HEADLINE REPORT OF SBP’S SME GROWTH INDEX™

GROWTH & COMPETITIVENESS
FOR SMALL BUSINESS IN SOUTH AFRICA

FEBRUARY 2014
INTRODUCTION

GROWTH AND COMPETITIVENESS

The National Development Plan (NDP) sets an ambitious aim: to treble the size of South Africa’s economy by 2030. It is a daunting challenge. By the plan’s own admission, to achieve this will require sustaining a robust rate of economic growth – at a minimum of 5.4% a year over 15 years – a feat that few countries have proven capable of. It is, however, a necessary challenge. South Africa’s high rate of unemployment and extreme inequality call for bold and far-sighted solutions. Meeting the NDP’s growth target would not only guarantee South Africa’s material prosperity, but would be an elevating and inspiring narrative for the country – ‘an optimistic new story’, as the NDP phrases it.

As the NDP makes clear, getting South Africa onto a high-growth track requires changing the way the country operates. Small and Medium Enterprises (SMEs) demand particular attention. Developing a strong and growing SME community is a keystone of the NDP’s vision. SMEs are expected to be central to South Africa’s job creation efforts, in line with international trends. SMEs have, in fact, been a central focus of government’s growth strategies since the 1980s, but with limited results.

Part of the problem has been the dearth of empirical information about South Africa’s SMEs. Understanding this sector – and the policy decisions aimed at growing it – has tended to rely on anecdote, theory and/or ideology. So has the debate around an appropriate policy approach to SMEs. Together, these shaky foundations have, inevitably, generated poor returns.

The National Planning Commission has recognised that an absence of reliable information undermines the prospects for successful policy. This is of no small importance. The NDP is an attempt at evidence-based policy making. It proceeds from the view that a problem must be clearly identified and understood in terms of the available evidence, and that this – rather than preconceptions and assumptions – should inform the policy response. In recognising this, the Commission also recognises the importance of gathering multiple perspectives, and encouraging greater engagement around issues of concern.

SBP’s SME Growth Index is a project geared towards establishing a solid, evidence-based understanding of South Africa’s SMEs. The largest, most comprehensive study of the SME community ever undertaken in South Africa, it is now in its third year. The data that has been assembled over the course of the study provides an unparalleled resource for understanding the lived dynamics of South Africa’s SMEs. Rather than start-ups or survivalist enterprises, it is focused on established firms. It is in this cohort of the business community that we can best hope for firm growth and the developmental benefits it will bring.
Growth signifies that firms are confident, able and eager to seize opportunities. Growing firms generate employment and support the expansion of a country’s economy as a whole. Indeed, the NDP foresees that jobs will emerge from “small and expanding firms” – a qualification easily ignored when the focus is squarely on launching small start-ups. South Africa needs not just more SMEs, but more sustainable, growing SMEs.

Firm growth does not happen in isolation. Information and technology have fundamentally changed how business is done, and national borders are increasingly obsolete as economic boundaries. South Africa needs to be competitive in a fast-paced global market.

A country’s competitiveness is fundamentally about how hospitable to business the economy is, what natural and regulatory advantages and disadvantages it offers, and how well the economic actors within it are able to operate. Some factors are external and immutable, such as geographical location and natural resources. Others are internal and subject to adjustment, such as the regulatory framework or the availability of adequate skills. Yet others may involve a combination of these two sets of factors, as, for example, the nature of historical trading relationships.

Competitiveness for individual firms is intimately linked to their operating environment. But it is also a measure of how adroitly they are able to adapt to challenges within their environments, and how successfully they can devise strategies to seize opportunities.

In South Africa’s pursuit of the twin objectives of growth and competitiveness, how are the country’s SMEs faring?

This report presents selected findings from the 2013 SME Growth Index, providing a snapshot of the SME community in 2013. This is the latest instalment of a larger narrative, built up over the three years since the annual SME Growth Index was launched. The focus is on firm growth, on interrogating the differences between firms on differing growth trajectories, and identifying the factors propelling firm growth.

The report links these findings to an assessment of South Africa’s competitiveness. Studying firm dynamics and performance reveals insights into the dynamics of the economy at large. By understanding both the burdens and efficiencies that firms engage within South Africa’s economy, we can begin to understand what promotes and undermines South Africa’s competitiveness. More critically, we can act to improve it.

This report is intended to support informed, evidence-rich debate on the state of South Africa’s SME economy, and what can be done to encourage it. If the NDP’s ambitions are to be realised, this is a debate that urgently needs to get underway.
The SME Growth Index tracks the dynamics driving South Africa’s SME community, with a particular stress on their ability to grow. It is a longitudinal study tracking a sample of some 500 SMEs in three sectors deemed to have high-growth potential – manufacturing, business services and tourism. The tourism firms include a subset participating in the programmes of the Tourism Enterprise Partnership (TEP), enabling an assessment of support programmes of this kind.

Firms were randomly selected within our focus sectors, after controlling for two key variables: each of our panellists employed fewer than 50 employees; and all had been in operation for at least two years. Our panellists were thus established firms that had survived the start-up period and were at a phase where upscaling and expansion were possible.

Note should be taken of the age distribution of the firms. Nearly three quarters of the firms have been operating for more than 10 years, and more than half of these for over twenty years. Less than 10% are between two and five years old. The firms on our panel are aging – along with their owners, with relatively few new entrants to the market. Since our panel closely matches the Stats SA data on employers, this suggests that there is an overall aging of the SME cohort. As firm owners approach retirement age, the shrinking of this community and with it the loss of potential opportunities, is a real danger.
These factors underline the importance of understanding the dynamics of established, scalable SMEs. A vast body of research indicate that it is these firms, rather than start-ups, that drive economic growth and employment creation. A clear, evidence-based understanding of them is imperative if their contributions are to be encouraged.

To construct as comprehensive an understanding of South Africa’s SMEs as possible, SBP’s SME Growth Index collects a vast array of data. This is both quantitative and qualitative. It seeks to understand what can empirically be verified, as well as what SME owners think. Over the three years the annual SME Growth Index has assembled South Africa’s largest ever data-set on SMEs, with a cumulative total of over 2 million data points.

As its name implies, the SME Growth Index is particularly focussed on understanding the dynamics driving firm growth. The first two rounds of the survey found indifferent growth among our panellists, and they identified a clutch of factors hindering growth. General economic difficulties, an unconducive business environment, skills shortages and a heavy administrative burden were particularly prominent.

This round of the SME Growth Index sought to analyse firm growth by organising the data according to growth trajectory. Change in firm turnover between 2012 and 2013 was used to assign firms to one of four categories: shrinking firms, whose turnovers have declined; stagnant firms, with no change in turnover; moderate growth firms, which saw an increase in turnover of 10% or less; and high growth firms, which saw an increase of more than 10%. The intention is to shed some light on the factors that enable firm growth and those that undermine it.

<table>
<thead>
<tr>
<th>Growth Trajectory</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Shrinking</td>
<td>22%</td>
</tr>
<tr>
<td>Stagnant</td>
<td>15%</td>
</tr>
<tr>
<td>Moderate growth</td>
<td>24%</td>
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<td>High growth</td>
<td>39%</td>
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Growing the number of SMEs in the economy, and growing the size of existing SMEs, are both vital objectives for South Africa’s future prosperity.

Firm growth is measured by turnover and by numbers of employees. Both are important – turnover has a strong bearing on the wealth being created in the economy, while employment has an obvious social impact.

The first two rounds of the Index – 2011 and 2012 – took place in tough economic circumstances. In both years, just over half our panel reported an increase in turnover, and around a third reported an increase in employment. In 2013, the global economic crisis continued to bite, although growth in Africa provided some enticing opportunities. We identified a measure of growth among the firms on our panel, but it was subdued, often driven by inflation, and not producing large numbers of jobs.

ARE THEY SURVIVING?
To gauge how difficult 2013 had been, we asked our panellists whether they had experienced a threat to their survival. Some 29% indicated that they had experienced such a threat. Although this was a small improvement from the situation in 2012 – when 35% of our panellists reported a survival threat – it underlines the grave circumstances facing SMEs. As our 2012 study found, many are struggling to survive, rather than pursuing growth. Tourism enterprises, at slightly more than one third, evidenced the greatest perception of a survival threat, followed by manufacturing. A sense of a survival threat was lowest among business services panellists, at just over one in five.
The aggregate annual increase in turnover was 13% across the panel – denoting a small measure of real, above inflation growth

ARE THEY GROWING?
Growth in turnover was clearly evident. In 2013, nearly two thirds of the overall panel showed an increase in turnover, 15% saw no change, while just over one in five saw a decline. The aggregate annual increase in turnover was 13% across the panel – denoting a small measure of real, above inflation growth. It is marginally better than the increase of 9% recorded in 2012, suggesting that 2013 has been slightly better for business. Business services firms generally saw the largest overall increases, followed by manufacturers, with tourism operators having experienced the smallest increases in terms of average turnover.

Panellists that had grown (beyond inflation-driven growth) tended to attribute this primarily to their own strategies. These had typically involved seeking out new or increased work. For example, a business services panellist commented: “The market changed. The quality of claims have a higher value so more input is needed to sort them out. We targeted top claims, and are billing more hours. We have reduced wastage.” Another said: “We have the right people in the right positions, good training, hard work and passion.”

In sectoral terms, business services and tourism firms were most likely to have grown, more than two thirds of each reporting turnover growth. Less than one fifth of these firms reported a decline in turnover. Interestingly, firms in the tourism industry were also the most likely to have perceived a survival threat, possibly pointing to considerable volatility in the sector. Among manufacturers, only 57% reported growth, and over a quarter experienced a decline in turnover.

“DID THE FIRMS’ TURNOVER INCREASE, DECREASE OR STAY THE SAME IN 2013?”
% OF FIRMS

<table>
<thead>
<tr>
<th>Sector</th>
<th>Increase</th>
<th>Decrease</th>
<th>Stayed the same</th>
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<tbody>
<tr>
<td>Manufacturing</td>
<td>17</td>
<td>18</td>
<td>14</td>
</tr>
<tr>
<td>Business services</td>
<td>69</td>
<td>68</td>
<td>64</td>
</tr>
<tr>
<td>Tourism</td>
<td>64</td>
<td>22</td>
<td>19</td>
</tr>
<tr>
<td>Total</td>
<td>68</td>
<td>30</td>
<td>15</td>
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Turnover growth was unevenly distributed across the age spectrum of the panel. Younger firms demonstrate a more pronounced turnover growth than their more mature counterparts – although typically off a lower base. Younger firms were also less likely to have experienced a turnover decline. Among the youngest cohort of firms – those in operation between two and five years – some 18% experienced a decline in turnover, 14% moderate growth and 55% high growth. In contrast, among firms operating for more than 20 years, the proportions experiencing shrinkage and those experiencing high growth were much the same, at round 30% in both cases.

Just under half of the panel (some 48%) indicated that their staff numbers had remained constant in 2013.
ARE THEY HIRING?

Employment is the measure of growth that most observers – not least policy makers – would wish to encourage. Employment growth in 2013 was modest. Just under half of the panel (some 48%) indicated that their staff numbers had remained constant in 2013, while a third had increased staff, and the balance (18%) had reduced their staff. This pattern matches closely what has been observed in the previous two years.

Business services firms were by a small margin more likely to have taken on new staff. Manufacturing firms were more likely to have shed jobs, raising questions about the prospects of manufacturing as a major job producer under current circumstances. Across the sectors, the dominant pattern was to keep employee numbers constant. There was nonetheless a clear relationship between turnover growth and employment growth. The proportion of firms taking on new staff increased sharply in tandem with turnover growth. While only one in eight shrinking firms took on new employees, half of high growth firms did so.
It is important to acknowledge that firms at different stages of their development experience differing growth dynamics. This should be of prime importance to policy makers. Understanding the dynamics at work at different points in the age continuum enables policy to be tailored for greatest impact among specifically targeted groups of firms.

Across the panel, younger firms were substantially more likely than their older counterparts to have increased their staff numbers. Nearly half of the youngest cohort – those that have been operating for two to five years – reported having taken on employees. Among the oldest group – those operating over 20 years – just over a quarter had done so.

Older firms show a greater overall ability to take on new staff in larger numbers.
This picture is, however, nuanced by the type and quantity of employment being created. While more of the younger firms had taken on new staff, the number of new positions created at each of these firms was quite small – on average just under two new positions. In contrast, while fewer more established firms had increased staff numbers, where they had done so, they had created more new jobs per firm, particularly in relation to permanent staff. When expanding, firms operating between 5 and 10 years took on an average of four new staff; those aged between 10 and 20 years, five new staff; and those older than twenty, a little short of six new staff.
Interestingly, while the demand for permanent employees rises with firm age, there is far more variance among demand for part-time and temporary staff. This is probably related to firms’ growth cycles – business expansion creates demand for staff, but at these moments it may be unclear whether this will justify a long-term commitment.

An even more notable relationship exists between firm age and job-shedding among those firms that decreased their staff numbers. Among the youngest firms, the aggregate number of jobs lost was just over three – nearly double the number of jobs that job-creating firms were producing. For firms aged between five and ten years, and for those between ten and twenty, around seven jobs were lost. Among the oldest firms, however, each job-shedding firm lost around three jobs: a substantially lower rate of loss than the rate of job creation happening at this level.

THE OVERALL PATTERN
While turnover continues on a moderate upward track, employment growth remains disappointing. Revenue growth has enabled hiring, but not on a significant scale. As vehicles for employment, business services firms significantly outperform manufacturing and tourism.

It is also clear that firm age matters greatly. Attempts to stimulate start-ups, or to carry them through their formative years, have an important place in an economic strategy, but it is not at this level of the SME community that extensive job creation can be expected. On the contrary: older, more established, more sophisticated firms show a decidedly greater ability to create and sustain jobs. If state policy is to attempt to leverage SMEs for employment, it should direct its efforts at these firms.

FOREIGN MARKETS
In today’s economy, firms must frequently seek opportunities across borders. A substantial proportion of our panel was trading outside South Africa, principally in Africa – most commonly in the SADC region – and in Europe. In 2013, a third of firms reported exporting and just over a quarter importing. Among exporting firms, exports accounted for some 12% of turnover; and among those importing, imports came to around a third of their input costs.

The portion of firms exporting increased only slightly since 2012 (from 30%). In contrast, imports were markedly down from 36% in 2012. This decline in importing and slight increase in exporting, is largely attributable to the devaluation of South Africa’s currency over this period. While this may make the country’s exports more affordable overseas – and in this sense, contribute to competitiveness – it imposes burdens on firms that require foreign inputs.
Since just under half of manufacturing firms import for their production, this has profound implications for the viability of government’s reindustrialisation strategy. It is also an unstable underwriter of competitiveness, given the possibility of currency appreciation. Indeed, close to 40% of exporters identified currency volatility as one of the greatest shocks they had experienced in 2013.

Foreign trade, especially exporting, can be a key driver of firm growth. We did not, however, find a straight correlation between firm growth and the extent to which firms were exporting. Growing firms were more likely than shrinking or stagnant firms to report an increased market presence outside South Africa. Shrinking firms, however, derived a greater proportion of turnover from exports than stagnant firms.

Interestingly, despite government’s policy commitment to supporting exports, several of our panellists were frustrated at administrative inefficiencies. As one manufacturer put it: “Onerous, crazy. It appears government doesn’t want you to export. For small business this is a huge problem.”
To understand what is holding growth back – or promoting it – the SME Growth Index interrogates SMEs’ views on the business environment. Business does not operate in a vacuum, and the effectiveness and efficiency of such things as the quality of legislation, markets and institutions can be decisive for firms’ performance, and for the performance of the economy as a whole.

The broad impression of the business environment held by the panel was not positive. Some 71% said that it became harder to operate a business in South Africa in 2013. Only 9% said it had become easier. One in five believed it had not changed. These numbers represent a marginal improvement in sentiment over 2012, but are nonetheless deeply negative.

**THE BUSINESS ENVIRONMENT**

HAS IT BECOME EASIER OR HARDER TO OPERATE A BUSINESS IN 2013?

71% of the panel said it had become harder to operate a business in South Africa in 2013
Firm growth, it seems, is happening in spite of a difficult business climate, rather than as a response to a favourable one.

Nearly three in four manufacturers and business services firms said that it had become harder to operate a business in 2013. Less than 6% of firms in these sectors felt it had become easier. Tourism firms were notably more positive, with just under 17% saying it had become easier – although well over half of tourism firms felt that it had become more difficult.

The sense that doing business had become more difficult was widely held across the spectrum of firm growth. This was most pronounced among firms that had experienced a decrease or stagnation in turnover, but was also evident among growing firms. Some 69% of moderate growth firms and 62% of their high-growth counterparts felt that it had become more difficult to run a business. Firms with a more positive outlook tended to say that things had remained the same, rather than that they had become easier. Firm growth, it seems, is happening in spite of a difficult business climate, rather than as a response to a favourable one.

**HAS IT BECOME EASIER TO OPERATE A BUSINESS OVER THE PAST YEAR? BY GROWTH TRAJECTORY**
South African firms are operating under adverse circumstances, which firms in competitor economies may not have to contend with.

Interestingly, the challenges of the overall environment appear to be driven mainly by domestic factors, rather than global conditions. We asked our panel to identify the top three factors that inhibited the growth of their firms over the past year. As a whole, their responses placed lack of skills in first place, followed by burdensome regulations, local economic conditions, a lack of finance and the cost of labour. Together these accounted for well over half (58%) of the panel’s responses.

From a competitiveness perspective, this is concerning. South African firms are operating under adverse circumstances, which firms in competitor economies may not have to contend with. These challenges distract firms from their core business, push up the costs of operations and may overwhelm weaker firms entirely.

Differences were evident in the impediments identified by firms in different sectors. A lack of skills was the dominant concern for firms in manufacturing and business services, and also ranked highly among tourism firms. Tourism firms, however, cited a lack of finance as their most common impediment – probably reflecting the presence of a large proportion of very small firms in this sector – while it was not a major problem for manufacturing and business services firms. Tourism firms also cited global economic conditions more frequently than their counterparts – suggesting a tightening of discretionary consumer spending.
As in 2012, manufacturers and tourism firms expressed greater concern about municipal costs and services than did business services. Manufacturing and tourism make fixed investments, or seek to attract people to specific locales. They therefore depend heavily on efficient local administration to a degree that a skills-founded business services firm does not. Business services, by contrast, showed an elevated concern about regulations, likely linked to substantial changes in financial services regulations.

Fewer distinctions appear across the growth continuum. High-growth firms were most concerned about skills shortages, suggesting that they are running into challenges as they try to recruit more staff. – and the regulatory burden. Both factors are to a significant extent a reflection of governance failures; a poor education and training system, and burdensome and often inefficiently administered compliance requirements. It appears that government shortcomings have placed the greatest brake on growth in precisely that part of the SME community where job creation would most likely and most strongly occur.

South Africa’s business environment is a difficult one, restricting growth and undermining the competitiveness of individual firms and the economy as a whole. One panellist cynically remarked: “Business owners are no longer business owners, they are just juggling clowns.” South Africa’s hopes for the future rely on changing this situation. The discussions that follow analyse some of the contributory factors in more detail.
Regulatory compliance costs have long been recognised internationally as a burden on business, both for individual firms and for the economies within which they operate. Heavy compliance burdens, and ineptly administered regulations, add to the costs of doing business, and constrict firms’ ability to grow. Cumulatively, they hinder national economic growth. The need for regulatory reform to create a simpler, more efficient business environment has been a stated government commitment for decades. The 1995 White Paper on Small Business, for example, put it succinctly: “Inappropriate or unduly restrictive legislative and regulatory conditions are often viewed as critical constraints on the access of small enterprises into the business sector and as obstacles to their growth.” More recently, the NDP – and New Growth Path – also recognise the need for an improved regulatory environment.

Previous rounds of the SME Growth Index have noted the concerns of South Africa’s SMEs about the costs of regulatory compliance and the hurdles this is placing in the way of firm growth – a phenomenon hitting smaller firms notably harder than larger ones.

In 2013, each firm on the panel spent an average of 75 hours a month dealing with red tape – the equivalent of 8 working days. The highest overall time commitment was by business services firms, at an average of 99 hours per month.

To understand the direction that the regulatory environment is taking, we asked the panel to assess whether the red tape burden had increased, decreased or stayed the same over the preceding year. A clear majority of SMEs (60%) believe that the red tape burden has increased, with virtually all the remainder saying that it has remained constant. Less than 1% of the panel indicated that the burden had lessened.

Red tape is an issue across the sectors. Three quarters of business services panellists reported an increase, as did 59% of manufacturers and 43% tourism firms. Among business services firms, the Financial Services Board was identified as a critical concern. One panellist remarked of the FSB: “The amount they demand is outrageous - why is the responsibility on me? There is inefficiency and a lack of accountability. It is a box-ticking game.”

A panellist in the tourism sector, who had established his guest house because of a passion for the sector, remarked: “When I started, I wanted to be a host. Now I am an admin manager.”

Shrinking and stagnant firms were more likely than growing firms to say that red tape had increased, whereas high growth firms were more likely to report that the level of red tape had stayed the same.
HAS RED TAPE INCREASED, DECREASED OR STAYED THE SAME?
BY GROWTH TRAJECTORY (%)

- **Shrinking**
  - Increased: 67%
  - Decreased: 2%
  - Stayed the same: 33%

- **Stagnant**
  - Increased: 68%
  - Decreased: 1%
  - Stayed the same: 30%

- **Moderate growth**
  - Increased: 61%
  - Decreased: 38%
  - Stayed the same: 38%

- **High growth**
  - Increased: 56%
  - Decreased: 44%
  - Stayed the same: 44%
In 2013, each firm on the panel spent an average of 75 hours a month dealing with red tape – the equivalent of 8 working days.

To understand the nature of the red tape panellists were faced with, we asked them to identify the chief sources of red tape burdens in 2013. By a considerable margin, SARS inefficiencies dominated the responses, at around one quarter of the total. This was a particular problem for manufacturers and business services panellists. Several panellists noted that while SARS can efficiently collect revenue, it is less efficient at paying refunds or resolving problems. Difficulties in obtaining tax clearance certificates remained a source of frustration. Challenges associated with SARS have emerged as a key concern in every round of the annual survey. A common theme is the need for SARS to reorient its approach from one that is punishment-based to one that recognises the specific challenges that it imposes on small businesses, and works constructively with this sector to better business success.

Labour – incorporating problems relating to bargaining councils, the CCMA, Workman’s Compensation and so on – was the second most frequently cited issue, and was the largest single concern for manufacturers, identified by nearly one third as a critical challenge. Municipal issues, which emerged as a significant concern in 2012, were the largest source of concern for tourism operators. Among business services firms, FSB regulations constituted 9% of responses.
Business concerns regarding the compliance burden related not only to the volume of regulatory requirements and poor administration, but also to the frequency of regulatory change. We asked the panel if they believed they knew all the regulations they were expected to comply with. Only two firms in five were confident that they did.

“DO YOU FEEL YOU KNOW ALL THE REGULATIONS YOUR FIRM NEEDS TO COMPLY WITH?”

South African firms continue to labour under a heavy burden of red tape and restrictive regulation.
Looking towards the future, three firms in five expected the compliance burden to grow. The balance generally expected it to remain constant, with negligible numbers expecting a decline. This is in line with the expectations expressed in 2012.

A disturbing finding emerged from the subset of panellists who had opened other businesses. Well over half of these reported that completing all the necessary administrative procedures had taken in excess of 60 days. Around one third of those who had opened new businesses reported having spent over four months on the process. That these are experienced business owners underlines how cumbersome these processes are. They also call into question the data provided by World Bank/IFC’s Doing Business 2013, which reports that opening a business in South Africa typically takes 19 days. This appears to be an optimistic estimate, significantly understating the reality.

The findings of the SME Growth Index on red tape are mirrored in the 2013/2014 Global Competitiveness Report, which identified considerable concern about labour regulations and an inefficient bureaucracy. Business owners’ concerns about labour legislation are particularly worrying, given that this typically acts as a disincentive to hire new employees.

These findings should raise very clear warnings about the danger of imposing increased regulatory burdens. Despite this, there were contradictory pulls on government policy during 2013. On one hand, guidelines were issued by the Department of Trade and Industry and the Department of Cooperative Governance and Traditional Affairs on reducing municipal red tape. On the other, the Department of Trade and Industry produced a bill to introduce a system of mandatory licensing of all business activities, to be administered by municipalities – a level of government with severe capacity constraints.

At a sector level, regulatory proposals to restrict brokerage fees in the insurance industry pose a critical threat for financial services SMEs. Small brokerages do not have the advantages of scale that large operators have, and depend on these fees for their viability, offering a personalised service as their competitive advantage. To restrict this could push them to extinction – much as occurred to independent pharmacies when dispensing fees were capped in 2006.

In summary South African firms continue to labour under a heavy burden of red tape and restrictive regulation. Judicious reform of the operations of a few key institutions, such as SARS, could make a far-reaching contribution to a better business environment. Meanwhile, businesses are required to commit substantial resources to regulatory compliance, creating both a direct and indirect brake on growth. There is a widespread expectation that this burden will grow in future, posing a further threat to the country’s competitiveness.
LABOUR ENVIRONMENT

If SMEs are to grow in a manner that creates jobs, their experience of the labour environment must be clearly understood. Reorienting South Africa’s business environment to one that encourages employment should be a key policy objective, and requires a solid evidence-based approach. Previous rounds of the SME Growth Index have revealed that our panellists have considerable concerns around labour issues.

We asked our panel an open-ended question about the impediments to hiring. Overwhelmingly, this came down to two issues: inadequate skills and labour legislation. Together, these accounted for nearly two thirds of responses.

Skills shortages were most acutely felt by business services firms, while labour law was the greatest hindrance for manufacturers and tourism firms. Within labour law, the issue standing out most clearly was the perceived inability to dismiss unneeded staff. As one manufacturer put it: “Labour laws are very restrictive. You have ideas but they are too risky. If the project doesn’t go well, you can be stuck with them.” Another expressed similar sentiments, sketching his firm’s strategy: “We prefer to upgrade technology and upskill the staff we have so that they can be more efficient and productive. We also have a very selective client base and are more niched, ensuring that we do not have to staff up rapidly to handle exponential growth.”
At a sector level manufacturers noted the adversarial state of labour relations as a significant problem.

The skills shortages concerning the panel incorporated a wide spectrum of capabilities. Several panellists spoke of a lack of basic literacy and numeracy, others sought higher-level technical or professional skills. One business services panellist, commenting on difficulties in finding higher-order skills, summed up the key challenge as “Getting the right level of leadership and management – middle management we find are underqualified. The level of the B. Com is not as high as before. It is difficult to attract the right people.”

At a sector level manufacturers noted the adversarial state of labour relations as a significant problem.

Over half the shrinking firms identified labour laws as the greatest barrier to employing staff. While this was also a key issue for growing firms, it was coupled with the challenges created by skills shortages.
Labour laws and skills shortages have been repeatedly identified as key challenges in every round of the annual survey. This is in line with other studies, which consistently identify labour laws and skills shortages as critical constraints to South Africa’s competitiveness. The 2013-14 Global Competitiveness Report, for example, ranks a shortage of skills in the workforce and restrictive labour regulations as the “most problematic factors for doing business” in South Africa. Indeed, numerous education indicators in the Global Competitiveness Report indicate that the state of education in South Africa is a cause for major concern. The quality of South Africa’s education system and the quality of its maths and science education received respectively the third lowest and lowest rankings of all the 148 countries surveyed.

Bluntly put, the poor preparedness of South African school leavers to enter the labour market, and the legislation that governs the labour market, create substantial constraints on employment growth. As one manufacturer put it: “Finding the right person with the right skills is difficult. There is a major lack of skills, this stemming from poor ground roots education.” Our results suggest – in common with the Global Competitiveness Report – that focussed and successful interventions in attending to skills shortages and in prudent reform of labour law could make a substantial difference to SMEs’ willingness to hire.

**TRAINING**

How are our firms responding to skills constraints? In the first instance, they are spending money on training their staff. A majority of panel firms conduct training of some description. Most common is on the job training, followed by formal training not affiliated to the Sectoral Education and Training Authorities (SETA). A minority use SETA services – as noted in the 2012 report, this is often because some of the SETA offerings are mandatory.

An **upskilled** workforce would enable firm and national economic growth, and boost the competitiveness of South Africa.
By a considerable margin, business services firms were more likely than their counterparts in other sectors to have provided training, reflecting the sector’s demand for higher-level skills and qualifications.

The relationship between training and firm growth is somewhat ambiguous. Stagnant firms were least inclined to have trained, but shrinking firms conducted on-the-job training at a higher rate than any other group. Growing firms were more likely to have conducted formal training than others.

There is broad agreement that an upskilled workforce would enable firm and national economic growth, and boost the competitiveness of South Africa and its individual firms, over the long-term. A government review of the SETA system published in 2013 noted that a prime goal of the SETAs is to support small business. However, the SETAs are not well regarded by SMEs. They are criticised for focusing on qualifications rather than skills development, and accessing their services is perceived to be a cumbersome process. One panellist in the business services sector commented that: “In my opinion, SETAs are a bureaucratic nightmare. Send all the money to tertiary institutions and skills training. They are an unmitigated nightmare. They are staffed by incompetent people. Look at the Asian Tigers. They upskilled, not by building empires.”
Certainly larger firms are far better positioned than SMEs to take advantage of SETAs’ offerings. They have the administrative capacity to negotiate the regulatory obstacles. They arguably also have the voice to press for training that is more in line with their needs. Indeed, a good case could be made that the SETAs essentially represent a tax on SMEs and a subsidy to larger firms. In this way, they are a hindrance rather than a help to SME growth and competitiveness.

YOUTH EMPLOYMENT
Youth unemployment is a burning concern around the world. SMEs are recognised as the key drivers of job creation, and provide a natural entry point to the labour market for young job seekers. Indeed, data from Stats SA suggests that young work seekers are more likely to find opportunities in smaller firms than in larger ones. We sought to understand the panel’s perspectives on employing young people. Our panellists indicated that about 25% of their employees were under the age of 30. We posed an open-ended question as to the concerns, if any, they would have about hiring new, young entrants to the job market. Two in five said they had none (a handful even indicating a preference for such employees), while the remainder expressed some concerns.

Foremost among the concerns about young work-seekers was a perception of poor work ethic. Many felt that young people had a sense of entitlement, and did not perform productively. Allied to this was a widespread view that they had unrealistic expectations of their earnings and felt they would use small firms to gain experience and skills and then depart for better positions in larger firms. As one panellist put it: “I won’t hire young entrants, they’re full of nonsense. They want to live life and earn directors’ salaries and are not prepared to work for it. They feel that we owe them something.”

SMEs are recognised as the key drivers of job creation, and provide a natural entry point to the labour market for young job seekers.
To probe possible solutions, we asked the panel what would make employing young work seekers more attractive for their firms. Wage subsidies or incentives for employment were the most frequently mentioned possibility. This was followed by suggestions for training subsidies and improving skills and education. Together these accounted for some two thirds of responses. In view of the recent introduction of the Youth Employment Tax Incentive (YETI) these are important findings. The YETI aims to get young people into the job market through subsidised employment, and to ensure skills acquisition. One panellist expressed support in these terms: “The youth wage subsidy would be helpful as long as there isn’t a huge amount of red tape and bureaucracy.” Our results suggest that, provided it is well implemented, it has great potential.

Following these “youth-specific” suggestions, many panellists reiterated the need to ease South Africa’s labour regulations. These panellists commonly cited the difficulty of dismissing unsuitable employees. Given concerns about skills and work ethic, this is a concern that weighs most heavily in relation to young job seekers.

Our panellists indicated that about 25% of their employees were under the age of 30.
Reforms to both increase the skills pipeline and introduce greater flexibility into the labour market are of great importance.

These results are consistent with those of 2012, which indicated that 55% of the panel were in favour of a youth wage subsidy, and that very few would use it as a means to replace older workers (and for those contemplating doing so, it would be done at the retirement of the older workers). Simply put, older and more experienced workers are too valuable to the firms they work for, for such a replacement strategy to be viable.

Young people who are unable to secure entry-level jobs are likely to find themselves frozen out of employment in the long-term. With few skills and little experience, they will become not only unemployed but unemployable. However, young people are in general not attractive prospects for SMEs, and South Africa’s labour legislation compounds this. Reforms to both increase the skills pipeline and introduce greater flexibility into the labour market are of great importance. The YETI is a welcome first step.
Crime remains a critical challenge in South Africa, touching every facet of life. We asked our panellists about their experiences of crime, and the impact it was having on their firms.

A little over half reported that their firms had been victims of crime in the past year. The costs of crime amounted to the equivalent of some 3% of turnover.

The most common crime experienced was theft through burglary. This was reported by three firms in five that had been victims of crime, or a little under a quarter of the panel as whole. This was followed by internal theft – shrinkage – and by fraud and cable theft.

By a considerable margin, crime hit manufacturing firms most frequently – 57% having been victimised. Just under 40% of tourism firms had fallen victim to crime, as had a little under one third of business services firms.

Patterns of crime followed the nature of each sector’s operations. Manufacturers were particularly hard hit by shrinkage, burglary and cable theft; business services firms by burglary and fraud; and tourism firms by burglary, shrinkage and fraud. Manufacturing and tourism operations tend to have substantial investment in property and equipment, limiting their ability to move to a different location. Business services firms are better able to move premises in response to declining security.
Violent crime affected a significant minority of firms. Of those that had suffered crime, 7% had experienced armed robbery, and 4% hijacking. Armed robbery tended to hit manufacturing and business services firms, while hijacking had a larger impact on tourism operators.

Around two thirds of panellists felt that the threat of crime to their firms had remained constant over the preceding year, and a quarter that it had increased. Official statistics show that crimes directed at businesses have increased over the past few years. Many firms are spending additional funds on security. But crime also appears to be constraining growth more indirectly. One panellist put it thus: “The effect of crime on South Africa has resulted in no forward planning because the buyers and suppliers do not want to commit to the long term relationship. It is having a negative effect on the mindset of the entire country because everyone you talk to daily is affected, be it friends, family, suppliers, customers etc. It inflates prices because of having to guard, protect yourself and your company and keep up with technology in order to do so. I drive around with a gun – this is a negative mindset. Insurance increases. It has a negative impact on life, on the manufacturing industry etc. It changes the focus from trying to have a good business to worrying about crime – terrible to live in a threatening environment. Delivery times increase as people carry less stock.”

Another concern was the interface between crime and adversarial labour relations. Some panellists reported that staff deliberately sabotaged operations, targeted them or their managers, and intimidated other staff. One manufacturing panellist said that this was driving him seriously to consider closing his business. “The owner and senior staff have been personally threatened and intimidated by staff, where wheels on their cars have been punctured deliberately, death threats made at their homes etc. The Financial Director landed up in a wellness centre last year for 3 weeks and was booked off work for 5 weeks due to the threats and intimidation.”

Crime is imposing substantial direct and opportunity costs on business, and detracting from growth. Firms face significant risks of financial loss, and potential violence and emotional damage associated with crime. This degrades owner and staff morale, and productivity. The additional costs of security degrade firms’ competitiveness, and by extension the competitiveness of the country as a whole. Indeed, the Global Competitiveness Report ranks South Africa at position 141 of 148 countries surveyed for the business costs of crime and violence.

The costs of crime amounted to the equivalent of some 3% of turnover in 2013.
As an economy moves beyond its factor endowments, it and its firms will inevitably need to strive to produce more efficiently and to identify new economic opportunities. Innovation is a high-yield means of growth and a non-negotiable for international competitiveness.

Our panellists felt generally positive about the prospects for innovation in South Africa: two thirds of the panel agreed that the environment was conducive to innovation. A little over half of the panel had introduced new products or services in the past year, and just under a third had come up with new production processes or distribution methods (these proportions include firms that indicated having done both).

Business services firms were by a considerable margin the most likely to have innovated in both ways. Manufacturers came next – around half had innovated their offerings, but only a quarter their processes. Among tourism firms, two in five had innovated their services and products and slightly below a third had innovated their processes.

There was a correlation between growth and innovation. Growing firms showed considerably higher rates of innovation than shrinking or stagnant firms. This applies both to product and service innovation and process and distribution innovation.
Our findings also demonstrate an interesting relationship between innovation and firm age. Innovation is relatively rare among young firms, but accelerates rapidly as they begin to establish themselves in the market – at five to ten years of age. Innovation drops somewhat at ten years – these firms are likely to have a recognised brand, a suite of offerings and established clients, perhaps making innovation less necessary. As they approach the twenty year mark, they begin to innovate at higher rates again. By this point, entrepreneurs are confident about exploring new avenues, and also need to fend off challenges from newer market entrants.

Growing firms showed considerably higher rates of innovation than shrinking or stagnant firms.
To understand the nature of firms’ innovations, we asked our panellists to indicate whether their activities were: new to the market as a whole; significantly improved to the market as a whole; new to the firm; or significantly improved to the firm (they were free to offer multiple responses). Most innovation reported was in relation to their firms, rather than to the market as a whole – they altered their own activities and undertook things they had not previously done, but which others may have done. Close to two thirds of innovating panellists reported innovations new to the company, and just over half reported that they had significantly improved to their firms. Two in five reported innovation in relation to the market as a whole.

By a considerable margin, and across most types of innovation, stagnant firms were least likely to innovate.
Interestingly, among those that were innovating, there was an ambiguous link between the type of innovation and firm growth. By a considerable margin, and across most types of innovation, stagnant firms were least likely to innovate. Shrinking firms, however, were innovating at comparable rates to growing firms in some areas, and only marginally less in others. Shrinking firms were in fact the most likely to have introduced products that were entirely new to the market.

Innovation is an important part of firms’ growth but is never a guarantee of it. The high level of innovation among shrinking firms points to two possible scenarios: innovation may be a strategy to turn around firms’ problems; or failed innovations may trigger a decline in firms’ fortunes. In practice, our sample probably reflects a combination of these.

How innovations arise is critical to understanding how they may be encouraged. This in turn is important for stimulating firm growth and competitiveness. An overwhelming majority of innovating firms reported that information sharing within firms (for example, discussions among colleagues) was “highly important”. This was followed by interactions with clients. Of secondary importance were information from local suppliers, international suppliers, trade fairs and exhibitions and professional associations.

Designated research institutions appeared to play little part in panellists’ innovation strategies. Some 60% said that they did not make use of information from universities, more than half did not make any use of government or public research, and just under half did not use information from private research groups. These overall trends are fairly constant among all growth trajectories.
Innovation is a crucial element of South African economic policy. The SME Growth Index shows that the country’s SMEs are making a substantial contribution to innovation, and that some are deriving growth benefits from doing so.

In terms of competitiveness, our findings both compare and contrast with those of the Global Competitiveness Index. In the latter’s evaluation South Africa performs quite creditably on innovation, ranking 37th of the 148 countries in the sample. The Competitiveness Index however raises concerns about South Africa’s availability of scientists and engineers – reflecting broader concerns regarding the country’s access to skills. On the other hand, the Global Competitiveness Report gives a relatively high rating to cooperation between universities and business. This is clearly not reflected by our panel, and suggests that such cooperation is occurring among larger companies. This is in contrast to countries like Germany, where universities cooperate extensively and successfully with smaller companies.

Innovation is a crucial element of South African economic policy.
Firms must be in a position to invest in the assets and resources they need. This is critical for growth and competitiveness. A substantial proportion of our panellists are investing in their businesses. Just over a third of our panellists had acquired new major assets in 2013.

These investments had a clear correlation with firm growth. The higher the level of growth achieved, the more likely it was that a firm had invested in new assets. Nearly half of all high-growth firms had invested, as opposed to one in five shrinking firms. Whether failure to invest is more likely to be a cause or a consequence of declining turnover is not clear, however.

The scale of investment taking place within the investing firms is by no means trivial. On average, investing firms acquired assets equivalent to around 19% of their total asset value. Business services firms had the highest aggregate level of investment, equivalent to around 26%. This was followed by tourism firms, at 19%, and manufacturers at 14%. One should, however, bear in mind that the overall asset value of manufacturers tends to be higher than that of firms in other sectors, so this by no means implies smaller outlays.

Once again, the level of investment correlates well with firm growth. Investment increases alongside firm growth – from around 12% for investing firms that are shrinking to some 25% for those that experienced high growth.
It is notable that there was a clear statistical relationship between investment and innovation. Some 72% of firms that had invested had also innovated their products or processes. This is to be expected, since innovation will often be enabled by new machinery or software. The investments made were widely divergent, according to the nature of each firm’s business. They included renovations and extensions to property, and purchases of machinery and machine tools, computer and IT equipment and vehicles. The substantial amounts spent emphasise the contributions that SME make as customers to other firms.

The higher the level of growth achieved, the more likely it was that a firm had invested in new assets.
HOW ARE FIRMS FINANCING THEMSELVES?

We asked our panellists to identify the sorts of financing that their firms had used (though not necessarily applied for anew) over the past year. We found a diverse mix. Topping the list were bank credit/overdraft facilities – suggesting that established SMEs are able to access bank finance, despite the perception that banks are reluctant to extend credit to SMEs. Substantial numbers of our panellists reported having bank loans or lease agreements with financial institutions.

Internal funding – chiefly retained earnings – was the second most widely used source of funding. Loans from family, friends and shareholders (arrangements based heavily on trust and personal relationships) were used by around one in four SMEs.

The use of bank finance was far more common among manufacturers and business services than among tourism firms. This may be accounted for by the generally larger size, greater sophistication and more advanced age of manufacturing and business services firms on the panel. Many tourism firms on the panel do not hold assets in the name of the firm, but rather in the name of the owner. This makes manufacturing and business services firms better credit prospects. Tourism firms were substantially more likely to have used retained earnings to fund themselves.

About one in five firms used trade credit, this being most prominent among manufacturing firms.

Financing from government is rare. Just under 6% of the panellists received grants or subsidised loans. These firms are mostly in manufacturing and tourism, sectors for which incentives are more readily available.

About **one in five** firms used trade credit, this being most prominent among manufacturing firms
%OF FIRMS USING...

- Manufacturing
- Business services
- Tourism
- All

Bank overdrafts /credit lines
Retained profits or sale of assets
Leasing or hire purchase
Loans from family, friends, shareholders
Trade credit
Bank loan
Grants/loans from government
Equity
Other
IS FINANCE A BARRIER TO GROWTH?

As previously mentioned, a lack of finance was identified as a concern for firm growth, particularly among tourism firms, but overall, other barriers appear far more important. Finance constraints seem to be a problem for younger firms, while more established and more sophisticated firms seemed able to satisfy their needs through a mix of funding sources.

Most of the panel felt that there had been no deterioration in their firms’ ability to access finance over the preceding year. The outlook for the coming year was even better, with 29% expecting it to improve, against only 16% expecting it to worsen.

Around half of the firms that had invested had financed their investments using cash; bank finance was used by about a third. But although cash featured more prominently in firms’ investment financing strategies than bank finance, we found little evidence that access to the latter was indeed a widespread problem. This is supported the latest Doing Business report, which ranks South Africa among the top global performers in terms of access to credit.

Some 18% of the panel indicated having applied for bank loans in the year prior to the survey. Another 16% applied for bank overdraft or credit facilities. As this represented a minority of the panel, we asked whether our other panellists might have needed finance, but had been reluctant to apply for it. A very small proportion indicated this to have been the case. Only 3% of the panel said they had not applied for a bank loan, and 4% for overdraft or credit, because they expected to be rejected or felt they lacked the collateral. Firms’ growth trajectory had an ambiguous relationship to whether they applied for bank finance. A higher proportion of growing firms had applied for bank finance compared to shrinking or stagnant firms, but there was no evidence that the latter groups were more reluctant than their growing counterparts to apply because they feared rejection or had insufficient collateral.

Moreover, an overwhelming majority of applicants were successful. Well over two thirds of overdraft and credit applications were granted in full, as were over three quarters of loans. Only 13% of credit and overdraft applications and 10% of bank loan applications were rejected. An additional small minority refused the offers made because of unfavourable conditions.

Growing firms were somewhat more successful than shrinking ones in securing bank loans, but less so in obtaining overdraft facilities.
By a considerable margin, manufacturing firms were more likely than those in the business services sector or tourism to have applied for financing of all types. Manufacturers’ assets depreciate, and require regular maintenance and updating to remain competitive. Proportionately fewer business services firms, and even fewer tourism firms, had applied for finance.

While access to finance is undoubtedly an important enabler, a lack of access does not seem to be a crippling problem. Our results suggest that South Africa’s established SMEs are in general finding the funding they need. This finding is in line with the Global Entrepreneurship Monitor’s most recent report on South Africa, which indicated that sufficient funding is available, although difficulties exist in gaining access to it. Ease of access differs significantly across sectors and firm ages. Any attempt to stimulate the SME community by offering finance must take into careful account the differentiated nature, needs and objectives of SMEs.

Only **13%** of credit and overdraft applications and **10%** of bank loan applications were rejected.
Customers are dragging their feet; those that usually paid in 30 days are now only paying in 60 to 90 days

CASH FLOW
A predictable throughput of funds is essential for business operations. Almost 40% of our panellists reported that they had experienced significant cash flow problems in 2013. Whereas more than half of shrinking firms had experienced a problem, this applied to less than a third of high growth firms.

Cash flow problems tended to stem from firm-specific issues, such as a lack of business or seasonal changes, which were particularly problematic for tourism firms.

A large proportion of panellists with cash flow problems reported that their clients paid late. One panellist summed up the problem thus: “Customers are dragging their feet; those that usually paid in 30 days are now only paying in 60 to 90 days. ... It has put a lot of pressure on the business.”

This is a problem the SME Growth Index has previously identified. While both the public and private sectors contribute to this problem, government appears to be the worst offender. Nearly half the panellists who dealt with government rated it as a bad payer. This is intimately linked to red tape burdens discussed elsewhere. The complex processes intended to prevent corruption require a level of competence that the civil service frequently does not possess. According to one panellist, government “is bogged down in their own red tape and bureaucracy”.

Related to this is the levying of VAT on invoices rather than on receipts. Firms may become liable for large bills to SARS before they have actually received any actual funds for a particular sale. When a debtor is tardy in meeting his or her obligations, and SARS demands the applicable VAT, this can seriously compromise a firms’ cash flow.
Small business and entrepreneurship are key elements of South Africa’s economic strategies. To this end, significant resources have been committed to drive their development. These have tended to be directed at start-ups. We sought to understand the extent to which established SMEs such as those on our panel are benefitting from state support.

**INITIATIVES SPECIFIC TO SMEs**
- **Small Enterprise Finance Agency (SEFA) direct lending**: financing to SMEs and cooperatives.
- **Small Enterprise Finance Agency (SEFA) indirect lending**: financing to intermediaries, joint venture, partnerships and other collaborative relationships.
- **National Youth Development Agency (NYDA) grant funding**: grants to young entrepreneurs.
- **National Empowerment Fund (NEF) funding**: various funding instruments to promote black-owned SMEs.
- **National Empowerment Fund (NEF) non-financial support**: technical support and assistance to SMEs.
- **Small Enterprise Development Agency (SEDA) general support**: technical support to SMEs.
- **SEDA (Small Enterprise Development Agency) Technology Programme (STP)**: support to technology-based SMEs, with a stress on preventing early stage failure.

**GENERAL SUPPORT APPLICABLE TO SMEs**
- **DTI 12i**: Tax allowance for environmentally-friendly manufacturing investments.
- **DTI Manufacturing Development Programme Incentive**: establishment cash grants.
- **DTI Small and Medium Manufacturing Development Programme**: part of the Manufacturing Development Programme, but applicable to SMEs only.
- **DTI Manufacturing Investment Programme**: part of the Enterprise Investment Programme: cash grants.
- **DTI Co-operatives Incentive Scheme**: cash grants to co-operatives in manufacturing, retail and services.
- **DTI Small and Medium Enterprise Development Programme (SMEDP)**: manufacturing: cash grants for investment by offering SMEs in manufacturing and tourism.
- **Export Market and Investment Assistance (EMIA)**: cash grant to promote exports of South African goods.
- **IDC/DTI Support Programme for Industrial Innovation (SPIII)**: manufacturing: cash grants to private enterprises and SMEs in IT and manufacturing projects.
- **DTI/CSIR National Foundry Technology Network**: provides services, skills and R&D to develop a globally competitive foundry industry.
- DTI/IDC Manufacturing Competitiveness Enhancement Programme (MCEP): cash grant to encourage manufacturers to upgrade their production facilities.
- DTI Business Process Outsourcing and Offshoring (BPO and O) Investment Incentive: investment cash grants.
- DoL Business Process Outsourcing and Offshoring (BPO and O) Training and Skills Support Grant: cash grant for training purposes.
- DTI Small and Medium Enterprise Development Programme: Tourism (SMEDP): cash grant for capital investment: cash grant to expand existing facilities.
- DST Innovation Fund (IF): cash grant for companies doing R&D
- IDC/DTI Support Programme for Industrial Innovation (SPII): information technology: cash grants to support technical development in IT and manufacturing
- DTI Small Enterprise Development Agency Technology Programme: supports early stage ventures in technology.
- NRF Technology and Human Resources for Industry Programme (THRIP): cash grant supporting research, technology and training.
- DTI Black Business Supplier Development Programme (BBSDP): cash grant for black-owned businesses to gain access to business development services.
- Export Credit Insurance Corporation: underwriting export credit loans and investments outside the country.
- DTI Small Enterprise Development Agency: non-financial services and support.
- DTI Sector Partnership Fund (SPF): cash grant for partnerships in manufacturing, agro-processing and ICT sectors.
- DTI Critical Infrastructure Programme (CIP): cash grant for enterprises investing in infrastructure.

We sought to understand the extent to which established SMEs such as those on our panel are benefiting from state support
Some 19% of our panelists had participated in government support programmes. However, the bulk of these were smaller and younger firms in the tourism sector. These included the subset of TEP-supported firms that were selected specifically to assess the impact of this programme. TEP support accounted for around half of the support that our panelists received. Excluding these specifically selected firms, it is clear that a very small proportion of firms receive state support. Only one in ten manufacturers and less than 7% of firms in business services were involved in government sponsored incentive programmes.

Do government support schemes help firms to grow? There is no clear answer – shrinking firms had the highest participation rate, followed closely by high growth firms.

Only one in ten manufacturers and less than 7% of firms in business services were involved in government sponsored incentive programmes.
We asked panellists not taking part in government incentive schemes to indicate why not. A lack of awareness of what is available proved a decisive hurdle. A majority of firms not participating in support schemes (and close to half the panel as a whole) was either not aware of available incentives, or did not know whom to contact to access them. The red tape implications also had a significant effect on uptake: a quarter of those not participating in support programmes said that the amount of paperwork involved dissuaded them from applying.

State support, therefore, is a tool used by a minority of firms. Its impact in driving growth and competitiveness among South Africa’s SMEs appears to be marginal at best. A key flaw is the lack of awareness among prospective clients. Only a third of panellists said that they had no reason to seek assistance, suggesting that relevant, well-designed and accessible programmes would find a receptive audience.
The 2013 SME Growth Index sought to gauge SMEs’ optimism and identify their strategies for the future.

Very notably, many panellists were angry and frustrated. Many of their comments indicated they felt that they were expected to contribute to the economy and to create employment under difficult conditions – but that their needs were not acknowledged. The following comment from a manufacturer exemplifies this: “We are so fed up... we are working 24/7 and have sleepless nights. We are the only ones worrying. You get to the stage that nothing is coming from your efforts and you call it quits. We drive past the squatter camp daily – people want to work, but you get stuck with people you can’t get rid of. We are getting out from the frustration. The cement company went on strike – enough is enough! Salary demands are getting unreasonable and the knock-on effects are hitting us. Work is actually available, but not on the conditions we would be able to meet. This firm needs unskilled people, so this is a bad situation all round.”

Despite this, many of our panellists retain positive aspirations. Well over half reported that their aspirations for their firms had changed for the better. Some 31% reported no change, and 12% a change for the worse. These results closely mirror those of the previous rounds of the SME Growth Index and indicate that despite any immediate and long-standing difficulties they face, SMEs are drawing on a deep well of optimism and resilience.

By a considerable distance, tourism firms were the most inclined towards optimism, with over two thirds having adjusted their aspirations for the better. This represents a significant growth in optimism among tourism firms compared to 2012. This is probably due to a general improvement in the tourism market in early 2013, notably a rising number of foreign tourists, especially those from South Africa’s non-traditional markets. Manufacturers were least inclined towards optimism. However, even among these firms, the largest single group reported improved aspirations (46%).

Unsurprisingly, growing firms were more optimistic than shrinking or stagnant firms. For example, while over a third of shrinking firms had changed their aspirations for the better, nearly three quarters of high growth firms had done so. It is also notable that those adjusting their aspirations for the worse were a minority among all growth classes.
Firms’ strategies for the future confirm the overall positive aspirations of our panellists. A general growth orientation was clearly evident in firms’ plans for the coming year. Nearly two thirds indicated that they intended to increase production or service offerings, meaning that they hoped to increase the quantitative scale of their operations. By contrast, less than 2% intended to reduce them.

The intention to grow is complemented by a widespread intention to introduce new goods or service offerings. This demonstrates that South Africa’s SMEs appreciate the importance of innovation and competitiveness.

The intention to innovate is not distributed evenly across the growth spectrum. Shrinking and high growth firms are more likely than their stagnant and moderate growth counterparts to wish to innovate. A probable explanation for this is that shrinking firms recognise the need to explore new avenues of business as a long-term survival strategy. For high-growth firms, this is already an integral part of their growth and competitiveness strategy. A noticeable proportion of our panellists (around one in six) intends opening new businesses. This testifies to the entrepreneurial spirit of our SME owners. High growth firms were far more likely than others to be intent on doing this.
Very few panellists intend to close or sell their businesses, dispose of assets or retrench staff. Those that are considering doing are currently shrinking – shrinking firms are five times more likely than high growth ones to be considering retrenching staff.

True to their growth aspirations, a majority of our panellists intended to seek out new markets, both domestic and foreign. Seven in ten of the panel hoped to find new markets in South Africa, with varying proportions seeking markets in other parts of the world. For many, seeking foreign markets was a necessary growth strategy. Said one: “Market expansion within South Africa would be ideal, but the market is saturated, so future opportunities are abroad”.

Of those seeking foreign markets, the largest group was focussed on the SADC region. This was followed by Africa beyond SADC, and Europe. Asia follows at some distance, with the choice of destinations influenced by established foreign relationships.

There were notable differences across sector. Manufacturers tended to focus on African markets. Geographically more accessible and undergoing rapid economic growth, these are lucrative target markets within which South African firms perceive a competitive advantage. Tourism panellists, by contrast, envisage a wider spread of markets, with a particular focus on Europe, North America and Asia.
Overall, high growth firms tended to have the greatest ambitions for finding foreign markets.

No clear correlations were apparent between firms’ growth level and their intended markets. Overall, high growth firms tended to have the greatest ambitions for finding foreign markets, followed closely by shrinking firms. The lowest interest in seeking foreign markets was among stagnant firms. As in the case of innovation, this probably points to shrinking firms being alert to the need for new markets for survival, and growing firms already understanding their importance.

In sum, South Africa’s SMEs are ambitious for growth, but face constraints from a difficult business environment. This is a source of frustration for firms, and a substantial concern in relation to the NDP’s vision of a 6% growth rate. In our 2012 report, we argued that our SMEs were surviving rather than growing. Our findings in 2013 were a little more positive, but the challenges remain significant and pressing.
The SME Growth Index aims to give SMEs a voice. As in past years, our panellists had an opportunity to present their perspectives as to what they would most like to see government and big business doing to improve the business environment.

The views expressed were diverse, but a number of distinct themes emerged. In addressing government, the five most frequent responses were as follows:

• The regulatory burden is distracting SMEs from their business activities, and must be reduced.
• Opportunities and assistance should be made available for SMEs – but these need to be tailored to the particular, differentiated needs of different segments of the SME community. For the most part, established SMEs need better information on tendering opportunities, and better – more transparent – management of the tendering process, rather than dedicated support.
• SMEs struggle with the administrative demands imposed by South Africa’s labour legislation, finding it an obstruction to growth, and a disincentive to taking on new staff. It needs to be reformed.
• Overall, the efficiency and effectiveness of governance across all spheres needs to be improved.
• Improving the skills of the workforce is imperative – in particular, government needs to ensure a vastly improved quality of education to underwrite South Africa’s future economic success.

Panellists were also asked what message they would like to give to big business. In 2012, the key message here was for larger firms to integrate SMEs into their value chains. In 2013, we asked panellists what other messages they would like to send to big business. While replies were wide-ranging, the top five were:

• Pay suppliers on time
• Be more willing to vigorously confront government on the regulatory environment
• Source products from local suppliers, rather than import
• Combat corruption, act ethically, and within the law at all times
• Refrain from anti-competitive behaviour (such as price fixing), as this has a detrimental impact on SMEs and the local supply chain
For a country desperately needing economic growth, few goals can be as important as the growth of a strong SME community. As the NDP recognises, a growing community of SMEs, and the growth of individual small firms, is an indispensable element of South Africa’s hopes for the future. This will be possible only if South Africa strives constantly to raise its competitiveness. To enable growth and competitiveness, we need a clear-eyed, evidence-based understanding of our SMEs, of the hindrances that are holding back their growth, and of the opportunities that can further be exploited.

The findings of the 2013 SME Growth Index point to a resilient but frustrated SME community. Our SMEs seek growth, but operate in tough conditions.

We are seeing a moderate but encouraging overall improvement in the fortunes of the SME community. Turnover growth has been positive, and a smaller proportion of firms faced a survival threat in 2013 than in 2012. Employment growth has, however, been more restrained, pointing to the persistence of hurdles to job creation.

To assist our SMEs toward sustainable growth attention must be paid to the nuances within the community. Different types of firms have different needs and will respond to different incentives. For example, in sectoral terms, business services firms show a more pronounced tendency to hire than others – if they can find the skills they need. Older firms show a greater overall ability to take on new staff in larger numbers. Government needs to factor in these distinctions when thinking about how to encourage SME growth and employment creation. In particular, the research shows that government’s emphasis on assisting start-up enterprises is misplaced as a strategy for employment growth on a significant scale.

Key to getting SME growth on track is reforming South Africa’s business environment. The evidence is clear that South African SMEs confront tough, often hostile, operating conditions. Along with standard commercial pressures – which in the prevailing economic climate are themselves daunting – our SMEs operate in an environment in which governance and social failings impose numerous additional burdens. This holds back their growth, and undermines their competitiveness.

Firstly, dealing with the regulatory burden is a priority for changing the dynamics of the business environment. Red tape saps considerable resources from SMEs and shifts the focus of owners and managers from growth to compliance. Despite government’s acknowledgement of these problems, not enough has been done to address them. Indeed, a series of recent and contemplated state interventions – such as the Business Licensing Bill, new BEE codes, the Women Empowerment and Gender Equality Bill – point towards a more restrictive environment. A thorough review and reform are long overdue.
Secondly, South Africa’s labour environment remains another key problem for SMEs. Labour legislation has repeatedly been identified in the SME Growth Index (and in much other research besides) as a prime burden to smaller firms, and a major negative consideration for hiring. The evidence suggests that reforms in this field, particularly making hiring and firing procedurally easier, would be useful to SMEs, enabling them more robustly to create employment.

Thirdly, an equally serious problem is the shortage of skills. Matching much other research in this area, we find South Africa’s SMEs are struggling to find, attract and retain people with suitable skills. Although a contributing factor is the competition for skills that SMEs face from larger firms, a more important matter is simply the inadequate supply of skills in the economy as a whole. Much of this stems from a failure of the country’s education system to prepare workseekers for the job market – indeed, it is greatly concerning that many lack basic literacy and numeracy. Moreover, as a means to generate vocational skills, the SETAs have not performed well. Growth and competitiveness – both for SMEs and for the national economy – depend greatly on a vast improvement of South Africa’s education and training system. In the interim, the very valuable contribution of individual firms to upskilling staff through formal and on-the-job training needs to be recognised.

Fourthly, the impact of crime on growth and competitiveness must be understood and every effort must be made to reduce it. The costs that crime extracts – and the violent nature of much of the crime to which South Africans are exposed – are not always properly recognised. Both in terms of the direct costs (losses to firms), and indirect costs (increased spending on security and lowered staff morale), crime is deflecting attention away from firms’ business operations. These costs are felt most acutely by smaller firms. Improved security would do much to improve the fortunes of South Africa’s SMEs.

On a more positive note, South Africa’s SMEs recognise the importance of innovation and are innovating. It is noteworthy that a strong correlation exists between firm growth and innovation. However, innovation demands skills, and satisfying skills requirements – chiefly in engineering and the hard sciences – makes substantial improvements to the education system all the more urgent. Greater cooperation between South Africa’s research institutions is also called for. In this regard, there is scope for greater cooperation between innovating SMEs and public sector research groups, principally government-backed institutions and universities.
It furthermore appears that finance, although of core importance for business, is less of a problem than might commonly be assumed. In general, South Africa’s established SMEs are able to access the funding that they require – although smaller and younger firms tend to experience greater problems. So, while a good case could be made for support initiatives to increase the availability of funding to SMEs, this is unlikely to be of decisive importance for the growth of the SME community as a whole. It is, however, likely to have an important impact on particular segments of that community; this further underlines the necessity of clearly understanding the nuances of South Africa’s SMEs and targeting assistance appropriately.

In relation to state support, it appears that well-designed and well-pitched initiatives could have a positive impact, but that at present this is not the case. Existing support and incentives are accessed by a minority and seem to have a rather limited impact. Potential recipients are frequently unaware of support offerings, and those that are regard them as difficult to access. Improvements in both marketing and administration are required.

Furthermore, state support has tended to focus on start-up firms. This should be reoriented to recognise the importance of older and more sophisticated firms to growth and job creation. Support for new ventures is important, but it is qualitatively different from what is needed by established firms. It is among the latter that growth prospects are most pronounced and job growth most likely. If state support is intended to promote employment, more attention should be directed at established SMEs.

In conclusion, all indications are that for South Africa to achieve the growth that it needs, it cannot continue on the track that it has travelled thus far. Fortunately, there is a growing recognition of the need for evidence based decision making and a growing body of evidence as to the interventions required. To contribute further to this, SBP will in the coming year publish an extensive report analysing the consolidated data from the first three years of the SME Growth Index. In line with the original objectives of the SME Growth Index, this will enable a comprehensive understanding of the dynamics of our SMEs over time, and how best to support and sustain growth trajectories in this critical sector.
SBP’s SME Growth Index is a multi-year project geared towards establishing a solid, evidence-based understanding of South Africa’s small and medium enterprises. It is the largest, most comprehensive study of the SME community ever undertaken in South Africa, and one of few of its kind worldwide. The data assembled over the course of the study provides unparalleled insights into the lived dynamics of South Africa’s SMEs.

SBP ACKNOWLEDGES THE FINANCIAL CONTRIBUTION OF THE:

Friedrich Naumann Foundation for Freedom

Tourism Enterprise Partnership (TEP) South Africa

National Treasury of the Government of the Republic of South Africa

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