



Encouraging small business

Is government doing more harm than good?

The Centre for Development and Enterprise (CDE) held its 12th debate on 6 September 1999. The speakers were Alec Erwin, Minister of Trade and Industry; Bulelwa Belu-Toni, Editor-in-Chief of the Western Cape-based community newspaper *Big News for Small Business*; and Temba Nolutshungu, director of the Free Market Foundation of South Africa. Judi Hudson, senior research coordinator at CDE, chaired the debate.

What the speakers had to say...

Alec Erwin opened the debate by saying that the most striking feature of the South African economy – apart from its racial domination – is the underdevelopment of small and medium enterprises (SMEs).

There are clear historic reasons for this. From the early 1950s, but particularly in the 1960s, there was a systematic programme to reduce the scope for SME development, particularly in central city areas which would have been the heartland of such development. This was associated with the dominance of the very large mining houses which began to conglomerate and create a major hold on the economy. This in turn was linked to the growth of South Africa's banks and their close association with the country's large enterprises.

Consequently, the SME sector that one would have expected to emerge more fully was structurally restrained. The previous government took minimal steps to support SMEs. There was only one activity to consciously promote this area – the Small Business Development Corporation (SBDC).

This structural problem was not one that the market was easily going to correct. One of the first priorities for the new government was to begin a process of changing the environment in which small and medium businesses could operate. One of the first acts tabled by the Ministry of Trade and Industry was the Small Business Act which emerged out of the consultative process with the President's conference on small business.

In essence government's approach is, firstly, to create a platform for advocacy where small and medium business people can articulate their positions. Nedlac is not geared to this and government thought it imperative to create a separate platform. The forum created was the National Small Business Council. Regrettably, the council has run into management problems, but the structure is one government still believes is necessary in creating an advocacy forum for SMEs.

Secondly, government created two support institutions focussing on specific needs identified in the SME sector. Khula was set up to address problems of finance and

concentrates on two areas: the provision of an underwriting or guarantee facility that will provide an impetus for the banking sector to go into retail lending into the SME sector, and the creation of a wholesaler that will lend on at reasonable rates to other retail financing institutions.

The level of lending by the banking sector into the SME sector was too low. Attempting to go into retail lending

directly (through the SBDC, for instance) would not reach enough people. The institutions, however, that borrow from Khula have the capacity to reach large numbers of people, are more familiar with the intricacies of the market and have a greater interest in serving the market.

Khula is beginning to have some impact. It does not receive a great deal of credit because all too often it is Khula that is

blamed for non-lending by the banks. Khula's achievements are considerable given its two years of existence; the number of people it has reached and the money it has underwritten far exceeds the previous performance of any similar institution in this country.

The establishment of the second institution deliberately separated support per se from financial support. Ntsika promotes mainly business service centres and government's three major efforts in getting out into the market: local business service centres (LBSCs) of which 93 are accredited across the country, manufacturing advice centres, and techno-entrepreneur programmes designed to concentrate on manufacturing support for SMEs. The latter work through women's groups and the like.

Given that Khula and Ntsika were set in motion in mid-1997, government support for the SME sector is beginning to extend its net quite well.

Government has also completed a thorough regulatory review of aspects of its own administration that have a negative impact on SMEs. A host of areas have been highlighted, from taxation to municipal and licensing by-laws, from certain aspects of the Labour Relations Act to a wide range of compliance requirements. Government will be processing these through the appropriate departments and cabinet to see whether it can make regulatory or legislative changes that would benefit the operation of SMEs.

Clearly, government cannot do everything the small business sector wants. One of the main challenges is for the Department of Trade and Industry (DTI) to address the structural problem in the capital lending market. There is too heavy a dependence

on collateral. Instead of lending to the income stream, banks are looking for collateral. Unlike many countries at this stage of industrialisation, collateral – for black people in particular – is absent. Most South Africans are still buying their homes; land ownership has been distorted; and central city and prime sites for business or land holdings were removed – again, mostly from black people.

A further problem lies within the DTI itself. The department has not been as effective as it could have been in communicating its achievements and what is on offer. There will be a new style of communication.

Bulelwa Belu-Toni said government had done well given the status of small business development in South Africa before 1994. It had created a friendly environment for SMEs for the first time. Ntsika's business development services and its accredited LBSCs have created capacity. Khula has improved, increasing its loans to black entrepreneurs from 27% to 64% over the past six months. These agencies have made a considerable effort to assist women, the disabled and rural people.

However, no framework has been stipulated that ensures the smooth operation of the initiatives set up by government via its various acts of parliament. Ntsika may have accredited nearly 100 LBSCs, but most of them are dying. One in the Western Cape was closed only last week; there was no money left for salaries.

Government has done well to form bilateral relationships with the foreign funders of NGOs, but this has eaten into the direct funding of the NGOs themselves. Understaffed and with limited financial support, NGOs are no longer able to assist government to implement the legislation it has put in place. Government should have conducted an audit of NGOs working in the area of small business promotion before 1994 and set up partnerships with this existing network rather than establish Ntsika.

There are concerns about the staffing of Ntsika. Ntsika employees are well paid, but use this employment experience as leverage to find other jobs. There is no incentive for them to address the concerns of the clients government is targeting and staff turnover is extremely high. A partnership

between government and the NGOs would have translated into realistic salaries, funded by the private sector, paid to staff committed to making an impact at grass roots level. This

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WHAT ARE THE CDE DEBATES?

CDE debates are intended to air issues underlying the topic and to raise the challenges that must be met by the players and the policy makers. CDE views these debates as a contribution to the formation of an informed public opinion. This pamphlet is widely distributed and publicised as CDE's contribution to keeping the debate alive.

partnership would have achieved a great deal more than Ntsika has done.

The criticism of Khula can be traced back to the non-engagement of the banking sector by government prior to setting up Khula. If government had consulted this sector, it could have solicited a commitment from the banks which would have included access to records and the reflection of loans to the SME sector. A penalty and incentive system for small business loans could have been set up as has been done effectively in Taiwan. South Africa's banks generally remain ignorant about Khula. This exacerbates the resistant attitude that banks have towards SMEs.

A hurdle within Khula is that it remains inaccessible to the prospective borrower. Quite often, a would-be entrepreneur will approach Khula three or more times before he or she receives due attention. SMEs cannot afford to waste such time.

Of serious concern is the nightmarish relationship between national government and the provincial administrations. The communication between national and provincial government is negligible. Local authorities are constrained by the regulatory framework. If these relationships could be enhanced, delivery could be expedited.

The presidential job summit held late last year made several recommendations regarding the promotion of small business. Those involved look forward to their implementation.

There is a strong need for cleaner, clearer inter-departmental relationships between public works, labour, trade and industry and prisons. There is too little resource collection to prevent the same contractors winning tenders time and again. A team approach where a successful contractor of quality is linked with those who are genuinely making an effort, even if they are micro, survivalist enterprises, will go a long way to spreading the workload and creating role models.

Government could do better by re-assessing the staffing of Ntsika and Khula. Funds are not moving from Ntsika to the LBSCs as intended. The staff at both should be paid on commission and on proof of actual delivery to the SMEs they are meant to target.

A training academy would be helpful where LBSC mentors are equipped to a set standard with the necessary skills and information and prepared to respond dynamically to issues commonly presented. If an LBSC could offer the right advice first time around, it would instill confidence within its target community. This in turn would prevent frustrated prospective entrepreneurs from overwhelming Ntsika with queries that should be dealt with at LBSC level. Training LBSC mentors would engender internal capacity even before building capacity within small enterprises.

If Ntsika and Khula are not delivering, close them down. A great deal is being invested in Ntsika, but with little impact. Both institutions need lean and mean staffing with task-orientated jobs. Once an employee has completed his task, he should move on or renegotiate his contract.

Temba Nolutshungu praised government for being serious about small business development, but said the country as a whole was not serious enough. In 1997 South Africa shed 97 000 jobs from the formal sector of the economy; this year will add a further 45 000 to that figure.

These statistics drive one point home: the country is not serious about addressing the challenges facing the small business sector which is where jobs are created.

A 1990 study of the European Union countries showed that in Spain SMEs accounted for 90% of the jobs created, in the UK 71% and in France 64%. Job creation is South Africa's major challenge; jobs are not created by big corporations, but by the small business arena which is more labour intensive than big business which is capital intensive.

On examining the small business sector, which can be likened to the goose that lays the golden eggs, one finds a constraining labour policy. Small business is not able to cope with the network of compliance requirements and the myriad of labour laws which have been imposed on the sector in recent times.

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The goose, wanting to lay its golden eggs, is faced with a range of licensing laws that reflect the previous dispensation. Government has done much to deregulate laws pertaining to certain industries, but there remains a plethora of businesses where one can but assume that

government is making it difficult for an entrepreneur to enter. Licensing laws as known to South Africans should be done away with and replaced only with regulations that are absolutely necessary, such as vehicle registration.

As they stand, South Africa's licensing laws give bureaucrats discretionary judgement. The criteria in place are not objective but open to individual interpretation. Bureaucrats have the power via these laws to determine

who will and who will not be in business. Some of these laws were originally intended to keep certain people from the economic mainstream. That they are still in place is embarrassing.

The government is doing a lot of good, but it could do a great deal more. The National Small Business Council (NSBC) was a well-intentioned initiative but it was a stillborn baby. Statutory organisations will play to His Master's Voice and an organisation that cannot bear criticism or interact positively with the community it is intended to serve will not have any effect.

A barrier to small business development is the Skills

Development Levies Act promulgated earlier this year. The imposition of such a levy across the board will translate into small businesses subsidising big business because, generally, it is the big business sector which needs to train employees for specific tasks, such as in information technology. Those employed in the SME sector learn their skills on the job. This may not have been the intention of the architects of the Skills Development Act and the subsequent Skills Development Levies Act, but this will be a sad, unintended consequence.

Labour legislation in South Africa does not encourage employment. Too many small businesses get tied up in the legalities of this legislation. Witness the case load of the Council for Conciliation, Mediation and Arbitration (CMMA) which hears grievances mostly from the small business sector, not from big business. The bureaucratic, time consuming experiences of small businesses who have been called to a CMMA hearing are demotivating and do not encourage employment.

Make it easy for the entrepreneur to start his own business and for him to employ others. One avenue would be permitting customised contracts, negotiated in the presence of an official of the Department of Labour, which would waive the onerous requirements of existing labour legislation such as the Labour Relations Act. This would encourage employment and provide an income for someone who would otherwise be out of a job.

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Points raised during open discussion...

- Two key issues emerge when reviewing government's initiatives so far: capacity and strategy. Both are seriously missing in Khula and Ntsika. South Africa did not have the advantage of learning the lessons of international best practice with regard to small business development and therefore scarce resource strategy is vital. A policy analysis conducted last year revealed that neither Ntsika nor Khula knew what its strategies were. Neither has a strategy to support micro-finance institutions or the LBSCs. Both institutions should be held to account against set benchmarks and targets.
- Collaborative relationships are vital to the success of small business development and structures to facilitate this between the public and private sector (NGOs) are necessary.

Alec Erwin said small, medium and micro enterprises were a difficult sector which will take

time to develop. The attrition and turnover rate is high. Government has made a clear and conscious choice: it will not be responsible for each and every enterprise it helps to set up.

The LBSCs are intended to be partnerships with NGOs; government will not pay the operational costs of these enterprises. The system is that government will give a start-up fund, but thereafter the enterprise has to be self-sustaining. If the system is to be successful, there have to be strong NGOs with a base in the community from whence they will draw their funding. The whole concept is a partnership. Government is looking to create a business sector, not an extension of government.

Whether the facts show that LBSCs are dying is another matter. A survey of the companies office shows that there has been a dramatic increase in the registration of small enterprises. The net gain



has increased over the past five years. Other evidence also shows this sector is growing rapidly.

Government cannot do away with all licensing laws, but can look into streamlining them.

There is a lot of information for small business, particularly with regard to training, on the DTI 'brain' website (www.brain.org.za) but the department needs to make this more accessible.

Temba Nolutshungu conceded that the SME sector was growing, but said it could double in size if the issues concerning the sector were addressed constructively.

- It is time for a reassessment of the SME sector and the impact made by government and the private sector in terms of quality, not numbers. Have the criteria used to accredit an LBSC been relevant, for instance. Government and business should not be asked to provide business training for the LBSCs which would be required to be passed on to those running small and medium businesses. What should have been done was to train the LBSC staff to do their tasks efficiently. Establishing yet another structure to be met by small business will not work.
- There has been little mention of the role of the private sector in the promotion of small business. By and large, the private sector has not appreciated the socio-economic and political significance of such a move. Due attention should be given to the role that the private sector can, should and must play.
- The key issue when discussing small business promotion is business capacity. If this basic issue is addressed, it will unlock the development of the SME sector.
- The small business regulatory review is an important project. Hopefully the law review structure to come out of this will be a semi-permanent body constituted in the main by people outside government.
- Necessary health, safety and traffic regulations should not be confused with discretionary licensing, a remnant of apartheid. Regulation of standards and operating criteria are necessary, but a bureaucratic interpretation of economic regulations and entry barriers is unacceptable.
- Surely the government is wasting money if it finances people who are not well trained for the job they hope to do? If an applicant cannot state his aims and objectives, or has no bookkeeping in place, he will fail. Alec Erwin said government would not chop and change policy. He was sceptical about the notion that entrepreneurs can be 'trained'. Support should be given, yes. This is the distinction that has to be made.

The DTI will interact with both government and outside groupings on the points raised by the regulatory review. This is part of the overall

process of economic reform, creating greater transparency, predictability, equity and simplicity. Equity is one of the fundamental principals government is trying to generate; equity of access, treatment and possibility. It is government's intention to remove discretionary licensing.

Important structural changes in the world economy reveal a new generation of SMEs. Medium enterprises which demonstrate innovation, flexibility and product development are growing in number. The information technology sector is an obvious area. South Africa's real weakness is its poor quality of basic education. It will take two decades to correct the structural problems in small and medium enterprise; this country is but a quarter of the way through this time span.

- The labour laws do not apply to those who operate as independent contractors. These people and/or companies are governed by the general laws of business. This in its own way adds flexibility to the labour market.
- Government has done well to target women in its encouragement of small business, but it has generally ignored the country's youth, particularly graduates. Young people want to be part of the policy making and transformation process, and part of the institutions and structures.

Bulelwa Belu-Toni said there are differences between a graduate entrepreneur and an employee. An entrepreneur with a degree would leap at opportunity, take an idea and run with it. An employee will wait for someone else to create that opportunity. She pointed out that citizens have responsibilities. As citizens, individuals should make an effort to be innovative and to create programmes that will engage young people. These programme proposals should be put not only to the DTI but to other departments which may have budgets to kick start them.

How can young people help government? There are numerous volunteer programmes where young graduates can get involved, gain experience and use it to their employment advantage. Regrettably, black South Africans do not have a culture of volunteering.

Alec Erwin said the Minister of Labour had identified at least 15 areas where the law may need to be adjusted to accommodate small and medium businesses. These pertained particularly to overtime, leave and working hours. There has been a dramatic

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change in the structure of employment with a huge increase in the area of sub-contracting. This makes it difficult for South Africa to peg its employment figures.

On the question of the youth, he said that when government talks to a person, it must be confident that it is talking to a representative group. Or it must accept that it is talking to individuals or certain interest groups. There are structures to accommodate youth representation in

Nedlac but they may not represent all the country's young people. On issues of advocacy, the better organised the group or organisation, the better government hears. South Africa's young people need to toughen their structures and movements. They were able to do this in difficult times; they should not collapse in easier times. Government is acutely aware of the problems of the youth, particularly unemployment.

Concluding remarks by chair Judi Hudson

Important issues have been raised in tonight's debate. Speakers have highlighted issues of capacity, strategy and the appropriate institutional form for promoting SMEs.

Government has taken steps to create a SME friendly environment since 1994. But is government doing the right things? Does it have the capacity to implement the agenda it has set for itself? Are the right mechanisms and institutions in place? How much delivery is actually taking place? What are the trade-offs that have been made? How is government measuring its impact in this area? What is actually going on at national, provincial and local levels?

Behind this set of questions lurks a more fundamental issue: should government be intervening in this area at all? Or should government's only role be to get

rid of legislation and regulations that inhibit entrepreneurs?

Many well-intentioned efforts to provide support to SMEs fail. It is important to understand the reasons for failure as well as unravel the reasons behind successful initiatives. What makes for a successful entrepreneur and the emergence of an enterprise culture? Can one train entrepreneurs? Is the emergence of entrepreneurialism the result of government programmes and/or private sector initiatives? Or is it more the impact of family and/or cultural values in the context of opportunity?

If South Africa is to promote a national climate that encourages and supports the growth of small and medium enterprises and entrepreneurs these questions need to be addressed as a matter of urgency.



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