INTERDEPENDENT AND CONFLICTING OBJECTIVES IN SOUTH AFRICAN SMME POLICIES: COMPETITIVENESS VS. EMPLOYMENT CREATION

R.S. Cass1*
1School of Mechanical, Industrial and Aeronautical Engineering
University of the Witwatersrand, South Africa
rob.s.cass@gmail.com

ABSTRACT

The National Small-Business Strategy, as proposed in the 1995 White Paper on Small Business, was developed to assist the processes of employment creation and economic growth through assisting SMMEs in becoming more competitive in the global marketplace. Debate as to the effectiveness of this strategy and the subsequent development programmes has given rise to claims of conflict between the goals of economic growth and employment creation through SMMEs. The purpose of this research was therefore to determine links between employment creation potential, and growth potential through increased competitiveness, of ten South African SMMEs. Interviews were conducted with owner-managers of each of the SMMEs. The interviews focussed on issues of competition and competitive practices, labour issues, technology issues and perspectives on the South African business environment. Thematic Content Analysis was used to extract themes emerging from the interviews from which links between competitiveness of the SMMEs and employment creation potential could be drawn. Results show that SMMEs aiming to become more competitive will tend to limit their dependence on labour to minimise costs and productivity constraints. Therefore, the policy objectives of economic growth and employment creation through SMMEs are divergent.

* Corresponding Author
1 INTRODUCTION

Government, through the Department of Trade and Industry (DTI) has recognised the important role Small, Medium and Micro-Enterprises (SMMEs) play in job creation, economic growth and equity in South Africa\(^1\) and has therefore developed several support programmes for SMMEs. These programmes include the Centre for Small Business Promotion (CSBP), National Small Business Council (NSBC), Ntsika Enterprise Promotion Agency and Khula Enterprise Finance\(^2\)\(^3\).

These support programmes, originally proposed by the 1995 White Paper on Small Business as the ‘national small-business strategy’, were proposed with the primary objective of “creating an enabling environment for small enterprises”. The more specific objectives of the national small-business strategy are as follows:

- To help facilitate wealth redistribution.
- Employment creation.
- Encouraging economic growth.
- Develop relations between small enterprises.
- Level competitive advantages relating to organisation size.

Debate has since arisen as to the validity of these objectives, and in particular the objectives of economic growth and employment creation. Dorfling\(^4\) addresses this issue stating: “With the government perceiving SMMEs as agents to address three key objectives - namely, employment promotion, redistribution, and the improvement in international competitiveness - there is a serious challenge in attempting to balance these needs.” Kesper\(^5\) reported that much of the growth that takes place in the SMME economy does not directly create employment. Furthermore, Kesper\(^5\) proposes that two of the goals - employment creation and economic growth through international competitiveness - are conflicting i.e. International competitiveness may only be achieved at the expense of employment creation. Through empirical research Kesper\(^5\) observed that South African SMMEs which are able to compete internationally are highly unlikely to create employment for the unskilled majority of workers. Rogerson\(^6\) noted a recurring theme in identifying reasons for failure in the implementation of SMME policies - A lack of clear selection criteria for support programmes as a result of different development objectives (competitiveness, poverty alleviation and black empowerment).

Therefore, a mismatch exists between the model of the SMME used by policy makers in South Africa and the true nature of South African SMMEs, which produces conflict between the intended effect of SMME support policies and the reality of their implementation.

2 INTERDEPENDENT AND CONFLICTING OBJECTIVES IN SOUTH AFRICAN SMME POLICIES: COMPETITIVENESS VS. EMPLOYMENT CREATION

2.1 Description of SMMEs

In South Africa, the abbreviation used in describing the small enterprise economy is SMME (Small, Medium and Micro Enterprises). The size of an enterprise is defined by: the number of employees, total annual turnover and total gross asset value of the enterprise. SMMEs are defined by a size classification schedule, most recently
published in the National Small Business Amendment Bill, revised from the National Small Business Act (No. 102 of 1996).

Wong & Aspinwall\(^7\) identify six categories of SMME characteristics, namely: ownership and management; structure; culture and behaviour; systems, processes and procedures; human resources; customers and markets. Supuuenyong, Islam & Kulkarni\(^8\) confirm these categories, incorporating the structure and ownership and management categories. On a more fundamental level, the characteristics which separate SMMEs from large enterprises may be divided into three categories of distinction, namely: ownership, resources and size. These three categories may then be subdivided to form the categories proposed by the aforementioned authors, with some overlapping, as shown in figure 1.

![Figure 1: Categorisation of SMME](image)

Using the characteristics model of Wong & Aspinwall\(^7\) and Supuuenyong, Islam & Kulkarni\(^8\), and incorporating the characteristics proposed by the OECD\(^9\) and Kesper\(^5\), the following general characteristics of SMMEs are proposed:

2.1.1 **Ownership and management structure**

SMMEs are autonomous, independently owned enterprises not operating within the structure of a large organisation, differentiating them from small business units. Owner-managers of small, and particularly micro, enterprises tend to lack business management skills obtained through formal training which explains the lack of strategic development and focus on core processes most often found in SMMEs\(^{[10]}\)\(^7\).

2.1.2 **Culture and behaviour**

SMMEs generally display a unified culture allowing for easier implementation of new strategies, processes etc. However, the culture of an SMME is almost a direct
reflection of the outlook of the owner manager and this often stands in the way of strategic development.

2.1.3 Systems, processes and procedures

SMMEs generally have less complex systems and tend to operate with a more labour oriented approach, which allows these systems to be more flexible in adapting to changes, yet they tend to focus on operations rather than strategic issues. Achanga et al refer to the vulnerability of SMMEs caused by the low barrier to entry which often exists in their markets. Furthermore, they discuss the limited buying power and influence an SMME has relative to its suppliers.

2.1.4 Human resources

SMMEs tend, as a result of small operations, to have less definite job descriptions and little job specialisation which in turn develops a more versatile work force. Lack of resources among SMMEs leads to very little human resource development. SMMEs generally have lower capital costs associated with job creation due to their more labour oriented approach.

2.1.5 Customers and markets

SMMEs tend to serve a small number of customers within local and regional markets with few cases of exporting to global markets. SMMEs also tend to have a small number of product lines and therefore a higher degree of specialisation often serving niche markets. In the case of SMMEs this is not normally a strategic response to the nature of the market but rather the product of a lack of resources which would allow for greater diversity.

The characteristics of SMMEs often form the constraints within which the success of an SMME is bound. However, other characteristics may be the competitive advantage which allows an SMME to be successful.

2.2 Employment Creation Potential of SMMEs

A fundamental theory, on which the employment creation potential of SMMEs is argued both for and against, is that small enterprises are generally more labour intensive and large enterprises are generally more capital intensive. The capital intensive nature of large enterprises is based on economies of scale and better access to finance coupled with the focus on automating processes to better take advantage of large standardised product lines. The labour intensive nature of smaller enterprises is based on lack of finance opportunities for capital expenditure and therefore the focus is on lower technology processes. This often forces small enterprises into niche markets where flexibility is valued above cost. As large organisations continue to follow the trend of focussing on their core-competencies and outsourcing non-core functions, market opportunities present themselves to smaller enterprises and their importance in the supply chain, and economy as a whole, is increased.

The employment creation potential of SMMEs has been garnering attention for many years, most notably since the work of David Birch (between 1979 and 1987) quantified the contribution of SMMEs to overall employment in the USA, and underlined the almost overwhelming significance of this contribution. The validity of these findings became cause for debate as to whether job creation potential was
really related to enterprise size. The most notable criticism came from Davis et al\textsuperscript{14} and was based on doubts as to the validity of Birch’s methodology and applicability of the experimental data. A comprehensive analysis of small business’ employment creation potential was carried out by Neumark et al\textsuperscript{15} using more reliable data and comparing Birch’s methodology with a proposed improved methodology. This analysis found that small enterprises do create more employment than large enterprises, but not to the extent proposed by Birch.

There are also various debates around employment creation with respect to the development of the small business economy. Kesper\textsuperscript{5} acknowledges the differences between conditions of SMMEs in South Africa and those in industrialised countries, specifically with regard to the prevalence of survivalist operations which rarely expand beyond one-person operations, and product specialisation as a result of lack of resources rather than strategic development. This casts doubt over the labour absorptive capacity of SMMEs as a result of ‘Jobless Growth’ whereby growth in a firms’ turnover, profitability or capacity is not necessarily accompanied by employment growth. This is attributed to perceived inflexibility of the labour market resulting from South Africa’s post-Apartheid labour policies rendering labour more costly and less productive.

Berry et al\textsuperscript{16} address the fact that, because small firms are generally more labour intensive than large firms, they are affected more by labour market regulations. South Africa’s labour market is characterised by a high variance in skills and massive oversupply of unskilled labour. In an unregulated labour market (or even one less rigorously regulated than South Africa) this would allow enterprises to employ unskilled labour at low cost and thereby establish a competitive advantage. However, labour regulation undermines the supply-demand relationship of employee skills and wages and is believed to deter many SMMEs from generating employment. Labour regulation is seen to affect SMMEs more than large enterprises.

Robson\textsuperscript{17} casts more doubt over the contribution of small enterprises to employment creation, based on perceived shortcomings of the methodologies often used to calculate employment creation by enterprise size, as well as ignorance of external factors affecting employment creation for all enterprises. The perceived methodological shortcomings are similar to those of Davis et al\textsuperscript{14} and are based on the view that employment creation through processes of birth, expansion, contraction and death of enterprises should be analysed as a dynamic process rather than the traditional static process views. The dynamic process view would account for employment creation as a function of time, which would be a better indication of real employment created rather than a gross value for a change in number of jobs between time periods.

Robson\textsuperscript{17} argues that often small and large enterprises are viewed as independent systems when in fact they are both part of a single complex system in which the performance of either is dependent on many internal and (possibly more importantly) external factors. Development or ‘success’ of either may often be a result of the other’s failure, or vice versa. For example, if a large manufacturing plant were to close down for strategic or financial reasons one would expect to find an upsurge in small business start-ups by those retrenched employees, most likely out of necessity. Conversely, the success of a large enterprise may provide more opportunities for smaller enterprises to provide support services.
2.3 SMMEs competing in a global economy

In terms of the micro-economic picture of competitiveness there are several factors, both internal and external, which influence how organisations compete. Internally, there are factors such as size, ownership, resources and the subsequent characteristics of the organisations. Externally there are market conditions, globalisation and country/industry specific legislation. Porters Five Forces analysis gives a generalised framework of the competitive characteristics of a market. These five forces include the external factors: threat of new competitors, threat of substitute products or services and intensity of competitive rivalry; and the internal forces include: bargaining power of customers and bargaining power of suppliers\(^{18}\). Figure 2 gives a diagrammatic representation of Porters five forces.

![Figure 2: Porters Five Forces Model\(^{18}\)](image)

Direct involvement of management with their customers as well as their flexibility and innovative responses to market needs are likely to be advantageous for SMMEs in competing against new entrants as well as established rivals within their industry. This focus on the customer is likely to build strong relationships with customers and allow the SMME to establish a firm customer base. This should also be advantageous in mitigating the threat of substitute products as it is likely that new products will be a response to market need which the SMME will be aware of and be able to produce an innovation to fill this need. The generally small proximity in which SMMEs operate is also likely to be advantageous in this regard as proximity to the customer allows for a greater level of service and flexibility.

The few management levels in SMMEs is often an advantage as the person responsible for sales and purchasing often bears more responsibility in the business that the corresponding person in a large enterprise. This means that they will be motivated not by short term savings or sales but rather by long term sustainability. Also, the relationships built with customers and suppliers give SMMEs a certain amount of bargaining ability. However, the size of the enterprise in terms of buying power or dependence on specific customers is still an important factor when
considering bargaining power of both suppliers and customers. Small businesses are often not able to command the level of service or terms that they would like from their suppliers and are often forced into providing similar terms to their customers.

The generally less capital intensive practices employed by SMMEs means that often the barrier to entry in their market is low. This makes them more vulnerable to the threat of new entrants, particularly other SMMEs which will target such markets and potentially have the same competitive advantages. Very rarely do SMMEs compete with large enterprises in potentially capital intensive industries. Instead, SMMEs usually find a niche in the market to which they are better suited and able to compete. Often such a niche may be as a supplier of a specialised product or service to a large enterprise. Thus often SMMEs complement large enterprises by finding a place in the larger supply chain rather than competing directly. Rogerson\(^6\) argues that the entire current structure of the SMME sector is flawed in that, rather than supporting large enterprises by offering complementing products and services and fitting into the upstream or downstream supply chain as in many developing economies, South African SMMEs are attempting to compete directly with large enterprises, albeit in somewhat different consumer groups.

Faced with increased competition as a result of globalisation, manifested in more competitive, turbulent and demanding markets, SMMEs must operate more efficiently and become more productive if they are to remain competitive. Accomplishing this will require innovation from SMMEs regarding production practices and usually require technology implementation in the form of advanced manufacturing techniques\(^{19}\). This applies specifically to manufacturing SMMEs but may be extended to any SMME (service or production) which may improve the efficiency of their operations with increased employment of technology.

Government, through the department of science and technology, recognises the role technology plays in improving manufacturing operations, for businesses of all sizes, and the associated benefits. The National Advanced Manufacturing Technology Strategy (NAMTS) was established with the goal of stimulating technological upgrading in industry and to facilitate the flow of technological resources and building of an environment which is conducive to innovation. The resources required for such an environment include skilled manpower, technology infrastructure and funding which form the approach for the support provision of the NAMTS\(^{20}\).

Further goals of the NAMTS include:

- Ensuring that technology resources are better developed, focused and utilized.
- Developing the capacity of the manufacturing sector to master advanced technology to become more innovative, flexible and customer oriented.
- Facilitating the move from raw material-intensive manufactured goods towards progressively more knowledge-intensive goods and services.

These goals are to be achieved in line with the acceleration of economic growth, the creation of wealth on a sustainable basis, and the improvement of quality of life of South Africans. The NAMTS does however make provision for these goals to be link competitiveness with important national and social goals such as economic growth, employment creation and equity\(^{20}\).

According to Dangayach & Deshmukh\(^{21}\) greater use of technology will improve the competitive position of the business and may allow it to gain a competitive
advantage. The benefits associated with employment of advanced production techniques or methods include: reduced unit cost of production, increased return on equity, inventory or resource savings, increased flexibility and improved quality of production. Despite the obvious benefits Fulton & Hon describe the reluctance of SMMEs, particularly the smaller enterprises, to adopt new technologies due to the financial investment required as well as a lack of confidence in their ability to acquire and deploy the knowledge required for successful implementation of the technology.

Rogerson makes particular reference to the dichotomy in South African SMMEs with regard to evolution of business practices. Many South African SMMEs are characterised by expansion through replication of micro-businesses, or ‘involution’, which results in increasing the number of employees in proportion with the growth of the business. The opposite of this is ‘evolutionary’ expansion, as a result of growth through process replication or intensification, and through the use of capital, skill and/or technology upgrading.

2.4 Aim of the Study

Information on the SMME sector in South Africa is particularly poor with very little statistical information available on the sector. Despite a strong trend SMME research since the inception of the 1995 White Paper, many issues around SMME characteristics, and SMME development, in South Africa remain relatively unclear. Therefore more information on the dynamics of South African SMMEs with regard to competition and employment creation is required. As the body of knowledge on South African SMMEs grows, more specific questions will emerge for research, and development policies may be formulated with a greater understanding of the SMME environment in South Africa. More specifically, this research will add to the debate on social and economic contribution of SMMEs and potential of SMMEs to create employment and help to propel the country economically.

The aim of this paper was to determine whether the requirements for South African SMMEs to compete more effectively on a global level have a positive or negative impact on employment creation. This translates to establishing whether the goals of economic growth (through increased competitiveness) and employment creation - as intended by the 1995 White Paper on Small Business - are conflicting.

2.5 Research Methodology

Ten semi-structured interviews with SMME owner-managers were conducted. The sample contained participants from across the SMME size spectrum and across different industries as far as is possible. There was however, a small bias toward production-based SMMEs rather than service-based SMMEs.

The research question was aimed at growth through increased competitiveness of SMMEs and its relation to employment creation. A dichotomy is presented in the literature between newly formed SMMEs and established SMMEs with regard to expansion and employment growth potential. Therefore it was decided that the SMMEs making up the survey should fit into the category of established SMMEs who are not operating in a survivalist mode. The criteria to judge this is the number of years the business has been operating. The requisite number of years the business must have been operating to qualify for the sample was set at ten years.
Two additional interviews with industry role-players, who were expected to have complementing or contrasting views to those of the SMME owner-managers, were conducted to give greater context, perspective and relevance to the results. The additional interview participants were a human development consultant, with many years experience in assisting both small and large enterprises, and a high level local politician, from the Midvaal municipality in Southern Gauteng, who has been directly involved with local business development and was able to offer the political perspective on matters to do with the business environment and small business development.

The interview structure was divided into four sections each generally addressing a separate theme, namely:

- Issues of competition and competitiveness in the industry.
- Issues regarding labour.
- Issues regarding technology.
- General discussion with regard to the business environment in South Africa.

2.6 Research Findings

Data obtained from the interviews was analysed using the thematic content analysis technique from which 12 central themes emerged as shown in table 1 below.

<table>
<thead>
<tr>
<th>Theme 1</th>
<th>Most of the SMMEs surveyed serve local markets and commonly serve a niche in the market.</th>
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<tbody>
<tr>
<td>Theme 2</td>
<td>Price is generally the most important competitive dimension for most SMMEs surveyed.</td>
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<tr>
<td>Theme 3</td>
<td>Competition is different in each industry but most SMMEs manage to define themselves in their market and separate themselves from their competitors.</td>
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<tr>
<td>Theme 4</td>
<td>Competition from the East and particularly China is a great threat to most of the surveyed SMMEs.</td>
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<tr>
<td>Theme 5</td>
<td>Most of the SMMEs surveyed engage in fairly conservative business practices focusing on long term sustainability.</td>
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<tr>
<td>Theme 6</td>
<td>Much of the work in the surveyed SMMEs is unskilled and is easily replaceable however most do have several positions which require skilled workers who are becoming scarce and are difficult to retain.</td>
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<tr>
<td>Theme 7</td>
<td>The work in most of the surveyed SMMEs is labour intensive, but is used in conjunction with appropriate or complementing technology.</td>
</tr>
<tr>
<td>Theme 8</td>
<td>Complicated labour relations are a common issue among the surveyed SMMEs.</td>
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<tr>
<td>Theme 9</td>
<td>Employment numbers tend to increase with business growth. However, several of the SMMEs surveyed are intent on keeping the business small.</td>
</tr>
</tbody>
</table>
Theme 10 | Technology provides the opportunity to be more productive and could expand market opportunities for most of the surveyed SMMEs.

Theme 11 | Common challenges faced by the surveyed SMMEs in the South African business environment are: over regulation and red tape, bribery and corruption, crime and BEE.

Theme 12 | Input costs have increased dramatically over the past few years and have caused artificial growth and affected profit margins of the surveyed SMMEs.

2.7 Discussion

2.7.1 Competitiveness and Employment Creation

The literature research presents a possible conflict in some of the objectives of the national small business strategy, most notably the objectives of employment creation and economic growth of SMMEs. It is proposed that much of the growth that takes place in the SMME economy does not directly create employment and that SMMEs which are able to compete internationally are highly unlikely to create employment for the unskilled majority of workers.

The following points in this regard have been observed through this research:

- In the past (and especially prior to the labour relations act) business growth in terms of turnover/profitability was directly associated with employment growth in the SMME.
- SMMEs are experiencing greater competition in their markets, especially from imports and most notably imports from the East. SMMEs which operate within a niche in the market are generally more protected from competition.
- SMMEs that have made capital investments in appropriate technology to upgrade their production systems have become more competitive in their respective markets.
- SMMEs which have the potential and resources to invest in capital equipment tend to follow this trend in order to remain competitive in their market, become more competitive in their market, or enable themselves to access new markets. The competitive advantage that stems from increased capital investments relates to more efficient production including: shorter production time, reduced input costs (material and energy efficiency), and less demand on labour. The aim, however, is not necessarily to eliminate the role of labour in the production process, only to make it more productive. Therefore this does not have the effect of downsizing the labour force but does allow the business to grow without growing the labour force.
- Generally South African labour is becoming more expensive, less productive, and more troublesome through legal and regulatory issues relating to modern labour relations. Therefore, additional motivation exists for making capital investment which lowers the dependence on labour as businesses want to be more productive and avoid costly labour issues.
- There is little desire or motivation among SMME owner-managers to create employment.
Therefore, one may conclude that the potential of the SMMEs surveyed in this project to grow, through becoming more competitive in their market or expanding into alternative markets, conflicts with their ability to create employment.

The survey dealt only with established SMMEs, as detailed in the research sample section of the research methodology. This matches the theory of Kesper (2002) with regard to the phenomenon of jobless growth in SMMEs however this may limit the applicability of the results and conclusions to the context of such established SMMEs. As previously described, much of the literature suggests that most employment creation potential of SMMEs comes from establishment and initial growth of new enterprises. For new SMMEs to be established on a scale which will assist the amount of employment creation required in South Africa will take much assistance from government.

2.7.2 Philosophical Response

Employment creation is one of the most pressing issues in South Africa and is clearly at the root of many social problems in the country. Since government is responsible for starting most major development initiatives the issue of employment creation becomes politicised. The result of this is that much impetus of employment creation becomes lost in the course of party politics. Employment creation is imperative to South Africa and should be de-politicised if the goal of creating real employment on a large scale is ever to be achieved.

This research shows the limited ability of established SMMEs to create employment. The goal of employment creation must therefore be achieved through new business formations. However, the business environment in South Africa is very restrictive, especially concerning small business start-ups. Therefore, if South Africa is to truly realise the employment creation potential of small enterprises government must re-engineer the regulatory environment and support measures to stimulate entrepreneurship and encourage new business formations.

In the process of employment creation, South Africa needs to be careful to ensure that any employment created is meaningful in an economic development sense. Employment which is created must add to the economic development of the country and assist to make South Africa more competitive on a global scale. Creating artificial employment positions which do not contribute to making organisations more competitive and more successful in stimulating the local economy are not sustainable in the long term. There is scope for programmes such as the extended public works programme and similar initiatives as they assist in alleviating poverty in the short term which is vital for South Africa. However, these programmes are not creating employment and are not assisting South Africans to make a meaningful contribution to the economic development of our country.

All businesses are motivated by the traditional focus on the ‘bottom line’. Businesses need to develop a focus on the triple bottom line of economic success or profitability, social development and environmental consciousness. The social development and environmental consciousness aspects are especially important because, although they are not reflected in current economic success they are the factors which will determine the long term sustainability of the country and the respective business.
3 CONCLUSION

SMMEs do have the potential to create sustainable employment. However, for South African SMMEs to become more competitive in a global marketplace more efficient production systems are required to lower costs and increase output. The factor limiting productivity then becomes labour and labour is becoming increasingly expensive through increased wages and complicated and tenuous labour relations. Therefore, small businesses aiming to become more competitive will tend to limit their dependence on labour to minimise costs and productivity constraints. So, the goal of economic growth for SMMEs conflicts with national goal of employment creation through SMMEs.

The qualitative nature of this study means that data of greater depth was gathered from a small sample of the population. The chosen sample included SMMEs from across industries and size categories but was limited to established businesses - those older than ten years. Since the research question was specifically aimed at analysing links between employment growth and increasing competitiveness the sample needed to consist only of established SMMEs and therefore may be limited in its applicability to the entire SMME economy.

The strength of this research is that it shows that the greatest potential for creating employment in South Africa comes from the formation of new SMMEs. For this employment to be sustainable requires these SMMEs to succeed over a long term. An influx of newly formed SMMEs which succeed in the long term will develop the economy, stimulate a more competitive environment, and thus achieve the national goals proposed by the White Paper on Small Business. The focus of small business development in South Africa should therefore be on new business formations and entrepreneurship.

4 REFERENCES


