



business environment specialists

alert

Small business development in South Africa

Time to re-assess

South Africa lags behind other developing countries in promoting the growth and sustainability of small businesses

"With millions of South Africans unemployed and underemployed, the government has no option but to give its full attention to the task of job creation, and generating sustainable and equitable growth."

"Small, medium and micro-enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country."

"We [the government] believe that the real engine of sustainable and equitable growth in this country is the private sector. We are committed to doing all we can to help create an environment in which businesses can get on with their job. We believe in the principle of working together with our partners in the private sector – big and small businesses – in realizing our hopes and aspirations for this economy."

These are direct quotations from Trevor Manuel's Foreword to the White Paper on Small Business, published at the beginning of 1995, when he was Minister of Trade and Industry. Fifteen years on, the statements seem as pertinent as ever - but the context is very different.

South Africa is in the grip of a recession. Businesses are closing down. There are job losses on a frightening scale – 475 000 in the first two quarters of 2009, according to Statistics SA. These are enormous challenges for the new Administration. Within government, we have seen a significant restructuring of Ministries in the economic cluster, and the advent of the National Planning Commission. New strategy documents have been adopted – on a national youth policy, and the second economy – with a strong bearing on possibilities for integrating marginalised segments of the population into the productive economy. On the economic policy agenda, priorities cover the spectrum from poverty alleviation, unemployment, job creation, the challenge of stimulating economic growth, generating public revenue, and improving public sector efficiency.

This is a good point to take stock of small business development in South Africa. Are the government's efforts in the sector appropriate in our current circumstances and for the road ahead? And what role can the private sector play? Should we be looking at new alliances - public-private partnerships to deliver public goods that neither the government nor markets can deliver on their own?

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Government initiatives over the past fifteen years have fallen short

The impacts and achievements of the government's initiatives have fallen disappointingly short of aspirations. For informed observers this is simply a statement of the obvious.

For the past fifteen years the government has invested in a plethora of initiatives aimed at supporting and growing the SMME sector. Broadly speaking, it has focused simultaneously on high-end enterprise development, and the encouragement of micro-enterprise activity as a means of reducing the gap between the first economy and the underdeveloped second economy. An institutional framework was established comprising support agencies including Ntsika, subsequently replaced by SEDA (Small Enterprise Development Agency); and on the financial support side, Khula Enterprise Finance and the Apex Fund that provides micro-finance loans of less than R10 000. On the policy front, the National Small Business Act was passed in 1996, and stipulations pertaining to the sector were built into the BEE Codes of Good Practice.

A great deal of taxpayers' money has gone into these initiatives. For 2008/9 alone, the adjusted appropriation for SEDA amounts to over R400 million, with an additional R38 million going to the Apex Fund and R70 million to Khula. Furthermore, government-backed finance is provided to the small business sector by other agencies such as the Industrial Development Corporation, and the Umsobomvu Fund which was tasked with promoting entrepreneurship, job creation and skills development among young people (now absorbed into the newly established National Youth Development Fund). There are also sector-specific frameworks such as the mining industry's Social and Labour Plan (SLP) that compels mining and production companies to develop strategies and programmes that create economic opportunities for low-skilled and under-employed communities in their operating areas.

Despite this, South Africa lags behind other developing countries in promoting the growth and sustainability of small businesses. On start-ups, the Global Entrepreneurship Monitor (GEM) 2008 figures show that eight in 100 adult South Africans own a business that is less than 3.5 years old - significantly behind other low to middle income countries, where on average 13 out of 100 adults are building new businesses. GEM also reports that only 2.3 percent of South Africans own businesses that have been established for over 3.5 years, indicating a high failure rate among start-ups – with South Africa ranking 41st out of 43 countries in the prevalence (survival) rate for established business owner-managers.¹

This suggests that government support agencies and initiatives have been less successful than intended – as might also be inferred from the institutional re-jigging. From the outside it is impossible to assess the gap between intentions and outcomes with any accuracy, as there is a dearth of publicly available data, impact assessments and M&E reviews. Nevertheless in a telling admission to the parliamentary portfolio committee in 2008, Department of Trade and Industry director-general Tshediso Matona said that SEDA was largely ineffective and that the government's small business support efforts had delivered few results. He conceded that "we are doing things on such a miniscule scale that given the needs and challenges we will not be able to make an impact."²

Small businesses are vital for employment

Why is the small business sector important? The answer generally given is that small businesses help to drive economic growth, create employment, and are sources of innovation and new ideas.

Small businesses are important for job creation and employment. Forty five percent of all employed people in South Africa work in firms with less than 10 employees

Currently economists are locked in a debate about the role of small business as actual drivers of economic growth, and the evidence is contested. But small businesses are incontestably important for job creation and employment both in developed and developing economies, though the balance shifts between the formal and informal sectors. In South Africa, Dr Neil Rankin of Wits University estimates that 73 percent of workers are employed by firms with less than 50 employees; and that 45 percent of all employed people work in firms with less than 10 employees.³

As we know, for various reasons South Africa's large businesses have not been creating jobs on the scale needed to lower the unemployment rate. In the twenty year period from 1985 – 2005, no more than ten percent of all new employment positions were produced by large established firms.⁴ With unemployment as the country's central and most salient problem, a top priority must be to grow small businesses in the formal sector, and in particular to provide appropriate support and a conducive environment for opportunity-driven entrepreneurs who establish new businesses not out of necessity but because they recognise and seize opportunities. Opportunity-driven entrepreneurs generate new business ideas, mobilise resources and ultimately create jobs. The GEM 2008 report notes that the mean number of jobs created by opportunity-driven firms is 4.4 per business, compared to just 1.6 for necessity firms.

Small businesses are diverse

A common criticism of the government's approach to SMME development is that it has been over-ambitious, with a complex mix of strategies. However, SBP would argue that in fact the approach has not been sufficiently differentiated or nuanced.

Small businesses are very diverse, and they have different needs. They operate in the formal and informal economies. Some are simply survivalist; others are run by people with entrepreneurial flair. Some are start-ups; some are growing rapidly; others are well-established and stable. Some business owners have a very low level of skills; others are experienced and highly sophisticated. They operate in different markets – local, national, global. All of this may seem obvious – but the crucial point is that policies and actions to support the small business sector need to reflect this diversity.

In this context it is questionable whether the government's strong focus on micro-enterprises is warranted. The vast majority of micro-enterprises in South Africa fall into the second economy, and are essentially survivalist. The assumption (or pious hope) appears to be that by supporting these enterprises they will eventually graduate into the first economy, though there is little evidence from other developing economies that survivalists can make that leap.

There is certainly a good case for making it as easy as possible for survivalist businesses to survive. They have an important role in the set of mechanisms available for poverty alleviation, and they give a sense of personal agency and dignity to people who would otherwise be unemployed and dependent on welfare – but they should not be a central concern in small business policy.

The main thrust of small business policy must be to strengthen the productive private sector – we need to shift the emphasis from 'small' to 'enterprise'. The development of micro-enterprises and small businesses is not an end in itself, but a means to an end. The goal is to grow output, employment and income through the development of a vibrant private sector.⁵

A top priority must be to grow small businesses in the formal sector and to provide appropriate support, as well as a conducive environment for opportunity-driven entrepreneurs

It is good to support small and micro-enterprises operating in the informal economy so that they can enter and survive in the formal economy; but it is of much greater importance to support more mature and viable SMEs to upgrade their products, processes, and levels of quality, productivity and innovation to enable them to integrate into local, national, and international value chains – to become profitable, productive and performance-driven enterprises.

Towards a comprehensive new small business strategy

An innovative integrated approach to enterprise development is needed to support and grow sustainable businesses in South Africa. In this regard, the primary role of government must be to act as a facilitator, as SBP has argued consistently over the years.

A mix of elements is required that will:

- Promote entrepreneurship, skills, and the development of social capital and networks
- Improve the growth potential of small businesses through access to finance, information, ICT, and good infrastructure
- Support incubator facilities where necessary (with access to physical infrastructure and basic business development services)
- Improve access to markets (for which business linkages are an important mechanism)
- Cut red tape and create a more enabling environment, including the reduction of crime and corruption
- Drastically improve statistical data on the small business sector, where there is a paucity of reliable information
- Recognise that small businesses operate in specific sectors, and that sector-specific factors have impacts across the spectrum of business sizes
- Place a premium on dialogue and collaboration with stakeholders and partners, especially in the private sector, to develop targeted programmes in specific sectors and localities.

Throughout the world, as in South Africa, a variety of tools have been implemented for small business development including business incubation, facilitated finance, business development services, and business linkage programmes. But mostly these are implemented in isolation from each other. For more effective impact, a joined-up approach is needed.

Growing business skills and strengthening a business culture

For many start-up businesses, some form of mentoring is needed in varying degrees to grow business skills. One to one mentoring is effective but expensive and unless economies of scale can be achieved, providing these support services to small enterprises is difficult to sustain.

It is important to strengthen a business culture where this is lacking. Entrepreneurial culture is not as strong as it should be in South Africa. As discussed in a previous SBP Alert⁶ it is essential to build this, particularly among young people, and to provide them with the necessary skills to pursue an entrepreneurial path. In enterprise development research there is a growing interest internationally in social capital as the fourth form of capital – alongside financial, human and physical capital – to underpin and expand

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business development. Networks are a vital element of social capital, providing both 'vertical' and 'horizontal' linkages.

The apartheid legacy left many South Africans ill-equipped with the necessary skills, resources and confidence to start up and run viable businesses of their own. Generations of discriminatory legislation and practice meant that the majority of black South Africans had limited access to business opportunities and formal business training. There were few opportunities for informal business socialization, which is so important for entrepreneurial success, including role models provided by business-owning family members, or fellow community members employed in responsible business positions.

SBP has developed and tested a peer networking model with considerable promise (see Box: *Business Bridge*). Running a small business is often a difficult and lonely undertaking, and the peer-group format provides an environment where members can admit their difficulties, brainstorm solutions, and gain access to information. Peer-group learning can be a valuable part of small business development and business linkage programmes, helping to build business confidence, grow local business relationships, develop an appreciation of corporate expectations, and transfer soft skills such as business professionalism.

There is a growing interest in social capital as the fourth form of capital – alongside financial, human and physical capital – to underpin and expand business development

Business Bridge: A peer networking model

SBP has piloted its Business Bridge peer networking model with considerable success in South Africa and Malawi, as an effective vehicle for building social capital and networks among small business owners.⁷

Business Bridge is targeted at entrepreneurs wanting to grow their businesses and employ more people, with a particular focus on broadening their client base, acquiring more corporate clients, and tendering successfully for government business.

It provides entrepreneurs with an informal forum, supported by a facilitator, in which to meet on a regular basis to share experiences, ideas and challenges, and to contribute constructively to the collective learning of the group. The key objective is to build capacity among members, enabling them to establish business relationships with other SMEs, and to develop the necessary knowledge and capacity to successfully enter the supply chains of large corporations. Members network with and learn from their peers, and provide mentoring, capacity and confidence-building support to one another. They also share area-specific information on administrative and logistical issues, including identification of the main players in specific sectors and emerging opportunities that match the skills available within the group.

The forum also provides an opportunity for facilitated interactions between member SMEs and potential buyers. Procurement representatives from large companies and the public sector attend forum meetings to provide detail on their procurement requirements and processes to make tendering processes more accessible for SMEs and increase their chances of success, and engage with SMEs on a personal level to identify possible opportunities and challenges to winning contracts. Business Bridge SMEs have also benefited from interactions with other players, such as commercial banks and Revenue Authorities, who have provided them with product information tailored to their needs. Through these interactions, members are able to access expertise and technical advice that would otherwise be costly or hard to come by for small businesses like theirs.

A public-private alliance for small business development?

Over the past fifteen years there has been a significant increase in various new types of alliances to address development issues – among companies themselves, and between organisations in the public and private sectors and civil society, involving public-private and multi-sector partnerships. Some of these partnerships are international, others operate at national or local levels. Alliances of this kind are an important addition to the portfolio of strategies for companies, governments and NGOs to develop innovative responses and strengthen development impacts, particularly in the context of business linkages programmes supported by multi-sector partnerships and collective business action.

Corporates' role in poverty reduction and development

"Research by the International Business Leaders Forum, World Bank and UNDP has identified three key spheres of influence through which responsible business practices can contribute to development and poverty reduction: through core business activities; through social investment and strategic philanthropy; and through engagement in public policy dialogue, advocacy and institution building.

"One of the most obvious and surprisingly untapped ways that large companies can support development objectives in the countries and communities in which they operate is through spreading economic opportunity through a variety of small enterprise development, training and business linkage initiatives."

Source: Jane Nelson, *Building Linkages for Competitive and Responsible Entrepreneurship*, Harvard University/UNIDO 2007

Business linkages as a development tool

Among the broad range of mechanisms available to support the growth and development of entrepreneurial enterprises into competitive businesses, some of the most effective are private sector led initiatives that broaden big companies' value chains to incorporate small businesses.

'Vertical' business linkage can involve backward linkages (where large companies acquire goods and services from small enterprises) as well as forward linkages (where large companies sell goods and services to small enterprises or distribute goods and services through them e.g. franchise or retailing arrangements). Vertical linkages can also be a strong stimulus for 'horizontal' linkages, where small enterprises work together to increase their capacity to access markets, for example through shared production of large orders, collective purchasing or group leasing equipment.

Initiatives to establish and expand linkages between big business and SMEs are very often driven by individual corporations' efforts to pursue corporate social responsibility and improve their integration into local economies; but as the UN Global Compact on Sustainability observes, most company initiatives "are too peripheral from core business, too isolated from one another, and too disconnected from wider systems to make much of a collective impact." On the other hand, collective approaches, which bring together a number of large businesses with a shared interest in expanding linkages with local SMEs, offer a more sustainable model to increase the number and impact of business linkages, with an enhanced capacity to achieve 'public good' outcomes on a broader scale. SBP itself has had considerable experience in developing and facilitating large-scale collective business linkage programmes in South Africa, Tanzania and Malawi.⁸ Under this model,

Small business development on the scale needed in South Africa requires a new, sustained engagement between the private sector and government

groups of companies in the same sector or location work together with governments, NGOs, community organisations and on occasion donor agencies to extend the reach and development impact of their value chains.

The collective approach reduces transaction costs for participating businesses, which are able to share information about linkage opportunities and SMEs' capacity-building needs, learn from one another's experiences of working with particular SMEs, and collaborate to develop tools and systems to facilitate the scaling up and expansion of linkages. These approaches also offer a wider pool of potential partners to the SMEs themselves, supporting diversification and potentially broadening the impact on local communities.

Collaboration and information sharing among large firms is not necessarily easy to achieve, however. Such processes run counter to ordinary business practice, and require strong commitment from the highest levels of participating organisations.

Government facilitation - at national, provincial and local levels - can encourage collective approaches by facilitating contact between relevant companies, and contributing to the resource costs of establishing the necessary structures for long term success. These can include forums for collaborative action and facilitation of regular meetings, development of SME databases and mechanisms for information sharing, and so on.

Development initiatives must get down to the level where small businesses actually operate, and must be closely targeted in different sectors, value chains, and localities

Corporate involvement in small business development

A number of major companies operating in South Africa are involved in small business development initiatives. Perhaps the most well-known is the Anglo Zimele Empowerment Initiative Limited, the Anglo American Group's enterprise development fund.

Anglo Zimele operates as a catalyst to empower entrepreneurs in South Africa through the creation and transformation of SMEs, particularly in rural areas. Since its inception 18 years ago it has invested in numerous SMEs across a variety of industries, and provides loan and equity finance to support start-up or expanding businesses.

Anglo Zimele operates through three major funds: the Supply Chain Fund (supply chain transformation and enterprise development), the Anglo Khula Mining Fund (enterprise development and technical support), and the Small Business Start Up Fund (SBSF), its most recent initiative. Established in October 2007, the SBSF focuses on sustainable businesses within a radius of approximately 50 kms around South African operations of the Anglo American group, with a strong concentration in rural areas.

The SBSF assists enterprises with seed and working capital, which they might not receive from other financial institutions, at a favourable interest rate. Of the current investment portfolio, 40 per cent is with women-owned businesses and 34 per cent with youth-owned enterprises. Entrepreneurs qualifying for SBSF loans must be local residents or members of the local community. Their businesses are not necessarily dependent on the mining industry.

Operating alongside the SBSF are Small Business Hubs (incubators) that provide local entrepreneurs with tangible support including basic business planning and business advice. The hubs also offer access to administrative facilities such as business equipment (fax machines, printers etc), internet and meeting facilities.

Getting down to (small) business

Effective small business development on the scale needed in South Africa requires a new, sustained engagement between the private sector and government at national, provincial and local levels.

There is a large and pressing agenda, but crucial issues include improving the regulatory, administrative and operating environment, and ways to expand market development for SMMEs.

Most important of all, small business development initiatives must get down to the level where small businesses actually operate, and must be closely targeted in different sectors and value chains, and in specific localities – in our cities, small towns and rural areas – to grapple with their diverse characteristics, needs, constraints and opportunities.

¹Global Entrepreneurship Monitor South Africa, 2008 Report, www.gemconsortium.org

²City Press, *End of the road for hapless seda boss*, 26 April 2008

³Dr. Neil Rankin, *Is South Africa missing a middle?* 2008, unpublished paper, African Economic Research Consortium (AERC), School of Economics & Business Sciences, Witwatersrand University

⁴Finscope, Small Business Survey Report – Gauteng, 2006

⁵Paul Vandenberg, *Is small still relevant?*, Small Enterprise Development, vol. 17 no. 2, June 2006

⁶SBP Alert, *Boosting youth employment through entrepreneurship*, June 2009 www.sbp.org.za

⁷*Networks achieving business growth: Psi Malawi*, and *The next evolution of linkages: Pilot phase. Final report*, www.sbp.org.za

⁸The relevant publications on SBP's Psi (Private sector initiative) programmes in South Africa, Tanzania and Malawi can be found at www.sbp.org.za



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SBP is a not for profit company specialising in improving the environment for doing business. We have worked in Africa and internationally since 1998 providing innovative solutions for policy formulation, better regulation and development in emerging markets. We have a special interest in small business as vehicles for growth and job creation.

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