business environment specialists sbp

alert

Bulletin 2 2015 | An sbp occasional paper | www.sbp.org.za

2015 SME Growth Index Headline Results

Contrary to global trends where small and medium enterprises (SMEs) constitute the largest employer in either developed or developing economies, established small firms in South Africa are showing a decline in employment, turnover and a majority are struggling to survive.

These worrying trends are the latest in the findings from SBP's 2015 SME Growth Index. An extensive annual study, the SME Growth Index is based on a survey of a panel of 500 established firms, employing less than 50 people and operating in three sectors: manufacturing, business services and tourism. The study's panel was 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. The SME Growth Index is the largest, most comprehensive study of the SME community ever undertaken in South Africa, and one of a few of its kind worldwide. The data assembled over the years since its establishment in 2011 provides unparalleled insights into the lived dynamics of South African SMEs.

This Alert focuses on key themes to have emerged from the 2015 SME Growth Index - the fifth annual round of the study. In particular it reports on how South African SMEs are faring in terms of employment, turnover growth and their survival in a tough economic climate.

How are SMEs performing?

Just over one in five firms of the panel reported a decline in turnover from the previous year and a further twenty percent reported no growth in turnover in the same period. Only fifty six percent of the panel reported an increase in turnover at an aggregate annual increase of just on eleven percent, marginally better than the nine percent recorded in 2012 but down from an average of thirteen percent in the previous year.

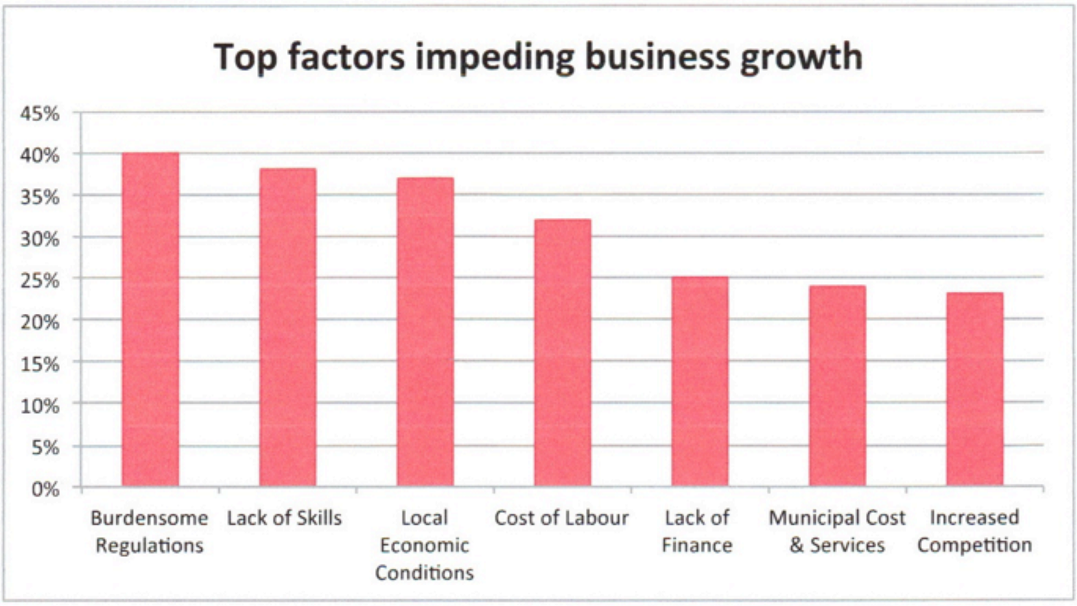
Burdensome regulations represent the top factor impeding business growth

Year on year changes in the sub-indices of the SME Growth Index are showing downward trends. Seventy eight percent of the panel report that the business climate is becoming increasingly hostile to their firm growth, representing the highest number of firms reporting this since the SME Growth Index base year in 2011.

Asked what constituted the top factors that inhibited the growth of their firms over the past year, SMEs reported burdensome regulations in the first place (40%), followed by lack of skills (38%), closely followed by local economic conditions at 37% and cost of labour at 32%.

While the extent of the regulatory burden has been repeatedly raised by the firms as a top factor impacting on their firm growth since the study's base year, it has risen to the top impediment to firm growth for the first time in five years. Over seventy five percent of the panel report that the amount of red tape has increased, up two percentage points from the previous year.

From a competitiveness perspective, the increasing regulatory burden is deeply concerning. South African firms are operating under severe and adverse circumstances, which firms in competitor economies may not have to contend with. The challenges of the overall business environment appear to be driven mainly by domestic factors, rather than global conditions.



External shocks

Coupled with an increasing regulatory burden, the study also investigates the impact of external shocks on the firms' profitability. Panellists surveyed were far more vulnerable to external than to internal shocks than in the previous years. Contraction in the market was the largest single shock experienced by small firms in 2015 – over thirty five percent of the firms reported their bottom lines having being hit by this. The second highest external shock was rise in input prices (34%), followed by increased competition (32%), increased electricity costs (32%), currency volatility and increased transport costs (26% and 25% respectively).

Late payments

These findings collectively translate into significant cash-flow problems for the enterprises; the life-blood of a small firm. Over thirty eight percent of the panel reported a significant cash-flow problem, up two percentage points from the previous year.

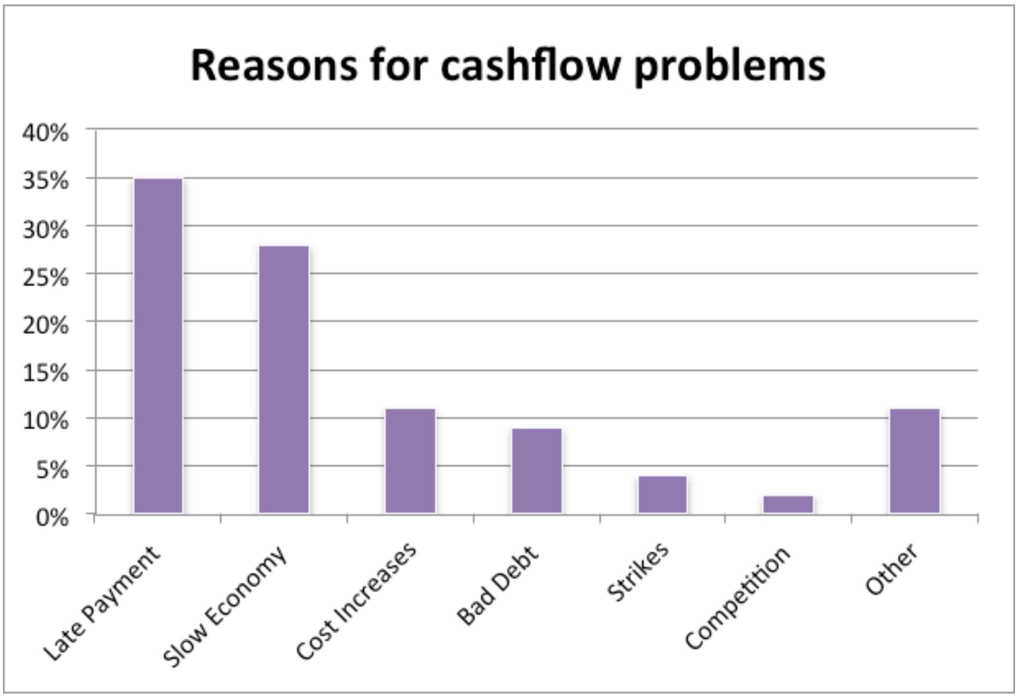
The large proportion of firms reporting cash-flow problems attributed this to late payments from their clients and a slowing down in economic activity in their respective industries. Cost increases and margin squeeze together with bad debts have also contributed significantly to the firms' cash crisis. Panellists report that it takes on average between 46-60 days to receive payment. One panellist sums up the problem noting: "Customers are dragging their feet; those that usually paid in 30 days are now only paying in 60 days ... it puts a huge pressure on the business".

Related to cash-flow problems is the levying of VAT on invoices rather than on receipts. Firms often become liable for large bills to SARS before they have received any actual payments for a particular sale. In a tough economic climate, the knock-on effect from late payment and paying VAT up-front has a serious impact on the firm's ability to survive.

Are SMEs employing?

The number of firms reporting a decrease in staff has spiked for the first time since the SME Growth's base year, from eighteen percent in the previous year to twenty one percent in 2015.

The shrinking role of small firms as job creators in South Africa has a troubling dimension. Not only could they be sources of dynamism and economic growth for the country – as they are in other economies – but as previous findings from the SME Growth Index show, smaller firms employ the type of people whose labour market characteristics mirror those of the unemployed and most marginalised in our labour force.



The SME Growth Index has found a strong bias in SME hiring patterns towards unskilled employees. Those without matric qualifications are statistically nineteen percentage points more likely to be employed by SMEs and SMEs are more likely to employ young work seekers than those in middle age. Relative to a 35 year old, a 20 year old is almost four percentage points more likely to be employed in a small firm.

It is with good reason that SMEs worldwide are viewed as lynchpins of successful employment strategies. The SME Growth Index findings send an important message to government: given the right conditions, SMEs in South Africa could provide an important source of employment for the most marginalised in the South African labour market.

Key messages

For a country desperately needing economic growth, few goals can be as important as the growth of the SMEs, which constitutes over sixty percent of South Africa's business community in terms of employment. While government's efforts have been on encouraging new business start-ups, the SME Growth Index has consistently shown over the years that older firms – those that have been operating between 5 to 10 years and older show a greater ability to take on new staff in larger numbers.

Key to getting job creation and SME growth on track is reforming South Africa's business environment. The evidence is clear that our SMEs are confronting tough, hostile operating conditions. Along with standard commercial pressures – which in the prevailing economic climate are themselves daunting – SMEs are operating in an environment in which governance and social failings are imposing numerous additional burdens.
The current downward trend in turnover and employment absorption shown by SMEs is bad news for South Africa. The latest findings of the SME Growth Index, coupled with those taken from previous years, point to some important messages for government:

- Dealing with the increasing regulatory burden must be a priority of government for changing the dynamics of the business environment. Red tape saps considerable resources from all businesses, but even more so among SMEs. Despite government's acknowledgement of these problems, the SME Growth Index findings show that the burden of the government regulation has increased year on year.

  Every existing and new government policy and regulatory initiative must be looked at through a lens as to whether its effect on business – especially SMEs, job creation and economic growth will be positive. Failure to do so poses a very real threat of collapsing the growth and job creation prospects of South Africa's SMEs irreversibly.

- Late payments coupled with paying VAT on invoice are having a crippling effect on the ability of SMEs to survive and grow. Businesses have to carry the 'cost' of VAT, which must be declared to SARs, until it receives payment from the customer. The various thresholds applied to VAT compliance play a role in how regularly the business has to file their VAT forms, which can be as often as every two months for firms with a turnover of less than R30-million a year. For many SMEs the cash flow of the firms generally does not accommodate the money needed to pay VAT when it is due. While SARS has tried to address this issue with the turnover tax, the qualifying criteria excludes the majority of small businesses. Consideration needs to be made towards lifting the thresholds relating to turnover tax to allow more small businesses the flexibility of when they have to make VAT payments and in reducing the compliance burden associated with paying VAT for smaller firms.

- South Africa's labour environment remains a key problem for SMEs. Labour legislation has repeatedly been identified in the SME Growth Index and in many other studies, as a prime burden to smaller firms, and a major negative consideration for hiring. For manufacturing firms, the extension of collective bargaining agreements is particularly onerous and has a direct effect on their decision to hire new people.

  As a community, SMEs are not taking on staff in large numbers as they are elsewhere in the world, depriving those least competitive in the job market of the opportunities to earn an income and the dignity of work. In a country where unemployment levels have reached global highs, the sustainability and growth of our SMEs should be of utmost importance to government. Labour laws that allow SMEs to enlarge, and reduce, their workforces faster and less expensively need to be considered, as do tax incentives that reward SMEs showing growth and employment in real terms.

If small business is not growing as it must, and in accordance with the goals set out in the National Development Plan, the question is why. The latest headline findings of the SME Growth Index signal a crisis in confidence on the part of South Africa's SME community, driven in part by an excessive focus on regulation combined with a tough economic climate.

The signs are crystal clear – the business climate for SMEs is becoming ever more hostile. There needs to be a quantum change in government's thinking if conditions are to become any better for SMEs to grow, employ more people and prosper. Data collected from the SME Growth Index shows that what SMEs need and what they want are primarily opportunities to achieve success and an environment to make this possible. This, rather than political intervention or subsidies is what will help them to thrive.

The 2015 SME Growth Index is supported by SBP with additional funding from the Friedrich Naumann Foundation for Freedom and the National Treasury of the Government of the Republic of South Africa.

business environment specialists sbp

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.

79 Oxford Road, Saxonwold, Johannesburg, South Africa
PO Box 1051, Houghton 2041, Johannesburg, South Africa
T +27 11 486 0797, F +27 11 486 0810
www.sbp.org.za
info@sbp.org.za
www.smegrowthindex.co.za

SBP acknowledges the financial contribution of the Friedrich Naumann Foundation for Liberty.