

R&D INCENTIVES

in the start-up space

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Besides lip service, we look at how government incentivises SMEs and what more they should be doing.

In the 2016 Budget Speech, Minister Gordhan stated that support for innovation and support for small businesses is key to achieving our country's optimistic growth targets.

Despite this fact, discussion on important incentives needed to stimulate growth through research and development or innovation was conspicuously absent from the finance minister's Budget Speech. Where is the assistance to smaller innovative companies going to come from?

Due to the relatively low barriers to entry, there are an increasing number of start-ups in software. Statistics show that a large proportion of venture capital in Africa goes into software development projects, highlighting the significance of this industry in the start-up space.

Looking at current business trends, it is clear that software development has a vital role to play in economic growth. A lot of innovative development in software is taking place. Even in traditional non-software driven spaces such as manufacturing, where advances in 3D printing, automation and robotics are emerging. In addition, the increasing

use of cloud computing and its associated software development is giving South African entrepreneurs the chance to innovate and compete on a global scale.

South Africa offers many initiatives which encourage start-ups in the software development sphere such as the Silicone Cape initiative and the Johannesburg Centre for Software Engineering (JCSE). Business incubation hubs, such as Jozihub, aim to connect entrepreneurs with great ideas to software developers who can make things happen. *However - what is the government doing to make it easier for these entrepreneurs?*

What incentives are currently available for companies conducting innovation in South Africa?

There are a number of instruments companies can access in order to fund innovation. The Department of Trade and Industry (DTI) has recently relaunched the Support Programme for Industrial Innovation (SPII) which offers companies cash grants of up to R5 million on qualifying innovation. The DTI also has a smaller, easier to access fund offering up to R2 million.

Additionally, the Technology Innovation Agency (TIA) offers soft loans and incubation facilities. However, the flagship programme for companies conducting research and development (R&D) in South Africa is the R&D

tax incentive, which is currently administered through the Department of Science and Technology (DST). This initiative offers a 150 per cent tax incentive to companies conducting pre-approved research and development.

According to the latest statistics from the DST, 876 applications were made since the inception of the R&D incentive in November 2006 to February 2015. Of these, 47.5 per cent were submitted by SMEs. This statistic does not state how many of these applications actually received approval.

The question remains as to whether or not the tax incentive, together with SPII and TIA programmes are able to achieve the goals of stimulating economic growth through innovation and encouraging small business development.

Are these incentives good enough?

The current R&D tax incentive does not offer much for start-ups. A tax saving has no real benefit to a company in a tax loss situation, which most start-ups find themselves in. In addition, there seems to be a general lack of awareness around the R&D tax incentive. This means that many companies have already spent money on R&D and sometimes completed it before they are aware of the incentive.

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The criteria for approval are quite stringent and, among other factors, require that the research uncovers information or develops a product or process which is globally innovative. Many start-ups in South Africa conduct R&D on local innovations which may not meet this criterion. An additional difficulty is the long delay in obtaining approval. For start-ups this could be a disaster. With cash flow constraints, a start-up could fail due to a delay in even a small R&D incentive pay-out.

The extremely low approval rating for software projects is of particular relevance to software start-ups. Only 30 per cent of software projects are approved as they generally fail on innovation criteria and technical uncertainty, according to the DST.

As it is a cash grant, SPII seems like a better option for start-ups. The innovation criteria appear to be less stringent, although feedback on application approvals seems quite slow from the DTI. A grant is hugely beneficial to a start-up, but is also limited by the start-ups ability to provide the other 50 per cent of the project costs. SPII at this stage also has a limited budget.

TIA could also be a good option for start-ups as it would provide a loan for the funding of the project to be paid back from royalties of future sales. Previously the application process for TIA was quite onerous and it is currently

undergoing a review to determine its optimal funding process (how best to give it and who best to give it to).

What should the government be doing?

As mentioned in the Minister's speech a task team is currently reviewing the R&D tax incentive. A major focus of this review is on amending the incentive to assist with the encouragement of start-ups and SMEs, particularly in the software industry. Hopefully the recommendations from this task team will make their way into legislative changes.

Government has put decent incentives in place to stimulate growth through R&D and innovation. These need to be better promoted, be more effectively administered and the budgets for these programmes need to be increased.

According to SME South Africa, the failure rate for small business in South Africa is as high as 80 per cent - one of the highest in the world. Government needs to recognise this failure rate and create an enabling environment for companies to succeed. We are working with government to get this right, so that R&D and innovation incentives perform a significant role in achieving entrepreneurial success.