



Entrepreneurial Perspectives

A Comprehensive Overview of Small, Medium, and Micro Enterprise Development in South Africa

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Abstract: The small, medium, and micro enterprise (SMME) sector is viewed as a catalyst for economic growth in the whole world due to its potential to substantially contribute towards employment creation and poverty reduction, among other things. In South Africa (SA), SMMEs have accounted for approximately 40% of gross domestic product and 47% of the workforce in the past few years. Despite the critical role of this sector in SA's economic growth, literature on understanding its development and trends is scant. This study, therefore, provides a comprehensive analysis on the development of SMMEs in SA. We first conceptualize the term by comparing the definitions of SMMEs from various countries. We later trace the regulatory development of SMMEs during the period from 1940 to 2020. We provide an in-depth discussion on the performance of SMMEs during the period from 2008 to 2021 from different lenses such as provincial, sectoral, and demographic analyses. The results confirmed that, in terms of the number of firms, the sector has remained resilient over the reviewed period. We found that the sector contributes significantly towards economic growth and employment in SA, and this has increased over the years under review. Lastly, we identified several financial and non-financial challenges faced by SMMEs.

Keywords: Small; Medium; and Micro Enterprise; South Africa; Regulatory framework; Performance; Financial and non-financial challenges

JEL Classification: L26

1. Introduction

All over the world, small businesses are recognized as great contributors to fostering economic growth and development. These enterprises are being given increasing policy attention because of the growing disappointment with the results of development strategies focusing on large-scale, capital-intensive, and high import-

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dependent industrial plants (Taiwo, Ayodeji & Yusuf, 2012). The contribution of small and medium enterprises (SMEs) can be seen through various economic aspects such as job creation, economic growth, and technological innovation, among others. Global estimates from the World Bank (2022) suggest that SMEs contribute 40% towards gross domestic product (GDP) in emerging countries and more than 50% towards employment in the whole world. Moreover, empirical literature also gives credit to the importance of SMEs for economic growth and job creation (see, for example, Acs, 2006; Taiwo *et al.*, 2012; Chimucheka, 2013; Stan, 2014; Yahaya, *et al.*, 2016; Yusuf & Albanawi, 2016; Zafar & Mustafa, 2017; Adeosun & Shittu, 2021, among others).

The case of South Africa is no different as the SME sector is also considered to be the backbone of the country's economy and an important driver of innovation and competition (Katua, 2014). Small and medium businesses encourage people to be creative in finding innovative solutions to emerging social challenges and creating of job opportunities, eradicating inequalities, and contributing to economic growth (Tuffour *et al.*, 2020; Msomi & Olarewaju, 2021). The South African government and other policymakers also rely on the SME sector for the realization of the 2030 objectives¹ of the creation of more jobs and inclusive economic growth. The sector is expected to contribute to the country's GDP by either manufacturing goods of value, or through the provision of services to both consumers or other enterprises (Berry *et al.*, 2002). According to Engineering News (2021), the SME sector currently represents 98% of all businesses in SA. They account for approximately 40% of the GDP and 47% of the workforce (OECD, 2017; Global Entrepreneurship Monitor (GEM), 2017). Furthermore, SA is one of the countries that participated in the third OECD Ministerial Conference on SMEs, where participating countries made a commitment to prioritize policies supporting the development of SMEs (OECD, 2018).

Despite the importance of small businesses to the South African economy, literature on understanding its long-term development and trends is scant. Our careful review of the literature suggests that existing studies such as Rogerson (2000), Olawale & Garwe (2010), Van Scheers (2011), Cant & Wiid (2013), and Neneh & Van Zyl (2017), among others, have focused on the determinants of SME growth and performance in certain sectors within a short period of time in SA. In this paper, we contribute to the body of knowledge by providing a comprehensive review of small,

¹ Government envisages having reduced unemployment from 24.9 % in June 2012 to 6% by 2030 and increased total employment from 13 million to 24 million. In terms of economic development, it is projected that by 2030, South Africa's GDP will have increased 2.7 times from the 2010 size. <https://www.gov.za/sites/default/files/Executive%20SummaryNDP%202030%20%20Our%20future%20-%20make%20it%20work.pdf>.

medium and micro enterprise (SMME)¹ development in SA over the past few decades by consulting an extensive amount of related literature, official documents, policy papers, and legislative acts. To the best of our knowledge, our study is the first study to include micro-enterprises when analyzing small to medium businesses in SA. In this paper, we conceptualize SMMEs with reference to various definitions used across the globe. We also trace the regulatory development and policies affecting SMMEs from 1940 to 2020. We conduct an in-depth analysis of the performance and contribution of SMMEs during the period from 2008 to 2021 from aggregated to provincial, sector, and demographic aspects by various indicators. We believe that our findings will guide researchers in the future research arena related to SMMEs in SA.

2. Organisation of the Study

The rest of the paper is organized as follows. Section 2 conceptualizes the SMME sector in SA with reference to other countries. Section 3 explores its regulatory development. Sections 4 and 5 analyze its performance and contribution respectively. Section 6 identifies challenges faced by SMMEs, and the last section concludes.

2.1. Definition of SMMEs

Defining small, medium and micro enterprises remains a challenging exercise across the globe. This is mainly because there is currently no universally accepted definition for this group of firms (Katua, 2014). According to the Organisation for Economic Co-operation and Development [(OECD), 2005], the lack of a globally accepted definition is due to the varying sizes of firms in this category across countries. The SMME sector encompasses successful enterprises with a large number of employees in some countries, while it only includes small firms in other countries (Herr & Nettekoven, 2017). Therefore, using any single definition of SMMEs for multiple countries in different stages of economic development would be misleading. Although there are various definitions used around the world, the majority of the definitions used include indicators such as the number of employees, annual turnover, and total gross asset value as defining factors. Among these indicators, the number of employees is the most used and comparable indicator across different countries and has different definitions within certain countries. Out of 267 definitions that exist in the world, 92% utilize the number of employees (see Hatten,

¹ In defining small and medium enterprise, there is a new category of micro enterprise to describe the smallest size of enterprise. Generally, the new term is called "MSME" (micro, small, and medium enterprise), while in South Africa it is called "SMME" (small, medium, and micro enterprises).

2011; Gonzales, 2014; Berisha & Pura, 2015). We, therefore, use these three indicators to compare the definitions of SMMEs in various countries. Table 1 below presents a comparison between various countries, including SA, in the disaggregated format of micro, small, and medium enterprises in terms of these indicators¹.

Table 1. Definition of SMMEs in Various Countries

Country	Number of employees			Annual turnover			Total gross asset value		
	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium
Developed countries									
European Commission	0-9	10-49	50-250	<€2m (\$2.2m)	<€10m (\$11m)	<€50m (\$55m)	<€2m (\$55m)	<€10m (\$11m)	<€43m (\$47.3m)
Canada	1-4	5-99	100-499	<\$30k	\$30k-\$3m	\$3m-\$20m	NA	NA	NA
Developing countries (Asia)									
Brunei Darussalam	0-4	5-19	20-99	<B\$100k (\$74.6k)	<B\$1m (\$745.8k)	<B\$5m (\$3.7m)	<B\$60k (\$44.7K)	<B\$600k (\$447.5K)	B\$3m (\$2.2m)
Cambodia	1-9	10-50	51-100	NA	NA	NA	<\$500k	\$500k	\$500k
Indonesia	1-4	5-19	20-99	<Rp300m (\$20.1k)	<Rp2.5b (\$167.4k)	<Rp50b (\$3.3m)	<Rp50m (\$3.3K)	<Rp500m (\$33.5K)	<Rp10b (\$669.6k)
Palestinian Authority	1-4	5-9	10-19	<\$20k	<\$200k	<\$500k	<\$5k	<\$50k	<\$100k
Vietnam	1-10	11-100	101-200	>\$131.9k	\$439.7k	>\$2m	>\$131.9K	>\$131.9K	>\$877K
Developing countries (Africa)									
Algeria	1-9	10-49	50-250	<DZD 40m (\$297.5k)	<DZD 400m (\$2.1m)	<DZD 4bm (\$29.8m)	NA	NA	NA
Eswatini	0-3	4-10	11-50	≤L60k (\$3.3k)	≤L3m (\$163.4k)	≤L8m (\$435.8k)	<L50k (\$2.7k)	<L2m (\$108.1k)	<L5m (\$272.4k)

¹ The selection of the countries and regions presented in table 1 is based on the availability of data.

Mala wi	1-9	10- 30	31- 100	<MK5 0m (\$49.5 K)	< MK20 0k (\$197. 1K)	<MK1 b (\$989. 1K)	<MK50m (\$49.5K)	< MK200 k (\$197.1 k)	<MK1b (\$989.1 K)
Moroc co	N/A	N/A	N/ A	<MAD 10m (\$1m)	<MA D200 m (\$20.1 m)	<MAD 200m (\$20.1 m)	NA	NA	NA
Rwan da	1-3	4-30	31- 100	<Fr300 k (\$262. 5k)	<Fr12 m (\$10.5 k)	<Fr50 m (\$43.8 k)	<Fr500k (\$437.5)	<Fr15m (\$13.1K)	<Fr75m (\$65.7k)
Tunisi a	1-6	7-49	50- 199	<TND 15m (\$4.9m)	<TND 15m (\$4.9 m)	<TND 15m (\$4.9m)	< TND15m (\$4.9m)	<TND1 5m (\$4.9m)	<TND 15m (\$4.9m)
South Africa	1-4	5-49	50- 200	<R150 k (\$8.2k)	<R10 m (\$545. 5K)	<R50 m (\$2.7 m)	<R100k (\$5.5k)	<R4m (\$218.2 k)	<R18m (\$982.1 k)

Note: N/A denotes not applicable, k denotes thousands, m denotes millions, b denotes billions and numbers in brackets denote US dollar converted from various local currencies using the exchange rate of June 2023.

Sources: Authors' compilation based on Eurostat (2018); National Small Business Act in South Africa (2004); the Asian Development Bank (2020); ESCAP (2023); Esubalew & Raghurama (2017); Government of Canada (2023)

Table 1 confirms the fact that there is no universally accepted definition of SMMEs. When defining SMMEs using the number of employees, the maximum number of employees differs from 19 in the Palestinian Authority to 499 in Canada, with SA capped at 200. In addition, we observe that the maximum number of employees in developing countries of Asia and Africa tends to be smaller than that in the developed countries. That could be due to the fact that when the economy becomes wealthier, the size of any business considered to be small or medium relative to the other business in that country becomes larger. Although using the number of employees is the most popular indicator to define SMMEs, one must be cautious about it for two reasons (Gibson & Van der Vaart, 2008; Hatten, 2011; Gonzales, 2014; Berisha & Pura, 2015). First, using employment to define SMMEs incorrectly suggests that enterprises must have more employees along their growth path. Such a definition may overlook the importance of labour efficiency. Second, the laws and regulations in labour and social security in developing countries are relatively strict, which tends to impose higher costs in hiring full-time employees. As a result, enterprises are encouraged to hire part-time employees and that is not reflected in the government statistics (Gibson & Van der Vaart, 2008).

Similar to the definition by employment, the definition by assets also confirms the fact that there is no universally accepted definition of SMMEs. The maximum value of assets ranges from \$657,000 in Rwanda to \$47.3 million in the European Commission, with SA lying in the middle at \$982,100 (see Table 1). Among those variations, we observe that as the countries become more economically developed, the maximum value of assets increases accordingly. Although asset size is one of the commonly used indicators to define SMMEs, there are deficiencies in this method. Firstly, similar to our previous discussion on an employment-based definition, the asset-based definition tends to overlook the importance of capital efficiency where the firm's growth path is concerned. Secondly, cross-country comparison is difficult when governments have different definitions of a firm's assets in defining business size. Some include fixed assets only in defining firm size while others include fixed assets and land. Third, SMMEs rarely have an accurate estimate of their fixed asset value but tend to underestimate them when substantial asset taxes are imposed. This situation is more prevalent in the developing countries (Gibson & Van der Vaart, 2008).

On definition by turnover, the patterns displayed in turnover are similar to those in assets. The maximum value of turnover ranges from \$438,000 in Rwanda to \$5 million in the European Commission, with SA lying in the middle at \$2.7 million (see table 1). Among those variations, we observe that the maximum value of turnover in developing countries is smaller than that in developed countries. Such a pattern exists in employment, asset and turnover definitions. Among the three indicators, while employment figures and profits of SMMEs in developing countries are often distorted by tax consideration, defining business size by turnover reflects more the functional and behavioral attributes of enterprises (Gibson & Van der Vaart, 2008).

3. Regulatory Development of SMMEs in South Africa

Having discussed the definition of SMMEs, we proceed to explore the regulatory development of SMMEs in South Africa. During apartheid, SMME sector was either largely neglected by the policymakers or discouraged by repressive measures in case of black-owned enterprises. It was not until early 1980s that the government started to take the first initiative to support small firm by establishing the Small Business Development Corporation (Berry et al., 2002). Since the country's democratic transition in 1994, the development and use of SMMEs as catalysts for economic growth have been a part of the national government's objectives. The regulation of the SMME sector formed part of the broader regulatory framework for businesses in South Africa. After 1994, the new government adopted some of the already existing pieces of legislation that were designed to regulate and promote small businesses and introduced new ones. One of the major legislations that was inherited from the

apartheid government is the Industrial Development Corporation Act, which was first introduced in 1940 and amended in 2001. The Act provides for the establishment of the Industrial Development Corporation (IDC), whose main objective is to promote the establishment of new industries and industrial undertakings, and the development of existing industries and industrial undertakings (South African Government, 2021). Following this, the SA government published the Businesses Act in 1991 with the aim to amend certain laws regarding the licensing and carrying on of businesses including SMEs, and shop hours. The Act also made new provisions for such licensing and carrying on of businesses (South African Government, 2021).

Through the Department of Trade and Industry (DTI), in 1995, government developed a white paper on a national strategy for the development and promotion of small businesses in South Africa. The purpose of this white paper was to initiate a discussion on a support framework needed for SMEs – a framework that would include legislation, institutional reforms and financial support, among other things (DTI, 1995). It was the first major effort by the SA government to design a policy framework targeting the entire spectrum of the SMMEs sector. The mechanism for the small enterprise support outlined in the white paper later became constitutional through the National Small Business Act in 1996. The Act made provisions for the establishment of the National Small Business Council and the Small Enterprise Promotion Agency. It provides guidelines for organs of state to promote small businesses in the country and for the comprehensive definition of SMMEs. It also legalized the establishment of new institutions, affirmative procurement reform, and the formation of an advisory board to review the regulatory environment of SMMEs (South African Government, 1996). In 2005, the SA government published the Co-operatives Act with the aim to make provision for principles for the formation and registration of co-operatives, the establishment of a co-operatives advisory board, and the winding up of co-operatives (South African Government, 2005). Following this, the government published the Companies Act in 2008 with the intention to make provisions for regulating the registration of companies, mergers and relationships between companies and shareholders (South African Government, 2008).

SMMEs in South Africa operate in a regulated social and business environment. As a result, they are required to comply with various other legislations that are not necessarily designed to govern businesses. The most applicable legislation is the Skills Development Act of 1998, which provides for and regulates employment services. The Act also provides for the financing of skills development through a levy-financing scheme and a National Skills Fund (South African Government, 1998). However, most SMMEs regard the skills levy required in this Act as an additional tax to them. Compliance with such regulation is relatively demanding and time-consuming to SMMEs – so much so that some of them outsource this function (Christianson 2003; Krause et al., 2010). Another legislation that affects SMEs is the

Public Finance Management Act (PFMA) of 1999, which requires firms that are dealing with public entities to comply with tender processes (South African Government, 1999). Similar requirements apply, in terms of the Municipal Finance Management Act of 56 of 2003, in cases where firms are doing business with municipalities and municipal entities (South African Government, 2003). Other legislations that enterprises are required to comply with, particularly if they intend to do business with public entities, include the Preferential Procurement Policy Framework Act of 2000, Broad-Based Black Economic Empowerment (BEE) Act of 2003 and Municipal Property Rates Act 6 of 2004 (South Africa Government, 2003). A study by Nieuwenhuizen (2019) revealed BEE and municipal issues were the most onerous red tape issues, which inhibit SMME growth. In addition, SMMEs are required to comply with tax requirements in South Africa. This is governed by legislations such as the Value-added Tax Act of 1991 and the Income Tax Act of 1993. The two legislations require enterprises to register for value-added tax and income tax, respectively (South African Government, 1991, 1993). A study by Smulders and Stiglingh (2012) shows that the smaller the business, the higher is the relative cost of annual tax compliance. The compliance requirements of these multiple regulations become a burden to SMMEs, which constrains their development (see Soni 2014, Nieuwenhuizen, 2019).

Despite the concerted effort of the SA government to stimulate SMME growth through various regulatory initiatives such as the Business Act (1991), National Small Business Act (1996), Company Act (2008) and the establishment of the Department of Small Business Development in 2014, among others, the growth of the SMMEs remains marginal. The number of SMMEs increased slightly from 2.2 million firms in 2008 to 2.3 million in 2021 (Small Enterprise Development Agency, 2021; Stats SA, 2021). Furthermore, although there are certain policies and legislations that may promote growth in SMMEs, existing studies on developing countries showed that the regulatory framework and legislation can also be one of the biggest constraints to SMME growth (see Cant and Wiid, 2013; Nyamwanza et al., 2016). Experience in South Africa is no different from those in other developing countries as compliance with these multiple regulations becomes a burden to SMMEs, which constrains their development (see Soni 2014, Nieuwenhuizen, 2019). Table 2 summarises a list of legislations governing SMMEs in South Africa in a chronological order.

Table 2. Summary of the Regulatory Framework of SMMEs in South Africa

Year	Policy or Legislation	Relevance for SMMEs
1940	Industrial Development Corporation Act	Makes provision for the promotion and support of SMMEs
1991	Businesses Act	Makes provision for the licensing and carrying on of businesses and shop hours
1991	Value-Added Tax Act	Provides for compliance requirements pertaining to value-added tax
1993	Income Tax Act	Provides for compliance requirements pertaining to income tax
1996	National Small Business Act	Provides for guidelines for organs of state to promote small businesses Provides for the definition of different categories of SMMEs
1998	Skills Development Act	Regulates employment services
1999	Public Finance Management Act	Provides for compliance requirements for SMMEs when doing business with national and provincial government entities
2000	Preferential Procurement Policy Framework Act	Provides for the framework on the implementation of procurement policies
2003	Municipal Finance Management Act of 56	Provides for compliance requirements for SMMEs when doing business with national and provincial government entities
2003	Broad-Based Black Economic Empowerment Act	Provides for the regulation of the promotion of black economic empowerment and transformation
2004	Municipal Property Rates Act	Provides for compliance requirement to municipal property rates requirements
2005	Co-operatives Act	Makes provision for principles guiding the formation and registration of new co-operatives
2008	Companies Act	Regulates the registration of companies, mergers and relationships between companies and shareholders
2014	The establishment of the Ministry of Small Business Development	Coordinates an integrated approach to the promotion and development of SMMEs and to ensure an enabling legislative and policy environment to support their growth

Sources: Authors' compilation based on the Industrial Development Corporation Act of 1940, Businesses Act of 1991, Value-Added Tax Act of 1991, Income Tax Act of 1993, National Small Business Act of 1996, Skills Development Act of 1998, Public Finance Management Act of 1999, Preferential Procurement Policy Framework Act of 2000, Municipal Finance Management Act of 56 of 2003, Broad-Based Black Economic Empowerment Act of 2003, Municipal Property Rates Act of 2004, Co-operatives Act of 2005, Companies Act of 2008, Nieuwenhuizen, 2019.

4. Performance of SMMEs in South Africa

This section presents the current profile of SMMEs in South Africa. It covers the definition, structure and performance of the different types of businesses within the SMME sector. The geographic, demographic, and economic trends used in this section are based on the quarterly labour force survey (QLFS) conducted by Stats SA over the period from 2008 to 2021. Following the Small Enterprise Development Agency (SEDA) (2016), the study uses the combination of the number of employers and own-account workers as a proxy for the number of SMMEs. The number of own-account workers is used as a proxy for firms operating in the informal sector, while the formal sector is measured through the number of employers. Figure 1 presents trends in the number of SMMEs in South Africa over the past 14 years.

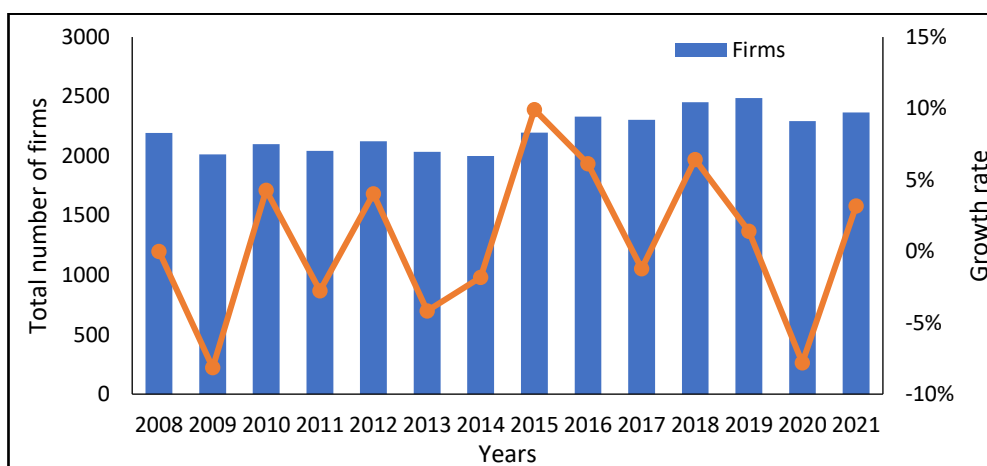


Figure 1. Number of SMMEs in SA

Source: Authors' compilation based on Stats SA-QLFS data (2021)

South Africa currently has a total of 2.3 million SMMEs (SEDA, 2021; Stats SA, 2021). As depicted in Figure 1, the sector has evolved over the past 14 years. In 2008, it comprised 2.2 million firms. By 2014, the SMME sector had lost 200 000 firms. In 2015, the number of SMMEs increased to 2.2 million and subsequently to 2.5 million in 2019. As expected, this was followed by a sharp decline of 8% in 2020 to 2.3 million. The abrupt decline can be attributed to *inter alia* the COVID-19 outbreak, which created a harsh business environment for existing firms and discouraged the establishment of new firms. In 2021, the sector started showing some form of improvement, with a growth of 3% of the total number of firms.

The SMME sector in South Africa is characterized by a highly dualistic economy that encompasses formal and informal sectors, with limited interaction between them. The former is characterized by high productivity whereas the latter one is of low productivity (Berry *et al.* 2002). According to Bhorat *et al.* (2018), the informal

sector includes micro businesses, which are predominantly own-account workers with no registered employees. These businesses are typically non-VAT registered, unlicensed, unregulated and unknown to the government (STATSSA, 2014; McLaughlin, 1989). According to SEDA (2016), the informal SMME sector includes survivalist self-employed persons from the poorest levels of the population. Conversely, the formal component consists of micro, small and medium enterprises that meet the government financing, licensing and regulatory requirements (McLaughlin, 1989; SMME South Africa, 2022). This includes businesses such as registered grocery stores, restaurants, petrol stations, banks and insurance companies, among others (SMME South Africa, 2022).

One unique characteristic of the SMME sector in South Africa is that it is dominated by informal firms, accounting for 70% of the total number of SMMEs in South Africa, while the formal sector accounts for 30% (SEDA, 2020). Existing literature shows that there are two types of entrepreneurship, that is, “necessity entrepreneurship” and “opportunity entrepreneurship”, which affect economic development differently (see Acs, 2006, and Thurik *et al.* 2008). The former one is having to become an entrepreneur because of no better option. Although it is counter-cyclical in nature, it creates very precarious employment. Any increase in the number of such enterprises therefore does not necessarily have any significant positive effect on economic development. The latter one is an active choice to exploit the business opportunities by starting a new business that has a significant and positive effect on economic development (Acs, 2006). Based on the high informal-formal SMMEs ratio in SA, we argue that the SMMEs do not contribute substantially to its economic development.

On the trends of formal and informal firms from 2008 to 2021, figure 2 shows that the number of firms operating in the informal sector has grown over the past 14 years from 1.3 million in 2008 to 1.6 million in 2021. On the other hand, the number of firms in the formal sector declined from 850 thousand in 2008 to 812 thousand in 2021 (Stats SA, 2022). Furthermore, the informal sector appears to also have been growing faster than the formal sector over the period under review, with the former growing at an annual average growth rate of 1.3%, while the latter declined at an annual average rate of 0.1%. Despite accounting for the largest number of firms, the informal sector does not contribute much to employment, relative to the formal sector (SEDA, 2019). This could be because the sector is dominated by own-account workers. The virtually non-existent growth in the formal sector can be attributed to the regulatory environment and restrictive legislation that we have discussed in the previous section. Studies by Nyamwanza *et al.* (2016) and Nieuwenhuizen (2019) also confirmed that regulations and legislation are the most important constraints to SMME growth in many developing countries, including South Africa. Figure 2 below shows the trends of formal and informal firms over the period from 2008 to 2021.

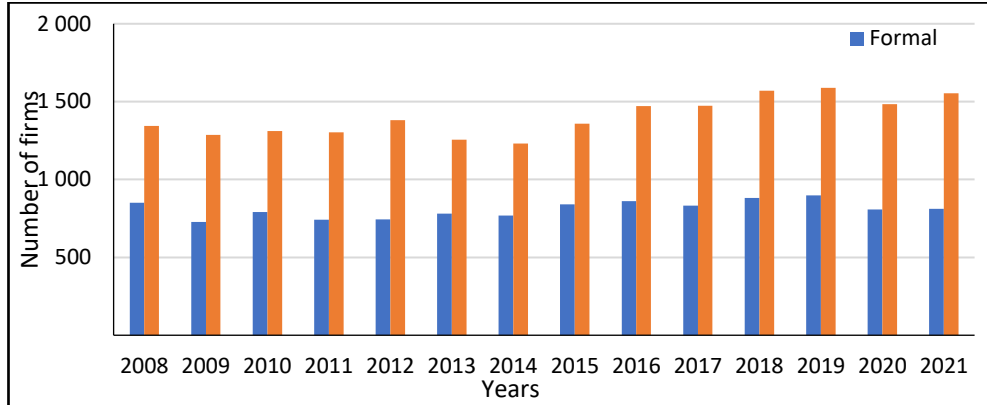


Figure 2. Trends on Formal and Informal SMME Sectors in South Africa

Source: Authors' compilation based on Stats SA-QLFS data (2021)

On the ownership of SMMEs in South Africa, we found that it spreads unevenly across various racial groups. This includes black, coloured, Indian, and white owners. Figure 3 below presents the percentage shares of SMME ownership across the four groups, comparing the years 2008 and 2021.

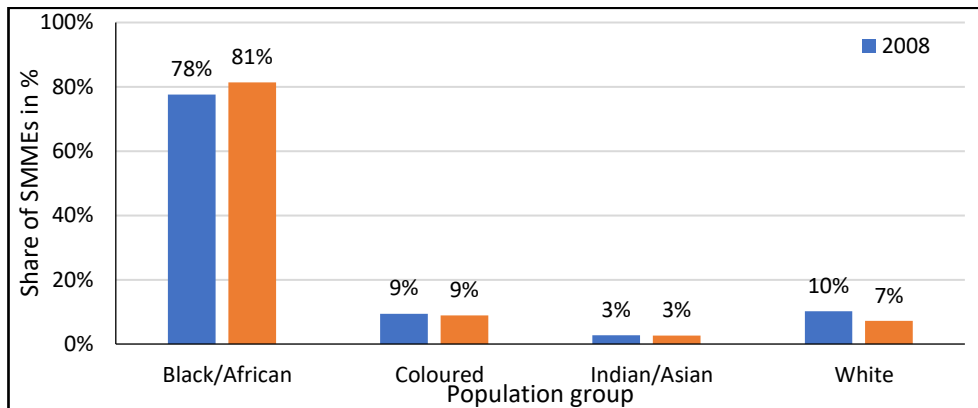


Figure 3. Distribution of SMMEs in SA by Population Group in 2008 and 2021

Source: Author's compilation based on Stats SA-QLFS data (2021)

Over the past decades, the bulk of SMMEs in South Africa have been owned by the black population, with racial distortion in education, economic empowerment, and income. Such racial distribution offers insight into the relatively low contribution of the SMME sector to employment and economic growth in SA compared to many other developing countries. As shown in figure 3, black-owned SMME firms accounted for 78% of the total number of SMMEs in 2008; this grew over the years to 81% in 2021. The second largest share (9%) is owned by the coloured group, followed by the white population (7%). The high number of SMME firms owned by blacks is expected given that the SMME sector is dominated by informal firms,

which are operated mainly by blacks (Odeku, 2021). On the spatial distribution of SMMEs, the number of SMMEs differs across the nine provinces in South Africa. Figure 4 presents a comparison between the years 2008 and 2021 on the spatial distribution of SMMEs across provinces.

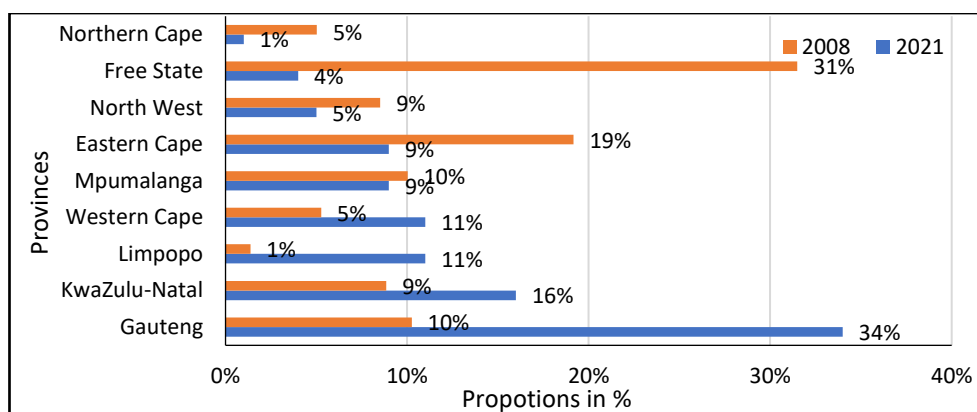


Figure 4. Distribution of SMMEs in SA by province in 2008 and 2021

Source: Authors' compilation based on Stats SA-QLFS data (2021)

Gauteng Province (GP) hosts the majority of SMME firms in South Africa. In 2008, the province accounted for 31% of the total number of SMME firms in the whole country, and this proportion has increased by 3% over the years to 34% in 2021. The concentration of SMME firms in GP is owed to its population densities and contributions to economic growth (Department of Small Businesses, 2019). This is also justified by the available infrastructure and other forms of support that are attractive to businesses in the province. KwaZulu-Natal accounts for the second largest proportion of SMMEs in the country, accounting for 16% of the total number of SMMEs in 2021. This is a decline from 19% in 2008. KZN is followed by the Western Cape and Limpopo provinces, which both (individually) represented 11% of the total number of SMMEs in 2021. The two provinces gained firms over the reviewed period and their share increased from 5% and 1% respectively. As shown in Figure 4, the proportions of SMMEs residing in the two provinces have increased from what was recorded in 2008 by 1% and 2%, respectively. On the other hand, the Free State and Eastern Cape lost a significant share of their firms. This is shown by the sharp declines depicted in Figure 4 from 31% in 2008 to 4% in 2021 in the case of the Free State and 19% to 9% in the Eastern Cape.

In terms of the sectoral structure, we observe that most of the SMMEs in SA are active in the tertiary sector where it is labour-intensive in nature. Fewer SMMEs can afford to be in the primary and secondary sectors where it requires inputs of land and machinery respectively. Figure 5 presents the proportions of these firms across different industries, comparing the years 2008 and 2021.

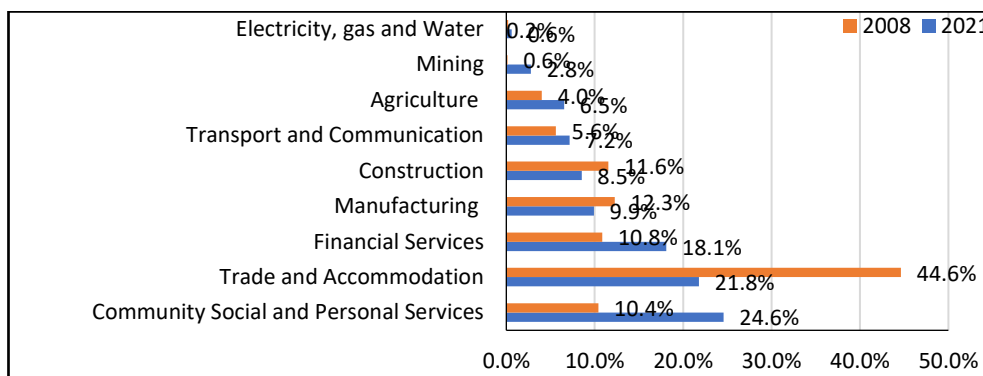


Figure 5. Distribution of SMMEs in SA by Industry in 2008 and 2021

Source: Authors' compilation based on Stats SA-QLFS data (2008 and 2021)

The community, social, and personal services industry currently accounts for the best part of the SMME sector in SA. In 2008, 10.4% of the SMMEs were operating in this industry. By 2021, this had more than doubled to 24.6%. This is consistent with the fact that the services sector is one of the biggest contributors to economic growth and employment in South Africa (Matekenya & Moyo, 2021). The trade and accommodation industry is the second largest industry in the SMME sector. In 2021, the share of SMMEs operating in this industry declined to 21.8%, from 44.6% in 2006. The decline is not fortuitous and can be explained by the outbreak of the COVID-19 pandemic, which led to the temporary closure of many business activities. This is followed by the financial services industry, which accounts for 18.1% of the total number of SMMEs in 2021; this share increased from 10.8% in 2008. Due to the relatively high fixed cost involved, the utility industry (electricity, gas, and water) and mining industries account for the lowest shares of SMMEs in South Africa. In 2021, the shares for the two industries increased to 0.6% and 2.8%, from 0.2% and 0.1% in 2008, respectively. In terms of growth, estimates from Stats SA (2021) show that over the period from 2008 to 2021, the finance industry has been the fastest growing industry in the SMME sector, at an annual average growth rate of 2.6%, followed by the transport and community, and social services industries, growing at an annual average rate of 1.2%.

5. Contribution of SMMEs to the South African Economy

As mentioned before, the informal sector is not registered and not regulated in some instances. As a result, information on their performance and contribution to the economy is usually not recorded. For this reason, the discussion in the subsequent sections focuses on the formal component of the SMME sector. Because the SMME sector is dominated by informal firms which accounts for 70% of the total number of SMMEs in South Africa, there is an important caveat that our analysis may not

provide a complete picture on the contribution of the SMME sector to the economy, particularly on the contribution to employment. Existing studies argue that the informal sector in developing countries, which mainly consist of survivalists and micro enterprises, function as an unemployment cushion for those unskilled and young labour in times of economic slowdown (Ayyagari, Demircuc-Kunt & Maksimovic, 2014; Cumming, Johan & Zhang, 2014). Given the data limitations, such a hypothesis of growing employment in the SMMEs in times of economic slowdown cannot be verified.

When we consider the formal sector of SMMEs in SA, it contributes to the economy through various channels. This includes, among others, the generation of jobs, value-added, inclusion, and poverty reduction (OECD, 2017). Due to data availability constraints, this study only provides a discussion on the contribution of SMMEs to the economy through output and employment from aggregated to provincial and sectoral levels. Following the Bureau for Economic Research (2016), we use the combination of salaries paid, profits and depreciation as a proxy for the output of SMMEs. Employment is measured through the combination of the number of employees and own-account workers. The trends in the output of SMMEs in South Africa are presented in Figure 6.

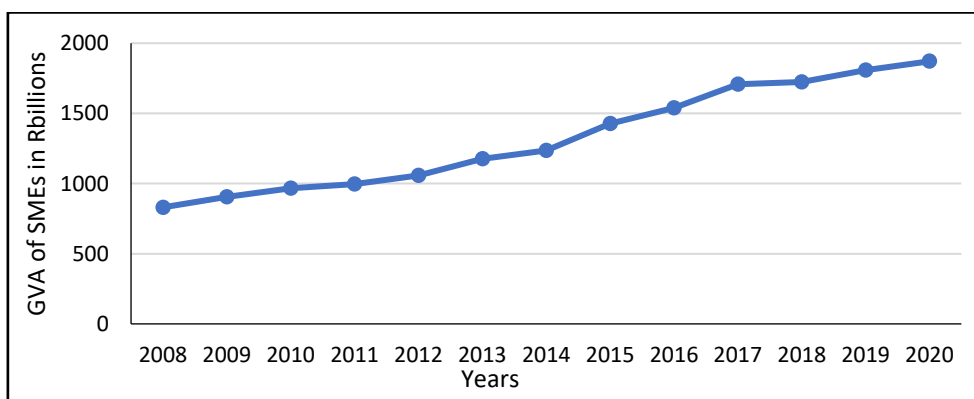


Figure 6. Output Generated (GVA) by SMMEs in South Africa during 2008-2020

Source: Own computation based on Stats SA-AFS database (2020)

As depicted in Figure 6, the output for the SMME sector, measured through gross value-added (GVA), grew over the years at an annual average growth rate of 7%. By 2020, the GVA for the sector had increased to R1.9 trillion from R830 billion in 2008. In terms of the contribution by different industries in the SMME sector, estimates from Stats SA (2020) show that in 2020, the manufacturing, trade and business sector accounted for the biggest share of the output in the sector. These three industries contributed 22%, 21%, and 19%, respectively. A similar picture is depicted for the year 2008, where the business services industry was the biggest contributor (25%) followed by the manufacturing industry at 23% and trade industry

accounting for 20%. The significant contribution by the three industries is as anticipated given that they also account for the majority of the SMME firms in South Africa. Figure 7 presents the contribution of the SMME sector to South Africa’s economic activity.

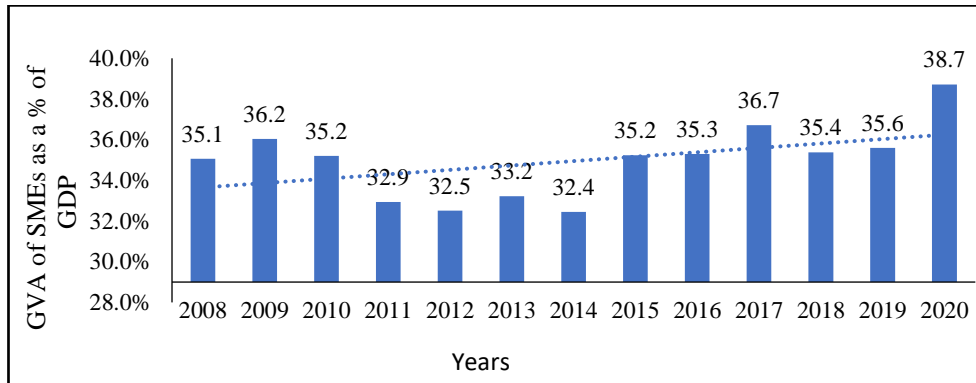


Figure 7. Output of SMMEs as a Share of GDP during 2008-2020

Source: Authors’ computation based on Stats SA-AFS data (2020) and IMF database (2020)

The contribution of SMMEs to South Africa’s total output grew over the period from 2008 to 2020, with fluctuations in between. In 2008, the sector accounted for 35.1% of the total output of the country. This declined in 2011 to 32.9% and further declined to 32.1% in 2014. In 2015, the contribution of SMMEs increased to 35.2% and further increased to 38.7% in 2020. The increase in the output for the SMME sector and its contribution to economic growth, despite the ripple effect that COVID-19 has had on the world economy, is a sign of resilience. Furthermore, this underscores the view that, if given the necessary support, the sector can then be the main contributor to a country’s economy. Trends of jobs generated by SMMEs in South Africa are presented in Figure 8 below.

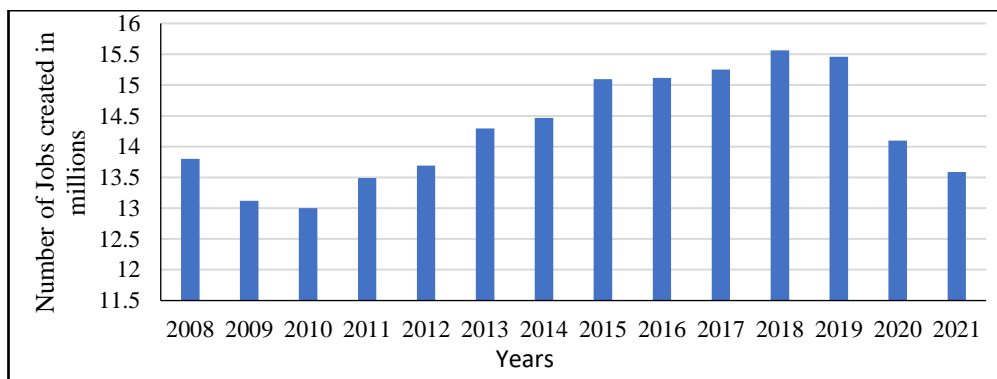


Figure 8. Employment Created by SMMEs in South Africa During 2008-2021

Source: Authors’ computation based on Stats SA-AFS data (2021) and IMF database (2021)

The trends in Figure 8 show that there has been a general upward trend in the number of jobs created by SMMEs over the past 14 years, except during two adverse economic periods brought about by the global financial crisis and the COVID-19 pandemic. In 2008, the sector had 13.8 million jobs; this increased to 15.6 million in 2018. In 2020, the sector experienced a sharp decline of 8.8%, from 15.5 million jobs in 2019 to 14.1 million jobs. This was followed by a further decline in 2021 to 13.6 million jobs. The decline is not unexpected and can be attributed to the outbreak of the COVID-19 pandemic and the subsequent lockdown. The trends in the growth rates suggest that the SMME sector has been buoyant, as the rate at which the number of jobs was declining started to slow down in 2021, from 8.8% in 2020 to 3.6%. Figure 9 shows the number of jobs in the SMME sector by industry.

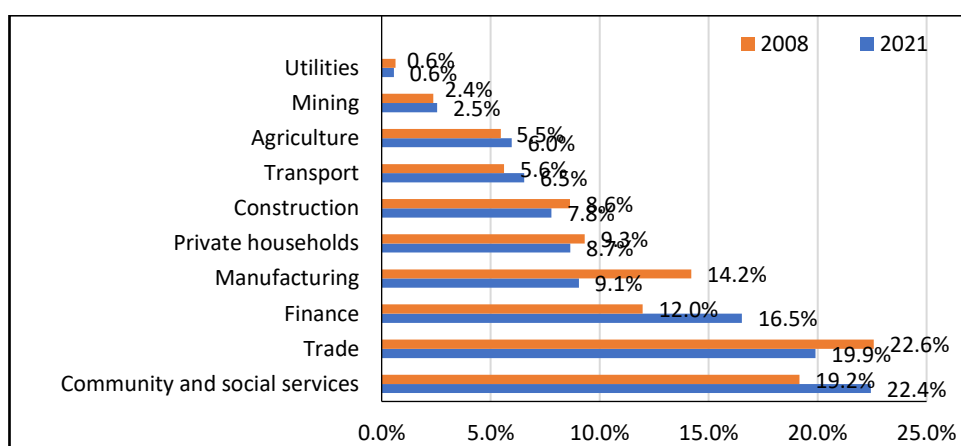


Figure 9. Distribution of Employment by Industry in 2008 and 2021

Source: Own computation based on Stats SA-QLFS data (2021)

The community and social services industry appears to be the biggest employer in the SMME sector. In 2021, the contribution of this industry increased to 22.4% from 19.2% in 2008. The trade industry is the second largest industry and accounted for 19.9% in 2021. This is lower than the contribution (22.6%) that the industry recorded in 2008 and suggests that the trade industry lost jobs and firms over the reviewed period. The higher contribution of the community and social services and trade industries is expected, as the two industries also account for the majority of firms in the SMME sector.

In terms of the provincial distribution, we found that the concentration of SMME firms and their contribution to employment differs across the nine provinces in South Africa. The distribution of employment created by SMMEs across these provinces is presented in Figure 10.

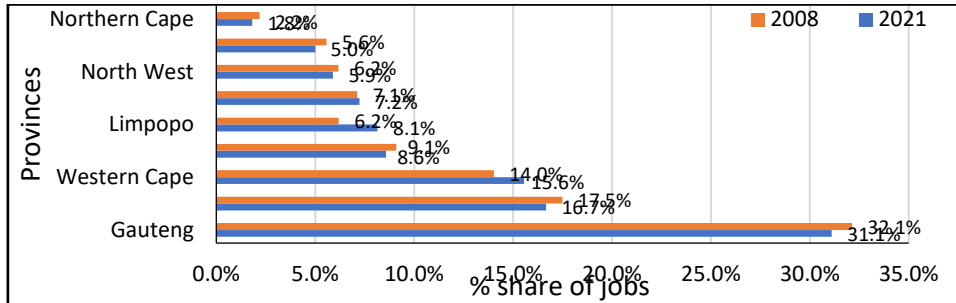


Figure 10. Distribution of Employment Created by SMMEs by Province in 2008 and 2021

Source: Own computation based on Stats SA- QLFS data (2021)

In 2021, the share of jobs created by SMMEs in Gauteng declined to 31.1% from 32.1% in 2008. Although this is a decline, the province remains the highest contributor to employment created by SMME firms in South Africa. KwaZulu-Natal is the second largest contributor and accounted for 16.7% of the total number of jobs created by SMME firms in 2021, followed by the Western Cape (15.6%). Over the period from 2008 to 2021, more than 60% of the provinces lost jobs and firms in the SMME sector. The high contribution of Gauteng, KwaZulu-Natal, and Western Cape can be attributed to the infrastructure and opportunities that create a conducive business environment for SMMEs. The SMME sector also contributes to the economy through total revenues generated. The data used in this section represents mainly the formal component of the SMME sector. Figure 11 shows the total turnover for all industries in South Africa.

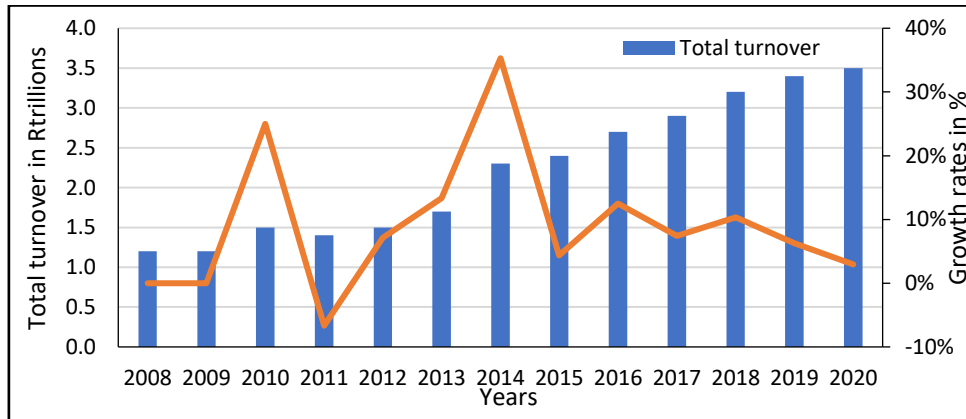


Figure 11. Total Turnover of SMMEs in SA from 2008-2020

Source: Own computation based on Stats SA-AFS data (2020)

The total revenue generated by SMMEs grew over the years from R1.2 trillion in 2008 to R3.5 trillion in 2020. Of the R1.2 trillion in 2008, 66% was from small firms,

while 34% was from medium firms. A similar picture is depicted with the revenues generated in 2020. The contribution of small firms increased, marginally, to 70% in 2020, while the share of small firms declined to 30%. In terms of growth rates, revenues generated by SMMEs grew at an annual average growth rate of 10%. Small firms appear to have been growing faster than medium firms, at an annual average growth rate of 11%. Figure 12 shows the distribution of revenue generated by SMMEs across different industries, comparing 2008 and 2020 figures.

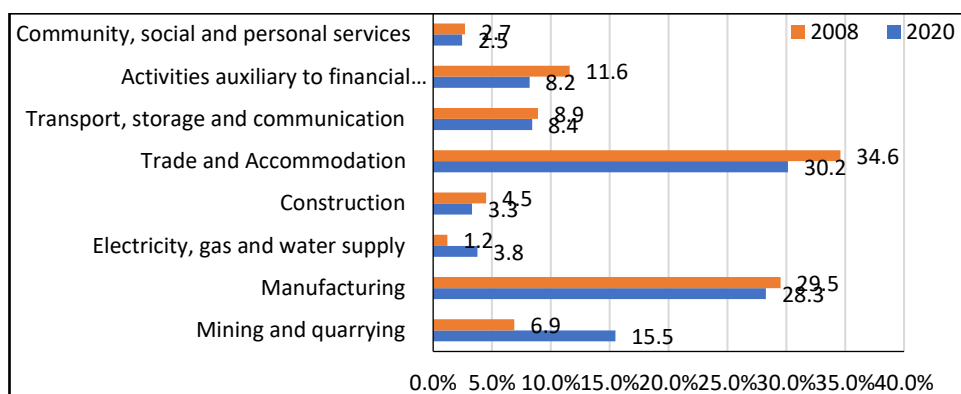


Figure 12. Total Turnover by Sector

Source: Own computation based on Stats SA-AFS data (2020)

The trade industry remains the main contributor to the total revenue in the SMME sector. In 2008, the industry accounted for 34.6% and this declined to 30.2% in 2020. The second largest contributor is the manufacturing industry. In 2020, the contribution of this industry declined to 28.3% from 29.5% in 2008. The contribution of some of the industries, such as mining and quarrying electricity gas and water supply, improved from 6.9% and 1.2% in 2008 to 15.5% and 3.8% in 2020, respectively.

7. Challenges Faced by SMMEs in South Africa

In this section, we identify and discuss the factors impeding the survival and growth of small businesses in South Africa. We observe that most of the existing studies focus on constraints rather than conditions that promote SMMEs growth, which is problematic for two reasons. Firstly, it is almost impossible for entrepreneurs to identify all the factors that hinder firm growth. Secondly, the removal of these constraints is only a necessary but not a sufficient condition for their growth. Therefore, the situation is more complex to be understood.

The challenges can be categorized as financial and non-financial (Ngcobo & Sukdeo, 2015; Cant 2012; SMME South Africa, 2018; Moos & Sambo, 2018). On financial factors, there has been insufficient financial support in terms of the amount of

available finance, the access to finance, and the cost of finance. First, on the amount of available finance, recent reports show that SA has one of the lowest saving rates in the world. Its saving rate only stood at 0.5% while its emerging market peers such as Brazil and India are as high as 16.5% and 10.8% respectively (Deloitte 2023). With a low saving rate and narrow saving base, the amount of finance that is available to the business sector, especially the SMMEs is limited. Second, on the access to finance, there has been a mismatch situation on both the lenders and the entrepreneurs. The problem of asymmetric information in the SMME sector makes the lenders unable or costly to determine credit risk, thereby affecting the supply of loans. In addition, poor knowledge on the side of entrepreneurs reflected in application procedures and writing business plan also limited their access of finance (Outsourced Finance, 2020; Finmerge, 2015; Ngcono & Sokdeo, 2015, Mahembe, 2011; Berry *et al*, 2002). Last, SMMEs face relatively high costs of finance. The absolute amount of operational work and therefore costs is about the same for every loan irrespective of its size. Together with the higher risk of default involved, the interest premium charged on small loans will rise to exorbitant levels. The high rates prevent some small businesses from applying for funding from lending institutions (Chimucheka & Rungani, 2011, Berry *et. al.* 2002)

On non-financial challenges, the first one faced by the SMMEs is the restrictive legislation. Some small business owners believe that labour laws and other regulations can be an inhibitor to SMME growth, especially the compliance requirements, regulatory bodies, and minimum wage restrictions (SMME South Africa, 2018). In support of this, Nieuwenhuizen (2019) found that most government regulations are restrictive, expensive, and arduous to comply with. This includes the compliance requirements from the Skills Development Act, SARS, post-filing, VAT, and labour laws, among others. In the Global Entrepreneurship Monitor (GEM) report (2022), South Africa received a low score of 4.1 out of 10 for supportive government policies, and 3.9 out of 10 for taxes and bureaucracy, which is a clear indication of the ineffectiveness of the South African government in this regard.

The second one is the inadequate supply of infrastructure. The physical infrastructure in South Africa is regarded as insufficient according to the international comparison. Out of the 13 low-income countries, SA ranked number nine in 2021 (GEM Report, 2022). Small businesses in the country struggle to access certain areas for business due to poor infrastructure, and as a result, they are forced to operate in highly competitive areas. Newly established SMMEs tend to fail in highly competitive areas, due to a lack of adequate resources needed for them to stand up to the competition (Msomi & Olarewaju, 2021).

The third one is inaccessibility to business networks (Outsourced Finance, 2020). Small businesses often find it difficult to access the right business networks and end

up failing to enjoy the benefits associated with the right business networks such as mentorship and access to funding, among other things. The fourth challenge pertains to human resources. According to Ngcono & Sokdeo (2015), small businesses battle with issues related to rising labour costs. As a result, some businesses end up with no employees other than the business owners. This concurs with the issues pointed out in Outsourced Finance (2022). Apart from the above challenges, SMMEs in South Africa also suffer from low entrepreneurial education at school and post-school, insufficient research, and development transfers, as well as inadequate commercial and professional infrastructure (GEM Report, 2022). Additionally, the National Entrepreneurial Context Index constructed by GEM indicated that South Africa was ranked 40th out of 53 countries in 2022. SA was also one of three economies, alongside Togo and Tunisia, with all dimensions considered as insufficient.

8. Conclusion

This paper provides an overview of SMMEs in South Africa for the period from 2008 to 2021. It covers a discussion on the definition of SMMEs, the regulatory framework for SMMEs in South Africa, trends in the current structure, performance, contribution of SMMEs to the country's economic growth, and challenges faced by the SMME sector in South Africa. The findings confirm that the number of SMMEs in South Africa has slightly increased over the years, at an annual average rate of 1%. We found that a larger share of SMMEs in South Africa has operated in the informal sector since 2008. The formal-to-informal SMME ratio has been low, which is not conducive to economic development. The majority of SMMEs in South Africa operate in the community and social services industry, followed by the trade industry. A similar depiction is seen in the trends for employment. The findings suggest that although the informal sector accounts for the majority of SMMEs, it does not contribute much to employment as the sector is dominated by own-account workers. In terms of the sector's contribution to economic growth, the findings confirm that SMMEs account for nearly 40% of the total GDP of the country. In terms of revenue generated by SMMEs, the total annual turnover has increased over the years, with the trade sector being the major contributor. On the challenges faced by SMMEs in South Africa, the analysis confirmed that SMMEs battle with inhibiting factors, such as the inability to access funding, rising employment costs, inability to attract skilled workers, lack of access to business networks, restrictive labour regulations, and poor infrastructure. Based on these findings, we recommend that policymakers should first improve the formal-informal SMME ratio to realize the developmental benefits brought by the opportunity entrepreneurs operating in the formal sector. Policies to reduce the number of self-employed and strengthen the existing SMME sector by reducing the regulatory burdens, and providing training,

financial and management assistance should be pursued. Once the formal SMME sector has been strengthened, policies on improving the condition for and quality of the general business environment, such as on the rule of law, infrastructure, financial market efficiency, and labour market flexibility, should be adopted.

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