



**The role of enterprise development in the reduction of poverty:  
A case study of Drakenstein Municipality in the Western Cape**

**By  
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.....  
Signed

.....  
Date

## ABSTRACT

**Background:** The core question is whether poverty can be reduced through SMME development, particularly in the Drakenstein region of the Western Cape in order to create significant job opportunities and to reduce poverty through entrepreneurship. There is therefore a need for policy measures and radical interventions through the provision of an enabling legislative environment to support small business development.

**Objectives:** The aim of this study was to assess the current government support programmes as well as the effectiveness of programmes of the Drakenstein Municipality. The study also examined government's support to the informal sector. It argues that local governments are strategically well placed to deal with poverty alleviation because local government is closer to the people than the other spheres of government, and was seen as pivotal in reducing poverty.

**Methodology:** The research used a descriptive quantitative research method in order to describe the status quo as it is at present. The aim of the study is to investigate the role of enterprise development in the reduction of poverty. The research therefore made use of both primary and secondary data sources in order to obtain data regarding small business development in South Africa, and more specifically in the Drakenstein Municipal area. Descriptive statistics, which describe and summarise numeric quantitative data into meaningful information, was used on the quantitative data captured in SPSS while thematic analysis, which entails the process of data reduction by focusing on repeated words or phrases of the respondents, responses, was used to analyse qualitative data.

**Findings:** It was found that at a macro-level, SMME's felt that government policy is not effective to support SMME's. The general trend among SMME's was that they were not aware and have never used the identified government support programmes for SMME's.

**Recommendations:** The importance and role of enterprise development as a mechanism for poverty reduction has also been emphasized. It is clear that the environment to support SMME's is not conducive for the growth and development of these businesses. The golden thread is that businesses in the informal sector require much more support to ensure they are

able to grow. Generally, SMME's in both sectors has the potential to grow if they are provided with the necessary support.

**Keywords:** SMME's, Poverty reduction, Formal/Informal-entrepreneur, Enterprise Development, Drakenstein Municipality in the Western Cape.

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## ABBREVIATIONS

BEE	Black Economic Empowerment
BBBEE	Broad Based Black Economic Empowerment
BRIC	Brazil, Russia, India, China
CDE	Centre for Development and Enterprise
CDI	City Development Index
CWDM	Cape Winelands District Municipality
DTI	Department of Trade and Industry
GEAR	Growth, Employment and Redistribution
GDP	Gross Domestic Product
GNU	Government of National Unity
GEM	Global Entrepreneurship Monitor
HDI	Historically Disadvantage Individual
IDP	Integrated Development Plan
IDC	Industrial Development Corporation
ILO	International Labour Organisation
LED	Local Economic Development
NEDLAC	National Economic Development and Labour Council
NEPAD	New Partnership for Africa's Development
NSBA	National Small Business Act
PPPA	Preferential Procurement Policy Act
RDP	Reconstruction and Development Plan
SAMAF	South African Micro-Finance Apex Fund
SBP	Small Business Project
SCM	Supply Chain Management
SMME	Small, medium and micro enterprise
SETA	Skills Education Training Authorities
SPV	Special Purpose Vehicle
SRM	Supplier Relationship Management
TIPS	Trade and Industrial Policy Strategies
UCT CIE	University of Cape Town Centre for Innovation and Entrepreneurship
UIF	Unemployment Insurance Fund
UNISA	University of South Africa



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# Chapter 1

## 1.1 Introduction and background to the study

Timm (2011:10) declares that:

*“policymakers, consultants, bureaucrats and all those that serve small businesses in South Africa have become increasingly aware that more needs to be done to support small businesses if the country is to address the widening inequality and persistent poverty as well as unemployment and job losses”.*

The above statement cannot be emphasised enough given the fact that South Africa has an astounding dependency on state benefits, with an increased number of social grant beneficiaries, from two million in 1999 to fourteen million in 2009. This trend is alarming, and hence it is vital to promote and support entrepreneurship (Timm, 2011:10). This sector arguably, develops due to increased unemployment; functioning as a place of last resort for those unable to become employed in the formal economy. Growing small businesses could assist in the reduction of the population’s dependence on social grants, and at the same time boost job creation and ensure equitable growth. There are however various factors which prevent small businesses being set up and growing including ineffective enterprise development support programmes, inflexible legislative environment to support entrepreneurs, lack of business and financial management skills, to mention but a few.

Timm (2011:10), further alludes to the fact that developmental opportunities, through small business development, are being overlooked. A Finmark Trust Finscope 2010 survey as cited in Timm (2011), found that 2,5 million jobs could be created through small businesses by 2020. This study also indicates that 500 000 people could be taken off the social grant schemes, if small businesses are actively supported by government. SMMEs have a big potential to bring about social and economic development, by contributing significantly in employment creation, income generation and catalysing development in urban and rural areas. Therefore, research in this field recognizes that enterprise development has an important role to play in poverty alleviation in South Africa.

This study has been broadly structured into eight parts to provide a practical and handy reference source for a wide range of readers. Firstly, the researcher introduces the rationale and different definitions of poverty as well as the current role of SMME’s in the South African economy. The author has assessed the current legislative environment within which enterprises

are operating in South Africa. Furthermore, this study assesses the current government support programmes as well as the effectiveness of programmes of the Drakenstein Municipality. The study also examines government's support to the informal sector. Abrahams (2003:3) argues that local government are strategically well placed to deal with poverty alleviation because local government is closer to the people than the other spheres of government. The provision of infrastructure and other municipal services, as well as flexible municipal by-laws are critical for businesses to flourish. The provision of enterprise development support programmes which includes enhancement of entrepreneurial skills for instance, is seen as pivotal in reducing poverty.

Drakenstein Local Municipality is a Category B municipality and forms part of the Cape Winelands District Municipality, which also includes the Category B municipalities of Stellenbosch, Breede Valley, Witzenberg and Langeberg. It stretches from just south of the N1 freeway, including Simondium in the south, up to and including Saron in the north. The Klein Drakenstein, Limiet and Saron Mountain Ranges forms its eastern edge, and the agricultural areas immediately to the west of the R45 form its western border. Paarl and Wellington are the main urban centres in the municipality, located in close proximity to the N1 in the south, with smaller rural settlements at Saron and Gouda in the north and Hermon in the mid-west.

*“In an effort to alleviate poverty and reduce inequality, the National Development Plan has set the objective of having zero households earn less than R418 per month by 2030. The Drakenstein Municipality was in 2011 still behind this target with approximately 14.7 per cent of its 61 859 households earning less than R400 a month. Lower levels of household income increases indigent dependency on municipal support. Municipal resources are therefore strained in an effort to provide free basic services” (Western Cape Provincial Treasury, 2015:13).*

The table below illustrates a breakdown of household income per municipal area in the Cape Winelands District in 2011.

*Table 1: Cape Winelands District Household income, 2011*

Municipality	Non-income	R1-R4800	R4801-R9600	R9601-R19600	R19601-R38200	R38201-R76400	R76401-R153800	R153801-R307600	R307601-R614400	R614001-R1228800	R12281-R2457600	R2457601 or more
CWD	13.1	1.9	3.4	13.2	20.3	18.4	12.3	8.9	5.7	1.9	0.5	0.4
Witzenberg	6.4	1.9	4.0	18.5	25.8	20.9	10.4	6.8	3.9	0.9	0.3	0.2
Drakenstein	13.0	1.7	3.1	10.7	17.2	18.4	14.0	11.0	7.4	2.5	0.7	0.4
Stellenbosch	20.6	2.1	3.5	10.2	16.5	15.5	11.5	8.5	6.6	3.3	1.0	0.7
Breede Valley	12.0	1.7	2.9	14.9	22.2	19.0	12.6	8.5	4.7	1.0	0.3	0.2
Langeberg	9.7	2.3	4.4	15.5	24.9	20.0	11.0	7.3	3.6	0.8	0.2	0.2

Measuring levels of poverty and inequality for the period 2006 to 2011, the Statistics South Africa's 2014 Poverty Trends Report specified that the lower-bound poverty line (LBPL) for March 2011 was set at R443 (per capita, inflation adjusted poverty line) meaning that any individual earning less than R443 a month would have to sacrifice essential food items in order to obtain non-food goods. Compared to the above specified average household income data, it is concerning to note that approximately 9 093 households (14.7 per cent) in the Drakenstein Municipality earned less than R400 a month in 2011, therefore had to survive on less than what an individual person requires as per the LBPL measure. This high rate of unemployment and poverty is found in especially the previously disadvantaged communities. There is therefore a need to create economic opportunities with corresponding job creation. Given the many dimensions of poverty, this research will explore the holistic view adopted by Drakenstein Municipality:

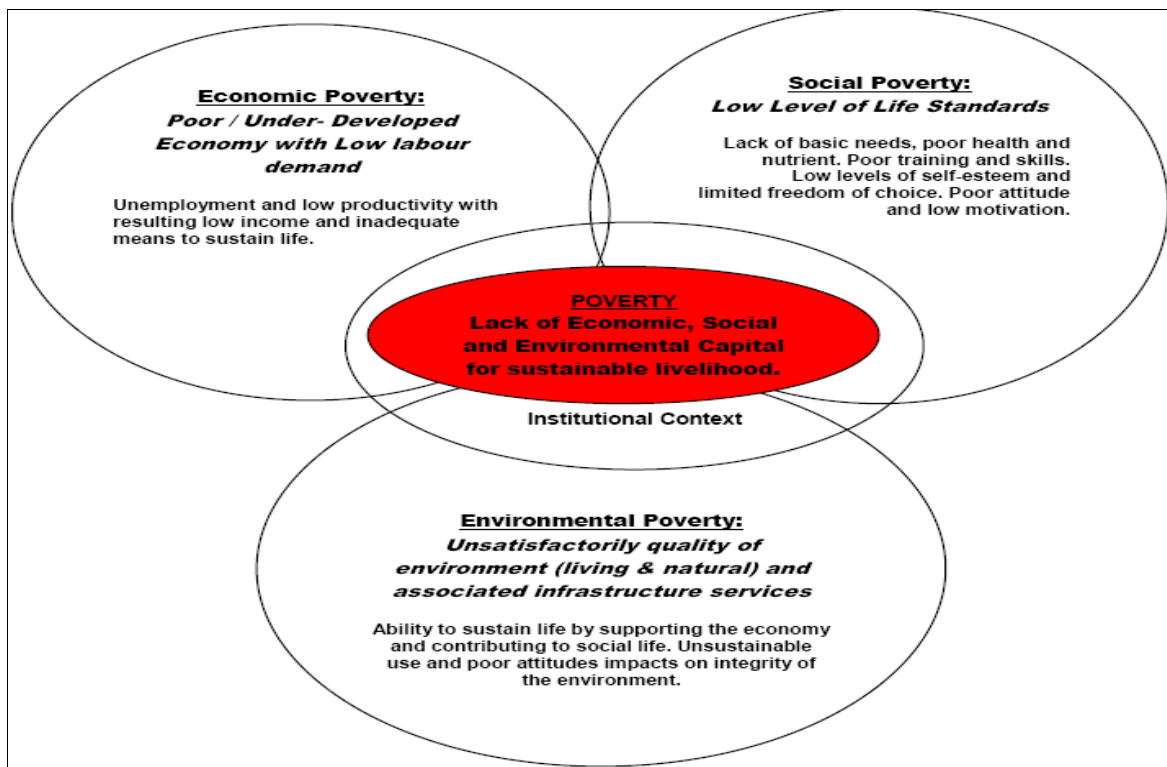


Figure 1: Cycle of poverty

(Source: Drakenstein Municipality (IDP, 2011:5).

## **1.2 Problem statement**

Enterprise development as a mechanism for poverty reduction in South Africa is a very topical subject. There is growing pressure on government to support SMME's and to create an enabling environment for enterprises to function optimally. It is widely acknowledged that enterprise development has a meaningful role to play in addressing poverty. Currently, enterprise development support programmes fails to adequately address the needs of entrepreneurs, hampering the ability of the SMME sector to adequately address poverty. Furthermore, the legislative environment (red tape) is not conducive for starting and growing small businesses. The government procurement processes presents an opportunity to meaningfully support small businesses, however there are various challenges that small businesses face, including a lack of understanding of the tender procedures, procurement rules and systems and lack of tender process advice and support. This study investigated to what extent the role of enterprise development can address poverty reduction at local government level and specifically in Drakenstein Municipality.

### **1.2.1 Sub problems**

#### **1.2.2 Sub problem 1**

Ineffective enterprise development programmes to enhance enterprises.

#### **1.2.3 Sub problem 2**

Ineffectiveness of tender processes in supporting SMME's.

#### **1.2.4 Sub problem 3**

Ineffective government support to the informal sector.

#### **1.2.5 Sub problem 4**

Unfavourable legislative environment to support entrepreneurs.



### 1.3 Background to the research problem

According to Green, Kirkpatrick & Murinde (2006:2), it is important to comprehend the ways in which enterprises can contribute to economic growth and the reduction of poverty, especially in light of the 2030 Agenda for Sustainable Development of eradicating poverty in all its forms.

According to Everatte (2005:76), in the parliamentary debate on nation building and reconciliation in 1998, South Africa was argued as a country comprising of two ‘nations’ divided by poverty, by the then Deputy President Thabo Mbeki: *“One of these nations is white, relatively prosperous, regardless of gender or geographic dispersal. It has ready access to a developed economic, physical, educational, communication and other infrastructure. The second and larger nation of South Africa is black and poor with the worst affected being women in the rural areas, the black rural population in general and the disabled. This nation lives under conditions of a grossly underdeveloped economic, physical, educational, communication and other infrastructure. It has virtually no possibility to exercise what in reality amounts to a theoretical right to equal opportunity”*.

Mbeki argued that poverty reduction is fundamental to transformation. The poverty issue came under the spotlight again in 2003, with the release of a report by the South African Human Rights Commission. The report highlighted government’s performance with regard to socio-economic rights. This was followed by various studies which confirmed that the levels of poverty in South Africa is still the same, or has worsened since our democratic transition (Everatte,2005:76). Although Drakenstein experienced moderate growth between 2005 and 2013, the municipality’s growth trends during this period was however characterised by net job losses, in particular within the agriculture, manufacturing and construction sectors. Such jobless growth is a distinctive feature of a post-recession economy that undergoes structural and cyclical changes as it follows a natural trend of consolidation and expansion (Western Cape Provincial Treasury, 2015:36).

According to the SBP Occasional Paper (2009:2), common definitions of poverty focus on income levels or the consumption levels of individuals, however there are various other dimensions of poverty. The achievements and impact of government interventions have largely been unsuccessful to meaningfully grow and develop small businesses. Government has created various initiatives aimed at supporting and growing the SMME sector. However, this

has largely been focused, on the high-end enterprises and on encouraging microenterprise activity to reduce the gap between the formal economy and the informal economy (SBP Occasional Paper, 2009:2).

### **1.3.1 Research postulation**

There are various challenges faced by enterprises in order to effectively address poverty reduction. The present study has:

- Investigated the effectiveness of SMME support programmes and support network of Drakenstein Municipality
- Examined the procurement processes of Drakenstein Municipality to support SMME's
- Examined the type of support to the informal business sector by Drakenstein municipality
- Examined the legislative environment to support entrepreneurs

### **1.3.2 Objectives of this study**

The WBCSD (2004:4) suggests that various studies undertaken, indicated that SMME's have an important role to play in reducing poverty, as well as in the global and national economies. This study has investigated and explored:

- The reasons why government enterprise support programmes has failed to enhance enterprises, making suggestions for the way forward
- The role local government procurement processes can play in supporting SMME's.
- Initiatives that Drakenstein Municipality has undertaken to support entrepreneurs in the informal sector.
- The legislative and institutional framework for small businesses to function optimally.

The outcomes are elaborated on in chapter five, using graphic presentations to illustrate results. Pie charts and graphs were used to present the findings of the structured interviews.

### **1.3.3 Research design and methodology**

A descriptive quantitative research method was used. The sample population consisted of and the research instruments entailed:

- One hundred questionnaires were distributed to SMME's within the broader Drakenstein Municipal area.
- Eight interviews with employees from Drakenstein Municipality responsible for enterprise development were conducted.
- Interviews- The interviews were uniform and were conducted on a one-on-one basis. The information obtainable using this method is considered to be more objective and unbiased. In order to avoid constraints, the interviewer stayed within the parameters of a set questionnaire. The questions were the same for each interviewee, hence allowing for a homogeneous outcome.
- Questionnaires- A questionnaire was undertaken as a method of data collection.

### **1.3.4 Delineation of the study**

The study focussed mainly on entrepreneurs in the tourism, agricultural, finance and business services sectors, manufacturing sector and government services sectors, wholesale and trade. Attention was given to two groups:

- Group 1 – Entrepreneurs operating in both formal and informal sector.
- Group 2 – Enterprises operating for a period of at least five years.

### **1.3.5 Significance of the study**

The significance of the study is to illustrate and to present the importance of the role of enterprise development in reducing poverty as well as government's role in achieving this goal. It is imperative, that in order for SMME's to contribute to the reduction of poverty, and to create jobs, they need to operate in an enabling legislative environment together with support programmes which they can benefit from. Fundamentally, the SMME's are able to grow the economy of the region. State funded support programmes in developing countries like South Africa have generally proved to be inept.

Their efficacy is often doubtful. Enterprise development studies shows that such programs have failed to live “up to the market” and are too burdened by bureaucratic controls. At the same time, the small and medium and micro enterprises (SMME’s) have played a crucial role in evolving an alternative pathway that is more market-oriented and allows for poverty alleviation and income generation among the marginalized groups. SMMEs are the creative leaders who have an enormous potential to “eradicate poverty through profits” and “enabling dignity and choice through markets” (Ghosh, n.d).

The primary aim of the study is to bring to the attention of policy makers the importance of SMME’s and enterprise development in order to grow the economy. The study is therefore aimed at guiding policy makers to revise policies and to put mechanisms in place to create an enabling environment within which entrepreneurs and SMME’s can operate. The objective of this study is to stimulate growth in this sector, address poverty and unemployment and contribute to the local economy.

### **1.3.6 Expected outcomes, results and contributions of the research**

The expected outcomes and findings are intended to alert policymakers, after studying the facts at hand, of the inefficient support as well as regulatory and legislative framework within which SMME’s operate, which prevents them from meaningfully contributing to the reduction of poverty, creation of jobs and growing the local economy. The expectation is that the research would confirm that there are certain challenges faced by entrepreneurs that hamper their ability to assist in addressing poverty reduction. The findings of the research intends to highlight the role that enterprise development can play in the reduction of poverty and investigating ways in which government can assist entrepreneurs in terms of government’s broader legislative framework.

## **1.4 Summary**

South Africa is faced with high levels of unemployment and government needs to actively address issues like job creation, generating sustainable and equitable growth. SMME’s are widely being acknowledged as a mechanism through which job creation, economic growth and equity can be achieved in South Africa. In conclusion, the aim of this research is to draw the attention of policy makers of government and to encourage them to take suitable and practical measures that will encourage people to start small businesses in a flexible legislative

environment with support programmes that will significantly enhance their businesses. The following measures would significantly assist small businesses to grow and to ultimately:

- contribute to poverty reduction;
- implement inclusive reforms;
- build capacity;
- procure more goods and services for the public sector from SMMEs;
- encourage friendly regulatory environments; and
- involve business in identifying necessary reforms.

The next section highlights the connection between enterprise development, job creation and poverty reduction. A background into SMME development in South Africa is provided, and the concept of small business in South Africa is elaborated on in order to understand what constitutes the SMME sector. This section discusses the extent to which enterprise development can play a role in poverty reduction and discusses current interventions undertaken by Drakenstein Municipality to support SMME's.

## Chapter 2: Literature Review

### 2.1 Introduction

This chapter sheds light into the role of enterprise development in the creation of jobs, the generation of income and the reduction of poverty. Having provided a framework and theoretical underpinnings of the connection between enterprise development, poverty and job creation, this chapter assesses various interventions undertaken by Drakenstein Municipality to support small businesses. The writer argues that entrepreneurship is the catalyst for growing the local economy of Drakenstein and that it has a meaningful impact on job creation and poverty reduction. The extent to which entrepreneurship have been promoted and supported, however, is insufficient and it is imperative therefore that government and institutions responsible for enterprise development pursue policy goals to meaningfully support small businesses.

In order to create significant job opportunities and to reduce poverty through entrepreneurship, there is therefore a need for policy measures and radical interventions through the provision of an enabling legislative environment to support small business development; effective government support programmes; effective interventions targeted at the informal sector and creating opportunity through government procurement processes.

The core question is whether poverty can be reduced through SMME development, particularly in the Drakenstein region of the Western Cape. In order to address the above objectives, the research examines the SMME framework as it relates to poverty alleviation. It further provides the socio-economic background of the Drakenstein region and the challenges of SMME development in response to poverty alleviation. It identifies the role of local government in supporting the development of SMME's. The research also examines and critically analyses the current initiatives created by government to provide support to small business and questions whether these will translate into more sustainable businesses that can create jobs and enable skill transfers which will contribute to poverty reduction in the Drakenstein region (Agupusi, 2007:3).

After reviewing the literature, the author decided to use the Drakenstein Municipality as a case study, for the mere fact that local economic development is a key priority for the Municipality, not only on paper, their vision on development is clear. They are taking a pro-poor approach to development and actively attempt to put interventions in place to support small businesses. However, in chapter 6 of this study, this is discussed in more detail when the writer assesses the interventions undertaken by the Municipality to support small businesses. There is indeed an attempt on the part of the Municipality to support small businesses and the intentions are developmentally oriented, as outlined in the Constitution, however the author attempted to assess whether current interventions of the Municipality have to some extent had a meaningful impact. The legislative and institutional framework for small business has also been investigated. The reason why government initiatives to support SMME's have been a failure thus far, are analysed. Initiatives undertaken by the Drakenstein Municipality to support the informal sector are also examined as well as the success thereof.

The next section provides an illustrative framework of the concept of small, medium and micro enterprises to provide an understanding of what constitutes the SMME sector.

## **2.2 SMME Development in the South African context**

### **2.2.1 Background to small business in South Africa**

Firstly, in order to study the subject matter under investigation, it is important that one understands what constitutes the SMME sector. The concept of small business has very diverse interpretations and it depends on the level of economic development of a country, size of the enterprise and the sector's contribute to the country's GDP. Small businesses in developed countries like the US, include up to 500 employees, while in developing countries like South Africa, this number is considerably lower. This ambiguous definition of small business can affect research findings and essentially interventions aimed at supporting the sector and thereby underestimates its contribution to socio-economic development. The characteristics of small businesses include ownership and management, entrepreneurship, labour status, the formal and informal economy and the size of the entity (Agupusi, 2007:3).

Globally, the criterion adopted to define small businesses is the size of an entity. According to South Africa’s 1996 National Small Business Act, an “SMME is seen as a separate and distinct business entity, including co-operative enterprises, and non-governmental organizations, by one owner or more persons which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy” (National Small Business Act, 1996:2). SMME’s in the South African context are classified into four categories:

- a) Survivalist enterprises;
- b) Micro-enterprises;
- c) Small enterprises
- d) Medium enterprises

The survivalist enterprise is generally seen as providing an income below the poverty line, those operating in the informal economy, for the mere fact that they cannot find employment in the formal sector and started operating in the sector to earn an income. Micro-enterprises are considered as businesses with a turnover of below the VAT registration limit of R300 000. Many of these informal and micro-enterprises provide the livelihoods of millions of people in South Africa (Annual Review of Small Business, 2004:5). The table below sets out the definition of small business in South Africa.

*Table 2: Categories of the SMME sector in South Africa*

<b>Size of enterprise</b>	<b>Number of employees</b>	<b>Annual Turnover</b>	<b>Gross Assets</b>
Medium	Between 100-200 depending on industry	R4 m to R50m depending on industry	R2 m to R18 m depending on industry
Small	Fewer than 50	R2 m to R25 m, depending on industry	R2 m to R4,5 m, depending on industry
Very small	10 to 20 depending on industry	R200 000 to R500 000, depending on industry	Between R150 000 to R500 000, depending on industry
Micro	Fewer than 5	Less than R150 000	Less than R150 000

*Agupusi (2007:4)*



It needs to be acknowledged that there are fundamental differences with regard to policies and the structure of small, medium, micro and survivalist enterprises. Policies and programs therefore, needs to be developed to support each category under the SMME umbrella and not adopt a one-size-fits all approach as is currently the case. For the purpose of this study, the term small business meaning small, medium and micro-enterprises has been used. It has been found by research regarding South African SMME's that there is a mismatch between the reality and the model of the SMME sector used by South African policy makers. According to Kesper (2000:1), the South African SMME sector is far from homogenous and would require a fine-tuned set of interventions rather than the generic assistance which have been provided thus far (Kesper, 2000:1).

### **2.3 Summary**

South Africa's SMME sector is extremely diverse and complex. Furthermore, its significance towards poverty reduction and job creation has to a large extent, been underestimated. Berry et al (2002:3) as cited in Ladzani & Mboniyane (2011:8) are of the opinion that research regarding the economics of the SMME sector as well as policy implementation is lacking. It is important that policy decisions which may impact small businesses should be based on accurate information regarding numbers, structure, size, their contribution to the economy and the state of the economy. The lack of inadequate information about small businesses in South Africa as well as the ambiguous definition regarding SMME's, have serious implications for growing and developing this sector.

The next section introduce government's agenda in terms of supporting and growing small businesses in order to achieve socio-economic objectives. The concept of poverty is defined and entrepreneurship development as a poverty reduction strategy is discussed.

## 2.4 Poverty and Enterprise Development in South Africa

*“With millions of South African’s unemployed and underemployed, the government has no option but to give its full attention to the task of job creation, and generating sustainable and equitable growth. Small, medium and micro-enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country. We (the government) believe that the real engine of sustainable and equitable growth in this country is the private sector. We are committed to doing all we can to help create an environment in which businesses can get on with their job. We believe in the principle of working together with our partners in the private sector – big and small businesses – in realizing our hopes and aspirations for this economy” (SBP, 2009:1).*

This was Trevor Manuel’s Foreword to the (White Paper on Small Business, 1995) which was published in 1995 when he was the Minister of Trade and Industry. After twenty five years, this statement is as important, although the context is very different. Even though South Africa has faced minimal effects of the global recession in 2008, many businesses closed down which resulted in a frightening scale of job losses with about 475 000 in the first two quarters of 2009, according to (Statistics SA, 2009). Various strategy documents have been developed with a strong emphasis of integrating the most neglected portion of the population into the productive economy. The Economic Policy agenda prioritizes the challenge of poverty alleviation, job creation, unemployment, the challenge of stimulating economic growth, generating public revenue and the improvement of public sector efficiency. Government efforts to support the SMME sector is acknowledged, however, the question needs to be asked: whether the type of support is appropriate for the road ahead (SBP, 2009:1).

People would be able to escape the evils of poverty and earn a living through enterprise development. Ladzani and Mboniyane (2011:8) contend that *“small businesses are the backbone of many economies across the globe”*. In turn and over time, they create jobs as well as empowering other individuals and the communities in which they live.

Adenutsi (2009:3) contends that these countries are generally poor, which is a result of low productivity and an over dependency on primary sectors with limited or no value added.

Currently, South Africa is ranked as the 32<sup>nd</sup> biggest economy and the 57<sup>th</sup> most productive country in the world. A result of low productivity essentially means that capital formation remains low, consumption of essential life-sustaining commodities is low and real per capita income remains low. This essentially means that as a result of low per capita income, individuals lack the necessary income not only to meet their basic needs, but lack the financing needed to start their own businesses. The result of this is they have poor credit records, leading to poor cash flow. This poses real threats to small business growth. Bowen et al (2009:16) as cited in Ladzani & Mbonyane (2011:553) states that a lack of credit is one of the main hindrances facing small businesses and therefore leads to poor small business growth (Ladzani & Mbonyane (2011:553).

Furthermore, since the poor lack the necessary income, they also lack collateral which will allow them to get access to loans and other funding mechanisms. Adenutsi (2009:3) conceptualizes this theory as follows:

*“Invariably, this situation lends credence to the popular known ‘vicious cycle of poverty hypothesis which underlies the perpetuation of underdevelopment of these economies of which Sub-Saharan Africa, Latin America, the Caribbean and South East Asia have dominated since human civilization”* (Adenutsi, 2009:3).

The MEC of the Department of Economic Development, Environmental Affairs and Tourism in the Eastern Cape has emphasized, in his speech on 16 November 2011, that jobs will not be created by large enterprises but rather from SMME’s (Jonas, 2011:1). Since the world is increasingly driven by market processes and entrepreneurial activity, developmental experts and policy makers are now reaching consensus that entrepreneurship has a significant role to play in the creation of jobs, income generation and reducing poverty. It is clear that entrepreneurial activity has fundamental policy implications for the creation of jobs, empowerment through income and the reduction of poverty in a low-income economy.

## 2.5 Entrepreneurship as a Poverty Reduction Strategy

Having given the background, above, between poverty and enterprise development, this section attempts to argue that entrepreneurship does indeed have the potential to be used as a key part of any poverty reduction strategy. However, it is essential to first put into context what the concept of poverty means and how it is measured by some economists. *“Poverty is a complex socio-economic condition – a condition that afflicts a person, a household, or a community and makes him/her unable to provide his/her basic necessities of life because of not having adequate resources to generate sufficient income”* (Mensah & Benedict, 2010:141).

Despite the complexity of poverty, analysts study the dynamics of poverty by using indices or single numbers, headcount ration, poverty gap index etc. These measures use income to measure the resources that the poor lack. The poverty line may also differ from country to country and, depending on the focus of the analysts in a country, different lines may be used (Mensah & Benedict, 2010:141).

South Africa is still faced with the challenge of breaking the poverty chains of a large portion of its population (Landman, 2003:1). It is agreed by many economic and political analysts that about 40% of South Africans are living in poverty, with 15% of the poorest, desperately trying to make ends meet. According to the (Human Sciences Research Council, 2005), statistics on poverty and inequality showed that 57% of the population of which 95% are black, live below the poverty line. Hence, many South Africans are faced with a moral challenge that motivates for working collaboratively towards economically and socially integrating poor fellow citizens (Landman, 2003:1).

Schwabe (2004:1) as cited in Mensah & Benedict (2010:14) argue that since there was no significant change in the percentage of people living in poverty in South Africa between 1996 and 2001 (end of RDP) and (end of GEAR), poverty levels have increased. Many people have tried to improve the quality of their lives by venturing into various forms of business. Some of the reasons for starting their own businesses include unemployment or retrenchment, recognizing an opportunity in the market and turning their hobbies and passion into a business or having a natural talent for the business as well as obtaining additional income (Mensah & Benedict, 2010:149).

Agupusi (2007:2) is of the opinion that the development of SMME's is seen globally and especially in developing countries as a key strategy for achieving economic growth, job creation and poverty reduction. Since 1994, therefore, small businesses have been promoted in South Africa as a vehicle to grow the economy and also socio-economic integration. Given the inability of the formal and public sector to absorb the increased number of job seekers in South Africa, more attention has focused on entrepreneurship and its potential for contributing to economic growth and job creation (Herrington, Kew & Kew, 2009:4). However, much needs to be done to support small businesses, to enable them to grow and create jobs. As a result of the growing rate of unemployment in South Africa, the attention has moved towards the promotion of small businesses by both private sector and government to one that will stimulate growth and, more importantly, create jobs and reduce poverty, especially among previously neglected groups (Agupusi, 2007:2).

After the first democratic election in 1994, the Government of National Unity (GNU), a multi-party agreement which consists of seven political parties, recognized that underemployment and unemployment would strongly affect the capacity of breadwinners to improve the economic circumstances of their households (Underwood, 2009:570).

*“The response from the GNU in 1995 was the White Paper on National Strategy for the Development and Promotion of Small Business in South Africa, which sought to encourage circumstances in which small micro enterprises could develop: The stimulation of small, medium and micro enterprises must be seen as a part of an integrated strategy to take the South African economy onto a higher road – one on which our economy is diversified, productivity enhanced, investment is stimulated and entrepreneurship flourishes”.*

The emphasis on enterprise development was further endorsed with the ANC's announcement in 2011 that government's main focus would be to boost support to small businesses in order to create jobs (Timm, 2011:1). It is evident the world over that small businesses are key in order to create, by far, the most jobs. Between 1985 and 2005, 90 percent of all new jobs were created by small, micro and medium companies in South Africa (Finscope Small Business Survey Report, 2006). If one looks at Brazil, it was revealed that 96 percent of new jobs were created by enterprises with fewer than 100 employees between 1995 and 2000.

The Finmark Trust's Finscope 2010 survey, found that 2, 5 million jobs could be created by small businesses in South Africa by 2020. In addition to this, 500 000 people could be taken off the social grant schemes if small businesses were supported more actively (Timm, 2011:1).

There are many lessons that South Africa could incorporate from India and Brazil. Of course Brazil and India's populations are larger, and these countries also have larger land areas which make it difficult to draw much from these lessons, but South Africa, along with these two countries share some similarities (Timm, 2011:1). Development issues faced by all three countries include a shortage of quality infrastructure, lack of quality education, low share of international trade, while South Africa, like Brazil, is one of the most unequal countries in the world. In spite of these similarities, Brazil is ranked the 6<sup>th</sup> most entrepreneurial country in the world, while South Africa rank a low 35<sup>th</sup> out of 54 countries according to GEM 2009, and India ranked 15<sup>th</sup> out of 43 countries in GEM 2008.

Ladzani & Mboniyane (2011:550) are of the opinion that the small business sector in South Africa did not receive sufficient support from government and that this therefore led to the low growth rate of these SMME's. Support was mainly geared towards big business instead of SMME's. However, this picture has changed since the 1990's. The study suggests that despite various efforts from government to support SMME's, the impact has to a large extent been unsuccessful (Ladzani & Mboniyane, 2011:550).

## **2.6 Summary**

There is significant evidence that enterprise development plays a significant role in the reduction of poverty and unemployment. However, numerous factors such as ineffective support programmes, rigid legislative and regulatory framework, and inability of government to meaningfully create an opportunity for small businesses through its procurement processes, and lack of adequate support to the informal sector, amongst other things, make it difficult for small enterprises in South Africa to expand and for entrepreneurs to start up. The importance of small businesses in growing the economy can no longer be understated. Its significance has been realized by many emerging economies in the reduction of poverty and the creation of jobs. However, despite various policies and strategies to promote the SMME sector, we are still way behind other emerging economies in terms of entrepreneurial activity in our country. This chapter suggests that if more can be done to support the sector, many people can be taken

out of poverty and earn an income. The following section will deal with the legislative environment within which small businesses operate and the effectiveness of these to support small business.

The next section discusses the legislative and policy framework for enterprise development in the South African context. Firstly, local government's constitutional mandate towards socio-economic development is provided. The legislative and policy constraints for small business development is then elaborated on.

## **2.7 Legislative Mandate and policy framework for enterprise development**

The regulatory and legislative environment in South Africa has been criticized by many development experts, as one of the major hindrances to the growth and development of small businesses. In South Africa there are about a hundred and thirty seven national government laws governing the SMME sector, excluding the by-laws at local government level as well as tax. It is not within the scope of this study to examine all of these laws, but to discuss in general the policy framework that has an impact on small business development. Regulations associated with starting a business have been very complex in recent years. The question needs to be asked whether legislation is conducive for business growth or whether is it a big contributor to high unemployment. First of all, the South African Constitution, Section 152 states the objectives of local government as including:

- To provide democratic and accountable government for local communities
- To ensure the provision of services to communities in a sustainable manner
- To promote social and economic development
- To promote a safe and healthy environment
- To encourage the involvement of communities and community organizations in the matters of local government.

Section 153 stipulates the development duties of municipalities

- Structure and manage their administration, and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community.
- Participate in national and provincial development programmes (Constitution, 1998:24).

The Constitution is clear on the developmental role of local government in promoting economic development. As mentioned in previous chapters of this research, enterprise development has been identified by government as a mechanism through which economic development can be achieved. At local government level, municipalities can actively support enterprise development through the development of by-laws, which should be in line with national and provincial legislation as well as local economic development strategies. Drakenstein municipality, have to some extent taken advantage of this. Small businesses still face the burden of an inflexible regulatory framework.

On the other hand, South Africa's restrictive employment regulations are seen as one of the biggest regulatory constraints to business growth. In the Thornton survey, inefficient government bureaucracy or 'red tape' was cited by a third of businesses as another challenge. Policies which are not directly linked to the business sector but which have a marked impact on business efficiency were also mentioned, for example the government's ineffective policies on crime (ranked as the second most problematic factor for doing business in South Africa by the Global Competitiveness Report, 2008-2009 (Herrington, Kew & Kew, 2008:33). Enterprises operate within a set of policies, laws and regulations (hereafter regulations) which is often a burden rather than supportive. SMME's in particular are affected by these policies and laws and hence are unable to comply. This places a major constraint on businesses and those wanting to start businesses and therefore leads to growing levels of unemployment and poverty.

The 1995 White Paper identified unduly restrictive or inappropriate legislative and regulatory conditions as critical constraints on the growth and development of small businesses (Herrington et al, 2008:33). The 2008 report noted that South Africa's restrictive employment laws are seen as one of the biggest regulatory obstacles to business growth. To date, however, not enough has been done to reduce the negative impacts of the regulatory environment, as is evident from the Global Competitiveness Index of 2009/2010 (Herrington, et al, 2009:48).



Mahadea & Pillay (2008:431) highlight the following:

*“high tax rates and complex tax administration are constraints to enterprise development and can force firms to operate in the “grey” economy, where the pay-off from productive activities can be high, with possible tax evasion or avoidance”.*

Government policies and programmes, entrepreneurial education and capacity and technology transfer have frequently been cited in the Global Entrepreneurship Report as the most negative aspects. It has been cited as the most limiting factors since 2001 (Herrington et al, 2008:33). The extremely rigid legislative environment is also one of the reasons many small enterprises often prefer to operate in the informal economy to avoid tax expenses and costly regulation (Van den Berg, 2006:12). In doing so, they do not enjoy the benefits of the formal economy including access to credit, suppliers and customers. They keep their businesses small and sometimes away from customer traffic to avoid government officials from approaching them. These entrepreneurs could be enticed to the formal economy through a more reasonable regulatory and favourable policy environment.

Poverty can be reduced by easing their burden in the following ways: operating cost of running a business is very high and by decreasing the number and level of payments, can increase the income of poor entrepreneurs (Van den Berg, 2006:21). Procedures should be more efficient to reduce time, in order for micro-entrepreneurs to concentrate on their businesses. National and international markets could work faster if regulatory burdens are reduced.

Chamberlain and Smith (2005:18) state that since the late 1990s, the United Kingdom regulatory environment has been characterized by a number of initiatives aimed at minimizing regulatory burden and stimulating business growth and development. The first policy action aimed at decreasing regulatory burden was the formation of the *“Better Regulation Task Force”* in July 1997, replacing the former Conservative government *“Deregulation Task Force”*. This signifies a broad policy shift away from so-called *“no regulation”* to *“smart regulation”*. The main roles of the Task Force is to make recommendations to government on how to improve regulations and to provide general advice to government departments on creating regulations with the lowest possible administrative burden. Another policy initiative also explicitly aimed at creating a less burdensome regulatory environment was the passing of the Regulatory Reform Act in 2001. This Act enables ministers, subject to parliamentary scrutiny, to change or repeal laws in order to remove or reduce over cumbersome regulatory

burdens. Collaboratively, these factors make the legislative burden less complex and allow enterprises to start and grow hence creating employment and providing income for workers and entrepreneurs (Chamberlain & Smith, 2005:18).

Taking a closer look at South Africa's Labour legislation, the reduction of regulation is supported by many donors, however the International Labour Organization emphasizes the fact that this may not be good for workers if driven too far. The International Labour Organization approach is to seek a balance between a lighter burden on entrepreneurs and adequate support for workers, including wage levels, safety and health and social security. These latter aspects, despite the assurance from government that the small business sector plays a crucial part in the future economic growth, shows that little has been done to improve the regulatory environment confronting entrepreneurs (Rwigema & Venter, 2004:311).

A television talk show on Sunday night, 8<sup>th</sup> April 2012, wherein an interview was conducted with an entrepreneur and one of the members of the Free Market Ideology Foundation, which was at the time, taking government on in terms of its rigid labour laws. It is acknowledged that labour laws have been introduced to combat exploitation, however, it was argued that SMME's are willing to pay but cannot afford to pay the minimum wage. Great emphasis is put on the role of entrepreneurship and the fact that it is seen as a key mechanism to drive job creation and economic growth in South Africa. A lot of emphasis has also been placed on the efficacy of the policy framework that governs South African entrepreneurs (Rwigema & Venter, 2004:312). The World Bank found that regulatory reforms in developing countries could add as much as 1.4 per cent to average annual GDP growth in these countries. Excessive red tape compliance costs have the potential to make firms behave in ways that could damage South Africa's overall socio-economic prospects. Although South Africa has a much more favourable legislative environment than other developing countries, there is still room for improvement (Mahadea & Pillay, 2008:436).

The SMME policy and institutional environment for small business development in South Africa is discussed in the next section. The concepts of enterprise development has various definitions, but various authors views regarding the concept is provided. This section also discuss the failure of the current government SMME support programmes to support small businesses. The section also highlights some of the lessons South Africa can learn from Brazil, China and India.

## **2.8 SMME policy and institutional support for SMME development in South Africa**

Growing the economy is imperative in addressing poverty, unemployment, gender equality, health and other social issues. Small business development is an essential tool and mechanism to achieving economic growth. *“Enterprise development refers to investing time, knowledge and capital to help small, medium enterprises establish, expand or improve businesses including empowering modest income generating informal activities to grow and contribute to the local economy”* (Verwey, 2011:4). Enterprise development encompasses amongst other things, commercial business services and market development. Furthermore, it includes, entrepreneurship development, de-risking business ideas, growing and investing in small, medium and micro-enterprises (SMME’s). Interventions aimed at encouraging the start of small businesses to providing business skills development, through mentoring, training and coaching all form part of enterprise development.

Enterprise development is cost-effective and can be easily achieved compared to other forms of empowerment, for example, bringing in a black shareholder. Another advantage is that, through providing small suppliers the ability to execute larger deals, they gain valuable experience and this could lead to profitability and sustainability in their businesses (Verwey, 2011:5).

The South African Enterprise Agency Forum suggests that enterprise development initiatives encompass investment in beneficiary entities, providing grants and loans, providing seed capital, security, access to capital through provision of collateral, relaxed security requirements, extended credit terms for procurement amounts owed by the beneficiary entity, timely payments for goods supplied, infrastructure support to suppliers and other entities in the same area or community, labour intensive production and construction methods and investment and support to enterprises operating in rural areas.

Orford (2005:12) states that both the GEM 2004 report and the Small Enterprise Survey suggest that government support for small businesses has been hampered by poor quality of service delivery and accessibility. This is not due to a lack of investment or effort; on the contrary there are a wide range of government support programmes with the aim of developing small businesses. However, government needs to rethink the way in which it supports small

businesses (Orford, 2005:12). At the time of this study, the Western Cape Provincial Government embarked on a very ambitious programme to support small enterprises. The Department of Economic Development and Tourism has in the past supported a range of initiatives to support small enterprises. These have included training and finance and general business development services. However, the Department of Economic Development and Tourism indicated that these programmes have not reached all enterprises throughout the province and therefore these programmes have not meaningfully supported small businesses.

Numerous government structures to assist small enterprises have been created. Some of these structures include; SEDA, KHULA, Red Door, The Business Place, Umsobumvu Fund, National Youth Development Agency, National Empowerment Fund to mention a few. Few, however, assist small businesses with the demands of the marketplace. Most focus on generic skills training and questionable small business finance. A vibrant SMME sector needs to be developed in order to stimulate entrepreneurial activity in any economy. During the apartheid years, the SMME sector was neglected and it was only with the establishment of the Small Business Development Corporation in the 1980's that interest was revitalized (Rwigema & Venter, 2004:315). However, much later, in 1995 the South African government formulated an official policy on the SMME sector in the form of the White Paper on National Strategy for the Development and Promotion of Small Business in South Africa, which was translated into the National Small Business Act 102 of 1996. In addition to this Act, the DTI has implemented a number of initiatives that has facilitated and promoted the development of the SMME sector. In recent years, government also developed the National Informal Sector Strategy and various other policy changes took place. However, the implementation of these policy changes leaves much to be desired.

Rogerson (n.d) as cited in Underwood (2009:570) is of the opinion that there are factors which are of utmost importance despite considerable government assistance and support. These include: skills and business training, better access to finance; and a more flexible regulatory framework and have been identified as key strategic aspects to support the three pillars of promoting entrepreneurship, namely; strengthening the enabling environment; enhanced competitiveness and capacity at the enterprise level (Underwood, 2009:570).

Many concerns have been raised with regard to the effectiveness of South Africa's SMME policy. According to Mahadea and Pillay (2008:439) the small business entrepreneur has to comply with numerous taxes, imposing a heavy burden on the owner in terms of finance, administration, paperwork and time. Mahadea and Pillay (2008:439) found that the most common taxes which are constraints for business growth include VAT, income tax, the Unemployment Insurance Fund (UIF) and the Skills Development Levy. It should be noted that tax related legislative reforms are not in the control of local government, but municipalities can lobby National Government, through Provincial Government and the South African Local Government Association.

According to Orford (2005:11) the regulatory environment is a major challenge for the survival and growth of small and new businesses. The GEM 2004 report provides some evidence with regard to the impact of regulations on development and growth of small businesses. South Africa's legislative and regulatory environment is relatively favourable, however some areas in the legislative environment could be improved. Consistent with other policy research by the Centre for Development and Enterprise together with the SBP and the GEM 2003 Report, the GEM 2004 report endorses the call for the establishment of a regulatory impact assessment that can review all existing and proposed legislation in order to consider its impact on small enterprise (Orford, 2005:12).

Smallbone, Xiao & Xu (2008:657) contend that in China the government provided a legal basis of government involvement in SMME promotion, through the Law on Promoting SMME's, which was introduced in 2003. This happened after the government of China realized the potential contribution of SMME's as job creators and to increase social inclusion. Currently, the objectives of national SMME policy in China is to improve the environment for SMME development and to increase employment in SMME's as well as their wider contribution to economic and social development. Secondly, the Law on SMME Promotion is linked to business development services through government intervention. In China, the role of national government is mainly focused on the provision of guiding rules and policies, leaving government agencies with the responsibility of enacting them, through developing and implementing measures suitable for local conditions (Smallbone, et al, 2008:657).

According to Berry et al (2002:16), generally, policies and schemes aimed at small business appear to be working best in Brazil and are less successful in India and South Africa. Policies to create effective support agencies to assist small businesses start up and grow their business have been less effective, awareness levels regarding these government support programmes are still very low. South Africa's black economic empowerment legislation for example has failed to support skilled black people starting their own businesses. Red tape is one of the most common challenges faced by small businesses, which is also true for Brazil, but the Brazilian government has been successful in promoting and supporting small businesses.

It needs to be asked: *how did Brazil get it right?* Firstly, the country's small business policies is entrenched within the law Lei Geral which was passed in 2006, which inter alia was developed to lower taxes for small and micro businesses and government procurement from small businesses was also boosted. Secondly, the Brazilian government developed an overarching development plan which contains clear and measurable goals, set by its Presidency. The government has 65 targets aimed directly at small businesses which allowed for a coordinated support system among the various small business support agencies and government departments (Berry et al, 2002:16). The Ten Year Review (2004:42) contends that bureaucracy and the burden of red tape as well as unintended negative impacts of new laws and regulations have an enormous impact on small businesses.

The next section discusses the current government support to small businesses in South Africa. This section highlights the flaws in the current support programmes and concludes based on the current research, that there is little or no impact of the current programmes to support small business.

## 2.9 Lack of meaningful support to small businesses

According to Harmse (2012:12), governments around the world realize the significant role that small and growing businesses play in their economies. SMME's are responsible for many innovations and the creation of jobs. In South Africa, the situation is no different. Currently, government constantly works towards supporting SMME's in various ways, however, these efforts have had minimal impact. The GEM Report also suggests that an important reason for the failure of government programme to support small businesses is due to poor service delivery. Each year the GEM Study interviews a carefully selected group of people knowledgeable about entrepreneurship and small business support.

One of the areas that these experts are asked about is whether government policies and programmes are supportive of people starting and running new businesses. The experts in South Africa are relatively positive about the degree of emphasis placed by government on small business promotion, however, they are sceptical about:

- Entrepreneurs being able to find support from government;
- The prospect of finding a wide range of support services from a single agency (Harmse, 2012:12).

An example is the KHULA mentorship Programme. Evidence from research conducted by the UCT CIE suggests that mentors can play a critical role in supporting small enterprises. Indeed, the centrepiece of a highly successful loan programme run by the UCT Centre for Innovation and Entrepreneurship at the time of this study, aligns loan recipients with mentors. However, the key to these mentors adding value to their clients lives lies in recruiting suitably experienced mentors. In the case of the KHULA Mentorship Programme, however, many of the mentors used have little or no business experience, struggle to understand basic accounting concepts and are consequently not capable of adding value to their clients (Orford, 2004:19). The result is a highly expensive programme with little or no impact.

Studies suggest that not many small businesses are aware of initiatives that government has put in place to support small enterprises. The SME survey is a survey that is conducted annually utilizing data from over 2,500 small and medium enterprises. This survey is focused specifically on the perceptions of SME regarding government support. It found that over 60% of businesses were aware of the Sector Education and Training Authorities (SETA's), 45% of

businesses were aware of the Industrial Development Corporation (IDC) and less than a third of businesses surveyed have heard of the Competitiveness Fund. However, less than 15% of businesses had heard of any of the other government support structures. Use of government support structures is even lower. Only 1% of businesses had used any of Ntsika, the MAC's, KHULA, BRAIN and Umsobomvu Services. The only two structures that had been used by more than 10% of the businesses surveyed were the SETA's and the Competitiveness Fund (Orford, 2004:19).

A lack of awareness stems from poor marketing. Seventy percent of businesses/participants in the SME survey felt that government incentives are communicated poorly. However, the problem goes beyond poor marketing. There is evidence of deep suspicion about the quality, usefulness and accessibility of government services amongst small businesses. The SME survey found that 63% of small businesses think that the impact of support structures is either very bad or bad. In addition there is no evidence that use of a specific government service results in businesses being more likely to rate government support for small businesses as useful or very useful. Overall evidence from a variety of sources, including anecdotal evidence conducted by the FEM team in SA, suggests that small businesses in general are not aware of most of the government's efforts to support small businesses, and even when they are aware of them are sceptical about their value to their businesses (Orford, 2004:19).

## **2.10 Summary**

The current legislative and regulatory environment is not conducive for the growth and development of small businesses. The regulatory burden does not encourage people to start or grow their businesses, and hence result in more people trapped in the vicious cycle of poverty. The rigid legislative environment is one of the reasons many continue to operate in the informal economy and they are likely to stay there and never become part of the mainstream formal economy. This phenomenon is also true for Brazil. There are many lessons South Africa can learn from Brazil as well as China in the alteration of the cumbersome legislative framework to one that supports and ease the act of doing business in South Africa.

More should be done to reduce the cost of doing business in South Africa, if poverty is to be meaningfully addressed. In South Africa, there are many government support programmes aimed at SMME's, however, many of these programmes to a large extent have had minimal



impact to growing sustainable businesses. Some of the reasons may include the generic approach taken by these structures to support SMME's, lack of alignment between programmes, and a lack of awareness of these different programmes.

The next section discusses the developmental importance of the informal sector in South Africa. The section highlights the significance of this sector in the reduction of poverty and job creation. The poor conditions faced by the informal sector suggests that policies should be developed to ensure that this sector of the economy operates successfully.

## **2.11 Developmental importance of the informal economy**

This section attempts to investigate the developmental importance of the informal economy in South Africa. The aim of the research is not to examine informal sector interventions in detail as this is quite a complex sector and will require a complete study on its own, however, the informal sector plays a huge part in providing livelihoods to many of the poor in South Africa and hence this sector is discussed in the broad sense.

The importance of the informal economy cannot be emphasized enough however it has been, to a large extent, been underestimated. The Global Entrepreneurship Monitor Report found that the percentage of women involved in the informal economy is far greater compared to the percentage of men involved in the sector (80% informal businesses is owned by women compared to 65% owned by men). The informal sector is defined as follows:

*Unorganised, unregulated and mostly legal but unregistered economic activities that are individually or family owned and use simple, labour intensive technology” (Blaauw, 2005: 1). “This coincides with Statistics South Africa’s definition of informal sector employment, namely: “unregistered business, run from homes, street pavements or other informal arrangements”. Therefore the second economy is characterized by survivalist businesses, established as inter alia, curb side (sidewalk) traders, traders in pedestrian malls and at transport interchanges and small home based businesses such as spaza shops. The first economy is modern but also houses an informal component. Informality in this sector originates primarily from the cumbersome procedures and regulations (DTI, 2011:1).*

Until recently, employment in the informal sector was based on the characteristics of the enterprise in which the person is employed. The definition of “*informal economy*” proposed at the 15th International Conference for Labour Statistics (ICLS) recommended that the informal sector be defined in terms of one or more of the following criteria:

- (a) non-registration of the enterprise in terms of national legislation such as taxation or other commercial legislation;
- (b) non-registration of employees of the enterprise in terms of labour legislation; and
- (c) the small size of the enterprise in terms of the numbers of people employed. Statistics South Africa has used this enterprise-based definition in order to derive estimates of informal employment in South Africa (Valodia & Devey, 2004:1).

It is almost impossible to ignore the significance of this sector in the creation of jobs in South Africa. In this context, it is imperative that government provides, inter alia, an enabling legislative and regulatory environment that support development (DTI, 2011:1). South Africa and the developing world have recently realized the important role that the informal economy can play growing the economy. Informal employment provides a large portion of South African households with sustainable livelihoods and therefore for some, this is an important means of household income.

The developmental role of the informal sector has been disputed by many due to the diversity of activities found in this sector. To this end, certain parts of the sector have been characterized by extreme vulnerability which resulted in inappropriate policies toward the sector. The fact that such a wide range of activities are embraced within the sector, means that policy makers should be conscious of the diversity of the sector and of its potential to contribute towards employment, growth and output.

*“Since its “discovery” in the early 1970s, the informal economy has become an important area of research. Contrary to the initial conceptualisation of the informal sector as a transitory “backward” sector which would, in line with the Lewis model, disappear with development and growth, the informal sector has become a growing phenomenon in developing countries. Unlike South Africa, most developing countries do not directly collect statistics on informal employment”* (Valodia & Devey, 2004: 7).

If the aforementioned is recognized this would certainly lead towards more appropriate policy making and therefore the promotion of those parts of the informal economy which appear to have a greater developmental impact. It is also true that the wage levels are higher in the formal sector than the informal sector and hence these differences assist policy makers to determine labour force movements between the two sectors. The general tendency of labour movement from the informal to the formal suggests that people are attracted to higher wages. This tendency is either an indication that employment in the informal sector is a viable option for workers or that the sector is seen as a last resort for those who would prefer to find employment in the formal sector. Various research findings have indicated that the informal sector may indeed be a viable option for certain types of labour. The characterization of the informal sector as a last resort option is challenged by this assertion, as it suggests that for certain types of workers it may be the first choice in certain types of economic conditions.

According to the South African White Paper, the survivalist enterprise sector is by far the largest (DTI, 2011:1). This therefore means that most people are involved in the informal sector where they have little institutional support. It has been suggested that South Africa's informal sector accounts for approximately 30 percent of working South Africans in other words between one and two million enterprises. A study done by the Bureau of Market Research at UNISA found that the informal or unrecorded economy had absorbed a large portion of the South African workforce from 2004 to 2005. In 1980, 92,3 percent of all employment was offered by the formal economy and 7,7 percent by the informal sector. This changed in 2004 to a share of 79,4 percent for the formal economy and 20,6 percent for the informal economy.

Improvement of the conditions of the poor in the informal sector has thus far been minimal, despite its potential for the absorption of a large, unskilled, labour force. According to International evidence, policy towards the informal sector should be aimed at four objectives; job creation, the promotion of increased output and increased production of activities in the informal sector as well as to generate a better and stable working conditions for employees in the sector as a means to reduce vulnerability of the poor involved in the sector. In order to address these objectives, the following may be formulated:

- productivity enhancing policies

- Policies which seek to improve legal and institutional environment of the informal sector
- Welfare type policies (World Bank, 2006:12).

The next section will discuss procurement as an opportunity to support small businesses. This section suggests that more should be done to support small businesses to benefit from government procurement processes. Furthermore, the study suggests that when granting contracts, government should aim to advance socio-economic development objectives. A new approach to small business development is suggested.

## **2.12 Procurement opportunities to empower small businesses**

Prior to 1994, the government procurement system in South Africa favoured large and established businesses and it was very difficult for newly established business to enter the procurement system. In 1994, however, government procurement was granted constitutional status, and was recognized as a means of addressing past discriminatory policies and practices. Due to the discriminatory and unfair practices of the past, a number of groups in South Africa were prevented from accessing government contracts. Local government as the implementation arm of government is well placed to achieve this goal through its local economic development mandate, and this study aims to investigate whether there is an attempt by the Drakenstein Municipality to achieve this.

This section attempts to elaborate on the potential of government procurement to empower small businesses. Although the writer discusses procurement as an opportunity to empower entrepreneurs, it is argued that procurement merely presents an opportunity to empower small businesses. The aim of this section is not to provide an in-depth assessment of the Preferential Procurement Policy Framework Act, Act Number 5 of 2000, but rather to highlight some of the shortcomings and therefore the inability of the Procurement Policy Framework to empower small businesses. According to Toomey (1998:2) international experience show that generic training is less effective in promoting small business than linking business training to actual market demands. Inter-firm linkages, most often through subcontracting, is a strategy used successfully in Taiwan, Indonesia, Malaysia and Brazil. Such linkages are usually government

supported and provide incentives for both large and small businesses to work together productively.

A range of policy initiatives and programmes were introduced by the South African government since 1994, aimed at economic transformation and more specifically, those that give effect to the vision and objectives of redressing the imbalances in the economy and inequality in South Africa (Makgoe, 2006:1). Under the apartheid regime, South Africa was characterized by segregation and unequal resource allocation. The male-dominated white minority had exclusive political and economic power and used this to promote their own sectional interest to the detriment of other population and gender groups.

As a mechanism to redress the imbalances of the past, government has developed various policies and promulgated a number of pieces of legislation.

*Among these pieces of legislation and policy frameworks are: the Preferential Procurement Policy Act, Act 5 of 2000 (PPPFA), the Broad based Black Economic Empowerment Act, Act No. 53 of 2003 (BBBEE Act), and the National Small Business Act, Act 102 of 1996 (NSBA) All these Acts and other related policies, underpin in some way both the bill of rights and the obligation of the government to redress and address the socioeconomic imbalances as enshrined in the Constitution of the Republic of South Africa, Act 108 of 1996 (Makgoe, n.d:1)". "Section 217 of the Constitution provides that when an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contract for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive, and cost-effective" (Makgoe, 2006:2).*

The objects of these Constitutional principles is to ensure maximum participation and competition that will result in value for money in the supply of goods and services to the government, whilst also ensuring equal treatment of all through the use of mechanisms that are open and transparent, however, the Constitution also recognizes problems and socioeconomic imbalance brought about by the past regime, and thus creates a platform for addressing them.

Section 217(2) provides for the organs of state to implement a procurement policy providing for categories of preference in the allocation of contracts. This, however, must be provided within a National framework. There have been debates in business, legal and other circles about government procurement being used for any other purpose than 'doing business'. This debate

has been intensified further by the debates around section 9 of the Constitution on equal treatment of all.

As stated, the Constitution, through the provisions of sections 9(5) and 217(2) do oblige the government to undo and rectify the imbalances and injustices due to previous unfair treatment and discrimination. It has also been universally accepted that government procurement can be used as an instrument of government policy to facilitate social and economic empowerment. Rogerson (2004:1) states that procurement provides employment and business opportunities and, depending on how it is implemented, can be used as a mechanism of government policy to facilitate socioeconomic development. Morris (1998) as cited in (Bolton 2006:196) states that:

*Public procurement is an important item of public expenditure with far reaching social, economic and political implications. To argue that public procurement is a sacred cow which should be 'outside the political arena' is restrictive and unwarranted. Purchasing policies pursued by public authorities should be open to modification in the light of pressing social and economic problems even if this requires procurement decisions not to be guided exclusively by commercial criteria.*

Craig (2003:141) as cited in Bolton (2006:196) further states that and I quote “*the very power to grant contracts should be able to be utilized to advance socially desirable objectives, precisely because organs of state cannot be and should not be politically neutral towards such matters*”. To effect the provisions of section 217 of the Constitution, the PPPFA was promulgated in 2000. This Act provided the framework for the preferential procurement policy. The Act prescribes that, amongst others: a preference point system should be followed when awarding contracts; based on prescribed amounts, maximum 20 or 10 points may be allocated for specific goals provided the lowest price scores 80 or 90 points respectively; the contract is awarded to the bidder scoring highest points.

The intention of the Act with allocation of 20 or 10 points for specific goals is to address socio-economic issues through giving bidders qualifying for such a competitive advantage over others. These specific objectives may include SMME, local economic development and HDI. The regulations under this act defines HDI as including all blacks, people with disability and white women. The latter is the bone of contention as there is much scepticism around white women having been disenfranchised prior to 1994, and also due to misuse of the status.

The biggest criticism of the system is that it emphasizes price as an overriding criterion and this is perceived as not adequate for empowerment by proponents of social and economic reforms. There are still existing and perceived elements seen to be impacting on its effectiveness:

- Government departments not nurturing and building capacity of officials to design and develop specifications that will be unambiguous and clear to the users and suppliers so that it enables fair evaluation of bids and responsiveness by suppliers, in particular from black owned enterprises.
- Officials and in particular supply chain management practitioners not having a uniform understanding and application of government procurement objectives and related policies.
- There is lack or omission of proper demand management that leads to poor supply chain management planning and budgeting.
- There exists a general lack of exerting leadership in instilling paradigm shift and change management in the direction of new government procurement regime.
- There is inadequate supplier relationship management (SRM) and supply chain performance management by government institutions and Supply Chain Management Units.
- Generally, targeted enterprises that are doing business with the government do not have core competencies in any specific industry or sector, that is, many are in the ‘business of tendering’
- Small black owned and large enterprises do not collaborate and cooperate, thus missing on market opportunities created through black economic empowerment sufficient high-quality service.

### **2.13 A new approach to support business development services**

A key lesson is that despite significant investment, public-sector support for small enterprises has, generally speaking, failed. Where the public sector plays a strategic role in partnering with private and non-government agencies, it is capable of facilitating effective support to small enterprises. This experience is in line with international experience, and the emerging best practice amongst international donors supporting small enterprises is to reduce direct support

to small enterprises in favour of supporting the development of efficient Business Development Services markets. The Committee of Donor Agencies for Small Enterprise Development argues that support for small enterprises should be based on a private sector led market economy framework. They argue that the guiding principles for this Business Development Services (BDS) approach include:

- A fundamental belief in the principles of a market economy, where the state has a role in providing an enabling environment, in correcting and compensating for market failures, and in provision of public goods, but not in the direct provision of private goods that can be more efficiently provided by the market.
- The assumption that the majority of business development services (training, consultancy, advisory services, marketing, information and technology services and business linkages) are private goods and are thus similar in nature to any other services. Therefore market rules apply.
- The expectation that with appropriate product design, delivery and payment mechanisms, business development services can be provided on a commercial basis even for the lowest income segment of the entrepreneurial small enterprise sector.

Adoption of these principles implies a fairly major rethink of the government's role in supporting small enterprises. It implies that the government's role in providing services should be strictly limited. In principle private-sector companies operating on a commercial and entrepreneurial basis should be relied upon to provide services to small businesses.

## **2.14 Summary**

The contribution of the informal economy towards job creation and unemployment can no longer be understated. With the current high levels of unemployment, many venture into this sector as a last resort since they cannot find employment in the formal economy. Many of the businesses in this sector, also provide employment to others struggling to find jobs. Despite their contribution to job creation, however, there have been minimal improvement of the conditions within which this sector operates. Procurement is one way local government can advance its socio-economic objectives. Currently, however small businesses are unable to take full advantage of this opportunity. Some of the reasons for the uneven playing field between big and small businesses are rigid procurement policies and lack of understanding by small business about the procurement processes, to mention a few. Local government is well placed to advance socio-economic goals through its local economic development mandate.



The next section provides the background of the development landscape in the Drakenstein Municipal area.

## **2.15 Development perspective: Drakenstein Municipal area**

The Drakenstein Municipality is characterized as a category B Municipality, falling within the ambit of the Cape Winelands District and it comprise four towns, Wellington, Saron, Paarl and Gouda. Drakenstein was found to be the most populous municipality within the Cape Winelands District comprising 217 089 people in 2007. It has a lucrative manufacturing and business services base, therefore it is the economic hub of the region and has experienced positive growth between 2001 and 2009. Despite the positive growth experienced, there are still high levels of poverty and people dependent on government social grants (as will be illustrated later in this chapter).

Although unemployment declined from 22,8% to 20,2% between 2001-2007, the economy experienced challenges in absorbing entrants into the labour market, therefore presenting an opportunity for people to start their own businesses. What is of concern is youth unemployment which is a staggering 65,6% of the unemployed labour force. The highest unemployment rate is 15-19 years at 43,7%, 20-24 years at 35,9% and 25-34 at 19,6% (Drakenstein Draft, 2010:102). Entrepreneurship and small business development presents an opportunity for Drakenstein municipality to significantly reduce the level of unemployment by providing adequate infrastructure and an enabling business environment (Agupusi, 2007:9). Drakenstein Municipality had the largest economy in the Cape Winelands District in 2009 with a total regional gross value added in the region of 31,9%.

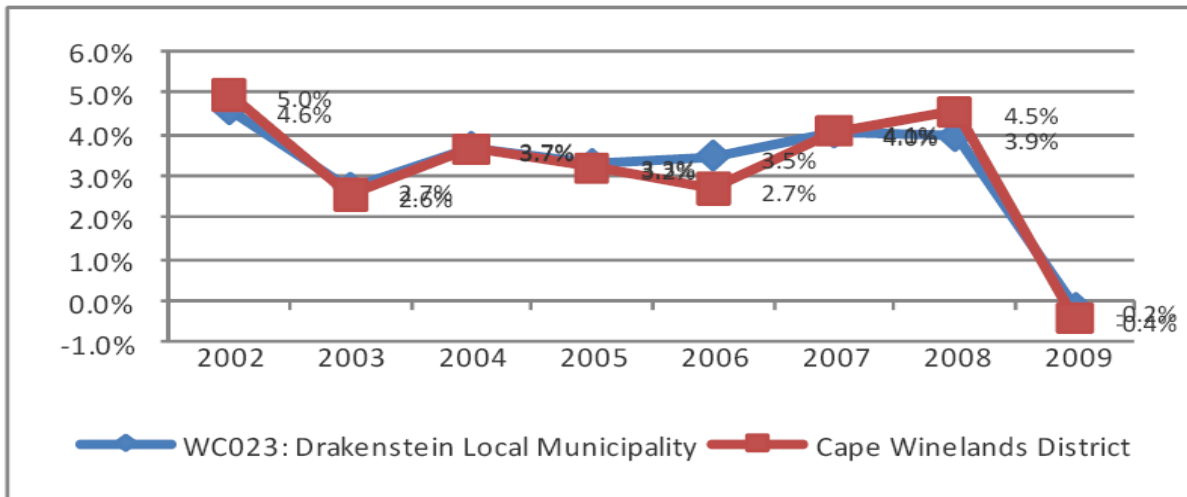


Figure 2: Difference in growth rates of Drakenstein municipality and Cape Winelands District municipality

Source: Drakenstein Final Draft (2010).

The Drakenstein economy along with that of the District has moved in tandem with an annual average growth of 3,2% between 2001 and 2009. The economy of Drakenstein grew to R6,8 billion in 2009 from R5,3 billion in 2001. Drakenstein’s local economy growth outperformed that of the District except for 2002, 2007 and 2008. The Municipality does acknowledge that even though progress has been made in terms of economic growth, communities still live in abject poverty.

## 2.16 Household income

Household income serves as a proxy indicator of the standard of living of a particular community, i.e. whether it is predominantly a poor, middle income or an affluent community. More importantly household income informs the Municipality regarding the level of poverty, which has policy implications with respect to the Municipality’s indigent, poverty relief and tariff policies (Drakenstein Final Draft, 2010:95).

The economic benefits of a relatively high growth rate over the past decade in Drakenstein have not trickled down in terms of employment and social upliftment. In part, this is due to the structural constraints in the economy, namely:

- Strong dependence on primary production and related inputs
- The relatively low level of employment creation relative to growth
- The large concentration of family owned businesses

- Dependence of the economy on Cape Town and the broader provincial economy
- Changes in the labour process that do not favour low wage, unskilled work (triple bottom line reporting)
- Low and seasonal income niches in tourism and farm work
- High entry costs into local economic opportunities (wine, tourism etc.)
- Limited opportunities for Black Economic Empowerment based innovation and growth

It can therefore be concluded that Drakenstein as with many municipal areas in the Western Cape, has not been immune to the fact that, high economic growth has not benefitted the poorest of the poor communities in the Drakenstein Municipal area. As a result of low household income, many find it extremely difficult to start their own businesses. Mbonyane and Ladzani (2011:552) state that it can become problematic to run or start a business if the finances are not available or not managed properly. Bowen et al (2009:16) as cited in Mbonyane and Ladzani (2011:552), states that small business growth is delayed if proper financing is not available.

## **2.17 Economic overview of Drakenstein economy**

Drakenstein is the second largest economic centre in the Western Cape and the largest contributor towards GDP rate (40%) of the Cape Winelands District Municipality. Finance and business services are currently the largest sectors with a contribution of 25,6% in 2007. Drakenstein experienced a slightly lower growth rate of 2,69% than the CWDM with a rate of 2,87% during the period between 1995-2004. The percentage of Drakenstein is potentially economically active population was 66,7% in 2007 (Drakenstein IDP Report, 2010:12). Drakenstein's economy is fairly diversified. The manufacturing sector, however, experienced a decline in GDP contribution from 32,4% in 1995 to 25,6% in 2007.

Being the second biggest employer (22%), the manufacturing sector is also the biggest contributor to the gross geographic product (26,6%), but the sector has been in decline since 1998, resulting in job losses in the clothing and textile industry (Drakenstein IDP Report, 2010/11:20). Most citizens in Drakenstein Municipality are employed in the following economic sectors: manufacturing, trade, agriculture, finance, and government service sectors. The second biggest growth sectors are retail and trade with (22% of gross geographic product) and the third employer (15,5%).

Drakenstein serves as the service centre within the wine and fruit belt. Agriculture is the third biggest sector (14,9%) and is also the biggest employer (29%) however, employment in this sector is seasonal. Tourism remains a neglected sector/industry in Drakenstein even though it is a priority within the District. Small, medium and micro-enterprise (SMME) development is both a provincial and district priority and needs further support in Drakenstein. Collectively focusing the effort on continued and improved economic growth is hence of utmost importance (Drakenstein IDP Report, 2010/11:20).

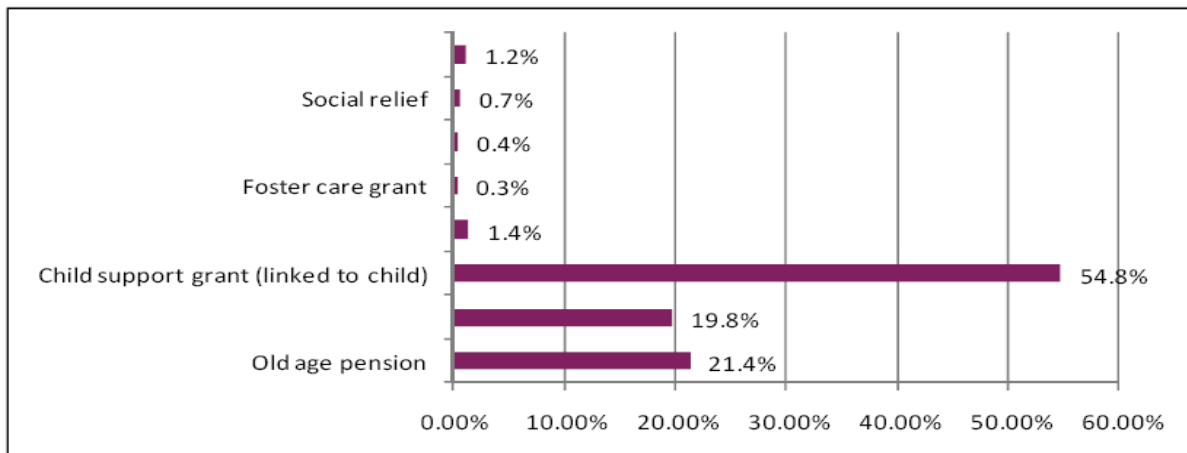
## **2.18 Socio-economic analysis**

Those earning a low income or no salary (R0-R3200 per month) constitutes 69,2% of the population and fall within the poverty level and therefore experience the challenge of meeting their basic needs. Those falling within the low income bracket of the population and the medium income category (R3201-R25601) per month constitute 16,7% and 0,7% fall within the high income category (R25501 and more per month). “Drakenstein has one of the highest average incomes in the country with most households (57,6%) in the middle-income category.

Despite this relative wealth, the socio-economic statistics show extreme deprivation and poverty amidst this wealth. Nearly one quarter of households of Drakenstein earn less than R800 per month and 42% of households earn below the household subsistence level. The unemployment rate is 22,8% or 29 000 and a total of 13% or 4 836 households have no income. Population of 55,8% is employed; 30,1% of the population is not economically active and 14,1% of the population of Drakenstein Municipality is unemployed.

The Human Development Index (HDI) for income is 0,79 (WC 0,82). The high rates of unemployment and poverty are found in especially the previously disadvantaged communities. There is therefore a need to create economic opportunities with corresponding job creation (Drakenstein IDP Report, 2010/11:21). In general the HDI and City Development Index (CDI) for Drakenstein is 0,70 (WC 0,72) and 0,78 (WC0,81) respectively.

Sixty eight percent of homes are made of brick, whilst 23,2% are informal dwellings made of traditional materials and 8,8% of households live in a flat. Those dependent on the old age pension grant constitutes 21,4% of the population and those dependent on disability 16,9%. Fifty five percent of households in Drakenstein depend on the child support grant.



*Figure 3: Percentage of people dependent on government social grants*

Source: Drakenstein Final Draft: Regional Development Profile (2010). Note: These are statistics from Stats SA Census 2001 and Community Survey 2007. At the time of this Study, Stats SA statistics for 2012 had not yet been released.

As a result of poverty, moral decay, lack of social infrastructure and services has led to an increase in social problems. The economic integrity of the area is affected as a result of these problems and the social upliftment of these communities is urgently needed, including improving the livelihoods of the community through training and skills development and increased access to education (Drakenstein IDP Report, 2010/11:22).

This problem is not unique to Drakenstein but to the whole country. According to Verwey (2011:4) unemployment had increased in the first quarter of 2010 to 25,2% based on results from statistics South Africa (STATSA) in SAPA (2010) and definitely serves as a wake-up call for South Africa. Verwey (2011:4) is of the opinion that enterprise development is the mechanism that can be used to turn this picture around.

## 2.19 SMME Support and Development

One of the sectors prioritised by the Drakenstein Municipality is the small and medium enterprise sector. This also includes the informal sector. The majority of the businesses in Drakenstein are established businesses. Firms operating for more than 10 years within the Drakenstein area amounts to just fewer than 50% and also operated from the same premises for more than ten years (CWDM Firm-level study, 2005). The micro end of the market needs support to develop and grow in order to broaden participation in the economy (Drakenstein LED Strategy, 2007:25).

The Municipality designed an initiative to enable businesses to run optimally and is targeted at start-up and emerging enterprises in the formal and informal markets. Drakenstein Municipality attempted to increase procurement of services from SMME's. Services provided for SMME's include, amongst others: training, mentoring, marketing, advice and counselling and business networking. The above is provided through voucher systems, business advice centres, and coordinated networks or on a one-on-one basis. The Municipality's sector support strategy include working in partnership with SEDA which provides the following services:

- Establishing an incubator programme for small businesses
- Establishing business linkages between large and small business to help expose and grow the SMMEs
- Commissioning a study on the SMME sector composition as part of the baseline economic dataset for the municipality
- Investing in selected business hives as locations for SMMEs to operate from
- Hosting and supporting an annual small business expo

The Municipality has put interventions in place to change the urban environment in both Wellington and Paarl to ensure that informal traders have secure space to allow them full access to economic opportunities of the relevant business centres. Although the strategy identified key interventions, at the time of this study, it was unclear which mechanisms will be put in place to measure the impact of these interventions on small business growth.

## 2.20 Procurement

Local procurement creates a multiplier effect which stimulates local economic development. Government is a significant buyer of goods and services and is well placed to use its buying power to broaden participation, impact on the local economy and encourage reinvestment in the local economy (Drakenstein LED Strategy, 2007:28). Buy local and Preferential Procurement Policies are policies which was developed by National Treasury to address historic inequalities and to stimulate economic development.

Clear guidelines, targets and a system for the evaluation of broad based black economic empowerment status of a service provider is entrenched within Drakenstein's Procurement Policy. The Municipality's BEE procurement target of all procurement was 20% but has increased to 40% since 2008. Their Procurement Policy also reflects the importance of small businesses and promotes joint ventures and preferential procurement as well as sub-contracting with SMME's.

Whilst the government is creating a host of market opportunities, there are other supply-side constraints which impact on the performance of the SMMEs. Rogerson (2001) identified the complexity of the relationship between supply side constraints and the working of targeted procurement. These constraints include:

- skills development;
- access to tender information;
- legislative framework;
- access to finance; and
- availability of labour based technology.

Given the potential multiplier effect of procurement spending in the area, corporates in the Drakenstein area are encouraged to adopt similar policies with the addition of buy local and SMME quotas as part of their contribution to supporting the local economy (Drakenstein LED Strategy, 2007:28). The Local Procurement Accord was negotiated by the Department of Economic Development and social partners and both are committed to the ambitious targets in respect of the localisation of procurement (National Development Plan, 2012:129).

## 2.21 Informal sector

*“To promote decent work, it is necessary to eliminate the negative aspects of informality while at the same time ensuring that opportunities for livelihood and entrepreneurship are not destroyed, and promoting the protection and incorporation of workers and economic units in the informal economy into the mainstream economy. Continued progress towards recognized, protected decent work will only be possible by identifying and addressing the underlying causes of informality and the barriers to entry into the economic and social mainstream” (ILO, 2002:1).*

Essentially, the informal sector should actually be a study on its own, since it is a very complex sector with its own unique challenges, however it does form part of the overall SMME sector and hence it is discussed in this study, but will not be discussed in such great depth. Secondly, within the Drakenstein context there is minimal information or literature the researcher could work with to make a more accurate and detailed assessment. One should not ignore that there are linkages between formal and informal economies and therefore one should not view the ‘first’ and ‘second’ economy as structurally disconnected.

The International Labour Organisation has certain goals for the informal sector:

*Promotion of decent work*

*–Immediate: to recognise those who currently work in the informal economy in the law, provide them with legal and social protection and representation and voice;*

*–Short and medium term: to enable them to move into more formal work arrangements by ensuring that workers and entrepreneurs have the capacity, flexibility and conducive legal and policy frameworks to do so; and finally*

*–Long term: to create formal employment opportunities for all workers and employers” (ILO, 2002:1).*

Informal sector employment increased by 5, 7% or 115 000 jobs in the 2nd quarter of 2009 (Stats SA). It is a sector that could meaningfully contribute to poverty reduction and job creation if the necessary support is provided to this sector. As indicated in the preceding section of this chapter, the informal sector provides an opportunity for sustainable livelihoods for the poor and as a means of income. The Drakenstein Municipality however have a draft Informal



Trading Management and Policy Framework for the management of the informal sector which is in line with the Business Act of 1991.

The informal sector plays a pivotal role in the urban and peri-urban economy of Drakenstein, as is the case in many South African towns. Survivalist businesses forms the majority of the sector, with the retail sector making up the majority of the sector and it has a few linkages with upstream activities (Drakenstein LED Strategy, 2007:14). Many residents fall outside the more established economy and survive through establishing or working for themselves as an informal trader, survivalist business or by working on a small farm or job creation programmes. Growing the size and jobs of this economy is key to combating unemployment and improving the livelihoods of the poor.

## **2.22 Legislative environment**

South Africa's biggest challenges include "redressing historic inequalities and developing bridges between the first and second economies that facilitate movement from informal to formal. This would assist in broadening economic participation both of the historically disadvantaged and of the poor in the economy of the municipal area (Drakenstein LED Strategy, 2007:27). As discussed earlier in this chapter, the legislative environment is not conducive for the growth and development of small businesses in South Africa.

According to SBP (2011:4) the regulatory environment can ease or complicate the conduct of business. In South Africa, the regulatory burden is high – SBP's 2005 Study on Counting the cost of red tape put the cost of compliance for South African businesses at R79 billion, which is equivalent to 6,5 percent of GDP. Smaller enterprises are disproportionately impacted by these regulatory burdens. Worldwide there is increased recognition among policy makers to reduce unproductive regulations which discourage small business growth and those wanting to start their own businesses.

The former Minister of Finance Pravin Gordhan acknowledged that the regulatory environment in South Africa needs improvement:

*"We need to do a lot better to drop the red tape, we've been too slow at removing constraints on small businesses and we've been pathetic in terms of helping small businesses to become more dynamic within our own context as well. There are many regulatory constraints faced*

*by small businesses and it is not within the scope of this thesis to examine each of these laws (Moorad, 2011:1)”.*

Labour regulations specifically, for example the difficulties associated with reducing staff, is a major regulatory constraint to business growth. Other key areas of regulatory obstacles include:

- Broad based black economic empowerment as a constraint on access to business opportunities;
- SARS inefficiencies, making it difficult to do business and to achieve compliance.

### **2.23 Summary**

Following the City of Cape Town, Drakenstein is the second biggest economy in the Western Cape. Despite the growth that the town has experienced, this has not benefitted the poorest communities in the Drakenstein Municipal area. Many are still dependent on government social grants as their only means of income. This, therefore, makes it extremely difficult for those who want to start businesses to get access to funding. Drakestein Municipal Procurement Policy reflects the importance of small businesses and promotes joint ventures and preferential procurement as well as sub-contracting with SMME's. However, the implementation of this policy is extremely difficult, because there are so many policies at a national level which governs procurement. Small businesses therefore, are unable to take full advantage of this opportunity.

Local governments in South Africa have not yet realized the importance that the informal sector presents for their local economies. If there is a better understanding of this sector, more can be done to improve the conditions of businesses operating in this sector. The next section discusses the research design and methodology.

## **Chapter 3: Research design and methodology**

### **3.1 Research Methodology**

Research methodology is a systematic way to solve a problem. It is the science of studying how research is to be carried out. Essentially, the procedures by which researchers go about their work of describing, explaining and predicting phenomena are called research methodology. It is also defined as the study of methods by which knowledge is gained. Its aim is to give the work plan of research (Rajasekar et al, 2013: 5). The study was conducted by making use of applied research. In an applied research, one solves certain problems employing well known and accepted theories and principles. Such research is of practical use to current activity. Research on social problems for example, have immediate use and they have immediate potential applications.

### **3.2 Research design**

In order to answer the main research question related to the role of enterprise development in the reduction of poverty, the following was done: Firstly, the researcher embarked upon a literature review to determine the current status of enterprise development in addressing the poverty challenge. Secondly, after this objective was achieved, certain key organisations which are directly responsible for enterprise development was identified in order to gather information regarding the key objectives identified in this study.

### **3.3 The Questionnaire and Interview**

The research methods applied in this study were interviews and questionnaires.. Questionnaires were distributed by the researcher in the Drakenstein Municipal area and interviews were conducted. The data was then collected, analysed and interpreted.

- One hundred questionnaires were distributed to SMME's within the broader Drakenstein Municipal area.
- Six interviews with employees from Drakenstein Municipality responsible for enterprise development were conducted.
- Interviews- The interviews were uniform and were conducted on a one-on-one basis. The information obtainable using this method is considered to be more objective and unbiased. In order to avoid constraints, the interviewer stayed within the parameters of a set questionnaire. The questions were the same for each interviewee, hence allowing for a homogeneous outcome.

### **3.4 Pilot study**

The possibility of errors occurring in questionnaire design is almost certain irrespective of how carefully the questionnaire is designed (Babbie & Mouton, 2006:244). Pre-testing is important especially if more than one language or cultural group is included in the study. To avoid such errors, the researcher pre-tested the questionnaire. The researcher completed a pilot study with identified organisations and individuals working with SMME's. The researcher was not obliged to use a representative sample for pre-testing, however the researcher should use people to whom the questionnaire is at least relevant, and in this study, the researcher has done exactly that.

The researcher made the questionnaire available to those who were willing to participate in the pilot study. This method is more effective than reading through it and look for errors. The draft questionnaire for this study was given to two experts in the Provincial Government of the Western Cape and the Department of Economic Development and Tourism to look at the way it was formatted and the suitability of the questions posed. Following this exercise, the questionnaire was tested on 8 local government employees, who form part of the sample population, to check the degree of its user-friendliness. After this test the draft questionnaire was given to a statistician at the Cape Peninsula University of Technology to examine. When this process was finished, a new refined questionnaire was developed, taking into account all the various recommendations and advice of the afore-mentioned participants.

### **3.5 Questionnaires**

In this research study the tool that was used to collect the data was a questionnaire (refer Annexure A).

#### **3.5.1 Advantages and disadvantages of questionnaires**

Self-administered structured questionnaires, whether disseminated by hand (i.e. delivered at a person's home or office), by post, (i.e. via *snail-mail*), via e-mail or the Web, have the following distinct advantages:

- They are more cost effective to administer than personal (face-to-face) interviews.
- They are relatively easy to administer and analyse
- Most people are familiar with the concept of a questionnaire
- They reduce the possibility of interviewer bias

- They are perceived to be less intrusive than telephone or face-to-face surveys and hence, respondents will more readily respond truthfully to sensitive questions
- They are convenient since respondents can complete it at a time and place that is convenient for them (Eiselen et al, 2005:2).

The most important disadvantage of self-administered structured questionnaires that are disseminated by hand, post, e-mail or the Web is:

- That the response rate tends to be low, especially when the questionnaire is too long or is complicated to complete,
- the subject matter is either not interesting to the respondent or is perceived as being of a sensitive nature.
- Another disadvantage is that the researcher does not have control over who fills in the questionnaire even though it may be addressed or delivered to the intended participant. (Eiselen et al, 2005:2)

According to Babbie & Mouton (2006:239), the format of a questionnaire and the nature of the wording of the questions asked have equal importance. “An improperly laid-out questionnaire can lead respondents to miss questions, confuse them about the nature of the data desired, and even lead them to throw the questionnaire away” (Babbie & Mouton, 2006:239). The questionnaire was designed as an instrument to assess the perceptions of people operating as SMME’s within the formal and informal economy regarding the effectiveness of the legislative framework to support them, the effectiveness of government SMME support programmes, the effectiveness of government procurement processes to support small businesses and their perceptions of the initiatives undertaken by Drakenstein Municipality to support the informal sector.

The researcher applied a quantitative approach to the study which is concerned with objective assessment of attitudes, opinions and behaviour. Research in such a situation is a function of the researcher’s insights and impressions.

- One hundred questionnaires were personally distributed by the researcher with the assistance of the local economic development department at Drakenstein Municipality. Recipients were requested to complete the questionnaire and to return them to the researcher within a period of two weeks. The researcher was careful to avoid

developing a complex and lengthy questionnaire. The period for the distribution of the questionnaires was three weeks.

- The questionnaire was carefully prepared to obtain the required and relevant information. These businesses are mostly situated in the Paarl and Wellington area. Prior to the distribution of the questionnaire, the researcher first explained the aim of the research to the participants. In total one hundred questionnaires were distributed. It is the most extensively used method in various economic and business surveys. The questionnaire was administered to a selected sample from a specific population from the databases of the LED Department at Drakenstein Municipality; database of SEDA and the database of the Drakenstein Business Federation. The businesses on these databases are small, medium and micro enterprises which fall within the specific target population chosen by the researcher. These are both formal and informal businesses that have been operating for a period of five years. This sample allowed the researcher to assess the perceptions and opinions of the participants regarding the key objectives of the study.
- Questionnaires were also emailed to some of the participants. The participants were contacted telephonically before questionnaires were emailed. The reason why the researcher chose to use questionnaires was because it is quick and easy to develop, code and interpret. It is easy to standardise the questionnaire, meaning every participant is asked the same question in the same way. The researcher can therefore be assured that everyone in the sample answers exactly the same questions, making this method very reliable.

### **3.6 Interviews**

Interviews have been used as a primary data collection tool for this study. The same questions were asked in the same sequence to all interviewees to ensure uniformity. Throughout the study six one-on-one interviews were conducted. By using this method, information is found to be more objective and unbiased. The researcher was emotionally prepared to conduct the interview, conducting the interview with an open mind, without reservations and with the required objectivity. Because the researcher knew none of the participants, it contributed to objectivity towards them. The researcher contacted each participant personally. Participants were informed about the theme and aim of the research as well as what their participation would involve namely six interviews of between 40 to 60 minutes each. After the introduction, the participant's permission was asked and the first interview was arranged with each participant.

A suitable date, time and place in accordance with each participant's schedule were arranged. Subsequent interviews were arranged at the end of previous interviews. The interviewees were also made aware how the information would be recorded that is using voice recorders.

### **3.6.1 Semi-structured individual interviewing**

In general, semi-structured individual interviewing entails pre-formulated questions, which were asked in a similar sequence to all the participants. This type of interviewing was followed during all the interviews with the participants. The advantage of this type of interview is that the data is collected systematically. This was especially helpful in the comparison of data between the participants. The disadvantage of this type of interviewing is that relatively little information regarding the participants everyday world (in-depth experience) can be collected.

1) Personal interviews – the researcher followed a rigid procedure, seeking answers to a set of pre-conceived questions through personal interviews. This method of collecting data is usually carried out in a structured way where output depends upon the ability on the interviewer to a large extent (Kothari, 2004:17). Interviews were conducted with the employees in the:

- LED Department of the Drakenstein Municipality – From a Constitutional point of view, local government is obliged to promote socio-economic development of their local communities. They fulfil this function by using various methods to improve the livelihoods of local people. The fact that enterprise development falls within the ambit of local economic development means that municipalities are responsible for creating a conducive environment within which people can start and grow their businesses (in the formal and informal sector) and eliminate any hindrances towards the development of small businesses.
- Employees of Small Enterprise Development Agency (SEDA) – This is a government organisation, situated in the Drakenstein region, mandated to support the development of SMME's through various types of interventions. This may include amongst others access to markets, access to funding, skills development, tender advice etc. They are therefore an important part of the selected target population because the researcher would be able to gather information regarding the effectiveness of the programme.

- Informal Trading Association – This forum was established by the Drakenstein Municipality to support informal traders in the Drakenstein region. This forum is the voice of informal traders in the region to address challenges and red tape that hinder business growth of informal traders. This forum was chosen to participate in the interviews in order to gather information regarding the challenges faced by businesses in the informal sector and the type of support provided by the Drakenstein Municipality to address these challenges.
- Drakenstein Business Federation – This forum was established by the Drakenstein Municipality in partnership with business, labour, community and anyone who had a vested interest in business within the Drakenstein region. This forum is the voice of business that will be active in influencing growth of the local economy. Secondly, these businesses have a crucial role to play in terms of prompting their members to become levers of change in Drakenstein. This forum is therefore an important part of the target audience since they are the voice of big and small business in the region and are informed about the challenges faced by small businesses and can therefore, through the partnership between the forum and the municipality, guide appropriate action to address developmental issues.

The reason why the above organisations were interviewed is because they are directly responsible for enterprise development and work with SMME's on a daily basis. Therefore they were in a better position to answer the research questions since they are more informed about the challenges faced by SMME's in the area. The researcher decided to conduct the interviews using a structured approach, using a list of questions from a previously compiled questionnaire commonly known as interview schedule. The researcher asks these questions face to face to a respondent and records the latter's responses. The interviewer is restricted to the questions, the wording and their order as they appear on the schedule, with relatively little freedom to deviate from it.

Each question was read and the responses were recorded on a standardised schedule. The researcher was familiar with the questions in the questionnaire and have read them fluently. The researcher interacted with respondents throughout the interviews. The researcher was familiar with the respondents, their background, values and expectations and knew how to respond in specific situations. Using interviews as a method to obtain information, the researcher was able to assess the level of comprehension participants have regarding the



particular topic. Secondly, it was a powerful form of formative assessment. This means the researcher was able to use it to explore how a participant feels about a particular topic without having to do observation or in-depth interviewing. Structured interviews can also be used to identify participants whose views the researcher wants to explore in more detail (through the use of focused interviews, for example) (Kothari, 2004:17).

### **3.6.2 Interview discussion:**

Interviews were held with key staff members from Small Enterprise Development Agency (SEDA), the Drakenstein Business Federation, LED staff from the Drakenstein Municipality and the Informal Trading Association. The following section elaborates on the interview and discussions held with these organisations. The interviewer asked the following questions:

1. What do you think about the effectiveness of government policy to support SMME's?
2. What do you think about the effectiveness of the government SMME programmes to support SMME's?
3. What support is Drakenstein Municipality providing to informal businesses?
4. What are the obstacles businesses face when applying for assistance through government programmes?
5. How can government support SMME's through its procurement processes?
6. What challenges are businesses faced with in the informal sector?

## **3.7 Questions and responses:**

### **3.7.1 What do you think about the effectiveness of government policy to support SMME's?**

The first question was asked to determine whether the government policy environment is indeed effective in order to support SMME's to grow and develop and contribute to the creation of jobs. The majority of the interviewees feel that South Africa has good policies in place however these do not work well to support SMME's to grow. Interviewees indicated that government policy is ineffective and red tape remains a challenge, discouraging people from starting businesses and then feel that some of these policies are unnecessary and some need to be changed in order to better support SMME's.

Although there is a vision at national level, the implementation of policy is inconsistent. There is a lot that South Africa can learn from their BRIC counterparts regarding SMME development. There is a need to create a favourable environment for businesses at local level.

Local governments are in a favourable position to create that environment through by-laws. There should be a stronger economic vision and lessons can be learned from how the previous government used to support businesses.

Government policy is not effective to support businesses in the informal sector especially from a municipal point of view. The Drakenstein council must create an environment where both informal and formal businesses can trade in an orderly manner. Both the formal and informal sector is governed by local level by-laws. The informal sector is slowly dying in the Drakenstein area, which is a great concern, since many of these people have been trading for all their lives and as a result will have no source of income.

The Municipality's LED unit should provide support to ensure informal businesses mature to become part of the formal sector. Informal traders need to be educated through capacity building initiatives. The South African Revenue Services can also play a part in transforming the sector by educating business around tax related issues. The sector is not seen as an important part of the economy which is another concern.

All interviewees feel the need for legislation to be made more transparent and realistic. For example, the new Companies Act creates a lot of problems for SMME's. They do not understand the procedure, because it is quite different to registering a close corporation in the past. The process before the Companies Act was introduced was much easier. At the time of the study, it was difficult for black people to access a BEE certificate as they are not familiar with the process. The disadvantaged are not benefiting from BEE procurement and there is no enforcement mechanism for those who are engaged in fronting. There needs to be a different legal regime for the management and development of SMME's. There is also a need for a different set of laws to govern those businesses that are not yet at a stage of successful operation. Government only introduces legislation without consulting with business, and business just has to comply.

### **3.7.2 What do you think about the effectiveness of the government SMME programmes to support SMME's?**

First of all, the interviewees feel that the application for these support programmes are tedious especially when people apply for funding and in some cases businesses are unable to get funding because they are blacklisted. There is the realization that there are too many support programmes but what matters, is that entrepreneurship is about filling a gap in the market place. China, India and Brazil have been very successful in stimulating entrepreneurship in their countries. These economies are performing well, because they have made many changes in terms of regulatory reform and tax reform. Another concern which was highlighted as a concern, is the message that government convey in terms of SMME support.

Some found it difficult to comment on the effectiveness of the other SMME support programmes but in terms of the SEDA Provincial Programme, they are aware of what the mandate of SEDA is to support enterprise development. Comments on the SEDA programme include: SEDA is very successful in that they are actively involved in developing small businesses and the aim is to empower these businesses to create jobs and be sustainable. The process for enterprise development is quite effective. When SEDA receives a client for the first time, an assessment is done on the entire company operations and turnover. The aim of the programme is to see that more people are employed and the company turnover is growing.

This is indicative of whether the programme is on the right track. SEDA identifies projects which can assist companies to grow. The service is designed to help them, because finance is a major obstacle for SMME's. It takes 5-10 years for a company to raise finance. SEDA assists and measures the company over a period of time. Businesses are measured to determine whether the services offered has made an impact on the company. It was highlighted by almost all interviewees that not everyone is an entrepreneur and therefore some of them do fail. SEDA therefore develops entrepreneurial skills to decrease the level of entrepreneurial failures. SEDA is measured by DTI based on whether the companies assisted by SEDA have indeed contributed to the creation of jobs.

From a local government perspective, jobs created is an output of various policies and interventions put in place and effectively implemented and therefore they work in partnership with local government, which in this case is Drakenstein Municipality. Clients are also sometimes referred to other institutions and support is monitored but all institutions have

different sets of criteria for assistance. The waiting period for assistance can be long, and time is a major constraint for SMME's and therefore there is much room for improvement.

### **3.7.3 What support is Drakenstein Municipality providing to informal businesses?**

Some respondents were not sure what type of support is being provided by the Municipality to informal businesses. It was highlighted that there is no strategic approach to local economic development. The Municipality does have a 5-10 year support strategy, however respondents indicated the only assistance provided by the Municipality to the sector is infrastructure. Some of the issues faced by informal businesses in the Drakenstein area is information, where to get access to information and which institutions to approach. The Municipality does a great job in referring people to the right institutions to get assistance. The Municipality has a Seed Fund Programme to support the informal sector with equipment and to help them grow their businesses.

It was difficult to determine whether the Seed Fund was successful in achieving the outcomes the municipality set out to achieve, but there are lessons to be learned from this. The problem is that businesses who are really in need of funding, struggle to get access to it. It was suggested that the Seed fund Programme should have been implemented through a mentorship programme. There is way too much political interference when it comes to selecting the right businesses in need of funding. It is unclear what the criteria was to select the beneficiaries. When business plans are presented, about 90% of them need to be turned down because the people clearly have no idea what their product or service is about. It is important that the selection criteria is thoroughly thought through because not everyone is an entrepreneur.

Secondly, when people are empowered, these people also need to be mentored. For example, when providing funding to SMME's, it should not be given at once, but in stages, and funders should therefore closely monitor the progress made by the business. It was suggested that capacity building is needed, especially for those who are directly involved in business plan assessment, because many of them do not understand it themselves. The Municipality needs to get skilled people involved in entrepreneurship who has thorough experience and knowledge of the industries and sectors in the area, those who are able to read a business plan and analyse whether people are entrepreneurial or not. Financing institutions should not only provide funding but also monitor over time whether businesses are progressing.

### **3.7.4 What is the obstacles businesses face when applying for assistance through government programmes?**

It was highlighted that it is difficult when businesses apply to get access to funding, because they need collateral. A good programme assisting small businesses is the Micro-MBA programme, which is accredited by Services SETA. It provides emerging entrepreneurs with training on the basics of business practice. Red tape is a major obstacle which needs to be looked at and the blockages to business growth removed. Major challenges faced by business when applying for assistance through government programmes is access to information and access to the internet. Businesses do not have the necessary resources to apply for programmes for example, downloading forms to complete. Most of them are using public transport and often do not have money to get to the place for assistance.

The waiting period for assistance is too long, for example, when applying to the National Empowerment Fund the waiting period can be up to 60 days but can be as long as nine months. There is a need to redesign the financing assistance to small businesses in South Africa e.g., In Brazil, corporates make available large sums of money for enterprise development. These companies are responsible for development of the country and therefore receive incentives through tax rebates. The Red Door Programme is a good programme. At the time of this study, Red Door used to work in partnership with the Municipality.

It was suggested that support should be directed to those who are already in business. It is important not to create expectations that every person starting a business will be successful. It was indicated that Drakenstein municipality does engage with Informal Trading Association but more support needs to be provided to support the sector. The only type of support provided by Council is business space where traders can trade. Traders need to be provided with training as well. A suggestion was made that support to the sector needs to be customized to meet the needs of businesses. The majority of traders stay small or they phase out because of the lack of support.

### **3.7.5 How can government support SMME's through its procurement processes?**

Participants feel that there is too much paperwork when businesses apply for a tender and procurement processes need to be made more transparent. Careful recruitment of procurement staff is absolutely imperative. Qualified and competent staff that understand their roles need to be employed. Information on tender opportunities and processes must be freely available to SMME's. People applying for support often do not have the skills and expertise.

They are having difficulty filling in long application forms and often if they do get assistance with completing the forms and submit applications, it does not mean they will get the support needed. Government programmes should be focused on mentoring prospective business owners from idea generation through the entire start-up process until the business has been registered and operating successfully. Support should be provided for at least the first five years of the business.

It was suggested that government can support SMME's by unbundling contracts. Tender applications should provide for partnership between the winning company and emerging businesses and goods and services to be procured from emerging local businesses. Creative ways need to be identified to allow emerging businesses to benefit from procurement processes. Institutional leadership is needed to make a difference. Government could provide SMME's with proper skills for example, facilitating joint ventures where major companies form joint ventures with small companies. Other interventions include skills transfer through mentoring programmes and proper research to ensure competitiveness of the sector.

Procurement needs to be brought closer to the informal sector. There are too many requirements for businesses to comply with and they never fulfil the criteria. The municipality should work with its partners involved in enterprise development and corporates to educate and train people on what is needed to apply for a tender and educate them on the entire process. Informal traders need to be informed about certain developments that will take place in the town as it might have an impact on his/her business. There is a need to correctly characterize small, medium and medium enterprise because each of these are different in nature.

### **3.7.6 What challenges are businesses faced with in the informal sector?**

Participants highlighted the need to better communicate with the informal sector since the sector has a lot to offer. They produce excellent products and feel that they should be supported through export opportunities. Furthermore, business training, mentorship and how to exploit new markets are some of the areas where support is needed. Assistance should be provided for the establishment of co-operatives within the informal sector. Challenges faced by businesses in the informal sector include access to information, unreliable transport and training. Sector specific training should be provided instead of general business skills training and the focus should be more on learnerships. The informal sector creates a lot of jobs and therefore it is important to determine how this sector could be assisted. It would be useful to study the Indian model on enterprise development. The SMME sector need to be assisted as a whole and not individually.

Informal sector by-laws have been the problem in the country for many years and still are. Informal traders felt that they are not consulted when by-laws are developed. By-laws causes great obstacles for the informal sector. There are too many laws that hinder SMME development. It was indicated that the sector in Drakenstein municipality was very successful in previous years dating back to 1985. Informal traders used to make a turnover of up to R60 000, but these businesses have vanished. It is important to assess why this is the case. Although informality should be embraced, more should be done to ensure businesses advance to be semi-formal.

### **3.7.7 Research Delineation**

The study focussed mainly on entrepreneurs in the tourism, agricultural, finance and business services sectors, manufacturing sector and government services sectors, wholesale and trade.

Attention was given to two groups:

- Group 1 – Entrepreneurs operating in both formal and informal sector.
- Group 2 – Enterprises operating for a period of at least five years.

### **3.8 Sampling Design**

The research did not focus on a national or provincial population since this does not fall within the parameters of the study. The sample design used by the researcher was convenience sampling where the population elements were selected for inclusion in the sample because they are easily accessible. In this study the researcher secured data from both informal and formal sectors and selected a fixed number of government employees with whom to conduct interviews. The nature of the sampling was drawn from fifty SMME's in the formal sector and fifty businesses in the informal sector.

The businesses were selected from the manufacturing, business and financial services sector, government services, tourism, etc. Within the informal sector, businesses include street traders, spaza shops, small pavement vendors etc. The businesses in both formal and informal sector were of a similar nature and hence the results are not biased. The researcher also used area sampling. It is quite similar to cluster sampling and is used when the total geographical area of interest happens to be big one.

Under area sampling the total area is divided into a number of smaller non-overlapping areas, generally called geographical clusters, then a number of these smaller areas are randomly selected, and all units in these small areas are included in the sample. Area sampling was especially helpful where there was no list of the population concerned. It also makes the field interviewing more efficient since an interviewer can do many interviews at each location. The geographic location of the sample was the Drakenstein Municipal area, Wellington and Paarl, since the main business centres are situated in these areas.

### **3.9 Sample & population**

The study object is called the population, consisting of individuals, organisations, groups, events and human products or the conditions to which they are exposed (Welman, et al, 2006:52). The research problem is related to a specific population and the population includes the total collection of all units of analysis about which the researcher wishes to make specific conclusions (Welman, et al, 2006:52). For this study, the chosen geographic area consists of two towns in the Drakenstein Municipal area. The researcher focussed on businesses from the two main business centres, Wellington and Paarl, fifty from the informal sector and fifty from the formal sector, which gives a total of one hundred participants.



The researcher chose to select those entrepreneurs who have been operating for a period of at least five years. This allowed the researcher to make a comparison between those businesses who are operating successfully and those who are not successful. The researcher was therefore able to determine the reasons why certain businesses are more successful than others while operating for the same period of time.

### **3.10 Primary and secondary data sources**

Primary sources are direct sources of evidence that the researcher creates or gathers themselves. Primary sources provide original information or evidence and are the first evidence of a phenomenon being observed and recorded. Examples of primary sources include documents, letters, diaries, photographs, maps, charts, sound recordings, completed questionnaires, completed scales, interview transcripts, all kinds of research data, newspapers etc. (Kothari, 2004:17). In this study, the researcher used a combination of primary and secondary sources.

The researcher used various government documents to obtain data regarding small business development including the Drakenstein Integrated Development Plan, Drakenstein Local Economic Development Strategy etc. These are some of the most important documents since it articulates the socio-economic profile of the entire Drakenstein Municipal area as well as the priority areas for the Municipality. Secondary sources provide analysis, discussion or interpretation of primary sources. Secondary sources do not provide original information or evidence. They refer to original information or evidence published in primary sources. They comment on, analyse, interpret or discuss primary sources. Examples of secondary sources include publications, textbooks, newspaper and magazine articles, histories, criticisms, and commentaries on experiences, events or phenomena. The essential point is that these accounts are not first-hand accounts.

It is helpful, perhaps to think of secondary sources as second-hand material. The distinction between primary and secondary sources is the degree to which a researcher is removed from the event described. This indicates to the reader whether the researcher is reporting impressions first-hand or recounting something second-hand.

In addition to the main problem, the following sub-problems were identified:

1. Ineffective enterprise development programmes to enhance enterprises.
2. Ineffectiveness of tender processes in supporting SMME's (3).
3. Unfavourable legislative environment to support entrepreneurs (2).
4. Ineffective government support to the informal sector.

Below is a discussion of how this research study attempted to resolve sub-problems that have been identified:

### **Sub-problem 1: Ineffective enterprise development programmes to enhance enterprises.**

In Chapter 2, a literature review was undertaken in order to identify the nature and dynamics of the SMME sector and how enterprise development programmes support the enhancement of SMME's. The linkage between enterprise development and poverty reduction was discussed in detail.

### **Sub-problem 2: Ineffective tender processes and support**

Government procurement processes were identified as mechanisms through which enterprise development can be achieved and was recognized as a means of addressing past discriminatory policies and practices. Many challenges hampering the effective implementation of procurement to advance socio-economic objectives were identified. The questionnaire was used to gather information regarding the respondents' perception about government procurement processes as an opportunity to support small businesses.

### **Sub-problem 3: Unfavourable legislation environment**

The literature review also discussed the policy and legislative environment which is fatally flawed in South Africa and does not support the growth and development of small businesses. Legislative constraints include the burden of an inflexible regulatory framework; restrictive employment regulations; inefficient government bureaucracy or 'red tape'. A questionnaire was used as a research tool to gain insight into the above problems. The perceptions of selected respondents regarding enterprise support programmes and the legislative environment to support SMME's were gathered using the questionnaire.

#### Sub-problem 4: Ineffective Government support

The informal economy plays a huge part in providing livelihoods to many of the poor and therefore its importance cannot be emphasized enough, however it has, to a large extent been underestimated. As a result of this, support for the sector has to a large extent, been minimal. Challenges faced by this sector include, amongst others, inappropriate policy environment; lack of institutional support and unfavourable working conditions. The questionnaire used, gathered information regarding the challenges faced by businesses in this sector as well as support interventions introduced by the Drakenstein Municipality.

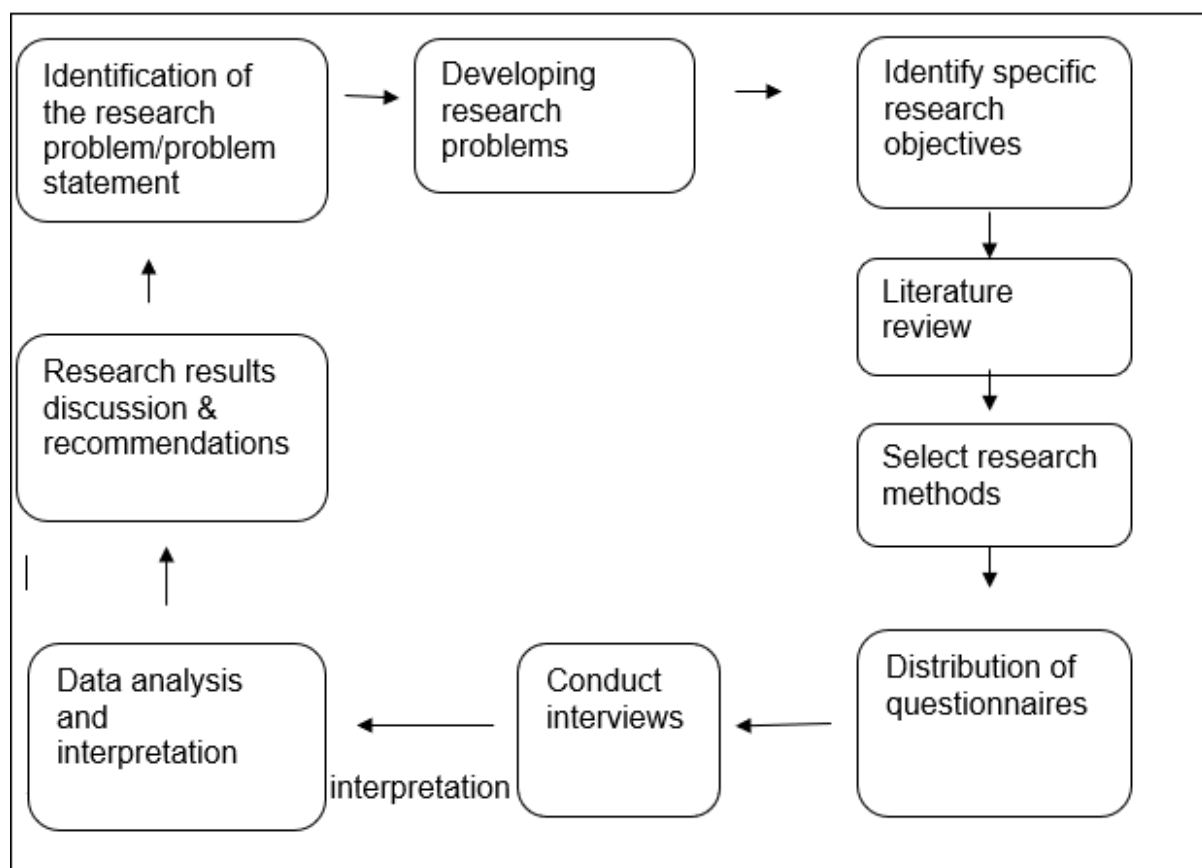


Figure 4: Research process

Source: Researcher's own interpretation

The diagram above summarizes the research process which was undertaken by the researcher. The traditional research process was followed starting by defining the research problem. The research problem identified in this study is that it has been widely acknowledged that enterprise development has a significant role to play in addressing poverty. However, SMME support programmes fails to adequately address the needs of entrepreneurs hampering the ability of the

SMME sector to adequately address poverty. Secondly, the legislative environment is not conducive for starting and growing small businesses. The informal sector plays a huge role in job creation, but does not get the necessary support. The government procurement processes presents an opportunity to meaningfully support small businesses, however small businesses are faced with various challenges including a lack of understanding of the tender procedures, procurement rules, and systems and tender advice and support.

This study investigated to what extent enterprise development can address poverty at local government level and specifically Drakenstein Municipality. The study investigated and explored the following research objectives:

- To what extent enterprise development can advance socio-economic challenges in the Drakenstein region;
- Examined the reasons for failure of government enterprise support programmes to enhance enterprises;
- Evaluated the legislative and institutional framework for small businesses to function optimally;
- Examined the role that local government procurement processes presents in supporting SMME's; government initiatives to support SMME's has been a failure thus far, the study explored the reasons for this and suggest some actions for the way forward;
- Evaluated initiatives undertaken by Drakenstein Municipality to support entrepreneurs in the informal sector.

### **3.11 Summary**

This chapter highlighted the research process which was undertaken by the researcher by means of a diagram followed by a comprehensive explanation of the entire process. The chosen sample population was those businesses operating for a period of five years both in the informal and formal sectors. The researcher used a descriptive quantitative research method in order to describe the status quo as it is at present. The aim of the study is to investigate the role of enterprise development in the reduction of poverty. The researcher therefore made use of both primary and secondary data sources in order to obtain data regarding small business development in South Africa, and more specifically in the Drakenstein Municipal area. The researcher decided to use both convenience sampling and area sampling. Convenience sampling occurs when the population elements are selected for inclusion in the sample because

they are easily accessible. Area sampling is especially helpful where there is no list of the population concerned.

For the purpose of this study, the researcher made use of both questionnaires and interviews to collect data. The reason why the researcher chose to use questionnaires was because it is relatively quick and easy to develop, code and interpret. Questionnaires were distributed to businesses operating in both the formal and informal sectors. The researcher also conducted one-on-one interviews, with people who are directly involved in providing support to small businesses in the Drakenstein Municipal area. These individuals include Municipal officials working in the LED Unit at Drakenstein Municipality, staff member of the Small Enterprise Development Agency (SEDA), a staff member at the Siyakhaya Business Advisory Agency and the Chairperson of the Informal Trading Forum. The next chapter is discussing the interpretation of the results which was collected by using the above mentioned research methods.

## **Chapter 4: Presentation and discussion of results**

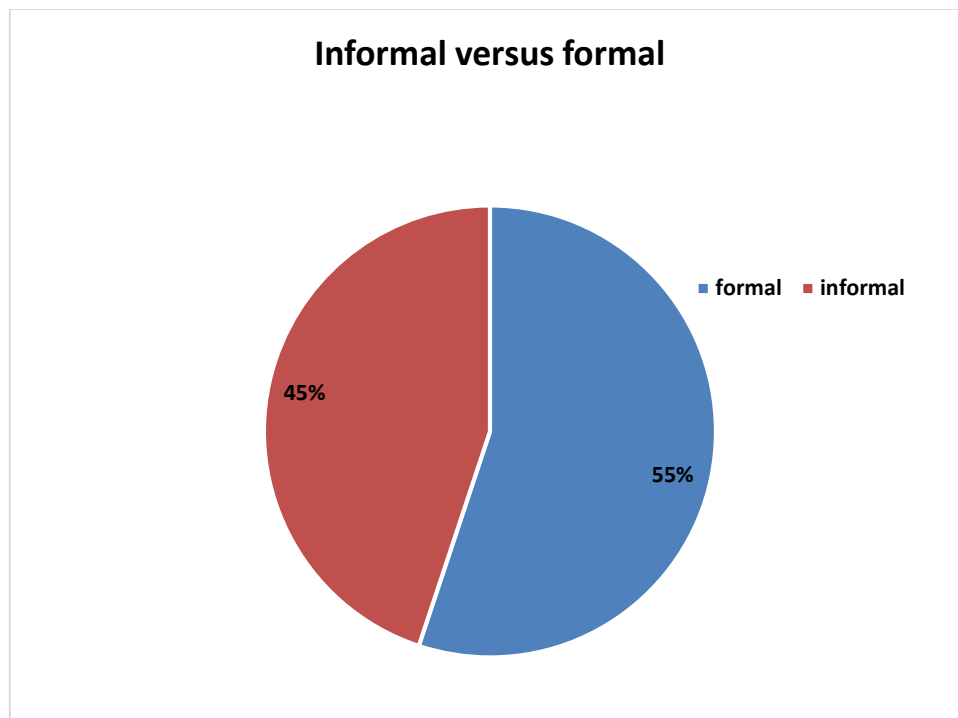
### **4.1 Introduction**

The target population which was selected consisted of people owning SMME's within both the formal and informal sector in the following sectors; wholesale and retail trade, customer service, agriculture, manufacturing within the Drakenstein Municipal area. These entrepreneurs had been operating for a period of at least five years. The geographical location of the sample chosen for the study was Paarl and Wellington which forms the biggest business centres within the Drakenstein Municipal area.

## 4.2 Analysis of research results

### 4.2.1 Formal versus informal

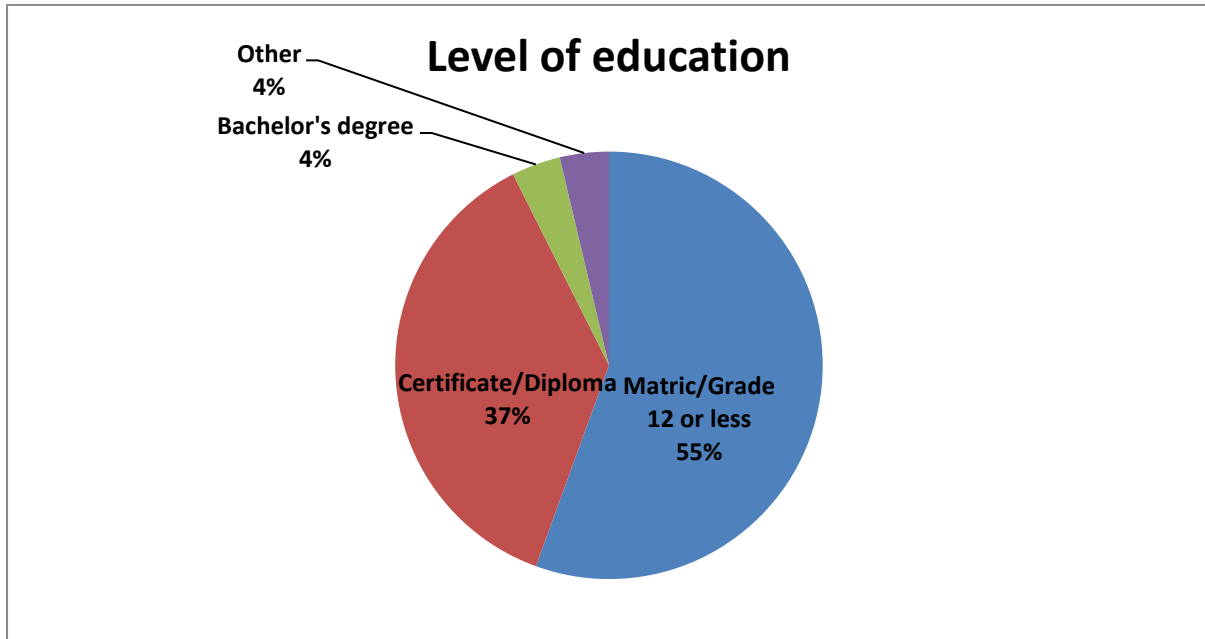
In the final analysis, representatives from forty eight SMME's from both formal and informal sectors formed the sample population. In the category of general information, as illustrated in figure 5 below, SMME's that participated in the survey, constituted the same size from both the formal and informal sectors.



*Figure 5: Formal versus informal*

The result of the study shows that 55% of the sample population comprises entrepreneurs from the formal sector and 45% of entrepreneurs operate within the informal sector.

#### 4.2.2 Education levels

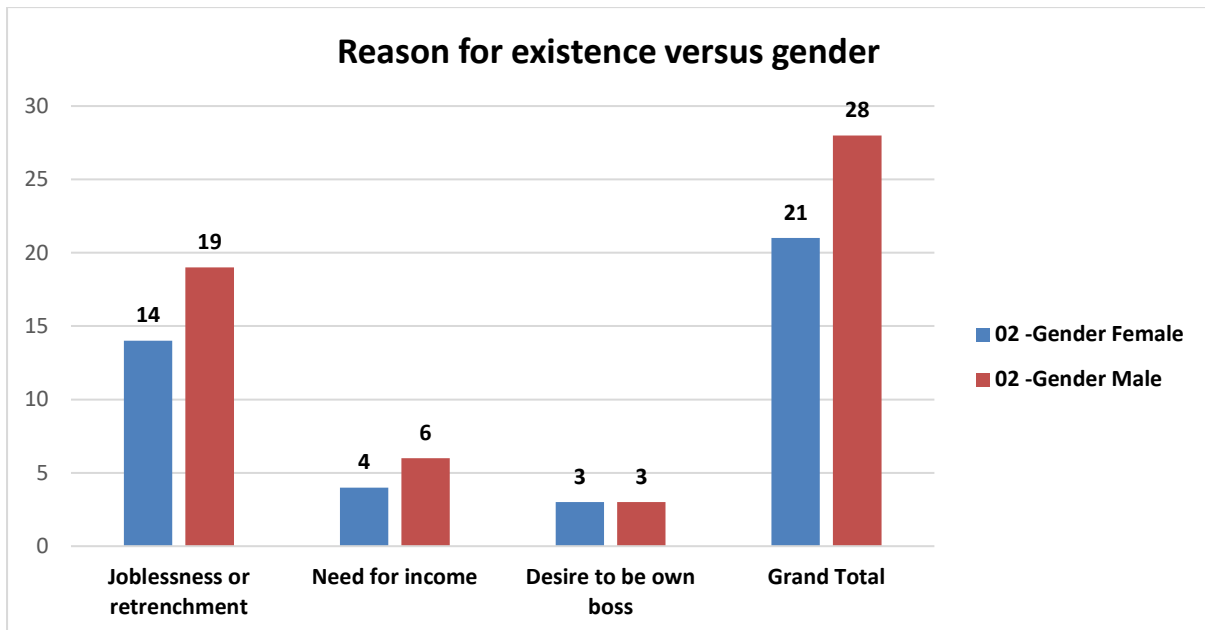


*Figure 6: Education levels*

It is evident from the data that 55% of the sample either have matric or no formal type of education. These are typically entrepreneurs who operate within the informal sector who previously had no form of income and who started a business to improve their livelihoods. Thirty seven percent of the sampled entrepreneurs had a certificate or diploma and therefore had received formal education then started a business. Four percent had Bachelor's degrees and the remaining 4% had other qualifications.

### 4.2.3 Reasons for starting a business

The study aimed to determine the reason why people started businesses. The sampled entrepreneurs were provided three options as to why they decided to start businesses.



*Figure 7: Reason for starting a business*

Among the entrepreneurs sampled, nineteen female respondents indicated that they started a business due to joblessness and fourteen male respondents indicated that they are business for the same reason. Six males indicated that a need for income necessitated them to start a business and four female respondents indicated the same. Three males and three females felt that they started a business because they merely had the desire to be their own boss.



#### 4.2.4 Time operating

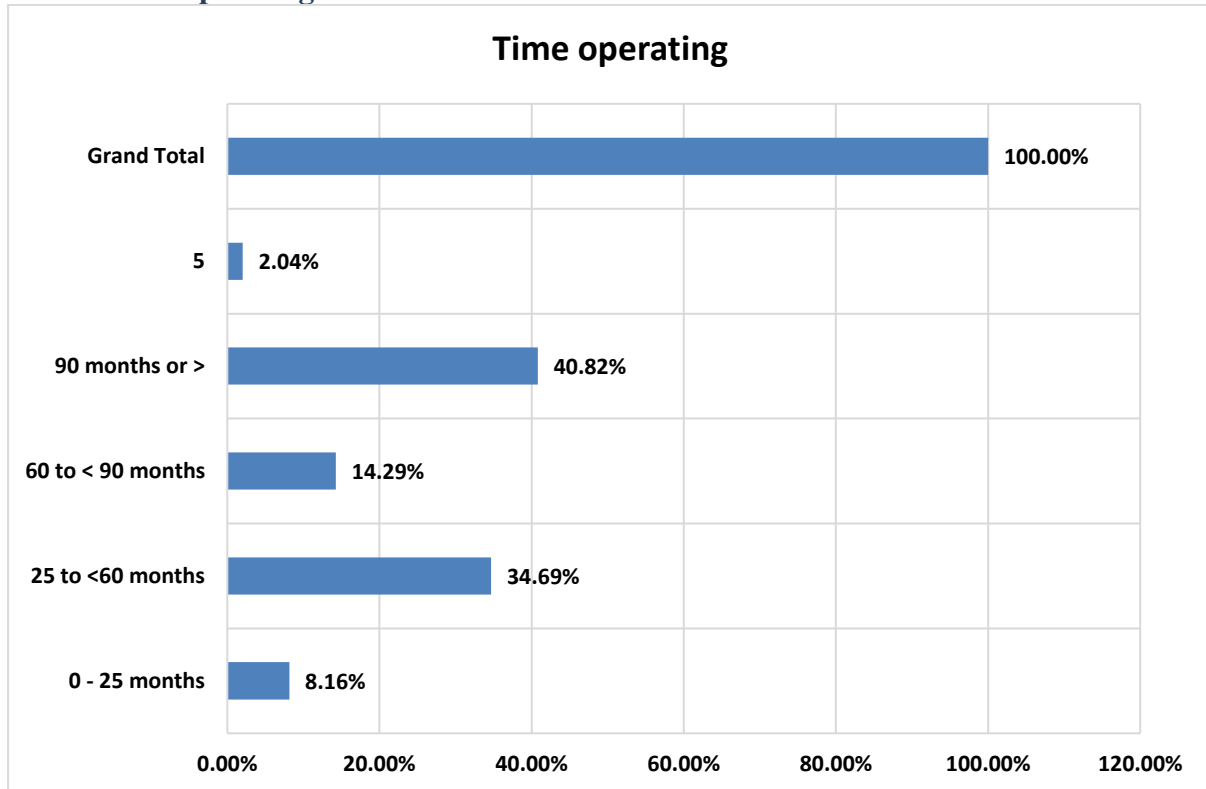


Figure 8: Time operating

The majority of respondents have been operating their businesses for more than seven years, whilst 34,69% of respondents have been operating for two years but less than five years. From the results illustrated in the above graph, it can be concluded that the majority of entrepreneurs, although struggling to get the necessary support, have the tenacity which is crucial for operating an enterprise whether in the formal or informal sector. This is important to note as it is an indication that entrepreneurs do not easily give up and are potentially committed to succeed.

#### 4.2.5 Success of business

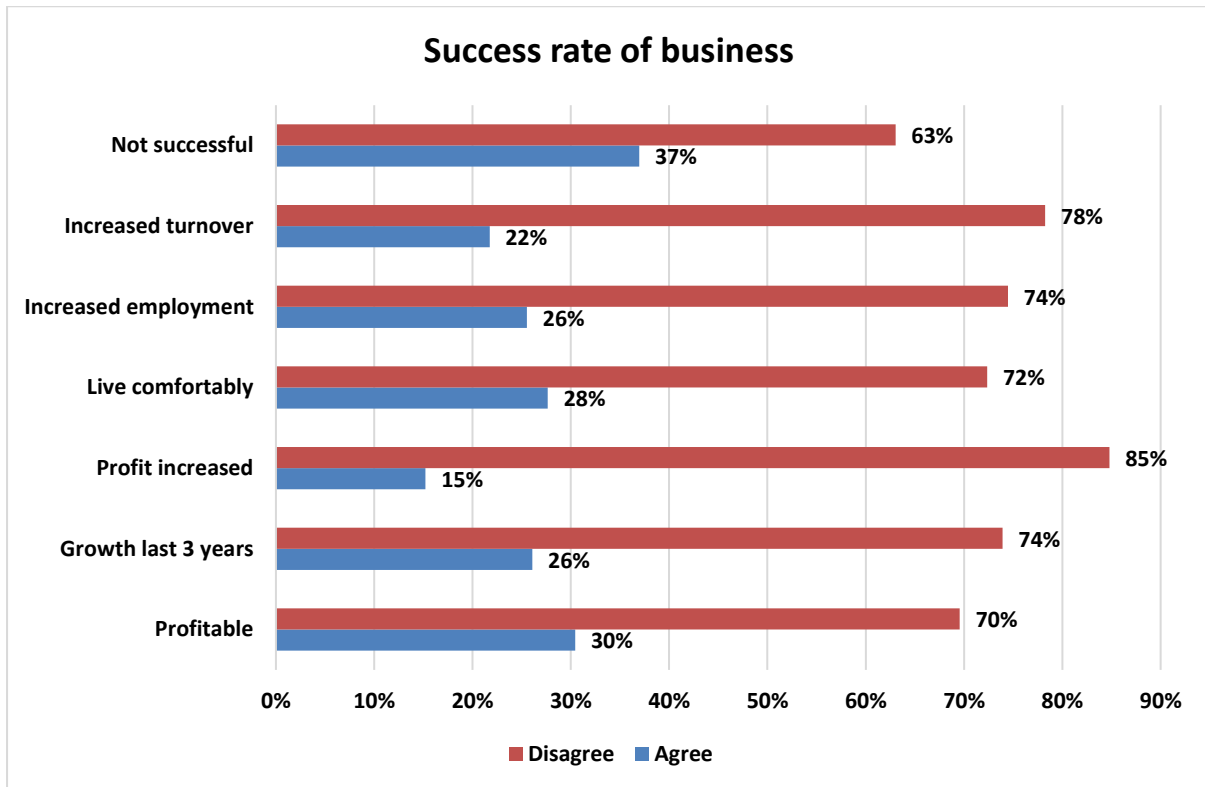


Figure 9: Success rate of business

The questionnaire reveals that, of the sampled entrepreneurs, 70% disagreed that their business had been profitable during the last financial year. The analysis of the questionnaire indicated that 30% of respondents agreed with the statement that their business had been profitable during the last financial year. The results also indicate that 74% of businesses have not grown in the last three years (at the time of this study). The study earlier indicated that when funding or any other type of support is provided to SMME's, this should be coupled with the necessary mentorship and training on for example managing finances within the business.

Therefore, one can conclude that if these businesses received mentorship with regard to managing their finances, the result would have been different.

#### 4.2.5.1 Success of business

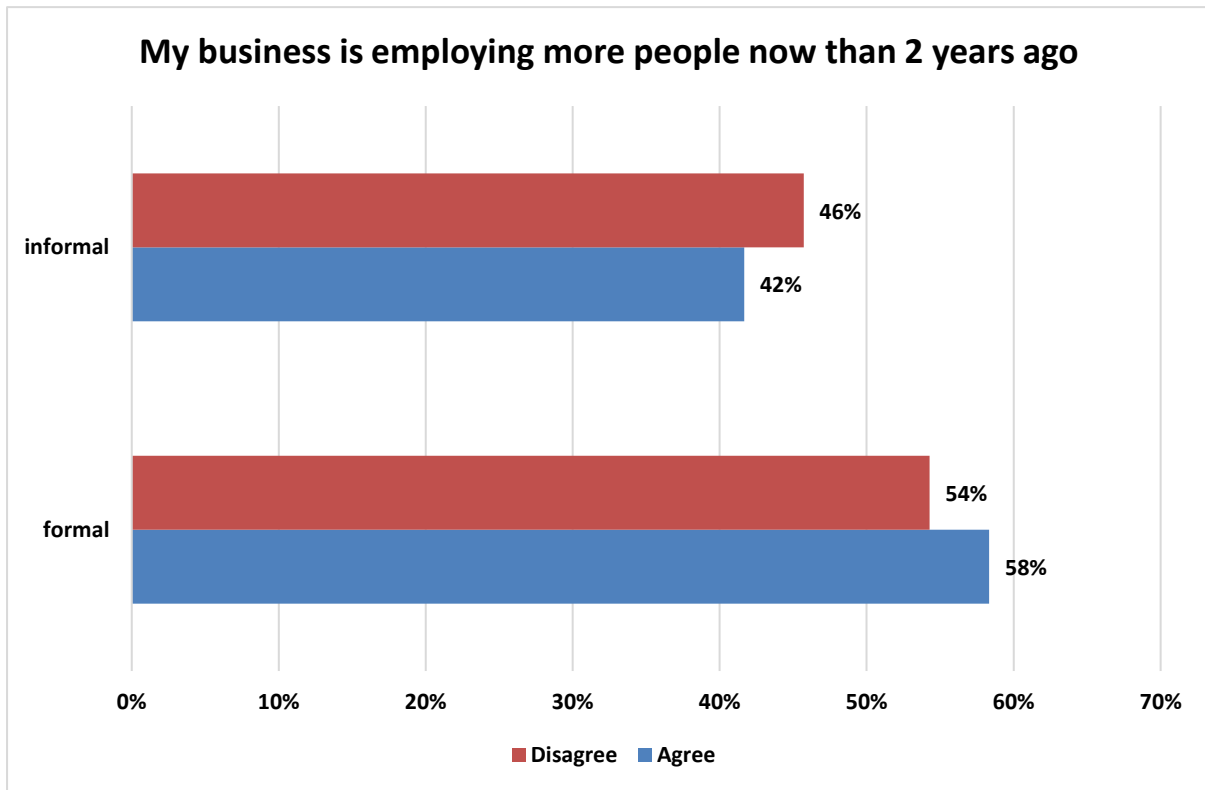


Figure 10: Increase in employment

The researcher wanted to determine if there is a difference between what the informal and formal businesses experienced with regard to employment increase at the time of the study compared to two years prior to the study. The graph above indicates that 42% businesses in the informal sector agreed that they've experienced an increase in employment, whilst 58% of businesses in the formal sector indicated that they have experienced an increase in employment.

A chi-square was done to compare the relationship between two variables, in this case, the difference in experience between the formal and informal businesses. The researcher's expectation was that the formal are more likely to agree that they are employing more people than businesses in the informal sector although not significantly more than participants in the informal sector. The fact is, that this links to the literature review indicating that the SMME sector is far from homogenous and would require a fine-tuned set of interventions rather than the generic assistance which have been provided thus far. The dynamics of informal businesses vary significantly compared to formal businesses and hence the need for well-designed policies to enable and support the informal sector.

#### 4.2.6 Awareness of government support programmes

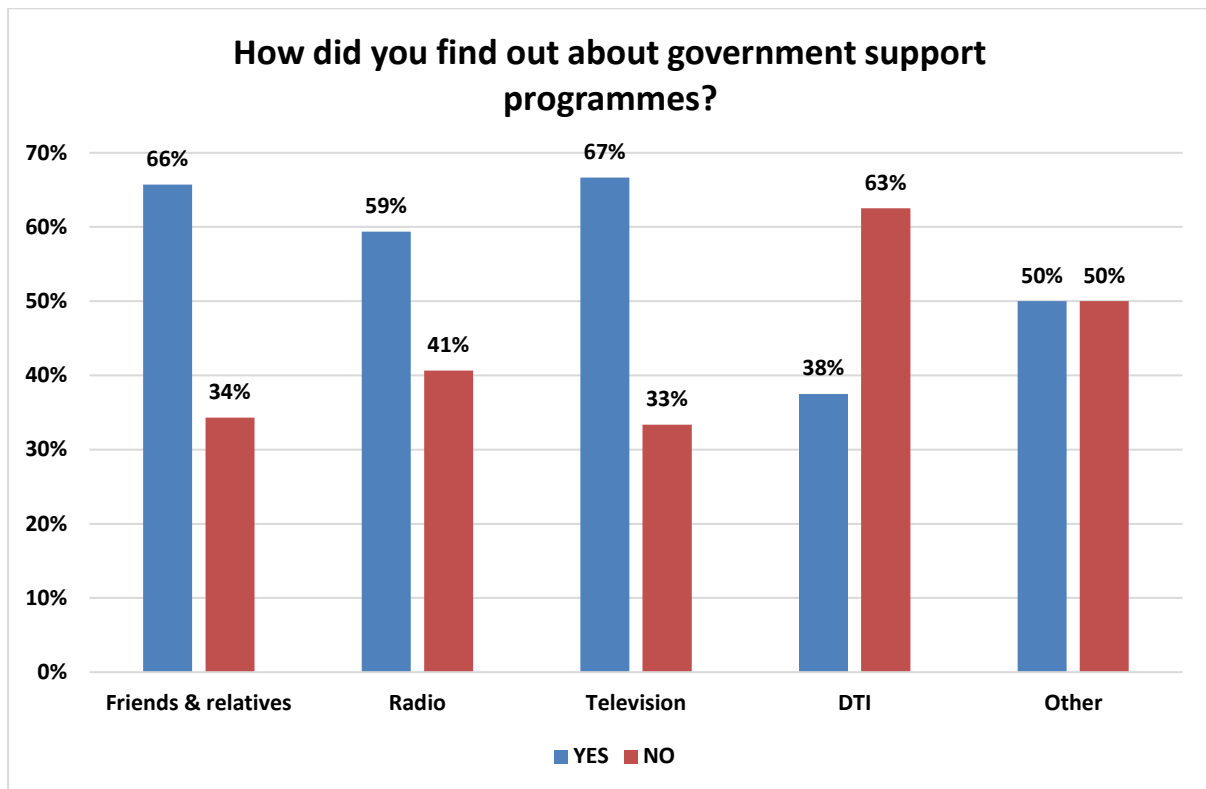


Figure 11: Awareness of government support programmes

Sixty seven of respondents were made aware of these government support programmes through television and 66% of respondents were informed by their friends and relatives. This is a clear indication that more needs to be done by government to reach out to SMME's, making them aware of these programmes for them to fully take advantage of these programmes. Drakenstein has both urban and rural areas and for this reason, SMME's in the rural areas could be excluded from mainstream media and therefore could possibly will not be informed of these government programmes.

#### 4.2.7 Needs experienced when starting my business

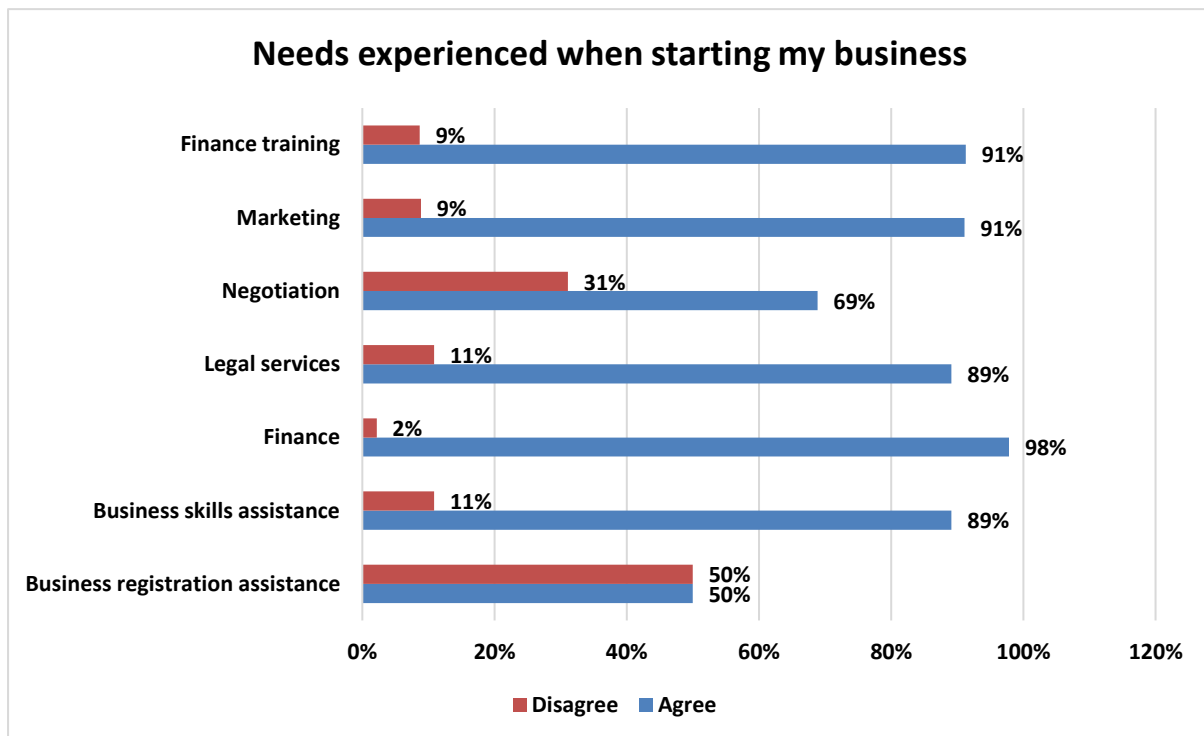


Figure 12: Needs experienced when starting my business

Ninety eight percent of respondents indicated that they needed access to funding when they started their businesses, 91% responded that they needed financial training and marketing support and 89% indicated that they needed business skills assistance. Support with regard to these elements should therefore be strengthened.

#### 4.2.8 Obstacles experienced when applying for support programmes

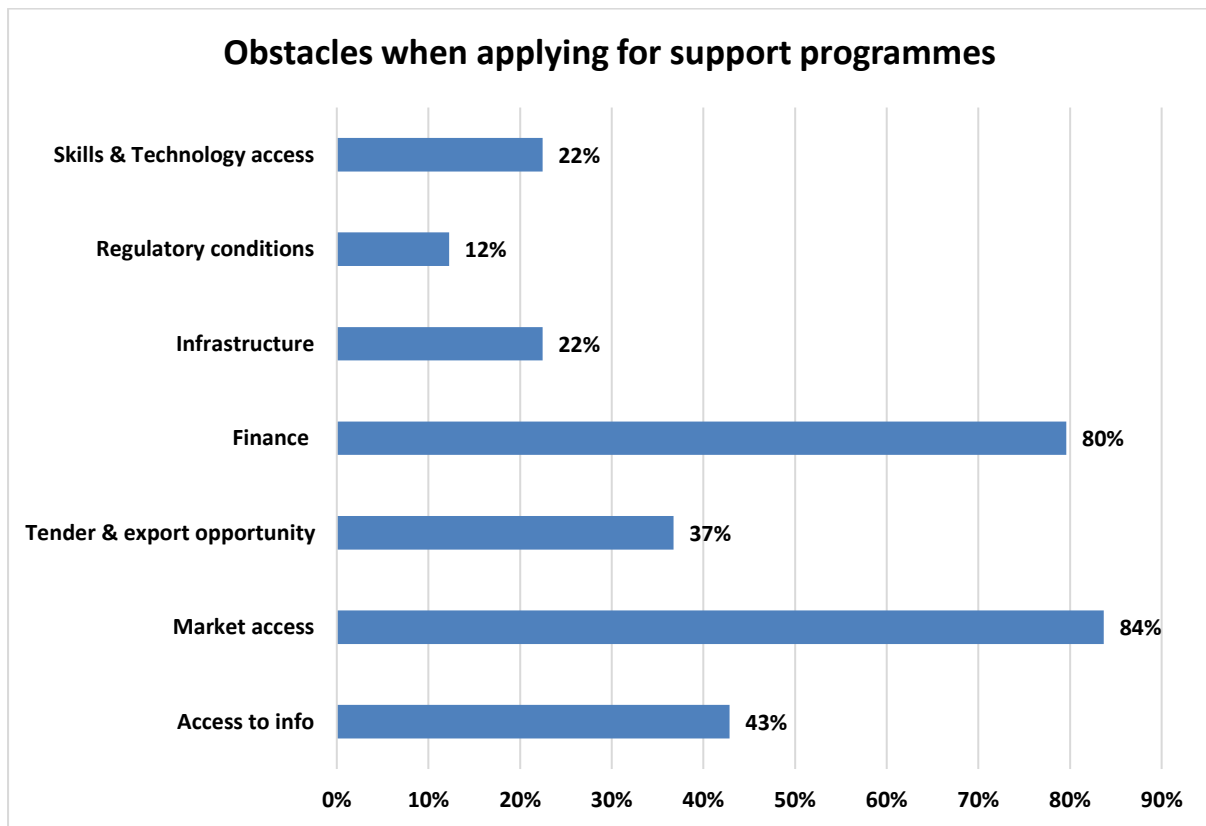


Figure 13: Obstacles experienced when applying for support programmes

The results from this graph links to the outcomes of the previous graph. Market access, finance and business training were the three top areas where businesses experienced obstacles. Eighty four percent highlighted marketing as an area which they struggled with when applying for support. It could be that, at the time of applying for support, the programme offered were not specifically aimed at market access.

#### 4.2.9 Challenges faced by informal businesses

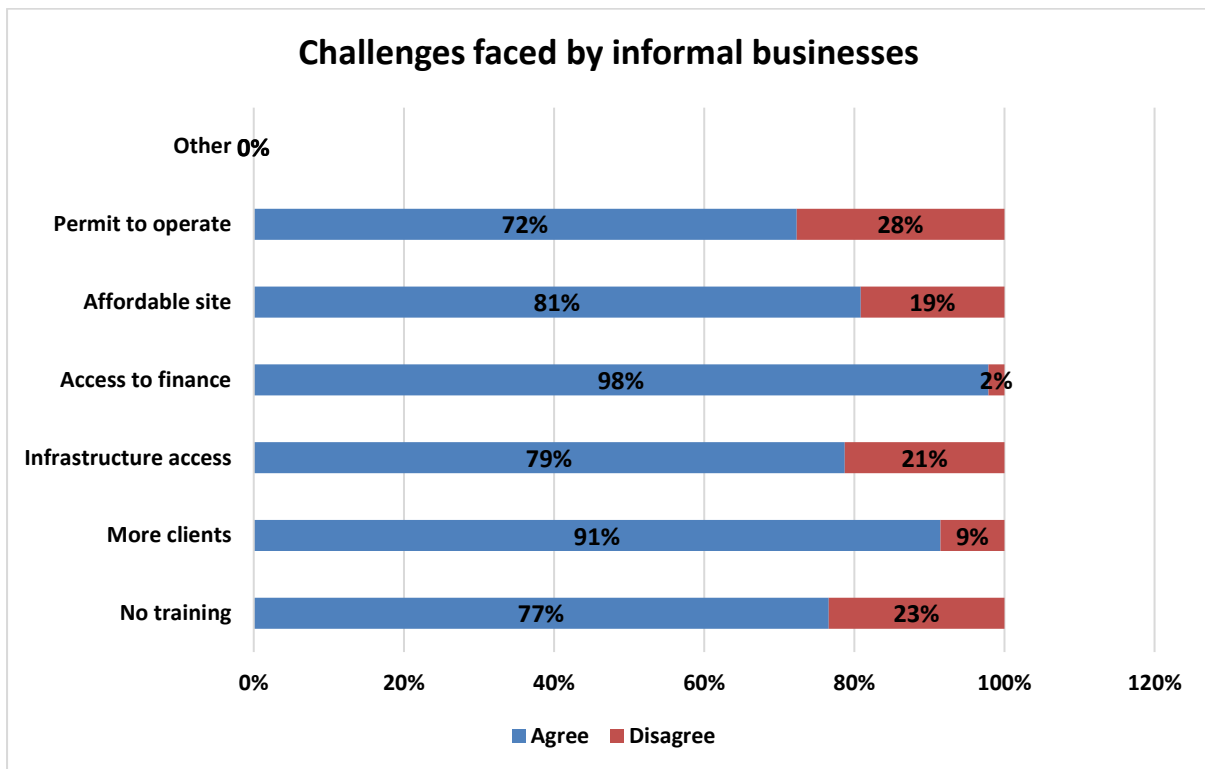


Figure 14: Challenges faced by informal businesses

Ninety eight percent of informal businesses indicated that they had challenges regarding access to finance. Ninety one percent indicated challenges regarding gaining more clients. These challenges are similar in nature in terms of the the results from the previous two graphs. These results were expected by the researcher as the literature review indicated that this sector struggles in terms of obtaining general business support due to the nature of the sector.

#### 4.2.10 Informal sector support: Drakenstein

Participants were asked to explain the type of support provided by the Drakenstein municipality to the informal sector. Responses from participants can be grouped as follows:

- Some participants indicated that transparency of support to entrepreneurs
- Support to the sector should be formalised
- Support is needed to become formal. Some businesses indicated that they would like to become formal in order to become eligible for support offered to formal businesses.
- Some indicated that they do not receive any support. The reason for this could potentially be that they are not aware of the support provided by the municipality

- Displaying tolerance towards the sector
- Sites not good enough to operate from. Participated indicated that they were placed in areas where they struggled to gain market access.

#### 4.2.11 Tender support

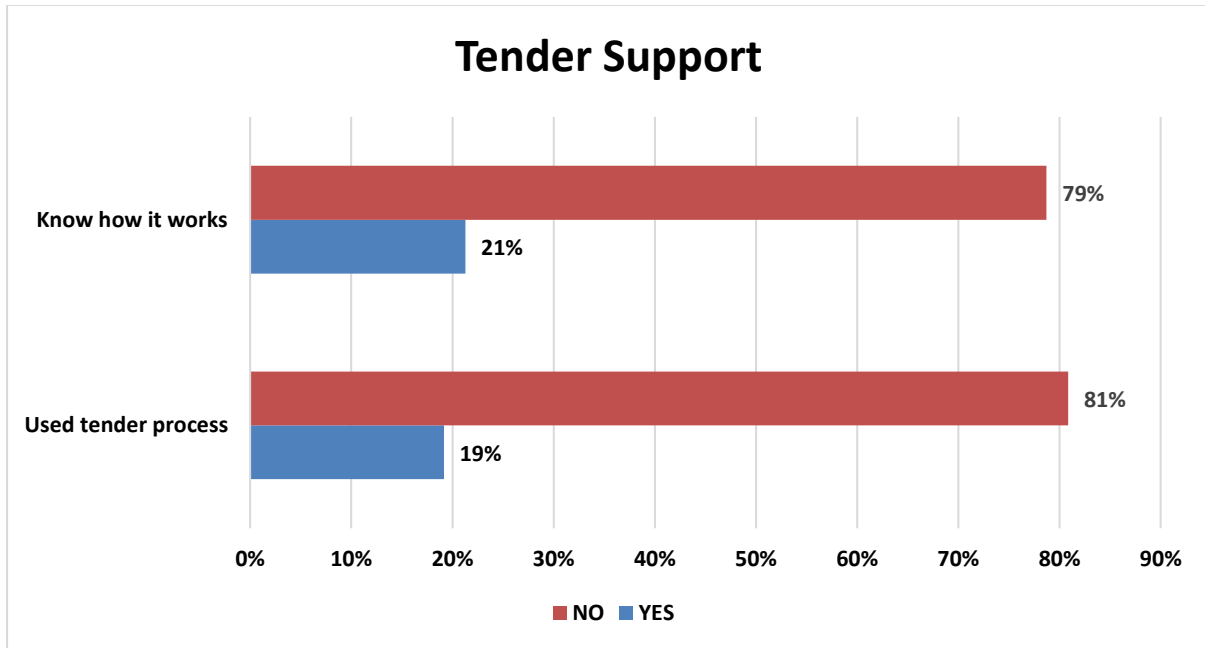


Figure 15: Tender support

#### 4.2.12 Government support to SMME's through tender contracts

Participants were asked whether they know how tender processes works and whether they have used tender processes. 79% of participants answered that they do not know how tender processes works and 21% answered yes to the question. Eighty one percent of participants answered that the have not used tender processes and only 19% indicated that they have used tender processes before. A further question was asked to participants to gain more insight based on their responses as indicated above.

This was an open ended question where participants were asked about government support to SMME's through its procurement processes. The top issues raised by participants include:

- Transparency is needed when awarding tenders. Participants indicated that they don't want to do business with government due to the lack of transparency. Although some municipalities advertise all tenders that have been awarded, transparency can be



improved by contacting each business individually to inform them about the business that was awarded the tender and providing reasons why.

- They need more information on how government tender processes works and information to be accessible. Based on the outcome of the previous question about whether participants know how tender processes works, one could argue that, if more information is made available on how tender processes works, more businesses would apply for tenders.
- Participants indicated that there are no much bureaucracy, rules, regulations. Participants indicated more needs to be done to simplify tender processes to make it easier to apply. Procurement legislation and regulations are developed at a national level and local policies are aligned to that of national.
- Too many forms to complete and more needs to be done to educate them to complete these tender documents. This could potentially be one of the reasons why the percentage of people who have used tender processes is so low.

#### 4.2.13 Effectiveness of SMME support programmes

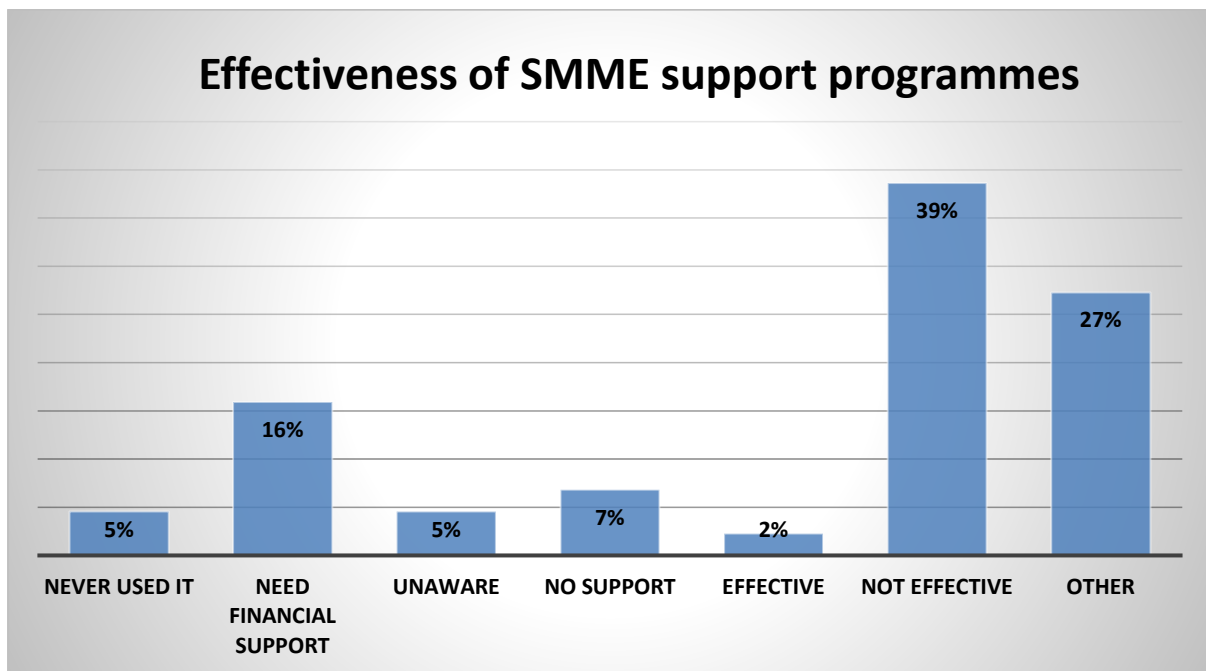


Figure 16: Effectiveness of government SMME programmes

The research reveals that an overwhelming 39% of participants indicated that SMME support programmes are not effective versus 2% of the participants who indicated that support programmes are effective. This aligns with the researcher's review that SMME support programmes are not effective and that more needs to be done to support SMME's to put them on a new growth trajectory. Other reasons provided by participants which accounts for 27% of participants include that they do not have comments and they do not know whether government SMME programmes are effective or not.

#### 4.2.14 Effectiveness of government policy to support SMME's

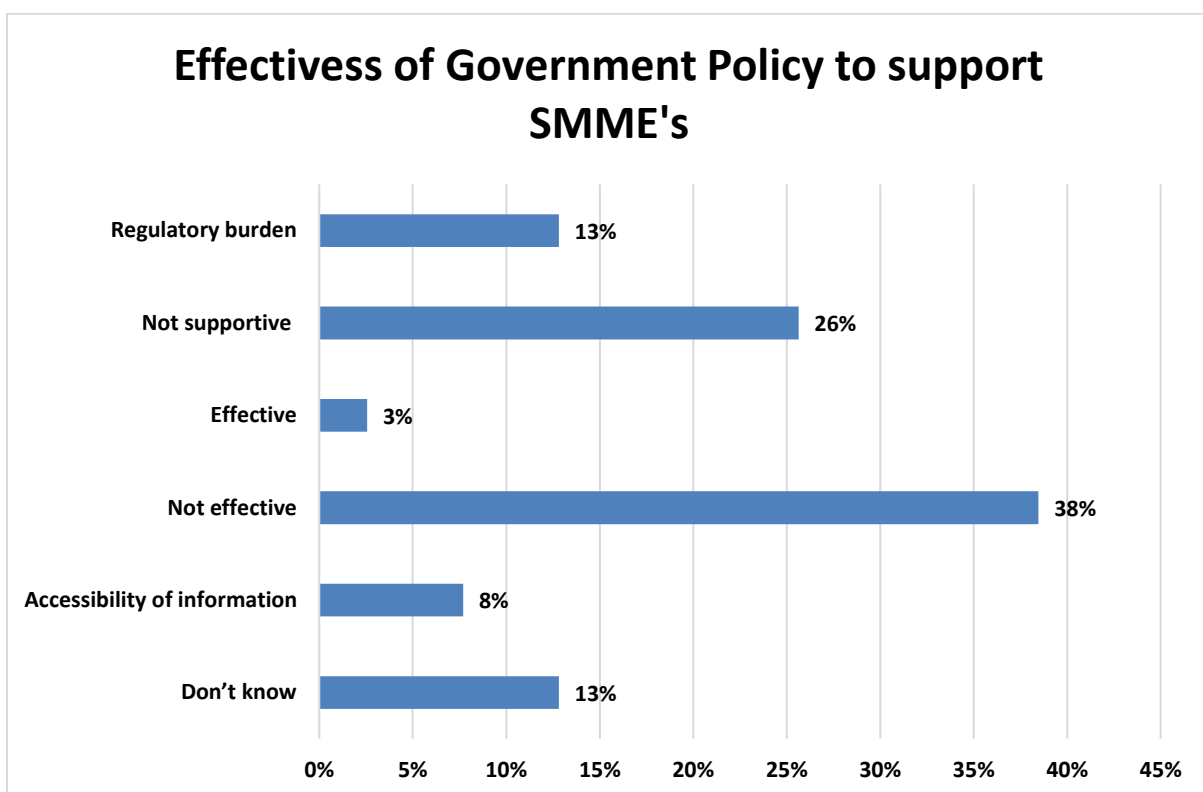


Figure 17: Effectiveness of government policy to support SMME's

The research results revealed that 38% of the sampled population feels that government policy to support SMME's is not effective. The results indicated that 26% of the sampled population indicated that government policy environment is not supportive towards SMME's. The results further revealed that 13% of the sampled population feels that the government policy environment places a regulatory burden on them.

#### 4.2.15 Number of employees in formal and informal sector

The results revealed that the number of employees in the both informal and formal sectors are almost equal. It can be said that both sectors have equal potential for job creation. Therefore it is imperative that both sectors are provided equal attention by government.

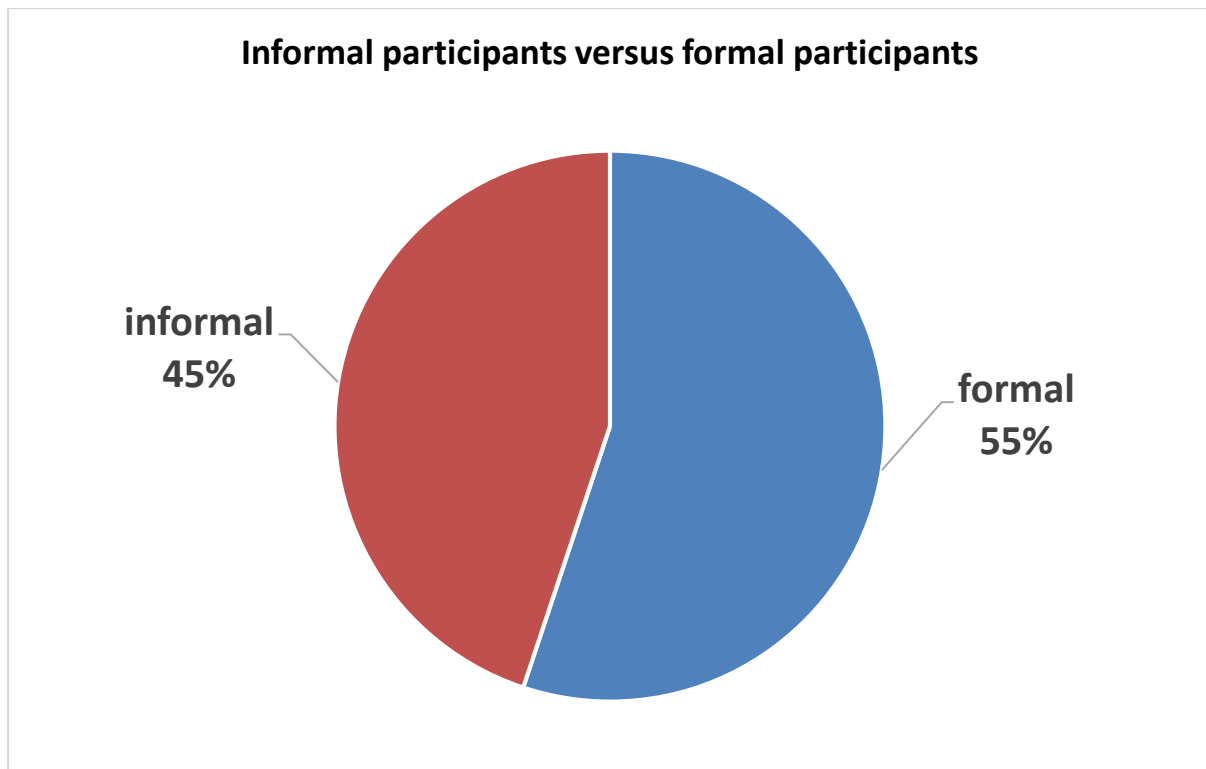


Figure 18: Informal participants versus formal participants

#### 4.2.16 Familiarity with government support programmes

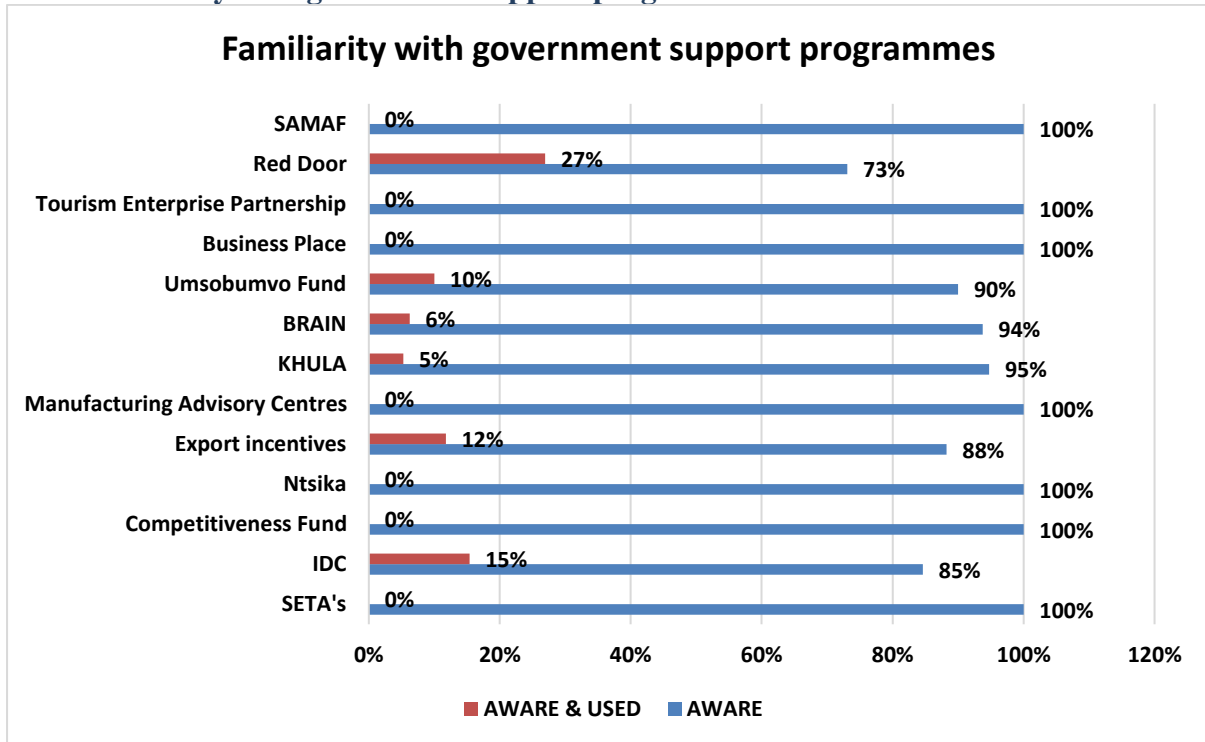


Figure 19: Familiarity with government support programmes

As indicated in the literature review, government has created various initiatives aimed at supporting and growing the SMME sector, however not many small businesses are aware of initiatives that government has put in place to support small enterprises. The above support programmes were listed for participants to select between whether they are aware or whether they are aware and have used any of these programmes. The top three programmes which participants were not only aware of but have also used include Red Door (27%), Industrial Development Bank (15%) and the Export initiatives (12%) programme. However, the results indicates that the highest percentage of participants who are aware of all these programmes have not used them.

The possibility of people not using these support programmes could potentially be linked to some of the reasons as stated below where participants had to rate the assistance received through government support programmes. The reasons with the highest percentage include:

- People are inaccessible;
- Assistance are insufficient and
- Processes taking too long.

This confirms the researcher’s hypotheses that the achievements and impact of government interventions have largely been unsuccessful to meaningfully grow and develop small businesses as it could be due to the fact that not many SMME’s make use of government support programmes.

#### 4.2.17 Rate assistance received through support programmes

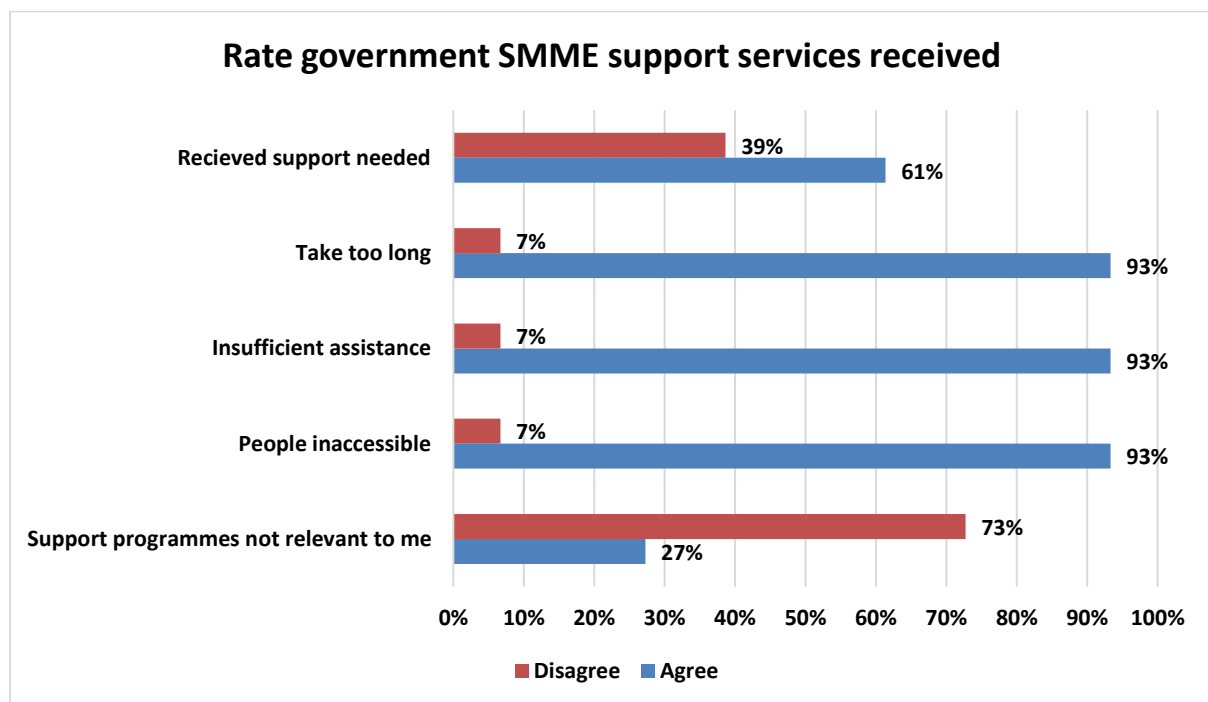


Figure 20: Rate government SMME support services received

The results indicates that 73% of the participants disagree with the statement that SMME support programmes are not relevant to them. The top three areas which scored the highest percentage are 93%, where participants agreed include:

- 1) people are inaccessible,
- 2) insufficient assistance, and
- 3) support taking too long.

The fact that most people rated the above factors so high, could potentially be that they do not know who to contact when applying for support, their needs were not met and after applying for support, they probably were not kept informed about their application or do not know how the government’s internal approval processes works. It could also be that their application forms were incomplete but was probably not made aware of this.

#### 4.2.18 Importance of initiatives from local government to meaningfully support the informal sector

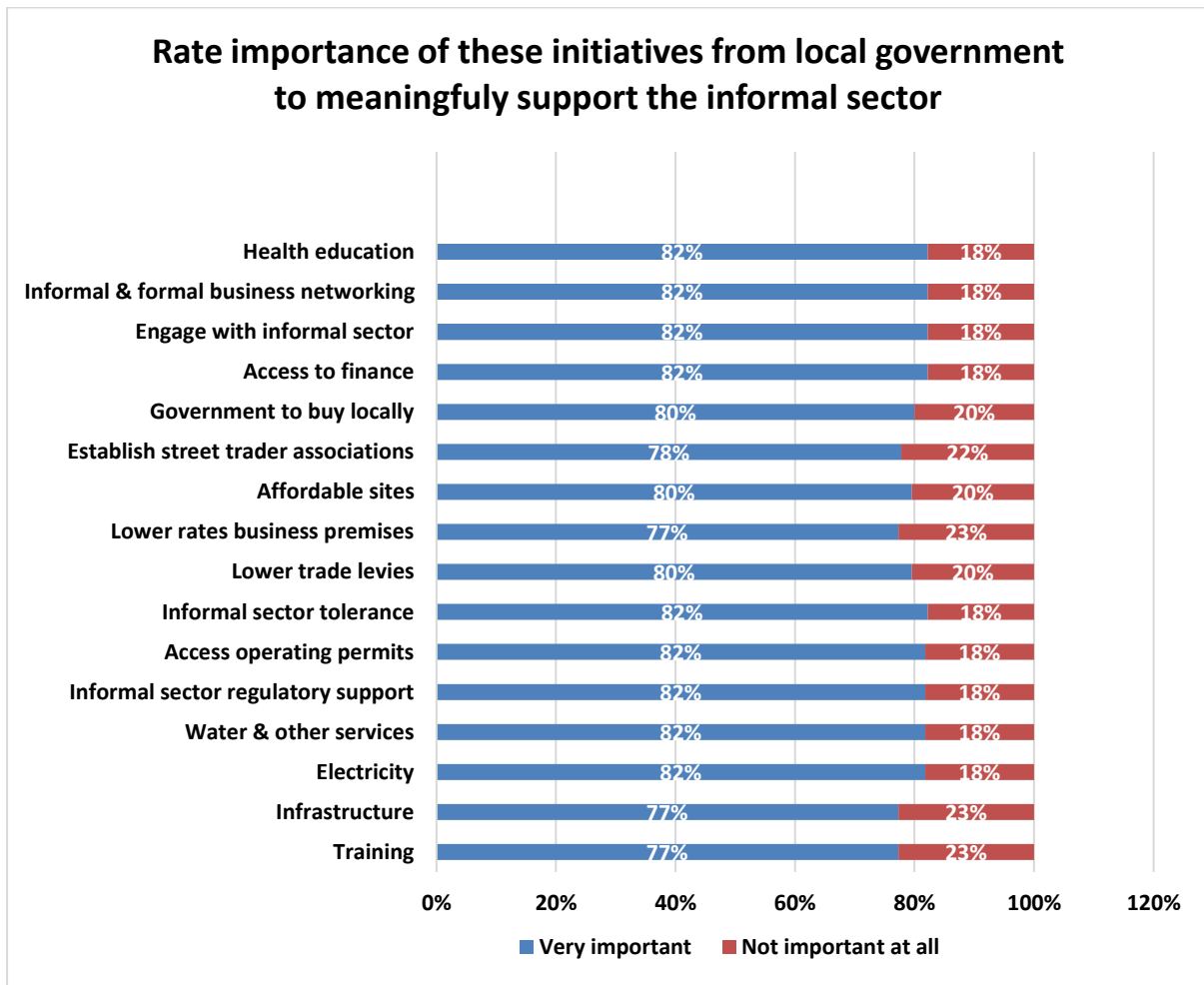


Figure 21: Meaningful support from local government to the informal sector

### **4.3 Summary**

It became clear, through the study that both the formal and informal sectors have the potential to create much needed employment and income and that an enabling environment should be created in order for both sectors to grow.

## **Chapter 5: Summary of the results and recommendation**

### **5.1 Introduction**

In Chapters four and five, a presentation and discussion of findings were made. In this chapter, conclusions will be drawn and recommendations made. The research examined that the role enterprise development can play in reducing poverty and analysed whether SMME development in the greater Drakenstein region can play in reducing poverty. These SMME's operate within wholesale and retail trade, customer services, manufacturing, agriculture in the Drakenstein area. The discussion that follows stems from the researcher's research results and is a true reflection of what is currently the case.

### **5.2 Recap of objectives of this study**

The WBCSD (2004:4) suggests that various studies undertaken, indicated that SMME's had an important role to play in reducing poverty, as well as in the global and national economies. This study has investigated and explored the objectives:

1. The reasons why government enterprise support programmes has failed to enhance enterprises, making suggestions for the way forward.
2. The role local government procurement processes can play in supporting SMME's.
3. Initiatives that Drakenstein Municipality has undertaken to support entrepreneurs in the informal sector.
4. The legislative and institutional framework for small businesses to function optimally.

## 5.3 Major Findings

### 5.3.1 Findings 1

The reasons why government enterprise support programmes has failed to enhance enterprises, making suggestions for the way forward. About 26% of business owners feel that government policy to support SMME's is not effective. In contrast to this, 38% of the sampled population feels that government policy environment is not effective to support small businesses (figure 4.2.14). As revealed in this research study and supported by the notion of the SBP (2005) study, which indicated that smaller enterprises are disproportionately impacted upon by these regulatory burdens. It should be noted that policy change is potentially the most effective economic development strategy for reducing poverty.

Furthermore, policy change for small enterprises must complement larger policy processes that support a sound macro-economic environment, the adequate provision of public services and the creation of a reliable social safety net. Broad policies for small enterprises can be most effective when they are consistent with a municipality's poverty reduction strategy. What is needed are clear simple and well-enforced rules and regulations for the creation of a conducive policy environment for the enterprise economy. Getting the policy environment right can have a major impact because it affects all enterprises throughout the economy. Enterprises, through their business associations will need to dialogue with government on the reform of the policy environment.

The process of fine-tuning the system, which has taken centuries to develop in advanced countries, should be an on-going one. Simple rules of registration allow businesses to start up quickly and to get on with the task of making goods and providing services. The level of regulation will affect whether entrepreneurs make a positive choice of entering the formal economy instead of the informal one. This study revealed that SMME's in particular are affected by these policies and laws hence are unable to comply. (Herrington, Kew & Kew, 2008:33) shares this sentiment that enterprises operate within a set of policies, laws and regulations (hereafter regulations) which is often a burden rather than supportive.



To this end, policy recommendations include: firstly there is a need to simplify the existing business regulations to reduce the administrative burden that enterprises face. This could be achieved in a relatively short space of time if the government is sufficiently committed to the reforms.

Further recommendations:

- Simplify the regulatory environment. The first step would be to appoint an expert panel to prepare a comprehensive regulatory review for small and medium-sized companies to assess whether special conditions are required. The National Government established the National Small Business Development Department, which was set up specifically to support the SMME sector in the country. In recent years, there have been initiatives and policies put in place by this department, including work which commenced in 2018 through the amendment to the Small Business Act by revising the “small business definition” ensuring that these definitions are current, relevant and applicable to the structure and nature of SMME’s thereby ensuring access to government support programmes while promoting their financial sustainability and ability to promote and create employment over the medium to long term. Regulatory Impact Assessments should be done to assess impact of new regulations.
- Policies aimed at small businesses should include targets, driven from the top with better monitoring mechanisms and a more simplistic support architecture. Policies should encompass clear targets with realistic goals and regular monitoring of these targets should be set. These targets would allow for a more coordinated support system among the various government departments and small business agencies.
- Policies should be custom made to respond to the diversity of the South African SMME sector. There are many avenues available to SMME’s to raise specific concerns, like NEDLAC and the Black Management Forum, however these have not been effective enough. SMME’s should be allowed, through organized business forums to actively participate in the drafting of legislation.
- In order to ensure an effective SMME policy environment, it is crucial that research on the SMME sector be collected, organized and analysed to avoid policy decisions that have been taken on a partial or anecdotal understanding of the characteristics and needs of SMME’s.
- Regulatory reform needs to be encouraged through the implementation of a Regulatory Impact Assessment function in the President’s Office. Regulatory impact assessments should determine the administrative and compliance cost of existing and new policies

on business.

- Introduction of a policy by DTI to enable informal businesses who aims to become formal. Registration for these entrepreneurs should be simplified in order to benefit from the policy. An internet portal should be set up for these businesses wanting to sign up to become formal. The law should reduce the number of steps and pieces of information an entrepreneur is required to follow to register and offer them lower taxation. In this regard, there are many examples in Rwanda, Singapore and Malaysia that can be applied in the South African context. In 2019, the National Department of Small Business development NIBUS (National Informal Business Upliftment Strategy) that seeks to uplift informal businesses. It is just one year after the development of the Strategy and therefore it is premature to discuss the outcomes in implementing this strategy.
- Procedural audits are needed for closely targeted reform, to observe and track direct business interactions with government departments and agencies step-by-step, so as to uncover blockages at the points where they occur. This requires a methodology similar to a ‘time and motion’ study. Procedural audits of this kind are essentially the responsibility of government. For effective and committed reform, such audits must be owned’ by the departments and agencies concerned.

### **5.3.2 Findings 2**

The role local government procurement processes can play in supporting SMME’s. The question was asked on how government could support SMME’s through its procurement processes. Education regarding government procurement processes was highlighted as one of the main ways in which government could assist businesses with. Seventy nine percent of businesses do not know how government procurement processes works (figure 4.2.11). This could be as a result of various reasons which may include among others; that fact that they do not know how the process works and they have never therefore applied for a tender. The research indicated and has been supported by Rogerson (2001) who identified skills development has one of the key supply side constraints for targeted procurement.

International best practice in relation to public procurement recommends that countries improve notifications of tenders advertised, make procurement plans more detailed and implement better compliance with policy. Recommendations would be:

- The Municipality should inform the SMME's why they were not awarded the contract. The process should not end once the tender is awarded, rather it should be coupled with a training programme for SMME's on procurement processes. The LED department in the municipality should take responsibility for training SMME's in terms of the municipality's procurement processes and procedures. SMME's should be taught how to complete procurement forms.
- Improve procurement processes through:
  - ✓ Enforcement of shorter payment cycles
  - ✓ Maintain and enforce strict procurement processes
  - ✓ Simplify tender processes and documentation through automated systems
  - ✓ Debrief SMME's on unsuccessful tender applications
  - ✓ Enforce the rotation of suppliers or sub-divide contracts to allow for sub-contracting to SMME's
  - ✓ Improve the skills and ability of government officials, provide training and monitor officials more strictly.

In recent years, the Drakenstein municipality started to implement standard operating procedures with regard to its procurement processes. The procedures stipulate amongst others the number of days within which tenders need to be evaluated and adjudicated. Training of SMME's regarding these processes remain relevant and should be ongoing.

### **5.3.2.1 Drakenstein Municipal Business Development Framework**

At the time of this study, the Municipality has developed a business development framework which is closely aligned with their LED Strategy. The framework was developed to recommend specific, practical steps to enable Drakenstein Municipality to implement a coherent and achievable business support strategy and plan. In terms of policy and approach the Drakenstein Municipality aims to:

- Make Drakenstein as business friendly as possible;
- Support the LED Unit to act primarily as a policy maker and regulator of publicly funded business support activities;

- Utilize market mechanisms to provide services to such businesses to meet certain identified needs. Drakenstein municipality works closely with key partners in the enterprise development space.

After research was conducted regarding the types of business services needed, key business development activities were identified. Developing SMME's remains critical for the Municipality although attention will also be provided to existing businesses. The approach that the municipality uses to support businesses is a service delivery approach. Bureaucracy has also been identified as an impediment to business growth when businesses deal with local authorities.

The research and in the Thornton survey, inefficient government bureaucracy or 'red tape', cited by a third of businesses as another challenge. This was further supported by the 1995 White Paper as cited in (Herrington et al, 2008:33) which identified unduly restrictive or inappropriate legislative and regulatory conditions as critical constraints on the growth and development of small businesses

These impediments include:

- ✓ Zoning applications
- ✓ Business Registration
- ✓ Application for services
- ✓ Business Licenses

The assistance provided by the municipality is customized to suit the needs of the different types of SMME's. This ensures that services provided address the specific needs of a specific type of business. From the analysis done regarding the different business development programmes, it is however unclear whether the aims as set out in the business development framework has been achieved. It is difficult to determine the success of the interventions implemented by the Municipality. Firstly, there was no clear indication as to the type of interventions that were implemented to develop SMME's except for two programmes which include the Seed Fund Programme and the Infrastructure Programme (Containers) which was provided to the informal businesses at the time of this study, therefore only these two could form part of the analysis.

The Seed Fund Programme, from the outset, was set up to be a failure. There was no proper assessment criteria applied in order to ensure that proper selection process was followed when funds were allocated. Secondly, businesses were not monitored in terms of how they spend the funds and therefore the municipality is unable to determine the success of the programme. Thirdly, some of these businesses who benefited from this programme has closed down after a while, hence they were not successful.

The Infrastructure Programme (Containers) set up for informal businesses has been criticized by many businesses. Some business owners mentioned that even though this programme had good intentions, this is only one solution to the many problems they are faced with. They were of the opinion that the programme was not well thought through and that the municipality should forge better relationships with businesses in the informal sector and start talking to them in order to understand their challenges and to devise effective strategies to support them.

### **5.3.3 Findings 3**

Initiatives that Drakenstein Municipality has undertaken to support entrepreneurs in the informal sector. Generally, the perception exist amongst respondents in the informal sector that there is absolutely no support towards businesses in this sector. As indicated earlier, as a result of the weak operating environment for business ventures in most developing countries, potential entrepreneurs resort to economic activity in the informal sector for generating income.

This both limits potential benefits for the micro-entrepreneur (e.g. Access to finance & support services) and hinders the growth of the formal sector by draining resources and reducing the tax base, competitive capacities and the economic and social resilience of people in African countries. This view is supported by the Department of Trade and Industry (2011:1) that although this sector by far the largest with 30% of the work force involved in this sector, they have little institutional support. Informal economy workers tend to have little or no access to formal mechanisms such as insurance, pensions and social assistance for coping with risks. Flexibility is enhanced through the SMME's suppleness in substituting factors of production and their ability to adjust faster to the economic shocks. Informal businesses are therefore just not resilient enough to deal with such shocks.

As indicated in Chapter 3 of the research, the informal economy is a sector that could meaningfully contribute to poverty reduction and job creation if the necessary support is provided to this sector. This has been confirmed by Stats SA in stating that the informal sector employment increased by 5, 7% or 115 000 jobs in the 2nd quarter of 2009 (Stats SA). It is a sector that could meaningfully contribute to poverty reduction and job creation if the necessary support is provided to this sector.

This is true and has also been confirmed by the World Bank that improvement of the conditions of the poor in the informal sector has thus far been minimal, despite its potential for the absorption of a large, unskilled labour force. A recommendation would be to develop an integrated approach to upgrading the informal economy which could include: enterprise upgrading, skills development, the extension of social protection, improved observance of labour laws including on safe work, and organizing workers and employers. An example is the coordinated approach to the informal economy taken by East Asian countries. These countries have started to take an integrated approach to support the informal economy.

This approach is based upon enhancement of representation and voice to empower and enable the informal economy workers and employers. Through empowerment and voice, it is about seeking to increase personal and household earnings through greater access to productive resources and markets and will attempt to reduce vulnerabilities rooted in income insecurity. This findings are supported by Hussain, Bhuiyan & Bakar (2014, 4:10), in their journal research article in which they found that, SMME's has been played an important role in the development of the economic growth of a country as well as alleviating poverty through new job creation and provide income for the people.

#### **5.3.3.1 Further recommendations for development of informal economy**

A comprehensive strategy should be formulated for assisting the informal sector, therefore a mix of following policy options may need to be considered:

- The research contends that it is almost impossible to ignore the significance of this sector in the creation of jobs in South Africa. In this context, it is imperative that government provides inter alia an enabling legislative and regulatory environment that support development. The first priority in closing the gap between formal and informal economies is the legal recognition of the informal enterprises.

- This is supported by the (DTI, 2011:1) which stated that *informality in this sector originates primarily from the cumbersome procedures and regulations*". Therefore a recommendation would be to pass legislation to formally recognize the sector. Legal recognition will ensure empowerment of businesses in the informal sector and allow them to formally bid for government contracts and supplies, obtain credit from finance institutions, enter into and enforce the business contracts that enhance business opportunities and prospect for expansion and growth with job opportunities. As indicated earlier, the National Informal Business Upliftment Strategy was developed to provide targeted support to the sector, however it is premature to discuss the results of the implementation of this strategy at this stage.
- Priority needs to be given to simplify and raise awareness about the rules. The registration and compliance to the regulatory requirements may be complex and time consuming and which need to be streamlined to reduce cost and burden, particularly for the micro enterprises with inability to cope and afford these services.

- **Building incentives for formalization:**

Incentives need to be built for stronger linkages of the informal enterprises to formal, larger enterprises. Large enterprises often work with small enterprises to benefit from tax breaks, lower costs and special incentives. Franchising and sourcing from micro businesses are critical in developing these businesses. If big businesses see the value of sourcing or franchising through small firms (most do anyhow) and realize the importance of improving productivity of their entire value chain, practical improvements in business practices as well as working conditions can take place rather quickly.

- **Scaling up marginal operations:**

Marginal, subsistence-oriented economic activities tend to remain too small and remain confined to the limited market unless steps are taken to gain a scale of economy as well as diversification. Cooperatives, and sometimes self-help organizations, are best placed in achieving the goals of up-scaling and diversification. This view is supported by the World Bank (2006:12) which stated that according to International evidence, policy towards the informal sector should be aimed at four objectives, job creation the promotion of increased output and increased production/productivity of activities in the informal sector. These businesses should be supported to form cooperatives and therefore enjoy the benefits of joint marketing, production and diversification.

- The current legislative framework for the informal sector is flawed. Trader organisations and other stakeholders should be consulted instead of confiscating peoples goods or eviction from the streets.
- This is a sector that provides an income for many people and therefore local government should play a supportive and enabling role.
- Informal trading versus informal settlements – Informal trading should be conceived in the same manner as informal settlements and the focus should be on upgrading rather than eviction and to also acknowledge the role it plays. No eviction unless alternative accommodation (economic opportunity) is provided.
- Greater participation in decision-making needed – identify creative ways to include trade organisations and traders in decision making. Create a representational system to involve street traders and officials in participatory decision-making.
- Government funding mechanism specifically targeting the informal trading sector.
- Linking the informal trading network with a network of producers in the informal sector i.e. primary producers need market outlets.
- National Policy on the informal economy, to inform provincial and local level strategies and by-laws is possibly needed.

#### **5.3.4 Finding 4**

The legislative and institutional framework for small businesses to function optimally. The Municipality has developed a business development framework which is closely aligned with their LED Strategy. The framework was developed to recommend specific, practical steps to enable Drakenstein Municipality to implement a coherent and achievable business support strategy and plan. In terms of policy and approach the Drakenstein Municipality aims to:

- Make Drakenstein as business friendly as possible to function optimally
- Support the LED Unit to act primarily as a policy maker and regulator of publicly funded business support activities
- Utilize market mechanisms to provide services to such businesses that meet certain identified needs. This is being done, however, outcomes from support needs to be made visible to the sector.



After research was conducted regarding the types of business services needed, key business development activities were identified. Developing SMME's remains critical for the Municipality although attention will also be provided to existing businesses. The approach that the municipality uses to support businesses is a service delivery approach. Bureaucracy has also been identified as an impediment to business growth when businesses deal with local authorities.

The research and in the Thornton survey, inefficient government bureaucracy or 'red tape', cited by a third of businesses as another challenge. This was further supported by the 1995 White Paper as cited in (Herrington et al, 2008:33) which identified unduly restrictive or inappropriate legislative and regulatory conditions as critical constraints on the growth and development of small businesses.

These impediments include:

- Zoning applications
- Business Registration
- Application for services
- Business Licenses

The assistance provided by the municipality is customized to suit the needs of the different types of SMME's. This ensures that services provided address the specific needs of a specific type of business. From the analysis done regarding the different business development programmes it is however unclear whether the aims as set out in the business development framework has been achieved. It was difficult to determine the success of the interventions implemented by the Municipality at the time.

Firstly, there was no clear indication as to the type of interventions that were implemented to develop SMME's except for two programmes which include the Seed Fund Programme and the Infrastructure Programme (Containers) which was provided to the informal businesses, therefore only these two could form part of the analysis. The Seed Fund Programme, from the outset, was set up to be a failure. There was no proper assessment criteria applied in order to ensure that proper selection process was followed when funds were allocated.

Secondly, businesses were not monitored in terms of how they spend the funds and therefore the municipality is unable to determine the success of the programme. Thirdly, some of these businesses who benefited from this programme has closed down after a while, hence they were not successful. The Infrastructure Programme (Containers) set up for informal businesses has been criticized by many businesses. Some business owners mentioned that even though this programme had good intentions, this is only one solution to the many problems they are faced with. They are of the opinion that the programme was not well thought through and that the municipality should forge better relationships with businesses in the informal sector and start talking to them in order to understand their challenges and to devise effective strategies to support them.

In recent years, however, the municipality has automated various services related to zoning applications, business registration on the municipality's database, business licences etc. These efforts are part of the municipality's overall economic development strategy which was developed in 2019.

#### **5.4 Sample population**

The research findings revealed that 50% of the SMME's represented constitute businesses operating in the formal sector and the remaining 50% are those operating within the informal sector. From the survey, it was evident that about 55% of the audience had a matric or no qualification at all (figure 4.2.2). This strengthens the viewpoint of Timm (2011:10), when he concluded that the sector develops due to increased unemployment, functioning as a place of last resort for those unable to get employed in the formal economy. A recommendation would be to start creating awareness among communities regarding entrepreneurship and the opportunity of gaining an income when starting your own business. This can be done by the Local Economic Development Department in conjunction with other government departments in the form of workshops, an annual SMME Indaba or where case studies can be presented by successful businesses in the area. This would stimulate interest in people to start their own businesses.

## 5.5 Reasons for starting a business

The study revealed that 14 females who participated in the study, started a business because they were unemployed or retrenched and 19 males felt that they needed to start a business (Figure 4.2.3). The research therefore revealed that they have indeed opted to start a business to escape their circumstances. This also verifies the sentiment by (Ghosh, N.D) when he concluded that (SMME's) have played a crucial role in providing an alternative pathway that is more market-oriented and spirited for poverty alleviation and income generation among the marginalized groups. Irrespective of the reasons why these people have started a business, there is no guarantee that these businesses will survive and be successful and ultimately change their life's for the better.

Since the majority of people who started businesses were unemployed or retrenched, could possibly be as a result of the fact that they do not have the necessary qualifications and experience, and are therefore unable to find employment. As a result, they felt that the only option they had was to start their own businesses. Mensah and Benedict (2010:14) supports this sentiment by arguing that some of the reasons for starting a business include unemployment or retrenchment. The possible pathway for generating employment and income among the grassroots lies in promoting the innumerable SMMEs who have the ability to achieve this objective and better the socio-economic health of the country. South Africa can draw from the experiences of Japan, China, EU and the ASIAN tigers who had taken up SMME development as a means of achieving the goals of sustainable development.

Therefore it is essential that SMME's are provided with the necessary mentorship and training to provide them with the necessary skills to operate successfully. A recommendation is to develop an adopt a business mentorship programme which could assist SMME's to gain the necessary skills to run their businesses. The Municipality developed an SMME Support Plan which was signed off by Council on 26<sup>th</sup> of March 2020. Some of the key support interventions outlined in the Plan, involves, skills development, funding opportunities, accessing markets, regulatory modernization, small business support services, SMME support through procurement and SMME incubation and innovation. This Plan is currently being implemented.

## **5.6 Profitability**

The study revealed that most participants felt that their businesses have not been profitable for the last three years (figure 4.2.5). This could be as a result of various reasons including a lack finance, need for training, marketing, access to markets, need for information and advice. Government and local government provides various SMME programs to assist SMME's with the above mentioned challenges. It will take a few years for Drakenstein municipality to assess the long term impact of the implementation of its SMME support plan, however, some short term outcomes for example the provision of SMME support services can have immediate impact.

This is supported by Lombard (2009) which states that experts in South Africa isolate education and training as South Africa's main weakness with regard to an enabling environment for entrepreneurship. Often SMME's may not know what mechanisms should be put in place for them to operate optimally. Many times, small businesses are under the impression that they need finances to make their businesses more profitable and this should not be the case. Many programmes have failed to adequately address the needs of SMME's.

For South Africa to increase economic growth and employment creation, it needs a higher proportion of entrepreneurs to progress beyond the start-up phase. There are way too many SMME support agencies and institutions offering similar types of services to SMME's. A recommendation would be that government should amalgamate these institutions and set up a Special Purpose Vehicle (SPV) to offer logistical support in four primary areas of operation including training, market access, credit and capital, entrepreneurial culture and local and sectoral development.

## **5.7 Success of business**

The research indicated that 46% of business in the informal sector agree that they are employing more people now than 2 years ago whereas 42% of respondents in the informal sector disagree with this statement (figure 4.2.5.1). Furthermore, 58% of businesses operating in the formal sector agreed that they are employing more people now than 2 years ago and 54% of businesses in the formal sector disagreed with this statement.

It is therefore evident that the formal sector is better off than businesses operating in the informal sector. This can be attributed to a number of factors. The research has indicated that although the Drakenstein economy has shown positive growth between 2005-2013, it is difficult to identify a single root cause of such jobless growth in Drakenstein, it is expected that this phenomenon was influenced by several socio-economic factors including a growing population and automation within the agriculture, manufacturing and construction sector that had a negative impact on semi-and unskilled employment levels. To this end, this is consistent with the Western Cape Provincial Treasury (2015) report and it is obvious that businesses within these sectors were bound to suffer the consequences of these factors.

Businesses in the formal sector will always be in a better position especially when applying for support services including funding, access to markets, training etc. Businesses operating in the formal sector are those people who have opted to start their own businesses because they want to be their own boss or have seen a gap in the market place and therefore want to fill that gap. Businesses operating in the informal sector are generally those who never had a formal post-matric qualification or have been searching for employment and therefore have opted to start a business as a last resort. A recommendation would be to turn attention towards market-driven business development services (BDS) with the aim of assisting small enterprises to overcome market imperfections in accessing technology, information and finance needed to operate more competitively and with greater efficiency in domestic and global markets.

Training programmes to acquire better management and marketing techniques, services for technology diffusion and acquisition. This is especially necessary in the age of artificial intelligence. Assistance in the identification of niche markets and alternative products have proven very effective in helping SMME's when those activities are too costly to be performed in-house. Such programmes are better left to meso institutions such as business centres, business associations, NGO's because they are closer to the clients and therefore, these institutions have a better idea of the needs of SMME's.

## 5.8 Informal sector support

Generally the perception exist among 77% of respondents in the informal sector that some of the challenges they faced was they did not receive any type of training (figure 4.2.9). As indicated earlier, as a result of the weak operating environment for business ventures in most developing countries, potential entrepreneurs resort to economic activity in the informal sector for generating income. This view is supported by the Department of Trade and Industry (2011:1) that although this sector by far the largest with 30% of the work force involved in this sector, they have little institutional support.

Informal economy workers tend to have little or no access to formal mechanisms such as insurance, pensions and social assistance for coping with risks. Flexibility is enhanced through the SMME's suppleness in substituting factors of production and their ability to adjust faster to the economic shocks. Informal businesses are therefore just not resilient enough to deal with such shocks. As indicated in Chapter 3 of the research, the informal economy is a sector that could meaningfully contribute to poverty reduction and job creation if the necessary support is provided to this sector. This has been confirmed by Stats SA in stating that the informal sector employment increased by 5, 7% or 115 000 jobs in the 2nd quarter of 2009 (Stats SA). It is a sector that could meaningfully contribute to poverty reduction and job creation if the necessary support is provided to this sector.

This is true and has also been confirmed by the World Bank that improvement of the conditions of the poor in the informal sector has thus far been minimal, despite its potential for the absorption of a large, unskilled labour force. A recommendation would be to develop an integrated approach to upgrading the informal economy which could include: enterprise upgrading, skills development, the extension of social protection, improved observance of labour laws including on safe work, and organizing workers and employers. An example is the coordinated approach to the informal economy taken by East Asian countries. These countries have started to take an integrated approach to support the informal economy. This approach is based upon enhancement of representation and voice to empower and enable the informal economy workers and employers. Through empowerment and voice, it is about seeking to increase personal and household earnings through greater access to productive resources and markets and will attempt to reduce vulnerabilities rooted in income insecurity.

### 5.8.1 Further recommendations for development of informal economy

**A comprehensive strategy should be formulated for assisting the informal sector, therefore a mix of following policy options may need to be considered:**

- The research contends that it is almost impossible to ignore the significance of this sector in the creation of jobs in South Africa. In this context, it is imperative that government provides inter alia an enabling legislative and regulatory environment that support development. The first priority in closing the gap between formal and informal economies is the legal recognition of the informal enterprises. This is supported by the (DTI, 2011:1) which stated that *informality in this sector originates primarily from the cumbersome procedures and regulations*”.

Therefore a recommendation would be to pass legislation to formally recognize the sector. Legal recognition will ensure empowerment of businesses in the informal sector and allow them to formally bid for government contracts and supplies, obtain credit from finance institutions, enter into and enforce the business contracts that enhance business opportunities and prospect for expansion and growth with job opportunities. As indicated in this earlier in chapter 5, in recent years, government have put in place a number of interventions, one being the development of the National Informal Business Upliftment Strategy which is currently being implemented.

- Priority needs to be given to simplify and raise awareness about the rules. The registration and compliance to the regulatory requirements may be complex and time consuming and which need to be streamlined to reduce cost and burden, particularly for the micro enterprises with inability to cope and afford these services.
- Building incentives for formalization:  
Incentives need to be built for stronger linkages of the informal enterprises to formal, larger enterprises. Large enterprises often work with small enterprises to benefit from tax breaks, lower costs and special incentives. Franchising and sourcing from micro businesses are critical in developing these businesses. If big businesses see the value of sourcing or franchising through small firms (most do anyhow) and realize the importance of improving productivity of their entire value chain, practical improvements in business practices as well as working conditions can take place rather quickly.

- **Scaling up marginal operations:**  
 Marginal, subsistence-oriented economic activities tend to remain too small and remain confined to the limited market unless steps are taken to gain a scale of economy as well as diversification. Cooperatives, and sometimes self-help organizations, are best placed in achieving the goals of up-scaling and diversification. This view is supported by the World Bank (2006:12) which stated that according to International evidence, policy towards the informal sector should be aimed at four objectives, job creation the promotion of increased output and increased production/productivity of activities in the informal sector. These businesses should be supported to form cooperatives and therefore enjoy the benefits of joint marketing, production and diversification. Part of this strategy should be based on public and private partnerships for local economic development to facilitate access to social security schemes, business opportunities and skills training.
- The current legislative framework for the informal sector is flawed. Trader organisations and other stakeholders should be consulted instead of confiscating peoples goods or eviction from the streets.
- This is a sector that provides an income for many people and therefore local government should play a supportive and enabling role.
- Informal trading versus informal settlements – Informal trading should be conceived in the same manner as informal settlements and the focus should be on upgrading rather than eviction and to also acknowledge the role it plays. No eviction unless alternative accommodation (economic opportunity) is provided.
- Greater participation in decision-making needed – identify creative ways to include trade organisations and traders in decision making. Create a representational system to involve street traders and officials in participatory decision-making.
- Government funding mechanism specifically targeting the informal trading sector.
- Linking the informal trading network with a network of producers in the informal sector i.e. primary producers need market outlets.
- National Policy on the informal economy, to inform provincial and local level strategies and by-laws is possibly needed.



## 5.9 Effectiveness of government policy

About 38% of business owners feel that government policy to support SMME's is not effective. Twenty six percent of the sampled population feels that government policy environment is not supportive to support small businesses (figure 4.2.14). As revealed in this research study and supported by the notion of the SBP (2005) study, which indicated that smaller enterprises are disproportionately impacted upon by these regulatory burdens. It should be noted that policy change is potentially the most effective economic development strategy for reducing poverty.

Furthermore, policy change for small enterprises must complement larger policy processes that support a sound macro-economic environment, the adequate provision of public services and the creation of a reliable social safety net. Broad policies for small enterprises can be most effective when they are consistent with a municipality's poverty reduction strategy. What is needed are clear simple and well-enforced rules and regulations for the creation of a conducive policy environment for the enterprise economy. Getting the policy environment right can have a major impact because it affects all enterprises throughout the economy. Enterprises, through their business associations will need to dialogue with government on the reform of the policy environment. The process of fine-tuning the system, which has taken centuries to develop in advanced countries, should be an on-going one. Simple rules of registration allow businesses to start up quickly and to get on with the task of making goods and providing services.

The level of regulation will affect whether entrepreneurs make a positive choice of entering the formal economy instead of the informal one. This study revealed that SMME in particular are affected by these policies and laws hence are unable to comply. (Herrington, Kew & Kew, 2008:33) shares this sentiment that enterprises operate within a set of policies, laws and regulations (hereafter regulations) which is often a burden rather than supportive. To this end, policy recommendations include: firstly there is a need to simplify the existing business regulations to reduce the administrative burden that enterprises face. This could be achieved in a relatively short space of time if the government is sufficiently committed to the reforms.

Further recommendations:

- Simplify the regulatory environment. The first step would be to appoint an expert panel to prepare a comprehensive regulatory review for small and medium-sized companies to assess whether special conditions are required. This includes regulations in relation

to business registration, tax, labour and local government. Regulatory Impact Assessments should be done to assess impact of new regulations. Amendments to the definition of “small businesses” is a step in the right direction as indicated earlier in Chapter 5. Policies should be custom made to respond to the diversity of the South African SMME sector. There are many avenues available to SMME’s to raise specific concerns, like NEDLAC and the Black Management Forum, however these have not been effective enough. SMME’s should be allowed, through organized business forums to actively participate in the drafting of legislation.

- Policies aimed at small businesses should include targets, driven from the top with better monitoring mechanisms and a more simplistic support architecture. Policies should encompass clear targets with realistic goals and regular monitoring of these targets should be set. These targets would allow for a more coordinated support system among the various government departments and small business agencies.
- In order to ensure an effective SMME policy environment, it is crucial that research on the SMME sector be collected, organized and analysed to avoid policy decisions that have been taken on a partial or anecdotal understanding of the characteristics and needs of SMME’s.
- Regulatory reform needs to be encouraged through the implementation of a Regulatory Impact Assessment function in the President’s Office. Regulatory impact assessments should determine the administrative and compliance cost of existing and new policies on business.
- Introduction of a policy by DTI to enable informal businesses who aims to become formal. Registration for these entrepreneurs should be simplified in order to benefit from the policy. An internet portal should be set up for these businesses wanting to sign up to become formal. The law should reduce the number of steps and pieces of information an entrepreneur is required to follow to register and offer them lower taxation. In this regard, there are many examples in Rwanda, Singapore and Malaysia that can be applied in the South African context.
- Procedural audits are needed for closely targeted reform, to observe and track direct business interactions with government departments and agencies step-by-step, so as to uncover blockages at the points where they occur. In effect this requires a methodology similar to a ‘time and motion’ study. Procedural audits of this kind are essentially the responsibility of government. For effective and committed reform, such audits must be owned’ by the departments and agencies concerned.

- Establishing a Permanent Forum for Small, Medium and Micro enterprises which would enable members from the private sector and the government to discuss challenges specifically related to the SME sector and to together develop solutions.

### 5.10 Effectiveness of SMME programmes

It is interesting to have observed that 39% of business owners feel that SMME programmes are not effective and only 2% feel that SMME programmes are effective (figure 4.2.13). These can be attributed to various reasons. There are indications that originally well-intended policy measures suffer from sub-optimal implementation. General distrust of external agencies among SMME's, on the one hand and the incapacity of support institutions to persuasively raise awareness about their existence and effectiveness on the other, are said to be at the heart of the problem. The Committee of Donor Agencies for Small Enterprise Development (n.d) supports this and asserted that support for small enterprises should be based on a private sector led market economy framework. Moreover, the poor coordination of service providers results in a replication of services and clustering of institutions in urban areas:

Specific interventions that can be pursued by local authorities:

- Municipalities should distinguish between the different categories of SMME's that operate locally and develop suitable support strategies for them.
- Any form of support offered by the municipality must be coordinated or consolidated with similar services from other spheres of government available in the same area. Disjointed support activities dilute the overall impact and create barriers between the public sector and businesses.
- It is recommended that municipalities involve specialised partners, such as local universities, NGO's and trade organisations, in support services.
- The municipality could invest in advisory centres for micro and very small businesses and facilitate technical support and training of business owners and employees. As indicated earlier, an SMME Support Plan was signed off by the Drakenstein Council on 26<sup>th</sup> of March 2020 which is currently being implemented.
- Business support services can be decentralised and made more accessible through one-stop-shops located in disadvantaged communities.
- The administrative burden from regulatory compliance could be reduced through direct assistance in filling out forms when start-up register for municipal services or apply for

licences or permits. Such support services would need to be advertised extensively in order to have the desired level of utilisation. The Drakenstein municipality implemented an automated system which businesses can use. The aim is to lessen the administrative burden for SMME's and businesses in general. Many of the municipality's have been shortened by the use of this automated system.

### 5.11 Tender support

The following statements was made: knows how government procurement processes works and have used procurement processes before. Seventy nine percent of participants indicated that they do not know how procurement processes works and eighty one percent of participants indicated that they have not used government procurement processes before (figure 4.2.12).

This could be as a result of various reasons which may include among others; that fact that they do not know how the process works and they have never therefore applied for a tender. The research indicated and has been supported by Rogerson (2001) who identified skills development has one of the key supply side constraints for targeted procurement. This could be due to the fact that many of the business owners in the informal sector has had limited or no schooling and probably are unable to read or write. International best practice in relation to public procurement recommends that countries improve notifications of tenders advertised, make procurement plans more detailed and implement better compliance with policy.

Recommendations would be:

- The Municipality should inform the SMME's why they were not awarded the contract. The process should not end once the tender is awarded, rather it should be coupled with a training programme for SMME's on procurement processes. A department or division within the municipality should be established to take responsibility for training SMME's. SMME's should be taught how to complete procurement forms.
- Improve procurement processes through:
  - ✓ Enforcement of shorter payment cycles
  - ✓ Maintain and enforce strict procurement processes
  - ✓ Simplify tender processes and documentation through automated systems
  - ✓ Debrief SMME's on unsuccessful tender applications

- ✓ Enforce the rotation of suppliers or sub-divide contracts to allow for sub-contracting to SMME's
- ✓ Improve the skills and ability of government officials, provide training and monitor officials more strictly.

### **5.12 Drakenstein Municipal Business Development Framework**

The Municipality has developed a business development framework which is closely aligned with their LED Strategy. The framework was developed to recommend specific, practical steps to enable Drakenstein Municipality to implement a coherent and achievable business support strategy and plan. In terms of policy and approach the Drakenstein Municipality aims to:

- Make Drakenstein as business friendly as possible
- Support the LED Unit to act primarily as a policy maker and regulator of publicly funded business support activities
- Utilize market mechanisms to provide services to such businesses that meet certain identified needs. Drakenstein itself should not seek to provide point of delivery business development services itself, but work with key partners in the enterprise development space.

After research was conducted regarding the types of business services needed, key business development activities were identified. Developing SMME's remains critical for the Municipality although attention will also be provided to existing businesses. The approach that the municipality uses to support businesses is a service delivery approach. Bureaucracy has also been identified as an impediment to business growth when businesses deal with local authorities.

The research and in the Thornton survey, inefficient government bureaucracy or 'red tape', cited by a third of businesses as another challenge. This was further supported by the 1995 White Paper as cited in (Herrington et al, 2008:33) which identified unduly restrictive or inappropriate legislative and regulatory conditions as critical constraints on the growth and development of small businesses

These impediments include:

- ✓ Zoning applications

- ✓ Business Registration
- ✓ Application for services
- ✓ Business Licenses

The assistance provided by the municipality is customized to suit the needs of the different types of SMME's. This ensures that services provided address the specific needs of a specific type of business. From the analysis done regarding the different business development programmes it is however unclear whether the aims as set out in the business development framework has been achieved. It is difficult to determine the success of the interventions implemented by the Municipality. Firstly, there was no clear indication as to the type of interventions that were implemented to develop SMME's except for two programmes which include the Seed Fund Programme and the Infrastructure Programme (Containers) which was provided to the informal businesses, therefore only these two could form part of the analysis.

The Seed Fund Programme, from the outset, was set up to be a failure. There was no proper assessment criteria applied in order to ensure that proper selection process was followed when funds were allocated. Secondly, businesses were not monitored in terms of how they spend the funds and therefore the municipality is unable to determine the success of the programme. Thirdly, some of these businesses who benefited from this programme has closed down after a while, hence they were not successful.

The Infrastructure Programme (Containers) set up for informal businesses has been criticized by many businesses. Some business owners mentioned that even though this programme had good intentions, this is only one solution to the many problems they are faced with. They are of the opinion that the programme was not well thought through and that the municipality should forge better relationships with businesses in the informal sector and start talking to them in order to understand their challenges and to devise effective strategies to support them.

### 5.13. Conclusion

#### **Limitations of the study: Recommendations for future studies**

The research attempted to identify and address some of the challenges faced by businesses in both the formal and informal sector. Businesses in both these sectors do indeed have the potential to expand and create employment and therefore support for SMME's should be prioritized. However, the researcher has indicated in the study that the informal sector in itself is a very complex sector and requires more in-depth analysis in order to better understand it and to develop strategies to adequately address the challenges.

The research attempted to investigate the role and contribution that small and micro enterprises could play in eradicating poverty. SMME's play a significant role in the development of industries and economies. It has been determined that they do not only play an important role in introducing new products and new techniques into the market, but they also contribute to the reduction of poverty through the creation of jobs. Very often people are unable to find jobs in the formal economy and then decide to start a business to earn an income.

SMME's including those operating the informal sector, have been identified as a high potential sector for employment generation and provision of livelihood to millions of people in several countries. SMME sector makes a tremendous contribution to the economy. Such contributions have multiple facets and dimensions. SMMEs generate new jobs in the economy and, thus, contribute positively to employment generation and poverty reduction. Further, it is claimed that this additional employment comes with relatively low investments in capital compared to the large enterprises, and therefore, has a lot of relevance for those economies that are characterized by surplus labour and paucity of capital.

This study have examined an expanded database of firms in the formal and informal sector in the Drakenstein Municipal area. The study begins with the hypothesis that enterprise development is a mechanism for poverty reduction in South Africa. The research suggests that there is growing pressure on government to support SMME's and to create an enabling environment for enterprises to function optimally.

This study explored the role of micro, small, and medium enterprises in the reduction of poverty in the Drakenstein Municipal area using a database of firms in the formal and informal economy. The study finds evidence of a causal connection between firms which have been

operating in an environment which is supportive for the growth of SMME's and the firm's ability to expand and create jobs. Research studies conducted previously have assessed the potential of SMME's in contributing to job creation.

A Finmark Trust Finscope 2010 survey, as cited in Timm (2011) found that 2,5 million jobs can be created by small businesses by 2020. This study also indicated that 500 000 people could be taken off the social grant schemes, if small businesses are actively supported by government. The achievements and impact of government interventions have largely been unsuccessful to meaningfully grow and develop small businesses. This study therefore investigated to what extent the role of enterprise development can address poverty reduction at local government level and specifically Drakenstein Municipality.

The researcher then formulated the following hypotheses:

- 1) Enterprise development has a meaningful role to play in addressing poverty;
- 2) For small and micro enterprises to grow, more needs to be done to support SMME's with due regard to the effectiveness of SMME support programmes and support network of Drakenstein Municipality; procurement processes of Drakenstein Municipality to support SMME's; type of support to the informal business sector and the legislative environment to support entrepreneurs.

In order to test the hypotheses, detailed analyses were carried out at five levels:

- a) The extent to which enterprise development has advanced socio-economic challenges in the Drakenstein region;
- b) The reasons why government enterprise support programmes has failed to enhance enterprises , making suggestions for the way forward;
- c) The legislative and institutional framework for small businesses to function optimally;
- d) The role local government procurement processes can play in supporting SMME's;
- e) At the micro-level, the study examined initiatives Drakenstein Municipality has undertaken to support entrepreneurs in the informal sector.

The current report presents the results of the micro-level research. The main research question related to the role of enterprise development in the reduction of poverty: Are the current SMME support mechanisms effective for the growth and development of SMME's? These are the



questions the present study explores through a systematic examination for a direct link between poverty reduction and the prevalence of micro, small, and medium enterprises in the formal and informal economy. These SMME's operate within wholesale and retail trade, customer services, manufacturing, and agriculture in the Drakenstein area.

To pursue this empirical analysis, this study builds on the analysis of Koshy & Prasad (n.d:1) on the role of SMME's for employment generation and the provision of livelihood to millions of people in several countries. Consequently, this study goes even further to investigate the support environment for SMME's. Furthermore, the conclusions of this study does not, on its own, make a definitive case for or against small, medium and micro enterprises. It simply offers a case of the contribution of micro and small enterprises to contribute to poverty reduction in developing economies. It became clear across both informal and formal sectors that the main reason why people have started a business was because they were retrenched or unable to find a job. From the results, it can be said that starting a business prevented these people from falling into the poverty trap.

At a macro-level, SMME's in both formal and informal economy felt that government policy is not effective to support SMME's. The general trend among SMME's in both informal and formal sectors was that they were not aware and have never used the identified government support programmes for SMME's. In this regard, the conclusion can be made that the reason why these SMME's have never used these government support programmes is because they were unaware that it existed. From the interviews conducted, the study indicated that there were very little trust between municipal officials and the local business organisations. There is also a general trend in both sectors indicating that SMME's do not know how the government procurement processes work. Although the researcher does not advocate government procurement as a means to grow SMME's, it does provide an opportunity for SMME's to increase their income streams.

The study has indicated that it is difficult for supply chain officials from the Drakenstein municipality to assist SMME's because their work is guided by legislation. The results indicated that it is only SMME's in the formal sector which experienced an increase in their turnover over a period of two years, but the same cannot be said about SMME's in the informal sector. The results also indicated that there is very little support provided by Drakenstein Municipality towards businesses in the informal sector. Furthermore, the study indicated that

businesses in the formal sector are better off financially than businesses in the informal sector. Although, the study was not meant to conduct an in-depth analysis of the informal sector, the study confirmed most of the assumptions made by the researcher.

It is clear that the environment to support SMME's is not conducive for the growth and development of these businesses. The golden thread is that businesses in the informal sector require much more support to ensure they are able to grow. Generally, SMME's in both sectors has the potential to grow if they are provided with the necessary support.

## Annexure A: Questionnaire

### Ethical Statement

In undertaking this research, the researcher has consulted the ethical guidelines of Cape Peninsula of Technology in order to ensure that this study meets the acceptable ethical guidelines. The researcher undertakes to abide by the Code of Research Ethics of Cape Peninsula University of Technology. Participants in the survey will know they are taking part in this research and the research will be carried out with their consent. This consent is voluntary and will be based on an adequate understanding of the survey. The anonymity of the research subjects will be respected, no pressure will be put on subjects to complete this survey and the confidentiality of participants will be respected. In order to give participants a clear understanding of the study we provide a:

- Letter of invitation to participate from Prof Andre Slabbert from Cape Peninsula University of Technology.
- Verbal overview of the study by the researcher, Cheryl Gordon (Persensie).

### Questionnaire

#### Section 1- General Business Information

##### 1. Are you the:

Owner	
Manager	
Owner/Manager	
Other (specify)	

##### 2. Gender

Male	
Female	

##### 3. Historical racial category

African	
Coloured	
White	
Indian/Asian	
Other	

##### 4. For how long has your business been in operation?

0 - under 25 months	
25 - under 60 months	
60 - under 90 months	
90 months or more	

##### 5. What is your highest formal educational qualification?

Matric/Grade 12 or less		Master's degree	
Certificate/Diploma		Doctorate	
Bachelor's degree		Other	
Honours degree			

**6. Major reasons for SMME establishment**

Joblessness retrenchment	or	
Need for income		
Desire to be own boss		

**7. In which economic sector would you classify your business (mark with X) Please only tick one:**

Agriculture		Community, social and personal services	
Manufacturing		Forestry & Fishing	
Finance		Customer services	
Business services		Government services	
Wholesale and retail trade		Other (please specify)	

**8. Premises/site where you operate from**

Formal premises	
Home	
Structure build at the back of home	
Operating on the street pavement	
Informal site	
Allocated land	
Other	

<b>9. Success of business</b>	
	Strongly agree
	Agree
	Disagree
	Strongly disagree

9.1 My business has been profitable during the last financial year				
9.2 My business has grown over the past three years				
9.3 The profit has been increasing over the past three years				
9.4 I make enough money to live comfortably				
9.5 My business is employing more people now than two years ago				
9.6 The turnover/sales of my business have increased over the past two years				
9.7 My business is not successful				

**10. How many people do you employ?**

5 or fewer employees	
6 - 20 employees	
21- 50 employees	
51 - 200 employees	
More than 200 employees	

**11. How effective, do you think, is the government policy environment to support SMME's?**

**12. Knowledge of Government SMME support programmes (only tick those you are aware of or have used)**

<b>Which Government SMME support programmes are you familiar with</b>	<b>I AM AWARE OF IT</b>	<b>I HAVE USED IT</b>
12.1 SETA'S		
12.2 IDC		
12.3 Competitiveness Fund		
12.4 Ntsika		
12.5 Export incentives		

12.6 Manufacturing Advisory Centres		
12.7 KHULA		
12.8 BRAIN		
12.9 Umsobumvo		
12.10 Business Place		
12.11 Tourism Enterprise Partnership		
12.12 Red Door		
12.13 SAMAF (South African Micro Finance Fund)		

<b>13. Please rate SMME support programme in question 12 that you are aware of (or have used) for your company</b>	<b>Poor</b>	<b>Satisfactory</b>	<b>Good</b>	<b>Excellent</b>
13.1. SETA'S				
13.2. IDC				
13.3. Competitiveness Fund				
13.4. Ntsika				
13.5. Export incentives				
13.6. Manufacturing Advisory Centres				
13.7. KHULA				
13.8. BRAIN				
13.9. Umsobumvo				
13.10. Business Place				
13.11. Tourism Enterprise Partnership				
13.12. Red Door				
13.13 SAMAF (South African Micro Finance Fund)				

<b>14. How did you find out of the government SMME programmes for SMME'S?</b>	<b>YES</b>	<b>NO</b>
14.1 Referral's by friends and relatives		
14.2 Over the radio		
14.3 Television advertisement		
14.4 From the Department of Trade and Industry		
14.5 Other		

**15. How effective, do you think, is the government SMME support programmes?**

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<b>16. If you have received government support through its SMME support programmes, please rate the assistance you have received.</b>	Strongly Agree	Agree	Disagree	Strongly disagree
16.1 SMME Support programmes are not relevant to me				
16.2 I find it difficult to reach the right people in order to access support programmes				
16.3 The assistance which is provided to us isn't enough				
16.4 Assistance provided through SMME support programmes is taking too long				
16.5 I received the support I needed				

<b>17. What support is Drakenstein Municipality providing to the informal businesses? (Please explain fully)</b>


<b>18. Needs experienced when starting my business included:</b>	Strongly Agree	Agree	Disagree	Strongly Disagree
18.1 The business registration application forms were not in my local language				
18.2 I needed business & management skills				
18.3 I needed assistance in accessing finance				
18.4 I needed access to legal services				
18.5 I needed assistance on how to negotiate				
18.6 I needed assistance with marketing				
18.7 I needed training on financial management & planning				

<b>19. Which of the following obstacles have you experienced when applying for a support programmes? More than one option can be chosen</b>	
19.1 Access to information, advice and support networks	
19.2 Access to markets	
19.3 Government tender and export opportunities	
19.4 Access to finance	
19.5 Infrastructure facilities	
19.6 Legal and regulatory conditions	
19.7 Access to skills and technology	

**20. Have you ever used government tender processes?**

YES	NO

**21. Do you know how government tender processes works?**

YES	NO

**22. How could government support SMME's through tender contracts?**



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<b>23. Please indicate your challenges as an informal business</b>	Strongly Agree	Agree	Disagree	Strongly Disagree
23.1 I have had no training				
23.2 I need assistance to get more clients				
23.3 I need access to infrastructure and services				
23.4 I need access to finance				
23.5 I need an affordable site to operate				
23.6 I need a permit to operate				
23.7 Other, please specify:				

<b>24. Please rate the importance of the following initiatives from local government to provide meaningful support to the informal economy?</b>	Very important	Important	Not important	Not important at all
24.1 Training for informal traders				
24.2 Provision of infrastructure facilities (hawking stalls, ablution/toilet facilities) to assist informal business				
24.3 Provision of electricity				
24.3 Provision of water and other services				
24.4 Flexible regulatory support for informal economy				
24.5 Flexible process for informal businesses to access operating permits				
24.6 Tolerance towards the informal economy				

24.7 Lower trade levies				
24.8 Lower rates for business premises				
24.9 Allocation of street trading sites to be done in a fair and transparent manner				
24.10 Affordable site rentals				
24.11 Establishment of street trader and informal business associations				
24.12 Assess processes of government to buy locally				
24.13 Addressing access to finance for the sector				
24.14 Talk to informal businesses to identify their challenges				
24.15 Promote business networking between informal and formal businesses				
24.16 Health education to ensure good standards of environmental health, public health and occupational health is maintained				

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