



The Environmental Context for SMME Development in Kwazulu-Natal

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DPRU Conference Paper Johannesburg
27-29/10/08*

Introduction

- SMMEs is the focus of considerable policy interest in South Africa and many other countries.
- SMMEs are an important source of jobs, contributing significantly to the economic growth of countries and to advancing national and individual prosperity.
- If countries, particularly those in Africa, are to grow out of poverty, unemployment and create a more prosperous future, they will need more SMMEs and bigger businesses (Moss, 2007: 223).
- To achieve this, a better environmental condition is required for entrepreneurs.

Introduction

■ 5 main sections:

1. Review of the literature on internal and external constraints
2. Research methodology
3. Results
4. Factor analysis
5. Policy recommendations

1.Literature Review

- The interaction of firms with their formal and informal institutions determines the environment in which the entrepreneurs operate at any point in time and in different places (North, 1994).
- The environment refers to a broad range of conditions that affect entrepreneurs (Moss, 2007: 235).
External/Internal to the firm.
- Changes in the environment can have positive or negative consequences for business growth. The business environmental conditions are particularly unfriendly in much of Africa (World Bank, 2006).

1. Literature Review- Internal Environment

■ Access to Finance

- Investment Climate Survey (2004:12), finance ranked among the top five constraints to business development in Sub-Saharan Africa
- Institutions view small firms as high-risk ventures with poor collateral; lending to them entails high administrative costs in relation to the size of the loans.
- While financial is necessary, the ability to manage finance and keep proper records is more important.

1.Literature Review- Internal Environment

- **Human Resources and Management skills**
- Labour laws affect the hiring of labour; stringent legislation robs the market of its flexibility, making hiring or firing too costly.
- When there is a shortage of skilled people, retention of labour is also a problem.
- Recruitment process for quality labour becomes more difficult, time consuming and expensive.

1.Literature Review- Internal Environment

■ Innovation and Technology

- All businesses need to innovate, adopt new ideas and practices to satisfy the changing needs of the market in a global environment.
- Some conservative entrepreneurs often view modern technology as extremely expensive and may still prefer the conventional way of doing business.
- A myopic view ultimately constrains the growth prospects, resulting in businesses missing out on opportunities in the changing environment.

1. Literature Review- External Environment

- External environment relates to factors over which the entrepreneur does not have full control, including:
 - Legal restrictions, such as requiring multiple licenses to start a business.
 - Lack of property protection
 - Excessive regulations and red tape
 - Availability or reliability of infrastructure services
- Environmental factors make running a business prohibitively onerous and raise the transaction costs.

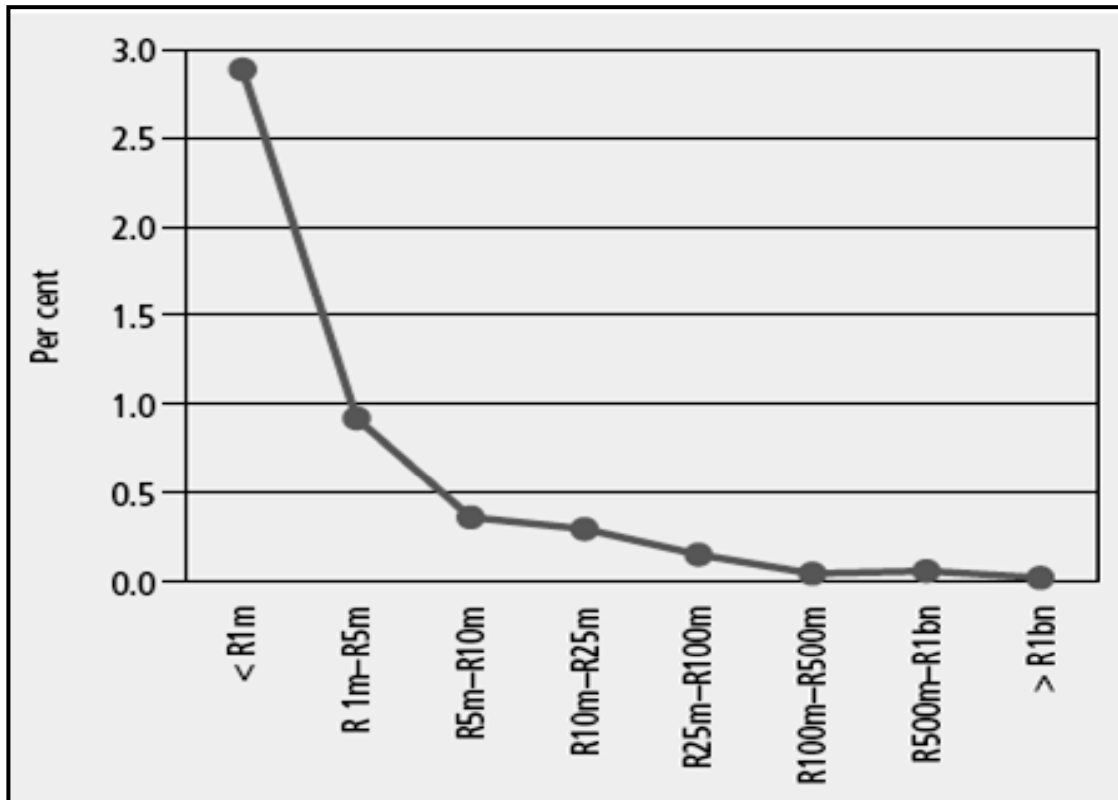
1.Literature Review- External Environment

- Investment climate surveys suggest that, compared with other developing country regions, Sub-Saharan Africa is a high-cost, high-risk place to do business.
- Overall, doing business in Africa costs about 20% to 40% more than in other developing country regions.
- Effect: scaring away foreign investors, squashing domestic entrepreneurs, forcing many small business entrepreneurs into the informal sector.
- This results in less investment, less growth and higher poverty.

1.Literature Review- External Environment

■ Taxation

Figure: 1: Annual Cost of Tax Compliance as a percentage of Turnover



Source: (Small Business Project, 2005: 46)

1.Literature Review- External Environment

- **Taxation**
- Cost of tax compliance is regressive.
- Annual cost of tax compliance for the small business (with an annual turnover of about R1m), is almost 3% of turnover.
- Larger firms, that have the resources to engage tax consultants, the cost is between 0.1 to 0.5 % of turnover.
- SMME compliance cost in South Africa was R79b (about 6.5% of SA's GDP) in 2004, whereas in OECD it was less than 3%.

1.Literature Review- External Env.

■ Regulation and Laws

- According to the World Bank, regulatory reforms in developing countries could add as much as 1.4% to average annual GDP growth in these countries (Orford *et al*, 2004: 51).
- In Africa, entrepreneurs face greater regulatory hurdles than in any other region.
- Some African countries, like Rwanda, Mauritius, Botswana, Namibia and Nigeria, that have made progress with introducing reforms to their business environment, are registering high rates of economic expansion.
- Sub-Saharan Africa had the lowest business environment reform intensity .

1.Literature Review- External Environment

■ Crime

- 29% of the respondents in the 2004 Investment Climate Survey rated crime as a major or very severe problem in South Africa (World Bank, 2006).
- The cost of security was equal to about 1.1% of sales.
- April 2007 – March 2008 indicates that the number of reported murder cases in South Africa was 18,487, (giving a rate of 38.6 per 100 000 of the population).

1.Literature Review- External Environment

■ Crime ...(continued)

- Business burglary rate over the same period was 131.7 (62,995 cases),
- 497.1 for house burglary (237,853 cases) and 247.3 for aggravated robbery (118,312 cases), (Natal Witness, 1/7/2008).
- In Kwazulu-Natal, home robbery - the most feared crime-,increased from 2667 to 3480 cases (30%), and business robbery increased from 997 cases to 1923 (92%) over the same period.
- Crimes retard entrepreneurial activity and slow down business growth and development of an economy. Brain-drain.

2. Research Methodology

■ Research Objectives

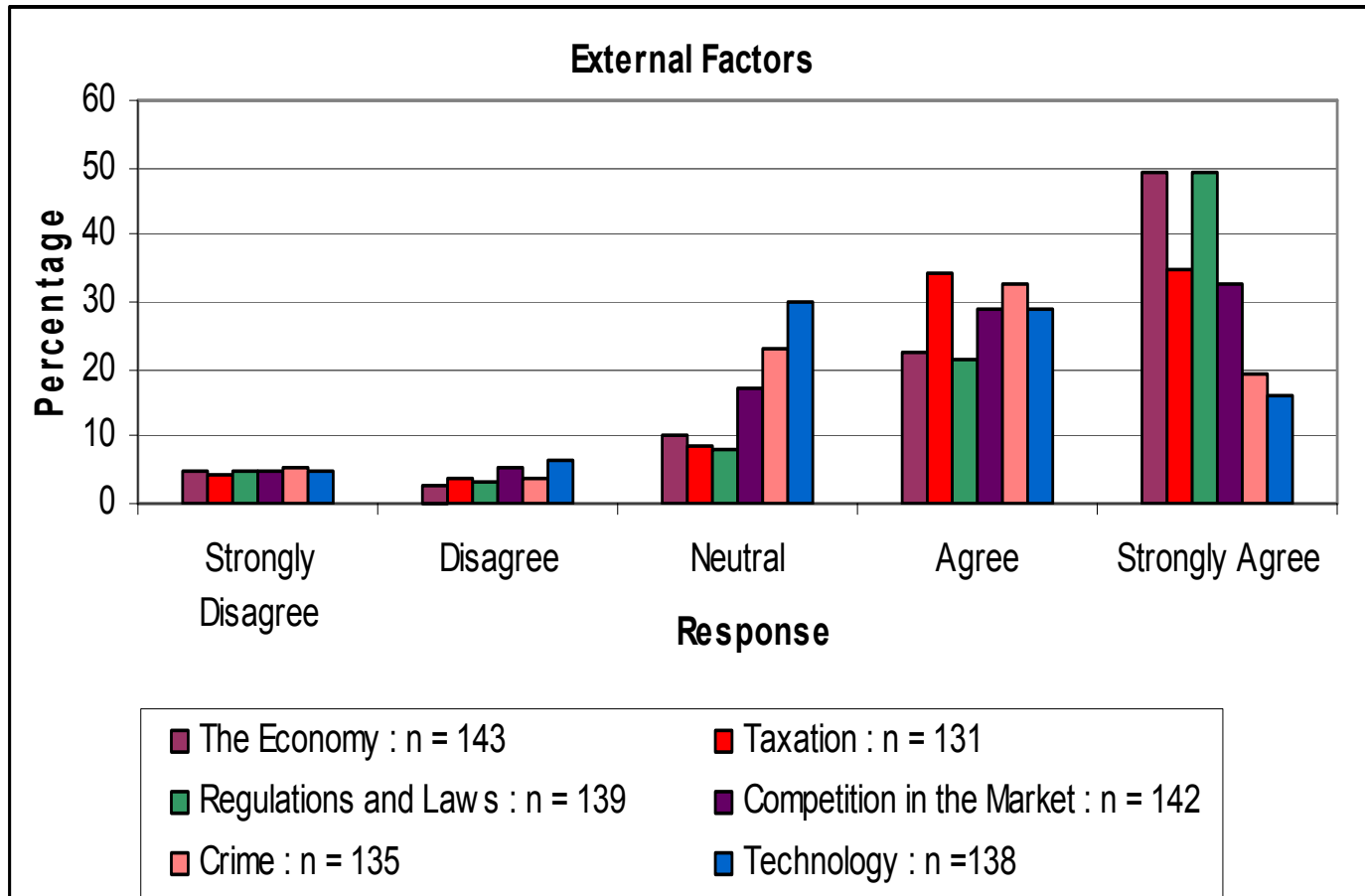
- To evaluate the external environmental conditions that favour or constrain entrepreneurship and small business development in the Pietermaritzburg (KZN) region.
- To evaluate the internal environmental conditions that favour or constrain entrepreneurship and small business development in the Pietermaritzburg (KZN) region.

■ Research Design

- A sample of 150 firms was randomly chosen.
- Relevant data was gathered by means of a questionnaire.
- It was initially pre-tested on a sub-sample of 10 firms.

3. Results-External Factors

Figure: 2: External Environmental Factors

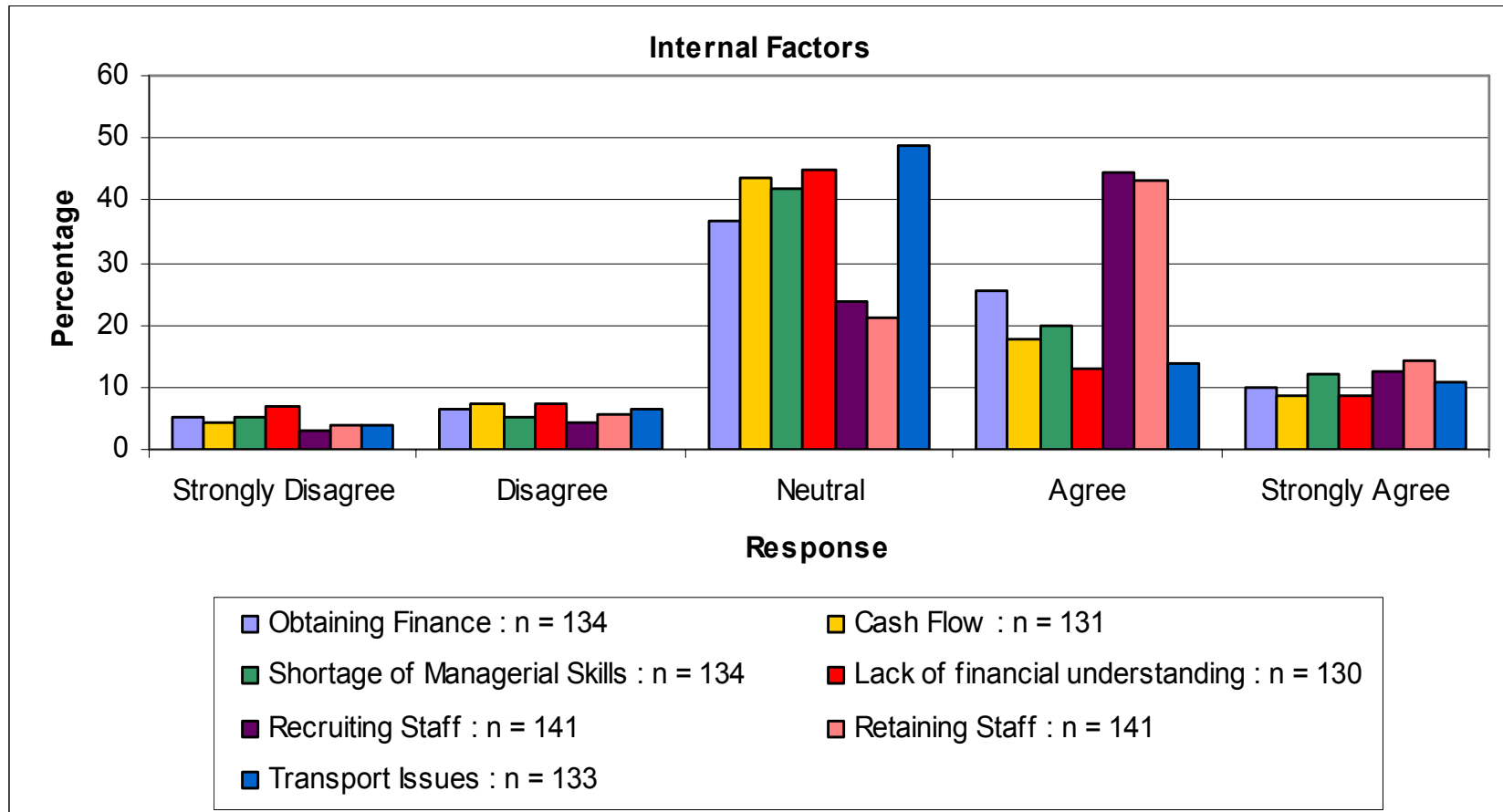


3. Results-External Factors

- About 71% of the surveyed businesses (figure 2) felt that adverse conditions in the economy are an inhibitory growth factor.
- 69% agreed or strongly agreed that taxation was a constraint to the growth their business
- 71% perceived that regulation and laws are a constraint to their business development
- 45% viewed technology as a constraint while 30% remained neutral

3. Results-Internal Factors

Figure 3: Internal Factors



3. Results - Internal Factors

- With regard to finance, about 11% of the respondents stated obtaining finance is not a problem.
- About 37% were neutral.
- However, about 35% (figure 3) felt that obtaining finance to grow their businesses is a major constraint.
- Modal response to question on cash flow (43.8%) was neutral.
- 26% perceived cash flow to be an obstacle to their businesses.

3. Results - Internal Factors

- Skills of planning, organising, leading and controlling are imperative for business development.
- 41.9% remained neutral, whilst 31.9% agreed that shortage of managerial skills or business expertise is a constraint to business growth.
- At times, businesspersons do not understand the practice of good record keeping.
- With regard to financial understanding, the modal response was neutral (45%),
- About 22% agreed that a lack of financial understanding retards growth of the business (figure 3).

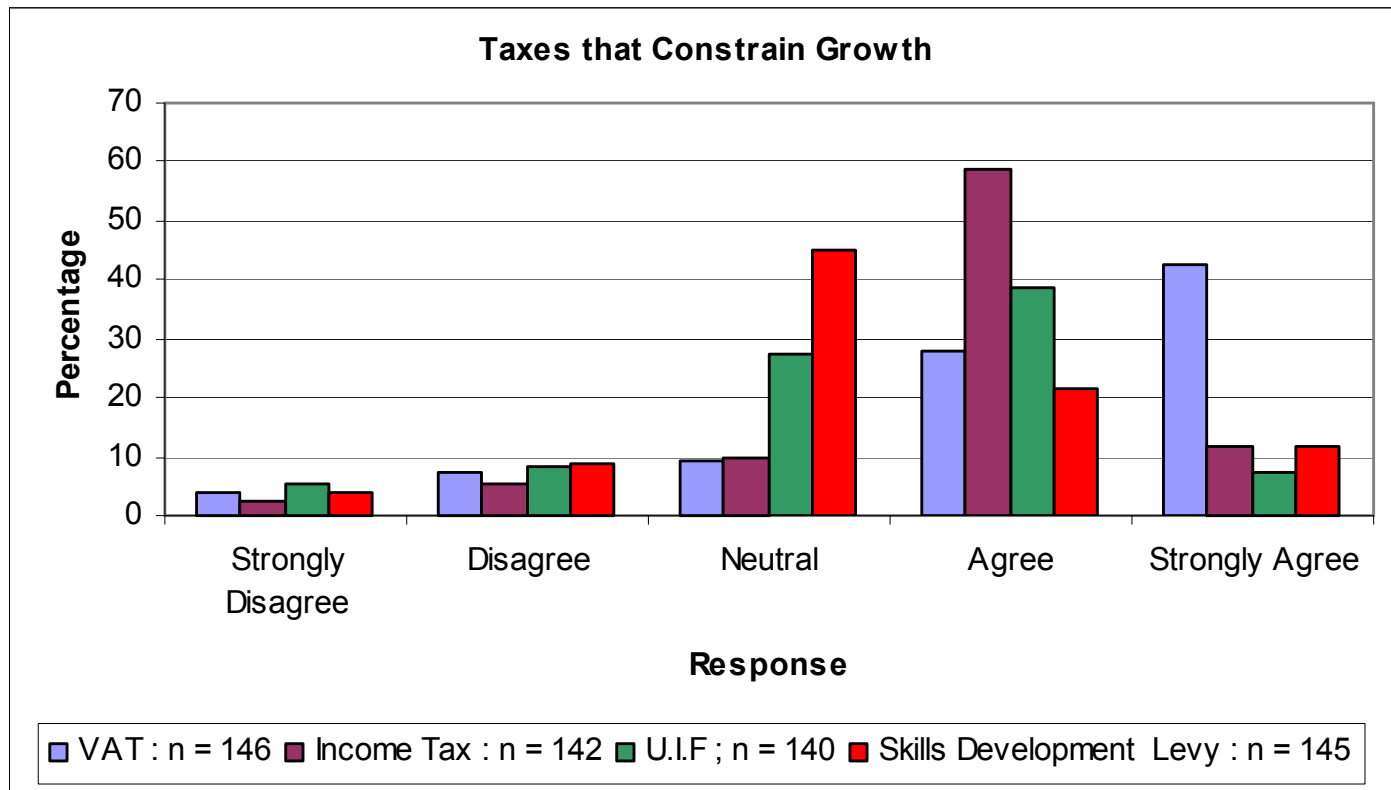
3. Results - Internal Factors

- 57% stated that recruiting staff, and another 58% indicated that retaining staff was a constraint to business growth.
- Constantly rising fuel prices place a heavy cost burden on businesses and individuals.
- 48.8% gave a neutral response to the transport question.
- 24% perceived transport issues to constrain business in Pietermaritzburg.

3. Results-External Factors

■ Taxes that Constrain Growth

Figure: 4: Taxes that Constrain Growth



3. Results - Internal Factors

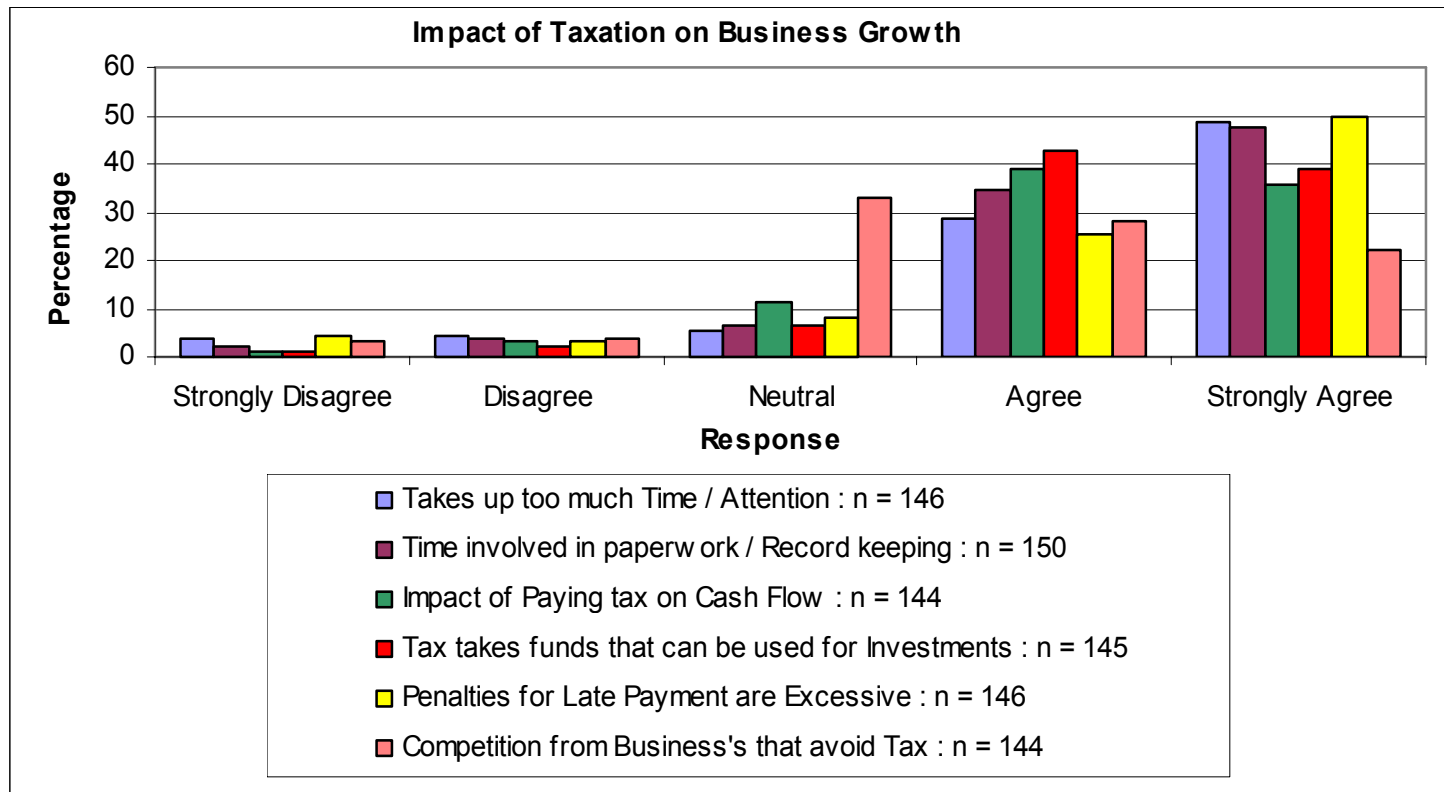
■ Taxes that Constrain Growth

- Taxes examined were VAT, income tax, Unemployment Insurance Fund (UIF) and the Skills Development Levy.
- (71%) agreed that VAT and income tax are constraints to business growth.
- A third indicated that the skills development levy is a constraint, though 45% of respondents remained neutral.
- 40% of respondents agreed or strongly felt that UIF is a constraint to business growth.

3. Results-External Factors

■ The Impact of Taxation on the Business

Figure: 5: The Impact of Taxation on Business Growth



3. Results-External Factors

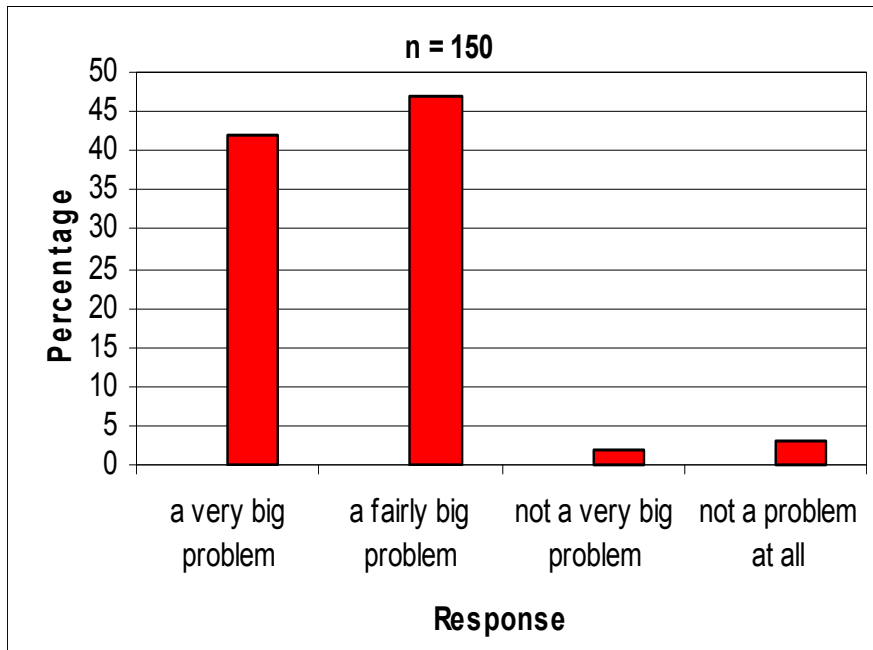
■ The Impact of Taxation on the Business

- 80% felt that taxation takes up too much managerial attention.
- Over 80% agreed that the amount of time involved in keeping records and paperwork was excessive.
- Paying taxes impacted on the cash flow for over 55% of respondents.
- 80% agreed that tax takes money out of the business that could be used for investment.
- 75% found that penalties for late payment are excessive.
- 50% agreed that competition from businesses that perhaps avoids tax affects business negatively.

3. Results-External Factors

■ Crime and its Effects

Figure 6: Is Crime a Problem?

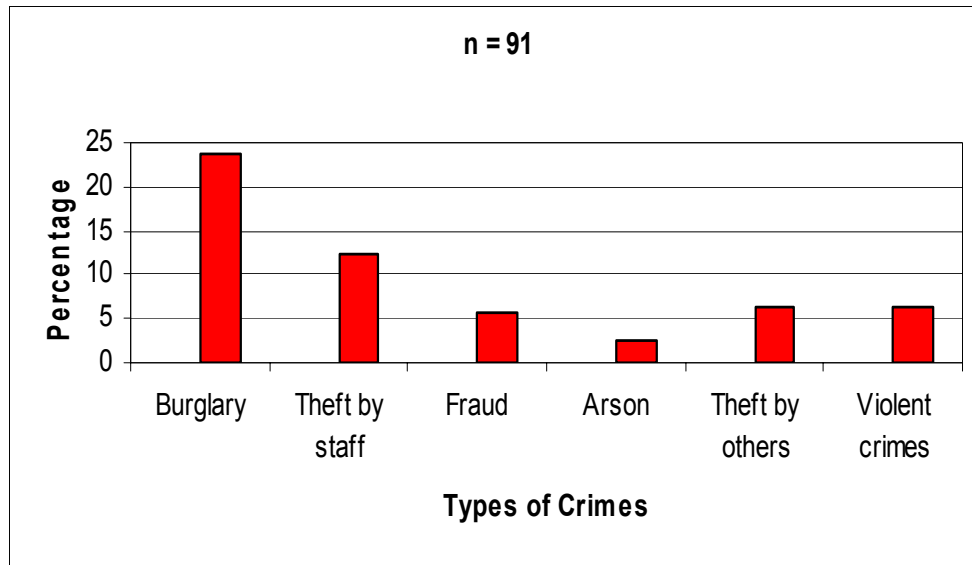


- Almost 89% indicated that crime is a fairly big problem.

3. Results-External Factors

- **Crime and its Effects- Types of Crime**

Figure 7: Types of Crime

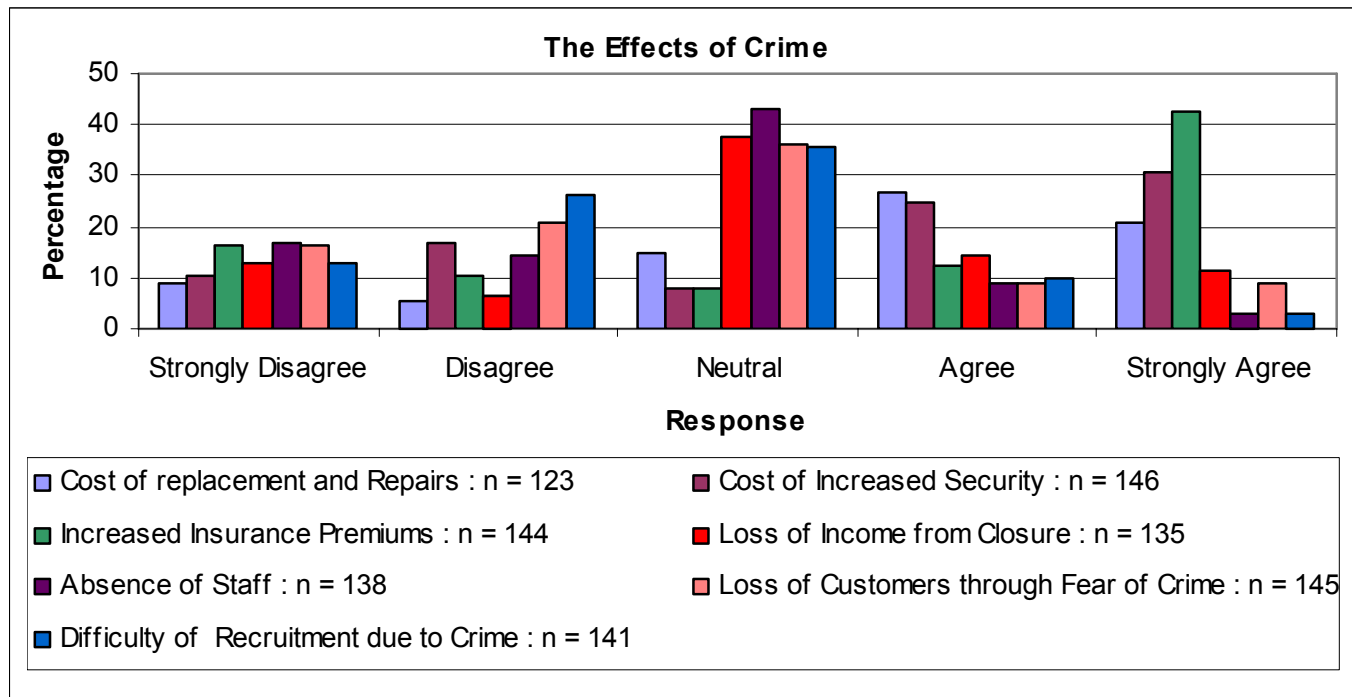


- **Burglaries (almost 25%) were most common, followed by theft by staff and others (20%).**

3. Results-External Factors

■ The Effects of Crime on the Business

Figure: 8: Effects of Crime on Business Growth



3. Results-External Factors

- **The Effects of Crime on the Business**
- Losses due to crime in South Africa amounted to R2,272 million (Investment Climate Survey, 2004).
- Costs of replacements of stolen stocks and repairs to damaged windows, doors and locks: (47%).
- Over 50% experienced increased security costs due to installing alarm systems and employing security guards.
- Increased Insurance Premiums: 55%
- Loss of Income from Closure: 25% agreed, 38% neutral.
- Absence of staff: 11%
- Loss of customers through fear of crime: 17%
- Difficulty in Recruitment due to crime: only 13% agreed, 35% remained neutral and almost 40% of respondents disagreed.

4. Factor Analysis

- The Principal Components method was used with varimax rotation.
- Table shows: 3 clusters are jointly explaining 59.210 % of the total variance in growth constraints.
- All of these 3 clusters have eigen values over 1.

Table 1: Total Variance Explained

Component	% of Variance	Cumulative %	Eigen values
1	36.159	36.159	4.701
2	12.794	48.953	1.663
3	10.257	59.21	1.333

4. Factor Analysis

- All variables (13) are loaded in order to now look at the classification of the different sets of clusters.
- The first set of factors is labelled as “**management**” and it consists of 5 items which had loadings ranging from 0.605 to 0.816 (table 2).
- The management cluster, being largely internal factors to the business, accounts for 36.159% of the variance.
- Cronbach’s alpha for this cluster: 0.7278.
- Table 2 : **Management** cluster

Management cluster	Values
Retaining staff	0.816
Recruiting staff	0.810
Shortage of management skills	0.653
Keeping up with new technology	0.626
Transport issues	0.605

4. Factor Analysis

- The second cluster is labeled “Finance related cluster”.
- Consists of 4 factors, with loadings ranging from 0.574 to 0.800 (table 3).
- Finance cluster accounts for 12.794% of the total variance (table 1).
- Cronbach’s alpha calculated for factor 2 equaled 0.8251.

Table 3: Finance related cluster

Finance related cluster	Values	Environment
Cash flow	0.800	Internal
Obtaining finance	0.780	Internal
Lack of financial understanding	0.574	Internal
Crime	0.658	External

4. Factor Analysis

- Cluster 3, consisting of 4 factors, has loadings ranging from 0.486 to 0.813
- The third set is largely 'external', classified as **economic** , and accounts for 10.257% of variation.
- Table 4: **Economic** related cluster

Economic related cluster	Values	Environment
The economy	0.813	External
Taxation	0.602	External
Laws and regulations	0.597	External
Competition	0.486	External

4. Factor Analysis

■ Synthesis

- Internal constraints (cluster 1 and 2) jointly account for almost 49% of variance in growth.
- Factor 3 (external constraints) accounts for 10.257% of the total variance.
- Collectively these three factors account for almost 60% of the variance in environmental growth constraints.

5. Discussion, Recommendations and Conclusion

- The business entrepreneur has little control over external factors.
- To certain degrees, internal factors are within the control of the entrepreneurs; these are areas over which improvements can be made with pro-active strategies.
- Managerial and entrepreneurial skills should be enhanced, in areas where these are sorely lacking, especially with regard to cash flow, keeping or understanding financial statements and use of technology as well as the recruitment and retention of appropriate staff, with possible support for training.

5. Discussion, Recommendations and Conclusion

- Provision of finance is certainly necessary but not a sufficient condition for advancing enterprise development.
- The ability to manage finance effectively is critical.
- Taxation and regulations were also seen as major constraints to growth
- The management factor has the greatest variance on growth, followed by finance and then the external cluster.
- Policy on small business should focus on both the internal conditions and external environmental factors.

5. Discussion, Recommendations and Conclusion

- On the external front, addressing the problem of **crime** in its various manifestations and of perceived high levels of **taxation** and **regulation** are critical for SMME development.
- The broad environment needs to be a safer and better place for individuals to live, work and conduct businesses with attractive prospects of ethically earning adequate returns.
- The habitat for an optimal development of entrepreneurship is a safer business-friendly environment with minimum legislation and regulation, effective policy interventions, as well as visionary leadership.

Thank you!