

COMPETITION

The Side Hustle – The Dangers of not being legally compliant

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Entrepreneurs and small and medium businesses (SME) have been heralded by many commentators as the panacea for job creation and for boosting the South African economy. However, entrepreneurs and SME businesses have to start somewhere, and they typically do as part-time start-up companies where the founders have to work long hours as they strive to become cash flow positive as soon as humanly possible.

SMEs contribution to the economy

Small businesses collectively make an important contribution to South Africa's Gross Domestic Product. According to information published by Statistics South Africa^[1] ("**Stats SA**"), small businesses generate just over one-fifth of total turnover in the formal business sector. According to Stats SA, industries in the South African formal business sector generated R10,5 trillion in total turnover^[2] in the 2019 financial year.

The information published by Stats SA, thus, shows that small businesses were responsible for generating R2,3 trillion (or 22%) of the R10,5 trillion in the formal business sector.

Common legal compliance issues faced

Receiving appropriate legal advice during and after the start-up phase could save your business a lot of money and help to avoid costly litigation and penalties as your business scales. Often the penalties, for even inadvertent legal non-compliance, can financially cripple a start-up business. We consider below some of the relevant legal compliance issues that affect start-ups and SMEs in South Africa today.

The list below is by no means an exhaustive list but is intended to highlight some of the legal compliance issues commonly faced by start-ups and SMEs.

1. Deciding on the legal entity through which the business will be conducted

- A legal entity (such as a private company) provides asset protection and a host of other legal benefits for a start-up business. It is, therefore, crucial for the business founders to decide up front on the legal entity to be used to conduct business, how the relationship between the founders, shareholders and investors will be regulated and what written agreements and legal documents need to be prepared for the proper operation and functioning of that legal entity.
- Shareholders in a private company would be well-advised to have a Shareholders Agreement drawn up by an experienced attorney, as that Shareholders Agreement regulates the commercial relationship between the shareholders, including:
 - how working capital will be raised by the company (for example, will the money required to operate the business be sourced from banks, from the shareholders themselves or from other means);
 - how the shareholders will share in the profits of the company;

- whether the shareholders will be required to approve the budget and business plan for the company, or any changes thereto;
- the mechanism to be followed if a shareholder wishes to exit (including so-called come along and tag along provisions); and
- how a shareholder's shares in the private company will devolve on her/his passing.

2. Protecting your business idea

- Entrepreneurs often come up with novel and useful ideas of how to solve a need they have identified in society. However, one should take care not to share that business idea too widely before having considered whether the idea, business process, invention, service, work or product is capable of legal protection.
- It would, therefore, be prudent to do some research on this point or ideally consult an intellectual property attorney who can guide you on the intricacies around copyright, patents and trademarks.
- In addition, your attorney will be able to guide you on, amongst other things, when to insist on using a non-disclosure agreement (NDA) and the appropriate provisions that NDA should contain in order to afford your business with the desired legal protection.

3. Labour Legislation

- It is highly unlikely that, as a small start-up, you will be employing personnel to assist you in your business at the outset. However, as you grow the business, you will need people to help you with certain aspects of your business.
- There are a few seminal legislative provisions that businesses need to comply with from a labour law perspective. These include, but are not limited to, the Labour Relations Act, 1995, the Basic Conditions of Employment Act, 1997 and the Occupational Health and Safety Act, 1993.
- However, a mistake that some start-ups make is that they either do not enter into written independent contractor or employment agreements with their employees, or they do not do so on appropriate legal terms. This mistake has the potential to put your most valuable human resource at loggerheads with the start-up business, which could ultimately divert the company's resources away from commercially exploiting its innovative business idea.

4. The Protection of Personal Information Act, 2013 (POPIA)

- The purpose of POPIA is to, amongst other things, give effect to the right to privacy contained in section 14 of the Constitution of the Republic of South Africa, 1996 by safeguarding the "personal information"^[3] of a "data subject" when such information is "processed" by a "responsible party", as those terms are defined in POPIA. Fundamentally, if a public or private body or any other person processes^[4] personal information, that body or person must comply with the conditions referred to in section 4 of POPIA pertaining to the lawful processing of "personal information" and "special personal information".
- In terms of the Proclamation by the President for the commencement of certain sections of POPIA (Proclamation No. R. 21 of 2020), businesses have a grace period until 30 June 2021 to ensure that they are compliant with the provisions of POPIA. Because POPIA's far-reaching provisions will affect start-up businesses (as well as larger well-established businesses), all businesses should acquaint themselves with the prescriptive provisions of POPIA as soon as possible and take the appropriate steps to ensure legal compliance by 30 June 2021.

5. Consumer Protection Act, 2008 (CPA)

- Section 5(1)(a) of the CPA provides that the CPA applies to every transaction occurring within the Republic of South Africa, subject to certain stated exceptions. Where a start-up company intends marketing and selling goods or services to consumers, it is crucial for that start-up company to understand its obligations and responsibilities to consumers under the CPA before trading commences. The CPA essentially governs the obligations on suppliers arising from, amongst other things, the marketing and sale of goods to consumers. The CPA, thus, regulates issues such as direct marketing, a consumer's right to return goods, unfair, unreasonable or unjust contractual terms, warranties on goods, lay-bys, liability for damage caused by goods and investigations by the National Consumer Commission.
- Since offences under the CPA and prohibited conduct could result in some hefty administrative penalties (of up to 10% of annual turnover) and/or even imprisonment of up to 10 years, it is crucial for start-ups to assess the risks of legal non-compliance, even during the start-up phase.

6. Industry specific codes, legislation and regulations

Many industries have codes and regulations which apply to the businesses in those specific industries. By way of example, the Competition Commission has issued guidelines, market inquiry reports and strategic documents which may apply to your business. An attorney with experience in your industry will be able to identify those legislative texts which apply to your chosen industry.

Conclusion

Whilst the internet has made information readily available and accessible, information is no substitute for receiving practical legal advice bespoke to your business in a timely manner. In the same way that large businesses build a team of professionals and advisors around themselves, so too should start-ups ensure that their attorney (as one of their core team players) understands their business and gives them timely, practical and tailor made legal advice.

This legal advice is particularly important during the start-up phase where the structuring of the business occurs, where shareholder roles are defined and where operational decisions are made which affect the long-term strategic direction, operation, feasibility and financial sustainability of the business.

[1] <http://www.statssa.gov.za/?p=13900> accessed on 22 February 2021.

[2] Turnover includes money received from the sales of goods and/or from services rendered, as well as from the leasing or hiring of transport equipment, machinery, equipment, land, buildings and mineral rights.

[3] The term "personal information" includes financial information about a person, their employment history and their contact details (email address, physical address or telephone number).

[4] The term "processing" includes the collection, receipt, storage or use of "personal information".



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