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Small, Medium and Micro Enterprises and the Informal Sector

Key findings

- SA's informal sector, estimated at 23 per cent of total employment, is small in comparison to the rest of Sub-Saharan Africa.
- At 10,1 per cent of total provincial employment, the Western Cape has an even smaller informal sector than the national average.
- While provincial formal sector employment has grown significantly between 2000 to 2005, informal sector employment has contracted, thus not contributing to total provincial employment growth and leaving more of the labour force with no income at all.
- Formal sector employment is significantly superior to informal sector employment in respect of job permanency, written contracts, paid leave, pension and retirement funding, UIF provision as well as remuneration levels.
- Informal sector employees forgo a wide range of benefits because a large number of informal sector firms are not incorporated into the regulatory framework that governs employment relations.
- Small businesses are found in the formal and informal sector, but are more prevalent in the latter in the Western Cape.

- Africans tend to dominate employment in the smallest firms, with 42,5 per cent of individuals engaged in micro-enterprises being african.
- The bulk of micro-enterprise activity is concentrated within private households (31,4%) and the wholesale & retail trade (26,9%) sectors.
- Several key issues inhibit the performance of SMME and informal sector firms. These include access to financial services, skills training, physical infrastructure and basic services, business-related infrastructure, and the impact of regulations.
- Understanding these constraints and their underlying causes may help policymakers understand some of the mechanisms by which poverty traps persist over time.

1. Introduction

PER&O 2006 identified an important issue related to employment growth namely that, while the formal sector appeared to be growing, the informal sector was lacklustre and did not appear to be generating new employment. In fact, informal sector employment appeared to be stagnant at best, preventing the sector from making a greater contribution to the provincial economy.

This year, we take a closer look at the informal sector and Small, Medium and Micro Enterprises (SMMEs) in the Province. This section presents some descriptive statistics of informal sector and SMME employment.

The section continues by looking at some of the factors that may hinder growth, employment expansion and rising incomes in these sectors. It is hoped that this section raises some important issues for further debate and investigation.

2. SMMEs and the informal sector

In PER&O 2006, it was noted that the informal sector was not performing well, that it was in fact flagging and therefore not making the contribution it could to employment growth and the alleviation of poverty.

Informal sector employment was, at best, stagnant and, at worst, falling between 2000 and 2004. While greater formal sector employment should, arguably, be the primary focus of policy in this area, the informal sector should not be neglected.

In this section, we look at some of the characteristics of the informal and SMME sectors and some of the issues and challenges facing them.

2.1 Descriptive overview of informal and small business sectors

The dividing line between the informal sector and the formal sector is not always a clear one, with varying definitions being used in different countries attempting to categorise economic activity that essentially falls on a (multi-dimensional) continuum.

Further, classifying businesses according to size can be done in more than one way, thus leading to situations where firms identified as small using one criterion are not necessarily small according to another.

Although there is no universally accepted definition of what constitutes an informal enterprise, there is consensus that they are small scale, and operate outside registration, tax and social security frameworks, and health and safety rules for workers, with informal economic activity being defined by its 'precarious' nature.

Nevertheless, the formal-informal distinction is not simple. For example, analysis has shown that more than 45 per cent of formal sector workers are similar to their informal sector counterparts because they do not have written contracts, permanent positions or paid leave.

2.2 The informal sector in the Western Cape

2.2.1 The informal sector in the Western Cape

The informal sector in SA is relatively small by international standards. The International Labour Organisation (ILO) (2002: 7) estimates that approximately 78 per cent of non-agricultural jobs in sub-Saharan Africa, excluding SA, are located in the informal sector, with the figures for Asia and Latin America being 65 per cent and 51 per cent respectively.

In contrast, in SA it is estimated that the informal sector comprises 51 per cent of non-agricultural employment¹.

While international comparisons reveal SA's informal sector to be relatively small, inter-provincial comparisons reveal that the Western Cape's informal sector is even smaller. According to the LFS of September 2005², approximately 9,7 per cent of total employment in the Province is in the informal sector, compared to around 20 per cent for the country as a whole see Table 1.

The formal sector dominates total employment in both periods in the Province. In 2005, the formal sector employed over 1,3 million individuals, equivalent to 77 per cent of total employment. In contrast, the informal economy employed only around 168 000 individuals, while domestic workers, who are neither truly formal nor informal sector, accounted for under 6,0 per cent of employment.

In the five years between 2000 and 2005, the formal sector created 226 000 net new jobs, a result which is statistically significant. This reflects a rapid rate of job creation at 4,9 per cent a year, compared to 1,5 per cent a year overall. Thus, the formal sector has vastly outperformed the informal sector in the Province, the latter having shed around 16 000 jobs over the five years.

Contraction in the informal sector occurred at 1,8 per cent a year was, however, only statistically significant at a slightly lower level of confidence. This is worrying as the informal sector is not contributing to employment growth, leaving more labour force members without any form of income whatsoever.

¹ International Labour Organisation, 2002, 19

² Own calculations, Statistics SA 2006

Table 1: Formal and informal sector employment, 2000 and 2005

	2000		2005		Change		
	'000s	Share (%)	'000s	Share (%)	'000s	Share (%)	Ave. ann. growth (%)
Western Cape							
Formal	1 047	65,4	1 327	76,9	281	225,6	4,9 **
Informal	183	11,4	168	9,7	-16	-12,5	-1,8 *
Domestic workers	85	5,3	98	5,7	13	10,6	2,9 *
Subtotal	1 315	82,1	1 593	92,3	278	223,7	3,9
Agricultural workers	235	14,7	127	7,3	-108	-86,8	-11,6 **
Unspecified	52	3,2	6	0,3	-46	-36,9	-35,8
Total	1 601	100,0	1 726	100,0	124	100,0	1,5
SA							
Formal	7 091	57,9	7 987	64,9	896	1 436,4	2,4 **
Informal	2 032	16,6	2 462	20,0	430	690,0	3,9 **
Domestic workers	930	7,6	859	7,0	-71	-114,1	-1,6 *
Subtotal	10 054	82,1	11 309	91,9	1 255	2 012,3	2,4
Agricultural workers	1 914	15,6	925	7,5	-989	-1 585,5	-13,5 **
Unspecified	271	2,2	67	0,5	-204	-326,8	-24,3
Total	12 238	100,0	12 301	100,0	62	100,0	0,1

Source: Own calculations, September 2000 and September 2005 LFS, Statistics SA 2001 and 2006

Notes: Statistically significant changes at the 95 per cent confidence level are indicated with a double asterisk (**).
Statistically significant changes at the 90 per cent confidence level are indicated with a single asterisk (*).

In SA, as a whole, the informal sector accounted for 20,0 per cent of aggregate employment in 2005, while domestic workers accounted for a further 7,0 per cent. Consequently, just fewer than two in three workers in SA were employed in the formal sector. The Western Cape, therefore, has a small informal sector and large formal sector relative to the rest of the country.

Interestingly, the absolute and relative decline in the size of the Western Cape's informal sector is not mirrored nationally, with the informal sector expanding by around 430 000 jobs in the first half of the decade. The expansion in both formal and informal sector employment nationally is found to be statistically significant.

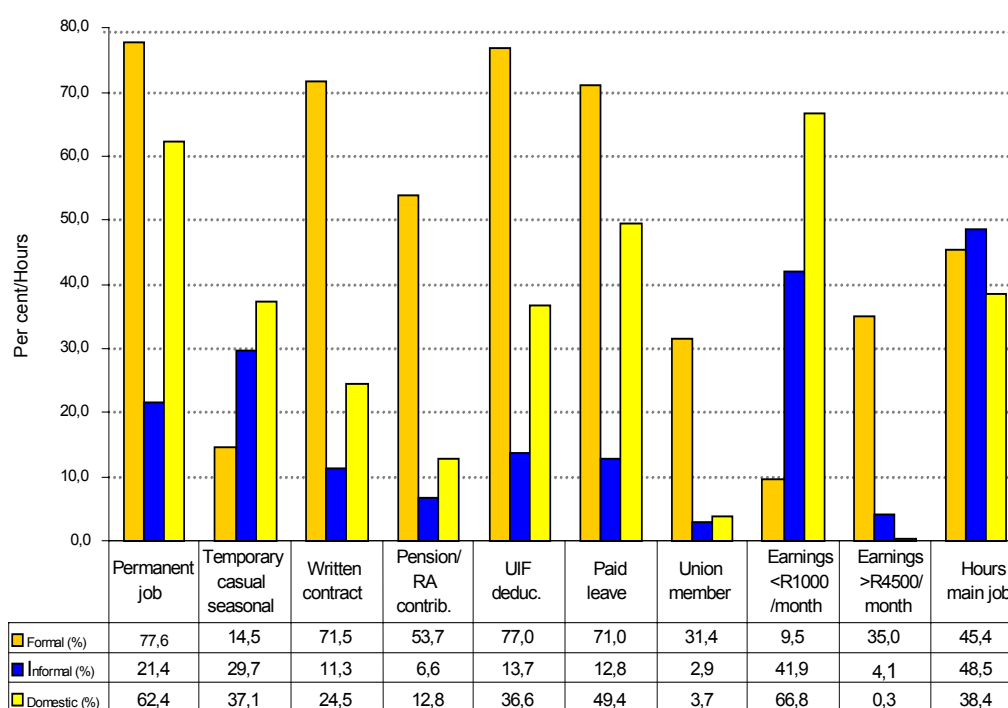
Enthusiasm for the role and potential for the informal sector to provide employment and incomes to those unable to secure formal sector employment must, however, be tempered by the fact that formal and informal sector employment cannot be viewed as substitutes for each other.

In terms of the quality of employment, formal sector employment is significantly superior to that in the informal sector, with formal sector workers being significantly better off than their informal and domestic workers counterparts on a number of counts.

Figure 1 illustrates the differences between the 'quality' of (non-agricultural) formal, informal and domestic work employment in the Province in 2005. Formal sector workers are better off than their informal counterparts in terms of job permanence. In 2005, more than three-quarters of the formal sector employed had permanent jobs, compared to only 21,4 per cent of informal sector workers and about 62,4 per cent of domestic workers.

Labour market protections, such the right to written contract were extended to domestic workers in 2002. It is interesting to note that, to a certain extent, domestic workers have benefited as a result, with informal sector workers (11%) being least and formal sector workers (71,5%) the most likely to have written contracts.

Figure 1: Characteristics of formal, informal and domestic work employment, excluding agricultural Sector, Western Cape, 2005



Source: Own calculations, September 2005 LFS, Statistics SA 2006

Notes: Permanent jobs include fixed term contracts. Proportions reported for earnings categories exclude those who did not answer the relevant questions.

The incidence of paid leave is far higher amongst those employed in the formal sector (71%), as is the incidence of deductions for pensions and retirement funding (53,7%), and the UIF (77%). This is compared to the informal sector where the incidence rates reach 12,8 per cent, 6,6 per cent and 13,7 per cent, respectively.

Unionisation rates in the formal sector are also significantly higher (more than ten times higher) than in both the informal and domestic work sectors. Informal sector employees forgo a wide range of benefits because a large number of firms in the informal sector are not incorporated into the regulatory framework that governs employment relations.

The evidence suggests that formal sector employment is far superior to other forms of employment in terms of remuneration. In 2005, about 67 per cent of domestic workers earned less than R1 000 per month, 42 per cent of informal sector workers earned no more than R1 000 per month, compared to 9,5 per cent of formal sector workers.

Conversely, 35 per cent of the formal sector earned more than R4 500 per month, compared to 4,1 per cent of informal sector workers and virtually no domestic workers (0,3%). Informal sector workers tended to work longer hours on average compared to both domestic and formal sector workers.

Thus, in the Western Cape, informal sector workers find themselves inferior to both formal sector and domestic workers in terms of job security, legal protection and access to benefits. Informal sector workers have less legal recourse in the event of disputes with employers, while their lack of benefits in terms of pension/retirement and UIF contributions makes them particularly vulnerable to both sudden retrenchment and retirement.

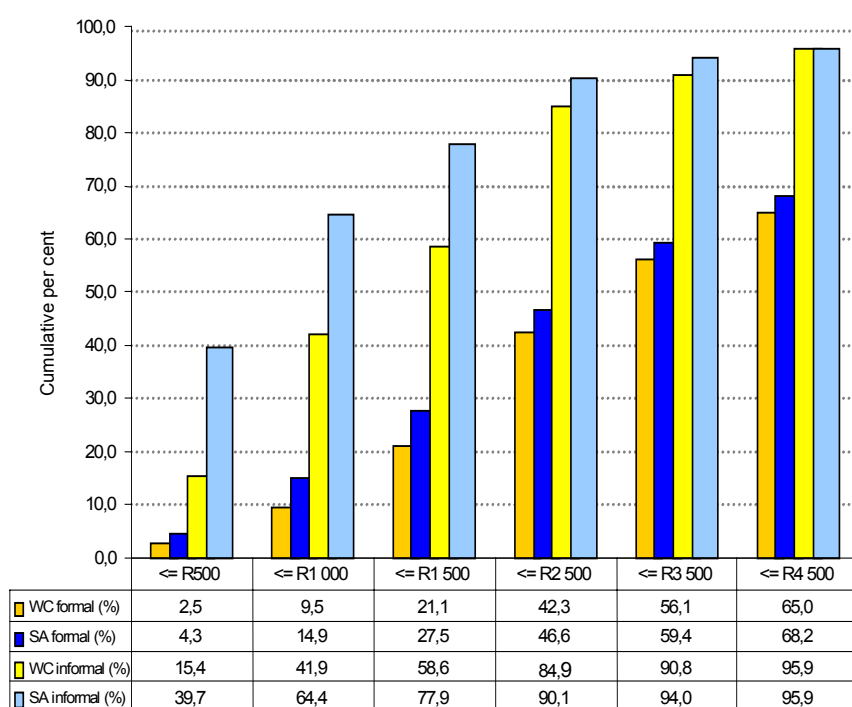
The fact that there is virtually no union membership amongst the informally employed means that this group of workers has very little voice in terms of policymaking and very little bargaining power vis-à-vis employers, a fact that is confirmed by the low levels of access to the various benefits and the relatively longer working hours.

The inferior position of informal sector workers in terms of remuneration is clear from Figure 2 below, which indicates the proportion of workers in a given sector that earn below a given level of income. For both SA as a whole and the Western Cape on its own, informal sector workers are more likely to be earning low wages.

For example, 64,4 per cent of informal sector workers in SA report earning no more than R1 000 per month, compared to 14,9 per cent of formal workers. Similarly, for the Western Cape, the respective proportions are 41,9 per cent and 9,5 per cent.

At the other end of the remuneration scale, less than 5 per cent of informal sector workers in the Western Cape and in SA earn more than R4 500 per month, while this is true of around one-third of their formal sector counterparts (35,0% and 31,8%, respectively).

Figure 2: Cumulative distribution of formal and informal non-agricultural employment across income, 2005



Source: Own calculations, September 2005 LFS, Statistics SA 2006

Notes: This figure excludes individuals who refused or omitted to answer the income question, as well as those who did not know the answer to the question.

Informal sector workers in the Province, however, find themselves in a superior position to informal sector workers nationally. Only 15,4 per cent of informal sector workers in the Western Cape report earning no more than R500 per month, while 58,6 per cent earn no more than R1 500 per month. In contrast, 39,7 per cent and 77,9 per cent, respectively, of informal sector workers nationally report earnings below these thresholds.

It is only above incomes of R3 500 per month where the gap is reduced to around four percentage points and less. Although this figure does exclude individuals who refused or omitted to answer the income question, including these would not improve the relative situation of informal sector workers. Since higher income earners are most likely to refuse to detail their incomes, their omission actually underestimates the gap between the earnings profiles of informal and formal sector workers.

The educational profile of informal sector workers in the Province, as is the case nationally, is poorer than that of formal sector workers, with domestic workers being the least educated of the three groups (Table 2). In the formal sector, 36,1 per cent have matric certificates, while 13,3 per cent have diplomas or certificates and 8,6 per cent have a degree.

Only 12,1 per cent of the formal sector employed have no secondary education at all. In contrast, only 21,8 per cent of those employed in the informal sector have matric certificates, while less than seven per cent of workers have post-secondary educations (diplomas, certificates or degrees), and 26,2 per cent have no secondary education.

Amongst domestic workers, the profile is even more biased towards lower educational attainment, with 81,1 per cent of domestic workers not having completed matric.

Table 2: Educational attainment of the employed, by sector excluding agricultural workers, Western Cape, 2005

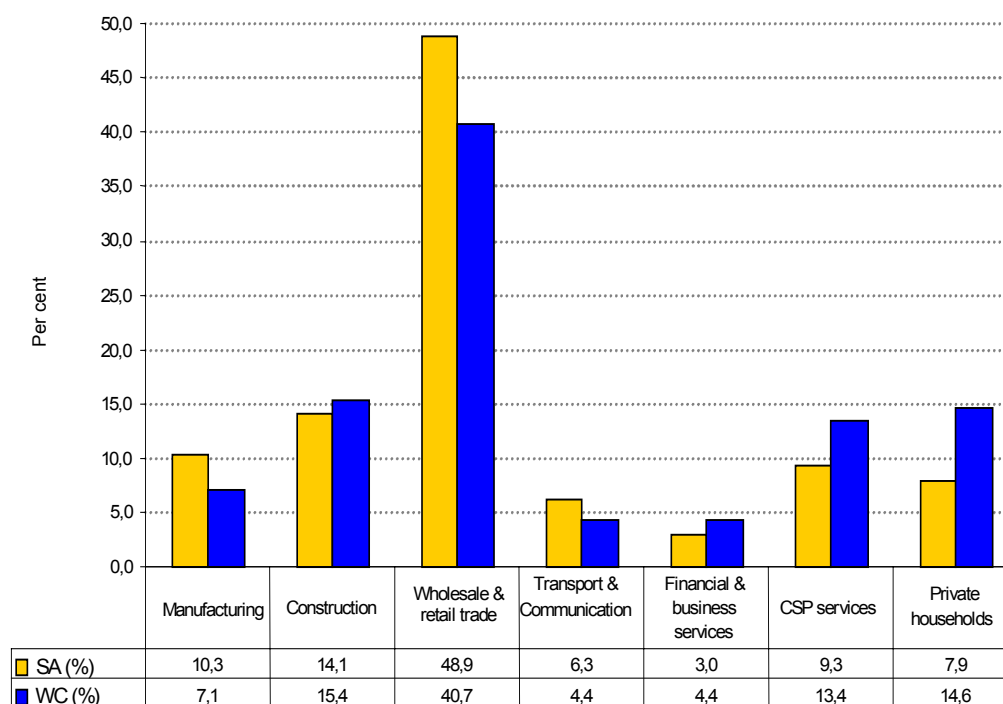
	Formal	Informal	Domestic	Total
No education	0,6	4,8	2,2	1,5
Grades 0-7	11,5	21,3	29,2	15,8
<i>No secondary education</i>	12,1	26,2	31,4	17,3
Grades 8-11	28,0	40,2	49,8	31,1
Grade 12	36,1	21,8	13,4	31,3
<i>At least some secondary education</i>	64,1	62,0	63,1	62,5
Diploma	13,3	6,0	0,0	11,0
Degree	8,6	0,7	0,0	6,8
<i>Post secondary education</i>	21,9	6,7	0,0	17,8
Total	100,0	100,0	100,0	100,0

Source: Own calculations, September 2005 LFS, Statistics SA 2006

Sectorally, both nationally (48,9%) and within the Province (40,7%) the informal sector employment is concentrated in the wholesale & retail trade sector. This is followed by employment in construction, which employs 15,4 per cent of the provincial informal workforce and 14,1 per cent nationally.

The provincial and national sectoral distributions of informal employment, however, diverge here. In the Western Cape, private households (14,6%) and CSP services (13,4%) are the next most important sectors for informal employment. In contrast, nationally, manufacturing (10,3%) and CSP services (9,3%) complete the four most important informal sector employers.

Figure 3: Sectoral distribution of non-agricultural informal sector employment, 2005



Source: Own calculations, September 2005 LFS, Statistics SA 2006

2.3 The small business sector in the Western Cape

Small businesses are to be found in both the formal and informal sectors and the small business sector can, therefore, not be discussed by contrasting it with the informal sector. Small businesses are categorised as such according to the number of employees.

Micro enterprises have no more than four regular workers, very small businesses have fewer than 20 regular workers, and small businesses have fewer than 50 workers. Medium enterprises employ up to 200 people.

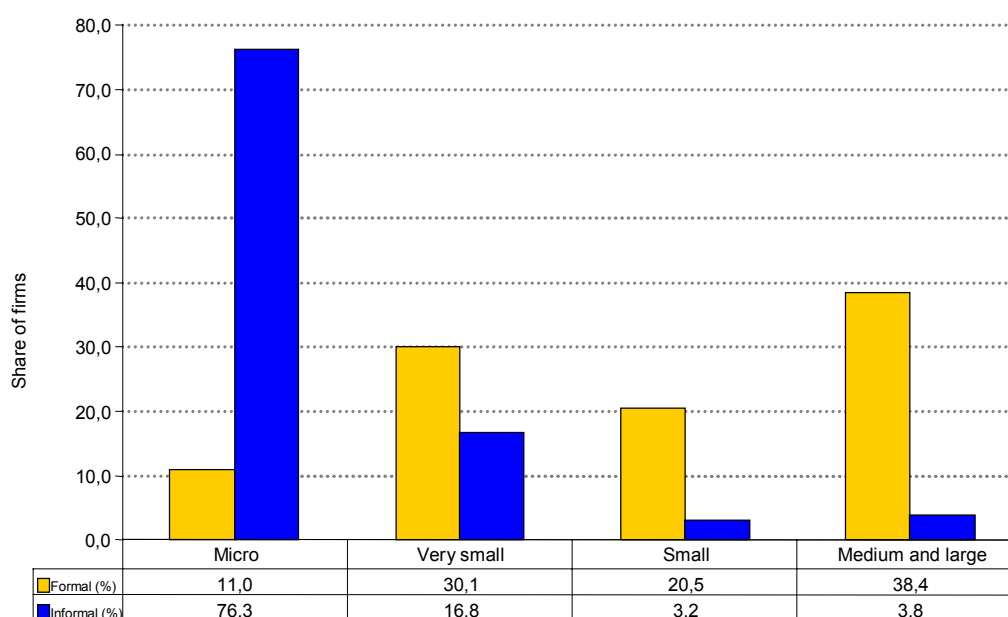
Micro enterprises can be classified as survivalist or non-survivalist enterprises. Survivalist enterprises do not employ anyone and examples of such enterprises include hawkers, vendors and spaza shop owners. Non-survivalist enterprises employ no more than four regular workers. Both these types of enterprises tend to form part of the informal economy. They typically do not pay any tax and are usually not registered. Very small enterprises operate in the formal economy and have access to modern technology.

Small businesses are highly heterogeneous cutting across industries and the formal-informal sector divide. They vary in size, turnover and purpose, amongst other things and are likely to operate from business or industrial premises. In most cases, they are owner-managed or controlled directly by the owner company, and are also likely to be registered with taxation authorities. Medium enterprises, although still owner-controlled, have more complex ownership and management structures and there is increased division of labour.

Unsurprisingly, small businesses are most prevalent in the informal sector (see Figure 4 below). In 2005, 76,3 per cent of informal sector workers reported working in firms with fewer than five regular workers, while this was true of only 11,0 per cent of formal sector workers.

Very small (30,1%) and small enterprises (20,5%) tend to be more prevalent in the formal sector. In contrast, 16,8 per cent of informal sector workers worked in very small enterprises and only 3,2 per cent worked in small enterprises. More than nine in ten informal sector workers work in firms with fewer than 20 regular workers, compared to only four in ten in the formal sector.

Figure 4: Employment by enterprise size and sector, Western Cape, 2005



Source: Own calculations, September 2005 LFS, Statistics SA 2006

In 2005, half of the employed in the Province were coloured (50,2%), while 25,5 per cent were african and 23,4 per cent were white (see Table 3 below). However, this pattern does not hold across firms categorised by number of employees.

Africans tend to dominate employment in the smallest firms, with 42,5 per cent of individuals engaged in micro-enterprises being african.

Table 3: Employment by enterprise size and race, Western Cape, 2005

	African			Coloured			White			Total		
	'000s	Share of race (%)	Share of firm size (%)	'000s	Share of race (%)	Share of firm size (%)	'000s	Share of race (%)	Share of firm size (%)	'000s	Share of race (%)	Share of firm size (%)
Micro	163	37,1	42,5	128	14,8	33,4	88	21,9	23,0	384	22,2	100,0
Very small	126	28,7	27,8	216	24,9	47,7	107	26,6	23,7	453	26,2	100,0
Small	62	14,1	21,0	160	18,5	54,2	73	18,2	24,9	296	17,1	100,0
Medium & large	80	18,1	14,6	328	37,9	60,3	129	31,9	23,6	545	31,6	100,0
Total	439	100,0	25,5	867	100,0	50,2	403	100,0	23,4	1 726	100,0	100,0

Source: Own calculations, September 2005 LFS, Statistics SA 2006

Notes: Totals may not tally due to the omission of the Don't Know and Unspecified categories, as well as the omission of asian employment, which total less than one per cent of employment.

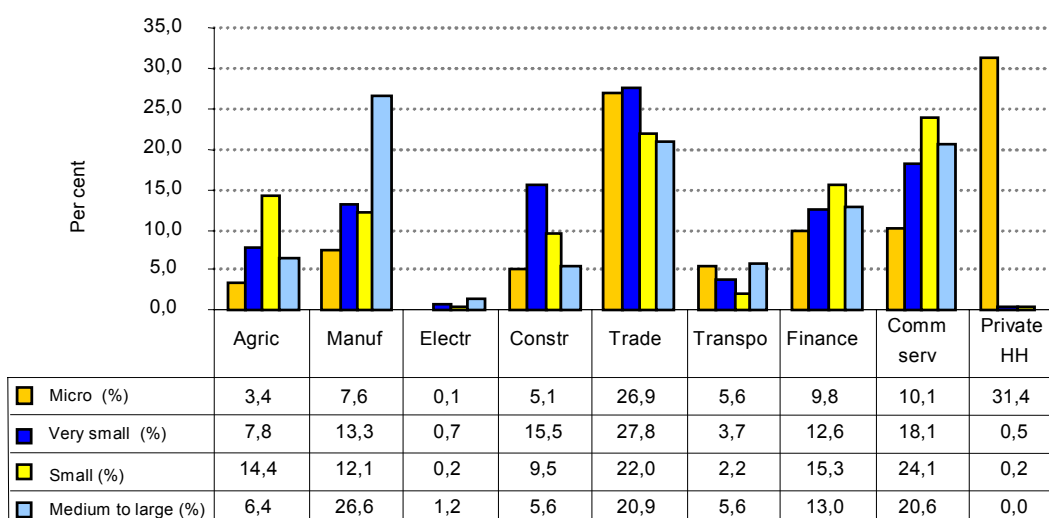
Coloureds, on the other hand, account for a disproportionate share of employment in larger firms: 54,2 per cent of those working in small firms and 60,3 per cent of those in medium and large firms are coloured. Interestingly, whites account for a consistent share of around 23 to 25 per cent of employment, across all firm sizes.

Most africans work in the smallest firms – 37,1 per cent in micro-enterprises and 28,7 per cent in very small firms. In contrast, 37,9 per cent of coloureds and 31,9 per cent of whites are employed in medium and large firms, while 24,9 per cent of coloureds and 26,6 per cent of whites are employed in very small firms.

These differences are rooted in the differential rates of engagement in the informal sector by race, where one-fifth of employed africans are employed in the informal sector in 2005, compared to 7,5 per cent of coloureds and 4,2 per cent of whites.

Figure 5 illustrates the pattern of enterprise size in specific industries in the Western Cape. The bulk of micro enterprise activity is concentrated within private households (31,4%) and the wholesale & retail trade (26,9%) sectors, with financial & business services and CSP services accounting for around 10 per cent of employment each.

Figure 5: Employment by enterprise size and industrial sector, Western Cape, 2005



Source: Own calculations, September 2005 LFS, Statistics SA 2006

Note: Medium enterprises as identified using the 2005 LFS include large firms as the question seeking to establish the size of the business only identifies firms with 50 or more workers.

Wholesale & retail trade also accounts for the largest share of employment in very small enterprises: almost 28 per cent of those working in very small enterprises are engaged in wholesale & retail activity. Four other sectors make up the bulk of very small enterprise employment, namely CSP services (18,1%), construction (15,5%), manufacturing (13,3%) and financial & business services (12,6%), collectively accounting for around 60 per cent of employment.

2.4 Constraints Facing the SMME and Informal Sectors

The literature on micro, very small, small and medium enterprises points to two reasons for engaging in these entrepreneurial activities. An individual may start a business in order to take advantage of an opportunity that exists in the market. Alternatively, individuals may start a business as a way of supporting themselves and their families.

Necessity is more likely to motivate women than men to start a small business and such a business is likely to operate in the informal sector while men are more likely to engage in opportunity motivated small businesses.

The informal sector is therefore often viewed as a type of 'safety net', in that it provides employment and income-earning opportunities for those excluded from formal sector employment. Many of those engaged in the informal sector would, in its absence, be unemployed and unable to access any alternative form of income, including state grants. However, employment in the informal sector is clearly inferior to that in the formal sector (see section 5.2.1 above).

Putting the size of the informal sector into context, it is estimated that the labour component of the informal sector alone contributes over R5,5 billion annually to Western Cape Gross Geographic Product. While the informal sector may be small, labour productivity in SA micro-enterprises is high relative to other African and other middle-income countries.

Like any part of the private sector, firms in the informal sector require an enabling environment that will encourage growth and expansion, which in turn will hopefully benefit workers in this sector in terms of better incomes. There is also the hope and, in some quarters, the expectation that growth in the informal sector will spill over into the formal sector through the 'formalisation' of informal sector firms.

This enabling environment, however, is more than simply a generally favourable (macro)economic environment, but extends to local crime levels, prospects for small-scale or micro-finance and the ability of informal sector firms to engage with formal sector businesses. Many of the issues surrounding the performance of the informal sector are very much micro-economic, with especially local government playing a critical role in providing the infrastructure and environment that growth requires.

The informal sector in SA has been the subject of research focussing on the reason for its small size compared to other countries. The key question is why the informal sector is so small in the face of such high rates of unemployment.

In the 1993 SALDRU and various October Household Surveys, it was found that the unemployed are substantially disadvantaged in relation to the informally employed in terms of income and expenditure.

The fact that the percentage of unemployed people in the Western Cape is growing suggests that there are barriers which prevent many of the unemployed from entering the informal sector.

The barriers to entry in the informal sector limit its attractiveness to the unemployed and this sector may be unable to absorb significantly more of the currently unemployed.

One of the important questions that must be asked in the SA context is why do so many people 'choose' to remain unemployed rather than moving into self-employment. In other words, what are the issues that constrain expansion of the informal and SMME sectors?

Identifying these constraints and their underlying causes may help policymakers understand some of the mechanisms by which poverty traps persist over time. It is plausible that many individuals and households are classified as poor today due to the exclusion from profitable opportunities in the labour market of first or second earners in the household.

This is a potential outcome not just from exclusion of the chance to work in the formal sector but also a result of constraints that exclude individuals from opening spaza shops, entering street trading, and engaging in other informal sector activities.

International and SA research have identified several issues that inhibit the performance of informal sector firms and keep incomes in this sector low. The key issues are access to financial services, access to skills training, access to physical infrastructure and basic services, access to business-related infrastructure, the impact of regulations, sector-specific constraints, and poor collective action amongst the informally employed.

2.4.1 Access to financial services

Access to financial services, specifically savings and credit facilities, is seen by many to be critical to the success of private enterprise, whether located in the formal or informal sector. Such facilities help firms and their owners purchase equipment and stock; cope with irregular and often unpredictable cash flow problems; and make larger scale investments required to expand the business.

However, small firms in general and informal firms in particular find it difficult or even impossible to access formal sector credit, due to perceptions of their higher risk. Informal sector firms are, therefore, often forced to cope without credit or must access credit from less reputable and significantly more expensive sources of credit, with negative consequences for the firms' sustainability.

Capital constraints are important to the SMME sector for two reasons. First, they may keep individuals from engaging in SMME activities and second, they may impact negatively on the growth rates of existing small enterprises.

A 2003 Micro-Enterprise Investment Climate (MICA) Survey conducted in Tshwane, Ekurhuleni and Stellenbosch found that 43 per cent of manufacturing micro-enterprises cited access to finance as a serious concern.

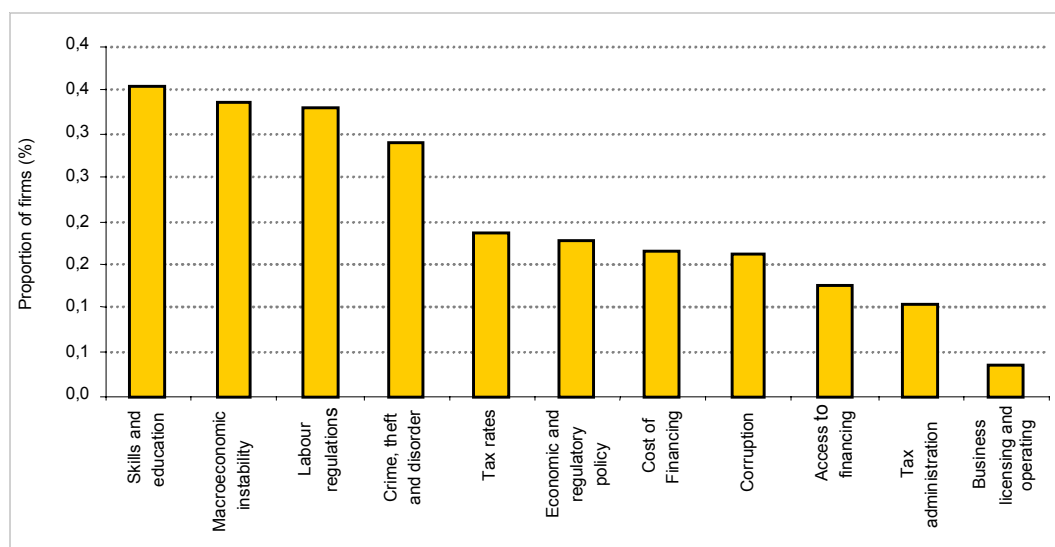
The contrast with larger firms is stark. Based on interviews conducted with 800 formal sector firms, the SA Investment Climate Survey found that fewer than one-fifth of firms cited either access to or cost of financing as major or very severe obstacles, which is considerably lower than in most comparable middle income countries. However, the World Bank findings suggest that the divide here is more an issue of formal versus informal rather than large versus small.

Out of about 600 firms interviewed in the Investment Climate (ICA) survey, 21,7 per cent were from the Western Cape. The size breakdown of the Western Cape firms was as follows: 60 had less than 50 employees, 36 employed between 50 and 199 employees and only 33 employed more than 200 employees.

The survey asked firms if a set of issues were seen as constraining the operation and growth of their businesses and to rank the severity of the constraint on a four a point scale. The focus was on the perceived constraints, which are likely to be highly correlated with actual constraints.

Figure 6 presents some of the results from the ICA survey sorted by the percentage of firms that related an obstacle as major. Interestingly, capital constraints are not identified as most important constraints to business, although they are identified as major obstacles by a substantial proportion of firms.

Figure 6: Perceived obstacles to business by firms in SA, 2004



Source: World Bank, 2004

Two types of capital constraints hinder small business growth. The cost of financing (for example, interest rates) is mentioned as an obstacle by 16,4 per cent of firms while access to financing (for example, collateral) is identified as a constraint by 12,6 per cent of firms.

Capital constraints lead the majority of new small businesses to rely on their own savings or assistance from relatives or friends for start-up capital because costs of financing are too high and many entrepreneurs lack of the required collateral.

Financial institutions do not serve small business owners and the poor efficiently. Adopting a microfinance framework which has proved to be successful in other developing countries such as Bangladesh may be a welcome tool in the fight against poverty and unemployment³.

Since 1995 the national Government has actively promoted the SMME sector because of its potential to contribute to innovation and its ability to impact on economic growth. Institutions such as the National Small Business Council and Ntsika Enterprise Promotion Agency and recently the Small Enterprise Development Agency form part of the national government's on-going initiatives.

However, as international evidence shows many of the SMME firms do not survive for more than five years and fewer develop into high growth firms.

Access to credit for informal businesses should be promoted carefully, since credit is only useful if managed well. As shown above, individuals operating in the informal sector tend to be less educated than those in the formal sector, while arguably bearing greater responsibility than their formal sector counterparts of similar educational attainment.

³ Micro-finance is the provision of a range of the poor's financial service needs, including credit, savings, insurance, remittance management while micro-credit is the provision of small-scale loans to the poor.

Thus, facilitating access to credit without providing informal sector entrepreneurs with financial skills may have serious negative consequences for the enterprise, its employees and its owner(s). Focus is therefore shifting towards the savings ability of micro-entrepreneurs, rather than encouraging the accumulation of debt.

2.4.2 Access to skills training

Individuals engaged in informal sector activity tend to be less educated and have fewer marketable skills than their formal sector counterparts. In the Western Cape in 2005, 18,1 per cent of formal sector workers have been trained in skills that can be used for work, compared to 12,5 per cent of informal workers.

One way in which to boost the performance of informal sector firms and improve incomes is through skills training. However, informal sector workers and entrepreneurs are constrained in their access to skills training. Surveys of Johannesburg and Durban that indicated that very few people working in the informal sector have ever accessed training.

The skills required, however, are not uniform across activities or individuals and include varying business skills, life skills and even literacy, numeracy and communication skills.

According to the MICA survey, approximately 21 per cent of micro-enterprises had managers with post-secondary or vocational training, while in manufacturing micro-enterprises, managers were less educated and those in black-owned businesses most often did not have any secondary education at all.

This contrasts starkly with the four-fifths of managers of larger enterprises surveyed in the Investment Climate Survey having university qualifications. It is also clear from Figure 6 that skills and education are the top constraint facing firms surveyed in the ICA survey, with more than one-third (35,5%) of firms citing it as a major constraint.

Although training is available via the SETA system, informal sector firms as well as small formal sector firms do not necessarily find this training to be accessible. Large corporations, for example, find the administrative and other requirements of the SETA system to be onerous, hindering the expansion of learnerships. It is therefore not surprising that this would apply even more so to smaller firms who are less able to dedicate the resources and expertise to this issue.

A sustained increase in the utilisation of the learnership system on the part of informal and small businesses is possible if SETAs ensure that their offerings are relevant and flexible. Specifically, for example, it is important that informal sector workers are able to access part-time learnerships, as their livelihoods would otherwise be negatively impacted by full-time attendance.

Learnerships need also to be accessible in terms of the level of education required by participants, particularly since the educational profile of informal sector workers is relatively low.

2.4.3 Access to infrastructural and other services

All businesses require access to infrastructural and other services in order to thrive. Water, sanitation and refuse removal services, as well as access to electricity, are important municipal services that may support or constrain, in their absence, the informal business sector.

Consequently, given that most informal sector workers in the Western Cape work from home, it is important that these households have access to these services.

Further, the provision of formal housing and the general upgrading of informal settlement are important interventions in this regard. Thus, service delivery and the provision of formal housing are not just important from a societal or welfare point of view, but also from an economic point of view.

Transport infrastructure and services are also highly important, with historical settlement patterns resulting in large proportions of poor people living relatively distant from their places of employment, in many cities and towns across the country. Cape Town and other Western Cape towns are not different in this regard, with many of the poorest workers having to travel long distances to work.

Those engaged in informal sector activity, even when working from home, are not unaffected, facing high transport costs either getting themselves and their products to places of sale in markets, at intersections or on pavements in business districts, or getting stock or raw materials from distant suppliers to their places of work in their homes.

Apart from high costs, poor accessibility of public transport on either end of a given journey will impede the ability of informal sector businesses to grow.

Safety and security are important to ensure that economic activity thrives. Crime, theft and disorder ranked fourth amongst firms in the ICA survey, with 29 per cent of firms identifying it as a major hindrance (see Figure 6). Crime negatively affects informal sector operators, perhaps even more than it does formal businesses, since the former are unlikely to have insurance against stock and property losses.

Informal sector businesses are typically more exposed to criminal activity due to less security at their premises and, particularly for traders, the exposed nature of their activities. Further, informal sector operators may be less forthcoming in terms of reporting crimes, due to greater fear of retribution or a less favourable relationship or perception of police.

This may be particularly important where informal businesses do not operate fully within the bounds of the law and police involvement may hold negative consequences for the business itself. The imperative for local government to facilitate informal sector activity also impacts on informal sector exposure to crime.

The creation of more favourable conditions for the informal sector, such as improved provision of infrastructure, services and storage facilities, while reducing the exposure to crime inherent in many informal sector activities, may also help foster greater trust between informal sector operators and the police.

2.4.4 The regulatory environment

The regulatory environment in SA has come under much investigation over the past decade. In particular, various studies have claimed that regulation in SA is stifling the growth of businesses, particularly smaller businesses, although this view is not held by all.

According to the ICA survey, one-third of firms identified labour regulations as a major constraint, making it the third most important constraint after education and skills, and macroeconomic stability (see Figure 6).

The Labour Relations Act (LRA) (Act no. 66 of 1995) has made the dispute resolution system cheaper and more accessible to vulnerable workers but the more personal relationship between the employer and employee in small businesses may lead the dispute resolution system to operate as a disincentive to employment creation in the SMME sector.

In addition, labour legislation provisions impose a burden of high labour costs on small firms, which may inhibit the entry and growth of these firms.

Tax rates are mentioned by 18,6 per cent of firms as an obstacle in the Investment Climate Survey (see Figure 6). Micro and very small businesses, though, would typically not identify tax rates as impeding their formation or growth.

According to LFS data, point out, nine in ten informal workers reported earnings below the personal income tax threshold in 2001, therefore nullifying the argument that individuals turn to informal sector employment to escape paying tax.

However, for better established SMMEs, high tax rates would, as expected, impact on profit margins and may be viewed more negatively. Another regulatory constraint as mentioned by 10,6 per cent of the firms in the ICA survey is tax administration (see Figure 6).

The time and effort required for tax administration is costly to small businesses. However a large component of tax compliance costs can be ascribed to firm-level inefficiencies.

Inefficient firm-level choices are also often motivated by firms' perception of the risks associated with accidental non-compliance, for example, penalties that could result from losing a tax submission in the e-filing process. A reduction in the tax compliance burden may help to create a more enabling environment for small businesses.

However, where the regulatory environment is of particular concern for informal businesses is in the area of local government regulations. It is estimated that around 10 per cent of informal sector workers in the Western Cape work in public spaces, making street trading licences an important issue, while those selling alcohol are affected by provincially-issued liquor licences.

While some local municipalities have made great strides to liberalise the regulatory environment, many others continue with restrictive land use legislation, business licensing legislation and by-laws which constrain SMME growth.

The City of Cape Town, for example, has reduced legislation impacting on street trading. However, in most other municipalities in the Western Cape this is not the case especially as far as street trading, business hours and operating from home are concerned.

In some municipalities, although these restrictions exist, a lack of political will or capacity results in a lack of enforcement and thus explains the low impact of business licensing and operating regulations on SMMEs.

A recent study on the impacts of sector specific policies and regulations on the growth of SMMEs found that sector specific regulations create some significant costs for SMMEs, particularly in the automotive, pharmaceutical and tourism sectors.

In contrast, however, the study suggests that sector-specific regulations have very little impact on the behaviours and costs of SMMEs in agri-processing and in the clothing and textiles sectors, and that ICT and financial services SMMEs are simply unaware of sector-specific regulations.

Almost by definition, however, informal sector firms do not adhere to the various regulations, such as VAT and UIF registration, and compliance with labour and minimum wage legislation, and as a result it is unlikely that informal businesses are hindered by legislation.

Of the 240 enterprises surveyed in the MICA survey, only 38 per cent were registered for VAT, while about 70 per cent of firms who were not registered with any government agency being identified as informal businesses.

2.4.5 Other constraints

Informal and small businesses face various other constraints, which are specific to the industry in which the business operates, or may vary according to the individual business' location, customer profile or product or service.

A spaza shop owner in Khayelitsha, an informal sector trader in Cape Town city centre selling curios to tourists and a vegetable seller trading at Cape Town station are likely to face different issues. This requires more nuanced policymaking based on a greater, more detailed understanding of the various types of informal businesses.

A lack of access to business support services is an important constraint on the growth and development of small and informal businesses. The Western Cape, though, has a relatively strong platform from which to address these concerns in the Red Doors (local business service centres established as part of the Real Enterprise Development Initiative).

While few informal businesses are not in some way connected to the formal sector, these connections are not always beneficial to informal businesses. Informal firms source their inputs and/or stock from formal sector businesses, however, very few are able to break into the market supplying larger formal enterprises.

Micro-enterprises are often poorly integrated into supply chains, with no more than 2,0 per cent of their sales going to firms with more than 100 employees. Being involved in formal sector supply chains can enable informal sector firms to grow more rapidly, access better technology and forge lasting business relationships that will ensure greater stability for the informal business and enhance sustainability.

In this way, formal sector firms can help improve the fortunes of competitive informal businesses, and government can promote formalisation through its procurement requirements.

Employees in informal sector and small businesses are less likely to be organised in terms of belonging to unions. This lack of bargaining power means that workers are more likely to be exploited and less able to negotiate for higher wages and better working conditions.

While there is much to gain through collective action in terms of working and living conditions, attempts at organising informal sector workers in SA have not generally been very successful.

2.5 Constraints to self-employment in the Western Cape

Various studies have been undertaken in SA, investigating the informal sector and attempting to identify those factors that constrain the sector's growth, thereby preventing it from providing employment and incomes to those who would otherwise be unemployed.

Unfortunately, attention paid to the informal sector has been somewhat lacking in the Western Cape, in terms of both research and policymaking. Some investigations that have been done focus on the issues surrounding hindrances to self-employment in the Western Cape.

These hindrances to self-employment are classified as profit barriers where individuals do not view an activity as being able to generate profit, capital barriers that limit individuals' access to funds, skill barriers in terms of technical or entrepreneurial skills, future-limiting barriers which arise when informal work today limits an individual's opportunity to access formal employment in the future, and hidden cost barriers that include formal or informal restrictions and other costs.

This analysis is based on the responses of self-employed and unemployed individuals from a representative sample of the Mitchell's Plain magisterial district, meaning that although it is not representative of the province or even the City of Cape Town, it is representative of the magisterial district and provides important insights that are arguably of relevance elsewhere in the province.

Relative to the rest of the City and the Province, unemployment in the Mitchell's Plain magisterial district is extremely high. In fact, unemployment rates in the area mirror the national rates more closely than they do the provincial rates. In 2000, the official unemployment rate was estimated at 28,4 per cent, compared to 16,6 per cent for the Province as a whole, while the expanded unemployment rates were 46,3 per cent and 21 per cent respectively.

When asked why they did not choose self-employment as a means of escaping unemployment, broadly unemployed respondents in the Khayelitsha/Mitchell's Plain (KMP) survey of 2000 identified a lack of capital or money to start a business as the reason, with a further 5,0 per cent of respondents giving alternative answers that were classed as capital barriers.

Given the dominance of capital barriers as a deterrent to entering self-employment, other reasons were relatively unimportant, with skill barriers (4,5% of respondents), future-limiting barriers (3,9%) and profit barriers (2,4%) the most commonly mentioned.

Previously self-employed individuals in the survey were identified and were asked the why they terminated their self-employment. Two in five individuals identified a lack of profits as the reason for ending self-employment, while 15 per cent said they did not have money to buy stock. Crime and violence was another important reason for ending self-employment, cited by 6,0 per cent of respondents.

However, few individuals left self-employment for paid employment (6,5%). Recent work suggests that there may be a significant degree of churning in the SA labour market, with large proportions of workers changing labour market status over relatively short periods of time. With the recent construction of the LFS panel, this issue can hopefully be investigated in more detail.

In a later study, using the 2005 Khayelitsha Survey Wave III (KS-III) data hindrances to self-employment in Khayelitsha were investigated. The KS-III survey tried to return to those individuals in Khayelitsha who had been surveyed in the original KMP Survey of 2000.

This study looked at individuals' perceptions of factors that prevent them from entering self-employment. Respondents were asked to identify the extent to which each of 17 hindrances prevented them from entering a given type of self-employment.

Crime was perceived to be the dominant hindrance keeping the unemployed from entering self-employment, with other hindrances including the risk of business failure, a lack of access to start-up capital and high transport costs.

These findings from the Khayelitsha surveys are important steps in reaching a better understanding of the issues that prevent engagement in self-employment activities.

As the various issues are identified and better understood through consultation with those affected, policy can begin to reduce and eliminate those obstacles preventing particularly poor people from full engagement in the provincial economy.

3. Conclusion

While overall employment growth has been relatively slow, this has been because of the divergent performances of the formal and informal sectors. The formal sector performance has been good, with employment expanding at an average rate of 3,3 per cent per annum, adding approximately 216 000 jobs over the first half of the decade.

In contrast, the informal sector has performed poorly, shedding one in 20 jobs each year, with employment falling from 225 000 in 2000 to 174 000 in 2005. This pattern of employment change mirrors closely the overall SA experience.

However, the informal sector should not bear the burden of absorbing labour force participants into employment. Despite being viewed as a type of safety net, informal sector employment is of inferior quality relative to that in the formal sector. Lack of compliance with labour, safety and minimum wage legislation, combined with very little bargaining power on the part of informal sector workers, means that they often have inferior employed conditions.

Worker are employed on a temporary, casual or seasonal basis, are less likely to have written contracts or paid leave, and are less likely to have their employers pay pension or retirement contributions or UIF deductions. This leaves informal sector workers open to exploitation while they work and vulnerable to poverty once they no longer are able to work. Organising informal sector workers may not be easy, however, government should encourage and facilitate the process where possible. It is also important that informal sector workers are able to access and be heard by these organisations.

Promoting the small business sector is important for economic development and tackling the negative effects of unemployment and poverty in the Western Cape. There is therefore a need to distinguish between categories of small businesses that operate locally in order to develop strategies to support them.

The informal and the SMME sectors face various constraints to their growth and prosperity. Problems in terms of access to finance, training, infrastructure and services, as well as the regulatory environment all work to limit enterprises' growth and performance.

Advisory support centres could target micro and very small enterprises and facilitate technical support and training of business owners. The administrative burden as a result of regulatory compliance could be reduced for start up small businesses through direct assistance in applying for licences and permits.

The unbundling of big contracts to involve small businesses, incentives to larger businesses to sub-contract to small businesses and shorter payment cycles, since small businesses have limited credit and rely heavily on regular payments for their cash flow management, could benefit small businesses greatly.

One of the most important issues is the low skills and educational levels that characterise these sectors. The skills lacked by workers in these enterprises range from basic literacy and numeracy to assertiveness, and to general and specific business skills, including basic accounting concepts.

Provision of training to workers in this sector in a way that is flexible and responsive to the trainees' needs is critical for improved performance and incomes.

Provincial and local governments have important roles to play in creating an enabling, small business-friendly environment. Local government can ensure that registration, licensing and other regulations relating to informal enterprises do not stifle growth.

Experiences of other SA cities reveal that policymaking must be proactive, with active steps being taken to identify, understand and eliminate problems that constrain this sector and limit its contribution to the achievement of our society's ideals.