

“The small business sector is both an engine of job creation and a site of innovation.” (Words: 4497)

1. Introduction

The current role of small, medium and micro enterprises (SMME's) in SA (Anon., 1994:1) was outlined by Dr Vusi Gumedi, a senior economist in the Policy Unit of the Presidency at a Wits-Ekurhuleni Symposium held in Brakpan. Gumedi said that the SMME sector makes up more than 95% of the total enterprises in the country, contributing more than half of employment and about 35% of gross domestic product. Indeed, according to Gumedi, small and medium manufacturing enterprises dominate economic activity in the manufacturing sector. “Calculations suggest that more than 90% of the number of manufacturing enterprises is small and medium in size, which means that more than 30% of manufacturing GDP and more than 40% of employment in the manufacturing sector can be attributed to these enterprises,” he noted.

However, it is believed that, despite the prominence of SMME's in South Africa's manufacturing sector and indeed in the entire economy, there are still a number of external and internal constraints that affect the performances of these SMME's. According to Gumedi, some of the main internal constraints confronting SMMEs include poor quality of products and services, a lack of skills, poor employee relations, a lack of finance, and a lack of planning. External constraints, he suggested, include high inflation and interest rates, a lack of access to market and customer information and stringent competition. As far as exporting is concerned, Gumedi noted that it is perhaps easier for small enterprises to break into foreign markets than to maintain their export activities. “Small and medium manufacturing enterprises can venture into exporting with relative ease if they are connected to another enterprise or an intermediary and also if they can access information about export markets.

However, Gumedi observed that enterprises are more likely to use suppliers, customers and industry associations to gather market-related information than government agencies, even though the latter may be better sources for information. "Enterprises should be encouraged to seek information from government, while government agencies should market their activities more effectively for the benefit of, especially small enterprises," Gumedi said (Bulletin, 2003).

2. Entrepreneur vs Small Business

Du Plessis(1995:5) researched the definition of the word entrepreneur by writing that the French root of the word "entrepreneur" comes from the term "enterprise" and is derived from the French word "entreprendre". The German equivalent term is "unternehmen", meaning "to undertake".

The popular meaning of the word entrepreneur is a person who undertakes risks to begin or maintain a productive operation, usually in an independent capacity.

An entrepreneur is an innovative person with a directed energetic drive with the objective of increasing economic wealth by being able to organize and control environmental variables, who moves in areas of uncertainty creating a risk taking environment and who is capable of coping with stress, strain and uncertainty.

The small business may be seen as the embodiment of the free enterprise system. It reflects the freedom of the entrepreneur in starting, running, building, curtailing or even discontinuing a business to his own advantage. It is accepted that the advantage the entrepreneur gains from the business, such as profit and progress, will eventually be a benefit to the whole community, on account of the investment and developing emanating from the circumstances. The growth in bug business often creates new developmental opportunities in the small business sector. Entrepreneurship is not at all the same as running a small business. Entrepreneurship is mainly concerned with the act and process of

creating a new business, whereas the term, small business, is usually used to refer to organizations already established and in operation. The two are interrelated, since entrepreneurship is the source from which all businesses spring. There are many definitions for a small business. Individuals, institutions and even countries have different views on what the small business really is.

According to Stonier & Hague (1964:316), the word entrepreneur is one which we have used before. It is not a pleasant word, but, compared with the alternative words 'undertaker' and 'enterpriser', it seems the most desirable. The entrepreneur has so far been regarded as a human calculating machine. We have assumed that he is the one person in the firm who hires factors of production and that his decisions are always based on an attempt to maximize profits. His chief aim is to avoid losing money. It is clear, therefore, that the entrepreneur is a special type of factor of production. He is the only factor of production whose duty it is to combine and organize other factors of production.

The entrepreneur can be considered as possessing marginal revenue productivity in just the same way as any other factor of production. What, then, is the function of the entrepreneur in the economic system? Why is he productive? Because typical entrepreneur of the nineteenth century was also the owner of the capital of his firm, economists confused the returns which he received qua entrepreneur with the money he earned qua capitalists. They didn't realize that the receipt of interest as a reward for waiting and the receipt of profit as a reward for taking the risks of business are not the same thing.

3. The Theories of growth and employment.

3.1. The Neoclassical growth theory

The Neoclassical growth theory focuses on capital accumulation and its link to savings decisions. We start by pretending that there is no technological progress.

This implies that the economy reaches a long-run level of output and capital called the steady-state equilibrium.

The steady-state equilibrium for the economy is the combination of per capita GDP and per capita capital where the economy will remain at rest, that is, where per capita economic variables are no longer changing, $\Delta y = 0$ and $\Delta k = 0$. It is reached at point A on figure1. The production function in per capita terms is written

$$Y = f(k).$$

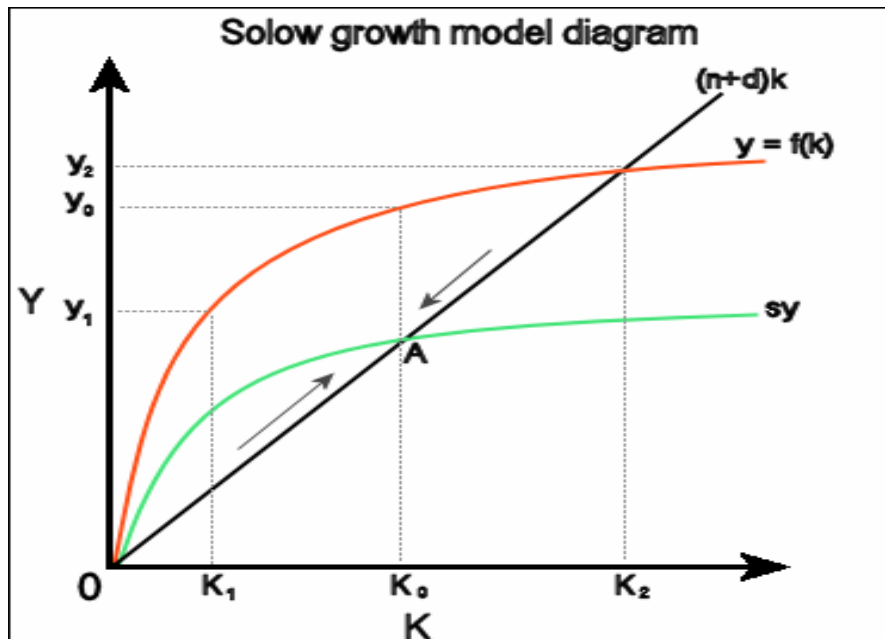
The economy is in a steady-state when per capita income and capital are constant. The steady –state values of per capita income and capital are those values where the investment required to provide capital for new workers and to replace machines that have worn out is just equal to the saving generated by the economy. If saving is greater than this investment requirement, then capital per worker rises over time and therefore output does as well.

The investment required to maintain a given level, k , of capital per capita depends on population growth and the depreciation rate, the rate at which machines wear out. Thus, the investment required to maintain a constant level of capital per capita is $(n + d)k$. We also assume that saving is a constant fraction, of income, so per capita saving is sy . Since income equals production, we can also write $sy = sf(k)$. The net change in capital per capita, Δk , is the excess of saving over required investment:

$$\Delta k = sy - (n + d)k$$

The steady state is defined by $\Delta k = 0$ and occurs at the values of K_0 . The key to the neoclassical growth model is that when saving, sy , exceeds the investment requirement line, then k is increasing, and therefore economic growth.(Dornbusch,Fischer & Startz, 2004:61).

Graph 1: The Solow Growth Model



Source: Wikipedia, 2007:1

3.2. The Endogenous Growth theory

The poor performance of neoclassical in illuminating the sources of long-term economic growth has led to dissatisfaction with traditional growth theory. In fact, according to traditional theory, there is no intrinsic characteristic of economies that cause them to grow over extended periods of time. The literature is instead concerned with the dynamic process through which capital-labour ratios approach long-run equilibrium levels. Any increases in the GNI that cannot be attributed to short-term adjustments in stocks of either labour or capital are ascribed to a third category, commonly referred to as the Solow residual. This residual is responsible for roughly 50% of historical growth in the industrialized nations.

According to the neoclassical theory, the low capital – labour ratios of developing countries promise exceptionally high rates of return on investment. The free-

market reforms impressed on highly indebted countries by the World Bank and the International Monetary Fund should therefore have prompted higher investment, rising productivity, and improved standards of living. Yet even after the prescribed liberalization of trade and domestic markets, many LCD's experienced little or no growth and failed to attract new foreign investment or halt the flight of domestic capital.

3.3. Supply – side Economics

The first interpretation, basic supply-side economics, is simply an application of classical and neoclassical economic theory to government policy-making. According to this view of supply side economics, government economic policies should focus on aggregate supply rather than on aggregate demand. As aggregate supply is the result of the economic behaviour of producers, they, rather than consumers, should be considered the driving force in the economy and their economic behaviour should be considered the most important determinant of the real and nominal economic activity.

As government economic policies can, and frequently do, have significant negative substitution effects (drive economic agents away from rational-welfare maximizing-economic decisions), they should be structured in such a way so as to minimize the substitution effect. If one follows this interpretation, supply-side economics is essentially no different from mainstream classical and neoclassical economics. It emphasizes the objective of efficient allocation of resources more than any other objective of economic policy and recognizes the importance of negative substitution effects of government economic policies and, particularly, of tax policies (Gandhi, 1987:5).

3.4. The Human Capital Approach

The analysis of investments in health and education is unified in the human capital approach. Human Capital is the term economists often use for education, health, and other human capacities that can raise productivity when increased. Analogy is made to conventional investments in physical capital: After an initial investment is made, a stream of higher future income can be generated from both expansion of education and improvements in health. As a result, a rate of return can be deduced and compared with returns to other investments. This is done by estimating the present discounted value of the increased income stream made possible by these investments and then comparing it with their direct and indirect costs. Of course, health and education also contribute directly to well-being, but the human capital approach focuses on their indirect ability to increase utility by increasing incomes. The impact of human capital investments in developing countries can be quite substantial (Todaro & Smith, 2006:380).

3.5. Employment Opportunities vs Educational Demands.

The amount of schooling received by an individual, although affected by many non-market factors, can be regarded as largely determined by demand and supply, like any other commodity or service. However, because most education is publicly provided in less developed countries (LDC), the determinants of the amount demanded turn out to be much more important than the determinants of supply. On the demand side, the two principal influences on the amount of schooling desired are (1) a more educated student's prospects of earning considerably more income through future modern-sector employment (the family's private benefits of education) and (2) the educational costs, both direct and indirect, that a student or family must bear. The amount of schooling demanded that is sufficient to qualify an individual for modern-sector jobs appears to be related to or determined by the combined influence of four variables: the wage or income differential, the probability of success in finding modern-sector employment, the direct private costs of education, and the indirect or opportunity costs of education (Todaro & Smith, 2006:450).

3.6. A 'General theory of employment'

The essential idea put forward in the General Theory is quite simple and we shall begin by explaining it. In the individual firm, employment depends on the entrepreneur's ideas about how many men he must employ to maximize profits. In the economy as a whole, employment depends on the decisions of all individual employers, added together, about how many men to employ in order to maximize profits. The main factors which determine the level of employment in the economy as a whole, Keynes calls aggregate supply and aggregate demand. At any given level of employment of labour, aggregate supply price is the total amount of money which all the entrepreneurs in the economy, taken together, must expect to receive from the sale of the output produced by that given number of men, if it is to be just worth employing them. In other words, the aggregate supply price, when any given number of men is employed, it is the total cost of producing the output made by that number of men (Stonier & Hague, 1964:400).

3.7. Technological progress and Capital accumulation

For well over a century economists have accepted the fact that the accumulation of capital is one of the crucial elements in economic growth. However, despite the pioneering work of J.A. Schumpeter, beginning in the 1900's, it is only in the last ten or twenty years that the role of technological progress has been widely accepted by economists. It is now agreed that, on the one hand, it helps to make possible a steady rise in productivity and, on the other, it sustains a continuing growth of demand.

Capital accumulation can lead to growth only so long as the labour force has not been fully equipped in accordance with the latest techniques, and so long as consumers have not been supplied with as much as they want of all existing

goods, at the prices and in the quantities determined by existing production methods (Stonier & Hague, 1964:380).

3.8. Theory of growth

According to Ghatak(1995:49) explains that the theory of growth, as stated by the classical write such as Smith, Mill, Malthus and Ricardo, can be described in a simple way. Given a certain amount of labour(and assuming, of course, the labour theory of value),at a certain level of production, wages will be paid to each worker according to the level of subsistence and any 'surplus' ,i.e. the difference between total production and total consumption which is assumed to be equivalent to the total wage, will be accumulated by the capitalist. Such accumulation will increase the demand for labour and, with a given population, wages will tend to rise.

4. The importance of SMME's

According to Van der Waal (2001:25), the importance of SMMEs for employment is enormous, both in industrialized, developed nations like USA or European countries, and developing countries. . There are other important contributing factors of the SMME's.

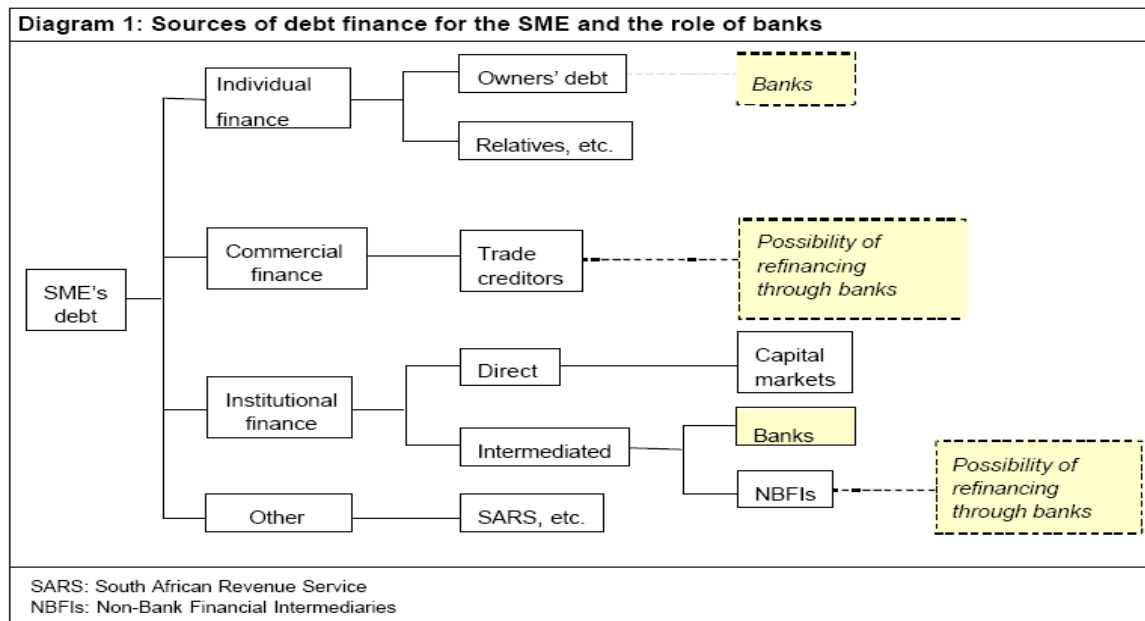
- SMMEs are important for the promotion of national and regional economic development
- SMMEs play a role in alleviating poverty and assessing those who are disadvantaged
- SMMEs play a role in promoting democracy and civil society
- SMMEs play a role in promoting a more flexible, innovative and competitive economic structure.

5. Interventions of facilitating SMME growth

Interventions aimed at promoting and facilitating SMME growth can be implemented at three levels, viz. micro, meso and macro.

1. Macro level is concerned with national policy and regulation, like the legal framework, taxes, interest levels and exchange rates.
2. At the meso level, interventions are aimed at developing the capacity of institutions, which provide services to small enterprises to enhance their efficiency, effectiveness and sustainability.
3. The micro level is concerned with the instruments, which are delivered directly by organizations to small enterprises.

6. Debt Finance and Role of banks



Source: Anon, 2005:82

It is also recognised, however that the tax system severely affects these types of business in so far as tax compliance is concerned. In addition, small businesses are highly dependent on working capital provided by the owners. When their profits are taxed owners often have to use short -term debt that increases their risk of exposure. To assist small enterprises through the tax system various options can be pursued including taxing enterprises at differentiated rates (e.g. a progressive corporate rate structure), tax incentives (e.g. tax holidays) and taxing these businesses on their cash flow.

The theoretical case for a cash-flow tax system is quite strong. One serious problem is the international consequences. South Africa, however, intends implementing cash-flow taxation in a particular sub-sector of the economy, namely the micro and small business sector, which functions mainly in closed economic environment. The international consequences of such a tax are therefore less acute. Limiting cash-flow and taxation to this sub-sector has the added advantage of improving its cash flow and capital requirements. On the negative side, cash-flow taxation increases the incentive for tax evasion and avoidance. The application of this form of taxation to a sub-sector of the economy will probably add to opportunities for tax arbitrage. These tax reliefs are thus mainly intended for manufacturing businesses and are aimed at promoting job creation and improving the cash flow of small businesses. (Black,Calitz,Steenkamp and associates, 2005:175)

7. A Review of small businesses

“As large enterprises have restructured and downsized small, medium and micro enterprises (SMMEs) have come to play an increasingly important role in South Africa's economy and development. The sector has grown significantly. In 1996, around 19% of those employed were in the informal sector of the economy. By 1999 this had risen to 26%. The government has therefore targeted the SMME sector as an economic empowerment vehicle for previously disadvantaged

people. As a result, SMMEs have received significant attention and investment, ranging from the establishment of state-initiated projects to supportive legislation, a variety of funding institutions and government incentives through the Department of Trade and Industry (DTI). The National Small Business Act, passed in 1996, helped to establish many of the supportive structures now in place.

According to Anon (2003:5), a discussion document reviewing the impact of the government's policies since 1994, there were 2.3 million people who owned at least one Value Added Tax (VAT) unregistered company. Of these, only 338 000 owners had employees, a total of 734 000. These numbers may raise the question of the job creation potential of these enterprises, but it also demonstrates the level of self-employment, a large portion of which may be survivalist. Data on small and medium enterprises suggests that these enterprises contribute about half of total employment, more than 30% of total gross domestic product. Also, one out of five units exported is produced in the small and medium sector in South Africa.”

Recent progress in small business development in South Africa is associated with an on-going wave of down or right sizing among large businesses. Small firms frequently face the challenge of survival and develop a sustainable strategy for growth. Historically, alliances (between big and small firms) have provided a means for firms to survive in highly uncertain environments, improve their ability to exploit complex business opportunities, spread risks, innovate and grow without increasing its payroll(Ahwireng-Obeng & Egunjobi, 2001:44).

7. SMME contribution towards GDP

The SMME sector contributes 42% to GDP. Approximately half of all people in formal employment are employed by SMMEs and 80% of the Department of Trade and Industry's R91m budget for enterprise

Table1: Contribution of SMME's to GDP by industry 2002 – 2004

	Manufacturing		
Medium and Large	65%	62%	62%
Very small & small	29%	30%	31%
Micro	6%	8%	7%
	Trade, hotels & restaurants		
Medium and Large	53%	49%	49%
Very small & small	27%	30%	31%
Micro	20%	21%	20%
	Total		
Medium and Large	65%	61%	60%
Very small & small	27%	30%	28%
Micro	8%	9%	12%
Year	2002	2003	2004

Source: Business Guidebook, 2003:5

8. Economic policies that Support SMME's

Policymakers ought to take heed of our uncertainty about the best target for the economy. Once a target is chosen, policymakers need to remember that we are unsure of the exact magnitude and timing of the effects of policy actions. Policymakers must account for the effects that policies have on the public's expectations of the future. A large country does not have the option of not having a macroeconomic policy. The government is always uncertain about how the economy will react to policy changes. In practice, governments work which econometric models of the economy in estimating the effects of policy changes. An econometric model is a statistical description of the economy or some part of it(Dornbusch,Fischer & Startz, 2004:181).

According to Anon (2007:1) there are economic policies that the government has put in place to assist small businesses to not only be established but to also be competitive internationally.

- **BEE** is a strategy that aims to increase black participation at all levels in the economy. It tries creates opportunities for black people because they didn't have them freely before. BEE redresses those imbalances of the past through ownership, management and control over companies and resources. Unfortunately it only benefits only a few individuals. In the Mail and Guardian online, an article was released that the Finance Minister Mr Manuel said that BEE needs an overhaul and review, there are abuses in the system.
- **ASGISA** has been another government initiative to improve job creation and reduce poverty. The target is to increase annual growth to average at 4.5% and higher between 2005 and 2009 and average growth should be

at least 6% of GDP between 2010 and 2014. The Deputy President recently came with the first report of the developments of ASGISA. One of the constraints is to look into the regulatory environment that could be unnecessarily hampering the development of businesses.

- The **DTI** and associated organisations have facilitated the initiatives that the government has made. These are the centre for Small business Promotion (CSBP), Ntsika Enterprise Promotion Agency and Khula Enterprise Finance. The CSBP implements and administers the aims of the national strategy. According to the DTI, an agreement has been signed with the European Union (EU). The EU has agreed to donate R550m to start a risk capital fund for SMME's. And industry development is spent on SMMEs. Ntsika receives R35m of this money, while Khula receives R20m.
- The **Fiscal Policy** from the National Treasury also makes a contribution towards the development of SME's. It is generally recognised that small and medium-sized enterprises are important for creating job opportunities in the economy.
- The **GEAR** (Growth, Employment and Redistribution) is a macro economic strategy that was adopted in June 1996 by the Department of Finance. Their objective is to address economic development, broadening employment, redistribution of income and socio economic opportunities in favour of the poor.
- The **RDP** (Reconstruction and Development Program) address the social and economic problems that

9. A view from the SMME's perspective

Small and medium enterprises in South Africa are alive, well and regard themselves as highly competitive. This is according to the SME Survey 2004. In percentage terms 1% say that they are extremely uncompetitive, 1% are somewhat uncompetitive, 12% say that they are neither uncompetitive nor competitive, 28% say they are somewhat competitive and 58% say they are extremely competitive. A startling 86% of the SMEs surveyed regard themselves as somewhat competitive or very competitive. A further 12% regard themselves as neither competitive nor uncompetitive. This leaves a mere 2% of SMEs who believe they are not competitive. (SME Survey 2004)

Another survey has been conducted in 2006 of which the focus of the research was around the following key areas:

- **BEE:** That Black Economic Empowerment is having an increasingly positive effect on the competitiveness of SMEs.
- **IT:** That the impact and role of IT has increased in importance over the past three years, and that IT has a significant impact on the competitiveness of SMEs in South Africa.
- **Enabling environment:** That the enabling environment for SMEs and entrepreneurship in South Africa is improving on a year-by-year basis, as the economy continues to show healthy growth.
- **Government:** That the role of government in fostering the competitiveness of SMEs has not improved significantly over the past two years. Financial
- **Services:** That financial services institutions continue to be major contributors to the enabling environment for SMEs was on the factors that

affect entrepreneurship in SA as well as the impact of IT and financial services on SME growth(SMME Survey,2006).

The findings of the survey were that the initiatives that government has tried to implement have not been very effective. SMME's cannot easily access resources and are not very competitive as they should be. Access to finance, skills and expertise is still a problem. This lack of access has a negative impact on the competitiveness of small businesses. Implementation of information technology (IT) is also needed.

10. Conclusion

South Africa has a great potential to grow even faster economically The current unemployment rate is 25.5% and it is very clear that SMME's have a great contribution to make to that growth. Although SMME's are only one of the many ways to contribute towards economic growth, it is still an important issue that the government needs to give great attention to.

The challenges that the government needs to look at are problems such as magnitude and contribution to the economy, equity finance, on-banking financial intermediaries, skills development, latest technology and access to banking services and information and access to capital markets. The current regulatory laws are seemingly restricting businesses to progress. South Africa needs more young entrepreneurs to step forward and be ambitious to start their own businesses and create more jobs. This can be achieved by encouraging young people to be more entrepreneurial from a young age. With the 2010 world cup around the corner, small businesses have an opportunity to get a good push forward and will then have to come with mechanisms for sustainability.

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