**INNOVATIONS FOR
SUCCESSFUL SOCIETIES**

REWORKING THE REVENUE SERVICE:
TAX COLLECTION IN SOUTH AFRICA, 1999-2009

SYNOPSIS

Between 1998 and 2009, the South African Revenue Service dramatically improved tax compliance, increasing the number of income-tax payers from 2.6 million to 4.1 million people. Several internal organizational changes helped the revenue service persuade more South Africans to pay their taxes. This case study tells the story of two of those changes in particular. The organization used several strategies to rebuild the ranks of upper and middle management, transforming the racial make-up of the organization while improving performance. Meanwhile, in order to improve service for taxpayers, a team of managers and consultants separated back and front offices and introduced an annual "filing season" in which employees of the revenue service left their offices to help taxpayers file their returns. In each of these changes, Pravin Gordhan, revenue-service commissioner from 1999 to 2009, played a central role, both determining policy and overseeing the details of implementation.

David Hausman drafted this case study based on interviews conducted in Pretoria, South Africa in February 2010. Case originally published 2010. Additional text added in December 2013.

INTRODUCTION

Pravin Gordhan learned how to manage people by organizing protests. Beginning in the 1970s, Gordhan worked for the anti-apartheid movement, which sought to end his country's system of racial discrimination enshrined in law. He helped lead a grassroots campaign to oppose the election of the South African Indian Council, an institution created by the apartheid government as part of its policy of racial separation. He had a knack for mobilizing people, and he rose through the ranks of the liberation movement, eventually joining the

negotiations that crafted a new democratic constitution.

When Gordhan became commissioner of the South African Revenue Service (SARS) in 1999, he found himself in charge of an organization whose legitimacy had eroded.

In the apartheid period, tax evasion was a form of protest among those who sought racial equality. But businesses also often underpaid. "Large parts of big business were in bed with the old government, and were selective on compliance," said Ivan Pillay, chief officer for enforcement and compliance risk, who became

SARS deputy commissioner. The mindsets of some businesses "were still informed partly by that kind of approach—where you've got to break the law, you've got to circumvent."

Management was weak and the tax service had hemorrhaged revenue as a result. For example, line officers sometimes turned a blind eye to under-payments from those who owed money. Gordhan said: "In SARS, 1998, you could walk in with a bottle of whiskey and just give it to [the officer]…, and it was accepted over the counter," he said. "You could say, 'Come, let me take you to lunch.' That was accepted."

More effective revenue collection was essential for the new government to deliver on its promises to citizens. In 1998, with 30% unemployment and average life expectancy under 56 years, South Africa faced massive service-delivery challenges, including an imperative to extend water, electricity, health care, and housing opportunities to people previously unserved.[1] At the same time, the government wanted to keep taxes low enough to prevent international investors from pulling their money out of the country.

Part of the solution was to persuade more citizens to pay their taxes. Before the turnaround at the revenue service, only 2.6 million of approximately 43 million South Africans paid income tax. Although that number was deceiving—the majority of South Africans earned too little to be required to pay—it was nonetheless far lower than it could have been. The country's tax base was narrow, but evasion had aggravated this problem.

Restoring legitimacy was essential to convince the citizens and businesses who paid a large share of the taxes to comply—and more broadly to persuade South Africans that they had a social obligation to help support the services they used.

Gordhan and his reform team had to figure out how to move forward with this agenda.

THE CHALLENGE

Some of the hard work had already taken place. In 1997, the legislature had agreed to make SARS autonomous from many of the country's civil service rules to allow it more flexibility.[2] The new agency also merged tax and customs authorities that had been units of the treasury until 1996. Although management now had the freedom to hire, pay, and reorganize, the reform team had to contend with several internal problems: a lack of qualified middle managers, underrepresentation of black employees and managers, and low standards of service.

"Within the organization, middle management was an impervious layer," Pillay said. "The prevailing culture was typical of a governmental department of the time. It was very white and Afrikaans. There was little diversity and some hostility. It was very difficult to get to the bottom of anything."

For Gordhan, the challenge was to make the institution more diverse while retaining staff with skills and experience. "I had to recognize that knowledge was vested in a team of people who were coming from the white community and who, in 1998, constituted, if I'm not mistaken, 65% of the organization," Gordhan said. "So part of the organizational challenge was also to transform the demographics of the organization and give black South Africans an opportunity to both enter the organization and grow within it."

In addition to improving management and diversifying the ranks, Gordhan's team also sought to build better relationships with citizens and businesses. Service had received little attention in the past. The new leadership had to find ways to inspire the organization's line officers to make the experience for taxpayers friendlier and easier, and more understandable.

FRAMING A RESPONSE

The initial focus was on processes, people and the provision of professional service. The

finance minister, Trevor Manuel, had insisted that no one would be laid off in the short term, a stipulation partly associated with agreements that underpinned the country's transition to majority rule.

Gordhan and his management team hoped to retain experienced employees, who were mostly white, while transforming the organization racially and instituting dramatic customer service policies. The solution, he decided, was to ask workers to sacrifice job security in exchange for employment security—in other words, to promise staff a position, but not necessarily the position the person currently held. "Together with Judy Parfitt [the general manager for human resources at SARS] we worked out an approach which said, 'We don't want to fire anybody in SARS in this process of transforming the organization. We want to keep them on board,'" Gordhan said. "'We want their skills to be available to us, but at the same time there will be change.' There wouldn't be paralysis as a result of taking this approach."

As a first step in racial transformation, Gordhan brought several hundred black employees into informal management positions. "I created a management team below the existing executive team which would allow for more participation by black managers, although not with formal power but at least with some informal influence," he said. "We convened senior managers representing each of the SARS offices, both the customs and revenue business, but instructed each of them that they had to come with a black individual—which was unheard of— to ensure that there would be a more diverse set of people representing the offices. That's when we first talked about transformation in the broad sense and began to get people to buy in."

According to Gordhan, the early meetings laid the foundation for reforms that combined racial transformation with a new conception of the role of a revenue agency in a fully democratic

South Africa. "[Senior managers] participated and they heard the message, which said we're going to make this into a different organization. We're going to start a change process," Gordhan said of the initial meeting. "To their credit, there were several senior white managers who had bought into my approach by then and openly supported the need to transform the organization, even at that meeting, in the early days. I can't say we got buy-in, but we started an awareness that we were going to begin to move differently. It took another, probably six to nine months if not more, to experiment with setting up a transformation unit, generating ideas about how transformation could begin."

These early transformation efforts metamorphosed into a human resources plan, Gordhan said. "At the same time a new colleague had also come in on the HR [human resources] side of the business and began to set up for the first time formal HR processes and systems and so on which played an important foundational role," he said. "So those sorts of business initiatives— the HR system, the early notion that we need to change the organization—all of this came together some time in 1999."

The new colleague Gordhan mentioned was Judy Parfitt. "She became a key ally in bringing black managers into the organization, as were some of the other white managers," Gordhan said. "They had a more entrepreneurial side, given more space."

The plan for large internal reforms— including, among other things, racial transformation, recruitment of new managers, and a new service orientation—became formal during Gordhan's second year as commissioner. The internal reform team engaged the help of consultants to assist with aspects of the re-organization. The consultants brought some new ideas and assumed responsibility for some of the work of overhauling the organization, lifting some burdens from the shoulders of the people who had

to oversee the agency's daily operations. Gordhan said: "That then formalized the process; it was late 1999, if I'm not mistaken, early 2000, then we began to kick off the *siyakha* process. *Siyakha* in Zulu means 'We are building.' That formalized the journey."

GETTING DOWN TO WORK

Some early high-profile and aggressive tax collection initiatives helped build momentum for reform. For example, in one high-profile case, SARS seized shares of an insurance company in order to force shareholders to pay their taxes.

As SARS pursued more aggressive enforcement, it benefited from the strong backing of the finance minister. "The political backing was a crucial part of ensuring that when you get pushback, as we did in some instances from, say, the private sector and so on," Gordhan said, "we would have both the legitimacy and the political backing and our own institutional strength to be able to cope with that."

But enforcement was expensive in terms of staff time and good will. Therefore, the reform team worked hard to change hearts and minds, first deepening and formalizing some of the personnel changes it had launched experimentally and then altering the relationship to South African citizens.

Overhauling management

As a first step, Gordhan launched an informal but systematic search for top managers to staff a process-engineering unit. "Together with the consultants we developed our own process team. … One of the things that we did as far as our people were concerned, as many would attest to, is that we took huge bets on them—meaning we couldn't wait for 10 years for somebody to get 10 years' experience and then say now you can take on this one simple position," Gordhan said. "So taking bets meant judging a person's character, level of commitment and capability and

placing them in a completely new position which they might not have been adequately trained for. Most of them did marvelously; some didn't. But we learned by actually doing."

Much of this management search took the form of recruiting, both inside and outside the organization. "You have to walk the floor and talk to people and observe processes," Gordhan said. "That's how I learned. Then you'll also begin to identify enthusiastic people, and you'll spot them in different parts of the country, in different roles. Then you take your chances and pull them in and constitute the team, give them a clear mission." The management team discovered many people with talents the organization needed and encouraged them to apply.

Gordhan also looked for likely candidates in other government institutions and in business. "Over time people from the private sector were willing to come and work with us as well, partly because we're outside of government, partly because there were huge advantages in being part of the change processes, but also to contribute to the country," he said. SARS made a special effort to identify talented and skilled black applicants. It identified black teachers who had accounting skills and consider jobs with the agency.

Johan van Loggerenberg, who worked in police intelligence under the apartheid regime, was one of those whom Gordhan approached. "Mr. Pravin Gordhan had the idea to develop an intelligence unit to enhance the enforcement of tax and customs compliance," van Loggerenberg said. "He arranged a meeting where he interviewed me himself." Van Loggerenberg said he was impressed by what he called Gordhan's uncanny ability to think strategically and technically at the same time, and he decided to join the organization even though he had never before considered a career in taxation.

Pillay said Gordhan's ability to attract qualified people with integrity was among the most important factors in the organization's

turnaround. "It all comes down to appointing the right people," Pillay said. "We sought to attract and retain the right people—people whom we knew, people of integrity." Van Loggerenberg agreed. "Gordhan brought in key resources at multiple levels in the organization," he said. "He began to build small nucleuses all over the department of capable and willing people."

In tandem with the search for managerial talent, Gordhan and Parfitt negotiated with unions to restructure the organization. The program, formalized in the Siyakha People Placement Protocol, was meant both to facilitate racial transformation and to promote managerial talent and people with special skills. Formal negotiations with the union allowed the process to advance. The Siyakha protocol was "a change protocol, negotiated with the unions and co-signed with them," Gordhan said.

Johan du Toit, a consultant who worked with Parfitt at SARS for six years, played a central role in designing the process, which required approximately 20% of SARS employees to reapply for newly created positions, competing with applicants from outside the organization. Employees who did not receive one of the new positions were retained at SARS; their pay was frozen, though not reduced.

Those who reapplied took three tests: (1) a psychometric test called "Potential Index Batteries / Situation-Specific Evaluation Expert," developed by a South African company and intended to measure basic capabilities such as memory, mental alertness and self-acceptance; (2) a functional proficiency test; and (3) a "Lee Moral" test, which du Toit recalled as "a traditional, extensive, psychometric-centric intervention (hence expensive, but robust) for determining managerial competency."

The reshuffling affected units throughout the organization. In the enforcement and compliance risk unit, for example, Pillay said, "We had a meeting, looked at statistics, performance and

potential. At the team-leader level, with a view to kick-start equity, we showed preference to people who showed promise." Those who lacked management talent were re-assigned to technical positions, but Pillay said he did his best to soften the blow. "We took managers into a room, explained that they were still needed, though not as managers," he said.

Gordhan described this as a foundational reform that enabled transformation and later customer-service improvements. "Any managers who were in fact technically competent but not managerially competent necessarily became specialists," he said. "That opened up spaces for people, black people with even master's degrees and so on, to come in from the outside and begin to occupy those spaces and learn the business and so on."

Customer service

Gordhan said he had a simple approach to the problem of how to create a service mentality. "You demand the best and you walk the floor, that's how," he said. More specifically, Gordhan and his team improved customer service by separating front and back offices, taking SARS staff to the taxpayers during an annual filing season, recognizing staff who provided good service, and publicizing the mission of SARS.

By centralizing core administrative functions, such as accounting and human resources, in a few national offices and reorienting branches toward customer service, Gordhan hoped to achieve several goals. Segregating the "back office" support functions from "front office" contact with citizens could theoretically reduce the space for favoritism by enhancing oversight, increasing efficiency, and improve the taxpayers' interactions with SARS personnel.

"One of the things that South Africans pre-1998 were used to was coming into an office and saying, 'I know Adrian. Can I speak to Adrian please?'" Gordhan said. "This design—to change

the way branch office staff interact with taxpayers—was deliberate in the sense that it didn't want that kind of contact to continue." The separation of front and back offices made such informal dealings more difficult. "You wanted to cut down the opportunities for any mischief or fraud or whatever on the one hand," Gordhan said.

Durban, South Africa's third-largest city, was chosen as the pilot site for the front office-back office split. Because the pilot project in Durban would set an example for SARS offices throughout the country, top management paid close attention to details. Displaying his hands-on approach, Gordhan himself went to Durban for the launch. "There was obviously a lot of apprehension. People didn't know where the hell we were going," Gordhan said. "I remember, I was in Durban on the first day. The staff didn't have a clue of what to do. There was another, I think one or two senior managers were with me. We were on a floor above but we could see what was happening on the service floor. So we said, 'Ah, let's go.' So we went down. We showed them exactly how to arrange tables, chairs, how to arrange queues, how to service people, how to make sure that they don't wait too long in the queue. No sooner had we done that and set that as an example, that example spread throughout the country. People began to innovate in their own way."

SARS then used the Durban example to help other regional offices transform themselves. "You can just change one section, make it work, and then others can come and see it," Gordhan said. "So when we started, from KwaZulu-Natal we went to the Western Cape. If I'm not mistaken, at the early stages we probably brought 50 people over from the Western Cape to come and have a look and say, 'This is what your future is going to look like; participate in it and make it happen on your side.' It worked."

As the pilot project expanded, customer service improved, often purely as a result of the independent initiatives of the branch managers. "One of the most wonderful things: At the Belville office in Cape Town, the manager decided now it is a cold morning and people are still in the queue outside, so what we're going to do is give biscuits, tea and coffee," Gordhan said. "Of their own accord—no head-office instruction. So part of it you drive from the top in terms of intent and example. Most organizations will have activists if you give them the space to pick up that and add their own variations."

The new division of responsibilities between the front office and the back office established a more formal relationship with citizens and limited the space for favoritism, but it could also make the service seem less approachable. Gordhan said: "It has a flip side to it, because people are used to the personal contact with an individual they know. So it took a little while for the public to get used to the fact that we're working differently."

To help give the service a friendlier face, a public-relations campaign accompanied the roll-out of the new front-office concept and inaugurated an annual "filing season" outreach initiative. The campaign included not only advertising but also physically taking staff out of their offices and going to the taxpayers at their workplaces. Gordhan said. "Today that has become a very institutionalized thing where you will go to big companies, set up computers and help the staff of, say, 4,000 in a particular building to fill out their tax returns." The field trips were also reached people outside big offices by setting up operations in libraries and city centers.

This tactic of making tax offices more accessible was a new phenomenon in South Africa. "We've generated a lot of enthusiasm and awareness among the South African public as a result of reaching out to them, not just sitting in our offices and waiting for them," Gordhan said.

The program reached out not only to citizens and firms, but also to tax advisers. Gordhan described the tax advisers as a particularly difficult group to persuade. "They tend to be laggards in this process and don't like change, which would narrow their space to maneuver around either tax or customs administration," he said. The new SARS management opened up channels of communication and responded quickly to complaints.

Gordhan stressed the importance of responsiveness. "So there would be times people would phone my office, I would take a call," he said. "On one occasion I can remember clearly a guy said, 'In your Durban office X, Y, Z isn't working and the managers aren't fixing that up.' That afternoon I put a team of five or six people together and I said, 'Go to Durban. Go and meet this gentleman first and listen to what he is saying. Then go to the office and go to check; are the things he is saying true?' Sixty percent of it was true."

To improve staff morale, the reform team made sure that relatively few people had to move to new cities or locations as a result of the internal reorganization. It also started to recognize strong employee performance and offered bonuses to teams and divisions that performed well not just in raising more taxes but also in improving service and efficiency.

A strict policy on corruption was a corollary of the new model. "Within, I think, six months, we banned all gifts in SARS," Gordhan said. "We banned all acceptance of dinners and lunches. Initially it was like a blanket ban: You accept nothing. Then slowly we sort of loosened things up. But in that way we established integrity as a key value. If we caught you, you knew you would be dealt with."

OVERCOMING OBSTACLES

Over 80% of the agency's workforce was unionized at the time of the reforms. The unions could have blocked efforts to change job descriptions, move people to new locations, and create a more efficient organization, but they did not. Participants in the change process attributed the union cooperation to Pravin Gordhan's leadership style as well as the way the new job structure was designed.

Initially many different unions had represented workers and managers in the tax service. The apartheid government had encouraged a kind of "divide and rule" approach that fragmented union membership.

After the transition new rules required that each union be at least minimally representative of employees of different ethnic or racial backgrounds. This reduced the number of unions to two, which eased negotiation.

For their part, the agency directors were careful not to play the unions—one still majority white and the other, majority black—against each other, so as to build a commitment to a nonracial workplace.

The directors and the unions sat together for eight months to craft an agreement before moving change forward. They developed a shared strategy and principles for resolving disagreements. The agreement included two-year pay protection in addition to a ban on retrenchments. The pay protection covered people who were moved into positions that generally carried lower remuneration than the posts they had left or failed to retain. During a two-year grace period, these employees could obtain additional training and try to win promotions or other jobs that paid more.

The resulting Siyakha Protocol made it possible to overhaul the agency. Unions and agency directors held a joint "road show" at the agency's regional offices to make sure employees and managers knew about the details of the changes they had agreed to. Without the protocol and the effort to communicate its terms, the resistance to change could easily have resulted in thousands of labor disputes.

ASSESSING RESULTS

Measured by the size of the tax base, the organizational reforms were a success: As of 2009, 4.1 million South Africans paid income tax, compared with 2.6 million in 1998/1999. Nominal revenue collection increased by an average of 7% to 12% annually during Gordhan's tenure and went from 2.2 billion rand in 2000 to over 6.1 billion in 2009.[3]

As a share of gross domestic product, South Africa's tax revenue grew slightly from 24.2% to 27%,[4] roughly in line with the Scandinavian countries, the United Kingdom, New Zealand, and neighboring Botswana, but well above the level in many other countries.

By early 2010, the South African Revenue Service was known as one of the best-functioning public institutions in South Africa.[5]

The SARS reforms were a case of successful racial transformation. "Today the complexion of the organization from 65% white would probably be closer to 60% black in the broader sense, if not 65," said Pravin Gordhan, SARS commissioner from 1999 to 2009. "It's an interesting figure that we've been able to switch without firing anybody." Gordhan gained respect for his success as commissioner, and he went on to become South Africa's finance minister in 2009.

The organization's task was made easier because it had the resources to expand its staff. The number of SARS employees increased from approximately 12,500 in 1998 to 14,751 in 2009.[6]

SARS also received a generous budget early on: From 1999 to 2000, for example, its budget increased from 1.75 billion South African rand (approximately US$250 million) to 2.197 billion rand—an increase of 25%. As a middle-income country, South Africa could afford to put money into revenue collection, though the agency's budget more than paid for itself in new revenue generated.

REFLECTIONS

The SARS experience holds lessons for reformers elsewhere. By attracting people with organizational skills out of the private sector and other government departments, Gordhan created a group of dynamic managers. By reshuffling management and technical personnel, the agency retained technical skills while making its management more diverse, and more competent. Finally, by separating front and back offices, setting an example, and rewarding individual initiative, Gordhan and his team created an organization with a reputation for excellent customer service.

Gordhan's success was a "people story," not a technology story. "Part of our broader strategy was that this would be a non-technology change," Gordhan said. "So although there will be adaptations to some of our existing legacy systems, we would not focus on technological investment at this point in time. It was more about processes and people and changing the service approach and ultimately also changing the enforcement approach of SARS. That is what we worked with for five or six years."

Further, in the view of the members of the reform team, the success came from the aptitudes the organization's leaders developed during the fight against apartheid. Gordhan said careers in activism provided crucial preparation: "We built organizations from nothing in the 1970s." In his view, the experience of the struggle helped develop strategic and tactical skills and made people understand the importance of engaging with people to build support. Ivan Pillay, who worked with Gordhan in the anti-apartheid movement, also pointed to activism as a management asset: "We were able to generate a lot of energy."

Endnotes

[1] CIA World Factbook 1998. http://www.umsl.edu/services/govdocs/wofact98/226.htm. Accessed 14 April, 2010.

[2] No. 34 of 1997: South African Revenue Service Act (Part I, Section

2) http://www.info.gov.za/view/DownloadFileAction?id=70780

[3] World Bank World Development Indicators, http://data.worldbank.org/data-catalog/world-development-indicators. Accessed 15 December, 2013.

[4] Barron, Chris. "Newsmaker: Oupa Magashula, Commissioner of the South African Revenue Service. Times Live. http://www.timeslive.co.za/business/article212185.ece; South African Revenue Service. *Annual Report 2003, p. 13;* South African Revenue Service. *Annual Report 2009*, p. 25.

[5] See, for example, http://www.southafricaweb.co.za/article/tax-returns-south-africans-do-it-online Accessed 14 April 2010 or http://www.mg.co.za/article/2009-09-07-sars-employees-down-tools Accessed 14 April 2010

[6] South Africa Revenue Service. *Annual Report 1998-1999,* p. 52; South African Revenue Service. *Annual Report 2009*, p 52.