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Job creation versus job shedding and the role of SMEs in economic development

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SMEs have historically played an important role in contributing to economic development of many countries around the world. Naturally all businesses start as small businesses or even start out of small businesses initiated by individuals. Evidence from this study shows that SMEs represent vast portion of businesses in developing countries including South Africa. In South Africa, SMEs account for about 91% of the formal business entities, contributing to about 51 and 57% of GDP, providing almost 60% of employment. The main challenges affecting SMEs in South Africa include lack of management skills, finance, access to bank credit, access to markets, appropriate technology, low production capacity, recognition by big companies, lack of interest, long bureaucracy processes, and support for the roles that small businesses can play in economic development. This study re-assesses the role of SMEs in creating jobs, boost, enhance and support economic development in South Africa.

Key words: Small business, entrepreneurship, job creation, job shedding, economic development, poverty alleviation.

INTRODUCTION

The problem

One of the significant characteristics of a flourishing and growing economy is a booming and blooming small and medium enterprises (SMEs) sector. Small and medium enterprises play an important role in the development of a country (Feeney and Riding, 1997). SMEs contribute to economic development in various ways: by creating employment for rural and urban growing labor force, providing desirable sustainability and innovation in the economy as a whole. In addition to that, large number of people relies on the small and medium enterprises directly or indirectly (Fida, 2008). The development of SMEs is seen as the way to accelerating the achievement of wider socio-economic goals, including poverty alleviation (Cook and Nixson, 2000). Economics plays an important role in the development process of any country. An increase in the living standards of the people is the main concern of any development process. Life sustaining is the ability to provide basic necessities for all at reasonable prices. Everyone has certain basic needs without which life would not be possible. There is no development when the benefits of economic progress

are used only by a small number of people, while the majority are being excluded (Todaro and Smith, 2003). The negative effects of recent economic downturns have seriously affected the socio-economic conditions of many people worldwide. As a response to these negative conditions, it is necessary that small, medium and large entrepreneurs enhance their job creation abilities (Barakat, 2001). A well supported and enhanced small business sector is likely to continue contributing to the economic development process in the same way as large business (Abraham, 2003).

Decline in living standards and unemployment due to economic downturns are the most challenges facing many poor people in developing countries. This has been made worse by the fact that the formal economy has been continuously shedding jobs and at the same time many workers being retrenched (Abraham, 2003; DTI, 2004). As a result, hundreds of new job seekers of whom the majority are youths increase the army of unemployed people. It is recognized that the development and growth of small, micro and medium enterprises plays an important

role in supporting economic development. Policies and strategies to support and enhance the development of small business are together an important part of the programmes to create better conditions for all. Arguably, such strategy should be outlined in a White Paper by the relevant Department and Small Business Act passed by the Parliament (DTI, 2002).

Research focus

This is an exploratory research on job creation vs. job shedding in South Africa. It focuses on the role of SMEs in economic development and how they can be increased to contribute meaningfully to job creation, reduce unemployment and poverty in the country. The objective of this study was to re-examine the role of SMEs in supporting and enhancing economic development through the process of job creation. Given the study objective, the following research questions were explored:

- (1) Why develop small businesses?
- (2) Why are small businesses and entrepreneurs important for economic development?
- (3) Is the promotion of small businesses and entrepreneurship a good strategy for economic development?
- (4) What should governments do in order to revive their ravaged economies at least in short run to give the hope for life?

This study also hypothesizes that both small businesses and entrepreneurship form the hub of economic development and serves as the answer to job creation for the majority of the unemployed poor people. It is in the study's opinion that the answers to these questions will to some extent fill the gaps in the research on the role of SMEs in economic development in South Africa.

METHODOLOGY

This was an exploratory study for which information was obtained through a document method. Although it might be argued that the primary-secondary distinction is blurred, the difference is clear as far as both data sources are concerned. Primary sources are the original written materials of the author's own experiences and observations, while secondary sources are the materials derived from someone else as the original source (Bailey, 1994). This study investigates the role of SMEs in contributing to economic development by analyzing both primary and secondary data sources. Secondary sources include data from official documents (e.g. statistical reports, annual reports, inter-office memos, and financial reports), mass media (printed and audio-visual, newspapers, magazines, journals and newsletters), personal documents, bibliographies, memoirs and personal letters to the press (Baker, 1998). An examination of these various sources (triangulation) assists in looking at the role of SMEs as job creators holistically. Primary data was collected from small business owners in and around Johannesburg. A simplified questionnaire was designed and distributed to the participants. Interviews were conducted with the respondents randomly. Overall 143 small business owners were interviewed giving the total sample for this

study.

RESULTS

Relevance of SMEs in economic development

SMEs play significant contribution in the transition of agriculture-led economies to industrial ones furnishing plain opportunities for processing activities which can generate sustainable source of revenue and enhance the development process. SMEs shore up the expansion of systemic productive capability. They help to absorb productive resources at all levels of the economy and add to the formation of flexible economic systems in which small and large firms are interlinked. Such linkages are very crucial for the attraction of foreign investment. Investing transnational corporations look for sound domestic suppliers for their supply chains (Fida, 2008). SMEs produce about 25% of OECD and 35% of Asia's exports respectively (OECD, 1997). SMEs are also the major growing force behind the fastest growing economy of China, in terms of contribution to the national GDP (accounting for 40%), scale of assets, diversification of products, and the creation of employment. Similarly, the role of SMEs is well acknowledged in other countries such as Japan, Korea, and all other industrialized economies in terms of creating employment, reducing poverty and increasing the welfare of the society (Horn, 1995; Pang, 2008). Experts and economists are unanimous about the role and importance of small and medium enterprises in the development of Pakistan economy. According to the Small and Medium Enterprises Development Authority (SMEDA), "SMEs constitute nearly 90% of all the enterprises in Pakistan; employ 80% of the non-agricultural labor force; and their share in the annual GDP is 40%, approximately (Harvie and Lee, 2003; Neumark et al, 2008).

Politicians, academicians and developmental economists are of the view that enhancing small business development and promoting entrepreneurship would be a good strategy to contribute and promote economic development. From the viewpoint of economic development, small businesses create almost half of new jobs in the economy, and it is assumed that they are good jobs (Edmiston, 2007). One of the main characteristics of the informal sector of the economy is its flexibility in the production (Sanchez, 2006). Based on "small is smart", successful businesses are those that continuously introduce new/improved varieties of products. Small businesses are more flexible and better to adapt to changing market conditions. Therefore, it is important to create an environment conducive in which small businesses can operate, innovate and create needed jobs as a strategy to better economic development (Edmiston, 2004).

At the core of urgent efforts to improve the economic situation of developing countries, a strong focus on macroeconomic stabilization including the promotion of SMEs,

the pursuance of massive trade and investment liberalization programme are vital to encourage foreign direct investment (DTI, 2004). In order to achieve this, the country should move toward relaxation of most restrictions on current and capital transfers, introduces tax relief to investors as well as improve access to foreign exchange at near market rates, in order to create a conducive environment where small business could be promoted (DTI, 2002).

Contribution of SMEs to the economy

An important contribution of small businesses to national economy is derived from the US economy. Small businesses are job creators and are what really drive the U.S. economy. Small business with fewer than 500 employees drives the US economy by providing jobs for every half of the nation's workforce. During 2001 - 2002, small businesses with less than 20 employees increased employment by 853,074. Small businesses represent 99.7% of the firms, creating more than half of the private non-farm gross domestic product including 60 to 80% of the net new jobs in the economy. In 2004, there were an estimated 23,974,000 businesses in the US, of which 5,683,700 were small businesses who employed about 5,666,600 people (Longly, 2006).

From the socio-economic development viewpoint, SMEs provide a variety of benefits (Advani, 1997). SMEs have advantages over large-scale businesses because they can adapt easily to market conditions and they can withstand adverse economic conditions given their flexible nature. They are more labour intensive than larger firms and they have lower capital costs associated with job creation. They play critical roles to ensure income stability, employment and economic growth (Liedholm and Mead, 1987; Schmitz, 1995). The contribution which small businesses can make to national economy and wealth creation need to be recognized by the governments from the beginning and be considered as part and parcel of the economic development process. Small businesses which can be defined as small firms with less than 500 employees are integral part of any national economy (Edmiston, 2007). They employ more than half the workforce in the private sector, generate about 3/4 of net new jobs each year and produce more than half of the private sector's output. SMEs, defined as businesses with fewer than twenty employees in New Zealand, accounted for 39% of total value-added output in 2004, upwards of 2% points from the previous year. SMEs accounts for 96% of all enterprises in New Zealand. The labour-led government recognizes SMEs as one of the drivers of the economic transformation we envisage for the country (Dalziel, 2006).

Very few of us are aware of the contributions small businesses make to the American economy. According to the Small Business Administration, the US had approximately 19 million businesses. Of those, about 15 million

operated as sole proprietorships. Of the remaining 3.3 million corporations and partnerships, a full 99.8% employ fewer than 500 people and are classified as small businesses for small business administration programmes. Of the 10.5 million jobs created in the private sector between 1980 and 1986, 6.6 million (or 63.5%) were created by small business (Business Blog, 1998; Khan and Rivsi, 2000). SMEs represent a vast portion of businesses in South Africa. They account for about 91% of the formal business entities, contributing to about 51 and 57% of GDP, providing almost 60% of employment (Ntsika, 1999; Berry et al, 2002).

Support for SMEs

Business is a war that has corporate buyouts and land grabs and fists full of patents in place of guns and planes and war ships (York, 2009) . While most developing countries of Africa, Asia, and Latin America struggle to create and support viable SME's, advanced countries such as USA, Japan, China and Ireland have made good progress in this regard by providing continued support to economic development initiatives. In countries such as Democratic Republic of Congo (DRC), Sudan, Liberia and many others, SME's are initiated from virtually nothing or zero because of wars (Mbendi Business, 2003). Politicians in these countries have often eloquently expressed their support for small businesses and entrepreneurship creation time and again; however, they have not yet realized this dream. All around the world small businesses are known to be the employer, the customer and supplier of goods and services to the local market, including the provision of the majority of entrepreneurship in the economy (Barakat, 2001).

In South Africa, policies and programmes to support small business development are an important part of the democratic government's strategy to create better life for all. This strategy is outlined in a White Paper by the Department of Trade and Industry (DTI) the lead department for small, medium and micro enterprises (SMEs). A national strategy for the development of small business in South Africa was formulated in 1995. A year later, the National Small Business Act was passed by the Parliament, which provided for the institutions to implement this strategy. With large businesses restructured and downsized, small businesses have played an increasing role in South African economy and development. In 1996, about 19% of the people employed were in the informal sector of the economy. By 1999 this figure increased to about 26%, suggesting a significant growth. At the same time the government targeted the small business sector as an economic empowerment vehicle for previously disadvantaged people. A review of the impact of the government's development policies since 1994 suggested that almost 2.3 million people owned at least one value added tax (VAT) unregistered company. Of these only 338,000 owners

had employed a total of 734,000 people (DTI, 2002).

Most developing and developed countries have argued that the creation of small businesses and the encouragement of entrepreneurship is a solution to national economic development. However, the link between small business and the economic prosperity of a nation does not always hold true. Perhaps this is the best illustration of the case in most developing countries in Africa, Latin America and Asia. Small business has existed for years among different civilizations, and even the Holy Bible describes the early trade that existed between individuals which was small in scale. Ultimately, small business led to medium and large businesses and finally to multinational companies (Dana, 1988).

SMEs and job creation

SMEs are the starting point of development in the economies towards industrialization. However, SMEs have their significant effect on the income distribution, tax revenue, and employment, efficient utilization of resources and stability of family income. According to the United Nations Industrial Development Organization UNIDO, for developing countries, integration into the global economy through economic liberalization, deregulation and democratization is seen as the paramount way to triumph over poverty and inequality. Important to this process, is the development of an animated private sector, in which small and medium enterprises can play a central role (Bies, 2002; Fida, 2008). SMEs have a propensity to employ more labor-intensive production processes than large enterprises. Consequently, they contribute significantly to the provision of productive employment opportunities, the generation of income and, eventually, the reduction of poverty. According to the statistics, in industrialized countries, SMEs are major contributors to private sector employment. Empirical studies have shown that SMEs contribute to over 55% of GDP and over 65% of total employment in high income countries. SMEs and informal enterprises, account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries (Fida, 2008).

Data produced by DTI show that the bulk of net new jobs were created by firms with 500 employees or more. Net jobs are the total of new jobs created by the firm startups and expansion/cross job creation, minus the total number of jobs lost by the firm closures and contractions/cross job lost (Edmiston, 2004).

Table 1 shows that from 2004 to 2007, small firms with less than 20 employees accounted for about 18.4% of the net new jobs, despite employing more than 44.1% of all jobs in 2007. Midsize firms with 20 to 499 employees accounted for about 34.2% of the new net jobs with a share of total employment of 32.6% in 2007; while large firms with more than 500 or more employees accounted

for about 47.4% with a share of total employment of 23.3%. Looking at the figures in Table 1, the argument could be that these figures are difficult to reconcile, given the fact that over the same period of time small businesses' share of total employment normally increased. During 1996 - 1999, small businesses employed 19 to 26% of all workers in the country. In 2004 all small businesses employed about 23.4% of all workers, medium businesses employed about 29.5% of workers, while large businesses employed about 47.1%. However, in 2007, the numbers of large businesses declined to 23.3% but increased to 44.1% for small businesses.

The reason for this situation can be attributed to the migration process of businesses across different class sizes during one period to another. The share of total employment by class size during 2004 and 2007 is provided in Figure 1.

Strategic planning can help any business to grow and expand during a period of time. Small businesses will never remain small forever as some of them will grow and expand beyond 20 workers by joining medium and large businesses when using a given strategic planning (Schayek, 2008). This type of migration to another class size reduces the share of small businesses by becoming medium size.

The migration of businesses into and out of class sizes also contribute to decrease or increase of jobs in those class sizes (Edmiston, 2004). Countries such as South Africa and New Zealand who are ranked higher in doing business have small informal economies representing 12.7% of GNP. Contrarily, countries such as Burkina Faso and Mali have worse business environments and have an informal economy that contributes about 38.4% of GNP (Newberry, 2006). In contrast, countries such as DRC, Zimbabwe and Congo have the very worse business environments and have an informal economy that contributes less than 10% of GNP (Mbendi Business, 2003).

Trade and investment liberalisation

Liberalization programmes should be directed toward massive privatization campaign of public institutions. The intention should be to attract foreign investment with the hope of increasing economic development activity by bringing in much needed revenue. This kind of strategy can be considered a right step in the right direction (WTO, 1998), but others will consider it as detrimental to national pride. The emphasis on generating more revenue is important for the country and its economy, because it helps to bring in much needed foreign currencies to support the country's development process. More foreign currencies will help create much needed jobs including related economic activities that enhance and support social and economic development in the country. However, given the reality in most developing countries, Dana (1988) said that it is quite impossible to predict how

Table 1. Estimates of job creation and destruction by firm size (2004 – 2007) in South Africa.

| Employment by class size | Share of gross job creation (2004 - 2007) | Share of gross job destruction (2004 - 2007) | Share of net new job created (2004 - 2007) | Share of total employment (2004 - 2007) |
|--------------------------|---|--|--|---|
| <20 | 17.4 | 26.1 | 18.4 | 44.1 |
| 20 – 499 | 36.3 | 30.4 | 34.2 | 32.6 |
| 500+ | 46.3 | 43.5 | 47.4 | 23.3 |

Source: Researcher's calculations (2009).

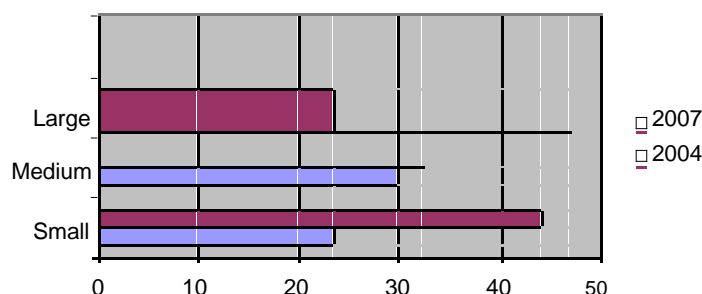


Figure 1. Share of total employment by class size, 2004 and 2007.

to the improvement of the country's socio economic conditions and sustainability? If trade liberalization is a good policy to be pursued by a country to reach its full potential in terms of economic and social development, it cannot ignore the importance of SME's, and their contributions to the national economy. Trade liberalization and foreign direct investment should focus on a concerted effort to assist the development of SME's (WTO, 1998).

Trends in SMEs job creation

The importance of small business in the economy has been convincingly debated by policy makers, researchers and economists for many decades (Neumark et al., 2008). A pilot study by the researcher examined the role of small businesses in development and trends in job creation by small businesses using special employment tabulation approach for the 2003 to 2005 period. One-on-one interviews were conducted to collect data over a number of 83 small businesses owners in Johannesburg and Durban. The findings from this study provided new evidence on the role of both small businesses and entrepreneurs in the country's economy. The findings also suggested that small businesses owners have the same characteristics, face the same obstacles, but differ in their understanding of how small businesses assist economic development. In line with the pilot study, jobs creation by small businesses is a process which is accomplished by new small business openings, expansions of existing small businesses, loss/closures of small businesses and

contractions. Following Schayek (2008), job creation among small businesses in Johannesburg and Durban is an important and interesting aspect of small businesses' contribution to economic development in the two cities, a contribution which is in itself a strategy to promote economic development (Table 2).

One major common characteristic between these two metropolitan areas is that both cities have areas with fast-growing small business sectors as well as areas with a stagnant small business sector, but with the potential for expansion in employment growth is shown in Table 2. Table 2 suggests that small business in Johannesburg (JHB) and Durban metropolitan areas enjoyed much more growth in their start-ups stages than those in the lower-growing areas of Kwamashu, Regents Park and Ormonde. The share of loss of employment in all the businesses as a result of closures and contractions is not significant. However, the share of contractions in small businesses is much lower than that of closures for every area. The results in Table 2 suggest that small business start-ups and expansion in both areas are encouraging to some extent. The extent of employment losses in small business sector as a result of closures and contractions are almost the same between the faster and slow growth small businesses.

However, it is critical to create a conducive environment in which both start-ups and expansion of small businesses should be enhanced than the allocation of resources as retention efforts aimed at preventing struggling small businesses from collapsing. Small business start-ups encourage owners to seek and explore new

Table 2. Trends in job creation in Johannesburg and Durban, 2004-2007.

| Areas | Start-ups | Closures | Expansions | Contractions | Total |
|--------------|-----------|----------|------------|--------------|-------|
| Durban Metro | 30 | - 8 | 6 | - 3 | 25 |
| Kwa-Mashu | 10 | - 6 | 2 | - 5 | 1 |
| JHB Metro | 33 | - 5 | 12 | - 4 | 36 |
| Regents Park | 6 | - 3 | 3 | - 2 | 1 |
| Ormonde | 4 | - 4 | 0 | 0 | 0 |

Source: Own calculations (2009).

Table 3. Challenges facing small business owners start-up.

| Challenge | Johannesburg (%) | Durban (%) |
|---|------------------|------------|
| Getting needed credit | 34.1 | 36.2 |
| Finding honest workers | 17.2 | 16.3 |
| Developing relationships with customers | 30.3 | 28.4 |
| Dealing with government bureaucracy | 18.4 | 19.1 |

Source: WTO (1998).

markets opportunities in which better services could be provided. Expansions of small businesses could lead to scarce resources for economic development being used/misused to enhance and support the production of uncompetitive goods and services (Erickcek, 1997).

CHALLENGES FACING SMEs IN SOUTH AFRICA

Despite its commendable contribution to the nation's economy, SMEs sector does not get the required support from the concerned government departments, banking sector, financial institutions, and corporate sector, which is handicapped in becoming more competitive in the national and international markets, and which need to be taken up for immediate and proper redressal (SMBDCI, 2005). Although, having the potential to create jobs and accelerate economic growth in South Africa, they are bound to various challenges affecting their ability for expansion (Fida, 2008). The most general challenges affecting SMEs include lack of management skills, finance, access to bank credit, access to markets, appropriate technology, low production capacity, recognition by big companies, lack of interest, long bureaucracy processes, and support for the roles that small businesses can play in economic development (WTO, 1998; Ntsika, 1999; DTI, 2002; Gaomab, 2004; ABSA, 2005; SMBDCI, 2005).

SMEs experience more problems and hardships during both economic progress and economic downturns (Gaomab, 2000; Edmiston, 2007). Regulations and bureaucratic practices for SMEs start up encourage the dominance of large corporations in the formally regulated economy by providing incentives to entrepreneurs to operate informally or illegally in the government's

regulated environment (Table 3).

Table 3 shows that developing relationships with customers, getting needed credit and dealing with government bureaucracy have been the most critical challenges facing the start-up of small business by both owners in Johannesburg and Durban. They also argued that low rate credit facilities including fair and flexible collateral conditions could assist the promotion of small business in the country. In addition to regulations facing small businesses, evidence shows that the sector is significantly underfinanced. The conditions set by most financial institutions to acquire credits/loan disqualify most applicants from getting needed finances. These limitations disproportionately affect small businesses given their scarce financial and human resources.

Experience has shown that generally the number of legally initiated small businesses increased within favourable investment climate, including low cost in conducting businesses (Newberry, 2006). However, South Africa has resolved to face these challenges by creating an alternative source such as Khula Finances that provides new entrepreneurs with financial assistance (DTI, 2002). In facing the start-up of their small businesses, about 85.6% of investigated owners in Johannesburg and 77.4% in Durban expressed that they used their personal savings.

Conclusion

There can be little doubt that at the centre of a country's economy, a truly SMEs development would be at the heart of the progress, where production, employment and output could be increased. Evidence from this study

suggests that SMEs sector creates the majority of the country's net new employments. A good approach is to focus mainly on developing an attractive and supportive climate to SMEs development. SMEs produce more than half of the country's non-farm output by making significant contributions to the economy of South Africa and other developing countries. SMEs represent vast portion of businesses in South Africa and account for about 91% of the formal business entities, contributing to about 51 and 57% of GDP, providing almost 60% of employment (Ntsika, 1999; Berry et al, 2002).

Despite its commendable contribution to the nation's economy, SMEs face various challenges, however, they remain important source of growth and development. SMEs are continuously depending on more expensive alternatives to traditional loan than big businesses. All these demonstrate that there is a need to implement a plan of action aimed at creating conducive and supportive environment where SMEs could be promoted and expanded. The key to a successful strategy is to get the policies right.

SUGGESTIONS FOR POLICY INTERVENTIONS

Given important contribution of SMEs to economy, policies to support, promote and enhance productive capacity of this sector seem justified. Because of the vital role SMEs play in job creation, the government should be keenly interested in understanding the dynamics of this sector by developing it further, providing the necessary financial support and undertaking various initiatives to achieve its growth.

Revolutionary support from the government is very much needed for the development of SMEs in the country. Strategic policy decisions are encouraged to provide both technical and financial assistance to the SMEs sector. Programmes that encourage community development in low-and moderate-income areas to promote SMEs are also needed. To sum up, policy interventions should target the creation of conducive environment and assistance in which SMEs can expand its activities. This type of development can only be achieved through increased productive capacity that benefit SMEs and entrepreneurs in various ways. However, further research is needed to assess the comparative advantage of SMEs production at the regional and national levels respectively.

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