

**The New Growth Path:**  
**Small Business Sector**

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Small business is praised for its potential to create jobs and grow the economy. Do you believe that overall policy in the form of the newly released New Growth Path and the Industrial Policy Action Plan together with the budget support the development of small business in South Africa? Substantiate your answer with references to the relevant documents.

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“Any growth path must be judged not by the targets for job creation it sets, but by the instruments of macroeconomic management it adopts.” (NUMSA, 2011)

[ 2198 words]

## **1. Introduction**

Implemented late 2010, the New Growth Path (NGP) focuses primarily on employment creation as its pinnacle crux, with the vision of 5 million jobs being created by 2020 (New Growth Path, 2010:8). Analogous to its predecessors (RDP, GEAR and AsgiSA), the NGP sets out multiple ambitious targets, much to the scepticism of many economic debates.

This essay will prove to contend that the NGP and its ancillary initiatives will substantially support the development of small business, and consequently aid in economic growth and job-creation. Firstly, a background of the small business sector will be provided in order to assert the relevance of the sector as a key driver of the economy. Then an analysis of the micro- and macro-economic policies will be provided, focusing primarily on the effect the policies have on small business. International comparisons will also be made, with the case of Brazil, a key BRICS member. Finally, alleged drawbacks of the NGP will be rebutted; some with the aid of the projected rand-dollar exchange rate *vis-à-vis* the minimal effectiveness of the NGP.

## **2. Background**

Small business in South Africa is incorporated in the collective category: Small, Micro and Medium Enterprises (SMME) (Ntsika, 1999:16). The SMME sector in South Africa comprises a significant contribution to both economic growth and employment.

The sector currently boasts a 30% contribution to national GDP (Herrington, 2007). It also accounts for 73% GDP in the community, social and personal services category, and a prominent contribution (approximately 60%) to agricultural, trade and construction industries (Herbst, 2001:111). Furthermore, small business contributes 61% of total national employment (Herbst, 2001:112).<sup>1</sup>

Strong evidence certainly suggests of the potential influence that small business has on the success of the NGP. To date, it has been argued that small businesses are not adequately playing their expected role in the economy (Agupusi, 2007). This is due to a number of constraints, *viz.* policies which do not sufficiently deal with the semi-formal and informal business sectors, and the restrained capital allocations given by government institutions such as the Khula Fund and the Industrial Development Corporation (IDC) (Agupusi, 2007). With the revision of these drawbacks under the NGP, small businesses now certainly have an increased potential to be a greater engine for economic growth and employment creation.

## **3. NGP Policies: Micro- and Macro-environment**

In order to establish the strength of the NGP, it is necessary to study the various micro- and macro-environment policies which form the basis of the policy document. The fundamental policies include (but not limited to): competition, infrastructure, trade, procurement, financing and tax relief.

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<sup>1</sup> Estimates are subject to variation due to poor SMME data collection prior to year 2000. See Ntsika (1999:61)

### 3.1 Competition

The first identifiable manner in which the NGP proves to favour SMME-generated economic and employment growth is through its competition policy. In the president's State of the Nation Address (2012), strong attention was directed to policy developments with a high domestic focus. Much to the benefit of SMMEs, the NGP has adopted a more pro-active stance by reiterating the need for a stronger domestic competition policy. The promotion of fair competition, including more stringent laws and financial consequences against anti-competition, is inherent to the success of small business (Etro, 2007a). The NGP's adapted<sup>2</sup> competition policy signals a greater effort to prevent price fixing, market division and collusive tendering, which often marginalises small businesses out of markets (Alexander, 2004:136).

One can further find indications of the success potential of the policy: Kampel's (2004)<sup>3</sup> recommendations of the dire need to improve on the effectiveness of the prior competition policy, in relation to its time- and cost-constraints as well as its inaccessibility against small business, extensively form the basis of the adapted NGP policy. Advocates of competition argue that the adapted policy will remarkably break the barriers-to-entry into markets for SMMEs (Lake 2011:5). SMMEs will further benefit due to an increased economies-of-scale, resulting in more globally competitive SMMEs (NIPF, 2004).

### 3.2 Trade Policy

SMMEs are further supported to advance the goals of the NGP through the trade policy. The NGPs trade policy is focused on (a) promoting exports, (b) tackling unfair competition against domestic producers, and (c) assisting new activities to achieve competitiveness (New Growth Path, 2010:17). A review of the trade policy by The Task Group of the Policy Board<sup>4</sup> (2011) estimates that SMMEs will contribute over 50% of GDP by the year 2020, indicating a 20% increase in the expected impact SMMEs will have on economic growth.

### 3.3 Local Procurement

Under the Preferential Procurement Policy Framework Act (PPPFA), the NGP prescribes local procurement by public entities in an attempt to promote domestic production (New Growth Path, 2010:17). To the benefit of SMMEs, as further stated by Rogerson (2004:25), local procurement will provide trade and employment opportunities for small business, and further facilitate social and economic development. The benefits of local procurement include the promotion of heightened domestic competition and innovation (Thai, 2007b), which increases the efficiency of the economy. An increase in efficiency will certainly lead to further economic growth. In addition, Dodgeson *et al.* (2005) describes local procurement as a job-driver for small business, which can further reduce the distributional inequalities faced by society. Local procurement as a policy instrument will drive small business to amplified

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<sup>2</sup> Adapted from the Competition Amended Act [No. 15 of 2000]

<sup>3</sup> See *"The Role of South African Competition Law in Supporting SMEs"* (2004)

<sup>4</sup> The Task Group's estimations point to a probable contribution to GDP of more than 50%. See *"A SUPPLY-SIDE REGULATORY REVIEW – By The Task Group of the Policy Board for Financial Services and Regulation"* (2008)

profitability, output and employee growth, with more than 40% of small businesses projected to expand (Kruger, 2011).

### 3.4 Payment Policy

To cure the prolonged cash-flow problems faced by many small businesses, public entities are now required to provide payment within 30 days to all local suppliers (New Growth Path, 2010:21). Evidently, as argued by Rogerson (2004:26), such a payment policy protects the interests of small business and places them at an advantage within the domestic environment, enabling them to contribute significantly to GDP and participate as a key driver of employment. With over 35.7% of SMMEs in the Free State province alone experiencing cash-flow related failures (FS Provincial Profile, 2005:119), the policy is indeed a step in the right direction. Additionally, “name-and-shame” consequences increase the level of impact the policy has (*pro* small business). Name-and-shame strategies have proven to be an effective tool in policy implementation over the past decade (Beck, 2008).

### 3.5 Financing

Under the auspice of the NGP, the Industrial Development Corporation (IDC) has substantially increased its capacity for lending to local firms and key job drivers over the next five years to over R10 billion (Patel, 2012:2). Reported by Statistics SA (2009), 61.1% of small business owners require start-up capital, with only 15.5% obtaining loans. The South African Yearbook (2000:256) further cites that between 70% and 80% of SMMEs in South Africa fail, due largely to limited access to finance (see appendix: Figure 2 & Figure 3). Further findings by Sweeny *et al.* (2006) indicate that 56% of SMME’s still require funding three years after start-up (see Figure 1 below).

Figure 1: SMME Prolonged Access to Financial Problems

Problems with access to finance at start-up?	Problems with access to finance 3 years after start-up?					
		Yes		No		TOTAL
Yes	10	56%	8	44%	18	100.0%
No	0	0%	12	100%	12	100.0%
TOTAL	10	33%	20	67%	30	100.0%

Sources: Sweeny, Williams and Anderson, 2006

In the second budget of the EDD, Minister Ebrahim Patel proposed an increased R219, 4 million for small business funding, through transfers to Khula and the South African Micro-Finance Apex Fund (SAMAF). The increase in funding opportunities for SMMEs will, as argued by Sweeny *et al.* (2006), support the growth of the sector by incentivising small business owners to start and/or expand their business. Further notable reductions in the failure rate of SMMEs can be anticipated (Rogerson, 2004:56). Ultimately, the increased funding opportunities will encourage unemployed people to move into self-employment (Mangat, 2012), further increasing the number of profitable projects being established.

### 3.6 Single Funding Agency

The NGP assures a single SMME funding agency through the consolidation of Khula, SAMAF and the IDC (New Growth Path, 2010:21). In the 2009 Global Entrepreneurship Monitor Report, Brazil<sup>5</sup> was ranked the sixth most entrepreneurial country, compared to South Africa's thirty-fifth ranking. The Trade and Industrial Policy Strategies Report (TIPS, 2008:143) also found that South Africa's array of funding agencies, in comparison to Brazil's single agency, produced a lack of co-ordinated strategies and was "confusing for both business owners and government". Drawing on both the findings of TIPS and the success of Brazil (a high performing BRICS and IBSA partner), the NGP adopts a single-agency policy which has proven to be successful. As further argued by Timm (2011), the establishment of the consolidated agency will lead to greater efficiency and result in the NGP policies having a larger impact on small businesses. The co-ordinated effort of a single agency will lead to greater market penetration and synergy presented by small businesses, ultimately increasing the success rate of SMMEs as is experienced by Brazil.

### 3.7 Tax Relief

Further support in favour of small business is given by the Finance Minister in the 2012 Budget Speech. Key features of the budget speech pertinent to small business include (a) tax-relief and simplified tax-structure for small business, (b) tougher customs trade environment to combat under-valuation of imports, and (c) initiation of a Competitive Enhancement Programme (CEP) as part of IPAP.

Benefits of the CEP originate largely from the programmes focus on agro-industries which are not only key job drivers, but also mainly run by small businesses. Hence small businesses will be able to gain greater command over scarce resources, improve on their productivity, product quality, and gain access to international markets (Lester, 2012).

The benefits of the tax relief result from cost-reductions which will improve the cash-flow woes of many small businesses (Sweeny, 2006). Essentially, SMMEs will pay a reduced tax bill in a tiered manner (Collin, 2012). The simplification of the tax system also reduces the administrative burden faced by small business, which now need to submit two (previously eighteen) tax returns (Gordhan, 2012:15). Bannock (2005) argued that the prior tax system was non-conducive for the growth of SMME's, and the red-tape imposed had a detrimental effect on their opportunities to expand. Evidence of the success of a similar tax relief policy (though it contains several more items) is given by the Small Business Tax Relief in America. Since approval by Senate in 2010, American small business owners continue to grow their businesses and create jobs (Gustafson, 2011:6), which is the envisioned success of the South African tax relief.

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<sup>5</sup> Brazil and South Africa share similar developmental and economic traits. Brazil's SMME sector contributes 22% GDP and 59% national employment. See *"How South Africa can boost support to small business: Lessons from Brazil and India"* (2009)

### 3.8 Infrastructure

Support to small businesses is sustained by the NGPs infrastructure policy. The NGP public investment policy is predominantly focused on the construction of new infrastructure (New Growth Path, 2010:21). Lehohla (2002:67) argues that important infrastructural elements are necessary to the success of small business. Olawale (2010:732) further indicates that “the quality of infrastructure can affect the growth prospects of new SMMEs, especially in a developing country such as South Africa”. With increased investments in infrastructure, efficiency across the economy will be improved (Lehohla, 2002:68), providing a sustainable environment for the growth of SMMEs.

## 4. Rebutted Shortfalls

Much to no surprise, the NGP has been plagued with a remarkable level of scepticism. Some of these alleged failures include (a) the ambiguous loose monetary policy and (b) the negative correlation between economic and employment growth.

### 4.1 Loose Monetary Policy

The most significant ambiguity of the NGP lies heavily in its macroeconomic policies. The NGP is rooted around a restrictive fiscal and looser monetary policy, with the aim of a “more competitive exchange rate and reduced investment costs through lower real interest rates” (New Growth Path, 2010:16). However, the prescriptive “looser monetary policy” raises an eyebrow on the independence of the South African Reserve Bank (SARB). Argued by Lings (2012), the success of the macro-economic policy will be limited: unless the government exercises control over the SARB in the future, there is no clear mechanism on how the rand will be weakened. In light of the above-mentioned ambiguity, analysis of the rand-dollar exchange rate by prudently assuming that SARB maintains its independence and rejects the prescription of the NGP (but continues to accumulate foreign currency reserves as is currently doing), we note that the exchange rate will still prove to be competitive and advantageous to small businesses (see appendix: Figure 4). We can only find that, ignoring market externalities, should the recommendations of the NGP be considered by SARB this will lead to an even more competitive exchange rate (Stevenson, 2012:9). Thus small business will benefit from exports being internationally competitive, and gain an advantage over the lower real interest rate which will substantially reduce the cost of borrowing.

### 4.2 Economic Growth and Employment Creation

The NGP places economic growth and increased employment as a mutual goal. However, Van Tonder *et al.* (2011) argue that there exists a weak translation of economic growth into employment creation due to employers developing a preference for capital over labour. In order to counter the preference for capital, it is necessary that government focuses heavily on labour-absorbing industries. Firstly, the NGP (and IPAP) focuses its efforts on labour-absorbing job drivers such as infrastructure, agriculture, and mining. As ascertained by Tregenna (2009), these industries have a historically high labour-capital ratio (see appendix: Figure 5). This indicates their sustained preference for labour over capital, as output increases. Furthermore, Lighthelm and Cant (2003) contend the nature of small business by its labour intensiveness, which is conducive for employment creation in South Africa. Thirdly, Lewis (2001) extrapolated other factors necessary for SMME employee growth (see

appendix: Figure 6). These factors, which have been emphasised by the NGP, highlight the achievable mutual goals imposed by the NGP. Finally, a study of the OECD countries conducted by Thurik (1999) indicated a strong link between high business ownership and higher growth of employment in the economy. All in all, evidence sufficiently refutes the claim of a weak (or negative) correlation between economic and employment growth.

## **5. Conclusion**

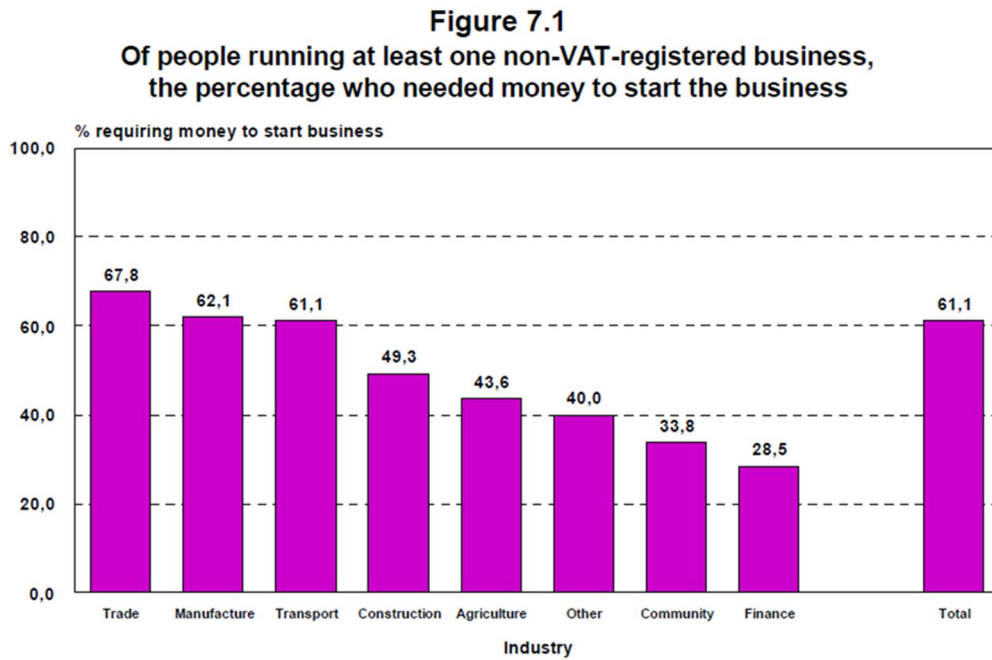
This essay assessed the feasibility of the NGP by largely considering the potential economic impact it could have on the small business sector. As ascertained by the research included, the NGP policies will result in an envisioned 40% SMME growth. Furthermore, the tougher trade and competition policy will result in an increased SMME contribution to national GDP and employment.

The essay hence finds that the policies of the NGP prove to favour the SMME sectors ability to create both employment and economic growth.

Contrary to the pessimism surrounding the NGP, it is recommended that the NGP be fully adopted by the economy. The joint effort of both private and public bodies will indeed ensure that the once “unrealistic” goals of the NGP become South Africa’s living reality, with employment creation being the central indicator of the success of the NGP.

6. Appendix:

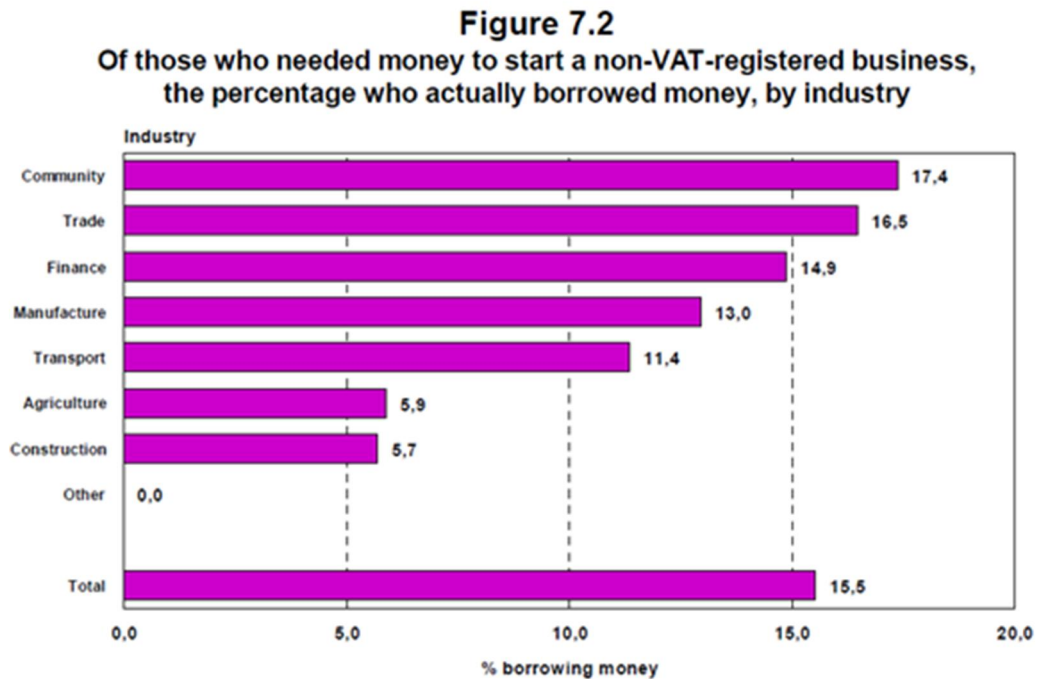
Figure 2: SMME's requiring start-up capital:



Source: Stats SA Survey of employers and self-employed  
Note: If owners run more than one business, only the main business is included.

Source: Statistics SA (2006)

Figure 3: SMMEs who obtain funding



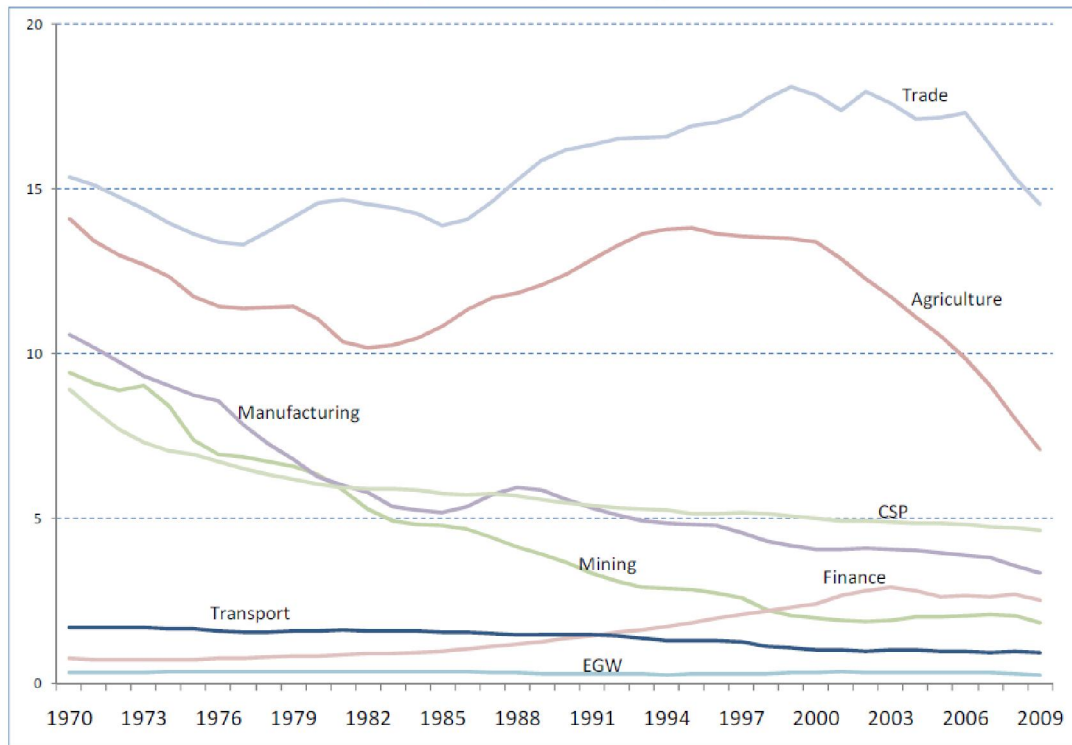
Source: Stats SA, Survey of employers and self-employed  
Note: If owners run more than one business, only the main business is included.

Source: Statistics SA (2006)



Figure 5: Labour-Capital Ratio, per industry

Figure 3: Labour-Capital ratio by major sector, excluding construction, 1970-2009

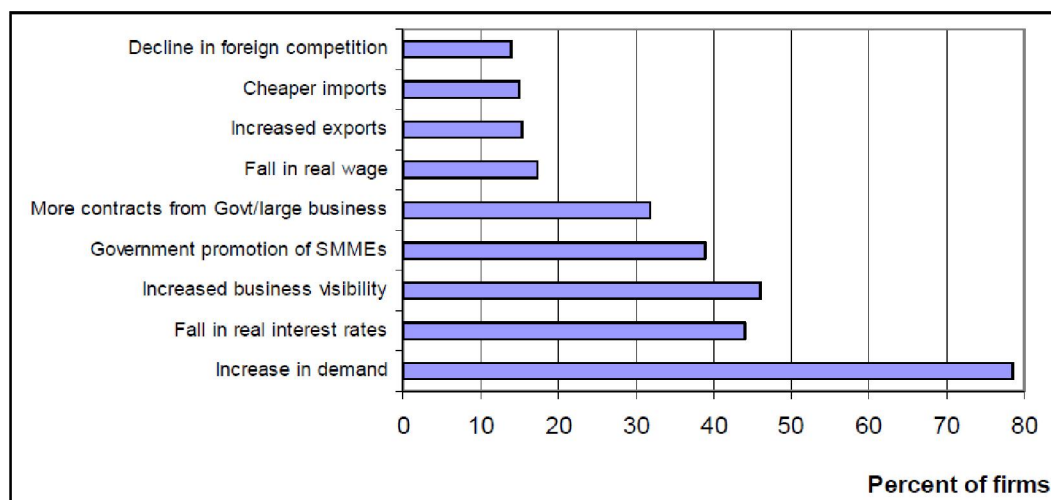


Note: calculated in constant R2000 prices. Mining = mining; Manufacturing = manufacturing; EGW = electricity, gas and water; Construction = construction; Trade = trade, catering and accommodation services; Transport = transport, storage and communication; Finance = financial intermediation, insurance, real estate and business services; and CSP = community, social and personal services.

Source: Tregenna (2009)

Figure 6: SMME growth factors

Figure 3.4: Necessary Conditions for SMME Employee Expansion



Source: Lewis (2001)

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