The MSME Voice

GROWING SOUTH AFRICA'S SMALL BUSINESS SECTOR

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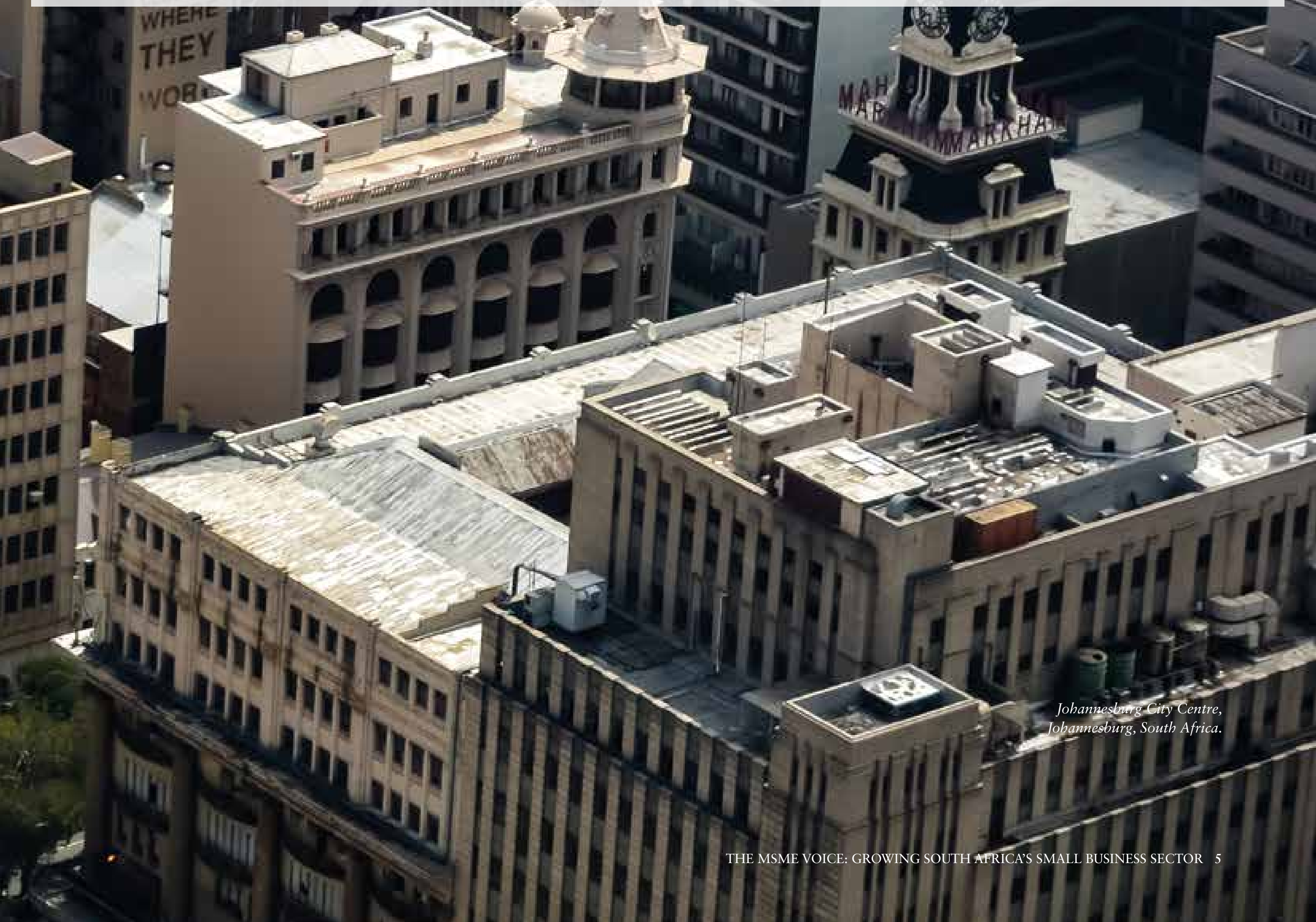
Front cover:
South African female entrepreneur having a meeting in a coffee shop.

Acronyms

IFC	International Finance Corporation
MSME	Micro, Small, Medium Enterprise
IMF	International aMonetary Fund
SA	South Africa
RSA	Republic of South Africa
GDP	Gross Domestic Product
IDI	In-depth Interview
IDC	Industrial Development Corporation
QLFS	Quarterly Labour Force Survey
S&P	Standard & Poor's
StatsSA	Statistics South Africa
SARS	South African Revenue Service
CIPC	Company and Intellectual Property Commission
ED	Enterprise Development
B-BBEE	Broad-Based Black Economic Empowerment
CSD	Central Supplier Database
HR	Human Resources
EFT	Electronic Funds Transfer



Johannesburg City Centre, Johannesburg, South Africa.

Foreword

We are pleased to present *The MSME Voice*. This report follows *The Unseen Sector*, which was launched in 2019 to provide an in-depth assessment of the micro, small and medium enterprise (MSME) landscape in South Africa. *The Unseen Sector* laid the foundations for engagement with the sector, measuring the small business sector size, access to finance and markets. This report builds on that and existing work to provide insight and recommendations that can help tackle unemployment and support economic transformation and female entrepreneurship.

With *The MSME Voice*, we focus on listening to the small business owners, bringing their perspective to the discussion and strategy design, backed by their business journeys, the constraints they face and the opportunities they see to build sustainable businesses.

Small businesses already employ a large portion of the population in sub-Saharan Africa and contribute significantly to economic growth. In South Africa, small enterprises employ between 50 and 60 percent of the country's work force and contribute around 34 percent of GDP. However, the MSME sector has been relatively stagnant over the last decade.

This report brings more light to the biggest issues affecting formal and informal small businesses, such as the need for more training on financial literacy and business acumen, the impact of macroeconomic weakness on their activities, the high reluctance to formalize and limited access to business infrastructure. The small businesses interviewed show that few MSMEs have business insurance to protect themselves and their assets, and cash is king for most of their transactions.

To unlock the fantastic opportunity to strengthen the MSME environment, the report recommends both public and private sector stakeholders to initiate activities across three main pillars: (a) focus on SME banking; (b) drive formalization; and (c) build better business management tools and skills.

We hope this report will provide a platform for further policy discussion and partnership engagements that will lead to greater access to finance and better financial services for small businesses in South Africa. This report only highlights some of the key insights discovered through the research. A much richer dataset was built through the 2,600 face-to-face interviews, which provides deeper insight to inform the development of policy interventions and financial solutions to help small businesses thrive.

We trust that you will be inspired by the voice of small business.

Adamou Labara

Country Manager for Southern Africa
International Finance Corporation

A woman stitches brands on spa and hotel slippers at a small textile manufacturing business in downtown Johannesburg. Photo: Karel Prinsloo / IFC

Piece, a store specializing in indigenous craft from around Southern Africa.
Photo: © John Hogg / World Bank

Executive Summary

Understanding what small businesses need to grow and thrive is critical to designing innovative solutions that support small businesses to become greater engines of economic growth and job creation.

Small businesses are an important part of South Africa's economy. South Africa's 5.78 million[1] micro, small and medium enterprises employ about half of the country's work force and contribute to around 34 percent of gross domestic product (GDP), yet their voice is often excluded from the national conversation. *The MSME Voice* starts to change that. IFC asked 2,600 small business owners and entrepreneurs from across South Africa, industries, gender and the formality spectrum to share their business journey, the challenges they face and opportunities they see to create sustainable businesses.

The small business voice is crucial to identify what the public and private sector should do to tackle the barriers to MSME growth and unlock access to funding and markets. In that vein, *The MSME Voice* brings the small business perspective to the fore and compiles insight from in-depth qualitative and quantitative interviews with small business owners and entrepreneurs, with the goal to inform the design of regulation, creation of tools and provision of financial services that will meet the needs of South Africa's MSMEs.

This report follows *The Unseen Sector*, a joint report by IFC and the World Bank, in partnership with the South African Department of National Treasury, which assessed the size and profile of the micro, small and medium enterprise market in South Africa, and the obstacles to growth and financing availability.

The Unseen Sector found that MSME sector growth has stagnated over the past decade and that only 14 percent of small businesses in South Africa are formalized. That means many micro and very small enterprises are creating opportunities for self-employment. In addition, the report highlighted that informal businesses struggle more to access finance than their formal counterparts, and that female ownership not only lags behind male small business ownership in the country, but is on the decline.

The MSME Voice builds on that body of work to delve deeper into the barriers and opportunities small business owners confront daily, from their perspective, to inform solutions that stimulate the sector, create more jobs and boost female participation and entrepreneurship. Enabling small businesses to grow and contribute to job creation is important in a country with an unemployment rate that is close to 30 percent.

The MSME Voice refers to formal and informal businesses. Based on the research, the report identifies several variables which better define the informality-formality spectrum, progressing beyond the classical binary definition of formality, which defines formal businesses as those that are registered with the Companies and Intellectual Property Commission and/or the South African Revenue Service, while informal businesses are unregistered.

[1] *Unseen Sector – A Report on the MSME Opportunity in South Africa*, International Finance Corporation [2018].

Report Highlights

What are the biggest issues affecting small businesses? The small business voice showed us these are the key issues and opportunities.

Rising unemployment is driving more people to pursue informal self-employment opportunities to make a living without having basic financial literacy and business acumen. This has an impact on the success of small businesses, since the core focus of the owner is often on personal financial survival rather than on growing and developing the business. In these circumstances, the interviews found that profit made in the business is often spent on personal expenses rather than being reinvested into the business. Additionally, many of the survivalist informal business owners stressed that they don't have the business and financial skills necessary, especially when compared to formal business owners, to grow their business. Survivalist informal MSMEs are more likely to be black-owned and in the micro segment, female-owned. From an income inequality point of view, uplifting the lower end of the MSME size spectrum should be a priority.

Formal businesses are struggling to manage macroeconomic weakness. High unemployment and low GDP growth is leading to lower spending by customers and shrinking markets. The interviews found that many formal small businesses are downsizing as a result, employing fewer people and investing fewer resources in the growth of their businesses.

Despite a difficult economic environment, MSME owners show strong levels of personal resilience and adaptability through learning and adapting their businesses to meet the challenges.

MSMEs often start their business life informally and are reluctant to formalize despite the benefits. Formalization can open access to new sources of funding and markets, including government tender processes. Interviews with informal business owners found that many believe formalization is too bureaucratic, complex and costly. One of the key formalization activities is registering a business with the Company and Intellectual Property Commission (CIPC). Many informal businesses interviewed said the benefits of registration are not clear and there is a perception that the costs outweigh any potential benefits. Several informal businesses are even deliberately keeping their businesses suppressed in order not to have to face mandatory registration.

The lived experience of the formal sector is quite different, with many having benefited substantially from registration. The research also shows that there are considerable advantages associated with going through the process of formalization, including opening new markets and opportunities in terms of contracts with larger businesses, enterprise development opportunities and government tenders.

South African businesses do business with very little. The interviews found that 48 percent of informal businesses had no business infrastructure, and even amongst formal businesses the extent of access to business infrastructure was limited. More than a quarter of formal businesses and almost half of informal businesses operate from a residential premise. The lack of business infrastructure hampers MSMEs' ability to scale and grow, and the lack of equipment was raised by both informal and formal businesses as the second largest challenge at start-up. Purchasing equipment is the top reason for borrowing, and the theft of business equipment the top risk faced by formal businesses. Equipment is also the top reason why informal businesses would borrow in the future and they regard their current business infrastructure, namely equipment, vehicles and property, as main source of collateral to borrow money against.

Uptake of formal finance and services is limited and impedes small businesses' ability to develop and grow. The interviews found that 79 percent of informal businesses have never borrowed money, and of those that have, only 21 percent utilized a bank loan. Only 2 percent of informal businesses have borrowed money for their business in the last 12 months. 58 percent of formal businesses indicated that they have never borrowed money and 54 percent of those who have borrowed money for their business obtained a bank loan. Only 19 percent of formal businesses used a bank loan to start their business.

The interviews found that businesses often cannot produce the required paperwork to apply for finance and, like the business registration process, find the application process complex and overwhelming. There is also a perception that interest rates on business loans are exorbitant. As a result, many businesses leverage informal and more flexible sources of finance, such as their own personal savings and loans from friends and family members.

Most small business owners struggle with cash flow, the interviews found. This prevents them from accepting new contracts that demand upfront working capital. It also makes it difficult for small businesses to work with government departments and tenders, and often payment from government post the delivery of goods or services by the MSME is slow.

More than a quarter of formal MSME owners interviewed (29 percent) use their personal bank accounts for business purposes, with 63 percent in the informal sector doing so; limiting the ability of small businesses to build a business banking track record and gain access to much needed business finance.

The MSME ecosystem remains dependent on cash, the report interviews found. Across the formality spectrum small businesses, their employees, their customers and suppliers use and rely on cash as a common form and flow of financial exchange. Beyond its functional value as a form of financial exchange, 38 percent of informal business owners say that using cash helps them to keep track of their money. The prevalence of cash is not unique to the informal sector, formal businesses also expressed the intangible value of cash in helping them with financial, money and cash flow management.

Few MSMEs have specific insurance products for their business to protect their assets against operational and business risks. Most simply cannot afford to cover themselves and their businesses, so they prioritize personal insurance.

Only 15 percent of informal businesses have access to a smartphone or tablet, only 9 percent have a laptop, 9 percent have an email address and 9 percent have a social media page. This suggests a low level of digital connectivity. As a result, access to electronic platforms are limited, making physical small business hubs preferable to digital assistance at this point.

MSME owners recognize the importance of financial and business acumen and they are hungry to access it. The last major constraint small business owners identified is access to business and financial knowledge. MSMEs, particularly those who start a business because they saw a gap or opportunity in the market, are hungry for input and feedback in the form of training, mentorship and networking.

Employees prepare materials at Khanyile Solutions,
a small clothing manufacturer in Johannesburg, South Africa.
Photo: Karel Prinsloo / IFC

Women-owned businesses don't differ significantly from male-owned businesses on key business metrics, yet they are faced with a heavier burden in terms of 'proving' themselves. The research found that women-owned businesses do not differ profoundly in terms of profile or needs versus the MSME population in general. However, what is apparent is that women owners struggle with the additional hurdle of having to prove themselves as professional businesspeople, more so than their male counterparts. This has a limiting effect on the level of finance they can access, the customers they are able to attract and, ultimately, the growth and success of their business, particularly in the informal sector.

Resident wine maker at Stellakaya Winery, Stellenbosch, South Africa.
Photo: © John Hogg / World Bank

Strengthening Initiatives

The MSME Voice **demonstrates the big opportunity for financial and government actors to strengthen the MSME environment. Shifting the MSME sector into a larger job-creating engine requires support during the start-up and growth phases of the MSME business lifecycle. Based on the findings from the interviews with small business owners, we categorize our recommended initiatives across three pillars.**

Unlock SME Banking

Access to Finance: Reducing the complexity involved with finance applications, finding alternative ways of evaluating applicant credit-worthiness, and helping small business owners to compile the required documentation can help more entrepreneurs to access formal lines of credit. Consideration should also be given to the size and structure of loans and the type of collateral required to secure the loan. Given that many small businesses struggle with liquidity, financial institutions have an opportunity to think about alternative working capital funding beyond a traditional term loan to bridge short-term cash flow gaps. This could increase the ability of the business to access financing without the need for a lengthy and complex application process.

Boost Banking: The interviews found that when a business account is opened, it is often with the same bank that the owner uses for their personal banking. This presents an opportunity for financial institutions to make the process of applying for a business banking account more seamless. In addition, attractive start-up packages could help to lure business owners to open business bank accounts and separate their personal and business finances. Financial institutions should also develop financial and payment solutions fit-for-purpose for informal businesses to address the specific needs of this sector. Lastly, financial institutions should ensure that their frontline staff and relationship managers are sensitized to the specific issues faced by female business owners and that they are treated equally and respectfully.

Specialized MSME Insurance: Small business owners face many business and external risks which can affect their survival and longevity. There is an opportunity to create insurance products that bundle together personal and business insurance at a reasonable price for MSMEs. In order to stimulate the uptake of insurance products, awareness of the importance and value of business risk cover to protect the business against potential risks need to be enhanced and communicated with small business owners.

Facilitate Formalization

Increasing awareness: The lived experience of the formal small business sector is quite different from informal business operators, with many benefitting from registering their business and opening a business banking account. Therefore, the first hurdle is to actively and effectively communicate the tangible benefits of formalization to business owners to enable informal business owners to conduct a cost-benefit analysis and make more informed decisions around formalization. A lack of knowledge regarding the potential sources of funding, or knowledge of the various financial options available, also hinders the sector's development. Government and private sector institutions could raise awareness about their funding initiatives and financial solutions for small businesses, as well as their business development and support services for MSMEs. Greater awareness leads to greater uptake and participation, which in turn leads to stronger businesses, able to compete in the formal sector.

Smoothing the Process: Equally important to overcoming attitudinal barriers, the business registration process could be improved to make it easier for small businesses to formalize. Currently, informal business owners feel overwhelmed by the complexity of the process and the bureaucratic requirements involved. Simplification of the process and offering hands-on assistance, potentially through physical business hubs, would help to ease the burden and result in higher levels of formalization and better employment in South Africa.

Build Better Business Management

Access Knowledge: Small businesses not only need financial tools, they also want support for growing their financial knowledge to make better business decisions. Different MSME segments have different requirements and initiatives that need to be tailored to each segment in order to maximize their relevance and effectiveness for the informal to formal business. Partnerships with government can drive mentorship programs and financial institutions and fintechs could offer essential business services such as bookkeeping and payroll services.

Financial Records: Financial readiness also hinders the development of the MSME sector. Exacerbated by the fact that most MSMEs form part of the informal sector, many businesspeople are unable to produce the necessary documentation required by financial institutions to assess bankability and approve applications. These documents could include up-to-date management accounts, their latest financial statements and tax clearance certificates, among others. Fintechs and private sector institutions can play a critical role in providing business management solutions to MSMEs, which would introduce more record-keeping rigor into small businesses, potentially in a more affordable, accessible and simplified manner. The ability to keep and generate financial records would not only improve business management amongst small businesses, but also increase access to finance and financial services.

Support Resilience: Small businesses need help navigating macroeconomic fluctuations and both the public and private sector have a role to play. Financial institutions can help small businesses understand and navigate market fluctuations and proactively design financing for the changing economic environment. The public sector can promote legislation and cross-border trade to help more South African businesses expand their market access, diversify their revenue streams and reach new customers. Access to vibrant markets on the continent would help MSMEs to grow and create more jobs.

1 The Unseen Sector: South Africa's MSME Landscape

South Africa has experienced limited economic growth over the past decade and the outlook predicts only slight growth over the next three years. Small businesses do not operate in a vacuum. The broader economic and regulatory environment in South Africa influences their ability to grow and thrive. Economic factors can control some of these factors and others are outside of the country's control. Ensuring the public and private sector work together to provide enough enabling mechanisms to lessen the negative influence of a weak economy will be critical to maintain the health of the sector.

The Small Business Outlook

Limited economic growth and rising unemployment will drive more MSMEs to the informal survivalist level. Due to limited access to bank financing and the use of profits to fund personal expenses rather than reinvestment in business development – as highlighted by MSME respondents in the research on which this report is based – the growth of these businesses are likely to remain constrained.

The macroeconomic environment will exert considerable pressure on the earning potential of informal MSMEs. If growth doesn't accelerate, customers will face significant pressure on their incomes, hindering the ability of MSMEs to expand their client base and earning potential.

Given that many MSMEs will be informal and survivalist in nature, their ability to significantly absorb the unemployed will be constrained. Rather, informal MSMEs will likely be small operations with relatively few permanent employees.

The growth of the MSME sector is hindered by bureaucratic complexity, which makes it harder to start businesses and conduct cross-border trade.

Access to information for and on MSMEs remain an issue. Accurate and consolidated data on MSMEs needs to be readily available to stakeholders in order to address the sector's needs. Furthermore, many potential entrepreneurs currently lack the financial education necessary to make the most of financing opportunities. This will need to be rectified for the MSME sector to reach its potential.

THE MSME VOICE
(Wholesale and Trade, Small Business, Informal, Male, Gauteng Province)

"The way I see it, I can either sit here and moan about not getting business, or I can make it work. I found two other ladies at the cash and carry where I buy stock and we agreed that we will all club in … we get [product] at a bulk discount. We were able to maximize our profits. My shop is not as full as it was five years ago, but it's still open. I used to have four guys working, and now I only have two guys."

Man at work in a barber shop.
Photo: Arne Hoel / World Bank

THE UNSEEN SECTOR

South Africa's small business sector is characterized by a high level of informality, limited employment opportunities for youth and only a few sources of finance. The following is an overview of the MSME landscape in South Africa based on the findings of the joint IFC and World Bank report, *The Unseen Sector*.

Low rate of established entrepreneurship. South Africa's rate of established entrepreneurship is low compared with other African countries. South Africa should have a rate of early stage entrepreneurship three times higher than it currently does.

Survivalist Driven. Half of South Africa's entrepreneurial activity is driven by necessity by individuals with limited alternative sources of income. This inhibits the growth of the MSME sector as the individuals involved must focus on day-to-day considerations rather than scaling their operations and expanding their commercial interests. IFC estimates that only around 14 percent of the MSME sector in South Africa is formalized. This limits access to financing opportunities for would-be entrepreneurs.

Ownership Inequality. Ownership of MSMEs reflects patterns of racial and gender-based inequality in the broader South African society. Black ownership of MSMEs declined between 2008 and 2017, from 79 percent to 76 percent. Female ownership, meanwhile, declined from 48 percent to 38 percent in the same period. Additionally, black and female ownership was concentrated in the micro and small business segment of the MSME sector and, as the size of businesses grew, rates of black and female ownership declined. Furthermore, the sector is not significantly reducing South Africa's high rates of youth unemployment.

Largely Urbanized. Most MSMEs are concentrated in regions with large urban populations. For example, more than half of all MSMEs in South Africa are in Gauteng Province, home to the business and government hubs of Johannesburg and Pretoria.

Limited Finance. Around $16 billion in total funding is available to the small business sector, and commercial banks account for 68.9 percent, or $11 billion, in financing for the formal MSME sector. However, as informal businesses account for the vast majority of MSMEs, most have limited access to these funds. As such, the IFC estimates that there is a $30 billion gap between supply and demand for MSME financing. Government and microfinance institutions provide most of funding for the informal sector.

What's preventing the small business sector from growing in South Africa? *The MSME Voice* delves deeper into this question in the following sections to understand the challenges and needs from the small business owner experience and the solutions that would help transform the sector into a bigger job creating engine.

The MSME Owner: Understanding the Small Business

To better understand the realities of running a small business in South Africa and the needs of entrepreneurs, it is important to hear the ups and downs of the entrepreneurs' journey in their own words. The MSME's Voice findings are informed by nearly 8,000 hours of interviews with 2,555 small businesses across the formal and informal spectrum, varying businesses size from micro to medium, representing 12 sectors. Interviews were conducted in six languages by a team that traveled 35,860 kilometers to eight metro areas.

This section provides an overview of the small business owners interviewed, their business make-up, ownership structure, and ability to access infrastructure and financial resources. This section of the report also captures the business outlook of the owners interviewed. The profiles of formal versus informal business are compared to shed light on challenges that need to be overcome and potential prioritization areas. Formal businesses represent 60 percent of the MSMEs interviewed. The methodology for sampling a representative pool of small businesses is found in the Annex.

Owner Demographics

Table 1 shows the demographic profile of the business owners interviewed, as well as the sectors in which the businesses operate. The interview pool was selected to be representative of South Africa's MSME sector. There are stark racial differences between those operating formally and informally. The informal sector is largely comprised of black-owned businesses, while the formal sector shows a very skewed racial profile compared to the overall demographics of the country.

Table 1: The Interviewees: Demographic profile of owner, shareholder, partner or co-owner and business sector

Demographic	Informal Businesses	Formal Businesses
Gender	*% of interviewees*	*% of interviewees*
Male	56%	58%
Female	44%	42%
Race of owner		
Black	94%	42%
Coloured[2]	4%	6%
White	1%	39%
Indian/Asian	1%	13%
Sector		
Services	50%	59%
Manufacturing	27%	18%
Trade	17%	20%
Agriculture	5%	3%

[2] Coloured is a population group used by South Africa's government and census bureau.

From a sector perspective, the services sector dominates both types of businesses. However, formal businesses represent a greater overall proportion of MSMEs operating in the services sector, while the informal sector has a higher number of manufacturing businesses, which includes activities such as repurposing products made by someone else, making anything from crafts to food preparation.

Ownership Structures and Business Longevity

The MSME interviews show that most informal businesses are owned by a single owner, at 79 percent, while there is a more diversified ownership structure in the formal sector. Table 3 outlines the ownership structure breakdown across the small businesses interviewed.

Table 2: Business ownership structure

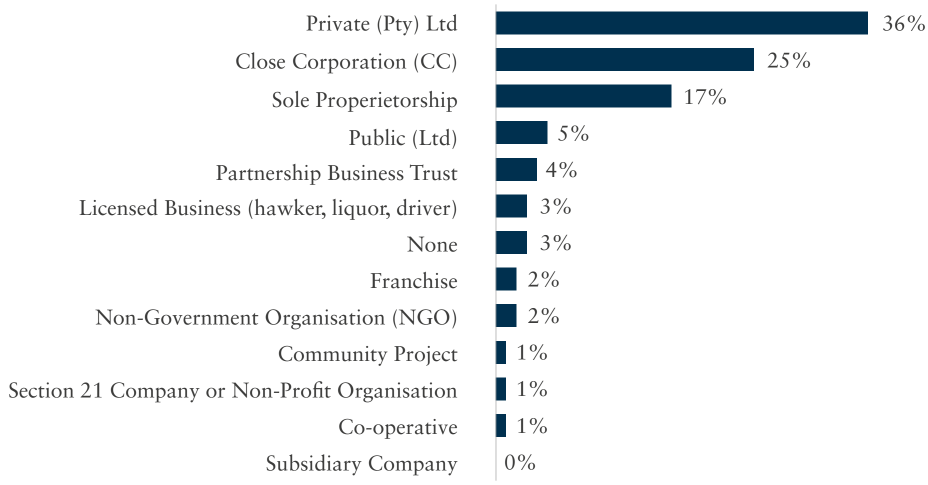
Ownership Structure	Informal Businesses	Formal Businesses
I own the business	79%	57%
I am a co-owner of the business	10%	19%
I am a partner in the business	9%	16%
I am a shareholder in the business	2%	8%

Workers doing maintenance in a workshop.
Photo: Eric Miller / World Bank

The difference in ownership structures between informal and formal MSMEs is often informed by the reason the business is established in the first place. Based on the interview findings, informal businesses are often created for survival when there are no alternative job opportunities, while formal businesses tend to respond to a gap in the market. In a survival context the primary focus is often on generating a personal income, while the focus of a formal business tends more towards the business income, profit and longevity.

The most common types of formal businesses are private companies, close corporations and sole proprietorships (Figure 1). The dominance of private companies and close corporations is driven by the ease of registration and compliance with regulations such as businesses seeking to be tax compliant as well as the ability to access financing and contracts, thus separating personal from business liability.

Figure 1: Type of business (formal sector)



The interviews additionally found that many formal businesses started life informally and then formalized as they grew and matured, suggesting that formal businesses comprise more of those businesses that were successful in terms of reaching their growth goals. This dynamic is reflected in the greater longevity of formal businesses depicted in Table 3, where the average number of years in existence for formal businesses is five years longer than that of informal businesses. The increased focus by formal business owners to build the business, as opposed to prioritizing generating a personal income, means that funds are more likely to be reinvested in the business and spur additional growth and stability.

Table 3: Number of years in existence

Years	Informal Businesses	Formal Businesses
0 to 1 year	10%	3%
Up to 2 years	14%	5%
Up to 3 years	13%	5%
Up to 4 years	11%	5%
Up to 5 years	18%	14%
Up to 10 years	21%	27%
Up to 20 years	9%	21%
More than 20 years	4%	20%
Mean Average	*6 years*	*11 years*

The shift in mindset between the ability of the business to generate a personal income for survival versus ensuring the success of a business as a business, is likely to result in greater levels of forward planning and reinvestment in the business, which in turn results in greater longevity.

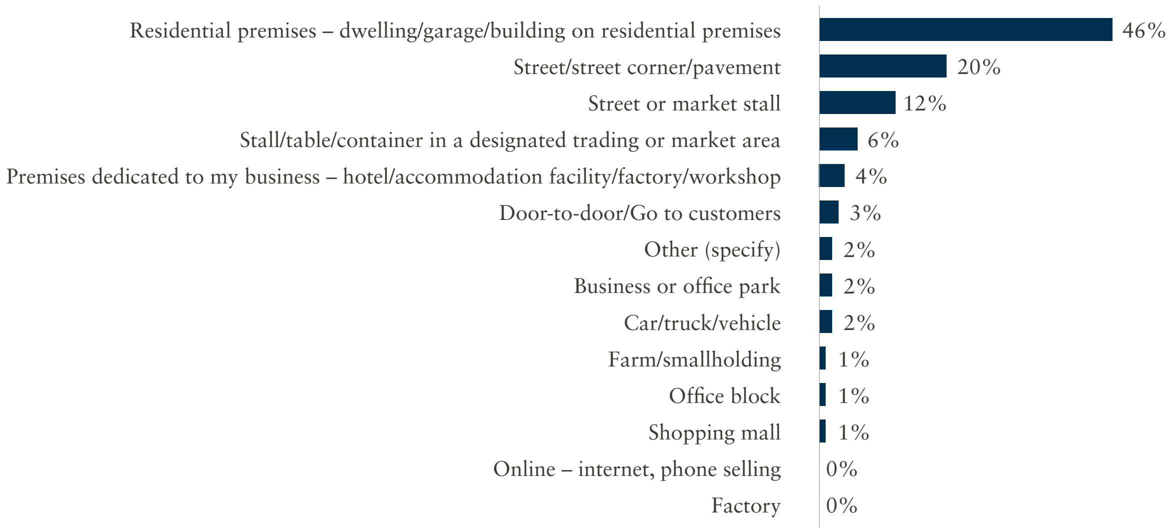
Business Infrastructure

South African businesses operate with alarmingly little infrastructure. The interviews found that 48 percent of informal businesses had no business infrastructure, and even amongst formal businesses the extent of access to business infrastructure was limited. More than a quarter of formal businesses and almost half of informal businesses operate from residential premises.

Access to the right infrastructure is vital to the small business owner. This includes premises to operate from, equipment, transportation and technology such as online payment systems, computers and smartphones. Access to finance could play an important role in enabling small businesses to build better business infrastructure.

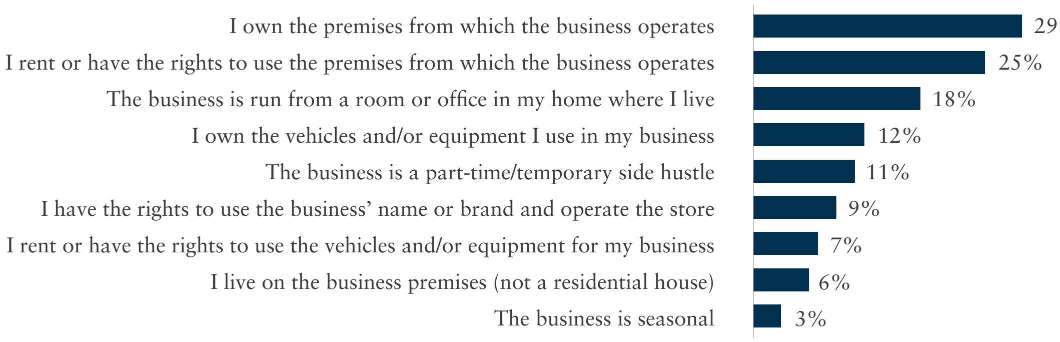
Most of the informal businesses interviewed operate from residential or temporary premises (Figure 2). Based on the interview findings, businesses operating from a residential premise are more likely to be run by older owners, be women-owned and operate in the services or manufacturing sectors. In addition, these businesses are more likely to classify themselves as stable and mature compared to informal businesses using temporary or informal premises such as a street, pavement, market stall, container or residential property. Businesses run in residential premises have the added benefit over many informal temporary premises of access to amenities to support the day-to-day functions such as water and electricity.

Figure 2: Business location (informal sector)



However, the interviews also show that less than a third of informal businesses have the business rights or formal personal rights to the assets that they use to run the business (Figure 3). This hampers their efforts to raise capital for expansion, as well as leaving the business vulnerable to eviction.

Figure 3: Business rights (informal sector)



In addition, 48 percent of informal business have no business infrastructure at all (Figure 4). These businesses are mostly owned by young business owners and are in the 'start-up' or 'growing slowly' phases of business development with less than 1,000 rand per day sales turnover. These businesses tend to be in the trade or agricultural sectors.

Businesses with at least some infrastructure are more likely to be male-owned businesses and belong to older owners in the 36-64 year old age group. The interviews found that these businesses are more likely to be in the group with a sales turnover of 5,000 rand per day or more. The owners in this category describe their businesses as being in the 'growing very fast' or 'stable or mature' phases. Most of these businesses are in the services sector and are more likely to be in Durban and Johannesburg.

Formal businesses, by contrast, are far more likely to have fixed premises (Figure 5) and own or have formal rights to the assets that they use to run the business (Figure 6). This creates a far more stable operating environment.

Figure 4: Business infrastructure (informal sector)

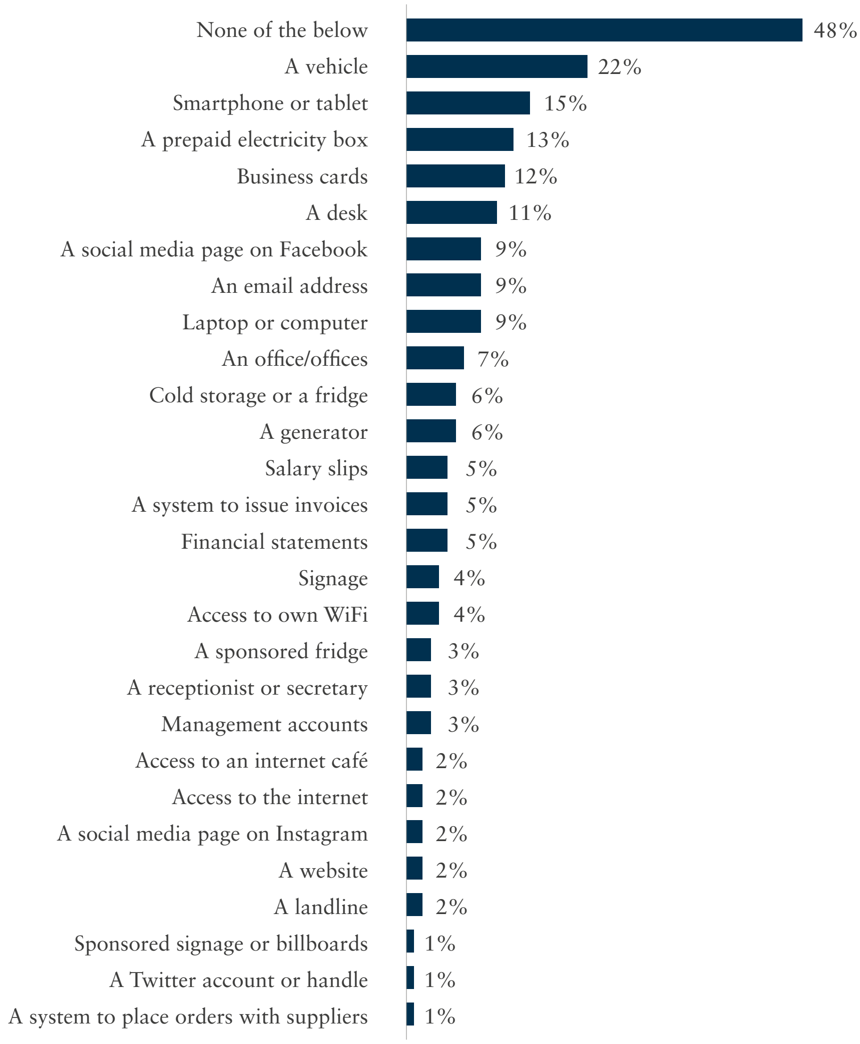


Figure 5: Business location (formal sector)

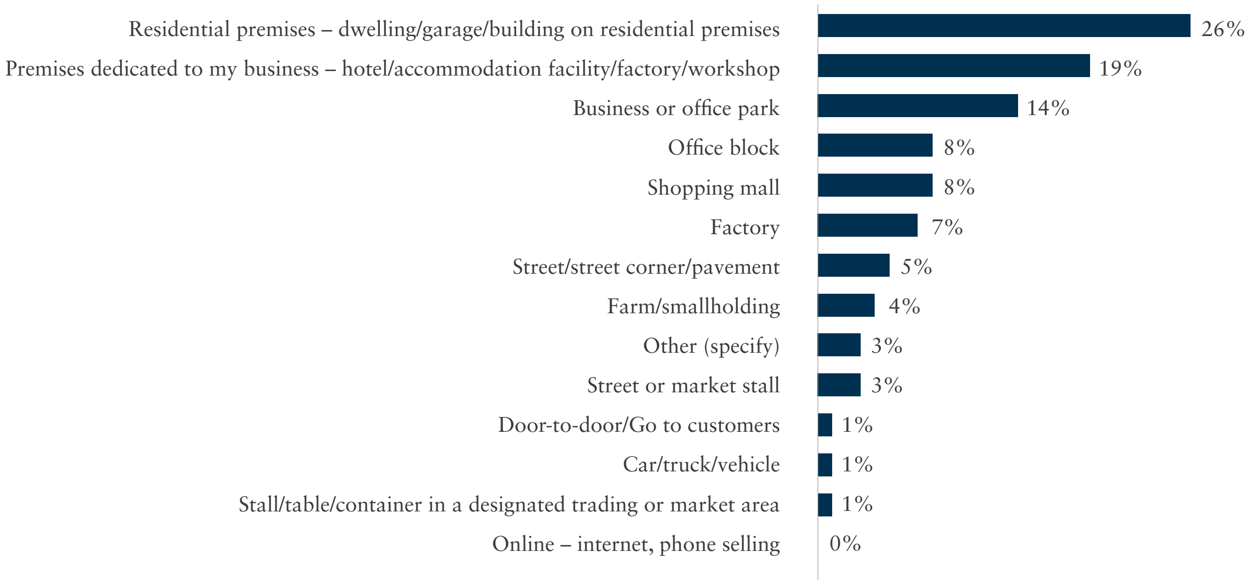
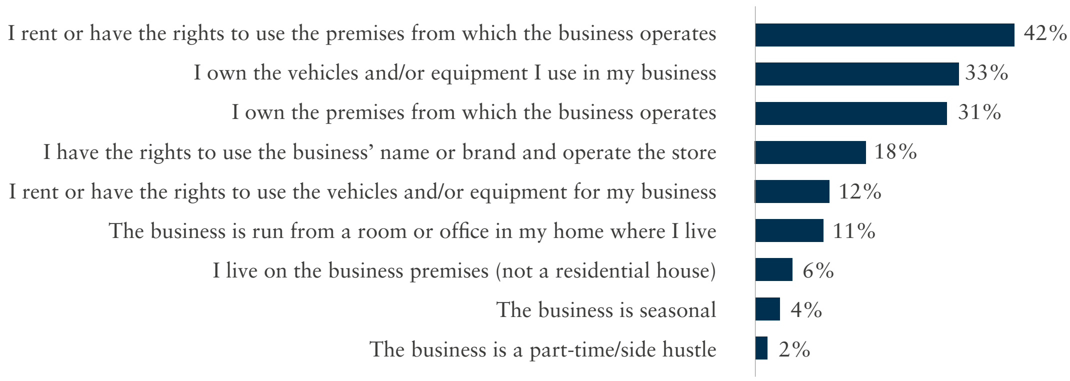


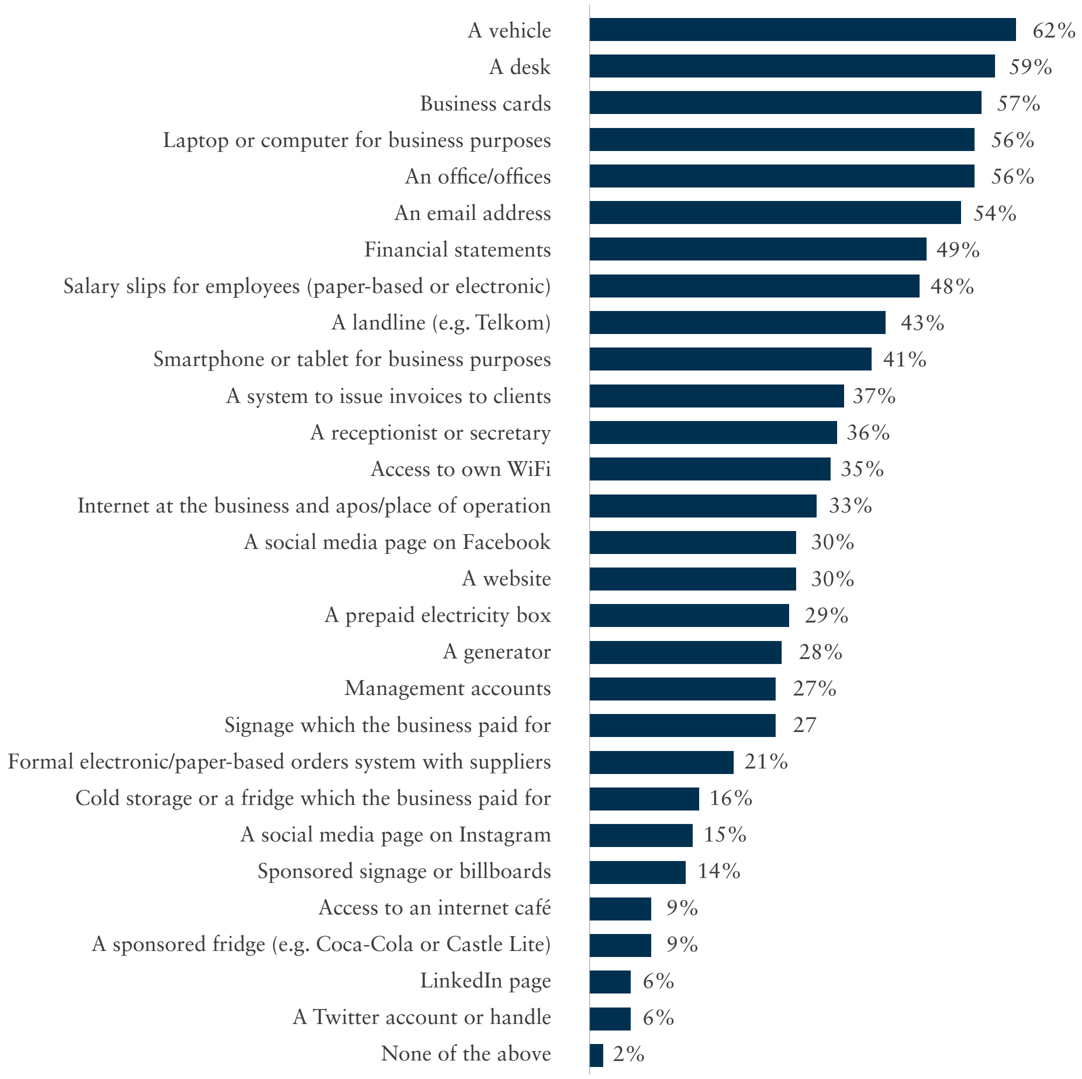
Figure 6: Business rights (formal sector)



Formal businesses operating out of residential properties are more common in the 'start-up' or 'slow growth' phases, where the focus is on establishing and growing the business, typically at a lower cost by using available personal assets. Businesses in this phase are less likely to have the ability to raise the finance required for separate business premises. The interviews found that most businesses operating out of residences are black women-owned businesses.

In stark contrast to informal businesses, formal businesses have much greater access to both moveable and immoveable infrastructure, with only 2 percent not having any of the infrastructure items listed in Figure 7. The businesses that have a vehicle as part of their infrastructure tend to describe their growth phase as 'growing very fast' or 'stable and mature'. The research therefore suggests that the presence of a vehicle can be a good indicator of a business in a stable or growing phase.

Figure 7: Business Infrastructure (formal sector)



The level of digital infrastructure amongst MSMEs was very limited. Only 15 percent of informal businesses have access to a smartphone or tablet, and less than 10 percent of informal businesses have a website, email address or social media page. Access to the internet or WiFi amongst informal businesses was rare. Although formal businesses had greater access to digital infrastructure, it remained restricted. Just over half of formal businesses had a laptop, computer or email address, and a third had access to the internet or WiFi. Only 30 percent of formal businesses had a social media page or website.

THE MSME VOICE

(Construction, Formal, Pool and Renovations, Male, KwaZulu-Natal)

"Once you have the infrastructure, big companies start looking at you. If you have the right equipment you get the job done in half the time and with half the effort."

Small business owners interviewed with access to technology felt that this access had a dramatic influence on the profitability of their businesses and helped them to remain relevant. However, for the majority of MSMEs, the cost of such technology, for example, point-of-sale devices, flash machines, business automation systems and tracking systems, was perceived to be out of reach. This suggests that initiatives focused on driving access to relevant technology may help to unlock further potential in the MSME sector.

THE SME VOICE
(Trade, Micro, Informal, Male, KwaZulu-Natal)

"This is a flash machine, I received it free as part of a program. It helps me … brought new clients that come to buy airtime from this machine and then they remember bread and the newspaper while they are here…"

The research found that the level of business infrastructure density was a key indicator in determining where a business would be classified on the informality-formality spectrum and is also one of the key variables resulting in strong differentiation between the various South African MSME segments.

Business Expansion

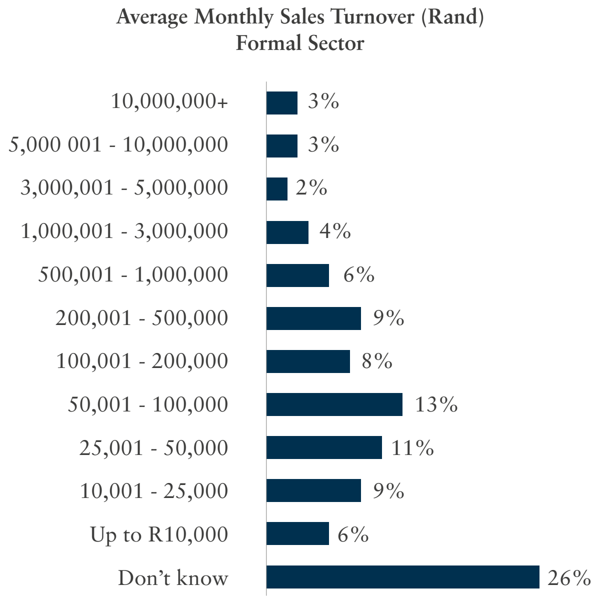
Only 19 percent of formal business owners interviewed said their enterprise has more than one outlet or branch, suggesting that even MSMEs in the formal sector tend to be very localized and domestically focused with limited reach to other areas within South Africa. Unlocking additional markets for these businesses could provide further growth avenues.

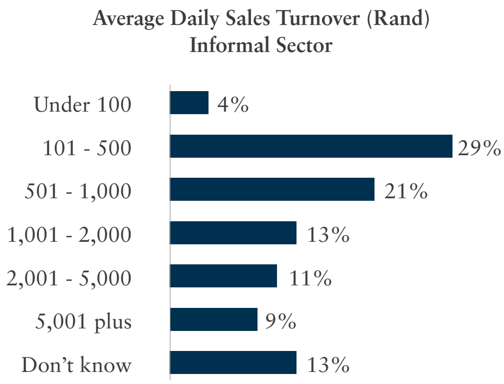
The qualitative analysis of the interview findings suggests that there is a strong desire amongst small business owners to expand their businesses and access bigger or additional markets. The discussions with owners showed that the key difference between those that are able to scale up versus those owners who are not, is the knowledge of how to do so, and resources and skills required to grow geographically, whether through physical locations or additional customers. Many small businesses also did not fully understand how to maximize the opportunities available under Broad-Based Black Economic Empowerment, South Africa's government initiative to diversify ownership in the country. In particular, their understanding and knowledge of how to maximize the opportunities available to them through Enterprise Development (ED) was limited.

Financial Performance

Half of the informal businesses interviewed record a turnover of between 100 rand and 1,000 rand per day, as shown in Figure 8, which translates to between 2,600 rand and 26,000 rand per month, assuming 26 working days in a month. In contrast, only 15 percent of formal MSMEs record a similar level of income while 59 percent record turnover levels higher than 25,000 rand per month, compared to 33 percent of informal businesses.

Figure 8: Average sales turnover





At the lower end of the informal daily sales turnover spectrum defined as earning 500 rand or less per day, the interviews found an over-representation of women-owned businesses, many of which are in the agricultural sector. These owners tend to describe their business as 'downscaling' or in a 'start-up' phase. This suggests that these businesses are born of necessity, struggling to survive, and likely to be exclusively focused on meeting the personal income survival needs of their owners.

Businesses with turnover less than 200,000 rand per month, which account for just under half of all formal MSMEs interviewed, are mostly in the 'start-up' or 'slow growth' phases and tend to be community-based businesses, offering social services or personal services.

Figure 9: Average gross profit values per month

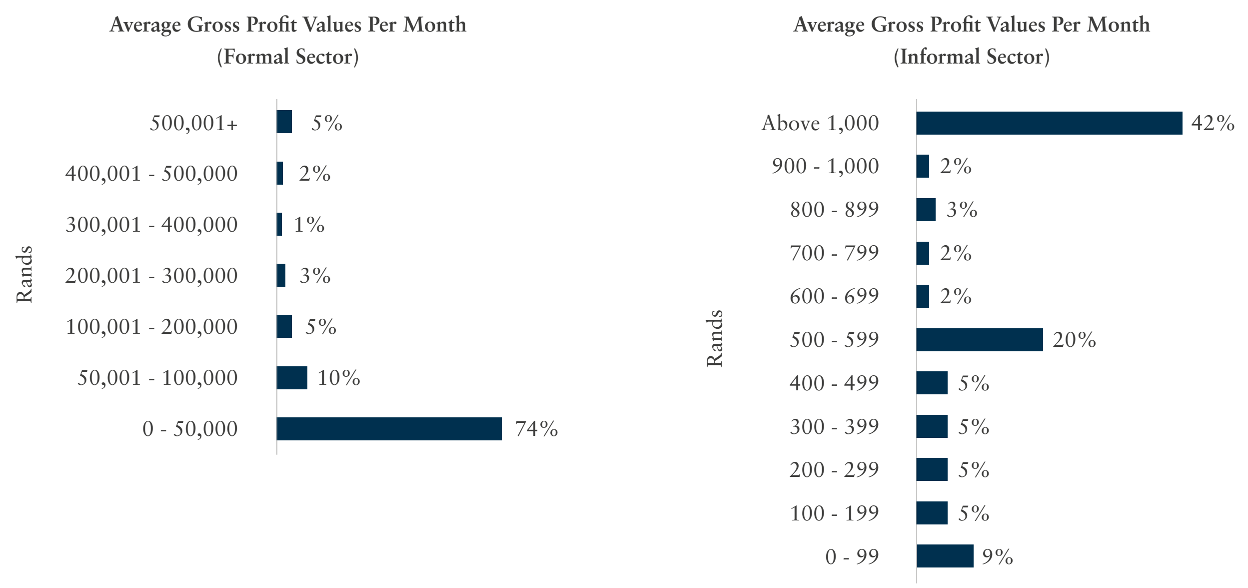


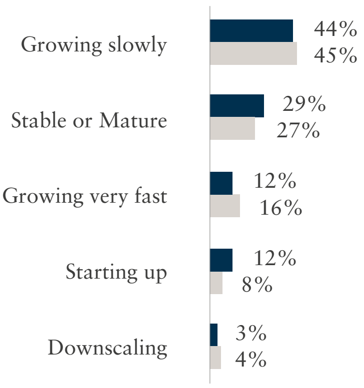
Figure 9 shows that, despite higher turnover levels, formal businesses rarely breach a gross profit of 50,000 rand per month. The profit values are also low for the informal sector, with 58 percent reporting a profit value below 1,000 rand per month, equivalent to around 38.5 rand per day if we assume 26 working days a month. In summary, the interviews found that small businesses, in both the formal and informal sector, have very little profit to reinvest back into the businesses to support growth, resulting in a constrained business ecosystem.

Figure 10: Average mark-up on sales

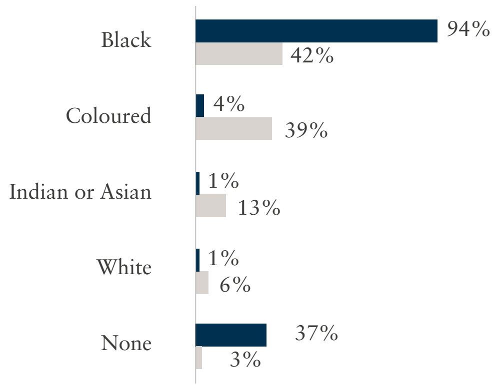
Contributing to the low profit turnover is small margins on products that the small business owners interviewed sell. Both formal and informal businesses are adding a mark-up on their products below 100 percent. Figure 10 shows the average mark-up across the businesses interviewed. This is particularly low for informal businesses, almost half of which only mark their sales up by 20 percent or less. Low operating margins limit the ability of small businesses to invest in the business, or save to acquire infrastructure or assets that can help the business grow. This creates a vicious cycle. Businesses need finance to expand, but limited profit limits their ability to repay loans. The interview findings therefore show that financial institutions and government should create small business lending products that tailor the size and repayment terms to small business needs and capabilities.

Fact Sheet: Informal versus formal business corpographics

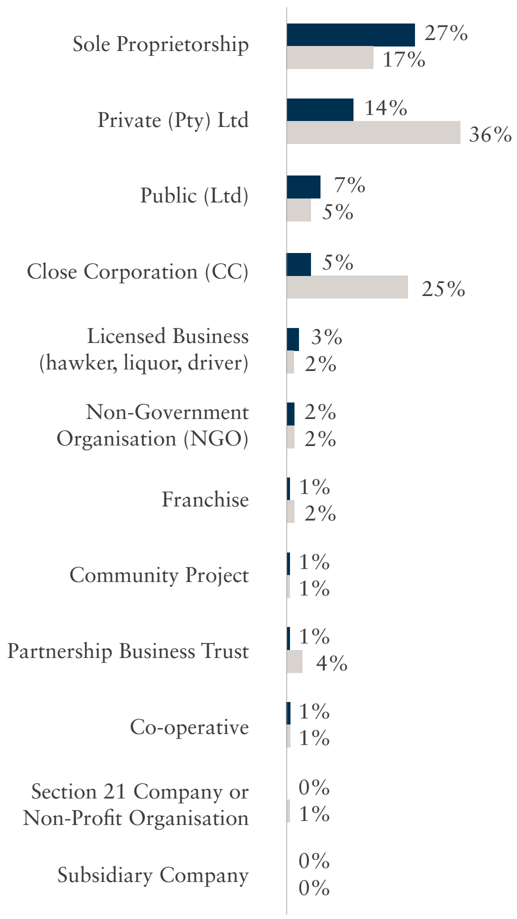
Business Phase



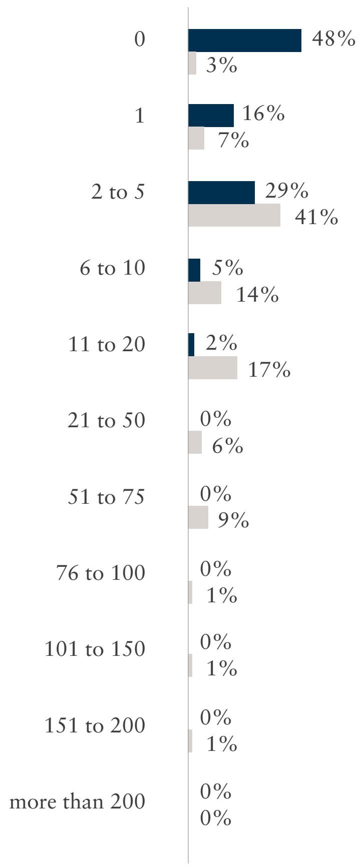
Population Group



Business Type

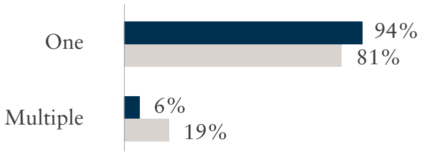


Number of Permanent Employees

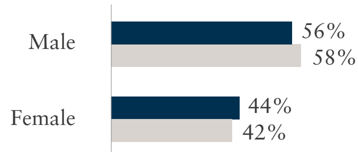


Informal (Weighted base) Formal (Weighted base)

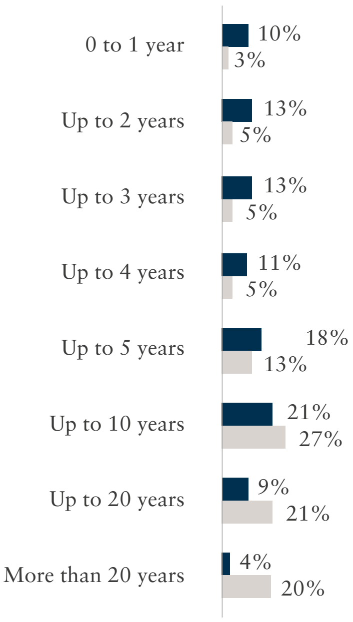
Number of Business Outlets/Branches



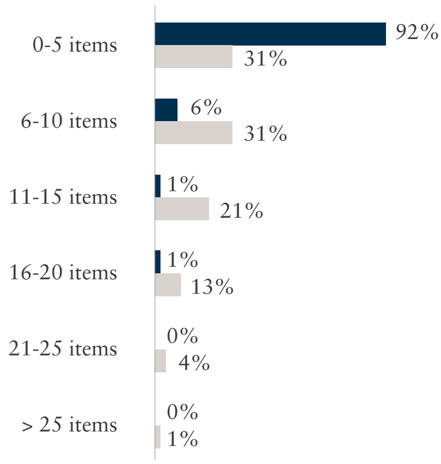
Gender



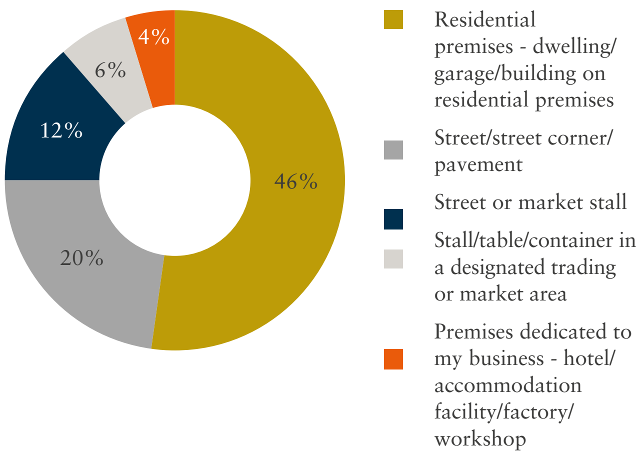
Business Existence



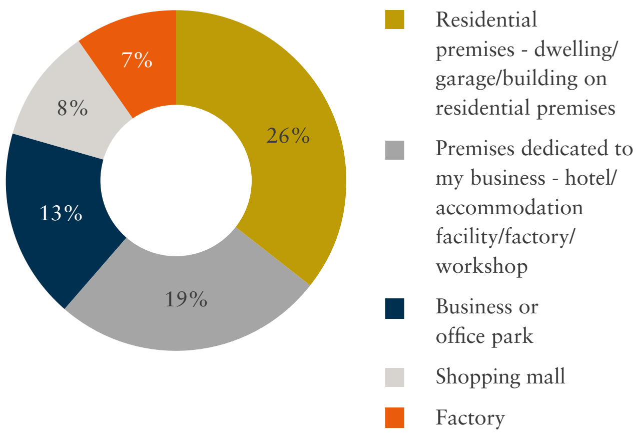
Level of Business Infrastructure



Top 5 Most Common Business Locations Informal



Top 5 Most Common Business Locations Formal



SOUTH AFRICA'S BUSINESS FORMALITY SPECTRUM

- *The Unseen Sector found that 86% of South Africa's MSME sector operated informally, which means that, although many small businesses are creating opportunities for self-employment and the ability to generate an income, this report highlighted that informal businesses are also creating jobs, albeit in the informal economy. 36 percent of informal businesses create permanent employment opportunities for others. The research indicates that as informal businesses mature, employment opportunities transition from being part-time to permanent. Furthermore, the research found that, on average, informal businesses experienced a 35 percent increase in the number of employees, pointing to the job creation potential of small business. At start-up only 15 percent of formalized businesses employed more than 10 people on a permanent basis – however, the research indicates that this has grown to 35 percent of formalized businesses now employing more than 10 people on a permanent basis.*
- *The MSME Voice builds on The Unseen Sector to delve deeper into the reasons for informality, the benefits of formalization and the differences between informal and formal businesses.*
- *Formal MSME businesses perform better, both in terms of longevity, as well as financial performance compared to informal MSME businesses. This can be attributed to several factors, such as access to finance, secured business premises and greater access to infrastructure.*
- *By contrast, informal businesses have a shorter lifespan and are less profitable. The research shows that they have much lower access to finance, are less likely to have stable premises and have low levels of infrastructure.*
- *Informality prohibits access to markets and limits access to finance as a result of a lack of visibility.*
- *The MSME Voice identified five key variables, which better defines the informality-formality spectrum in South Africa:*
    - *Business registration with CIPC or SARS;*
    - *Number of permanent staff;*
    - *The role of cash in the business for expenditure and business income;*
    - *Type of bank account used for business purposes;*
    - *Business infrastructure density.*
- *Acknowledging the formality spectrum and adopting these variables as indicators to address and drive formalization is critical. The MSME segmentation summarized in Section 6 of this report, indicates that there is a missing-middle along the formality spectrum. It also points to key groups of MSMEs which are more receptive to formalization strategies, and which can be targeted specifically.*
- *It is important to encourage formalization as far as possible or, in the absence of this, create conditions for informal businesses that mimic the advantages of formalization – access to markets enabled by stable premises, access to business infrastructure, and particularly access to enabling technology and access to finance.*

Students during a training session at the Lunghile Nursing College, a small business in Johannesburg, South Africa. Photo: Karel Prinsloo / IFC

2 The Small Business Lifecycle: From Idea to Operation

Small business owners are tenacious and adaptable, with a strong determination to survive and thrive. Understanding the road that small business owners travel and the challenges they face along the way, as well as their outlook, is critical to understand the type of support they need. This chapter follows the journey the small business owners interviewed traversed, and provides recommendations on tailoring products and tools that will meet their needs, based on their experiences running a small business, business phase and outlook.

Business Mindset

Common to all small business owners interviewed is a desire for financial security, financial freedom and growth. What varied was the ultimate goal of this security, ranging from a focus purely on the personal financial position of the owner, or a broader vision for the business itself.

Based on the interviews, the small business owners that see themselves as entrepreneurs tend to be positive and tenacious, able to spot gaps in the market and find creative solutions. They are resilient and able to pull through challenging periods, maintain focus and retain responsibility for getting things done. They are driven and, even though it is a hard road, few interviewed said they would be willing to give up the freedom and satisfaction they get from running their own businesses.

THE MSME VOICE
(Construction, Small, Formal, Female, KwaZulu-Natal)

"It's about being tenacious, to make sacrifices, to compromise and to focus … it's a hard road..."

The small business owners interviewed who chose to start their enterprise as a result of unemployment with a survivalist mindset, regard running a business as a temporary source of income to make ends meet. As the unemployment rate rises in South Africa, this survivalist sector is likely to expand, along with increasing numbers of failed start-ups. This dynamic will make it increasingly difficult for financial institutions to finance small businesses at affordable rates when presented with increased MSME risk profiles.

The key is to distinguish which MSMEs have an owner with a vision, passion and a plan for their business versus those who are simply moving from day to day to survive. Providing guidance and training on formulating realistic business plans from entrepreneurs with a clear vision, could help to identify those MSMEs with a real future versus those that represent a poor risk. At the same time, alternative risk assessment tools and funding solutions or providers are required to support and sustain survivalist informal businesses.

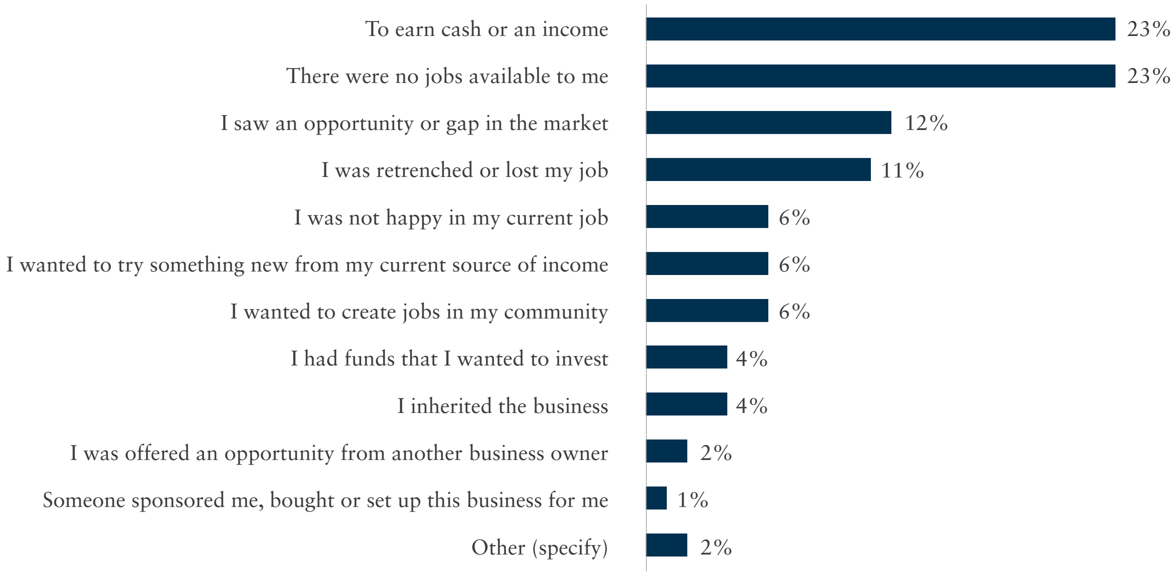
The Business Idea

There is a considerable difference between the reasons why informal business owners started their operation and why formal business owners launched their enterprise, as summarized in Figures 11 and 12).

Informal businesses are more commonly started because an income is needed for the owner, usually due to unemployment with 57 percent of small business owners interviewed citing a need to earn cash or an income for their primary reason in engaging in business ownership. These owners cited a lack of jobs or being retrenched. There is a sense that it was a forced event as the owner had no other choice, and the primary priority for the business owner is to earn money to use for personal living expenses. This leads to the phenomenon mentioned in *The Unseen Sector*[3] report where the focus of these businesses is on operational day-to-day issues rather than on scaling and expanding their commercial interests.

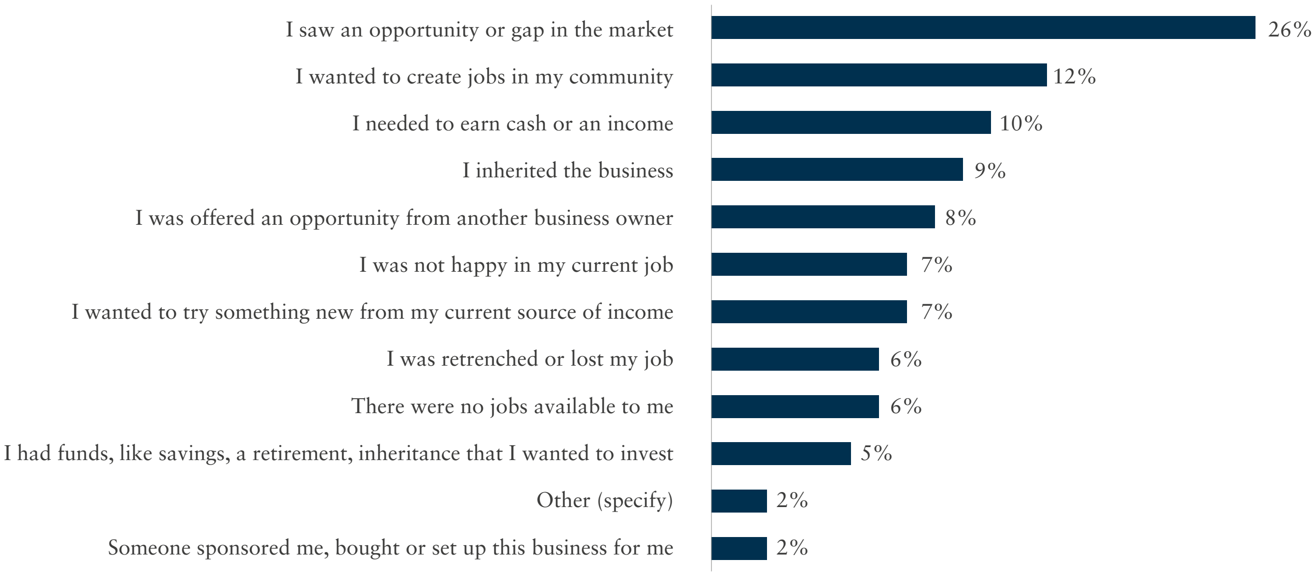
[3] *The Unseen Sector* – A Report on the MSME Opportunity in South Africa, International Finance Corporation [2018].

Figure 11: Reasons for business start-up (informal sector)



The interview results indicate that the reasons for starting a formal business are far more deliberate in nature and focused on the growth and success of the business rather than its ability to provide a day-to-day income for the owner. Only 22 percent started a formal business due to a need for employment versus the 57 percent seen in the informal sector.

Figure 12: Reasons for business start-up (formal sector)



Both formal and informal small businesses are most likely to try to fund start-up through personal savings and investments. However, while informal businesses are prepared to take finance from family and friends (Figure 13), this is less the case with formal businesses who appear to prefer not to involve family and friends and rather access finance through impersonal sources such as bank loans and business partners (Figure 14).

Figure 13: Sources of start-up finance (informal sector)

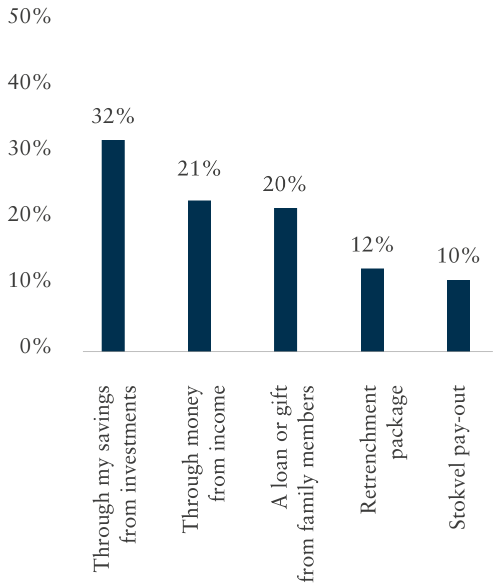
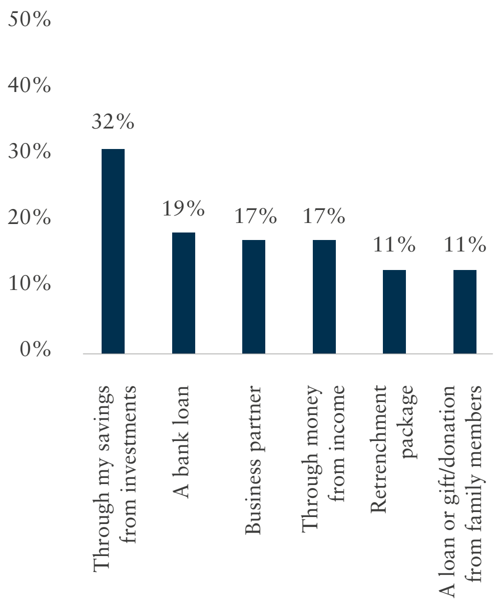


Figure 14: Sources of start-up finance (formal sector)

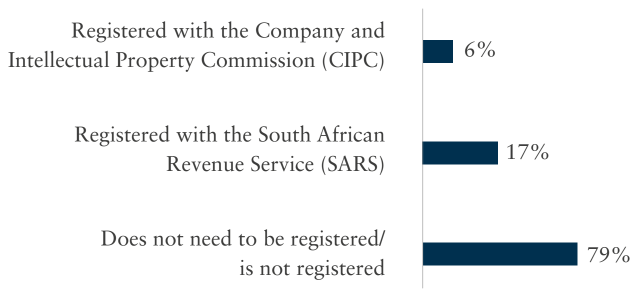


While many informal businesses may not be able to get approval for formal lines of credit, there is also an attitudinal barrier. Smaller or informal businesses felt that the cost of finance was prohibitive in terms of fees and interest rates for repayment, and this poses a financial risk that the owners said they could not afford, given low revenues in the start-up phase. Furthermore, smaller and informal businesses shared an expectation of rejection and therefore a view that the cost of engaging, particularly in terms of time, effort and frustration, was prohibitive and futile.

Business Registration

Many informal businesses interviewed are not registered with the South African Revenue System or the Companies and Intellectual Properties Commission, the two key avenues to register a business in South Africa. The information was collected in interviews and accompanied by additional validation with SARS and CIPC.[4] The vast majority are not registered in any capacity (Figure 15).

Figure 15: Business registration compliance (informal sector)

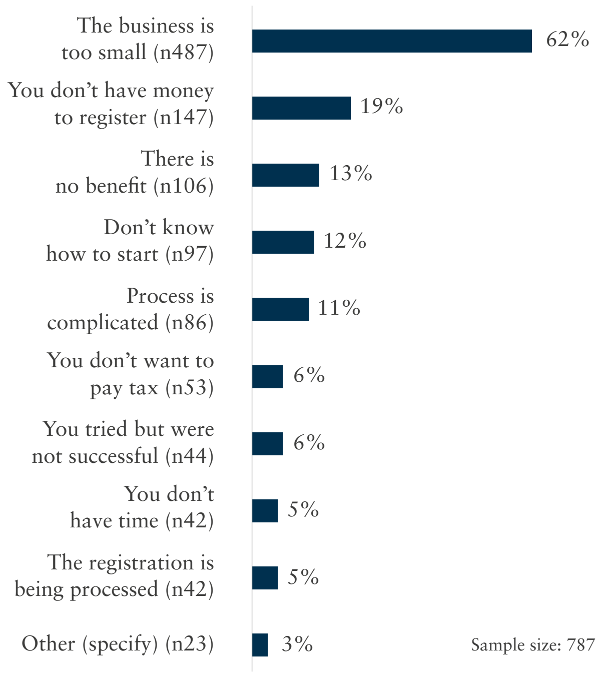


The main reason owners provided for not registering a business was because the business was too small at 62 percent (Figure 16). Any business can register regardless of size, so the finding indicates small business owners don't know they can register, or the issues of tax compliance and registration complexity play a bigger role than indicated. Overall, business owners said they see little benefit in registering, and believe that it may be a punitive step in terms of both cost, as well as time and effort in navigating a process they perceive to be complex.

The interview findings also suggest that there are owners who deliberately want to stay below the financial threshold that would require them to register. They would prefer to reinvest profits back into the business to avoid paying tax and other costs associated with formality such as CIPC and other industry related fees, as well as the accounting systems and capacity needed to generate financial reports. Those who are not exposed to what they are able to access as a result of formalization, see registration as a pure cost, rather than an investment.

[4] Respondents were re-contacted telephonically and asked to verify their responses, in respect to registration. A further step was taken to verify business names on the CIPC database for those that indicated registration with the CIPC.

Figure 16: Reasons for non-registration (informal sector)



The interviews asked informal business owners to describe what would lead them to change their mind and consider business registration (Table 4). The factors described echo some of the reasons formal businesses said they registered their businesses. The top reason at 53 percent is to get more customers followed by government incentives, access finance and the ability to partner with large businesses. The informal business perspective on registration indicates that a campaign to explain the benefits of registration and a process to make registration easier and more attractive in terms of tax structures and registration costs could spur greater formalization amongst informal operations.

Table 4: What would make informal businesses register?

Getting more customers	53%
Government incentive	26%
So I can borrow money	24%
Doing business with larger businesses	24%
Getting access to training and business skills development	22%
A quick and easy registration process	21%
Gaining easier access to markets	19%
Being able to do business with government	15%
Legislature requirement	6%
Other	4%

An additional barrier for informal businesses was not being registered with industry bodies and the Central Supplier Database (CSD) of the South African government, a database that enables suppliers to conduct business with the South African government. As a result, of not being registered with those bodies or on the CSD, the smaller or informal businesses can't qualify for government tenders.

Most formal businesses interviewed are registered with SARS (Figure 17) and a third are also registered with the CIPC. In the case of registered formal businesses, SARS registration would usually be in a business capacity, although for some this may be in a personal capacity), unlike informal businesses where registration with SARS is usually in a personal capacity.

The key reason formal business owners interviewed cited for registering is to comply with the law at 86 percent while 27 percent said they want to avoid fines and 22 percent registered to avoid harassment from authorities. Figure 18 outlines the reasons formal business owners are registered. This is echoed in the qualitative research where owners, particularly those operating in more regulated industry and commerce, register because they need to show to clients and customers that they are a legitimate business. That said, a proportion of formal businesses also acknowledge that there are benefits associated with registering, such as being able to sign business contracts, access finance, reach new clients and receive government assistance. Communicating such benefits as the primary reasons for registering may aid in convincing more businesses to become formally registered, along with solutions around helping them to manage the ongoing compliance requirements that a formal business needs to implement.

Figure 17: Business registration compliance (formal sector)

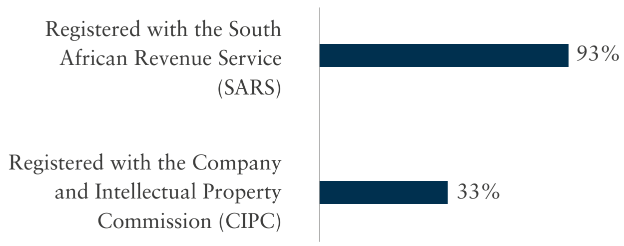
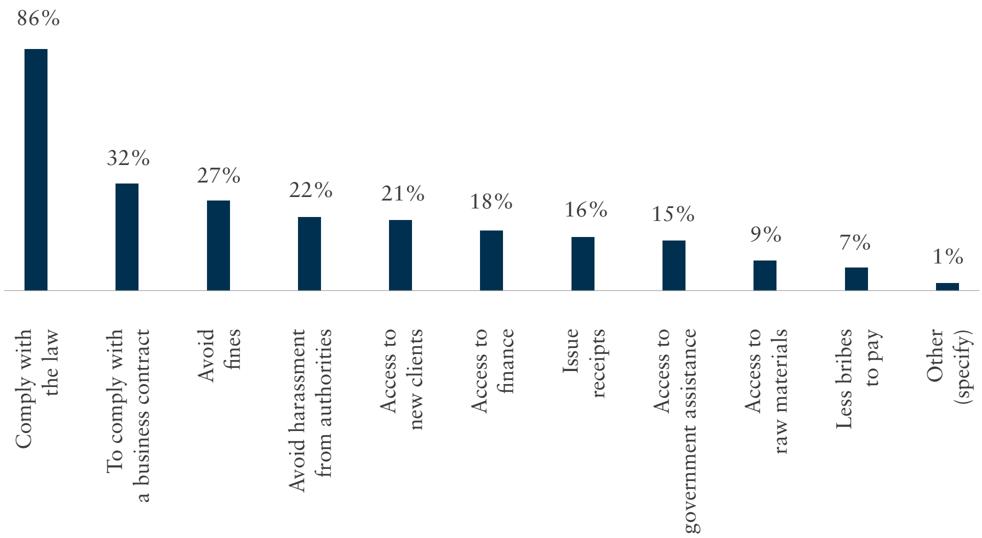


Figure 18: Reasons for registration (formal sector)



Within the formal businesses interviewed, there was higher awareness of industry bodies and the benefits of being engaged with the Central Supplier Database. These are important bodies in terms of unlocking potential for small businesses. Industry bodies were viewed by the formal business participants as a way to access information, training and networks, as well as being facilitators to access new markets and new clients. Since the awareness of these bodies and benefits are higher in formal businesses, it helps to explain why formalization is viewed more positively by those who have gone through the process.

Business Challenges

Formal and informal small businesses face similar challenges, as outlined in Figures 19 and 20. The primary challenges point to an environment where access to markets and customers is constrained and the level of competition is fierce. In the formal business sector 31 percent of business owners mentioned not having enough customers as their key challenge during their start-up phase, followed by not having the right equipment in second place at 29 percent, and too many competitors as the third most prevalent challenge at 26 percent. The same order of challenges was raised by informal businesses, but appeared to be more pronounced with not having enough customers mentioned by 40% of informal business owners. The qualitative interviews highlighted that foreign business owners are better able to collaborate and partner to benefit from, for example bulk buying discounts to bring their selling prices down or increase their margins, compared to South African business owners. Most formal and informal businesses serve the general public, followed by other small businesses and retailers, and most clients are repeat customers. 80% of formal businesses and 92% of informal businesses are found by their customers through walk-ins or walk-bys, pointing to the importance of the business location, foot flow and marketing. However, most formal businesses rely on word-of-mouth referrals, face-to-face recommendations, flyers, pamphlets, brochures or business cards to attract customers. Informal businesses also rely on word-of-mouth referrals and face-to-face engagements – however, social media platforms such as WhatsApp and Facebook, ranked higher than traditional marketing mediums such as flyers, pamphlets, brochures, posters and business cards.

The lack of access to markets has a knock-on effect for small business revenues and profits. Lower revenues and profits limit the ability of business owners to purchase additional resources such as equipment and stock that could help grow the business. Unlocking a sufficient customer base is the most critical challenge small business owners face in both the start-up and growth phase of their business. 53 percent of informal businesses said they would register their businesses if it enabled them to get more customers, in stark comparison to 24 percent willing to register for the benefit of gaining access to finance.

The informal and formal sectors differ in that finding the right staff is a greater challenge for formal than informal businesses. This may be due to formal businesses following more stringent recruitment processes and formal businesses having less flexibility around replacing staff who are not a good fit to comply with labor laws. Formal businesses also employ more people on a permanent basis and therefore their experience is more pronounced. For informal businesses, crime or theft by others was cited by interviewees as a more of a concern compared to formal businesses. This is not surprising, given the lower incidence of stable and secure business premises for informal businesses.

Figure 19: Challenges at start-up (informal sector)

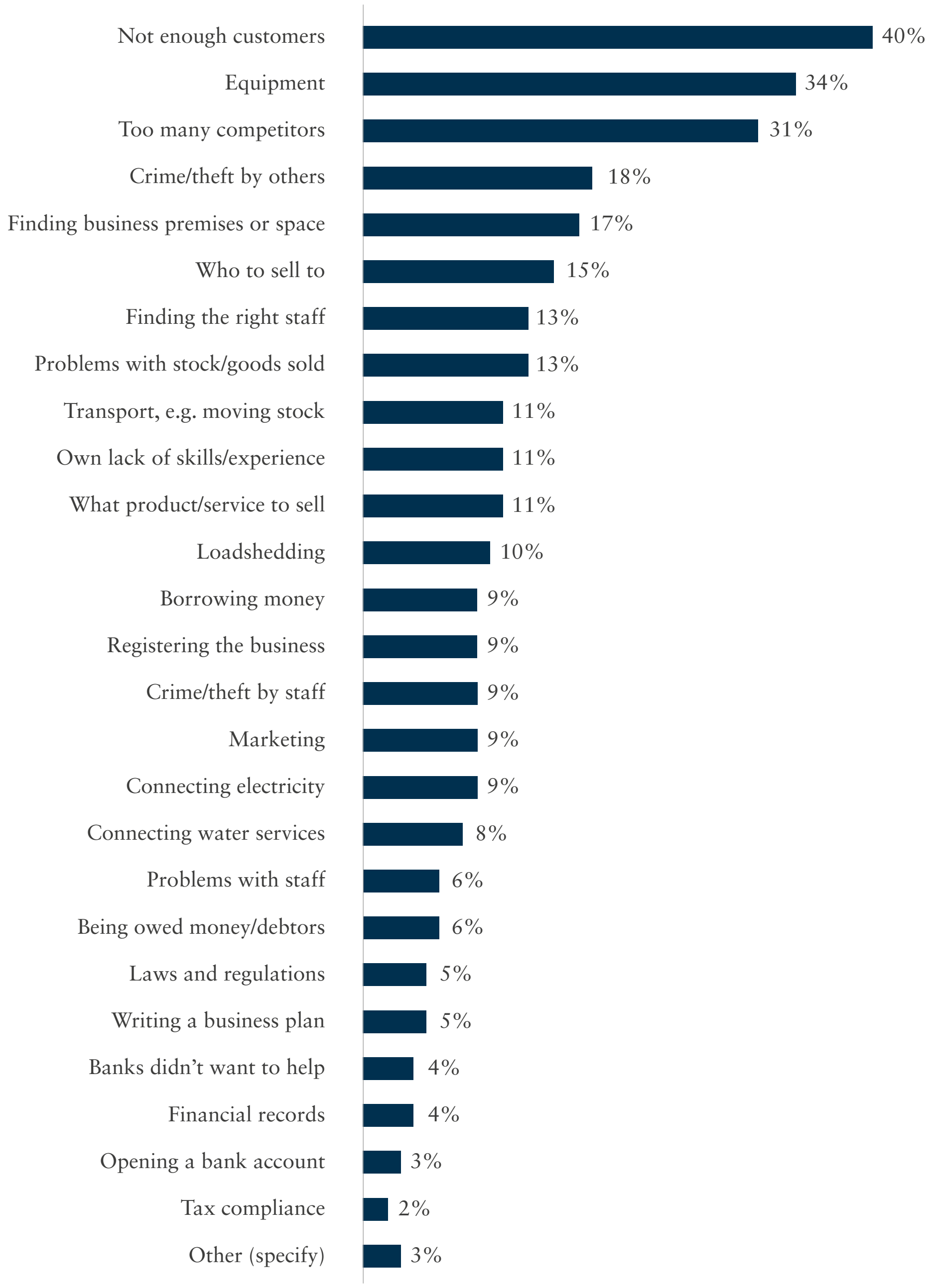
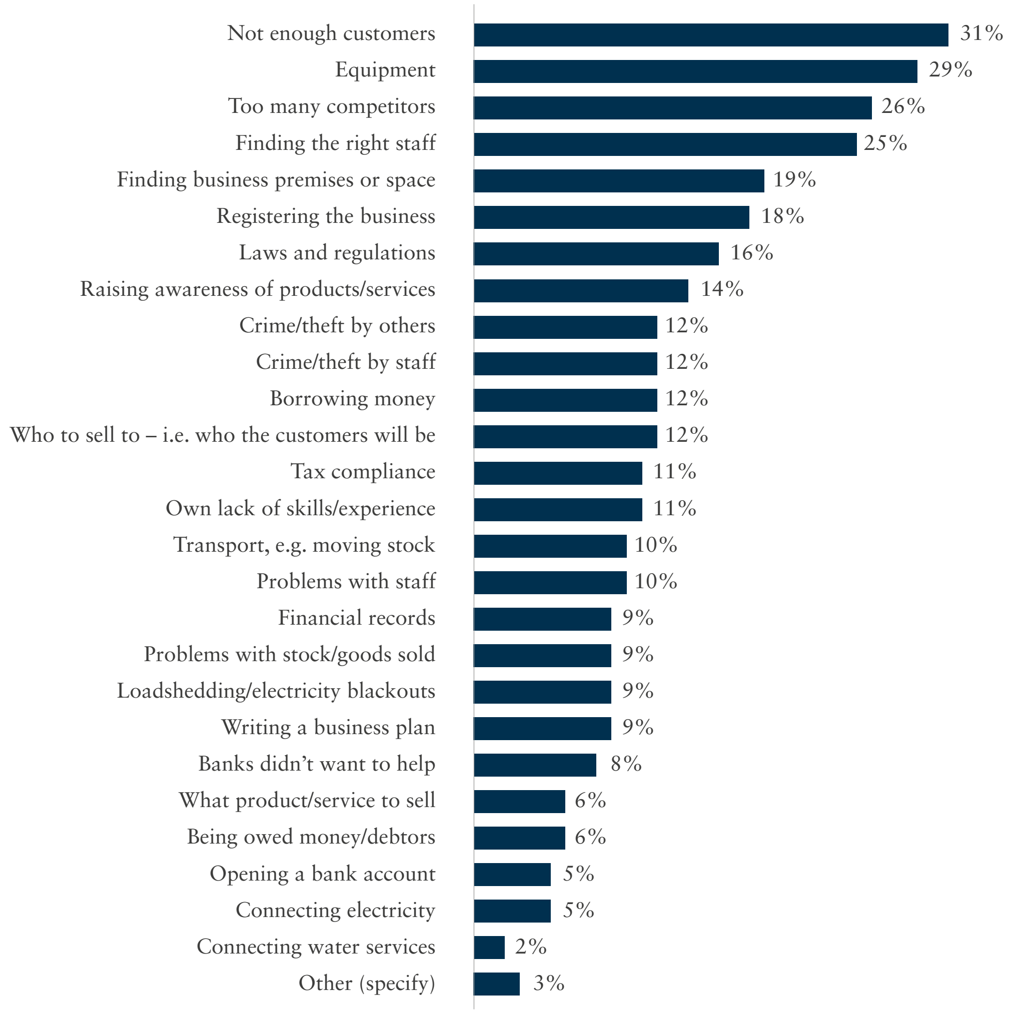


Figure 20: Challenges at start-up (formal sector)



The qualitative research further suggests that key challenges for small businesses exist around access to financing and funding, that would enable them to take advantage of the opportunities they see to scale their businesses. Scaling a business often requires hiring more staff, purchasing equipment or technology, all of which the businesses interviewed struggle to achieve, given the tight financials they operate with and the pressure experienced to become leaner in an environment of weak growth and rising costs.

The Three Stages of Business Development

This section focused on the start-up phase of an MSME business. However, as the business matures, there are key differences and challenges at each stage of development that potentially require different or nuanced offerings and support from government and financial institutions.

The quantitative research divided the business maturity of those interviewed into four life stages – starting-up, growing, stable or mature and downscaling. The interviews showed that most businesses in both the formal and informal sectors describe themselves as either growing or stable and mature (Figures 21 and 22). However, it is important to note the following:

First, there are more informal businesses in the 'growing' and 'starting-up' stages than formal businesses in those categories. Formal businesses interviewed more often described their operation as stable or mature. The research suggests that many small businesses transition to become formalized as they grow and become more mature. Therefore, nurturing growing informal businesses could help them to make the transition to become registered and part of the formal economy.

Secondly, in both the informal and formal small business sectors, the interview findings show that businesses are far more likely to describe themselves as growing slowly, as opposed to growing fast. This is particularly apparent in the informal sector where 76 percent of businesses categorized as growing said they are growing slowly rather than quickly, compared to 63 percent in the formal sector.

It is important to note that the 'stable or mature' description may not mean that the business has become big, but rather that it is no longer in a growth phase. Therefore, this description could be either positive or negative, depending on whether the business has stagnated or is simply running to capacity as planned.

Figure 21: Business phase (informal)

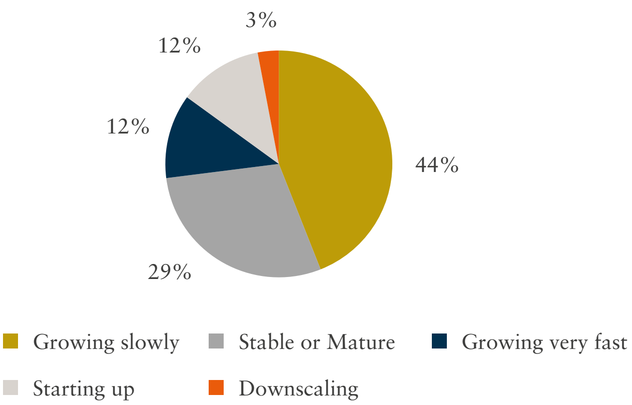
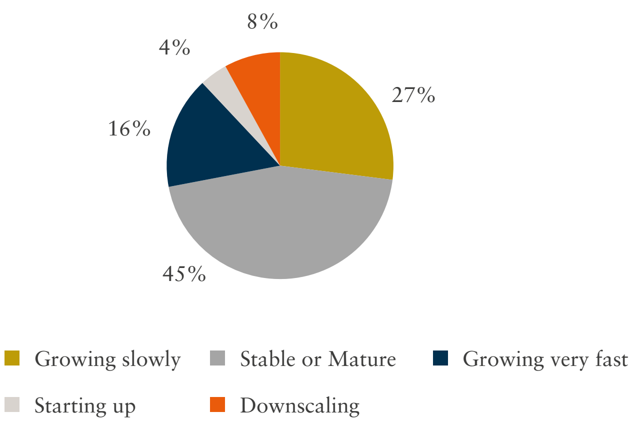


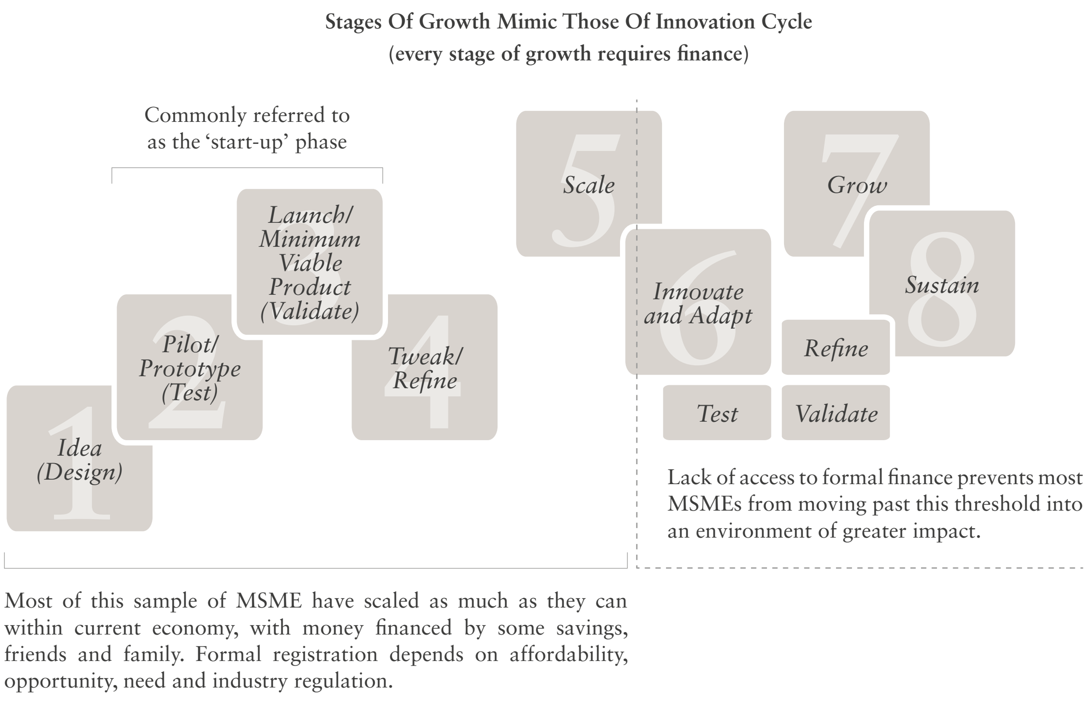
Figure 22: Business phase (formal)



The qualitative research explored the features of each stage of the business lifecycle. What became apparent from this exploration was that vast differences exist in terms of how the key resources of time, money and people are managed, depending on the level of business maturity.

Despite this, every stage of growth requires finance. However, the type of finance and support required at each stage differs.

Figure 23: The entrepreneurial life cycle



Phase: Starting-up

In this phase, the idea for the business is conceptualized. This could be through finding a solution to a problem or identifying a gap in the market. It could also be the thought that the entrepreneur could be doing the business activity better than their employer and deciding to branch out on their own. For those focused on surviving, this would entail finding something to make or sell in order to get by.

In this stage of business development, a few entrepreneurs may seek out information about the industry they will operate in (through online research, industry bodies, networking or workshops, while many will move into simply creating a prototype or testing their idea. Some will register their business at this stage, but this is more likely to be those operating in sectors where industry legislation is more stringent, such as construction and transportation. Many will choose to remain informal to avoid the costs of registration and compliance at a stage in their business when finance is tight and there is little to no revenue.

Once the idea is concrete, the business developer needs to find funding to start the business. Depending on the nature of the business, this could entail finance for raw materials, equipment, marketing materials or other infrastructure. The amount of finance needed will also be driven by what is required to produce a prototype or to service their first customers. There is then a process of receiving customer feedback, refining the offering and implementing processes that make the delivery of the offering or service more efficient. In addition, this is often when basic accounting systems are implemented, and business and personal finances are separated (less so for the survivalist type of business). Some may employ a few people at this stage.

The interviews showed that most start-up business owners fund this phase through their own savings or by approaching family or friends. Few can raise finance from institutions at this stage, since there is no track record of the business and there is also a fear of committing to loans at a stage when the owner is unsure whether the business will succeed.

Based on the needs expressed from the small business owners interviewed, the type of support required at this initial phase include:

- Mentorship programs to help entrepreneurs crystalize their ideas and develop a sound business plan.
- Enterprise Development incentives and networking events specifically focused on supporting start-ups.
- Incubator programs to provide basic infrastructure and services for start-ups in return for a stake in the business or repayment once the business has reached profitability.
- Seed capital programs for start-ups with strong ideas and clear business plans.

What is clear, is that start-ups that are unable to find the capital to develop and test their ideas sufficiently, are more likely to fail quickly. In addition, the qualitative research found that many businesses have remained in this start-up state despite having been in existence for 10 to 15 years and about half had remained informal. This is often due to a lack of capacity and finance to build scale within the business.

Figure 24: Life cycle stages 1 to 4

1. Idea (Design)

Find a solution to a problem.

Spot a gap.

Join a going business.

Find something to make or sell to survive.

2. Pilot/Prototype (Test)

Learn about the industry/role; some start talking to people.

Purchase basic material, equipment or stock to start operating.

Create a pilot or make a prototype – show people.

Some do market research.

Put marketing information together.

Decide whether operation help needed yet.

Some may register at this point (CIPC/SARS and/or industry body) – dependent on target market, sector admission, and business knowledge.

3. Launch/Minimum Viable Product (Validate)

Land a customer/sale.

Some start networking.

Produce/manufacture.

Deliver service/product.

Track record of invoices/receipts (some).

Some may register at this point – depending on available finance and opportunity need.

4. Tweak/Refine

Find more customers/sales – build network.

Learn about supply and demand to keep customers happy.

Improve production or manufacturing process.

Refine efficiency of service or product delivery.

Some may employ full-time.

Create bookkeeping system – from paper to Excel to software or outsourced.

Registered businesses either aware of or generating accounts and financial reports.

The speed with which an enterprise can develop these stages is directly related to business maturity – they are less likely to be held up by challenges, lessons and growing pains.

Phase: Scale, Innovate and Adapt

This is the stage of business in which customer relationships are built and there is significant growth in the volumes and types of products and services offered. Operating systems are refined in this stage and more people may be employed. The qualitative research found that employment can double in this phase of the business lifecycle.

CIPC and SARS registration at this point becomes important to comply with regulations and maintain a new level of growth. Some businesses are then able to acquire some sort of credit facility such as a credit card or overdraft, and start the process of becoming finance ready and looking for further financing.

The challenge at this stage is the need to drive revenue growth to achieve scale and invest in technology, people, systems and infrastructure while struggling with poor economic conditions.

The type of support that businesses need at this stage, based on feedback from the small business owners in the interviews, include:

- Help with business registration.
- Training from an operational and systems point of view to be compliant with tax and labor regulations.
- Credit facilities that allow the business to remain liquid, such as working capital to take advantage of business opportunities while waiting for payments to come in.

Phase: Grow and Sustain

At this stage, businesses can access funding and finance and there is significant growth in profitability, which can be invested back in the business to build capacity for further growth. This is often the point at which a small enterprise becomes a medium enterprise. In this phase, business systems become more complex, and so do functions such as human resources, managing a growing team and working with labor unions.

The type of support businesses need at this level includes:

- Reviews of business functions and systems to ensure maximum cost-effectiveness and efficiency.
- Human resource training and support to engage with trade unions.
- Access to finance to fund larger scale capital investment or expansion into new markets.

It is at this stage where businesses start contributing more substantially to the community through graduate placement programs or internships and higher job creation.

Figure 25: Life cycle stages 5 to 8

Impact starts to be visible in Stage 7 and 8

5. Scale

Build customer relationships – reputation and WOM are NB!

Keep in touch with markets.

Grow volumes of products and services.

May employ more people.

Refine operating systems.

Formalize accounting system.

Most have registered by this point.

6. Innovate and Adapt

Invest in infrastructure:

Culture – people, training, systems – drive performance.

Technology and innovation – drive efficiency and value through systems, products and services.

Get finance-ready and look for financing.

Open new markets and opportunities.

Create stronger value propositions for customers.

7. Grow

Able to access funding and finance.

Substantial growth in profitability – business owner finally makes some money!

Organization can channel profitability back into investment.

8. Sustain

Access to funding is relatively straightforward.

Grow from generation to generation.

Create more impact on employment.

Evolve into legacy organization.

KEY FINDINGS

- *There are essentially two mindsets in terms of those who start a small business – a deliberate choice versus to survive due unemployment and a need to earn an income.*
- *In the case of the deliberate entrepreneurs, these small businesses are more likely to be formalized, and the focus of the owner is on the business, rather than on personal survival. Therefore, business planning and the reinvestment of profit occur more often, allowing the business to develop.*
- *The focus of those who are forced into small business ownership through lack of employment, particularly with micro businesses, is on earning a day-to-day living rather than on developing the business. Profits are far less likely to be reinvested in business development and little forward planning takes place.*
- *When creating financial service and other product offerings for small businesses it's important to understand the vision, passion and plan for the business that the owner has, keeping in mind that this may not be formally written down.*
- *This doesn't mean survivalist small businesses don't deserve or require support – but the support needed will be different.*
- *Formalization does have benefits and these are recognized by those who have taken the step to register. However, the perceived cost-benefit analysis by those business owners in the informal sector, particularly at the micro level, deters them from registering. Often these businesses are unaware of the benefits that exist with formalization, while others feel that the potential benefits may not be worth the effort to learn how to do it, change their way of doing business and incur additional costs. Therefore, communication on the tangible benefits of formalization is necessary, along with ensuring that red tape is minimized by government and aid is given to ease the registration process.*
- *The needs of businesses are very different depending on where in the business lifecycle they find themselves. Many small businesses remain trapped in the start-up phase due to a lack of access to finance and markets to scale and grow, as well as a lack of knowledge around what is required to move to the next phase. This requires different intervention at different maturity levels to help businesses progress, as it is at the mature end of the spectrum when they become significant contributors to the employment landscape.*

Resident wine maker at Stellakaya Winery, Stellenbosch, South Africa.
Photo: © John Hogg / World Bank

3 The Nature of Small Businesses

The small business owner makes decisions daily on where to spend his or her capital. It's a constant battle to balance financial resources between the need to meet financial obligations and investment in the business to boost growth. Small businesses also need manage the lag between paying suppliers and receiving payment from customers while also ensuring enough funds to pay employees. Liquidity is paramount and, in the small business world, cash is critical. This represents a constant concern for small businesses, but also many opportunities for institutions to engage and smooth the road. This section explores the daily operational context of small businesses and tracks their spending patterns.

Business Operations

In terms of annual business cycles, most of both formal and informal small businesses operate throughout the year and also run fairly stable businesses throughout the year, peaking over the festive season in December. This is driven largely by small businesses in the retail, wholesale and manufacturing sectors. This peak is marginally less steep for formal businesses when compared to informal businesses (Figures 26 and 27).

The incidence of importing stock is low both amongst formal and informal businesses and equipment and stock are the most common imported items where importation does occur (Figures 28 and 29). 27 percent of formal businesses are involved in importation versus 18% of informal businesses. Formal businesses are more likely to import stock, whilst informal businesses tend to import equipment followed by stock.

The qualitative research found that import taxes significantly reduce margins for small and micro manufacturers and therefore sourcing of goods from import markets is relatively scarce. Trade compliance factors can also delay production in the manufacturing and trade sectors.

Figure 26: Months of business operation (informal sector)

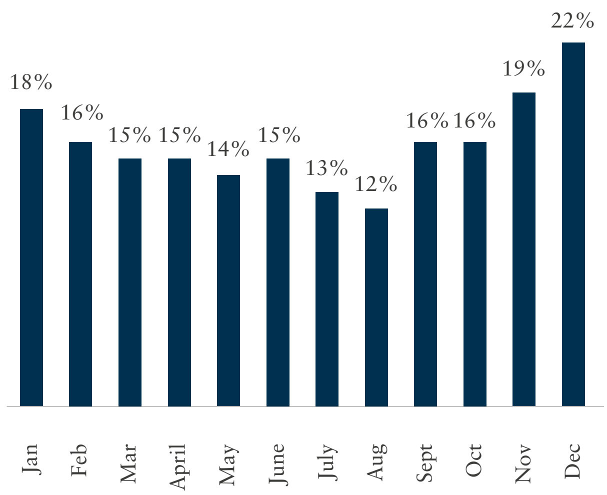


Figure 27: Months of operation (formal sector)

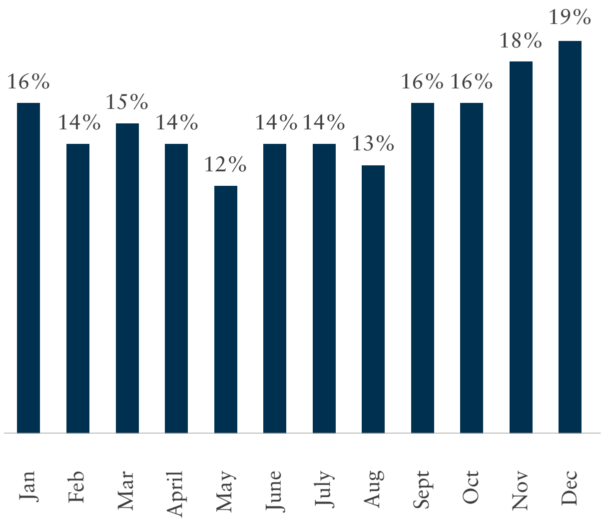


Figure 28: Type of goods imported (informal sector)

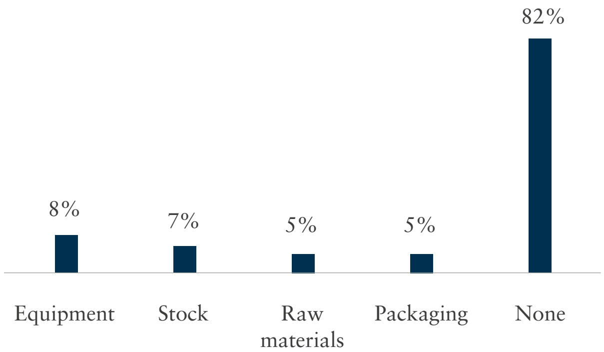
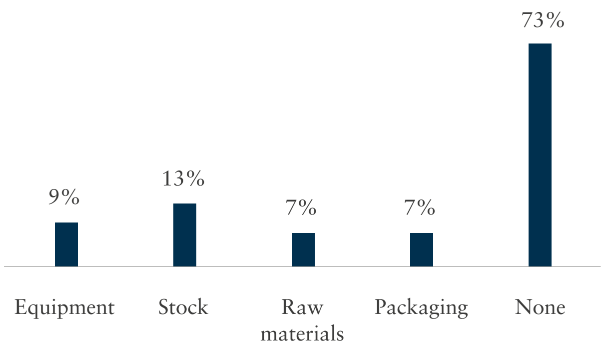


Figure 29: Type of goods imported (formal sector)



Customer Profile

The primary customers for both formal and informal small businesses are members of the general public. The customer profile is shown in Figures 30 and 31. The interview results show that the difference between formal and informal business is that formal businesses are more likely to have other businesses as customers. Often, other businesses require a supplier they are using to be registered and placed on a supplier database – also contributing to formalization. Formal businesses have access to a broader customer profile compared to informal businesses.

Figure 30: Main customers (informal sector)

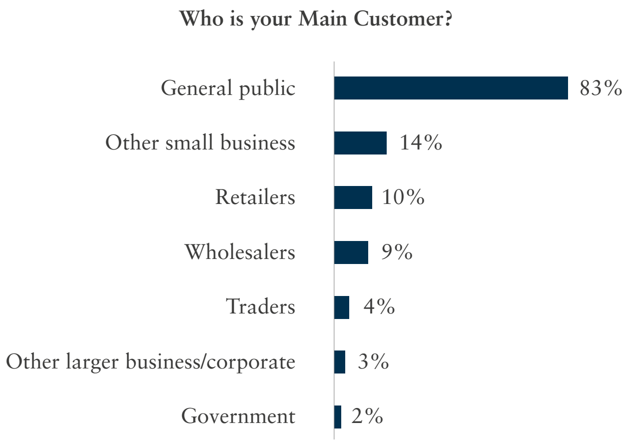
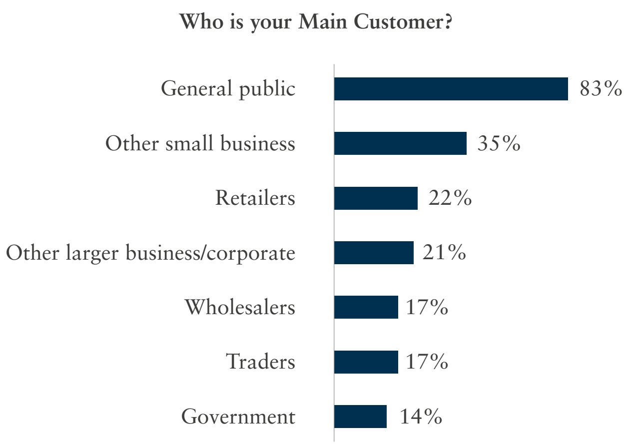


Figure 31: Main customers (formal sector)



For both formal and informal businesses, the interviews with small business owners show that repeat customers are critical, accounting for over 80 percent of customers (Figures 32 and 33). The interviews also found that the majority of customers were acquired initially through walk-ins. Formal businesses show a higher percentage of once-off or new customers compared to informal businesses, suggesting that they are better able to reach and acquire new business.

Figure 32: Customer description (informal sector)

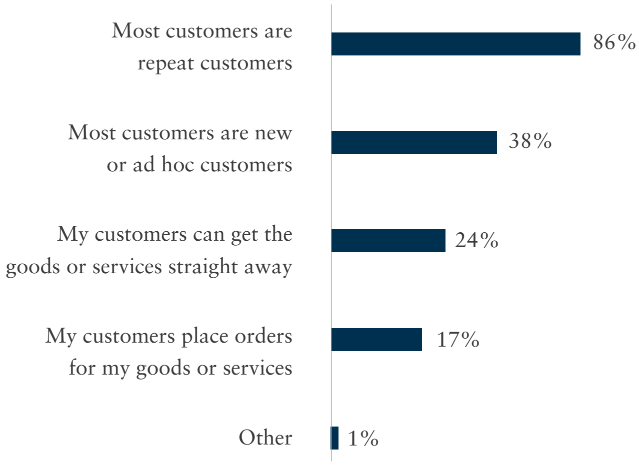
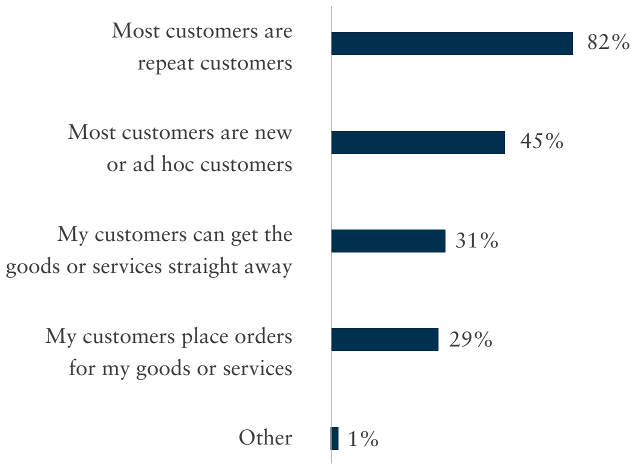
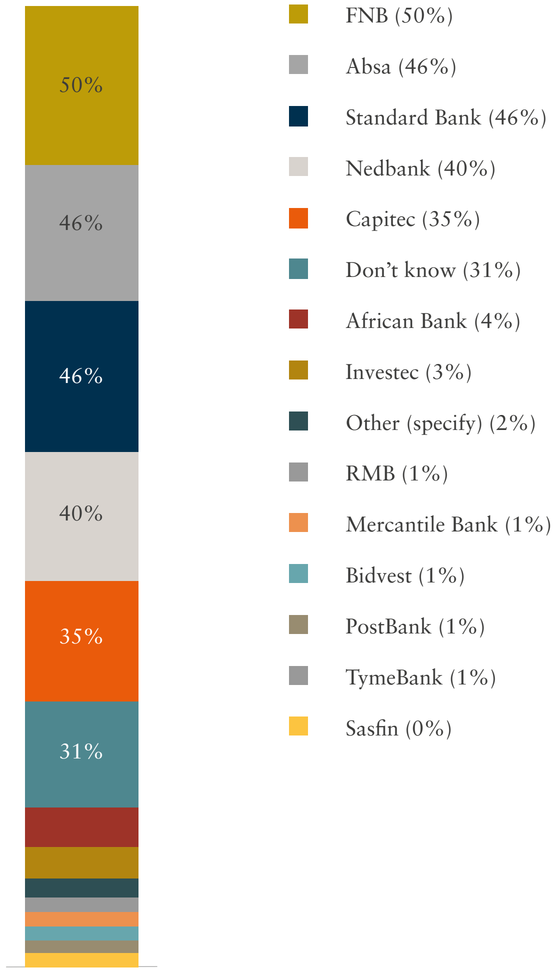


Figure 33: Customer description (formal sector)



In terms of payments from customers, informal businesses are far more likely to be cash-based, with 95 percent of informal businesses interviewed saying their customers pay in cash, compared with 63 percent of formal businesses. Therefore, it is not surprising that formal customers appear to have a higher awareness of the banking institutions used by their customers than informal businesses do. However, given the prevalence of cash, indications of which banks their customers use are likely to be perception-driven (Figure 34).

Figure 34: Banks which MSMEs' customers use (formal sector)



Managing Suppliers

Formal and informal businesses have similar patterns in terms of how frequently they purchase stock (Figures 35 and 36), which tends to be on a weekly or monthly basis.

While the interviews show that most suppliers to the informal sector demand full payment in cash on delivery (Figure 37), formal businesses are able to negotiate alternative payment terms (Figure 38). This is influenced by the level of trust suppliers have when dealing with a formal business.

Figure 35: Frequency of purchasing stock (informal sector)

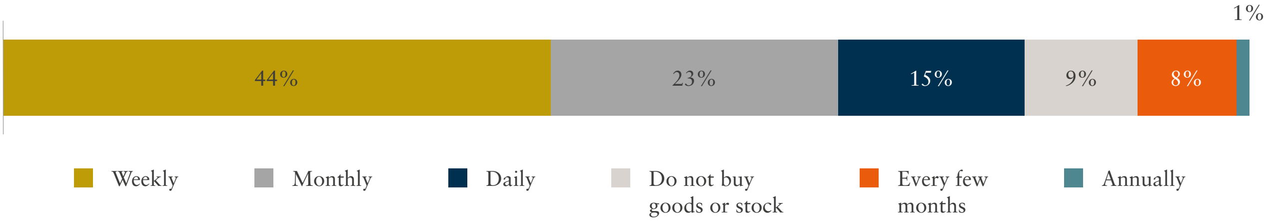


Figure 36: Frequency of purchasing stock (formal sector)

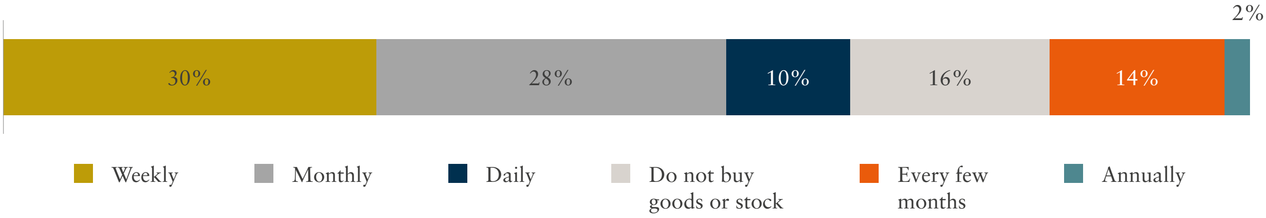


Figure 37: Supplier payment terms (informal sector)

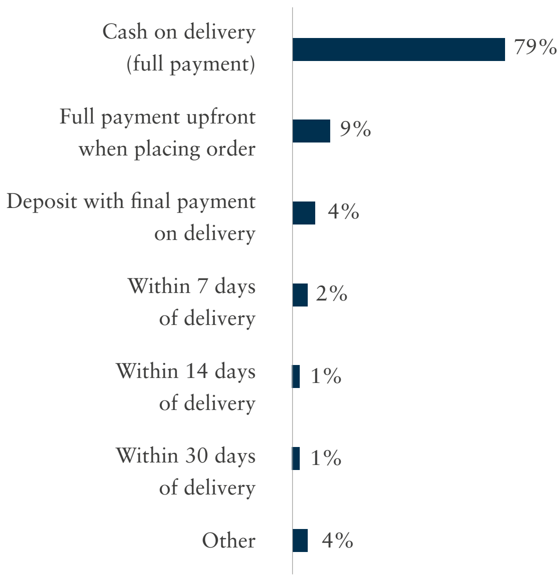
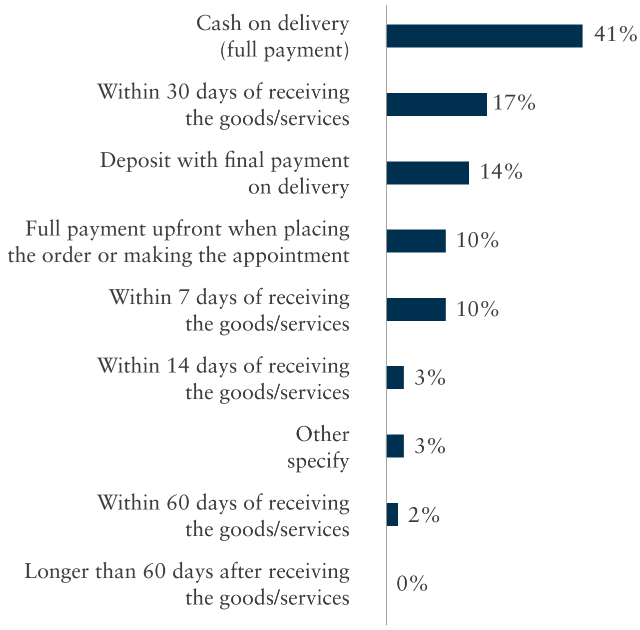


Figure 38: Supplier payment terms (formal sector)



Both formal and informal small businesses experience a lag between when payment is due to suppliers and when customers pay (Figures 39 and 40). However, the effects of this are slightly different for informal versus formal businesses. For informal small businesses, the gap arises because their suppliers demand upfront payment, suggesting that they are less able than formal businesses to negotiate delayed payment terms with these suppliers. Informal businesses are more likely to demand an upfront deposit from their customers as a result. On the other hand, formal businesses are often able to negotiate better supplier payment terms and, as a result, are less likely to demand a deposit from their customers.

Figure 39: Supplier versus customer payment (informal sector)

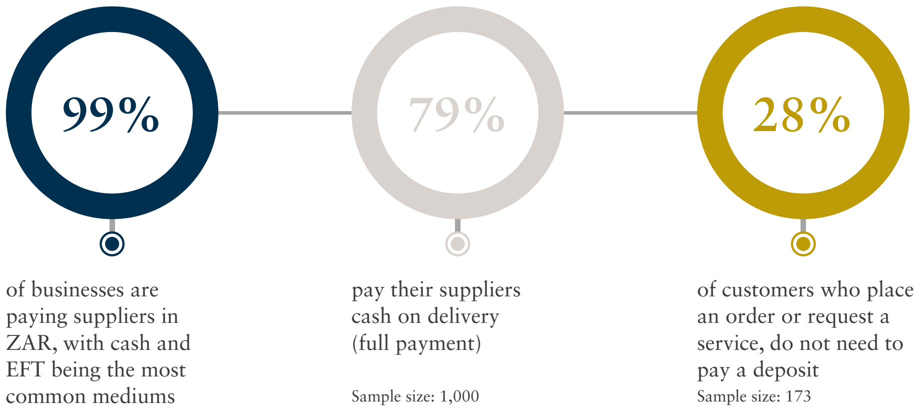
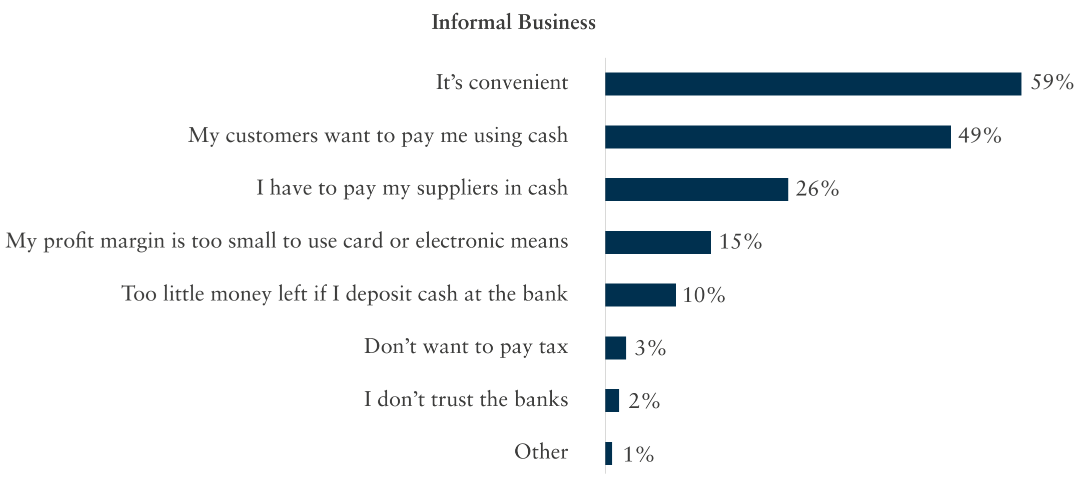
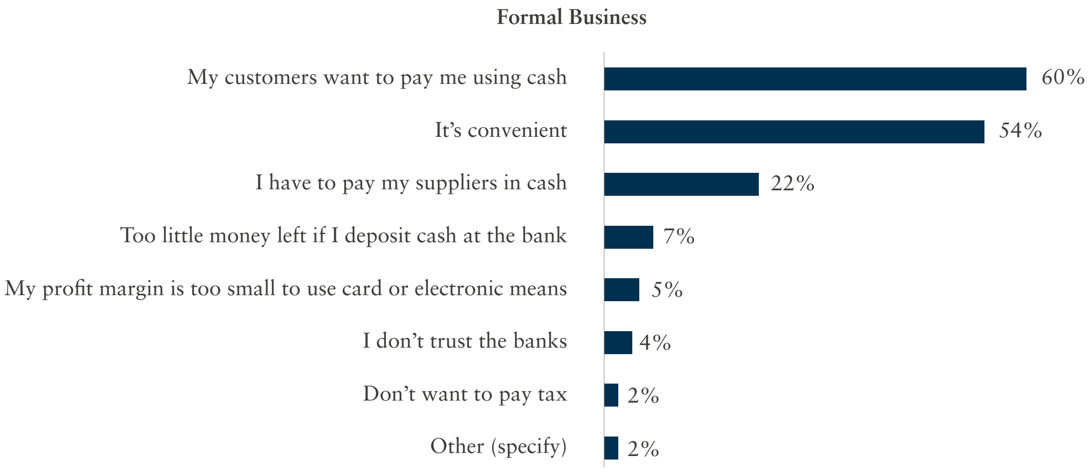


Figure 40: Supplier versus customer payment (formal sector)

Despite the greater flexibility formal businesses may have in paying suppliers, cash remains critically important for both types of businesses, because customers want to pay in cash, suppliers need to be paid in cash and it is the most convenient and inexpensive way of transacting when margins are low (Figure 41).

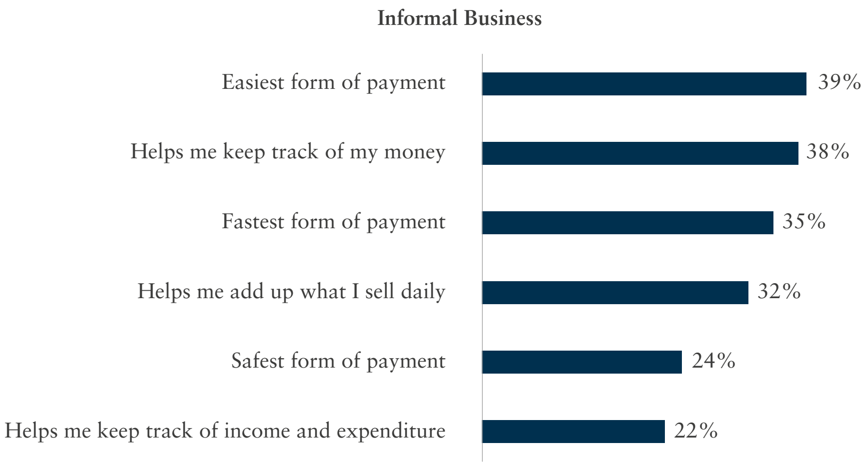
Figure 41: Reasons for using cash

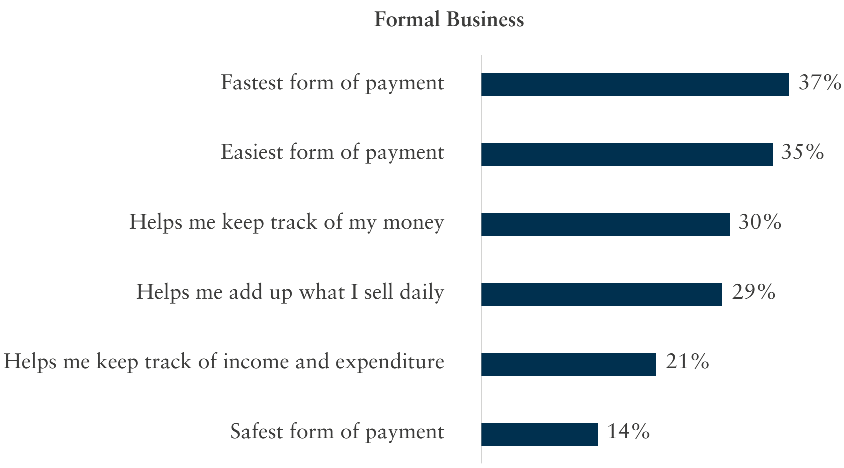




The research shows that MSMEs are strong believers in cash as the easiest, fastest and safest way of transacting and use it as a way to keep track of their money (Figure 42).

Figure 42: How using cash helps the business





Cash is lifeblood of small businesses in South Africa. Despite being banked, small businesses use cash as their primary means of transacting. Cash is not only the preferred medium for making and receiving payments it is the way the small business ecosystem function.

The main reasons for preferring cash are the facts that 59 percent of business owners find cash to be the most convenient way to transact and 39 percent regard cash as the easiest form of payment. 49 percent of their customers want to pay informal businesses in cash and 38 percent of business owners say that using cash helps them to keep track of their money. 95 percent of customers pay informal businesses for their products or services in cash, 77 percent of informal businesses pay their employees in cash. 86 percent of informal businesses pay their suppliers and vendors in cash, partly because 79 percent of supplier payment terms dictate cash on delivery with a further 9 percent demanding full payment upfront at the time of placing an order – 26 percent of suppliers demand payment from informal businesses in physical cash.

The prevalence of cash is not unique to the informal sector. Cash, at 31 percent, is the second most common method for paying employees amongst formal businesses. 63 percent of formal businesses' customers pay in cash, even though 82 percent of customers are repeat customers and familiar with the business. After electronic transfers, cash is the second most common form of financial exchange between businesses and suppliers, at 37 percent. Similar to reasons cited by the informal sector, formal businesses also regard cash as a fast, convenient and easy form of payment and 60 percent of formal business owners state that the main reason for using cash is because their customers pay them in cash. Formal businesses also explained the value of cash in helping them with financial management – cash helps business owners to keep track of their money, helps them to add up what they sell daily and helps them keep track of their income and expenditure.

Despite 99 percent of formal businesses being banked, only 14 percent of formal businesses stated that they receive no cash in their business. Of the 13 percent unbanked informal businesses, 57 percent cited that the main reason for not having a bank account is that they prefer to use cash. Similarly, of the 1 percent unbanked formal businesses, 59 percent said the reason for not having a bank account is that they prefer to use cash. However, unlike informal businesses, who tend to use most of their cash immediately, 58 percent of formal businesses deposit their cash at a bank, with 32 percent using cash received to pay salaries and wages, 20 percent using cash to replenish stock and 16 percent using cash received to pay for personal expenses.

Speed and ease of use are key drivers for using cash, despite concerns of safety when using this medium

What effect does being paid by cash have on your businesses?

The development and adoption of digital payment forms is therefore a complex matter. Convincing small businesses to switch to digital means of doing business will require fit-for-purpose transactional solutions which are not only safe and simple to use, but also address the more complex needs and requirements of small business owners such as the ability to keep track of their money, determine their profits and conduct daily reconciliations.

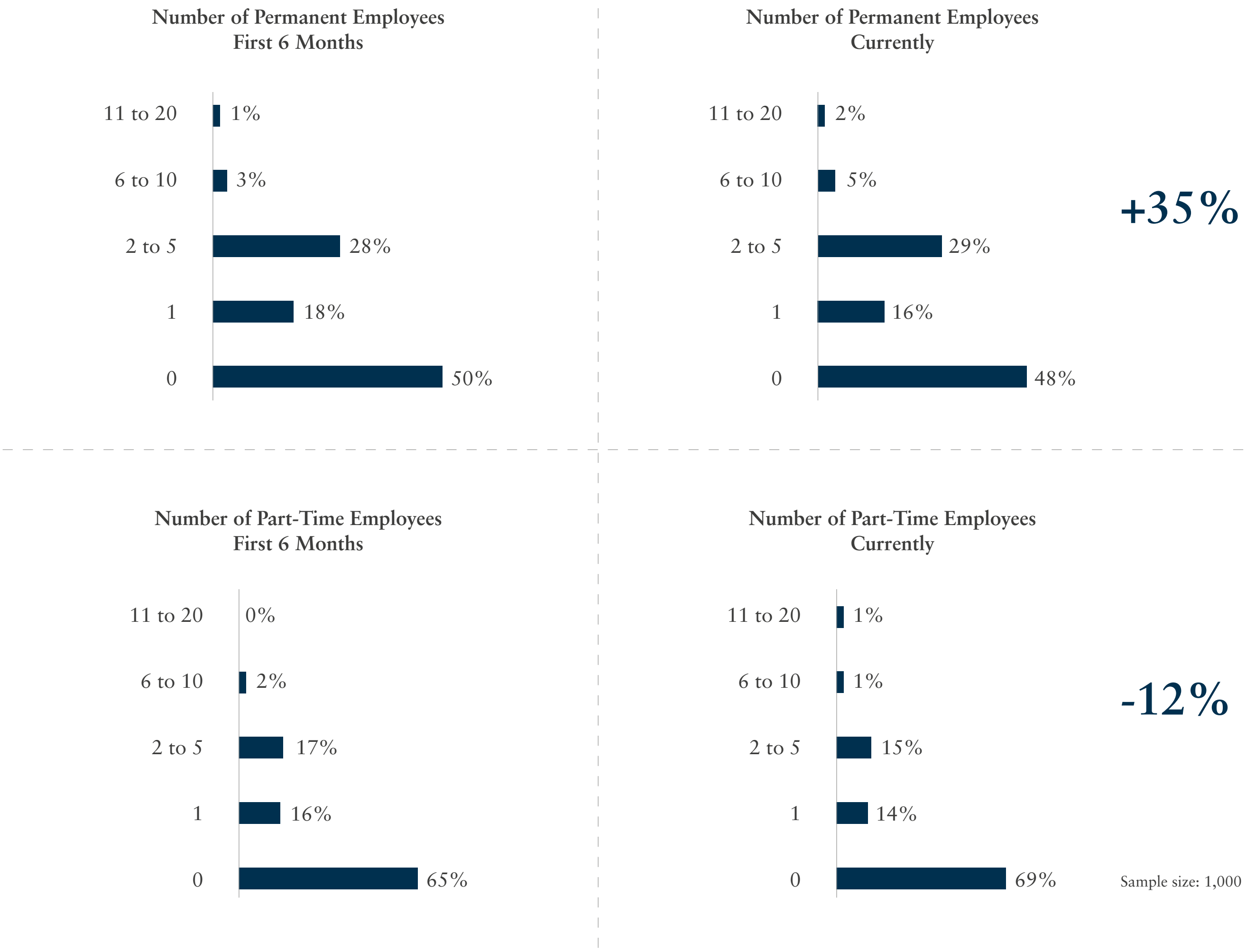
Digital solutions would also need to be fast and easy to use for small business owners to process sales and serve customers quickly, whilst also enabling businesses to collect and access their money quickly to assist MSMEs to manage their cash flow. In addition, digital solutions need to perform the functions people handling cash do naturally out of habit, without thinking. The impact of the change management required within small businesses themselves, as well as across the ecosystem, is significant.

Small Businesses and Their Employees

Micro businesses and start-ups are least likely to employ people, but as businesses grow and become more established, their ability to provide employment also grows, the interviews with business owners show. The qualitative research estimated that, at the stage when a business scales up, it often doubles the number of people that it employs. However, many small businesses are struggling to move out of the start-up phase, limiting their ability to create jobs.

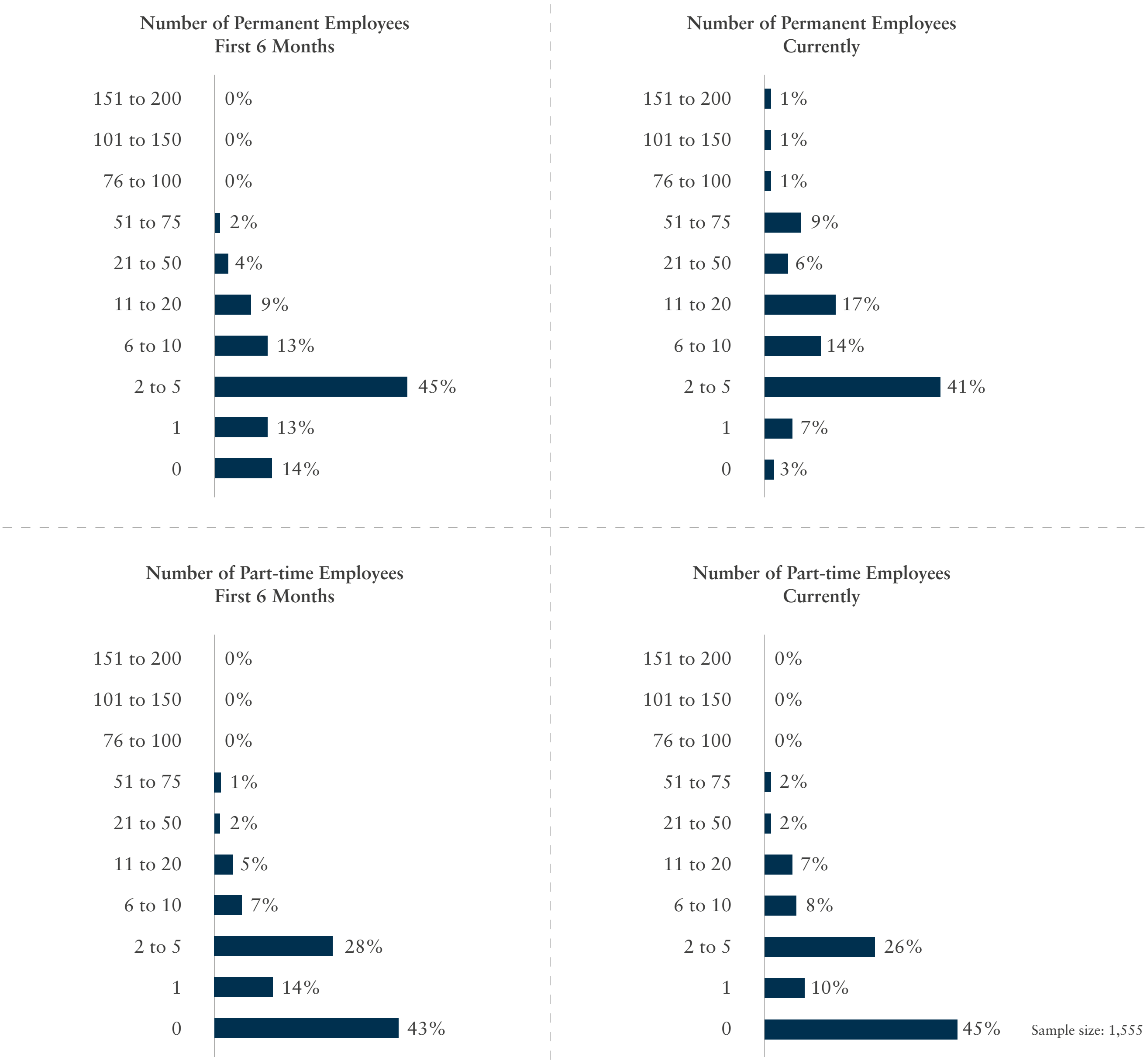
In the quantitative research, business owners were asked how many people they employed in the first six months of their existence and how many people they now employ. In the case of informal businesses, the number of both part-time and full-time employees is relatively stable (Figure 43). The interviews show that, as the business matures, it employs more full-time employees and fewer part-time employees.

Figure 43: Employees in first 6 months versus currently (informal sector)



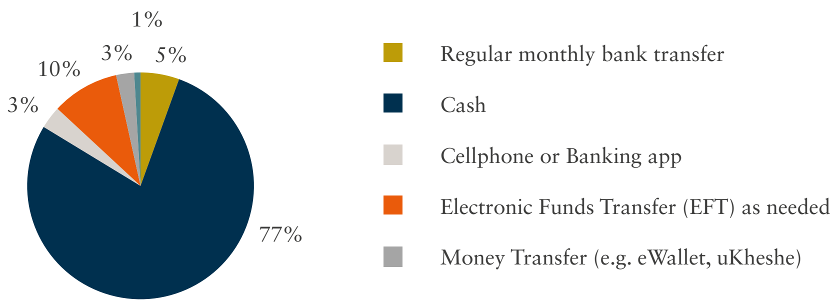
Small business employment trends show that formal businesses grow their workforce, with the percentage of businesses employing more than ten people increasing to 35 percent of formal businesses, compared to 15 percent of formal businesses at start-up. Like informal business, formal businesses tend to employ more full-time staff and less part-time staff beyond the first six months (Figure 44). However, formal businesses are likely to employ more people in the long-term than informal businesses. 53 percent of formal businesses reported an increase in permanent employment from start-up (first six months of operation) to their current date of operation. 57 percent of informal businesses reported no change in both permanent and temporary employment from the start-up stage to the current date of operation.

Figure 44: Employees in first 6 months versus currently (formal sector)



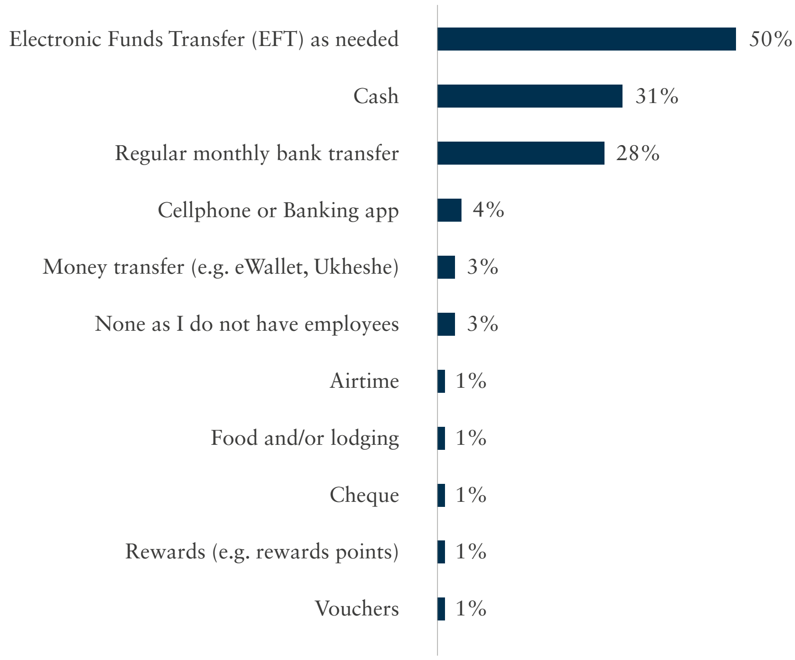
The interviews and survey show that 77 percent of small businesses pay their employees in cash with a monthly bank transfer a distant second (Figure 45).

Figure 45: Employee payment (informal sector)



While some formal businesses still pay their employees in cash, EFTs are the most common method of remuneration. Formal businesses tend to have accounting and payroll systems for record-keeping and tax compliance, which can be capitalized on for salary distribution. (Figure 46).

Figure 46: Medium used to pay employees (formal sector)



KEY FINDINGS

- *The small business sector is predominantly cash based across both the formal and informal sectors. Suppliers often need to be paid in cash, and customers pay in cash. Therefore, cash liquidity is a priority for small business day-to-day operations.*
- *Formal businesses have some advantages over informal businesses when it comes to their ability to smooth out the business cycle, acquire new customers and negotiate alternative payment terms with suppliers. These are key advantages that could be more effectively communicated and leveraged to advise informal businesses on their formalization decision-making.*
- *Formal businesses have more capacity to create employment. However, both formal and informal businesses are showing an increase in employing full-time staff and a decrease in employing part-time staff over the long-term.*

The team at Est Est Alea restaurant, Johannesburg, prepare for lunch.
Photo: IFC / Karel Prinsloo

4 Unlocking Access to Finance

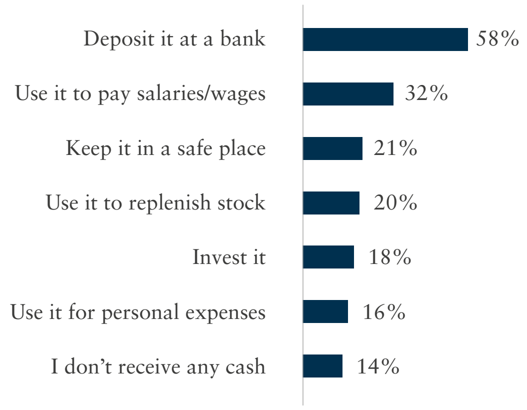
A major source of frustration for MSME owners is access to the finance needed to operate, remain liquid, and grow. The lived experience of owners is that applying for financing is an onerous process that takes them away from the important work of running the business, as well as a process that many feel unequipped to negotiate due to a lack of financial knowledge. It is not surprising then, that many opt to take loans from friends and family or turn to self-funding. It is also not surprising that many in the informal sector use their personal accounts for the business. Most business owners who have a business banking account opened it at the bank where the owner's personal account is held – an indication of the need for familiarity with the institutions and its processes. This section reviews how businesses deal with the revenue they receive, their approach to borrowing and risk, as well as banking penetration and which financial products and banks they are using.

Financial Overview

Both formal and informal small businesses operate almost exclusively in the local currency, the South African rand. This finding is in line with the research finding that cross-border trade is extremely limited in the South African small business sector.

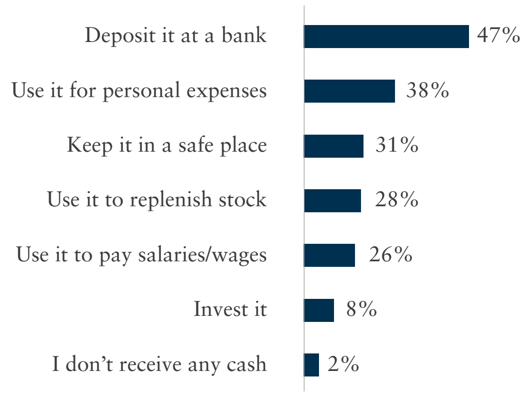
The research found that cash received is treated differently, depending on whether the business is formal or informal. Formal businesses are significantly more likely to deposit cash received into a bank account than informal businesses. Cash that is not deposited is largely used for the purposes of paying salaries or wages, kept in a safe place or used to replenish stock (Figure 47). Very few business owners in the formal sector use the cash earned at their business for personal expenses.

Figure 47: Use of cash received (formal sector)



In contrast, almost 40 percent of informal business owners are using cash received for personal expenses, the second highest use of cash received in the informal sector (Figure 48). This reflects the survivalist mentality present in the informal sector that has been described previously.

Figure 48: Use of cash received (informal sector)



Profits are also used differently depending on whether the business is in the formal or the informal sector. Formal businesses are far more likely to reinvest profits back into the business and, while this is also the top use of profits for informal businesses, their rate of using profits for personal expenses is much higher. This focus on the business, rather than on personal expenses, allows formal businesses to grow or become financially stable far more reliably than their informal counterparts (Figures 49 and 50).

Figure 49: Use of profits (formal sector)

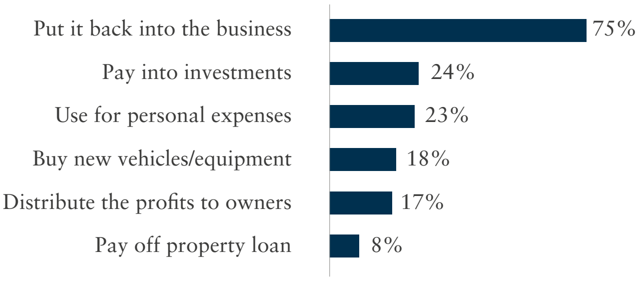
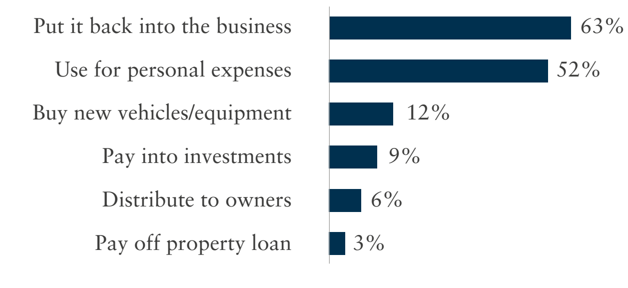


Figure 50: Use of profits (informal sector)



Funding, Borrowing and Risk

The qualitative research shows that, as a business matures, attitudes towards the financial risk associated with borrowing money changes. Businesses in the start-up phase and informal businesses interviewed are very risk averse and prefer to source funding from personal savings, retrenchment payouts or friendly lenders such as family and friends. However, as business and financial acumen grow, the desire to access formal loans from financial institutions increases, which can be reinvested in infrastructure that will help the business expand to new markets, hire more people or purchase assets. This could be in the form of a bank overdraft, business loan or equity investment.

The small business owners interviewed believe that most financial institutions are not willing to help them. Only medium-sized enterprises and some smaller businesses that have scaled up, have started to experience and regard financial institutions as investment partners, the interviews found. This skeptical view of financial institutions stems from experiences of rejection and expectation of rejection due to many of the smaller and informal businesses not being able to meet a bank's criteria for finance approval. To apply for finance small businesses need to provide a trading history, registration, a personal or business asset and a business plan. Many small businesses are not able, or prepared, to provide these. Interest rates are also perceived to be high and therefore risky. The interviews found that 43 percent of the small business owners said they would consider a low interest rate when choosing a bank or financial institution to borrow from for business purposes in South Africa.

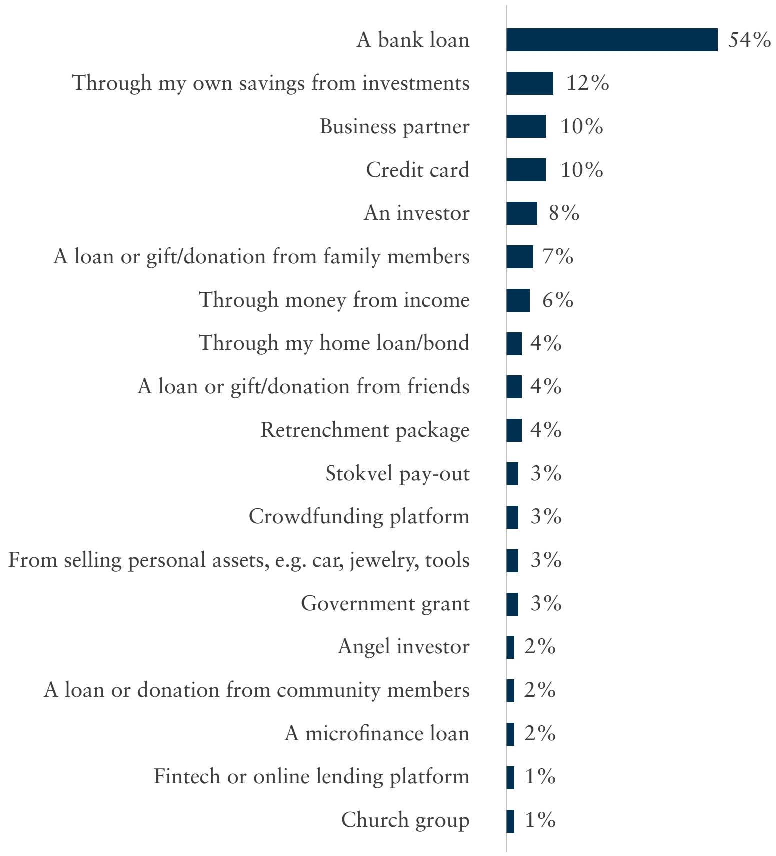
The interviews and survey found few small businesses owners are aware of private and government funding initiatives that are available outside of traditional financial institution credit lines. However, among those who are aware, few have been successful in terms of acquiring funding, and the red tape and criteria involved in applying makes accessing funding as difficult as accessing financing.

Accessing financing or funding can be overwhelming, with many small businesses not having the expertise to provide the documentation required such as financials, business plans and forms. Making processes simpler and more tailored to the reality of small business owners could unlock their ability to access funds and therefore the means to grow.

The interviews reflect the above wariness of borrowing money, with 79 percent of informal businesses stating that they have never borrowed money, and 58 percent of formal business saying the same. Formal businesses are more likely to have borrowed money at some point. However, 74 percent of formal businesses have not taken out a loan in the past 12 months and are not currently in the process of paying back a loan.

The interviews with business owners show that, while informal businesses largely access finance for maintenance and growth through informal channels such as family and friends, own savings, stokvel payouts and business partners, the use of bank loans is limited at 21 percent. Formal businesses are far more likely to use a bank loan for maintenance and growth of the business (Figure 51).

Figure 51: Source of finance for maintenance and growth (formal sector)



The scale of loans was also found to differ between the two sectors, with informal businesses mainly borrowing amounts between 1,000 rand and 50,000 rand, and formal businesses borrowing amounts between 10,000 rand and 500,000 rand, depending on the business size and requirements. Small businesses used loans for similar reasons across formal and informal sectors, namely to buy equipment, buy more goods, to start a business or to expand the business premises. The purposes for which money is borrowed is similar between the two sectors, it is simply the scale of borrowing that is substantially different.

The experience of applying for a loan is similar across both sectors, with some nuanced differences. Around 80 percent of small business owners interviewed said it took about seven days from loan application to approval or rejection, and an additional seven days from approval to receiving the funds in their bank accounts, a process totaling 14 days. Both informal and formal sector businesses had to fill in an application form that was as long as five pages.

Differences between the experiences of the two sectors center around the level of communication received while waiting for approval. Formal businesses said they were significantly more likely than informal businesses to be kept up-to-date with the progress of their loan application and were also more likely to be asked for additional information. This may be due to the greater amounts being borrowed and therefore both a higher standard of service as well as scrutiny being delivered by the bank (Figures 52 and 53). This seems to result in a much higher level of satisfaction with the loan application process amongst formal businesses compared to informal businesses (Tables 5 and 6).

Figure 52: Loan application process (formal sector)

79%
of businesses say it takes up to **7 days** from the day of applicaton until funds are in their account

13%
say it takes up to **15 days**

4%
say it takes up to **30 days**

4%
say it takes more **than 30 days**

75%
of businesses say it takes up to **7 days** from applying for a loan to when they heard they had been granted the loan

15%
say it takes up to **15 days**

4%
say it takes up to **30 days**

6%
say it takes more **than 30 days**

67%
of businesses said that the application forms were up to 5 pages long

81%
of businesses said that the bank kept them informed thoughout the process of application

45%
of businesses were never asked for any additional information, and **27%** were asked once

Sample size: 852

Figure 53: Loan application (informal sector)

88%
of businesses say it takes up to **7 days** from the day of applicaton until funds are in their account

6%
say it takes up to **15 days**

3%
say it takes up to **30 days**

3%
say it takes more **than 30 days**

81%
of businesses say it takes up to **7 days** from applying for a loan to when they heard they had been granted the loan

8%
say it takes up to **15 days**

4%
say it takes up to **30 days**

7%
say it takes more **than 30 days**

85%
of businesses said that the application forms were up to 5 pages long

65%
of businesses said that the bank kept them informed thoughout the process of application

57%
of businesses were never asked for any additional information, and **28%** were asked once

Sample size: 224

Table 5: Satisfaction with loan (formal sector)

Satisfaction with loan	
Loan amount you received in comparison to how much you applied for	79%
The communication from the bank/s during the process	78%
The time between applying for the loan and receiving the funds	78%
Your overall loan application experience	77%
The waiting period to hear if you were granted the loan	76%
The length of the application forms for the loan	72%
The interest rate you were charged	68%
Fees charged	63%

Table 6: Satisfaction with loan (informal sector)

Satisfaction with loan	
The communication from the bank/s during the process	67%
Loan amount you received in comparison to how much you applied for	62%
The time between applying for the loan and receiving the funds	62%
The waiting period to hear if you were granted the loan	60%
Your overall loan application experience	59%
The interest rate you were charged	57%
The length of the application forms for the loan	57%
Fees charged	53%

Most of the formal and informal businesses said they would not take out a personal loan for business purposes with 91 percent of informal businesses and 73 percent of formal businesses saying this. In addition, very few business owners who borrowed money had to be referred for debt counselling. Only 5 percent of informal businesses who borrowed and 2 percent of formal businesses needed debt counseling.

The formal and informal businesses interviewed said that they did not intend to borrow money in the future, at 72 percent of formal businesses and 61 percent of informal businesses.

The business owners that are considering applying for a loan said they will likely apply for an amount between 1,000 rand and 50,000 rand for informal businesses and between 10,000 rand and 500,000 rand for formal businesses. The common plans for the loan include equipment or stock purchases and other expansion initiatives. Property, vehicles and equipment are most commonly mentioned as the form of collateral that the business is willing to put up in order to secure the loan. However, quite a large portion of both formal and informal businesses do not have any of those forms of collateral, with 48 percent of formal businesses and 66 percent of informal businesses interviewed stating they don't. This heightens both the likelihood and expectation of rejection by the bank.

Affordability, trust, convenience and service are the attributes that businesses are looking for in deciding which financial institution to borrow from. This is common across both formal and informal businesses (Figures 54 and 55).

A vet at work at the Mzananda Animal Clinic in Khayelitsha, Cape Town, South Africa. Photo: Trevor Samson / World Bank

Figure 54: Important factors in selecting loan provider (formal sector)

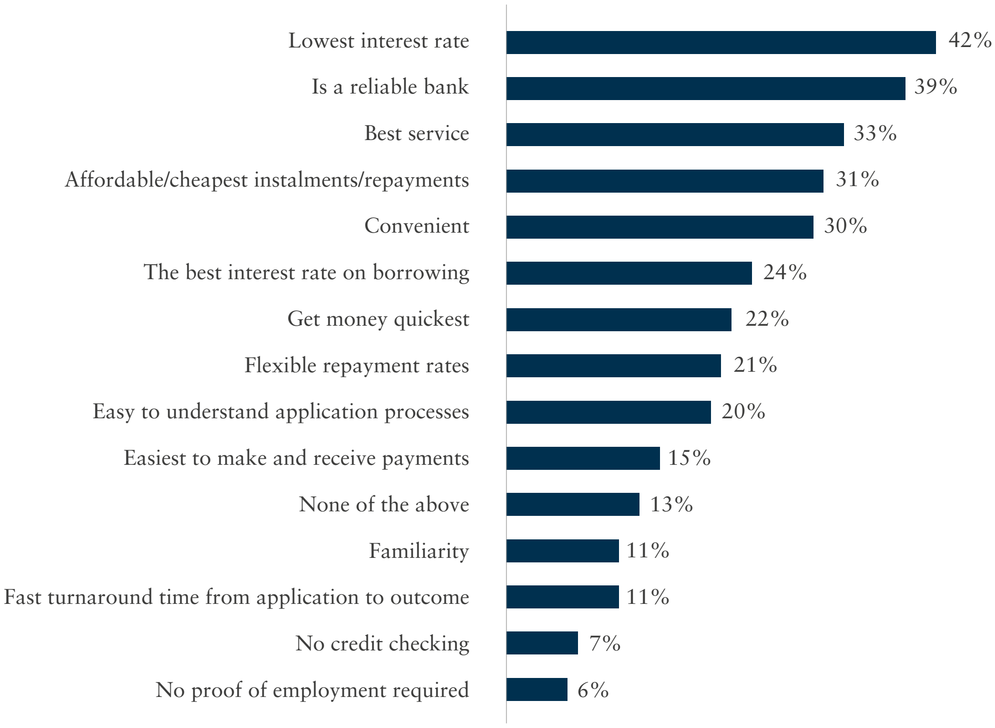
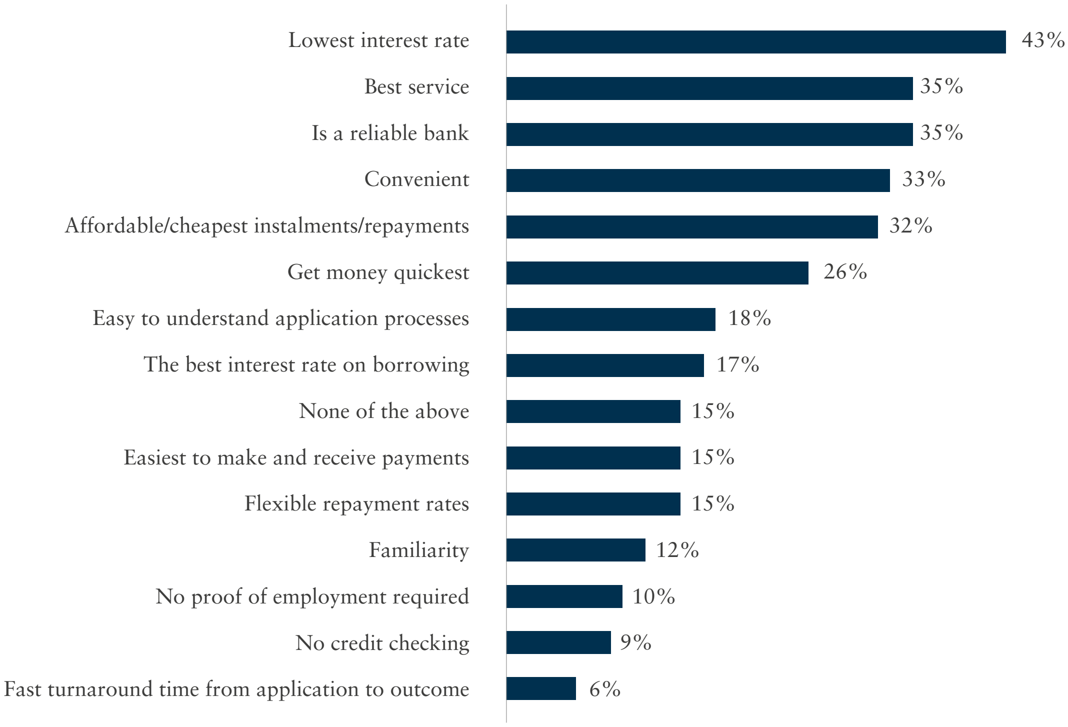


Figure 55: Important factors in selecting loan provider (informal sector)



In terms of risk, formal and informal businesses perceive the same top risks to their businesses (Figures 56 and 57). The perception of reported risk is consistent along the continuum of formality. The risk of theft, which incorporates both equipment and stock, is top of mind for business owners, indicating a need for theft prevention mechanisms with regard to safety and security at business premises, particularly regarding stock and equipment. Another top reported risk is the loss of earnings in the form of income, and in the form of threat to employment, due to bankruptcy. Mitigating the risk to loss of income or bankruptcy can be explored via offering financial planning and management skills, including forecasting capabilities, to ensure financial stability and longevity of the business.

Figure 56: Top perceived risks (formal sector)

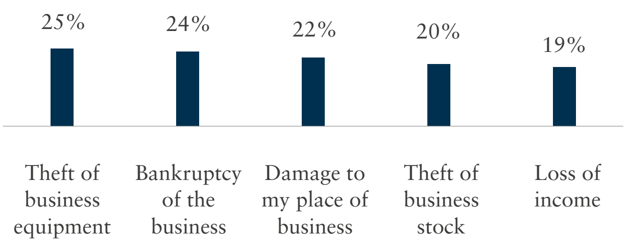
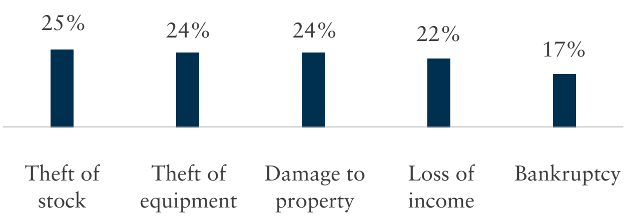


Figure 57: Top perceived risks (informal sector)



However, formal businesses are far more likely to have some form of business cover than informal businesses, although only one third have business insurance specifically. Informal businesses tend to have personal insurance products if they have any type of insurance at all (Figures 58 and 59).

In the case of both formal and informal businesses, the key reason for not having insurance coverage for the business or its assets is due to the added expense of having cover with 65 percent of informal business interviewed saying it is too expensive and 61 percent of formal businesses saying the same. While small businesses are risk averse when it comes to debt, they are prepared to take the risk of not having insurance.

Figure 58: Top risk cover in place (formal sector)

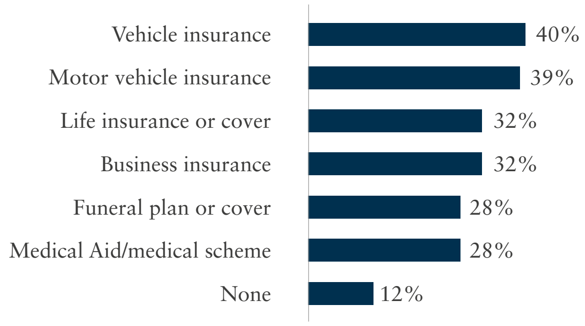
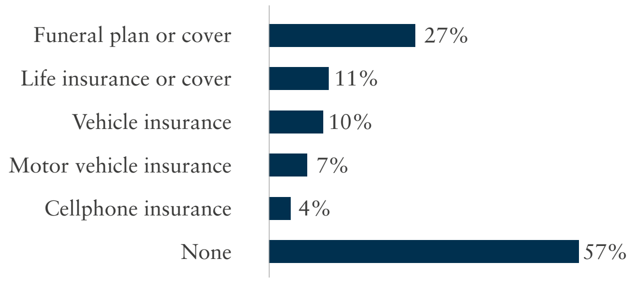


Figure 59: Top risk cover in place (informal sector)



Banking Penetration

The research shows that most small business owners are banked in some capacity, with 87 percent of informal businesses and 99 percent of formal businesses banked. However, most informal businesses are using their personal accounts to transact on behalf of the business. Only 21 percent transact exclusively using a business account for the business, while 61 percent use a personal account or a combination of personal and business accounts. This is in contrast with 70 percent of formal businesses interviewed who use a business account for their business, versus 16 percent who use a combination of personal and business accounts or a shared business account.

For informal businesses who are unbanked, the key reasons provided for not being banked is that they are operating on a purely cash basis (57 percent) and that bank fees are too expensive (36 percent). This reflects the finding that these businesses tend to be operating in survival mode and expenses like bank fees are viewed as unnecessary costs. Those who are using their personal accounts for business banking rather than opening a separate account are quite satisfied that their personal account is enough (29 percent), and that they do not need a separate account because their business is not registered

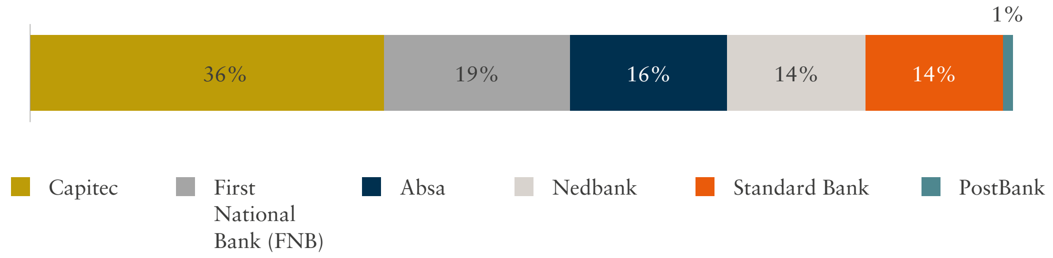
(24 percent) and the business income does not justify having a separate account (19 percent). The small number of formal businesses who use their personal account have similar justifications for not having a separate bank account.

There is a stark difference in terms of the way formal and informal small businesses are banked and each is discussed in more detail in the following sections.

Informal Sector

In the informal sector, businesses tend to make use of only one bank, and that bank tends to be the personal bank of the business owner. Capitec leads the other major banks as the financial institutions most used by the small business owners interviewed, achieving a penetration of almost double the next most used small business banking brand, FNB (Figure 60).

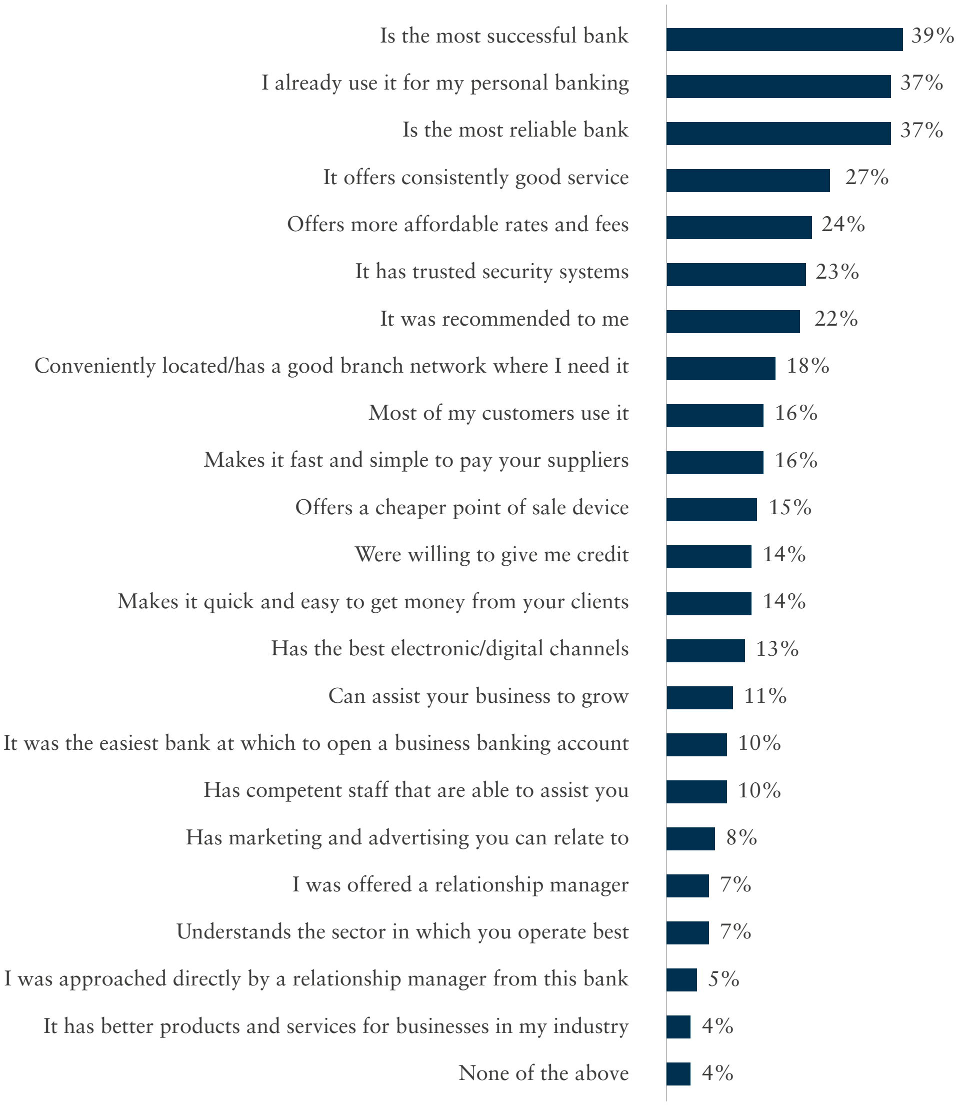
Figure 60: Main bank used for business banking (informal sector)



Khayelitsha Craft Market, Cape Town, South Africa.
Photo: Trevor Samson / World Bank

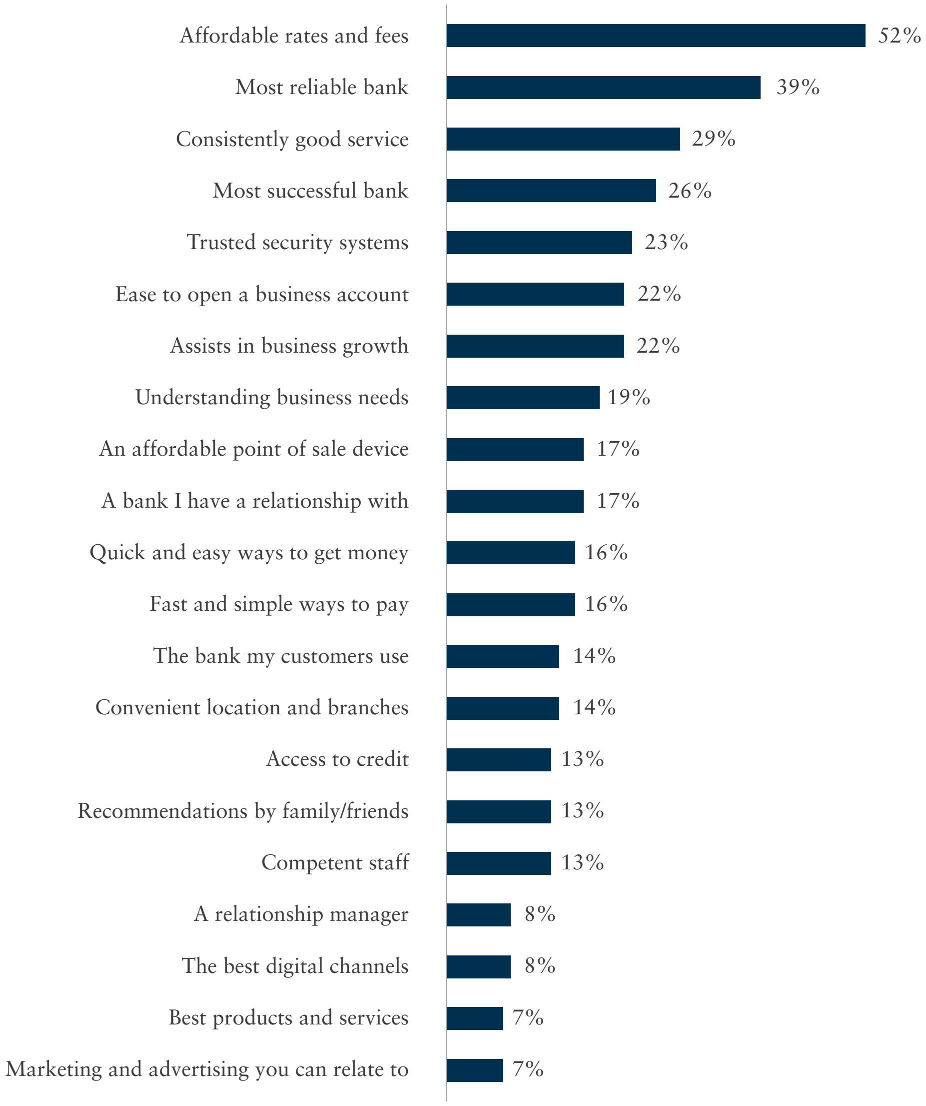
Amongst small businesses that are banked, the top two reasons for selecting a bank for business banking are that it is perceived to be successful and reliable, and therefore a safe place for their money, and that they already use it for their personal banking (Figure 61).

Figure 61: Reasons for choice of business bank (informal sector)



When both banked and unbanked small business owners were asked what they look for in a bank for their business, they said affordability and reliability are the most critical factors (Figure 62).

Figure 62: Reasons for choice of service provider (informal sector)

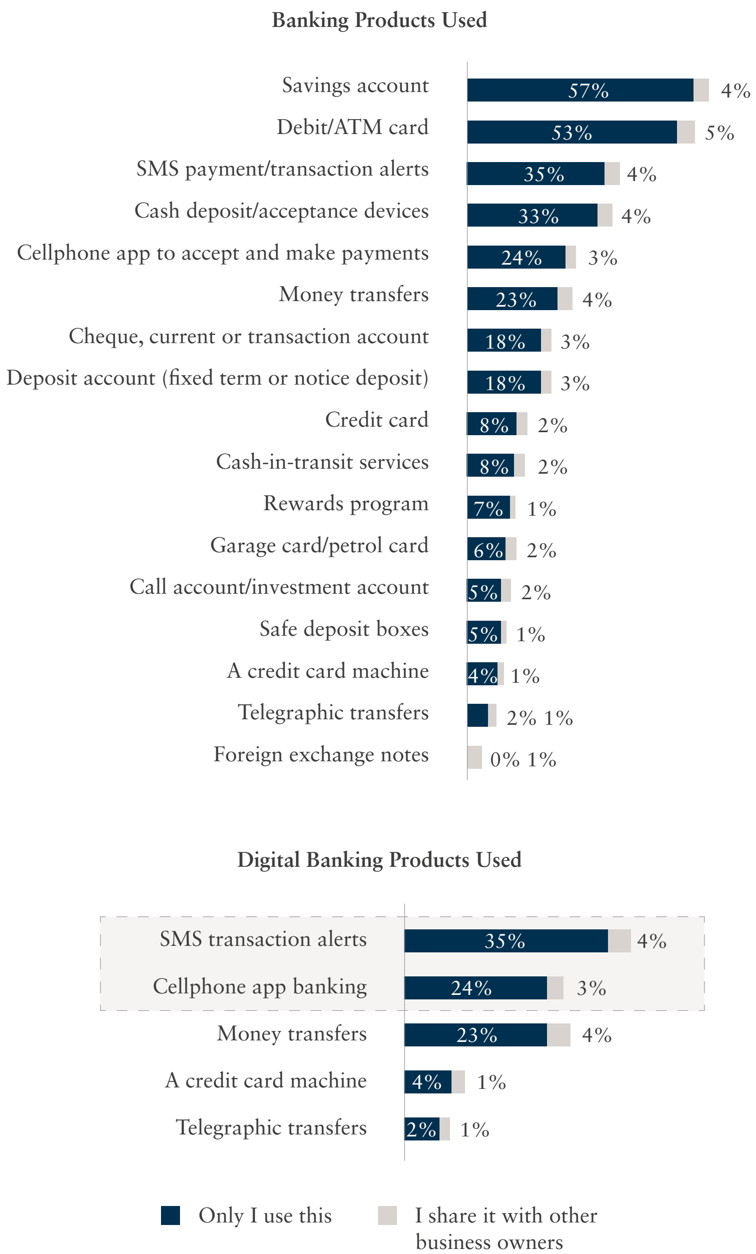


Interviewees that use Capitec said the bank is perceived as having affordable fees, cheaper point of sale devices, and is also seen as being accessible to informal businesses. This has led to its dominance in the informal sector, particularly at the lower end of the informal sector where the use of Capitec skews towards small businesses with a daily turnover of below 1,000 rand, as well as towards younger owners and women owners.

FNB is differentiated on aspects such as offering relationship managers, product range and services for businesses. These attributes appealed to business owners interviewed who have stepped out of the survivalist mindset and therefore are considering needs beyond the cost of the bank account.

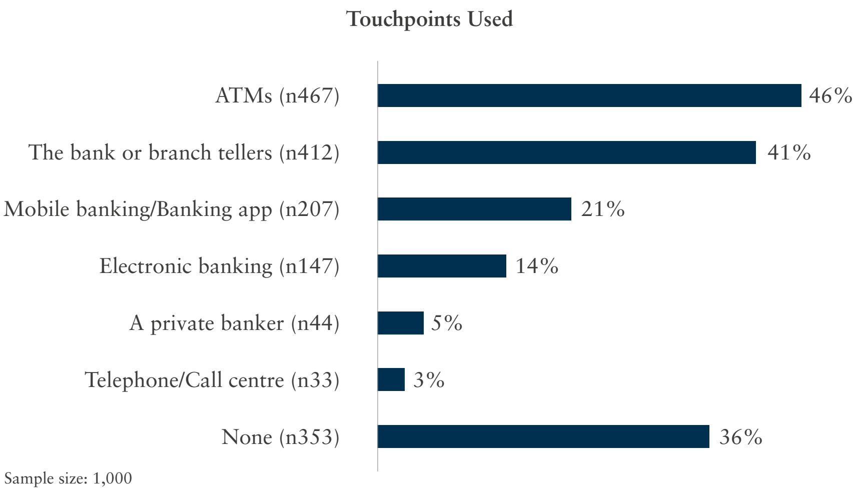
The banking products used by informal businesses who are banked are relatively basic – a savings account and debit/ATM card are the two key products. Only around one-third of informal businesses are using some form of digital banking product and this tends to be in the form of an SMS transaction alert service, cellphone banking and/or money transfers (Figure 63).

Figure 63: Banking products used (informal sector)



Most interactions with financial institutions are digitally via ATMs or physically by going into a bank branch. The main reason for using ATMs is convenience. The advantage of going into a bank is the sense of safety that it provides due to the environment and security measures in branches, as well as the ability to get advice when the task at hand is more complex (Figure 64). With 95 percent of customers paying informal businesses in cash and 86 percent of informal businesses paying their suppliers or vendors in cash, the need for physical financial infrastructure in South Africa remains critical and relevant until the informal business ecosystem adopts digital payment mechanisms.

Figure 64: Touchpoints used (informal sector)



Top Three Reasons for Touchpoint Usage	
ATM	54% easy to use
	51% saves me time
	42% more convenient
Bank or Branch Tellers	48% safe to use
	47% easy to use
	29% get best advice
Mobile Banking/ Banking App	53% saves me time
	48% easy to use
	39% safe to use

Sample size: 1,000

Formal Sector

Like the informal sector, most formal businesses are using only one bank for their business banking, but FNB dominates amongst this sector, followed by Standard Bank and Absa (Figure 65). Formal businesses choose their business bank for reasons that include reliability, service and where they already bank personally.

Figure 65: Main bank used for business banking (formal sector)

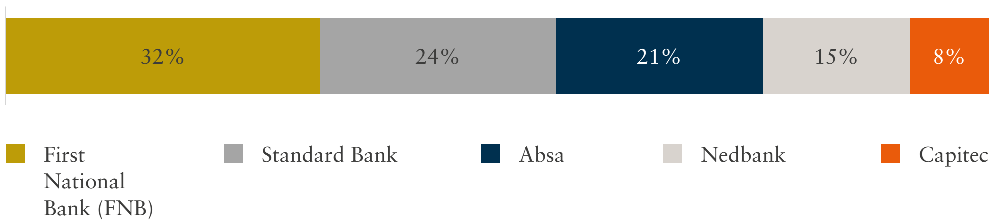
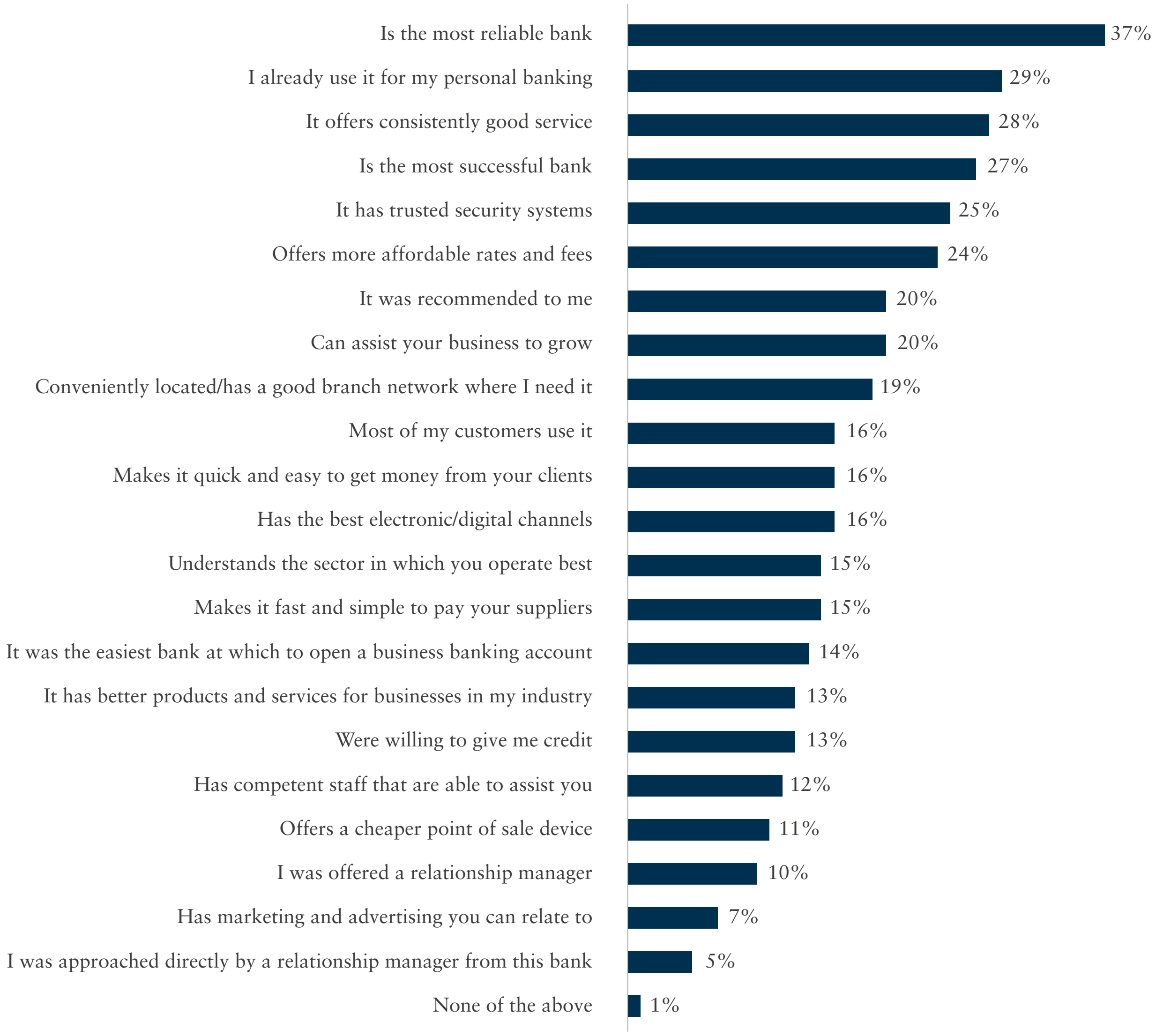
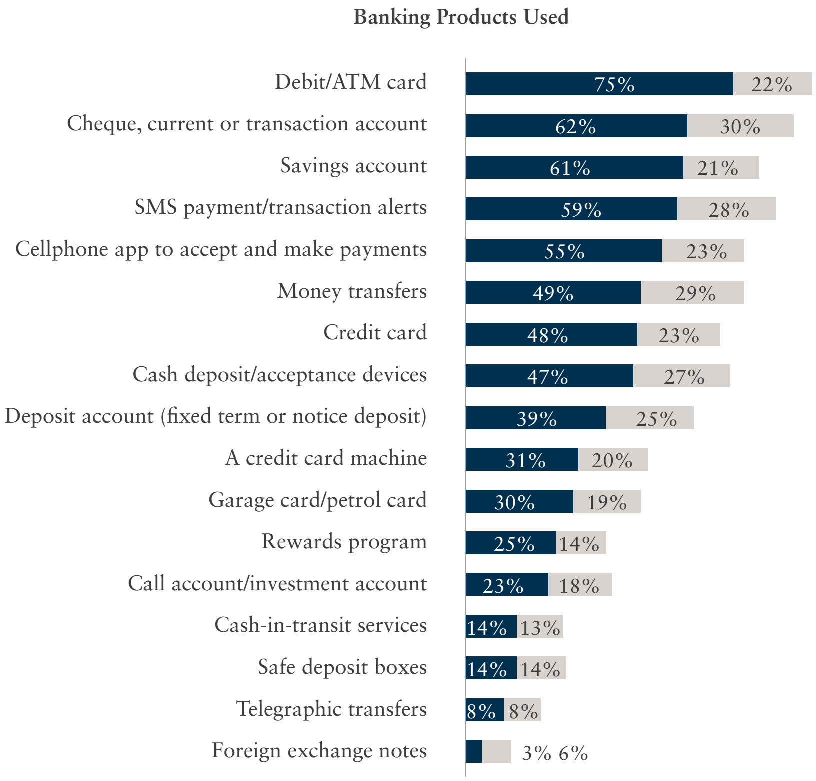


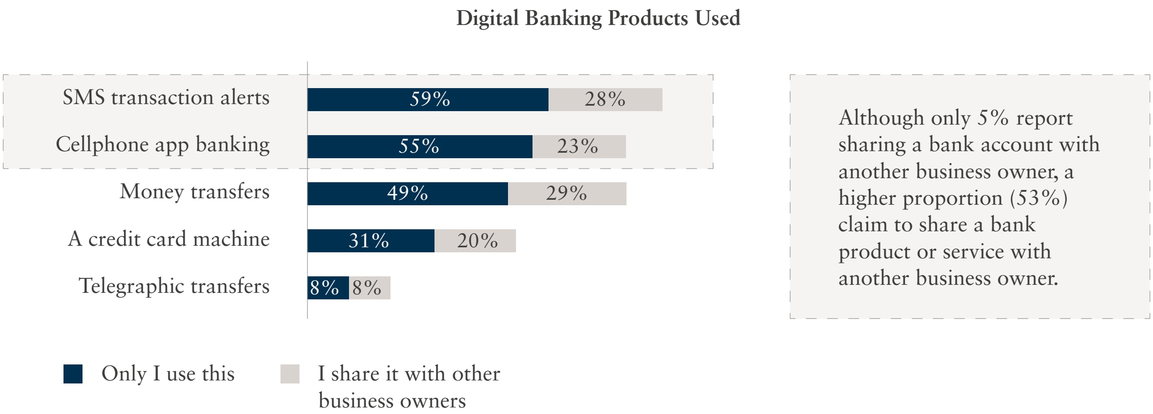
Figure 66: Reasons for choice of business bank (formal sector)



Formal businesses are using a much broader array of financial products than the interviews found for informal businesses, reflecting their more complex needs (Figure 67). There is also a much higher incidence of sharing these facilities with other business owners.

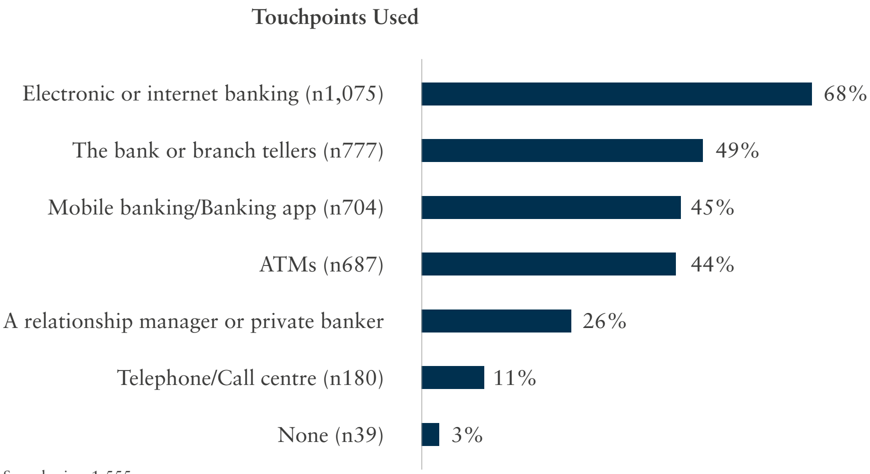
Figure 67: Banking products used (formal sector)





Banks used by the formal sector are differentiated on value-added offerings such as rewards programs, forex tools, petrol cards and telegraphic transfers. Formal businesses are looking for value-added benefits over what they perceive banks to have as standard offerings (Figure 68).

Figure 68: Touchpoints used (formal sector)



Top Three Reasons for Touchpoint Usage	
Electronic or Internet Banking	**44%** saves me time
	39% safe/easy to use
	38% more convenient
Bank or Branch Tellers	**42%** easy to use
	40% safe to use
	29% more convenient
Mobile Banking/ Banking App	**44%** saves me time
	43% easy to use
	41% more convenient

Sample size: 1,555

The research shows that formal businesses are far more likely than informal businesses to be digitally engaged with higher use rates for either internet or mobile/app banking. This is largely due to convenience and a perception of safety. Branches and ATMs are also still widely used in this sector, presumably when it is necessary to conduct tasks such as depositing cash takings.

Fishing vessels arrive back in Hout Bay harbour, Cape Town, South Africa.
Photo: John Hogg / World Bank

KEY FINDINGS

- *Informal and formal small businesses are risk averse when it comes to debt, but are risk takers when it comes to insurance. The uptake of business insurance is low and even personal forms of insurance are low amongst informal businesses. Insurance is viewed as an expense that they cannot afford, given other priorities.*
- *Small businesses tend to view financial institutions as transactional rather than as business partners when it comes to financing. There is a substantial skepticism around the interest rates charged and also a fear of rejection, along with the rigorous criteria and processes associated with applying for a loan.*
- *There is limited awareness of funding options beyond traditional bank loans and many small businesses confuse funding with financing. However, those who are aware of it, report similarly complex requirements and application processes that often preclude them from receiving funding.*
- *The result is that many businesses, particularly informal businesses, tap into informal sources of finance they may have available before considering a loan.*
- *Formal business owners are far more likely to take out financing for their business than informal business owners, and when they do, they tend to borrow larger amounts. However, borrowing is an infrequent occurrence and usually linked to substantial purchases such as equipment or business expansion. Business expansion refers to scaling or opening additional stores or outlets.*
- *Formal businesses have a higher level of satisfaction with financial institutions when it comes to the loan application processes compared to informal businesses.*
- *Informal businesses have simpler banking needs and tend to use their personal banking accounts for business purposes if they are banked. Informal business owners' focus is on finding a reliable provider at the lowest cost.*
- *Formal businesses have more complex banking needs. They are looking for value addition to basic banking products offered.*
- *For both formal and informal businesses, the bank chosen for business banking is typically the bank where they have their personal accounts and already have a relationship with.*
- *Formal businesses are far more likely to use electronic/digital forms of banking than informal businesses, who appear to prefer more traditional banking channels. That said, there is some penetration of mobile banking amongst the informal sector, which suggests that this platform provides the best means of converting some of their cash activity to a digital platform.*
- *The use of digital banking though, will always remain constrained as long as businesses continue to operate strongly on a cash-based platform.*

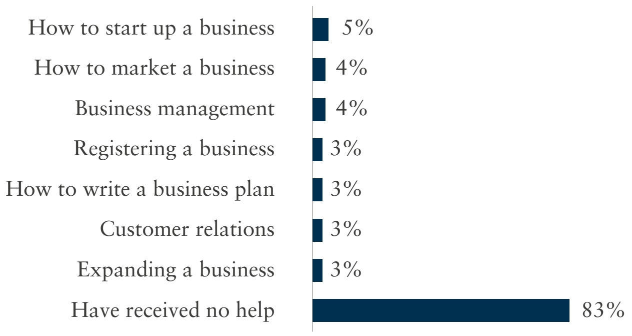
5 Building Small Business Knowledge Services

Small business owners recognize that they have knowledge gaps in terms of business and financial acumen and want to learn and network. The small business sector business acumen varies across the maturity, size and formalization spectrum. At the micro informal end of the spectrum, there is very little business and financial knowledge. This increases as businesses grow and formalize. As with interventions aimed at addressing financial challenges, initiatives and non-financial support need to be tailored to individual types of small businesses.

Informal Sector

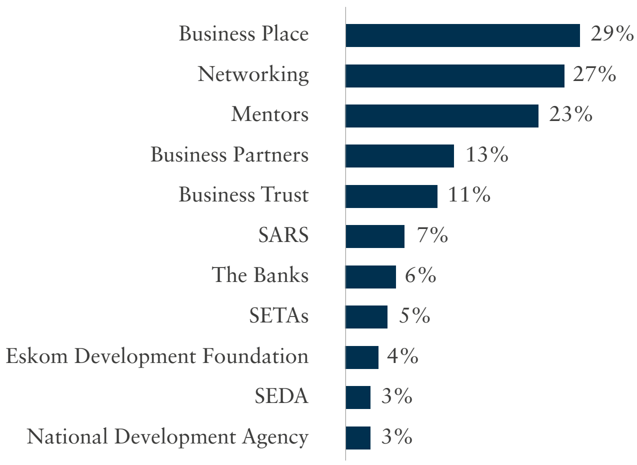
Most informal businesses have never received any sort out training (Figure 69).

Figure 69: Top 5 types of training received (informal sector)



If the business owner received training, it was most often informal, such as through a mentor, business partner or networking (Figure 70).

Figure 70: Sources of training (informal sector)

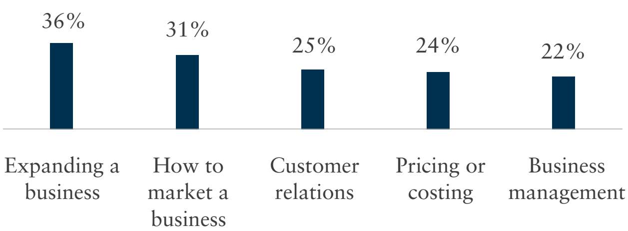


Only 6 percent of informal businesses interviewed are aware that their bank offers training. A similar lack of awareness exists around government initiatives, with only 28 percent of owners interviewed saying they are aware of these opportunities. However, 15 percent of informal businesses are taking advantage of government initiatives, whether that be training or funding), indicating an uptake level of such programs of 54 percent amongst those who are aware of them. This suggests that a concerted awareness campaign could go a long way to stimulate participation in these programs.

Most business owners interviewed indicated that they would like training to be conducted in English (70 percent), while 30 percent would prefer to be trained in their home language, the most commonly mentioned of which were isiZulu and isiXhosa.

The top topics on which informal businesses would like to be trained are given below (Figure 71). These training needs reflect a desire for basic business training amongst informal small business owners.

Figure 71: Top training needs (informal sector)



The research showed a lack of digital banking in the informal sector, and this theme continues with very low preferences for online training amongst this group. Only 4 percent said they would prefer online training options, and 3 percent said they would like an app-based training system. The majority said they would prefer face-to-face training at 93 percent, and mentorship or coaching at 18 percent. Mentorship and coaching skews particularly towards younger informal business owners and those in the start-up phase of a business.

Formal Sector

Like the informal sector, the research shows that the majority of formal businesses have not received any training and, where they have, much of it has been through informal channels (Figures 72 and 73). That said, there has been more formal training experienced in this sector than in the informal sector overall.

Figure 72: Top types of training received (formal sector)

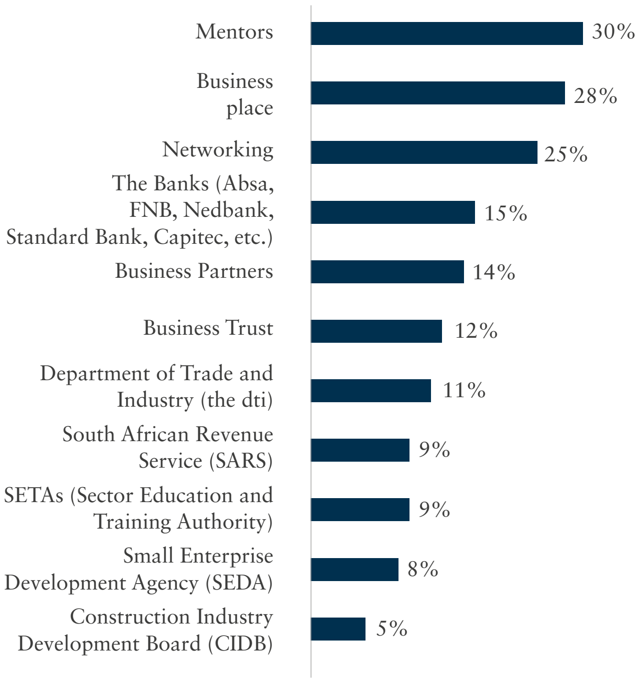


Figure 73: Sources of training (formal sector)

Only 19 percent of formal businesses were aware that training was offered by financial institutions, while 96 percent were aware of government initiatives, programs and funding. In addition, 64 percent of formal businesses have participated in such initiatives, which points to an uptake of 67 percent amongst formal businesses. That said, it is more likely that it is the funding rather than the training aspect of these initiatives that these businesses are aware of and have taken up since the majority have had no training. This suggests that if banks could raise awareness of their initiatives, the uptake could be substantial.

Over 80 percent of formal businesses would prefer training to take place in English, and their training needs are like those of informal businesses, although it is likely that this would be at a less basic level than for informal businesses, given the higher level of business and financial acumen that formal businesses tend to have (Figure 74).

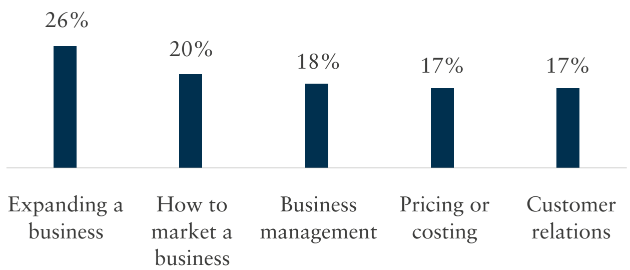


Figure 74: Top training needs (formal sector)

There is a greater appetite amongst the more tech-savvy formal sector for digital forms of training. However, face-to-face is still the preferred method overall (Figure 75).

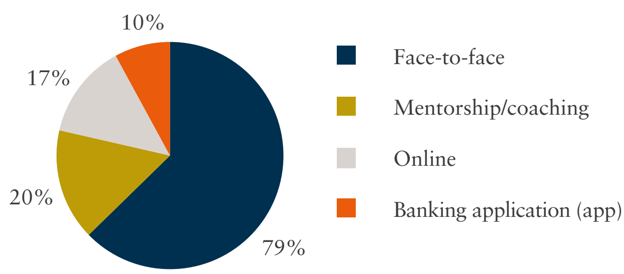


Figure 75: Preferred medium of training (formal sector)

KEY FINDINGS

- *There is a strong desire for input and training at every level of the small business spectrum, although the training needs differ along the spectrum.*
- *Most of the formal and informal business owners have never received any type of training, and many of those who say they have, have received informal training through the likes of networking, mentors and business partners.*
- *More awareness needs to be driven around training initiatives offered by financial institutions and government, as there is low awareness of these (especially amongst the informal sector), but uptake is good amongst those who are aware.*
- *Informal sector training needs to be focused on business basics at a simple level. Formal business also shows a need for business basics training, but it is likely that this is required at a more advanced level, given their generally higher levels of business and financial acumen.*
- *While there may be a place for digital training platforms amongst the formal sector, face-to-face is preferred by the vast majority as the medium through which training needs to occur.*
- *English is the preferred language for training. However, particularly in the informal sector, there are some who would prefer to be trained in their home language.*

A sculptor at work in his studio.

6 The MSME Segmentation Model

The small business sector is complex and not homogenous. Helping the sector to thrive will involve resisting the temptation to treat all small businesses as one. Apart from the obvious difference in terms of size and turnover, business needs and challenges differ based on stage in the business lifecycle, outlook and level of formalization. This section explores the different business typologies that exist, and presents a segmentation model that will help institutions to tailor their initiatives more accurately, so that these initiatives create the impact desired. The typologies are informed by the 2,555 interviews with small businesses across South Africa.

Qualitative Business Typologies

The qualitative research uncovered four key business typologies driving different behaviors amongst small businesses in terms of their approach to the management of money, time and human resources. Driving these typologies are a combination of owner mindset, survivalist through to entrepreneurial, business maturity and an understanding or knowledge of business and finances. The four typologies uncovered were:

Survivalists

Survivalists are owners with little financial and business acumen, who value financial stability but don't know how to achieve it. They have often been forced into the MSME sector through loss of, or lack of, employment. In other words, they had no choice. They often start the MSME journey with very few resources and are therefore extremely cautious and risk averse when it comes to spending money on the business. They mostly live hand to mouth and spend the little they earn on personal financial survival. The businesses they own tend to be micro and informal.

A small business owner makes breakfast pastries called 'Magwenya' in Freedom Square, Soweto.
Photo: IFC / Karel Prinsloo

Figure 76: Survivalist portrait

Portrait of Survivalist Segment

CAUTIOUS	RISK/DEBT AVERSE	CONSERVATIVE

"...the hardest experience is when you don't know how to pull the crowd, how to bring the customers, so everything may flow..."

"You have to know what customers around you want."

"...even the salary, it is hand to mouth, so it is not that we have to put it in the bank because it is in and out."

"We will save money by rather buying things in smaller quantities instead of big bulk."

Age of business: 18 years.

Industry: Trade/General Dealer.

Fnancial Products: Personal bank account, cellphone banking.

Revenue Source: Cash sales on goods.

Start-up Finance Source: Family.

Business Systems: Paper records of sales and invoices ONLY to monitor pricing and track demand; order book, cash till.

BUSINESS JOURNEY

- Borrowed money to purchase a small shop space that was a bakery.
- Learnt how to operate stock from her sister, also a shop owner.
- Gradually added products to general merchandise as demand shifted – hair products, hardware, blankets, electricity, airtime.
- Never applied for financing as bank interest is too high.
- Knows of grant funding by SEDA and YDA, but it's a waste of time to fill in all the forms.
- Understands a registered business can get money back from SARS, but paperwork is too arduous and turnover is below threshold.
- Have built a customer base on WOM.
- Not considering computerising tills or purchasing POS, as too expensive.

A DAY IN HER LIFE

- She monitors stock, orders, sales, invoices, receipts and pricing – add 50% mark-up.
- Detailed record-keeping of items sold vs what is left in stock in a ledger.
- Bank cash once a week on averages and only if a big payment is coming up (e.g. R5,000) as prefer to pay electronically.
- Live hand to mouth on cash coming in.
- Mostly manage alone or at month-end.
- Trade seven days a week, 09:00 to 10:00 or up until 18:00 or 19:00.
- Count money at the end of the day or next morning – take what they need from day to day.

GOALS

- Revamp the shop for higher visibility from afar to grow customer base.
- Increase stock range and variety.

FRUSTRATIONS

- Security, as constantly threatened by theft and robbery.
- How to attract customers.
- Deposit and withdrawal fees at banks are too high.

MOTIVATIONS

- Current business model is easy and comfortable (even if not profitable).

Emerging

There is a mix of formal and informal, small and micro businesses in this typology, as well as a mix of those who were forced into the sector through job losses and those who saw an opportunity and wanted to be their own boss. What makes this segment unique is that they are very operationally focused. They would like to grow, but spend long hours working operationally in the business rather than focusing on the business to drive the desired growth. They tend to be experts in the trade they are conducting. They are primarily focused on delivering to clients, but have only a basic working knowledge of business systems. Their goal tends to be financial stability and they struggle to get by, with only a little being saved towards a growth goal such as the purchase of a vehicle. They are hardworking, determined and eager to learn about business management and how to make their business more successful.

Supermarket and restaurant in Alexandra Township, Johannesburg, South Africa.

Figure 77: Emerging portrait

Portrait of Emerging Segment

RESPONSIBLE | DETERMINED | RISK-TAKER

"My uncle has helped to mentor and coach me... how I spend the cash, how to manage cash flow, profits, how to try and grown the business... he has made millions in construction, which also goes up and down."

"I'm trying to grow the business, so I'm as broke as hell."

"You need financial advice and an accountant for monitoring margins, profit and loss across your products."

Age of business: Two years.

Industry: Wholesale & Trade.

Fnancial Products: Personal account – for swipe deposits; business account – cash deposits and through which suppliers are paid; POS, drop safe, insurance on structure and contents, including stock.

Revenue Source: Alcohol sales.

Finance Source: Loans from girlfriend, uncle.

Business Systems: Two permanent employees, outsource accountant.

BUSINESS JOURNEY

- Has experience managing failed business.
- To optimise profitability, he risked his savings and a R300,000 personal loan taken out by his girlfriend to renovate and start business.
- Applied to Blue Bottle, a discount buying group that is cheaper, with fewer T&Cs than other franchise groups or buying direct from Makro/SAB, etc.: and who also assist with marketing and promotions.
- He passes discounts along through price differentiation strategy (cheaper) to attract customers away from other five stores in the area.
- Business pays for essentials and some personal expenses (kids' school fees, rent, etc.) but doesn't yet pay himself a salary.
- He pays tax as a sole proprietor (registration for tax was mandated by franchise registration).

A DAY IN HIS LIFE

- He is in the store by 09:00, until around 21:00.
- Looks after stock, orders, merchandising, cash flow, collecting stock, and does this electronically through tab that comes with franchise ownership.
- Banks money every second day – money leaves the store in various inconspicuous ways (whiskey box given to friends, backpacks, etc.).
- Employees manage sales and till in-store and do deliveries to bulk purchase customers.
- He has two delivery vehicles – one for him, one for staff.

GOALS

- Grow the business.
- Build stock levels and diversify.

FRUSTRATIONS

- A poor credit record from defaults 2012-2017.
- Finance options limited to friends and family.
- Perceives no grant funding would be given for sale of alcohol.
- Safety and security of moving cash around.

MOTIVATIONS

- Loves selling!
- Learn more about business to grow more profitable.

Affluent

Businesses with these types of owners tend to be small or micro, but have formalized. Like the Emerging segment, they are working long hours in the business, but have recognized that in order to grow, they need to create space for themselves to work on the business. As such, they are focused on putting together systems and building the infrastructure, as well as building a clean record and reputation, to allow themselves the space to start scaling the business. This typology is always looking for new opportunities and are avid networkers, passionate about their businesses.

Employees prepare materials at Khanyile Solutions,
a small clothing manufacturer in Johannesburg. Photo: IFC / Karel Prinsloo

Figure 78: Affluent portrait

Portrait of Affluent Segment

CONFIDENT | PASSIONATE | NETWORKER

"Strive for better, always push for your best."

"I am the youth ambassador to the presidency, and this is what the youth feel... government is failing to get information to young entrepreneurs to get funding and (when they do) to pay them on time. And no cash flow kills a business."

"Banks... rebrand from an educational perspective. On how to be approved and how to pay it back... incentivise with a mentor... the day-to-day operation, on what to do."

"Innovate, innovate, innovate. Take risks. Fail. Learn."

Age of business: Five years.

Industry: Manufacturing.

Financial Products: Personal cheque and busniess account linked through FNB.

Revenue Source: From clothing sales – in-store and online.

Finance Source: Personal savings, family loan, private equity, 2015 business loan from FNB.

Business Systems: Design tools, IT, outsourced HR, accounting, retail trademark.

BUSINESS JOURNEY

- He started his first business five years ago whilst studying a B.Com. majoring in Finance and Information Systems. He worked in promotions to save money to invest whilst conceptualising the idea.
- Whilst various partnerships have helped shape the direction, systems and financing of the business, none have worked in the long term. Buying out each has required family loans and business savings – he almost lost the business.
- FNB rejected a loan application in 2013, but approved it in 2015 once a good financial standing was re-established, with no outstanding creditors.
- His strategy for growth is to become a known leader in his field, and he has elevated his profile through Fashion Week, being on Forbes 30 Under 30 list, and becoming a NDP youth ambassador. Through this network, he became aware that private sector and government funding channels exist.
- He offers students and graduates hoilday or part-time work for experience.
- He has eight employees.

A DAY IN HIS LIFE

- His focus is on sales, networking, cash flow and managing his team and outsourced partners.
- His team manages research, design, production and logistics.

GOALS

- Reposition into high-end luxury streetwear.
- Expand office space to include in-studio photography and print through WESCO funding.

FRUSTRATIONS

- Bulk production (small margins), rely on good logistics and planning – but sometimes his demand outweighs supply.

MOTIVATIONS

- Passion and to not get it wrong as a black entrepreneur, to not fail expectations.
- Creating jobs.

Pioneers

Pioneers are all formal businesses and skewed towards being of a medium size. Owners in this typology have moved away from working in the business and are focused on working on the business. They tend to have high levels of business and financial acumen. Their goals are often centered around expansion of the business into new markets, business sustainability and innovation around operations, infrastructure and offerings.

Forklift loading stock off of a truck.

Figure 79: Pioneer portrait

Portrait of Pioneer Segment

HUSTLER	VISIONARY	RISK-TAKER

"Look, my overdraft is R1.3 million, it's a huge amount but I don't mind if I am paying a repayment of R18, R19, R20K a month, it's rolling turnover."

"We are very relevant, we've changed with the times."

"No-one taught me how to be a businessman, it would have been nice to go to business school, but I persisted."

"I have created businesspeople amongst my staff, they are now BEE partners."

Age of business: 24 years.

Industry: Transport.

Fnancial Products: FNB corporate account – transaction, petrol cards, credit cards; eWallet, overdraft [all employees at FNB too].

Revenue Source: Transportation, truck rental, waste management.

Finance Source: Overdraft.

Business Systems: Full business. Infrastructure and IT integration across muliple divisions.

BUSINESS JOURNEY

- Started out as a Survivalist.
- Now runs a diverse fleet of trucks and has diversified into garden services, site clearing, cleaning services, pest control, concrete/steel palisading and general maintenance.
- The company employs 106 people.
- He learnt early on that networking and finding deals brought money in, and that reinvesting profits grew assets: "Used the system to work for me."
- In two to three years, he had an income record and business bank account, and could finance a property and car, which became leveraged assets loans.
- As tenders required governance, he learnt to keep financial records, and about compliancy, tax, etc.
- His father and brother joined as partners, enabling them to scale further by leveraging three personal asset bases to invest in more equipment, machinery, vehicles and employees.
- The business is B-BBEE Level 1, and is committed to ED, staff and community upliftment.

A DAY IN HIS LIFE

- Deal-making, networking, and ensuring enough work for tomorrow, next week and next month to support employees and diversified growth.
- All transactions are electronic.

GOALS

- Continue to diversify and grow.

FRUSTRATIONS

- SA labor and labor unions.
- ED programmes – not monitored by government, easy to 'tick box' and manipulate: "ED partners are too green(business acumen), I have nothing to work with."

MOTIVATIONS

- Enjoy impact of financial freedom and community and staff upliftment.

Leveraging the insight from the qualitative research and exploring the quantitative data to confirm those factors which drive differences in small business owner attitudes and behaviors, this report develops a quantitative segmentation model which expands on the above typologies into six distinct segments.

Quantitative Segmentation Model

The following segmentation model was developed from the quantitative research. The basis for the segmentation encompasses business maturity and business formality as its two key dimensions. These are strongly correlated with the reasons behind why the small business was started. The model shows that, as a business moves up the size and formality spectrum, conception due to having no other option decreases, while conception due to spotting an opportunity increases. This refers to the mindset referenced throughout this document regarding the primary focus, ranging from personal financial survival to growing and developing the business itself.

Figure 80: Segmentation dimensions

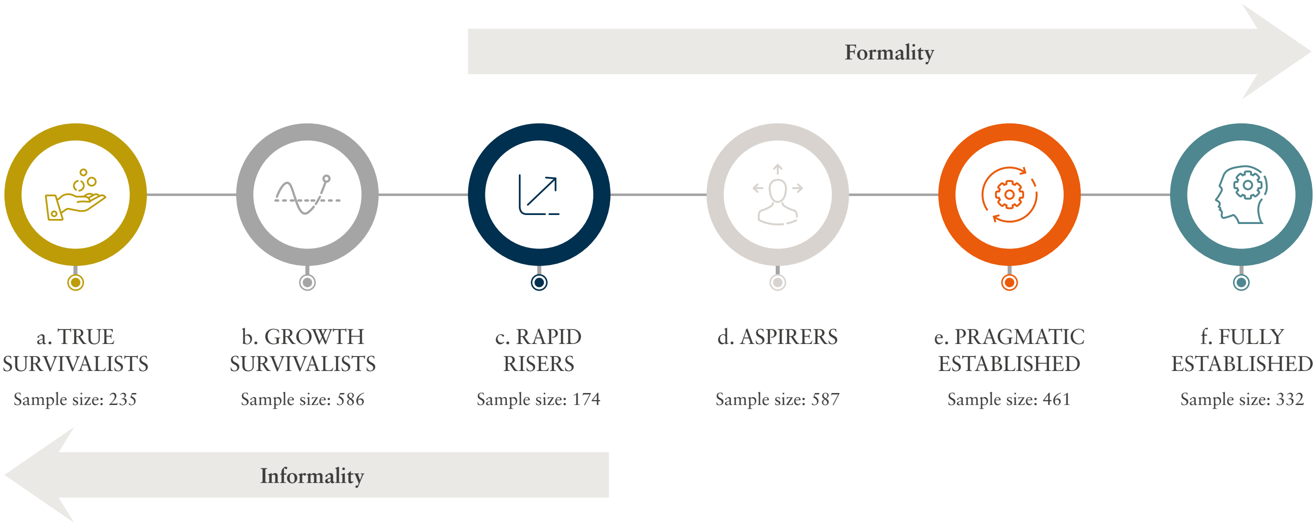
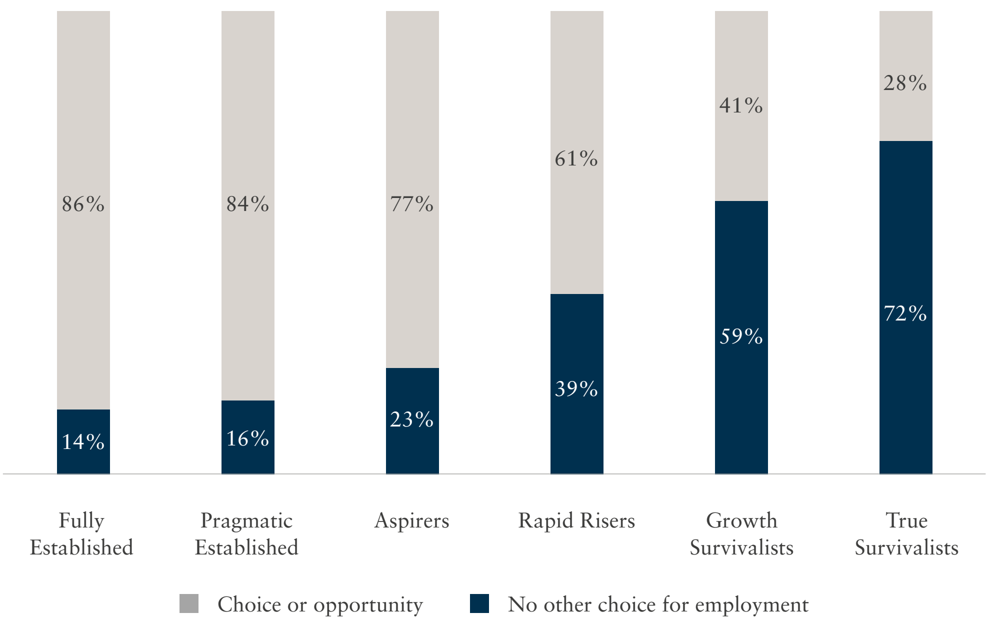


Figure 81: Segment reasons for start-up



A description and fact sheet of each of the segments has been developed using the following dimensions.

True Survivalists

True Survivalists are at the bottom of the small business spectrum. They are the sole owners of their businesses and started the business to create self-employment due to unemployment or a lack of employment opportunities. What sets them apart is that they mostly view their business as a form of employment rather than as a business entity, and they use the revenue for personal expenses. The businesses are often young – less than 3 years old – and are in the start-up or slow-growth phases. They tend to have locations driven by convenience, such as street corners or residences, and their business structure is extremely sparse (limited to a smartphone in very few cases). They have the largest number of unbanked owners, but the majority have a personal bank account. However, this account is often not used for the business since the business is usually fully cash-based. They are not registered or licensed and don't pay tax.

Figure 82: True Survivalists (n265) fact sheet

SARS And CIPC Registration	Total	True Survivalist
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	1%
Is registered with the South African Revenue Service (SARS)	63%	2%
Does not need to be registered/is not registered	31%	97%
Business Location	**Total**	**True Survivalist**
Residential premises – dwelling/garage/building on residential premises	35%	47%
Premises dedicated to my business	13%	1%
Street/street corner/pavement	11%	20%
Business or Office park	8%	-
Street or market stall	7%	14%
Office block	5%	1%
Factory	5%	-
Shopping mall	5%	-
Farm/smallholding	3%	-
Stall/table/container in a designated trading or market area	3%	8%
Door-to-door/Go to customers	2%	5%
Car/truck/vehicle	1%	2%
Online – internet, phone selling	-	-
Number Of Permanent Staff	**Total**	**True Survivalist**
0	20%	97%
1	10%	3%
2 to 5	32%	-
6 to 10	12%	-
11 to 20	13%	-
21 to 50	5%	-
51 to 75	5%	-
76 to 100	1%	-
101 to 150	1%	-
151 to 200	1%	-

Number Of Business Infrastructure Items	Total	True Survivalist
0-5	55%	99%
6-10	21%	1%
11-15	13%	-
16-20	8%	-
21-25	3%	-
Financial Product Ownership	**Total**	**True Survivalist**
Debit/ATM card	80%	76%
Savings account	73%	81%
SMS payment/transaction alerts	67%	46%
Cheque, current or transaction account	61%	16%
Cash deposit/acceptance devices	58%	37%
Money transfers	56%	19%
Cellphone app to accept and make payments	56%	21%
Deposit account (fixed term or notice deposit)	45%	15%
Credit card	44%	3%
Garage card/petrol card	31%	1%
A credit card machine	31%	1%
Call account/investment account	27%	2%
Rewards program	25%	6%
Cash-in-transit services	20%	7%
Safe deposit boxes	19%	5%
Telegraphic transfers	10%	1%
Foreign exchange notes	6%	-
Business Compliance And Process	**Total**	**True Survivalist**
Pays Income Tax (company not personal)	38%	-
Pays Value Added Tax (VAT)	37%	-
Has a trade license	32%	1%
None	30%	92%
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	-
A bookkeeper/auditor/accountant that assists with financial records	27%	-
Contributes to the Unemployment Insurance Fund (UIF)	27%	-
Has a B-BBEE certificate	22%	-
Has a municipal license	17%	1%
Does stock manually (i.e. in a book)	15%	6%
Has an industry body operating licence	12%	-
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	-
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	-
Has Funeral cover for employees	7%	-
Has Health or Medical insurance for employees	6%	-
Has Death or Disability cover for employees	5%	-

Growth Survivalists

Growth Survivalists are like True Survivalists in that their businesses were born of personal necessity. However, they display slightly more sustainable business practices and show signs of reinvestment into the business when profits allow. They still use profits for personal expenses, which limits growth, and they often describe themselves as growing slowly. They may also be job creators and employ up to five employees. Like True Survivalists, their location is based on convenience, they are largely cash-based businesses and not registered or licensed. However, they have better longevity – being in business for up to 5 years – reflecting their marginally better focus on business reinvestment.

Figure 83: Growth Survivalists (n506) fact sheet

SARS And CIPC Registration	Total	Growth Survivalists
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	1%
Is registered with the South African Revenue Service (SARS)	63%	0%
Does not need to be registered/is not registered	31%	99%
Business Location	**Total**	**Growth Survivalists**
Residential premises – dwelling/garage/building on residential premises	35%	46%
Premises dedicated to my business	13%	3%
Street/street corner/pavement	11%	23%
Business or Office park	8%	1%
Street or market stall	7%	12%
Office block	5%	1%
Factory	5%	-
Shopping mall	5%	1%
Farm/smallholding	3%	-
Stall/table/container in a designated trading or market area	3%	7%
Door-to-door/Go to customers	2%	3%
Car/truck/vehicle	1%	1%
Online – internet, phone selling	-	-
Number Of Permanent Staff	**Total**	**Growth Survivalists**
0	20%	34%
1	10%	25%
2 to 5	32%	38%
6 to 10	12%	3%
11 to 20	13%	-
21 to 50	5%	-
51 to 75	5%	-
76 to 100	1%	-
101 to 150	1%	-
151 to 200	1%	-

Number Of Business Infrastructure Items	Total	Growth Survivalists
0-5	55%	99%
6-10	21%	1%
11-15	13%	-
16-20	8%	-
21-25	3%	-
Financial Product Ownership	**Total**	**Growth Survivalists**
Debit/ATM card	80%	77%
Savings account	73%	85%
SMS payment/transaction alerts	67%	46%
Cheque, current or transaction account	61%	18%
Cash deposit/acceptance devices	58%	51%
Money transfers	56%	32%
Cellphone app to accept and make payments	56%	30%
Deposit account (fixed term or notice deposit)	45%	27%
Credit card	44%	6%
Garage card/petrol card	31%	5%
A credit card machine	31%	3%
Call account/investment account	27%	6%
Rewards program	25%	9%
Cash-in-transit services	20%	9%
Safe deposit boxes	19%	8%
Telegraphic transfers	10%	2%
Foreign exchange notes	6%	1%
Business Compliance And Process	**Total**	**Growth Survivalists**
Pays Income Tax (company not personal)	38%	-
Pays Value Added Tax (VAT)	37%	1%
Has a trade license	32%	2%
None	30%	82%
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	-
A bookkeeper/auditor/accountant that assists with financial records	27%	-
Contributes to the Unemployment Insurance Fund (UIF)	27%	-
Has a B-BBEE certificate	22%	-
Has a municipal license	17%	4%
Does stock manually (i.e. in a book)	15%	9%
Has an industry body operating license	12%	-
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	1%
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	-
Has Funeral cover for employees	7%	1%
Has Health or Medical insurance for employees	6%	-
Has Death or Disability cover for employees	5%	-

Rapid Risers

With Rapid Risers the balance shifts more to those who have started a business out of choice and away from those who have been forced into business out of necessity. They are sole-owned businesses that are rapidly growing and can employ up to five people with plans to employ more. They straddle the formal and informal sectors.

The informal characteristics they have are that they are unlikely to be registered with the CIPC, they operate from residential premises, use personal or dual bank accounts for business banking, use cash to pay salaries and lack processes around payroll and other human resource areas. However, more formally, they are registered with SARS, they invest in infrastructure such as vehicles, equipment, digital devices and platforms, and business cards.

Figure 84: Rapid Risers (n374) fact sheet

SARS And CIPC Registration	Total	Rapid Risers
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	24%
Is registered with the South African Revenue Service (SARS)	63%	78%
Does not need to be registered/is not registered	31%	6%
Business Location	**Total**	**Rapid Risers**
Residential premises – dwelling/garage/building on residential premises	35%	45%
Premises dedicated to my business	13%	8%
Street/street corner/pavement	11%	9%
Business or Office park	8%	5%
Street or market stall	7%	9%
Office block	5%	4%
Factory	5%	1%
Shopping mall	5%	4%
Farm/smallholding	3%	2%
Stall/table/container in a designated trading or market area	3%	2%
Door-to-door/Go to customers	2%	4%
Car/truck/vehicle	1%	5%
Online – internet, phone selling	-	-
Number Of Permanent Staff	**Total**	**Rapid Risers**
0	20%	18%
1	10%	15%
2 to 5	32%	44%
6 to 10	12%	10%
11 to 20	13%	11%
21 to 50	5%	-
51 to 75	5%	2%
76 to 100	1%	-
101 to 150	1%	-
151 to 200	1%	-

Number Of Business Infrastructure Items	Total	Rapid Risers
0-5	55%	90%
6-10	21%	10%
11-15	13%	-
16-20	8%	-
21-25	3%	-
Financial Product Ownership	**Total**	**Rapid Risers**
Debit/ATM card	80%	84%
Savings account	73%	74%
SMS payment/transaction alerts	67%	75%
Cheque, current or transaction account	61%	73%
Cash deposit/acceptance devices	58%	64%
Money transfers	56%	67%
Cellphone app to accept and make payments	56%	68%
Deposit account (fixed term or notice deposit)	45%	54%
Credit card	44%	51%
Garage card/petrol card	31%	29%
A credit card machine	31%	34%
Call account/investment account	27%	27%
Rewards program	25%	28%
Cash-in-transit services	20%	23%
Safe deposit boxes	19%	20%
Telegraphic transfers	10%	11%
Foreign exchange notes	6%	5%
Business Compliance And Process	**Total**	**Rapid Risers**
Pays Income Tax (company not personal)	38%	20%
Pays Value Added Tax (VAT)	37%	28%
Has a trade license	32%	23%
None	30%	23%
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	5%
A bookkeeper/auditor/accountant that assists with financial records	27%	6%
Contributes to the Unemployment Insurance Fund (UIF)	27%	4%
Has a B-BBEE certificate	22%	14%
Has a municipal license	17%	10%
Does stock manually (i.e. in a book)	15%	15%
Has an industry body operating license	12%	5%
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	-
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	1%
Has Funeral cover for employees	7%	3%
Has Health or Medical insurance for employees	6%	-
Has Death or Disability cover for employees	5%	2%

Aspirers

These businesses have formalized and are registered with SARS and CIPC and are starting to pay VAT. They have a lifespan of up to 10 years and are often located in an office park. Their infrastructure is still limited, but it is evolving to include not only physical infrastructure, but sustainable business practices such as invoicing systems, salary slips and financial statements. They are also more active in terms of marketing and using media such as flyers, pamphlets or brochures to target customers. Profits are largely reinvested back into the business. This segment, while not as likely to get financing from bank loans as those further up the spectrum, have begun to rely less on funding from family and friends and more on self-funding strategies. They can employ up to 20 people, but are unlikely to have formal human reosurce processes implemented such as Unemployment Insurance Fund contributions, Health or Medical insurance or other benefits for employees.

Figure 85: Aspirers (n587) fact sheet

SARS And CIPC Registration	Total	Aspirers
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	28%
Is registered with the South African Revenue Service (SARS)	63%	90%
Does not need to be registered/is not registered	31%	2%
Business Location	**Total**	**Aspirers**
Residential premises – dwelling/garage/building on residential premises	35%	32%
Premises dedicated to my business	13%	17%
Street/street corner/pavement	11%	5%
Business or Office park	8%	11%
Street or market stall	7%	4%
Office block	5%	7%
Factory	5%	5%
Shopping mall	5%	11%
Farm/smallholding	3%	4%
Stall/table/container in a designated trading or market area	3%	2%
Door-to-door/Go to customers	2%	-
Car/truck/vehicle	1%	-
Online – internet, phone selling	-	-
Number Of Permanent Staff	**Total**	**Aspirers**
0	20%	2%
1	10%	6%
2 to 5	32%	48%
6 to 10	12%	19%
11 to 20	13%	19%
21 to 50	5%	2%
51 to 75	5%	4%
76 to 100	1%	-
101 to 150	1%	-
151 to 200	1%	-

Number Of Business Infrastructure Items	Total	Aspirers
0-5	55%	47%
6-10	21%	50%
11-15	13%	3%
16-20	8%	-
21-25	3%	-
Financial Product Ownership	**Total**	**Aspirers**
Debit/ATM card	80%	81%
Savings account	73%	80%
SMS payment/transaction alerts	67%	63%
Cheque, current or transaction account	61%	49%
Cash deposit/acceptance devices	58%	54%
Money transfers	56%	49%
Cellphone app to accept and make payments	56%	53%
Deposit account (fixed term or notice deposit)	45%	39%
Credit card	44%	23%
Garage card/petrol card	31%	15%
A credit card machine	31%	12%
Call account/investment account	27%	14%
Rewards program	25%	16%
Cash-in-transit services	20%	17%
Safe deposit boxes	19%	11%
Telegraphic transfers	10%	6%
Foreign exchange notes	6%	3%
Business Compliance And Process	**Total**	**Aspirers**
Pays Income Tax (company not personal)	38%	44%
Pays Value Added Tax (VAT)	37%	45%
Has a trade license	32%	40%
None	30%	4%
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	20%
A bookkeeper/auditor/accountant that assists with financial records	27%	16%
Contributes to the Unemployment Insurance Fund (UIF)	27%	17%
Has a B-BBEE certificate	22%	23%
Has a municipal license	17%	17%
Does stock manually (i.e. in a book)	15%	13%
Has an industry body operating license	12%	10%
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	7%
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	4%
Has Funeral cover for employees	7%	5%
Has Health or Medical insurance for employees	6%	3%
Has Death or Disability cover for employees	5%	2%

Pragmatic Established

These businesses are fully registered with SARS and CIPC, as well as paying VAT. The business was started by choice and has a span of up to 20 years, with owners describing their business as stable or mature. They are the most likely segment to say that they are driven by the idea of creating jobs for the community. They have physical infrastructure but have not fully incorporated digital systems within the business such as WiFi, social media or website. Some in this segment have instituted employee benefits such as Risk or Health cover, and are fully tax compliant with respect to their employees (PAYE, UIF). There is still some use of cash in these businesses, but most transactions are done electronically and through a separate business bank account. Business financing is done formally through a bank loan.

Figure 86: Pragmatic Established (n491) fact sheet

SARS And CIPC Registration	Total	Pragmatic Established
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	33%
Is registered with the South African Revenue Service (SARS)	63%	94%
Does not need to be registered/is not registered	31%	1%
Business Location	**Total**	**Pragmatic Established**
Residential premises – dwelling/garage/building on residential premises	35%	23%
Premises dedicated to my business	13%	21%
Street/street corner/pavement	11%	7%
Business or Office park	8%	16%
Street or market stall	7%	2%
Office block	5%	7%
Factory	5%	10%
Shopping mall	5%	6%
Farm/smallholding	3%	4%
Stall/table/container in a designated trading or market area	3%	1%
Door-to-door/Go to customers	2%	-
Car/truck/vehicle	1%	1%
Online – internet, phone selling	-	-
Number Of Permanent Staff	**Total**	**Pragmatic Established**
0	20%	2%
1	10%	3%
2 to 5	32%	27%
6 to 10	12%	22%
11 to 20	13%	25%
21 to 50	5%	10%
51 to 75	5%	8%
76 to 100	1%	2%
101 to 150	1%	1%
151 to 200	1%	-

Number Of Business Infrastructure Items	Total	Pragmatic Established
0-5	55%	3%
6-10	21%	42%
11-15	13%	50%
16-20	8%	5%
21-25	3%	-
Financial Product Ownership	**Total**	**Pragmatic Established**
Debit/ATM card	80%	84%
Savings account	73%	64%
SMS payment/transaction alerts	67%	78%
Cheque, current or transaction account	61%	84%
Cash deposit/acceptance devices	58%	62%
Money transfers	56%	71%
Cellphone app to accept and make payments	56%	68%
Deposit account (fixed term or notice deposit)	45%	53%
Credit card	44%	70%
Garage card/petrol card	31%	52%
A credit card machine	31%	53%
Call account/investment account	27%	41%
Rewards program	25%	35%
Cash-in-transit services	20%	23%
Safe deposit boxes	19%	26%
Telegraphic transfers	10%	14%
Foreign exchange notes	6%	8%
Business Compliance And Process	**Total**	**Pragmatic Established**
Pays Income Tax (company not personal)	38%	69%
Pays Value Added Tax (VAT)	37%	57%
Has a trade license	32%	53%
None	30%	-
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	57%
A bookkeeper/auditor/accountant that assists with financial records	27%	60%
Contributes to the Unemployment Insurance Fund (UIF)	27%	56%
Has a B-BBEE certificate	22%	37%
Has a municipal license	17%	26%
Does stock manually (i.e. in a book)	15%	17%
Has an industry body operating licence	12%	19%
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	12%
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	11%
Has Funeral cover for employees	7%	11%
Has Health or Medical insurance for employees	6%	11%
Has Death or Disability cover for employees	5%	8%

Fully Established

This segment is the most established and has the strongest infrastructure of all the segments. These businesses are often owned by multiple parties in the form of shareholders, co-owners or partners in the business. They have the highest variation in terms of how they are paid by their customers, but it is still most commonly cash or via EFT. Cash received and profits will be reinvested in the business or distributed to shareholders, and most transactions like salaries or supplier payments will be through a business bank account. This segment is the least likely to use profits for personal expenses.

Within this segment, there is a sub-segment of tech-savvy businesses who have a high level of infrastructure and are growing fast. They have strong digital infrastructure, use social media extensively for marketing purposes and have the most varied repertoire of financing sources, including crowdfunding platforms.

Figure 87: Fully Established (n332) fact sheet

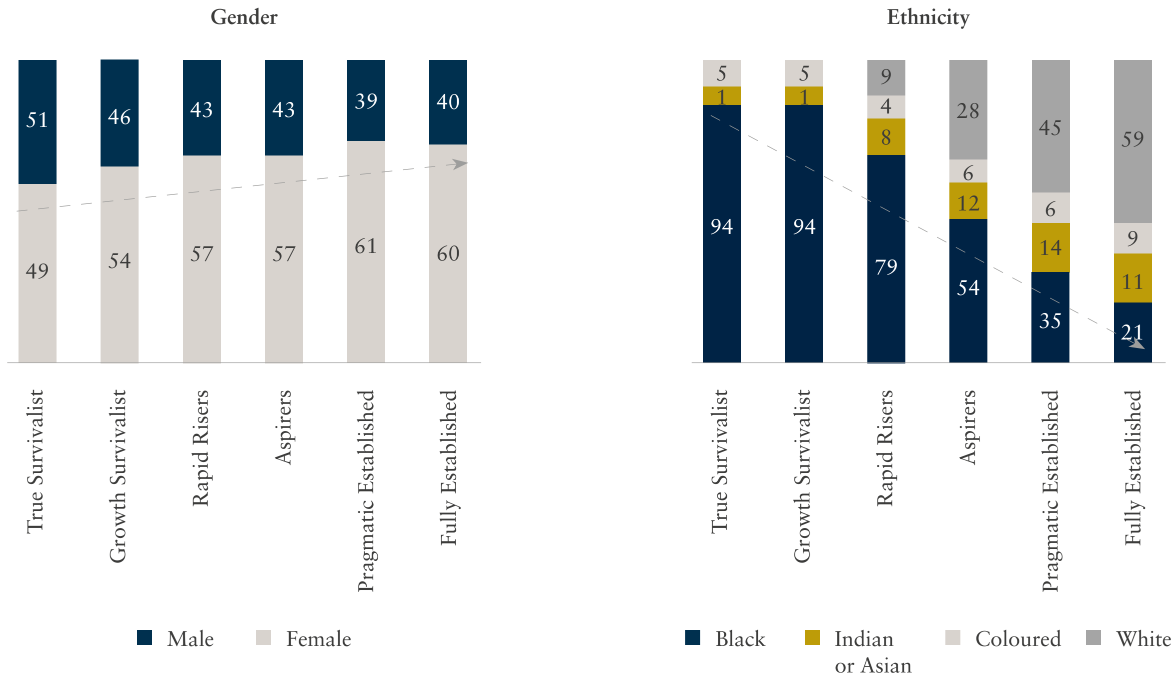
SARS And CIPC Registration	Total	Fully Established
Is registered with the Company and Intellectual Property Commission (CIPC)	23%	45%
Is registered with the South African Revenue Service (SARS)	63%	97%
Does not need to be registered/is not registered	31%	-
Business Location	**Total**	**Fully Established**
Residential premises – dwelling/garage/building on residential premises	35%	17%
Premises dedicated to my business	13%	26%
Street/street corner/pavement	11%	5%
Business or Office park	8%	16%
Street or market stall	7%	1%
Office block	5%	8%
Factory	5%	11%
Shopping mall	5%	6%
Farm/smallholding	3%	6%
Stall/table/container in a designated trading or market area	3%	-
Door-to-door/Go to customers	2%	-
Other (specify)	2%	3%
Car/truck/vehicle	1%	-
Online – internet, phone selling	-	1%
Number Of Permanent Staff	**Total**	**Fully Established**
0	20%	-
1	10%	2%
2 to 5	32%	18%
6 to 10	12%	20%
11 to 20	13%	20%
21 to 50	5%	18%
51 to 75	5%	14%
76 to 100	1%	3%
101 to 150	1%	3%
151 to 200	1%	2%

Number Of Business Infrastructure Items	Total	Fully Established
0-5	55%	-
6-10	21%	-
11-15	13%	23%
16-20	8%	55%
21-25	3%	20%
Financial Product Ownership	**Total**	**Fully Established**
Debit/ATM card	80%	74%
Savings account	73%	57%
SMS payment/transaction alerts	67%	74%
Cheque, current or transaction account	61%	90%
Cash deposit/acceptance devices	58%	61%
Money transfers	56%	68%
Cellphone app to accept and make payments	56%	63%
Deposit account (fixed term or notice deposit)	45%	59%
Credit card	44%	77%
Garage card/petrol card	31%	63%
A credit card machine	31%	60%
Call account/investment account	27%	53%
Rewards program	25%	40%
Cash-in-transit services	20%	30%
Safe deposit boxes	19%	34%
Telegraphic transfers	10%	18%
Foreign exchange notes	6%	14%
Business Compliance And Process	**Total**	**Fully Established**
Pays Income Tax (company not personal)	38%	88%
Pays Value Added Tax (VAT)	37%	84%
Has a trade license	32%	69%
None	30%	-
Complies with Pay As You Earn (PAYE) Tax on behalf of employees	27%	83%
A bookkeeper/auditor/accountant that assists with financial records	27%	86%
Contributes to the Unemployment Insurance Fund (UIF)	27%	86%
Has a B-BBEE certificate	22%	55%
Has a municipal license	17%	43%
Does stock manually (i.e. in a book)	15%	31%
Has an industry body operating license	12%	39%
Has a skills development programme (e.g. Sector Education and Training Authority (SETA))	9%	37%
Does stock-taking digitally (i.e. using a mobile app or software programme)	8%	40%
Has Funeral cover for employees	7%	27%
Has Health or Medical insurance for employees	6%	26%
Has Death or Disability cover for employees	5%	25%

Demographics and Corpographics

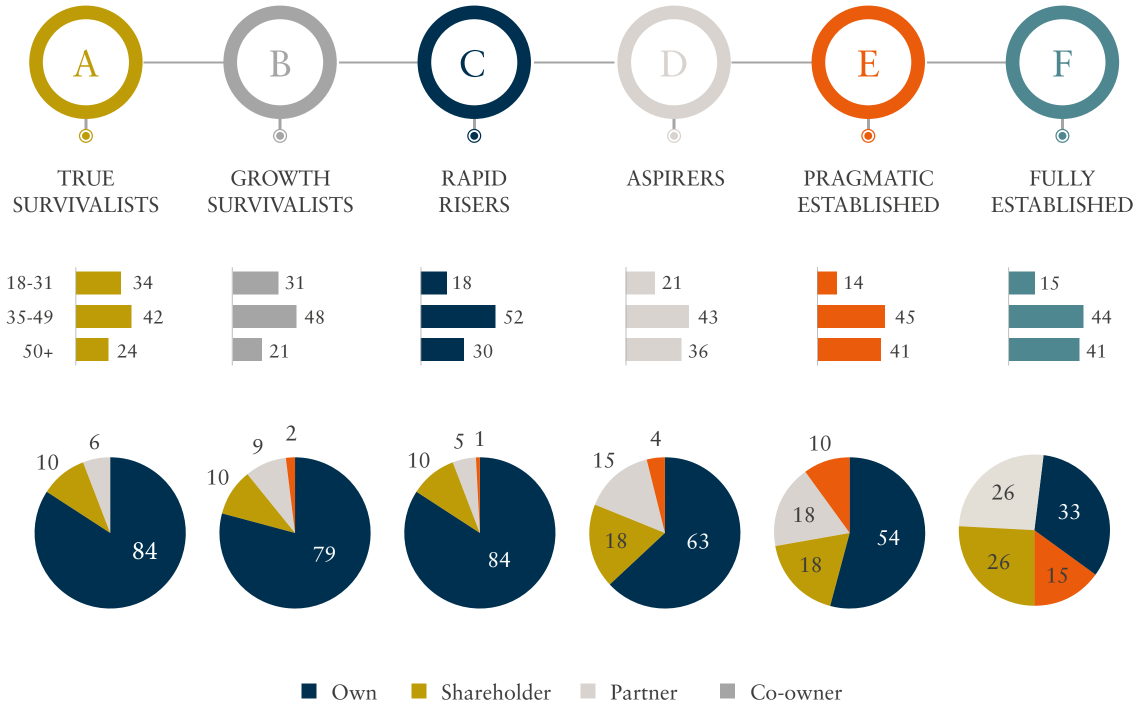
There are some significant demographic profile changes as one moves through the small business segment spectrum. Two of the most extreme are gender and race. The number of women-owned businesses decreases as one moves up the spectrum, as does the number of black-owned businesses (Figure 88).

Figure 88: Gender and ethnicity



Younger owners are more present in the lower end of the spectrum, and older owners are more present in the upper end of the spectrum. This is to be expected, given that businesses take time to mature. However, given that the level of youth unemployment in South Africa is at critical levels, it is important to support young entrepreneurs as an important means for job creation (Figure 89).

Figure 89: Age and ownership

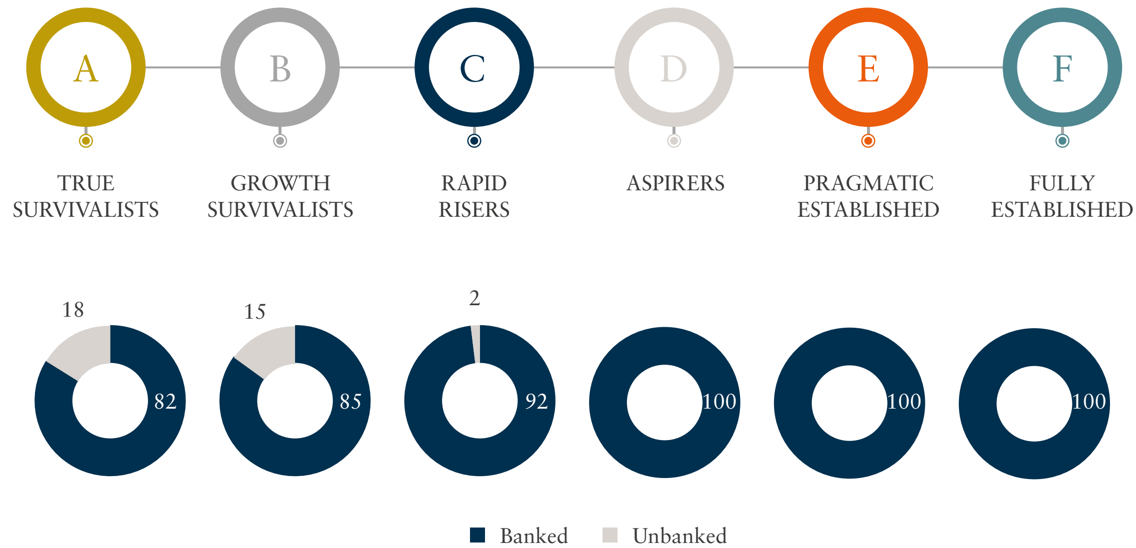


From an ownership point of view, diversifying ownership from sole owners through to shared ownership occurs as one moves along the small business segment spectrum (Figure 89).

Across the segments, most owners are banked, even if that is having a personal account rather than a business account.

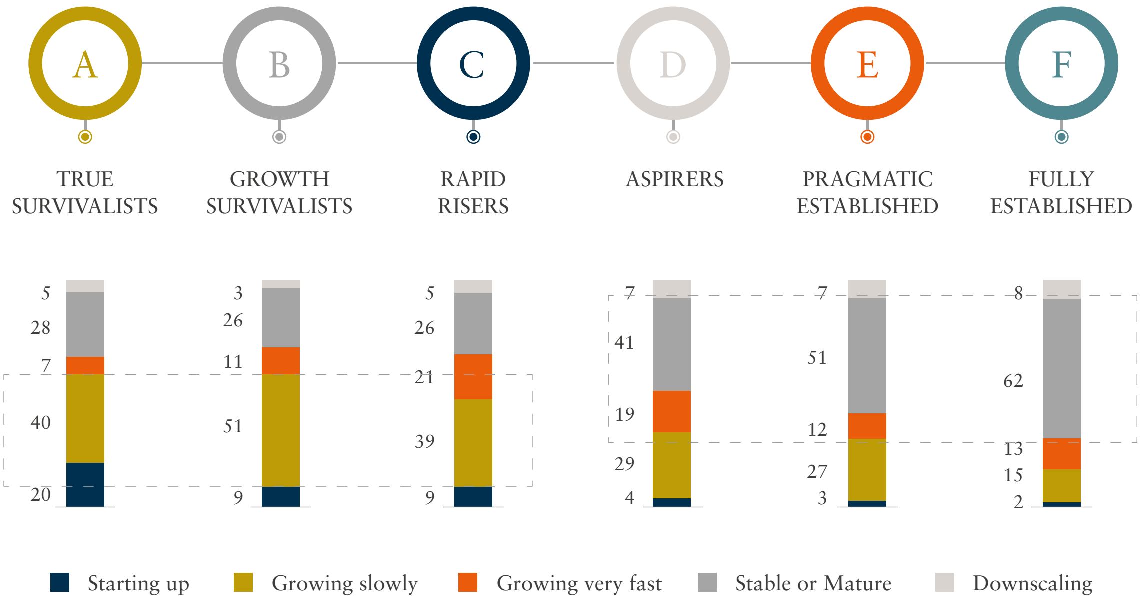
As one moves up the spectrum (Figure 90), the unbanked disappear completely, and it becomes more and more likely that a separate bank account is set up for the business. This process is completed once the business becomes fully formalized.

Figure 90: Banked versus unbanked



Moving along the spectrum the business lifecycle mix changes significantly; there is a decrease in the level of starting-up and growing slowly outlooks. Growing fast peaks in the middle segments, while the prevalence of the mature and stable stage increases as one moves forward. The type of infrastructure a business has follows this pattern, with very little infrastructure at the start-up phase, with more infrastructure in use in the middle segments when growth is fast, and then strengthening of infrastructure beyond the physical toward business systems in the higher segments (Figure 91).

Figure 91: Business outlook and infrastructure



Repertoire of Business Infrastructure

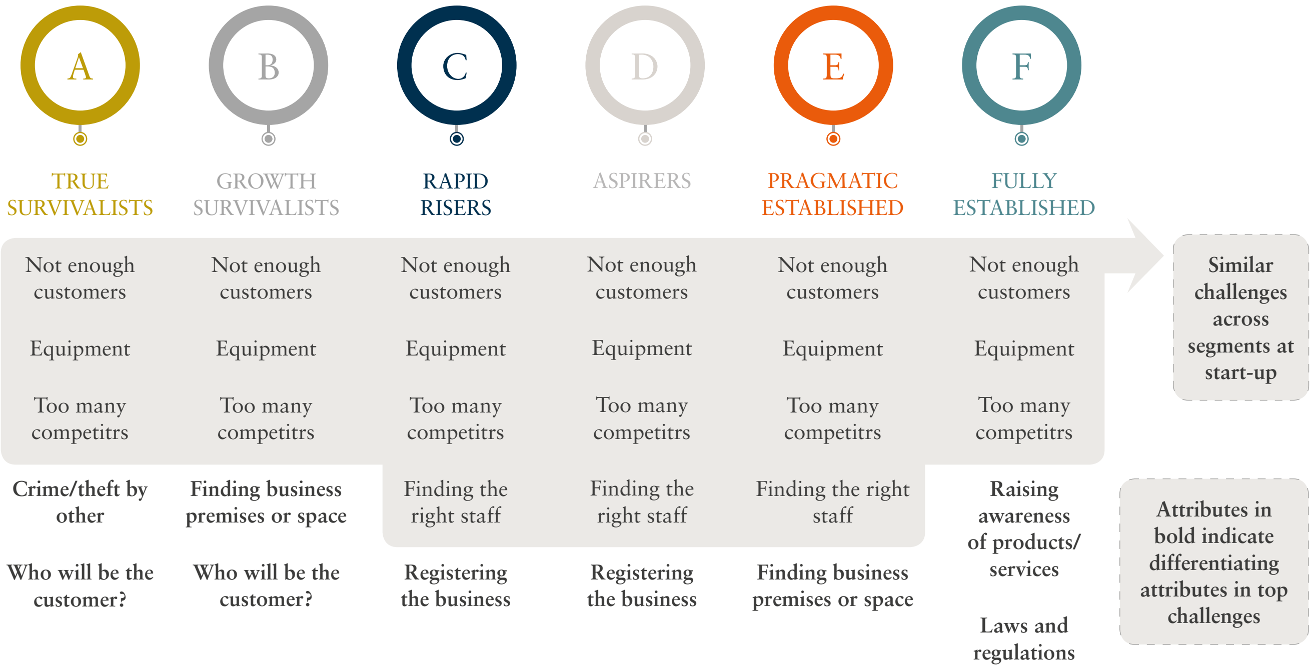
0.5	0.9	2.7	5.7	10.8	18.1
Smartphone/tablet	Smartphone/tablet, vehicle	Smartphone/tablet, vehicle, email address, Facebook page, and business cards	Has physical infrastructure, but not of processes and procedure around staffing and business systems	Has higher incidence of business systems	Strong infrastructure and higher compliance with staffing processes

Andiswa Silinga, Co-founder of Gemini: GIS and Environmental Services. SAICA Enterprise Development helped the small business grow.
Photo: Karel Prinsloo / IFC

Challenges and Growth Areas

Some challenges faced by small businesses are universal, regardless of fall-off, the business size and formality. These include not enough customers, insufficient infrastructure or equipment, too many competitors and staff skillsets. However, there are some challenges that are unique to the different segments (Figure 92). This is where government initiatives can be tailored to help specific segments. For example, providing safe places to do business for those at the lower end could help to reduce the challenge of crime and theft experienced. Small business aid offices could provide step-by-step guidance for those wanting to go through the registration process so that it is not an overwhelming process. Financial service providers could also support this function.

Figure 92: Challenges experienced



There are certain areas for training that are requested across all segments pertaining to basic business topics. However, although the topics might be the same, the underlying content would need to be adjusted for each segment, and made more advanced for those in the higher segments, and simpler for those in the lower segments, since they are less likely to have significant business or financial acumen or knowledge (Figure 93). The research also indicates a correlation between the specific training requirements and the stage of business development. This suggests that training tailored by segment would be more effective in addressing appropriate issues and targeting the right knowledge requirements and gaps at the right time, than one-size-fits-all training programs. The medium in which the training is delivered is also important, with most small businesses preferring in-person training over electronic channels and platforms.

Figure 93: Training required

Business Training Needs	True Survivalists	Growth Survivalists	Rapid Risers	Aspirers	Pragmatic Established	Fully Established
Expanding a business	**34%**	**40%**	**31%**	**29%**	**23%**	**24%**
How to market a business	**31%**	**34%**	**24%**	**22%**	**18%**	**17%**
Customer relations	**23%**	**27%**	**20%**	**19%**	**18%**	14%
Business management	**20%**	**22%**	**24%**	**20%**	**18%**	**17%**
Pricing or costing	16%	**29%**	**21%**	**19%**	**19%**	14%
Productivity improvement	14%	17%	14%	15%	15%	**20%**
Financial budgeting or forecasting	14%	16%	14%	14%	12%	14%
Accounting and bookkeeping	8%	12%	16%	11%	14%	**17%**
Knowledge of laws and regulations relevant to small business	14%	15%	14%	13%	14%	9%
How to write a business plan	17%	21%	11%	9%	6%	7%
Registering a business	**20%**	21%	8%	8%	7%	5%
Employee/Staff management	2%	12%	11%	11%	12%	15%
How to start-up a business	11%	14%	14%	9%	5%	5%
Knowledge of employee laws and regulations (labor law)	3%	8%	12%	10%	11%	12%
Debt management	6%	6%	8%	10%	10%	12%
Computer-related training	7%	9%	10%	9%	10%	12%
Accessing and responding to tenders	6%	7%	9%	10%	10%	8%
Technical training on goods and services being provided	6%	7%	5%	7%	9%	10%
Types of insurances relevant for business	4%	7%	8%	8%	7%	12%
Obtaining loans, finance and operating on credit	7%	6%	7%	7%	8%	9%

Lastly, financial products or financing and other support required differ dramatically from segment to segment. Requirements become more comprehensive and complex the further up the spectrum one moves. The following graphic explains the support needs of business within each segment (Figure 94).

Figure 94: Segment business support needs summary

TRUE SURVIVALISTS	GROWTH SURVIVALISTS	RAPID RISERS
"I make an income for myself." These business owners survive with very little infrastructure and business processes. At start-up, they would need very little financing, but would need support on business basics (defining a product and its consumer base). There is appetite to register their business if this increases customer base. They operate in a cash economy, which makes them vulnerable to crime, so protection against theft would be a useful value-add.	*"I make an income for myself and others."* This segment's needs are very similar to True Survivalist, but have additional requirements associated with growth and staffing (finding business premises and business planning). Loss of their limited infrastructure (smartphone or vehicle) would have a severe impact, so there is a need for affordable risk cover, perhaps linked to their funeral offering.	*"I want go grow."* This segment requires assistance with business registration, development and instituting of HR processes to overlay with a fast-growing business.
ASPIRERS	PRAGMATIC ESTABLISHED	FULLY ESTABLISHED
"I want to entrench my business prospects." This segment needs guidance on sustainable business practices like the employment of a part-time bookkeeper/ account, compliance with PAYE and UIF.	*"I want to streamline and maximize my business processes."* These two segments have high levesls of infrastructure and are at the upper end of the continuum of formality. However, they do indicate appetite for training on streamlining business processes and accounting practices. Compliance (PAYE, VAT and Income Tax) may be an area of development in relevant businesses.	
		TECH-SAVVY
		"I like to amplify my business processes using digital platforms." They could be enticed through digitally enhanced product offering and platforms.

KEY FINDINGS

- *The small business spectrum can be segmented into six segments based on the level of business maturity, reasons for starting an MSME and the resulting mindset of personal subsistence versus business development focus) as well as their level of formalization: True survivalists, growth survivalists, rapid risers, aspirers, pragmatic established and fully established.*
- *These segments are markedly different from each other in terms of mindset, level of infrastructure, training needs, financing and support requirements, and business complexity. As such, any programs or offerings, from government or financial institutions, need to be specifically tailored to address the needs of businesses within each segment.*
- *The numbers of women-owned, black-owned and youth-owned business decreases as one moves up the small business size and formality spectrum. These have been identified as vulnerable but priority groups in South Africa, and therefore initiatives need to be focused on the lower-end in order to help these groups elevate and grow their businesses to reach the next level.*

Street scene from Soweto.
Photo: IFC / Karel Prinsloo

7 A Focus on Women-Owned MSMEs

Women-owned small businesses are more likely to be earning less revenue and accessing less finance than their male counterparts, the interviews found. The question is whether this is because of fundamental profile and needs differences between men-owned and women-owned small businesses, or whether there are other factors at play. What becomes apparent from the interviews is that there are few differences on the surface. Rather, women-owned small business report encountering attitudinal barriers that are not faced by their male counterparts. This section explores this in more depth.

THE MSME VOICE
Agriculture, Small, Formal, Tech Solutions, Female, Gauteng

"I'm very used to the ego, the patriarchal society, it doesn't faze me as much as it used to. I don't take it personally."

THE MSME VOICE
Construction, Small, Formal, Maintenance and Renovations, Female, KZN

"It's even harder when you are a woman. You are a wife, a mother, a sister, a daughter. Your work load is much higher than your male counterparts."

Business Profile of Women-Owned MSMEs

On the surface, women-owned businesses are similar to the male-owned small business profile in both the formal and informal sectors. However, there are nuances that are noteworthy, and some qualitative research findings which suggest that women-owned businesses face a greater burden in terms of 'proving themselves' and thereby accessing customers, funding and financing compared to their male counterparts. This requires businesswomen to develop behavioral and social navigation skills which are simply not a requirement for their male counterparts.

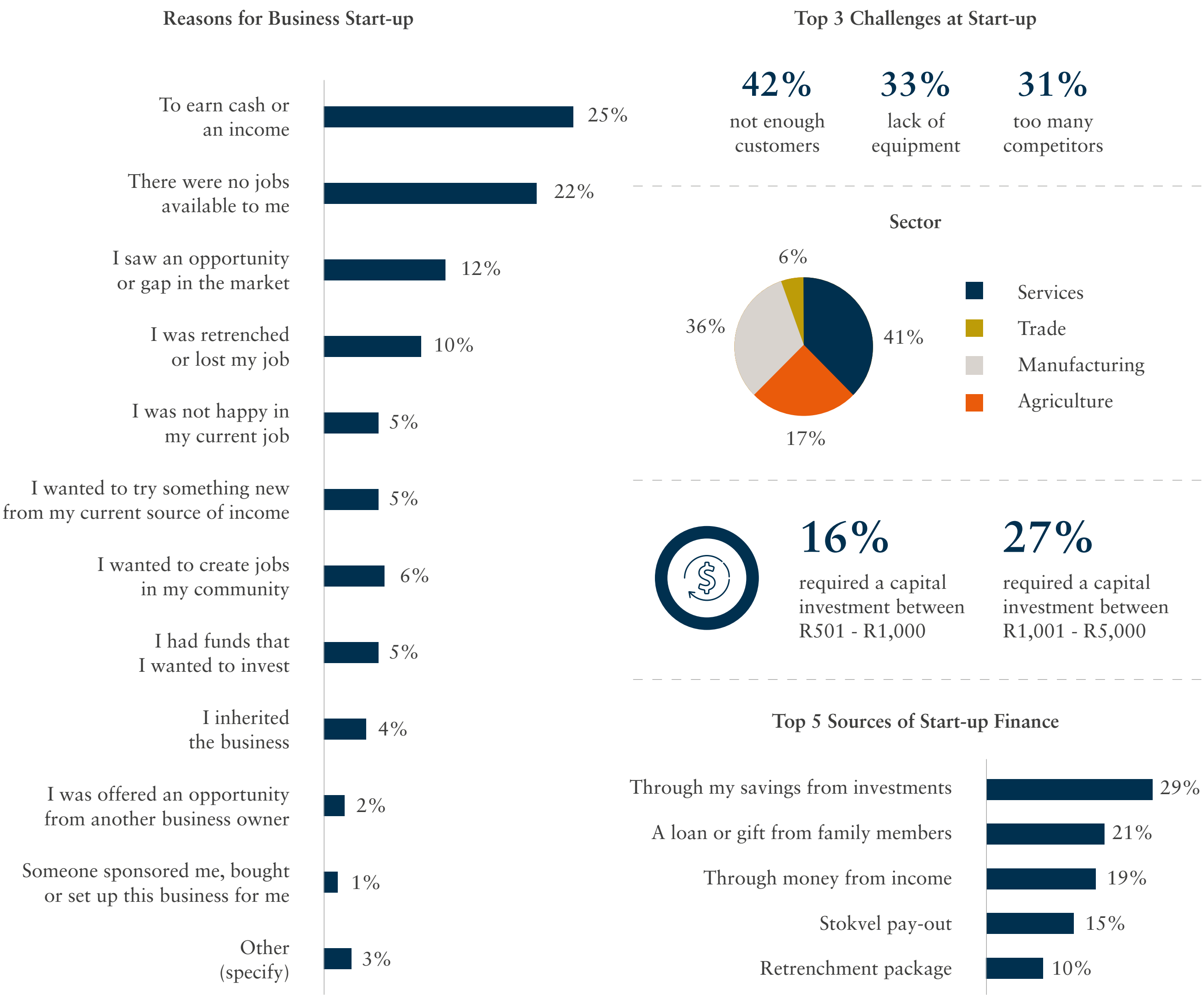
The female participants in the study felt that there was an assumption made, which some male participants confirmed, that women are less likely to want to sacrifice home and family in favor of their business, and are therefore more suited to employment or a lighter role in a business, rather than as the main owner or entrepreneur. This was more pronounced in the more male-dominated industry sectors.

In the informal sector, the main reasons for women starting a business are due to a lack of finding formal employment and the need to earn an income. Like the informal sector overall, women face the key challenges of sourcing customers, limited equipment and a competitive environment. In addition, they source start-up financing from savings and personal income and family and friends (Figure 95).

Where women-owned informal businesses differ from male-owned informal businesses is in the size of their businesses, the sectors in which they tend to operate, and in the amount they require for capital investment to start their businesses. There are more women-owned businesses at the lower end of the informal spectrum with daily sales turnover of between 101 rand and 500 rand, and they are over-represented in the Survivalist segment. The capital required to start their businesses was also lower than the informal small business sector overall. This lower access to funding may be driven in part by attitudinal hurdles on the part of financers, or by reluctance of women owners to go through the experience of facing attitudinal hurdles whether perceived or real. This may have the effect of constraining their ability to grow their businesses, and therefore result in businesses operating and remaining at this lower end.

In terms of the sectors in which women-owned informal businesses operate, they are more likely to be in the manufacturing sector, which includes activities such as repurposing products made by someone else and making crafts and cooking food, compared to male-owned small businesses. Women-owned businesses are less likely to be in the services sector, the interviews found. In the services sector, there is a greater requirement to prove professionality than in the manufacturing sector where the quality of the product can speak for itself.

Figure 95: Profile of women-owned businesses (informal sector)



The profile of formal women-owned businesses is almost identical to male-owned formal businesses in all aspects, including which sectors they operate in, the challenges they face and the finance they required to start their businesses. It may be that the simple act of formalization helped them to mitigate some of the attitudinal barriers women in the informal sector are facing. In other words, the fact of being a formal business helps to communicate professionalism, irrespective of gender. This does not mean that formal women-owned businesses do not face these attitudes at all, but instead that being formal may dampen their effect (Figure 96 and 97).

Figure 96: Profile of women-owned versus male-owned businesses (informal sector)

Reasons for Business Start-up	Top Challenges at Start-up	Top Sectors
Women 25% needed to earn an income 22% no jobs available to me 12% gap in the market *Men* 23% no jobs available to me 21% needed to earn an income 13% gap in the market	*Women* 42% not enough customers 33% lack of equipment 31% too many competitors *Men* 39% not enough customers 34% lack of equipment 32% too many competitors	*Women* 41% services 36% manufacturing 17% trade *Men* 57% services 20% manufacturing 18% trade

Top Sources of Finance	Risk Cover	Banking
Women 29% through own savings/investments 21% loan or gift from family 19% through money from income *Men* 35% through own savings/investments 22% through money from income 18% loan or gift from family	*Women* 32% funeral cover 13% life insurance cover 8% vehicle insurance *Men* 23% funeral cover 11% vehicle insurance 9% life insurance cover	*Women* 65% use a personal bank account for business banking 20% use a business bank account for business banking *Men* 62% use a personal bank account for business banking 23% use a business bank account for business banking

Figure 97: Male-owned versus female-owned MSME profiles (formal)

Reasons for Business Start-up	Top Challenges at Start-up	Top Sectors
Women 27% gap in the market 11% create jobs in community 10% earn cash or income *Men* 26% gap in the market 12% create jobs in community 10% earn cash or income	*Women* 34% not enough customers 27% too many competitors 25% lack of equipment *Men* 28% not enough customers 31% lack of equipment 26% finding the right staff	*Women* 21% financial/business services 18% manufacturing 17% community and social services *Men* 17% manufacturing 16% financial/business services 12% sale/maintenance of motor vehicles

Top Sources of Finance	Risk Cover	Banking
Women 40% through own savings/investments 19% bank loan 17% business partner *Men* 38% through own savings/investments 20% bank loan 18% business partner	*Women* 56% motor vehicle insurance 35% business insurance 33% life insurance cover *Men* 60% motor vehicle insurance 32% life insurance cover 30% business insurance	*Women* 69% use a business bank account for business banking 15% use a personal bank account for business banking *Men* 71% use a business bank account for business banking 12% use a personal bank account for business banking

Training Needs

The training needs of women-owned business reflect that of the sector overall. Training providers should ensure that women-owned businesses are equally included in terms of access to these initiatives, and that the initiatives are designed to work for women who may be balancing greater household responsibilities than their male counterparts (Figures 98 and 99).

Figure 98: Top training needs (informal sector)

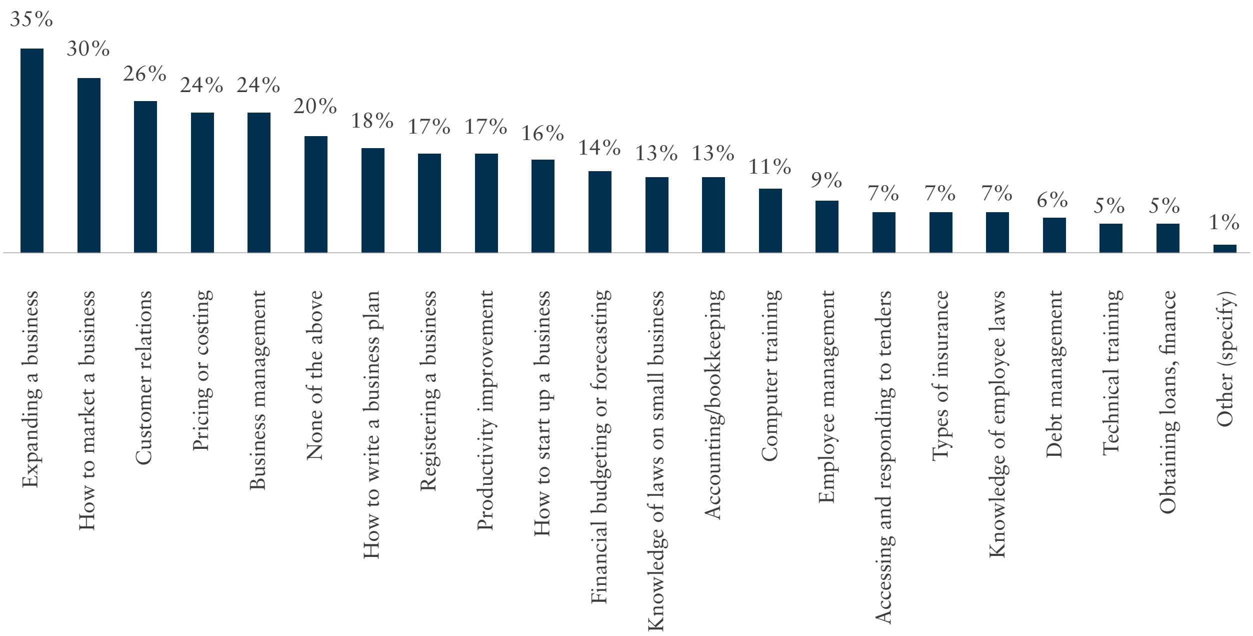
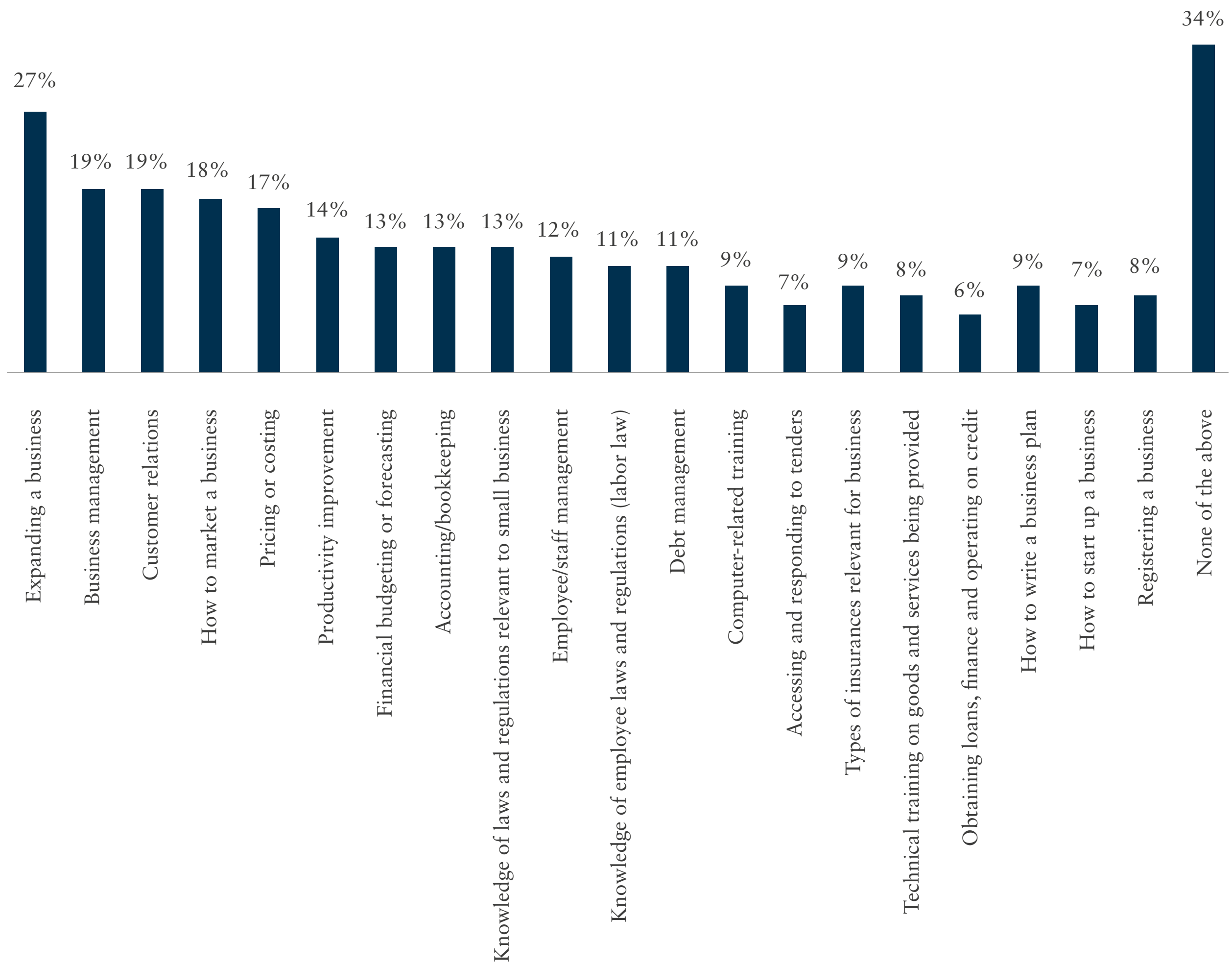


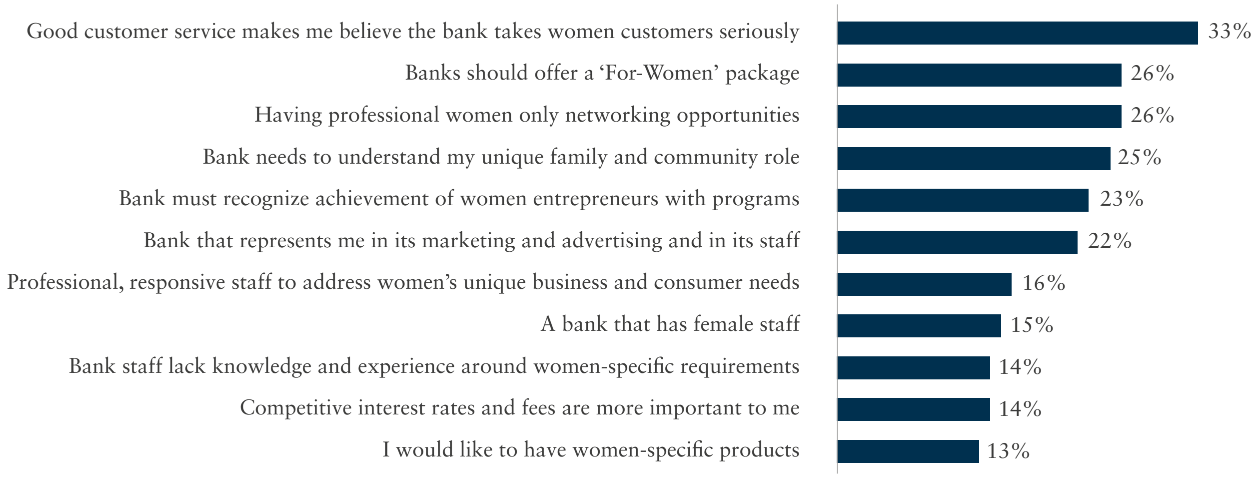
Figure 99: Top training needs (formal sector)



Banking Women-Owned Businesses

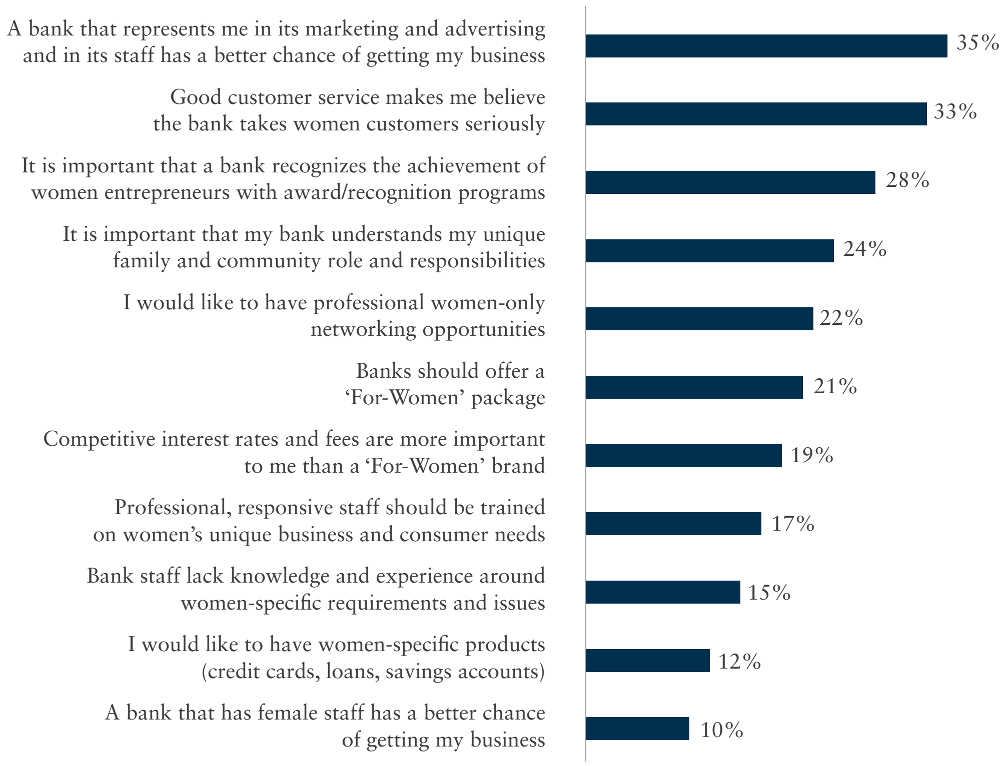
The interviews found women-owned businesses want financial institutions to be true business partners and to treat them equally and seriously. In interviews, women-owned businesses said this could take the form of better customer service, banking packages that are tailored to their needs and help in connecting them with other women-owned business through networking events. Women-owned businesses said they want to be taken more seriously as businesspeople and be recognized for their achievements. This is true for both informal and formal women-owned businesses (Figures 100 and 101).

Figure 100: Women focus areas for financial institutions (informal sector)



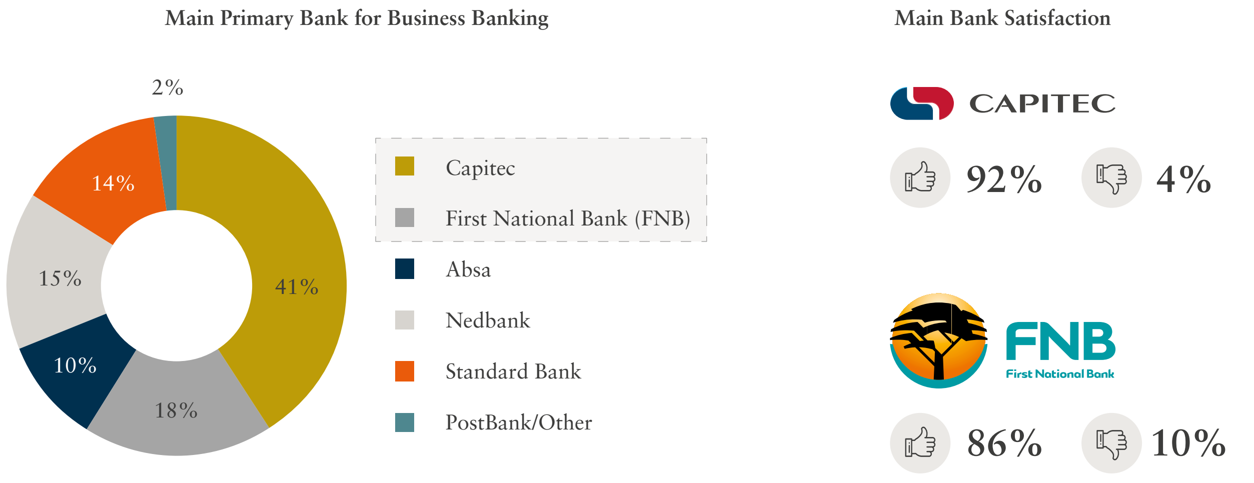
In interviews, women-owned formal businesses said it is important to see themselves reflected in the bank's marketing efforts and customer-facing staff (Figure 101). Businesswomen want to be reflected and represented, not just in what the bank offers, but also in terms of how the bank represents itself, openly and explicitly.

Figure 101: Women focus areas for financial institutions (formal sector)



The choice of primary bank and Capitec's dominance in the informal sector is reflected amongst women-owned informal small businesses, and their levels of satisfaction are similarly high (Figure 102).

Figure 102: Main bank chosen and satisfaction with main bank (informal sector)



Similarly, in the formal sector, choice of main bank is not dependent on gender and no bank is standing out as the preferred choice for women specifically (Figure 103).

Figure 103: Main bank chosen and satisfaction with main bank (formal sector)

Sample size: 595

KEY FINDINGS

- *Women business owners face attitudinal barriers that their male counterparts do not.*
- *Formalization helps women-owned businesses to counteract some of these attitudinal barriers.*
- *The training needs of women do not differ from those of men. Therefore, it is not the content of the training that needs to be adjusted, but rather ensuring that women owners have equal access to these initiatives, and that they are designed in a way that allows them to participate when often faced with more household duties compared to male-owned businesses.*
- *Women-owned businesses would like to see a change in attitudes in terms of being viewed as equals to their male counterparts by their bank. Women business owners say they want to see this in terms of the customer service approach they receive, as well as the products and value-added services that are offered to them.*
- *Formal business owners want to see banks recognizing women in their marketing efforts and in their staff.*

8 Growing the Small Business Future

This report brought the voice of the small business owner into the national conversation on how to grow the small business future in South Africa and enable the MSME sector to drive economic growth and create jobs and work for more people in the country.

Through the 2,600 interviews with small businesses owners from micro enterprises to medium-sized businesses, from Johannesburg to Cape Town, and from manufacturing to services, we heard what owners need to thrive and drive business development.

Differences exist across the size and formality of the business, but there are key areas that small business owners said pose challenges and present opportunities for their future. The findings highlight the areas where both the private and public sector can work to design, build and implement solutions that will support small businesses to grow, tailored to the needs of their size, reason for existing and phase of growth they are in.

Drive Visibility

Increasing visibility unlocks possibilities that informal businesses don't have access to, such as access to new markets and customers. Visibility extends to better record-keeping, financial and business management. Greater visibility and formalization can create access to finance and funding that can be invested in infrastructure and expansion activities, as well as increase opportunities for small businesses to work with governments and in large corporation supply chains. The major barriers to formalization center around limited knowledge of the process and the benefits it brings. The perception amongst small businesses is that there is a significant amount of complexity and cost to formalization and that the benefits of doing so will not outweigh these.

Unlock SME Banking

A key ingredient in unlocking growth is access to finance and markets. The small business perception is that the banking system, programs and initiatives that have been put in place to help them have not been designed with their needs and realities in mind, with many reporting unsuccessful attempts at accessing finance or funding. This has led to a sense of alienation and a disconnect between government, industry and financial institutions, and the small business owner.

The research indicates that financial institutions can respond in three ways to unlock SME banking. Firstly, financial institutions can increase innovation in the digital payments space to improve the flow of money in the MSME ecosystem, as well as transition financial management from a physical activity to a digital, data-driven function, which could ultimately improve business performance and access to finance. Secondly, financial institutions can play a role in protecting small business owners against critical risks by offering relevant insurance solutions to the sector. Lastly, financial institutions could approach small business lending differently, by specifically addressing the liquidity challenges faced by small businesses, as well as the need to purchase equipment, vehicles and property to expand and grow their businesses.

What Can Government Do?

The challenges faced by MSMEs suggest that there are three key areas where government could play a bigger role to generate bigger small business development impact.

POLICY WITH PURPOSE

Small business margins are tight and survival of the business often uncertain. As a result, small business owners shy away from burdensome compliance costs and taxation. The consequence is a high level of informality and businesses remaining invisible – to their customers, potential financiers and the economy. Government could intentionally use policy to increase visibility by building data. Better data can inform policy reforms, provide market insights to develop more appropriate solutions for the sector and support initiatives, assist to quantify the impact of small businesses on the economy and job creation more accurately, and enable both the public and private sector to understand MSME trends. Policy reforms could also incentivize formalization, albeit against a new definition of formality.

REDUCE BUREAUCRATIC AND LEGISLATIVE COMPLEXITY AND COSTS

Another reason for non-formalization is that small businesses feel overwhelmed by the perceived process and requirements of pre- and post- formalization. Therefore, reducing bureaucratic complexity and the costs involved with registration will help to encourage formalization. In addition, providing hands-on assistance to small businesses registering would help them to navigate the process with more confidence and ease.

The same issue applies to patent processes which MSMEs find onerous and costly. Reducing costs and complexity of this process for MSMEs would encourage more small businesses to engage and protect their intellectual property.

MSME engagement in cross-border trade is negligible, as these businesses struggle to gain access to export markets, yet many are hungry for new markets and opportunities. Reducing complexity for small businesses and providing support for those who wish to export could unlock additional opportunity.

SIMPLIFY AND AMPLIFY COMMUNICATION EFFORTS

There are several perceptual barriers at work in the small business sector, ranging from levels of knowledge and awareness around government initiatives and funding, to mental blocks around the value-equation linked to formalization and the perceptual barriers faced by women-owned MSMEs.

In terms of knowledge barriers, government could amplify and clarify communications around how government funding works, the initiatives already in place to aid small businesses, and how small business taxation works. In addition, communication to explain the benefits, rather than just the requirements, of formalization may encourage more informal businesses to register.

Given the lack of access to internet connectivity among informal businesses, there is an argument for the establishment of physical business and advisory hubs near to clusters of MSME businesses. The type of support that could be offered at these hubs could range from help in registering, assisting small businesses to become more digitally savvy, help in accessing funding to training programs, and networking opportunities.

Finally, it is important to address the attitudinal barriers faced by women-owned businesses in trying to access funding and non-financial support. This is an internal communications job where government employees need to be sensitized around gender equality, as well as potentially instituting targets for funding and support initiatives.

IMPROVE ACCESS TO FINANCING AND IMPROVE MSME LIQUIDITY

From a government perspective, this would include making it more attractive for financial institutions to grant financing to small businesses, for example through legislation, incentivization or subsidization. Incentives could also be used as a tool to encourage the private sector to offer business mentorship, training and networking initiatives aimed at small businesses.

Given the sector's liquidity issues and the experience many MSME businesses have with long payment times with government, it is important for government to consider reviewing payment policies or incentivizing quicker payment to MSMEs.

What Can Industry Do?

The small business knowledge gap issue often prevents MSMEs from achieving their business goals in terms of growth and stability, as well as having an impact on non-compliance with formalization. In addition to this, MSMEs express a strong desire to build or expand their business networks. Industry is best positioned to help address these challenges and desires.

FOCUS ON INITIATIVES AIMED AT UPSKILLING MSME OWNERS

Industry bodies can play a critical role in helping to bridge the small business owners' knowledge gaps. Moreover, they would be able to provide much needed expertise in terms of training from an industry-specific viewpoint, making training initiatives tailored and impactful for MSMEs operating in specific industries. Further targeted training based on growth stage MSMEs, particularly around general business training, could help to increase the health of industry sectors overall.

PROVIDE MENTORING AND NETWORKING OPPORTUNITIES

MSME owners express a keen desire to engage in mentoring and networking activities. Once again, industry bodies are best placed to offer these sorts of opportunities so that MSMEs can access industry-specific contacts that will be most relevant to them.

One such opportunity could be the institution of incubation hubs and accelerator programs with funding, training, mentorship and networking components for promising or innovative MSME businesses to have access to resources and knowledge to start or accelerate business growth.

What Can Financial Institutions Do?

Lack of access to financing is a challenge MSME business owners face in their quest for growth and success. Small business owners expressed their frustration in terms of gaining access to financing and often resort to using personal savings and loans from friends and family, particularly informal business and those just starting out. In addition to making financing more readily available, financial institutions can play a role in providing knowledge and expertise, particularly in the area of financing, to their MSME clients, thereby helping to close financial acumen gaps.

PROVIDE COACHING AND EDUCATION ON FINANCING

Coaching and financial education could be offered by financial institutions as a value-added service to MSME businesses who have an account with the business, or as part of a specific business account package, or even in the way that staff communicate with MSME business around how loans work with those who are applying.

Additionally, small businesses struggle with competencies such as bookkeeping and payroll management. Financial institutions could consider ways in which they can help to deliver some of these services as part of a business package.

Overall, the focus needs to be on educating and coaching, rather than simply informing MSME clients of product structures and requirements.

REVIEW REQUIREMENTS AND ADAPT FOR THE MSME REALITY

One of the biggest barriers to financing qualification is the largely rigid and onerous requirements needed by an MSME. Many MSMEs, particularly informal MSMEs but also those in the formal sector, do not have the required documentation as part of their normal operations, such as a business plan or records kept in the way the bank would like them, or they don't have assets for traditional collateral. Therefore, looking at what alternative elements could be used in assessing credit-worthiness such as length of time in business, reputation, transactional activity, business vision or company profile, could provide alternative funding assessment avenues. Financial institutions could innovate by developing different types of financing to address the needs of informal businesses. Introducing financial services to address the needs of the informal sector expands the size of the bankable business market in South Africa.

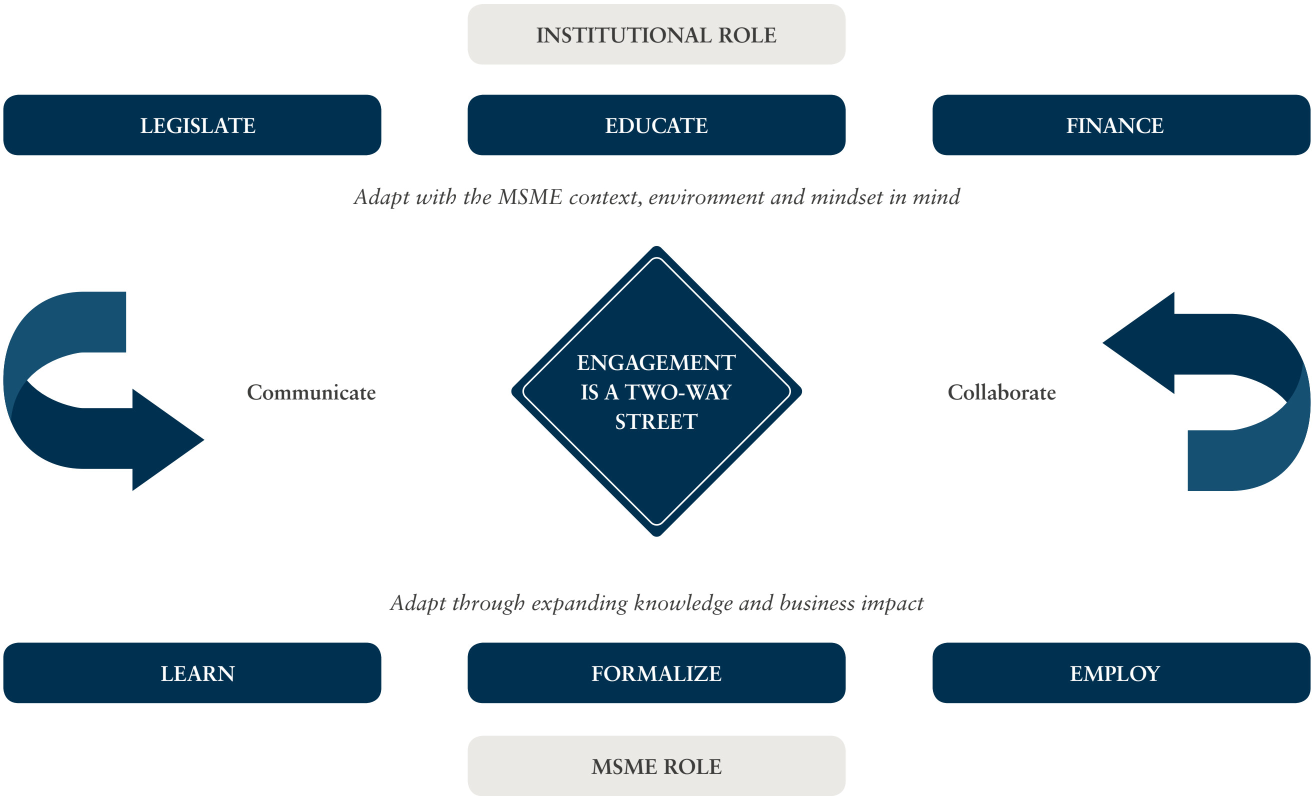
Apart from reviewing qualification criteria, a more general simplification of the loan application process and more hands-on assistance in taking business owners through it, as well as ensuring affordable quick access, could help to ensure that MSMEs are able to receive the financing they need to pursue business opportunities.

A further way in which financial institutions could simplify the banking process for owners, is by offering an integrated personal-business financial service for owner-managed sole proprietorships. Financial institutions can also encourage owners to open business accounts, rather than use their personal accounts, by creating more seamless account opening processes for existing personal clients. This ultimately represents additional business for financial institutions, since MSME owners often open their business accounts with the same institution where they hold a personal account. Specifically designed start-up packages could also help to encourage the opening of business accounts.

In terms of product offerings, financial institutions should ensure that their products are appropriate for the type of MSME that they are dealing with. Banks could consider financing against secured contracts to help MSME liquidity and ability to take on more substantial contracts for formal MSMEs, products that bundle personal and business insurance for small and micro businesses to make insuring businesses more affordable and reducing business risk, or developing alternative collateral requirements depending on the size and structure of the loan needed.

Finally, in order to address the attitudinal barriers women express facing when applying for financing, financial institutions need to engage in frontline staff training to ensure that they are sensitized to gender inequality issues.

Ultimately, it is a collaborative effort between institutions and MSMEs to ensure the health of the MSME sector, with the institutional role being that of providing education, appropriate MSME-friendly legislation and financing, and the MSME role of learning, engaging with public and private partners, and helping to bridge the employment gap.


INSTITUTIONAL ROLE
LEGISLATE
EDUCATE
FINANCE
Adapt with the MSME context, environment and mindset in mind
Communicate
ENGAGEMENT IS A TWO-WAY STREET
Collaborate
Adapt through expanding knowledge and business impact
LEARN
FORMALIZE
EMPLOY
MSME ROLE

9

APPENDIX Methodology

A two-pronged approach was utilized to undertake this study to ensure robustness and depth of insight, comprising of both quantitative and qualitative research methods. The detail of each method is outlined in the sub-sections that follow below.

Qualitative Phase

The SME Voice employed a qualitative, cross-sectional design to conduct in-depth interviews with business owners. A total of 45 in-depth interviews (IDIs) were conducted across three cities in South Africa: Johannesburg (GA), Durban (KZN) and Cape Town (WC). Fieldwork was conducted in April and May of 2019.

Table 7: Sample for Business Owner Interviews (reached sample)

	Agriculture	Manufacturing	Construction	Services	Trade	Transport	Total
Micro 1-5 Employees	Johannesburg 1x Informal	Johannesburg 1x Formal 1x Informal	Johannesburg 1x Informal	Johannesburg 1x Formal 1x Informal 1x Informal	Johannesburg 1x Formal 1x Informal 1x Informal	Johannesburg 1x Formal 1x Informal	12
		Cape Town 1x Formal		Cape Town 1x Formal 1x Informal	Cape Town 1x Formal	Durban 1x Informal	5
	Durban 1x Informal		Durban 1x Formal	Durban 1x Formal	Durban 1x Informal		4
Small 10-50 Employees	Johannesburg 1x Formal	Johannesburg 1x Formal 1x Informal	Johannesburg 1x Formal	Johannesburg 2x 1x Formal 1x Informal	Johannesburg 2x 1x Formal 1x Informal	Johannesburg 1x Formal	9
		Cape Town 1x Formal		Cape Town 1x Informal		Cape Town 1x Formal	3
	Durban 1x Formal			Durban 1x Formal		Durban 1x Informal	3
Medium 100-200 Employees		Johannesburg 1x Formal		Johannesburg 1x Formal	Johannesburg 1x Formal		3
			Cape Town 1x Formal	Cape Town 1x Formal	Cape Town 1x Formal		3
	Durban 1x Formal	Durban 1x Formal				Durban 1x Formal	3
Total	5	8	4	12	9	7	45

Sampling methodology

Non-probability, purposive sampling was used to define the sample, as well as to recruit participants against the sample outline. Quota sampling was used to recruit participants against the sample outline. Recruiters were briefed by the research team and provided with a recruitment questionnaire to administer to potential participants. Recruiters identified potential participants, adopting a snowballing method and administered the recruitment questionnaire. Suitable candidates were suggested to Kantar, who reviewed the completed questionnaire and conducted a secondary screening. Once the candidate was confirmed as a participant by Kantar, the interviews were scheduled to be convenient to respondents, and ideally at their place of business.

All interviews were recorded via an audio recorder. Audios were uploaded from the recorder to the project manager. All audios were transcribed by professional transcribers and used for analysis, alongside field notes taken by the researchers, and photographs taken by the researchers or shared by participants.

Quantitative Phase

The quantitative methodology consisted of a face-to-face tablet-based (CAPI) survey which took 60 minutes to complete. The sample was divided between 'formal' and 'informal' businesses as follows:

Formal businesses of n1,555 based on a sampling frame generated from business lists[5] and n1,000 informal businesses, sampled from across the eight major metropolitan areas. This totaled n2,555 interviews across the micro, small, medium (MSME) category. Those interviewed had to have an ownership element in the business (i.e. business owner, shareholder in the business, partner in the business or co-owner in the business).

Fieldwork was conducted between May and August 2019 for informal businesses, and May and September 2019 for the formal businesses.

Informal Business Sample

Informal SMEs are not likely to appear on a business list or databases, as these are usually businesses that are non-registered entities operating in the informal sector. Targeting these businesses was therefore done using the following approach:

- **Metropolitan municipalities.** The eight Metropolitan Municipalities[6] across five of the nine South African provinces were used as the sample landscape. These formed the different strata. Because of the large differences in the population sizes among the metropolitans, it was necessary to deviate from proportional allocation. The power allocation rule, a disproportional allocation technique that is applied internationally, was used to determine the number of informal businesses to be drawn per region. The aim of using the power allocation rule is to decrease the number of informal businesses to the larger metropolitans and to increase the number of businesses to the smaller strata. In short, power allocation results in an allocation between equal allocation and proportional allocation.
- **Enumerator Areas (EAs).** 250 EAs were drawn, using systematic sampling from areas that were determined to have a high probability of informal business activity.[7] The number of interviews were pre-determined and distributed appropriately between the eight metropolitan areas.
- **Business Activity Screening.** At the beginning of the survey, a screening procedure was included to identify potential interviewees. A full description of all the business activities of the owner was taken, and the principal activity classified into a business stratum[8] – (individual activities that are forms of selling labor, like domestic servants or windshield washers, were excluded).

[5] Sourced from Brabys/Mapit and Marketing Matrix.

[6] Gauteng: Ekurhuleni; City of Johannesburg (including Soweto), City of Tshwane; Free State: Mangaung (Bloemfontein); Eastern Cape: Buffalo City (East London); Nelson Mandela Bay (Port Elizabeth); KwaZulu-Natal: eThekwini (Durban); Western Cape: City of Cape Town.

[7] Aerial photographs based on GeoTerraImage's land use database (2016) were used to derive the business density of EAs.

[8] Anyone who sells any product; selling includes bartering or selling for money or who prepares food or drink for sale, or carries out repair services, or provides a service to others, or manufactures any product, or a combination of these activities. These were then further classified into four sectors: services, manufacturing, trade and agriculture.

- **Business size.** Businesses could be of any size, including sole trader, family businesses and firms with employees.
- **Weighting.** Weights were assigned to make weighted sample records represent the target population as accurately as possible. The weight of an EA is the inverse of the inclusion probability of an EA to be selected. The population data consists of business activity points with a high probability of informal business activity (and is not a reference to individual informal businesses).

Table 8: Informal sample by Metropolitan Municipality

	Ekurhuleni	City of Johannesburg	City of Cape Town	City of Tshwane	Nelson Mandela Bay	Mangaung	eThekwini	Buffalo City
Sell something in the same form that I buy from someone else	12	23	12	19	10	10	6	7
Sell something that I buy but add value to	19	19	15	10	13	8	11	13
Sell something that I make	37	20	28	26	14	13	19	9
Sell something that I collect from nature	4	1	1	-	-	3	2	1
Sell something that I get for free	8	4	8	3	2	1	3	1
Rear livestock/ poultry and sell	5	2	4	2	-	5	1	-
Sell by-products of animals	2	5	5	4	7	-	4	5
Grow something and sell	3	4	2	10	4	8	2	2
Provide energy service	1	2	1	1	-	4	2	1
Render a professional service	3	1	-	3	1	-	1	-
Render a skilled service	44	32	34	30	23	21	33	24
Render building/ construction services	3	5	4	4	2	1	2	2
Render tourism-related services	-	2	1	5	1	1	-	-
Render other services	39	37	33	30	23	21	10	11

Formal Business Sample

There isn't a single database capturing all formal businesses in South Africa. Therefore, the following process to sample formal business was followed:

- **Sample frame development.** Business entities were sourced from list suppliers and compiled into a database (n55,048) that detailed geographical location (province and locality (rural/small urban/metro (implicit stratification), size of business and sector).[9] This defined the population.
- **Size of business:** Size was determined by number of permanent employees: Micro (0-10), Small (11-50) and Medium (51-200).
- **Database cleaning:** Multiple databases were merged and cleaned in a process that involved the removal of non-profit organizations (NPOs), removal of duplicate entries, and removal of enterprises that were larger than 200 permanent staff.
- **List verification:** Telephonic verification was performed on a selection of list entries to validate the list.
- **Sample design.** The sample (n2,000) was drawn from the sample frame population using a stratified random design on industrial sector and employee size category as the primary stratification variables. Province and geographic area (urban, non-metro urban, and rural) were secondary stratification variables. In Phase One of data collection these businesses were targeted for interviewing.

  Phase Two of the data collection used a combined approach of (a) businesses drawn at random from the population database, and (b) snowballing based on strict matching criteria from the population sampling frame. The final sample was weighted to the stratified random design proportions. For the achieved sample (n1,555), a precision of +/-2.5 percent with 95 percent confidence, will be achieved at a total level (of analysis).

Table 9: Sample according to sector and size

Sector	Micro	Small	Medium	Grand Total
Agriculture, hunting, forestry and fishing	24	20	12	56
Mining and quarrying	9	11	3	23
Manufacturing	179	124	50	353
Electricity, gas and water supply	8	3	1	12
Construction	58	53	21	132
Wholesale and commission trade, except of motor vehicles and motorcycles	115	70	24	209
Retail trade, except of motor vehicles and motorcycles; repair of personal household goods	127	50	20	197
Sale, maintenance and repair of motor vehicles and motorcycles; retail trade in automotive fuel	85	67	17	169
Catering and accommodation	91	47	14	152
Transport, storage and communication	53	38	21	112
Financial intermediation, insurance, real estate and business services	211	105	40	356
Community, social and personal services	172	48	9	229
Grand Total	**1,132**	**636**	**232**	**2,000**

[9] Agriculture, hunting, forestry and fishing; mining and quarrying; manufacturing; electricity, gas and water supply; construction; wholesale and commission trade, except of motor vehicles and motorcycles; retail trade, except of motor vehicles and motorcycles; repair of personal household goods; sale, maintenance and repair of motor vehicles and motorcycles; retail trade in automotive fuel, catering and accommodation; transport, storage and communication; financial intermediation; insurance, real-estate and business services; community, social and personal services. These were based on the Standard Industrial Classification of all Economic Activities defined by Statistics South Africa's (StatsSA).

Table 10: Sample by province and locality

Province	Metro	Non-Metro Urban	Rural	Grand Total
Eastern Cape	128	75	9	212
Free State	54	72	0	126
Gauteng	410	94	1	505
KwaZulu-Natal	211	119	9	339
Limpopo	0	79	12	91
Mpumalanga	2	100	4	106
North West	3	115	6	124
Northern Cape	0	83	1	84
Western Cape	258	150	5	413
Grand Total	1,066	887	47	2,000

A table of how macro informal sectors were defined and identified in the sample is given below.

	Manufacturing	Services	Trade	Agriculture
Sell something in the same form that I buy from someone else (don't add value, e.g. cigarettes)			X	
Sell something that I buy, but add value to, e.g. repackage, cook, etc.	X			
Sell something that I make, e.g. crafts, clothes, food, furniture, bricks	X			
Sell something that I collect from nature, e.g. herbs, firewood, charcoal, thatch, sand, stone			X	
Sell something that I get for free, e.g. second-hand clothes, scrap metal			X	
Rear livestock/poultry and sell, e.g. chickens				X
Sell by-products of animals, e.g. meat, eggs, milk			X	
Grow something and sell, e.g. fruit, vegetables, plants (like a nursery)				X
Provide energy services, e.g. electricity, gas, and water		X		
Render a professional services, e.g. doctor, lawyer, accountant, engineer, consultant		X		
Render a skilled services, e.g. mechanic, plumber, hair salon, barber, painting, landscaping		X		
Render building/construction services		X		
Render tourism-related services, e.g. accommodation/hotel/B&B/ guesthouse, tour operators		X		
Render other services, e.g. car wash, garden services, transport (taxi services), catering		X		

Segmentation Sample

The segments were derived from the unweighted total (n2,555) of informal and formal business through SPSS 2 Step Cluster analysis. The decision on the final number of segments was made by using software developed by Kantar, called optimal segment evolver (OSE). The software is based on Calinsky & Harabasz index (1974)[10] and the HINoV[11] (Heuristic Identifier of Noisy Variables) algorithm. Based on the outputs, a final six segmentation solution was implemented. The variables that played the biggest role in defining the six segmentations are:

- Level of business registration with CIPC or SARS;
- Number of permanent staff;
- The role of cash in the business for expenditure and business income;
- Type of business bank account used;
- Business infrastructure density.

As there was strong differentiation amongst the segments, indexing using a 50 percent difference interval to total was used to profile and understand the business behavior within segments.

[10] Psychometrika- Vol.50, No.2, 159-179; An examination of procedures for determining the number of clusters in a data set – Glenn W. Milligan and Martha C. Cooper.
[11] Journal of marketing research; Vol XXXVI; 501-509 (1999); HINoV – A new model to improve market segment definition by identifying noisy variables; Frank J Carmone, Ali Kara, Sarah Maxwell

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Tackling the $5.2 trillion SME finance gap hinges on providing best practices for small and medium enterprises to thrive and grow. Alongside our Investment services, we provide these through Advisory Solutions to catalyze investment opportunities in emerging and developing market economies.

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Students at the Lunghile Nursing College,
a small business in Johannesburg, South Africa.
Photo: Karel Prinsloo / IFC

Woman who works in the daycare kitchen of a local farm. South Africa.
Photo: Trevor Samson / World Bank

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Vendors prepare food in Freedom Square, Soweto.
Photo: IFC / Karel Prinsloo

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