HEADLINE REPORT OF SBP’S SME GROWTH INDEX™

EASIER, HARDER FOR SMALL BUSINESS IN SOUTH AFRICA

FEBRUARY 2013
INTRODUCTION

As a water-stressed country, South Africa should understand that water is not an infinite natural bounty. Sustaining our growing population, and providing for the needs of industry and agriculture, emphasises the imperative of managing it carefully. Unfortunately, there is plenty of evidence that often this is not heeded. The consequences could be severe.

There is, by analogy, a warning for many of the country’s endeavours. Both inertia and misconceived strategies can be detrimental courses of action. For decades, South Africa has recognised the importance of a vibrant small business community. Already part of state thinking in the 1980s, when the ANC took office in 1994, it was part of its manifesto. It was reiterated in the RDP White Paper, and in every significant economic policy plan since. South Africa even passed a Small Business Act, as early as 1996, when the grand designs for a future society were being laid. Most recently, it receives significant attention in the National Development Plan.

It is notable, though that the national conversation seems to fall most heavily on the outcomes of a small enterprise economy, especially as it relates to dealing with the country’s crippling socio-economic problems. The contribution that small business makes in generating employment is near universally recognised. So is the corollary acknowledgement, that a healthy and much expanded small business community could be a keystone of a new economic deal for South Africa. The NDP remarks in sketching a roadmap for South Africa over the next two decades:

A large percentage of the jobs will be created in domestic-oriented activities and in the services sector. Some 90 per cent of jobs will be created in small and expanding firms. The economy will be more enabling of business entry and expansion, with an eye to credit and market access. By 2030, the share of small- and medium-sized firms in output will grow substantially. Regulatory reform and support will boost mass entrepreneurship. Export growth, with appropriate linkages to the domestic economy will be critical in boosting growth and employment, with small and medium-sized firms the main employment creators.

This is a very meaningful comment, for it recognises something that typically receives far less public attention: the needs of SMEs. It is as if South Africa recognises that it needs small businesses, but has not yet realised fully that small businesses have needs. And by government’s own admission, little has been done to assist in its development. (For a discussion of this see the SBP Alert “Current state of legislation in South Africa”, August 2012.) At some level, it seems that the development of the small business economy was something that has been assumed rather than encouraged. A little like a farmer waiting for rain and forgetting to irrigate.
By 2030, the share of small- and medium-sized firms in output will grow substantially. Regulatory reform and support will boost mass entrepreneurship.

This raises the question of what might have been done. What should be done at the present juncture? Indeed, what can be done? These are questions to be addressed on both the macro and micro levels. On the one hand, what policy level interventions can be made to underwrite the success of a robust small business community? On the other, what decisions are firms making, and are they responding to market conditions? Together, these two strains of information are the sinews of good policy and supportive endeavours.

They raise a pressing demand for solid, evidence-based understanding of the phenomena at work in our small business community – but all too often this is lacking. The SME Growth Index aims to provide it.

The quality of South Africa’s information, and the responses it enables, could make the difference for our small businesses between decline, mere survival and growth. The indications are not all positive. A key concern is the relatively low rate of entrepreneurial activity in South Africa, and the extent to which it is powered by necessity rather than by choice. On top of that, local and global economic conditions, and the business environment are not always propitious. Dr Mark Mobius of Franklin Templeton Investments commented a few months ago: “They’ve got to make South Africa a much more attractive place for investment… I’m not only talking about foreign investment. I’m talking about local investment.”

The SME Growth Index taps into the experiences of small to medium sized enterprises to seek the answers to these questions. It has been undertaken in the belief that successful small business will entail business growth. It endeavours to understand the environment within which small businesses are operating, and to gauge the responses of small business operators to it. It is its exploration of the latter element among the largest sample of small enterprises ever assembled for such a study in South Africa, that gives the Index its key relevance.

The Index is a longitudinal study. Now in its second year, this report presents selected findings from the second round of the study, conducted during 2012. It is best understood in relation to the first round report, Priming the Soil. (This is available on www.smegrowthindex.co.za). As with its predecessor, it is hoped that this will stimulate discussion of these matters on a foundation of solid evidence. This will be crucial for working towards a durable policy and institutional response.
The 2012 SME Growth Index continues the analysis initiated by the 2011 round. It targets a sample of some 500 established, small and medium sized firms operating across selected sectors of the economy for a longitudinal study over an initial period of three years. In demographic terms, it was broadly representative of the small business community. A full exposition of this can be found in the 2011 headline report, Priming the Soil. The goal is to track the attitudes and experiences of firms, with a particular stress on studying what makes them expand or contract. When completed, the 2012 round had assembled a staggering 230 000 data points. The size of the sample and the envisaged timeframe are unprecedented in South Africa.

The firms selected for participation in the SME Growth index employed between 10 and 49 employees (in line with international norms in defining “Small and Medium Enterprises”). In order to measure the growth trajectory, growth potential and overall longevity, panellists had to have been in operation for two years or more. The panellists were drawn in broadly equal proportions from three sectors of the economy: manufacturing, business services and tourism. Those in the tourist sector were further divided between those sharing the characteristics of Panel as a whole, and firms supported by the Tourism Enterprise Partnership (TEP). Part of the mandate of this organisation is the incubation of new and very small enterprises. These are fascinating in their own right, and are being analysed separately, but as they are not comparable to the others, they have been excluded from analysis presented in this report.

The nature of the data collection enables us to investigate and analyse trends as they relate to particular segments of the Panel. One of the most vexing questions in business environment analysis is the impact of firm size. While there may be some general recognition that small and large businesses are different and will respond differently to circumstances, it is less clearly understood that within the SME economy, there are significant variations. In understanding their dynamics, and in formulating policy responses, these nuances may be of critical importance. We therefore collated the responses by dividing the firms into size-defined quartiles, running from the smallest panellists to the largest. These consisted of those employing between 10 and 20 people; those employing between 21 and 30 people; those employing between 31 and 40 people; and those employing between 41 and 49 people. The results when analysed from this perspective were frequently intriguing.

The survey threw up a very disturbing result that merits an early mention. Panellists were asked if the survival of their enterprises had been threatened over the past year. Over one third, or 35% reported that they had experienced a threat to their survival.
Tourist enterprises were most likely, at 39%, to have experienced such a threat, followed by 36% of manufacturers, and 30% of business service operators. The sense of threat was felt most keenly by the smallest of the firms, those employing fewer than 21 people, and the largest, those employing more than 40. Of the former group, around 37% reported a survival threat, and of the latter, 37%. Firms employing between 21 and 30 people reported a rate of 31%. Those in the 30-39 people size class were by a considerable margin the least likely to have experienced such a threat, with some 21% reporting one. It must, however, be noted that even this figure represents one respondent in every five. This underlines that the year preceding the survey was a very difficult one indeed.
**Turnover**

To understand the type of business that the panellists were doing, we asked them to estimate the proportional contribution that each category of clients made to their turnover.

The different sectors exhibit distinct patterns. Manufacturers and business services firms were heavily reliant on business clients, predominantly local big business (constituting some 41% of the turnover of manufacturers and 38% of the turnover of business services providers), followed by local SMEs. This demonstrates their reliance on local value chains. Local households and government and parastatals made smaller, but important, additional contributions. Exposure to foreign clients was relatively small.

Tourism, by contrast, consonant with its involvement in the personal leisure market, was focussed on the household market. Local households and individuals accounted for some 25% of its turnover, and their foreign counterparts for 23%. This was followed by big business, local SMEs, foreign business and government and parastatals.

Having established how turnover is generated, we looked at how it was being spent – in other words, what were their costs in relation to their turnover. (Note that certain costs are excluded, such as rent and interest on capital, which can vary sharply depending on numerous criteria and could distort the figures. These costs do not, therefore, represent all costs borne by businesses.) The results are not encouraging.
This basket of costs as a proportion of turnover was largest for manufacturers, at 72%. It amounted to 69% for tourism operators and 65% for those in business services. When these costs are combined with the other costs such as rent and interest, the profit margins are slender, and the consequent incentives for operating an SME somewhat thin.

The distribution of costs varied across sectors, reflecting their diverse nature. For manufacturers, the largest share of their costs came from material inputs – representing some 39% of turnover. Manufacturers’ labour costs were lowest, representing the greater requirement for other inputs of their part and its more intensive use by business services and tourism panellists. Manufacturers spent some 24% of turnover on labour, both permanent and temporary, while tourism firms spent around 33%, and business services firms 43%. In the latter case, this reflects the premium placed on skills, qualifications and expertise.

The scale of non-productive spending was concerning. Despite repeated commitments over decades to deal with this, small businesses are incurring considerable expense in dealing with the regulatory burden. Red tape constitutes 4% of a firm’s turnover to move through the average firm. Among firms in the tourism sector, the equivalent amount is a substantial R1 in every R17.

The costs of red tape hit the smallest firms particularly hard. Firms employing fewer than 21 people were spending some 5% of their turnover on meeting these costs. Those employing 21 to 30 people spent 2%; those employing 31 to 40, slightly less than 3%; and those employing more than 40 were spending a little over 2%. Red tape is thus particularly regressive and hurts those firms that are most vulnerable the most.
ARE BUSINESSES GROWING?

A clearer understanding of the factors driving small business growth is central to the SME Growth Index. This is expressed across two dimensions, these being changes in turnover and changes in employment.

A small majority of firms had increased their turnover. Just over a quarter had seen a decline, and for the balance, it had not changed. Business services panellists (67%) were most likely to have seen turnovers increase, followed by those in tourism, at 44%. Manufacturers, at 42%, were least likely to have experienced an increase. Tourism operators (33%) were also the most likely to have seen a decrease. Some 25% of manufacturers and 17% of business services panellists had seen a decline.

Panellists employing between 21 and 30 people tended to incline towards stability, with 35% having shown neither growth nor decline, 49% having seen an increase, and 15% a decline.
51% Increases
22% Stayed the Same
27% Decreased

HAS TURNOVER CHANGED OVER THE PAST YEAR

FIRMS REPORTING CHANGE IN TURNOVER OVER PAST YEAR BY SIZE CLASS

- Fewer than 21
- 21-30
- 31-40
- More than 40
In each category, the largest proportion of panellists reported turnover growth – among larger firms it was particularly pronounced. Among firms employing between 31 and 40 people, over two thirds reported turnover growth. On the other hand, those who reported decreases were spread somewhat more evenly throughout the panel, although panellists employing fewer than 21 people reported by far the largest incidence of decline. Panellists employing between 21 and 30 people tended to incline towards stability, with 35% having shown neither growth nor decline, 49% having seen an increase, and 15% a decline.

The aggregate magnitude of the turnover increase was around 9%. Matched against inflation, this represented very slight growth. Firms that had not been subject to shocks had fared moderately well, recording year-on-year turnover changes of 11%, almost double those of the firms whose survival had been threatened. The impact of threats to survival to changes to firms’ turnovers, on an aggregate level was most pronounced among business services panellists. Whereas in manufacturing and tourism, the difference in aggregate turnover change between firms that had experienced a threat and those that had not was 1 or 2 percentage points, it was a highly visible 14 percentage points among firms in the business services sector. This implies a particular volatility in the sector, expressed directly in their experience of a survival threat.
The SME Growth Index is intended to help understand trajectories of employment creation among SMEs and to interrogate the reasons behind it.

Breaking down the data by firm size illustrates the same patterns in the impact of survival threats on turnover. Non-threatened firms employing fewer than 21 people had achieved an aggregate turnover growth of some 16%, while all firms (and, surprisingly, particularly those that had experienced a survival threat) that employed between 31 and 40 people showed substantial growth. Firms with more than 40 employees, and which had experienced a threat to survival, had been the worst affected, showing a decline of more than 11% over this period.

In turnover terms, then, SMEs have shown a modest propensity for growth. All in all, on paper, growth has been most pronounced among manufacturers and tourism operators and larger firms. However, for the most part, growth has been driven by inflation, rather than by expansion. When inflation is taken into account, most firms are standing still in terms of turnover growth.
Important as it may be, turnover is a blunt instrument to measure business growth. Employment is a more accurate measure. A “growing” firm is intuitively understood to be taking on new employees. This, moreover, dovetails with the job creation benefits that make SMEs attractive for policymakers. The SME Growth Index is intended to help understand trajectories of employment creation among SMEs and to interrogate the reasons behind it.

So what was the state of play? The largest proportion of panellists’ firms (44%) had kept their overall employment numbers constant over the preceding year are captured below. Just over a third of panellists (34%) had increased their staff numbers, while the remainder, 22%, had decreased theirs.

This makes for an interesting comparison with last year’s findings. In the year preceding that survey, some 43% had kept their numbers constant, 31% had grown them and the balance had seen a decline. Thus, the broad trends were consistent. Somewhat disturbing is that the aspirations we recorded were far more positive than what transpired. Some 42% had hoped to increase staff numbers, and a mere 7% expected to see a decrease. In other words, around one in five panellists who

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had hoped to add staff were not able to do so. And some three times the proportion of firms experienced declining numbers compared with those that had expected to. Hopes were, in other words, sorely disappointed.

However, there is an important nuance here. Although a plurality of our panellists reported having taken on new staff, there was a noticeable shift in the manner in which they were being employed. Firms were increasingly seeking flexibility in their employment relationships, taking on new staff in non-permanent and part-time capacities as opposed to permanent ones. Aggregate permanent employment was shrinking, with an overall decline of 6%.

The fall in permanent employment correlates clearly to the experience of a survival threat. Overall, threatened firms had decreased their permanent staff complement by some 11%, with manufacturing and business services having been particularly hard hit. However, firms in all sectors showed an aggregate fall in employment. Manufacturing, with a net fall of some 8% registered the highest, followed by business services at 7% and tourism at 1%.
In size terms, only those firms employing fewer than 21 people did not record a decline in permanent staff. Taken as a whole, it saw no change. All other size classes shed permanent employees: those employing between 21 and 30 people by 9%, those employing between 31 and 40 people by 8% and those employing more than 40, by an extraordinary 19%.

Those firms that had experienced a threat to their survival fared even worse. Irrespective of size class, they all reported a drop in permanent staff, with an aggregate decline of 11%. Among firms employing between 21 and 30 people and more than 40 people, the scale of the decline was quite catastrophic: 23% among the former and 28 among the latter.

Even firms that had not experienced a shock had seen a decline, with the single exception of those employing fewer than 21 people. Non-threatened firms employing more than 40 people had seen a decline of 15%.

Overall, then, the data suggests an anaemic growth trajectory. Rather than describing a purposeful, opportunity-driven and opportunity-driving process of expansion, what emerges is a picture of a business community paddling along. It is delivering sufficient momentum for something beyond its own survival, but nothing like that which development thinking has envisaged for it. In particular, its job creation benefits are uneven. The decline in permanent employment opportunities is a clear sign that our SMEs are adjusting themselves to limit their exposure to the labour market. This is clearly not the optimum growth scenario for South Africa.
WHAT IS THE ENVIRONMENT LIKE FOR SMES?

If small business in South Africa is not growing as it must, the next question is why. An objective of business environment research is to investigate the impact of the broader environment on the operation of businesses individually and collectively. This is important as it relates to micro-economic policy, but means much more: the interaction business with government, technology and society. Best practice internationally recognises that governments should constantly seek out more effective means to facilitate entrepreneurship. How is this experienced in South Africa?

To investigate this issue, we asked the Panellists to assess the business environment, in terms of whether it had become easier or more difficult to operate an SME in South Africa over the past year. The overall results were unequivocal: South Africa had become less accommodating to small and medium sized business. Nearly three quarters of respondents, some 74%, agreed that running an SME had become more difficult. A further 19% felt that conditions had not changed, while a little over 6% felt that it was easier to operate an SME.
74% agreed that running an SME had become more difficult.

Manufacturers were most negative about the direction of the business environment. Some 81% felt it had become more difficult, and only 3% that it had become easier. Some 71% of business services panellists felt that things had become more difficult, and only 7% that they had become easier. Tourism panellists were markedly more upbeat, with some 13% feeling that business had become easier – although around two thirds agreed that it had become more difficult.

These results are jarring when measured against government’s emphasis on manufacturing as a growth area. Simply stated, manufacturers are the most negative about trends in the business environment. This reproduces the results of the 2011 study fairly closely. Given that manufacturing is also an endeavour that is likely to require specific fixed capital investment whose options for disposal in the event of failure are limited, that its input prices are climbing, that it may require scarce and pricy hard artisanal skills, and that it is prone to unionisation (even in small scale plants), it is a tough sector to operate in. This may also explain why manufacturing in South Africa is in long-term decline. Tourism, by contrast, far less subject to these conditions, evidences much greater confidence. These results point to a pressing need for serious policy adjustments to assist manufacturing if its industrial plans are to have any chance of succeeding.
Panellists were then asked to elaborate on these responses. The responses provided by those who felt it was easier to operate an SME generally did not in fact relate to the broader environment, but rather reflected firm-level strategies, such as having opened a new line of business for the firm. As one noted: “We have improved business processes and increased the capacity of our staff.”

Those panellists who felt that operating an SME was more difficult cited a wide range of factors. The overall state of the economy featured strongly across the Panel. Simply stated, there was not enough work available. A panellist from the manufacturing sector put it succinctly: “Rising prices, shrinking margins. The average man in the street has less spending power and people are cutting out luxuries”. Those from the tourism industry noted the decline in foreign visitors, and the expense of long-haul flights.

A number cited governance factors. These included steep rises in administered prices and municipal accounts, uncertainty about the supply of services and the bungling of visa applications. The political climate, giving the impression – rightly or wrongly – of state weakness, confrontational rhetoric and the potential for violence, was also noted. This was particularly the case in tourism, as a factor discouraging visitors.

Lastly, legislation and regulations (“red tape”) were repeatedly raised. The compliance burden as a whole was widely viewed as onerous, diverting time and resources away from the core business of the firms. Labour legislation was linked to the difficulties of employing staff. One panellist noted: “Legislation, labour laws, bureaucracy, red tape, all take so much time trying to make sure that the house is in order”. There are a lot more restrictions on the way the business operates. More admin work that has to go into what we do and then you have all the requirements to fill in for tender opportunities, has all added to the burden.” Black Economic Empowerment (BEE) policy and dealing with SARS inefficiencies were mentioned by several panellists as being time-consuming and insensitive to the position of SMEs, while offering few benefits (very similar to the findings in the 2011 report).
To gauge the regulatory burden and its impact on the small business sector, we asked the Panel if it had increased, decreased or remained constant. Remarkably, not a single respondent said that the regulatory burden had decreased. Slightly more than half reported an increase in the burden, and slightly less than half indicated that it had stayed the same. Panellists in the tourism sector demonstrated the smallest perception of an increase in the regulatory burden, at 40%. Manufacturers were close to evenly split between those reporting an increase and those saying that it had remained constant, with a slight leaning towards the latter. The business services sector reported a far larger increase: some 63%.

In view of the overall opinion of the Panel that running an SME was becoming more difficult, we inquired about their exposure to events or trends that were particularly damaging to their profitability – which we termed collectively “shocks”. In view of the tough economic times – the impact of which came across clearly in the 2011 SME Growth Index – understanding the nature of problems faced by SMEs is of great importance.

EXTERNAL SHOCKS TO PROFITABILITY (% HAVING EXPERIENCED)
- Rise in Input Prices
- Increased Competition
- Contraction in Market
- Decline in Infrastructure
- Increased Red Tape and Regulations
- Currency Volatility
- Increased Electricity Costs
- Increased Municipal Rates and Taxes
- Increased Transport Costs
- Other
Panellists were far more vulnerable to external than to internal shocks. On the external front, increased input prices were the largest single shock experienced – 27% of the Panel reported their bottom lines having been hit by this. This was most pronounced among tourism operators, at 40%, followed by 28% of manufacturers and 17% of business services operators.

Behind increased input prices came market contraction (17%), increased red tape and regulations (14%), and increased electricity costs and competition (11% each). Market contraction and red tape were particularly acute among business services panellists, 23% and 22% respectively, while electricity prices made a disproportionate impact on manufacturers (15%).

Internally, loss of key staff was the most important factor, with 15% of the Panel indicated that they had experienced such a loss.

Firms employing fewer than 21 people reported shocks from input prices at a rate considerably greater than their larger counterparts, 31% as opposed to 25% among those employing between 21 and 30 people, 24% among those employing 31 to 40, and 18% among those employing more than 40. This probably relates to the restricted cash flow and the smaller room for financial manoeuvre on the part of smaller firms.
Smaller firms also exhibited a heightened vulnerability to the loss of key staff. Among those employing fewer than 21 people, **15%** reported this as a shock, roughly comparable with the Panel average.
Smaller firms also exhibited a heightened vulnerability to the loss of key staff. Among those employing fewer than 21 people, 15% reported this as a shock, roughly comparable with the Panel average. It was most acute among those employing between 21 and 30 people, where 20% of panellists cited this factor. Some firms of this size were arguably of a size that denoted expansion towards larger production volumes and turnover, while still experiencing the constrained cash flow and resources of a small enterprise – with consequent implications for the ability of firms to pay competitive salaries and their reliance on a necessarily limited number of key people. The loss of a specialist, with technical or organisational skills, or institutional memory, would have a more profound impact. Among larger firms, it was rather less serious, 12% of panellists in firms employing between 31 and 40 people and 10% in those employing more than 40 people.

Larger firms were more vulnerable than smaller ones to regulatory factors, or “red tape”. A full 36% of firms employing between 31 and 40 people reported having experienced this as a shock, as did 16% of those employing more than 40.

All in all, the picture that emerges is one of an SME community struggling with the prevailing conditions, and in a very real sense, battling to stay afloat. It would not be an exaggeration to say that a widespread business objective and lived experience is one of simple survival, rather than expansion – although not yet one of decline.
Trends often do not progress in a linear fashion. Frequently, the highest reports of a given factor occur either among those employing between 21 and 30 people, or between 31 and 40.

We also identified a noticeable continuity between the results in this round of the SME Index, and those of the previous round. The same factors – input prices, market contraction, the regulatory burden, and to a limited extent, electricity prices – featured as the key vulnerabilities in both rounds.

Moreover, the 2011 report indicated the extent to which the entrepreneurial community is ageing: some 43% were older than 50 years of age. We also found that, particularly among manufacturers, advancing age was not matched by new entrants, and that no succession plan or ready option for a profitable sale existed. When this is combined with extent to which firms have experienced threats to their survival and the numerous difficulties that entrepreneurs encounter in running a firm, our evidence suggests the steady shrinking of the entrepreneurial pool.

Another intriguing factor emerges when the results are examined by firm size: trends often do not progress in a linear fashion. Frequently, the highest reports of a given factor occur either among those employing between 21 and 30 people, or between 31 and 40, even where a general trend from one end of the spectrum to the other may be discerned. This is a phenomenon that needs to be probed carefully. As has been suggested above, it provides some evidence for the existence of what might be termed an “expansion and contraction band” among SMEs. In other words, firms in this group might be more prone to changes in staff or turnover, and might find their fortunes abruptly intersecting with an aspect of the environment that had not concerned them previously.
WHAT IS HOLDING GROWTH BACK?

If SMEs are to generate wealth and jobs – the not unreasonable preoccupation of policy makers – they will need to grow. Having established that most find the environment in which they operate a difficult one, we asked the Panel to identify the factors that impede business growth. In contrast to the “shocks” – measured in terms of profitability, and tended to represent more sudden changes to conditions – these barriers were longer-term and largely structural. To deal with them, policy interventions of some nature would likely be necessary.

The immediate observation is that a wide range of factors are hindering business growth, suggesting that any attempt to address the problem will require action on multiple fronts. Single issue interventions, although not without merit, will have limited overall impact.

However, a clutch of four factors dominated the results, accounting for some 60% of the total. Local economic conditions topped the list by a small margin – some 18% of respondents identified this as their most important impediment to business growth. This was followed, in descending succession, by lack of skilled staff, lack of finance, and regulations.

These were followed by a “second string” of responses, measured in single digits, collectively amounting to 27% of responses. The most significant of these were costs of doing business, global economic conditions and lack of markets, and the cost of labour.

Local economic conditions topped the list followed, in descending succession, by lack of skilled staff, lack of finance, and regulations.
Interestingly, local economic conditions, although the top-ranked factor overall, was the top-ranked factor only for business services panellists. Some 26% of business services panellists ranked it as the top inhibitor of business growth. This proportion was also far larger, by some 8 percentage points, than the panel average, as well as constituting a considerably larger proportion of the sector total than the top ranked factors in manufacturing or tourism. The second and third largest proportions of panellists in the business services sector (21% and 14% respectively) named a lack of skilled staff and burdensome regulations as the top inhibitor.

Panellists in the tourism sector named a lack of finance as the single greatest inhibitor of business growth, with some 19% doing so. Global and local economic conditions were viewed as significant additional inhibitors. This reflected, primarily, cutbacks in travel and leisure spends by consumers both in South Africa and abroad.

Among manufacturers, as with their counterparts in tourism, a lack of finance was the single most widely named inhibitor. Around 14% of manufacturing panellists named this factor. However, at 12%, an equal proportion of panellists named a lack of skilled staff, burdensome regulations and local economic conditions.
What emerges is a view of three sectors facing three distinct sets of challenges. Business services emerged as a sector experiencing a concentrated set of constraints, these being factors inherent in the local environment—market conditions and regulation—and by deficiencies in qualitative inputs. Tourism is far more occupied with quantitative, financial inputs, and the state of the foreign and local economies.

Manufacturing is an outlier of sorts. The top three inhibitors named by panellists in this sector exist within a very narrow numerical range, considerably narrower than that of those in the other sectors. The range of factors named within the “top three” positions was also far wider than those of the other factors—three having been identified by an equal proportion in the second most frequently rated position. Manufacturers’ dominant concerns revolved around financial issues, market conditions, qualitative inputs, and the regulatory environment have a significant presence. The implications of this for policy are important, for they suggest that promoting the growth of the manufacturing sector—more so than for any other sector—would require multiple interventions. They would also need to alter extant policy.

Viewed from the perspective of firm size, it is apparent that the dominant factor for the Panel as a whole, the impact of adverse local economic conditions, becomes more pronounced as firms become larger. Thus, some 20% of panellists in firms employing more than 40 people identified this as their primary problem, as opposed to 16% of those employing fewer than 21, and 19% each of those employing between 21 and 30 and 31 and 40 people.

Smaller firms tended to view a lack of finance as the key problem. Some 19% of panellists whose firms employed fewer than 21 people named this as the most important inhibitor, as did 13% of those in firms with between 21 and 30 employees. By contrast, only 9% of panellists in firms employing between 31 and 40 people, and 7% employing more than 40 people identified this factor as their primary blockage to growth.

Human resources considerations—specifically a lack of skills and labour costs—were named most frequently by firms employing between 21 and 30 people and between 31 and 40.
The regulatory environment, consistent with responses elsewhere in the survey, registered more concern among the larger firms than the smaller ones. A full 25% of panellists in firms employing between 31 and 40 people rated this as the most important inhibitor of business growth, while 16% of those employing more than 40 people gave the same response. Some 12% of panellists in the smallest class of firms and 7% of those employing between 21 and 30 people indicated that this was their key barrier.

**Barriers to hiring**

Turning to employment matters specifically, we asked the Panel to rank the factors that dissuaded them from taking on additional staff.

A lack of demand was by a considerable margin the most prominent barrier to employment on the sample overall – some 45% ranked this as their most pressing issue. Difficulties in finding skilled people came in second, at 16%, closely followed by labour regulations at 15%.
In all cases, the top two factors listed came close to, or exceeded, two thirds of the responses made. Lack of demand was the largest single factor across all three sectors, and approached half the responses given by the panellists in the manufacturing sector. Panellists in the business services and tourism sectors both identified difficulty in finding suitably skilled people as the second most common factor. The panellists in the manufacturing sector, by contrast, found labour regulations to be the most common inhibitor after inadequate demand.

All in all, the Panel’s responses suggest that employment is blocked in the first instance by the general economic environment. Beyond this, we see two important sets of barriers that are susceptible to policy and institutional solutions.

Labour regulations make a particular impact on manufacturing, while skills – and by extension, education and training – hits the services sector very hard. The latter, skills shortages, has been a recurrent theme in analyses of South Africa’s labour market, and in the 2011 SME Growth Index, they emerged as a significant barrier to employment. The 16% of panellists who identified skills as a barrier in the 2012 survey actually represented a sizeable proportional increase over the 11% who named them in the 2011 survey.
When asked about particular skills - both "hard" and "soft" - that were lacking, the following were specifically named:

- Literacy and language/communication skills;
- Mathematical and scientific skills;
- Computer abilities;
- Sales and marketing abilities;
- Financial skills and an understanding of financial products;
- General life skills.

In addition to the mix of both advanced and basic skills that panellists found lacking (and which mirrors the findings of the previous year’s survey), a striking number of panellists referred to attitudinal deficiencies on the part of staff, particularly younger people. Problems relating to work ethic and poor self-motivation were repeatedly raised. One itemised the following criticisms: “Non-attendance, laziness, bad work ethic, theft. Have an attitude of expectance. I work so you must pay me – no matter how badly I do my job”. As panellists made remarks in a similar vein elsewhere in the survey too, (for example, while discussing shocks to his firm, one panellist drew a distinction between those who “have been with me for 20 years” and the “younger guys who don’t know they need to align”), this is a matter of extensive concern.

This dimension – which might be termed socio-cultural – is certainly an important one, but is difficult to quantify. Comparative evidence makes clear that jobs, rather than welfare entitlements, are the economic resources most sought by South Africans. What the panellists’ response may be reflecting is a sense of expectation generated by life in a consumer society, and which views work not as a satisfying end in itself, or even as a part of building a successful career with the mobility that it would entail, but merely as a necessity to enable consumption.

Youth Wage subsidy
A subsidy to businesses employing young labour market entrants, to cover part of their wages, has been floated and extensively commented on over the past two years. To evaluate the likely impact of such a policy, the views of the panel were sought.

Around 55% of panellists were in favour of the introduction of a Youth Wage Subsidy. Manufacturing respondents, with 56% in favour, were slightly more committed to it than panellists in business services or tourism, at 54% and 55% respectively.
The subsidy had the most pronounced support among firms employing between 31 and 40 people – interestingly, the class that showed itself to have been most likely to have hired in the preceding year. Some three quarters of such firms supported the subsidy. Smaller firms registered an overall agreement with the idea, but of a less emphatic nature. Larger firms – those employing over 40 people – however, did not share this view, with the attitude tipping sharply away from support for subsidy. This was the only size class in which a majority of panellists did not favour the subsidy: only 44% were in favour, and 56% opposed.

Those who rejected the Youth Wage Subsidy were asked to explain their views. Probably mentioned more than any other factor, was a general negative perception of the work ethic of young people (as noted earlier). One panellist said that older staff were more reliable and “untrained youth often come in with bad attitude”.

Those firms that indicated an interest in the Youth Wage Subsidy were asked if they would use it as a means to displace older workers with new and subsidised employees – a central plank of the objections to the scheme raised by unions. The resounding response to this was no. Only 13% indicated that they would use it to replace older employees (this would mostly be done after the retirement of the older employee). This was highest among manufacturers, at 21%, but only at 8% among panellists operating business services firms, and 6% among those in tourism.
With regards to the magnitude of such a subsidy, panellists were asked to indicate what amount would make a meaningful contribution and encourage them to take on younger people. The mean among panellists in the manufacturing sector was R1 706.92; among panellists engaged in business services it was R1 910.17; and among tourism panellists it was R1 766.61. These estimates are in line with the amounts proposed by the Treasury. The fact that manufacturers required the smallest subsidy – albeit not by a large margin – implies that this could be a useful tool for revitalising the sector.

**Training**

The Sectoral Education and Training Authorities (SETAs) are government’s flagship skills development initiatives, and were conceived as a means to drive a “skills revolution”. Their efficacy has, however, been widely questioned.

Slightly more than one quarter of the panellists (26%) reported having participated in training organised by a SETA in the past year. This is in contrast to non-SETA training conducted externally to firms (53%) and on-the-job training (66%). This means that of all the training options examined for the SME Growth Index, SETAs were the most infrequently used.
Panellists in the manufacturing sector participated in training organised by SETA at a higher rate than those in the business services and tourism sectors: some 30% of manufacturing panellists indicated having done so, against 29% in business services and 10% in tourism.

It is apparent that participation in SETA programmes correlates to firm size. In the smallest size class, only 18% had participated in SETA programmes, rising to 23% among those in the class employing between 21 and 30 people. In stark contrast, the participation rate in both of the largest classes (those employing between 31 and 40 and those employing more than 40 people) exceeded 40%. This strongly implies a link between size and the ability to participate in the SETAs’ offerings.

Only 26% of firms reported having participated in SETA training.
Impressions of the benefits from the SETA programmes among those who participated were varied. Some said that they had undertaken it in order to comply with particular standards – “have to comply with legislation so we do do it”, one panellist commented – while others were clearly trying to improve the skills and qualifications of their workforces.

The qualitative remarks of those who participated indicate a greater degree of satisfaction among smaller firms that had participated in SETA programmes than with their larger counterparts (inversely to the use of the system). This may be a function of the greater complexity, sophistication, and probably age, of larger firms. For such firms, for assistance to make an impact, it would likely need to be specialised and address complex skills issues.

On the other hand, there was also considerable criticism. Some panellists described their experiences with a curt “no value”.

Those who did not participate in SETA programmes were also asked to explain why not. A chief issue was that training was being carried out elsewhere, so there was no need for the SETA offerings. One panellist remarked that employees were trained in-house “as we want staff to work in accordance with our business”.

A lack of knowledge of what SETAs offered was discernable. One panellist in the business services sector commented: “Not aware of any [training] and do not know who to approach for that sort of info. No one has approached us either. Out of sight out of mind.” Other panellists reported that the SETAs did not offer training relevant to their needs – a matter closely related to the criticism of some of the panellists who had participated in SETA training, that training provided was too basic for their needs.

Lastly, a number of respondents indicated that their lack of engagement with the SETAs arose from a perception of them as cumbersome, inefficient and bureaucratic, and not being able to offer value for the amount of effort that working with them entailed. One panellist said that there was “not enough time to complete the paperwork”.
LOOKING TO THE FUTURE

To understand the SME sector’s incipient confidence in respect of operating an enterprise in the current environment, panellists were asked about their intentions for the coming year, and the state of their aspirations regarding their firms. Together, these responses provide an insight into the state of the SME community as it contemplates the future.

From the point of view of concrete intentions, the picture emerging from the Panel was a moderately positive one. Over 60% of panellists indicated that they intended either introducing new products and services or seeking new markets. Another 20% intended opening new locations, and a further 18% intended opening a business in a new industry. These responses suggest a response to economic circumstances predicated on adaption in order to remain in business. Considering the difficult economic circumstances, this is encouraging.

Some 9% intended selling the business, 1% closing it, 8% disposing of assets, and 7% retrenching staff. Those panellists naming these factors, suggesting a more pessimistic outlook, were a relatively small minority of the total.

Manufacturers provided an interesting mix of answers. They tended, on the one hand, to be intent on introducing new products: 68%, as opposed to 61% of business services panellists and 53% of those in tourism. They were also the most likely to be intending to seek out new markets, at 71%, while its counterparts in other sectors registered 60% and below. They were, however, also the most likely to be intending to sell the whole business, at 15%.

Panellists’ aspirations – understood as a more generalised and impressionistic sense of optimism or pessimism regarding the firms’ prospects – matched the generally upbeat tenor of their intentions.

Aspirations were interrogated extensively in the first round of the SME Growth index, and discussed in some detail in the 2011 report. In brief, it was found that a majority of the Panel (55%) hoped to grow their businesses over the coming five years. Panellists in the business services sector were the most inclined towards optimism here, with 70% hoping to grow, while those in the manufacturing sector were considerably less optimistic, at 49%. Only 29% of those in the tourism sector hoped to grow.

Panellists described the regulatory environment as complex, burdensome and imposing unrealistic demands on business.
IN THE YEAR, DOES YOUR FIRM INTEND DOING ANY OF THE FOLLOWING? (MULTIPLE RESPONSES ALLOWED)

62% Introduce new goods/products/services
20% Open new locations
15% Sell equity in the business
61% Look for new markets
18% Open a new business in a different industry/sector
7% Retrench staff
8% Dispose of assets in the business
9% Sell the whole business
1% Close the business
1% Close locations
Over 60% of panellists indicated that they intended either introducing new products and services or seeking new markets.

The 2012 study showed a general upswing in the mood. Across the Panel, some 57% had adjusted their aspirations for the better, 11% for the worse, while those of 31% had remained the same.

Panellists in the manufacturing sector were, on balance, the most negative in the sample, registering both the lowest proportion [44%] having improved in their aspirations, and the highest proportion [17%] with a negative adjustment.

Just over half of tourism panellists had altered their aspirations for the better, and a very small 6% had changed them for the worse.

Consistent with the findings of the first round survey, panellists in the business services sector evidenced a high degree of optimism, with 57% having adjusted their aspirations for the better. However, around one in seven business services firms had changed their aspirations for the worse – suggesting some noteworthy problems in the sector, or the revision of previously optimistic attitudes. Attitudinally, though, business services are “on the move”, as fewer than one third of Panellists reported keeping their aspirations constant. This was sharply divergent from the pattern among panellists in the manufacturing and tourism sectors.
Viewed from the perspective of firm size, the greatest degree of optimism was evident among firms employing fewer than 21 people. Some 63% of these had altered their aspirations for the better, and only 11% for the worse. Firms employing between 21 and 30 people most inclined to keep their aspirations stable. Although a plurality of firms employing more that 41 people showed a tendency towards optimism (47%), it also demonstrated the highest propensity for negativity, at 16%.

Fleshing out these numbers, Panellists’ comments pointed to a range of prompts for their views. These related both to factors internal to their firms, and to factors in the broader environment.

Market improvement came out strongly. Several responses indicated a belief that South Africa was emerging from its economic difficulties. One Panellist said: “There is a feeling that, locally, things are improving economically and that, as a result, clients are more willing to spend on IT services.” Another, noting the impact of the turmoil in refining the economic field, commented: “Bit more work coming in. Either because of a turn in the market or possibly because the market has shrunk during the recent tough economic times and now there are just less of them to do the existing work.”

A prominent sub-theme here was the seeking or expansion of opportunities abroad. This came up repeatedly, in relation to markets in Africa and elsewhere.

Changes to the conduct of business came across strongly as an internal factor driving confidence. This took the form of new skills, new equipment or new management processes. A business services panellist, for example, said that: “Staff became more skilled which meant they were able to take on more complex assignments, allowing management more time to service senior staff of companies and attract more business.” Innovation featured prominently, involving new ways of operating, or diversifying firms’ offerings. One Panellist said that he was: “thinking out of the box more. Innovative marketing strategies. Decluttering and simplifying procedures, [and] trying for a bigger market share.”

Among the panellists whose aspirations had declined, three broad factors featured. The first is the business environment, which some several felt was still depressed, and affecting them adversely. Some firms faced particular, industry specific issues. A panellist involved with mining companies said that they were not spending money owing, inter alia, to political threats to the mines. Secondly, staffing issues, with some panellists being sceptical of the people they did or might employ. One described them as “less competent and willing”. Thirdly, and possibly most widespread, was the regulatory environment. Many panellists – this appeared most pronounced in the manufacturing sector – described it as complex, burdensome and imposing unrealistic demands. One panellist was fairly typical in citing: “Economic conditions, labour relations, labour policies are biased against employers and SMEs.”
All in all, the most important message is that SMEs, despite the hazards of the environment and their manifold constraints, are remarkably buoyant. This is particularly so among the service-oriented panellists. This sense of optimism and a desire to improve their enterprises is a potentially valuable asset for South Africa.

On the other hand, this is clearly not evenly spread. There is considerable variance and volatility within the results. Manufacturing emerges, once again, as a struggling sector. Aspirations here are considerably more restrained in comparison with those of its peers.

It is also not evenly shared among the various size classes. Once again, we have found that there is no straight correlation between the issue at hand (in this case, aspirations) and firm size. That the most positive results, overall, were to be found among firms employing between 31 and 40 people, and that those employing more than 40 strongly suggests a growth-focussed attitude that is being terminated once firms grow into the upper end of the scale.

**Market expansion**

Acknowledging that firms faced barriers to their expansion, we asked about their experiences of expanding markets. As to the sort of market expansion opportunities they had explored in the past year, panellists gave two distinct sets of answers.

The first was a geographically defined response. This group sought to expand into regions where they were not operating, particularly in Africa. One respondent summed this up: "Looking at opportunities in Africa - where we join hands with other companies in order to see how best we can get business for the group, establishing marketing arms around Africa."

The second was qualitatively defined. This group was looking at finding new markets by diversifying its offerings. For example, one panellist in the tourism sector indicated a move into conferencing – "to date this has been restrictive as restaurant can only cater for a limited amount when offering conferencing facility. In building new facility, [we] can seat 250 people for meals."

Probably the most interesting point to emerge from this inquiry was not the barriers to expansion, but the relatively small number that did not wish to expand. At only 13%, this demonstrated that the desire to seek out new markets was overwhelming.

The largest single factor preventing market expansion, cited by 28% of panellists, was a lack of finance. This was followed by a lack of demand, or the general unavailability of a market to expand to, at 22%. A further 11% cited lack of skills, and 10% competition and imports. Regulatory factors, corruption, crime, BEE and dealing with SARS together contributed some 16%.
Competition and imports constituted a significant problem among manufacturers, with some 15% identifying them as the primary barrier.

Lack of finance was a particularly important barrier to market expansion among panellists in the tourism sector, some 37%, and among firms employing fewer than 21 people, some 34%. Competition and imports constituted a significant problem among manufacturers, with some 15% identifying them as the primary barrier. A lack of skills was a particularly acute problem for business services panellists.

We also asked our panellists if they had submitted tenders for business. Just over half of all panellists’ firms had not tendered for contracts. The most common form of tendering was to large firms, with 29% of panellists having submitted such a tender. Tenders to government varied in accordance with the geographical accessibility of the sphere: thus, some 20% had tendered to local government, 18% to provincial government, and 15% to national government.

There was considerable cynicism about tendering, in relation to both the public and private sector, with many panellists alleging that results were pre-determined and that tendering was meant to provide a veneer of competition.
PANELLISTS’ CONCERNS

The data demonstrates that SME operators were facing a tough set of conditions, but retained a resilient attitude. Whether they would realise their aspirations or would fail would depend on their ability to function within conditions as they might exist in the future. We therefore asked the Panel to name the top concern regarding prospects for future business growth. A number of possible responses were offered for their consideration, including a generic “Other” category.

The results here are striking. They indicate that the future concerns of the SME sector are significantly concentrated on a small number of factors. The three factors identified most frequently together accounted for nearly three quarters of responses. These were municipal rates and services; regulations and red tape; and the global economy. While the responses made regarding barriers to growth recorded a wide spread of views, which would in turn call for a wide range of interventions, the concentration of responses here could potentially suggest high-impact avenues for action.

Municipal Rates and Services

The top concern for the Panel was municipal governance – the costs it imposes through rates and service charges and the quality of governance it provides. Some 38% of panellists ranked this issue as their top concern. It was named as the top concern by close to double the number of Panellists who identified the second most widely cited concern. Tourism and manufacturing panellists were most concerned about it: 47% of the former and 45% of the latter. The degree of concern that they expressed was quite logical since both are heavily dependent on local governance for their inputs and efficient operation.

Panellists in the business services sector were markedly less concerned about it. Such firms are more likely to depend on their human capital than the physical environment. However, even among this group, 25% rated it as their top concern.

A greater concern about municipal governance was evident among companies that had experienced a threat to their survival than among companies that had not. Some 41% of companies that had experienced a threat to their survival rated this as their top concern, a little in excess of the Panel average.

Municipal rates and services also seemed to be a more pressing concern for larger than smaller firms. The proportion of those employing fewer than 21 people was, at 39%, comparable to the sample as a whole. Those employing between 21 and 30, by contrast, were far less concerned (32% of this group rated this as their top concern). Firms employing between 31 and 40, and more than 40 people each registered more concern than the Panel average: 45% among the former, and 43% among the latter.
MOST IMPORTANT FACTOR INHIBITING GROWTH

- Municipal Rates and Service: 38%
- Regulations and red tape: 21%
- Local Economic Conditions: 9%
- Global Economy: 15%
- Corruption: 2%
- Labour Relations: 2%
- Other: 2%
- Crime: 1%
- Skills: 3%
- Political Environment: 2%
- Financial environment: 4%
- Crime: 1%
- Skills: 3%
- Local Economic Conditions: 9%
- Global Economy: 15%
- Corruption: 2%
- Labour Relations: 2%
- Other: 2%
- Crime: 1%
- Skills: 3%
- Political Environment: 2%
- Financial environment: 4%
Regulations and red tape
Regulations and red tape have been contentious aspects of South Africa’s economic regime for decades. SBP’s research has drawn attention to this in the past, and officials in government and the ruling party have conceded that the administrative burden on small business must be reduced. Other commentators have added that it is not merely the existence of a significant administrative burden that is problematic; in South Africa, this burden is the responsibility of a sometimes inefficient bureaucracy. As economist Chris Hart once commented, “red tape must work.”

With a Panel average of some 21%, regulatory issues were the second most frequently named factor. Business Services panellists were markedly more concerned (at 26%) about this factor than the panel average – reflecting the extent to which some of their operations are subject to specific professional regulatory regimes. Manufacturers registered a level of concern consonant with the average, 21% indicating this was the most pressing concern for business growth. Panellists in tourism were far less concerned, with 11% giving it their top ranking.

The regulatory regime was of lesser concern to the smallest panellists, of whom some 16% ranked it as their top concern, than to the larger categories. It must, however, be remembered that the costs of the regulatory burden actually weighed most heavily on smaller firms; the inference is not that they were unconcerned about the issue, but that other issues were more pressing for them. Concerns about red tape were most prominent among Panellists in the 21 to 30 and 31 to 40 size classes, some 26% and 24% of panellists in the respective groups viewing it as their top concern. Concern declined a little among the largest firms: this factor was named by about 21% of firms employing more than 40 people, roughly the same as the Panel average. This suggests that exposure to the regulatory burden is a partial function of firm size, but that there appear to exist certain elements in the intermediate groups that drive this concern up.

Irrespective of the relative importance they accorded to the issue, the clear sentiment of the panel was that no relief was in sight. A majority of the Panel (54%) expected to see an increase in the regulatory burden. Another 44% expected it to remain constant. Underlining a general view that no significant regulatory reform is to be expected, a paltry 1.3% expected a decrease in the burden.

Global economy
Ongoing difficulties in the global economy were distinctly affecting the sentiments of South African SMEs. It ranked as the third most commonly named factor, cited by some 15% of the Panel as their top concern.
Panellists described the regulatory environment as complex, burdensome and imposing unrealistic demands on business.

The global economy impacted especially severely on firms in the tourism sector (24%). Panellists in the business services sector were less concerned about the global economy – some 14% ranked it as their top concern. Among manufacturers, it was ranked as the top concern by only 12%. These results tally with the turnover structure, which showed a far greater direct exposure to foreign markets among tourism panellists than among manufacturers or those in business services. Indeed, for the latter two, this exposure was likely to be indirect, mediated largely through other clients.

Concerns about the global economy predominated among firms employing fewer than 21 people, and more than 40. Firms in these two size classes were probably each exposed to the global economy in their own ways; the smaller ones in servicing foreign clients, for example, as guesthouses, the larger being large and competitive enough to be plugged into global value chains.

The real importance of the global economy emerges when the data is analysed from the perspective of the differences between firms that had and had not experienced a threat to their survival. It was a particularly important variable for firms that had experienced a survival threat. Of the firms that ranked the global economy as their primary concern, some 41% were firms that had experienced such a threat – some six percentage points higher than its share of the sample as a whole, with a concomitantly smaller share among the firms that had not experienced such a threat.
LISTENING
TO THE VOICES

As a group, SMEs are frequently spoken about, but seldom spoken to. To fill this gap, the Index attempts to capture and present their views, both aggregated and nuanced, to highlight the matter of concern, and to suggest possible avenues for action. As in the 2011 headline report, we asked panellists an open-ended question as to what they would like to see government and the private sector doing to improve the environment for SMEs in the country.

The range of replies was extremely broad. The ten most frequently cited avenues for action are set out below.

- SMEs, irrespective of their size, sector, or the race or sex of their owners, need to be integrated into value chains in the broader economy, with a firm eye on firms’ abilities to make a productive contribution.
- Corruption in both the private and public sectors must be eradicated.
- Labour legislation needs to be reformed to recognise the greater burden it is placing on SMEs, to alleviate the direct and opportunity costs it is imposing, and to make the employment of additional staff more attractive.
- The general administrative and compliance burden of operating in the economy – red tape – must be reduced.
- The tax burden should be reviewed, along with a view to correcting deficiencies in the South African Revenue Service, and simplifying tax matters in general.
- Public administration – governance – needs to be carried out more efficiently and effectively at all levels, but with an especial stress on municipal government.
- Business in general needs to voice its concerns and perspectives more volubly and with greater unity.
- BEE must be reviewed.
- Training and skilling of the workforce should receive higher priority in both the public and private sectors.
- More appropriate facilities and instruments to finance SMEs should be developed and made more accessible.

As a group, SMEs are frequently spoken about, but seldom spoken to.
KEY MESSAGES

Delivering on the potential of a robust small business community will require the concerted efforts of a range of stakeholders. Fortunately, as stated at the beginning of this report, the need for such a sector is generally acknowledged. South Africa now needs to move towards a consensus as to how this is to be done, and which interests need to adjust themselves to achieve it. This is certainly highly contested territory, but the sentiments of the National Development Plan cannot be bettered: “The environment must be conducive to taking advantage of opportunities that arise.”

In the previous report, we set out three considerations that needed to form the backdrop to any discussion of SME support. These are worth reiterating.

Firstly, evidence is crucial. Professions of commitment to the development of SMEs abound, but much thinking about the means to do so relies on doubtful and incomplete evidence. We need to know a great deal more if we hope to fashion effective responses. The SME Growth Index is a contribution to this.

Secondly, a successful SME community will underwrite a successful society, and a successful society will do the same for a successful SME community. Our findings make it very clear that what happens outside a firm’s immediate business activities can nevertheless exercise a great influence on its fortunes. Such matters as education, governance and service provision are critical for the fate of our SMEs. There are few borders between the SME community and society.

Thirdly, our SMEs are businesses. This is sometimes lost in national conversation. Small businesses are neither the “the acceptable face of capitalism”, nor make-work schemes, nor community improvement initiatives. They should not be treated as avatars of observers’ ideological preconceptions. They will operate as well as they are able to exploit available opportunities – always provided, of course, that the environment exists within which these opportunities can arise. Unless opportunities and incentives exist for reasonable economic returns, our SMEs will struggle to flourish.

To government the first message is to strive for ever-greater competence in what must be its core activity: governing. This is sometimes obscured by the ideological and political debate. On numerous issues panellists showed frustration with governance. Indeed, combined with the increase of administered prices municipal governance (or misgovernance) can make a crippling impact on business. This is most directly expressed through the failure of government to pay its suppliers timeously. These issues, unglamorous and tedious though they may sometimes appear, are critical for the smooth functioning of the country, and the maintenance of an environment within which business can thrive.
The second, as argued in the 2011 headline report, is the need for regulatory reform. It bears mentioning that this has been a supposed goal of government since 1994. The Reconstruction and Development White Paper, post-apartheid South Africa’s first developmental blueprint, made an explicit commitment in this regard. This is entirely in keeping with international best practice. Yet headway on this matter has been limited. The evidence from the Panel is that large amounts of time, effort and resources are being devoted to dealing with government-imposed administrative matters.

In process terms, at least on the legislative front, regulatory impact assessments are crucial. A clear understanding of the probable consequences of legislation should be standard procedure. There are two necessary corollaries. The first is that these should be taken as serious guides to policy. It is arguable, with reference to a suite of amendments to labour legislation that has been under consideration for some a number of years, that this is not the case at present. The second is that the initial design of legislation should be realistically framed. The Women Empowerment and Gender Equality Bill, with its demands for reconfiguring the workforce and denying any consideration of skills, capacity or finances in so doing, is an example of the latter.

The third, government intervention needs to be qualitatively improved. A formula for the successful encouragement of viable, employment-generating enterprises is one which has so far escaped South Africa. Well-conceived, practicable support could be vital for the country’s SMEs. This requires a proper understanding of the environment and the targets of intervention. This report has, for example, demonstrated the correlation between firm size and their trajectory. Such nuances are crucial for designing appropriate interventions.

Moreover, substantial elements of the State lack the capacity and expertise to play this role. Where this situation exists, State intervention may do more harm than good. This demands two complementary course of action. The first is to refrain from action or intervention where it lacks the ability to intervene with proper expertise. The second is that where the State feels a pressing need to intervene – and there are certainly good cases that can be made for this – it must ensure that it has the expertise and resources to do so effectively.

The fourth, to deal with the shortage of skills, the education and training regime must be overhauled. For a country at South Africa’s level of development, its competitiveness will depend on the value-adding skills of its workforce. At present, South Africa is failed by both its education system and its state-sponsored skills development regime.
Big business, firstly, needs to integrate the need to develop SMEs and small scale entrepreneurship into its own planning.
CONCLUDING COMMENTS

A strong SME community is an unexploited potential within South Africa. In fact, it is more than that: it is a necessity. For wealth and employment generation that benefits large number of people, international experience offers few alternatives.

But this is being allowed to drain away. The SME Growth Index has that our SME community is fundamentally geared towards survival, rather than growth. Decline, although not an imminent threat, is a phenomenon that should not be dismissed. But it has also demonstrated that even in an unpropitious economic climate, there is still a deep well of confidence and optimism. The restraints within which it is operating are preventing this from becoming a reality in our wider economy.

The SME Growth Index is meant to supply solid, accurate information that can be used by researchers and policy-makers. It seeks to supply the evidence upon which sound interventions rely. For our part, SBP will be taking the research forward by publishing a selection of themed papers, further plumbing the information yielded by the Index.

The SME Growth index has shown the need for a policy framework that is sensitive to the very range of circumstances pertaining to SMEs of different types and sizes. Policy, whether regulatory or incentivising (but arguably more so the latter), must be based on a recognition and understanding of these nuances. Just as a “one size fits all” approach is not a viable one for a diverse economy, so would an equivalent approach not be optimal for our SMEs.

In this respect, interesting findings – worthy of wider attention – are the differences across sectors, and the correlation of attitudes and trends to firm size. The Index demonstrates the very different conditions of firms operating in different sectors, and indicates the particularly tough circumstances of manufacturing – calling into serious question the viability of government’s reindustrialisation strategy, at least on its current path. In terms of size, we have found a particular strain of confidence among firms employing between 30 and 39 people, which is mirrored by neither group of firms in the adjoining size classes.

Certainly, it is clear that conditions arising from the generally unfavourable global economic environment are a major barrier facing our SMEs. But they are not the only one, nor are they an excuse for inaction. Recently, an economist warned in the media that “Government has not made doing business in South Africa easy. If they are so keen on business investment, things need to change and industries need to be supported”. This is quite consonant with our own findings.

Fortunately, where barriers have been created by policy or regulation, they are far more amenable to being addressed than those that are not. The twin questions which arise are whether the will to make the changes exists, and whether what comes after it is in fact an improvement.

This report, and its predecessor, showed a need for greater flexibility in the environment for SMEs, but it did more than that, and in so doing, attempted to avoid reproducing a sterile shouting match on whether or not less regulation would be “good”. As a country, we need to go beyond this, and look at the quality of regulation as well as its intrusiveness.

Our data indicate that what SMEs need and what they want are primarily opportunities to achieve success and an environment to make this possible. This, rather than political intervention or subsidies is what will help them thrive.

None of this will happen by itself. The economic fields need to be watered.
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