



THE ECONOMICS OF SMMEs IN SOUTH AFRICA

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BACKGROUND TO THE STUDY

Since 1994, South Africa has been faced with the challenges of re-integration into world markets as a global economy, while at the same time positioning itself to realise the high expectations of its populace regarding a successful transition towards a more democratic order. To achieve the objectives of economic growth through competitiveness on the one hand, and employment generation and income redistribution as a result of this growth on the other, South Africa's small-, micro- and medium-sized enterprise (SMME) economy has been actively promoted since 1995. Despite voluminous research, however, there is still little clarity about the extent to which South Africa's SMMEs contribute to poverty alleviation, economic growth, or international competitiveness.

SMMEs encompass a very broad range of firms, from established traditional family businesses employing over a hundred people (medium-sized enterprises), down to the survivalist self-employed from the poorest layers of the population (informal micro-enterprises). While the upper end of the range is comparable to the small- and medium-sized enterprises (SME) population of developed countries, statistics reveal that an immense majority of SMMEs are concentrated on the very lowest end. These are primarily black survivalist firms.

OBJECTIVES OF THE STUDY

Against this background, the objectives of this study are twofold: the provision of a more comprehensive understanding of the challenges at stake in order to give future SMME policies a firm grounding; and an explanation of the lack of the impact of policy thus far. It also puts forward some new suggestions regarding the direction that government policy should take.

In detail, this study attempts the following:

- **Revisit the rationale of SMME policies**

While there is a general consensus on the importance of SMMEs in South Africa, their economic rationale to date has been neither well argued nor rigorously investigated. In particular, there is a lack of clarity on how SMMEs fit within the industrial policy framework and with regard to other objectives of government.

- **Propose some goals for policy**

Optimising the SMMEs' contribution to employment and economic development could be translated into the following broad objectives:

- Raising the rate of formation of new SMMEs with growth potential, since these SMMEs will contribute to investment, employment, and income generation;

- Encouraging new SMMEs arising from previously disadvantaged backgrounds, since these start-ups can contribute to a redistribution of economic ownership and income, as well as a more participatory economy;
- Increasing the rate of graduation of micro-enterprises into the SME categories, since only then will the legacy of apartheid be overcome;
- Raising performance of existing SMMEs with a view to increasing both their competitiveness and their ability to fulfil a role in society; and
- Decreasing the undesirable mortality rate of SMMEs that could be viable undertakings.

- **Main areas of intervention required**

Achieving these broad objectives typically requires policies, which focus on:

- Increasing the supply of entrepreneurial talent and opening opportunities;
- Providing support to existing SMMEs – micro-enterprises in particular – at no higher than its social opportunity costs;
- Providing incentives for formalisation of enterprises, including cultural bridging; and
- Assisting SMMEs (where necessary) to use resources as efficiently as possible.

Within the context of overall macro-economic performance, the ideal policy package for SMME support in South Africa should allow this sector to maximise its contribution to the economy's overall performance in terms of growth, employment and income distribution. This is likely to involve making more resources available to the sector as well as raising the efficiency with which it uses the resources already available to it.

- **Evaluation of policies to date**

With policy initiatives already under way, the study aims to disentangle the reasons for modest SMME growth, and why it has not made a more significant contribution to employment and overall economic growth in South Africa. By doing so, the study aims to assist the Department of Trade and Industry (DTI) in reconsidering its current SMME policy as an integral part of its industrial development strategies.

OUTLINE OF THE STUDY

The study is comprised of the following elements:

- **A reflection on the rationale for SMME promotion and the economic role of the SMME sector (Chapters 1 and 2)**

These sections are focused on how exactly the SMME sector contributes to economic growth, employment, and income distribution in the economy.

- **A re-examination of South Africa's SMME policy framework, and assessing current institutions and policy instruments (Chapter 3)**

The report traces major policy developments in SMMEs since the birth of the democratic government. It looks at the specific policy framework and the kind of institutions that were set up to support these policies. An assessment is made of some of the key problems and limitations of both the policies and the institutions. This part is guided by two main concerns:

- Has DTI policy been in line with its institutional capacity?
- Are the policy instruments in use the best to foster the growth of SMMEs?
- **An assessment of current research on South Africa's SMMEs, and highlighting the impact of specific "factor markets" on the performance of SMMEs (Chapter 4)**

Chapter 4 represents the main contribution of the report: it harnesses existing research on SMMEs and draws on a range of new primary micro-works, such as the World Bank Gauteng Firm Survey by Chandra *et al.*, (2001). This includes an analysis of labour markets, product markets, financial markets, as well as other relevant factors.

- **Making some recommendations on how to establish a more enabling environment and identifying the need for further research (Chapter 5)**

As a conclusion from the above, the last chapter highlights the main areas in which further research is required.

1 THE ECONOMIC RATIONALE FOR SMME PROMOTION

1.1 INTRODUCTION

This section begins with a general outline as to why a dynamic SMME sector is important to an economy. It attempts to provide a theoretical perspective as to how it can be specifically linked to the unemployment and productivity problem in South Africa. It aims, with a level of abstraction, to understand how an economy with typically South African characteristics functions, specifically with regard to productivity and unemployment.

This chapter is organised into three sections. It first sketches the main functions of SMMEs and the theoretical conditions necessary for their attainment. It then describes the current state of the South African economy with regard to its structures, and the effect of economic reforms. It then specifically investigates the potential impact that SMMEs can have on employment, considering micro-enterprises on the one hand, and SMEs on the other.

1.2 MAIN FUNCTIONS OF SMMES

Firstly, SMMEs as enterprises have some economic roles to fulfil. They contribute to a country's national product by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products, and to a lesser extent, services to foreign clients, thereby contributing to overall export performance.

From an economic perspective, however, enterprises are not just suppliers, but also consumers, which have an important role to play if they are able to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demands of their clients. Demand in the form of investment plays a dual role, both from a demand-side (with regard to the suppliers of industrial goods) and on the supply-side (through the potential for new production arising from upgraded equipment). In addition, demand is important to income-generation potential of SMMEs, and their ability to stimulate the demand for both consumption and capital goods.

Most importantly, and from a South African context, SMMEs have, at least in theory, the potential to generate employment and upgrade human capital. Economic historians have demonstrated the importance of this phenomenon in Europe's industrialisation and the subsequent development of other emerging economies. As technological progress in agriculture liberated the agrarian labour force, this unskilled excess labour force was absorbed into small manufacturing industries and exposed to business experience, thereby encouraging a "learning-by-doing" effect. This combination of the employment of a vacant labour force, and improvement of their

skills through business exposure, strongly characterised the process of industrialisation and development.

South Africa's current economic situation is comparable to the above scenario: the excess labour force is "released," not so much from the agricultural sector, but rather large enterprises in the secondary and tertiary sector. Generally, these enterprises are not necessarily facing economic recession, but rather are growing and transforming themselves in such a way that their demand for unskilled labour is decreasing. This results in an abundant pool of unskilled labour, which SMMEs can possibly employ and upgrade.

From a different viewpoint, it has been suggested that, in cases of "jobless growth" and a mismatch between the demand and supply of unskilled labour, a shift in both the sectoral composition of the economy and the occurrence of growth in different categories of firms may be an important avenue for the generation of both employment opportunities and growth. The question here is whether a more robust SMME growth strategy in South Africa will bring about such changes. This in turn depends on whether SMMEs are more labour-intensive and therefore likely to employ unskilled labour, and whether they are able to provide a "skills upgrading process."

With these categories of functions defined from a theoretical perspective, the following section examines the structure of the South African economy to see whether SMMEs can, in their current position, fulfil these roles.

1.3 STRUCTURAL FEATURES OF THE SOUTH AFRICAN ECONOMY AND ITS IMPLICATIONS FOR SMME GROWTH

1.3.1 The apartheid legacy

In comparison with many other developing countries, the contribution of South Africa's SMMEs to employment and economic growth is low. This relatively poor performance is often associated with the racial distortions in education, income and economic empowerment inherited from the previous regime. Nevertheless, there is a danger in ascribing all the responsibility for the underdevelopment of SMMEs to political disenfranchisement, since the corollary to this argument is that the new economic order provides a sufficient condition for the revitalisation of the SMME economy. The removal of apartheid, although necessary, has been insufficient in unravelling the full potential of the SMME economy, because the inherited structures contribute to the following:

- A highly dualistic economy not only characterised by a high productivity (modern) and a low productivity (informal) sector with little interaction between them, but also a division along racial lines;
- A transition phase marked by political uncertainty and considerable crime and violence, both impacting negatively on local and foreign direct investment in the modern sector;

- A recent shift in industrial policy to liberalisation of trade and finance, and a rapid technological change reflecting a comparable process at the global level; and
- Low levels of education and training among the participants in the traditional sector who have, in addition, suffered from the suppression of entrepreneurial activities.

1.3.2 International experience in dealing with such legacy

South Africa's peculiar features imply that policy makers may only partly draw on international experience when looking for policy responses to promote economic and employment growth. There are other economies, such as Chile or Venezuela, for example, that have an historically strong mining base. Like South Africa, they suffered from high levels of unemployment and/or underemployment, resulting in income inequality, because public interventions and resources were focused on strengthening the mining industry, to the detriment of the more labour-intensive agricultural and manufacturing sectors.

Chile, for example, solved the unemployment dilemma by creating a large public sector, while other governments protected their agriculture and manufacturing sectors so that the shrinkage in employment would not be so pronounced. For a country like South Africa, however, protectionism and increased state expenditure are contrary to the liberal philosophy adopted, as shown below.

1.3.3 Way forward for South Africa

South Africa has recently adopted a regime of trade liberalisation and fiscal prudence, thereby limiting the use of protectionism and public sector employment. This may partly explain why unemployment levels and income inequality have increased.

Taking into account the characteristic dual economy, adequately remunerative employment could originate from:

- The high productivity sector increasing its level of employment, i.e. absorbing people previously located in the low productivity sector (or unemployed); and
- The low productivity sector increasing its income generating capacity through investment, technological improvement and education and training.

However, the success of each of these mechanisms is limited by the historical neglect of education and training for both employers and employees in the low productivity sector. Therefore the key challenge is identifying the best policy levers available to the government, given the problem of inequality and the overall thrust of an economic

reform strategy comprising fiscal prudence, trade liberalisation and deregulation of various economic sectors.

1.4 CAN SMMES RESOLVE THE UNEMPLOYMENT PROBLEM? – THEORETICAL CONSIDERATIONS

This section tries to highlight, from a theoretical standpoint, the requirements for using SMMEs as vehicles for employment creation. The interaction between capital, productivity and demand for labour are first explained, followed by a review of the conditions for equilibrium.

1.4.1 Capital, productivity and demand for labour

Economic production is defined as the combination of capital and labour to generate a “product.” The demand for labour can be understood as a function of the country’s national product, the availability and productivity of both capital and labour, and the ratio of substitution between capital and labour. More precisely, the productivity of one factor is boosted by the quality and abundance of the other factor, and this explains the difference in labour demand amongst enterprises and across countries.

Countries with a broad capital base (typical of developed countries) exhibit high labour productivity, and because their national product is high, will be able to employ the majority of their labour force. By contrast, developing countries, South Africa included, are characterised by lower capital endowments and an abundance of low-skilled labour. Overall productivity in developing economies cannot be high as long as only a limited number of workers are needed to operate the fixed amount of capital. This results in a dearth of employment opportunities for unskilled labour.

A similar distinction can be made between the various sizes of enterprises. This is done on the assumptions that the larger firms are more capital-intensive, and that the demand for labour is directly related to its marginal productivity. In large capital-intensive firms, the first few workers are highly productive, but as workers are added, their marginal productivity tapers off fast. Thus the demand curve for labour as a whole or for high-skilled labour starts high on the vertical axis of a typical demand – supply diagram for labour, but then falls sharply.

In contrast, the labour demand of the micro-enterprise sector does not achieve high levels at any point. To begin with, much of the demand is imputed since the workers are self-employed. In addition, the marginal product of the labour employed is low because of the limited capital and simple technologies employed. The demand hence remains relatively flat (elastic), because of the low barriers to entry.

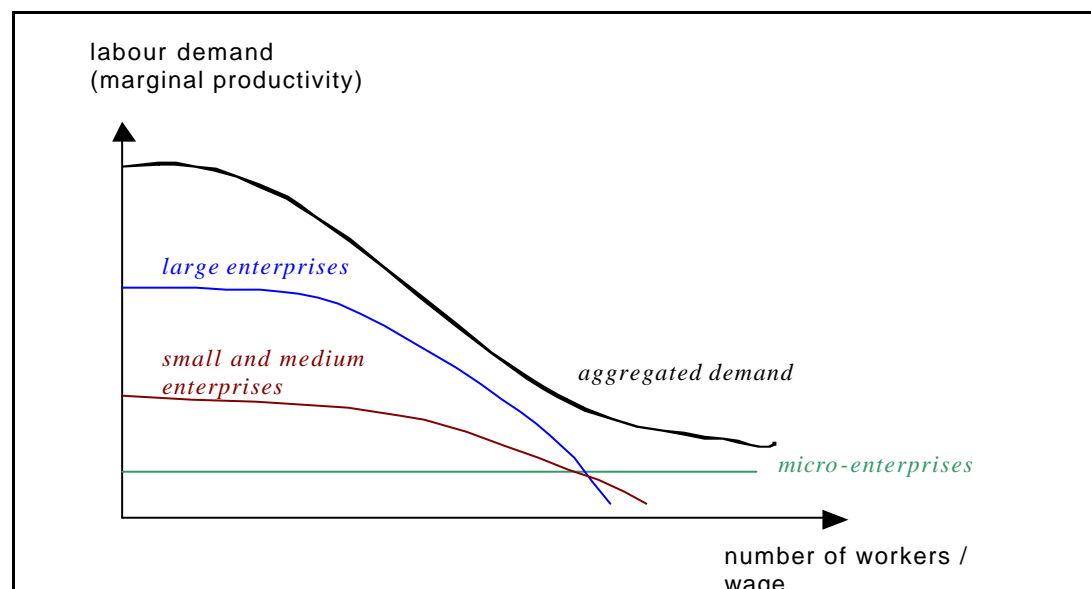
The labour demand of the SMME sector lies between these two extremes. The first workers are relatively more productive than those in micro-enterprises, but less so than those in large firms. Productivity declines slower than in large firms as workers are added, but faster than in micro-enterprises. This is illustrated in Figure 1.1.

1.4.2 Labour markets, wage rates and productivity

The summation of the three labour demand curves described above constitutes the total demand curve, which in turn is a function of the wage. Its intersection with the supply curve of labour represents the equilibrium wage, which is applicable to all low-skilled workers in the absence of labour legislation or other institutions, which affect wages of various subgroups of the workers, found in this labour market segment.

As Figure 1.1 illustrates, the demand curve is steep at the beginning, where most of the demand for labour originates from the high productivity sector, but flattens towards the bottom where it reflects the existence of the micro-enterprise sector. In other words, in a country with a large labour supply, the equilibrium wage for this category of relatively unskilled workers is defined by the marginal labour productivity in the micro sector.

Figure 1.1: Labour demand curve by size of enterprise



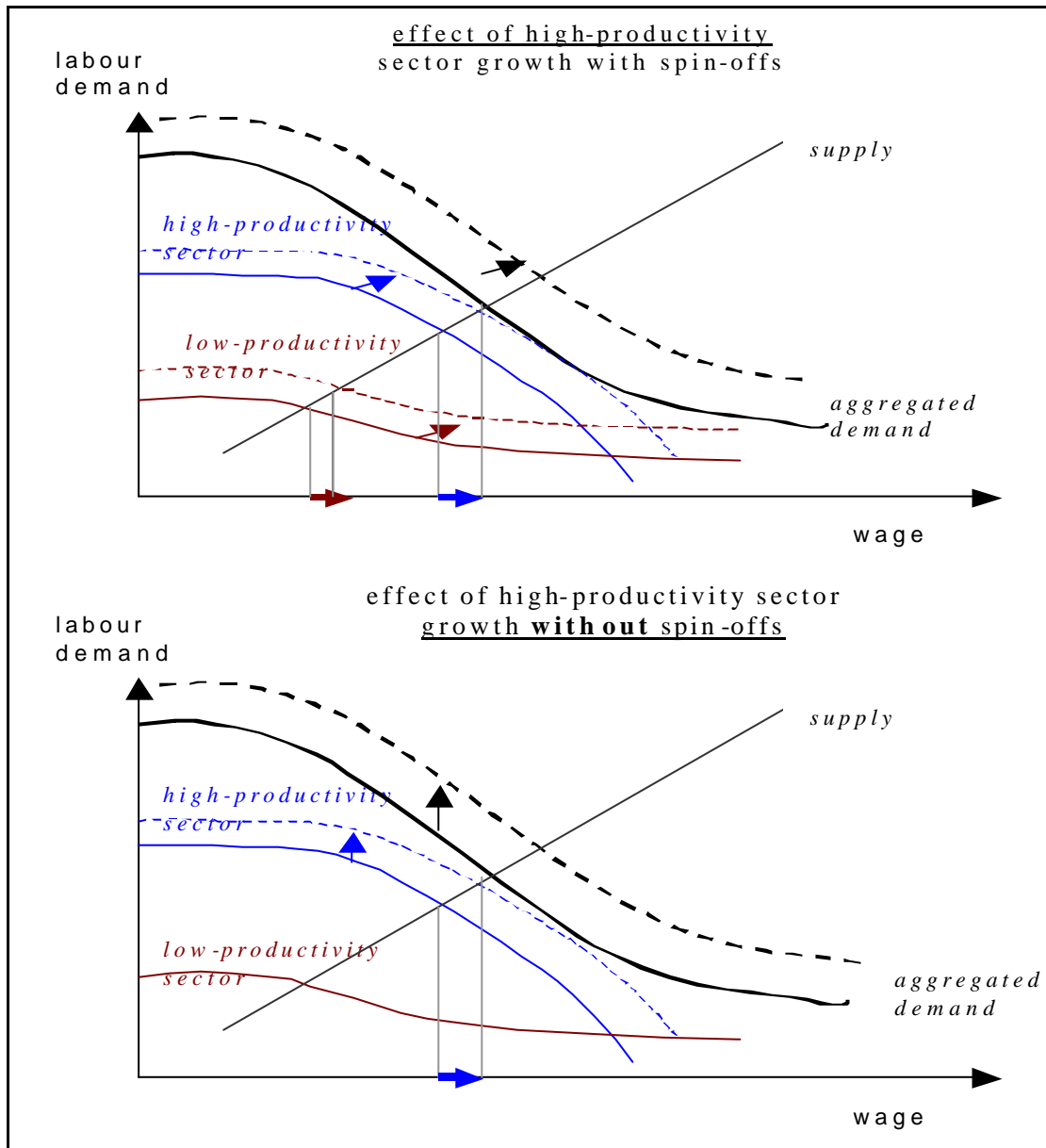
1.4.3 Role of the high productivity sector on labour markets

A healthy high productivity sector directly contributes to employment creation. However, when capital is scarce, its main impact on employment is indirect, by means of technology spin-offs, subcontracting and transfers to the lower productivity sectors. The combination of an increase in the demand for labour in the high productivity sector, as well as the rest of the economy, produces a rightward shift of the labour demand curve.

In South Africa's case, however, technological upgrading seems to work in the opposite direction. The high productivity or modern sector seems to grow 'vertically,' i.e. with no transfer, technology spin-offs or other indirect benefits. As a result, wages in the high productivity sector rise, but fall in the other sectors. Such growth causes more income inequality, reinforced by the likely fall in wages of low-skilled micro-

enterprise employees because this segment of the labour market gets flooded (see Figure 1.2).

Figure 1.2: Effect of high productivity sector growth on labour demand



International experience suggests that the direct (low) employment creation capacity of the high productivity sector does not vary much across developing countries, but that the extent of its positive impact on employment creation in the lower productivity sectors does. In the case of Latin America as a whole, for example, there has been virtually no net employment creation of this sort in the 1990s – even though a modest rate of overall economic growth was achieved. The Latin American experience suggests that the high productivity sector cannot be expected to provide the answer to a developing country's employment needs in a world of liberalization, fiscal prudence and rapid technological change. Its employment growth is slow, and

unless productivity was raised in the other sectors, the equilibrium wage would stay low for a discouragingly long period.

1.4.4 Role of the micro-enterprise and SME sectors¹

Returning to employment and wages in the low-skilled segment of the labour market, it is important to distinguish between the micro-enterprise sector and the SME sector. The micro-enterprise economy increases the average productivity of labour in the economy as a whole by 'pulling into production' unemployed low-skilled labour, whose skill levels are not sufficient to qualify for employment in larger firms. Although this probably does not raise the average labour productivity of the employed labour force, it makes the most productive use of the unemployed economically active population. This has the effect of raising total output in the economy at little or no opportunity costs. By means of support measures, the average labour productivity of those so employed could be enhanced.

The marginal product of labour in the micro-enterprise sector determines the equilibrium wage for unskilled labour in the whole economy, although labour legislation and trade union power artificially push up wages in large-scale firms and part of the SME sectors, so that the actual wages tend to lie above those paid in the non-unionised micro-enterprise sector. Nevertheless, the social and economic importance of having policies that raise productivity in this micro sector must be viewed in light of the fact that its impact on earnings can go beyond the micro-enterprise itself. Their successful implementation raises not only the incomes of people employed therein, but of all other comparable workers in the economy whose incomes are not above the equilibrium due to 'institutional distortions.'

Promoting the micro-enterprise sector with a micro-finance programme, for example, may raise the productivity of enough micro-enterprises (or induce the formation of dynamic ones to replace less productive micro-enterprises) so that the labour demand (labour productivity) curve of that sector will rise. Unfortunately, this cannot be the final resolution to the challenge of adequate employment, because the productivity levels of micro-enterprises have a relatively low ceiling. Hence, while effective policies impact positively on micro-enterprise productivity, they achieve poverty alleviation at the most, but not an expansion of the middle class.

The SME sector, by contrast, is not just a desirable complement to growth in the high productivity sector and a multiplier of productivity increases in the micro sector, but holds in itself the main key to whether the country will succeed or fail in confronting its employment challenge. Labour productivity is sufficiently high in most of this sector so that its workers earn above the poverty line. Further productivity improvements raise average wage levels of this sub-sector. Even more helpful, however, is the horizontal expansion of this sector, through entry of new and growth in size of existing firms. This shift in the size distribution of firms can be explained by:

¹ Please note that there is a distinction between SMMEs and SMEs. This is intentional, as medium-sized enterprises are often different from micro-enterprises.

- The redeployment of former lower skilled micro-enterprise employees to SME firms (or the 'maturation' of micro-enterprises into SMEs) until eventually only a few micro-enterprises are left; and
- The redeployment of high-skilled and less-skilled workers from the high productivity sector, which tends to replace labour with capital.

SMMEs therefore emerge not only from a productivity perspective, but also with an interest in income distribution, as the most promising section of South Africa's economy. The country could have raised its average labour productivity by allocating a high share of capital to large firms, which yield scale economies, and/or firms using modern technologies. In this case, only a few high-skilled and well-paid workers would be needed to operate this capital, while the majority of the labour force produces with little capital, and hence low levels of productivity and remuneration. In this scenario, labour (as the abundant factor of production) is sub-optimally used and income distribution worsened, especially with regards to unskilled workers and labour entrants in particular.

Since South Africa boasts a large pool of low-skilled workers, maximising average labour productivity of those who are employed seems to be the wrong path to follow at this time. Such a strategy would lead to a high rate of unemployment, and hence inequality in income distribution. While the micro-enterprise segment usually absorbs some of the unemployed, therefore slightly increasing the overall productivity of the economy, it is more desirable to have SMEs generate the bulk of employment, which is more productive, and hence able to pay higher wages.

Admittedly, the correlation between firm size, labour intensity and labour productivity varies from country to country and industry to industry, but allows a first assessment of the potential of the SMME sector. If the theoretical assumptions above are accepted, and it acknowledged that the upgrading of skills in the labour force is pivotal to a prosperous SMME sector, it becomes equally clear that the overall economic success of a country like South Africa depends on the nature and effective implementation of its SMME support policies.

2 SIZE, PROFILE AND PERFORMANCE OF SOUTH AFRICA'S SMME ECONOMY

2.1 INTRODUCTION

Any policy decision concerning South African SMMEs requires accurate information about their size and structure, as well as the contribution of SMMEs to the economy. In particular, there is need to know the number and size of SMMEs, and where to find them. Because their needs vary strongly according to these two criteria, it is also important to know their distribution across age categories and across industries. Moreover, the potential of SMMEs for economic empowerment can only be estimated with a sense of the share of previously disadvantaged individuals (PDI) in the ownership of SMMEs. Apart from these specific questions, more general information on the share of SMMEs to the economy can enlighten macro-economic policy on the impact of their actions on the sector.

Unfortunately, accurate information is far from being available in South Africa, especially on the informal sector, which apparently represents at least two-thirds of the SMME population. Although the annual reviews of the *State of Small Business in South Africa*, published by Ntsika Enterprise Promotion Agency (Ntsika), represent an official source of data, they are not easily usable.²

This chapter aims to present an overview of available estimations on the SMME sector according to a variety of data sources. The diversity of statistics indicates just how difficult it is to undertake quantitative work on SMMEs in South Africa, and indicates the urgent need for complementary research.

² In the last few years (1995-99), Ntsika tended to publish very comprehensive statistics based on fragmentary and sometimes outdated sources, which were compiled with a lot of extrapolation. For example, the combined data sources used for the 1997 review were the Registrar of Companies, the Receiver of Revenue, Unemployment Insurance Fund (UIF), National Population Census 1996 and Sectoral Censuses, as well as October Household Surveys from Statistics South Africa (SSA), Matrix Marketing databanks, Development Bank of Southern Africa employment series, the Reserve Bank and other commercial research agencies (Ntsika, 1999:76). This posed several potential problems, as economic SMME databases in South Africa are prone to inconsistency, national surveys and censuses are often published with a three to four year time lag and the extrapolating assumptions may be discretionary. Because the accuracy of the statistics was often questioned, Ntsika seems to have chosen, since 2000, to follow a more cautious line, with the result that that information stays very general and is no longer as comprehensive as it used to be. Most of the analyses make reference only to *formal* enterprises, and omit absolute numbers of establishments and employees.

2.2 NUMBER OF SMMEs IN THE VARIOUS SIZE CATEGORIES

The difficulty in any statistical work on SMMEs is perhaps best demonstrated when answers to the most basic questions, for example, “How many SMMEs are there in South Africa?” Unfortunately, an answer to this question is not easy to answer. Table 2.1 compares several estimates made by various institutions in the past few years.

Table 2.1: Different indicators for the size of the SME sector

Source	Survivalist	Micro	Very small	Small	Medium	Large	Total
Ntsika 1999	184,400	466,100	180,000	58,900	11,322	6,017	906,739
Statistics SA, 2000/Ntsika 2000	Informal: 1,138,854		330,271	94,804	52,620	12,249	1,628,797
Business Partners ³	2,3 million		600,000		35,000	n/a	2,9 million
Management Sciences Group Survey, 1999	micro: 960,740 "informal": 862,580		formal: 445,880 (of which 357,780 private)				2,3 million
Eskom Survey, 1999	900 000+ 'in-home businesses'; total 3 million if one includes farmers					n/a	3 million
Global Entrepreneurship Monitor, SA 2001 ⁴	betw. 0.73 and 1.15 million	1,709,142					between 2.44 and 2.86 million

Source: Compiled by Rashid Ahmed, MFRC, and Magali von Blottnitz, UCT

The correspondence between the size categories is approximate, since sources tend to use divergent definitions.

As Table 2.1 shows, there is a considerable potential for error, especially in the survivalist and micro categories (informal sector). Considering that even Ntsika has drastically revised its estimation from 0.9 million to 1.6 million between 1999 and 2000, it can probably be surmised that Ntsika's 1999 estimations were somewhat “out of the picture.” Accordingly, it can probably be said that there are between 1.6 and 3 million SMMEs in South Africa.

It is particularly noteworthy that the two “official sources” (Ntsika and Stats SA) suggest much lower totals than private research groups. There may have been an under-estimation of the informal sector by Stats SA and Ntsika, due to the strong reliance of their figures on various industrial censuses, which not are likely to capture informal businesses very accurately.⁵ Estimates for the informal sector mainly derive from employment data contained in the October Household Survey; there is a potential for error in extrapolating enterprise figures from employment figures.

Private investigations, on the contrary, were generally centred on the actual question, i.e. the existence of enterprises. So although they may not have had the statistical

³ Per presentation made to DTT's 'SME Reference Group.'

⁴ The South African Global Entrepreneurship Monitor (GEM) team has not actually attempted to quantify the number of enterprises, but rather the proportions of South Africans who are entrepreneurs/business owners. Extrapolations to the number of enterprises are own calculations, with the help of Stats SA's October Household surveys, as well as GEM's indications on the size of entrepreneurial teams and the phenomenon of ownership of several businesses.

⁵ According to Stats SA, the censuses follow a methodology of 1988 and “include the most important enterprises.” See Stats SA, *Financial Statistics of Manufacturing*, Monthly Statistical Release P3042.1., as well as *Financial Statistics of Wholesale Trade*, Monthly Statistical release P6142. This is mostly problematic, against the background of South Africa's history of apartheid which entailed the under- or non-recording of black – and in particular 'homeland' – business activities until 1995.

power of Stats SA (in terms of sample size), their data may have been closer to reality. For example, the Global Entrepreneurship Monitor 2001⁶ found out that the “multiple ownership of businesses” was a frequent phenomenon (for example, almost 54% of “established business owners have started at least one other firm in the last 1.5 years”). This can explain why there may be more enterprises than there are self-employed. What this suggests is that the number of firms is likely to be higher than 1.6 million.

A data and methodology problem is encountered in the consideration of size categories. Although the Small Business Act has provided an official definition of four size categories (micro, very small, small and medium), this is not followed by the official state agencies in that they either add new categories (“survivalist category”⁷ in 1995-99) or ignore some (“very small category,” Stats SA, Ntsika 2000), without explanations. Private studies are probably even less disciplined as far as their definition of size categories is concerned, also combining a legal criterion (formality) with a size criterion (micro-enterprises), which makes comparisons rather hazardous.

It must be emphasised, however, that the weight of the smallest size categories (micro-enterprises) is overwhelming. Although their contribution to GDP is minor, they represent between 1.2 and 2.8 million businesses, i.e. between 69% and 80% of all SMMEs.

In terms of dynamic evolution of the size classes, it is almost impossible to make accurate comments. While previous Ntsika publications may have suggested a decrease in the proportion of survivalist businesses (from 23% to 20%) and a significant increase in the micro- and very small category (from a combined 67% to 71%) between 1995 and 1997, the Management Services Group sees an increase in all categories, but mainly in the smallest informal size class (as well as in the public service) between 1998 and 1999.

2.3 SECTORAL STRUCTURE OF SOUTH AFRICA’S SMMEs

The only sources giving comprehensive information on the numbers of firms by sectors are the data published by Ntsika (1997, 1999, 2000) for the years 1995, 1997 and 1999. This is problematic, since Ntsika may have overlooked a number of enterprises, which may or may not be concentrated in a few sectors.

A summary of statistics is presented below.

2.3.1 Current sectoral profile

Table 2.2 shows a static picture of the SMME population by sectors for the last five years.

⁶ Conducted by the Graduate School of Business of the University of Cape Town

⁷ Essentially, Ntsika defines the “survivalist” enterprise as a business in which “the income generated is less than the minimum income standard. Annual turnover is typically less than R12,000.” (Annual Review 1999, p. 15).

Table 2.2: Ntsika statistics on the sectoral distribution of South Africa's enterprises

		1995	1997	2000*
1	Agriculture, Forestry etc.	92300 11.0%	98,060 10.8%	204,429 12.6%
3.	Manufacturing	113555 13.6%	106,019 11.7%	163,343 10.0%
5.	Construction	79974 9.6%	88,516 9.8%	147,830 9.1%
6.	Trade; repairs; hotels and restaurants	351,183 42.0%	365,980 40.4%	699,106 43.0%
7.	Transport, storage, communication	50007 6.0%	58,796 6.5%	85,360 5.2%
8.	Financial and business services	65700 7.9%	77,826 8.6%	111,996 6.9%
9.	Social and personal services	80400 9.6%	107,013 11.8%	179,837 11.1%
		836850	906,690	1,626,459

Source: Own calculations based on Ntsika 1997, 1999 and 2000.⁸

Because of the statistical weakness of the estimates presented above, these figures should be seen as providing an order of magnitude, rather than very precise indications. Thus, the comparison between the three years may not be very reliable.

Nevertheless, interesting findings emerge from these estimations. It is not surprising that the sectors SIC 2 and 4 (mining and quarrying, and electricity and water supply) are almost irrelevant to the SMME economy. More interesting is the distribution between primary, secondary and tertiary sectors.

Table 2.3: Primary, secondary and tertiary economy depending on enterprise size

	Among informal / survivalist- micro businesses			Among large enterprises			Among all enterprises		
	1995	1997	2000	1995	1997	2000	1995	1997	2000
Primary (SIC 1)	6.4%	8.4%	13.7%	24.6%	25.3%	N/a	10.8%	10.8%	12.6%
Secondary (SIC 2-5)	22.7%	21.6%	20.7%	34.8%	32.2%	N/a	23.6%	21.9%	19.4%
Tertiary (SIC 6-9)	70.9%	70%	63.6%	40.6%	42.6%	N/a	65.4%	67.2%	66.2%

Source: Own calculations based on Ntsika 1997, 1999 and 2000.⁹

⁸ It is important to note that the 2000 estimations follow a different methodology than the previous years, and may therefore not be fully comparable. The statistics include large enterprises, because it was not possible to isolate them in the 2000 figures. However large enterprises have barely any impact on the overall sectoral distribution. The figures do not add up to 100% because some sectors which are less relevant for SMMEs (mining and quarrying, electricity, glass, and water supply), as well as "other activities not adequately defined," have been left out of this table.

⁹ Figures for 2000 do not add up to 100% because the SIC 10 ("other activities not adequately defined") has been excluded.

Table 2.3 reveals two interesting findings. First, a pronounced majority of the smallest of South Africa's enterprises, which come mostly from the informal sector, are active in the tertiary sector, especially in trade. This is not surprising, as it is well known that primary and secondary activities require an amount of capital (land for the former, machinery and equipment for the latter), which is often not affordable to 'emerging' enterprises.

However, the differences between the 1995-1997 estimations and the 2000 estimations in this regard are striking; the 2000 estimations (which capture almost twice as many informal businesses as the previous ones) seem to have identified a much higher proportion of those firms in the primary sector than the previous studies. This may be due to an effective change in land ownership or to a better count of emergent farmers in the previous homelands and other rural areas.

Surprisingly, the 2000 estimations also suggest that secondary activities such as manufacturing and construction are even more dominant in the informal sector than in the formal economy. Again, it is difficult to separate the dynamic effects (decrease of the secondary sector within the last decade) from the impact of the change of methodology.

2.3.2 Sectoral dynamics

As mentioned before, any accurate comments on the sectoral evolution of the SMME population made on the basis of Ntsika statistics is perilous, given the margin of error suggested by the gaps between 1997 and 2000.

More limited studies are probably helpful in examining the dynamics of the various sectors. In particular, GEM (2001) gives indications on the sectors in which start-ups were created in 2000-2001 and the sectors where new firms were present. A comparison of these figures with the overall distribution of enterprises as suggested by Stats SA 2000 may indicate dynamic sectors.

The difficulty with this approach is that a sector with a high proportion of "start-ups and new firms" can be either a new, developing, or characterised by a very high firm turnover, i.e. there are many births and many deaths within each year. Despite its caveats¹⁰, a look at the registration and deregistration statistics of the Registrar of Companies can help support the interpretations of GEM's results.

These two sources, presented in Tables 2.4 and 2.5, enable the building of qualified presumptions on the following questions: In the last five years and in 2000, which sectors witnessed the most enterprise creation? In which sectors does entrepreneurship appear to be sustainable?

¹⁰ Firstly, the Registrar of Companies per definition cannot capture the informal sector. In addition, unfortunately, not every new registration signifies the creation of a truly trading company. Registrations may be driven by mergers, change in legal status or activity, or relocation; also, sometimes a dormant company is registered only for tax purposes. Similarly, take-overs and relocations can affect deregistrations.

Table 2.4: Sectoral distribution of start-ups and new firms compared to the total distribution of South Africa's enterprises

SIC		GEM 2001		Ntsika 2000
		Start-ups ¹¹	New firms	Total
1	Agriculture, hunting, forestry and fishing	1.3%	2.6%	12.6%
3.	Manufacturing	14.3%	19.1%	10.0%
5.	Construction (including mining and quarrying)	3.7%	5.0%	9.1%
6.	Trade; repairs; hotels and restaurants	46.8%	54.3%	43.0%
61+ 63	Of which wholesale, incl. fuel and vehicles	6.0%	6.5%	
62+ 64	Of which retail, repair, hotels & restaurants	40.8%	47.9%	
7.	Transport, storage and communication	9.8%	1.7%	5.2%
8.	Financial and business services	10.4%	13.1%	6.9%
9.	Community, social and personal services	13.6%	4.2%	11.1%
		100%	100%	100%

Sources: Own calculations based on GEM 2001, Ntsika 2000.

Table 2.5: Registrations and de-registrations of CC's and Pty's by sector (1990-2000)

SIC Codes	1990-1999		1999			2000		
	Registrations	Registr. / Ó formal	Registrations	Deregistrations	deregistr. / registr	Registrations	2000 / 1990-99	
1	Agriculture/primary sector	14,988	38.8%	3,542	237	6.7%	3,775	25.2%
3.	Manufacturing	43,013	111.6%	6,824	768	11.3%	7,357	17.1%
5.	Construction	46,212	170.4%	6,983	680	9.7%	7,572	16.4%
6.	Trade; repairs; hotels and restaurants	206,437	156.8%	35,047	3,377	9.6%	40,603	19.7%
7.	Transport, storage & communication	21,632	54.2%	2,961	271	9.2%	3,237	15.0%
8.	Financial & bus. Services	247,525	365.5%	37,374	4,061	10.9%	40,721	16.5%
9.	Social & personal services	27,552	47.2%	4,813	394	8.2%	5,531	20.1%
	Totals	610,404	147.6%	98,041	9,846	10.0%	109,359	17.9%

Source: Own calculations based on Registrar of Companies, as quoted by Ntsika, 1999-2000.

¹¹ GEM defines "start-ups" as businesses that have not paid salaries for more than three months, while a "new firm" is a business "that has paid salaries for between three months and three-and-a-half years".

- **Sectors with high company creations in the last 5-10 years**

According to both sources, two sectors emerge as having had a strong creation activity, namely the financial and business services and trade/hotels and restaurants. This is not surprising as these are known to be popular start-up activities. In the former case, though, this dynamic creation activity seems to be compensated by a fairly high “attrition rate”¹², almost 11% of new registrations in 1999.

The manufacturing sector is fairly dynamic, as GEM results suggest (high share among new firms in particular). Nevertheless, according to registration statistics, the sector’s creation activity is rather ‘average’ relative to its size in the formal economy. What is more, the sector appears to have the highest attrition (11.3%).

- **Sectors with high company creations in 2000**

Looking at most recent creations (in 2000), the above-mentioned three sectors remain significant. In addition, the sector of “social and personal services” emerges both from GEM results (very high share of start-ups but not of new firms) and from the Registrar’s data as a sector where creations have accelerated in 2000.

- **Contradictory results**

For three sectors, the two sources apparently yield contrary results. Apart from possible measuring weaknesses, other explanations are also sought for this discrepancy.

Construction: The Registrar suggests that in the last 10 years, the construction sector has had the second-most vibrant registration activity, albeit with a slight slow-down in 1999, while the GEM findings suggest that there are rather few new firms in that sector. While its overall ‘attrition profile’ is average (9.7%), it is very dramatic among private companies (46.3%).

This could possibly be attributed to a discrepancy between the formal and informal sector, a high “infant mortality” rate leading to a much smaller number of living young companies than were created, and/or the re-registration of proprietary companies (Ptys) as close corporations (CCs), and the phenomenon of dormant companies.¹³

Transport and communication: This sector consists of among others, activities such as “telecommunications” or “tour operators/ travel agencies,” which are known to be popular start-up activities – and also activities such as taxi driving. While GEM found a very high share of start-ups – though not of new firms in that sector – the registration activity seems to have slightly slowed down in 1999-2000, especially for CCs.

¹² The ratio of deregistrations to registrations, which we call an “attrition rate,” should not be seen as a proxy for a “mortality rate,” which would be the ratio of deaths to the entire sector’s population which is typically much lower.

¹³ Examples of these are black economic empowerment companies, which are registered for the purpose of winning government tenders, while in reality they are merely fronts for older white-owned firms. This trend has received widespread publicity and criticism.

This may arise from a difference in the delimitation of the sectors¹⁴ or by the fact that while the communication and tourism sectors are beginning to be saturated, which shows up as a high infant mortality. This may have reduced the attractiveness of the sector for start-ups.

Agriculture, fishing and hunting: The primary sector shows an intriguing pattern when comparing registrations in 2000 to the registration activity in 1990-99. Undoubtedly, there has been a great acceleration in the registrations of CCs in 1999-2000. However, GEM does not corroborate this, as they found very few new firms in that sector. The hypothesis of an “old sector” is also confirmed by the low rate of attrition. It is difficult to correctly interpret these results without a study of the structural changes in agriculture as a whole. This would require knowing what proportion of agricultural businesses is registered as CCs or private companies. In any case, the land reform process seems to be slowly generating some emerging farming businesses.

2.4 ETHNIC STRUCTURE OF SOUTH AFRICA’S SMMES

Given South Africa’s specific history of apartheid, which meant the exclusion of the majority of potential entrepreneurs from proper education and access to property and/or financial resources, it is important to know to what extent and in what forms PDIs are able to take their part in business.

2.4.1 “Black businesses”

The following statistics could be used: Ntsika estimated the share of PDI ownership at 50% in 1997; GEM suggests that in 2001, 76.8% of entrepreneurs are either black, coloured or Indian. While it is plausible that there has been an increase in the share of PDIs in the last four years, most of the difference is, however, believed to stem from Ntsika’s under-estimation of the informal sector.

The share of “non-whites” is noticeably higher in the informal sector/survivalist firms than in the formal sector. The World Bank study on formal SMMEs in the Johannesburg area illustrates the very small significance of PDIs in the formal economy.

¹⁴ GEM follows international sector codes, while the Registrar classifies companies along the South African SIC system.

Table 2.6: PDI share according to various studies

	Survivalist Micro	+ Very Small	"unspecified"	Small	Total
Ntsika 1997:					
Number of PDI-owned firms	434,428	15,875	16,625		466,928
PDI-share within size category	65.9%	15.8%	35.9%		57.9%
GEM 2001					
	Survivalist		Declared firms ¹⁵		
Number of white-owned firms	28,525		392,220		420,745
Number of Indian-owned firms	4,989		90,650		95,639
Number of coloured-owned firms	42,633		186,658		229,290
Number of black-owned firms	653,405		1,039,615		1,693,020
Total number of PDI-owned firms	701,027		1,316,922		2,017,949
PDI-share within category	96.1%		77.1%		82.7%
Chandra 1999 (formal and urban)					
		< 20 employees		20-49 employees	
Number of PDI-owned firms		110		35	
PDI-share within size category		18.5%		18.0%	

2.4.2 Racial distribution by sectors

Taking a look at the main sectors, it appears that the share of PDIs is highest in transport and communication, mining and quarrying, and construction and trade (Ntsika) as well as community services (GEM). In agriculture and financial and business services, the share is lower.

¹⁵ "Declared firms" are not necessarily formal businesses, but enterprises whose owners view themselves as owning a business, while "survivalist" firms are those whose owners do not know whether they can qualify themselves as business owners or not.

Table 2.7: Racial distribution of firm ownership by sector

SIC Codes	NTSIKA 1997		GEM 2001				
	White	PDI	White	Black	Coloured	Indian	PDI
1. Agriculture, hunting, forestry and fishing	39,500 57.5%	29,235 42.5%	11,972 45.8%	14,170 54.2%	0 0.0%	0 0.0%	14,170 54.2%
2. Mining and quarrying	2,895 29.0%	7,090 71.0%					
3. Manufacturing	35,962 41.2%	51,280 58.8%	42,607 19.0%	131,305 58.6%	37,793 16.9%	12,436 5.5%	181,534 81.0%
4. Electricity, gas and water Supply	4,998 58.3%	3,570 41.7%					
5. Construction	24,808 30.1%	57,720 69.9%	30,283 43.4%	14,170 20.3%	25,339 36.3%	0 0.0%	39,508 56.6%
6. Trade; repairs; hotels and Restaurants	107,106 35.1%	198,330 64.9%	121,484 15.2%	524,274 65.8%	101,139 12.7%	49,743 6.2%	675,157 84.8%
7. Transport, storage and communication	9,973 21.4%	36,688 78.6%	30,283 24.0%	83,128 65.9%	12,669 10.0%	0 0.0%	95,797 76.0%
8. Financial services, insurance, real estate & business services	56,525 73.2%	20,725 26.8%	91,201 57.8%	41,564 26.3%	12,669 8.0%	12,436 7.9%	66,669 42.2%
9. Community, social and personal services	48,381 46.7%	55,190 53.3%	23,945 12.4%	137,917 71.3%	25,339 13.1%	6,218 3.2%	169,474 87.6%
	338,981 42.1%	466,928 57.9%	351,774 22.1%	946,527 59.4%	214,948 13.5%	80,833 5.1%	1,242,308 77.9%

2.4.3 Cross-racial partnerships

The socio-economic context of PDIs, in particular the lack of funds to start businesses on their own, as well as the rise of so-called “affirmative procurement” (preference given by the government or large corporations to black-owned firms in their tendering activities), have led to an increase of cross-racial partnerships in the establishment of firms.

Recent data proves that these partnerships are very prevalent for urban formal SMMEs in the Johannesburg area. Chandra (1999) provides evidence that, among urban formal businesses, when PDIs are associated to a business they hold on average less than 10% of the firm (see Table 2.8), the remainder being presumably white South Africans (or possibly foreigners). There appears to be no significant sectoral differences in this regard.

In general, it appears that almost two-thirds of these partnerships were only started in the last four years. The textile/clothing sector seems to be the only one that had significant PDI participation before that period.

Table 2.8: Cross-racial partnerships among Johannesburg's formal SMMEs, by sector

	Total no of firms	Firms with PDI ownership			Mean share	Share held by PDI, overall
		Number	Duration of PDI ownership	5 yrs and +		
3. Manufacturing	398	69	38	31	8.9%	1.5%
30 Food, beverages and tobacco	115	19	16	3	9.5%	1.6%
31 Textiles, clothing and leather goods	98	20	6	14	9.4%	1.9%
35 Basic metals & metal products	93	5	3	2	9.8%	0.5%
39 Manufacture of furniture	92	25	13	12	8.8%	2.4%
5. Construction	92	12	9	3	7.1%	0.9%
6. Trade; repairs; hotels and restaurants	146	36	22	14	8.5%	2.1%
62 Retail trade, except of vehicles	112	32	19	13	9.3%	2.7%
64 Hotels and restaurants	34	4	3	1	7.6%	0.9%
7. Transport, storage and communication	47	6	4	2	7.6%	1.0%
86 Computer and related activities	91	22	18	4	7.3%	1.8%
96 Recreational, cultural and sporting activities	11	1	1	0	7.6%	0.7%
	785	146	92	54	8.5%	1.6%

Source: Chandra (1999) Table A1.2

This phenomenon is, however, believed to be specific to formal urban businesses, as it seems unlikely that significant white-PDI partnerships take place in the informal sector or in rural areas.

2.5 GEOGRAPHIC LOCATION OF SOUTH AFRICA'S SMMES

Owing to the poor infrastructure in rural areas (including banking infrastructure), it is important to take consideration of the location of the enterprises. Furthermore, an interesting question is the extent to which the potential for SMMEs in the rural areas is fully exploited.

2.5.1 Rural and urban SMMEs

Table 2.9: Distribution of SMMEs in 1996, according to type of location¹⁶

	Ntsika 1997			Ntsika 2000	
	Survivalist Micro	& Very small Small	& Medium	Total SMMEs	Total SMMEs
Mainly urban provinces: Gauteng, Western Cape and KwaZulu-Natal ¹⁷	415,800	175,400	8,770	599,970	944,034
In %	63.9%	73.5%	77.5%	66.6%	57.9%
Mainly rural provinces (other 8 provinces)	234,900	63,400	2,552	300,752	685,622
In %	36.1%	26.5%	22.5%	33.4%	42.1%
Total number of enterprises	466 100	180 000	11 322	900,722	1,629,656

As Table 2.9 shows, Ntsika's estimations in the last few years (until 1999) seem to have grossly under-estimated the number of enterprises in the most rural provinces, especially the Eastern Cape, Limpopo Province and Mpumalanga. In these provinces, SMMEs are – even more often than in urban areas – of an informal and survivalist nature. The new evaluation method used by Ntsika in 2000 suggests a much better balance between urban and rural areas than was until recently assumed.

GEM's results, on the other hand, suggest a much lower prominence of rural businesses, although in the survivalist economy almost a third of businesses come from rural areas (Table 2.10).

Table 2.10: Distribution of SMMEs, according to location

	Survivalist		Formal and semi-formal		Total	
Metro ¹⁸	320,309	47.7%	1,081,043	64.8%	1,401,352	59.9%
Small Town	148,310	22.1%	251,509	15.1%	399,819	17.1%
Rural	203,575	30.3%	335,898	20.1%	539,473	23.0%
Total	672,194		1,668,450		2,340,644	

Source: GEM 2001 combined with Stats SA/OHS 1999 (own calculations)

Note that it would seem that small enterprises are at a disadvantage in small towns, relative to rural areas.

2.5.2 Evidence of untapped potential in rural areas

From these divergent sources, it is difficult to establish precisely the number of SMMEs in rural areas. GEM suggests another approach to this conundrum, which is the comparison of existing entrepreneurs with the potential for further business creations.

¹⁶ Source: Ntsika, State of Small Business in South Africa, *Annual Review*, 1999, Table 6 p. 33.

¹⁷ Although they have significant rural areas, especially KwaZulu-Natal, three provinces (Gauteng, Western Cape and KwaZulu-Natal) are classified as "mainly urban," while the other six provinces are termed "mainly rural."

¹⁸ Calculation based on the assumption that approximately 9 million of people aged 16 and above reside in South Africa's metropolises.

One limitation of the GEM methodology is that the business creation potential is self-assessed, i.e., respondents are asked whether they believe that there are opportunities and that they would have the skills necessary to start a business. However, the results are intriguing, and suggestive of a huge untapped business potential in rural areas – especially among black people.

Table 2.11: Untapped potential of “opportunity entrepreneurship”

	White	Indian	Coloured	Black	Metro*	Small Town	Rural	Total
Potential opportunity entrepreneurs ¹⁹	7.0%	6.2%	8.1%	5.8%	6.3%	5.4%	6.0%	6.1%
Actual opportunity entrepreneurs	8.1%	6.2%	6.1%	2.6%	6.3%	3.8%	0.7%	3.7%
Untapped potential	-1.1%	0.0%	2.0%	3.2%	0.0%	1.6%	5.3%	2.4%
No of adults	38,350	0	49,364	657,139	0	87,008	593,420	665,490

Source: GEM 2001, combined with OHS data. Note – all percentage figures are percentages of the adult population within the category.

Table 2.11 shows that among urban and white and Indian populations, there is little or no potential for more entrepreneurship opportunity; the figures even suggest a negative untapped potential among the whites, presumably because many entrepreneurs realise *a posteriori* that either they do not have the skills, or the market potential is insufficient.

On the other hand, it seems that, with the appropriate support (including finance, infrastructure and mentoring), there could be a considerable increase in entrepreneurship in rural areas and among coloured and black people. This suggests that government policy should endeavour to stimulate small business activity among those population groups.

The figures in Table 2.11 have two limitations, though. First, the “actual opportunity entrepreneurs index” of 0.7% for rural areas does not mean that there are a few entrepreneurs among rural populations. Rather, GEM indicates that 1.8% of the rural adult population is involved in entrepreneurial activities and 2.9% own established businesses. However, these rural businesspeople are mostly characterised as “necessity entrepreneurs.”²⁰ The scarce job opportunities in rural areas possibly distort the distribution between “necessity” and “opportunity entrepreneurs,” leading to an exaggeration of the “untapped potential.”

The second caveat is that the “potential opportunity entrepreneurs” are self-assessed. It is possible that, with their lack of exposure and business experience, rural and black South Africans over-estimate both the opportunities present on the market, and their own ability to start a business.

¹⁹ Defined as adults who believe that there are good business opportunities in the area they live in, that they have the skills to start a new business, and would not be prevented by fear of failure.

²⁰ That is, engaged in business activities “primarily because they have no better chances for work”; by contrast, “opportunity entrepreneurs” are owner-managers of start-up or new firms “primarily to take advantage of a business opportunity.”

2.6 SMMES' CONTRIBUTION TO THE ECONOMY

Although statistics about the weight of SMMEs in the economy are frequent and popular, giving reliable and precise estimations is difficult. Once more, the reason is the lack of statistics about the informal sector, which considerably affects the economy. Therefore, again, the approach in this section will be to present multiple sources and estimations and discuss the differences.

2.6.1 SMMEs contribution to employment

Several technical difficulties arise when comparing the figures below. The definitions of "employed" may vary, depending on whether or not they include domestic workers, public sector employment and "self-employed." The largest disturbing factor, though, is the estimation of the "informal sector."

Table 2.12: Contributions to employment by firm size - overview*

	Survivalist & Micro ²¹	Very small	Small	Medium	Large	Total
Ntsika 1995						
In %	13.66%	13.35%	19.89%	13.77%	39.33%	100.0%
No of jobs	901,550	880,900	1,313,000	909,100	2,596,400	6,600,950
Ntsika 1997 (1999, p. 35)						
In %	13.97%	14.44%	16.57%	12.30%	42.72%	100.0%
No of jobs	1,033,000	1,068,300	1,225,900	909,820	3,160,000	7,397,020
Ntsika, 1997 (1999, p. 41)						
In %	Informal: 12.8%	"Formal" (including public sector) 87.2%				100.0%
No of jobs	1,174,000	7,972,000				9,146,000
Abedian, 1997						
In %	informal: 13.0%	"formal SMEs" 38.8%			38.4%	91.2% ²²
No of jobs	1,052,000	3,135,000			3,097,000	7,284,000
Ntsika 2000 & Stats SA 2000						
In %	informal: 26.1%	'micro formal' 12.8%	12.1%	15.3%	33.6%	100.0%
No of jobs	2,705,000	1,332,003	1,252,298	1,591,046	3,488,653	10,369,000

Sources: Ntsika, 1997 1998 and 1999 editions (combined data sources were used); Abedian, 2001, based on CSS (1998), Employment and Unemployment in South Africa Ntsika, 2000, combined with OHS 2000

2.6.2 Comments on the informal sector

In all developing countries, the so-called informal sector (consisting of survivalist and micro-enterprises) functions largely as an unemployment cushion for those with

²¹ Between 1995-1999, Ntsika used the term "micro" to describe informal sector generating more than a subsistence income. In this table, therefore, the column "survivalist and micro" corresponds to the informal sector. By contrast, Ntsika 2000 considers only formal employment – so the category termed "micro" has for our purposes been shifted to the "very small" column. The figures on the informal sector employment in 2000 are taken from the OHS 2000, not from Ntsika.

²² To arrive at 100% of jobs, it would be necessary to add domestic service, which employs 788,000 individuals.

limited skills and young job seekers. Accordingly, the number of micro-enterprise activities typically rises during economic decline.

Nevertheless, assessing the scale and performance of the informal sector, which, by definition, comprises statistically unrecorded activities (since recording is typically limited to the formal sector), has been a difficult task – more so in South Africa where the black population used to be prosecuted if involved in such activities. Apart from the difficulty in researching the hidden economy, different definitions of unemployment and full- or part-time self-employment lead to divergent observations.

Indeed, the 1996 Population Census estimates the number of workers employed in the informal sector to be at least 1.4 million and the total employed labour force to amount to 9.1 million (Ntsika, 1999:35), while the distribution below only ascribes 382 400 employees (and 650 500 self-employed) to the informal sector (see second row of Table 2.1) with formal and informal employees not exceeding 7.4 million in 1997 (Ntsika, 1999:51). It is therefore likely that this distribution underestimates the extent of informal sector employment – by perhaps as much as about 1.7 million!

Given the possible inaccuracy of the available data, the hypothesis of a numerically growing informal sector during times of economic decline can be neither contested nor totally confirmed, although its plausibility for South Africa is perhaps emphasised by the fact that it has been frequently observed in other countries.

2.6.3 Data by industries (see Appendix A2)

According to the latest estimations of Ntsika 2000, the sectors with the highest contributions to employment by very small (“formal micro”) and small enterprises were the services sector, with a combined 70.9% of employment in “community, social and personal services”, 59.5% in “trade, repairs, hotels and restaurants”, and 44.3% in business services. Meanwhile, medium-sized enterprises were significant in agriculture (52.3% of formal employment) and manufacturing (24.6%). These figures, however, could change significantly if the informal sector were included.

2.6.4 Dynamic analysis: are SMEs employment generators?

From Table 2.12, it is tempting to answer the question whether South African small firms are dynamic employment *generators*. When comparing changes in the distribution of employment over size classes between the successive estimations, it seems that this is the case – although the doubt remains whether the increase of estimated figures comes from a better capture of the informal and smallest activities, or from a real change.

Assuming that there has been an actual increase in the demand for labour, the next question is whether this is explained by the growth of individual enterprises, or by the formation of new firms. Dividing the employment figures by the number of establishments can help answer that question. Due to the inconsistencies in data

collection, the available data sets only allow for a tentative development of either answer, in particular with regards to informal enterprises.

Table 2.13: Average number of employees in South African firms by size class, 1995 and 1997

Average no. of employees	Survivalist	Micro (all)	Very Small	Small	Medium	Large
In 1995	1	2	5	21	79	456
In 1997	1	2	6	21	80	525
Difference	0	0	+1	0	+1	+69

Source: Adapted from Ntsika (1997; 1999:50); note that combined data sources are used

Acknowledging the possible misrepresentation of actual trends by the available data and returning to the question of SMMEs as employment generators, it seems that micro-enterprise and very small firm *formations*, and not the expansion of existing SMMEs, accounted for the overall employment growth in the SMME sector between 1995 and 1997, while the bulk of private sector employment growth resulted largely from the expansion of large enterprises.

2.6.5 SMME contribution to the GDP

As mentioned before, discussing SMME contribution to the GDP is problematic, since the GDP typically records only formal activities, while most SMMEs are active in the informal sector. Therefore, in theory, two approaches are possible: either ignoring the informal sector entirely, which can only give a partial answer to the question of the economic significance of SMMEs; or attempting to quantify the value added generated by informal enterprises.

Table 2.14: Contributions to GDP by firm size – overview

	Survivalist	Micro	Very small	Small	Medium	Large	Others	Total
Ntsika 1995 ²³								
In %				21%	12.0%	67.0%		100%
In million R				76,020	43,440	242,540		362,000
Abedian, 1997								
Scenario 1, in %	1.2%	13.25%	9.43%	17.24%	15.11%	43.73%		100.00%
In million R	7,622	81,572	58,061	106,153	93,076	269,312		615,796
Scenario 2, in %	1.24%	11.00%	9.43%	14.99%	15.11%	48.23%		100.00%
In million R	7,622	67,721	58,061	92,302	93,076	297,015		615,797
Ntsika 1999								
In %				25.2%	8.3%	46.3%	21.2%	100.0%
In million R				170,585	56,024	312,958	136,314	675,881
Ntsika 2000								
In %			5.8% ²⁴	13.9%	15.1%	65.2%		100.0%
In million R			47,027	112,314	121,607	527,070		808,017

Sources: Ntsika, 1995; Abedian, Chapter 1, in: Policy Board for Financial Services, Access to Finance for SMMEs, 2001; Ntsika 1999; Ntsika, 2000, combined with Stats SA, Release P0441, 2001.

Table 2.14 suggests that Abedian has made the only attempt to quantify the contribution of the smallest, informal firms to value added. The methodology that he used was to split gross value added into compensation of employees and gross operating surplus. The first part was allocated to the various size categories according to their contribution to employment, while gross operating surplus was allocated to each type of enterprise using assumed weights.²⁵ Depending on the assumptions, he arrived at a combined 12-14.5% of GDP being generated by informal SMMEs.

Several improvements could be undertaken to refine this approach. Assuming that compensation of employees is distributed across the size classes according to the employment weights implies that the wage per worker is constant across size classes. There is considerably evidence to suggest that this is not the case. While allocating the share of value added corresponding to compensation of employees between the size categories, it would make sense to assume different salary levels. The assumption that salary levels are homogenous across the size categories probably led to an over-estimation of the contribution of survivalist and micro-enterprises.

On the other side, Abedian worked with Ntsika's former estimations of employment within survivalist and micro-enterprises, which (as shown in the previous section) are probably strongly understated. Moreover, in terms of the absolute figures, it would have been more correct to calculate the value added by informal enterprises as being

²³ Total value added differs from the 1995 GDP; it possibly includes only the value added of the private formal sector. The data is drawn from the censuses published by Stats SA, such as the Manufacturing Census, which use size definitions, which differ from those in the Small Business Act.

²⁴ Again, for Ntsika 2000, the "micro" category has been shifted to the "very small" column, because it refers to formal businesses.

²⁵ The weights were, for scenario 1: survivalist 0,0; micro 0,05; very small 0,05; small 0,20; medium 0,20 and large 0,50; and for scenario 2: survivalist 0,0; micro 0,0; very small 0,05; small 0,15; medium 0,20 and large 0,60.

“on top” of the official GDP of 615.8 billion Rand. Thus the value added by survivalist and micro-businesses would have been slightly higher.²⁶

Nevertheless, Abedian’s estimates seem to be a good proxy of the orders of magnitude.

2.6.6 Data by industries (see Appendix A2)

In terms of the sectoral distribution, the broad lines are pretty similar to the comments made on the employment figures, with very small and small enterprises dominating in the services sector, and medium-sized enterprises strongly contributing to the agriculture and manufacturing sectors. It should be noted that these numbers ignore informal contributors due to lack of data.

Significant differences between employment distribution and GDP distribution appear, however, in two sectors:

- The trade and hotel/restaurants sector, where micro/very small enterprises represent 35.8% of employment but only 3.1% of value added. This suggests that the smallest supermarkets, petrol stations and restaurants operate at very low surplus levels; and
- The services (especially finance and business services) sector, where large enterprises contribute to 69.3% of GDP, supposedly referring to the (relatively) high margin business of South Africa’s large finance institutions.

2.6.7 Dynamic analysis: is the share of SMEs growing?

The data available barely enables intertemporal comparison. Indeed, both the size categories and the underlying GDP figures are inconsistent. From Ntsika’s explanations it is not clearly recognisable whether the “large enterprises’ GDP” includes the contribution of public and parastatal enterprises or even of government services.

2.6.8 SMMEs’ contribution to Investment

Another important dimension of the economic weight of SMMEs is their contribution to investment. While there is very little information on this question, Abedian (1998) has attempted to quantify this figure with a very rough approach.

²⁶ To be exact, the value added by the informal sector would have been bln R 75.4 (scenario 1) or bln R 89.0 (scenario 2).

Table 2.15: SMEs contribution to nominal gross fixed capital formation 2000 (R million)

Sector	Assumptions:		SMEs	Large enterprises	Total
	SMEs	Large			
Agriculture	100%	0%	4,101	0	4,101
Mining	0%	100%	0	10,601	10,601
Manufacturing	40%	60%	12,202	18,304	30,506
Electricity	0%	100%	0	6,980	6,980
Construction	50%	50%	605	606	1,211
Wholesale, retail trade, catering and accommodation	70%	30%	6,091	2,611	8,702
Transport	20%	80%	3,870	15,480	19,350
Finance	20%	80%	6,370	25,481	31,851
Community services	100%	0%	0	17,018	17,018
Total			33,239	97,081	130,320
Percentage share of total			25.5%	74.5%	100,00

Source: Abedian, in: Policy Board Report on Access to Finance for SMMEs²⁷

Although this estimation would need to be refined, it is interesting in that it suggests very low investment behaviour of SMMEs compared to their share in employment and production. A reason may be these enterprises' difficulties in getting access to sufficient finance to undertake investments. This certainly requires further attention.

2.7 STATISTICAL DATA ON SMMEs – CONCLUSIONS AND RECOMMENDATIONS

Any policy decision concerning SMMEs requires accurate information about the size and structure of South Africa's SMME economy. Ntsika aims to facilitate such decision-making by publishing annual reviews on the *State of Small Business in South Africa*. Nevertheless, the data presented in the various editions of the above publication can be improved to meet the requirements of policy makers for a number of reasons.

Ntsika can only encourage Statistical Agencies such as Statistics South Africa and private researchers to address the shortcomings with regard to correctness and coverage of the existing databanks, but it must request SMME data that: is more detailed (both by size-class and by industry instead of sectors); relies on more than just a single data source; and reflects changes over time by maintaining the same definitions.

2.7.1 Directions for data collection

Improvements to data collection need to be considered in the following areas:

²⁷ Notes on methodology: The percentage allocation of nominal gross fixed capital formation to large enterprises and SMEs was assumed, as above.

- **Better coverage of the smaller sized, and in particular, micro-sized establishments**

The currently reported low contribution of micro-enterprises to total employment contradicts anecdotal evidence and is probably not an accurate reflection of reality. Given the complexity of the task, particularly on the informal sector, it is recommended to proceed with limited-scope samples and case studies rather than using a census-like methodology, which is likely to be too “massive” to capture the subtleties of the informal sector. Some initiatives such as the World Bank Firm Study on the Johannesburg area is likely to provide a number of new insights in this regard, but a similar job would be needed in rural areas. Stats SA’s recently established series of Labour Market Surveys could also be considered in this regard.

- **Standardisation of data collection procedures**

This particularly applies to sampling methods and definitions, to allow for comparisons between data sources and various years.

2.7.2 Directions for data presentation

In certain cases, it is likely that the data are correctly collected but not appropriately presented. It is strongly recommended that Ntsika devote extreme attention to the following issues:

Continuity: Even if improvements of the previous years’ methods and results are welcome, they should always be presented in such a way that comparison across the years is possible.

Precision with regards to industry: Each of the nine main sectors consists of very diverse activities. Manufacturing alone comprises about 75 industries. While presenting detailed statistics on a triple-digit SIC basis would be too unwieldy, certain industries would need to be singled out, in particular:

- Manufacture of food products, beverages and tobacco products;
- Textiles, clothing and leather goods;
- Basic metal and metal products, machinery and office equipment
- Manufacture of furniture;
- Retail trade;
- Sale, maintenance and repair of vehicles;
- Trade in fuel;

- Hotels and restaurants;
- Travel agencies and other supporting transport activities;
- Post and telecommunications;
- Computer and related activities;
- Business consulting and other business activities; and
- Recreational, cultural and sporting activities.

Precision with regards to size: If, for a particular reason, the official size categories provided by the Small Business Act cannot be used, the underlying definitions should be explained.

Disclosure of method and reference population: Tables and graphs should indicate clearly the population they refer to (e.g. is it only the formal sector, or formal and informal), the primary sources utilised for the data offered and, if it stems from own calculations, and the rough approach used.

2.7.3 Directions for data analysis

With more detailed information on SMMEs, data analysis can take a number of additional directions, such as:

- Verification of information obtained from Stats SA with household/labour market and enterprise surveys (and vice versa): Recent empirical work such as the 1999 World Bank Survey in Greater Johannesburg and the National Enterprise Survey are first attempts to generate information for representative samples. Nation-wide coverage and repetition of these surveys is to be encouraged.
- Refinement of estimations on the informal sector: E.g. its contribution to employment and value added, based on the newest estimations on the number of firms in the informal sector.
- Generation of data on more precise performance indicators: Apart from the (static) contribution to output and employment, SMMEs' investment behaviour, wage levels and labour productivity inform about their performance.
- Generation of time-series data: The relative growth of the SMME sector and its performance emerges over time. Indicators that require further investigation over time and by industries (and later size-class) are: ratio of employment growth in SMMEs to that of the overall economy; ratio of value added by

SMMEs to that of the overall economy; ratio of the number of SMMEs to that of all establishments; and capital/labour ratio of SMMEs (labour intensity).

Some of these analyses are already offered by the latest Ntsika publication on the state of SMMEs in South Africa, but as mentioned before, this has been limited to formal sector activities and appears to exclude those activities that are not recorded by Stats SA's sectoral censuses.