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MACRO REVIEW

Open for business? A review of the
SMME landscape in South Africa



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The **CRA** helps business and government leaders plan for a future South Africa and identify policies that will create a more prosperous society. It uses deep-dive data analysis and first hand political and policy information to advise groups with interests in South Africa on the likely long term economic, social, and political evolution of the country.

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Agis is a Johannesburg-based strategy and economic-development consulting firm active throughout Africa. Founded and run by former leaders of Michael Porter's Monitor Group and the Advisory Services of the International and Finance Corporation (IFC) for Sub-Saharan Africa, Agis advises companies, development finance institutions (DFIs), and foundations on growth strategies, performance improvement, and private sector-led economic development.

The team has extensive experience in strategy design, implementation plan development, organisational capacity improvements, digital financial services, retail banking, financial inclusion and investment mobilisation.

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KEY TAKEAWAYS



- There are roughly **2.55 million** 'SMME owners', a proxy measure for the number of SMMEs in South Africa.
- SMMEs account for approximately **98% of formal firms**, but only **28% of jobs**.
- Some **74.5%** of SMME owners are **Black**, **4.3%** are **Coloured**, **4.5%** are **Indian/Asian** and **16.7%** are **White**.
- SMMEs are caught in a cycle of limited bargaining power, cash flow constraints, significant skills and resource gaps and a taxing regulatory environment.
- On average, **31 companies** with taxable income of less than **R10 million** close down each week.

Leader

Small, Medium, and Micro Enterprises (SMMEs) have the potential to drive economic growth and employment in South Africa. However, this potential is not being realised.

Although an estimated 98% of all registered businesses in the country are SMMEs, these businesses consistently create less than 28% of jobs, a far cry from the government's ambitions of 90% contribution to job creation by small businesses by 2030. In fact, large firms with over 250 employees remain the lynchpin of job creation and account for just under 70% of businesses employing 10 or more people.

This edition is a collaboration between the Centre For Risk Analysis (CRA), a political risk and economic policy think tank, and Agis, a strategy and economic-development consulting firm active throughout Africa. In addition to its economic development consulting and strategy design experience, Agis has also actively invested in three SMMEs.

The report features three sections:

In the **first section**, the CRA presents **data on SMMEs**. Although sources differ on how SMMEs are classified, the CRA attempts to provide some estimates of the number of small businesses operating in South Africa.

The numbers outline the contribution of SMMEs to the economy, the proportion of formal versus informal firms, the ownership profile of SMMEs, small firms' contribution to employment, as well as the proportion of SMMEs by industry. Notably, the formalisation of business is strongly correlated to employment.

However, the number of informal businesses has grown faster than the number of formal businesses. Between Q1 2017 to Q1 2019, the number of formal SMME owners who employ staff decreased by 8.3%, while the number of formal SMMEs with owners working for themselves increased by 9.8%. This has resulted in SMME employment increasing only marginally, by 2.6% over that period.

Also highlighted as a concern is the sustainability of SMMEs. As available data indicates, some 107 377 new SMMEs entered the market in Q1 2019. However, these new firms struggle to survive. Consider that the number of SMMEs operating for less than two years declined in comparison to the previous year. On average, 31 companies with taxable income of less than R10 million close down each week.

In the **second section**, Rolf Endres and Boikanyo Mothibatsela of Agis share their insights into the **opportunities and challenges facing small businesses** operating in South Africa. Their experience highlights that SMMEs are caught in a cycle of limited bargaining power, cash flow constraints, significant skills and resource gaps and a taxing regulatory environment. This results in many SMMEs battling to compete, grow and create sustainable jobs.

The **third and final section** of the report showcases the joint policy recommendations of the CRA and Agis. These recommendations include: relaxing labour laws for small firms, consistent enforcement of rules and regulations, promoting business skills (as well as maths, science and technology) at school level, and redirecting the emphasis of funding and technical support away from micro businesses towards slightly larger firms with the ability to absorb such capital and the capacity to grow.

— David Ansara, Rolf Endres and Boikanyo Mothibatsela

Section I

LANDSCAPE OF SOUTH AFRICA'S SMEs

47% of SMEs employ 2-5 people



Of all SME employees



72% are Black



12% are White



9% are Coloured

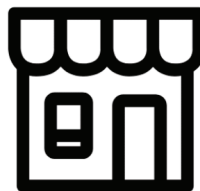


5% are Indian



39% of owners are the only employee

59% of SMEs are fewer than 3 years old



26% of SMEs are 3-5 years old

13% of SMEs employ more than 5 people



19% of SMEs are involved in consultation



14% of SMEs are involved in construction

12% of SMEs are involved in manufacturing



13% of SMEs are involved in food & beverages

52% male

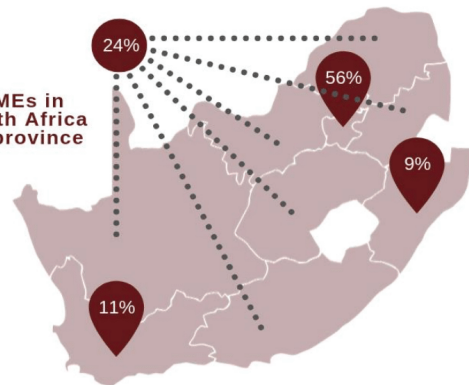


47% female



Source: SME South Africa, An Assessment of South Africa's SME landscape Challenges, Opportunities, Risks & Next Steps, November 2018

SMEs in South Africa by province



Depending on the source of the data, this report refers alternately to Small and Medium Enterprises (SMEs) and Small, Medium, and Micro Enterprises (SMMEs).

Businesses overview

Table 1: Enterprise^a size by turnover, 2017

Industry	Large	Medium	Small	Very small
	Turnover lower limits Rm			
Forestry and fishing	30.0	18.0	3.0	2.0
Mining and quarrying	234.0	60.0	24.0	2.0
Manufacturing	306.0	78.0	30.0	2.0
Electricity, gas and water supply	306.0	78.0	30.6	2.0
Construction	156.0	36.0	18.0	2.0
Wholesale trade	384.0	192.0	36.0	2.0
Retail and motor trade	234.0	114.0	24.0	2.0
Accommodation and catering	78.0	36.0	30.6	2.0
Transport, storage and communication	156.0	78.0	18.0	2.0
Activities auxiliary to financial intermediation, real estate and other business services ^b	156.0	78.0	18.0	2.0
Community, social and personal services ^c	78.0	36.0	6.0	2.0

Source: Statistics South Africa (Stats SA), *Annual Financial Statistics 2017*

a An enterprise is a legal unit or a combination of legal units that includes and directly controls all functions necessary to carry out its activities.

b Excludes financial intermediation, insurance, pension funding and business services not classified elsewhere.

c Excludes government and educational institutions.

d Preliminary figures.

Table 2: Enterprises^a by industry, 2009-17

Industry	2009	2012	2013	2014	2015	2016	2017 ^d	Change 2009-17
Forestry and fishing	1 779	1 676	1 587	1 541	1 555	1 456	1 405	-21.0%
Mining and quarrying	2 297	2 234	2 237	2 247	2 348	2 447	2 603	13.3%
Manufacturing	57 239	49 479	47 605	45 405	45 285	45 966	47 438	-17.1%
Electricity, gas and water supply	1 033	507	563	622	754	947	1 127	9.1%
Construction	40 660	36 291	34 896	33 735	34 789	35 571	36 479	-10.3%
Trade	127 962	110 694	106 173	102 989	103 854	101 932	101 454	-20.7%
Transport, storage and communication	18 832	16 650	15 975	15 691	16 136	16 243	16 332	-13.3%
Activities auxiliary to financial intermediation, real estate and other business services ^b	213 538	101 366	99 031	97 591	100 308	99 866	100 246	-53.1%
Community, social and personal services ^c	29 732	26 480	25 986	25 727	26 478	26 752	27 478	-7.6%
All industries	493 072	345 377	334 053	325 548	331 507	331 180	334 562	-32.1%

Source: Stats SA, *Annual Financial Statistics 2010-17*

a An enterprise is a legal unit or a combination of legal units that includes and directly controls all functions necessary to carry out its activities.

b Excludes financial intermediation, insurance, pension funding and business services not classified elsewhere.

c Excludes government and educational institutions.

d Preliminary figures.

Chart 1: Contribution of business by size to turnover estimates, 2017

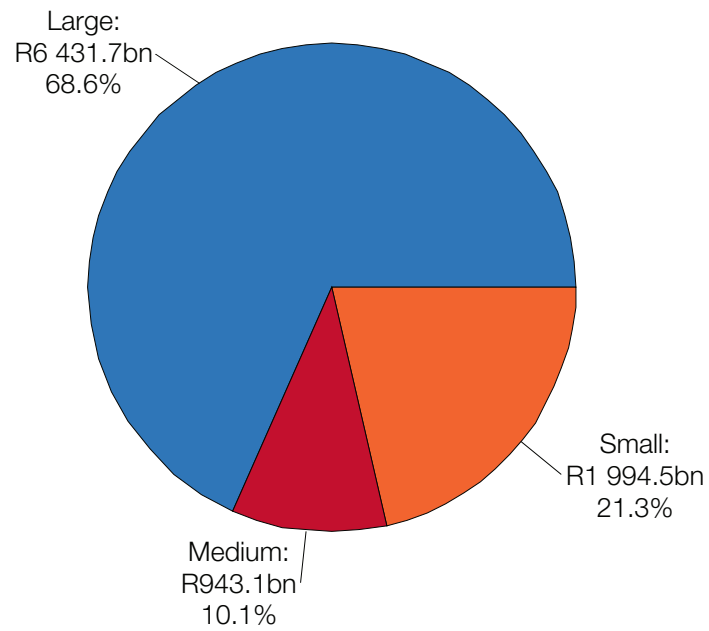


Chart 2: Contribution of business by size to employment cost estimates, 2017

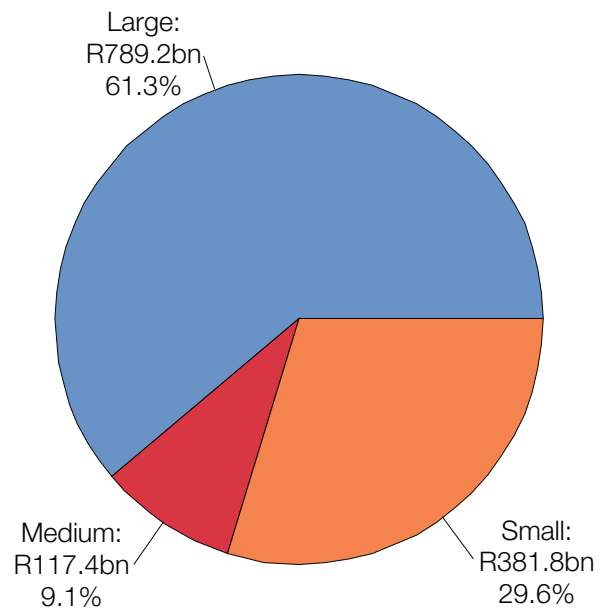


Chart 3: Contribution of business by size to capital expenditure estimates, 2017

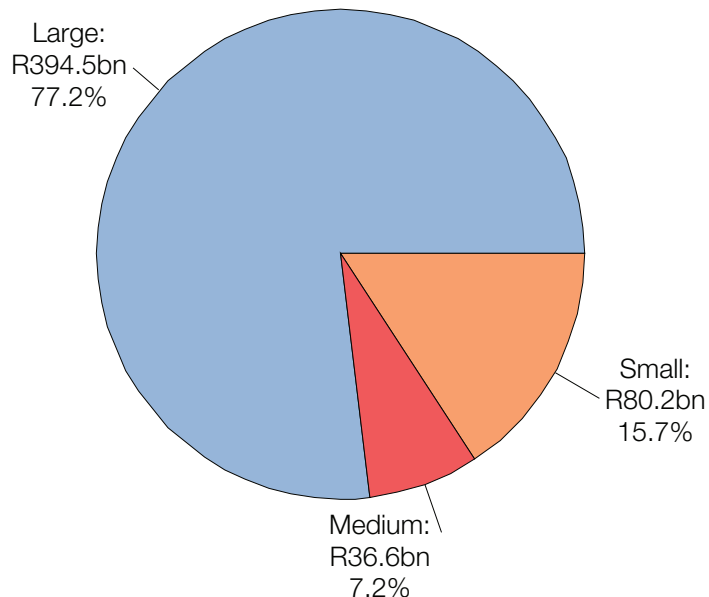
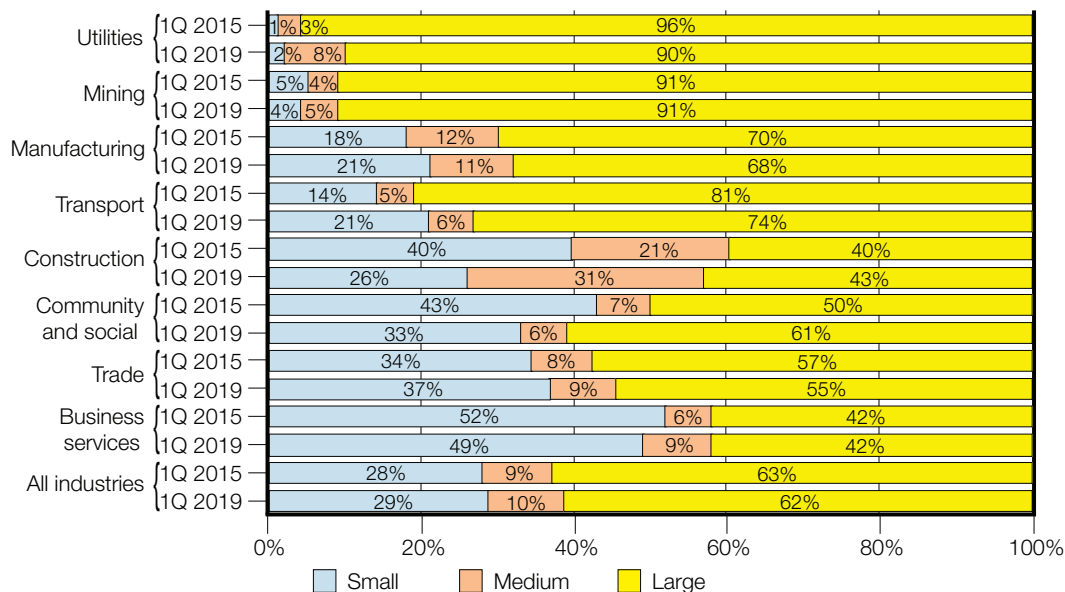


Chart 4: Percentage of turnover in each industry by business size in formal business sector^a, 1Q 2015 vs 1Q 2019



According to Statistics South Africa (Stats SA), the entire formal business sector generated R2.4 trillion in turnover in the first quarter of 2019. Out of this amount, large businesses contributed 62%, followed by small businesses, at 29% and medium-sized businesses, at 10%. Three industries, namely business services; trade and community, social and personal services are characterised by a large number of small players. Examples include hairdressers, dry cleaning services and veterinary clinics (community, social and personal services), lawyers and estate agents (business services), corner cafes (trade).

SMME trends

Table 3: Small Medium and Micro Enterprises (SMMEs), 1Q 2017-1Q 2019

	1Q 2017		1Q 2018		1Q 2019		Change 1Q 2017- 1Q 2019
	Number	Proportion	Number	Proportion	Number	Proportion	
Employer	951 220	5.8%	843 253	5.1%	872 711	5.3%	-8.3%
Own account worker	1 527 657	9.3%	1 599 910	9.6%	1 677 829	10.2%	9.8%
SMME owners	2 478 877	15.1%	2 443 163	14.7%	2 550 540	15.4%	2.9%
Working for someone	13 859 949	84.4%	14 066 897	84.8%	13 853 471	83.9%	0.0%
Helping in household business	80 327	0.5%	69 954	0.4%	109 030	0.7%	35.7%
Total employed	16 419 153	100.0%	16 580 013	100.0%	16 513 041	100.0%	0.6%

Source: Small Enterprise Development Agency (SEDA), *SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019*

According to the Small Enterprise Development Agency (SEDA), in the first quarter of 2019, 5.3% of all employed people also employed others, while 10.2% worked for themselves. At 2.55 million, the number of SMME owners comprises the proxy measure for the number of SMMEs in South Africa.

Table 4: Formal and informal SMMEs, 1Q 2018 and 1Q 2019

Sector	1Q 2018				1Q 2019			
	Employer	Own account worker	Total	Proportion	Employer	Own account worker	Total	Proportion
Formal	472 014	186 705	658 719	27.0%	523 606	212 592	736 198	28.9%
Informal	328 152	1 386 081	1 714 233	70.2%	315 380	1 439 063	1 754 443	68.8%
Agriculture	43 087	16 883	59 969	2.5%	29 987	15 442	45 429	1.8%
Private households	—	10 242	10 242	0.4%	3 737	10 732	14 470	0.6%
Total	843 253	1 599 910	2 443 163	100.0%	872 711	1 677 829	2 550 540	100.0%

Source: SEDA, *SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019*

In the first quarter of 2019, 68.8% of SMMEs were operating in the informal sector and 28.9% in the formal sector. Most SMME owners in the formal sector also employ other people, while in the informal sector, the majority are own account workers.

Chart 5: SMMEs by industry, 1Q 2017-1Q 2019

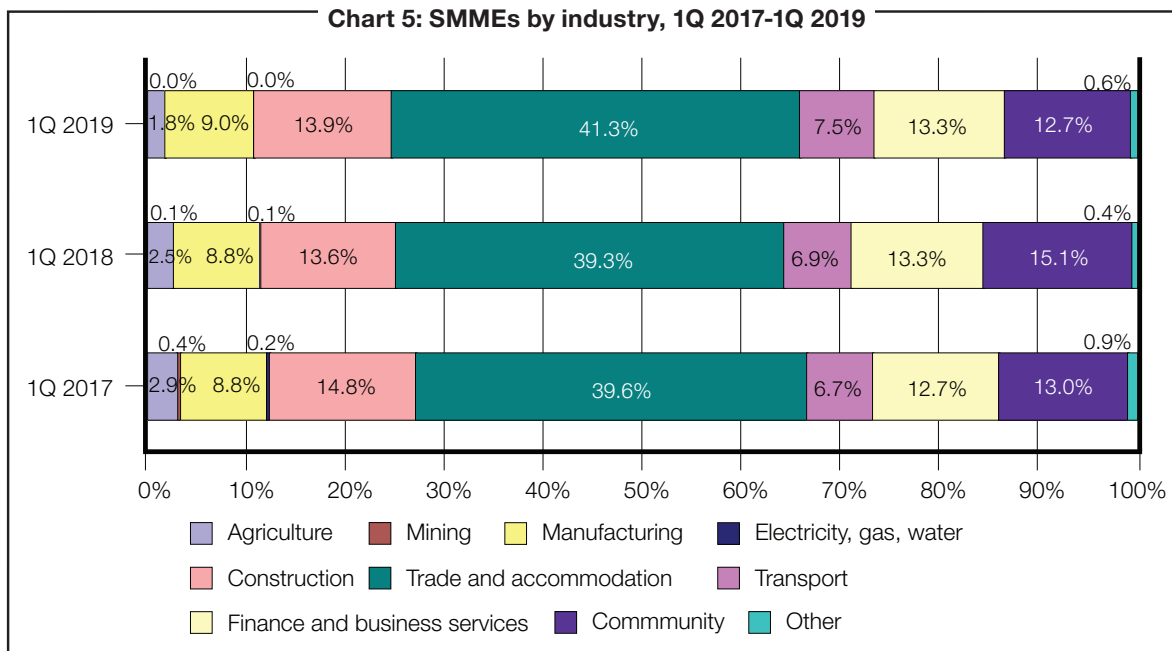


Table 5: Enterprise age of SMMEs, 1Q 2017-1Q 2019							
Years	1Q 2017		1Q 2018		1Q 2019		Change 1Q 2017- 1Q 2019
	Number	Proportion	Number	Proportion	Number	Proportion	
0-1	97 673	3.9%	111 611	4.6%	100 739	3.9%	3.1%
1-2	381 668	15.4%	383 214	15.7%	327 310	12.8%	-14.2%
2-3	241 100	9.7%	203 799	8.3%	242 041	9.5%	0.4%
3-5	381 156	15.4%	371 315	15.2%	425 128	16.7%	11.5%
6-10	572 494	23.1%	543 874	22.3%	571 898	22.4%	-0.1%
11-20	516 882	20.9%	552 905	22.6%	586 780	23.0%	13.5%
21-50	284 877	11.5%	271 954	11.1%	294 185	11.5%	3.3%
> 50	3 027	0.1%	4 489	0.2%	2 459	0.1%	-18.8%
Total	2 478 877	100.0%	2 443 163	100.0%	2 550 540	100.0%	2.9%

Source: SEDA, SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019

Some 107 377 new SMMEs entered the market in the first quarter of 2019. The number of SMMEs operating for less than two years declined in comparison to the previous year, while those operating for two to fifty years increased on average.

Table 6: Employment by SMMEs, 1Q 2017-1Q 2019							
Sector	1Q 2017		1Q 2018		1Q 2019		Change 1Q 2017- 1Q 2019
	Number	Proportion	Number	Proportion	Number	Proportion	
Formal	6 092 354	57.6%	4 972 307	56.0%	6 631 459	61.2%	8.8%
Informal	1 200 400	11.4%	1 053 129	11.9%	1 115 405	10.3%	-7.1%
Agriculture	794 673	7.5%	417 417	4.7%	537 157	5.0%	-32.4%
Private households	2 398	0.0%	0	0.0%	5 258	0.0%	119.3%
Provided to others	8 089 824	76.5%	6 442 852	72.5%	8 289 280	76.5%	2.5%
Employer	951 220	9.0%	843 253	9.5%	872 711	8.1%	-8.3%
Own account worker	1 527 657	14.5%	1 599 910	18.0%	1 677 829	15.5%	9.8%
Total	10 568 701	100.0%	8 886 015	100.0%	10 839 819	100.0%	2.6%

Source: SEDA, SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019

In the first quarter of 2019, 10.84 million people worked in SMMEs. Of these, 2.55 million jobs were for SMME owners and 8.29 million were jobs for their employees. The formal sector provides 61.2% of SMME employment.

Table 7: SMME owners by race, 1Q 2017-1Q 2019

Race	1Q 2017		1Q 2018		1Q 2019		Change 1Q 2017- 1Q 2019
	Number	Proportion	Number	Proportion	Number	Proportion	
Black	1 825 007	73.6%	1 828 808	74.9%	1 901 361	74.5%	4.2%
Coloured	116 983	4.7%	94 252	3.9%	108 631	4.3%	-7.1%
Indian/Asian	100 846	4.1%	98 136	4.0%	115 520	4.5%	14.6%
White	436 041	17.6%	421 967	17.3%	425 027	16.7%	-2.5%
Total	2 478 877	100.0%	2 443 163	100.0%	2 550 540	100.0%	2.9%

Source: SEDA, SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019

Table 8: Formal and informal small^a businesses, 2010-17

Sector	2010	2011	2012	2013	2014	2015	2016	2017
Formal	587 000	623 000	595 000	614 000	572 000	620 000	633 000	640 000
Informal	1 328 000	1 312 000	1 359 000	1 323 000	1 310 000	1 367 000	1 441 000	1 525 000

Source: Trade and Industrial Policy Strategies (TIPS), *The Real Economy Bulletin Special Edition: The state of small business in South Africa*, January 2019

a With under 50 employees.

According to Trade and Industrial Policy Strategies (TIPS), the number of formal small businesses increased from 587 000 in 2010 to 640 000 in 2017. The number of informal businesses grew from 1.33 million to 1.53 million over the same period.

Table 9: Small business by people employed in the formal and informal sectors, 2017

Number employed	Formal	Informal
20 to 49	47 000	—
10 to 19	82 000	—
5 to 9	128 000	—
2 to 4	183 000	190 000
1	45 000	94 000
Own account	156 000	1 210 000

Source: TIPS, *The Real Economy Bulletin Special Edition: The state of small business in South Africa*, January 2019

Formal SMEs

Table 10: Firms by size, 2011-16

Size ^a	2011	2012	2013	2014	2015	2016
Micro	169 986	170 509	171 060	173 267	175 264	176 333
Small	63 864	64 876	66 247	67 137	67 977	68 494
Medium	15 257	15 753	16 442	16 790	17 197	17 397
Large	5 144	5 304	5 517	5 603	5 713	5 735

Source: Small Business Institute (SBI), *The number of formal micro, small and medium businesses in South Africa Preliminary findings of stage 1 of the Baseline Study of Small Businesses in South Africa*, November 2018

a Definition of firm size is based on "person-years" of micro: 0-10; small: 11-50; medium: 51-200; large: 201+

According to the Small Business Institute (SBI), South Africa's formal employing segment in the economy is much smaller than originally thought, consisting of just over 250 000 businesses — far off the mark of current estimates.

Table 11: Employment by firm size, 2011-16

Size ^a	2011	2012	2013	2014	2015	2016
Micro	658 333	666 078	670 906	678 680	685 544	685 264
Small	1 434 918	1 457 779	1 495 092	1 518 610	1 537 180	1 549 411
Medium	1 426 006	1 463 427	1 537 806	1 568 034	1 615 652	1 628 429
Large	8 453 986	8 747 449	9 223 595	9 543 214	9 790 224	9 702 416

Source: SBI, *The number of formal micro, small and medium businesses in South Africa Preliminary findings of stage 1 of the Baseline Study of Small Businesses in South Africa*, November 2018

a Definition of firm size is based on "person-years" of micro: 0-10; small: 11-50; medium: 51-200; large: 201+

While formal SMEs account for approximately 98% to the number of formal firms in the economy, they only account for 28% of jobs. Based on international trends, this figure should be at about 60% to 70%. The majority (56%) of jobs in South Africa come from only 1 000 larger employers, including government — and these jobs are growing at a faster rate than jobs created by SMEs.

Section II

The SMME experience

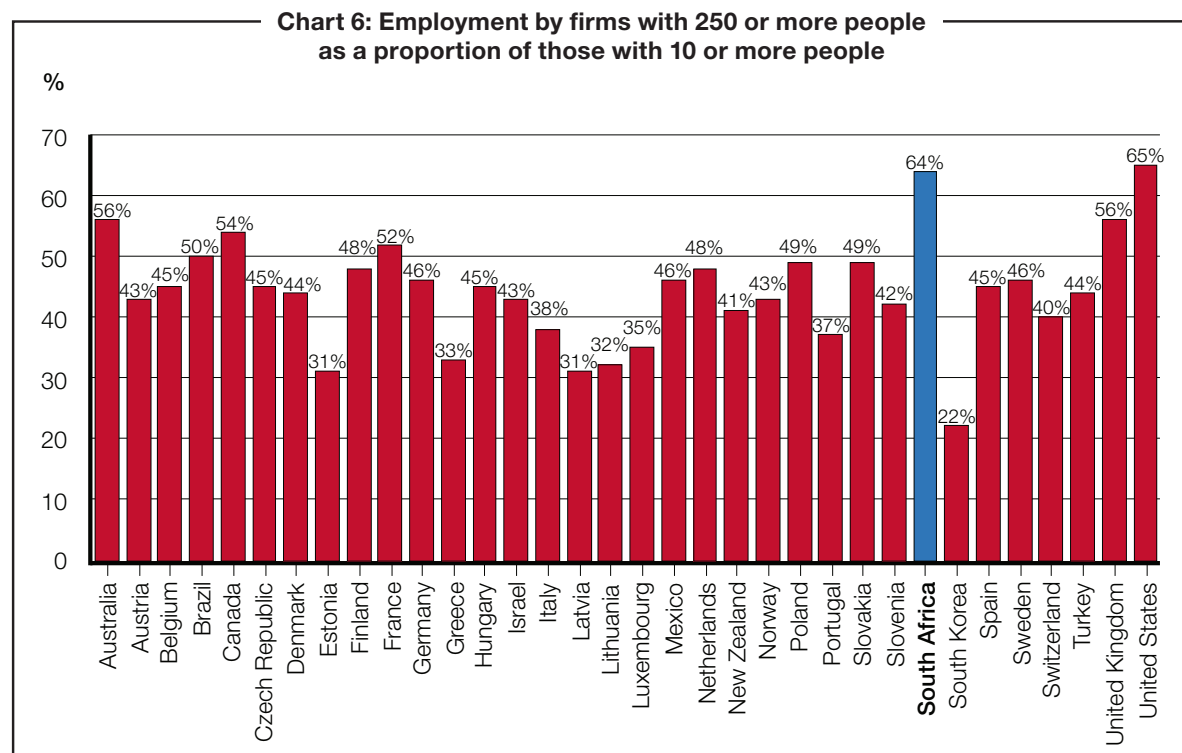
In this section, Rolf Endres and Boikanyo Mothibatsela of Agis share their insights into the opportunities and challenges facing small businesses operating in South Africa. The Agis team has a long history of working with client organisations in the economic development domain to deliver tailor-made solutions for private-sector driven economic development, inclusive of financial markets, country competitiveness and value chain/cluster strategy development. Much of this work has focused on core sectors of activity including agriculture, agri-processing, tourism, trading and manufacturing across Sub-Saharan Africa. These sectors are deemed to have the potential to generate significant employment and increase broad-based economic activity. Agis has also invested in three SMMEs and has gained first-hand experience in the challenges of running SMMEs in South Africa.

Contribution to job creation still minimal

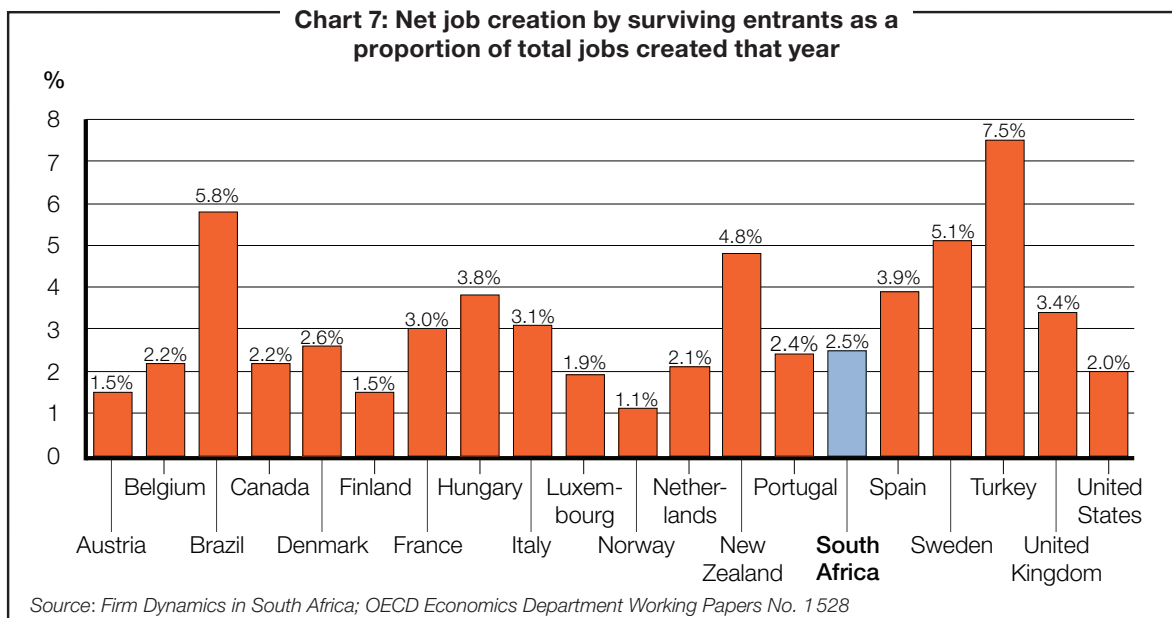
The government has placed small business at the forefront of tackling South Africa's triple challenge of poverty, unemployment and inequality. However, there has been minimal impact over the past few years. Although an estimated 98% of all registered businesses in the country are SMMEs, these businesses consistently create less than 28% of jobs, a far cry from the government's ambitions of 90% contribution to job creation by small businesses by 2030¹. In fact, as outlined below, very large firms with over 250 employees remain the lynchpin of job creation and account for just under 70% of firms that employ 10 or more people².

1. *Small Business Institute Survey 2018; South African Revenue Service; National Treasury*

2. *Firm Dynamics in South Africa; OECD Economics Department Working Papers No. 1528*



Similarly, business founders, owners and investors are yet to see the fruits of an SMME-driven economy more generally. SMME failure rates are high: on average, 31 companies with taxable income of less than R10 million close down each week. For those which do survive, growth and returns are meagre. As illustrated in **Chart 7**, “surviving entrants” (firms surviving for more than two years) remain small and lag behind many medium and high income economies in terms of net job creation: only 2.5% of new jobs created in any given year are generated by SMMEs that were established two years prior.



Neglected SMMEs

Policymakers, investors and other stakeholders have focused on exciting technology start-ups, micro businesses — or larger, established players. While these play an important role in creating economic growth and employment, older, small-to-medium sized businesses have not been adequately prioritised.

This is true not just in South Africa, but across a number of countries in Sub-Saharan Africa. For example, Development Finance Institutions (DFIs) presently focus financial and technical assistance either on trying to get on-board as many small-holder farmers (SHFs)/micro enterprises through direct grants as well as funding for financial institutions in-country. Government policies and support also tend to focus on employment generation through micro enterprises by creating as many business founders/owners as possible, with less emphasis on growing small to medium-sized employers. Accessing capital, particularly for smaller micro enterprises, often requires an entrepreneur to be well networked and at times, quite lucky. In the absence of these advantages, many rely on personal savings or injections from friends and family.

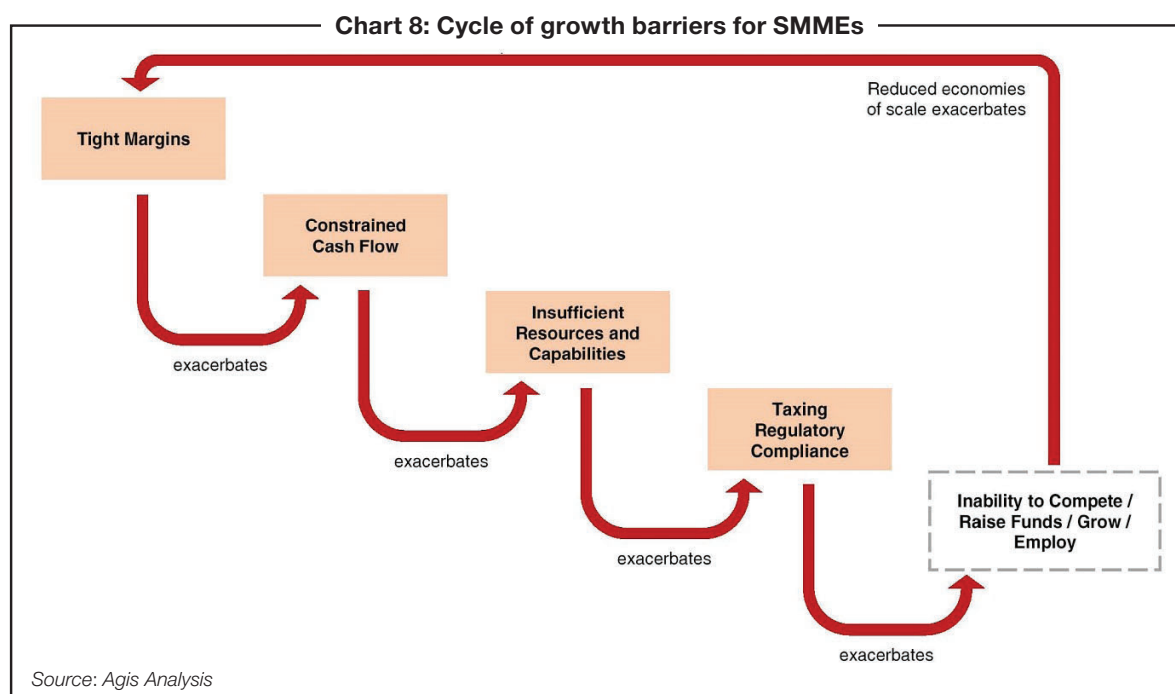
Agis Experience

Agis, having noted the “gap in the market”, chose to make a number of investments into SMMEs in the Fast-Moving Consumer Goods (FMCG) and consumer-facing sectors. The experience gained during extensive deal sourcing and the subsequent investment period, is reflected in this paper.

Why businesses struggle to grow

SMMEs are caught in a cycle of limited bargaining power, cash flow constraints, significant skills gaps and having to operate in a taxing regulatory environment. Each of the aforementioned challenges exacerbates the next:

- Tight margins (these vary by industry conditions) and poor terms of trade as a result of weak bargaining power constrain cash flows;
- Poor cash availability exacerbates challenges in sourcing adequate human and other skills requisite for growth;
- A lack of sufficient resources and capabilities as well as inadequate systems and processes to support growth means that existing, scarce resources are deployed to address not only business operations, but also regulatory compliance;
- This in turn further hampers companies' ability to grow and create jobs. This ultimately limits economies of scale, which in turn further reduces the ability to improve margins, setting off the cycle once more.



Limited bargaining power

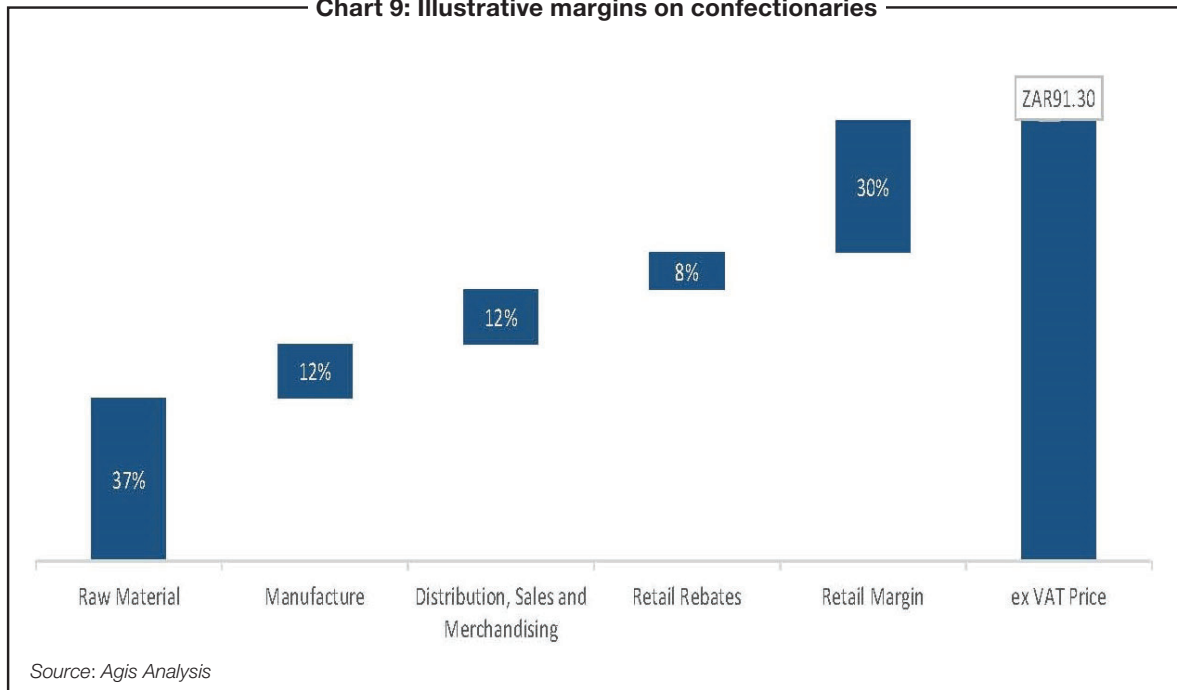
South African markets are highly concentrated. For instance, in FMCG, just three retail chains control over two thirds of the formal grocery retail market. This worsens the weak bargaining position of small businesses, and results in ever tighter margins. In the current economy in particular, consumers are highly price sensitive, and any additional margin that is paid to retailers results in a margin squeeze for manufacturers. The strong bargaining power of big retail also results in their ability to extract a margin from the value chain that is in addition to normal retail margins in the form of rebates. These rebates, whilst referred to as marketing and early settlement discounts, often just function as an additional margin. Companies with larger product offerings that have lower reliance on the formal retail channels are often able to negotiate lower rebates; small companies are unable to do so.

Agis Experience

Agis' portfolio companies sell into formal retail. In some cases, almost three quarters of total product margin is captured by distributors and retailers.

In addition to the margin structure, the businesses have often had to accept settlement discounts (in some cases for payment within 90 days of statement), and rebates of up to 15%. Larger competitors are able to renegotiate terms.

Chart 9: Illustrative margins on confectionaries

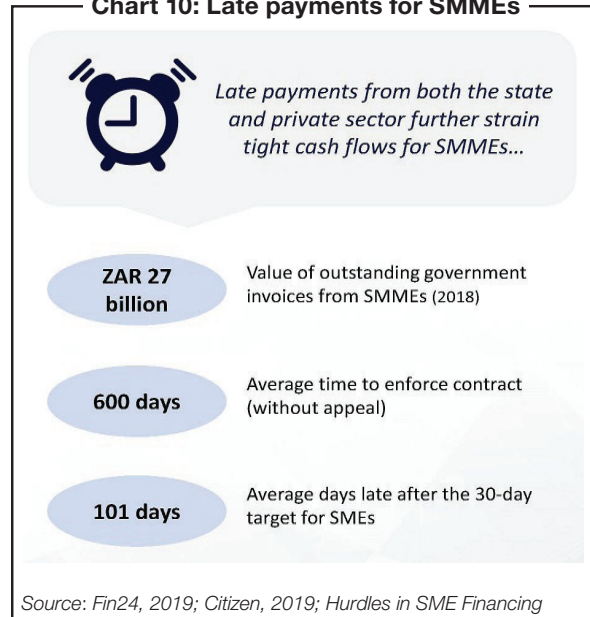


Cash flow constraints

The cash flow pressure created by these thin margins and additional settlement discounts is exacerbated by late payments and difficulties in accessing suitable working capital finance. The challenge of late payments has been widely discussed in public discourse as it relates to SMMEs providing services to the state. Over R27 billion in invoices from SMMEs remained outstanding at the end of 2018. Combined with late payments from private sector buyers, SMMEs in the country average receivables that run over 100 days late – after the average 30-day payment terms.

This has severe knock-on effects on SMMEs' ability to remain operational, pay wages and salaries, rent and other expenses – never mind to fund expansion and growth.

Chart 10: Late payments for SMMEs



Agis Experience

In its early stages, one of Agis' portfolio companies faced a key challenge with regard to expansion capital from traditional financial intermediaries to fund a new vehicle. The business by its nature was asset light, and cash remained constrained due to late payments. Despite profitability and a reliable cash flow, directors had to take on personal surety to unlock requisite funding, from a non-traditional asset-based lender.

For many small businesses, without the backing of a third-party investor or funding provided by friends and family, there is no way to overcome these cash flow and capital challenges in an effective or efficient way. That is particularly the case, as business and personal assets in SMMEs are frequently not clearly delineated, resulting in business funders not having further credit capacity in their personal capacity³.

3. *Fin24*, 2019; *Citizen*, 2019; *Hurdles in SME Financing*, 2019; *Business Insider*, 2019

Human resource constraints

With limited cash flows, small business owners and operators struggle to hire adequate skills and often lack the requisite business tradecraft themselves to manage their businesses, finances and employees.

Inherently, SMMEs have thin layers of management. Expectations of owner-managers exceed those of general management, and cover all other roles in the business: they are tasked with ensuring operational oversight, finance, tax compliance, human resource management, customer interactions and sales, marketing and strategy. Coupled with fundamental tasks of identifying opportunities and implementing strategies for growth, this is often overwhelming, resulting in none of these functions being adequately delivered.

Chart 11: Illustrative General Manager responsibilities in a small business



In addition to the stretch, many business owners or managers are not equipped to navigate all the vital functions of running a growing business. A 2015 survey by Statistics South Africa (Stats SA) and the Bureau of Economic Research (BER) found that more than half of SMME owners in South Africa have not completed their secondary education. In contrast, 95% of entrepreneurs in the United States had completed high school.

This situation is compounded by a limited pool of human capital that SMMEs can tap into, owing to affordability. Available talent that works for larger corporates typically earn three to four times what small businesses can afford. This presents SMMEs with a “catch-22” situation, where the businesses lack the staff and capabilities to grow their business to a point where the business can afford the very staff and capabilities required to achieve the growth.

Table 12: SMME owners by education level, 1Q 2017-1Q 2019

Education level	1Q 2017		1Q 2018		1Q 2019		Change 1Q 2017- 1Q 2019
	Number	Proportion	Number	Proportion	Number	Proportion	
No schooling	94 799	3.8%	87 822	3.6%	81 611	3.2%	-13.9%
Less than primary school completed	238 124	9.6%	210 446	8.6%	182 399	7.2%	-23.4%
Primary school completed	117 820	4.8%	106 477	4.4%	134 282	5.3%	14.0%
Secondary school not completed	819 086	33.0%	864 020	35.4%	896 277	35.1%	9.4%
Secondary completed	667 850	26.9%	618 897	25.3%	701 603	27.5%	5.1%
Tertiary	504 519	20.4%	518 545	21.2%	504 464	19.8%	0.0%
Other	36 679	1.5%	36 955	1.5%	49 903	2.0%	36.1%
Total	2 478 877	100.0%	2 443 163	100.0%	2 550 540	100.0%	2.9%

Source: SEDA, SMME Quarterly Update 1st Quarter 2018 and 1st Quarter 2019

The number of SMME owners with primary and secondary schooling increased in Q1 2019 by 26.1% and 13.4% respectively compared to Q1 2018. The number of owners with tertiary education declined by 2.7% over the same period.

Agis Experience

In Agis' investee companies, challenges around staffing and capabilities are experienced first-hand. Full time management lacks the specific capabilities to address any of the underlying issues in detail, because of a lack of experience and skills in that domain. This results in none of the business functions delivering to their full potential, thus undermining growth. This has resulted in Agis having to be fully operationally involved in the businesses and taking on a range of tasks that would otherwise not be adequately performed, such as:

- Planning cash flows in detail to ensure liquidity management;
- Negotiating with value chain partners;
- Designing and implementing full controls processes across the organisation, down to each stock movement from an inventory perspective;
- Ensuring tax compliance and engaging with authorities on Value-Added Tax (VAT), Pay As You Earn (PAYE), Unemployment Insurance Fund (UIF), Skills Development Levy (SDL) etc;
- Checking the detail of payroll and commissions for all staff members;
- Managing regional managers directly, rather than via a general manager;
- Ensuring customer and client complaints are addressed.

Regulatory burden and enforcement failures

Faced with tight cash flows and stretched from a management perspective, many small businesses are ill-equipped to deal with taxing regulatory compliance. Part of the reason for this is that the regulatory burden is disproportionately high for small businesses from both a cost, time and administrative perspective.

Agis Experience

Agis is invested in a small food manufacturer. The investee company has to meet a plethora of regulatory requirements to be allowed to operate and to supply the retailer market. For this manufacturer, a full time employee is required to ensure that all regulatory requirements are met on an on-going basis – 25% of the available management staff time. Significantly larger manufacturers require the same full time employee – but as a function of a large management team, regulatory requirements typically only absorb 5% of management staff time.

Some of the regulatory/certification requirements include:

- managing requirements for health inspections (national department);
- obtaining and maintaining a certificate of acceptability (municipality);
- ensuring ongoing compliance with product category specific regulations relating to product characteristics and the way the products are marketed;
- compliance with SANS standards and annual calibration of equipment;
- gaining full Hazard Analysis and Critical Control Point (HACCP) accreditation and controlling each of thirteen possible hazards for one product line and fifteen for a second;
- managing 59 standardised operating procedures, and documenting each with up to three different records;
- ensuring full traceability on each Stock Keeping Unit (SKU) to source of origin of each ingredient;
- running at least two trainings for all staff each month, with additional training on specific roles;
- completing ongoing hygiene testing on product, facilities, and staff;
- ensuring shelf-life testing;
- gaining label compliance approvals;
- developing and gaining approval for Sanitation Standard Operating Procedures (SSOP);
- ensuring monthly audits by religious food certification bodies.

Of course, not all companies seek to achieve regulatory compliance – allowing them to gain a significant competitive advantage from a cost perspective. In South Africa, insufficient enforcement of regulation appears to be the norm in certain sectors. This is driven by capacity constraints (e.g. a lack of inspectors), capability (departments not understanding the implications of lack of enforcement), and lack of interest in enforcement. In some cases, regulation has also not kept up with changing times, with attempts by industry bodies to ensure updates to policies and regulation not gaining traction with the relevant authorities.

Agis Experience

The honey industry experiences significant adulteration of product. However, South African regulations do not include the international Association of Official Analytical Chemists (AOAC) benchmark tests to identify such adulteration – exacerbated by the fact that no laboratory in-country provides the benchmark test. This results in Agis' portfolio company having to fly samples to Europe, driving up costs, working capital requirements, and triggering delays.

Conclusion

Small firms struggle to reach the economies of scale necessary to improve profitability and thereby remain small. SMME development needs to focus on creating the right factors for companies to not just survive, but to be in a position to grow.

There needs to be a clear emphasis on reducing barriers to the growth of SMMEs, considering in particular the challenges of tight margins, constrained cash flows, lack of appropriate human capital, and regulation that is more business friendly for small enterprises.

Section III

Joint policy recommendations

Following the data and analysis presented in the previous two sections of this report, the CRA and Agis propose the following interventions to facilitate SMME growth in South Africa:

1. Government and regulatory bodies should **develop regulations that are appropriate to the size of organisations**. Large businesses tend to have the resources to navigate their way through extensive regulations, while SMMEs have to employ greater relative financial and human resources to comply, diverting attention from critical business functions. This includes freeing SMMEs from the provisions of broad-based black economic empowerment.
2. SMMEs should be provided with exemptions **from existing labour regulations**. This would include, inter alia, increasing flexibility to hire and dismiss staff, and freeing small business owners from having to comply with minimum wages laid down in bargaining council agreements (as well as statutory national minimum wages), and removing provisions in the Basic Conditions of Employment that reduce small businesses' operational flexibility.
3. The rule of law is essential for the proper functioning of a market economy. Government and regulatory bodies should ensure **consistent enforcement of rules and regulations**. In addition, rules governing business activity should be simplified wherever possible to make them more easily accessible to SMMEs.
4. Efforts should be made to reduce the **costs and delays involved in enforcing contracts**, for instance by the establishment of small claims commercial courts.
5. **Business skills** should be promoted as a part of the basic school curriculum. This would include a greater emphasis on quantitative skills through a focus on science, technology, engineering and mathematics (STEM) disciplines and subjects such as business studies that combine basic bookkeeping, marketing and economics. This would enable new entrants to the job market to participate actively in a modern, skills-intensive economy.
6. Commercial banks, government, and development finance institutions (DFIs) should consider **shifting funding and technical support** away from the creation of new 'survivalist micro-enterprises' towards supporting the growth of larger SMMEs. These firms tend to be more sustainable, and generally have greater capacity to absorb capital and technical support. As a result, they are more likely to grow, and thus contribute more meaningfully to job creation than 'micro' businesses.

SMMEs have the potential to contribute significantly to employment, income generation and asset accumulation. Unlocking this potential requires implementing innovative reforms to make South Africa truly open for business.

