CHAPTER 1

BACKGROUND AND DEFINITION OF THE PROBLEM

"More and more professionals and entrepreneurs
are conducting their business from residential properties –
sometimes through force of circumstances,
but more often, by choice."

(Egan, 1994: 30)

1.1 INTRODUCTION

More than 30 million Americans are currently working from home and the figures are still rising. This trend is not only happening in this world leader, but is almost old news in most developed countries, including South Africa. They are generally known as "home-based businesses", where a certain floor area is being utilised as an office or even consulting rooms and small stores. But the latest trend which has developed from this phenomenon is where a whole residential property is being utilised as a small business venture without residents permanently occupying the property.

The trend towards out-of-town living (moving away from the city centres), brings with it the necessity to travel long distances to and from work, often in heavy traffic. Escalating office and shop rentals contribute to this problem, while the emergence of the "virtual office" also makes the options for the entrepreneur of the location-decision even more important (Sheedy, 1994: xiii).

Although the residential office option has much going for it, prospective entrepreneurs would be well advised to carefully consider the pro and cons before making a decision that could either make or break their new venture. To consider the feasibility of such a location-decision and in order to develop a framework and recommendations for these entrepreneurs, aspects like the kind of business, local authorities' rules and regulations, advantages, disadvantages and other factors will be explored in this doctoral dissertation for what can be the future location-solution for small businesses.

1.2 LITERATURE REVIEW

The word *entrepreneur* and the concepts derived from it such as entrepreneurial, entrepreneurship and entrepreneurial process are frequently encountered in discussions of the management of new, fast growing, innovative small business ventures. These concepts are easily related. Entrepreneurship is what an entrepreneur actually does. Entrepreneurial refers to the approach they take. The entrepreneurial process is what the entrepreneur engages in (Wickham, 1998: 4).

Even though there are usually a failure to pin down the rich and complex phenomenon of entrepreneurship in a universal definition, it is the very variety of entrepreneurship and the endless possibilities that it presents that makes it so challenging. Entrepreneurship is a social and economic phenomenon. The entrepreneur is, first and foremost, an individual who lives and functions within society. Entrepreneurs are characterised not by every action they take, but by a particular set of actions aimed at the creation of new wealth. Entrepreneurship is about value generation (Wickham, 1998: 6).

Both entrepreneurship and small business management are of critical importance to the performance of the economy. However, it is useful to draw a distinction between them since small business and entrepreneurial ventures serve different economic functions. They pursue and create new opportunities differently, they fulfil the ambitions of their founders and managers in different ways and they present different challenges to economic policy makers. Drawing this distinction is an issue of classification which is being discussed in the literature chapters (Wickham, 1998: 18).

During the last two decades small, medium and micro enterprises (SMME's) all over the world have changed their locations for a variety of reasons. The extensive amount of investment in new locations indicate the significance of location decisions (Karakaya & Canel, 1998: 321).

One of the most momentous decisions any manager will ever make – whether running a multibillion rand conglomerate or a neighbourhood clothing store – is the decision to move the business or any part of it. Whether it means shifting a plant, an office, a warehouse or a showroom, anyone who faces such a decision must live with the consequences for a long time after. Moving a business is obviously more than just packing up the files and the computers, calling a truck and setting up your business somewhere new. The multitude of factors that go into a decision to move, demands that the executive consider all the relevant location factors concerning his enterprise and classify them into required and desirable criteria.

Required criteria are those that must exist; if the location does not have all of the required criteria it should not be considered as an option. The *desirable criteria*, however, are those that you would like to have but they are not essential for the success of the business. Each industry has location factors that are unique: factors that are important for a retail site are often irrelevant to a manufacturing firm.

Also zoning laws are a factor for any business and should be researched early in the site selection process. These laws are established by communities and local governments to control the type of businesses that are opened and to insure that the community development occurs in a well-planned manner. If a site is not zoned for the type of business the entrepreneur wishes to open, the local government will determine if the property should be rezoned to the new classification.

The entrepreneur and small business are therefore confronted with various different options of location of which the residential-based location has become an increasingly popular option. The empirical part of this study will investigate the viability of this location-decision with all its dimensions.

1.3 BACKGROUND AND IMPORTANCE OF STUDY

Before the developments of the railroads and communication systems in the world, economies depended on people working from their residential homes. The number of these businesses, referred to as *cottage industries,* decreased during the past hundred years as industrial parks, office complexes and shopping centres became more common. However, the trend has now come full circle, and residential-based businesses are once again becoming more and more common.

This phenomenon is also starting to increase by numbers in South Africa. More and more small businesses are starting to open or move their business to a residential property – this happens because of various reasons. Firstly, the electronic revolution, with the development of the internet and other increased technology, made it possible for businesses to work from virtually any location possible. Secondly, the increasing, and sometimes unaffordable high rent at office blocks, shopping centres and other locations, made entrepreneurs and small businesses reconsider the importance of the location-decision (Lambing & Kuehl, 1997: 52). Many other technological and economic reasons are being explored in this research study.

But it is not only technology and economics that created this residential-based business phenomenon. It is also the result of a growing need for independence and creating an image that will differentiate the small business from competitors. The opportunities at a residential property is endless and the entrepreneur is not bounded anymore to the strict rules and regulations of the landlord or shopping centre.

Almost every day now, new small businesses start operating from residential properties and many of them are successful beyond the dreams of their founders. Sadly, many are not. The reality is that merely saving on the rent is not enough. Running a business from a residential property requires the same drive and skills demanded of any other business person – it may require even more.

According to IDC/LINK, a New York-based market research firm, the residential-based businesses in the United States ranges from computer businesses and cleaning services to medical industries and consulting firms. Except for the manufacturing industry, the residential property option is almost open to any small, medium and micro enterprise (Beech, 1997: 92).

The importance of this study therefore lies in the investigation of this new phenomenon, namely residential-based businesses, and to define, evaluate and develop actions and recommendations for future entrepreneurs considering this option.

No proper definition currently exists for a residential-based business in South Africa. The best starting point would be to look more specifically at the definition of home-based businesses. First of all, a distinct difference can be found between "home-based" and "home-managed", according to Laurie (1996: 21).

Typically, "home-managed" businesses consist of service-orientated businesses where the entrepreneur conducts business at the customer's location or has to travel. A business can be considered "home-managed" if two out of three main functions needed to run a business, for example, operations and marketing, are performed outside the home office.

The "home-based" business on the other hand can be service- or production orientated but business is conducted at the entrepreneur's location and not elsewhere. All the main business functions therefore are being managed from home. In both these scenarios the property is being occupied by full-time residents that takes up a certain dwelling area inside the home (Laurie, 1996: 21).

The residential-based business can therefore be defined as the same as a home-based business, except that the whole property is being used for business purposes and no full-time occupants are living in the home.

1.4 DEFINITION OF THE RESEARCH PROBLEM

From the above discussion, it is clear that residential-based businesses are starting to create a new phenomenon in the location-decision of SMME's. While the research problem is discussed in more detail in Chapter 6, it could be summarised as follows:

- Why is this phenomenon of locating at a residential property becoming so increasingly popular?

- Are these small businesses experiencing any growth in sales and customers since there previous location? (if any)

- There should certainly be many advantages as well as disadvantages of this location-decision. Is it therefore not only viable, but also advisable to make this strategic, long-term location-decision for the SMME?

- What specific actions and recommendations are there for prospective entrepreneurs wanting to make this decision?

1.5 PURPOSE OF THE STUDY

The main purpose of this study is to investigate the role of residential-based businesses as an alternative location-decision for SMME's. More specifically, investigate and explore the following:

- The residential-based business phenomenon
- The future existence of these businesses
- The problems regarding the local authorities
- The advantages and disadvantages of this location-decision
- The correct actions to take to ensure in future success at this location

1.6 OBJECTIVES OF THE STUDY

One primary objective and 5 secondary objectives have been identified for this research study. They are:

Primary objective:

- *To suggest specific actions and recommendations for a successful residential-based business.*

Secondary objectives:

- *(1) To measure the effectiveness of residential-based businesses as location for SMME's.*
- *(2) To measure what kind of SMME's are likely to make a success of a residential-based location.*
- *(3) To measure the influence and problems perceived from the local authority regarding a residential-based business.*
- *(4) To measure the advantages and disadvantages of a residential-based business versus a business at a different location.*
- *(5) To measure the growth of residential-based businesses.*

1.7 METHOD OF STUDY

The study consists of a literature study (theoretical) as well as an empirical study.

The literature study provides a better insight into the research problem as well as the necessary background to guide the empirical part of the study. An extensive study of related literature was conducted during this phase of the study.

The empirical study consists of a self-administered questionnaire taken to the relative owners / managers of residential-based businesses in the greater Pretoria metropolitan area. This area has been chosen for the study because of the visual and very recognisable nature of these businesses in the main arteries of this region (Duncan, Schoeman, Pretorius, Charles, Soutpansberg, Zambesi and other streets). When the questionnaires were completed, they were coded, the data captured into a statistical software package and analysed by the Department of Statistics at the University of Pretoria.

The research methodology is discussed in more detail in Chapter 6. It should be stated at this point that the Microsoft package used to write this study was Microsoft Word 2000 and done in UK English. The reference technique used right through the study as well as the bibliography was the Harvard method of reference.

1.8 OUTLINE OF THE CHAPTERS

The outline of the study was done in such a way that it follows in a sensible order to build up to the specific research study and objectives. Each chapter investigates the basic concepts in the current literature and then narrows it down the next section (chapter) where that specific aspect is being discussed. This leads to the empirical study where the specific research problem and objectives are being addressed.

Chapter two focuses on the fundamentals of entrepreneurship and small medium and micro enterprises (SMME's). Both these concepts are being defined with there specific characteristics and differences. There are also looked at the role that SMME's play in an economy and specifically the state of small business in South Africa.

Chapter three focuses solely on the SMME environment as such with the specific management issues regarding this business sector. The structure and importance of SMME's are emphasized regarding their survival aspects. Specific advantages and disadvantages of SMME's are also investigated. Lastly, the location-decision of SMME's is mentioned as an essential part of their survival.

Chapter four specifically then investigates all the different location theories developed through the years. The relevance and importance of these theories are being discussed as well as the conducting of the location search. Certain considerations are important during this search and all the relevant location factors are discussed in detail. Finally the location-decision is being discussed as well as methods of how to quantify this location-decision.

Chapter five then narrows the literature down to the specific research problem, namely the different types of locations for SMME's. The Central Business District (CBD), shopping centres / malls, office blocks, industrial parks, home-based businesses, telecommuting and lastely residential-based businesses are being discussed and evaluated.

In *chapter six* the research methodology is discussed in more detail and the specific methods used to gather the empirical information are outlined. The chapter will also look at the reliability and validity of the study.

Chapter seven reports all the research findings by means of descriptive research, reliability tests, factor analysis and cross tabulations.

In *chapter eight* all the conclusions and recommendations of this research study are being discussed.

CHAPTER 2

THE FUNDAMENTALS OF ENTREPRENEURSHIP AND SMALL, MEDIUM AND MICRO ENTERPRISES (SMME's)

"It's not the critic who counts, nor the observer who watches from a safe distance. Wealth is created only by doers in the arena who are marred with dirt, dust, blood and sweat."

(Joseph R. Mancuso)

2.1 INTRODUCTION

There used to be a phrase, common in the 1960's, that "What's good for General Motors is good for the United States". It may be the case today in many countries that the small business sector regards what is good for small business as being good for that country. Even the casual newspaper reader knows about the key role which small firms play in employment creation, their overall importance in the economy, their role in innovation and also the importance in which governments attaches to small enterprises (Storey, 1998: 1).

To provide guidance for public policy makers means that, as the small business sector grows in importance, it is even more necessary than in the past to examine its role in an economic, social and political framework. The role of small businesses in creating employment should not only be seen as part of employment policy, but also as part of urban and social policy. One central question always is whether efforts should be made to encourage the unemployed, many of whom may lack business skills, to create their own jobs by becoming self-employed.

The question now arises if it is reasonable to provide public funds to an individual living in a deprived inner-city area to start their own business as a way of creating employment for themselves. Also given that the risk if the business fails may be that they are saddled with a burden of debt which they are unable to service (Storey, 1998: 2).

Whether to encourage the maximum development of small business or not, still remains to be argued, but one cannot forget that whilst the small firm sector exhibits very high rates of churning – births and deaths – a key element in small firm policy making is the extent to which small firms ultimately grow into medium and large-sized firms. This could also then lead to an important strategic location decision for the small enterprise.

This chapter investigates:

- the various definitions of entrepreneurs as initiators of small enterprises;
- the distinction between entrepreneurship and small, medium and micro enterprises (SMME's) and the focus of each, and
- the role of SMME's in the economy;

2.2 DEFINITION OF ENTREPRENEURSHIP

In a detailed study of this issue, the American entrepreneurship researcher William Gartner (1990) asked fellow academics and business leaders for their definitions of entrepreneurship. From 44 different definitions obtained, some 90 different attributes of entrepreneurship were identified. The definitions obtained were not just variations on a theme; in fact many shared no common attributes at all. This indicates that the quest for a universal definition has not moved on much since 1971 when Peter Kilby commented that the entrepreneur had a lot in common with the "Heffalump", a character in A.A. Milne's *Winnie-the-Pooh*, noting that he is also:

> "*a rather large and important animal. He has been hunted*
> *by many individuals using various trapping devices,*
> *but no one so far has succeeded in capturing him. All who*
> *claimed to have caught sight of him report that he is*
> *enormous, but disagree on his particularities.*"

The word *entrepreneur* and the concepts derived from it such as entrepreneurial, entrepreneurship and entrepreneurial process are frequently encountered in discussions of the management of new, fast growing, innovative small business ventures. These concepts are easily related. Entrepreneurship is what an entrepreneur actually does. Entrepreneurial refers to the approach they take. The entrepreneurial process is what the entrepreneur engages in (Wickham, 1998: 4).

This might seem very mediocre, but offering a proper definition of the entrepreneur or entrepreneurship presents an immediate problem. Not because a definition is not available, but rather that there seem to be too many definitions. Even though the economic and management literature is full of possible definitions, the problem is there does not seem to be much agreement on what are the essential features of an entrepreneur (Wickham, 1998: 4).

Even though there are usually a failure to pin down the rich and complex phenomenon of entrepreneurship in a universal definition, it is the very variety of entrepreneurship and the endless possibilities that it presents that makes it so challenging. Entrepreneurship is a social and economic phenomenon. The entrepreneur is, first and foremost, an individual who lives and functions within society. Entrepreneurs are characterised not by every action they take, but by a particular set of actions aimed at the creation of new wealth. Entrepreneurship is about value generation (Wickham, 1998: 6).

Although entrepreneurial activity may be found in various spheres of life, the term is most commonly thought of in terms of business life. Most observers use the term in relation to small business or new business ventures. In reality, many established businesses – even giant corporations – engage in entrepreneurship (Bagshawe, 1995: ix). This kind of entrepreneurship inside the giant corporation is usually known as intrapreneurship and falls outside the scope of this study.

Entrepreneurship is a particular approach to wealth-generating activity. Entrepreneurs are characterised by the way they go about creating new value. The recognition of this fact gives us three angles of approach to the entrepreneur in that they might be considered as:

- a manager undertaking an activity – i.e. by means of the particular tasks they perform and the way they undertake them;
- an agent of economic change – i.e. by the effects they have and the type of changes they create; or as
- an individual – i.e. by means of their psychology, personality and personal characteristics.

Each of these three aspects is reflected in the variety of definitions that are offered for the entrepreneur. The function of each of these definitions is not just to characterise the entrepreneur but also to distinguish them from other types of people involved in the generation of wealth (such as investors or "ordinary" managers) (Wickham, 1998: 6).

Timmons (1994: 7) defines entrepreneurship as creating and building something of value from practically nothing. That is, entrepreneurship is the process of creating or seizing an opportunity and pursuing it regardless of the resources currently controlled. Entrepreneurship involves the definition, creation and distribution of value and benefits to individuals, groups, organisations and society. Entrepreneurship is very rarely a get-rich-quick proposition; rather, it is one of building long-term value and durable cash flow streams (Timmons, 1994: 7).

Timmons (1994: 6) further defines entrepreneurship as a human creative act. It involves finding personal energy by initiating and building an enterprise or organisation, rather than by just watching, analysing, or describing one.

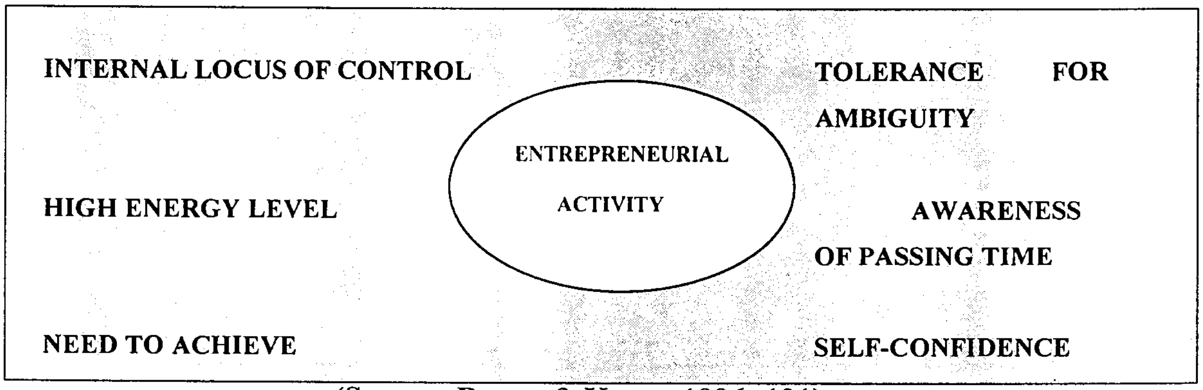
Entrepreneurship usually requires a vision and the passion, commitment and motivation to transmit this vision to other stakeholders, such as partners, customers, suppliers, employees and financial brokers. It also requires a willingness to take calculated risks – both personal and financial – and then doing everything possible to influence the odds. Entrepreneurship involves building a team of people with complementary skills and talents; of sensing an opportunity where others see chaos, contradiction and confusion; and of finding, marshalling and controlling resources (often owned by others) to pursue the opportunity (Timmons, 1994: 7).

Kuratko & Hodgetts (1998: 5) mention that the characteristics of seeking opportunities, taking risks beyond security and having the tenacity to push an idea through to reality combine into a special perspective that permeates entrepreneurs.

Timmons (1994: 3) furthermore sums up the realities for entrepreneurs: "*Anyone (can be a entrepreneur) who wants to experience the deep, dark canyons of uncertainty and ambiguity; and who wants to walk the breathtaking highlands of success. But I caution, do not plan to walk the latter, until you have experienced the former.*"

Furthermore an entrepreneur is a risk taker in the private enterprise system, a person who seeks a profitable opportunity and takes the necessary risks to set up and operate a business. Entrepreneurs are also different from other people. Research has identified roughly 40 personality characteristics that are associated with entrepreneurship (Boone & Kurtz, 1996: 121). Figure 2.1 illustrates six traits that appear to be especially important for successful entrepreneurs:

FIGURE 2.1 - Traits for successful entrepreneurs



(Source: Boone & Kurtz, 1996: 121)

- *Internal locus of control.* People with this trait believe that they can control their own fates, that the difference between success and failure depends on them.
- *High energy level.* No doubt about it, it takes a lot of work to start and build a successful business. Entrepreneurs must be willing and able to work long hours.
- *Need to achieve.* Successful entrepreneurs like to set their own goals and are motivated by the opportunity to achieve them.
- *Tolerance for ambiguity.* Starting a new company is risky, so entrepreneurs must tolerate ambiguous, uncertain situations.

- *Awareness of passing time*. Entrepreneurs tend to be impatient people who like to stay active; they rarely procrastinate.
- *Self-confidence*. Running a business requires the ability to make decisions and manage numerous details. Entrepreneurs need to have confidence that they

  can handle these challenges, not to mention other challenges that will arise in the future (Boone & Kurtz, 1996: 121).

Entrepreneurship is therefor more than the mere creation of business. Although that is certainly an important facet, it is not the complete picture as seen in the above discussion. There are deeper underlying characteristics and traits that differentiate entrepreneurs from the rest and which gives birth to successful small enterprises.

As noted above the definition of entrepreneurship is probably one of the most conceptual problems in the small business sector. In its broadest sense an entrepreneur may be described as a person who has the ability to explore the environment, identify opportunities for improvement, mobilise resources and implement action to maximise those opportunities. The terms thus include a variety of innovators who, on the business side, work in small, medium as well as large enterprises and on the non-business side, in voluntary or government institutions.

2.3 A DISTINCTION BETWEEN ENTREPRENEURSHIP AND SMALL BUSINESS MANAGEMENT

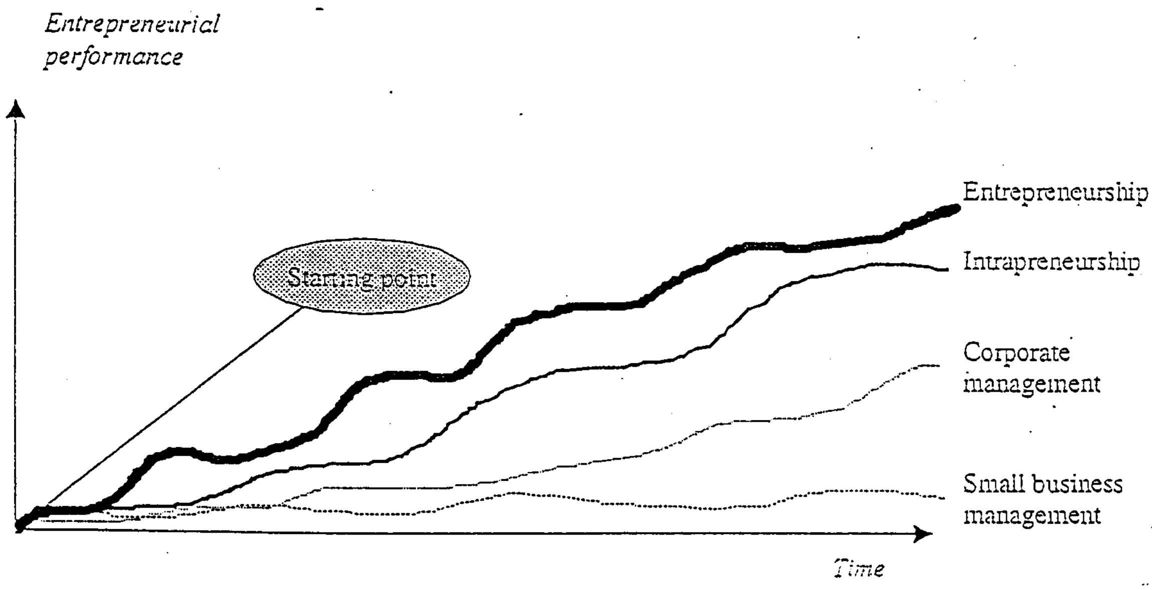
Both entrepreneurship and small business management are of critical importance to the performance of the economy. However, it is useful to draw a distinction between them since small business and entrepreneurial ventures serve different economic functions. They pursue and create new opportunities differently, they fulfil the ambitions of their founders and managers in different ways and they present different challenges to economic policy makers. Drawing this distinction is an issue of classification. There are two approaches of which the first one is between the characteristics of an entrepreneur and a small business manager.

This approach is problematic, because the entrepreneur is not distinguished by a distinct personality type and there is no independent test that can be performed to identify an entrepreneur. The question is consequently a matter of personal opinion. Some people may regard themselves as true entrepreneurs while others may judge themselves to be "just" small business managers. This can be an emotive issue and it is not clear what benefits are to be gained by placing people into different conceptual bags in this way (Wickham, 1998: 18).

Therefore, rather than trying to draw a distinction between managers, it is more valuable to draw a distinction relating to what they manage, that is between the small business and the entrepreneurial venture. There are three characteristics which distinguish the entrepreneurial venture from the small business, namely innovation, potential for growth and strategic objectives (Wickham, 1998: 18).

Entrepreneurship as further seen by Timmons (1994), McClelland (1964) and Carland, Hoy and Boulton (1984) is seen as the starting of a business (utilising of an opportunity) and/or the growth and development of that specific business. Small business management is seen as the starting of the business, growth and development up to a certain stage, then losing its entrepreneurial flair (Figure 2.2).

Figure 2.2 – Entrepreneurial performance versus Time



(Source : Van Vuuren & Nieman, 1999: 5)

2.3.1 Innovation

An entrepreneurial venture is usually based on a significant *innovation.* This might be a technological innovation, an innovation in offering a new service, an innovation in the way something is marketed or distributed, an innovation in the way the organisation is structured and managed or in the way relationships are maintained between organisations.

The small business on the other hand, is usually involved in delivering an established product or service. This does not mean that a small business is not doing something new. They may be delivering an innovation to people who would not otherwise have access to it, perhaps at a lower cost or a higher level of service. However, the small firm's output is likely to be established and produced in an established way. So while a small business may be new to a locality, it is not doing anything essentially new in a global sense, whereas an entrepreneurial venture is usually based on a significantly new way of doing something (Wickham, 1998: 19).

2.3.2 Potential for growth

The size of a business is a poor guide as to whether it is entrepreneurial or not. The actual definition of what constitutes a small business is a matter of judgement depending on the industry sector, for example a firm with one hundred employees would be a very small shipbuilder, but a very large firm of solicitors. However, an entrepreneurial venture usually has a great deal more potential for growth than does a small business. This results from the fact that it is usually based on a significant innovation. The market potential for that innovation will be more than enough to support a small firm. It may even be more than enough to support a large firm and signal the start of an entire new industry.

The small business on the other hand, operates within an established industry and is unique only in terms of its locality. Therefore, it is limited in its growth potential by competitors in adjacent localities. A small business operates within a given market; the entrepreneurial venture is in a position to create its own market (Wickham, 1998: 19).

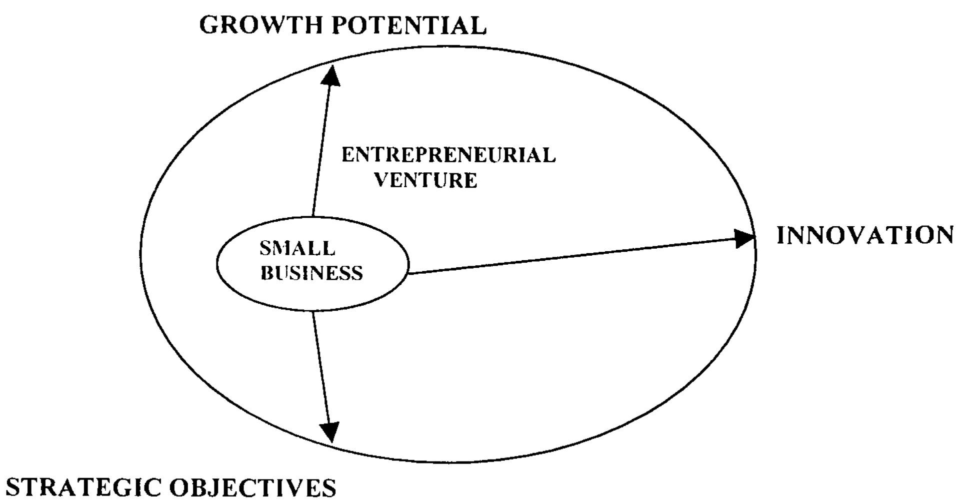
2.3.3 Strategic objectives

Objectives are a common feature of managerial life. They take a variety of forms, for example they may be formal or informal, and they may be directed towards individuals or apply to the venture as a whole. Most businesses have at least some objectives. Even the smallest firm should have sales target if not more detailed financial objectives. Objectives may be set for the benefit of external investors as well as for consumption by the internal management. The entrepreneurial venture will usually go beyond the small business in the objectives it sets itself in that it will have strategic objectives. Strategic objectives relate to:

- *growth targets* - year on year increases in sales, profits and other financial targets;
- *market development* - activities to actually create and stimulate the growth and shaping of the firm's market;
- *market share* - the proportion of that market the business serves; and
- *market position* - maintaining the firm's position in its market relative to competitors (Wickham, 1998: 20).

The distinction between an entrepreneurial venture and a small business is not clear-cut. Generally it can be said that the entrepreneurial venture is distinguished from the small business by its *innovation, growth potential* and *strategic objectives*. However, not all entrepreneurial ventures will necessarily show an obvious innovation, clear growth potential or formally articulated strategic objectives and some small businesses may demonstrate these characteristics.

FIGURE 2.3 - Difference between a small business and an entrepreneurial venture



(Source: Wickham, 1998: 20)

2.4 ENTREPRENEURS AS INITIATORS OF SMALL BUSINESS VENTURES

Entrepreneurship is the symbol of business tenacity and achievement. Entrepreneurs are the pioneers of today's small business successes. Their sense of opportunity, their drive to innovate and their capacity for accomplishment have become the standard by which free enterprise is now measured. This standard has taken hold throughout the entire world. Entrepreneurs will continue to be critical contributors to economic growth through their leadership, management, innovation, research and development effectiveness, job creation, competitiveness, productivity and formation of new small business industry (Kuratko & Hodgetts, 1998: 6).

Entrepreneurship essentially involves the courage to endure uncertainty, to take risks and to break new ground. But we should also recognise that successful entrepreneurs are required to perform such complementary managerial functions required in a small business enterprise as responsible direction and control, exploiting ideas for expansion, the identification of market opportunities and the improvement of organisational efficiency and cost-effectiveness (Bagshawe, 1995: ix).

Of all the players who feature in the management of the modern world economy, it is entrepreneurs who most attract our attention. It is clear that entrepreneurs are self-starting individuals that take great personal risk in order to bring the benefits of new products and services to wider world markets. There are even concern at the pace of economic and social change entrepreneurs bring and of the uncertainty they create. Whether they are admired or questioned, they cannot be ignored. The modern world and especially small business is characterised by change. Whether it is shifts in political orders, developments in economic relationships or new technological advancements, these changes feed of each other and are becoming global. Developments in information technology allow capital to seek new business investment opportunities even more efficiently. Success is sought out more quickly; failure punished more ruthlessly. Customers expect continuous improvement in the products and services they consume (Wickham, 1998: 2).

As a result, small businesses have to become more responsive. In order to keep their place in their markets they have to innovate more quickly. In order to compete they have to become more agile. This is an issue for any profit-making organisation, but even more so for small business enterprises in order to survive. The boundary between the world of the "market" and the public domain is being pushed back and blurred.

Consequently the world is demanding both more entrepreneurs as well as entrepreneurs starting successful small businesses. In the mature economies of the western world small businesses provide economic dynamism. These fast-growing businesses are currently the main source of new job opportunities. The vibrant economies of the Pacific Rim are driven by the successes of thousands of new small ventures.

It is also the individual entrepreneurs who must restructure the post-Communist countries of eastern and central Europe and provide them with vibrant market economies. In the developing worlds entrepreneurs and small businesses are increasingly responsible for the creation of new wealth and for making its distribution more equitable (Wickham, 1998: 2).

The entrepreneurial revolution that is currently under way will have a greater impact on the future economic growth of countries than any other event in history. As we learn more about the relatively small number of emerging firms that are contributing to the growth in jobs and economic development, the importance and enormity of the field of entrepreneurship and small business enterprises are becoming more and more apparent (Sexton & Kasarda, 1996: xvii).

Change presents both opportunities and challenges. The opportunities come in the shape of new possibilities and the chance for a better future. The challenges lie in managing the uncertainty these possibilities create. By way of a response to this challenge, small businesses must aim to take advantage of the opportunities while controlling and responding to the uncertainties. This response must be reflected in the way entrepreneurs manage their businesses. In short: we must become more entrepreneurial in small businesses. To do this we first need to explore and understand the small, medium and micro enterprises (SMME's)(Wickham, 1998: 2).

2.5 THE ROLE OF SMME'S IN AN ECONOMY

The casual reader of high quality financial magazines and newspapers might be forgiven for believing that small firms hardly exist in the leading developed economies. Casual scrutiny may fail to identify even a single article either about a business with less than fifty employees, or about the small firm sector more generally. Instead, perhaps most pages of the newspaper might well be exclusively concerned with very much larger firms and with a particular focus upon those which are quoted on stock exchanges. This emphasis on large firms characterises virtually all financial and economic newspapers.

The above is not surprising if realised that information of large public companies need to be publicly available and widely disseminated for quoted companies, to enable investors to make informed decisions regarding share purchases or sales. It is also the case that large firms produce the bulk of private sector output in most developed countries. But the under emphasising of small firms is surprising in that politicians in many countries have emphasised, for at least a decade, the importance of small enterprises as a mechanism for job creation, innovation and the long-term development of economies. In its coverage of enterprises, more than 95% of column space in the *Financial Times* is devoted to large firms, whereas in the European economy more than 95% of firms are in fact small and these small firms provide more than half of all jobs in the European Community. This is a striking imbalance in coverage (Storey, 1998: 7).

This draws attention to the fact that small firms, however they are defined, constitute the bulk of enterprises in all economies in the world. Such firms also make a major contribution to private sector output and employment, one which appears to be increasing over time. Before small firms are being defined as such, it is notable that measuring precisely how many exist in the economy at any point in time leads to some problems. Many small firms deliberately do not register with the state authorities. Others have such a short lifespan that the state authorities do not have time to register their existence before the business ceases trading. Finally, many of the businesses are so small that the state does not deem it worthwhile to register their existence and such enterprises are exempted from registration on grounds of size. This causes problems for those given the task of estimating the size of the small firm sector, its contribution to output and employment, estimating whether this has changed over a period of time and making comparisons between different countries (Storey, 1998: 7).

For all of the above reasons, small firms statistics tend to be somewhat speculative. Whilst a large part of this literature chapter is focussed on addressing the above issues, the uncertainty of small business statistics in virtually all countries has to be in the forefront of the mind of the reader.

2.5.1 Definitions of SMME's

There is no single, uniformly acceptable definition of a small firm. This is because a "small" firm in, say, the petrochemical industry is likely to have much higher levels capitalisation, sales and possibly employment, than a "small" firm in the car repair trades. Definitions, therefore, which relate to "objective" measures of size such as number of employees. sales turnover, profitability, net worth, etc., when examined at a sectoral level, mean that in some sectors all firms may be regarded as small. while in other sectors there are possibly no firms which are small (Storey. 1998: 9).

The Bolton Committee in the United Kingdom (1971) attempted to overcome this problem by formulating what they called an "economic" definition and a "statistical" definition. The "economic" definition regarded firms as being small if they satisfied three criteria:

- they had a relatively small share of their market place;
- they were managed by owners or part-owners in a personalised way, and not through the medium of a formalised management structure;
- they were independent. in the sense of not forming part of a large enterprise.

Given this "economic" definition, Bolton then devised a "statistical" definition which was designed to address three main issues:

- firstly, to quantify the current size of the small firm sector and its contribution to economic aggregates such as gross domestic product, employment, exports, innovation, etc.;
- secondly, to compare the extent to which the small firm sector has changed its economic contribution over time;
- and thirdly, the statistical definition. in principal, has to enable a comparison to be made between the contribution of small firms in one country with that of other nations (Storey, 1998: 9).

Following the Bolton Committee there have been a number of criticisms of both its "economic" and its "statistical" definitions. Taking the "economic" definition first, the Bolton criterion that a small business is "managed by its owners or part-owners in a personalised way, and not through the medium of a formal management structure", is almost certainly incompatible with its "statistical" definition of small manufacturing firms which could have up to 200 employees. Whilst Bolton recognised that some smaller firms may "have one or more intermediate layers e.g. supervisors or foreman to interpret their decisions and transmit them to employees", it still regarded small firm owners as taking all the principal decisions and exercising the principal management functions.

The work of Atkinson & Meager (1994), however, demonstrates that managerial appointments – not simply supervisors or foremen – are made when firms reach a size of between 10 and 20 workers. At that size, owners are no longer the exclusive source of managerial decisions.

The second questionable aspect of the Bolton "economic" definition is the emphasis upon the inability of the small firm to affect its environment – most notably its inability to influence, by changing the quantity which it produces, the price at which a product or service is sold in the market-place. In this respect Bolton is clearly influenced by the economist's concept of perfect competition. In practice, however, many small firms occupy "niches". They provide a highly specialised product or service, possibly in a geographically isolated area, and often do not perceive themselves to have clear competitors. As a result, in the short and possibly medium term, they can maintain higher prices and higher profits than the general industry "norm" (Storey, 1998: 10). Bradburd and Ross (1989), show that whilst large firms are generally more profitable than small, in heterogeneous industries – where niches are more likely to exist – this relationship is reversed.

Moolman (1987: 712) describes what is also known as an "economic" definition for small businesses in that it is independent, privately owned and privately managed. Characteristics of his definition for SMME's are:

- *independence*: this means that the enterprise is privately and independently owned and managed and free from outside control;

- *common organisation structure:* functions are being managed informally and the management structure is usually not section-divided;
- *owners are the entrepreneurs:* owners are not only the shareholders, but also the initiators, decision-makers and risk takers, and
- *multiple accountability:* owners are accountable for owners equity, assets, liabilities, loans and the overall management of the enterprise (Kroon & Moolman, 1992: 124).

An alternative "economic" perspective on defining a small firm to that provided by Bolton is provided by Wynarczyk *et al.* (1993). Building upon the observation of Penrose (1959) that small and large firms are as fundamentally different from each other as a caterpillar is from a butterfly, they attempt to identify those characteristics of the small firm, other than size *per se*, which distinguish it from the larger enterprise. They argue there are three central respects in which small firms are different to large firms, namely uncertainty, innovation and evolution. Turning to the criticisms of the Bolton Committee "statistical" definitions of small firms, five points emerge:

- Firstly, there is no single definition, nor even any single criterion of "smallness". Instead, four different criteria are used in the definition – employees, turnover, ownership and assets.

- The second criticism is that three different upper limits of turnover are identified for the different sectors, and two different upper limits of employees are identified. These make the definitions too complex to enable comparisons to be made either over time or between countries.

- The third criticism of statistical definitions based upon 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.

- Fourthly, there are problems with employee-based criteria in comparing small and large firms over time. As Dunne & Hughes (1989) point out, output per head in constant prices varies according to firm size. They show that, using an index of net output per head where 1979 equals 100, by 1986 output per head in enterprises with less than 100 workers was 125.1, whereas that for enterprises with more than 1000 workers was 132.8. Hence taking account of these increases in productivity over the last twenty years, the manufacturing upper limit for a small firm which was 200 in 1971, would be much closer to 100 in 1993.

- The fifth criticism of the Bolton Committee definitions is that they treat the small firm sector as being homogeneous. Even though the Committee, in their text, explicitly recognised that this was not the case, its single statistical definition for the smaller firm implies the existence of homogeneity (Storey, 1998: 13).

To overcome a number of the above-mentioned problems, the lead of the European Commission (EC) can be followed. They coined the term "small, medium and micro-enterprises (SMME's) and disaggregated them into three components:

- micro-enterprises: those firms with between 0 and 9 employees;
- small enterprises: those firms with 10 to 99 employees;

- and medium enterprises: those firms with 100 to 499 employees.

The SMME sector is herefore taken to be enterprises which employ less than 500 workers. In several respects the EC definitions reflect the "break points" in SMME development which researchers like Atkinson & Meager (1994) and Lyons (1993) have identified. Their findings suggest that there is a marked shift to formality around the ten to twenty employee mark and that it is important to subdivide the SMME sector in this way.

The major advantage of the EC definition is that, unlike Bolton, it does not use any criteria other than employment and it does not vary its definition according to the sector of the enterprise. In almost all senses the EC definitions are currently more appropriate than those of the Bolton Committee:

- The EC definitions are exclusively based upon employment, rather than a multiplicity of criteria;
- The use of 100 employees as a small-firm limit is more appropriate; given the rises in productivity which have taken place in the last two decades.
- The third benefit is that the EC definition recognises that the SMME group is not homogeneous, in the sense that distinctions are made between micro, small and medium-sized enterprises (Storey, 1998: 14).

According to the White Paper of the South African Government on the national strategy for the development and promotion of small business (1995), the most important distinction is between survivalist activities, micro-enterprises, small enterprises and medium-sized enterprises, with the general term "small business" and the abbreviation "SMME's" widely used to contrast this with bigger business. The following characteristics of the four categories are outlined in the White Paper:

- *Survivalist enterprises* are activities by people unable to find a paid job or get into an economic sector of their choice. Income generated from these activities usually falls far short of even a minimum income standard, with little capital invested. virtually no skills training in the particular field and only limited opportunities for growth into a viable business.

- *Micro-enterprises* are very small businesses, often involving only the owner, some family members and at the most one or two paid employees.
- *Small enterprises* constitute the bulk of the established businesses, with employment ranging between five and fifty. These enterprises will usually be owner-managed or directly controlled by the owner-community.
- *Medium enterprises* constitute a category difficult to demarcate vis-à-vis the "small" and "big" business categories. It is still viewed as basically owner/manager-controlled, though the shareholding or community control base could be more complex. The employment of 200 and capital assets (excluding property) of about R5 million are often seen as the upper limit (White Paper, 1995).

According to the National Small Business Act of 1996, small business are being defined as: "*A separate and distinct business entity, including co-operative enterprises and non-government organisations, managed by one owner or more, including its branches and subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy and which can be classified as a micro-, a very small, a small or a medium enterprise.*

2.5.2 State of small business in South Africa

The role played by small businesses is being increasingly recognised the world over. The perceived potential of small businesses to create employment has cause governments in many countries to begin to pay the small business sector more attention. Although, almost everywhere, results are not matched expectations, available evidence indicates that the sector contributes meaningfully to economic growth, social development and employment provision. In the European Union, for example, the small business sector accounts for much of total employment, and a large portion of the total gross domestic product (GDP) (Ntsika, 1999: 11).

For South Africa, statistics show that the SMME sector absorbed nearly 57% of the people employed in the private sector, and contributed 42 % of formal total GDP in 1997. Figures for 1998 remain in the same neighbourhood; and the number of registered enterprises since the 1994 general elections has continue to rise. By any account, the SMME sector in South Africa is important, and the attention it draws from the government is therefore well deserved (Ntsika, 1999: 11).

The goals and objectives of small business promotion strategy are fairly well known, and differ little between countries. The goals of the South African SMME promotion strategy are, according to the 1995 White Paper on Small Business Development, among others, the following:

- Economic growth and development;
- Poverty alleviation;
- Income redistribution;
- Employment creation;
- Economic empowerment of previously disadvantaged population groups;
- Democratisation of economic participation; and
- Replacement of the present rather oligopolistic structure of the economy with one that allows a much higher degree of competition.

The objectives or the more narrow goals that the promotion strategy expects the South African SMME's to achieve are, among others, to:

- Create jobs at low capital cost;
- Contribute significantly to the economy in terms of output of goods and services;

- Improve forward and backward linkages between economically, socially and geographically diverse sectors;
- Create opportunities for developing and adapting appropriate technology;
- Provide an excellent breeding ground for entrepreneurial and managerial talent;
- Develop a pool of skilled and semi-skilled workers;
- Act as ancillaries to large-scale enterprises;
- Adapt to market fluctuations;
- Fill market niches which are not profitable for large enterprises;
- Lend themselves to develop policies favouring decentralisation and rural development; and
- Help alleviate the negative consequences of restructuring the economy (Ntsika, 1999: 12).

A static picture of the state of small business in South Africa describes the structure of the small business sector at a particular point in time. Thus, it does not show the evolution of variables and indicators that help describe structural changes and key trends in the sector.

Data on small businesses is, in general, poor in South Africa, and data that can be used to study small business trends is even poorer. However, certain indicators can be used to measure progress in this sector. The number of new registrations of businesses can provide a proxy for measuring entrepreneurial activity, but it must be interpreted with caution. Not every registration truly identifies a new enterprise. Registrations are often affected by take-overs, relocation, or changes in activity or legal status.

Nevertheless, a sharp increase occurred in enterprise registration between 1990 and 1998. The number of private companies registered increased from 6 369 in 1990 to 236 551 in 1998. This represents an almost 3,5-fold increase in nearly a decade. Also the number of Close Corporations (CC's) increased from 28 008 in

1990 to 73 114 in 1998, representing an approximate 2,5-fold increase during this period (Ntsika, 1999: 61).

Even though the SMME sector in South Africa is confronted with difficulties and particular challenges that largely have to do with the recent past of the country, it is playing a very significant role in the economy, in terms of job creation and income generation. The new government is addressing the problems by creating an enabling environment, designing and implementing programmes, and providing and strengthening institutional support for small business sector development. Already there are signs that these efforts are beginning to bear fruit; and given certain developments that favour this SMME sector, it is expected that its role in the economy will increase and even become crucial in the future.

2.5.3 The difference between SMME's and larger firms

The factors involved in the difference between SMME's and larger firms are uncertainty, innovation and evolution.

2.5.3.1 Uncertainty

The three dimensions of uncertainty are:

- Firstly, the uncertainty associated with being a price-taker, which can be considered to be the inverse of the Bolton definition which emphasized the small share of the market place.

- Secondly, the source of uncertainty for small firms is their limited customer and product base – the classic example of which is where small firms simply act as subcontractors to larger firms. Lyons and Bailey (1993) describe what they refer to as "subcontractor vulnerability".

They argue this depends not only upon dependence on dominant customers, but also upon the extent to which output is specialised to particular customers, the specificity of investment decisions made and the probability that the customer will withdraw the custom. They clearly show that, even for subcontractors as a whole, the smaller firm clearly perceives itself to be more vulnerable than the large firm perceives and also acts accordingly.

- The third dimension of uncertainty relates to the much greater diversity of objectives of the owners of small firms, compared with large. Many small business owners seek only to obtain a minimum level of income, rather than maximising sales or profits. Small business owners do not have to concern themselves with reporting their actions to external shareholders, and so "performance monitoring" effectively does not exist. For a small firm the relationship between the business and the owner is very much closer than it is between the shareholder and the large firm. The motivation of the owner of the small firm is therefore a key influence upon small fir performance. This contrasts with the large firm management literature, which emphasises the importance of control. Here the central issue is how the owners of the business ensure that the managers of the business act in their interest and how senior managers exert control over more junior managers. This form of "internal" conflict is absent in a small firm, where ownership and control are located in the hands of a few people, or possibly a single individual (Storey, 1998:11).

The central distinction between large and small firms then, is the greater external uncertainty of the environment in which the small firm operates, together with the greater internal consistency of its motivations and actions.

2.5.3.2 Innovation

The second key area of difference between small and large firms is their role in innovation. The glamorous role which Schumpeter (1934) saw small firms playing – that of initiating "gales of creative destruction", through the introduction of totally new products, does have some basis in fact, but the much more conventional role which small firms play in innovation relates to their "niche" role as discussed earlier. It is the ability of the smaller firm to provide something marginally different, in terms of product or service, which distinguishes it from the more standardised product or service provided by larger firms (Storey, 1998: 12).

The small firm, however, is also much less likely to undertake research and development than a large firm, and is less likely to have a high proportion of its staff concerned exclusively with research. Even so, small firms are more likely to introduce fundamentally new innovations than larger firms, this feature often being attributable to small firms having less commitment to existing practices and products (Pavitt *et al.* 1987).

2.5.3.3 Evolution

The third area of difference between large and small firms is the much greater likelihood of evolution and change in the smaller firm. Reference has already been made to the transition which Penrose (1959) observed the small firm to make in becoming larger. She saw this as being comparable to the transition from a caterpillar to a butterfly, whereas management theorists have seen it to be not a single-stage change, but rather a multiple-stage change. Thus, small firms which become larger undergo a number of stage changes which influence the role and style of management and the structure of the organisation (Scott &Bruce, 1987). The key point is that the structure and organisation of the small firm is more likely to be in a state of change as the firm moves from one stage to another, than is the case for larger firms.

2.6 SUMMARY

As can be seen in above literature review, Wynarczyk *et al* (1993) argue that the essential dimensions in which small firms differ from large relate to uncertainty. innovation and firm evolution. They argue that it is these dimensions which should be explored as a "bottom-up" way of theorising about small firms, rather than implicitly assuming that a small firm is a "scaled down" version of a large firm.

The definition of SMME's is a contentious issue for management researchers and still there is no one correct definition for this field of study. It has been suggested that the limited scale of its operations characterise the small organisation. Restricted activity in terms of market share and limited turnover are indicative of a small scale of operation but the most frequently used indicator of size is the number of employees. Small organisations will normally employ fewer people than larger ones, although opinions differ about the number of people employed in them. Definitions of small firms further also differ between countries, but the important role and contribution of SMME's towards economies all around the world remains an all-important issue in this field of study.

In the following chapter (Chapter 3), the SMME environment will be explored in further detail.