

**Government's Intervention on Failure of Small and Medium
Enterprises in South Africa**

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DECLARATION

I hereby declare that this dissertation submitted by me for the Master's degree, for the Programme in Governance and Political Transformation at the University of the Free State (Bloemfontein) is my own original work and has not been submitted by me or any other individual at this or any other university. I also declare that all reference materials used for this study have been properly acknowledged. I hereby cede copyright of this product in favour of the University of the Free State.

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ABSTRACT

Small and Medium Enterprises (SMEs) make a tremendous contribution to worldwide economies. In South Africa, they are considered the lifeblood of the economy as they are expected to address the high unemployment and poverty rates which the country is experiencing. However, it has come to light that SMEs do not grow in South Africa. It is thus critical to study factors which cause failure within the SME sector. This study investigates the factors that cause SME failure, which are divided into two environments, namely the micro- and the macro-environment. The study further investigates the effectiveness of the three strategies that entail the South African small business policy and effectiveness of institutions created by government to assist and support SMEs, i.e. Small Enterprise Development Agency, National Youth Development Agency and Small Enterprise Finance Agency.

Keywords: SMEs, LED, entrepreneurship, entrepreneurs, business failure, ISEDS, ISPSES, Poverty, GDP, Inequality.

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ABBREVIATIONS

CPI	Corruption Perception Index
CPPP	Community Public Private Partnership Programme (CPPP)
DFI	Development finance institutions
DTI	Department of Trade and Industry
GDP	Gross Domestic Product
GEM	Global Economic Monitor
ISEDS	Integrated Small Enterprise Development Strategy
ISPESE	Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise
JSCE	Johannesburg Centre for Software Engineering
LDE	Local Development Economic
NAMAC	National Manufacturing Advisory Centre (NAMAC)
NYDA	National Youth Development Agency
OECD	Organisation for Economic Co-operation and Development
R&D	Research and Development
SARS	South African Revenue Service
SBC	Small Business Corporation
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SME	Small and Medium Enterprise
SBP	Business Environment Specialists
TEA	Total Early-Stage Entrepreneurial Activity
UNIDO	United Nations Industrial Development Organisation
USA	United States of America
VAT	Value Added Tax
WEF	World Economic Forum
VOCS	Victims of Crime Survey

CHAPTER 1

1.1 BACKGROUND

As early as 1995, the South African Government realised the importance of Small and Medium Enterprises to the economy and as a result, the White Paper based on the National Strategy for the Development and Promotion of Small Businesses in South Africa was published (National Credit Regulator, 2011). According to the document, “Small, medium and micro enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country” (National Credit Regulator, 2011: 7).

The Small and Medium Enterprise sector has been globally recognised and acknowledged as a crucial factor in encouraging and promoting economic growth (Nieman & Nieuwenhuizen, 2009). This sector contributes a significant share to economic growth and employment creation across many countries. According to Raynard and Forstater (2002), SMEs account for over 90% of enterprises and contribute around 50 to 60% of job opportunities globally. Furthermore, information gathered from both developed and developing countries indicates that the SME sector plays an important role in economic development, economic growth and employment creation (Fan, 2003; Tambunan, 2008; Wattanapruttipaisan, 2003). Global SMEs established that in developed countries, such as the United States of America (USA), SMEs contribute up to 39% of GDP and around 53% of jobs. In Germany, SMEs create 78% of jobs and contribute 75% to GDP. Furthermore, approximately 99% of all European businesses are SMEs (Matt & Ohlhausen, 2011).

In developing countries, Haselip, Desgain and Mackenzie (2013) found that the SME sector accounts for over 93% of the total enterprises in Morocco and provides 46% of total employment. In Ghana, the SME sector makes up approximately 70% of GDP (Abor & Quartey, 2010). Andzelic, Dzakovic, Lalic, Zrnica and Palcic (2011) found that in Montenegro, SMEs make up 80.22% of all businesses and create employment for around 60% of the national workforce, and in Serbia, SMEs make up 99% of all businesses and employ over two-thirds of the national workforce. Also, in Nigeria, SMEs make up 98% of businesses (Ademola & Michael, 2012).

Pandya (2012) states that SMEs play a vital role in developing countries as they have the capacity to improve income distribution, employment creation, poverty reduction

and development of entrepreneurship in the rural economy. Hence, it can be concluded that a flourishing and vibrant SME sector is a key driving force in the development of every country's economy. As such, encouraging the creation of a well-supported and improved SME sector will likely contribute to economic development in the same way as large businesses.

Maas and Herrington (2006) state that SMEs are considered one of the primary remedies to the country's development issues, such as poverty, income inequality and unemployment. This has been confirmed by various studies (Finweek, 2012; Abor & Quartey, 2010; CIB, 2012) and the results of these studies have revealed that Small and Medium Enterprises contribute a significant share to South Africa's GDP and employment rate. For example, a study conducted by FinScope (2010) showed that there were as many as 5,579,767 small business owners and 5,979,510 small businesses in South Africa. Also, a study by CIB (2012) reported that SMEs in South Africa provide close to 7.8 million jobs. Furthermore, Finweek (2012) established that approximately 9 million South Africans are employed by SMEs and these SMEs contribute around 60% of the national GDP. Moreover, Abor and Quartey (2010) pointed out that approximately 91% of formal businesses in South Africa are SMEs and that they contribute between 52 and 57% of GDP and account for approximately 61% of employment.

Another estimation forwarded by the Banking Association of South Africa (2013), showed that the total economic output of Small and Medium Enterprises to the GDP of South Africa is close to 34%. In addition, other studies (Phillips & Bhatia-Panthaki, 2007; Monks, 2010) remarked that in South Africa, SMEs are especially important for creating jobs for the unskilled, the poor and low-income workers, which characterises the predominance of the labour force.

The growth of SMEs has been on the national agenda since 1994. The democratic Government realised that one of the main indicators of a strong and booming economy is the presence of well-established small and medium enterprises. Hence, more focus was placed on the growth of Small and Medium Enterprises. President Thabo Mbeki, in his 2007 State of the nation address, emphasised that for small businesses to experience growth in South Africa there should be a review of the tax system, levy payments and business registration (State of the Nation Address: 2007). The aim of this initiative was to introduce a simpler and more streamlined system for all

businesses (Fin24, 2010). In 2009, President Jacob Zuma reaffirmed the importance of small business growth in South Africa's economy, and he stated that small businesses put wealth in the hands of the entrepreneurs and their community, and that it is often more labour-intensive than capital intensive large enterprises (State of the Nation Address: 2009). Hence, he also concluded that more focus should be dedicated in ensuring that small businesses in South Africa grow through implementing policies that broaden the participation of SMEs, including those owned by black people, women and the youth (Entrepreneur today, 2017).

1.2 MOTIVATION

The definition of SME varies across different countries and sectors due to the lack of clear set criteria as to which businesses can be classified under SMEs. The most generally utilised description of SMEs in South Africa is the one provided by the National Small Business Act 102 of 1996, which was amended in 2003 (Abor & Quartey, 2010; Fatoki & Garwe, 2010). According to the act, an SME can be defined as "a different and unmistakable element including cooperate enterprises and non-governmental associations oversaw by one proprietor or more, including its branches or subsidiaries if any is prevalently done in any sector or sub-sector of the economy specified in the schedule of size standards and can be named a SME by fulfilling the criteria said in the schedule of size measures" (Mahembe, 2011:24).

SME growth has been considered as a key driver in the creation of wealth, employment, and economic development in every country around the world (Davidsson, Achtenhagen & Naldi, 2010:69-72). Edelman, Brush, Manolova, and Greene, (2010) suggest that SME growth is the most important source of job creation and also considered a valuable measure of entrepreneurial success. Another important factor of SME growth is its ability to foster innovation (Aidis & Mickiewicz, 2004; Pasanen & Laukkanen, 2006).

The growth of businesses is essential for meeting economic objectives such as creating wealth, job creation and social objectives such as alleviating poverty and improving standards of living (Davidsson, *et al.*, 2010; Zindiye, 2008). Growth enables small businesses to turn into larger firms that are able to achieve their full potential in their contribution towards development. Furthermore, Karadeniz and Ozcam (2010:61) emphasise that growth-oriented businesses are more important for

economic development than small and new firms. Consequently, Širec and Močnik (2010) remark that the growth of small firms has become a primary priority amongst governments around the world since SME growth is essential for the creation of wealth, employment and economic development. As a result, encouraging growth-oriented business people to establish high growth businesses is high on the agenda of governments (Birdthistle, Hynes, Costin & Lucey, 2010; Bosma, Van Praag & Wit, 2000), as it is the most important source of new jobs and also considered a key measure of entrepreneurial success.

In South Africa, in spite of the noted contributions of SMEs to the economy, SMEs do not grow (Fatoki, 2013:209-212) but rather assume a survivalist position (Smit & Watkins, 2012:105). Herrington, Kew and Kew (2010) observed that in South Africa, only 1% of all newly established SMEs grow and survive for longer than one year. Also, studies by Fatoki (2013:213-216) and Kesper (2001) discovered that small businesses in South Africa are mostly dominated by firms that only achieve a survival position and grow in number but not size. Likewise, Fatoki and Garwe (2010) remark that in South Africa, the predominance of newly established SMEs do not advance from the initial stage of growth to other stages like survival, success, take off and maturity.

Fatoki and Garwe (2010) reiterated that approximately 75% of new SMEs in South Africa do not grow and develop into established businesses. Furthermore, besides the fact that SMEs in South Africa do not grow, other studies (Fatoki & Garwe, 2010; Adeniran & Johnston, 2011) in South Africa have also established that SMEs have a high failure rate, as between 70 and 80% of SMEs are prone to failure (Adeniran & Johnston, 2011). Moreover, despite the nation's encouragement of entrepreneurial ventures and programmes aimed at stimulating entrepreneurship, the level of entrepreneurial activity remains one of the lowest in the world. According to the Global Entrepreneurship Monitor (GEM) (2014), South Africa has an alarmingly low level of entrepreneurship.

The Global Entrepreneurship Monitor report (2014) surveyed more than 206,000 individuals and 3,936 national experts on entrepreneurship within 73 economies. The report showed that South Africa's Total Early-Stage Entrepreneurial Activity (TEA) dropped from 34% to 7% in 2014. This means that for every 100 adults aged 18 to 64 years in South Africa, only about 7 individuals are engaged in entrepreneurial activity.

The GEM report (2014) further noted that South Africa's performance is lower than other similar economies, whose average TEA rate was around 14%. As such, Persson (2004) is of the opinion that many of these SMEs do not provide benefits to society.

This lack of growth of SMEs, coupled with their alarming failure rate in South Africa, has added to the high unemployment rate which is currently estimated at 26.7% (Trading Economies, 2018). This becomes a major concern for a country with a high level of poverty and inequality as statistics from the World Bank (2014) reported that 45.5% of South Africans live in absolute poverty. Furthermore, the report indicated that with a Gini score of 0.69, this means that South Africa has one of the most unequal income distributions in the world. The Gini coefficient measures income inequality on a scale of 0 to 1. The closer the Gini score is to 1, the more unequal a society and vice versa. Moreover, considering that 16.6 million South Africans depend on government grants to survive (South African Social Security Agency, 2015), it becomes imperative for the health of the South African economy that these SMEs succeed and grow. Hence, SMEs are considered the primary answer to job creation, alleviation of poverty, sustainable economic growth, equitable distribution of income and the overall stimulation of economic development in South Africa (Maas & Herrington, 2006). Consequently, encouraging greater numbers of individuals to start sustainable businesses has become a priority for many countries as growth-oriented businesses have been identified as catalysts of employment, innovation and skill (Bosma *et al.*, 2000).

All around the world, when looking at the global trends of SMEs, it becomes evident that they are the backbone of every economy, as they address the issues of job creation, equality in the distribution of income and wealth, economic growth and economic development. However, the lack of SME growth will result in the lack of entrepreneurial success and thus reduce the rate of job creation by these businesses. As a result, it becomes necessary to boost the growth of SMEs in order to start providing their benefits to society.

1.2.1 Overview of Government Intervention in South Africa

For decades there has been a focus on small business growth in South Africa. In 1996, Parliament passed the National Small Business Act. According to Maye (2014), the Act provided for the establishment of the National Small Business Council, to

“represent and promote the interests of small business” and to “advise the national, provincial, and local spheres of government on social and economic policy that promotes the development of small business” (Maye, 2014: 2).

In 2004, the National Small Business Amendment Act established the Small Enterprise Development Agency (SEDA), which brought together three other entities, namely the Ntsika Enterprise Promotion Agency, the National Manufacturing Advisory Centre (NAMAC), and the Community Public Private Partnership Programme (CPPP). As part of the Department of Trade and Industry, SEDA aims to provide small business development and support by working in partnership with other organisations. As of the end of 2017-2018, SEDA had 53 branches, 7 mobile units, 17 electronic information kiosks, 15 satellite offices, 64 incubation centres, and 64 ‘access points’ throughout the country (SEDA Annual Report, 2017-2018).

More recently, the Government created the Small Enterprise Finance Agency (SEFA) in 2012, in order to simplify and expand financing for small businesses. Whereas SEDA operates in the development and support space, SEFA is a direct financing agency. Previous agencies worked with other intermediaries to provide financing to small businesses, but SEFA provides financing directly to business owners and entrepreneurs.

According to the United Nations Development Programme (2014), SEFA offers several different types of financing. Bridging loans are short-term loans designed to finance working capital needs so that businesses can meet their current obligations with immediate cash flow. Term loans have a fixed period of one to five years, with either a fixed or floating interest rate, and can be used to finance assets with a medium to long-term lifespan. Structured finance can be used to finance approved business needs that fall outside of the scope of term- and bridging loans. The financing that these facilities offer ranges from R50, 000 to R5 million.

Despite all these initiatives, the growth of small business has remained stubbornly anaemic. The failure of SMEs to blossom in South Africa may be attributed to a number of factors, some of them well-known. These include inadequate access to financing, limited market access, poor business skills and networks, insufficient research and development, and limited engagement of the private sector. In addition to these rather classic challenges, South Africa faces a unique and difficult hurdle. The long years

before liberation and freedom (43 years) were very poor preparation for entrepreneurship, particularly among black and other disadvantaged groups. The youth and women, in particular, were not equipped with technical or entrepreneurial skills or opportunities. Indeed, the informal sector was practically non-existent. In response, the Government has launched a massive social protection programme, which has led, in some cases, to a sense of dependence on, even entitlement to, such assistance by some of these groups (United Nations Development Programme, 2014).

Thus, although the Government has identified and sought to promote SME development as a crucial driver in job creation and poverty reduction, the majority of South Africans do not possess the requisite experience and skills to survive in the business environment. This position is supported by the findings of research conducted by ABSA Bank Small Business Section, which revealed that 63% of small businesses fail in the first 18 months of their trading. The following are cited as constraints affecting the survivability of SMEs capability and capacity of SMEs to provide quality goods and services according to the requirements of big companies, inappropriate technical skills, insufficient operative and financial management skills, and lack of access to finance (United Nations Development Programme, 2014).

1.3 PROBLEM STATEMENT

Small businesses in South Africa do not grow (Fatoki, 2013; Kesper, 2001; Fatoki & Garwe, 2010; Smit & Watkins, 2012). This situation is not only prevalent in South Africa but in other parts of the world as well. An analysis of more than 28,000 SMEs in Africa and Latin America showed that less than 3% of SMEs grow by four or more employees after their initial start-up (Liedholm, 2002). In understanding the reasons why SMEs do not grow, studies (Delmar, 1996; Gundry & Welsch, 2001: 453-470; Wiklund & Shepherd, 2003) have shown that SME owners have little interest towards growth. This might be due to the fact that many small business owners are not interested in growth or might be deliberately refraining from growing (Gundry & Welsch 2001:453-470; Wiklund & Shepherd, 2003). Whilst SME growth increases a business's ability to create sustainable jobs, the low interest in growth amongst business owners becomes problematic because only growth-oriented firms have been found to create sustainable jobs and contribute to economic development in every country around the world.

The 2014 GEM report further shows that the rating of South Africa's entrepreneurial eco-system – the conditions that enhance (or hinder) new business creation – have slipped. The biggest reasons for the decline are the country's poor ratings on government programmes, primary education, restricted and inhibiting regulatory environment and restrictive labour laws.

According to Mike Herrington (executive director of GEM) when compared with the entrepreneurial activity rates of different countries, South Africa should have an increasing rate in the region of 14%, which if achieved would go a long way towards reducing unemployment and alleviating the poverty experienced by much of its population (GEM, 2014).

The lack of growth of SMEs coupled with the alarming failure rate and low entrepreneurial activity has resulted in the high rate of unemployment. SMEs in South Africa are expected to be an important vehicle to address the challenges of job creation, sustainable economic growth, equitable distribution of income and the overall stimulation of economic development. With South Africa having one of the highest unemployment rates and the biggest disparities in income and living standard in the world, creating sustainable jobs is central to economic growth and political stability in the country.

Maas and Herrington (2006) point out that the creation of new SMEs is seen as a vital component of the solution to South Africa's developmental issues. Fatoki and Garwe (2010) stress that without the sustainability and growth of SMEs in South Africa, the country risks economic stagnation. Hence, encouraging the creation, growth and sustainability of SMEs becomes vital to the economic prosperity of South Africa. Consequently, it becomes essential to conduct research on factors that affect the growth of SMEs.

The International Finance Corporation (IFC), a World Bank Group (2010:14-16), notes that the following elements hinder the growth of SME across different regions and countries:

- **Physical infrastructure:** Improvement in infrastructure may enhance the prospects of higher productivity gains and higher rates of return, facilitating access to a range of financial services, e.g. electricity shortages may increase the costs of physical outreach for banks. On average, 22% of small firms own

generators, compared to 35% of medium-sized firms and 51% of large firms, probably due to the substantial fixed costs of owning and operating a generator.

- **Heavy regulation:** There are differences among countries in terms of time taken and costs incurred registering property and enforcing contracts. These costs are higher in developing countries, as compared to developed countries. SMEs often lack the capacity of larger firms to navigate through the complexities of regulatory and bureaucratic procedures in terms of costs of registering property. Countries with lower costs of registering property have large SME sector. Mexico and Columbia simplified business registration procedures and that led to increases in the number of registered businesses.
- **Heavy taxes:** 33% of SMEs in low- and middle income countries report tax rates as a major obstacle to growth. Developing countries impose heavy taxes on the formal sector where the informal sector is large to compensate for forgone tax revenue from informal businesses. As a result, the heavy imposition of taxes on the formal sector creates more informal sector business as no taxes are imposed in the informal sector, allowing them to offer lower prices and thereby draw customers away from their formal sector competitors.
- **Corruption:** 42% of firms in middle income countries, 34% in low income countries and 18% in high income countries perceive corruption as a major obstacle. SMEs are more likely to pay a bribe to get things done than larger firms, since SMEs have fewer resources and less bargaining power. This may also mean that SMEs do not comply with all regulations, making them more likely targets for corrupt officials.
- **Characteristics of SMEs (capacities):** The small size implies that managers and owners perform a wide range of tasks compared to those in larger firms, since there is no room for specialisation. This requires diverse skills that SME owners and managers may not have. Moreover, SMEs may not take advantage of economies of scale related to accounting, business planning and market research to the same extent that large firms can. As a result, SMEs under-invest in activities that may enhance their productivity and transparency.

The number of businesses that are failing in their first year of establishment is high, and the rate of unemployment is still high despite government intervention. The study

aims to investigate the factors affecting SME growth and the role that the Government is playing towards supporting entrepreneurship and SMME development in South Africa. It also explores whether Government is playing a role in assisting SMEs, addressing the main challenges that are affecting the growth of small businesses as the number of companies that are failing is increasing. The objective is to determine factors affecting the growth of SMEs and what the Government is doing to address these challenges as failure of SMEs has a direct impact on the country's economic growth and unemployment rate.

1.4 AIMS AND OBJECTIVES

1.4.1 Aim

The primary aim of the study is to identify factors that prevent SMEs from having the economic impact they are supposed to have. In reaching the objective, focus will be placed on the environment from which the business operates. The environment has an important influence on SMEs. There are variables or reasons, both outside and inside the business that may have an impact on the continued, successful existence of the business. Beck, Demirguc-Kunt and Levine (2005: 199-229) contend that for SMEs to flourish, it is significant to reinforce both the internal and external business environments. Changes relating to the business environment either have a positive or negative result on the SMEs' progress or failure in most of Africa (World Bank, 2010).

1.4.2 Primary Objectives

The primary objective of this study is to determine reasons for SME failure in South Africa.

1.4.3 Secondary Objectives

The study has four secondary objectives. The focus of each of the objectives are discussed below.

- **Analysing the state of SMEs in South Africa.** In reaching this objective, the focus is on analysing the current state of affairs of SMEs in South Africa with the aim of finding the root problem and how to address it. It appears that as much as they are striving to contribute to the economy of the country by creating jobs and alleviating poverty, red tape has a negative impact on their success.

- **Highlighting the consequences of the failure rate of SMEs.** The objective is to highlight the critical consequences that failure has on SMEs. Business failures have a high cost in terms of employment, lost productivity, purchasing power (unpaid wages), finance (unpaid debts), poverty reduction and income equality. Business failures can also lead to social problems such as crime, drunkenness and prostitution. Business failure can further lead to a reduced income for the Government in the form of lower taxes and increased expenditure on crime prevention.
- **Assessing the Institutions in place to support SMEs and addressing challenges.** The Government fully understands the significance of the provision of fertile ground for all SME types to breed and grow. As a result, different institutions were established with aim of motivating SMEs and to promote employment in the country. Institutions such as SEFA, NYDA and SEDA that offers financial and non-financial programmes to SMEs.
- **Investigating interventions to address challenges that are affecting growth in SMEs.** There are interventions in place, such as the Department of Small Business which was established in 2014 with the aim of demonstrating the Government's commitment to placing SMEs and co-operatives at the centre of economic growth and job creation.
- **Developing recommendations to assist to develop sustainable SMEs.** This should be a point of action plans for the SMEs to avoid the high failure rate.

1.5 CONTRIBUTION TO THE STUDY

This study will contribute to the field of study in the following ways:

- Small and Medium Enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country (National Credit Regulator, 2011). Since the growth of SMEs is a fundamental source for creation of jobs (Wiklund & Shepherd, 2003), and given that most fail at the establishment phase, this study aims to determine factors affecting the growth of SMEs in South Africa.

- The outcome of the research may contribute to the development of the South African economy. By understanding the factors affecting the growth of SMEs and examining programmes and policies put in place by the Government to assist SMEs, this study can help establish or correct existing policies. Especially those designed to support entrepreneurs to establish sustainable businesses and promote the growth of small businesses. The outcome of this research will provide entrepreneurs with information they can use to increase the performance of their businesses. The information, in turn, may have an impact on not only the entrepreneurs and their businesses, but also on their dependants, their employees, and the communities where the businesses are located at large.
- The study will also contribute to the ongoing research on SMEs in South Africa and the importance thereof. By examining the factors affecting the growth of SMEs and government intervention in assisting with the development of SMEs, the study adds to the existing body of knowledge on the topic.

1.6 RESEARCH METHODOLOGY

Babbie and Mouton (2011) define methodology as a body of methods, techniques and procedures employed in a research design to collect data, “as well as underlying principles and assumptions that underlie their use”. A qualitative research design will be adopted for this study. The argument in this study primarily follows the analytical-deductive approach, in that general and established theories and concepts are utilised and applied to the phenomenon of Small and Medium Enterprises. The conceptual framework is provided through an in-depth analysis. The study aims to determine the factors affecting the growth of Small and Medium Enterprises in South Africa; and secondly, it assesses the programmes put in place by the Government of South Africa to propel entrepreneurship and Small and Medium Enterprise development. Moving from the government intervention in assisting SMEs, the study formulates recommendations to assist in developing sustainable Small businesses.

The research design represents a combination of descriptive- and exploratory strategies. Through the descriptive focus, it provides a picture of the state of entrepreneurship in South Africa and how it is affecting the economy.

The method of investigation used in the literature review and documentary study is a qualitative method which is comprised of books, newspaper articles, journals, internet sources, and the reports of research- and academic institutions and government departments.

1.7 RESEARCH LAYOUT

1.7.1 Chapter 1: Background and motivation of the study

This chapter highlights the problem that will be investigated, and the way it will be concluded. The chapter will present the study background, motivation as well as the problem statement.

1.7.2 Chapter 2: Conceptualisation

Concepts highlighted in the study will be clarified and explained in the most important areas, the definition for Small and Medium Enterprise, as well as the Local Economic Development.

1.7.3 Definition of Small and Medium Enterprise

In South Africa, the most generally utilised meaning of SMEs is the one provided by the National Small Business Act 102 of 1996, which was amended in 2003 (Abor & Quartey, 2010; Fatoki & Garwe, 2010). Subjectively, the act defines SMEs as "a different and unmistakable element including cooperate enterprises and non-governmental associations oversight by one proprietor or more, including its branches or subsidiaries if any is prevalently done in any sector or sub-sector of the economy specified in the schedule of size standards and can be named a SME by fulfilling the criteria said in the schedule of size measures" (Mahembe, 2011:24).

1.7.4 Local Economic Development

Local Economic Development (LED) can be defined as the ability of a municipality or even region to generate income and improve quality of life for its residents (Meyer-Stamer, 2008). The main aim of LED is to remedy market failures, such as to remove barriers to entering markets for small businesses and availability of information, and to create public-private partnerships. According to Meyer-Stamer (2003), one of the main purposes of LED is to create positive conditions for businesses to grow. LED has become a global phenomenon that is utilised to eradicate poverty and create jobs in

urban and rural areas. The South African Government has realised that the potential for support exists at the local government level, with a focus on attracting investments, creating jobs and boosting demand.

1.7.5 Chapter 3: Literature Review challenges faced by SMEs

This chapter provides background to the proposed study, through a literature review of articles published by other scholars and researchers in South Africa. The intention is to convey knowledge and ideas to the reader about what had been said on the different causes of Small and Medium Enterprise failures. The challenges will be categorised as internal challenges which are related to the personal characteristics of the SME owners. These characteristics include education and skills of management, and external challenges which relate to the external environment where the business operates. Also included are markets and economic variables, corruption and crime, and access to appropriate information and communication technology. The small business policy and programmes established by the Government will be assessed with the aim of determining their effectiveness.

1.7.6 Chapter 4: Recommendations

Chapter 4 will provide recommendations based on the conceptualisation and literature review conducted on how to develop sustainable Small and Medium Enterprises.

1.7.7 Chapter 5: Conclusion

Chapter 5 will offer an overview and summation of the research with specific focus on the findings of every chapter.

1.8 CONCLUSION

This chapter provided a general context to the study and provided insight into the reasons for the selection of the sample. A brief background on the importance of small and medium-sized enterprises in South Africa, the concept of LED and government intervention on the failure of SMEs has therefore been presented in this chapter. Subsequently, the primary and secondary objectives and the contribution to the analysis were discussed in this chapter. In addition, the chapter presented the methodology and the framework chosen for the study. The next chapter is on the role of SMEs in South Africa and the Implementation of LED.

CHAPTER 2: The role of SMEs in South Africa and the Implementation of LED

2.1 INTRODUCTION

Good governance can be defined as the manner in which public institutions ought to conduct public affairs, economic growth and manage public resources in order to benefit the general population, especially the poor and the most vulnerable in society (Agagu, 2007:9). Huynh and Jacho-Chávez (2009; 121-143) indicate that effective governance seems to have been connected to economic growth and income per capita. Small businesses flourish in favourable terms of governance (Friedman, Cox, & Tribunella, 2010:37-54. Friedman et al (2010:37-54) further notes that starting a business requires a trust in the integrity of government, the rule of law and political

stability. SMEs play a critical role in influencing shifts in the economic landscape, given their existence either in the formal economy or in the informal sector outside of state regulatory structures (Acs, Desai & Klappre, 2008:265-281) (William & Nesai, 2010). Thai and Turkina (2014:490, 510) suggest that it is vital for policymakers to understand what drives entrepreneurs to start their businesses and the institutional challenges they experience in the SME sector so as to develop policy measures that will be beneficial to the development of SMEs in their country. Bjørnskov and Foss (2008) and Wennekers *et al.* (2002:25-68) reckon that, in this context, good governance plays a vital role in making that happen.

This chapter will discuss the key concepts relating to Small and Medium Enterprises (SMEs). A discussion on SMEs is important as they are attributed as drivers of economic development worldwide (Fan, 2003; Tambunan, 2008; Wattanapruttipaisan, 2003). Before SMEs can be discussed, an understanding of individuals who start these businesses is required as SMEs result from the activities undertaken by entrepreneurs (Nieman & Niewenhuizen, 2009). The chapter will therefore commence with an overview of the terms “entrepreneurship” and “entrepreneur”. Next, definitions attributed to SMEs from an international as well as a South African viewpoint and their relevance to the economy will be discussed. This will be followed by a definition of Local Economic Development and the role that SMEs play in LEDs.

2.2 ENTREPRENEURSHIP

There is no uniform definition for entrepreneurs and entrepreneurship. This has caused confusion about who can be regarded as an entrepreneur (Chell, 2008; Kobia & Sikalieh, 2010:110-127; Praag, 1999:311-355). Consequently, different scholars have given their own definitions of SMEs (Cronje, Du Toit & Motlatla, 2000:491; Hisrich, Peters & Shepherd, 2005; Nieman & Bennett, 2006:49; Rwigema & Venter, 2004). These definitions emanate from various fields of study. Despite the differences in the definitions, scholars (Baumol, Robert & Carl, 2007; Radipere & Shepherd, 2014: 189-198) are in agreement that entrepreneurship is important for economic growth. In ordinary discourse, an entrepreneur is an individual who exploits opportunities overlooked by other people (Casson & Giusta, 2007:223). Entrepreneurship can be described as a process by which an entrepreneur seeks opportunities and creates something to fill the gap. Casson and Giusta (2007, 223) suggests that the

opportunities might require development of new products, the development of a new way of inventing existing products, or simply substituting the existing products for a better output. Entrepreneurship is a business of taking risks (Casson & Giusta, 2007:223). Entrepreneurs must take on the risk with the hope of making profit. Therefore, entrepreneurs need to identify the right business niche in which they are well-equipped to take advantage of that demand. The next section addresses the concepts of entrepreneurship and the entrepreneur.

2.2.1 Definition of Entrepreneurship

The concept of entrepreneurship has been an area of discussion among scholars, educators, researchers, and policy makers. Nevertheless, entrepreneurship as a research field is a more recent phenomenon. In the late 1980s, entrepreneurship was first seen as a field of study and it was in that decade that it started to be regarded as its own field (Ireland & Van Aucken, 1987:9-20). Entrepreneurship started receiving attention over the years that followed. There has also been a large increase in the amount of field research carried out (Kuratko & Hodgetts, 2007:36). As a result, various authors have suggested several interpretations. Some of these definitions are outlined below in Table 1.

Table 1: Definition of entrepreneurship

Scholars	Definition
Cronje, Du Toit and Motlatla (2000:491)	Entrepreneurship is the process by which a person collects resources to act upon an opportunity to meet consumers' needs through an invention by accepting the risk of success or failure.
Kuratko and Hodgetts (2001: 235)	Entrepreneurship is a process of innovation and creation of new ventures through four major dimensions, namely individual, organisational, environmental, and process.

Zahra and George (2002:255-288)	Entrepreneurship is a process through which businesses or individuals first identify and then pursue business opportunities to generate wealth.
Ulhøi (2005: 939)	Entrepreneurship is defined as an ability to recognise and risk willingness to exploit business opportunities.
Moreland (2006:5)	Entrepreneurship is a process that uses innovation to discover opportunities and create value.
Nieman and Bennett (2006:49)	Entrepreneurship is the entire process of establishing and growing a new business.

Adapted and modified from Hitt, Camp, Ireland and Sexton (2002) and Isaga (2012:12).

Hisrich *et al.* (2005) and Rwigema and Venter (2004) have identified common terms that have been used in multiple definitions of entrepreneurship in the above table. These terms include but are not limited to creation, initiative thinking and value creation through projects, appreciation and acceptance of unmet social and economic needs. Rwigema and Venter (2004:6) combined these words to arrive at the following definition of entrepreneurship: "Entrepreneurship is the process of conceptualising, planning, launching and cultivating a business opportunity in a dynamic and unstable environment through innovation into a potentially high growth venture".

The above discussion has focused on entrepreneurship. Although there are several definitions of the word, many of the definitions incorporated common terminologies such as developers, seekers of opportunity and risk-takers. These terminologies are popular among definitions of entrepreneur. This can be noted in the following section of the study.

2.2.2 Definition of an Entrepreneur

The word "entrepreneur" means "between-taker" or "go-between" in French (Hisrich *et al.*, 2005). The concept has been in existence since the start of bartering. However,

the term started receiving attention in the Middle Ages when the economic markets emerged (Landström, Gouya & Fredrik, 2012). During that time, entrepreneurs were viewed as managers overseeing large projects (Hisrich *et al.*, 2005). In the years that followed, the concept entrepreneur evolved gradually to differentiate their risk-taking trait. Richard Cantillon, a well-known author of economics in the 1700s, described entrepreneurs as individuals who buy and sell goods at unpredictable prices and thus bear the risk of price fluctuations (Bridge, O'Neill & Martin, 2009). Knight (1921) added that the main theme for the concept of entrepreneurs is ambiguity. According to Knight (1921), entrepreneurs are risk-takers determined to bear uncertainty in order to obtain income. Schumpeter (1949) introduced the concept of creativity in yet another theory of entrepreneurship. Schumpeter argued that only extraordinary people have the potential to become entrepreneurs. In conclusion, the word entrepreneur has been around for centuries, although its importance has grown slowly over the years. In Table 2, the different definitions of entrepreneurs are presented.

Table 2: Definition of an Entrepreneur

Scholars	Definition
Bowey and Easton (2007:274)	An entrepreneur is a person who identifies opportunities and organises resources to fulfil his or her own economic and social goals without necessarily taking the risk(s).
Nieman and Niewenhuizen (2009)	Entrepreneurs are people who seek unsatisfied market needs and try to meet those needs by allocating resources, taking the risk and creating a company.

Marques, Ferreira, Ferreira and Lages (2013:78).	An entrepreneur is a person who discovers and/or creates opportunities and inventions, using resources to maximise the benefits of such innovations.
Kuratko (2014: 248)	Entrepreneurs are ambitious, confident, hardworking, dedicated individuals who enjoy being independent, use their failure as a learning experience, burn with competitive desire to excel and create new ventures by assuming the risk.

Adapted and modified from Desta (2015).

From the above table, it can be noted that there are numerous definitions of entrepreneurs. As a consequence, the term does not have a uniform definition, thus, making entrepreneurship a complex concept to define (Kuratko & Hodgetts, 2001). However, many definitions have basic terms used to describe entrepreneurs, which are risk-takers, developers, and opportunities-chasers. This study will use the following definition of entrepreneurs by combining these key terms: An entrepreneur is an individual who recognises opportunities, gaps or unsatisfied needs in the market, and address those identified needs to try by creating a new business.

This section discussed the concepts of entrepreneurship and entrepreneurs. It was deemed necessary to provide an overview of the concepts prior to discussing SMEs since entrepreneurs are the ones who start these businesses. The following section will focus on the main subjects of this chapter, which are SMEs.

2.3 SMALL AND MEDIUM ENTERPRISES (SMEs)

SMEs have a vital role to play in addressing the country's problems of unemployment, economic growth and equity. In March 1995, the South African Government introduced steps to establish an enabling climate in National Strategy for the Development and Promotion of Small and Medium-sized Enterprises to tackle the unemployment rate (DTI, 2005). In addition, Cass (2012) suggests that the strategy was created to

alleviate poverty, reduce the unemployment rate and stimulate economic growth by assisting small business to become competitive in the global market. The importance of developing SMEs in South Africa is becoming even more important in order to maintain social stability by creating jobs to counter the high unemployment rate (Mbedzi, 2011). SMEs are seen as a vehicle for economic growth and sustainable development (Arema & Adeyemi, 2011: 200).

2.3.1 Definition of Small and Medium Enterprise

The concept of SMEs differs between countries due to the lack of clear criteria as to which enterprises can be categorised as SMEs. In addition, the concept of SMEs varies across industries as well. Mahembe (2011) states that businesses vary in terms of capitalisation, jobs and revenue rates. Therefore, definitions that use size measures such as number of employees, productivity, turnover and net value, when applied to one sector, could result in all businesses being classified as small, while the same definition could lead to a different result when applied to another sector. Therefore, there is no universal definition of SMEs (Gibson & Van Der Vaart, 2008; Stamatović & Zakić, 2010:152). According to the OECD (2004), two types of methods can be used to define SMEs, which are qualitative and quantitative methods. Quantifiable metrics such as number of employees, total net assets, revenue and turnover are used in the quantitative approach (Ayyagari, Beck & Demirguc-Kunt, 2007; Haselip, Desgain & Mackenzie, 2014; Ogechukwu, 2011). Due to its simplicity, number of employees is the most commonly used quantitative method of defining SMEs (Ardic, Mylenko & Saltane, 2011; Ayyagari *et al.*, 2007; Beck, Demirguc-Kunt, & Levine, 2005). In developed countries such as the United States or the United Kingdom, number of employees and turnover are used to define SMEs (Gbandi & Amisah, 2014). Nevertheless, even when using the number of employees to classify SMEs, there is still a difference between countries and across sectors in setting the upper and lower size limits for Small and Medium-sized Enterprises. On the other hand, SMEs can be described qualitatively using their legal status and/or management experience (Dababneh & Tukan, 2007).

UNIDO (2004) defines SMEs by using qualitative and quantitative measures. In quantitative terms, it uses the number of employees to define SMEs. This gives the developed and developing countries specific categorisations (Elaiyan, 1996). In

developed countries, it categorises enterprises with 100 499, 00 workers as medium, whilst enterprises with 99 or fewer employees are classified as small. On the other hand, in developing countries, businesses with between 20 and 99 workers are classified as medium enterprises (Elaiian, 1996). Small businesses are those that have between 5 and 19 employees (Elaiian, 1996). In its qualitative analysis, UNIDO defines SMEs as labour intensive, having highly personalised enterprises with a vulnerable and uncertain competitive position (Dababneh & Tukan, 2007).

2.4 SMALL AND MEDIUM ENTERPRISES IN SOUTH AFRICA

The globally recognised lack of uniform definition of SMEs is also apparent in South Africa. The widely used definition of SMEs in South Africa is the one set out in the National Small Business Act 102 of 1996, which was amended in 2003 (Abor & Quartey, 2010; Fatoki & Garwe, 2010). Qualitatively, the act defines SMEs as “a separate and distinct entity including cooperative enterprises and non-governmental organisations managed by one owner or more, including its branches or subsidiaries if any is predominantly carried out in any sector or sub-sector of the economy mentioned in the schedule of size standards and can be classified as an SME by satisfying the criteria mentioned in the schedule of size standards” (Mahembe, 2011:24). By taking into account quantitative metrics such as number of employees, annual turnover and gross asset value, the act also gives a further breakdown of SMEs as set out in Table 3 below.

Table 3: Definition of SME in South Africa.

Size of the Enterprise	Number of employees	Annual Turnover	Gross Asset Value
Small	Not more than 50	Less than R2 million or R25 million, depending on the sector.	Less than R2 million or R4.5 million, depending on the sector.

Medium	Not more than 100 or 200, depending on the sector.	Less than R4 million or R51 million, depending on the sector.	Less than R4 million or R51 million, depending on the sector.
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Source: Government Gazette of the Republic of South Africa (2003).

For the purpose of this study, the quantitative definition of the National Small Business Act 102 of 1996 of SMEs will be adopted. More specifically, the distinction provided on the number of employees by the act will be used to classify SMEs. Thus, small businesses in this study refer to businesses that have a maximum of 50 employees, whilst medium enterprises refer to businesses with a maximum of 200 employees. The following sections will continue the discussion of SMEs in South Africa by elaborating on the role which SMEs play in South Africa's economy and what the Government's perspective is on the SME sector.

2.5 THE ROLE OF SMEs IN SOUTH AFRICA

2.5.1 Contribution to Employment

The high unemployment rate, measured at 29%, is a major concern for South Africa (Stats SA, 2019). The private and public sectors have struggled to absorb the rising number of job seekers (Mitchell, 2013). Therefore, in order to address the high unemployment problem, South Africa needs a dynamic economy with an emerging and stable SME environment (Abrie & Doussy, 2006; 1-13; Fourie, 2008; Mahadea, 2012).

In addition, SMEs employ people whose labour market characteristics make it difficult for them to get a job (SBP Alert, 2013). Among these labour market characteristics is lack of skills and education. Muthethwa (2013) notes that South Africa's high proportion of job seekers either tend to be unqualified or have not completed grade 12. Thus, the ability of SMEs to create jobs for unskilled/uneducated labour is vital for South Africa's labour force. The youth unemployment rate in South Africa is estimated at 55.2% between the ages of 15-24, which is alarmingly high. SBP Alert (2013:5) also warns that "Chronic youth unemployment has emerged as one of South Africa's most serious problems; it could be a permanently destabilising factor without resolving it."

Hence, it can be concluded that SMEs have enormous potential in creating new jobs that will suit South Africa's unemployed labour force.

2.5.2 Poverty Reduction

The SME sector is expected to offer solutions to the high poverty and unequal income distribution rate in South Africa. The House Affordability Index (2019) shows that more than half of the South Africa's population is living on less than R1, 230 a month. The Index further highlights that a quarter of the population (approximately 13.8 million people) are living on less than R19 a day. An estimated 56% of South Africans (30.4 million people) are living on less than R41 a day. The Government of South Africa offers grants to people to reduce the rate of poverty. An estimated 45.2% of the population of South Africa relies on government grants as a basic income (South African Social Security Agency, 2015). However, social grants are not adequate to resolve the country's poverty issue (Hagen-Zanker, Morgan & Meth, 2011). It is necessary to create new jobs that will allow individuals to earn income and thus reduce poverty. However, due to delays in service delivery, South Africa is witnessing a rise in civil actions and high levels of social unrest (Hagen-Zanker *et al.*, 2011). The SME sector employs an estimated 29% (Small Business Institute Study, 2019). SMEs have an important role in helping to create jobs, and demonstrates the importance of ensuring that SMEs receive the necessary support in order to reduce the pressure which the Government is facing in providing grants.

2.5.3 Unequal distribution of income

South Africa has one of the world's most unequal income distributions with a Gini coefficient of 0.65 (World Bank, 2014). The Gini coefficient calculates inequality at a rate of 0 and 1. The closer the Gini score is to 1, the higher the income of the family, and vice versa. Even though there has been a decline in between-race income inequality in post-apartheid South Africa, it still remains remarkably high by international standards (Hagen-Zanker *et al.*, 2011; Leibbrandt, Murray, Woolard & Finn, 2010). Africans are much poorer when compared to other races (Leibbrandt *et al.*, 2010). Furthermore, within-race inequality has shown an increase significant enough to stop South Africa's aggregate inequality from declining (Leibbrandt *et al.*, 2010). The highest interracial inequality in South Africa was observed within the Black African race (Hagen-Zanker *et al.*, 2011; Leibbrandt *et al.*, 2010). The income equality

of a country is directly influenced by a lack of jobs and employment (Leibbrandt *et al.*, 2010). Thus, unequal income distribution can be improved by the creation of employment opportunities. Therefore, job creation through SMEs can go a long way in reducing the high income inequality gap which South Africa is facing.

However, despite all the expectations on SMEs in solving South Africa's economic problems, whether directly or indirectly, different studies have concluded that these businesses do not grow (Fatoki, 2013; Fatoki & Garwe, 2010; Kesper, 2001; Smit & Watkins, 2012). Furthermore, Atkinson (2012:71) added that "South Africa generally has a low SME start-up rate and a high failure rate of young SMEs". Consequently, the South African Government has come up with different measures to help SMEs overcome the challenges they face. It has set up several institutions with the aim of creating more businesses and growing the existing ones.

2.5.4 Gross Domestic Product

The SME sector accounts for a large proportion of gross domestic product (GDP) on a global level, which is contrary to South Africa's reality. At present, the contribution of SMEs to South Africa's GDP is relatively small. South African SMEs contribute only 20% of the GDP, according to Fatoki and Van Aardt Smith (2011). Compared to other developing countries such as Brazil (59%) and Chile (57%) and developed countries such as Japan (55%), China (60%) and Germany (87%), this number is relatively low. In fact, this is also verified by the OECD (2010), which estimates that large corporations contribute more to GDP than SMEs in South Africa. OECD (2010) indicates that the main reason for SMEs' low contribution to GDP could be due to South Africa's low growth rate and high failure rate, as most SME owners/managers lack sufficient professional skills and are poorly motivated. The following section will discuss more about the Government's actions to help the SME market.

2.6 LOCAL ECONOMIC DEVELOPMENT (LED)

The role of local government in fostering economic growth, job creation, poverty alleviation and ensuring a reasonable standard of living for local residents and communities is further reflected in a number of policy frameworks formulated by the South African Government. These policy frameworks position local government to develop and implement local economic development policies aimed at addressing challenges of poverty, unemployment and inadequate resources. In addition, local

government must consider available resources while planning and also find the most cost-effective ways to implement initiatives aimed at creating economic growth, job creation and alleviating poverty for local communities (Mdhluli, 2013:15). This section describes what Local Economic Development (LED) is and discusses the laws and regulations aimed at promoting local economic growth.

Local government has to consider available resources when planning and also consider the most cost-effective ways of implementing programmes aimed at economic growth, job creation and poverty alleviation to local communities (Mdhluli, 2013:15). This section defines what LED is and examines the laws and regulations aimed at encouraging local government to promote LED by enhancing local economies, creating jobs and improving the living standards of local communities and what the role of SME is in LED.

2.6.1 What is LED?

LED is an economic development initiative by national government that enables and promotes local people to work together to achieve sustainable growth and development (Sibanda, 2013:647). Nonetheless, other scholars such as Bartik (2003) and Sibisi (2009:5) refer to LED as a term related to the development of a region, specifically aimed at stimulating growth in the local economy, compete and create jobs, by making better use of locally available resources. Meyer and Venter (2013) describe LED as a participation in which local people from all sectors work together to stimulate local business development, resulting in a robust and sustainable economy. In fact, it is also a way of helping to build decent jobs and improve the quality of life for all, including the poor and marginalised. Meyer and Venter (2013) define LED as a participation in which local people from all sectors work together to stimulate local commercial activity, resulting in a resilient and sustainable economy. Moreover, it is also a way to assist in creating decent jobs and improve the quality of life for everyone, including the poor and marginalised. In doing so, LED encourages public, private and civil society sectors to form alliances and work together to find solutions to common economic challenges. In essence, LED aims to establish partnerships to boost its economic future and the quality of life for everyone. According to Goga, Murphy and Swinburn (2006:27), LED is a process through which partners from the state, business and non-governmental sectors work together to create better conditions for economic

growth and job creation. Such stakeholders are creating an LED plan that is essentially used as a tool for improving the local economy.

An LED strategy is a comprehensive plan with short-, medium- or long-term goals and activities that outlines what will be done. It ultimately sets out an agenda to promote and improve the cultural, physical, social and environmental resources of a local community and tackle both challenges and opportunities. SMEs throughout the world are seen as the cornerstones of national economies. In the case of South Africa, they have the potential to reduce unemployment, generate income, create assets, and contribute to skills development, assisting local municipalities to deal with challenges including but not limited to skewed settlement patterns, backlogs in service delivery and spatial segregation (Meyer & Venter, 2013). The LED may play a significant role in addressing some of these challenges.

2.6.2 LED in South Africa

LED in South Africa aims to create sustainable and inclusive local economies that take advantage of local resources, address local needs and contribute to natural development goals such as economic growth and eradication of poverty. Municipalities in South Africa are undergoing economic changes either through an increase or closure of enterprises in their localities. Business closure has a direct impact on employment, poverty and local sources of income, which is why municipalities are expected to be of a transformative nature and are designed to improve social and economic conditions conducive to business development and promotion (Malefane and Mashakoe 2008; Helmsing, 2003). LED is thus related to development of local government growth in South Africa. Kanyane (2008) notes that LED is an individual- and sector-driven municipal program that attracts and strengthens public and private partnerships. Local government, industry and private sectors are the sectors referred to. The activities of the three industries have an effect on the provincial jurisdiction of various municipalities. According to Phago and Tsoabisi (2010), in a wider Provincial Growth and Development Policy, LED is a bottom-up socio-economic strategy aimed at creating a stable and sustainable business environment to boost their competitiveness. LED recognises that citizens, businesses and government are in the best position to change the economic conditions that stimulate growth, which is required to create jobs and therefore reducing poverty in South Africa.

LED is defined as focusing on the development of local areas as opposed to regional or national development. This form of growth is the responsibility of local councils and communities willing to promote development of the area (Rogerson, 2009). LED's goal is to create local employment in local government, alleviate poverty and redistribute resources and opportunities to the benefit of all community members (Tomlison, 2003; Kanyane, 2008; Phago & Tsoabisi, 2010). World Bank (2002) defines LED as the process through which partners from the public, business and non-governmental sectors work together to create better conditions for economic growth and job creation. The Department of Provincial and Local Government Department (DPLG), now the Cooperate Governance of and Traditional Affairs (COGTA), describes LED as an outcome based on local stakeholder-driven initiatives to promote economic growth and development. It includes recognising and using local resources, skills and ideas (Moyo, 2007:221). LED's emphasis is on socio-economic development of communities that use local resources.

Based on the definition of the World Bank, businesses within municipalities are expected to achieve sustainable economic growth in order to improve the quality of life. Improvement in education, jobs, income and literacy (Kanyane, 2008) entails the quality of life within the LED system. Malefane and Mashakoe (2008) argues that LED's emphasis should be on community needs and creating an environment for private sector investment by investing in the public sector and promoting business retention, growth and development. Business growth that uses local resources, including labour and manufacturing materials, can create local wealth and jobs. LEDs must create jobs by making the local economy grow. This means that in the municipal areas, more businesses and factories should be built. As part of the Integrated Development Plan (IDP), key stakeholders in a municipality need to come together to reach agreement and take decisions to grow the economy and create income opportunities for more people, especially the poor (Bouare, 2001). Former Department of Provincial and Local Government Department has identified the following key principles underlying LED:

- The main challenges facing South Africa are poverty and unemployment. LED strategies must focus on creating jobs and reducing poverty.

- LEDs must target historically disadvantaged people, marginalised communities and places, black economic empowerment firms and Small and Medium-sized Enterprises to allow them to participate fully in the country's economic life.
- LED encourages local ownership, community participation, local leadership and joint decision-making.
- LED includes local, national and international community, business and government collaborations to address issues, develop joint ventures and construct local areas.
- LED uses local resources and expertise to optimise local development opportunities.
- LED involves the integration of diverse economic initiatives in an all-inclusive approach to local development.
- LED depends on versatile solutions to tackle changing circumstances at local, national and international level.

South African Government views LED as the path to follow in the sense of empowered local government, constructive acts by local communities and the need to ensure that growth is centred and outcomes pro-poor. LEDs are more likely to have different pro-poor solutions (Nel, 2001). It is both a spatial and sectoral strategy that focuses on the improvement of job creation and the comparative and competitive advantages of a given locality. On the other hand, it focuses on the growth of specific economic sectors such as SMMEs and tourism. According to Tomlinson (2003), LEDs may also have a pro-poor approach to poverty alleviation as endorsed by DPLG or a pro-growth approach to economic growth as advocated by DTI. LED approaches are part of a relatively new growth strategy in South Africa. Economic and social growth has been delegated to local government by the national government. Whereas policies are in place, LED strategy has produced little success for various reasons, mainly due to lack of municipal challenges and resource challenges.

2.6.3 Approaches to LED in South Africa

Recent discussions on LED concentrate on two approaches, pro-poor and pro-growth or market-led LED. The pro-growth approach places emphasis on promoting economic growth through competitiveness in the market and attracting investment. The pro-poor

LED strategy focuses on approaches to alleviate poverty (Helmsing, 2003). The LED literature indicates that the pro-growth strategies are typically concentrated in Western Europe and North America, whereas in the developing countries, there is a need to focus on poverty reduction, thus the pro-poor LED approach (Rogerson, 2003). Pro-poor LED planning in developing countries encourages and helps local stakeholders to encourage poor people to gain access to and benefit from economic activities and help poor people become entrepreneurs. Both strategies are equally important and can be implemented together to achieve greater socio-economic goals, according to Nel, Hill and Eising (2002).

These strategies promote a sustainable development by ensuring that large companies are able to produce spin-offs for the small- and emerging business sectors. Looking closely at the disparity between pro-poor and pro-growth approaches to LEDs, it is clear that the pro-growth approach aims to improve local economies by promoting the objectives of self-reliance, entrepreneurship, business expansion competitiveness and job creation.

LED's pro-poor approach, however, is characterised by a bottom-up approach towards achieving empowerment, democracy, engagement, local collaboration and environment sustainability (Rogerson, 2003). Pro-poor LED strategy basically suggests turning to poverty alleviation and helping poor and marginalised groups to take advantage of economic activity. The idea behind this approach is to ensure that, through socio-economic consideration, poor people profit from economic activities within local areas. The difference is that this approach not only looks at business development, but also focuses on implementing strategies that will help the poor take advantage of available economic opportunities.

This can be achieved by creating economic strategies to encourage limited access to either economic activity or support and information to build capacity for potential economic opportunity (Pretorius & Blaauw, 2008). South Africa's LED policy shows bias against pro-growth policies in urban areas in particular. South Africa's LED policy remains driven by pro-growth activities aimed at achieving sustainable economic growth (Nel & Rogerson, 2005). Present initiatives across urban areas in South Africa are similar to the international record of urban areas having initiated LED programs to support building local competitiveness by stimulating potential growth of SMEs.

Entrepreneurship is also promoted by considering localities as strategic spaces for production, consumption and information processing activities. Despite increasing global competition, manufacturing retention and promotion remains important. Regardless of the increasing number of LED literature, there seems to be only a small emphasis on LED's contribution to alleviating poverty. There is no doubt that LED offers mechanisms for developing and improving economic activities, but without the inclusion of social development goals, it would seem to be unsustainable. Nel and Binns (2003) note that South Africa's policy imperatives are similar to the social responsibility of promoting social progress, but whether the resources in municipalities can achieve social goals is unclear (Nel & Binns, 2003). The following section will discuss the role of SMEs in the implementation of government initiatives to support the SME market.

2.7 The ROLE OF SMEs IN LED

SMEs in South Africa play an important social and economic role through their economic influence and job creation, a role that is highly valued in times of crisis and rising unemployment. Nonetheless, the growth of small businesses helps to address numerous economic development challenges in the country, such as high unemployment rates, inequality, demographic developments and the need for structural change (Oualalou, 2012:57). Malefane (2013) argues that the development of SMEs provides multiple job opportunities that can help lower unemployment rates and tackle the demographic challenges posed by growing populations. In addition, the development of the SME sector can help to increase competition and productivity, thereby stimulating income growth in general and per capita. Such growth will also stimulate structural change, since a SME sector is synonymous with innovation and technological upgrades. Sibanda (2013:663) also agrees with the statement that the SME sector plays a crucial role in the South African economy by generating job opportunities for communities in the second economy and by providing livelihood to the dependants. In this regard, South African SMEs contribute approximately forty-five (45%) to the GDP (Sibanda, 2013). Nevertheless, Malefane (2009) argues that the support provided by South African Government to SMEs is widely recognised as the country's initiative for economic transformation and poverty alleviation. On the other hand, this recognition stems from the Government's legislative and political commitment through policy and strategy to ensure sustainable development of SMEs.

SME growth in the local government typifies part of a LED strategy that is aimed at achieving, among other goals, the constitutional mandate of local government to promote economic development by working for disadvantaged and marginalised communities (Meyer & Venter, 2013). Therefore, LED strategies can be defined as a mechanism that addresses local development issues and brings together national, provincial and local government, businesses, community groups, and international development partners to work together in collaboration (Wekwete, 2014:9). Partnerships between these parties will contribute positively to solving absolute and relative poverty, lack of infrastructure, growing information of urban economies and decline and disappearance of existing industries.

2.8 CHALLENGES OF LED IN LOCAL GOVERNMENT

SMEs face multi-faceted and wide-ranging challenges. Inadequate business support services, quality or lack of infrastructure as well as inadequate institutional economic delivery vehicles to support and enhance SMEs in addition to a restrictive legal and regulatory environment are among the factors hindering SME growth (Adams & Madell, 2002:43). Municipalities' regulatory impact on small businesses is related to their developmental and service delivery roles, although the ultimate impact of regulations is a function of the transformation capacity of a particular municipality. Though uneven enforcements may result from capacity constraints, municipalities may often choose to selectively adopt such regulations. According to the National Treasury (2015:207), most rural local municipalities such as Tzaneen, Ba-Phalaborwa, and Molemolle Local Municipalities are faced with the challenge of raising their own income, particularly as most households are impoverished. There are, however, many families and local businesses that can afford to pay for services that lead to economic development.

The Department of Cooperative Governance and Traditional Affairs (2009:51) posits that LED is critical for the development of the country but has been erratic in practice due to the skills required to shape and direct economic growth in local spaces. As a result, South Africa has an advanced legal and policy context for LED, yet there are still challenges regarding implementation. In terms of the National LED Framework, municipalities have a very clear and defined facilitation role to play towards promoting economic development and job creation.

The need for LED also stems from the developmental challenge that economic development does not occur everywhere at the same time, but occurs unevenly and inequitably across economic space, environments and social groups. This causes major challenges in terms of satisfying the needs of the citizens with regard to employment opportunities, wealth creation and services particularly the non-payment of municipal service fees in South Africa. As a result, it also leads to the community engaging in municipal protests. South Africa is faced with a situation in which the local government system is placed under ever-increasing pressure as poor people move from rural to urban areas in search of work and improve their living standards. In this sense poverty and unemployment affect economic development. It should also be remembered that the business sector will not grow if people are working, and eventually the market will be weak as no money will be spent on stimulating economic growth. Municipalities will not be able to aid LED innovations, through funding and skilling them, and as such a local economy will suffer.

2.9 THE CONTRIBUTION OF SMEs TOWARDS THE SOUTH AFRICAN ECONOMY AND LED

Poverty and unemployment are the most troubling challenges facing many South African communities (Mensah & Benedict, 2010). Therefore, SMEs are associated with economic growth, job creation and income generation within poor and disadvantaged communities in the country. These businesses are considered to be the primary source of employment for the poor so that they can earn income required to purchase goods and services (Ndabeni, 2006). SMEs are also considered to be the primary source of tax revenue that allows governments to finance pro-poor programs such as healthcare, clean water and education. A variety of technical and financial support structures have been implemented in South Africa in an effort to allow the sector to perform its function effectively (Diale, 2009; Ladzani & Netswera, 2009). This support has come from institutions of government, parastatals, private institutions and NGOs. Such interventions' primary goal is to achieve greater socio-economic goals, including poverty reduction through small business development in the country. The following section aims to provide literature on how SMEs contribute to the economy and LED in South Africa.

SMEs are seen as the engine of the South African economy and LED rather than large enterprises. These enterprises, ranging from a business with fewer than 200 employees to micro-enterprises with fewer than five employees, are the largest source of employment and income for many South African communities and are the source of most new jobs.

These businesses are seen as the solution in most rural areas and townships in South Africa to rising levels of poverty, unemployment and inequality. SMEs in South Africa generate about 35% of GDP, contribute 43% of total wages, and employ about 54% of all private sector employees (Naidoo & Urban, 2010). Indeed, the development and promotion of these enterprises could be critical in advancing the economic performance in the local economies and the overall economy in the country. Additionally, the white paper on Small Business and National Small Business Act in South Africa view SMEs as the engine for socio-economic development. Nonetheless, designing and fostering such enterprises could be crucial to advancing economic performance in the local economies and the country's overall economy. In addition, the White paper on Small Business and National Small Business Act in South Africa considers SMEs as the driver of socio-economic development. These businesses are believed to be able to tackle high unemployment in South Africa as they have a huge labour absorptive ability:

- Promoting local competition by creating marketplaces in which they grow by identifying new places as they respond to demand changes and international competitiveness because of their flexibility;
- Reducing inequalities created during the apartheid era in terms of patterns of economic ownership and limited career opportunities for black workers;
- Contributing to black economic empowerment by having SMEs initiated, owned and controlled by those who were disadvantaged in the past; and
- Playing a vital role in people's effort to meet their needs in the absence of social support systems.

SMEs are more predominant in the local economies (Ndabeni, 2006). SMEs are at the core of any local economic development process. They are considered as the first and primary source of direct employment, income generation and innovation in their area of establishment (Chew & Chew, 2008). According to Kesper (2001), a range of

standard of living conditions such as disposable income, home foreclosure rates and new small business start-ups could be influenced by the level of employment in local economies. In addition, SMEs contribute to a significant proportion of all taxes in the local economy such as income tax, property tax and employment tax. Therefore, having more businesses in the local economy can enhance tax revenue for local governments, bringing in more money to repair roads, develop schools and improve public services (Ihua, 2009; Egana, 2009; Kongolo, 2010).

There is also increasing recognition of the role that SMEs play in reducing poverty in South Africa's local economies (Mensah & Benedict, 2010). These businesses are meant to create and sustain the jobs needed for poor people to work and earn the income needed to buy goods and services. Small businesses therefore contribute to poverty reduction through the creation of jobs either through the start-up of new enterprises or the expansion of existing ones and thus providing income to the poor. The poor in this context refers to individuals who own micro- and small businesses, workers, dependants of such poor employees or owners, the unemployed who can get jobs from these businesses, and poor people who buy goods and services from small businesses in the city.

They attempt to move out of poverty by working for themselves. It could therefore be argued that SMEs are essential to local economic growth and if the Government does not create a sustainable environment for them, they will fail. The idea is that the small enterprises will first meet the owner's needs and expand into medium enterprises, which will not only grow the owner's profits, but also create jobs for others. South Africa could achieve the goal of improving economic development and creation of wealth and employment if the sector is prepared to improve business performance (Njiro & Compagnoni, 2010).

2.10 CONCLUSION

The chapter researched literature available on SMEs and LEDs. The chapter commenced with the conceptualisation of entrepreneurship and entrepreneurs. After reviewing the definitions of entrepreneurs, the following definition has been adopted for this study: entrepreneurs are individuals who find opportunities, gaps or unmet market needs by creating new businesses. The discussion then focused on SMEs. A thorough discussion on the role of SMEs in South Africa was presented. According to

the above literature, SMEs are responsible for job creation, poverty alleviation and the uneven distribution of income. Nonetheless, for the sake of the research, there is a new standard definition of SMEs – the quantitative description of the South African National Small Business Act 102 of 1996, which uses the number of staff to define the scale of SMEs (Government Gazette of the Republic of South Africa, 2003). In this regard, small enterprises in this study refer to businesses that have a maximum of fifty employees, whilst medium enterprises refer to businesses with a maximum of two hundred employees. Hereafter, the concept of LED was discussed. LED in South Africa was analysed and it went further to discuss the approaches of LED. According to literature it was discovered that LED revolves around two approaches. It revolves around the pro-poor and pro-growth or market-led LED. These approaches provide for a balanced growth by ensuring that large businesses can generate spin-offs to the small and emerging business sectors. The discussion that followed analysed the role of SMEs in LED. Since SMEs are embedded in LED, however, LED is faced with different challenges. These challenges consist of the following:

- Landscape and social groups, creating major challenges in terms of satisfying the needs of the citizens with regard to employment opportunities;
- Implementation of policies;
- Skills required to shape and direct economic growth in local spaces; and
- Wealth creation and services, particularly the non-payment of municipal service fees in South Africa. As a result, it also leads to the community engaging in municipal protests.

In the next chapter, a discussion on factors affecting the growth of SMEs will be presented.

CHAPTER 3: Factors Affecting the Growth of SMEs and Analysis of Government's Small Business Policy

3.1 INTRODUCTION

Small and medium-sized enterprises (SMEs) are seen as the lifeblood of most developing economies (Afande, 2015). Small business growth is thus essential to achieving economic goals such as job creation, poverty eradication and living standard improvement (Davidsson, Achtenhagen & Naldi, 2010:7; Zindiye, 2008). Consequently, motivating growth-oriented business people to set up high-growth companies is high on the Government's agenda (Birdthistle, Hynes, Costin & Lucey, 2010; Bosma, Van Praag & De Wit, 2000:9) as it is the most significant source of new employment and is also considered a key indicator of business success. In South Africa, in spite of the noted contributions of SMEs to the economy, they do not grow but rather assume a survivalist position (Fatoki, 2013). Herrington, Kew and Kew (2010) found that only 1 percent of all newly established SMEs in South Africa grow and survive for more than a year. In addition to the fact that SMEs in South Africa are not growing, other studies in South Africa have also shown that SMEs have a high rate of failure, as between 70 and 80% of SMEs are prone to failure (Fatoki & Garwe, 2010; Adeniran & Johnston, 2011). Despite the nation's encouraging environment for entrepreneurial ventures and programs to stimulate entrepreneurship, SMEs are usually faced with numerous challenges that have a negative impact on their prosperity and economic development. SME owners often point to a variety of concerns when they need to identify the most important challenges their enterprises face. Before the challenges can be discussed, a broad understanding of SME failure is required.

3.2 SME FAILURE

There is a lack of uniform definition for SME failure which scholars are in agreement with. This makes SME failure a complex concept to define and it becomes difficult to put into perspective an approach to tackling such failures. Several studies have been conducted that sought to define SME failure, but none of them are in agreement. There are therefore several different definitions that are credited to the word "failure" when applied to an SME. For example, several of these studies relate to failure in terms of

insolvency – when a business becomes insolvent and therefore unable to pay its dues to creditors as they become due and payable. Some of the terms commonly used to describe SME failure are ‘bankruptcy’ (Schwartz & Menon, 1985), ‘failure or severe form of financial distress such as loan default or non-repayment of creditors’ (Keasey & Watson, 1991); closure of a unit but not total closure (within a franchise organisation) (Castrogiovanni, Justis & Julian, 1993); a firm gone out of business with losses to its creditors (Duncan & Handler, 1994); or discontinued ventures leading to liquidation whether voluntary or involuntary (Lussier, 1995).

Shepherd (2003:318, 2005:124) conceptualises and characterises business failure as insolvency, pointing out that insolvency arises when income decreases and expenditure increases to such an extent that the company becomes insolvent and is unable to attract new debt or equity financing. In such a case, it cannot operate under the same ownership and management structure. Fatoki (2014) asserts that the Statistics of Liquidations and Insolvencies published by Statistics South Africa is one of the primary measures of business failure. Watson (2003) expands the definition of SME failure to include the following reasons:

- Discontinued operations that result in losses to its creditors;
- Discontinuance, which is defined as the prevention of more losses; and
- Retirement due to bad health.

According to Ritchie and Richardson (2004), failure is an ‘end state’ when a business operation fails to meet the requirements of a sustainable business. In this regard, failure is a concomitant development that starts somewhere through some other reason which, if unaddressed, results in what Ritchie and Richardson term an end state. In the same vein, Cannon and Edmondson (2005:300) brought a view that failure is deviation by which an SME organisation strays from expected and desired results, therefore leading to its failure. However, Lussier and Pfeifer (2001:229) define business failure using a non-financial prediction model that looks at business failure as ‘not profiting over the past three years’. It can be observed that a lack of benefit is a consequence that follows previous events which would have precipitated such loss. For example, profit comes from the selling and managed expenses. For example, poor sales could mean a decrease in customer base, or ignoring competition, thus hindering

business performance. It is therefore insufficient to say failure is not having made enough profits.

All these attempts at defining failure meander around the same conceptualisation, short of insolvency, whereby a business is unable to pay its debts as they become due and payable. Hence, such a business is left to a free fall or seizure of operations as a result. It can be concluded that SME failure occurs when a business drastically loses revenue, either because its sales are too low or dropped considerably. It could also be that the competitive environment is untenable, causing its cash flow to drop or slide, making it unable to meet its financial obligations as they become due and payable. To further understand the challenges faced by SMEs, the micro- and macro-environment which they operate in will be analysed in the following section.

3.3 CAUSES OF SME FAILURE

In light of the above discussion aimed at defining SME failure, the need to identify the exact causes of failure is one of the main objectives of this study. Additionally, the process that leads to generating lessons for assisting in building sustainable businesses in South Africa naturally follows. The following section will discuss the causes of SME failure in the environment which the business operates in. The factors causing SME failure will be categorised into two environments, namely micro- and macro-environment.

3.3.1 Micro-Environment Factors

The Micro-environment consists of internal conditions or events within the organisation that influence the activities and choices of the organisation. These factors include but are not limited to personal characteristics of entrepreneurs, low levels of research and development (R&D), technology application, skilled labour, and managerial skills (Van Scheers, 2012).

3.3.1.1 Personal Characteristics of Entrepreneurs

SMEs' growth and success in South Africa is largely dependent upon their manager or owner's personal characteristics. Most scholars and organisations have concluded that the success and growth potential of a small- and medium-sized company lies primarily in the characteristics that the entrepreneur possesses, but the bone of

contention has been the degree of significance among these entrepreneurial traits listed.

According to Singh and Rahman (2013), innovation, futuristic mind-set, risk-taking ability, adaptability and commitment are the most essential entrepreneurial factors relating to successful entrepreneurs. In support of this view, James, Carland and Hoy (1986) identify the following as characteristics of entrepreneurs as a whole: the need for achievement, innovation preference and risk-taking. Many academics have been researching the traits which an entrepreneur should possess in order to operate a successful SME. The purpose of these studies was to build a standard personality profile that would define the key features of a successful entrepreneur. Chell (2008) argues that there is not a single set of characteristics every entrepreneur must have for every venture opportunity. From this point of view, it can be said that the chances for entrepreneurs to succeed can be improved and attributes such as abilities and actions can be learned through mentorship and nurturing. This argument is further supported by Nieuwenhuizen (2004), who proposes that entrepreneurial characteristics can be acquired by birth, through the life experiences of individuals, and through the entrepreneurial cycle.

Ferrante (2008) explains that individual entrepreneurial characteristics consist of ascribed characteristics which are traits one is born with and no effort is invested to earn them. Achieved traits are features learnt through a combination of personal choices, efforts and abilities. Learnable features are highly desired qualities in people with whom entrepreneurs want to surround themselves in building a high potential business. Learnable characteristics and necessity characteristics are crucial to being a successful businessman. The characteristics are discussed at length in the table below:

Table 4: Characteristics of entrepreneurs (Source: Neneh, 2011).

Types of characteristics	Attributes
1. Learnable characteristics	Need for achievement; need for power; calculated risk taking; commitment and determination; creative tendency; leadership; self-confidence; innovativeness; tolerance of risk, ambiguity and uncertainty;

	resourcefulness; creativity; visionary; independent thinker; hard worker; optimistic; creativity, self-reliance; motivation to excel and persistence in problem solving.
2. Ascribed characteristics	Race; ethnicity; gender; socio- economic origin; age, family influence.
3. Achieved characteristics	Education and experience.
4. Demand and requirement characteristics	Accommodation to the venture; stress; economic and professional values, ethics, team building and creativity; knowledge and experience of the business environment.

One of the main attributes that makes a small and medium company owner competitive over another is the fact that they have ambitions, at least basic plans, and ideas on how to go about their business. For these purposes, personality, human capital and environment effects on success have to be interceded by strategies and tactics. This idea contrasts sharply with the theoretical stance of the ecological approach, which suggests that the environment forms and selects essentially process of random behaviour, including the ability of the environment to produce certain failure and success rates.

3.3.1.2 Low levels of research and development (R&D)

Creating R&D capability is important to SMEs, as it can help to assess the viability of turning innovations into real businesses. Investing in R&D allows companies to access innovative solutions through the discovery process. Maas, De Coning and Smit (1999) point out that creative companies are likely to grow more quickly than conventional start-ups. According to the Bureau for Economic Research (2016), South African SMEs are considered to be less innovative compared to those in developing countries. Booyens (2011) suggests that innovation in South Africa is stifled by the failure of small businesses to form strong upward linkages with larger firms. As a consequence, this failure denies them information transfer opportunities. The GEM (2014) report proposes that the Government should provide incentives for R&D in

order to encourage innovation, to attract and strengthen lasting relationships between domestic and foreign knowledge intensive firms.

3.3.1.3 Lack of skilled labour

The labour market in South Africa is highly regulated with a high level of rigidity in the labour market. The challenges faced in this regard include the failure to attract and retain suitable workers, the loss of key employees, low productivity and insufficient employee training and development (Brink & Cant, 2003). It was confirmed by the Johannesburg Centre for Software Engineering (JCSE) (2016) that South Africa has suffered from a major shortage of skills, particularly in technical fields such as ICT and engineering, financial specialists, accountants, sales managers, marketing managers and specialised technical skills, to name a few. The study also points out that the number of employers hiring overseas to replace rare skills has risen from 12% in 2014 to 26% to 2016. Companies tend to pick these skills from Asia, India, and Eastern Europe in particular.

DTI (2008) recognises that skills shortage serves as a constraint on development for SMEs. Nieman and Neuwenhuizen (2009) observe that the lack of skills can be attributed to lack of education. The lack of education imposes significant barriers to business activities. According to Nieman and Neuwenhuizen (2009), there is a positive relationship between education and business operations. In other words, the higher the level of education an SME owner attains, the higher the entrepreneurial activity that will take place. The problem is not just the lack of skilled labour, but the inability of SMEs to recruit the skilled labour that exists in South Africa because they cannot afford highly qualified individuals. Labour can only be hired at a cost and within the confines of the South African labour regulations, such as the Employment Act and the Minimum Wage Act (Fatoki & Garwe, 2010).

3.3.1.4 Management skills

Lack of management skills is one of the reasons identified as cause of SME failure in South Africa (Mughan, Lloyd-Reason and Zimmerman, 2004:429; Viviers, Eeden and Venter, 2001:4; Ligthelm & Cant, 2002:6; Clover & Darroch, 2005:243; Strydom & Tustin, 2003:1; Rwigema & Karungu, 1999:107; Freeman, 2000:372; Thornhill & Amit, 2003:500). Business failure surveys suggest that SME owners often have a good idea but because they do not understand how to run a business, they under-exploit the

identified opportunity (Ladzani & van Vuuren, 2002:157; Strydom & Tustin, 2003:34; Rwigema & Venter, 2004:25).

Apart from the lack of basic skills, South African small businesses also lack the skills required for a management level. This lack of management skills among SME owners and managers can be explained to a large extent by the lack of education and on-going training. Herrington and Wood (2003) state that there is a clear gap in the education and training system in South Africa, which has decreased the management capabilities in the SME sector. Lack of education and training are amongst the reasons for the low level of entrepreneurial creation and high failure rate of SMEs.

3.3.1.5 Technology application

Access to appropriate technology remains a significant challenge for SMEs in South Africa and other developing countries. Aryeetey, Baah-Nuakoh, Duggleby, Hettige and Steel (1994) note that South African small businesses have low productivity due to the use of obsolete technology, making it difficult to compete with bigger firms. SMEs are mainly technology consumers rather than technology adapters (Office of Small and Medium Enterprises Promotion, 2007).

SMEs face numerous challenges and barriers which make advancing their technological capabilities difficult. Ngwenyama and Morawczynski (2009) highlight the following barriers preventing small and medium-sized enterprises from implementing and advancing their technological capacity:

- Lack of knowledge on strategic use of technology
- Lack of required skills.
- Perceived high setup costs
- Rapid technological change
- Geographical factors

It can be concluded from the above literature that it is important for SMEs to invest in technology as it plays a crucial role in the development of businesses. Leboea (2017) is of the same opinion, namely that the presence of technology in SMEs will help the business to maximise the opportunities presented and is also seen as a critical enabler to improve sales. It can be inferred from the above-mentioned literature that investing

in technology is essential for SMEs, as it plays a crucial role in the development of business. The presence of technology in a small business allows a business to exploit the opportunities it provides and it is also seen as a vital enabler for increasing sales (Leboea, 2017).

3.3.2 Macro-Environment Factors

A SME's profitability determines the potential for growth and success possibilities. Profitability is measured not only by internal factors but also by macro-factors. The macroeconomic factors influencing the failure of South African SMEs include economic indicators such as foreign direct investment, unemployment, inflation, taxes paid, exchange rates and or inflation. When the macroeconomic indicators are not favourable, this will result in the increase of the failure rate of South African SMEs.

3.3.2.1 Access to capital

Finance is the lifeblood of any business enterprise. Therefore the lack of adequate financial resources places significant constraints on SME growth. The lack of access to finance not only hinders the growth of SMEs, but also reduces the chances of survival of SMEs in South Africa. In addition, the lack of access to finance will not only result in the above mentioned outcomes, but will also hinder the full potential of SMEs as engines of poverty alleviation, job creation and economic growth in general (Mazanai & Fatoki, 2012). Cook and Nixon (2000) note that despite recognition of the role of small and medium-sized enterprises in the development process in many developing countries, SME growth is constrained by limited availability of financial resources to meet a range of operational and investment needs.

Research by the World Bank found that around 90% of SMEs surveyed said financing was a significant constraint on new investment (Parker, Riopelle and Steel, 1995). Levy (1993) also found that smaller businesses had restricted access to financial resources compared with larger organisations. The role of finance has been perceived as a critical element for SME growth (Cook & Nixon, 2000). A large number of SMEs in the sector have no access to adequate and acceptable forms of credit and equity or, indeed, more generally, financial services (Parker *et al.*, 1995). Formal financial institutions have designed their products to serve the needs of large enterprises.

A cursory analysis of survey and research results of SMEs in South Africa, for instance, reveals common reactions from SME owners interviewed. When asked what they perceive as constraints in their businesses and especially in establishing or expanding their businesses, they answered that access to funds is a major constraint (Financial Services Regulatory Task Group, 2007). Typical hindrances towards small businesses obtaining finance include: inadequate collateral on the part of the entrepreneur, a lack of credit history (Financial Services Regulatory Task Group, 2007), the inability to produce an acceptable business plan according to financial institutions, poor market research and the absence of a viable business idea, and lack of access to vibrant markets (GEM, 2014).

3.3.2.2 Labour regulations

Regulatory burden has been identified as a major challenge facing South Africa's SME sector (SBP, 2014). The constant changes in the regulatory environment, the need to keep track of overlapping and sometimes contradictory regulatory requirements across multiple government departments and levels, poor communication and access to information, and administrative inefficiency in government departments and municipalities are among regulatory challenges faced by SMEs. According to SBP SME Growth Index (2015), Small businesses spend eight working days a month dealing with compliance, legal and regulatory red tape. This means that SME owners and managers are spending a disproportionate amount of time dealing with labour regulatory compliance as opposed to income generating activities.

The Davis Tax Committee Interim Report on Small Business (2014) indicates that it costs SMEs an amount of R18, 000 a month or R218, 000 a year to comply with all tax requirements (Business Environment Specialists, 2014). The high cost of compliance with legislation in South Africa is seen as a threat to the SME sector and entrepreneurship (Viviers, 2004). Overregulation is still an issue in South Africa and significant deregulation has to take place in order for SME success to be supported.

3.3.2.3 Late payments

A large number of SMEs experiencing cash flow problems attributed this to late payments from their customers and a slowing down in economic activity in their respective industries (Timm, 2011). Late payments, combined with the payment of VAT on invoices, have a crippling effect on the sustainability and development

potential of SMEs. Businesses must bear the 'harm' of VAT, which must be reported to SARS until it collects payment from the company. The varying thresholds applicable to VAT compliance play a role in how frequently the business has to file its VAT forms, which can be every two months for businesses with a turnover of less than R30-million a year. Although SARS has attempted to address this problem through the turnover tax, most small businesses are exempt from the qualifying criteria. Small Business Institute (2019) claimed that a small business killer is the late payment of invoices and terms longer than 30 days. The state is a notoriously bad payer, mainly because of inefficiency and corruption, but big businesses are not innocent either.

3.3.2.4 Lack of government commitment

Government policies are instrumental in promoting and enhancing entrepreneurial practices, as they provide the forum for launching and maintaining new businesses. In South Africa, policy negotiations are conducted between organised labour, government and organised business. Small businesses are largely excluded from the policy discussions (Lings, 2014:167). As a result, small businesses have to comply with the burdensome industry-wide agreements, which include labour legislation, amongst others, which is a major obstacle to job creation. Bushe (2019) highlights that these agreements are usually not beneficial to small businesses and add substantially to the cost of business, yet small business development is critical to job creation.

The Government of South Africa is providing a two-pronged support structure to the SME sector: one is financial (in the form of property loans, working capital and grants), and the other is non-financial (in the form of advice, marketing, management, networking, research and development and technical support) (Gunto & Alias, 2013). However, majority SMEs are not aware of the availability of services such as Small Enterprise Finance Agency (SEFA) and the Small Enterprise Development Agency (SEDA) in South Africa (Maas & Herrington, 2006). The Department of Trade and Industry (2005) highlighted inter-departmental cooperation within the Government as one of its weakness when it comes to programme planning and implementation. It further stated that as result of departmental conflicts, various departments abandon any coordination of efforts and develop their own SME functions. This leads to a duplication of efforts and hampers the creation monitoring and evaluation framework for assessing the success of SME programmes by government.

3.3.2.5 High levels of crime

South Africa has one of the world's highest corruption rates. South African enterprises are vulnerable to all kinds of crime, such as theft and fraud. According to the Victims of Crime Survey (VOCS) (2017), South Africans are reluctant to start home businesses due to high levels of house robberies and burglary. The high crime rate in South Africa, according to the OECD (2014), pressured SMEs to increase spending on security. As a result, increased spending on security has a ripple effect on the overall cost of doing business. The percentage of households who claim they were discouraged from investing in starting a home business in fear of crime increased from 8.1% to 11.8% in 2016 (Business Tech, 2017). According to the Global Crime and Fraud Survey (GCF) (2018), South Africa's economic crime is now at its highest level in the last decade. South African organisations that have witnessed economic crime now stand at a record 77%, led by Kenya in second place (75%) and France in third place (71%). The global average is 49 % (GCF, 2018).

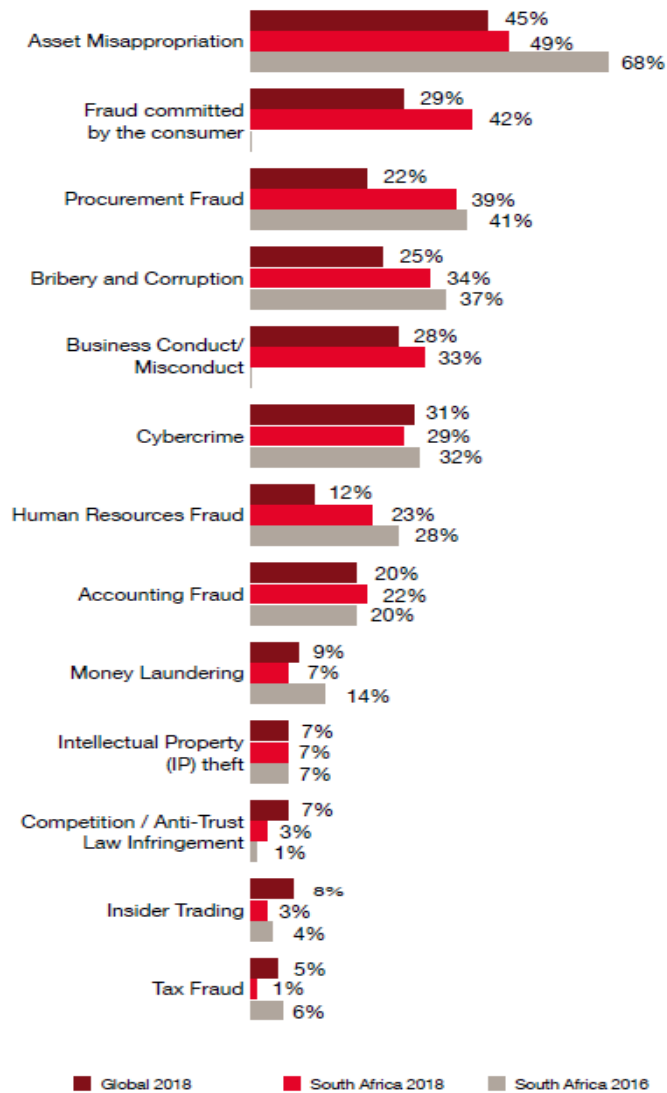


Figure 1: Types of Economic Crimes (Global Crime and Fraud Survey, 2018).

The Investment Climate Assessment Report - South Africa (2005) identified crime as one of the country's main constraints hampering SME growth and development. In 2008, the South African Presidency commissioned SBP to conduct a national study on the effects of crime on South African small businesses. The study found that most of the 446 SMEs surveyed identified criminal activity as one of the major hindrances to the growth of their businesses. A report by the United Nations Office on Drugs and Crime (2013) reported that South Africa is one of the five most dangerous nations in the world and that crime is an important issue that must be tackled head-on by the Government. Crime has a negative effect on businesses as it discourages their attempts to grow and develop (Fatoki, 2014). This effect

becomes more acute in SMEs as some may not have insurance to cover their loss due to criminality.

Another constraint negatively affecting SMEs is corruption. Transparency International Global Corruption Report (2008) describes corruption as “the abuse of entrusted power for private gain”. The above-mentioned study argues that corruption both in public and private establishments is growing in South Africa. A study by Fatoki (2014) argued that the reason why SMEs engage in corruption is often linked to problems with regulatory compliance and bureaucracy. Corruption increases operating costs, decreases efficiency and ultimately lowers revenue. This hinders companies from joining profitable businesses, decreases growth opportunities and reduces sales, investment and jobs.

3.3.2.6 Economic factors

Economic factors have a direct impact on the potential attractiveness of different strategies and patterns of consumption in the economy and have a significant and uneven impact on organisations in different industries and locations. Anyanwu (1993) explains that inflation has an impact on the success rate of small enterprises. South Africa's inflation rate was at 5.1% in 2018 (Statistics South Africa, 2018). This means that consumer demand is decreasing which result in low profitability for businesses and this affects the growth and success of SMEs. High prime interest rates also have an effect on the growth of SMEs. According to SARB (2019), South Africa's interest rate is set at 10%, which means that small businesses will have to pay more on their debt and monthly mortgage bond instalments. Another economic factor that has an impact on small businesses is fluctuating exchange rates. A rapidly fluctuating exchange rate can mean that a business contract that was profitable when it was agreed upon becomes a bad deal, thus affecting the cash-flow of the business.

3.3.2.7 Tax law

Tax is one of the main inhibitors for SME growth. The higher the taxation rate the Government imposes on SMEs, the greater the reduction in opportunities for income (Ahwireng-Obeng & Piaray, 1999). The VAT and corporate tax related costs in South Africa are among the highest in the world (Viviers, 2004). The complexity of the tax system further increases business costs, as many SMEs do not have the capacity to prepare tax returns and therefore need to hire consultants for a fee in order to meet

these legal requirements. According to the South African Revenue Services (SARS), SME classed as small business corporations are taxed in the following manner depicted by Table 5 below (SARS, 2018):

Table 5: Small Business Corporation (SBC) tax rates for financial years ending on any date between 1 April 2019 and 31 March 2020.

Taxable income (R)	Rate of tax (R)
0 – 79 000	0%
79 001 – 365 000	7% of taxable income above 79 000
365 001 – 550 000	20 020 + 21% of taxable income above 365 000
550 001 and above	58 870 + 28% of the amount above 550 000

Source: SARS (2019).

The above information is not known to SMEs due to a lack of capacity explained in paragraph 3.3.1.4 under management skills. That could be the reason why SMEs view the money as additional profit without taking their tax obligations into account. This could be the reason why most of them are not in good standing with regard to tax matters, because once they submit their tax returns, in most of the cases, they are liable to pay tax but the money has already been spent (Davis Tax Committee Interim Report, 2014). SME owners should be provided with tax education and entrepreneurs must pay their taxes in a timely manner to avoid interests and penalties.

3.3.2.8 Infrastructure

Infrastructure is the basic systems and services that businesses and the society needs in order to function effectively and facilities necessary for an economy to function (Rogerson *et al.*, 1999:137). Poor access to physical infrastructure is a major challenge to business growth and adds significantly to the cost of doing business. Infrastructure is one of the key enablers for SMEs growth (GEM, 2014). The quality of infrastructure can affect the growth prospects of new SMEs, especially in developing countries such as South Africa. Many developing countries suffer from a deplorable state of basic infrastructure such as transportation, telecommunication, electricity and high property rates. Businesses of all sizes are directly affected by the prices, tariffs

and levies imposed by municipalities for service delivery. Due to the range of services offered by municipalities, the rates and tariffs that companies face include water, sanitation, refuse collection, and electricity tariffs (Pahwa, Bester, Nieuwenhuyzen, Dawood and Pieters, 2006). Electricity and water availability remains a major hindrance in South Africa for example Phuthaditjhaba in QwaQwa has been without water for a long time, resulting in recent strikes and looting of local businesses. The resultant load-shedding and the price hikes consumers have experienced over the past few years affect the production and turnover of new SMEs (Mthimkhulu & Aziakpono, 2015: 17).

3.3.2.9 Globalisation

Globalisation has made the world more interconnected by moving economic activity from a local orientation to a more regional and global one (OECD, 2000). The problem that globalisation has generated, however, is in terms of economies of scale and research and development. These two considerations are of the utmost importance to ensure that the SME is successful. It may seem that small businesses are at a great disadvantage for both these instruments of competitiveness, and many analysts have projected the loss of profitability for small and medium-sized companies as globalisation increases (OECD, 2000). Globalisation is increasing competition in the industry in which they work. In order for small enterprises in South Africa to survive and succeed, owners and managers have to develop a full understanding of the dynamics at play and have built skills and competencies that will give them a competitive edge.

Globalisation increases the competition in the industry in which they are operating. In order for SMEs in South Africa to survive, thrive and achieve success, the owners and management have to develop a better understanding of the dynamics at play and develop the skills and competencies that will give them a competitive edge. It is also important for SME owners to be able to interpret environmental challenges to combat the increased competition brought by globalisation. This will assist SMEs in retaining their profitability and competitiveness.

3.4 CONCLUSION

The failure rate of SMEs is very high in South Africa. The high failure rate negatively impacts the ability of SMEs to contribute meaningfully to job creation, economic growth

and more equal income distribution in South Africa. The literature revealed that there are many factors contributing to small business failure. Failure factors are both internal and external. Internal factors are largely controllable by the organisation and include management skills, characteristics of entrepreneurs, lack of and technology application. External factors are largely uncontrollable by the organisation and include access to capital, economic factors, globalisation and crime. The above literature revealed the need for personal development by SME owners and managers through training and the need for government to create a sustainable environment for SMEs. The following section will present an in depth discussion of South Africa's small business policy and organisations created by government to assist SMEs.

3.5 SOUTH AFRICA'S SMALL BUSINESS POLICY

The 1995 White Paper highlighted, among other things, the need for the Government to create an enabling legal framework to promote access to information and advice, to support the recruitment of small firms, and to improve access to finance and affordable physical infrastructure. Since drawing attention to the major challenges facing the SME sector in South Africa, it is clear that an effective policy is of paramount importance to change and improve the current unsatisfactory situation. In the following section, policy elements will be defined in order to have a clear understanding of the term. The three government strategies that make up South Africa's small business policy will be discussed so as to illustrate what government seeks to achieve. The key government institutions for support of small businesses will also be discussed as they are the drivers of policies created by government and ensure success. The final section will further discuss the consequences of failure of SMEs because of inadequate policies or poor implementation thereof.

3.5.1 Policy Elements

A policy is a plan of action decided upon or selected by a political organisation or institutions (Moss, 2014). Anderson (1997:18) supports this view and adds that a policy is a course of action or inaction chosen by the Government to address a given problem or interrelated set of problems, or the manner in which courses of action are determined to achieve the appropriate objectives. Policies do not dictate how things should be done, but rather set the boundaries under which they should be done. According to Moss (2014), the main purpose of the policy is to ensure consistency in

the decisions and actions taken throughout the institution. In line with this view, the South African Presidency described policies as statements of what the Government strives to achieve through its work and why (Presidency, 2007:22). The following section will review South Africa's three small business strategies so as to determine whether the policy bridged the market imperfections through financial support, information and advisory services. Boter, Hjalmarsson and Lundstrom (1999:01) writes that this is the role of an SME policy.

3.5.2 South Africa's Small Business Policy

Government strategies which comprise South Africa's small business policy are depicted in the following figure:

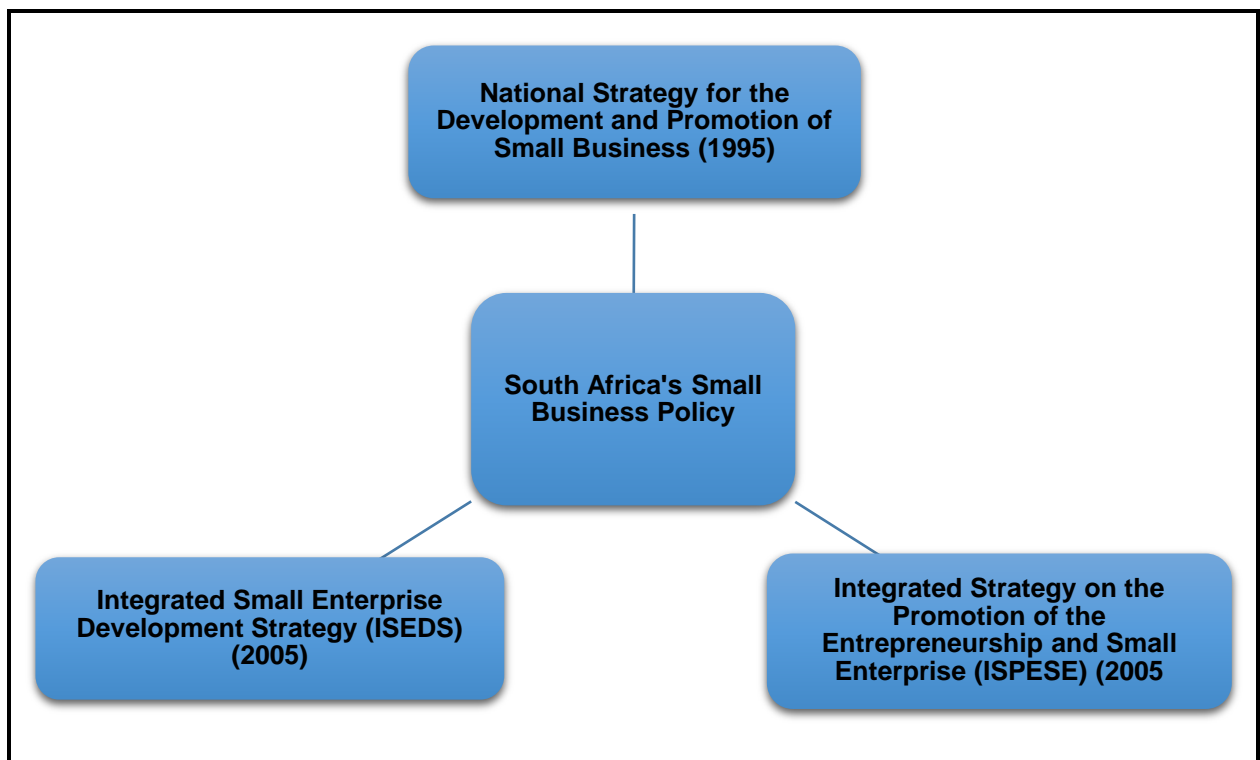


Figure 2: Government strategies entailing South Africa's small business policy (Moos, 2014).

3.5.3 National Strategy for the Development and Promotion of Small Business

Following the publication in 1995 of the White Paper on the National Strategy for the Development and Promotion of Small Business, the post-apartheid Government developed the National Strategy for the Development and Promotion of Small Business. This strategy was seen in the sense of the post-apartheid agenda of SMEs,

which defined main growth goals such as job creation, redistribution and improvisation. The introduction of the strategy was seen as an important part of the democratic Government's efforts to create a better life for all and the Government's contribution to the process of stimulating and supporting small businesses and creating an enabling environment (Rogerson, 2004: 765). The White Paper on National Strategy for the Development and Promotion of Small Business (1995) lays out the national priorities for the SME sector of which the primary objective is to "create an enabling environment" within the context of national, regional and local policy structures for the growth of SMEs (Diale, 2009). More specific policy goals have been established to promote the basic goal to:

- Facilitate greater education of income, wealth and earning opportunities.
- Address the legacy of apartheid-based disempowerment of black business.
- Promote the advancement of women in all business sectors.
- Build long-term jobs.
- Stimulate sector-focused economic growth.
- Strengthen cooperation between enterprises.

The strategy was therefore the first and most important attempt by the Government of South Africa to create an investment-friendly environment for SME development in the country as a way to reduce basic disparities in the economy. However, the strategy did not yield the expected results (Dockel, 2005).

3.5.4 Integrated Small Enterprise Development Strategy (ISED)

The Integrated Small Business Development Strategy (ISED) was published in 2005 to support the course set out in the 1995 White Paper by applying the information gathered and experience gained over the past years in action (DTI, 2005:13). According to Mpahlwa (2008:28), the strategy for developing small businesses was based on three pillars, focusing on increased financial and non-financial supply, creating demand for SME products and services, and reducing regulatory constraints. A ten-year policy plan was created with the following goals (DTI, 2003:24):

- Increasing the small business contribution to the South African economy;
- Creating an enabling environment for small businesses;

- Building a long-term, sustainable employment in the small business sector;
- Increasing the representation of previously historically marginalised individuals in the small business sector; and
- Increasing competitiveness of the small business sector and its enabling environment.

In terms of differences between the first two policies, two of the goals of the ISEDS were to improve the contribution of the organisation as well as its profitability. These goals were not included in the national strategy of 1995. Whilst both set the objective to create long-term jobs, the ISEDS added that the jobs had to be sustainable. It could be that the Government realised that many small businesses were struggling to survive the first three years of operation, therefore jobs were not secured.

3.5.5 Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (ISPESE)

The SME sector in South Africa has traditionally been constrained by the legal and regulatory climate, market access, access to capital, skills and managerial knowledge, access to appropriate technology, tax burdens, and access to quality business services in poor areas (DTI, 2005). To tackle these issues and to coordinate the efforts of all public and private sector organisations working to support SMEs, the Integrated Strategy for the Promotion of Entrepreneurship and Small Enterprises (ISPESE) was established in 2005. The plan is based on the following objectives:

- Ensuring that the overall mission of encouraging entrepreneurship and supporting small businesses is carried out in an efficient and effective manner.
- Ensuring alignment and better coordination;
- Encouraging increased engagement by the private sector
- Ensuring progress across the entire entrepreneurial spectrum
- Focusing on specific target groups, regions and priority sectors.

ISPESE also added an objective that focused on promoting entrepreneurship across the entire spectrum. According to Moos (2014), the Government became very clear about what it had to accomplish with the ISPESE policy in terms of results. Nevertheless, the progress of the strategy has been hampered by adverse economic

conditions, the limited execution of many planned activities, and inadequate coordination and monitoring structures across government (National Evaluation Report of the ISPESE, 2018). The strategy was an appropriate response to the underlying problems faced by SMEs in South Africa. There was a lack of clear implementation guidance, structured planning processes and robust monitoring and assessment frameworks due to the decentralised nature of the strategy. As a result, the strategy has not achieved its intended results. It can be deduced from the literature above that South Africa needs a decisive policy and a sustainable and enabling environment for SMEs and the development of entrepreneurship. The following section will take a closer look at institutions that were established to assist SMEs.

3.5.6 Government Institutions Supporting SMEs

Countries around the world have long recognised the importance of SMEs to economic growth. As a result, different policy measures have been developed and organisations have been set up to foster the growth of the sector. South Africa is no exception to this. Considering that there are approximately 5,900,000 small businesses in South Africa (Finscope, 2010), well-functioning support agencies are vital.

3.5.6.1 The Small Enterprise Development Agency (SEDA)

The Small Enterprise Development Agency (SEDA) is an agency of the Department of Small Business Development. The Agency was established in December 2004, through the National Small Business Amendment Act (Act 29 of 2004). SEDA's main mission is to develop, support and promote small enterprises in South Africa in general. Services provided by this institution include tender advice, networking and business links, providing guidance to access markets, technical support for businesses and improving productivity (Atkinson, 2012). The strategic objectives of SEDA include amongst others the promotion of competitiveness and capabilities of small business through coordinated service programmes and projects. The key services provided by SEDA include assisting small business with registration, compilation of business plans, facilitating access to market for local SMMEs, finance, technology, providing small business owners with training and mentoring (Njiro & Compagnoni, 2010).

3.5.6.2 Small Enterprise Finance Agency (SEFA)

The Small Enterprise Finance Agency (SEFA) is a merger of SAMAF (the South African Micro Finance Apex Fund), Khula Enterprise Finance (Ltd) and the Industrial Development Corporation small business activities. SEFA was launched in April 2012 as a fully owned subsidiary of the Industrial Development Corporation. The current SEFA product portfolio is therefore made up of two categories, namely retail and wholesale products (where retail products focus on direct lending to the entrepreneur and the wholesale product focus on providing entrepreneurs with access to financing through a partner organisation (Pienaar *et al.*, 2013:2). Financing of SMEs has been simplified with the creation of SEFA because too many small businesses were still finding themselves struggling to access finance (Masote, 2012:7).

3.5.6.3 National Youth Development Agency (NYDA)

The National Youth Development Agency (NYDA) was also introduced to encourage entrepreneurship, job creation and skills development among South Africans between the ages of 18 and 35. It is committed to creativity in order to create opportunities for young people to acquire appropriate skills, pursue job opportunities or even start up their own companies (Ladzani & Netswera, 2010). The NYDA was launched in June 2009 through the merger of the Umsobomvu Youth Fund and the National Youth Commission. One of the strategic objectives of NYDA is economic participation, which aims to improve youth participation in the economy through targeted and integrated programs (Perks, 2010). The Economic Engagement Program includes corporate finance as one of its products. The central objective of Enterprise Finance is to promote entrepreneurship among young people by providing credit finance to expand, purchase or purchase existing enterprises or start new ones.

3.5.6.4 Provincial SME desks

Provincial SME offices were formed to ensure the provincial representation of SME interests and to contribute to the implementation of the Government's National Strategy. The purpose of these offices is to provide support to SMEs in all provinces. SMEs desks have been set up with the intent of becoming "one-stop information centres" which would speed up and simplify the communication process. Essentially, the function of these provincial SME offices is to organise support programs and activities for small businesses within the provinces. Provincial growth planning for the

development of SMEs is therefore geared towards adapting national policy guidelines and changing them to local circumstances. Distribution of income, wealth and economic opportunities indivisible from growing labour absorption in SME sector, addressing the inequalities of the past between blacks and women's access to economic activities, and further promoting the growth of black and small enterprises in rural areas.

3.5.7 Reasons Why Government Support of Small Businesses Failed

Although the importance of SME development has grown throughout the years, SME development and government support programmes have not been without criticism. Schmitz (1998) identified the following points of criticism to SME support, which includes:

- Insufficient awareness of programmes;
- Uneven distribution (concentration in urban areas);
- The high cost of searching for support services; and
- Cumbersome administrative requirements of government programmes.

SME owners indicated that one of the main challenges that they encounter is access to basic information from government on starting and growing a business in South Africa. According to GEM (2018), SMEs find it difficult to get assistance when inquiring about available programmes via telephonic or web-based platforms. Telephone calls are rarely answered, websites are not user friendly, information on the website is often more than a year old and in other cases offerings are good, but no application forms are provided. The Western Cape Youth Report (2008) highlighted that poor service delivery is the main reason for failure of government programmes. Lack of qualified and experienced personnel was identified as exacerbating the poor performance of a number of government programmes. Unqualified and inexperienced business advisors were employed. The 2016 experts' assessment of government programmes indicated that very little has changed in this respect.

3.6 CONSEQUENCES FOR SME FAILURE

Business failure affects not only the company itself, but also its stakeholders; it can result in serious damage to businesses in the short term and in the medium term (Hart

& Knott, 2005). Unincorporated SMEs do not enjoy limited liability; they are often secured by the owners' personal assets. Failure can therefore lead to a loss of business and personal properties. Incorporation would help to reduce personal losses to entrepreneurs in the event of failure. According to Maas and Herrington (2006), there are also emotional costs associated with a new SME failure. In fact, South Africa has a tough stance against failure, which excludes many aspiring entrepreneurs. Hart and Knott (2005) further state that the effects of the failure may also have an impact on the government policy. In addition, business failures are costly in terms of jobs, lost productivity, purchasing power (unpaid wages), finance (unpaid debts), poverty reduction and income equality. Fatoki (2014) states that business failures can also lead to social issues such as violence, alcohol abuse and prostitution, as well as reduced income for the Government in the form of lower taxes and increased expenditure as result of crime.

Mitchell *et al.* (2008) suggest that the impact of a new SME failure can be both negative and positive. While the negative effects of failure manifest in monetary and emotional costs, their positive effects are correlated with experience, understanding, and other cognitive constructs. Nevertheless, the majority of lenders, as well as venture capitalists, consider past failure to be a virtue. The meaning of a new SME failure must at least be understood in the context of start-up experience. Failure can, in reality, promote learning and a new beginning, leading to success. This is consistent with the view of Markman, Phan and Ballkin (2007) that personal perseverance is linked to the willingness of an individual to continue in the face of challenges, threats and failures. In fact, just as much as these challenges can be resolved, enterprises continue to struggle.

The problems with SMEs highlighted here are not new. They are the specific conditions of South Africa that can be changed. SMEs need to make a positive contribution to the economy. The Government will play its part in ensuring that its capabilities are strengthened and regulatory reforms streamlined (Mahlaka, 2014). According to the Mail & Guardian (2013), this high rate of failure can also explain why South Africa has not been so successful in attracting small businesses to create jobs. Big firms produce more net jobs in South Africa than small firms do, mostly due to the high attrition rate of small businesses.

Mail & Guardian (2013) further points out that SMEs in South Africa are hampered by three main challenges, namely access to skilled labour, business regulations and access to finance. Small businesses in South Africa have been worse off in these particular areas as compared to other African countries (Mail & Guardian, 2013).

3.7 CONCLUSION

This chapter identified and discussed the challenges affecting the growth of SMEs in South Africa. These relate to access to infrastructure, lack of finance, poor management skills, economic factors and crime. It went further to discuss the strategies entailing the small business policy namely, National Strategy for the development and promotion of small business (1995), Integrated small enterprise development strategy (ISEDS) and Integrated strategy on the promotion of entrepreneurship and small enterprises (ISPESE). Comparing the objectives of the strategy, it can be concluded that the Government's aim has slightly changed from 1994 to 2005. Government institutions and programmes that are established to assist the SME sector were discussed and there was no indication that the programmes have succeeded in assisting the small business sector. The recommendations and remedial actions of the study are presented in the next chapter.

CHAPTER 4: Recommendations to SME Owners and Government Institutions

4.1 INTRODUCTION

The study found that the SME sector in South Africa plays an important role in the economy of the country. Abor and Quartey (2010:223) note that SMEs employ majority of the workforce and contributes half of the nation's GDP. The growth of SMEs is therefore necessary to support the economic challenges currently facing the country, such as unemployment, poverty and inequality. As a result, this chapter will discuss recommendations for the SME owners and Government. The purpose of this section is to present measures that may be used to remedy the causes of failure among small businesses as mentioned in mentioned in Chapter 3.

4.2 RECOMMENDATION

The below recommendations are addressed to SME owners and managers, government and institutions that provide assistance to small businesses based on the findings of the study.

4.2.1 Feasibility Study

The literature review highlighted that South African SMEs were less innovative compared to those in developing countries. It further notes that SMEs do not perform feasibility studies into their newly-ventured business or market climate, hence the majority of SMEs fail in their infant stages (Fatoki & Garwe, 2010). By carrying out a proper feasibility study, the target audience and their purchasing power can be clearly identified. This process will determine the likelihood of the business succeeding strength. A feasibility study is important as remedies for the above can reduce high failure rates in small business.

4.2.2 Improving the levels of managerial competence and skills

The study revealed that poor management skills forms part of the major challenges faced by the SME sector in South Africa. It was established that the lack in management skills amongst SME owners and managers can be attributed to insufficient education and on-going training. Herrington *et al.* (2009) notes the importance of business education to enhance skills and knowledge in starting and

managing a business. Another means by which managers of SMEs can acquire and improve on their managerial skills, is through training. Institutions established by government, such as SEDA and IDC, can provide SME owners and managers with training. Business Mentoring could also assist SME owners and managers with opportunities to develop and enhance their managerial and entrepreneurial skills. Rankhumise and Lehobye (2012:5601) point out that SME owners do not always come from a business background, therefore business mentoring is important as it allows the transfer of skills that may not be acquired. In this way, owner-managers would be able to learn management skills through action, with the support of a person with extensive business experience (Cline, 2011:35).

4.2.3 Access to Finance Gap

Access to capital is among the factors that affect the growth of SMEs in South Africa. The study found that there is limited access to financial resources for small business, as opposed to large corporations. Interventions should firstly focus on increasing financial education and improving financial literacy among SME owners. Past studies mentioned that the majority of SME owners did not understand the products and terms on offer, owing to financial illiteracy. It is important for SME owners receiving on-going training to be familiar with the management of finance and be able to raise capital for refinancing the venture.

Secondly, increasing levels of formality of the SME sector would have a positive impact on the SME sector being able to access finance. Registering a business makes it easier to separate the business from its owners, thus reducing the likelihood of a credit application being rejected. Increasing the formality of SMEs could lead to access to funding from public and private sector financing schemes available and access to other support programs such as business development services.

Lastly, the need for training in cash management and experience for owners of small businesses cannot be overemphasised. The South African Government needs to set up dedicated small business structures to educate and make resources available to small businesses at affordable rates.

4.2.4 Late Payments

The research mentioned that the bulk of SMEs' cash flow problems are attributed to late consumer payments combined with VAT payments on invoices. SMEs are often liable to SARS before receiving any direct payments for a specific transaction. It is thus important that an SME Ombudsman should be established, specifically responsible for resolving disputes between a SME and clients such as government departments, and non-government entities such as corporations. The dispute resolution function of the Ombudsman will focus on contractual agreements, late or non-payment of amounts owed and payable within the 30-day window period.

4.2.5 Labour Regulations

The study found that SMEs in South Africa spend, on average, eight working days a month dealing with regulatory burdens. Frequent changes in the regulatory environment, the need to keep track of overlapping and sometimes conflicting regulatory requirements across multiple departments and levels of government mean that the SME owner spends a disproportionate amount of time dealing with regulatory compliance. A number of SME owners do not have labour law knowledge and financial resources to meet the complex administrative burden of employing and managing staff. The CCMA, in partnership with BUSA, created an online platform where SME owners can access labour related information such as recent law amendments to employment law that factor in the National Minimum Wage Act, as well as guides on labour law requirements.

4.2.6 Marketing and Product Awareness of Government schemes

The Government has established a number of institutions across South Africa to provide the SME sector with financial and non-financial support. However, the research done for this study reveals that very few SMEs are aware that such institutions exist (Maas & Herrington, 2006). The lack of awareness of the nature and existence of these programs can affect the access that enables their execution, making the programs themselves appear ineffective. The Government should put in place the following measures to improve the efficiency of the programmes:

- Publicise the various schemes and programmes through a wide variety of media on an on-going basis, ensuring that the targeted recipients are reached;

- Provide accessible information about the benefits and products that the institution can offer SMEs;
- Organise networking seminars and conference activities which bring SME owners together; and
- Develop a partnership with activities hosted by business chambers.

4.2.7 Monitoring and evaluations of current government programmes

Monitoring and evaluation of current SME schemes is very important in order to determine which programmes meet the needs of the SME sector and support programmes that may need to be redesigned to make them more appropriate for the sector they are intended to serve. The gap in SME support programmes may not necessarily lie in the unavailability of support programmes, but rather the manner in which the available schemes are managed and administered. As part of the evaluation, an assessment can then be made as to the effectiveness of the programmes.

4.3 REMEDIAL ACTIONS TO AVOID FAILURE OF SMEs

4.3.1 Pre-Emptive Actions

Business failure is a slow process that includes descending spirals, hence it is important for SME owners to always be prepared to take all the required actions to avoid failure of the business. In order to manage a business, the owners need to be aware of symptoms that lead to business failure and how to manage them. These symptoms include but are not limited to cash shortage, insufficient profit, high operating expenses, inadequate sales and burdening debts. Therefore, it is important for SME owners to be trained on the abovementioned aspects of business (Yanchus *et al.*, 2003:2).

4.3.2 External advice

SMEs should always seek assistance from highly trained financial accountants and legal experts on a regular basis, beginning at the start-up level and going through all the phases of business life.

4.3.3 Planning and Forecasting Process

A successful business will have the mechanisms in place to observe business plans and an information system which regularly updates the management on progress towards its objectives. For SMEs that are growing and healthy, the process can serve as the foundation for long-range strategic, operational, and financial planning. However, in an underperforming SME or turnaround, it is especially critical to improving profitability and may be the basis of the success or failure of the business.

4.3.4 Strategic Plans

Compiling a strategic business plan is a crucial step in developing a long-term view of where the business is going and how it plans to get there. Considering that the process of starting a market-driven business is difficult but critically important to recognise an opportunity and that success depends on strong customer focus. South African business owners would be expected to be highly receptive to marketing (Grünhagen & Mishra, 2008:1). When a business considers raising capital, the benefits of having a strategic plan become apparent as the main marketing facets of the business would be well established.

4.4 CONCLUSION

This chapter presented the recommendations for ensuring better success of SMEs in South Africa, as it was determined through the literature review. Recommendations for SME owners and government and organisations that assist SMEs were also identified as SMEs cannot succeed on their own. The following chapter will draw conclusion for this study and also indicate the areas of further study on the topic.

CHAPTER 5: Conclusion

5.1 INTRODUCTION

The previous chapter presented the recommendations for SME owners, Government and Organisations that assist SMEs to ensure that small businesses in South Africa are sustainable. This chapter concludes the study by summarising the literature review and revisiting the objectives of the study. The chapter will be divided into three sections. The first section will provide a brief summary of the study, the second section will discuss how the objectives of the study were addressed, and the third and final section will suggest areas that require further research.

5.2 LITERATURE SUMMARY

The literature was covered in chapters two and three. Below, the main findings of each literature chapter are summarised.

5.2.1 SME and Local Economic Development

In chapter two, literature on SMEs and LED was presented. Firstly, the concepts of entrepreneurship and entrepreneurs were discussed. The topic was deemed important, because entrepreneurs are the individuals who start these businesses. Entrepreneurs were defined as individuals who identify opportunities, gaps or unsatisfied needs in the market, and try to meet these identified needs by creating a new business. Next, the discussion focused on SMEs. Definitions of SMEs were presented from a South African context. Here, it was observed that the definitions of SMEs vary amongst countries because of the lack of clear criteria as to which businesses can be classified under SMEs. Subsequently, a specific definition of SMEs was used in this study. The study used the quantitative definition of The National Small Business Act 102 of 1996 of South Africa which uses the number of employees to classify the size of SMEs (Government Gazette of the Republic of South Africa, 2003). In this regard, small businesses referred to in this study were businesses that have a maximum of 50 employees, whilst medium enterprises referred to businesses with a maximum of 200 employees.

Hereafter, the concept of LED was discussed. In this discussion, LED in South Africa was analysed and it went further to discuss the approaches of LED, according to

literature, and it was discovered that LED revolves around two approaches. It revolves around the pro-poor and pro-growth or market-led LED. The pro-growth approach places emphasis on promoting economic growth through competitiveness in the market and attracting investment. The pro-poor LED strategy focuses on approaches to alleviate poverty (Helmsing, 2003). The LED literature indicates that the pro-growth strategies are typically concentrated in Western Europe and North America, whereas there is a need to focus on poverty reduction in the developing countries, thus the pro-poor LED approach (Rogerson, 2003). Pro-poor LED planning in developing countries encourages and helps local stakeholders to encourage poor people to gain access to and benefit from economic activities and help them become entrepreneurs. Both strategies are equally important and can be implemented together to achieve greater socio-economic goals, according to Nel, Hill and Eising (2002). These approaches are equally important and can be practiced together to achieve greater socio-economic objectives.

The discussion that followed analysed the role of SMEs in LED. The literature revealed that SMEs in South Africa play an important social- and economic role through their economic influence and job creation – a role that is highly valued in times of crisis and rising unemployment. Nonetheless, the growth of small businesses helps to address numerous economic development challenges in the country, such as high unemployment rates, inequality, demographic developments and the need for structural change (Oualalou, 2012:57). It further highlighted that the development of SMEs provides multiple job opportunities that can help lower unemployment rates and tackle the demographic challenges posed by growing populations (Malefane, 2013). In addition, SME growth in the local government typifies part of a LED strategy that aimed at achieving, among other goals, the constitutional mandate of local government to promote economic development by working for disadvantaged and marginalised communities (Meyer & Venter, 2013).

The last section of the chapter focused on the challenges faced by LED in local government as well as the contribution of SMEs towards the South African economy and LED. Challenges faced by LED were discussed. According to the Department of Cooperative Governance and Traditional Affairs (2009:51), LED is critical to the development of the country but has been erratic in practice due to the skills required to shape and direct economic growth in local spaces. As a result, South Africa has an

advanced legal- and policy context for LED, yet there are still challenges regarding implementation. The need for LED also arises out of the developmental challenge that economic development does not occur everywhere at the same time. Instead, it occurs unevenly and inequitably across economic space, landscape, and social groups, creating major challenges in terms of satisfying the needs of the citizens with regard to employment opportunities, wealth creation and services – particularly the non-payment of municipal service fees in South Africa. As a result, it also leads to the community engaging in municipal protests.

The section went on to discuss the contribution of SMEs towards the South African economy and LED. Previous literature showed that SMEs are inextricably connected to economic growth, job creation and income generation within poor and disadvantaged communities in the country. These enterprises are purported to have the ability to create jobs for the poor and enable them to earn the income required to buy goods and services (Ndabeni, 2006). They are also regarded as the primary source of tax revenue, which allows governments to fund pro-poor services such as health care, clean water and education.

5.2.2 Factors Affecting the Growth of SMEs and Analysis of Government's SME Policies and Programmes

Chapter three of the study focused on the factors affecting the growth of SMEs in South Africa and an analysis of government's SME policies and programmes. SMEs are seen as the lifeblood of most developing economies (Afande, 2015). Small business growth is thus essential to achieving economic goals, such as job creation, poverty eradication and living standard improvement (Davidsson *et al.*, 2010; Zindiye, 2008). Consequently, motivating growth-oriented business people to set up high-growth companies is high on the government's agenda (Birdthistle *et al.*, 2010; Bosma *et al.*, 2000), as it is the most significant source of new employment and is also considered a key indicator of business success. In South Africa, in spite of the noted contributions of SMEs to the economy, they do not grow but rather assume a survivalist position (Fatoki, 2013). Herrington, Kew and Kew (2010) found that only 1% of all newly established SMEs in South Africa grow and survive for more than a year. In addition to the fact that SMEs in South Africa are not growing, other studies in South Africa have also shown that SMEs have a high rate of failure, as between 70 and 80%

of SMEs are prone to failure (Fatoki & Garwe, 2010; Adeniran & Johnston, 2011). Firstly, the concept of business failure was discussed. The topic was deemed important for the reader to gain understanding of what is meant by business failure. According to literature, there is no exact definition for SME failure, although some schools of thought have tried to define it in order to provide better context. However, Shepherd (2003:318; 2005:124) conceptualises and characterises business failure as insolvency, pointing out that insolvency arises when income decreases and expenditure increases to such an extent that the company becomes insolvent and is unable to attract new debt or equity financing. In such a case, it cannot operate under the same ownership and management structure.

The chapter highlighted the factors affecting SME growth and further showed that these factors can be grouped into two categories, which are micro- and macro-environments. Micro-environment refers to any factors that are internal and can be controlled, such as research and development, the entrepreneur's characteristics, management skills and technology application. Macro-environment, on the other hand, refers to factors that are external and cannot be controlled by the SME owner, such as economic factors, labour regulations, crime and corruption. In assessing the factors affecting the growth of SMEs, government policies and programmes established to improve the performance of SMEs were analysed. The three Government strategies entailing South Africa's small business policy – the National Strategy for the Development and Promotion of Small Businesses, Integrated Small Enterprise Development Strategy, and Integrated Strategy on the Promotion Entrepreneurship and Small Enterprises – were discussed so as to give the reader a better understanding of what government seeks to achieve. The chapter further discussed government institutions that were established to assist small businesses with financial and non-financial service, which include but are not limited to SEDA, SEFA, NYDA and Provincial SME desks.

The last section of the chapter focused on the reasons why the Government support of small business has failed. According to literature, these reasons include, amongst others, lack of awareness (outreach); uneven distribution (concentration in metropolitan areas); the high cost of searching for support services which has not been mitigated by effective information on how and where to access support; and

cumbersome administrative requirements of Government programmes resulting in user fatigue and high levels of disappointment (Berry *et al.*, 2002).

5.3 ACHIEVEMENT OF OBJECTIVES

In this section, the objectives of the study are presented along with the corresponding findings.

5.3.1 Primary Objective

The primary objective of this study was to find out the reasons why SMEs fail in South Africa. Different factors from different business environment were analysed. These factors were categorised under the following business environments, namely Micro-environment and Macro-environment. Different factors under the micro-environment were discussed, including managerial skills and characteristics of the entrepreneur, amongst others, whilst the factors under the Macro-environment were economic, such as labour regulations, crime and corruption.

5.3.2 Secondary Objectives

The study had five secondary objectives. The findings of each of the objectives are discussed below.

5.3.2.1 Analyse the state of SMEs in South Africa

According to the literature study, SMEs are seen as the lifeblood of most developing economies (Afande, 2015). Small business growth is thus essential to achieving economic goals such as job creation, poverty eradication and living standard improvement (Davidsson *et al.*, 2010; Zindiye, 2008). Consequently, motivating growth-oriented business people to set up high-growth companies is high on the Government's agenda (Birdthistle *et al.*, 2010; Bosma *et al.*, 2000), as it is the most significant source of new employment and is also considered a key indicator of business success. In South Africa, in spite of the noted contributions of SMEs to the economy, they do not grow but rather assume a survivalist position (Fatoki, 2013). Herrington, Kew and Kew (2010) found that only 1% of all newly established SMEs in South Africa grow and survive for more than a year. In addition to the fact that SMEs in South Africa are not growing, other studies in South Africa have also shown that SMEs have a high rate of failure, as between 70 and 80% of SMEs are prone to failure

(Fatoki & Garwe, 2010; Adeniran & Johnston, 2011). Despite the nation's encouraging environment for entrepreneurial ventures and programs to stimulate entrepreneurship, SMEs are usually faced with numerous challenges that have a negative impact on their prosperity and economic development.

5.3.2.2. Highlight the consequences of the failure rate of SMEs

The literature study highlighted failure affects not only of the company itself, but also its stakeholders, which can result in serious damage to businesses in the short- and the medium term (Hart & Knott, 2005). Unincorporated SMEs do not enjoy limited liability; they are often secured by the owner's personal assets. Failure can therefore lead to a loss of business and personal properties. Incorporation would help to reduce personal losses to entrepreneurs in the event of failure.

According to the literature study, there are also emotional costs associated with a new SME failure. In fact, South Africa has a tough stance against failure, which excludes many aspiring entrepreneurs. Hart and Knott (2005) further state that the effects of the failure may also have an impact on the government policy. In addition, business failures are costly in terms of jobs, lost productivity, purchasing power (unpaid wages), finance (unpaid debts), poverty reduction and income equality. Fatoki (2014) states that business failures can also lead to social issues such as violence, alcohol abuse and prostitution, as well as reduced income for the Government in the form of lower taxes and increased expenditure as a result of crime. Mitchell *et al.* (2008) suggest that the impact of a new SME failure can be both negative and positive. While the negative effects of failure manifest in monetary and emotional costs, their positive effects are correlated with experience, understanding, and other cognitive constructs.

5.3.2.3. Government's Small and Medium Enterprise policies and programmes

The literature study observed that the 1995 White Paper highlighted, among other things, the need for the Government to create an enabling legal framework to promote access to information and advice (White Paper on the National Strategy for the Development and Promotion of Small Business, 1995). This will lead to support of the recruitment of small firms and to improve access to finance and affordable physical infrastructure. The Government developed strategies entailing the small business policy and established institutions to improve the SME landscape and the performance of small businesses.

5.3.2.4 Assess the programmes in place to support SMEs and address challenges

The literature study analysed various programmes put in place by the South African Government to assist small businesses. According to the literature, these programmes have not been effective due to various reasons. Some of the reasons identified include:

- Lack of awareness (outreach);
- Uneven distribution (concentration in metropolitan areas);
- The high cost of searching for support services which has not been mitigated by effective Information on how and where to access support; and
- Cumbersome administrative requirements of Government programmes resulting in user fatigue and high levels of disappointment.

5.3.2.5 Investigate interventions to address challenges that are affecting growth in SMEs

According to the literature study, there are interventions in place to assist small businesses. Among others, this includes the Department of Small Business which was established in 2014 with the aim of demonstrating the Government's commitment to place SMEs and co-operatives at the centre of economic growth and job creation. The Government also created SEFA to assist SMEs with access to finance. The product portfolio consists of retail and wholesale products (where retail products focus on direct lending to the entrepreneur and the wholesale products focus on providing entrepreneurs with access to finance through partner organisations) (Pienaar *et al.*, 2013:2). NYDA was also introduced to encourage entrepreneurship, job creation and skills development among South Africans between the ages of 18 and 35. It is committed to creativity in order to create opportunities for young people to acquire appropriate skills, pursue job opportunities or even start up their own companies (Ladzani & Netswera, 2010). Lastly, Provincial SME offices were formed to ensure the provincial representation of SME interests and to contribute to the implementation of the Government's national strategy and provide support to SMEs in all provinces.

5.4 AREAS OF FURTHER RESEARCH

It should be noted that whilst this study has made contributions in understanding factors that influence the failure of SMES, there are some limitations which lay the foundation for future research. For instance, the study stated the various factors that influence SME failure, which consists of Micro-environment factors and Macro-environment factors. Future research should look into the impact of the failed small businesses on the overall economic development of South Africa. Furthermore, a comparison should be made with different Southern African Development Community (SADC) countries to investigate which countries have a healthy environment for small businesses and what South African SME owners and Government can adopt.

As noted in chapter three, the organisations offering assistance to small business, such as SEDA, SEFA and DTI, amongst others, have not been effective due to lack of awareness. Future studies should evaluate the appropriateness of the current financing and support schemes, thus ensuring that what is provided in terms of support really does meet the needs and what is being demanded by the small business sector. Furthermore, the study highlighted the need for SME ombudsman. Future research should look into how this can be established, its mandate and how it can help in decreasing the failure rate of SMEs in South Africa.

5.5 CONCLUSION

Firstly, a brief review of the previous two chapters of the study was presented. The chapters included the conceptualisation chapter and literature review chapter. The suggested recommendations were then constructed for SMEs as well as for Government and organisations that provide assistance to SMEs. The last section elaborated on areas that were identified in this research for other research studies to investigate.

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