Chapter 1: Introduction

1.1 Background

The objective of this study was to propose a model that can determine the contribution of small business to capital generation and consequently to the development of the South African economy.

An economy needs jobs that are supported by an increase in gross domestic product output by job and an increase in income *per capita* to achieve economic stability. It is also important to create growth through the factors supporting growth. It appears that the four factors of growth, namely the size and quality of the labour force, the quantity and quality of capital, improvements in technology and the availability of natural resources, specifically referred to in Sub-section 3.3, are difficult or impossible to manipulate. It is especially difficult to manipulate the size of the workforce and the availability of natural resources. The other two factors, namely quantity and quality of capital and improvements in technology, are linked to capital generation and are relatively easier to manipulate. Even the quality of the work force can be improved if capital is available. An economy needs capital to increase the quality of labour, availability of capital for research and development or to improve the level of technology, thereby improving competitiveness.

The terms *growth* and *development* as two important parameters in this study are defined as follow:

1. ***Growth*** in this study refers to economic growth which is the process of increasing gross domestic product[1]
   a. ***Growth*** does not necessarily imply *capital generation* as explained in Chapter 3

[1] See sub-section 3.2 for full discussion

2. ***Development*** in this study refers to *capital generation* measured via an increase in assets and/or an increase in owners income and/or an increase in employees income and/or an increase in the payment of taxes.
    a. *Capital generation* plays a role in economic development, but it is not the only factor playing a role in economic development. Economic development is a wide field of study of which development through capital generation only refers to a small section.
    b. *Capital generation* plays a role in stimulating at least three of the four factors of *growth*, but it is not the only stimulant
    c. Naturally, *capital creation* implies *growth*, but *growth* does not necessarily imply *capital generation* as explained in Chapter 3.

Capital generation, as a factor influencing economic development (Thirlwall, 1999: 109), can be manipulated through various economic and business interventions. As a controllable factor, capital generation in small businesses is measured by the proposed model as a way of supporting economic development. Economic growth is measured by utilising readily available financial data to calculate the contribution of business to capital generation. The model is explained in detail in Chapter 3.

In essence, the model calculates the capital growth of a business by analysing the growth in assets, taxes, employees' and owners' income. If growth is positive, taking into account the effect of inflation, the business is contributing to capital generation. The business can, therefore, pay its employees and owners better, thereby increasing their spending power, it can contribute more to taxes to improve the country's overall strength, and it can strengthen the position of the business by enlarging its asset base.

The problems associated with small business development, and the lack of effective measurements to confirm the effectiveness of these development efforts, result in a management dilemma for development and government agencies which support the development of both small, medium-sized and micro enterprise. The impact of their efforts on the economy, with regard to capital generation, cannot be effectively measured and can therefore not be optimised. This management dilemma will be discussed in more detail in sub-section 1.2.

It is also argued that the pure creation of jobs and increasing the contribution to gross domestic product will not necessarily improve the economy and therefore should not be used as measuring tools in developing economies. This is contrary to the current measurement of the contributions of small and medium-sized enterprises in South Africa. The proposed model is more in line with international trends and is supported by the World Bank (the International Bank for Reconstruction and Development/the World Bank 2000: xxiv) and recent economic research (Mohr and Fourie, 2002: 684).

The proposed model will improve the decision-making criteria of state departments, aid organisations, and financial and non-financial development organisations. The model will add an economic-development dimension to the current decision-making criteria and assist these entities to optimise limited capital and human resources. The proposed model appears flexible and can be adapted in order to enable research in specific fields of small business development. It will enable the researcher to identify areas of strength within the economy where small enterprises perform better than in other areas. This research can support development agencies to focus their energies towards areas of higher potential development in small and medium-sized enterprises.

Based on economic theory, discussed in Chapter 3, there are various parameters that must be addressed to ensure real economic growth. Economic growth is only achieved when there is an increase in the real potential (full employment) income. Naturally, growth comes into its own only when potential is fully utilized.

Lastly, gross domestic product, per head of the population, must increase. The conflicting evidence regarding the contribution of small businesses to development, analysed later in this chapter, can be attributed to the methods of interpretation and measurement that are not standardized. This proposed model provides insight to the creation of capital affects related to economic development and the development of individual businesses. Capital provides businesses with the opportunity to attract good resources, to expand the business and to absorb risk in order to grow.

This chapter serves to operationalise the key concepts in the problem statement of the actual phenomena to be studied. The chapter also formulates the items used to define all the variables in the study. A separate chapter is dedicated to defining small business because of the importance and complexity of such a definition for the study.

It was not the objective of this research to *question* the contribution of small businesses to economic development. Rather, the research aimed to *analyse* and *interpret* the degree that small businesses contribute to economic development in South Africa through capital generation. The degree that they contribute to economic development, and the impact associated with this development, is limited to aspects of the model that are necessary to understand their capital contributions. Information regarding the impact of the development of small and medium-sized enterprises will help the 250 development agencies (in 2001), to optimise their resource planning (Harley, 2001: 11).

The parameters, or risk factors, influencing the success of small businesses have been analysed in the literature (Chapter 4). The effects that these risk factors have on the success of small businesses were accounted for by analysing the data, drawing conclusions and making recommendations. The proposed model, and model results, must not be read in isolation. The secondary benefits of small business development were considered, as were the risk factors influencing development. These benefits are reducing the burden of government to support the unemployed, to develop entrepreneurial skills, to create new markets and to distribute income over a broader income basis, and so on.

Primary data used in the study highlight important issues that impact on development and on the application of limited resources. The net result of the study is a model to determine the measurement of capital generation by small businesses as a contribution to economic development.

1.2 Research problem

There are two main research dilemmas:

1. The first is that there is conflicting evidence about the contribution of small businesses to development, both locally and internationally. The impact of small business on development, as a method of stimulating the South African economy, is therefore studied to determine the actual contribution of these businesses to the economy.
2. Secondly, conflicting statements about the contribution, and way that contribution is measured, raises the question of what the best method to measure small business contribution in a developing country should be.

Various statements in the literature confirm that small businesses contribute to economic development in South Africa and other developing and transitional economies (Levy, 1996: 1, Belisle, 1997: 18, and Bureau of Market Research, 2001: 1). In the White Paper of the Department of Trade and Industry, 1995, sub-section 2.2.3, the impact on economic development is acknowledged: "The small business sector is seen as an important force to generate employment and more equitable income distribution, to activate competition, exploit niche markets (both nationally and internationally), enhance productivity and technical change, and through all of this stimulate economic development." Physical proof of government's belief in the contribution of small business is seen in the National Small Business Council programme. It is also stated that small and medium-sized enterprises have the potential to become significant exporters, to promote economic growth, and to alleviate poverty among various groups in a society (Badrinath and Kirpal, 1997: 6). One of the greatest challenges facing the South African government in future decades will be economical growth that brings tangible benefits to the majority of the population (Toomey, 1998: 217).

The report of the Bureau of Market Research (2001: 3) states "The role of the informal sector is particularly relevant when levels of unemployment and poverty are high and economic growth is slow. The development of the informal sector has been suggested as a possible means of providing some form of survival or subsistence income".

Contradictory to the statements supporting small business development is that of Bradburd and Ross (1989: 259), who showed that in the United States large businesses are generally more profitable than are small businesses in heterogeneous industries, except where niches exist. There is a direct link between capital generation and profitability. This raises the question of whether small business development is the optimal tool for establishing economic development. This again is contradicted by Burns and Dewhurst (1986: 195), who state that small European businesses are more profitable than larger businesses. There is mixed empirical evidence supporting claims that small and medium-sized enterprises create jobs (Hallberg, 2000: 5).

It is clear from the statements that small and micro business development is seen as an important driver in the South African economy. The relevance of these statements must be questioned considering that, according to the Katz Commission, 90% of taxes are collected from 8% of businesses in South Africa (Cape Argus, 1997 (1): 1). The hypothesis that they either contribute (H_{10}), or do not contribute (H_{1a}), will be tested.

Statistical data on small business success from financial institutions and statistics published by the state on small business development indicate that the success rate for small businesses in South Africa is between 20% and 30%, depending on the relevant business sector (Nattrass, and Glass, 1986: 2). Data from the Anglo American Small Business Development Arm (1995 to 2001) also highlighted the risk of failure in small and medium-sized enterprises.

In contrast to South Africa, small and medium-sized enterprises in India, Bangladesh, and Pakistan contribute 90% to employment in the industrial sector and between 60% and 70% of domestic industrial production. The positive results retrieved from small business development in Asia are being used to justify the South African small business strategy (Rutten and Upadhya, 1997: 8).

Another hypothesis is that differences between developing economies will have differing impacts when policies are being designed (Hallberg, 2000: 2). This research does not address this hypothesis.

Historically, there was a general trend of small business decline[2] in the developed nations of Europe, especially the United Kingdom and the North American nations (Canada and the United States of America). The decline in the economic weight of small businesses has been reflected in a major shift in the proportion of the working population that earns its income from profits as opposed to wages or salaries (Bannock, 1981: 2). Storey (1996: 24) showed a similar trend[3]. This trend has started to change because of the new integrated world economy where flexibility is now becoming more important. Similarly, only those businesses that can offer better value-added products and services to an expanding and international client base, and deliver them quickly, will succeed.

[2] See chapter 4: The importance of small businesses
[3] See sub-section 4.3.4: Small business impact on employment

This trend has not only decreased the importance of size, but also provides an advantage to smaller entrepreneurial businesses (Jetro, 1999: 3).

It can be concluded that:

1. Different levels of economic development have different small and medium-sized enterprise strategies supporting the economy (Hallberg 2002: 2).
2. South Africa prefers economic growth, used in the first world, as a measurement tool since all reports refer to growth measured by Gross Domestic Output and no reports refer to development through capital generation as a measurement (Badrinath and Kirpal, 1997: 6 and Bureau of Market Research, 2001: 3).
3. Using economic *growth* as a measurement of economic prosperity in gross domestic product and job creation shows positive results in local and international published statements.
4. Using *development* measures, measuring capital generation, such as the contribution to tax and asset growth, shows negative contribution to capital generation in South Africa.

A research problem is formulated in sub-section 1.3 to analyse the impact of manufacturing small businesses on economic development in South Africa: A proposed model for the measurement of capital generation by small businesses as a contribution to economic development.

1.3 Problem statement

Institutions such as the South African government, donor countries and private businesses invest large amounts of time, resources and money in small business development to stimulate the economy. These investments are made without a proper tool to measure the net direct effect of the investments on the economy and specifically on economic development. Weaknesses of not having proper measurement tools include:

1. Researchers currently using gross domestic product and job creation as measures of growth only and ignoring the impact that small business development has on economic development.
2. Researchers measuring the financial success of businesses and ignoring their impact on government and employees.

It is not possible to determine whether small businesses in South Africa contribute to capital generation and, therefore, development. It is critically important for a developing country with limited resources to know what the net effects of these investments are to enable it to invest available resources for economic growth and development in the best possible ways.

No studies, similar to the work done in this study, have been attempted to establish the effectiveness of small business development or to measure its contribution to capital generation in South Africa. However, models do exist to determine the macro-economic impact of business development on growth. These models measure the effects of gross domestic product and job creation on growth (Reid, 1995: 6).

The South African government has aggressively embarked on a drive to develop the small business sector. This drive is based on international studies which state the effectiveness of small business development on job creation and on the gross domestic product. Actions, based either on myth or reality, encourage governments in both developing and industrialized countries to intervene to promote small and medium-sized enterprise development (Hallberg, 2000: 22). However, scale-based enterprise promotion has little empirical support.

Because the effects, of enterprise development on the South African economy, are not known, large amounts of scarce resources are invested without knowing how effective these investments are. If the net results of these investments cannot be determined, it becomes very difficult to determine the weaknesses and strengths of the strategy. No intervention is possible to influence positively the internal and external factors hampering small business development since the relative influences of these factors are not measured.

Small business development was successful in certain countries within their specific macro-economic environments. There are some similarities between South Africa and these countries, but there are just as many differences.

1.4 Research questions

The fundamental question that needs to be answered is whether small business in South Africa contributes to capital and job generation and, therefore, economic development. The word *additional* in the hypotheses refers to the increase in capital generated over and above the increase in capital generated to cancel the effect of inflation. The hypotheses necessary to test the research question are:

1. H_{10}: Small businesses do not generate additional capital.
2. H_{1a}: Small businesses generate additional capital.

The H_{10} and H_{1a} hypotheses have the sub–hypotheses which follow:

i. H_{20}: Small businesses do not generate additional income for their employees.

ii. H_{2a}: Small businesses generate additional income for their employees.

iii. H_{30}: Small businesses do not generate additional income for government (tax).

iv. H_{3a}: Small businesses generate additional income for government (tax).

v. H_{40}: Small businesses do not generate additional income for their owners.

vi. H_{4a}: Small businesses generate additional income for their owners.

vii. H_{50}: Small businesses do not generate additional income for investment in assets (capital and goods).

viii. H_{5a}: Small businesses generate additional income for investment in assets (capital and goods).

These eight sub-hypotheses are followed by the final two hypotheses regarding job creation by small businesses:

1. H_{60}: Small businesses do not contribute to job creation.
2. H_{6a}: Small businesses do contribute to job creation.

1.5 Research objective

The objective of this research was to propose an efficient and effective model to analyse the impact of the development of the manufacturing small business sector on capital generation in South Africa. All over the world small and medium-sized enterprises play a disproportionately large role in light manufacturing, especially of differential products (products that are not manufactured by larger companies because of low volumes or specific technical issues). There is a similar pattern in South Africa, although on a smaller scale compared to international norms (Levy, 1996: 1).

For the proposed model to be successful, it needs to comply with the parameters which follow:

1. The data should be easily accessible and accurate. This was achieved by using data from the audited financial statements of a business. The data were obtained from a structured interview or directly from the audited financial statements.
2. The proposed model should be operationally applicable to different sectors.
3. The proposed model should be operationally applicable to different geographical regions.
4. The data should be easy to interpret.
5. The effect of inflation and fluctuations in employment should be considered. This was done by correcting the data to eliminate the effects of inflation by normalising the data with the consumer price index, excluding interest rates on mortgage bonds, and by normalising different employment numbers to analyse the impact on *per capita* income growth.
6. Trends should be considered. Data were shown as percentages to analyse the trends.
7. The effect of business cycles should be minimised. Different manufacturing industries were analysed to reduce the effect of business cycles on the industries and the analyses were done over a five-year period.

1.6 Approach

Definitions of *small business* in both the South African and international contexts needed to be understood so that parallels with international research could be drawn.

A model needed to be developed to understand the impact of small businesses on development in a South African context. The model was based on the understanding of the definitions of *small business*. International best practice and development economic theory were used to construct the model and the measuring parameters. Based on the parameters that needed to be measured, a practical solution to obtain information to analyse the parameters necessary to measure development was designed.

Data were collected by using interviews or by obtaining financial data directly from the institutions. The data were used to fill the model to be used to determine the contribution of businesses to development and to capital generation. Lastly, the results of the study were used to draw conclusions, to make recommendations, and to identify areas for future research.

1.7 Benefits of the study

The study will benefit two main groups:

1. Governments and development agencies will have a model to analyse the impact of their developmental efforts on capital generation on the level of small businesses and on the macro economy
2. Researchers and institutions will have a research tool to improve their understanding of the impact of small businesses on development and capital generation.

The proposed model will provide users with a tool to evaluate capital generation and job creation by small business as well as larger businesses as:

1. It measures the number of direct jobs created.
2. The number of jobs created can be compared with the average number of jobs created in the industry.

3. The contribution of sectors and industries to job creation can be measured.
4. Capital generation can be measured to determine if small businesses generate additional capital in assets, taxes and in the incomes of owners and employees.
5. Capital generation can be measured to determine which sectors, industries or sizes of businesses generate the most additional capital.
6. It gives an indication of the strength of the businesses based on their ability to grow assets.
7. It gives an indication of the effectiveness of small businesses in improving the lives of employees.
8. It gives an indication of the abilities of small businesses to contribute to government income through tax.
9. It highlights areas of concern and opportunity.
10. A better understanding of current small business development in South Africa is created.
11. It provides clearer definitions for identifying manufacturing small businesses in South Africa.

1.8 Nature and form of results

The proposed model determines whether businesses contribute to economic development through capital generation. The results were analysed by reporting on the businesses' contribution towards tax, asset growth, employees' and owners' incomes.

The proposed model highlights areas of small business development in South Africa by identifying the optimal business size and age to be targeted. It assists stakeholders to identify the optimal impact areas on which to focus developmental efforts. These include high growth sectors when stakeholders are considering investing in this sector of the economy. The model gives a picture of the effectiveness of small business development when measured against its impact on the development of the economy. The proposed model uses a direct analysis approach and does not consider the indirect benefits that small businesses provide.

1.9 Conclusion

This study is relevant to an understanding of the impact of small business development on the South African economy, especially considering the conflicting evidence about the contributions of small businesses and the different ways they are measured in the literature.

It is important that the model is based on economic theory and best practice and that it is tested against actual primary data. The relevance and importance of managing the scarce financial and human resources effectively in South Africa must be acknowledged as one of the main drivers to justify this study. South Africa, with its high population growth rate, the Auto Immune Deficiency Syndrome, unemployment and lower-than-expected economic growth, will benefit by making the right decisions in supporting economic development. Small business development is only one way of assisting economic development.

Without a model to determine the impact of small business development on the economy in South Africa, no investment or development organisation can make an objective investment decision to benefit the economy optimally, especially as capital generation is an important parameter for development. The model will not analyse the secondary spin-offs of small business in South Africa and will only inform the reader of these secondary benefits.

Chapter 2: Defining a Small Business in South Africa

2.1 Introduction

The term *small business* is defined and used differently in South African literature. The same is seen internationally. The differences between the definitions, as described in this chapter, make it difficult to find similarities between local and international research. Rothwell and Zegveld (1983: 8) and Hallberg, (2000: 1) support this when they state that the role of small and medium-sized enterprises in the economy varies nationally, as does their contribution to technological innovation. Stanworth and Gray, (1991: 3) contends that the definitions may even change over time. Sauermann, (1997: 7) also confirms the difficulty of defining a small business by stating that a small business cannot even be defined in exact terms. There is no accepted international benchmark against which to measure and interpret. These differences in measurement and interpretation are seen throughout the research.

The literature sources used here span three decades. The reasoning behind this is to analyse differences between economies and cultures and to become aware of the shifts that occur as countries develop and changes in the economy occur.

It is important to understand and define a small business in South Africa in order to understand the unit of analysis. This chapter will look at South African and international definitions. A better understanding of the different measurements will assist the writer to incorporate more literature and to develop a better understanding of the context.

The definition developed in this chapter will be used as one of the parameters to define the scope of the study and clarify its delimitations. The sources of currently-used definitions which follow will be used to develop a definition to be used in this thesis:

1. Small businesses as defined in South African literature and as published by private and public institutions, in research papers and other publications.
2. International definitions of small businesses.
3. Practical applications of definitions, such as in procurement policies and other indirect methods, as additional sources to define and verify the relevance of definitions of small business used in local and international literature.

Different units of measurement used in defining small business must also be considered. Measurements, and units of measurement most applicable to South Africa, must be selected. Information about small businesses must be accessible and measurable. These businesses must at least be registered entities with good fundamental accounting practices. These will minimize personal data interpretation and bias.

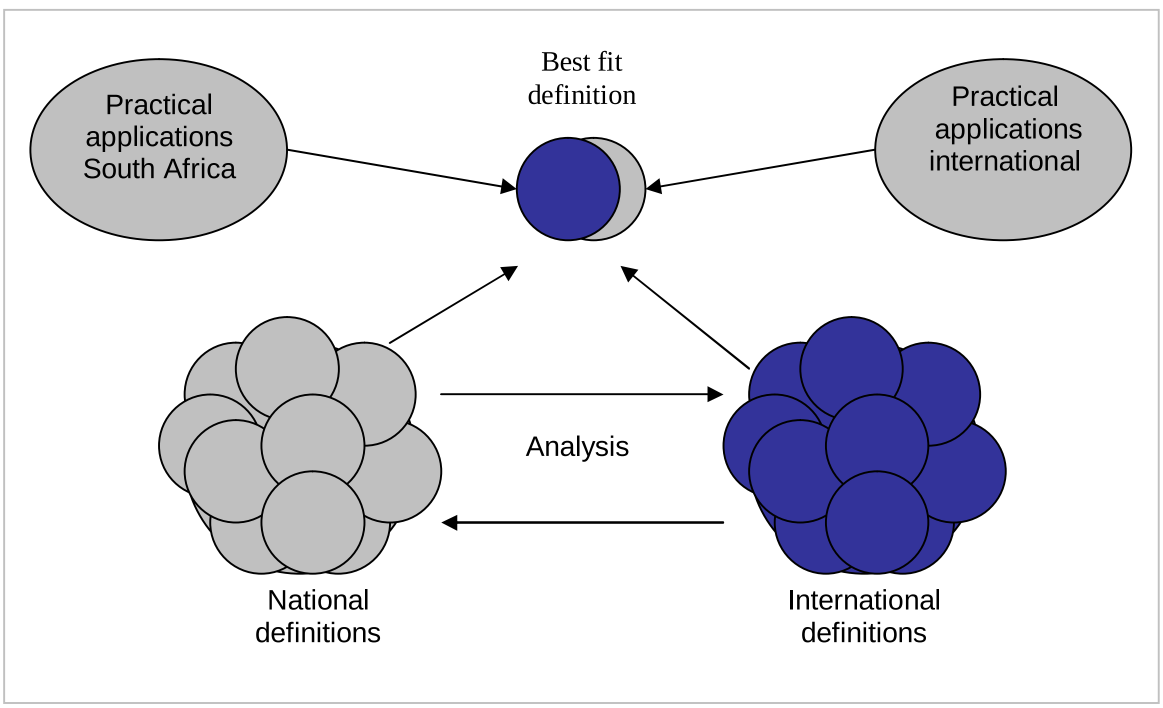

Figure 2.1 Graphical representation of the development of a so-called best-fit definition compiled by the writer

A definition for this study will be developed by considering the factors illustrated in Figure 2.1 and discussed already in this chapter.

2.2 Delimitation and scope of the study

Analysing and defining a small business in the South African context will constitute the bulk of the chapter. The definition will be used to clarify the scope and delimitation of the study. The description of the geographical area and industry sector will also form part of this chapter. Current small business definitions used in the South African and international context will be discussed.

The chapter provides insight into the different entities on the continuum from survivalist to medium-sized businesses. This will provide the reader with a better perspective of what constitutes a small business to clarify the delimitation and scope of the study. Clarifying what constitutes a small business will also assist in developing a better understanding of the field of study.

2.3 Geographical area

The study does not analyse the total South African small business industry in all economic sectors. It only focuses on the manufacturing industry in Gauteng[4] and North West as a sample. The model is tested against a sample of the total local manufacturing small business sector in these provinces. This sample has a total size of 45 manufacturing businesses.

[4] Most small (42%) and very small (50%) businesses are in Gauteng.

Figure 2.2 Map of South Africa

This map of South Africa shows that Gauteng is the smallest of the nine provinces geographically and that North West is located to the west of Gauteng.

KwaZulu-Natal has the largest population, with 9.4 million counted in the 2001 census. However, Gauteng is the most densely populated province, with some 8.8 million people (19.7%) occupying just 1.4% of the country's land area.

The most rural area is Northern Province. Gauteng, with both Johannesburg and Pretoria within its boundaries, is almost entirely urban. North West has 3.67 million people or 8.2% of the total population (Statistics South Africa (2), Census 2001). The province of North West constitutes 9.5% of South Africa's land area. The two provinces, Gauteng and North West, constitute two extremes in population density in South Africa.

2.4 Industry

This research focuses on the manufacturing industry. The reasons are that:

1. Small business, especially in manufacturing, acts as the breeding ground for innovation. The Bolton Committee (1971: 10) called the small business sector the seedbed for the industry of the future. This is supported by Aldonas (2003: 2), in his paper on the impact of manufacturing small businesses in the United States, and by Storey (1996: 24)[5].
2. Data from the manufacturing industry are more readily available to the researcher.
3. It is easier to measure its contribution based on physical output or the end product that is manufactured.
4. The manufacturing small and medium-sized enterprises industry is distinct in the literature.
5. Growth in the manufacturing industry is common to newly-industrialised countries and is associated with developing economies (Haslam, Neale, and Johal, 2000: 70).

This study specifically focused on the following sectors within the manufacturing industry[6]:

1. Motor.
2. Building.
3. General engineering providing engineering services especially to the mining and agriculture industries.
4. Furniture and funeral.
5. Food.

[5] The role of small business: see sub-section 4.3.3

[6] For a detailed description of the industries and the grouping of industries, see sub-section 6.12

2.5 Definitions

This section will discuss both local and international definitions for developed and developing countries. The data were then used to analyse and define a best-fit definition of a small business in the South African manufacturing industry. This analysis will form a critical part of the delimitation used for selecting small business data for the model.

2.5.1 Local definitions of small business

A generic international definition is not easy to find. Most definitions, or classifications, of small businesses are specific to a particular country (Hallberg: 2000: 1). This is true of both the measurement and the size of the measuring units.

Countries have widely different definitions of small and medium-sized enterprises. In India, for example, the criteria for determining small and medium-sized enterprise status is based on investment in the business, while in South Africa small and medium-sized enterprise eligibility depends on the number of employees and turnover.

It is important to understand the current method used to define small businesses in South Africa to enable us to understand and analyse data from local literature.

Older literature illustrates changes in definitions over time. In the Republic of South Africa President's Council Report[7] (1985: 3), for example, certain qualitative measures were used to define a small business. These measures were:

[7] The 1971 Bolton Report indicated that this is not a good measurement. See International comparisons.

1. ***Independent economic unit***: The business is owned and run independently with ownership residing in one person or a small group of persons.
2. ***Simple organisational structure***: It normally has an informal organisational structure, with numerous functions and responsibilities residing in one person.
3. ***Small influence on the market***: The business does not have a significant influence on the prices or the quality of goods offered.
4. ***Ownership identified with the entrepreneurial function***: Ownership is identified with the entrepreneurial function, partly supplying capital, managing the business and sharing in profits. In large businesses the functions of ownership and management are usually not shared, with businesses run by professional managers.

The reason why this definition was used is that there was no acceptable quantitative measure for defining a small business. The fact that *small* has a different meaning in different countries and that it is measured in different ways are supportive of this method of defining small and medium-sized enterprises.

The difference between medium–sized, small and informal businesses can be described as a grey area in South Africa according to the Republic of South Africa President's Council Report (1985: 5).

The South African Government has determined that small and medium-sized enterprise classification is important to understanding which types of policy interventions are most appropriate (Lucas, 1992: 3). These reasons for small and medium-sized enterprise classification have been identified:

1. Policy makers and service providers need to know which target groups should be assisted so that they can develop better policies and services for small businesses.
2. Small business owners need to know into which target group they fall so that they can determine the support measures for which they qualify.
3. Researchers need a common understanding of what small business is so that they can measure and compare performance in different regions and sectors and in other countries. For example, survivalist businesses are best served with interventions that complement the community development approach, whereas micro-enterprises need increased access to finance and information to help them to move into the small and medium-sized business league. Small and medium-sized businesses require an individualised package of technical assistance, training and credit sources.

The National Small Business Act[8], Chapter 1, (The Republic of South Africa National Small Business Act 102 of 1996: 2) provides the first national definition of small business. The Act describes a small business as a separate and distinct business entity. It cannot be part of a group of businesses. If it does have subsidiaries and branches, they must all be included in the measurement of its size. A small business should be managed by its owner or owners and the business can be a natural person, a sole proprietorship or a partnership. It can also be a legal person, such as a closed corporation or company.

The definition in the Act includes agricultural activities and the activities of professionals. It is essential to determine the criterion for distinguishing between self-employment, which is covered by the definition, and casual labour, which is not. Self-employment activities are performed for one's own account and risk. By applying this criterion, it becomes clear that economic activity based on an

[8] This Act is the best comparative definition of small businesses based on international definitions. See sub-section 2.8: International definitions

authoritative relationship, such as in domestic work and selling goods for someone else, does not qualify as self-employment and therefore does not qualify a person for small and medium-sized enterprise status.

The National Small Business Act (The Republic of South Africa National Small Business Act 102 of 1996:18) classifies small businesses into four categories: micro, which includes survivalist businesses, very small, small and medium-sized. The Act uses employment, turnover and assets criteria to classify small businesses. The business must comply with all three. This study only focuses on small businesses. The definitions in the sections which follow have been included to clarify and demarcate the upper and lower limits of the study.

2.5.2 Informal business sector

Informal businesses were excluded for the purposes of this study. They form the lower border of small business.

An informal business can be defined as an unrecorded, and frequently illegal, business activity. Illegality, as defined, excludes socially unacceptable and criminal activities (The Republic of South Africa President's Council report, 1985: 7).

This older definition is replaced by the more detailed National Small Business Act definitions that distinguish between businesses using different criteria. They reflect the change in focus by government to increase its support to small businesses. They redefine informal businesses, thereby enabling them to become part of the economic structure.[9]

The report of the National Manpower Commission (1983: 5) sees the informal sector as part of small business. It is difficult to compare the South African

[9] See chapter 2 sub-section 2.1.2

informal sector with international data, since most data are based on businesses that are registered entities operating according to the rules and regulations of the country. The study will exclude informal businesses such as street vendors, businesses not registered for tax and businesses with only one employee. These are businesses described as survivalist businesses[10] by the National Small Business Act.

It is almost impossible to determine the extent of the informal small business sector (subsequently referred to as the *informal sector*) in the Republic of South Africa, particularly in respect of determining the employment potential of this sector (Martins and Ligthelm, 1995: 4). This is mainly due to the fact that it is not clear as to what constitutes the informal sector.

Problems in defining the informal sector have already been discussed and the examples which follow indicate practical problems that are encountered in quantifying it:

1. Many people are only involved in the informal sector to supplement income from their usual occupations. A mechanic, for example, may repair motor cars of friends or acquaintances over week-ends for remuneration. This must be seen as an informal sector activity. It probably does not contribute to the provision of employment, although it may do so indirectly. One of the requirements that could therefore have been included in the definition of the informal sector is that people must be involved in the informal sector full-time or for the larger part of the day. This would mean that people earning the smaller part of their income through the informal sector are excluded.

[10] See chapter 2, sub-section 2.1.2

People who work part-time, such as street vendors who operate during peak hours only, might also be excluded. Such a narrow definition disregards the contribution of the informal sector to creating the means of existence even where it does not lead to the creation of conventional, measurable, full-time employment opportunities.

2. Informal sector activities are often undertaken to bridge a period of unemployment. The person concerned does not have to earn an adequate income from the informal sector to make a living, because he can rely on savings, unemployment insurance or other sources to do so. In such a case the informal sector does not offer a permanent means of living to the person concerned. The issue that is raised is whether this really identifies the informal small business as an *employment opportunity*.

Children are often involved in the informal sector. Many of them would not have been classified as economically active if it were not for the informal sector (in other words, they would not be workers or work seekers). Strictly speaking, they should not be taken into account when determining the potential of the informal sector to provide employment opportunities.

The extent to which illegal activities, such as prostitution or smuggling, should be included could also be questioned. If it is decided to include such illegal activities two problems in particular become apparent:

1. There is not always a clear distinction between legal and illegal activities. *Shebeens*, for example, were seen as totally illegal until recently. If, as a result of this, they are excluded from any assessment of the informal sector, the figures will be distorted (even more so if a sudden change in policy legalises many of the shebeens). The same is true for unlicensed taxis and street vendors.
2. A comparison with other countries would then be made difficult, because what is considered to be illegal differs from country to country. If provincial

and local authority ordinances are also taken into consideration, an activity which is illegal in one area may be legal in another.

A whole family often undertakes an informal sector activity, but the different members of the family are not always involved to the same degree. The wife can, for example, assist only during busy lunch hours. To say that the employment effect equals the number of persons in the family would be incorrect. It would also be incorrect to take only those working full-time into account. Many activities in the informal sector do not provide full-time work (as in the case of street vendors who sell their wares only during peak hours), but these activities still contribute materially to the means of existence of the people involved.

It is necessary to calculate the real cost of creating these informal ventures and the risk involved in the establishment of such ventures. The impact of these ventures on business in similar markets must also be established to calculate the real contribution to economic growth. It is necessary to determine if these small ventures contribute to the economy or only share a limited market. If the latter is the case, these ventures do not contribute to the economy by creating something additional or new.

2.5.3 Survivalist businesses

Survivalist businesses are businesses with no paid employees and minimal assets. These businesses generate income below the minimum income standard or the poverty line, and their main aim is to provide minimal subsistence to the unemployed and their families. Most entrepreneurs in this category are involved in hawking, vending, subsistence farming and so on.

In the National Small Business Act, the survivalist sector is considered part of the micro-enterprise sector. It is estimated that the survivalist sector constitutes 23.3% of all businesses in South Africa and provides approximately 3% of total employment. This category has great potential for the absorption of unskilled labour. This has been confirmed by the correlation between the unemployment rate and the amount of self-employment in unregistered, mainly survivalist, businesses that prevail in informal settlements and in rural areas. The largest number of South Africa's survivalist businesses is in KwaZulu-Natal (23%), Gauteng (21%), the Eastern Cape (17%), and Northern Province (11%) (The Department of Trade and Industry, 1998: 2).

2.5.4 Micro-enterprises

Micro-enterprises have a turnover below the Value Added Tax registration limit (presently R300,000.00 *per annum*) and have fewer than five paid employees. These businesses tend to lack formality in terms of registration for tax purposes, labour legislation, business premises and accounting procedures. Examples of micro-enterprises are spaza shops, mini-taxis and household industries. Micro-enterprises, with no employees, constitute approximately 31% of all businesses and contribute an estimated 3.9% of total private-sector employment. Micro-enterprises with one to four employees make up 16.4% of all businesses and contribute about 6.8% of employment. The largest numbers of micro-enterprises are located in Gauteng (34%), KwaZulu-Natal (18%), the Western Cape (14%) and the Eastern Cape (10%). (The Department of Trade and industry's National Small Business Act, 1995, and Department of Trade and Industry, 1998: 2).

2.5.5 Very small businesses

Very small businesses generally employ fewer than ten paid employees, but in the mining, electricity and manufacturing and construction sectors they employ fewer than 20 people. They operate in the formal market and usually have access to modern technology. The smallest of these businesses comprise self-employed owners with no employees, such as artisans and professionals. Very small businesses make up an estimated 19.7% of all businesses recorded and account for 13.3% of employment. The largest concentrations of very small businesses are found in Gauteng (42%), the Western Cape (16%) and KwaZulu-Natal (15%). (Department of Trade and Industry, 1998: 2).

2.5.6 Small businesses

Small businesses have fewer than 50 paid employees, are more established and have more complex business practices. Usually the owners do not manage the business directly, and have secondary coordinating mechanisms. Growth from a small to a medium-sized business requires an accumulation of resources as well as a set of appropriate incentives for business expansion. Small businesses constitute an estimated 7.6% of all businesses and contribute 19.9% of employment. Almost 50% of small businesses are found in Gauteng (46%). A further 16% and 12% are located in KwaZulu-Natal and the Western Cape respectively (Department of Trade and Industry, 1998: 2).

2.5.7 Medium-sized businesses

Medium-sized businesses are businesses with up to 100 paid employees, but this number rises to 200 in the mining, electricity and manufacturing sectors. Although usually still controlled by an owner/manager, the ownership and management structure is more complex. Often the decentralization of power to an additional management layer and a greater division of labour are the main differences between small and medium-sized businesses. A more complete separation of ownership and management is often the natural barrier between medium-sized and large businesses. Medium-sized businesses make up 1.4% of businesses recorded and account for around 13.8% of employment. They are concentrated in the metropolitan areas of Gauteng, KwaZulu-Natal and the Western Cape. In practice, the number of employees has become the most important criterion, whereas in micro-enterprises turnover is the most vital criterion. The turnover and asset criteria are flexible enough to take into account large differences across various sectors of the economy (Department of Trade and Industry, 1998: 2).

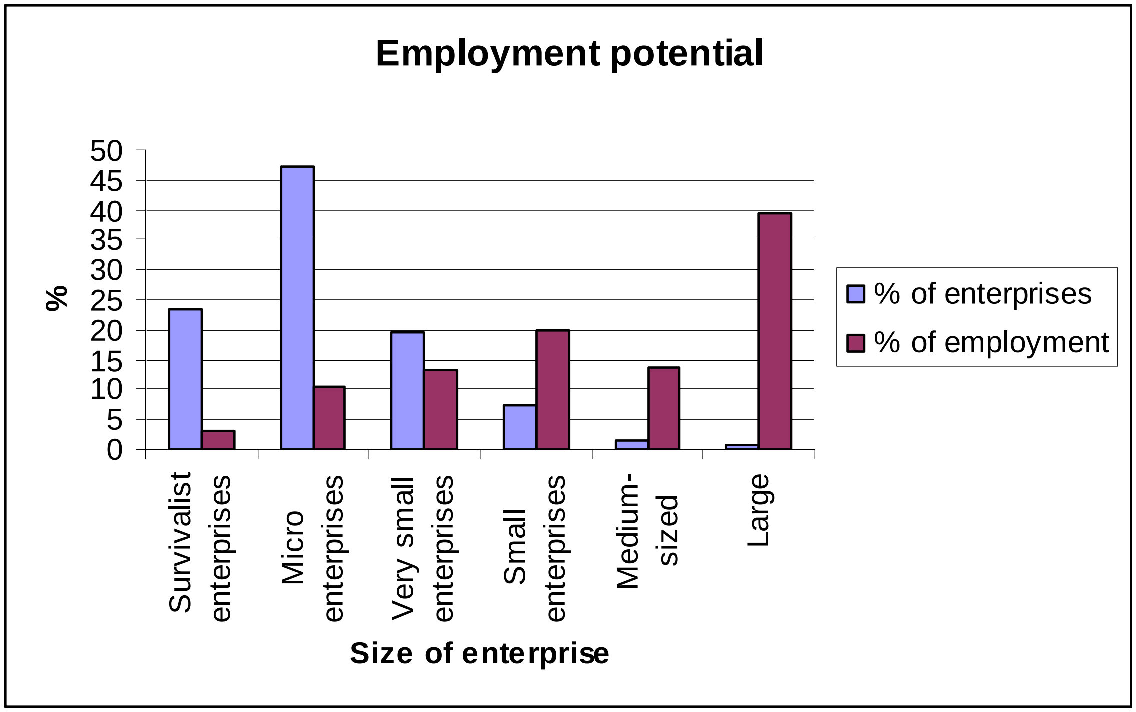

Figure 2.3 Employment potential of different-sized businesses

The employment potential of businesses is based on the data retrieved from the National Small Business Act and Department of Trade and Industry, (1998: 2). The writer compiled the graph from these data.

This graph is supported by data from Levy (1996: 1) who confirmed that 14166 businesses, employing fewer than 100 people, provide only 23.9% of employment whereas 3208 manufacturing businesses, employing 100 or more people, provide 76.1% of employment.

Compared to other developing nations such as Korea, Singapore and others, our manufacturing small businesses contribute far less to job creation. Out of 11 countries, the average of job creations for business employing five to 19 people was 11.9% compared to 5%. The section of the sample that is measured in this study of businesses employing 20 to 99 people showed a similar trend. In South

Africa: 18.9% are employed, compared to 18.5% in the rest of the world (Levy, 1996: 1).

This data show that the size of a business has a direct impact on the percentage contributed towards employment in South Africa. There is a definite difference between how much very small and small businesses contribute to job creation. The impact that small businesses have on job creation, compared to that of very small and micro businesses, supports government's drive to develop this sector.

Comparing the two methods of defining small business, it is clear that the latter is a quantitative method compared with the more qualitative method used in the Republic of South Africa President's Council Report. This again emphasises the differences in ways of defining small business.

2.6 Contract-grading as a measure of validating small business definitions

2.6.1 South Africa

Many developing countries in Africa have contractor-grading systems for contracts. Contractors are generally classified in terms of their resources, such as their financial capability, equipment, supervisory staff and previous experience (Special Sectoral Report No. 1, November 1997: 4). Monitors are appointed to verify contractor classifications and to reassess classifications from time to time. Contracts are packaged to suit contractors in a particular classification, usually in terms of complexity, monetary value and nature of the work. Typically, contractors may not tender for work above their contract status but may tender for work below their status. This grading system has proved useful in developing local industries (Public Procurement in the European Union, 1998: 6).

However, it has also worked as a trade barrier for foreign businesses as the system ensures that work, that the local industry is capable of undertaking, is packaged appropriately (Wittig, 2000 (2): 30).

In the context of determining small and medium-sized enterprise status, the question of registration can be approached in a number of ways and may be required for a number of reasons. One of them is to identify the small and medium-sized enterprise's field of operation (activity) in order to target and promote certain types of business effectively. In South Africa, registration is considered necessary for accreditation purposes and as a means of identifying activities (Special Sectoral Report No. 1, November 1997: 6):

1. Compiling a database and for the packaging of contracts.
2. Regulating the industry.
3. Ensuring "equitable" workloads to pre-qualified contractors.
4. Certifying the *bona fides* of small and medium-sized enterprises.

Proposals for registration in South Africa for public-sector procurement reform suggest that registration must be instituted as a means of:

1. Compiling a database for the packaging of contracts and identifying target groups.
2. Regulating participation in public-sector procurement.
3. Promoting good business practices and adhering to statutory regulations and requirements.
4. Censuring those who transgress codes of conduct, who fail to meet their tax, levy or service charge obligations, or who obtain work in fraudulent ways.

Non-registered suppliers, service providers and contractors should not be permitted to participate in public-sector procurement activities. The registration must be subject to the observance of a code of conduct which should, *inter alia*, require signatories to undertake:

1. To tender only on projects which they are capable of executing, with the resources they are able to marshal, in accordance with the terms and conditions of contract.
2. To remunerate staff in accordance with relevant labour legislation.
3. To pay into the Unemployment Insurance Fund, workman's compensation, service charges, Value Added Tax, income tax and other appropriate taxes.
4. To adhere to safety and health regulations as far as their workers are concerned.

(Special Sectoral Report No. 1, November 1997: 8).

South Africa promulgates proposed public policy in advance of legislation in Green Papers and White Papers. This is similar to the approach used in the United Kingdom.[11] Creating an enabling environment for reconstruction, growth and development in the registration and categorization of contractors and businesses will enable:

1. The operation of a preference scheme or approved public-sector tender list which would reduce industry and public-sector costs associated with the tender process.
2. Performance monitoring to facilitate the promotion of improved contractors and to ensure compliance where standards are violated.
3. Targeting of resources to emerging businesses which are demonstrating progress and the withdrawal of support from those which have graduated or have failed to progress.

[11] A Green Paper is earlier in time, less firm and designed to bring tentative policy into public discussion. A White Paper, on the other hand, states relatively firm policy from which a government will not deviate lightly and is used eventually to draft an act.

It is clear that contract-grading is not a good way of defining, or supporting definitions of, the manufacturing industry. It does, however, highlight the fact that countries adapt definitions according to local needs and the environment and not for purely scientific reasons. In this section, it is clear that government adapts definitions to protect and optimise its tendering processes. International best practices, or comparative definitions, are neither guidelines nor necessities for government when defining small business.

2.6.2 United States

In the United States a well-developed programme of assistance to small and minority business entities has been in existence since the 1950s. The principal programmes are designed to assist small business concerns, regardless of whether they are owned and controlled by persons in historically disadvantaged categories (Wittig, 2000 (1): 40).

The United States Government has, for many years, required procuring entities to set procurements aside for exclusive competition between small businesses. The Government maintains a number of programmes designed to assist small businesses that are owned and controlled by persons that fall within categories that have been characterized by historical discrimination or prejudice (Wittig, 2000 (1): 20).

The United States uses its small and medium-sized enterprise definitions to support government objectives in procurement procedures, as does South Africa. Definitions are driven by government goals and objectives.

2.6.3 India

In India the major government procurement strategy is based around cottage industries. The term *cottage industry* is used to refer to the production of traditional goods in villages by very small units.

The government of India supports the growth of Small Scale Industries as a matter of policy. This has been an important and permanent feature of the Government's long-standing industrial policy (Wittig (1), 2000: 45). There has always been an emphasis on the establishment of new small scale industries, particularly in industrially backward areas, and a concern for their viability and continued growth. From time to time, the Government has initiated assistance programmes to achieve its broad objectives. (Wittig (1), 2000: 45).

National Small Industries Corporation (India) and the Director of Industries have been entrusted with the responsibility of certifying an industrial unit as an Small Scale Industry unit (Wittig, 2000 (1): 45). In other words, a small-scale unit has to be registered with the National Small Industries Corporation (India) or the Director of Industries of the states concerned in order to be eligible for the benefits available to Small Scale Industry units. This registration is an essential eligibility criterion for participation in the Government's public buying programme.

The Indian government has found that the cottage industry, by its very nature and tradition, offers employment benefits in the rural areas, and generally assists the economically and socially disadvantaged to supplement income. (Wittig (1), 2000: 45). Its other objectives are skills improvement through training, transfer of technology, promotion of self-reliance, building a strong rural community base, and rural industrialization.

India uses its small and medium-sized enterprise definitions to support government objectives in procurement procedures and to guide the laws that govern industry, as does South Africa. Definitions are driven by government goals and objectives to support specifically the cottage industry, which can be compared to our survivalist industries[12].

2.6.4 Europe

The European Community's procurement directives were promulgated to liberalise its internal market. The rationale underlying the directives, and the principles embodied in them, are based on trade liberalisation. They are not meant to serve as, or to substitute for, domestic procurement laws in member states. They are intended to open public procurement markets within the member states that have traditionally been closed and that remain resistant to trade liberalization (Wittig (1), 2000: 49). The directives have been interpreted as allowing only a small role to policies intended to assist small and medium-sized enterprises[13] in the European Community. Available evidence tends to show that the benefits of trade liberalisation within the Community far outweigh national policies favouring domestic businesses.

The current Community approach tends to rely on improving access, for small and medium-sized enterprises, to public procurement through such initiatives as training and other non-interventionist approaches. This is indicated in the European Union report (Public Procurement).

The European Commission, however, does not appear to rule out the possibility of preferential measures for small and medium-sized enterprises for procurements below the threshold of application as set out in the directives. For acceptance by the Commission, such programmes are likely to require clear definitions of qualifying small and medium-sized enterprises, compatibility among national regimes and strict conformity with European Community treaty

[12] See sub-section 2.5.2
[13] See table 2.2

requirements on transparency, equality of treatment and non-discrimination. However, they cover only the countries that accede to it (Wittig (1), 2000: 49).

Procurement and procurement policy can be summarised by highlighting that procurement policy is there to:

1. Develop local small and medium-sized enterprises.
2. Protect them against international businesses.
3. Support political motivations to promote disadvantaged communities and countries.
4. Target and support specific growth areas.

Unlike South Africa, the European Union uses its small and medium-sized enterprise definitions to support regional integration objectives in procurement procedures. Definitions are driven by regional goals and objectives. It is clear that this is driving integration at a regional and not at a national level.

2.7 International definitions

2.7.1 Background

There is no single and uniformly acceptable definition of a small business. This is because a small business in, say, the petrochemical industry is likely to have much higher levels of capitalization, sales and possibly employment, than a small business in the car repair trade (Storey, 1996: 25). Definitions, therefore, which relate to objective measures of size, such as the number of employees, sales turnover, profitability, net worth and so on, when examined, mean that in some sectors all businesses may be regarded as small, while in other sectors there may be no small businesses.

2.8 Analysis of definitions

The Bolton Committee in (1971: 1) attempted to overcome this problem by formulating an *economic* and a *statistical* definition (Storey, 1996: 20).

The *economic* definition regarded businesses as being small if they satisfied these criteria:

1. They had a relatively small share of their market place.
2. They were managed by owners, or part-owners, in a personalised way, and not through formalised management structures.
3. One or two persons make all the critical management decisions, such as those about finance, accounting, personnel, purchasing, processing or servicing, marketing, and selling, without the aid of internal specialists with specific knowledge in only one or two functional areas.
4. They were independent, in the sense of not forming part of a large business.

The *statistical* definition emphasised:

1. The size of the small business sector, its contribution to aggregates such as gross domestic product, employment, exports, innovation and so on.
2. The extent to which the small business sector has changed its economic contribution over time.
3. That comparisons could be made between the contributions of small businesses in one country with those of other nations.

In 1971 the Bolton Committee (1971: 20) defined a manufacturing small business as a one with fewer than 200 employees (Storey, 1996: 21). Not using turnover is supported by comparing the Strainrite Companies located in Auburn, Maine, with a local South African manufacturing business.

The United States business employed 85 people in Maine and another 40 people throughout the United States, and had approximately R60 million in sales. These included sales to China, Japan, the United Kingdom and Mexico (Aldonas, 2003: 3).

The South African business that was used in the research, with approximately 100 employees, only had 25% of the turnover of the United States business. This phenomenon is apparent even among the local businesses listed in Appendix 3. It is clear that it will be difficult to use turnover as a measure.

There are criticisms about the Bolton Committee's *economic* definition, according to Storey (1996: 20) and Stanworth, Westrip, Watkins, and Lewis. 1982 (1982: 14). These are listed:

1. The first criticism is that the work of Atkinson and Meager 1994 (in Storey 1996: 20) demonstrates that managerial appointments, and not simply those of supervisors and foremen, are made when a business reached a size of between ten and 20. At that size the owners do not make all managerial decisions. This differs from the Bolton definition of businesses of more than 200 employees that are owner-managed.
2. The second criticism is about the concept of *perfect competition* reflected in the Bolton definition. According to Bolton, a small business is regulated by its environment. Up to the turn of the century, small businesses usually operated in a niche market, where the environment does not regulate them.

There are also problems with the *statistical* definition:

1. The first is that there is no single definition or criterion of smallness. Different definitions use the number of employees, turnover, ownership and assets.

2. The second is that three different upper limits of turnover are identified for the different sectors and two different upper limits of employees are identified. This complicates definitions over time and between countries
3. The third criticism, based on monetary units, is that they make comparisons over time very difficult, since appropriate index numbers have to be constructed to take account of price changes. They also make international comparisons more difficult, because of currency value fluctuations.
4. Fourthly, there are problems with employee-based criteria in comparing small businesses over time. As Dunne and Hughes (1989: 2) point out, output per head in constant prices varies according to business size.
5. The fifth criticism is that it treats the small business sector as homogeneous

Another way of defining a small business is provided by Wynarczyk *et al* in Storey (1996: 21). They argue that there are three central areas in which small businesses are different to large businesses:

1. ***Uncertainty***. Three dimensions of uncertainty can be identified. The first is associated with being a price-taker. The second source of uncertainty for small businesses is their limited customer- and product–base. The third relates to the much greater diversity of the objectives of the owners of small businesses, compared to those of large businesses.
2. ***Innovation***. Rothwell (1986: 27) showed that the early development of the semi-conductor industry in California stemmed from the establishment of small businesses which were able to grow extremely rapidly. Innovation is also the ability of small businesses to provide something marginally different, in terms of products or services, which distinguish them from the more standardized products or services provided by large businesses.
3. ***Evolution and change***. Small businesses that become large undergo a number of stage changes which influence the role and style of

management and the structure of the organization. The key point is that the structure and style of management of a small business is more likely to change as the business moves from one stage to another than is the case for a large business (Scott and Bruce 1987: 46).

To overcome a number of these problems, following the lead of the European Commission, the term *small and medium enterprise* has been coined. The small and medium-sized enterprise sector itself is disaggregated into three components:

1. Micro-enterprises are those with one to nine employees.
2. Small businesses are those with ten to 99 employees.
3. Medium-sized enterprises are those with 100 to 499 employees.

Sengenberger, Loveman and Piore (1990) in Ehlers (2000: 47) did a comprehensive review on an international comparison between small businesses in France, Germany, Italy, Japan, the United States and the United Kingdom. The report showed that there is an increase in the share of total employment in small businesses that are defined as those who employ fewer than 100 employees. In Australia, as stated on the Australian Bureau of Statistics web page, 1996, a manufacturing small business will also employ fewer than 100 people.

This excludes the agricultural, hunting, forestry and fishing industries, which employ fewer than 500 people in Europe. Special definitions also exist for craft traders. The problem with these European Community definitions is that they are too *all-embracing* for smaller countries such as Greece, Ireland, Spain and Portugal, where nearly all the businesses fall within the definition of a small and medium-sized enterprise. This will also be the case for a large percentage of businesses in South Africa.

Because of all the problems associated with definitions it will be necessary to tailor or adjust the definition used in this research according to current research done in South Africa and the specific area that will be researched. Storey (1996: 22), concludes in his analysis of the definition of a small business that the best current definition is that used by the European Community, but that each researcher most likely will use his or her own definition of small business.

It is important to note that countries do not use the same definitions and that a small business in one country may be a big business in another. The main driver for having a definition is to assist government to structure its policies (Belisle, 1997: 14).

There are nevertheless three parameters that are generally accepted, either singly or in combination, in defining small and medium-sized enterprises in most countries. These are:

1. The number of workers employed. This is the most widely used criterion.
2. The level of capital investment or assets.
3. The volume of production or business turnover, sometimes measured in average annual receipts over a predetermined period of time.

In many countries, medium-scale industry is not defined and is understood to include those that fall between small and large industries.

2.8.1 International comparisons

In the United Kingdom, 95% of all businesses have fewer than 100 employees (Storey, 1996: 28). In the United Kingdom, the Department of Trade and Industry (2005) states, on its web site, that the new thresholds (above) for small and medium-sized businesses employing fewer than 50 people will apply to annual accounts in respect of financial years ending on or after 30 January 2004 (Department of Trade and Industry, 2005).

Table 2.1 Number of businesses and size of businesses by country

European Community businesses by member states, 1993, adapted by the writer to reflect on definitions in the South African context.

Source: ENSR (1993: 17)

Country	Number of enterprises (x 1000)	Number of enterprises per 1000 Inhabitants	Average business Size (people employed)	Employment share 0-9 (%)	Employment share 0-499 (%)
Belgium	530	53	5	28	69
Denmark	180	35	9	22	76
France	2040	36	7	28	67
Germany (FRG only)	2160	35	9	17	62
Greece	670	67	3	59	91
Ireland	130	36	6	34	83
Italy	3170	55	4	48	81
Luxembourg	20	43	9	23	74
Netherlands	420	28	10	28	72
Portugal	640	62	4	36	80
Spain	2020	52	4	36	83
United Kingdom	2630	46	8	26	65
South Africa	800	16			
South Africa (incl. micro)	2800 to 3800	56 to 76			
Total European Community	14600	45	6	30	70

If the number of small businesses, by 1000, people is analysed, it is clear that the more developed countries, such as France, Germany, Denmark, Ireland and the Netherlands have a lower average number of small businesses than do Greece, Italy, Spain and Portugal. France, Germany, Denmark, Ireland and the Netherlands have the largest business size, while Greece, Italy, Portugal and Spain have smaller businesses. The wealthier countries have larger business sizes measured by number of people employed than the less wealthy countries such as Portugal, Spain and Greece.

Table 2.2 Proportion of employment by sector and size

Source: European Community data taken from ENSR (1993:14)

Portion of employment by sector and size				
	Less than 100 %	100-499 %	More than 500 %	Total %
All sectors				
United States of America	37	14	49	100
United Kingdom	45	18	35	100
European Community	55	16	29	100
Manufacturing				
United States of America	20	15	65	100
United Kingdom	24	15	61	100
European Community	42	20	38	100

The highest portion of employment in the United States of America, in all sectors as well as in manufacturing, is in large businesses. The major difference between the European Community and the United States of America is not in medium-sized businesses but in small businesses. The European Community has a lot more small businesses that employ fewer than 100 people. The same results are displayed in the comparison between European Community and United States of America manufacturing. A comparison between United Kingdom and United States of America results show that the two countries are similar.

A comparison of the data between United States of America, the United Kingdom, the European Community and the individual countries in the European Community triggers the question of how reliable comparisons between regions based on a uniform definition can be. It would be suggested that data should first be normalized against the economic strength of a region. It might be argued that small and medium-sized enterprises, which are based on local niche markets to give them their competitive advantage, are very dependent on the local market and economy. It is therefore acceptable that a business in Spain will serve a smaller niche market than a similar business in the United States of America or the United Kingdom.

Accordingly, in the South African context, reference is usually made to small, medium-sized and micro-enterprises and not to small and medium-sized enterprises. In view of the focus of this work, the references will be to small and medium-sized enterprises, although South African programmes are more accurately geared to small, medium-sized and micro enterprises.

Industries in India are classified into the following categories, according to size: large-scale industries, medium-scale industries, small-scale industries, and the tiny sector. There are no formal legal definitions for large-scale and medium-scale units. A general consensus on definitions has, however, emerged in usage. A unit with a total investment exceeding R150 million is considered to be large-scale, and a unit whose total investment in plant and machinery does not exceed R4.5 million is small-scale. Medium-scale units have investments falling between those two extremes. The definition of investment does not cover money spent on buying land and erecting buildings and workshops, nor does it include working capital (Wittig, 2000: 46).

In Hungary, the definitions of size categories are based on government recommendations and are currently used primarily for official statistical purposes (Wittig 2000 (2): 47). The definitions correspond to those employed to collect statistics in the European Union. The European Union and the Hungarian definitions differ in the magnitude of the thresholds used, with the Hungarian thresholds set at about one-half those of the European Union.

The categories of businesses are:

1. Micro-enterprises, with fewer than ten employees.
2. Small businesses, with between ten and 49 employees, and a turnover of Forint (Ft) 700 million or a maximum balance sheet of Ft 500 million.
3. Medium-sized businesses, with between 50 and 249 employees and a turnover of Ft 4,000 million or a maximum balance sheet of Ft 2,700 million.

To be considered a small and medium-sized enterprise, the maximum number of workers is 29 in the Lao People's Democratic Republic, 75 in Malaysia, 100 in Brunei Darussalam, Indonesia, Myanmar, Singapore and Viet Nam, but 200 in the Philippines and Thailand. In countries that distinguish between *small* and *medium-sized*, the maximum number of workers in small businesses ranges from ten in Brunei and the Lao People's Democratic Republic, 50 in Myanmar, Thailand and Viet Nam and to 100 in the Philippines (Wittig (1), 2000: 48).

The data show the variations that occur even among countries in the same region, some of which are at similar stages of development. For example, a business with 80 workers is not a small and medium-sized enterprise in Malaysia but is one in the Philippines. Similar variations exist with regard to the criteria of capital and turnover.

2.8.2 Conclusion

Based on local and international definitions and procurement legislation, Table 2.4 was constructed to highlight different criteria that are used in different countries and regions. The table highlights the similarities and common trends in definitions.

Table 2.4 Small business definition summary

A high-level summary of local and international definitions referring to small businesses developed from the research in this chapter.

Criteria	South Africa President's Council	South Africa National Small Business Act	SA Procurement	United States Procurement	India Procurement	Europe Procurement	Bolton Committee	Hungarian	Wynarczky	Asia
Independent economic unit	Yes	Yes		Yes	Yes		Yes			
Simple organisational structure	Yes				Yes					
Small influence on market	Yes			Yes			Yes			
Own risk or account		Yes								
Managed by owner or small group	Yes	Yes	Yes	Yes			Yes			
Employees		1 - 50		Less than 100		Less 100 or 0 - 499	200 or lees	10-49	10 – 99	29-200
Registered entities - legal requirements			Yes							
Different considerations per industries (i.e. market share, industry, growth trends etc.)			Yes	Yes		Yes	Yes			
Financial criterion – turn over			Yes	Yes				Yes		
Financial criterion – balance sheet			Yes		< US$ 750 000			Yes		
Supervisory staff			Yes							
Previous experience			Yes	Yes						

Criteria	South Africa President's Council	South Africa National Small Business Act	SA Procurement	United States Procurement	India Procurement	Europe Procurement	Bolton Committee	Hungarian	Wynarczky	Asia
No direct affiliation to large enterprises				Yes						
Price taker									Yes	
Limited customer and product base									Yes	
Diversity of objective from owner									Yes	
Innovation									Yes	
SME procurement			Yes	Yes	Yes	Yes				

Table 2.4 clearly shows that the number of employees is a very strong quantitative measure used to define a small business. For this study the definition used by the National Small Business Act (more than ten employees and fewer than 50) will be used for all industries except construction, mining and manufacturing. It is important to mention that the figure doubles[14] in the definition of small businesses in construction, manufacturing and mining. If we apply this rule to small businesses, South Africa becomes comparable to Europe, Asia and the United States of America, considering that these use 100 employees as the maximum cut-off. Similar to Hungry adapting the European method of measure to its own economy, South Africa has to adapt its measurement.

For this study, *small business* will be defined as businesses in the manufacturing industry employing between 20 and 100 people. Businesses in the manufacturing industry, employing less than 20 people will be defined as *very small businesses.* The model will compare *very small businesses* with small businesses to highlight differences in capital generation.

[14] See sub-section 2.1.4: Very small enterprises

There is a definite change, between very small and small businesses, to creating employment (Figure 2.3). This change in employment potential supports the decision to focus more on small businesses and less on very small business, using the definition in the National Small Business Act. During the analysis of the data businesses between 0 and 132 employees will be evaluated to understand the differences between these entities.

European Union and United States of America data highlight the differences in sizes of small businesses in the different regions. This phenomenon also exists between industries. To avoid normalising data between industries, the manufacturing sector will be selected. Data need to be normalised to enable effective comparisons between countries. It is not the intention of this study to compare South African data with international data, but only to compare trends.

It clear that a *small business* must be an independent economic unit managed by an individual or a small group. Although financial criteria, such as turnover and assets, play important roles, they will not be used as part of the criteria as there are no clear definitions. It is also important to note that the sector, as well as the stage of economic development, plays an important role in determining size.

Evaluation of *small business* definitions in this chapter has shown that they clarify the role of these definitions.

It is not essential for countries to provide uniform and international definitions. It can be argued that these small businesses only compete within the boundaries of a particular country and that it is not necessary to define *small business* uniformly and internationally.

The role of these definitions is to support legislation to help and protect small businesses. With the globalisation and disappearance of borders, these definitions will need to be revisited, firstly in integrated regions such as the South African Development Community and the BENELUX countries and lastly in larger trading blocks such as Europe. One such example is the development of a definition in the European context as described in sub-section 2.6.4.