

# The number of formal micro, small & medium businesses in South Africa

Preliminary findings of stage 1 of the Baseline Study of Small Businesses in South Africa.



## 'New dawn' for small business in South Africa?

President Ramaphosa has asserted that, “the growth of our economy will be sustained by small businesses, as in the case of many countries”. And most of our policy documents since the 1995 white paper have laid out South Africa’s ambitions to emulate the job creating power of small and medium enterprises (SMEs) around the world. Under the right conditions, a robust SME community has the capacity to be a dynamic transformational force since, in the words of the World Bank, “relative to larger firms, SMEs enhance competition, entrepreneurship, job growth and spur economy-wide efficiency, innovation and economic growth.”

But without credible small business data, it is not possible to formulate reasonable and targeted strategies – by both the public and private sectors – to help grow and invigorate this important segment of our economy.

Sound and credible data is a vital element to unlocking a ‘new dawn’ for small businesses in South Africa.

Unlike a number of emerging and middle-income countries, South Africa does not have a regular census or a periodic survey that tracks the performance of micro, small and medium enterprises (SMEs) in their complete variety. The absence of reliable, comprehensive and consistent data has led to wide-ranging estimates on the number of SMEs in South Africa and their contribution to GDP and employment. For instance, the survey of employers and self employed last published in 2014, estimates that there are approximately 1.5 million non-VAT registered businesses. On the other hand, the Finscope 2010 study estimates 5.9 million small businesses in South Africa. The Bureau of Economic Research 2016 study (essentially an update of an earlier 2008 study from the Department of Trade and Industry) estimates the number of small businesses to be in the region of 2.2million.

The ranges in these estimates are wide, and fluctuate wildly. It is disturbing how little we still know about our SMEs. We do not know how many exist, how many people they employ, what sectors they dominate, what they contribute to the nation’s GDP, whether they are contracting or growing and what real-time challenges they face. It means that policies and support initiatives for small business are built on architecture based on assumptions and estimates.

Further, government has failed to apply a common definition of what constitutes micro, small or medium businesses, leading to ambiguity, ever-multiplying red tape challenges for SMEs and less than desirable support for entrepreneurs starting, running, and growing their enterprises.

Persistent low rates of job creation, policy uncertainty and a stagnant economy mean that it is now more important than ever to understand the number, size and characteristics of micro, small and medium enterprises if they are to assist South Africa in overcoming poverty and inclusive, transformative growth.

## SBI response

Responding to the president's call to action, The Small Business Institute (SBI) in partnership with the Small Business Project (SBP) has been working this year on **South Africa's first, comprehensive baseline study of small businesses in South Africa**. As the 'big voice for small business' the SBI's motivation for the study is simple: to galvanise a new compact, based on solid evidence, to fulfil the president's wish to place small business centre-stage in our economic recovery and to help build the SME community to play a role in the transformation of our society.

## Stage one of the SME Baseline Study

The preliminary stages of our SME baseline study of facts has entailed investigating how many formal micro, small and medium employing businesses exist in South Africa.

Reflecting on the lack of reliable data to date, our initial investigations included reviewing research into the SMME landscape to establish where gaps exist in our understanding of small businesses, including analysing material from a new firm-level dataset created by the South African Revenue Service and National Treasury from tax data filed by formal firms ("SARS-NT Panel"). This dataset contains a rich set of variables providing new insights into the SME landscape, to which we were afforded access by National Treasury.

## New Data and methodology

Our analysis of this dataset required careful reflection of several principal considerations. These included the *lack of coherence in SME definition* applied in South Africa; SMEs are defined differently across different sets of legislation, statistical studies and policy documents, which make it difficult to determine and track the performance of SMEs and allow for comparisons. Coupled with this is the *lack of coherent data*, which makes it difficult to evaluate various assertions about how much SMEs actually contribute to important aspects of the economy, such as employment. Reflecting on these considerations, we applied a coherent definition of SMEs to our analysis of the dataset as set out below.

Employment and firm numbers as illustrated in the tables and charts below are based on the SARS-NT dataset; a dataset which captures "formal" firms and employment - those enterprises which are registered for tax, and employees for whom the enterprise has submitted an IRP5. Employment numbers are weighted by the period over which an individual is employed, and thus employment numbers are equivalent to 'person-years'.

The data comes from two sources. The first is from IRP5 forms which companies must issue to employees where remuneration is paid or has become payable. By grouping these forms by the anonymous identifier of the issuing entity we can calculate firm size where a "firm" is the entity which submits the return. This may not exactly correspond with a business unit - for example a "firm" in the IRP5 data is the entity with a common IRP5 identifier. A business may run multiple payrolls, each with a separate IRP5 identifier, and thus count as multiple "firms" in the dataset. This approach is likely to underestimate the number (and contribution to employment) of big firms since these may run multiple payrolls each with a different IRP5 identifier. This data runs from 2011 to 2016.

The second source of data is from Company Income Tax (CIT) submissions. The sample of firms captured by the CIT data is lower than for the IRP5 data, since the CIT data is limited to companies who complete fields like 'turnover'. However, this data is useful since it allows us to calculate effects like labour productivity (turnover per employee) and how this is changing over time in each firm size group. The CIT data runs from 2010 to 2014.

There are 267 959 firms, and 13,565,521 'person-year jobs' in the IRP5 data in 2016. This is in comparison to Statistics South Africa (StatsSA) estimate of 14,552,000 people employed in Q3 of 2016 from the Quarterly Labour Force Survey (QLFS) (excluding employment in private households) or 9,282,000 in the

same period from the Quarterly Employment Survey (QES), which collects data from formal enterprises which are registered for VAT.

Analysed by size group definitions based on 'person years' of: micro (0-10), small (11-50), medium (51-200) and large (201+), the tables below illustrate the breakdown of *number of firms* and *employment* by size group and year.

### Firm numbers by firm size

size_group	2011	2012	2013	2014	2015	2016
Micro	169986	170509	171060	173267	175264	176333
Small	63864	64876	66247	67137	67977	68494
Medium	15257	15753	16442	16790	17197	17397
Large	5144	5304	5517	5603	5713	5735

### Firm proportions by firm size

size_group	2011	2012	2013	2014	2015	2016
Micro	0.67	0.66	0.66	0.66	0.66	0.66
Small	0.25	0.25	0.26	0.26	0.26	0.26
Medium	0.06	0.06	0.06	0.06	0.06	0.06
Large	0.02	0.02	0.02	0.02	0.02	0.02

### Employment numbers by firm size

size_group	2011	2012	2013	2014	2015	2016
Micro	658333	666078	670906	678680	685544	685264
Small	1434918	1457779	1495092	1518610	1537180	1549411
Medium	1426006	1463427	1537806	1568034	1615652	1628429
Large	8453986	8747449	9223595	9543214	9790224	9702416

### Employment proportions by firm size

size_group	2011	2012	2013	2014	2015	2016
Micro	0.05	0.05	0.05	0.05	0.05	0.05
Small	0.12	0.12	0.12	0.11	0.11	0.11
Medium	0.12	0.12	0.12	0.12	0.12	0.12
Large	0.71	0.71	0.71	0.72	0.72	0.72

## High-level findings

- South Africa's formal employing SME segment in the economy is much, much smaller than originally thought, consisting of just over 250 000 businesses – far off the mark of current estimates.
- While formal SMEs contribute nearly 98.5% of the number of formal firms in the economy, they only account for 28% of the jobs. Based on international trends, this should be about 60 to 70%.
- The majority, 56% of jobs in South Africa, come from only 1,000 larger employers, including government – and these jobs are growing at a faster rate than what SMEs are creating.
- Small firms pay more to retain staff than the larger firms (as a percentage of turnover) but are not employing people at a desirable rate.

What is clear from the breakdown of the number of firms and employment by size group and year shown in the tables is that micro firms are the most numerous and the count of firms falls as size increases.

In 2016 there were 176 333 firms defined as Micro (66% of the total), 68 494 Small firms (26% of the total), and 17 397 Medium ones (6.5% of the total).

South Africa's formal, employing SME segment of the economy is much, much smaller than originally thought. Collectively, there are only some 250 000 formal employing micro, small and medium enterprises in South Africa.

While formal SMEs contribute nearly 98.5% of the number of formal firms in the economy their employment numbers are the inverse: only 5.1% of employment occurs in micro firms, 11% in small firms, and 12% in medium ones. Combined micro, small and medium firms only employed 3,863,104 people or just over 28% of total formal jobs.

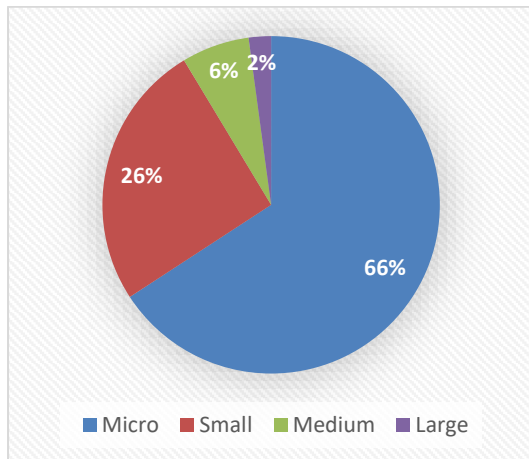


Figure 1: Proportion of Firms by size classification

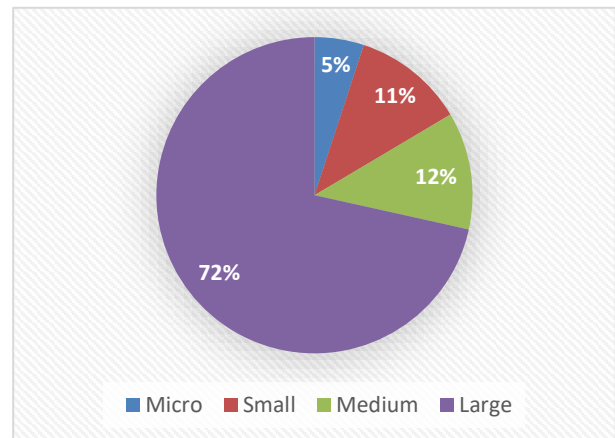


Figure 2: Proportion of employment by size classification

Concentration of employment is even more noticeable if employment is ranked by the size of the company – our findings show the largest 1000 companies in South Africa, including government, created 56% of all employment. Larger firms have also dominated employment growth (in terms of both the number of jobs added and growth rates) over the five year period prior to 2016. Large firms added 1,248,430 jobs, medium 202 423, small 114 493 and micro 26 931. Growth rates over this period, from large to micro firms, were 15%; 14%; 8%; and 4.1%. These figures suggest that over time employment is becoming more concentrated in larger firms (including government).

## Labour productivity and average wages

As we investigate further, the CIT data can be used to obtain measures of labour productivity (turnover per employee), capital intensity (capital stock per employee), and average wages (employee costs per employee).

The emerging results from this data challenge some of our preconceptions about SMEs.

The preliminary analysis on labour productivity (turnover per worker) and employment costs (wages) suggests that, unlike in many other similar countries and what might have been the case previously in South Africa, across many sectors smaller firms have higher labour productivity and employment costs than larger ones. What this means is that, on average, small and micro firms pay better and have more turnover per person employed than larger ones. These also seem to be increasing faster over the recent past than those for larger firms. These results suggest that formal small and micro firms - at least over the past five years - are not where jobs for the lower-skilled are being created in the South African economy. Rather, it suggests that small South African firms are becoming more skill-intensive.

# Policy, legislative and regulatory coherence?



A principal factor hampering good policy is government's failure to apply a common definition of what constitutes micro, small or medium businesses across its laws, regulations and key strategies including international treaties and protocols. As a key component of the initial stage in our baseline study of facts, we conducted a review of some 70 laws, regulations and strategic policy documents pertinent to small business only to discover that there are numerous interpretations of small enterprises across the spectrum.

Our review sought to assess if a main definition of SMMEs is in place and applied consistently and if not, whether there is an approach which appears to be dominant in how decision-makers consider SMMEs. Specifically, the review looked into whether common quantitative elements are regularly in evidence to establish thresholds that would help to consistently and clearly distinguish micro, small, medium and large enterprises. The review focused on practicalities without imposing any conceptual framework, i.e., we considered whether there are clear and common usages of the terms rather than whether the terms are appropriate. For non-statistical documents which we consulted, we extracted information which was placed into a standardised matrix. The matrix also collated information such as the objectives of the legislation or policy or strategy, the relevant sectors it covered and the registration requirements whenever relevant. A distinct matrix was used for the statistical surveys which referred to the unit of analysis of the surveys (for instance self-employed business owners), broad themes covered by the questionnaires (for example assets, access to finance, number of employees, etc.), and some issues concerning sample design. Once the key information was gathered, we looked at commonalities focusing on the classification of businesses.

## Key findings

*Proxies used to define enterprises are outdated, complicated to apply, track and verify.*

While the National Small Business Act (NSBA) of 1996 as amended in 2003 and 2004 explicitly sets out definitions for five enterprises categories – micro, very small, small, medium and large - across 11 sectors, they are not applied in any of the laws, policies and strategies reviewed save in only one other Act: the Preferential Procurement Policy Framework Act, 2017. The NSBA Schedule 1 that defines enterprises is particularly data-intensive given that it relies on data for employment, for turnover, and for assets employed with thresholds applied for each of the five enterprise categories in each of the 11 sectors. Despite some criteria being specified in monetary terms, the NSBA Schedule has not been updated in 15 years irrespective of the impact of factors such as inflation have had on the nature of business.

*Few pieces of legislation refer to SMMEs as a collective term or to sub-categories of small firms.* Only a few pieces of legislation refer to SMMEs as a collective term or to sub-



categories of small firms and when reference is made to specific size-related indicators, these are for exemption purposes or for specific requirements. The exception are the several pieces of B-BBEE legislation which have specific categories of small enterprises that directly relate to size, i.e. 'Qualifying Small Enterprise' (QSE) and the Exempted Micro Enterprise (EME), based on turnover figures. Start-ups or "emerging enterprises" are also distinguished from other enterprises for the purpose of exemption using a time-bound criterion: start-ups are enterprises in the first year of their formation or incorporation, irrespective of their turnover.

*B-BBEE legislation is not systematically adopted.* Whilst threshold levels for enterprises are set out in the main B-BBEE legislation, some sector codes introduce new categories of small entities to reflect sector specificities - for instance 'qualifying small financial institutions' differ in the financial sector code and 'small growers' likewise in the forestry sector code.

*Fragmented and disjointed approaches to referencing SMME in legislation.* There was little, if any, commonality applied to referencing SMMEs and their categorisation as stipulated in the NSBA in the full range of legislation reviewed.

*Policy and key support strategies refer to SMMEs in only broad qualitative terms.* Increasing attention has been made by government to supporting SMMEs in key policy documents and support strategies. However, no clear-cut definition is applied; references to SMMEs are presented collectively and also in broad qualitative terms. Another key point that emerges from the review is the distinction between what constitutes a formal and informal enterprise is not explicitly defined.

What is clear from the findings of the review is that there are divergent and siloed approaches at play across government in terms of identifying and supporting SMMEs. In turn, it means that there is no policy or regulatory coordination, no harmonisation across laws and no coordination across government to understand the impact of its interventions.

## Next stages

Preliminary findings from stage 1 of our path-breaking SME baseline study of facts represent a mere tip of the ice-berg in terms of our understanding the full landscape that applies to micro, small and medium businesses in South Africa. The findings that we have already gathered from the initial stages of the research have profound implications for policymakers and legislators as well as for corporate businesses engaged in SME development. Substantial further work will be done to fully describe the size, nature and characteristics of small and emerging businesses in South Africa, using a bouquet of survey methodologies. Given the extent of the study, the SBI will report on outcomes periodically in addition to releasing Issue Papers on the implications of the findings as they become available. The full study expected to be completed in early to mid-2019.

Economic transformation and job creation built on a long-term sustainable strategy is an imperative for South Africa. As the president recently said, "We need to have the capacity, the *data* and the political will to make the right choices". Without reliable evidence on which to base a coherent single-minded strategy we will continue to fail to unleash our SMEs and their entrepreneurial value to drive innovation and grow their enterprises to employ millions more South Africans in the jobs of today and tomorrow.