Resource Report 3:

Literature review on entrepreneurship, housing and housing finance

A research project sponsored by the National Department of Housing, the Social Housing Foundation, Nedbank and the FinMark Trust

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Shisaka Development Management Services (Pty) Ltd
in Association with CSIR Built Environment

Shisaka Development Management Services
Reg.2002/018833/07
PO Box 2601, Saxonwold, 2132
Tel: 011 447 6388; Fax: 011 447 8504
Email: shisaka@shisaka.co.za

CSIR Built Environment
PO Box 395, Pretoria, 0001
Tel: 012 841 2571; Fax: 012 841 3400
Email: mnapier@csir.co.za

This research into Housing Entrepreneurs has been undertaken by Shisaka Development Management Services (Pty) Ltd in association with CSIR Built Environment

Authors of this Report:

Judi Hudson

The ideas expressed are based on research undertaken and extensive discussions within the Team.

Project Team:

Team Leaders

Matthew Nell and Ishmael Mkhabela

Project Co-Ordinator

Ros Gordon

Project Members

Judi Hudson, Maurice Makhathini and Mark Napier

Specialists

Otto Holicki, David Gardner, Robert McGloughlin and Kgaogelo Mamabolo

Social Researcher

Progressus

Administration

Kim Foster and Kendel Nordin

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The Finmark Trust, the Social Housing Foundation,
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Co-ordinator

Kecia Rust – The Finmark Trust

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Reports produced as part of the Housing Entrepreneurs Research Project:

Final Reports:

Research Report: Consolidated analysis of research into Small Scale Landlords and Home Based Entrepreneurs (April 2006)

Small Scale Landlords: Research Findings and Recommendations (3 May 2006)

Home Based Entrepreneurs: Research Findings and Recommendations (to be released in July 2006)

Resource Reports

Literature Review

Resource Report 1: Literature review of Small Scale Landlords (6 February 2006)

Resource Report 2: Literature review on the financial needs and products available to Small Scale Landlords and Entrepreneurs from Commercial Banks. (6 February 2006)

Resource Report 3: Literature review on entrepreneurship, housing and housing finance (6 February 2006)

Resource Report 4: Literature review on Home Based Entrepreneurs (6 February 2006)

Small Scale Landlords

Resource Report 5: Research into Landlords in Inner Cities (6 February 2006)

Resource Report 6: Research into Landlords in Townships (6 February 2006)

Resource Report 7: Research into Successful Landlords (6 February 2006)

Resource Report 8: Research into Service Providers in respect of Small Scale Landlords (6 February 2006)

Resource Report 9: Research into Public Sector Stock (6 February 2006)

Home Based Entrepreneurs

Resource Report 10: Research into Home Based Entrepreneurs (6 February 2006)

Resource Report 11: Research into Successful Entrepreneurs (6 February 2006)

Resource Report 12: Research into Service Providers in respect of Entrepreneurs (6 February 2006)

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1.1 Background

Finmark Trust, the Social Housing Foundation, Nedbank and the Gauteng Department of Housing have appointed Shisaka Development Management Services in association with the CSIR to undertake research into 'Housing Entrepreneurs'. Housing Entrepreneurs are defined as small scale landlords and entrepreneurs who operate or use their house as part of their business activities.

The purpose of the research is to understand **how housing and housing finance can be used as a tool to promote the emergence and growth of entrepreneurs and small scale landlords.** Specifically the study aims at:

- **Identifying the housing finance interventions** necessary to build an entrepreneurial and small scale landlord sector in low income areas.
- Developing **appropriate information products and tools** to assist emerging entrepreneurs and landlords in their efforts at becoming housing entrepreneurs.
- Focusing on the potential for small scale entrepreneur landlords to be the model for **dealing with difficult to transfer state owned stock.**
- Understanding the key issues which would support **a productive relationship between the landlord and the tenant** in the small scale sector in the mutual interests of both parties.
- Inform policy and strategy directions so as to facilitate **better access to housing investment opportunities for either entrepreneurs or small scale landlords**, such as are already being realised in the middle and upper income sector of South Africa.

This report forms part of Phase 1 of the research and comprises a literature review of **entrepreneurship, housing and housing finance.** International and national literature was reviewed through an Internet search, as well as documentation provided by professionals in the development sector.

1.2 Focus of the review

A vibrant enterprise sector holds the potential to mop up unemployment, drive growth and make a substantial contribution to black economic empowerment. The importance of this role is **difficult to overstate in the South African context** where research by Haroun Bhorat, for example, shows that employment would have needed to expand more than 33% since 1995 to have provided jobs for all new entrants in the job market.

However, it is also true to say that ten years into South Africa's democracy, the **growth of the enterprise sector has been modest**. According to the most recent Global Entrepreneurship Monitor (GEM), SA is in a group of countries with **below average rates of entrepreneurship**. SA is the only developing country in the GEM survey that is not performing on key measures of entrepreneurial activity, we are also the only one whose scores are getting worse. We lag behind Chile, Thailand, Mexico in terms of entrepreneurship. (It must be said that while South Africa might be 'in bad shape' in comparison to many developing countries, in GEM terms, we're 'in good company holding our own against some developed countries'.)[1] Previous Minister of Trade and Industry, Mr Alec Erwin, has said that the small and medium enterprise (SME) contribution to GDP at 35% 'should' be between 60 and 80% - something which would be achievable in the next ten to fifteen years. [2]

While government's commitment to promoting small business is not in question, its track record in supporting South Africa's entrepreneurs is not well-regarded. South Africa is not unique, across the globe supporting small business is difficult. All over the world, countries see supporting entrepreneurs as a good idea, but to do so effectively is complicated. Many well-meaning but ill-founded interventions have failed. Nevertheless, it does suggest a need for **thinking freshly about enterprise development**, uncoupled from tired debate.

The challenges are considerable. South Africa has the double whammy of integrating itself into the global markets as a competitive economy while simultaneously overcoming internal problems created and continuously reinforced by apartheid. Our specific history has also meant the exclusion of the **majority of potential entrepreneurs from 'proper' education and access to property rights and/or financial resources** is a challenge worth rising to since creative individuals express tremendous leverage on an economy.

[1] Comment by Gillian Godsell Sol Plaatje Memorial Lecture series on entrepreneurship May 2004
[2] Business Day 12 November 2002

This literature review aims to understand **key dynamics within entrepreneurship and specifically the role of housing/housing finance** in this, viewed in an international context. As Rust reminds us, there **are two ways in which housing can play a role – most commonly the use of the house is as the venue for the business**. This aspect is covered in Resource Report 4 on home-based enterprises by the CSIR. The **use of housing as collateral against which finance can be raised to grow the business is the second**, and less common aspect.[3] This paper attempts to inter alia explore this aspect, to the extent that there is data available. In particular, the work of Peruvian economist Hernando de Soto, whose research argues that in developing countries more than 70% of inhabitants are typically excluded from the formal legal system, which means that they do not enjoy property rights [4] - is considered. Also included is a case study of South ShoreBank's rehabber entrepreneur programme.

In setting the scene for the discussion, the paper begins by highlighting the context and definitional aspects of entrepreneurship; it then makes reference to a number of myths and assumptions that somewhat unhelpfully characterise debates about entrepreneurship and blunts the success of interventions to promote it. Thus, the paper attempts to shift discussion towards actual understanding and isolate some key fundamentals that policy-makers and the private sector can build on in a constructive sense. The discussion then moves to regulations and small business; access to finance; debates around formality and informality of operations and the role of regulations in this context; reflections on De Soto's thesis and its South African applications and then a focus on entrepreneurial failures – a painful but often inevitable feature of many entrepreneurial endeavours. It is hoped that this approach offers sufficient backdrop for the broader consideration of 'mechanisms to support the emergence of entrepreneurs' as stipulated in the Finmark request.

The exploratory nature of this work is emphasized.

[3] Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.3

[4] Rose, R 'Absence of property rights slows integration – De Soto' in Business Day 6 May 2005

3 A note on the basics

The National Small Business Act defines a small business as 'a separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column 1 of the Schedule.'

Table 1: Schedule 1 to the National Small Business Act of 1996

Sector or sub-sectors in accordance with the Standard Industrial Classification	**Size or class**	**Total full-time equivalent of paid employees**	**Total annual turnover (Rm)**	**Total gross asset value-fixed property excluded (Rm)**
Agriculture	Medium	100	5.00	5.00
	Small	50	3.00	3.00
	Very small	10	0.51	0.50
	Micro	5	0.21	0.10
Mining and quarrying	Medium	200	39.00	23.00
	Small	50	10.00	6.00
	Very small	20	4.00	2.00
	Micro	5	0.21	0.10
Manufacturing	Medium	200	51.00	19.00
	Small	50	3.00	5.00
	Very small	20	5.00	2.00
	Micro	5	0.21	0.10
Electricity, gas and water	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Construction	Medium	200	26.00	5.00
	Small	50	6.00	1.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Retail and motor trade and repair services	Medium	200	39.00	6.00
	Small	50	19.00	3.00
	Very small	20	4.00	0.60
	Micro	5	0.20	0.10
Wholesale trade, commercial agents and allied services	Medium	200	64.00	10.00
	Small	50	32.00	5.00
	Very small	20	6.00	0.60
	Micro	5	0.20	0.10
Catering, accommodation and other trade	Medium	200	13.00	3.00
	Small	50	6.00	1.00
	Very small	20	5.10	1.90
	Micro	5	0.2	0.10

Sector or sub-sectors in accordance with the Standard Industrial Classification	**Size or class**	**Total full-time equivalent of paid employees**	**Total annual turnover (Rm)**	**Total gross asset value-fixed property excluded (Rm)**
Transport, storage and communications	Medium Small Very small Micro	200 50 20 5	26.00 13.00 3.00 0.20	6.00 3.00 0.60 0.10
Finance and business services	Medium Small Very small Micro	200 50 20 5	26.00 13.00 3.00 0.20	5.00 3.00 0.50 0.10
Community, social and personal services	Medium Small Very small Micro	200 50 20 5	13.00 6.00 1.00 0.2	6.00 3.00 0.60 0.10

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

As Trade and Industry Policy Strategies (Tips) points out, **SA thresholds are low**. Many businesses which Americans and Europeans regard as SMEs would be regarded as large enterprises in SA. **Small businesses can be classified as micro, very small, small or medium enterprises. Survivalist business is generally defined as providing income only below the poverty line.**

According to Tips, the number of businesses overall increased between 2002 and 2003. The numbers of employers and self-employed went up by 7,3% from 1,62 million to 1,75 million – an increase which is 'higher than the overall increase in the economically active population suggesting that entrepreneurship is becoming an increasingly viable option for individuals', [5] boosting incomes and lifting hope. **The number of new private Companies and Close Corporations registered every year has increased almost steadily over the past 12 years. On average, micro-enterprises employ approximately a third of SA workers, small businesses account for almost 75% of employment.**

According to GEM, an international study involving more than 43 countries, the most entrepreneurial age group is 25-44 year olds. This group accounts for about 70% of all entrepreneurs across all countries in the survey since 2001. But in SA, men between the ages of

[5] Trade and Industry Policy Strategies Annual review of small business 2003

25-44 are on average less than half as likely as their peers in other developing countries to start their own businesses. Those between the ages of 18 and 24 are 40% less likely to start businesses than their peers in developing countries. [6]

It has to be noted that the absence of coherent data on the small business sector makes it difficult to entrepreneurship practitioners and government to provide assistance to the small business sector. Various agencies produce different estimates for example, which are difficult to reconcile. It also points to the need to introduce a degree of consistency in the statistics to be used for policy and review purposes.

In addition to poor data, unhelpful assumptions regarding entrepreneurship abound and can act to stymie many well-intentioned efforts to promote the sector.

[6] quoted in 'von Broembsen 'Effective nurturing is key to fostering business skills' in Business Day 16 May 2005

4 Separating fact from fiction[7]

In his February 2003 state of the nation speech, President Thabo Mbeki confirmed that 'the development and support for small and medium business...remains a priority for government. Accordingly, more financial and other resources will be committed to the development of this sector of our economy.'[8] Against the backdrop of widespread unemployment, many feel government should do more to help South Africa's would-be entrepreneurs. But in some ways, and as this paper will demonstrate, government ought to 'lighten up' – on inappropriate regulations - and do less. (discussed in more detail below)

As noted earlier, government interventions to promote SA's SME sector have not been a dazzling success. Trade and Industry Policy Strategies (Tips) quotes a survey in 2000 showing that 57% of emerging SMMEs interviewed in Gauteng and 70% in the Western Cape, for example, had never had contact with or even heard of any small business support institution. [9] A World Bank survey indicated that 'no more than 20% of SMMEs were aware of Khula and Ntsika programmes. [10] But perhaps more importantly, **international debates and practice reveal a shift from direct government-led provision of support to entrepreneurs to government taking on a facilitative or enabling role**. This affords the private sector a greater role in the delivery of business development services (BDS). Thus, there is a shift from supply side interventions to more demand-led strategies. Government should not crowd out private sector BDS providers through providing subsidies to service providers.

[7] This section draws on a presentation by the author titled Debunking myths about entrepreneurship in the SAn context to the Sol Plaatje memorial lecture group, 16 May 2004

[8] Mbeki, T State of the nation address of the president of South Africa Houses of Parliament, Cape Town, 14 February 2003, p.14.

[9] TIPS The economics of SMMEs December 2002, p.39

[10] Chandra V et al Constraints to growth and employment in South Africa: Evidence from small, medium and micro-enterprise firm surveys World Bank 2000, p.v. There may well be exceptions to this picture, but it would be fair to say that government's 'reach' into this sector is seen to be low. There is an uneven spread in where, how and in which field services are offered. Poor co-ordination results in a replication of services and clustering of institutions in urban areas.

Everybody loves the rags to riches story of a lone entrepreneur working on a world changing invention in a garage, selling it to a large company and making billions. In reality, successful entrepreneurs are more likely to be **embedded in helpful networks or relationships of support built up over time**. [11] (discussed in more detail below) They have often suffered the steep learning curve of business failure at least once before succeeding. Any business is risky, few more so than a small enterprise. Not everybody can or has the appetite to do it. Most often small entrepreneurs succeed through careful management of resources and careful financial discipline, seldom through a flashy stroke of genius.

Some will be surprised to learn that **most small business are not entrepreneurial but stagnant, reactive, status quo operations. Entrepreneurship represents growth-oriented, innovative outlook on business**. The former serves an important function in an economy, but they do not provide much dynamism. As Godsell observes, 'the most painful and marginal pavement subsistence is all that can be offered by rows of traders offering meagre and identical wares.' [12] And importantly in the context of this study although access to finance is often held out as the main problem facing entrepreneurs, it's not that simple.

These issues are discussed in more detail below and the implications for housing teased out, where it makes sense to do so.

[11] Hudson, J Debunking myths about entrepreneurship in South Africa Presentation to the Sol Plaatje Memorial Lecture Series, May 2004

[12] Godsell, G and Clarke, I November 1996 Creating jobs one by one: A manual for enthusiastic amateurs Centre for Developing Business, University of the Witwatersrand p.38

5 Regulations and the environment for entrepreneurship

The regulatory and administrative aspects of the environment in which firms operate can have a substantial impact on a country's competitiveness and capacity to create jobs as well as on the health of the SME sector. Why? Compliance costs vary with firm size, small business suffers most. **While regulations affect the private sector as a whole, they weigh most heavily on smaller firms because of their limited administrative resources, uncertain cash flows, limited understanding of their rights in relation to, for example, tax matters. Complying with regulations can be expensive and difficult,** assuming a business can work out what constitutes compliance in the first place. [13] Many small firms do not know if they are even complying with regulations, for example, as it is not just the quantity of regulations but also the quality thereof that affects compliance. Few SMEs have dedicated in-house tax specialists or human resources staff, for example. In addition to costs of lawyers and consultants there is little doubt that navigating 'red tape' requires not just time but patience and results in a fair amount of stress. A large corporation may well be able to absorb these costs, the situation is different for a small enterprises. This is also the area where there is the greatest degree of non-compliance.

Examining the costs of administrative compliance in almost 8 000 SMEs, an OECD report found that compliance costs per employee were over five times higher for the smallest SMEs than for the largest. An American study has concluded that firms employing fewer than 20 employees face an annual regulatory bill of US $6 975 per employee. This burden is 60% higher than that faced by firms with more than 500 employees**. A South African study found that compliance costs represent 8,3% of turnover for enterprises with annual sales of less than R1million, and 0,2% of turnover for corporations with sales of R1 billion or more**. Average compliance costs per person employed for firms with fewer than five employees are apparently ten times higher than for a firm with between 200 and 499 employees. [14]

[13] For a fuller discussion of these issues see Hudson, J An enabling environment for private sector growth: Lessons from the international experience published by the SBP, November 2002; Hudson, J Understanding regulatory impact assessments: Key issues from the international experience published by the SBP, January 2003; Hudson, J A small business perspective on tax compliance published by the SBP, October 2003.

[14] SBP Counting the cost of red tape for business in South Africa: Headline report November 2004,p.2.

The disproportionate impact of regulations on small business has a sharp significance in the South African context where the weight of the smallest size category (micro) is overwhelming. **Importantly for this study, inappropriate regulations effectively drive a wedge between the informal and formal sectors, when the challenge is to create greater linkages between the two**. (this theme will be returned to later in the paper) In Bolivia, one of the most heavily regulated economies, an estimated 82% of business activity takes place in the informal sector.

A large informal sector can be an indication that the regulatory costs on business are too high and inappropriate. A UK study found that 18% of non-registered businesses stated that they intentionally forego growth so that their turnover remains below the VAT-registration limit. So, VAT can act as an additional incentive for producers to avoid taxation altogether and join the informal economy. [15]

A 2004 study suggests that South African businesses incurred regulatory compliance costs of about R79 billion, or 6,5% of GDP.[16] While international comparisons come with hazards – cultures, systems and administrative arrangements differ, for example. The table below provides illustrative material from the OECD's postal questionnaire of between 300 and 1 200 businesses with fewer than 500 employees covering tax, employment and environmental regulations and excluding businesses in agriculture and mining, and those without employees:

[15] see Hudson, J 'A small business perspective on tax compliance' SME Alert published by the SBP, October 2003, p.4

[16] SBPCounting the cost of red tape for business in South Africa: Headline report November 2004, p.2

Estimated regulatory compliance costs in some developed countries as a percentage of GDP

Australia	3,0
Austria	3,8
Belgium	1,8
Finland	1,0
Iceland	1,3
New Zealand	2.8
Norway	2,8
Portugal	5,0
Spain	5,6
Sweden	2,2

Source: OECD PUMA Multi-country Business survey [17]

While it is not possible to make a direct comparison, the impression is that South Africa has a high regulatory compliance burden. However, it is interesting to note that a small scale survey in Uganda put compliance costs higher – as much as 11% of GDP for all firms. [18] Thus, there is a need for caution, these issues need to be investigated further.

One benchmark for reflecting on the levels of regulatory compliance, is the previously quoted World Bank's Doing Business in 2005 study: New Zealand topped the list of countries where it was the easiest for businesses to operate, followed by the US, Singapore, Hong Kong, Australia and Norway. Botswana and South Africa rank in the top quartile with Botswana ahead of SA – **our relatively rigid labour market increased the regulatory burden on businesses, curtailed employment and economic growth, according to the report**. Other findings include:

- **it takes 38 days to register a new business in South Africa** – faster than Germany, definitely snappier than Haiti which comes last at 203 days. But Doing Business points out that for business entry, only two procedures – registering for statistical purposes, and for tax and social security – are necessary to fulfill the social functions of the process.

[17] Cordova-Novion, C and De Young, C 'The OECD PUMA multi-country business survey – Benchmarking the regulatory and business environment in Evans, C, Pope, J and Hasseldine, J (eds) Tax compliance costs: A festschrift for Cedric Sandford Prospect Media, 2001

[18] quoted in SBPCounting the cost of red tape for business in South Africa: Headline report November 2004.

Australia, New Zealand and Canada limit the process to these two. South Africa has 9. Why?

Table 2: Regulations and the environment for entrepreneurship

	Starting a business			Closing a business	
	Number of procedures	**Time (days)**	**Cost (% of income per capita)**	**Time (years)**	**Cost (% of estate)**
Best country	2 (Australia, Canada, New Zealand)	2 (Australia)	0.0 (Denmark)	0.4 (Ireland)	1 (Colombia, Finland, Kuwait, Netherlands, Norway, Singapore)
Worst country	19 (Chad)	203 (Haiti)	1268.4 (Sierra Leone)	10.0 (Brazil, India, Chad)	76 (Central African Republic, Chad, Lao PDR)
Argentina	15	32	15.7	2.8	18
Brazil	17	152	11.7	10.0	8
Chile	9	27	10.0	5.6	18
India	11	69	49.5	10.0	8
Mexico	8	58	16.7	1.8	18
South Africa	**9**	**38**	**9.1**	**2.0**	**18**
Thailand	8	33	6.7	2.6	38
Uganda	17	36	131.3	2.1	38
Venezuela	13	116	15.1	4.0	38

Source: ***Doing Business in 2005: Removing obstacles to growth***

- It takes 58 procedures for a creditor to collect her debt in Sierra Leone but only 11 in Australia; 27 days in Tunisia but 1459 in Guatemala, according to Doing Business. **South Africa's 26 procedures take 277 days.** The fewer procedures, the lower the cost, the shorter the time to resolve the disputes. As confidence in dispute resolution rises, entrepreneurs become more willing to enter contracts beyond their narrow circle of known business partners.

Table 3: Enforcing Contracts

	Enforcing contracts		
	Number of procedures	**Time (days)**	**Cost (% of debt)**
Best country	11 (Australia)	27 (Tunisia)	4.2 (Norway)
Worst country	58 (Sierra Leone)	1459 (Guatemala)	256.8 (DRC)
Argentina	33	520	15.0
Brazil	25	566	15.5
Chile	28	305	10.4
India	40	425	43.1
Mexico	37	421	20.0
South Africa	**26**	**277**	**11.5**
Thailand	26	390	13.4
Uganda	15	209	22.3
Venezuela	41	445	28.7

Source: ***Doing Business in 2005***

- A survey of 1 794 businesses of all sizes conducted by Markdata and published by the SBP in which VAT - cited in 19% of responses, with other tax-related issues (PAYE and SARS together totalling 20%) – **emerged as the most troublesome and time-consuming regulations,** labour laws were mentioned in 12% of responses, and SETA and RSC levies in 11%. On average the annual costs of regulatory compliance per firm were R105 174 for all sizes and sectors, as indicated in the table below.[19]

Average estimated annual administrative, manpower, supervisory, and professional costs of regulatory compliance: means for the range of applicable state regulations

Type of regulation	**Mean cost**
Company registration (initial)	R 9 371
Professional fees	R 6 107
TOTAL	**R 15 478**
Company registration (annual)	R 6 262
Professional fees	R 3 388
TOTAL	**R 9 650**
Tax compliance	R15 709
Professional fees	R11 589
TOTAL	**R27 298**
Labour and employment	R11 735
Professional fees	R 6 557

[19] SBPCounting the cost of red tape for business in South Africa: Headline report November 2004, p.9

TOTAL	**R18 292**
Employment equity/empowerment	R 5 525
Professional fees	R 6 835
TOTAL	**R12 360**
Additional regulations	R18 866
Professional fees	R 3 241
TOTAL	**R22 107**
Government information	R 6 389
Professional fees	R 2 283
TOTAL	**R 8 672**
Local government regulations	R 5 542
Professional fees	R 1 253
TOTAL	**R 6 795**
Overall means costs of compliance per firm	R120 652
Mean recurring costs	
(initial registration included)	R105 174

Source: SBP 2004

Studies in different geographical areas may well throw up different emphases; almost every sector of the economy has regulations specific to its type of operations. Home-based enterprises (HBEs) would need to be investigated carefully to see which aspects might impact on their operations, for example shebeens and the liquor laws; zoning applications, by-laws, signage specifications and so on. What, if any, are the regulatory barriers that hobble HBEs? Are there any regulatory barriers that prevent the use of housing/housing finance in terms of entrepreneurship? If so, what are these? How can these be addressed? The Finmark study hopes to plug this gap in current knowledge.

This is an important agenda since as it has been argued, external forces tend to have more impact on small businesses than on larger ones. SMMEs are relatively less able to deal with 'shocks' in the global economy and are therefore particularly vulnerable. [20] **Changes in government regulations, tax laws, labour and interest rates affect a greater percentage of expenses for small businesses than they do for large corporations.** As Welsh and White remind us, 'such

[20] Department of Trade and Industry Annual review of small business in South Africa – 2003, Enterprise Development Unit, DTI, 2004, p.16

limitations mean that small businesses can seldom survive mistakes or misjudgements.' [21] If housing is coupled to entrepreneurship, the risks for entrepreneurs may well increase.

The Commission on Private Sector and Development has commented on two major structural challenges that confront the private sector in all developing countries to varying degrees, namely: micro enterprise and many SMEs operate informally, and many SME have barriers to growth.

[22]**Commitment to reforming the regulatory environment by eliminating artificial and policy-induced constraints to growth has to be a key aspect in terms of creating a facilitating environment for enterprise growth**. Importantly, regulations do not only incur costs, but clearly have very important benefits. Business interests do not determine public policy choices - social and environmental concerns are just as important as the impact on business.

It is worth noting that measures announced in South Africa's 2005 budget speech – turnover limit for eligibility for tax relief raised from R5md to R6mn; VAT payments for businesses with an annual turnover of less than R1mn will be required every four months instead of every two; those with annual payrolls of R500 000 or less will be exempt from the Skills Development Levy – suggest that the **objective of regulatory reform for small business is gaining currency.**

In addition, an idea that is currently being explored in the Presidency and National Treasury is that of **Regulatory Impact Assessments (RIAs).** This is a potentially promising strategy since one of the key features of an RIA is a focus on the impact of regulations (existing and proposed) – positive, negative, and possible unintended consequences - on small business. In the UK, government departments are reminded to 'think small first' when assessing the impact of proposed regulation [23], and in this way RIAs can make it easier to spot, control and ditch inappropriate regulations that may discourage entrepreneurship.

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[21] Welsh, J and White, J 'A small business is not a little big business' in Harvard Business Review July-August 1981

[22] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.11

[23] For a fuller discussion on RIAs see Hudson, J Understanding regulatory impact assessments: Key issues from the international experience published by the SBP, January 2003

6 Injecting a small business voice into the policy domain

The voice of small business is often not heard in policy debates – the demise of the National Small Business Council has contributed to this fact in South Africa as has the predominance of corporate power in many business associations – but more importantly most entrepreneurs are too busy running their businesses to participate in policy debates.

There is a further aspect. **Women, more likely than men, will be 'invisible entrepreneurs', operating from home-based enterprises**. Quoting Farbman and Steel, Rogerson argues, 'it is critical, therefore, **that policy support structures contain an element which is aggressive in terms of seeking them out** and helping these groups of poor women address their particular needs.' [24] Again, the **use of RIAs** which necessitates consultation with stakeholders – business, government, civil society and so on - might be a useful, structured way to access the voice of these entrepreneurs.

[24] Rogerson, C In search of the African miracle Final report prepared for the CDE, March 1999, p.19

7 The benefits of a regulatory reform agenda

A time-and-motion study measuring the obstacles facing entrepreneurs performing standardised tasks, the World Bank's Doing Business report has three main findings:

- **Businesses in poor countries face much larger regulatory burdens than those in rich countries** - 3 times the administration costs, nearly twice as many bureaucratic procedures and delays associated with them. In short, countries that most need entrepreneurs to create jobs and boost growth – poor countries – put the most obstacles in their way;
- **Overly complex regulation and weak property rights exclude the poor from doing business.** With burdensome entry regulations, few businesses bother to register, opting to operate in the informal economy instead. In most poor countries 40% or more of the **economy is informal. Women, young and low-skilled workers are hurt the most;**
- **The payoffs for reform appear to be large. Businesses spend less time and money on dealing with regulations; government spends fewer resources regulating and more providing basic social services. An improved regulatory environment could increase annual economic growth in many developing countries by as much as 1,4% a year**. More specifically, in 2002, the Dutch government set a goal of cutting expenditures on administrative burdens by 25% by 2006. Actal, an independent agency for cutting red tape, estimates that $2billion has already been saved by doing impact assessments before new regulations reach parliament. The benefits of regulatory reform are likely to be greater in developing countries, which regulate more.

8 Finance and entrepreneurship

The lack of access to capital and its high costs – important factors in enterprise growth - are common complaints among would-be entrepreneurs. For many the solution lies in pressuring banks to extend more loans.

The reality of small business lending is complex, however. **There are practical difficulties in lending to start-up businesses** with no collateral or risk capital, questionable business plans, limited managerial resources, [25] and there are important variances between lending to the small, medium and micro categories – different issues relate to different types of businesses, survivalist businesses have different constraints to medium businesses**. Several problems experienced by lending institutions in SA, for example, stem from a lack of capacity to provide aftercare mentoring and selection of appropriate people to support. Small loans to micro and very small enterprises are expensive to administer.** Despite the Saambou and Unifer reminders, it is often forgotten that banks are fragile institutions. In the words of a South African banker 'you go a bit loose and soft and you go belly up very quickly in this market.' [26]

In addition, the Commission on the Private Sector and Development notes that 'many countries lack rules for sharing credit information, which makes it **virtually impossible for creditors to check how indebted a potential client already is**. In addition, creditors have **limited protection in the case of default**, significantly lessening their willingness to assume the risks associated with small and medium enterprise lending.' [27] The Commission adds, **'SMEs are risky ventures. They require risk capital, but the sources of such capital are difficult to tap**. So SMEs generally have to turn to classic debt financing. This can be difficult for them, because few **entrepreneurs in developing countries can leverage assets as collateral** the way they do in developed countries. Why? Mainly because **of informal property rights and the lack of mortgage markets**.

[25] Antonie, F 'Financing development: The banking sector and SMMEs' in Indicator Vol 18, No. 2, June 2001, p.2.

[26] Interview with Iraj Abedian, Standard Bank, 14 August 2002

[27] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.18

Collateral requirements act as a screen that selects wealthy borrowers and crowds out many entrepreneurs with high growth potential.' [28] **Weak property rights make the use of assets as collateral difficult**. In addition, domestic financial institutions can operate in monopolistic conditions, with limited shareholder pressure to enter into new and more difficult markets, such as lending to SMEs. Where banks have the will, they often lack the skill to engage with SMEs.

Perhaps banks could come to the party more; there is a need to 'examine whether current regulations governing financial institutions and/or financial markets inhibit or facilitate the availability and optimal allocation of finance for entrepreneurial activities'. [29] In her comparative best practice study for the World Bank, Thrya Riley argued that 'South African banks still have some way to go in developing efficient and effective mechanisms for interacting with small business.' [30]

But importantly, **studies demonstrate that the majority of successful enterprise start-ups in developing countries are financed by entrepreneurs' personal savings, resources in the family and/or informal flexible loans within networks, rather than from institutional sources**. [31] Again and again, the key finding of local and international research in this area is that **personal and family savings as well as non-formal sources of credit** are important in entrepreneurial success. Riley notes that of the approximately 500 million micro and small entrepreneurs in the world, fewer than 10 million – or 2% - enjoy access to financial services from the formal financial sector. [32] In a survey of about 400 entrepreneurs across 18 sites in four metropolitan areas – commissioned by the Finmark Trust - only 15% of the sample said they had accessed a loan of some sort – of this, only 36% said the loan had been from a bank.

[28] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.18

[29] see OECD Fostering entrepreneurship pp28-30 quoted in CDE 'Supporting South Africa's emerging entrepreneurs' Key to Growth Research Report no. 12 p. 32

[30] Riley, TA International best practice lessons for financing emerging entreprises: Lessons for South Africa Development Southern Africa 13 (6), 1996, pp.799-810 quoted in CDE 'Supporting South Africa's emerging entrepreneurs' Key to Growth Research Report no. 12 p.53

[31] G Buckley Microfinance in Africa: Is it either the problem or the solution? in World Development 25, 1997, pp. 1081-1093.

[32] Riley, TA International best practice lessons for financing emerging entreprises: Lessons for South Africa Development Southern Africa 13 (6), 1996, pp.799-810 quoted in CDE 'Supporting South Africa's emerging entrepreneurs' Key to Growth Research Report no. 12 p. 21

Only three of the 400 respondents included in the sample had a current mortgage loan, and none of these indicated that they had used the mortgage to start their business. Only 2 respondents had accessed their loan from a micro-lender, and another five from a mashonisas; 25 respondents had accessed their loan from family or friends, and 5 from their employer.[33] Thus, the majority of respondents relied on their savings in order to start their business. **The majority of SMEs in South Africa finance their capital requirements through private savings from individuals as well as retained earnings.** [34]

In a World Bank led investigation of informal financial institutions in four African countries – Ghana, Nigeria, Malawi, Tanzania – it is argued that informal financing institutions, defined as financial activities not regulated by central banking supervisory authorities, have a major role to play in serving market niches that the formal banking network cannot readily reach. [35] Given poor information and inadequate infrastructure makes it difficult for formal financial institutions to reach these markets, these informal intermediaries, according to Steel et al, 'may provide the best financial linkage to the bulk of the population.' [36] Unlike formal banking, informal financial transactions rarely involve legal documentation.

The study concludes that such **informal financing institutions are an important vehicle for mobilising household savings and financing small enterprises and it recommends that informal finance be better integrated into financial development strategies.**

Mutual trust of members of the group often acts as a lubricant in these informal transactions. **Many immigrant communities are successful in generating start-up capital as a result of the networks within which they operate**. 'Like stokvels, the Chinese hui, Korean key and Japanese tanomoshi have little legal backing and formal rules. They rely on moral sanctions imposed within their tightly knit communities' [37] to stop misuse/abuse of pooled funds.

[33] quoted in Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004

[34] World Bank Survey 2001 quoted in van Biljon, W and Meyer, A A study into the reasons why historically disadvantaged entrepreneurs have difficulty in accessing financial assistance for their businesses Graduate School of Business, November 2002, p.12.

[35] Steel et al 1997 quoted in Rogerson, C In search of the African miracle Final report prepared for the CDE, March 1999, p.32

[36] Steel et al 1997 quoted in Rogerson, C In search of the African miracle Final report prepared for the CDE, March 1999, p.32

[37] quoted in Financial Mail 31 May 1996

As Sunter and Godsell point out, it is easy to overlook the role of trust and personal relationships in business, but the success of the enterprise will depend substantially on relationships and networks of this kind. [38] **Social networks - who people know - have value**. This is particularly the case for SMEs. Whereas physical capital refers to a physical object (house), human capital refers to properties of individuals (education), **social capital refers to the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them**. [39] This trust is good not just for business operations but also plays an important role in terms of poverty alleviation. For example, spazas are operated by struggling poor entrepreneurs and their customer case is constituted primarily by lower income customers. Current research by the Finmark Trust in the Financial Diaries Project points to credit lines from spaza shops as one of the significant financial instruments used by the poor (Finmark Trust 2005).[40]

These networks should not be overly romanticised, however. They can boost business performance by facilitating information flow, facilitate entrepreneurs meeting the 'right' people, 'link entrepreneurs with sources of financing, human skills, partners, suppliers and information.' [41] **A wide variety of specific benefits flow from the trust, reciprocity, information and cooperation associated with social networks and the inclinations that emerge from these networks to do things for each other, reciprocate.** However, as Godsell and Clarke point out, **networks can drain as well**. Dissipating networks include non-contributing members, who simply consume resources. [42] In addition, relying on social networks for repayment might not be an optimal approach for larger amounts that SMEs may require.

[38] Sunter, C and Godsell, G 'Climate change? Job creation through small and medium enterprises' in CPS Policy Forum Job creation series 6, 1999, p.3.

[39] Putnam, D Bowling alone: The collapse and revival of American community Touchstone, 2000, p.19

[40] quoted in Rogerson, C 'Reaching out to informal women entrepreneurs in Johannesburg: The case for a market development approach towards spaza retailing' 2005, unpublished, p.39

[41] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.33

[42] Godsell, G and Clarke, I November 1996 Creating jobs one by one: A manual for enthusiastic amateurs Centre for Developing Business, University of the Witwatersrand

In addition, one study noted that while a shortage of funds was often cited as a prominent problem experienced by SMEs, this '**shortage of funds should not necessarily be interpreted as a lack of access to borrowing.** Bad debt [poor payment by customers] and small profit margins [often a result of overtrading] create a perception among SME owners that shortage of funds is their major problem.' [43] This is an important point. Cash flow problems are often a bitter reality for SMEs. The SA Receiver of Revenue's insistence that VAT should be paid on invoice, not on receipt of payment, has exacerbated this, particularly for SMEs that sub-contract to larger entities that are tardy in their payments - like the government.

Relaxing the credit bottleneck may surface other problems or constraints unrelated to access to finance. [44] As one constraint is removed, another often emerges. In essence, **too narrow a focus on access to capital overlooks other factors that make a substantial difference in the life of a small business, such as:**

- The ability **to defer gratification and save money to set up a business** rather than take on a debt burden;
- **Business skills** such as successful management of cash flow, administration of an overdraft facility and other operational issues.

Small businesses generally confront a range of constraints over and above financial needs including: access to improved technology, raw materials, skills training and information on market opportunities. [45] In essence, **financing support on its own is not enough; business skills and a helpful environment for private sector growth have to be developed in tandem**. What the evidence does point to is an opportunity for banks to encourage savings rather than taking credit, as a means to building up sufficient resources for successful entrepreneurial activities.

[43] Business Report 27 November 2001

[44] J Dawson and A Jeans Looking beyond credit: Business development services and the promotion of innovation among small producers, Intermediate Technology, London, 1997, p.10.

[45] Dawson, J and Jeans, A Looking beyond credit: Business Development Services and the promotion of innovation among small producers Intermediate Technologies publication, UK, 1997

9 Case Study: South Shore Bank's rehabbers[46]

'One of the keys to the program's success has been the matchmaking ability of the bank's lenders to link talented people to assets' – Mary Houghton, President Shorebank

South Shore Bank (SSB) is a fully licensed, commercial bank, with a community development mission located on the south side of Chicago. SSB played an important role in building growing locally-based rehabber entrepreneurs who have to date, upgraded and rehabbed around 20 000 housing units in South Shore, creating wealth for themselves, African American entrepreneur role models for younger generations, and jobs and affordable housing for local residents. The local residents realised real estate appreciation and improved, secure, affordable rental housing and job opportunities that resulted from the rehabbing work. The unconventional approach to entrepreneurial development created a profitable lending niche for SSB, successful businesses, and visible development benefits. According to Pikholz, at the heart of the successes are **entrepreneurs who grew their businesses with support of successful and devoted provider agencies that understood the specific market in which they operated, and who worked very closely with entrepreneurs** to perfect their programmes. Most of SSB's rehabbers, roughly 50% of SSB's real estate customer base, began with relatively little business management experience and assets, but with considerable entrepreneurial talent, commitment and rehabbing skills. Says Pikholz, 'Without a penny of subsidy from government, the finished product is a beautiful building that invites the typical tenant, a young woman with a child, to rent the safe and affordable housing.' [47] A motivating belief was that **community economic development should be market-driven and accountable**, and that this double bottom-line focus (returns and community development) could be best done through a for-profit institution.

[46] This case study has been extracted from Pikholz, L Growing small and micro businesses through a credit plus strategy: Lessons from the international experience Shorebank Advisory Services, Paper prepared for CDE, 1999

[47] Pikholz, L Growing small and micro businesses through a credit plus strategy: Lessons from the international experience Shorebank Advisory Services, Paper prepared for CDE, 1999,p.17

Shorebank's best known enterprise support programme is its multi-family mortgage loan program, which finances 'entrepreneur residents' in the business of rehabbing apartment buildings in Shorebank's economically distressed target areas. Indeed, in 1973 South Shore was suffering from the effects of rapid change. Block by block of beautiful brick homes intermingled with sections of predominantly large walk up, 3-story brick rental buildings.

Since the beginning of the programme in 1974, housing development by SSB has increased at an average of 43,97% units per year. Multifamily rehabbing has been Shorebank Corporation's most profitable and successful business line, which has brought more mainstream investors into the niche. Large banks now compete to make loans to rehabbers.

A consortium of savings and loan associations were aggressively urged by Shorebank to undertake a 300 unit, publicly financed, scattered site rental housing rehabilitation project in South Shore. The project demonstrated strong market demand for the highly attractive rehabilitated, secure and affordable rental properties. This made it easier for smaller, local entrepreneur rehabbers to proceed without subsidy, to risk their own savings to purchase other buildings, and for South Shore to finance and support them.

With SSB financing, the rehabber-entrepreneurs succeeded by acquiring under-valued assets (apartment buildings in a neighbourhood that had undergone racial change), effectively investing in their upgrade cost through shrewd purchasing of materials and use of their own and other inexpensive labour. They also took advantage of the strong demand for safe and affordable housing. In sum, says Pikholz: '**the market was right, the rehabbers had the skills and entrepreneurial drive, and they matched their motivation with a huge time commitment.**' [48]

Two other factors were critical to their success:

- **SSB's lenders creatively structured their loans**; and
- Learning took place through **informal information sharing and meetings with fellow entrepreneurs**. SSB initiated the process of information sharing.

[48] Pikholz, L Growing small and micro businesses through a credit plus strategy: Lessons from the international experience Shorebank Advisory Services, Paper prepared for CDE, 1999,p.15

The way South Shore lenders **tailored the loans to meet customer needs was a critical success factor and a very different approach to the technician style asset based approach other commercial banks were taking** to the same market. The loan programme operated simply without much paperwork which fits the pragmatic style of most borrowers, the deal's inability to afford much in soft costs, as well as the personality of SSB's chief lender, Jim Bingley. Jim is described as having a 'disdain for bureaucracy and a passion for interactive customer contact, both in meeting the borrower's financial needs and "collecting hard and fast" when a borrower slips on a scheduled payment. Bingley was the 'connector' – to money, new rehabbers, and information.

SSB's mandate to lenders was simple: 'If a guy comes in with a promise, make it work financially.' Loans were structured to **fit the borrower's cash flow**, which might mean an initial six months moratorium of principle payments; approving loans with **an additional amount for working capital** to fund early bank repayments, and/or offering a line of credit to buy a property quickly and cheaply for a desperate seller. Since the early 1980s the work of these entrepreneurs has affected well over a third of South Shore's rental housing units. Demand is still strong today, over 20 years later.

Information was delivered through rehabber entrepreneur rehabber networks started by a modest bank effort to aid information sharing. The local rehabbers in South Shore knew of one another's skills and reputation but did not meet with one another on any structured basis. Jim understood that the rehabbers could benefit from interacting with one another. He knew most of the local rehabbers since they had taken out a loan from a bank. He offered them the bank's boardroom as a place to meet on Saturday morning to talk about issues of common interest. The primary motivating force for his decision was the fact that entrepreneurs learn best from other entrepreneurs. Indeed, networks can create an entrepreneurial climate for coaching, mentoring and learning as well as strengthen the links between companies. [49]

In the beginning, SSB helped organise the meetings for its rehabber-entrepreneur customers around specific topics, for example, boilers – with half the attendees proven operators, and half novices. The operators who had done well had credibility; the others listened and learned. In recent years, the rehabbers run their own meetings at a local McDonald's restaurant.

[49] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.27

While finance was the main product that SSB was selling, SSB's lenders **also provided business development services** to borrowers on an informal and unstructured basis, for example, by advising them on:

- Learning when they were probably overpaying for a property;
- Alternative rehabbing options, especially if rehabbers did not have much extra cash on-hand;
- The practice of starting small, and what type of building they should first renovate to begin building their expertise base.

This **technical assistance was informally delivered, simply as part of the lender-client conversations** – which improved the SSB's ability to **reduce its exposure** as well as the **entrepreneur's ability to succeed**. SSB's real estate department has a preference for first-time rehabbers starting with a **small building which is a good fit with their existing capacity and then grow them as they develop more competencies in the real estate business**. If a rehabber has never rehabbed a building SSB prefers to finance a less sophisticated rehab scope (e.g. to finance a repair job on a six flat). For bigger apartment buildings with large rehab needs, SSB prefers rehabbers to show that they will devote significant time to the project. If they are not already working on the rehab full-time by the time they are doing 36 unit rehabs, the rehabber entrepreneurs should demonstrate that it is their intention to do so in the future.

Essentially, the rehabbers were successful because:

- A **strong market for affordable housing** enabled them to buy under-valued assets, often with SSB's assistance;
- They acquired **loans that SSB tailored and structured to meet their cash flow needs**;
- Of **information sharing**, learning and informal networks, in which SSB's lenders initially played an important, though not formal, role; and
- They were **skilled trades people with entrepreneurial flair**; SSB recognised and 'banked' their talent.

Unlike SSB, many other banks that are forced to invest in economically distressed neighbourhoods do use government subsidies because they have neither the market knowledge of their markets or customers. Many believe that loans made to rehabbers are simply a 'cost of doing business', given the Community Reinvestment Act which requires banks not to discriminate against customers in economically distressed communities. (somewhat crudely stated)

The SSB success demonstrates the opportunities which arise when non-financial business development services accompanies finance – the nurturing role of the SSB contributed significantly to their success. Success is attributed to local entrepreneurs in South Shore, the SSB's own real-estate lenders and the lending staff.

It shows that 'business development services that help grow successful enterprises can be delivered on a cost-effective and sustainable basis if they are tailored to the needs of entrepreneurs (who paid at least a portion of the cost), rather than the supply-driven traditional delivery of cookie-cutter technical assistance packages that so often fail.' [50] Successful BDS provision occurs when interventions are demand-driven and delivered by providers in a sustainable manner that are designed to reach and benefit entrepreneurs cost-efficiently, at scale and in an accountable and market-driven manner.

[50] Pikholz, L Growing small and micro businesses through a credit plus strategy: Lessons from the international experience Shorebank Advisory Services, Paper prepared for CDE, 1999,p.23

10 Formality and informality: Mind the gap

Entrepreneurship was certainly blunted by apartheid policies, which contributed to a highly dualistic economy characterised by a high productivity (modern) and a low productivity (informal) sector with scant interaction between them, and a division along racial lines. Our specific history meant the exclusion of the majority of potential entrepreneurs from proper education and access to property and/or financial resources.

The apartheid legacy is linked to the structural role and status of the SMME sector and partly explains the participation of various groups on the basis of race and gender. For example, in 1999, StatsSA estimated the number of entrepreneurs (self-employed persons) to be about 1 630 000 or 3,7% of the population. About 70% of these 1,6 million entrepreneurs operate in the informal sector, 41% are women – this illustrates two of the main challenges of any SMME support strategy. The 1999 October Household Survey data showed that non-survivalist enterprises were still dominated by whites and Asians, accounting for 6,4% and 3,8% respectively. Black non-survivalist entrepreneurs accounted for only 0,54% of all economically active people. [51] African females have the highest incidence of informality while those of white males have the highest incidence of formality.

Formal and informal entrepreneurs respond differently to the regulatory environment, the latter tend to ignore regulations, taxes, levies and health standards. Even though regulations may not be enforced in the informal sector, these regulations – taxes, levies, health standards and the like - act as a barrier to development by keeping a large proportion of the population out of the economy. [52] **Development requires formalisation because it is only when SMEs operate in the formal sector that they can access capital and utilise infrastructure in order to grow**.

[51] Berry and others, The economics of small, medium and micro enterprises Trade and Industrial Policy Strategies, 2003, p.14

[52] Bannock, G et al Indigenous private sector development and regulation in Africa and Central Europe: A 10 country study January 2003, p.2.

[53] Says the Commission on Private Sector development, '…in many poor countries, SMEs are marginal in the domestic ecosystem. Many operate outside the formal legal system, contributing to widespread informality and low productivity. They lack access to financing and long-term capital, the base that companies are built on.' [54]

While the informal sector plays an important role, it is not uncomplicated. In the words of Andre Ligthelm of the Bureau for Market Research, '**While it offers opportunities for the unemployed, jobs in this sector tend to be low paid, with little job security. Moreover, entrepreneurial activity is promoted, but at the price of non-compliance in rest of tax, labour and other regulations**.' [55]

Illustratively, one hundred and fifty South African informal sector enterprises were recently asked whether or not officials had interfered with their operations in any way; 28% said yes, 62% of these had had stock confiscated or destroyed, 19% had been prosecuted and fined, 17% had been ordered to close or move on, 10% had been asked to pay bribes. These are costs borne by these enterprises. Advantages of formalisation identified were: less harassment (30%); cheaper stock/inputs and credit (17%); the possibility of government aid (24%); and a better image for marketing and tenders. Among the perceived disadvantages to registering their businesses were taxes (38%) costs in relation to rewards (22%) and red tape (7%). [56] **If regulation were simplified, entrepreneurs would find benefits in moving to the formal sector in the form of greater access to credit and courts; secure premises, corporates, the public sector might take them on as suppliers as enterprises need a tax certificate to tender for contracts.**

The question of informality is made more complex because there are non-survivalist but unregistered micro-businesses that are 'informal' by default – largely a form of tax evasion. This points to the need to make a distinction between an informal economy of survival, an informal economy of growth, and a formal – often highly profitable and skilled – micro-sector. Authorities

[53] see SBP 'An enabling environment for private sector growth: Lessons from international experience' SME Alert November 2002, p.3.

[54] Commission on the Private Sector and Development Unleashing entrepreneurship: Making business work for the poor Report to the secretary-general of the United Nations, 1 March 2004, p.1

[55] quoted in Hudson, J 'Not any job will lead out of poverty' Enterprise March 2004

[56] SBPCounting the cost of red tape for business in South Africa: Headline report November 2004, p.14

would most likely be interested in registered non-survivalist but unregistered business – this might be a successful bed and breakfast in Johannesburg's leafy northern suburbs - and getting them into the tax net, but less likely to try and collect tax from an operator selling curried vetkoek at a taxi rank or a shoe polisher at a roadside.

11 Moving up a ladder?

Small business consultants have suggested that rather than see the informal sector as 'unfair competition' to the formal sector, it is more useful to see it as **an incubator to build skills and assets before an enterprise enters the formal sector**. Tips makes reference to **a continuum of situations from informal to formal business:**

From seed stage, not operational to Occasional, secondary, non-registered to Permanent, informal, non VAT-registered to Sole proprietorship and partnerships to Close corporations and companies

The increased degree of formality apparently moves from:

1. Operational
2. Continued activity
3. Registration for VAT
4. Permanent employees
5. Registration as legal entities (CIPRO).[57]

But as Tips points out, **the reality is far from simple**. 'The formality criteria are intertwined and not necessary correlated – for example, corporations registered with the Companies and Intellectual Property Registration Office (CIPRO) may well be trading only occasionally or even not at all, while non-VAT registered trades may provide many jobs, at least on a casual basis', says Tips. [58]

Is the informal sector really a budding formal sector SMME? Surveys conducted across Southern Africa indicate that **less than one percent of firms 'graduate' from the micro-enterprise seedbed** and become more established enterprises employing more than 10 people. [59] Why is this so? Part of the explanation lies in an overly complex regulatory environment and onerous compliance costs – discussed earlier - which penalises smaller firms, discussed earlier.

[57] Trade and Industry Policy Strategies Annual review of small business 2003 p.5

[58] Trade and Industry Policy Strategies Annual review of small business 2003 p.5

[59] Mead, DC and Liedhold, C 1998 'The dynamics of micro and small enterprises in developing countries' in World Development 26, p.67

Regulations (to start a business, for operations, enforcing a contract, closing a business), if excessively complex, can become significant barriers for enterprises and hamper business growth and thus prevent the smooth graduation of a business into more sophisticated levels. This paper has noted some of the hassle factors associated with informality.

In addition, **small business is often dynamic and rapidly changing**, for example, a business **may move one rung up the ladder one year, but two steps down a few months later**. Says Barrie Terreblanche, editor of the South African Big News for the Business Owner, 'serious research is needed into the extent of graduation from informal to formal business, and whether it is at all possible on a large scale. My unhappy conclusion is that well-intentioned attempts at getting informal business to graduate to formal businesses have been a waste of scarce developmental resources. My observations suggest that informal business owners either remain informal, or leave their businesses to become formal employees. Unemployed youths who are encouraged to start their own businesses fail in frightful numbers when their attempts are coupled to formal business arrangements such as bank loans or contracts. It leaves them with ruined credit records and dashed confidence… It seems that a **major step forward would be for the development community to accept this reality,** and to rather train informal business owners to become employable, and to support employed middle management to become employers.' [60]

Importantly, some entrepreneurs, notably women entrepreneurs in HBEs, are often **less willing to pursue a growth orientation**, aiming for business stabilisation and income security rather than high-risk growth opportunities. The HBE offers an opportunity for child care and there is no aspiration to graduate this kind of business. This does not mean there are no exceptions. The spaza shop market – actively discouraged during the apartheid days – is now recognised as a significant part of the retail market in SA playing an important role in supply chains to more formal outlets. Indeed, the growth of spaza shops in the apartheid days, for example, shows how the efforts of ordinary people 'voting with their feet' created new rights in the business field despite a hostile official and legal environment. [61] The point is that this ladder cannot be assumed to be automatic.

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[60] quoted in CDE 'Supporting South Africa's emerging entrepreneurs' Key to Growth Research Report no. 12 p. 21

[61] This process been powerfully documented by John Kane-Berman in his books The Silent Revolution and Beating apartheid and building the future published by the SAIRR, 1990.

It would be unwise to **underrate the degree of economic activity and commercial spirit in the informal sector. Inappropriate regulations offer incentives to remain small and informal, loosening them has a far better pay-off.**

According to Peruvian economist, Hernando de Soto, 'We…cut dramatically the costs of the red tape to enroll small businesses. By 1994 Peru had the world's highest growth rate of about 13% per annum. It was a huge shock… All we had to do was make sure **the costs of operating legally were below those of surviving in the extralegal sector**, facilitate the paperwork for legislation, make a strong effort to communicate the advantages of the programme, and then watch hundreds of thousands of entrepreneurs happily quit the underground.' [62] A study conducted in Egypt concluded that the extra-legal economy employs over 8 million people (about 40% of the workforce) and has assets of almost $250 billion, 30 times the market value of all companies registered on the Cairo Stock Exchange. [63]

Informal entrepreneurship has 'boomed' in South Africa with a total growth of 10.9% in the period 2002-2003, highest among African women at 13.9%, for African men growth is 10.7%. [64] **This growth represents a potential resource that could be harnessed for growth and development and suggests that attention should be paid to barriers to entry in the formal sector**. [65] This entrepreneurial energy is there and must be fostered. Our economy would grow faster and more equitably if the most successful elements of the informal sector could be brought into the formal sector. **Part of the challenge is in making the process of formalising easier so that informal enterprises do not become trapped in sub-scale** activities, [66] and easing the tangle of bureaucracy which stacks the odds against entering the formal economy.

Nevertheless, it will be a difficult journey.

[62] Hudson, J (ed) 'The mystery of capital: Why capitalism triumphs in the west and fails everywhere else': A South African conversation with Hernando de Soto CDE Focus November 2001, p.2.

[63] quoted in Commission on the Private Sector and Development, Report to the Secretary-General of the United Nations Unleashing entrepreneurship: Making business work for the poor United Nations Development Programme, New York, 2004, p.9.

[64] See Annual review of small business in South Africa – 2003 p.23

[65] ibid

[66]

12 Reflecting on De Soto's thesis

What makes the "North" rich and the "South" poor? According to De Soto, in his books *The Other Path a*nd *The mystery of capital*, the poor do not need the transfer of goods but the transfer of rights. The oppressed of the poorest nations just need functioning markets and the rule of law. 'Five sixths of the world's population are locked out of the capitalist system. Most are as marked off as apartheid once separated black and white South Africans.' [67] Men and women of the third world simply lack the institutional tools taken for granted in the west such as the enforcement of laws and the transferability of property. How can banking or credit fulfil its functions without contracts? The poor lack collateral as their assets cannot be traded. They cannot get bank loans to expand their businesses or improve their properties. Their potential is locked up in what de Soto call 'dead capital'; their assets – houses, land or businesses – are part of what we would call the black economy. Lying outside the established legal framework of enforceable property right, these assets are useless for generating wealth. Capitalism and globalisation is nothing more than a legal framework which through representations and rules allows us to interconnect. In short, **the poor lack property rights** – 'houses but no titles, crops but no deeds; businesses but not statutes of incorporation.' [68]

In the west, a house is not just somewhere to live, with four walls and a roof; it also has a parallel existence as a producer of capital which we can use to secure credit. In the developing world, because property rights are not adequately documented, assets cannot be traded outside local circles where people know and trust each other, cannot be used as collateral for a long, cannot be offered as 'live' capital. [69] Overly complex regulations means that it is little wonder that most people build houses or start their businesses outside the legal system.

As industries and cities grew in the west, countries such as Britain and the US drew all their property rights, formal and informal, into a single legal system. This allowed them to participate in an expanded market, made their assets transferable and fungible, accelerated specialisation, and division of labour, and allowed them to benefit from economies of scale.

[67] ibid p.20
[68] Blundell, J 'A man with the potential to change millions of lives' in The Scotsman 5 April 2004
[69] Leonard, M 'Liberty, equality, property' in New Statesmen 4 September 2000

De Soto encourages poor peasants working in marginal jobs to consider themselves as part of the formal economy; taxi drivers and street corner gum vendors should consider themselves capitalists. Poor people should use their property – farms jitneys, pushcart tobacco stands, scooters, chickens, huts – to apply for loans and expand their businesses. [70] His central insight is that to escape from poverty you need assets – assets which you can put to work.[71]

[70] Editorial ‘Capitalism and the masses’ in Las Vegas Review-Journal 10 May 2004
[71] Leonard, M ‘Liberty, equality, poverty’ in New Statesman 4 September 2000

13 A South African take

It has been estimated that housing in former black townships is worth R68,3 billion. [72] A study commissioned by the Finmark Trust surveyed entrepreneurs in 18 sites in four metropolitan areas – Johannesburg, Ekurhelune, eThekweni, and Cape Town – to attempt to understand the role that housing plays in the entrepreneurial process. It asked the following kinds of questions: 'do entrepreneurs consider their housing as an asset to their business? Does their home help them access finance? How might the opportunities that housing provides entrepreneurs be amplified? [73] While about 68% of the respondents for the survey said that their dwelling made it easier to start their own business, only 3% of these (about 8 respondents) said it made it easier to obtain a loan. Among the respondents who owned their home and who had expressed an in-principle willingness to sell, and who had accessed loan finance to start their business, the use of the house as security increased considerably, with 50% (5 respondents) having offered their home as security. Only one respondent did not offer security for their home. Says Rust, 'what this data tells us is that **for those households who sought finance, the status of their housing as an 'asset was significant in their ease or struggle with the process**.'[74]

The Finmark study found that 'for a range of reasons, township entrepreneurs generally do not leverage capital using their property as collateral.' [75] Are housing assets 'dead capital' for low income households? Rust argues however, that the concept of 'dead capital' does not capture 'the very **alive role that housing does play in entrepreneurial development. Many households use their homes as a base for their initial forays into entrepreneurialism. By using their housing as a retail space, a place of production, or for storage within their overall livelihood strategy, households are operating as emerging entrepreneurs.** In this way, even if housing is not leading to wealth creation, it does have an **important impact on reducing the costs of entrepreneurial activity, at least in the start-up phases**.

[72] quoted in Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.1
[73] quoted in Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.2
[74] Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.5
[75] Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.8

In an environment, where entrepreneurs are not seeking large scale funding, and where the small scale nature of their businesses means that space costs can be a significant drain on their operations, the role of housing in such cost savings is important.' [76]But is there more that can be done? If so, what? What are the reasons behind not wanting to leverage their property as collateral? Are there any regulatory obstacles?

There is strong anecdotal evidence that many entrepreneurs use their access bond facilities – which allows you to deposit spare cash into your home-loan account and withdraw the surplus when needed - as 'shock absorbers' to tide them over dips in cash flow, cash flow problems. However, this runs the risk of insufficient separation of private and business funds, and there are no tax advantages to the business if this approach is adopted. More research is needed on this aspect, however, as the plural of anecdote is not data.

The more assets an entrepreneur commands, the greater the capacity to buffer against external shocks – which as noted earlier tend to knock small business greater than larger ones. This points to a further **use of the house by entrepreneurs, namely as cushion.**

In addition, commenting on his new jazz enterprise in Newtown, Brad Holmes, promised the same quality of entertained as at the old Bassline - a popular Melville jazz venue - 'We outgrew Melville. It was becoming too much of a bar culture and the rental was too high…I have major faith in Newtown; I basically put my house on it.' [77] To what extent he is illustrative of a trend towards doing this, is hard to say and merits further investigation. What is more certain is that putting up your house is a great sign of an entrepreneur's commitment to their business – a necessary ingredient in terms of that business' success.

Rising property prices – escalating by a reported 32% nationally – have made housing that much more valuable asset, placing dream homes beyond the reach of the pockets of many aspirant home owners. Says Wendy Machanik of Wendy Mackanik Properties, 'There are quite a few options for savvy homeowners to boost their bond repayments. The most obvious is to sublet a portion of the property Income from an additional cottage, flatlet or even a room can generate from around R2 000 to R5 000 per month in rental, which makes for a substantial reduction in your bond repayments.'

[76] Rust, K The role of housing in entrepreneurial activity in South Africa 8 November 2004, p.9
[77] van Rooyen, K 'Another milestone for the Bassline's Brad' in Sunday Times 27 February 2005

Working from home is beneficial as a result of the savings on office rentals and the offer of tax relief. Bylaws permitting you can set up a studio or consulting room to help pay off the bond. [78] There are also significant opportunities in the B&B market using the housing space, more recently building conference facilities onto this house has also emerged as an attractive business option in Gauteng. There are also many examples of entrepreneurs taking advantage of the property boom to buy properties, remodel them and sell to make fast money, or buy a property to rent so that a steady income is produced to sustain them comfortably through volatile ups and downs in their other enterprises with monthly rents acting to stabilize potential cash flow hiccups.

[78] Jordaan, L 'How to get that dream home' in Femina July 2005, p.40

14 Failure

Part of the reason for not using the house as collateral might be related to a reluctance to put their home at risk, given the up-and-down, extremely dynamic nature of many entrepreneurial endeavours, and downright failure in many circumstances. The reality is that large proportions of small businesses the world over fail more than once before succeeding. Henry Ford's first two car ventures failed. [79] **Early mortality of small firms is a global phenomena**, some studies report that in some cases less than 50% of small firms survive longer than 5 years in Europe or the US. [80] South Africa's minister of trade and industry disclosed, in June 2001, that 117 246 small business enterprises receiving government assistance had failed during the past four years, losing more than R68million. [81] Writing for the Business Day Colin Anthony notes that **'about 75% of businesses fail within their first three years**. [82] In a post-apartheid context where for many owning a house generates a 'sense of security, independence and pride', [83] losing your house might be a devastating consequence of business failure if housing is attached to it. Housing is still shelter. (Note that business closure should not be automatically seen as failure, since the entrepreneur might have simply moved on to better prospects – the key is to follow the entrepreneur rather than the business.)

From an entrepreneurial perspective, the real issue is whether or not this failure is used as a learning curve. In many ways, it boils down to a question of attitude. Social and cultural contexts either create positive attitudes towards entrepreneurship or lead to negative or suspicious attitudes. In Hong Kong, goes the joke, if you start a business your family works nights to help you. In America, friends invest in your company. But in Britain, people tell you that you will fail, and if you succeed they scratch your car. [84]

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79 'Vital intangibles' in The Economist 27 March 1997
80 Quoted in Tips Annual state of small business 2003 p.22
81 Business Times 9 April 2002
82 Anthony, C 'Time for government to get its SME policies right' in Real Business 22 March 2005
83 Zack, T and Charlton, S Better off, but… Beneficiaries' perceptions of the government's housing subsidy scheme June 2003, p.5
84 'Envy versus enterprise' in The Economist 8 July 1999

In 1999, Clem Sunter argued that South Africans had adopted the British approach viewing entrepreneurs 'greasy little so and so's; successful ones as 'nouveau riche greasy little so and so's'. [85] Thankfully, cultures can and do change. In China, businessmen were once paraded through the streets in dunce caps and violently persecuted as 'class enemies'. But after the Cultural Revolution, Deng Xiaoping unleashed entrepreneurial spirit, saying 'to get rich is glorious'. [86]

It would also seem that entrepreneurship is no longer seen as a consolation prize for not getting a job in the formal sector in SA, since many business operators have stated that they would not take a formal job if this was offered to them and the data on self-employment stats in SA quoted earlier in this report, suggest reasons to be cheerful in this regard.

A risk-taking achievement oriented culture, that is open to all and does not attach stigma to failure, boosts entrepreneurship. Regulations can play a part. Good bankruptcy laws that allow entrepreneurs to try again are important. By contrast, bad bankruptcy laws can take the spark from a country's entrepreneurial spirit. Illustratively, a typical business bankruptcy might take four months in Ireland, according to the World Bank's Doing business in 2005 five in Japan, but can take more than ten years in India and Brazil! South Africa's two years needs to be seen in this context – not among the worst, but leaving room for improvement. Does personal bankruptcy legislation in SA provide an appropriate balance between encouraging risk-taking and protecting creditors?

Lenders may well have to develop alternative lending products that do not rely on the home as collateral, as a result of this reluctance.

[85] Sunter, C and Godsell, G 'Climate change? Job creation through small and medium enterprises' in CPS Policy Forum Job creation series 6, 1999, p.3.

[86] 'Capitalist and communist no contradiction' in Business Day 12 November

15 Concluding remarks

During the apartheid days, South Africa's small business economy was either neglected or in the case of black-owned enterprises, actively discouraged. That is no longer the case**: SMMEs have increased their role as suppliers of the public sector and of corporates, their share in national exports and in overall employment, and their relative significance in many other dimensions of the economy has been noted**. President Mbeki has made encouraging remarks regarding commitment to reducing the costs of doing business, particularly for smaller enterprises, which – as this paper has demonstrated – is to be welcomed. Nevertheless, considerable challenges remain.

In **this regard a focus on housing as an asset to enterprises, its role in accessing finance and how the opportunities that housing provides entrepreneurs can be amplified are critically important areas for discussion.** There are many questions that remain: Is housing/housing finance used differently for different sizes of business – e.g. small, medium and micro businesses? In what way? Is this an appropriate avenue for intervention in terms of promoting entrepreneurship? What are the potential consequences – positive, negative and unintended? While the focus of many discussions is oftentimes on how to the protect the bank from risk, to what extent is the time ripe to consider ways in which the individual proprietor can be protected from risk.

What emerges is that currently the role of housing and entrepreneurship – beyond HBEs – is currently not well understood. For this reason, the Finmark study is plugging a critical gap.

16 Key findings

This report sets out the **key dynamics of entrepreneurship** based on a review of local and international studies [87]and focuses on:

- Entrepreneurship internationally and in South Africa
- The role of housing in Entrepreneurship
- The regulatory environment in South Africa for Entrepreneurs
- Key issues regarding the ability of informal and small scale Entrepreneurs to formalise and grow
- Finance and support for Entrepreneurs.

The use of the house by Entrepreneurs is explored in more detail in Resource Report 4.

1. **Entrepreneurship in South Africa: Entrepreneurship in SA holds the potential to drive growth, mop up unemployment, and contribute to meaningful BEE**. The importance of this role is difficult to overstate in the South African context. However, in the last ten years the growth of the enterprise sector in South Africa has been **modest and the country lags in terms of international comparisons** [88]. Moreover, government's 'reach' into this sector is seen to be **poor**, although its good intentions are not disputed. The **challenges are considerable**. South Africa has the double whammy of integrating itself into the global markets as a competitive economy, while simultaneously overcoming internal problems created by apartheid.

   Despite the above difficulties there are promising signs. According to Trade and Industry Policy Strategies [89] the number of businesses overall in SA increased between 2002-2003, as did the number of employers and self-employed, suggesting that **entrepreneurship is becoming an increasingly viable option**. The number of new private Companies and Close Corporations registered every year has increased almost steadily over the past 12 years. **On average, micro-enterprises employ approximately one third of South Africa's workers, small businesses account for almost 75% of employment .**

[87] This research is detailed in Resource Report 3 undertaken as part of the Housing Entrepreneurs Research project

[88] Global Entrepreneurship Monitor

[89] TIPS, The economics of SMME's December 2002

SMMEs have increased their role as suppliers of the public sector and of corporate's and their share in national exports and in overall employment has been noted.

2. **Role of housing**: There are a number of ways in which housing and housing finance can play a role in entrepreneurship – the two most frequently mentioned are as the **venue for the business and as collateral against which finance can be raised to grow the business**. The latter is less widely used in SA, possibly because of the high rates of business failure and the risky aspect of potentially losing your home.

   A study commissioned by the Finmark Trust et al [2004] estimated that housing in former black townships is worth R68,3 billion [90]. Yet the study found that for a range of reasons, township entrepreneurs generally do not leverage capital using their property as collateral. Part of the reasons for this might be related to a reluctance to put their homes at risk, given the up-and-down, extremely dynamic nature of many entrepreneurial endeavours, and downright failure in many circumstances.

   Early mortality of small firms is a global phenomenon. Colin Anthony notes that about 75% of businesses fail within their first three years [91]. In a post apartheid context where for many owning a house generates a 'sense of security, independence and pride' losing your house might be a devastating consequence of business failure if housing is attached to it. Given this Lenders may well have to develop alternative lending products that do not rely on the home as collateral.

   Rust [92]argues that housing is not 'dead capital' but does play a role in entrepreneurial development. **Many households use their home as a base for their initial forays into entrepreneurialism**. By using their house as a retail space, a place of production, or for storage within their overall livelihood strategy, households are operating as emerging entrepreneurs. In this way, even if housing is not leading to wealth creation, it does have an important impact on reducing the costs of entrepreneurial activity, at least in the start up phases.

[90] Township Residential Property Markets, June 2004, Shisaka

[91] Anthony, C 'Time for government to get its SME policies right' in *Real Business* 22 March 2005

[92] Rust, K *The role of housing in entrepreneurial activity in South Africa* 8 November 2004, p.3

In an environment, where entrepreneurs are not seeking large scale funding, and where the small scale nature of their businesses means that space costs can be a significant drain on their operation, the role of housing in such costs savings is important. The use of the house by Entrepreneurs is explored in more detail in Resource Report 4.

A further aspect is to see the **house as a cushion for the entrepreneur:** the more assets an entrepreneur commands, the greater the capacity to buffer against external shocks – which as noted earlier tend to knock small business greater than larger ones.

3. **Definitions, misconceptions and assumptions**: The National Small Business Act defines a small business as 'a separate and distinct business entity, including cooperative enterprises and non-governmental organizations, managed by one owner or more which, including its branches or subsidiaries, is predominantly carried on in any sub sector of the economy'. There are a number of misconceptions and assumptions regarding entrepreneurship, for example:
    - The tendency to view SMMEs as one homogenous lump, when in fact there are important differences. **It is important to segment the market.**
    - Many small businesses are **not entrepreneurial, but stagnant, reactive, status quo operations**. Entrepreneurship represents a **growth oriented, innovative outlook on business.**
4. **Regulation**: The regulatory and administrative context within which firms operate can have a **substantial impact on the health** of the SMME sector. This is because compliance costs vary with firm size, **small business suffers most** because of their limited administrative resources, uncertain cash flows and limited understanding of their rights [93]. Almost every sector of the economy has regulations specific to its type of operations. A South African study found that compliance costs represent 8,3% of turnover for enterprises with annual sales of less than R1 million and 0,2% of turnover for corporations with sales of R1 billion or more [94].

[93] J Hudson, An enabling environment for private sector growth: Lessons from international experience, November 2002

[94] SBP, Counting the cost of red tape for business in SA: Headline report, Nov 2004

While there are important benefits to regulations, if excessively complex, they can become **significant barriers for enterprises, hamper business growth and prevent the smooth graduation of a business** into more sophisticated levels. While it is not possible to make a direct comparison with other countries, the impression is that South Africa has a **high regulatory compliance burden**. A 2004 study suggest that South Africa businesses incurred regulatory compliance costs of about R79 billion, or 6,5% of GDP .[95]
Commitment to reforming the regulatory environment by eliminating artificial and policy induced constraints to growth has to be a **key aspect in terms of creating a facilitating environment for enterprise growth**. The objective of regulatory reform for small business is gaining currency. This is evident in measures announced in South Africa's 2005 budget speech, for example the turnover limit for eligibility for tax relief raised from R5million to R6 million, a change in VAT payment requirements and exemptions in respect of the Skills Development Levy.

In addition the concept of **Regulatory Impact Assessments** which is being explored in the Presidency and National Treasury, focuses on determining the impact of regulations both existing and proposed on small business.

The World Bank's Doing Business [96] report indicates that the payoffs for reform **appear to be large.** Businesses spend less time and money on dealing with regulations, government spends fewer resources regulating and more providing basic social services. An improved regulatory environment could increase annual economic growth in many developing countries by as much as 1,4% a year.

International debates and practice reveal a shift in approaches to the role of Government **from direct government-led provision of support** to entrepreneurs to government taking on a **facilitative or enabling role**. This affords the private sector a greater role in the delivery of business development services (BDS). Thus, there is a shift from supply side interventions to more demand-led strategies.

[95] SBP, Counting the cost of red tape for business in South Africa, Headline report, November 2004
[96] 2005 study

5. **Ability of Entrepreneurs to grow**: The apartheid legacy is linked to the structural role and status of the SMME sector and partly explains the participation of various groups on the basis of race and gender. For example in 1999, Stats SA estimated the number of entrepreneurs to be about 1,63 million or 3,7% of the population. **About 70% of these entrepreneurs operate in the informal sector, of which 41% are women.**

   The 1999 October Household Survey data showed that non-survivalist enterprises are dominated by Whites and Asians, accounting for 6,4% and 3,8% respectively, with Black non survivalist entrepreneurs accounting for only 0,54%.

   Formal and informal entrepreneurs respond differently to the regulatory environment, the latter tend to ignore regulations, taxes, levies and health standards. These regulations as detailed above keep large proportions of the population out of the economy. **Development requires formality because it is only when SMME's operate in the formal sector that they can access capital and utilise infrastructure in order to grow.**

   Informal entrepreneurship has 'boomed' in South Africa with a total growth of 10,9% in the period 2002 to 2003, highest among African women at 13,9%, for African men growth is 10,7% [97]. This growth represents a potential resource that could be harnessed for growth and development and suggests that attention should be paid to **barriers to entry in the formal sector .[98]**

   Inappropriate regulations effectively drive a wedge between the informal and formal sectors, **when the challenge is to create greater linkages between the two**. A large informal sector can be an indication that the regulatory costs on business are too high and inappropriate. **The growth in informal entrepreneurship in SA points to the need to look afresh at barriers to entry in the formal sector, an area which has not enjoyed sufficient research focus. Part of the challenge is in making the process of formalizing easier so that informal enterprises do not become trapped in sub-scale activities and easing the tangle of bureaucracy which stacks the odds against entering the formal economy .[99]**

[97] See Annual review of small business in South Africa – 2003
[98] See Annual review of small business in South Africa – 2003
[99] See Annual review of small business in South Africa – 2003

Small business consultants have suggested that the informal sector is an **incubator to build skills and assets before an enterprise enters the formal sector**. Trade and Industry Policy Strategies (Tips) makes reference to a continuum of situations from informal to formal business. The reality is far from **simple and this ladder cannot be assumed to be automatic.**

Surveys conducted across Southern Africa indicate that less than one percent of firms ‘graduate’ from the micro-enterprise seedbed and become more established enterprises employment more than 10 people [100]. Small business is often dynamic and rapidly changing, for example, a business may move one rung up the ladder one year, but two steps down a few months later.

Barrie Terreblanche, editor of the South African Big News for the Business Owner says that well intentioned attempts to get informal business to graduate to formal business has been a waste of scarce resources. A major step forward would be for the development community to accept this reality[101] .

Some entrepreneurs, notably women entrepreneurs in Home Based Enterprises, are often **less willing to pursue a growth orientation,** aiming for business stabilisation and income security rather than high risk growth opportunities. In addition the Home Based Enterprise offers an opportunity for child care and there is not aspiration to graduate this kind of business.

6. **Financing and support:** International studies repeatedly demonstrate that the majority of successful enterprise start-ups in developing countries are financed by **entrepreneurs' personal savings, resources in the family and/or inflexible loans within networks rather than from institutional sources [102]**. Networks, trust and social capital – who people know - are thus vital ingredients in entrepreneurial success. **Successful**

[100] Mead, DC and Liedhold, C 1998 ‘The dynamics of micro and small enterprises in developing countries’ in *World Development* 26

[101] Quoted in CDE ‘Supporting South Africa’s emerging entrepreneurs’ *Key to Growth* Research Report no. 12

[102] G Buckley, Microfinance in Africa: is it either the problem or the solution in World Development 25,1997

entrepreneurs are more likely to be embedded in helpful networks or relationships of support built up over time. [103]

The lack of access to capital and its high costs – important factors in enterprise growth – are **common complaints** among would be entrepreneurs. However small enterprises face a **range of constraints** over and above financial needs including access to improved technology, raw materials, skills training and information on market opportunities. **Financing support on its own is not enough – business skills and a helpful environment** for private sector growth must be developed in tandem . Business skills that are targeted, sector-specific and delivered in a market based approach, are likely to meet with greater success. Several problems experienced by lending institutions in South Africa, stem from a lack of capacity to provide aftercare mentoring and selection of appropriate people to support.

In a World Bank led investigation of informal financial institutions it was concluded that informal financing institutions (for example stokvels) are an important vehicle for mobilizing household savings and financing small enterprises and it recommended that informal finance be better integrated into financial development strategies.

[103] Sunter, C and Godsell, G 'Climate change? Job creation through small and medium enterprises' in *CPS Policy Forum* Job creation series 6, 1999, p.3.