



Annual Review of Small Business In South Africa – 2004 A Statistical Review



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Minister of Trade & Industry – Mandisi Mpahlwa



It gives me great pleasure to present on behalf of the Department of Trade and Industry (**the dti**), the *Annual Review of Small Business in South Africa – 2004*. This is the second time that **the dti** has co-ordinated the production of the Annual Review which in the past was produced by Ntsika Enterprise Promotion Agency. I am pleased that the Review continues to build on the good work undertaken in 2003, and again consists of a combination of primary research published here for the first time and a synthesis of the small enterprise research available in South Africa (SA).

As in 2003, the Review assesses the outcomes or impacts of our policies and programmes. This is an important distinction from past evaluations of **the dti**'s programmes and policies, which had tended to focus on the outputs of our programmes. Today, our primary concern is no longer whether an additional Local Business Service Centre (LBSC) has been established or whether five more SMMEs¹ were assisted through export development. Important as these output measures are, what matters most for us is whether, taken in its totality, the full array of government support measures has had a positive impact on the SMME economy, and especially on government's core objectives of poverty alleviation, equity and competitiveness.

The 2004 Review provides a nuanced analysis, which takes into consideration the global economic environment in which all of SA's firms – big and small – operate. We find positive developments in many areas. The number of entrepreneurs active in SA has increased once again, with an additional 100,000 people finding the means to become entrepreneurs in the informal sector. The formal sector has also seen an increase in the number of entrepreneurs, with almost 40,000 new entrants. However, we must be cautious in interpreting these statistics too literally; we strive to verify these trends through qualitative research focused on the Mpumalanga Province and the Agro-Fishing and Informal Retailing sectors.

The results from these analyses are less positive. We find that in both the fishing and the informal retailing sectors, regulatory issues remain a source of concern for small enterprises. These results corroborate the findings of a number of other studies commissioned or supported by **the dti**. We are happy to report that these issues are now receiving focused attention through a number of inter-departmental initiatives and we are confident that, where feasible, burdensome regulations hindering small enterprise development will be addressed. The findings from our study on the small enterprise sector in Mpumalanga underline once again the close relationship between formal sector economic trends and those of the SMME sector. We find that small enterprises have benefited from the general economic growth of the Province but that for the emerging sector in particular, constraints to growth and increased employment remain.

We believe that these constraints and others raised in the course of **the dti**'s regular interactions with small enterprise owners and policy practitioners are addressed to a significant extent in a revised strategy for small enterprise development tabled in Cabinet in 2005.

Mandisi Mpahlwa M.P.
Minister of Trade & Industry

¹ Small, medium and micro enterprises

the dti is proud to present the *Annual Review of Small Business in South Africa – 2004*. The objectives of the Annual Review are to provide a description of trends and an analytical assessment of the performance of the small enterprise sector within the broader context of the SA economy as a whole.

A second-order objective of the Review is to begin to provide a consistent conceptual framework for analysing the small business sector. In particular, we are concerned with the often conflicting and inaccessible data sets used by small business researchers and analysts. In this publication, we have taken the view that we need to introduce a degree of consistency in the statistics to be used for policy and review purposes. Throughout the 2004 Review, as in the 2003 edition, we have therefore tried to use Statistics South Africa (Stats SA) data wherever possible. In most cases the series we draw upon are those which Stats SA continue to collect, thereby ensuring that subsequent Reviews are able to draw from a consistent and reliable dataset accessible to all researchers and analysts.

The 2004 Review is structured into two parts. *Part One: Regular Features* provides an over-arching review of trends in the small business economy and is supported by detailed statistics. In *Part Two: Research Features*, we hold a mirror of qualitative research results to the detailed statistics and draw from this combined rich source of information, policy-relevant issues. Due to the paucity of quantitative data on small business we believe that the most reliable analysis is likely to come from combining what quantitative data there is with focused qualitative information.

In *Part One: Regular Features* we begin in chapter 1 by providing an assessment of the performance of the SMME sector by drawing on quantitative and qualitative analyses. We go on to propose some broad conclusions by reflecting on the key drivers and inhibitors of the sector's development, thereby presenting a coherent picture of the SA SMME sector.

In chapter 2 we describe the key basic statistics for the SMME sector, comparing trends between 2003 and 2004 for the following dimensions:

- Number of entrepreneurs;
- Sectoral distribution;
- Geographic spread of SMMEs;
- Distribution by demography;
- Entrepreneurial dynamism (entry and exits); and
- Contribution to economy by employment and GDP.

In *Part Two: Research Features* we start with an analysis of the Agro-Fishing and Informal Retailing sectors of the economy. These chapters are intended to challenge the notion that SMMEs are homogenous across the various sectors of the economy. Chapter 3: Fishing and chapter 4: Informal Retailing go some way to debunking this myth. Both chapters draw on primary research recently completed, reach some interesting conclusions around the obstacles to SMME growth and highlight key policy spaces for government intervention.

Chapter 5 provides a review of the SMME economy in the Mpumalanga Province. Drawing on primary research collected through almost 100 SMME interviews, this chapter highlights the key features of the provincial SMME economy, underscoring growth trends and impediments to faster growth of the sector.

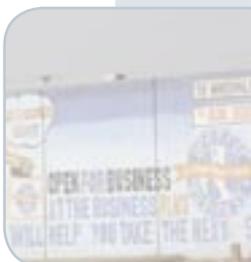




Part 1: Regular Features

Review of Trends and Performance

The SA Small Business Sector in 2004



1. Introduction

This overview chapter of the *Annual Review of Small Business – 2004* is intended to serve a number of purposes. First, we aim to provide an assessment of the performance of the SMME sector in relation to the broader South African (SA) economy in 2004. This is done by drawing upon both the quantitative and qualitative analyses described in later chapters. Secondly, the chapter synthesises and, in reaching its conclusions, draws upon a substantial body of relevant SMME-related research being conducted across SA. These analyses are used to develop a coherent picture of the SA SMME sector, review its performance in 2004 and begin to reflect on the key drivers and inhibitors of the sector's development.

In developing this analysis we make use of the basic conceptual framework developed by the Global Entrepreneurship Monitor (GEM) and depicted below (*see Figure 1*). As the graphic suggests, there is a range of factors which impacts on both large and small enterprises' growth performance. These broad factors, for example the overall macro-economic outlook, efficiency of the financial markets and a well-functioning labour market, are the core underlying determinants of all size enterprises' growth potential.

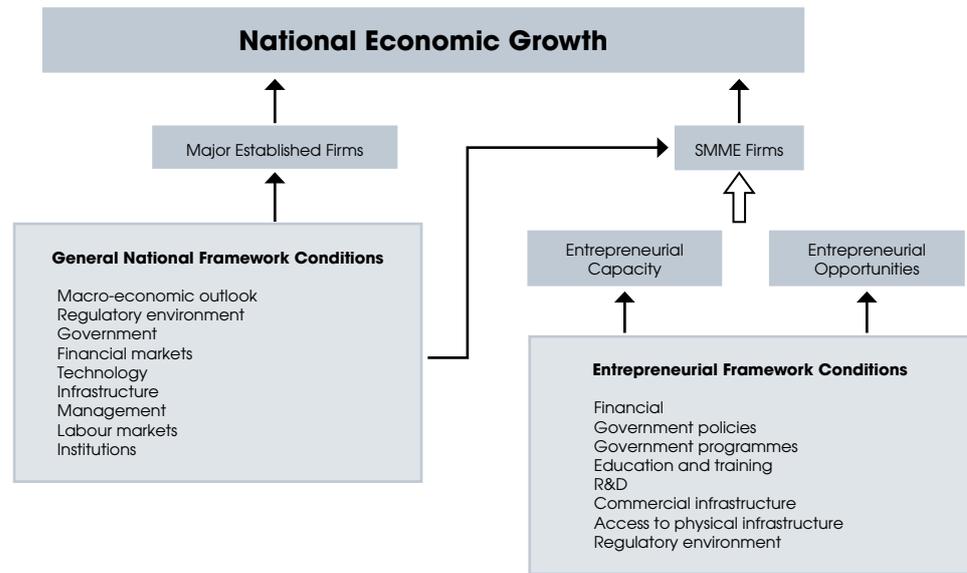
In addition, SMME growth potential is also shaped by two key dimensions to entrepreneurship – entrepreneurial capacity and entrepreneurial opportunity. Capacity refers to the resources, be they financial, physical or intellectual (for example, a particular skill) that an entrepreneur can draw on to operate his/her business. Opportunity, in contrast, refers to whether the market in a particular locality is fully saturated or if business opportunities are presenting themselves. The latter is perhaps not as relevant in the current era of globalisation, but in rural areas or areas such as SA's main metropolises where many businesses compete for the same limited disposable income, it may well be that the quantity and quality of entrepreneurial opportunities could be constrained.

Both entrepreneurial capacity and opportunity are impacted by a range of policies at all tiers of government. Some of these are shown in Figure 1. A key objective of the Annual Review is that through undertaking primary research, a range of impediments to small enterprise development is uncovered and reflected upon, leading to initial policy proposals or corrective action.

Ideally, we would want to report on each of the dimensions described below. However, lack of consistent and reliable data makes this an impossible task. Nonetheless, we hope that by drawing on a variety of research sources, we are able to make some judgements with respect to at least some of the more important dimensions described.



Figure 1 – Conceptual framework of SMME development



Source: GEM 2002

2. The context for SMME development

2.1 The economic environment in 2004

2.1.1 Globally

SA's small enterprises operate in global, regional and local economic environments which may not always be supportive to their growth prospects. With the end of apartheid, SA has become firmly part of the global economy, and trends in the world economy play an increasingly important role in the growth prospects of businesses across the size spectrum. SMMEs are relatively less able to deal with 'shocks' in the global economy and are therefore particularly vulnerable. Moreover, small business is often a minor link in global value chains, sometimes supplying narrowly specified goods and services to other suppliers that are themselves very low down on the global supplier value chain. Cutbacks due to weak global growth may therefore still have an impact on SMMEs, even when they – on the face of it – supply only local markets.

Fortunately, the world economy grew rapidly in the year under review. Growth for the world economy as a whole was a record 5%, with Africa growing by a similar amount. While the US recovered strongly, the EU continued to grow only slowly. However, the main impetus for the world economy was South Asia and parts of East Asia, with China and India in particular expanding rapidly. The Commonwealth of Independent States (formerly Russia) also grew strongly and overall growth was relatively dispersed across the world, thereby setting the scene for significant merchandise trade growth rates.



Global merchandise trade rose by almost 9% in real terms in 2004, its highest rate of increase since 2000. Asia accounted for a substantial portion of the growth in trade, with China, South Korea and Singapore all growing their exports at rates of more than 20%. Africa as a whole shared in the upswing in trade growth rates, with exports growing at over 4%. Imports to Africa grew at over 10%. A significant portion of these imports were capital goods such as machinery, suggesting that a period of strong economic growth and trade may be in the offing for the region.

2.1.2 Domestically

After SA's relatively poor growth performance in 2003, the economy responded strongly to a variety of local and international developments and grew by a solid 3.5% in 2004. Importantly, growth in the second half of 2004 topped 5% and we believe that this will have been maintained into 2005. The main international developments underpinning SA's better performance was the strength of the commodity cycle, with iron ore, steel, copper and aluminium prices increasing in response to strong global demand, particularly in Asia. On the domestic front, domestic expenditure remained relatively strong as consumers continued to take advantage of the low interest rate environment and the expectation of continued strong housing price growth.

The main sectors of the economy contributing to a stronger economic performance in 2004 were manufacturing, construction and services. The manufacturing sector recovered partly as a result of the softening of the value of the Rand in 2004 and stronger export demand. The construction sector grew strongly in 2003 at 5%, and this accelerated to 6.5% in 2004 as the strong growth in house prices persisted and banks' advances on mortgages assisted consumers wishing to renovate their properties. In addition, government's more expansionary fiscal policy – in particular in relation to infrastructure investment – will have had a substantial effect on the construction sector's capacity utilisation. The service sector continues to underpin SA's stronger economic performance. Once again the transport and telecommunication services, as well as financial services, are the main driving forces behind the services growth rate.

Table 1 – Real GDP: percentage change, seasonally adjusted annualised rates

Sector	2003	2004
Primary sector	1	3.5
<i>Agriculture</i>	-6	1
<i>Mining</i>	4.5	4
Secondary sector	0	3
<i>Manufacturing</i>	-1	2.5
Tertiary sector	4	4
TOTAL	3	3.5

Source: SA Reserve Bank Quarterly Bulletin, March 2005

As SA's small enterprises are not spread across the economy in the same proportions as large companies, the nature or structure of growth is often as important as growth in its own right. The broad-based nature of the economy's strong performance in 2004, coupled with the continued good domestic expenditure rates, will have supported the SMME sector in the year under review, and this is borne out by the results of our provincial and sectoral qualitative analysis.

With respect to the informal sector, the continued strong performance of construction and services is likely to have had a positive effect on small enterprise performance. These two sectors account for about 90% (by number) of all informal enterprises, and consequently the framework conditions for informal sector growth were relatively accommodating. The formal small enterprise sector is concentrated in the financial and business services (44%), trade (23%) and manufacturing (12%) sectors. Once again, the services and trade sectors' performance has been good, driven mainly by domestic expenditure, while the manufacturing sector – which performed solidly if unspectacularly – was, in addition to domestic expenditure, also supported by some increased demand for exports.

SA's exports grew by 25% in US dollar terms in 2004 but the major portion of this increase was due to the appreciation of the Rand. In physical volume terms, SA's exports were relatively stable; many of the commodity sectors such as platinum, coal and iron ore were in great demand internationally but these sectors also often suffer from supply-side constraints and are therefore not always very responsive to changes in international demand.

2.2 The regulatory environment in 2004

In the *Annual Review of Small Business – 2003* we referred to as yet unpublished research into the cost to the SA economy of red tape, an important study which was being undertaken by SBP. SBP has now published a full report, *Counting the Cost of Red Tape for Business in South Africa*¹, which is based on a comprehensive survey of some 1,800 enterprises.

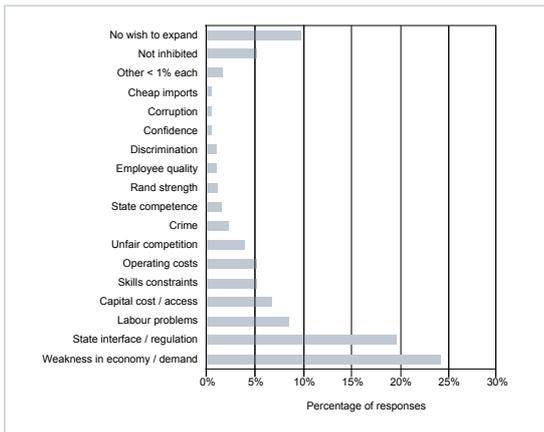
Results from the SBP study suggest that red tape is not only of significant financial cost to the SA economy. In fact, what may be of even more significance than the approximately R79-billion which firms and individuals spend on regulatory compliance, is the extent to which the regulatory environment is acting as a brake on economic development. Figures 2 and 3 indicate survey respondents' views on the factors inhibiting business and employment growth. Interestingly, factors such as crime, corruption

¹ SBP, June 2005

and affirmative action – which are often cited by the media as major impediments to growth – feature relatively low down on the list of factors. Instead, the regulatory environment – or the ‘state interface’ as SBP describes it – labour problems and their high cost, and relatively low skill levels are cited as the key factors by most respondents.

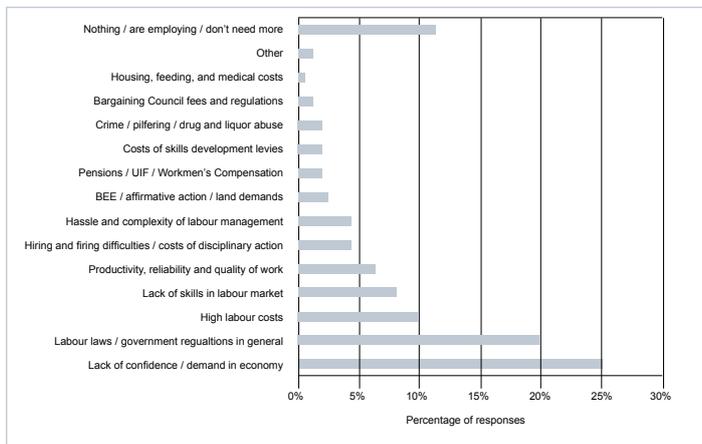


Figure 2 – All firms: factors inhibiting business growth



Source: SBP, *Counting the Cost of Red Tape for Business in SA, 2005*

Figure 3 – All firms: constraints on increased employment

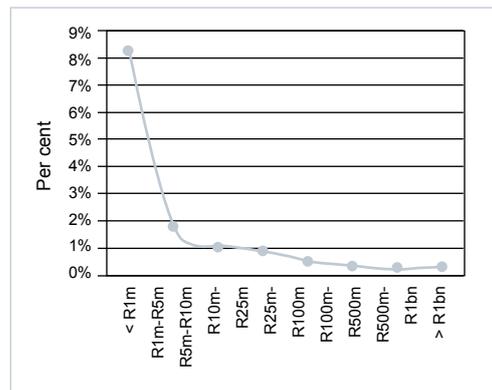


Source: SBP, *Counting the Cost of Red Tape for Business in SA, 2005*

However, it is not just that respondents see regulatory compliance as an impediment to growth and an expensive burden; compliance costs are also not evenly distributed amongst size classes of enterprises. The SBP research shows that regulatory compliance costs are regressive: small firms bear the heaviest burden in relation to firm size.

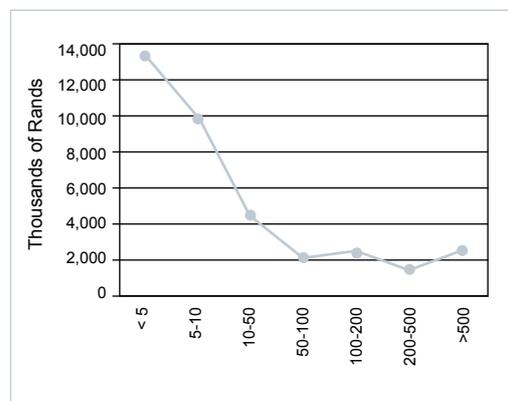
Figures 4 and 5 indicate that for very small firms, more than 8% of turnover and more than R13,000 per employee is spent on annual regulatory compliance. Although these costs fall relatively quickly as we move up the firm-size continuum, they nonetheless remain significant.

Figure 4 – All firms: annual regulatory compliance cost as a percentage of turnover



Source: SBP, *Counting the Cost of Red Tape for Business in SA, 2005*

Figure 5 – All firms: annual regulatory compliance costs per employee by number of employees



Source: SBP, *Counting the Cost of Red Tape for Business in SA, 2005*

The SBP study estimates that total recurring compliance costs for the formal sector amounted to nearly R79bn in 2004, equivalent to about 6.5% of SA's gross domestic product (GDP) in 2003. Whilst international comparisons should be treated with caution because of the difficulty in choosing 'true' comparator countries, it is nonetheless concerning to note that the OECD² average is less than half of this at 3% of GDP.

² Organisation for Economic Co-operation and Development



Table 2 – Estimated regulatory compliance costs in some developed countries as a percentage of GDP*

Australia	3
Austria	3.8
Belgium	1.8
Finland	1
Iceland	1.3
New Zealand	2.8
Norway	2.8
Portugal	5
Spain	5.6
Sweden	2.2
Average	3

Source: SBP, *Counting the Cost of Red Tape for Business in SA, 2005*

* C Cordova-Novion and C De Young, *The OECD PUMA multi-country business survey – benchmarking the regulatory and business environment*, in C Evans, J Hasseldine and J Pope (eds), *Tax compliance costs: a festschrift for Cedric Sandford*, Sydney, 2001

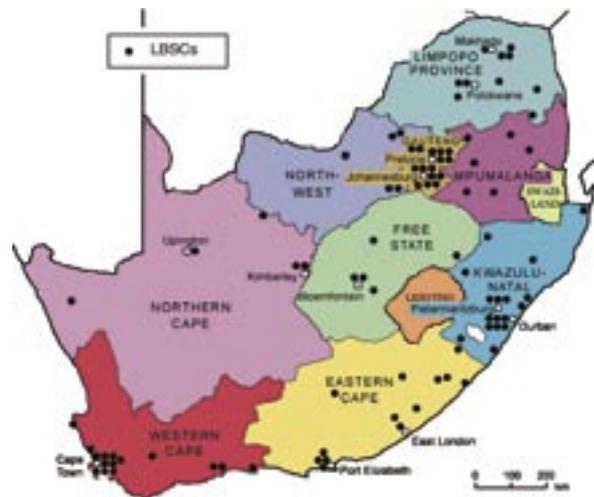
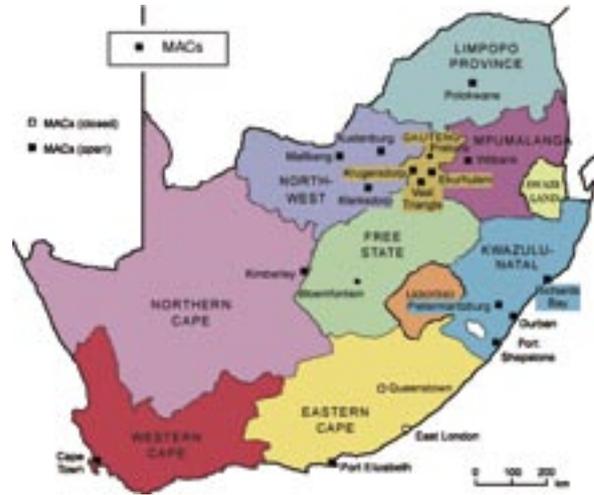
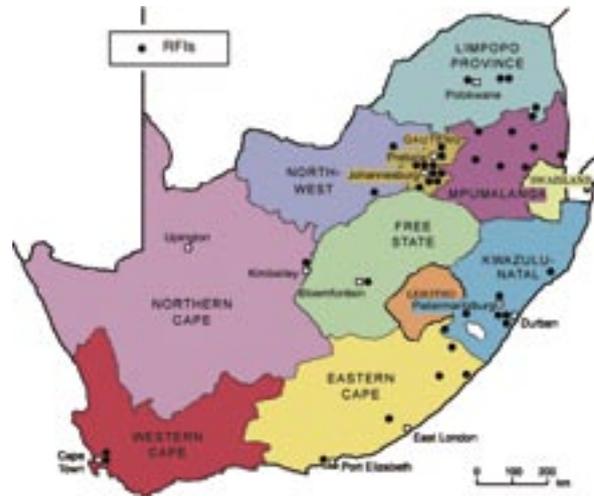
It is important to note that regulation is a necessary and socially justifiable activity in any modern economy. However, what is of particular concern to small enterprises is the high cost of ensuring compliance and the regressiveness of this burden. Moreover, the democratic Government of SA has over the last decade taken many important decisions to modernise the economy and has proposed many socially desirable policy interventions. The challenge in the medium term will therefore be to ensure that the regulatory burden (1) does not increase further and (2) that where possible, the costs of compliance are ameliorated for all enterprises, but particularly for small business.

2.3. The institutional environment in 2003

Government departments at all three tiers (national, provincial and local) continue to make good, albeit uneven, progress in providing an institutional network for small business. The three maps in figure 6 illustrate the current extent of roll-out of three key programmes of national government. The Local Business Service Centres (LBSCs) suggest the greatest reach for this seda³-co-ordinated programme, with at least three to five Centres in the least-industrialised provinces, increasing to almost 20 in KwaZulu-Natal and Gauteng. The coverage of Retail Financial Institutions (RFIs), a programme of Khula Enterprise Limited, and the Manufacturing Advice Centres (MACs) – while less extensive – are still considerable, with at least one RFI and one MAC in every Province except the Free State.

³ Small Enterprise Development Agency

Figure 6 – Institutional network of key small business support institutions



Source: Ntsika Enterprise Promotion Agency and Khula Enterprise Finance Annual reports, various



3. Trends and performance

3.1 Entrepreneurial dynamism

The SA economy experienced an accelerated growth rate in 2004 and this is reflected in the growth of the number of entrepreneurs in both the formal and informal sectors. The number of entrepreneurs in the formal sector grew from 506,000 in 2003 to 545,000 in 2004, an increase of just under 40,000. This is a particularly promising development as it is generally acknowledged that the formal small enterprise sector has a higher propensity to increase employment than the informal sector, which is characterised by many one-person enterprises.

The informal sector (including subsistence farming), whilst continuing to grow, slowed from the over 10% growth between 2002 and 2003 to growth of about 4.5% between 2003 and 2004. Nonetheless, some 68,000 new entrepreneurs entered the market in 2004, with about half of these new entrants involved in some form of subsistence agriculture.

Whilst we are mindful that one year of positive data does not represent a trend, we do believe that the data may represent a significant turnaround in the fortunes of the small enterprise sector. In the 2003 Review we noted that whilst an increase in informal sector activity suggests a significant degree of entrepreneurial dynamism, these entrepreneurs are likely to be necessity rather than opportunity entrepreneurs.

The slowing of informal sector growth and the acceleration of formal sector small enterprise entrants suggest that perhaps the small enterprise economy has reached a lower turning point. It may be that the informal sector is fully saturated, but considering the negligible entry barriers, this is unlikely. We believe it is more likely that aggregate growth in the economy is drawing more entrepreneurs into the formal small enterprise sector whilst the modest increase in formal sector employment (for all size classes), in particularly construction, services and Government's Expanded Public Works Programmes, may be beginning to absorb unskilled labour. In addition, the increase in subsistence farming could be related to land reform, which was expected to have a lagged impact.

Table 3 – Number of employers or self-employed (in their main capacity)

		Among population of working age (15-65)			Among elderly (65+)	TOTAL
		Formal	Informal	Total		
Sept 2003	Employers/self-employed (incl. commercial farms)	506,000	1,234,000	1,750,000	58,000	1,808,000
	Subsistence farming		261,000	269,000	39,000	308,000
	TOTAL			2,019,000	97,000	2,116,000
Sept 2004	Employers/self-employed (incl. commercial farms)	545,000	1,267,000	1,824,000	61,000	1,885,000
	Subsistence farming	-	296,000	302,000	47,000	349,000
	TOTAL			2,126,000	108,000	2,234,000
March 2005	Employers/self-employed (incl. commercial farms)	575,000	1,252,000	1,836,000	56,000	1,892,000
	Subsistence farming	12,000	370,000	385,000	64,000	449,000
	TOTAL			2,221,000	120,000	2,341,000

Source: Stats SA LFS, September 2004 and March 2005 (table 3.11.1 and 7.1)

* For all values of 10,000 or lower the sample size is too small for reliable estimates.

* For the population of working age, employers or self-employed are defined as those “Working on his/her own or with a partner, in any type of business (including commercial farms)”, while subsistence farming is defined as “Working on his/her own small farm/plot or collecting natural products from the forest or sea”.

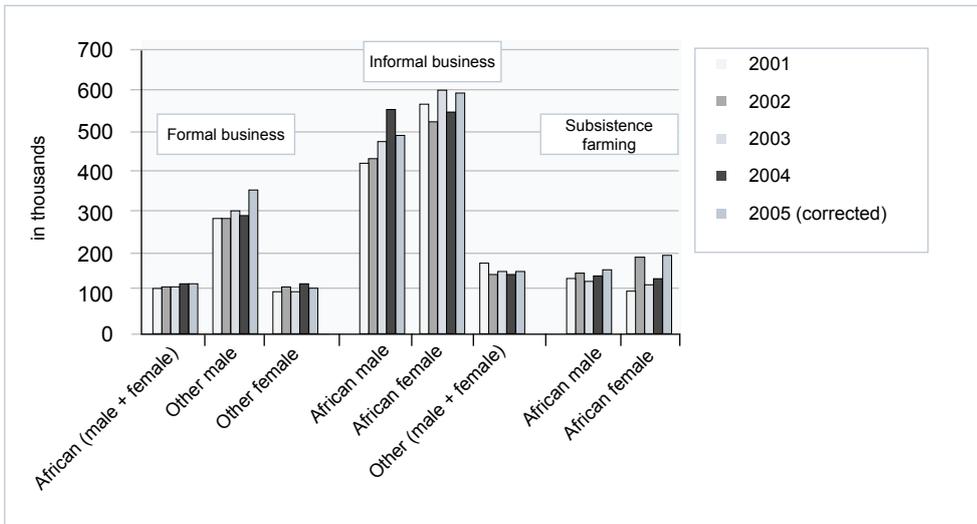
* For the elderly, employers or self-employed are those who “Run or do any kind of business, big or small, for himself/herself”, while subsistence farming concerns those who “Do any work in his/her own or the family’s plot, farm, food garden, cattle post or kraal or help in growing farm produce or in looking after animals for the household”.

* Note: Total includes ‘don’t know / unspecified’ sector.

* Note: Due to rounding, numbers do not necessarily add up to totals.

Turning to the demographics of employers and the self-employed, we see that in the formal sector, black African men and women remain in the minority, with mainly white entrepreneurs dominating the sector. There is, however, a significant increase in black African participation in the sector in 2004, although it is too early to tell if this is likely to be sustained. In the informal sector, black African men and women dominate, with a substantial increase in the number of black African men entering the sector. The data do not allow us to say with certainty in which sectors these new entrants are involved but it is probable that the service sector and perhaps construction have seen the major portion of the increase.

Figure 7 – involvement of various population groups in business, 2001-2005



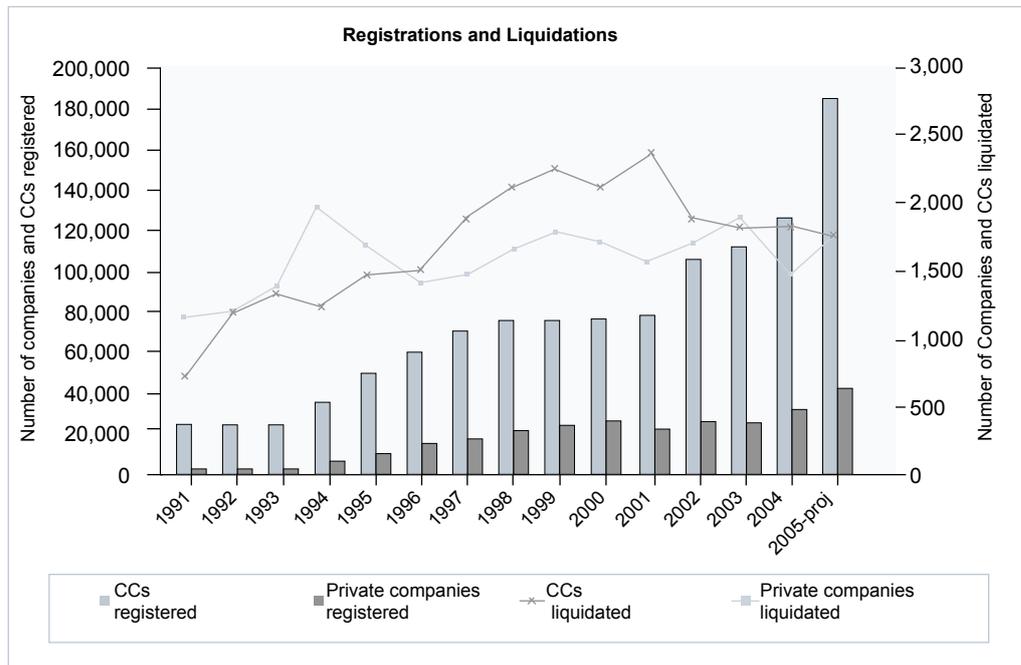
Source: LFSs, September 2001 to March 2005

3.2 Entrepreneurial capacity

Entrepreneurial capacity refers to the ability of SMMEs to remain in operation and grow production and employment. This is an important dimension for policy-makers, as a high rate of small business failures can be costly to the economy in terms of unutilised or underutilised investment, in its effect on the entrepreneur’s own financial position and, of course, to creditors to the company. In addition, the benefit to the economy of start-up businesses is relatively small; research by the GEM suggests that the most significant benefits to the broader economy accrue when small enterprises begin to grow rapidly and start to increase employment and production.



Figure 8 – Number of registrations and liquidations of CCs and companies, 1991-2005



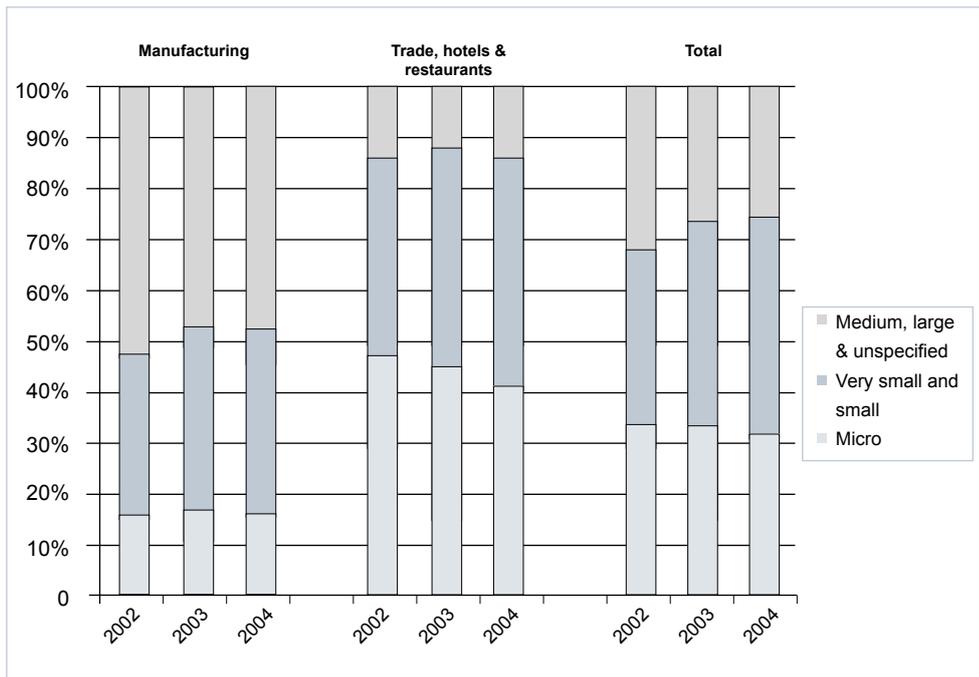
Source: Compiled from CIPRO 2004-2005, Stats SA 2003 and Ntsika 2002

In figure 8 we present data on new registrations and liquidations of companies and close corporations (CCs). Whilst we accept that these data reflect the more formal end of the small business spectrum, and is therefore not fully reflective of all small businesses, the information remains interesting.

According to the 2004 statistics from the Companies and Intellectual Property Registration Office (CIPRO), the number of CCs registered continues to increase significantly. This corresponds to the Statistics SA (Stats SA) data, which show an increase in the number of employers and the self-employed in the formal sector, giving us further confidence that this was not merely a statistical anomaly. Private companies are generally medium and large enterprises, so this statistic is not as reliable for our purposes, but here registrations have also increased, supporting the view that SA is currently experiencing broad-based growth across many sectors of the economy. The liquidation statistics have also improved, with CC and private company liquidations stable and declining, respectively.

However, to obtain a true reflection of the entrepreneurial capacity in SA we need to assess the contribution of small business to employment and GDP. The trend for small enterprise contribution to total employment over the last three years seems to be towards an increase in the share of very small and small firms at the expense of medium & large firms and micro enterprises. However, we must caution that the change is relatively small still and it will be necessary to assess the 2005 data before we can draw any firm conclusions on the sustainability of the changes seen.

Figure 9 – Contribution of micro, very small and small firms to employment, 2002-2004



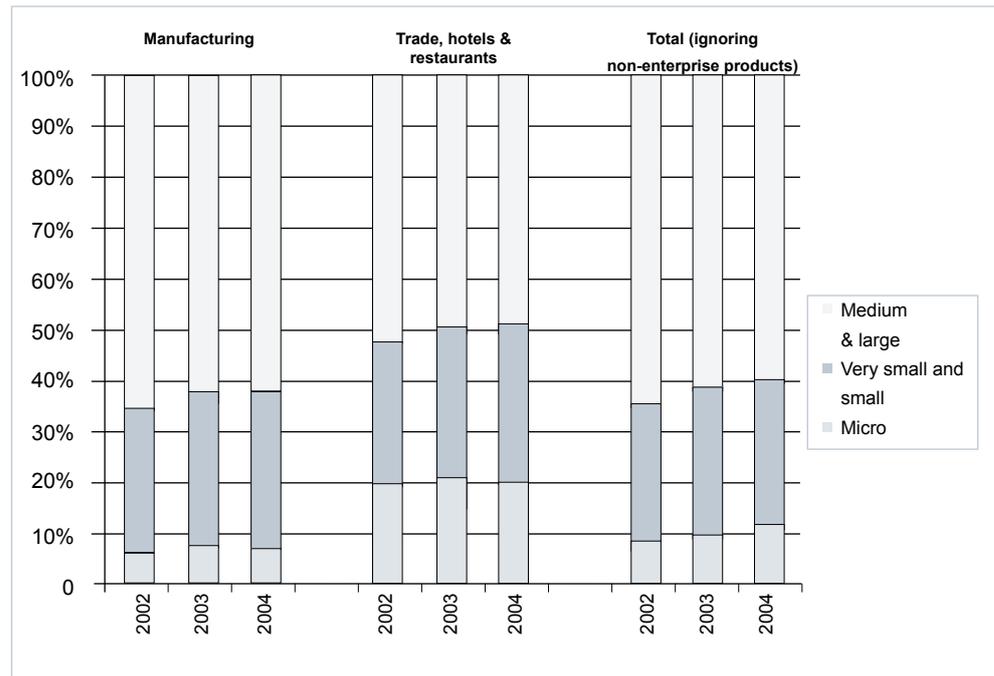
Source: own calculations based on LFS Sept 2002, 2003, 2004
 (Size categories according to number of permanent employees)

Given the lack of wide-ranging data on small business production figures, it is rather hazardous to undertake an estimation of SMMEs’ contribution to the GDP, let alone to draw firm conclusions from the year-to-year comparison of the results obtained in such an exercise. The comments below should therefore be interpreted as presumptions rather than strong assertions.

Using an approach we have characterised as ‘the Abedian GVA2 method’, and which is elaborated on in chapter 2, the contribution of micro, very small and small enterprises to the GDP has been estimated as follows:



Figure 10 – Contribution of SMMEs to GDP by industry, 2002-2004



Source: As per table 27, in chapter 2

Overall, there is little significant change to the origins of GDP, with the contribution of medium & large enterprises declining only marginally. However, when the contribution to GDP data is viewed over a longer period, a significant trend is becoming increasingly clear. Whilst the contribution of the small business sector is relatively stable, the micro and very small sectors have increased their contributions by about three percentage points over the period. This is still only a small change but coming as it does over such a long period, it would appear to be significant and suggests a slow structural change to the SA economy.

4. Conclusions

The year under review has been positive for the small enterprise. SA has experienced strong GDP growth and, crucially, the nature of the growth was broad-based. Consequently, sectors in which small enterprises are concentrated, such as construction and a variety of service sub-sectors, benefited significantly. Two important issues arise from these developments. First, it is simply not reasonable to expect the SMME sector to grow in a contractionary or slow-growth environment. The ‘rising tide lifts all boats’ paradigm is clearly apparent in the year under review. Secondly, the nature of growth is also important. Narrowly focused growth with, for example, the mining

or manufacturing sectors dominating, will support small enterprise growth less than either broad-based growth or growth in sectors with strong linkages to the SMME economy, such as construction or services.

The generally improved economic conditions prevalent in SA in 2004 were mirrored in both the quantitative and qualitative analyses undertaken in this Review. With respect to the quantitative analysis, we see increases in the number of entrepreneurs operating in the formal as well as the informal sector. At a qualitative level, in both the informal retailing sector and the Mpumalanga Province, we have heard encouraging reports from entrepreneurs who have managed to grow their enterprises. Related to this, an interesting finding from the quantitative analysis is that the rate of growth of new entrants to the formal sector has risen above that for the informal sector. It is too early to be able to draw firm conclusions from this but we have speculated that, considering the buoyant economic environment, it may be that opportunity as opposed to necessity entrepreneurship may be beginning to make a comeback.

With respect to the informal sector, it may be saturated or it may be that the employment growth (although limited) and the impact of Government's Public Works Programmes are starting to have an effect. Furthermore, the boom in the construction sector with its demand for relatively unskilled labour may be attracting necessity entrepreneurs back into employee status, thereby accounting for the slowing of the new entrant growth rate in the informal sector.

Whilst there have been a number of positive developments in the small enterprise sector in 2004, areas of concern remain. We report on a comprehensive survey of enterprises assessing the extent to which regulations impact on enterprises. The results are astonishing; regulations are cited as a significant deterrent to further growth and employment, impose substantial costs on firms attempting to comply and affect size classes of firms unevenly.

Moreover, the qualitative research undertaken in both the fishing and informal retailing sectors highlights the significance of regulation at different tiers of government. In informal retailing, local government regulations are most important. In the fishing sector, national government regulations which govern the allocation of permits are crucial determinants of enterprise success or failure. Furthermore, regulations are not just a financial cost to firms; if implemented badly they may also be a significant source of uncertainty for entrepreneurs and thereby deter further investment or employment creation. This is not to imply that regulations are not socially desirable; however, a balance needs to be found between the desirable effects of regulations and the costs, however broadly defined, imposed on firms as a result.



Finally, in this chapter we reported briefly on the institutional support available to small enterprises. This is an important element in any small enterprise development strategy and it was therefore disappointing to note that the network of institutions supporting small business has in a number of instances contracted when compared to the 2003 Review. This was particularly the case for Khula's RFI programme, although it must be noted that we do not attach any measure of the efficiency of individual institutions and it may therefore be the case that, as efficiencies and economies of scale arise for RFIs, uncompetitive institutions will be out-competed.

We are of course also mindful that seda will be launching a range of institutions as part of the new Integrated Small Business Strategy. Nonetheless, with more than two million small enterprises operating in SA and potentially needing institutional support, the need for a widespread, readily accessible institutional network has never been greater.

Part 1: Regular Features

The SA Small Business Sector 2004-2005

A Statistical Review



1. Introduction

This chapter presents the findings of a statistical investigation that was undertaken as part of the Department of Trade and Industry's (**the dti**'s) Annual Small Business Review. The Review, which in the past was carried out by Ntsika Enterprise Promotion Agency, has been commissioned to Trade and Industrial Policy Strategies (TIPS) for the first time in 2004 for the year 2003.

This year's Review is the second consecutive investigation undertaken by TIPS, and to some extent can be regarded as an update of the 2003 Review. In addition to updating the 2003 statistics, this chapter has strived to add new analyses or modify previous methods where this was required to increase the relevance and understandability of the results. However, every effort has been made to allow this report to stand on its own, independently of the work done in 2004.

Compared to the *Annual Review of Small Business in South Africa – 2003*, the following changes should be mentioned:

- Most figures on non-VAT¹-registered businesses could not be updated, as Stats SA did not repeat the Survey of Employers and Self-Employed (SESE). For other analyses, an effort has been made to increase the consistency by focusing on the calendar year 2004.
- On the other hand, the analyses on the entrepreneurs' profile are more extensive.
- Also, the analyses of the business dynamics are deeper, especially with a comprehensive review of turnover growth by sector.
- Lastly, we provide a new section on medium-term trends with an analysis of evolutions between 2001 and 2005, which should be more reliable than the year-to-year comparison provided in the previous report.

2. Definitions, data and methodology

2.1 Concepts of entrepreneurial business, self-employed, micro enterprise and small business

In literature or current economic life, the concept of 'small businesses' often covers different implicit areas of focus. The lack of clarity about what is understood as a small business can affect the reliability of research findings.

In some cases, the relevant feature is the *entrepreneurial dimension*: there is a natural concern for the economy's capacity to generate new activities, or to create new entities



¹ Value-added Tax

in response to new needs. However, many entrepreneurial ventures do not reach the stage of small businesses, as they never start operations. On the other hand, many small businesses are age-old entities, such as family businesses which have been passed from generation to generation.

Another interesting characteristic often associated with small businesses is *ownership and management*. The issues here are both concentration versus competition, and the broad economic participation of the population, not only as (co-)owners of productive entities, but as agents who are able to exercise a power in the management of these entities (unlike in an economic model of participation of individuals through small shareholdings in large firms). However, some small businesses are not owner-managed (for example, if the owner employs a manager to run it), while some owner-managed entities are actually large.

Other studies are concerned with the *labour status* of the economic agents, who can be employees, employers or self-employed. The latter ones, even if they are not providing permanent jobs to the community, can be regarded as small business entities of their own.

A further area of focus is on the *informal or semi-formal economy*. This sector occupies a major part of the population, especially in rural or peri-urban areas, and especially among the black African population group. A majority of informal businesses can be categorised as micro enterprises, but other entities may be larger. Many informal activities are also intermittent, in the sense that they may be started, discontinued and reactivated several times during a year, depending on the needs and availability of their owners.

Lastly, there is a concern around the *size of entities*. This is the criterion most frequently adopted internationally for small business studies. However, the limits of what constitutes a 'small' business vary from one economy to the next. In developed countries, entities with fewer than 500 employees are usually considered as small and medium enterprises² (SMEs), while in developing countries the thresholds are generally lower. In SA, micro enterprises are occasionally described as businesses whose turnover is below the compulsory VAT registration limit (R300,000). A further distinction is the 'survivalist' business, which is generally defined as providing income only below the poverty line.

However, all these criteria do not fit exactly with the official definition.

² Both the European statistical institute Eurostat and the Canadian Industry Canada use 499 employees as a threshold, while the European Commission refers to a maximum turnover of €20-million or maximum assets of €10m.

2.2 The official definition of 'small business'

The National Small Business Act of 1996, defines a 'small business' as follows:

a separate and distinct business entity, including co-operative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column I of the Schedule.

Small businesses can be classified as micro, very small, small or medium enterprises, following a complex set of thresholds. The National Small Business Act, as revised by the National Small Business Amendment Bill of 2003, defined the thresholds per industry as in Table 4.

Compared to developed-country standards, SA thresholds are low. Many businesses which Americans or Europeans regard as SMEs would in SA be regarded as large enterprises.



2.3 'Small businesses' or 'SMMEs' in this Review

The purpose of this Review is to provide information for a wide range of users with different interests, so the present report will embrace as comprehensive a definition of small businesses as possible, providing that the economic activity remains below the thresholds for a large enterprise. This means that it can include manufacturing enterprises employing 150 to 199 full-time employees, as well as survivalist hawking enterprises, or occasional home-based evening jobs. Since agriculture is one of the sectors considered relevant in the official small business definition, it seems correct also to include subsistence farming in a review of small businesses.

The terms 'small business' and 'SMME' are used as synonyms, whereas the term 'corporation' refers specifically to entities (especially CCs and companies) registered with the CIPRO.

The owners of these SMMEs are hence referred to as business owners or 'employers and self-employed', while we have tried to keep the term 'entrepreneur' for those involved in a start-up or a new business activity³.

Figure 11 illustrates the variety of situations covered by this Review. It shows a continuum of situations, from the most informal to the most formal type of enterprise, but the reality is far from being so simple. The formality criteria are intertwined and not necessarily correlated – for example, corporations registered with the CIPRO may well be trading only occasionally or even not at all, while non-VAT-registered trades may provide many jobs, at least on a casual basis.

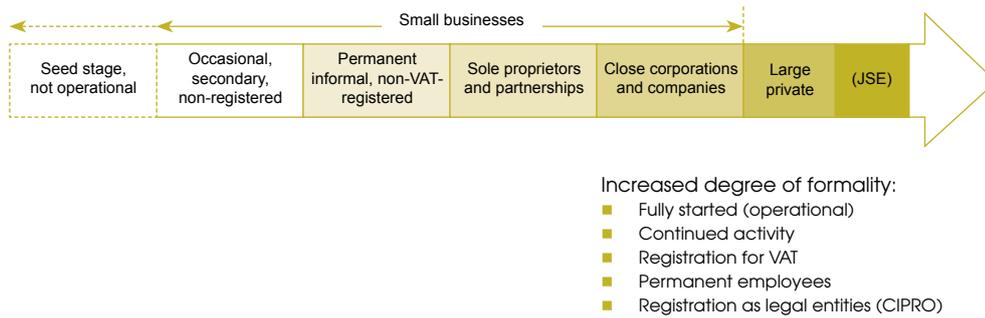
³ To avoid confusion, persons working without pay in a family business – although they are sometimes referred to as self-employed for example, Statistics Canada) – were ignored in this Review.

Table 4 – Thresholds for the classification as micro, very small, small or medium enterprise

Sector or sub-sectors in accordance with the Standard Industrial Classification (SIC)	Size or class	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value (fixed property excluded) (Rm)
		Less than:	Less than:	Less than:
Agriculture	Medium	100	5.00	5.00
	Small	50	3.00	3.00
	Very small	10	0.50	0.50
	Micro	5	0.20	0.10
Mining and Quarrying	Medium	200	39.00	23.00
	Small	50	10.00	6.00
	Very small	20	4.00	2.00
	Micro	5	0.20	0.10
Manufacturing	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.00	2.00
	Micro	5	0.20	0.10
Electricity, Gas and Water	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Construction	Medium	200	26.00	5.00
	Small	50	6.00	1.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Retail and Motor Trade and Repair Services	Medium	200	39.00	6.00
	Small	50	19.00	3.00
	Very small	20	4.00	0.60
	Micro	5	0.20	0.10
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	64.00	10.00
	Small	50	32.00	5.00
	Very small	20	6.00	0.60
	Micro	5	0.20	0.10
Catering, Accommodation and other Trade	Medium	200	13.00	3.00
	Small	50	6.00	1.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Transport, Storage and Communications	Medium	200	26.00	6.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.60
	Micro	5	0.20	0.10
Finance and Business Services	Medium	200	26.00	5.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Community, Social and Personal Services	Medium	200	13.00	6.00
	Small	50	6.00	3.00
	Very small	20	1.00	0.60
	Micro	5	0.20	0.10

Source: Schedule 1 to the National Small Business Act of 1996, as revised by the National Small Business Amendment Bill of March 2003

Figure 11 – From informal to formal businesses



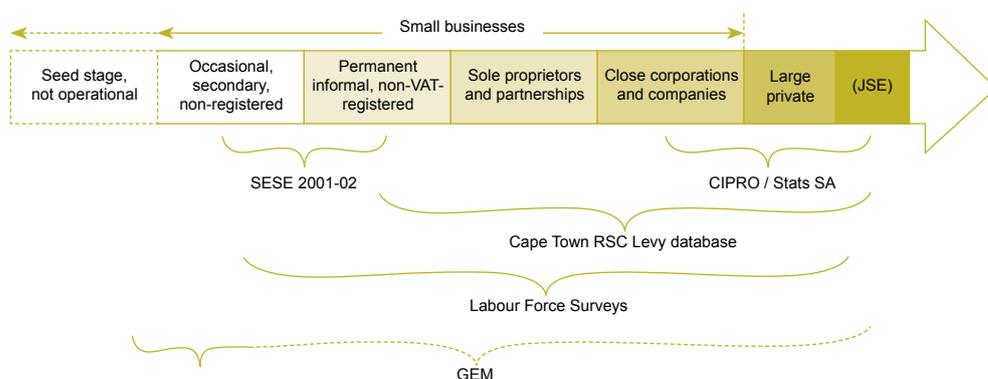
2.4 The lack of comprehensive data on small businesses

Not surprisingly, since there are different concepts of businesses, there are also different qualities of data. However, in the last few years, data collection exercises have shed some light on several sectors of less formal enterprises.

- The businesses that are formally registered have a continuous trade, and permanent employees are captured by several business registers and therefore reasonably well known.
- Informal enterprises, on the other hand, have been described best by an extensive survey of non-VAT-registered businesses, carried out by Stats SA in 2001 (SESE, published in 2002). *Unfortunately, this survey has not been updated since then, so that it is almost impossible to ascertain with sufficient reliability the trends of that sector in the last few years. It would be extremely useful if Stats SA could repeat the SESE at least every two years.*
- Entrepreneurial businesses in their infant stages are better known since 2001, when a team at the University of Cape Town’s Graduate School of Business joined the global GEM team in running annual surveys of entrepreneurship.
- In fact, at present the ‘informational opacity’ seems to be highest among a segment of small business that is potentially very significant – sole proprietors and partnerships – which usually have a permanent and substantial formal activity but are not registered with the CIPRO.
- Lack of data is particularly acute among unregistered businesses that employ only casual staff or none, are only a minor side occupation of their owner, or operate on an ‘on-and-off’ basis. While in developed countries these cases can be considered as marginal, in SA many of these informal and micro enterprises are key to the livelihoods of millions of people.

Figure 12 illustrates how different data sources cover different types of small businesses.

Figure 12 – Data available for each type of small business



Entrepreneurial businesses, as described in the GEMs, tend to overlap significantly with other categories.

To obtain the maximum information, this Review has attempted to combine different sources of data, all of which describe a specific segment of the SMME economy, and have particular drawbacks. Table 5 presents an overview of these data sources, including their weaknesses and strengths.

Table 5 – Data used and drawbacks

Data source	Public?	Sector of focus	Reference period	Data type	Advantages	Drawbacks
Stats SA Business Register	No	CIPRO-registered corporations	2004 & 2005	Business register	Systematic, detailed information	Does not cover entities such as sole proprietors
CIPRO 'Registration statistics'	Yes	CIPRO-registered corporations	Annual	Business register	Systematic	No indication if entities are economically active
Stats SA Labour Force Survey (LFS)	Yes	Main activity of individuals	Bi-annual	Household survey	Wide coverage	Little detail on businesses themselves
GEM	Yes	Start-ups and new firms	Annual	Household survey	Detailed profile of entrepreneurs	No information on businesses themselves; samples relatively small so year-to-year comparisons not really possible
Stats SA SESE	Yes	Non-VAT-registered businesses	2001	Household survey	Systematic, detailed information	Not updated since 2001
City of Cape Town Regional Services Council (RSC) Levy database	No	Entities employing at least 1 person / has income of at least R10,000, in greater Cape Town	Annual 2000-2004	Business register	Systematic information, wide-ranging	Possible bias (under-reporting); quality problems; covers only specific urban area; difficult to single out non-business entities
CIPRO Registrations by sector	No	CIPRO-registered corporations	2004 & until 5 Oct. 2005	Business register	Systematic and classified by industry	No indication if entities are economically active
Stats SA Statistics on liquidations and insolvencies	Yes	CIPRO-registered corporations	Monthly, until Aug. 2005	Statistics	Systematic and classified by industry	Covers only small portion of business deaths
Stats SA GDP	Yes	All (business and non-business)	Quarterly	Accounting	Systematic / official	Difficult to single out non-business entities



2.5 Methodology

Generally speaking, the methodology for this Review was defined according to three principles:

- *Multiple data source approach*: Because of data weakness, this statistical review attempts to compare, recoup and triangulate as many sources of data as possible on any question to try to explain the differences between these sources, rather than work on a single source.
- *Minimise the effect of short-term fluctuations*: When figures in a particular data source were found to fluctuate strongly from one year to the next, usually owing to small sample sizes, the effect of these fluctuations was corrected by building averages across several years. This especially occurred for GEM data and LFS data related to elderly persons.
- *Minimise extrapolations*: To reduce the arbitrary component in the figures presented, as well as the risk of modelling mistakes, the Review tries to use each data source for what it is meant, rather than building it into an extrapolating model. This means that the output (statistical tables and charts) may not respond exactly to the frequently asked questions, but some verbal clues are given to help the reader to bridge the gap.
- There are three exceptions to the last principle, of which only one is major:
 - Extrapolation was used to estimate the total number of small businesses, as this is a question which cannot find an answer in any single data source.
 - A simple model, presented here, was built to estimate the lifespan of firms in Cape Town.
 - A more comprehensive econometric model was built to estimate SMMEs' contribution to GDP. This model is based on numerous assumptions, and as such its validity can be questioned.

Below we describe in detail the techniques used for the analysis of the most problematic data sources.

2.5.1 Estimation of the number of small business owners, in total and by category, from the LFSs

Stats SA's LFSs provide two measurements with regard to businesses:

- Business owners
 - First, in table 2.1, they estimate the number of individuals of working age who “run or do any kind of business, big or small, for himself/herself”. This is also the definition used for persons aged 65 and over (table 7.1 and 7.2).
 - In addition, in table 3.11, they measure the number of people “working on [their] own or with a partner, in any type of business (including commercial farms)”.
 - It is not entirely clear what the difference between these two definitions is, but since table 3.11. provides a distinction between the formal and informal

sector, it was preferred. However, the other definition is also used to enable the inclusion of people aged 65 and over.

There are also two definitions of subsistence farming:

- Subsistence farming
 - In tables 2.1, 7.1 and 7.2, the definition includes people that “do any work in his/her own or the family’s plot, farm, food garden, cattle post or kraal, or help in growing farm produce or in looking after animals for the household”.
 - Meanwhile, in table 3.11, the focus is on people “working on his/her own small farm/plot or collecting natural products from the forest or sea”.
 - Again, the definition from table 3.11. was preferred when a distinction between formal and informal was required, while the former definition was used to enable the inclusion of people aged 65 and over.

- Other marginal activities, such as construction of own home, were statistically not very significant and therefore not considered, except in the estimation of the total number of businesses.

The numbers were used as they appear in the tables, or, in the case of elderly people, average values were built across the years available.

2.5.2 Contribution to employment, from the LFSs

The calculation of the contribution of each business size class (micro, very small, small and larger) to total employment was derived from a table indicating the number of regular workers per business and per sector, as follows:

- The number of regular workers per business and per sector was taken from table 3.14 in LFS September 2004, and entities were transferred to size categories (micro, very small, small and medium & large) according to the thresholds proposed by the National Small Business Act (the specific thresholds of agriculture was taken into account).
- Non-business sectors, such as private households with employed persons and extraterritorial organisations and foreign governments, were ignored. A problem was encountered in the sector labelled Community, Social and Personal Services (CSP), which included business as well as non-business, for example, government departments, schools, hospitals, etc. For that sector, the portion linked to business was estimated as follows:
 - It was assumed that 100% of employment in micro entities, 75% of employment in very small entities, 6.6% of employment in small entities and 2% of employment in medium & large entities come from private businesses.
 - This set of assumptions meant that the private CSP business sector was strongly concentrated on micro and very small businesses, while government



entities and other non-business entities were more likely small, medium or large.

- Overall, it meant that 38% of employment in the CSP sector was assumed to come from private business entities, while 62% was assumed to come from state or other non-business entities.
- The assumptions are relatively arbitrary and may cause modelling errors for that particular sector.
- The share of 'micro', 'very small' and 'small' businesses and the share of 'medium & large' and 'unspecified' to total employment were then calculated sector by sector and overall.

2.5.3 Contribution to GDP

The contribution of small businesses to GDP was even more difficult to ascertain.

Up to 2001, this figure has been estimated on the basis of sectoral censuses, with the disadvantage that the smaller and more informal producers, which were not well represented in the older censuses, were underestimated. Therefore industrial censuses have been discontinued.

In light of the dearth of data, this study has adopted an approach developed in the past by Abedian (2001) in a *Report to the Policy Board for Financial Services and Regulation*. The principle of this approach is to divide the GDP into two components – the total compensation of employees and the gross operating surplus – which are allocated separately to the size classes of businesses, in each sector.

More specifically, the steps for the calculation were as follows:

- GDP statistics for the four quarters of the year 2004 were added, industry by industry, to obtain the total Gross Value Added (GVA) per sector for the calendar year.
- Again, a problem came from the treatment of non-business entities, even more so since Stats SA's presentation of their share has changed since 2004. In the 2005 releases (relative to the 2004 GDP), a distinction was made between 'General government services' and 'Personal services' as producers. Meanwhile, in 2004, three categories were presented – 'Community, social and personal services', 'General government services' and 'Other producers'. This means that in the 2005 releases, 'Other producers' (such as private households) were amalgamated into the 'Personal services' category.
- In each sector, the total compensation of employees was allocated to firm categories according to their contribution to total employment, as derived from the calculation presented in section 2.5.2 above (that is, based on LFS data). This may pose problems, as it implicitly rests on the assumption that the average remuneration per employee is the same across all size categories. However, it is

more likely that on average, the remuneration of small business employees is more modest than in large enterprises.

- Specifically for the CSP sector, for practical reasons, the 'Personal services' category from the GDP Release was assumed to correspond to the 'Private Business CSP Sector' as calculated from the LFS data.
- This first step resulted in a table showing, in each of the 10 SIC codes, the assumed total compensation of employees for each size category.
- The gross operating surplus was allocated according to assumptions on the level of profitability of each type of business. For this second step, two sets of weights were assumed, leading to two sets of estimations.
 - For GVA 1, gross operating surplus was allocated using the following weights: survivalist 0,0; micro 0,05; very small 0,05; small 0,20; medium 0,20 and large 0,50.
 - For GVA 2, the weights were: survivalist 0,0; micro 0,0; very small 0,05; small 0,15; medium 0,20 and large 0,60.
- Based on these weights, the gross operating surplus for each sector was multiplied by the relevant weights, generating an assumed gross operating surplus by sector and by size category.
- Finally, for each sector and size category, the assumed compensation of employees was added to the assumed gross operating surplus to generate the assumed GVA.
- In each sector, the assumed GVA of each category was compared to the GVA of the sector to determine the contribution of micro, very small, small, and medium & large businesses to the sector's GVA. Similarly, the total across sectors resulted in the contribution of SMMEs to GDP.



2.5.4 Estimated number of sole proprietors and partnerships, based on Cape Town database

In the absence of data on the total number of formal, non-incorporated businesses in SA, the Cape Town levy database was used to provide a basis for the estimation. The principle was to calculate a ratio of the number of sole proprietors and partnerships to the number of CCs and companies in Cape Town, and to apply this ratio to the number of CCs and companies in SA, which is well documented.

The payers of Cape Town's RSC Levy are classified according to their type of business, which normally enables one easily to recognise sole proprietors (business type 1) and partnerships (business type 2). However, CCs and companies are only coded together with other registered entities such as trusts or clubs (business type 4), which may include non-business entities. To concentrate on business entities and obtain a good estimate of the number of CCs and companies, the accounts coded with business type 4 were further filtered according to another field, 'type of organisation'⁴.

⁴ The types of organisation listed in the database are PRI, CCO, OTH, IND, PAR, PUB. The possible types of business are (1) sole proprietors, (2) partnerships (3) public or state entity, (4) company, close corporation, trust or club, (5) other and (7) unknown.

Unfortunately, there seems to be some confusion regarding the classification. Indeed, a cross-check of both fields suggests that the 'type of business' data may not be entirely reliable, as the entries do not necessarily correspond to each other. For example, a type of organisation coded 'Par' does not necessarily correspond to a business type coded '2' (partnerships) nor does organisation type 'PUB' correspond to business type '3' (public or state entity). Also, there were substantial missing data for the 'type of organisation' (42%).

Owing to these data problems, the estimation was based on a range.

2.5.5 Lifespan analysis from the Cape Town database

Reference population:

- The lifespan analysis was generally carried out on accounts which had been liquidated, suspended or recorded as 'dormant'. Other non-active accounts (such as the exempted entities) were not considered.
- The overall lifespan analysis was based on the accounts with a 'business type' coded 1, 2 or 4 (these are sole proprietors, partnerships, and companies, CCs, trusts and clubs). Although the majority of them by far are companies and CCs, the inclusion of a small number of non-business accounts, such as clubs, causes a risk of distortion.
- For the sectoral analyses, the problem is less likely to exist since most activities (such as agriculture, manufacturing and trade) refer to business only. Therefore all accounts carrying the relevant primary SIC code were included in the sectoral lifespan analysis. Sectors 84 and 9, which contain the largest number of non-business accounts, were excluded from the totals.

Calculation of lifespan:

- Generally speaking, the lifespan was calculated as the difference between the date on which the account was suspended / liquidated / registered as dormant, and the date of its registration. This is because the dates of establishment of the businesses were often missing, with missing data unlikely to follow the same pattern as available data.
- The 'levypayer's life' (based on the date of registration on the database) was therefore used as proxy for the entire lifespan of the business, posing the following problems:
 - Since the database was only established in 1987, the method could not capture the true age of accounts older than 17 years (the maximum lifespan of a business as levypayer).
 - Registration patterns were irregular, influenced more by levy collection efforts of the City's finance department than by economic factors. In particular, measures specifically targeted at firms that had omitted to register, caused an acceleration of new registrations in 2002 to 2004, although most of the firms have been in existence for a long time.

- From the 29,373 accounts which were suspended / liquidated / dormant, 10,558 had to be ignored because the registration date was missing or aberrant (481 cases), the liquidation date was missing or aberrant (22 cases), or the suspension date was missing or aberrant (10,055 cases). The high number of missing or aberrant suspension dates may affect the reliability of the statistics.

Presentation of the results by sector:

- Unlike the 2003 report, it was preferred to present median as opposed to average lifespan of each sector to control for abnormal values in this 2004 Review.

2.5.6 Turnover growth analysis from the Cape Town database

The principle behind the turnover growth analysis was to compare, on an account-by-account basis, the turnover reported for December 2004 with turnover figures reported in the previous years, and to calculate, for that particular account, a real turnover growth rate. Specifically, the procedure was as follows:

Data preparation:

- The reference population, in each year, was made up of all the accounts recorded as active both in December 2004 and in 2002 or 2000 respectively. The reference population is therefore slightly more numerous for the two-year growth analysis.
- Technically, it was necessary to establish a link between the databases of each year to connect each 2004 turnover to the historical figures.
- A problem arose in connection with the 'zero values':
 - For example, in the 2000 to 2004 growth analysis, 28,517 accounts were identified that were active on both dates. Of those, 3,597 were recorded with a zero turnover in 2000 (13% of total), and 7,856 accounts had a positive 2000 turnover but their 2004 turnover was 0 (28% of total).
 - It was decided to ignore the zeros values, both for 2000 or 2002 (since no growth rate can be calculated on a zero turnover) and for 2004 (since the 0 is likely to mean delayed or omitted reporting, rather than an absence of business income). A problem of this approach is that it may have caused an underestimation of the number of declining businesses.

Calculation of an inflation-adjusted rate:

- The reported turnover for 2004 was divided by the reported turnover for 2000 or 2002 to obtain a growth factor for the period.
- The root of this growth factor was then extracted to obtain a nominal growth rate per annum.
- The inflation for the periods was derived from the McGregor's database; the rates used were the average inflation rates per annum as the roots of the compound yearly rates.
- The nominal growth rate per annum was then inflation-adjusted by division.



Results analysis:

- Sector analyses were based on primary SIC only. Due to the high number of sectors, the growth information was reduced to a single measurement, rather than histograms. The median growth rate was preferred to the average growth rate as single measurement, since the averages could have been distorted by some very high growth rates for businesses with a very low 2000 turnover.
- The analysis by firm age was based on the date that the business was established, to the extent that such data were available. Unfortunately, the data were often not available. For example, from the 17,064 accounts with a positive turnover in both 2000 and 2004, only 11,634 (68%) had a usable date of establishment. A study of the registrations of the last few years has shown that for many of the businesses registered after 2002, no date of registration was captured in the database.

3. How many small businesses are there in SA?

Owing to the data problems mentioned earlier, there is no simple way to determine a definite number of small businesses. It is more appropriate to replace the question 'how many small businesses' by several more specific questions.

3.1 How many people define themselves as employers or self-employed?

A first approach to the number of businesses is to look at the number of individuals who work on their own or with a partner, in any kind of business that they own. For September 2004, Stats SA's LFS provides the following estimations:

Table 6 – Number of people working on their own or with a partner

Number of persons of working age (15-65) working on (their) own or with a partner, in any type of business (including commercial farms)	1,824,000
Number of persons of working age (15-65) working on (their) own small farm/plot or collecting natural products from the forest or sea	302,000
Number of elderly persons (65+) who run or do any kind of business, big or small, for (themselves)	61,000
Number of elderly persons (65+) who do any work in (their) own or the family's plot, farm, food garden, cattle post or kraal, or help in growing farm produce or in looking after animals for the household	47,000
Number of persons who do any construction or major repair work on (their) own home, plot, cattle post or business, or those of the family	22,000*
TOTAL	2,256,000

* This number relates only to persons of working age. For elderly persons, the figure found in the survey is too small for a reliable estimate.

Potentially, this gives a total number of employers or self-employed, including subsistence farmers and home builders, of 2.26-million. It must be noted though that this only describes people's main activity, so that an individual who owns a business in addition to his employment, may not be captured here.

The following notes must be considered when trying to infer the number of small businesses from these statistics:

- A number of people run some kind of business while being employed, or define themselves as unemployed although they run some (survivalist) business activity. They are not recorded as employers here.
- Entrepreneurs are frequently involved in several businesses, which may or may not be related to one another, so behind one employer there may be two, three or more businesses.
- On the other hand, there are frequently two or more partners involved in one business.
- Lastly, if one wants to consider small businesses specifically, the number of owners of large businesses must be deducted from the above total.

The first two elements are likely to have more impact than the latter two, therefore 2.26-million is presumably a low estimate for the number of small businesses.

3.2 How many people are running a business or busy starting up a new business?

The GEM undertakes annual surveys in the SA population to estimate, among other things, the proportion of entrepreneurs in the country (so-called Total Entrepreneurial Activity rate, or TEA). In GEM terminology, a start-up becomes a running business when it starts paying wages and salaries.

In 2004, the survey has come to the following estimates:

Table 7 – Proportion of entrepreneurs in SA

Proportion of adults currently:	
Starting a business	3.90%
Running a business less than 3.5 years old ('new firms')	1.60%
Running a business older than 3.5 years ('established firms')	1.40%



Combining these rates with the estimated population of working age proposed by the LFSs yields the following number estimates:

Table 8 – Number of entrepreneurs in SA

Number of adults currently:	
Starting a business	0.98-million
Running a business less than 3.5 years old ('new firms')	0.40-million
Running a business older than 3.5 years ('established firms')	0.35-million
TOTAL	1.73-million

To interpret this figure, it is important to bear in mind that:

- 'Starting' a business does not necessarily mean that the business is already trading. The entrepreneurial reality is such that many start-ups (projects) never reach the stage of actual operation.
- On the other hand, it is not clear how one-person businesses, self-employed and informal businesses are covered by the GEM. Since the criterion for 'new' or 'established firms' is the payment of wages or salaries, one-person businesses which are not formally paying a salary to their owners, or informal businesses whose employees are not paid (see section 3.4) may not be recorded in these estimations.
- Also, it must be noted that the GEM sample size is usually limited, so that there is a fairly large error margin in the results, causing ample year-to-year fluctuations.

3.3 How many firms are registered with the Registrar of Companies and Close Corporations?

Entities registered with the CIPRO, such as private companies, CCs or incorporated professionals, are relatively well defined, but they represent only a portion of SA small businesses. Many other businesses are not registered, either because they are informal (for example, not even VAT-registered), or because they operate as sole proprietors or partnerships with unlimited liability of their owners.

The CIPRO listings record the following number of 'active' entities in each category ('Active' in this table does not refer to real economic activity, but to the fact that the firm has not been liquidated, dissolved or otherwise taken out of the active accounts).

This number is approximately consistent with the number of accounts in Stats SA's Business Register, which includes 1,290,569 registered businesses in 2004.

Table 9 – Number of corporations registered with the CIPRO, 2005

	Total active entities as at 31/07/2005
Close corporations	1,092,482
Public companies	3,756
Private companies	382,863
Non-profit (Section 21)	14,438
Limited by guarantee	88
External companies	967
Incorporated (professionals)	7,447
Company inlimited	7
TOTAL	1,502,048



But how many of these corporations are actually trading?

At first sight, the number of corporations (1.5-million) seems high for what should be only the top end of the small business pyramid. However, entities registered and recorded as ‘active’ in the CIPRO’s books (that is, not deregistered liquidated or otherwise) are not necessarily economically active businesses. The following factors explain why a significant proportion of companies and CCs are not trading:

- They may be still in the starting-up process.
- They may have been stillborn.
- They may have ceased trading without deregistering.

Various indices suggest that these three situations may well concern more than half of the registered CCs.*

Stats SA has attempted to estimate the economic activity of registered companies and corporations according to their filing of tax returns to the SA Revenue Service (SARS). A possible drawback of this method, however, is that a number of entities – especially the smallest and most informal ones – possibly do not supply their tax returns to the SARS in spite of having some economic activity. On the other hand, there is also a possibility that businesses that supplied their returns four or five years ago have since ceased any activity. These two effects presumably balance each other reasonably well, so that the approach adopted by Stats SA may give a reasonable estimate of the number of active, registered businesses.

Table 10 – Active and inactive corporations in SA (2004)

Not economically active	862,029 (67%)
Economically active	428,540 (33%)
TOTAL	1,290,569

Source: Stats SA Integrated Business Register, 2004

* The number of start-ups has been seen to be in the range of 0.6-million to one million. An interview with an agent offering online CC registration services revealed that up to 90% of the CCs that he registers with the CIPRO are stillborn, for a number of reasons: either because the would-be entrepreneur discovers that his/her business idea is not viable, or because there is a breakdown in communication with the partner, or because the entrepreneur has been unable to secure the funding necessary for the start-up, or for any other reason. Other anecdotal evidence suggests that many entrepreneurs have registered CCs in anticipation of a favourable tax regime for small businesses, but when the new tax regulations came into effect in 2003, they went back to trading under their own name because they could not qualify for the reduced tax rates.

3.4 How many firms operate in the formal sector but are not registered with CIPRO?

A large portion of the very small and micro businesses in the formal sector (that is, businesses registered for VAT and possibly other taxes such as Pay as You Earn, or PAYE), are not incorporated (registered with CIPRO). Rather, they operate as sole proprietors or partnerships with unlimited liability of their owners.

In the absence of access to the SARS data on VAT- or PAYE-registered businesses, there is hardly any data enabling one to estimate the size of this particular business population.

However, the statistics from the City of Cape Town's RSC Levy database may give some clues as to the size of these sectors.

In December 2004, the database was composed of 49,978 active accounts, of which 12,517 were registered as sole proprietorships, 2,043 as partnerships, and 31,680 were in the category 'company, close corporation, trust or club'. Within the latter category, the database gives a further breakdown by 'type of organisation' which, although it may not be entirely reliable⁵, seems to suggest that 5,239 accounts are non-business accounts (possibly corresponding to the clubs and non-business trusts).

If one assumes that 75% to 95% of the remaining entities are either CCs or companies, then the ratio of sole proprietors and partnerships to CCs and companies would be 58% to 73%. Applying this ratio to the total number of CCs and companies

⁵ In particular due to the large amount of missing data: 42% of entries are blank. Also refer to comments in section 2.5 Methodology.

considered active in SA (428,540, according to the Stats SA Business Register 2004) would yield an estimated number of sole proprietors and partnerships of 248,553 to 312,834.

From this exercise the best possible estimation of the number of formal, non-incorporated businesses is in the range of 240,000 to 320,000.

3.5 How many South Africans are involved in informal business activities?

Not surprisingly, informal businesses are the most difficult to estimate. Two sources by Stats SA are available: the SESE, run in 2001, which focused on businesses not registered for VAT purposes; and the LFS, which has already been presented, and is updated twice a year.

- The SESE found that in March 2001, approximately 2.29-million people were owners of at least one non-VAT-registered business. These businesses were usually one-person enterprises, since only 14.8% of them (338,000) had one or more employees, either paid or unpaid. Unfortunately these data have not been updated in the last four years.
- Also in 2001, the LFS estimated the number of self-employed in the informal sector at 1.17-million. The estimate for September 2004 was at 1.267-million, indicating a growth of 8.3% over the three years.
- The reason for the considerable divergence between these figures is not entirely clear. It may have to do with the survey approach.⁶
- Applying the LFS estimate growth rate to the SESE estimate leads to an updated number of persons running non-VAT-registered businesses of 2.48-million.
- Lastly, if one assumes that some of these entrepreneurs own more than one non-registered business, the number of these informal (non-VAT-registered) businesses at the end of 2004 may be over 2.6-million.

3.6 Summary

Assuming that

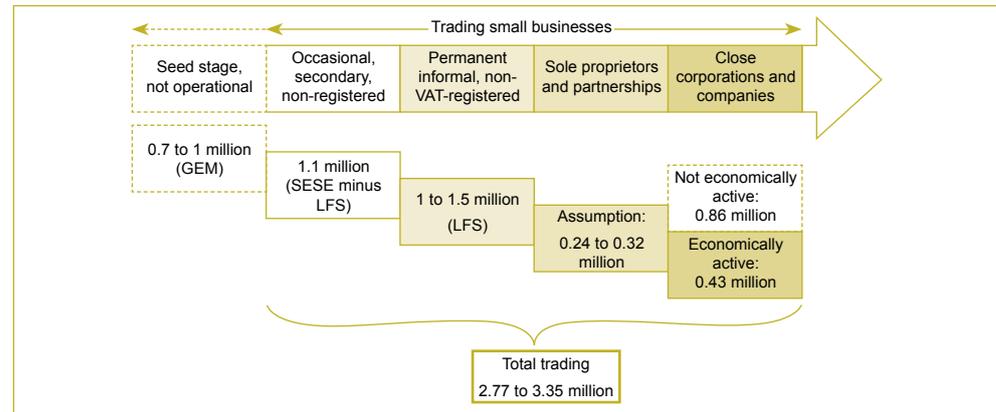
- The Stats SA estimation of economically active corporations is correct;
- The number of firms that are registered for VAT without being incorporated (sole proprietors, partnerships, etc.) is in the range of 240,000 to 320,000; and
- The informal businesses mentioned in the LFS are those trading on a regular basis, while the others that came up in the SESE study only trade occasionally

then the number of trading small businesses would be between 2.75-million and 3.35-million – of which 1.1-million are trading only occasionally.

⁶ The survey approach in the SESE case may have been interpreted as valuing every economic activity of individuals, so that a number of surveyed persons were keen to declare some informal activity, which they preferred to keep unmentioned in the LFS because they saw themselves primarily as unemployed.



Figure 13 – Estimated number of trading small businesses, by segment



4. A profile of the SMME sector (mainly formal)

A number of analyses in this section concentrate on those small businesses for which there is reasonably good data – the ‘formal & active corporations’ registered with the CIPRO and known by the SARS. The reader must, however, bear in mind that this population does not represent the entire formal small business population of SA, since it does not include sole proprietors and partnerships. The latter are also not included among ‘informal’ non-VAT-registered businesses, based on Stats SA’s SESE survey. Nevertheless the two sub-populations taken together give a reasonably balanced picture of the SMME economy.

4.1 How small are our small businesses?

From the three criteria prescribed to categorise businesses as micro, very small, small or medium, the number of employees (more specifically the number of permanent, full-time equivalent employees) is often the most convenient, since it is generally the easiest to obtain and applies across all sectors (except agriculture).

However, economically speaking it is the least appropriate since (1) it says little about the extent of economic activity, and (2) it also does not reflect the true labour creation of these businesses, since many small businesses employ mainly casual staff to retain their flexibility.

Although a more significant indicator of size is annual turnover, this information is often not available. In the Stats SA Business Register (2004), the CIPRO-registered entities have been classified by turnover. The result is as follows:

Table 11 – Size distribution of SA registered corporations, according to turnover (2004)

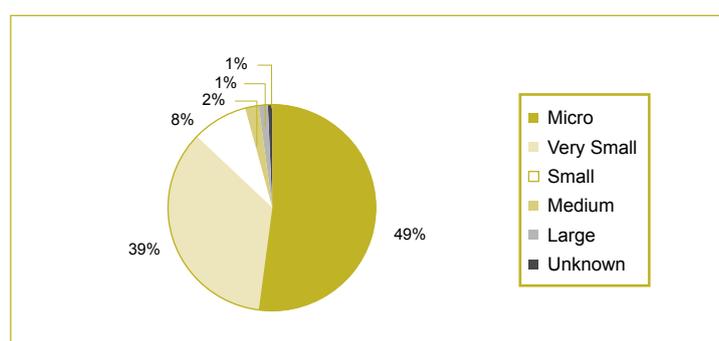
	Numbers	%	% (ignoring 'unknown')
Micro	212,161	16.4	49.8
Very small	170,338	13.2	40.0
Small	32,397	2.5	7.6
Medium	6,748	0.5	1.6
Large	4,596	0.4	1.1
Unknown	864,329	67.0	
TOTAL	1,290,569	100.0	100.0

Source: Stats SA Integrated Business Register, 2004



Figure 14 shows that almost half of the CIPRO-registered active entities are micro enterprises, and almost 90% are either micro or very small. Large enterprises represent less than 1% of all registered companies and corporations. It must be noted that this result underestimates the proportion of micro and very small enterprises to the total (formal) economy, for two reasons. First, to the extent that some of the enterprises classified as unknown are economically active (but not complying with tax filing requirements), they are likely to be at the bottom-end of the size distribution. Secondly, these statistics do not include firms that are not incorporated with CIPRO – sole proprietors and partnerships – that are on average significantly smaller than corporations. Therefore it is safe to assume that at least 60% of our formal SMMEs are micro enterprises, with SMMEs representing more than 95% of the country's formal business entities. Needless to say, if one were to include informal businesses, the proportion of micro enterprises would be even higher.

Figure 14 – Size distribution of registered corporations, based on turnover



Source: Stats SA Integrated Business Register, 2004 (only CIPRO-registered entities regarded as economically active; classification based only on turnover; businesses categorised as 'unknown' are those for which no turnover was available).

4.2 In which sectors do small businesses operate?

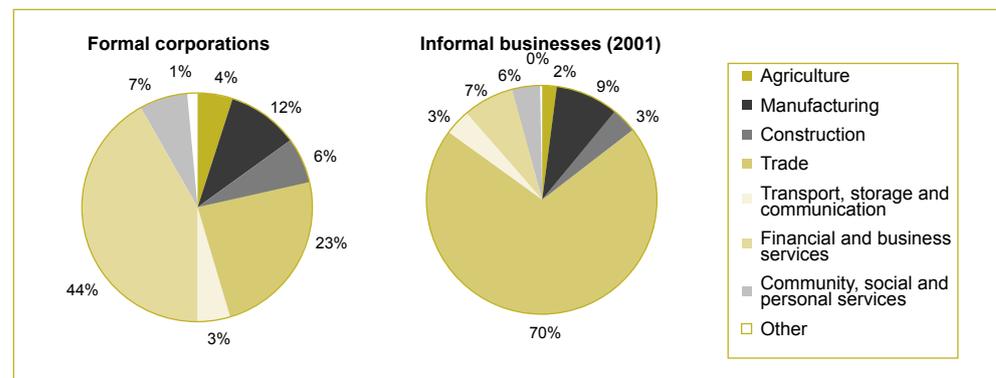
The industries in which small businesses in the formal sector operate are very different from the ones preferred by informal businesses.

Figure 15 shows that more than three-quarters of small businesses are involved in services (including trade) rather than the production of goods (the latter represents 22% of formal businesses but only 14% of informal businesses). This is not surprising, since primary and secondary activities (in particular agriculture, manufacturing and construction) are generally quite capital-intensive and therefore are more advantageously carried out on a larger scale.

Among the producers of services, a large proportion of formal firms are involved in financial, business and professional services (including engineering and Information Technology, or IT), while the majority of informal businesses are involved in trade, including accommodation and restaurants. These are sectors with relatively low entry barriers but intense competition and mediocre survival rates (*see section 7*).

Table 12 provides more detailed information on corporations registered with the CIPRO.

Figure 15 - Main industries for formal and informal businesses



Source: Stats SA Integrated Business Register, 2004

Source: Stats SESE Study, 2002

Formal businesses are defined as corporations registered with the CIPRO and for which the turnover is known.

Table 12 – Distribution of registered corporations, by industry

	Including potentially inactive firms		Only active firms	
	No. of registered firms	% distribution	No. of firms	% distribution
Agriculture	29,026	2.2	16,365	3.8
Mining and Quarrying	6,255	0.5	1,852	0.4
Manufacturing	89,825	7.0	52,468	12.3
Electricity, Gas and Water	3,748	0.3	835	0.2
Construction	96,694	7.5	26,977	6.3
Retail, Motor Trade & Repairs	301,574	23.4	58,019	13.6
Wholesale Trade & Allied Services	34,449	2.7	26,493	6.2
Catering and Accommodation	23,431	1.8	14,666	3.4
Transport, Storage & Communication	43,676	3.4	13,955	3.3
Financial & Business Services	531,488	41.2	183,308	43.0
Community, Social & Personal Services	81,928	6.3	29,849	7.0
Unknown	48,475	3.8	1,453	0.3
TOTAL	1,290,569	100.0	426,240	100.0

Source: Stats SA Integrated Business Register, 2004

4.3 Where are SA small businesses situated?

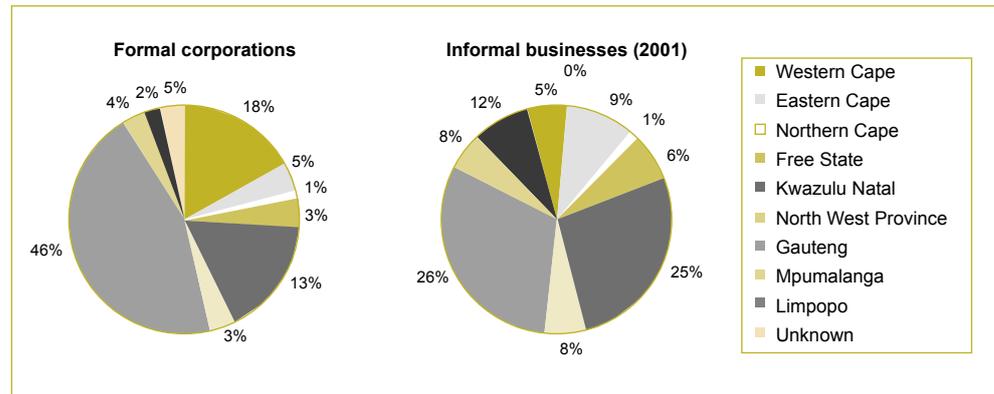
4.3.1 Distribution by province

Again, the provincial profile of small businesses differs strongly depending on whether one considers formal or informal businesses. Figure 16 illustrates the difference between registered corporations and non-VAT-registered businesses. The following should be noted from the figure:

- Not surprisingly, Gauteng is the leading province for both informal and formal businesses, but while it accommodates 46% of companies and CCs, it only accounts for a quarter of informal enterprises.
- The Western Cape, the second-biggest province where formal corporations are concerned, is the second-smallest province for informal businesses, accommodating only 5% of such businesses.
- On the other hand, provinces with large rural populations, such as the Eastern Cape, KwaZulu-Natal, the North West, Mpumalanga and Limpopo, accommodate higher proportions of informal businesses.



Figure 16 – Number of formal and informal business by province



Source: : Stats SA Integrated Business Register, 2004

Source: : Stats SESE Study, 2002

Formal businesses are defined as corporations registered with the CIPRO and for which the turnover is known.

Table 13 estimates the business density of each province by comparing the number of enterprises to the population of the province. It shows that the proportion of formal businesses to the provincial population is highest in Gauteng and the Western Cape, while the ratio of informal businesses to population is highest in Gauteng, KwaZulu-Natal and Mpumalanga. In proportion to their populations, Limpopo and North West lag behind with regard to their formal businesses, but they have an average rate of informal businesses. The inhabitants of the three Cape provinces are less likely to be involved in informal businesses.

Table 13 – Number of enterprises per province, compared to the population

Province	Formal SMMEs (2004)	Informal SMMEs (2001, '000)	No. of SMMEs to population of working age (%)	
			Formal (2004)	Informal (2001)
Western Cape	76,876	111	2.4	4.0
Eastern Cape	21,772	209	0.5	5.3
Northern Cape	4,759	17	0.8	3.0
Free State	12,524	129	0.7	7.2
KwaZulu-Natal	53,045	580	0.9	10.5
North West	10,971	175	0.5	7.9
Gauteng	196,715	616	3.1	11.4
Mpumalanga	14,879	191	0.8	10.3
Limpopo	9,493	266	0.3	8.7
Unknown	20,610	0		
TOTAL	421,644	2,294	1.4	8.5

Source: Own calculations based on Stats SA data (Business Database, SESE and LFS for Sept. 2001 and 2004)

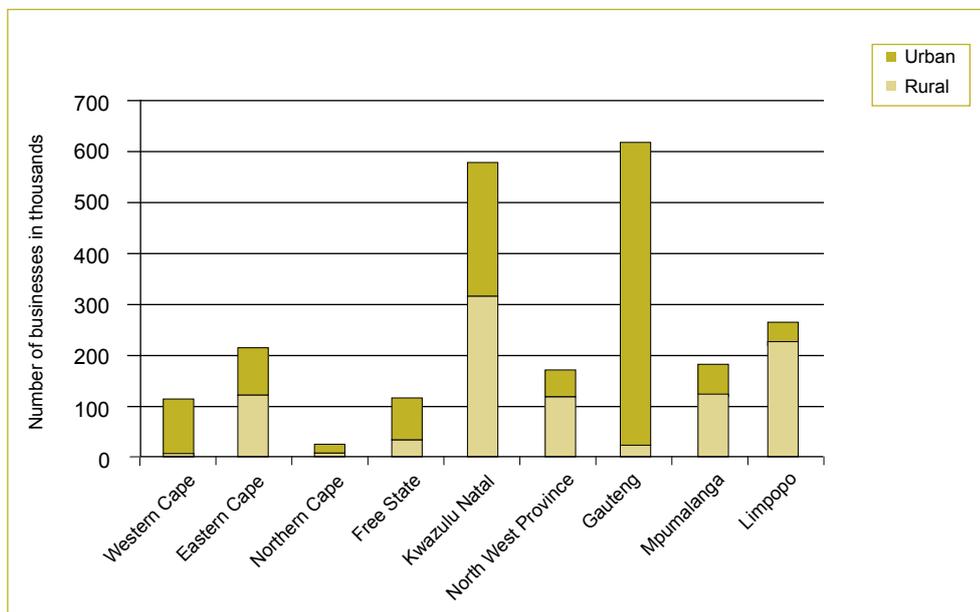
Formal active SMMEs are corporations registered with the CIPRO, whose turnover is known and below the relevant sector's threshold for a large business.

4.3.2 Rural versus urban businesses

Most of the usual sources on SMMEs do not provide information on the location of businesses in rural or urban areas. Two partial sources are available – the SESE Survey on non-VAT-registered businesses (2001) and the GEM surveys on start-ups and new firms (annual).

For informal enterprises, the SESE data estimated that in 2001, 42% were rural and 58% were urban businesses. However, large variations are evident from one province to the next, as illustrated in figure 17.

Figure 17 – Distribution of informal businesses by province and type of location (urban or rural)



Source: Stats SA SESE Study, 2002

For formal enterprises, the proportion of urban businesses is expected to be significantly higher. To verify this, a model was built on the latest estimations of the GEM, using an estimated distribution of the adult population between the types of location.

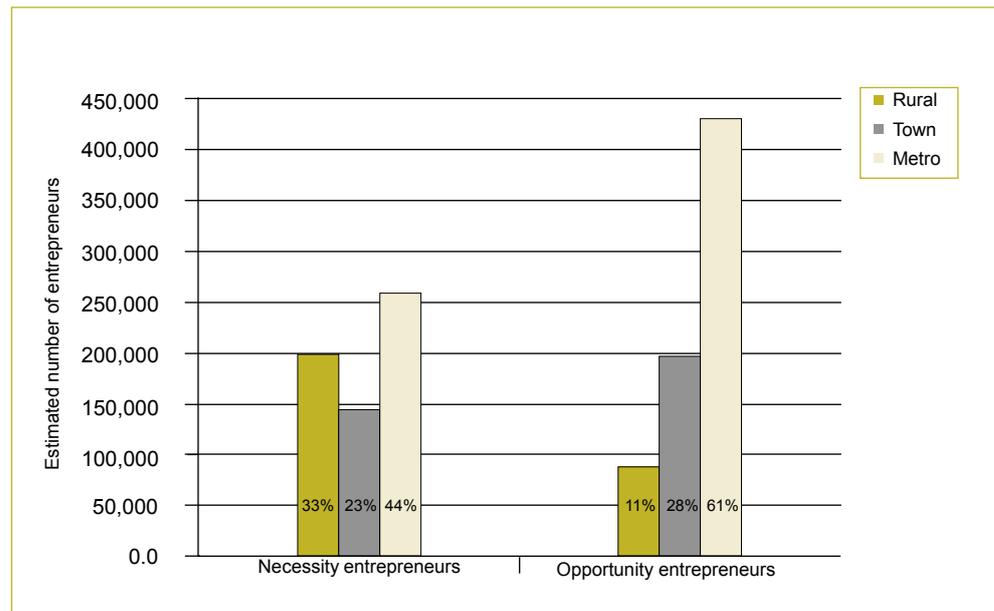
The model leads to the prediction that, overall, the proportion of rural entrepreneurs is in the region of 20%, while 25% of entrepreneurs originate from town settings and more than half are located in metropolises.

A more detailed result, distinguishing between necessity and opportunity entrepreneurs⁷, is shown in figure 18.

⁷ The GEM defines 'opportunity entrepreneurs' as people who are taking advantage of a business opportunity, while 'necessity entrepreneurs' are people who have no better options for work.



Figure 18 – Estimated number of entrepreneurs by type of location (2004)



Source: Own calculations based on GEM 2004

The model leads to the estimation that, for necessity entrepreneurs (whose businesses are likely to be informal), approximately one-third are operating in rural areas while almost half operate in metropolises. As for opportunity entrepreneurs (who are more likely to own formal enterprises), the proportion of rural businesses is only 11%.

The following factors may have contributed to the divergence between the SESE Study (which estimated that 42% of informal businesses are rural) and the model based on GEM (which arrives at a 20% share of rural businesses, or 34% for necessity entrepreneurs):

- The SESE Study may not be up to date. It is possible that migrations from rural areas towards metropolises have continued to take place since 2001 and have created a stronger increase in entrepreneurship in urban than in rural areas.
- The SESE's survey method is likely to have captured more 'fringe' micro businesses than the GEM method. One of the issues already discussed is that GEM's definition of firms is based on the payment of salaries, which may not actually take place in informal, especially rural, settings.
- There is no exact correspondence between 'necessity' and 'informal'. Some entrepreneurs may formalise their business even though their motivation is the lack of better opportunity.
- The GEM study focuses on start-ups and new firms, and does not consider older firms. Since the life expectancy of businesses is generally higher in rural areas, the GEM data may therefore underestimate the proportion of rural businesses.

5. A profile of SA's small business owners

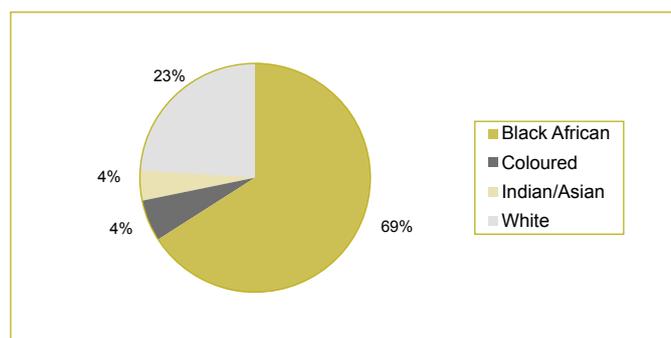
For practical reasons linked to data, the terms 'business owner' or 'employers and self-employed' often refer to people aged 15 to 65 years and described by Stats SA as (1) "Running or doing any kind of business, big or small, for himself/herself", or as (2) "Working on his/her own or with a partner, in any type of business (including commercial farms)". Unless indicated otherwise, the statistics therefore do not include persons involved in subsistence farming, or persons aged 66 and over.

5.1 Population group

5.1.1 Distribution of businesses according to ethnic background of owners

According to the latest LFS, the ethnic distribution of business owners was as follows:

Figure 19 – Business owners by population group



Source: LFS, September 2004

Figure 19 shows that black Africans represent over two-thirds of the country's business owners, while Whites represent almost a quarter of them. However, this figure hides a great disparity between formal and informal businesses.

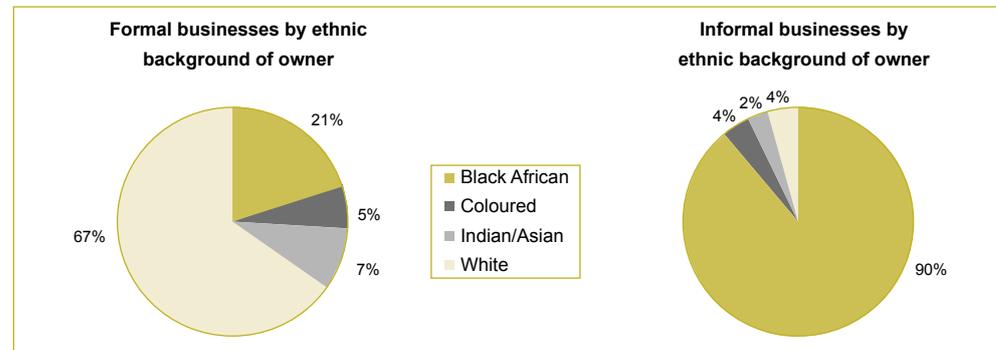
The 2003 Review had shown that black Africans represented 90% of informal business owners, while their share in formal businesses was only 21%. Conversely, Whites accounted for 67% of formal businesses but only 4% of informal ones. The share of Indians/Asians was also more significant among formal businesses (7%) than informal ones (2%). Unfortunately, the latest LFS results do not distinguish between the formal and informal sectors in their detailed ethnic breakdown.

As already mentioned, the LFS statistics have the disadvantage of allowing only one activity per person, so that it may underestimate the number of micro enterprises which are run in addition to employment or another form of activity. The 2001 Survey of



non-VAT registered businesses (SESE) had identified almost twice as many informal business owners as the figure suggested by the LFS, especially among the black African and Indian/Asian population groups. A possible explanation for this is that these population groups more frequently combine an employment with an informal activity.

Figure 20 – Formal and informal businesses by ethnic background of owner



Source: : Stats SA LFS, 2003

Source: : Stats SESE Study, 2002

Formal businesses are defined as those regarded as formal by their workers.

5.1.2 Entrepreneurial activity in each population group

To get a better understanding of the extent of entrepreneurial activity in each population group, it is interesting to relate the numbers of employers and self-employed in each group to the corresponding active population.

Table 14 – Employers and self-employed by population group (September 2004)

	Employers and self-employed ('000)	In % of economically active population
Black African	1,260	11.0
Coloured	72	4.3
Indian/Asian	65	13.4
White	428	20.1
TOTAL	1,837	11.6

Source: : Own calculations based on Stats SA LFS September 2004, Tables 2.1 and 2.3.1

Table 14 shows that previously disadvantaged communities are still under-represented as business owners compared to their demographic weight. Coloured business owners are particularly under-represented as this population group is more often found in some form of employment. Black African business owners are also relatively few, especially if one considers that their entrepreneurial activity happens mostly in the

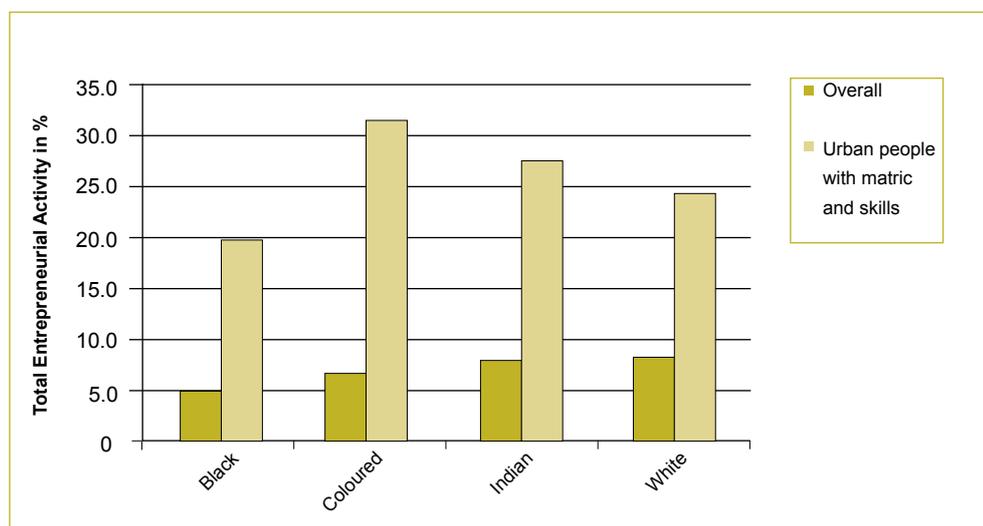
informal sector – reflecting the difficulties of many black Africans to find suitable employment. However, as indicated, the statistic for black Africans would be higher if it were based on the SESE data.

5.1.3 The effect of location and education

In its 2004 report, the GEM team has tried to investigate the reasons for the different levels of entrepreneurial activity across population groups. In particular, they have recalculated the entrepreneurial rates after controlling for the type of location (rural versus urban) and the level of education. They show that the racial differential is no longer statistically significant among people who live in metropolitan areas and have completed secondary education.



Figure 21 – Entrepreneurial activity by population group, controlling for location and education



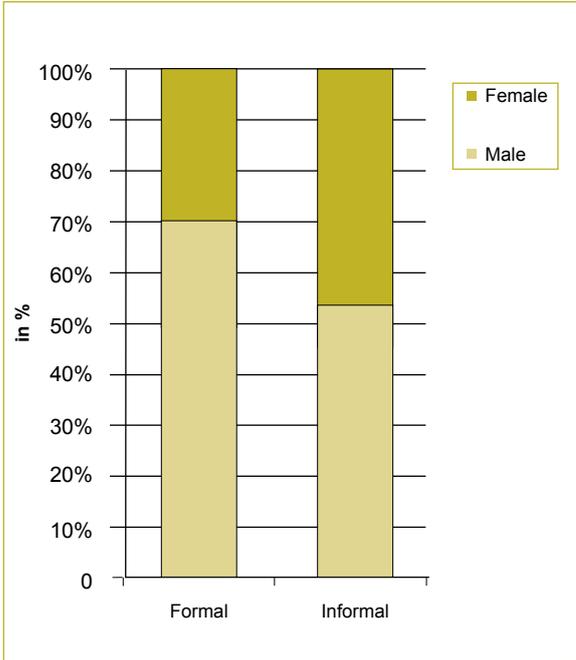
Source: : Adapted from GEM 2004

5.2 Gender

Figure 22 shows the distribution of business owners by gender, according to the LFSs. It is clear that the share of female entrepreneurs is far higher in the informal sector (47%) than in the formal sector (30%). This is mainly driven by the strong entrepreneurial activity of black women, which takes place mainly in the informal sector.

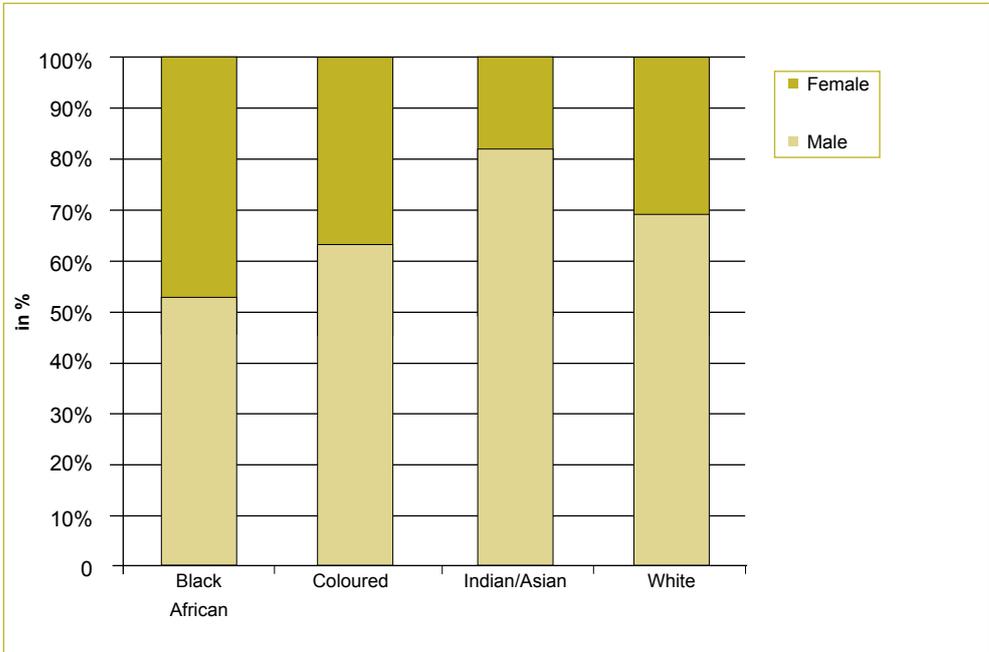
The distribution by gender according to the population group confirms these differences: the two population groups that are most significant in the formal sector – whites and Indian/Asians – are dominated by male entrepreneurship, while roughly half of black African businesses are owned by females.

Figure 22 – Distribution of business owners by gender for the formal and informal sector



Source: : LFS, September 2004

Figure 23 – Gender distribution of business owners according to population group



Source: : LFS, September 2004

Again, it is interesting to compare this distribution to the general participation of women in economic activity to determine whether the smaller number of women entrepreneurs is explained by the fact that many women are not economically active.

Table 15 shows that although the female active population is smaller than the male, the proportion of active persons choosing to run their own business is still slightly lower among women (11.4%) than among men (11.9%). This is consistent with the GEM results which show that, on average between 2002 and 2004, the total entrepreneurial activity of women (4.8%) was significantly below that of men (5.9%).

However, the differential is inverted if one considers, as assumed in the 2003 Review, that the LFS underestimates the number of informal women entrepreneurs (which may be explained by a higher tendency of women to combine informal entrepreneurship with employment).

If one were to estimate the number of informal businesses according to the 2001 SESE data instead of following the LFS, one would find that female entrepreneurship, at 20% of the active population, is significantly higher than the 15% male entrepreneurship, as illustrated in Table 15.

Table 15 – Employers and self-employed by gender

	Employers and self-employed ('000)				In % of economically active population	
	Formal	Informal	TOTAL	SESE informal (2001)	TOTAL	Total SESE*
Male	380	667	1,043	901	11.9	14.6
Female	165	600	793	1,383	11.4	22.2
TOTAL	545	1,267	1,836	2,284	11.6	17.9

Source: Own calculations based on Stats SA LFS September 2004 and SESE 2002

* Total SESE is provided for argument's sake as the sum of informal entrepreneurship as resulting from the SESE Survey and formal entrepreneurship as resulting from the LFS.

The SESE Study further provides information on the industries preferred by both genders in the informal sector, as illustrated in Table 26. Unfortunately, a similar breakdown is not available for the formal sector.



Table 16 – Sectoral distribution of men-owned and women-owned informal businesses (2001)

Industry*	% of male businesses	% of female businesses
Trade	58.4	76.5
Manufacture	8.1	10.1
Finance	9.4	5.8
Community	6.3	5.7
Construction	7.5	0.2
Transport	7.1	0.7
Agriculture	2.7	1.2
Other	0.4	0.1

Source: Stats SA SESE, 2002

* Industry of main businesses of men and women running at least one non-VAT-registered business.

In light of this data uncertainty, a valid conclusion is that:

- Women are less likely than men to be economically active.
- Among those economically active, women are probably as likely as men to engage in entrepreneurial activity.
- However, the enterprises run by women are generally more vulnerable, in the sense that they are:
 - Often informal;
 - Often run in addition to another activity (such as employment); and
 - Operating in more vulnerable sectors, especially trade, catering and accommodation, as well as CMT (classified as manufacturing).

5.3 Age group

Although the promotion of youth entrepreneurship is an important policy priority of Government⁸, there is little statistically reliable information available on the age of SA's business owners. The LFSs report only on the activities of individuals of working age (15-65) as opposed to the elderly (66 and over).

The best source of information for South Africans aged 18 to 65 is the GEM reports, which examine entrepreneurship by age category in SA⁹. However, due to relatively small sample sizes, the GEM statistics tend to fluctuate significantly from one year to the next, so that it is best to look at average values over the three years.

⁸ For example, through the Umsobomvu Youth Fund.

⁹ The entrepreneurship definition used in the GEM captures only start-ups and businesses less than 3.5 years old, but it is likely that older businesses are more often owned by older people. The proportion of young people involved in start-ups and new businesses can therefore be regarded as a good approximation of total youth business ownership.

Table 17 – TEA¹⁰ by age category in 2002-2004

In %	18-24	25-34	35-44	45-54	55-64
Average entrepreneurship	3.5	6.8	6.2	5.1	4.3

Source: GEM, SA Executive Reports, 2002, 2003 and 2004

Table 17 shows that entrepreneurship is quite low among very young people (18-24), but that it is highest among people aged 25 to 34. This can probably be explained by three factors:

- First, the proportion of black Africans is highest among young people, hence the racial differences interact with the age factor.
- Secondly, a number of young people are not yet economically active but are rather trying to improve their qualifications; conversely, people aged 25 to 34 are often economically active but find themselves unable to find employment (*see figure 25*), so that they may turn to entrepreneurship as an alternative source of income.
- Thirdly and most importantly, many young people probably do not feel confident enough to start a business. It is possible that the environment in large cities like Johannesburg and Cape Town is more supportive for young entrepreneurs. This would explain why entrepreneurship is significantly higher in Gauteng and the Western Cape than in other provinces, as illustrated by table 18 (which was already included in the 2003 Review).



Table 18 – TEA by age category and region in 20024

In %	18-24	25-34	35-44	45-54	55-64
Gauteng and Western Cape	7.9	10.4	11.1	9.9	5.8
Rest of SA	3.0	6.2	6.6	5.0	4.0

Source: GEM, SA Executive Reports, 2003

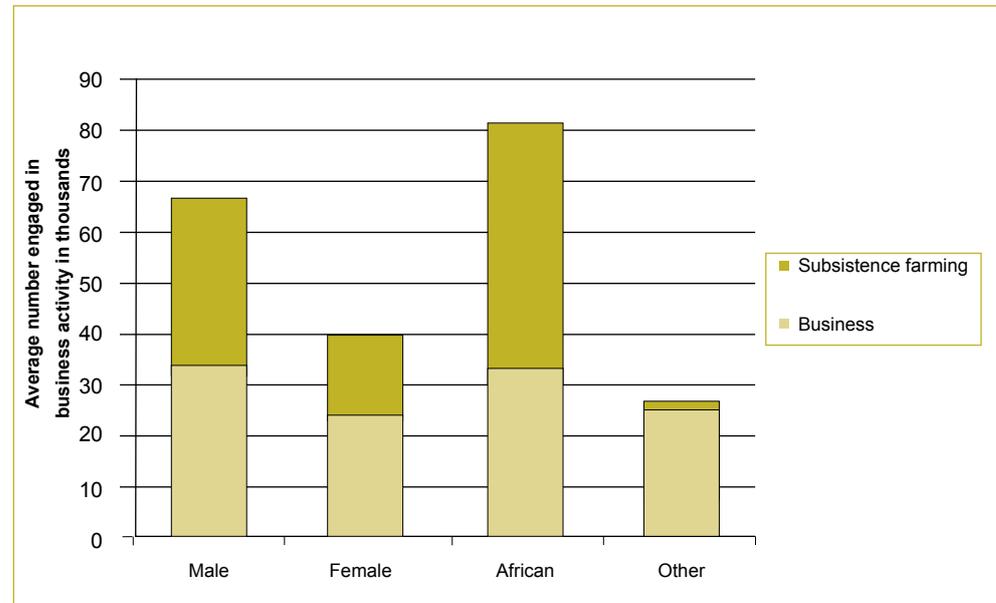
In addition to youth entrepreneurship, an issue of interest is the business activities of the elderly. This is particularly relevant in the population groups where grandparents are *de facto* responsible for feeding and educating their grandchildren, especially black African households living in rural areas.

In this respect, the information provided in the LFSs confirms that the majority of elderly people engaged in business is black African, especially as far as subsistence farming is concerned. As for younger entrepreneurs, men are more likely than women to be running a business after the age of 65, but the participation of women remains significant. This is illustrated in Figure 24.

¹⁰ TEA is the number of entrepreneurs divided by the population of working age, whereby entrepreneurs are defined as persons who are, on their own or with partners, either busy starting a business, or running a business that has paid salaries for less than 3.5 years.

If one relates the number of people aged 66 and over, engaged in some business activity (*stricto sensu*), to the total number of people in this age category, one can derive a business activity rate which, although not entirely comparable, can be plotted against the entrepreneurial activity rates of the younger population groups from the GEM surveys. Figure 25 shows these results. Overall, there is still a need to provide more support to youth entrepreneurs to absorb some of the very high youth unemployment.

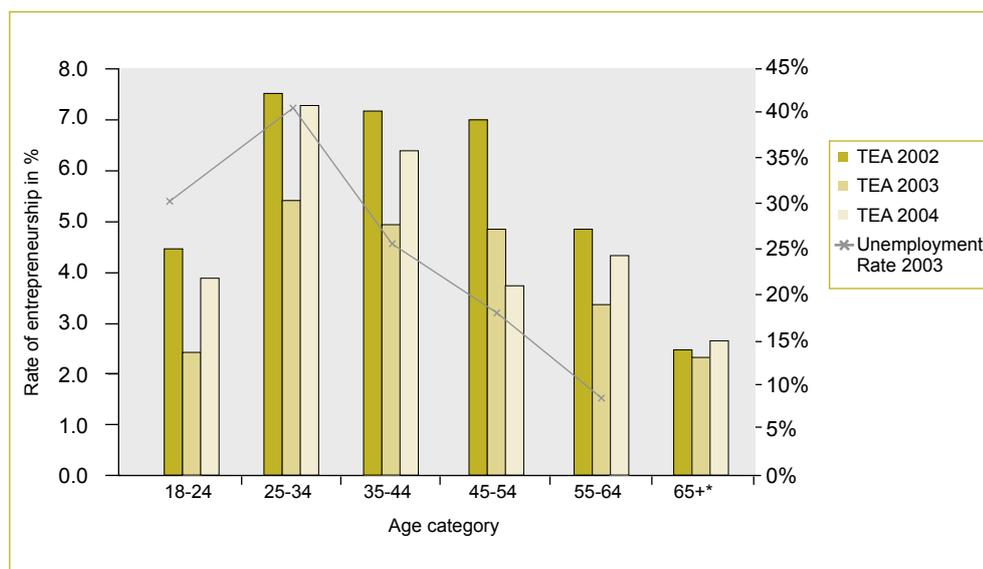
Figure 24 – Business activities of the elderly, by category



Source: LFS, September 2001-September 2004

Note: Due to the relatively small sample sizes, averages have been built to neutralise year-to-year fluctuations.

Figure 25 – Entrepreneurship and unemployment by age in SA, 2002-2004¹¹



Source: Compiled from GEM 2003 and LFS, September 2002-2004

Note: For the age category 65+, the figures correspond to a business activity rate rather than an entrepreneurial activity index.

5.4 Educational level

An important policy element in stimulating youth entrepreneurship is to improve the education standards of the youth. Indeed, it is proven that entrepreneurship levels increase with education. In addition, the fact that people with a tertiary education are more likely to own established firms confirms that firms owned by entrepreneurs with better qualifications have a higher life expectancy. This is illustrated by Table 19.

Table 19 – Entrepreneurial activity of South Africans according to their education

	Start-ups (%)	New firms (%)	Established firms (%)	Total business ownership* (%)
Without matric	3.1	0.9	0.8	4.0
With matric only	4.9	2.4	1.8	7.2
Tertiary qualification	6.9	4.3	5.2	10.4

Source: Adapted from GEM 2004

* Total business ownership is the number of persons owning a business, divided by the total number of persons in this category. It differs from the sum of the entrepreneurial activity rates since some persons can own several businesses, which means they are counted both as new firm owners and owners of an established firm.

¹¹ The rate used for this figure is not strictly speaking an 'unemployment rate' since the number of unemployed is related to the total population and not the economically active population. Unfortunately the LFS does not give an age breakdown of the active population.

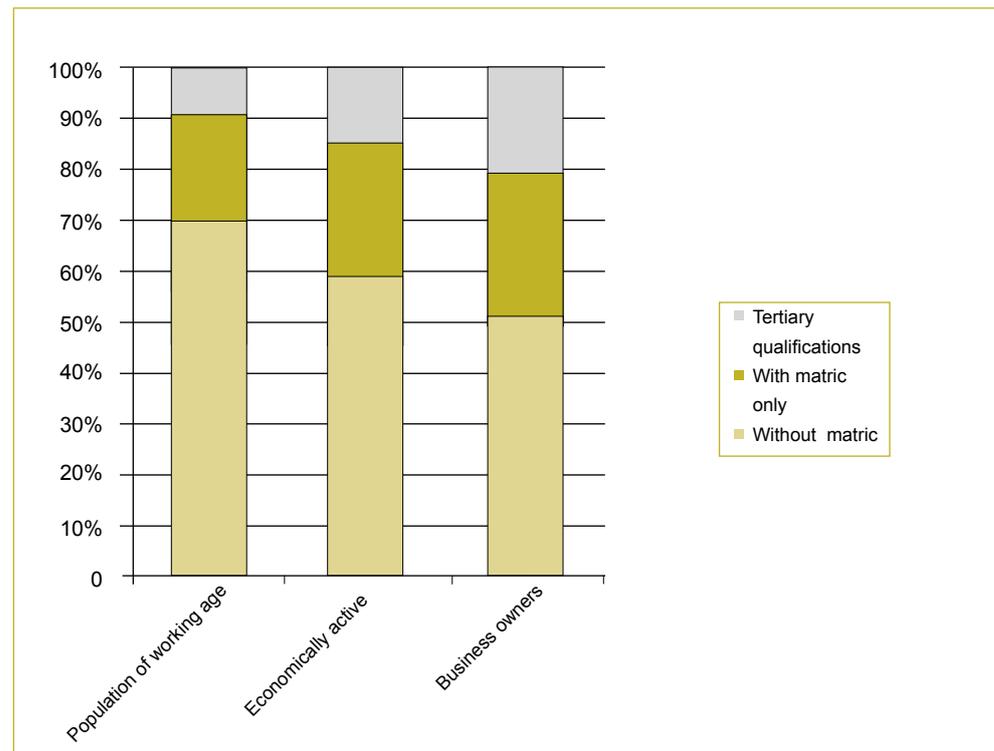
In spite of this positive relationship between education and entrepreneurship, there is still a majority (51%) of entrepreneurs without matric. However, the rate is significantly lower than among the total population, as illustrated by Table 20 and Figure 26. In addition, GEM 2002 has also shown that entrepreneurs with matric employ on average far more people than those without matric.

Table 20 – Educational level of entrepreneurs compared to SA population

	Population of working age		Economically active		Entrepreneurs	
	In '000	In %	In '000	In %	In '000	In %
Without matric	20,445	70	9,224	58	869	51
With matric only	6,082	21	4,223	27	484	28
Tertiary qualification	2,546	9	2,178	14	351	21
TOTAL	29,305	100	15,778	100	1,704.3	100

Source: Compiled from GEM 2004 and LFS, September 2004

Figure 26 – Educational attainment of entrepreneurs, compared to SA population



Source: Compiled from GEM 2004 and LFS, September 2004

6. Contribution of SA's small businesses to the economy

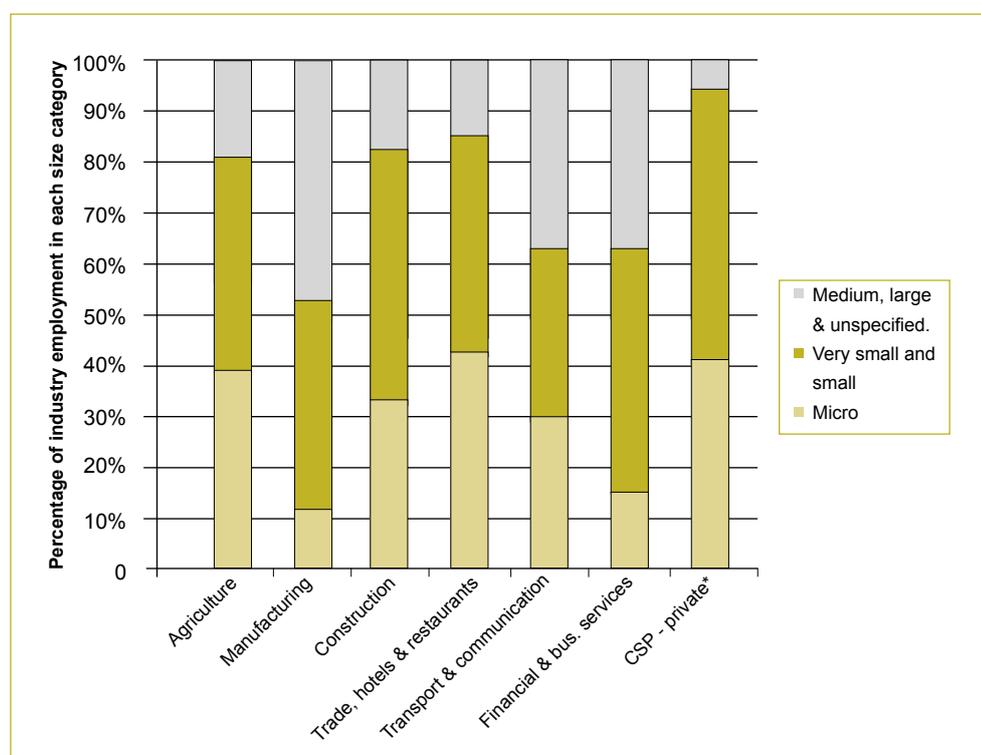
The main source of data for this section is a table published in the LFSs. Unfortunately, this Survey distinguishes only between the sizes of establishments up to 50 employees, so that it is not possible to include medium-sized enterprises (50 to 200 employees) here¹². We therefore refer to small businesses as the micro, very small and small enterprises as defined in Schedule 1 to the Small Business Act.

6.1 Contribution to employment

Table 21 presents the SA working population (11.6-million people) according to the sector and size of the entity they work for. (This includes the work of the entrepreneurs themselves, as well as casual and seasonal workers, who are heavily used by small businesses). It shows that, on average, micro enterprises employ approximately one-third of South African workers, while cumulatively, micro, very small and small businesses account for about 71% of employment¹³. The contribution of micro and very small enterprises is particularly high in the sectors of trade, construction and community services (after correcting for the share of government), which are typically labour-intensive sectors.



Figure 27 – Contribution of micro, very small and small businesses to employment by industry



Source: Own calculations based on LFS, September 2004, Table 3.14.

* CSP private refers to the assumed 'private' share of Community, Social and Personal Services, as discussed.

¹² Another problem is that the Survey does not distinguish between government employees and employees of the private sector, therefore estimations in the Community and Social Services sector may be biased.

¹³ This is based on LFS data, whereby surveyed workers were asked to indicate the number of regular employees in the entity they work for. This may not be entirely reliable as surveyed workers may over- or underestimate the number of employees in their business, especially if it involves different branches.

Table 21 – Contribution of micro, very small and small businesses to employment (2004)

	Micro (%)	Very small (%)	Small (%)	Medium & large (%)	Unspec. / don't know	TOTAL
Overall	33	9	29	27	2	100
Agriculture	39	11	31	19	1	100
Mining and Quarrying	*	*	4	93	3	100
Manufacturing	14	18	21	45	3	100
Electricity, Gas & Water	*	12	17	57	14	100
Construction	34	31	18	13	3	100
Trade, Hotels & Restaurants	43	28	14	13	2	100
Transport, Storage & Communication	30	18	15	35	2	100
Financial & Business Services	16	28	20	33	3	100
<i>Community, Social and Personal Services (1)</i>	16	26	22	34	3	100
<i>of which government services (assumed)</i>	0	10	34	54	2	100
<i>of which private services (assumed)</i>	41	50	4	1	4	100

Source: Own calculations based on LFS, September 2004, Table 3.14.

* For all values of 10,000 or more the sample size is too small for reliable estimates. (1) is as derived from Stats SA data. Government services include schools, hospitals, governments, etc. Assumption for share of private businesses: 100% of micro entities, 75% of very small entities, 6.6% of small entities and 2% of medium & large are private. Note: The table does not include South Africans employed by private households or extraterritorial organisations.

6.2 Contribution to GDP

As discussed in section 2.5: Methodology, the contribution of small businesses to GDP is very difficult to ascertain. Owing to the dearth of data, the present study has adopted the approach presented in the 2003 Review as the 'Abedian method (2002)'.

The principle of this approach is to divide the GDP into two components: the total compensation of employees and the gross operating surplus. The first component is allocated to firm categories according to their contribution to employment, while the surplus is allocated according to assumptions on the level of profitability of each type of business, based on two sets of weights, leading to two sets of estimations. As indicated in the 2003 Review, the implicit assumption of equal remuneration across size categories probably results in a bias in the Abedian method. If large firms remunerate their employees better than small and especially micro-enterprises, the Abedian

method may over-estimate the share of these firms. It therefore seems safer to work with the more conservative 'GVA2' estimations. The Abedian method, based on the 2004 GDP figures (sum of the four quarters) generates the following estimates:

Table 22 – Contribution of micro, very small and small enterprises to the 2004 GVA

GVA1	Micro (%)	Very small (%)	Small (%)	Medium & large (%)	Unspec.	TOTAL
Agriculture, Forestry & Fishing	15	7	23	55	0	100
Mining & Quarrying	3	3	12	81	1	100
Manufacturing	9	11	20	58	1	100
Electricity & Water	3	8	19	65	6	100
Construction	21	19	19	39	2	100
Trade, Catering & Accommodation	23	16	17	43	1	100
Transport, Storage & Communication	15	10	18	56	1	100
Financial & Business Services	9	13	20	57	1	100
Community, Social & Personal Services	31	37	9	21	3	100
Government					100	100
TOTAL 2004	12	11	15	46	16	100
TOTAL (excl. government)	14	13	18	54	1	100
<i>2003 values for comparison*</i>	<i>13</i>	<i>12</i>	<i>19</i>	<i>56</i>		<i>100</i>

GVA2	Micro (%)	Very small (%)	Small (%)	Medium & large (%)	Unspec.	TOTAL
Agriculture, Forestry & Fishing	12	7	20	62	0	100
Mining & Quarrying	0	3	10	86	1	100
Manufacturing	7	11	18	64	1	100
Electricity & Water	0	8	16	71	6	100
Construction	19	19	17	43	2	100
Trade, Catering & Accommodation	21	16	15	48	1	100
Transport, Storage & Communication	12	10	15	62	1	100
Financial & Business Services	6	13	17	64	1	100
Community, Social & Personal Services	29	37	7	24	3	100
Government					100	100
TOTAL 2004	9	11	13	51	16	100
TOTAL (excl. government)	11	13	15	59	1	100
<i>2003 values for comparison</i>	<i>10</i>	<i>12</i>	<i>16</i>	<i>62</i>		<i>100</i>

Sources: Stats SA Releases: LFS, September 2004 and GDP Release, Q2 2005

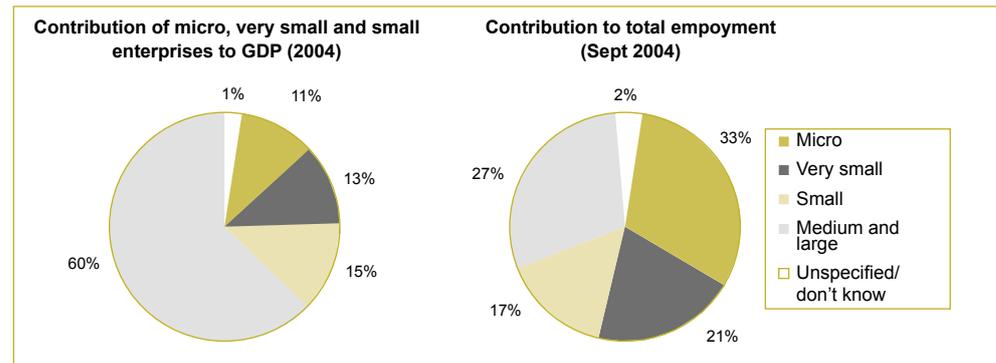
Methodology: As in Abedian, in Falkena et al. (2002). * Unfortunately the results are not entirely comparable because of a change in Stats SA's GDP methodology. In 2003, the GDP releases distinguished between (i) Community, social and personal services, (ii) General government services and (iii) Other producers. While the latter two have a very low gross operating surplus, their contribution to the compensation of employees is significant. In 2004, 'Other producers' have been amalgamated into 'Personal services'.



These estimations would suggest that enterprises employing less than 50 regular employees would – after neutralising non-enterprise producers such as government – generate between 39% and 45% of the production of enterprises.

6.3 Summary

Figure 28 – Contribution of small businesses to employment and GDP



Source: Own calculations with Abedian method (GVA2), based on Stats SA Releases, 2004

Source: Own calculations based on LFS, September 2004

7. The dynamics of small businesses in Cape Town

This section tries to investigate the worrying phenomenon of early mortality of small firms and the extent to which small firms are growing firms.

Unfortunately there is no data source in SA to track businesses over time on a comprehensive, nationwide level. Therefore this analysis is based on local case study data – the database of all establishments trading and paying RSC levies in Cape Town.

The analyses are based on a longitudinal study of the businesses from the City of Cape Town's RSC Levy database for the years 2000, 2002 and 2004. Even though the data present some quality problems, owing to missing data and irregular data keeping¹⁴, the possibility to follow businesses for several years, observe registration and liquidation trends, as well as the turnover evolution of firms which are operating as going concerns, provides very useful insights.

¹⁴ In particular, the number of registrations for the RSC Levy increased sharply in 2003 to 2005 due to a series of steps undertaken by the City to enforce the obligation to register. This is the reason why the discussion on 'entries and exits' presented in the 2003 Review has not been repeated in 2004, as figures would be distorted by this specific action.

7.1 Average lifespan of businesses in Cape Town

7.1.1 General findings

Table 23 represents the distribution of liquidated, suspended or dormant accounts according to the 'age' that they have reached up to liquidation/suspension. (It must be noted that the 'age' is measured according to the date of registration for RSC Levy, which may differ from the actual date of start-up).

Table 23 – Lifespan of liquidated, suspended or dormant Cape Town businesses according to type of business

Lifespan	Sole proprietors & partnerships (%)	CCs & companies (%)	All accounts (%)	Sample size (all accounts)
2 years and less	17.3	20.1	19.7	3,714
3 years	8.0	10.9	9.8	1,839
4-6 years	22.0	26.0	24.5	4,613
7-10 years	20.4	19.4	19.8	3,721
11 years or more	31.9	23.3	26.2	4,928
TOTAL	100.0	100.0	100.0	18,815

Source: Own analysis based on Cape Town RSC data, December 2004¹⁵

Lifespan is calculated as the difference between the date of registration for RSC levy and the date of suspension/liquidation.

The table confirms the widely held view that almost 30% of businesses die (or become dormant) less than three years after registering. The proportion of businesses surviving for more than 10 years is just over one-quarter. Of course, these results are biased, since they only take into account those businesses which have been suspended or liquidated.

The table further shows a striking difference between CIPRO-registered entities (such as companies and CCs) and non-registered entities (sole proprietors and partnerships). As illustrated in figure 29, CCs and companies seem to have a lower life expectancy than sole proprietors and partnerships. This may be counter-intuitive, as one would expect that more formalised businesses would be better protected against odds.

The finding raises the following hypotheses:

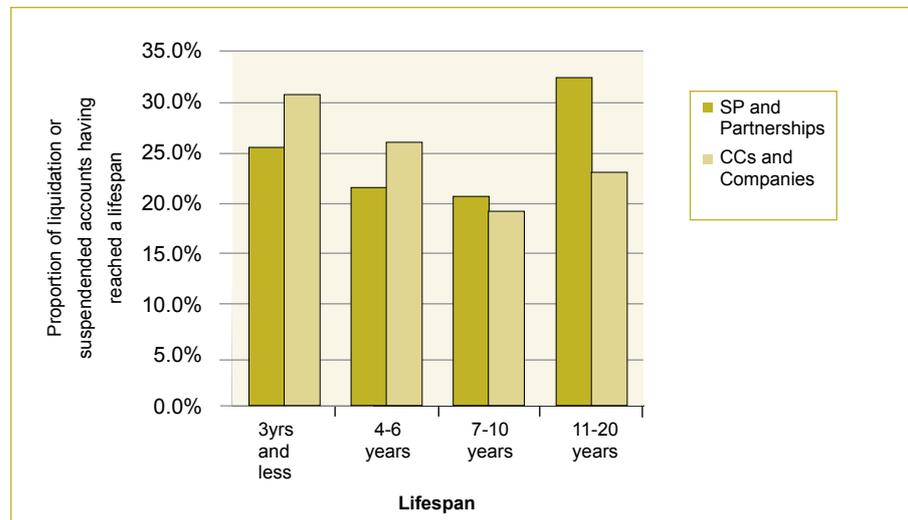
- The compliance burden for registered companies (for example, legal costs and costs of accounting) may be too high, and may distract the entrepreneur's attention from actual business issues.

¹⁵ Results are not necessarily comparable with those published in the 2003 Review (based on December 2001), as the database, which was established in 1987, has 'grown older', so that the average lifespan is automatically longer (the maximum lifespan is now 17 years as opposed to 14 years in 2001).



- Entrepreneurs starting CCs or companies may be too ambitious and engage costs without having properly sounded their market, while non-registered firms usually start small.

Figure 29 – Lifespan of incorporated and non-incorporated businesses



Source: Own calculations based on Cape Town RSC Levy database, December 2004

Lifespan applies to all accounts liquidated, suspended or dormant and is calculated as the difference between the date of registration for RSC Levy and the date of suspension/liquidation.

7.1.2 Sectors with the longest and shortest lifespans

As in the 2003 Review, the duration of the life of suspended, liquidated and dormant accounts was analysed by sector, yielding the following results:

Table 24 – Median lifespan of liquidated and suspended accounts, by industry

SIC	Description	Sample size	Median
1	Agriculture, Hunting, Forestry & Fishing	225	9.0
2	Mining & Quarrying	17	7.0
3	Manufacturing	1,826	6.1
4	Electricity, Gas & Water Supply	6	2.1
5	Construction	987	5.0
6	Trade & Repairs, Hotels & Restaurants	6,755	5.9
7	Transport, Storage & Communication	523	5.0
8	Financial Intermediation, Insurance, Real Estate & Bus. Services	6,217	5.0
9	Community, Social & Personal Services	1,855	6.0
0	Other	450	4.0
	Overall without 84 and 9*	15,700	5.0

Source: Own analyses of Cape Town RSC Levy database, December 2004

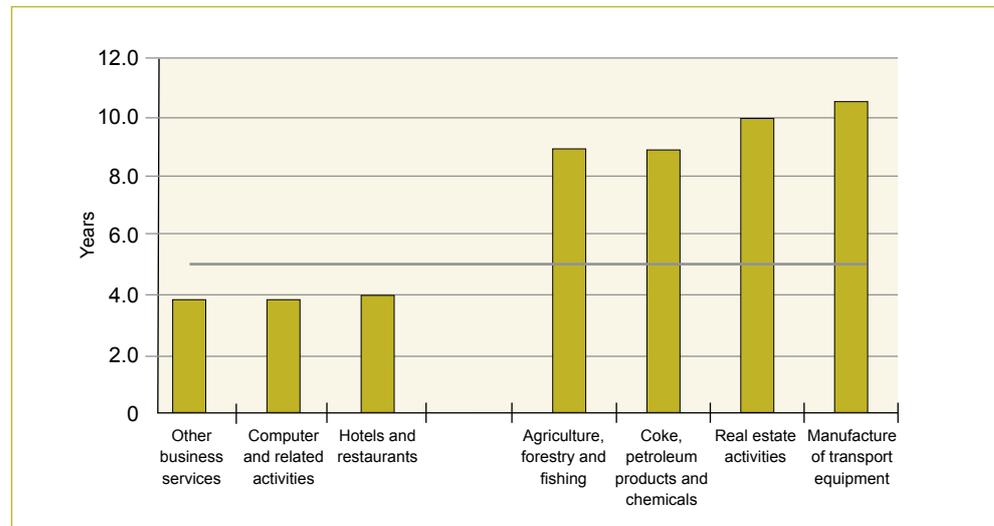
* The database includes non-business entities, which tend to have longer lifespans than typical business enterprises. Most of them are classified under the SIC codes 9 (for example, schools, hospitals and government entities) or 84 (for example, body corporates). To correct the potential bias, these two sectors have been excluded when calculating the cross-sector median lifespan.

Figure 30 shows the sub-sectors with the highest and lowest lifespan, respectively. Although the values are not comparable with the previous Review's values due to a different methodology, the figure shows that:

- Two of the most vulnerable sectors (IT and catering & accommodation) are the same as in 2001.
- The leisure sector, which was identified as the most vulnerable of all in 2001, seems to have recovered.
- However, the sector 'other business services' (which comprises activities such as legal, accounting, tax consultancy, market research, management consultancy, architectural and engineering, advertising, labour recruitment, etc.) is affected by a high infant mortality, which was not visible in 2001.
- Three of the most robust sectors (agriculture, real estate and vehicle manufacturing) are the same as in 2001.
- The other sector with the longest lifespan is the chemical industry.
- Most of the sectors with a long lifespan are not very relevant for small businesses.



Figure 30 – Sectors with the lowest or highest median lifespan



Source: Own analyses based on Cape Town RSC Levy database, December 2004

The horizontal line shows the median lifespan across all sectors.

Note that the 'Electricity Gas & Water supply' sector was not taken into account for this analysis due to the small sample size.

7.1.3 Mortality of informal micro enterprises

The RSC Levy database per definition gives no information on informal businesses, which are not registered for any tax or levy. For those, the only evidence available is of an anecdotal nature or based on field research, usually with very small samples.

The 2003 Review quoted a finding by Rogerson & Rogerson (1997), which estimated a 50% to 60% mortality rate of new black businesses in the Johannesburg inner city. More recently, the University of Cape Town/Saldru¹⁶ Financial Diaries Project (2005)¹⁷, which studied 46 survivalist businesses in three townships – Langa (Western Cape), Diepsloot (Gauteng) and Lugangeni (KwaZulu-Natal) – found that 48% of these businesses were not sustained: either they had been started and then stopped during the course of the year, or they were only very recent start-ups. This suggests that many informal businesses have at best a very discontinuous existence.

7.2 Turnover growth of Cape Town businesses

The 2003 Review included an analysis of the year-to-year turnover growth of Cape Town businesses between December 2000 and December 2001. However, a one-year growth is not necessarily a good indicator, as turnover patterns may fluctuate, especially for young businesses and even more if businesses have only traded for a few months during the first year.

¹⁶ SA Labour and Development Research Unit

¹⁷ The Focus note on *The Financial Management of Survivalist Businesses* can be downloaded from the website www.financialdiaries.com.

Therefore the 2004 Review looks at two-year and four-year growth patterns, from 2000 to 2004 and from 2002 to 2004¹⁸. In addition, growth rates have been inflation-adjusted to concentrate on real economic growth. The findings are presented below.

7.2.1 General findings

Table 25 represents the distribution of firms depending on the turnover growth rate which they have achieved over the two- and four-year periods. Not surprisingly, the average yearly growth rates over the four-year period tend to concentrate more in the middle range (-5% to 25% per annum) than those of the two-year period, since a smoothing effect occurs.

It is encouraging, though, that the majority of firms (more than 60%) has achieved a real growth rate higher than 5% per annum over the two- and four-year periods. This suggests that businesses are indeed growing in real terms. However, this may be caused by a survivorship bias).

Table 25 – Distribution of Cape Town firms depending on growth achieved

	Inflation-adjusted turnover growth rate in % per annum						Sample size
	<-25%	-25%-5%	-5%-+5%	5%-25%	25%-50%	>50%	
2002-2004	9.4	14.0	16.4	29.7	14.3	16.2	19,233
2000-2004	6.6	13.7	17.9	36.1	14.6	11.0	17,064

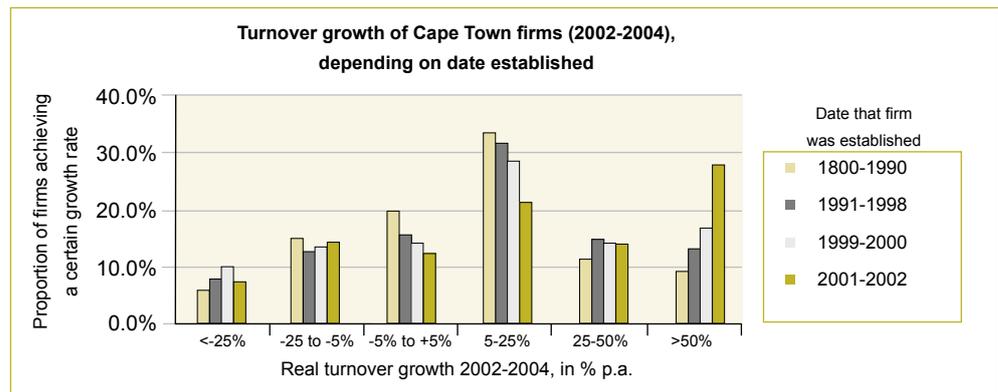
Source: Own analysis based on Cape Town RSC Levy database, December 2000, 2002 and 2004

As discussed in the 2003 Review, the statistics confirm that young firms are more likely to have high growth rates, while established firms are more likely to be stable, or even slightly declining in real terms. Strong declines (beyond -25%) are most likely to occur among firms which have only been in existence for a few years. This is illustrated by figures 31 and 32.

¹⁸ Warning: Apart from the obvious survivorship bias, turnover figures reported to the City of Cape Town may be biased since they form the basis for the calculation of the RSC Levy. But there is no reason to think that the bias should be stronger in one year than in the other, therefore year-to-year comparisons should reflect economic reality. Note that the methodology considers only the accounts with a positive turnover (zero values are frequent but is likely to come from delayed reporting rather than an actual absence of sales).

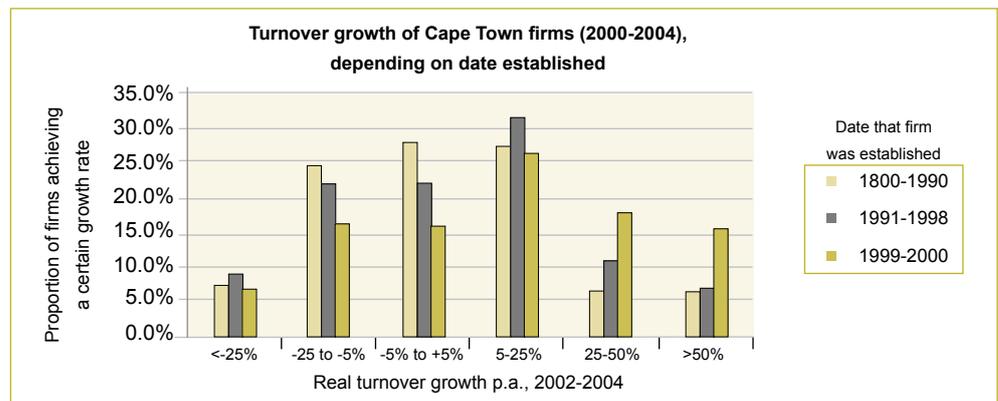


Figure 31 – Growth by age category, 2002-2004



Source: Own analysis based on Cape Town RSC Levy database, December 2002 and 2004

Figure 32 – Growth by age category, 2000-2004

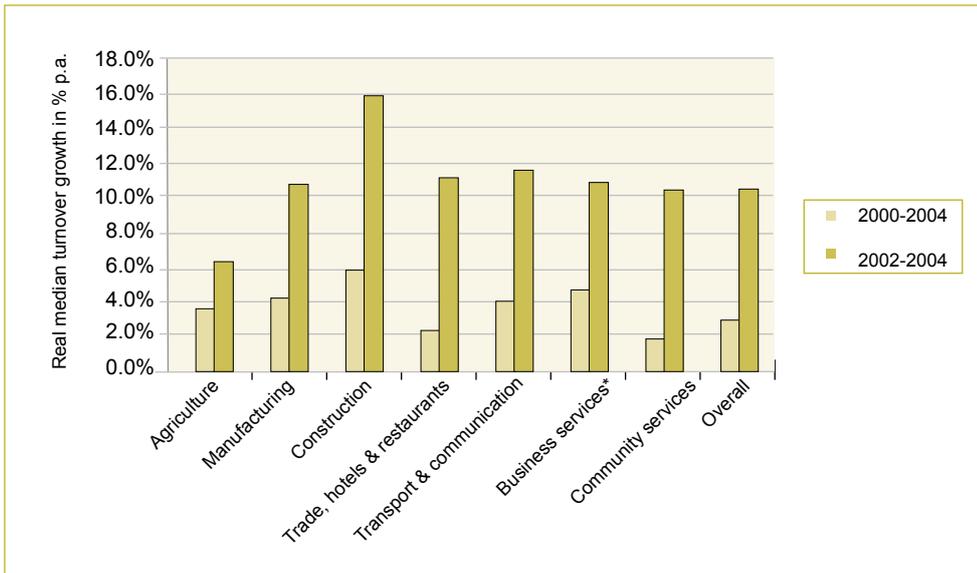


Source: Own analysis based on Cape Town RSC Levy database, December 2000 and 2004

7.2.2 Sectors with the highest and lowest growth

The median growth rates for each period were compiled according to the industry classification (SIC). The results are displayed in Figure 33.

Figure 33 – Turnover growth of Cape Town businesses, by industry



Source: Own analysis based on Cape Town RSC Levy database, December 2000, 2002 and 2004

The figure confirms some of the results discussed previously:

- Construction firms, and to a lesser extent businesses in the manufacturing and transport & communication sectors, have recovered and/or expanded over the last few years.
- The firms in the community services sector have not experienced much growth.
- Agriculture enterprises have the lowest growth for the period 2002 to 2004, but this may be caused by the higher average age of those enterprises compared to the overall sample; their growth over the four-year period is average.
- Conversely, businesses in the trade, hotels & restaurants sector have a growth rate just above average for the two-year period but very low over four years. This seems to be related to the very high mortality of the sector – the short-term growth is high because most firms are young, but the medium-term growth is low as many firms experience a decline after a few years (or, in fact, have to close down).
- In terms of growth, firms in the business services sector are generally performing slightly better than average, but this again may be distorted by the lower age of these firms (as discussed, this sector is characterised by a high mortality).

7.3 Summary

To conclude on the dynamics of Cape Town small businesses, we discern two contradicting trends. On the one hand, business mortality remains high. On the other, those businesses which do survive often achieve substantial real growth, even over a four-year period. These two observations reveal the two facets of entrepreneurship – risk and opportunities.



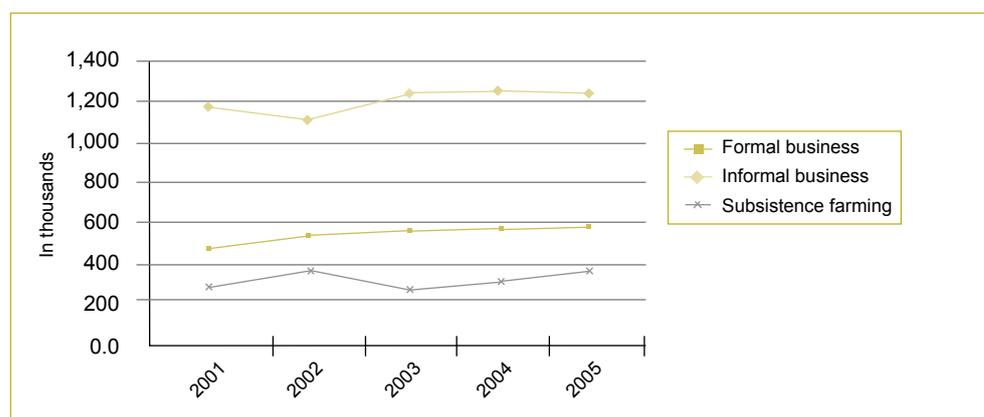
8. Review of trends and outlook, 2001-2005

8.1 Evolution of the number of small businesses

Just as there are different indicators on the numbers of small businesses, there is no simple way of observing trends. The CIPRO statistics show an ever-increasing number of registered entities (especially for CCs, non-profit companies and, to a lesser extent, other private companies), but it has already been said that this is not necessarily representative of the entire small business sector.

The most reliable source hence remains Stats SA's LFSs, which have a good coverage of the entire sector, can be consulted on a number of years and have followed a relatively stable methodology. Table 26 shows statistics for the last three years, while Figure 34 summarises the findings for the most important sectors since 2001.

Figure 34 – Evolution of the number of employers and self-employed, by sector



Source: LFSs, September 2001 to March 2005

Figure 34 shows that overall, small business activity is increasing, although not uniformly. A positive sign is that the most consistent, albeit slow, increase is for formal businesses, which went up by 17% over the four years. Informal businesses, meanwhile, are stabilising. Subsistence farming, on the other hand, is also increasing, possibly reflecting the progress in land redistribution.

Table 26 – Number of employers or self-employed (in their main capacity)

		Among population of working age (15-65)			Among elderly (65+)	TOTAL
		Formal	Informal	Total		
Sept 2003	Employers/self-employed (incl. commercial farms)	506,000	1,234,000	1,750,000	58,000	1,808,000
	Subsistence farming		261,000	269,000	39,000	308,000
	TOTAL			2,019,000	97,000	2,116,000
Sept 2004	Employers/self-employed (incl. commercial farms)	545,000	1,267,000	1,824,000	61,000	1,885,000
	Subsistence farming	-	296,000	302,000	47,000	349,000
	TOTAL			2,126,000	108,000	2,234,000
March 2005	Employers/self-employed (incl. commercial farms)	575,000	1,252,000	1,836,000	56,000	1,892,000
	Subsistence farming	12,000	370,000	385,000	64,000	449,000
	TOTAL			2,221,000	120,000	2,341,000

Source: Stats SA LFS, September 2004 and March 2005 (table 3.11.1 and 7.1)

* For all values of 10,000 or lower the sample size is too small for reliable estimates.

* For the population of working age, employers or self-employed are defined as those "Working on his/her own or with a partner, in any type of business (including commercial farms)", while subsistence farming is defined as "Working on his/her own small farm/plot or collecting natural products from the forest or sea".

* For the elderly, employers or self-employed are those who "Run or do any kind of business, big or small, for himself/herself", while subsistence farming concerns those who "Do any work in his/her own or the family's plot, farm, food garden, cattle post or kraal or help in growing farm produce or in looking after animals for the household".

* Note: Total includes 'don't know / unspecified' sector.

* Note: Due to rounding, numbers do not necessarily add up to totals.

8.2 Registrations and liquidations of CCs and companies

8.2.1 General trends

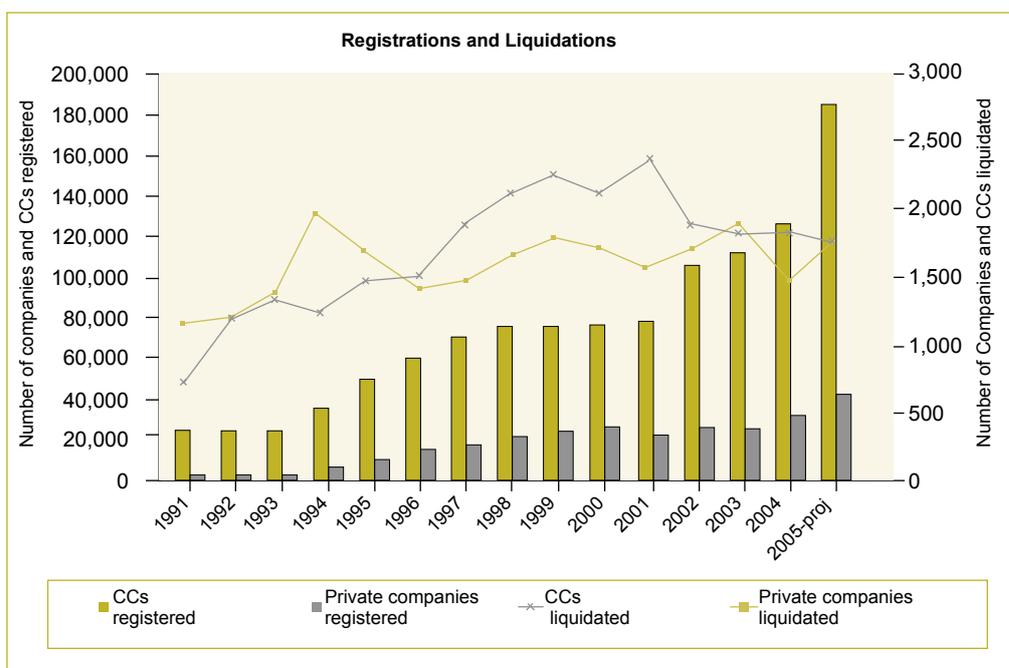
The number of new (private) companies and CCs registered every year is high and has increased almost steadily over the past 15 years. For the first nine months of 2005, there have been more than 140,000 new CCs and over 35,000 new companies registered. A positive trend of the last two to three years is that the number of liquidations is on the decrease, especially for CCs¹⁹. Liquidations of companies are set to go

¹⁹ The reported number of liquidations from 1 January to 31 August 2005 is at 1,126 for CCs and 1,138 for companies.



up again in 2005, but this increase must be seen against the sharp decrease in 2004, as well as the fact that, through ever-increasing registrations, the ‘living stock’ of companies is growing.

Figure 35 – Number of registrations and liquidations of CCs and companies, 1991-2005



Source: Compiled from CIPRO 2004-2005, Stats SA 2003 and Ntsika 2002

Note: “2005 Proj” is a projected value for 2005, based on a pro rata applied to values reported for the truncated year. For liquidations, real figures were available up to the cut-off date of 31 August 2005, while registrations were available until 5 October 2005. The increase in the registration of CCs in 2005 may not be as extreme as suggested by the chart, but already registrations up to 5 October 2005 (142,808 CCs) are significantly higher than those for the whole year in 2004 (128,746 CCs).

8.2.2 Sector differences

Figure 36 shows that the sectors with the most new registrations are trade and services, especially financial and business services. These are also the sectors with the highest number of liquidations.

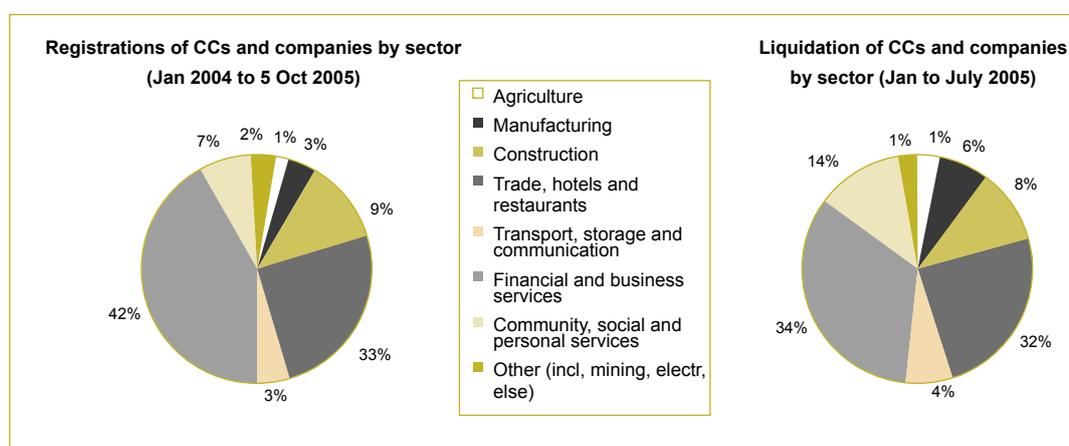
Compared to 2003, three sectors have changed their registration and liquidation patterns:

- As in 2003, the manufacturing sector is characterised by a higher proportion of liquidations compared to its share in total registrations. This may indicate a relative vulnerability of this industry. Nevertheless, there has been a decrease in the number of manufacturing liquidations (which represent only 5.8% of total liquidations in the period January to July 2005, as opposed to 8.2% in 2002 to 2003 and 7.7% in 2004).

- The construction sector, which had been singled out in 2003 as one of the most vulnerable ones, seems to be recovering. It has seen a sharp increase in the number of new registrations, while the liquidations in this sector have remained stable.
- The share of the business services sector has decreased equally in registrations and liquidations (from 38.5% of liquidations in 2002 to 2003 to 34.6% in 2005, and from 46% to 42% of registrations).
- On the other hand, the sector of Community, Social and Personal Services seems to be suffering. Liquidations in this sector are increasing both in the absolute and the percentage of the total number of liquidations, and the sector's proportion of total liquidations is significantly higher than its share in total registrations.



Figure 36 – Registrations and liquidations by sector



Source: Compiled from CIPRO 2005

Source: Compiled from Stats SA 2005

To conclude this section, statistics are generally encouraging, and seem to point at the following trends:

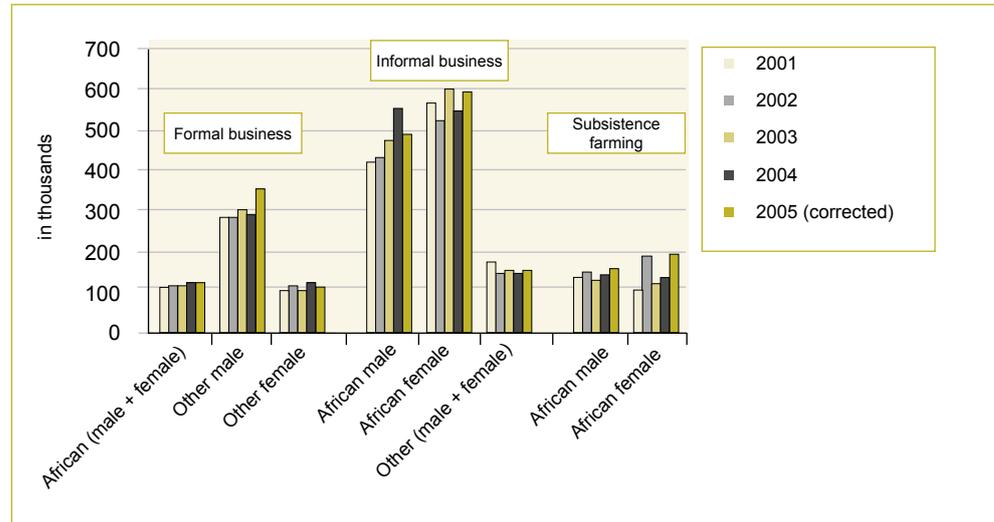
- A continued dynamism in the creation of new companies, especially the smallest companies (CCs).
- A general improvement in the liquidation statistics.
- An apparent recovery in the construction and manufacturing sectors.
- However, the situation in the Community, Social and Personal Services sector is worrying, with a significant increase in liquidations.

Although interesting, these statistics apply only to the top-end of the small business population, namely registered corporations. In addition, a newly registered CC is not necessarily actually trading, and liquidations play only a minor part in the disappearances of small businesses – most of them simply become dormant. Nevertheless, there is no reason to assume that actual economic developments are different from the trends suggested here.

8.3 Involvement of main population groups in small businesses

8.3.1 African versus other business owners

Figure 37 – Involvement of various population groups in business, 2001-2005²⁰



Source: LFSs, September 2001 to March 2005

Figure 37 shows that the slow growth of formal businesses observed is at least partly carried by a consistent increase in the participation of black Africans over the period. However, the progress in participation of black Africans in formal business remains very slow, and the number of black Africans (male and female) who define themselves as running a formal business is still far from the levels of other population groups, even though black Africans are far more numerous in the adult population.

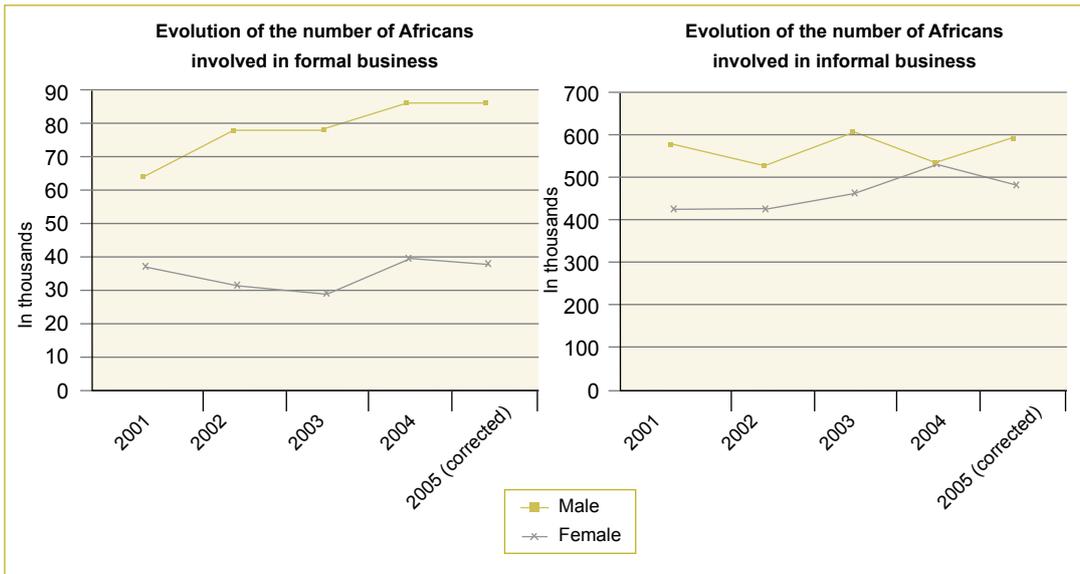
Non-black African males remain by far the largest group among owners of formal businesses. Unfortunately the latest LFS releases do not provide a breakdown between Coloured, Indian and White owners, nor is it possible to determine whether the sharp increase in March 2005 is due to a sampling error.

It is more difficult to recognise a trend for informal businesses. Generally, the participation of black Africans, both male and female, seems to be growing, although irregularly. Other population groups have slightly reduced their involvement in this sector. As to subsistence farming, which is only significant for black Africans, the growth has been rapid, especially among women, who in 2005 outnumbered their male counterparts. Overall, if one looks at the numbers from the perspective of the promotion of black- and women-owned business, it must be admitted that – at least for black African businesses – government policies have not had the expected impact.

²⁰ The 2005 series is 'corrected', as it would seem that the March 2005 LFS reports have inverted figures of 'female African' and 'male other' in all types of activity.

Figure 38 shows that black African women remain rare in formal business, and their numbers are not growing significantly. The increase in the number of black African men owning a formal business is too slow to enable a significant structural change in the economy and society. Black Africans, and women in particular, are still primarily turning to informal businesses for their livelihoods.

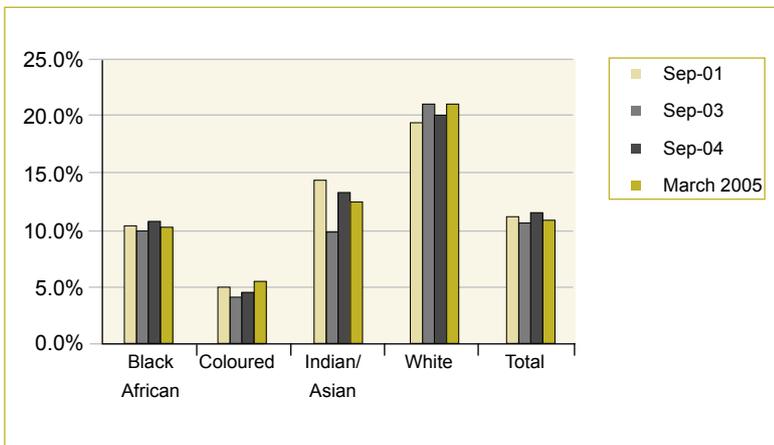
Figure 38 – Evolution of the participation of Africans in formal and informal businesses



Source: LFSs 2001-2005

Figure 39 confirms that there is no clear progress in the tendency of each population group to become involved in business activity.

Figure 39 – Evolution of the entrepreneurial activity by population group, 2001-2005

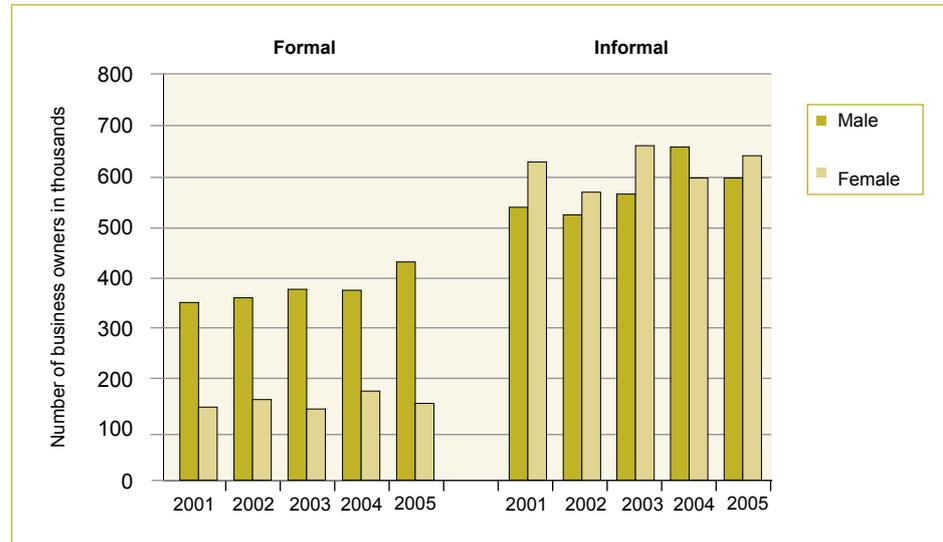


Source: LFSs, September 2001 – March 2005



8.3.2 Entrepreneurship by gender

Figure 40 – Evolution of male and female entrepreneurship, 2001-2005



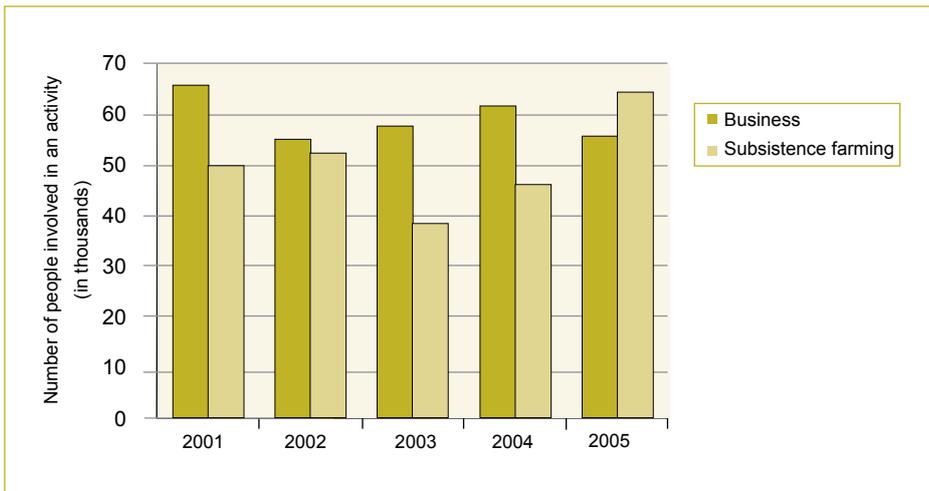
Source: LFSs, September 2001 – March 2005

Again, the data show that Government's efforts to promote female entrepreneurs have not had a significant impact on figures. While there is a visible growth trend among the number of male business owners, the number of women running a business, both formal and informal, does not follow an obvious trend.

8.3.3 Entrepreneurship by age category

Similarly, figure 41 shows that the number of elderly people running a business is not decreasing; on the contrary, there seems to be a growing trend for subsistence farming. This may point to the continued financial vulnerability of the aged, which forces them to remain economically active.

Figure 41 – Evolution of entrepreneurship of the aged, 2001-2005



Source: LFSs, September 2001 – March 2005

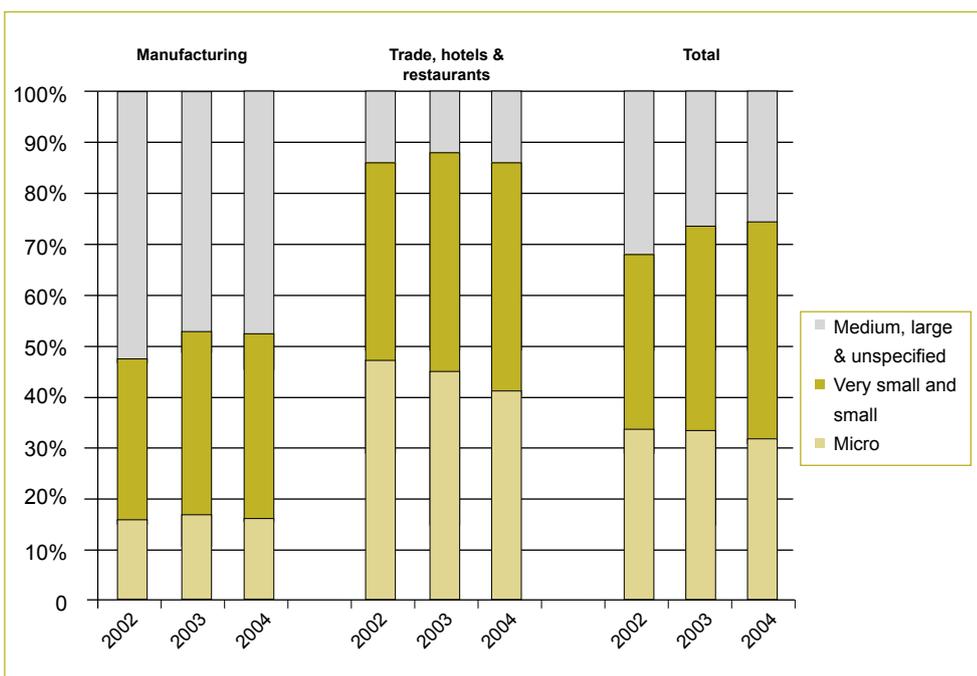


8.4 Contribution of small businesses to the economy

8.4.1 Contribution to employment

The trend over the three years seems to be towards an increase in the share of very small and small firms. In the manufacturing sector this has been at the expense of medium & large enterprises, while in the trade sector, micro enterprises have mostly declined. This trend is illustrated in figure 42.

Figure 42 – Contribution of micro, very small and small firms to employment, 2002-2004



Source: Own calculations based on LFS, September 2002, 2003 and 2004

(Size categories according to number of permanent employees)

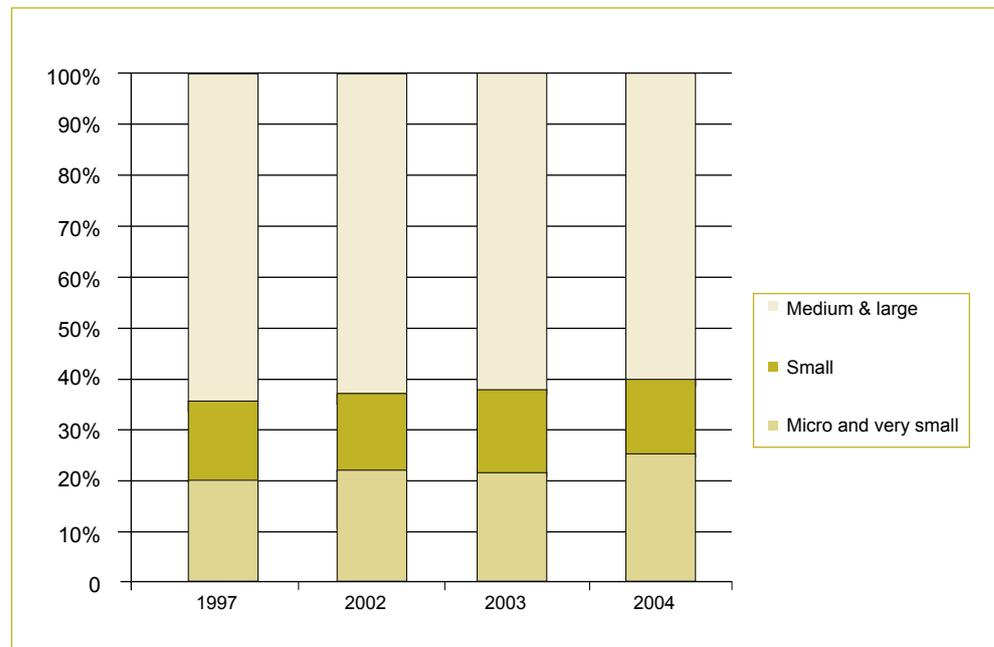
8.4.2 Contribution to GDP

Estimations on the evolution of SMMEs' share in GDP are subject to the reservations already expressed in the methodology used. Since the model's factors (in particular share of profit) are held constant, the resulting share of micro, small and medium firms should be stable. Indeed, Table 27 and Figure 43 show that the shares of the various categories have been relatively stable since 1997. However, to the extent that the differences observed are due to real changes as opposed to data / sampling effects (Abedian's results were based on the same methodology but using different data), it would seem that the share of micro and very small enterprises (less than 20 employees) is on the increase, while the share of medium & large entities is eroding. This trend would mean that our economy is indeed undergoing a slow structural change.

Table 27 – Trends in the contribution of micro, very small and small businesses to the GVA of enterprises (Abedian method GVA2)

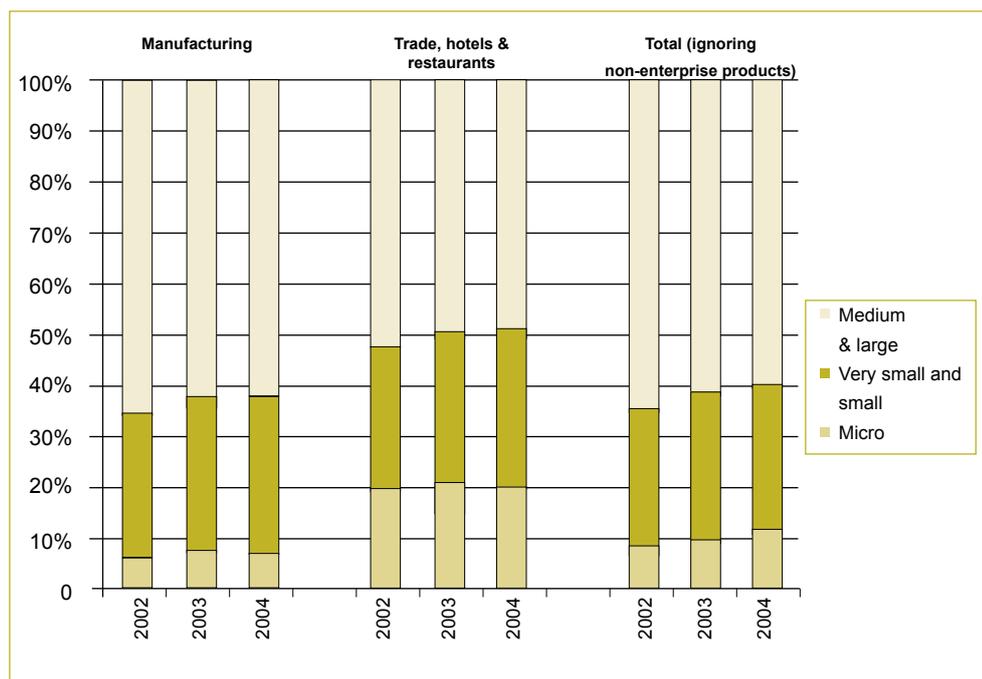
	Micro	V. small	Micro & V. small	Small	Medium & large	Source
1997	12	9	21	15	63	Abedian in Falkena et al 2002
2002	10	12	22	15	64	Small Business Review 2004
2003	10	12	22	16	62	Small Business Review 2004
2004	11	13	24	15	59	Small Business Review 2005

Figure 43 – Contribution of micro, small and medium & large businesses to GDP, 1997-2004



Source: As per table 27 above

Figure 44 – Contribution of SMMEs to GDP by industry, 2002-2004



Source: As per Table 27 above

8.5 Summary and discussion of trends

8.5.1 Number of businesses, formal and informal

Overall, there is no doubt that the number of active businesses is increasing, especially in the formal sector (see for example, the LFS). This is the joint result of an acceleration in new registrations (especially for CCs) and a slow decrease in the number of liquidations.

In all provinces, the number of formal active SMMEs has increased faster (7.4%) than the population of working age (+0.8%).

In the informal sector, which has witnessed strong growth between 2002 and 2003, the number of businesses is stabilising, but subsistence farming – which can be interpreted as agricultural informal micro-businesses – is growing fast.

8.5.2 Size of SMMEs

It cannot easily be said which size category of SMMEs has increased most. According to the LFS data, there is a decrease in the employment by micro businesses, but an increase in employment by very small and small businesses, while medium & large businesses have slightly reduced their contribution to employment.

8.5.3 Sectors

This section of the Review summarises some findings from various analyses for the most important sectors of the small business economy:

- **Manufacturing: *Recovering***
 - There has been a marked decrease in the number of manufacturing liquidations between 2002 and 2005 (from 8.2% of total liquidations in 2002 to 2003 to 5.8% in the period January to July 2005).
 - Furthermore, the Cape Town database shows that both the lifespan and the median turnover growth of manufacturing businesses were higher than average (the chemical industry and vehicle manufacturing have the longest lifespan; however, this is not likely to be relevant for small businesses).
 - Nevertheless the sector remains vulnerable, since its share of liquidations is higher than its share of total registrations.
- **Construction: *Recovering and expanding***
 - The construction sector, singled out in the 2003 Review as one of the most vulnerable, seems to be recovering.
 - It has seen a sharp increase in the number of new registrations, while liquidations have remained stable.
 - Firms have shown the highest turnover growth in the Cape Town database.
- **Business Services: *Shrinking but unequal***
 - The share of the business services sector has decreased equally in registrations and liquidations (from 38.5% of liquidations in 2002 to 2003 to 34.6% in 2005, and from 46% to 42% of registrations).
 - According to the Cape Town database, two sub-sectors are characterised by a very short lifespan – the IT sector and ‘other business services’ (legal, accounting, consultancy, engineering, etc).
 - In terms of growth, firms in the business services sector generally are performing slightly better than average, but this may again be distorted by the lower age of these firms – as discussed earlier, this sector is characterised by a high mortality.
 - Real estate is one of the sectors with the longest lifespan in Cape Town.
- **Trade, hotels and restaurants: *Fragile***
 - From 2002 to 2005, liquidations in this sector have increased relative to the total number of liquidations over the period.
 - In the Cape Town database, catering & accommodation remains one of the sectors with the shortest lifespan.
 - The growth pattern of businesses in the trade, hotels & restaurants sector is intriguing – typical businesses seem to have a relatively high growth for the two-year period but very low over four years.
- **Community & Social Services: *Distressed***
 - Liquidations in this sector are increasing, both in the absolute and the percentage of the total number of liquidations. The sector’s proportion

of total liquidations is also significantly higher than its share of total registrations.

- According to the Cape Town database, the firms in this sector have not experienced much turnover growth.
- On the other hand, the leisure sector, which was identified as the most vulnerable of all in 2001, seems to have recovered partially.

8.5.4 Entrepreneur profile

According to the LFS:

- The participation of black African women in businesses is fluctuating, both for formal and informal businesses, but it is strongly increasing as far as subsistence farming is concerned.
- Black African men are a growing source of both formal and informal entrepreneurship, as well as subsistence farming.
- Non-black African men are increasingly involved in formal businesses, and to a lesser extent in informal businesses. Meanwhile, the participation of non-black African women in formal and informal businesses remains low.





