Who are the small firm entrepreneurs in South Africa?

SME Growth Index Thematic Paper

Prepared for the Employment Promotion Programme

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May 2013

28 May 2013

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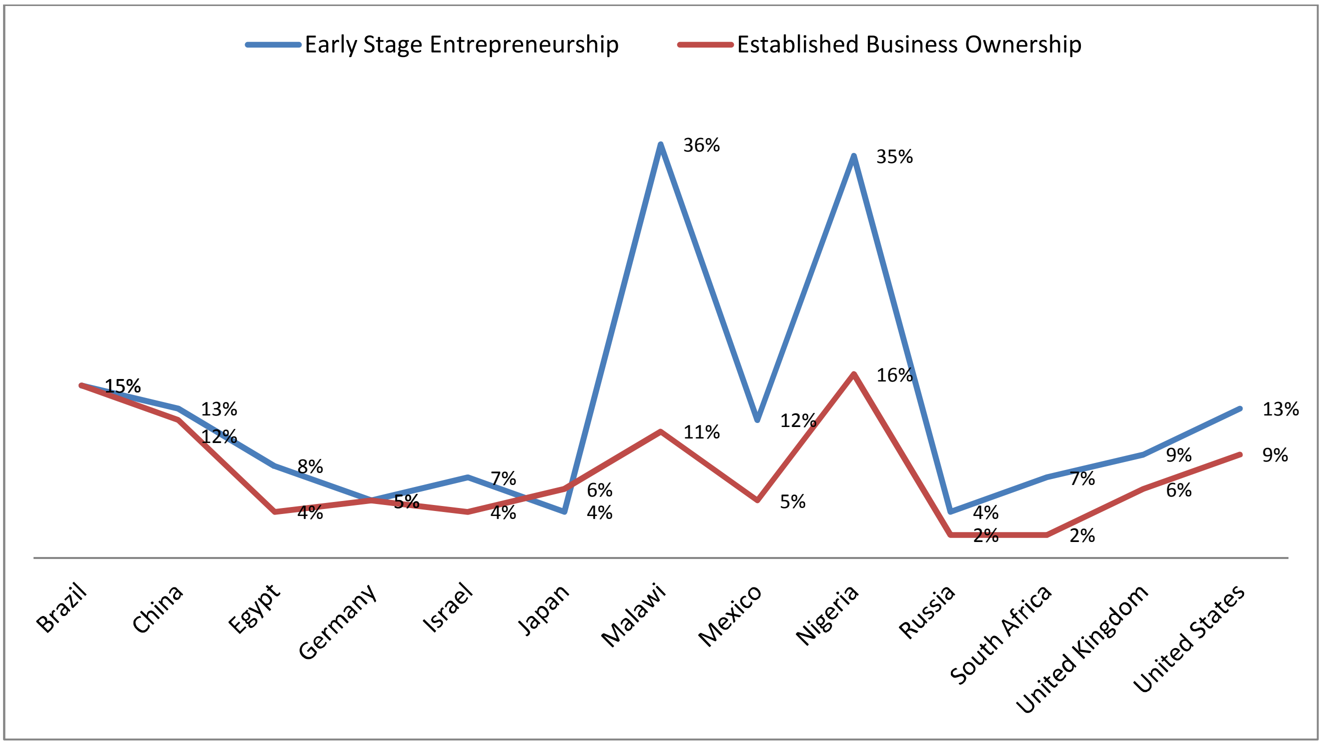
It is generally recognised that on their own, capital, labour and natural endowments do not on their own create wealth. Rather, they are assets with the potential to do so, and to bridge the space between the potential and the actual, vision, organisational ability and – more often than not – raw chutzpah are needed. Providing this bridge is the entrepreneur.

Since the 1980s, South Africa has in theory prioritised the development of a vibrant SME community, and necessarily a growing pool of entrepreneurs, as an important part of its economic strategy. Yet, according to the Global Entrepreneurship Monitor, South Africa's performance in this area has been poor. The GEM's most recent report shows that by most measures South Africa is outperformed by all of its African peers taking part in the study – and indeed by most other countries too. For example, only around 7% of South Africa's adult population (18-64 years old) is involved in early-stage entrepreneurship – in other words, with start-ups and young firms – while another 2% were operating firms that had been in operation for more than 3 and a half years. The latter figure placed it in last place in the entire study, although it did share this spot with Panama and Russia.



In general, the state of entrepreneurship in South Africa is bleak. In general, entrepreneurship tends to decline with higher levels of economic growth. South Africa, although technically a middle income country, faces challenges better associated with a much poorer one: yet the extent of entrepreneurship seems more in line with an advanced economy – and an entrepreneurial underperformer at that.

Equally worrying, and intriguing, is the sharp drop in the proportion of people engaged in start-up entrepreneurship and those operating established businesses. The five percentage point difference – with only 2% of the adult population involved in established business – suggests extensive failure in sustaining businesses once they are established. Concern about this very point was made during the time this paper was under preparation by the minister of trade and industry, Rob Davies, who said: "There's a scary statistic, it tells us that if there are seven small businesses started in South Africa, in one year only two of them will continue to be in existence. In other words, five of them will be out of business within a year."

The ability of firms to survive beyond their initial start-up is an important consideration. It signifies that the business owner has found a profitable market role of the firms, and acquired the business skills to make use of it. In a very real sense, each small firm that survives its start-up is a real, potentially long-term contributor to the economy, and to the broader societal benefits that this implies.

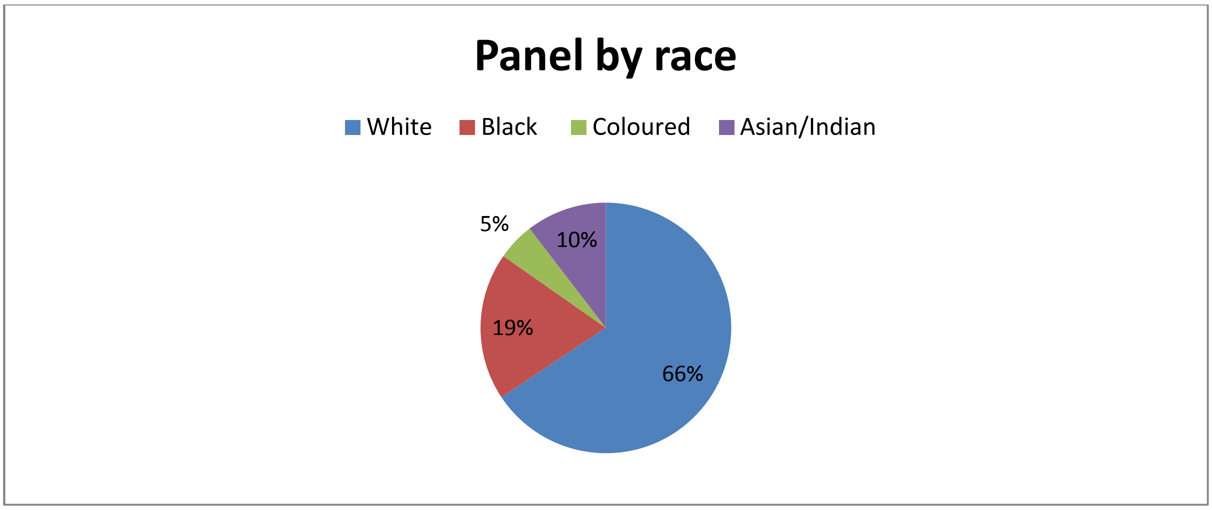
The resulting question is what makes particular firms survive and prosper? As with much pertaining to SMEs in South Africa, there are extreme information gaps. SBP's SME Growth Index represents the most comprehensive and systemic attempt to fill this gap, helping to foster understanding of the dynamics within the SME community and pointing the way to bolstering the positive and mitigating the negative.

Central to this is an understanding of who the country's entrepreneurs are. This would provide some understanding of the type of person most likely to succeed in business. At this point is important to draw a distinction between self-employment and entrepreneurship. An entrepreneur has a purposeful relationship with the firm he or she heads; he or she will seek out opportunities and derive some satisfaction from doing so. A self-employed person, by contrast, is primarily interested in the income. In practice, the distinction may not always be a sharp one: a self-employed person may develop a keen business intuition, while an entrepreneur may ultimately wish to limit ambitions to the generation of a certain level of income while concentrating on "tried and tested" business patterns. However, in general, entrepreneurship is associated with firm growth and expansion; with innovation and wealth generation.

The SME Growth Index was deliberately so named to highlight the centrality of firm dynamism, specifically, firm *growth*. The parameters of the sample were designed to reflect this. Panellists had to have been operating in the formal economy and to have been in existence for at least two years. They are thus not informal enterprises, where survivalists – the self-employed – would tend to be concentrated. They are also not start-ups, but established firms, which have at least overcome the initial hurdles involved in getting a business going. The assumption of the SME Growth Index is that these are characteristics inherent to entrepreneurs, and the panel is therefore a snapshot of the country's entrepreneurial community.

Demographics

Given South Africa's history, and the stress placed on Black Economic Empowerment, a first port of call for understanding the country's entrepreneurs is an exposition of their race.

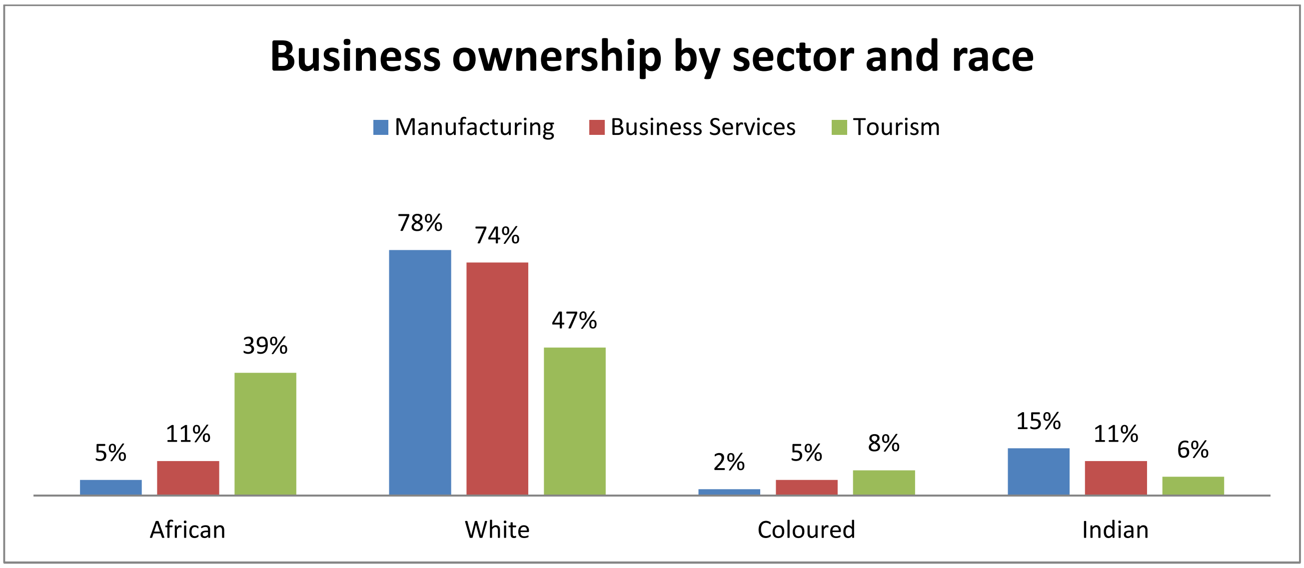


White people constitute a two thirds majority of the entrepreneurs on the Panel. Together with Asian/Indian people (referred to for convenience as Indian people hereafter), their share of the entrepreneurial cohort exceeds by a considerable margin their share of the labour force. Whites comprise some 11% of the labour force and Indians 3%. African and coloured people (19% and 5% of the panel respectively) made a contribution considerably smaller than their share of the labour force: Africans constitute some 75% of the latter and Coloured people 11%.

These proportions – randomly selected for the study – closely mirror the employer characteristics as recorded in the Quarterly Labour Force Survey: these being composed of 63% white, 9% Indian, 5% Coloured and 23% African people.

Contrary to what is sometimes assumed, the demographic profile of any given profession or career, at any given time and place, are unlikely to mirror the profile of the working population as a whole. Different groups tend to make use of what have been called “mobility ladders”. South Africa, however, is a somewhat extreme case, associated with the historic racial exclusion of large parts of the population from economic opportunities. Moreover, for reasons that need not be examined here, the country’s white and Indian populations enjoy a higher level of human development and overall living standards than do its African and Coloured populations. This suggests a link between development and entrepreneurial participation. It can confidently be assumed that even allowing for inter-group differentials, under appropriate conditions, substantial space exists for greater entrepreneurial involvement by African and Coloured people.

How are South Africa’s entrepreneurs distributed across the economy?



Clearly, the distribution is asymmetrical. White people are dominant in each of the three sectors under review, but particularly so among manufacturing and business services. The same is true, on a less pronounced scale, among Indian panellists. Among African and Coloured panellists, very small proportions are involved in manufacturing and larger, but comparatively modest, proportions are involved in business services. This reflects the historical structure of the economy, and the manner in which opportunities are available to prospective entrepreneurs.

Another intriguing fact is that some 8% of the entrepreneurs sampled are of foreign origin – the largest proportion being from Europe, specifically from Britain. The potential benefits to the South African economy of foreign entrepreneurial capabilities should not be underestimated.

It is worth noting the prominence of tourism among African and Coloured panellists. Among the tourism sample is a significant number of firms supported by the Tourism Enterprise Partnership. Firms so supported constitute the overwhelming majority of African and Coloured owned tourism firms.

Around 37% of the panel are female. Among manufacturers, the account for about 15%, among business services panellists for around 20%, but among tourism operations, for just under half – although, in the latter case, this proportion is significantly bouyed by the impact of TEP.

This suggests that demographics which have historically not produced large proportions of the country's entrepreneurial community have been assisted to a significant extent to do so through official support. If TEP supported firms are removed from the sample, around half of the African and Coloured owned firms disappear.

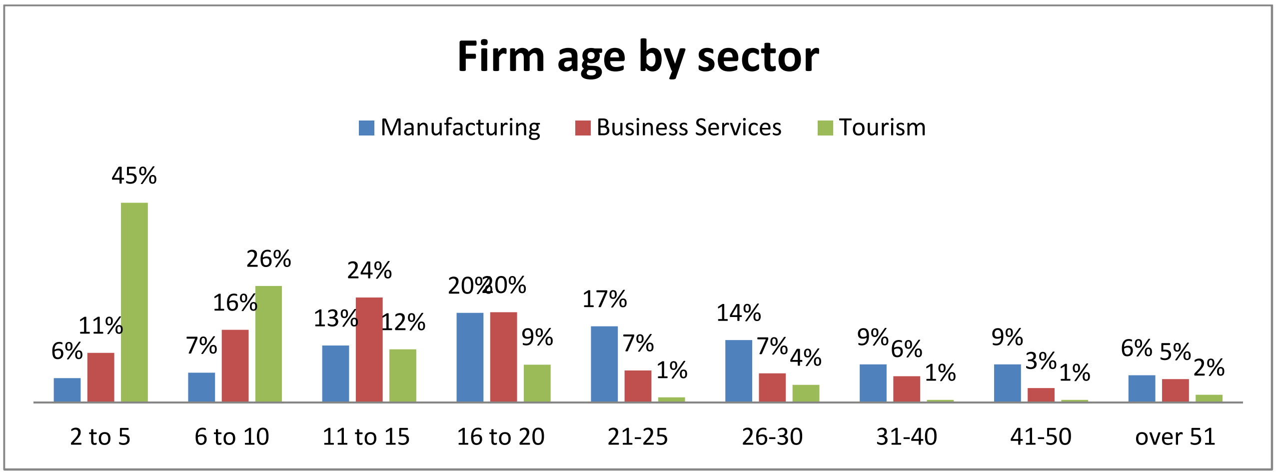
A final salient characteristic that should be mentioned is the view of the firms as family owned entities. This is a matter of some sociological importance, and impacts, for example, on the conditions under which it will be prepared to grow, and how it is likely to recruit staff. In essence, it is seen not just as a means of income, but as an investment for future generations. Just under half of the SMEs (47%) regard themselves as family owned. Small firms tend to adhere to this conceptualisation somewhat more than larger ones. This identification is highest among manufacturing firms (62%). More than half of tourism firms (58%) regard themselves the same way. Business services tend to be less oriented this way, with only 25% regarding themselves as family owned.

Speculatively, the nature of the commitment demanded by the business probably plays a role in determining these patterns. Manufacturing firms tend to be older than others, and have in many cases been passed down through one or more generations. Tourism firms, and particularly the smaller ones, probably dominate families' livelihoods and future prospects. In both cases, the identification of a business with a family and with that family's fortunes becomes obvious. Tourism and manufacturing firms also depend on fixed investments: plant, property, vehicles etc. They are a long-haul commitment, and can be passed on to others. Business services firms, by contrast, are far more wedded to the skills that particular individuals have. While it is not uncommon for such a firm to be passed on, the key assets of such firms are the quality and reputation of individual people. A good accountant will probably perform just as well as the owner of a firm as he or she would as a well-paid employee of another firm. The sense of personal, long-term attachments to a name, brand or premises are thus likely to be less intense.

Counting the years

Intuitively, one would expect that a random sample of firms would evidence a steady decline in numbers when looked at from point of view of years in operation. In other words, fewer and fewer firms operating at a given time will survive as time moves away from that point.

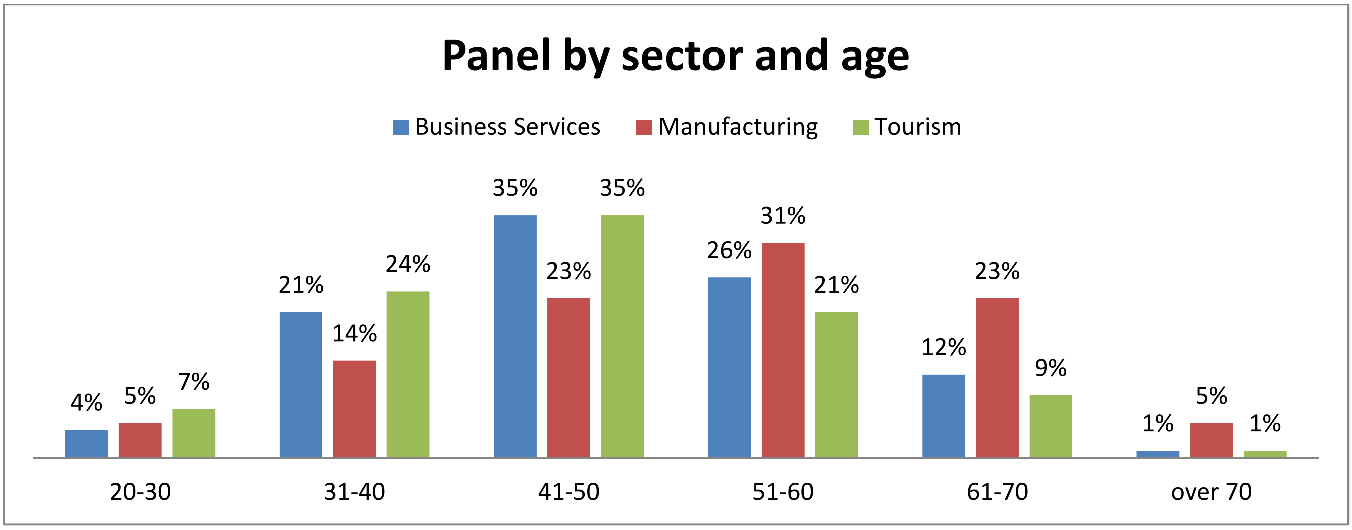
This is not the case with the Panel. In part, this reflects the decision to limit the parameters of the study to those employing 10 or more people – with the partial exception of the TEP supported sample, several of which employ fewer than 10 – a decision which is likely to remove a large proportion of young firms from consideration. Acknowledging this, there are nevertheless some intriguing patterns.



Tourism proceeds in a broadly linear fashion the youngest group (2 to 5 years old) holds 45% of the tourism firms, including most of the TEP-supported ones. The category encompassing those between 6 and 10 years old constitutes a further 26% of the tourism firms, while the category encompassing those aged between 11 and 15, and 12%. Cumulatively, these firms account for 4 in 5 of the tourism SMEs. This would represent a “natural” distribution. In the South African context, it also reflects the relatively low entry barriers to the sector – typically an investment in a property and assets such as vehicles, but relatively little specialised training is needed – the take-off in the sector as South Africa become more open to foreign visitors and domestic consumers had money for leisure as a result of the prosperity up till about 2008; and the support government has given the sector (through TEP) in hopes of its revenue and employment generating role.

Perhaps more interesting is the distribution of the manufacturing firms and to a lesser extent those in business services. Just under two thirds of manufacturing firms are between 11 and 30 years old. Another quarter are even older, while only 11% are younger. This points to an aging community of manufacturing firms. It may be that the overall picture in the sector is somewhat distorted by the absence of firms employing fewer than 10 people, but given that the average staff of a manufacturing firm is 29 people (and that relatively few of the manufacturing firms are located in the 10-20 employee category), this is unlikely to make a material difference. Existing manufacturing firms are simply growing older, and not being reinforced by younger ones.

The aging of firms is reflected in the aging of entrepreneurs. These two trends are distinct, but have a similar consequence.



The bulk of the entrepreneurs are in their 40s and 50s, with smaller, but noticeable, proportion in their 30s. This is not surprising: this age cohort has gone through its education and has acquired some work experience, as well as some personal wealth. These are important tools for undertaking an entrepreneurial endeavour.

Few entrepreneurs are in their 20s. In general, this age group does not have the capital or experience to embark on entrepreneurship. Tourism is best represented here, owing to the comparatively low barriers to entry – at least, insofar as professional qualifications or specific skills are concerned.

Those of more advanced age, 60 and older, make for revealing interpretation. There is a fairly sharp drop in the proportion of firms represented by the 60 to 70 year demographic and that between 50 and 60. This indicates that there has been, in the past, a reasonably good throughput of entrepreneurs into what now comprises the 50 to 60 year age group. It also implies indicates that the 60 to 70 year age range is the time at which many entrepreneurs retire, or scale back their activities.

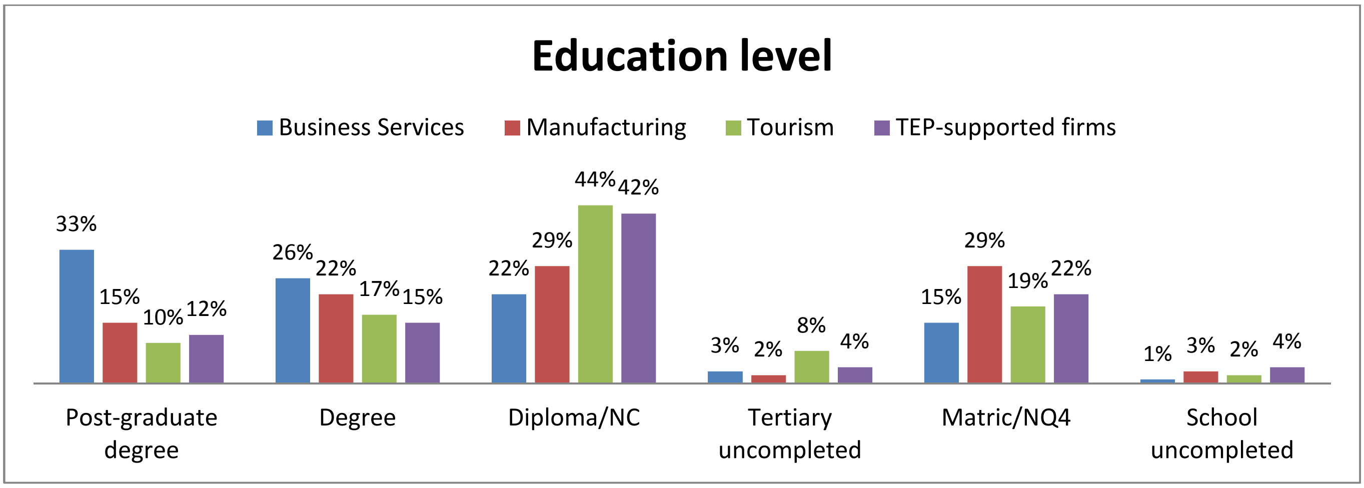
This pattern is followed by the panellists in tourism and in business services. However, among manufacturers, the pattern is different. Manufacturing entrepreneurs are simply older – and growing older – than their colleagues in other sectors. Some 59% of them are 51 years of age or older. Indeed, nearly one third – or 29% – of manufacturers are 61 or older. The implications of this are profound. Manufacturers are an aging group; their ranks are demonstrably not being replenished by new entrants. Indeed, many indicate that they do not have any succession or sale plan for their retirement, and expect simply to close their businesses when they retire. This in turn suggests that manufacturing is in a rapid decline, with few entrepreneurs willing to enter the sector.

Education and experience

Having shown the racial differentials in firm ownership and acknowledged its historical roots, it is perhaps more important to understand the current *manifestations* of these roots. Arguably the best proxy in this regard is educational attainment.

Studies of entrepreneurship elsewhere have highlighted the link between business owners' formal education, their work experience prior to establishing or taking over their own firms, and the success of these firms.

The panel is a generally well educated group. Nearly three quarters have a tertiary qualification of some sort – a degree, certificate or diploma, with a minority having not completed their studies – while 40% have a bachelors or post-graduate degree. By contrast, among the general population over 20 years old, only around 5.5% have postgraduate training. Some 22% of the SME owning cadre have only a matric, while only 3% have not completed school.



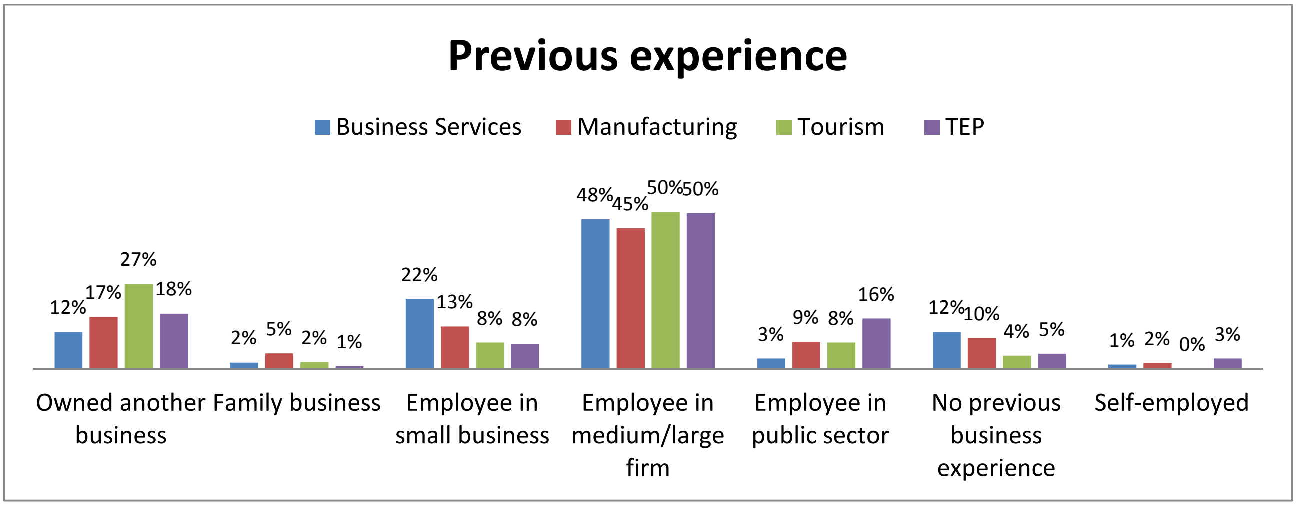
The notable differences in the education levels bespeak the requirements and career paths relevant to the various sectors. The most highly educated are involved in Business Services – some 59% have a bachelor's or post graduate degree. The largest single group among business services panellists, comprising one third of them, held post-graduate degrees. This is consonant with the nature of the business services sector, whose chief requirements are high-value, credentialed professional skills. It also explains the dominance of white and Indian people in this sector, given the higher level of educational attainment among these groups relative to Coloured and African people.

The qualifications held by tourism operators are heavily anchored in diplomas. Across the panel, there is little real difference in the educational profile of supported and unsupported tourism firm owners. The owners of some 44% of unsupported and 42% of TEP-supported held diplomas – signifying a directed, vocational education, and one likely to be attained at a lower cost and shorter period of time than a degree. Roughly even proportions hold either degrees, or secondary school/incomplete tertiary education.

The level of formal education is lowest among manufacturers, although around two thirds have some form of tertiary education. Just under two thirds have not advanced past high school. Some the two largest concentrations of manufacturers, each comprising 29%, had either a matric or a diploma. This suggests that for manufacturers, the chief preparation for entry into an entrepreneurial role was either a "hands-on" career, where skills were acquired practically, or through specific vocational training.

Preparation for entrepreneurship is generally recognised as needing to go beyond formal education and training. Entrepreneurs certainly benefit from that, but this is augmented – indeed, bridged into practice – by their exposure to the world of work. A study for the Kaufmann Foundation in the United States, published in 2009, found that a staggering 96% of respondents rated their previous work experiences as important for their current success.

The distribution of previous work experience is shown in the following table.



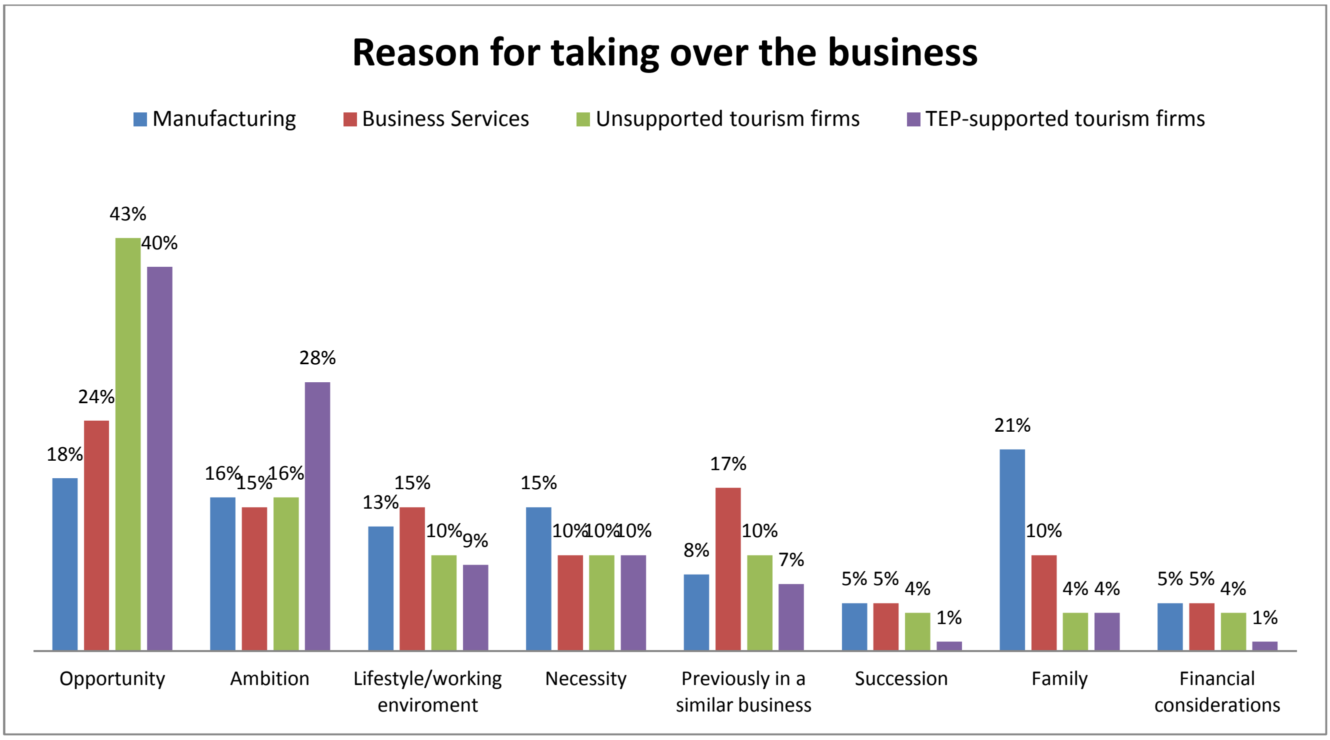
By a considerable margin, the most common previous career path is employment with a medium or large firm. Something in the region of half of all panellists report this. Having owned another business also features strongly – successful entrepreneurs will frequently try their hands at other endeavours, while business failure can itself teach valuable lessons to be applied in future.

Small business employment is most pronounced among business services owners, probably reflecting the overall nature of such firms: often relatively small, specialising in providing a unique, high-value niche service.

Interestingly, although large numbers of panellists identified their businesses as family owned, a very small proportion listed involvement in a family business as a previous career. (Even if one assumes that there may have been some definitional confusion and some answered "no previous experience" to signify a career that began with their current family firms, although not in a managerial or ownership role, this proportion remains marginal.) The implication is that even for those working in family owned firms, some part of most formative careers have taken place outside of them.

Taking charge

Panellists were asked how they had come to head up their firms. The wide range of responses is indicative of the heterogeneity of the entrepreneurial community.



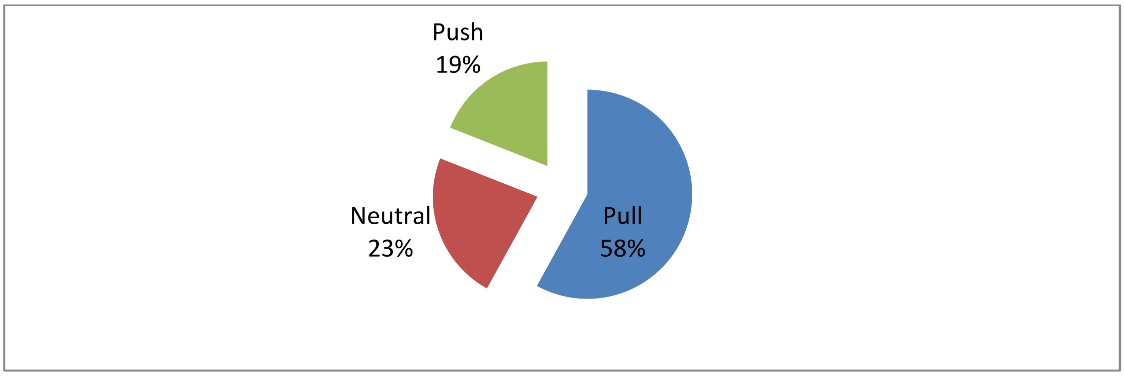
Throughout the SME community as a whole, the dominant factors influencing the entry to entrepreneurship are perceived business opportunities and professional ambition. Together these constitute just under half of the total responses. Those seeking a more congenial lifestyle or working environment account for another 12%. These can be considered eminently "positive" drivers, since they imply that the entrepreneur is attempting to improve his or her position, to achieve something better – a strong case of what is typically referred to as “improvement-driven entrepreneurship”. And it is precisely this sort of entrepreneurship that creates wealth and jobs.

It is apparent that the processes by which business owners find themselves at the helms of their firms show clear sectoral patterns. Acting on a business opportunity was the driving force behind both supported and unsupported firms. Those in the tourism sector tend to ascribe their paths to a personal drive or to having found an opportunity. They display in this respect a highly optimistic view of their career choices. A very interesting finding is the large proportion of panellists in TEP-supported firms whose entry into the field was driven by ambition. State support, through the TEP initiative, is clearly playing a role in bridging aspirations and reality. Whether this is will translate into long-lived and growing firms over the medium to long term is an open question.

Entry to business service entrepreneurship was spread across a more diverse range of processes. Opportunity and ambition play important roles. However, the desire for a particular lifestyle or working life – generally speaking, being free of the constraints of corporate culture – ranks highly. Business services entrepreneurs also link their experiences to having worked in a similar business. In other words, there is a linear progression into the current firms, using a broadly constant skill set.

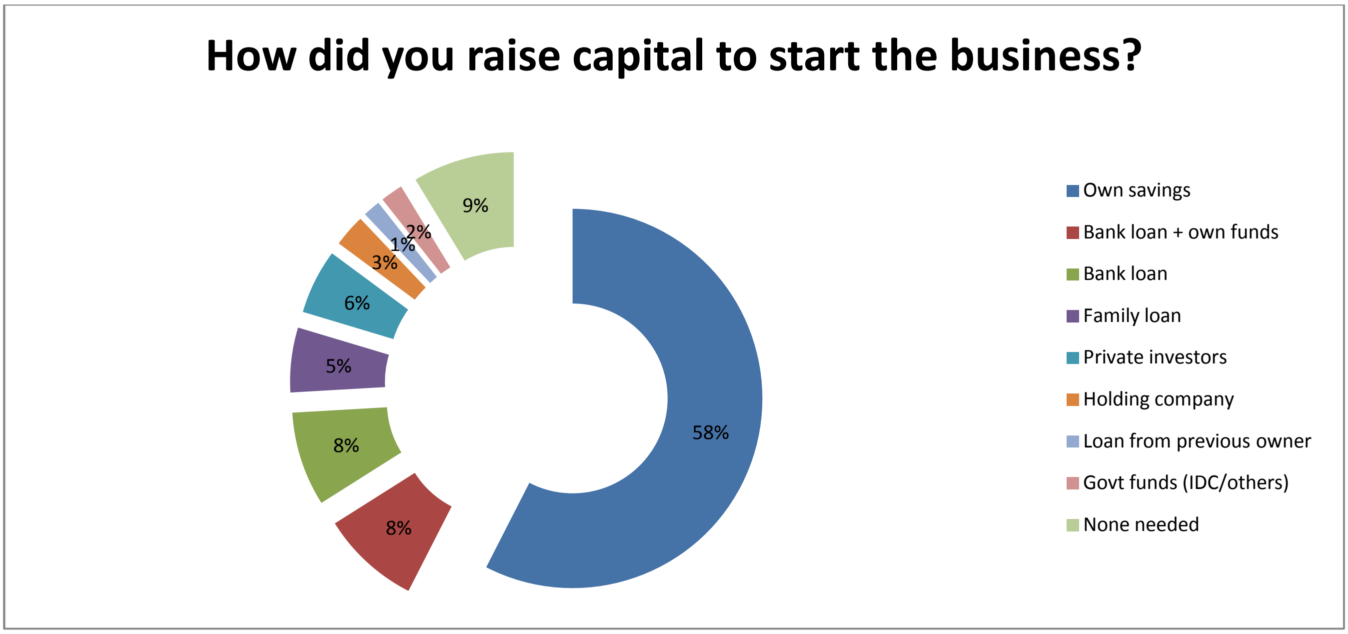
Manufacturers seem to have been streamed into their careers by circumstances to a greater extent than is the case with entrepreneurs in business services or tourism. About one in five of the manufacturers reports that the career was driven by family considerations (chiefly, that the firm was family owned and they were expected to join it). Another 15% are motivated by necessity – the highest such proportion by a substantial margin. Opportunity-driven motivations were the lowest of any sector.

As a whole, then, the dominant reasons for entry to entrepreneurship are so-called pull factors.



Close to three in five entrepreneurs cite pull factors, while some one in five cite either push or neutral ones.

The drivers behind entrepreneurial undertakings need to be complemented by the resources to make it happen. Crucial here is the ability to raise funding.



SMEs' predominant source of initial financing comes from the entrepreneur's savings. Around 58% relied entirely on their savings, while another 8% used a mix of own savings and bank loans. Taken together, this means that a shade short of two thirds of SME owners relied entirely or to some degree on their own savings. Straight bank loans were used by some 8%.

There do not appear to have been any material differences across the race groups in the patterns, although the fact that white and to a lesser extent Indian people have both historical assets (which can be used to leverage credit) and education (providing access to jobs that enable the accumulation of savings) implies an advantage here. This is not a static situation, of course, and it has been noted that African people own homes at higher levels than other South Africans, while increasing numbers have come into high-paying white collar employment. Funding, although important, is unlikely to be an absolutely fatal brake on entrepreneurial activity. Studies elsewhere have come to the same conclusion.

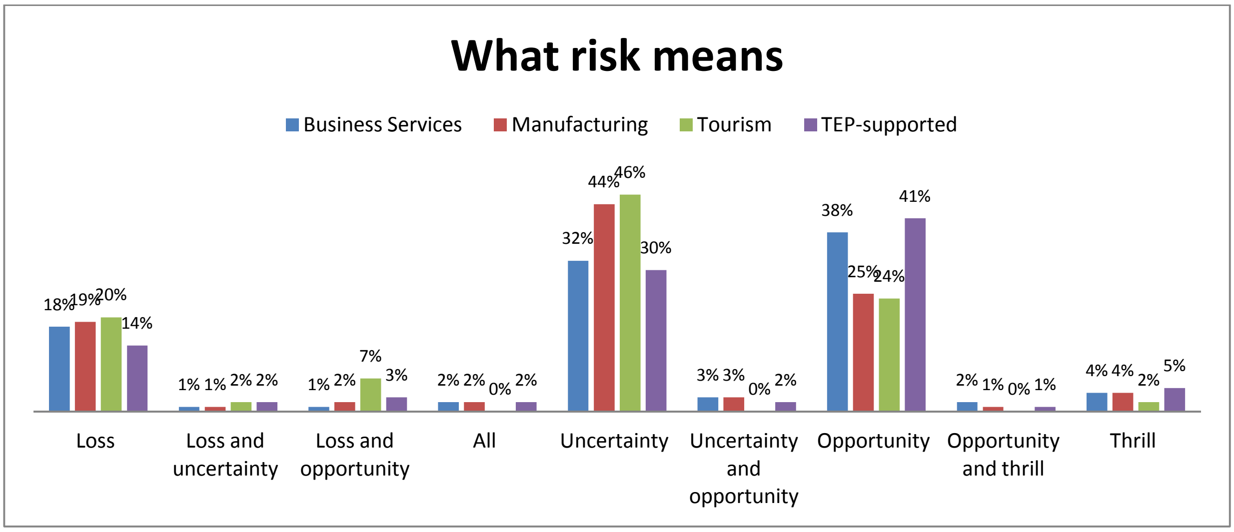
It is important to note that banks have become more reticent to provide financing to businesses in recent years. This may make the figures here (16% having accessed some sort of bank loan) too optimistic for the foreseeable future. The need for alternative avenues of financing will be extremely important.

Of some note, however, is the small proportion receiving their capital from private investors and family – the so-called "Angel" investors. Only 11% financed their start-ups in this way. Angel investors are a phenomenon that is not deeply understood, certainly not in South Africa. However, as banks seek to cut back on risk, it is an attractive avenue for aspirant entrepreneurs. It does presuppose a great deal of trust in the entrepreneur, and also in the existence of acquaintances or relations who have the necessary funds and the expertise to evaluate business ideas. These conditions are simply not available for large parts of the population.

Attitudes to risk

Whether or not entrepreneurs are willing to take risks can have important implications for the capacity of firms – and the economies they constitute – to grow and innovate by seeking out unorthodox opportunities. Perhaps more importantly, it provides a measure of insight into entrepreneurs' thinking about the economic environment. While not a perfect proxy by any means, it is reasonable to assume that a willingness to take risks would signal a higher level of confidence in the economy at large than would a lack of such willingness.

To gauge this, panellists were asked to associate the concept of risk with any or all of four other concepts: loss; uncertainty; opportunity; and thrill.



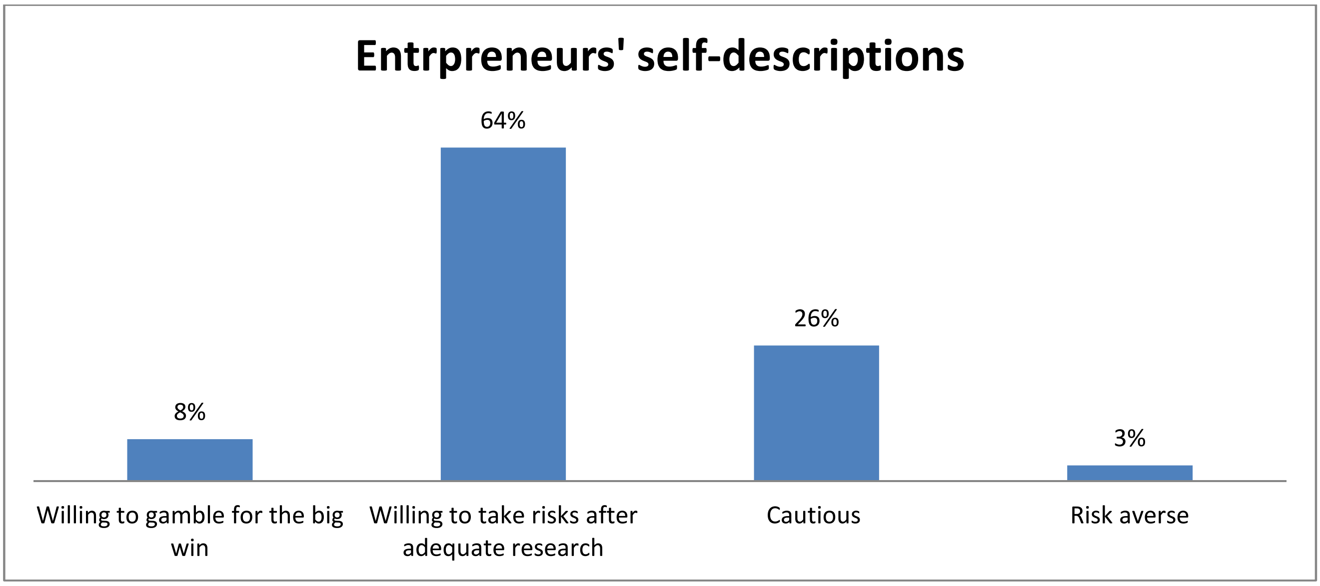
The responses indicate a propensity towards caution. Overall, uncertainty is the most common association, shared by over two thirds of the panel, with a particular spike among those in manufacturing and tourism. Loss, the most strongly negative association, is identified by just under one in five.

On the other hand, the second largest overall identification is with opportunity. Around one third of the responses gave this as their understanding of risk – suggesting a positive view of risk. Business services panellists and TEP-supported firms dominated these responses.

Very few of the responses suggested a "devil-may-care" approach, embodied in the concept of thrill.

Interestingly, the age of the entrepreneurs has at best an ambiguous relationship with the views on risk. Younger entrepreneurs are indeed more prone to see it as opportunity, and less as a loss than their older counterparts; but the association of risk with uncertainty is largely constant along the age continuum. Perhaps counterintuitively, the greatest concentration of responses linking risk with thrill are found among those of 65 years of age and older. It is unclear why this should be so, but it is plausible that entrepreneurs of that age have experienced rewarding careers, have gained considerable personal confidence and have amassed a comfortable degree of financial and material security. This type of entrepreneur may remain active for reasons of personal fulfilment. Irrespective, this finding challenges the view of innovation or conservation as being necessarily bound to age.

Another inquiry sought out entrepreneurs' self-descriptions.



These responses match the attitudes to risk outlined above fairly closely. They describe a SME community that does err on the side of caution, but which is not risk averse when opportunity beckons.

Conclusion

Who are the entrepreneurs? The short answer to this is that South Africa's entrepreneurs are people who have made a commitment to operating their own businesses, have confronted the realities of the country's market, aligned their attitudes with these realities, and marshalled the various resources at their disposal to do so.

More specifically, the "typical" entrepreneur is white, male, middle-aged and educated. He has work experience and was more than likely drawn into his endeavours by considerations of ambition and opportunity, the so-called pull factors. Once drawn into an entrepreneurial line, he drew largely on his own resources to finance his start-up. He tends to be somewhat cautious, but is willing to risk things when he is convinced that the odds are in his favour.

This is, of course, a highly stylised and poorly nuanced rendering of the country's entrepreneurs. Sectorally, there is a considerable difference between entrepreneurs in business services and tourism and those in manufacturing. The latter in particular is an aging group, both in terms of its firms and owners, and – government declarations notwithstanding – its long-terms survival is at present questionable.

Moreover, around one third of the panel are not white. Indian people have a strong entrepreneurial presence. However, the relative absence of African and Coloured entrepreneurs point to a pressing need to open the way for more to engage in entrepreneurship. This should not be seen as a drive for "representivity" – although the entrepreneurial deficit is explicable with reference to history – but as a recognition that South Africa direly needs more entrepreneurs and that the potential of particular demographics has not been exploited.

It is interesting to note in light of the information presented in the foregoing pages that South Africans do seem to hold their entrepreneurs in high regard. This is certainly the message from the GEM reports. So there is likely to be a cohort that would be interested in such a career. The question is whether it can be encouraged and if so, how?

One dimension that has not been discussed here might be termed the socio-cultural, the cognitive and attitudinal preparation of people in the early part of their lives to seek out not only an entrepreneurial career in general, but to identify the specific opportunities that would actualise it. A number of sociological researchers have pointed out that entrepreneurial uptake is often disproportionately high or low among certain groups, a product of the values and example they have been exposed to. There is no easy way to influence or impart these, and in the South African case, the extent of social disruption makes it a doubly difficult proposition. This is, however, a crucial information gap that might fruitfully be examined.

More concretely, successful entrepreneurship appears to start with an education, and – probably more importantly – with career experience. From here, a desire to start a business would need to be complemented by the ability to identify a suitable opportunity.

It is not clear whether these steps lend themselves to any sort of policy encouragement. Certainly, a good cognitive basis from a solid school education would be extremely important; enhancing this with further good quality technical, vocational or academic training would be a worthwhile further investment. These are, at least in theory, within the purview of government policy, albeit not within that of micro-economic policy.

Little can, however, be done to ensure uptake by firms to provide work experience; even less could probably be done to ensure that it is those with an entrepreneurial disposition that are so employed. And less still can be done as a matter of official policy to induce successful employees to surrender comfortable, prospect-filled work for an uncertain entrepreneurial endeavour. That motivation must come from within the prospective entrepreneur – a function, perhaps, of the socio-cultural dimension.

Where government interventions might have a greater chance of success are in the provision of both hard and soft resources. On matters of hard resources, funding constraints are likely to become an increasingly serious matter for prospective entrepreneurs, and scope exists for official support here. This can, however, be a double edged sword: insofar as a lack of funding can keep potential entrepreneurs out of the market, the discipline imposed by having to marshal resources and resourcefulness to overcome this hurdle are a powerful motivation for success. Easy or condition-free financing could be abused. On matters of soft resources, the TEP programme has shown some success in assisting entrepreneurs bin the tourism industry, despite some criticism about the relevance and applicability of some of TEP's assistance. Nevertheless, with appropriate monitoring and evaluation, this may be a model with some wider applicability.

Finally, entrepreneurs need to find a prudent balance between caution with the use of their resources and the adventurous spirit that can drive growth and innovation. This too cannot easily be driven by official decree (although innovation funding mechanisms, for example, could be considered), but is a part of an entrepreneur's toolbox. However, a healthy sense of courage and adventure is likely to be nurtured by an accommodating economic environment. This implies one that is properly regulated, but not needlessly so; overseen by an effective and honest civil service; one in which the legal and physical infrastructure is maintained. In other words, and environment in which doing business is easy and predictable – allowing entrepreneurs to gamble with a smaller set of unpredictable.

For now, however, South Africa's entrepreneurial community is a tough one, but is too small and in some senses too beleaguered to drive the economic development agenda that official pronouncements seem to envision. If South Africa is serious about changing this, it needs to start both an extensive conversation about getting an entrepreneurial spirit moving, and taking concrete steps to deal with those issues that – as matters of common cause – are retarding it.