

CHAPTER 1

INTRODUCTION

“Small, Medium and Micro-Enterprises (SMMEs) represent an important vehicle to address the challenges of job creation, economic growth and equity in our country. Throughout the world one finds that SMMEs are playing a critical role in absorbing labour, penetrating new markets and generally expanding economies in creative and innovative ways. We are of the view that – with this appropriate enabling environment – SMMEs in this country can follow these examples and make an indelible mark on this economy. The stimulation of SMMEs must be seen as part of an integrated strategy to take this economy onto a higher road – one in which our economy is diversified, productivity is enhanced, investment is stimulated and entrepreneurship flourishes” (RSA, 1995).

1.1 Introduction

The government’s National Strategy for the development and promotion of the small business sector in South Africa was formally endorsed by parliament in early 1995. The Strategy established several important objectives for the development of the small, medium and micro enterprises (SMMEs) sector over a ten year period.

To achieve these objectives, the South African government established institutions and programmes designed to improve the access of the SMME sector to critical resources, including finance, infrastructure, training and counseling, information, markets and technology. It also called for efforts to strengthen the SMMEs’ associations and chambers as well as efforts to improve the legislative and regulatory environment for the small business sector.

South Africa's integration into the global economy in 1994 provokes the question about its potential for building competitive advantage and prosperity at the local level in the context of an increasingly global economy. According to Timmons (1994), the experience of prospering localities in industrialized countries, in particular, Western Europe and Japan, suggests that the small and medium-sized enterprise (SME) sector is at the largest forefront of local economic development. Small and medium enterprises (SMEs) are reported to resolve the persistent problems of insufficient employment growth while being highly efficient in flexibly serving increasingly segmented consumer markets (Kesper, 2000).

The small business sector discussions had been taken up in South Africa, where, according to Rogerson (1994), SMMEs hold a numeric majority. SMMEs are expected to function as a driving force both in South Africa's social and economic transition if supported by supply-side measures targeting enterprises' constraints. Some studies on South African SMMEs reveal, however, a mismatch between reality and the model of the SMME sector used by South African policy makers. According to Kesper (2000), the South African SMME sector is far from homogeneous and would require a fine-tuned set of interventions rather than the generic assistance currently provided. Kesper (2000), also suggests that only the few, more dynamic SMMEs show a potential to contribute to rapid employment creation, while survivalist activities (as a result of "enforcement self-employment") constitute the vast majority of the South African SMMEs economy and grow in number but not in size.

1.2 Background to the study

A brief look at the historical development in South African political economy in addressing the problem of white people in the 1920s will help us understand that economic empowerment is not a new concept in South Africa. According to Qunta (1995), it has been there backed by legislation for white people.

According to Qunta (1995), the government began addressing the problem of white people in 1922 after the white workers' strike in protest to the number of black people who were starting to compete for employment.

The Industrial Conciliation Act of 1924 excluded black people from the definition of "employee" (Qunta *et al.*, 1995). This was followed by the Wage Act of 1925, which increased wages for white workers and also improved their standard of living. The private sector was subsequently subsidized to offer employment and acceptable wages for white people and according to Human (1993), these labour policies resulted in the retrenchment of 13 000 black workers by 1933. The most devastating legislation that was passed was the separate education system introduced in 1948 (Qunta *et al.*, 1995). Leaders such as Dr. H. F. Verwoerd stressed that the upliftment of white workers could only occur effectively if they were protected against "non-white competition" (Madi *et al.*, 1997).

With this brief scenario one would be essentially naive to believe that the current government in South Africa will not "look out" for its colleagues in a country that has for so long catered for a few. This will force the government to offer sensible and practical support in the form of appropriate legislation, for example, the National Small Business Act (NSBA), No. 102 of 1996. The government hoped that this Act would give impetus to the efforts of promoting the small business sector into the mainstream of the South African economy (RSA, 1995).

Since 1994, the democratically elected South African government has been faced with the challenges of re-integration into world markets as a global economy, while at the same time positioning itself to realize the high expectations of its populace regarding a successful transition towards a more democratic order. To achieve the objectives of economic growth through competitiveness on the other hand, and employment generation and income redistribution as a result of this growth on the other, South Africa's small business economy has been actively promoted since 1995 and according to Kesper (2000), since then there is still little clarity as to whether the

government's National Strategy to develop and promote the small business sector has indeed created an enabling environment for that sector to the attainment of its objectives of poverty alleviation, economic growth and job creation.

Job creation and growth of the small business sector will remain one of South Africa's urgent needs for years, if not decades, to come. Many of the country's most severe social and economic ills, according to Qunta (1995), result directly from inadequate progress in both these domains.

Much has been written about the need to address South Africa's burgeoning unemployment crisis. Everybody presents almost the same statistics. According to Magali Malherbe (2003), unemployment was running at about 49%, an increase of over fifty points from 1999 when it was only 32%. The same report indicates that at a sectoral level the long-term trends are even more disconcerting as between 1994 to 2003 the manufacturing sector had shed 22% of its jobs, construction had declined by 35% and mining by 47%. South Africa's economy, according to the same report, needed 400 000 jobs a year to just absorb net new entrants into the labour force. What is more worrying still, as per the same report, is that the majority of the unemployed (about 65%) have never worked before.

Much too has been mentioned of the need for job creation and reforming South Africa's labour markets. Job Summits have come and gone, with little change. What South Africa needs, one would assume, is a business environment in which one is able to do business, get a return on investment and employ people.

While opinions may differ widely on the most effective measures to achieve steady progress, one factor has not been placed in doubt, namely that the richest source of job creation will come, not from South Africa's big business sector, but from the small business sector. This reality is hardly unique to South Africa, but a proven fact in virtually every country, developed and less-developed alike (Kesper, 2000).

Small, medium and micro-enterprise (SMME) development was identified by the South African government as a priority in creating jobs to solve the high unemployment rate in South Africa. Presently South Africa's unemployment figure stands at 37% (Gideon Nieman & Marius Pretorius, 2004). In other words 6.9 million people out of 18.8 million economically active people are unemployed. According to them (2004), about 400 000 people join the labour market per year and that there are about 100 000 job losses per year owing to downsizing, reengineering and re-organization. They (2004) also point out that the growth of South African's labour force is about 2.8% per annum and that an average real economic growth rate of approximately 6% per annum is required to keep pace with the labour force growth.

South Africa's first democratically elected government moved quickly to attack the source of the problem. Decades of apartheid and disempowerment of the majority led to the new government to formulate an integrated national plan, based on many of the lessons from other countries. As a result, South Africa launched itself on a new, untried and ambitious experiment, called the ***National Strategy for the development and promotion of small business***, designed to forge a wide-ranging of public-private initiatives to develop and promote small businesses rapidly throughout the country. This was indeed the first attempt by government to put together an integrated framework for attacking the problems of joblessness in the country. The government's National Strategy is meant to fill a policy vacuum that has been felt for many years.

The government has got very high marks especially from the majority of the black population for the processes it undertook to develop the National Strategy and its forth-right efforts to confront these challenges. As of this year (2005), implementation of the government's National Strategy for the development and promotion of the small business sector will be underway for ten years. Institutions and programmes were developed without the benefit of history or sound precedents. It is also, however, very important to note that the government's National Strategy could encounter enormous difficulties and

growth pains in achieving its objectives because of South Africa's dearth of entrepreneurial tradition and culture among the previously disadvantaged populations, as well as lack of basic education and management experience needed to run successful businesses. These factors alone may mean that progress will be slow, regardless of the resources committed to these efforts. However, the South African's National Strategy for the development and promotion of the small business sector is an integrated institutional framework, which needs to be viewed and analyzed in totality to assess as to whether it has indeed played a pivotal role in facilitating an enabling environment for success for small businesses in this country.

Pressure to achieve measurable progress in these areas is reaching a critical point, as joblessness and economic disparities grow. Like the old government elected in 1994, the government elected in 1999, was also committed to the implementation of the institutional framework for the government's National Strategy. This institutional framework requires a close review from government and private sectors, most especially because its objectives of job creation and wealth creation (economic growth) are of national importance, as they will affect every citizen of this country.

The small business sector encompasses a very broad range of firms, from established traditionally family businesses employing many people (medium-sized enterprises) down to the survivalist self employed from the poorest layers of the population (informal micro enterprises). While the upper end of the range is comparable to the small and medium-sized enterprises (SMEs) population of developed countries, statistics reveal that an immense majority of small, medium and micro enterprises (SMMEs) are concentrated on the very lowest end (RSA, 1995). These are black survivalist firms.

According to the explanatory memorandum attached to the Bill (1995), the government's National Strategy arose from the White Paper on National Strategy for the development and promotion of small business in South Africa, where it identified the necessity for the creation of a more enabling legal framework which would give formal recognition to government's involvement

in small business support. This commitment by government, in the form of national legislation, was also welcomed in the context of the macro-economic blueprint detailed in the 'Growth, Employment and Redistribution (GEAR) Strategy document (RSA, 1995). The National Small Business Act (NSBA) should then be seen in the context of the GEAR Strategy and the White Paper, where the history of the small business person and entrepreneurs in South Africa is acknowledged as heroic by any standards. While black entrepreneurs have borne the brunt of discrimination through the limiting of the scope of business activities, all small business owners and entrepreneurs have waged daily battles against a hostile environment of bureaucratic red tape and institutions indifferent to their needs.

The extent to which these difficulties are minimized, is the benchmark the study will use in determining whether the government's National Strategy for the development and promotion of the small business sector spearheaded by the National Small Business Act is 'an instrumental building block' to underpin the government's commitment to facilitate a more enabling environment for the small business sector in this country.

It should however, be clearly understood that the National Small Business Act does not represent concrete support measures to the small business sector in the form of financial assistance, tax incentives, special export programmes and other supply side measures. It simply puts in place a broad framework from which such initiatives can be implemented.

The vision of the government's initiative in creating this National Strategy is clearly illustrated in Nelson Mandela's words when he commented on the Employment Equity Act (No. 55 of 1996):

"The primary aims of affirmative action must be to redress the imbalances created by apartheid. We are not asking for handouts for anyone nor are we saying that just as white skin was a passport to privilege in the past, so black skin should be the basis of privilege in the future. Nor is it our aim to do away with qualification. What we are against is not the upholding of standards as

such but the sustaining of barriers to the attainment of standards; the special measures that we envisage to overcome the legacy of past discrimination are not intended to ensure the advancement of unqualified persons, but to see to it that those who have been denied access to qualification in the past can become qualified now, and that those who have been qualified all along but overlooked because of past discrimination, are at last given their due. The first point to be made is that affirmative action must be rooted in the principles of justice and equality” (October 1991).

According to Ntsika’s and other agencies’ statistics (Ntsika’s Annual Review, 2002:6; Stats SA (2003), Financial Statistics of Manufacturing, 2003:13) it can be estimated that there are between 1.6 to 3 million small, micro and medium enterprises involved in the standard economic activities in this country. It is then logical to conclude that a study in this huge sector would be a mammoth and time consuming task if one had to conduct the study on the entire sector and also considering that each sub-sector within the entire SMME sector has its own characteristics and unique dynamics. For this reason, this study will, after evaluating the effectiveness of the government’s National Strategy’s institutional framework, only investigate and report the impact the government’s National Strategy has had on the small black economic empowerment mining (SBEEM) sector in the hope that it will give a general perspective of the entire SMME sector.

The mining sector was chosen for its sustainability considering the estimated mineral reserves as per the estimations by the Department of Minerals and Energy (South Africa’s Minerals Industry Annual Review, 2003/2004). The mining sector is also attractive considering its national contribution to the Gross Domestic Production (GDP). According to the Department of Minerals and Energy (South Africa’s Minerals Industry Annual Review, 2003/2004), the mining sector in 2003 contributed about 8% (about R81 billion) to the GDP of the country.

The reason for selecting the small-scale mining sector to be used in the study, even though the South African mining industry is dominated by big

companies, is because the study wants to assess the impact the government's National Strategy has had on small businesses and since small-scale mining sector falls within the small business sector category, it is assumed that the findings of the study will be in line with what the study wants to assess. The other reason why the small-scale mining sector was chosen is because the South African government has identified small-scale mining as one of the vehicles for stimulating rural economies and job creation as a contribution towards sustainable livelihood, especially in rural areas. This initiative is in line with the broader macro-economic framework that promotes the small, medium and micro enterprises (SMMEs) in the national economy. The government's objective is to bring about commercially viable and environmentally sustainable small-scale mining projects in South Africa in an effort to enhance the developmental aspects of small-scale mining and its potential towards rural development.

According to the Department of Minerals and Energy (2004), it is estimated that about 1 000 jobs can be created for every 7 to 10 sustainable small-scale mining projects assisted. A holistic approach in addressing major issues and constraints in the small-scale mining sector is the key to facilitate the promotion of the small-scale mining sector in this country.

1.3 Purpose and objectives of the study

1.3.1 Purpose of the study

There is still an apparent lack of accuracy on the information with regard to the economic impact the government's National Strategy has had on job creation and economic growth on the SMME sector in South Africa (Rogerson, 1997; Kesper, 2000; Ntsika, 2004). Basic text books with regard to SMME sector development in particular are scarce as one mainly finds journals and papers on the subject. The range of textbooks on SMMEs is also limited. A thorough literature review and analysis is necessary to place the SMME sector in its proper context. The argument is that SMMEs as

contributors to South Africa's employment creation and economic growth should be analyzed and contextualized.

The significance of the direct contribution made to employment levels and the economy by rapidly growing small firms can easily be demonstrated. Storey (1994:158) has found out that rapidly growing firms constitute a tiny proportion of the small firm population, but that they make a major contribution to job creation over a ten-year period.

Recognizing that most programmes created under the government's National Strategy for the development and promotion of the small business sector in this country have been operating for ten years to date, it is clear that undertaking an analysis of their economic impacts on the small, medium and micro-sized businesses should produce a representative perspective on the impact of the government's National Strategy.

This research study is then, deemed necessary as a means of developing a 'warning' system, which could assist both the concerned government and private sector structures incorporated in the government's National Strategy to make both major adjustments in approach as well as fine-tuning of existing programmes if necessary.

In essence the study is expected to provide an independent assessment of the impact of the government's National Strategy in relation to its key objectives of employment generation and economic growth in this country, and the impact it has had so far on the small black economic empowerment mining companies and the effectiveness and efficiency of the utilization of resources allocated to the implementation of the government's National Strategy. The study then, will review the institutional framework created by the government's National Strategy, the programmes created by these institutions and the utilization of their resources.

In summary, the study is intended to provide a frank and practical assessment in order for any interested parties to make efforts in making the government's

National Strategy more effective in meeting the critical objectives of job creation, income generation and economic growth in this country.

1.3.2 Objectives of the study

The main objectives of this study is to evaluate the impact the South Africa's National Strategy has had so far on the small business sector in general and specifically on the small black economic empowerment mining sector. The main focus areas can be summarized as follows:

- Analysis of the institutional framework created within the government's National Strategy spearheaded by the Department of Trade and Industry.
- Analysis of the effectiveness of the government's National Strategy through the provision of services by service providers (both financial and non-financial) created under the government's National Strategy and SMMEs who have received those services.
- Analysis of some government's departments not incorporated within the government's National Strategy's framework but having SMME developmental programmes themselves and other business organizations.
- A primary investigation of some parastatal organizations and provincial SMME desks.
- A study of the impact of the government's National Strategy through a structured questionnaire on small black economic empowerment mining companies.

Against this background, the objectives of this study are twofold: the provision of a more comprehensive understanding of the structure of the government's National Strategy's framework and the challenges at stake if any in order to highlight them to give future SMME policies a firm grounding i.e. an

explanation of the impact of the policy thus far and whether the policy has had any significant positive impact on the small black economic empowerment mining sector. It will also put forward some new suggestions regarding the direction that the government's policy should take.

In detail, the study will attempt to:

Revisit the rationale of the SMME policies

While there is a general consensus on the importance of SMMEs in South Africa, their economic rationale has not been well argued nor rigorously investigated. In particular, there is a lack of clarity on how the SMME sector fits within the industrial policy framework and with regard to other objectives of government (Kesper, 2000).

Propose some goals for policy

According to Rogerson (1997) optimizing the SMMEs' contribution to employment and economic development could be translated into the following broad objectives:

- Raising the rate of formation of new SMMEs with growth potential since these SMMEs will contribute to investment, employment and income generation.
- Encouraging new SMMEs arising from previously disadvantaged background, since these start-ups can contribute to redistribution of economic ownership and income, as well as a more participatory economy.
- Increasing the rate of graduation of micro-enterprises into the SME category, since only then the legacy of apartheid can be overcome.

- Raising the performance of existing SMMEs with a view to increasing both their competitiveness and their ability to fulfil a role in society.
- Decreasing the undesirable mortality rate of SMMEs that could be viable undertakings.

Main areas of intervention required

Achieving these broad objectives typically requires policies, which focus on:

- Increasing the supply of the entrepreneurial talent and opening opportunities.
- Providing support to existing SMMEs – micro-enterprises in particular – at no higher than its social opportunity costs.
- Providing incentives for formalization of enterprises, including cultural bridging.
- Assisting SMMEs (where necessary) to use the resources as efficiently as possible.

Within the context of the overall macro-economic performance, the ideal policy package for SMME support in South Africa should allow this sector to maximise its contribution to the economy's overall performance in terms of growth, employment and income distribution (RSA, 1995). This is likely to involve making more resources available to the sector as well as raising the efficiency with which it uses the resources already available.

Evaluation of policies to date

With policy initiatives already under way, the study aims to disentangle the reasons for SMME sector growth (low or high), and why it has made or not

made a more significant contribution to employment and overall economic growth in South Africa. By doing so, the study aims to assist the government in reconsidering its current SMME policy as an integral part of its industrial developmental strategies.

The impact of the government's National Strategy on small black economic empowerment mining companies

Apart from interviews with the institutions created under the government's National Strategy, services providers (financial and non-financial), other government institutions not created under the National Strategy and business institutions but involved in SMME developmental programmes, and other secondary data in relation to the SMME sector, the study will attempt to investigate the government's National Strategy's impact on the small black economic empowerment mining companies.

1.4 Problem statement

The current literature and statistics with regard to the structure of the small business sector is inconclusive (Kesper, 2000). There is a lot of conflicting assessment between different agencies' statistics including that of Ntsika. In addition, no literature or any research study was found (both from the private and public sectors) which analyzed the impact of the government's National Strategy on South Africa's small businesses.

This thesis will therefore serve as a seminal first step in evaluating the impact the government's National Strategy (designed in 1995) has had on the SMME sector with regard as to whether it has created an enabling environment for small businesses to achieve the government's National Strategy's objectives of job creation and economic growth.

The dearth to the unemployment crisis in South Africa is continuously posing major challenges to the South African government in both social (crime) and economic (income generation) circles. On the global arena, South Africa is

also faced with challenges of re-integration into the world markets, while at the same time positioning itself to realize the importance of addressing the local challenges. The international and local challenges, one would assume, will pose conflicting strategic priorities within the government's overall macro-economic strategy which are aimed at addressing both the local and international challenges.

It is a result of such challenges that forced the government to move quickly to launch the new and untried National Strategy for the development of the small business sector in this country. The National Strategy was structured to forge a wide range of participants in both the private and public sectors hoping that it would address the local challenges (job creation, poverty alleviation, economic growth) while also being globally competitive at the same time.

The government's initiative could, one would also assume, face enormous difficulties and pains to achieve its objectives because of the country's apartheid legacy which has created South Africa's dearth of entrepreneurial tradition and culture, lack of business skills and finance most especially among the targeted group (blacks). These factors may mean that progress to the attainment of the objectives of the government's initiative would face tremendous difficulties.

Since it is believed that job creation does not exist in the entire small medium and micro enterprises (SMMEs) but only in small medium enterprises (SMEs), the small black economic empowerment mining sector was chosen to compare the findings of the government's National Strategy's impact by an evaluation of the National Strategy's instructional framework and other related institutions to the extent the small black economic empowerment mining sector has benefited from the government's National Strategy and whether the Strategy has created an enabling environment for that particular sector.

The small black economic empowerment mining companies' database from the Department of Minerals and Energy is not updated on a regular basis and that created problems when conducting interviews with the small-scale mining

companies. Most of the companies in the current database no more exist or have changed locations and contact particulars.

1.5 Delimitation of the study

As a first step in the development of the government's National Strategy's impact analysis some limitations in this study will occur. The following aspects need to be noted:

- As an exploratory study, the study may encounter problems because of lack of well documented literature and statistics on the impact the government's National Strategy has had on small, medium and micro enterprises sector. The popular source of well documented statistics on SMMEs is that of Ntsika's *'The State of Small Business in South Africa'*. However, Ntsika's statistics also fall short of detail and clear elaboration on the impact the government's National Strategy has had on the SMME sector.
- Understanding the impact of the government's National Strategy and the attainment of its objectives require well researched statistics. Unfortunately, there is a lot of conflict on the literature and statistics available on SMME (especially Ntsika's and other agencies' sources) with regard to the size and structure of the sector. This may be because different agencies use different sources when conducting their studies.
- The major challenge to this study is that information on micro-enterprises, which is believed to constitute the largest part of the SMME sector, is hard to find as most of them operate without being properly registered.
- The small black economic empowerment mining companies' database has other companies in it well above the definition of the SMME sector (for example, African Rainbow Minerals Ltd, Mvelaphanda etc). Therefore, the Department of Minerals and Energy's database on small black economic

empowerment companies would be misleading as other big black companies are listed as such in the database.

- The information in the small-scale mining database is not regularly updated, so the interviews conducted on the small black economic empowerment mining companies was limited to the available updated information by the Department of Minerals and Energy, which also had a lot of misrepresentation especially with regard to their existence and contact particulars.
- When conducting the interviews with most small-scale mining companies, a lot of convincing had to be done to them to participate in the study, since most of them had doubts that the information sourced from them was required for study purposes only.

1.6 Research design

This thesis is an exploratory study to the extent that it could lead, through more continuous and perhaps comprehensive studies in both government and private circles in assessing the impact of the government's National Strategy for the development of small businesses in this country.

The approach was to start with investigations of the institutions created under the government's National Strategy i.e. CSBP, Ntsika and Khula. Secondly the effectiveness of the government's National Strategy through interviewing service providers (both financial and non-financial) and recipients (i.e. SMMEs) of those services. Thirdly, other government departments and business organizations, though not part of the institutional framework of the government's National Strategy but who are also involved in SMME sector developmental initiatives were also interviewed. Fourthly some parastatal organizations and provincial SMME desks were interviewed and lastly, a random sample of twenty-two (22) respondents of a population of all small black economic empowerment mining companies which are forty-four (44) in

total, according to Department of Minerals and Energy's database for 2005, were interviewed.

1.6.1 Type of study

This research study is a qualitative study. Unlike quantitative studies it is based on the following:

- Meanings expressed through words.
- Collection of results in non-standardized data which was classified into categories.
- Analysis was conducted through the use of conceptualization.

While number depends on meaning (Dey, 1993: 28), it is not always the case that meaning is dependent on number. Dey (1993: 28) also points out that: "The more ambiguous and elastic our concepts are, the less possible it is to quantify our data in a meaningful way". Qualitative data are associated with such concepts and are characterized by their richness and fullness based on the opportunity to explore a subject in as real a manner as is possible (Robson, 1993). A contrast can thus be drawn between the "thin" abstraction and description which results from quantitative data collection and the "thick" or "thorough" abstraction associated or description associated with qualitative data (Dey, 1993; Robson, 1993).

The nature of the qualitative data in this study therefore, had implications for both its collection and analysis. To be able to capture the richness and fullness of the data in this study, it had to be collected in a non-standard way, unlike that of quantitative study. The non-standardized and complex nature of the data in this study was classified into categories during analysis before it could meaningfully be analyzed; otherwise the most that could result was an impressionistic view of what it means. While diagrams and statistics are used

to show frequency of occurrence in other categories of data, the way the qualitative data is analyzed in this study is through the creation of a conceptual framework.

1.6.2 Propositions/assumptions

Most of the literature on the impact of the government's National Strategy for the development and promotion of the SMME sector in South Africa points out that the National Strategy has not had a significant positive impact on the SMME sector so far (for example, Levy, 1992; Cattell, 1993; Rilley, 1993; TaskGro, 1993; Eichler, 1994; Hirschowitz, 1994, Manning and Mashigo, 1994, Horn 1995; Sawaya, 1995, Rogerson and Reid, 1997). With this background the assumptions of the study are as follows:

- The South Africa's National Strategy has not created an enabling environment for the development of the small, medium and micro enterprises for the attainment of its objectives.
- From the background of the above assumption, it can then be concluded that the government's National Strategy has not created an enabling environment in the small black economic empowerment mining sector and therefore the entire SMME sector as a whole.

1.6.3 Research methodology

The methodological framework used in this study was as per the following stages:

- An investigation into the institutions created under the institutional framework of the government's National Strategy by conducting interviews with the Centre for Small Business Development (within DTI), Ntsika and Khula.

- An evaluation of the effectiveness of the government's National Strategy through interviews with service providers (both financial and non-financial) and the services recipients (SMMEs).
- Investigation into other government and business institutions not incorporated in the institutional framework of the government's National Strategy but having SMME developmental programmes as their institutions' initiatives.
- Investigation into some parastatal organizations and provincial SMME desks.
- Investigation into a random sample (through a questionnaire) in the small black economic empowerment mining sector to assess what the government's National Strategy's impact has had on the sector. This study was in an effort to cross-check the outcome of the study in the first phase of the study with regard to the institutional framework of the government's National Strategy.

1.6.4 Sample design of the study

The first phase of the study focused on the evaluation of the institutional framework of the government's National Strategy and comprised of the following:

- The Department of Trade and Industry (DTI) through its Centre for Small Business Promotion department in Pretoria was interviewed. The Centre for Small Business Promotion was selected because it was conceived as the central policy making, coordinating and performance monitoring group of the government's National Strategy.
- Ntsika Enterprise Promotion Agency (NEPA) in Pretoria was interviewed. Ntsika was selected because under the government's National Strategy for

SMME development and promotion, it was given the mandate to provide a wide range of non-financial services to local service delivery groups.

- Khula Financial Enterprise Limited in Johannesburg was interviewed. Khula was selected because under the government's National Strategy, it was given the mandate to improve access to finance for the SMME sector.
- Twelve financial services providers, twelve non-financial providers and twelve service recipients (SMMEs) were interviewed i.e. three respondents in each category in the four provinces the study was conducted were randomly selected. The provinces were selected for the study because the author was conducting business in those regions.
- Other government departments not incorporated in the institutional framework of the government's National Strategy including other business organizations were also interviewed. These were chosen on the basis that they have their own SMME developmental programmes.
- Other parastatals and the four provincial SMME desks in the targeted provinces were also randomly selected and interviewed.

The second phase of the study through a structured questionnaire interviewed 22 (50%) of the existing 44 small black economic empowerment mining companies as per the Department of Minerals and Energy's database. The sample of twenty two respondents was randomly selected.

1.7 Possible findings of the study

Most agencies who report on SMME development in South Africa point out that the government's SMME development initiative has not yet played a pivotal role in creating an enabling environment for SMME development.

Against this background the possible findings of the study are as follows:

- The South Africa's National Strategy has not had any significant impact in creating of an enabling environment for SMME sector development.
- Following from the above possible finding, it follows that the government's National Strategy has not had any significant impact on the small black economic empowerment mining sector and therefore the entire SMME sector.

1.8 Structure of the study

This study is developed in eleven chapters:

Chapter 2: South Africa's political background and its legacy

This chapter will attend to discuss the political background of South Africa and its legacy. It starts from the 17th century when the Dutch colonized this country and through the 18th century when the British arrived. The chapter also points out the impact that political legacy has had on entrepreneurship in South Africa.

Chapter 3: The SMME sector in South Africa

The chapter will give an overview of the South Africa's SMME sector with regard to its size, profile and performance in the country's overall economy.

Chapter 4: International, regional and local experiences in SMME development

This chapter will attend to discuss the international, regional and local experiences with regard to SMME developmental initiatives.

Chapter 5: South Africa's Strategy for the development and promotion of the SMME sector

This chapter will discuss the evolution and the structure of South Africa's National Strategy's institutional framework for the development and promotion of the SMME sector in this country.

Chapter 6: South Africa's mining industry overview

Since the study will investigate the impact the South Africa's National Strategy has had on the small black economic empowerment mining companies, this chapter will give an overview of South Africa's mining industry.

Chapter 7: Type of study

This chapter discusses in detail on the type of this study and specifically how data was collected and analyzed.

Chapter 8: Problem statement, research objectives and hypotheses/propositions

This chapter discusses in detail on the problem statement, research objectives and the hypotheses/assumptions of the study.

Chapter 9: Research methodology

The study's design, process and implementation will be discussed in this chapter.

Chapter 10: Research results and analysis

This chapter will present the findings of the study.

Chapter 11: Conclusions and recommendations

In this chapter a final discussion on research conclusions, the implications of the study and recommendations will be offered.

1.9 Summary

The study aims to contribute to the analysis of the impact of the government's National Strategy, since its inception in 1995, as to whether it has indeed achieved its objectives of job creation, income generation and economic growth in general, and specifically its impact on the small black economic empowerment mining companies in South Africa based on the findings of the study.

The descriptive findings on their job creation, income generation and economic growth will confirm unambiguously whether or not the present institutional framework of the government's National Strategy for the development and promotion of small businesses as a whole has been successful in tackling the problem of employment and economic growth in this country.

The following chapter will discuss South Africa's political background and its legacy and the impact such legacy has had on entrepreneurship in this country.

CHAPTER 2

SOUTH AFRICA'S POLITICAL BACKGROUND AND ITS LEGACY

2.1 Introduction

This chapter will attend to discuss the political background of South Africa and its legacy. It starts from the 17th century when the Dutch colonized the country and through the 18th century when the British arrived. The chapter also points out the impact of this political legacy on entrepreneurship in South Africa.

2.2 Political background

South Africa was colonized by the Dutch in the 17th century and then by the British from 1806 onwards (Qunta *et al.*, 1995). They found the indigenous Africans (including the Khoi and San) who archaeologists conservatively estimate to have been here since at least 770 AD.

Almost as soon as the Dutch arrived, trouble developed between them and the Khoi, who, though at first hospitable, gradually realized that their land and liberty were under threat. The armed clashes that ensued between the Dutch and later the British settlers on one hand and the indigenous people on the other hand started in 17th century and continued for close on to two centuries (Human *et al.*, 1993). Africans in the Cape bore the brunt of the colonists thrust, as eight wars of resistance were fought in Eastern Cape alone. The last major war was fought between the British settlers and the Zulu speaking Africans in 1879. The last to loose their independence were the Venda people in 1878.

The two important issues that these wars revolved around were land and labour. Control of either or both ensured wealth for the victor and poverty for

the loser. From the early days of colonization, labour was in short supply. According to Qunta (1995), initially the Dutch imported slaves from Malaysia and Java, and also enslaved the Khoi. As they expanded their control over the country and began to farm, their labour needs increased.

Diamonds were discovered in 1867 near the Vaal and Orange rivers and three years later in Kimberly (Browning *et al.*, 1989). Gold was discovered in the Witwatersrand area in 1886. The discovery of diamond and gold transformed the economy of the country from a largely agricultural one to an industrial one with mining and mining related manufacturing activities. As a result, the need for skilled and unskilled labour increased dramatically. The problem that the Dutch and the British had had from the beginning (how to get Africans off land and onto White farms and mines) now increased. So did their efforts.

When the British had disputes with Africans, they conducted what they referred to as “pacification campaigns”. Such campaigns were usually accompanied by widespread burning of crops and looting of livestock. The historian Bernard Magubane refers to these as “scorched earth campaigns that were meant to deprive the Africans of their entire independent livelihood”. According to Magubane (1979), in the war of 1851 with King Kreli of the Gcaleka people, the British invaded his land and confiscated 37 000 head of cattle, 14 000 goats and a few horses. Kreli’s headquarters were burnt down and a further 10 000 head of cattle were taken.

2.3 Discriminatory measures

2.3.1 Land reservation

The land that had not been seized through warfare was taken through legislation, namely the notorious Native Land Act of 1913. According to Qunta (1995), the effects of the Native Land Act were to reserve 13% of land for Africans and to leave the rest for Whites. The land reserved was largely inhospitable and unproductive and was situated in what was later to be known

as “Bantustans”. The Native Land Act was like a legislation mopping-up operation after most of the land had already been lost through warfare.

The absence of Africans in the main stream of the economy has its origins not only in the loss of vital wealth producing resource such as land, but also in the array of legislative measures adopted by successive white governments from the time the first colonists arrived. It is clear that discriminatory labour legislation had their origins not in the coming to power of the Nationalist government in 1948 but much further back. The National Party built upon what had already existed, and implemented these measures with a religious zeal.

One of the earliest Acts was the Vagrancy Act of 1809. According to Adams (1993), the effect of the Act was to declare all black people who were not working for whites, Vagrants. Anyone who was a vagrant was breaking the law. In addition, Africans were required to carry a pass and they could only obtain it once they had a labour agreement with a white farmer. If they did not have such an agreement they could be arrested under the Vagrancy Act. The Court could then assign them to work for local farmers as part of their punishment. Anyone who did not have a "fixed abode" or a "visible" means of support could be classified as a Vagrant.

The Vagrancy Act of 1867 was also meant to curtail the "idleness" of the indigenous people. It covered all those who were "without sufficient or visible lawful means of support, wanderers and loiterers". Those who fell foul of this law were sent to prison or were sentenced to work in the municipality, public works, divisional council or for any private person.

Another technique used by the British to get Africans away from subsistence farming and onto White farms and mines was to impose arbitrary taxes on them. According to Qunta (1995), through the Glen Grey Act of 1894, a labour tax was introduced, which every African farmer had to pay. Given that they were not involved in a cash economy, the Africans were forced to go to the mines to earn the money to pay the tax. Cecil John Rhodes justified the tax by saying that the Act "removed the natives from the life of sloth and laziness

teaching them the dignity of labour, and made them to contribute to the prosperity of the state and give some returns for the wise and good government". In light of such sentiments, Zimbabwean historian Tendai Mudenge (1988) was perhaps not overstating matters when he called Rhodes "Africa's greatest racist".

Poll taxes were introduced and failure to pay constituted a criminal offence. It was resistance to one such poll tax that gave rise to the last armed uprising by Africans in the 1900s. According to Madi (1997), that uprising was called the Bambata uprising, after the name of the leader who refused to pay the poll tax that the British had imposed in Natal.

The earliest legislation that controlled Africans who were in the employ of the colonists was the Master Servant Ordinance. Ostensibly it was meant to regulate the relations between employers and employees. The Ordinance was promulgated in the Cape in 1841. A harsher version was enacted in 1856, after the Cape had been granted representative government by the British.

The Native Labour Regulation Act of 1911, according to Madi (1995), had the same effect as the Master and Servant Act but was applicable to the mining industry only, and like the earlier Act, applied only to African workers. Leaving employment without notice was a criminal offence, as was refusing to obey a command of the employer.

2.3.2 Job reservation

As more and more Africans were forced off their land, they moved into mines and developing industries. White workers, especially the unskilled ones, saw African workers as a threat because they had to compete with them for employment. The skilled workers also feared being undercut by African artisans. According to Browning (1989) the first official colour bar relating to jobs came into being in 1893 with the stipulation that only whites could become engine drivers.

The first job reservation legislation was the Mines and Works Act of 1911 and according to Browning (1989), it made racial discrimination, in the form of hiring on the basis of race, official. It set aside 32 types of jobs in the Transvaal and Orange Free State for which only whites could be recruited. Thousands of black people, including the "coloureds", were prevented from getting wages as carpenters, or other skilled workers. But the Act did not keep skilled black people out entirely, since paying them unskilled wages for skilled labour was cost-effective for the mine owners. According to Browning (1989), black miners earned about a tenth of the wages of their White counterparts.

The 1922 strike by white workers came as a result of mine owners trying to replace some white workers with black workers in order to save costs (Madi 1995) and according to Madi (1995) it was the biggest and most violent strike by white people in the history of this country. On the insistence of White workers, who demanded more protection from the competition with black workers, the Mines and Workers Act of 1926 was passed to more effectively enforce the colour bar. It provided that no Africans or Indians should work in jobs that required certificates.

The Apprenticeship Act of 1922, which was amended in 1944, provided for apprenticeship as an entry requirement for certain specified trades. An educational requirement of standard six was also prescribed. This effectively excluded black people who through lack of educational opportunities very rarely reached standard six and who would in any case find it difficult to obtain an apprenticeship.

The 1951 Native Building Workers Act removed Africans from the ambit of the Apprenticeship Act and defined the areas they could work (Browning, 1989). It provided for their training and control. It also prohibited anyone in an urban area outside the "Native" reserves from employing Africans in the building industry and in other allied occupations. The minister concerned had the right to decide how many learner builders were to be trained each year. Thus not only were skilled Africans removed from the major urban centers and away

from competing with white tradesmen, but the number of people who could be trained each year was restricted.

The Factories Act of 1941 enforced segregation in the place of work by requiring different work areas and separate facilities (canteens and toilets among other things) for different racial groups (Browning, 1989). The cost of satisfying these requirements discouraged employers for employing more than one group and they usually settled for white people. After 1924, the job reservation became an integral part of the South African economy, despite the fact that it was inefficient and costly for employers.

The National party continued this trend started by the British. By the time the pass laws, which were at the heart of the influx control, were abolished in 1986, millions of Africans had received convictions and had their lives disrupted.

2.3.3 Education

The most powerful tool in ensuring white domination was an education system for blacks specifically designed to be inferior to that of whites. It is useful to quote Dr. H. F. Verwoerd's now famous words: "When I have control over native education, I will reform it so that the natives (i.e. blacks) will be taught from childhood that equality with Europeans is not for them" (Nkwanazi and Rall, 1994).

Verwoerd remained true to his promise. The syllabi and examinations used in black schools were different from those used in other races. Different education departments saw to it that differences were maintained. The subject material was kept different, aimed at keeping black education inferior. A cursory glance at the sums that were spent on an African child and White child is instructive. Nkwanazi and Rall (1994) recorded that in 1990, R3 083 was spent on a White child and only R 764 was spent on an African child. Thus four times as much was spent on a White child.

According to the Race Relation Survey (1993/1994), African teachers were not adequately trained. In 1992, 14% of the teachers at the Department of Education and Training (DET) schools in the "non-independent Bantustans" did not have a teaching qualification, and 57% were under-qualified, i.e. did not have a matric with three more years of teaching training.

Furthermore, African schools have been overcrowded; facilities such as good libraries and laboratories were virtually non-existent. It is therefore not surprising that there was such a vast discrepancy in the matriculation pass rate between African and White pupils. According to the Race and Relation Survey (1993/1994), in 1991 matriculation examination, only 41% of African pupils passed and 11% obtained matriculation exemption, as opposed to 95% of White pupils who passed and 42% who gained exemption. In 1992 the percentage of Black pupils who passed matric was 44% whilst 98% of Whites passed.

Those few Blacks that managed to pass were limited in their choice of University. They were barred from attending White Universities unless they obtained a special permission from the Minister of Education. He would give such exemption only where the desired course was not available at the various ethnic Universities. These Universities were usually referred to as "bush colleges", not on account of their location but because of the type of education provided there. None of them had facilities of medicine, business or engineering, for instance. Students mostly studied arts related courses.

There is a vital absence of Africans in the technical fields on account of these policies. According to Leadership Magazine (1994), in 1991 there were only 30 African engineers as against 17 840 White ones; 31 pharmacists as against 731 White ones. In 1994, there were only 60 African chartered accountants out of 14 036 in the country and fewer than 20 architects out of a total of 2 650.

2.4 Legacy of discrimination

2.4.1 Inequality

Discrimination (i.e. Apartheid) has left a legacy of inequality. In the labour market the disparity in the distribution of jobs, occupation and income reveals the effects of discrimination against black people. These disparities are reinforced by social practices, which perpetuate discrimination in employment against this disadvantaged group (blacks), as well as by factors outside the labour market, such as lack of education, medical care and transport.

Black people have suffered as a result of job reservation and education and lack of skills under apartheid. This discrimination sometimes takes the form of direct and conscious decision, based on the prejudice or stereotypes, to exclude certain groups from jobs or promotions. For instance, some employers, believing that black people are not assertive enough to manage or supervise other employees will not consider them in any senior position.

Whereas South Africa is not poor by international standards, it is infamous for having the most unequal distribution of income in the world. According to Country Review (1996) the International Labour Organisation (ILO) concluded that South Africa had the highest levels of inequality than any country in the world.

The Labour Commission notes that the country's skewed income distribution is reflected in the fact that the bottom 20% of income earners captures a mere 1.5% of the national income, while the wealthiest 10% of the households receive fully 50% of the national income. Further, poverty is overwhelmingly concentrated in the African and Coloured population: 95% of the poor are Africans. The Labour Market Commission notes that roughly 33% of Coloured population lives in poverty, compared to 20% for Asians and 0.7% for Whites.

This racial inequality is also reflected in the situation with respect to unemployment in the country. According to Wingrove (1995), in 1994,

unemployment stood at 41% among Africans, among Coloureds was 23%, whilst among Asians 17% but was only 6.4% amongst Whites.

The Green Paper on Employment and Occupational Equity (1996) pointed out that amongst the employed, a third of the Blacks earn below R500 per month, compared to fewer than 5% of Whites. The Green Paper also noted that a white male South African was five thousand times more likely to be in top management position than an African woman. These apartheid-induced inequalities are reflected in the current distortions within the occupational and professional structures of the labour force. A survey of some 107 organisations by the Breakwater Monitor in 1996 indicated that in the top managerial ranks of most companies, Africans constituted only 2.9%, Coloureds were 0.43%, Asians 0.21% whilst Whites were 96.38%. The same study found out that for the lowest grades Whites constituted 1.85%, Africans 89.01%, Coloureds 7.94% and Asians 1.20%. There is, in short, little correlation between the composition of the workforce at technical, professional, and managerial levels and the overall demographics of South Africa.

2.4.2 Economic growth

The World Competitiveness Yearbook (1997) rated South Africa last out of 46 countries with respect to competitiveness of its workforce. A skilled labour force increases a country's competitiveness. Racial discrimination in education and access to employment, coupled with the constant denial of opportunities to blacks has led to the very poor overall skills levels to be found in South African labour market. Inequalities led to market distortions, which in turn resulted in the inadequate utilization of resources. It follows that the reduction in inequality in society is therefore a way of promoting economic growth and job creation.

2.5 The impact of the legacy on the small business sector

The legacy of apartheid constitutes an important factor in the inability of black-owned or –controlled small business to face business development constraints. According to the White Paper on National Strategy for the development and promotion of small business in South Africa (Notice No. 213 of 1995), for decades, if not centuries, the majority of South Africans were deprived of viable business opportunities in the following ways:

- Bantu Education restricted opportunities for the acquisition of technical and professional skills by black people.
- There was total absence of entrepreneurial education or sensitizing for young people in a way that could encourage them to enter business and acquire a culture of entrepreneurship.
- Apartheid confined the majority of the African people to homeland areas which were not only poorest in terms of living standards and business opportunities, but also lacked a dynamic business environment.
- Even outside the homelands the system of apartheid made it impossible for black would-be entrepreneurs to participate in business apprenticeships and partnerships with more established (non- black-owned/controlled) enterprises.
- Racially segregation residential areas, enforced through the Group Areas Act, not only uprooted millions from the places of residence and business, but also led to large capital losses and virtually destroyed the fabric of black small businesses.
- The drastic curtailment of property ownership rights of blacks made it impossible for them to acquire assets that could serve as collateral for loan

financing; it also excluded blacks from the long-run process of capital accrual and growth through rising property values and share prices.

- Apartheid left no real space for the business involvement of black women; marriage laws reduced women to unions with no contractual capacity at all; even though marriage laws have changed, customary law remains intact and there are cultural, behavioural and attitudinal constraints which affect women's participation in business, particularly in rural areas. There are also restrictions in terms of access to land.

2.6 The government efforts to address the apartheid's legacy

According to the White Paper on National Strategy for the development and promotion of the small business sector in South Africa (1995), due to apartheid's legacy, the government's small business support policies will for a considerable time also have to focus on the particular needs of black enterprises and ways to overcome the remaining consequences of the apartheid legacy. The White Paper also points out that this does not imply that policies should only focus on black-owned or –controlled enterprises or business-infrastructure facilities in formerly black-reserved towns, but that policy differentiation will have to include affirmative support.

The new South Africa's government (elected in 1994) came up with many policies in an effort to trying to completely swipe out the apartheid legacy in the country. One of these policies named the National Small Business Act (No. 102 of 1996) is the government's effort to develop and promote the small business sector mostly involved by the black majority, thereby trying to readdress the prevailing apartheid legacy in the country.

The overall objective of the government's National Strategy was to create an enabling environment for SMME growth in the country as a way of addressing basic inequalities in the economy. The mechanism for small business support outlined in the White Paper became constitutional through the National Small Business Act, which also provides the first comprehensive definition of

SMMEs. The Act legalized the establishment of new institutions, affirmative procurement reform and the formation of an advisory board to review SMMEs' legal and regulatory environment.

2.7 Conclusion

This chapter discussed South Africa's political background and its legacy focusing on the impact of such legacy on small business sector and the government's efforts to address that legacy.

In the following chapter, the South African SMME sector will be discussed.

CHAPTER 3

THE SMME SECTOR IN SOUTH AFRICA

3.1 Introduction

Although the statistical base of SMMEs in South Africa is still poor, there can be little doubt about their relative significance. The small business sector is highly diverse in this country, with structures, problems, growth potential and access to support differing widely between segments. These differences relate as much to the economic sectors – retailing, manufacturing, mining, etc. – as they relate to stages of growth of enterprises, viz. start-up, expanding or stagnating.

From a broad strategy perspective 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 “SMMEs” widely used to contrast this sector with big(ger) business. Due to the similarity of some of the obstacles facing them, survivalist and micro-enterprises are often lumped together.

This chapter begins with a general outline as to why a dynamic SMME sector is important in an economy. It attempts to provide a theoretical perspective as to how it can specifically be linked to the unemployment and productivity problem in South Africa. It aims, with a level of abstraction, to understand how an economy with typically South African characteristics functions, specifically with regard to productivity and unemployment. The chapter also sketches the main functions of SMMEs and the theoretical conditions necessary for their attainment. It will also describe the current state of the South African SMME economy with regard to its structures, and the effect of economic reforms. It will specifically investigate the potential impact that the SMME sector can have on employment, considering the micro-enterprises on one hand, and small medium enterprises (SMEs) on the other.

3.2 Main functions of SMMEs

SMMEs as enterprises have some economic roles to fulfill as they contribute to a country's national product by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products, and to a larger extent, services to foreign clients, thereby contributing to the overall export performance.

From an economic perspective, however, enterprises are not just suppliers, but also consumers, which have an important role to play if they are able to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demand of their clients. Demand in the form of investment plays a dual role, both from a demand-side (with regard to the suppliers of industrial goods) and on the supply-side (through the potential for new production). In addition, demand is important to income-generation potential of SMMEs, and their ability to stimulate the demand for both consumption and capital goods.

Most importantly, and from a South African context, SMMEs have, at least in theory, the potential to generate employment and upgrade human capital. Economic historians have demonstrated the importance of this phenomenon in Europe's industrialization and the subsequent development of other emerging economies. As technological progress in agriculture liberated the agrarian labour force, this unskilled excess labour force was absorbed into small manufacturing industries and exposed to business experience, thereby encouraging a "learning-by-doing" effect. This combination of employment of a vacant labour force, and the improvement of their skills through business exposure, strongly characterized the process of industrialization and development (Kesper, 2000).

South Africa's current economic situation is comparable to the above scenario: the excess labour force is "released" not so much from the

agricultural sector, but rather large enterprises in the secondary and tertiary sector (Kesper, 2000). Generally, these enterprises are not necessarily facing economic recession, but rather are growing and transforming themselves in such a way that their demand for unskilled labour is decreasing. This results in an abundant pool of unskilled labour, which SMMEs can possibly employ and upgrade.

From a different viewpoint, it has been suggested that, in cases of “jobless growth” and a mismatch between the demand and supply of unskilled labour, a shift in both the sectoral composition of the economy and the occurrence of growth in different categories of firms may be an important avenue for the generation of both employment opportunities and growth. The question here is whether a more robust SMME growth strategy in South Africa will bring about such changes. This in turn depends on whether SMMEs are more labour-intensive and therefore likely to employ unskilled labour, and whether they are able to provide a “skills upgrading process”.

With these categories of functions defined from a theoretical perspective, the following section examines the structure of the South African economy to see whether SMMEs can, in their current position, fulfill these roles.

3.3 Structural features of the South African economy and its implications for SMME growth

3.3.1 The apartheid legacy

In comparison with many other developing countries, the contribution of South Africa’s SMMEs to employment and economic growth is low (Manning, 1996). This relatively poor performance is often associated with the racial distortions in education, income and economic empowerment inherited from the previous white regimes. Nevertheless, there is a danger in ascribing all the responsibility for the underdevelopment of SMMEs to political disenfranchisement, since the corollary to this argument is that the new economic order provides a sufficient condition for revitalization of the SMME

economy. According to Kesper (2000), the removal of apartheid, although necessary, has been insufficient in the unraveling of the full potential of the SMME economy, because the inherited structures contribute to the following:

- A high dualistic economy not only characterised by a high productivity (modern) and a new low productivity (informal) sector with little interaction between them, but also a division along racial lines.
- A transition phase marked by political uncertainty and considerable crime and violence, both impacting negatively on local and foreign direct investment in the modern sector.
- A recent shift in individual policy to liberalization of trade and finance, and a rapid technological change reflecting a comparable process at the global level.
- Low levels of education and training among the participants in the traditional sector who have, in addition, suffered from the suppression of entrepreneurial activities.

3.3.2 International experience in dealing with such legacy

South Africa's peculiar features imply that policy makers may partly draw on international experiences when looking for policy responses to promote economic and employment growth. There are other economies like Chile or Venezuela, for example, which have a historically strong mining base. Like South Africa, they suffered from high levels of unemployment and/or underemployment, resulting in income inequality, because public interventions and resources were focused on strengthening the mining industry, to the detriment of the more labour-intensive agricultural and manufacturing sectors.

Chile, for example, solved the unemployment dilemma by creating a large public sector, while other governments protected their agriculture and

manufacturing sectors so that the shrinkage in employment would not be so pronounced. For a country like South Africa, however, protectionism and increased state expenditure are contrary to the liberal philosophy adopted, as shown below.

3.3.3 Way forward for South Africa

South Africa has adopted a regime of trade liberalization and fiscal prudence, thereby limiting the use of protectionism and public sector employment. This may partly explain why unemployment levels and income inequality have increased.

Taking into account the characteristic of dual economy, adequately remunerative employment could originate from:

- The high productivity sector increasing its level of employment i.e. absorbing people previously located in the low productivity sector (or unemployed).
- The low productivity sector increasing its income generating capacity through investment, technological improvement and education and training.

However, the success of each of these mechanisms is limited by historical neglect of education and training for both employers and employees in the low productivity sector. Therefore the key challenge is identifying the best policy levers available to the government, given the problem of inequality and the overall thrust of an economic reform strategy comprising fiscal prudence, trade liberalization and deregulation of various economic sectors.

3.4 Can SMMEs resolve the unemployment problem? – a theoretical consideration

This section tries to highlight, from a theoretical standpoint, the requirements for using SMMEs as vehicles for employment creation where the interaction between capital, productivity and demand for labour are explained.

3.4.1 Capital, productivity and demand for labour

Economic production is defined as the combination of capital and labour to generate a “product”. The demand for labour can be understood as a function of the country’s national product, the availability and productivity of both capital and labour and the ratio of substitution between capital and labour. More precisely, the productivity of one factor is boosted by the quality and abundance of the other factor, and this explains the difference in labour demand amongst enterprises and across countries.

Countries with a broad capital base (typical of developed countries) exhibit high labour productivity, and because their national product is high, will be able to employ the majority of their labour force. By contrast developing countries, South Africa included, are characterized by lower capital endowments and an abundance of low-skilled labour. Overall productivity in developing economies cannot be high as long as only a limited number of workers are needed to operate the fixed amount of capital. This results in a dearth of employment opportunities for unskilled labour.

A similar distinction can be made between the various sizes of enterprises. This is done on the assumptions that the larger firms are more capital-intensive, and that the demand for labour is directly related to its marginal productivity. In large capital intensive firms, the first few workers are highly productive, but as workers are added their marginal productivity tapers off fast. Thus the initial demand for labour as a whole or for high-skilled labour is high, but then falls sharply as workers are added.

In contrast, the labour demand of the micro-enterprise sector does not achieve high levels at any given point. To begin with, much of the demand is imputed since the workers are self employed. In addition, the marginal product of the labour employed is low because of the limited capital and simple technologies employed. The demand hence remains relatively flat (elastic), because of the low barriers to entry.

The labour demand of the SMME sector lies between these two extremes. The first workers are relatively more productive than those in micro-enterprises, but less so than those in large firms. Productivity declines slower than in large firms as workers are added, but faster than in micro enterprises.

3.4.2 Labour markets, wage rates and productivity

The summation of the three labour demand scenarios described above constitutes the total demand, which in turn is a function of the wage. Its intersection with the supply of labour represents the equilibrium wage, which is applicable to all low-skilled workers in the absence of labour legislation or other institutions, which affect wages of various subgroups of the workers, found in this labour market segment.

The demand is high at the beginning, where most of the demand for labour originates from the high productivity sector, but flattens towards the bottom where it reflects the existence of the micro-enterprise sector. In other words, in a country with a large labour supply, the equilibrium wage for this category of relatively unskilled workers is defined by the marginal labour productivity in the micro sector.

3.4.3 Role of the high productivity sector in labour markets

A healthy high productivity sector directly contributes to employment creation (Kesper, 2000). However, when capital is scarce, its main impact on employment is indirect, by means of technology spin-offs, subcontracting and transfers to the lower productivity sectors. The combination of an increase in

the demand for labour in the high productivity sector, as well as the rest of the economy, produces a rightward shift of the labour demand.

In South Africa's case, according to Rogerson (1998), however, technological upgrading seems to work in the opposite direction. The high productivity or modern sector seems to grow "vertically" i.e. with no transfer, technology spin-offs or other indirect benefits. As a result, wages in the high productivity sector rise, but fall in the other sectors. Such growth causes more income inequality, reinforced by likely fall in wages of low-skilled micro-enterprises because this segment of the labour market gets flooded.

According to Kesper (2000), international experience suggests that the direct (low) employment creation capacity of the high productivity sector does not vary much across developing countries, but that the extent of its positive impact on employment creation in the lower productivity sector does. In the case of Latin America for example, there has been virtually no net employment creation of this sort in the 1990s – even though a modest rate of overall economic growth was achieved. The Latin American experience suggests that the high productivity sector cannot be expected to provide the answer to a developing country's employment needs in a world of liberalization, fiscal prudence and rapid technological change. Its employment growth is slow, and unless productivity was raised in other sectors, the equilibrium wage would stay low for a discouraging long period.

3.4.4 Role of the micro-enterprises and the SME sector

Returning to the employment and wages in low-skilled segment of the labour market it is important to distinguish between the micro-enterprise sector and the SME sector. The micro-enterprise economy increases the average productivity of labour in the economy as a whole by "pulling into production" unemployed low-skilled labour whose skill levels are not sufficient to qualify for employment in larger firms. Although this probably does not raise the average labour productivity of the employed labour force, it makes the most productive use of the unemployed economically active population. This has

the effect of raising total output in the economy at little or no opportunity costs. By means of support measures, the average labour productivity of those so employed could be enhanced.

The marginal product of labour in the micro-enterprise sector determines the equilibrium wage for unskilled labour in the whole economy, although labour legislation and trade union power artificially push up wages in large scale firms and part of the SME sectors, so that the actual wages tend to lie above those paid in the non-unionized micro-enterprise sector. Nevertheless, the social and economic importance of having policies that raise the productivity in this micro sector must be viewed in light of the fact that its impact on earnings can go beyond the micro-enterprise itself. Their successful implementation raises not only the incomes of people employed therein, but of all other comparable workers in the economy whose incomes are not above the equilibrium due to “institutional distortions”.

Promoting the micro-enterprise sector with a micro-finance programme, for example, may raise the productivity of enough micro-enterprises (or induce the formation of dynamic ones to replace less productive micro-enterprises) so that the labour demand (labour productivity) of that sector will rise. Unfortunately, this cannot be the final resolution to the challenge of adequate employment, because the productivity levels of micro-enterprises have a relatively low ceiling. Hence, while effective policies impact positively on micro-enterprise productivity, they achieve poverty alleviation at the most, but not an expansion of the middle class.

The SME sector, by contrast, is not just a desirable complement to growth in the high productivity sector and a multiplier of productivity increases in micro-sector, but holds in itself the main key to whether the country will succeed or fail in confronting its employment challenge. Labour productivity is sufficiently high in most of this sector so that its workers earn above the poverty line. Further productivity improvements raise average wage levels of this sub-sector. Even more helpful, however, is the horizontal expansion of this sector,

through entry of new and growth in size of existing firms. This shift in the size distribution of firms can be explained by:

- The redeployment of former lower skilled micro-enterprise employers to SME firms (or the “maturation” of micro-enterprises into SMEs) until eventually only a few micro-enterprises are left.
- The redeployment of high skilled and less skilled workers from the high productivity sector, which tends to replace labour with capital.

SMMEs therefore emerge not only from a productivity perspective, but also with an interest in income distribution, as the most promising section of South Africa’s economy. The country could have raised its average labour productivity by allocating a high share of capital to large firms, which yield scale economies, and/or firms using modern technologies. In this case, only a few high skilled labour and well paid workers would be needed to operate this capital, while the majority of the labour force produces with little capital, and hence low levels of productivity and remuneration. In this scenario, labour (as the abundant factor of production) is sub-optimally used and income distribution worsened, especially with regards to unskilled workers and labour entrants in particular.

Since South Africa boasts a large pool of low-skilled workers, maximizing average labour productivity of those who are employed seems to be the wrong path to follow at this time. Such a strategy would lead to a high rate of unemployment, and hence inequality in income distribution. While the micro-enterprise segment usually absorbs some of the unemployed, therefore slightly increasing the overall productivity of the economy, it is more desirable to have SMEs generate the bulk of employment, which is more productive, and hence able to pay higher wages.

Admittedly, the correlation between size, labour intensity and labour productivity varies from country to country and industry to industry, but allows

a first assessment of the potential of the SMME sector. If the theoretical assumptions above are accepted, and it is acknowledged that the upgrading of skills in the labour force is pivotal to a prosperous SMME sector, it becomes equally clear that the overall economic success of a country like South Africa depends on the nature and effective implementation of its SMME support policies.

All over the world it has been recognized that the small business sector plays an important if not critical role in the economic and social development of a country. This also applies to South Africa, where the small business sector has been neglected during much of the century following the discovery of diamonds and gold, and the establishment of a modern, capitalist economy with almost exclusive white control.

According to Kesper (2000), while the importance of large industrial, mining and other enterprises for growth of the economy cannot be denied, there is ample evidence that the labour absorptive capacity of the small business sector is high, the average capital cost per job created is usually lower than in big business and its role in technical and other innovation is vital for many of the challenges facing South African economy.

Given South Africa's legacy of big business domination, constrained competition and unequal distribution of income and wealth, 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 internally and internationally), enhance productivity and technical change, and through all of this stimulate economic development.

Taking into account the very large micro segment of the small business sector, as well as those struggling in the survivalist activities it should be clear that the small business sector plays a crucial role in people's efforts to meet basic need and help marginal groups for example, female heads of household, disabled people and rural families, to survive during the current of fundamental structural changes where the formal economy is unable to

absorb the increasing labour supply and social support systems are grossly inadequate.

Experience has shown that in the past black people have been able to make far greater progress in the micro- and small-enterprises. Thus, the SMME sector has – all its impediments notwithstanding – proven to be a highly significant vehicle for black economic empowerment.

3.5 Size, profile and performance of South Africa's SMME economy

3.5.1 Introduction

Any policy decision concerning South African SMMEs requires accurate information about their size and structure as well as contribution of SMMEs to the economy. In particular, there is need to know the number and size of SMMEs, and where to find them. Because their needs vary strongly according to these two criteria, it is also important to know their distribution across industries. Moreover, the potential of SMMEs for economic empowerment can only be estimated with a sense of the share of previously disadvantaged individuals (PDIs) in the ownership of SMMEs. Apart from these specific questions, more general information on the share of SMMEs to the economy can enlighten macro-economic policy on the impact of their actions on the sector.

Unfortunately, accurate information is far from being available in South Africa, especially on the informal sector, which according to the available statistics, it can be estimated to represent at least two-thirds of the SMME population. Although the annual reviews of the *State of Small Business in South Africa*, published by Ntsika Enterprise Promotion Agency, represent an official source of data, they are not easily usable.

During 1995 to 1999 period, Ntsika tended to publish very comprehensive statistics based on fragmentary and sometimes outdated sources, which were

compiled with a lot of extrapolation. For example, the combined data source used for the 1997 review were the Registrar of Companies, the South African Receiver of Revenue (SAR), Unemployment Insurance Fund (UIF), National Population Census (NPC) 1996 and sectoral Censuses, as well as October Household Surveys from Statistics of South Africa (SSA), Matrix Marketing Databanks (MMD), Development Bank of Southern Africa (DBSA) employment series, the Reserve Bank of South Africa (RBSA) and other commercial research agencies (Ntsika, 1997:76). This posed several potential problems, as economic SMME databases in South Africa are prone to inconsistency as national surveys and censuses are often published with a three to four year time lag and the extrapolation assumptions may be discretionary. Because the accuracy of the statistics was often questioned, Ntsika had chosen, since 2000, to follow a more cautious line, with the result that the information stays very general and is no longer as comprehensive as it used to be.

This section aims to present an overview of available estimations on the SMME sector according to a variety of data sources. The diversity of statistics indicates just how difficult it is to undertake quantitative work on SMMEs in South Africa, and indicates the urgent need for complementary research.

3.5.2 Numbers of SMMEs in the various size category

The difficulty with regard to this study in statistical work was perhaps best demonstrated when answers to the most basic questions were required, for example, “How many SMMEs are there in South Africa?” Unfortunately, an answer to this question is not easy to obtain as Table 3.1 on the following page demonstrates by comparing several estimates made by various institutions.

Table 3.1: Different indicators for the size of the SMME sector

Source	Survivalist	Micro	Very small	Small	Medium	Large	Total
Ntsika 1999	184 400	466 100	180 000	58 900	11 322	6 017	906 739
Ntsika 2000/ Stats SA 2000	Informal 1 138 854		330 271	94 804	52 620	12 249	1 658 797
Business Partners	2.3 million		600 000		35 000	n/a	2.9 million
Management Sciences Group Survey, 1999	micro: 960 740 “informal”: 862 580		formal:445 880 (of which 357 780 private)				2.3 million
Eskom Survey, 1999	900 00+ “in home business”; total 3 million if one includes farmers					n/a	3 million
Global Entrepreneurship Monitor, SA 2001	below 0.73 and 1.15 mil.	1 709 142					between 2.44 and 2.86 mil.

Source: Compiled by Rashid Ahmed, MFRC, and Magali von Blotnitz, UCT
The correspondence between the size categories is approximate, since sources tend to use divergent definitions.

As Table 3.1 shows, there is a considerable potential of error, especially in the survivalist and micro categories (informal sector). Considering that even Ntsika has drastically revised its estimation from 0.9 to 1.6 million between 1999 and 2000, it can probably be surmised that Ntsika’s 1999 estimations were somewhat “out of picture”. Accordingly, it can probably be said that there are between 1.6 and 3 million SMMEs in South Africa.

It is particularly noteworthy that the two “official sources” (Ntsika and Stats SA) suggest lower totals than private research groups. There may have been an under-estimation of the informal sector by Stats SA and Ntsika, due to the strong reliance of their figures on various industrial censuses, which are not likely to capture informal business very accurately. Estimates of the informal sector mainly derived from employment data contained in the October Household Survey; indicate that there is a potential for error in extrapolating enterprise figures from employment figures.

It seems, private investigations on the contrary, were generally centred on the actual question, i.e. the existence of enterprises. So although they may not have had the statistical power of Stats SA (in terms of sample size), their data may have been closer to reality. For example, the Global Entrepreneurship Monitor 2001 (conducted by the Graduate School of Business of the

University of Cape Town) found out that the “multiple ownership of business” was a frequent phenomenon (for example, almost 54% of established business owners have started at least one other firm before). This may explain why there may be more enterprises than there are self-employed. What this suggests is that the number of firms is likely to be higher than 1.6 million.

A data and methodology problem is encountered in the consideration of size categories. Although the Small Business Act has provided an official definition of four size categories (micro, very small, small and medium), this is not followed by the official state agencies (especially Ntsika) in that they either add new categories (“survivalist category”) in 1995-1999 or ignore some (“very small category,” Stats SA, Ntsika 2000), without explanations. Private studies are probably even less disciplined as far as their definition of size categories is concerned, also combining a legal criterion (formality) with a size criterion (micro-enterprises), which makes comparisons rather hazardous.

It must be emphasised however, that the weight of the smallest size categories (micro-enterprises) is overwhelming. Although their contribution to the GDP is minor, they represent between 1.2 and 2.8 million businesses, i.e. between 69% and 80% of all SMMEs.

In terms of dynamic evolution of the size classes, it is almost impossible to make accurate comments. While previous Ntsika publications may have suggested a decrease in the proportion of survivalist business (from 23% to 20%) and a significant increase in the micro- and very small category (from a combined 67% to 71%) between 1995 to 1997, the Management Services Group sees an increase in all categories, but mainly in the smallest informal size class (as well as in the public service) between 1998 and 1999.

3.5.3 Sectoral structure of South Africa’s SMMEs

The only sources giving comprehensive information on the number of firms by sector are the data published by Ntsika (1997, 1999 and 2000) for the year

1995, 1997, and 1999. This is problematic, since Ntsika may have overlooked a number of enterprises, which may or may not be concentrated in a few sectors.

A summary of statistics is represented below.

3.5.3.1 Current sectoral profile

Table 3.2 shows a static picture of the SMME population by sectors for the five year period (1995 to 2000).

Because of the statistical weakness of the estimates presented, these figures should be seen as providing an order of magnitude, rather than very precise indications. Thus, the comparison between three years may not be very reliable.

Nevertheless, interesting findings emerge from these estimations. It is not surprising that the sectors of mining, and quarrying, and electricity and water supply are almost irrelevant to the SMME economy. More interesting is the distribution between primary, secondary and tertiary sectors.

Table 3.2: Ntsika statistics on the sectoral distribution of South Africa's enterprises

	1995	1996	2000
1. Agriculture, Forestry etc	92 300 11.0%	98 060 10.8%	204 429 12.6%
3. Manufacturing	113 555 13.6%	106 019 11.75%	163 343 10.0%
5. Construction	79 974 9.6%	88 516 9.8%	147 830 9.1%
6. Trade; repairs; hotels and restaurants	351 183 42.0%	365 980 40.4%	699 106 43.0%
7. Transport, storage, communication	50 007 6.0%	58 796 6.5%	85 360 5.2%
8. Financial and business services	65 700 7.9%	77 826 8.6%	111 996 6.9%
9. Social and personal services	80 400 9.6%	107 013 11.8%	179 837 11.1%
	836 850	906 600	1 626 459

Source: Own calculations based on Ntsika 1997, 1999 and 2000.

It is important to note in Table 3.2 that the 2000 estimations follow a different methodology than the previous years, and may not fully be comparable. The statistics include large enterprises because it was not possible to isolate them in the 2000 figures. However large enterprises have barely any impact on the overall sectoral distribution. The figures do not add up to 100% because some sectors which are less relevant for SMMEs, as well as “other activities not adequately defined” have been left out of this table.

Table 3.3 reveals two interesting findings. First, a pronounced majority of the smallest of South Africa's enterprises, which come mostly from the informal sector, are active in the tertiary sector, especially in trade. This is not surprising, as it is well known that primary and secondary activities require an amount of capital (land for the former machinery and equipment for the latter), which is often not affordable to “emerging” enterprises.

However, the difference between the 1995 to 1997 estimations and the 2000 estimations are striking; the 2000 estimations (which capture almost twice as many informal businesses as the previous ones) seem to have identified a

much higher proportion of those firms in the primary sector than the previous studies. This may be due to an effective change in land ownership or to a better count of emergent farmers in the previous homelands and other rural areas.

Table 3.3: Primary, secondary and tertiary economy depending on enterprise size

	Among informal/survivalist-micro business			Among large enterprises			Among all enterprises		
	1995	1997	2000	1995	1997	2000	1995	1997	2000
Primary	6.4%	8.4%	13.7%	24.6%	25.3%	n/a	10.8%	10.8%	12.6%
Secondary	22.7%	21.6%	20.7%	34.8%	32.2%	n/a	23.6%	21.9%	19.4%
Tertiary	70.6%	70%	63.%	40.6%	42.6%	n/a	65.4%	67.2%	66.2%

Source: Own calculations based on Ntsika 1997, 1999 and 2000.

Surprisingly, the 2000 estimation also suggest that secondary activities such as manufacturing and construction are even more dominant in the informal economy. Again, it is difficult to separate the dynamic effects (decrease of the secondary sector within the last decade) from the impact of the change of methodology.

3.5.3.2 Sectoral dynamics

As mentioned before, any accurate comments on the sectoral evolution of the SMME population made on the basis of Ntsika is perilous, given that margin of error suggested by the gaps between 1997 and 2000.

More limited studies are probably helpful in examining the dynamics of the various sectors. In particular, GEM (2001) gives indications on the sectors in which start-ups were created in 2000 - 2001 and the sectors where new firms

were present. A comparison of these figures with the overall distribution of enterprises as suggested by Stats SA 2000 may indicate dynamic sectors.

The difficulty with this approach is that a sector with a high proportion of “start-ups and new firms” can be either new developing or characterised by a very high firm turnover, i.e. there are many births and many deaths within each year. Despite its caveats, a look at the registration and deregistration statistics of the registrar of companies can help support the interpretation of GEM’s results.

The statistics, presented in Tables 3.4 and 3.5, enable the building of qualified presumptions on the following questions: which sectors witnessed the most enterprise creation in the periods under consideration and in which sectors does entrepreneurship appear to be sustainable.

- **Sectors with high company creations in the last 5-10 years**

According to both sources, two sectors emerge as having had a strong creation activity, namely financial and business services and trade/hotels and restaurants. This is not surprising as these are known to be popular start-up activities. In the former case, though, this dynamic creation activity seems to be compensated by a fairly high “attrition rate”, almost 11% of new registration in 1999.

The manufacturing sector is fairly dynamic, as GEM results suggest (high share among new firms in particular). Nevertheless, according to registration statistics, the sector’s creation activity is rather “average” relative to its size in the formal economy. What is more, the sector appears to have the highest attrition (11.3%).

- **Sectors with high company creation 2000**

Looking at the creations in 2000, the above-mentioned three sectors remain significant. In addition, the sector of “social and personal services” emerges both from the Registrar’s data as a sector where creation accelerated in 2000.

- **Contradictory results**

For three sectors, the two sources apparently yield contrary results. Apart from possible weaknesses, other explanations are also sought for this discrepancy.

- **Construction**

The Registrar of companies suggests that in the last 10 years to 2000, the construction sector has had the second-most vibrant registration activity, albeit with a slight slow-down in 1999, while the GEM findings suggest that there were rather few new firms in that sector. While its “attrition profile” is average (9.7%), it is very dynamic among private companies (46.3%). This could possibly be attributed to a discrepancy between the formal and informal sector, a high “infant mortality” rate leading to a much smaller number of living young companies than were created, and/or the re-registration of proprietary companies (Ptys) as close corporations (CCs), and the phenomenon of dormant companies.

- **Transport and communication**

This sector consists of among others, activities such as “telecommunications” or tour operators/travel agencies”, which are known to be popular start-up activities – and also activities such as taxi driving. While GEM found a very high share of statistics of start-ups - though not of new firms in that sector – the registration activity seems to have slightly slowed down in 1999 -2000, especially for CCs.

This may arise from a difference in the delimitation of the sectors or the fact that while the communication and tourism sectors are beginning to be saturated, a high infant mortality is perceived. This may have reduced the attractiveness of the sector for start-ups.

- **Agriculture, fishing and hunting**

The primary sector shows an intriguing pattern when comparing registration in 2000 to the registration activity in 1990-99. Undoubtedly, there has been a great acceleration in the registrations of CCs in 1999-2000. However, GEM does not corroborate this, as they found very few new firms in that sector. The hypothesis of an “old sector” is also confirmed by the low rate of attrition. It is difficult to correctly interpret these results without a study of the structural changes in agriculture as a whole. This would require knowing what proportion of agricultural businesses is registered as CCs or private companies. In any case, the land reform process seems to be slowly generating some emerging farming businesses.

Table 3.4: Sectoral distribution of start-ups and new firms compared to the total distribution of South Africa's enterprises

	GEM 2001 Start-ups	New firms	Ntsika 2000 Total
Agriculture, hunting, forestry and Building	1.38%	2.6%	12.6%
Manufacturing	14.3%	19.1%	10.0%
Construction (Including mining and quarrying)	3.7%	5.0%	9.1%
Trade repairs; repairs; hotels; and restaurants	46.8%	54.3%	43.0%
Of which wholesale, incl. fuel and vehicles	6.0%	6.5%	
Of which retail, repair, hotels & restaurants	40.8%	47.9%	
Transport, storage and communication	9.8%	1.7%	5.2%
Financial and business services	10.4%	13.1%	6.9%
Community, social and personal services	13.6%	4.2%	11.1%
	100%	100%	100%

Source: Own calculations based on Gem 2001, Ntsika 2000

Table 3.5: Registration and de-registrations of CC's and Pty's by sector (1990-2000)

	1990-1999		1999			2000	
	Registrat- ions	Registró formal	Registr- tion	Dereg.	%.	Registr- tion	2000/ 1990-99
Agriculture/ primary sector	14 988	38.8%	3 542	237	6.7%	3 775	25.2%
Manufacturing	43 013	111.6%	6 824	768	11.3%	7 357	17.1%
Construction	46 212	170.4%	6 983	680	9.7%	7 572	16.4%
Trade; repairs; hotel and restaurants	206 437	156.8%	35 047	3 377	9.6%	40 603	19.7%
Transport, storage & communication	21 632	54.2%	2 961	271	9.2%	3 237	15.0%
Financial & Bus. Serv.	247 525	365.5%	37 374	4 061	10.9%	40 721	16.5%
Social & personal services	27 552	147.6%	4 813	394	8.2%	4 813	20.1%
Totals	610 404	147.6%	98 041	9 846	10.0%	109 359	17.9%

Source: Own calculations based on Registrar of companies, as quoted by Ntsika, 1999 - 2000

3.5.4 Ethnic structure of South Africa's SMMEs

Given South Africa's specific history of apartheid, which meant the exclusion of the majority of potential entrepreneurs from proper education and access to property and/or financial resources, it is important to know to what extent and in what forms Previously Disadvantaged Individuals (PDIs) are able to take their part in business.

3.5.4.1 "Black business"

The following statistics could be used: Ntsika estimated the share of PDI ownership at 50% in 1997; GEM suggests that in 2001, 76% of entrepreneurs are black, coloured or Indian. While it is plausible that there has been an increase in the share of PDIs with regard to this statistics, most of the difference is, however, believed to stem from Ntsika's under-estimation of the informal sector.

The share of "non-white" is noticeably higher in the informal sector firms than in the formal sector. The World Bank study on formal SMMEs in the Johannesburg area illustrates the very small significance of PDIs in the formal economy.

Table 3.6: PDI share according to various studies

	Survivalist	Very small	Small	Total
Ntsika 1997				
Number of PDI owned firms	434 428	15 875	16 625	466 928
PDI share within size category	65.9%	15.8%	35.9%	57.9%
GEM 2001	Survivalist		Declared firms	
Number of white owned firms	28 525		392 220	420 745
Number of Indian owned firms	4 989		90 650	95 639
Number of coloured owned firms	42 633		186 958	229 290
Number of black owned firms	653 405		1 039 615	1 693 020
Total number of PDI-owned firms	701 027		1316 922	2 017 949
PDI-share within category	96.1%		77.1%	82.7%
Chandra 1999 (formal and urban)	< 20 employees		20-49 employees	
Number of PDI-owned firms	110		35	
PDI share within category	18.5%		18%	

3.5.4.2 Racial discrimination by sector

Taking a look at the main sectors, it appears that the share of PDIs is higher in transport and communication, mining and quarrying and construction and trade (Ntsika) as well as community services (GEM, 2001). In agriculture and financial and business, the share is lower.

3.5.4.3 Cross-racial partnerships

The social economic context of PDIs, in particular the lack of funds to start business on their own, as well as the rise of the so called “affirmative procurement” (preference given by government or large corporations to black-owned firms in their tendering activities), have led to an increase of cross-racial partnerships in the establishment of firms.

Table 3.7: Racial distribution of firm ownership by sector

SIC Codes	NTSIKA 1997		GEM 2001				
	White	PDI	White	Black	Coloured	Indian	PDI
1. Agriculture, hunting, forestry fishing	39 500 57.5%	29 235 42.5%	11972 45.8%	14170 54.2%	0 0%	0 0%	14 170 54.2%
2. Mining, Quarrying	2 895 29.0%	7 090 71.0%					
3. Manufacturing	35 962 41.2%	51 280 58.8%	42 607 19.0%	131 305 58.6%	37 793 19.9%	12436 5.5%	181 534 81.0%
4. Electricity, gas water supply	4 998 58.3%	3 570 41.7%					
5. Construction	24 808 30.1%	57 720 69.9%	30 283 43.4%	14 170 20.3%	25 339 36.3%	0 0%	39 508 56.6%
6. Trade; repairs; hotels and restaurants	107 106 35.1%	98 330 64.9%	121 484 15.2%	524 274 65.8%	101 139 12.7%	49 743 6.2%	675 157 84.8%
7. Transport, storage and communication	9 973 21.4%	36 688 78.6%	30 283 24.0%	83 128 65.9%	12 669 10.0%	0 0%	95 797 76.0%
8. Financial, insurance, real estates business services	56 525 73.2%	20 725 26.8%	91 201 57.8%	41 564 26.3%	12 669 8.0%	12 4336 7.9%	66 669 42.2%
9. Community, social and personal services	48 381 46.7%	55 190 53.3%	23 945 12.43%	137 917 71.3%	25 339 13.1%	6 218 3.2%	169 474 87.6%
	338 981 42.1%	66 928 57.9%	351 774 22.1%	946 527 59.4%	214 948 13.5%	80 833 5.1%	1 242 308 77.9%

3.5.5 Geographical location of South Africa's SMMEs

Owing to poor infrastructure in rural areas (including banking infrastructure), it is important to take consideration of the location of the enterprises. Furthermore, an interesting question is the extent to which the potential for SMMEs in the rural areas is fully exploited.

3.5.5.1 Rural and urban SMMEs

As per Table 3.8 shows, Ntsika estimations (until 1999) seem to have grossly under-estimated the number of enterprises in the most rural provinces, especially the Eastern Cape, Limpopo Province and Mpumalanga. In these provinces, SMMEs are – even more often than in urban areas – of an informal and survivalist nature.

Table 3.8: Distribution of SMMEs according to location

	Ntsika 1997				Ntsika 2000
	Survivalist & Micro	Very small & Small	Medium	Total SMMEs	Total SMMEs
<i>Mainly urban provinces:</i>	415, 800	175.400	8,770	599,970	944,034
In %	63.9%	73.5%	77.5%	66.6%	57.9%
<i>Mainly rural provinces)</i>	234,900	63,400	2,552	300,752	685,622
In %	36.1%	26.5%	22.5%	33.4%	42.1%
Total number of enterprises	466 100	180 000	11, 322	900,722	1,629,656

GEM's results (Table 3.9), on the other hand, suggest a much lower prominence of rural business, although in the survivalist economy almost a third of businesses come from rural areas.

Table 3.9: Distribution of SMMEs according to location

	Survivalist		Formal and semi-formal		Total	
Metro	320,309	47.7%	1,081,043	64.8%	1,401.352	59.9%
Small Town	148,310	22.1%	251,509	15.1%	399,819	17.1%
Rural	203,575	30.3%	335,898	20.1%	539,473	23.0%
Total	672,194		1,668,450		2,340,644	

Source: GEM 2001 combined with OHS.

It is also important to note that it would seem that small enterprises are at a disadvantage in small towns, relative to rural areas.

3.5.5.2 Evidence of untapped potential in rural areas

From these diverge sources; it is difficult to establish precisely the number of SMMEs in rural areas. GEM suggests another approach to the conundrum, which is the comparison of existing entrepreneurs with the potential for further business creations.

One limitation of the GEM methodology is that the business creation potential is self-assessed, i.e. respondents are asked whether they believe that there are opportunities and that they would have the skills necessary to start a business. However, the results are intriguing, and suggestive of a large untapped business potential in rural areas – especially among black people.

Table 3.9 shows that among urban and white and Indian populations, there is little or no potential for more entrepreneurship opportunity; the figures even suggest a negative untapped potential among the whites, presumably because many entrepreneurs realize *a posteriori* that either they do not have the skills, or the market potential is insufficient.

Table 3.10 Untapped potential of “opportunity entrepreneurship”

	White	Indian	Coloured	Black	Small			Total
					Metro	Town	Rural	
Potential opportunity entrepreneurs	7.0%	6.2%	8.1%	5.8%	6,3%	5.4%	6.0%	6.1%
Actual opportunity Entrepreneurs	8.1%	6.2%	6.1%	2.6%	6.3%	3.8%	0.7%	3.7%
Untapped potential	-1.1%	0.0%	2.0%	3.2%	0.0%	1.6%	5.3%	2.4%
No of adults	-38,350	0	49,364	657,139	0	87,008	593,420	665,490

Source: GEM 2001 combined with OHS data.

On the other hand, it seems that, with the appropriate support (including finance, infrastructure and mentoring), there could be a considerable increase in entrepreneurship in rural areas and among coloured and black people. This

suggests that government policy should endeavour to stimulate small business activity among those population groups.

The figures in Table 3.9 have two limitations, though. First, the “actual opportunity index” of 0.7% for rural areas does not mean that there are a few entrepreneurs among rural populations. Rather, GEM indicates that 1.8% of the rural adult population is involved in entrepreneurial activities and 2.9% own established businesses. However these rural business people are mostly characterized as “necessity entrepreneurs”. The scarce job opportunities in rural areas possibly distort the distribution between “necessity” and “opportunity entrepreneurs” leading to an exaggeration of the “untapped potential”.

The second caveat is that the “potential opportunity entrepreneurs” are self-assessed. It is possible that, with their lack of exposure and business experience, rural and black South Africans over-estimate both opportunities present on the market, and their own ability to start a business.

3.5.6 SMMEs’ contribution to the economy

Although statistics about the weight of SMMEs in the economy are frequent and popular, giving reliable and precise estimation is difficult. Once more, the reason is the lack of statistics about the informal sector, which considerably affects the economy. Therefore, again, the approach in this section will be to present multiple sources and estimations and discuss the differences.

3.5.6.1 SMMEs’ contribution to employment

Several technical difficulties arise when comparing the figures below. The definition of “employed” may vary, depending on whether or not they include domestic workers, public sector employment and “self-employed”. The largest disturbing factor, though, is the estimation of the “informal sector”.

Table 3.11: Contribution to Employment by firm size – overview

	Survivalist & Micro	Very Small	Small	Medium	Large	Total
Ntsika 1995 In %	13.66%	13,35%	19.89%	13.77%		100.0%
No of Jobs	901 550	880 000	1 3 13 000	909.100		6 600 000
Ntsika 1997 (1999, p. 35) In %	13.79%	14.44%	16.57%	12.30%		100.0%
No of Jobs	1 033 000	1 068 300	1 225 000	909. 820		7 397 020
Ntsika, 1997 (199, p 41) In %	Informal: 12.8%	"Formal including public sector" 87.2%				100.0%
No of jobs	1 174 000	7 972 000				9 146 000
Abedian, 1997 In %	Informal: 13.0%	"formal SMEs" 38.8%		34.4%		100.0%
No of jobs	1 052 000	3 135 000		3 097 000		7 284 000
Ntsika 2000 & Stats SA 2000 In %	Informal: 26.1%	"micro informal" 12.8%		12.1%	33.6%	100.0%
No of jobs	2 705 000	1 332 003		1 252 000	3 488 653	10 369 000

Sources: Ntsika, 1997, 1998 and 1999 editions (combined data were used);
Abedian, 2001, based on CSS (1998), Employment and Unemployment in South Africa
Ntsika 200, combined with OHS 2000

Comment on the informal sector

In all developing countries, the so called informal sector (consisting of survivalist and micro-enterprise) functions largely as an employment cushion for those with limited skills and young job seekers. Accordingly, the number of micro-enterprise activities typically rises during economic decline.

Nevertheless, assessing the scale and performance of the informal sector, which by definition, comprises statistically unrecorded activities (since recording is typically limited to the formal sector), has been a difficult task – more so in South Africa where the black population used to be prosecuted if involved in such activities. Apart from the difficulty in researching the hidden economy, different definitions of unemployment and full/or part-time self-employment lead to divergent observations.

The 1996 Population Census estimates the number of workers employed in the informal sector to be at least 1.4 million and the total employed labour force to amount to 9.1 million (Ntsika, 1999: 35), while the distribution below

only ascribes 382 400 employees (and 650 500 self-employed) to the informal sector (see second row of Table 3.1) with formal and informal employees not exceeding 7.4 million in 1997 (Ntsika, 1999:51). It is therefore likely that this distribution underestimates the extent of informal sector employment – by perhaps as much as about 1.7 million.

Given the possible inaccuracy of the available data, the hypothesis of a numerically growing informal sector during times of economic decline can be neither contested nor totally confirmed, although its plausibility for South Africa is perhaps emphasized by the fact that it has been frequently observed in other countries.

Data by industries

According to Ntsika (2000), the sectors with the highest contribution to employment by very small (“informal micro”) and small enterprises were the service sector, with a combined 70.9% of employment in “community, social and personal services”, 59.5% in trade, repairs, hotels and restaurants”, and 44.3% in business services. Meanwhile, medium-sized enterprises were significant in agriculture (52.3% of formal employment) and manufacturing (24.6%). These figures, however, could change significantly if the informal sector were included.

Dynamic analysis: are SMEs employment generators?

From Table 3.10, it is tempting to answer the question whether South African small firms are dynamic employment generators. When comparing changes in the distribution of employment over size classes between the successive estimations, it seems that this is the case – although the doubt remains whether the increase of estimated figures comes from a better capture of the informal and smallest activities, or from real change.

Assuming that there has been an actual increase in the demand for labour, the next question is whether this is explained by the growth of individual

enterprises, or by the next formation of new businesses. Dividing the employment figures by the number of establishments can help answer that question. Due to the inconsistencies in data collection, the available data sets only allow for a tentative development of either answer, in particular with regards to informal enterprises.

Acknowledging the possible misrepresentation of actual trends by the available data and returning to the question of SMMEs as employment generators, it seems, one would assume that micro-enterprise and very small business *formations*, and not the expansion of existing SMMEs, account for the overall growth in the SMME sector.

3.5.6.2 SMMEs' contribution to the GDP

Discussing SMME contribution to the GDP is problematic, since the GDP typically records only formal activities, while most SMMEs are active in the informal sector. Therefore, in theory, two approaches are possible: either ignoring the informal sector entirely, which can only give a partial answer to the question on the economic significance of SMMEs; or attempting to quantify the value added generated by informal enterprises.

Table 3.12 suggests that Abedian has made the only attempt to qualify the contribution of the smallest, informal firms to value added. The methodology that he used was to split gross value added into compensation of employees and gross operating surplus. The first part was allocated to the various size categories according to their contribution to employment, while gross operating surplus was allocated to each type of enterprise using assumed weights. Depending on the assumptions he arrived at a combined 12-14.5% of GDP being generated by informal SMMEs.

Table 3.12: Contribution to GDP by size – overview

	Survivalist	Micro	Very Small	Small	Medium	Large	Others	Total
Ntsika, 1995								
In %				21%	12.0%	67.0%		100%
In million R				76 020	43 440	42 540		362 000
Abedian, 1997								
Scenario 1, in %	1.2%	13.25%	9.43%	17.24%	15.11%	43.73%		100%
In million R	7 622	81 572	58 061	106 153	93 076	269 312		615 796
Scenario, 2 in %	1.24%	11.00%	9.4%	14.99%	15.11%	48.23%		100%
In million R	7 622	67 721	58 061	92 302	93 076	297 015		615 797
Ntsika, 1999								
In %				25.2%	8.3%	46.3%	21.2%	100%
In million R				170 585	56 024	312 958	136 314	675 881
Ntsika 2000								
In %			5.8%	13.9%	15.1%	65.2%		100%
In million R			47 027	112 314	121 607	527 070		808 017

Sources: Ntsika, 1995: Abedian, Chapter 1, in: Policy Board for Financial Services, Access to Finance for SMMEs, 2001 Ntsika 1999, Ntsika, 2000, combined with stats SA Release P0441, 2001.

Several improvements could be undertaken to refine this approach. Assuming that compensation of employees is distributed across the size classes according to the employment weights implies that the wage per worker is constant across size classes. There is considerable evidence to suggest that this is not the case. While allocating the share of value added corresponding to compensation of employees between the size categories, it would make sense to assume different salary levels. The assumption that salary levels are homogeneous across the size categories probably led to an overestimation of the contribution of survivalist and micro-enterprises.

On the other hand, Abedian worked with Ntsika's former estimations of employment within survivalist and micro-enterprises, which (as shown in the previous section) are probably strongly underestimated. Moreover, in terms of the absolute figures, it would have been more correct to calculate the value added by informal enterprises as being "on top" of the official GDP of 615.8 billion Rand. Thus the value added by survivalist and micro-business would have been slightly higher.

Nevertheless, Abedian's estimates seem to be a good proxy of the orders of magnitude.

Data by industries

In terms of sectoral distribution, the broad lines are pretty similar to the comments made on the employment figures, with very small and small enterprises dominating in the service sector, and medium-sized enterprises strongly contributing to the agriculture and manufacturing sectors (Ntsika 1999). It should be noted that these data ignore informal contribution due to lack of data.

According to Ntsika (2000), significant differences between employment distribution and GDP appear, however, in two sectors:

- The trade and hotel/restaurants sector, where micro/very small enterprises represent 35.8% of employment but only 3.1% of value added. This suggests that the smallest supermarkets, petrol stations and restaurants operate at very low surplus levels.
- The services (especially finance and business services) sector, where large enterprises contribute to 69.3% of GDP, supposedly referring to the (relatively) high margins of South Africa's large finance institutions.

Dynamic analysis: is the share of SMMEs growing?

The data available barely enables intertemporal comparison. Indeed, both the size categories and the underlying GDP figures are inconsistent. From Ntsika's explanations it is not clearly recognizable whether the "large enterprises' GDP" includes the contribution of public and parastatal enterprises or even the government services.

3.5.6.3 SMMEs' contribution to investment

Another important dimension of the economic weight of SMMEs is their contribution to investment. While there is very little information on this

question, Abedian (1998) has attempted to qualify this figure with a very rough approach as Table 3.13 portrays.

Although this estimation would need to be refined, it is interesting in that it suggests very low investment behaviour of SMMEs compared to their share in employment and production. A reason may be difficulties experienced by these enterprises in getting access to sufficient finance to undertake investments. This certainly requires further attention.

Table 3.13: SMMEs contribution to nominal gross fixed capital formation 2000 (R million)

Sector	Assumptions		SMEs	Large Enterprise	Total
	SMEs	Large			
Agriculture	100%	0%	4 101	0	4 101
Mining	09%	91%	954	9 647	10 601
Manufacturing	40%	60%	12 202	18 304	30 506
Electricity	0%	100%	0	6 980	6 980
Construction	50%	50%	605	605	1 210
Wholesale, retail, catering and accommodation	70%	30%	6 091	2 611	8 702
Transport	20%	80%	3 870	15 480	19 350
Finance	20%	80%	6 370	25 481	31 851
Community service	100%	0%	0	17 018	17 018
Total			33 239	97 081	130 320
Percentage/ Total			25.5%	74.5%	100.00%

Source: Abedian, in: Policy Board report on Access to Finance for SMMEs

3.5.7 Statistical data on SMME – conclusions and recommendations

Any policy decision concerning SMMEs requires accurate information about the size and structure of South Africa's SMME economy. Ntsika aims to facilitate such decision-making by publishing annual reviews on the *State of Small Business in South Africa*. Nevertheless, the data presented in the

various editions of the publication can be improved to meet the requirements of policy makers for a number of reasons.

Ntsika can only encourage Statistical Agencies such as Statistics South Africa and private researchers to address the shortcomings with regard to correctness and coverage of the existing databanks, but it must request SMME data that:

- Is more detailed (both by size-class and by industry instead of sectors).
- Relies on more than just a single data source.
- Reflects changes over time by maintaining the same definitions.

3.5.7.1 Directions for data collection

Improvements to data collection need to be considered in the following areas:

Better coverage of the smaller sized, and in particular, micro sized establishments

The currently reported low contribution of micro-enterprises to total employment contradicts anecdotal evidence and is probably not an accurate reflection of reality. Given the complexity of the task, particularly on the informal sector, it is recommended to proceed with limited-scope samples and case studies rather than using a census-like methodology, which is likely to be too “massive” to capture the subtleties of the informal sector. Some initiatives such as the World Bank Firm Study on the Johannesburg area are likely to provide a number of new insights in this regard, but a similar job would be needed in rural areas. Stats SA’s established series of Labour Market Surveys could also be considered in this regard.

Standardisation of data collection procedures

This particularly applies to sampling methods and definitions, to allow for comparisons between data sources and various years.

3.5.7.2 Directions for data presentation

In certain cases, it is likely that the data is correctly collected but not appropriately presented. It is strongly recommended that Ntsika devote extreme attention to the following issues:

Continuity

Even if improvements of the previous years' methods and results are welcome, they should be presented in such a way that comparison across the years is possible.

Precision with regard to industry

Each of the nine main sectors consists of very diverse activities. According to Ntsika manufacturing alone comprises about 75 industries. While presenting detailed statistics would be too unwieldy, certain industries would need to be singled out, for example manufacturing.

Precision with regard to size: If, for a particular reason, the official size categories provided by the Small Business Act cannot be used, the underlying definitions should be explained.

Disclosure of method and reference population: Tables and graphs should indicate clearly the population they refer to (e.g. whether it is only the formal sector, or formal and informal). The primary sources and the approach used for the data offered need to be explained as well.

3.5.7.3 Directions for data analysis

With more detailed information on SMMEs, data analysis can take a number of additional directions, such as:

- Verification of information obtained from Stats SA with household/labour market and entrepreneur surveys (and vice versa): Recent empirical work such as the 1999 World Bank Survey in the greater Johannesburg and the National Enterprise Survey are first attempts to generate information for representative samples. National-wide coverage and repetition of these surveys is to be encouraged.
- Refinement of estimations on the informal sector: For example, its contribution to employment and value added, based on the newest estimations on the number of firms in the informal sector.
- Generation of data on more precise performance indicators: Apart from the (static) contribution to output and employment, SMMEs' investment behaviour, wage levels and labour productivity inform about their performance.
- Generation of time-series data: The relative growth of the SMME sector and its performance emerges over time. Indicators that require further investigation over time and by industries (and later size-class) are: ratio of employment growth in SMMEs to that of the overall economy; ratio of value added by SMMEs to the overall economy; ratio of the number of SMMEs to that of all establishments; and capital/labour ratio of SMMEs (labour intensity).

3.6 Conclusion

The previous chapter discussed the main functions of SMMEs with an emphasis on the structural features of the South African economy and its implications for SMME growth.

A theoretical consideration was also outlined as to whether SMMEs can resolve the unemployment problem and lastly the chapter attempted to give an overall view of the South Africa's SMME economy with regard to size, profile and the performance of the SMME sector.

In the following chapter, international, regional and local experiences with regard to SMME development will be discussed.