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alert

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CONTENTS

Developing a new path for SMEs in South Africa; Reassessing for growth.

"The economy," said Reserve Bank Governor Gill Marcus recently, "is facing a difficult time as it is buffeted by both global and domestic challenges". This sentiment distils widespread concerns for the fortunes of South Africa's economy. The economic headwinds of the past few years have shown that the world is both changing and uncertain. The cashflows of the commodities boom and the pre-crisis years are over. South Africa needs to trim its sails and alter course accordingly.

This calls for imaginative and bold action in respect of South Africa's options for economic development. Such action may not in fact require a great leap. Small and medium enterprises have long been a staple part of official economic thinking in South Africa. A series of official strategies beginning with the Reconstruction and Development Programme have placed them at the centre of South Africa's future, particularly regarding job creation, and politicians across the political spectrum voice their agreement.

A focus on SMEs is sound. SMEs play a critically important role in economies across the world. A number of studies demonstrate above all that they are the key propellers of job creation. There is evidence that the contribution made by SMEs is more pronounced in developing than in developed countries. Under the right conditions, a robust SME community has the capacity to be a dynamic, transformational force since, in the words of the World Bank, “relative to larger firms, SMEs enhance competition, entrepreneurship, job growth and spur economy-wide efficiency, innovation, growth and poverty alleviation”.

Entrepreneurship is a precondition for any business. In this regard, South Africa is an underperformer. The latest report by the Global Entrepreneurship Monitor shows how far behind its peers South Africa has fallen. As a developing country, its entrepreneurial uptake should exceed some 10% of the adult population. But as things stand, its entrepreneurial uptake is closer to that of a poorly performing developed country. Only around 7% of South Africa’s adult population is involved in early-stage entrepreneurship – in other words, with start-ups and young firms. Another 2% is operating firms that have been in existence for more than three and a half years. The latter figure places it in last place in the entire study, sharing this spot with Panama and Russia. Against this, around 15% of Brazilians are in early-stage entrepreneurship, while another 15% operate established firms.

A lot hinges on getting South Africa’s entrepreneurial culture right. South Africa is a society of extremes. A glittering modern consumer culture sits alongside – and just out of reach of – a society mired in dire poverty. South Africa’s unemployment malaise, at 25% of the workforce, is one of the worst in the world, four times the global rate of 6%. More than 16m people subsist on social welfare grants. Millions of socially mobilised and predominantly young people stand to live out lives of frustrated aspirations. There is growing recognition that the job creation outcomes of economic development are not solely about putting unemployed people to work for a wage, as important as that is, but about offering those presently excluded a stake in society.

But it would be a mistake to reduce economic development to job creation. A worthwhile economic development process is also about producing wealth and value. Economies need to understand their strengths, and how these can be leveraged. This is all the more so as the boundaries between national markets are blurring, and expanding knowledge and communication continuously open up new opportunities and vulnerabilities.

These goals – the social imperative of employment, and the economic imperative of competiveness – are not always easy to reconcile. A recent study of SMEs in the developing world drew attention to this[1]:

> “With countries all around the world struggling to recover from the crisis, job creation policies are at the top of the agenda for policymakers. Our results caution that the challenge for policymakers is not only to create more jobs, but also to create better quality jobs to promote growth. … Growth and increases in productivity require a policy focus on the potential obstacles, which range from lack of access to finance, the need for business training and literacy programs, as well as addressing other constraints such as taxes, regulations and corruption, which are the focus of an active research agenda. In addition, policies to improve entrepreneurship and innovation are likely to be important, since lack of dynamism is a distinguishing feature of developing countries and young firms tend to be productive and among the fastest growing.”

Although less part of the public conversation, considerations of competitiveness are as important for South Africa as the need for jobs. South Africa’s economy is in many respects a highly sophisticated one. It draws its advantages from efficiencies, rather than factor inputs, and will in time need to graduate towards an economy driven by innovation. This economy is the backbone of the country’s ability to underwrite its extensive welfare expenditure – the need for which even robust employment growth will not dispense with for at least a generation. Projected overall economic growth falls far short of the sustained rate of 5.4% (at a minimum) that the National Development Plan (NDP) regards as necessary.

All of this makes for a complicated, multi-faceted set of priorities: more entrepreneurs, more jobs and ever expanding economic efficiency. If anything can be done to encourage them, a clear understanding of the SME environment and SME dynamics is essential. But the South African SME landscape is poorly understood, and information about it is often fragmentary, anecdotal or simply non-existent.

SBP’s SME Growth Index aims to remedy this. An extensive annual study, it is based on a survey of a panel of 500 established firms, employing fewer than 50 people and operating in three sectors: manufacturing, business services and tourism. It interrogates the firm-level experiences and dynamics of South Africa’s SME community. The sample is randomly selected; highlighting its applicability, it broadly reflects the demographic profile of the country's business owners, as captured in the official Quarterly Labour Force Survey. It is the largest such project of its kind, and is now approaching its third round. The longitudinal nature of the study is particularly important as it allows trends over time to be identified. So far, a vast amount of data has been gathered – some 65 000 data points in the 2011 round and 235 000 in the 2012 round. This is intended as the solid, empirical evidence that has so far eluded so much of the national conversation around SMEs. The insights that this provides are unique and unprecedented.

This Alert focuses on a number of themes to have emerged from the first two rounds of the Index. In particular it seeks to interrogate how South African SMEs are faring in meeting the twin objectives of employment creation and competitiveness.

Who are the entrepreneurs?

The prominent local economist Chris Hart comments that the debate on employment creation tends to ignore the crucial variable of *employer* creation. There is no dispute that South Africa needs more entrepreneurs. More than that, it needs entrepreneurs capable not just of starting businesses, but of sustaining and growing them: in other words successful entrepreneurs.

The SME Growth Index is a study of established firms. They have survived the initial start-up, and so can offer insights into the dynamics behind firm sustainability and success. The business owners in the SME panel have, on the whole, undergone an extensive process of preparation for their entrepreneurial careers. They are far better educated than the workforce as a whole. For example, 40% have a bachelor's or post-graduate degree, as opposed to some 5.5% of the total adult population. Most of the remainder have a diploma or vocational qualification, and only 3% have not completed school. Virtually all had previous work experience, most commonly in a medium or large firm.

Another important finding of the study is the motivation for going into business. By a large margin, panellists identified "pull" factors, such as opportunity and ambition, as the driving force behind their career choices. Fewer than one in five indicated that they had been "pushed" into them, for example, through retrenchment and the lack of an alternative job.

These characteristics mirror research findings elsewhere, which show a relationship between business owners' formal education and work experience and the success they make of their businesses. For example, a 2009 study for the Kauffman Foundation in the United States found that an overwhelming 96% of respondents rated their previous work experiences as important for their latter success[2]. In economies relying on information and placing a premium on innovation, this preparation is likely to be doubly important, in developing potential entrepreneurs' grasp of industry technologies and processes.

These characteristics hold some clues for the poor entrepreneurial uptake. The well-documented failings of the South African education system mean that many young people enter the workforce without adequate academic or even cognitive training, and are unable to find work that would hone skills for a career as value-adding entrepreneurs.

Positive, opportunity-driven motivations for entrepreneurship – evidenced by most of the business owners on the panel – is also associated with firm growth. People who are passionate about the careers they have chosen are likely to strive more enthusiastically for success.

These findings correlate well with those of the Global Entrepreneurship Monitor. In its latest report on South Africa, it rates the state of education as the most problematic area for the development of entrepreneurship. It also finds that the entrepreneurial space is largely occupied by opportunity-driven people as opposed to those motivated by necessity. However, the latter point is not entirely positive. Necessity-driven entrepreneurship can certainly play an important role in South Africa's development, even if the growth expectations of such firms are smaller than those motivated by opportunity. It is not clear precisely why necessity-driven entrepreneurship is restrained. South Africans have a favourable view of entrepreneurs, but intangible cultural factors, such as fear of failure, or lack of role models probably play a significant dissuasive role. Noting the central role of "cultural and social norms" in motivating people to take up entrepreneurial careers, the report says that these were "given an unfavourable mean score by the experts, indicating that South Africa's culture does not make entrepreneurship a highly desirable career choice for its population".

What are firms' growth trends?

With an existing SME community motivated by opportunity and ambition, at least some of the conditions for firm growth exist. Both rounds of the SME Growth Index show strong aspirations among panellists to expand their businesses.

Generally speaking, this is not happening. On aggregate across the panel, turnover increased by some 9% over the period between 2011 and 2012. When inflation is factored in, the overall increase is very slight: to the point that turnover growth is probably more accurately measured, at most, as something in the region of 3%, or even as reflecting no growth at all. The most frequently cited reasons for this include adverse economic conditions, escalating business costs, a hostile regulatory environment and a shortage of skilled staff.

Skills shortages deserve particular attention. This is not only because of the acknowledged lack of skills in the economy, nor because skills raise the marketability (and therefore wages) of workers, but because in contemporary economies, they are a key to competitiveness. A recent study in the UK argued[3]:

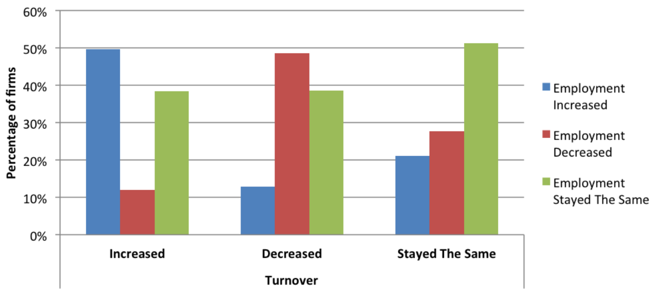
"Globalising markets and increasingly open models of innovation therefore pose significant skills and people management challenges for smaller firms. This in turn emphasises the importance for SME innovation of the national 'skills ecosystem' and related legal, vocational education and industrial relations systems."

For largely these reasons, the NDP envisages a more skilled workforce.

The SME Growth Index demonstrates a strong correlation between firm turnover growth and skills acquisition (training). A majority of firms (some 58%) whose turnovers had grown between 2011 and 2012, had invested in training for the business owner. Nearly two thirds (65%) of growing firms had invested in their employees. By notable contrast, only 26% of the owners of firms whose turnovers had declined had undergone training; and only 50% of the firms that had experienced a decline in turnover had provided training to their employees.

How do turnover and employment growth fit together?

The SME Growth Index data suggests a correlation between turnover and employment growth. Approximately 50% of firms that experienced turnover growth also reported an increase in their employment base. This is illustrated in the following graphic.



Source: SME Growth Index

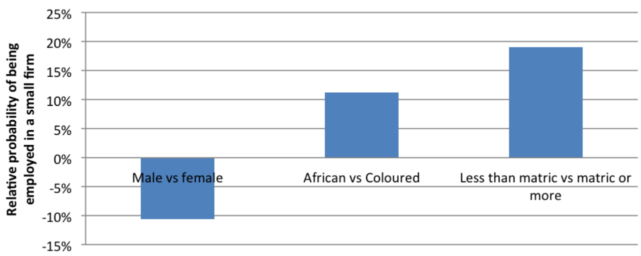
It appears that as turnover increases, it is likely that employment will do so as well. Business growth is the most frequently cited reason for increasing employee numbers: the number of panellists citing this factor is equivalent to around three quarters of the firms that increased employment. A very small proportion, around 2%, indicates having substituted labour-saving equipment for staff.

In general, healthy, wealth-producing SME growth in South Africa is, in other words, very good for jobs.

SMEs are important for job creation

With good reason, SMEs are viewed as lynchpins of successful employment strategies. SMEs tend to be labour rather than capital intensive. In fact, in the South African context, the social impact of SME hiring is underappreciated. This is because small firms employ people whose labour market characteristics make them most likely to be unemployed and marginalised. The SME Growth index found a strong bias in SMEs' hiring patterns towards unskilled employees.

Unemployment is most severe among Africans, women and those with educational qualifications below a matric (in other words, the low-skilled). If employed, however, people from these groups are disproportionately likely to be employed in SMEs. In particular, those without matric qualifications are statistically far more likely – some 19 percentage points more likely – to be employed by SMEs than those holding higher qualifications. Selected differentiators are shown in the chart below.



Source: Stats SA, own calculations

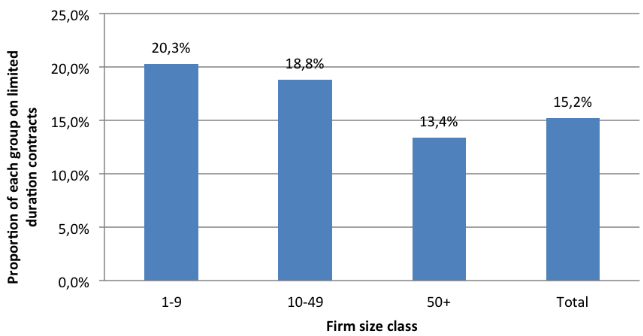
Notes: These are based on the marginal effects estimated using a probit estimator of whether a person was employed in a firm with more than 50 employees compared to a firm with less. Males are compared to females, Africans to coloureds and those with less than a matric to those with more. The model controls for gender, race, age (and age squared), education level, province of residency and time period. It uses the first 14 rounds of the Quarterly Labour Force Survey collected by Statistics South Africa (2008Q1-2011Q2).303,783 individual observations are used to calculate these figures.

A final important feature concerns age. Chronic unemployment among the country's youth has come to the fore as one of the most serious problems facing South Africa; unaddressed, it could be a permanently destabilising factor. It is in this respect that SMEs might offer their most compelling attraction. SMEs are more likely to employ young (and older) workseekers than those in middle age. Relative to a 35 year old, a 20 year old is almost 4 percentage points more likely to be employed in a small firm.

There is, however, an important nuance. Whether or not firms are adding to employment seems to be related to the ratio of skilled to unskilled workers. Firms with a larger proportion of unskilled staff are less likely to be growing than those with smaller proportions. It seems that unskilled employment has an indirect link to the availability of skills, and by implication, the efficiencies and productivity gains that they bring. Seen from this perspective, the imperatives of competitiveness and employment are linked rather than incompatible.

Unfortunately, this also means that there is a limited capacity for absorbing unskilled labour and that this is compounded by the shortage of skilled labour.

Finally, SMEs are most likely to employ staff on a fixed-term or temporary basis. Data from Stats SA shows a clear correlation between the size of firms and the use of such labour (as a proportion of overall employment in the various size categories). The smallest firms are most prone to using such labour, closely followed by SMEs of the Panel's size: 10-49 people. In each case, around one in five employees holds his or her position on a temporary or part time basis. This is substantially above the proportion employed in this way in larger firms. This is illustrated in the graph below.



Source: Stats SA and own calculations

Notes: This table has been compiled on the basis of employees with a written contract, and excludes from the calculations those whose terms were "unspecified".

Those engaged in this way arguably fulfil a wide range of functions, and are not necessarily poorly skilled. Expensive specialist skills may be required from time to time, but may not be needed permanently within a firm. However, temporary work does allow firms to engage untried, low-skilled people without the risk of being locked into indefinite obligations.

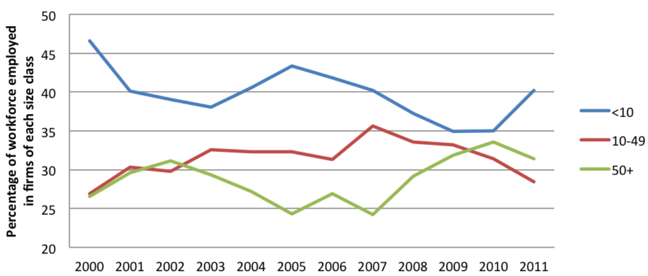
Such labour provides an important element of flexibility, allowing firms to ramp up their activities when warranted, and dispense with labour costs at other times. In a tough economic environment, these are costs that have implications for firm survival. It also clearly has the collateral benefit of allowing firms to skirt the labour regime: by taking only a time-bound responsibility for staff, employment can cease with the expiry of a contract, avoiding the potentially costly and time-consuming dismissal that might arise in relation to a permanent employee.

These factors reduce the risk of hiring untried applicants, and potentially give them a first entry into the labour market.

SMEs in the South African economy

SMEs' potential to create jobs is accepted as axiomatic. Unfortunately, this is not happening at present. Between 2011 and 2012, the Panel reported an aggregate 6% decline in permanent employment. This has a broader context.

Over the past decade, a major change has taken place in the distribution of employment across the economy. Data from Stats SA shows that firms employing fewer than 10 people provide the largest share of employment throughout this period – many of these being very small, in the informal sector, with little potential for growth. Perhaps more telling is the interplay between the group matching the SME Growth Index panel (in other words, those with 10-49 employees, those upon whom a special hope for growth and job creation rest) and their larger counterparts. They start off evenly proportioned, each at around 27% of the total. As the decade progresses, the 10-49 category accounts for an increasing share of the total, reaching a high of some 37% in 2007. At this point – more or less coincident with the global economic crisis, the share of employment in these SMEs falls sharply, and it is superseded by that in the larger firms. This is shown graphically below.



Source: Stats SA and own calculations

There is certainly an element of displacement within this trend; for example, some of the firms in the 10-49 group would have shrunk to fall below the 10 employee category. The key message here, though, is that the very SMEs that would be expected to drive employment growth are precisely the ones that have lost the greatest traction over recent years.

What prevents hiring?

If policy makers are to fashion a response to unemployment, it is essential to understand what stands in the way of employment creation at present.

The single most common hindrance identified by the Panel is a lack of demand. This is followed by a lack of skills, and by labour regulations. Interestingly, firms that are growing their staff numbers and firms that are not show little difference in the factors they identify. The single exception is the attitude to labour regulations. Non-growing firms are much more likely to report the latter as a constraint than growing firms. Not surprisingly, the types of firms which find labour regulations the most constraining are those with higher proportions of unskilled labour. This is a long-standing concern, and is repeatedly referred to by panellists in their comments in both rounds of the SME Growth Index.

This implies that some liberalisation of the labour regime would be beneficial for the creation of low-skilled jobs. A recognition of this surfaces from time to time in government thinking: Minister Gordhan, for example, commented during an address in mid-2011, that "we may have to change the way we see the labour dispensation in South Africa". However, in view of pending amendments to labour legislation, which will reduce the flexibilities available in employer-employee relationships, such liberalisation appears unlikely.

Skills shortages also feature prominently as a constraint, although in this case it was of slightly greater concern to growing firms – probably an indication that to find skills a hindrance to hiring would in many cases presuppose an intention to hire in the first place. Skills should, however, be correctly understood. They include both hard skills – which require specialised academic or vocational training – and soft skills. The latter incorporate general social, cognitive and life skills. A remarkable degree of concern is apparent in respect of the latter, with a special worry about the work ethic of younger employees. This failing is arguably a close relation of the cultural barriers to entrepreneurship that GEM has identified. There is no simple solution to this, and certainly not a purely economic one. It is a malaise rooted in a poorly performing education system, as well as broader social dysfunction.

To the extent that it can be rectified, it requires a long-term society-wide response.

SMEs and international markets

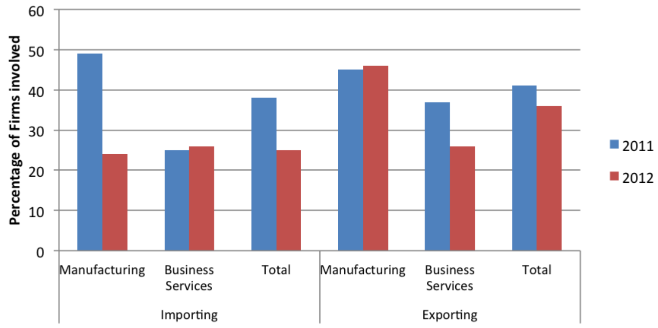
One of the key trends of the present is the growing interconnectedness, if not outright integration, of national markets. For many interest groups, this is an unappealing prospect, but it is not one that can be wished away. Indeed, with proper analysis and appropriate innovation, it is one that holds out significant opportunities. Foreign markets – such as Africa's growing middle class – offer commercial opportunities that may not exist within limited national markets. Value chains are increasingly global in nature. The benefits to SMEs from exporting are considerable. The NDP specifically envisages them doing so.

It is not alone in this. For example, a recent study of SMEs in the US reports a growing number of SMEs are exporting, along with a rising interest in doing so on the part of many that are not. Says the chair of the US National Small Business Association: "The growth we're seeing in small-business exporters underscores a broad change in attitude about exporting. Not only are small businesses seeing growing opportunities available to them via exporting, they increasingly view their goods and/or services as valuable in a global marketplace[4]."

It must be noted that importing and exporting only relate to manufacturing and business services – tourism firms obviously do not operate in the same way. In 2012, the SME Growth Index found that around 36% of firms (excluding those in tourism) exported and 25% imported. Overall, manufacturers are more engaged with foreign markets than business services firms.

Importing and exporting are not opposed activities. They are often part of the same continuum. Imports are frequently necessary as inputs into a local production process. Such products may even then be exported. Imports may also allow a local industry to exist by providing cost-effective inputs or capital goods that could not be obtained locally.

The 2011 and 2012 rounds of the Index together indicate a noteworthy development: there has been a contraction in firms' involvement in international markets, with proportionately fewer importing and exporting.
This is illustrated in the following graph.



Source: SME Growth Index

These changes are in some instances significant. For example, the proportion of manufacturing firms involved in importing halved over this period. What explains it? The most obvious explanation for this change is the exchange rate. In July 2012, 1 US Dollar cost about R8.20 compared to R6.70 a year earlier. This depreciation made it more expensive for South African businesses to import. Unfortunately, hopes that some interests may have harboured for a depreciation-driven export surge were not met. Manufacturing exports rose marginally, but exports as a whole declined.

Advantages that may arise from a weakened currency need to be measured against whether local inputs can be obtained cost-effectively and efficiently. One panellist alluded to the complexities of depreciation: "Input costs versus importing goods makes it more viable to import. This would solve a number of problems i.e. I would not have any more drama from unions, labour, electricity etc." To this might be added the fact that building productive capacity in the first place often involves importing, whether capital goods or intermediate inputs. These may be difficult to obtain, and sharply increased prices as a result of currency changes may be detrimental. In other words, from the perspective of the Panel, depreciation (at least on its own) is not a viable strategy.

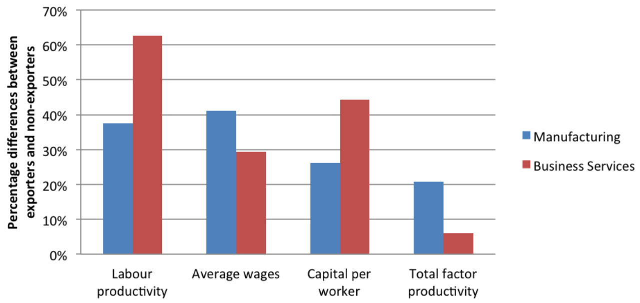
What then are the prospects for South Africa's SMEs to expand their export efforts? Among firms in the Panel that do export, this is typically a subsidiary activity rather than core business. Some 80% derive less than 20% of their revenue from doing so. Only around 7% of manufacturers export all their production. The biggest export market is the SADC region, followed by Africa beyond SADC. North America, Europe, Australia and New Zealand follow. Interestingly, despite official enthusiasm for the Brazil-Russia-India-China (BRICs) group, very few SME exports go to Asia or South America.

There is considerable interest in exploring foreign markets on the part of firms in the Panel not currently exporting: around a third of manufacturers and just under a quarter of business services firms intend looking for markets in Africa with smaller proportions looking at other destinations. Some panellists comment that doing so is a sustainability strategy, since South Africa cannot provide the necessary opportunities. For example, one business services panellist said: “Withdrawn from the market, gone into other African countries”. Far fewer are interested in setting up plants or offices abroad.

The ability to export is a function of competitiveness. South African SMEs have demonstrated an ability to cultivate new markets (market expansion into Africa outside South Africa’s neighbours has occurred largely over the past 20 years). Abundant evidence exists from across the world about the firm characteristics associated with exporting. Exporting SMEs tend to be larger in size than non-exporters. The wages they pay their employees tend to be higher. They also tend to have higher labour productivity and to be more capital intensive. These correlations come across very clearly in the SME Growth index. Exporters have higher levels of labour productivity (63% higher for business services and 38% for manufacturing), they pay, on average, higher wages (41% higher for manufacturing and 29% for business services) and are more capital intensive (26% for manufacturing and 44% for business services).

Most interesting is total factor productivity (TFP). It has been termed a “residual” measure: it accounts for productivity gains once clearly measurable factors such as hours worked and capital invested are excluded. The Economist terms this firms’ “secret sauce”, measuring how well they are faring with firm efficiencies, technological adoption, innovation and dynamism. More than any other measure, TFP gives insight into firms’ ability to secure the knowledge-based competitive advantages that are so important in the contemporary economy. In this respect, exporters in the Panel perform better than non-exporters, particularly in manufacturing. For manufacturers TFP levels in the Panel are more than 20% higher than non-exporters, and for business services firms 6%.

All of this indicates that in addition to investing heavily but effectively in their businesses, exporters have clearly gained advantages in terms of management and adaptability. This information is shown in the graphic below.



Source: SME Growth Index

Enhanced productivity and, by implication, general economic competitiveness and performance is critical. Assistance in these areas would help get non-exporters to a point where their competitiveness mirrors that of exporters. At this point, they can seriously consider taking advantage of export opportunities. And as guidance for policy direction, it makes more sense to assist current exporters to expand their footprints – by supporting their market penetration, providing guidance on the target market, or perhaps by support to assist high potential exporters to operate more competitively – than to help non-exporters get going from scratch.

Red Tape

The appropriate balance between social and economic imperatives comes into sharp relief in examining an economy’s regulatory system. While few dispute the necessity of regulation, the compliance burden it places on firms needs to be proportionate to the goals it is meant to achieve. This is not always the case. A report by the Economist Intelligence Unit observed that “it is an irony of modern business that regulation, a concept designed to reduce risk by protecting the interests of corporates, customers and society at large, has itself become one of the most serious risks that companies face”.

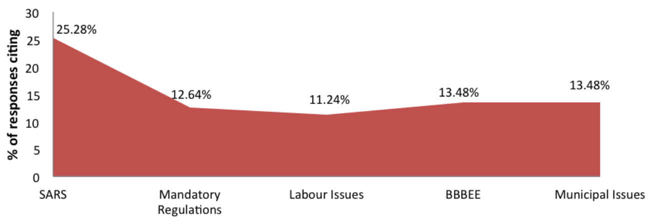
A heavy regulatory burden weighs on SMEs more than on their larger counterparts. For this reason, an environment nurturing to SMEs will be one in which regulations are prudently thought through with regard for their impact on business performance, and in which they are administered competently.

South Africa's regulatory environment has been a matter of concern for years. In 1994, the RDP White Paper promised "favourable amendments to legislative and regulatory conditions" for SMEs' development. This has not transpired; some years ago, Minister Gordhan described South Africa's efforts to assist SMEs as "pathetic". As one panellist succinctly put it: "compliance as a whole is a huge issue – (there is) just too much".

The SME Growth Index shows that SMEs are spending some 4% of their turnovers on compliance costs. And because it tends to impose "fixed" costs, it is felt more severely by smaller firms than by larger ones.

Red tape is interrogated at various points in the SME Growth Index. Panellists cite a wide range of factors, but a small group dominate the responses. Asked about which aspects of red tape they find most costly and frustrating, the top five account for some three quarters of responses. These are: inefficiencies in the South African Revenue Services (SARS); mandatory regulations; labour laws and regulations; Broad-Based Black Economic Empowerment (BBBEE); and municipal issues. These are shown in the following graphic.

Top five most costly and frustrating red tape issues over past year



Source: SME Growth Index

Inefficiencies within SARS, and the demands they impose on SMEs, are repeatedly raised. Most frequently cited are the difficulties that panellists encounter in obtaining tax clearance certificates. As foundational documents for many if not all transactions – such as tendering for business – not being able to obtain them timeously has extreme knock-on effects. These are felt by many of the panellists.

SARS is seen as adhering to an ethic of punishment rather than of facilitation, and of penalising firms for its own failures. These problems are illustrated in the case of a small business whose owner was interviewed by SBP. Having been subjected to a VAT audit, the firm was presented with a demand for payment that excluded its input claims. The demand was, in other words, for an amount that the firm could not have owed, and which would have compromised its cash flow badly. When the firm queried this, it was told that the problem arose from late capturing of the data. To rectify the situation, an objection would need to be lodged – which in SARS own estimation could take months to resolve. Calls to the monitoring centre were unhelpful as no one could assist. Meanwhile the firm needed tax clearance certificates to tender for business – but according to SARS' systems, it was unable to obtain them because it was not compliant. Eventually, the firm was able to trace the official working on the case, and in this way the matter was resolved. The process had taken around a year. The costs of this, in the estimation of the owner, came to around R50 000 in direct and opportunity costs, took around 100 hours, and involved dozens of phone calls. It also resulted in the loss of a substantial contract, for lack of a clearance certificate. SARS ultimately refunded the firm R500. The firm owner comments: "They (SARS) don't care. Small business doesn't have the resources to handle this. It needs one point of contact to solve this (sort of problem)."

The inefficiencies within SARS, and the difficulties that these create for SMEs, need to be addressed urgently. Dealing with queries and complaints quickly and efficiently would make a positive difference. A tax ombudsman, an institution introduced by the Tax Administration Act of 2011 (but not in fact appointed), with the authority and resources to investigate complaints should be introduced.

SARS is only one of numerous sources of red tape; each such source will tend to impact on a specific part of the SME community. For example, labour issues are of particular concern to manufacturers, municipal issues to tourism firms and mandatory regulations (such as those arising from the Financial Advisory and Intermediary Services Act) on business services. The concerns they provoke tend to be fairly consistent across the panel, and also consistent with the problems arising in relation to SARS. Panellists feel that a great deal of time, effort and money is required to remain compliant – in return for few benefits – while the administering bureaucracies are inefficient.

Red tape and future growth

When asked about barriers to future growth, panellists ranked red tape prominently. Around one in five panellists name it as their greatest concern. It is the second most frequently cited concern, after municipal rates and services. Red tape is, remarkably, a greater concern than either the local or global economies.

Panellists expect the red tape burden to increase in future. Early 2013 was marked by fierce debate about the Licensing of Businesses Bill. Government officials justified the bill in question on the basis that it would combat competition from illegal immigrants, and trade in counterfeit goods, although such practices are crimes under already existent laws. The bill would, if implemented, have required everyone conducting any sort of business to be licensed by a local authority. It would empower thousands of state officials to conduct inspections and to confiscate goods from transgressors. It also set punitive penalties (including prison terms) for those not compliant. The administrative burden this legislation would impose on smaller scale businesses, both informal and formal, is self-evident. Given the deficiencies in municipal governance, there is little plausibility that it could be applied efficiently or uniformly in large parts of the country. Many business owners would likely be made non-compliant through inefficient processing of their applications. There would also be a distinct prospect that corrupt officials would use it as a tool to harass business operators. In all respects this bill was a matter of regulatory burden without any visible redeeming benefits.

Following widespread public condemnation, the bill was withdrawn to be redrafted. However, Minister of Trade and Industry Rob Davies defends it as not constituting red tape, since he describes red tape as unnecessary regulation[5]. This must be questioned. All regulation is red tape, and regulation invariably places burdens on business. The extent to which this is justifiable depends on striking a prudent and proportionate balance between this burden and the social or economic benefits it provides.

These costs, direct and indirect, can be substantial, and can disrupt firms' prospects of success. Because of the smaller capacity available to them, SMEs feel the regulatory burden more heavily than larger firms. Mirroring the experiences of a number of Index panellists, the Organisation for Economic Cooperation and Development comments[6]:

> A major consequence of the asymmetric rise in fixed costs is not only the diversion of scarce financial resources away from productive investment, but also, and equally important, the absorption of management time. Both are critical for SMEs. Investment ability may be compromised if the cost of compliance to regulation deflects an excessive amount of resources, including capital as well as current expenditure. Absorption of management time implies that scarce managerial resources cannot be used for directing the strategy and managing the operations of the enterprise.

The SME Growth Index demonstrates a need for regulatory reform. This is by no means an argument for complete deregulation. Regulation is necessary, but South Africa needs better regulation: better in its design, more efficient in its application and less demanding on the time and resources of those subject to it. This calls out for better and more serious use of Regulatory Impact Assessments. In an economic environment in which so many other threats confront firms, it is imperative to deal with those issues that lend themselves to action.

It is also clear that prudent policy requires keeping a constant watch on the manner in which regulations interact with circumstances. There is no ideal state of regulation for all times and circumstances. While regulation is necessary, and costs incurred through it justified, more economical means of achieving goals may arise over time.

Conclusion

As a contributor to a strategy for tackling South Africa's economic and social challenges, a thriving SME community has few equals. SMEs' general tendency towards labour intensity and the openings they offer to the lesser skilled highlight the priority that should be

accorded to their growth and development.
At present, the dominant narrative is about what is failing to happen: the SME economy is largely stagnant, and is a long way from the purposive, wealth-and-job-creating growth that the country desperately needs.

If this is to be turned around, it is likely to require a reorientation of the manner in which the SME environment is approached. SBP has previously argued that "it is as if South Africa recognises that it needs small businesses, but has not yet realised fully that small businesses have needs." Enthusiasm for the social and developmental outcomes expected from SMEs must be accompanied by an equal acknowledgement of the conditions that they require to function and grow. It also requires recognising that an SME is a business and its ability to provide any benefits to society depends on its commercial viability in the market.

The key consideration, in other words, is competitiveness.

South Africa is buffeted by both domestic and international turbulence; but some things are within South Africa's control and some are outside it. With a struggling global economy clearly beyond South Africa's control, the imperatives of managing those things within the country's control are ever more urgent.

Most immediate among them is to rethink the regulatory environment. SMEs are contending with an environment ill-suited to their needs. They face numerous demands for compliance, and find that these are often indifferently managed by the officials responsible. Proper assessments of the costs and benefits of regulations are called for. Regulation is necessary, but it must take place with a clear eye on its implications for competitiveness.

Another need is to escalate the potential for firm productivity. Dealing with this encompasses a wide range of possible activities: investment in capital, innovation, upskilling, to name three. South Africa's skills shortage is a prime problem. It is also one that cannot be addressed solely within the workforce. The roots of the problem are in a problematic education and social system, and need to be addressed at that level.

The latter point serves to illustrate that SMEs function within the circumstances of their host societies and their prospects are influenced by them. Their potential is influenced by such "non-business" factors as the quality of education, healthcare and policing. In this regard, the call in the NDP for a "capable state" cannot be supported too enthusiastically. Successful SMEs would be well served by, and would well serve, a successful society. The comment by a senior official of the Small Enterprise Development Agency that "small enterprise development is everyone's business"[7] is probably more widely applicable than even he may have realised.

Likewise, suggestions for a ministry of small business must be viewed with scepticism. First and foremost, SMEs are businesses. Integration into the broader economy is non-negotiable to their success. Their success lies in linking into value chains on rational commercial grounds, and not on political support. Indeed, the Department of Trade and Industry has warned of the potential for such an institution to "ghettoise" SMEs. This warning should be taken seriously.

All of this is not to say that there are no grounds for special consideration for SMEs. They do not have the same capacities to focus on their non-core business as larger firms, they often operate with tighter margins, and many SMEs represent a first attempt at entrepreneurship. Assistance in the forms of training, finance or exposure to markets (local or foreign) can be greatly beneficial.

Perhaps most of all, South Africa needs to cherish its entrepreneurs, and its entrepreneurship. A past report from the Global Entrepreneurship Monitor commented: "In an ideal entrepreneurial environment, the pull factors should outweigh the rest. Only then can one say that a true entrepreneurial culture exists in a country."[8] This is equally applicable to the environment that attracts people to entrepreneurship and to the environment that makes it possible for them to thrive. Minister in the Presidency, Trevor Manuel, has called for serious action on the NDP; helping SMEs thrive would be a good place to start.

End Notes

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business environment specialists sbp

79 Oxford Road, Saxonwold, Johannesburg, South Africa
PO Box 1051, Houghton 2041, Johannesburg, South Africa
T +27 11 486 0797, F +27 11 486 0798
www.sbp.org.za
info@sbp.org.za
www.smegrowthindex.co.za

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