SME SOUTH AFRICA

AN ASSESSMENT OF SOUTH AFRICA'S SME LANDSCAPE

Challenges, Opportunities, Risks & Next Steps

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In On Africa (IOA) is one of the leading Africa-focused research, consulting and publishing firms, based in Africa and focused solely on Africa. IOA was founded in 2007 and aims to ensure data-driven decision-making through quality research and analysis. IOA offers a wide range of services to help clients to better understand Africa and to accelerate growth on the continent.

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SME South Africa, a division of Adclick Africa, commissioned Africa-focused research consulting firm In On Africa (IOA) to conduct a comprehensive assessment of the state of SMEs in South Africa, with a focus on the key challenges, opportunities, risks and proposed next steps. This publication has been compiled by IOA for public release by SME South Africa, and presents a summary of the key findings from this research.

The research was conducted from IOA's offices in Johannesburg and through a web survey with more than 1,000 SME owners across the country. While IOA, SME South Africa and Adclick Africa believe that the information and opinions contained herein are reliable, they do not make any warranties, express or implied, and assume no liability for reliance on or use of the information or opinions contained herein. Furthermore, IOA, SME South Africa and Adclick Africa indemnify themselves from unforeseen errors due to certain sources being gathered from third parties.

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Background

The small business sector in South Africa is a critical part of the national economy. In 2018, the national unemployment rate has grown to 27.2%[1] and more than 250,000 jobs have been lost in three key South African industries (manufacturing, community work and trade).[2] Government is therefore looking to small businesses in its efforts to achieve the 2030 National Development Plan (NDP) objective of creating 11 million new jobs by 2030.[3]

However, SMEs continue to struggle in South Africa due to a wide range of challenges, and their survival rate is concerningly low. In 2016, most small businesses in South Africa (including micro businesses) did not survive beyond five years.[4] The rate of survival beyond 3.5 years – what the Global Entrepreneurship Monitor (GEM) identifies as the length of time required to become established – is similarly poor.[5]

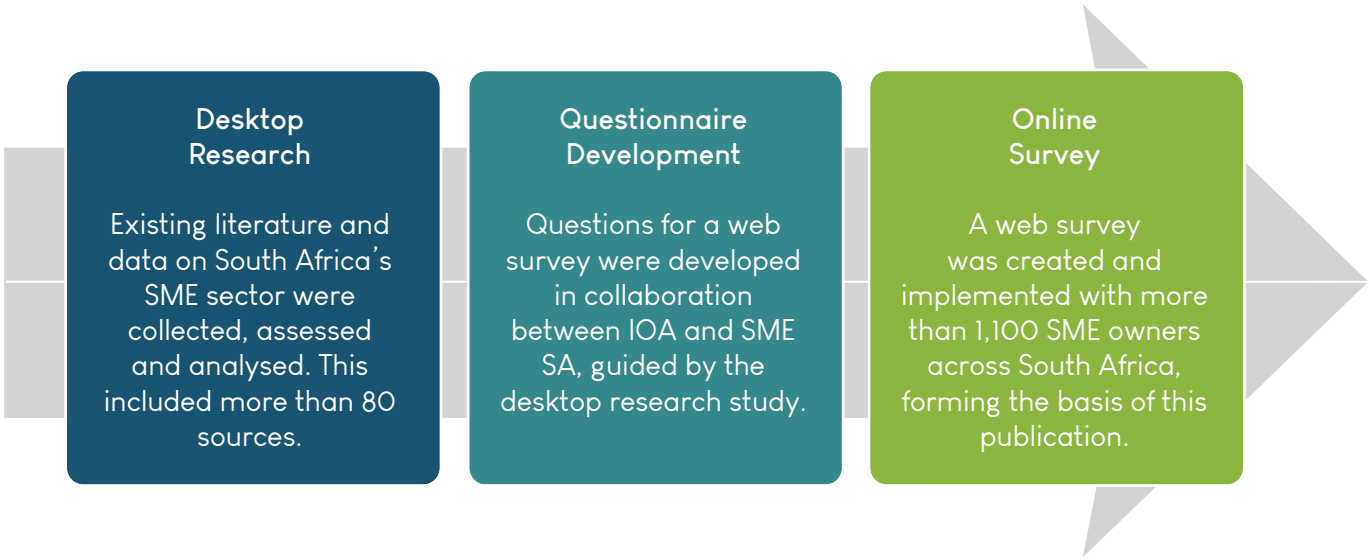
It is within this context that SME South Africa has recognised the critical need to support and develop the SME sector. In order to better understand the challenges and opportunities in the sector, SME South Africa partnered with research and publishing firm, In On Africa (IOA), to conduct research on the state of small businesses in South Africa.

The research highlights the reality of SMEs that are often neglected yet are an essential component of the economy. These are small businesses that are in their early years of establishment, do not receive enough support and funding opportunities. As such, they struggle to generate enough revenue to keep afloat in tandem with employing more people.

This publication presents a summary of the key findings and recommendations from this research, aiming to serve as an important resource to help inform future decision-making in the SME sector.

Methodology

The study included both desktop and primary research, and was conducted between May and August 2018.



[1]'SA's unemployment crisis in numbers', Engineering News, October 2018. http://www.engineeringnews.co.za/article/sas-unemployment-crisis-in-numbers-2018-10-02/rep_id:4136
[2]Head, T. 'Jobs Summit: Six alarming figures on South African unemployment rates', October 2018. https://www.thesouthafrican.com/jobs-summit-unemployment-south-africa/

Sample Summary – 1,157 South African SME Owners

47% OF SMEs EMPLOY 2-5 PEOPLE

39% OF OWNERS ARE THE ONLY EMPLOYEE

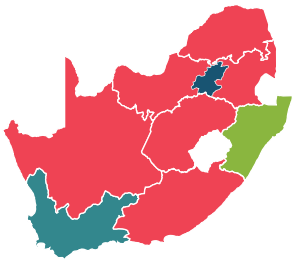
13% OF SMEs EMPLOY >5 PEOPLE

MALE **52%**

FEMALE **47%**

*1% PREFER NOT TO SAY

56% OF SMEs ARE LOCATED IN GAUTENG



11% Western Cape

9% KwaZulu-Natal

24% Other Provinces

59% OF SMEs LESS THAN 3 YEARS OLD

*26% of SMEs are 3-5 years old

19% CONSULTING

14% CONSTRUCTION

13% FOOD & BEVERAGES

12% MANUFACTURING

71% OF SMEs GENERATE A TURNOVER OF <R200 000

20% OF SMEs GENERATE R200 000 - R1MILLION

BLACK **72%**

WHITE **12%**

9% COLOURED

5% INDIAN

*2% PREFER NOT TO SAY

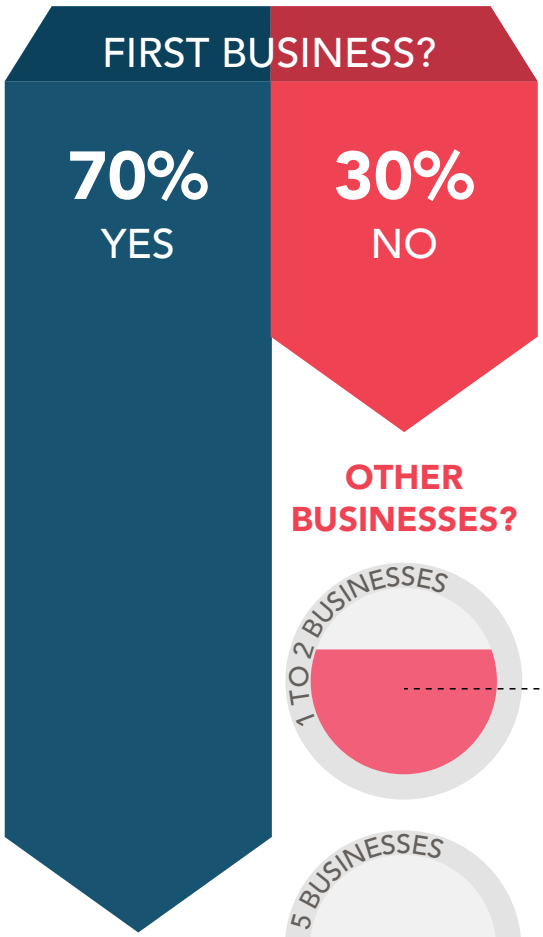
[3]Tandwa, L. 'ANC's Jeff Radebe insists it will reach its 2030 NDP targets', news24, July 2017. https://www.news24.com/SouthAfrica/News/ancs-jeff-radebe-insists-it-will-reach-its-2030-ndp-targets-20170702

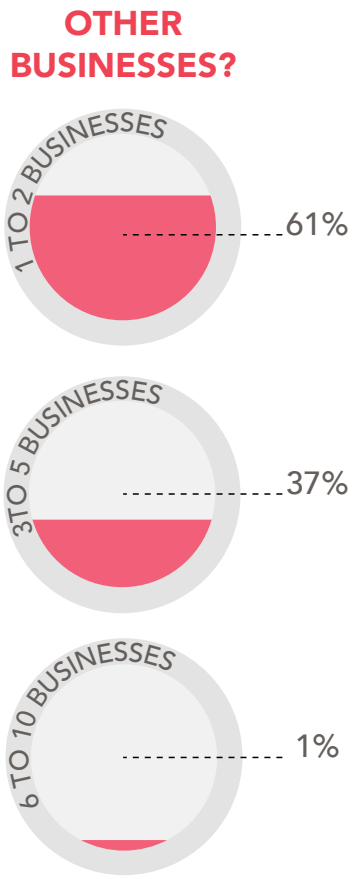
[4]Friedrich, C. 'Why do 70% to 80% of Small Businesses Fail Within Five Years,' MoneyWeb, December 2016. https://www.moneyweb.co.za/mybusiness/why-do-70-to-80-of-small-businesses-fail-within-five-years/

[5]'Global Report 2017/18'. Global Entrepreneurship Monitor (GEM), April 2018. https://www.gemconsortium.org/report/50012

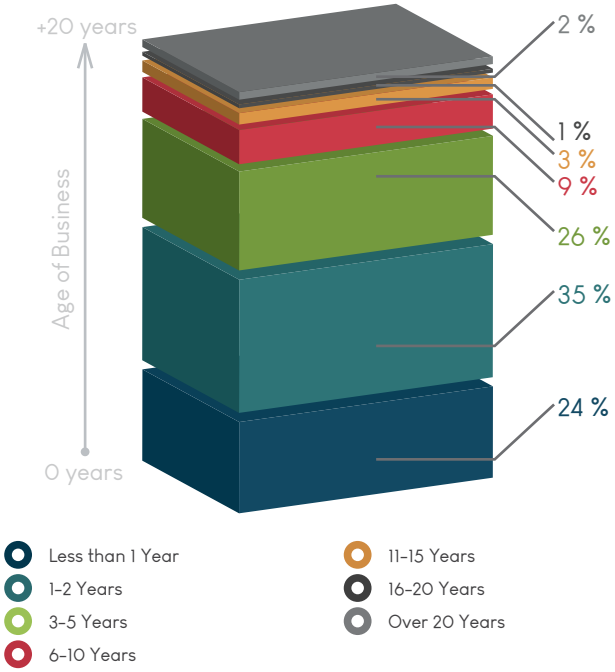
In comparison to other sub-Saharan African countries, South Africa has one of the lowest rates of established businesses.[6] This reality of a landscape of relatively young businesses is reflected in the findings of our survey of SME owners in South Africa.

Many of the SMEs (39%) that were surveyed are 1-(wo)man operations, while close to half (47%) employ 2-5 people. These results suggest that SMEs in the country may currently be contributing less to local employment than what has been reported in other studies.





The SMEs were predominately very young, with around 60% of owners noting operation for less than 3 years. For the most part, SME owners were operating their first business (70%).



In line with our results, research by the Small Business Institute (2018) reports estimates that are considerably different to what is commonly believed about the contribution SMEs make toward the economy. More specifically, initial findings of their study on SMEs purports that the small business sector only employs 29% of South Africans.

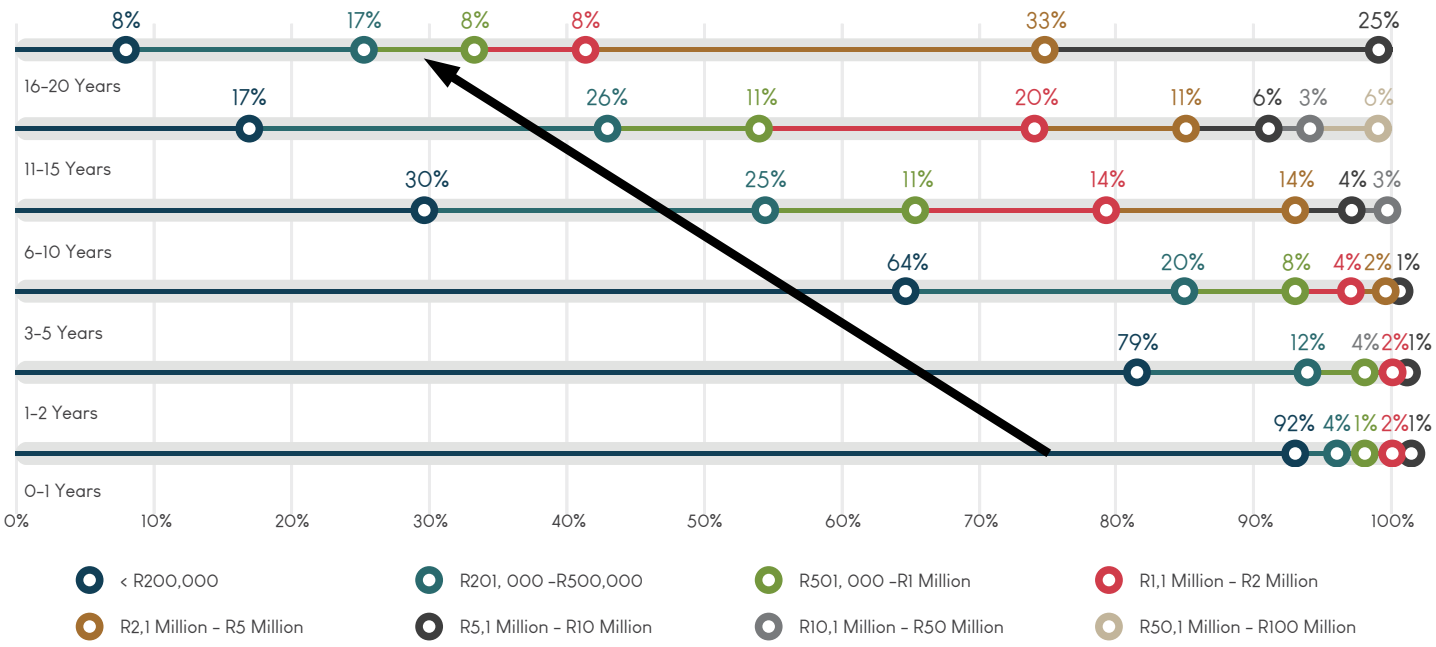
[6] Herrington, M., Kew, J. & Kew, K. 'The Crossroads: A Goldmine or a Time Bomb?' Global Entrepreneurship Monitor, 2014. http://www.academia.edu/30312979/2014_GEM_SOUTH_AFRICA_REPORT_South_Africa_The_crossroads_a_goldmine_or_a_time_bomb

Maturity VS Employment and Turnover

The majority (71%) of our survey respondents operate small businesses that generate a revenue of under R200,000 annually. Coupled with the fact that almost 60% of SMEs surveyed have been in operation for less than three years, it is understandable (and highly relevant in the context of South Africa's high unemployment) that SMEs report fairly limited employment numbers. As is illustrated in the two graphs below, the age of a business is closely linked to its revenue and, therefore, also to the number of employees. The potential for job creation grows as a small business matures. This paints a positive picture of the role of small businesses in helping to create jobs, and demonstrates the importance of ensuring that SMEs receive the necessary support early on (i.e. in the first 3-5 years) to mature to a stage where they are equipped to significantly contribute to job creation.

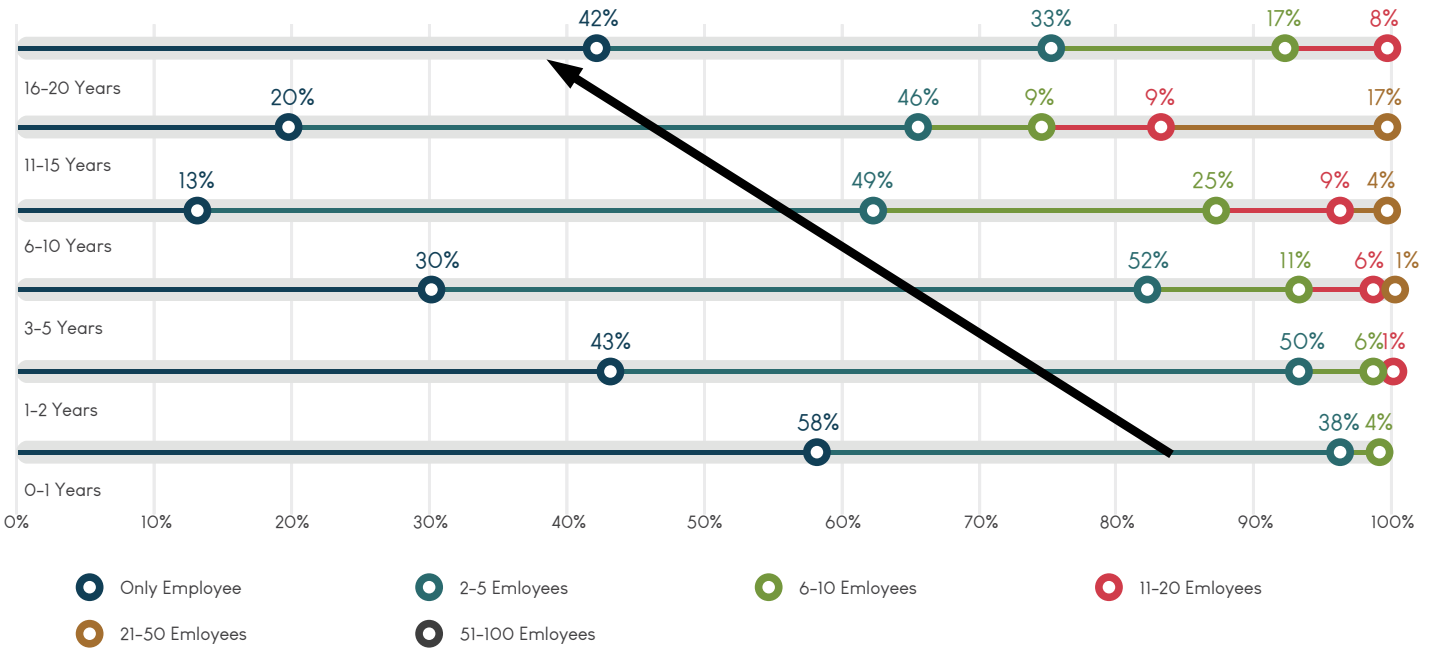
Age of business VS Annual turnover

% share of survey sample



Age of business VS Number of employees

% share of survey sample



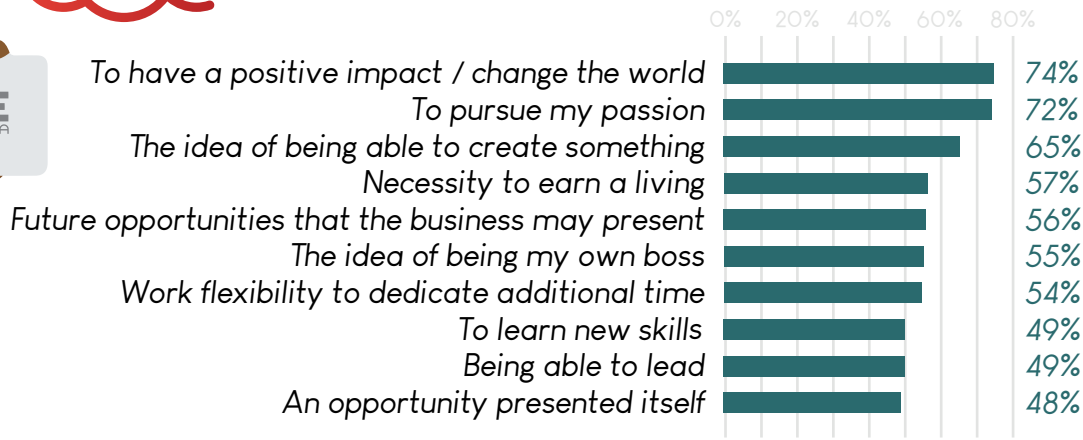
Nature of Entrepreneurship

With most SME owners starting their businesses out of idealistic and intrinsic reasons, the support mechanisms that exist should encourage this drive of SMEs to positively impact the world around them.

Reasons for starting a business

% share of survey sample

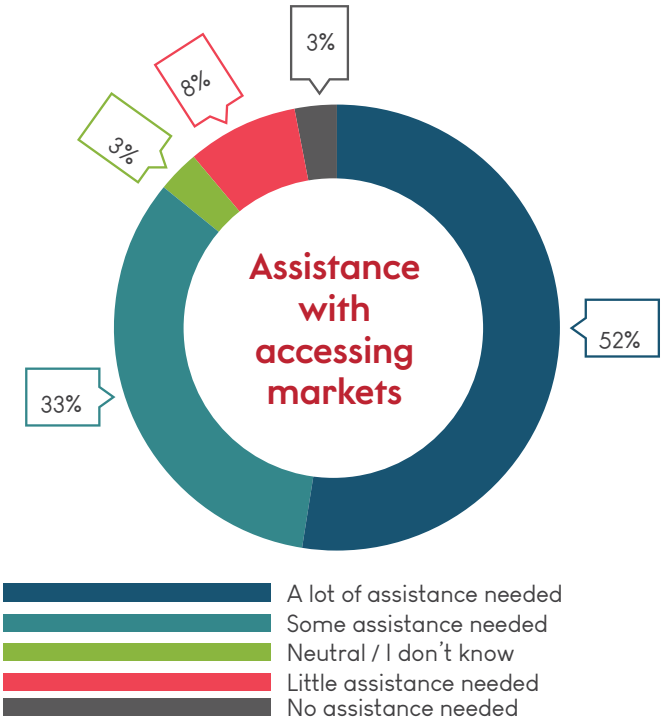
Respondents could choose multiple reason options

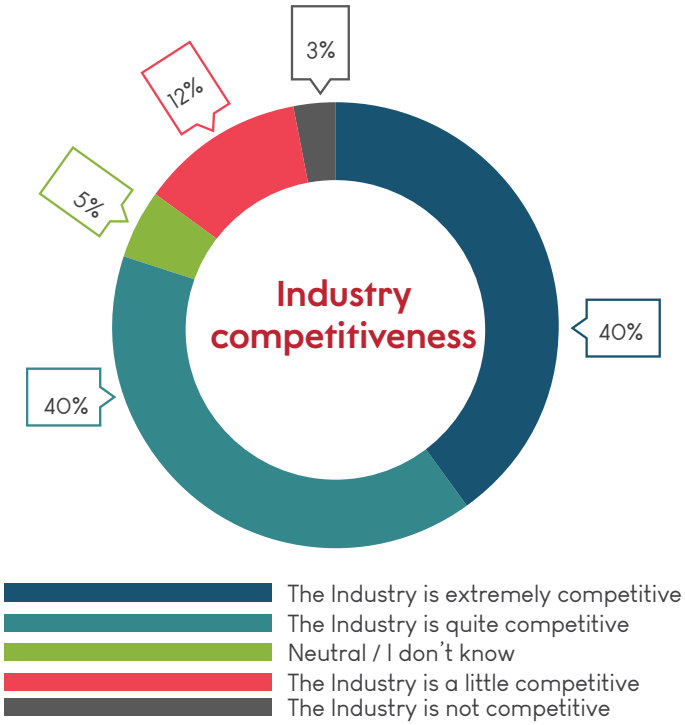


Market Access & Competitiveness

SMEs in South Africa tend to have limited market access.[7] This was clearly illustrated by survey respondents in relation to areas of support that is needed, for which "access to markets" was selected by a total of 85% of respondents.

SMEs are currently operating within highly competitive business environments, and given the current state of South Africa's economy and the level of unemployment, this will likely continue for the foreseeable future.





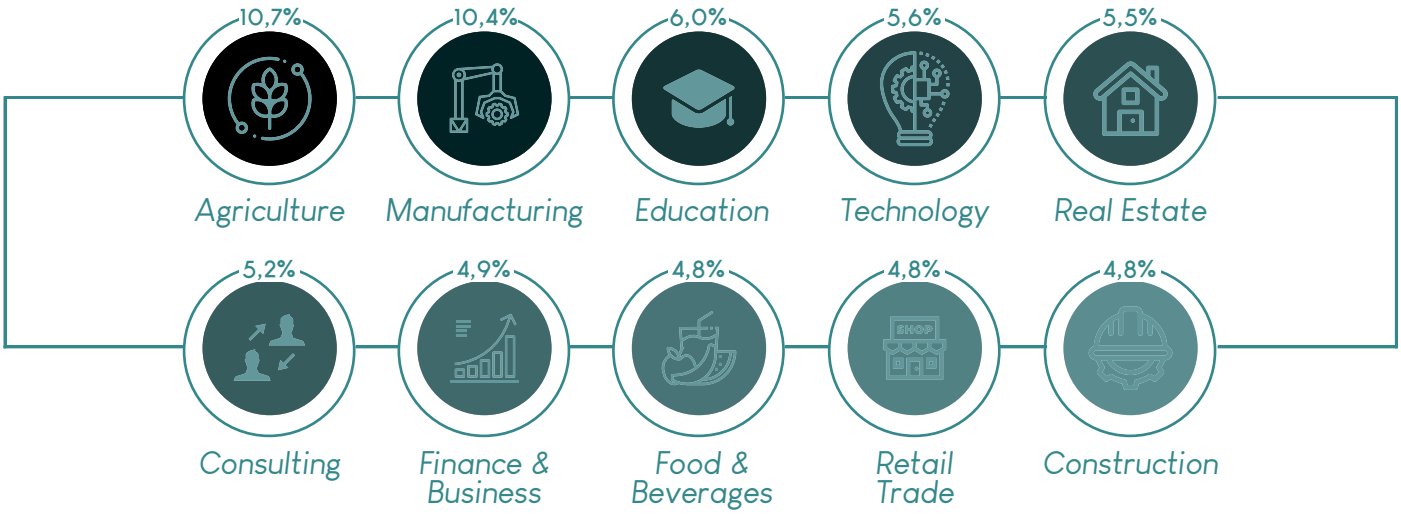
[7] 'Market Access Vital for SME growth', Fin24, 2015. https://www.fin24.com/Entrepreneurs/News/Market-access-vital-for-SME-growth-20150527

SME Expansion Opportunities

When asked which industry/sector SME owners might expand into, they were most drawn to agriculture and manufacturing, followed by education, technology and real estate.

Top 10 sectors / industries that SME owners would like to expand into

% share of survey sample



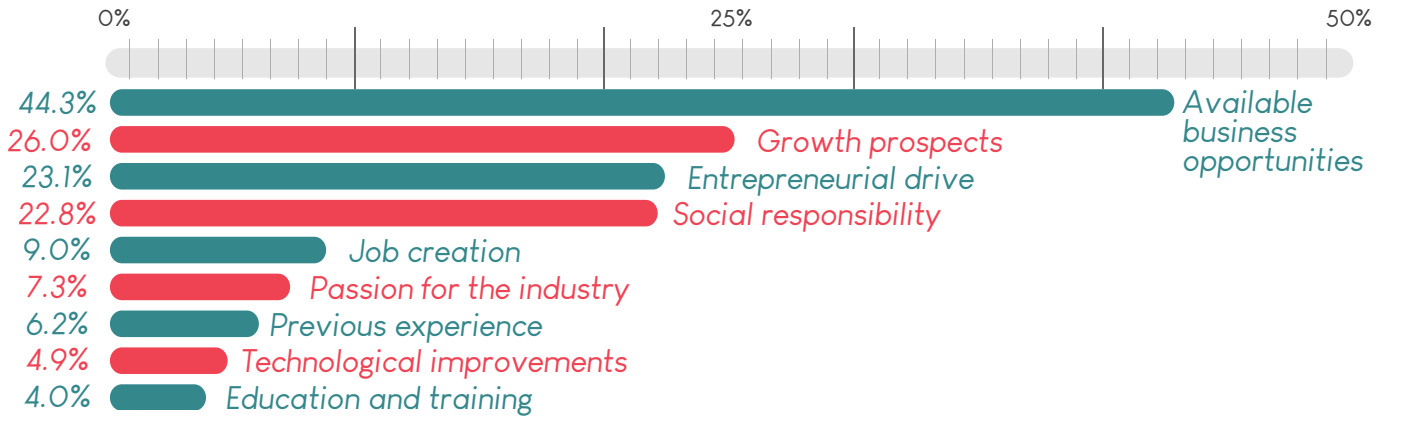
Business owners in the top four most well-represented industries are inclined to expand within their current area of focus.

Top Most Well-Represented Industries	Consulting	Construction	Food & Beverages	Manufacturing
#1 Industry For Expansion	Finance & Business Services	Manufacturing	Food & Beverages	Manufacturing
#2 Industry For Expansion	Consulting	Construction	Agriculture	Real Estate
#3 Industry For Expansion	Education	Agriculture	Manufacturing	Retail Trade

The search for new business opportunities is the primary driver for expansion across industries. Growth prospects per industry are additional stimulants in pushing SME owners to explore the available opportunities.

Main reasons for wanting to expand into selected industries

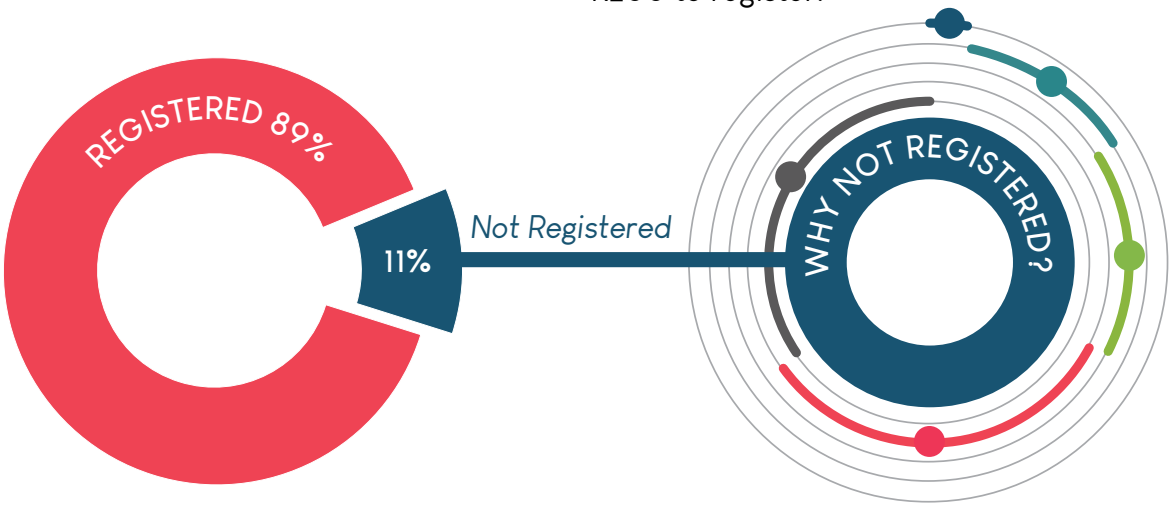
Thematic analysis of responses



CIPC Registration

Registering with the CIPC is a requirement for businesses that want to work within the formal sector. An encouraging 89% of SME owners that were surveyed have registered with the CIPC.

Of those who have not registered, a third (34%) feel that their businesses are too small and another third (33%) feel that they have not had the financial resources required – it is approximately R200 to register.[8]



- 34% I think my business is too small to be registered
- 33% I haven't had the financial resources
- 16% I don't know what the benefits would be
- 13% Other
- 3% I haven't had the time

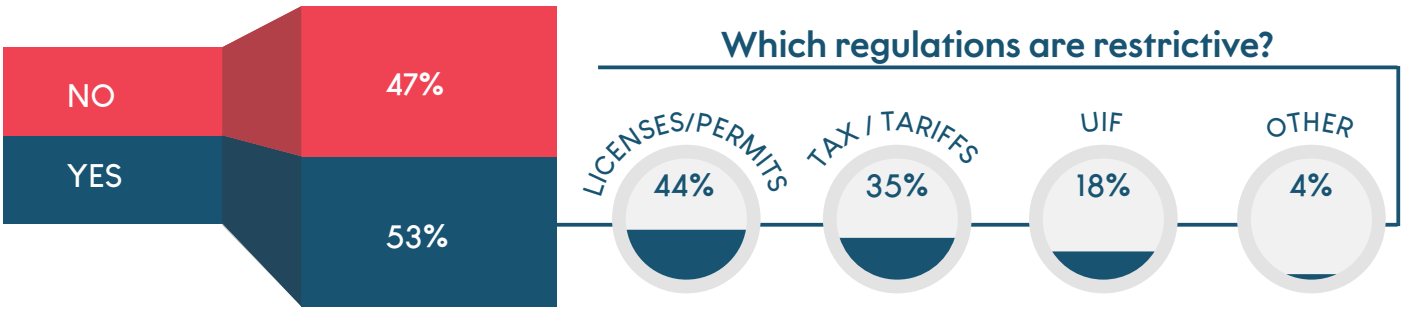
Perceptions of Government Regulations

SME owners were quite evenly split in their opinions regarding whether or not government regulations are restrictive. Just over half (53%) believe that they are. In particular, these owners pointed to licenses/permits (44%) and tax/tariffs (35%).

It is important that the government creates an environment that is less restrictive and more enabling to ensure that SMEs are able to compete and succeed. Assistance from government is important in both reducing the SME failure rate and helping small businesses to grow.

Are government regulations restrictive?

% share of those who feel that regulations are restrictive



[8] The CIPC provides a clear guide to registration – 'Step by Step Guide: New Company Registration': http://www.cipc.co.za/files/6914/1102/7352/Step_by_step_guide_-_Private_company_registration_v1_0.pdf

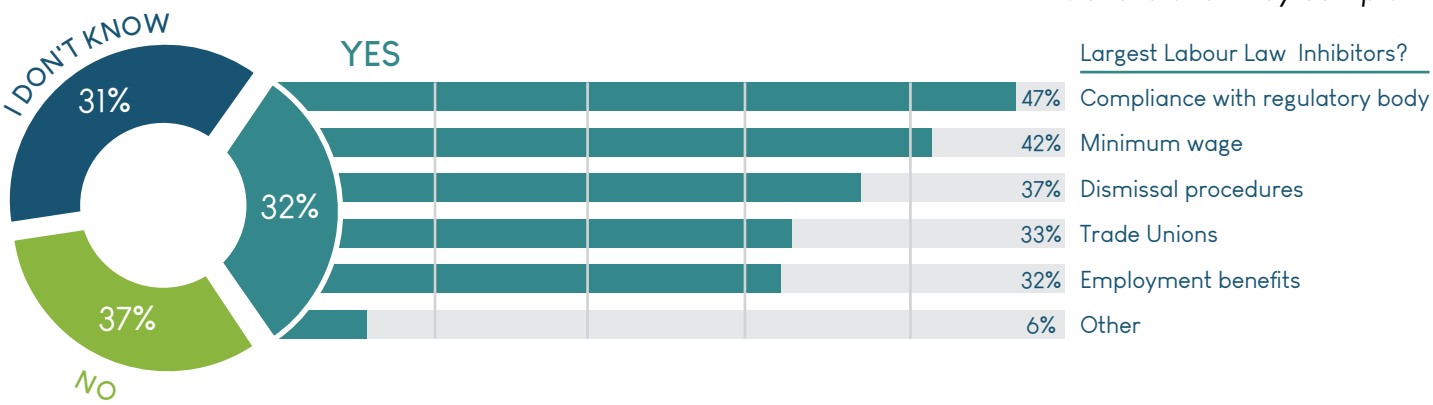
Perceptions of Labour Law

A third (32%) of owners feel that South African labour law inhibits SME growth, while 37% indicated that labour law does not. The remaining 31% are unsure, suggesting that many owners are not aware of the possible impact of labour law on their businesses.

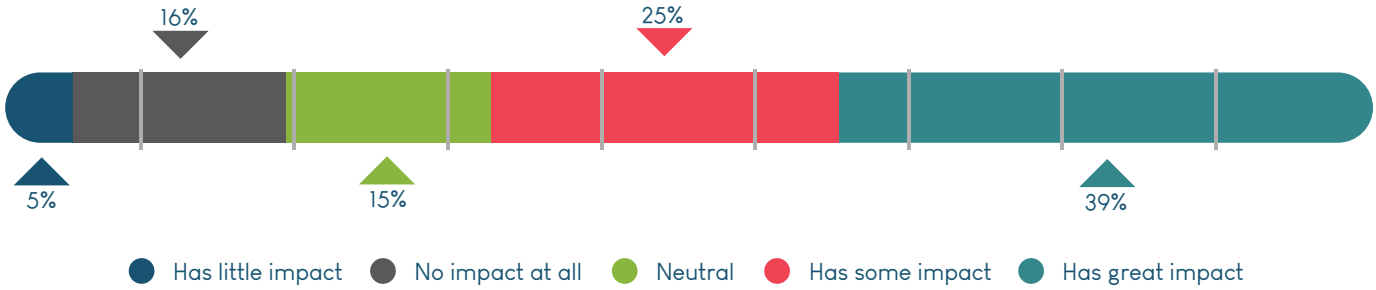
SME owners who believe that labour law does act as an inhibitor highlighted compliance with regulatory bodies (47%) and minimum wage restrictions (42%) as the biggest concerns. Dismissal procedures were also noted by more than a third (37%) of these owners.

Perceptions on whether Labour Law acts as a growth inhibitor?

% share of survey sample



Most SME owners feel that industry compliance has either some or a great impact on their businesses.

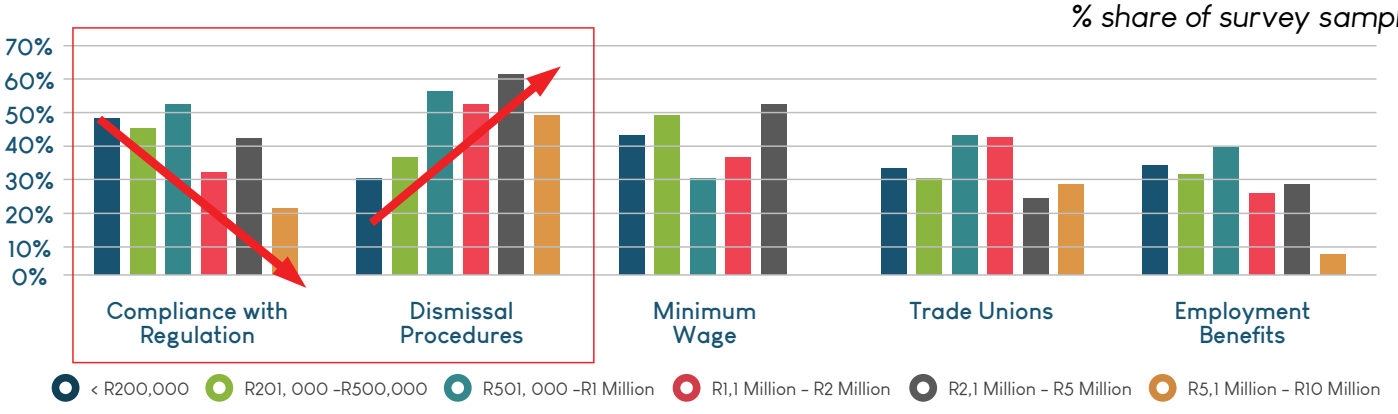


Compliance with regulatory bodies appears to become less of an issue as businesses grow their annual turnover. Larger SMEs are able to meet tough regulatory compliance as they increase their pool of available capital and human resources.

Conversely, dismissal procedures become increasingly challenging as SMEs make more money. This suggests that bigger SMEs are put under greater pressure to retain staff – even if they become less productive and profitable in doing so.

Labour Law and Regulations vs Annual Turnover

% share of survey sample



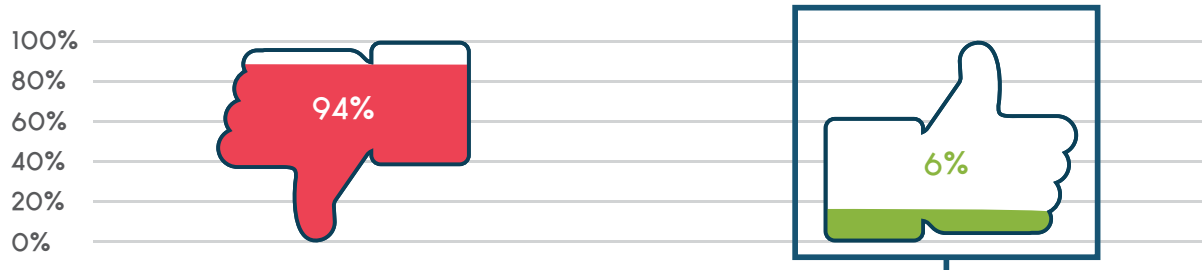
Government Funding

Financing is an important factor that affects the growth and survival of any small business. It is especially important as the business starts out and before it has its own steady revenue stream. While South Africa prioritises entrepreneurial spirit, there are many barriers in the path of entrepreneurs who are looking to start their own businesses. For small businesses and entrepreneurs, finance can (theoretically) be accessed through a wide range of sources, including government and the private sector. The government alone provides several different forms of funding, such as grants, tax incentives, loans and equity finance options.[9]

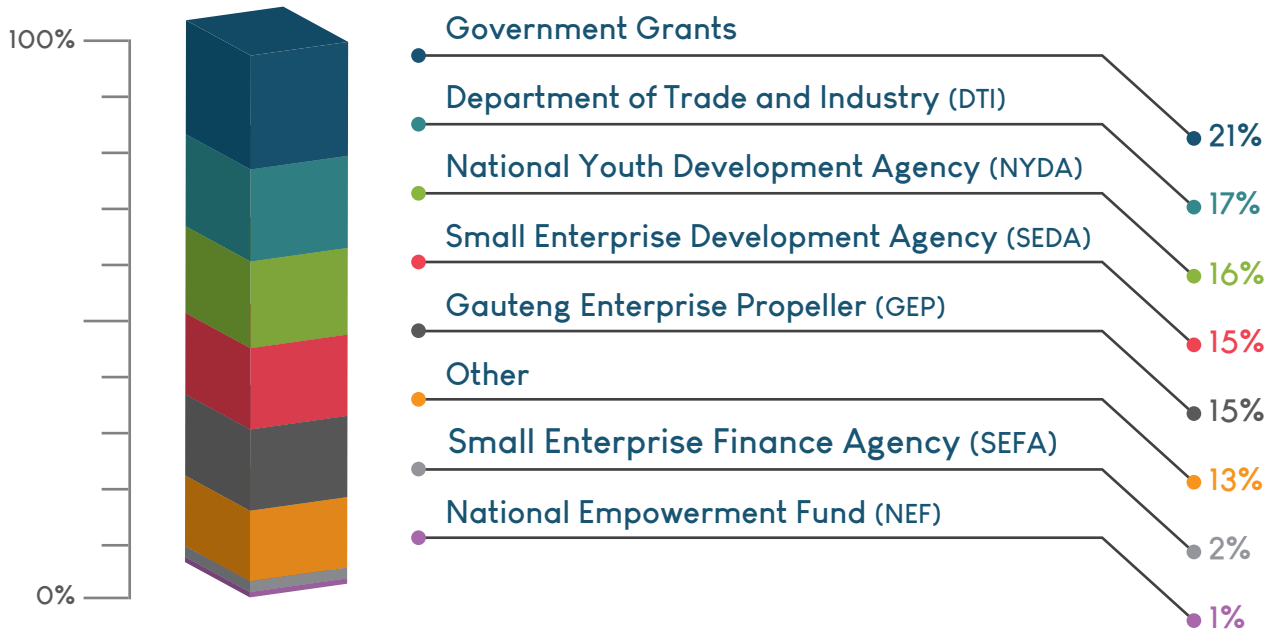
94% of our survey respondents indicated that they have not received funding from government. Only an incredibly small portion of the sample (6%) indicated to having received government funding. The small number of SME owners who have received government funding poses a considerable challenge for small businesses, particularly start-ups.

SMEs that have received government funding

% share of survey sample



Main sources of government funding



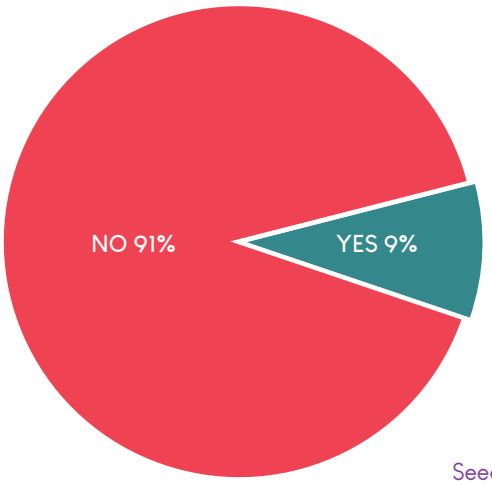
[9] 'South African SMME Government Grants', Thinkroom, n.d. https://www.thinkroom.co.za/our-thinking/our-articles/36-south-african-smme-government-grants

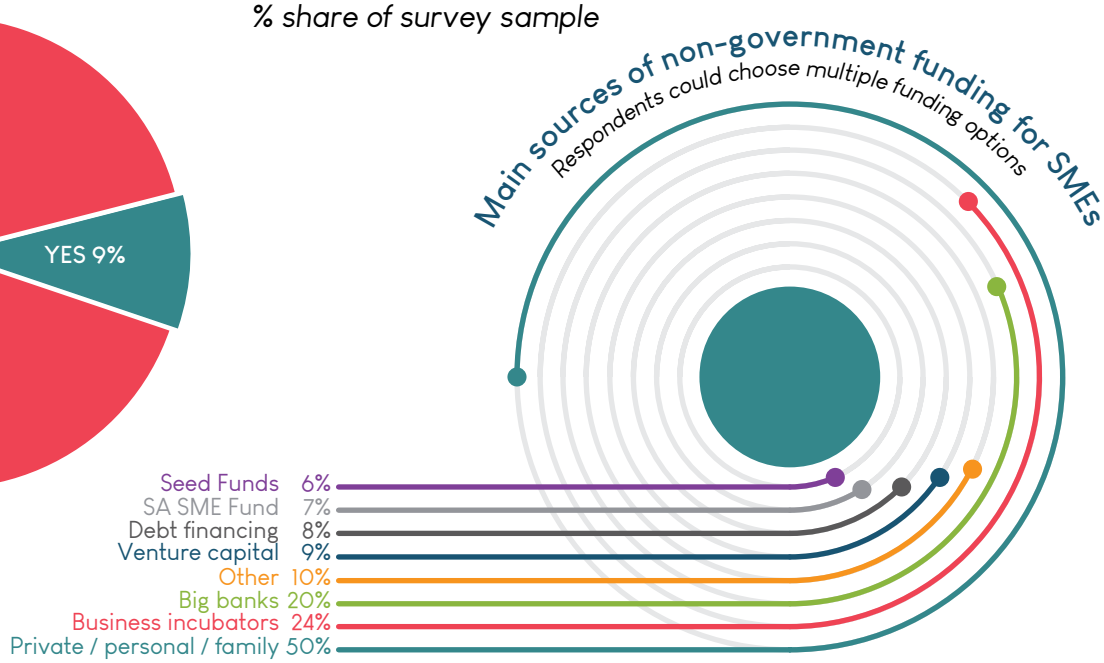
Non-Government Funding

Of the 9% of all SME owners who indicated that they receive non-government funding, the majority of funding was sourced personally and/or from family. This is in support of current literature on small businesses which asserts that most SMEs are self-funded. Nearly a quarter cited business incubators as their primary source (24%) while a further 20% pointed toward large financial institutions such as big banks.

SMEs that have received non-government funding

% share of survey sample



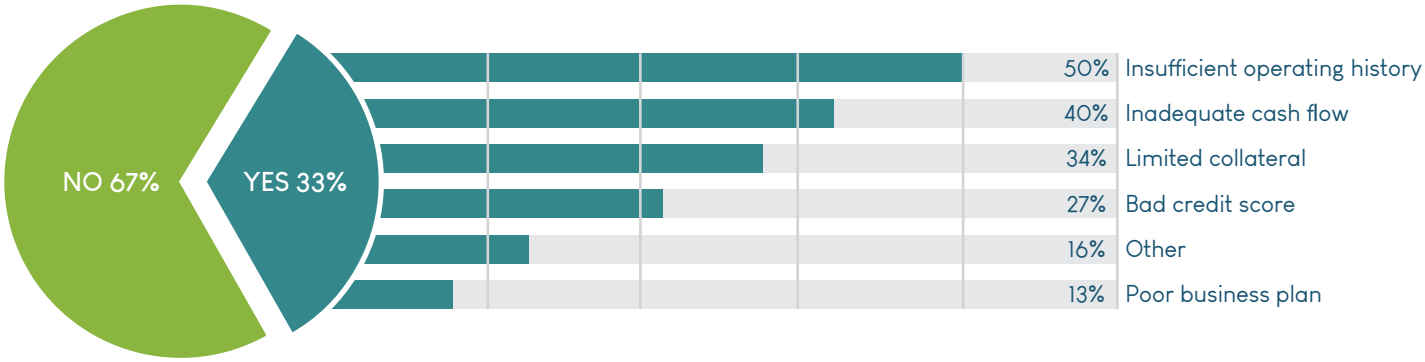


Funding Refusal

Out of the 1,157 SME owners surveyed, 33% indicated that they have been refused funding. These findings demonstrate that SME owners are not aware of what is required to qualify for funding such as having a good operating history and adequate cash flow.

SME owners who have been refused funding

% share of survey sample



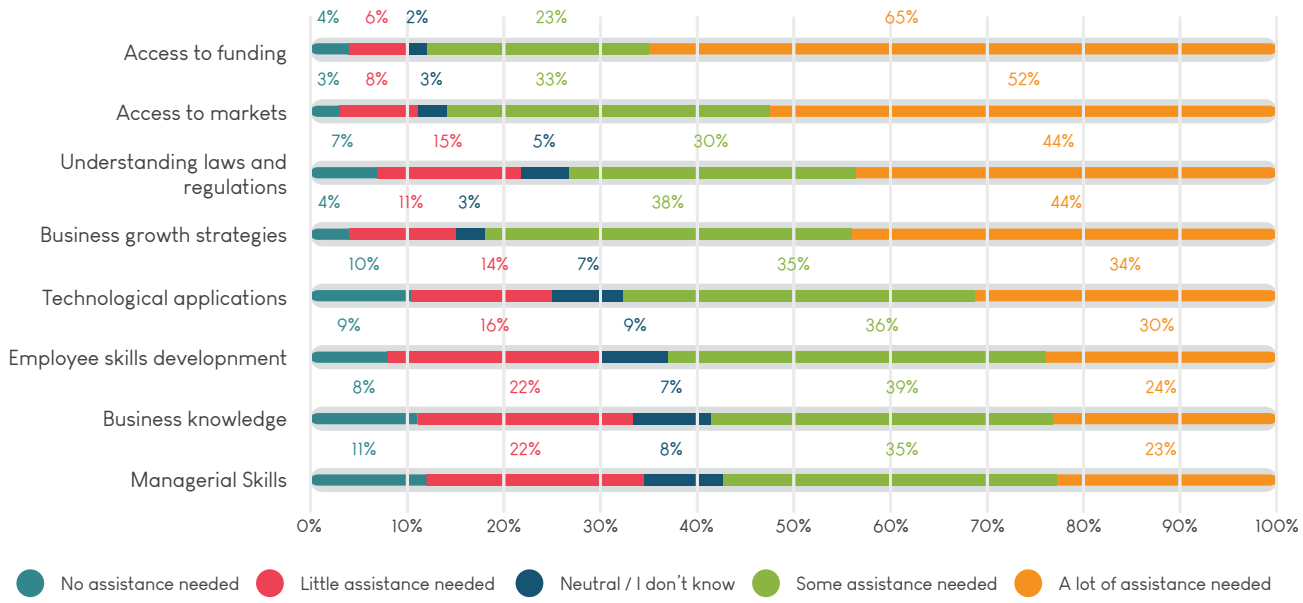
Development Assistance Needed

In the recent GEM report for 2017/2018, South Africa was found to be one of the least supportive countries in terms of providing support for entrepreneurs.[10] This is confirmed by our research findings, with our survey respondents emphasising various kinds of assistance they need to grow their business.

A combined 88% of respondents indicated that they need either some or a lot of funding-related support. The lack of support in accessing markets was similarly prominent, followed by the need to gain a better understanding of laws, regulations and growth strategies.

Development assistance needed by SME owners

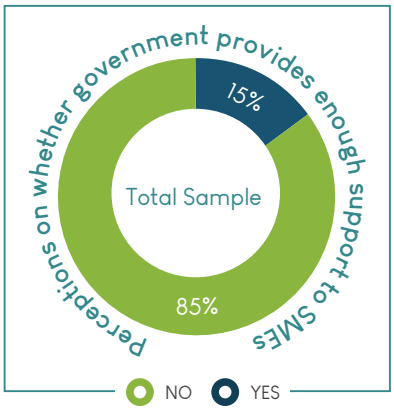
% share of survey sample



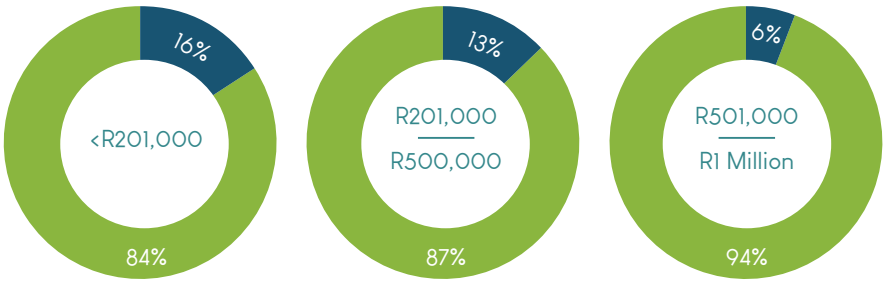
Perceptions of Government Support

A high percentage of SME owners (85%) indicated that they believe that government is not providing enough support, with only 15% of the sample believing that government is providing ample support.

The perception that government is not providing enough support increases parallel to the turnover of small businesses.



Perceptions on government support VS Annual turnover



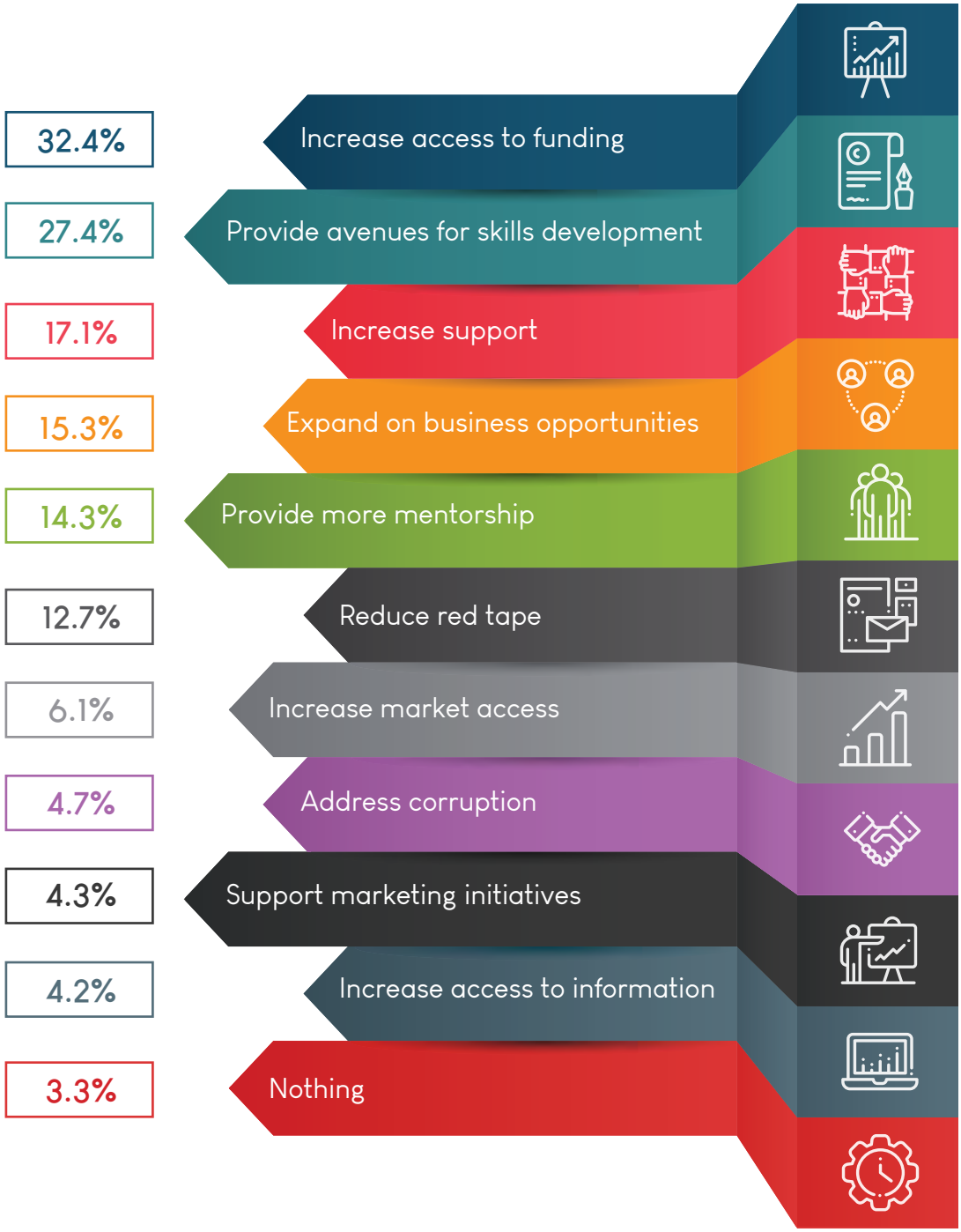
[10] 'Global Report 2017/18'. Global Entrepreneurship Monitor (GEM), 2018. https://www.gemconsortium.org/report/50012

Thematic Analysis of SME Support Needs

In addition to SME owners rating the level of development assistance needed (see previous page), they were also posed an open-ended question about areas of critical support. Through a thematic analysis of their responses, it was found that, around a third of SME owners (32.4%) indicated that there is a need to increase access to funding. This finding is consistent with earlier findings that only a small number of SMEs in South Africa can access government and non-government funding. It illustrates that many SME owners continually struggle when it comes to accessing funds throughout different stages of their business operation. Skills development is another key area that must be prioritised to better support the SME sector – 27.4% of SME owners referred to skills development gaps when asked about the kind of support that they need.

Critical support required by SMEs to improve business performance

% share of survey sample

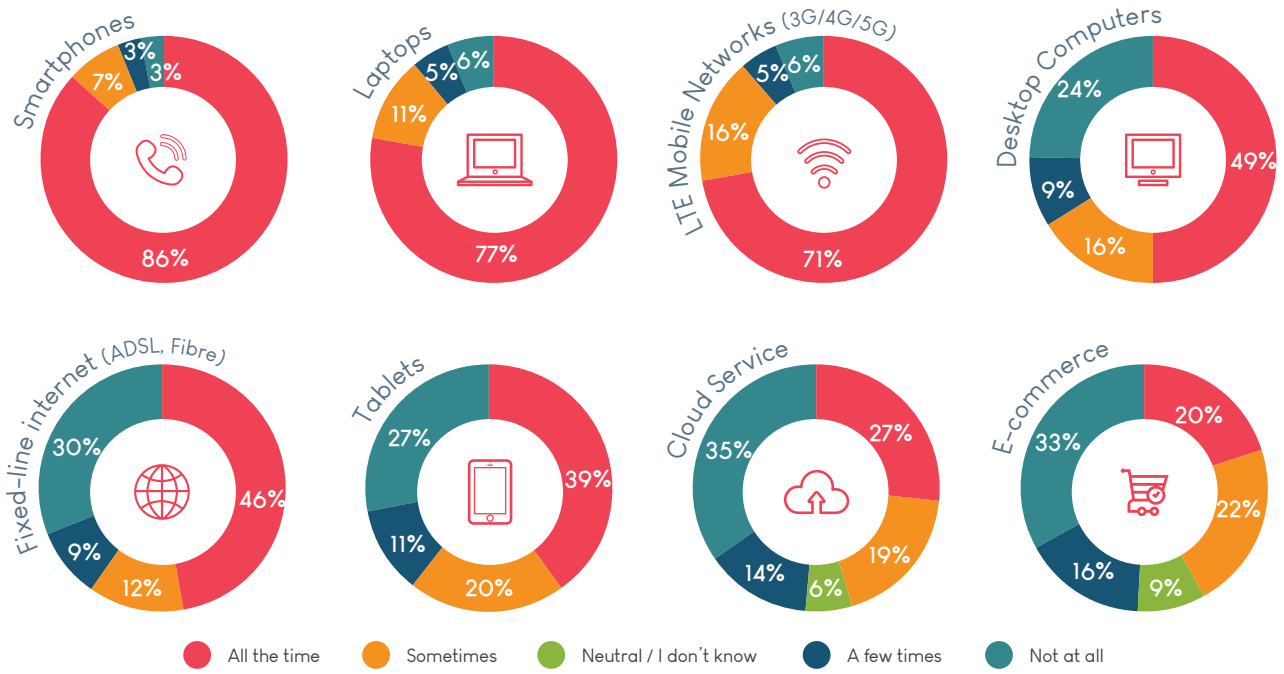


Use of Technology

With the ever-changing nature of the technological landscape, small businesses are continuously adopting new ways of doing business. The decentralisation of technological services has enabled SMEs to access new markets, reduce business costs, and increase efficiency. Our surveyed SME owners were asked about the kind of technology they use in their business. A large majority (86%) indicated that they use smartphones in their business "all the time". In contrast, only 20% use e-commerce on a regular basis, and just 22% make regular use of cloud services.

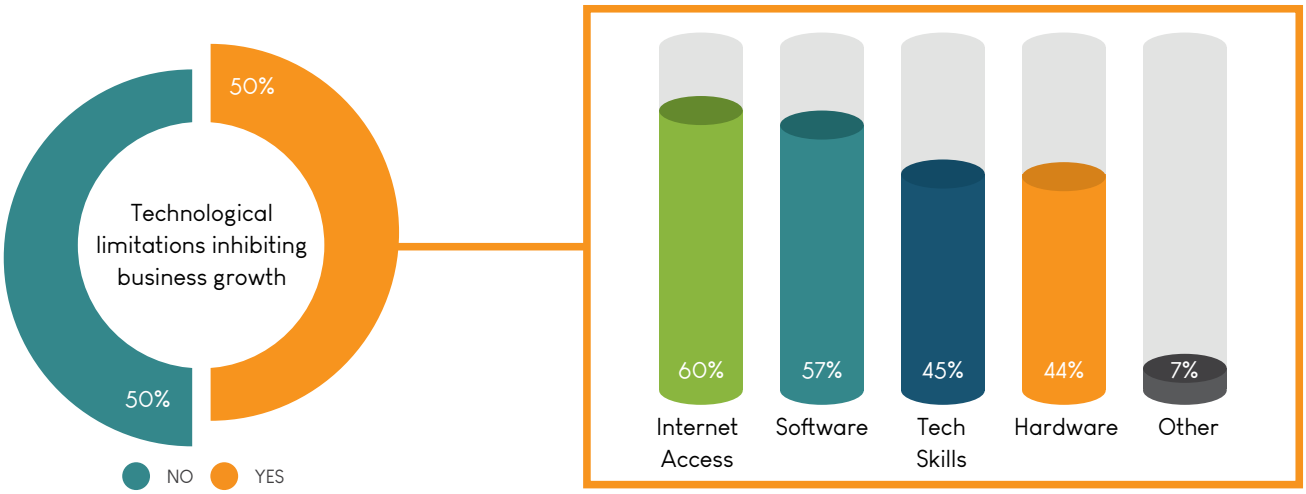
Kinds of technology used

% share of sample survey



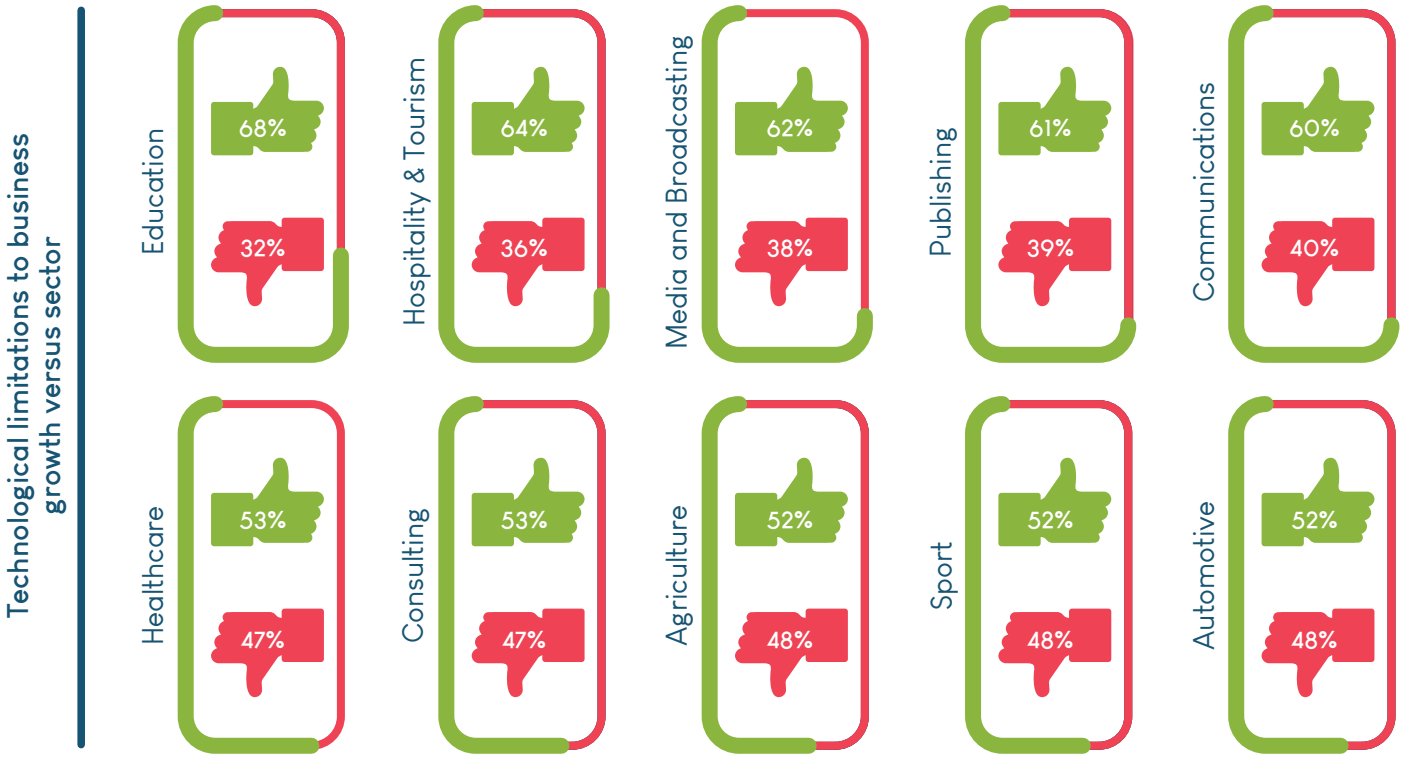
Technological Limitations Hindering Growth

SME owners were asked whether technological limitations pose an obstacle to growing their business. There was an exact 50/50 split between the respondents. Of the 50% of SME owners who indicated that technology poses a challenge, stable and reliable internet access was cited by 60% of respondents as the principal obstacle. This may be directly linked to the previous findings that SME owners are not maximising the use of e-commerce and cloud services. This emphasises the huge need for improved and cheaper internet access in order to grow the SME sector.



Technological Limitations Across Sectors

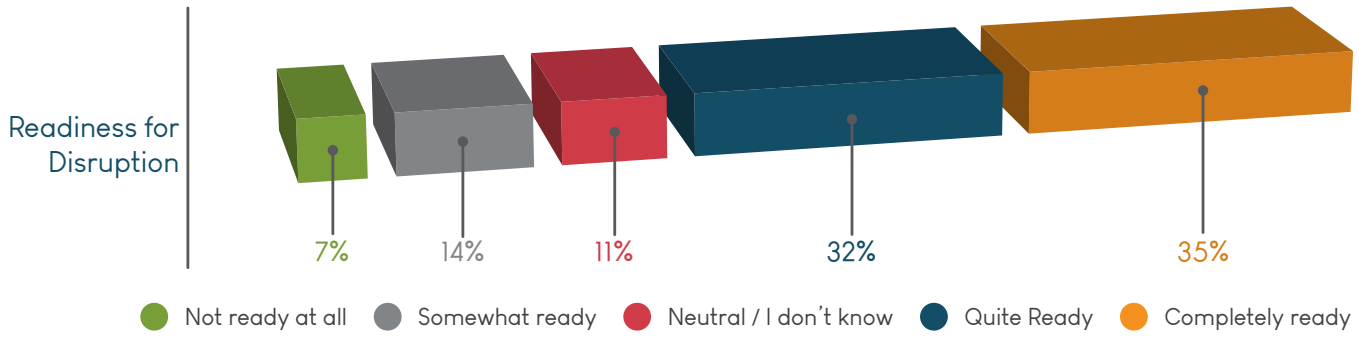
Our data suggests that SMEs working in the education sector (68%) are most significantly impacted by technological limitations, followed by hospitality and tourism (64%). There is a definite need to make education more efficient and accessible, and technology has a key role to play in achieving this. E-learning, for example, is one way of making education more accessible. As such, SMEs working within the education sector (and many others) require more access to different kinds of technology.



Readiness for Disruption

The 4th Industrial Revolution is defined as "a range of new technologies that are fusing the physical, digital and biological worlds, and impacting all disciplines, economies, and industries."[11] It is disrupting the way business is done across sectors while creating opportunities for businesses.

35% of SME owners surveyed believe that their businesses are prepared for disruption while 32% feel their businesses are quite ready for innovation. It is important for SMEs to use technology to better position themselves to take advantage of opportunities for growth when presented.



[11] 'Why building your digital enterprise is pivotal to success', T D Global, 2018. https://thinkdglobal.com/insights/business-in-the-age-of-digitisation

Conclusion

Through this research, SME South Africa undertook to deepen its understanding of South Africa's SME sector, the challenges and risks faced by SME owners, and the opportunities available to the sector. The research also endeavoured to bring to light important insights to inform strategic recommendations to fast-track the growth of SMEs.

Through its collaboration with IOA, this research serves as a platform from which to build. Key insights will be used as a basis for discussion and debate, and it is our hope that the results will help to inform future projects, interventions, businesses and policies.

As with all research, it is important to take into consideration the limitations when looking to generalise the results to the broader population of SMEs in South Africa. This research provides a snapshot of just some of the hundreds of thousands of SMEs in the country.

The results do, however, provide some incredibly valuable insights into the challenges faced by SMEs in the country, and from these insights, we have drawn a wide array of strategic recommendations to inform the way forward. What follows is a handful of quotes from SME owners that took part in the survey and a selection of some of our strategic recommendations.

> Entrepreneurs create and bring to life new technologies, products and services and create new markets and jobs along the way. It has been proven that the country's economy needs more people who are entrepreneurial and innovative to progress.

> My passion for business is infiuenced mostly by the area I live in... there are so many unemployed people with lots of talent and skills but no knowledge nor funds to help them forward. So, I want to eradicate that because it's something that can help our community.

> The full maximizing of funding opportunities is key as funding remains the common obstacle shared amongst SMEs. The ideas presented by SMEs across SA are developmental and fit but without sufficient funding they remain just ideas.

> Entrepreneurship can be introduced at the early stages of education. That'll give people enough information as early as possible, so they'll be able to make informed decisions as to whether business is for them or not.

Strategic Recommendations

Regulations

- The current regulatory framework hampers the growth of SMEs to a considerable degree. The government should look to revisit existing laws and what could be amended in order to encourage SME growth.
- While government expects SMEs to comply with various regulations, it should offer assistance to entrepreneurs on how to navigate the stringent business environment. With red tape and dismissal procedures highlighted as impeding factors to business growth, one of the solutions would be for the government to provide larger tax breaks for SMEs in tandem with loosening legislation.
- The government should encourage partnerships between SMEs and larger companies through providing incentives for collaboration. This will enable SMEs to gain additional access to markets.

Funding

- More information about funding should be made available to SMEs, from where it needs to be accessed to additional guidance on what the requirements are to secure funding.
- Funding sources need to provide constructive feedback to entrepreneurs who have been refused funding, as well as those who have been successful, in order to increase the success rate of future funding applications.
- Both government and the private sector need to take the initiative to train and mentor SME owners on various business aspects, including how to write good business plans, how to integrate accounting systems into their operations and how to better manage their businesses.

Support

- As highlighted, the maturity of an SME directly impacts its employment contribution and revenue stream, and thus SMEs require substantially more support during their initial years of operation.
- Providing support in these initial stages can help SMEs contribute to employment while reducing the current high rate of failure.
- Entrepreneurs need to be encouraged to think about innovative ways of doing business. This could be achieved through receiving mentorship from successful business owners who operate within a niche.

Technology

- Small business owners should better-utilise technology that is easily accessible – such as their smartphones – to take advantage of web-based services that can help to grow their business.
- In order for this to happen, education on the use, benefits and cost-effectiveness of technology, such as e-commerce and cloud services, needs to be offered to SMEs to proactively encourage uptake.
- There is a critical need for affordable and quality internet access in the country. One way of doing this is through deregulating the telecommunications industry and ending the monopoly of the existing companies by allowing more entrants to the market.

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