

## Accelerating small business growth in South Africa

### A roundtable discussion

Our previous SBP Alert, *Small business development in South Africa: Time to reassess* (August 2009) argued that it was time to acknowledge that South Africa lags behind other developing countries in promoting the growth and sustainability of small businesses; and that the impacts of government initiatives in this sector over the past fifteen years have fallen far short of what is needed to support job creation. Taking stock of these disturbing realities, we contended that effective small business development on the scale needed will require a new, sustained engagement between the private sector and government at all three levels – national, provincial and local.

The publication struck a responsive chord among a wide range of people concerned with small business development issues. Clearly, the time is ripe for a more concentrated engagement in this area.

As the next step to help take the process forward, SBP hosted a small high-level roundtable discussion at the end of September to tackle topics central to a creative debate.

Participants in the roundtable were drawn from government – including the Presidency – business chambers, parastatals, research organisations, and major private sector players engaged in small business development.

This is an edited version of the day's discussion, summarising key points that emerged.

## Impacts of the global economic crisis

*“What began as a financial crisis in a handful of industrialized economies continues to spill over into the real economy, engendering massive contractions in consumer demand, rising unemployment, and mounting protectionist pressures worldwide. Developing countries have not been spared from its fallout; many are now facing slumping demand for their export products along with falling commodity prices, significant reductions in foreign investment and remittances, and a more general liquidity shortage. The strong interdependence among the world’s economies makes this a truly global economic crisis in every sense.”*

Klaus Schwab’s opening words in his Preface to *The Global Competitiveness Report 2009-2010* (World Economic Forum, October 2009) establish the context for the roundtable discussion.

Efforts to support SME development in South Africa must take account of harsh global realities, with declining domestic and foreign markets, and increasing competition from foreign firms. These forces will shape the business environment for years to come.

- The developed world is doing all it can to support its enterprises to break into the developing world’s markets, and South African SMEs are likely to experience increased competition in our domestic market. Protectionist policies might be counter-productive, however – many small businesses say that tariff and trade barriers hurt rather than help them.
- In addition, the strong Rand is currently hurting many domestic businesses.
- South Africa is likely to see a proliferation of fragile micro businesses in the next few years. As more and more people are retrenched, they are starting up survivalist businesses because they have no other options. With greater numbers of people being forced into survivalist businesses, the customer base for goods and services must inevitably shrink, and there will be fewer people to whom these micro-businesses can viably provide goods and services.
- At the other end of the spectrum, South Africa’s medium sized businesses – especially exporters – will be hard-pressed. Their challenges and needs differ in many ways from those of smaller businesses. National and local government policy-makers must give conscious attention to this segment, to reduce constraints, stimulate their activities, and ensure as favourable an operating environment as possible.
- Small business development initiatives must focus much more strongly on opportunity-driven entrepreneurs who can generate new business ideas, mobilise resources and create jobs.
- It is critically important to develop and expand value chains that can accommodate and grow small businesses, for example in the agricultural sector.
- A sustained and vigorous effort to attract more foreign direct investment must be seen as an integral element in small business development policy, as part of the strategy to expand local supply chains. A decline in FDI creates big problems for small firms.

The developed world is doing all it can to support its smaller enterprises to break into the developing world’s markets

## Conceptualising the sector for targeted policies

Do we need new ways of thinking about SMMEs? Is it sensible or useful to use an acronym which obscures more than it denotes? This segment of the economy is very

heterogeneous, with businesses ranging in size from micro-enterprises to quite large firms. For policy purposes it is certainly not good enough to think of SMMEs or 'small business' in general terms. No single policy can cover all of these businesses, formal and informal, operating in different industrial sectors and with many sector-specific challenges. Data categories should be sufficiently differentiated to provide detailed and nuanced information to support targeted policy approaches and practical interventions.

- Should medium-sized businesses really be yoked together with small businesses? And should micro-businesses perhaps be treated as a distinct category?
- In practice, SMMEs are defined in a number of different ways, generally with reference either to the number of employees or to turnover bands (or a combination of both, as in the National Small Business Act 1996, which also allows for variations according to industry sector). The Act's categories aren't used consistently by state agencies or by private sector data-bases and research studies, making comparisons difficult and unreliable. For statistical purposes, it would make a great deal of sense for the various data-gathering bodies in the public and private sectors to arrive at – and use – agreed categories covering the SMME sector.
- The definition of SMMEs by size is necessary, but it is not sufficient for an understanding of a sector where the realities are not only complex, but also dynamic.
- We should widen the perspective to include stages of growth – this could be a more useful tool for understanding how to help firms grow, create jobs and become more robust.

## South Africa needs better data

Our information sources on the sector are poor; and they are also very difficult to access, particularly the official statistics. We don't know how many small businesses there are, how many people they employ, or what the sector contributes to GDP. Because of the paucity of data, it's hard to say what works. You can't have evidence-based policy in the absence of evidence.

However, government has realised that the situation is highly unsatisfactory, and the issue of information needs is to be considered at Cabinet level.

The points below highlight key issues that should be taken into account, to improve the quality and usefulness of small business data.

### *The current scene*

- Surveys are sporadic, and it isn't possible to put together the pieces from different data sources.
- A nation-wide small business baseline study is needed urgently; but even a national survey will be of limited value unless it can also track companies over time.

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- In theory, the South African Revenue Service should have excellent data but it is not publicly available. However, it is possible that even SARS might be missing a considerable amount of data.
- Statistics SA draws small business data from SARS and is reluctant to share information, which it regards as confidential to government.
- The Companies and Intellectual Property Registration Office (CIPRO) should have good databases, but as business activity is not monitored their lists include many inactive companies.
- The National Credit Regulator is required by law to set up a national credit register, and a proposal is with the dti, awaiting approval. The register will include small businesses with turnover under R50 million.
- Business Chambers could potentially play an important role in data collection at the local level (in some countries Chambers are responsible for CIPRO-type business registration); but they would need to use the same data-collection model across the country.

### *What should the data be able to tell us?*

- We need information on the size and spread of the SMME sector (including location, sector, and age of business).
- Each firm should be allocated a unique identifier number that would allow the firm to be tracked across the different public sector databases (SARS, CIPRO, Stats SA).
- It must be possible to match information across data sets to provide a composite picture of industry sectors.
- Company performance must be tracked by sector and over time, to identify trends and factors affecting growth or failure.
- Above all, information must be put into the public domain, and be freely available to the private sector and researchers.

**Small business development initiatives must focus more strongly on opportunity-driven entrepreneurs who generate new business ideas, mobilise resources and create jobs**

## **Accelerating and consolidating small business growth**

The development of a more robust, energetic and innovative small business sector in South Africa requires multi-faceted mutually reinforcing approaches. South Africa's weak entrepreneurial culture is now becoming a focus of attention, and some serious initiatives are beginning to address the issue. From a broader business perspective, however, it is equally important to raise awareness that value-adding activity is crucial. Far too many small business owners don't see that they can and must move their businesses up the value chain, particularly if they want to break into export markets. As one roundtable participant put it graphically, "There is a huge difference between producing raw nuts, and processing and packaging them." South Africa needs to support small industry more vigorously. Small businesses can create more economic activity through import substitution and by developing their own products. Training appropriately skilled employees is a further vital dimension for business development based on value-add. And the regulatory, administrative and operating environment must be constantly monitored to uncover and remove constraints on small business growth.

## Procurement and payment difficulties

Businesses in a metropolitan municipality interviewed recently by SBP reported that procurement procedures aren't standardised: different departments and agencies have their own documentation, and procurement policy does not appear to be uniformly followed.

They expressed frustration with the procedures involved in registering as approved suppliers on departmental databases and panels. In many instances national supply chain management guidelines are misinterpreted or incorrectly applied by municipal departments.

Small businesses are at risk when they experience cash flow constraints, and late payment from clients can seriously impact on their viability. National supply chain management regulations require municipalities to pay for goods and services within a month of being invoiced. In practice, waiting times are unpredictable.

Businesses said that delays in obtaining purchase order numbers from departments in turn delay the submission of invoices. According to one respondent, "Purchase order numbers can take days or can be provided immediately, depending on the person you're dealing with." According to another, "Certain people can get you your payment within a week for a very large amount, at other times you wait over 160 days for a relatively small payment." Final payments, or payments to settle budget deviations, can apparently take over six months, despite relatively small amounts involved in many cases.

## *Value chain and procurement opportunities*

- Public procurement processes could be a major stimulus for small business growth; but in practice inflexible government tendering specifications and contracting all too often prevent small enterprises from qualifying. The current system does not actively support the growth of small business. There should be an educative element built into procurement processes to help improve small businesses' capacity to respond successfully.
- To open up opportunities for small business to supply goods and services in the public sector, and develop local supply chains, contracts should where possible be broken down into smaller components (for example, it was mentioned that Defence Force regional bases buy bread from a central supplier at inflated costs compared to what they would pay local suppliers).
- BBBEE score-carding requirements will have negative unintended consequences on small businesses. In awarding contracts there should be a greater emphasis on whether businesses can actually do the job – which would serve to strengthen the more viable enterprises.
- We need a massive and sustained campaign in government at all levels to raise awareness of the potential role that public procurement can play in small business growth and local economic development – essentially, to "think small business first".
- Local governments, Chambers and larger businesses operating in particular localities should collaborate more actively to develop opportunities for business linkages that will expand small businesses' participation in local value chains.

**Public procurement processes could be a major stimulus for small business growth, but current practices don't actively support this**

## Impact of crime on small business

According to the recently released 2009 national crime statistics, there were more than 70 000 burglaries at business premises, up from 63 000 in 2008; while there were close on 14 000 robberies – an increase of over 4 000.

South African crime statistics do not differentiate between the sizes of businesses affected. However, the negative impacts of crime on small businesses were highlighted by a survey SBP conducted in 2007 among black business owners in inner city areas, townships and informal settlements in Cape Town, Durban and Johannesburg.

Over half of the businesses had experienced at least one incident of crime in the past year. Burglary and robbery accounted for over 60 percent of these crimes. Almost a third of these businesses had been victimised twice or more, and almost one fifth three times or more.

A quarter of all respondents – and almost a third in townships and informal settlements – said they were unwilling to expand or invest further in their businesses because of crime.

## *Incubation and new business support*

- Incubation can be an effective and flexible tool for small business development, and we need more of these programmes. However, this is an expensive and resource-intensive approach, and it is important to monitor programmes' effectiveness and return on investment. It is also necessary to guard against creating dependency.
- New businesses need the whole package – from business plans to access to funding and operational support.
- In the private sector, incubators are largely driven by commercial considerations. Where the financial success of the initiating companies is related to the success of the incubated businesses, this creates an incentive to make sure that programmes work. Selection criteria can also be more demanding than in public sector programmes.
- In the nature of things, government-sponsored incubation programmes have to be open to a wider range of aspirant small businesses. Even so, filtering criteria could and should be tightened; business plans should be evaluated more realistically; and the business skills and capacity to provide practical support to small business must be geared up significantly. Where programmes emphasise quantity over the quality of participants there are too many dropouts and resources are wasted.
- A greater emphasis on public private partnerships in business incubation could help to increase efficiency. As far as possible the primary focus should be on supporting real entrepreneurs, who can grow their businesses and thereby create employment for others who are not temperamentally equipped for an entrepreneurial role. Private sector-driven models can provide more intensive support than government initiatives, working with businesses with real growth potential.
- In this context, government should play a much greater role as a facilitator, encouraging private sector companies to provide incubator services for a broader range of small businesses, through incentives such as tax breaks, or a voucher system enabling new businesses to access training and (say) six months back office services, for example.
- BBBEE requirements can also be used to encourage businesses to put money into enterprise development which can be scaled up through private sector investments.

**SME development  
in South Africa must  
take harsh global  
realities into account**



## The business environment: Constraints to doing business in Gauteng

A recent survey conducted by SBP, covering more than 500 businesses in Gauteng across the different size bands, probed the major challenges they face when doing business.

Over 80 percent rated crime as a major or very severe obstacle to doing business. Other key challenges included inadequate road and transport infrastructure; shortages of skilled employees; and - according to 40 percent of the respondents - government inefficiency.

Businesses reported a range of challenges associated with local and provincial government regulations, inefficient administrative processes (mainly long delays in processing various requests and approvals), unsatisfactory interactions between government and business, inconsistency and unpredictability, and a perceived lack of accountability among officials.

### *Making the business environment easier*

- The international experience is that very large numbers of businesses – up to 80 percent and more – fail in their first ten years. Where the environment favours entrepreneurs, for example in the USA, it is relatively easy to re-enter the market. If the environment is too punitive (as with credit black-listing, for instance), re-entry is much harder, and we lose the learning that failed entrepreneurs have gained, which could equip them to be better business people the second time around. The issue of credit history needs to be dealt with more sensitively in South Africa. The USA also has better coping mechanisms to support re-entry, including much greater labour flexibility. These are important considerations in a competitive globalised economy.
- In considering barriers to the growth of small businesses, a number of participants in the roundtable voiced concerns related to anti-competitive practices among large businesses, sparking a lively debate. It was argued that in certain sectors large businesses effectively limit small business innovation and entry, or set pre-conditions for entering their supply chains, or impose other contractual obligations on small businesses. By contrast, the EU has strong regulations against anti-competitive behaviour that inhibits small business growth.
- However, it was also argued that entrepreneurs will find innovative ways to bring their products to consumers, and that consumers will opt out of using suppliers that are over-priced. There is a fine line between relying on market forces to self-regulate, and intervention, which should be resorted to only in extreme cases.
- Essentially we need evidence-based research to focus, for example, on ten anti-competitive practices, to identify and cost the impacts on small businesses and employment.
- More broadly, we need to know much more – and in much greater detail – about regulatory and administrative costs and constraints, and the ways in which these affect businesses nationally and in specific regions and sectors.

The regulatory, administrative and operating environment must be constantly monitored to uncover and remove constraints on small business growth

## *Support not just for start-ups but for business growth*

- Currently government's focus is heavily skewed towards start-ups as such. Policy should focus more consciously on supporting businesses through their first three to five years – to ease some of the pressure on start-ups – and on encouraging small firms to grow.
- Policy-makers need to understand the dynamics of business growth –growing a small business into a medium-sized firm is very different from growing a medium-sized business into a large one. Across the continuum, businesses at different stages of growth have different needs.
- Medium-sized businesses are generally left to fend for themselves by government – but they need an enabling environment to expand. Fostering their growth is at least as important as chasing after foreign investment.

### **Going forward: A practical recommendation**

Small business needs a voice, a champion in government, and a platform to engage with government and with big business. The National Small Business Advisory Council has proved ineffectual in this regard.

The necessary champion can perhaps be found in the Presidency, where the Deputy President's portfolio includes the second economy and small business.

A crucial initiative would be to pull together a task team from government and the private sector with a strong mandate to provide a comprehensive policy overview and investigate key topics – such as establishing a baseline, tracking business development over time, the possibilities for incubators, access to finance and other forms of support – as a basis for firm recommendations to take to government.

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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](http://www.sbp.org.za)  
[info@sbp.org.za](mailto:info@sbp.org.za)

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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