

Glass Ceiling

What impact does municipal performance have on SMME growth?

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Richard Morrow and Rutendo Nyaku

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The Brenthurst Foundation

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About the Authors

Richard Morrow is an Analyst at The Brenthurst Foundation. Richard focuses on public sector reform and policy strategy. He has worked across 10 countries in Africa; served on two Presidential advisory teams; and has designed investment strategies for numerous investment promotion agencies on the continent. He holds a MA in International Relations from Durham University.

Rutendo Nyaku is a Machel-Mandela Fellow at The Brenthurst Foundation. Her work concentrates on digital transformation and political representation – particularly electoral processes and the performance of political representatives. She has designed communication strategies for numerous non-profit organisations in the international development sector; supported the coordination of multiple high-level political dialogues and has served as an election observer in West Africa. She is currently a non-executive board member in two non-profit organisations. Rutendo is completing a MPhil degree in Justice & Transformation from the University of Cape Town (UCT).

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PO Box 61631, Johannesburg 2000, South Africa

Tel +27-(0)11 274-2096

Fax +27-(0)11 274-2097

www.thebrenthurstfoundation.org

Cover image: A vehicle navigates a disintegrated road in Makhanda, Eastern Cape / Richard Morrow

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Summary

This paper sought to test a hypothesis about the relationship between local municipalities and small, micro, and medium enterprises (SMMEs). It posited that poor performing municipalities, as measured by governance, financial management, and service delivery, have a more detrimental impact on the performance of SMMEs when compared with those municipalities which perform well.

Using the *Consolidated General Report on Local Government Audit Outcomes MFMA 2022/21*, published by the Auditor-General of South Africa, eight local municipalities were selected across four provinces. This included four within municipalities with clean audits and four within those that had disclaimed audits. A survey was conducted amongst 85 SMMEs to measure perceived performance of their respective local municipality and to quantify their economic impact on businesses.

Survey data illustrates a clear divide in how SMMEs view municipal performance based on the latter's audit outcome. In municipalities with disclaimed audits, roughly half of all SMMEs view governance and financial management to be abysmal whereas 41% consider service delivery to be very poor. Only 3% perceive governance to be very good. This stands in stark contrast with those SMMEs located in municipalities with clean audits, where the majority perceive governance, financial management, and service delivery to be good. Only 6% view service delivery to be very poor.

Most SMMEs feel that the performance of their local municipality has a direct impact on their business, irrespective of audit outcome. An interesting observation here is that the majority SMMEs identify this impact to be negative: 50% of those operating within poor performing municipalities and 36% of those in top performing municipalities. An important caveat here is that 32% of SMMEs in municipalities with clean audits described the impact as being positive, meanwhile 15% felt it to be very positive, and 3% saw it as extremely positive.

This impact ultimately bears a financial burden, with SMMEs in poor performing municipalities more likely to suffer when compared with those in the top performing municipalities. Of the SMMEs surveyed, 60% reported losing revenue due to the performance of their local municipality, with 77% being in municipalities with disclaimed audits and 33% located in municipalities with clean audits. Most of those SMMEs which reported losing revenue – irrespective of their municipality's audit outcome – stipulated this to be 13% and above of their gross annual revenue.

Additionally, SMMEs in the worst performing municipalities are more likely to invest in systems and measures to support their business' operations. This comes as 93% of those SMMEs in municipalities with disclaimed audits reported having to invest in systems to offset municipal shortcomings, compared with 45% of those operating in municipalities with clean audits. When assessing the cost of these measures, one can observe that an SMME operating in a municipality with a disclaimed audit will spend up to double what their counterpart will expense in a top performing municipality.

Introduction

Municipalities play an integral role in the cohesion of communities, the growth of local economies, and ultimately, the forward trajectory of South Africa. Across South Africa there exist 257 municipalities, each varying in shape and size to reflect the country's diverse nature. Of these, there are 205 local municipalities which are responsible for providing their communities with basic services—be it water, electricity, roads, and sewerage—, all of which are necessary for citizens and businesses to thrive.

The *Consolidated General Report on Local Government Audit Outcomes MFMA 2021/22* which is published by the Auditor-General of South Africa (AG) and measures the quality of auditees' financial statements, performance reports, and the status of their compliance with key legislation, reveals that of the country's 166 audited local municipalities, only 18 (11%) received the best possible audit outcome while 12 (7%) were given the worst possible audit outcome. Between these two extremes were the remaining 136 local municipalities: A further 69 received audits which were unqualified with findings, 51 which were qualified with findings, and three which were adverse with findings. A total of 13 local municipalities received outstanding audits, meaning they had failed to submit their audits within an adequate timeframe.¹

In her latest report, the AG stressed how local governments across South Africa face “greater demands than ever before to regain the trust of South Africans,”² principally through the provision of basic services such as clean water, sanitation, electricity, waste management, and key infrastructure including roads. This, she added, needed to be done in a manner which was both “prompt and financially responsible.”³ Her remarks come at a time when many local municipalities continue to fall short across the key pillars of governance, financial management, and service delivery. This is because they are either unable or unwilling to do so.

Bad governance, financial mismanagement, and poor service delivery all have a negative and cascading effect on residents and business alike. Indeed, several of South Africa's largest companies have reported difficulties associated with operating in municipalities where each of the above are left wanting. Many of these companies have had to invest millions of Rands in systems to offset these challenges while in some instances they have relocated their operations to other parts of the country in search of improved municipalities and operating conditions. But what about the millions of small, micro, and medium enterprises (SMME) scattered across South Africa – how are they affected by municipal performance?

According to survey data collected by The Brenthurst Foundation, SMMEs operating in the country's top performing local municipalities (as audited by the AG) perceive governance, financial management, and service delivery to be better than their counterparts operating in the country's worst performing municipalities. As such, fewer SMMEs in top performing municipalities are likely to lose money as a direct result of their municipality's performance, which in turn sees them spending less money on systems and measures to support their

¹ 'Consolidated General Report on Local Government Audit Outcomes MFMA 2021-22', Auditor-General of South Africa, 31 May 2023.

² Ibid. p 2.

³ Ibid.

operations. In fact, SMMEs operating in the country’s worst performing municipalities can spend up to twice as much as on such systems compared with those operating in top performing municipalities.

If South Africa is to unlock the growth of its SMME community, then it is vital that greater focus is placed on local government performance considering the unnecessary burden poor performance can have on a business.

About This Study

This study is fundamentally concerned with understanding the impact local municipal performance has on the performance of SMMEs in South Africa. As such, a central hypothesis was formulated:

Local municipalities in South Africa face significant governance shortcomings and financial sustainability risks, leading to diminishing investment in service delivery and maintenance of key infrastructure. This results in poor-performing municipalities. Because of this, SMMEs located in poor-performing municipalities suffer an increased number of costly growth constraints compared to those located in better performing municipalities (i.e. those with improved levels of governance, financial management, and service delivery.)

A total of eight local municipalities were identified using the AG’s *Consolidated General Report on Local Government Audit Outcomes MFMA 2021/22*. Four municipalities whose audits were financially qualified with no findings (best performing) were chosen while four were chosen with disclaimed audits (worst performing). For the purposes of this paper, similar terminology is used interchangeably, for example, top performing versus worst performing, and clean versus disclaimed.

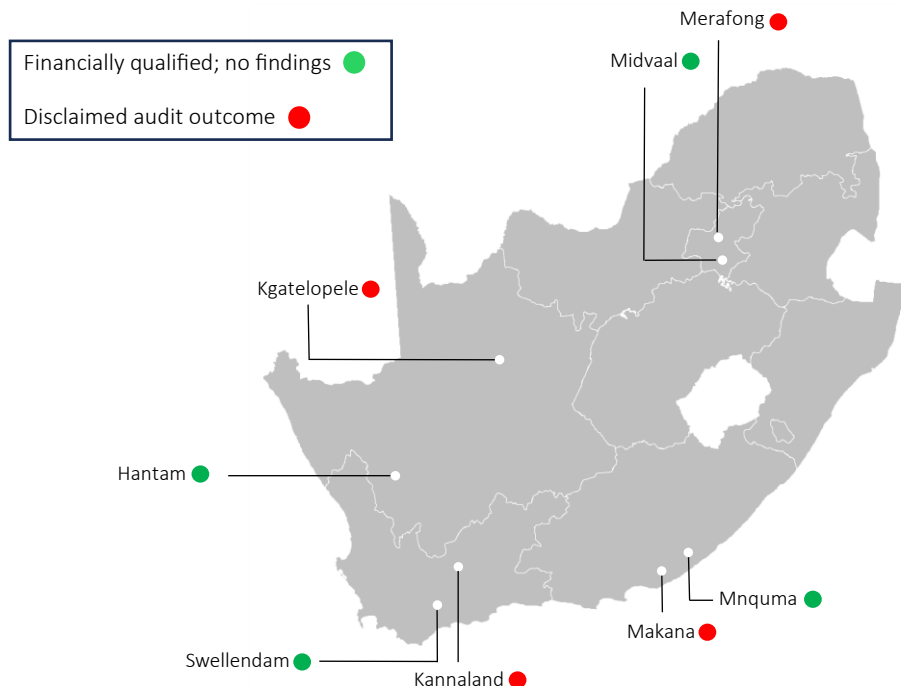


Exhibit 1: Local municipalities selected for this study.

Source: *The Brenthurst Foundation*

The choice of local municipalities was predicated on the availability of clean and disclaimed pairings in each province. For example, while there were local municipalities in the Free State which had disclaimed audits, there were none which were awarded with clean audits. This therefore disqualified the province from the study. Similarly, there were no local municipalities in KwaZulu-Natal which were given disclaimed audits while three boasted clean audits. The province was therefore also disqualified. In instances where there were multiple local municipalities to choose from (i.e. multiple clean and disclaimed local municipalities within a province), preference was given to those which shared geographic proximity and similar population sizes.

A list of SMMEs was then sourced within each municipality. For the purposes of this study, an SMME was defined as being a formal business which employed fewer than 250 full-time employees. These were identified and their contact information collated using various online directories. An online survey was then distributed amongst the list of businesses. A total of 85 businesses spanning the eight selected local municipalities were surveyed as part of this study.

A research trip was conducted in the Makana Local Municipality. The purpose of this visit was to expand upon the quantitative aspect of the study by conducting semi-structured key informant interviews. This enabled the authors to observe and document several of the themes conveyed through survey findings of those businesses operating in the municipality.

The Role of Local Government

There are three spheres of government in South Africa: national, provincial, and local government. According to Section 40 of the Constitution, the three spheres are “distinctive, interdependent and interrelated.” This means that there are certain responsibilities and objectives which intersect across all three spheres, whilst other responsibilities are exclusively the responsibility of the concerned sphere.

Section 40 further clarifies that the national government is responsible for making laws, setting policies, and providing services that affect the whole nation such as civil registry systems, and issuing ID books and passports. The national government’s work is administered through various departments that initiates various projects and programmes affecting the broad goals of the country.⁴ On the other hand, the provincial government is responsible for social services, economic functions, and the administration of provincial governance. Some of the services the provincial government deliver include education, provincial road networks, human settlements, and the management of the provincial treasury.⁵

There are three categories of local government – metropolitan, district, and local government. Section 2 of the Municipal Structures Act describes a metropolitan municipality as having a “high population density”, “an intense movement of people, goods, and services,” “extensive development,” and “multiple business districts and industrial areas.” There are eight metropolitan municipalities in South Africa – referred to as Category A municipalities-, and they are each authorised to have an exclusive municipal executive and legislative authority.⁶ On the other hand, a district municipality is referred to as Category C and defined as “a municipality that municipal executive and legislative authority in an area that includes more than one municipality.”⁷ Simply put, a district municipality has several local governments within a demarcated geographical boundary, and it shares a municipal executive and a legislative authority amongst the local governments.

Finally, a local municipality is referred to as a category B municipality according to Section 155 (1) of the Constitution. A local municipality is governed by a municipal council which sets the agenda, designs the programmes and projects of the municipality, and oversees the implementation and delivery of services and programmes.⁸ The daily implementation of programmes and delivery of services is managed by the municipal administration in accordance with Section 44 (1) of the Municipal Structures Act.⁹ Local municipalities and metropolitan municipalities are further demarcated into wards led by a ward committee whose responsibilities are to liaise between the people in the ward and with the local municipal’s executive on issues being confronted by the ward.

⁴ ‘Constitution of the Republic of South Africa’, *South African Government*, May 1996, <https://www.gov.za/documents/constitution/constitution-republic-south-africa-1996-04-feb-1997> (Accessed 5 March 2024).

⁵ Ibid.

⁶ ‘Local Government: Municipal Structures Act 117 of 1998: Section 155’, *South African Government*, December 1998, Available at https://www.gov.za/sites/default/files/gcis_document/201409/a117-980.pdf (Accessed 5 March 2024).

⁷ Ibid., Section 155 (1).

⁸ Ibid., Section 44 (1).

⁹ Ibid.

Local governments have the specific mandate of managing and delivering the services that are used by people daily as outlined in Schedule 4 and 5 of the Constitution of South Africa and the Municipal Structures Act 117 of 1998 (MSA).¹⁰ According to Section 152 of the Constitution, local governments must deliver services and administer programmes with the intention of achieving five broad objectives. These objectives include the sustainable provision of services, accountable governance, the promotion of, and development of safe and healthy environments and to encourage the socio-economic development of communities within the boundaries of a local municipality.¹¹

The MSA and Schedules 4 and 5 of The Constitution outline the specific services that local governments need to manage and deliver to reach their five broad objectives outlined in section 152 of The Constitution. The services include refuse removal and waste disposal, parks and recreation, street lighting, local tourism, electricity and gas reticulation, public transport, health services, water and sanitation services, roads, storm water controls, and public amenities.

To deliver these services, Section 156 of the Constitution gives local governments the authority to create and administer by-laws that can assist them in providing efficient and transparent services to the local municipalities. This section also provides for local governments to receive an allocation from the national budget and to raise their own revenue in support of their legal responsibilities and obligations.^{12 13 14}

Beyond the specific responsibilities that are outlined in the Constitution, local governments may also perform other functions and administer other services and programmes if they are mandated by the national and provincial governments. In such a case, the municipality becomes an implementing agent of national and provincial spheres of government.¹⁵ These services include inter alia primary health care services, housing, firefighting, as well as library services. Although pieces of legislation like the Municipal Systems Act and the Constitution provides that local governments should receive funding to administer services that are outside their explicit constitutional obligations; these mandated services typically become “unfunded mandates” or “under-funded mandates.”¹⁶ As a result, many local governments are unable to deliver services efficiently and satisfactorily as obligated by the Constitution or mandated by the national and provincial governments.

The services delivered by local governments are further complicated in areas where there is a district municipality and a local municipality. Representatives of the municipal council sit on the district council which oversees the administration and delivery of services across all the

¹⁰ ‘Constitution of the Republic of South Africa’, *South African Government*, May 1996, <https://www.gov.za/documents/constitution/constitution-republic-south-africa-1996-04-feb-1997> (Accessed 5 March 2024).

¹¹ *Ibid.*, Section 152.

¹² ‘Intergovernmental Fiscal Relations Act 97 of 1997’, *South African Government*, December 1997, Available at https://www.gov.za/sites/default/files/gcis_document/201409/a97-97.pdf (Accessed 5 March 2024).

¹³ ‘Local Government: Municipal Systems Act 32 of 2000’, *South African Government*, November 2000, Available at https://www.gov.za/sites/default/files/gcis_document/201409/a32-000.pdf (Accessed March 5, 2024).

¹⁴ Constitution of the Republic of South Africa, Section 214.

¹⁵ ‘What Are Municipalities and How Are They Structured?’, *Civics Academy*, Available at <https://civicsacademy.co.za/what-are-municipalities-and-how-are-they-structured/> (Accessed 22 January 2024).

¹⁶ M. Basdeo, ‘The Impact and Dilemma of Unfunded Mandates Confronting Local Government South Africa: A Comparative Analysis’ *Africa’s Public Service Delivery and Performance Review*, September 2012, Vol. 1 No. 2: 51-66.

local municipalities within the district as mandated by Section 84 of the Constitution (1996). The district municipality's role is to coordinate an even delivery of the services that each local municipality is required to deliver.

A district municipality also has responsibilities such as ensuring a bulk supply of electricity, water, sewage purification and disposal; maintaining municipal road networks which form a road system for the whole district; establishing and controlling fresh produce markets which serve the whole district; imposing and collecting taxes, levies, and duties – although the limits of this duty depend on national legislation. Many of the services set out in Section 84 of the MSA overlap with local municipalities' responsibilities. However, the difference is that while local municipalities deliver services only to their constituents, the district council ensures that certain services are delivered in bulk, and that the quality-of-service delivery is the same across the municipalities.

The Relationship Between Local Municipal Performance and SMME Growth

Setting the Scene

According to the *Consolidated General Report on Local Government Audit Outcomes MFMA 2021/22*, which is published by the Auditor-General of South Africa (AG) and measures the quality of auditees' financial statements, performance reports, and the status of their compliance with key legislation, only 18 (11%) of the country's 166 audited local municipalities were awarded the best possible audit outcome. By contrast 69 (42%) received audits which were unqualified with findings; 51 (31%) which were qualified with findings; three (2%) which were adverse with findings; and 12 (7%) were given disclaimed audits. A total of 13 (8%) local municipalities received outstanding audits (See Exhibit 2 for a description of each audit outcome).¹⁷

The performance of local municipalities (as illustrated by their audit outcomes) is said to have a noticeable impact on the performance of those businesses located within them. In 2021, Clover moved its cheese production facility from the Ditsobotla Local Municipality in the North West province to the eThekweni Municipality in KwaZulu-Natal following a litany of service delivery failures.¹⁸ The Ditsobotla Local Municipality has consistently received a disclaimed audit since the 2017/18 financial year, with its most recent audit being categorised as outstanding due to financial statements not having been submitted in a timeous manner.

Growthpoint Properties – the country's largest commercial property owner with a market capitalisation of R35 billion on the Johannesburg Stock Exchange (JSE) – has also criticised the poor levels of service delivery in many of the municipalities where its 300 portfolio properties are located. A central concern for them has been the increase in municipal rates despite scant improvements in service delivery.¹⁹

And in November 2023, Astral Foods, South Africa's largest poultry producer boasting a market capitalisation of R6.84 billion on the JSE, has linked deteriorating business performance with municipal dysfunction. They specifically identified the local municipalities of Lekwa (Mpumalanga) and Matjhabeng (Free State) as being problematic as both have failed to provide reliable and affordable electricity and water services to the company, forcing it to invest in backup generators and boreholes. Consequently, the poultry producer is taking legal action against the municipalities for their failure to honour their service delivery obligations.²⁰

¹⁷ Auditor-General of South Africa, 2023.

¹⁸ Penelope Mashogo, 'Clover closes SA's biggest cheese factory due to municipal woes in North West', *News24*, 08 June 2021, Available at <https://www.news24.com/fin24/companies/clover-closes-sas-biggest-cheese-factory-due-to-municipal-woes-in-the-north-west-20210608> (Accessed 28 November 2023).

¹⁹ Kabelo Khumalo, 'We are paying more for fewer or no services, says Growthpoint', *BusinessDay*, 02 November 2023, Available at <https://www.businesslive.co.za/bd/companies/property/2023-11-02-we-are-paying-more-for-fewer-or-no-services-says-growthpoint/> (Accessed 7 November 2023).

²⁰ 'Astral's losses highlight SA's municipal mess', *BusinessDay*, 23 November 2023, Available at <https://www.businesslive.co.za/bd/opinion/editorials/2023-11-23-editorial-astrals-losses-highlight-sas-municipal-mess/> (Accessed 24 November 2023).

The Lekwa Local Municipality was given a disclaimed audit in 2022/21 whereas the Matjhabeng Local Municipality’s audit was qualified with findings.

Type of Audit	Description
Financially qualified with no findings (Clean)	<ul style="list-style-type: none"> Produced quality financial statements free of material misstatements. Produced quality performance reports that measure and report on performance in a manner that is useful and reliable. Complied with key legislation relating to financial and performance management.
Unqualified with findings	<ul style="list-style-type: none"> Produced quality financial statements but struggled to produce quality performance reports and/or to comply with all key legislation.
Qualified with findings	<ul style="list-style-type: none"> Produced financial statements containing material misstatements that were not corrected before the financial statements were published. The municipality also had challenges with the quality of the performance report and/or compliance with key legislation.
Adverse with findings	<ul style="list-style-type: none"> A municipality included so many material misstatements that the Auditor-General disagreed with virtually all the amounts and disclosures in the financial statements.
Disclaimed with findings	<ul style="list-style-type: none"> A municipality could not provide the Auditor-General with evidence for most of the amounts and disclosures in its financial statements. The Auditor-General was unable to conclude or express an opinion on the credibility of the financial statements. Municipalities with adverse and disclaimed opinions are typically also unable to provide sufficient supporting documents for the achievements they report in their performance reports, and do not comply with key legislation.

Exhibit 2: The different types of audits

Source: Auditor-General of South Africa; Brenthurst Foundation

Electricity crises have plagued the country since loadshedding was first introduced in 2007. The highest cumulative amount of time lost to loadshedding equates to 283 days. This was witnessed in 2023 – 16 years into the country’s loadshedding crisis. While loadshedding is not a direct result of a local municipality’s performance, its actions can nonetheless affect the provision of electricity to residents and businesses alike. The Emfuleni Local Municipality in Gauteng reportedly collected R4.5 billion in electricity bills from residents and businesses but failed to pay Eskom using said funds. This was the result of “mismanagement, maladministration and a failure to keep the electricity business separate from its other affairs,” a reality which has plunged the municipality into debt.²¹ The municipality’s most recent audit was qualified with findings.

Municipalities such as Emfuleni purchase the lion’s share of electricity from Eskom, making them its most important customers. The difficulty arises in that many either struggle to pay the energy provider, or choose not to, creating a vicious cycle whereby the state-owned entity incurs losses, its debt grows, its ability to ensure adequate maintenance declines, and

²¹ Tania Broughton, ‘Municipality collected 90% of electricity bills but failed to pay Eskom’, *News24*, 06 July 2023, Available at <https://www.news24.com/fin24/economy/municipality-collected-90-of-electricity-bills-but-failed-to-pay-eskom-20230706> (Accessed 8 December 2023).

loadshedding persists. Resultingly, as of August 2023, the amount owed to Eskom by municipalities is R63 billion.²²

Water is increasingly becoming the next big crisis for the country's local municipalities. And although 'watershedding' has not become a ubiquitous phenomenon, infrastructure across the country is deteriorating at record levels, jeopardising both the quality and supply of potable water. The Department for Water and Sanitation's 2023 *Blue Drop* report illustrated this point, announcing that 46% of South Africa's drinking water was of an "unacceptable" level vis-à-vis microbiological compliance standards.²³ For the residents of some municipalities in South Africa the water crisis is a daily reality. In KwaZulu-Natal, for example, the South African Human Rights Commission (SAHRC) found that numerous municipalities and Water Service Authorities (WSAs) had violated residents' right to access clean drinking water, adding that the impact on businesses and the consequent undermining of employment, livelihoods, and local economic development was "devastating."²⁴

The AG estimates that from 2016 to 2022, irregular expenditure among the country's local municipalities totalled R166 billion.²⁵ It is important to note that this figure represents the total value which was reported; the true value is likely to be larger owing to several municipalities failing to disclose this information. In her 2021/22 report, the AG summarised the financial situation for many local municipalities in clear and simple terms: "Local government is losing billions of rand each year because of poor decisions, neglect or inefficiencies."²⁶ Additionally, local municipalities are said to be "living beyond their means",²⁷ with South Africa's National Treasury forecasting operating deficits for the 2022/23 financial year.²⁸

Those who suffer the most are ultimately the residents and businesses of those local municipalities which fail in their duties and responsibilities. And while this section has highlighted the plight of large businesses when confronted with poor performing municipalities, there are many smaller businesses across South Africa who are significantly impacted by the performance of their local municipality.

Municipal Performance and the Impact on SMMEs

South Africa is home to an estimated 5.75 million small, micro, and medium enterprises (SMMEs), employing 50-60% of the country's labour force and contributing 34% of its GDP.²⁹ Small businesses are in many ways the economic engine of South Africa and the key driver of economic and societal change.

Despite the significant role SMMEs play in South Africa, they are confronted with a myriad of challenges – many of which can be attributed to poor municipal performance. A survey

²² Denene Erasmus, 'Snowballing municipal debt to Eskom hits R63bn', *BusinessDay*, 20 August 2023, Available at <https://www.businesslive.co.za/bd/national/2023-08-20-snowballing-municipal-debt-to-eskom-hits-r63bn/> (Accessed 5 November 2023).

²³ 'Blue Drop Report, National 2023', *Department of Water and Sanitation*, December 2023.

²⁴ 'KZN Water Inquiry Report', South African Human Rights Commission, August 2022, p 100.

²⁵ Authors' calculations using data from respective annual reports.

²⁶ *Ibid.* p 42.

²⁷ 'Media Statement: Local Government Adopted Operating and Capital Budgets for 2022/23 MTREF', National Treasury of South Africa, 29 November 2023, p 9.

²⁸ *Ibid.*

²⁹ 'The MSME Voice: Growing South Africa's Small Business Sector', *IFC*, 12 February 2020.

conducted by The Brenthurst Foundation between November and December 2023 combined with site visits in January 2024 has found that businesses located in municipalities with disclaimed audits suffer a host of unnecessary challenges (also referred to as frictional costs) compared to those located in municipalities with clean audits.

Governance, Financial Management, and Service Delivery

Survey data depicts a polarising view of municipal performance in the areas of governance, financial management, and service delivery. Exhibit 3 shows that in municipalities with disclaimed audits, roughly half of all SMMEs view governance and financial management to be abysmal whereas 41% consider service delivery to be very poor. Only 3% perceive governance to be very good. This stands in stark contrast with those businesses located in municipalities with clean audits, where most perceive governance, financial management, and service delivery to be good. Only 6% of these SMMEs view service delivery to be very poor.

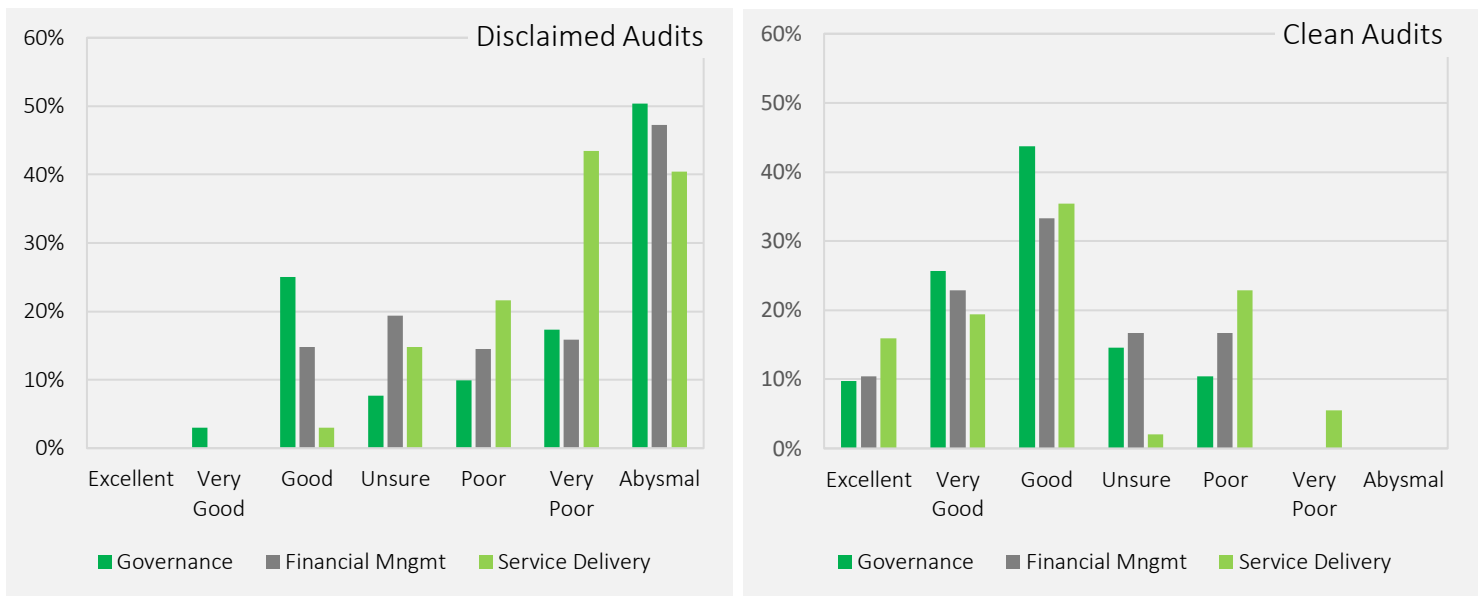


Exhibit 3: SMMEs in municipalities with disclaimed audits perceive performance across key domains to be worse compared with those awarded clean audits.

Percentage of respondents; n=85

Question: How would you describe the performance of your local municipality in terms of governance/financial management/service delivery?

Note: Figures are rounded to nearest whole number and therefore might not total 100.

Source: The Brenthurst Foundation survey (November-December 2023)

Impact of municipal performance on business operations and revenue

Local municipal performance – as measured by governance, financial management, and service delivery – has a direct impact on the performance of SMMEs, as suggested by survey findings. Of the businesses surveyed, 81% felt that their local municipality’s performance has a direct impact on their business. This view was shared by 86% of SMMEs in municipalities with disclaimed audits and by 85% in municipalities with clean audits.

Exhibit 4 shows that of the SMMEs in municipalities with disclaimed audits who felt directly impacted by their municipality, 50% viewed their municipality’s impact to be negative, while 38% described the impact as being extremely negative, and 22% labelled it as very negative. Only 4% felt the impact to be very positive whereas 4% were unsure. An interesting observation is that the majority (36%) of SMMEs in municipalities with clean audits who felt directly impacted by their municipality also viewed the impact to be negative, while 2% described it as being very negative. However, 32% described the impact as positive, 15% felt it to be very positive, and 3% saw it as extremely positive. A further 12% were unsure of the nature of their local municipality’s impact on business performance.

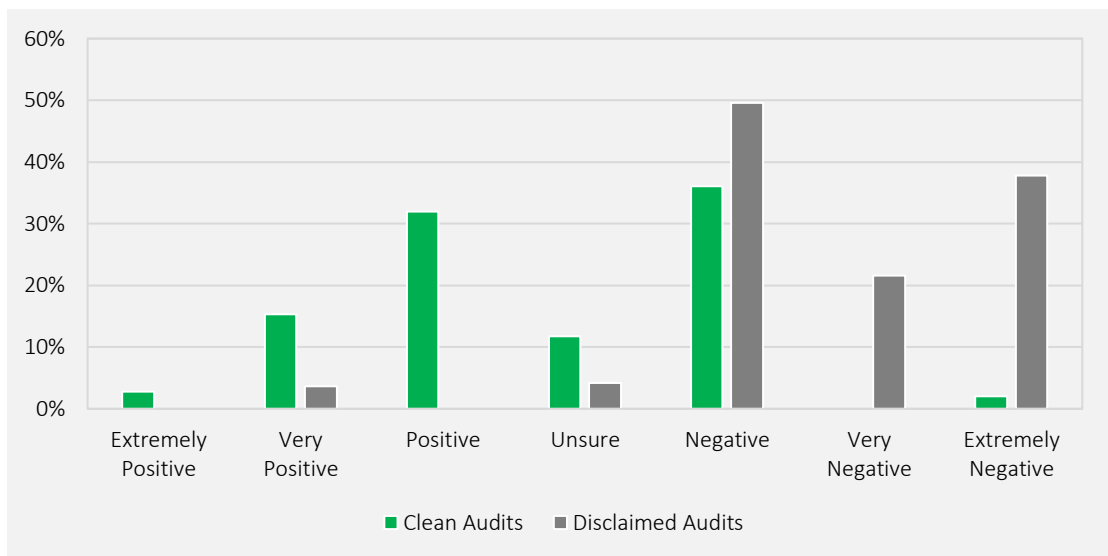


Exhibit 4: The majority of SMMEs who feel impacted by the performance of their local municipality describe it as negative.

Percentage of respondents; n=69

Question: How would you describe the direct impact which your local municipality has on the performance of your business?

Note: Figures are rounded to nearest whole number and therefore might not total 100.

Source: The Brenthurst Foundation survey (November-December 2023)

The negative scoring showcased by those SMMEs from municipalities with clean audits is largely influenced by those operating in the Eastern Cape’s Mquma Local Municipality who, despite their municipality being awarded a clean audit outcome, felt that their municipality was performing poorly in the areas of financial management and service delivery. This is a likely explanation for why 83% of SMMEs in Mquma perceived municipal performance as having a negative effect on their respective businesses.

The direct impact which local municipalities have on a SMMEs ultimately bears a financial cost. This comes in two forms with the first being the impact on gross annual revenue generation. Of the SMMEs surveyed, 60% reported losing revenue due to the performance of their local municipality, with 77% being in municipalities with disclaimed audits and 33% located in municipalities with clean audits.

Exhibit 5 shows the gross annual revenue lost by SMMEs due to the performance of their local municipality. For those in municipalities with disclaimed audits, one in every two lost 13% and above of their gross annual revenue. This is followed by 11% who reported losses between 4-

6%; a further 10% who recorded losses of 1-3%; 8% at between 10-12%; and 5% between 7-9%. A total of 23% of SMMEs were unsure of their losses. By contrast, three-quarters of SMMEs in municipalities with clean audits who lost revenue due to municipal performance identified these losses as being 13% and above. This was followed by 19% who reported losses of 4-6%; 6% who recorded losses of 10-12%; and 3% with losses between 7-9%. Only 4% were unsure of their losses.

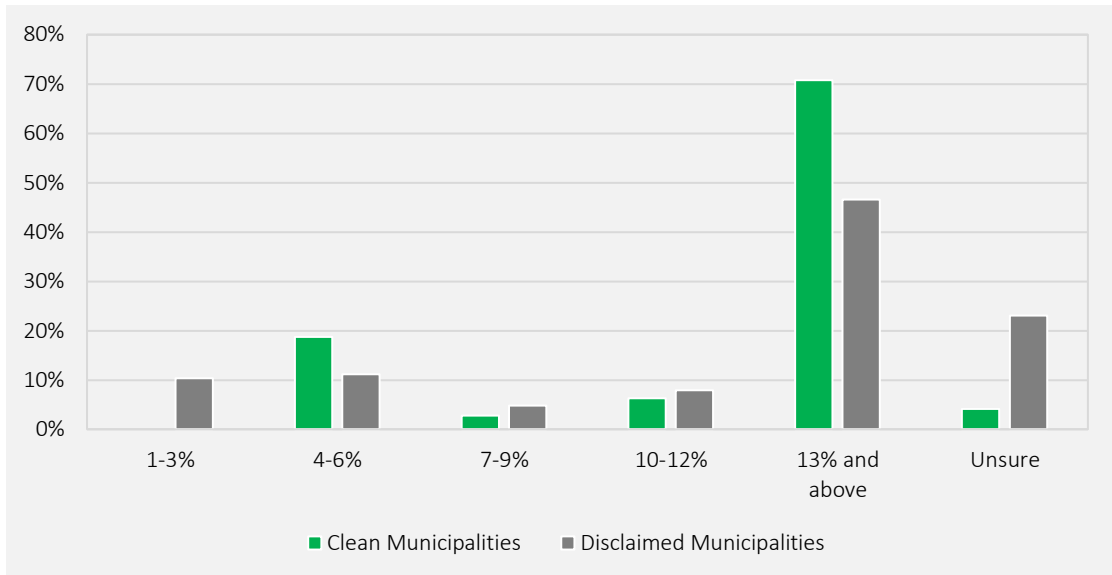


Exhibit 5: Most businesses who have lost revenue due to municipal performance report it to be 13% and above of gross annual revenue.

Percentage of respondents; n=51

Question: If the performance of your local municipality has directly resulted in your business losing revenue, what percentage of gross annual revenue do you estimate this to be?

Note: Figures are rounded to nearest whole number and therefore might not total 100.

Source: The Brenthurst Foundation survey (November-December 2023)

While fewer SMMEs in municipalities with clean audits report losing revenue because of their municipality’s performance, those that do, report sizeable losses. The recent closure of the Mazeppa Bay Hotel, an iconic Wild Coast resort which falls within the Mngquma Local Municipality, can help explain this phenomenon. Although the municipality was awarded a clean audit for the 2021/22 financial year, Mazeppa Bay Hotel was forced to close its doors in part because of poor road infrastructure which had a direct impact on tourist numbers.³⁰ “What’s happened on the Transkei Wild Coast [where the Nquma Local Municipality is located] is that basic infrastructure has collapsed”, says Dr Div de Villiers, director of the environmental advocacy group Green Ripple. “As one crosses the Great Kei River, you notice the environmental degradation. Raw sewage is running into the rivers, waste is dumped

³⁰ Estelle Ellis, ‘Blow to Wild Coast tourism as iconic hotel shuts its doors’, *Daily Maverick*, 01 February 2024, Available at <https://www.dailymaverick.co.za/article/2024-02-01-blow-to-wild-coast-tourism-as-iconic-hotel-shuts-its-doors-thanks-to-pandemic-and-unusable-roads/> (Accessed 04 February 2023).

everywhere, water supply is unreliable, flood damage is unrepaired, roads are washed away, security is a problem, and illegal development is rampant,” he adds.³¹

Mnquma had previously been labelled as a “basket case”³² for two decades before the municipality’s leadership decided to introduce change, beginning with a new municipal manager in 2016. Annual reports from the AG illustrates its transformation, progressing from an adverse audit outcome and R461 million in irregular spending in 2017/18, to being one of only 18 local municipalities in the country to earn a clean audit for 2021/22 and an irregular expenditure bill totalling zero. And while this is an achievement in and of itself, the damage from its troubled past, namely infrastructure degradation as highlighted above, has a lasting impact on the municipality and its businesses.

Investments to offset municipal shortcomings

In response to poor municipal performance many SMMEs will look to invest in systems and measures which supplement municipal shortcomings. This is the second financial cost which SMMEs must bear, and it is a reality experienced by 67% of those surveyed. Almost all SMMEs – 93% – in municipalities with disclaimed audits reported having to invest in systems of this nature, compared with 45% of those operating in municipalities with clean audits.

The nature of these systems varies. Solar systems and generators provide electricity; boreholes together with water capture and purification systems provide potable water; and security measures including CCTV and electric fencing ensure safety for businesses, employees, and customers. Others have also invested in their own refuse removal, road repairs, and the maintenance of street verges.

The cumulative cost to businesses for these measures differ, as shown in Exhibit 6, with the majority (29%) of those SMMEs in municipalities with disclaimed audits investing up to R50,000. This is followed by 22% who’ve invested up to R25,000; 17% with investments of up to R250,000; 11% investing R251,000 and above; and 9% investing up to R100,000. A total of 12% did not know how much they had invested on such measures. By comparison, most SMMEs (43%) in municipalities with clean audits have invested up to R25,000, while 19% have invested R251,000 and above; 9% invested up to R100,000; 8% invested with investments up to R50,000; and 6% investing up to R250,000. A total of 15% did not know how much they had invested. Therefore, businesses operating in the country’s worst performing local municipalities can spend up to twice as much on systems to offset municipal shortcomings when compared with those operating in the country’s best performing local municipalities.

³¹ Div de Villiers cited in Estelle Ellis, ‘Grader sent to save Eastern Cape’s vital Mazeppa Bay Road breaks down’, *Daily Maverick*, 16 February 2024, Available at <https://www.dailymaverick.co.za/article/2024-02-16-grader-sent-to-save-eastern-cape-vital-mazeppa-bay-road-breaks-down/> (Accessed 04 March 2024).

³² Natasha Marrian, ‘From disclaimer to clean: how Mnquma did it’, *Financial Mail*, 08 June 2023, Available at <https://www.businesslive.co.za/fm/features/2023-06-08-from-disclaimer-to-clean-how-mnquma-did-it/> (Accessed 4 February 2023).

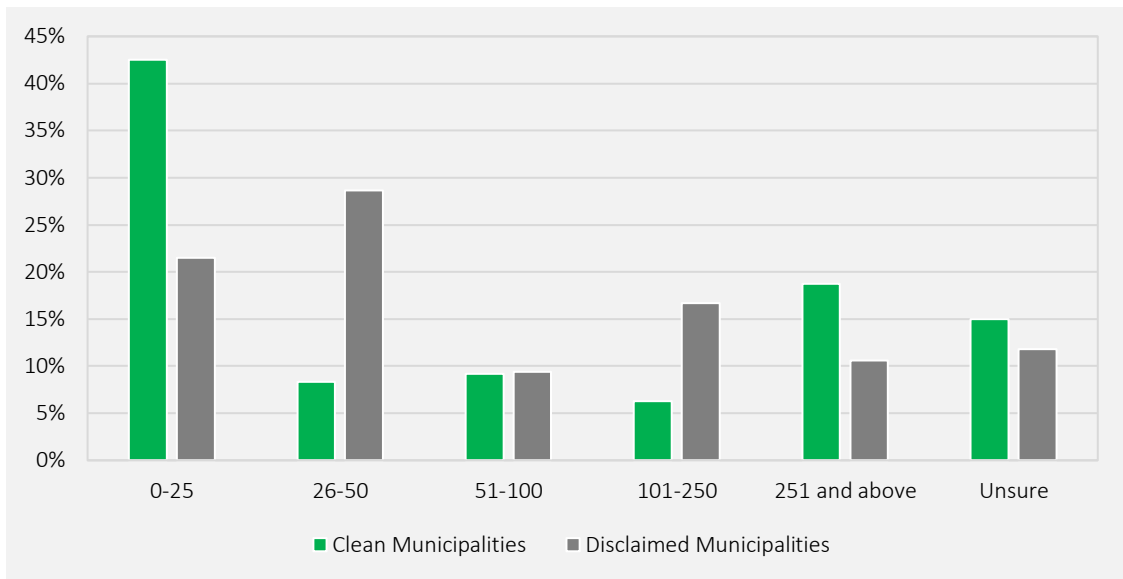


Exhibit 6: Most SMMEs operating in municipalities with disclaimed audits will invest twice as much to offset service delivery shortcomings compared with those in municipalities with clean audits.

Percentage of respondents; Thousands of Rands; n=57

Question: If the performance of your local municipality has directly resulted in your business investing in systems or measures to support its operations, what do you estimate the cumulative costs to be?

Note: Figures are rounded to nearest whole number and therefore might not total 100.

Source: *The Brenthurst Foundation survey (November-December 2023)*

Case Study: Makana Local Municipality

The Makana Local Municipality in the Eastern Cape is illustrative of a municipality where bad governance, financial (mis)management, and poor service delivery have had a pronounced impact on the local SMME community. Home to an estimated 97 000 people, the municipality attributes much of its economy to tertiary sector activities, with community, social, and personal services providing the lion’s share of employment and economic activity.³³ The seat of the municipality is in Makhanda – formerly Grahamstown –, a city renowned for its educational institutions including Rhodes University, St Andrew’s College, Kingswood College, and the Diocesan School for Girls. The city’s education ecosystem alone contributes as much as R1.3 billion to the municipality’s economy, which stood at R8.5 billion in 2021.³⁴ Makhanda also plays host to the annual National Arts Festival which injects an estimated R94 million into the city’s economy each year.³⁵

Yet despite its significance as a hub for education and culture, the city of Makhanda is in dire straits. In the AG’s most recent report, the Makana municipality was reported to have spent R7,8 million deemed as fruitless and wasteful; a further R370 million in irregular spending; and R779 million which has been described as unauthorised.³⁶ While the municipality has overspent in some areas, it has underspent in others. In 2023 South Africa’s National Treasury

³³ ‘Economic Impact Assessment of the Makhanda Education Industry’, Makhanda Circle of Unity, February 2023.

³⁴ Ibid.

³⁵ Zimkita Linyana, ‘The city gears up for a live National Art Festival’, *Grocott’s Mail*, 28 March 2022, Available at <https://grocotts.ru.ac.za/2022/03/28/national-arts-festival-back-on-makhandas-streets/> (Accessed 23 January 2024).

³⁶ Auditor-General of South Africa, ‘Consolidated General Report on Local Government Audit Outcomes MFMA 2021-22 (website)’, <https://mfma-2022.agsareports.co.za/municipality/1-makana> (Accessed 24 January 2024).

ordered the municipality to repay R60,7 million from its municipal infrastructure grant for failure to spend it.³⁷ In her 2018/19 report, the AG noted how the municipality had failed to appoint a permanent municipal manager for four years, and that its municipal infrastructure grant had to be managed by the Sarah Baartman District Municipality due to the municipality's mismanagement of the grant in prior years.³⁸

Poor governance and financial management ultimately translate into deteriorating levels of service delivery. This includes the provision of potable water and sanitation, refuse removal, road maintenance, and street lighting. "Our infrastructure is in a perilous state ... we've gone back to being a frontier town," says Richard Gaybba, director of the Makana Business and Residents' Association (MB&RA). It is estimated that as much as 75% of municipal piped water is lost due to damaged or broken water infrastructure. This results in water having to be trucked to communities in the east of Makhanda, an historically informal section of the town. This exercise can cost as much as R4,200 each day and has in previous instances become a daily occurrence.



Exhibit 7: The Makana Local Municipality can spend as much as R4,200 a day to transport potable water to a single community – a phenomenon which can be repeated daily.

Source: Richard Morrow

Eugene Repinz, who operates two hotels along the town's High Street, speaks of how poor service delivery and the subsequent deterioration of infrastructure have had a direct impact on tourist activity and ultimately revenue generation for his businesses. "Parents would make the journey down [to Makhanda] from Gauteng with their kids ahead of the new academic year," notes Repinz as he explains the indirect economic contributions the town's elite schools

³⁷ Estelle Ellis, 'Treasury orders Makhana Municipality to pay back R60.7m in unspent infrastructure grants', *Daily Maverick*, 27 November 2023, Available at <https://www.dailymaverick.co.za/article/2023-11-27-treasury-orders-makana-municipality-to-pay-back-r60-7m-in-unspent-infrastructure-grants/> (Accessed 14 December 2023).

³⁸ 'Consolidated General Report on Local Government Audit Outcomes MFMA 2018-19', Auditor-General of South Africa, 01 July 2020.

have on the local economy. “They would make a holiday out of it; stay three or four days, maybe the week. These are wealthy individuals. Now they’re here for a day or two and then back on the road.”

Otto Ntshebe is another local business owner who has linked the poor performance of the local municipality and the deterioration in service delivery with a dwindling tourism sector – a reality which has negatively affected his top line. As a self-employed tour operator Otto relies on an attractive town to draw tourists, many of whom he transports between Gqeberha and Makhanda. “Tourism is dead [in Makhanda]”, bemoans Otto. A mainstay of his business would be to provide tourists with a tour of the key sites associated with the 1819 Battle of Grahamstown. To access the site where Makhanda, the Xhosa leader after whom the town was renamed, launched the assault on the British settlement of Grahamstown one must navigate through the pothole-ridden streets of Fingo in the eastern part of town. Once at the site one is greeted by a series of stone blocks depicting the unfolding of the battle. “We don’t even take care of our history,” cries Otto as he points to the litter and uncut grass which obfuscates the site’s historical significance. He concedes that he has increasingly sought work in Gqeberha where he believes there are more business opportunities.



Exhibit 8: Organisations such as the Makhanda Business and Residents’ Association and Makhana Revive! will spend between R350 and R450 to repair a square meter of road.

Source: Richard Morrow

For the MB&RA in Makhanda, addressing the service delivery deficit is a costly but necessary undertaking. “We’ve now had to build our own roads” says Richard Gaybba, adding that it costs the MB&RA between R350 and R450 per square metre for road repairs. Eugene Repinz has also had to make several investments to maintain operations at his hotels, including R300 000 for a complete borehole system, together with R35 000 each month as part of a payment plan for a solar system he had installed. Other community initiatives include Makana Revive! which is a Section 18A organisation aimed at raising and disbursing funds to improve the safety, health, security, sustainability, and cleanliness of Makhanda.

The plight of the Makana Local Municipality's SMME community is no accident. Bad governance, financial mismanagement, and poor service delivery have all created an environment whereby businesses are forced to operate with a handicap. This comes as the majority of SMMEs viewed the municipality's performance across key domains (governance, financial management, and service delivery) to be abysmal. Additionally, 65% described its impact on business performance as being extremely negative, with 82% reporting lost revenue as a result and 100% having to invest in systems to support their performance.

The education and cultural hub of Makhanda – the seat of the Makana Local Municipality – is a shadow of its former self as SMME owners lament the town's deterioration caused by the actions – and in many cases lack thereof – of the local municipality. The Makana Local Municipality illustrates firsthand the detrimental impact a municipality can have on SMMEs.

Conclusion: Dysfunctional Municipalities are Bad for Business

Local municipalities are the bedrock upon which South Africa's communities and businesses are built. This is because they provide many of the basic services which are necessary for citizens to thrive and businesses to operate, be it potable water, electricity, and road infrastructure.

The unfortunate reality across South Africa is that an increasing number of local municipalities are failing to perform optimally across the pillars of governance, financial management, and service delivery. The *Consolidated General Report on Local Government Audit Outcomes MFMA 2022/21* published by the Auditor-General of South Africa (AG) reveals that of the country's 166 audited local municipalities, only 18 (11%) received the best possible audit outcome while 12 (7%) were given the worst possible outcome. Between these two extremes stood the balance: 69 (42%) received audits which were unqualified with findings; 51 (31%) which were qualified with findings; three (2%) which were adverse with findings; and 13 (8%) received outstanding audits.

This paper sought to test a hypothesis about the relationship between local municipalities and small, micro, and medium enterprises (SMMEs). It posited that poor performing municipalities, as measured by governance, financial management, and service delivery, have a more detrimental impact on the performance of SMMEs when compared with those municipalities which perform well.

Using the *Consolidated General Report on Local Government Audit Outcomes MFMA 2022/21*, eight local municipalities were selected across four provinces. This included four within municipalities with clean audits and four within those that had disclaimed audits. A survey was conducted amongst 85 SMMEs to measure perceived performance of their respective local municipality and to quantify their economic impact on businesses.

Survey data illustrates a clear divide in how SMMEs view municipal performance based on the latter's audit outcome. In municipalities with disclaimed audits, roughly half of all SMMEs view governance and financial management to be abysmal whereas 41% consider service delivery to be very poor. Only 3% perceive governance to be very good. This stands in stark contrast with those SMMEs located in municipalities with clean audits, where the majority perceive governance, financial management, and service delivery to be good. Only 6% view service delivery to be very poor.

Most SMMEs feel that the performance of their local municipality has a direct impact on their business, irrespective of audit outcome. An interesting observation here is that the majority SMMEs identify this impact to be negative: 50% of those operating within poor performing municipalities and 36% of those in top performing municipalities. An important caveat here is that 32% of SMMEs in municipalities with clean audits described the impact as being positive, meanwhile 15% felt it to be very positive, and 3% saw it as extremely positive.

This impact ultimately bears a financial burden, with SMMEs in poor performing municipalities more likely to suffer when compared with those in the top performing municipalities. Of the SMMEs surveyed, 60% reported losing revenue due to the performance of their local

municipality, with 77% being in municipalities with disclaimed audits and 33% located in municipalities with clean audits. Most of those SMMEs which reported losing revenue – irrespective of their municipality’s audit outcome – stipulated this to be 13% and above of their gross annual revenue.

Additionally, SMMEs in the worst performing municipalities are more likely to invest in systems and measures to support their business’ operations. This comes as 93% of those SMMEs in municipalities with disclaimed audits reported having to invest in systems to offset municipal shortcomings, compared with 45% of those operating in municipalities with clean audits. When assessing the cost of these measures, one can observe that an SMME operating in a municipality with a disclaimed audit will spend up to double what their counterpart will expense in a top performing municipality.

The Makana local municipality in the Eastern Cape serves as a case study for how one of the country’s worst performing municipalities can have a negative impact on its SMME community. This comes as the majority of SMMEs viewed the municipality’s performance across key domains (governance, financial management, and service delivery) to be abysmal. Additionally, 65% described its impact on business performance as being extremely negative, with 82% reporting lost revenue as a result and 100% having to invest in systems to support their performance.

Based on this study’s findings, the initial hypothesis stands: SMMEs operating in the country’s worst performing municipalities can be said to suffer an increased number of costly growth constraints when compared with their counterparts operating in top performing municipalities.

This does not suggest, however, that SMMEs operating in municipalities with clean audits are without their challenges. The Mquma Local Municipality in the Eastern Cape demonstrates how local municipal performance is in many ways a continuous exercise of improvement and not necessarily an end goal. In her latest report, the AG awarded the municipality with a clean audit; a testament to the deliberate effort by the local municipality aimed at turning itself around after nearly two decades of poor performance. Yet key challenges remain, namely poor infrastructure, which continue to stymie SMME growth irrespective of the municipality’s positive audit outcome. Although in the short-term municipalities can report clean audits with accurate data, the effects of bad governance, financial mismanagement, and poor service delivery require a more dedicated and long-term effort to overcome.

The majority of South Africans favour small business as the route to wealth creation and argue that the government should make it easier to start a SMME.³⁹ Indeed, a separate study by The Brenthurst Foundation found that there are numerous challenges affecting the growth of the country’s SMME ecosystem, ranging from accessing finance to business registration and formalisation.⁴⁰ Poor performing local municipalities can be added to this list. It is therefore vital that in addition to addressing these well documented challenges, local municipal performance is addressed with equal importance.

³⁹ ‘Survey of South African Voter Opinion’, *The Brenthurst Foundation and SABI Strategy Group*, March 2024, Available at <https://www.thebrenthurstfoundation.org/surveys/survey-of-south-african-voter-opinion-march-2024/>.

⁴⁰ Richard Morrow, Marie-Noelle Nwokolo and Rutendo Nyaku, ‘Glass Ceiling: Challenges Confronting South Africa’s SMME Community’, *The Brenthurst Foundation*, November 2023.

Failing which and the role of local municipalities will become less relevant and SMMEs, where possible, will have to take these core responsibilities into their own hands and at their expense. For those SMMEs who cannot afford this alternative, however, they will continue to suffer constrained growth. Local municipalities are where the rubber meets the road for businesses of all sizes across South Africa. It is therefore vital that they provide a conducive environment within which businesses operate should they have the greatest opportunity to flourish.