



TIPS WORKSHOP SERIES

The SMME Economy in South Africa

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TRADE AND INDUSTRIAL POLICY STRATEGIES

Workshop on SA SMMEs Points Towards Crucial Future Research

*At the end of 2003, TIPS, in conjunction with the **Small Business Project (SBP)**, hosted a workshop on the Economics of SMMEs [1] in SA. Bringing together policy-makers, practitioners and the research community, the workshop debated the lessons learnt in developing the small business sector and the challenges we still face. Importantly, the workshop assisted in the formulation of a medium-term agenda for further research in this area.*

Since 1994, SA has been faced with the challenges of reintegration 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, SA's SMME economy has been actively promoted since 1995. Despite voluminous research, however, the extent to which SA's SMMEs contribute to poverty alleviation, economic growth or international competitiveness is still largely unclear.

Presentations

Rashad Cassim, head of the School of Economics and Business Science at the University of the Witwatersrand, initiated the workshop discussion by explaining the background to a study [2] of SMMEs compiled by TIPS in 2002.

The study describes the SA economy as a classic middle-income economy with high levels of inequality and poverty, but moreover as a dualistic economy - with high and low productivity sectors. In addition, SA's economic policy embraces a pro-growth strategy of fiscal prudence, trade reform and public sector restructuring. Evaluating the overall performance of the SA economy makes it clear that a fundamentally flourishing SMME sector is unlikely in the face of low overall economic growth. In this scenario, the question is: how will much-needed employment be created?

Cassim further probed the determinants of labour demand in a middle-income economy such as SA's. Whereas developed countries exhibit high absorptive capacity and a high capital base, SA has a limited capital base, an abundance of unskilled labour and low overall economic productivity. From the TIPS report, Cassim highlighted that SMMEs contribute 25% of SA's total fixed capital formation, and thus stressed the importance of micro enterprises to overall economic productivity through the absorption of those on the margins. Moreover, the contribution of medium enterprises should be seen as central to the employment challenge in the long run.

Cassim raised the important point that investigating the success and mortality rates of SMMEs is key to devising the kind of policies that are needed in SA to make SMMEs grow and be sustainable. In this regard, he stressed the importance of further research in terms of international comparisons, as well as longer time-series research to determine SMMEs' growth paths and ascertain the reasons behind such businesses' success or failure. In addition, since access to finance is a major constraint for start-up or small firms in SA, research on the

SMME sector should probe the nature of financial intermediation. He suggested that, although the reasons behind low bank borrowing in the sector vary from lack of collateral to lack of investment or demand opportunities, the competitiveness of the SA banking sector - especially in terms of its small business loan portfolio - should be scrutinised and compared to that of other countries, for example Brazil and Malaysia. The cost-reducing effects of more competition in the local banking sector - and the resultant benefits for small businesses - cannot be over-emphasised.

Cassim also noted the impact of the labour market - with its heterogeneous labour force and high dispersion of productivity within and across sectors - on the SMME sector, and the importance of evaluating the market's current structure in an international comparative perspective.

In terms of the product markets, he noted the importance of relevant, up-to-date and reliable information on what SMMEs are producing and for which segments of the market.

According to Cassim, a future effective SMME policy package should include strong support for an efficient SMME sector in a competitive, open economy. Included in such a strategy must be the encouragement of increased local activity through the development of regional/sectoral growth pockets and supply-side support, and the opening up of export possibilities.

Reg Rumney, information services director at the BusinessMap Foundation and the second speaker at the workshop, focused on SMME development in the context of black economic empowerment (BEE) and the restructuring of State assets.

According to Rumney, the ANC government's Reconstruction and Development Programme (RDP) of 1994 first emphasised the importance of small business development among black people, and so introduced the first definition of black economic empowerment. Currently, 90% of very small businesses (VSMEs) are owned by black people, and 70% of SMMEs. However, small and medium enterprises (SMEs) are still mainly owned by white people.

Rumney said restructuring at first glance has had a limited impact on BEE and the distribution of wealth to a larger section of the population. Telkom's empowerment shareholding, which stands at less than 6%, is a case in point. However, the sale of State forestry assets, to some degree at least, has achieved the dual aims of BEE at company and community level by implementing sustainable affirmative action and human resource development programmes at the local level.

On the other hand, economic liberalisation has created a number of new black radio stations and the first BEE free-to-air TV channel. So the overarching aim of government's restructuring policy - the liberalisation of the SA economy - and the State's objective of playing a continuous developmental role in SA to deal with the legacies of apartheid, poverty and unemployment - are able to create more space for empowerment - and by implication for SMMEs - than the mere privatisation of State-owned assets.

In terms of government's BEE policy, Rumney said a move away from the criterion of direct equity transfer in existing businesses to alternative means of distributing wealth by

channelling equity into entrepreneurial activity should stimulate the expansion and sustainability of the small business sector.

In addition, a focus on promoting empowerment in economic activity such as small mining, small farming, tourism and franchising should not only promote sustainable BEE but also SMME development - as would further economic liberalisation, higher rates of economic growth and making available alternative forms of capital to the small business sector.

In terms of the State's procurement policy, Rumney observed that the Preferential Procurement Policy Framework Act of 2000 is not particularly 'small-business friendly' and has not introduced an effective monitoring mechanism to assess its impact on the small business sector. However, this could improve with the introduction of the balanced scorecard approach of the empowerment charter movement - for example, the mining charter already makes provision for small business development through procurement.

In her presentation, Judi Hudson of the Small Business Project reflected on how the enabling environment can contribute to private sector growth in SA. She referred to a 10-country study [3] co-ordinated by London-based Banrock Consulting which found an appropriate regulatory and institutional environment to be the single most important element in any economic growth strategy. Only one other factor - available skills, especially technical skills - is as closely correlated with per capita economic growth.

Hudson observed that sound macro-economic policies - while an essential basis for development - have not been sufficient to encourage business growth in SA. The rate at which jobs have been created lags well behind the number of job seekers, while employment should have expanded by more than 33% since 1995 to have provided jobs for all new entrants in the job market.

To boost private sector growth and job creation, Hudson suggested that the enabling environment for business, especially small business, should be revisited. However, it is important to understand that SA needs better regulation or in some cases re-regulation, not simply deregulation. While an enabling environment is good for all business, irrespective of size, and regulations affect the private sector as a whole, they weigh most heavily on smaller firms. For example, it has been found that compliance costs per employee are over five times higher for the smallest SMMEs than for the largest, while an American study concluded that firms employing fewer than 20 employees face an annual regulatory bill of US\$6,975 per employee. This burden is 60% higher than that faced by firms with more than 500 employees.

So it is no wonder that informal operators tend to ignore regulations, taxes, levies and health standards. Unfortunately, inappropriate regulations also act as a barrier to development by keeping many of them out of the formal economy. Hudson listed three approaches, advocated by the OECD [4], which could help the small business sector to function more effectively within the regulatory environment.

Of major importance is active assistance to small businesses, in particular to meet the administrative compliance requirements of regulation. In addition, regulatory impact assessments could indicate which regulatory requirements should be modified to make them

less onerous for SMMEs, and could establish specific mechanisms to ensure that the regulatory design takes better account of small business needs and concerns. Hudson stressed that care must be taken to structure such assessments in a manner that does not add to the administrative burden of small businesses. Another problem of regulatory impact assessments is how to get a sufficient number of entrepreneurs involved in the regulatory debate - most are too busy managing their businesses to spend a significant amount of time in government departments to voice their regulatory difficulties.

In terms of a future research agenda, Hudson noted that, up to now, studies of the small business sector largely relied on perceptions rather than facts - the result of a lack of strong research-based evidence. She suggested that future research should incorporate a greater quantitative component to measure regulatory costs for small businesses in both the formal and informal sectors of the SA economy.

Chris Rogerson of the University of the Witwatersrand presented some preliminary ideas on the way forward for prospective research on the SMME sector, and identified certain gaps in existing SMME research studies. Up to now, Rogerson noted, SMME research was mainly supply-driven, and most research was produced for the short term and neglected longitudinal studies in favour of 'snapshot-type' studies. He referred to recommendations from previous attempts to put in place a small business research agenda specifically that of Ntsika/the ILO [5] - which highlighted the need for greater participation by users/beneficiaries in determining research agendas, the need for demand-oriented research from beneficiaries, and the importance of including marketing strategies for the different types of SMMEs. However, Rogerson also observed that although demand-oriented research was necessary, an exclusively demand-oriented approach missed the big picture. According to him, a 'big picture' research agenda would involve core policy-relevant issues and would locate local research within wider international debates on SMME development. Thus Rogerson suggested four potential research thrusts for the SA SMME sector.

In the first place, he stressed the necessity of improving the current poor statistical base in terms of national and regional data on SMMEs to enable relevant policy decisions and the development of appropriate indicators to measure and monitor the performance of implemented policy. In addition, regional, and especially sectoral, research on SMMEs should be emphasised - specifically since the SMME economy is extraordinarily heterogeneous - which could link to the dti's priority sectors to investigate SMMEs in the ICT, tourism and clothing sectors.

Secondly, Rogerson emphasised a need to move beyond investigating mainly SMMEs' support needs, such as funding and training, towards research on the conditions under which small firms - of various types - grow and fail. Rogerson suggested that a focus on entrepreneurs' perceptions often over-emphasised external constraints and vitally missed the dynamics of change over time in this sector. In the third place, little is known of the impact of HIV/Aids on the SMME economy, although major research of the pandemic's effect on large businesses has been conducted. Rogerson noted that work that has been done, suggests a link between the impact of HIV/Aids and the establishment of micro and survivalist informal enterprises as a 'household coping' mechanism.

However, there is little understanding of the effects of HIV/Aids on existing SMME

development trajectories. A recent study that used longitudinal research to assess how SMMEs are addressing HIV/Aids at the workplace level and its impact on business development has been useful and should point the way towards further research in this area. Lastly, a policy-relevant research agenda on local initiatives should be drafted to match the dti's SMME policy, which includes a focus on strengthening the links to local economic development. Rogerson observed that local government intervention is crucial for SMMEs - both in terms of growth and poverty alleviation.

Discussion

The discussion from the floor that followed the four presentations raised a number of interesting questions and areas for future research.

Barbara Groeblichoff from the Friedrich Neumann Foundation suggested that a substantial investment in research infrastructure for the small business sector was imperative to move away from trying to derive appropriate policy from imperfect knowledge of the sector.

Dirk van Seventer from TIPS concurred by saying that the TIPS 2002 publication on SMMEs was based on fairly old data and that the organisation, in conjunction with Statistics SA, is exploring the possibility of allocating resources to provide up-to-date, comprehensive data for the sector.

SMME sector specialist researcher Magali von Blottnitz confirmed the considerable uncertainty over small business data and the difficulty researchers experience in trying to compare various incomplete and contradictory data sources.

John Orford of the UCT [6] Graduate School of Business' Centre for Innovation and Entrepreneurship commented on SMMEs' higher labour-absorptive capacity due to the fact that labour is cheaper in the small business sector, and suggested that future research should take a critical look at the 'user-friendliness' of the SA labour and capital markets towards small business. He noted the example of Brazil, where labour market flexibility possibly contributed to the development and prominence of the SMME sector.

Orford also observed that, in terms of the risk/reward equation, the SA SMME sector is not unique in its difficulty to access finance. Various country studies have shown that most entrepreneurs use, at least in part, their own resources/savings to establish start-up businesses. However, in terms of small business development and BEE, the emphasis should be on alternative ways in which to unlock capital for black people and a move away from high-profile, narrow-based empowerment.

Cas Coovadia of the Banking Council of SA and Rumney both noted the possibility that there might be a policy mismatch between the promotion of BEE and of the small business sector, which could create barriers to introducing a greater section of the population into the formal sector.

Small business owner Phillip Thobela asked the question whether government, and specifically parastatals, or the private sector contributed most to empowerment, and by implication to the small business sector. He noted that although parastatals take the lead in

terms of affirmative action and affirmative procurement, most economic activity occurs in the private sector -which has to be transformed to assist in creating a deracialised economy and opening up further business opportunities for a greater segment of the SA population. In terms of SMME development, the question of how individuals are given access to resources to allow them easier access to capital should be considered.

On the regulatory environment, small business incubator manager Allon Raiz noted that entrepreneurs seldom know the difference between the various government agencies designed to assist and promote the small business sector, for example Ntsika and Khula, or whether and in what manner other government initiatives, (such as the Umsombomvu Youth Fund, which is mandated to create a platform for job creation and skills development) are accessible to entrepreneurs. Because funding agencies are not in touch with small businesses and their major regulatory concerns, the sector seems to exhibit reluctance in proactively trying to solicit administrative and funding assistance and seems to support deregulation. And on this issue, Hudson notes that rather than one-sidedly promoting deregulation, regulatory best practice should be advanced -principles, legislation, policies and regulations that promote an enabling environment for SMMEs and allow small businesses to be established and managed successfully over the long term.

Orford suggested that a study should be done on the success or failure of the education system to produce entrepreneurs. A longitudinal study of how learners experience entrepreneurial contact and which ideally assesses such contact once the learners leave the school system and enter the workplace should be considered. It was also noted that longitudinal studies could pose problems in terms of the dynamic nature of the SMME sector. For example, a small business surveyed in Phase I of the study could have closed down by the time Phase II commences, with the resultant loss of valuable information. A possible solution could be to also survey specific entrepreneurs rather than only small businesses.

Julius Nyalunga of the dti noted that the department is currently undertaking various assessments of the SMME sector. For example, a three-year study on the profile of SMMEs in SA is under way, while an international conference on regulatory impact assessments is being planned and a study on the cost of compliance for the small business sector. In addition, local development agencies are being established in Mpumalanga and the Northern Cape, in conjunction with the UNDP [7] and UNOPS [8] to provide very poor municipalities with training programmes and access to finance.

The dti is further in the process of revising its integrated support strategy in terms of SMMEs, realigning the incentives available for small businesses with government's policy objectives, and establishing a fund to assist micro enterprises to access finance. On this issue, Rogerson observed that local economic development should not only be a national government initiative -an action plan should be developed between local government and local municipalities, which also includes the private sector and other players in the sector.

Medium-Term Research Programme

The workshop clearly highlighted the research gaps that exist in terms of the SMME sector. Crucially, what appears to be missing is a broad-ranging, qualitative assessment of the outcomes of government's initiatives in enterprise development. Moreover, the lack of

longitudinal or time-series data illustrating the effect of government's enterprise development strategy over time has long been a critical weakness of research efforts around SMMEs.

TIPS has followed up the workshop by formulating a co-ordinated programme of research on SMMEs that would address these deficiencies. Two research clusters have been prioritised:

- Sectoral studies on SMMEs will interrogate specific sectoral issues concerning the growth and/or survival of SMMEs, first within two of the dti's priority sectors - tourism and agriculture - both of which has limited existing research.
- The stronger linkage proposed by government between SMME support and Local Economic Development (LED) planning highlights the importance of examining this nexus for informing local, provincial and national policy interventions. In the medium term, TIPS will initiate the following three LED research programmes:
 - A national audit of local authority initiatives to support SMME development;
 - The role of high-technology incubators; and
 - Planning for the informal economy.

In addition, an in-depth study of LED initiatives for the provision of 'innovation infrastructure' in support of SMMEs is planned. The importance of developing relationships and linkages between SMMEs, the advantages that flow from spatial proximity, the collective efficiency gains of small industry clusters and the role of deliberative institutions that can substantially 'thicken' the common knowledge of the group by encouraging collective discussion cannot be underestimated. Drawing on international experience, this research will examine the practical issues of local initiatives to establish an infrastructure specific to the needs of emerging high-technology SMMEs.

Endnotes

1 Small, medium and micro-sized enterprises

2 The *Economics of Small, Medium and Micro Enterprises in South Africa*, by Al Berry, Magali Von Blottnitz, Rashad Cassim, Anna Kesper, Bala Rajaratnam and Dirk Ernst van Seventer, first published by TIPS in December 2002. To download an electronic version of this publication, please visit <http://www.tips.org.za/research>.

3 Seven African and three Central European countries were included in the study

4 Organisation for Economic Co-operation and Development

5 International Labour Organisation

6 University of Cape Town

7 United Nations Development Programme

8 United Nations Office for Project Services