ICSB 2015 - Extended Abstract

**Track:**

Small Business and Small & Medium Enterprises

- ***Background***

South Africa's new Department of Small Business Development (DSBD) is to have a special focus on cultivating black-owned high growth entities to meaningfully transform the economy. The state-owned Small Enterprise Development Agency (Seda) is finalising a strategy which is based on international experience but rooted in local realities to identify these high growth entities. Phaho and Mazwai's Presentation at the International Council for Small Business conference in 2011 is the basis of the strategy.

This strategy would, among other things, address grinding poverty and endemic unemployment in black communities that continue in spite of 20 years of Post-Apartheid democracy. Apartheid, which treated blacks as inferior subjects and denied them rights, including that of being entrepreneurs, was ruthlessly implemented in the last 46 years of white minority rule which ended in 1994. The post-1994 democratic government has had limited success in improving the lot of black entrepreneurs and/or revitalising the black small business sector.

- ***Blacks and Small Business***

A 1993 study by the World Bank (Riley 1993: 5) argued that the poor state of black small, medium and micro entities (SMMEs) is a consequence of restrictions that barred blacks from starting and owning businesses. Terreblanche (2005:315) agrees and argues that government policy prevented blacks or certain classes of blacks from specific activities and restricted movement.

Horrel (1989:11) zeroes in, arguing that when the restrictions were modified, black traders could provide only daily necessities such as milk, bread, vegetables or coal. Licences were restricted to a limited number of businesses such as grocery shops, butchers, fish friers, dairy owners and wood or coal dealers. Specific legislation continued to bar blacks from the trades, manufacturing, and from forming companies or partnerships. These restrictions thus dampened the culture of entrepreneurship in the then oppressed black communities.

### *.1 Efforts to Induct Blacks into Small Business*

When the African National Congress (ANC) assumed power in 1994, it prioritised the creation and growth of black entrepreneurs (ANC 1994:94). Thus, a *White Paper for the Development and Promotion of Small Business in South Africa* emerged (dti: 1995, 70). This resulted in the Small Business Act which, Nieman (2001:445) argues, was the first effort to create small business policy.

The *Integrated Strategy into the Promotion of Entrepreneurship and Small Business* (dti: 2006), which was premised on three legs: access to financial support, non-financial support and markets, was also finalised in 2006. These efforts to assist black entrepreneurs cascaded down to provincial and municipal levels.

South Africa's resultant and diversified national small business support system, reflected in the National Directory of Small Business Support (dti: 2010), lists national, provincial and municipal government institutions and programmes which provide business development services (BDS). It boasts specialist interventions for women and youth entrepreneurship, and for people with disability.

As Amra, Hlatshwayo, and McMillan (2013) opine, the promotion of SMMEs for the creation of employment and economic development has also been a recurring policy

emphasis in development strategies, as has been more recently the National Development Plan (2012). Unfortunately, the return on investment has not met expectations.

For instance Bukula, Naidoo, Rogerson and Sithole (2011: 6) argue that five out of seven small businesses in South Africa fail in their first year of starting up, compared to a 50 percent failure rate internationally. However, this assertion is based on qualitative studies because of quantitative data limitations (Amra, Hlatshwayo and McMillan: 2013, 5). However, and arguably, black small businesses reflect the highest casualties.

Two government ministers even set up teams to review the provision of support for primarily black owned small businesses. In 2014 President Jacob Zuma set up a Ministry for Small Business Development, saying the small business sector was critical for economic development and transformation (Presidency: 2014).

- ***Definitional Issues***

Koski and Pajarinen (2012: 196)and Mason, and Brown (2013: 212) recalled the hotly contested assertion by David Birch when they asserts theory by David Birch that entities described as Gazelles are responsible for the most jobs created. Mason, and Brown (2013: 212) argue that "… there is considerable empirical evidence to support the proposition that only a small proportion of firms, often termed gazelles, create the majority of jobs in any cohort of new businesses". Indeed, several studies challenge the "gazelles" theory. The term "high growth firms" also refers to small business with a high growth rate.

"Blacks" refers to South Africans from the indigenous African, Coloured and Asian communities previously discriminated against; while a "township" is a settlement of black people, located outside white areas in terms of the policy of Apartheid (Terreblanche: 2005, 319).

- ***Objectives of the Paper***

The paper analyses South Africa's efforts to integrate blacks into the economy through entrepreneurship and small business development. It argues that the mass rollout of support without a strategic focus on specific sectors or categories is the likely cause of the limited success. The paper thus justifies the new approach and highlights how it was conceived, the research undertaken and the analysis of the local small business landscape.

- ***Methodology***

The paper will be a literature review based on findings and arguments by numerous scholars and researchers, local and international. The focus will also be on the impact of government interventions, using several proxies and indicators.

- ***Promoting Black High Growth Entities to Transform South Africa's Economy***

The Small Business Project (SBP) (2009) rightfully called for the desperate reassessment of South Africa's small business strategy, arguing that it was not delivering the expected outcomes. Then, and unsurprisingly, in 2011, a business daily surmised that this parlous state of affairs should be keeping the ruling party awake at night and in cold sweat (Business Day 2013).

The Department of Trade and Industry (**dti**) stated that South African SMMEs are less dynamics, with a majority of enterprises remaining in the nascent and baby business phase (less than 3.5 years)…(having) a high rate of liquidations as well as large numbers of registered but inactive enterprises (dti: 2008, XXVII). Statements by the SBP, the Business Day and the **dti** reinforce the concerns that, despite the interventions referred to above, black small businesses languish at the bottom.

After all, in 2002, Ntsika's *Annual Review on the State of Small Business Development in South Africa* (Ntsika n.d.:45) showed that black SMMEs predominate in the informal sector and micro-enterprise community while whites, and an increasing number of Asian and Coloured people, are in the more established, formal and growing SMMEs. Ntsika, which was a Government agency, made a pertinent observation that the number of enterprises owned by Blacks decline the more sophisticated the enterprise.

Twelve years later a World Bank study (2014) found that most entities owned by blacks in townships are informal or survivalist operations. This buttressed the finding of the Survey of Employers and Self-Employed (SESE) which showed that blacks still predominantly run informal businesses (StatsSA; 2013). According to the SESE, which is conducted every four years, the 1, 5 million people running an informal business in 2013 had turnover levels of R1,500 (110 USD) or less in the month prior to the survey, and less than 10 percent had nett profits of more than R6,000 (450 USD).

South Africa's strategy has been to get as many blacks as possible into small business and government development agencies would facilitate this effort, and even improve the lot of existing black-owned small businesses. As there has been no significant change in the location of small black businesses in the economy, arguments by Ligthelm (2011: 176), Shane (2009) and Cheng, Stough, and Jackson (2009: 30) could hold sway.

They argue that depending on more start-up companies to reinvigorate depressed economic regions will not necessarily yield results and, secondly, the success of any entrepreneurship programme must not be based on the quantity of businesses created but must also be on their quality. Ligthelm (2011) adds that a survival analysis on informal business in operation between 2007 and 2010 reveals that those that survived had entrepreneurial zeal.

Arguments in the three articles cited above are upheld by the Global Entrepreneurship Monitor (GEM) report (2014: 24), which shows gross disparities between early stage entrepreneurship and mature entities provide proof. The total entrepreneurial activity (TEA) for early stage companies was 10.6 percent for early stage companies, but then it drops to 2, 9 percent for mature companies (GEM: 2014, 24). Obviously, as this has been the case for over 10 years of the study, it does suggest that graduation rates are a major problem.

To use another indicator, a continuing spate of attacks by locals on foreign-owned small businesses reflects the low levels of local entrepreneurship in black communities. The foreigners were doing better than the locals, which exposes the gross shortcoming in entrepreneurial finesse between local blacks and foreign operators (Ismail nd).

Furthermore, South Africa introduced black economic empowerment (BEE) legislation that compels the private and public sectors to give preference to blacks in the allocation of contracts, thus giving them access to the market **(dti**: 2003). However, lessons from international experiences are that this could be counterproductive.

Gomez (2012: 51) has warned that regardless of four decades of substantial institutional and financial support to integrate the Bumiputera into the Malaysian economy, there was considerable evidence that these programmes have been unsuccessful. Malaysia had sought to legislate the Bumiputera, a previously marginalised community, into the economy; which is what South Africa is doing.

Ironically, South Africa is now seeing the emergence of black entrepreneurs who want opportunities simply on the basis of race, the “entitlement syndrome”, rather than on performance. This unintended consequence could, among other factors, be one of the reasons

why the black small business sector has not flourished, justifying comments by Gomez and as the Malaysian experience has shown.

Although the SBP (2014) indicates that turnovers in the small business sector grew by 13 percent, suggesting higher levels of growth in the sector than other parts of the economy, its respondents included mature white companies. Also, Bisseker (2014) points out that since 2009, small businesses have shed over one million jobs.

Thus, and as we argued in our 2011 paper, a rethink is appropriate, particularly in the light of new initiatives which include the Gauteng Provincial Government's efforts to revitalise township economies as part of the renewal of black small business (Mazwai 2015).

The implementation of this rethink is based on a further extensive literature review on determining or finding high growth entities, which was a continuation of the work started by the author of this paper and presented at ICSB 2011 (Phaho, and Mazwai: 2011). Several variables associated with high growth entities have emerged from the latest review.

However, while these variables suggested the way forward, assertions by Gibb (2000), Curran (2000) and Dyck, and Ovaska (2011) had to be factored in as they highlight the shortcomings of transferring ideas and concepts from one environment to another without taking into account the political, economic and socio-cultural differences between these environments.

In fact, Dyck, and Ovaska (2011) showed that economic freedom, property rights, and corruption are statistically significant in explaining differences between countries in new firm creation. This meant taking South Africa's environment into account, more so that of the black small sector, when assessing which of the variables on high growth entity identification would be appropriate.

Thus, of all the variables that were identified from the review, the following are relevant: human resources; strategy; regulatory, compliance and localisation; innovation and creativity; and, finance and financial management. Financial management is extremely important because it is a weakness in small black businesses in particular, and one that overcomes this shortcoming could be a good performer or have potential.

Another factor that has to be taken into account is that South Africa's growth strategy is driven by the National Development Plan (NDP: 2012) and the Industrial Participation Action Plan (IPAP: 2012), and these include "localisation" in terms of inputs, components or raw materials in all processes. Hence, "localisation" is one of the variables to identify high growth entities.

To ensure black small businesses become part of the South Africa's human resources development strategy, which is skills development sensitive, identifying black high growth entities will also focus on specific sectors, for instance manufacturing, infrastructure, agro processing, ICT and services. This indirectly deals with, among other issues, attempts to wean blacks away from retailing, and thus the informal sector.

The strategy also overcomes the "entitlement syndrome" as selection will be undertaken by the country's major accounting firms rather than individuals or politicians who would look at colour rather than performance.

Of critical importance is that, as Mason, and Brown (2013: 217) warn against a dramatic shift away from start-up policy to high growth policy, Government will continue to stimulate black start-ups. These, new start-ups, weak as they are, are the pipeline for companies to become future high growth ones.

The new approach envisages that a longitudinal monitoring and evaluation matrix will be established with a local university to monitor the project over five years, noting the factors that lead to the collapse, survival or growth of entities.

- ***Conclusion***

The above creates the case for the identification and support of high growth entities as the most credible approach in small business development for South Africa. In the initial paper Phaho and Mazwai (2011, 3), the authors suggested a three-stage approach:

- Small business should be an integral part of economic development strategies rather an add-on;
- The government should revamp and integrate the country's innovation strategies into the entrepreneurship and small business support architecture; and,
- The government must introduce a mechanism that identifies small businesses with the potential for high growth (that is, identifying and supporting winners).

Firstly, the identification of high growth entities in the quest to create 11 million jobs by 2030 is at the heart of the National Development Plan (2012). Secondly, incubators now pockmark the small business development landscape and these are feature significantly in the rollout of entrepreneurship development programmes.

Thirdly, the rollout of the new approach to small business development shows that South Africa is determined that performance rather than entitlement will drive small business development. The "cherry on the top" is that the longitudinal matrix that will monitor the implementation of the project from year to year has within it the seeds of deep knowledge creation.

This will lead to the determination of the characteristics of black small businesses and the identification of elements, including socio-cultural ones, which stimulate or constrain entrepreneurship in these communities. This knowledge creation is critical for a South Africa that must guide its black citizens to focus more on creation of new wealth rather than redistribution or entitlement, as some aspects of economic redress legislation are wont to do.

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