SMMES IN SOUTH AFRICA: UNDERSTANDING THE CONSTRAINTS ON GROWTH AND PERFORMANCE

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Abstract:

Small, Medium and Micro Enterprises (SMMEs) have been identified as a key component to advancing inclusive growth and development in South Africa. This paper serves to present a snapshot of the current profile of SMMEs in South Africa as well as the key inhibitors of growth for SMMEs. We provide a comparative perspective of the role of SMMEs and entrepreneurship in South Africa, then profile the current landscape of SMMEs in South Africa, evaluating the characteristics of SMMEs across three dimensions: firm, owner and employee characteristics. Following this, we distinguish between formal and informal SMMEs in order to highlight the unique nature of informality in South Africa. This paper also evaluates the endogenous and exogenous impediments to growth faced by South African SMMEs. Endogenous challenges are internal to the firm while exogenous challenges are external to the firm. In summarising these findings, we present the major challenges inhibiting the growth of SMMEs in South Africa, taking into account firm heterogeneity in terms of both firm size and informality status.

Keywords:
SMMEs; South Africa; inclusive growth; development; entrepreneurship; informality.

JEL codes:
E2, E26, J26, J4, J46, O1, O4, O17

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I Introduction

The National Development Plan (NDP) lays out several goals for South Africa for 2030, including elimination of income poverty, reducing inequality, and reducing unemployment to 6 percent. There is a substantial gap between these goals and the current economic climate in South Africa: The incidence of household poverty stands at 57 percent and the unemployment rate at 27 percent. South Africa is also one of the most consistently unequal societies in the world, with a Gini coefficient of 0.69[1] (StatsSA, 2014), which has not changed significantly over the last decade. Acceleration of inclusive growth is therefore crucial if South Africa is to realise significant reductions in poverty, inequality and unemployment.

Small, Medium and Micro Enterprises (SMMEs) have been identified as a key component to advancing inclusive growth and development in South Africa. In the National Development Plan, government highlights the importance of these businesses for job creation, innovation and competitiveness, with the goal that 90 percent of new jobs will be created by SMMEs in South Africa by 2030. The successful entry and growth of these firms may create a sustainable mechanism through which the wages of those at the bottom of the wage distribution can be increased and the level of inequality reduced. Entrepreneurship has often been presented as an alternative for the unemployed who are unable to be absorbed into formal employment. This view is supported by the international literature. For example, van Praag and Versloot (2007), in a systematic review of 56 studies, find that entrepreneurs are an important source of job creation and that there are positive, long-term spill-over effects to entrepreneurship which serve to increase employment growth rates. Furthermore, supporting the growth of existing SMMEs could serve to encourage innovation and employment creation in these businesses. The SME Growth Index (2013) for example, finds that 52 percent of SMMEs on a high growth path increased employment in the last year, compared with only 12 percent of SMMEs with declining turnover.

Owing to the constraints in finding reliable and representative firm data in South Africa, the data used in this paper is from multiple sources. These sources in turn, use alternative methods to classify SMMEs in South Africa, making comparability across datasets difficult. The profile of SMMEs in Section 3 uses individual-level data from the LMD (2013). The latter categorises SMMEs by the number of employees. Using this data, we can distinguish between own-account workers, micro, small, medium or large firms. SMMEs are classified as those firms employing 49 or fewer workers. The discussion in Section 4 around challenges faced by SMMEs, on the other hand, uses firm-level data from various sources. Here, the definition of an SMME varies, but is generally classified as those firms employing 99 or fewer employees.

This paper then serves to present a snapshot of the current profile of SMMEs in South Africa as well as the key inhibitors of growth for SMMEs. Section 2 provides a comparative perspective of the role of SMMEs and entrepreneurship in South Africa. Section 3 profiles the current landscape of SMMEs in South Africa, evaluating the characteristics of SMMEs across three dimensions: firm, owner and employee characteristics. Following this, we distinguish between formal and informal SMMEs in order to highlight the unique nature of informality in South Africa. Section 4 evaluates the endogenous and exogenous impediments to growth faced by South African SMMEs. Endogenous challenges are internal to the firm while

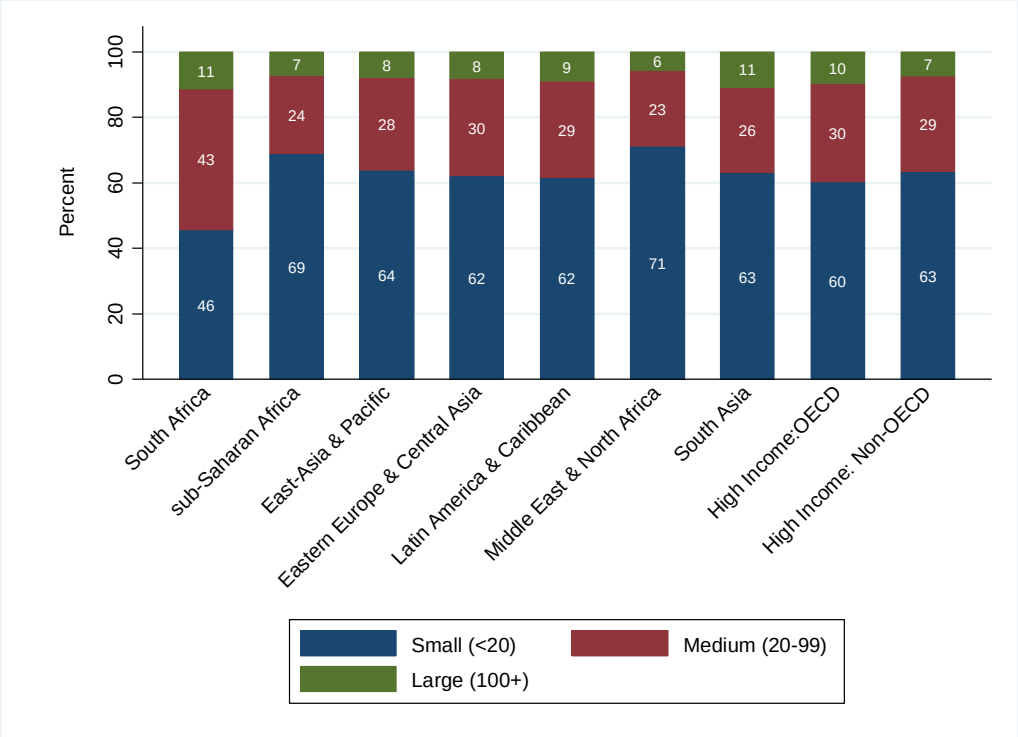
[1] A Gini coefficient of 0 indicates perfect equality, while a Gini coefficient of 1 indicates perfect inequality.

exogenous challenges are external to the firm. Section 5 serves to summarise the findings from Section 3 and 4, presenting the major challenges inhibiting the growth of SMMEs in South Africa, taking into account firm heterogeneity in terms of both firm size and informality status. Here, tentative policy recommendations are made based on the challenges that have been identified. Finally, section 6 concludes the paper.

2 South African SMMEs in Comparative Perspective

The extent to which SMMEs, and entrepreneurship particularly, have been harnessed to increase employment and reduce inequality in South Africa has been disappointing. In low-income countries, formal and informal SMMEs contribute over 70 percent to employment and 60 percent to GDP. In middle-income countries, the SMME contribution to employment and GDP is higher, at 95 and 70 percent respectively (Ayyagari et al., 2007). Conversely, South African SMMEs employ around 56 percent of the workforce (DTI, 2008) and contribute an estimated 45 to 50 percent to GDP (DTI, 2004). The share of firms categorised as SMMEs in South Africa and across regions is illustrated in Figure 1. This figure indicates that 45 percent of firms are small in South Africa—considerably lower than any of the regional averages. Furthermore, South Africa has a relatively large share of large firms, although this average is comparable to that of South Asia and High Income OECD countries.

Figure 1. Firm Size Share by Region: Manufacturing



Source: World Enterprise Survey (2007).
Notes: this data includes manufacturing firms only.

Concentrating on entrepreneurship particularly, Table 1 gives the proportion of the population aged between 18 and 64 engaged in various levels of entrepreneurial activities, using the Global Entrepreneurship Monitor (GEM) data for 2015. This table shows that South Africa ranks low in all three measures of entrepreneurial activity. South Africa's Nascent Entrepreneurship Rate[2] is 5.5 percent, its New Business Rate[3] is 4.9 percent and its Established Business Rate[4] is 5.0 percent, ranking it 35th, 32nd and 53rd out of the 60 countries studies, respectively. All three of these rates are lower than the average for Africa, Asia and

[2] Rate of 18-64 year olds setting up a new business
[3] Rate of 18-64 year olds owning businesses no older than 3.5 years.
[4] Rate of 18-64 year olds owning businesses older than 3.5 years.

Latin America, indicating that levels of entrepreneurship in South Africa lag behind comparative regions.

Table 1. Percent of 18-64 Year Olds Engaged in Entrepreneurial Activity by Region

Region	Nascent Entrepreneurship Rate	New Business Ownership Rate	Established Business Ownership Rate
Africa	12.5	7.9	10.1
Asia & Oceania	6.0	7.4	10.4
Latin America & Caribbean	12.9	7.5	8.5
Europe	4.8	3.1	6.6
North America	9.0	4.8	8.1
South Africa	**5.5**	**4.9**	**5.0**
South Africa: Rank/60 Countries	**35/60**	**32/60**	**53/60**

Source: GEM (2016).
Notes: A nascent entrepreneur is someone setting up a business. A "new business" is a business no more than 3.5 years old. An "established" business is a business which is more than 3.5 years old.

Ultimately, relative to comparable regions, and across a number of different indicators, it is clear that the economic role of small and medium enterprises is unusually marginalised within South Africa. This is linked broadly to the significant barriers to both entry and growth for SMMEs of various sizes relative to large firms in South Africa. For example, while access to credit is a constraint for both SMMEs and larger firms, it is a stronger constraint for growth and entry of SMMEs due to their higher risk profile. Therefore, for SMMEs to absorb a substantial proportion of the unemployed into the labour market, as well as provide wage employment for these individuals, these barriers to growth for small and medium firms must be addressed.

In order to do this, it is necessary to take into account the heterogeneity of SMMEs in South Africa. SMMEs range from informal, own-account enterprises to formal, employment-creating firms. Own-account SMMEs are almost always informal and survivalist in nature. These firms struggle just to remain in business and need substantial support if they are ever to grow to become employment creating firms. On the other hand, formal SMMEs may have the internal capabilities to compete but may be crowded out due to obstacles faced in their broader business environment. Therefore, the challenges faced by SMMEs, and hence the typology of policy interventions, will differ depending on the characteristics of the firm. The following section aims to profile South African SMMEs in order to identify these differences.

3 Profile of SMMEs in South Africa

This section presents an overview of the profile of SMMEs in South Africa. We define SMMEs as follows: Businesses made up of the entrepreneur only and employing no workers are referred to as “Own-account”; businesses with between 1 and 4 employees (excluding the owner) are referred to as “Micro”; businesses with between 5 and 9 employees are referred to as “Small”; businesses with between 10 and 49 employees are referred to as “Medium”; and businesses with 50 employees or more are referred to as “Large”. “SMME” refers to the combination of “Own-account”, “Micro”, “Small” and “Medium” businesses and includes all businesses with between 0 and 49 employees.

Section 3.1 presents the industry, occupation and regional characteristics of firms by the size categories described above. Following this, Sections 3.2 and 3.3 present the owner and employee characteristics by firm size. Lastly, Section 3.4 highlights the distinction between formal and informal SMMEs in South Africa.

3.1 Firm Characteristics

Table 2 presents the industry breakdown by firm size. The largest proportion of SMMEs function within the wholesale and retail industry (30 percent), followed by the community and social services industry (23 percent), the financial industry (14 percent) and the construction industry (11 percent). Thus, small business tends to operate within service industries. The breakdown of SMMEs to more disaggregated firm sizes reveals that more than 50 percent of own-account workers operate within the wholesale and retail sector, a proportion that decreases as the size of the SMME increases. These SMME wholesale and retail jobs are typically categorised as low-skilled occupations, for example shop salespeople, petrol attendants, street vendors, and cashiers.

Table 2: Industry Profile by Firm Size

Main Industry	Own-Account	Micro (1-4)	Small (5-9)	Medium (10-49)	Large (50+)	SMME Overall	Ratio of SMME to Large
Agriculture	1.0	5.7	6.1	6.1	6.2	5.2	0.8
Mining	0.0	0.2	0.9	0.5	7.5	0.4	0.1
Manufacturing	10.4	7.1	7.5	10.8	19.3	9.5	0.5
Utilities	0.0	0.3	0.7	0.7	1.6	0.5	0.3
Construction	7.3	16.3	11.7	9.1	4.8	10.6	2.2
Wholesale & Retail	52.3	29.1	27.9	24.6	10.4	30.4	2.9
Transport	6.5	11.5	6.8	4.2	7.0	6.4	0.9
Financial	9.0	10.0	14.6	16.3	15.7	13.7	0.9
CSP	13.4	19.8	23.9	27.7	27.7	23.3	0.8
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.7
Total	**100**	**100**	**100**	**100**	**100**	**100**	

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: The ratio represents the overall SMME firm industry proportion divided by the large industry proportion. “Transport” indicates the Transport, Storage and Communications Sector.

To expand further on the skills profile of SMMEs, Table 3 presents the major occupations across firm size in South Africa. According to the SASCO skills level classification, over 70 percent of SMME employees are functioning in low- to medium-skill level occupations, with the highest proportion of employees working in elementary occupations (low-skill). Of the elementary workers, most report functioning as farm hands and labourers, street food vendors, and helpers and cleaners in offices. Other major job functions reported amongst SMME

workers were shop salespeople and petrol attendants, other protective service workers (rangers and game wardens), cooks, bricklayers and stonemasons, and motor vehicle mechanics.

This low skills profile of SMMEs may present a barrier to growth, as skills, experience and education are important requirements for the growth and development of a business, specifically the skills and experience of the entrepreneur. Thus, skills development amongst small business owners and employees may be an important enabling factor for development in the sector. Approximately 18 percent of SMMEs function in high skill occupations (professionals and technical and associate professionals), the majority of which are primary and other teaching associate professionals, business consultants and accountants. This is not an insignificant proportion of high skill occupations and it indicates that while most SMMEs service medium- to low-skill industries, some SMMEs are also operating in more skill-intensive industries in South Africa.

Table 3: Main Occupation by Firm Size

	SASCO Skill Level	SMME (0-49)	Large (50+)	Ratio of SMME to Large
Legislators, etc.	Undefined	10.2	7.3	1.4
Professionals	4	5.3	9.4	0.6
Technical	3	12.7	11.1	1.1
Clerks	2	9.9	14.6	0.7
Service and shop sales	2	17.4	12.8	1.4
Skilled agriculture	2	0.7	0.3	2.3
Craft and related	2	13.9	10.5	1.3
Plant & machine operator	2	7.5	12.2	0.6
Elementary	1	22.4	22.0	1.0
Total		**100**	**100**	**-**

Source: Labour Market Dynamics in South Africa (2013), own calculations.

In terms of the location of small firms,

Table 4 presents the provincial breakdown of South African firms. More than 30 percent of South Africa's SMMEs are located in Gauteng, which holds two of the country's largest cities, Johannesburg and Pretoria. The large concentration of small and large businesses in Gauteng is unsurprising as this is a prominent economic hub in the country. Besides Gauteng, the Kwazulu-Natal and the Western Cape also hold a large proportion of both SMMEs and large businesses – which is not surprising given that these provinces also contain large metros with significant economic activity.

The Northern Cape, the North West and the Free State all have a small number of business activity both in terms of SMMEs and large businesses, as these areas generally have low levels of economic activity and are concentrated around agriculture and mining (StatsSA, 2017). A relatively small proportion of SMMEs function within low economic activity areas (combined, approximately 20 percent of SMMEs are located in the Northern Cape, Free State, North West and Limpopo) and these businesses may face greater spatial and network challenges than SMMEs in areas with higher levels of economic activity and better infrastructure. Overall then, South Africa's SMMEs are located in similar areas to large businesses and are generally concentrated around the country's major economic centres.

Table 4: Provincial Profile by Firm Size

Province	Own-Account	Micro (1-4)	Small (5-9)	Medium (10-49)	Large (50+)	SMME Overall	Ratio of SMME to Large
Western Cape	8.5	12.7	17.3	15.6	15.9	14.2	0.9
Eastern Cape	10.5	12.0	10.1	8.9	6.3	9.9	1.6
Northern Cape	0.8	2.1	2.9	2.5	1.9	2.2	1.2
Free State	4.6	5.5	6.7	5.6	4.0	5.6	1.4
KwaZulu-Natal	16.6	16.6	16.2	17.1	17.5	16.8	1.0
North West	4.5	5.0	5.4	5.4	7.3	5.2	0.7
Gauteng	31.9	26.5	27.7	32.7	33.9	30.6	0.9
Mpumalanga	10.1	7.3	6.7	6.0	6.7	7.0	1.0
Limpopo	12.6	12.3	7.1	6.3	6.5	8.6	1.3
Total	100	100	100	100	100	100	

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: The ratio represents the overall SMME firm province proportion divided by the large province proportion.

Table 5 presents a snapshot of worker earnings and wage inequality across firm size. The Gini coefficient measures inequality of wages between workers employed within firms of different size categories. This table indicates that there is a higher degree of wage inequality within SMMEs compared with large firms, with the Gini coefficient measured at 0.81 and 0.65, respectively. This supports our previous finding that there are heterogeneous activities and occupations within SMMEs. For example, small firms serve low-skilled industries (such as street food vendors) that pay low wages, but also serve high skilled, niche industries, such as small professional practices (for example, accountants) who earn very high wages. This results in higher wage inequality within SMMEs than within large firms where there may be a more even dispersion of occupations and skills, resulting in slightly lower levels of intra-firm inequality.

In addition, the prevalence of low pay (those earning below two-thirds the overall median income) falls as firm size increases. While 50 percent of those employed in own-account and micro enterprises are earning a low wage, this falls to 40, 32 and 27 percent for those working in a small, medium and large enterprises, respectively. Furthermore, median income increases as firm size increases, with the median income in large firms more than double that of owner-only firms. This suggests that businesses move from being low-skill oriented to high-skill oriented as the business size increases, with differing occupation types.

Table 5: Inequality and Low-Earners by Firm Size and Formality

	Gini Coefficient	Low-Earners (%)	Median Income
Owner Only	0.89	50.0	2 364
Micro (1-4)	0.78	50.0	2 400
Small (5-9)	0.88	40.0	3 000
Medium (10-49)	0.74	32.4	3 599
SMME overall	0.81	39.4	3 045
Large (50+)	0.65	27.3	4 960
Overall	0.76	34.8	3 564

Source: Labour Market Dynamics in South Africa (2013), own calculations
Note: All figures are based on wages, not overall income. Low-earner rate simulates a poverty rate based on wages; The “low-earner” line is R2376, which is two thirds of the overall median income

Overall, the firm characteristics indicate that SMMEs generally operate in the wholesale and retail and other service industries. Within these industries, we identified that SMMEs tend to operate in low-skill occupations, although a number of small and medium business operated in high-skilled occupations. Geographically, the majority of SMMEs are found in high economic activity provinces. Additionally, wage inequality within SMMEs was higher than in larger firms, indicating that both high and low wage employment exists in SMMEs. Lastly, there is also a higher proportion of low earners in SMMEs than in large firms, although this proportion drops as the size of the SMME increased. Together, this firm profile suggests that although SMMEs are different from large firms overall, there is also heterogeneity across the different size categories of SMMEs.

3.2 Owner Characteristics

Here, we profile the individuals who are most likely to own small businesses in South Africa.

Table 6 presents the characteristics of the self-employed (i.e. firm owners) by firm size. By far the largest group of SMME owners are own-account workers (businesses with no employees), constituting about 63 percent of the self-employed. The proportion of business owners in each SMMEs category decreases as the size of the business increases.

SMMEs have approximately three times more female owners than large businesses, although males own the majority of businesses in all cases. SMMEs also have a higher proportion of young owners. The racial profile indicates that while the majority of SMMEs are owned by Africans, the majority of large firms are owned by Whites. While large firm owners have on average more than a secondary school education, SMME owners, on average, have not completed secondary school. SMMEs are more likely than large firms to be located in rural areas. Lastly, in terms of earnings, median wages are significantly lower for SMME owners than large business owners, which likely follows from the previously noted characteristics of the self-employed—owners of SMMEs more likely than owners of large firms to be female, younger, African and have fewer years of education, all of which are associated with lower earnings levels in the South African labour market.

Overall, these characteristics indicate that SMMEs, as opposed to large firms, present more self-employment opportunities for workers with fewer labour market opportunities, such as females, young workers, Africans and less educated workers. Together, the high proportion of young business owners (less experienced), low levels of education, and low median wages for SMME owners indicate that SMME owners have relatively low skills levels. This supports our previous finding that SMMEs generally operate in low-skill industries and occupations. This further suggests provisionally, that skills development for small business owners may be an important factor for the growth and success of SMMEs, as suggested by Steenkamp and Bhorat (2016).

Table 6: Characteristics of Owners by Firm Size

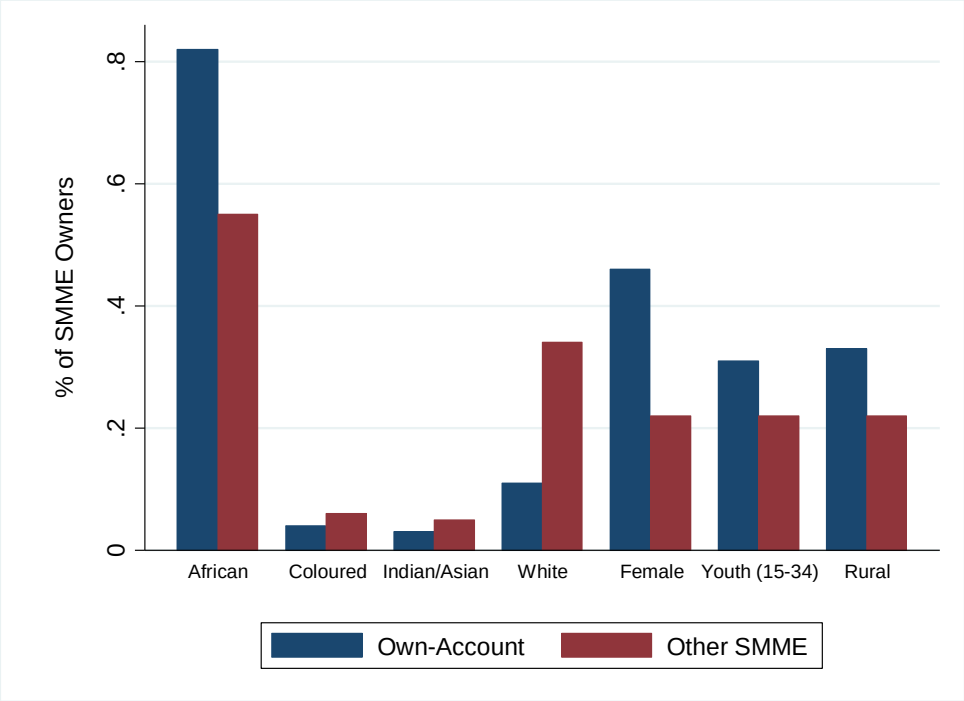
	Own-Account	Micro (1-4)	Small (5-9)	Medium (10-49)	Large (50+)	SMME overall	Ratio of SMME to Large
Female	46.3	23.7	22.3	14.9	12.8	37.4	2.92
Youth (15-34)	31.3	25.7	16.3	13.4	25.0	27.9	1.11
African	82.1	66.1	38.8	28.7	33.2	72.2	2.17
Coloured	3.9	5.5	5.7	5.8	3.9	4.5	1.17
Indian/Asian	3.4	5.1	5.2	7.0	10.4	4.1	0.40
White	10.6	23.4	50.3	58.5	52.5	19.2	0.37
Ave. Years of Education	9.4	10.7	12.2	13.1	12.9	10.1	0.79
Rural	32.8	26.8	14.7	10.0	17.9	28.8	1.60
Median Income	2 364	4 960	11 409	14 881	8 000	3 078	0.38
Weighted N	1 281 678	482 336	121 561	132 708	19 461	2 018 283	-
% of Owners	62.9	23.7	6.0	6.5	1.0	99.1	-
N	7 773	2 658	696	624	87	11 751	-

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Note: The ratio represents the overall SMME statistic divided by the large firm statistic.

Disaggregating within the SMME size categories, we observe that most of the self-employed are own-account workers. The previous finding that SMMEs have a relatively high concentration of employers from disadvantaged groups (females, youth, Africans and less skilled) is even more marked for the smallest SMMEs. We observe a very clear structural breakdown of these owner characteristics as the size of the SMME increases from own-account worker to businesses with employees. As seen in

Figure 2, 82 percent of own-account workers are African, while on average 55 percent of the remaining SMME owners are African; a similar trend exists for the proportion of youth and females. Median wages also increase considerably as the business moves from own-account worker to becoming a larger SMME. Thus, of SMMEs, own-account workers are the most vulnerable group and most likely to represent survivalist enterprises. Interestingly, as firm size increases for SMMEs, owner education levels and median wages actually surpass that of large firms. This indicates higher skills and experience levels amongst small and medium SMMEs and suggests that the higher skilled SMME occupations (professionals and technical and associate professionals from Table 3) may be found amongst small and medium sized businesses.

Figure 2: Owner Characteristics: Own-Account and Other SMMEs



Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: "Other SMME" includes entrepreneurs employing between 1 and 49 workers.

Overall, the profile of SMME owners indicates that these entrepreneurs, and specifically own-account workers, have relatively poor labour market prospects. The owners of these firms are likely to have few employment alternatives and their livelihoods depend heavily on the success of their business. The profile of own-account workers combined with the large number of own-account businesses relative to other firm sizes, also suggests that this form of self-employment presents the lowest barriers to entry for this group. For example, an own-account entrepreneur does not require the skills necessary for employing workers (as is the case for larger SMMEs). This may also indicate that these businesses struggle to reach levels of productivity which would allow them to hire employees. The presence of both low and high skilled SMMEs also suggests that there is heterogeneity in the type of SMMEs that operate in South Africa, where the owners of these businesses face varying challenges to growth and development, depending on the type of business.

3.3 Employee Characteristics

Now that we have a sense of the characteristics of SMME owners, we consider the profile of the workers employed by SMMEs in South Africa.

Table 7 presents employee characteristics by firm size.

From Table **11** we observe that 58 percent of workers are employed in SMMEs, and most of these are found in medium sized businesses (10-49 employees). Overall, SMMEs and large firms tend to have similar employee characteristics: both employ more males, fewer youth, and mostly African workers in almost equal proportions. However, SMME employees earn lower median wages than large firm employees, which may be partially driven by the marginally lower average years of education and higher rural employment in SMMEs. This also indicates that there may be more low-skilled workers employed in SMMEs than in large firms, considering the skills profile presented in Table 3.

Table 7: Characteristics of Employees by Firm Size

	Micro (1-4)	Small (5-9)	Medium (10-49)	Large (50+)	SMME Overall	Ratio of SMME to Large
Female	33.8	41.2	44.2	38.9	41.3	1.06
Youth (15-34)	43.1	45.2	42.4	41.5	43.0	1.04
African	74.0	65.7	68.2	69.5	69.1	0.99
Coloured	7.7	12.1	12.0	12.7	11.0	0.87
Indian/Asian	3.6	2.7	3.8	4.3	3.6	0.84
White	14.7	19.5	16.0	13.6	16.3	1.20
Ave. Years of Education	10.0	10.8	11.3	11.4	10.9	0.96
Rural	32.3	24.0	20.1	17.4	23.6	1.36
Median Income	2 400	3 000	3 599	4 960	3 185	0.64
Weighted N	1 571 209	1 173 309	4 063 998	4 842 825	6 808 516	-
% of Employees	13.5	10.1	34.9	41.6	58.4	-
N	9 147	7 068	23 496	26 753	39 711	-

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: The ratio represents the overall SMME statistic divided by the large firm statistic.

Thus, the distinction between SMMEs and large firms, as well as across SMMEs of various sizes, is predominantly driven by differences between owners rather than differences between employees.

3.4 Profile of Formal and Informal SMMEs

SMMEs tend to have more characteristics of survivalist firms compared to large firms, especially those in the smallest size categories. However, even amongst own-account businesses, which appear most vulnerable, there is likely to be a difference between those that are formal and informal in both the challenges they face and the policies needed to address them. In order to delve more deeply into the different types of SMMEs as well as the growth paths they may follow, this section examines the informality status of SMMEs as a key marker of vulnerability.

StatsSA uses firm characteristics to classify employed persons into the formal and informal sectors, which is the definition of informality used in this section.[5] Employers, own-account workers and unpaid household workers are all classified as being in the formal sector if they are registered for *either* income tax *or* Value Added Tax (VAT). Employees are classified as formal sector workers in two stages. First, if income tax is deducted by the employer they are classified as formal sector workers. Second, if income tax is not deducted by the employer, then they are classified as formal sector workers if the establishment has 5 or more workers.

[5] A broader definition of informality is often used in South Africa, that of informal employment. This dual definition considers both the characteristics of the firm and the employment relationship between firm and worker. Our analysis uses the informal sector definition in all calculations. This is because the aim of this paper is to review the constraints to SMME growth from the perspective of the firm, and not the employee.

BOX 1: INFORMALITY IN CONTEXT

South Africa is relatively unique in the developing country context in that the informal sector is unable to act as a successful buffer against unemployment. In many developing countries, the unemployment rate is low as many the low-skilled workforce is employed in the informal sector, mostly in survivalist enterprises. In South Africa, however, there are barriers to entry into the informal sector and this, coupled with a shortage of employment opportunities in the formal sector, leaves the unemployed with few opportunities to earn an income. These informal sector barriers in South Africa have historical roots. Apartheid-era legislation enforced spatial segregation which left many black South Africans in informal settlements, separated from the city centre and geographically distant from labour market opportunities. In addition, relatively high levels of labour law enforcement in South Africa may be hampering growth in informal activities (Fernandez et al., 2017).

As seen in Table 8 below, South Africa has a relatively small rate of informality, with only 29 percent of individuals in informally employment. This is less than half the average informality rate for sub-Saharan Africa, and well below the informality rate of many developing regions. Therefore, there is a dire need to put policies in place which serve to increase participation in the informal sector, because for many labour market participants, informal sector employment may be a realizable alternative to unemployment. Successful policies which promote access to and growth in the informal sector could potentially serve to decrease inequality by absorbing marginalised individuals into the economy.

Table 8. Informality Rates by Region

	Informal Employment/ Non-Agricultural Employment
Latin America & the Caribbean	51
Sub-Saharan Africa	66
Middle East & North Africa	45
Eastern Europe & Central Asia	10
South Asia	82
East & South-East Asia &d Pacific	65
China	33
South Africa	**29**

Source: Vanek et al. (2014), authors' own calculations.
Source for South African data is QLFS 2016 Q3.

Table **9** provides the proportion of SMME owners and employees in the informal sector in South Africa. While the majority of SMME owners are operating in the informal sector (69 percent), a small proportion of the SMME workforce is in the informal sector (16 percent). This is linked to the fact that the vast majority of SMMEs are owner-only (i.e. do not hire any employees) and that 87 percent of these SMMEs are found in the informal sector. As the size of the SMME increases (i.e. more workers are employed), the propensity to operate in the informal sector decreases. Therefore, the informal sector is a relatively small source of secondary employment in South Africa.

Table 9: Informality Rate of SMME Owners and Employees

	Owner	Employee
Owner Only	86.9	-
Micro (1-4)	54.0	69.1
Small (5-9)	15.3	2.0
Medium (10-49)	3.3	0.2
SMME Overall	69.2	16.4

Source: Labour Market Dynamics in South Africa (2013), own calculations.

3.4.1 Owner Characteristics

Table **10** presents the characteristics of SMME owners across the informal and formal sectors. Businesses in the formal sector tend to have more male, non-youth and white owners, who have on average a post-secondary school education (and are thus relatively well educated). Formal SMMEs also have high median owner wages—more than four times larger than those of informal sector entrepreneurs. These types of businesses may have higher entry barriers for workers with poorer labour market outcomes, such as females, youth, Africans and the less skilled, as these groups are poorly represented amongst formal sector business owners. Informal sector SMMEs are also most likely to be located in rural areas, and their owner median earnings are very low, at only R2426 per month.

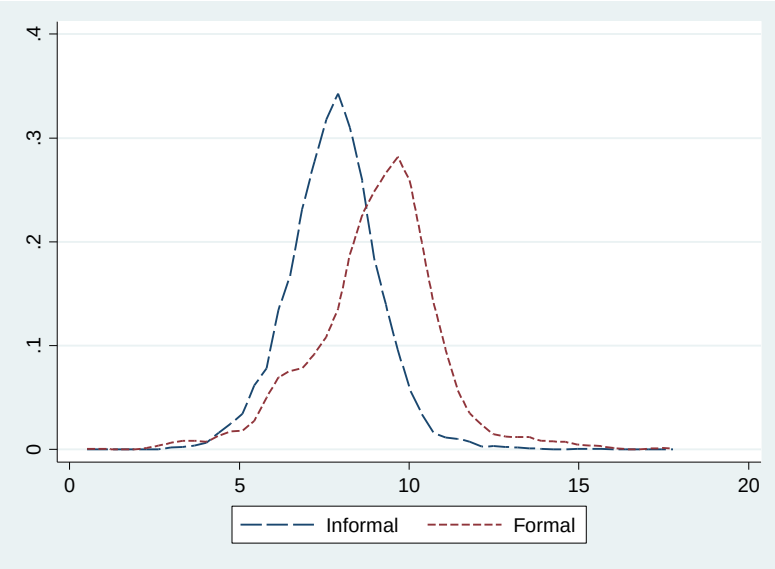
Figure **3** presents the kernel density plots of the distribution of log of earnings for formal and informal SMME owners. From the figure, we observe that formal SMMEs owners earn higher incomes, while informal SMMEs owners have lower, and slightly less variable incomes. This is likely due to the fact that labour legislation, such as minimum wages, does not cover the informal sector. This allows for lower wages at the bottom end of the wage distribution in the informal sector than the formal sector, where labour legislation is enforceable.

Table 10: Characteristics of SMME Owners, Formal and Informal

	Formal SMME (0-49)	Informal SMME (0-49)	Ratio of Formal to Informal
Female	25.3	42.8	0.59
Youth (15-34)	17.7	32.4	0.54
African	34.1	89.1	0.38
Coloured	7.1	3.4	2.11
Indian/Asian	8.6	2.1	4.11
White	50.2	5.5	9.20
Ave. Years of Education	12.6	9.0	1.40
Rural	10.9	36.7	0.30
Median Income	10 000	2 426	4.12
Weighted N	620 654	1 397 629	-
% of SMME Owners	30.8	69.2	-
N	3 302	8 449	-

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: The ratio represents the formal SMME statistic divided by the informal SMME firm statistic.

Figure 3: Distribution of Log of Owner Earnings, Formal and Informal SMME



Source: Labour Market Dynamics in South Africa (2013), own calculations.

These differences between the profiles of formal and informal small business owners suggest that there is significant heterogeneity amongst entrepreneurs in the two groups. Informal small businesses seem to represent survivalist firms, whose owners have poor alternative labour market opportunities and whose welfare might therefore rely heavily on the income from their business. Informal business owners therefore represent labour market participants who face significant barriers to entry as entrepreneurs in the formal sector. The combination of young, poorly educated and low earning entrepreneurs in informal SMMEs also indicates that these businesses have the lowest skill and experience requirements for owners. Arguably, it is these different characteristics which require both a contrasting set of policy solutions for each component of this SMME cohort, but in turn also may present alternative contributions to a

more inclusive growth agenda. For example, assistance to informal firms may be viewed as part of a poverty reduction strategy of the state, whilst interventions for formal SMMEs could be an attempt to increase wage employment levels and to redistribute market share amongst a larger set of firms.

3.4.2 Employee Characteristics

Table **11** expands on the differences between formal and informal SMME employees. From the table, we observe that the vast majority of SMME employees are employed in the formal sector, as discussed previously. Both the formal and informal sectors hire more males, although the informal sector employs fewer females than the formal sector. This is linked to the definition of the formal and informal sector used, which excludes private household workers, the majority of whom are female. Informal SMMEs employ relatively more youth than formal sector SMMEs. The largest proportion of African workers are found in the informal sector. Formal sector workers have substantially more education than informal sector workers, indicating that a poorly educated workforce is a greater constraint for small informal businesses that small formal businesses.

Table 11: Characteristics of SMME Employees, Formal and Informal

	Formal SMME (1-49)	Informal SMME (1-49)	Ratio of Formal to Informal
Female	43.2	31.4	1.38
Youth (15-34)	41.9	48.9	0.86
African	65.8	85.9	0.77
Coloured	11.8	7.2	1.64
Indian/Asian	3.8	2.2	1.77
White	18.6	4.7	3.94
Ave. Years of Education	11.3	9.2	1.23
Rural	20.4	39.9	0.51
Median Income	3552	1984	1.79
Weighted N	5 693 254	1 115 263	-
% of SMME Employees	83.6	16.4	-
N	33 048	6 663	-

Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: The ratio represents the formal SMME statistic divided by the informal SMME firm statistic.

Lastly, in terms of income, median wages are almost two times higher in the formal sector (where labour legislation such as minimum wages apply) than in the informal sector. This distinction in wages for employees in the formal and informal sectors supports our hypothesis that informal sector employment is a driver of wage inequality. However, if the nearest alternative to informal sector employment is unemployment, and therefore zero wages, then employment in the lower-paying informal sector will improve overall inequality. For this reason, it is concerning that the informal sector provides such a small proportion of SMME employment, approximately one fifth of that of the formal sector. Indeed, as a route into formal sector employment—and as a process towards a good job as it were—the portal provided by informal microenterprises is critical.

3.4.3 Informal Sector Firm Characteristics

Besides entrepreneur and owner characteristics, we now explore further heterogeneity amongst SMMEs in the informal sector. Table **12** presents some of the business characteristics of informal businesses. From the table, we observe that the vast majority (85

percent) of informal businesses are represented by own-account workers. The majority of the remainder of informal firms are micro businesses and there are very few small and medium informal businesses[6]. From the table, we observe that very few informal businesses have operating licenses or permits, at 11 percent overall. In terms of turnover and average net profit, our previous observation that informal own-account businesses represent survivalists is confirmed. Here we observe that the turnover of own-account businesses is approximately half of that of micro firms, and that this gap widens as firm size increases.

[6] We exclude medium-sized informal sector firms from this table as there were only two observations of such firms in the SESE (2013) data.

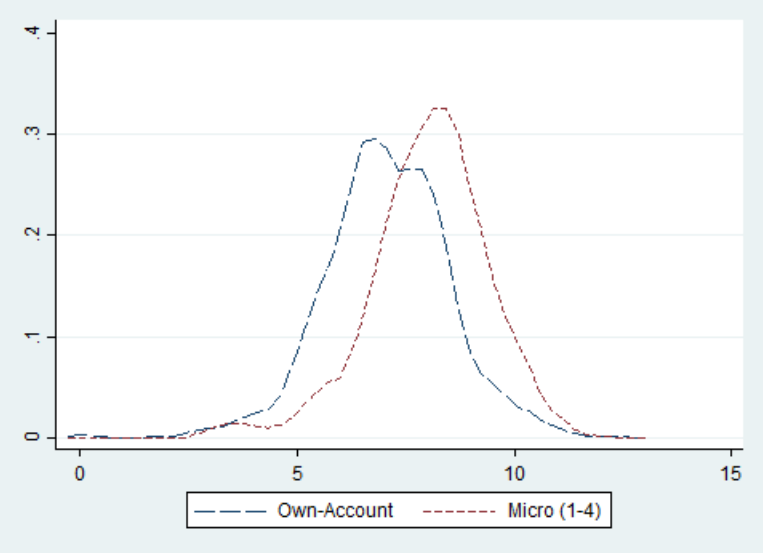
Figure 4 illustrates this distinction between the turnover of own-account and micro enterprises more clearly. Besides lower average turnover, the figure indicates that the turnover of informal own-account businesses remains below that of informal micro enterprises at all points of the distribution.

Table 12: Characteristics of Informal Firms

	Own-Account	Micro (1-4)	Small (5-9)	Overall
Licensed	8.2	23.8	69.0	11.0
Monthly Turnover	3 146	6 284	81 567	4 382
Monthly Average Net Profit	2 180	3 555	42 629	2 790
Monthly Employee Pay	-	1 518	12 549	2 337
Average Profit/Turnover	69.3	56.6	52.3	63.7
Use of Profit				
-Reinvest in business	14.6	25.6	44.6	16.4
-Spend on household items	72.1	54.5	13.1	69.1
Weighted N	1 168 050	185 675	14 106	1 369 505
% of Informal Firms	85.3	13.6	1.0	100
N	1 517	207	15	1 741

Source: SESE (2013), own calculations.
Notes: Businesses larger than small are not presented due to small sample size.

Figure 4: Distribution of Log of Monthly Turnover: informal own account and informal micro.



Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: Firms larger than micro were excluded due to small sample size.

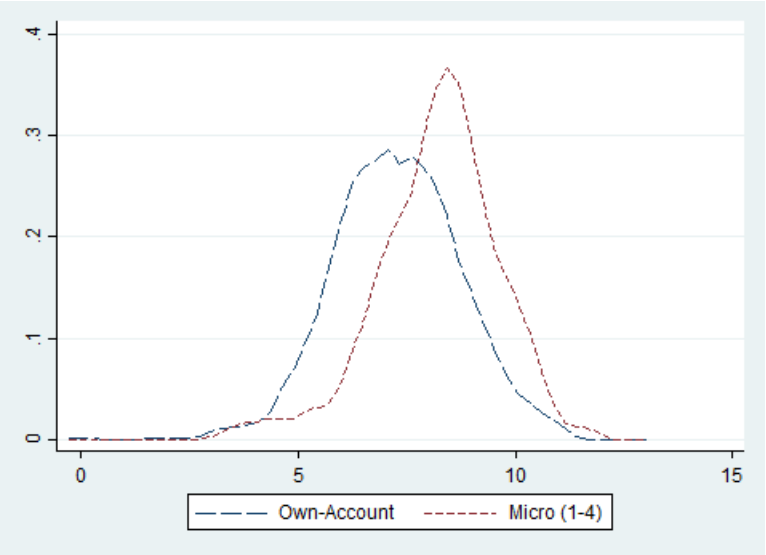
In terms of profits, the majority of informal SMMEs treat profits as a form of wages, where approximately 70 percent of informal business owners reported using their profits to buy household items. The proportion of owners who re-invest profits into the business increases as the business size increases, where over 72 percent of own-account business owners use profits for household expenses. This supports our hypothesis that the majority of informal own-account businesses are survivalist firms, where the livelihood of these business owners depends heavily on the income from the business.

Besides the use of profit, we observe that the Rand value of profits of informal businesses is very low. Informal SMMEs have average profits of R2790 per month, which is lower than the overall median SMME owner wage of R3078 (from

Table **6: CHARACTERISTICS OF** as well as the overall median SMME employee wage of R3185 (from

TABLE 7). These overall low profits are driven primarily by the profits of own-account businesses, while profits rise as the business size increases. Absolute net profits of own-account businesses are approximately only half of that of informal micro enterprises. It is important to note however, that profit as a proportion of turnover tends to be higher for own-account businesses than for larger SMMEs. This is likely due to the fact that own-account businesses do not have any employee costs. Figure 5 illustrates the distribution of profit for own-account and micro informal businesses. The table confirms the observation that micro businesses earn higher profits than own-account workers at all points along the profit distribution. We also observe that the profits of informal micro businesses are slightly less variable than those of informal own-account businesses.

Figure 5: Distribution of Log of Average Monthly Profit by Firm Size



Source: Labour Market Dynamics in South Africa (2013), own calculations.
Notes: Firms larger than micro were excluded due to small sample size.

Overall, we have observed clear segmentation of the owner characteristics for formal and informal SMMEs, where formal SMME owners tended to be majority male, non-youth, White and high-skilled—individuals who generally have good labour market prospects in terms of employment and wages. On the other hand, informal SMME owners were represented by relatively more females, youth, Africans and low-skilled individuals—those that generally have poorer labour market prospects. Thus, we observe heterogeneity in the types of individuals who are likely to own formal and informal businesses, with initial evidence that the informal SMME sector presents more opportunities for survivalist businesses. The informal SMME firm characteristics indicate that there is further heterogeneity of business outcomes within the informal sector. While informal SMMEs overall represent survivalist type firms, own-account informal businesses drive this phenomenon.

Larger informal SMMEs are able to generate higher gross incomes through their sales and services than own-account businesses. This could be due to the fact that a larger productive workforce in certain sectors and product markets is more equipped to drive sales than a single person business. Besides turnover, we also observed that larger SMMEs were able to convert more of their turnover into absolute profits, and that these profits were more likely to be re-invested into the business. Informal own-account businesses on the other hand, were less productive in the sense that they presented lower absolute profits than larger SMMEs, and their profits were generally used for private expenses, as opposed to being re-invested into the business.

These lower profit levels and the difference in the likelihood of re-investment into the business indicates that there is greater heterogeneity in the growth prospects of informal own-account

businesses and larger SMMEs. The smaller profit base and lack of re-investment observed for own-account businesses may hinder growth and development opportunities in these businesses. On the other hand, the relatively high profits and re-investment rates for larger SMMEs are likely to encourage growth and development.

It is clear from the overall profile of SMME firms, owners and employees presented that there is a distinction between SMMEs and large firms in South Africa, particularly in terms of firm and owner characteristics. More importantly, we identify heterogeneity across South African SMMEs of different sizes. Specifically, there is a clear distinction between SMMEs which have employees and those which do not. Own-account businesses are typically owned by individuals who are at a higher risk of poverty and unemployment. There is also a high informality rate amongst these types of businesses, indicating that, for these individuals, there are lower barriers to entry into the informal sector than the formal sector.

This distinction between own-account and employment-creating SMMEs indicates a bifurcated market for SMMEs in South Africa. This suggests that the impediments for growth and entry for these two types of SMMEs will differ. The following section will attest to the veracity of this distinction.

4 Factors Constraining SMMEs in South Africa

Individuals face many challenges in starting and growing their own businesses. Below we consider these challenges under two distinct categories: *endogenous* and *exogenous* obstacles to entry and growth. Endogenous obstacles include those which are internal to individuals who wish to start a business. Broadly speaking, these are challenges which concern availability and access to resources (both physical and non-tangible) at an individual level. The second category of constraints, exogenous obstacles, includes all external economic and political factors which create an environment which is not conducive to the entry and development of SMMEs in South Africa. Broadly speaking, these external constraints can be divided into two main areas of concern: access to markets (the economic environment) and regulation and governance (the policy environment).

We note here that there is a significant degree of interaction between the endogenous and exogenous factors. Challenges that emanate from the macro level impact on the access to resource problems which individuals encounter at the micro level. This interaction is particularly strong in a country such as South Africa, that exhibits high levels of inequality and in which the history of apartheid still exerts great influence on the socio-economic outcomes we observe today.

4.1 Endogenous Obstacles

4.1.1 Lack of Financial Assets

In order for businesses to operate effectively they must have access to various physical assets. For example, a construction business might need power tools in order to function, and a food retailer might need a cold storage unit to hold stock. Besides basic operation, businesses also need access to assets in order to grow and remain competitive. According to the SME Growth Index data (Business Environment Specialists, 2014), high levels of business investment in assets such as these are associated with significantly higher growth levels, particularly for SMMEs, and small businesses with the lowest levels of investment are most likely to shrink.

In order to purchase these physical assets, business owners either need private access to finance or they need access to credit. The majority of investments needed to start and develop a business are greater in value than what the average South African entrepreneur is able to afford privately. For example, most South African's require credit in order to purchase a motor vehicle, a common input for a business. Thus, in most cases business owners, irrespective of firm size, will require access to credit in order to make the required investments necessary to start, maintain and grow a business. In the case of SMMEs in particular, as we noted in the profile of small business entrepreneurs, SMMEs owners are generally individuals with relatively poor socio-economic characteristics—female, young, African and poorly educated—and these individuals are therefore even less likely to have access to private finances, for example through savings or inheritance. Access to credit, specifically affordable credit, is therefore particularly important for small business owners. This is reinforced in

Table 13 below, which outlines the access to and use of financial products for small, medium and large businesses. The table indicates that small and medium businesses are more likely to need a loan than large businesses, suggesting that SMMEs are less able to privately finance their investments and costs than large businesses. An empirical study by Makina et al. (2015) also reinforces the notion that small firms gain more from access to credit, as the paper finds that access to formal credit has a significant positive effect on SMME business growth and size.

Table 13: Access to and use of Financial Products

	South Africa Small (5-19)	South Africa Medium (20-99)	South Africa Large (100+)	Ratio: Large to Small	Ratio: Large to Medium
% of firms not needing a loan	42.9	54	63.1	1.47	1.17
% of firms with a checking or savings account	96	99.4	100	1.04	1.01
% of firms with a bank loan/line of credit	22.9	35	40.4	1.76	1.15
% of loans requiring collateral	69.6	74.1	65.6	0.94	0.89

Source: World bank enterprise survey (2007)
Notes: Data is for manufacturing firms only.

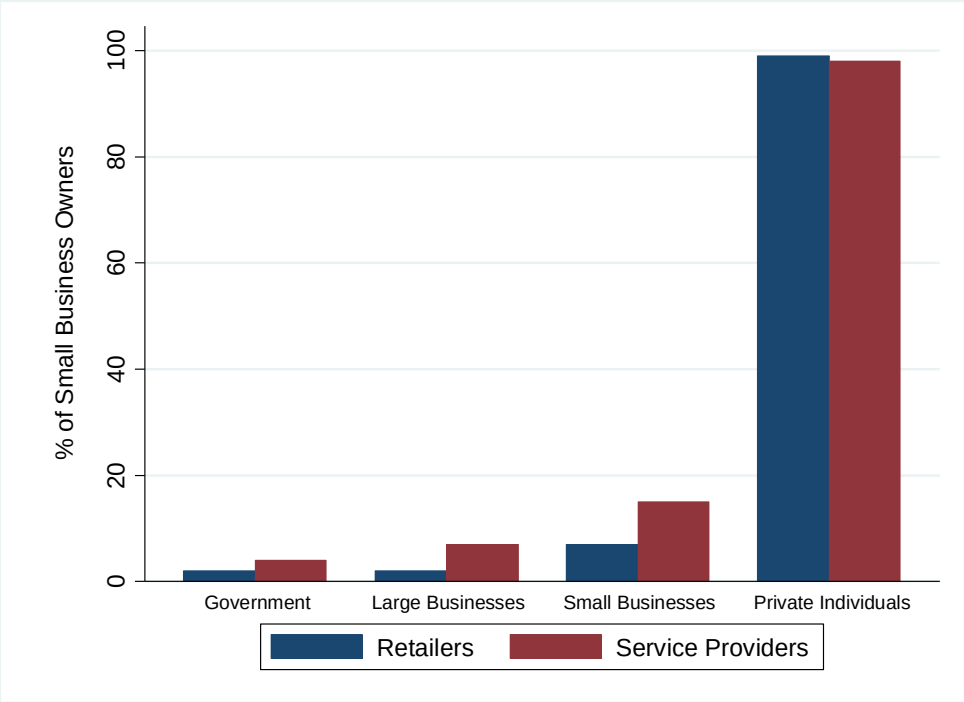
While we have identified that access to affordable credit is an important factor in the establishment and growth of small businesses, gaining access to credit is widely quoted as a significant challenge for small business owners. FinScope (2011) finds that access to credit and access to affordable credit are amongst the most regularly reported obstacles for growth amongst SMME owners. The report also finds that approximately 42 percent of SMME owners are financially excluded—meaning that they do not use any formal or informal financial products or services, and that any saving that does occur happens at home, while any borrowing is from friends or family. As

Table **13** indicates, large businesses are far more likely to have a bank loan or line of credit, and are more likely to make use of other financial products such as chequing or savings accounts. Larger firms are also more likely to use loans to finance investments and working capital, while small and medium businesses are more likely to finance investments internally or through supplier credit. This suggests that while SMMEs are the most in need of credit from financial institutions, they are least likely to get it, or alternatively, are not offered credit at affordable rates, leaving SMMEs with relatively little credit.

This difficulty for small business owners in gaining access to credit is likely due to the conservative lending practices of banks. In deciding whether to provide credit to an entrepreneur or business—and the rate at which credit is offered—banks rely on the credit risk profile of the owner or business. According to FinScope (2011), an owner or business risk profile depends on factors including the sustainability of the income of the business, whether there are alternative income sources, and attitudes towards risk and risk mitigation. The report presents an analysis of these factors for SMMEs.

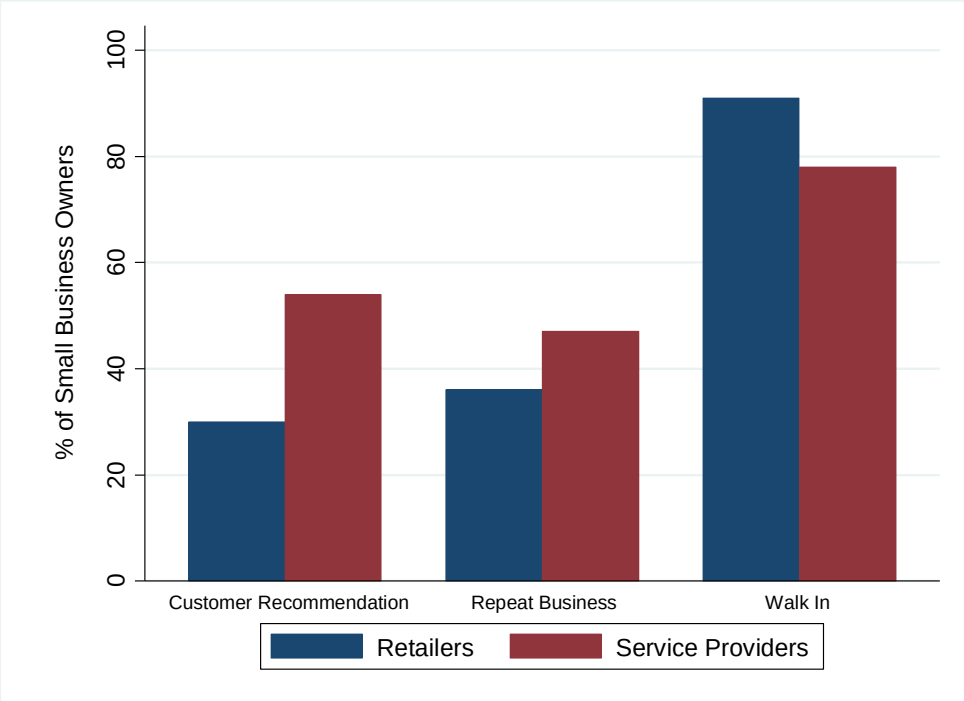
Generally small businesses tend to have relatively unsustainable incomes. From Figure 6 we observe that SMMEs rely mostly on private individuals as customers, as opposed to other small businesses, large businesses or the government, which are perceived as more consistent customers. As we observed from Table 2, there is a high concentration of SMMEs in the retail and wholesale industry which generally trades in the final product market. This market is more likely to serve private customers, as opposed to other businesses and government, thus we might expect to see this trend for the retail SMMEs. However, Figure 6 reinforces this pattern for services orientated SMMEs, illustrating that the incomes of even non-retail SMMEs rely on private customers. From Figure 7, we observe that SMME customers are most likely to be “walk in” customers, rather than repeat customers, or customers referred to the business. This pattern is most marked for retail SMMEs, which we might expect given the nature of the final product market. Services SMMEs tend to have slightly more repeat and referral customers, however they are also dominated by “walk in” customers.

Figure 6: Type of customers of small businesses in South Africa



Source: FinScope, 2011

Figure 7: Customer acquisition



Source: FinScope, 2011

A business owner's risk profile will also be influenced by how many alternative sources of income they have. For small entrepreneurs, particularly own-account workers who we observed in the profile section as having poor labour market alternatives, few alternative income streams exist. FinScope (2011) finds that for 67 percent of SMME owners, their business was their only source of income. This makes SMMEs riskier for credit providers, as they are more likely to default when the business provides less income.

Many entrepreneurs also have poor experience with business and financial management. FinScope (2011) finds that more than half of SMMEs did not keep financial records, and of the owners who did, 81 percent did not receive any assistance with their record keeping. For the informal sector specifically, SESE (2013) indicates that 86 percent of SMME owners had not been exposed to any financial literacy courses. Furthermore, 78 percent of informal small businesses report not keeping any business accounts—the majority of these businesses chose not to keep records because they either believed the business to be too small, or they did not see any reason to keep records. In terms of business advice and information, most owners relied on themselves and did not seek business advice elsewhere. For those owners who did seek advice, the main source of business advice came from friends and family (FinScope, 2011; SESE, 2013). FinScope (2011) also reports that SMME owners generally had poor coping strategies for the major threats to their businesses. For example, 35 percent of retail SMME owners reported having no coping strategy in place should they experienced theft or loss of business stock, and a further 14 percent did not know what they would do in this event. Only around 2 percent indicated that they would claim from insurance. This illustrates a poor knowledge of business and finance management amongst many SMME owners as well as poor risk mitigation strategies, an unfavourable factor for the risk profile of these entrepreneurs.

Overall, these factors—no alternative income sources, unsustainable income streams, poor business and financial management skills, and a lack of risk mitigation strategies—result in high credit risk profiles for SMME entrepreneurs. These factors make SMME entrepreneurs unattractive to formal lenders, where the perceived risk of defaulting is high. Thus, because of the conservative nature of banks and other formal lenders, entrepreneurs, specifically nascent entrepreneurs, face major challenges accessing credit. In the event that these businesses do access credit, it comes at unaffordable rates as the credit market perceives the need to mitigate risk.

Table **13** provides evidence for this, where the loans of large businesses are less likely to require collateral than those of small and medium businesses.

These findings are to be taken in the context of different types of SMMEs. These limitations to credit are mostly relevant for younger SMMEs, while the Business Environment Specialists Report (2014) quotes the following for more established SMMEs (approximately over five years old):

"*While access to finance is undoubtedly an important enabler, a lack of access does not seem to be a crippling problem. Our results suggest that South Africa's established SMEs are in general finding the funding they need*."

In summary, this section has identified that access to credit is important for the establishment and growth of SMMEs, particularly very young SMMEs, compared to large businesses which are better equipped to find alternative resources. Access to credit is a relatively significant constraint for SMMEs given that they are perceived by lenders to be riskier. Thus, lending institutions often reject credit applications from SMME entrepreneurs, or offer credit at unaffordable rates. While this is the case for the youngest and least mature SMMEs, this is not necessarily the case for established SMMEs, as these businesses are generally able to find the credit they require (Business Environment Specialists, 2014).

4.1.2 Human Capital

4.1.2.1 Education and Training

As noted in the profile section, small business owners have lower levels of education when compared to large business owners. In order for entrepreneurs to successfully start and grow a business, they require certain skills that can be developed through education and training programmes. A lack thereof can present a major constraint for SMMEs. Here, we elaborate on the education profile of entrepreneurs by firm size.

Table 14 indicates the proportion of firm owners with various levels of education by firm size. This table indicates that the education level of the owner increases systematically as firm size increases. Own-account entrepreneurs are more likely to have less than a secondary school education than both larger SMME and large firm owners. Furthermore, owners of own-account businesses are least likely to have completed secondary education or tertiary education. This suggests that owners operating the smallest businesses may struggle to expand due to a lack of education and skills. Looking at the informal-formal split, the education characteristics of owner-only business owners are very similar to the characteristics of informal business owners.

Furthermore, using the World Bank Enterprise data (2007),

Table **15** shows that large manufacturing firms are substantially more likely to offer formal training than small or medium manufacturing firms. While only 24 percent of small firms offer formal training, this increases to 43 percent for medium firms and 66 percent for large firms. Across all industries, the previous section identified that very few small informal business owners were exposed to financial literacy programmes. In addition,

Table **15** indicates that senior managers in large firms have on average 17 years of experience, similar to that of medium firms (16 years) but far higher than that of small firms (11 years). This lack of experience of small firm managers may constrain the potential of small firms to grow, relative to medium and large firms.

Table 14: Education level of Firm Owners by Firm Size, years of schooling

	Own-Account	Micro (1-4)	Small (5-9)	Medium (10-49)	Large (50+)	Formal	Informal
No Schooling	5.3	2.7	1.4	0.5	0.0	0.4	5.8
Incomplete Primary	12.1	7.9	3.6	2.1	0.7	1.8	13.6
Complete Primary	6.7	4.2	1.1	0.5	1.0	1.0	7.4
Incomplete Secondary	42.3	33.6	17.8	9.1	18.4	17.0	45.8
Complete Secondary	22.3	30.1	34.4	35.4	33.8	36.7	21.4
Tertiary	10.1	20.3	41.5	52.2	45.1	43.0	6.0

Source: Labour Market Dynamics in South Africa (2013), own calculations.

Table 15: Skills and Training by Firm Size

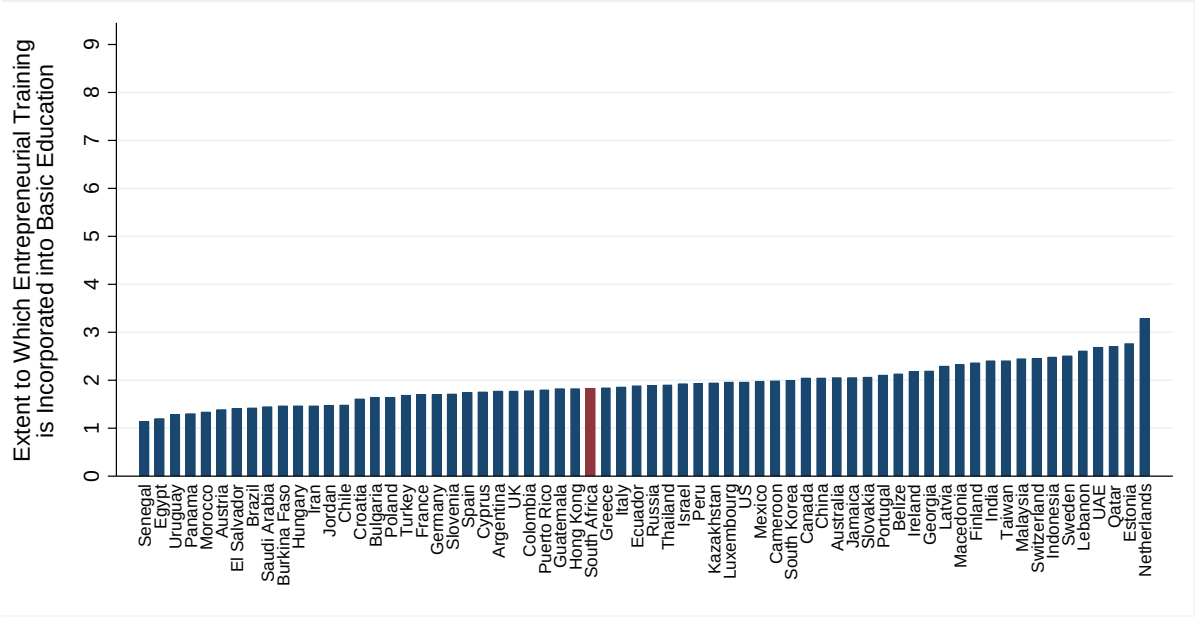
	South Africa Small (5-19)	South Africa Medium (20-99)	South Africa Large (100+)	Ratio: Large to Small	Ratio: Large to Medium
Percent of firms offering formal training	24.2	42.5	65.8	2.72	1.55
Years of the top manager's experience working in the firm's sector	10.8	16.1	17.4	1.61	1.08

Source: World Bank enterprise survey (2007)
Notes: Data is for manufacturing firms only.

Within a global context, Figure 8 and Figure 9 show the extent to which training in the creation and management of SMMEs is incorporated into basic and postgraduate studies in 66 countries. For these questions, the Global Entrepreneurship Monitor (2016) data is in the form of a Likert scale of 1 (highly sufficient) to 9 (highly sufficient). Figure 8 indicates that, in terms of training in the creation and management of SMMEs in primary and secondary school, South Africa's score of 1.77 is low but comparable to the other countries in the survey. While the score for postgraduate training is higher (2.32), this is the 12th lowest score out of the 66 countries sampled. This means that South Africa postgraduate students get comparatively little training on how to set up and manage an SMME.

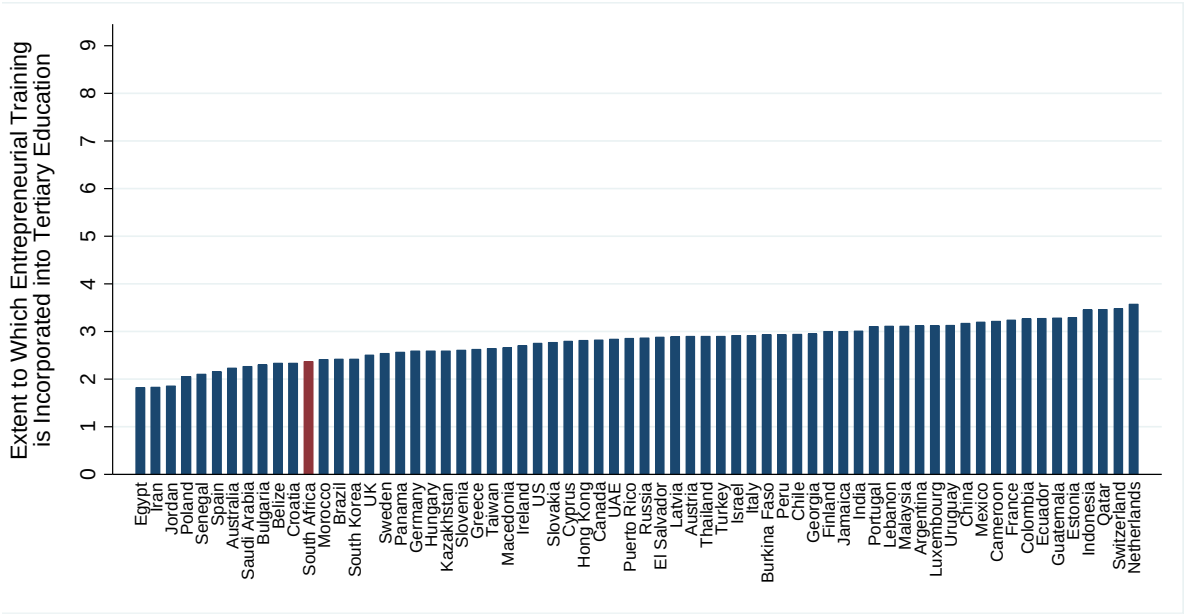
As seen previously, entrepreneurship remains an underutilised tool which would serve to lift those who are unable to secure formal sector employment into wage-generating opportunities. Because of the identified lack of skills and education amongst SMME owners, there is a need for the government to provide serious and thoughtful entrepreneurial training throughout the various stages of the South African curriculum.

Figure 8. Extent to which training in creating or managing SMMEs is incorporated into Primary and Secondary education



Source: Global Entrepreneurship Monitor (2016).

Figure 9. Extent to which training in creating or managing SMMEs is incorporated into Higher education



Source: Global Entrepreneurship Monitor (2016).

4.1.2.2 Perceptions About and Exposure to Entrepreneurial Activity

Black South Africans were denied access to the majority of skilled work under apartheid, excluding individuals from any meaningful participation in the economy. Underemployment, low levels of education and a lack of skills training remain the legacy of these apartheid-era legislation. This, coupled with the current pervasive unemployment rates, means that Black youth are unlikely to grow up in a household containing family members who are able to expose them to Black entrepreneurial role models, knowledge about market opportunities or access to labour market networks. Furthermore, because apartheid confined the creation of wealth to White South Africans, many Black South Africans lack the assets needed to provide collateral to fund entrepreneurial activities. This cycle is vicious, with previously disadvantaged youth continued to be prejudiced in the opportunities afforded them in the labour market.

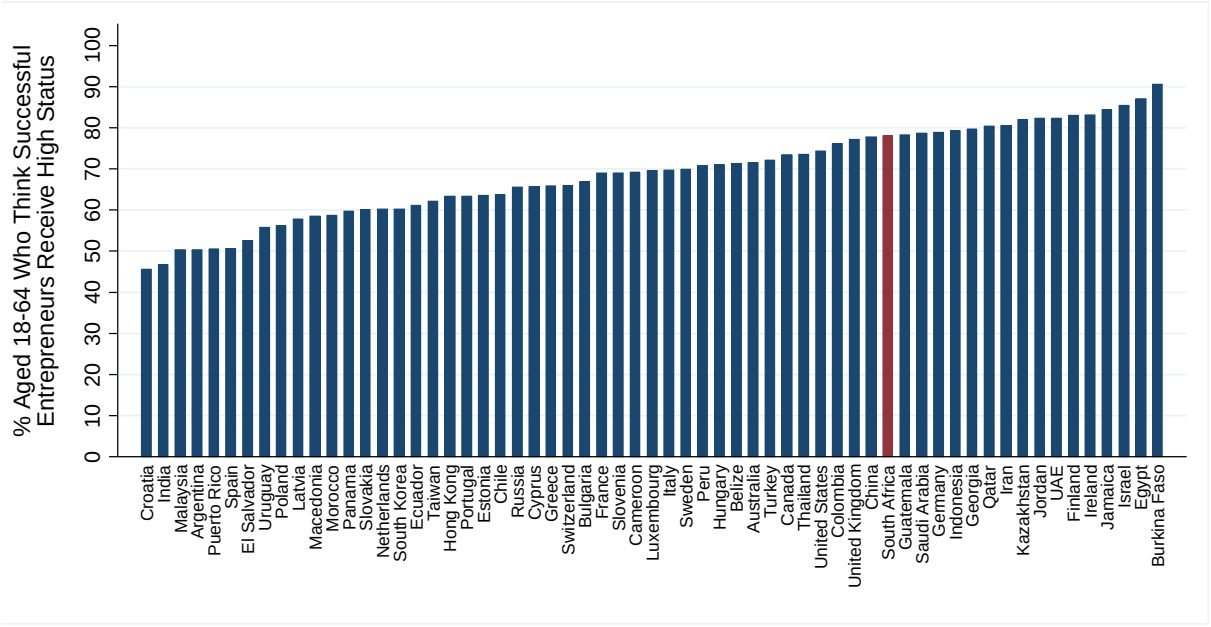
Figure 10 and Figure 11 provide information about perceptions of entrepreneurship in South Africa. Figure 10 indicates that 78 percent of South Africans aged 18 to 64 years old think that successful entrepreneurs receive a high status, putting South Africa at the upper end of the distribution. Figure 11 indicates that 73 percent of South Africans aged 18 to 64 years old believe that being an entrepreneur is a desirable career choice—again, this is at the upper end of the distribution. These figures indicate that entrepreneurship is viewed as desirable in South Africa, relative to other economies.

However, while most South Africans believe that entrepreneurship is desirable, few believe that opportunities for such activities exist. Figure 12 gives the proportion of 18 to 64 year olds who perceive good opportunities to start a firm in the area they reside in. Only 35 percent of South Africa said that they thought that good opportunities for entrepreneurship existed, leaving South Africa at the lower end of the distribution of the countries included in this study. Furthermore, Figure 13 shows that only 38 percent of South Africans believe that they have the necessary skills to start a business. Therefore, while entrepreneurship may be desirable in South Africa, few South Africans believe that the opportunity and skills for such activity exist.

Overall, South Africans appear to lack the education and training needed to both start a business and grow it into a viable, employment generating enterprise. For the unemployed,

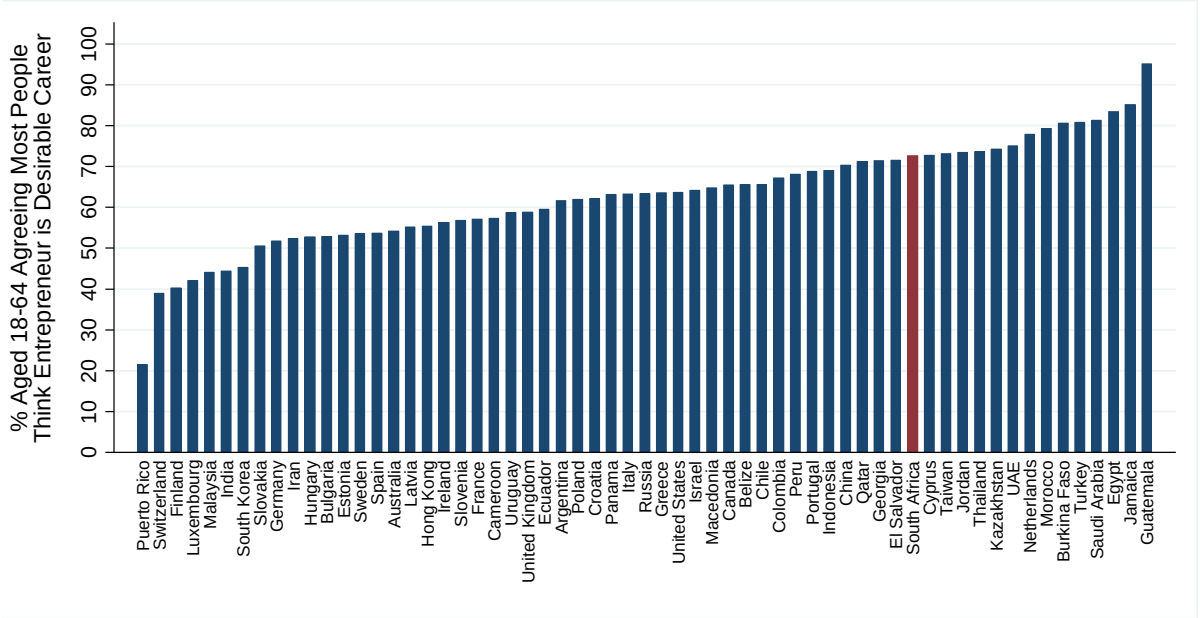
this dearth of entrepreneurial skill appears related to the lack of viable entrepreneurial role models in the communities in which they reside. In other developing economies (particularly Latin America and sub-Saharan Africa), entrepreneurial activity—especially in the informal sector—is high, despite low levels of education.

Figure 10. Percent of 18-64 Year Olds Who Think Successful Entrepreneurs Receive High Status



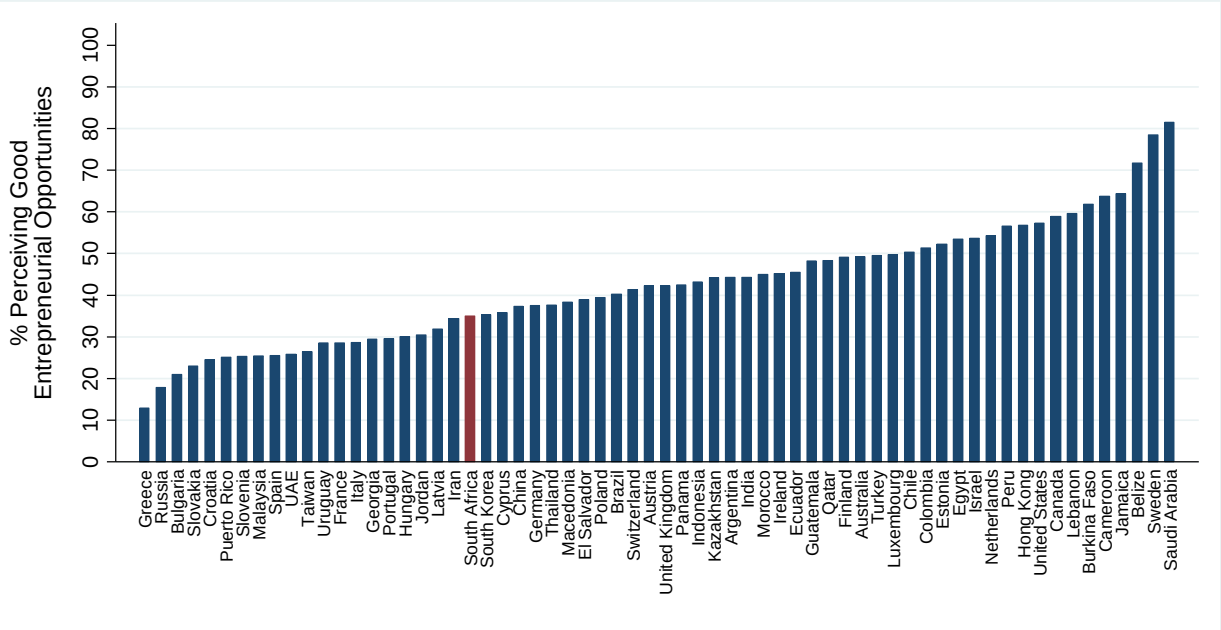
Source: Global Entrepreneurship Monitor (2016).

Figure 11. Percent of 18-64 Year Olds Who Agree That Most People Think Being an Entrepreneur is a Desirable Career Choice



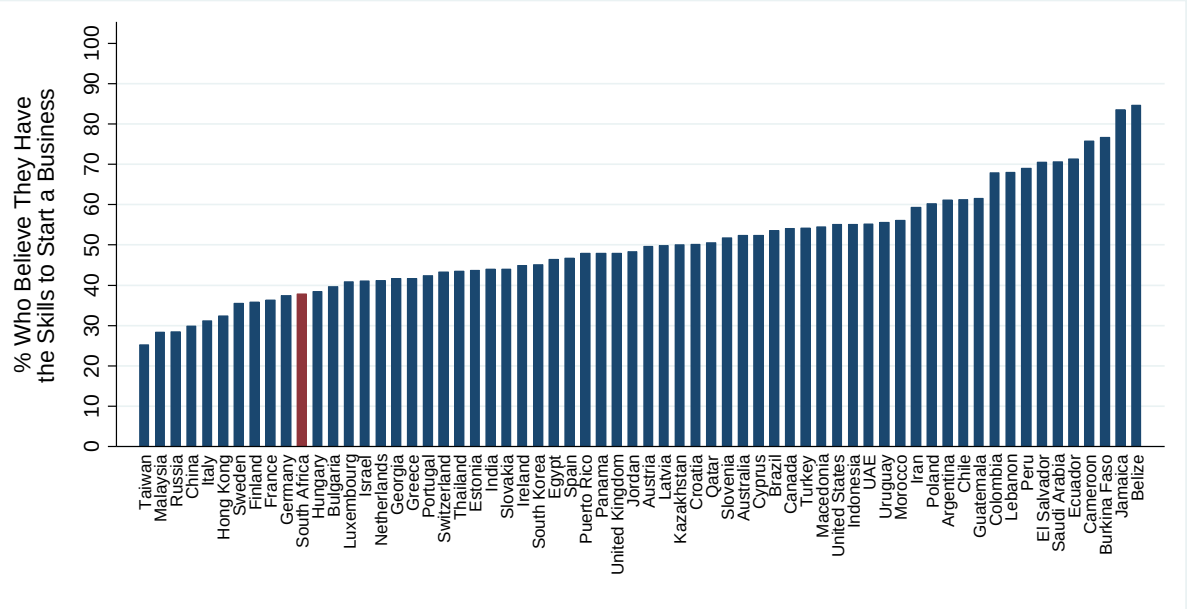
Source: Global Entrepreneurship Monitor (2016).

Figure 12. Percent of 18-64 Year Olds Who Perceive Good Opportunities to Start a Firm Where they Live



Source: Global Entrepreneurship Monitor (2016).

Figure 13. Percent of 18-64 Year Olds Who Believe they have the Skills to Start a Business



Source: Global Entrepreneurship Monitor (2016).

4.2 Exogenous Obstacles

4.2.1 Constraints Imposed by Incumbents

4.2.1.1 Relative Advantages and Behaviour of Incumbents

Any entrant to a market will be constrained by other competitors already operating in that market. Incumbents in any market typically have advantages relative to entrants due to the existing scale of their operations and having been present in the market for a longer period of time. These advantages range from having lower per unit production costs due to scale and efficiency, having an established customer base and so on.

Strategically, incumbents can ensure that they achieve such advantages by investing in their own business operations in ways that raise costs for entrants and make it less likely for entrants to succeed in the market. This has been the case, for example, in the beer industry where the dominant firm, South African Breweries (SAB), successfully raised the set up costs for small breweries (Banda et al., 2015). Small breweries have thus alleged that SAB offers additional incentives to liquor outlets in order to ensure that their products are the most visible at these selling outlets. Further, to promote their own recently launched craft beer product, SAB has offered outlets a sales service package, a premium draught tap, branded glassware, branded merchandise, management of aged stock and draught machine services. This means that competitor micro-breweries have to incur similar costs in order to compete with the monopolist, SAB, to ensure that their products also obtain visible positioning and space. This is in addition to the amount (approximately R 20 000) required to install a keg at relevant bars, shebeens and other outlets that is incurred by all brewers who wish for their beer to available on tap at bars. SAB is also able to offer flexible payment terms which allows customers to send stock back after events or promotions. While large and established firms like SAB can afford to do this, smaller firms are more reliant on being paid timeously and require certainty of sales to manage their cash flows effectively.

A further constraint on entrants and small firms is the role that brand loyalty and switching costs play in committing customers to buying products from a particular provider. This is a particular problem in markets where products are differentiated and brand recognition is important. This is of course often the case in the wholesale and retail industry, where SMMEs are concentrated. For example, in the brand cognisant alcohol market, SAB, despite being already being a monopolist, maintains considerable advertising expenditure to consolidate and maintain its dominant position. On average, SAB spends 24 cents on advertising for every litre of beer that is sold while Brandhouse, its closest competitor, spends over four times this amount at R1.13 per litre of beer sold (Banda et al., 2015). These are both large scale brewers—for small scale brewers looking to build a profile and grow within the market, the cost of advertising would be significantly higher per litre given the low volumes sold.

In the formal grocery market, large incumbent firms also invest considerably in maintaining brand awareness and brand loyalty. They are also better resourced to run promotions and loyalty incentive programmes to attract customers to their stores. Smaller retailers have indicated that their inability to invest in advertising and promotions is a major challenge (Das Nair & Dube, 2015b).

Entrants to a market also have to contend with anti-competitive behaviour by incumbents looking to protect market share and exclude competitors from the market. Large dominant firms have the ability to engage in a number of exclusionary acts aimed at keeping competitors out of the market. One such practice is requiring or inducing suppliers or customers not to deal with competitors. The Competition Commission has alleged that SAB has induced taverns and shebeens not to trade with competitors by offering them SAB branded fridges that must be used to stock only SAB products. Because these small businesses are both financially and

space constrained, the result is that they often only stock SAB products. SAB also offers shebeens and taverns incentives for promoting SAB products and prominent display positioning (Banda et al., 2015). While this case was never heard at the Tribunal[7], a study of the entry of a black-owned micro brewer, Soweto Gold, has recently found that this behaviour is still ongoing and indeed has acted as a growth constraint for them (Matumba & Mondliwa, 2015).

Large firms may also have the ability to price below their costs, thereby pricing competitors out of the market. Since the enactment of the Competition Act in 1998, only one firm has been found guilty of this prohibited practice of predatory pricing in South Africa. In 2015, the Competition Tribunal found that Media 24, the print media division of the media company Naspers, had engaged in such predatory behaviour to drive a competing community newspaper, Gold Net News (GNN), out of the market.

Large firms that operate at various levels of the supply chain can impose considerable constraint on smaller firms operating within that industry. For example, in the grocery retail market, the large national chains have invested in their own storage and distribution centres and mechanisms (Das Nair & Dube, 2015a). This allows these firms to manage and distribute their stock more effectively than smaller firms. In addition, vertically integrated firms can constrain smaller firms through their ability to control the supply of inputs or facilities that are essential to production in a particular market. Firms that possess considerable financial power can also create exclusionary effects by buying-up, and then refusing to supply, scarce intermediate resources to competitors. For example, many inputs into the production of beer are locally produced and controlled by SAB. Micro-breweries therefore need to either import or source these inputs from SAB. SAB, as a vertically integrated competitor, thus has the ability to anti-competitively raise its rivals' costs as well as supply competitors with malt of poor quality (Matumba & Molindwa, 2015).

Small entrants may circumvent these challenges through understanding the value chain and using collective buying schemes to increase their combined market share (Das Nair & Dube, 2015a). Buyer groups, consisting of a number of small players, have been particularly useful in achieving cost savings in stock procurement, transferring skills to and across small retailers and allowing these retailers to benefit from advertising and promotions.

It should also be noted that it is not just single dominant firms that can undermine entry and success in a market. Firms acting together in collusion can conspire to impose constraints to increase or protect their collective market share. The Competition Commission has recently conducted raids on nine fresh market produce market agents.[8] It is alleged that the agents, who serve as intermediaries between farmers and buyers of fresh produce, are involved in coordinated activities aimed at undercutting prices charged by smaller intermediaries by charging below market prices for certain periods of time in a trading day. As soon as small agents are out of stock, the larger intermediaries then allegedly raise their prices significantly, thereby achieving higher prices through their price fixing activities. Such behaviour serves to keep emerging farmers and intermediary agents out of the market.

The exclusionary acts considered above are prohibited by the Competition Act no. 89 of 1998. This should provide protection for small and medium firms against exclusionary and anti-competitive behaviour. However, while the Act's prohibition in itself can deter firms from acting

[7] The Competition Tribunal dismissed the case upon referral from the Commission finding it did not have jurisdiction due to differences between complaint and Commission referral. The merits of this part of the case were thus never heard.

[8] See http://www.compcom.co.za/wp-content/uploads/2017/01/CompCom-raids-fresh-produce-market-agents.pdf (Accessed 24 March 2017)

anti-competitively, the Competition Act is limited in its scope. First, prohibitions against exclusionary acts only apply to dominant firms. Second, the burden is often on the complainant to prove not only that it has suffered from the prohibited conduct, but also that the behaviour resulted in the substantial lessening of competition in the market as a whole. This restricts the use of competition policy as a tool to provide effective protection for SMMEs against the constraints imposed through the anti-competitive behaviour of larger firms.

The implication of the forgoing discussion is that small and medium firms, particularly those in the formal sector, which are likely to compete with larger firms, experience constraints which are imposed by firms already operating in the market. These constraints not only limit the expansion of SMMEs in the market, but also serve to deter potential entrants. Some of these constraints are due to efficiency and scale, while others are imposed through anti-competitive behaviour. The first category of constraints is not prohibited and will need to be dealt with through policy measures that support the entry and growth of small businesses. Small firms are afforded some form of reprieve against the second category of constraints through the Competition Act. However, we have noted its limitations in this regard, therefore further policy intervention which serves to restrict the behaviour of incumbents may be appropriate. Measures to decrease the high levels of market concentration present in many sectors of the South African economy may be particularly useful. We consider concentration as a factor which facilitates the imposition of anti-competitive constraints on SMMEs in more detail in the following section.

4.2.1.2 Market Concentration as a Compounding Factor

It is no coincidence that the Competition Act concerns itself predominantly with the conduct of dominant firms. In general, the potential for constraints to be imposed on SMMEs by larger firms increases with the degree of market power held by incumbents. While few studies have looked at the precise levels of concentration across industries in South Africa, it is widely recognised that levels of concentration are high in many sectors of the South African economy (Roberts, 2010).

The manufacturing sector has been the subject of some enquiry on the subject of market concentration and provides a case for the consideration of the implications of market concentration for SMMEs in South Africa. Studies estimating market concentration in South Africa suggest a relatively high degree of concentration (Du Plessis, 1978; Fourie & Smit, 1989; Leach, 1992; and Fedderke & Szalontai, 2009). Making use of newly available administrative tax data, Fedderke, Obikili and Viegi (2016) calculate market concentration for a number of manufacturing sub-sectors.

Table 16 shows the concentration share of the top 5 percent of firms by market share.

Table 16: Concentration Share of Top 5% of Firms by Market Share

	2001	2010	2011	2012	Percentage change 2001-2012	Annualised change per year
Food and Food Products	65.93	75.63	73.51	79.72	20.9%	2%
Beverages	76.27	92.46	91.57	93.14	22.1%	2%
Textiles	36.00	60.77	60.26	62.79	74.4%	5%
Clothing, except Footwear	34.18	68.47	68.22	73.89	116.2%	7%
Leather and Leather Products	27.69	75.34	78.00	78.17	182.3%	10%
Footwear	39.99	54.56	55.48	54.10	35.3%	3%
Wood and Wood and Cork products	38.45	63.08	70.35	65.32	69.9%	5%
Furniture	56.68	62.28	63.98	64.69	14.1%	1%
Paper and Paper Products	78.13	85.55	85.22	85.17	9.0%	1%
Printing, Publishing and Allied Industries	48.90	71.28	70.45	73.46	50.2%	4%
Basic Chemicals	68.55	75.66	78.80	86.04	25.5%	2%
Rubber Products	40.33	77.44	75.70	72.46	79.7%	5%
Plastic Products	30.22	79.39	81.25	61.48	103.4%	7%
Glass and Glass Products	69.74	61.99	77.32	76.79	10.1%	1%
Other Non-metals	60.07	71.52	73.11	70.44	17.3%	1%
Basic Iron and Steel Industries	76.00	83.26	83.67	82.49	8.5%	1%
Non-ferrous Metal Basic Industries	70.60	88.45	89.23	87.55	24.0%	2%
Metal Products, except Machinery and Equipment	47.49	60.52	58.46	60.13	26.6%	2%
Machinery, except Electrical	38.41	69.86	75.01	82.47	114.7%	7%
Electrical Machinery Apparatus	51.60	78.76	77.84	75.36	46.0%	4%
Motor Vehicles, Parts and Accessories	78.87	84.01	84.97	87.19	10.5%	1%
Transport Equipment	58.99	70.60	76.29	75.97	28.8%	2%
Other Manufacturing Industries	50.66	61.88	76.60	79.44	56.8%	4%

Source: Adapted from Fedderke et al. (2016) and own calculations.
Notes: Concentration ratios for 2001 use a large sample survey of South African manufacturing which had lower coverage than the administrative tax data used in other years. The category of "Other Chemicals" has been omitted from the table because no data is available for this subsector for the 2001 estimation of concentration not based on administrative tax data.

Persistently high and increasing market concentration levels suggest that competition has not increased in these sub-sectors over time. In fact, it seems to have decreased, with the share of the market captured by the top 5 percent of firms increasing on average by 3 percent per year for the period between 2001 and 2012.

High and growing concentration ratios would suggest low entry and high mark-ups in these sectors over the period, however this is not always the case. This may be linked to the extent of financial barriers to entry in a given sector. In sectors where barriers are low, incumbents may be required to protect their dominance by keeping mark-ups low. On the other hand, in sectors with high barriers to entry, incumbents may be able to maintain high mark-ups due to low competitive pressures (that is, low entry and exit). Fedderke et al. (2016) show that while

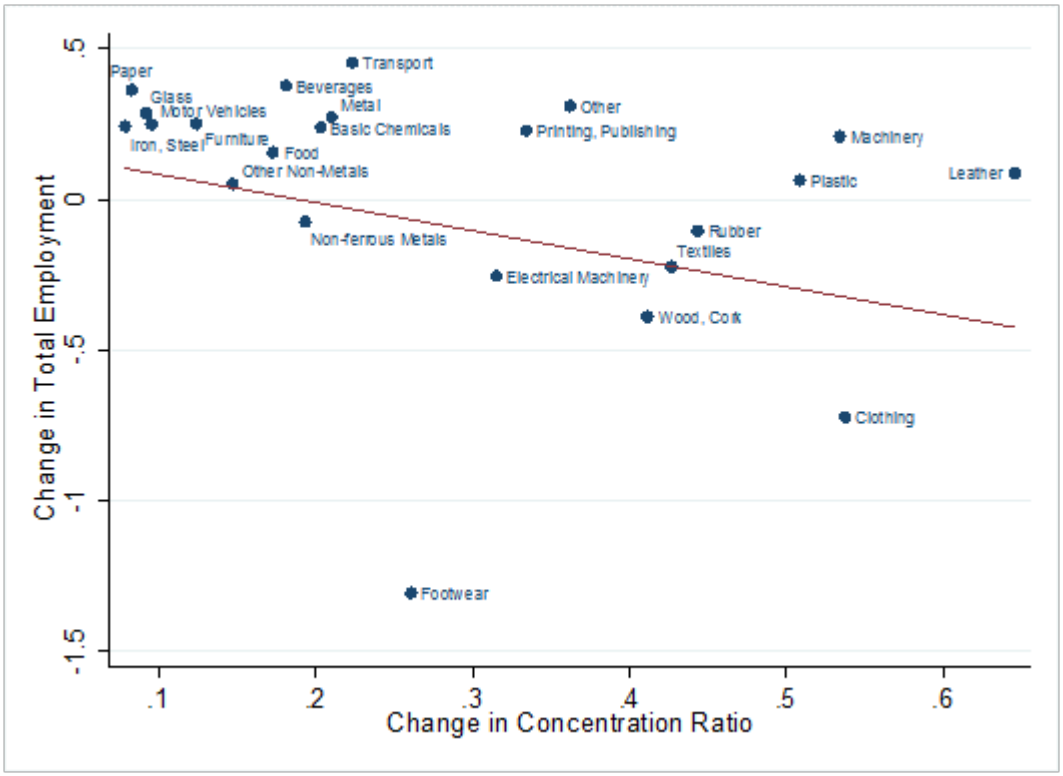
this is not always the case, this relationship between barriers to entry and mark-ups holds in some sub-sectors[9].

The market concentration-mark up relationship can serve as an indicator as to which types of policies are appropriate for enabling SMME participation within different sectors. High concentration and high mark-ups may be suggestive of a sector in which SMMEs have not been able to enter at all, and thus attention should be paid to the obstacles to entry for such a sector. High concentration and low mark-ups, on the other hand, may suggest that it is not the entry stage which presents the greatest challenge for firms, but rather that firms are unable to grow once they have entered due to constraints imposed by incumbents. In these sectors, SMME promoting policy should not merely be concerned with traditional barriers to entry, but should also focus on barriers to growth and how these can be overcome. Overall, while barriers to entry do seem to be an important factor in explaining mark-ups and dominance, heterogeneity across industries means that each industry must be assessed individually to understand the dynamics of entry and dominance for that industry.

Furthermore, employment creation may be stifled in highly concentrated industries with low rates of entry and growth. In Figure 14, we plot change in overall employment against change in the top 5 percent concentration ratio over the period 2001 to 2012 for each of the manufacturing sub-sectors in Table 15. There is a negative relationship between changes in concentration and changes in employment. Higher increases in the concentration ratio are correlated with lower, and in some cases negative, changes in employment. This is in line with existing research on the relationship between concentration levels and employment for manufacturing in South Africa. Fedderke and Szalontai (2009) have found that increased concentration unambiguously lowers employment in the manufacturing industry in South Africa. Fedderke and Naumann (2011) find similarly that higher industry concentration is negatively associated with both employment and employment growth. The implication of this finding is clear: addressing market structure can serve to increase employment levels.

[9] Chemicals, Metals, Machineries and Motor Vehicles, Clothing and Textiles, Food and Food Products and Printing and Publishing.

Figure 14: Changes in concentration ratios and employment for manufacturing subsectors in South Africa, 2001-2012



Source: Fedderke et al. (2016) and LMD 2012, LFS September 2001 (own calculations).

The implications of continued high concentration levels and low levels of industry growth are that patterns of economic ownership are likely to be replicated, with the economically disenfranchised likely to remain excluded from the economy. Allowing dominant firms to maintain their dominance and capture increasing shares of the market, in an environment that does not allow SMMEs to participate, will only exacerbate already high levels of inequality. Thus, enabling new service providers to enter and thrive is key for South Africa to reach its unemployment and inequality targets.

4.2.2 Constraints Imposed by Historical Legacy and Ineffective Governance

4.2.2.1 Limited Infrastructure

The provision of infrastructure is a key element in facilitating the emergence, growth and success of firms in an economy. In order to support all businesses in the economy, infrastructure—specifically transport networks, communication systems, provision of utilities and land—need to be optimally available. This is particularly important for small businesses for whom the costs and time spent using infrastructure are a relatively high proportion of income. According to the 2013 GEM National Expert Surveys, South Africa ranks below the overall average ranking of 3.7 and the Sub-Saharan African average ranking of 3.1 for physical and services infrastructure that does not discriminate against SMMEs[10], with a ranking of 2.8[11]. This suggests that overall infrastructural support for SMMEs in South Africa is generally poor and heavily biased against SMMEs.

[10] Ease of access to physical resources, communication, utilities, transportation, land or space at a price that does not discriminate against SMEs.
[11] Likert scale of 1 (highly insufficient) to 9 (highly sufficient).

In order for firms to gain access to the market, the labour force and be able to operate productively, it is important that effective transport systems exist. Transport networks, including road, aviation, ports and train systems, for both labour and goods, need to be safe, reliable, accessible, comprehensive in reach, and affordable, in order for them to function as an asset for the local economy and encourage business growth.

Firms rely on transport infrastructure to reach the major economic hubs and to access their respective markets. This is particularly important in South Africa, where due to the entrenched problem of spatial mismatch, millions of labour market participants are located significant distances from the urban centres. Spatial mismatch refers to the fact that there are large geographical distances between substantial segments of the labour market—specifically Africans due to South Africa's Apartheid history—and the country's economic hubs and jobs. Naudé (2008) finds that distance from the city centre is an important factor in explaining African unemployment rates in South Africa, while for White South Africans distance is not important. This is significant in our case, because as we found in the profile section, Africans are most likely to own small businesses, presenting an alternative to unemployment for this group. Thus, any constraints relating to spatial mismatch will impact on SMMEs, specifically African owned SMMEs, relatively more than large businesses. This important separation between the labour force and the economy results in challenges for SMMEs, for example, SMME owners and potential entrepreneurs (particularly those amongst the unemployed) will find it relatively costly to travel to the economic hubs for business purposes, and these are the areas where their businesses are most likely to grow and mature. Thus, effective and affordable transport infrastructure is an important factor for SMME development in South Africa.

As we can see from Table 17, transportation is the largest challenge for medium sized businesses, and transportation is a constraint for small businesses relative to large businesses. According to the National Household Travel Survey Report (2013), the majority of South African workers make use of taxis to get to work, while the other major transport sources are walking all the way to work, buses and private cars. The most important challenges reported in the survey were the poor condition of roads, taxis being too expensive, reckless driving of taxi drivers, crime, congestion and poor availability of buses.

Table 17: Infrastructure

	South Africa Small (5-19)	South Africa Medium (20-99)	South Africa Large (100+)	Ratio: Large to Small	Ratio: Large to Medium
% of firms identifying transportation as a major constraint	3.4	5.1	1.6	0.47	0.31
% of products lost to breakage or spoilage during shipping to domestic markets	1.7	1.1	1.3	0.76	1.18
Number of electrical outages (typical month)	0.8	1.0	1.2	1.50	1.20
If there were outages, average losses due to electrical outages (% of annual sales)	1.8	1.5	1.6	0.89	1.07
% of firms owning or sharing a generator	10.8	18.8	36.1	3.34	1.92
% of firms identifying electricity as a major constraint	19.9	19.1	30.7	1.54	1.61

Source: World bank enterprise survey (2007)
Notes: Data is for manufacturing firms only.

SMMEs engaged in logistics or regional/cross-country business also rely on long-distance infrastructure. Land-based long distance transport systems face significant challenges in

South Africa, namely high logistics costs and deteriorating infrastructure (particularly poor road conditions). Issues of deteriorating roads not only make transportation challenging, but can also be costly because of the vehicle maintenance costs that result from this. As we see from Table 17, small businesses experienced the highest incidents of products lost to breakage and spoilage during domestic transportation. This indicates that for the smallest businesses, relative transportation costs are highest, making it a relative constraint for small businesses.

Having access to basic utilities, including water, electricity and sanitation, is another important infrastructural necessity in business operations. Access to electricity is generally far-reaching in South Africa, where the data indicate that 71 percent of small businesses reported having access to electricity for their business operations (SESE, 2013). Despite the general availability of electricity, a major challenge to businesses is "Load-Shedding" – or regular power-outages experienced in South Africa. The 2015 SME survey found that 71 percent of SMME owners viewed frequent and pro-longed power-outages as the largest threat to their business, with power-outages surpassing crime as the leading challenge for SMMEs. Load-shedding is the direct result of poor electricity infrastructure that cannot support the country's electricity demands. Table 17 indicates that although larger businesses experience more regular electricity outages than small and medium businesses, the average sales losses due to these outages were greater for SMMEs. This is likely due to the fact that large businesses are better equipped to mitigate the losses associated with these outages, as the table indicates that SMMEs were less likely to own a generator—a significant investment for most small businesses. Thus, the challenges associated with electricity outages present a relative constraint for SMMEs.

Besides transportation and utilities, infrastructure that allows for efficient communication is also essential for business operations. Specifically, firms are required to market themselves, as well as communicate with employees and customers. Communication presents a relatively small challenge for small businesses. SESE (2013) finds that only 13 percent of informal SMME owners have no means of communication for their business, while 82 percent use a cellular telephone for business communication.

In terms of access to water, 81 percent of small businesses reported having access to tap water for their operations (SESE, 2013), again indicating far-reaching water provision. Access to sanitation for small businesses was more varied, where only 42 percent of small businesses had a flushing toilet on site, and 10 percent had access to a flushing toilet off site. Most of the remainder of small businesses had access to latrine (with and without ventilation), while 8 percent had no access to toilet facilities. The Gauteng SMME Policy Framework also highlighted sanitation as challenge for SMMEs in the province. Besides making working conditions hostile, a lack of suitable sanitation can also present a major health and safety hazard.

Another aspect of infrastructure that is needed to support business is access to land. In order for business to develop and grow, business needs access to affordable premises that is close enough to workers, the market, and that is safe and suitable for work. According to the Small Enterprise Development Agency, difficulty accessing land or securing operating premises is one of the key challenges for SMMEs in the agriculture, manufacturing, ICT and tourism sectors. For agriculture specifically, gaining access to arable land was also a notable challenge. Land access has often been hampered by many firms' inability to secure leases from municipalities. FinScope (2011) also identifies "space to operate" as the largest obstacle for small business growth, particularly in Gauteng. According to the Gauteng SMME Policy Framework, many SMMEs in the province operate out of illegal or informal premises, particularly businesses located in townships and informal settlements. Again, this presents a

health and safety risk for workers. Thus, a challenge surrounding the availability and access to productive and suitable land exists.

Overall, this section has briefly considered the constraints that infrastructure can pose to SMMEs. We have observed that due spatial mismatch in South Africa, SMMEs (specifically African owned SMMEs) need to both travel and transport their workers significant distances to access economic centres and their markets. We also found that in terms of domestic movement of goods, SMMEs experienced the most damages to stock during transportation. Because of this, it was found that transportation is a relatively higher constraint on SMMEs. We also noted that electrical outages were a challenge for SMMEs, in particular relative to large businesses who are more equipped to mitigate the losses that are associated with power-outages. Lastly, we identified that access to land was a constraint for SMMEs, who often struggle to obtain leases from municipalities, farming SMMEs struggle to find arable land, and SMMEs in Gauteng often operate out of informal or illegal premises.

4.2.2.2 Crime

In South Africa, there is a growing body of evidence to suggest that crime is a major binding business environment constraint, particularly for informal enterprises (Cichello et al., 2011; Gough, Tipple and Napier, 2003; McDonald, 2008). Crime impacts the business environment through acting as a direct violation of firms' property rights, and therefore lowers the incentive for firms to reinvest. Such a risk may cause firms to forgo potentially new technologies and more profitable production choices. It also creates barriers to the access of inputs as suppliers prefer not to operate in high-crime areas. In addition, for informal firms in informal areas, crime may erode advantages such as the convenience associated with their location. This is because hours of operation become conditioned by the probability of a crime occurring.

Bhorat and Naidoo (2017) consider 2012 World Bank Diepsloot Enterprise Survey data to provide a view of perceptions and incidence of crime in an urban township setting in South Africa. They show that almost 27 percent of firms surveyed in Diepsloot rank crime as the most serious business obstacle in that area. Compared to the other potential obstacles, crime was perceived to be the most serious obstacle to the operations and growth of enterprises in this urban township setting. They estimate the relationship between firm characteristics and incidence of crime using this data. Results suggest that older firms are more likely to be a target of crime than newer firms. Further, they find that firms that rent their business premises and firms that are wealthier in terms of fixed assets are more likely to be targets for criminals. Therefore, criminal theft appears to be targeted at physical assets and stock rather than cash. Bhorat and Naidoo (2017) note that, within the informal sector, crime thus seems to affect more established, wealthier and better performing firms.

These are the types of entrepreneurs that are possibly at the periphery of, or moving toward, integration into the formal economy. However, they cannot get out of the 'trap' due to constraints imposed by factors such as crime. The implication is that they remain in the informal sector facing setbacks due to such factors, while firms already in the formal economy are able to operate and grow further as they are able to absorb the costs of factors such as crime.

Chandra, Nganou, and Marie-Noel (2002) also finds that crime was perceived to be a major constraint on entrepreneurs in the informal sector in Johannesburg, but shows that the perception of crime is more pervasive than the reality. The data show that over 50 percent of firms perceive their business to be constrained by crime, however, in reality only 30 percent of firms were victimised by crime in 1998. Conversely, Devey, Valodia, and Velia (2005) show that whilst 41 percent of larger manufacturing firms in the Greater Durban Metropolitan Area perceive crime to be a major constraint to growth, 72 percent of firms were actually victims of

criminal activity in either 2000 of 2001, and 66 percent of them having been victims in both years. Perceptions of crime though are critical even if they do not align with reality. They can impede entry and expansion of enterprises by impacting on an entrepreneur's decision to either start a business or to invest in improving or expanding an existing business.

A comprehensive study on the impact of crime on small business in South Africa by McDonald (2008) makes use of a firm survey of small business in both formal and informal areas of South Africa's three major cities and confirms that crime is a problem for businesses in both the informal and formal sectors. Over half (54 percent) of the businesses in the survey had experienced at least one incident of crime in the previous year. McDonald's analysis however concluded that the direct costs of crime were disproportionately higher for small firms. For firms with a turnover of less than R750 000 per annum, the study finds that the average cost of crime was just over 5 percent of sales. For enterprises with a turnover of less than R10 000 this cost goes up to at least 20 percent of turnover, rising to as much as 36 percent of turnover for enterprises with a turnover of below R5 000.

The author also emphasises the indirect costs of crime making particular reference to how crime can constrain firms from investing in and expanding their businesses as well as the impact on firm performance given the reduced passing trade due to fear of crime among clients and suppliers. The loss of this revenue is particularly limiting for firms operating in townships and informal settlements. These same firms are also considerably less likely than the sample average to have insurance coverage and thus are typically not able to absorb the direct costs of crime as well. In line with this, McDonald notes that the probability of closure following one or more incidents of serious crimes appears to be significant for these firms (McDonald, 2008).

Stone (2006) proposes that the costs of crime to firms operating in the formal sector of the South African economy appear to be in line with costs in other middle-income countries. However, he argues that the composition of these costs is substantially different: South African firms bear more of the costs in direct losses to crime, whereas in other countries, the costs are more heavily weighted toward crime prevention.

Table 18 provides various indicators of crime-related costs for manufacturing firms of different sizes in the formal sector in South Africa based on the 2007 World Bank Enterprise Survey. While 91.3 percent of large firms paid for security, just over two-thirds of firms with less than 20 employees did, making these firms more susceptible to the negative effects of crime. Security costs as a proportion of annual sales was fairly consistent across firms of different sizes with this ranging from 1.4 percent for large businesses to 2.4 percent for small firms.

Table 18: Crime related costs of firms in South Africa

	South Africa Small (5-19)	South Africa Medium (20-99)	South Africa Large (100+)	Ratio: Large to Small	Ratio: Large to Medium
% of firms paying for security	67.2	82.2	91.3	1.36	1.11
If the establishment pays for security, average security costs (% of annual sales)	2.4	2	1.4	0.58	0.70
% of firms experiencing losses due to theft and vandalism	36.4	46.7	52.6	1.45	1.13
If there were losses, average losses due to theft and vandalism (% of annual sales)	3.1	2.2	1.2	0.39	0.55
% of firms identifying crime, theft and disorder as a major constraint	36.8	41	31.6	0.86	0.77

Source: World bank enterprise survey (2007)
Notes: Data is for manufacturing firms only.

Losses due to theft and vandalism were experienced at a high level by firms of all sizes, with larger firms reporting having experienced this at a higher rate than small businesses (53 percent compared to 36 percent for small businesses). However, as a proportion of total annual sales, losses were more than double those of large businesses for small firms (3 percent in comparison to 1 percent). Not surprisingly then, more small and medium firms (37 and 41 percent, respectively) identified crime, theft and disorder as a major constraint compared with large businesses (32 percent). The indicators thus support the literature which suggest that crime is a constraining factor for firms of all sizes, but one which disproportionately impacts SMMEs relative to large firms.

4.2.2.3 Corruption

Table 19 lists a number of measures indicative of how manufacturing firms of various sizes in the formal sector experience corruption in South Africa. Small and medium sized firms report a higher incidence of bribery than large firms, with 5 percent of small firms and 4 percent of medium firms indicating that they have experienced at least one bribe payment request compared to 2 percent for large firms.

The proportion of firms that indicated they were expected to give gifts to secure government contracts was also higher for small and medium firms at 34 and 39 percent, respectively. The proportion for large firms was 22 percent. As a percent of contract value, this was highest for small firms at 3 percent of the contract value. For large firms the proportion was just 0.5 percent.

A number of small firms (7 percent) also indicated that they were expected to give gifts to obtain an import licence. Just under 10 percent of small firms and 4 percent of medium firms indicated that they were expected to give gifts to get an electrical connection. Further, 8 percent of medium firms indicated that they were expected to give gifts to obtain a water connection. This is concerning as such basic access is essential to the operations of a firms and expectations to give gifts to obtain these, place an additional cost on small firms relative to larger firms.

The proportion of small and medium firms (14 and 19 percent, respectively) that say they are required to give gifts just to “get things done” is also more than double the proportion of large firms who indicate the same (7 percent). Despite all of this seemingly indicating that smaller

firms are worse affected by corruption, the proportions of small, medium and large firms in South Africa that identify corruption as a major constraint is fairly similar across these categories ranging between 16 percent for large firms and 18 percent for medium firms.

Table 19: Corruption

	South Africa Small (5-19)	South Africa Medium (20-99)	South Africa Large (100+)	Ratio: Large to Small	Ratio: Large to Medium
Bribery incidence (% of firms experiencing at least one bribe payment request)	5.4	3.8	1.7	0.31	0.45
% of firms expected to give gifts to secure government contract	34.3	38.5	22.4	0.65	0.58
Value of gift expected to secure a government contract (% of contract value)	2.7	1.8	0.5	0.19	0.28
% of firms expected to give gifts to get an import license	7.3	0	0	0	-
% of firms expected to give gifts to get an electrical connection	9.8	3.8	0	0	0
% of firms expected to give gifts to get a water connection	0	8.3	0	-	0
% of firms expected to give gifts to public officials "to get things done"	13.9	18.5	6.8	0.49	0.37
% of firms identifying corruption as a major constraint	16.4	17.7	15.6	0.95	0.88

Source: World bank enterprise survey (2007)
Notes: Data is for manufacturing firms only.

It is clear however that, relatively speaking, small and medium firms bear greater costs due to bribery and corruption. Apart from the Survey indicating that small and medium firms are more likely to experience such incidents, in relative terms it is smaller firms who are disadvantaged by these corruption costs as larger firms are more likely to be able to absorb these costs. For anyone making a decision to enter a market or looking to remain operational or grow within a market, such costs act as constraints to the development of small firms and deter entry and expansion.

4.2.2.4 Low-Skilled Labour Supply

Over the last four decades, South African firms have seen an increase in their capital-labour ratio, particularly in the primary and secondary sectors. This has led to a decline in the ratio of unskilled to skilled workers, as firms have been forced to adopt new technologies in order to remain competitive (Bhorat & Hodge, 1999; Bhorat, 2004; Edwards, 2001; Burger and Woolard, 2005; Bhorat & Mayet, 2012).

Therefore, skills-based technological change is driving labour demand in South Africa, leaving firms unable to meet their skills needs in a generally undereducated population. The 2016/2017 World Economic Forum's Global Competitiveness Report ranked an inadequately educated workforce as the third highest constraint to doing business in South Africa, cited higher than policy instability, corruption and crime. However, it is important to understand whether a lack of skilled workers is more of a constraint for SMMEs than for large firms, exacerbating the unequal growth path between firms of different sizes. For example, SMMEs may find it relatively more difficult to attract high-skilled workers if they are unable to compete

with the salary and benefits offered by larger firms. Data from the World Bank Enterprise Survey (2007) indicates that 11 percent of large firms identified an inadequately educated workforce as a constraint to growth, marginally higher than the figure for medium firms (10 percent), and almost double that for small firms (6 percent).

However, these figures do not consider heterogeneity amongst small firms. The 2013 SME Growth Index surveyed 500 SMMEs in sectors deemed to have high growth potential—manufacturing, business services and tourism (Business Environment Specialists, 2014). The SMMEs were asked the top three factors inhibiting growth over the past year. Overall, a lack of skilled staff was the most regularly cited growth constraint. Dissecting impediments to growth by growth trajectory, this data shows that while 12 percent of shrinking SMMEs felt that a lack of skilled staff was a constraint to growth, this figure increased to 17 percent for SMMEs experiencing high growth. Therefore, a lack of skilled staff is chiefly a constraint for SMMEs that have the potential to be on a higher growth path.

Furthermore, the 2010 FinScope survey asked SMME owners about the skills needs of their employees. While 27 percent of micro (1 to 4 employees) firm owners stated that their employees required specialised skills, training, a matric or tertiary education, this increased to 40 percent for small or medium (5 to 49 employees) businesses. Together, the data indicates that a low-skilled labour force presents a greater constraint for larger SMMEs as well as those SMMEs on a higher growth path.

Dealing with this skills mismatch is therefore critical, and the government has recognised this by promoting employment growth in low-skilled occupations as well as skills-development (particularly growth in PhD, science and technology graduates) to meet high-skilled labour demand. It is therefore encouraging to note that education levels amongst South Africans have been rising, although overall tertiary graduation rates and technical skills levels remain low. While in 2008, 78 percent of South Africans did not have a complete secondary school education, this number had decreased by 5 percentage points in 2016. Furthermore, the percentage of South Africans with tertiary education has increased from 7 to 8 percent within the same period (StatsSA, 2016).

4.2.3 Constraints Imposed by the Policy Environment

4.2.3.1 Limiting Policy, Regulation and Bureaucracy

Small businesses, in the formal sector, particularly, have to comply with various regulations and laws. Dealing with government procedures and processes, in addition to the explicit costs, can also be time consuming. While these costs may be imposed on small and large businesses alike, the financial and time costs can often impose a higher burden on small businesses relative to larger ones. While large firms may be in a position to employ someone to explicitly deal with these issues, small firms often have to unload this burden on the owner or a manager who may not have the time or ability to deal with such bureaucracy effectively. Indeed, having to comply with regulations and laws may even deter individuals and small businesses from expanding beyond the informal sector.

The World Bank Enterprise Survey (2007) investigates a number of measures indicative of constraints faced by small, medium and large firms in South Africa in their dealings with government officials and departments. The proportion of senior management time spent dealing with requirements of government regulation was highest for medium sized firms at 7 percent, while it was 5 percent for small firms and 6 percent for large firms. Tax rates were also identified as being a major constraint by medium firms considerably more than for small and large firms. This was also true for the proportion of firms identifying tax administration as

a major constraint, although the difference across the size groups was not as stark. Business licenses and permits were most frequently identified as a major constraint by small firms.

In terms of regulatory labour costs, compulsory worker insurance, maintenance of minimum working standards and instituted minimum wages may all impose costs on firms. This may deter them from formalising and growing within the formal sector. Here too, it seems that these costs are not particularly high for firms in South Africa compared to elsewhere in the world. Fernandez et al. (2017) consider labour costs and regulation as barriers to formality in sub-Saharan Africa and Latin America. Overall, labour tax and contributions amount to just 4 percent of total profits for South African firms. This is very low in comparison to other countries. Fernandez et al. also estimate a "other labour market rigidities" index which considers the following factors: hindrance to hiring additional workers, rigidity of hours, difficulty of firing redundant employees, legally mandated notice period, mandatory severance pay, and the labour force participation rate. The index score is moderately high at 59, indicating that labour market rigidities exist but are not as high in many other emerging countries.

When we consider employee costs specifically for small firms at an aggregate level using data from the Quarterly Firm Survey (QFS) (see Table 20), it is clear, that as a proportion of turnover, employment costs are higher for small firms in the formal sector, with employee costs amounting to 17 percent of turnover in 2016. The proportions for medium and large firms are 14 and 12 percent, respectively. These proportions have increased for both medium and small firms between 2010 and 2016.

This table also shows that small and medium firms in the mining, manufacturing, CSP and real estate industries have high employee costs as a proportion of turnover, relative to large firms. The latter two industries are labour-intensive. Mining does not have a high number of SMMEs active within the sector due to the high capital requirements of operating within that sector. The higher employment costs relative to turnover for this sector is likely due to low turnover for SMMEs within a sector dominated by large firms. SMMEs in these sectors thus face a higher labour regulatory burden than other sectors, and will be particularly affected by any regulation that imposes additional labour costs on them. It is also interesting to note that employee costs as a proportion of turnover have increased considerably for small firms in most sectors between 2010 and 2016, while this proportion has declined for large firms over this period. This suggests that employee costs are not just a larger relative constraint for small firms in the formal sector, but that it is also increasingly so. As indicated, the wholesale and retail industry is the dominant industry for SMMEs. Table 20 illustrates that employee costs as a proportion of turnover in this industry was low relative to other industries, making it relatively easy for SMMEs to compete. However, while this measure has remained stable for small and medium firms, it has declined for large firms. Therefore, it may be becoming harder for SMMEs to compete in this industry in recent years.

With respect to employee costs imposing higher cost burdens on small businesses in comparison to larger firms, a particular regulatory cost that should be taken into account, especially for labour-intensive industries, is the imposition of a new universally binding national minimum wage in the near future. While minimum wages currently exist in the form of sectorally imposed minimum wages, a national minimum wage of R 20 an hour (initially) will be implemented by "no later than 1 May 2018".[12] Such an imposition has the potential to constrain very small businesses who may not be able to pay employees this amount. Indeed, having to comply with such an imposition in the formal sector may even deter businesses in

[12] See http://www.thepresidency.gov.za/newsletters/statement-deputy-president-cyril-ramaphosa-finalisation-agreements-labour-stability-and (Accessed 6 March 2017).

the informal sector from formalising. It has however been noted that there will be an opportunity for businesses in this position to apply for an exemption of up to 12 months. The details of such exemptions and support are yet to be finalised.

Table 20: Employee Costs as a Proportion of Turnover: 2010 and 2016

Industry	Firm Size	2010	2016	change (%)
All industries	Large	12.9	12.5	-2.9
	Medium	13.8	14.4	4.7
	Small	15.5	17.0	9.6
	Total	**13.6**	**13.9**	**2.8**
Mining	Large	20.2	22.5	11.6
	Medium	23.9	23.3	-2.6
	Small	23.8	28.5	19.6
	Total	**20.5**	**22.7**	**11.2**
Manufacturing	Large	9.0	8.4	-6.7
	Medium	13.7	11.4	-16.7
	Small	19.6	19.7	0.7
	Total	**11.5**	**11.0**	**-5.0**
Utilities	Large	15.8	11.8	-25.4
	Medium	22.5	6.0	-73.1
	Small	21.0	11.1	-47.1
	Total	**16.0**	**11.5**	**-27.9**
Construction	Large	17.5	17.4	-0.5
	Medium	16.7	19.5	16.6
	Small	21.7	15.2	-30.1
	Total	**18.5**	**17.0**	**-8.2**
Wholesale & Retail	Large	7.4	7.0	-5.7
	Medium	7.6	7.6	0.6
	Small	10.4	10.1	-2.6
	Total	**8.5**	**8.2**	**-3.0**
Transport	Large	15.9	15.9	-0.1
	Medium	12.4	15.9	28.7
	Small	17.7	17.1	-3.2
	Total	**16.0**	**16.1**	**0.9**
Real Estate & Other Business Services	Large	26.3	26.8	1.8
	Medium	27.2	33.2	22.2
	Small	20.9	27.1	29.9
	Total	**24.7**	**27.5**	**11.1**
CSP	Large	25.9	25.6	-1.4
	Medium	28.7	26.2	-8.7
	Small	24.1	31.4	30.2
	Total	**25.5**	**27.7**	**8.6**

Source: QLFS, 2010 Q3 and 2016 Q3.
Notes: This data is for the formal non-agriculture business sector in South Africa.

5 Constraints to SMME Growth: A Simple Ranking Analysis

The following section summarises the key findings from the above SMME profile and challenges sections. Here, we rank the constraints to growth faced by SMMEs of various sizes to identify the key areas in which policy can be utilised to enable small business growth.

In order to rank challenges to growth consistently, we make use of the FinScope 2010 data. This is a nationally representative sample of 6000 SMME owners in South Africa. The objective of this survey is to describe the size and scope of small business in South Africa, as well as to identify the developmental and financial needs of SMMEs. The survey asks small business owners to name the single biggest obstacle to growing their business. Table 21 summarises these findings by firm size. Growth constraints are ranked on a colour scale from green to red, where the least regularly cited constraint is green and the most regularly cited constraint is red. Rankings are based on the proportion of firms identifying each constraint as the biggest obstacle to growth. This is done by firm size; therefore, constraints are ranked horizontally.

Table 21. Major Obstacles to Growth by Firm Size

	Access to Finance	Education & Skills	Infrastructure	Crime & Corruption	Competition	Regulation & Policy
Own-Account (0 Employees)	23.5	3.4	35.2	9.0	15.9	13.0
Micro (1-4 Employees)	13.2	3.1	41	14.4	18.7	9.6
Small & Medium (5-49 Employees)	15.3	3.1	22.5	8.3	41.3	9.5
Total	**20.0**	**3.3**	**36.2**	**10.6**	**18.2**	**11.8**

Source: FinScope (2010).

The constraints to growth are defined as follows:

1. Access to finance: Includes access to finance and cost of finance.
2. Education and Skills.
3. Infrastructure: Includes space to operate, telephone or internet, electricity, transportation and access to land.
4. Crime and Corruption.
5. Competition.
6. Regulation and Policy: Includes tax, customs and trade regulations, labour regulations, business licensing, policy uncertainty, harassment by officials, legal system/conflict resolution and zoning regulations.

Overall, infrastructure is most regularly perceived as the most significant constraint to growth for SMMEs, followed by access to finance and competition. Interestingly, very few SMME owners perceived skills and education as the biggest constraint to growth. However, this question does not specifically list lack of skilled staff as an option, and this therefore cannot be reliably ranked. Nevertheless, we have seen from the challenges section that a lack of skilled staff is a major constraint for large and growing SMMEs.

From the table, over a third of own-account businesses identify infrastructure as the most important constraint to growth. Within infrastructure, the greatest challenge for own-account businesses is access to space to operate, followed by transportation and electricity access. For own-account businesses, the second most regularly quoted obstacle is access to finance. Similarly, micro enterprises are most likely to identify infrastructure as the biggest growth constraint, again driven by challenges associated with space to operate and electricity. The heterogeneity between own-account and micro enterprises becomes apparent in that competition is the second most cited obstacle to growth for micro enterprises, with finance falling to the fourth most cited constraint. For small and medium businesses, competition becomes the most regularly cited growth constraint, followed by infrastructure. Overall, these results indicate that as the size of the firm increases, the major obstacle to growth moves away from access to finance and towards competition; however, infrastructure remains a common obstacle across firm size.

In the profile section, we identified a bifurcated market for SMMEs in South Africa. Own-account workers make up the majority of SMMEs and are more likely to be informal and owned by vulnerable individuals than larger SMMEs—namely youth, Africans, females and the poorly educated. Furthermore, small and medium firms are more likely to be formal, pay higher wages and owned by higher-skilled and less vulnerable entrepreneurs—Whites, males and non-youth. Enabling both types of SMMEs to access a higher growth path will have a marked impact on their contribution to the economy and will be overall poverty and inequality reducing. Thus, policies to alleviate the constraints to growth for these types of SMMEs should be carefully targeted, taking into account this heterogeneity.

Access to finance is primarily a constraint for the smallest SMMEs. This is well-known in South Africa and there are many government initiatives in place to facilitate the financing of small business, especially those that are black, female and youth owned. For example, the Small Enterprise Financial Agency (SEFA) was established to provide financial support for SMMEs, up to a limit of 3 million rand. Furthermore, the National Youth Development Agency (NYDA) was established to address the youth unemployment crises particularly, and provides micro-finance grants for survivalist youth entrepreneurs. These initiatives will have the most significant impact on own-account, survivalist type SMMEs, as these businesses were the most likely to identify access to finance as their biggest obstacle to growth.

Competition is the most regularly cited constraint to growth for small and medium SMMEs. As Section 4.2.1 identified, some competition constraints, for example those associated with the efficiency and scale of competitors, are not legally prohibited. For this reason, these constraints should be dealt with through more general policy measures that support the entry and growth of small businesses. In terms of anti-competitive behaviour, small firms are somewhat protected by the Competition Act, although we have noted its limitations in this regard. Therefore, additional and possibly stronger policy intervention which serve to restrict the behaviour of incumbents may be necessary.

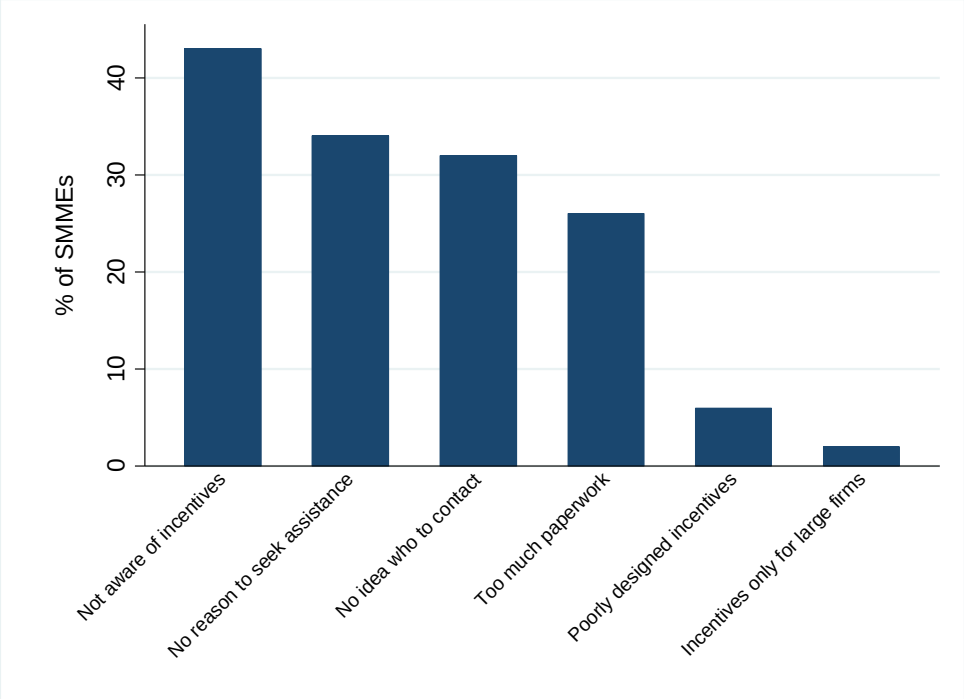
Infrastructure is identified as a major obstacle to growth across SMMEs of all sizes. The major driver of this constraint is access to space to operate. In South Africa, major economic hubs are not designed to accommodate substantial informal and micro business trade. Therefore, not only are vulnerable South Africans spatially separated from areas of high economic activity, these areas are yet to undergo the radical spatial transformation required to accommodate large-scale entrepreneurship.

Warwick Junction is an example of the integration of informal trade into the Durban city centre. The 1996 Warwick Junction Urban Renewal Project was born out of a combination of inclusive national legislation and a highly progressive local-level policy framework. The project objective

was to focus on safety, trade, employment opportunities and an effective public transport system for the area (Badsha, 2003). The city council spent approximately 4 million rand on infrastructure, creating a lucrative inner city trading opportunity for informal vendors, orientated around Durban's primary transport node. In 2009, Warwick Junction accommodated 460 000 commuters and 5000 to 8000 traders on a daily basis (Dobson et al., 2009). However, conditions at Warwick Junction have been deteriorating in recent years, with much of the area falling into disrepair (van Schilfgaarde, 2013). As a result, social relations between traders and city officials is breaking down. Most notably, there were intense clashes over the city's 2009 proposal to build a mall on the site of the Warwick Junction morning market. This case study illustrates how instrumental local government is in creating spaces in which informal activity can thrive.

Recently, there has been an increase in policies focussing on the development of infrastructure, specifically for small business. For example, the National Informal Business Upliftment Strategy (NIBUS) makes provision for funding infrastructure in areas shared by a number of informal traders. While this is a positive initiative, more can be done on the local level to understand the specific infrastructure requirements of SMMEs in the community.

Figure 15: Reasons SMMEs Did Not Participate in Government Support Programmes



Source: SME Growth Index Data (2013) in Business Environment Specialists (2014).

Overall, while government policy does exist to enable SMMEs to overcome the major constraints identified, the SME Growth Index (2013) indicates that 81 percent of SMME owners did not participate in any government support programme. Figure 15 outlines the reasons for this, and shows that the majority of SMME owners did not participate due to lack of information—either because they did not know the programme existed or because they did not know who to contact. Therefore, as the onus is on small business owners to find the support that they need, the extent to which these programmes are effective will depend on both their visibility and their accessibility.

6 Conclusion

SMMEs have been identified as a key component to advancing inclusive growth and development in South Africa's National Development Plan, with government highlighting the importance of these businesses for job creation, innovation and competitiveness. The National Development Plan envisions that 90 percent of new jobs will be created by SMMEs in South Africa by 2030. However, the current marginalised economic role of small and medium enterprises, particularly in relation to comparable regions, suggests that SMMEs operate within an environment that is not conducive to their success in South Africa. This goal of SMME driven job creation will thus not be achieved without appropriate policy intervention geared towards assisting SMMEs in overcoming the obstacles impeding these enterprises.

In this regard, we have noted that there is a clear distinction between SMMEs and large firms in South Africa, particularly in terms of firm and owner characteristics. However, more importantly, we have identified heterogeneity across South African SMMEs of different sizes. This indicates that while all SMMEs are constrained relative to large firms, the types and degree of constraints differ across SMMEs. Specifically, two distinct groups of SMMEs can be identified from the SMME profile—larger SMMEs, which tend to be owned by males, non-youth, Whites and the high skilled—and on the other hand—own-account businesses, which tend to be in the informal sector and are represented by relatively more females, youth, Africans and low-skilled individuals. Own-account businesses therefore predominantly represent survivalist type firms, who generally have poor labour market prospects. This group is economically significant, as own-account businesses make up 63 percent of SMME entrepreneurs.

We have identified different constraints that are currently impeding both of these groups of SMMEs. Using the 2010 FinScope small business survey data, we have considered which constraints are most binding on SMMEs of differing sizes. Own-account businesses, which are more likely to be located in the informal sector, identify infrastructure as the biggest constraint to growth. Access to finance is the second most regularly quoted obstacle for this group of firms. Similarly, micro enterprises, which are roughly equally distributed between the formal and informal sectors, are most likely to identify infrastructure as the biggest growth constraint. However, for this group of firms, the second most identified most binding growth constraint is competition. For small and medium businesses, almost all of whom are in the formal sector, competition becomes the most regularly cited growth constraint, followed by infrastructure. Overall, the results indicate that as size increases and formality status changes, the major obstacle to growth moves away from access to finance and towards competition. However, infrastructure remains an overarching obstacle across all SMMEs.

In contrast, relative to SMMEs, large firms which are already active and established in the economy face the least constraints to growth and indeed, as incumbents, can even act as a constraint on the growth of SMMEs. The implication of this is that larger firms are able to operate and grow with relative ease, while SMMEs (both in the formal and informal sector), and the unemployed, face considerable challenges that prevent them from entering and growing in the market. This reinforces an unequal growth path in which large firms, and those able to access the economic opportunities afforded by these firms, are able to capture economic opportunities and grow. On the other hand, small and medium firms face considerable constraints to entry and growth, therefore the unemployed are unable to access economic opportunities either as entrepreneurs or employees of SMMEs.

This bifurcated market for SMMEs requires a nuanced set of policy solutions for each component of the SMME cohort to achieve a more inclusive and equal growth agenda. Assistance to smaller firms, which are more likely to be located in the informal sector and be survivalist, may primarily be viewed as part of a poverty reduction strategy of the state. Interventions for larger firms, either already within or on the periphery of the formal sector, should be focused on increasing wage employment levels and redistributing market share amongst a larger set of firms. Further, those businesses in the informal cohort that are survivalist should be supported, so that they are able to enter the formal sector and move beyond mere economic participation for the sake of survival and towards increased earnings and employment creation.

SMMEs have the potential to be a sustainable mechanism through which the wages of those at the bottom of the wage distribution can be increased and the level of inequality reduced. However, they will only be able to fulfil this potential in an environment which minimises their growth constraints. Where constraints are uniformly binding on SMMEs, such as in the case of infrastructure, broad interventions to enable SMMEs to overcome their shared impediments are appropriate. However, where it is clear that constraints differ according to SMME size, and within different sectors, policies to alleviate the constraints to growth should be carefully targeted and tailored.

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