SMEs believe that much needs to be done before this can become a reality.

“My first priorities are my business and my family – if you want me to create jobs, you need to make it worth my while.”

90% of NEW JOBS will be created by SMEs by 2030.

NATIONAL DEVELOPMENT PLAN

2015 SME INSIGHTS REPORT
In 2014 the South African Institute of Chartered Accountants (SAICA) commissioned their inaugural survey into certain practices, attitudes and characteristics of Small and Medium Enterprises (SMEs) in South Africa. The study was conducted digitally and respondents were invited to participate by email, through SAICA-affiliated Small and Medium Practices (SMPs) and through the business media. The survey attracted sponsorship from CQS, and was supported by DotNews – our thanks to them both.

Our target was to attract 100 SMEs to respond, and to achieve several objectives:
- To provide a platform for SMEs to raise their voices;
- To explore ways in which SMPs could add value to the sector whilst broadening their own business base;
- To understand the needs of SMEs better so that SAICA could engage with National Government and with their own SMPs and SMEs directly with the objective of improving the performance of the sector given its critical role in the National Development Plan (NDP).

The 2014 survey attracted over 800 respondents, which was an indication of the extent to which SMEs needed to express their point of view. The survey results were shared with the Ministry of Small Business Development, Business/Partners (South Africa’s largest risk-based lender to SMEs), and with Small Enterprise Finance Agency (SEFA – the subsidiary of the IDC specialising in small and micro-business financing).

As is often the case, surveys of this nature answer many questions, but usually uncover many others. The SMP division of SAICA decided late in 2014 that it should undertake a second survey to follow up on many issues raised by the first survey, and to explore new and important concepts. The same method of encouraging SMEs to participate was used, and DotNews and Sage Pastel must be thanked for mailing the survey link to their clients and for encouraging them to participate. Fieldwork began in March and ended in June 2015. The response from SMEs has once again surprised us, with over 1,300 SMEs participating in the 2015 survey.

The 2015 survey results will once again be shared with various government departments in an attempt to influence policy toward this sector, and with SME funders and our own SMPs in an effort to create healthy growth and sustainability in the sector. The results will also be publicised in the industry and business media as feedback to the SME sector, and in an effort to guide and influence both government and big business in the ways they deal with SMEs with the objective of creating an improved business environment.

Executive Summary of the Findings

The findings in the 2015 survey followed on from the major findings of the 2014 results. In the interest of comparability, the major findings and recommendations of the 2014 survey were:
- The number of people employed grows rapidly with turnover, and with the length of time an SME survives. It is not sufficient to only stimulate SME creation to create jobs. The stimulation of existing SMEs to grow may be more beneficial to job creation.
- Half of the SMEs in the sample have been in existence for 10 years or more. With only 8% starting less than a year ago.
- 90% of the SMEs surveyed conducted less than 10% of their business with government at any level. 72% do not deal with government at all.
- SMEs are positive about the prospects for their business in terms of turnover growth and profitability.

As is often the case, surveys of this nature answer many questions, but usually uncover many others. The SMP division of SAICA decided late in 2014 that it should undertake a second survey to follow up on many issues raised by the first survey, and to explore new and important concepts. The same method of encouraging SMEs to participate was used, and DotNews and Sage Pastel must be thanked for mailing the survey link to their clients and for encouraging them to participate. Fieldwork began in March and ended in June 2015. The response from SMEs has once again surprised us, with over 1,300 SMEs participating in the 2015 survey.

The 2015 survey results will once again be shared with various government departments in an attempt to influence policy toward this sector, and with SME funders and our own SMPs in an effort to create healthy growth and sustainability in the sector. The results will also be publicised in the industry and business media as feedback to the SME sector, and in an effort to guide and influence both government and big business in the ways they deal with SMEs with the objective of creating an improved business environment.

Executive Summary of the Findings

The findings in the 2015 survey followed on from the major findings of the 2014 results. In the interest of comparability, the major findings and recommendations of the 2014 survey were:
- The number of people employed grows rapidly with turnover, and with the length of time an SME survives. It is not sufficient to only stimulate SME creation to create jobs. The stimulation of existing SMEs to grow may be more beneficial to job creation.
- Half of the SMEs in the sample have been in existence for 10 years or more. With only 8% starting less than a year ago.
- 90% of the SMEs surveyed conducted less than 10% of their business with government at any level. 72% do not deal with government at all.
- SMEs are positive about the prospects for their business in terms of turnover growth and profitability.
• SMEs consider their most difficult obstacles in growing their businesses to be:
  o Government-generated red tape
  o B-BBEE codes
  o Labour laws
  o Raising growth finance
  o Tax laws
• The research indicates that there are numerous actions that government could consider to motivate SMEs to grow and employ:
  o Government sector to speed up payment in order to reduce cash flow pressure for SMEs and allow working capital to finance growth
  o Tax incentives for growth and employment
  o A relaxation of labour laws for this sector
  o A reduction of red tape
  o Easier access to risk finance – for about a third of SMEs

The 2015 research sought to shed more light on the plight of SMEs, the effect that policy has on them, and the extent to which they engage with the procurement engine of government. The highlights of the 2015 survey findings and recommendations are:
• Of all SMEs, two-thirds will start at least two businesses, a third will start at least three, and 3% will start at least 10. Given that SME success increases with mentorship and technical assistance, one of the best sources of mentoring for new SMEs may be more experienced SMEs.
• Policymakers should reduce the amount of red tape to start business, and then the amount of red tape needed to comply with legislation during the lifespan of an SME. Although regulation is necessary, a more balanced approach is needed.
• If government wishes to maximise the power of their procurement engine for transformation and job creation they should do more to make their business more attractive to SMEs by improving payment terms and simplifying the tender process. A small band of SMEs generate more than 50% of their turnover from business with government, and run successful businesses. On average these SMEs employ more people than the rest of the sample. What is evident is that government can grow jobs at a faster rate if they utilise SMEs to a larger extent as their service providers.
• There exists a B-BBEE conundrum. On the surface, the big business sector either, two business environments which SMEs can access government contracts; the only directors, and the CEO. While this approach is needed.
• Of all SMEs, 50% of new jobs will be created by the SME sector.
• In the quest for job creation from SMEs there exists an employment sweet spot. The number of people employed in SMEs grows rapidly with turnover, and with the length of time an SME survives. If government wants to hit the NDP targets for wealth and job creation by 2030, they are going to have to do several things differently. Current practice will not work, government should focus more efforts at growing and keeping SMEs in business in order to derive this benefit.
• Many SME shareholders are also the chairpersons of their boards, the only directors, and the CEO. While this enables extremely flexible decision-making it also leads to poor governance and, sometimes, to rushed decisions. There are a number of ways SMEs can improve their governance, which will in turn improve their ability to secure funding and improve the management of business risks and thus have a positive effect on their survival rate.
• The main reasons for SME failure are cash-flow related. A lack of financial planning and control are at the heart of their problems. SMEs need to have basic financial acumen, whether this is through training programmes or through a business advisor, this capability is essential to assist them in managing their financial risk of failure.
• Consistent with the 2014 survey results, SMEs again indicated that they consider their most difficult obstacles in starting their businesses to be:
  o Government- and big business-generated red tape
  o Obtaining finance
  o VAT registrations
  o Compliance with legislation
  o Finding customers

So from a red tape and payment point of view, SMEs can be assumed to prefer doing business with other SMEs.
• Internal findings (SME has control)
  o Governance (funding)
  o Main reasons for SME failure and ways to mitigate
• External findings (to SMEs)
  o SMEs and job creation target
  o Reducing red tape
  o Policymakers should encourage business with government
  o B-BBEE conundrum
  o Who is working with government?
Finding Two – If government wants to hit the NDP target for job creation it will have to do something differently

As longevity increases, turnover increases, and employment increases. If government wishes to achieve its employment sweet spot, which is the NDP 2030 goal of SMEs creating 90% of new jobs, it should be willing to accept that certain things may have to be done differently to aid in the growth of existing SMEs. While it is vitally important to encourage new SMEs, the research indicates that SMEs only start to meaningfully contribute to job creation when they grow to R2m or more in turnover. The larger the SME, the more likely it is to employ significant numbers of people. Taking into account further that there is a high level of failure of new SMEs, government’s policy to grow the sector should be two-pronged:

- To encourage more SME start-ups and to provide them with strong financial access and technical support;
- To actively encourage those SMEs who have survived the first few years, to grow.

It is clear from the relationship between longevity, growth and employment that government policy will almost certainly have to use all the levers to affect SME growth that it has in its potential armoury if it is to succeed. Based on both the results of this survey and the 2014 results, these levers might include:

- Technical assistance at a scale beyond micro-enterprises to all SMEs;
- A more efficient way of introducing risk capital to SMEs that show promise;
- Subsidies for employment beyond the youth subsidy;
- Tax breaks and rewards for those SMEs who show growth and employment in real terms;
- Labour laws that allow SMEs to enlarge and reduce their workforces faster and less expensively;
- Simpler value-added tax (VAT) registration;
- Prompt payment of SMEs that all forms of government do business with;
- More incentives for big business to pay on time and to provide enterprise development opportunity through the B-BBEE system;
Increasing the scale of government-assisted access to growth finance. South Africa has consolidated its SME funding agencies into SEFA under the IDC. Government should concentrate more effort and funding through this agency, including enabling access to funding and the speed of processing of risk-based finance through this agency.

Finding Three – Policymakers should reduce red tape around starting a business

One of the main barriers to starting a business in almost all developing countries is the difficulty of obtaining finance. This holds true for South African SMEs where this is considered the second most difficult barrier when starting a new business. In South Africa, red tape from government is considered to be the biggest obstacle with red tape from the private sector coming in third place. Compliance with legislation and registering for VAT are also significant obstacles. Finding customers and marketing the business are the biggest commercial/operational obstacles.

South Africa is ranked 120 out of 144 in the 2014/15 Global Competitiveness Report for the ‘Burden of government regulation’. We could learn some lessons from other African countries. In Rwanda for example, who are ranked 6 out of 144 for the same element, starting a business takes on average 6.5 days, whereas in South Africa it takes approximately 48 days.

While red tape is a significant barrier to starting a business, it may logically be argued that as compliance increases with size it may therefore be a factor that influences the degree to which SMEs may wish to grow. The same red tape that makes it difficult to start an SME or to graduate from micro enterprise to SME may also inhibit the future growth of the enterprise. The World Economic Forum’s Global Competitive Report is again instructive. South Africans rate restrictive labour regulations as the most problematic factor to doing business. South Africa ranks 143rd out of 144 countries on hiring and firing practices and 136th for pay and productivity. Policymakers who recognise that red tape needs to be reduced and/or simplified would do well to consider the effect of current labour law on SME enablement, and their consequent ability and willingness to create jobs. Although regulation is necessary, a more balanced approach is needed. VAT registration in particular is considered the most onerous of the red tape issues. Currently the red tape around VAT registrations exists in an attempt to prevent fraud. This objective is important. SAICA has always advocated that the South African Revenue Services (SARS) should make it easy to register, and then to develop effective risk responses to control VAT fraud - making the lives of honest SMEs a lot easier. The red tape issue is not restricted to government. Red tape from large private sector businesses is also a significant obstacle for new SMEs.

Finding Four – Policymakers should do more to encourage business with government

Most SMEs do no work for government. Why?

73% of SMEs who answered the survey do no work for government at any level. A further 15% of the sample generated less than 10% of their turnover from government. Only 8% derived more than 25% of their turnover from government.

But there are a minority of SMEs who seem to have built good businesses with government. Given that government is the biggest sector in the economy, and that it has an overt strategy to drive transformation and SME growth through its procurement engine, why is this strategy not yet yielding the results the country desperately requires? It is not possible to definitively answer this question based on the 2015 survey results, but several strong pointers are evident from individual questions that were asked to respondents:

- The tender process in government is not considered transparent. This issue means that many SMEs do not even try to engage with government. One would think that simply improving transparency would help. Even SMEs who do business with government believe that this lack of transparency is a major problem.
- The tender process is also considered as too onerous and decisions regarding awards are considered to take too long. These two points, taken together with the transparency of the process and the perception of long payment terms, will inhibit the ability of government to make the most of the power of its B-BBEE legislation and the size and power of its procurement engine either for transformation or for job creation. It is important to note that Mr. Nene announced government’s intention to create one portal for doing business with government in his 2015 budget speech. This is expected to have a positive effect on the willingness of SMEs to engage with government.
- Long payment terms are a concern for many SMEs. It is also evident from the survey results that a lack of start-up capital, late payments, overheads that are too high, and bad debt are major causes of SME
Finding Five – The B-BBEE conundrum

B-BBEE is a system designed to encourage the growth of small business and the integration of previously disadvantaged sections of the community into the economy. Following on from the finding that 73% of our sample did no business with government, it came as no surprise that 40% of SMEs do not have a B-BBEE rating or don’t know what it is. The research also indicated that 24% of SMEs do no business with big business. This sector is one that also requires a lot of red tape before business can commence. On the other hand, SMEs pay fast and do not generally require B-BBEE certification or tax clearances. They are simply easier to do business with. So from a red tape and payment point of view, SMEs can be assumed to prefer doing business with other SMEs. The problem with this trend is that it does not further the national agenda. If policymakers are to engage with the SME market with the objective of creating 90% of new jobs by 2030 from it, they will need to institute new policies which give these businesses the breathing space they require. When asked about the new codes, SMEs seem to be even less informed or interested. 51% said they didn’t know what their new rating would be or said there was no reason for it to change, while a further 16% said they were non-compliant. 67% are simply not engaged. Only 11% had plans to score at level 3 or higher, even though 75% are Exempt Micro Enterprises (EMEs) and thus qualify as at least a level 4. As mentioned in our finding regarding businesses that do significant business with government, becoming more B-BBEE compliant does assist in attracting business from this sector. SMEs may believe that the red tape associated with this is significant, but it seems so are the rewards. While faster payment from both government and big business is important, a simplified B-BBEE qualification system for SMEs – even one that differs from the big business version – will help. The new codes have recognised this and EMEs under R10m require only an affidavit to confirm their B-BBEE status. However, government is going to have to become both brave and creative to stimulate SMEs to the level that they will grow to be able to provide 90% of new jobs by 2030. It may even help to give tax breaks to SMEs that grow, employ and have B-BBEE scores that indicate transformational effort. As Albert Einstein is credited with saying: “Doing the same thing over and over and expecting a different result is the definition of insanity.”
Finding Six – Some SMEs manage to do more than 50% of their business with government. What can be learned from them?

This set of findings is both hugely surprising in certain respects and instructive in terms of the job-creating power of government’s procurement engine. The profile and characteristics of SMEs in this category:

- 60% of the businesses in this category where white-owned, 32% are Black-owned, 5% are Indian-owned and 3% are Coloured-owned.
- The average turnover of these businesses is a little lower than the total sample, mainly due to some very large SMEs in the total sample.
- The average number of people employed by the companies doing more than 50% of their business with government is significantly higher than the total sample.

This sub-sample is weighted towards agriculture, construction, ICT and transportation and logistics industries, which are high-employment sectors. It may be wise for government to concentrate its procurement efforts to SMEs in these and other industries who employ higher than normal numbers of employees vs. turnover if it is to leverage its procurement spend toward the objective of job creation.

- These businesses have been in business almost the same time as those in the total sample (11.6 years vs 11.8 years).
- They have embraced the B-BBEE concept to a much greater extent than the total sample, mainly due to some very large SMEs in the total sample, but still 37% have no idea how the new codes will affect them.
- These SMEs are still paid fastest by other SMEs, but some government departments are better at paying faster and that they manage their debtors better, or simply that some government departments are better at paying faster and that they have, as a result, attracted more SME suppliers. These possibilities would have to be explored through further research.
- There needs to be enhancements to the government tender process.

The lessons from SMEs in this category:

- It is possible for the government procurement engine to be a catalyst for SME establishment, growth and job creation. For this to happen:
  - More SMEs need to be aware of their status, based on the turnover brackets most of our sample should have qualified as EMEs and thus should have a level 4 or higher, thus there clearly should be more awareness of the B-BBEE codes and the advantages they supply to SMEs.
  - SMEs need to be paid faster. There is evidence from this subset of the sample that government can, and does, pay some SMEs in a timely manner. This may be because these SMEs have their documentation process better organised, or that they manage their debtors better, or simply that some government departments are better at paying faster and that they have, as a result, attracted more SME suppliers. These possibilities would have to be explored through further research.
  - There needs to be enhancements to the government tender process.

Finding Seven – SME shareholders are also directors and CEOs, making decision-making easy, but governance questionable

Most SMEs are started by entrepreneurs. At the beginning, many of them are the 100% shareholder, the sole directors and the CEO all rolled into one. And this strong alignment between views is what gives them advantage. They are fast on their feet. Unfortunately it also means that when they get things wrong, there is no counterbalance. Usually, they are optimistic people, and this natural optimism, which they require as a characteristic, can become their Achilles heel.

Discussion with SEFA and with BUSINESS/PARTNERS reveals that SMEs do better if they have a mentor, or a wise advisor to consult with regularly. Both organisations, as part of their process, assign these technical assistance teams and mentors to each SME that they invest in to reduce the risk of failure, but also to increase the development dividend that is their purpose.

The Institute of Directors has issued an important document in this regard entitled Governance in SMEs, which highlights some of the benefits of improved governance in SMEs and how to go about implementing this. SAICA is well positioned to perform this role of mentor/advisor through its SMP division who have as their clients small and medium-sized businesses. SMPs are also geographically dispersed, and have existing strong relationships with SME clients.

Recommendations from the Banking study into SMEs and the SME survey in 2014, pointed out important roles that SMPs could play to assist SME clients and included:

- Accounting and reporting
- Risk identification and management
- General business advice
- Cash-flow management
- Funding sourcing
- Governance advice
- Business plan preparation
- B-BBEE certification and advice

Internal Findings

These findings encompass issues relating to behaviour and controls that are in the ambit of the SME. These findings concentrate on issues that SMEs can improve upon to help increase their own chances of success.

SIGNS OF ENHANCEMENTS TO GOVERNANCE

The average number of people employed by the companies doing more than 50% of their business with government is significantly higher than the total sample. Some SMEs manage to do more than 50% of their business with government. What can be learned from them?
Finding Eight – Main reasons for SME failure

According to SMEs, the main reasons for SME business failure are overwhelmingly cash-flow related. The diagram below demonstrates that from the view of SMEs, they start with too little capital, they collect debtors late, are subject to bad debts, overhead levels that are too high, and they are victims of the risks they haven’t identified. Effectively, a lack of financial planning and control are at the heart of many of their problems. Research that SAICA previously undertook with the major lenders to SMEs confirmed that many of these small businesses would do well to engage SMPs (CA[s]AI) to assist with business and cash-flow planning, and risk identification and mitigation. It was also the view of the banks and SME risk-based lenders that SMPs could assist SMEs when it comes to sourcing finance more successfully.

We know from the SAICA Enterprise project, the BUSINESS/PARTNERS’ mentorship and technical assistance philosophy, and the reasons behind the government allocation of R3bn in funding for mentoring of micro-enterprises that if we could teach SMEs to overcome their technical shortcomings they might do better financially and they would, as a consequence, employ more people. Given that financial and cash-flow issues are cited by SMEs as the primary causes of business failure, and given the importance of SMEs’ role in job creation as a part-solution to poverty, government could do worse than to extend their technical assistance funding to SMEs who are likely to create significant employment. SAICA would be an ideal partner to dispense this assistance given their level of expertise and the geographical diverse nature of their SMP membership.

Conclusions

The 2015 SME research follows on from some powerful conclusions contained in the 2014 edition of the research. The unexpectedly high number of respondents is a sign that SMEs are frustrated, and that they feel that government has the levers to significantly improve the conditions under which SMEs will thrive in South Africa, and that if used they may make different decisions regarding growth and employment.

• We know that red tape is considered by SMEs to be the largest barrier to entry. This red tape issue rates even higher than the need for access to finance. We know that compared to some of our African neighbours we could make it easier for entrepreneurs to start successful SMEs in South Africa.

• We know that technical assistance makes a significant difference to the success or failure of SMEs. Government has recognised this and has already made R3bn available to lend technical assistance to micro-businesses. The research would suggest that this type of assistance should be extended to SMEs. It stands to reason that then experienced and successful SMEs are likely to be more successful than first-time new business owners. It also stands to reason that building a database of technical assistance providers, that includes the use of experienced SMEs, is an obvious strategy.

• Access to finance for SMEs in developing countries is regarded as the number one challenge. South Africa needs to significantly scale and improve the efficiency of its SME funding agency. Traditional lenders require collateral against SME loans and so they will, in a country like South Africa which until 1994 had concentrated wealth in a small proportion of the population, not be able to fund many of South Africa’s SMEs. However government funding agency SEIFA and other government grants and funding channels have the ability to take on more risk when providing access to funding, thus being able to fund a wider range of SMEs. They need to ensure an efficient process is in place to allow easy access and timely funding to SMEs.

• SAICA, through its SMP members, could play a significant role in increasing governance levels in SMEs, reducing their risk, improving their access to finance, and helping them to improve both their business and financial planning and their cashflow management.

Big business and the public sector need to rethink the ways in which they work with SMEs. Paying them on time is an important first step. Significant opportunities exist in the enterprise development part of B-BBEE legislation. The truth is that the markets of both big business and government will grow only if we can succeed in increasing employment. If the NDP is correct in its expectation that 80% of new jobs will come from SMEs, then – for the sake of sustainability, the growth of the fiscus, and private sector turnover – anything that can be done to stimulate SME growth is not only altruistic, but in their own interests.