THE COST OF COMPLIANCE

A STRATEGIC PERSPECTIVE OF THE COSTS OF COMPLIANCE AS A RESULT OF THE IMPLEMENTATION OF DUTY AT SOURCE IN THE FUEL INDUSTRY

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SUPERVISOR

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Confidentiality Clause

15 December 2005

To Whom it Concern

Re: Confidentiality Clause

Due to the strategic importance of this research, it would be appreciated if the contents remain confidential and not be circulated for a period of five years.

Yours Faithfully

116009

ASHIKA PILLAY

DECLARATION

I

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Hereby declare that this thesis entitled: **The Cost of Compliance in the Fuel Industry** is the result of my own investigation and research and that it has not been submitted in part or in full for any other degree or at any other university.

A. PILLAY [MS]

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ABSTRACT

The South African Revenue Services fulfils a number of roles in the reform process of South African Society through its collection of revenue to fund Government programmes, the facilitation of trade and economic security and contributing to an economy that supports growth and development.

As the key revenue collector of government, SARS is mandated to collect revenue from all taxes. These tax types include Income Tax, VAT, PAYE, and Skills development, Levy, Customs Duty and Excise Tax. One of the taxes administered by the SARS on behalf of the Ministry Of Finance is Excise Duty. The Customs and Excise Act 91 of 1964 defines Excise duty as any duty leviable on certain locally manufactured goods. The tax on these goods is commonly referred to as sin taxes by the Ministry of Finance as these goods are seen as luxury goods. Products on which Excise Duty in levied include alcohol, fuel, beer, cigarette, tobacco, spirits and wine.

Prior to 2 April 2003 the system used by the Oil industry to account for the sales of fuel was a sales based system. This effectively meant that excise duty could be deferred for a period of up to two years. This manner of taxation allowed the fuel industry to only pay tax once there had been a sale of the fuel. It therefore reduced the tax liability at the time of manufacture.

The Duty at Source initiative of the SARS was aimed at ensuring that all excise duties be collected at the time of manufacture rather than the time of sale. Duty at source for the fuel industry was implemented on 2 April 03. Duty at source requires that the duty is paid at source i.e. at the time of manufacture of fuel in the refineries. The purpose of the new system was to facilitate the easier collection of revenue and to introduce greater efficiency both for the South African Revenue Services as well as the external role players. The implementation of this new system of assessing duty created a series of administrative and compliance burdens for both parties i.e. for SARS and taxpayers. The implementation was further not supported by a strategic framework.

Due to the lack of the strategic perspective, this study undertakes to identify, suggest and evaluate strategies to manage the cost of compliance as a result of the duty at

source implementation. To support the suggested strategies an operational framework will also be developed to facilitate successful implementation.

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LIST OF ABBREVIATIONS

	DESCRIPTION
BCG	Boston Consulting Group
BP	British Petroleum
CGT	Capital Gains Tax
DAS	Duty at Source
DEFRA	Department for Environment, Food and Rural Affairs
PAYE	Pay as You Earn
RBV	Resource Based View
R&D	Research and Development
SARS	South African Revenue Service
SDL	Skills Development Levy
STC	Secondary Tax on Companies
STEEP	Social, Technological, Ecological, Economic and Political sectors of an Environment
VAT	Value Added Tax
VCA	Value Chain Analysis
UIF	Unemployment Insurance Fund

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CHAPTER 1

THE COST OF COMPLIANCE IN THE FUEL INDUSTRY

1.1 <u>EXECUTIVE SUMMARY</u>

The South African Revenue Service (SARS) is an autonomous government department charged with the collection of all duties and taxes due to the state. One of the taxes administered by the SARS on behalf of the Ministry Of Finance is Excise Duty. The Customs and Excise Act 91 of 1964 defines Excise duty as any duty leviable on certain locally manufactured goods (Section 1 of the Customs and Excise Act, 91 of 1964). The tax on these goods is commonly referred to as sin taxes by the Ministry of Finance as these goods are seen as luxury goods.

Prior to 2 April 2003 the system used by the Oil industry to account for the sales of fuel was a sales based system. This effectively meant that excise duty could be deferred for a period of up to two years. This manner of taxation allowed the fuel industry to only pay tax once there had been a sale of the fuel. It therefore reduced the tax liability at the time of manufacture.

The Duty at Source initiative of the South African Revenue Service was aimed at ensuring that all excise duties be collected at the time of manufacture rather than the time of sale. Duty at source for the fuel industry was implemented on 2 April 03 (Government Gazette: 24639 dated 1 April 2003). Duty at Source requires that the duty is paid at source i.e. at the time of manufacture of fuels in the refineries. The purpose of the new system was to facilitate the easier collection of revenue and to introduce greater efficiency both for the South African Revenue Service as well as the external role players (South African revenue Service- Excise Project Initiation Document dated 2000-05-16). The implementation of this new system of assessing duty created a series of administrative and compliance burdens for both parties i.e. for SARS and taxpayers. Further, a post implementation review of the effectiveness of Duty at Source was not undertaken

Due to the lack of post implementation review, this study undertakes to identify and suggest remedies to manage the cost of compliance as a result of the duty at source implementation.

1.2 BACKGROUND AND CONTEXT

The South African Revenue Service is a government department that is mandated to collect all monies due to the state. These monies are usually recovered in the form of taxes and duties levied.

The SARS levy both direct and indirect taxes. Direct taxes include income tax, capital gains tax, PAYE, donations tax, estate duty, transfer duty and stamp duty. Some of the indirect taxes include VAT, customs and excise duties, fuel levy, environmental levy, road accident fund and air passenger tax.

One of the taxes levied by the SARS is excise duties. Excise duty is a duty levied on certain locally manufactured goods (section 1 of the Customs and Excise Act, 91 of 1964). These goods include: tobacco, alcohol, wines, spirits, beer and fuel.

Prior to April 2003, these excise duties were collected from the manufacturers on a sales basis. This effectively meant that SARS will only recover the excise duties on any of these commodities once a sale has taken place. This system of taxation had serious shortcomings which exemplified the need for a review of the system of excise taxation. This sales based system was replaced with the Duty at Source system.

Duty at Source is a comprehensive overhaul of operations within Excise in order to improve efficiency and control. It was aimed at changing the focus of operations from non-value added administrative functions to a greater emphasis on compliance and proactive control.

Duty at Source comprises three key components (SARS Project initiation Document dated 2005. 05.16).

- Determining dutiable volumes upfront, at the point of manufacture of product
- Enforcing control procedures and increasing compliance by setting up Enforcement teams
- Auditing clients to ensure compliance with procedures, integrated with Revenue audits (SARS project initiation document. Excise. 2005).

In addition to these three components, Duty at Source relies heavily on Customs controls around exports and border posts to minimise round tripping activities. The incentive to act fraudulently in this way will be reduced by the three components of the initiative but will not be eradicated without applying the appropriate Customs controls (Rabie, etal.2003).

The SARS undertook a number of benchmark exercises in an attempt to fully understand the nature and management of Duty At Source in the excise arena (SARS Project initiation Document dated 2000.05.16). Countries consulted in the benchmark exercises included Canada, United Kingdom, New Zealand and a number of the EU countries.

The New Zealand authorities (Dunn, etal.2001) indicated that excessive or unnecessary compliance costs can be caused by a number of different factors:

- Not enough consideration being given to compliance costs issues in policy development.
- An inherent bias to regulate—especially where compliance costs are difficult to identify and /or quantify.
- The tendency for those designing and monitoring regulations failing to take into account the perspective of business, particularly small business.

- Duplication of conflicts between obligations imposed by different Acts that have not been identified during the policy making process.

According to the customs authorities in the United Kingdom cost reduction and compliance with laws is not a new issue. Most government departments have been seeking to reduce them, sometimes as part of major policy reviews (ww.wco.omd.org).

Compliance costs arise from most government interventions. However, Dunn, etal (2001) assert that businesses and private individuals should not incur more compliance costs than necessary. This requires an increased awareness of the balance between the costs of compliance and the objectives of government policy. In practical terms, this means that compliance costs will be given due weight with other costs and benefits when new laws and administrative processes are being designed.

By virtue of SARS not undertaking a post implementation review of the Duty at Source initiative, it was difficult to ascertain whether SARS' approach is consistent with the other government authorities. Hence the need for this study.

1.3 MOTIVATION FOR THE STUDY

The fuel industry contributes significantly to the government revenue. In 2004 R18.8B was collected as fuel levy. This represents 5% of the total government revenue. Estimates by the SARS indicate that there is currently a fuel tax gap of approximately R250M. The fuel tax gap means the difference between the duty that should be collected and the actual duty that is collected. The Duty at Source initiative was identified as a means of closing this gap in addition to improving export controls and reducing administrative burdens. However, since its implementation in April 03, both SARS and the external stakeholders have weathered severe financial constraints in adhering to the Duty at Source requirements. These constraints relate to the financial and other resources required to implement Duty at Source. This issue is further exacerbated by the fact that the implementation of DAS was not supported by a post implementation review.

As a result of the afore mentioned, this study is intended to understand, evaluate and analyse the costs of compliance with Duty at Source requirements. These costs could be financial and/or non financial. The outcome will then inform a recommended strategy to deal with both internal and external stakeholder compliance. This strategy will be supported by an operational framework for proper management of the costs of compliance.

1.4 VALUE OF THE STUDY

Prior to the implementation of Duty at Source, the tax regime was not piloted to ascertain its effectiveness within the South African context.

A post implementation review of the effectiveness of Duty at Source was not undertaken. In numerous stakeholder engagements, the fuel industry clients constantly highlight the shortcomings of the Duty at Source tax regime.
The value of this study lies in the fact that it is the first to be conducted since implementation of the Duty at Source tax regime. It would form the background against which further studies can be undertaken. The results from this study would certainly add value in ascertaining the compliance costs imposed on both the SARS as well as its fuel stakeholders. It would assist the SARS in reviewing its legislative and/or administrative burdens imposed on industry with a view to increasing efficiency at the least cost to profit and productivity.

The compliance model developed will be used to augment the compliance management of a highly dynamic industry. It would serve to highlight the approach that the SARS need to adopt in ensuring compliance.

1.5 PROBLEM STATEMENT

Excise Duty is a fiscal duty, i.e. this duty forms part of the Government's fiscal policy to generate revenue for its own spending. It is therefore imperative that the government manages this tax type in a streamlined approach.

However, the Excise regime of South African was always focussed on administration rather control and audit. This resulted in SARS being exposed to loss of excise revenue due to lack of knowledge of dutiable production volumes, improper focus on administration and the lack of a management information system.

Without implementing the three components of Duty at Source, the following would have continued unabated:

- Loss of revenue through inadequate knowledge of dutiable volumes
- Continuation of fraud
- An inappropriate focus on administration rather than compliance
- Poor management information about the business, making it difficult to effectively manage the excise operations (www.sars.gov.za).

In order to manage and address these issues, it is imperative that the SARS understands the cost of compliance. It would also be necessary to study the perceptions of other role players in the industry such as manufacturers of fuel, the licensed warehouses that store the manufactured fuel and the licensed distributors.

The problem statement, therefore, is:

What is the cost of stakeholder compliance as a result of the implementation of duty at source in the fuel industry?

The benefits of this study will include:

- Less administrative work for the SARS
- Reduced administration for the fuel industry clients
- Greater focus on the management of risk in the fuel industry

- The development and implementation of a compliance model that is supported by a strategic framework.

1.6 RESEARCH OBJECTIVES

Essentially this study will focus on the compliance costs as a result of the implementation of the DAS tax regime by the SARS.
The objectives of the study can be defined as follows:

- to identify the different types of compliance issues facing the stakeholders in the fuel industry
- to identify the cost of compliance
- to establish a shared view of the current strategic intent and operational reality within the fuel industry
- to develop a compliance model for SARS to manage compliance within the fuel industry
- to assess the options in terms of whether they are acceptable or not for SARS
- to select the major options and develop an operational framework to mitigate excessive costs and operationalise value adding activities.

1.7 RESEARCH DESIGN AND METHODOLOGY

In discussing the appropriateness of different forms of research strategies to suit the particular type of research being undertaken, Yin [1994] identifies a number of criteria which influence the researcher's selection.
The criteria which are summarised in table 1.1 include the form of the research question, the control over behavioural events and whether the research focuses on contemporary events.

According to Yin (1994), the case study is appropriate in situations where the questions to be asked is how or why?, where there is no requirement for control over behavioural events and where the research focuses on contemporary events.

In this study, the fundamental questions that are being asked are how are the costs of compliance being managed? ; What should be the strategy in managing the cost of compliance and why are different methods of compliance management more effective than others in different situations?

STRATEGY	FORM OF RESEARCH QUESTION	REQUIRES CONTROL OVER BEHAVIOURAL EVENTS?	FOCUSES ON CONTEMPORARY EVENTS?
Experiment	How, why	Yes	Yes
Survey	Who, what, where, how many, how much	No	Yes
Archival analysis	How, why	No	Yes/no
History	How, why	No	No
Case study		no	yes

Table 1.1 Forms of Research
Source: Yin 1994: 12

1.7.1 Presentation of Case Study

The focus of this study is on contemporary events rather than past events, and the author has no control over events being examined.
Prima facie, therefore, the case study is a relevant research strategy to employ in this instance. This contention is supported by Schramm:

The essence of a case study, the central tendency among all types of case study, is that it tries to illuminate a decision or a set of decisions: why they were taken, how they were implemented, and with what result (Schramm. 1971 in Yin.1994.p.12)

As the study is of a qualitative rather than a quantitative nature, the approach to the dissertation is one of a case study of the South African Revenue Service. The first section of the dissertation will be the case study itself comprising a strategic analysis.

In conducting the strategic analysis, a review will be done of existing research and studies that have been completed on the cost of compliance.

The strategic analysis will be followed by the identification of possible strategic options going forward.

The study is intended to be a cross sectional study. The sample design will comprise a simple random sample. As there are only seven fuel companies operating in South Africa, the field of study will include all these companies. These companies are Shell, Engen, Total, BP, Excel, Petrosa and Caltex. However, the study will be confined to the tax administration of these companies.

Sources of data will include primary, secondary and tertiary sources. Refer to appendix 2 for sources of primary data.

1.7.2 Data Collection

Data collection will inform the strategic analysis of the South African Revenue Service and the fuel industry.
The industry analysis developed in section one, as well as the internal analysis completed will be used to identify strategic options. To solidify this, questionnaires will be handed to tax managers in the seven fuel companies. The seven companies will include Sasol, Shell, Petrosa, Engen, Caltex, BP and Excel. The questionnaires will place emphasis on the cost of compliance and the options available to reduce such costs.

The data collected comprises a range of evidence, including official documentation, archival records, interviews and direct observations, to determine how compliance costs are being managed in relation to the regulatory responsibilities of revenue administrations.

While many of the documentation examined during the course of the study are publicly available, a small percentage of documents were provided in confidence due to the operationally sensitive nature of the data which they contained. In compliance with the terms under which the information was provided, such data has not being identified nor its source referenced. This data comprises a very small part of the study and has been considered only in the development of the questionnaire.

1.7.3 Data Analysis to Identify Strategic Options

The data collected will be analysed to inform the strategic options available to the South African Revenue Service.

In addition to the data collected as mentioned above, questionnaires administered to the tax managers of the seven fuel companies will also be analysed.
Interpretation of the questionnaires will aim to glean information about:

- Financial costs of compliance
- Non financial costs of compliance
- The competitive forces within the fuel market
- External forces with the fuel market
- Strategies that other authorities have employed in preparing for the implementation of duty at source.
- Activities and /or actions to reduce compliance costs.

The purpose of the interviews with strategic personnel managing the fuel industry in SARS will be to assist in identifying the appropriate mechanism within the compliance model and to develop the strategic framework.

Strategic options will be identified from the information obtained from the questionnaires and the strategic analysis.

1.7.4 Evaluation of Strategic Options

The proposed strategic options will be assessed on three criteria: suitability, acceptability and feasibility.

In assessing the suitability of the options, various methods will be employed. These will include value chain analysis, business profile and portfolio analysis.

The selected strategies will then be assessed for acceptability. Acceptability of the options will be determined by examining the expected performance outcomes if the strategy is implemented. The performance outcomes will be based on the analysis of return and risk.

The feasibility option will evaluate whether SARS has the necessary resources and competencies to deliver a strategy.

1.7.5 Selection of Strategy / Strategies

From the statistics presented in the literature review it is anticipated that the costs of compliance will inform a short term recommendation for reducing the cost of compliance. It is also anticipated that a long term strategy will be developed. In order to implement the best strategy, interviews will be conducted with key personnel at the South African Revenue Service.

1.8 LIMITATIONS OF THE PROPOSED STUDY

Duty at Source has been implemented in the alcohol, spirits, wine, beer and tobacco industries. This study will not cover these mentioned industries. Neither will the recommendations suggested for Duty at Source in the fuel industry be extrapolated into these industries.

The study will be confined to the tax compliance obligations of the fuel companies only.

The need for confidentiality and the prescriptive nature of legislation that prevents SARS from disclosing information places another limitation on this study.

1.9 NATURE AND FORM OF RESULTS

The dissertation will be presented in the written format of a thesis. The study will comprise the elements given in the research design. The study will document the strategies that have been identified for the South African Revenue Service.

1.10 CONCLUSION

As the revenue administration of Government, the South African Revenue Service has the mandate to finance development through delivering revenue to the fiscus, to facilitate trade and to contribute to an enabling environment for further growth.

SARS' role in revenue collection encompasses the development and implementation of effective tax laws that ensure compliance and fair collection. SARS has constantly engaged in bench marking exercises to promulgate new laws in South Africa. This bench marking exercise resulted in the development and implementation of the Duty at Source initiative.

Duty at Source is a tax regime that requires the payment of excise duty at the time of production of such excisable goods. This shift from a sales based system of collecting excise duty to a Duty at Source system was justified in the context of increased revenue collection, higher rate of compliance and trade facilitation

However, the implementation of the Duty at source initiative was not supported by a post implementation impact assessment.
This gap gave rise for the need for a study to assess the compliance cost as a result of the duty at source initiative within the fuel industry.

This study is qualitative in nature and comprises a case study on the cost of compliance in the fuel industry.

The value of this study lies in the fact that it is the first to be undertaken to understand the costs of compliance as well as suggest recommendations to manage such costs.

Although duty at source was implemented in the spirits, alcohol, tobacco and beer excise regimes, this study is confined to the assessing and understanding compliance costs in the fuel industry only.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Compliance requirements are essential for the collection of the correct duties and taxes for any government institution. This ensures that the government is collecting the right taxes at the right time. Since government's major source of income is through taxes, it is imperative that businesses comply with tax requirements. Yet when the law is overly complex or difficult to understand or comply with, it can often be ignored. Compliance costs can act as a brake on business growth, regardless of the business size. However, it is expected that most businesses accept that compliance costs are a necessary component of doing business and/or interacting with the different government departments.

Compliance costs are further magnified by rapid and frequent legislative changes for example the Duty at Source tax change in South Africa. Not only do businesses have to spend a lot of time understanding what is required of them under new legislative changes, but there is also lack of communication between the different government departments, resulting in greater compliance costs.

2.2 WHAT IS COMPLIANCE?

The free dictionary (online) defines **compliance** as acting according to certain accepted standards.

According to the American Heritage Dictionary (online) Compliance is the act of complying with a wish, request, or demand; acquiescence.

These definitions extrapolate the need for companies to conduct their business within defined standards and within the bounds of law.

2.3 WHAT ARE COMPLIANCE COSTS?

Dunn (etal. 2001) asserts that compliance costs are the administrative and paperwork costs that businesses incur when meeting an obligation imposed by regulation.

These include administrative burdens and all other associated compliance costs, such as equipment purchases, retooling, recurrent production costs, buying specialists' services, staff training and monitoring compliance. The cost of identifying and understanding the regulatory environment also forms part of the cost of compliance. Dunn (2001) further asserts that costs can also arise from increased liability due to new legal obligations.

The key cost areas are often experienced in terms of money, and time, including the cost of assessing expertise. Some costs are non monetary and cause stress and anxiety. Dunn (2001) refers to this as "psychic costs".

The Australian Government defined compliance costs to include additional costs accrued from obscure, complex or uncertain law (commonwealth of Australia. 2004.5)

Compliance costs are the costs to affected parties of interacting with government in meeting an obligation or providing a service. Compliance costs are incidental to the obligation itself and are often related to the processing and providing information.

2.4 WHY COMPLIANCE COST REDUCTION IS IMPORTANT?

Businesses must accept the need for compliance with government. In fact compliance is often viewed as an integral part of a company's branding as a responsible employer. However, excessive compliance requirements can stifle business growth. It is becoming increasingly prevalent across the world that businesses are constantly lobbying government about reducing excessive compliance costs across a wide range of activities.

Dunn ([2001) found that compliance costs can act as a brake on business growth. In essence, compliance costs discourage growth by reducing incentives to be innovative and by placing barriers on expansion. This can impact negatively on the economic and international competitiveness of a country.

When the economic growth of the country is affected, compliance costs can have a real impact on the Government's key social and economic objectives. The benefits of reducing costs include higher growth, higher levels of employment and stronger enterprises. Therefore, it is in the interests of business and Government to get it right.

Small businesses usually suffer the most with regard to high compliance costs. In South Africa, there has been a government drive to encourage the growth and development of small businesses. This initiative is currently been driven by the South African Revenue Service which is focussing on tax simplification for small businesses. Hence government would not want to stifle the very industry it is seeking to grow.

2.5 INTERNATIONAL INITIATIVES ON COST OF COMPLIANCE

Compliance cost issues have been addressed in many overseas countries. These countries and their findings will be discussed in greater detail. Governments the world over are constantly seeking to reduce the cost of compliance in order to ensure that businesses are able to sustain their competitive advantage in the international markets.

This section will focus on the initiatives of three countries whose governments have made significant strides in attempting to reduce the cost of compliance. These countries are Australia, New Zealand and United Kingdom.

2.5.1 Australia

The Australian Government began its compliance cost reduction programme in 1996 with the introduction of a Task Force. It had also introduced a number of policies which, while not specifically focussing on compliance cost reduction, have nevertheless reduced these costs. The Australian approach focuses on monitoring and advisory agencies, systematic regulatory reviews and attention to higher level frameworks (Wilson: 1996). The attempts at streamlining taxes in Australian were affected through the following key policies and programmes:

2.5.1.1 The Small Business Deregulation Task Force

The key mandate of this task force was to advise the Australian government on revenue-neutral ways to halve paperwork and compliance burden on small businesses and to recommend solutions to identified problems (OECD. 1996).

2.5.1.2 Red Tape Reduction Task Force

This task group was mandated to advise on the need for regulation and the reduction of compliance costs, as well as promoting cultural change in the Queensland Government (OECD.1996).

2.5.1.3 National Competition Policy [Ncp]

The aim of the NCP is to promote competition with the aim of increasing efficiency, choice and innovation (OECD.1996).

2.5.1.4 Regulatory Reform Bodies

These bodies generally oversee regulatory reform processes and provide independent advice to the Government when appropriate. Increasingly, these bodies work at the policy development stage to ensure tight focus and minimum impact to business (OECD.1996).

2.5.1.6 Parliamentary Committees

These committees support Government by monitoring national reform programmes and the activities of national reform bodies, as well as overseeing the review of the NCP (OECD.1996).

2.5.2 UNITED KINGDOM

There are a number of key structures and mechanisms either already in place or under consideration in the United Kingdom aimed at improving the quality of regulation and reducing compliance costs.

These key policies and programmes will be enumerated as follows:

2.5.2.1. The Regulatory Impact Unit

The role of this Unit is to work with other Government Departments, agencies and regulators to help ensure that regulations are fair and effective (Dunn.2001.159). This Unit's work also involves identifying risk and assessing options to deal with regulations.

2.5.2.2 The Better Regulation Task Force

The mandate of this task force is to advise Government on action which improves the effectiveness and credibility of government regulation by ensuring that it is necessary, fair and affordable. The task forces comments on the quality of existing or proposed regulation. It tests against six principles of good regulation by asking whether the regulation is:

- Fair
- Necessary
- Simple to understand
- Affordable
- Effective
- Commands public support (better regulations task force. 2000).

2.5.2.3 <u>The Small Business Service [SBS]</u>

The main objective of the SBS is to:

- Provide a strong voice within Government for small firms.
- Simplify and improve the quality and coherence of support to small firms.
- Help small firms deal with regulation and ensure small firms' interests are properly considered at the earliest possible time (Dunn.2001.161).

2.5.3 <u>NEW ZEALAND</u>

The New Zealand Government, in their attempt to reduce compliance costs, engaged business to understand the nature of the compliance burden. Some of the practices adopted by the New Zealand Government in reducing compliance costs included the following:

2.5.3.1. <u>The Code of Good Regulatory Practice and the Generic Policy Development Process [GPDP]</u>

This Code (the Code of Good Practice and the Generic Policy Development Process. 2000) sets out the guidelines for making legislation under the headings of efficiency, effectiveness, transparency and clarity. The GPDP has five main objectives, namely:

- To provide transparency at a very early stage of the policy development process.
- To encourage earlier, explicit consideration of key policy elements and trade-offs
- To clarify the responsibilities of participants and accountabilities of policy agencies.
- To provide opportunities for substantial external input into policy and its review
- To formalise the process of interaction between public and private sector participants in the policy process (Dunn.2001.49).

2.5.3.2 <u>Legislation Advisory Committee</u>

The role of this committee is to encourage policymakers to consider the non-legislative means of achieving a policy objective. This committee's role is to point out the various non-legislative options available for implementing a policy, including the use or enforcement of existing laws, information and education campaigns and economic instruments (Dunn. 2001.50).

2.5.3.3. <u>Regulatory Impact Statements and Business Compliance Costs Statements</u>

Since 1998 the New Zealand Government requires that all policy proposals submitted to Cabinet must be accompanied by a Regulatory Impact Statement (RIS) which must contain information that identifies the objectives of the policy proposals, an indication of the legislative and non-legislative impacts of the proposal and a statement of the benefits of the policy proposal.

From 2001, the New Zealand Government further required that all policy proposals that have compliance costs implications for Business must be accompanied by a Business Compliance Cost Statement (BCCS). According to Dunn (2001) the BCCS must identify:

- The source of any compliance costs
- The parties likely to be affected
- The quantitative or qualitative estimates of compliance costs
- The longer term implication of the compliance costs for business. Are they one off costs? Will they be recurring over time?
- An assessment of the risks associated with any estimates
- The key issues relating to compliance costs identified in consultation
- Any overlapping compliance requirements with other agencies
- The steps that were taken to ensure compliance costs are minimised.

The New Zealand Government has amended the entire legislation development process to ensure that compliance costs are kept to the minimum.

The attached diagram consolidates the various instruments used by the New Zealand Government to ensure cost effective laws are promulgated.

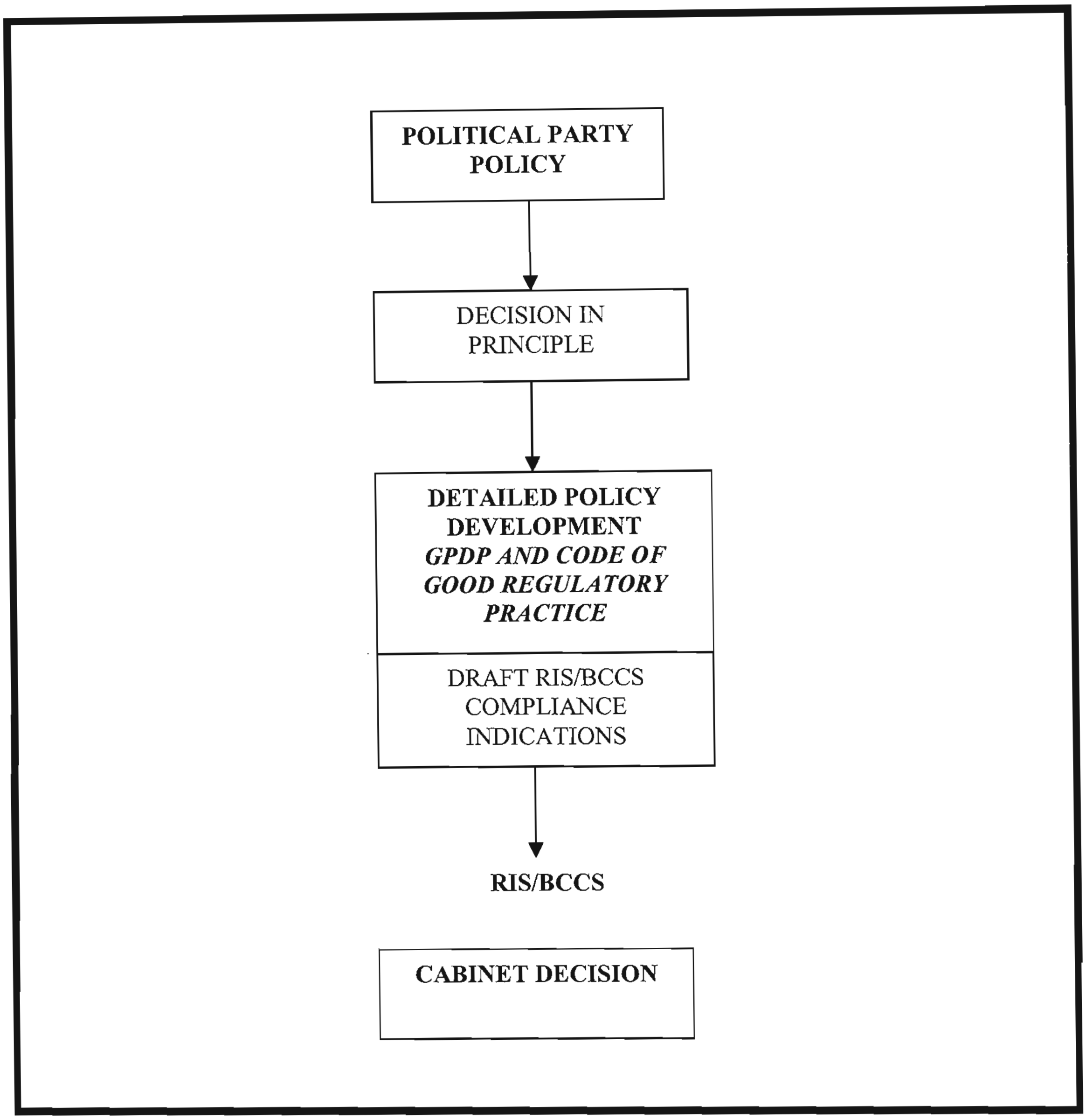


Fig 2.1. Instruments used by the New Zealand Government to manage compliance costs.

Source: Available online at: http://www.businesscompliance.govt.nz

A study of the different Governments highlight once again the need to reduce compliance costs to business. It also highlights Governments' commitment to improving the productivity of the Businesses in their country.

2.6 COMPARATIVE STUDIES OF THE COST OF COMPLIANCE

Compliance costs can relate to legislation, regulation, administration costs and financial costs. Compliance costs are a major consideration of businesses and the Government of a country. Hence a number of studies around the world were undertaken to understand the nature of compliance costs and their impact to business.

These studies will be extrapolated in the ensuing section.

2.6.1 The Rand Study

A study was conducted by the Department of Energy Affairs in 2001 which was aimed at obtaining a high level understanding of the issues relating to the fuel and energy industry. The aim of the study was to obtain close up understanding of the issues industry leaders considered critical to the success of their current operations as well as those likely to be significant in the years ahead (www.rand.gov/publications)

One of the key findings that emerged from the industry Leaders' discussions with Rand was that regulations were a concern. The study highlighted that current and future regulations were a threat to oil companies' bottom line. Accordingly, changes were recommended to resolve concerns about return on investment, capital availability, regulatory flexibility, compliance costs and uncertainty.

A countervailing argument was that there are some opportunities in regulation. The variation in the discussants' views on regulation was issue, region and even refinery-specific and was said to depend largely on how they affect one's business (www.rand.gov/publications).

The Rand study reported that the fuel industry was preoccupied with regulatory compliance and business restructuring challenges which made longer term planning very difficult.

The study further recommended that the Department of Energy Affairs assume a more prominent role in policy development pertaining to the fuel industry.

2.6.2 Environmental Compliance By Chemical Facilities Study

This study was undertaken in 2003 by, Falk, Mitra and Berczyk to evaluate environmental compliance by chemical facilities in Indiana. This study was presented in a case study format and resulted in the development of a conceptual model to show how government policies provide economic incentives or disincentives in promoting voluntary compliance by the chemical facilities.

The study reported in Indiana that some of the major compliance problems chemical companies' faces include:

- Lack of knowledge of reporting requirements by small facilities.
- Lack of co-operation and communication with chemical facilities
- Lack of concern by the facilities of the consequences for not reporting
- No clear set of incentives provided to chemical facilities to reduce the release of toxic chemicals beyond the threshold quantities
- Lack of training on compliance requirements
- Monitoring compliance by small facilities
- Lack of enforcement

Mitra (etal.2003) concluded that is was important that the Government educate members of the chemical facilities about the compliance requirements of the chemical industry. These compliance requirements ranged from training to enforcement of compliance requirements.

2.6.3 Study of Compliance Costs in Australia

The Australian Government conducted studies to ascertain what factors are relevant to reducing compliance costs. The following factors are considered relevant to reducing compliance costs:

- Providing simplified forms for tax reforms
- Assistance to employers in terms of helpfulness and business support teams
- Encouraging the use of the internet (www.ato.gov.au).

The studies in Australia highlighted certain design principals which minimise compliance costs. These are summarised as follows:

- initial costs
- Recurrent costs (The net compliance cost estimate provides a more accurate reflection of the recurring costs of compliance.
- deductibility of compliance costs (which is not available for exempt bodies/government)
- time required to make changes (estimate)
- cost of that time (staff hourly rate – type of staff required to make change; i.e. clerical, accountants, computer operators)
- automation or manual change to system for recurrent costs (online at http://www.ato.gov.au/corporate/content.asp).

The following table lists some of the ATO's compliance initiatives, albeit that some of the compliance cost savings are a by product of measures designed for other purposes.

	Education	Form Redesign	Legislation	Administration	Information Technology
Individuals	Tax education kit for years 9-12 Tax Agent Seminars	Tax Pack redesign Short form Pensioner Tax Pack	Limiting of the amendment period for some taxpayers to two years Family tax benefit reducing from 12 to 3 benefits	Change of address over phone Tax help program 13" binders for enquiries Binding oral advice	E-Tax Electronic Forms for Tax Agents
Small Business	Record keeping program Call centres Pay As You Go (PAYG) guide Substituted Accounting Period (SAP) brochure and letter Fact Sheets PAYG brochures (individual and business) SAP tax agent kit PAYG flyer PAYG reference guide PAYG worksheets		Simplified tax system legislation being developed (simplified depreciation and trading stock regimes Extension of Fringe Benefit Tax (FBT) exemption for remote housing PAYG system to replace the provisional and company instalments and Prescribed Payment System (PPS) and Reportable Payment System (RPS) reporting systems	Voluntary Tax Payments '13' number for enquiries Client Teams Business Entry Point Australian Business Number (ABN) One ATO registration area for business 24 hour call strategy	Restaurant electronic cashbook E-record Registered software facility project Magnetic media for group certificates

Large Business			TLIP rewrite of Capital Gains Tax (CGT) Removal of indexation and averaging (CGT)		
Superannuation	Expos (eg. Investment expo) Tax Agent seminars Self Managed Superannuation Fund (SMSF) education kit	Form F redesign Redesign publications			SuperReport (assist computerised data supply to the ATO) Developing Funds data validation facilities Improvements to website
Excise	Excise service standards brochure Fuel grants advisory committee (consultative, co -design)			Centralisation and simplification of licensing requirements Simplification or reporting arrangements Streamlining of concessional spirit admin arrangements Ready reckoner for the alcohol industry (to calculate credits on transitional stock on introduction of GST)	Increased efficiencies through the implementation of compliance audit software

GST	Media campaign Mailout of booklets Australia wide education seminars GST hotline	Single Business Activity Statement(BAS) and remittance		Australian Business Number (ABN)	Public Key ABN digital signature certificate
ATO wide	A fax from tax			Small Taxation Claims Tribunal	Electronic Funds Transfer (EFT) Electronic Lodgement Service (ELS)

Table 2 .1. Compliance cost reduction initiatives undertaken by the Australian Government.

Source: available online from: http:www.ato.gov.au/corporate/content.asp

2.6.4 <u>The DEFRA Guidance Paper of Oil Storage Regulations</u>

The United Kingdom Department for Environment, Food and Rural Affairs (DEFRA) commissioned a guidance paper in 2001 to provide background information and interpretation of the minimum legal standards in the control of oil storage regulations (DEFRA.2001.1).

In addition to defining the regulations pertaining to oil storage, this paper highlighted the compliance costs of these regulations to business. These costs (online) are enumerated as follows:

- Oil consumers i.e. operators of oil storage facilities would be responsible for meeting the requirements of the proposed legislation. These costs related mainly to the replacement of existing tanks with storage tanks that met the standards defined in the new regulations.

- Compliance costs for small businesses have been minimal. These costs were cited as one off compliance costs which would have minimal impact to small businesses.

- Non Recurring Costs. The main one -off compliance costs to firms were identified as the costs of upgrading existing tanks or installing new tanks according to the required design specification.

- Recurring Costs. The main recurring costs were identified as the routine maintenance costs. It was expected that maintenance costs will be high as there will be a requirement to ensure that reasonable standards as proposed in the regulations are met at all times. This would be achieved through annual inspections and services. The paper further identified that these recurring costs will be borne by a minority of the businesses in the supplier market.

The DEFRA paper also highlighted costs that must be borne by the UK Government. These costs pertained mainly to the costs of enforcing the new regulations. However it was cited that these enforcement costs will be negligent to the cost of pollution control.

This paper extrapolates the compliance costs to both business and the Government. Given the financial nature of the compliance cost, it is inevitable that these costs will be passed to the consumer in the form of higher fuel prices.

2.6.5 Industry Compliance Costs: A Study By Unnevehr And Jensen

In 2001 Unnevehr and Jensen undertook a study to ascertain what compliance costs would look like in a risk based integrated food system (Unevehr & Jensen. 2001. Industry Compliance Costs: what would they look like in a risk based integrated food system? Centre for Agricultural and rural Development. Iowa State University).

The purpose of this study was to examine the cost of reducing risks in the food industry.

The study highlighted that regulation of any industry but particularly the food industry, was likely to escalate compliance costs. These compliance costs are incurred by firms who must change production processes in some way to meet new standards, labelled real resource compliance costs (Unnevehr etal.2001.2).

Costs can be either fixed costs that require investment over a number of years or variable costs that are incurred with each unit produced. Unnevhr (2001. 3) asserts that costs can be very concrete and easy to measure , such as the purchase of new equipment, or they can be fuzzy.

Table 2.2 shows the different kinds of modelling tools used by economists to measure compliance costs and their impact on the market.

Unnevehr (2001) asserts that measuring direct compliance costs and their partial equilibrium impact on the market is usually the focus of regulatory analysis.

These kinds of modelling efforts are useful for illuminating the long run effects of the regulation and their resulting costs. Such dynamics are important in determining incentives for innovation and compliance.

MODELLING TOOLS	COST ANALYSIS
Direct compliance costs	Estimated cost of training Changes in production processes
Partial Equilibrium analysis	Market effects and welfare effects of changes to regulations
Multi market model	Substitution in demand reduces welfare costs
Variable cost Function	Costs of improving quality and safety
Risk analysis model	Costs of interventions. Leads to rising marginal costs of control

TABLE 2.2 Modelling tools and their uses in cost analysis.

SOURCE: adapted from Unnevehr & Jensen 2001: p2.

The study concluded that regulation has an impact on long-run incentives to invest in new technologies and therefore it is likely to bias the nature of productivity and growth. Unnevehr (2001) further asserted that it is important to analyse costs as it allows one to choose among regulatory alternatives. Greater benefits can be achieved more quickly at lower costs with incentive based measures.

2.6.6 The APEC Economic and Energy Sector Impact Study

The objective of this study (Schneider etal. 2000. Trade and Investment Liberalisation in APEC: Economic and Energy Impacts. ABARE Research Report. Canberra) was to assess the impact on APEC economies of the implementation of the BOGOR programme. As well as examining the implications for economic growth in the region, the study also analysed the specific impacts that trade and investment liberalisation had on the region's energy sector

Schneider (2000) asserts that the energy sector impacts of implementing APEC's BOGOR trade liberalisation program arose from three groups of influences. These were:

- Macroeconomic Effects. Liberalising trade regimes can be expected to lead to higher national incomes, principally through the benefits flowing from increased specialisation in economic activity. Reducing tariff and non tariff barriers to trade, including production subsidies, allows a country to channel its natural, human and technical resources into activities in which they are used most productively. While liberalisation may involve compliance costs for some sectors, the more efficient allocation of an economy's resources can lead to lower costs of production.

- Effects of reducing trade barriers in the energy sector. The removal of trade barriers in the energy sector will reduce the price of that fuel in the economy and can therefore lead to an increase in consumption

- Effects of changes in economic structure. The shifts in energy consumption and production at both the individual and regional levels can have implications for the pattern of energy trade. These shifts can also create compliance costs.

The policy implications of this study highlighted that member economy adoption of the policies to implement APEC's BOGOR programme of trade liberalisation will produce benefits for APEC as a whole (Scneider.2000.12)

The study also revealed that there are important direct implications for APEC's energy policy makers with regard to the BOGOR programme. Whilst trade liberalisation will benefit both developing and developed member countries, the implementation of the programme will require certain legislative changes. These regulatory or legislative changes will in turn create compliance costs which must be managed in a constructive manner.

2.6.7 <u>The Dowlatabadi, Boyd and Macdonald Study</u>

Dowlatabadi, Boyd and MacDonald (2004) indicated in their study of the cost of going green that how much a policy is expected to cost and who bears the brunt of that cost plays a significant role in the debates that shape regulations.

This study highlighted a clear distinction between compliance costs and production costs at the business level. Dowlatabadi (etal.2004) asserted that firm-level costs were critical to their decision-making and shape their responses to proposed legislation. Thus, two key dimensions to costs are the boundary at which impacts of policy are measured and the baseline. The boundary defines how far away from the point of compliance costs are measured whilst the baseline defines what the counterfactual would have been in the absence of policy.

Within firms, conventional wisdom had asserted that reported costs of compliance with regulations understate changes in total production costs. Heretically, Porter etal (Dowlatabadi. 2004.5) asserted that compliance could lead to net savings in production costs. However actual empirical studies report that actual compliance costs and changes in production costs were not significantly different.

This study concluded that the very policies used to reduce compliance costs of firms can lead firms to relocate production elsewhere. Dowlatabadi (2004) further asserted that whenever uncertainty existed about the compliance costs of a policy, there is no factual basis to support decisions being made.

2.6.8 A Study on Compliance and Choice: A Strategic View

This study asserts that compliance should commence with the realisation that compliance and choice co-exist on a continuum. It is an unavoidable fact than an organisation, for the most part; need to comply with the demands of their environment.

Often, within this environment of compliance, the organisation will be required to make a choice. For every choice an organisation makes, it is required to perform many more acts of compliance.

Companies operate within the context of an industry and macro environment and they are not self sufficient or closed systems (Stoner & Freeman. 1992). Generally the organisation's strategic process involves analysing the external environment and formulating a response that complies with the environment. Even in the case of an industry that requires an ongoing innovative strategic response by the organisation, the organisation is complying with the demand for continual innovation.

This study highlighted that organisations face a wide range of demands for compliance. Even though some of these organisations are able to make choices from time to time, these choices are made against a background of compliance.

Compliance to the demands of their environment, actions of important players in an industry, expectations of stakeholders and physical constraints and limitations are inescapable. Non –compliance as a general response by organisations would lead to chaos.

The study further extrapolated that compliance and choice represent alternative perspectives from which organisations frame their strategies. Organisations either comply with the dictates of their environment or perceived constraints or they break away from compliance and shape their own destinies.

Research by Baden- Fuller and Stopford (1992) indicates that the firm matters and not the industry. If organisation's strategy was shaped largely by compliance and not choice then this conclusion would certainly not have been reached.

The debate between compliance and choice centres on two extremes of a continuum. The business approach to strategy should either be reactive [compliance] or proactive (choice). Despite being forced to comply in many instances, a business strategy that relies on compliance condemns the business to being also-rans.

Organisations need to deliver value within the constraints and confines of their organisational context and content. This framework may be technically seen as an imposition of compliance requirements on an organisation; however, the evidence shows that organisations who dictate their own terms and who shape their own environments, secure superior returns.

2.6.9. <u>Study on Lowering the Cost of Compliance</u>

This undated paper was written by David Baum who is an independent writer based in Santa Barbara in California. In his research paper (available online) Baum stated that manufacturing companies are taking a broad view of compliance , using it as an umbrella term for all aspects of governance, risk management and regulatory compliance. He further indicated that this is particularly evident for process manufacturing companies, which must not only abide by new fiscal regulations but must also adhere to strict regulations concerning the manufacture and distribution of their products.

According to Baum (online), there are four distinct types of rules and regulations facing process manufacturing companies:

- Generic regulations such as International Accounting Standards and Sarbanes Oxley
- Industry regulations that are specific to certain industries
- Customer requirements enforced by specific clients, such as how the product must be manufactured or invoiced
- Internal rules and procedures, such as standard operating procedures.

Baum (online) added that these requirements are motivating companies to adopt technology that support formal business processes and consistent reporting methods. He alluded to the fact that compliance is an information management problem and thus entails control over the storage, access and presentation of data.

The article highlighted that too many companies are treating compliance as a tactical issue and not thinking strategically. There are numerous environmental regulations, health and safety issues and financial reporting requirements for most firms. It is therefore important that managers develop a common approach to these regulations so they can achieve true savings. The goal must be to reduce the cost of monitoring internal compliance, as well as providing better documented evidence that those processes are being followed.

In support of this article Kvitka (online) asserted that one of the most important initial steps for compliance is business process documentation to assist in identifying risk and mitigating controls. Kvitka (online) also stated that while documented procedures alone cannot strengthen corporate governance, they are a necessary component of compliance.

This paper highlights the importance of proper documentary controls to ensure compliance with a range of rules and regulations. Proper documentation, supported by integrated information technology, is the key element in lowering the cost of compliance.

2.6.10 AMR Research on the Rising Cost of Compliance

The AMR research group based in America conducted a survey on 69 companies in 2004 to ascertain companies' compliance cost in response to regulations.
The survey results revealed that in today's regulatory climate, compliance spending has become another cost of doing business (online).

The results also revealed that many companies expected compliance spending to be once off cost but in fact, compliance spending is going to be growing.

The research revealed that more than one-third of enterprises underestimated their compliance costs in 2004 and hence 35% of the respondents spent more than they budgeted for compliance (online).

The research highlighted several best practices in managing compliance costs:

- Take a holistic approach: AMR Research says the companies that unite diverse requirements- including financial, operational and IT needs- to meet the goals of compliance will benefit the most (online).
- Know who, what and how: identify which internal and external constituents play key roles in any directive [who]. Determine the major functional capabilities required to address compliance regulations [what]. Prepare the IT infrastructure and supporting services required to sustain these roles and capabilities [how].
- Plan in order to mitigate costs: by putting time and effort into planning, companies may save money and effort down the line (online).
- Put governance and risk management first: compliance won't work well without clear governance and strong risk management practices (online).

All the studies cited in this section affirm that compliance costs are the result of some regulation or policy imposed by the policy makers of the country. Some of these compliance costs are recurring in nature whilst others tend to be once off costs to ensure standards as prescribed by the regulation are being met.

In addition, the studies highlight that compliance costs can either be administrative, financial or regulatory in nature.

2.7 ENVIRONMENTAL ANALYSIS PERTAINING TO COMPLIANCE COSTS

In understanding the impact of compliance costs to business, it is imperative that there is an understanding of the environment in which businesses operate because this environment will largely dictate the competitive forces and the macro environmental issues that will enable businesses to sustain their competitive advantage. These external factors are key to understanding and managing compliance costs.

Thompson and Strickland (2003) assert that all organisations operate within a macro environment consisting of the economy at large, societal values and lifestyles, governmental legislation and regulation, technological factors, and the company's immediate industry and competitive environment as depicted in Fig 2.2.

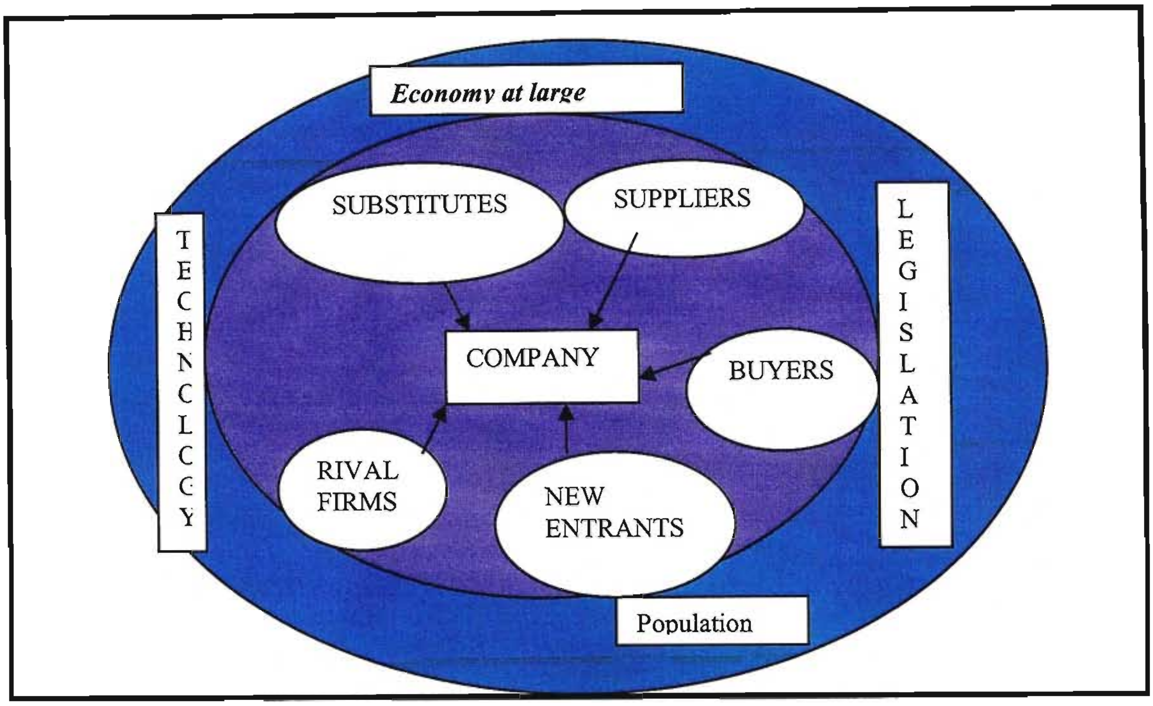


Fig .2.2 A company's macro environment

Source: Thompson & Strickland.2003:75

Thompson and Strickland (2003) assert that the macroeconomic environment includes all the relevant forces outside a company's boundaries –relevant in the sense that they are important enough to have a bearing on the decisions a company ultimately makes about its business model and strategy. Although a large portion of the macro environment is outside the company's sphere of influence, companies are nonetheless obliged to monitor them and adapt the company's strategy as may be needed. The forces in a company's macro environment having the greatest impact on its strategy, however, typically revolve around the company's immediate industry and competitive environment (Thompson & Strickland.2003.73).

There is a number of analysis tools used to analyse the external and competitive environment of a company. These include an industry analysis as espoused by Porter and the STEEP analysis. Each of these tools will be extrapolated in detail.

2.7.1 <u>Industry Analysis</u>

This tool is commonly referred to as the Five Forces Model and is used to analyse major economic and technological forces that will ultimately influence an industry's profit potential. Fleisher & Bensoussan (2003) asserts that identifying the profit potential [i.e. attractiveness] of an industry provides the foundation for bridging the gap between the firm's external environment and its resources.

The Five Forces model comprises the following elements:

- Threat of new entrants
- Bargaining power of suppliers
- Bargaining power of buyers
- Threat of substitutes
- Rivalry among existing competitors

Porter states that competitive strategy must grow out of a sophisticated understanding of these rules of competition with the ultimate aim of developing competitive strategies to cope with and, ideally, influence or change these forces in favour of the firm (Fleisher.2003.61)

2.7.1.1. <u>Threat Of New Entrants</u>

Fleisher (2003) assert that entry barriers define the level of difficulty facing new firms considering competitive entry into the industry. The threat of new entrants is defined by several entry barriers:

- Entry price deterrent. If the cost of entry far exceeds the forecasted revenue yield, new firms will not be enticed to enter the industry.
- High costs. The level of capital required to enter an industry may deter competitive entry, especially if a high proportion of the start up costs are unrecoverable.
- Product differentiation. Many advantages are available to incumbents through branding, including customer loyalty and the flexibility to co-brand other products.

- Distribution access. To make inroads into a new market, the entrant may encounter significant barriers to market access posed by having to surmount the incumbent's established relations with distributors. Even when this can be done, costly incentives have to be offered to persuade distributors to carry the new products.
- Government. Subsidies to incumbents, regulations that increase capital costs or entry restrictions are some entry barriers introduced by interventionist government policy.
- Switching costs. It is often costly for consumers to switch to new products, heavily favouring the incumbent's competitive position (Fleisher. Etal. 2003. p.62).

2.7.1.2. <u>Bargaining Power Of Suppliers</u>

Fleisher (2003) assert that this force refers to the ability of suppliers to influence the cost, availability and quality if input material to firms in the industry.

Bargaining power has several casual factors:

- Concentration. Fleisher (2003) assert that if the industry is concentrated and dominated by fewer firms than the industry it sells to, supplier power will be high.
- Diversification. The proportion of total supplier sales that an industry represents will vary inversely with supplier power.
- Switching costs. An industry's ability to switch supplier costs effectively will decrease supplier influence. Availability to forward integrate will increase supplier influence, open options for industry to backward integrate will decrease supplier influence.
- Government. In mixed economies, the government often function as a supplier and can exert substantive bargaining force (Fleisher, etal. 203. P.63).

2.7.1.3. <u>Bargaining Power of Buyers</u>

Fleisher (2003) indicated that the influence of the firm's customers play an important role in defining industry structure by virtue of their ability to force prices down by comparison shopping or by raising quality expectations.

Several factors impact buyers bargaining power:

- Differentiation. A rich and unique set of product attributes will decrease buyer power. Conversely, a commodity product will increase buyer power.
- Concentration. If the buyer represents a high proportion of the firm's sales, buyer power will be high.
- Profitability. A buyer earning low profits will be much more price sensitive
- Importance of quality. If product quality is vital to the buyer's business model, buyers will be less price sensitive.
- Switching costs. Open options to backward integrate will enhance buyer power (Fleisher. 2003. p.63).

2.7.1.4 <u>Threat Of Substitute Products</u>

Thompson and Strickland [2003] assert hat firms in one industry are quite often in close competition with firms in another industry because their respective products are good substitutes. the presence of readily available and attractively priced substitutes creates competitive pressure by placing a ceiling on the prices the industry can charge for its product without giving customers an incentive to switch to substitutes and risk sales erosion (Thomson. Etal. 2003. p.88).

When substitutes are cheaper than the industry's products, industry members come under competitive pressure to reduce their prices and find ways of absorbing costs.

Consumers are ale to compare prices, quality and other product attributes by virtue of the availability of substitute products. This competition forces industry participants to heighten their efforts at marketing and distribution of their products.

Another determinant of the strength of competition from substitutes is how difficult or costly it is for industry customers to switch to substitutes. Typical switching costs include extra price premiums, the cost of additional equipment and employee retraining costs. If switching costs are high, sellers of substitute products must offer a major cost or performance benefit in order to entice the industry's customers away. When switching costs area low, its much easier for sellers of substitutes to convince buyers to change over their products (Thompson and Strickland. 2003.p.88).

2.7.1.5 <u>Rivalry among Existing Competitors</u>

Fleisher (2003) assert that the intensity of rivalry within an industry which has been empirically demonstrated in a number of instances to be the most influential of the five forces is determined by several factors:

- Market growth. High market growth will reduce rivalry because one firm's sales increases will not displace the sales growth of competitors, thus reducing the probability of retaliation.
- Cost structure. A high fixed cost structure usually precipitates overcapacity during demand troughs and the requisite fight for market share to secure feasible volume ranges.
- Barriers to exit. Often low profit firms are induced to remain in the industry for various reasons, including asset specialisation, fixed costs of exit or government restrictions.
- Switching costs. Commodity products will encourage switching based on price leading to competition on market share/volume. Conversely, product differentiation will protect the firm from unwanted switching by exiting customers (Fleisher. Etal.2003.p.64).

Fleisher [2003] assert that the purpose of the five forces model is to analyse major economic and technological forces that will ultimately influence an industry's profit potential. Identifying the profit potential (i.e. attractiveness) of an industry provides the foundation for bridging the strategic gap between the firm's external environment and its resources.

2.7.2 STEEP Analysis

STEEP is an acronym that denotes the Social, Technological, Economic, Ecological and Political/legal sectors of an environment. Fleisher (etal. 2003) asserts that the STEEP domains are not meant to be mutually exclusive as the primary purpose of the breakdown into the different elements is to avoid overlooking major aspects of the general environment in the analysis.

The five STEEP elements will be described in greater detail below.

2.7.2.1 Social

The social component of the general environment describes the characteristics of the societal context in which the organisation exists. Demographics, cultural attitudes, literacy rates, education levels, values, lifestyles, age distribution and the mobility of the population all contribute to the social component of the general environment. Fleisher [etal. 2003] recommends that is important that analysts monitor this element in terms of the strategic directions and also take a proactive role in helping to develop competitive strategy that builds the company reputation among its key stakeholders.

2.7.2.2. Technological

Digital communication, biotechnology, chemicals and medicine are a few of the fields in which technological changes have opened new areas to commercial competition. The technological component of the general environment is compounded by the impact of science and technology in product and process innovation as well. This includes new approaches to producing goods and services as well as new equipment (Fleisher. etal. 2003.272).

Companies must identify and monitor the effects of technological change as it affects competitive strategy.

2.7.2.3. Economic

The economic component of the general environment indicates the distribution and uses of resources within the entire society. It is important because consumption patterns are largely influenced by economic trends such as interest rates, exchange rates, inflation rates, debt spending patterns and levels of disposable income. Of prime importance to the analytical task is the identification. Monitoring and forecasting of these economic variables to which a company's strategic competitive forces are most sensitive (Fleisher. Etal. 2003. 273).

2.7.2.4. Ecological

The ecological environment encompasses both the physical and biological environments within which organisations interact. Fleisher [2003] highlights aspects such as green house emissions, recycling, pollution and biotechnological advances as some of the key ecological issues for consideration within the STEEP analysis.

2.7.2.5. Political/Legal

This component of the general environment relates to the Government of a country as well as public interest in certain industries and lobbying efforts by interest groups.
In many countries, the policies and regulations of Government is a key constraining factor in achieving competitive advantage.
The Government itself is a large consumer of the production of the country and through its consumption and regulation; it can either compromise competition or engender greater competition.
The actions and policies of government must continually be assessed to understand what the compliance costs are and how these costs can be legally minimised without any constraint to the standards required.

Fleisher (2003) assert that the rationale for environmental analysis will vary at any given time within an organisation. An organisation's success or failure can substantially depend on how accurately its decision makers read the environment, and how effectively they respond to it.

2.8 ANALYSIS OF THE RESOURCES AND CAPABILITIES OF COMPANIES WITH REGARD TO COMPLIANCE COSTS

Compliance costs, by their very nature, will impact on the resource capability of a business. It is therefore imperative that companies analyse their resource capabilities so that they are able to factor in any compliance costs that may be necessary to maintain or sustain their competitive advantage.

Lynn (2000) asserts that analysing the resources of an organisation involves not only exploring the role and contribution of the main resources, but also developing an understanding of two main issues. First, it in important to explore how resources deliver profits in companies and provide services in public companies. Second, it is essential to identify those resources that enable an organisation to compete and survive against competition (Lynch. 2000.247).

An internal analysis of a company's resources and capabilities is usually undertaken through the use of certain analysis tools. These tools are the value chain analysis and the resource based analysis.

Each of these tools will be discussed in greater detail.

2.8.1 Value Chain Analysis

Hitt (etal. 2003) assert that value chain analysis allows a company to understand the parts of its operations that create value and those that do not. This view is further supported by Fleisher (2003) who indicates that the unique strength of the value chain analysis is that it can be used as an analytical tool to help firms bridge the strategic gaps between the firm's capabilities and opportunities and threats in it environment. Hence the two main purposes of the value chain analysis are to identify:

- Opportunities to secure cost advantages, and
- Opportunities to create product/service attribute differentiation

Porter (Fleisher.2003.105) views the value chain as composed of all the activities and processes that a company performs to design, produce, market, deliver and supports its products or services. He classifies all these activities into two main categories:

A] Primary Activities

These include:

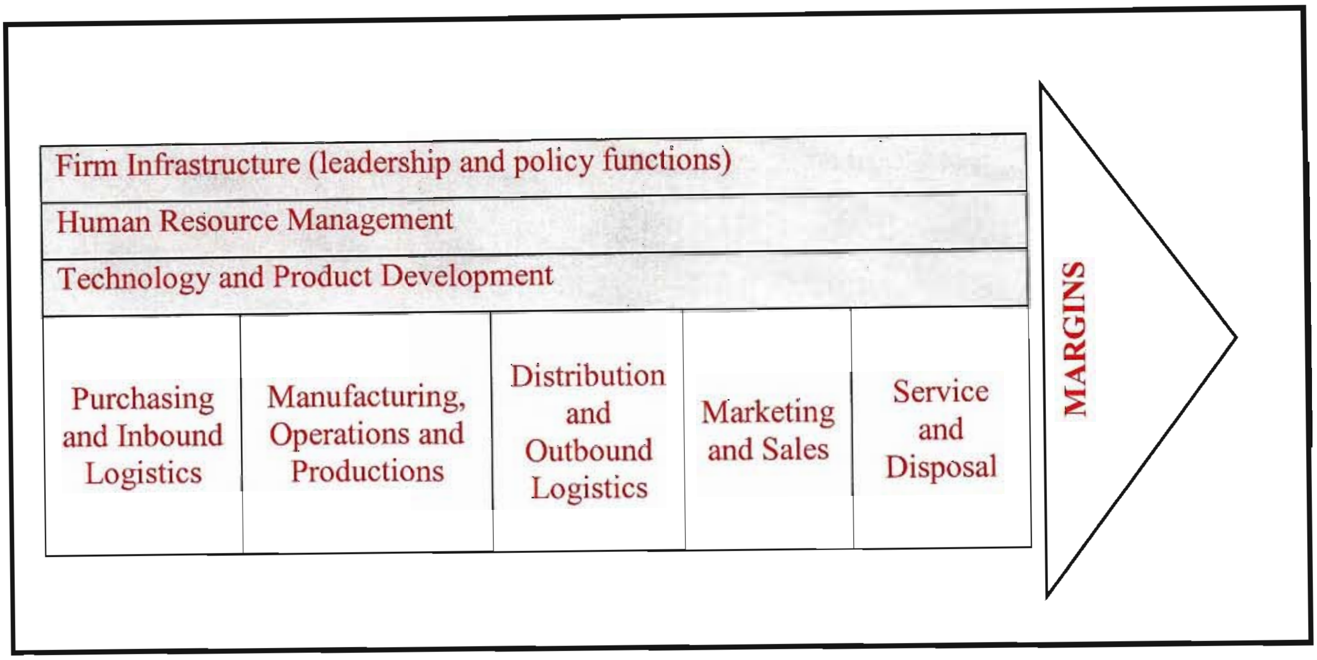
- Inbound logistics- inventory, warehousing and handling
- Operations- transformation of inputs into final products
- Outbound logistics –distribution
- Marketing and sales-marketing communications, pricing and channel management
- Service- post sale support

B] Support Activities

- Technology development- engineering, R&D, information technology
- Human resource development- hiring, incentive schemes, training, promotion
- Firm infrastructure- accounting, planning

The price charged to the firm's customers less the costs of all these activities determines the firm's profits. All of the suppliers of the firm's inputs and buyers of the firm's products and services will also have value chains composed of their own primary and support activities (Fleisher.etal. 2003. P.106).

SUPPORT ACTIVITIES



PRIMARY ACTIVITIES

Fig 2.3 The Value Chain

Source: Hitt,Ireland &Hoskisson.2003:93

Fleisher (2003) assert that value chain analysis addressed several critical deficiencies with the inward looking focus of previous management tools. The unique strength of value chain analysis is that it allows firms to gain a better understanding of their strengths and weaknesses and from an industry perspective, it supports a better understanding of competitive positioning relative to key customers and suppliers.

2.8.2 The Resource Based View Analysis [RBV]

The main factors underpinning the Resource based view theory is that firms own or control sets of resources that support unique strengths allowing the firm to perform activities better than or at lower costs than rivals. Fleisher [etal. 2003] assert that RBV theory defines a hierarchy of four broad categories of resources as potential sources of competitive advantage.

- Tangible Assets

These comprise physical factors of production consumed in the delivery of customer value. Examples include plant, machinery, land, inventory and building.

- Intangible assets

These are factors of production that cannot be seen or touched but do contribute to the overall customer value add of the company. Examples include brand name, customer goodwill, patents, and company reputation and copyright

- Organisational Capabilities

Lynch (2003) asserts that organisational capabilities refer to the skills, routines management and leadership of the organisation.

- Core competencies

Fleisher (2003) comments that core competencies are the individual human skill and talent, collective organisational capacity and learnings that allow the company to act on critical processes and activities to transform its tangible and intangible assets into competitively superior customer value.

The source of competitive advantage within a company is often multifactorial in that it usually cannot be attributed to only one type of resource. Rather it is the interaction between these four different types within a competitive context that drives a company's competitive advantage (Fleisher. Etal. 2003.208).

The resource Based view Analysis can be summarised in terms of figure 2.4

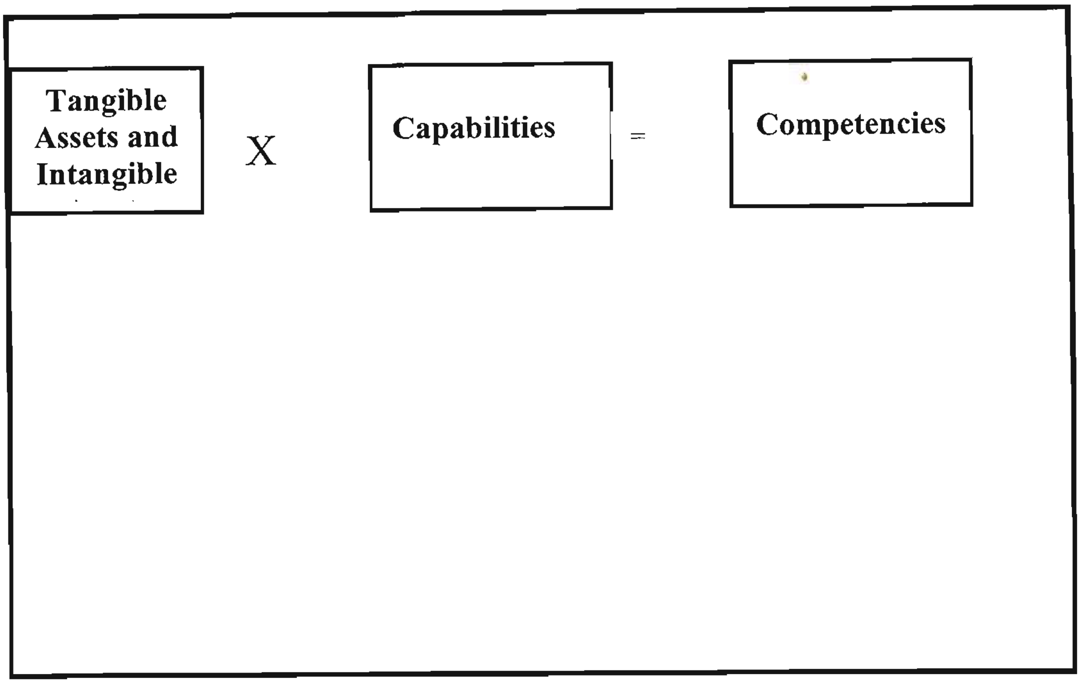


Fig 2.4 The Resource Based View of a Company

Source: Fleisher & Bensoussan. 2003: 209

Fleisher (2003) assert that the fundamental premise underpinning the Resource Based View theory is the recognition that firms own or control sets or resources that support unique strengths, allowing the firm to perform activities better or at lower costs than rivals. The source of competitive advantage within a firm is often multifactorial in that it usually cannot be attributed to only one type of resource. Rather, it is the interactions between the four types of resources within a competitive context that drives a firm's competitive advantage (Fleisher. 2003. P.208).

2.9 STRATEGIC OPTIONS TO EVALUATE COMPLIANCE COSTS

In assessing strategic options, three types of evaluation criterion can be used. These are suitability, acceptability and feasibility. Each of these criteria will be discussed in greater detail.

Figure 2.5 highlights the various components of strategic options.

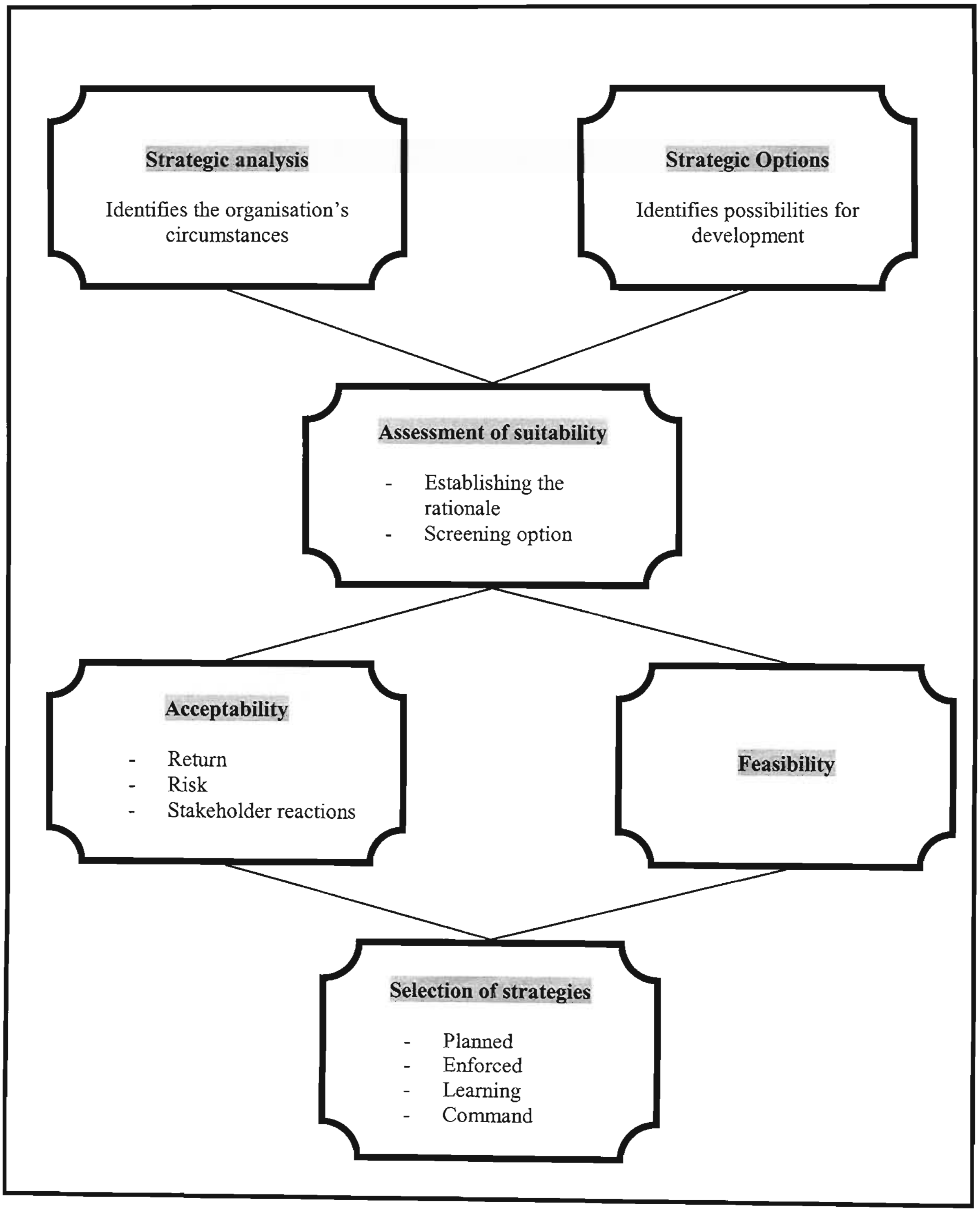


Fig 2.5 Components of strategic options.
Source: Johnson & Scholes. 2000: 353

2.9.1 Suitability

Suitability is a broad assessment of whether the strategy addresses the circumstances in which the organisation is operating (Johnson & Scholes.2000. 353).
Johnson and Scholes assert that assessing the suitability of strategic options can be a useful basis on which to screen options before more detailed analysis are undertaken concerning the acceptability and feasibility of those options. This process can consist of two stages: first establishing the rationale for/strategic logic for each strategic option in its own right; and second, establishing the relative merits of an option when a number of choices are available.

Different categories of analytical techniques can be used to assess the suitability of options. These techniques will be discussed in greater detail.

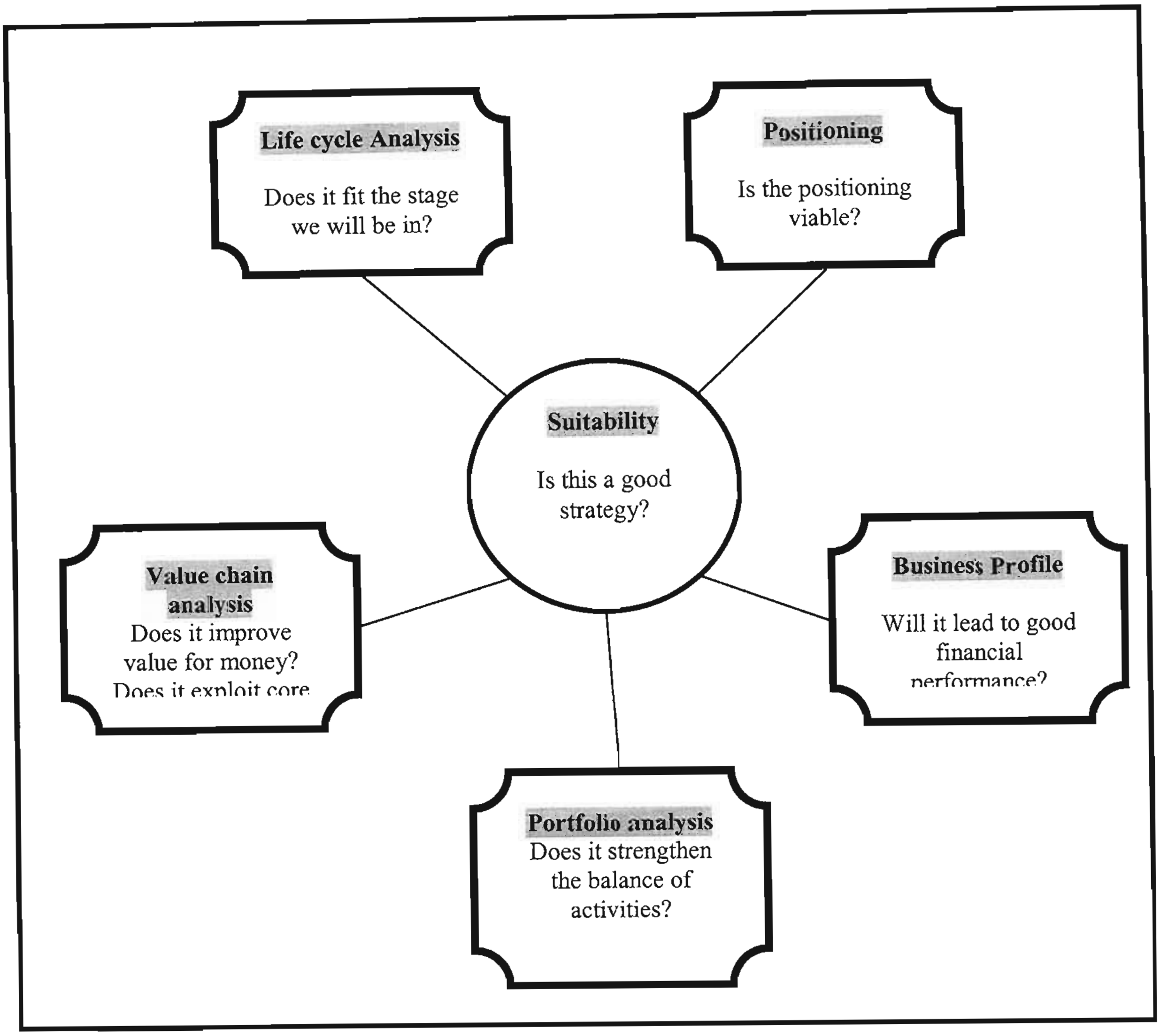


Fig 2.6 components of suitability

Source: Source: Johnson & Scholes. 2000: 354

2.9.1.1. <u>Life Cycle Analysis</u>

Johnson and Scholes (2000) assert that a life cycle analysis assesses whether a strategy is likely to be appropriate given the stage of the product life cycle. They further assert that the purpose of this matrix is to establish the appropriateness of particular strategies in relation to these two dimensions. The crucial issue is establishing where an organisation is currently positioned on the matrix and therefore what types of strategy are most likely to be suitable.

The position within the lifecycle can be determined in relation to eight external factors of the evolutionary stages of industry. These are market growth rate, growth potential, breadth of product lines, number of competitors, and spread of market share between these competitors, customer loyalty, entry barriers and technology (Johnson and Scholes. 2000.358).

2.9.1.2 <u>Positioning</u>

Positioning within the market is usually underpinned by the forces of demand, i.e. it is important to know whether demand for a product will grow or decline. Organisations are continually faced with the challenge of assessing positioning in terms of lowest cost or product differentiation.

Johnson and Scholes (2000) assert that assessing suitability of a particular strategy requires companies to list key resources and competences that underpin the strategy.

2.9.1.3 <u>Portfolio Analysis</u>

Johnson and Scholes (2000) define portfolio analysis as a tool that analyses the balance of the organisation's strategic business units. This tool is usually used to establish the basis for an organisation's approach to diversity.

One of the commonly used portfolio matrices is the BCG matrix (Fleisher etal.2002.30) assert that the BCG matrix allows a multibusiness firm to compare the merits of its individual business units in order to determine appropriate market strategies for each business. The business units are evaluated based on attractiveness of the industry in which they compete and their relative competitive position.

The suitability option enables an organisation to evaluate the suitability of its strategy. The commonly used techniques for assessing suitability include life cycle analysis, positioning, value chain analysis, portfolio analysis and business profile analysis. Whilst some of these techniques are useful to evaluate strategies of multi business organisations, some of them do not add value within a government organisation strategy.

2.9.2 Analysing Acceptability

Johnson and Scholes (2000.370) assert that acceptability is concerned with the expected performance outcomes, such as risk or return, if a strategy is implemented The acceptability of strategies can be assessed in three broad ways: return, risk and stakeholder reactions.

Three types of assessments can be used to analyse returns. These are:
Return on capital employed
Payback period, and
Discounted cash flow.

Risk is usually analysed in terms of the various financial ratios that detail profitability and liquidity.

2.9.3 Analysing Feasibility

Feasibility is concerned with whether an organisation has the resources and competences to deliver a strategy (Johnson, etal.1999.383).

Some of the tools used to analyse feasibility include:
Funds flow analysis
Break-even analysis, and
Resource deployment analysis

In determining strategic options it is imperative that the strategy is assessed in terms of suitability, acceptability and feasibility. Not all of these components are necessary in determining strategic options but at least one component should be considered.

2.10 COMPLIANCE MODEL

On review of literature pertaining to the cost of compliance, a compliance model has been developed. This model seeks to understand what actions must be taken to deal with compliance and/or non compliance.

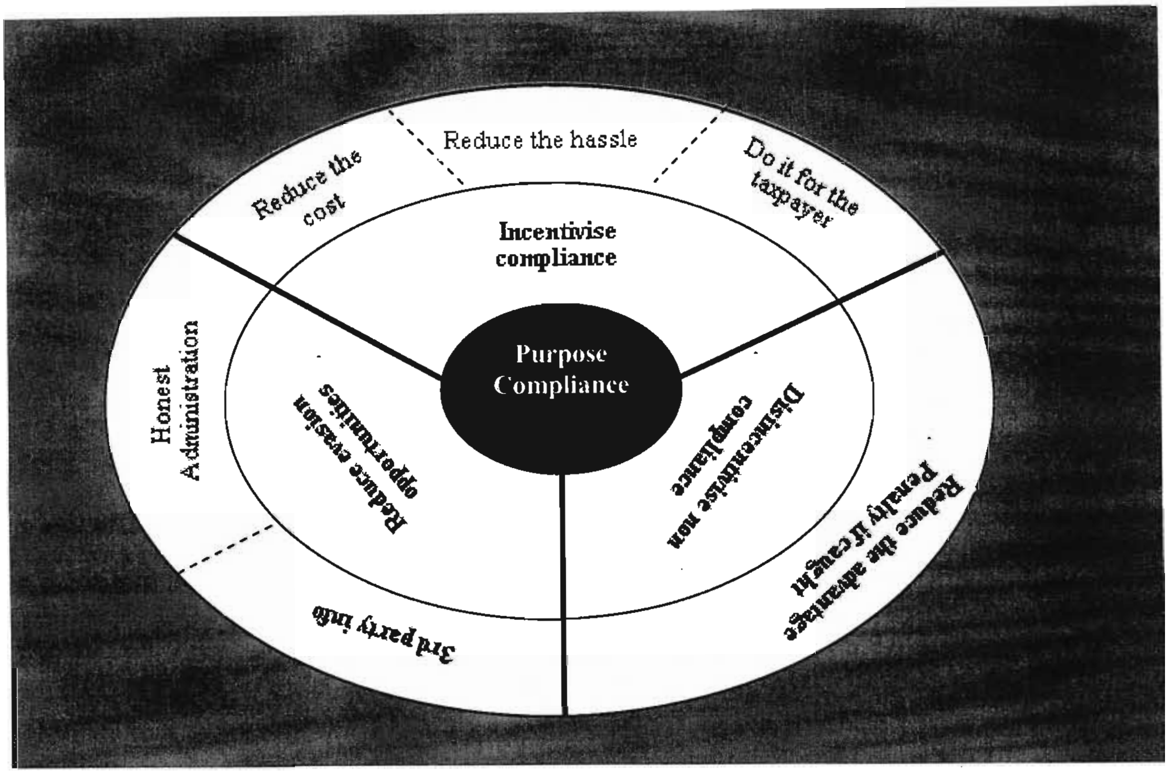


Fig 2.7 Compliance model—adapted from the South African Revenue Service strategic Plan 2005-2008.

According to SARS (SARS strategic Plan 2005), the model is premised on the following:

- The majority of taxpayers will prefer compliance over non compliance provided they are aware of their obligations and are educated about tax and filing processes
- Taxpayer behaviour must determine the nature of Government's Administrative responses
- The behaviour of taxpayers will vary from compliant to accidental to gross evasion.

- The response and treatment of each type of behaviour must be commensurate with the degree or extent of non compliance. The sanction must be proportionate to the offence.
- In the South African context, the cast majority of citizens were economically marginalised and awareness of tax was low in many sectors. As far as tax awareness is concerned, this legacy persists and it is vital that tax education campaigns be undertaken to redress the issue.
- Easy access, simple systems and facilitation of compliance through better service are important contributors to improved compliance.
- Credible, legitimate and form enforcement with appropriate sanctions is a strong disincentive to non-compliance.

The compliance model seeks to understand what the main criterion is for incentivising compliance. This is postulated as

- Reduce the cost of compliance
- Reduce the hassle
- Do it for the taxpayer

The key defining feature of this approach is that compliance can be achieved as a result of legitimate and compliant behaviour. This can be transposed as a government-business partnership that seeks to ensure fair and level playing fields.

The second component of the model postulates the consequence of non compliance and this is reflected as:

- Reduce the advantage
- Penalise for non compliance

The model seeks to improve the government- business partnership by discouraging non compliant behaviours and in the consequence of non compliance is aimed at increasing the cost to company by virtue of penalties.

The final component of the model is aimed at reducing opportunities for evading compliance. Evasion implies an intention to deliberately undermine the laws of a country with the express purpose of increasing profits. This therefore requires that government must continually revisit its approach to honest administration to ensure compliance.

The compliance model factors in the need to understand the impact of legislation and the resultant behaviour of taxpayers. This model furthermore places great reliance on the regulator/government to understand what the compliance issues are and to take appropriate actions in managing total compliance.

2.11 CONCLUSION

Compliance costs are costs to affected parties of interacting with government in meeting an obligation or providing a service. Compliance costs are incidental to the obligation itself and are often related to the processing and providing of information.

Some international studies on compliance costs were postulated. In particular, compliance costs initiatives of the United Kingdom , New Zealand and Australia were considered. These developed countries have well defined governmental bodies to assist in identifying and reducing compliance costs.

Comparative studies on the cost of compliance focused on eight studies on the cost of compliance. These studies have postulated that compliance costs can be administrative, financial or regulatory in nature.

In understanding the impact of compliance costs to business, it was postulated that an environmental analysis is necessary. In this regard, two analysis tools were identified. These are Porter's Five forces model and the Steep analysis.

Compliance costs, by their very nature, will impact on the resource capability of a business. It is therefore necessary that companies analyse their resource capabilities so that they are able to factor in any compliance costs that may be necessary to maintain or sustain their competitive advantage. In this regard, the value chain analysis and the resource based view tools were identified as instrumental in analysing the resources and capabilities of an organisation.

Once the internal and external analysis have been conducted, it is necessary to assess strategic options. Three criterion have been identified to assess strategic options. These are suitability, acceptability and feasibility.

The compliance model has been developed as a response to the strategic options available. The key defining feature of this model is that compliance can be achieved as a result of legitimate and compliant behaviour.

CHAPTER 3

CASE STUDY ON THE SOUTH AFRICAN REVENUE SERVICE

3.1 INTRODUCTION

The South African Revenue Service fulfils a number of roles in the reform process of South African Society through its collection of revenue to fund government programmes, the facilitation of trade and economic security and contributing to an economy that supports growth and development (SARS Strategic Plan. 2005).

As the key revenue collector of government, SARS is mandated to collect revenue from all taxes. These tax types include Income Tax, VAT, PAYE, and Skills development, Levy, Customs Duty and Excise Tax.

The Customs and Excise Act [Act 91 of 1964] defines Excise Duty as the tax collected on certain locally manufactured goods. This is a tax that is levied on certain locally manufactured goods viz, beer, tobacco, alcohol, spirits, wine and fuel. Of interest, is the manner in which the Excise duty was collected historically. Prior to 2003, Excise duty was collected on a sales basis i.e. duty was paid only at the time of sale. Legislation allowed duty on these excisable goods to be deferred for a period of up to two years. This duty deferred scheme created inefficiencies in the tax collection initiatives of the SARS. It also exacerbated the risk of non- compliance by industry and circumvented enforcement initiatives by SARS.

As a result of a great deal of inefficiency, SARS researched and finally promulgated a new approach to Excise Tax collection in South Africa. This new regime was called Duty at Source. The Duty at Source principles inherently changed the focus of Tax collection from a sales based system to taxation at the time of manufacture. Hence Excise tax became dutiable at the point of production and this alleviated the need for SARS to wait for up to two years for payment of excise duty.

The Duty at Source regime was applied a staggered basis across the different Excise regimes. In April 2003, the DAS principle was adopted in the fuel industry.

The compliance model developed in chapter two will be extrapolated within the SARS environment.

The techniques postulated in chapter 2 will be utilised in analysing the Macro environment pertaining to the fuel industry, SARS internal environment and the strategic options available to SARS in managing the cost of compliance. Although SARS involvement cut across all industry types, this study will only highlight SARS' role in Fuel industry.

3.2 BRIEF OVERVIEW OF THE SOUTH AFRICAN REVENUE SERVICE

In 1997, the South African Revenue Service was launched as the key revenue organ of the Government. This led to the promulgation of the South African Revenue service Act No.34 of 1997 (Section 1 of the South African Revenue Service Act no.34 of 1997).

In terms of this Act, the South African Revenue Service is tasked:

- To collect all revenue and taxes due;
- To ensure maximum compliance with the legislation
- To provide a customs and excise service that will maximise revenue collection, protect the South African Borders as well as facilitate trade.

3.2.1 Taxes Administered By SARS

SARS administers a number of taxes, listed below. In determining a policy and ultimately a strategy, it is essential that all taxes be taken cognisance of.

The attached table highlights all the taxes administered by SARS.

Direct taxes – levied on natural and legal persons	Indirect taxes – levied on goods and services (consumption)
• Income tax	• Value Added Tax
▪ Corporate and Personal Income tax (including Secondary Tax on Companies (STC) and Capital Gains Tax (CGT))	• Customs and Excise Duties
▪ Payroll taxes (PAYE, SDL, UIF)	• Fuel Levy
▪ Tax on Retirement Funds	• Road Accident Fund
▪ Donations tax	• Air passenger tax
• Estate duty	
▪ Transfer duty	
▪ Stamp duty	
▪ Marketable Securities tax	
▪ Uncertificated Securities Tax	

Table 3.1. Taxes administered by SARS.

Source: Enforcement Policy- Governing Divisional Activities. South African Revenue Services. 2004

3.2.2 <u>Vision of SARS</u>

To be an innovative revenue and customs agency that enhances economic growth and social development, and supports our integration into the global economy in a way that benefits all South Africans [online at www.sars.gov.za].

3.2.3 <u>Mission of SARS</u>

To optimise revenue yield,

Facilitate trade and enlist new tax contributors;

by promoting an awareness of the obligation to voluntarily comply with South African tax and customs laws, and providing a quality and responsive service to the public [available online at www.sars.gov.za].

The efficient and effective execution of the SARS mandate is dependent on the following pre-conditions:

- A compliance culture among taxpayers, traders and tax/ trade professionals that supports a high level of voluntary compliance.
- The perceived likelihood of non-compliance being detected and adequately addressed.
- Appropriate technology that enables SARS activities in a cost-effective manner that is comparable with taxpayer/ trader preference
- High levels of integrity, consistency and fairness in the way SARS carries out its functions
- Staff that have the required capability (service orientation and technical knowledge and skills) to perform their duties
- The generation of timely and reliable information that is necessary for planning, decision-making and risk management

a) A legitimate internal control and quality assurance environment that inhibits fraud, collusion and non-performance

b) Strategic positioning of SARS

3.3 THE MACRO ENVIRONMENT

Thompson and Strickland (2003) assert that the macro economic environment includes all the relevant forces outside a company's boundaries- relevant in the sense that they are important enough to have a bearing on the decisions a company ultimately makes about its business model and strategy.

The steep analysis and the 5 forces model juxtaposed by Porter will be used to analyse the macro environment pertaining to SARS.

3.3.1 STEEP Analysis

The Steep analysis will focus on the social, technological, ecological, economic and political dimensions.

3.3.1.1 Social

Increased revenue collections allows the government of the country to increase spending on social services, health care and engender greater equity in the distribution of tax contribution

The Aids epidemic has had an impact on the South African economy. The Fuel industry has implemented a HIV/ AIDS programmes as well as other social upliftment programmes to improve the social welfare of South Africa.

3.3.1.2. Technological

The pace of technological change is outpacing the ability of revenue authorities to keep abreast of new developments and meet taxpayer expectations. The private sector is streets ahead of tax Administrations in technological advancement and utilisation (SARS Enforcement Policy: 2004:10)

. There is now greater need for electronic submission of tax documentation. Furthermore, Tax Administrations need to rapidly improve their training programs to regularly retain staff to appropriately respond to these challenges. Most businesses are promoting a paperless environment as more and more processes are automated and in this regard Tax Administrations need to review their methodologies, legislative and operational policies.

Technology advancements to improve production capability and output availability is the key driving force in the Fuel industry.

The industry is characterized by huge technological investment in addition there is an increase of web enable technology and the internet. This increased reliance on the internet is a source of sustained competitive advantage.

3.3.1.3 Economic

The first democratic government of South Africa in 1994 inherited an economy in crisis. Rapid interventions at the level of macroeconomic policy averted South Africa's potential de-industrialisation, brought inflation down to single figures, reduced the levels of the budget deficit to levels the industrialised world can often only envy, and set South Africa on a sustainable growth path. Despite these real achievements, key problems remain. They manifest themselves in areas such as unacceptably high unemployment levels. Clearly, while the macroeconomic policies are bedded in, and producing benefits such as the increasing amounts of state revenue available for development stimuli rather than debt repayment, economic growth needs to be galvanised. There is a need for much higher levels of investment and economic growth (SARS Enforcement Policy. 2004:7).

The fluctuation of the world oil price has placed industry under tremendous pressure and this pressure in turn is passed over to the end user in the form of higher price for Fuel.

3.3.1.4 Ecological

The effects of an eroding ecological environment have heralded the need for stringent environmental controls. Within the South African context, the government has, amongst others, imposed an environmental levy on plastic bags. The key reason for such a levy is the protection of the environment against the harmful effects of plastic bags. Other laws and policies have been implemented to protect the ecological environment in South Africa.

One of the key reasons underpinning the implementation and marketing of bio Fuels is the concern about the ability of oil supplies to continue to meet growing demand as well as the need to reduce carbon dioxide emissions.

3.3.1.5 Political

South Africa is a new democracy, borne from a turbulent political past. Before 1994 the previous government served but a small minority of citizens in the country, at the expense of the civil rights of the majority. This cannot be ignored when looking at the history of non-compliance of tax-laws. South Africa has undergone great change on all levels of society and the economy since the inception of a new government in 1994. The legacies of the past and new efforts of government and the impact of the changing environment have led to additional factors, which impact on the compliance climate in the country (SARS Enforcement Policy 2004:5).

The fuel industry is regulated by the government. Whilst this regulation is aimed at ensuring fair and consistent pricing of Fuel, such regulation in themselves, become restricting as opportunities cannot be exploited fully. Such regulations can also become a source of non compliance if it is not understood.
A number of government promulgated legislation seeks to regulate the industry. Government seeks to influence industry profits via the MPAR (Marketing of Petroleum Activities Returns) and the basic Fuel Price systems (BKPS). These systems achieve the goal of fastening efficiency in a regulatory environment (online www.sapia.com).

The steep analysis highlights the general environmental elements within which SARS and the fuel industry operate. Although SARS is not a profit – seeking company its role in the general environment is to understand the key issues and to ensure that such issues are cascaded into the compliance laws promulgated.

3.3.2 Five Forces Model

Ehlers and Lazenby (2004) assert that the five forces model influence the intensity of industry competition and the industry's profit potential. In order to deal with these forces, an organisation needs to know they work in the industry and how they affect the organisation in a given situation.

This section will highlight the forces affecting the fuel industry and SARS' role in managing and influencing the industry.

3.3.2.1 Threat of New Entrants

There are only 7 major players in the fuel industry. These are:

- Shell
- BP
- Caltex
- Petrosa
- Engen
- Total
- Excel

These are multinational companies whose brands have become indelible in the minds of the South African economy. The huge capital investment coupled with a regulated environment, is a deterrent for new comers. Being an industry that supplies an essential product, the government plays a significant role in the regulation and ultimate compliance within this industry. This interventionist government policy becomes a significant entry barrier for newcomers.

In addition, the distribution access is tightly managed within these seven companies, thereby disincentivising new entry.

3.3.2.2 Bargaining Power of Buyers.

The pricing of petroleum products are regulated by government as well as the international oil price. Hence switching cost of buyers tends to be low. The inherent nature of the product is that it is an essential product and there tends to be little discernment or differentiation about the products of each company.

3.3.2.3 **Bargaining Power of Suppliers**

There are few suppliers in the industry. These comprise suppliers in the Middle East and the US. Switching cost tends to be low. The supplier industry is concentrated and dominated by a few companies hence suppliers power is high.

This industry is one of the few dominated by cartels, which further reinforces the strong bargaining power of suppliers

3.3.2.4 **Threat Of Substitute Products**

There is little or no substitute for fuel in South Africa. Hence there is little danger from substitute products. The industry is researching substitute products as a response for cleaner fuel and less pollution.

The eminent production of fuels from vegetable oils will be perceived as the closest substitute for fuel. However, since this product will be manufactured and sold by the same players in the industry, the threat will be marginalised.

3.3.2.5 **Rivalry Among Existing Competitors**.

This industry is characterized by high market growth which invariably reduces rivalry among the seven companies. Further the industry is regulated by government who is involved in price setting and this reduces rivalry as well.

The five forces model highlights SARS role in ensuring that the industry's economic development is sustained through the promulgation of a fair and efficient tax system. The regulated nature of this industry, the impact of the oil price as well as the existence of oil cartels, makes SARS role in ensuring compliance, an important one.

3.4 INTERNAL ANALYSIS

The internal analysis will focus on the SARS as an organ of state. This analysis will extrapolate the core competencies and internal capabilities it has in order to manage compliance in the fuel industry. The tools and techniques used to conduct this analysis include Value Chain Analysis and the Resource Based View analysis. Each of these analyses will be discussed in greater detail.

3.4.1 Value Chain Analysis

The primary activity of SARS focuses on communicating laws to regulate Tax collection, manage the actual tax collection, improve and enhance border security and improve taxpayer education.

The VCA of SARS can be captured in the ensuring diagram. Whilst a typical value chain analysis reflect the primary activities as inbound logistics, operations, outbound logistics, marketing and customer service, the SARS value chain has been amended to focus on its own business, i.e. communicating, registrations, filing, assessing and payments

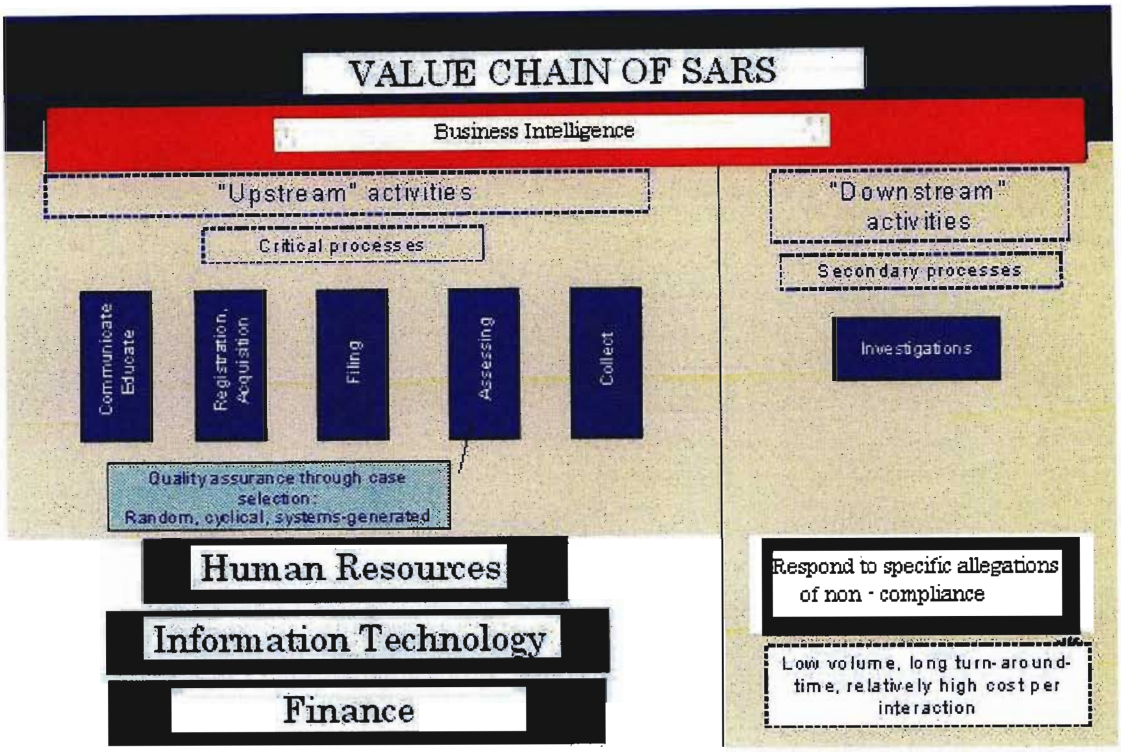


Fig.3.1 Value Chain of SARS

Source: Adapted from SARS Enforcement policy. 2004:10

Based on the legislative framework within which SARS operates, certain obligations are imposed on both SARS and taxpayers. Both SARS and taxpayers are duty-bound to adhere to these obligations, and have no option but to participate in activities of this nature.

By their very nature, these activities should result in an interaction between SARS and 100% of all liable taxpayers, and constitute a typical life-cycle of a taxpayer ie from registration to de-registration. These generally relate to issues around:

- Registration or subscription to a particular tax product
- Filing certain information with SARS, and in that context, making certain declarations to SARS, in a prescribed format
- Determining the extent of liability of the taxpayer, through some form of assessing, and
- Receiving payments made by taxpayers.

These activities typically have a high volume but short turn-around time, and are relatively cheap per transaction or interaction to maintain (SARS Enforcement policy. 2004:15)

It is crucial for these processes to contain an inherent element of quality assurance, in order to identify and address issues of non-compliance as they arise. Should this not be the case, the errors and instances of non-compliance are passed down-stream, where the costs of corrective action increase.

While SARS does not have discretion in respect of performing these functions, it does have some discretion in respect of *how* these functions are performed. In this regard, the concept of taxpayer centricity should form the basis of informing the manner in which the activities are performed. This should be supplemented by an approach in terms of which the SARS response is dictated by the behaviour displayed by a particular taxpayer.

Due to the very nature of these activities, they could be viewed as critical processes within the organisation.

Secondary processes

In an ideal world, a revenue authority could consist solely of the so-called critical activities referred to above. However, there will always be some taxpayers who intentionally do not comply with the obligations imposed on them by legislation.

SARS has certain legislative processes at its disposal in order to address these instances of non-compliance. Certain of these legislative remedial tools are potentially invasive of a taxpayer's privacy and other constitutional rights.

It consequently becomes necessary to determine in which instances, and to what extent, these legislative (remedial) tools should be applied. Certain principles can be distilled in this regard:

SARS action in these instances should typically relate to a credible, specific allegation of non-compliance
The SARS response should be determined by the behaviour displayed by a taxpayer.

The least invasive tool should be applied, with escalation to more invasive tools only after a less invasive method has proved unsuccessful

Furthermore, due to the substantial volume, not all instances of potential non-compliance can be investigated and addressed. In this regard, case selection should be purely risk-based, and may have regard to the issues of leveraging, in order to achieve the most optimal impact on compliance levels. Issues of leveraging may include aspects of media coverage, selection of high-profile non-compliant entities and stakeholder relationship management.

These activities typically have a low volume but long turn-around time, and are relatively expensive per interaction to maintain.
One could therefore regard the application of these processes and activities as secondary, in the sense that they do not relate to a typical life-cycle in the majority of taxpayers' lives, and are undertaken at the discretion of SARS.

SARS commitment to fair and efficient tax lows in enshrined in its continuous amendments of its various legislation it is empowered to administer. There has been a commitment by SARS management to ensure all tax legislation is reflective of the changing business environment

However, it is evident that some of these laws are difficult to interpret, or create admin burdens on company. This result in increasing the cost of compliance in general.

The tax collection function of SARS has become increasing efficient. This is largely due to huge investments in technology and skills within the organization. This efficiency is further supported by an increased focus on taxpayer education and marketing of SARS as a key contribution in the economic and social up liftment of South Africa.

Non Compliance within the SARS environment is endemic of the behaviours identified in the compliance model. Each type of behaviour will require a different enforcement and or education approach by SARS.

3.4.2 Resource Based View Analysis

The main factor underpinning the Resource Based View is the recognition that a firm own or control sets of resources the support unique strengths, allowing the firm to perform activities better than or at lower costs that rivals (Fleister etal 2003.p. 207).

Whilst SARS has no rivals to complete against, it certainly needs to collect taxes while expending the least amount of resources.

SARS' sources of competitive advantage can be defined into four broad categories. These are tangible assets, intangible assets, organisational capabilities and core competencies.

3.4.2.1 Tangible Assets

SARS has acquired a number of buildings and technological equipment that has ensured it has set itself as way ahead from the rest of the other government organisations. Large scale investments in technological equipment such as the container scanner, computers etc place SARS in a favourable position to engage even the largest multi national company for tax collection.

3.4.2.2 Intangible Assets

In the past few years, SARS has earned a reputation of being the most client friendly government department. It has the reputation of efficiency, professionalism and a client centric approach.

3.4.2.3. Organisational Capabilities

Perhaps the greatest organisational capability lies in the strategic focus of the leadership of SARS. Mr P. Gordhan (the Commissioner of SARS) has taken the leadership lifecycle into a new dimension. The minister of Finance (Mr Trevor manual], has on a number of occasions, complimented MR Pravin Gordhan on his excellent leadership of SARS (SARSNews.2005:1).

3.4.2.4. Competencies

One of the critical competencies required by SARS is a skilled and highly professional staff component who is focussed on improving efficiency and effectiveness.

Key to delivery on the SARS legislative mandate is issues around efficiency and effectiveness. As it became clear that the manner in which SARS affects its mandate was neither optimally efficient nor effective, the next principle which was developed turned on arranging its resources in such a manner as to ensure optimal efficiency and effectiveness. This implies:

- Applying the most appropriate resources to a particular situation (considering issues of cost, skill, complexity and the like).
- Making it as easy and cost-effective as possible for both SARS and taxpayers.
- Applying quality control as early on in processes as possible (where it is cheaper and more cost-effective)

The Resource Based View analysis highlights SARS strong capability and competencies. It extrapolates SARS' leadership commitment to developing an organisation which is worthy of its mandate of tax collection.

3.5 STRATEGIC OPTIONS

The key role players in the fuel industry are seven multi national Companies. These are Shell, BP, Engen, Total, Caltex, Excel and Petrosa.

Each of these companies is required to comply with a number of laws both internationally and locally as well. These multi national companies will not risk their international reputation by consciously engaging in tax evasion activities. Rather their non compliance is associated with the burden of increased administration and could be described as unintentional non compliance.

The attached diagram reflects the fuel industry's position within the compliance model. This industry fall within the "committed compliance" group and therefore SARS must ensure its enforcement activity is supported by the appropriate approach.

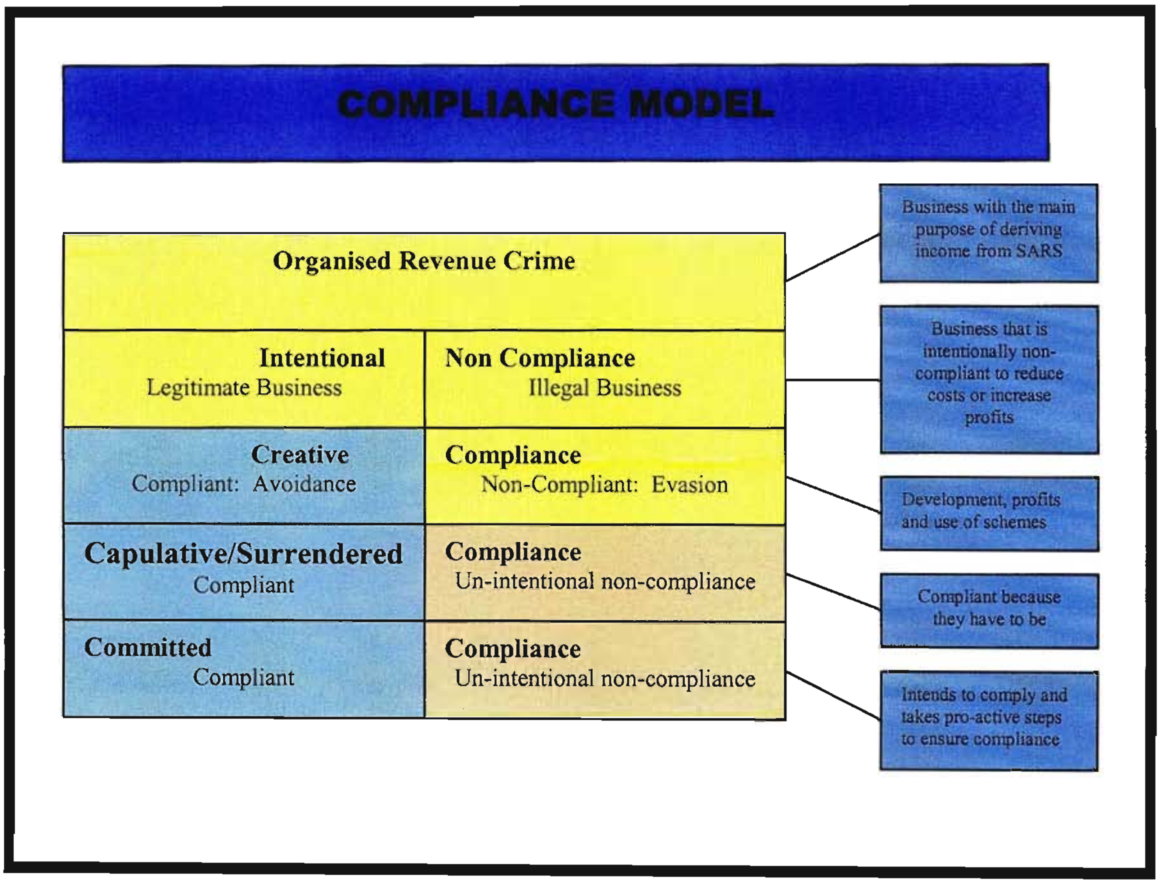


Fig: 3.2 Compliance Model of SARS

Source: Adapted from SARS strategic plan. 2005

An analysis of the behavioural factors shows that taxpayers can be classified into the following broad categories:

Committed compliance:	Taxpayers who intend complying with legislation and who take pro-active measures to ensure that they comply. Non-compliance by these taxpayers is attributable to unintentional errors.
Capitulative / surrendered compliance:	Taxpayers who comply because they have to. Non-compliance by these taxpayers is attributable to either unintentional errors, or to risks taken knowingly in the belief that their non-compliance would remain undetected.
Creative compliance:	This relates to taxpayers who develop, promote or use schemes to avoid, postpone or reduce their tax liability Non-compliance is generally a technical interpretative issue, as creative compliance can constitute either evasion or avoidance.
Intentional non-compliance:	These taxpayers operate either legitimate or illegal businesses, which are intentionally non-compliant in order to increase profits or reduce expenses, and who are aware of their non-compliance.
Organised revenue crime:	These taxpayers operate businesses or structure their business transactions in such a manner as to derive their sole / main income from SARS.

Table 3.2 Classification of taxpayers

The Compliance Model promotes the use of tailored responses to different taxpayer groups based upon their behaviour, compliance risk levels and history. A key theme continues to be the improvement of overall levels of compliance while reducing the actual costs of compliance to business. The model is intrinsic to the policy, legislative and administrative processes of the tax system and the manner in which SARS interacts with its customers. Good service and quality within these initial processes must balance stringent enforcement actions. Enforcement actions are reliant on the optimal functioning of these critical processes and draws on a broader suite of compliance tools than the (almost exclusively audit-focused) compliance products upon which the organisation has relied in the past.

In view of the compliance approach adopted, the strategic option available to SARS is the adoption of a grand strategy commonly referred to as Porter's grand strategy.
This entails a focused strategy by combining cost differentiation per industry and reducing cost in order to increase/ improve compliance.
SARS is able to implement a focused strategy in the fuel industry partly because it has implemented cost cutting technologies thereby reducing administration expenses.

SARS must consider the option of treating each industry differently by taking into account different industry needs. This requires that the compliance model developed earlier on be tailored to respond to the level of compliance in different industries.

The Strategic options will be evaluated in terms of suitability feasibility and acceptability.

3.5.1 Suitability

The suitability of SARS strategy option will be evaluated in terms of the life cycle analysis.

3.5.1.1 Life Cycle Analysis

When SARS introduced Duty At Source in the fuel industry in April 2003, its tax regime was new and in its introduction phase. This stage was characterised by new administrative and compliance requirements for the fuel industry. Some of these requirements, due to their large capital investments to effect the new requirements, have not being implemented by industry.

Three years after implementation, SARS has effected some changes to the Duty at Source tax regime. These changes were in response to concerns and issues raised by external stakeholders. A number of these changes have had a positive effect on compliance in the fuel industry.

Subsequent to the introduction phase, Duty at Source is currently in the growth phase. This phase is characterised by observations of the fuel industry's compliance after necessary changes were effected.

SARS' grand strategy of focussed differentiation is complemented by this growth phase in tax implementation.

3.5.1.2 <u>Positioning</u>

The South African Revenue Service is the only revenue authority in South Africa. Hence it does not have to position itself against competitors. However, it must position itself as an efficient and effective revenue authority whose integral role in tax collection and poverty eradication become the underpinning success of the Government.

In the past few years, SARS has managed to increase and enhance its reputation as a fair and efficient revenue authority. This sentiment is expressed by the Minster of Finance in his speech in Parliament at the launch of SARS' 2005 annual report:

"I trust that Parliament and the South African society as a whole can draw pride from the organisational performance of SARS and SARS' contribution to ensure our democracy enjoys fiscal independence through sustained revenue collection, improved trade facilitation and, ultimately, our collective efforts to build a South Africa that truly belongs to all who live in it."

3.5.1.3 <u>Portfolio Analysis</u>

According to Fleisher (2003) the portfolio analysis allows a company to compare the merits of its individual business units in order to determine appropriate market strategies for each business unit.

SARS has a number of business units viz, customs, Excise, audit, assessment, taxpayer service, large business centres and a number of support service business units. Each business unit can be evaluated in terms of their relative strength and market position.

The Duty at Source Excise regime will be evaluated from a BCG perspective as this business unit is responsible for the implementation and management of Duty at Source in the fuel industry.

The Excise business unit can be diagrammatically reflected as follows:

The BCG Growth Matrix

Real Market Growth		High (Relative Market Share)	Low (Relative Market Share)
	High	Earnings: high, stable, growing Cash Flow: neutral strategy: invest for growth. **Star**	Earnings: low, unstable, growing Cash Flow: negative Strategy: analyse **Problem Child**
	Low	Earnings: high, stable Cash Flow: high stable Strategy: milk **Cash Cow**	Earnings: low, unstable Cash Flow: neutral or negative Strategy: divest **Dog**

Relative Market Share

Table 3.3 BCG matrix

Source*: *Fleisher & Bensoussan. 2003: 34

At the time of implementation of Duty at Source in the fuel industry, the excise business unit was a "problem child. This is mainly due to a lack of synergy

At the time of implementation of DAS, the Excise Business unit was deemed to be a problem child. The problem child is characterised by high market growth but low market share. The strategy advocated within the BCG Matrix, is one of analysis. SARS certainly exerted a large percentage of its excise resource in analysing its strategy.

Flowing from such analysis, some changes were made in the DAS manual for the fuel industry.

Whilst some of these changes were well received within the industry, there is still a need for further refinement and amendment.

Whilst SARS undertook an analysis of the problems within the fuel industry; it did not develop a strategy to manage and grow the DAS tax regime into a "STAR". This lack of post implementation review as well as a lack of defined strategy to manage the fuel industry has resulted in the excise business unit remaining as a "problem child."

3.5.2 Acceptability

Johnson and Scholes (2000) assert that acceptability is concerned with the executed performance outcomes, such as risk or return, if a strategy is implemented.

SARS is an organ of state and as such, is allocated a fixed expenditure budget every year. This budget is allocated by the Ministry of Finance to enable SARS to execute its mandate as the Revenue authority of the country.

SARS is not evaluated in terms of return on capital employed, Discounted Cash Flow and Payback period.

Hence analysing acceptability of SARS focused differentiation strategy within the context of Acceptability will not yield information that can potentially impact on the compliance strategy.

3.5.3 Assessing Feasibility

Johnson and Scholes (2000) assert that feasibility is concerned with whether an organisation has the resources and competence to deliver a strategy.

As was discussed in the RBV analysis, SARS has a strong and competent work force that is able to effectively and efficiently deliver on its Mandate.

Other feasibility tools such as funds flow analysis, and breakeven analysis is not warranted within the SARS context.

3.6 CONCLUSION

SARS was officially launched in 1997 as the Government's revenue authority within the country. SARS administers all the direct and indirect taxes promulgated by law.

The Vision and Mission of SARS reflect a dynamic organisation which is capable of responding to changes very rapidly.

The two tools were used in the macro environmental analysis of SARS and the fuel industry. This is Steep and Porters 5 forces model.

The Steep analysis highlights the environmental elements within which SARS and the fuel industry operates. Although SARS is not a profit seeking organisation; its role within STEEP is to understand the key issues and to ensure that such issues are cascaded into the compliance Laws promulgated.
The 5 forces model extrapolates SARS' role in ensuring that the industry's economic development is sustained through the promulgation of a fair and efficient tax system.

Two tools were used to conduct an internal analysis of SARS. These were VCA and RBV. The Value Chain Analysis reflected SARS' unique value chain of communication; registrations; assessing; payment and enforcement. Within each activity, value is added upstream and downstream, thereby creating an environment which is conducive to inculcating compliance.
The RBV analysis reveals SARS' strong capabilities and competencies which has positioned the organisation as a leader of governments departments in South Africa.

The strategic options available to SARS are one of focussed differentiation. This strategy is supported by a compliance model which highlights different types of taxpayer behaviours that influence the responses of SARS. These behaviours include: committed compliance, capulatitive compliance, creative compliance, intentional non-compliance and organised revenue crime. Each of these behaviours will inform the differentiated approach adopted by SARS.
The fuel industry would fall into the committed compliance taxpayer behaviour and hence, SARS would be required to tailor responses to manage such compliance.

The suitability of SARS' strategic options of focussed differentiation is analysed in terms of Life Cycle Analysis, Portfolio Analysis and positioning. The Life Cycle Analysis reflects SARS as being in the growth phase.

SARS position in the market place is unique in that it is the only revenue authority in the company. However, in order to endanger a culture of compliance, SARS must ensure that it is perceived to be fair and efficient in its treatment of tax matters. The BCG Matrix positions SARS' Excise Business Unit in the "problem child" area. This element requires that SARS must analyse the problems and issues pertaining to compliance within the fuel industry.
Acceptability of SARS strategic options is limited as SARS is not a profit-seeking organisation and hence is not governed by the usual business principles.

Feasibility of SARS strategic options is constrained by SARS Mandate which is an organ of state created for the efficient collection of revenue due to the state.

CHAPTER 4

DATA ANALYSIS AND RESULTS

4.1 INTRODUCTION

This section analyses the results of the mailed questionnaires and conclusions drawn from the completed questionnaires which are completed by the seven fuel companies. The seven companies comprise Shell, BP, Engen, Caltex, Petrosa, Total and Excel.

The results are set out in graphical format as well as narrative form. The questionnaire comprised nine open ended questions. The results of this analysis are necessary to complement the strategic options identified in chapter three.

4.2 QUESTIONNAIRE RESULTS ANALYSIS

Seven questionnaires were handed to the Tax Managers of Shell, Engen, BP, Petrosa, Excel, Total and Caltex. All seven questionnaires were returned fully completed and hence formed the basis of analysis as presented in this section.

The results of the questionnaire will be analysed in terms of the following key focus areas:

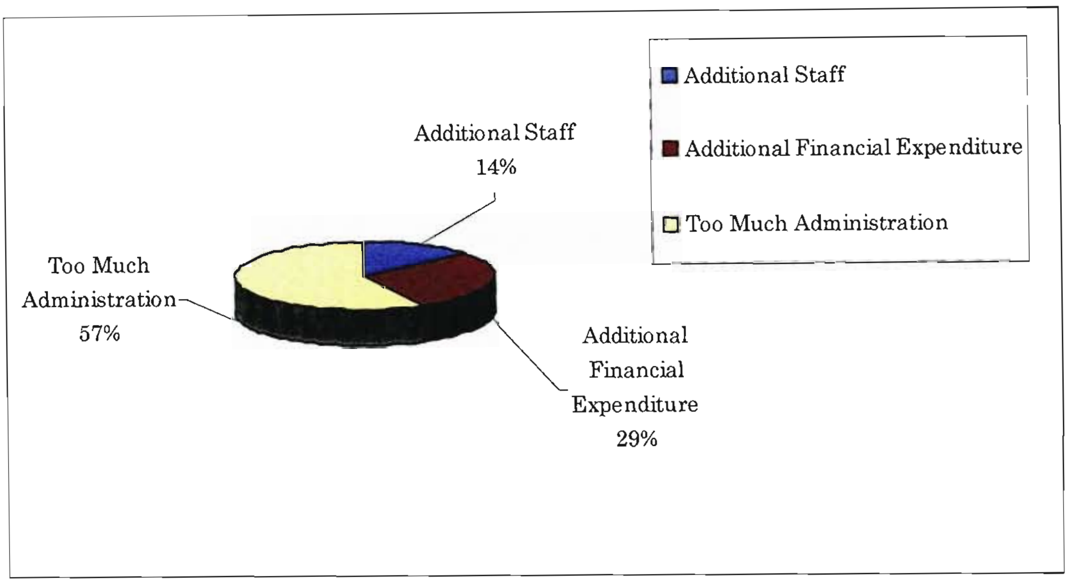
- Main compliance cost concerns
- Cost of complying with legislation or regulations
- Impact of compliance costs
- Practical actions to reduce compliance costs
- Non specific legislation issues
- Use of E commerce
- Suggestions for reducing compliance costs

4.2.1 Main Compliance Cost Concerns

This question entailed an understanding of compliance costs and to assist in the answering of this question, a brief explanation was included in the questionnaire.

The responses to the questions have been presented graphically as follows.

4.2.1.1 Please identify your main business compliance costs concerns in the fuel industry.



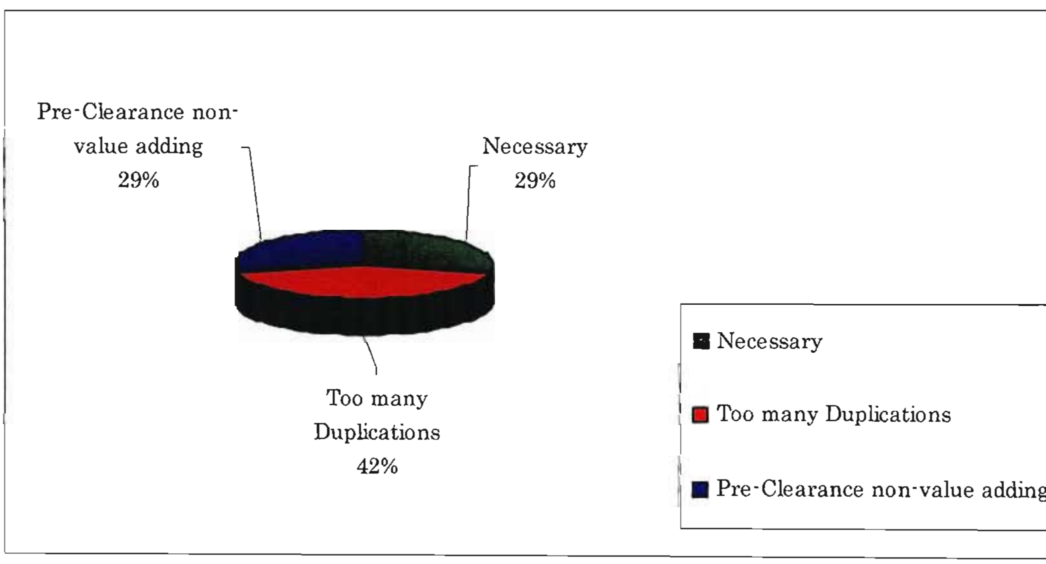
This response is captured within the context of three dimensions: additional staff, additional financial expenditure and too much administration.

57% of the respondents highlighted the increased administration as one of the main compliance cost concerns. This group felt that the compliance requirements in the fuel industry have increased the industry's reliance on administrative work.

29% of the respondents cited the additional financial outlay that was required to manage compliance issues within the fuel industry. They felt that this additional outlay could not be justified from a return on investment point of view.

14% of the respondents stated that their compliance costs concerns can be attributed to the increase in staffing numbers. This in turn affects their profitability.

4.2.1.2 <u>Describe why you think the costs of complying with the legislation or regulations are excessive and / or unnecessary</u>.



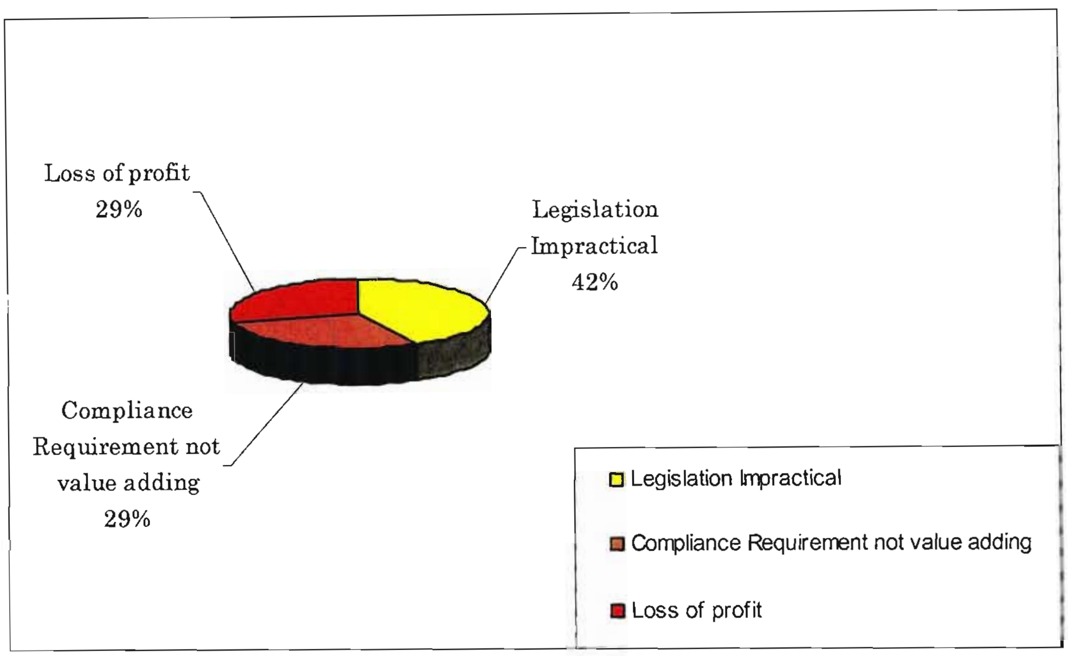
42% of the respondents indicated that there is too much duplication which in turn creates unnecessary compliance costs.

29% highlighted that the pre clearance processes were unnecessary. These clearance processes relate to the importation, exportation, local manufacture and movement of fuel products.

Another 29% postulated that all the compliance regulations are necessary and warranted. This group viewed compliance as a necessary tool ensuring sustaining and building competitive advantage.

4.2.1.3 **Impact of compliance costs on your business**

Assess the impact of your identified compliance costs on your business and business decisions. Wherever possible, provide an estimate of the time and level of costs associated with your key compliance cost concerns

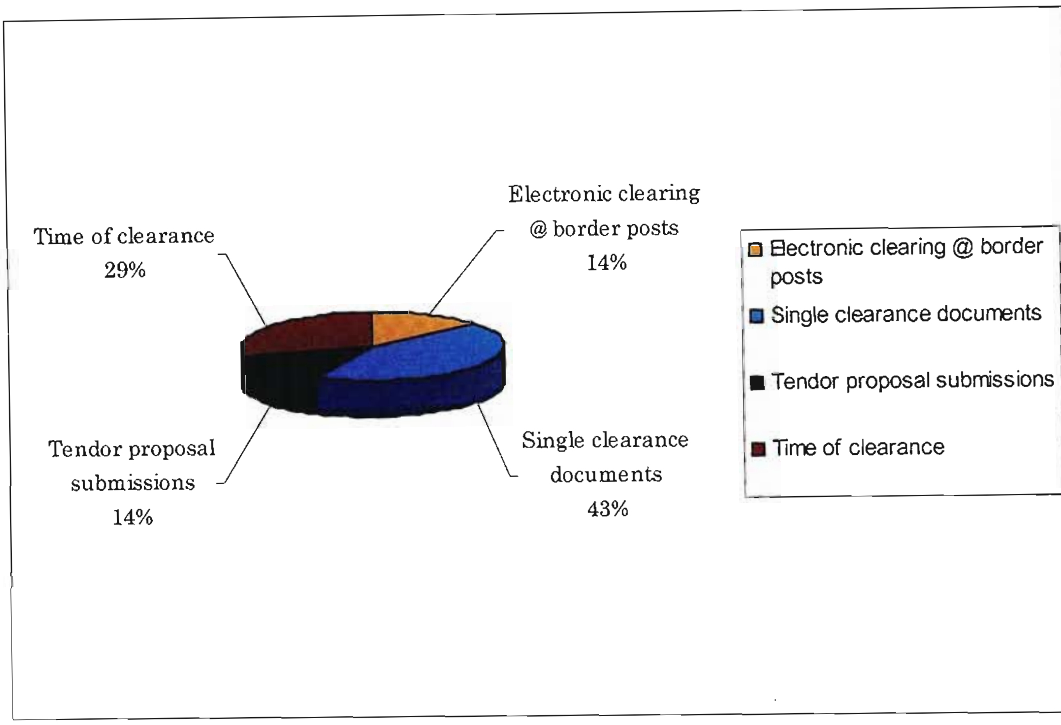


Response to the impact assessment yielded the following results:

42% of the respondents viewed the Customs and Excise Legislation as being impractical. Their view is that the legislation does not consider the rapid response business model that has become synonymous with the age of global trading.

29% of the respondents attributed loss of profit to excessive compliance costs and a further 29 % regarded these compliance requirements as non value adding.

4.2.1.4 **Practical actions to reduce the compliance costs you have identified Business is best placed to propose effective and practical solutions to remedying compliance cost issues. Please share your views on practical, workable solutions that relate to your compliance cost concerns.**



The practical working solutions have been postulated in the following manner:

43% of the respondents are of the view that SARS must consider the use of single clearance documents. This, they state, will reduce compliance costs. The single clearance documents must also include processing documents pertaining to other tax types administered by SARS.

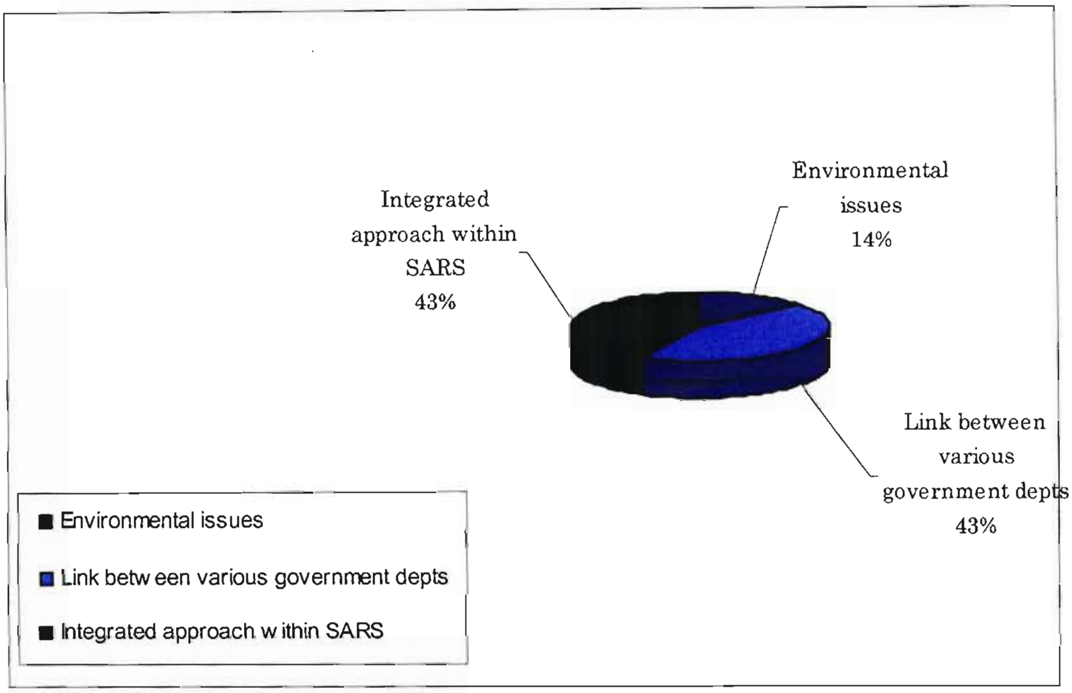
29% indicated that SARS must consider the time of clearance as a practical way to reduce unnecessary compliance burdens. This concern emanates from the fact that the very nature of fuel products warrants longer clearance processing time relative to other products.

14% of the respondents cited the lack of electronic processing at the border posts as a key impediment to managing compliance costs. These respondents therefore suggested that the current electronic systems used throughout SARS be utilised at the border posts as well.

An additional 14% stated that the tender submission process be streamlined to ensure competitive sustainability.

4.2.1.5 Non specific Legislation issues

What do you consider to be some of the non-specific legislation and issues that raises cost of compliance in the fuel industry?



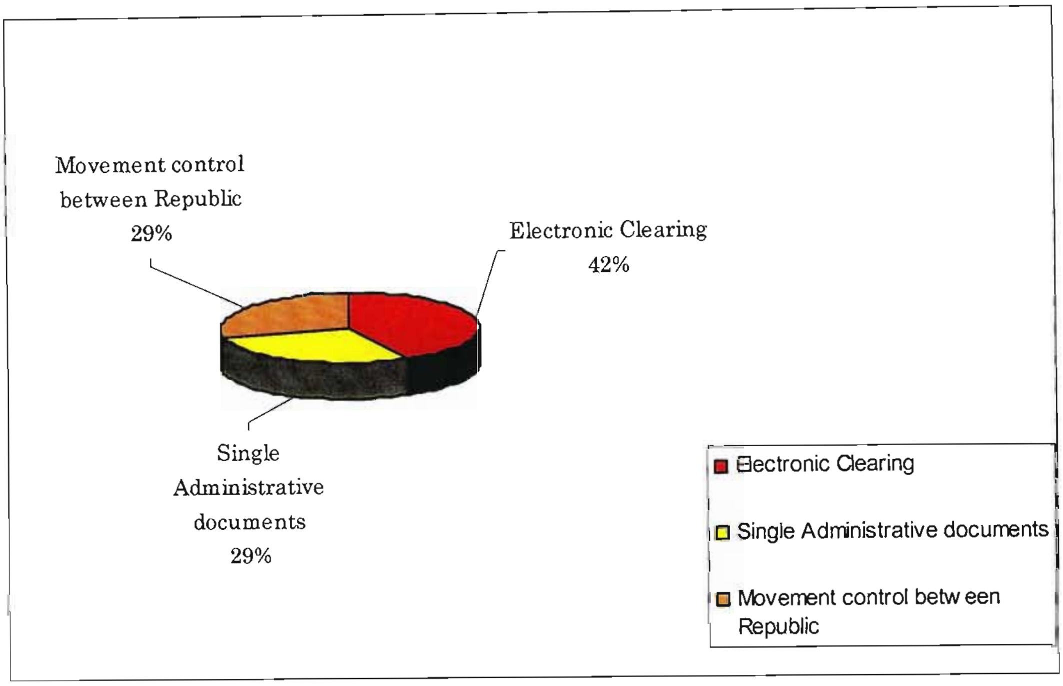
The non legislation issues have been grouped into three categories: Integration within SARS, environmental issues and integration with other government departments.

43% of the respondents indicated that the lack of integration between the various sections within SARS increases their compliance costs as they are required to submit the same information to different SARS' officials at different times.

A further 43% extrapolated the need for SARS to create links with other governmental departments, viz, The South African Reserve bank, the Department of Minerals and Energy etc. These respondents indicated that such link up would reduce the duplication of information.

14% of the respondents cited environmental issues as the non legislation issue that increases the cost of compliance. These respondents view these environmental issues as necessary yet burdensome.

4.2.1.6 **Can you identify examples of what you consider good compliance cost regulations?**



The compliance cost examples were clustered into three components: electronic clearing, movement control between the Republic and single administrative documents.

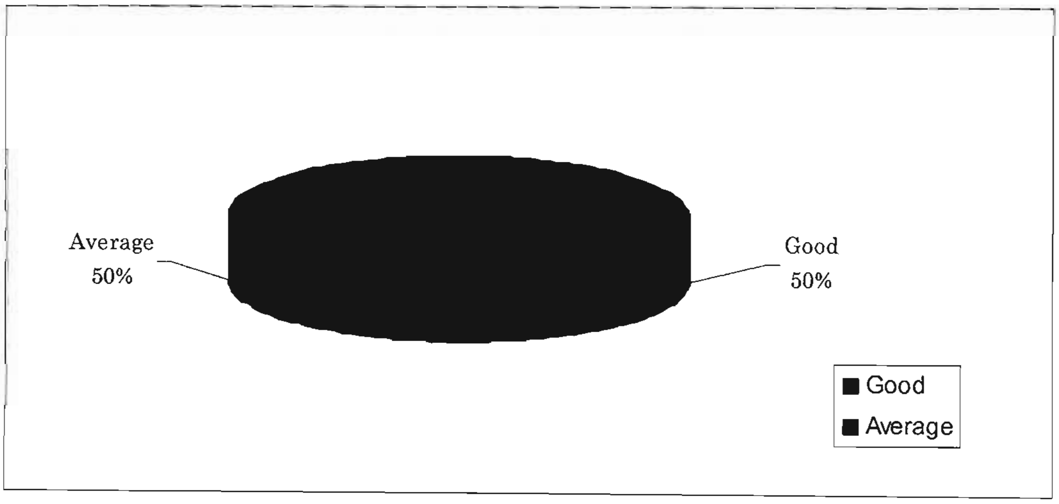
42% of the respondents cited electronic clearing as a good compliance cost reduction tool. Electronic clearing pertains to the manner in which the fuel industry presents the requisite documents to SARS to account for the import, export and movement of fuel products.

29% of the respondents indicated the movement control within South Africa is a good compliance management tool. This group of respondents indicated their satisfaction with the control mechanisms instituted by SARS.

Another 29% highlighted that a single administrative document would be a good compliance reduction tool. Currently the fuel industry accounts for import, export and in transit movement of fuel products on different documentation.

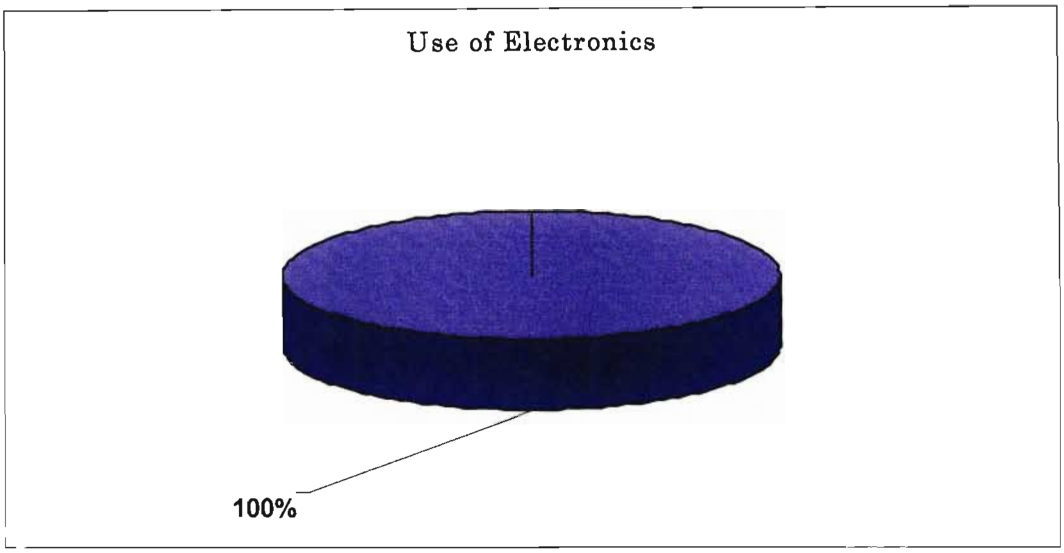
4.2.1.7 <u>There is increased use of web technology for submitting forms, answering questionnaires, and accessing / using government services generally. Please comment on your experiences and indicate whether additional electronic services would reduce your compliance costs.</u>

This response has been captured in two graphs. The first graph deals with the respondents' experience of electronic means of doing business and the second graph deals with whether there is a need to provide additional electronic means.



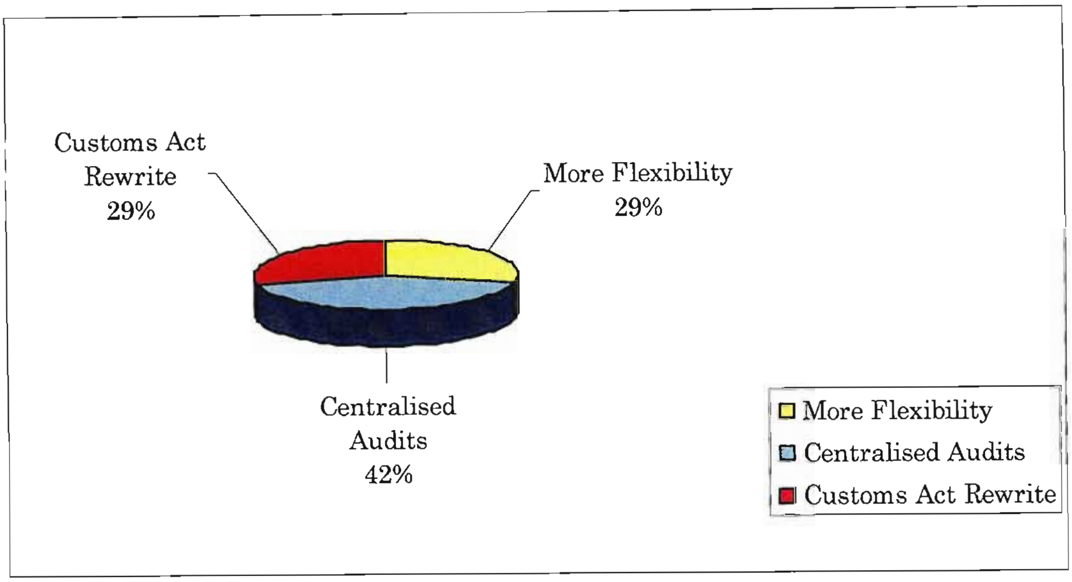
The response to the respondents' experience in using electronic channels as a means of reducing compliance costs has been equal.

50% of the respondents rated their experience as good while the other 50% rated their experience as being bad.



The respondents' response to the additional use of electronic channels of doing business was 100% affirmative. Respondents cited this channel of communication as being the most effective and least time consuming.

4.21.8 Please make suggestions on how the SARS can assist in reducing compliance cost



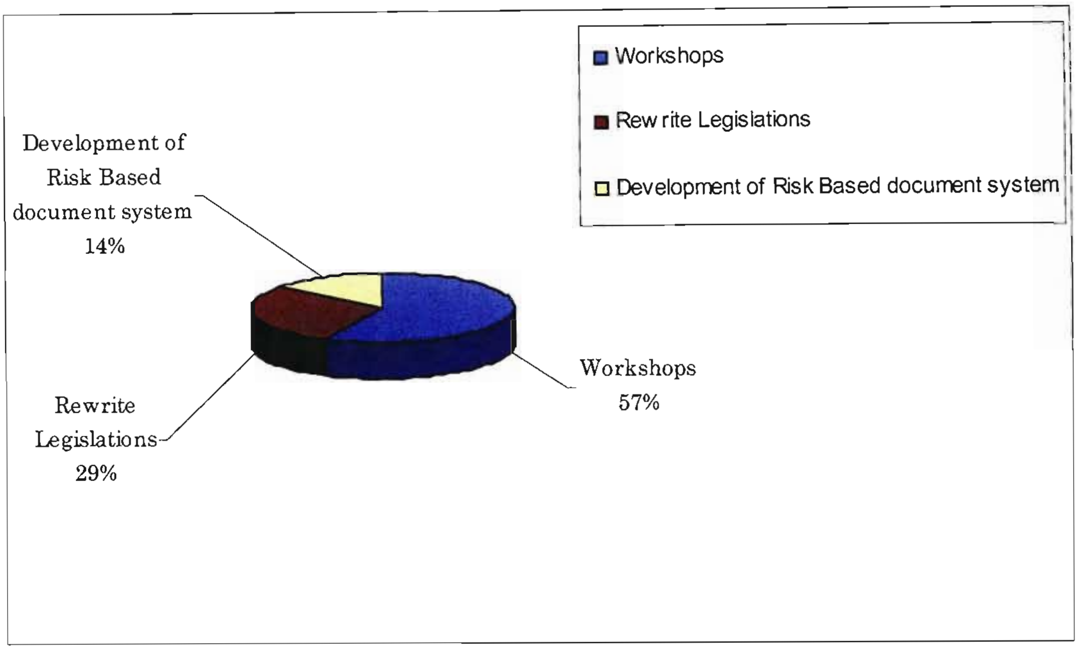
The response to this point has been quantified in terms of the rewrite of the Customs and Excise Act, centralised audits and more flexibility.

42% of the respondents suggested that SARS consider a centralised approach to the auditing of the companies in the fuel industry. They indicated that this centralised approach will reduce duplication of information required by different parties within SARS.

29% proposed the need for the rewrite of the Customs and Excise Act, 91 of 1964. This group felt that the legislation did not support the global business model.

29% suggested that SARS grant stakeholders in the fuel industry greater flexibility. This will in turn reduce unnecessary compliance costs.

4.2.1.9 Any other comments.



The comments were restricted to three dimensions, viz, workshops, rewrite of legislation and development of a risk based system.

57% of the respondents suggested that SARS should have regular workshops to constructively engage and inform stakeholders of changes.

29% responded that there is a need to a rewrite of the Customs and Excise Legislation as the current law is not consistent with the global approach of conducting business.

14% of the respondents cited the need for a risk based system to alleviate unnecessary compliance costs.

4.3 CONCLUSION

The respondents of the questionnaires comprised the senior tax managers in the seven fuel companies.

The responses to the questionnaire highlighted areas of focus for the South African Revenue Services to reduce compliance costs. The suggestions and recommendations will be extrapolated into chapter five wherein conclusions and recommendation will be highlighted.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

Compliance requirements are essential for the collection of the correct duties and taxes for any government institutions. This ensures that the government is collecting the right taxes at the right time. Since government's major source of income is through taxes, it is imperative that businesses comply with tax requirements.

This study examined the cost of compliance in the fuel industry. The value of this study is exemplied by the fact that a new tax collection mechanism called DAS was implemented in April 2003 in the fuel industry, which was not supported by a strategic framework.

The ensuing sections will highlight areas where compliance costs have been well managed and will also make recommendations for further enhancement and improvement. These recommendations will inform a short term strategy which SARS can adopt in the fuel industry.

5.2 SUMMARY OF FINDING OF QUESTIONNAIRE

The questionnaire administered to the tax managers in the fuel industry highlighted the following:

There have been increased compliance costs as a result of the implementation of DAS. These can be contextualised in terms of increased financial expenditure, additional staff and increased administration.

Some of these compliance burdens can be reduced or eliminated if SARS revisits its approach to compliance in the fuel industry and introduce greater efficiency in its work methodology.

These findings highlight the need for an approach that is flexible and can respond effectively to the dynamism of the Fuel industry.

5.3 RECOMMENDATIONS

This study entailed a review of compliance cost in the fuel industry. A case study of the South African Revenue Services was undertaken and the recommendations flow from such.

5.3.1 Macro Economic

SARS is well positioned within the economy to play a pivotal role in the development and sustaining of a balanced and growing economy. As such, SARS must become more involved in the major tax paying industries in South Africa It can achieve this by seeking partnerships with other governments departments in the promulgation of various law that ultimately impact on its own ability to collect taxes.
These is especially impacting in the Customs and Excise Business Units and as many of the key enabling drivers are advocated by the Department of Trade and Industry and SARS Act as a collector and custodian of such laws.

5.3.2 Internal Capabilities

SARS is a dynamic organ of state and as such requires a committed and professional workforce.
The internal analysis in Chapter 3 highlighted SARS strong management of the primary activities of the value chain. However, key to the success in the primary activities, is the need for an informed strategy to manage the support service i.e. HR Finance and Information Technology. IT support is excellent and SARS must continue to build on this key competence.

Finance is largely directed by the expenditure budget allocated by the Minister of Finance. SARS does have some flexibility in manoeuvring this budget to achieve its overarching objectives.

The roll-out of DAS in the fuel industry was not supported by the placement of trained staff. In fact, the roll-out was managed without an assessment of the required staffing numbers. The shortages of staff as well as the lack of critical technical skills have in themselves become a key contributor of increased compliance costs. This is largely attributed to the need for rework, unavailability of technical advice.
Although a concerted effort has been made of appointing personnel to manage the fuel industry, much more effort is required to train and skill such personnel.

5.3.3 Electronic Channels of Communication

Whilst great strides have been made in developing the IT capabilities at SARS, certain areas of the business have not yet benefited from such. One such area is the fuel industry. Currently all fuel accounts are submitted manually to SARS.
This is an administrative burden for both SARS and the stakeholders in the fuel industry.

SARS must consider electronic submission either through Electronic Data Interchange Systems or through another web enabled technology. The use of IT will translate into less paperwork, greater accuracy in recording and a more established way of assessing whether the correct duty has been paid.

5.3.4 Workshops

Since implementation of DAS, stakeholder interaction on a national level has been minimal. This is largely due to the limited workshops held between SARS and the stakeholders.
Workshops are beneficial as it afford an opportunity for both parties to express their expectations and frustrations. It fosters an enabling environment that is focussed on resolution of issues without constraint to the Customs Act.

It is recommended that SARS facilitate workshops to all stakeholders in the fuel industry at least once a quarter. Such workshops must be based on constructive customs-to-business partnerships wherein compliance costs are addressed and solutions are sought in the reduction or eradication of such.

5.3.5 Rewrite of Customs Legislation

The current Customs and Excise Act, 91 of 1964 places great emphasis on manual controls such as accounting for the movement of fuel products within the company. South Africa operates within a global environment which is characterized by speed of transactions, ease of implementations and increased bottom-line profitability. The Customs and Excise Act tends to be very prescriptive of the manual and documentary evidence to support particular actions in the fuel industry. This prescriptive approach is incongruent to the international rapid response business model and hence it becomes another factor that increases compliance costs.

It is recommended that SARS consults with the fuel industry in the rewrite of the Act. Whilst it is accepted that controls must not be compromised through this process, the Rewrite has the capability of enhancing such controls without the burden of unnecessary processes.

5.3.6 Hours of Work

SARS' hours of business is confined to a 5 day working week. The fuel industry, however works on a 24 hour, 7 day a week timeline. The world has become a global village necessitating the need for such working hours.
The fact that SARS' business hours are considerably shorter than the fuel industry, compliance costs are increased in order to meet deadlines within SARS working hours.
SARS must respond to international trading practice and increase its working hours.

5.3.7 Risk based excise surety

SARS currently require that the fuel industry transact on a surety basis,viz, movements of dutiable products without duty being paid is allowed as long as the client has lodged a surety for the respective shipment. This surety tends to be reasonably high and places additional strain on the resources of the fuel industry. This surety amount is calculated in the same manner as all other surety for other industries.

The Fuel industry does not fall into the intentional non compliant category in the Compliance Model. It is proposed that SARS apply a risk based surety for this industry. This would significantly reduce the costs of compliance in the fuel industry.

5.3.8 Revised documentation submission procedures

The fuel industry currently submits their document s manually. In addition, the fuel account comprises a number of pages that do not add value to the duty calculation.

It is recommended that SARS consider an upgrade to their processing system that will enable the fuel industry to submit their documents electronically.

In addition, it is proposed that SARS revisit the fuel account document as it is currently cumbersome and requires a considerable time for completion. SARS should aspire towards a one page account which is used in many other customs administrations.

5.3.9 Advisory Bodies

A study of some countries' compliance control mechanisms have revealed that they have implemented a number of advisory and control bodies whose sole mandate is to monitor the cost of compliance once a law has been promulgated. In some instances, these bodies will also engage industry prior to implementation to quantify the cost of compliance.

It is proposed that SARS consider the implementation of such advisory bodies who will engage with industry to assess the impact of intended as well as existing legislation.

These bodies should also be empowered to advise SARS when a particular legislation is raising the cost of compliance unnecessarily.

5.4 CONCLUSION

This study has revealed that there are significant opportunities for the South African Revenue Service to revisit its policy and procedures to ensure that compliance costs can be reduced in the fuel industry.

The recommendations extrapolated in this chapter that will contribute to the reduction of compliance costs include: macro economic, internal capabilities, hours of work, electronic, means of communication, risk based surety; re-write of legislation, workshops and revisit of document submission procedures.

Based on these recommendations, SARS will be in a position to develop a strategic framework that will assist it in reducing unnecessary compliance costs in the fuel industry.

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The South African Revenue Service Act number 34 of 1997

Interviews

Ms Nelisa Mali. Appointed in SARS as the Product Manager of Excise

Mr Tony Lester. Appointed in SARS as the advisor to the Product Manager

Mr Mark McLoughlin. Appointed in SARS as the National Specialist for the Fuel Industry.

Mr Tim La Fontaine. Appointed in SARS as the National Fuel Specialist

APPENDIX 1

QUESTIONAIRE ON THE COST OF COMPLIANCE IN THE FUEL INDUSTRY

Name of Business

Address:

Phone:

Email:

Email

THE DISCUSSION QUESTIONAIRE

This questionnaire is intended to get a high level of understanding of the compliance cost concerns in the fuel industry.

A brief overview of compliance has been included in the questionnaire to assist you in completing this questionnaire.

Wherever possible, please respond via the format provided here.

Your assistance in answering this questionnaire is really appreciated.
You are assured of your confidentiality.

What Are the Compliance Costs?

- Compliance costs are the administrative and paperwork costs that businesses incur when meeting an obligation imposed by regulation. They include administrative burdens and all other associated compliance costs, such as equipment purchases, retooling, and recurrent production costs.
- They also include the costs associated with identifying and understanding the regulatory requirement and may include costs of buying in specialist services (such as legal, accounting, computer systems, research) or employing new staff to satisfy regulatory obligations; training staff and monitoring compliance.
- Compliance costs are distinct from the direct costs of any government requirement, such as the amount of tax payable.

1. **Your key compliance cost concerns.**

Please identify your main business compliance costs concerns in the fuel industry.

2. **Describe why you think the costs of complying with the legislation or regulations are excessive and / or unnecessary.**

3. **Impact of compliance costs on your business**

Assess the impact of your identified compliance costs on your business and business decisions. Wherever possible, provide an estimate of the time and level of costs associated with your key compliance cost concerns.

4. **Practical actions to reduce the compliance costs you have identified**

Business is best placed to propose effective and practical solutions to remedying compliance cost issues. Please share your views on practical, workable solutions that relate to your compliance cost concerns.

5. **Non specific Legislation issues**

What do you consider to be some of the non-specific legislation and issues that raises cost of compliance in the fuel industry?

6. **Can you identify examples of what you consider good compliance cost regulations?**

7. There is increased use of web technology for submitting forms, answering questionnaires, and accessing / using government services generally. Please comment on your experiences and indicate whether additional electronic services would reduce your compliance costs.

8. Please make suggestions on how the SARS can assist in reducing compliance cost.

9. Any other comments.

Appendix 2
Sources of primary data for research

WCO
- Kyoto & other conventions
- Data Model
- Customs reform
- Arusha declaration (integrity)

WTO
- Lome Convention
- Doha
- Pre-ship inspection
- Harmonised Tariffs
- Rules of Origin
- Generalised System of Preferences (GSP)

DTI
- Trade Policy
  - Trade incentives/ initiatives
  - IDZ
  - DCC
  - MIDP

International Trade Agreements

United Nations Commission for Trade Development (UNCTD)
- Resolutions
- Business Policy

International Maritime Organisation (IMS)
- Resolutions
- Business Policy

International Civil Organisation (ICO)
- Resolutions
- Business Policy

SACU, SADC, Nepad
Regional Trade Agreements
Bilateral Agreements

South African Laws and Statutes
- Constitution of the Republic
- Promotion of Administration of Justice Act
- Access to Information Act

SARS
- VAT Act
- SA Revenue Services Act
- Business Policies

Customs
- Customs & Excise Act, The Act, Rules, Schedules
- Business Policies
- Business Plans

Other Government Departments
- National Interdepartemental Structure (NIDS)
- National Program Border on Control (NCPS)
- Border Affairs Co-ordinating Committee (BACC)