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The Influence of Excise Taxation Levied on Product Sales on the Financial Sustainability of South African Tobacco-and-Alcohol-Selling Small, Medium and Micro Enterprise

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In South Africa, Small, Medium and Micro Enterprises (SMMEs) are often described as the driving forces of the national economy, mainly due to the socio economic value they add. Unfortunately, prior research suggests that South African SMMEs are adversely influenced by an array of economic factors, one of which is taxation. One form of taxation, which influences an array of South African SMMEs, is that of excise taxation; as levied on specific products that are considered detrimental to the social-and/or environmental well-being of South African citizens. When taking into account that excise taxation has increased year-on-year for the past 20 years, the perception was formulated that South African tobacco-and-alcohol-selling SMMEs that are subject to excise taxation, experience weak financial sustainability. As such, this study placed emphasis on the influence excise taxation levied on products sold on the financial sustainability of tobacco-and-alcohol-selling South African SMMEs. This study was exploratory and empirical in nature and fell within the positivistic research paradigm. A total of 50 members of management of South African tobacco-and-alcohol-selling SMMEs were targeted, all of whom had to adhere to strict delineation criteria. Stemming from the results, it was found that with the most recent increase in excise taxation, less alcohol products and tobacco products were sold by these business entities, resulting in drastic reductions in profitability levels and liquidity levels, negatively influencing their financial sustainability.

Keywords: Excise taxation, retail, financial sustainability, SMME, South Africa.

JEL Classification: H20, H71

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1. Introduction

According to the South African National Small Business Act No. 102 of 1996, a Small, Medium and Micro Enterprise (SMME) is officially defined as a separate, distinct, legal business entity, together with its relevant branches and/or subsidiaries, that is owned and/or managed by one natural person or more, while operating in any sector and/or sub-sector of the national economy (South Africa, 1996). These business entities are of great importance to South Africa due to the socio-economic value they add; mainly in relation to the national Gross Domestic Product (GDP) and their provision of employment opportunities to the national workforce (Arbor and Quartey, 2010; Bhorat et al., 2018). In recent times, business entities have been reported to contribute up to 56% per cent to the South African GDP while simultaneously employing approximately 60 per cent of the South African workforce (Petersen, et al., 2018; Masama and Bruwer, 2018). Despite the value, which these business entities have added to the South African economy over the years, prior research (Hung et al., 2013; Wiese, 2014) avers that South African SMMEs have among the worst failure rates in the world. This view is supported by recent studies (Fatoki, 2018, Renault et al., 2018) where it was found that an estimated 75 per cent of these business entities fail after being in operation for only 36 months.

The foregoing is disconcerting when taking into account that the failure rate of South African SMMEs has not significantly changed for the better since the early 2000s (Bruwer, 2016). A probable reason for the high South African SMME failure rate is the harsh economic environment in which these business entities have to operate (Bruwer and Van Den Berg, 2017). This view is particularly supported by deteriorated South African economic indicators (e.g. GDP, GDP per capita, unemployment rates, etc.) between 2014 and 2017 (Masama, 2017). In turn, such an economic environment also allows for increased effects of economic factors - those factors that have a distinct influence on the economic well-being of natural persons and non-natural persons, over which such persons have little and/or no control (Lekhanya and Mason, 2014; Masama and Bruwer, 2018). The South African government has actively promoted small business through several initiatives to streamline the business environment in which small enterprises operate. One of the measures that were introduced was the provision of tax relief. Notwithstanding this effort of Government, one economic factor, which still adversely affects South African SMMEs, in general, is that of taxation (Barnes et al., 2016; Sitharam and Hoque, 2016; Dladla and Khobai, 2018). This concerning fact was confirmed by the 2005 Commissioner for the South African Revenue Service (SARS), Pravin Gordhan, by acknowledging that compliance with the tax regime is still a considerable burden for small businesses (SAIT, 2014).

Taxation is a mandatory imposition placed on a country's natural persons and non-natural persons by government, with the main intent to obtain funds to, in turn, finance state expenditure (Salie, et al., 2014; Barnes et al., 2016; Huxham and Haupt, 2018). In a South African dispensation, taxation is collected on behalf of government by the South African Revenue Service (SARS). The collection of taxation generally takes place through means of direct taxation initiatives (e.g. Pay As You Earn) and indirect taxation initiatives (e.g. Value Added Taxation) (Bohlmann and Breitenbach, 2016; Ugwuanyi and Ugwunta, 2017). An indirect taxation, which affects South African SMMEs that sell certain products which are harmful to human health and/or the natural environment is that of excise taxation (also known as sin tax) (De Lange, 2013; Salie et al., 2014). Though the notion of excise taxation is moral, a study by Hendricks et al. (2015) found that since this type of taxation increases on an annual basis, it is believed to influence South African SMMEs financial sustainability adversely, which, in turn, may have a knock-on effect on the business entities' overall existence. Therefore, the following research question was formulated within the ambit of this study:

Does excise taxation levied on the sales of products, as soled by South African tobacco-and-alcohol-selling SMMEs, have a negative influence on their financial sustainability?

For the remainder of this paper, discussion takes place under the following headings: 1) literature review, 2) research design, methodology and methods, 3) results and discussion, 4) recommendations and 5) conclusion.

2. Literature Review

In order to elaborate on the identified research problem, under this heading, relevant discussion takes place under the following sub-headings: 1) financial sustainability of South African SMMEs and 2) excise taxation in South Africa.

2.1. Financial sustainability of South African SMMEs

Financial sustainability has to do with the attainment of a business entity's applicable financial objectives (Masutha and Rogerson, 2015; Houghton, 2016). Otherwise put, this phenomenon pertains to the manner in which a business entity achieves its financial objectives through being profitable (income exceeds expenses), solvent (assets exceed liabilities) and liquid (has sufficient cash on hand) (Bruwer, 2016; Bruwer and Coetzee, 2016; Okanga and Groenewald, 2017; Masama, 2017). More often than not, profitability and liquidity will have a direct impact on the solvency of any business entity – rendering these two sub-components of financial sustainability as the two most important (Beck et al., 2016; Strydom et al., 2018). When focus is shifted on the financial sustainability of South African SMMEs, two previous studies (Wiese, 2014; Bruwer and Coetzee, 2016) confirmed that these business entities are not achieving their financial objectives to a large extent.

2.2. Excise taxation in South Africa

The Customs and Excise Act No. 91 of 1964 was signed into law by the South African government in order to introduce the concept of “sin tax” to the Republic (South Africa, 1964). The main intent of excise taxation is to discourage the consumption of products that are hazardous to human health and wellness by, in turn, increasing state revenue (Hendricks et al., 2015; Ncanywa and Mgwana, 2018). Examples of such products include alcohol products, tobacco products, plastic bags, petroleum products and carbon dioxide emissions (Van Walbeek and Shai, 2014; SARS, 2018).

Notwithstanding the foregoing, the consumption of products that are hazardous to human health and wellness did not eradicate extensively over the years (Salie et al., 2014; Hendricks et al., 2015; Mukong and Tingu, 2018). In a regional study done during 2015 on the perceived impact of sin tax on South African SMMEs, results confirmed that sin tax resulted in increased customer price complaints, difficulties to achieve desired profits levels and customers resorting to buying cheaper and/or alternative alcoholic products (Hendricks et al., 2015). This view is supported by annual increases in excise taxation on alcohol products and tobacco products (see Table 1).

International studies on the effectiveness of the recently introduced sin tax in the Gulf Cooperation Council region in reducing harmful behaviour claims that sin tax is failing to reduce cigarette consumption significantly. Trends indicate a shift in consumer behaviour with consumers moving to lower-cost products, while still maintaining their consumption levels (Webster, 2018). Regardless of the aforementioned, companies do not support the sin tax notion, as the price increase will ultimately be passed on to the consumer (Clowes, 2017).

The constant increases in excise taxation support previous studies (Hendricks et al., 2015; Sornpaisarn et al., 2017) where it was found that business entities that trade with, inter alia alcohol products and tobacco products incur greater taxation-related expenses year-on-year. Although sin tax does not severely influence the economic sustainability of business in a negative way, it may result in a negative influence on the profitability of such business entities (Salie et al., 2013). Moreover, compliance cost and the resulting tax burden placed on SMMEs through excise tax, along with penalties and fines for non-adherence to the excise regulations, can have an adverse effect on small enterprises (Hendricks et al., 2015).

In 2005, a study done on Gauteng SMMEs on the responsibilities for taxes, duties and levies, results returned that 31.8 per cent of small enterprises and 25.8 per cent of medium enterprises source out the administrative function of customs and excise duties (Abrie and Doussy, 2006). The latter results in inevitable cost implications, which, apart from adversely influencing profitability, can have a detrimental effect on tax compliance. Half of the small businesses surveyed were of the opinion that the burden of complying with tax regulations has increased during the past three years. This perception gives rise to a “negative tax morale” among enterprises (Abrie and Doussy, 2006).

Table 1. Increases in excise taxation on alcohol products and tobacco products in South Africa between 2013 and 2018

| Year | Increased taxation on alcoholic products | Increased taxation on tobacco products |
|------|---|--|
| 2013 | +7.5c per bottle [whiskey] +7.5c per 340ml can [beer] +7.3c per bottle [wine] | +60c (per 20 packet) |
| 2014 | +R4.80 per bottle [whiskey] +9c per 340ml can [beer] | +68c (per 20 packet) |
| 2015 | +R3.77 per bottle [whiskey] +15.5c per 340ml can [beer] | +82c (per 20 packet) |

| | | |
|------|---|------------------------|
| | +15c per bottle [wine] | |
| 2016 | +R3.94 per bottle [whiskey] +11c per 340ml can [beer] +24c per bottle [wine] | +81c (per 20 packet) |
| 2017 | +R4.43 per bottle [whiskey] +11c per 340ml can [beer] +30c per bottle [wine] | +R1.06 (per 20 packet) |
| 2018 | +R11.17 per bottle [whiskey] +14.6c per 340ml can [beer] +30c per bottle [wine] | +R1.22 (per 20 packet) |
| 2019 | +R4.54 per bottle [whiskey] +12c per 340ml can [beer] +R22c per bottle [wine] | +R1.14 (per 20 packet) |

Source: Schreuder, 2018; Cronje, 2018; Mboweni, 2019

3. Research Design, Research Methodology and Research Methods

This study was both exploratory and empirical in nature. In core, this study was empirical in the sense that, through survey research, a questionnaire was used as data collection tool to glean primary data from respondents. The questions posed in the questionnaire were mostly closed-ended and quantitative in nature – rendering the study to fall within the positivistic research paradigm. In turn, this study was exploratory in nature, as limited prior research studies have been conducted on the identified research problem.

For this study, the targeted population were members of management of South African SMMEs. All respondents had to adhere to the following list of delineation criteria in order for their respective responses to be regarded as valid:

- Respondents should have been regarded as members of management of their respective SMMEs.
- Respondents should have had decision-making power in their respective SMMEs.
- Respondents should have been at least 18 years of age.
- Respondents should have had at least a partial secondary education.
- Respondents should have been South African citizens.
- Respondents should have been actively involved in their respective SMMEs business processes.
- SMMEs of respondents should have been classified as formal business entities.
- SMMEs of respondents should have been classified as non-franchised business entities.
- SMMEs of respondents should have been classified as sole traders.
- SMMEs of respondents should have operated in the Cape Town City Bowl, South Africa.
- SMMEs of respondents should have been in existence for at least three years.
- SMMEs of respondents should have been operating in the retail industry.
- SMMEs of respondents should have adhered to the definition of a SMME as per the Small Business Act No. 102 of 1996.

Taking into account that the size of the population was unknown to the authors, a mixture of non-probability sampling methods was used to select a representative sample: 1) purposive sampling and 2) convenience sampling. This approach was followed as respondents (and their respective SMMEs) had to adhere to strict delineation criteria, while simultaneously being within proximal reach of the authors, since data had to be collected in a two-month period, along with funding limitations. A total of 50 respondents were targeted of which only 34 favourably responded (68% response rate). Throughout the study, applicable ethical considerations were adhered to, which include, but are not limited to protection from physical harm, informed consent, voluntary participation, anonymity of respondents, and confidentiality.

4. Results and Discussion

Stemming from the data collected, 100 per cent of respondents adhered to the delineation criteria as stated in Section 3. When respondents were asked whether the sale of tobacco- and/or alcoholic products is regarded as their main source of income, 47.1 per cent mentioned "yes" while 52.9 per cent said "no". Although not asked, it is probable that sampled SMMEs may have sold popular non-tobacco- and/or non-alcoholic products (e.g. vape products, cold drinks and water) to customers, which made up their major source of income.

Notwithstanding the above, as all sampled SMMEs sold tobacco- and alcoholic products, all of them were subject to excise taxation. To shed light on the latter, respondents were asked whether increases in excise taxation had a negative influence on the quantity of sales on tobacco- and/or alcoholic products. In both instances, 55.9 per cent indicated “yes” while 44.1 per cent stated “no”. These results are quite concerning as 47.1 per cent of sampled SMMEs solely relied on the sales of tobacco- and/or alcoholic products to remain in operation for the foreseeable future.

To better understand the financial implications of increased excise taxation on tobacco- and/or alcoholic products of sampled SMMEs, respondents were first asked whether this phenomenon had a negative influence on their respective business entities’ profitability. 38.2 per cent said “yes” while 61.8 per cent indicated “no”. As a follow-up question, asked whether this phenomenon has a negative influence on their respective business entities’ liquidity, a total of 44.1 per cent stated “yes” while 55.9 per cent mentioned “no”. Stemming from the results it is highly probable that sampled SMMEs had to increase the selling price of their tobacco- and/or alcoholic products in order to increase and/or sustain their profitability and/or liquidity. This is directly in line with the predicted managerial implications proposed by Salie et al. (2013). Although not validated by the results, it may be that the number of cash sales made by sampled SMMEs was on the decline as liquidity was problematic for 44.1 per cent of these business entities. Hence, the inference can be made that cross-price elasticity (Riley, 2012; Hendricks et al., 2015) on tobacco- and/or alcoholic products may be reaching its limit. Otherwise stated, it may be the case that customers are reaching their price ceiling to pay for tobacco- and/or alcoholic products.

In order to ascertain whether the reduction in the quantity of sales in tobacco- and/or alcoholic products had a negative influence on the financial sustainability of sampled SMMEs, a multiple regression analyses was performed. A summary of the results is evident in Table 2. Taking into account the R² values, the inferences can be made that 1) 10.6 per cent of the variances for reductions in profitability were explained by the reduction of the quantity of sales of tobacco- and/or alcoholic products and 2) 4.8 per cent of the variances for reductions in liquidity were explained by the reduction of quantity of sales of tobacco- and/or alcoholic products. This makes sense, as many factors may have caused reductions in profitability and/or liquidity of sampled SMMEs. Moreover, only one of the two tested relationships were statistically significant – at the 10 per cent level.

Table 2. Regression analysis of reduced quantity of sales of tobacco- and alcoholic products and the reduced profitability and reduced liquidity of sampled SMMEs

| Dependent variables | | Reduced profitability | Reduced liquidity |
|---|----------------|-----------------------|-------------------|
| Independent variables | R ² | 0.16 | 0.048 |
| | F | 3.793 | 1.619 |
| | Sig. | 0.06 | 0.212 |
| Reduced sales of alcoholic and tobacco products | Std β | 0.326 | 0.219 |
| Sig. | Sig. | 0.060* | 0.212 |
| *p-value ≤ 0.100 (significant at 10% level). | | | |
| N = 34 | | | |

In quintessence, the reduction of the quantity of sales of tobacco- and/or alcoholic products had a weak positive statistically significant relationship with the reduction in profitability ($\beta = 0.326$) at a 90 per cent confidence interval. As such, the following statistically significant prediction can be made from the foregoing result: *When sampled South African SMMEs experienced a reduction in the quantity of sales of tobacco – and / or alcoholic products, it will reduce the profitability of these business entities.*

5. Recommendations

From the results, it is apparent that sampled South African SMMEs financial sustainability is adversely affected by increases in excise taxation. When taking into account that these business entities are responsible for employing full-time employees, while also contributing to the national GDP, initiatives should be put in place to safeguard South African SMMEs from adverse repercussions from increases to excise taxation.

It is recommended that national government provide a form of tax relief to South African SMMEs that sell alcohol products and/or tobacco products, to a reasonable extent. This can take the form of a turnover tax-table whereby such registered small businesses can claim back a certain percentage of excise taxation paid throughout the year in order to re-invest in existing infrastructure. Another recommendation is to implement excise taxation rebates for registered South African SMMEs up to a certain percentage of their turnover.

6. Conclusion

Although South African SMMEs add significant socio-economic value to the South African economy, previous studies suggest that these business entities' financial sustainability is adversely influenced by increases in excise taxation. This, in turn, is reported to result in the demise of South African SMMEs that sell alcohol products and/or tobacco products. Stemming from the results, evidence was provided, which indicates that these business entities were negatively influenced by most recent increases in excise taxation. This is specifically supported by a reduction in sales made of alcohol products and/or tobacco products, which, in turn, had a negative influence on sampled business entities' financial sustainability.

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