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Ons verw. nr./Our ref. No.

Mr M Morobe
CODESA
P O Box 307
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Dear Mr Morobe

RE: THE INVITATION BY CODESA FOR PUBLIC COMMENT

Regarding CODESA's invitation for public comment, the Small Business Development Corporation respectfully submits the attached document entitled: "A Strategy For Entrepreneurship and SME Development for the New South", as a contribution for consideration.

I would intimate that Working Group 1 and/or 2 should find this submission of relevance.

Kind regards

Yours sincerely

W.B. Vosloo

DR W B VOSLOO
MANAGING DIRECTOR

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A STRATEGY FOR ENTREPRENEURSHIP AND SME DEVELOPMENT

FOR THE NEW SOUTH AFRICA

Dr W B Vosloo

Entrepreneurship and the nurturing of small and medium sized enterprises have in recent years become the dominant themes of development economics. This rediscovery of the importance of the spirit of free enterprise was on the one hand prompted by the failure of centrally planned socialist economies, and on the other by the achievement elsewhere of impressive prosperity. In examining the success of certain East Asian and Western countries, business leaders, policymakers and academic analysts focused quite properly on the creative energies of entrepreneurs and the benefits of relatively unconstrained competition.

THE IMPORTANCE OF SME DEVELOPMENT (*1)

The virtues of the SME-sector are by now almost completely unquestioned. In all successful economies, they are seen as essential for growth, job creation and social progress. Those with entrepreneurial talents and skills outdo others in mobilising productive resources to start enterprises that not merely survive, but prosper.

SME's are flexible and adapt easily to changing market opportunities. They require relatively little capital, can combine simple and advanced technology as appropriate, and being generally labour intensive, contribute significantly to job creation.

Of approximately 800 000 ***formal*** business entities in South Africa, an estimated 91 percent or 720 000, can be classified as SME's. Their estimated share of the GDP stands at about 30 percent and they employ approximately 2,4 million people - that is, 17 percent of the economically active population of 14,3 million. These figures ignore the informal sector, which probably involves an additional 4,4 million persons and accounts for a further 15 percent or so of the GDP. That brings the total SME contribution to the GDP to 45 percent, and the number of jobs it provides to some 6,8 million. (*2)

Unfortunately the SME-sector's political influence - its impact on public policy-making - is not remotely commensurate with the importance of its economic contribution. By contrast, large businesses have a large influence on official policy and thus to gain much more from subsidies and other government incentives.

There are also indications that large corporations pay taxes at a much lower average rate than SME's - again because of various tax-related incentives that favour big - that is, capital intensive - business.

Given the importance of the SME-sector in South Africa's future economic development, it is essential that *economic policy abandons its bias in favour of the large-business sector. There should be equal opportunity not only to make profit, but also to retain it.*

THE CASE FOR A CONSCIOUS SME DEVELOPMENT STRATEGY

Most people believe that free markets most fruitfully employ economic resources. Those same people are therefore somewhat sceptical about the effectiveness of public expenditure and state intervention to achieve growth. If they are right - and I firmly believe they are - we can reasonably deduce that SME entrepreneurship flourishes best when free markets are allowed to function.

That is a necessary condition, however, not an adequate one. Several factors argue for a carefully formulated national strategy for SME development.

First, we must realise that *past laws and government policy do bear heavily on South Africa's present inequitable distribution of wealth and opportunity.* We must further accept that real liberation and economic empowerment require affirmative action to assist the disadvantaged to make productive use of their new economic freedom. Entrepreneurship development is a highly efficient and cost-effective means of economic empowerment through job creation and added wealth. Most governments have come to realise they have an important, even crucial, role to play as *facilitators of entrepreneurship development, by pursuing a cohesive strategy for SME promotion.*

Let us also look at the human reality, the motivation for such a strategy.

South Africa's economy has in recent years shown little growth and produced few new jobs. At the same time, the population growth and urbanization have outstripped most social indices. The result is increased unemployment, and deepening poverty, particularly among those who have no qualifications, are newly urbanised, or lack employable skills. It is their fate, above all, that must be addressed by an economic development strategy.

But on what should that strategy be centred?

More and more business leaders and policy makers are turning to the SME-sector for solutions to unemployment, poverty, and social unrest. They know that any solution, if it is to prove viable in the long run, cannot be based on direct, or indirect, redistribution of wealth. That offers, at best, only short term-relief. Sustained economic recovery can only be achieved through increased output - the creation of wealth, rather than its redistribution. The SME-sector has proved in certain countries that it has great potential to provide this increase in output, and in a job-creating other than in a capital-consuming way. Surely it can, and must play an equally vital role in the future economic development of the entire Southern African region.

For government to look benignly on the SME-sector is not enough. A comprehensive strategy is required to address specific constraints hampering the emergence of SME entrepreneurship. The most important constraints are: access to capital, access to affordable business premises, access to markets, lack of appropriate business skills, unnecessary regulation, inadequate support systems. All these will have to be addressed through a variety of programmes and systems.

EXISTING GOVERNMENT SUPPORT FOR SME'S

Government's SME-policy amounts to:

- A 50 percent shareholding in the Small Business Development Corporation;
- An undisclosed number of loans granted to medium-sized industries by the IDC;
- Partial funding of 11 small-business institutes at various South African universities;
- ***Ad hoc*** annual grants to the SBDC, which is utilized for small-business development programs by the SBDC;
- ***Ad hoc*** grants (amounts not disclosed) to the Development Bank and various homeland-based development corporations.

In the budget for the 1991/92 fiscal year a total of R 1 411 million was allocated to export trade promotion. This amount will be distributed to approximately 2 500 beneficiaries, most of them are large companies under the General Export Incentive Scheme. In the same budget only R 75 million was earmarked for SME-development through the SBDC, though well over 700 000 businesses in South Africa rank as SME's.

Clearly, SME-development does not have a high priority in the development strategies and policies of the present government.

THE CONTENTS OF A SME DEVELOPMENT STRATEGY : OBJECTIVES AND PROGRAMMES

International experience indicates that any comprehensive SME development strategy should contain at least the following objectives and programmes:

Fostering an enabling environment for the encouragement of entrepreneurship and SME creation and growth.

Experience has shown that if the operating environment is hostile to private enterprise and relatively unconstrained competition, it makes little sense to mount costly promotion and assistance programmes.

Specific ***programmes of action*** which would foster an enabling environment include:

- * Promoting an entrepreneurship culture through media coverage, public information campaigns and the publicising of role models.
- * Providing entrepreneurship education by including instruction in basic business practice and entrepreneurial behaviour in the curricula of educational and training establishments.
- * Combining vocational training with entrepreneurial development.
- * Removing unnecessary legal and administrative constraints by ongoing deregulation, regional and local levels of government.
- * Introducing tax policies friendly to young enterprises.
- * Providing decentralised, community-based, "one-stop" programmes to assist self-employment and enterprise creation. These programmes should be aimed at particular target groups, business sectors and geographical areas, and include the following: start-up loans, training, information, counselling (each adapted to specific development needs), business plan development, business establishment and operational guidance in starting, running and expanding a business.

Mobilising financial resources by way of appropriate financial assistance programmes for SME creation and growth.

In many countries, access to capital and credit is a serious problem faced by most small and medium enterprises. Most commercial financing institutions regard lending to novice entrepreneurs as highly risky, and require collateral that few can raise.

Financial assistance programmes in use around the world include:

- * Devising credit schemes and loan programmes suitable to the specific short, medium and long-term needs of the full spectrum of entrepreneurs: informal sector micro unit, self-employed production and service units, sector-specific business, high-tech business, female entrepreneurs, etc.
- * Harmonising and coupling appropriate financing schemes with other forms of assistance.
- * Establishing and operating joint credit-guarantee schemes.
- * Exploring and applying new, as well as traditional, forms of finance, including financing outside the banking system.

Providing appropriate low-cost affordable rental facilities or individually owned premises if they are not provided by commercial developers.

Such facilities take the form of shopping centres, factory units and workshops, industrial parks, offices, etc.

Specific programmes under this category include the following:

- * Industrial park estates coupled with other forms of assistance and support services for infant or expanding enterprises.
- * Shopping centres aimed at providing neighbourhood commercial facilities of a pioneering nature.

- * Business premises development projects aimed at promoting private ownership amongst disadvantaged communities.
- * Incubator or enterprise centres aimed at upgrading infant enterprises.
- * Industrial hives or business parks aimed at the recycling of redundant buildings, urban renewal projects, self-employment incubator facilities, entrepreneurship training and development for retrenched or unemployed persons.

Upgrading and improving the skill and technology levels of SME's.

Many owners and managers of small and medium-sized enterprises are not able to exploit opportunities through lack of information, poor management skills, insufficient market awareness, poor product design and quality control, ignorance, lack of technological sophistication, etc. A wide variety of support services should be offered, such as :

- * Information on business opportunities, credit facilities, technology and market trends by way of enterprise information centres.
- * Practical advice on: how to run and manage a business; and business plan development; recordkeeping and bookkeeping; costing and pricing; marketing; meeting legal requirements; product design; quality improvement; improvements in marketing techniques and networks; credit and other forms of finance; identification, development and implementation of new business projects.
- * Practical training in all phases of running and managing a business: buying and selling; recordkeeping and bookkeeping; costing and pricing; marketing; financial accounting; etc.
- * Mentorship programmes involving retired executives and other experts who provide practical counselling services.

- * Counselling campaigns using journals, advertising, radio broadcasts, television, memoranda, publications, demonstrations, displays and brochures.

These techniques can be used to promote suitable technologies and handicrafts as well as to disseminate information on specific products and processes of interest of small-scale operators and home industries.

Providing appropriately structured, staffed and financed support systems and schemes.

The methodology of entrepreneurship development is evolving rapidly, but there is still great scope for innovation and improvement. The critical issues are how to reach a sufficient number of deserving potential and existing enterprises, and how to avoid complex assistance schemes the cost of which is out of proportion to results achieved.

The following guidelines are applicable to enterprise-development systems and schemes:

- * Various aspects of enterprise-development (eg. training, market/project identification, counselling and financing) should be coupled and combined as closely as possible.
- * Various assistance organisations, particularly those funded by the State, should collaborate closely and avoid duplication of services.
- * Trade and employer's associations, chambers of commerce and other non-governmental organisations must be encouraged to play a growing role in providing information, advice, training and other forms of assistance.
- * Better use must be made of participative and group schemes in which entrepreneurs assess and define their own priorities and exchange experiences eg. vertical and horizontal alliances and collaborative networks such as Japan's supplier-group system, Europe's industrial districts and California's technological innovation network alliances in Silicon Valley.

- * Delivery systems and the nature of the assistance provided must be adapted to specific needs in relation to size, location, level of sophistication, educational background of participants, sectoral peculiarities etc. In short, assistance schemes must be tailor-made.
- * The entrepreneurial sector must be given quick and easy access to user-friendly information and sources of help (ie. the "single-window" or "business incubator")
- * Private associations and foundations, whose role in promoting entrepreneurship and self-employment has increased in recent years, should be further encouraged.
- * In order to increase the income base of their communities, cities and towns must be encouraged to develop well-structured plans to expand business activities within their boundaries.

CONCLUSION

It is no exaggeration to say that the overall health of our economy depends largely on dynamic entrepreneurial activity in the small and medium enterprise sector. It is therefore vital that a SME development strategy should become a key component of South Africa's long-term economic development strategy.

The time is overdue for the South African government to realise that its current priorities, policies and institutional arrangements, so far as the SME-sector is concerned, is totally inadequate for building a more prosperous South Africa. Too much public money is being wasted on unproductive expenditure.

We need to redress the imbalances that presently exist between policies aimed at supporting the activities of big business and policies aimed at the SME-sector. We will not achieve a more prosperous South Africa by focusing support initiatives almost exclusively on the big-business sector. The inputs of the rest of the entrepreneurial team are also important. After at least nine out of ten business entrepreneurs belong in the SME-sector.

We must re-focus on the true nature of economic development at the grassroots level in cities, towns, villages. No economic miracle is going to happen through foreign investment and export promotion schemes alone. There will be no "kick-started" short-cuts to a more prosperous and equitable society and economy.

Real economic development is a "do-it-yourself" process at grassroots level - but it can be helped by sound economic policies.

We need to re-discover the enterprising individual who takes risks, breaks new ground and plays an innovative role in our economy.

We need to think of our entrepreneurial stock as precious human capital that requires to be nurtured and mobilised. ***Entrepreneurial activity is THE ESSENTIAL SOURCE of economic growth and social development.*** It should not be ignored in any development strategy. If we continue to misunderstand the role of entrepreneurship, future generations of South Africans will pay a heavy price. In the end, a society only gets the kind of small and medium enterprise sector it is prepared to foster.

FOOTNOTES

*1 In the economies of Europe, Japan and the United States an SME (Small and Medium Enterprise) is defined as any business with less than 500 employees. A "small business" is considered to having less than 200 employees and a "medium enterprise" to have between 200 and 500 employees. In some definitions annual turnover as well as total capital employed are also taken into account. The most important qualitative characteristics of SME's are that the management of the enterprise is linked with its ownership, that its decisionmaking is independent, that its management is highly personalised and that its behavioural patterns are entrepreneurial or risk-taking. These qualitative criteria are for analytical purposes then coupled to certain measurable criteria such as size of market share, number of employees and size of capital or asset base.

*2 These estimates are based on calculations made by the SBDC Economic Research Unit, 1991. See also "The role of Small and Medium Sized Businesses in the South African Economy". Focus of Key Economic Issues, No 47, November 1991, Department of Economics University of Pretoria.

In these surveys SME's are defined as businesses with less than 200 employees: "small businesses" are those with less than 50 employees and "medium sized" as those with between 50 and 200 employees. Should the abovementioned international definition be applied to the South African situation, the role of SME's in South Africa would turn out to be even more prominent than currently perceived.