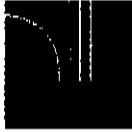


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**SOCIO-ECONOMIC TRANSFORMATION IN SOUTH AFRICA
BLACK ECONOMIC EMPOWERMENT AND SMALL, MEDIUM
AND MICRO ENTERPRISES**

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"Black Economic Empowerment" (BEE) in South Africa

This Working Paper series includes revised versions of papers that were presented at the workshop 'To BEE or not to BEE: South Africa's Black Economic Empowerment (BEE), Corporate Governance and the State in the South'. The workshop took place on 25-26 June 2006 at the Danish Institute for International Studies (DIIS) in Copenhagen with financing from the Danish Research Council on Society and Business (FSE) and DIIS. The papers do not constitute any official DIIS position on the subject. They can be downloaded free from www.diis.dk. For more information, please contact Stefano Ponte (spo@diis.dk).

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Abstract

Economic and social transformation of post apartheid South Africa has been a central goal for the democratic regime but broad empowerment of the majority of black South Africans is yet to take place. Small, Medium and Micro Enterprises (SMMEs) have been recognized as central for economic growth and transformation since the mid-1990s, and have developed under an economic framework influenced by the state's transformation strategies, particularly Broad-Based Black Economic Empowerment (BBBEE). Yet, little research is available on the opportunities and challenges faced by SMMEs in the context of the BEE strategy, and on their potential contribution for socio-economic transformation. This paper aims to enrich this debate by looking at the synergies between SMMEs and the BEE strategy, and by examining the potential that SMMEs hold to facilitate BEE. While acknowledging the limitations of the data available, the overall conclusion is that positive interactions between the SMME and BEE frameworks can contribute to the empowerment of more disadvantaged South Africans and therefore to meaningful socio-economic transformation.

SMMEs will play a prominent role in the second decade of our democracy and beyond as we seek to accelerate economic growth, reduce unemployment and bridge the gap between the first and second economies.

Trade and Industry minister Mpahlwa,
cited in *Sowetan*, 20 September 2005

Introduction

South Africa has embarked on a major socio-economic transformation over the last 12 years to achieve social equality and overcome the legacy of racial discrimination against the black majority left by the apartheid regime. Economic transformation, which has been pursued through a broad institutional framework, has led to the emergence of a visible black middle class in the country over the last decade. Nevertheless, change has been limited, and the great majority of black South Africans still remain marginalized – demonstrating that major improvements need to be made if significant transformation is to be achieved.

Since 2003, substantial adjustments have been made to what is now called the Broad-Based Black Economic Empowerment (BBBEE) policy framework.¹ In his State of the Nation address, President Mbeki underlined the importance of smaller businesses within the Black Economic Empowerment (BEE) strategy and identified them as important engines for economic growth and transformation. Yet, little research is available on the opportunities and challenges that Small, Medium and Micro Enterprises (SMMEs) face within this process. This paper analyzes the potential contributions of these enterprises to achieving the socio-economic goals of BEE. Central questions to be tackled include: Is the SMME framework properly geared to support the sector and to advance the goal of broad empowerment and transformation? Are the elements of the BEE strategy obstructing or aiding this process? Can the majority of black South Africans who remain poor and marginalized be empowered through the development of SMMEs?

To address these questions, the paper summarizes the BEE strategy in relation to SMMEs' institutional framework, and elaborates on the links between the two. It provides a general picture of small businesses in South Africa by identifying their characteristics and the main challenges faced by entrepreneurs. It also discusses the role of both public and private actors in this context. Finally, it discusses the overall impact of empowerment policies on SMMEs in South Africa and the possibilities of achieving broader transformation.

While acknowledging the limitations of the data available and recognizing that broader research is needed within the field, the main conclusion reached is that positive interactions between the recently adjusted SMME and BEE frameworks could contribute to the empower-

¹ See BEE Commission (2001) and Broad Based Black Economic Empowerment Act (2003).

ment of more disadvantaged black South Africans if certain conditions are in place. The central argument is that the newly-adjusted BEE strategy has the potential to contribute to broader empowerment in several ways. First, compliance with BEE requirements can encourage procurement from – and development of – SMMEs. This is likely to translate into a broader distribution of economic benefits. Second, given that both BEE regulation and the SMME framework encourage the development of SMMEs, an expected growth of the sector can result in increased employment, skills development and economic growth. Finally, since Corporate Social Investment (CSI) initiatives are now further encouraged under new regulation, they may provide support and opportunities to disadvantaged communities and individuals who are not usually beneficiaries of developments in the formal economy. In this regard, the new BEE framework may facilitate links between the so called first and second economies, with SMMEs playing an important role in this process.

The Black Economic Empowerment (BEE) Strategy

The 1994 elections in South Africa marked the end of white minority rule and the beginning of a new era of political, economic and social transformation in the country. While political power shifted from white to black hands without the major social disruptions that many had expected, the economy remained widely dominated by the white minority, and socio-economic transformation soon proved to be a major challenge. The newly elected government, under the leadership of the African National Congress (ANC) was committed to altering the racial patterns characterizing the economy, and a broad range of policies and institutions were set in place to guide economic transformation. It was clear that an active approach to transformation was needed if substantive changes were to take place. Although the framework has been adapted over the years and up until now guidelines and regulations are still being adjusted, government has remained committed to the process.

The strategy of Black Economic Empowerment (BEE) has been the cornerstone of this process. It was designed to overcome the racial and social divide left by the apartheid regime. Its specific aim has been to promote the advancement of blacks within the economy. Interventions to achieve racial transformation of the economy have been pursued with determination since 1994. The legal and policy frameworks have moved from a largely persuasive approach

to a more assertive one. Specific aims of the BEE strategy include the development of a visible black middle class, the improvement of skills within the black population, and increasing black ownership and management in the economy. According to the legislation in place, Black Economic Empowerment is to be a broad-based and inclusive process, guided by good governance, and linked to a sustainable growth strategy (Deutsche Bank, 2006).

To achieve its aims, the BEE strategy entails the use of legislation, regulation, the restructuring of state-owned enterprises, preferential procurement, partnerships, financial assistance and skills development programmes. Although the strategy has been mainly government-driven, the private sector has become more involved throughout the years, particularly through the formulation of industry transformation charters. These charters are to serve as guidelines for companies operating in a range of sectors and, as will be discussed in more detail, are guided by a set of rules developed by government, particularly the generic scorecard for transformation.

All in all, there are at least 24 laws as well as policy and regulatory provisions dealing with empowerment. They cover more than ten sectors, nine gambling boards, ten government tender boards, tender boards of state enterprises, a marine council, broadcast and telecommunication authorities, small business promotion bodies, a privatisation fund and labour relations institutions (Businessmap, 2006). Some of these provisions include: the Employment Equity Act (1998), which requires employers to implement affirmative action in favor of Previously-Disadvantaged Individuals (PDIs) to ensure equitable representation at the workplace; the Preferential Procurement Policy Framework Act of 2000, which provides a framework to encourage procurement from empowered entities; and the Skills Development Act (1998), which provides an institutional framework for improving the skills of the South African workforce (Bezuidenhout et al., 2005).

IN SEARCH OF MEANINGFUL TRANSFORMATION: BECOMING BROAD-BASED

In the 1990s, BEE focused mainly on the transfer of ownership to black hands. Therefore, only a handful of individuals seemed, at least in the public eye, to be benefiting from the process. BEE tended to be seen as a narrowly-based strategy, and it became the focus of growing criticism and dissatisfaction. Government was forced to review the policy, renaming it 'Broad-based Black Economic Empowerment', and the President called on society as a whole to become more engaged with it. Government institutions in particular were encouraged to employ all their legislative leverage and buying power to force the pace of change. De-

partments at all levels of government were expected to implement the strategy and the Department of Trade and Industry (DTI) was allocated the leading role. Several mechanisms and institutions were created or adapted to serve the new approach to empowerment and two main institutions, the National Empowerment Fund Trust (NEF) and the Industrial Development Corporation (IDC) were geared for guiding transformation. The NEF, which had been established in 1998 by the National Empowerment Fund Act to promote and facilitate ownership of income-generating assets by historically disadvantaged persons (HDPs),² was boosted. The IDC, a state corporation established in 1940 and utilized under apartheid to promote Afrikaner empowerment, was restructured to serve the government's objectives by providing finance to advance black empowerment in the industrial sector (Bezuidenhout et al., 2005).

Overall, the framework became more comprehensive and the scope of transformation was broadened following the publication of the BEE strategy by the Department of Trade and Industry (the DTI) in 2003, the approval of the Broad-Based BEE Act in 2004, and more importantly with the release of the Codes of Good Practice in late 2005. The Broad-Based Empowerment Act established a legislative framework for the promotion of BEE with the main objective of facilitating the process through a national policy. It promoted the formulation of codes of good practice, the publication of transformation charters and established the Black Economic Empowerment Council. The Council is to advise on BEE related issues, review progress and achievements and facilitate partnerships. Broadly speaking, the strategy identified three kinds of components and beneficiaries (see Table 1).

Table 1: Components and Beneficiaries of BEE

Component	Beneficiary
Direct Empowerment	Equity holders, executives and other owners and managers of economic resources
Human Resource Development	Employees and job seekers
Indirect Empowerment	Suppliers, communities and other relevant external stakeholders

Source: Department of Trade and Industry. The Codes of Good Practice on Broad-Based Black Economic Empowerment. 2004

² HDPs are defined as persons or categories of persons who, prior to the adoption of the 1996 Constitution, were disadvantaged by unfair discrimination on the basis of their race. This is a narrower definition to that of PDI's, which includes those persons previously disadvantaged by unfair discrimination on grounds of gender and disability as well as race.

The BB-BEE codes of good practice, which were released for public comment in 2005, were drafted to serve as guidelines for the implementation of the Broad-Based Black Economic Empowerment Act. They bring together the government's transformation strategy in a coherent and consistent way across all industries, something that had been missing over the previous decade (Deutsche Bank, 2006). They also include a Generic Scorecard aimed at guiding the measurement of empowerment across all sectors of the economy as in Table 2.

Table 2: The Generic Scorecard

Element	Weighting
Ownership	20%
Management and Control	10%
Employment Equity	10%
Skills Development	20%
Preferential Procurement	20%
Enterprise development	10%
Residual (Social Development and & Industry Specific Factors)	10%

Source: DTI

Although direct empowerment through ownership and management has remained a central element of the scorecard, the new strategy reflects a broader understanding of transformation by highlighting the importance of developing human resources and related aspects. The first phase of the codes released in November 2005 dealt mainly with the measurement of ownership and management and control elements of the scorecard. The second phase, released in December 2005, dealt with the elements of employment equity, skills development, preferential procurement, enterprise development, the residual element (industry-specific and corporate social investment initiatives) and also included a section on the so called Qualifying Small Enterprises (QSE). The codes were open for public comment until 31st March 2006 and are expected to be gazetted before the end of 2006.

The scorecard approach has encouraged the voluntary development of industry transformation charters across a wide range of sectors. These charters establish clear indicators for companies and serve as guidelines for empowerment requirements. Since the early years of empowerment, 19 charters have been developed. Although they established their own guidelines before the codes existed, they are now expected to be amended and aligned with the codes in order to be gazetted. These charters are only binding for their private sector

signatories, but once gazetted they will also become binding on the public sector (Deutsche Bank, 2006).

The charters have given more certainty to the transformation process and have enabled companies to measure their own progress in BEE terms by establishing more specific benchmarks. Following the guidelines set by the particular industry charters, the BEE status of any company can be determined through a points system of qualification. Although different organizations currently provide services to determine the BEE status of companies, they follow different measurement procedures and no institution has been recognized as an accreditation agency. This is expected to change with the implementation of the codes.

The adjustments made to BEE over recent years illustrate the complicated nature of transformation. It has been a slow process, and economic players have been frustrated with the constantly changing operational environment. Their hope is that once the codes become fully operational, BEE compliance will be easier. Implementation still faces several challenges such as the shortage of skills, administrative costs, maintaining investor confidence, and financing. The government's target is to transfer 25% of formal economic wealth to black people over the next 10 years. An estimated R1.3trn will be needed for this, and finding the money and developing the appropriate financial schemes will be a major challenge (Deutsche Bank, 2006).

Although a portion of the previously-disadvantaged population has advanced in the economy since 1994 and a black capitalist class has become increasingly visible, the vast majority of black South Africans remain poor, uneducated and un- or under-employed. Gross inequalities still characterize both South African society and economy. The income gap within the black population has widened. The transfer of wealth has been narrow and the Gini coefficient has increased from 0.56 in 1995 to 0.64 in 2005. While the coefficient varies by race, the rise in the national figure is driven by the widening income gap within the black population, which rose from 0.50 to 0.62 (Deutsche Bank, 2006). Although many black South Africans increased their quality of life, many others became worse off. According to the Living Standard Measure (LSM), by 2004 black people still remained a minority group at the higher levels of standard of living (*Mail and Guardian*, Johannesburg, 11 September 2003). Therefore, despite the government's commitment to transformation and apparent will to empower the majority of disadvantaged individuals and communities, broad empowerment is yet to be seen.

Small, Medium and Micro Enterprises in South Africa

Despite the importance of SMMEs within the South African economy, there seems to be no universally applicable definition. More importantly however, is that the term 'SMME' captures a broad and diverse range of enterprises. Indeed, within the definition of SMMEs, basic survivalist initiatives and highly organized enterprises are included – making it difficult to generalize about the sector as a whole. For the purposes of this paper, the following five categories of business will be used, as in the National Small Business Act (National Small Business Act, 1996):

Survivalist enterprises: under this category, the income generated is less than the minimum income standard or the poverty line. Survivalist enterprises are considered pre-entrepreneurial, and include hawkers, vendors and subsistence farmers; in practice, survivalist enterprises are often categorized as part of the micro-enterprise sector.

Micro enterprises: the turnover under this category is less than the VAT registration limit; these enterprises are not usually formally registered. They include, for example, *spaza* shops, minibus taxis and household industries. They employ no more than five people.

Very small enterprises: these are enterprises employing fewer than 10 paid employees, except in the mining, electricity, manufacturing and construction sectors, where the figure is 20 employees. These enterprises operate in the formal market and have some access to technology.

Small enterprises: the upper limit in this category is 50 employees. Small enterprises are generally more established than very small enterprises and exhibit more complex business practices.

Medium enterprises: enterprises with a maximum of 100 employees, or 200 for the mining, electricity, manufacturing and construction sectors. These enterprises are often characterized by an additional management layer.

While keeping these gaps in mind, the SMME term is here used to identify the broad range of small and medium enterprises and the SME term is used when excluding the very small, micro and survivalist enterprises. Specific references to the different categories will be made when needed.

AN OVERVIEW OF THE SECTOR

SMMEs in South Africa share most of the general characteristics of the sector elsewhere, but also face some challenges which are particular to the South African context – namely the imbalances left by the legacy of apartheid. Under the apartheid regime, the majority of black South Africans were prevented from running a business. As a consequence, the rate of black ownership in the bigger enterprises is low. Although since 1994 the opportunities for owning and developing a business have greatly increased, the sector still has untapped potential for further contributing to economic growth, job creation and social transformation. The following characteristics and data help to illustrate this point:

- According to the Registrar of Companies 1990-2000 statistics, Small and Medium enterprises represent 97.5% of the number of registered businesses in SA, employ 55% of the country's labour and generate approximately 42% of total remuneration. Meanwhile, only 44% of people in the private sector were employed by SMMEs in 1995. This number rose to 52% in 2000 and 68% in 2002 (*Financial Mail*, Johannesburg, 15 May 2004).
- Small and Medium enterprises are numerically most prevalent in agriculture, retail trade, manufacturing, and community, social and personal services. The construction sector is the sixth-largest field of activity for them (Development Bank of Southern Africa, 2005).
- In terms of spatial presence, the geographical distribution of Small and Medium enterprises is in line with the national distribution of GDP. The larger the GDP of a province, the higher the number of SMTs. This supports the notion that Small and Medium enterprises do require collective efficiency, external economies and the benefit of economic agglomeration (Development Bank of Southern Africa, 2005).
- According to interviews held with the owners of small and micro enterprises, many small businesses in South Africa were created right after 1994, with the rate of creation increasing after 2000. Many of these were initiated by white South Africans who were retrenched from big companies and who saw in small businesses an escape from the effects of affirmative action and a hope for a better future.

- In terms of racial composition, SMEs are largely white-owned, while micro and survivalist enterprises are mainly black-owned. Although Previously Disadvantaged Individuals (PDI) now start many enterprises, most of these enterprises are survivalist. According to Ntsika's 2001 data, blacks set up 88% of all new micro-enterprises and 63% of all survivalist enterprises (*Mail and Guardian*, Johannesburg, 11 September 2003).
- Family businesses and close entities comprise over 84% of all registered businesses in South Africa and are the engine of the economy. Of the estimated 1.1 million registered family businesses, 330,000 are economically active companies (including Close Corporations) and 870,000 are economically active individuals (sole proprietors and partnerships) (Balshaw, 2004).
- Out of a total of 906,700 firms operating in South Africa, only 6,000 are large enterprises, or 0.7%. The remainder is made up of SMMEs, including survivalist and micro enterprises (Development Bank of Southern Africa, 2005).
- Estimates for 2004 suggest there are between 2m and 3m SMMEs in the country and about 60% of them are survivalist – unable to support their owner above the poverty line (*Financial Mail*, Johannesburg, 15 May 2004).
- According to the 2005 South African Global Entrepreneurship Monitor (GEM) report, 45% of South African entrepreneurs are 'necessity-driven' (Von Broembsen et al., 2005).

Despite their limited size, micro-enterprises seem to be absorbing a significant proportion of the unemployed, both by facilitating self-employment and by creating jobs. As Rogerson argues, the bulk of employment creation by South African SMMEs is likely to emerge from new micro-enterprise formations. This finding is reinforced by research conducted in Johannesburg by the World Bank which showed that net employment growth in the SMME economy was accounted for by the arrival of new firms. The research suggest that employment growth in the SMME sector was more the result of the formation of new micro-enterprises and very small firms rather than the expansion of existing SMMEs (Rogerson, 2004). Although employment will not automatically translate into socio-economic transformation, the provision of a source of income is the first step to improving the conditions of the more marginalized.

The sector is expected to grow as a result of ongoing transformation as black South Africans in the public and private sectors, who have benefited from affirmative action, switch to self-employment during the next decade to take advantage of contacts they have made and the experience they have gained. Trade and industry minister Mpahlwa argues that 'the rapid expansion of black consumer spending and the black middle class . . . create incentives for business start-ups . . . [T]he unfolding process of black economic empowerment is triggering new black owned and managed SMMEs' (*Daily Dispatch*, Johannesburg, September 2005)

This overview of the SMMEs sector illustrates that it is extremely varied, with enterprises ranging from informal survivalist initiatives to highly organized medium-sized entities. They operate separately in different contexts under what have been described as the first and second economies. They have access to different resources and opportunities and reflect the racial divisions left by apartheid.

THE INSTITUTIONAL FRAMEWORK

The 1995 White Paper on Small Business, together with the National Small Business Development Act of 1996, represent the country's first policy framework for SMMEs. The main institutional pillars created around this legislative framework were: Ntsika Enterprise Promotion Agency, which was to provide non-financial or business development services; Khula Enterprise Finance, set up as a finance institution supporting finance intermediaries dealing with the SMME entrepreneurs; Local Service Centres (LSC), later known as Local Business Service Centres, which were decentralized vehicles for small business support; Tender Advice Centres set up to give advice for public procurement contracts; Manufacturing Advice Centres (MAC) set up to improve competitiveness in local, national and international markets; and the Community Public Private Partnership Programme (CPPP), established in 1999 to facilitate the entrepreneurial base in rural and peri-urban South Africa (Bezuidenhout et al., 2005).

Although these structures survived for a couple of years and through their support some successful business initiatives were facilitated, overall their efforts were uncoordinated and ineffective. The National Small Business Amendment Act (signed in 2004) sought to provide a more integrated range of services for small business by merging Ntsika, Namac and the CPPP into the Small Enterprise Development Agency (SEDA) and realigning the development agencies. Overall, the framework was adapted to become as in Table 3.

Table 3: State-Owned Development Agencies

Institution	Services
SEDA	Its mandate is to implement the national SMME strategy. The agency is the amalgamation of three previous entities: Ntsika Enterprise Promotion, the Community Public Private Partnership Programme (CPPP) and the National Manufacturing Advice Centres (Namac). It provides non-financial support and has the mandate of integrating support agencies across the country. It is establishing itself in 9 provincial offices, 53 district branches and 284 Enterprise Information Centres in Municipalities. The primary difference with the earlier Ntsika and Namac is that 80% of the focus of the agency will be on micro and small enterprises with the remaining 20% dedicated to medium enterprises. This is accompanied by a vision of future 'one-stop shops' at the branch-level where other state initiatives such as Khula and the NEF will also be housed.
Khula	Khula's mandate is to facilitate loan and equity capital to small, medium and micro enterprise through the medium of Retail Financial Intermediaries by offering a range of financial resources and information to the public. Khula's Operations are divided into two divisions: Loans and Credit guarantees.
National Empowerment Fund (NEF)	The NEF promotes investment and transformation solutions to advance black economic participation. It promotes and supports business ventures pioneered and run by HDPs. Through its subsidiary NEF Ventures, it disburses start-up capital with allocation to be biased in favour of investments where PDI, specially women, are actively involved.
Industrial Development Corporation (IDC)	The immediate objectives of the IDC are to create employment, to develop SMEs and to accelerate BEE. Part of its strategy is to promote entrepreneurship through the development of competitive industries and to identify unrecognized business opportunities.
The SA Micro-finance Apex Fund (Samaf)	Samaf has been established as a company to address poverty, unemployment and to provide affordable access to financial services for the poor. Its vision is to become an effective facilitator of micro financial services and to build a vibrant micro finance industry in SA. It now has <i>pro-poor finance institutions</i> in all nine provinces. The Fund is to provide small loans of up to R100,000.

In South Africa, all economic actors are expected to play an active role in the socio-economic transformation of the country and SMMEs have been identified as important agents in this process. They are expected both to benefit from and to actively contribute to the BEE strategy. Accordingly, the development of SMMEs over these years has been guided by this transformation imperative and the institutional framework has been influenced by the different objectives guiding it. Three objectives have guided the strategy supporting SMMEs in South

Africa. First, the economic objective of small business promotion; second, the welfare objective of supporting income generation in the survivalist sector: and third, the socio-political objective of empowerment (*Enterprise*, Johannesburg, 31 May 2003).

There are few reliable figures available on the impact and performance of government support programmes concerning the SMME sector as a whole (Rogerson, 2004). According to Khula 2005 Annual Report, during that year 51% of beneficiaries were black owned and managed business, 49% were women owned and managed businesses and 38% were business located in rural areas outside Gauteng, Western Cape and Kwa Zulu Natal (Khula, 2005). Agencies working with small businesses, including the Department of Trade & Industry (DTI), are struggling with inadequate data on the number and nature of small, medium-sized and micro enterprises and with the difficulty in measuring the effect of the government's efforts (*Financial Mail*, Johannesburg, 15 May 2004). However, according to general perceptions in the South African media and to the results of interviews held with several small entrepreneurs,³ it seems that the institutional framework has been unable to address the needs that exist within the sector and that entrepreneurs' perception of government support is generally negative.

A summary of the main concerns shared by medium and small entrepreneurs illustrates that few are informed about the existing support from government. Those who know argue that making use of the available support mechanisms is not easy. According to the 2004 SME Survey, poor communication is a real part of the problem. The survey found that 70% of SMEs felt that government communicates its incentives poorly or very poorly, and that 64% of SMEs felt that government communicates legislation poorly or very poorly (*Business Day*, Johannesburg, 15 August 2004). Red tape within these mechanisms and within the broader regulatory framework is a major concern. According to a survey, which investigated the opinions of entrepreneurs from medium-sized businesses employing between 50 and 250 people, regulation and red tape is reported as the greatest constraint to the expansion of business in South Africa. While, in 2005, 41% of business owners in the country cited regulation and red tape as the biggest constraint to the growth of their business, the rate went up to 45% in 2006. The second greatest threat for South African business owners, at 44%, is the lack of a skilled workforce, up from 36% in 2005 (Grant Thornton, 2006).

³ 10 small entrepreneurs operating in different sectors were interviewed at the Small Business Week in Cape Town in November 2005. Other 10 small and medium enterprises were interviewed in the East London area in July 2006.

According to data collected by the SME Survey, which has been taking place every year since 2003, the impact of governmental initiatives on the competitiveness of SMEs was found to be minimal. 9% of respondents were positive and 62% were negative on the impact of government initiatives in 2004 (the figures for 2005 remained almost exactly the same) (SME Survey, 2005). Analysis of interviews shows that government policies and programmes designed to support entrepreneurs are the second most frequently identified factor limiting entrepreneurial activity.

Other obstacles identified by entrepreneurs were: lack of access to business opportunities, particularly lack of transparent tendering processes that puts smaller enterprises at a disadvantage; the government's inadequate service delivery record; and a poor understanding of the business environment. Access to finance was also identified as a major obstacle due to the rigid criteria used by financial institutions, the high costs of borrowing money and the slow procedures in accessing support. Unfair competition from imported products and the centralization of large businesses in Johannesburg have also been identified as challenges by many respondents. Overall, red tape and lack of information on services provided were major obstacles, most government support structures were perceived as inefficient, and procedures considered cumbersome and confusing.

These constraints, however, mainly affect the larger enterprises and are hardly applicable to the smaller and more basic ones where the majority of disadvantaged individuals operate. Therefore, it is important to acknowledge the big gap between the characteristics of smaller and larger enterprises and the differences between their needs and challenges.

Moving beyond the criticism of government institutions and offering a broader analysis of the constraints that affect implementation of the policy framework, a study entitled 'Development Report 2005 – Overcoming underdevelopment in South Africa's second economy' offers an interesting analysis of the limitations of the government's approach to SMMEs in general, but in particular to small enterprise support since 1994. According to this report, South Africa's socio-economic policies and institutions have been shaped in a way that prioritises socio-economic development via the growth of formal enterprises and job creation in the first economy, while relegating the economic activity of the majority of households in the second economy to the status of a 'welfare problem'. According to this report, the overall framework makes no clear distinction between entrepreneurial small business and non-entrepreneurial self-employment initiatives and support is well geared towards the needs of the former, but not the latter (Development Bank of Southern Africa, 2005). The smaller businesses that operate in the second economy, as the study highlights, are constrained by weak demand in the second

economy and by the lack of connections with the first economy. The framework in place seems to wrongly assume that in South Africa, although there are 'two economies', enough linkages can be made between the first and second economies to ensure that micro-enterprises could serve as suppliers for the first economy. Although it could be so, the report argues, there are few opportunities for this to happen since the country's first economy is capable of producing most of what it needs cheaply or can import it from other countries. Furthermore, a robust consumer market that will demand many of the goods produced by very small businesses is lacking, and the pockets of informal manufacturing in rural areas are being wiped out by improvements in transport infrastructure which allows 'imports' of cheap goods from urban areas.

Overall, as Rogerson's research also indicates, the government's SMME programmes have been largely biased towards small and medium-sized enterprises, where white ownership is dominant, and have to a large extent by-passed micro-enterprises where PDIs are most present. In this light, DTT funding allocations have inevitably favored established small and medium enterprises rather than emerging micro-enterprises and the informal economy (Rogerson, 2004). Similarly, the Development Report explains how until recently micro-finance strategies have excluded pro-poor lending, assuming that the poor cannot afford to pay interest. Despite their remarkable impact and financial success, the few South African micro-finance institutions that adopted a pro-poor approach (working to support non-entrepreneurial self-employment and providing opportunities for 'graduation' to entrepreneurial small business) remain outside the mainstream (Development Bank of Southern Africa, 2005).

However, there are indications that this may be changing, and that public policies supporting the smallest businesses may be starting to follow a more effective approach. The establishment of the Samaf fund (see above) is an indication of such change. It highlighted the government's interest in supporting small businesses not only as part of its economic strategy, but also as part of its attempt to racially transform the country. In this regard, reflecting on the importance of micro finance and survivalist enterprises for empowerment, President Mbeki in 2004 stated that:

[T]he Apex Fund will begin to extend micro loans to support small and family businesses. This will signify the completion of the spectrum of the public funding profile of BEE, covering businesses of all sizes, from the smallest to the biggest, achieving the goal of broad based empowerment. Factually, the assertion that all that BEE amounts to is benefiting a 'small elite that tends to be recycled' is entirely false (Mbeki, 2004)

But Mbeki's words and his view on the scope of the fund could be seen simply as part of a political discourse in which government is trying its best to demonstrate its commitment to broader empowerment. But even if this commitment exists, and small businesses are now recognized as important agents for transformation, much more needs to be improved before SMMEs can fully play their expected role.

SUGGESTIONS FOR A BETTER FRAMEWORK

Current institutional arrangements demonstrate government's increasing interest in creating a better framework to foster the SMME sector in general and survivalist enterprises in particular as part of a broader vision of BEE. Although it is too early to evaluate the impact of this new approach, it seems important to highlight some limitations, which have been identified by either entrepreneurs or researchers.

An outstanding limitation is the lack of awareness and knowledge of the system. Therefore, the first step to be taken is to improve the dissemination of information. Most of the entrepreneurs interviewed in both the Eastern and Western Cape provinces were unaware of the support mechanisms offered by the government. Now that the framework has been adjusted, government needs to apply an effective marketing strategy so that the information can reach the potential beneficiaries. Once this has happened, government needs to make sure that effective implementation is taking place, that red tape issues are addressed, that access to finance is facilitated, and that feedback from beneficiaries is used to improve support mechanisms on a regular basis. Finally, government needs to encourage cooperation between the different institutions supporting SMMEs and adapt regulations to be more business friendly. In this regard, entrepreneurs identified tax legislation and benefits and the improvement of public procurement procedures as main issues to be addressed.

In addition, since business develops in a broader social and economic context, it is important to be aware of the social aspects that influence small businesses in different ways. As Hudson explains,⁴ successful entrepreneurs are likely to be embedded in networks and relationships of support since business success depends substantially on relationships of this kind. These networks provide entrepreneurs with valuable information and support. This is a largely informal process that requires neither state intervention nor taxpayers' money (*Enterprise*, Johannesburg,

⁴ She is basing her comment on the Small Business Project which has extensive experience in facilitating business linkages in South African small towns

31 May 2003). However, it does require an adequate social context where these networks and relationships can develop.

Although South African society has come a long way in terms of nation building and social support networks have long existed and played a major role in the struggle for democracy, society is still fragmented and is characterized by marked racial, cultural and social divisions. Although these fragmentations exist within South African society as a whole, they are particularly evident in the disconnection and disparities that exist within the major urban centres and between the urban and rural areas. These divisions inevitably translate into a lack of appropriate socio-economic spaces where new businesses are more likely to flourish. The picture of vibrant city markets and streets filled with small entrepreneurs providing goods and services to the broad range of people of all races and backgrounds that live in South Africa seems to remain an ideal. The lack of social integration, of adequate public transport and of safe public spaces has on the contrary given way to a growing boom in shopping centres that will inevitably affect small businesses negatively.

Therefore, considering that business success will depend greatly on relationships and networking, it seems necessary to work towards a more integrated approach to supporting SMMEs that will not just provide adequate regulation but that will also strengthen the broader social integration needed for these types of networks to flourish. In this regard, a broad inter-institutional approach is needed to work towards the establishment of a reliable and safe transport system, the creation of public spaces in the urban centres, and the building of linkages between rural and urban communities. These elements can play an important role in the construction of broader cooperative networks and provide a better context for the development of small businesses.

SMMEs AND BEE

Since the early years of empowerment the government has highlighted the link between SMMEs and BEE, but only in recent years has the importance of small businesses for transformation been emphasized. In his 2006 State of the Nation address, President Mbeki made particular reference to the importance of the small business sector for South Africa and its inevitable link with growth and the transformation process in the country. He noted that the Accelerated and Shared Growth Initiative of South Africa (ASGISA) is to fast track economic development and confirmed the need to expand the SMME sector, paying particular attention to the development of women and youth and Broad Based Black Economic Empowerment (Mbeki, 2006)

The SMME and BEE frameworks have been better aligned recently. On the one hand, the strategy for BB-BEE highlights the importance of SMMEs in the transformation process. On the other, the national strategy for the development and promotion of small business identifies the creation of new black-owned and black controlled enterprises as a key issue. Similarly, institutions such as the NEF and the IDC were requested to serve both empowerment and SMMEs, and different programmes (i.e the DTI's Small and Medium Sized Enterprise Development Programme and the Black Business Supplier Development Programme) have aimed at fast-tracking the implementation of the BEE Strategy (Bezuidenhout et al., 2005).

In sum, the interactions between the two frameworks have become clearer throughout the years. Policies and institutions have been aligned to better serve the needs of SMMEs within the transformation process and to advance the goals of empowerment through the active participation of the smaller enterprises. Yet, implementation of BEE remains a challenge for many small businesses and their potential contribution to economic growth remains untapped.

THE GENERIC SCORECARD AND SMMEs

An overview of the BEE generic scorecard illustrates some of the existing links between the two frameworks and some of the positive and negative effects of transformation on SMMEs. On the positive side, implementation of the scorecard stimulated the transfer of ownership to black entrepreneurs and, through procurement policies, created business opportunities that did not exist before. Subcontracting practices provided opportunities for the development and transfer of managerial and technical skills. Also, through the scorecard elements of enterprise development and CSI, government and private companies were encouraged to invest in the development of smaller businesses. It seems that BEE has served to encourage several private and public enterprises either to start to implement or strengthen existing initiatives supporting small businesses. The activities of companies like Eskom, Absa, SAB Miller and others serve to highlight these initiatives.

The Eskom Development Foundation assists many promising new businesses with grants and also offers mentoring provided by its own staff (*Business Day*, Johannesburg, 17 October 2005). The Absa Business Center in Pimville provides access to small businesses including informal traders and *spaza* shop owners in Soweto with the aim of bringing the informal business sector into the formal economy and into the banking system (*Sowetan*, Johannesburg, 25 July 2005). The Anglo Zimele strategy identifies empowerment opportunities within the Anglo American supply chain (*The Star*, Johannesburg, 25 July 2005) and the Khula-Anglo-American Mining Fund invests and adds value to viable SMEs such as black owned and black empow-

ered business involved in small-scale mining activities. The Shoprite – Khula venture funds franchise opportunities owned by entrepreneurs from previously disadvantaged communities (*City Press*, Johannesburg, 10 July 2005). Finally, South African Breweries implements initiatives such as the Kick-start project and the Taverner Training Project.⁵

Although the scorecard triggered some positive dynamics, it also had a negative impact on SMMEs, affecting their performance and growth potential. Particularly, the implementation requirements were initially the same for businesses of all sizes. SMMEs struggled to comply with the economic and administrative costs and found it difficult to make use of the opportunities provided. The smallest businesses, particularly family-owned ones, struggled the most. Although they were intended beneficiaries of the government's institutional framework supporting SMMEs and of some of the BEE initiatives, compliance with the generic scorecard translated into administrative and economic costs that were difficult to absorb and threatened their performance. The biggest challenge became to find a suitable black partner and skilled black managers to fulfill the ownership and management targets. In addition, considering the lack of information and knowledge that has characterized this process, entrepreneurs were highly confused on how to empower their businesses, and on how to get the accreditation for it. Overall, businesses were incurring undesirable costs and risks that affected their stability and potential for growth. The lack of information and understanding of the BEE demands and possibilities became a fundamental problem and undermined its credibility.

⁵ The Kickstart Project aims at promoting an entrepreneurial culture among young people, providing training, grants for start-up ventures, mentorship and assistance during the setting up business phase. It promotes competition and facilitates mentorship and monitoring for a period of six months. Some small entrepreneurs interviewed at the Small Business Week in Cape Town in 2005 underlined the positive impact of this project and highlighted the appropriateness of the model followed by SAB. They particularly highlighted the benefits of receiving mentorship from big business and of being assisted during the setting up phase. The Taverner Training Project teaches business skills to the owners of a number of licensed *shebeens*. It was introduced as a pilot study and as an incentive to encourage *shebeen* owners to legalize their establishments in 2002. Although this has also been recognized as a positive initiative and *shebeeners* might be benefiting from it, it is necessary to study the broader impact of this initiative at a community level and understand the business interests that the sponsoring company has in such a project. Source:

www.sablimited.co.za/SABI.td/Primary/CorporateResponsibility/CSI/Projects/Default.

THE SCORECARD FOR QUALIFYING SMALL ENTERPRISES

With the release of the Codes of Good Practice in late 2005, new rules for small firms have been set. The codes reflected the government's better understanding of the particular challenges faced by small businesses within the transformation framework. Although under the codes SMMEs are still expected to contribute to empowerment, the framework has been adapted to better serve their needs. The codes define a new category for compliance called the Qualifying Small Enterprises (QSE). These are classified according to the National Small Business Act, based on turnover and employee numbers.

Although the classification parameters are still the subject of debate, this section of the codes affects mostly those businesses with 50 or fewer employees that, according to their sector, have turnovers below certain amounts (see below).⁶ Micro-enterprises with annual revenue below VAT registration (which in 2006 stands at R 300,000) are exempted from the codes and become automatically empowered (The Codes of Good Practice, 2005).

Table 4: Qualification Levels for Small Enterprises

Industry	Maximum Turnover	Maximum Employees
Agriculture	R 2m	50
Mining	R 7.5m	50
Manufacturing	R 10m	50
Energy (electricity, gas and oil)	R 10m	50
Construction	R 5m	50
Retail and motor	R 15m	50
Wholesale and allied sectors	R 5m	50
Catering and Accommodation	R 10m	100
Transport, storage and communications	R 10m	50
Finance and business services	R 10m	50
Community, Social and Personal Services	R 10m	100

Source: Department of Labour SA

⁶ The DTI is currently revisiting thresholds and categories that would define QSEs. As a result of consultations with stakeholders, it appears that there will be an increase in the thresholds for both Qualifying Small Enterprises (QSE) and Exempted Micro Enterprises (EME).

Under the scorecard for Qualifying Small Enterprises, indicators have been adapted and all elements weigh 20% (see Table 5). The scorecard allows companies to choose five out of seven BEE factors for scoring purposes. Bonus points are granted for QSEs where black ownership exceeds 20 points and where QSEs use all seven elements of the scorecard. Businesses owned by black women and those with employee share plans can score further bonus points.

Table 5: Scorecard for Qualifying Small Enterprises

Elements	Weight
Ownership	20%
Management Control	20%
Employment Equity	20%
Skills Development	20%
Preferential Procurement	20%
Enterprise Development	20%
Social Development / Industry specific	20%

With the codes, the burden for qualifying small white owned business was eased since they now do not necessarily have to bring in black partners or even black managers to get a good score and can concentrate their efforts on scoring on the other elements. This could be seen as a step backwards in terms of economic transfer and could apparently place black businesses at a disadvantage by expecting them to compete on the same level with white businesses. I argue that this is not the case. Considering that businesses could choose to score on more than five elements, by meeting higher targets of black ownership and management, black entrepreneurs will still have a greater chance to score higher than their white counterparts. This means they will have a competitive advantage within the South African context and are likely to be chosen for preferential procurement purposes.

Overall, under the QSE scorecard, small businesses, both black and white, are still expected to contribute to empowerment but in a broader and more flexible way. The emphasis on ownership and management is shifted to a broader approach in which the development of skills, preferential procurement, and enterprise and social development play equal roles. The hope seems to be that meaningful transformation can be achieved through an approach that encourages contributions to all the different transformation elements and that by working on the development of human resources more sustainable empowerment can be built through the

years. While white businesses are still encouraged to promote black ownership and management, small black owned/managed firms are not automatically considered as empowered and are instead encouraged to actively contribute to transformation by working on the other elements of the scorecard (Janish, 2006). This is a positive development. It lightens the burden on existing white firms that struggle in a competitive environment, gives certain preference to black owned firms while also putting pressure on them all to contribute to broad empowerment. Finally, it is important to note that although the new scorecard provides a better framework for SMMEs in general, the playing field is not completely level. Black firms who have been historically disadvantaged and that in most cases did not exist before 1994 will still struggle more for finance, appropriate skills and success than their white counterparts.

Concluding Remarks

Socio-economic transformation is not a finite goal, but a long and complicated process that requires adequate policies and institutions and an active role from both government and the private sector. It requires clear targets, guidelines and beneficiaries. Although the transformation framework has moved forward in this direction, and targets and guidelines are now much clearer, the South African government still needs to work out ways in which the benefits will reach not just those who have been historically disadvantaged, but also and particularly those who are now marginalized.

According to 1999 estimates, previously disadvantaged individuals had a 22% share in very small enterprises, 57% in micro enterprises and 87% in survivalist businesses (Development Bank of Southern Africa, 2005). Therefore, if empowerment is to become broader, special attention should be given to the needs of the smallest enterprises. The smallest undertakings play a central role in the development of South Africa, both because an important number of PDI's survive within the sub-sector and because they seem to play an important role in easing the negative impact of the high unemployment rate that prevails in South Africa by providing self-employment opportunities.

Notwithstanding the importance of businesses in general and that the larger SMEs contribute greatly to employment creation and economic growth, it seems that socio-economic transformation is more likely to be achieved if strategies to support the smallest initiatives are strengthened. A friendlier institutional environment for the development of SMMEs and the

strengthening of micro-enterprises in particular, together with adequate BEE policies, can facilitate socio-economic transformation. BEE could serve to strengthen micro enterprises and in the long term bring at least some of them into the formal economy. BEE could create the missing link between the first and second economies, mainly through the application of the Enterprise Development (ED) and Corporate Social Investment (CSI) elements of the scorecard.

Although it is too early to evaluate the success of the newly adapted BEE framework, it seems that the direction being taken will strengthen the positive synergies between the SMME and BEE frameworks and encourage the possibilities of socio-economic change. The Small Enterprises Development Agency's (SEDA) focus on small and micro enterprises (formal and informal) and the creation of the Apex fund illustrate the government's growing interest in supporting these ventures. If these practices are implemented on a larger scale and over a long period of time, it is likely that more micro and survivalist enterprises will graduate into viable undertakings and that more disadvantaged individuals and communities will become empowered.

Small enterprises provide the majority of jobs within the South African economy; therefore, if BEE fosters their growth, the result will be more jobs for a majority of black South Africans. But despite the positive dynamics fostered by the new BEE strategy, it is still difficult to measure its real impact and the extent to which these efforts are benefiting a broader number of disadvantaged individuals. More research and analysis is needed on the limitations of this approach and on the interaction between the so called first and second economies.

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