



Annual Review of Small Business in South Africa – 2003



the dti

THE DEPARTMENT
OF TRADE AND INDUSTRY
SOUTH AFRICA



Table of Contents

List of Acronyms	7
Minister's Foreword	9
Preface	11

Part I: Regular Features

Chapter 1

Review of Trends & Performance - The SA SMME Sector in 2003

1. Introduction	15
2. The context for SMME development	16
2.1 The economic environment in 2003	16
2.2 The regulatory environment in 2003	17
2.3 The institutional environment in 2003	22
3. Trends and performance	22
3.1 Entrepreneurial dynamism/opportunities	22
3.2 Entrepreneurial capacity	24
3.3 Contribution to GDP	27
4. Conclusion	28

Chapter 2

Key Small Business Statistics in South Africa

1. What is a small business?	33
1.1 The official definition	33
1.2 From informal to formal: a continuum of situations	33
2. How many small businesses does SA have?	35
2.1 How many people define themselves as employers or self-employed?	36
2.2 How many people are running a business or busy starting up a new business?	37
2.3 How many firms are registered with the Registrar of Companies and Close Corporations?	38
2.4 How many South Africans are involved in business activities that are not registered for VAT purposes?	39
3. How small are our small businesses?	40
4. In which sectors are small businesses operating?	43
5. Where are SA Small businesses situated?	44
5.1 Distribution by province	44
5.2 Distribution by type of location (urban/rural)	45
6. How do SA's small businesses contribute to the country's economy?	47
6.1 Contribution to employment	47
6.2 Contribution to production	49

7. How many small businesses appear and disappear each year?	52
7.1 Registrations and liquidations of Close Corporations and Companies	53
7.2 Entries and exits in Cape Town	54
7.3 Average lifespan of businesses	54
8. To what extent are small businesses growing businesses?	57
9. Who are SA's entrepreneurs?	58
9.1 Population group	58
9.2 Gender	60
9.3 Age group	62
9.4 Educational level	63

Part II: Research Features

Chapter 3

Sectoral Profile – Tourism SMMEs

1. Introduction to the tourism sector	67
2. The economic performance of tourism	68
3. Tourism SMMEs	71
3.1 Definition and structure	71
3.2 Lifestyle entrepreneurship	73
3.3 Industry transformation and policy priorities	73
4. Growth constraints on tourism SMMEs	74
4.1 Established SMMEs	75
4.2 Emerging SMMEs	78
5. Support initiatives for tourism SMME development	84
5.1 The Tourism Enterprise Programme (TEP) – The DEAT flagship	84
5.2 Pro-poor tourism pilots in Southern Africa	86

Chapter 4

Sectoral Profile – SMMEs in the Food Processing Complex

1. Introduction to the sector	91
2. Economic performance of the food processing sector	91
3. A profile of the food processing sector	94
4. Food processing SMMEs	97
5. Growth challenges	99
6. Supporting the growth of food processing SMMEs	103

Table of Contents

Chapter 5

Provincial Profile – Focus on the Free State

1. Introduction	109
2. The changing role of SMMEs in the Free State manufacturing economy	109
2.1 Context and macro profile	109
2.2 Contribution to the provincial economy	110
2.3 Sectoral change	111
2.4 Key spatial findings	113
3. Survey findings	116
3.1 Established versus emerging manufacturing SMMEs	117
3.2 Inter-sectoral variation	122
4. Policy issues	125
4.1 Policies to strengthen the SMME economy	125
4.2 Policies to support established SMME manufacturers	126
4.3 Policies to support emerging SMME manufacturers	126

Chapter 6

Issue Profile – Business Development Services

1. Introduction	131
2. Changing directions of support provisions for SMMEs	131
3. Towards a new BDS paradigm	133
3.2 Moving towards private sector provision	134
3.3 Emphasis on market development	134
4. Key differences between old and new approaches to BDS	134
4.1 Starting points: out with the old, in with the new	134
4.2 Changing definitions	135
4.3 Changing objectives of intervention	136
4.4 Approaches to intervention	136
4.5 Out with direct service provision, in with market development	136
5. Private sector provision of BDS in SA: selected findings from Nelspruit	137
5.1 BDS awareness and knowledge levels	138
5.2 BDS usage and satisfaction levels	139
6. Conclusion	142
References	143

List of Figures

Figure 1	–	Conceptual framework of SMME development	15
Figure 2	–	Institutional network of key small business support institutions	21
Figure 3	–	Evolution of the number of employees and self-employed, by category, 2002 and 2003	23
Figure 4	–	Contribution of firms to employment, 2002 and 2003	26
Figure 5	–	Estimated contribution to GDP	28
Figure 6	–	From informal to formal businesses	35
Figure 7	–	Data available for each type of small business	36
Figure 8	–	Size distribution of registered corporations	41
Figure 9	–	Main industries for formal and informal businesses	43
Figure 10	–	Number of formal and informal businesses per province	44
Figure 11	–	Distribution of informal businesses by province and type of location (urban or rural)	46
Figure 12	–	Contribution of small businesses to employment and GDP	52
Figure 13	–	Registrations and liquidations of CCs and Companies, 1991-2003	53
Figure 14	–	Registrations and liquidations by sector	53
Figure 15	–	Entries and exits from the base of levy-payers in Cape Town	54
Figure 16	–	Sectors with the highest and lowest lifespan	55
Figure 17	–	Year-to-year turnover growth of Cape Town firms	58
Figure 18	–	Formal and informal businesses by ethnic background of owner	59
Figure 19	–	Gender distribution of owners of formal and informal businesses	61
Figure 20	–	Entrepreneurship and unemployment by age and region in SA, 2002	63
Figure 21	–	Educational attainment of entrepreneurs, compared to SA population	64
Figure 22	–	Two dimensions of tourism	
Figure 23	–	Aspects of SA's tourism industry	69
Figure 24	–	The international flows of foreign tourists to SA	70
Figure 25	–	The three different kinds of enterprises in the SA tourism economy	73
Figure 26	–	Employment and changes in output in the food processing sector (SIC 301-304)	92
Figure 27	–	SA's agricultural imports	96
Figure 28	–	SMME food processor markets	103
Figure 29	–	SMMEs' share of total manufacturing enterprise and employment in the Free State	111
Figure 30	–	Sectoral composition of SMME manufacturing, 1994-2003	112
Figure 31	–	Changing geography of SMME enterprises, 1994-2003	114
Figure 32	–	Changing geography of SMME employment, 1994-2003	116
Figure 33	–	Location of emerging SMME interviews	120
Figure 34	–	Changing approaches to BDS provision	135
Figure 35	–	BDS awareness and knowledge of services	139
Figure 36	–	BDS usage and satisfaction levels	141

Table of Contents

List of Tables

Table 1	–	Total and average structured and once-off administrative burdens of VAT	19
Table 2	–	Number of employers or self-employed (in their main capacity)	23
Table 3	–	Registrations and liquidations of Companies and Close Corporations	24
Table 4	–	Estimated percentage sectoral contribution to GDP by size-class: Abedian method (GVA2)	27
Table 5	–	Thresholds for the classification as micro, very small, small or medium enterprise	34
Table 6	–	Number of employers or self-employed (in their main capacity)	36
Table 7	–	Number of entrepreneurs	37
Table 8	–	Number of corporations registered with the CIPRO, 2003	38
Table 9	–	Active and inactive corporations in SA (2004)	39
Table 10	–	Best estimate of the total number of trading small businesses	40
Table 11	–	Size distribution of SA registered corporations, 2004	41
Table 12	–	Distribution of formal corporations by sector	44
Table 13	–	Enterprise density per province	45
Table 14	–	Entrepreneurial activity by location and region in SA	46
Table 15	–	Contribution of micro, very small and small businesses to employment, 2003	48
Table 16	–	Contributions to employment: comparison of Stats SA with Ntsika 2002	48
Table 17	–	National estimates of employment creation by entrepreneurial firms	49
Table 18	–	Small business' contribution to production	50
Table 19	–	Contribution to GDP: comparison 1997-2003	51
Table 20	–	Contribution of SMMEs to GDP according to Ntsika 2002	51
Table 21	–	Average lifespan of deactivated accounts by main sector	55
Table 22	–	Growth of Cape Town levy-payers by age of business	57
Table 23	–	Employers and self-employed by population group	58
Table 24	–	Non-VAT registered businesses by population group	59
Table 25	–	Employers and self-employed by gender	60
Table 26	–	Sectoral distribution of men-owned and women-owned informal businesses	61
Table 27	–	Total entrepreneurial activity by age category and region in 2002	62
Table 28	–	Entrepreneurial activity of SA according to their education	63
Table 29	–	Educational level of entrepreneurs compared to SA population	64
Table 30	–	Employment, output and salaries in food processing relative to manufacturing as a whole	92
Table 31	–	Concentration in the food sector, 1996	95
Table 32	–	Market-oriented small enterprise interventions	133
Table 33	–	Different forms of BDS	137
Table 34	–	Main reasons for use of particular forms of BDS	142

List of Acronyms

BDS	Business Development Services
BDS/LED	Business Development Services and Local Economic Development
CC	Close Corporation
CIPRO	Companies and Intellectual Property Registration Office
DEAT	Department of Environmental Affairs and Tourism
DTEEA	Department of Tourism, Environmental and Economic Affairs
EU	European Union
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GGP	Gross Geographic Product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Co-operation)
GVA	Gross Value Added
HACCP	Hazard Analysis and Critical Control Point
HHS	Household Survey
IDZ	Industrial Development Zone
ISBDS	Integrated Small Business Development Strategy
JSE	Johannesburg Securities Exchange
LBSC	Local Business Service Centres
LFS	Labour Force Survey
MAC	Manufacturing Advice Centre
NDA	National Department of Agriculture
OECD	Organisation for Economic Co-operation and Development
PTY	Proprietary Limited
RFI	Retail Financial Institution
RSC	Regional Services Council
SA	South Africa
SADC	Southern African Development Community
SARS	South African Revenue Service
SDI	Spatial Development Initiative
SESE	Survey of Employers and Self-Employed
SETA	Sector Education and Training Authority
SIC	Standard Industrial Classification
SME	Small and Medium Enterprises
SMEDP	Small, Medium Enterprise Development Programme
SMME	Small, Medium, Micro Enterprises
STATS SA	Statistics South Africa
TDCA	Trade, Development and Co-operation Agreement
TEA	Total Entrepreneurial Activity
the dti	Department of Trade and Industry (South Africa)
TSA	Tourism Satellite Accounting
UCT	University of Cape Town
UNISA	University of South Africa
VAT	Value-Added Tax
WTO	World Trade Organisation
WTTC	World Travel and Tourism Council

Minister of Trade & Industry – Mandisi Mpahlwa



It gives me great pleasure to present on behalf of the Department of Trade and Industry (**the dti**), the *Annual Review of Small Business in South Africa – 2003*. This is the first time that **the dti** has co-ordinated the production of the Annual Review which in the past was produced by Ntsika Enterprise Promotion Agency. This latest development is yet another indication of the maturing of **the dti** into an effective policy management and economic leadership institution. Within this approach, national government establishes the overall policy framework and has put in place core institutions. Our role thereafter is not to become involved in the direct

implementation of programmes of support but regularly and consistently to evaluate and review the effects of our policies. This separation of the function of implementation from evaluation, we believe, will lead to an increasingly crisp focus on core business within each organisation.

Furthermore, we are increasingly concerned with the **outcomes** or **impacts** of our policies and programmes. This is an important distinction from past evaluations of **the dti's** programmes and policies, which tended to focus on the outputs of our programmes. Today, our primary concern is no longer whether an additional Local Business Service Centre (LBSC) has been established or whether five more SMMEs¹ were assisted through export development. Important as these output measures are, what matters most for us is whether, taken in its totality, the full array of government support measures has had a positive impact on the SMME economy and especially on government's core objectives of poverty alleviation, equity and competitiveness.

This Review is therefore about understanding government's role in the economy and the influence this has on the small business sector. Moreover, it is about providing a nuanced analysis which takes into consideration the global economic environment in which all of South Africa's (SA's) firms – big and small – operate, and acknowledging that, even given the best policies and programmes, other factors can and sometimes do work against government policy. Nonetheless, I am happy that this Review finds some positive developments to report, including an increase in the number of entrepreneurs active in the economy and an increase in the contribution of small firms to employment.

These promising advances will not make us complacent. Much work still has to be done; we remain concerned with the precarious position of many black women entrepreneurs active in the informal sector, the high rates of SMME failures, the general lack of support from large financial institutions for SMMEs, and the overall business and regulatory environment which in key areas continues to inhibit SMME growth and development. These and other important issues have been raised through this Review and an extensive countrywide review initiated last year. I am delighted to report that we have listened to the many contributions made, and a new Integrated Small Business Development Strategy (ISBDS) will be launched shortly, which will address many of these concerns. Through the ISBDS, the role of small business in job creation, economic empowerment and poverty reduction is recognised and enhanced, and we will implement a series of concrete directions and actions to meet these objectives fully.

A handwritten signature in black ink, which appears to read 'M. Mpahlwa'. The signature is written in a cursive, flowing style.

Mandisi Mpahlwa M.P.
Minister of Trade and Industry

¹ Small, medium and micro enterprises

The dti is proud to present the *Annual Review of Small Business in South Africa – 2003*. The objectives of the *Annual Review* are to provide a description of trends and an analytical assessment of the performance of the small business sector within the broader context of the SA economy as a whole.

A second-order objective of the Review is to begin to provide a consistent conceptual framework for analysing the small business sector. In particular, we are concerned with the often conflicting and inaccessible data sets used by small business researchers and analysts. In this publication, we have taken the view that we need to introduce a degree of consistency in the statistics to be used for policy and review purposes. Throughout the Review, we have therefore tried to use Statistics South Africa (Stats SA) data wherever possible. In most cases the series we draw upon are those which Stats SA continue to collect, thereby ensuring that subsequent Reviews can continue to draw from a consistent and reliable dataset accessible to all researchers and analysts.

The Review is structured into two parts. Part One: Regular Features provides an over-arching review of trends in the small business economy and is supported by detailed statistics. In Part Two: Research Features, we hold a mirror of qualitative research results to the detailed statistics and draw from this combined rich source of information policy-relevant issues. Due to the paucity of quantitative data on small business, we believe that the most reliable analysis is likely to come from combining what quantitative data there is with focused qualitative information.

In Part One: Regular Features we begin in Chapter 1 by providing an assessment of the performance of the SMME sector by drawing on quantitative and qualitative analyses. We go on to propose some broad conclusions by reflecting on the key drivers and inhibitors of the sector's development to form a coherent picture of the SA SMME sector.

In Chapter 2 we describe the key basic statistics for the SMME sector by comparing trends between 2002 and 2003 for the following dimensions:

- Number of entrepreneurs;
- Sectoral distribution;
- Geographic spread of SMMEs;
- Distribution by demography;
- Entrepreneurial dynamism (entry and exits); and
- Contribution to the economy by employment and gross domestic product (GDP).

In Part Two: Research Features we start with an analysis of the Tourism and Food-processing sectors of the economy. These Chapters are intended to challenge the notion that SMMEs are homogenous across the various sectors of the economy. Chapter 3: Tourism and Chapter 4: Food Processing go some way to debunking this myth. Both Chapters draw on primary research recently completed, come to some interesting conclusions around the obstacles to SMME growth and highlight key policy spaces for government intervention.

Chapter 5 provides a review of the SMME economy in the Free State Province. Drawing on primary research collected through SMME interviews, this Chapter highlights the unevenness of industrial development within the province, the high birth rate of SMMEs, and less encouragingly, the relative stagnation of existing SMMEs.

We conclude the Review with Chapter 6 which discusses the importance of Business Development Services (BDS) to SMME development and notes the increasing support amongst international small business practitioners for developing market-friendly BDS delivery channels.

Part I: Regular Features

Chapter 1



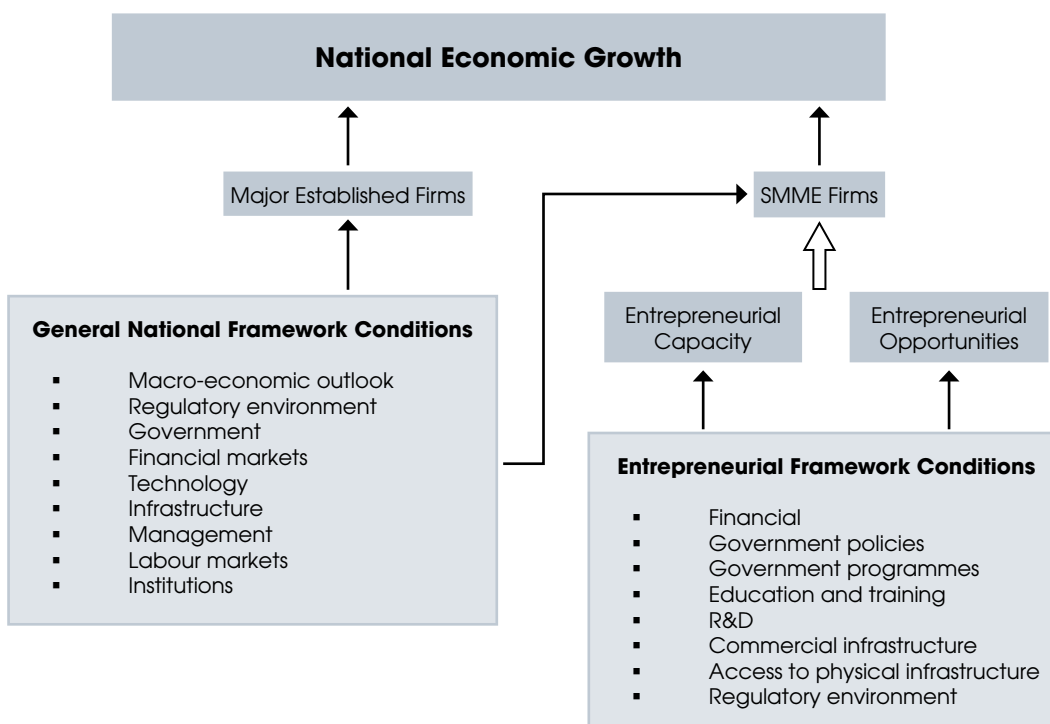
Review of Trends & Performance – The SA SMME Sector in 2003

1. Introduction

This overview Chapter of the *Annual Review of Small Business in South Africa – 2003* is intended to serve a number of purposes. First, we aim to provide an assessment of the performance of the SMME sector in relation to the broader SA economy in 2003. This is done by drawing upon both the quantitative and qualitative analyses described in later Chapters. Secondly, the Chapter synthesises and, in reaching its conclusions, draws upon a substantial body of relevant SMME-related research being conducted across SA. These analyses are used to develop a coherent picture of the SA SMME sector, reviews its performance in 2003 and begins to reflect on the key drivers and inhibitors of the sector's development.

We propose a conceptual framework broadly consistent with that used by the Global Entrepreneurship Monitor (GEM) and depicted below. Ideally, we would want to report on each of the dimensions described below. However, lack of consistent and reliable data make this an impossible task. Nonetheless, we hope that by drawing on a variety of research sources we are able to make some judgements with respect to at least some of the more important dimensions described.

Figure 1 – Conceptual framework of SMME development



Source: GEM 2002

2. The context for SMME development

2.1 The economic environment in 2003

SA's small businesses operate in global, regional and local economic environments which may not always be supportive to their growth prospects. With the end of *apartheid*, SA has become firmly part of the global economy, and trends in the world economy play an increasingly important role in the growth prospects of businesses across the size spectrum. SMMEs are relatively less able to deal with 'shocks' in the global economy and are therefore particularly vulnerable. Moreover, small business is often a minor link in global value chains, sometimes supplying narrowly specified goods and services to other suppliers themselves very low down on the global supplier value chain. Cutbacks due to weak global growth may therefore still have an impact on SMMEs even when they, on the face of it, supply only local markets.

In 2003, the global economic environment was characterised by a strong recovery in the US and parts of East Asia. Whilst Europe saw some elements of a recovery, on the whole this was fairly weak and consumer spending remained very weak. Global trade conditions were relatively positive with China growing its exports, particularly to the US, very significantly. SA's largest trade partner is the European Union (EU) and the tepid growth there did little to help SA exports. Continued implementation of the SA/EU Trade, Development and Co-operation Agreement (TDCA) has resulted in significant increases in trade, but initial research suggests that this has tended to occur in sectors dominated by relatively large firms, such as the autos sector. The extent to which SMMEs are able to participate in international trade remains a cause for concern.

The SA economy performed largely in line with international trends, with very weak economic growth in the first half of 2003 and recovering to moderate growth in the second half of the year. The main sectors contributing to SA's poor growth performance were the manufacturing and primary sectors. As small businesses are mainly clustered in service sectors, many would have been only indirectly affected by the slowdown in manufacturing and primary production. Moreover, as most of the services offered by small business are directly to households (as opposed to other businesses), the impact of sluggish growth in manufacturing would have been further muted.

A key explanatory factor of SA's poor growth performance is to be found in the strong appreciation of the rand against a basket of currencies. This appreciation coincides with a faltering in SA's trade performance, which had been underpinned previously by the depreciation of the rand in 2001. For 2003 as a whole, the volume of exports increased by a mere 1% over 2002. In value terms, SA's trade performance was significantly weaker in 2003 compared to 2002, with exports declining from R286-billion in 2002 to R256bn in 2003. Those SMMEs supplying export industries with goods and services

will have been the most significantly affected even though these make up only a small, although important, proportion of SA's SMMEs.

Whilst production growth slowed in 2003, domestic expenditure continued to grow significantly. In particular, household spending remained buoyant, and as many SMMEs supply households with goods and services, this will have had a significantly positive impact on many SMMEs' growth performance in 2003. Household spending was notably influenced by the SA Reserve Bank relaxing its monetary policy stance, with interest rate cuts starting in mid-2003. This will have been a particularly important development for many SMMEs which are often highly geared.

On balance, however, neither the global nor the local economy provided a sufficiently expansionary environment for small business in 2003. With economic growth sluggish, export potential relatively low due to the unfavourable movement of the Rand and imports buoyant, most SMMEs involved in manufacturing will have struggled to grow production and value added. SMMEs involved in the trade sector, though, are likely to have fared better, with imports growing strongly in volume terms and prices declining due to the strength of the rand.

2.2 The regulatory environment in 2003

SA's post-1994 economic policy has as its core the creation of an equitable, sustainable and internationally competitive economy. A key pillar of government policy is support for the small business sector. However, with many economic policies being pursued concurrently, it is not always clear what the broader (net) impact of government's new policies is. This is a crucial issue for small business, particularly micro and very small businesses, as they often lack access to the formal processes which better-resourced large business can use to provide feedback on the likely impact of new policies.

This was particularly the case in 2003, as no fewer than 61 Bills were legislated. In at least a third of these, issues relating to small business interests were present. There is no reliable way of assessing whether small business interests were taken account of, but on the balance, with no organised national voice, the chances are likely to have been rather slim.

At a more practical level, the regulatory environment in respect of the two key dimensions of tax and labour regulation compliance remained stable in 2003. There were no significant exemptions provided for small business in the year under review, and the significant costs of particularly tax compliance remain largely unmitigated.

Moreover, complying with regulations can be expensive and difficult, assuming small businesses are aware of what constitutes compliance. This is largely because of their

limited administrative resources – many small firms do not have dedicated human resources staff or tax professionals. A key research finding from a recent 10-country study (seven in Africa – including SA – and three in Central Europe), released at the end of 2002, is that an appropriate regulatory and institutional environment is the single most important element in an economic growth strategy. Only one other factor – a country's level of available skills, especially technical skills – is anywhere near as strongly correlated with per capita economic growth.

Moreover, the World Bank's *Doing Business in 2004* – published during the period under review – notes that, “heavier regulation is generally associated with more inefficiency in public institutions, longer delays and higher cost and more unemployed people, less productivity and investment, but not with better quality of private or public goods”.

According to *Doing Business* it takes 38 days to register a new business in SA – faster than in Germany, the Netherlands and China. However, the cost of registering a business in SA amounts to approximately 8.7% of income per capita; in Denmark there is no monetary cost.

Also according to *Doing Business*, SA is slower than Zimbabwe and Cote d'Ivoire in enforcing legal contracts, taking 207 days to go through the legal process. Illustratively, a simple commercial contract is enforced in seven days in Tunisia and 39 days in the Netherlands; in Guatemala, it takes almost 1,500 days. The cost of enforcement is less than 1% of the disputed amount in Austria, Canada and the UK, but more than 100% in Burkina Faso, the Dominican Republic, Indonesia, Malawi and the Philippines.

New Zealand has 19 procedures to enforce a contract, SA has 26. A typical business bankruptcy might take six months in Ireland or Japan, but can take more than 10 years in Brazil and India, *Doing Business* found. In SA it takes two years. It costs less than 1% of the value of the estate to resolve insolvency in Finland, the Netherlands, Norway and Singapore – and nearly half the estate value in Chad, Venezuela and Sierra Leone. In SA it costs 18%.

Many entrepreneurs continue to see the Skills Development Levy as ‘just another tax’. Not having produced a training plan that can be recognised by their Sector Education and Training Authority (SETA), some entrepreneurs pay their levy without claiming it back.

Particularly constraining is the SA Revenue Service's (SARS's) decision that Value-Added Tax (VAT) should be paid on invoice rather than on receipt of payment, which has led to cash flow constraints for small businesses sub-contracting to larger entities that are sluggish in paying – for example, many government departments.

Upstart Business Strategies – using the Mistral approach pioneered in the Netherlands – recently quantified VAT-induced administrative burdens for small businesses in a SA context: the costs of complying with the information obligations resulting from government-imposed legislation and regulation (costs of taxation, permits, licences, interest, fees and dues, and penalties) are not included in the definition of administrative burdens. The total administrative burden for an SMME in terms of VAT amounted to R8,441 a year. According to Upstart’s report, “of the enterprises registered for VAT, approximately 498,500 are SMMEs”. Upstart then notes that the total VAT-induced administrative burden for the 498,500 SMMEs amounts to R4.37bn. These administrative burdens originate mainly from the obligation to keep records (70% of the total administrative burdens) followed by the tax return (28%).

Table 1 – Total and averaged structured and once-off administrative burdens of VAT

Information obligations	VAT		Regional Services Council	
	Total (Rm)	Average per SMME (R)	Total (Rm)	Average per SMME (R)
<i>Once-off burdens</i>				
Registration	30	1,063	22	161
Communication with SARS	12	97	0	9
Inspection by the Commissioner	26	506	5	562
Notify changes	3	83	2	63
De-registration for VAT/RSC	1	664	1	103
Total once-off burdens	72	2,414	31	898
<i>Structural burdens</i>				
Record burdens	3,071	3,556	n.a.	n.a.
Tax returns	1,227	2,471	1,394	1,497
Total structural burdens	4,298	6,027	1,394	1,497
Total administrative burdens	R4,370m	R8,441	R1,425m	R2,395

Source: Upstart Business Strategies

The cumulative impact of these regulations – not just the individual pieces – is to dampen business responsiveness and potentially discourage entrepreneurship. It must be remembered that even during *apartheid* – when regulations discriminated specifically against the development of black businesses – there were many examples of black entrepreneurs transcending the previous government’s best efforts to prevent the emergence of a black entrepreneurial class. The growth of the taxi industry, shebeens, spaza shops and personal services such as hairdressing, shows how consumer demand and entrepreneurs’ supply response can create new rights in the business field despite a hostile official and legal environment. A cumbersome regulatory environment may or may not prohibit entrepreneurship, but there can be little disagreement that it does make it more complicated to run a business, thereby – at minimum – constraining economic activity to some degree.

Informal operators tend to respond differently to the regulatory environment – ignoring taxes, levies, and health and safety standards. But even though regulations may not be enforced in the informal sector, inappropriate regulations act as a barrier to development by keeping a large proportion of the population out of the formal economy. Essentially, overly onerous regulations create a perverse incentive for businesses to remain small and informal.

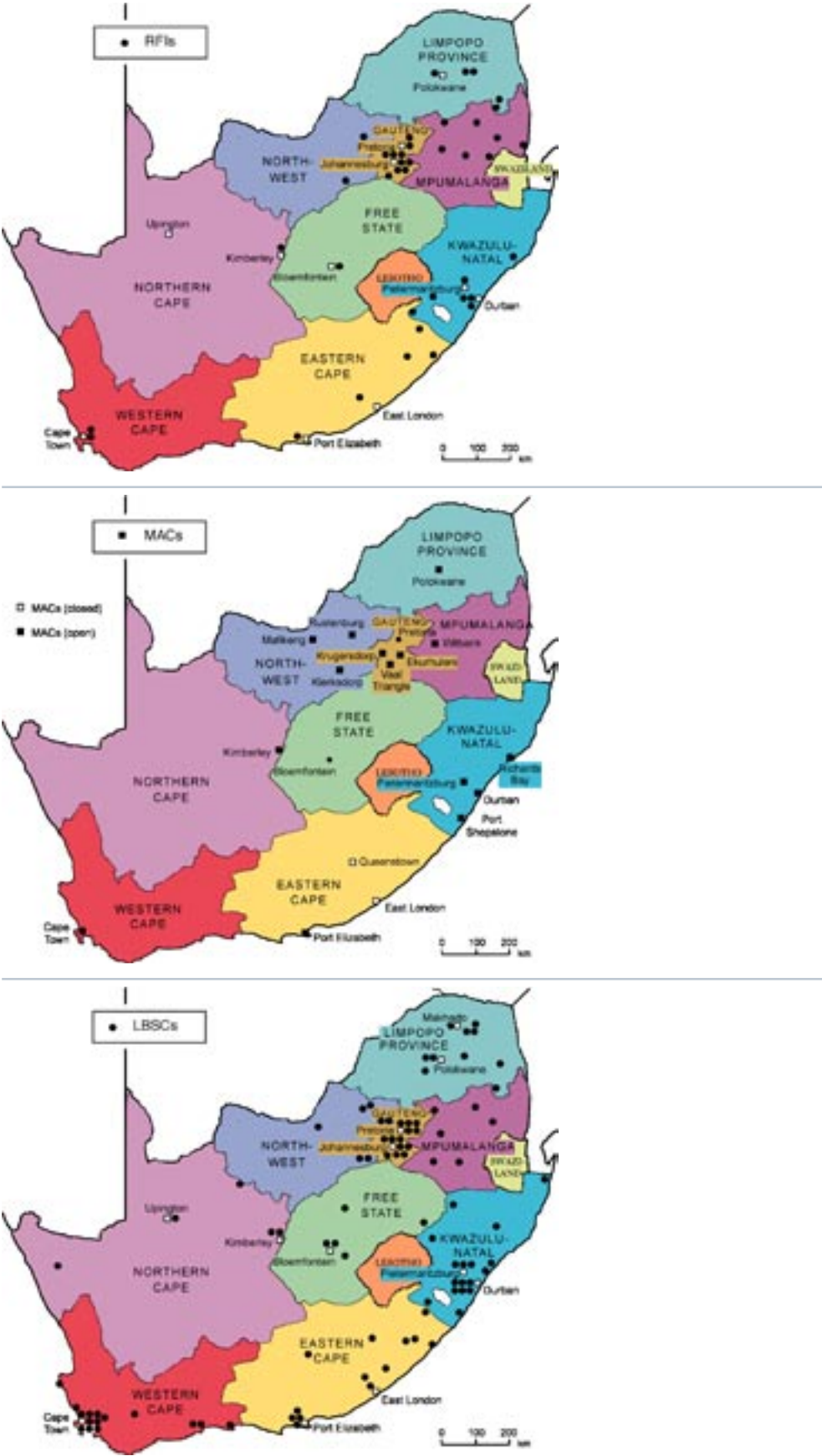
The informal sector may be a hotbed of entrepreneurial activity but for people working in the sector, conditions are often unpleasant. There is little job security, jobs tend to be low-paid, social benefits are non-existent, paid vacation unlikely, and adherence to health and safety regulations almost certainly absent. Entrepreneurial activity might be promoted here but largely at the price of non-compliance in respect of tax and other regulations. Importantly, firms do not grow to their efficient scale, thus reducing the number of productive jobs and diminishing the opportunities for growing out of poverty. Moreover, as these enterprises do not pay taxes, they not only reduce tax revenues but perpetuate a cycle of constrained growth, as high growth requires further capital which cannot be accessed (from the formal sector at least) without being registered for tax or having a VAT number. Registering for tax or VAT increases the regulatory burden, potentially lowering profits and thereby reducing an enterprise's incentive to grow and employ additional staff.

Inappropriate regulation therefore appears to divide the economy into formal and informal sectors and erects barriers between the two which perpetuate the division. Small business consultants have suggested that rather than see the informal sector as 'unfair competition' to the formal sector, it is more useful to see it as an incubator to build skills and assets before an enterprise enters the formal sector. However, surveys conducted across Southern Africa indicate that less than 1% of firms 'graduate' from the micro-enterprise seedbed and become more established enterprises employing more than 10 people. A part of the challenge lies in making the process of formalising easier for these enterprises so that they do not become trapped in sub-scale activities.

The need for empirical, research-based data on the level and cost of regulation emerged during the period under review. More needs to be known about the regulatory framework and its impact – including the monetary cost – on doing business before we can hope to address the challenge effectively.

While this section has focused on the benefits of a lighter regulatory touch, the need for regulations must be kept in mind. Regulations can be used to collect taxes, protect citizens and consumers from unsafe products, protect employees from unfair employment practices, as well as protect the environment for current and future generations. However, it is equally true that policy-makers should take full account of the practical realities for business – particularly small business – and understand the costs, benefits and risks of potential courses of action prior to the implementation of new policy directions.

Figure 2 - Institutional network of key small business support institutions



Source: Ntsika, Khula Annual Reports, various

2.3 The institutional environment in 2003

Government departments at all three tiers (national, provincial and local) continue to make good, albeit uneven, progress in providing an institutional network for small business. The three maps (*see Figure 2*) illustrate the current extent of roll-out of three key programmes of national government. The LBSCs suggest the greatest reach for this Ntsika co-ordinated programme, with at least three to five Centres in the least-industrialised provinces, increasing to almost 20 in KwaZulu-Natal and Gauteng. The coverage of Retail Financial Institutions (RFIs), a programme of Khula Enterprise Finance Limited, and the Manufacturing Advice Centres (MACs) – while less extensive – are still considerable, with at least one RFI and one MAC in almost every Province.

3. Trends and Performance²

3.1 Entrepreneurial dynamism/opportunities

Overall, the number of small businesses has increased between 2002 and 2003. The number of employers and self-employed went up by 7.3% from 1.62-million to 1.74-million. This increase is higher than the overall growth in the economically active population, suggesting that entrepreneurship is becoming an increasingly viable option for individuals. Of course this data says nothing about what influenced the decision to become self-employed or an employer, and in the current economic environment it is likely that much of the increase could be explained by **necessity** rather than **opportunity** entrepreneurship. If this is indeed correct, it confirms the view that government's policies and programmes for the formal, big business sector have a significant influence on the performance and development of SMMEs.

Nonetheless, the rate of new creations is significant and suggests a degree of dynamism in SA's SMME sector. Qualitative research suggests that SA's micro and very small enterprises are relatively easily able to enter the business environment in specific sectors such as services. We therefore see a significant rate of new (mainly micro) enterprises entering the informal sector and thereby increasing the intensity of competition and lowering the returns to individual entrepreneurs.

Unfortunately, the number of employers in the formal sector has not progressed – this indicator declined by 0.4%. While formal male entrepreneurship experienced slight growth, formal female entrepreneurship regressed both in African and other population groups. This suggests that efforts by government to encourage female entrepreneurship in the **formal** sector have not yet borne fruit.

² It is an abiding concern that SA's statistical agencies remain unable to collect comprehensive data on trends and economic performance of the SMME sector. This section of the report therefore draws on literature from a variety of sources to attempt to provide an analysis of the sector's performance over the last year.

On the other hand, informal entrepreneurship has boomed, with a total growth of 10.9%. The growth is highest among African women, at 13.9%, while for African men the increase is 10.7%. This trend is confirmed by other research which shows a significant increase in the number of African women entering the economically active population and becoming increasingly important economic agents in SA society.

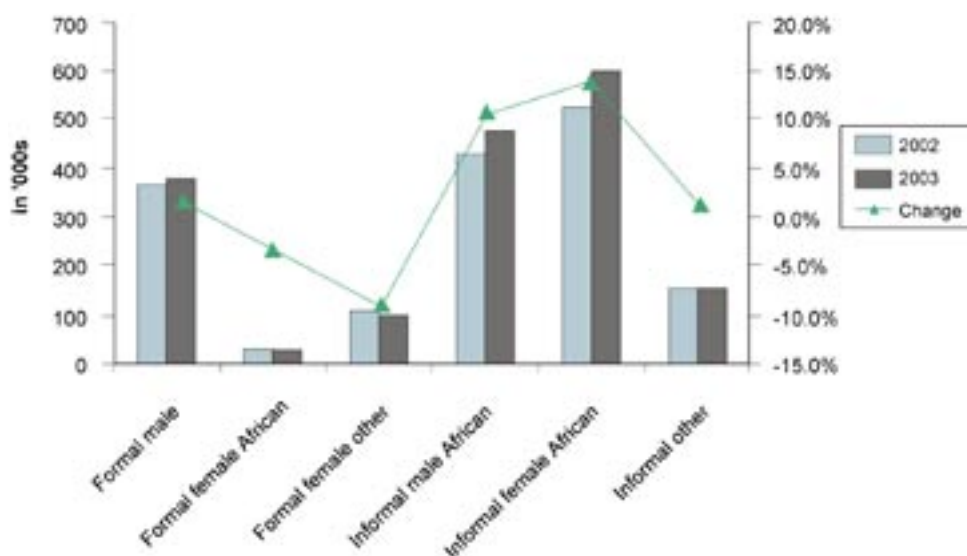
Non-African population groups meanwhile play a minor role in informal entrepreneurship.

Table 2 - Number of employers or self-employed (in their main capacity)

	2002		2003	
	Formal	Informal	Formal	Informal
Employers or self-employed in their main capacity	508,000	1,113,000	506,000	1,234,000
Total	1,621,000		1,740,000	

Source: Stats SA Labour Force Survey September 2002 and 2003

Figure 3 - Evolution of the number of employers and self-employed, by category, 2002 and 2003



Source: Own calculations based on Stats SA Labour Force Survey September 2002 and 2003

Making the point that SA entrepreneurs are willing and able to enter markets where the barriers to entry are relatively low may seem redundant, but the policy implications of this are quite significant. For one, it suggests that SA entrepreneurs do not lack entrepreneurial flair, as has sometimes been argued. Rather, it suggests that perhaps more attention should be paid to issues around barriers to entry in the **formal** sector and perhaps the kinds of support required by entrepreneurs once they have already become active in a sector.

The question of barriers to entry emerges in the sectoral studies on food processing and tourism. These studies show that the concentrated structure of the two sectors functions, if not as a direct barrier to entry, then at least as a powerful constraint on the growth potential of existing and particularly emerging (black-owned) SMMEs in these two sectors. This finding raises questions about the potential for competition policy to be considered as an area for policy intervention in order to support the upgrading and establishment of SMMEs. A policy initiative that has been implemented in other countries to encourage tourism SMMEs involves special government support incentives for new tourism enterprises in emerging or peripheral (for example, rural) destinations to avoid large-scale corporate dominance. In the food sector, the policy initiatives focus on establishing fairer trading relationships between processors and retailers. Overall, the issues around competition in the two sectors should perhaps be more thoroughly investigated as part of developing black economic empowerment (BEE) support programmes in these two sectors of the economy.

3.2 Entrepreneurial capacity

Entrepreneurial capacity refers to the ability of SMMEs to remain in operation and grow production and employment. This is an important dimension for policy-makers as a high rate of small business failures can be costly to the economy in terms of un- or under-utilised investment, and the effect of business failures on the entrepreneur's own financial position and of course creditors to the company. In addition, the benefit to the economy of start-up businesses is relatively small; research by the GEM suggests that the most significant benefits to the broader economy accrue when small enterprises begin to grow rapidly and start to increase employment and production.

In Table 3 below we present data on new registrations and liquidations of Companies and Close Corporations. Whilst we accept that these data reflect the more formal end of the small business spectrum, and are therefore not fully reflective of all small businesses, the data remain interesting.

Table 3 – Registrations and liquidations of Companies and Close Corporations

	2002	2003
New Companies	32,174	31,753
New CCs	107,300	110,723
Company liquidations	2,093	1,176
CC liquidations	1,683	3,154

Source: Companies and Intellectual Property Registration Office (CIPRO), internal statistics, March 2004

According to this year's statistics from the Registrar of Companies, there has been a relative stabilisation in the activity of registration of new businesses in 2003. The increase in the number of new Close Corporations registered in 2003 compared to

2002 is relatively low, especially if one considers that not all of these Close Corporations actually start trading. The number of company registrations has slightly declined. Overall, this is consistent with the finding that new entrepreneurs have more often chosen to stay in the informal sector.

The liquidation statistics seem to indicate a substantial increase in the number of Close Corporations liquidated in 2003.³ This seems to corroborate our earlier analysis which noted that the economic environment as a whole was not particularly positive and therefore will have done little to support SMME growth. In the following section of the Review we report on the statistics used in more detail. It is sufficient at this stage to merely state that approximately 293,000 Close Corporations are economically active. The liquidations for 2003 are therefore a negligible proportion of the total, especially when compared to the new Close Corporation registrations. Are there any policy implications that can be drawn from this? Tentatively, we could perhaps speculate that starting a small business is not currently an **insurmountable** hurdle in the SA context.

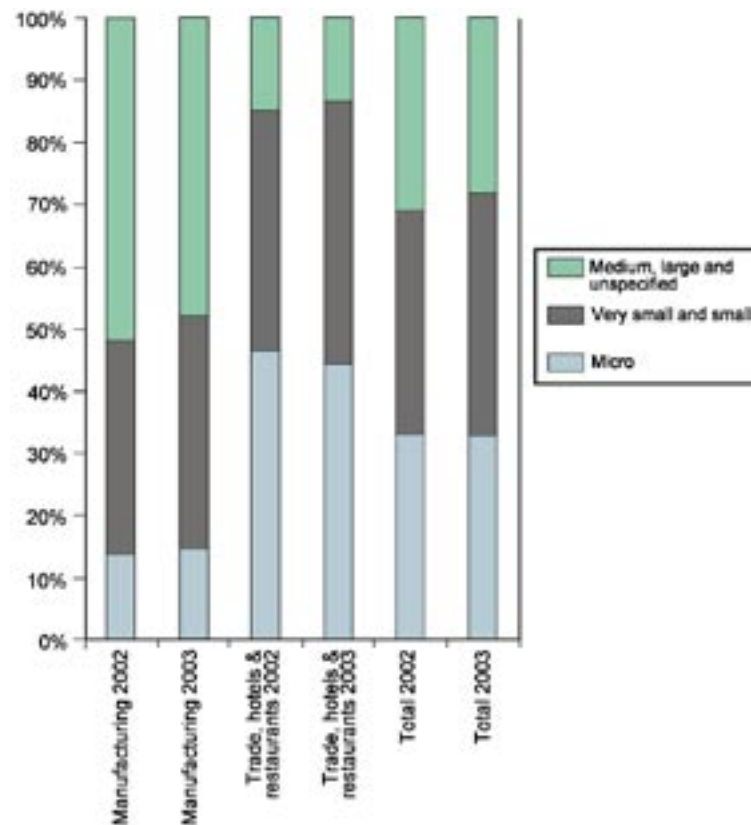
However, to obtain a true reflection of the entrepreneurial capacity in SA we need to assess the contribution of small business to employment and gross domestic product (GDP). Although most of the increase in entrepreneurship took place in the informal sector, this has not led to an increase in the contribution of micro enterprises to employment. The distribution of employment according to firm size⁴, for the total economy, remained largely static in 2003, although a positive development is the increase in the share of very small and small businesses from 36% to 39%.

At the more disaggregated level of the manufacturing and trade sectors, the picture is largely the same, with almost no change for micro enterprises, and small increases in the contribution by very small and small enterprises.

³ However, it must be noted that these data are not consistent with the data published by Statistics SA (Stats SA), which rather seemed to indicate a decrease in the number of liquidated Close Corporations but an increase in Company liquidations. On the other hand, another internal paper of the CIPRO also contained lower registration figures for private Companies.

⁴ Unfortunately, the Stats SA data do not allow for further disaggregation of the medium and large firm data. As a result, it is impossible to obtain a true reflection of the contribution of small, micro and medium firms.

Figure 4 – Contribution of firms to employment, 2002 and 2003



Source: Own calculations based on Stats SA Labour Force Survey September 2002 and 2003

Overall, these results seem somewhat promising. Although the growth in the number of entrepreneurs has mainly taken place in the informal sector (which is largely made up of micro enterprises), the intermediate layer of very small and small enterprises has been able to maintain, and in some sectors increase, its contribution to employment. Nonetheless, the data lead us to raise some issues of concern. For example, the growth in the number of new companies (which is likely to fall in the medium and large category) has been relatively static between 2002 and 2003, and compared to the stock of companies operating in SA, the increase in absolute terms has also been relatively low. Moreover, we are aware that many of these formal sector medium and large companies have been shedding employment over at least the last three to five years. We would therefore have expected the share of micro and small companies in total employment to have increased much more substantially than the data show, especially in view of the increase in new Close Corporation registrations.

It is impossible to infer, with any significant degree of confidence, what the underlying causes are for the somewhat counter-intuitive data shown in Figure 4 above. However, evidence from the Free State research as well as the sector studies presented later in the Review suggests that one of the key explanatory factors is the relatively poor performance of **established** SMMEs. Thus, except for the Bloemfontein-Botshabelo-Thaba Nchu

and Harrismith-Phuthaditjhaba clusters, SMME employment is in relative if not absolute decline for most of the rest of the Free State. Drawing on research conducted by the City of Cape Town, a similar pattern arises, with about 58% of the sampled firms demonstrating growth and 42% in decline.

3.3 Contribution to GDP

Given the lack of wide-ranging data on small business production figures, it is rather hazardous to undertake an estimation of SMMEs' contribution to the GDP, let alone to draw firm conclusions from the year-to-year comparison of the results obtained in such an exercise. The comments below should therefore be interpreted as presumptions rather than strong assertions.

Using an approach that we have characterised as 'the Abedian Gross Value Added 2 (GVA2) method' and which is elaborated on in a later Chapter, the contribution of micro, very small and small enterprises to GDP has been estimated as follows:

Table 4 - Estimated percentage contribution to GDP by size-class:
Abedian method (GVA2)

		Micro (%)	Very small (%)	Small (%)	Medium & large (%)	Other (%)	Total (%)
2002	Total	8	9	12	52	19	100
	(ignoring non-enterprise producers)	10	12	15	64	-	100
2003	Total	7	9	12	47	25	100
	(ignoring non-enterprise producers)	10	12	16	62	-	100

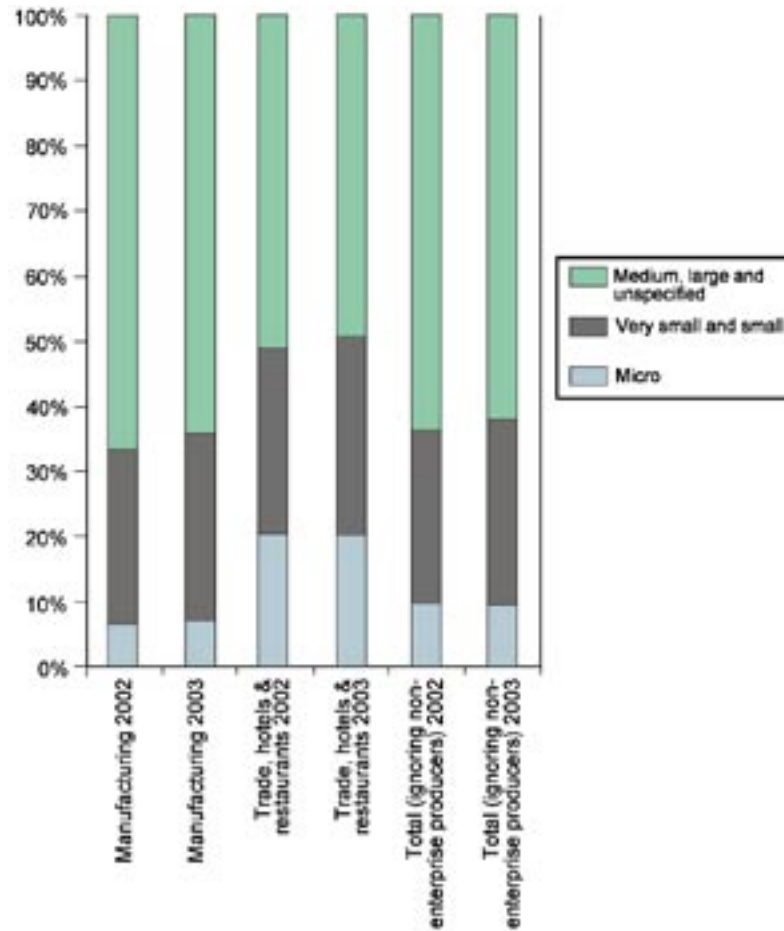
Source: Own calculations based on Stats SA releases: Labour Force Survey September 2002 and 2003, GDP releases 2002 and 2003

Overall, there is little significant change to the origins of GDP, except that the contribution of non-enterprise producers seems to have increased significantly. There may be a slight increase in the contribution of small enterprises to the GDP.

Looking at details by industry, one finds the same tendencies as in the contribution to employment (which is inherent to the employment-driven methodology): in manufacturing, a minimal increase in the share of micro enterprises, and in trade, a slight progress of the share of very small enterprises.

However, again, a longer-term view would help to establish whether these trends are reliable.

Figure 5 – Estimated contribution to GDP



Source: Own calculations based on Stats SA releases: Labour Force Survey September 2002 and 2003, GDP releases 2002 and 2003

4. Conclusion

This chapter has reviewed the trends in a variety of dimensions relevant to assessing the performance of the small business sector. Overall, we find some reasons for optimism. The number of entrepreneurs in the sector has, by a variety of measures, increased – although only slightly. This is particularly the case for black women entrepreneurs who are increasingly active in the informal sector. This, supported by anecdotal evidence, leads us to the view that for some sectors of the informal economy, the barriers to entry are relatively low. Based on the distribution of SMMEs by industry sector, it is clear that this is likely the case in many of the service sectors where some 70% of all SMMEs are concentrated, and especially in the trade sub-sector of services. Individuals attempting to enter the formal sector have not fared as well, suggesting that barriers to entry may vary significantly between the formal and informal sectors and within industry groups.

What is perhaps of more concern than the rate of entry and exit for SMMEs is the seeming stagnation of established small businesses. Existing enterprises seem to have a low propensity to create additional employment, leading to an expanding pool of individual self-employed or employer survivalist micro enterprises. In addition, the static rate of formal SMME creations suggests that there is little progression between survivalist micro enterprises and more formal small enterprises. The data do not exist to test whether there is progression from small to medium enterprises but this, too, appears unlikely. From a policy perspective, these conclusions suggest that whilst broad entrepreneurship programmes are important, the key issue is less about entrepreneurial opportunities and more about entrepreneurial capacity.

In this vein, it is worth noting that the kinds of initiatives likely to have a positive impact on entrepreneurial capacity reside within the domain of local government. Initiatives such as the City of Johannesburg's Fashion District, sectorally focused Incubators or – especially in rural areas – affirmative procurement schemes all have strong municipality or metro-level resonance.

This Overview has also highlighted the importance of environmental factors in accounting for small business success or failure. In the case of the three most important of these factors – the macroeconomy, the institutional and the regulatory environment – we have seen that much work remains to be done. Strong, broad-based economic and export growth remains scarce, leading to small and large business competing for the same limited demand. Moreover, the uneven spread of institutional support to small business, and especially the generally somewhat restrictive regulatory environment, seem to be key explanatory factors in the low growth rates of many established SMMEs.

Finally, we have said little about the Second Economy. Conceptually, this remains a difficult subject and certainly quantitative analysis remains a long way off. Nonetheless, there can be no doubt that for the millions of people who live on the margins of the modern industrial economy (consisting of large and small firms) this is almost certainly the most important issue. Small business development is not the panacea for the under-development and poverty characteristic of the Second Economy; however, it is an important part of government's directed and active strategy to ensure mobility between the First and Second Economies, create conditions for sustainable livelihoods and eliminate conditions of extreme poverty.

Part I: Regular Features

Chapter 2



Key Small Business Statistics in South Africa

1. What is a small business?

1.1 The official definition

The National Small Business Act of 1996 defines a 'small business' as "a separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column I of the Schedule".

Small businesses can be classified as micro, very small, small or medium enterprises, following the criteria below. A further distinction is the 'survivalist' business, which is generally defined as providing income only below the poverty line.

Micro enterprises are occasionally described as businesses whose turnover is below the compulsory VAT registration limit of R300,000, but this does not correspond to the official definition.

Table 5 shows the thresholds per sector, as prescribed by the Small Business Act and revised by the National Small Business Amendment Bill of 2003.

Compared to developed countries' standards, SA thresholds are very low. Many businesses which Americans or Europeans regard as Small and Medium Enterprises (SMEs) would, in SA, be regarded as large enterprises. This reflects the differences in the economic and social fabric.

1.2 From informal to formal: a continuum of situations

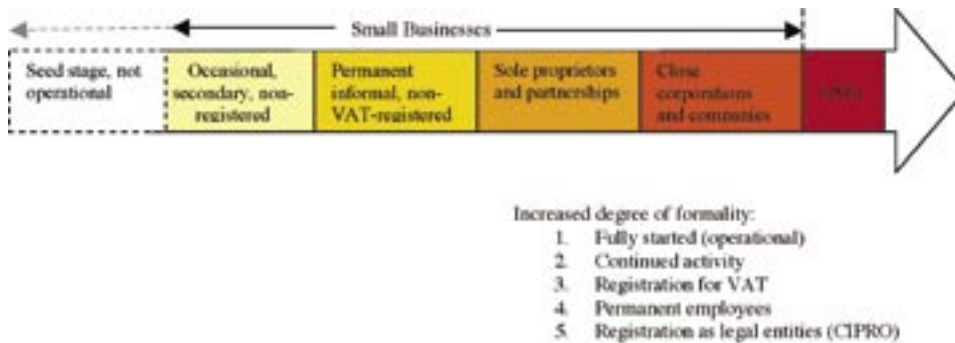
Taken in its broadest sense, the concept of a 'small business' can be very wide-ranging. It includes any form of economic activity – registered or not – that provides its owner with an income but remains below the thresholds for a large enterprise. This means that it can include manufacturing enterprises employing 150 to 199 full-time employees, as well as survivalist hawking enterprises or occasional home-based evening jobs.

Table 5 – Thresholds for the classification as micro, very small, small or medium enterprise

Sector or sub-sectors in accordance with the Standard Industrial Classification (SIC)	Size or class	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value-fixed property excluded (Rm)
		Less than:	Less than:	Less than:
Agriculture	Medium	100	5.00	5.00
	Small	50	3.00	3.00
	Very small	10	0.50	0.50
	Micro	5	0.20	0.10
Mining and Quarrying	Medium	200	39.00	23.00
	Small	50	10.00	6.00
	Very small	20	4.00	2.00
	Micro	5	0.20	0.10
Manufacturing	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.00	2.00
	Micro	5	0.20	0.10
Electricity, Gas and Water	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Construction	Medium	200	26.00	5.00
	Small	50	6.00	1.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Retail and Motor Trade and Repair Services	Medium	200	39.00	6.00
	Small	50	19.00	3.00
	Very small	20	4.00	0.60
	Micro	5	0.20	0.10
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	64.00	10.00
	Small	50	32.00	5.00
	Very small	20	6.00	0.60
	Micro	5	0.20	0.10
Catering, Accommodation and other Trade	Medium	200	13.00	3.00
	Small	50	6.00	1.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Transport, Storage and Communications	Medium	200	26.00	6.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.60
	Micro	5	0.20	0.10
Finance and Business Services	Medium	200	26.00	5.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Community, Social and Personal Services	Medium	200	13.00	6.00
	Small	50	6.00	3.00
	Very small	20	1.00	0.60
	Micro	5	0.20	0.10

Source: Schedule 1 to the National Small Business Act of 1996, as revised by the National Small Business Amendment Bill of March 2003

Figure 6 – From informal to formal businesses



The figure above shows a continuum of situations, from the most informal to the most formal type of enterprise, but the reality is far from being so simple. The formality criteria are intertwined and not necessarily correlated – for example, corporations registered with the CIPRO may well be trading only occasionally or even not at all, while non-VAT registered trades may provide many jobs, at least on a casual basis.

The businesses that are formally registered, have a continuous trade and permanent employees, are reasonably well known. But less formal businesses are not fully or not at all captured by statistics, either because they are not registered, employ only casual staff or no staff, are only a minor side occupation of their owner, or because they operate on an on-and-off basis. While in developed countries these cases can be considered as marginal, in SA many of these informal and micro enterprises are the key to the livelihoods of millions of people.

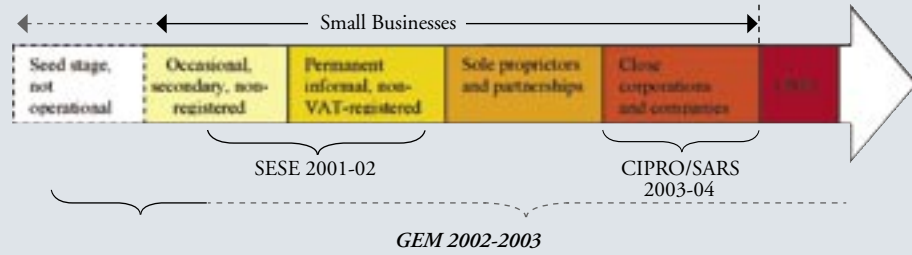
2. How many small businesses does SA have?

Type of small business and data

Not surprisingly, just as there are different concepts of businesses, there are also different qualities of data. The least formal enterprises are not necessarily the least known, since a recent extensive survey of non-VAT registered businesses by Stats SA has helped to put some figures on the ‘informal sector’. Even businesses that are in their infant stages are better known since the inception of annual Entrepreneurship Monitors.

In fact, at present the ‘informational opacity’ seems to be highest among a segment of small business that is potentially very significant: sole proprietors and partnerships, which usually have a permanent and substantial activity but are not registered with the CIPRO.

Figure 7 – Data available for each type of small business



This statistical review often presents separately two categories of small businesses for which there is reasonably good data – on the one hand, ‘formal and active corporations’ registered with the CIPRO and known by the SARS; on the other, ‘informal’, non-VAT registered businesses, based on the Survey of Employers and Self-Employed (SESE) by Stats SA. The reader must, however, bear in mind that these two populations taken together do not represent the entire small business population of SA.

On the other hand, entrepreneurial businesses, as described in the Entrepreneurship Monitors, tend to overlap significantly with other categories.

To work out reasonable estimates, the question “how many small businesses” should rather be replaced by several more specific questions.

2.1 How many people define themselves as employers or self-employed?

A first approach to the number of businesses is to look for the number of individuals who work on their own or with a partner, in any kind of business. This number can be derived from the latest Labour Force Survey (LFS). It must be noted, though, that this describes only people’s main activity – an individual who owns a business in addition to his employment would not be captured here.

Table 6 – Number of employers or self-employed (in their main capacity)

	Formal	Informal	Total
Employers or self-employed (including commercial farms)	506 ,000	1,234,000	1,750,000
Subsistence farming		261,000	269,000
Total			2,019,000

Source: Stats SA Labour Force Survey September 2003

According to the latest LFS (September 2003), 1.75-million South Africans were defining themselves as employers or self-employed (that is, “working on his/her own or with a partner, in any kind of business”).

However, this does not necessarily mean that there are 1.75-million businesses. The following factors must be taken into account:

- A number of people run some kind of business while being employed, or define themselves as unemployed although they run some (survivalist) business activity. These are not recorded as employers here.
- Entrepreneurs are frequently involved in several businesses, which may or may not be related to one another, so behind one employer there may be two, three or more businesses.
- On the other hand, there are frequently two or more partners involved in one business.
- Lastly, if one wants to consider specifically small businesses, the number of owners of large businesses must be deducted from the above total.

The first two elements are likely to have more impact than the latter two, which means that 1.75-million is presumably a low estimate for the number of small businesses.

2.2 How many people are running a business or busy starting up a new business?

The GEM undertakes annual surveys in the population to estimate, among other things, the proportion of entrepreneurs in the country. Unfortunately the sample sizes are rather small and it seems that this – as well as changes in the methodology – cause the results to fluctuate quite strongly from one year to the next.

Table 7 – Number of entrepreneurs

Number of people currently	2002	2003
Starting a business	1,000,000	693,073
Running a business less than 3.5 years old (“new firms”)	460,000	505,893
Running a business older than 3.5 years (“established firms”)	730,000	273,182
Total	2,190,000	1,472,148

Sources: GEM 2002 and own calculations based on the GEM 2003 complementary report⁵

It is important to note that ‘starting’ a business does not necessarily mean that the business is already trading. In GEM terminology, a start-up becomes a running business when it starts paying wages and salaries. This means that, among the entrepreneurs recorded as ‘currently starting a business’, some may be typical one-person businesses which are running but have not yet reached the stage where they can pay a remuneration to their owners, while others can be just at the stage of projects which might never come to fruition.

⁵ There is a possibility that the number of ‘new firms’ and ‘established firms’ are inverted for 2003. The fall in the number of ‘established firms’ does not seem to be explainable otherwise. However, the author did not confirm this mistake.

The high variation of results from one year to the next makes it difficult to draw a definitive conclusion on the number of entrepreneurs, but the order of magnitude from the LFS is more or less confirmed.

2.3 How many firms are registered with the Registrar of Companies and Close Corporations?

Only a portion of SA small businesses are incorporated as Companies or Close Corporations, that is, registered with the CIPRO. Many other businesses are not registered, either because they are informal, or because they operate as sole proprietors or partnerships with unlimited liability of their owners. Therefore, it is expected that at least one third, possibly over 50%, of our small businesses are not registered with the CIPRO.

The CIPRO listings record the following number of 'active' entities in each category:

Table 8 – Number of corporations registered with the CIPRO, 2003

Total active entities as at 24/11/2003	
Close Corporations	879,139
Public Companies	6,705
Private Companies	338,877
Non Profit (Section 21)	11,516
Limited by Guarantee	93
External Companies	2,152
External Companies under Article 21	9
Incorporated (Professionals)	6,901
Company Unlimited	7
Total	1,245,399

Source: CIPRO, 2004

But how many of these corporations are really trading?

At first sight, the number of corporations seems high for what should be only the top end of the small business pyramid. However, entities registered and recorded as 'active' in the CIPRO's books (that is, neither deregistered nor liquidated or otherwise) are not necessarily economically active businesses. The following factors explain why a significant proportion of Companies and Close Corporations are not trading:

- They may be still in the starting-up process;
- They may have been stillborn; or
- They may have ceased trading without deregistering.

Various indices suggest that these three situations may well concern more than half of the registered Close Corporations⁶.

Stats SA has attempted to estimate the economic activity of registered companies and corporations according to their filing of tax returns to the Revenue Service.

This approach is inevitably imperfect, since there is a possibility that a number of entities, especially the smallest and most informal ones, do not supply their tax returns to the SARS in spite of having some economic activity. On the other hand, there is also a possibility that businesses that supplied their returns four or five years ago have since ceased any activity. These two effects presumably balance each other reasonably well, so that the approach adopted by Stats SA may give a reasonable estimate of the number of active, registered businesses, as follows:

Table 9 – Active and inactive corporations in SA, 2004

	Number	Proportion (%)
Not economically active	862,029	66.8
Active	428,540	33.2
Total	1,290,569	

Source: Stats SA Integrated Business Register, 2004

2.4 How many South Africans are involved in business activities that are not registered for VAT purposes?

In 2001, Stats SA conducted a Survey of Employers and Self-Employed, with a focus on the ones that were not registered for VAT purposes. Although these data have not been updated in the last two years, they provide good complementary insights on a part of the economy that is not otherwise well known by statisticians, and therefore deserve a mention here.

As a result of the survey, Stats SA estimates that in March 2001 approximately 2.3-million people were owners of at least one non-VAT registered business. These businesses were usually one-person enterprises, since only 14.8% of them (338,000) had one or more employees, either paid or unpaid.

If one assumes that some of these entrepreneurs own more than one non-registered business, then the number of these informal (non-VAT registered) businesses may be over 2.5-million.

⁶ Since there are 0.6-million to one million start-ups, there may be several hundred thousands of Close Corporations that are still in their infant stages. An interview of an agent offering online Close Corporation registration services revealed that around 90% of the Close Corporations that he registers with the CIPRO are stillborn, for a number of reasons: the would-be entrepreneur discovers that his/her business idea is not viable, there is a breakdown in communication with the partner, the entrepreneur has been unable to secure funding, or for any other reason. Other anecdotal evidence suggests that many entrepreneurs have registered Close Corporations in anticipation of a favourable tax regime for small businesses, but when the new tax regulations came into effect in 2003 they went back to trading under their own name because they could not qualify for the reduced tax rates. They may have omitted to deregister their Close Corporations.

So what would be the best estimate on the number of trading small businesses in SA?

Assuming that:

- The Stats SA estimation of economically active corporations is correct;
- The number of firms that are registered for VAT without being incorporated (sole proprietors, or SPS partnerships, etc.) is between 30% and 60% of the number of economically active registered Close Corporations and Proprietary Limited (Pty) businesses; and
- There are 2.5-million informal (non-VAT registered) businesses of which 50% to 75% are trading on a regular basis:

The number of small businesses would be between 1.8-million and 2.56-million.

Table 10 – Best estimate of the total number of trading small businesses

	Low estimate	High estimate
CCs and Ptys active	428,540	428,540
SPs and Partnerships	128,562	257,124
Non-VAT registered ⁷	1,250,000	1,875,000
Total	1,807,102	2,560,664

Source: Own estimations based on the assumptions described above

3. How small are our small businesses?

From the three criteria prescribed to categorise businesses as micro, very small, small or medium, the number of employees is often the most convenient since it is generally the easiest to obtain and applies across all sectors (except agriculture). For comparability purposes, the employment figure used is the number of permanent, full-time equivalent employees.

However, economically speaking it is the least appropriate since (1) it says little about the extent of economic activity and (2) it also does not reflect the true labour creation of these businesses, since many small businesses employ mainly casual staff to retain their flexibility.

A more significant indicator of size is annual turnover; however, this is often not available. In the Business Register from Stats SA (2004), the CIPRO-registered entities have been classified by turnover. The result is as follows:

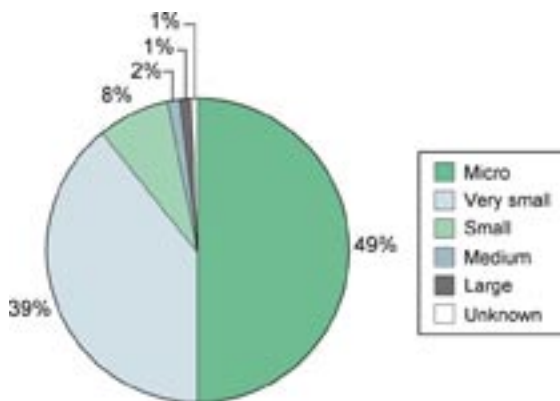
⁷ That is, normally with a turnover below R300,000.

Table 11 – Size distribution of SA registered corporations (2004)

	All businesses		Economically active only
	Number	%	%
Micro	212,161	16.4	49.0
Very Small	170,338	13.2	39.0
Small	32,397	2.5	8.0
Medium	6,748	0.5	2.0
Large	4,596	0.4	1.0
Unknown	864,329	67.0	0.5
Total	1,290,569	100.0	100.0

Source: Stats SA, Integrated Business Register, 2004

Figure 8 – Size distribution of registered corporations



Source: Stats SA, Integrated Business Register, 2004 (only CIPRO-registered entities regarded as economically active; classification based only on turnover)

If one ignores the businesses categorised as ‘not economically active’ (that is, those for which no turnover was available), one can nevertheless conclude that almost half of the CIPRO-registered entities are micro enterprises, and 90% are either micro or very small. Large enterprises represent as little as 1.1% of all registered companies.

It must be noted that this result probably still underestimates the proportion of micro and very small enterprises to the total economy, for two reasons.

First, to the extent that some of the enterprises classified as inactive are actually trading (but not complying with tax filing requirements), they are likely to be at the bottom end of the size distribution. Secondly, the statistics above do not include firms that are not incorporated with CIPRO – sole proprietors, partnerships and informal

businesses. Those are on average significantly smaller than corporations. The non-VAT registered businesses surveyed by Stats SA in 2002 had an average annual turnover of about R22,200 (urban businesses) and R9,300 (non-urban businesses) – far below the threshold of very small enterprises.

Therefore, it is safe to assume that, if one includes the informal sector, at least 60% of our SMMEs are micro enterprises, while SMMEs represent more than 95% of all the country's establishments.

For comparison purposes, the size distribution proposed by the Ntsika Report for 2002 was as follows:

1	Survivalist	5.0%
2	Micro (0)	8.8%
3	Micro (1-4)	11.5%
4	Very Small	11.7%
5	Small	14.6%
6	Medium	14.6%
7	Large	33.8%
8	Total	100.0%

Source: Ntsika 2003, Table 9 p. 39

This result shows a proportion of micro (including survivalist) enterprises to the total number of firms of about 25% only – very far from the 60% suggested above.

However, the Ntsika 2002 statistics seem unlikely, since the expectation should be that the bigger the size, the fewer the number of enterprises. It is probable that the data used for these statistics were strongly underrepresenting the informal part of the economy.

Before closing this section on the size of SA's small businesses, it is worth mentioning that, compared to developed countries, our SMMEs are very small in two regards:

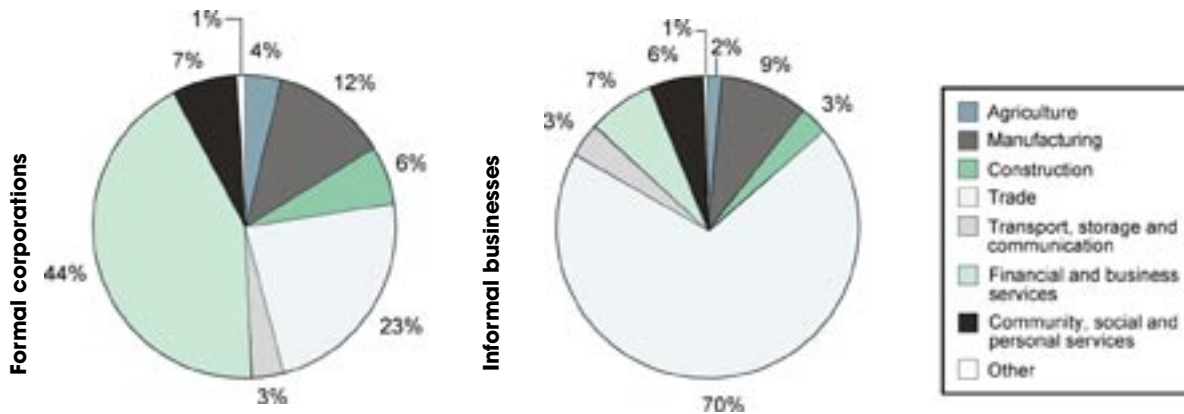
- The proportion of micro enterprises is far smaller due to the size of the informal sector.
- As mentioned in the introduction to this chapter, even formal small and medium enterprises are smaller than in OECD⁸ countries because the official thresholds are lower.

⁸ Organisation for Economic Co-operation and Development

4. In which sectors are small businesses operating?

The industries in which small businesses in the formal sector operate are quite different from the ones preferred by informal businesses. The two are presented below.

Figure 9 – Main industries for formal and informal businesses



Source: Stats SA, Integrated Business Register, 2004⁹

Source: Stats SA, SESE Study, 2002

The graphs show that more than three-quarters of small businesses are involved in services (including trade) rather than the production of goods (the latter represents 22% of formal businesses but only 14% of informal businesses). This is not surprising, since primary and secondary activities (in particular agriculture, manufacturing and construction) are generally quite capital intensive and therefore are more advantageously carried out on a larger scale.

Among the producers of services, a large proportion of formal firms are involved in financial, business and professional services (including engineering and IT¹⁰) while the overwhelming majority of informal businesses are involved in trade, including accommodation and restaurants. These are sectors with relatively low entry barriers but – as will be shown – intense competition and mediocre survival rates.

⁹ Formal businesses are defined here as corporations registered with the CIPRO and for which the turnover is known.

¹⁰ Information Technology

The table below gives more details on the sectors in which formal businesses operate.

Table 12 – Distribution of formal corporations by sector

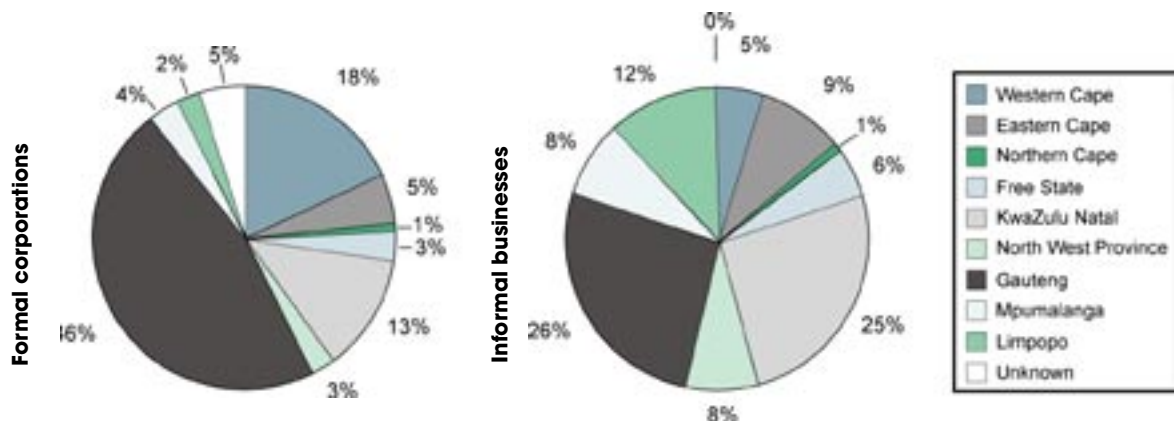
	Including potentially inactive firms		Only active firms	
	Number of registered firms	Percentage distribution	Number of firms	Percentage distribution
Agriculture	29,026	2.2	16,365	3.8
Mining and Quarrying	6,255	0.5	1,852	0.4
Manufacturing	89,825	7.0	52,468	12.3
Electricity, Gas and Water	3,748	0.3	835	0.2
Construction	96,694	7.5	26,977	6.3
Retail, Motor Trade and Repairs	301,574	23.4	58,019	13.6
Wholesale Trade and Allied Services	34,449	2.7	26,493	6.2
Catering and Accommodation	23,431	1.8	14,666	3.4
Transport, Storage and Communication	43,676	3.4	13,955	3.3
Financial and Business Services	531,488	41.2	183,308	43.0
Community, Social and Personal Services	81,928	6.3	29,849	7.0
Unknown	48,475	3.8	1,453	0.3
Total	1,290,569	100.0	426,240	100.0

Source: Stats SA, Integrated Business Register, 2004

5. Where are SA small businesses situated?

5.1 Distribution by province

Figure 10 – Number of formal and informal businesses per province



Source: Stats SA, Integrated Business Register, 2004¹¹

Source: Stats SA, SESE Study, 2002

¹¹ Formal businesses are defined here as corporations registered with the CIPRO and for which the turnover is known.

Again, the provincial profile of small businesses differs strongly depending on whether one considers formal or informal businesses. The two provinces that accommodate most formal corporations – Gauteng and the Western Cape with almost two thirds of them – account for less than a third of informal businesses.

On the other hand, provinces with a strong proportion of rural population, like the Eastern Cape, KwaZulu-Natal, the North West, Mpumalanga and Limpopo, accommodate higher proportions of informal businesses.

Table 13 compares the number of businesses to the population of the province. It shows that the formal business density is highest in the above-mentioned two provinces (Gauteng and Western Cape), while the ratio of informal businesses to the population is highest in Gauteng, KwaZulu-Natal and Mpumalanga.

Table 13 – Enterprise density per province

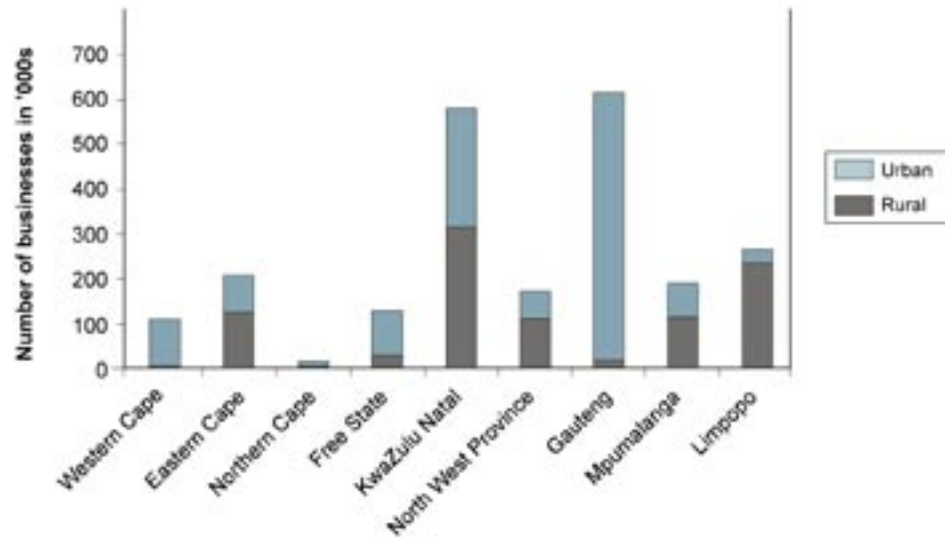
	Number of businesses per province (in '000s)			Number of businesses per inhabitant	
	Formal active	Informal	Population	Formal active %	Informal %
Western Cape	78	111	4,757	1.6	2.3
Eastern Cape	22	209	6,505	0.3	3.2
Northern Cape	5	17	818	0.6	2.1
Free State	13	129	2,741	0.5	4.7
KwaZulu-Natal	54	580	9,766	0.5	5.9
North West Province	11	175	3,799	0.3	4.6
Gauteng	199	616	9,443	2.1	6.5
Mpumalanga	15	191	3,252	0.5	5.9
Limpopo	10	266	5,415	0.2	4.9
Unknown	21	0			
Total	426	2,294	46,496	0.9	4.9

Source: Compiled from Stats SA releases

5.2 Distribution by type of location (urban / rural)

Unfortunately, the (formal) Business Register held by Stats SA does not at this stage include data on whether firms are based in an urban or rural setting. This information is only available for informal enterprises (SESE) and is as follows:

Figure 11 – Distribution of informal businesses by province and type of location (urban or rural)



Source: Stats SA, SESE Study, 2002

Overall, 42% of informal enterprises are rural and 58% are urban. The urban to rural rate, however, varies strongly from one province to the next. It can be expected that there is a far higher proportion of urban enterprises among formal businesses.

The data collected by the GEM provide additional insights into the distinction by type of location – also for formal enterprises. In fact, GEM does not distinguish between formal and informal businesses but whether entrepreneurs were motivated by a business opportunity or by necessity (the absence of an alternative source of income). To the extent that necessity entrepreneurs are more often informal businesses and opportunity entrepreneurs usually more formalised, their results confirm that formal businesses occur far more frequently in urban settings.

Table 14 – Entrepreneurial activity¹² by location and region in SA

	Opportunity entrepreneurship (%)							Necessity entrepreneurship (%)	Total entrepreneurial activity (%)	
	Gauteng	Western Cape	Eastern Cape	KwaZulu-Natal	Mpumalanga & Limpopo	Free State	Northern Cape & North West	SA	SA	SA
Rural	6.7	3.3	0.3	1.7	1.3	0.0	1.2	1.2	1.8	3.3
Urban	6.5	5.8	5.7	4.4	3.9	3.4	2.2	5.2	2.5	8.1

Source: GEM 2003 (adult population survey conducted in 2002), Chapter 3, Figures 6 and 7

¹² The table must be read as follows: 8.1% of adult South Africans in urban settings are involved in some entrepreneurial activity; that is, they are busy either starting up a new business, or running a business that has paid salaries for less than 3.5 years. This rate is only 3.3% in rural settings. Note that necessity and opportunity entrepreneurship do not necessarily add up to total entrepreneurship, since respondents may have indicated other reasons for starting a business.

The likelihood of a South African seizing a new business opportunity is more than four times higher in urban settings (5.2%) than in rural settings (1.2%). However, the likelihood of an adult getting involved in a new business because of the lack of other income-generating alternatives, is only slightly higher in urban areas (2.5%) than in rural settings (1.8%).

This difference could be interpreted as a sign that there are more business opportunities in urban areas than in rural areas. However, other research conducted by the GEM has shown a significant untapped business potential in SA's rural areas. The fact that opportunity entrepreneurship remains very low in these areas may therefore reflect a deficit in the supportive environment rather than a lack of potential *per se*. It is a challenge for policy-makers to improve support services for rural entrepreneurs.

6. How do SA's small businesses contribute to the country's economy?

The main source of data for this chapter is the LFS conducted by Stats SA. Unfortunately, this Survey distinguishes only between the size of establishments up to 50 employees, so that it is not possible to include medium-sized enterprises (50 to 200 employees) in this section¹³. In this Chapter, therefore, we refer to small businesses as the micro, very small and small enterprises as defined in Schedule 1 to the Small Business Act.

6.1. Contribution to employment

6.1.1 Micro, small and medium enterprises

The table below presents the SA working population (11.6-million people) according to the sector and the size of the entity they work for, measured by the number of regular employees. It shows that on average, micro enterprises employ approximately a third of SA workers, while overall, small businesses account for almost 75% of employment.

This result is obtained when the broadest definition of employment – including the work of the entrepreneurs themselves, as well as casual and seasonal workers, which are heavily used by small businesses – is used.

The contribution of micro and very small enterprises is particularly high in the sectors of trade, which have already been identified as the preferred sector for informal businesses, community services (after correcting for the share of government) and construction, which are typically labour-intensive sectors.

¹³ Another problem is that the Survey does not distinguish between government employees and employees of the private sector. Therefore estimations in the sector of Community and Social Services may be biased.

Table 15 – Contribution of micro, very small and small businesses to employment, 2003

	Micro (%)	Very small (%)	Small (%)	Medium and large (%)	Unspecified / don't know (%)	Total (%)
Agriculture	32	12	36	18	1	100
Mining and Quarrying	4	9	4	82	1	100
Manufacturing	15	17	20	46	2	100
Electricity, Gas and Water	0	0	16	59	24	100
Construction	36	33	17	12	1	100
Trade, Hotels and Restaurants	44	30	12	12	1	100
Transport, Storage & Communication	30	19	14	34	2	100
Financial and Business Services	18	27	20	32	2	100
Community, Social and Personal Services (1)	15	28	23	32	2	100
Community, Social and Personal Services (2)	45	41	7	3	4	100
Total	33	23	16	26	2	100

(1) Refers to the employment pattern of Community Services, including national, provincial and local government and attached entities; (2) is the assumed distribution after correcting for the effects of government-related employment.

Source: LFS, September 2003

The contribution of small businesses to employment resulting from this exercise is significantly higher than the previous estimation by Ntsika (2003, p. 36). This is not surprising since we have seen in previous sections that the Ntsika estimations seemed to have underestimated the number of micro and very small enterprises.

Table 16 – Contributions to employment: comparison of Stats SA with Ntsika 2002 Report

	Micro (%)	Very small (%)	Small (%)	Medium and large (%)	Unspecified / don't know (%)	Total (%)
2003 (based on LFS)	33	23	16	26	2	100
2002 (based on Ntsika)	32	10	14	44	–	100

Source: LFS, September 2003 and Ntsika, 2002

6.1.2 Start-ups and new enterprises

A different question to ask is what is the contribution of young businesses to employment. GEM 2002 has attempted to address this question, but used a narrow definition of employment (the number of permanent employees in an enterprise). As a result of this narrow definition, GEM captured only 3.5-million employees as opposed to the 11.6-million workers above, and came to the conclusion that the share of employment attributable to start-ups and young firms (less than 3.5 years old) was only 32%.

However, if one adds to the employees the jobs created for the owners of the businesses, the share of start-ups and new firms goes up to 45%, as illustrated in Table 17. The inclusion of casual and seasonal workers would presumably push this proportion up further.

Table 17 – National estimates of employment creation by entrepreneurial firms

	Start-ups	New firms	Established	Total
Estimated number of entrepreneurs	1,000,000	460,000	730,000	2,190,000
Estimated number of employees*	140,000	1,000,000	2,400,000	3,540,000
Share of total employees	4%	28%	68%	100%
Share of total job creation	20%	25%	55%	100%

* Excluding owner/s

Source: Adapted from GEM 2002 SA Executive Report, Table 3

6.2 Contribution to production

The contribution of small businesses to GDP is even more difficult to ascertain. In the past, this figure has been estimated on the basis of sectoral censuses, with the disadvantage that the smaller and more informal producers, which were not well represented in the older censuses, were underestimated.

In light of the dearth of data, the present study has adopted an approach developed in the past by economic consultant Iraj Abedian for a 2001 report to the Policy Board for Financial Services and Regulation. The principle of this approach is to divide GDP into two components: the total compensation of employees and the gross operating surplus. The first component is allocated to firm categories according to their contribution to employment, while the surplus is allocated according to assumptions on the level of profitability of each type of business. For this second step, two sets of weights are assumed¹⁴, leading to two sets of estimations.

¹⁴ GVA 1 was calculated in two steps: Total compensation of employees in the economy was allocated to the different types of enterprises using, as weights, employment per type of enterprise as a fraction of total employment. The second step was to allocate gross operating surplus to each type of enterprise using the following weights: survivalist 0.0; micro 0.05; very small 0.05; small 0.20; medium 0.20 and large 0.50. For GVA 2, step 1 is as above but the step 2 weights were: survivalist 0.0; micro 0.0; very small 0.05; small 0.15; medium 0.20 and large 0.60.

Replicating this calculation using the latest available figures generates the following estimates:

Table 18 – Small business' contribution to production

GVA 1 2003	Micro (%)	Very small (%)	Small (%)	Medium & Large (%)	Other (%)	Total (%)
Agriculture, Forestry & Fishing	12	7	24	57		100
Mining and Quarrying	5	7	13	75		100
Manufacturing	10	11	20	59		100
Electricity and Water	3	3	18	76		100
Construction	23	21	18	38		100
Trade, Catering and Accommodation	23	17	16	44		100
Transport, Storage and Communication	15	11	17	56		100
Finance and Business Services	9	12	20	59		100
Community, Social and Personal Services	12	22	22	43		100
Government and Other Producers					100	100
Total	9	9	14	42	25	100
Total (ignoring non-enterprise producers)	13	12	19	56		100

GVA 2 2003	Micro (%)	Very small (%)	Small (%)	Medium & Large (%)	Other (%)	Total (%)
Agriculture, Forestry & Fishing	9	7	21	64		100
Mining and Quarrying	2	7	10	81		100
Manufacturing	7	11	18	65		100
Electricity and Water	0	3	16	82		100
Construction	20	21	16	43		100
Trade, Catering and Accommodation	20	17	14	49		100
Transport, Storage and Communication	12	11	15	62		100
Finance and Business Services	6	12	17	65		100
Community, Social and Personal Services	11	22	21	46		100
Government and Other Producers					100	100
Total	7	9	12	47	25	100
Total (ignoring non-enterprise producers)	10	12	16	62		100

Sources: Stats SA Releases: LFS 2003 and GDP 2003 release

Methodology: As in Abedian, in Falkena et al, 2002

These estimations would suggest that micro, very small and small enterprises would generate between 28.7% and 32.9% of the country's GDP – or after neutralising non-enterprise producers such as government – 38.1% and 43.8% of the production of enterprises.

Compared to Abedian's results (which were based on the same methodology but using 1997 data), it seems that the contribution of very small and small businesses has increased slightly in the last six years. The next table shows the earlier results obtained by Abedian.

Table 19 – Contribution to GDP: comparison 1997 and 2003

	Survivalist and micro		Very small and small		Medium and large	
	1997	2003	1997	2003	1997	2003
GVA 1: % of GDP	14	13	27	31	59	56
GVA 2: % of GDP	12	10	25	28	63	62

Source: Abedian 2000 (based on 1997 data), compared with own results as per Table 18 above

Our new estimates are also significantly higher than the results obtained by Ntsika 2002, where the share of micro and small enterprises was believed to be 20.7% (see Table 20). The following factors can contribute to explain this divergence:

- Ntsika seems to have counted government and other producers as large enterprises.
- Ntsika’s estimations are based on extrapolations of older industry censuses, which are likely to have underestimated the smallest and more informal agents of the economy.
- On the other hand, there is probably a bias in the Abedian method, which implicitly assumes equal remuneration of employees in large, small or micro enterprises. In reality, it is likely that large firms remunerate their employees better than small and especially micro enterprises, so that the Abedian method may overestimate the share of these firms. It seems therefore safer to work with the more conservative ‘GVA2’ estimations.

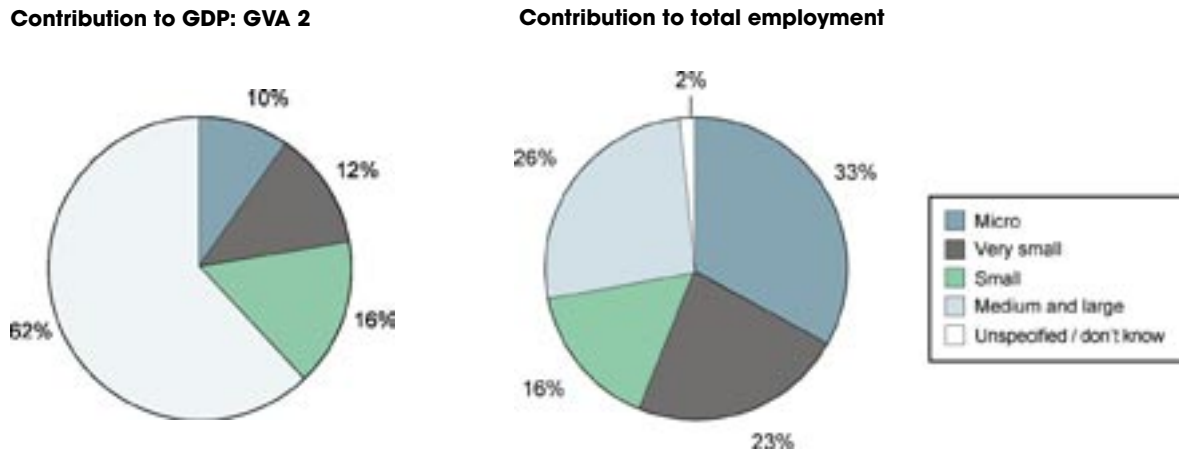
Table 20 – Contribution of SMMEs to GDP according to Ntsika 2002 Report

	Micro (%)	Small (%)	Medium (%)	Large (%)	Total (%)
Agriculture, Forestry & Fishing	3.4	9.2	43.8	43.6	100
Mining and Quarrying	1.6	1.9	2.8	93.7	100
Manufacturing	4.9	7.5	21.2	66.4	100
Construction	2.8	32.5	14.7	50.0	100
Trade, Catering and Accommodation	4.2	24.6	12.1	59.1	100
Transport, Storage and Communication	8.8	19.1	20.2	51.9	100
Community, Social and Personal Services and Finance and Business Services	15.7	13.9	2.6	67.8	100
Total	5.9	14.8	15.4	63.9	100

Source: Ntsika, 2002

6.3 Summary

Figure 12 – Contribution of small businesses to employment and GDP



Source: Own calculations based on Stats SA Releases, 2003

Source: Own calculations based on LFS, 2003

7. How many small businesses appear and disappear each year?

The early mortality of small firms is a world-wide phenomenon, with studies reporting that in some cases less than 50% of small firms survive longer than five years in Europe or the US¹⁵. For SA, though, there is currently no source of data allowing one to track businesses from one year to the next on a comprehensive, nation-wide level. We have two imperfect sources of data at our disposal:

1. For Companies and Close Corporations, which are registered with the CIPRO, it is possible to know on a national level the number of registrations per year as well as the number of (voluntary or compulsory) liquidations. However, a newly registered Close Corporation is not necessarily actually trading, and liquidations only have a minor influence on the disappearances of small businesses – most of them simply become dormant.
2. On a smaller scale, we have information on all establishments trading and paying Regional Services Council (RSC) levies in Cape Town. This database enables the tracking of levy-payers from year to year and recognising when they become dormant or are deregistered. Unfortunately, the scope of the present study did not allow an update of the 2002 study.

These two sources are discussed in further detail in the following sections.

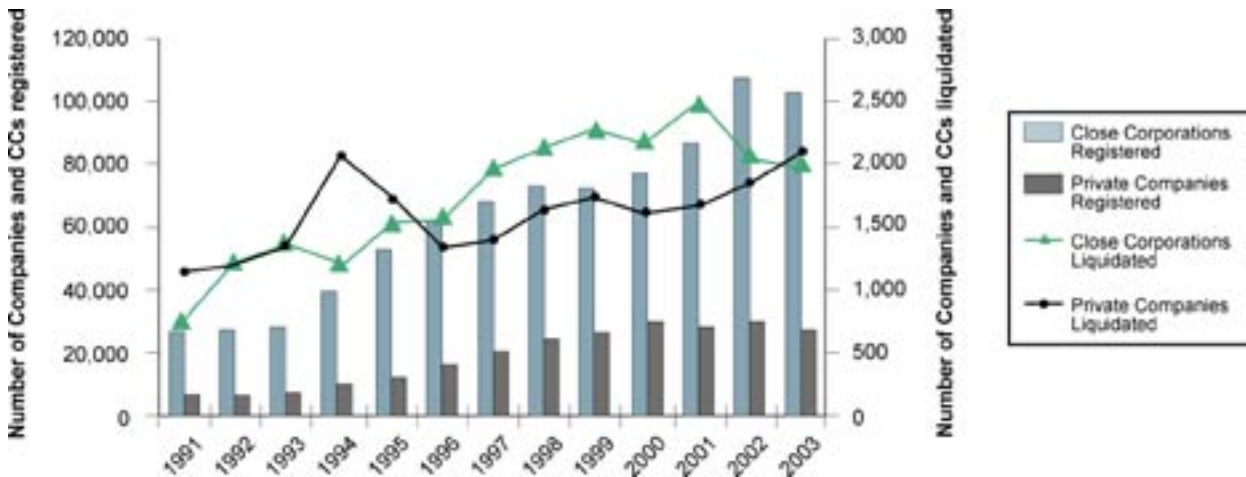
¹⁵ See, for example, Benassi (1995) or Winter (1995).

7.1 Registrations and liquidations of Close Corporations and Companies

The number of new (private) Companies and Close Corporations registered every year has increased almost steadily over the past 12 years. In the last few years, as many as 100,000 new Close Corporations and over 20,000 new Companies were registered every year. (Figure 13 suggests a slight decrease in 2003 but this may be due to the truncated year*).

Figure 13 shows that the sectors with the most new registrations are trade and services, especially financial and business services. These are also the sectors with the highest number of liquidations. However, sectors like manufacturing and construction show a higher proportion of liquidations compared to their share in total registrations. This may indicate a higher vulnerability of these industries.

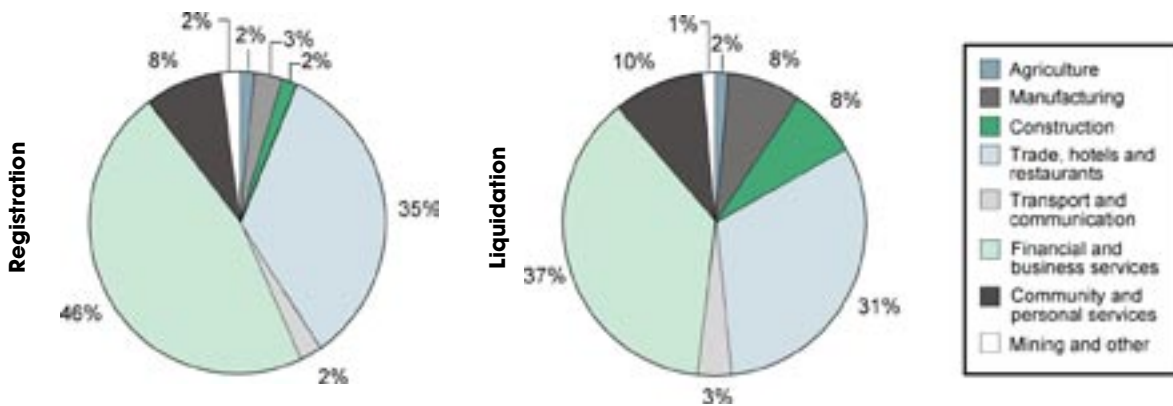
Figure 13 – Registrations and liquidations of CCs and Companies, 1991-2003



Source: Compiled from CIPRO 2004, Stats SA 2003 and Ntsika 2002

* NOTE: The number of registrations for 2003 is a preliminary figure for the year up to 24 November 2003.

Figure 14 – Registrations and liquidations of Companies and CCs by sector, 2003



Source: Compiled from CIPRO 2004

Source: Compiled from Stats SA 2004

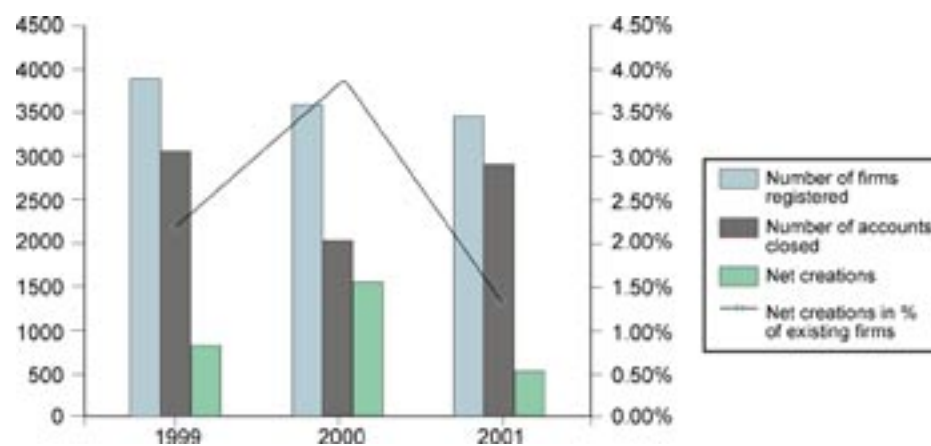
Although interesting, these statistics apply only to the top end of the small business population, namely registered corporations.

7.2 Entries and exits in Cape Town

A more representative figure is the one obtained from an analysis of the RSC Levy data of the Cape Town Unicity. The database contains about 40,000 accounts of businesses or other institutions paying levy to the Council. The analyses carried out in 2002 on the database extracts from the previous years show the level of rotation taking place within the database. Figure 15 shows that the number of new levy-payers added each year is close to 4,000, or 10% of the total database. However, exits, comprising deregistrations, liquidations and businesses becoming dormant, are almost as high. Net creations (entries minus exits) fluctuate between 1% and 4% of the total database.

It must be noted that not all levy-payers are businesses; non-business institutions (such as schools, hospitals and government institutions) are likely to have a lower turnover/rotation than businesses, therefore it can be expected that the actual turnover of businesses should be higher than the 1% to 4% shown here.

Figure 15 – Entries and exits from the base of levy-payers in Cape Town



Source: Compiled from City of Cape Town, 2002

7.3 Average lifespan of businesses

The issues of creations and closures raise the question of the life expectancy of businesses in various sectors. Again, it is difficult to obtain representative information since situations can vary a lot. From the 20,000 accounts which have, over the years, deregistered from the Cape Town levy database or been notified as dormant, about 2,500 cases have indicated a date of establishment. This enables us to analyse the duration of their life and to differentiate by sector. The result is shown in Table 21.

Table 21 – Average lifespan of deactivated accounts, by main sector

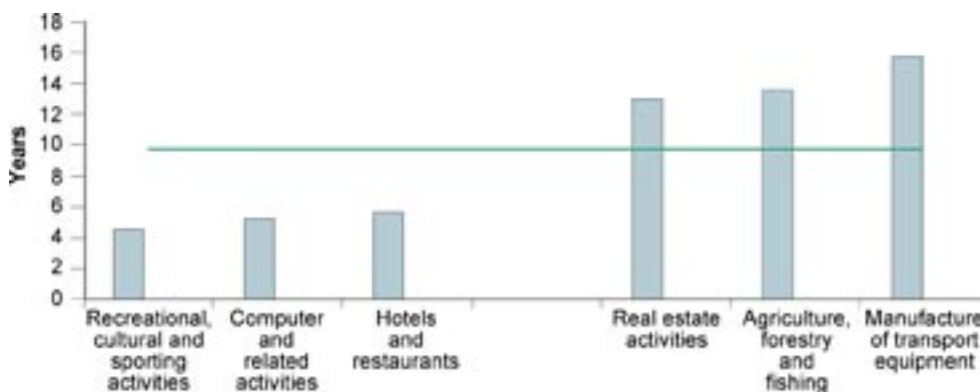
SIC	Lifespan in years	
	Average	Median
1 Agriculture, Hunting, Forestry and Fishing	13.4	6
2 Mining & Quarrying	8.6	8.6
3 Manufacturing	11.7	6.1
4 Electricity, Gas & Water Supply	2.1	2.1
5 Construction	11.8	5.1
6 Trade & Repairs, Hotels & Restaurants	9.1	5
7 Transport, Storage & Communication	8.5	5
8 Financial Intermediation, Insurance, Real Estate & Business Services	9.7	5
9 Community, Social & Personal Services	9.8	6.1
10 Other	6.2	3.1
Overall without 9 and 84*	9.6	5

Source: City of Cape Town, 2002

* The RSC Levy Database includes non-business entities, which tend to have longer lifespans than typical business enterprises. They are generally classified under the SIC codes 9 (e.g. schools, hospitals, government entities) or 84 (especially body corporates). To avoid a distortion, the sector 9 and sub-sector 84 have been excluded when calculating the cross-sector average and median lifespan.

In addition, the data enable one to look at sub-sectors specifically and single out those with the highest and lowest average lifespan, as illustrated by figure 16.

Figure 16 – Sectors with the highest and lowest lifespan¹⁶



Source: Compiled from City of Cape Town, 2002

This confirms the vulnerability of three segments – leisure, IT and restaurants – which have a life expectancy of four to five years (supposedly the real life expectancy of these sectors is even lower if one assumes that many do not even survive long enough to send their first filings to the RSC).

¹⁶ The line shows the average lifespan over the 2,500 businesses where it could be calculated.

Conversely, the sectors having the highest lifespan are not of much relevance to the small business debate – manufacturers of transport equipment are more likely to be large enterprises; real estate activities include entities such as body corporates, which are not small businesses in the classical sense; and it is quite obvious that agricultural enterprises should have a longer lifespan.

Other indicators of small business failures

The Cape Town levy database is interesting but provides only insights into the formal economy of the Cape Metropolitan Area. It is interesting to review other sources that reflect on the life expectancy of, on the one hand, informal micro businesses and on the other hand, other regions.

Micro enterprises

Unfortunately, there is very little data on the mortality rates of SA micro enterprises. However, the following finding by Rogerson & Rogerson suggests significant problems in the City of Johannesburg, especially in the informal sector:

“Property brokers and managers suggested that, of the new black businesses which opened in the inner city, between 50 and 60 percent failed to survive. The high death rate was emphasised in one interview in which it was observed that, “if a hundred companies moved in, 40 percent would have died within two months”. (Rogerson and Rogerson, 1997, p.95)

This is not necessarily representative of all micro enterprises; especially rural and possibly township-based informal micro businesses are likely to have a longer life expectancy.

Very small, small and medium

Another, more optimistic source of information regarding the risk of failure by small businesses is the recent analysis by credit information agency TransUnion ITC of their small business database. The agency reviewed the 400,000 ‘credit-active’ enterprises from databases which fulfilled the following criteria:

- Staff between five and 200;
- Turnover between R150,000 and R40m;
- Not disbanded, deregistered, failed or similar; and
- At least six months of existence.

In this sample, they evaluated the failure probability based on certain criteria found to be predictive of failure in the 2000 to 2001 period, and found that the average probability of failure¹⁷ was exactly 1%, with 42% of the SMME population having a failure rate of 0.5% or lower.

Of course, the fact that micro enterprises (less than five employees), which are dominant in numbers, were excluded from the analysis, explains the good results.

8. To what extent are small businesses growing businesses?

Small businesses are often regarded as having a better growth potential than large enterprises, hence offering some potential for economic growth and job creation. This hypothesis is difficult to verify with hard data, though. It would require tracking a representative sample of businesses over a sufficient number of years.

At this stage, the only large-scale study on turnover growth again comes from the City of Cape Town. In 2002, it reviewed the year-to-year turnover growth of its active levy-payers (2000-2001). The information was available for 18,460 entities.

Table 22 – Growth of Cape Town levy-payers, by age of business

Age:	Turnover Growth 2000-2001:						
	< -25 %	-25 to -5 %	-5 to 0 %	0 to +5 %	5 to 25 %	25 to 100 %	>100 %
< 2 years	18	16	3	8	16	25	13
2-3 years	18	11	3	3	11	25	30
4-6 years	22	17	5	5	18	23	10
7-20 years	20	18	6	6	20	21	10
> 20 years	17	19	6	6	22	22	7
Total	20	17	5	6	19	22	11
Total proportion of firms experiencing a decline: 42%			Total proportion of firms experiencing a growth: 58%				

Source: City of Cape Town, 2002

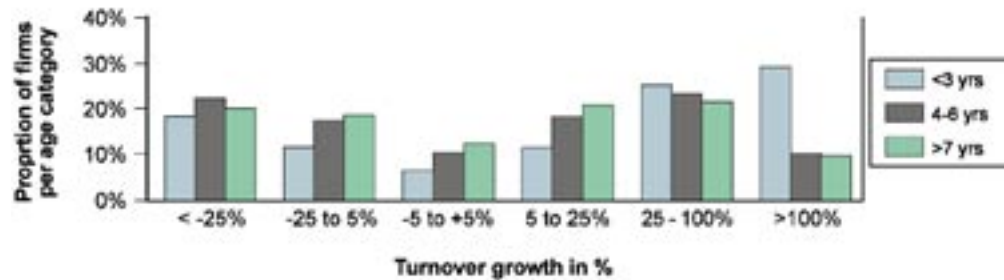
The main conclusion that can be drawn from the table is that the year-to-year turnover growth is not statistically predictable: it can take any negative or positive value throughout the lifecycle of a business. Stability is the least probable scenario; even older enterprises rarely maintain their turnover in a +/- 5% range. This is probably the biggest difference to large businesses.

Overall, the proportion of growing businesses (58%) slightly exceeds the proportion of declining businesses (42%), but there may be a survivorship bias since businesses that have been liquidated or deregistered are not considered in the analysis. In addition, the turnover figures have not been controlled for inflation.

¹⁷ Percentage of companies predicted to fail within 12 months based on the 2000/2001 statistics.

About a third of all businesses grew by 25% or more in the year 2002. This points at a relatively sound growth potential. Although the highest growth rates are found for businesses aged up to three years, even older firms can frequently sustain growth levels of 25% and higher. However, significant declines (-25% or more) remain a threat throughout the lifecycle of the business.

Figure 17 – Year-to-year turnover growth of Cape Town firms, depending on age



Source: City of Cape Town RSC Levy data, 2000 and 2001

9. Who are SA's entrepreneurs?

9.1 Population group

According to the latest LFS, employers and the self-employed represented the SA active population as follows:

Table 23 – Employers and self-employed by population group

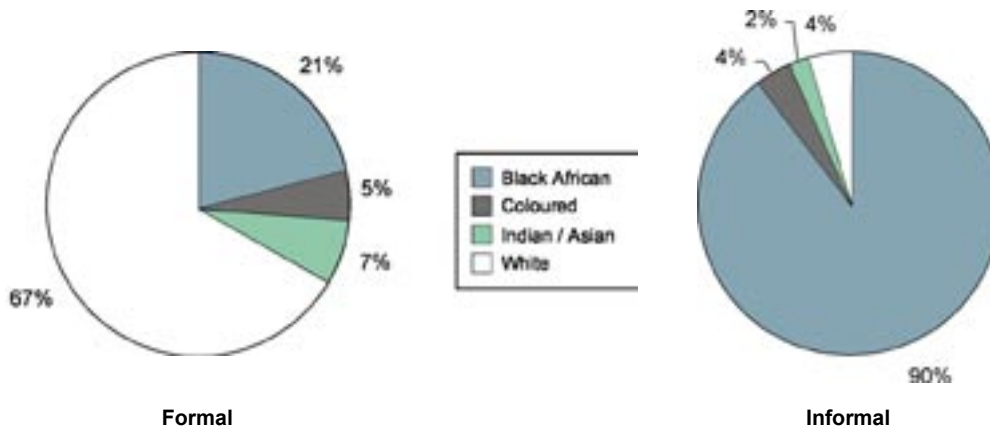
	Employers and self-employed (in '000s)			In % of economically active population		
	Formal	Informal	Total	Formal	Informal	Total
Black African	107	1,076	1,183	1	9	10
Coloured	26	45	71	1	3	4
Indian/Asian	35	21	56	6	4	10
White	336	89	425	17	4	21
Total	504	1,231	1,735	3	8	11

Source: Own calculations based on Stats SA LFS, September 2003

This table shows that Previously Disadvantaged Communities are still under-represented as entrepreneurs compared to their demographic weight. Participation in entrepreneurial activity by the Coloured population is particularly low as this population group is more often found in some form of employment. Participation by black African formal entrepreneurs, on the other hand, is also low but this is compensated by a high informal entrepreneurial activity, reflecting the difficulties many black Africans face in finding suitable employment.

Altogether the ethnic distribution of formal businesses is very different from informal ones, as illustrated in the following figure:

Figure 18 - Formal and informal businesses by ethnic background of owner



Source: Stats SA LFS, 2003

Source: Stats SA SESE Study, 2002

Formal businesses are defined here as those regarded as formal by their workers

As already mentioned, the LFS statistics have the disadvantage of allowing only one activity per person, so that it may underestimate the number of micro enterprises which are run in addition to an employment or some other form of activity. Therefore it is interesting to compare the results above with the results from the 2002 Survey of non-VAT registered businesses (SESE). If one combines the SESE statistics with the economically active population given by the LFS, the results are as follows:

Table 24 - Non-VAT registered businesses by population group

	Non-VAT registered businesses in 2002 (SESE)		Informal entrepreneurship according to LFS 2003 (%)
	In '000	In % of economically active population	
Black African	2,043	17	9
Coloured	85	5	3
Indian/Asian	53	9	4
White	99	5	4
Total	2,280	14	8

Source: Stats SA, SESE 2002 combined with LFS, September 2003

Comparing the two sources, the first finding is that informal entrepreneurship is significantly higher than suggested by the LFS – and it is higher for all population groups. However, the most significant deviations are found in the black African and in the Indian/Asian population. A plausible explanation for this is that these

population groups more frequently combine employment with an informal activity. The increased number of African entrepreneurs resulting from the SESE survey means that Africans represent 89.4% of the owners of non-VAT registered businesses, and 77% of all entrepreneurs.

9.2 Gender

As far as differences between gender are concerned, the results of the LFS are again quite different from the results obtained when using the SESE.

If one follows the LFS, the total entrepreneurship rate is the same for both genders, at 11% of the economically active population, with female entrepreneurship more often being informal. However, if one refers to informal entrepreneurship as described in the SESE, one finds that female entrepreneurship, at 20% of the active population, is significantly higher than the 15% male entrepreneurship, as illustrated in Table 25. Again, this is probably explained by a higher tendency of women to combine informal entrepreneurship with employment.

Table 25 – Employers and self-employed by gender

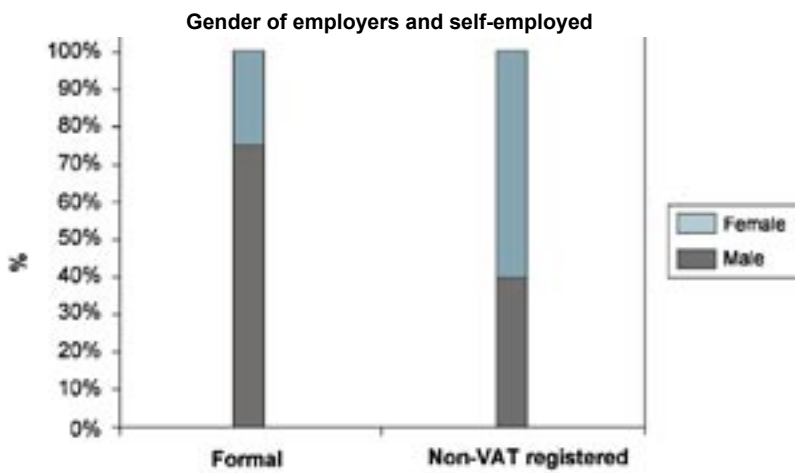
	Employers and self-employed (in '000s)				In % of economically active population				
	Formal	Informal	Total	SESE non-VAT reg	Formal	Informal	Total	Informal SESE	Total SESE*
Male	378	570	953	901	4	7	11	10	15
Female	128	664	797	1,383	2	9	11	18	20
Total	506	1,234	1,750	2,284	3	8	11	14	17

Source: Own calculations based on Stats SA LFS September 2003 and SESE 2002

* Total SESE is provided, for argument's sake, as the sum of informal entrepreneurship as resulting from the SESE survey and formal entrepreneurship as resulting from the LFS.

If one compares formal statistics from the LFS with statistics from the SESE study, the difference between formal and informal businesses in terms of the gender distribution becomes very obvious.

Figure 19 – Gender distribution of owners of formal and informal businesses



Source: Stats SA LFS, September 2003 and Stats SA SESE Survey, 2001

Hence women generally, and African women in particular, form the majority of small business owners, although they are still outnumbered by men in the formal sector.

- If one assumes that there are 2.8-million entrepreneurs overall, approximately 1.5-million (54%) are women.
- Of the 2.0-million African non-VAT-registered business owners, 1.3-million (62.6%) were women.

Women-owned businesses, although apparently more numerous than male-owned, remain weaker because they are usually smaller, less formal and operating in more vulnerable sectors, especially trade, catering and accommodation – as well as cut-make-trim (CMT, classified as manufacturing). On the other hand, construction and transport (and to a lesser extent finance) attract more men.

Table 26 shows the sectoral differences between informal male-owned and female-owned businesses.

Table 26 – Sectoral distribution of men-owned and women-owned informal businesses

Industry ¹⁸	% of male businesses	% of female businesses
Trade	58.4	76.5
Manufacture	8.1	10.1
Finance	9.4	5.8
Community	6.3	5.7
Construction	7.5	0.2
Transport	7.1	0.7
Agriculture	2.7	1.2
Other	0.4	0.1

Source: Stats SA, SESE Survey

¹⁸ Industry of main businesses of men and women running at least one non-VAT registered business.

9.3 Age group

Unfortunately, although the promotion of youth entrepreneurship, especially through the Umsobomvu Youth Fund, is an important policy priority of government, we have little statistically reliable information on the age of our business owners. The LFS and the SESE study do not include tables about this issue.

The only source of information that could be used is the 2003 GEM report, which examines entrepreneurship by age category in various regions of SA. The entrepreneurship definition used in the GEM captures only start-ups and businesses less than 3.5 years old. Unfortunately, the GEM report does not provide any indications of the age of owners of established businesses, but it is likely that these are more often owned by older people. The proportion of young people involved in start-ups and new businesses can therefore be regarded as a good approximation of total youth entrepreneurship.

Table 27 – Total entrepreneurial activity (TEA)¹⁹ by age category and region in 2002

%	18-24	25-34	35-44	45-54	55-64
Gauteng and Western Cape	7.9	10.4	11.1	9.9	5.8
Rest of SA	3.0	6.2	6.6	5.0	4.0

Source: GEM, SA Executive Report, 2003

The table shows that entrepreneurship is quite low among young people (18-24), especially in provinces other than Gauteng and the Western Cape.

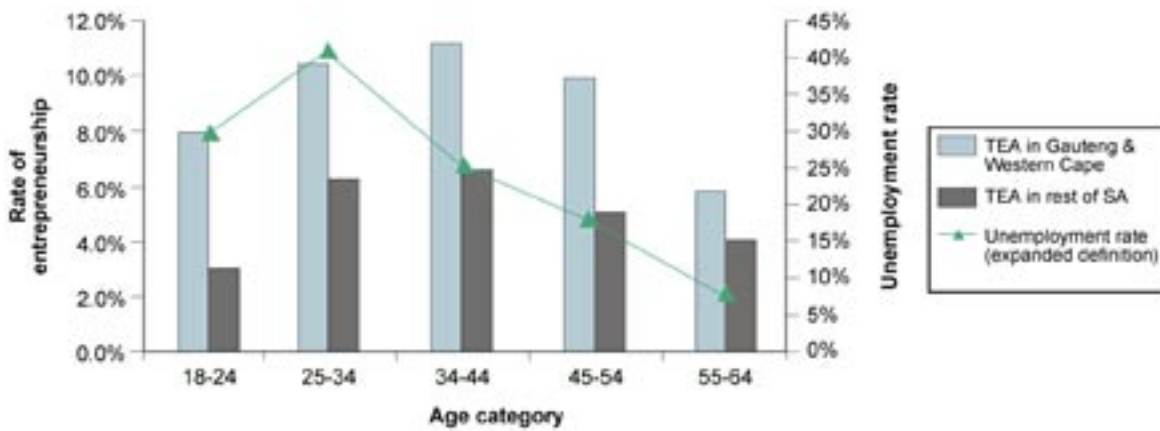
This can probably be explained by three factors:

- First, the proportion of Africans is highest among young people, hence the racial differences interact with the age factor;
- Secondly, a number of young people are not yet economically active but rather trying to improve their qualifications; and
- Thirdly, many of them probably do not feel confident enough to start a business.

It is possible that the environment in large cities like Johannesburg and Cape Town is more supportive for young entrepreneurs. Nevertheless, there is still a need to provide more support in order to absorb some of the very high youth unemployment.

¹⁹ TEA is the number of entrepreneurs divided by the population of working age, whereby entrepreneurs are defined as persons who are, on their own or with partners, either busy starting a business or running a business that has paid salaries for less than 3.5 years.

Figure 20 – Entrepreneurship and unemployment by age and region in SA, 2002²⁰



Source: Compiled from GEM 2003 and LFS September 2003

9.4 Educational level

An important policy element in stimulating youth entrepreneurship is to improve the education standards of the youth. Indeed, it is proven that entrepreneurship levels increase with education. In addition, the fact that people with a tertiary education are more likely to own established firms confirms that firms owned by entrepreneurs with better qualifications have a higher life expectancy. This is illustrated by the next table.

Table 28 – Entrepreneurial activity of South Africans according to their education

	Start-ups %	New firms %	Established firms %	Total business ownership %
Without matric	3.50	1.70	2.20	7.40
With matric only	4.80	2.30	2.50	9.60
Tertiary qualification	3.90	2.50	6.50	12.90

Source: Adapted from GEM 2002

In spite of this positive relationship between education and entrepreneurship, there is still a majority (57%) of entrepreneurs without matric. However, the rate is significantly lower than among the total population. In addition, GEM 2002 has shown that entrepreneurs with matric employ on average far more people than those without matric.

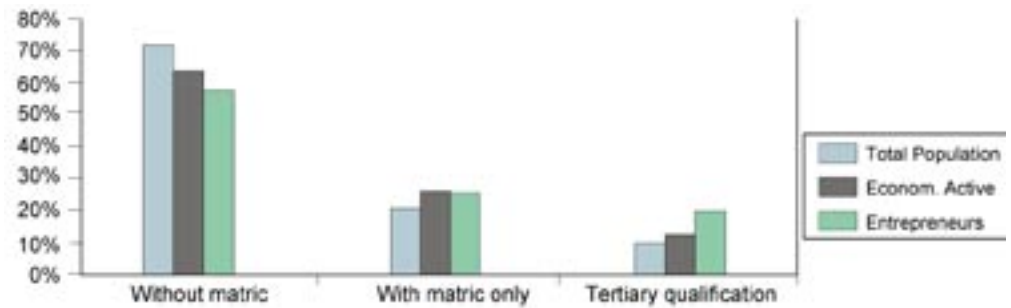
²⁰ The rate used for this figure is not strictly speaking an ‘unemployment rate’, since the number of unemployed is related to the total population and not the economically active population. Unfortunately, the LFS does not give an age breakdown of the active population.

Table 29 – Educational level of entrepreneurs compared to SA population

	Total Population		Econom. active		Entrepreneurs		Ave. no. of employees
	'000s	in %	'000s	in %	'000s	in %	
Without matric	21,112	71	12,450	62	1,240	57	0.7
With matric only	6,007	20	5,014	25	539	25	3.0
Tertiary qualification	2,638	9	2,376	12	412	19	2.9
Total	29,919	100	19,955	100	2,190	100	

Source: Compiled from GEM 2002 and LFS, September 2003

Figure 21 Educational attainment of entrepreneurs, compared to SA population



Source: Compiled from GEM 2002 and LFS September 2003

Part II: Research Features

Chapter 3



Sectoral Profile

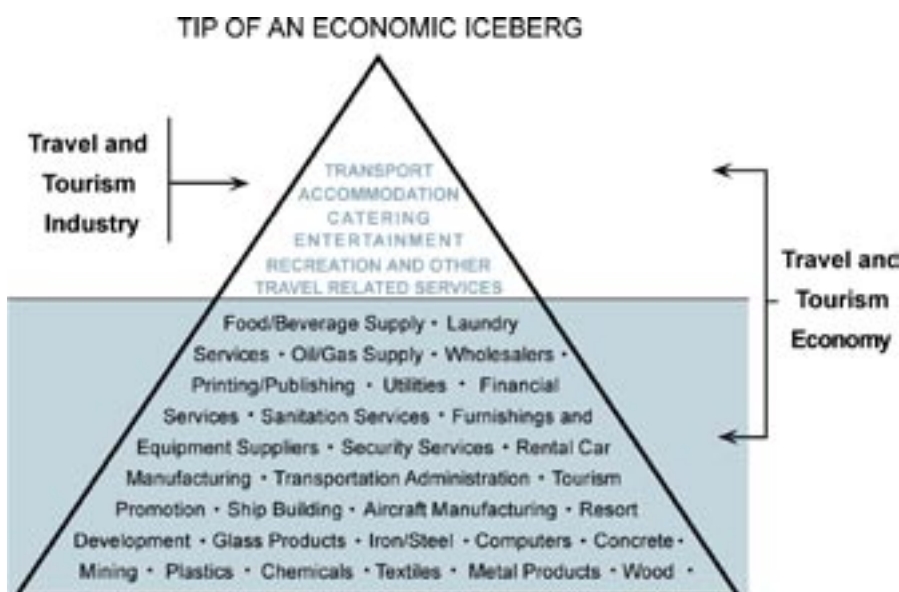
Tourism SMMEs

1. Introduction to the tourism sector

In terms of economic analysis, the tourism sector is highly distinctive in that it is not a sector that is formally classified as such in terms of the International SIC. One important consequence of this situation is that there is often considerable uncertainty around the precise boundaries of the tourism economy and how to measure its economic impact for employment creation or contribution to GDP.

The problems of definitional boundaries, data scarcity and measurement concerning tourism have been addressed in various ways. In SA, local definitions and measurement of the boundaries and impact of tourism have been influenced strongly by the system of Tourism Satellite Accounting (TSA), which follows the international standards used by the World Tourism Organisation designed to improve tourism statistics worldwide. Under this World Tourism Organisation TSA, a fundamental distinction is drawn between the narrow 'travel and tourism industry' and the broader 'travel and tourism economy'. It is evident from this conception of the boundaries of tourism that the travel and tourism industry – comprising transport, accommodation, catering, entertainment and related activities – essentially represents the tip of an economic iceberg (see Figure 22). Measurement of the economic performance of the wider travel and tourism economy needs to recognise the associated sectors in manufacturing, construction and services which are linked to and benefit from the growth of the travel and tourism industry.

Figure 22 – Two dimensions of tourism: 1) The travel and tourism industry
2) The travel and tourism economy



Source: Based on WTTC

2. The economic performance of tourism

Although the (low) statistical base is far from clear, it is evident that a marked improvement has occurred in the economic performance of the tourism sector since 1994. During the early 1990s, SA's tourism industry was in a real state of crisis, beset by several problems such as under-investment and the low numbers of international tourism arrivals, which was a legacy of sanctions and *apartheid* policies. In addition, it has been suggested that another factor behind the crisis in tourism during the late *apartheid* years was the consequence of mistakes made with past policy frameworks.

As compared to the growth and increasing economic impact of tourism in several other African countries (Egypt, Tunisia, The Gambia or Kenya), it was evident by 1994 that tourism development in SA had largely been a 'missed opportunity'. Over the past decade, new policy frameworks have been put in place – most importantly through the release of the 1996 *White Paper on the Development and Promotion of Tourism* – to maximise the opportunities for tourism to contribute to economic growth, job creation and enterprise development.

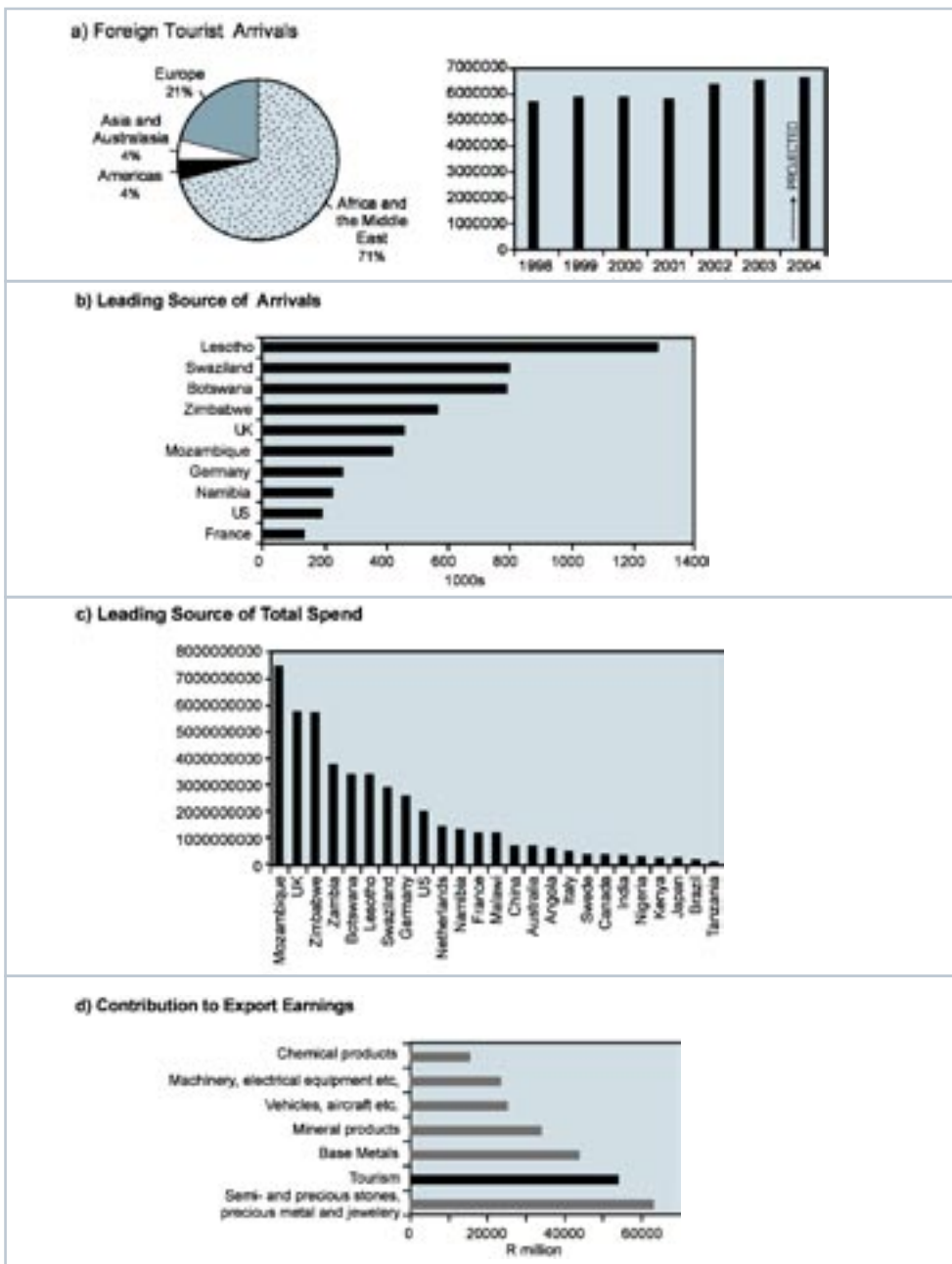
It is clear from the *Ten-Year Review* document published in 2003 by the Department of Environmental Affairs and Tourism (DEAT) that government regards the period since 1994 as one of considerable achievement, particularly in terms of the renewed growth of international tourism arrivals. At the height of SA's pariah status in the mid-1980s, international tourism arrivals were as low as 50,000 per year. Since 1993, a spectacular growth has occurred in international tourism, building upon the 'Mandela boom' associated with the new democracy, the events of September 11, the war in Iraq and subsequent international terrorism which have led to a reassessment of SA as a relatively safe destination for international travellers. Aspects of tourism's growth, economic contribution and source of foreign tourists are shown in Figures 23 and 24.

It is significant that 'regional tourists' from sub-Saharan Africa – rather than long-haul international travellers – account for a substantial share of SA's international tourism arrivals. Indeed, of the top 10 source markets for international tourists, six – Lesotho, Swaziland, Botswana, Zimbabwe, Mozambique and Namibia – are neighbouring countries. Many of these tourists are short-stay visitors (one to three days) who travel to SA for shopping, business, or to visit friends and relatives.

As the average spend per tourist differs between countries, the countries from which SA generates the highest tourism income are different from those that generate the highest number of tourists. Nevertheless, according to the most recent SA Tourism

data, six of the top 10 countries from which SA generates the most spending are, once again, regional African sources, with Mozambique ranked as number one. In total, during 2003, tourists from Mozambique, Zimbabwe, Zambia, Botswana, Lesotho and Swaziland spent R26.6bn in SA – almost half of the total income from foreign tourism.

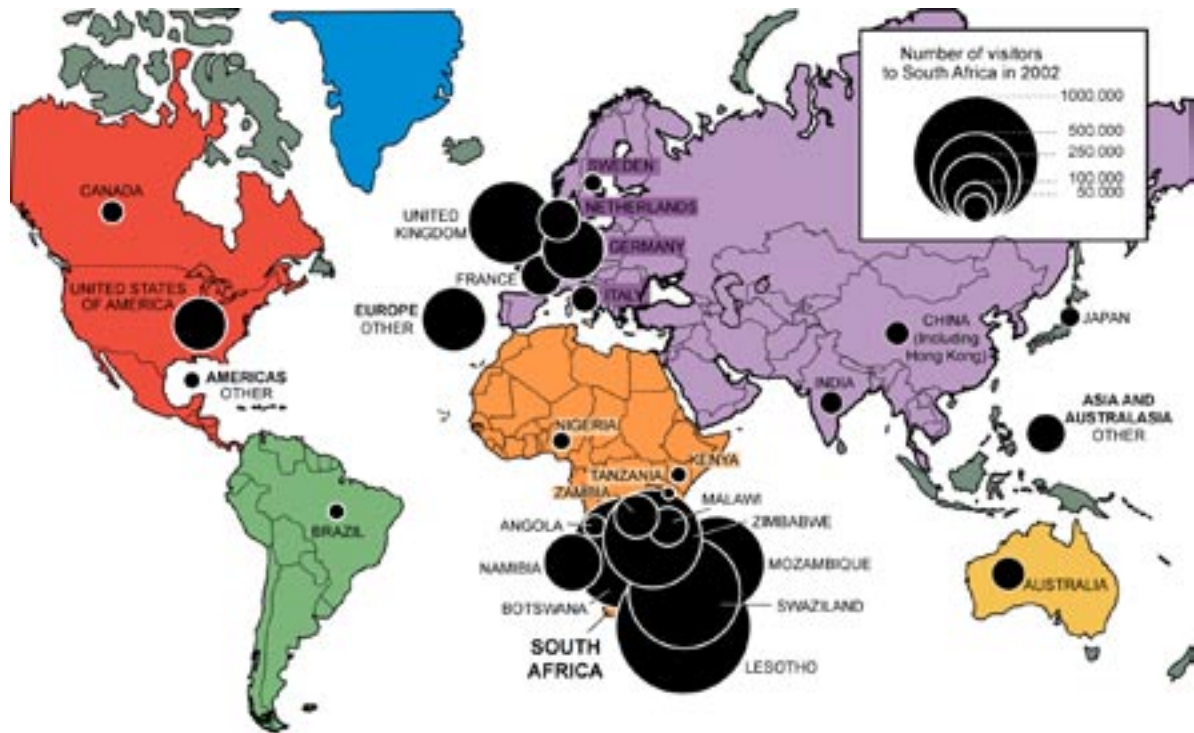
Figure 23 – Aspects of SA's tourism industry



Source: Based on data from SA Tourism

Although a large proportion of these regional African tourists are land travellers, the importance of air travel is reflected in the fact that between 1994 and 2003, the number of flights between SA and other African countries increased more than threefold. This growth in intercontinental air connections – the ‘Africanisation’ of SA’s international air transport linkages – is strongly due to rising demand for travel to SA from groups of especially business and shopping tourists.

Figure 24 – The international flows of foreign tourists to SA



Source: Based on data from SA Tourism

Finally, in terms of tourism spend, one should not lose sight of the considerable significance of domestic tourism in the SA economy. In addition to the R53.9bn spend of foreign tourists, domestic tourists accounted for a further R47bn, a fact which underlines the current importance of tourism as a source of foreign exchange, economic growth and potentially job creation and SMME development.

During 2003, the World Travel and Tourism Council (WTTC) estimated tourism in SA’s total current and anticipated economic contribution as follows:

▪ **Gross Domestic Product**

The Travel and Tourism Industry was forecast to contribute 2.9% to GDP in 2003, rising to 3.6% by 2013. The Travel and Tourism Economy was forecast to contribute 7.3% to GDP in 2003, growing to 8.8% by 2013.

- **Employment**

The Travel and Tourism Industry in 2003 accounted for 491,741 jobs or 2.9% of total employment. By 2013 this is forecast to expand to 751,100 jobs or 3.7% of the national total in a decade's time.

Employment in the broader Travel and Tourism Economy in 2003 was estimated as 1,118,530 jobs, 6.6% of total employment, or one in every 15.2 jobs. By 2013, the WTTC has forecast (perhaps over-optimistically) such employment to escalate to 1,650,140 jobs, 8.2% of total employment or one in every 12.2 jobs.

- **Exports**

In 2003, Travel and Tourism was forecast to generate 12.1% of total exports, growing to 14.6% of total exports by 2013. According to SA tourism data, the international tourist spend during 2003 of R53.9bn exceeded the export earnings of critical export categories such as vehicles, mineral exports and base metals, as well as net gold exports (R35.3bn).

Set against these impressive results are the findings of a recent, more critical external evaluation produced by the WTTC. This study suggests that, notwithstanding considerable post-1994 progress, the actual performance of tourism during the period 1994 to 2003 has been somewhat disappointing, as it certainly has not lived up to the optimistic and aggressive targets set in 1996. The WTTC stresses that the major disappointments relate to tourism's performance in terms of job creation and small business development. The Council argued that SA's travel and tourism economy has not yet met earlier promises to generate employment "at the speed of light", or to extend development opportunities to the farthest reaches of the nation. Despite this criticism, the WTTC firmly believes that future prospects for the sector "remain extraordinary". Further optimism and hype have been generated for tourism development by SA's successful bid for the 2010 Soccer World Cup.

3. Tourism SMMEs

3.1 Definition and structure

The definition of a 'tourism SMME' is open to debate, as it must relate to the boundaries of the tourism economy. Theoretically, the definition of tourism SMME should include those SMME operations which fall within the scope of the travel and tourism economy as well as those operating within the travel and tourism industry. For example, a small laundry business that mainly services the needs of a large hotel, a specialist producer of furniture for game lodges, or an exclusive producer of clothing geared for the tourism industry would fall within the widest definition of a tourism SMME. In practical terms, however, the analysis of tourism SMMEs is confined more narrowly to those particular enterprises operating within the bounds of the travel and tourism industry as such.

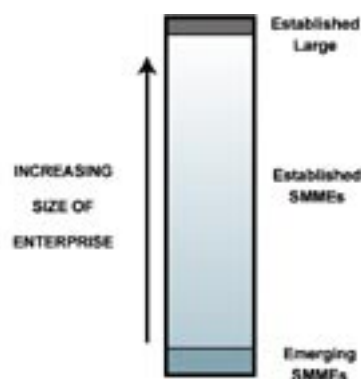
Structurally, SA's travel and tourism industry is highly concentrated and dominated by a small, elite group of large, mostly locally owned, tourism organisations. In the accommodation sub-sector, the leading enterprises are Sun International, Protea Hotels and Southern Sun Hotels, whereas in travel and touring the importance of Rennies Travel, Thompsons Tours, Avis or Imperial Car Rental, among others, must be highlighted. Although these large companies drive and economically dominate the SA tourism industry, it remains that the vast majority of SA tourism enterprises – as in most countries – would be classed as SMMEs. Indeed, as an economic sector, one of the most distinctive features of tourism is the overwhelming pre-eminence of small-scale entrepreneurship. In the United Kingdom (UK), 99% of enterprises in the travel and tourism industry would be classed as SMMEs and in Australia 95% would be classed as small or micro enterprises. Accurate data on the number of SMMEs in the SA tourism economy is unavailable; one study conducted in the Free State Province showed that at least 97% of enterprises in the province's travel and tour industry are SMMEs. On the basis of this evidence, there is little reason to suggest that the structure of the SA tourism industry is markedly different to that of Australia or the UK and that SMMEs represent at least 97% of existing tourism enterprises in SA.

In the experience of many developing world countries, large-firm dominance of the travel and tourism industry produces a marginalisation of small firms and their clustering in peripheral and low-profit niche areas of the tourism economy. The SA tourism economy can be conceptualised as a three-tiered hierarchy of enterprises. At the apex are the operations of the larger established groups of enterprises, which are responsible for, *inter alia*, the country's major travel and tour agencies, transportation, hotels, casinos and conference centres. The greatest proportion of the business hierarchy, however, is represented by the activities of at least two different kinds of SMMEs. The middle tier is formed by groups of established, almost predominantly white-owned, SMMEs which operate a host of different establishments – from travel and touring companies, restaurants, small hotels, self-catering concerns and resorts to game farms, bed-and-breakfasts or backpacking hostels. The lowest tier in the SA travel and tourism industry is represented by the emerging black-owned tourism economy, which constitutes a mix of formally registered micro enterprises as well as a mass of informal tourism enterprises.

What is not fully clear (due to the absence of reliable statistics) is the actual shape of this hierarchy as determined by numbers of established versus emerging enterprises (*see Figure 25*). Although there is evidence suggesting that a burst of emerging black-owned enterprises has occurred in the post-1994 period, encouraged by potential opportunities offered by SA's hosting of mega-events such as the World Summit on Sustainable Development in 2002, it is clear that in many niches of the travel and tourism economy – such as the provision of small-scale accommodation – there is a continual numerical dominance by the established groups of white-owned SMMEs. For example, one

estimate for 2002 patterns concerning the ownership of the country's bed-and-breakfast economy suggested that less than 5% of establishments were black owned. The different locations from which white and black bed-and-breakfast establishments operate mean that these businesses to some extent function in geographically segmented markets. In the case of travel and tour operators, however, beyond the markets of township tourism, there is direct competition between established and emerging SMME enterprises as well as the larger tour operators for this market. From a recent study of tourism SMMEs in the Free State Province, it was estimated that emerging SMMEs represent at most 7% of the current profile of tourism SMMEs in the province.

Figure 25 – The three different kinds of enterprises in the SA tourism economy



3.2 Lifestyle entrepreneurship

A distinguishing feature of tourism is that it often represents an important focus for 'lifestyle entrepreneurship', in terms of which economic motives are matched by non-economic personal and environmental factors to encourage the start-up of tourism small businesses, particularly in the operation of bed-and-breakfast accommodation or small guest houses. Certainly, the importance of 'lifestyle' factors is recorded in findings concerning the motivations of many white entrepreneurs running guest houses and other small-scale forms of accommodation in the Western Cape, the KwaZulu-Natal Midlands and the Free State. By contrast, economic motives represent the basis for development of the emerging tourism SMME economy, which includes – particularly in rural areas such as the Wild Coast – many small tourism entrepreneurs operating at the barest levels of economic survival.

3.3 Industry transformation and policy priorities

The transformation of the tourism industry has been identified as a priority for national government and formalised in the signing of a *Charter of Empowerment and Transformation* for the tourism industry in June 2001. The goals of BEE in SA

tourism are being achieved partly through equity shares granted in existing large travel and tourism enterprise, such as Southern Sun Hotels. In addition to the opening up of opportunities through skills training and infrastructural provision in undeveloped areas of tourism potential, an important policy focus has been to develop new tourism products which link, for example, to opportunities that are opening with tourism product development in cultural tourism or township tourism. In search of meaningful transformation, however, greatest significance attaches to the promotion of black ownership through the support of new emerging small tourism enterprises, especially in the travel and tour sector and in the provision of accommodation.

The most recent addition to national government's policy arsenal has been the publication of the *Responsible Tourism Guidelines* in 2002, which has subsequently been reworked into the *Responsible Tourism Handbook: A Guide to Good Practice for Tourism Operators*. These guidelines include a series of quantified targets for the tourism sector as a means of addressing the objectives of the 1996 *White Paper* in relation to the triple bottom line of sustainable development (economic, environmental and social sustainability). For example, in terms of prioritising opportunities for local communities, three significant guidelines are flagged for the private sector to engage in responsible tourism. First is to develop partnerships and joint ventures in which communities have a significant stake and, with appropriate capacity building, a substantial role in management. Such partnerships should take note of the fact that communal land ownership can provide equity in local enterprises. Secondly, enterprises should recruit and employ staff in an equitable and transparent manner and maximise the proportion of staff employed from the local community, once again setting targets for increasing the proportion of staff and/or of the enterprise wage bill going to communities within 20 kilometres of the enterprise.

Finally – and most importantly for tourism SMME development – established private sector enterprises should buy locally made goods and use locally provided services from locally owned SMMEs wherever quality, quantity and consistency permit. In addition, they should monitor the proportion of goods and services that the enterprise sources from businesses within a 50km radius and set a 20% target for improvement over three years. These responsible tourism guidelines offer a potentially important future stimulus for SMME development in the travel and tourism economy as a whole.

4. Growth constraints on tourism SMMEs

Recent research discloses that different sets of growth constraints impinge upon the development of different kinds of tourism SMMEs. In particular, there are certain differences between the growth constraints that affect established as opposed to emerging SMMEs.

4.1 Established SMMEs

4.1.1 Critical advantages

The group of established SMMEs in tourism enjoys a number of critical advantages over its emerging counterparts, which relate to the volume of its capital on the one hand and advantages in accessing and processing relevant information about the tourism market on the other. Among the most significant of these advantages are several factors which have also been recognised in developing countries where the most successful small-scale tourism entrepreneurs are often 'non-locals', as is the case in many parts of Latin America and Asia.

- Established SMME entrepreneurs enjoy advantages in terms of **access to capital**. Often the tourism SMME is linked to alternative sources of income, such as farming (agro-tourism or farm tourism) or other income-generating activities. In the case of retirement 'lifestyle entrepreneurs', these are often especially well-capitalised businesses through the asset base of the entrepreneur.
- In addition to economic capital, established entrepreneurs often enjoy high levels of **social capital** in terms of access to networks, sources of information and data to support their tourism businesses. High levels of social capital are frequently enhanced by the high levels of education of these entrepreneurs.
- Finally, established entrepreneurs potentially enjoy advantages in terms of their **cultural capital**, represented by their language proficiencies for dealing with different types of tourists (both domestic and international), a general awareness of the tourism market (albeit not always acquired through formal training) and sound acquired knowledge of the 'tastes' and 'experiences' generally sought by large segments of the tourism market.

In terms of the changing priorities for transformation, the growth constraints that face established SMMEs in the SA tourism economy are relatively little researched compared to an increasing body of work on the emerging SMME economy. During 2003, however, a survey was completed on the profile and issues confronting established tourism entrepreneurs in the Free State Province.

4.1.2 Profile and early development

The key findings of this study in relation to other earlier research concerning the profile and early development of enterprises were as follows:

- Established SMMEs overwhelmingly dominate the local tourism market, for example, in terms of the provision of different forms of accommodation, conferencing, farm visits or game lodges.
- There is a high level of female involvement – either as sole or joint proprietors of SMME tourism enterprises.
- Tourism SMME entrepreneurship is largely the domain of middle-aged or retirement-aged persons; the majority of entrepreneurs were 50 years or older.
- The majority of entrepreneurs had moved into tourism from prior work in other economic sectors.
- ‘Lifestyle’ factors are important motivations for the start-up and operations of these tourism businesses, with a household decision to fulfil the desire to run a tourism business living in pleasant countryside surroundings.
- Although many established tourism SMMEs have been in operation pre-1994, there has been a surge of new business development to take advantage of opportunities linked to the tourism boom of the post-1994 period.
- Start-up business capital is overwhelmingly derived from own sources and this group of entrepreneurs does not consider access to capital a constraint.
- At start-up, the core problem of these entrepreneurs related to marketing their accommodation establishments and more generally of ‘getting known’ in terms of their operations to the market groups of primarily domestic business and leisure tourists.
- The positive recent performance of these tourism businesses was reflected in the injection of new capital into many of these businesses. During the previous year, nearly two-thirds of entrepreneurs had invested new capital into their businesses via retained profits, mostly for the upgrading of existing or addition of new facilities, and in some cases the purchase of new property for development as a tourism product.

4.1.3 Growth constraints

The key findings in terms of the constraints upon the growth of these established tourism businesses relate to the following cluster of issues:

- As tourism is a marketing-intensive sector, it is not surprising that the most significant concerns of established entrepreneurs relate to the volume and quality of tourism marketing at national and especially provincial levels. In particular, the survey interviewees stressed that the Province was not reaching its potential for tourism because of the **poor state of existing tourism marketing** and of the under-marketing of tourism products and attractions in the province. Entrepreneurs widely condemned the “under-marketing”, the “lack of professionalism”, the “lack of organisation” and the “lack of imagination” in provincial tourism marketing. Equal criticism was directed at the state of many local tourism offices which were perceived as “unfriendly” or “lacking any muscle”.
- For smaller tourism SMME entrepreneurs, in particular those with only a few rooms in a bed-and-breakfast or small guest house, the disappointments concerning the poor state of official marketing often were felt strongly because of the escalating costs of private marketing in certain guidebooks, such as the *Portfolio of Country Places* guides or *Getaway* magazine.
- **‘Excessive’ or ‘unnecessary’ regulations** imposed by national, provincial and local authorities upon business development and which are negatively affecting the current state of tourism businesses were identified as a second important group of constraints. Among these regulatory issues, the most prominent concerns relate to constraints upon businesses from signage restrictions and regulations (which in the Free State Province were formulated in the 1940s), labour regulations and costs for zoning applications.
- A third group of growth constraints relate to issues of **infrastructural development** for the tourism economy, in terms of both human and physical infrastructure. Many entrepreneurs stressed the importance of human resource development and the need for improved skills training programmes to support momentum for the further development of tourism and the hospitality industry. Inadequate training facilities and inadequate trained labour were identified as potential blockages upon future business development. Further, entrepreneurs flagged the long-term importance of maintaining, upgrading and strengthening the existing physical infrastructure for tourism in terms of roads, air linkages and basic provision for reliable electricity and water supplies.
- The fourth set of issues that was highlighted by established entrepreneurs in the Free State study concerns the difficulties of **accessing assistance from available national government support programmes**, in part because of their

bureaucratic procedures and in part due to a lack of information on potential sources for support. The lack of information was often linked to the weakness of local authorities in general and of their understanding of the issues facing tourism development at a locality level. Of the small number of SMME entrepreneurs that sought to access financing through **the dti's** programmes, such as the SMEDP²¹, the results had been disappointing. Applicants complained that despite receiving acknowledgements from **the dti** of grant applications, no further communications were ever received, even after periods of up to 18 to 24 months. Other frustrated entrepreneurs bemoaned the 'red tape', excessive bureaucracy and paper work that surrounded applications for national government support initiatives.

4.2 Emerging SMMEs

It must be appreciated that, collectively, the group of emerging SMMEs operates at a disadvantage with respect to both the enormous market power enjoyed by large tourism enterprises and the advantages of economic, social and cultural capital of established SMMEs. The competition offered by established tourism businesses – both large and small – is clearly a major constraint upon the development of emerging businesses. This is well illustrated by the experience of emerging entrepreneurs in the travel and tour industry of Gauteng (*see Box 1*).

BOX 1 – A TALE OF TWO EMERGING TRAVEL OPERATORS

Cruiserline Vhupo Tours and Queen's Tours are typical of the new breed of tourism entrepreneurs emerging in township areas – and a key target for support under new national government policy initiatives for transformation.

Case Study 1: Cruiserline Vhupo Tours in Soweto

Cruiserline Vhupo Tours operates from the home of its co-owners, 40-year old Catherine Luthaga and 44-year old David Luthaga in Orlando West, Soweto. Both are relatively well educated. Both matriculated, with David holding diplomas in labour relations and management from the Damelin Education Group, while Catherine has completed two management courses at Damelin-Eden College and Damelin. David worked as a Personnel Officer for Coca Cola before he started his own minibus taxi business. Because of violence in the taxi industry he decided to leave the industry, selling the taxis and starting up the tour business by purchasing a bus that could be hired for national touring purposes.

Although the business has been in operation since 1994, it was only officially registered in 2000. Currently, the business is the household's major source of income, alongside a bed-and-breakfast establishment that Catherine operates. Cruiserline Vhupo has one 60-seater bus used mainly for national tours and two micro-buses, and employs three full-time people – two drivers and a mechanic. Typically, the business of running a tour company has been learned on the job and the owner is only now undergoing formal

²¹ Small, Medium Enterprise Development Programme

tour guide training. At the outset of the business, after the owner sold his taxis, the major problem he faced was that of marketing the company. He has been able to access minor support for business development from the Gauteng Tourism Authority (for brochures and business cards); similarly the Tourism Enterprise Programme provided financial support (R800) towards him attending a training workshop.

The business is now fully operational and has seen growth in the number of new clients over the last year, as well as return customers. 80% of the enterprise's business consists of the 'Soweto experience' – packaged trips to Soweto which include a tour, a meal and a visit to clubs. The other 20% is made up of individual tours to a variety of domestic destinations as well as airport transfers. David considers expanding access to market opportunities, through advertising – particularly to overseas travellers – as the major problems currently facing the business. At present, 75% of Cruiserline Vhupo Tours clientele are international rather than domestic tourists. In terms of marketing, David has attended a number of local exhibitions, including SA Tourism's annual INDABA in Durban, exhibitions at the Sandton Convention Centre and an exhibition in 1999 in the Netherlands from which he still receives business nearly five years later.

David sees the most important constraints on business development as twofold – “the dominance of the industry by white operators and the lack of associations to represent the interests of black tour operators”. Although he concedes that “doors are opening and the future seems bright” for black tour operators, access to finance for the purchase of new buses is a key factor hindering growth. In terms of business improvement, in addition to access to finance, David would like the larger tour operators, such as Thompsons Tours, to act as mentors to emerging travel and tour companies such as Cruiserline Vhupo.

Case Study 2: Queen's Tours

Queen's Tours is a home-based touring business which operates from Spruitview in Ekurhuleni. The owners are two women entrepreneurs – 45-year old Queen Makgopo and her partner, 35-year old Cecilia Mlangeni. Both women have matriculated and have a Diploma in Tourism from Birnam Business College as a post-matric qualification. Prior to running a tour enterprise, both women worked in a travel agency – one for 12 years – through which they learnt the basics of the tourism industry. Queen's Tours was started in 2001 with the purchase of vehicles from pension fund payouts. Currently, the company has two vehicles – a sedan and a kombi – hires other vehicles if required and employs three people on a freelance basis. The partners' knowledge of the tourism industry is based upon their job experience of working in the travel agency, supplemented by a short course in tour guiding.

The major challenges the enterprise faced at start-up were issues of financing and of marketing the business. These problems continue; it is said that business has dropped by as much as 50% during the last year. This downturn prompted the comment that tourism “is over-publicised” and “raises hopes for everyone” but that there is “not much in it”. Disappointment has also been expressed around the limited business the enterprise secured from the World Summit on Sustainable Development for which “they were prepared” – which leads them to be somewhat sceptical about the projected benefits that might flow from the 2010 World Cup.

The partners are of the opinion that running a tour business is particularly difficult for women – since many clients do not feel secure, the two women use men to operate the actual tours on their behalf. In their opinion, the market for travel and tour operators in Gauteng is “flooded” and “white dominated”. In an effort to improve their international client base, support for further international marketing and exposure is sought. The major preferred destinations are Soweto and Sun City, as well as cultural tours and airport transfers. They do not do ‘safari tours’, which they consider as ‘white-dominated’ and a form of tour about which they have little knowledge. Looking to the future, despite existing difficulties, these two entrepreneurs are confident that Queen’s Tours would grow as a business. They also stress that for black tour operators to be more successful in a market “flooded” and “throttled” by large companies, a degree of government intervention is essential. They suggest that partnerships, which include mentorships, should be formed between large established operators and small businesses to assist emerging SMMEs to “stand on their own”.

In rural areas, the opportunities for successful tourism entrepreneurship are further reduced by problems of infrastructural deficiencies for tourism development, in terms of both human and physical resources. For example, because of the numerous problems that face contemporary tourism entrepreneurs in the Wild Coast – although it is an area of considerable potential for tourism growth – much of the emerging rural tourism entrepreneurship here operates at bare survival levels and approximates a situation of ‘forced’ or necessity entrepreneurship (*see Box 2*). Indeed, the situation of rural tourism entrepreneurs offers the sharpest contrast to the findings concerning the growth constraints upon established tourism SMMEs.

BOX 2 – RURAL TOURISM SMME DEVELOPMENT IN THE WILD COAST

104 rural tourism entrepreneurs operating in the Wild Coast area were interviewed during 2000. The objectives were to understand the nature of rural tourism enterprise and entrepreneurs, and to determine the key constraints on enterprises and the support needs of entrepreneurs. The term ‘tourism SMME’ here refers to the travel and tourism economy as a whole and included a range of enterprises, from informal enterprises to registered SMMEs with up to 49 employees. Overall, a profile emerges of a largely survivalist informal sector of emerging tourism SMMEs.

Key findings were as follows:

- The largest groups of tourism SMMEs in the Wild Coast are involved in handicrafts production and selling (36%), fishing (30%) and accommodation provision (21%).
- In terms of age of enterprise, the largest share of enterprises has been established post-1994. In part this reflects a growth in rural tourism business and income opportunities linked to tourism development along the Wild Coast (especially with the implementation of the SDI²²) but also strongly points to deficiencies in labour absorption in the formal economy.
- The importance of push factors in tourism entrepreneurship is reflected in the fact that 85% of entrepreneurs had no previous experience of the tourism sector, 96% had received no training in tourism and 53% were unemployed prior to setting up the SMME
- Only one-third of tourism entrepreneurs had completed secondary schooling and almost half of entrepreneurs had completed only a primary education qualification.
- Rural tourism entrepreneurs identified a lack of demand and of access to finance as the most important problems they faced at start-up of their enterprises.
- For both start-up and working capital, the most important sources of finance were personal savings and gifts from friends/relatives. No entrepreneur had received any financial support from any government programmes.
- Major financial needs were expressed in terms of meeting household needs rather than for business development, an indication of the essentially survivalist nature of rural tourism SMMEs in the Wild Coast.

²² Spatial Development Initiative

- Most tourism entrepreneurs identified limited access to markets and marketing of their enterprises, as well as issues around crime, safety and security, as constraints upon business development. The seasonal nature of tourism in the Wild Coast means that many rural tourism entrepreneurs need to have alternative income sources.
- Few business linkages were forged by the majority of rural tourism enterprises with the larger formal tourism enterprises operating in the Wild Coast area.
- Lack of or poor infrastructure is clearly a major constraint upon the entire rural tourism economy of the Wild Coast. The government is starting to deal with the provision of tourism infrastructure through programmes or initiatives such as Spatial Development Initiatives (SDIs) and the Priority Areas for Tourism Infrastructure Investment and Poverty Relief Fund.
- Lack of information and access to information are further critical constraints; in terms of access to business information, the majority of entrepreneurs relied on word of mouth or had no sources of business information.
- The most commonly expressed support requirement related to the need to access larger markets (more tourists), with financial support identified as the second most important requirement.

In terms of understanding the problems facing emerging urban SMME entrepreneurs, the best evidence comes from a number of recent studies that have interrogated the difficulties of emerging tourism SMMEs in the accommodation sub-sector – currently one of the priority targets for government’s transformation policies. The findings show certain similarities to the problems facing established SMMEs but also a number of differences, and in general, a sharp divide between the issues confronting emerging urban-based and rural tourism entrepreneurs.

- The spatial pattern of emerging black-owned, small-scale accommodation establishments shows that they are largely confined to the *apartheid*-designated spaces of townships, with the largest clusters found in Soweto, Khayelitsha and Inanda. This distinctive geography offers opportunities, but at the same time imposes considerable limits upon the growth of these establishments. These emerging SMMEs are confined by geography to the specialised niche of ‘township tourism’ and thus do not attract the wider mix of business and leisure tourists that visit the parallel accommodation establishments operated by established SMME entrepreneurs.

- Features of similarity relate to the new surge of establishment growth post-1994, high levels of women entrepreneurship and a striking parallel in terms of a high proportion of entrepreneurs over the age of 50.
- ‘Lifestyle’ entrepreneurship is not a feature of the emerging SMME economy, in which economic motives for business operation are paramount.
- Education levels of emerging tourism SMME entrepreneurs are relatively high, with many entrepreneurs having tertiary qualifications and several former nurses and teachers amongst the ranks of new tourism entrepreneurs.
- Unlike the situation observed among rural tourism entrepreneurs in the Wild Coast, the majority of these tourism SMMEs were launched as a result of perceived market opportunities rather than as a result of a desperate search for survivalist incomes due to unemployment or retrenchment. The majority of the surveyed entrepreneurs could be classed as ‘opportunistic’ in the sense of initiating their businesses in response to perceived market opportunities and the observed increased flow of visitors to townships. Other factors which led to business start-ups were entrepreneurs’ (mainly women’s) interest or involvement in catering, entrepreneurs’ actual experience of travelling and of ‘being a tourist’, and prior experience of formal work in the tourism industry.
- As most start-up finance was drawn from own funds, there is a parallel between these entrepreneurs and the group of established entrepreneurs in terms of marketing their businesses as being the core problem at start-up of business.
- In line with the upturn in tourism as whole, many emerging township SMMEs offering bed-and-breakfast accommodation are reporting flows of repeat visitors due to enhanced enterprise marketing and improvement or upgrading of their premises. At the same time, there are increasing complaints of ‘market saturation’ in terms of the numbers of such establishments which opened – especially around 2002 to capture potential visitor flows from the World Summit on Sustainable Development.
- The major constraint identified for their business development was the need to improve the marketing of their businesses individually and the marketing of townships as new spaces for tourism products and activities on a collective basis.

- The need for financial assistance to assist with the upgrading of accommodation facilities, particularly to respond to the demands of discerning international tourists, is a second important growth constraint. Unlike the position of established SMMEs, which finance upgrading of their premises from retained earnings, such capacity for financing extensions currently does not exist for most emerging SMMEs.
- A lack of assistance for skills upgrading – both in terms of awareness of the tourism industry and of advice, information and skills for running a business – is a further key constraint upon business development.
- Finally, in common with the group of established SMMEs, the emerging tourism SMMEs complained of poor access to and outreach of national government support programmes, particularly concerning financing support for marketing, training and the upgrading of premises.

5. Support initiatives for tourism SMME development

It is evident that the support needs of SMMEs operating in the tourism economy are far from homogeneous. It is essential, therefore, that different forms of support interventions be developed for and targeted at different groups of SMMEs in SA tourism. Recent support programmes from national government and from the private sector for tourism SMME development are following this general direction and moving away from the notion that ‘one size fits all’ in terms of business development support and financing.

5.1 The Tourism Enterprise Programme (TEP) - The DEAT²³ flagship

The TEP, which has been largely financed through the private sector Business Trust, represents an important player in terms of funding support for tourism SMME development in SA. The TEP falls within the policy vehicle of the national government’s Tourism Action Plan and as such it represents a component of a larger and longer-term strategy to both attract and effectively cater for expected growth in domestic and international tourism. The TEP’s stated goal is to facilitate growth and expansion of SMMEs in the tourism economy, with the wider aim of achieving job creation and income-generating opportunities.

²³ Department of Environmental Affairs and Tourism.

The TEP works with SMMEs which are predominantly but not exclusively owned and operated by previously disadvantaged individuals (PDIs). In order to qualify for TEP funding, the enterprise should meet the following criteria:

- Have an annual turnover not exceeding R25m;
- Have total assets, including fixed property, of less than R10m;
- Employ less than 200 people; and
- Have been in operation for a minimum of two years.

The TEP approach is **demand driven** towards identifying, facilitating and ultimately fostering commercially viable business opportunities between enterprises and other related buyer, supplier, partner and investor firms and corporations linked to the tourism sector. The TEP focuses on the upgrading of existing businesses rather than the creation of new tourism businesses. The core support activities that are offered are indirect financial support to tourism SMME development rather than direct funding support. The funding offered by the TEP to prospective tourism SMME clients is on a cost-sharing basis. Activities that can be supported partially include assistance with identification of viable linkages or business opportunities; marketing assistance for events; development of business and marketing plans; training, tender support and advice; and identification of service providers.

The primary emphasis in the TEP is upon support which is channelled towards historically disadvantaged SMME entrepreneurs. The TEP has been involved in the following types of capacity building and linkages:

- Upgrading the status of homestays/bed-and-breakfast establishments that registered with the Tourism Grading Council of SA during the World Summit;
- Assisting SA National Parks with possible outsourcing requirements to SMMEs;
- Assisting an SMME with tender advice which helped it to win a multi-year cleaning contract on Robben Island; and
- ‘Introducing’ an SMME to the procurement department at the DEAT with the result that the enterprise was awarded a contract for travel management.

During 2003, as a result of an internal review of support programmes, the DEAT provided direct funding to support TEP activities. This includes the DEAT/TEP SMME Development Programme – a project funded by the DEAT and implemented by the TEP and which aims to co-ordinate and facilitate tourism SMME development with and within the provinces. The programme involves assisting SMMEs with marketing, training and development. Overall, these activities complement the core objectives of the TEP, although they are broader and more systemic in nature.

5.2 Pro-poor tourism pilots in Southern Africa

Pro-poor tourism is “tourism that generates net benefits to the poor” and seeks to “ensure that tourism growth contributes to poverty reduction”. An essential component of pro-poor tourism is support for tourism SMME development. In September 2002, a new programme of Pro-Poor Tourism pilots was launched in Southern Africa with support from the UK Overseas Development Institute in collaboration with local stakeholders in the private sector. The vision of this new programme is for Southern Africa (with SA as core focus) to become an international leader in the implementation of pro-poor tourism and to create a network of operators and government officials interested in stimulating, supporting and implementing pro-poor tourism strategies. Six pilot tourism operators are implementing improved pro-poor practice, with a set of pro-poor strategies suited to the specific business and community being developed with each operator. The goal is to create long-term measures that “will significantly affect local poverty and make business sense to the operator”.

Initially, a scoping stage of facilitation is undertaken to understand the current linkages between tourism operators and the local (poor) stakeholders. Building upon this, the next step is to identify the type of linkage or linkages that should be developed to maximise pro-poor impacts. Programme options include expanding local sourcing, establishing commercial relationships with local tourism services, sharing infrastructure services and information, developing equity or revenue shares, increasing the content of local labour, investing in training, and consultative planning.

BOX 3 – THE ALEXANDRA TOWNSHIP TOURISM PILOT

Township tourism in Alexandra is targeted as a beneficiary of one of the current Pro-Poor Tourism pilot projects in SA. The core focus of the project is to develop a stronger set of linkages between Alexandra and tourism growth taking place in Sandton, and especially through the Southern Sun Hotels Group, which operates six hotels in the Sandton area, including two interlinked five-star hotels which connect to the Sandton Convention Centre. The scale and nature of the Southern Sun Group operations mean that the enterprise enjoys considerable marketing muscle as well as business acumen to contribute towards the development of pro-poor tourism linkages.

For Southern Sun Hotels, the impetus to participate in developing mutually beneficial linkages derives from its need to implement transformation initiatives in line with the SA government's promotion of BEE in the tourism economy. In addition, there is a realisation that the enterprise can expand its links with the neighbouring community of Alexandra. Community needs in Alexandra in relation to tourism are manifold and include tourism market knowledge, employment, SMME development and, above all, commitments for expanded skills training in tourism services.

A number of existing linkages have been identified between the Southern Sun Group operations in Sandton and local stakeholders in Alexandra township. Among the most important economic linkages are the outsourcing of Southern Sun's cleaning/house-keeping operations to an Alexandra-based enterprise, an existing guest room decoration contract with the Disabled Centre in Alexandra, support to a local restaurant in Alexandra to supply equipment and training support, and plans to extend waste recycling through Alexandra-based waste recycling enterprises.

The pro-poor tourism pilot project aims to strengthen the existing linkages as well as to forge new economic linkages. Among the key proposals under discussion are the marketing of township tours to Alexandra through the Southern Sun hotels in Sandton; the recycling of guest amenities (in particular soap, bed linen, towels and paper) to township entrepreneurs for the making of craft objects; the sale of locally produced goods from Alexandra entrepreneurs, such as beaded key rings, arts and crafts, to Southern Sun guests; and general support for increasing local staff recruitment from Alexandra as well as skilling of staff so that their wage levels are boosted.

Overall, a common vision has been agreed between Southern Sun and the local Alexandra Chamber of Commerce, which seeks to develop tourism and related services and emerging SMME enterprises through linkages between Southern Sun and Alexandra stakeholders.

Part II: Research Features

Chapter 4



Sectoral Profile

SMMEs in the Food Processing Complex:

Development Prospects, Constraints & Opportunities

1. Introduction to the sector

SA's food processing sector is widely regarded as an important generator of growth, employment and a wide range of processed food products. The sector is highly diverse and includes 11 downstream sectors associated with the processing of raw meat, fish, milk, grains, fruit and vegetables. In several cases, primary agricultural commodities are processed more than once, as in the case of wheat which is first milled and then further processed into bread, cakes or biscuit products.

Food processing in SA is highly concentrated, with several very large and integrated companies dominating the production, domestic sales and exports of branded and non-branded commodities. Although the level of concentration has not changed dramatically in the recent past, the liberalisation of agricultural markets from the mid-1990s has opened many new opportunities for small and medium-sized food processors. In the dairy, grains and meat sectors there are now a significant number of new small and medium processors. The sector as a whole faces a set of unique challenges associated with the deregulation of agricultural markets, the liberalisation of the country's trade regime, the concentration of power in the retail sector, changes in private consumption patterns and variable weather patterns.

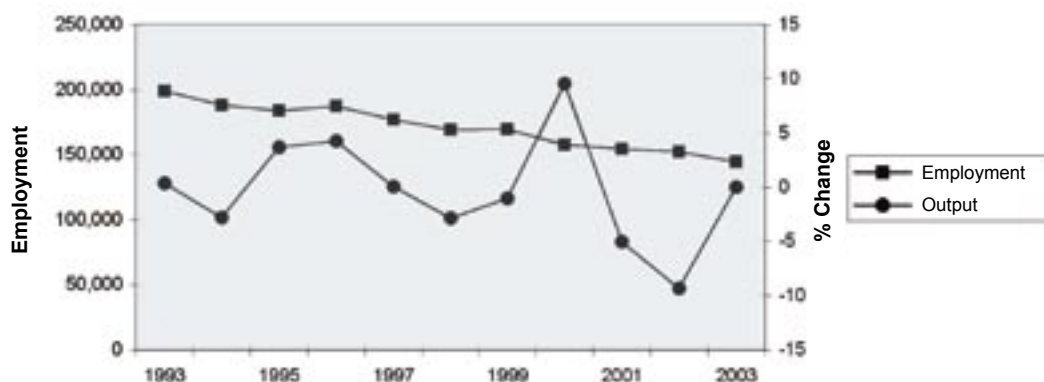
For the purposes of this chapter, food processing is defined using the Standard Industrial Classification (SIC) codes 301 to 304. These include manufacturing, processing and preservation of meat, fish, fruit, vegetables, oils and fats (301); manufacture of dairy products (302); manufacture of grain mill products, starches and starch products and prepared animal feeds (303); and manufacture of other food products, for example, bread, sugar, chocolate, pasta, coffee, nuts and spices (304).

2. Economic performance of the food processing sector

The food processing sector is recognised as an important component of SA's economy. Food processors contribute about 2.4% to total GDP, 3.2% to exports and 2% of total employment. The sector is also a significant part of SA's manufacturing economy and in 1998 contributed 13% of production volume in rand terms, about 12% of employment and 4% of manufactured exports. Besides these direct contributions to employment and output, there are also significant forward and backward linkages between food processing and other sectors of the economy. In 2003, the food sector spent R32bn in primary industries, R14bn in secondary industries, including manufacturing, and R17bn in the tertiary sector.

Despite the contribution of the food processing economy to growth and employment, the sector's economic performance in the last decade has been disappointing. Employment levels have declined from around 200,000 in 1993 to just over 140,000 in 2003. Output growth has also been very uneven and mostly disappointing in the period since 1993 (see Figure 26).

Figure 26 – Employment and changes in output in the food processing sector (SIC 301-304)



Source: Stats SA 2004

The performance of the food processing sector has been significantly worse than for manufacturing as a whole. Since the third quarter of 1999, the manufacturing sector has grown at an average of almost 4% per year. This increase has been driven by good performance in the motor vehicles and vehicle parts, chemicals and televisions, and communication equipment sectors, which in turn created demand in a range of allied industries. Over the same period, the food processing sector has, however, declined in importance in relation to other manufacturing sectors. The latest figures show that the food processors have sale figures of less than 10% and contribute to 8.2% of salaries in manufacturing. These figures are considerably lower than they were six years ago (see Table 30).

Table 30 – Employment, output and salaries in food processing relative to manufacturing as a whole

	Employees (%)	Output (%)	Gross salaries (%)
1997	14.1	12.7	9.9
2003	12.4	9.9	8.2

Source: Stats SA, 2004

The cause of declining employment and uneven output growth is related to the restructuring of the food processing sector in response to greater competitive pressures associated with lower tariffs and a freer trade regime, and the impact of mergers and acquisitions. In the last 10 years, SA's tariff structure has changed dramatically. From a complex system of quotas and tariffs, the trade regime has been simplified and liberalised. The result has been a rapid increase in cheap processed food imports that had a significant impact on several sectors of the food processing economy.

The disappointing sales figures in the recent past and the sector's poor performance relative to manufacturing as a whole are also related to low levels of domestic demand. Food processors are dependent on the domestic market through private household consumption. In 2002, high interest rates and high food inflation, combined with substantial job losses in the formal sector, had dampened consumption levels for food products, creating a difficult environment for food processors.

Although the food processing sector has not fared well in the recent past, there are encouraging signs associated with improved domestic performance and increased exports, especially to the Southern African region. The most recent manufacturing statistics show that food processing contributed 0.8% to the 3% increase in manufacturing output between May 2003 and May 2004. During this period, food processors increased sales by over R2bn, a figure that was third-highest in manufacturing as a whole behind the iron and steel, and automotive sectors. Figures on the sale of perishable and processed food show an increase of 36.7% between December 2002 and December 2003. Increased demand for processed food products and the rapid growth in the food processing sector are almost certainly a consequence of lower levels of food inflation and a significant drop in interest rates in the recent past.

There are also promising figures for processed food exports, especially to countries within Southern Africa. Recent research has shown that during the 1990s, exports of processed food products to Southern African Development Community (SADC) countries – mainly in the form of cereals, milling products, dairy and sugar – have increased dramatically. This regional market is becoming increasingly important for exporters of SA's processed food products.

The evidence on the economic performance of food processing suggests that while it has been disappointing in the recent past, there are promising signs for the future. Of importance is whether this growth leads to both employment creation and opportunities for small and medium-sized food processors.

3. A profile of the food processing sector

SA's food processing sector is highly concentrated, with several large, listed companies controlling both production capacity and sales in most food categories. These conglomerates tend to be vertically integrated into both primary production and retailing. Tiger Brands, for instance, has a controlling interest in the Spar retail group as well as interests in grain milling. Companies with backward linkages into primary production include Anglo Vaal Industries and Tongaat-Hulett, both of which are involved in primary production of raw material for processing into food commodities. The most integrated food processing sector is without question poultry production, where the largest companies have interests in 'parent material', day-old-chick and broiler rearing, feed manufacturing and final processing of mature chickens. A further characteristic of the large food processors is the interests they have outside of food production – usually in the pharmaceutical sector – and their recent investments in overseas food and non-food companies.

Concentration in the food sector is a consequence of both *apartheid* agricultural marketing legislation and the technological barriers to food processing. The 1937 Marketing Act permitted agricultural control boards to implement restrictive licensing on food processors. The logic of restricting the number of processors was based on the argument that there was excess capacity of raw material, which could have a detrimental impact on the income of white farmers. By controlling the number of processors, the State and its various control boards hoped to achieve the broader goal of the Marketing Act, which was to stabilise the income of white farmers. Restrictions on the establishment of dairy processors, for instance, led to a situation where five very large processors were able to create regional monopolies on both the sourcing and supply of milk products. In sectors that were not controlled through marketing boards – most notably chicken production and some vegetable and fruit processing – technical barriers to entry appear to have played an important role in leading to a concentrated structure of ownership.

The result of marketing legislation and technical barriers to entry is a sector characterised by extreme levels of concentration. There are, however, several qualifications that need to be made about the concentration of SA's food sector. First, there are variations in the level of concentration within the food sector. The number of firms and the level of concentration in the dairy sector are very high, whereas in grain and other food products the level of concentration is lower. Similarly, concentration within the major food groups varies considerably – compare for instance bakery products with sugar and sugar products (*see Table 31*).

Secondly, the level of concentration by food sector masks the extent to which individual firms are involved in a number of food groups. Tiger Oats, for instance, is involved in the production of milled products (wheat and maize), processed fruit and vegetables,

confectionary items, and dairy and meat products. Similarly, the new enterprise Pioneer Foods – formed when Bokomo Foods merged with Sasko – is involved in the production or processing of dried fruit, fruit juice, vegetables, bread and other baked products, grain, animal feed, eggs and broilers, and containers to transport fresh and processed food products. In other words, the use of food **groups** may under-estimate the extent of concentration in the food sector.

In the third place, there is evidence of both increasing concentration and market fragmentation in the period since 1996. The liberalisation of agricultural markets from the late 1980s opened up many new opportunities for small and medium processors, notably in baking, dairy, milling and meat production. In several of the food groups, the number of new processors has grown at an explosive rate. At the same time, however, restructuring in the food sector has led to mergers and takeovers, which is likely to have played a role in increasing concentration. These seemingly contradictory processes have led to a situation where the market share of the largest companies remains high, but these large companies now face considerable competition from many small and medium-sized processors. Despite their limited market share, these new firms have played an important role in changing the competitive environment of food processing in SA.

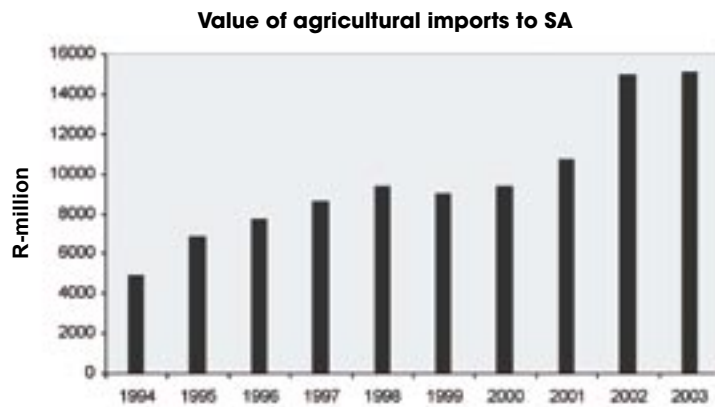
Table 31 – Concentration in the food sector, 1996

Food sector	Number of companies	Industry sales in percentage terms for largest	
		4 companies	10 companies
Meat, fish, fruit, vegetables, oils and fats	480	19.6	36.8
Vegetables and animal oils and fats	16	65.2	97.8
Canned and processed fruit and vegetables	157	35.0	55.0
Canned and processed fish	46	57.8	79.2
Dairy products	113	68.4	80.0
Fresh milk	46	70.8	83.5
Butter and cheese	17	82.0	97.4
Milk powder and other edible milk products	13	87.0	99.9
Grain mill products	283	36.0	56.4
Flour	209	42.6	64.8
Breakfast foods, starches and starch products	8	95.4	-
Prepared animal feeds	72	37.3	60.1
Other food products	821	26.1	53.3
Coffee, coffee substitutes and tea	15	80.4	95.8
Bakery products	522	45.3	62.6
Cocoa, chocolates and sugar confectionary	72	72.9	82.4

Source: Adapted from Vink and Kirsten, 2001

The liberalisation of agricultural markets from the late 1980s has played an important role in shaping the competitive environment for both small and large food processors in SA. There are, however, two other important factors affecting the operation of the food processing sector in SA. The first is associated with the broader liberalisation of the SA economy. Prior to the 1990s, SA's trade regime was regulated through a wide range of tariffs, quantitative restrictions, duties and a range of other protective measures. In the food sector, tariffs and trade restrictions virtually eliminated foreign competition in the domestic market. When SA became a signatory of the World Trade Organisation (WTO) after 1994, quantitative controls on imports were removed and tariffs were reduced and simplified. In general, the tariff rates for imports to SA have been set at levels below those stipulated by the WTO. The result has been a rapid rise in food imports from countries with large subsidies for agricultural production (*see Figure 27*).

Figure 27 – SA's agricultural imports



Source: National Department of Agriculture, 2004a

The liberalisation of SA's trade regime has had an impact on the processed food sector. In 2003, imports were more than R15bn – three times as much as in 1994 (in 2000 prices). These increases in the value of food imports have had a severe impact on several specific processed food sectors, most notably dairy and meat. Imported dairy and meat products frequently originate from countries where the agricultural sector is highly subsidised; the local landed price of these commodities is often a fraction of local production costs. Our survey of small and medium food processors suggests that subsidised imports of processed food products affect both large and small firms in SA.

The second broad factor affecting food processors is the structure of retailing. SA has a complex retailing structure with around 70,000 shops that can be broken down into three broad categories: large retail outlets (hypermarkets and supermarkets), medium retail stores (medium-sized retail stores), and small convenience stores (including spaza shops and 'cafés'). The structure of retailing is similar to that of food processing: a small

number of very large, formal retail chains control around 70% of turnover, while a large number of smaller stores control the remaining 30% of turnover. The concentration is most apparent in the supermarket sector where only 2% of supermarkets are responsible for between 50% and 60% of all food sales in SA. The large formal chains include the listed companies Pick 'n Pay, Shoprite-Checkers and Woolworths, and the soon-to-be-listed Spar group. SA's retail sector is characterised by intense competition for market share.

Food processors are dependent on formal retail chains for the sale of the products they manufacture. Given the structure of retailing in SA, the terms of trade are decidedly against processors who must supply large volumes and meet the increasingly strict specifications of retail buyers. They are also subject to a range of difficult 'buying practices', including long payment terms, rebates, discounts, returns and promotional discounts. Although the large food processors can use popular and heavily promoted brands to improve their terms of trade, retailers have responded with no-name or house brands, which they use to put pressure on large processors to reduce prices. Recent data on food consumption patterns suggest that no-name and house brands are the fastest-growing 'branded' processed food products. This growth in demand is driven by consumers who feel that house brands are equal in quality to the same branded item.

4. Food processing SMMEs

Agricultural marketing legislation represented a major obstacle to the development and growth of SMME food processors. Since the deregulation of most agricultural commodities from the mid-1990s – one of the government's key priorities – many new SMME food processors have emerged. In the dairy, milling and baking sectors, registration requirements and restrictions on supply effectively prohibited small and medium processors from operating. In all three sectors the number of new processors has expanded very rapidly. The number of dairy processors prior to market liberalisation was 40; six years later the figure had increased to over 500. In sectors that were not affected by marketing legislation – notably poultry production – changes in the structure of the industry have opened opportunities for small and medium-sized processors. Small food processors manufacturing niche products, like honey, chilli sauces and other condiments, were established due to perceived market opportunities rather than any changes in the regulation or structure of particular food sectors.

The size of food processors, as in other sectors of manufacturing, depends on the product and the technical requirements of the product. In general terms, however, manufacturers of primary agricultural products tend to be larger as this process often requires investment in relatively expensive machinery, equipment and vehicles for transport. Micro processors tend to be involved in the production of final food products such as bread, peanut butter and honey.

It is possible to identify several common characteristics of food processing SMMEs. One is that food processing SMMEs tend to sell and market their products outside of the formal retail structures that exist in SA. In other words, SMME food processors tend not to supply Pick 'n Pay, Shoprite-Checkers, Woolworths or Spar. Rather than supplying supermarkets, SMMEs supply smaller, independent retail stores or other enterprises involved in a further stage of processing. Small-scale wheat millers, for instance, often supply smaller independent bakeries or the 'in store' bakeries of independent retailers. Similarly, medium-sized poultry producers sell their product at the factory gate or through wholesalers. SMMEs also supply institutions and large businesses – mines, prisons, hospitals, schools and feeding schemes. The link between SMME food processors and other SMME businesses suggests that there are supply chains which are relatively independent of large processors and retail chains. A consequence of the market focus of SMME food processors away from formal retailers is that they tend to be more involved in supplying black South Africans in townships through spaza shops, networks of hawkers, or at commuter stations.

A second common finding across all of the food processing sectors is that SMME food processors usually supply local or regional markets. This finding applies to all food processing sectors and to both small and medium-sized food processors. Supplying local or regional markets effectively excludes these processors from retail chains, which require national supply capacity before they are willing to consider small or medium suppliers.

A third common finding across the sector is the competitive position of SMME food processors. SMMEs in this sector are competitive on the basis of price or quality, but rarely volume. Wheat millers who supply small bakeries with flour guarantee that their product is suitable for baking. Similarly, medium-sized broiler producers claim to produce a better quality chicken than larger integrated producers. In the dairy sector the competitive position depends on the product: fresh milk processors tend to compete on price whereas SMME cheese and yoghurt producers compete on the basis of quality. Fresh milk producers are able to supply their product at much lower costs due to lower overhead costs. Small cheese-makers, by contrast, provide a product of high quality to customers who are prepared to pay a premium for a better quality cheese.

The final set of findings is also prevalent for other manufacturing SMMEs. Food processing SMMEs are rarely involved in promotional efforts and much of their marketing is done through word-of-mouth or through the active efforts of company owners. Similar to other SMMEs in the rest of the economy, the owners of small and medium food processing companies are usually involved in all aspects of the business, including production, repair, financing and marketing.

5. Growth challenges

SMME food processors face a set of growth challenges unique to this sector. These challenges are related to the biological properties of the raw material, the liberalisation of SA's trade regime and the concentrated structure of food processing and retailing.

Securing sufficient and good quality raw material is one of the significant challenges facing small and medium food processors. Given the concentrated structure of the food processing sector, SMMEs often find it difficult to secure volumes that match their production capacity; farmers and secondary processors are geared to producing large volumes of raw material for processors with enormous capacity to both process and store raw material or the final product. Unfortunately for SMME food processors, smaller volumes of both raw material and animal feed cost more per unit value than for the larger processors. In the dairy sector, for instance, smaller processors frequently pay between 10% and 20% more for raw milk than the average market price.

A second problem associated with raw material supply is changes in the volume of supply. The dairy sector provides a dramatic illustration of this problem. Farmers must milk their cows every day; for processors to secure a regular supply of raw milk, they must be able to collect and process milk daily from their farmer-suppliers. The supply of milk from farmers is affected by the weather, feeding rates and also diseases like mastitis. Matching the supply of raw material from farmers with the demand for fresh milk is an extremely challenging task and processors frequently find themselves having to sell excess product to other processors at a considerable discount. Some dairy processors handle the problem of excess raw material by transforming raw milk into yoghurt or cheese, which have a longer shelf life. However, producing cheese and yoghurt requires additional skills and capital investment.

Variation in the quality of the raw material is a third-problem facing SMME food processors. Small and medium wheat millers, who supply smaller bakeries, rely on high quality wheat; better quality flour improves the baking process and the quality of the final product. If the wheat is of poor quality, it may have to be 'improved' using additives at the expense of the miller. A more serious problem faces dairy processors who have secured poor quality raw milk, as quality problems in this product cannot be remedied. The problem with raw milk quality explains why small, specialised cheese manufacturers usually milk their own cows rather than source milk from other dairy farmers. By milking their own herds, these processors can control the quality of the raw material that goes into producing high quality cheeses.

Food processors are also vulnerable to fluctuations in the costs of animal feed, which in the recent past have been extreme. Since the major component of animal feed is maize, changes in the maize price have a direct impact on the running costs for small and medium food processors. There is an additional problem with animal feeds: most of the larger meat processors – especially those producing beef and chicken – are vertically integrated into the feed industry. For example, Rainbow Chicken owns Epol, one of the country's largest animal feed manufacturers. Smaller and medium processors, who may be in direct competition with Rainbow Chicken, must purchase feed from a company that is a competitor in another market. Small and medium processors have voiced the concern that they may not be paying 'true market prices' for their animal feed requirements.

The problems associated with uneven supply, quality and the variable costs of inputs can have a devastating impact on the cash flow of small and medium-sized processors. Emerging SMMEs, who continue to find it difficult to secure funds from the formal banking sector, are especially vulnerable. One setback in terms of supply, quality or input prices has a potentially disastrous impact on the company's viability (*see Box 1 below*).

BOX 1 – VULNERABLE FOOD PROCESSING SMMEs: POULTRY AND DAIRY CASE STUDIES

The following two case studies of emerging SMMEs that have faced problems due to the biological nature of raw material illustrate the vulnerability of emerging SMMEs in this sector:

The experiences of two food processing SMMEs – one producing broilers and a second producing dairy products – demonstrate the impact of supply problems on emerging food processors. In 2001, the emerging poultry producer was faced with huge increases in feed costs, primarily due to the rising cost of maize. Feed costs represent a very high proportion of overall production costs in the broiler industry. In an attempt to manage the cost increases, the amount of feed given to the chickens was decreased. However, this increased the vulnerability of the chickens to diseases and the majority died shortly afterwards of a chicken-borne infection. Unable to secure bridging finance from the banks for an additional consignment of day-old-chicks, the processor was forced to buy live chickens from a local white farmer and then process them in the factory. Buying chickens in is not as economically efficient, but without access to bridging finance the processor was unable to purchase day-old-chicks or the feed they require to be raised to healthy chickens.

A dairy processing co-operative faced a similar problem with supply and cash flow. The farmer members of the co-operative were unable to supply sufficient milk to the processing plant and there were also concerns about the quality – the manager of the processing plant suspected that water was being added to the raw milk to increase the volume of milk delivered. Currently the processing plant purchases raw milk from a white farmer, also at a much higher cost. Production volumes are down and the co-operative is facing a cash flow problem. The manager of the facility has proposed that the co-operative purchase its own cows for milking, but he is finding it very difficult to secure finance for this expanded venture. In the meantime the processing plant – a state-of-the-art facility – is running at only 20% of its capacity.

A growth challenge for SMME food processors is linked to the structure of retailing in SA. Most SMMEs in this sector do not supply large retail chains because they do not meet the criteria for 'listing' as a regular supplier. Listed suppliers must normally have the capacity to deliver very large volumes of processed food products consistently and at a national scale. They must also meet certain objective quality criteria, such as HACCP (Hazard Analysis and Critical Control Point), and may further be subject to a routine of auditing the production facilities. The conditions for listing have, without question, become increasingly onerous for food processors, especially in the context of a growing concern by consumers over food safety.

The structure of retailing is a significant obstacle for growing SMME food processors. Without access to retail shelf-space it is very difficult for processors to expand beyond informal or trading networks. The decision to make the leap to retail-supplier is, however, risky. Several of the SMME food processors surveyed were in the process of making this leap, but it has required significant investments in new facilities and adapting to a more complex financial 'model'.

Becoming a listed supplier normally involves approaching the 'category manager' of a particular food commodity. The evaluation process varies between retailer chains. For example, Woolworths requires a facility audit that can cost up to R15,000 without any guarantees of becoming a listed supplier. While this system of auditing is relatively new, it appears that other retailers are following Woolworths' lead in demanding an audit. Even though some retailers may not demand an audit, all category managers will want to be certain that the company can supply sufficient and consistent volumes of processed food to the retailer's distribution depot. Interruptions in supply may be disastrous for food processors supplying formal retailers. In order to meet the requirements for volume and consistent supply, the processors surveyed were compelled to make significant investments in both production facilities and storage space. At the same

time, processors are encouraged to meet internationally recognised safety standards such as HACCP. Achieving HACCP accreditation usually requires considerable investment and upgrading of existing infrastructure and equipment.

Adjusting to new volume and process requirements is not the only adaptation food processors need to make when becoming a listed supplier to a retail chain. These companies must also adapt to a range of purchasing practices that are specific to retailers. SMME food processors not involved in retail chains usually have a small operating budget and rarely need to carry the costs of either storing raw materials or the final product. Payment terms are normally based on a cash-on-delivery system. When SMME companies make the leap to retail supplier, they are often required to bear additional costs in terms of storage. A more serious impact on the food processors' operating environment is the retailer's terms of payment, which varies from 90 to 120 days. For SMME food processors, this delay is very difficult to manage, especially as they have been accustomed to cash-on-delivery terms. Several of the food processors surveyed who had become retail suppliers felt that although their volumes had increased dramatically, they had 'less money' than before.

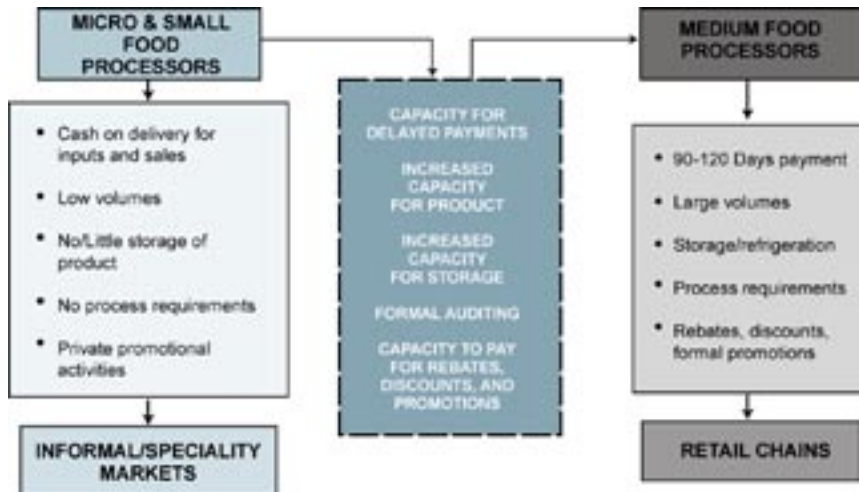
An extended payment term is not the only retailer buying practice processors must endure. Retail buyers often require standard rebates and discounts, they will charge processors for promotional costs and they will bargain very hard over price increases. In some cases retailers will ask processors to supply a consignment 'for free' to celebrate the opening of a new retail outlet.

The additional requirements and costs involved in meeting retailer needs may be offset by the larger volumes supplied by medium-sized food processors. However, the challenge for the owners of these companies is adapting to a radically different operating environment where there are new hidden costs.

Becoming a listed supplier rarely involves a contractual obligation from a retailer, and failure to meet the criteria for listing can be disastrous. One of the dairy producers surveyed had supplied a major retail chain with fresh milk under its 'no-name' brand. When the retailer received numerous complaints about the milk going sour before the 'sell-by-date', the quality of the milk was tested. The results showed that the milk had high levels of bacteria, which was a result of poor quality raw material rather than any problem in the pasteurisation process. The relatively high levels of bacteria were responsible for reducing the shelf life of the milk. Based on the results of the tests, the dairy processor was immediately de-listed from the retail chain, with disastrous results for its production volumes. This dairy processor is now undergoing a retailer audit – which has required additional investments in laboratory facilities and technicians to monitor the quality of both the raw material and the final product – in an attempt to re-establish its status as a listed supplier.

The survey of SMME food processors suggests a very clear distinction between micro and small processors supplying local or regional informal retailers, institutions, restaurants and other merchants of processed food. Medium-sized food processors usually need to be supplying retail chains, a shift that requires both additional resources and new business strategies (see Figure 28).

Figure 28 – SMME food processor markets



6. Supporting the growth of food processing SMMEs

This survey of SMMEs suggests that there is a need to acknowledge the specific problems facing SMME food processors in terms of raw material supply, changes in input costs and problems in quality, which – in the context of limited access to formal financial institutions – can threaten the long-term viability of such enterprises.

Franchising appears to be a particularly effective vehicle for establishing emerging food processing SMMEs. The Butterfield experience – where new owners are assisted in terms of training, equipment and business plans – appears to be a model that could be applied to other food processing SMMEs (see Box 2). An important advantage of this system is that food processing and retailing are combined into one enterprise.

BOX 2 – FOOD PROCESSING THROUGH FRANCHISING

The Butterfield franchise system has proved enormously successful in establishing small and medium-sized bakers run and owned by black South Africans. Since 2000, the company has focused on encouraging previously disadvantaged people to establish bakeries to supply black consumers. The bakeries have been established in the centre of cities like Johannesburg and Pretoria, or close to commuter facilities like train stations. Butterfield provides assistance in terms of training, equipment purchases and shop fittings, as well as an initial stock of flour, yeast and other baking ingredients.

The success of Butterfield's franchise system has been striking: at least 40% of the company's 110 franchises are owned by black-owned small food processor-retailers. According to Butterfield's managing director, not one of the black franchisee owners has failed. Butterfield's efforts to establish black-owned bakeries have been supported through grants from the Industrial Development Corporation (IDC) and through a Danish fund partner.

A key obstacle to the growth of SMMEs is the structure of SA retailing and the requirements involved in becoming a listed supplier. Retailer demands and difficult buying practices limit the extent to which small food processors can participate in these chains.

These findings on SMMEs in the food sector should be seen in the context of the Department of Agriculture and Land Affairs' discussion document on broad-based black economic empowerment (BEE) for agriculture (*AgriBEE: Broad-Based Black Economic Empowerment Framework for Agriculture*). Released in July 2004, the AgriBEE distinguishes between land-based agricultural activities and agri-business. While the BEE targets for farming are associated with land ownership, the targets for agri-enterprises are linked to preferred suppliers status – 50% of the preferred suppliers in the retail, tourism and distribution sector must be owned by black South Africans and SMEs by. Significantly, the document recognises the problem of delayed payments by recommending that “contractual agreements will be based on immediate (monthly) payments for work rendered by black companies to allow the smooth running of operations and maintenance of quality results”. Based on this survey of food processing SMMEs, the AgriBEE document appears to be addressing one of the key growth challenges in this sector.

The dti has a wide range of programmes supporting SMME development. In one of the programmes – the Sector Partnership Fund – almost 30% of successful applicants are involved in the agro-processing sector. This survey of currently operating SMME food processors raises two key policy implications for SMME support structures. First,

although the challenges facing SMME food processors may be exceptional, some of the difficulties they face are similar to those faced by other emerging SMMEs. The poultry and dairy processors facing financial difficulties were both unable to secure bridging finance from formal financial institutions to re-establish their enterprises to full capacity. Since **the dti** has programmes that address this particular problem, it appears rather to be a problem associated with information failure and accessing funds.

The second policy implication is more closely related to the distinctiveness of the food sector. If the key growth obstacle to SMME food processors is concentration in the retail sector, support structures should be geared towards assisting these enterprises to overcome the financial and technical obstacles to become listed suppliers. This means assisting businesses that are growing and attempting to break into the formal retail environment (*see Box 3*). It may also mean providing funds for technical assistance to improve the quality of the product and to ensure that the facilities meet the standards of retailers. This form of assistance – which involves ‘upgrading’ in the value-chain sense of the word – would build on the important intervention provided by the AgriBEE. While this empowerment proposal correctly identifies preferred suppliers as a way of transforming food processing, retailers are more likely to meet these goals when emerging SMMEs are in a position to meet the technical and food safety requirements that are becoming such an important aspect of food regulation. An important question is whether the wide range of existing support structures offered by **the dti** can be adapted to the specific needs of food processing SMMEs.

BOX 3 – MARWA HONEY QUEENS

In 1997, 12 enterprising women from Rustenburg started a non-profit organisation producing honey with four hives. They had received training in bee-keeping from a local farmer. The area around Rustenburg is ideally suited to honey production – unlike other parts of the country where pollen is scarce during winter, Rustenburg has a year-round supply thanks in part to its abundant aloes. The women also perceived a market opportunity, as there is a great demand for honey in SA, as well as for wax, propolis and honey grains, which are important and marketable by-products of honey production.

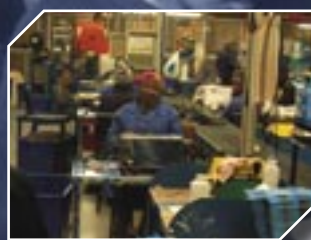
In the first few years, the women sold their product locally. Their customers were local community members and shops, and herbalists. By 2000, the business had reached a ‘turning point’: according to Boipelo Kubyana, the company’s financial director, they had to either move forward or close shop.

With financial and technical support from a range of agencies, including the National Department of Agriculture (NDA), the National Development Agency and Ntsika, the business was expanded and diversified. From four hives, the business has expanded to 100 hives. Their market now includes dairy companies, Spar shops in the North West and fruit and vegetable stores in the region. The company has also diversified into training and the women now share their knowledge and business acumen through training programmes funded by the NDA.

The 'Honey Queens' are planning further expansions of their food processing business. With a low interest loan from the Bakwena Platinum Corridor company, they have purchased a truck and office equipment, and plan to expand the number of hives to 500. This will also require new investments in processing facilities, as this much larger volume of honey cannot be processed manually. Crucially, they will also have to access new markets. To this end, the company's financial manager has approached various breakfast cereal processors and retailers to potentially buy the much larger volumes of honey that will be produced by the Marwa Honey Queens.

Part II: Research Features

Chapter 5



Provincial Profile

Focus on the Free State

1. Introduction

During 2003 to 2004, the Free State Province commissioned a series of detailed research investigations towards the creation of a new provincial economic development strategy. In this provincial profile, some of the key findings and issues from these research investigations are raised concerning SMME development, specifically in the important manufacturing economy. Issues are discussed in terms of the role of both established and emerging manufacturing enterprises.

- The first section offers a profile of the changing role of SMMEs in the manufacturing economy of the Free State, which is based largely upon an analysis of the Industrial Registers of the Bureau of Market Research at the University of SA (Unisa). This profile is situated within a discussion of the key dimensions of change impacting upon manufacturing development in the Free State as a whole.
- The second section draws together the key findings of 140 interviews across both established and emerging SMME manufacturers in the Free State. The major themes addressed in the structured interviews relate to developing a profile of entrepreneurs and their enterprises, an examination of their recent and projected business performance, job creation in manufacturing SMMEs, and issues of government support.
- The third section highlights policy issues concerning manufacturing SMME development.

2. The changing role of SMMEs in the Free State manufacturing economy

2.1 Context and macro profile

The Free State Province economy exhibits a high level of dependence upon primary sector activity, most importantly agriculture and mining. Compared to other provinces, the manufacturing base is underdeveloped; indeed, the manufacturing economy is estimated to contribute only 14% of gross geographic product (GGP) and 3.6% of manufacturing GGP in SA. Nevertheless, the Department of Tourism, Environmental and Economic Affairs (DTEEA) attaches considerable significance to the expansion of the manufacturing sector to ensure sustainable economic growth within a competitive environment.

The macro environment exhibits a number of distinctive features which impact upon the development of the Free State manufacturing economy as a whole – and not least on the role of SMME manufacturing. The most important features are as follows:

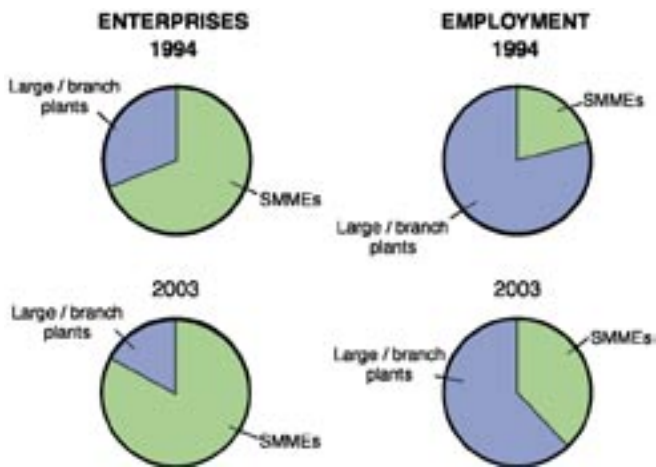
- The downscaling of gold mining, which affects particularly the Goldfields area.
- The weakening of the agricultural base.
- Key sub-sectors of manufacturing are related to agro-industries which have been experiencing retarded growth or even decline at national level.
- Many of the province's largest manufacturing enterprises are branch plants of firms headquartered elsewhere. External control reduces the long-term commitment of companies to the area and their ability and willingness to be involved in local development issues, including promoting SMMEs.
- The ending of Regional Industrial Development Programme incentives which supported industrial development points in the former 'homelands'.
- The proximity of Lesotho as a potentially attractive industrial base with more favourable trade access to international markets.
- Key links outside of the province of the petro-chemical complex in Sasolburg with Gauteng Province.
- The absence of any SDIs or Industrial Development Zones (IDZs) in the province.

2.2 Contribution to the provincial economy

Figure 29 shows the macro profile of SMMEs in the manufacturing economy of the Free State Province, as differentiated by the number of enterprises and their contribution to estimated total provincial manufacturing employment.

The analysis shows a considerable net increase in the total number of manufacturing establishments in the Free State between 1994 and 2003. That said, it should be noted that the almost near-doubling in the number of establishments must in part be attributed to improved data collection procedures. Between 1994 and 2003, records indicate that the number of manufacturing SMMEs increased from 318 to 845 enterprises. It is significant that the proportion of SMMEs in relation to total manufacturing establishments rose from 69% in 1994 to 83% in 2003 – an indication of the growing significance of SMMEs in terms of the overall manufacturing base of the Free State Province.

Figure 29 – SMMEs' share of total manufacturing enterprise and employment in the Free State



Source: Based on data from the Bureau of Market Research (BMR) Industrial Register

Despite the increase in the number of manufacturing establishments, the picture in terms of overall total manufacturing employment is of only a marginal increase in jobs between 1994 and 2003. This relatively stagnant picture of provincial manufacturing employment as a whole should be set against the increasing significance of SMME manufacturing in terms of share of total employment. In the manufacturing SMME economy, the number of jobs nearly doubled from 10,200 in 1994 to 18,100 by 2003. Accordingly, in a stagnant provincial manufacturing economy, there is a growing significance of manufacturing SMMEs in terms of their contribution to the overall manufacturing economy – between 1994 and 2003, the share of SMMEs in estimated total manufacturing employment in the Free State rose from 20.1% to 38.9% (see Figure 29). Behind this finding is the decline and closure of many large manufacturing enterprises and especially the closure of many branch plants over the same period. Another factor in the ‘hidden growth’ of the manufacturing SMME economy is downsizing by larger enterprises so that many enterprises defined as ‘large’ in 1994 have become (large-sized) SMMEs by 2003.

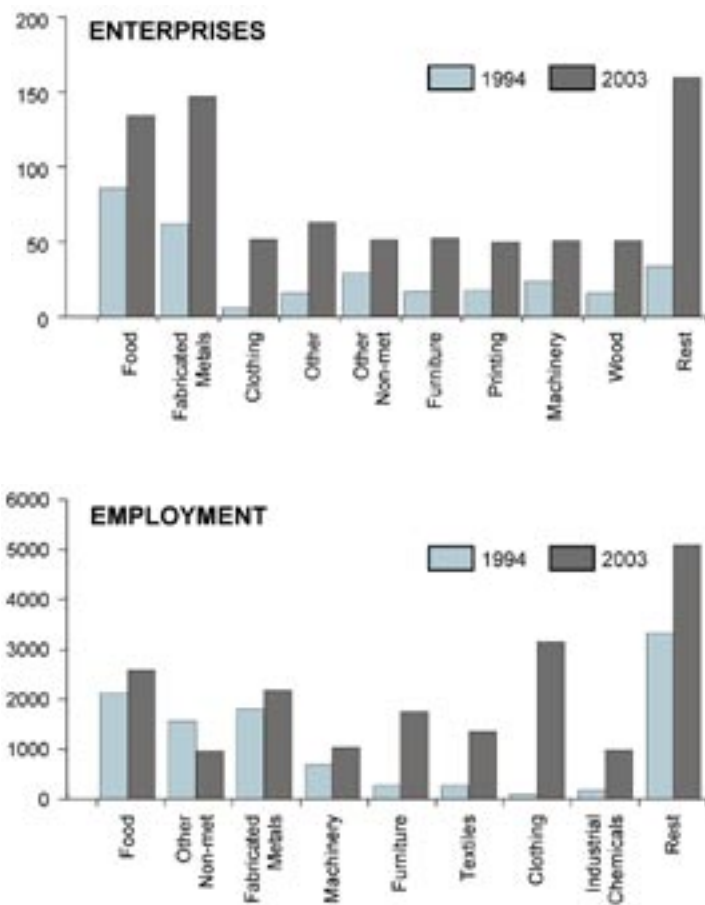
2.3 Sectoral change

2.3.1 Sectoral composition

It is evident from Figure 30 that significant changes have occurred in the sectoral composition or structure of the manufacturing economy of the Free State. In 1994, the leading sectors in terms of the number of SMME manufacturing establishments were food, fabricated metals, other non-metallic minerals products and machinery. By 2003, the leading sectors ranked in terms of the number of SMME manufacturing

establishments were fabricated metals, food, other (mainly jewellery) and furniture. Overall, it is shown that between 1994 and 2003, the largest growth in the number of new SMME manufacturers occurred in the sectors of fabricated metals, followed by the sectors of food, clothing and other. Although the number of fabricated metals SMME establishments expanded by a factor of two, the most rapid growth can be seen in new SMME establishments in the sectors of clothing, other, furniture, printing and wood. In terms of the number of SMME enterprises, between 1994 and 2003 the relative importance of the food sector reduced markedly.

Figure 30 – Sectoral composition of SMME manufacturing, 1994-2003



Source: Based on data from the BMR Industrial Register

2.3.2 Employment composition

The employment scenario in SMME manufacturing enterprises is somewhat different. Nearly 60% of 1994 SMME manufacturing employment was concentrated in the three sectors of food, fabricated metals and other non-metallic mineral products. In terms of 2003 SMME manufacturing employment, the situation has changed markedly with, in ranked order, the most important sectors being clothing, food, fabricated metals

and furniture. The remarkable SMME employment rise in the clothing sector was the most significant shift in terms of manufacturing employment in SMMEs in the Free State over this period. Healthy increases in SMME manufacturing employment were also recorded in the textiles and furniture sectors. Although SMME employment in the food and fabricated metals sectors showed a modest increase, their relative significance in terms of their share of overall SMME manufacturing employment was markedly reduced because of the significant surge in employment in clothing SMMEs.

Two further observations can be offered:

- First, the sector of other non-metallic mineral products appears to be in absolute decline in terms of employment.
- In the second place, the notable advance of the 'other' (mainly jewellery) sector in terms of enterprise numbers is not reflected in a parallel rise in its contribution to job creation in the manufacturing SMME economy as a whole.

2.4 Key spatial findings

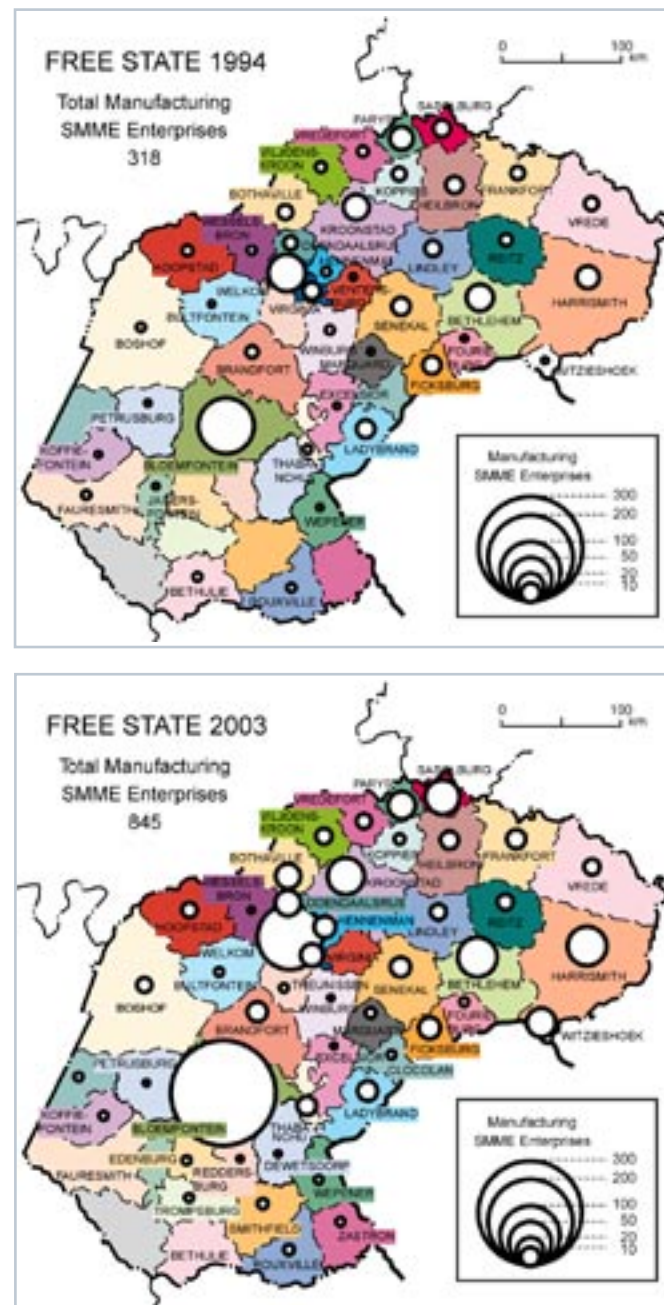
2.4.1 Concentration of manufacturing SMMEs

At the outset it must be noted that the spatial patterns observed in the SMME manufacturing economy are somewhat different to the patterns for the Free State manufacturing economy as a whole, which are influenced substantially by the downsizing and/or closure of many large manufacturing establishments and branch plants. The geographical patterns of SMME manufacturing in the province are shown in Figures 31 and 32. Figure 31 shows the changing patterns of manufacturing in terms of the number of SMME enterprises, while Figure 32 shows the shifting patterns as indexed by estimated total employment opportunities in SMME manufacturing.

Several points emerge when the changing geography of SMME manufacturing in the Free State province over the last decade is analysed. In terms of enterprises (*see Figure 31*), a number of points are of note. First is that growth in the actual number of SMME enterprises is taking place across nearly all areas of the Free State, including the province's largest urban centres and in the small towns. Secondly, however, the largest absolute growth of SMME manufacturing enterprises is strongly focused in the Bloemfontein-Botshabelo-Thaba 'Nchu cluster. This cluster expanded markedly from 28% of total manufacturing SMME enterprises in 1994 to 37% by 2003. Smaller growth was observed in the relative share of SMME manufacturing in the Harrismith-Phuthaditjhaba cluster – from a 4.7% share in 1994 to a 7.7% share by 2003 – in Goldfields from 16% to nearly 18% by 2003, and in Sasolburg from 2.5% to 3.9% by 2003. In the third place, it is significant that apart from these clusters, in relative terms,

SMME manufacturing has performed poorly where enterprise numbers in Kroonstad, Bethlehem and throughout the small towns of the Free State are concerned. Indeed, it is evident that the relative share of the number of SMME manufacturing enterprises in small towns declined from 37% in 1994 to 24% by 2003. The overall picture thus emerges that between 1994 and 2003, SMME manufacturing – as measured by enterprise numbers – became increasingly concentrated in the largest urban centres of the province, with the most rapid and vibrant growth evidenced in the Bloemfontein cluster.

Figure 31 - Changing geography of SMME enterprises, 1994-2003



Source: Based on data from the BMR Industrial Register

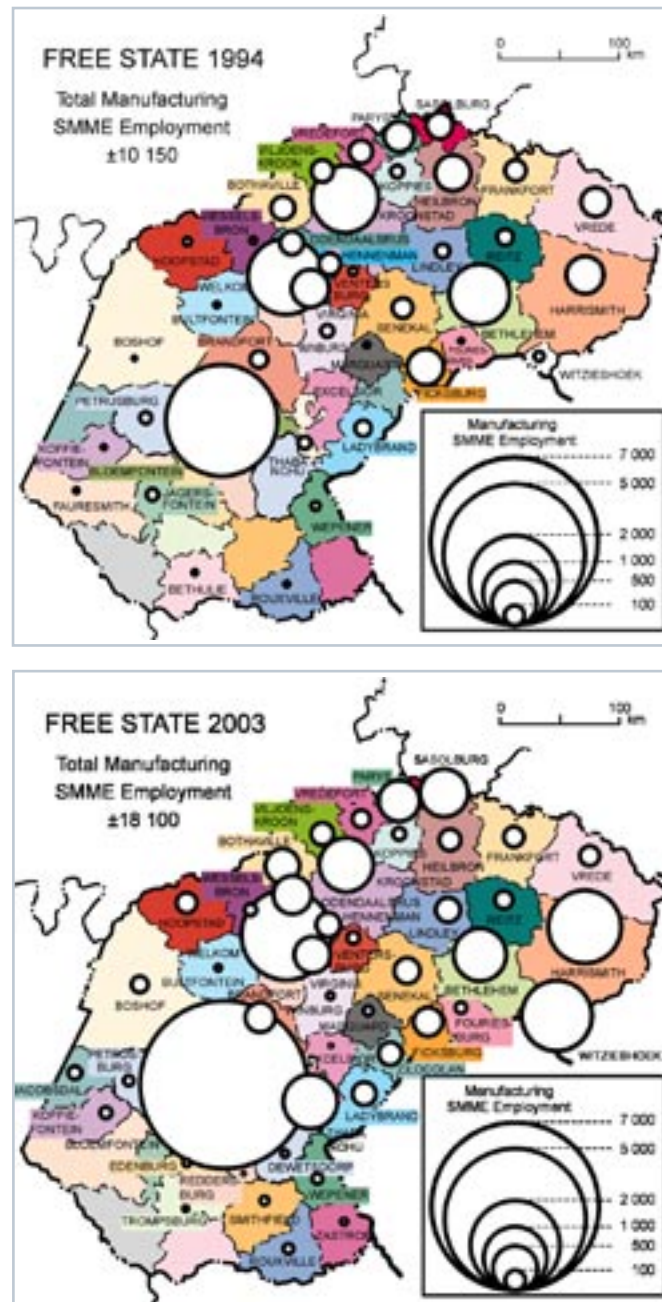
2.4.2 Concentration of manufacturing SMMEs

In terms of the patterns observable from estimated manufacturing SMME employment, as shown in Figure 32, a number of parallel comparisons and contrasts may be drawn. First, absolute growth in total employment in manufacturing SMMEs is less widespread than growth in enterprise numbers across the province. Indeed, significant growth is observed in only two areas of the province – the Bloemfontein-Botshabelo-Thaba 'Nchu and Harrismith-Phuthaditjhaba clusters. The former doubled its absolute number of employees in manufacturing SMMEs, and in relative terms advanced from 31% to nearly 43% of all SMME manufacturing employment in the Free State. The Harrismith-Phuthaditjhaba cluster recorded an equally impressive advance from only a 4% share in 1994 of total manufacturing SMME employment to 14% by 2003. Beyond these two clusters, limited growth was only recorded in Sasolburg and a number of smaller centres, including Parys and Ladybrand. For the rest of the Province, including the Goldfields, Bethlehem, Kroonstad and the majority of small towns, the situation is that of relative if not absolute decline in manufacturing SMME employment. The most marked relative declines were recorded for the group of small towns as a whole – down from 23% of total SMME manufacturing employment in 1994 to 17% by 2003. The Goldfields fell from 21% in 1994 to 15% by 2003, Kroonstad from 11% to 4% between 1994 and 2003, and Bethlehem from 9% to 4% over the same period.

Overall, two striking conclusions emerge from this analysis of the spatial restructuring taking place in the SMME manufacturing economy of the Free State:

- First, SMME manufacturing growth is increasingly focused upon the two clusters around Bloemfontein and Harrismith-Phuthaditjhaba.
- In the second place, outside of these two clusters, the performance of SMME manufacturing has been weak. More particularly, whilst enterprise growth in numbers has been recorded in areas such as the Goldfields, this expansion in the number of SMME enterprises has not been reflected in substantive job creation in SMME manufacturing.

Figure 32 – Changing geography of SMME employment, 1994-2003



Source: Based on data from the BMR Industrial Register

3. Survey findings

This section draws together the findings from surveys conducted in 2003 and 2004 that involved 140 interviews concerning both established and emerging SMME manufacturers in the Free State. A total of 50 interviews were completed with established SMME manufacturers and spread across the province. In addition, 53 interviews were

undertaken with emerging SMME manufacturers based in Mangaung and Thabong. Together, these two sets of material provide an overall profile of the characteristics and key issues confronting a range of SMME manufacturers across different production sectors.

In the final section, the findings are presented of an additional set of 37 interviews which targeted three important sub-sectors of Free State SMME manufacturing – food, fabricated metals and clothing. Using a parallel set of themes to that in the cross-sectoral survey, the objective in this set of interviews was to examine inter-sectoral variation in the SMME manufacturing economy, focusing particularly upon the more established end of the SMME spectrum.

3.1 Established versus emerging manufacturing SMMEs

3.1.1 Established manufacturing SMMEs: general findings

The major findings from the interview research on established manufacturing SMMEs can be summarised as follows:

- The typical established SMME manufacturing entrepreneur is white, male and aged between 31 and 50.
- The information concerning length of establishment of businesses reveals that the province's manufacturing SMME economy is a mixture of certain long-established enterprises along with groups of more recently established manufacturing firms.
- Although the desire for self-employment or the identification of market opportunities are the prime bases for SMME establishment, an increasing number of firms are set up out of necessity due to retrenchments.
- The major issues at start-up relate to growing knowledge of the business and securing markets rather than access to finance.
- At start-up, the core source of capital is the entrepreneur's own savings rather than formal bank sources.
- 'Lifestyle' factors emerge as important bases for explaining the locational choice of SMME manufacturers. The location of most SMME manufacturing establishments is the result of factors such as where the entrepreneur has grown up or where he/she chooses to live.
- The potentially fragile state of the manufacturing SMME economy was signalled by the fact that nearly half of entrepreneurs could offer no special advantages for their factory operations to be situated in Free State. Dissatisfaction was so strong amongst 16% of the sample that entrepreneurs were either planning to close down entirely or relocate their operations.

- The major disadvantages of operating in the Free State identified by these SMME manufacturers surrounded the stagnant or declining markets for industrial goods in the province and especially of declines taking place in the Goldfields area, and of the costs imposed by distance to input suppliers and access to markets, often situated in Gauteng. Other concerns highlighted by entrepreneurs related to the lack of any support system offered by government for manufacturing SMMEs and the lack of available skilled labour across the province.
- The recent business performance of SMME manufacturers has been mixed, with good results achieved through enterprise adjustments and poor results linked to a weak macro economy and labour problems.

3.1.2 Established manufacturing SMMEs: business performance findings

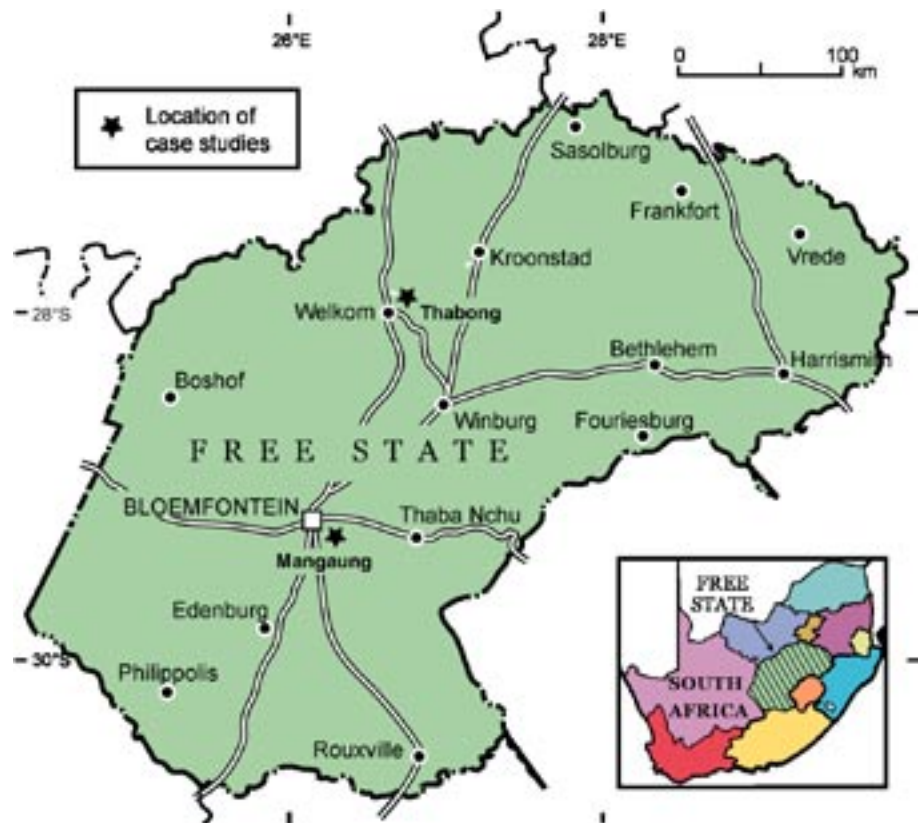
The major issues affecting improved business performance can be broadly grouped in terms of four sets of issues:

- First is a range of constraints on enterprise performance in relation to market decline and associated business cash flow difficulties. Geographically expanding the markets which are served by manufacturing SMMEs based in the province is a critical issue. Currently the provincial Free State market is the major (if not in many cases the only) market for 78% of SMMEs' and few firms' export, apart from Lesotho.
- A second set of issues concerning improved business performance surround labour. It was observed that there are distinct shortages of certain types of labour in certain sectors of manufacturing. For example, skilled labour of various forms is in short supply in the Free State and consequently must be recruited from outside the province, generally from Gauteng. Shortages of various types of labour for manufacturing point to shortcomings in existing training institutions in the province, which are failing to supply in the need for tool-makers or graphic designers, for example. Another prominent set of labour issues related to matters of poor levels of worker productivity, labour costs and the impacts of stringent labour laws. The low levels of worker productivity that several respondents alluded to were often linked to the effects of the HIV/Aids epidemic on workers' health. Taken together, these sets of labour problems coalesce and result in a reluctance by SMME entrepreneurs to take on additional labour and to create new jobs.

- A third group of constraints around improved business performance relate to unreliable or poor infrastructure. Infrastructure problems in terms of electricity, water supplies or refuse removal were particularly important in the case of manufacturers whose businesses were located in small towns rather than in the province's major geographical industrial clusters.
- In addition, the question of access to support structures was of widespread concern. The findings disclose that awareness levels of available national government support programmes for SMME development are poor. Beyond awareness, problems are experienced in accessing potential support programmes. Established Free State SMME manufacturers most commonly sought access to and support from the Small, Medium Enterprise Development Programme (SMEDP) grants and **the dti's** export incentives. It was found that whilst 20% of sample enterprises had tried to secure government support, only 6% were successful in securing SMEDP grants or export incentives. The disappointments in accessing national government programmes found expression in statements that **the dti's** national programmes were "all talk and no action", as in many cases no reply to the support request was ever received.
- Overall, the Free State is poorly perceived as a base for SMME manufacturing because of its stagnant economy and declining provincial and local markets.

A similar set of themes concerning characteristics, business development and performance were examined in terms of groups of emerging production SMMEs – primarily micro enterprises or informal manufacturers interviewed in Mangaung and Thabong (*see Figure 33*). It is evident from the findings that different sets of issues confront the groups of emerging SMMEs as opposed to established SMMEs in manufacturing and that these two groups have different business constraints and support needs.

Figure 33 – Location of emerging SMME interviews



3.1.3 Emerging manufacturing SMMEs: general findings

The major findings from the research on emerging manufacturing SMMEs in Thabong and Mangaung can be summarised as follows:

- The typical entrepreneur is black, male and aged between 31 and 60.
- The most common forms of emerging production SMMEs are engaged in metal-working (especially welding operations), burglar-proofing and brick-making activities. Women's involvement is largely in clothing and dress-making activities.
- The vast majority of enterprises were set up for reasons of necessity rather than choice or by 'opportunistic entrepreneurs'. The growth of this emerging manufacturing SMME economy crucially links to the weak state of employment creation in the formal economy. Joblessness, retrenchments and the need for household survival are at the root of the growing number of emerging production SMMEs.

- The largest group of emerging manufacturers are unregistered enterprises that operate from informal premises based in the home or back-yard.
- The major start-up constraints relate to critical shortages concerning access to finance, lack of equipment, machinery or tools, and inadequate premises or spaces for manufacturing operations.
- In common with the group of established manufacturers, the major source of start-up capital for emerging manufacturing SMMEs is the entrepreneur or household savings.
- The location of these businesses is determined by where the entrepreneur lives.

3.1.4 Emerging manufacturing SMMEs: business performance findings

- The recent business performance of emerging SMME manufacturers shows some growth in incomes and sales but almost no growth in long-term employment, as entrepreneurs prefer to take on casual workers or part-time employees if the volume of business orders expands.
- Most enterprises operate in narrow and geographically localised markets, with few manufacturing SMMEs having any 'exports' or sales of their output beyond the immediate locality in which they are situated.
- Emerging SMME manufacturers face different issues to those of established manufacturers in terms of seeking to expand their business operations.
- Lack of access to finance is a critical constraint which impacts upon the quality of equipment and machinery as well as entrepreneurs' capacity to improve their business premises. Human resource issues were further highlighted and underpinned by poor information and access to opportunities for training and skills upgrading.
- Overall, the findings on emerging SMME manufacturers highlighted the failures of national government support programmes to reach these 'target groups'.

3.2 Inter-sectoral variation

The question of inter-sectoral variations in issues impacting upon SMME development was explored by focusing on the food, clothing and fabricated metals sectors.

The following key detailed findings emerged from these 37 interviews:

- In terms of the **race of the entrepreneur**, certain differences – most distinctive within the clothing sector emerged. In the case of food and fabricated metals, the SMME entrepreneur was white. Of the seven clothing SMMEs, only one was run by a white South African, three were Indian owned, two were Taiwanese entrepreneurs and one was a black entrepreneur.
- **Male entrepreneurs were dominant across all sectors**, with four women entrepreneurs in food, two in clothing and two in fabricated metals. In total, 21% of the sample businesses were run by women.
- Where **reasons for establishment** are concerned, the majority of businesses in the food sector were set up by ‘opportunistic entrepreneurs’ (the definition here includes the desire for self-employment) and in a few cases because of the pressures of retrenchment or a withdrawal from mining work due to health reasons. Responses from the fabricated metals sector were similar, with the majority of businesses set up due to a recognition of business opportunities, often linked to a desire for self-employment. In clothing, the desire for self-employment (also expressed by new immigrants from Taiwan), was overwhelmingly the major reason for business start-up, and once again linked to market opportunities.
- The factors underpinning the **location of these SMME manufacturers** revealed sectoral differences. In the food sector, ‘lifestyle’ factors in terms of the entrepreneur’s place of residence, the take-over of an existing business operation or available land in a particular locality formed the major issues. For fabricated metals producers, the influence of the owner’s place of residence was strongly in evidence; also important were market opportunities around the mines and the availability of land. For clothing SMME producers, other factors came into the locational decision. ‘Lifestyle’ factors were not observed as exerting a significant influence upon the choice of where production activity would occur in any of the cases. Significantly, several entrepreneurs had relocated to the Free State from other parts of SA, Lesotho and Taiwan.

- In terms of the **locational advantages and disadvantages** of having a business operation in the Free State, entrepreneurs offered a variety of opinions. In the case of food manufacturers, several alluded to the input linkages back to the Free State agricultural sector, others to ‘lifestyle’ considerations of living in the Free State (albeit tempered in some cases by the recent growth of crime), and others to issues of cheap labour. The major disadvantages were clearly distance from SA’s major urban markets and associated transport costs. Producers whose markets were mainly in the Free State strongly asserted issues of the declining macro economy. Fabricated metals producers expressed access to local markets and the ‘lifestyle’ considerations of a “nice environment” as the most common advantages of a Free State business location. In common with the food SMMEs, the major disadvantages relate to transport costs to access suppliers, markets and spares. The group of clothing manufacturers defined the **relative** low costs of labour in the Free State as a major locational advantage, as well as the province’s centrality in relation to both major domestic markets (Gauteng) and export foci (Durban). In terms of disadvantages, several companies pointed to the lack of skilled labour and the poor quality of trained labour in relation to the needs of the clothing sector. Other producers were concerned that the Free State’s former advantage of ‘cheap labour’ was **increasingly no longer the case**.
- In terms of the existing **balance of advantages and disadvantages**, a few firms are currently considering the option of relocating their businesses. In the majority of cases, discontent is expressed by a desire to sell rather than to relocate. Nonetheless, one food producer was considering a move outside the province and a fabricated metals producer was relocating to Gauteng. In the group of clothing SMMEs, the major issue was the need to search locally for larger premises.
- In terms of **the size of the labour force**, different trends were observed. In the food sector, a greater number of firms are downsizing their labour force **rather than increasing their numbers of workers**. The state of the macro economy, labour legislation and increasing competition were mentioned as issues behind this downturn in labour absorption. For fabricated metals producers, the labour situation was one of general decline or, at best, of stagnation. The poor labour outlook was linked to weak market conditions, especially on the mines and in agriculture, as well as to more stringent labour legislation which had increased the costs of labour. In the group of clothing SMMEs, considerable labour absorption has taken place, although there are strong signals that the rate of job creation is slowing due to the pressures of labour problems and especially of rising labour costs, exchange rate difficulties and competition from imports.

- The question of major **obstacles to improved business performance** produced mixed responses. In the food sector, key concerns were the poor macro economy, made worse by conditions in mining and agriculture, and uncertainty over labour, particularly its productivity and rising costs. For fabricated metals producers, the key highlighted issues were labour costs, the impact of HIV/Aids on worker productivity, access to finance and concerns around the poor state of the macro economy – particularly in provincial mining and agriculture. Across all the groups of clothing producers, labour issues were of paramount importance, with concerns about poor productivity, rising labour costs and low levels of skills.
- The **narrowness of markets that are targeted by Free State SMMEs** is clearly of widespread concern across all three sub-sectors. The Free State and Gauteng are, not surprisingly, the major national markets which are served by local producers in all three sectors.
- In respect of taking on **additional workers**, the enterprises surveyed offered a fairly common set of responses, with improved market performance in a growing macro economy the most pertinent. The group of clothing producers was the most **distinctive** in its responses, as issues of training for labour were strongly highlighted as a core constraint upon further labour absorption by existing producers.
- In terms of **government support**, a picture emerges of almost minimal support for manufacturing SMME development. No access to government support programmes was secured by any food or fabricated metals SMME manufacturer. In the case of the group of clothing SMMEs, support had been secured from the provincial development corporation and a proactive local municipality.
- In looking to **future roles** that the **provincial and local governments** might assume in terms of support intervention, a range of responses was recorded. For the group of food SMMEs, a variety of issues were raised, including the need for greater local procurement, the importance of maintaining infrastructure (especially of electricity supplies) and the reduction of crime. In fabricated metals, the issues once more focused strongly on procurement as a basis for supporting Free State manufacturers; other issues related to support for workplace HIV/Aids programmes, improved information flows and infrastructure maintenance. Finally, among clothing SMMEs, the majority expressed the need for support related to improving training facilities for workers, advice on labour problems more generally, and support through “proudly South African” campaigns to defend these firms against rising levels of import competition.

4. Policy issues

Considerable policy significance is attached to the SMME economy in the Free State, especially to achieve the objectives of job creation. The provincial *Economic Strategy* document, released in March 2003, includes a target for generating 34,000 new jobs by March 2005 on the basis of the creation and survival for longer than three years of 3,400 micro businesses, 2,720 businesses of fewer than 20 employees expanding by an average of five employees, and 1,360 businesses of more than 20 employees taking on an average of an additional 10 employees. The achievement of these goals will require active policy intervention for, as shown in Chapter 3 of this report, the Free State is one of SA's provinces which is below the national average in terms of indicators of enterprise density and levels of opportunity entrepreneurship.

4.1 Policies to strengthen the SMME economy

Three essential requirements which cut across the issues facing groups of both established and emerging entrepreneurs form a broad framework for strengthening the SMME economy:

- The creation of motivated entrepreneurs;
- The unlocking of economic opportunities; and,
- Building the capacity of SMME entrepreneurs.

These three themes provide the organisational base for the development of appropriate action plans for strengthening the Free State's SMME economy. However, a range of different interventions is required to achieve the goals for job creation and must be designed to meet the differentiated support needs identified among the groups of established and emerging manufacturers.

4.2 Policies to support established SMME manufacturers

The following policy considerations are amongst the most important to provide support for established SMME manufacturers in the Free State:

- Improving the macro economy through creating a Provincial Industrial Strategy that supports down-streaming linkages of large enterprises to SMMEs.
- Maximising opportunities for industrial development through initiatives for local economic development, including local sourcing and public procurement programmes.
- Establishment of a (much delayed) provincial MAC.
- Reviewing the operations of existing technical training institutions in the province and their alignment with the labour needs of the manufacturing economy.
- Maintaining and enhancing the infrastructural base for the manufacturing economy at both provincial and local government level.

4.3 Policies to support emerging SMME Manufacturers

The following policy considerations are amongst the most important to provide support for emerging SMME manufacturers:

- Supporting the provincial MAC initiative.
- Identifying at both provincial and local government level the most promising sectors for encouraging and advising SMME entrepreneurs around business opportunities, especially to start up enterprises.
- Ensuring that all provincial sectoral planning includes specified targets for the upgrading of emerging SMME entrepreneurs and enterprises.
- Introducing provincial programmes aligned with national SMME initiatives that are geared towards enhancing SMMEs market access and business linkages; targeted assistance (including learnerships) for specific groups (unemployed, school-leavers, youth, women and the disabled); management and entrepreneurial development; and technology support for acquiring basic technologies.
- Markedly improving the access of existing and potential SMME entrepreneurs to information about business and market opportunities.
- Publicising success stories of **emergent** Free State entrepreneurs widely.
- Establishing a network of business advisers to enhance entrepreneurs' awareness of and access to business information and existing SMME support.

- Enhancing, in particular, the opportunities for women entrepreneurs, who are seemingly under-represented in the Free State SMME economy.
- Greatly improving entrepreneurs' access to sources of micro credit, both for start-up of new SMMEs and to support existing business operations.
- Upgrading the capacity and quality of existing business development service providers in the province.
- Supporting a programme of training workshops on the most promising sectoral and local opportunities identified for emergent SMME entrepreneur start-ups.
- Initiating a programme designed to encourage local governments to provide suitable and affordable business premises in the form of business incubators or local industrial parks for emerging entrepreneurs.

Part II: Research Features



Issue Profile

Business Development Services

1. Introduction

The approaches to support for small business have a chequered history. Currently, an important trend involves the shift away from government-led support provision towards a greater role for the private sector in the delivery of business development services (BDS) to the SMME economy.

The term ‘business development services’ refers to the wide range of services used by entrepreneurs to help them to operate efficiently and to grow their businesses, with the broader purpose of contributing to economic growth, employment generation and poverty alleviation. The BDS field focuses upon promoting access to and use of these services by SMMEs. Business development services are designed to help small enterprises to overcome barriers to increased profitability by improving their productivity and access to markets.

The international experience shows that access to BDS is necessary for the growth and development of small enterprises. After experimenting for decades with small-scale subsidised programmes – which had only a modest impact – international experience in the field of BDS shows a ‘paradigm shift’ to be occurring with the emergence of new high-impact strategies that can reach large numbers of businesses in a sustainable manner. The new paradigm for BDS focuses upon the development of effective markets for private sector providers to offer services which will help SMMEs to develop and compete.

This focus reviews the changing international approaches towards supporting business development services to highlight the growing significance of developing commercial markets for BDS provision. Against this background, attention turns to the SA situation. It is argued that in SA, very little is known about the development of markets for business development services. In 2004, two detailed studies were conducted in Queenstown and Nelspruit, which provide some insight into the development of commercial markets for BDS. The key findings from the Nelspruit BDS survey are presented here. The research, undertaken for the German Agency for Technical Co-operation²⁴ (GTZ), represents one of the most detailed market assessments so far conducted of private sector provision of business development services in SA.

2. Changing directions of support provisions for SMMEs

With the policy ‘discovery’ of the informal sector by many international development agencies in the 1970s, national governments began to subsidise the delivery of SMME support services of various kinds, including credit, business, technical training and assistance with identifying and accessing new markets. Enterprise promotion efforts in developing countries were mostly anchored on the belief that the small entrepreneur

²⁴ The Deutsche Gesellschaft für Technische Zusammenarbeit GmbH is one of the world’s largest consultancy organisations for development co-operation. GTZ implements bilateral technical co-operation activities in more than 130 partner countries, including SA.

was an individual that required continuous subsidisation in the form of free training, ready-made feasibility studies, purpose-built industrial estates, marketing assistance, credit, below-market interest rates and continuous advice. Although large institutions were created to ensure that subsidies went to small entrepreneurs, often these subsidies were hijacked for the benefit of more powerful groups, with the result that only limited benefits actually accrued to the poor. Moreover, those targeted entrepreneurs represented only a small fraction of the total population of entrepreneurs in any country.

The 1980s saw the beginnings of a move towards more market-based approaches in which service provision was driven by the demands of the target group which would be expressed in terms of significant beneficiary contributions, sufficient to cover most of the costs of service delivery. By the late 1990s and early 2000s, the emerging strategy for business development services focused on developing markets for services that were appropriate to and demanded by small enterprises, rather than the direct provision of business development services by governments or donors. The shift was towards an emphasis on being business-like and demand-led at the institutional level and it focused intervention strategies toward facilitating transactions between SMME 'clients' as opposed to 'beneficiaries'. The core challenge was to develop low-cost service products and delivery mechanisms to match the smallest client's needs and willingness to pay. This new 'best practice' approach also signifies a shift towards emphasising the creation of an enabling environment for SMME competitiveness and on developing markets for SMME-relevant services rather than substituting for them, as was the case with the old approach.

Above all, the changed approach seeks to broaden the impact and outreach of government support programmes by using the private sector to deliver services and by focusing scarce public resources on the facilitation of market transactions and the investment of public goods. At the institutional level, governments can accelerate market development by promoting innovation and by building institutional capacity in response to the recognition that SMMEs may need different types of services, institutions and delivery mechanisms than larger enterprises. The three suggested areas within which this approach to SMME development operates – the business environment, financial services and business development services – are highlighted in Table 32.

Table 32 – Market-oriented small enterprise interventions

	Open access to markets, accelerate market development	Invest in public goods, build institutional capacity	Reduce and rationalise traditional public interventions
Business environment	<ul style="list-style-type: none"> ▪ Competition policy ▪ Licensing and registration requirements, administration fees ▪ Commercial transactions law ▪ Intellectual and commercial property rights ▪ Tax, labour legislation ▪ Government procurement ▪ Flexibility in the implementation of regulations 	<ul style="list-style-type: none"> ▪ Infrastructure (transport, ports, market facilities, communications, IT) ▪ Information markets, standards, technologies ▪ Monitoring of SMME performance and impact of policies and interventions ▪ Public-private partnerships at local level to improve business environment 	<ul style="list-style-type: none"> ▪ Reconsider policies that reserve certain sectors for small-scale enterprises or grant them special protection ▪ Seek greater neutrality across firm sizes in tax and labour legislation and enforcement
Financial services	<ul style="list-style-type: none"> ▪ Financial sector competition policy ▪ Collateral legislation ▪ Prudential regulation and supervision ▪ Interest rate ceilings ▪ Regulations government leasing, venture capital, equity markets 	<ul style="list-style-type: none"> ▪ Innovation in loan products, lending methodologies, delivery mechanisms, risk assessment methodologies (e.g. credit scoring) ▪ Credit bureaus, registries ▪ Training and technical assistance to financial institutions serving SMMEs 	<ul style="list-style-type: none"> ▪ Reduce direct lending through public financial institutions ▪ Reduce SMME lending (portfolio) requirements on financial institutions ▪ Eliminate subsidised credit lines and credit guarantee schemes
Business development services	<ul style="list-style-type: none"> ▪ Target subsidies for market development to specific market failures ▪ Information on service providers, impact of services ▪ Enforce competition in service markets 	<ul style="list-style-type: none"> ▪ Innovation in products (especially for the smallest firms), delivery mechanisms ▪ Development of performance and impact indicators ▪ Training and technical assistance to private BDS providers ▪ Limit long-term subsidies for BDS to public goods (e.g. information, labour and management training) 	<ul style="list-style-type: none"> ▪ Increase cost recovery for publically provided or subsidised services ▪ Improve management and cost control in public BDS institutions ▪ Condition budgetary allocations to the achievement of impact ▪ Reduce duplication across agencies in services provided ▪ Use the private sector to deliver services ▪ Privatised service providers when financially sustainable

Source: Hallberg, 1999

3. Towards a new BDS paradigm

Historically, three developments are at the core of the emergence of a new paradigm for BDS provision.

3.1 Learning from micro finance

A starting point for many observers and practitioners has been the disappointments associated with the historical under-achievement of BDS interventions, particularly in contrast with the micro-finance revolution. In many parts of the developing world, clear guidelines on micro-finance intervention and delivery are widely accepted, tight systems of measurement have been developed, and a discernible micro-finance industry has emerged which is achieving both sound financial returns and outreach. A drive for greater sustainability lies at the root of this revolution. By contrast to micro finance, the provision of BDS has been typified by disparate and inconsistent methodologies and high cost/low outreach programmes which are dependent on continuous subsidies. Given this contrast, the question has been raised as to what BDS can learn from the changed approaches to micro finance.

3.2 Moving towards private sector provision

There is an increased acknowledgement that public sector organisations have not proved to be effective providers of BDS to SMMEs; in particular, government organisations are insufficiently ‘business-like’ or ‘close’ to SMMEs in terms of their cultures, staffing or structures. Moreover, subsidies for State-provided business support have created a set of market distortions that hinder the development of private sector provision. Accordingly, increased attention was directed towards the private sector – formal and informal – as the ‘natural’ suppliers of services to other businesses.

3.3 Emphasis on market development

The record of international experience, especially in developing countries, has caused an increased emphasis on the development of BDS markets. This shift represents a move away from supply-driven State- (or donor-) subsidised services and support for individual organisations towards developing more effective market environments that facilitate the delivery of demand-led services. Accordingly, the development of markets for services to which SMMEs can turn to support their business development is increasingly being viewed as a means to achieve the kinds of scale and sustainability (and implied impact) that micro finance has apparently achieved, albeit through different means.

4. Key differences between old and new approaches to BDS

By comparing the ‘old’ and ‘new’ approaches to BDS, it is clear that government and the private sector play markedly different roles (*see Figure 3A*). In particular, there are five key sets of differences between the old and new approaches.

4.1 Starting points: out with the old, in with the new

According to the OLD approach:

- SMMEs are seen as grateful beneficiaries of government-subsidised support.
- Government organisations and NGOs are the key providers of services.
- BDS is primarily considered as a set of primarily public goods.
- BDS is financed primarily by the State.

According to the NEW approach:

- SMMEs are seen as discerning consumers of services.
- The activities of the private sector in functioning markets become paramount.
- BDS is a set of private goods.
- The financing system is through consumer-provider transactions.

4.2 Changing definitions

The OLD approach:

- Emphasised donors' and government's supply-side beliefs of what was *good* for SMMEs.
- Encompassed a strong emphasis upon training and counselling SMMEs.

The NEW approach:

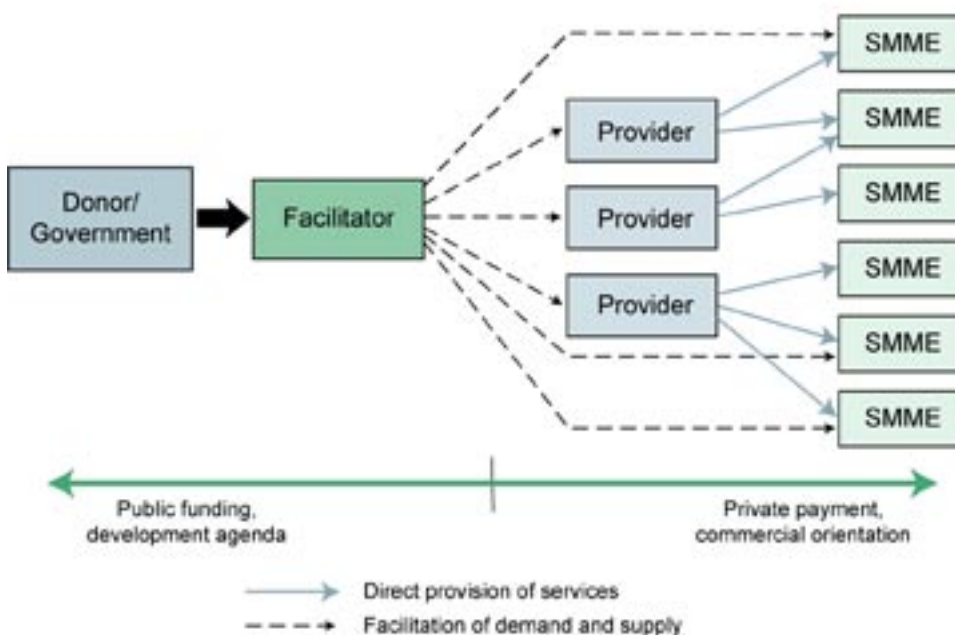
- From a market development perspective reflects a demand-side orientation as constituted by SMMEs' own view, and is therefore much broader.
- BDS is best conceptualised in terms of a broad and continuously changing frontier or array of services that are needed by SMMEs to effectively run their businesses.

Figure 34 – Changing approaches to BDS provision

a) Old Approach: Substitute for the Market



b) New Approach: Facilitate Market Development



4.3 Changing objectives of intervention

According to the OLD approach:	According to the NEW approach:
<ul style="list-style-type: none">▪ The emphasis within BDS programming centred on building the capacity of organisations to deliver improved services or on delivering services directly.	<ul style="list-style-type: none">▪ From a market development perspective, the main objective of BDS programming is recast in terms of enhancing and improving the functioning of BDS markets.

4.4 Approaches to intervention

The OLD approach:	The NEW approach:
<ul style="list-style-type: none">▪ Generally supported a set of organisations which were often government-related in designing and delivering BDS, with an implicit assumption of continued subsidy and often standardised forms of BDS.	<ul style="list-style-type: none">▪ Demands a different method – in line with the market development paradigm – which is anchored upon a new understanding of markets for BDS.

4.5 Out with direct service provision, in with market development

According to the OLD approach:	According to the NEW approach:
<ul style="list-style-type: none">▪ Governments (and donors) intervened in BDS markets at the level of transactions, in terms of either providing services directly to SMMEs or permanently subsidising services from non-government providers.	<ul style="list-style-type: none">▪ Governments (and donors) focus on promoting transactions between SMMEs and private sector suppliers. The focus is upon ‘facilitating’ the expansion of markets rather than ‘providing’ services.

Source: Based on Committee of Donor Agencies for Small Enterprise Development, 2001

Overall, the market development approach to BDS is anchored upon the fundamental belief in private sector markets as engines of growth and as efficient suppliers of goods and services. In terms of application, the market development approach starts by both understanding the existing supply of BDS from the private sector, donor-supported programmes and government and seeking to identify ‘market failures’ that can result in a gap between the supply and demand for services.

The goal of market development interventions is to overcome these market failures and rather to take advantage of opportunities to expand the service market for SMMEs. The desired outcome is that a large proportion of SMMEs buy the BDS of their choice from a wide selection of products which are (primarily) offered by unsubsidised private sector suppliers in a competitive and evolving market.

5. Private sector provision of BDS in SA: selected findings from Nelspruit

Table 33 – Different forms of BDS

1.	Advisory services relating to production processes
2.	Environmental management training and advisory services
3.	Facilitation of business linkages
4.	Quality training and advisory services
5.	Advertising services
6.	Identifying new markets including new markets
7.	Providing information to meet specifications and standards
8.	Training on using customer feedback to develop new markets
9.	Assistance with regard to tendering
10.	Accounting services
11.	Advisory services in business planning/management and mentoring
12.	Computer hardware and software services including maintenance and website design
13.	Legal support/advisory in legal processes
14.	Management and business skills training
15.	Financial planning/business plans for finance
16.	Negotiation skills regarding government/other contracts

Source: GTZ, 2004

The German SA programme on Business Development Services and Local Economic Development (BDS/LED) is engaged in the development of functioning markets for BDS that benefit local SMMEs, assisting them to realise their growth potential and hence create more employment. GTZ firmly believes in the ‘new approach’ towards facilitating market development for private sector provision of BDS. More specifically, GTZ argues that this new approach is the best way to enable a large proportion of SMMEs to obtain the business service that they need or want. The promotion of vibrant private sector BDS markets is thus seen as an important ingredient to stimulate the economic growth and competitiveness of local economies.

One of the key mistakes of past BDS programmes was that they often assumed which services SMMEs wanted. However, from a host of SA studies in which interviews with entrepreneurs were conducted it has been shown that SMMEs have a range of different ‘needs’ and that different kinds of SMMEs have different support needs that may be critical to their operation, survival and growth.

According to the new approach, the entry point of developing a high-impact BDS strategy is to obtain a good understanding of the demand by SMMEs for BDS and of the systems that put financial pressure on providers to respond to those demands.

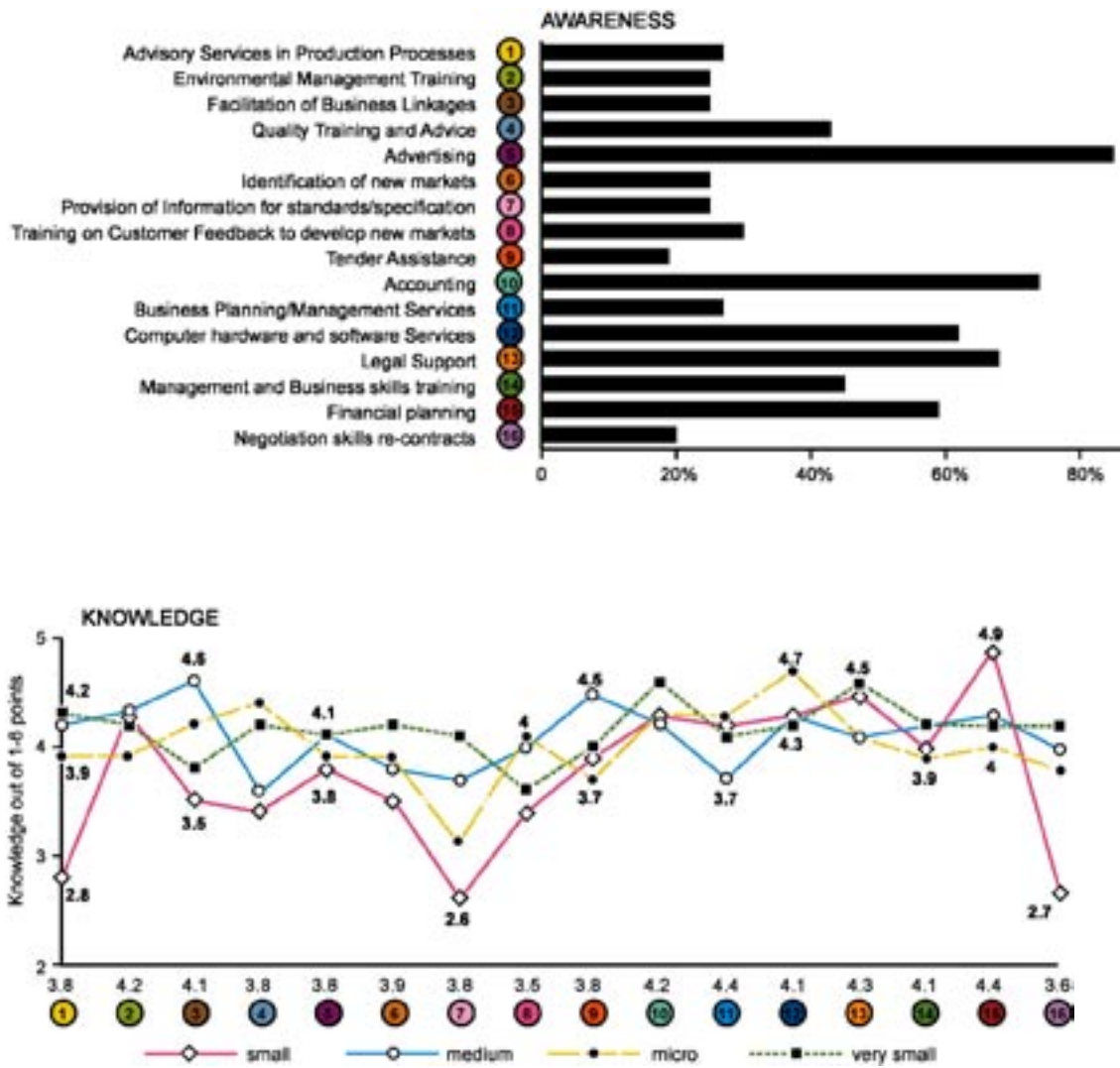
The Nelspruit study sought to undertake a market assessment for BDS, with an analysis of demand and usage of BDS in the locality. In particular, the GTZ study focused upon local knowledge, use and satisfaction of SMMEs with a range of different kinds of BDS. More specifically, the study examined a cluster of 16 different forms of BDS which were identified for purposes of the market assessment (*see Table 33*).

Based upon a sample of 440 companies in Nelspruit, the major findings concerning awareness, knowledge, usage and satisfaction levels of BDS were as follows (*see Figures 35 and 36*):

5.1 BDS awareness and knowledge levels

- Considerable variations in knowledge and awareness levels exist concerning business development services in Nelspruit.
- Awareness levels were highest for advertising, accounting and legal services, and lowest for assistance regarding tendering and negotiation skills.
- The extent of knowledge about different business development services varies between different kinds of SMME.
- Although small and medium-sized enterprises generally have a better knowledge of services than micro or very small enterprises, it was shown that micro enterprises had the best knowledge levels of certain types of BDS, most notably quality training and advisory services; training on customer feedback to develop new markets; and advice on business planning, management and mentoring.
- The most important sources of information about BDS were colleagues and, in a few cases, advertisements and the activities of consultants.

Figure 35 – BDS awareness and knowledge of services



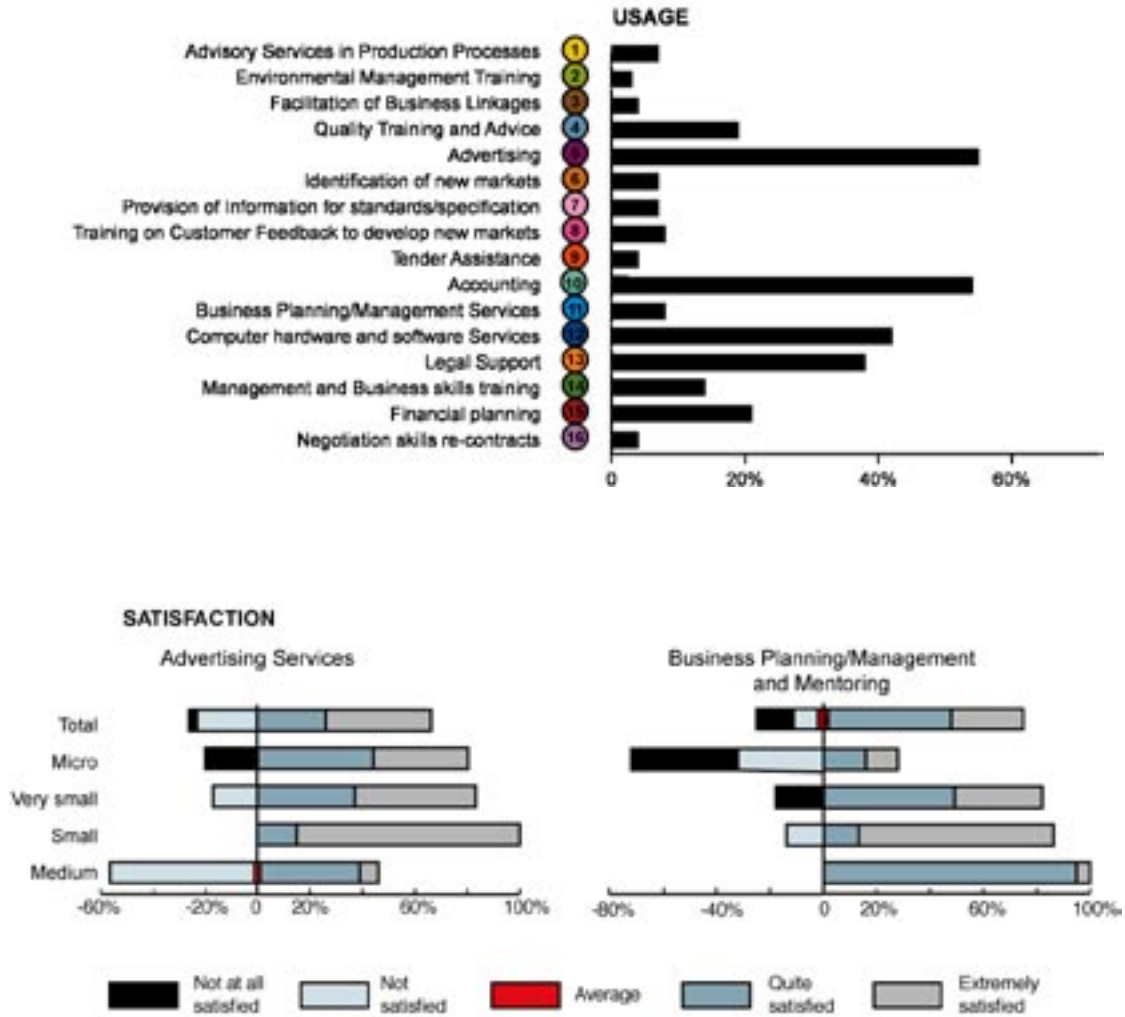
Source: GTZ, 2004

5.2 BDS usage and satisfaction levels

- Overall usage of most forms of BDS in the Nelspruit area is relatively low.
- The highest usage incidence is recorded for advertising services (used by 55% of SMMEs), accounting services (54%), computer hardware and software services (42%) and legal support services (38%).
- The lowest levels of service usage incidence were recorded for environmental management (3%), facilitation of business linkages (4%), negotiation skills (4%), and tender support (4%).

- In the majority of cases, non-usage of particular BDS services was explained by firms perceiving these services as 'not relevant' or being unaware of its local provision.
- Not surprisingly, a strong relationship was recorded between actual knowledge of where to obtain a service and where the service was actually obtained from.
- In terms of services considered for future usage, it was shown that the five services with the highest past usage incidence – advertising, accounting, legal support, computer hardware/software services and financial planning – also exhibited the highest future usage incidence.
- Usage of BDS was linked to perceived benefits, with the most important being improvements in productivity of enterprises, improvements in customer or potential customer relationships, improved quality of product or service delivery and smoother and more efficient running of the business.
- Usage of BDS was also contingent upon the extent to which services were perceived as accessible in Nelspruit.
- It was shown that only five of the 16 kinds of BDS were perceived as reaching an acceptable limit of accessibility. The services that do not appear at all accessible in terms of ease of access are:
 - Environmental management;
 - Facilitation of business linkages;
 - Assistance with tenders; and
 - Negotiation skills regarding government and other contracts.
- Satisfaction levels of service provision varied between the different kinds of services and also between different categories of SMMEs.
- On the whole, satisfaction levels were lowest and deemed 'unacceptable' for current provision of the following services:
 - Facilitation of business linkages;
 - Quality training and advisory services;
 - Provision of information to meet specifications and standards;
 - Assistance with regard to tendering assistance;
 - Advisory services in business planning management and mentoring; and
 - Negotiation skills regarding government contracts (worst of all).

Figure 36 – BDS usage and satisfaction levels



Source: GTZ, 2004

The major motivations for using a particular service are shown in Table 34.

Table 34 – Main reasons for use of particular forms of BDS

Form of BDS	Main reason for usage
Advisory services in production processes	Received complaints about product or service delivered
Environmental management training	Required to by law
Facilitation of business linkages	Increase in competition
Quality training and advice	Need/desire to be more professional
Advertising	Increase in competition, growth or expansion of business and/or insufficient demand for product or service delivered
Identification of new markets	Business in decline
Provision of information for standards/ specifications	Complaints received about product or service delivered
Training on customer feedback to develop new markets	Skills shortage in business
Tender assistance	Business in decline and increased competition
Accounting	Need for financial assistance
Business planning/management services	Need to be seen as more professional and skills shortage in business
Computer hardware and software services	Need to be seen as more professional
Legal support	Not knowing correct legal procedures
Management and business skills training	Business expanding and skills shortage in business
Financial planning	Need for financial aid/assistance and expansion of the business
Negotiation skills re-contracts	Expansion of the business

6. Conclusion

Overall, it is evident that the ultimate objective of BDS interventions is to improve the performance of SMMEs in SA. The market development approach to BDS is anchored upon the recognition that addressing market failures to efficient and effective provision of BDS would have a higher chance of providing quality, affordable BDS to a large proportion of small businesses than a traditional, public sector driven and highly subsidised service offering. Moreover, the market development approach is premised upon the view that the provision of subsidies and subsidised services may ‘crowd out’ private sector suppliers who do not receive such subsidies.

Reliance upon the private sector to achieve a greater outreach of delivery of BDS than has been achieved by the public sector demands as a starting point an improved understanding of how SA BDS providers can be financially self-sustainable. In turn, this necessitates a better level of understanding of the actual demands of BDS in specific markets, as demonstrated by the findings from the pioneer GTZ investigation in Nelspruit.

Part I: Regular Features

Chapter 1

Review of Trends & Performance – The SA SME Sector in 2003

- Bannock, G. (2002), *Indigenous Private Sector Development and Regulation in Africa and Central Europe: A 10 Country Study*.
- Hudson, J. (2003), 'Understanding Regulatory Impact Assessments: Key Issues in the International Experience'. *SME Alert*, published by the Small Business Project.
- Kane-Berman, J. (1991), *The Silent Revolution*, published by the SA Institute of Race Relations, Johannesburg.
- Kane-Berman, J. (2004), 'Radical Changes Needed to Labour Law'. *Argumentum*, Vol. 4, No. 2, March 2004.
- Mead, D.C. and Liedhold, C. (1998), 'The Dynamics of Micro and Small Enterprises in Developing Countries'. *World Development* 26, p.67.
- Small Business Project (2002), *An Enabling Environment for Private Sector Growth: Lessons from the International Experience*, published by the Small Business Project.
- Upstart Business Strategies (2004), 'Value-Added Tax Act and Regional Services Councils Act-induced Administrative Burdens for Small Businesses'. Presented at the *Easing the Administrative Burden for Small Enterprises* workshop, Johannesburg, 18 June 2004.
- World Bank, International Finance Corporation and Oxford University Press (2003), *Doing Business in 2004: Understanding Regulation*.

Chapter 2

Key Small Business Statistics in South Africa

Literature:

- Benassi, M. P. (1995), 'Compiling Statistical Information on Small and Medium-sized Enterprises: Practical and Methodological problems'. *European Union Answers*, Session 8 at High-Level Workshop on SMEs, Employment, Innovation and Growth, OECD Washington DC.
- CIPRO (2003), 'Registration Statistics' – unpublished document.
- CIPRO (2004), 'Registration Listings by Industry' – unpublished document.
- City of Cape Town (2002), 'Report on the Analysis of the 2001 RSC Levy Database' (extract as per January 2002) – unpublished document.
- Falkena, H. et al. (2002), 'SMEs' Access to Finance in South Africa – A Supply-side Regulatory Review'. The Task Group of the Policy Board for Financial Services and Regulation – Internal report.
- Global Entrepreneurship Monitor (2002), *2002 South African Executive Report*, The Graduate School of Business, University of Cape Town.
- Global Entrepreneurship Monitor (2003), *2003 South African Executive Report*, The Graduate School of Business, University of Cape Town.
- Global Entrepreneurship Monitor (2004), *2003 Complementary Report*, The Graduate School of Business, University of Cape Town.
- National Parliament, Schedule 1 to the National Small Business Act, 1996, as revised by the National Small Business Amendment Bill, March 2003.
- Ntsika Enterprise Promotion Agency (2003), *State of Small Business in South Africa, 2002 Report*, Pretoria.
- Rogerson, C.M. and Rogerson J.M. (1997), 'The Changing Post-apartheid City: Emergent Black-owned Small Enterprises in Johannesburg'. *Urban Studies*, Vol. 31 No. 1, pp. 85-103.

Statistics SA (GDP 2003) (2004), 'Statistical Release P0441, Gross Domestic Product, Fourth quarter 2003'. Released 24 February 2004, Stats SA, Pretoria.

Statistics SA (HHS 2003) (2004), 'Statistical Release P0318, General Household Survey, July 2003'. Released 27 May 2004, Stats SA, Pretoria.

Statistics SA (LFS 2003) (2004), 'Statistical release P0210, Labour Force Survey, September 2003'. Released 25 March 2004, Stats SA, Pretoria.

Statistics SA (Liquidations and Insolvencies 2003) (2004), 'Statistical Release P0043, Statistics of Liquidations and Insolvencies (preliminary), December 2003'. Released 29 January 2004, Stats SA, Pretoria.

Statistics SA (SESE 2002) (2002), *The Contribution of Small and Micro Enterprises to the Economy of the Country: A Survey of Non-VAT Registered Businesses in South Africa*, Stats SA, Pretoria.

Statistics SA (IBR 2004) (2004), Extracts from the Integrated Business Register.

TransUnion ITC (2003), 'Commercial Assessment Tools' presentation.

TransUnion ITC (2003), 'Small and Medium Enterprise Assessment Tool'. Electronic Brochure.

Winter, S.G. (1995), 'Small and Medium Enterprises in Economic Development: Possibilities for Research and Policy'. Policy Research Working Paper 1508, Washington D.C., The World Bank.

Interviews and correspondence

With CC4U and various Accounting and Auditing Firms, Statistics SA 'Business Frame', CIPRO Deputy Registrar.

Part II: Research Features

Chapter 3

Sectoral Profile - Tourism SMMEs

Dahles, H. and Bras, K. (eds) (1999), *Tourism and Small Entrepreneurs: Development, National Policy and Entrepreneurial Culture – Indonesian Cases*, Cognizant Communication, New York.

Dahles, H. and Keune, L. (eds) (2002), *Tourism Development and Local Participation in Latin America*, Cognizant Communication, New York.

Department of Environmental Affairs and Tourism (2003), *Tourism: 10 Year Review*, Department of Environmental Affairs and Tourism, Pretoria.

Pirie, G.H. (2004), 'Africanisation' of South Africa's International Air Links, 1994-2004, unpublished paper, University of the Western Cape.

Rogerson, C.M. and Visser, G. (eds) (2004), *Tourism and Development Issues in Contemporary South Africa*, Africa Institute of South Africa, Pretoria.

Tourism Business Council of South Africa (2003), *South African Tourism Industry: Empowerment and Transformation Annual Review 2003*, TBCSA, Johannesburg.

Tourism Business Council of South Africa (2002), *South African Tourism Industry: Empowerment and Transformation Annual Review 2002*, TBCSA, Johannesburg.

Thomas, R. (ed) (2004), *Small Firms in Tourism: International Perspectives*, Elsevier, Amsterdam.

World Travel and Tourism Council (2002), *South Africa: The Impact of Travel & Tourism on Jobs and the Economy*, WTTC, London.

World Travel and Tourism Council (2003), *South Africa: Travel & Tourism A World of Opportunity*, WTTC, London.

Chapter 4 **Sectoral Profile – SMMEs in the Food Processing Complex**

Department of Trade and Industry (1998), *Sectoral Prospects: Growth Guidelines for South Africa's 80 industries 1997-2001*, the dti and IDC, Pretoria.

Department of Trade and Industry (2002), *A Guide to the Real Economy*, the dti, Pretoria.

National Department of Agriculture (2004a), 'Abstract of Agricultural Statistics'. NDA, Pretoria.

National Department of Agriculture (2004b), *AgriBEE: Broad-Based Black Economic Empowerment Framework for Agriculture*, NDA.

Statistics South Africa (2004), *Manufacturing Production and Sales*, Stats SA, Pretoria.

Vink, N. and Kirsten, J. (2002) *Pricing Behaviour in the South African Food and Agricultural Sector*, Report commissioned by the National Treasury, Pretoria.

Chapter 5 **Provincial Profile – Focus on the Free State**

The material in the Free State provincial profile was taken from two unpublished larger reports submitted to the Premier's Economic Advisory Council of the Free State:

Marais, L., Nel, E. and Rogerson, C. (2004), *Manufacturing Industry Study of the Free State: Current Trends, Spatial and Sectoral Considerations and Future Prospects*.

Rogerson, C.M. (2004), *Opportunities, Obstacles and Action Steps for the Development and Strengthening of SMMEs in the Free State*.

Chapter 6 **Issue Profile – Business Development Services**

The Nelspruit material was taken from a study undertaken by GTZ BDS/LED:

GTZ (2004), *Market Assessment – Nelspruit: To Establish Which Business Development Services Should be Used for Intervention in Nelspruit*.

The parallel investigation is titled *Market Assessment – Queenstown: To Establish Which Business Development Services Should be Used for Intervention in Queenstown*.

Useful sources on changing international approaches to support provision are:

Committee of Donor Agencies for Small Enterprise Development (2001), 'Business development services for SMEs: Guidelines for Donor-funded Interventions'. The World Bank Group, Washington DC.

Dawson, J. and Jeans, A. (1997), *Looking Beyond Credit: Business Development Services and the Promotion of Innovation Among Small Producers*, Intermediate Technology Publications, London.

Hallberg, K. (1999), *A Market-Oriented Strategy for Small and Medium-Scale Enterprises*, Discussion Paper No. 40, International Finance Corporation, The World Bank, Washington DC.

Useful sources on changing approaches to BDS provision are:

Gibson, A. (2000), *Key Elements in the Emerging Market Development Approach to BDS*, unpublished presentation to the Seminar on Emerging Good Practices in BDS, ILO International Training Centre, Turin, 4-8 September.

Hitchins, R. (2000), *Developing Markets for Business Development Services: Designing and Implementing more Effective Interventions*, Issue Paper No. 5, Swiss Agency for Development and Cooperation, Berne.

Miehlbradt, A. and McVay, M. (2003), *Business Development Services: Testing the Guiding Principles: BDS Update for Fourth Annual BDS Seminar, Turin, Italy September 2003*, Small Enterprise Development Programme of the International Labour Organisation, Geneva.

Miehlbradt, A. and McVay, M. (2003), *Developing Commercial Markets for Business Development Services: BDS Primer for Fourth Annual BDS Seminar, Turin, Italy September 2003*, Small Enterprise Development Programme of the International Labour Organization, Geneva.

Miehlbradt, A.O. (2002), *Assessing Markets for Business Development Services: What Have We Learned so Far?*, SEED Working Paper No. 28, International Labour Office, Geneva.

Sievers, M. and Vandenberg, P. (2004), *Synergies Through Market Linkages: Who Benefits from Linking Finance and Business Development Services?* SEED Working Paper No. 64, International Labour Office, Geneva.

Enterprise Development Unit
Department of Trade and Industry (the dti)

Private Bag X84
Pretoria
0001

Tel: 0861 843 384 Tel: +27 12 394 9500 (international)
Customer Contact Centre

www.thedti.gov.za

