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Title: Is the state's presence on the entrepreneurial scene a hindrance or a boost to sustainability: Finding South Africa's "conversion factors" in small business success.

Abstract: Entrepreneurship is nourished by both cultural adaptation and institutional support. Institutions are universal while culture is somehow specific. It requires a supporting culture for entrepreneurialism to emerge and it further requires that the necessary institutional mechanism is in place. One of the opted means to ensure economic participation of previously disadvantaged groups in post apartheid South Africa has been to focus on supporting the emergence of small and medium enterprises. Through institutionalised state support by way of providing start-up funding and skilling, the state has been at the centre of driving the initiative. However, the efforts of the state through funding has thus far not yielded sustained entrepreneurs, seen in the form of surviving businesses. In some cases, success seems to emerge in corners where the state is not expected to assist, despite its assistance. The main question that emerges, therefore, is what are the factors that would contribute to the survival of entrepreneurship in South Africa. Does South Africa—particularly the historically disadvantaged groups such as blacks—lack Amartya Sen's "conversion factor" in order to fully utilise the institutional support provided for entrepreneurship. On the other hand, does the institutional support provided hampers the essence of entrepreneurship by instilling a sense of entitlement on potential entrepreneurs. The latter may also be exacerbated by a mere deficit in terms of the culture that is necessary for entrepreneurship among majority of South Africans. This paper assesses the rate of success in SMMEs in South Africa with the aim to explain the role, limitations, and possible distortions that emerge with the initiatives undertaken by the state in supporting and developing entrepreneurs. The paper attempts to answer the question as to whether South Africa is endowed with the necessary "conversion factor" to turn institutional assistance into sustainable business success or thriving entrepreneurs.

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Introduction

Entrepreneurship, or ability to engage in enterprise, is constituted by multiple facets that are possessed by individuals. Individuals are the bearers of entrepreneurship spirit, expressed when they engage in entrepreneurial activities. The society or communities within which individuals exist provide a residue of cultural and behaviour traits that could determine an individual's predisposition to engage in entrepreneurial activities. To complete the cycle, the government may adopt policies aimed at building bridges in the form of institutional financial support and also encouraging individuals to express their entrepreneurial spirit; engaging in entrepreneurial activities. The relationship between the three elements of entrepreneurship (viz. Individuals, social traits, and the institutional environment) is a determinant of ability to engage in entrepreneurship and sustainability of entrepreneurship.

By looking at small and medium enterprises including informal businesses in South Africa, this paper explores the interlink between the individual as a potential agent to engage in entrepreneurial activities; the social and cultural traits characterising societies or communities; and the institutional environment created by government policy towards entrepreneurship. In order for entrepreneurship to be successful and sustainable, there need to be individuals with

appetite to engage in entrepreneurial activities. These are individuals who are more likely to emerge from societies or communities that have social and cultural traits that do not disparage involvement in entrepreneurial activities. Further, poor appetite for entrepreneurship among individuals, and societal deficiencies when it comes to traits that are supportive of entrepreneurship can be bridged by government's ability to create a policy environment that encourages emergence of entrepreneurship. The state could play a role by raising the rhetoric of 'doing it yourself', and may provide funding for small business as well as training and skilling on entrepreneurial activities.

The reality is that, where individual appetite for entrepreneurship is in abundance and the social and cultural traits favour entrepreneurship, there is no need for government to intervene in creating a favourable entrepreneurial environment, although such intervention may most likely improve the situation. This paper explores the reverse case of this scenario. By looking at the case of South Africa, the paper focuses on how lack of individual appetite for entrepreneurship coupled with deficit in terms of socio cultural traits favourable for entrepreneurship, continue to undermine (the state's) attempts to create a favourable environment for emergence and sustainability of entrepreneurs.

It is important that government intervention in creating a favourable environment for entrepreneurs is cognisant of the idea that there need to be a "conversion factor" that will translate the state's intervention mechanism into emergence and sustainability of entrepreneurship in the South Africa. If government intervention either through providing finance and skills falls short of enhancing the conversion factor that will spark and render sustainable entrepreneurship, then no amount of state efforts will enhance entrepreneurship. That South Africa generally has lower levels of conversion factor when it comes to translating existing opportunities (either in the form of a fertile environment or start-up funding for entrepreneurs) is quite evident.

A global measure of Total Entrepreneurial Activity (TEA) shows that South Africa has progressively declined from 9.3% in 2001 to 5.9% in 2009¹. South Africa has had a cumulative 40% decline in terms of entrepreneurial activity from 2001 to 2008. It is noted that the declining entry rate and the failure rate of small and medium enterprises in South Africa is higher than any

¹ Global Entrepreneurship Monitor

sampled country². It is observed further that “75% of new SMEs in South Africa do not become established firms”³. Clearly there is a decline in entrepreneurial activity measured in its contribution to the GDP in South Africa.

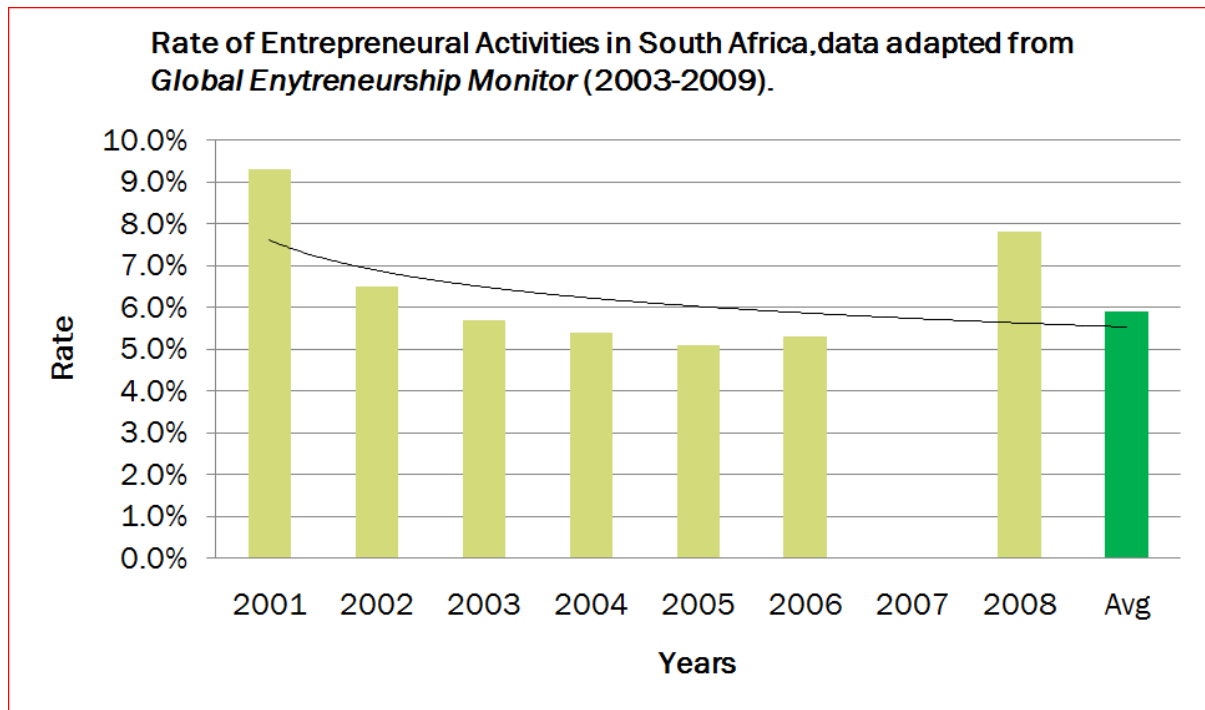


Figure 1, Measure of Entrepreneurship activities in South Africa

The trend in the decline of entrepreneurial activities coincides with the rising state efforts to prong up entrepreneurship in the country. There have been concerted government efforts, notably through the Department of Trade and Industry, to prong up entrepreneurship as a way to address the growing unemployment and also to ensure that that the economy benefits from entrepreneurship in South Africa. There are different explanations as to why a country may show declining levels of entrepreneurial activities. The first that comes for South Africa is the obvious structural constrain due to more than 40 years of apartheid regime. However, this explanation becomes inadequate with the observation that there were on aggregate more entrepreneurs, (albeit most were in informal businesses) among historically disadvantaged communities (viz. blacks) during apartheid era than it is the case in the post apartheid era. And the progressive decline of entrepreneurship from 2001 up to date demonstrate either the changing conditions of entrepreneurship in South Africa or failure of government policy to encourage the emergence of

² Fatoki, Olawale, David Garwe, “Obstacles to the Growth of the new SMEs in South Africa: a principal component analysis approach”, African Journal of Business Management, Vol. 4(5), pp.729-739, May 2010, p 730.

³ ibid

entrepreneurship. The large presence of black entrepreneurs during apartheid era eliminates the explanation that South Africans do not possess the entrepreneurial acumen.

It is argued here that the state's presence—through government policy—on the entrepreneurial environment is a factor that has changed the environment in a way that altered the individual traits regarding entrepreneurs. This has created a lag in terms of ability to undertake entrepreneurial activity and also diminishing resilience needed for sustainability of businesses once established. By using Amartya Sen's "capability approach", we are able to identify factors whose absence inhibits the ability of individuals to engage in entrepreneurial activities. The capability approach "...assesses people's welfare in terms of their functioning and capabilities, which are defined as individual's actual and future activities and states of being respectively"⁴. According to this model, different countries have varied capabilities when it comes to converting opportunities into outcomes. The same goes for different groups within a country. The theory measures the individual's ability to convert existing opportunities into activities and achievements: thus, ability and potential to act. This ability, according to the model, is explained as a "conversion factor", and the conversion factor can be poor in certain societies and stronger in others. This approach, to put it simply, focuses on the outcomes instead of inputs.

As will be argued below, we can use the capability approach—which Sen uses to explain opportunities and inequalities in a welfare setting—to explain how an altered entrepreneurial environment has impacts on the individual's "functional ability" and capabilities to undertake entrepreneurial activities. We can use this theory to investigate what constitutes ability to convert external opportunities into starting an entrepreneurial venture and possibly succeed as an entrepreneur.

We need to adapt the capability approach to the topic of entrepreneurship. First, we explain the theoretical assumptions behind the notion of "functional ability" and "conversion factor" and see how that elucidates individual's ability to engage in entrepreneurial activity. Then, that would be followed by a section on how state policy on entrepreneurship in South Africa has negatively affected the functional ability of individuals, thus, has obscured the conversion factor, removing the ability of individuals to convert external opportunities into business activities. Before

⁴ Wiebke Kuklys, Ingrid Robeyns, "Sen's Capability Approach to Welfare Economics", February 2004, CWPE 0415, p.1

discussing the relevance of the capability approach in understanding entrepreneurship, let us imagine the ecosystem of entrepreneurship, by way of a diagram.

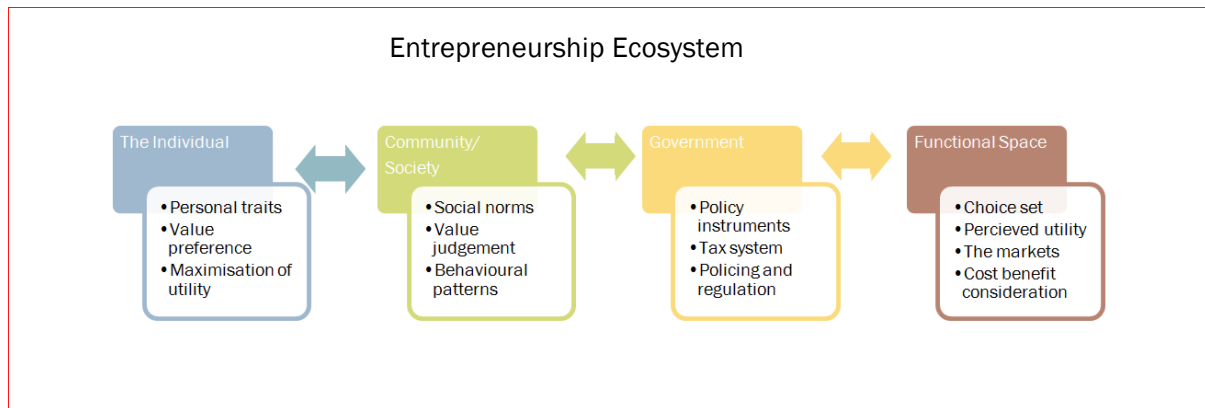


Figure 2, Entrepreneurship ecosystem

Let us observe the theoretical basis of the capability approach and its potency in explaining the ecosystem of entrepreneurship and behavioural patterns.

The capability approach and behavioural traits of entrepreneurship

The theory of capability approach, used by Sen to explain welfare impacts in society and also policy evaluation, is a potent tool in explaining factors that contribute towards entrepreneurial spirit and how individuals utilise that spirit as a set of capabilities to act and achieve a set of goals. A functioning space of an individual comprises of “all functioning an individual can achieve”⁵. The functioning space is an environment that an individual operates: those are the givens that are external to an individual as a potential actor. The content of the capability space can be thought about as government policy or even the markets. Kuklys and Robeyns refers to this as the “individual’s choice set”⁶. Although their postulation and modelling is more complex than presented here, the core of their assumptions is that the individual exists within a set of choices which could also be interpreted as “an augmented budget set”, which in essence cannot be altered by the individual. Individuals can only make choices but may not alter the choice set or the content of what has to be chosen.

In the context of entrepreneurship, the choice set is nothing but all the relevant external factors including advantages and disadvantages of entrepreneurship. This refers to a combination of

⁵ Wiebke Kuklys, Ingrid Robeyns, “Sen ‘s Capability Approach to Welfare Economics”, February 2004, CWPE 0415, p.5

⁶ Ibid.

factors such as the market conditions, rate of return, prospects success, for example. Essentially, these factors cannot be directly altered by an individual. The individual's capability in this case refers to the decision to make choice from a given set of choices. The individual makes a particular choice based on the utility to be achieved per choice made. The freedom to make that choice—granted that the choice yields utility—constitutes the conversion factor. Capability approach treats choice as an intrinsic value, thus, "The welfare of individuals is represented by utility, usually understood as desire fulfilment or preference satisfaction"⁷. The functional ability of an individual is seen in potential to make a choice within a given choice set. Let us recapture how this model understands the behaviour of an individual when it comes to ability to engage in entrepreneurship.

The utility to be gained by an individual as she approaches a given choice set (benefit and satisfaction of engaging in entrepreneurial activity, for example) determines potential to see and convert the given choice opportunity into an act of engaging in entrepreneurial activity. One may receive more utility on choice A which may involve benefit a;b, while the next person may see utility in option C which has benefit a;c. The two individuals will ultimately make different choices as their aggregation of utility from the given choice set varies. Their functional ability is therefore not the same and their ability to convert given resources into functions would differ. Hence, their conversion rate would subsequently vary. The functional ability of individuals to convert resources, information, and given choice set into engaging in entrepreneurial activities depends very much on the construction of the functioning space (i.e. the environment, choices, and benefits relating to entrepreneurship). The functional ability of an individual, thus the conversion rate, is influenced by this functional space which may be impacted by government policy or the markets.

Our focus here is on how government policy in South Africa impairs conversion factors by altering the functioning space of a potential entrepreneur, thus, adversely influencing the individual's functional ability and utility set. We observe how this plays out in the entrepreneurial environment in South Africa.

Now that we have attempted to use the capability approach to explain the ability of individuals to convert opportunities and resources into undertaking entrepreneurial activities and sustaining being entrepreneurs, we are in a position to observe the reverse reaction of the model, where the

⁷ Wiebke Kuklys, Ingrid Robeyns, "Sen's Capability Approach to Welfare Economics", February 2004, CWPE 0415, p.6

state's policy inhibits the necessary conversion factors among individuals to engage in entrepreneurial activities. The conversion rate of regarding seizing opportunities into business ventures is low among South Africans. It is important to explain how the situation came to where it is, and how it can be reversed.

With more collapse of newly established businesses, the rate of new entrances into entrepreneurial activities also declines. The solution to this problem is for the state to identify means to enhance conversion factors for establishment and sustenance of small businesses. Government efforts through providing start-up finance; training and skilling; will not yield desired results as long as it does not constitute the conversion factor necessary for starting new businesses. This is due to a peculiar way in which government policy on entrepreneurship has been conceptualised. The policies that have been adopted thus far (unintentionally) thwart the individual endowments and traits necessary for driving one to engage in entrepreneurial activities.

Government presence on the entrepreneurial environment in post apartheid SA

Government public policy on any sector or area of operation could either be an enhancer or an inhibitor. It is rare for government policy to have no impacts on the situation, thus leave situation as is. Since the collapse of apartheid, government has taken efforts to create “design interventions...that will promote development of SMMEs”⁸. The nature of intervention that has been preferred by government is made of providing start-up funding and also skilling entrepreneurs. Under the Department of Trade and Industry's “Empowerment and Enterprise Development” programme, government seeks to finance small enterprises and also to train and provide non financial support for small business⁹. The measure used by government (particularly DTI) to assess its programme on developing entrepreneurs is indicative of the nature of the approach preferred, and raises concerns with the conception that went into its intervention strategy.

The main emphasis when it comes to government programme on developing entrepreneurs is on the number of disbursement of grants or funds. One of the objectives of the programme is to ensure sustainability of small businesses, however this is not measured. The 2005/06- 2011/12 Strategic overview of the South African Micro Finance Apex Fund, a fund aimed at providing finance and support for micro enterprises, talks to increasing the number of disbursements and

⁸ Ntsika Enterprise Development Agency.

⁹ *Estimate of Public Expenditure 2009*. National Treasury [www.treasury.gov.za]

also increasing the value of disbursements made to small enterprises¹⁰. Sustainability and survival of small entrepreneurs that have received funding and support is not one of the measures stated in “Selected performance and operations indicators” for this sub-programme.

Within the entire Empowerment and Enterprise Development programme of the DTI, including all sub-programmes falling under this programme¹¹, none attempts to measure sustainability of businesses that have been assisted through this government programme, at least not any of listed performance indicators talk to this point. The sustainability of established entrepreneurs is a core factor that would drive the contribution of small businesses to the economy and would ultimately motivate further new entrants. At the core of government policy on entrepreneurship is the assumption that providing start-up funding for entrepreneurs is sufficient for development and survival of entrepreneurs. Not only is this approach inadequate, but may in turn distort the entrepreneurship environment.

One of the most important factors determining an individual’s ability to engage in entrepreneurial activity, and possibly survive and succeed as an entrepreneur, is the psychological lure of individual expression. The satisfaction and honour of having to start one’s business is an important element of individual expression that sustain entrepreneur. It is the “intangible characteristic of heroic Schumpeterian entrepreneur”¹² which provides a self-fulfilling motivation for engaging in entrepreneurial activity. While entrepreneurs aim to succeed and gain financial returns from their activities, it is not only prospects for financial returns that motivates and sustain an entrepreneur’s ability to be resilient, but it is rather the ability to defeat and experience of beating the odds that brings the ultimate psyche for entrepreneur. To put it simply, it is the hardships of entrepreneurship that sustain entrepreneurs.

Without the hardships, expressed sometimes in the form of scarcity of resources, entrepreneurship lacks the self-motivating factor. This may dampen the spirit for the birth of new firms and may lower the level of resilience among entrepreneurs who have already started new businesses. The implication of this is that, the removal of the odds removes the psychological motivations for engaging in entrepreneurs. This, in a sense, obscures the

¹⁰ *Estimate of Public Expenditure 2009*. National Treasury [www.treasury.gov.za]

¹¹ The sub-programmes falling under this programmes include Khula Enterprise Finance, Small Enterprise Development Agency. These agencies are mandated to play a leading role when it comes SMMes in South Africa.

¹² Thomas Grebel, Andreas Pyka, and Horst Hanusch, “An Evolutionary Approach to the Theory of Entrepreneurship”, in *Industry and Innovation*, Volume 10, No 4, 493-514, December 2003, p 500

conversion factor when it comes to starting and sustaining businesses. Let us see how government policy, focusing on the case of South Africa, has effectively removed this “conversion factor” by distorting the self-motivation factor that drives entrepreneurship.

Distorting the ecosystem of entrepreneurship: South Africa

The government policy on developing entrepreneurship has created greater expectations that tend to relate entrepreneurial success with government assistance. This has two negative effects on entrepreneurship in South Africa:

- Even if it were well conceived and potent, government policy of awarding grants to entrepreneurs has a potential to reach only one third of entrepreneurs in the country
- Expectations to be awarded grants or receive state assistance in whatever form, has made entrepreneurship a less fulfilling activity but rather an extension of welfare

Government policy or intervention would most likely reach out to formal institutions and sectors. In the case of small enterprises in South Africa, approximately two thirds of this population are in the informal sector and would not be registered¹³. While government policy is under these conditions likely to reach and affect the SMME population that is in the formal sector, which is a small fraction of the SMME population in the country, the expectations created from the rhetoric of government policy would invariably reach and affect the larger SMME population including those in the informal sector. There emerges an asymmetry between potential benefits from government policy on one hand, and the adverse effect of the rhetoric of government assistance on the entrepreneurial ecosystem at large. The result is that, the potentials of government policy on the entrepreneurial scene is far outweighed by the negative impacts of the rhetoric of assistance.

The potential of government policy in relation to developing entrepreneurship, assuming the policy is well conceived, would more likely affect one third of the SMME population. The reality being that such policy is not well placed because it focuses merely on disbursement of grants; creating expectations that the state is there to assist those who intend to engage in entrepreneurial activities. This expectation has a potential to disturb entrepreneurial ethos, particularly the self-motivation of ‘doing it yourself’ which forms greater part of potential entrepreneurs. Therefore, the idea of state funding or assistance may contribute to the ‘wait and

¹³ Al Berry et al, *The Economies of SMMEs in South Africa*, in Trade and Industrial Policy Strategy, December 2001, p.12.

receive' attitude, where success in entrepreneurship is no longer perceived to be arising from inner individual trait, but has to do with 'connections' and access to state funds. This, it can be argued, is a sentiment that is beginning to grow in post apartheid South Africa, and it explains the lower levels of entrepreneurship among South Africans. Entrepreneurship is also about self-expression even if it may come against the backdrop of necessity and survival instincts. The individual endowment to begin business and the necessary resilience to sustain a business after business has been established is negated by the expectation of state intervention.

The idea that those who survive as small business owners owe their success to state intervention is a disincentive that takes away the importance of individual fulfilment. This constitutes a shifting value system in the ecosystem of entrepreneurship, and affects the perceived utility of engaging in the trade. Individual endowment is one of the factors difficult to empirically measure, but it is potentially one of the most contributors to determining if one becomes an employee or an entrepreneur¹⁴. This is not to talk yet about success, but the birth of a small business. Isenberg writes that "Unfortunately, many governments take a misguided approach to building entrepreneurship ecosystems. They pursue some unattainable ideal of an ecosystem and look to economies that are completely unlike theirs for best practices"¹⁵. South Africa comes quite closer, of not a perfect fit, to this observation.

As it was the case in attempts to uplift the spirit of entrepreneurship for native Malaysians, observes Isenberg, South Africa has also engaged in a policy that attempts to enhance entrepreneurial spirit among black South Africa, characterised as having experienced structural injustices under apartheid system. The government's policy on entrepreneurship is expressed through the Department of Trade and Industry's funding mechanisms. Isenberg argues quite correctly that, such intervention policies not only failed in Malaysia, but may negatively affects the image of entrepreneurship "stigmatizing recipients as less capable"¹⁶. Even worse, this may result in stigmatizing success cases as owing all their success to government programmes. A more poignant observation made by Isenberg is that "Similarly, recent reports on South Africa's Black Economic Empowerment program have reached the conclusion that BEE has discouraged

¹⁴ Thomas Grebel, Andreas Pyka, and Horst Hanusch, "An Evolutionary Approach to the Theory of Entrepreneurship", in *Industry and Innovation*, Volume 10, No 4, 493-514, December 2003.

¹⁵ Daniel .J Isenberg, "How to Start Entrepreneurial Revolution", *Harvard Business Review*, June 2010, p 42

¹⁶ Daniel .J Isenberg, "How to Start Entrepreneurial Revolution", *Harvard Business Review*, June 2010, p.47

entrepreneurship among the bulk of black South Africans and has benefited primarily the elite and well-connected”¹⁷. This has a more pernicious effect on entrepreneurship landscape.

Due to perceived lack of transparency and perceived corruption in granting funding for entrepreneurs and the general state policy on entrepreneurs, South Africa will inevitably suffer on two counts of state intervention. The first effect is that of diminishing individual motivation and resulting in the individuals waiting for the state for assistance. The second challenge is the one of merely associating successes in entrepreneurship with greed and corruption. A negative image of entrepreneurship determines the functional ability of individuals and their freedoms to decide whether or not to engage entrepreneurship. Even if corruption may be seen to take place in the tertiary and secondary sectors of the economy, involving assets acquisition and big government contract, the image of entrepreneurship in small businesses and informal sectors would be negatively affected.

While South African government’s policy on entrepreneurship is well intended, its unintended consequences cannot be denied. Due to its diversity and racial composite, South Africa further offers opportunity for inter-racial observation when it comes to explaining variance of conversion rate, determining ability to engage in business activities. Where expectations of state assistance on entrepreneurship are high, levels of entrepreneurial activities are evidently correspondingly low. These correlations raises interesting research questions that need to be fully pursued in order to address this challenge, although this configuration may be influenced by structural hierarchies among different racial groups.. According to the Global Entrepreneurship Monitor (2001), 1 in 22 blacks in South Africa is an entrepreneur; followed by 1 in 12 of coloureds, and 1 in 10 of white and Indian¹⁸. There is no doubt that government intervention policy is generally targeted at assisting historically disadvantaged, thus blacks. And it is without doubts that expectations to receive state assistance runs quite high among blacks, declines to wards coloureds, Indians, and whites, in that order.

Conclusions

Entrepreneurship is one of the most complex areas of interest to study. It becomes quite difficult to carry out a structured enquiry of a topic that is essentially in the informal sector of the economy: the larger population of entrepreneurs are in the form of small and medium

¹⁷ Daniel .J Isenberg, “How to Start Entrepreneurial Revolution”, *Harvard Business Review*, June 2010, p.47

¹⁸ Global Entrepreneurship Monitor, South Africa, November 2001

enterprises, and the larger number is constituted by small businesses that are informal. Naturally, entrepreneurship at that level has to have a high level of attrition, since opportunities for new entrants have to always be in place. This means that the entry and exit rate in terms of small businesses is quite high. It is difficult to measure such an unstable sector. That stated, it is quite possible to establish the entry and exit rate.

This paper has attempted to show how government policy on entrepreneurship has (unintentionally) altered the ecosystem of entrepreneurship in the country. South Africa is not the first country to experience this problem, and ensuing negative image of small businesses in the country can be changed to be more positive and enhancing of entrepreneurship. To use Sen's capability approach, the conversion factors necessary for people to embark on entrepreneurial activities can be restored. By way of carefully identifying the elements of entrepreneurial ecosystem, and subsequently analysing how the ecosystem has been impaired by government policy or the markets, for example, it is then possible to restore the system for optimal results.

The image of entrepreneurship determines the value system attached to the activity, and ultimately shapes the ability of individuals to engage in entrepreneurship. In the case of South Africa, government efforts should rather be devoted to changing the image of entrepreneurship and the general societal attitude towards that. This is possible to achieve, as Isenberg writes "Changing a deeply ingrained culture is enormously difficult, but both Ireland and Chile demonstrate that it is possible to alter social norms about entrepreneurship in less than a generation"¹⁹. The state in Chile has been successful in dislodging the attitude that associate entrepreneurship with greed. Instead of focusing on grant system, government in South Africa should rather invest on restoring the positive image of entrepreneurship. For example, "Until the 1980s employment in government, financial services, or agriculture was the main aspiration of Ireland's young people,...by the 1990s...[it was widely believed that] If you wanted to be respected and taken seriously, you needed to be a founder with a stake in a company trying to do something..."²⁰.

The progressive decline of total entrepreneurship activity (TEA) from 2001 to 2009 is an indication that individuals in South Africa have the necessary conversion factors to undertake

¹⁹ Daniel .J Isenberg, "How to Start Entrepreneurial Revolution", *Harvard Business Review*, June 2010, p.47

²⁰ Daniel .J Isenberg, "How to Start Entrepreneurial Revolution", *Harvard Business Review*, June 2010, p.47

entrepreneurial activities. The consistent decline of entrepreneurial corresponds with the growing state presence on the entrepreneurial scene, which distorts the ecosystem of entrepreneurship. Further work need to be carried to see the validity of this assumption, so that it can be established what measures need to be put into place to reverse the situation. Institutional support to entrepreneurs in South Africa would not be of good use unless it feeds into the ecosystem of entrepreneurship, instead of hindering it.