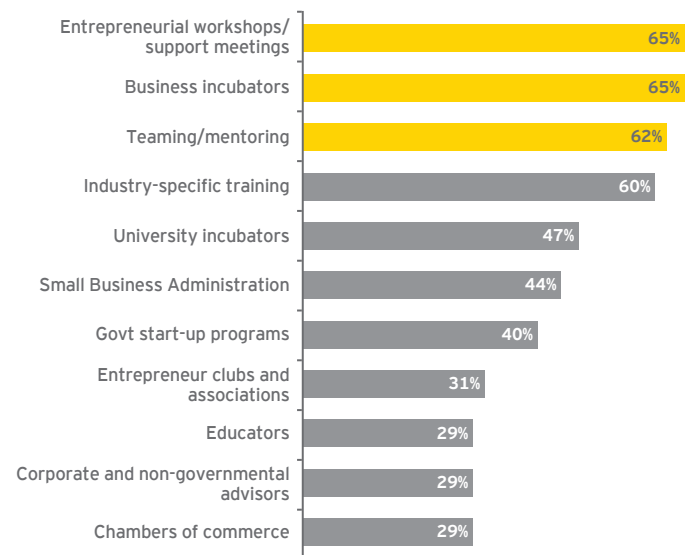
South Africa's entrepreneurs report improved access to various support structures, including business incubators, mentor programs, industry-specific training programs, entrepreneurial workshops and corporate engagement with start-ups. All this is encouraging news, particularly in terms of business incubators, as these are considered by local entrepreneurs to be the single most important tool for strengthening the future of entrepreneurship in South Africa.

The perception of network-related elements of coordinated support, such as clubs, associations, chambers of commerce and small business administration, where only a minority of entrepreneurs noted improvements, is less encouraging.

Among G20 countries, access to educators is falling most sharply in South Africa, with 30% of respondents reporting a deterioration in the past three years. This contrasts with competing rapid-growth markets that are reporting strong improvement. Some 61% of respondents from India report an increase in access to educators, while Russia (57%), Turkey (57%) and Indonesia (55%) follow the same trend. This again highlights the need for wider educational reform, while suggesting that informal learning and mentorship opportunities will remain vital in the years ahead.

Of the G20, South Africa does seem significantly more enthusiastic about tailored support for female entrepreneurs. As far back as 1998, for example, the Government set up the Technology for Women in Business initiative to help empower women within the technology sector.<sup>12</sup> This shows recognition of the value of more targeted entrepreneurial support.

Proportion of entrepreneurs citing improvement in areas of coordinated support over the past three years



Source: EY G20 Entrepreneurship Barometer 2013

60% of local entrepreneurs believe access to industry-specific programs has improved; the highest in the G20

<sup>12</sup> "Technology for Women in Business," *Western Cape Government website*, westerncape.gov.za, accessed 9 July 2013.

## Rankings table

Ranking	Access to funding	Score	Entrepreneurship culture	Score	Tax and regulation	Score	Education and training	Score	Coordinated support	Score
1	United States	7.12	United States	7.67	Saudi Arabia	6.40	France	6.58	Russia	6.23
2	United Kingdom	6.86	South Korea	7.53	Canada	6.34	Australia	6.53	Mexico	5.89
3	China	6.75	Canada	7.45	South Korea	6.34	United States	6.50	Brazil	5.87
4	Canada	6.62	Japan	7.28	United Kingdom	6.19	South Korea	6.40	Indonesia	5.84
5	Australia	6.48	Australia	7.18	South Africa	6.10	EU	6.25	India	5.76
6	South Africa	5.95	United Kingdom	7.00	Japan	6.07	United Kingdom	5.98	China	5.75
7	Japan	5.81	Germany	6.88	Germany	5.84	Germany	5.89	Turkey	5.66
8	South Korea	5.75	EU	6.07	Australia	5.75	Argentina	5.85	South Africa	5.65
9	Brazil	5.67	France	5.68	Russia	5.65	Canada	5.81	Argentina	5.64
10	Indonesia	5.53	Russia	5.05	EU	5.48	Brazil	5.78	Germany	5.53
11	India	5.48	India	4.95	Turkey	5.45	South Africa	5.67	France	5.41
12	EU	5.41	Brazil	4.88	Indonesia	5.38	Saudi Arabia	5.66	Saudi Arabia	5.39
13	Saudi Arabia	5.25	Italy	4.67	United States	5.33	Italy	5.47	EU	5.37
14	Germany	5.23	South Africa	4.33	Mexico	5.21	Russia	5.46	South Korea	5.36
15	Russia	5.04	Turkey	4.30	France	5.12	Mexico	5.32	Australia	5.31
16	France	4.74	Argentina	4.06	China	5.07	Japan	4.72	Canada	5.29
17	Turkey	4.57	Mexico	3.96	Brazil	4.83	Turkey	4.39	United Kingdom	5.19
18	Mexico	4.42	China	3.88	Italy	4.76	China	4.35	Japan	5.04
19	Italy	4.03	Indonesia	3.80	India	4.39	Indonesia	3.88	Italy	4.97
20	Argentina	3.27	Saudi Arabia	3.38	Argentina	4.31	India	3.49	United States	4.85

### About the EY Entrepreneurship Barometer model

The EY G20 Entrepreneurship Barometer 2013 introduces a model for scoring countries across the five pillars of entrepreneurship.<sup>13</sup> The purpose of this model is to help identify areas of relative strength by country and where opportunities for improvement lie.

The model is composed of qualitative information (from our survey of more than 1,500 entrepreneurs) and quantitative data based upon entrepreneurial conditions across the G20 economies. For each pillar, excluding coordinated support, this information is

weighted 50-50 between qualitative and quantitative inputs. For coordinated support, given a lack of quantitative indicators, this is based solely upon the survey responses.

The advantage of integrating both the survey results and quantitative data is the ability to provide an assessment of the current level and the trends in a G20 entrepreneurial ecosystem based upon local sentiment. To this end, official statistics (for example, on the average time taken to start a business or the tax burden) provide a baseline for each member country.

Survey information is an important complement to the baseline picture these statistics provide. Entrepreneurs' feedback on the pace of improvement or deterioration in conditions in their country's entrepreneurship ecosystem is incorporated in the model alongside the hard statistics.

Full details of the Barometer's methodology can be found on page 66 in the main EY G20 Entrepreneurship Barometer 2013 report.

<sup>13</sup> Note: As per the G20 membership, this list comprises 19 individual countries and also the European Union (EU), as an additional member. Our rankings show the performance of each country, along with an aggregate performance for the 27 EU Member States.

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## Contacts

### **Cheryl-Jane Kujenga**

Strategic Growth Markets  
Leader, Africa, EY  
+27 83 603 1509  
[cheryljane.kujenga@za.ey.com](mailto:cheryljane.kujenga@za.ey.com)

### **Yunus Naidoo**

Government & Public Sector  
Leader, South Africa, EY  
+27 83 414 8968  
[yunus.naidoo@za.ey.com](mailto:yunus.naidoo@za.ey.com)