Covid-19

Are we asking the right questions about...

Small businesses and their struggle for survival?

Introduction

On 29 April 2020, CDE hosted a discussion on the effects of Covid-19 on small businesses. The discussion was led by Harvard's Professor Ed Glaeser, and raised many important questions about supporting small businesses during this incredibly difficult period.

Glaeser is one of the world's most prominent economists. He is most famous for drawing attention to the economic benefits of idea exchanges amongst people and between firms in well-managed cities. In addition to Glaeser's valuable contribution, there were presentations by Michael Luca from the Harvard Business School; John Dludlu, CEO of the Small Business Institute; Andrew Donaldson from UCT; and Business Partners'Managing Director, Ben Bierman.

In introducing the discussion, Ann Bernstein said that the challenges small businesses face during this crisis are complex and vital to overcome for South Africa's future. SA does not really know how many SMMEs there are in the country, nor is there agreement about how we should define this sector. Thus, when we use the term small business, we have to be aware that we are talking about a range of enterprises, from informal survivalist firms that are not registered, employ one or two people and have few assets, to formal businesses that employ many people, have significant assets, and enjoy an annual turnover of many millions of rand. All of these firms have been hit hard by Covid-19.

In her view, there is a tendency in South Africa to talk about small business in isolation from the rest of the economy or big businesses. The lockdown has demonstrated in full force how connected small firms are to the rest of the economy – as service providers, as contractors and as key parts of the larger economic and social ecosystem. The realities of interconnectedness also raise critical questions about how we will deal with the (hopefully temporary) disappearance of the positive economic effects that business districts used to generate. Restaurants depend on their neighbouring retailers' being open, and vice versa. To what extent are we going to lose these kind of agglomeration effects, and what are the long-run implications of that?

CDE

May 2020

During the Covid-19 pandemic, CDE will release a new series of publications titled: 'Are we asking the right questions about....'. These will be short reports that contribute to public discussion about the crisis and how the country is responding.

Glaeser's reflections on cities and firms

Professor Glaeser pointed out that the majority of small businesses across the world can be found in service industries in large urban centres. It is these areas where the virus has had the most devastating effect.

This is, however, not a new challenge. For all the benefits that cities generate, urban proximity has always enabled the faster spread of viruses and bacteria. In the past, solutions were discovered to curb the impact of cholera, typhoid and other contagious diseases, which was critical for allowing cities to become centres of prosperity and innovation. Ultimately, cities are the absence of physical space between people. Social distancing is the opposite of that, so, until we get this pandemic under control, the benefits of living in cities could temporarily disappear.

It is not surprising therefore that a survey of US firms undertaken by Glaeser and colleagues at Harvard University at the beginning of April 2020 showed that 46% of businesses of under five employees had already closed down. Few firms believed that they would be able to survive the crisis if it lasted longer than six months.

Covid-19 and small business in South Africa – some survey results

At the beginning of April, StatsSA interviewed 707 small, registered businesses. Almost half of responding firms had temporarily closed their doors; five in six businesses experienced a drop in turnover and almost two-thirds of businesses felt that the impact of this pandemic would be worse than the 2008 recession. StatsSA conducted a second survey between 14 and 30 April, and 2,182 businesses responded. This time 47.9% businesses indicated temporary closure or paused trading activity, while 8.6% had permanently ceased trading. Thirty-eight per cent indicated they faced decreased access to financial resources, while 29.7% said they would survive less than a month without any turnover. The majority of the respondents (56.3%) indicated that they thought they could operate during level 4 of the lockdown. In the first survey, 38.8% expected to implement layoffs. This response increased to 45.6% in the second survey.

A survey undertaken between 7 and 17 April in Cape Town's Waterfront by a team at UCT under the leadership of Andrew Donaldson, indicates that at least 40% of small businesses believe that they won't survive the immediate crisis. The survey revealed that hospitality, food and beverage companies expect to layoff the greatest share of their workforce. If lockdown drags on through May most companies across all the sectors covered in this survey risk closing permanently.

A survey conducted by Retail Capital, a South African based funding company seeking to support small businesses during this pandemic, found that by mid-April 50.5% of small businesses had registered for government assistance, while 14.7% of the sample do not qualify for funding. In addition, 58.2% of the small businesses surveyed had to reduce employee salaries, 27.1% had to retrench their employees and 14.7% had to reduce salaries and retrench their staff. These responses came from a total of 1800 small business across a range of industries, such as: food and beverage; beauty salons and wellness; hotels, hospitality, tourism and travel; general retail.

Another survey conducted by 22 on Sloane, "the largest start-up campus in Africa", working with 120 "businesses and stakeholders" found that 92% of business operations have been impacted and 71% of businesses do not have enough cash to keep their business operational through the next 3 months. Although 83% of the respondents are located in Gauteng province, some have operations in surrounding provinces and neighbouring countries. The services that these small businesses offer mainly include activities such as retail, consulting, ICT and media.

While these survey results are revealing about the extent of the challenge in South Africa, effective government and private sector responses are hampered by the absence of proper data. The SBI's John Dludlu, sees it as a serious problem that South Africa lacks a comprehensive baseline study of small and medium enterprises. Policy makers and experts have based their interventions on widely differing estimates ranging from 670,000 enterprises to 6 million. Before we make large claims about the small business sector and its capacity to contribute to the revival of the economy after the crisis, we need to know much more about its current condition. We do know that these kinds of firms contribute far less to job creation than they did in the 1990s, and that it is probably medium-sized and large firms that have generated most of the employment in the country throughout the 21st century. We need, therefore, to be cautious about how much energy and resources we devote to this sector when designing our economic recovery strategy.

Are government and private sector programmes providing enough assistance?

It is nonetheless imperative that we do as much as is possible to keep small businesses afloat during the various phases of the lockdown. This raises the question of whether the funds set up to assist small businesses are sufficient. If we combine the private and the public-sector measures that have been put in place to assist small businesses, they combine to more than R6 billion to date. This is made up of over R2.5 billion earmarked for SMEs and informal sector operators from government and its agencies. Then there is the R1 billion donated by the Oppenheimer family into the South African Future Trust, which is being administered by SA's leading banks. The money is mostly available to bank clients whose businesses were financially sustainable prior to the pandemic. In addition, R1 billion donated by the Rupert family went into the Sukuma Relief Programme, which is being administered by Business Partners Limited. The programme was launched on 3 April 2020 and was oversubscribed by 6 April, with approximately 10 000 registered applications. The programme's administrators worry about SMMEs 'double dipping' due to a lack of coordination and alignment between various funding platforms. They have also found small businesses require more support than just additional funding.

Government also allocated R200 million specifically for the tourism sector, and small and informal traders are also eligible for commercial loans supported by the R200 billion credit guarantee scheme underwritten by the National Treasury and the Reserve Bank. In addition, those small businesses who have registered employees qualify for special assistance from the UIF. Many employers have been scrambling to submit claims to the UIF and have found that the application format is ever-changing. Frustration towards the funding process further increased when the UIF website crashed two days before April month-end.

It is important to ask whether our strict lock-down measures have made it impossible for most of the smaller, weaker businesses to survive. At level 4 of the lockdown, many companies are still not allowed to open their doors and many small businesses cannot access funding because they do not have the correct paperwork or cannot comply with the funding criteria. For informal businesses in particular, the impact of the lockdown has been devastating. Informal shops are largely reliant on localised supply chains to fill their shelves. Not only is supply being hampered but people living within low-income areas have either lost their jobs or had their salaries cut. While informal traders face the biggest challenges they also find it the hardest to qualify for and to access available relief funds.

Nevertheless, the measures put in place by both government and the private sector to save firms and help employees in the small business sector are extensive, and they will have a positive impact. At the same time, it is impossible to pump more and more resources into this sector. The country cannot afford it.

This raises the issue of targeting the relief measures. On the one hand, not all small businesses are vulnerable to the same extent. Those who are larger, and have more savings, are more likely to survive. Is there then some way to target help towards the most vulnerable? From a different perspective, small businesses frequently fail even when there isn't a pandemic. Is there a danger of propping up weak businesses that may never achieve competitiveness? Shouldn't we rather focus resources on stronger businesses that could go on to prosper and create more jobs in a post-crisis world? As University of Chicago Professor and former head of the Indian Reserve Bank Raghuram Rajan put it recently, "it made economic sense to support everyone (ie all firms) when the pandemic was expected to be shortlived and its effects mild. Now we must make hard choices." However, when considering these complex issues we also have to face the fact that specific targeting measures may be beyond current government capacity.

What is absolutely crucial in finding a way out of this crisis is to allow as many small businesses to operate, while containing the spread of the virus. It will be impossible to achieve the goals of transforming the economy and making it more inclusive if the current barriers to business operation remain. Many businesses could open in a safe and approved way; pay people's salaries and generate taxable revenue. Starting from this pragmatic point of view, John Dludlu spoke out against Minister Ibrahim Patel's depiction of online trading as 'unfair and exclusionary'. Dludlu asked us to consider a popular and free social media platform such as Instagram:

"If you are a user you would know from experience that many small businesses regularly promote their products and services here, find access to new markets and form partnerships and alliances. Surely this is what someone with oversight of the Competition Act should value during a time as testing as the one we currently face. When desirable collaborations of people, products and energy cannot take place in a face to face fashion, online is the next best place where it can. So it must surely be nonsensical to place yet another hurdle in the way of viable businesses on the basis that not all of them have equal access to these platforms?"

Glaeser's guidelines for the future

There is a raft of questions that continue to surround the issue of how small businesses will survive the Covid-19 struggle, and CDE aims to keep drawing attention towards this critical issue.

At the end of the discussion Professor Ed Glaeser put forward some big ideas that could guide South Africans as we seek to find our way out of this crisis, for the country as a whole and for small business in particular.

- "It is possible to think about broad principles that should guide the full and partial lockdown conditions that will be with us in the following months, but it is important not to make lockdown decisions by imitating what other places are doing. Rather draw on knowledge about local conditions and be ready to experiment.

- One principle that applies across contexts is the importance of thinking differently about restrictions on moving goods, compared to restrictions on moving people. Goods can move more safely than people, and if unnecessary restrictions are placed on the movement of goods, total economic breakdown and the spectre of famine become much more likely. It is worth remembering that even during the first plague in Athens as far back as 450BC more people died of famine than died from the disease.

- Massive, undifferentiated loans, are, at best, a stop gap measure. They may halt the carnage for a few weeks, but we need better policies going forward. Such policies must actually weigh the cost and benefits of various restrictions and forms of assistance, and ultimately target aid towards the businesses and more importantly the people that need it and can use it the most.

- We all have an obligation to ensure that nobody suffers any more than they have to. At the same time, though, that does not translate into a permanent obligation to keep every firm alive. That is not how firms and the economy work. Firms can declare bankruptcy, some of them should. As long as we are taking care of the people, especially workers, we can allow businesses to fail, and we are going to have to do that. Some businesses are just not going to be appropriate for the post-pandemic world.

- Despite the crisis and the uncertainty that prevails everywhere we should never lose sight of the need to get the fundamentals right. We should actually see this as an opportunity to renew our commitment to building a regulatory landscape that makes sense for South Africa. We need social policies that make sense and the right policies for health and education and infrastructure. The principles that CDE stood for before the pandemic, are still worth standing for now. Even though we are in a different world, we must remain focused on the things that will allow businesses, both big and small, to grow in the long-run."

CDE Board

L Dippenaar (chairman), A Bernstein (executive director), A Ball, C Coovadia, B Figaji, R Jardine, R Khoza, S Maseko, I Mkhabela, S Nkosi, S Ridley, M Teke, S Zibi

Published in May 2020 by The Centre for Development and Enterprise
5 Eton Road, Parktown, Johannesburg 2193, South Africa | PO Box 72445, Parkview, 2122
Tel +27 11 482 5140 | info@cde.org.za | www.cde.org.za