Development of BUSA policy position and strategy to boost sustainable enterprises, SME development and facilitate the transition of informal to formal enterprises

Phase 1: Background Report and Country Review

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Section A: Introduction and overview

Background to the research and objective

In a market economy, such as South Africa, enterprises are the key drivers of employment and consequently have a major, yet indirect, role to play in addressing poverty and inequality. Globally, small and formal enterprises are recognised as the most significant contributors to employment, yet in South Africa these enterprises are struggling to grow and expand and are accordingly not achieving the employment growth that is required. This research is targeted at understanding the main barriers to transition to the formal economy and to SME expansion with a view to making a constructive contribution to the policy framework for the creation of an enabling environment formalising and small enterprises.

The National Development Plan's (NDP) targets for job creation in the SME sector depend on the creation of a business environment that enables the growth and sustainability of existing small businesses, and the formation and formalisation of sustainable new enterprises to prosper. The NDP sets out several ambitious goals for SMEs including a target for 90% of new employment opportunities to be created by SMEs by 2030. This has been translated into a target of 800 000 new jobs being created per year by SMEs.

Given the importance of a conducive and enabling environment to support sustainable enterprises and SME growth as drivers of employment and poverty reduction, it is imperative that Business Unity South Africa (BUSA) equip itself to engage knowledgeably and constructively in the national policy debates on the issue of small business development and the separate, but interrelated, issue of transitions to formality. With SMEs coming increasingly under the spotlight, the time is ripe for this engagement particularly given the establishment of the Presidential Business bilateral process on the NDP and the establishment of the Ministry for Small Business Development.

As funding partners for this project, the ILO is committed to supporting BUSA's capacity to influence the development enabling environments that create conditions for economic growth and decent work. This means encouraging entrepreneurs to expand and create conditions for businesses to formalise - to innovate, generate decent employment and invest in human resources over the long term thereby boosting economic growth and raising living standards. The ILO's International Labour Conference 2007 Conclusions on Sustainable Enterprises provide useful guidance on an integrated approach to create an environment that is conducive to sustainable enterprises, enterprise development and the creation of productive employment and decent work. Social, economic and environmental dimensions are identified to provide a framework of sustainable development. This has relevance to all types of enterprises but is particularly useful in relation to the sustainability of SMEs and in facilitating the transitions to formality.

The objective of the project is to support BUSA in developing a coherent policy position together with a set of tangible measures that will promote an enabling environment to support sustainable SMEs and facilitate the transition of informal to formal enterprises in South Africa.

To achieve this objective, the project will be conducted over three phases, each with a set of tangible outputs comprising a mix of secondary and primary data collection and analysis coupled with a series of consultative workshops that will ultimately result in BUSA's policy position and a set of concrete measures for SME development and transitions to the formal economy.

Spanning a number of months during 2015, the project's three phases briefly involve:

- (Phase 1) a *review* of the literature and key studies on the barriers to SMEs impacting on their growth, expansion and job creation in South Africa within the context of the ILO 2007 conclusions for sustainable enterprises and including a 3-country review to identify good practice examples of success strategies for SME development;
- (Phase 2) *primary data collection* comprising a survey of a sample of SME business owners and their workforce, based on the ILO's EESE survey methodology but refined to the South African context; and
- (Phase 3) building on the outcomes from the two previous phases, *development of BUSA's policy position and concrete measures* to improve the enabling environment to boost SME development and facilitate the transitions to formality as a means to generating inclusive growth, employment and reducing poverty and inequality.

This report represents the outcomes of Phase 1 of the project conducted over two months. The report is based on a review of secondary data highlighting key factors impacting on the growth and expansions of SMEs in South Africa and the transition to formalisation. The observations contained in this report are focused in particular on the economic, political, social and environment conditions contained within the 2007 ILC's sustainable enterprises framework.

SMEs Global Importance

Conclusions from the Committee on Sustainable Enterprises reached by tripartite consensus at the ILO's 2007 International Labour Conference (ILC) recognise that the principal source of economic growth and employment creation stems from enterprises – from micro through to small, medium sized and large companies. Enterprises are at the heart of economic activity and development in nearly all countries. They are a major – often the main – source of tax revenues and sustainable enterprises provide the basis for social inclusion, poverty alleviation and equitable access to opportunities in a society (ILC conclusions 2007).

Ample evidence suggests that SMEs are the most significant source of new employment. According to recent studies, more than 95% of registered businesses in the world are small in size, employing less than 250 employees. Under the right conditions, SMEs can enhance competition, entrepreneurship, job growth and spur economy-wide efficiency, innovation and poverty reduction (World Bank, 2007).

In the OECD, for example, over 95% of enterprises are classified as SMEs and account for 60-70% of the working population. In Europe, 91% of enterprises are classified as micro businesses, employing between one and nine people and only 1% are large enterprises, with more than 250 employees. It is perhaps with SMEs that the "spirit of enterprise" is most readily associated. SMEs are more likely to have greater capacity to innovate and to derive economic benefits from the specialization of production processes (ILC Report, 2007). Their small scale combined with close owner-management organizational structures is also said to allow SMEs to respond more quickly to external changes than large enterprises with bigger structures, thereby increasing their dynamism.

SMEs are also likely to play a vital coordination or intermediary role between micro and large enterprises, constituting a strategic bridge toward improving the competitiveness of the broader private sector. This is especially important in the global environment, given the ever increasing importance of global and national value chains (ILC report, 2007).

SMEs in South Africa

SMEs play a vital role in South Africa's economy. More than half of formal non-agricultural employment is in firms with less than 50 employees and more than 80% is in firms with less than 250 employees (Kerr et al). SMEs are diverse, they range in size from micro, small to medium businesses and they operate in all sectors in the economy such as manufacturing, ICT, retail, tourism, business services and agri-processing, amongst others. However, a comparative picture of South Africa's SME performance, contribution to GDP and employment, to that of international comparisons is difficult due to a lack of clear definitions and robust statistical evidence – little is known about the dynamics of SMEs and their characteristics during different points in their growth cycles. Nonetheless, it is known that smaller firms have greater propensity to employ the more marginalised in our society; young people, African women and low-skilled workers are 19 percentage points more likely to be employed in SMEs (SBP, 2013). Estimates show that SMEs contribute between 40 – 50% of the country's GDP and constitute the majority of firms within the South Africa's business community (National Treasury, Budget Review 2011). Firms employing less than 50 employees constitute 60% of South Africa's overall business community and SMEs already account for 91% of the country's formalised businesses (BASA, 2013).

The NDP recognises the importance of the SME community in South Africa in achieving the country's socio-economic goals. It suggests that "a large percentage of the jobs will be created in domestic-orientated activities and in the services sector. Some 90% of jobs will be created in small and expanding firms. The economy will be more enabling of business entry and expansion, with an eye to credit and market access. By 2030, this share of small and medium sized firms in output will grow substantially. Regulatory reform and support will boost mass entrepreneurship. Export growth, with appropriate linkages to the domestic economy, will play a major role in boosting growth and employment with small and medium-sized firms being the main employment creators" (NDP, 2011).

Government has invested extensively in establishing a wide-ranging institutional framework to provide support to small business over the past two decades, and has established a number of programmes and initiatives over the years. In keeping with the general trend, the 2014 Budget provides for R6.5billion for the next three years towards extending small business support programmes and initiatives.

A common caution however is that government's approach to SME development and enterprise formalisation is that it has been overly ambitious with a complex, ever-changing mix of strategies. The World Bank's evaluation of eleven government programmes for instance found that their economic and development impact was not encouraging. The report notes that government's strategies had a tendency to be supply-driven, used a generic one-size-fits-all approach, and that they had overly complex goals (World Bank, 2007). This observation has been echoed in many other more recent studies which have found that the main element driving government's policy and support measures is based on an erroneous understanding that all small firms (from micro, small to medium sized enterprises) are homogenous in nature, and all require the same support (Timm; Rogerson; SBP).

Despite their importance as drivers for job growth, evidence gathered on a number of studies is beginning to show that SMEs in South Africa are declining in terms of their employment share, profitability and in number. This is in direct contradiction to global trends and the country's development needs. South African SMEs are beginning to show high rates of job destruction in the sector (SBP, 2013; Kerr et al 2013; QES 2014). Moreover, new enterprises have an exceptionally high failure rate – as many as 70% fail in their first two years giving the country one of the highest enterprise failure rates in the world (Olawale and Garwe, 2010). Existing SMEs are ageing, with few new entrepreneurs entering the market (SBP 2013). Research conducted by National Treasury's Economic Policy Unit also notes that South Africa has disturbingly low levels of growth in the SME sector, despite the extensive institutional support infrastructure that government has established. The findings, using data from StatsSA indicate that SMEs accounted for only 8.5% of the total non-financial investment activity in 2012 compared with 12.9% in 2010 (Davis Tax Commission, 2014). This creates a worrying picture for SMEs – contrary to global trends, much of the SME sector in South Africa appears to be struggling to formalise, grow and expand.

The informal sector in South Africa

Enterprises come in a wide variety shapes and sizes. In many countries, a significant amount of overall economic activity can be classified as informal. International studies show that the size of the informal economy tends to vary inversely with the level of development. The bulk of economic activity in low-income countries is usually made up of informal activities – typically in the order of 70% of the workforce – and it appears that in many poorer countries, the informal economy is getting bigger largely because the growth of the labour force is outstripping the growth of employment opportunities in the formal economy (ILC Conclusions 2007, World Bank, ILO, UNDP). There is a continuum between formality and informality, with employers and employees moving between the two and many enterprises juggling different aspects of formality and informality (ILC, 2007; DCED, 2011). However, despite their numerical significance and prevalence in many societies, most informal enterprises cannot be classified as sustainable enterprises if they operate illegally or do not integrate into their operations ethical values and social and environmental requirements as expressed by international standards and national laws and practices (ILC, 2007).

Informality is difficult to accurately define. Various degrees of informality can be found along a continuum between an enterprise operating completely informally to one that complies with all laws and regulation, which makes it difficult to measure the size and complexity of the size of the informal economy particularly in South Africa.

Transitions to formality – South Africa

Although much smaller than our developing country counterparts, it is estimated that 2.3 million people are reported working in the South African informal sector – defined as enterprises employing less than five people and not registered for value added tax purposes, representing some 16% of our labour force (QLFS, 2014). The Stats SA survey published in 2014 found that the number of informal businesses declined from 2.3 million in 2001 to 1.1 million in 2009, with a slight uptick to 1.5million in 2013. Findings show that there has been an increase in commercial lending to the informal sector between 2001 and 2013 (4% loans in 2001 to 17% loans reported in 2013). The study found that most of the informal enterprises have a turnover of between R1 000 to R10 000 per month and are predominately African owned by people falling within the 35-44 age group. The major reason for starting their enterprise was unemployment (60% in 2001 compared to 70% in 2013) and the vast majority, some 95%, operate only one enterprise. Asked what their major needs were, respondents to the survey stated “marketing” as their key priority (40.5% in 2013 against 27.4% reported in 2001) with the second most important priority being “reduced regulation” (21.5%in 2013 against 9.6% in 2001).

On average, individual incomes of informal workers are very low, suggesting this work should not be seen as alternative to formal employment. Cumulatively, however, these activities contribute between 5% to 7% to South Africa’s GDP (Skinner, 2014). Despite the important role played by this sector, many challenges and constraints threaten its sustained ability to mediate the impact of poverty and unemployment. These include legal and regulatory constraints, lack of access by enterprises in the informal sector to finance and financial services, access to markets, skills development and technology support, business infrastructure; poor stakeholder management systems; and lack of access to knowledge management (information) and capacity building opportunities.

Two initiatives by government have potential to shift the policy environment for the informal sector. The Draft Licensing of Businesses Bill, in its March 2013 iteration, would require any person involved in business activities – no matter how small – to have a licence. However, the draft bill provides no incentive to obtain a licence, but punishments for not doing so are draconian – confiscation of goods, fines and imprisonment for up to 10 years. If these provisions are pursued, they may provide a deterrent to enterprise creation and formalisation. An alternative approach would be to provide incentives for formalisation such as in Brazil, where informal traders are given a trade number which in turn facilitates the opening of a bank account and access to subsidised loans.

The second initiative is the national informal business upliftment strategy (NIBUS), released in March 2014. This is the first attempt at a nationally co-ordinated approach to dealing with the informal sector in South Africa. It proposes to tackle two critical issues: infrastructure and skills development. The challenge however will be to reach scale required. The skills programme pilot for example, will train only 1 000 informal traders, running the risk of "picking winners" and neglecting the majority (Skinner, 2014). Policy at both national and local level needs to recognise the diverse nature of informal activity and the fact that these activities that require support that is quite specific.

Given the importance placed on the SME sector by the NDP, it stands to reason that the challenge is to ensure an environment that enables SMEs to grow and expand their operations, and to put in place conditions under which start-ups can flourish and more entrepreneurs are encouraged to formalise and enter the market. As the World Bank put it "rewarding firms for being small is not the point of SME policies and support schemes. Creating a functioning ecology of firms is – where new ones can emerge, where existing ones can contract, and where firms can work with each other depending on the requirements of the sector" (M.Klein; IFC 2004 Annual Review).

Similarly and while often characterized by high levels of poverty, social exclusion and exploitation, the informal economy can be a source of innovation and economic growth. To facilitate the transition of informal businesses to formalise, measures should be focused on those that increase the rate of graduation into the formal economy, including policy frameworks that address the legislative and regulatory environment barriers to formalisation (ILC 2014; Proposed Conclusions on Transition from the Informal Economy). It thus appears, that there is much to be done in supporting transitions of enterprises from the informal sector into formalisation, and growing their capacity to make a positive contribution to the economy and employment.

Towards sustainable enterprises: the International Labour Conference (ILC) conclusions & the 17 Conditions

In June 2007, the International Labour Conference, a tripartite committee comprising governments, employers and workers organisations, focused its attention on how to promote sustainable enterprise development in a manner that aligns enterprise growth with sustainable development objectives and the creation of productive employment and decent work. It took stock of the international debate on the role of the private sector and sustainable enterprise in overall social and economic development.

Recognising that each country is different and that enterprises are the principle source of growth and employment, with SMEs constituting the majority of jobs across the world, the ILC concluded that 17 pillars – or conditions – are necessary in an economy to promote the development and growth of sustainable enterprises. These pillars constitute conditions for a conducive business environment, and are presented as a generic framework to guide governments and the social partners in promoting enabling conditions for sustainable enterprises, summarised below (Figure 1):

Condition	Explanation
1: Peace and Political Stability	Peace and political stability are basic preconditions to nurture the formation and growth of sustainable enterprises while war and civil conflict are major deterrents of investment, private sector development and employment.
2: Good Governance	Democratic political institutions, transparent and accountable public and private entities, effective anti-corruption measures and responsible corporate governance, are key conditions for making market economies and enterprises perform in superior ways and be more responsive to the values and long-term goals of society.
3: Social Dialogue	Social dialogue based on freedom of association and the effective right to collective bargaining, including through institutional and regulatory frameworks, is essential for achieving effective, equitable and mutually beneficial outcomes for governments, employers, workers and wider society. Social dialogue needs to be adaptable to local conditions and be inclusive of different types and sizes of enterprises and employment. Governments should partner with social partners to address barriers to enterprise sustainability.
4: Respect for universal human rights	Competitiveness should be built on values. Respect for human rights and international labour standards, especially core rights and principles such as freedom of association and collective bargaining, the abolition of child labour, forced labour and all forms of discrimination, is a distinctive feature of societies that have successfully integrated sustainability and decent work.
5: Entrepreneurial Culture	Governmental and societal recognition of the key role of enterprises in development and strong support, both public and private, to entrepreneurship, innovation, creativity and the concept of mentorship, particularly for start-ups, small enterprises and targeted groups such as women and youth, are important determinants of a conducive business environment. Respect for workers' rights should be embedded in programmes targeting entrepreneurial culture.

6: Sound and stable macroeconomic policy	Monetary, fiscal and exchange rate policies should guarantee stable and predictable economic conditions. Sound economic management should balance the objectives of creating more and better jobs with combating inflation and provide for policies and regulations that stimulate long-term productive investment. Attention should also be given to increasing aggregate demand as a source of economic growth contingent on national conditions. In the case of developing and least developed countries, achieving sound macroeconomic conditions usually requires the decisive support of the international community through debt relief and official development assistance.
7: Trade and sustainable economic integration	The varying development levels of countries must be taken into account in lifting barriers to domestic and foreign markets. Efficiency gains caused by trade integration can lead to positive employment effects either in terms of quantity or quality of jobs or a combination of both. However, as trade integration can also lead to job dislocation, increased informality and growing income inequality, measures must be taken by governments in consultation with the social partners, to better assess and address the enterprise, employment and decent work impact of trade policies. Actions are also needed at regional and multilateral levels to remove trade distortions and to assist developing countries in building their capacity to export value-added products, manage change and develop a competitive industrial base.
8: Enabling legal and regulatory environment	Poorly designed regulations and unnecessary bureaucratic burdens on businesses limit enterprise start-ups and the on going operations of existing companies, and contribute to informality, corruption and efficiency costs. Well-designed transparent, accountable and well-communicated regulations, including those that uphold labour and environmental standards, are good for markets and society. They facilitate formalization and boost systemic competitiveness. Regulatory reform and the removal of business constraints should not undermine such standards.
9: Rule of law and secure property rights	A formal and effective legal system which guarantees all citizens and enterprises that contracts are honoured and upheld, the rule of law is respected and property rights are secure, is a key condition not only for attracting investment, but also for generating certainty, and nurturing trust and fairness in society. Property is more than simply ownership. Extending property rights can be a tool for empowerment and can facilitate access to credit and capital. They also entail the obligation to comply with the rules and regulations established by society.
10: Fair competition	It is necessary to establish, for the private sector, competition rules that include universal respect for labour and social standards, and to eliminate anti-competitive practices at national level.
11: Access to financial services	A well-functioning financial system provides the lubricant for a growing and dynamic private sector. Making it easier for SMEs, including cooperatives and start-ups, to access financing, for example, credit, leasing, venture capital funds or similar or new types of instruments, creates appropriate conditions for a more inclusive process of enterprise development. Financial institutions, particularly multilateral and international ones, should be encouraged to include decent work in their lending practices.
12: Physical infrastructure	Enterprise sustainability and human development critically depend on the quality and quantity of the physical infrastructure available, such as physical facilities for enterprises and employees, transportation systems, schools and hospitals. Reliable and affordable access to water and energy also remains a major challenge, especially in developing countries. Enterprises are also particularly assisted by local access to supporting industries such as service providers, and machinery suppliers and producers.
13: Information and communications technology	Expanding access to information and communication technologies (ICTs) is another crucial challenge in the era of the knowledge economy. The use of ICTs is, therefore, fundamental to the development of sustainable enterprises and must be fully utilized in this regard. Affordable broadband technology is also of extreme importance to countries and enterprises and should be facilitated.

14: Education, training and lifelong learning	Human talent is the single most important productive factor in today's economy. Focusing on the development of a skilled workforce and the expansion of human capabilities through high-quality systems of education, training and lifelong learning is important for helping workers to find decent employment and enterprises to find the skilled workers they need. Financial support should also be made available to enhance access of poor workers to training and skills upgrading. In this way, countries can achieve the twin goals of economic success and social progress.
15: Social justice and social inclusion	Inequality and discrimination are incompatible with sustainable enterprise development. Explicit policies for social justice, social inclusion and equality of opportunities for employment are needed. Effective exercise of the right to organize and bargain collectively is also an effective means to ensure fair distribution of productivity gains and adequate remuneration of workers.
16: Adequate social protection	Sustainable tax-based or other national models of universal social security that provide citizens with access to key services such as quality health care, unemployment benefits, maternity protection and a basic pension, are key to improving productivity and fostering conditions for transitions to the formal economy. Protecting workers' health and safety at the workplace is also vital for sustainable enterprise development.
17: Responsible stewardship of the environment.	In the absence of appropriate regulations and incentives, markets can lead to undesirable environmental outcomes. Tax incentives and regulations, including public procurement procedures, should be used to promote consumption and production patterns that are compatible with the requirements of sustainable development. Private market based solutions, such as the use of environmental criteria in assessing credit risk or investment performance, are also effective means to tackle this challenge.

Figure 1: 17 Pillars for Sustainable Enterprise

Source: ILO 2007; *Conclusions concerning the promotion of sustainable enterprises.*

These conditions can be broadly captured under political, economic, social and environmental conditions for sustainable enterprises. While all these conditions are prerequisites for sustainable enterprises, some are more important that others in addressing South Africa's challenge to encourage transitions to the formal economy and SME development.

In terms of political conditions - stability, good governance and recognition of the role of private enterprises in a market economy are important prerequisites for growth and investment in the South African economy. SMEs face bigger business continuity challenges in the face of political instability occurring both locally and in the rest of the continent; as well as as a result of lack of good governance, transparency and accountability or where there is corruption. Social dialogue is also not sufficiently effective, structured or capacitated to address the interests and challenges facing SMEs and to encourage transitions of enterprises to formality. Traditional forms of organising of employers and workers requires rethinking in order to encompass SMEs and in the interests of formalising businesses. There is clear recognition by the ILO that policy making in relation to SMEs is best informed by the enterprises and workers that are part of the sector.

The main barriers in respect of economic conditions for SMEs in South Africa pertain to: trade and sustainable economic integration; access to financial services and public funding; physical infrastructure; and an enabling, stable regulatory environment. Formalising businesses and SMEs face particular challenges in accessing market opportunities and financial resources and they bear a disproportionately higher economic cost as a result of the limited and costly infrastructure; and the transaction costs of a complex and cumbersome regulatory system. The lack of a common definition of SMEs, the lack of integration between government departments on policy impacting on small enterprises and general policy uncertainty poses a massive challenge for smaller enterprises. The ILO advocates that countries should understand and monitor the impact of their policies on SMEs.

From a social perspective, education, training and lifelong learning, particularly in entrepreneurial skills and stimulating an entrepreneurial culture, constitutes the most significant challenge to employment and contributes significantly to inequality and poverty.

Section B: Three Country Review

Global trade dynamics following the financial crisis of 2008 have had a dramatic impact on all nations. Depressed economic growth, job losses and reduced employment opportunities have led governments to the realisation that in the rebuilding of their economies, governments must prioritise SMEs to accelerate employment in order to advance inclusive growth. As the NDP makes it clear, getting South Africa on a high-growth track to achieve its socio-economic goals requires changing the way the country operates.

A country's competitiveness is fundamentally about how hospitable to business the economy is, what natural and regulatory advantages and disadvantages it offers, and how well the economic actors within it are able to operate. Some factors are endogenous and unchangeable, such as geographical location and natural resources. Others are subject to adjustment, such as the state of institutions, the regulatory environment or the availability of skills. Yet many others may involve a combination of these sets of factors, as, for example the nature of historical trading relationships in building a country's competitive advantage.

In selecting the three country SME strategies and transition policies for formalisation for review, the question of benchmarking South Africa's competitiveness against its peers was raised since SMEs demand particular attention towards achieving the country's high growth trajectory; they are a keystone of the NDP's vision. The Global Competitiveness Report (GCR) produced by the World Economic Forum was helpful in narrowing the countries for review. The GCR assesses the competitiveness landscape of 144 economies, providing insights into the drivers of their productivity and prosperity. It is the most comprehensive assessment of national competitiveness worldwide, offering a platform for dialogue between government, business and civil society about the actions required to improve economic prosperity.

With competeviness defined as the set of institutions, policies and factors that determine the level of productivity of a country, the GCR captures different aspects of competitiveness in 12 pillars, which have similarities with the ILC's 17 conditions for sustainable enterprises. The GCR 12 pillars against which the 144 countries are benchmarked as described as follows:

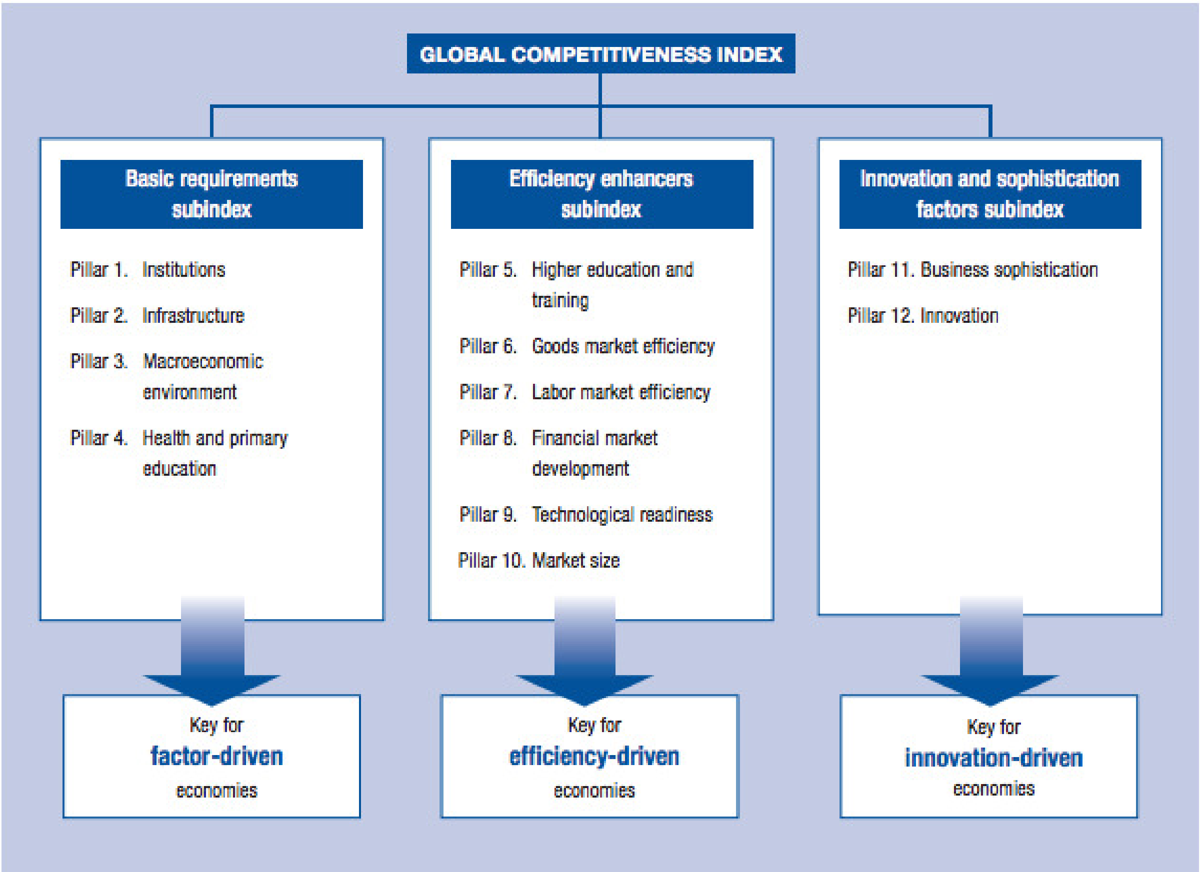

Figure 2: Global Competitiveness Index (overview)

Source: Global Competitiveness Report 2014-2015

The 2014/2015 GCR classifies South Africa as an "efficiency driven" economy. For the purposes of the country review, countries falling within the transitory phase between "efficiency" and "innovation" were regarded as interesting since they could offer valuable insights to South Africa, not only in terms of identifying priorities for growth, but also how these countries have established strategies for their SME sectors as key drivers of inclusive economic growth and job creation:

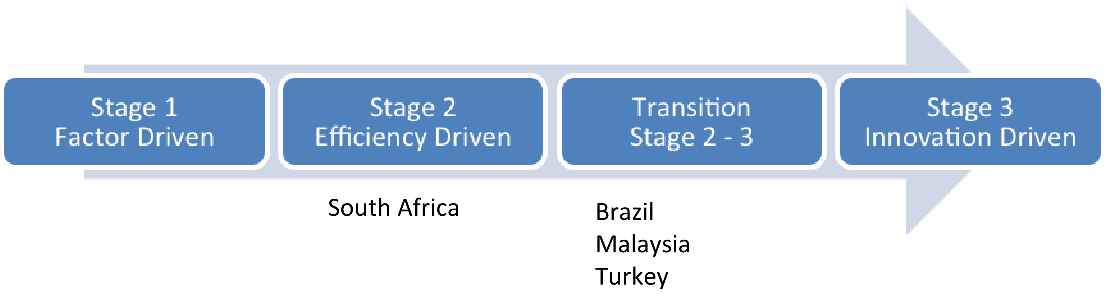

Figure 3: Country stage positions

In this transitory stage it is useful to note that competitiveness as identified by the GCR is driven by skills and education, supported by functioning labour markets and well developed financial markets. The 2014/2015 GCR rankings of the three transitory countries against South Africa show:

Global Competitiveness Rankings (2014-2015)	
Country	**Ranking**
Brazil	57
Malaysia	20
Turkey	45
South Africa	56

Figure 4: GCR Country rankings

Source : Global Competitivess Index, World Economic Forum (2014-2015)

The GCR rankings place South Africa and Brazil on an equal footing, while Malaysia and Turkey are ahead in terms of their competitiveness characteristics. The GCR was thus a useful tool to narrow the three countries for review, with a particular focus on their SME policies and strategies.

SME development in Malaysia:

The Malaysian economy has emerged strongly from the global financial crisis. Structural reform coupled with regional growth has been favourable in the development and inclusive growth targets of the Malaysian government.

SMEs represent 99.2% of all Malaysian businesses; they contributed 57.4% of total employment in 2012 (Malaysian 10th five year plan). Their economic importance is highlighted by their growth since 2003, contributing 31.4% to GDP in 2008 (up from 28.7% in 2003) with a projected contribution of 41% to GDP in 2014.

In 1996, a specialized agency known as the Small and Medium Industries Development Corporation (SMIDEC) was established to increase the development of small and medium enterprises (SMEs) by providing financial assistance, advisory services, infrastructure facilities, market access and other support programs. Its aim was to develop Malaysian SMEs to be competitive in the global market.

In 2004, the establishment of the National SME Development Council (NSDC) presented another chapter in SMEs development in Malaysia. As the highest policy-making body, its role was to formulate strategies for SMEs development across all the economic sectors and related Ministries and Agencies as well as to ensure effective implementation of the overall SMEs development programs in Malaysia. Specifically, the scope of work identified for the NSDC included;

- The formulation of broad policies and strategies to facilitate the overall development of SMEs across all sectors;
- Review of the roles and responsibilities of Government Ministries and Agencies responsible for SME development;
- Enhancing collaboration, coordination to ensure effective implementation of SME development policies and action plans;
- Encouraging and strengthening the role of the private sector in supporting the overall development of SMEs; and
- Providing emphasis on the development of Bumiputera SMEs[1] across all sectors of the economy.

In 2007, the NSDC appointed a single dedicated agency to coordinate programs across all related Ministries and Agencies and to formulate overall policies and strategies for SMEs. SMIDEC was tasked to assume the role and in 2009 was transformed into Small and Medium Enterprise Corporation Malaysia (SMEs Corp. Malaysia). SMEs Corp. Malaysia is now the central point of reference for information and advisory services for all SMEs in Malaysia (SMEs Corp. Malaysia 2013).

Recently, in 2014 the SME Corp. Malaysia simplified the definitions for Malaysian SMEs into two categories:

- Manufacturing: sales turnover not exceeding RM50million (equivalent to R165million)[2] *OR* full-time employees not exceeding 200 workers; and
- Services and other sectors: Sales turnover not exceeding RM20million (equivalent to R66m), *OR* full-time employees not exceeding 75 workers.

[1] Current incentives for the Bumiputera Economic Empowerment (BEE) programme which include interventions and support measures of approximately $10 billion to benefit ethnic Malays who represent 65% of the population.

[2] Conversion RM to ZAR 3.3 (April, 2015)

The new definition for Malaysian SMEs			
Category	**Micro**	**Small**	**Medium**
Manufacturing	**Sales turnover of less than RM300, 000 *OR* Full-time employees less than 5**	Sales turnover from RM300, 000 to less than RM15 million *OR* Full-time employees from 5 to less than 75	Sales turnover from RM15 million to not exceeding RM50 million *OR* Full-time employees from 75 to not exceeding 200
Services & Other Sectors		Sales turnover from RM300, 000 to less than RM3 million *OR* Full-time employees from 5 to less than 30	Sales turnover from RM3 million to not exceeding RM20 million *OR* Full-time employees from 30 to not exceeding 75

Figure 5: Malaysian SME definition

Source: SME Corp. Malaysia, 2014

SME contribution to sectors is broken down as follows:

Figure 6 outline the current facts and figures of SMEs in Malaysia

Economic Census 2011 (Reference Year 2010)				
	Total	SMEs	% of SMEs	% of SMEs over
Services	591,883	580,985	98.2	**90.0**
Manufacturing	39,669	37,861	95.4	**5.9**
Agriculture	8,829	6,708	76.0	**1.0**
Construction	22,140	19,283	87.1	**3.0**
Mining &	418	299	71.5	**0.1**
Total	**662,939**	**645,136**	**97.3**	**100**

Figure 6: Malaysian economic census data (SME contributions)

Source: SMEs Annual Report Malaysia, 2011/2012.

Since independence over 50 years ago, Malaysia has had a focussed economic strategy, embodied in the “Malaysian Plan” which are reviewed and published every five years (currently the 10th Plan for y2011-2015). These plans are characterised by their in-depth review of the current challenges and chart the development goals of the nation. The current 10th Plan underpins Malaysia’s commitment to become a high-income nation by 2020. Malaysia’s National Key Economic Areas (NKEAs) – identified as the areas where Malaysia can leverage competitive advantage and prioritise investment support – are premised on 6 key enablers to promote an enabling environment supportive of economic growth:

1. Creating a private sector-led economy
2. Supporting innovation and growth
3. Rationalising the role of government in business
4. Developing SME's as an engine of growth and innovation
5. Competing globally
6. Putting in place world-class infrastructure for growth.

As part of the current (10^{th}) economic plan, the Malaysian government is focused on developing strategies to enhance the performance of SME's with the following key focal areas:

- Reducing regulatory costs borne by SMEs
- Building capacity and capability
- Supporting the creation of an entrepreneurial culture
- Strengthening support systems for SMEs
- Enhancing access to financing for SMEs

In support of an entrepreneurial culture, the Malaysian government has adopted an education policy that encourages and rewards life-long learning among the workforce to raise the capacity and knowledge of its populace for life-long employment opportunities, with particular focus towards reducing the performance gap between rural and urban schooling. Under the last two economic stimulus packages, over half a million unemployed graduates, school leavers and displaced workers have been provided with skills upgrading programmes.

To bridge the gap from the "efficiency" drivers to those of "innovation", the Malaysian government has prioritised innovation capabilities and has put in place strict conditions to FDI incentive packages. These ensure the encouragement of knowledge transfer to the local economy as well as promote the establishment of local research centres.

Malaysia has had a long history in recognising the importance of SME development as a priority for its economic growth dating back to 1960. These initially focused on establishing new companies under their Bumiputera Economic Empowerment (BEE) policy, which gave preferential ownership and employment advancement especially in corporate management and professional occupations to the Bumiputera (“sons of the soil”) who represent about 65% of Malaysia’s population.   In the 1980s emphasis shifted away from policies favouring business start-ups to those supporting industrial development, which focused on providing support policies to transform existing SMEs by promoting sub-contracting relationships with international companies through the Vendor Development Programmes (VDPs).   The schemes, which were carefully monitored and assessed by the government, provided for technical management assistance for the FDI “anchor” (parent) company to participating Malaysian vendors, with financial support provided by the government as well as having the role as the active co-ordinator for the programme.

While some success was achieved with Japanese companies in establishing electrical and electronic assembly lines, a key lesson of the VDP programme soon however began to emerge. The international “anchor” companies were reliant on markets to sell their products but the participating Malaysian vendors became overly reliant on the anchor companies irrespective of prevailing market conditions. Furthermore, there was a conflict inherent in the VDP; anchor companies were more focused on quality production, while the government pressured anchor companies to engage with ever increasing number of local vendors irrespective of their production capacity.

Over the years, the Malaysian government has had mixed results in the roll-out of government funded incubators, with their effectiveness and sustainability in particular coming under scrutiny. Following a recent assessment, the government has introduced a new approach under its 10th plan that aims to increase engagement with the private sector for its incubator programme. New focal areas include: funding for incubators have been gradually shifted towards private sector financing with public private partnerships as an intermediate step; incubators have been encouraged to shift from being providers of workspace to include business development services, with incubator managers and operators receiving specialised training to upgrade their skills; new incubators are subjected to strict evaluation of their performance to ensure their financial sustainability together with clear key performance indicators measuring impact such as the rate of company maturation.

Recognising the need for reducing the regulatory burden for micro enterprises (employing less than 5 people), the government has introduced a simplified system for tax and social security costs along the French “auto-entrepreneur” model, which reduces the business registration process and collects social charges based on actual earnings on monthly turnover, replacing income tax.

The *Bumiputera Economic Empowerment (BEE)* policy is of particular interest to South Africa, given our own BBBEE policies. Post independence in 1971, the Malaysian government introduced the policy with aim of transforming the economy. Billed as a temporary measure under the government's New Economic Policy (NEP), the BEE policy was introduced to provide the Malayan population (representing around 65%) with preference quotas in university admissions and civil service jobs; a proportion of shares of any public quoted company (30%), and favouring Malayan-owned firms for various government contracts.

The effect of the BEE policies in Malaysia have been recognised as a key factor in uplifting the Bumiputera: the civil service is now 85% Malay and most universities reserve 70% or more of their places for the Bumiputera. However, there have been a number of criticisms levelled on the policy as to its trickle-down effects and its centrality in building a system of corrupt patronage (World Bank, 2011).

The government's methodology of calculating broad based equity share for unlisted companies has been described as being difficult at best. Indigenous, or Bumiputera, ownership of share capital which was 2.4% in 1970 had increased to only 20.3% in 1990 against a target of 30%, whereas non-Bumiputera (mainly Chinese) ownership of share capital had increased from 32.3% to 46.2% in the same period. Mahathir Mohamad, a former prime minister who in his time extended the reach of the NEP, lamented the policies shortcomings in 2002 and stated that bumputeras too often treat university places as a "matter of right", neglecting their studies (Economist, 2013). Most Chinese and Indian students flock to private and foreign universities and those who leave often stay away according to a World Bank study conducted in 2011. A survey in 2008 found that 71% of Malaysians agreed that "race-based affirmative action" was "obsolete" and should be replaced with a "merit-based policy". Both the ruling coalition and the opposition agree that the BEE system of discrimination should be dismantled, but the government fears alienating the hardline Malay vote (Economist, 2013).

Along the lines of the ILC Conclusions for sustainable enterprises which regards trade and sustainable economic integration as a critical pillar for sustainable enterprises (ILC Conclusions, 2007) trade integration is a key focus of Malaysia's 10th Plan and the ASEAN trade block provides the foundation for developing a world production base for its supporting countries. The ASEAN countries have identified collectively that no one country can attempt to specialise in all industries and by cooperation the focus is on practices that take advantage of the differences in stages of development and factor endowments of each country within the trading block. As a result of the steady growth in economic linkages with the ASEAN countries, Malaysia has achieved a diversified industrial sector for its SMEs mainly through support measures that promote SME joint ventures with ASEAN SMEs.

The Malaysian experience demonstrates the difficulty in focusing primarily on start-up enterprises. While this benefitted the Bumiputeras primarily, its impact on growth-orientated SMEs was not fully achieved. The shift in 2000 towards supporting existing small and medium firms to leverage technical assistance and managerial support off larger companies, where government played an active role of coordinator, has seen greater benefits in increasing the technical capacity and technology base of Malaysian SMEs.

SME Development in Brazil

SMEs account for 99% of Brazilian firms amounting to almost 6million entities in 2012 (SABRAE, 2012). The Brazilian economy has gone through a significant transformation during the past decade. Following nearly a quarter-century with very little growth in per capita GDP, there was a major change beginning in 2004. GDP per capita (adjusted for inflation) grew at a rate of 2.5% annually from 2003-2014, more than three times faster than the 0.8% annual growth of the prior government (1995-2002). This growth rate was achieved in spite of the 2008 global financial crisis, which pushed Brazil into recession (Brazil 2014-09 economic paper). Brazil has made huge gains in achieving more inclusive growth over the past decade, with both economic growth being the main contributor to the country's reduction in poverty and inequality and the government's Bolsa Familia cash-transfer programme to the poor which accounts for 0.5% of GDP.

Both unemployment and informality – the percentage of workers in the informal sector – have decreased considerably over the past decade. Unemployment peaked at 13% in 2003 and has declined steadily, except for some temporary upticks during the recession, to 5% today, a historic low. The percentage of workers employed in the informal sector has fallen sharply from 22.5% in 2003 to 13.3% mid-2014 due in the main to Brazil's economic performance and incentives for formalisation.

In Brazil, the SME sector is differentiated. The General Law of Micro and Small Business (Lei Geral da Micro e Pequena Empresa) introduced in 1999 provides the primary legislation for supporting the development of micro and small enterprises (MSEs) and excludes medium sized enterprises. Given that Brazil is a federal state with 27 federal units and while the General Law provides a definition for MSEs, the reality is that classifications of MSEs vary across states, and also by numerous institutions including both government and private (e.g. banks) for a variety of reasons such as incentive programmes.

The primary agency supporting MSEs in Brazil is SABRAE. Initially founded and controlled by government in 1972, the institution was privatised in 1990 and now operates as a non-profit private entity with the mission of promoting sustainable and competitive small businesses. SABRAE has 700 on-site service centres throughout the country, with over 5 000 small business experts working alongside a pool of external consultants and offers a wide range of non financial support services for start ups and existing small businesses.

SABRAE also defines the classifications of companies in Brazil. Classifications for a micro business in terms of turnover should not exceed BRL360 000 (roughly R1,5m) and BRL3.6m (roughly R15m) for small firms. The number of employees is also included in the classifications as follows:

Classification	Industry and Construction	Trades and Services
Micro Business	Up to 19 employees	Up to 9 employees
Small Business	From 20 to 99 employees	From 10 to 49 employees
Medium Business	From 100 to 499 employees	From 50 to 99 employees
Large Business	More than 500 employees	More than 100 employees

Figure 7: Brazil SME Definition

As noted earlier, according to SABRAE, 99.1% of all Brazilian companies are classified as micro and small enterprises amounting to almost 6 million entities in 2012. Their participation and employment ratios to the overall business sector are as follows:

Classification	Quantity	Participation	Jobs	Participation
Micro Business	5.961.402	93,1%	7.523.688	24,1%
Small Business	378.218	5,9%	8.633.694	27,6%
Micro + Small	6.339.60	99%	16.157.382	51,7%
TOTAL	**6.405.122**	**100%**	**31.277.977**	**100%**

Figure 8: SME apportionment Brazil

Deeper analysis of the figures shown above show that despite the high number of micro enterprises, almost 60% of them do not have any employees. This means that the business owner is the sole employee of the business in almost 4 million cases.

Nonetheless, micro and small businesses employ around 16 million people, accounting for upwards of 51% of private jobs created by private entities. Studies conducted by SABRAE show that for every BRL 100 000 in wages, BRL 40 000 is paid by micro and small businesses. In 2012, the average wage in these firms was BRL 1,344.00 (roughly R5 500).

MSEs are reported to account for around 25% of Brazil's GDP.

On the upper end of the scale, medium and large businesses account for a much lower percentage of Brazilian business entities. According to SABRAE, they represent only 0.9% (or nearly 54 000) of all Brazilian businesses:

Classification	Quantity	Participation	Jobs	Participation
Medium Business	39.301	0,6%	4.831.521	15,4%
Large Business	26.201	0,4%	10.289.074	32,9%
Medium + Large	65.502	1%	15.120.595	48,3%
TOTAL	6.405.122	100%	31.277.977	100%

Figure 9: SME Employment and participation Brazil

Despite being less in number, medium and large firms generate the larger number of jobs, totalling 15million and representing 48.3% of the jobs created by private firms. In 2012, the average wage in medium and large business was BRL 2,161.00 (roughly R9 000). Medium and large firms are an important component in Brazil's growing economy and in recognition of this government offers a wide range of various tax and credit incentives particularly towards innovation and technological research for these firms to maintain their growth.

The government offers number of incentive and support measures are offered to MSEs, the main benefits being in simplifying registration and tax collection through a single payment together with a myriad of services and support schemes offered through SABRAE.

Similar to South Africa's experience, micro and small business start-ups in Brazil are largely driven by necessity rather than opportunity entrepreneurs (S Timm) and the challenge for Brazilian policy makers is the high mortality rate of MSEs. SABRAE's surveys have found that over 50% of MSEs fail within two years and 60% after four years (Arroio). Financial difficulties account for 60% of business closures while a lack of capital accounts for 24%. The remaining 16% is attributed to taxes and regulatory issues. After firm closure, 29% individuals remained self reliant while 24% found employment (SABREA).

An interesting study conducted by Tulio Cravo in 2010 shows that the Brazilian economy is characterised by two special attributes: the poorer northern and north eastern parts of the country demonstrate different MSE characteristics to that of the richer south, with greater entrepreneurial activity being concentrated in the south than in the north. The paper argues that entrepreneurship may be linked to cultural phenomena that are clustered regionally. It concludes that differentiated policies and support measures for MSEs between the regions, tailored to achieve specific targets are needed to boost the longevity and sustainability of MSEs.

SME development in Turkey

Economic growth in Turkey was briefly interrupted by the 2009 global recession due to the drop in international demand and structural problems with international competitiveness. Turkey recovered quickly but GDP growth slowed again in 2012 as a result of weak domestic demand and spill-overs from the European debt crisis. Nevertheless, the Turkish economy has achieved steady growth with the improvement of international price competitiveness of Turkish products and services (SBA, EU 2014).

The figures recorded by Turkish SMEs have reflected this back-drop. The exceptionally high rates of GDP growth have seen extraordinary growth for the county's SMEs. SMEs are almost as important to the Turkish business economy as they are to most EU countries. SMEs account for 99.9% of all businesses in the country, contribute 76% to formal employment and 53% to GDP (SBA, EU 2014). The detailed breakdown is shown in Figure 16 below:

SME's in Turkey – Basic figures									
	Number of enterprises			Number of employees			Value added		
	Turkey		EU–28	Turkey		EU–28	Turkey		EU–28
	Num	%	%	Num	%	%	Billion €	%	%
Micro	2 326 148	97.3%	92.4%	5 019 845	46.5%	29.1%	29	19.6%	21.6%
Small	42 641	1.8%	6.4%	1 327 077	12.3%	20.6%	19	12.7%	18.2%
Medium-sized	18 132	0.8%	1.0%	1 830 242	16.9%	17.2%	30	20.6%	18.3%
SME's	2 386 921	99.9%	99.8%	8 177 164	75.7%	66.9%	78	52.9%	58.1%
Large	3 506	0.1%	0.2%	2 626 790	24.3%	33.1%	69	47.1%	41.9%
Total	**2 390 427**	**100.0%**	**100.0%**	**10 803 954**	**100.0%**	**100.0%**	**147**	**100.0%**	**100.0%**

Figure 10: SME's in Turkey - Basic figures

Source: European Commission 2014 SBA Fact Sheet Turkey

The definitions for Turkey's SMEs are outlined in the table below (Figure 11).

Turkey classifies its SMEs by the number of employees:	
Micro	Less than 20 employees
Small	More than 19 but less than 50 employees
Medium	Between 50 and 200 employees

Figure 11: SME Definition Turkey

The strategic focus on SME development in Turkey is a relatively recent occurrence with the first SME Strategy and Action Plan being prepared in 2003, which was prepared in preparation for European Union accession. The 3rd SME Strategy and Action Plan (KSEP) was implemented in 2011. The mandate for SME development in Turkey is primarily under the guidance of the SME development organisation KOSGEB, a government agency that provides non financial support services (mentoring, training, innovation etc) as well as being the head agency to ensure policy coordination across all ministries and stakeholder engagement. SME support programmes are also offered by the Ministry of Science, Industry and Technology in conjunction with other public and private sector agencies and NGOs. Particular attention is given to collaborative ventures between SMEs and universities.

Unlike their larger counterparts, micro enterprises show low productivity and weak development. As the head of KOSGEB put it in responding to the weak managerial capacity of micro firms "they don't know what they don't know" (KOSGEB Annual Report, 2012). In response, a key element of the new Strategy and Action Plan is to focus support services to help graduate micro businesses up the growth continuum. Furthermore, research conducted by the EU under the Small Business Act (SBA) in 2014 shows that while over 60% of Turkish exports were accounted for by SMEs, less than half only exported to one country (EU, SBA 2014). The report suggests that Turkey may be missing out on the opportunity to benefit from its location at the cross roads to Europe by a lack of focus on internalisation, which would also benefit from the weakened currency. Efforts to redouble the exporting capacity of SMEs are now a key element of the country's latest SME Strategy and Action Plan.

The 9th Development Plan for Turkey constitutes the country's economic goals with the guiding theme focused on technological improvement and innovation to improve the country's competitiveness. In line with this, the 3rd SME Strategy and Action (KSEP) has a strategic focus on five areas of development for the sector:

- Development and support of entrepreneurship
- Improvement of SME capabilities and corporate management skills
- Business and process improvement of investment climate for SMEs
- Enhancing the capacity of SMEs in research and development and innovation
- Facilitating access to finance for SMEs and new entrepreneurs

The EU has encouraged Turkey to adopt national legislation and policies on the EU's "think small first" principle, which aims to ensure that SME concerns are integrated into mainstream EU national legislation and policies. Under this principle, policy makers at all levels are expected to consult small business and keep their needs and limitations in mind during all phases of the legislative and policy processes. The Turkish government is also considering bringing in a Regulatory Impact Assessment (RIA) system with an "SME test" being a priority measurement for all new laws and regulations.

A further alignment with best practice in the EU is a focus on entrepreneurship. To facilitate this, the Turkish government has established the Entrepreneurship Council, which has introduced the Entrepreneurship Strategy and Action Plan for 2014-2016. This plan focuses on easing the regulatory framework for entrepreneurs, supporting an entrepreneurial culture at school level, training support, mentoring and financial support.

Turkey demonstrates an optimistic business mentality, which is reflected in a comparatively low fear of failure. The legal framework supports this - entrepreneurs who have experienced bankruptcy do not face high administrative barriers in restarting a business although they are not permitted to participate in public procurement tenders.

The business start-up process, judicial procedures in commercial disputes together with the licensing and permit systems are cumbersome even though company registration processes are relatively efficient and registration costs are limited (World Bank, 2014). Help desks have been set up by government for SMEs to access public procurement, which also provide training. E-procurement solutions are a very new development with the integration of the systems between the Public Procurement Office and KOSGEB currently underway.

In terms of stakeholder engagement and dialogue, KOSGEB oversees all SME related policies. It consults with SME stakeholders in the policy formulation process through its General Assembly, which is chaired by the Prime Minister. The Assembly has among its members high-level representatives from ministries and other government agencies, universities, private sector organisations such as chambers of commerce, federations and industrial zones. KOSGEB also has an Executive Committee with representatives from the public and private sector organisations

Entrepreneurial culture – South Africa and the three countries reviewed

The ability of nations to develop an entrepreneurial culture and create conditions that allow them to flourish and grow is critical to their countries economic success. Entrepreneurial innovations may improve standards of living. In addition to creating wealth from their entrepreneurial ventures, they also create jobs and the conditions for a prosperous society.

The Global Entrepreneurship Monitor (GEM) reports produced annually provide for the most comprehensive global comparative study of entrepreneurial behaviour. The GEM's benchmarking model provides a framework of conditions for entrepreneurship that need to be in place before a nation can collectively benefit from the entrepreneurial activities. These are a subset that flow from the social, cultural and political context of a nation and are conditions that are primarily determined by the legal and regulatory framework as well as institutions and infrastructure provided by government. Characteristics evaluated by GEM include attitudes to entrepreneurship; the types of activities; motivation for entrepreneurship, and early stage entrepreneurial activity (TEA) rate – the percentage of the adult population involved in either start-ups or running a firm for less than 3.5 years.

The latest GEM's 2014 report provides for a comparative review for Brazil, Malaysia and South Africa and selected findings from their latest report are discussed below. Note that Turkey was not reviewed in the GEM 2014 report. However, the EU's SBA facts 2014 do provide a comparison of entrepreneurial culture measured in 2012 in comparison to the EU benchmark, discussed separately.

Perceptions of social values towards entrepreneurship

Perceptions of entrepreneurial behaviour are evaluated in terms of the social value towards entrepreneurship and the regard that society ascribes to it, namely "good career choice" and the high status of success that it brings:

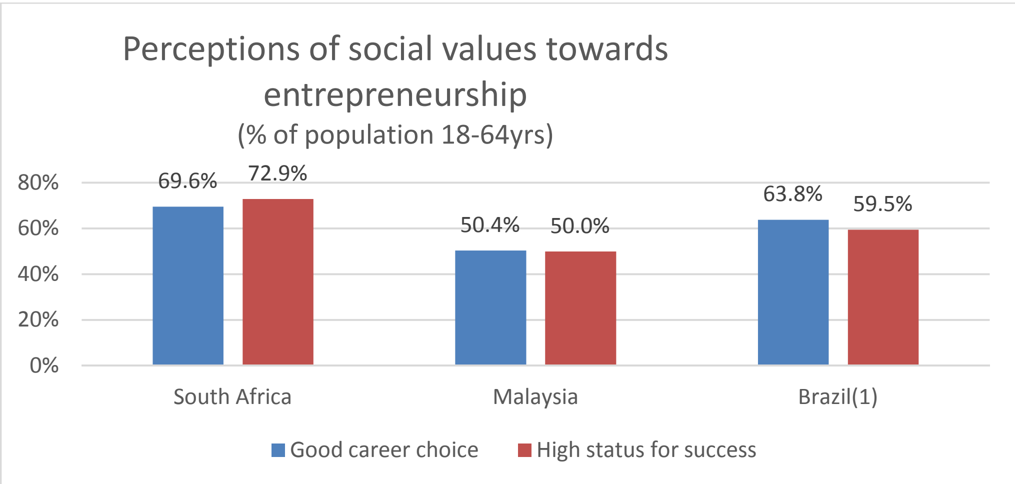

Figure 12: Perception of Social values toward entrepreneurship

Source: own calculations taken from GEM 2014 report. (1) As no data was available for Brazil the average value of surrounding countries is used as a proxy.

In comparison to Brazil and Malaysia, South Africa's perceptions of entrepreneurship are high in terms of being a good career choice and its status in contrast with Brazil (60%). In Malaysia only 50% value entrepreneurship as a career choice, which resonates with studies conducted by the World Bank for example that Malaysia's decades long BEE policy has stunted entrepreneurial ventures amongst the majority of its population.

Attributes for entrepreneurship

The GEM's model identifies that the degree of entrepreneurial opportunity coupled with entrepreneurial capability are the catalysts for business and that these two characteristics are the prerequisite for entrepreneurial success. These however need to be evaluated in conjunction with a nation's "fear of failure" as they impact together with the entrepreneurial intention to start a new business within 6 months:

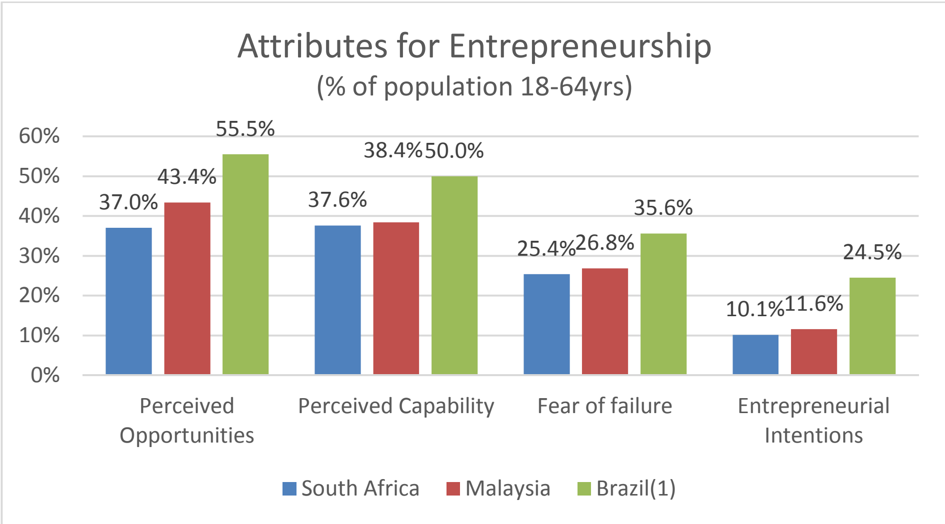

Figure 13: Attributes for entrepreneurship 2014

The attitudes reflected by Brazilians towards entrepreneurship are consistently higher than both Malaysia and South Africa despite a high fear of failure. Intention towards starting a business is twice as high in Brazil than in South Africa and Malaysia, with South Africa being the lowest in the countries reviewed for this report. South African's fear of failure translates into only 10% intending to start a business, the lowest of the three countries.

Total early stage (TEA) entrepreneurial activity

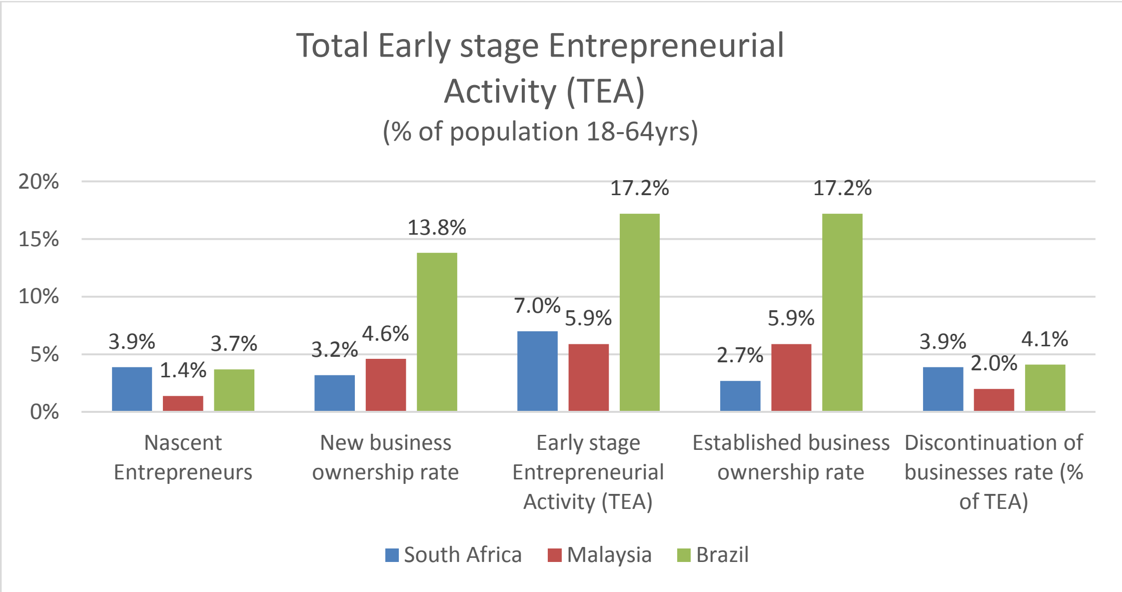

Figure 14: Total Early Stage Entrepreneurial Activity 2014

Brazil shows the highest rates of the countries reviewed with 13.8% followed by Malaysia at 4.6%. South Africa lags behind at 3.2%, one of the lowest TEA rates on the GEM's overall rankings for 2014.

Established ownership rates in Brazil at 17.2% shows that early stage entrepreneurs stay in business longer, while only 2.7% South Africans convert to being established businesses.

Motivation for early stage entrepreneurial activity

The motivation for entrepreneurial activity is evaluated in comparison to two of the three metrics offered by GEM, which identifies two types of entrepreneurial activities: necessity driven entrepreneurs who start a business as a source of income due to the inability to find employment, and opportunity driven entrepreneurs who have seized an opportunity to start their businesses.

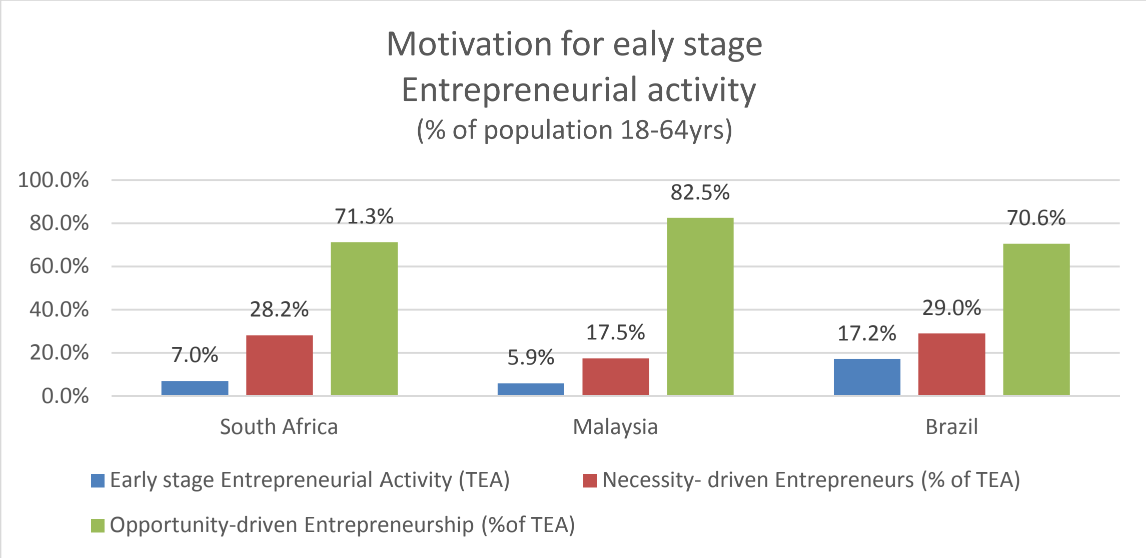

Figure 15: Motivation for Early Stage Entrepreneurial activity 2014

Opportunity driven entrepreneurs show the highest conversion rate in all three countries reviewed, with Brazil being the highest at 12%, followed by South Africa and Malaysia who achieve conversion rates of 5% of TEA.

Entrepreneurship in Turkey

The following findings are taken from the EU's SBA 2014 report, which measures entrepreneurial activity in Turkey against EU country averages:

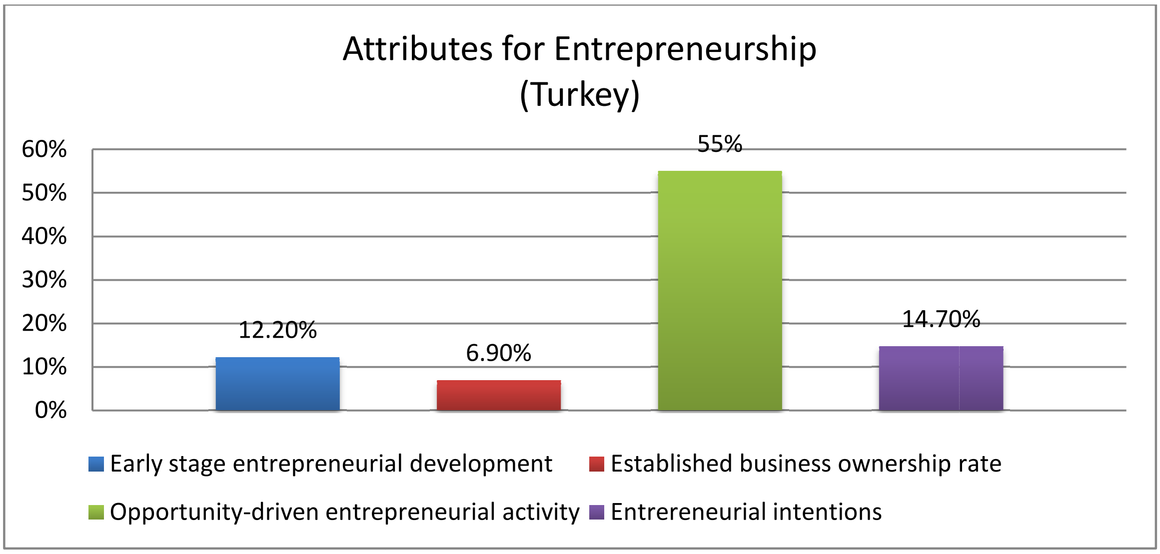

Figure 16: Attributes for Entrepreneurship (Turkey- 2012)

The SBA findings show that Turkey has an excellent overall score in entrepreneurial activity, far above the EU average and places the country amongst the best performers in the union.

Entrepreneurial education in Turkey is based on a strong institutional support framework. Entrepreneurship is an integral feature of Turkey's lifelong learning strategy, accompanied by an action plan that addresses entrepreneurship in secondary education. This might explain why the country shows a higher rate of early-stage entrepreneurial activity than the EU.

There are also a higher number of people who intend to start their own business more prevalent in Turkey, probably due to a low risk of failure and the ease to start up a new business after bankruptcy. KOSGEB's Entrepreneurship Support Programme helped start over 10 900 firms in 2013 and the first quarter in 2014, double the number reported in the previous period. The situation for women is better than most EU countries. This can be attributed to Turkey's gender equality action plan, which focuses particularly on women's entrepreneurship. Consequently, half of the firms that KOSGEB supports are start-ups led by female entrepreneurs (SBA, EU 2014).

Two new policy measures addressing entrepreneurship have been introduced recently. The Scientific and Technological Research Council of Turkey continued its efforts to develop entrepreneurship through a support programme targeting entrepreneurship education and mentoring activities. In addition, entrepreneurship is being tackled for the first time at national policy level through a new plan for 2014-2016, which covers the regulatory framework, support programmes, entrepreneurship culture, training and consultancy, and finance. Preparation of the plan has involved consultation across government ministries, universities and other several stakeholders including SMEs.

Emerging messages from the three country review

Obviously, each country reviewed has followed different strategies in prioritising their SME policies and strategies in accordance to each of their socio-economic goals and these differ with their various locations and economic conditions. However, some key messages emerging include (not in order of priority:

- *Social dialogue:* SMEs are notoriously difficult to organise; one of the key challenges for the sector and the informal economy is the lack of suitable representative structures. Within the South African environment, the lack of a representative body at national level within employers, workers or community for such enterprises poses an obstacle for dialogue on effective and appropriate policies for these sectors. Each of the countries reviewed have found innovative ways to involve SMEs in the policy and law making processes, for example Turkey's General Assembly

- *Targeted and differentiated policy and support measures:* SMEs are recognised as vitally important to the countries reviewed in terms of achieving their socio-economic goals and national competitiveness; Turkey and Malaysia focus on specific policies to redress shortcomings in their SME policies and support measures, which are assessed regularly to evaluate impact
- *Policy coherence and alignment:* is a key feature in ensuring that SME policy and support measures are an integral part of the country's economic policies. Regular monitoring, dialogue and policy adjustments are undertaken to address the adverse impact of the legal and regulatory environment on SMEs and formalising enterprises
- *Inter-departmental coordination: is a vital element in ensuring SME policies are coherent across all government departments and at all levels of government; Malaysia and Turkey for example ensure that SMEs are mainstreamed in all their key economic policies and do not fall within the ambit of one singular ministry or governmental unit*
- *Definitions of the SME sector have been simplified:* While these vary from country to country, Turkey, Brazil and Malaysia have each simplified the characteristics that determine their SMEs, which have helped in developing targeted policy and support measures, measuring impact and determining the size and nature of the sector in their economies.
- *Private sector approach* to implementing support services to SMEs such as in Brazil where the primary actor, SABRAE, operates as a private sector non profit entity
- *Building an entrepreneurial culture* is a central theme inherent in each of the country's reviewed. Malaysia, Turkey and Brazil have each adopted a life-long learning approach to help build a strong entrepreneurial culture.

Section C: Top Barriers to SME Growth – perspectives from SME owners

As highlighted in the ILC's 17 pillars for sustainable enterprises, the effectiveness and efficiency of factors such as the quality of legislation, markets and institutions can be decisive for sustainable enterprise performance, and for the performance of the economy as a whole. Over recent years, firms of all sizes report having faced a difficult business environment in South Africa. Policy uncertainty, coupled with stagnant economic growth and often contradictory regulatory changes has complicated the environment for doing business. Although this is a general problem for any sized business, SMEs – with smaller reserves, limited resources, less access to credit and with fewer options in general to deal with these conditions – are particularly vulnerable.

To provide a greater depth of understanding of the most significant barriers to small firm growth and expansion from SME business owners' perspectives, the following sections draw on SBP's SME Growth Index longitudinal study, which tracks the experiences of a randomly selected sample of 500 small firms employing less than 50 employees operating in three sectors (manufacturing, business services and tourism) across three metropolitan areas (Cape Town, Johannesburg and Durban).

The top barriers to SME Growth reported by respondents in the 2013/2014 SME Growth Index survey include, in order of priority:

- Lack of skills
- Burdensome regulations
- Local economic conditions
- Lack of finance
- Cost of labour

These barriers represent common obstacles in line with many other studies that have been conducted over the past five years or so and are discussed briefly as follows:

Skills shortages

Skills shortages, coupled with strict labour laws, have been identified as a key challenge in every round of the SME Growth Index and these findings are in line with other studies, which consistently identify a lack of skills and rigid labour laws as critical constraints for smaller firm growth. While the

SETAs have the mandate to develop skills plans in each of their respective sectors and have a prime goal of supporting small business training needs, they are often found lacking for focusing on the basic requirements for certification rather than the necessary skills required by the firm. SMEs often have to absorb the cost of training their employees including, in many instances, the costs for basic numeracy and literacy skills especially for new and young employees.

A critical requirement for sustainable enterprises is the availability of skilled workers that are able to adapt and adjust their learning to meet the dynamic needs of enterprises competing in changing domestic and international markets. The ILC's pillar supporting skills development for sustainable enterprises notes that in a rapidly globalizing world, governments' increased investment in human capital, through non-discriminatory, high-quality education and training systems and lifelong learning is essential in order to facilitate entry and re-entry into the labour market for all groups, and to increase levels of productivity and quality of employment (ILC, 2007). Reforming vocational education and training systems and, in this context, the development of school-to-work schemes could function as a driving force for the cultivation of entrepreneurial culture and technical skills required by enterprises, depending on their particular needs and competitiveness requirements. The competitiveness and viability – even survival – of enterprises especially SMEs increasingly depends on the ability to ensure that employees are motivated, skilled and committed (ILC, 2007).

There is a clear misalignment between the skills that are available and those required by the economy, worsened by labour laws than inhibit flexibility within the workforce. There are two sides to this coin. South Africa isn't creating enough entrepreneurs due in the main to deficiencies in our schooling system. The second aspect of skills misalignment is that businesses are unable to draw on an existing or available pool of labour, again due to failures in the schooling and training system. This puts smaller business at a particular disadvantage as they do not have the resources available to train, mentor and develop talent. Small firms need skilled labour to produce and compete.

Burdensome regulations

SME owners concerns regarding the compliance burden relate not only to the volume of regulatory requirements and administrative inefficiencies, but also the frequency of regulatory change. Only two firms in five surveyed in the SME Growth Index were confident that they knew all the regulations they need to comply with. Moreover, three firms in five surveyed expected the compliance to grow in the next year (SBP SME Growth Index 2013/2014). Regulations most problematic reported by the respondents include difficulties experienced in obtaining tax clearance certificates and dealing with SARs inefficiencies; labour issues such as dealing with the CCMA; municipal inefficiencies with regard to billing problems and obtaining permits; BEE compliance, and obtaining company registration certificates from CIPC such as changes to company name and directors.

Frequent changes in the regulatory environment, the need to keep track of overlapping and sometimes conflicting regulatory requirements across multiple departments and levels of government, poor communication and access to information, and administrative inefficiencies in government departments and municipalities mean that the SME owner spends a disproportionate amount of time dealing with regulatory compliance. Findings from the survey show that a SME owner spends on average nine working days a month dealing with red tape. Every one of these days represents management time spent away from core business functions, and thus of income (SME Growth Index, 2014).

The Davis Tax Committee Interim Report on Small Business indicates a median cost of R20 500 to small firms to comply with all tax requirements (DTC, 2014). Using the same hourly rate calculation used in the Davis report against the SME Growth Index findings (75 hours a month for all compliance issues), it can be estimated that the average cost of regulatory compliance to SMEs equates to roughly R18 000 a month, or R216 000 a year. If a company has a turnover of R5 million, these costs represent 4% of turnover (SBP, 2014), and more – up to 8% - for firms with less turnover. For larger businesses, with resources in place to deal with the regulatory burden, compliance costs are estimated at only 0.2% (Omidyar Network, 2013).

These results are echoed in a recent ILO cost of red tape study conducted in two municipalities in the Free State in 2012/2013 (An assessment of administrative barriers and regulatory costs for SMEs in South Africa, ILO 2015 unpublished). The study was based on a random sample of 414 firms, representing the SMEs operating in the province. Extrapolating to the total enterprise population in the province, the study findings show that the annual compliance cost of the surveyed SMEs amounts to R3.8 billion, equivalent to 2.7% of the annual GDP of the Free State province. SBP's earlier pioneering study conducted in 2004/2005 showed that red tape costs equated to R79billion for that year, equivalent to 6.5% of the country's total GDP in that year.

These are staggering costs but a more important finding from both the SME Growth Index and the ILO's red tape study is how businesses are consciously not growing to remain below a certain income and employee thresholds as coping strategies. In the ILO study, businesses went further in reporting that they were engaging in informal practices to cope with the increasing regulatory burden.

The appropriate balance between social and economic imperatives comes into sharp relief in examining an economy's regulatory system. Few dispute the necessity of regulation but the compliance burden it places on firms needs to be proportionate to the goals it is meant to achieve.

A key problem with the legal and regulatory environment is the haphazard formation of policy. Often new legislation is added to existing rules without a systematic approach to secure policy coherence or coordination. For instance, concern has been raised about whether or not the interdependency of the amendments to the BBB-EE Act and the new BBB-EE Codes and other laws and regulations (such as the Skills Development legislation, Employment Equity requirements, Companies Act and tax laws) have been considered in drafting the amended Codes.

The Donor Committee on Enterprise Development (DCED) noted in their paper focusing on ways to promote formalisation that high quality laws and regulations are essential if formalisation is to be nurtured. Good business environments – where laws and regulations are targeted, proportionate, evidence-based, enforceable and consistent – promote openness and transparency. These are critically important to informal economic actors who have in general low levels of literacy (DCED, 2011).

These observations resonate with the ILO's2014 paper on transitions to formality; it notes that informality is principally a governance issue stating that the growth of the informal economy can often be traced to: inappropriate, ineffective, misguided or badly implemented macroeconomic and social policies frequently developed without consultation; the lack of appropriate legal and institutional frameworks; the lack of good governance for the proper and effective implementation of policies and laws, and a lack of trust in institutions and administrative procedures. Macroeconomic policies, where not sufficiently employment focused, have reduced jobs or failed to create sufficient numbers of new jobs in the formal economy (ILO, 2014).

The current regulatory system not only makes existing SMEs less likely to succeed, it actively discourages many entrepreneurs from starting up in the first place and is a disincentive for the transition to formalisation in the informal sector. An unclear, ever changing regulatory landscape coupled with onerous compliance burdens further disadvantage small and early-stage businesses, removing perhaps their single and unique advantage of being small, dynamic and more nimble than their larger, more established businesses.

Implementation of a more r*obust*, *transparent* and *quality based* regulatory impact assessment system, will go a long way towards ensuring policy certainty and coordination; better regulatory governance, and reducing the regulatory burden for all businesses, particularly SMEs, as well as helping the transition to formality. Cabinet approved a RIA system in 2007, however implementation of the RIA practice by national government has been patchy at best (SBP, 2013; 2014). Most recently, Cabinet approved a new system for policy and regulatory impact assessment entitled "socio-economic impact assessments" (SEIAs), which it is hoped will address some of the implementation shortcomings of the RIA processes. A key element for the efficacy of the SEIAs will be that they will need to improve stakeholder engagement and ensure that the findings of the SEIAs are open to public scrutiny by accompanying bills to parliament, and being made publicly available.

Local economic conditions

According to a report by the UCT Centre for Innovation and Entrepreneurship (UCT, 2012), South Africa's market entry and participation remains difficult and unaffordable for new and growing businesses. In most cases, sectors are dominated by a few large, established businesses, which make it difficult for new and smaller businesses to compete. In most sectors, a consequence of this high industry concentration has been the development of a complex legislative system that is punitive of non-compliance to regulate these larger firms. The regulatory framework is thus considerably regressive to the extent that smaller SMEs struggle to meet the demands - and absorb the cost of compliance - associated with such regulation. This results in a significantly greater constraint for new entrepreneurial ventures than for those in peer countries.

Alongside the regulatory landscape, the ILC's 17 pillars note that a very important aspect of the investment climate and a prerequisite for sustainable enterprises is physical infrastructure (roads, electricity, water, telecommunications etc). Generally, enterprises with access to efficient and affordable transport, reliable energy supplies and modern telecommunication services tend to perform better than firms without them. These services, generally administered at municipal level have a fundamental impact on the ability of firms, in particular small firms to produce and compete in a "24 hour" global economy. Power stoppages, increasing transport costs coupled with billing problems all have a cumulative effect on all businesses and the economy as a whole. The state of physical infrastructure such as energy in particular is vital for the wellbeing of people in general and for the enabling the growth of enterprises, especially SMEs. South Africa's current power crisis is a fundamental problem impacting on the ability of SMEs and informal enterprises to survive and grow.

Impacting on the overall competitiveness of SMEs in particular are rising, high input costs, which in turn have a direct relation to the firms' profit margins and their ability to survive. Findings from the SME Growth Index in 2012 show alarming results in this regard. Taking a basket of selected costs including material inputs, electricity, fuel, labour, crime and red tape costs, the average firm was found to have spent up to 78% of their turnover. Excluded from the basket of costs were rent and interest on capital given their degrees of variance; hence these costs do not represent all costs borne by the businesses surveyed. When these costs are combined with others, the findings point to the lean profit margins of SMEs operating in the South African economy. Any additional shocks such as increases in the electricity tariffs could have serious impact on SME survival.

The issue of markets - or access to markets - is of particular importance to enterprise formalisation and growth. Market access, to local and international markets, and the ability of SMEs and formalising businesses to participate in the evolving needs of different value chains are regarded as particular constraints for such enterprises. The quality of the business environment overall, and efficiency of markets, needs to be seen in the context of the increasing globalization of production. The 2012 and 2013 rounds of the SME Growth Index together indicate a noteworthy development. The evidence shows that exporting SMEs gain advantages in terms of management and adaptability; the wages that they pay tend to be higher; they also tend to have higher labour productivity and to be more capital intensive (SME Growth Index, 2011;2012;2013). The ability of firms to export is a function of a nation's competitiveness. As guidance for policy direction it makes eminent sense to assist current exporting SMEs to expand their footprints – by supporting market penetration, providing guidance on the target market and perhaps by supporting high potential SMEs to operate more competitively – than to help non-exporters get going from scratch.

Finance

Financing is an essential component of innovative and growing economies, particularly at the beginning and early stages of business development. SMEs have four main funding channels to draw upon: personal, state, debt and equity. Debt and equity are both relatively well developed sectors in South Africa but there are critical market failures in the provision of finance to both early stage businesses and higher growth SMEs (FSB, 2006; DTC 2014). The mix of finance offerings such as microfinance, venture capital and angel funding are still under-developed in South Africa to service the increasing demand from start ups and expanding SMEs (University of Pretoria, 2013).

The micro-enterprise lending sector in particular remains under developed. According to a comprehensive report conducted in 2013 by the University of Pretoria, there are only 14 micro finance institutions (MFIs) operating in the country, collectively servicing just over 112 000 active loans. The lack in terms of the number of MFIs operating in the country and poor outreach is puzzling, particularly if compared to other peer (African) countries where a robust, innovative MFI sector can be found.

Similarly at the upper end of the scale, venture capital and angel finance also seems to play a relatively small role in providing finance to higher growth SMEs. There is a profound shortage of both venture and development capital available in South Africa. A study conducted by KPMG in 2013 found that compared with other emerging markets, including Russia, South Africa's private equity fundraising totals were the lowest in 2011 and 2012, with the difference in totals being significant.

Access to financial services – a key pillar of the ILC's conditions for sustainable enterprise – is a major constraint for SMEs and formalising enterprises. The ILC notes that a well-functioning financial system provides the lubricant for a growing and dynamic private sector. Making it easier for SMEs and start ups to access financing, for example credit, leasing, venture capital funds or similar or new types of instruments, creates appropriate conditions for a more inclusive process of enterprise development (ILC, 2007).

The Davis Tax Commission report throws some light on the critical problems for SMEs and start up enterprises found within the access to finance chain in South Africa. Citing a report conducted by National Treasury in 2013, it notes that the lack of finance is a fundamental impediment for firms employing fewer than 21 people particularly in the manufacturing and tourism sectors. The Small

Enterprise Financing Agency (SEFA) is the lead government institution in promoting SME lending either directly or through intermediaries. The report noted that while there has been some success by SEFA in direct lending, the wholesale product continues to face problems. For instance, the credit guarantee scheme administered by commercial banks declined by 90% since 2006, which suggests that the scheme is overly complicated to administer (DTC, 2013). The commission proposes that much further investigation needs to be done to review the barriers impacting on the provision of finance to SMEs, including micro-financing for smaller enterprises through to venture capital for higher-growth small firms.

Cost of Labour

Beyond the issue of lack of skills and entrepreneurial mindsets within the general workforce, South Africa's labour market conditions are particularly stringent and seldom ranked outside the bottom 20% globally (WEF Global Competitiveness Index). High labour costs, driven up by burdensome labour regulations, have had a negative impact on SMEs ability to create employment. Labour laws, particularly relating to dismissal procedures together with the time demands, delays, loss of productivity and actual monetary costs in defending dismissal disputes have a direct influence on hiring additional staff. For example, an analysis conducted by Professor Neil Rankin shows that for firms employing less than 50 employees, the average time in terms of staff days spent per case at the CCMA amounts to 11 days (SBP, 2013).

The SME Growth Index findings in 2013/2014 show that labour laws were reported as the greatest hindrance to hiring additional staff, second only to demand side considerations. These findings are further supported by numerous academic studies that have been undertaken in the past five years.

Research also shows that the reluctance to hire also results in a significant skills shortage, which further curbs the growth of SMEs and the development of the sector as a whole.

There is ample evidence internationally and locally, that overly restrictive labour laws reduce worker flows and hiring, and hinder productivity and economic growth. Adequate worker and social protection is undeniable but needs to be balanced alongside the need for greater competiveness, labour market flexibility and mobility and job creation. Government is ambitiously looking to SMEs to create 90% of the jobs to achieve its goals of reducing unemployment to 6% by 2030. The NDP suggests that, in order to achieve this, there is a clear need for greater flexibility in labour legislation, asserting that "a balance is needed between enabling faster expansion of employment opportunities and the protection of human rights" (NDP, 2011). At workplace level, the dialogue between SME employers and workers perhaps poses an opportunity to address enterprise sustainability, productivity, and decent work conditions and to resolve conflict.

Transitions to formalisation

Many countries have made great strides towards encouraging entrepreneurship, with Turkey being one of the most outstanding for all EU nations as noted above. There is however little consistency in the direction of public policy towards promoting the formalisation of informal actors (ILO). Many developing countries contain a large informal economy. While this informal part of the economy is typically characterized as poor, exploitative, insecure and unsafe, it can also be a safety net for many vulnerable groups including women entrepreneurs, as well as a place for innovation. The informal economy is a significant contributor to the domestic production of many developing countries, although this contribution is often unseen or difficult to measure and, while it remains informal, does not contribute to sustainable growth (DCED, 2011).

South Africa has seen low levels of entrepreneurial uptake as reported by GEMS (2012- 2013). Further to this, the GEM's studies show a low level of desirability in entrepreneurial activity among young people in the 15 -24 age group. This is reported to be attributed to the fact that entrepreneurs are seen to "work too hard for too little money". Furthermore the same study suggests that welfare protections offered by the South African government could be seen as a disincentive to pursue entrepreneurial activities. (GEMs ,2012). Evidence gathered by Stats SA on the SESE (Survey of the Self Employers and Self-employed) also points to a low level of entrepreneurship; in 2001 informal businesses aged 5 years or younger were reported to be just under 76% of those surveyed, whereas the same businesses were reported to be only 61.6% in 2013. This suggests an aging informal business sector (with little graduation to formal) and fewer new informal businesses

Many studies state that the informal economy is the result of a complex mix of economic, social and political factors and another inherent problem with informality is that it is difficult to define. Various forms of informality can be found along a continuum between an enterprise operating completely informally to one that complies with all laws and regulations.

Researchers often cite poor policy as a contributing factor to the growth and pervasiveness of the informal sector. This highlights the importance of ensuring a good mix of policy strategies to support the formality, and the graduation, of informal businesses into the formal economy.

The informal economy is also made up of different kinds of enterprises. Some are micro enterprises that are largely survivalist in nature whereas others are larger and more mature, with a greater potential for growth should they gain better access to markets and resources through an improved business environment. Typically informal business activity emerges where opportunity presents itself. This has contributed to policy strategists largely arguing that the informal sector is primarily a spatial problem with local and municipal governance being of major concern and where informal businesses are mostly operating in an environment of low income and high unemployment (largely in the inner city or informal settlements).

While informality can range from survivalist to growth-orientated enterprises, enterprise growth is typically associated with increasing degrees of formality. There are also different kinds of informality (unregistered enterprises, informal workers for example). As such, the informal economy contains a diverse range of enterprise actors and requires careful description and analysis (ILO, DCED). Many operate illegally, though the great majority sell legally manufactured products obtained from the formal economy. Their 'informalness' can be either intended, as a result of an implicit cost-benefit analysis to avoid the various requirements for business registration, or unintended, as a result of policies and regulations that deliberately prohibit businesses from operating in certain contexts and localities. Informal businesses are generally established in the township and inner city environments. The goods they sell and the services these businesses provide therefore form an integral part of the coherence of township life. (Sustainable Livelihood Foundation, 2011)

It is important to acknowledge the relationship between the formal and informal sector. There is often a tendency to associate negative influences from the informal sector to the formal economy. These criticisms however need to be contextualised. The formal economy is supported by and, to a large extent, dependant on informal businesses, as a main source of market access to the majority populace for their goods and produce. However, the informal sector is often not connected to companies in the formal sector as they service different customers where institutional and market voids exist. The DTI for example estimates the contribution of the informal sector to South Africa's GDP at approximately 8%.

When referring to informal employment, persons whose jobs are informal in that they lack basic social or legal protection or employment benefits, these can range from the informal sector to the formal sector and can also be found in households. Persons whose employment can be described as informal include: own-account workers and employers employed in their own informal businesses; contributing family members to either formal or informal enterprises; members of informal cooperatives; employees holding informal jobs in formal enterprises without social protection and benefits and domestic workers employed by household employees; and own-account workers engaged in the production of goods exclusively for their own final use by the household if the production comprises an important contribution to total household consumption (ILO, 2012).

Based on these characteristics, a study conducted by the ILO in 2012 shows some illumination on the number of persons employed in informal employment in South Africa, Brazil and Turkey:

Employment in the Informal Economy						
	Persons in informal employment		Persons employed in the informal sector		Persons in informal employment outside the informal sector	
	Thousands	% of nonagricultural employment	Thousands	% of nonagricultural employment	Thousands	% of nonagricultural employment
Brazil (2009)	32,493	42.2	18,688	24.3	13,862	18.0
Malaysia	N/A	N/A	N/A	N/A	N/A	N/A
South Africa (2010)	4,089	32.7	2,225	17.8	1,864	14.9
Turkey (2009)	4,903	30.6	N/A	N/A	N/A	N/A

Figure 17: Employment in the informal economy

Source ILO 2012 (Statistical update on employment in the informal economy)

Data on the informal economy in Malaysia has been lacking until very recently. The inaugural study of the informal sector conducted in 2012 estimates that there are 1million actors engaged in non-agricultural informal activities, with the vast majority self-employed or classified as own-account workers (67%) with the remaining 23% being identified as informal employees.

Brazil purportedly has a large informal economy with estimates ranging in the region of 40%. However, recent studies show that the size of the informal economy equates to around 17% of GDP

(Estimation of the underground economy in Brazil) with informal employment activities showing a decline from an average of 21% to 16% in 2011. Similarly, the informal sector in South Africa has shown a decline in numbers as noted earlier in this report. Findings from Stats SA's survey of employers and self employed in 2014 show that the number of informal businesses declined from 2.3million in 2001 to 1.1 million in 2009, with a slight uptick to 1.5million in 2013. Unemployment is increasingly the main reason for people running informal businesses (60,6% in 2001 to 69,2% in 2013) (Stats SA, 2013).

Because informality is created by different social, economic and political elements many governments and donor agencies are pursuing a variety of reform programmes to facilitate the transitions to formality. Although not exhaustive, the following typologies reflect the ways to address the causes of informality, many of which are blended in a reform programme (DCED, 2011): Bearing in mind the cost benefit mindset (often referred to as a disincentive to formalisation) in establishing an easy graduation for businesses from the informal sector to the formal.

- Reforms to business registration to promote formalisation
- Reforms to tax policy and administration by introducing more transparent and simplified tax reporting requirements and differentiating tax schemes for microenterprises
- Reforms for land ownership and titling that redress costly land registration systems, and enable female ownership of land and assets
- Reforms to labour regulation and labour-related issues by reducing the cost of compliance and regulatory requirements while maintaining workers' protection
- Reforms to the judicial system which often involves reducing the transaction costs and improving access to formal dispute resolution channels
- Reforms to intellectual property rights with campaigns to replace illegal products with legally protected products
- Reforms to financial services that increase the access of the poor to the full range of financial services
- Access to information about business regulation and rules that include information campaigns or increasing the availability of online information

While the barriers to enter the formal economy vary, labour and taxation laws and regulations are often the most common obstacles. Promoting formalisation and strengthening the rule of law involves a stepped process that encourages actors to move toward greater degrees of compliance and formality. As such measures may need to include a proper balance of incentives as well as compliance (DCED , 2011). Reforms should also distinguish between those that reduce the overall levels of informality (such as reforms that lead to broad-based economic growth) and those that increase the rate of graduation into the formal economy (such as increasing benefits from operating formally).

Section D: Emerging messages

It is well established that SMEs are the known engine for job growth. As key drivers of economic growth and poverty reduction, SMEs will be responsible for the creation of the greater part of much needed employment opportunities in South Africa.   The overall picture of South Africa's landscape is however one of pressing concern. The message from many studies is that the overall SME environment is far from conducive to existing firms and businesses that are transitioning to formality or new start ups. South Africa is experiencing a net loss of small businesses (4.9%) which exceeds the start-up rate (2.9%) at a time when policy objectives are focused on growing and formalising them.

Evidently, the success of entrepreneurship and sustainable businesses, particularly SMEs in South Africa in the coming decades will be strongly contingent on innovative and decisive policy changes that shape a more supportive and enabling environment for these firms and start-ups. There is a wide range of major challenges hindering SME growth in the current environment. To achieve the goals as stated in the NDP will require coordinated implementation of constructive solutions. Ultimately no single policy change will reflect transformation. Rather a suite of changes is necessary, incorporating both policies and intervention mechanisms that will serve to amplify and mutually reinforce business establishment and growth.

Messages emerging include, but are not limited to:

- Simplify and align the definition for small, medium and micro-businesses across all departments and legislation
- The diversity and heterogeneity of the SME community must be acknowledged. The main element driving policy and support measures is based on the "SMME" construct, which in turn leads to a misguided understanding that all firms are homogenous in nature, and all require the same support.
- Reform the regulatory and administrative burden impacting on small and formalising enterprises: the regulatory environment for South African business, especially SMEs and early-stage enterprises is not aligned, overly complex and particularly regressive. While a problem for all businesses, the red tape burden is felt more disproportionately by smaller firms and is often 10 to 20 times more than their larger counterparts.
- The ILO advocates regulatory monitoring, evaluation, dialogue and policy adjustment in order to address the potential adverse impact of the legal and regulatory environment on

SMEs and the disincentives for transitions to formal businesses. The regulatory environment should provide for simple, efficient and speedy registration of enterprises, regardless of size and there should not be multiple layers of legislation at national and local levels that serve to confuse, duplicate or discourage understanding of the regulatory and compliance requirements

- Policy coordination, coherence and policy certainty is crucial in building confidence in the local market by diminishing the regulatory uncertainty, burden and by ensuring effective and targeted support measures. The different policies, definitions, legislation, regulations and strategies driven from different ministries lead to uncertainties in policy direction and support implementation. Small businesses and those that have the potential to transition to formality are diverse, they range in size, are different in nature and operate across all sectors of the economy
- Informality is principally a governance issue. The growth of the informal economy can often be traced to inappropriate, ineffective, misguided or badly implemented policies, laws and regulations. Careful diagnosis of the multiple causes of informality is essential and needs to involve an assessment of the business environment, as well as of the broader governance systems in which businesses operate
- “Think small first” a principle that underpins all EU policy and legislative processes, which together with a robust, quality-based and transparent regulatory impact assessment system that measures the impact of policies and laws on SMEs and the transitions to formalisation could go a long way in reducing the heavy and onerous regulatory burden on small firms. As the ILC 2007 conclusions note, “countries should undertake a comprehensive review of the impact of existing policies and regulations on SMEs and labour legislation should be reviewed to determine whether it meets the needs of SMEs, while ensuring adequate protection and working conditions.”
- Recognition by social partners of the pivotal role of SMEs in a market economy and the importance of sustainable, profitable, enterprises in achieving country objectives of addressing unemployment, poverty and inequality.
- Differentiate and simplify policy and support measures: a common criticism of South Africa’s small business development strategies is that they have overly ambitious, are supply driven and with a ‘one size fits all’ approach
- Ensure robust and up-to-date statistical data: South Africa has poor statistical information of the SME sector, including informal and new start-ups

- Establish a stronger entrepreneurial culture through life-long learning such as programmes that have been introduced in Turkey, as well introducing entrepreneurial skills training in schools
- Investment in SMEs and transitions to formality in South Africa needs to grow rapidly especially at both the upper end of the financial chain such as venture capital and angel finance for high-growth SMEs, and at the beginning of the chain for new entrepreneurial start-ups and micro businesses
- Retain respect for core human rights and reduce labour costs incurred through complex unfair dismissal procedures and processes of the CCMA that are designed with larger businesses in mind and serve only to strain resources for SMEs and informal businesses, selective application of labour standards should be considered
- The culture of entrepreneurship – encouraging innovation and adaptability in the face of new challenges and opportunities requires attention. Education systems and the enterprise environment are inadequately geared to encourage entrepreneurial behaviour required for small business development.
- Access to information is critical for SME owners and informal actors, particularly in regard to employment policies and practices. For example, the CCMA estimates that approximately 80% of their cases com from SMEs. There is thus a significant opportunity to educate CCMA users to proactively prevent and manage disputes. This could be pursued by the CCMA introducing a self-service, web-based tool with the aim of improving employer/employee understanding and compliance and reducing red tape.
- Ensure open and transparent social dialogue, with the participation of SME businesses and employees, in policy and law making. Define the role of organised business in the NIBUS strategy and other strategies targeted at small enterprises. While it is often stated that SMEs are particularly difficult to organise and the informal economy even more so, models such as the General Assembly adopted by Turkey are of interest. Private sector organisations could play a more effective role in representing the interests of SMEs and be more active in providing services directly to SMEs and informal actors as well as improving access to information.

The failure of South Africa's SMEs, the lack of stimulus to formalise and thereby create decent work and drive job growth in contrast to international experience – and their high failure to survive – is an outgrowth of numerous factors that cumulatively express themselves in diminishing workforces – declining demand, restricted cash-flow, high input costs, dysfunctions in governance and policy uncertainty.

The aims of both the NGP and the NDP recognise the importance of the formation of new sustainable enterprises, and the expansion of existing small businesses. As the President stated in his recent State of the Nation Address "small business is indeed big business" for South Africa (SONA, 2015). This represents a clear opportunity to review, refine and supplement policies and strategies toward building a strong ecosystem to stimulate and boost the beneficial role that SMEs can play in South Africa's economic development.

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