

# KEY TO GROWTH



## Supporting South Africa's emerging entrepreneurs



**CDE RESEARCH**  
POLICY IN THE MAKING

**12**

# **KEY TO GROWTH**

**Supporting South Africa's  
emerging entrepreneurs**



THE **C**ENTRE FOR **D**EVELOPMENT AND **E**NTERPRISE

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*CDE Research: Policy in the Making* is a vehicle for disseminating research findings and policy recommendations on crucial national challenges. Each issue is based on in-depth research, including numerous specially commissioned background research reports written by experts in the field.

SERIES EDITOR

Ann Bernstein

This CDE report is a collective effort. It is based on a lengthy resource document produced by Professor Lawrence Schlemmer, senior consultant to CDE, assisted by Judi Hudson, a former CDE research co-ordinator. The resource document, in turn, is based on background research reports commissioned from experts in South Africa and abroad. The final report has been written by Dr Sandy Johnston, senior CDE associate, in collaboration with Dr Jeff McCarthy, a consultant to CDE, Professor Schlemmer, and Ann Bernstein, CDE's executive director. It has been edited by Riaan de Villiers, publishing consultant to CDE.

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'A good SMME strategy is in reality a good private  
sector development strategy.'

– Kristin Hallberg,  
International Finance Corporation

## EXECUTIVE SUMMARY

South Africa has not escaped the global trend in development wisdom that looks to entrepreneurship, in the form of small, medium, and micro enterprises (SMMES) in particular, for a variety of desirable outcomes, especially dynamic economic growth and employment creation.

However, its efforts to promote this economic sector have produced disappointing results. According to comparative research, entrepreneurship in South Africa lags behind that in Chile, Thailand, Mexico, and its other peers among emerging markets. Spending public money on promoting small and medium enterprises should produce concrete dividends, but the record suggests that, in this country, it has been more of a misplaced subsidy.

Almost ten years after the small business sector assumed a central place in the government's development strategy, we know too little about it, expect too many different things of it, and do not have a comprehensive strategy for developing it. Our figures on the basics lack authority: how many enterprises are there, of what sizes, in what sectors? Perhaps more importantly, we lack the convincing research on the dynamics and cycles of business formation and development that would help us craft enterprise development policies with greater confidence.

### Policy and performance

South Africa's poor comparative performance does not mean that South Africans lack entrepreneurial potential. CDE's research has produced far too many examples of successful entrepreneurship – by South Africans and immigrants – for such a gloomy verdict. Indeed, in the past this success was often achieved in the teeth of a political dispensation that was hostile to any show of energy and enterprise on the part of the majority of the population. In democratic South Africa there are many more cases of people who are meeting opportunity with ingenuity, and converting political freedom into economic independence.

Nor is South Africa's poor performance the result of neglect on the part of the new democratic government. On the contrary, the white paper of 1995 and the 1996 legislation that laid the foundation for government support to SMMES came early in the first decade of democratic rule, and gave small and medium business a central place in the country's development strategies. Enterprise-supporting bureaucracies were set up with mandates to enhance skills, facilitate access to finance, and conduct the kind of research that would guide policy independence.

Eight years later, however, despite numerous admissions by the government that it needs to overhaul policy in this area, a promised new overarching strategy for enterprise support has still not materialised. Research has been produced without much in the way of usable product, and in at least one case (the Ntsika Regulatory Review of 1997–9) the government has been reluctant to accept the sensible recommendations of its own task team.

CDE has identified the following reasons for the widely recognised underperformance of government programmes in this area:

- confusion of purpose, which makes entrepreneurship a vehicle for poverty relief and racially defined empowerment as well as for adding value to the economy;
- a misplaced emphasis on access to finance as the biggest obstacle to small business growth, despite evidence to the contrary in South Africa and elsewhere;
- a failure to adopt a holistic approach to enterprise support – for instance, by not encouraging the immigration of entrepreneurs from Africa and elsewhere;

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Spending public money on promoting small and medium enterprises should produce concrete dividends, but the record suggests that, in this country, it has been more of a misplaced subsidy

- concentration on the state-driven delivery of services rather than a more demand-driven strategy exploiting partnership possibilities with the private sector; and
- neglect of the fundamental premise of entrepreneurship support, namely that encouraging an enabling environment will be more successful than any attempt by state bureaucracies to deliver the right things to the right businesses.

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Encouraging an enabling environment will be more successful than any attempt by state bureaucracies to deliver the right things to the right businesses

### **International experience and South African successes**

*In evolving its recommendations, CDE has been guided first of all by home-grown success, which numerous case histories of successful emergent South African entrepreneurs have amply provided. Despite the apparently discouraging comparative figures, there are real signs of vitality and enterprise in response to opportunity. CDE's proposals for supporting – and stimulating – this entrepreneurial vigour is shaped by hard evidence from many international studies which:*

- downplay the role of access to loan finance as a factor determining the success of enterprises, and emphasise the importance of would-be entrepreneurs injecting some of their own resources into the businesses they create;
- identify the importance of more demand-driven, market-related skills development and support, especially by people with direct experience of successful entrepreneurship;
- confirm the importance of the business environment – including the direct and indirect costs of doing business – to the growth of successful small businesses; and
- place the RIA (regulatory impact assessment) principle at the heart of policies aimed at improving the entrepreneurial climate.

*South African research and experience confirm the validity of these international findings. Among the points of convergence are: the fallacy of overemphasising access to loan finance as a determinant of success; the importance of 'soft' variables such as individual and cultural attitudes; the need for a facilitating environment; and the potential of immigrant entrepreneurs.*

*These South African success stories and the lessons drawn from international experience have helped us to suggest ways forward, and formulate specific recommendations.*

### **CDE's recommendations**

*Flowing from the review of international research, and the research undertaken in South Africa by CDE and others, CDE's recommendations are as follows:*

#### **1. Develop new guidelines for supporting entrepreneurship**

*Policy in this area should be rationalised and re-prioritised, allowing social welfare and empowerment goals to be separated from the promotion of entrepreneurship and pursued by other, more appropriate means, thus leaving policies on entrepreneurship to concentrate on expanding the business sector in the most efficient way possible.*

*The government should assign a high priority to the promotion of entrepreneurship, and move from service delivery to facilitation. The most important priority is to create the most enabling environment possible for entrepreneurs. This does not mean that emerging entrepreneurs should be left to sink or swim. But in so far as resources are devoted to enterprise support, it should be through 'smart partnerships' between the public and private sectors.*

## 2. *Appoint a task team to find ways of reducing the costs of doing business in South Africa*

*The government is making a sincere effort to lower the operating costs of SMMES, but without paying attention to the broader framework in which entrepreneurs operate. The real costs arise from a wider range of elements than those currently targeted, and tend to have more impact on small businesses than large ones. They include the costs of security against crime; complex tax regulations, and special levies that are added to the tax burden and have a negative impact on the cash flows of small businesses; labour costs, and the costs of complying with complex labour regulations; infrastructure costs, including transport and information technology; and delays in giving foreigners work permits.*

*The government should immediately appoint a high-level public–private sector task team to examine ways of reducing these and other costs.*

## 3. *Establish a regulatory impact unit in the presidency*

*Such a unit should review the likely impact of all draft legislation on the costs of doing business, especially for SMMES. In this respect, it is vital to remember the key research finding that only one other factor – a nation’s level of available skills – is as strongly correlated with per capita income growth as an appropriate regulatory environment.*

## 4. *Encourage immigrant entrepreneurs*

*All South Africans need to appreciate fully the relationship between immigration policy and the promotion of entrepreneurship. We need an influx of skilled people to help develop our economy, and train our citizens. We should recruit skilled foreigners who already have job offers in South Africa, as well as those who do not yet have jobs. We should also allow entrepreneurs into the country, from Africa and further afield, who have experience in running small businesses, and not restrict entry to larger investors only. Whether or not the new immigration policy will encourage economic growth will depend on how the new regulations are defined, interpreted, and implemented. The country’s entrepreneurial vitality could be greatly boosted by the way in which government and officials apply criteria for admitting foreign entrepreneurs.*

## 5. *Build on the private sector’s strengths with respect to implementation*

*Stimulating private sector supply, and upgrading its capacity to respond to the demands of new and expanding private enterprises, should be a central tool of public policy.*

*Entrepreneurship support should be shifted away from state or quasi-state agencies to competitive private sector providers, by providing the latter with incentives to work with emerging entrepreneurs.*

*In the same way, incentives for large companies to subcontract to smaller businesses could play a very valuable role. A public–private task team should be created to determine what is appropriate for the government to do in this field, and what should be left to the private sector. Another important task for such a task team would be to determine what entrepreneurs in each sector of the economy really need.*

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Entrepreneurship support should be shifted away from state or quasi-state agencies to competitive private sector providers



## 6. Ensure much improved information

*It is widely agreed that policy-making in the field of entrepreneurship development is hampered by a lack of information. We need to know more about what is actually happening in the economy. How are South Africans responding to new opportunities? What SMME sectors are growing, and why? Which supportive measures work, and which don't?*

*How can we encourage the private sector to provide support services to developing entrepreneurs? What is the best way of providing aspiring entrepreneurs with access to finance? How can aspiring entrepreneurs best be matched with corporate partners requiring services? And what is the best way of monitoring the outcomes?*

*Besides these questions, we need to know far more about the rates of conversion from informal sector to formal. What are the qualities that distinguish enterprises that have made this conversion, both in South Africa and in other developing countries?*

*To clarify sound policy directions across the whole economy, we need to know more about the relationships between black economic empowerment, sector charters, and entrepreneurship. Policies that do not promote genuine economic growth through expanding successful entrepreneurship will not serve broad-based black economic empowerment in the long run.*

## 7. Celebrate entrepreneurs as heroes

*The country needs to identify, publicise, and celebrate black and white South Africans who have become successful entrepreneurs through their own resourcefulness, and against the odds. Make them the new struggle heroes of the second decade of democratic rule. Learn from their success for future policy, and help other South Africans by making them role models*

## Conclusion

*South Africa does not perform well in terms of entrepreneurship when measured against other countries. However, the comparative figures give us an interim report, not a verdict. They are sobering, but they should not discourage us because they do not tell the whole story. The main report contains many examples of people from widely different backgrounds who have converted opportunity into successful entrepreneurship. They could have been multiplied many times. If the poor performance statistics are a call to action, these case histories provide us with the encouragement, incentive, and direction to do better. We can do better if we focus on providing the best possible enabling environment for aspiring entrepreneurs to grow their businesses, if we shift the direction of enterprise support from government bureaucracy to public-private partnership, and if we celebrate the achievements of already successful entrepreneurs as they deserve. If we do these things, their ranks will multiply in an expanding and flourishing non-racial business sector.*

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Martin Brophy, left, owner of Lomar Printers, with one of 12 employees. This small printing firm specialises in work for packaging companies.

## INTRODUCTION

This report reviews recent South African and international research on entrepreneurship. The research confirms that entrepreneurship plays a key role in economic development. In line with this, many government planners, journalists, academics, civil society players, and business people agree that entrepreneurship, and smaller aspirant entrepreneurs in particular, should be vigorously encouraged. The government has adopted numerous policies aimed at achieving this goal, and programmes introduced to implement those policies have been well-funded and widely publicised.

However, this consensus lacks focus and a concentration of purpose, and displays several conceptions of the meaning and purpose of entrepreneurship. Notably, the government has sought to promote entrepreneurship in order to achieve a variety of hoped-for benefits, including black empowerment; providing a 'survivalist' cushion for people who have lost their jobs in the formal sector as a result of restructuring exercises; and driving economic growth and job creation.

### *Central concern*

We need to state clearly not only what this document is about, but also what it is not about. Its central concern is not to debate whether directing resources at the survivalist end of the informal sector is an effective way of alleviating hardship. Nor is it directly concerned with the merits of supporting entrepreneurship as a means of stimulating black economic empowerment.

These issues are not ignored in the pages to come, but they are dealt with only insofar as they affect the central concern of this study, namely to argue that the best way of encouraging entrepreneurship is to increase the number of ventures that successfully provide value-adding services to the formal sector.

In this respect, South Africa compares badly with other countries. In terms of the

A new, more realistic, and more businesslike approach to supporting small business and developing a culture of enterprise is required

Global Entrepreneurship Monitor (GEM), compiled by the Graduate School of Business of the University of Cape Town, this country:

- achieves the lowest score of all *developing* countries in terms of all the indicators used to measure entrepreneurship, namely ‘opportunity’, ‘necessity’, ‘start-up’, and ‘new firms’ (see page 19 for a definition of these terms);
- is in the bottom quartile of *all* countries in terms of ‘opportunity entrepreneurship’ and ‘new firm activity’; and
- achieves a low rate in terms of the survival of entrepreneur start-ups.<sup>1</sup>

There are deep-rooted structural reasons for this poor performance. The exclusions and distortions of apartheid have wreaked havoc in this sector of the economy as in all others, leaving many ill-equipped with the skills, resources, and confidence needed to embark on entrepreneurial careers. The government has identified what it now calls ‘enterprise promotion’ as an important vehicle of economic empowerment and development. However, it will be argued that government policy will have to be based on sounder analysis, and be more clearly focused, if it is to alter these unfavourable figures significantly and urgently.

A new, more realistic, and more businesslike approach to supporting small business and developing a culture of enterprise is therefore required. This is particularly true if entrepreneurship and particularly small businesses, are to achieve their full potential for creating jobs. This report contains a number of accounts of successful entrepreneurs, mainly historically disadvantaged South Africans. They illustrate a thriving spirit of entrepreneurship that contradicts the disappointing comparative figures with which this section began. This report has been written in the belief that the right policies will foster this spirit, bringing it to wider and fuller expression.

### Objectives and structure of the report

The most important source for this report is a major CDE resource document entitled ‘Entrepreneurship and expanding the business sector in South Africa’.<sup>2</sup> That report is based, in turn,

### Small beginnings at Park Station<sup>3</sup>

Amid hawkers and a bookstore that sells Bibles and other religious literature, Maluti Thedebehali has a stand offering coverless, dog-eared, and sometimes torn second-hand schoolbooks. At any hour of the day, people ploughing through the books and negotiating a price with Maluti or one of his assistants surround his stand. It is not only students who stop to buy. Some teachers have encouraged him to sell at their colleges.

Maluti started his business in 1997, shortly after the company he was working for had pulled out of South Africa. ‘That was the first time that the idea of selling second-hand books entered my head,’ he recounts. At the onset it was all a question of survival, and a desire for money. But now he gives books away because ‘my people don’t read’.

Books for students were and still are very expensive.

Maluti hit on the idea of specialising in textbooks at reduced prices. ‘I searched for an ideal location, a prime spot where I could establish myself, and pretty soon I decided on Park Station because of the number of students who use either trains or taxis to travel to school.’

Diminutive Maluti is described as ‘nifty, adroit, patient’ and ‘hyperactive’ – qualities that have no doubt enabled him to build a business capable of financing two assistants and a flat in Newtown. Some of the people he has hired have proved to be ungrateful, emerging as ‘crooks who pilfered my profits’, he says, but without rancour.

‘I started this business with five dirty and coverless books’ he laughs. ‘Today I have so many that I give some away for free.’

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on 12 background research reports commissioned from local and international analysts, additional CDE research, and other recent major studies of entrepreneurship in South Africa.

This report:

- extracts key themes from the document relevant to the more effective promotion of entrepreneurship in South Africa;
- illustrates and expands on these themes by drawing on the results of numerous international and local surveys, and by presenting studies of successful South African entrepreneurs;
- relates these themes to the results of recent research in South Africa and other countries, and to current emphases in South African government policy; and
- suggests new policy emphases that would bring much-needed focus to the promotion of small business and entrepreneurship in South Africa.

It is important to establish at the outset the understanding of entrepreneurship that informs this study. Most international analysts would agree with the following definition by Peter Drucker in his famous book on the subject, *Innovation and entrepreneurship*:

Entrepreneurship is a resource that adds to and often multiplies the value of the sum of other productive ingredients (eg land, labour, technology, etc) that lead to the economically valued outputs of a society.<sup>4</sup>

With this view of entrepreneurship guiding the report, we reflect in conclusion that if small business and entrepreneurship combine to add or even multiply such value, they are certainly worthy of policy support. However if they do not, it is worth reconsidering how we support them, or why we should support them at all. Arguably, political necessity and pressure of interests have forced the expansion and inflation of what we hope support for entrepreneurship in South Africa can achieve. Poverty alleviation and black empowerment are examples of this expanded agenda of policy goals that are sought through enterprise support. But, however pressing these imperatives and interests might seem, they should not be allowed to obscure the true priority in supporting entrepreneurship, namely to create an enterprise-supporting environment in which individuals who have the essential qualities of entrepreneurship will be encouraged to come forward in much greater numbers, and also expand the businesses they have already founded. The purpose of this report is to survey and analyse research findings in order to make policy recommendations on supporting entrepreneurship in South Africa. However, any project of this sort should be situated in a preliminary understanding of the subject, as well as a normative framework. Some introductory remarks should help to orient the reader in these respects.

### **The nature of entrepreneurship**

We have already referred to Drucker's definition of entrepreneurship as a resource that adds value to the economy, namely a quality displayed by individuals who have the right attitudes and capacities to recognise and develop market-related opportunities to provide goods and services for profit, especially in response to changing economic and/or business conditions. This disposition and talent can be shown at all levels of economic activity, in formal and informal businesses, and in large corporations and survivalist enterprises. Conventionally, however, we think of entrepreneurship in its strongest and purest forms at the level of small and medium business where individualism, self-reliance, and risk-taking

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are particularly prominent. It is this version of entrepreneurship that we associate with the conversion of change into opportunity, and with innovation, competition, and the exploitation of the new on which sustainable, market-led growth depends. Certainly this is an idealised version, but, as we shall see, there are plenty of examples in contemporary South Africa that conform to it. It is an ideal that policies should celebrate and make easier to realise.

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We should not have inflated expectations of what policies encouraging entrepreneurship can or should achieve

### How and why do people become entrepreneurs?

Entrepreneurs are a minority in all societies; therefore, we should not have inflated expectations of what policies encouraging entrepreneurship can or should achieve. Any one or any combination of the following factors can predispose individuals towards entrepreneurship:

- disposition: a mixture of psychological needs for autonomy and/or creativity ('I have always wanted to be my own boss/build something for my family') with qualities of self-confidence and self-reliance;
- cultural values in a given society that favour individualism as well as a tolerance of risk and failure;
- hope of material reward, coupled with a willingness to defer its enjoyment; and
- workplace experience which confers particular skills that can be used to produce or market goods or services, especially when this builds on advanced formal education.

Any one or a combination of the following can trigger entrepreneurship:

- the recognition of an opportunity in the marketplace for a particular product or service;
- larger economic movements, such as economic booms or recessions, that entice or force people into self-employment; and
- business dynamics such as restructuring, downsizing, or outsourcing.

## Different views of entrepreneurship

### Entrepreneurship and the state

'We need genuine black entrepreneurs ... who can help the state expand its industrial presence into places outside of the existing industrial enclaves owned by the giant corporations that still own much of the South African economy'.

– ANC MP Ben Turok<sup>5</sup>

### Entrepreneurship as panacea

'SMEs play a far more important role in developing countries than in the industrial countries, since they make a major contribution to socio-political stability. Successful SMEs not only absorb a significant part of the unemployed labour force, but also reduce crime and government expenditure on security and legal service ...

'Furthermore, creating SMEs is one of the most promising means of progressively redistributing the ownership of productive assets; ie SMEs have the potential to be an engine for black economic empowerment'. – *Report for the Policy Board for Financial Services and Regulation*<sup>6</sup>

### Entrepreneurship as 'real' empowerment

'The danger remains that the government and established white business appear to regard their obligation to assist in the development of black involvement in the economy as largely dispensed (sic) because of the high profile nature of these (empowerment) groups. As a result, the real empowerment imperatives, job creation and the development of new businesses, are left without any powerful protagonists to drive them'. – *Journalist Ann Crotty*<sup>7</sup> CDE 2004

These factors suggest that an orientation towards entrepreneurship is unlikely to be evenly or proportionally distributed through the population at large. This further suggests that the key task of policy aimed at raising levels of entrepreneurship should be to create conditions under which individuals can discover and express the qualities we have described. It follows that if support is to be delivered, it should be to individuals who in one way or another have exemplified those qualities and dispositions. It is also worth remembering that entrepreneurship – as we shall see later – is often concentrated among certain social groupings (eg among immigrants).

### Entrepreneurship today: the ‘halo effect’

Today, entrepreneurship is a valued and sought-after commodity virtually everywhere. However, this does not necessarily make it easier to design policies for supporting and developing entrepreneurship in any given society or economy. Indeed, because of its ubiquity, the notion of entrepreneurship is surrounded by a ‘halo effect’ that can confuse and blur the principles and purposes of supporting it. It is compatible with many, perhaps all, of the conventional wisdoms that have shaped the politics and economics of recent times, including:

- economic wisdom that holds innovation, opportunity, and competition – all associated with entrepreneurship – to be essential to economic development;
- business wisdom that enjoins large corporations to focus on core business, and smaller ones to take advantage of niche markets and the opportunities presented by outsourcing; and
- political wisdom that sees in entrepreneurship the empowerment of the self-realisation, self-reliance, and independence of mind that ward off collectivism and feed plural democracy.

This means that it is almost universally praised as a public good that ought to be more widely available, and a public resource that adds value beyond the individual entrepreneurs themselves. As a result, entrepreneurship is made to fit all sorts of views of economy and society (see box, **Different views of entrepreneurship**, facing page), which may or may not be in harmony with each other. These include:

- a prescription for the dynamic exploitation of globalisation, capitalising on and multiplying innovation and competition;
- a vehicle for redress and economic empowerment;
- a safety net for casualties of restructuring; and
- a source of valuable cultural attitudes and practices.

Above all, the current celebration of entrepreneurship has helped to reconcile former collectivists to the market by injecting an element of populism into the idea of ‘business’, especially where ‘small business’ can be championed against multinationals and ‘big capital’. Arguably there are no more zealous converts to small business among the world’s governments than adherents of the ‘third way’, ie, former socialists in Britain’s New Labour Party. Led by the chancellor of the exchequer, Gordon Brown, they regard what they describe as the ‘small business revolution’ as key to harnessing the market for ‘enterprise and wealth creation for all’. Brown’s rhetoric (which has echoes in the South African government) sums up the ‘halo effect’ admirably: ‘... by Britain championing entrepreneurship *open to all*, we serve a great patriotic purpose’ (emphasis added).<sup>8</sup>

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## Supporting entrepreneurship

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The priority is to clear space for smaller businesses that will add value to the economy

The universal endorsement of entrepreneurship makes it a good candidate for government support and promotion. However, in South Africa potential entrepreneurs who are to be supported, and hopes for the presumed beneficial effects of entrepreneurship, are both extremely varied. As a result, it is difficult to design policies that are sufficiently refined and discriminating to be effective. One size does not fit all, true priorities can be obscured, and it is unusually difficult for policy-makers to get it right in this field.

### Summary

Our starting point, then, is that we have to penetrate the general cloud of goodwill that surrounds the subject of entrepreneurship as a first step towards a clearer understanding of it, and more focused and more effective policies. Only in this way can we successfully measure the efficacy of policies for developing and supporting entrepreneurship. It is not enough for everyone to agree that entrepreneurship is central to economic growth and job creation, and that governments have an important role to play in promoting it. The priority is to clear space for smaller businesses in particular that will add value to the economy, and we should do this by facilitating an encouraging and hospitable environment rather than by trying to create bureaucratic support structures.

An essential preliminary to all of this, however, is to be clear about the current size and shape of the small and medium business sector, where entrepreneurship is most clearly expressed.

## Entrepreneurship in Mitchell's Plain, Langa, and Khayelitsha<sup>9</sup>

Meet some entrepreneurs from Mitchell's Plain, Khayelitsha, and Langa who have all launched their own hospitality businesses:

- Zeitoun Najjaar is a cultural tour guide who introduces tourists to the history of the slaves in Cape Town. 'The story of the slaves is our origin and yet it is such a neglected part of our culture. Having this business is my dream. But without business skills, I realise that this dream will surely die.'
- Lydia Masoleng, formerly a domestic worker, is a B&B owner from Khayelitsha. She says her three-bedroom house offers a homely environment to mostly international tourists for whom she cooks traditional Xhosa meals.
- Thandiwe Peter, an ex-nurse, owns a two-star B&B in Langa. She says she mostly receives guests from Durban and Johannesburg, although she has had international tourists staying in her three-bedroom home.
- Naiema Abrahams is the co-owner of a Cape Malay

take-away business, operating from Strandfontein. She still teaches at a high school as well.

- Lulu Silwana, a public relations management alumnus of the Technikon, owns a craft shop in Khayelitsha where she trains women who then sell their work in her shop. Their merchandise includes anything from traditional dolls, to table accessories and bedding.
- Lungi Khaye has been working at a restaurant in Crossroads for three years and will shortly be opening her own restaurant and guesthouse in Montana.
- Nadia Stoffberg owns an arts and craft gift shop which also sells traditional snacks in Mitchell's Plain. 'I want to change the perception people have of Mitchells Plain as a place of violence, crime and abuse. It should be marketed as a tourist destination and we have big plans for this.'
- Fatimah Shaik is a cultural tour guide, focusing on the slave route. She is based in Rondebosch East.

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Gloria Bacelain in front of her public telephone business, housed in an old shipping container in Molapo, Soweto.

## THE SIZE AND SHAPE OF THE SMME SECTOR

Any assessment of current policies for promoting and supporting entrepreneurship has to proceed from baseline assumptions about the size, significance, and health of the small business sector. Unfortunately, current information on small business in the country is far from authoritative. As the World Bank put it in 2001, 'One corollary to the relative underdevelopment of the small, medium, and micro enterprise (SMME) sector in South Africa is that little is known about the composition and features of this segment of the economy.'<sup>10</sup> A more recent survey confirms this view: 'Unfortunately, accurate information is far from being available in South Africa, especially on the informal sector, which apparently represents at least two thirds of the SMME population'<sup>11</sup>. There are two main reasons for this:

- First, as we have already pointed out, entrepreneurship occurs at all levels of enterprise, and over the whole range of economic activity. This makes it difficult to pin down, whether qualitatively or quantitatively. The divide between formal and informal enterprise exacerbates this general difficulty, because informal enterprises, by definition, lack some or all of the attributes in terms of which entrepreneurial activity can be recorded.
- Second, numerous bodies gather statistics relevant to recording entrepreneurship. Among these are the Department of Trade and Industry (DTI), the Department of Labour, the Receiver of Revenue, and the Registrar of Companies. The census and the now-discontinued October Household Survey (OHS) are also relevant to measurements of entrepreneurship. These bodies and instruments gather or record information on entrepreneurship for different purposes, using different methods and fields of measurement.

Given the varied character of this subject, and the wide range of statistical sources, it is not surprising that estimates of business activity relevant to a review of entrepreneurship can vary considerably.



Mindful of these difficulties, this review has followed the classifications of government bodies active in small business initiatives – notably the Ntsika Enterprise Promotion Agency – and has attempted to estimate numbers of enterprises for each.

The classifications are:

- *Survivalist enterprises*: pre-entrepreneurial, low-income, usually no paid employees, directed mainly at keeping alive, unregistered, non-tax-paying, and hence informal in status.
- *Micro enterprises*: operating below the VAT registration limit, often unregistered for other purposes as well; fewer than five employees.
- *Very small enterprises*: fewer than 10 paid employees, but registered for tax and other purposes and hence formal in status.
- *Small enterprises*: fewer than 50 employees, and formally registered.
- *Medium enterprises*: up to 100 employees, or 200 in mining, manufacturing, and construction.
- *Large enterprises*: more than 100 employees, or 200 in the case of mining, manufacturing, and construction.

This scheme illustrates the range involved, and puts into perspective the problems of diffuse purposes and policies to which we have already referred. To begin with, we are concerned with entrepreneurship in all these categories; however, our concerns and focus will narrow as we proceed.

### *Starting point*

Figures generated by Ntsika provide the starting point for a description of the SMME sector. In 1997 the agency's figures by enterprise class were as follows:

- 840 000 *survivalist enterprises*, accounting for 2,5 per cent of national employment;
- 500 000 *micro enterprises*, of which those with no employees accounted for 3,8 per cent of employment, and those with between one and four employees for 7,6 per cent;
- 180 000 *very small enterprises*, accounting for 14,4 per cent of employment;
- 58 900 *small enterprises*, accounting for 16,6 per cent;
- 10 000 *medium-sized enterprises*, accounting for 12 per cent of employment;<sup>12</sup> and
- 6 017 *large enterprises*, accounting for 43 per cent of employment.

However, an analysis of other statistical sources revealed that Ntsika's figures were incon-

An analysis of other statistical sources revealed that Ntsika's figures were inconsistent in a number of respects, and were probably serious underestimates

**Table 1: Estimated numbers of enterprises, 1999**

Survivalist / informal	1 200 000
Micro (owner only, some semi-formal)	500 000
Micro (0–4 employees)	350 000
Very small (<10 employees)	350 000
Small (<50 employees)	80 000
Medium (<100 employees or < 200 in certain sectors)	14 000
Large	6 500
<b>Total</b>	<b>2 500 500</b>

*Note: these figures include closed corporations.*

sistent in a number of respects, and were probably serious underestimates. Material surveyed included data generated by the OHS (on self-employment and the informal sector), SARS (registration for tax), a labour force survey undertaken for the department of labour, and figures for the registration of companies. An estimate of all enterprises by Christo Botes of Business Partnerships (previously the Small Business Development Corporation) helped CDE to arrive at a composite estimate for 1999 within the categories adopted by Ntsika (table 1).<sup>13</sup>

The total in table 1 is compatible with four other recent non-governmental estimates which range from 2,3 million to 3 million, and average 2,66 million.<sup>14</sup>

### *Considerable potential*

The DTI has estimated that 45 per cent of working South Africans are employed in the small business sector. This figure is confirmed by our estimates of employment in the categories micro (with employment), very small, and small, as reflected in table 2. Against this, small businesses account for 60 per cent of employment in most European economies, over 80 per cent of employment in southern European economies, and even higher percentages in some east Asian economies.<sup>15</sup> It is reasonable to infer from this that the small business sector in South Africa has considerable potential for employment creation and growth.

Despite being relatively low by international standards, the South African figure of 45 per cent represents 4,8 million working people – more than those employed by medium and large businesses combined. This obviously has important implications for any attempt to maximise the potential of entrepreneurship to create sorely needed jobs.

The findings presented so far suggest a number of points:

- The government bodies concerned with supporting entrepreneurship do not have a good statistical grasp of the business sectors in which entrepreneurship is found.
- Entrepreneurship in the South African economy is more extensive than Ntsika has estimated.
- In fairness to all concerned with generating figures, 'entrepreneurship' in South Africa

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Entrepreneurship in the South African economy is more extensive than Ntsika has estimated

**Table 2: Enterprises, employment, and rate of employment by enterprise, 1999<sup>16</sup>**

<b>Enterprises</b>	<b>Number</b>	<b>Employees</b>	<b>Rate</b>	<b>%</b>
Survivalist / informal	1 200 000	1 200 000	1,0	11
Micro (owner only, some semi-formal)	500 000	500 000	1,0	5
Micro (0-4 employees)	350 000	1 085 000	3,1	10
Very small (<10 employees)	350 000	2 077 000	5,9	19
Small (<50 employees)	80 000	1 665 000	20,8	15
Medium (<100 employees or <200 in certain sectors)	14 000	1 125 000	80,4	10
Large	6 500	3 414 000	525	31
<b>Total</b>	<b>2 500 500</b>	<b>11 066 000</b>	<b>4,1</b>	<b>100</b>

covers such a wide range of activities in such a wide variety of settings that they are very difficult to quantify, or study qualitatively.

- However, the level of entrepreneurial activity in South Africa is lower than the international average.

The level of entrepreneurial activity in South Africa is lower than the international average

### The international perspective

As noted previously, the rate of employment in the SMME sector of the South African economy is lower than in many others.

Ntsika has produced an estimate of the numbers of entrepreneurs and self-employed per 100 economically active people in order to estimate 'enterprise density'. It is difficult to say how reliable these figures are, but they also suggest an under-representation of smaller business and entrepreneurship in South Africa. For example, according to Ntsika, South Africa has an enterprise density of just 2 per cent as opposed to 4,1 per cent in both Swaziland and Zimbabwe.<sup>17</sup>

According to Statistics SA, survivalist enterprises in South Africa have increased by no less than 74 per cent since 1999, doubtlessly driven by high levels of unemployment.<sup>18</sup> This may well mean that we are catching up with the rest of the developing world in terms of rates of entrepreneurial activity, but hardly in an ideal form, because, as it is frequently observed, survivalist businesses rarely add significant value to the wider economic development purposes of entrepreneurship.

### GEM study

The most authoritative comparative study of entrepreneurship to date is that undertaken by the Global Entrepreneurship Monitor (GEM), which is sponsored by the United Nations, and based at the London School of Economics. The South African component of the study is researched by the UCT Business School. We will briefly review key findings from that

**Table 3: Entrepreneurship in 11 countries selected from the GEM<sup>19</sup>**

	TEA 2002	Necessity rate	Opportunity rate	Start-up rate	New firm rate	TEA 2001
1. Thailand*	18.9	3.35	15.31	11.63	8.4	n.a.
2. India*	17.88	5.04	12.42	10.89	7.45	11.55
3. Chile*	15.68	6.74	8.53	10.04	5.49	n.a.
4. New Zealand	14.01	2.25	11.57	9.13	6.06	18.07
5. Brazil*	13.53	7.5	5.78	5.69	8.46	12.74
6. US	10.51	1.15	9.11	7.09	4.57	11.61
7. South Africa*	6.54	2.38	3.3	4.71	2.0	9.45
8. Denmark	6.53	0.43	5.9	3.63	3.12	8.01
9. UK	5.37	0.69	4.38	2.49	3.05	7.8
10. Sweden	4	0.67	3.33	1.8	2.51	6.68
11. Japan	1.81	0.51	1.24	0.87	1.04	5.19

\* denotes developing countries comparable to South Africa.

study as a starting point for a discussion of CDE's own research into the international and comparative dimensions of South African entrepreneurship.

GEM surveys entrepreneurship in 37 countries. Its findings on 11 selected countries, including South Africa, appear in table 3. The figures in the columns are percentages, which reflect in order:

- *total entrepreneurial activity* (TEA) in 2002: the percentage of adults who are entrepreneurs;
- *necessity rate*: the percentage of all adults who are entrepreneurs out of perceived necessity;
- *opportunity rate*: the percentage of all adults who are entrepreneurs because of perceived opportunity;
- *start-up rate*: the percentage of all adults who have been involved in a new enterprise start up in the last 12 months and which has paid salaries or wages for less than three months; and
- *new firm rate*: the percentage of adults who own or part own an enterprise that has paid salaries and wages to others for between three and 42 months.<sup>20</sup>

The table shows that, in terms of total entrepreneurial activity, South Africa holds its own with or outperforms some developed countries, but lags far behind other developing countries. A low opportunity rate and a low survival rate are other salient features.

### Size matters, but so does shape

While an accurate statistical profile of entrepreneurs and their businesses is essential for sound policy-making, and international comparisons can both provide insights and spur action, this alone is not enough to guide policy-makers; there are additional important issues to do with size and shape.

The first point to be made – although, due to unreliable statistics, not with complete authority – is that survivalist and micro businesses make up a substantial part of South Africa's SMME sector. These categories sometimes overlap, but not always.<sup>21</sup> According to Trade and Industrial Policy Strategies (TIPS),<sup>22</sup> the informal sector 'apparently' accounts for at least two thirds of the total: 'It must be emphasised ... that the weight of the smallest size categories (micro enterprises) is overwhelming. Although their contribution to GDP is minor, they represent between 1,2 and 2,8 million businesses, ie between 69 per cent and 80 per cent of all SMMEs.'<sup>23</sup> Even if such evidence is less than completely watertight, the picture it points to of most South African 'entrepreneurs' running very small, usually informal, and often survivalist businesses accords well enough with general economic conditions in the country to be acceptable.

### *Conversion to formal enterprises*

The second point is that the conversion of enterprises from informal to formal concerns, and from smaller to larger ones, are even less well researched and understood. In the absence of hard data, experienced observers and practitioners in the small business field express considerable scepticism about the efficacy of attempts to help informal businesses convert to formal ones (see box, **Unconventional wisdom on entrepreneurship**, page 21.) Arguably, there could be no more valuable input into policy-making in this field than research that clarifies the causes of success – ie, the dynamics and cycles of business formation and development (or lack of it), as well as a clear idea of the qualities displayed by

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The conversion of enterprises from informal to formal concerns, and from smaller to larger ones, are even less well researched and understood

those businesses that do manage to convert from informal to formal, and/or grow in size. According to Professor Rashad Cassim of the University of the Witwatersrand, a model to follow in this regard is Brazil, whose government has ensured that policies for supporting and promoting enterprises are underpinned by extensive research, thus enabling the qualities needed for success to be identified.<sup>24</sup>

South African men are  
1,7 times more likely  
to be involved in  
entrepreneurial activity  
than South African  
women

### *Racial profile*

The third point to be made is that, given South Africa's history of racial exclusion, the racial profile of the SMME sector is important in any mapping exercise. In this respect, an examination of the 1999 October Household Survey data revealed that non-survivalist entrepreneurship in South Africa was still dominated by whites and Asians.<sup>25</sup> African non-survivalist entrepreneurs accounted for only 0,54 per cent of all economically active persons in the country, while white and Asian non-survivalist entrepreneurs accounted for 6,4 per cent and 3,8 per cent respectively. TIPS researchers confirm that 'an immense majority of SMMES are concentrated at the lowest end. These are primarily black survivalist firms.'<sup>26</sup>

Despite concerns about the lack of representation of Africans in more commercially complex SMMES, it would be unwise to underrate the degree of economic activity and commercial energy in the informal sector. The obvious racial imbalance does not mean that there are no successful black entrepreneurs. Home-based spaza shops, the 36 000 taverns of the shebeen trade, dealers in traditional medicine, and backyard and roadside vehicle repair services all add up to a massive display of entrepreneurial energy. There are also many African entrepreneurs who have made it at a higher level. Small businesses such as beauty parlours, construction firms, small retail chains, small manufacturers, bottling companies, and franchise operations have often shown great dynamism (see box, **Franchising and small business growth**, page 22).

As Ntsika points out, however, African representation in larger and more complex small businesses with higher entry barriers is still poor due to a relative lack of specialised education and skills.<sup>27</sup> A review of various success stories suggests that, with some notable exceptions that demonstrate great potential talent, African entrepreneurs have been most successful when:

### **Workers turn retrenchment into soap entrepreneurship<sup>28</sup>**

Six workers who lost their jobs seven years ago have found a new livelihood from producing powdered soap for their former employer, Unilever SA. In March 2002, Gauteng Soap Powders (GSP) was officially launched. A black-owned enterprise, GSP was built from R150 000 put together by the six partners who took over the soap powder operations their former employer outsourced.

Commenting on this initiative, Doug Baillie, former MD of Unilever SA, said:

'The success of this partnership lies in the successful transfer of knowledge and expertise. Through the partnership

with GSP, we commit ourselves to the development of small and medium business and black economic empowerment.'

Tony Smith of GSP pointed out that the company had been chosen for the deal – expected to grow GSP's turnover to R5 million a year from R1 million – due to its sound financial management and growth potential. GSP has already employed three more people. He concluded: 'We want to be a force to be reckoned with in the soap production business, and we are grateful for a chance to be part of big business.'

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## Unconventional wisdom on entrepreneurship<sup>29</sup>

Current wisdom is that South Africa should encourage the growth of entrepreneurship and job creation by helping to develop promising informal businesses into formal ones. Even more pervasive is the notion of 'start a business if you can't find a job'.

However, after eight years of observing interventions into informal business and the unemployed, Barrie Terblanche, editor of *Big News for the Business Owner*, believes that efforts in this direction are misplaced.

'Serious research is needed into the extent of graduation from informal to formal business, and whether it is at all possible on a large scale. My unhappy conclusion is that well-intentioned attempts at getting informal businesses to graduate to formal businesses have been a waste of scarce developmental resources.

'My observations suggest that informal business owners either remain informal, or leave their businesses to become formal employees. Unemployed youths who are encouraged to start their own businesses fail in frightful numbers when their attempts are coupled with formal business arrangements such as bank loans or contracts. It leaves them with ruined credit records and dashed confidence.'

Terblanche believes that formal business owners – who have the ability to create true wealth and proper jobs – are well educated and, more important, have previous work experience. 'The Global Entrepreneurship Monitor has shown beyond doubt the link between education and entrepreneurial success. For some reason, nobody has so far bothered to research the link between work experience and business survival. The circumstantial evidence is there: when we asked our readers (of *Big News*) what their greatest source of business training was, more than 90 per cent said "my previous job".'

Terblanche's conclusions were also arrived at from a nuanced understanding of the differing natures of informal and formal sector businesses. The key here is that an informal sector business is not simply a budding formal sector SMME.

'Informal business is run in the business owner's head. It is run (controlled) just as far as the business owner can see. Where he can't see, he is forced to appoint family members, and very often even his family members loot the busi-

ness. Therefore informal businesses never grow large.

'The owner of a formal business, on the other hand, is concerned with setting up abstract operational and control systems that run on their own. This is a very sophisticated activity. She can appoint anybody because all employees are controlled by the systems that she engineered. She can grow her business to any size.

'The question is, can such abstract thought be taught to an adult through a quick and cost-effective intervention? I have not seen one such intervention work. Each of these programmes has its success stories, but I would say they are less than 1 per cent of the participants – far too little to justify the spending of scarce developmental money.

'It seems that a major step forward would be for the development community to accept this reality, and to rather train informal business owners to become employable, and to support employed middle management to become employers.'

Terblanche recommends that South Africa's small business development strategy should be refocused along the following lines:

- Encourage corporate middle managers to leave their comfort zones, and start businesses. This can be done through grants and various other incentives.
- Improve the cultivation of strategic business thought and skills at school. It is far too expensive to correct their absence in adults.
- Research the low rate of conversion of informal businesses into formal companies, as well as the role of previous work experience in business success.
- Support informal businesses, but not by trying to turn them into formal businesses. A good start would be to study the support systems that already exist in the relationship between suppliers of goods and services to township spazas, for example.
- Help unemployed youths to become employable before trying to turn them into employers. If the funder is adamant that the money should be spent on self-employment of unemployed youths, make sure that a major job shadow programme is part of the intervention, and be very wary of getting them into debt.

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The incomes generated by informal businesses are critically low, and too few graduate from it to 'real' entrepreneurship

- they have acquired a stake in successful white or multiracial enterprises;
- their participation or acquisition has been 'sponsored' by a multi national company;
- companies they previously worked for have helped them to buy out non-core operations, and continued to buy those services from them;
- their investments have been backed by trade union capital and expertise; or
- they have successfully bid for contracts put out by the Department of Public Works and other state and parastatal agencies.

### *Age and gender*

Questions of age and gender are also pertinent to an analysis of the SMME sector. According to a GEM report, South African men are 1,7 times more likely to be involved in entrepreneurial activity than South African women, a figure that is slightly higher than the global average.<sup>30</sup> The same report claims to reveal a much more serious anomaly, namely a 'deficit' of entrepreneurial activity among young South African males: it states that South African men between 25 and 44 years are less than half as likely, and men between 18 and 44 years less than 40 per cent as likely, to be entrepreneurs than their peers in other developing countries.<sup>31</sup> Indeed, the report claims that much of the difference in entrepreneurial activity between South Africa and other developing countries can be accounted for by this deficit. Although this issue has not been researched in depth, this 'generation

## **Franchising and small business growth**

Many analysts regard franchising as an effective way of creating jobs and developing entrepreneurial skills, particularly among members of previously disadvantaged communities. South Africa has one of the fastest growing franchise sectors in the world.<sup>32</sup> Excluding the petroleum industry, the turnover of the franchise sector in 2001 was estimated at R70,3 billion (about 6,8 per cent of GDP).<sup>33</sup> In 2001, 43,6 per cent of franchise owners were black,<sup>34</sup> and black participation in franchising doubled between 1995 and 2000.<sup>35</sup>

Franchising is seen as less risky during economic slumps because of the powerful branding of most franchise companies. Banks are more willing to fund franchises than other small businesses, as they are seen as 'tried and tested' businesses, with a proven format and a generally lower failure rate than other new businesses.

Jo Schwenke, managing director of Business Partners, has stated that: 'Franchising provides a practical business model, immediately functional, and therefore accessible to previously disadvantaged individuals who have not had prior exposure to intensive training. Franchising also offers a supportive environment and ongoing growth potential.'<sup>36</sup>

However franchising offers no guarantees. According to

Ben Filmler, founder of the Mugg and Bean franchise, the success of a franchise rests almost solely on the capabilities of the operator.<sup>37</sup> This is reflected in selection priorities. According to the South African Franchise Baseline Census 2002,<sup>38</sup> the criteria for selecting potential franchisees that franchisors rated highest were 'relevant experience' and 'business acumen'. These were followed, in descending order, by 'financial stability', 'access to capital', 'interpersonal skills', and 'hard work'.

In an interview with CDE, Ben Cronjé, manager of the Butterfield Bread franchise,<sup>39</sup> said that attitude and drive were vital in franchise applicants. Applicants were initially assessed using the learning ability (LAB) battery of tests, which assesses, among other things, proficiency in English, numeracy, memory, and hand-eye co-ordination. Next, the applicant's 'attitude' was assessed by means of a psychometric test which identified qualities such as ambition, direction, goal-setting abilities, and a sound self-image. Finally, the applicant was interviewed by a panel, which tried to assess his or her problem-solving abilities, motivation, and general suitability as a franchisee.

CDE 2004

deficit' might be explained by weakness in family support systems that assist young people to enter and survive in business.

The picture of the South African SMME sector that emerges from the available evidence – however incomplete – is a sobering one. However much we applaud the vitality of the informal sector, and appreciate its role as a bulwark against absolute poverty for so many, it is undesirable that there should be such a large, racially uniform, survivalist component, and that so few should graduate out of it into formal business activity.

## Summary

Combining the insights derived from all this material, we note that:

- entrepreneurship in South Africa is poorly conceptualised, documented, and quantified;
- the level of small business activity should be higher if this country is to derive similar economic benefits to other middle-income developing countries;
- the survival rate of new businesses is low;
- the incomes generated by informal businesses are critically low, and too few graduate from it to 'real' entrepreneurship; and
- there are serious deficits in entrepreneurial activity that are related to gender, race, and age.

These concerns about the nature of entrepreneurship in South Africa provide a vantage point from which to assess government policy. In a weakly conceptualised, poorly documented, and underdeveloped sector of the economy, there are clear difficulties in ordering priorities and choosing strategies. Before proceeding to such an assessment, however, we need to take on board some salient lessons from international experience.

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In a weakly conceptualised, poorly documented, and underdeveloped sector of the economy, there are clear difficulties in ordering priorities and choosing strategies



A community worker distributes micro loans to women in Bangladesh. About five million micro startup loans have been extended in that country over the past 20 years.



## LESSONS FROM INTERNATIONAL EXPERIENCE

Global recognition of the various roles of entrepreneurship in economic growth and development has resulted in a substantial body of comparative literature and prescriptions for best practice being produced over the past decade or so. This section selectively reviews this literature, emphasising issues of economic culture as well as the role of finance and principles of best practice in government support for SMME development.

### Race means little, but economic culture is vital

Studies that highlight South Africa's comparatively poor performance in entrepreneurship when compared with those of other developing countries raise important questions of causality. The finding that black South Africans display significantly lower rates of entrepreneurship than others is an open invitation to a reductionist explanation. Internationally, socio-economic variables such as education have been found to be crucially important in accounting for these sorts of deficits. However, in South Africa the temptation to adopt over-racialised perspectives is ever present, and populists of both the left and right are quick to meet any challenge of development with racialised responses. In the sphere of small business and entrepreneurship, for example, relatively low participation rates by blacks are often assumed to reflect continued discrimination by the white business establishment, especially in respect of access to finance. This in turn, it is argued, requires affirmative support for aspirant entrepreneurs, and *dirigiste* measures to compel tardy and stubborn white business.

There is a counterpart to this racial interpretation, which, although insidiously influential, is less likely to be expressed in public. It is that low rates of entrepreneurship among black South Africans reflect an inherent incapacity for entrepreneurship. It is not difficult to see how the two race-based attitudes feed on each other in a destructive cycle. Inappropriate policies (such as relaxed lending criteria) lead to high failure rates, which reinforce racial stereotypes in turn. The perceived need to combat this enduring racism serves in turn to embed the policies and the assumptions on which they are based.

As is often the case, this destructive cycle is nurtured by parochialism. However, an international perspective can quickly give the lie to the racially reductionist assumptions on which it depends. For example, a BBC report on the global GEM report for 2002 stated that: 'Africans, or people of African descent, living in western countries are five times more likely to start their own businesses than their white counterparts ... and people from the Caribbean are twice as likely as white people to be entrepreneurs'.<sup>40</sup> This supposedly 'racial' pattern is of course the reverse of that in South Africa.

### *Supportive culture*

In contrast to the assumptions underpinning current South African government policy, enterprise among ethnic minorities in developed countries is based on informal finance, rather than credit from formal sources. Thus, according to the same BBC report, the GEM global report for 2002 found that 97 per cent of financing for ethnic minorities in developed countries came from personal or family sources.<sup>41</sup> This fits in with an emerging consensus that a supportive culture (pooled financial and labour resources, emphasis on self-reliance and independence) is more important than government assistance. In short, a global perspective on entrepreneurship does raise issues of culture, but not of the old-fashioned political and deterministic kind that is still articulated by many protagonists of both the political left and right in South Africa.

Many international researchers are currently emphasising the importance of attitudinal or cultural variables in promoting or retarding development and entrepreneurship.<sup>42</sup> In this regard, Davies has stated that entrepreneurship is:

... closely linked to attitude that rests on two fundamental decisions. These are to depend entirely on one's own abilities for economic security; and to expect opportunity only by first creating value for others. To do this ... one has to move away from the thinking that someone or something has to support you. It also requires freedom from entitlement – to move away from the thinking that something is owed to you. You need to move the locus of control within and not expect any form of entitlement.<sup>43</sup>

Many scholars have stressed the importance of prevailing attitudes, values, beliefs, and social norms – or 'mental software' – for explaining variations in entrepreneurship and economic development. Other things being equal, according to the OECD, 'an environment in which entrepreneurship is esteemed and in which stigma does not automatically attach to business failure, will generally be more conducive to entrepreneurship'.<sup>44</sup> Improving the institutional framework within which economic activity takes place, so as to bring about a closer relationship between risk and return, or between individual effort and reward, may 'be slow to show results unless cultural attitudes support risk-taking and individual reward,' says the same source.<sup>45</sup>

### *Values and attitudes*

Indeed, values and attitudes generally underpin market development. If these are hostile to business, 'then you have a problem', in the words of one commentator.<sup>46</sup> Writing for the *Harvard Business Review*, Professor William Sahlman notes that the American admiration

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A supportive culture (pooled financial and labour resources, emphasis on self-reliance and independence) is more important than government assistance

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'At bottom, no empowerment is as effective as self-empowerment'

for entrepreneurs, tolerance of failure, and willingness to throw money at a good idea all contribute to the American economy's success. 'Americans admire people just for trying – the harder, the better. We find something honourable – gutsy, even – in an entrepreneur starting company after company until he or she gets it right.'<sup>47</sup> Sahlman notes that in the United States entrepreneurs are elevated to the status of heroes, pointing to examples such as Sam Walton of Wal-Mart and Jeff Bezos of Amazon. According to him, the spin-offs are twofold:

- the best and brightest minds eschew the safety of large companies in favour of small, risky start-ups; and
- financiers are 'climbing over themselves to give money to anyone with a good business plan'.<sup>48</sup> In 1998, professional venture capitalists in the United States spent US\$26 billion on new ventures, contributing to America's reputation as the most entrepreneur-friendly capital market in the world.

### *Self-empowerment*

According to David Landes, the eminent economic historian of Harvard University, 'what counts [in promoting successful enterprises] is work, thrift, honesty, patience, and tenacity. To people haunted by misery and hunger, that may appear to add up to selfish indifference. But, at bottom, no empowerment is so effective as self-empowerment.' Says Landes: 'You want high productivity? Then you should live to work, and get happiness as a by-product.'<sup>49</sup>

The conclusion that some cultural values and practices are more functional to development and entrepreneurship than others still meets resistance. As Harrison has noted:

## **The savings and credit fallacy**

International experience (in the United States and Colombia, among other countries) shows that many if not most enterprise start-ups are financed with personal savings and/or family resources and informal flexible loans from friends.<sup>50</sup> This seems to be borne out in South Africa, despite the complaint that access to finance is the major obstacle to the formation of SMMEs:

- According to a study by CASE released in 1996, micro entrepreneurs in South Africa obtained about 75 per cent of their funds from personal savings or loans from friends or family. Only 6 per cent borrowed money from formal lending institutions.<sup>51</sup>
- In a study of 722 non-survivalist small businesses conducted in 1992, BMI found that successful businesses were adequately financed in the initial stages. The finance generally came from savings or loans drawn from informal networks.
- The authors of an evaluation of a micro enterprise development project run by a major bank report that a

group of women from Orange Farm attended a training course for micro entrepreneurs, where they were offered start-up finance. However, 85 per cent rejected the offer, using their own savings or borrowing from family members or other community resources instead. Some 70 per cent of these women are still in business, while most of the 15 per cent who accepted the financial assistance on offer appear to have failed.<sup>52</sup>

- A study by Unisa's Bureau of Market Research and the Kagiso Trust Consultancy of SMEs in the Tshwane metropolitan municipality found that, while a shortage of funds was cited as a major problem, this 'should not necessarily be interpreted as a lack of access to funds. Customer bad debt and small profit margins [as a result of overtrading] create a perception among SME owners that shortage of funds is their major problem.' Other findings confirmed that 'access to financing is not a major constraint, and that the financial system is indeed accessible to the majority of SMEs'.<sup>53</sup> CDE 2004

The implication is that all cultures are equally worthy, and those who argue to the contrary are often labelled ethnocentric, intolerant or even racist.<sup>54</sup>

However, global studies increasingly make it clear that there is no reason to assume that enterprise-friendly values are racially distributed or determined, or that they cannot be acquired. Another possible source of misunderstanding of culture in this context is the careless labelling of whole cultures:

The United States paradigm of entrepreneurial activity is set in a culture that values independent action, taking personal chances and self-reliance... This paradigm is not accurate for collectivist cultures. Programs funded to foster entrepreneurship in cultures that are collectivist, but which assume economic behaviour to be guided by the underlying values of highly individualist cultures, may run a serious risk of failure.<sup>55</sup>

It is fair enough to warn against crude assumptions about transferring values from one culture to another. However, while cultures may indeed tend towards 'individualist' or 'collectivist' poles, all are mixed when it comes to entrepreneurial talents and dispositions. In order to stimulate economic development, it is important to take positive steps to tilt the balance in favour of enterprise-supporting values by encouraging those who are predisposed towards them. As the late American senator Daniel Patrick Moynihan pointed out, cultures are not immutable:

The central conservative truth is that it is culture, not politics that determines the success of a society. The central liberal truth is that politics can change a culture and save it from itself.<sup>56</sup>

### The fallacy of finance

It has been part of the conventional wisdom that guides government policy on entrepreneurship in South Africa to identify a lack of access to finance as the principal impediment to the small enterprise economy. Certainly aspirant entrepreneurs often see this as the most visible (and bitterly resented) constraint. However, experts in this field regularly note that would-be entrepreneurs frequently erroneously blame a lack of finance for the failure or stagnation of their businesses. Bearing this in mind, it is necessary to distinguish between cause and effect in this issue, to be aware of constraints other than access to finance, and to consider the collateral dangers of 'soft' access to finance.

According to Rogerson, in a CDE background research paper reviewing African experience, 'The dangers of a credit monoculture in small enterprise development support programmes must be acknowledged. In particular, programmes of minimalist credit may not necessarily assist the poor, and may even serve to worsen their plight'. As Rogerson points out, 'it was acknowledged that while there were instances where improved access to credit would release a binding constraint on certain kinds of small enterprises, this could not be assumed to be the case'.<sup>57</sup> Moreover, 'a releasing of the credit bottleneck may well bring to the fore other problems not previously identified which have nothing to do with access to finance'.<sup>58</sup> It is also worth noting the distinction between access to finance at prevailing market rates of interest, and access to subsidised or soft loans. Subsidised rates may be a part of the answer to the problems of very poor entrepreneurs who can become impoverished by debt, but they do not adequately prepare those aspirant entrepreneurs for the financial discipline that will be required

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Would-be entrepreneurs frequently erroneously blame a lack of finance for the failure or stagnation of their businesses

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Personal and family savings as well as non-formal sources of credit are the keys to entrepreneurial success

after the start-up phase. Subsidised interest as well as financing policies that require minimal security and collateral pose particular risks in the development of careers in small business. Overall, the key finding of local and international research in this area is that personal and family savings as well as non-formal sources of credit are the keys to entrepreneurial success.

Recognition of the shortcomings in policies that emphasise credit to the detriment of other support invites consideration of three broad areas in which South African policies might learn from international research and experience. The first involves non-financial support services or business development services which are back on the international 'credit-plus' policy agenda. Such services typically include training, technology development, business linkages, and information. However, the mode of delivery of these services is shifting from the supply-side provision of generic, standardised packages towards a more market-led or demand-driven approach. The second involves government facilitation of a hospitable environment for entrepreneurs. The third explores the possibilities of informal, self-sufficient financing. It is to the last of these that we turn first.

### Entrepreneurs do it for themselves

Confirming the findings of numerous empirical studies, Thyra Riley of the World Bank notes that, of the approximately 500 million micro and small entrepreneurs in the world, fewer than 10 million – or 2 per cent – enjoy access to financial services from the formal financial sector.<sup>59</sup>

Undue focus on formal financial institutions ignores the importance of the informal systems of community support that are often the bases for successful small businesses. Clearly, it is not just access to finance that matters, but where the resources come from. For example, the rotating savings and credit associations (ROSCAs) found in many parts of Africa clearly offer more than just money. According to Buckley, it is clear that ROSCAs are popular because they offer a 'self-sufficient, voluntary-based organisational framework through which to save and borrow'.<sup>60</sup> Fukuyama points out that entrepreneurial cultures have a capacity to generate start-up capital quickly.<sup>61</sup> This is true of the Chinese, Korean, and Japanese families who tend to acquire their capital through rotating credit associations – employing the principle of pooling funds and rotating the pot among the membership, similar to South African stokvels – when they set up businesses in the United States.

#### *Rotating credit*

The advantages of rotating credit depend entirely on the mutual trust of members of the clubs. Fukuyama sees these associations as an important means by which 'co-ethnics' pool their savings to establish one of their members in business. 'Like stokvels, the Chinese *hui*, Korean *key*, and Japanese *tanomoshi* have little legal backing or formal rules. They rely on moral sanctions imposed within their tightly knit communities'<sup>62</sup> to prevent abuse of the pooled funds.

There is a need for informal finance institutions – defined as financial activities that are not regulated by central banking supervisory authorities – to be better integrated into national financial development strategies. As with many other aspects of entrepreneurship, this aspect of access to finance involves tricky issues of balance between formal and informal. Formal structures and regulations are required to protect the individuals who lend and borrow through such associations, and to provide the confidence and credibility

that are bridges to the formal economy. Nevertheless, it is in their informality and in innovative departures from conventional market notions of risk and return that they can contribute to easing the somewhat fraught stand-off that marks the question of financing entrepreneurship from formal market sources. Rather than trying to brow-beat the formal financial sector into deviating from its core practices, a more creative way forward may be to encourage the development of alternative providers of finance that are closer to communities and more innovative in their lending practices, but still subject to formal regulation.

For instance, in 2001 the task group on SME finance of the South African Policy Board for Financial Services and Regulation recommended that the 'current model of regulating 'common bond institutions' (co-operatives and village banks in particular) through exemptions from the Banks Act should be reviewed, and consideration given to the need for creating a regulatory authority for such institutions. This may enhance the credibility and growth potential of such institutions.'<sup>63</sup>

### *Grameen Bank*

A good example of this widely endorsed model of finance is the Grameen Bank in Bangladesh, which relies on disciplines of close community participation and social sanction for its impressively low default rate.<sup>64</sup> Community finance initiatives of this sort could foster the values that sustain entrepreneurship, and obviate the risks that flow from relaxed requirements for collateral or credit history, in the relatively anonymous context of state largesse, or soft finance from financial institutions whose hands have been forced by government. These risks include what the Financial Services Policy Board Task Group describes as 'potential inverse incentives' to default,<sup>65</sup> and the GEM report describes as a tendency in South Africa for micro finance to be used for consumption rather than production.<sup>66</sup> In more general and less technical terms, this may be labelled the danger of encouraging a 'culture of dependency'.

While community-based initiatives may have a place in financing informal entrepreneurs and guarding against these pathologies of subsidised credit, other creative alternatives are open to more complex businesses with better growth potential. Observers of

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Undue focus on formal financial institutions ignores the importance of informal systems of community support that are often the bases for successful small businesses

### **Entrepreneurship in Marang, North West<sup>67</sup>**

In 1997 a group of 12 (mostly unemployed) women in North West began to put money aside for a project to help them gain financial independence. They began planting green peppers and tomatoes on the plots of two of the women. Despite harvesting a crop of organically grown green peppers, they were forced to give them away because they were unable to gain access to any markets.

However, a visit to the Rand Show and a well-timed documentary on bee farming proved inspirational. A local bee farmer trained them and gave them one hive box per person. The Marang project is now a thriving and growing

business. There are 75 hives, with plans to expand to 300. Flowers are also being planted, and the women plan to get involved with local schools by helping them to create vegetable gardens or produce honey.

The company sells honey, honeycomb, beeswax, beeswax candles, pollen, and propolis, and also sells used brood chambers to stock farmers (who grind them up and use them as medication for their cattle). They also hire out beehives with resident swarms of bees to local fruit, lucerne, and vegetable farmers as a pollination service.

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Britain's small business sector point to an 'equity gap' for entrepreneurs seeking finance of £250 000 to £1 million (R3 million–R12 million), sums which are greater than 'ordinary' bank loans and smaller than typical venture capital funds. In response, the chancellor of the exchequer, Gordon Brown, has proposed establishing a 'British version of the small business investment companies set up in the United States in the 1960s, and the original source of finance for big American companies like Intel and Apple ... this might involve a mix of private finance and loans from the government, which could offer the money at a preferential rate in return for a share of the profits'.<sup>68</sup>

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Governments can play useful facilitating and supporting roles, but these should be carefully crafted and targeted

### **A light touch works best**

While international research and experience downplay policies of government support for access to formal finance, and endorse the possibilities of informal finance and self-reliance, the evidence does not support government passivity or indifference. It is clear that governments can play useful facilitating and supporting roles, but that these should be carefully crafted and targeted.

Until the 1970s, development policy tended to assume that governments generally acted in the public interest and enhanced welfare by eliminating market failures and redistributing resources. Accordingly, the World Bank and other authorities expected government bureaucracies to take exclusive responsibility for the design of technical support for enterprise in general and SMMEs in particular.

Increasingly, however, it was found that government failures may be as or more important than market failures. For example, whether in the area of export assistance through official trade promotion agencies, or in the area of small business support through centralised government enterprise departments, the experience of support to business was unsatisfactory. As regards enterprise support, the use of public sector service suppliers is considered to have failed in all but a few cases, notably in a few countries in East Asia.<sup>69</sup>

### *World Bank studies*

In a study for the World Bank, Phillips argues that, even given an appropriate policy environment, state institutions are only likely to be effective as long as they:

- enjoy the support and participation of the business community;
- are well funded, and have personnel experienced in relevant technical areas; and

## **Entrepreneurship in Sivuyile<sup>70</sup>**

Although Sonwabo Dunywa grew up in Guguletu, his childhood hobby flowed from visits to his grandparents in the Eastern Cape where he would fashion animals from clay. He later studied ceramics at Zenzele Enterprise and Sivuyile Technical College, and opened his own shop, Uncedo Pottery, in 1996 at the Sivuyile Tourism Centre. He linked his business to township tourism, and now receives between 20 and 50 customers a day.

But his really big break came in 2000 when the DTI funded him to attend a trade show in Italy. 'It was at that show that I realised I had to tailor-make my products to suit my clients if I wanted to remain competitive in the market,' he says.

Today he employs 20 people, and exports a range of brightly coloured products – including espresso cups, sushi plates, fruit bowls, and mugs – to the United States and Europe.

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- have a significant degree of autonomy from bureaucracy and political interference.

According to Phillips, these conditions have generally not been met.<sup>71</sup>

In another World Bank study, Levy isolates two conditions of success: interventions should support, not replace, the market; and they should have a 'light touch' through decentralisation of services.<sup>72</sup> To justify public intervention in general, it has to be shown that the public sector is:

- resolving a clear market failure (greater than any distortion the intervention itself might create); and
- intervening in a cost-effective way.

Phillips's conclusions are worth quoting at length:

Public support to promote enterprise since the 1970s in developing countries has moved from centralised state development agency initiatives to decentralised market development instruments. It is now increasingly agreed that, if it is to be economically efficient and practically effective, technical assistance for the enterprise sector needs to be flexibly organised and demand-responsive. While traditional centralised assistance may continue to be effective in some circumstances, assistance needs, to a large extent, to be moved out of the State or quasi-public agencies to competitive private service providers responding to the evolving needs of client enterprises, subject to service quality control. *Stimulating of private service supply and upgrading its capacity to respond to the demands of new and expanding private enterprises is therefore a central task of public policy*<sup>73</sup> (emphasis added).

Thus the trend is for the state to play a greater role in establishing an environment conducive to small business development through a facilitative rather than a hands-on/service provision role. This means that the state has a role in:

- providing an enabling policy for the legal and regulatory environment;
- correcting or compensating for market failures; and
- providing public goods such as basic infrastructure, education, and information services.

It should not, however, directly provide private goods that can be more efficiently provided by the market.

The facilitative approach envisaged in this vision can include the dissemination of market information and small-scale technologies. Governments can help firms gain access to information networks. Moreover, resources for enterprise development should be decentralised where appropriate in order to tailor programmes to the specific needs of an area and its enterprises.

### ***Business environment***

Central to the 'facilitative vision' of entrepreneurship support is the environment in which emerging entrepreneurs do business. Writing in the *Harvard Business Review*, Welsh and White make the important point that 'external forces tend to have more impact on small businesses than on large businesses. Changes in government regulations, tax laws, and labour and interest rates, usually affect a greater percentage of expenses for small businesses than they do for large corporations. Such limitations mean that small businesses can seldom survive mistakes or misjudgements.'<sup>74</sup> A World Bank report notes that entrepreneurs in developing and transitional economies face a 'triple burden of macroeco-

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Public support to promote enterprise has moved from centralised state development agency initiatives to decentralised market development instruments



## International best practice

In 1998 the Organisation for Economic Co-operation and Development (OECD) provided broad policy guidelines for fostering entrepreneurship based on a study of five countries: Australia, the Netherlands, Spain, Sweden, and the United States. They are:<sup>75</sup>

### **1. Examine the overall institutional framework within which economic activity takes place in order to establish whether it provides maximum scope for entrepreneurship to flourish. In particular:**

- Identify and dismantle remaining barriers to competition, which limit the incentives of enterprises to innovate and perform more dynamically.
- Examine whether current regulations governing financial institutions and/or financial markets inhibit or facilitate the availability and optimal allocation of finance for entrepreneurial activities.
- Allow scope for flexible employment contracts to be negotiated, with remuneration arrangements and working conditions that are well adapted to the needs of dynamic enterprises. Relax employment protection measures that inhibit restructuring or discourage entrepreneurs from taking on new workers.
- Examine the cost of complying with government-imposed administrative or regulatory requirements, and identify where reductions could be made, either by removing the requirements to comply or by reducing the administrative burden involved.
- Examine the overall effects of the tax system on entrepreneurship, and identify features that discourage entrepreneurs or the financing of entrepreneurial activity. Ensure that the tax system is transparent and that compliance is straightforward. Ensure minimum ongoing costs of complying with government administrative, regulatory and reporting requirements.
- Review and simplify the registration procedures required to create a business. Ensure that firms are able to close quickly should they wish to.
- Ensure that personal bankruptcy legislation provides an appropriate balance between encouraging risk-taking

and protecting creditors, given that the closure of unsuccessful firms is a necessary if unwelcome part of the entrepreneurial process.

- Re-examine the effects that social insurance provisions may have on encouraging or discouraging would-be entrepreneurs.
- ### **2. Ensure that specific programmes designed to foster entrepreneurship operate as part of an integrated and coherent strategy that complements the framework conditions. In particular:**
- Avoid policies that stem from too narrow a definition of entrepreneurship (eg, that entrepreneurship is only about start-ups or only about high technology) and which may divert attention from getting the broader economic policy settings right.
  - Widen the target population for entrepreneurship programs, where possible, to attract the participation of women, the young and minorities.
  - Undertake regular and comprehensive evaluation of programs, and ensure that evaluation findings are acted on.
- ### **3. Improve the effectiveness of entrepreneurship programmes by drawing on the knowledge of local levels of government. In particular:**
- Ensure that resources for programmes to foster entrepreneurship are decentralised where appropriate in order to better tailor programs to the specific needs of an area and its business.
  - Provide regular opportunities to exchange information at a national level on the experiences of local authorities in designing and implementing entrepreneurial skills and attitudes.
  - Increase opportunities for the unemployed to create their own jobs through self-employment schemes.
  - Facilitate networking among firms in order to foster a culture of mutual co-operation and risk-taking.
  - Promote the entrepreneurial non-profit sector by contracting-out where possible the delivery of public services that meet pressing demands in economic and social development.

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conomic, institutional/regulatory, and micro (firm)-level constraints'. It states that many new enterprises fail as a result of:

- the excessive costs of entry relative to their fragile positions at start-up;
- an inability to secure permits, acquire finance, or obtain business/technical support;
- high operating costs, including the cost of servicing debts;
- inaccessible business information (eg on how to export); and
- burdensome (eg onerous tax compliance) or inadequate (eg weak contract enforcement) state regulations.<sup>76</sup>

Infrastructural requirements for small business include:

- good roads, ports, and telecommunications facilities; and
- support services, such as legal advice, insurance, accounting, and consulting services operating in response to market demand.

As Morris notes: 'Where there is an established environmental infrastructure (eg financial institutions, utilities, transport, distribution channels, courts, police), entrepreneurship is facilitated.'<sup>77</sup>

### *Excessive regulation*

It bears repeating that government can fail to facilitate entrepreneurship through excessive or inadequate regulation. Bureaucratic overkill can certainly stifle economic activity. Starting a business is more complex and time-consuming in some countries than in others. For example, in the United Kingdom the paperwork involved in setting up a company takes about one week. In Australia, Japan and Sweden, too, the process is relatively straightforward. In Italy and Spain, however, it can take months.<sup>78</sup> The Institute for Liberty and Democracy in Peru has reported that registering a business in that country required 11 different procedures lasting a total of 289 days. The cost of registering businesses in Latin America is also significantly higher than in the United States. Other studies have found that while most countries do not have overt legal barriers to market entry as high as Peru's, all too many force small businesses into the informal sector, with costly taxes and regulations.<sup>79</sup>

In a paper on successful entrepreneurs and enterprise culture commissioned by CDE, Barse points out that it is important to note how features of government policy, law, and regulation arising from any level can provide a 'business climate' averse to enterprise, either directly or indirectly. 'Directly, there are a variety of regulations that increase entrepreneurs' costs of doing business and/or constrain business development. These include licensing fees and regulations, forms and filings to establish legally, and business location constraints.'<sup>80</sup>

Pointing to the dangers of possible unintended consequences of government actions, Barse continues: 'Indirectly, laws and regulations established to serve some other public policy goal may have negative implications for entrepreneurial activities. City planning or industrial development practices borrowed from advanced industrial countries, for example, may lead authorities in developing countries to banish micro-enterprises from city streets, harass "informal" producers or even to demolish entire neighbourhoods containing commercial vitality as well as homes because they are perceived as "slums" or "shanty towns".'

As the OECD points out, it is important to locate and dismantle barriers to entrepreneurship (see box, **International best practice**, facing page). Especially important is the need to allow flexible employment contracts to be negotiated.

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It bears repeating that government can fail to facilitate entrepreneurship through excessive or inadequate regulation

## Summary

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Values and culture matter when it comes to the individual attributes which make for entrepreneurship – but these have little or nothing to do with race

Perhaps there is no more enduring controversy over the whole range of growth issues in the developing world than the extent to which experience and prescriptions are transferable. There is a natural resistance to believing that the experience of others is a better guide than our own history, and the things you win when you win freedom include the freedom not to follow others. But, in the specific case of entrepreneurship support, the lessons of international experience are so consistent across varied societies that they can be taken up with confidence and enthusiasm. In this light, it is worth restating the main points of our review of this experience and these lessons:

- It is not finance that has the most telling effect in fostering entrepreneurship, especially where delivery reflects a misallocation of resources.
- It is essential to get the environment right in matters of infrastructure and regulation.
- Values and culture matter when it comes to the individual attributes which make for entrepreneurship – but these have little or nothing to do with race.
- Government policies in other areas can have unintended and undesirable consequences for entrepreneurship.

These insights provide a starting point from which to discuss the South African government's policy for supporting SMMEs.

## Entrepreneurship in Langa<sup>81</sup>

Monica Mahloane completed the academic component of her diploma in construction technology, but failed to find a company with which to do her in-service training. Undaunted, she set about turning her hobby into a business, inspired by watching busloads of tourists drive through the area of the township where she lived, taking

pictures 'of the township and its people as if it was a zoo'.

Beginning in 1987, she and her mother renovated their home over a period of two years and turned it into a restaurant. Lelapa Restaurant in Harlem Avenue, Langa, is now a thriving business, capturing a significant amount of the passing tourist trade.

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Dapney Mona of Daphlet Enterprises, a clothing design firm in Nelspruit, Mpumalanga, displays her creations at the Rand Show.

## GOVERNMENT POLICY ON SMMEs

This section of the report sketches the South African government's efforts to promote the SMME sector, and places them in critical perspective by reviewing international research and best practice, especially in the fields of finance and regulation.

South Africa's adoption of more market-friendly economic policies during the 1990s coincided with powerful international championing of the market in development debates. Included in this was growing policy support for SMMEs. Indeed, as we have already pointed out, support for the broader distribution of entrepreneurship and the promotion of small businesses in an economy marked by corporate concentration have helped to justify the emphasis on market mechanisms to achieve social and political outcomes. This trend has been strengthened by belief in the potential of small enterprises as a vehicle for black economic empowerment.<sup>82</sup>

The government's main strategy for promoting small businesses has been to distribute support services and goods, rather than to create a freer and more supportive environment. The 1996 National Small Business Act (no 102 of 1996), which laid the foundation for SMME support, provided for bureaucratic structures to deliver support directly to targeted recipients. The initial structures were the Centre for Small Business Promotion (CSBP), the Small Business Council, and the Ntsika Enterprise Promotion Agency (see box, **The Ntsika Enterprise Promotion Agency**, page 37). The CSBP and Ntsika were persuaded that access to finance was the most important constraint on black small businesses. As a result, Khula Enterprise Finance was added to the enterprise-supporting bureaucracies.

### Mixed agendas and capacity problems: delivery falls short

There is a broad consensus on the delivery record of these enterprise-supporting bureaucracies, supported by at least two extensive evaluations and reviews commissioned by the

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More than 90 per cent of black entrepreneurs who secure loans from commercial banks do so without credit guarantees from government agencies

DTI itself. The verdict is that a shortage of capacity and skills, as well as a lack of co-ordination and synergy among government departments and the new institutions meant to deliver goods and services to developing businesses has undermined the ability of the latter to meet their objectives.<sup>83</sup>

To their credit, those responsible for making and implementing government policy, up to and including the minister responsible, have been prepared to acknowledge the current shortcomings. For example, in 1999 Ntsika's chief executive officer stated that the then 16 tender advice centres (TACs) were 'a drop in the ocean', and were not always competently managed. Ntsika has accredited 103 Local Business Service Centres (LBSCs), which are trying to become sustainable.<sup>84</sup> However, research suggests that their personnel generally lack business experience, which undercuts the centres' effectiveness.

Several of the shortcomings are centred on Ntsika's flagship LBSC programme. It has been suggested that Ntsika runs too many programmes, and that this has undermined the efficacy of many of them, including the LBSC programme.<sup>85</sup> Analysts say LBSC and TAC personnel lack business skills and experience, which also limits their impact. Reviewing several studies of LBSCs, CDE researchers concluded that 'dedication is there aplenty. But the challenge on SMME development in the age of innovation and IT requires high-level business service skills that are not available in most LBSCs.'<sup>86</sup>

### *Internal failings*

Internal structural and capacity failings have also impacted negatively on the organisation's efficacy. As Ntsika's previous chief executive officer has put it, "what you see from the outside is a result of what is inside".<sup>87</sup> Ntsika has attempted to address this catalogue of shortcomings, refining its criteria for supporting SMMEs, and becoming more selective in the initiatives with which it engages. It has recognised that a lack of entrepreneurial experience among business development service (BDS) providers undermines the impact that such services can have. As a result, it is actively supporting the recruitment of experienced mentors and trainers by BDS providers. However, many service providers cannot afford to pay qualified mentors as much as they can earn in the private sector.

The effects of this lack of capacity are exacerbated by Ntsika's manifold responsibilities.<sup>88</sup> Presumably in order to remedy this, some of the programmes previously managed by Ntsika have been absorbed by the DTI itself. In addition, the Small Business Amendment Act (2003) has downgraded Ntsika's policy research function, and an ambitious new programme – the Black Business Supplier Development Programme – which seems to fall under Ntsika's original mandate is being run by the DTI. These might well be positive and rational moves, but they leave a question mark over Ntsika's future, and give no impression of a clearly formulated macro framework for SMME support. They also assume, perhaps optimistically, that the capacity for really making things happen resides in the DTI itself.

### **Policy innovations: but where's the plan?**

Over the past two years, the government has seemed more inclined to address these issues. In an interview with CDE, a senior DTI official has acknowledged that SMMEs face a number of constraints,<sup>89</sup> including a lack of infrastructure, low levels of education and skills, and onerous labour regulations. In its 2002 medium-term plan, the DTI drew a distinction between small business development and black economic empowerment, and stated that

strategic objectives would be formulated for each of these areas.<sup>90</sup> Programmes have been developed to help small businesses exploit the export market. In 2002 the DTI initiated a small exporters' programme and an export marketing and investment assistance programme.

### *Structural issues*

Structural and capacity issues are also on the agenda. In 2000 Alistair Ruiters, director-general of the DTI, stated that the department's structure was too rigid, and that it did not have the flexibility to maintain high levels of service delivery.<sup>91</sup> In the same year the minister of Trade and Industry, Alec Erwin, stated that the capacity of DTI and its monitoring of SMMES had to be improved.<sup>92</sup> There are indications from within DTI that monitoring capacity might still be a problem, but that initiatives are under way to address this.

In 2002 the DTI was restructured into functionally distinct units. One of the new divisions responsible for policy development is the enterprise and industry development division. Its first task was to draft amendments to the National Small Business Act, which are discussed below, and to help amend policy on small business development. As we shall see, the long-heralded statement of an integrated strategy for the sector has yet to appear.

Central to what is as yet a piecemeal and partial rethink of priorities is the targeting of support. The DTI is beginning to differentiate more explicitly between policies targeting small and emerging entrepreneurs and those directed towards survivalists. In the past, much of the work undertaken by agencies such as Ntsika, and much of the finance provided by Khula, were directed towards micro and small enterprises, with no real effort made to differentiate between these and survivalist concerns. Ntsika has clearly stated that it is currently aiming at servicing aspirant entrepreneurs rather than those who conduct informal business activities merely to survive.

In the same spirit, the government is beginning to celebrate the achievements of successful entrepreneurs with whom it has engaged through export promotion, trade and business linkages, and other programmes, in an online publication entitled *Real people: beyond the statistics*. While this reflects an acknowledgement of how important it is to cele-

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The long-heralded statement of an integrated strategy for the sector has yet to appear

### **The Ntsika Enterprise Promotion Agency<sup>93</sup>**

The Ntsika Enterprise Promotion Agency was established by the National Small Business Act of 1996. It comprises a number of units responsible for facilitating the development of the SMME sector, including:

- \* a market access and business linkages division;
- \* a policy, research, and information unit;
- \* an institutional support unit;
- \* a targeted assistance division; and
- \* a technology unit.

Ntsika has numerous responsibilities, ranging from skills development and training to the facilitation of linkages and networks, institutional funding, and technology development. While the organisation has taken a broad approach

to service delivery, its work is most visible through the Local Business Service Centres (LBSCs) and Tender Advice Centres (TACs) which it supports.

LBSCs are accredited organisations, distributed throughout the country, which offer a range of business development services to drop-in clients as well as more formalised training programmes. In 2002, a total of 103 LBSCs were accredited.

TACs provide a range of tender-related services, including the facilitation of networking with established contractors, training and assistance in tender completion, and tender advertising. By 2001 there were 16 TACs throughout the country.

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brate success, the government now needs to find ways to build and sustain an environment of positive reinforcement. The parliamentary subcommittee on SMME service providers and access to finance has also highlighted the importance of fostering a spirit of entrepreneurship,<sup>94</sup> and plans for doing this at school level are apparently in the pipeline.

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Developments thus far give the impression of being neither strategic nor integrated

### *Enabling environment*

Another central issue is the creation of an enabling environment for SMMES, including a regulatory environment conducive to the establishment, registration, and running of small businesses. In a speech on the role of woman entrepreneurs in January 2003, Erwin stated that emerging and small businesses faced the following constraints:

- the regulatory environment;
- educational opportunities and education systems;
- cultural factors;
- management training and job opportunities; and
- family responsibilities.<sup>95</sup>

In the same speech, Erwin outlined some of the steps his department intended to take to reduce or eliminate these constraints. These included improving the climate for entrepreneurship, by addressing some of the bureaucracy of starting a business, encouragement of teenagers to get appropriate training and experience that will enable them to become successful entrepreneurs, improve access to basic education, and encourage entrepreneurial activity from a school-going age. These priorities hold out real prospects of constructive developments in SMME support.

These and other hints of a change of direction have encouraged expectations of a new, strategic, integrated, small business support strategy. It was regularly reported in the second half of 2002 that a document outlining the new approach would be released before the end of that year.<sup>96</sup> Throughout 2003 and now into 2004 no such document has been made public. Instead there is a clear impression of a prolonged but as yet indecisive rethink, especially in the key areas of finance and regulation. As the discussions of finance and regulation which follow should make plain, developments thus far give the impression of being neither strategic nor integrated. In March 2003 the national assembly passed a bill amending the Small Business Act (1996).<sup>97</sup> This piece of legislation is largely concerned with the need to formalise the demise of the Small Business Development Corporation (SBDC), which was wound up in 1998. It's demise was variously ascribed by government spokespeople to its being 'bureaucratic and ineffective'<sup>98</sup> or 'due to corrupt practices by its officials', which caused it to collapse.<sup>99</sup> The Bill gives the minister the power to 'consult' with any body he feels satisfied represents the interests of small business. Aside from this tidying and patching up in the aftermath of the Small Business Council, the Bill's most important effect is to dilute the functions of Ntsika.

### **Funding small business**

As we have already noted, Khula Enterprise Finance owes its existence and its brief to provide wholesale financial support to entrepreneurs to the assumption that a lack of access to finance is the principal impediment to the small enterprise economy. Capitalised by the sale of the SBDC, Khula had disbursed more than R126 million in loans by 2002, but experienced serious difficulties with the collapse of several retail financial institutions (RFIs) that it had funded (see box, **The Khula Enterprise Finance Agency**, facing page). However,

Khula's critics not only question whether it has the competence and capacity to discharge its mandate, but also whether the assumption on which it is based is in fact valid.

As we saw in the previous section, international research and experience run counter to this assumption – and evidence suggests that South Africa is no exception to these global trends in small business financing.

According to the 2002 GEM report on South Africa, more than 90 per cent of black entrepreneurs who secure loans from commercial banks do so without credit guarantees from government agencies.<sup>100</sup> The report concludes (in diplomatic language) that 'in a substantial proportion of unsuccessful applicants (for bank loans), the failure of the application would not seem to be entirely unreasonable'. Almost three quarters of the entrepreneurs who were refused finance had one or more of the following characteristics: they had been blacklisted, were considered to have kept inadequate financial records, had no collateral, or were seeking working capital. The 2003 GEM report for South Africa builds on this by pinpointing managerial inadequacies as an important cause of cash shortages among 'black African, Indian, and coloured entrepreneurs with small and medium regis-

### The Khula Enterprise Finance Agency

The Khula Enterprise Finance Agency was established to channel funding to emerging and small enterprises. This is mainly done in two ways: providing credit guarantees and bulk loans through so-called Retail Financial Institutions (RFIs); and on a much smaller scale, providing direct loans to survivalist and emerging micro entrepreneurs. Specific programmes offered by Khula include:

- Khula Start (small loans to new businesses, specifically survivalist and very small businesses);
- a Micro Lending Plan (aimed at growing small businesses, and channelled through the RFIs);
- the Khula Guarantee Scheme (providing collateral to established banks for loans to small business people);
- the Khula Equity Fund (aimed at improving the gearing ratio of businesses through purchasing equity in the business); and
- the Thuso Mentorship scheme (providing pre-business plan and post-loan approval support to businesses applying for loans ranging between R100 000 and R1 million).

Since its inception, Khula has approved R246 871 023 in business loans, and R13 593 744 in capital loans. Between 1996 and 2000 it 'created' some 970 036 jobs.<sup>101</sup> However, there is a question mark over the sustainability of the enterprises it has supported: former senior employees of Khula have admitted that they fail at a rate of 70 to 80 per cent. In order to meet its targets in terms of enterprises reached, the chief executive officer

stated in 2000 that donor state funding would need to increase from R272 million in that year to R1 billion in 2004.

Khula has been sharply criticised. In 2000 at least two RFIs collapsed due to poor governance, fraud, and mismanagement. By 2003 Khula had written off R11.6 million in bad debt.<sup>102</sup> Evidence gathered by CDE researchers suggest that Khula's problems can be attributed to the following factors:

- inadequate and inappropriate managerial systems;
- incorrectly targeted products;
- inadequate criteria for selecting RFIs; and
- inadequate mentoring or after-care services.

These inadequacies have been compounded by a high level of 'unbankable' clients. Several of the RFIs appear to have displayed many of the same symptoms of failed businesses: too rapid expansion, fraud and mismanagement, a lack of adequate systems, unrealistic targets, poor capacity, and an inadequate understanding of target markets. Despite these failings, Wolfgang Thomas argues, in a CDE background research paper, that the principle underlying Khula's formation, namely private credit guarantees, is the correct one to follow.

However, the success of this model will largely depend on whether banks refer businesses with real potential to Khula, and on the provision of appropriate mentoring and after-care support.

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The poor performance of government-sponsored credit programmes up to 2002 severely dented market confidence in their capacity

tered businesses'.<sup>103</sup> It states that 'four essential financial practices' (in fact, the simplest and most basic elements of financial management) are crucial to the health of SMMES. It reports that more than 70 per cent of businesses that practised these fundamentals had secured loan finance, in the period under review, leading the researchers to conclude: 'In isolation, additional external finance is unlikely to address the underlying managerial weaknesses or the cash shortages in these firms, except perhaps in the short term. *A primary focus on finance providers and financial products does not appear to represent an optimal solution to the cash constraints facing these firms*'<sup>104</sup> (emphasis added).

The report to the Policy Board for Financial Services and Regulation on SME finance covers some of the same ground, though more cautiously: 'For those SMEs with acceptable "credit histories" and sufficient collateral, access to bank credit *appears to be* satisfactory. For start-ups, micro enterprises, entrepreneurs from previously disadvantaged communities, or any other group with limited collateral or weak (or limited) credit histories, access is more limited'.<sup>105</sup> However, it must be noted that these characteristics, particularly the absence of collateral and/or a track record of financial management, are very common to emerging and very small or small businesses. It is indeed for these very reasons that agencies such as Khula exist.

### *Poor performance*

The poor performance of government-sponsored credit programmes up to 2002 severely dented market confidence in their capacity. As one research report states: 'Weak management, poor corporate governance, and greed by some of their (*sic*) associates [RFI partners] brought about the well-known RFI collapses of 1999-2000.'<sup>106</sup> However, the bad debts that caused Khula to run up losses of R28,1 million in 1999-2000 and R11,6 million in 2000-2001 may also partly be due to credit-based approaches focused on apparent need rather than on track record or potential.

The DTI has recognised Khula's shortcomings, and has conducted an internal review into its functioning. As a result, the department has been considering changing Khula from a wholesale finance institution into a retail lender to small business.<sup>107</sup> According to Khula's former managing director, Sizwe Tati, the agency is no longer prey to the bad debts that caused it to write off R11,6 million in 2001. He has also claimed that management of and control over RFIs have been improved.<sup>108</sup> Khula has indeed been successful in developing safeguards against a repeat of the RFI debacle, to the extent that in the fiscal year 2001-2 no bad debts were written off at all.<sup>109</sup> Nevertheless, the confidence of potential entrepreneurs has been undermined, and black small business has been given a bad name in banking circles.

Although the DTI has not disguised its dissatisfaction with Khula's performance, this has not prompted a fundamental rethink of the government's basic assumption, namely that the main priority in small business support is to provide finance to a constituency that mainstream lending institutions regard as too risky. The lesson to be drawn from Khula's shortcomings is apparently no more than that the structures of delivery have been faulty. After suggestions for the establishment of a new organisation to replace Khula had been discarded,<sup>110</sup> the favoured solution appeared to be to move Khula closer to borrowers by turning it into a retail lender. The grounds for this choice were that a state-funded lender would be able to service this constituency as a 'development institution that needs to recover costs rather than one driven by profit for shareholders'.<sup>111</sup> The

conditions of such a transformation – better referrals, upgrade in mentoring and more streamlined and efficient management – would depend greatly on the availability of quality personnel, and a more determinedly businesslike approach. After a feasibility study (February-June 2003), however, the retail option was ‘put on hold’ on the grounds that it ‘would not be positive for Khula ... [and] ...would also be costly’.<sup>112</sup>

Deciding not to expand an organisation whose shortcomings are so well documented in order to lend directly in such a risky market was probably the correct decision. The larger question of whether a change of direction is required, rather than a refinement of existing practices, looms in the aftermath of stalled decisions and present uncertainty.

### *Future lending strategies*

Much will depend, of course, on Khula’s future lending strategies and criteria. The proposed establishment of a state-funded micro lender with responsibility for lending to micro enterprises – an initiative that has long been recommended by small business researchers and NGO advocates – complicates the position.<sup>113</sup> Lending to historically disadvantaged micro enter-

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The confidence of potential entrepreneurs has been undermined, and black small business has been given a bad name in banking circles.

## **An official view**

During his tenure as minister of Trade and Industry, Alec Erwin regularly commented – sometimes with refreshing candour – on the state of the government’s SMME programme, and the performance of the state and parastatal agencies responsible for implementing it. Some of these comments follow:

‘The SME programme is not something that is there because we like SMEs. It is a fundamental component of creating more economic activity in South Africa, more employment and a better dispersal of wealth. This is absolutely essential in order to achieve our goals of employment creation, income redistribution and economic prosperity’. (1998)<sup>114</sup>

‘In the commentary from all quarters on the work of the DTI, the three most frequent criticisms made are that we have no industrial strategy, we are not creating enough jobs, and we are failing to generate enough SMEs ... As minister I would accept that in each case the DTI would like to be able to say that there is no cause for criticism, but I cannot. (1998)<sup>115</sup>

‘There is inadequate co-ordination of the SMME strategy across the departments and levels of government and ... the lead department – the DTI – has inadequate resources applied to this sector if it is to fully implement the strategy.’ (2000)<sup>116</sup>

‘Frustration is rising, and the pressure on the new institutions such as Khula and Ntsika is immense’. (1998)<sup>117</sup>

‘If we’ve got something wrong in the last five years, it was to overestimate the capacity of the banking sector to advance the national imperative of promoting SMMEs. We were insufficiently aware of the constraints within which the sector is now functioning. We were taken in by their confidence, not realising that they were themselves catching a tiger by its tail in the global economy.’ (2000)<sup>118</sup>

‘Black empowerment could mean everything or nothing, and that could be its Achilles’ heel. If you cast too wide a net, you might not accomplish much.’ (2000)<sup>119</sup>

‘Failures occurred within Khula. We have to expect that there will be a failure rate. I sometimes say to the chief executive that, even though I instructed him to be cautious, he should not be too cautious. In building SMMEs, the rate of failure will be high. That is unfortunate for us, but we must expect it. To ensure that people that deal with money are always honest is often difficult. I am happy with the controls that we had in place with Khula. It is a pity that the retail structures were there, but the people there were not honest. If we are going to build SMMEs, we should not attack failure. One of the points that the Americans make to us time and time again is that we in South Africa are too embarrassed by failure. No small business is going to succeed the first time. They fail.’ (2001)<sup>120</sup>

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Lending to historically disadvantaged micro enterprises is often tacitly – and sometimes openly – regarded as poverty relief rather than business promotion

prises is often tacitly – and sometimes openly – regarded as poverty relief rather than business promotion. Shifting this function from Khula to a new organisation should, in theory, allow the former to be more discriminating and give it a better chance of effectively helping small and medium businesses with potential. However, as such businesses find it relatively easy to obtain commercial loans (as the research in this section reminds us), there is room to wonder just what Khula's role will be once the micro lending function is removed from it.

Developments in the second half of 2003 were not entirely reassuring on this score. As pointed out in an earlier section, statistics on the size and shape of the sector are incomplete and inaccurate. This deficiency is worsened by the absence of authoritative data on under- or poorly utilised financial assistance to the sector, not to mention other clear measures of performance in this area of government support. As part of what is clearly an effort to acknowledge and remedy this, Khula invited tenders for an 'impact assessment study' of its products – ie, loans – on end users.<sup>121</sup> Although this is a welcome, if overdue, initiative, some of the wording of the tender document sends worrying signals. For example, job creation statistics are to be collected in order to establish the proportion of jobs 'that have been *maintained*, versus *new jobs*' (emphasis added). Another part of the assignment is to determine and verify 'the number of families supported per loan'. Perhaps this is no more than slipshod and unchecked drafting. However, we need to remember the GEM report's verdict that in South Africa 'micro finance is often used for consumption rather than production'<sup>122</sup>. In this situation, it is easy to derive the impression from the wording of the Khula tender that financial support for SMMEs is still regarded, and provided, as a disguised subsidy or welfare payment.

### Regulation on the agenda?

While the government remains committed to providing finance to previously disadvantaged entrepreneurs, there have been welcome indications that it has begun to recognise the limitations to an unwarranted emphasis on access to loans as the panacea for SMMEs.<sup>123</sup> This is accompanied by a realisation that both the broader macroeconomic policy environment and a favourable regulatory environment are more important for developing successful entrepreneurs. As far back as 2000, the minister of finance, Trevor Manuel, acknowledged the disproportionate impact of regulatory costs on SMMEs.<sup>124</sup> The point has also been taken by government finance agencies. Acknowledging the negative effects of a tight regulatory environment on those that it is attempting to reach, Brendan Mbatha, a Khula marketing executive, said in 2002:

'Both the government and the private sector need to look closely at the extent to which a lack of innovation and a restrictive regulatory environment are sending contradictory messages, stifling the growth of small businesses.'<sup>125</sup>

### *Getting the regulatory environment right*

In January 2003 it was reported that the DTI was to commission a study 'to investigate regulations that impose disproportionately high costs on small, medium, and micro enterprises'.<sup>126</sup> It is widely believed that the regulatory environment is a crucial factor in promoting or retarding entrepreneurship, as the international research reported on earlier makes plain.<sup>127</sup> Evidence from Africa supports this global trend. One study of 10 countries (seven in sub-Saharan Africa, and three in Central Europe) has found that only

one factor, a nation's levels of available skills, especially technical, was anywhere near as strongly linked with per capita income growth as an appropriate regulatory environment.<sup>128</sup> Given all this evidence, and the available examples of international best practice, it is not surprising that the South African government should embark on a research project focusing on appropriate regulation. However, some evidence from South Africa itself suggests that regulation should not be looked on as another quick fix, and that the subject should be carefully placed in perspective. The evidence for this is provided by global comparative research conducted by the International Finance Corporation (see box, **IFC study of business regulations**, this page).

The comparative data presented in *Doing Business in 2004* provide a salutary corrective to the undue self-criticism and pessimism with which some South Africans habitually approach global comparisons. But does this mean that there are no causes for concern? The report itself should be seen in perspective. For instance, the range of regulations surveyed is quite narrow, excluding several regulatory areas that give rise to criticism in South Africa, notably taxation and by-laws. In addition, the field of financial regulation covered is quite restricted, concentrating mainly on the existence or otherwise of public and/or private credit bureaux. The generic financial issues that are of concern in South

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No thoroughgoing streamlining of the regulatory environment has occurred, or has even appeared to be in prospect

### IFC study of business regulations

Doing Business is an ongoing project of the International Finance Corporation (IFC), a member of the World Bank Group. It involves collecting and analysing data on business regulations in 130 countries, and establishing their impact on economic development in those countries.<sup>129</sup> The most recent publication emanating from the project, *Doing Business in 2004: understanding regulation*, focuses on the following aspects of a firm's life cycle: starting a business, hiring and firing employees, enforcing contracts, getting credit, and closing a business.<sup>130</sup>

The project has revealed that developed countries regulate less than developing countries,<sup>131</sup> and that the pace of reform of regulations is fastest in developed countries. In many OECD countries, reform is continuous.<sup>132</sup>

According to the IFC, 'Heavier regulation generally brings bad outcomes'.<sup>133</sup> Heavier regulation is generally associated with greater inefficiency in public institutions, and results in higher unemployment, increased corruption, poorer productivity, and less investment. The countries that regulate the most (poor countries) have the least enforcement capacity and the fewest checks and balances in government to ensure that regulatory discretion is not used to abuse businesses and exact bribes.<sup>134</sup>

According to the study, 'one size fits all': ie, many reforms undertaken in developed countries will be benefi-

cial in other countries as well. For example, computerising the business registration process has produced good results not only in wealthy countries but also in poorer countries such as Honduras, Moldova, Pakistan, and Vietnam.<sup>135</sup>

#### Key findings for South Africa

*Doing Business in 2004* suggests that the regulatory environment in South Africa compares favourably with those in many other countries, developed as well as developing. At least in terms of the IFC's narrow range of criteria, South Africa is comparatively lightly regulated in respect of: setting up businesses, hiring and firing, enforcing contracts, getting credit, and closing a business, even when compared to some developed countries.

It takes 32 days to register a business in South Africa, which is faster than many developed countries. Registering a business in South Africa takes less time than in countries such as the Netherlands, Germany, France, or China. South Africa is the eighth least regulated country in terms of labour law, and is only marginally more regulated than the United Kingdom or the United States. However South Africa is relatively inefficient in enforcing contracts (slower than Zimbabwe or Côte d'Ivoire, for example).<sup>136</sup> While *Doing Business* provides some interesting comparisons, its criteria are limited, and many areas of regulation are excluded.

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Africa – including, for instance, the regulations governing interest in the Usury Act – are not covered. The truth is that South Africa scores well on some of the most basic aspects of regulation, but the study is restricted to narrowly defined core issues and – inevitably – lacks a detailed treatment of national contexts.

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The 1995 white paper which laid the foundation for the government's small business support strategy acknowledged the need to streamline regulatory conditions

To its credit, the government has been led more by examples of international best practice than by any complacent assumptions about South Africa's relatively well developed legal and business infrastructure. Unfortunately there is a caveat. Its *intentions* have been creditable, but this has not yet been matched by delivery. Given the high-profile attention given to regulatory regimes internationally, and studies which record the dissatisfaction of South African business people with the regulatory regime, the January 2003 announcement of the DIT's regulatory study makes good sense. The news will doubtless prompt optimism that South Africa might adopt models of regulatory impact assessment (RIA) drawn from successful examples in the United States, the United Kingdom, and Australia<sup>137</sup> (see box, **The rules of good regulation**, facing page). However, what is surprising and disturbing is the fact that, through the medium of Ntsika, such a study has already been the subject of a long (and doubtless expensive) review process which recommended the RIA model as far back as June 1999.<sup>138</sup> Despite subsequent marginal changes to the labour and tax laws, the review appears to have achieved little, especially in proportion to the effort and expense expended on it and the breadth of its recommendations. Certainly no thoroughgoing streamlining of the regulatory environment has occurred, or has even appeared to be in prospect.

### Key question

It is worthwhile at this point to summarise and reflect on the place of the regulatory environment in the history and philosophy of entrepreneurship support in South Africa. That is because the need to get the regulatory environment right is central to the principle of facilitative support for entrepreneurship, which CDE endorses and wishes to promote.

The key question is: Why should something that has been embedded in the government's principles and goals from the start, and has come to be championed insistently by experts and interest groups alike, be so difficult to achieve?

The 1995 white paper which laid the foundation for the government's small business support strategy<sup>139</sup> acknowledged the need to streamline regulatory conditions. In that document the government committed itself to appropriate regulations, 'which are the result of transparent, consultative processes, with all the interest groups having a chance to state their interests and concerns, and with national economic growth and job creation within the RDP framework the overriding objective'.<sup>140</sup> However, the effect of this promising declaration is somewhat diluted by the white paper's overall tone. At all key points where the core philosophy of small business development is articulated, the delivery of support through bureaucratic structures is the predominant or even sole priority.<sup>141</sup> The impression is strengthened by expressions of intent such as: 'Guided by the overall vision of growth and development promotion within the RDP, the hundreds of thousands of small enterprises operating in the economy ... should gradually face an improved business environment, due to the impact of the different support agencies'<sup>142</sup>. The bias in favour of delivery support rather than facilitation is obvious. As a result, in the ten-year action plan of short-, medium-, and long-term measures to establish 'systematic programmes' of delivery, attention to the regulatory environment does not feature in the 32 priorities. Nor indeed do any other facilitative measures.<sup>143</sup>

*Biased approach*

This bias in approach was carried over into the Act<sup>144</sup> that duly followed the white paper. This is despite the fact that the act specifically includes attention to the regulatory environment in Ntsika's portfolio. Ntsika is directed to 'investigate, at the request of the director-general, the effect of existing and proposed legislation on small business, and to report to the director-general thereon'. In addition, it is directed to 'make recommendations to organs of government on existing and proposed policy affecting small business'<sup>145</sup> However, these commitments come only under 'other functions of the agency', after nine 'main functions', all of a 'delivery' nature, are listed. The wording and status accorded to the issue of the regulatory environment (and indeed all other aspects of the SMME environment other than skills and finance) were hardly likely to galvanise anyone into comprehensive action.

Despite all this, as we have seen, in the seven years since the act was passed, there has been one systematic attempt to review the regulatory environment, and some ad hoc changes to it. The Ntsika review had four main aims: to change the culture of regulation; establish co-ordination between branches of government, and provide consistency; simplify the administration of practical assistance to small business; and review legislation

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Regulation reform, which reduces the burden on business, supports entrepreneurship, and economic growth

### The rules of good regulation<sup>146</sup>

*'Our aim for Britain is to create an environment where businesses thrive and enterprise is rewarded. Alongside this, we must ensure that minimum standards exist to ensure fairness at work, safe products and a clean environment. In August 1998, I announced that no proposal for regulation which has an impact on businesses, charities or voluntary bodies, should be considered by Ministers without a regulatory impact assessment being carried out.'* – Prime minister Tony Blair, 9 August 2000.

The British government requires all its departments to undertake regulatory impact assessments (RIAs) of their proposed new bills and regulations. To ensure that RIAs are fair and thorough, the government has set up a regulatory impact unit in the cabinet office (the equivalent of South Africa's presidency).

Departments have to prove that they have considered all possible alternatives to regulation when aiming to solve a particular problem, including relying on 'consumer choice, competition and innovation,' improving the quality of government advice, allowing voluntary codes of practice, and even abolishing existing regulations.

If it is decided that new regulations are in fact essential, drafters are required to ensure that proposed new laws are:

- transparent – simple, open, user-friendly, and written in clear language;
- accountable – to ministers, parliament; and the public;
- consistent – with government's overall vision;
- targeted – having minimal side effects and unintended consequences; and
- proportionate – made only when necessary, based on a complete assessment of the balance between costs and benefits.

Departments are told to 'think small first' when drafting regulations. The regulatory impact unit reminds drafters that 'regulation can impact disproportionately on small firms', and requires them to show that they have accurately assessed the costs of proposed new regulations. Regulations must be designed to ensure that small firms, individuals, and voluntary associations will find it as easy as possible to comply.

The RIA procedure is not a recipe for total deregulation. When thinking about the costs and benefits of regulations, departments are required to assess social costs and benefits just as carefully as the impact on business. The goal is to achieve better regulation, not less regulation – although 'better' and 'less' often turn out to be the same thing.

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The emphasis on delivery that conditioned the approaches of the white paper and the act continues to dominate

that hinders small business, and report to the minister on it. The review was mandated to cover eight areas (including finance, taxation, labour, land, and property ownership), each with a task team, and was to have provided the minister with recommendations for tabling in parliament.

The targeting of issues could scarcely be faulted, and the method of procedure – review and synthesis of stakeholder submissions – was sensible and straightforward. In June 1999 a final report was produced,<sup>147</sup> which made policy recommendations in each of the eight areas, and on the regulatory environment in general. The philosophy on which the recommendations were based was enough to gladden the heart of any would-be entrepreneur:

Regulation reform, which reduces the burden on business and increases the transparency of regulatory regimes, supports entrepreneurship, market entry, and economic growth, which in turn produce more jobs. Reforms that reduce ‘red tape’ and paperwork burden for business and ordinary citizens which could then be spent on more economically beneficial activities.<sup>148</sup>

This promising rhetoric was followed by far-reaching proposals, notably in respect of the regulatory environment. They included an Office of Regulation Review, ‘to be established at the centre of government. (and) as free as possible from the bureaucratic chain of command, reporting directly to a cabinet minister or a ministerial committee on regulation reform’.<sup>149</sup> This office would, among other things, guide government departments on another main generic recommendation, that a regulation analysis statement should accompany all regulations emanating from parliament. The specific interests of small business, according to the report, should be vested in Ntsika itself. The agency should be ‘mandated in terms of section 10 (2) of the Small Business Act, 1996, to systematically review and assess the impact of regulations on small business and report to the director-general of trade and industry’. The report added: ‘This function is already in the act; however, it has not been effectively used.’<sup>150</sup>

The question of regulatory review surfaced again in the 2004 budget speech in the form of a promise to establish a ‘working group’ in 2004 to review the compliance burden on small businesses. While this must be welcomed, there is still room to wonder why such a vital issue should have led to so many false starts. The present situation can be summarised as follows:

### Entrepreneurship in Limpopo<sup>151</sup>

The 2003 Shoprite Checkers/SABC3 Businesswoman of the Year has achieved her success in an unusual field. Fhatuwani Ramabulana, 29, is the owner and managing director of Khumbe Poultry Farm at Wamondo near Thohoyandou in Limpopo province, whose 80 000 chickens provide eggs to the local community as well as shops and businesses in Messina, Giyani, Louis Trichardt, and the Mopani district.

Fhatuwani’s father started the farm in 1985 with funding from the Department of Agriculture. A qualified teacher, Fhatuwani, 29, took over the reins in 1999 when her father

died. Since then the business has grown from strength to strength, and currently turns over about R4 million a year.

The farm has become the life-blood of the impoverished local community. Besides providing it with a cheap source of protein, Fhatuwani employs 55 people – mostly widows and single mothers – and takes in students during school and university holidays. She also sponsors the local football team, and trains members of the community in good farming practice.

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- *eight* years after the act mandated Ntsika to carry out the task of researching the regulatory environment;
- *five* years after the completed review made extensive proposals for reform; and
- *one* year after the process was restarted from scratch;

the government has promised to set up a working group to review the regulatory burden on small business. (Just before this report went to press, president Thabo Mbeki promised, in his state of the nation address to parliament on 21 May, that this review would be completed by September 2004.)

The emphasis on delivery that conditioned the approaches of the white paper and the act continues to dominate. The encouragement of SMMES is a key performance area in the government's microeconomic reform strategy, which it began to implement in January 2003. However, the imperative of making the environment for the development of small business more hospitable through regulatory reform still does not receive the prominence it deserves in the strategy.

Meanwhile, calls for a regulatory review – based on a wealth of international experience and research – have become more focused and insistent. These calls are now focused on the RIA principle, which has become an essential part of encouraging small business and entrepreneurship in developed countries, and was, as we have seen, at the heart of Ntsika's own recommendations in the 1999 report. CDE itself called for the adoption of this principle in 2001,<sup>152</sup> following a round table discussion with the president's economic adviser and senior business leaders.<sup>153</sup> It has also been endorsed in the stakeholder initial position paper released by Business South Africa (BSA) ahead of the June 2003 growth and development summit (GDS). Disappointingly, however, the principle was not endorsed in the GDS agreements.

### *Unnecessary regulatory disincentives*

A clear statement of how and why the regulatory environment hinders the development of small business comes in the 2002 GEM report's 'assessment of the South African entrepreneurial climate'.<sup>154</sup> The assessment summarises and emphasises the unnecessary regulatory disincentives that impede the transition from informal to formal business status. The focus is on the 'enormous administrative and cash flow burden on registered businesses', the inhibiting effect of labour legislation on employment creation, and the red tape surrounding delivery of incentives (for example, in the export field) to registered businesses.

The disappointing progress made by government agencies in improving the entrepreneurial climate ought to be seen in perspective. This is not for the purpose of excusing poor performance, but with a view to improving it. There is no doubt that regulation is a difficult and complex subject:

- It is beset by genuine concerns and protective instincts of all sorts. Few if any informed commentators want simple deregulation; instead they seek an appropriate level of regulation that will make it easy to do business while still recognising the need to protect public interests.
- Protective sensitivities include not only obvious, powerful interests (such as organised labour), but interdepartmental turf wars and rivalry between national, provincial, and local levels of government. Even where rivalries are not a factor, difficulties of co-ordination are formidable.
- Capacity is a problem; to introduce the RIA principle of monitoring all draft legislation

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Calls for a regulatory review – based on a wealth of international experience and research – have become more focused and insistent



for its effects on (small) business would call for a considerable investment in skilled and specially qualified personnel. Ntsika's nomination of itself as the prime mover of regulation review, pending the establishment of a dedicated office of regulation review, may have been overambitious.

- Although CDE fully endorses the RIA concept, it remains aware that the successful co-ordination of legislation in order to minimise unintended consequences will ultimately depend on the politics of policy-making in the cabinet.

These difficulties and complexities make priorities difficult to define, and leadership difficult to assert. The DTI has responsibility in this area, but it is ideological, interdepartmental, and Alliance sensitivities that make authority and direction problematic.

### Summary

In summing up our review of government policy, we can do no better than to quote what is perhaps the most telling verdict, delivered in an interview with CDE researchers by a practitioner of small business support:<sup>155</sup>

Part of the problem was that government thinking was influenced by the RDP, and that small business support was located within that framework. Housing and health care can possibly be addressed through centralist control, but not business development. Business development is a facilitative process, requiring encouragement, support, and cheering from the side ... Government has done tremendous harm in creating the illusion that capital is the biggest obstacle to small business development.

Rather than deplore what CDE agrees has been a misplaced spirit of support, we would rather applaud the courage of those in government who have been prepared to be self-critical and welcome the signs that indicate a change of direction. However, these positive indicators do not yet amount to a wholesale strategic re-evaluation of the fundamental assumptions, tools, and tactics for the implementation of SMME support, which CDE will recommend.

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'Government has done tremendous harm in creating the illusion that capital is the biggest obstacle to small business development'



Albert Manguela of Beauty Gasa Gearbox and Diff, a specialised repair facility in Pennyville, Johannesburg. The firm employs five people.

## THE PRIVATE SECTOR

Although government policy is important for developing entrepreneurship and small business, the private sector has also come to play an increasingly important role. Unfortunately there is no systematic, research-based review of private sector initiatives in this field. This is a notable omission given the growing importance of black economic empowerment initiatives for small business development, especially the 'affirmative' procurement through outsourcing that is a requirement of the various sectoral charters. As a result, any interim assessment has to rely to a large extent on self-reporting by business themselves. Despite this lack of authoritative information, there are existing models from which both government and business might learn.

There are two main aspects to the role played by the private sector so far in SMME development: corporate social investment, and business relationships with SMMEs, including procurement of services, outsourcing, subcontracting, and partnerships (See box, **UNDP reports endorse corporate role**, page 50).

### *Commercial opportunities*

CDE's research shows that despite criticisms that South African firms are loath to engage in subcontracting and outsourcing relationships, such relationships between established companies and emerging black business account for a greater transfer of resources than donations (which currently run at 0,8 to 1,1 per cent of pre-tax profit).<sup>156</sup> Initiatives such as these work best when they benefit both parties in the relationship. For established companies they can offer real commercial opportunities; also, it is in their best interests to help SMMEs render a satisfactory service. Established companies are often the best placed to provide training in technical, managerial, and entrepreneurial skills. At their best, these relationships provide a model for supporting emerging entrepreneurs.

This kind of relationship shows clearly that sound business relationships and corporate

social investment need not necessarily be mutually exclusive. A number of established corporate enterprises in South Africa have combined forms of social investment with the fostering of sound business practices and relationships between themselves and emerging entrepreneurs (see box, **Zimele: big business meets small business**, page 54). Such initiatives are exemplified by partnerships that fall under the Zimele programme, or by driver-owner schemes such as those initiated by companies such as SAB-Miller and Woolworths. In each instance, the established partners provide ongoing business support and mentoring.

## UNDP reports endorse corporate role

Two reports published recently by the United Nations Development Programme (UNDP) clearly demonstrate the extent to which corporate support for small entrepreneurship has become part of mainstream development practice.<sup>157</sup>

The first, entitled *Unleashing entrepreneurship: making business work for the poor*, talks about 'realising that the poor entrepreneur is as important a part of the private sector as the multinational corporation ... acknowledging that the private sector is already central to the lives of the poor, and has the power to make these lives better ... using the managerial, organisational, and technological innovation that resides in the private sector to improve the lives of the poor ... unleashing the power of local entrepreneurs to reduce poverty in their communities and nations'.<sup>158</sup>

The second, *Partnerships for small enterprise development*, points out that corporate engagement with small enterprises can lead to reduced costs, improved market access, improved supply, closer compliance with environmental regulations, a closer relationship with governments, branding benefits, and more vibrant and diverse local economies.

### CSR initiatives

The document goes on to state that:

'CSR initiatives in the SME sector can be viewed as seeking to achieve some of these same objectives, with the corporation taking a longer-term perspective on the commercial return, but gaining substantial CSR benefit in the short term. This can take the form of benefits to the brand, improved and closer relationships with governments, and compliance with legal requirements (as increasingly in the case of South Africa). Thus there is a convergence of a Corporation's CSR and commercial supply chain/distribution agendas in support of SME development ...

'One can consider a spectrum of motivations that drive corporations to support SME development, from the purely commercial to the purely philanthropic, with most SME initiatives falling somewhere in the middle. The nature of the engagement will determine what kind of benefits will accrue to the corporation, and these may change over time. Thus, as the partnership matures and possibly expands, the purely business benefits may increasingly outweigh the initial CSR benefits.

'To better comprehend the motivators for the corporate sector, it is also useful to consider the life cycle of a partnership supporting SME development. In the early stages of a partnership programme, there may be considerable investment for limited direct financial returns, as the challenges of addressing the capability gap of SMEs are addressed.

'At this early stage, many of the benefits accruing to the corporation will be CSR-related. However, as the partnership programme matures, and the capabilities of SMEs increase, the investment return equation will begin to change. There will be less intensive inputs in support of SME development, and greater rewards for the corporation in terms of cheaper, better, more secure, and environmentally compliant inputs and easier-to-access and more stable markets.'

The document distinguishes two types of private sector support for entrepreneurship development: direct commercial links with SMEs, through supply chain or distribution linkages; and general support to SMEs that is (in the short term at least) not directly linked to the business of the corporation. It contains a wealth of case studies illustrating both types.

### Unilever in Vietnam<sup>159</sup>

In the 1990s, many local raw material and manufacturing suppliers lacked know-how of management concepts and

Established business concerns – especially large corporations – are also better able to adapt to the mentoring and other special needs of their SMME partners. For example, corporations can be more flexible on payments – perhaps agreeing on an initial payment, and cash on delivery – than government. Similarly, over the past five years a trend has emerged of private companies placing regular, smaller orders for goods, with the intention of helping SMMEs to overcome a lack of storage space and limited production capacity. Adaptable relationships such as these are often more difficult to implement in the public sector.

style, cost-effective operations, technology, quality control systems, safety standards, and environmental awareness. They also lacked access to business financing. Unilever identified SMEs for partnerships in raw material and packaging supply and distribution, and contract manufacturers. By defining quality standards, transferring technology, carrying out training and in some cases providing financial support, Unilever worked to develop the SMEs capabilities and capacities. As a result, Unilever enjoys additional production capacity, reliable raw material supply and distribution reach. Shorter lead times, lower working capital and, therefore, reduced financial risk and risk of obsolescence are further benefits to the company. These partnerships with local enterprises support 5 500 jobs, compared to 2 000 Unilever employees in Vietnam. Local supply partnerships account for 40 per cent of Unilever's raw materials, 80 per cent of packaging materials, and 55 per cent of production volume.

#### **DaimlerChrysler in Brazil and SA<sup>160</sup>**

In the early 1990s, DaimlerChrysler and Borgers, one of its German suppliers, developed natural fibre car components. There was a strong commercial incentive for the company to roll out this technology in South Africa, based on environmental considerations and import duty incentives. This was complemented by the developmental incentive of supporting sisal farming and processing in poor regions of South Africa. Borgers worked closely with Brits Textiles and NCI, the two South African manufacturers, to help them set up new processing systems and production lines. This included exchanges of personnel, provision of equipment, and skills training. DaimlerChrysler also worked closely with the South African Council for Scientific and Industrial Research (CSIR) to support sisal farming in South Africa. This included support associated with

the privatisation of several previously state-owned farms, working on the sisal process chain, and exploring alternative applications for sisal. The programme developed a stable and efficient local supply of sisal, generating long-term sustainable jobs for sisal farm workers and promoting economic growth in poverty-stricken areas. The two SMEs involved in the partnership gained by being able to develop world-class manufacturing standards, and gaining international exposure. Both were able to increase investment, sales, and turnover.

#### **Deloitte Touche Tohmatsu in SA<sup>161</sup>**

Deloitte Touche started Business Beat in 1996 as an empowerment initiative, and the project plays a central role in its corporate social investment programme. It is a small business support service, with offices in several centres. Its services include developing personalised management plans which can help aspirant entrepreneurs to acquire start-up finance. A key aspect of the scheme is that, instead of in-house capacity, it utilises independent professional service providers, such as black accounting and consulting practices.

Key players in Business Beat's partnerships include:

- corporations, franchisors, and public sector groups that encourage the development of SMEs;
- professional independent service providers that develop entrepreneurial potential in previously disadvantaged candidates;
- financial institutions that focus on providing assistance to small, medium, and micro enterprises;
- training and mentorship programmes that focus on skills transfer and access to specialist advice in areas such as taxation and IT; and
- black business organisations and associations.

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Linkages of this sort between established and emerging businesses have such substantial developmental potential that it would seem a logical policy goal to encourage more of them. It would be important, however, to stress shared interests in this rather than a legislated or otherwise enforced extension of partnerships of this kind, which would risk exacerbating South Africa's reputation as a high-cost business environment.

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Many of the constraints experienced by lending institutions have stemmed from a lack of capacity to provide aftercare, mentoring, and selection

### *Role of banks*

Banks are also important private sector actors in the development and support of entrepreneurship. While the role of finance in SMME development has already been discussed, it is worth briefly noting the relationships of the major banks with the small business sector up to now, although the financial services charter will greatly affect future relationships in this area. Relationships so far have not been easy, and banks' efforts to engage with this sector of the economy have met with criticism, frustrations, and reverses. They have constantly been criticised for being excessively cautious and 'risk-averse',<sup>162</sup> yet each of the major financial players has, or has had, an established micro lending arm targeting small emerging business.

Many of the constraints experienced by lending institutions have stemmed from a lack of capacity to provide aftercare mentoring and selection, mirroring Khula's experience. This suggests that South Africa's capacity for programme development and implementation is shallow – a scarcely surprising conclusion in the light of the general shortage of skills in society and the economy. A number of lessons have been learnt by the banks as a result of their various initiatives in the small business sector. One of these is that retired entrepreneurs do not make effective mentors.<sup>163</sup> Another is that applicants do not appreciate the

## **Zimele: big business meets small business**

One corporate initiative that has been successful has been undertaken by the Anglo-American Corporation. In 1989 Anglo, together with De Beers, embarked on a small and medium enterprise initiative. LITET, now Zimele, originally focused on creating labour-intensive projects. Through various initiatives, Anglo has been associated with more than R18 billion of black economic empowerment deals and more than R11 billion-worth of procurement from black-owned firms. However, of greater interest is the procurement from and partnership with SMMEs, which is now pursued on entirely commercial grounds *with employment being the outcome of successful enterprise and not the direct goal*. This is largely done through the Zimele programme. Where opportunities for procurement from black-owned SMMEs are identified, training, support, and mentoring are provided where necessary in addition to core facilitation in terms of simplified tender documents and expedited payment.

Zimele is also involved in business development, partnering existing or start-up businesses, providing funding

through loans and equity, and sharing skills and experience. Once the business has become sustainable (targeted at three years by Anglo), Zimele exits. According to Zimele's senior business development manager, Dr Lia Vangelatos, in 2001 Zimele's 21 SMME partnerships turned over R145 million, and collectively employed 1 234 people.<sup>164</sup>

Zimele emphasises that commercial principles have to be honoured. Factors such as price, quality, service delivery, and cost savings are adhered to at all times in the procurement process.<sup>165</sup> Furthermore, it has identified four warning signs that cast doubt on the ability of an aspirant entrepreneur to create a sustainable business: a reluctance to contribute start-up cash (however small the amount), unproven ability and aptitude for hard work, a record of dishonesty, and unrealistic expectations of quick wealth.<sup>166</sup>

The Zimele model has been so successful that it has been replicated in a number of other countries, including Kazakhstan, and adopted by the IFC as a linkage model.

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crucial requirements of business success; instead, they believe they ‘deserve a loan or a handout’.<sup>167</sup> Besides this, the Banking Council South Africa has found that ‘banks are targeted as unwilling partners, possibly to conceal some of the shortcomings of government and other initiatives’. And ‘there is pressure for “easy loans” with no own contribution and lowered standards to accommodate larger volumes of loans (and to) ... forgive blacklisting and poor credit records’.<sup>168</sup>

‘Our original estimations that for every 20 interested persons interviewed, only one would meet the entrance criteria and be registered, and furthermore that not more than 10 per cent of all registered applicants would qualify for finance proved to be more realistic.’<sup>169</sup> Notwithstanding these arguments, Riley, in a comparative best practice study for the World Bank, argues that South African banks still have some way to go in developing efficient and effective mechanisms for interacting with small business.<sup>170</sup>

A distinction needs to be made between two relationships: between the banks and small and medium businesses, and between the banks and micro or very small entrepreneurs. In a submission to the portfolio committee for trade and industry in 2000, the Banking Council argued that ‘the practical difficulties of lending to SMMEs vary significantly between small, medium, and micro enterprises’.<sup>171</sup> The reality is that lending to small and medium enterprises is profitable, and established small and medium enterprises do not, by and large, find it difficult to access bank finance (although start-up ones might). But the costs of making loans to micro enterprises are enormous compared to the typical size of the loans, and it is almost impossible for micro entrepreneurs to cover these costs. Lending to very small enterprises is not much different.<sup>172</sup>

## Value systems

Praise for initiatives such as Zimele and the banks’ defensive posture on lending to the SMME sector illustrate contrasting poles of private sector involvement in entrepreneurship support. Arguably, however, the main role of the private sector with respect to entrepreneurship is to sustain and expand the value systems that infuse our collective culture with the motivations and expectations on which vibrant entrepreneurial activity can be based. Some of South Africa’s business organisations do this to an extent, but there is very little evidence of wide and strategic programme activity in this field. There can be little doubt that it would be a good thing if the private sector were to expand its engagement in support of entrepreneurship, preferably in partnership with government. However this needs to be done in a way that retains and fosters the spirit of self-reliance and independence that characterises entrepreneurship, and treats private sector actors as what they are profit-maximising providers of goods and services. As a first step towards these things, however, it will be necessary to generate independent information on what is already happening – in South Africa and internationally – in private sector support for SMME development. Central to this would be an investigation of the relationship between empowerment requirements – especially sector charters – and SMME development. This relationship tends to be the subject of rhetoric rather than research.

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The costs of making loans to micro enterprises are enormous compared to the typical size of the loans

Roy Chibane, left, owner of Emoza Aluminum, with one of six employees. This small firm manufactures aluminium doors, windows, and gates in Johannesburg.



## LEARNING FROM SUCCESS

As this report has acknowledged from the beginning, it is important to take heed of global studies that reveal shortcomings in South Africa's performance as an enterprise society and economy. At the same time, if we are to have successful policies for supporting entrepreneurship, then it is important to learn from successful entrepreneurs themselves, especially those who have prospered without state-led delivery of resources to them. It is equally important to acknowledge that while we have plenty of home-grown entrepreneurial potential, waiting for a facilitative environment to unlock it, we can always do with more, and that entrepreneurship is a skill to welcome as much – if not more – than any other. By celebrating spontaneous success stories, we can help to facilitate the emergence of an enterprise-friendly culture, which is attractive not only to South African entrepreneurs but also those outside the country who are drawn by the vitality of our economy.

### Ingredients of success

The factors making for successful entrepreneurship in South Africa are somewhat under-researched, which makes it clear that not only are we some way from fostering and celebrating a culture of entrepreneurship, but also that policies *designed* to support entrepreneurship lack a crucial dimension. This point is made cogently by the TIPS study of the economics of SMMEs. 'SMME policies, and in particular those on micro-enterprises, focus more on constraints rather than investigating the conditions under which SMMEs *do* grow. This is problematic for a number of reasons. Firstly, entrepreneurs are usually unable to identify all the factors that negatively impact on their growth. *In addition, the removal of these constraints is necessary but insufficient for SMME growth*<sup>173</sup> (emphases added).

However, despite this deficit in our understanding of successful entrepreneurship, there are some clear research pointers, and there is plenty of anecdotal evidence.

In a CDE background research report, Dr Jeff McCarthy analysed in-depth interviews with 20 successful black entrepreneurs based in Johannesburg and Durban.<sup>174</sup> His study drew largely upon a new breed of younger, metropolitan-based entrepreneurs and professionals. Since then, CDE has also studied the histories of dozens of small entrepreneurs (see box, **Innovating and globalising**, page 56).

### Key themes

A number of themes emerge from McCarthy's study:

- Black entrepreneurs have created many successful businesses, but their achievements have generally been poorly documented, and are seldom celebrated. Perhaps understandably, South African researchers in the field of affirmative action and black economic empowerment typically deal in abstractions such as 'structural constraints' to black advancement. However, this tends to crowd out studies of how and why individual black people *do* become successful in business, despite these impediments. Recognition and, more importantly, learning from their successes tend to get lost.
- When asked to reflect on the reasons for their success, the respondents mentioned a combination of individual (personality) and contextual factors, with a general set of causal relationships being constructed as follows:
  - Success usually begins with a child born to a family that inculcates a strong work ethic and educational focus, with the 'bright star' of the household being pushed to achieve success.
  - There is no 'old school tie' network to penetrate the formal economy. Important factors that can substitute for this include attending a first-class university and/or working for a large corporation, which in turn prepares the individual culturally for operating in the economic establishment.
  - From this point on, the original personality and intellectual qualities which led the child to be successful at school can reassert themselves, with skills and acquired culture operating in synchronicity to produce the results that are required to succeed. An interest in a global perspective on the economy develops and grows.

These interviews confirm what is often believed about emerging entrepreneurs: that their values favour sustained growth and wealth creation. While the interviews recorded an unabashed materialism found in any globalised economy, there was also a high level of interest in two distinctive factors: world travel, and the family. This is what most respondents intended to spend money on, rather than on items of conspicuous consumption.

Only one substantial study of successful South African black business people appears to have been published in the past ten years or so. Ian Hetherington's book *Heroes of the struggle* (1998) examines mainly older black business people, many of whom became successful during the apartheid years.<sup>175</sup> As a result, his frame of reference does not accommodate urban-based enterprise in a context of modern information technology and globalisation. However, his findings on the personal attributes required for black entrepreneurial success are not very different from those suggested by CDE's other work.

Hetherington's interviews note the same heavy weighting towards the personal and family attributes referred to in McCarthy's findings: family backgrounds of pressure to succeed, high levels of personal drive and ambition, and (in his cases) an emphasis upon an eye for the market, self-discipline, thrift, and fortitude. However, very few members of the 'older school' referred to the value of a high-quality university

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Black entrepreneurs have created many successful businesses, but their achievements have generally been poorly documented, and are seldom celebrated



## Innovating & globalising

### Simon Boikanyo<sup>176</sup>

Simon Boikanyo runs a special kind of business with flair and panache that few can match.

He was born on 20 December 1954 in Oukasie just outside Brits, and is the sole owner of Boikanyo's Funeral Home. He took the plunge and started his business in 1988 after having worked in the undertaking industry for more than ten years.

'I saw the need in the black business community for such a service, and decided to start my own business, taking a loan of R50 000 from Business Partners to service the Letlhabile area just outside Brits.'

Simon was one of the chosen few asked to render their services at the funeral of the late Oliver Tambo, bearing testimony to the esteem in which he is held. 'When running a funeral home you must be honest and must have a heart as well,' says Simon.

'When I started my undertaking business, there was an old age home close by and whenever one of the occupants died, they were given a pauper's funeral. I couldn't let that go on – I could not let mothers and fathers be buried in such an undignified fashion. I therefore volunteered my services free of charge.

'Luckily for me, I got "payback" I didn't expect. People in the community heard that I was providing this service, and rewarded me by supporting my business.

'It's amazing what the power of good service and word of mouth can do for you. The esteem in which the community held me grew tremendously, and I established myself firmly in the area.'

But Boikanyo is not just heart. He is also a very astute businessman who certainly knows a thing or two about marketing.

'I realised,' he says, 'that I had to give people reason to choose my service above anyone else's. I therefore decided to invest a little more to provide that something special which would draw my clients, and for me that something was importing the vehicles I use in my business.

'I got the idea after visiting America to see how they conduct their funerals, and I was impressed. I decided to try and achieve the same standards here, importing a number

of vehicles over a period of time, and it's worked like a charm. I believe people use my service because they feel special when they come to me.'

Simon now has a total of 90 vehicles, 40 of which are imports. To further market his business, he maintains close ties with the community by often addressing groups of people on the merits of joint burial policies. Many form themselves into societies and join these schemes, which are mutually beneficial to both the community and his business. He repaid his first loan before the term expired, and took a second loan. In 1992 he bought the premises from which he had started operating, and has now opened branch offices in other parts of North West.

### Sir Dick's Uniforms<sup>177</sup>

A Cape Town uniform manufacturer has taken the lead by introducing online shopping to boost its export efforts. Sir Dicks The Uniform Company, based in Woodstock, is placing considerable emphasis on modern marketing techniques in order to supplement its export drive into Africa and Europe.

The company has a catalogue of its uniforms on CD-ROM, and is developing an Internet version that will be linked to an online shopping facility. Customers will be able to order online from anywhere in the world, although a 100-page hard copy version of the catalogue can also be sent to clients in Africa and Europe. Its managing director, Sedick Gierdien, says:

'The major hotels in Africa are all Internet-connected, so we aim to combine electronic marketing skills with an excellent product.'

The company has supplied leading hotels in Mozambique, Uganda, Zambia, Namibia, Malawi and Botswana. 'It's something we want to focus on strongly,' Gierdien says. 'There is a great need in Africa for this kind of service.'

Sir Dick's manufactures uniforms for the staff of mainly five-star hotels, the South African Navy and Air Force, the SA National Defence Force, and the Medical Corps.

'We have a good infrastructure here, and our transport going into Africa is excellent both by road and air, using South African transport companies,' says Gierdien.

**Sally Marengo**<sup>178</sup>

Sally Marengo began to import bathroom accessories from a garage in her back yard. Almost 10 years later, she runs a thriving operation that manufactures automotive and mining components. In 2001 her company, the Germiston-based KPL Die Casting, received the minister's award for outstanding entrepreneurial achievement at the annual President's Awards for Export Achievement, sponsored by the People's Bank and the *Sunday Times*.

Marengo started the manufacturing company in 1995, with production beginning the following year. The idea was conceptualised in the days when she imported bathroom components from the Far East, which she would assemble into items such as towel rails, to be sold locally. 'After numerous trips to overseas suppliers, I suddenly got this brainwave – I realised that making these fittings was something we could do ourselves.'

Marengo imported a single machine and set up a factory producing bathroom accessories from zinc alloy. But her little company faced increasing competition from imported products, and was not a viable proposition in that form. The breakthrough came when an engineering company had a problem with production of a spindle, and asked Marengo whether she would make it.

'They put us in touch with the company that gave them the initial order – and that's how we started. I struggled for a very long time; manufacturing is a different ball-game altogether. The real turning point came when people started contacting us. Suddenly, from making bathroom fittings, we were doing hinges for fridges.'

Marengo has taken care to get her costing correct, comply with labour laws, and build a happy workforce. Most of her 25 employees have been with her since the beginning.

'I've put a lot of sweat equity into this company, as has all of the staff. They've seen how we have changed. From a room of 100 square metres, we now have premises of some 18 000 square metres.'

**Sithembiso Mthethwa**<sup>179</sup>

Sithembiso Mthethwa sees a bright future for the company he formed six years ago. He knows he is in the right place at the

right time. Started in 1997 with three people, the Dudula Shipping Company now employs 240 people, and expected to turn over R350 million in the 2003 financial year.

What started as a small shipping agency has become a company with three primary divisions: logistics and shipping services, marine oil and tanker services, and ports and harbour services.

Among other things, the company has signed a deal to handle the rail logistics for 60 per cent of emergency food supplies, amounting to several hundred thousand tons of cargo, to neighbouring countries in the Southern African Development Community (SADC).

In a partnership with the Dutch firm Smit (Africa), the marine services subsidiary Dudula Marine operates three bunker barges in Richards Bay and Durban, and offers offshore support services, mainly to the oil industry.

Another partnership has been with the American company World Terminals, to form the ports and harbour services division. World Terminals is part of a group that owns and operates the largest railroad system in the eastern United States, and operates terminals and related businesses in many countries.

Mthethwa believes there is a huge potential for the movement of cargo in Africa, particularly petrochemicals.

He ascribes some of the company's success to building good relationships with partners and backers. Partnerships have helped to cut the costs of research and development by sharing past experiences.

He strongly believes in exercising patience in business. Several of the deals he has negotiated have taken time to come to fruition, although the contract may have been signed many months earlier.

What he finds disturbing is the expectation of instant wealth of some people in the climate of black economic empowerment.

He believes black empowerment is important, and will be a given for a long time. But it has to be done in a sustainable way. His advice to aspirant entrepreneurs is to look for opportunities.

'The basic premise is one of supply and demand. People should not feel that, because Joe Soap has got into business in a certain sector, they can do the same.'

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Immigrant entrepreneurs should be viewed as a developmental resource that can be harnessed to develop a vibrant SMME economy

education, or exposure to multinational corporations. By contrast, these were often spontaneously mentioned by McCarthy's respondents. This points to the increasing worldliness of successful black entrepreneurs and the emphatic value placed on a sound education, as well as exposure to and connections with modern transnational corporations. Although leading questions were asked about African identity, respondents exhibited a striking lack of political rhetoric. This was underlined by a broad scepticism about the meaning of 'being African' which came through in many responses.

In short, the ingredients for entrepreneurial success in South Africa are looking more and more like those found anywhere else in the world: sound families, excellent education systems, an active response to globalisation, and the cultivation of a national cultural disposition to celebrate intelligent risk-takers and small business success.

### Enterprising immigrants

Many South Africans regard entrepreneurs, from other countries, as potentially or actually 'dangerous'. This perception is sometimes reinforced by the activities of unscrupulous con artists from abroad. Yet it is clearly unwarranted to assume that entrepreneurial competition from immigrants generally damages an economy (see box, **Capitalising on immigrants**, this page). For example a survey by Rogerson of 70 immigrant-owned SMMEs revealed an average of 3,33 jobs created per business. In the same way, a doctoral thesis by Geyvu on Ghanaian immigrants in Durban showed that most of them employed previously unemployed South Africans.<sup>180</sup>

In the establishment or start-up phase of these new businesses, family or friends from

## Capitalising on immigrants

According to Reuven Brenner, an economist at McGill University, 'entrepreneurship inevitably implies a deviation from customary behaviour. This behaviour is initiated because entrepreneurs view themselves at a disadvantage from others in their societies, or in a worse position than in their own past.'<sup>181</sup> This is perhaps why immigrants tend to display more entrepreneurial behaviour, although the very fact that they immigrated suggests an opportunistic mindset – representing as they do enterprise moving to opportunity.

Another American economist, Thomas Sowell, has noted: 'Nothing is more common than to have poverty-stricken immigrants become prosperous in a new country and to make that country more prosperous as well. The Chinese have done this throughout south east Asia, the Lebanese in West Africa, and numerous other groups in various other regions of the world.'<sup>182</sup> By the late 20th century, all five billionaires in Thailand and Indonesia were Chinese.<sup>183</sup> Indeed, immigrant enclaves are hotbeds of entrepreneurial activity in many countries.

Argues Sowell: 'Seldom have middlemen minorities begun their careers in a community or country by bringing wealth with them. Almost invariably, they have created wealth, both for themselves and for the society around them, often creating not only particular businesses but in some cases whole industries and functions that did not exist before. Beginning often in poverty, middleman minorities have historically been hawkers and peddlers on a mass scale – for example, Jews in 19th-century America and Argentina, and the Lebanese in South Australia, West Africa, and many parts of the western hemisphere. It is from such humble beginnings that there ultimately emerged such businesses as Bloomingdale's, Haggard slacks, and Levi's.

Most peddlers, of course, never reached such economic heights, but many moved up to have their own stores and some eventually chains of stores.'<sup>184</sup> Adds Sowell: 'Many of the immigrants who helped to bring whole nations into the modern commercial world – the Lebanese in West Africa, and the Chinese in south east Asia, for example – arrived with little or no formal education.'<sup>185</sup>

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the home country are typically the beneficiaries of the new employment opportunities. However once the business is established and growing, the major beneficiaries of job creation by these immigrant-owned SMMEs are South Africans.<sup>186</sup>

As a starting point in policy formulation, immigrant entrepreneurs should be viewed as a developmental resource that can be harnessed to develop a vibrant SMME economy. Immigrants generally represent enterprise moving to opportunity. Rather than listening to those interests in South Africa who would like to drive them out, policy-makers should celebrate immigrant entrepreneurs. They generally have the necessary drive to work hard and succeed. South Africa, like many immigrant nations, has many examples of small business success by ethnic minorities over many decades. These have included Chinese, Portuguese, Italians, Greeks, Jews, Lebanese, and Indians. Today, west and central African traders are coming to South Africa to follow the same path of immigrant success. Initially, such ethnic communities rely upon ethnic networks to enhance business success. Later, the same individuals or their children elect to use business associations to enhance their efficacy.

### Summary

Whatever we can learn from the global market place of ideas and experiences, we should pay attention to our own stock of these things. If we do, we will reinforce rather than contradict the lessons of the international research, which we reviewed in the previous section. We will learn, above all, that the ingredients of our success stories are much the same as those of other countries, and that we should celebrate them, study them, learn from them, and craft policies round them.

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Rather than listening to those interests in South Africa who would like to drive them out, policy-makers should celebrate immigrant entrepreneurs

Betty Meyers, owner of Betty's Curtains and Interiors. Her distinctive products have been bought by numerous local companies, as well as hotels in Dubai.



## TOWARDS A NEW APPROACH

This review of available research – our own and others' – has yielded two powerful impressions. The first arises from the concerns raised by the comparative figures with which we began. They reveal that South Africa underperforms – especially when compared with other middle-income developing countries – in terms of every significant international measure of entrepreneurship.

The second impression comes from the studies of individuals with which we illustrate the powerful currents of entrepreneurial vitality in South Africa, despite the disappointing overall figures. It is at the point where the energy of the individual case studies contradicts the stagnation of national figures that CDE's points of departure towards a new direction take shape.

### **Entrepreneurs are a minority in any society**

Entrepreneurship is a quality, and not a deliverable commodity. It is a mistake to believe that there is an unlimited pool of enterprise, which needs only technical and financial support for a wave of successful small businesses to emerge. Entrepreneurship is a quality made up of psychological dispositions and cultural attitudes, expressed in skills that can be learned as well as knowledge and experience gained in education or employment. Only a minority of individuals in any given society express these attributes in ways that add value to the economy, though in groups such as immigrants, rural to urban migrants, or ethnic minorities the proportion may be higher.

Above all, entrepreneurship can only flourish where the values of the market are thoroughly and widely internalised. Policies to support entrepreneurship should work with the market – in deciding who should be loaned money, for instance – and not try to overrule it.

## Good intentions are not enough

It is not enough to value entrepreneurship, and support it through policy. *Why* we value it and *how* we support it will make the difference between clear policy goals and mixed purposes that might turn out to be cross purposes. In the end, this is the difference between success and failure. It is politically inevitable that entrepreneurship support in South Africa today should have multiple motivations. The 'halo effect' that surrounds the subject and the pressing needs for political and economic transformation make sure of that. However, the most important reason for supporting entrepreneurship is to increase the number of successful businesses that add value to the formal sector of the economy. This is best done by providing an enabling environment for the kind of people whose success stories appear in this report.

## We need more reliable and precise information

More – and much more reliable – information is needed about the size and shape of the SMME sector of the South African economy. It is here that underperformance and potential for improvement are concentrated. In a poorly documented and underdeveloped sector of the economy, there are clear difficulties in ordering priorities and choosing strategies. More reliable information is needed in order to guide policy better, and to monitor and assess policy outcomes with more confidence. However, this should not be a prescription for research without end and an infinite postponement of decisive action.

## Priorities must be developed

As we need to be clear on why we support widening the pool of entrepreneurship, so we need to be clearer about the problems faced by the sector. There is a broad and deceptively comfortable consensus about what is needed to support entrepreneurship, but this consensus lacks the kind of clarity about priorities which ought to take greater account of constraints on capacity. Where advocacy can be most useful is not simply in repeating the mantra of consensus (skills, finance, education, and the regulatory environment) but in arguing for a coherent, integrated, prioritised, and, above all, *achievable* package of policies. The problem of priorities seems evident in even the best work on the subject of entre-

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The most important reason for supporting entrepreneurship is to increase the number of successful businesses that add value to the formal sector of the economy

## From learning to cooking<sup>187</sup>

Cynthia Nongalaza was 45 when she took a voluntary severance package in 1996 and left her position as deputy principal of Nyanga Mkhanyiseli Primary School in the Western Cape. She started her own catering company, Cyn's Catering, selling about one cake a day. Today she employs 20 people, has a three-year contract with the Peninsula Technikon, and prepares at least 1 050 meals a day. She also runs the successful Embizeni Restaurant at the Luntu Centre in Guguletu, which attracts both local and foreign tourists.

She says her biggest challenge when she started the business was getting herself to believe in her product, and making people believe in her.

Seven years on, she no longer has a problem gaining her clients' confidence, and even caters for parliamentary functions, weddings, and birthday parties. Her dream is to expand her business by opening a top-class hotel and another restaurant, both in Guguletu.

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The government has failed to follow through on the recommendations of its own task team on streamlining regulations

preneurship. In the chapter that reflects on its main findings, the admirably comprehensive GEM report lists nine ‘framework conditions’ for entrepreneurship, and 46 ‘policy implications’ within them.<sup>188</sup> These cover both the dimensions of entrepreneurship support which we have labelled ‘facilitation’ and ‘delivery’, but when it comes to listing a dozen or so priorities for each of the formal and informal small business sectors, the emphasis is heavily skewed towards state delivery. In other words, the policy priorities (delivery of finance and skills) which it isolates are those very ones which its respondents have labelled ‘poorly executed, non-transparent, and unco-ordinated’, and which are subject to ongoing capacity problems. Meanwhile, the possible elements of a dynamic programme of facilitation are buried in the nearly 50 recommendations that don’t qualify as ‘priorities’.

### **The government’s commitment is fine, but its policies are flawed**

Government policy on entrepreneurship support has been driven by a commitment to make this fit into its broader conception of economic transformation. A policy reflecting elements of international best practice was adopted after widespread consultation. However, this policy was flawed in that it overemphasised providing access to finance and the direct delivery of support services. Although the department itself and its satellite bodies can point to impressive policy inputs, they are less forthcoming about outputs, and are only belatedly undertaking research on these and on impacts. Both CDE’s own research and that of others reflect a high degree of scepticism about the activities of these agencies, and even suspicion about wasted and misdirected resources. It is difficult to measure their success and failure rates, and the DTI itself has clearly experienced problems in the course of monitoring policy implementation. It is not at all clear what proportion of resources make it through to end users, but all the available evidence suggests that it is too small. Government support for entrepreneurship in South Africa has resulted in the creation of a costly but struggling bureaucracy for delivering finance and skills training to emergent entrepreneurs. However, there have been high default rates among aspirant entrepreneurs who have received loan funding, and the training and advice have largely been provided and managed by people with no business experience, a legacy of underestimating the government’s own capacity problems and the sheer difficulty of providing effective state-based expertise. In fairness, however, it is important not to overestimate the depth of capacity in the market. Lastly, the government has failed to follow through on the recommendations of its own task team on streamlining regulations.

### **We need to build on private sector strengths**

It is very hard to comment on the contribution the private sector is making to SMME development in South Africa. It has supported many projects and initiatives, but outputs and results have not been comprehensively assessed. And, as with assessing government programmes, it is important not to confuse propaganda with an independent audit of actual results.

Having said that, there can be no doubt that the private sector has the potential to make a significant contribution to expanding entrepreneurship. In this of all fields, the private sector has the expertise and capacity to make a real difference. Greater attention to public–private partnerships in this area is urgently required.

## Immigrants are a valuable resource

Debates about SMME development and immigration policy have paid too little attention to the potential contribution of immigrant entrepreneurs to the economy. This resource should be formally recognised and encouraged. Debates about immigration and entrepreneurship have continued in isolation from each other, ignoring international and local experience which points to the important contribution that immigrants make to building a successful culture of entrepreneurship, and supplementing the pool of positive role models for would-be South African entrepreneurs.

## We need to celebrate success – and learn from it

South Africa has done far too little to recognise, celebrate, and analyse the achievements of its successful emergent entrepreneurs. Too much has been invested in concentrating on the structural obstacles that aspirant black entrepreneurs have faced, instead of drawing on the lessons of those who have overcome them. CDE's review of the available evidence suggest that:

- Irrespective of race, South Africa's successful entrepreneurs are generally – though not always – well-educated, have entrepreneurial 'can do' attitudes, are innovative, and often have partners or relationships which reflect a global economic context.
- As is the case elsewhere in the world, immigrants and ethnic minorities are over-represented among South Africa's entrepreneurs. However, there are also rapidly growing numbers of black entrepreneurs who tend to 'select themselves' on the basis of their attitudes, education, hard work, customer orientation, and globalised perspectives.

## We need to deliver a business-friendly environment

'A good SMME strategy is in reality a good private sector development strategy.'<sup>189</sup>

Creating an enabling environment for entrepreneurship and removing obstacles to establishing and maintaining small enterprises will do more than any other set of policies to help small businesses. This has been said many times, and has been acknowledged by those elements of government most closely involved with entrepreneurship. *But it has never been declared as an open and acknowledged priority of the whole government, at the expense of delivering support. It is time to make such an openly acknowledged choice, with the backing of the highest levels of government.*

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Creating an enabling environment and removing obstacles to establishing and maintaining small enterprises will do more than any other set of policies to help small businesses

## Innovation from Soshanguve<sup>190</sup>

Herman Mokgatle runs an innovative small business, External Works Architecture. His idea was to develop comprehensive and innovative landscaping designs and prototypes for schools and community parks. The five-person Soshanguve-based company also provides clients with a detailed list of the quantities and costs of doing the land-

scaping. The institution concerned then asks companies or other organisations to sponsor the project.

External Works either does the work itself – it has 30 employees – or acts as an adviser. So far, seven schools have been landscaped, and 25 more are pending.

CDE 2004



Romain Blayndi, co-owner of The House of Abraham, with two of 10 employees. This firm manufactures and restores furniture in Johannesburg.



## RECOMMENDATIONS

CDE's work on how South Africa can encourage more entrepreneurship has consistently identified a common set of obstacles:

- What we are all trying to achieve in this field is not sharply defined, and there is often confusion about the objectives of SMME policy.
- The state of research on the South African SMME sector leaves much to be desired, and the facts about what is actually happening are difficult to establish.
- After ten years of good intentions, the results of the state-driven delivery approach to entrepreneurship support have not been impressive.
- The contribution of the private sector is hard to quantify, with little reliable and independent information available on private sector initiatives.

### Building blocks

In this context, it is important to clarify some building blocks that are essential to the recommendations for action that CDE will put forward.

**First**, there is the question of defining what we are trying to achieve. In South Africa, promoting entrepreneurship has been confused with poverty alleviation and welfare on the one hand, and racially defined empowerment on the other. This very broad agenda of policy goals has not been useful or helpful in achieving results. It is crucial to penetrate the general cloud of goodwill that surrounds any discussion of entrepreneurship as the first step to a clearer understanding of this subject, and more sharply focused policies.

**Second**, we need to agree as a country on the priority of achieving a more entrepreneurial society, and then on the ways in which we can do this. For CDE, the overarching goal of efforts to promote economic entrepreneurship can be stated very simply: to clear space for an explosive development of businesses that will add value to the economy. Poverty alleviation and welfare issues are important, but they must be dealt with by other policy spheres. They

should not be confused with efforts to help more entrepreneurs run their own businesses.

**Third**, we need to discuss how best to do this. We argue that efforts to achieve this goal should focus far more on facilitating and promoting an enabling and encouraging environment than on creating bureaucratic structures to deliver support. Advising and training aspiring entrepreneurs is best carried out by people who have experience of business, and ideally by those who have succeeded in it.

**Fourth**, it is important to recognise that entrepreneurship is not a discrete policy delivery area, such as housing or education. Entrepreneurs are individuals, and cannot be produced or reproduced like goods and services. What we should be promoting is a fundamental form of personal empowerment across our society – individuals having the freedom to undertake economic activity in whatever way they can, or in whatever space they can find a niche. Qualities of risk-taking and of matching opportunity, ideas, and delivery with markets cut across almost all dimensions of our society and our economy. Thus, in thinking about policy actions to promote entrepreneurship, it is crucially important not to do so in isolation. No government finds it easy to deal with issues that cut across many departments, policies, and levels of administration, and the South African government is not alone in facing this challenge. But if we are serious about fostering enterprise and promoting entrepreneurship, the challenge has to be faced, and there is much that can be learned from others.

### *Public–private partnerships*

We need these building blocks of a new approach because, despite ten years of policies designed to promote the small business sector, we still seriously underperform in this economic sector when compared with other developing countries. The honest reflections of some of the policy-makers involved confirm and underline what research – both South African and comparative – makes clear: the track record of the first ten years of democratic rule in this field is mixed at best. This does not mean that there are no successes from which to learn. The opening up of opportunities for all South Africans that has come with the achievement of democracy has seen many individuals successfully take advantage of new-found rights. It is important in this of all areas for South Africans to learn from the experiences of those who have used opportunity and their own resources to make something happen, in order to widen and deepen economic democracy. What have not worked are state-driven bureaucratic approaches, generally involving people without the necessary expertise or experience. It is time to move on. And it is time to move forward decisively.

Government leaders have talked of not creating a culture of entitlement. Speeches are peppered with reminders to citizens not to expect hand-outs from government, or to sit and wait for it to deliver on every area in which communities and individuals are challenged. President Thabo Mbeki has talked about the need for ‘a sustained campaign to further encourage the work ethic among all our people. We have to fight and overcome the attitude among some that they are entitled to receive free goods and services without any effort on their part to contribute to the creation of these goods and services.’<sup>191</sup>

There is no more fitting area of policy in which to put this commendable approach to work than that of entrepreneurship.

The government’s most senior leaders have also frequently talked of public–private partnerships as being essential to the delivery of goods and services in our society. There is no area with more obvious potential for such a synergy than this one. And yet the story of the first ten years of the direct promotion of SMMEs is remarkable (with one or two excep-

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Advising and training aspiring entrepreneurs is best carried out by people who have experience of business, and ideally by those who have succeeded in it

tions) for the isolation of government institutions, research, and policies from these partnership prospects. This must change if we are to deliver results on the scale we know we need to grow the economy.

Let us now turn to our practical recommendations for action.

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After years of promising rhetoric, South Africa needs to finally and consistently commit itself to implementing market principles

If South Africa is to expand dramatically the opportunities for entrepreneurs, we need to act boldly. CDE's recommendations for action include:

## 1 Adopt new guidelines for South Africa's approach to entrepreneurship

DON'T

- Confuse entrepreneurship with empowerment or affirmative action.
- See entrepreneurship as a mechanism for social welfare.

DO

- Identify entrepreneurship promotion as a general priority.
- Make a decisive shift from delivery to facilitation. This means that:
  - the government must create the best possible enabling environment for entrepreneurs to take advantage of opportunities;
  - government criteria for those who receive assistance as entrepreneurs must be based on business rather than welfare considerations; and
  - government partners for enterprise support need to have the skills and experience that come from direct experience of successful entrepreneurship.
- Build on private sector strengths: provide incentives for private sector service providers to work with new emerging entrepreneurs as clients; provide incentives for large companies to subcontract to smaller businesses and to promote emerging entrepreneurs.
- Identify those who are succeeding in different sectors of the economy, and learn from their success. Ask: what really works?, and learn from the answers.

## 2 Appoint a task team to find ways of reducing the costs of doing business in South Africa

According to the Economist publication *World in figures 2003*, the costs of doing business in South Africa are higher than in all but five other emerging markets in the world. Therefore, after years of promising rhetoric, South Africa needs to finally and consistently commit itself to implementing market principles. Currently, the government is making sincere efforts to lower the operating costs of SMMEs, but without looking at the broader framework within which entrepreneurs operate. The best SMME strategy is a good private sector development strategy. The real costs of doing business arise from a rather greater variety of elements than those that are currently targeted. External factors tend to have more impact on small businesses than large ones, and affect a greater percentage of expenses for small business than they do for large corporations. They include:

- the costs of security against crime;
- tax levels, and complex tax regulations;
- the costs of conforming with complex labour regulations;
- transport costs;
- the costs of information technology;

- the costs of obtaining strategic information from state agencies;
- the costs of special levies that are added to the tax burden; and
- delays in granting work permits to foreigners.

The government should appoint a high-level public–private sector task team to examine ways of reducing the costs of doing business in South Africa across the board, but focusing especially on obstacles to small business growth. The team should have a definite period in which to operate, and be instructed to make specific proposals for changes to policy and legislation. The government should commit itself to respond to this task team within a short time. Effective action in this regard will do more to empower all businesses than any number of short-term strategies. This is one programme that should neither be delayed nor bogged down in endless commissioned research and consultants' reports.

### 3 Establish a regulatory impact unit in the presidency

It is vital in this context to remember the key research finding that only one other factor – a nation's skills – is as strongly correlated with per capita income growth as an appropriate regulatory environment. Bearing this in mind – as well as the wealth of salutary experience gathered in the course of RIAs in other countries – the aim of this unit should be to review all proposed legislation before it is passed by parliament, in order to assess:

- Its likely impact on the costs of doing business;
- its likely impact on South Africa's global competitiveness as a place to do business; and
- its likely impact on small business.

Importantly, the potential of legislation for unintended consequences in different sectors of the economy and at different levels of economic activity should also be assessed.

### 4 Encourage immigrant entrepreneurs

There are two migration policy issues of great importance to this report and the national objective of expanding entrepreneurship.

- First, South Africa needs more skilled people to help increase economic growth. Immigration policy should therefore not just accommodate skilled foreigners who already have a job offer from a South African employer. In fact, immigration policy should encourage the recruitment of skilled foreigners to come and live in South Africa and (among other things) create new enterprises that will add wealth to our economy and increase the employment of our citizens.

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The government should appoint a high-level public–private sector task team to examine ways of reducing the costs of doing business in South Africa, focusing especially on obstacles to small business growth

#### Entrepreneurship in Thembisa<sup>192</sup>

Sheila Sekhitla is a nurse by training. However she left the profession to help her husband run various businesses in Tembisa. He passed away in 1992, leaving Sheila to run a newly established bottle store. She closed the bottle store and opened up The View guesthouse. Concentrating on tourism, she also started the Tembisa Tourism Association. She has worked hard at delivering a high quality of service, and has

been rewarded by her business flourishing. Starting from her house with a restaurant, bar, and four bedrooms, she has since bought the neighbouring property and turned it into a 200-person conference centre. The View guesthouse has recently been graded a 'three star' establishment by the Tourism Grading Council of South Africa, and Sheila is now also a qualified grading assessor herself. *CDE 2004*

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South African business can make a much bigger contribution to this area of nation-building than it is currently doing

- Second, the country's entrepreneurial vitality will be greatly boosted by the way in which government and officials apply criteria for the admission of foreign entrepreneurs. In general, the cabinet should instruct the Department of Home Affairs, and effectively communicate to all officials, that South Africa welcomes a diversity of entrepreneurs (big and small). In particular, capital requirements for business permits should reflect the reality that entrepreneurs come in many sizes, and that all are valuable to South Africa in their own ways. The regulations should allow for different levels of proposed investment by foreign entrepreneurs. They should require the smallest entrepreneurs (those intending, say, to start a family-run restaurant) simply to show that they have the skills and capacity needed to run a business of this kind, and that they are likely to be able to augment their own capital through business loans. In this respect it is vital for a prior demonstration of the ability to be self-employed to be added to the applicable criteria for the adjudication of 'qualifications'.

## 5 Build on the private sector's strengths with respect to implementation

The promotion of entrepreneurship should be built around public-private partnerships. Both the government and business have a profound interest in expanding entrepreneurship in our society, and incorporating more and more black South Africans as risk-taking, profit-seeking founders, owners, and managers of their own businesses. There is a wealth of private sector experience and expertise in this country. From large corporations through representative business organisations to service providers at the highest and more modest levels, South African business can make a much bigger contribution to this area of nation-building than it is currently doing.

One way of doing this would be to shift the emphasis of direct entrepreneurship support from the state or quasi-state agencies to competitive private service providers. The aim with this would be to achieve more sensitive responses to the evolving needs of client enterprises, as well as the strict quality controls and monitoring of outputs that research suggests have been lacking in public provision up to now. Stimulating private service supply, and upgrading its capacity to respond to the demands of new and expanding private enterprises, should be a central tool of public policy. In this light, a public-private partnership should be created to help the government:

- develop and apply a more entrepreneurial approach across all sectors of the economy;
- assess what is appropriate for government to do in this field, and what is best handled by the private sector;
- decide how best to use government resources for assisting previously disadvantaged individuals with entrepreneurship potential;
- decide on the most appropriate criteria for allocating enterprise assistance; and
- define what entrepreneurs in various sectors of the economy really need, in terms both of enterprise size and functional area (manufacturing, services, etc).

## 6 Ensure much better information

Most authorities in this field emphasise that the information deficit is an important handicap to clear and decisive policy-making in the field of entrepreneurship development. Certain specific aspects are particularly important and urgent.

We need to know much more about:

- the current private sector contribution in this field, including the mixture of motivations – business practices, BEE requirements, corporate social investment – that underpin and shape business involvement, as well as a balance sheet of what works and what does not.
- How to encourage service provision to clients by the private sector, how to match aspiring entrepreneurs with access to business services and finance, and how to monitor quality and outcomes.
- The relationship between employment and self-employment. Is the government right to emphasise the unemployed as the target for enterprise support, or should the emphasis be to encourage people with experience of employment to start their own businesses? Is the racial make-up of the self-employed sector skewed by unintended effects of affirmative action, which encourages whites to become contractors or consultants, and offers secure corporate employment to skilled and able black people?
- The rates and the prospects of conversion from informal sector to formal. What are the incentives, and what are the obstacles? More importantly, what are the qualities that distinguish enterprises that have made this conversion, both in South Africa and in other developing countries?
- The relationships between black economic empowerment, sector charters, and entrepreneurship. Policies that do not promote genuine economic growth through expanding successful entrepreneurship will not serve black economic empowerment.

These areas of research and analysis are vital in order to clarify policy and improve implementation.

## 7 Celebrate the achievements of successful entrepreneurs

Identify, publicise, and celebrate black and white South Africans who have become successful entrepreneurs through their own resourcefulness and against the odds. Make them the new ‘struggle heroes’ of the second decade of democratic rule. Learn from their success for future policy, and help other South Africans by making them role models.

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Identify, publicise, and celebrate black and white South Africans who have become successful entrepreneurs through their own resourcefulness and against the odds

### Theo Vilakazi’s one-drop method<sup>193</sup>

When Theo Vilakazi and Abdul Latif Bennett decided to go into the business of car washing, they wanted to be able to do it better than their competitors. They also wanted to get to their customers during office hours.

The main obstacles were resistance to the mess made by water, and how to rinse cars in parking garages that seldom contain taps. As a result, the pair designed a catch-

ment tray and back-pack pump system, patented the idea, and called it the One-Drop Method.

Today the company has five franchisees with a total of 80 employees. Customers include the head offices of Standard Bank, FNB, MTN, Liberty Life, and a Virgin Active gym. The franchisees wash employees’ cars as well as the companies’ executive fleets.

*CDE 2004*



Elizabeth Mayema and Cedric Mabizela, joint owners of LS Pottery. This small firm produces a wide range of ceramics, including garden ornaments and homeware.

## CONCLUDING REMARKS

As we have seen, South Africa does not fare well in measures of entrepreneurship rates across countries. However, these figures give us an interim report, not a verdict. They are sobering, but they should not be discouraging because they do not tell the whole story.

This report contains numerous histories of individuals from different backgrounds and in disparate fields who have converted opportunity into successful entrepreneurship. They could have been duplicated many times. If the poor performance statistics are a call to action, these case histories provide the encouragement, incentive, and direction to do better.

- We can do better if we focus on providing the best possible enabling environment for these individuals and their peers to grow their businesses.
- We can do better if we shift the direction of enterprise support from government bureaucracy to public–private partnership, and if we celebrate the achievements of successful entrepreneurs as they deserve.

If we do these things, their ranks will multiply in an expanding and flourishing non-racial business sector.

## ENDNOTES

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- <sup>17</sup> Ntsika, *The state of small business in South Africa*, 1997, p 18; cited in Schlemmer and Hudson, *Entrepreneurship*, p 15.
- <sup>18</sup> Statistics SA, Labour Force Survey, 2001.
- <sup>19</sup> Orford and others, *Global Entrepreneurship Monitor, 2002*, p 23.
- <sup>20</sup> *Ibid*, p 13–15.
- <sup>21</sup> One thing all the authorities in this field agree on is the difficulty of defining exactly what an 'enterprise' entails. The size of the informal/survivalist sector can vary greatly according to how demanding a definition is used.
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- <sup>23</sup> *Ibid*, p 14.
- <sup>24</sup> Prof R Cassim, address to a TIPS/Small Business Project workshop on SMMEs held in Johannesburg on 10 November 2003. See also *Business Day*, SA may adopt Brazil's business approach, 28 May 2003.
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