

CHAPTER 4

SMALL BUSINESS ENVIRONMENT IN SOUTH AFRICA

“The small business sector can play a major role in creating jobs and wealth in any economy. Consequently, the sector has recently drawn much attention from policymakers in both developed and developing countries”

(Ntsika, 1999: 16).

4.1 INTRODUCTION

Small organisations are vitally important to economies and they are not necessarily mini-versions of large organisations. They do have features common with other organisations but they also have unique characteristics and attributes that are reflected in the manner in which they are organised and managed. The small scale of their operations and subsequent lack of management depth could imply that small organisations do not apply the product life cycle concept for management, strategy and marketing purposes.

It is evident from the literature survey conducted on the product life cycle concept in the previous chapter that very little research has been done on the application of this concept in small organisations. The literature survey revealed that this concept is applied mainly by large organisations and its application was empirically tested among the large organisations internationally. Yet, its application by small organisations has not been sufficiently tested empirically among small organisations globally, and specifically not in the South African context. Small business in South Africa is incorporated in the collective category of small, micro and medium enterprises (SMMEs).

This chapter will be discussing the importance of small organisations to economies globally and will then emphasise the structure of small organisations in South Africa. The chapter will conclude with valuable information on the demarcation of the small organisational environment among which the empirical study will be conducted.

4.2 THE STRUCTURE OF SMALL ORGANISATIONS GLOBALLY

Small organisations do not normally have the organisational architecture that is found in large organisations. While small organisations usually employ staff to perform multiple tasks, large organisations tend to use specialists who perform the same activity. It can be deduced therefore, that many of the structural features of small organisations arise because of their size (Robbins: 1992 in Ehlers, 2000: 44).

According to Ehlers (2000: 43-44) small organisations often break down their tasks into functional subsections and assign employees to the selected task. However, specialisation is only economically feasible if the organisation is large enough. If expertise is sought it can be externally sourced but experts are very expensive on a contract basis or employed on a full-time basis. If the volume of the work does not warrant full-time employment of an expert, then this work will have to be done by someone else - a non-specialist, a consultant or the owner him/herself. Since it is very likely that the non-specialist will not be as effective and sufficient as the specialist, some of the cost advantages of specialisation will be lost to the small organisation.

4.3 MANAGERIAL INFLUENCE AND CONTROL OF SMALL ORGANISATIONS GLOBALLY

The owners of small organisations frequently experience tension between exercising the right to dictate organisational policy and goals and at the same time to react and respond to the knowledge and wishes of the employees.

Owners occupy a dominant position and the potential for tension exists between the desire of the owner to exert a strong influence on events and the need to empower employees (Ehlers, 2000: 44).

Owners co-ordinate the day-to-day activities within their organisations by direct, face-to-face supervision; they use one-way communication and the decision-making process is central in the person of the owner/manager of the organisation (Ehlers, 2000: 44).

Although the owners of small organisations would like to retain a substantial element of decision-making power, they are also seeking to promote flexibility, innovation and problem solving among employees.

In managing a small organisation creativity, adaptation, change, ambiguity, flexibility, problem-solving and collaboration occur regularly. These occurrences are the result of the changing environment in which small organisations operate - an environment where obtaining business orders are difficult, making predicting, planning and formalising more difficult.

4.4 THE GLOBAL IMPORTANCE OF SMALL ORGANISATIONS

Small organisations constitute at least 95% of organisations in the European Community. Despite their huge importance, and the relevance given to the small firm sector in terms of economic development, the message seemed to be ignored by the financial and economic commentators (Ehlers, 2000: 47).

Sengenberger, Loveman and Piore (1990) in Ehlers (2000: 47) did a comprehensive review on an international comparison between small organisations in France, Germany, Italy, Japan, the United States and the United Kingdom. The most important empirical result to emerge from the country reports is that there has been an increase in the share of total employment in small organisations that are defined as those who employ fewer than 100 employees. In general, the increase has been at the expense of large organisations. For the purposes of this study small organisations will be classified as those organisations employing 50 employees or less.

Kroon and Moolman (1992: 129) mention the following reasons for the importance of small organisations in any country:

- Small organisations are multitudinous, suppliers of employment and creators of work opportunities, innovators and initiators, subcontractors for large organisations, responsible for the manifestation of the free market

system, in many instances the entry point into the business world, playing an important socio-economic role.

- Small organisations can have a multiplying effect on the economy.
- Small organisations provide economic stability and a better distribution of economic activities.

While small organisations have remained an enigma for years, a series of empirical studies (Hall,1987; Evens and Javanovic, 1989; Loveman and Sengenberger, 1991; Scherer, 1991; Ivernizzi and Revelli, 1991 and Hughes, 1991) have enabled researchers to reach a far better understanding of the economic role of small organisations.

As a result of the above-mentioned studies Sexton and Kasarda (1996) in Ehlers (2000: 49) present stylised facts on the economic role of small organisations in different global market economies:

- There has been a shift in the size distribution of organisations away from larger organisations towards smaller ones.
- The growth rate decreased with organisational size and organisational age.
- Small organisations are at least as innovative as large organisations on an employee basis and generally have the innovative advantage found in high-technology industries.
- The small organisation's share of employment is growing faster in the goods-producing sectors than for the economy as a whole.
- Organisational survival is positively related to organisational size and organisational age.

- Small organisations produce at least a proportionate share of new jobs.

Apart from the global importance of small organisations there are certain advantages and disadvantages linked to small organisations.

The advantages and disadvantages will be discussed in the next section.

4.5 THE ADVANTAGES AND DISADVANTAGES OF SMALL ORGANISATIONS OPERATING GLOBALLY

It is important to reiterate that small organisations are not simply smaller versions of large organisations. They differ from large organisations according to their legal form, market position, staff capabilities, managerial styles, organisational structure and financial resources.

4.5.1 The advantages of small organisations

According to Boone and Kurtz (1996: 125-127) the differences between large and small organisations provide small organisations with the following unique advantages:

- **Innovation** – Small organisations are often the first to be offering new products to the market.
- **Better customer service** – A small organisation can be more flexible than a large organisation, allowing it to tailor its products and services to the exact needs of potential and current customers.
- **Lower cost** – Small organisations can often provide products and services at a cheaper price than large organisations. Small organisations usually have lower costs and can earn profits on lower prices than larger organisations.
- **Filling of isolated niches** – The size of large organisations can exclude

them from some markets. This situation provides substantial opportunities for small organisations with lower overhead cost.

4.5.2 The disadvantages of small organisations

Despite the unique advantages, small organisations have a variety of disadvantages. These disadvantages include the potential for poor management, a risk of inadequate financing and government regulations.

The most important global disadvantages for small organisations according to Boone and Kurtz (1996: 128-130) are:

- **Poor management** – Poor management is a common reason for the failure of small organisations. A lack of business training and knowledge often leads to bankruptcy. Only a few small organisation owners possess the specialised knowledge of an attorney, a professional marketer or an accountant and outside professionals should be sourced externally when needed.
- **Inadequate financing** – Many organisations start with inadequate capital and soon run short of funds. They often lack the resources to survive through tough economic times or to expand if they are successful.
- **Government regulations** – Small organisations all over the world complain extensively about regulations and red tape. Small organisations, cannot cope with the excessive paper work and they often have to utilise external experts to complete the necessary forms and to compile the necessary reports. This places a burden on the financial position of the small organisation.

The advantages and disadvantages discussed in paragraphs 4.5.1 and 4.5.2 are linked to certain secondary research objectives formulated in chapter one and research propositions to be discussed in the next chapter.

The discussion thus far provided a global view of small business. The rest of the discussion to follow will be directed at the South African economy and in particular the role of small, medium and micro organisations in South Africa. This will be emphasised by the content and role of the White Paper on the national strategy for the development and promotion of SMMEs in South Africa.

4.6 THE SOUTH AFRICAN ECONOMY

Different economic activities are performed across various industry sectors in South Africa, ranging from agriculture, mining, manufacturing, wholesale, retail and finance to transport, business services, personal services and imports and exports.

The South African economy furthermore is characterised by a low growth rate, a high inflation rate, taxes such as Valued Added Tax (VAT) and a high rate of unemployment. The South African economy grew at a growth rate of 2.5% during 1994, the first year after the first democratic elections and the opening of global trading boundaries for importing foreign products and exporting local products.

In 1995 the growth rate improved to 2.9%, but with the depreciation of the rand, which started at the end of 1996, the growth rate declined sharply to a mere 0.1% for 1998 (Ntsika, 1999: 17). The actual growth rate for the South African economy in 2000 was 3.10%, it is estimated that the growth rate will decline to 2.90% in 2001 and a growth rate of 3.00% is forecast for 2002 (<http://www.citadel.co.za>).

According to Ntsika (1999: 17 - 19):

- South Africa lags behind developing countries such as Argentina, Botswana, Brazil, Chile, South Korea and Malaysia in terms of employment and GDP growth.

- Apart from the low growth rate achieved, unemployment increased from 29.20% in 1995 to a high of 37.60% in 1997. According to Statistics South Africa, the South African economy lost half-a-million jobs since 1998.
- Apart from the low growth rate and high rate of unemployment, the turmoil in the financial markets caused monetary instability with lower direct foreign investment and capital flows in 1998.

All activities performed by the nearly 100 000 large, medium and small organisations are thus important to stimulate and provide economic growth (Bureau of Market Research - Report 245). Small and medium size organisations are an important part of the South African economy based on their significant contribution to the Gross Domestic Product (GDP) and employment.

According to Ntsika (1999: 45):

- Small organisations accounted for 28% of GDP and medium organisations for 13% in 1998.
- Small and medium enterprises accounted for almost 73% GDP in the community, social and personal services industries and they were also prominent in the agricultural, trade and construction industries with a contribution to GDP of more than 60% in each of these industries.

A more quantitative breakdown of the number of large, medium and small organisations in the different South African industries and industries per province will be provided in table format in chapter six. This quantification will be used as the basis for the stratified sampling procedure in the empirical part of this study.

4.7 THE SMME SECTOR IN SOUTH AFRICA

According to Ntsika (1999: 61) data on small organisations is, in general poor in South Africa and data that can be used to study small organisational trends is even poorer. The number of new registrations of organisations can provide an indication for measuring small organisational activities, but registrations are often influenced by take-overs, relocation or changes in activity or legal status and this phenomenon does not necessarily translate into growth.

A sharp increase occurred in organisational registrations in South Africa between 1990 and 1998. According to Ntsika (1999: 61):

- The number of Pty Ltds registered increased from 6369 in 1990 to 23 655 in 1998. This represents an almost 3.5 fold increase in nearly a decade.
- The number of Close Corporations (CCs) increased from 28 008 in 1990 to 73 114 in 1998, representing an approximate 2.5 fold increase during this period.

Large increases in new registrations occurred in trade, transport, finance and business services and the construction sector. According to Ntsika (1999: 63):

- The trade sector had the highest registration increase - from 1793 new registrations of Pty Ltds in 1990 to 7193 in 1998.
- The financial and business services sectors also showed a remarkable increase in the number of new registrations of Pty Ltds from 3039 new registrations in 1990 to 13 534 in 1998.
- The mining and manufacturing sectors have lagged behind.

- The manufacturing sector had moderate growth, with 1170 Pty Ltd registrations in 1998 and 662 registrations in 1990. One of the reasons for this moderate growth over a period of eight years could contribute to increased international competition since 1994 while lower gold prices impacted negatively on the mining sector.

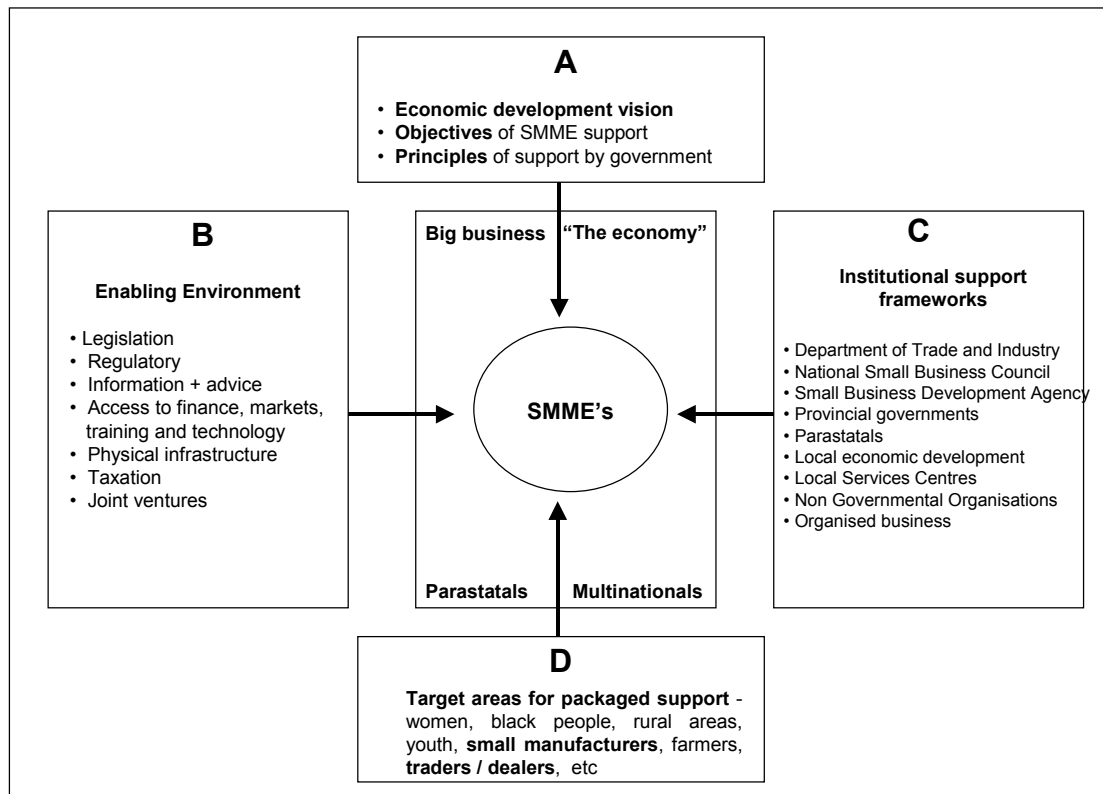
New registrations alone provide an incomplete picture of SMME sector in South Africa and it is also vital to look at the number of deregistrations. During 1990 to 1998 the rate of deregistration was very high, with one deregistration for every three new Pty Ltd registrations (Ntsika, 1999: 64). For close corporations, about one deregistration occurred for every six new registrations.

Based on the importance and contribution of small organisations to the South African economy as described in the preceding section, the government developed a small business promotion strategy directed at the socio-economic, macroeconomic and business and regulatory environments to be discussed in the next section.

4.8 WHITE PAPER ON NATIONAL STRATEGY FOR THE DEVELOPMENT AND PROMOTION OF SMMEs IN SOUTH AFRICA

The White Paper on small business, published by the Department of Trade and Industry, was tabled in Parliament on 20 March 1995. The main objective of this Act is to regulate, stimulate and promote small business activities in South Africa. The objective was to implement it across the full spectrum of the small-enterprise community including non-governmental organisations, private consultancies, partnerships and companies.

The White Paper is the result of an intensive process of consultation with key stakeholders in small businesses in South Africa and it consists of various parts as depicted in Figure 4.1.

Figure 4.1: The national SMME support strategy

Adapted from: White Paper (1995: 51)

The next section will be devoted to a discussion on each of the parts/components (A – D) as depicted in Figure 4.1.

4.8.1 Part A – Visions, objectives and principles

Part A of the national SMME strategy as depicted in Figure 4.1 consists of economic development, objectives of SMME support and principles of support by government.

(a) Economic development and vision

This section of the White Paper (1995: 10 – 15) provides the following on the economic development of small business in the South African economy based on size and diversity.

Based on size and diversity the policy stances in the White Paper accounts for the following four categories:

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- (i) **Survivalist enterprises** – activities performed by people who are unable to find a paid job or get into an economic sector of their choice.
 - (ii) **Micro-enterprises** – very small businesses, often involving only the owner, some family member(s) and at most one or two paid employees.
 - (iii) **Small enterprises** – constitute the bulk of the established business, with employment ranging between 5 and 50. The enterprises will usually be owner-managed or directly controlled by owner-communities.
 - (iv) **Medium enterprises** – 51 to 200 employees and a turnover of R5 million per annum.

(b) Objectives of SMME support

The **key objectives** described in this section of the White Paper (1995: 16 – 24) of the national small business strategy are:

- (i) Create an enabling environment for small enterprises.
- (ii) Facilitate greater equalisation of income, wealth and earning opportunities.
- (iii) Address the legacy of apartheid-based disempowerment of black businesses.
- (iv) Support the advancement of women in all business sectors.
- (v) Create long-term jobs.
- (vi) Stimulate sector-focused growth.
- (vii) Strengthen cohesion between small enterprises.
- (viii) Level the playing field between bigger and small businesses as well as between rural and urban businesses.
- (ix) Prepare small businesses to comply with the challenges of an internationally competitive economy.

Apart from the objectives of SMME support, Part A also includes key principles of government support to realise the national SMME support strategy. These principles are discussed in the next section.

(c) Principles of support by government

Ten **key principles** are underlying the government's national small business strategy:

- (i) The strategy is based on a joint vision for big, medium and small businesses in South Africa.
- (ii) All the segments of the small business sectors – survivalists, micro-, small and medium enterprises – need attention.
- (iii) The business efficiency and competitiveness of the whole small enterprise sector has to be developed, with due recognition of social, financial and other compliance standards relevant to an internationally competitive economy.
- (iv) An integrated support strategy has to give attention to both the supply and demand sides of small business activities.
- (v) Black advancement in the enterprise sector is a key factor in all spheres of the strategy; special emphasis also falls on other marginalised or disadvantaged groups.
- (vi) The scarcity of public funds demands careful prioritisation of support programmes and the skilful matching of different resources.
- (vii) Support policies will be sector focused and targeted with strict control of the application of public funds and full recognition of the market orientation of the economy.
- (viii) The institutional framework for small business support has to be restructured in order to reflect the evolving institutional diversity, the provincial thrust of policy implementation and effective bottom-up and top-down co-operation and co-ordination.
- (ix) Ultimate responsibility for the national strategy rests with the Department of Trade and Industry.
- (x) The private enterprise sector, co-operatives, NGO's, business associates and foreign assistance programmes all have a critical role to play in an integrated small business strategy.

The implication of the economic development and mission, objectives of SMME support and the principles of support by the government is that the government should put frameworks in place to realise this national SMME

strategy. The development of these frameworks will be discussed in the next section.

4.8.2 Part B – The enabling environment

The following factors depicted in Part B of Figure 4.1 and mentioned in the White Paper (1995: 25-40) will enhance the execution of the SMME support strategy:

- (a) Creating an enabling legal framework with special attention to a national Small Business Act, a Transaction and Procurement Act and a Small Business Finance Act.
- (b) To streamline regulatory conditions by reforming the small-claims courts and to establish a user-friendly environment for the simplification and standardisation of documents.
- (c) Access to information and advice by specifically providing certain principles as a guide for the involvement of government in this process.
- (d) Access to marketing and procurement.
- (e) Access to finance by supporting initial start-up equities, concessionaires, and commercial funding and ongoing subsidisation. By providing micro-enterprise with finance, venture finance, credit guarantees and information on access to finance, the initial initiative will be strengthened further.
- (f) Physical infrastructure with emphasis on providing support for home based businesses and entrepreneurs.
- (g) Training in entrepreneurship, skills and management by means of sharing knowledge, changing school curricula, modularising training programmes, training initiatives, research and a business mentorship system.
- (h) Industrial relations and the business environment to clear any misunderstanding between labour and small enterprise in creating a stable working environment.
- (i) Access to appropriate technology to make modern technology more accessible to small businesses.
- (j) Encouraging joint ventures with experienced local or foreign partners.

- (k) Capacity building and institutional strengthening by consulting with all the relevant stakeholders about developments.
- (l) Differential taxation and other financial incentives.

The factors mentioned above need to be institutionalised to assist interested organisations and/or individuals and to assign responsibilities to certain organisations and authorities.

These institutional frameworks will be discussed in the next section.

4.8.3 Part C – Institutional support frameworks

The government is serious about its intention to ensure that scarce public resources are channelled in the most effective way through its system. The following institutional support frameworks provided in the White Paper (1995: 41-47) will be streamlined in order to reach the above-mentioned goal (see Part C of Figure 4.1):

- (a) Department of Trade and Industry (DTI)
- (b) National Small Business Council (NSBC)
- (c) Small Business Development Agency (SBDA)
- (d) Wholesale funding agency
- (e) Restructuring of the Small Business Development Corporation (SBDC)
- (f) Small business support by provincial governments
- (g) Local authorities
- (h) Local Services Centres
- (i) NGOs and small business support
- (j) Organised business

The different elements of the national support strategy for small business as described above are linked to a process of strategy implementation based on a broad time framework. The funding for the implementation and monitoring of this national strategy will be obtained from various sources including funds from the local public, the private sector and foreign countries.

In order to achieve the objectives of this strategy funding by government allocation for SMME support will be increased to at least one percent of total budget spending for the next decade up to the year 2008.

4.8.4 Part D – Target areas for packaged support

As depicted in paragraph 4.6 small organisations have a very important role in, and contribution to make to the local economy. It is clear from the White Paper that the small business sector is playing a crucial role in the effort to meet the basic needs and helping marginalised groups. These marginalised groups include small manufacturers, traders/dealers, female heads of households, disabled people and rural families described as the target areas for packaged support as depicted in Figure 4.1.

4.9 SCOPE OF THIS STUDY

As mentioned in the demarcation section of this study in the introductory chapter this is an exploratory study aimed at investigating the use and application of the product life cycle concept among small manufacturing and small dealer organisations in Gauteng, South Africa. The literature study revealed that the product life cycle concept as marketing decision-making instrument was tested mainly among large organisations abroad.

The White Paper discussed in paragraph 4.8 further revealed that there is a lack of research among small organisations in South Africa. According to the White Paper (1995: 15) the volume of research with practical orientation and/or policy relevance is still limited, considering the needs of South Africa and the overall research capacity. This phenomenon provides more substance and relevance to the execution of this study in order to make a contribution to address the need of research among small organisations in South Africa.

To execute the empirical part of this study among small manufacturing organisations and small dealer organisations it is necessary to use respected publications such as The Standard Industrial Classification and the BMR

Registers published by the Bureau of Market Research at the University of South Africa.

These SIC and BMR Registers will be discussed in the next section.

4.10 THE STANDARD INDUSTRIAL CLASSIFICATION (SIC) AND BUREAU OF MARKET RESEARCH (BMR) REGISTERS

As mentioned in the introductory chapter the empirical part of this research will be executed among small manufacturing organisations and small dealer organisations in Gauteng, South Africa based on the quantitative selection criteria that will be motivated in chapter six. It is however necessary to provide a discussion on the SIC as this source will be used to select the small manufacturing organisations and small dealer organisations from the economic active population in South Africa. The discussion will highlight the International Industrial Classification and the customised Bureau of Market Research Registers developed to suit local economic activities.

4.10.1 The Standard Industrial Classification and the BMR Registers

Most countries base the classification of their economic activities on the International Standard Industrial Classification of all Economic Activities (ISIC) to publish statistical information. The ISIC proposed by the United Nations (UN) must however be adapted to suit particular economic and statistical conditions prevailing in individual countries. The ISIC covers the entire field of economic activities, dividing it into major divisions, major groups, groups and subgroups.

Based on the proposed ISIC classification of economic activities by the United Nations Table 4.1 provides a description of the SIC major divisions for economic activities in South Africa.

Table 4.1: The codes and major divisions of the SIC

Code	Major division
1	Agriculture, forestry, hunting and fishing
2	Mining and quarrying
3	Manufacturing
4	Electricity, gas and water supply
5	Construction
6	Wholesale and retail trade, repair of motor vehicles, motor cycles and personal household goods, hotels and restaurants
7	Transport, storage and communication
8	Financial intermediation, real estate and business services
9	Commodity, social and personal services
0	Private households, extritorial organisations, representatives of foreign governments and other activities not adequately defined

Adapted from: **BMR Report 245 (1997: 2)**

The Bureau of Market Research at the University of South Africa developed a BMR register covering the different SIC major divisions or parts of a major division for the economic activities in South Africa. The BMR Registers provide an overview of the establishments active in the most important sectors of the South African economy.

The empirical execution of this study will be conducted among organisations in the Manufacturing Register (major division 3) and the Trade Register (major division 6). Table 4.2 provides a description of the BMR Registers and its major divisions.

Table 4.2: The BMR Registers and the major divisions

Register	Major division
Commercial Farmers Register	1
Mines Register	2
Manufacturing Register	3
Construction Register	5
Trade Register	6
Hotels and off-sales Register	6
Financial and Insurance Institutions Register	8
Business Services Register	8
Public Sector Register	9
Associations and Trade Unions Register	9
Importers Register	1 – 9
Exporters Register	1 – 9

Adapted from: **BMR Report 245 (1997: 4)**

4.10.2 A description of the two major divisions used in this study

According to the BMR Report 245 (1997: 84) the major division 3, (Manufacturing) is divided into ten divisions with two digit codes extending from code 30 (manufacture of food, beverages and tobacco) to code 39 (manufacture of furniture and recycling). These divisions are further subdivided into major groups with three-digits (e.g. 304: manufacture of other food products), groups with four digit codes (e.g. manufacture of bakery products), and subgroups with five digit codes (e.g. manufacture of nut foods).

According to the BMR Report 245 (1997: 84 – 90) the Major division 6 comprises of wholesale and retail trade, repair of motor vehicles, motor cycles and personal and household goods, hotels and restaurants. Major division 6 is further divided into 4 divisions with two digit codes extending from code 61 (wholesale and commission trade, except for motor vehicles and motor cycles) to code 64 (hotels and restaurants). These divisions are further subdivided into major groups with three-digits (e.g. code 631: sale of motor vehicles), groups with four digit codes (e.g. code 6311: wholesale of motor vehicles and retail sales of new and used motor vehicles). The four digit codes are further divided into subgroups with five digit codes (e.g. code 63121: ambulances, caravans, jeeps, landrovers, microbuses, passenger motor vehicles, trailers and semi-trailers and vehicles sold by auctioneers).

The national distribution of large, medium and small organisations across the various BMR Registers in South Africa will be provided in chapter six.

4.11 CONCLUSION

This chapter provided an explanation on overview of the environment in which this study will be conducted. Substance was given for the selection of small organisations to be included as the sample frame for the empirical part of this study. It furthermore provided a universal perspective on the importance of small organisations to economies world wide together with its advantages and disadvantages.

To localise this study and to link the current chapter to the literature survey in chapters two and three, the White Paper for the development and promotion of small businesses in South Africa and the BMR Registers were briefly explained. A motivation for the choice of small organisations will be provided in chapter six.

The next chapter will provide a discussion on the different research propositions and the motivation thereof.