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SME Development and Impact Assessment 2004

Unlocking the growth potential: the role of financial services, business linkages and business support services for SME development.

Draft Summary

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Executive Summary

- Conclusion 1: the majority of business owners are well educated, but the majority of businesses are small, operate in the service sector with high competition due to a lack of innovative capacity and mostly serve local markets
- Conclusion 2: A large number of the business owners started a business due to a lack of alternatives or other reasons, but not because of a personal motivation
- Conclusion 3: The fact of having informal competitors represents a competitive disadvantage for formal businesses. Costs of regulation and lack of knowledge to become formal are major reasons for a high degree of informality
- Conclusion 4: Most businesses are younger than 5 years and there are moderate start-up and closure rates
- Conclusion 5: The employment dynamics for the sampled SMEs are moderate–contrary to popular belief, they do not seem to be a powerful "job engine"
- Conclusion 6: The usage of existing financial services among SMEs is fairly modest but this is mainly due to the fundamental structure and character of SME operators. Moreover, contrary to popular belief, a large number of businesses don't want financial services or credit
- Conclusion 7: Only very few businesses have business linkages. In addition, these linkages are of a very simple nature and have limited benefits
- Conclusion 8: The majority of businesses do not make use of BDS, but a large proportion uses market-related business services

Table of Contents

Section 1

Introduction

The role of the small and medium-sized enterprise (SME) sector is considered a key contributor to a country's overall economic development. The SME sector is the backbone of an economy, as it provides employment and income opportunities for a large number of people. In many countries, small and medium-sized enterprises are also at the forefront of technological innovation, diversification of production processes and intensification of export activities.

As a consequence, governments across the world have realised the important role of the SME sector in the overall economic development process and thus have devised policies and programmes to support SMEs. The Namibian government is no exception in this regard. In its 1997 SME policy, which is currently under review, it states the "government's firm commitment to transform the sector, as a priority, from its current state of deprivation and underdevelopment into a lead sector of the economy" (Republic of Namibia 1997, p. 1). Accordingly, the policy defined ambitious targets in terms of SME development: the SME sector was expected to create 35,000 jobs, increase incomes in the SME sector by 10%, diversify production activities into higher value-added activities and manufacturing, reduce the regulatory burdens and to increase the overall contribution of the SME sector to the country's GDP to 15% by 2005.

This study stems from a consultancy carried out for the Finnish Embassy on the needs and availability of business support services in Namibia. The purpose of this study is to provide a more analytic insight into one key question that is at the centre of the 1997 SME policy: what are the mechanisms of transforming the SME sector from its current state of deprivation and under-development into a lead sector of the economy? In other words, how do business grow into viable entities? Furthermore, how can this process be supported?

This study seeks to provide some analytical insights into factors that influence the development of businesses and provide recommendations for future policy making. For this purpose, a national survey on 370 businesses was conducted, including a sample of businesses that were used for last year's SME impact assessment. This allows us to look in more detail at the dynamics within these enterprises. It is important to note that the period under consideration is short (1 year), as this monitoring exercise just started. Moreover, due to the absence of any

reliable information on the overall size of the Namibian business (and SME) sector, no general conclusions for the whole of Namibia are possible. Nonetheless, such a monitoring exercise is of great value as it allows monitoring changes over time. Its long-term value stems from a regular repetition of this exercise in the future. On the immediate benefits, it will provide detailed insights into the changes that occurred over the last year.

This paper represents a summary of the major results and conclusions of the study. The purpose is to present some points of discussion for a separate workshop. The final report with detailed background material, more extensive discussion of the results and recommendations resulting from the workshop will be prepared and distributed after the conduct of the workshop.

The next section will provide a short overview of the methodology used and the survey sample. Section three provides a closer look at the characteristics and dynamics of SMEs between 2003 and 2004. Section four highlights the impact of the SME sector on GDP, employment and fixed capital formation. Section five summarises the major results in regard to businesses' usage of financial services. Section six discusses the extent of business linkages and section seven highlights the understanding and usage of business services.

Section 2

Methodology

The sample of businesses was comprised of a total of 411 businesses. Out of those 411 businesses, 309 were businesses from the 2003 SME Impact Assessment (for details see Stork, C., Matomola, M. and Louw, M. 2004). In addition, 102 new businesses, including in areas not formerly covered, were included. As one objective of the study was to look at the changes in businesses' performance between 2003 and 2004, information was collected for 2003 (the 309 businesses of last year's impact assessment provided information for 2003) and 2004. Most of the new businesses sampled also provided information for 2003 to make the results comparable. Due to the following reasons, information was not available for all 411 businesses in the database.

TABLE 1. Availability of information and sample response rates 2004

Reason for not having obtained information	No. of businesses
Refused to answer or was not available	22
Contact details incorrect/ no contact possible	7
Business does not exist any more/ closed down	12
Total not available	41

Thus, information for 2003 and 2004 was available for a total of 370 businesses. In a second step, businesses were classified according to the official SME definition. Although this definition is currently under review and will be modified, no changes have been announced yet so that the old definition was used as a cut-off point.

TABLE 2. The original 1997 MTI small and medium sized business definition[a]

Sector	Employment	Turnover less than (N$)	Capital employed less than (N$)
Manufacturing	Less than 10	1,000,000	500,000
Non-manufacturing	Less than 5	250,000	100,000

a. Source: (Ministry of Trade and Industry 1997)

After adjusting for inflationary changes of turnover and capital figures, 337 of the 370 sampled businesses fell within this classification, 33 were outside this definition. As the 33 businesses are too few, separate comparisons between SMEs and non-SMEs have not been carried out yet. It is the intention to do such a comparison for key characteristics of SMEs and non-SMEs in the future, when more data on non-SMEs becomes available through a separate survey that is currently being conducted on medium sized enterprises. Finally, businesses were classified according to different clusters, to make them comparable. For this purpose, businesses were clustered according to common characteristics.

TABLE 3. Sample Distribution according to clusters

Clusters	No. of SMEs	Percentage Share of SMEs	No. of non-SMEs	Percentage share of non-SMEs
ICT, Electronics and Business Consulting	40	11.88%	5	15.16%
Transport	26	7.72%	0	0
Body Care, Health and Creches	37	10.98%	0	0
Hospitality, Tourism and Crafts	32	9.5%	4	12.12%
Food: Manufacturing, Selling and Catering	81	24.05%	14	42.42%
Metal and Mechanics: Manufacturing Services	34	10.1%	4	12.12%
Textile and Leather: Manufacturing and Services	39	11.52%	1	3.03%
Construction, Maintenance and Carpentry	31	9.2%	2	6.06%
Other	17	5.05%	3	9.09%
Total	337	100%	33	100%

One crucial issue with any type of research is its validity. Central questions are: what do the findings tell and suggest? Are those findings relevant and valid? The same concerns govern this research and it is important to note the major limitations of this study.

The purpose of research always is to better understand a specific phenomenon of the world we live in, in our case it is the objective to obtain a better understanding of how SMEs operate and what type of support they need. Research can only be an approximation for understanding a phenomenon and has many limitations attached to it. These limitations are influenced by the research instruments chosen, the nature of the research objectives and the quality of the data. The task of the researcher is to minimize these limitations as far as possible.

In the context of this study it is important to note that the study is not a representative study of the entire SME sector in Namibia. The businesses selected in the sample have been chosen on the basis of business types in various regions but they are not geographically representative. The major problem is the absence of detailed information on the overall number of SMEs in Namibia. Such information can only be obtained through a census, surveying all businesses in the country. If we had this information already, it would be possible to select a random sample of SMEs and make inferences on the entire SME sector. In the absence of such information, estimations can at best provide a sketchy picture.

In this context, we have had long discussions on whether to include estimates (like GDP and employment) for the whole SME sector. Given the importance of these figures, we decided to include them nonetheless, but hint at the danger that they might not accurately reflect the whole picture. We would be happy to be proven wrong in the future, because this would indicate that more accurate information on the whole SME sector has become available.

Using a panel whereby a given number of businesses is surveyed on a regular (yearly) basis nonetheless provides useful information on the dynamics and changes that take place within the sampled business. Although it is not representative of the entire SME sector, the results will provide a detailed picture of factors that are important for SME development. In the future, it might be possible to compare it to insights from other studies. The real value of a panel study stems from its long-term approach by generating regular insights over time. The overall validity of this research should be placed within this context and understanding.

BOX 1. A Note of Caution – the validity of the research findings

Section 3

Business Characteristics & Dynamics

Influencing Factors

Firm size and firm characteristics

- Larger firms are more efficient than smaller ones, due to specialisation of work force; size also influences access to financial resources
- The sector of activity influences performance: retail and services are generally exposed to more competition than manufacturing

Business owner's characteristics and business orientation

- Entrepreneurs (i.e. owner is willing to take risk and to innovate) are more growth oriented than 'survivalists'
- Entrepreneurship is linked to education and professional experiences

Management decisions

- Crucial business skills positively linked to business performance are: strategic planning, flexibility, pro-active management, distinct customer orientation

Economic and regulatory context

- The size and access to markets (product, factor and credit markets) influence business performance
- The regulatory environment influences the degree of formalisation, start-ups and survival of businesses

Major Business Characteristics

Conclusion 1: The majority of business owners are well educated, but the majority of businesses are small, operate in the service sector with high competition due to a lack of innovative capacity and mostly serve local markets.

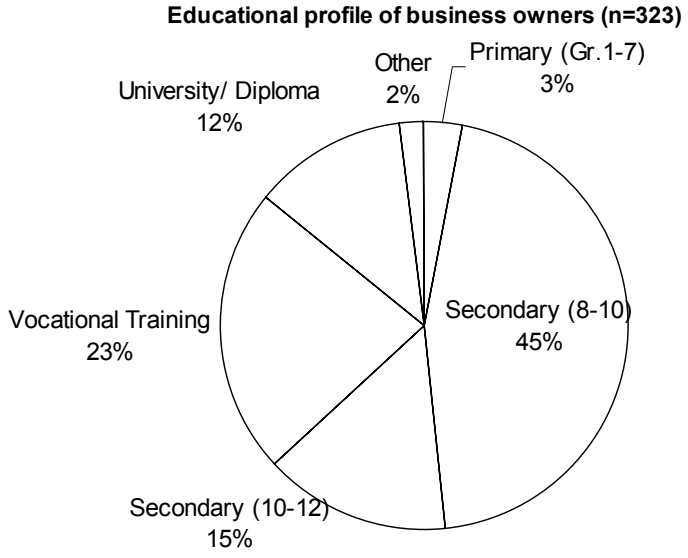

FIGURE 1. Educational Profile of business owners

More than half of the business owners have completed secondary education, 12% have a higher education degree and 23% have completed VET. The relatively high level of education can also be due to the fact that no other employment opportunities existed. Nearly 43% of all business owners in the sample are women.

TABLE 4. Business size (number of full time employees, excluding owner)

Employment size	No. of businesses	Percent
0 (only business owner)	80	23.74%
1	74	21.96%
2 to 5	166	49.26%
6 to 10	15	4.45%
11 to 15	2	0.59%
Total	337	100%

Of the 337 business, 44% had one full-time employee or less and about 50% employed between 2 and 5 full time employees. The total average number of full-time employees is 2.05. Of those 337 businesses, 88 were manufacturing businesses and 249 were businesses in the service sector. A look at the market orientation further reveals that the large majority of businesses serve local markets with limited market outreach. About 77% of the SMEs sell

their products or services locally, 18% in the region, 4% nationally and only 1% of SMEs export their products or services. About 56% of the 335 SMEs providing information buy their inputs locally, 14% in the region, 21% in Namibia and 10% internationally, whereby the majority of businesses source their input from South Africa. The limited market outreach is also due to the nature of the businesses and their products (most services like retail and other services are geared towards local needs). Nearly half of the businesses providing information on their major business difficulty mentioned high competition or a lack of customers. One major reason is that those businesses are often selling the same products or services without much product/ service differentiation. This had influences on businesses' performance. More than 2/3 identified competition as the major reason for them not to grow. Only 12% of the businesses actually mentioned that lack of money or cash flow problems constituted a major reason for not expanding or for low business performance.

When looking at the usage of financial services below, it becomes clear that lack of finance is not necessarily the major constraint. Similarly, very few businesses make use of ICT technologies: less than ¼ of all businesses use a PC for business purposes and 12% use the Internet (mainly in the tourist sector and ICT sector).

Points for discussion:

- What is necessary and what can be done to help businesses diversify?
- Are the limited market orientation and the resulting problems due to a limited market in the first instance or due to a lack of innovative capacity?
- One suggestion is to identify market opportunities and make the emerging business ideas available through a 'business exchange'
- Support should be context-specific by addressing varying market needs and for varying business types

Conclusion 2: A large number of the business owners started a business due to a lack of alternatives or other reasons, but not because of a personal motivation

In general, two groups of factors influencing start-ups can be identified: on the one hand, lacking alternatives in the economy might motivate people to start a business. Reasons might include the inability to find employment or other sources of income. These factors are known as 'push' factors as they push people into the business sector. On the other hand, people might deliberately choose to start a business, be it because they are motivated or see different business opportunities. These factors are known as 'pull' factors, as people are pulled into the business sector. About ¼ of all businesses stated to have started the business out of a lack of employment alternatives. This is a typical push factor and might hint at the survivalist nature of those businesses. About 16% indicated that having a business is better than being employed. For pull factors, about 43% indicated that they started a business to take a business opportunity and 11% to make additional money. For those owners, running a business is rather a 'hobby' to generate more income instead of a proper vocation to which they commit themselves full-time. About 6% had other reasons (e.g. they inherited the businesses or mentioned to 'help creating employment').

TABLE 5. Major reason for having started the business (SMEs)

	Better prospects than being employed	Otherwise I would have been unemployed	To take advantage of a business opportunity	To make money additional to my salary	Other
ICT, Electronics and Business Consulting	15%	10%	47.5%	10%	17.5%
Transport	26.92%	7.69%	38.47%	15.38%	11.54%
Body Care, Health and Creches	18.92%	29.73%	43.24%	2.70%	5.41%
Hospitality, Tourism and Crafts	10%	36.67%	43.33%	6.67%	3.33%
Food: Manufacturing, Selling and Catering	6.33%	32.91%	41.77%	16.46%	2.53%
Metal and Mechanics: Manufacturing Services	21.21%	21.21%	48.49%	9.09%	0
Textile and Leather: Manufacturing and Services	27.03%	35.14%	27.03%	5.40%	5.40%
Construction, Maintenance and Carpentry	13.33%	16.67%	50%	16.67%	3.33%
Other	23.53%	11.77%	52.94%	5.88%	5.88%
Total	16.11%	24.62%	42.86%	10.64%	5.77%

Points for discussion

- Do we need to better focus support according to business owners' motivation?
- How can we rise awareness for business opportunities and what running a business involves?
- The focus should be on encouraging potential business start-ups with a high degree of motivation and commitment to their businesses

Conclusion 3: The fact of having informal competitors represents a competitive disadvantage for formal businesses. Costs of regulation and lack of knowledge to become formal are major reasons for a high degree of informality.

About 46% of the SMEs are registered for VAT, 16% with a local authority and 33% with the Social Security Commission (SSC). Especially the construction, maintenance and carpentry cluster, metal and mechanics, Transport and ICT, Electronics and Business Consulting are predominantly registered for VAT. Although the food cluster is the most important one in terms of businesses, only 32% of the businesses are VAT registered. This reflects that a number of SMEs are rather small and informal businesses (like Shebeens). The same applies for the tourism and hospitality clusters, where especially woodcarvers are not registered as compared to B&Bs and hostels. The major reasons for not registering with any authority (be it VAT, local authority or SSC) is often a lack of knowledge on how to register and the procedures involved. Another major reason is the fear that registration might lead to disadvantages (e.g. if regulations are not met, there might be fines or problems with employing/ laying off

workers). It was perceived by some businesses that the registration process is a burden and represents an operating disadvantage. Formal businesses have complained about informal businesses having an unfair competitive advantage as they do not have to operate to the same standards and regulations. Especially businesses in clusters with high competition have voiced this concern. For example, formal butchers have all mentioned unfair competition by informal meat sellers as a major disadvantage. The major reason is that the informal businesses did not have to follow the same health standards than formal butchers, leading to sever price competition. Another disadvantage results for employed staff. Over 70% of businesses providing information on this issue stated not to have any written agreement or working contract with their workers. While this might represent an operational advantage in terms of reacting to changing demand and market situations, it can potentially weaken employees position vis-à-vis their employer.

Points for discussion

- One focus of any future SME policy should be on providing incentives for informal businesses to become formal
- Incentives in form of preferential tendering are often not effective as the majority of SMEs simply are too small to tender for government contracts
- Effective incentives should be in the form of tax incentives, preferential regulations and exemptions
- A simplification of rules and procedures is necessary to encourage businesses to become formal
- More efforts are needed to make regulations and procedures clear to businesses. Lack of information needs to be addressed through better awareness and outreach campaigns
- What is realistic and feasible?
- Should all businesses be encouraged to become formal?

Business Performance and Dynamics

Conclusion 4: Most businesses are younger than 5 years and there are moderate start-up and closure rates

More than 67% of all businesses are younger than 5 years and more than 85% are younger than 10 years. Whereas 21 new companies started in 2004, at least 12 businesses closed down between 2003 and 2004. Of those 12 businesses, 8 were younger than 5 years. In Namibia, the start-up rate is around 6.3% (of the businesses sampled). It is too early to provide detailed conclusions on the closure rates of businesses for the surveyed sample, as only one year of comparison is possible. Future data points will provide more detailed information in this regard. The estimated closure rate ranges between 3.6% to 6%, depending on the interpretation of business closures. The observations available, however, confirm experiences from other African countries. Observations for other African countries reveal that a large number of business closures appear before the business has reached its fifth anniversary. In addition,

annual closure rates are around10% (Mead, D. C. and Liedholm, C. 1998, p. 65). One major reason for relatively young SMEs are low entry barriers to the typical type of SME businesses (e.g. setting up a Shebeen to sell groceries or drinks). At the same time, low survival rates are due to the low operational profile of most businesses, whereby strong competition due to a lack of expansion into new markets, lack of finance, the emergence of employment alternatives or other personal motives are the major reasons for closures. The first years are certainly a crucial period for businesses, but growth-oriented businesses are more likely to diversify early and thus increase their own survival rates.

Points for discussion

- How can SME survival rates be increased?
- How can businesses with potentially better survival chances be identified?
- Targeted support is needed for businesses with high survival rates
- General (contextual) support is needed for businesses with low survival rates
- Support is crucial just before and after business start-up
- Given scarce financial resources, the viability of business ventures and ideas should be one of the central driving criteria for support

Conclusion 5: The employment dynamics for the sampled SMEs are moderate–contrary to popular belief, they do not seem to be a powerful "job engine"

In order to assess the overall employment effect, the number of new jobs created by employment category were calculated and then offset with the number of jobs that were laid off. All companies (SMEs and non-SMEs) that provided data for 2003 and 2004 were included. All 21 companies that were founded in 2004 were excluded, as the jobs created by them are solely due to their start-up. In addition, 7 companies for which only information for 2004 was available were also excluded. Table 6 and Table 7 highlight the overall employment effects. For male full-time employment, only 6 new jobs have been created between 2003 and 2004, whereas the largest increase was for full-time labour (+12).

TABLE 6. Number of male jobs created and laid off by employment category

Males	Employment growth (number of new jobs)	Employment Decrease (number of laid off jobs)	Total
Full time	92	-80	12
Part time	19	-16	3
Occasional	13	-31	-18
Commission	9	0	9
Total	133	-127	6

TABLE 7. Number of female jobs created and laid off by employment category

Females	Employment growth (number of new jobs)	Employment Decrease (number of laid off jobs)	Total
Full time	96	-51	45
Part time	8	-3	5
Occasional	5	-9	-4
Commission	2	-19	-17
Total	111	-82	29

Full-time female employment creation was much higher than male full-time employment (+45). In total, only 35 new jobs have been created, if all jobs are taken as being the same. When only looking at full-time employment, 57 new jobs were created between 2003 and 2004. In addition, 58 new jobs (including 51 full-time jobs) have been created by new business start-ups in 2004. The number of jobs lost due to business closures in 2003/2004 ranges between 16 to 35 (depending on the number of businesses considered to have closed down). As full-time employment is more important than other employment categories in regard to its income generation effects, the following analyses will focus on full-time employment. An analysis according to clusters reveals differences between male and female employment dynamics.

TABLE 8. Full-time jobs created and laid off by cluster (between 2003 and 2004)[a]

	Male jobs created	Male jobs laid off	Total effect	Female jobs created	Female jobs laid off	Total effect
ICT, Electronics and Business Consulting	10	-8	+2	8	-4	+4
Transport	4	-6	-2	2	0	+2
Body Care, Health and Crèches	10	-3	+7	23	-3	+20
Hospitality, Tourism and Crafts	21	-4	+17	11	-2	+9
Food: Manufacturing, Selling and Catering	17	-11	+6	27	-22	+5
Metal and Mechanics: Manufacturing Services	22	-19	+3	7	-3	+4
Textile and Leather: Manufacturing and Services	0	-7	-7	15	-15	0
Construction, Maintenance and Carpentry	8	-20	-12	3	0	+3
Other	0	-2	-2	0	-2	-2
Total	92	-80	+12	96	-51	+45

a. Note: exclude jobs created through new start-ups in 2004

Table 8 indicates that male full-time jobs were mainly created in the metal and mechanics cluster, hospitality and food sector. Job losses are dominant in the construction industry, metal and food clusters. Whereas the construction industry (-12), textile cluster (-7), transport (-2)

and other companies (-2) experienced a net loss of jobs between 2003 and 2004, businesses especially in the hospitality cluster (+17), body care (+7) and food clusters (+6) experienced net job growth. These developments are understandable in the context of construction businesses being very volatile and dependent on the number of contracts available, whereas the hospitality sector is one of the growth industries in Namibia. For female full-time employment, high fluctuations are especially pronounced in the food and textile clusters –two clusters, which are dominated by female labour. The greatest job gains were realised in the body care cluster (+20), hospitality (+9) and food sector (+5). Net losses are only experienced with other businesses, whereas the textile sector has the same amount of jobs created as were laid off, which leads to a net effect of 0.

TABLE 9. No. of full-time jobs created through new start-ups in 2004

	Male jobs created	Female jobs created
ICT, Electronics and Business Consulting	8	10
Transport	0	0
Body Care, Health and Crèches	1	1
Hospitality, Tourism and Crafts	0	2
Food: Manufacturing, Selling and Catering	8	9
Metal and Mechanics: Manufacturing Services	3	0
Textile and Leather: Manufacturing and Services	2	0
Construction, Maintenance and Carpentry	2	0
Other	3	2
Total	27	24

Table 9 clearly demonstrates that the majority of new full-time jobs (male and female) were created in the ICT, electronic and business consulting clusters, followed by the food cluster. On the one hand that indicates that new opportunities seem to exist in businesses dealing wit ICT, electronics or consulting (i.e. typical service oriented businesses). At the same time, the traditional sector (food) still seems to be attractive, which might also be due to low entry barriers into this sector, especially in the retail sector. The job increases in the hospitality and body care clusters thus seem to be due to expansion of existing businesses. In addition, the majority of businesses mentioned that they would only consider employing more staff if their business expands or if current staff resigns. More than 78% of all businesses mentioned that they do not intend to employ more staff during the next six months. Business growth thus seems to be a crucial condition for new job creation.

Points for discussion

- What needs to be done to increase the number of jobs created in the SME sector?
- What are the major barriers for job creation within SMEs?
- What role can regulations and policies play in this regard?
- The job creation rate over time is one useful indicator to screen businesses and their potential performance. It might be used to inform targeted support initiatives.

Section 4

Small Business Impact Assessment

This section attempts to estimate the impact of the small business sector on GDP and employment. Furthermore, the profitability of the business sectors will be analysed. The estimates are of a tentative nature given the lack of an industrial census and that no random sampling procedure could be used. The estimates derived will be based on procedures used in the 2002 and 2003 Small business impact assessment surveys, which can be used to indicate changes. Even if estimates for individual years cannot be accurate because of the limitations faced in Namibia, the difference between the estimates from year to year will be accurate if the same methodology is applied.

Small Business Impact on GDP

The contribution of small businesses to the GDP is done by extrapolating the average survey result for the manufacturing and service sectors. In order to derive reliable estimates for the GDP contribution of small businesses we need to be relatively sure about three things:

- That the sample used in survey is representative for Namibia;
- That the numbers of small businesses in Namibia is known; and
- That the numbers of businesses per cluster or sector is known.

At this stage we are not able to verify if any of these three conditions are fulfilled. However, assuming that the current survey in a fairly good way reflects the reality, we might fulfil the first preconditions for an extrapolation of the data.

The GDP calculation are based on the aggregate level of the business sectors (manufacturing and services) where the baseline surveys (RoN 1998,1999, 2000) can be used as a benchmark to estimate the number of small manufacturing and service businesses in Namibia. The Ministry of Trade & Industry (MTI) commissioned a head count of SME in seven of the 13 administrative regions in Namibia between 1997 and 1999 (RoN 1998, 1999, 2000). These head

counts provide the basis for the estimation of the contribution of small businesses to the GDP and employment in Namibia. The results from this partial census are used to extrapolate the number of manufacturing and other businesses in the missing regions of Namibia. These extrapolations are summarised in Table 10. Based on these estimations the total number of small manufacturing businesses is 11,971 in Namibia, while the number of small service businesses is 22,432. Accepting these estimates as reasonable will satisfy the second and third preconditions. It delivers the total number of small businesses in Namibia and the number for each category: manufacturing and services.

TABLE 10. Number of small businesses (source RoN 1998, 1999 & 2000)

Sector	Manufacturing	Other
Erongo & Otjozondjupa	806	3481
Ohangwena, Omusati, Oshana, Oshikoto	7229	7393
Khomas	408	4951
Caprivi & Kavango*	2,618	2,677
Rest of Namibia**	910	3,929
Total	11,971	22,432

*Figures are estimated based on the figures for Ohangwena, Omusati, Oshana, and Oshikoto. It is assumed that the Caprivi and Kavango region have a similar relationship between population and small businesses as the Ohangwena, Omusati, Oshana, and Oshikoto regions.

**figures are estimated based on the figures for Erongo and Otjozondjupa. The rest of Namibia is assumed to have a similar relationship between population and small businesses as the Erongo and Otjozondjupa regions.

The contribution to the GDP by small businesses is calculated by multiplying the number of small businesses with the corresponding average contribution of small businesses to GDP. The average value added (contribution to the GDP) is calculated using the following equation:

Average value added = average turnover - average cost of supplies and other non-wage costs.

The average value added is calculated for manufacturing and service businesses separately. The estimated contributions to the GDP of small businesses in 2002 have been re-estimated in Table 11. This was necessary since the GDP figures for Namibia for 2002 were not available when the report was printed. The 2004 survey used to a large extent the same panel of companies as the 2003 survey. 87 new companies have been added to the panel to substitute for companies that either closed down since they were questioned in 2003 or that preferred not to take part in the survey. The GDP contributions of small businesses for 2003 have been re-estimated using this new panel of companies. The total number of SMEs in Namibia has been estimated based on the 2001 Population and Housing Census (RoN 2003). A constant relationship between population and number of small businesses is assumed for certain regions (see Table 10).Table 11 displays the estimated contribution of small businesses to the GDP for 2002, Table 12 for 2003 and Table 13 for 2004. The percentage contribution to the GDP is calculated by multiplying the number of manufacturing businesses with the average value added by manufacturing businesses, adding to that the average value added by service business multiplied by the number of service businesses in Namibia; and dividing the whole lot by the total GDP for Namibia in current prices.

TABLE 11. Re-estimated contributions of small businesses to GDP for 2002

Business sector		Annual sales (turnover) of the business?	Annual cost of products bought for resale	Annual cost of supplies	Value added	Value added/ number of businesses
Manufac-turing	N	53	3	53		
	Minimum	960	480	120		
	Maximum	1,440,000	3,600	1,080,000		
	Sum	4,844,400	6,480	2,404,344	2,433,576	45,917
Services	N	161	103	161		
	Minimum	1,800	600	-		
	Maximum	2,173,500	960,000	120,000		
	Sum	22,906,020	6,038,040	2,605,968	14,262,012	88,584
Manufacturing sector SME contribution to GDP=11,971 x average value added/manufacturing business						549,620,844
Services sector SME contribution to GDP = 22,432 x average value added/service business						1,987,114,616
SME Contribution to GDP = The sum of all value added (Manufacturing and services sector)						2,536,735,460
SME Contribution to GDP in % (GDP 2002 N$31,550 million in current prices)						8.04%

TABLE 12. Small business contribution to GDP 2003

Business sector		Annual sales (turnover) of the business?	annual average cost of supplies (including products bought for resale)	Value added	Value added/ number of businesses
Manufacturing	N	109	109		
	Minimum	1200	0		
	Maximum	2,100,000	1,824,000		
	Sum	23,190,780	11,813234	11,377,546	104,381
Services	N	209	209		
	Minimum	3600	0		
	Maximum	1,500,000	516,000		
	Sum	31,067,092	12,366,420	18,700,672	89,477
Manufacturing sector SME contribution to GDP=11,971 x average value added/manufacturing business					1,249,546,818
Services sector SME contribution to GDP = 22,432 x average value added/service business					2,007,145,810
SME Contribution to GDP = The sum of all value added (manufacturing and services sector)					3,256,692,628
SME Contribution to GDP in% (GDP 2003: N$32,309 million in current prices)					10.08%

TABLE 13. Small business contribution to GDP 2004

Business sector		Annual sales (turnover) of the business?	annual average cost of supplies (including products bought for resale)	Value added	Value added/ number of businesses
Manufacturing	N	107	107		
	Minimum	9000	0		
	Maximum	3,200,000	2,700,000		
	Sum	26,865,020	13,312,486	13,552,534	126,659
Services	N	226	226		
	Minimum	3,500	0		
	Maximum	2,500,000	528,000		
	Sum	40,485,903	14,611,411	25,874,492	114,489
Manufacturing sector SME contribution to GDP=11,971 x average value added/manufacturing business					1,516,237,238
Services sector SME contribution to GDP = 22,432 x average value added/service business					2,568,215,064
SME Contribution to GDP = The sum of all value added (manufacturing and services sector)					4,084,452,303
SME Contribution to GDP in % (GDP 2004: 33,730.6 N$million estimated based on 4.4% growth)					12.11%

Based on these estimations the contribution of small businesses to GDP has increased from 8.04% in 2002 to 10.08% in 2003 and 12.11% in 2004. This implies that the SME sector continues to grow at faster rates than the average GDP growth.

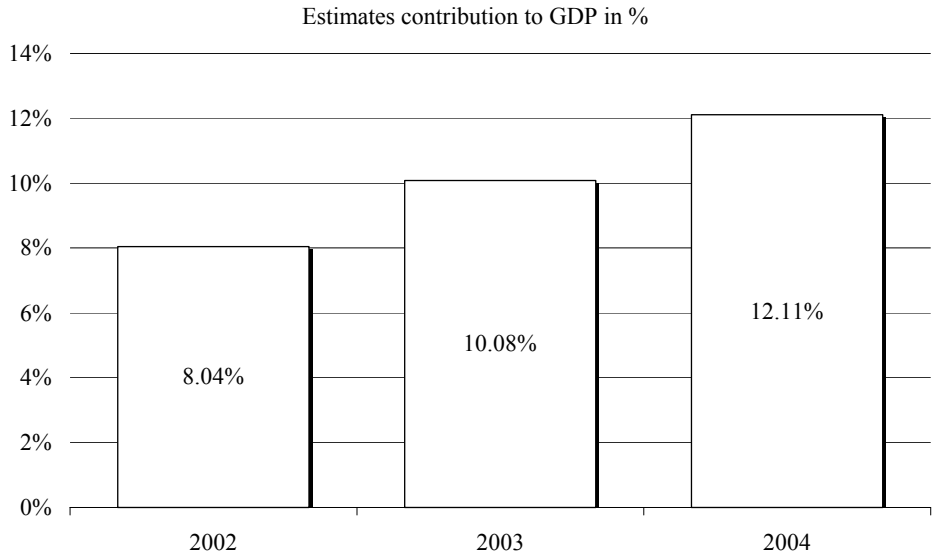

FIGURE 2. SME contribution to GDP in %

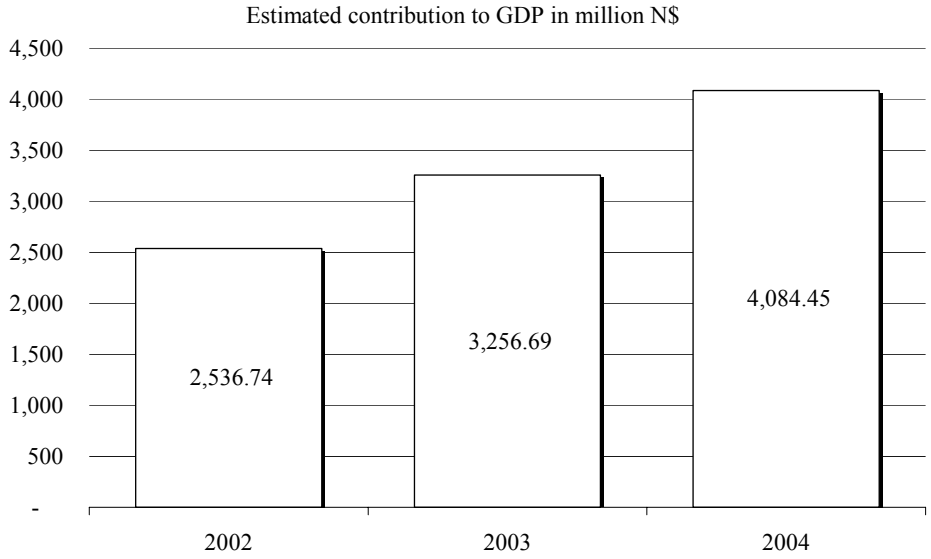

FIGURE 3. SME contribution to GDP in million N$

Table 13 displays the average annual value added by manufacturing and service businesses in 2004 to be N$126,659 and N$114,489 per business respectively. Based on the estimated number of small manufacturing and service businesses in Namibia manufacturing business contributed N$1,516 million and service businesses N$2,568 million, together N$4,085 million to GDP.

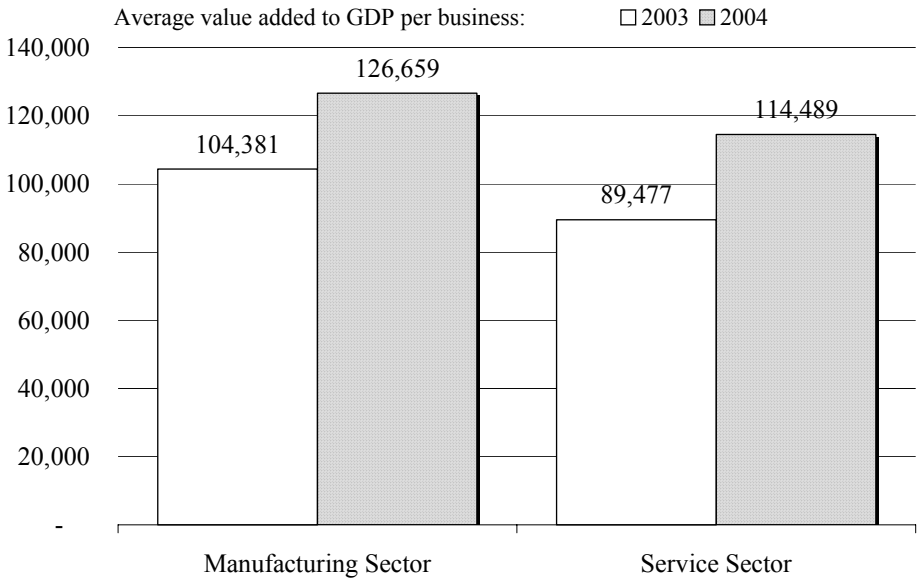

FIGURE 4. Average GDP contribution of businesses from the manufacturing and service sectors

When broken up in clusters it is disclosed that some clusters contribute to the GDP on average considerably more than others. At the high end, we find construction and ICT and hospitality with above average contributions, while on the lower end are the body and health care and the food clusters (see Figure 5). However, the ICT, electronics and business consulting cluster is the only one that whose average contribution to GDP per business is less in 2004 compared to 2003.

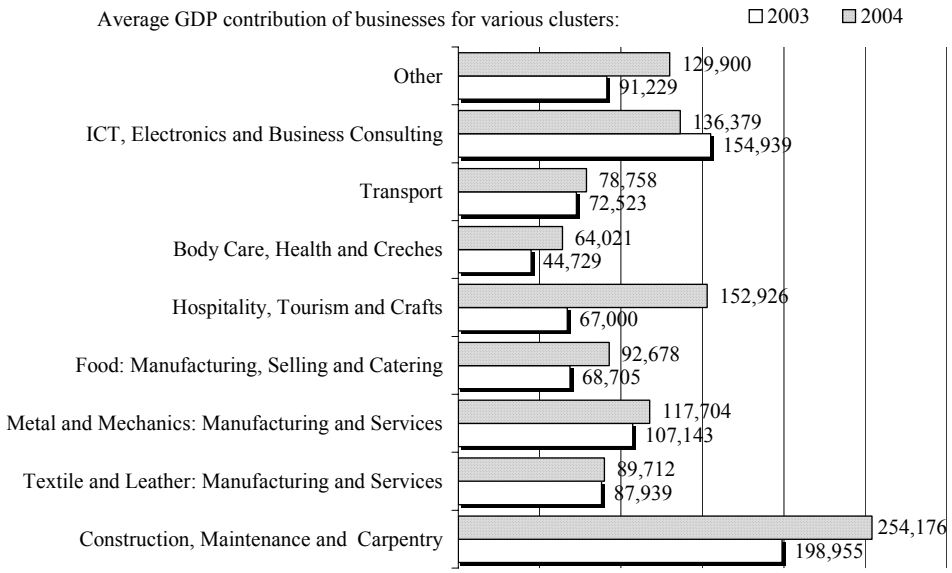

FIGURE 5. Average GDP contribution of businesses for various clusters

The value created per business is on average the smallest for the Body Care, Health and Creche cluster. Looking at the value added ratio, which is calculated by dividing the average value added by the average value of fixed assets for each cluster, this cluster does not look so bad any more. Still below average the body and health care sector performs better with a given fixed asset base than the hospitality or food cluster.

Small Business Impact on Fixed Capital Formation

In order to indicate the level of investment in an economy, it is necessary to measure investment in assets, usually referred to as Gross Fixed Capital Formation (GFCF). The contribution of small businesses to the GFCF in Namibia is calculated in the same way as the contribution to GDP. Table 14 displays the estimations for the Small Business Impact Assessment 2002 and Table 15 the estimations for the Small Business Impact Assessment 2003. Compared to 2002, the contribution of small businesses to the Namibian Gross Fixed Capital Formation (GFCF) has increased by about 70% in 2003, increasing from 5.05% to 8.54%.

TABLE 14. Small business GFCF in 2002

Business sector		Value invested in fixed assets in the last 12 months	Average GFCF
Manufacturing	N	16	
	Minimum	0	
	Maximum	29000	
	Sum	26416	1,651
Services	N	78	
	Minimum	0	
	Maximum	300000	
	Sum	966498	12,391
Small business manufacturing sector contribution to GFCF=11,971 x average GFCF for manufacturing sector			19,764,121
Small business services sector contribution to GFCF = 22,432 x average GFCF for service sector			277,954,912
Small business contribution to GFCF = The sum of all GFCF (manufacturing and services sector)			297,719,033
Small business contribution to GFCF in % of total GFCF in Namibia (GFCF 2002 N$5892 million, current prices)			5.05%

TABLE 15. Small business GFCF in 2003

Business sector		Value invested in fixed assets in the last 12 months	Average GFCF
Manufacturing	N	97	
	Minimum	0	
	Maximum	100,000	
	Sum	874,843	9,019
Services	N	186	
	Minimum	0	
	Maximum	330,000	
	Sum	4,138,722	22,251
Small business manufacturing sector contribution to GFCF=11,971 x average GFCF for manufacturing sector			107,966,449
Small business services sector contribution to GFCF = 22,432 x average GFCF for service sector			499,138,774
Small business contribution to GFCF = The sum of all GFCF (manufacturing and services sector)			607,105,223
Small business contribution to GFCF in % of total GFCF in Namibia (GFCF 2002 N$7111 million, current prices)			8.54%

For 2004 the Net Fixed Capital Formation (NFCF) rather than Gross Fixed Capital Formation (GFCF) was calculated. NFCF is considerable less than the GFCF due to capital consumption,

i.e. depreciation of capital goods. Therefore it is also a better estimator for the growth in the sector.

TABLE 16. Net Fixed Capital Formation in 2004

	Change in value of fixed assets 2003-2004	No. of businesses	Total NFCF in N$	Total NFCF in million N$
Manufacturing	39,054.24	11,971	467,518,336.74	467.52
Services	7,222.75	22,432	162,020,662.59	162.02
Total				629.54

The Net Fixed Capital Formation (NFCF) in 2004 has been larger than the Gross Fixed Capital Formation in 2003. The NFCF is usually smaller than the GFCF and therefore accelerated growth can also be expected for 2005.

Small Business Impact on Employment

The same assumptions are used as in the preceding two sections about the total number of small businesses in Namibia and its distribution between manufacturing and service sector to estimate the contribution of small businesses to employment. Table 17 shows the estimated share of the Namibian labour force that were employed in small businesses or were running them in 2002, Table 18 shows the same for 2003 and Table 19 for 2004. The estimates do not include part-time, occasional or commission workers. The calculations for 2002 and 2003 assumed that the owners work in the business. The last assumptions can be justified on the grounds that only business owners were interviewed and that they were met at the business.

TABLE 17. Estimated share of Namibian labour force employed in or running small businesses 2002

	Manufacturing Sector	Service Sector
Average number of full-time employees	1.25	1.44
Business Owner	1	1
Total	2.25	2.44
Number of businesses	11,971	22,432
Employment	26,878	54,756
Share of Labour Force (541447 RoN 2002)	4.96%	10.11%
Total Share	15.08%	

TABLE 18. Estimated share of Namibian labour force employed in or running small businesses 2003

	Manufacturing Sector	Service Sector
Average number of full-time employees	2.95	1.67
Business Owner	1	1
Total	3.95	2.67
Number of businesses	11,971	22,432
Employment	47,237	59,929
Share of Labour Force (541447 RoN 2002)	8.72%	11.07%
Total Share	19.79%	

In 2004 additional questions inferred about how many owners own and manage the business at the same time. Where owners worked full-time in a business they were added to the number of full-time employees. Another limitation is that the estimates for 2002, 2003 and 2004 use the same total labour force number which might not be very accurate. However, more up-to-date figures can presently not be expected.

TABLE 19. Estimated share of Namibian labour force employed in or running small businesses 2004

	Manufacturing Sector	Service Sector
Average number of full-time employees including owners that also manage the business	3.38	3.1
Number of businesses	11,971	22,432
Employment	40,443	69,489
Share of Labour Force (541447 RoN 2002)	7.47%	12.83%
Total Share	20.30%	

Keeping these limitations in mind, the share of people working in small businesses of the Namibian labour force has increased from 15% in 2002 to 19.8% in 2003 and to 20.3% in 2004. The average number of employees for small manufacturing businesses in 2004 declined in 2004 compared to 2003 while it increased for small service sector companies.

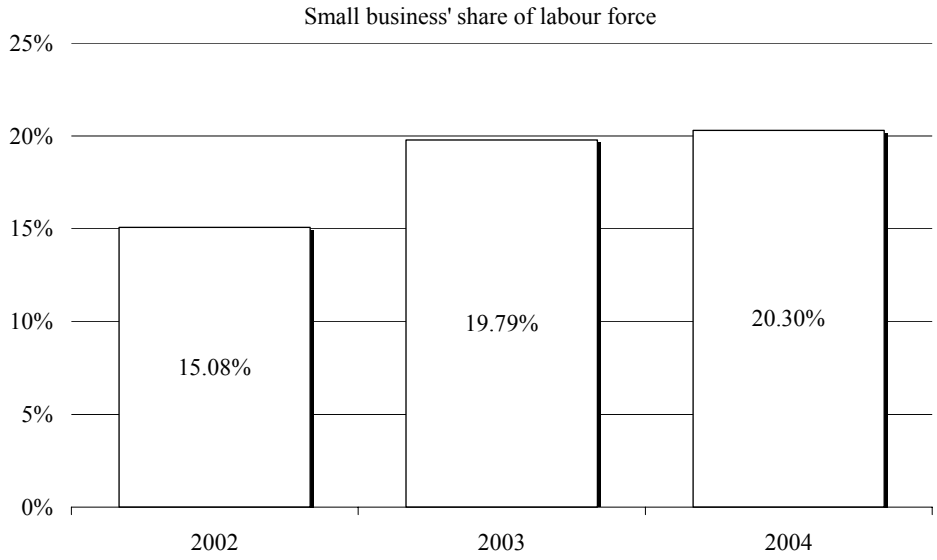

FIGURE 6. Labour force share of small business in 2002, 2003 and 2004

Section 5

Financial Services for SMEs

Reasons for Limited Access

The central characteristic of a transaction involving any form of credit is the fact that current claims over money are exchanged for future ones. A market failure is when a credit demand for a specific project is not satisfied, that is, if existing financial institutions do not satisfy the demand for credit. This is a common characteristic of financial markets all over the world. The major underlying reasons for this market failure are information problems (asymmetries) in regard to the borrower and his/ her behaviour:

Adverse selection:

- The lender does not know the person who wants to borrow and her financial background. Obtaining information about her is costly
- As a consequence of this uncertainty, collateral often is a major requirement to guarantee future repayment, which is often not affordable to borrowers

Moral hazard:

- The lender does not know the borrower's action and is unsure about his/ her efforts to pay back the loan
- Screening is costly and often uneconomical for small sums borrowed.

Small loan amounts are costly:

- Small loan amounts require high interest for the lender to achieve financial sustainability (if lending is market-based)
- High interest rates increase the portfolio risk of having riskier borrowers who cannot assure full repayment

Increase Access to Micro-Credit

Need for financial sustainability

- Lenders need to achieve financial sustainability in the long run. Subsidised loans might be useful at the beginning but lead to crowding out private suppliers in the long run and increase the risk of failure

Addressing the underlying information problems

- Usage of mass approaches common for private consumption lending, whereby standard scoring and screening methods are introduced and their administration facilitated by the consistent use of information technologies
- Shifting screening and selection burden to borrowers, e.g. through peer group lending schemes or compulsory training/ other support services

Comprehensive financial regulations

- Common standards and rules are necessary to assure same levels of service provision and to increase market transparency

Usage of financial services by SMEs

Conclusion 6: The usage of existing financial services among SMEs is fairly modest but this is mainly due to the fundamental structure and character of SME operators. Moreover, contrary to popular belief, a large number of businesses don't want financial services or credit

Although there are a variety of financing instruments available on the local market many SMEs appear not to fully make use of such services. This is supported by findings of the survey that revealed the following:

- Only 19% of SMEs make use off all available financial services.
- Over 60% never attempted to make use of any financial service.
- 76% of SME operators surveyed raised their start-up capital through informal sources e.g. own capital contribution (63%) and personal loans from family and friends (13%).
- Only 37% SME operators maintain either a business savings or business checking account.
- Only 13% of SMEs used banking sources to fund either shortfalls in working capital or major purchases.

Besides savings and checking accounts, by far the most commonly used financial products are bank loans accounting for 21% of SME start-up capital. In regard to funding major purchases and shortfalls in working capital, bank loans and overdraft facilities however play only a marginal role and contribute no more than 13% jointly. The overwhelmingly used form of funding

among SMEs for business expansion and cash flow shortfalls is personal contributions and retained earnings.

TABLE 20. Financial sources used to fund shortfalls in working capital

Sources of funding for shortfalls in working capital needs	No. of businesses	Percentage share
Bank loan	13	3.56%
Bank overdraft	34	9.32%
Family and friends contributions	9	2.47%
Personal contribution	148	40.55%
Retained earnings	161	44.10%
Total	365	100%

TABLE 21. Financial sources used to fund purchases for future business expansion

Sources of funding purchases for future business expansion	No. of businesses	Percentage share
Bank loan	11	3.05%
Cash flow from operations	69	19.11%
Government support programmes	1	0.28%
Grants	3	0.83%
Internal funds e.g business profits and retained earnings	212	58.73%
Overdraft	33	9.14%
Personal contribution	32	8.86%
Total	361	100%

The reasons why SME usage of financial services appears modest can in large part be explained by the following observations:

- About 45% of SMEs were set-up with initial start-up capital of less than N$5,000. This level of financing is very small and –due to high transaction and finance costs -largely falls outside the scope of the formal financial system. Only around 12% of SMEs used start-up capital in excess N$100,000 and those mainly include non-SMEs.

TABLE 22. Amount of start-up capital used by businesses

Start-up capital used N$	No. of businesses	Percentage share
0 to 5,000	151	45.35%
5,001 to 10,000	33	9.91%
10,001 to 50,000	82	24.62%
50,001 to 100,000	28	8.41%
>100,001	39	11.71%
Total	333	100%

TABLE 23. Major source of funding for start-up capital

Sources of funding for start-up capital	No. of businesses	Percentage share
Bank loan	76	20.71%
Government sources	1	0.27%
NGO sources.	2	0.54%
Other, specify:	9	2.45%
Own contribution	232	63.22%
Personal loans from friends, family or colleagues	47	12.81%
Total	367	100%

- Over 60% of SMEs neither have a business savings nor checking account. This makes the access to other financial services difficult for the bulk of SMEs that do not make use of banking facilities. Such facilities as bank loans and overdraft are conditional on a business having an established bank account.
- 70% of SME operators however maintain private savings accounts, presumably for both personal and business purposes. This suggests that there is little separation between business and personal finances indicating the informal nature of most SME operations. As stated previously, financial institutions requires formalised business establishments and readily available information on the business operations. The absence of this severely restricts access to existing financial services. In addition, a large number of businesses do not perceive business plans as important (see discussion on business services below).
- The majority of SMEs operate as sole proprietors with few formal structures. The sustainability of such informal structures is always a concern to financial institutions. More than half of SMEs surveyed stated that they are not registered for VAT, while only one third is registered for Social Security and 16% with a Local Authority body. The lack of formalisation of most SMEs suggests not only the informal nature of the business but also the financial sustainability of such a business.
- The lack of information about existing financial services is cited by 20% of SMEs as key reason why they preferred to fund their business through informal sources. This is a fairly significant proportion as 75% of those that funded the start-up of their businesses through own contribution said they did not know about alternatives sources. Much is required from financial institutions to publicise their product offering.

Generally, there appears to be a mismatch between the product supply from most financial institutions and SME demand. Findings from the survey reveal that easy access and flexibility of terms are considered as the main reasons why most SMEs prefer informal funding sources. This could indicate that existing financial services lack both these two considerations. Information as indicated above is the third critical component that explains why the usage existing financial services are moderate among SMEs. Most importantly however is that most SMEs fall outside the scope of the financial services market due to the informal nature of the majority. Most of the SMEs surveyed often have small and informal operating structures. The business operation is more often of a survivalist nature and lacks financially sustainability, as well dynamism.

TABLE 24. SMEs' demand for financial services currently not available

Demand for financial services currently not available	No. of businesses	Percentage share
Any financial help	9	3.72%
Do not know	15	6.2%
Financial Assistance from Government	3	1.24%
Government NGO loans	1	0.41%
Interest free loans	24	9.92%
Loans with low monthly instalments	4	1.65%
Loans without collateral	1	0.41%
Low interest loans	15	6.2%
Lower interest rates	1	0.41%
None	148	61.17%
SME loans	20	8.26%
SME pension fund	1	0.41%
Total	242	100%

Table 24 reveals that the majority of businesses (61%) do not perceive any need of financial services that are currently not available. This might be due to the above-mentioned lack of knowledge or information about existing services in the first instance. Those businesses that do perceive a need for service mainly would like to have interest free loans or loans with low interest rates, which indicates that the cost of accessing financial services is a major constraint. This also has to be interpreted in the light of the relatively low capital requirements for these types of businesses. One of the most surprising findings, however, is the fact that more then ¼ of those businesses not having used financial services (and credit in particular) did not even try to access credit because having debts was perceived as being 'bad.' This observation contradicts statements that lack of access to credit is the major problem for SME development. A large number of businesses do not perceive credit as an opportunity to expand or grow, but as a threat which should be avoided. This also hints at a low entrepreneurial orientation of those businesses.

TABLE 25. Reasons for not having used financial services

Reasons for businesses for not having made use of financial services	No. of businesses	Percentage share
I don't like to have debts	72	26,28%
Services are too expensive	19	6,93%
I have no access to financial services	24	8,76%
Lack of information about services	16	5,84%
None required at the moment	33	12,04%
Bank services are enough	12	4,38%
No, no reason given	72	26,28%
Other reason	26	9,49%
Total	274	100%

Another 26% did not provide any reason for not having used financial services, 12% stated not needing any services. About 9% mentioned not to have access to financial services (this includes reasons such as the business is too small or no collateral is available). Only 7% mentioned that the services were too expensive.

Points for discussions and policy considerations

- There is a need to re-classify SMEs into formal and informal business. For example, what should be considered an SME for the purpose of being able to access financial and other business support services?
- Apart from above, what are the major limitations for SMEs to access financial services?
- To what extent is access to finance a key constraint for SME growth and development in view of these survey findings?
- There appears to be a contradiction between the survey findings that most SMEs "do not require financial services" and those lacking access.
- What level of support should be made available to informal business compared to formal establishments?

Section 6

The role of business linkages for SME development

Background Business Linkages

Types of business linkages

- Supply chain linkages, whereby one company (SME) contributes to another company's production process (e.g. delivering inputs or processed intermediary products). This might be in regard to core-activities (e.g. production) or non-core activities (e.g. maintenance and servicing)
- Distribution linkages are generally those where the SME receives goods or services from another company (e.g. buying products, distribution or franchising, receiving expert inputs or technical advice)
- General support services are those where a firm provides general support to another company (SME), which does not necessarily have to be linked to both companies' production activities

Reasons to engage in business linkages

- Commercial reasons: sourcing local inputs or labour and using local distribution networks might have cost advantages; similarly, outsourcing core or non-core activities might be cheaper than doing it in-house
- Government regulations: regulations might oblige companies to use SMEs for tenders or co-operate with local companies
- Image/ branding: co-operating with local SMEs might increase the company's image as being an active promoter of the local economy (corporate social responsibility)

Preconditions for successful business linkages

- Trust in the partner's abilities and management skills are crucial for larger business to engage in business linkages; delivery on time and with constant quality are crucial for successful supply chain linkages

- The more complex the linkages (i.e. the more integrated production processes are), the more are the smaller partner's minimum requirements in terms of management skills, financial resources and market orientation

Potential benefits resulting from linkages (for SMEs)

- Potential benefits depend on the nature of the linkage. The more integrated the linkages are into the other partner's business processes, the more the potential benefits (e.g. in terms of technology, learning and efficiency spill-overs)
- Simple distribution or supply chain linkages have fewer benefits. These include: regular income opportunity (supplying) or cheap access to inputs (receiving), but otherwise limited spill-overs
- Some business partners might provide general support in terms of training or access to the partner's financial resources

Business Linkages - SMEs and Others

Conclusion 7: Only very few businesses have business linkages. In addition those linkages are of a very simple nature and have limited benefits

TABLE 26. Number of business linkages [a]

Cluster	Receiving products or services	Supplying products or services
ICT, Electronics and Business Consulting	6	2
Transport	0	0
Body Care, Health and Crèches	2	0
Hospitality, Tourism and Crafts	0	2
Food: Manufacturing, Selling and Catering	7 (2)	2 (1)
Metal and Mechanics: Manufacturing Services	3	2
Textile and Leather: Manufacturing and Services	4 (1)	4
Construction, Maintenance and Carpentry	5 (1)	3
Other	10	2
Total	37 (4)	17 (1)

a. Note: the number in brackets indicates the number of businesses in the respective cluster having more than one business linkage

In total, 37 businesses have a linkage whereby they receive products or services and 17 that supply products or services. Five businesses have more than one linkage (number in brackets), but no business had more than two linkages. The actual number of businesses receiving goods and services on a regular basis is much higher, though. This is due to the fact that not all businesses have mentioned to regularly buying inputs for this question. Most of the businesses replied in the BDS section (purchasing and sourcing) to get supplies form other businesses. However, these relationships do not necessarily have to be on a regular basis. This will be dis-

cussed in greater detail in the BDS section below. The majority of linkages (receiving) can be found in the construction, ICT, food and metal/ mechanics cluster. A larger number of businesses in the category 'other', including a flower shop, pharmacy, stationary, and chemical producer had business linkages with another business. Businesses supplying products and services can be found in the textile cluster, and equally in the hospitality, ICT and construction clusters. Businesses with more than one linkage are especially concentrated in the food cluster. These are businesses that get supplies and cater for other businesses at the same time. In regard to the size of the other business partner, 6 were of the same size as the SME/ non-SMEs, 9 were larger companies, 23 much larger and 9 were international firms.

Looking at the content of the business linkages, the simple nature of the relationships is predominantly a buyer-seller relationship. Products or services received by all businesses in the sample are mainly drinks and liquors for businesses in the food sector (mainly supplying from breweries and Coca Cola), computer hardware and electronics in the ICT sector, joinery and wood products (mainly wood supplies and tools), building materials and metal products and car accessories. The group 'other receiving' includes: hair and beauty products, coffins, books and stationary, cleaning materials, flowers, pharmaceuticals, fodder, photo material, plastic bags, tools and training services.

TABLE 27. Content of business linkage (receiving products or services, all businesses)

	Receiving products/ services	Supplying products/ services
Computer and electronics	4	1
Textiles and clothes	2	2
Leather products	1	1
Drinks and liquor	5	0
Catering services	0	2
Joinery and wood products	4	1
Souvenirs and crafts products	0	2
Building materials	3	1
Metal products and car accessories	3	1
Other	15	6
Total	37	17

Supplying businesses mainly supply textiles and cuts for tailors, catering services for larger businesses (e.g. daily supplying breakfast and lunch to a large mining company). The two supply relationships in the hospitality sector are woodcarvers who regularly supply lodges with artwork and souvenirs that are then sold by them in hotel crafts shops. The group 'other' includes: supplying office equipment, stationary and key cutting, cleaning production and services, welding, and upholstery work. The content of these relationships demonstrate the dominance of simple buyer-seller relationships. Receiving businesses largely buy inputs needed for their operation. Among businesses supplying products and services, there are only two linkages where the small business contributes to another business' production process. One tailor provides parts for another company producing shirts and trousers. A company produces chemicals and cleaning products for a number of larger companies using this input for a variety of derived chemical products. Two linkages are typical outsourcing linkages, whereby

another business provides catering services (breakfast and lunch) to another larger business. The other supply relationships provide smaller businesses with the opportunity to sell their products to larger companies on a regular basis. One joiner, for example, makes furniture for a furniture outlet; a stationer regularly delivers larger companies with stationeries and office equipment; and one leather manufacturer makes shoes for local shops.

As to the benefits, more than 51% of the businesses that receive products or services mentioned that the major benefit was to get an advantageous price or discount. Often, inputs were obtained at the wholesale price. This is also an indication of the predominance of simple distribution linkages, whereby the potential benefits are limited to a cheap price. Similarly, another benefit mentioned by 11% of the respondents was the ability to obtain products and services from their business partner on credit. Given that businesses often have problematic cash flow situations, this might be an important benefit for smaller businesses. Other benefits include: receiving quality products and on-time delivery; additional equipment (e.g. refrigerators from Coca Cola if businesses buy from them); transport costs are paid by the supplying company. Among the 41 linkages where businesses receive goods or services there was only one larger non-SME business that mentioned to get more targeted support from the partner business as part of the linkage. The business received training and financial assistance, thereby helping to improve its performance. This is the type of beneficial linkage that needs to be exploited to a greater extent. The major benefit for those businesses supplying goods or credit is to have a regular income and customers (79% of businesses having a supply linkage mentioned these two benefits). Given the overall difficult economic environment (in terms of high competition and lack of customers), a steady income base and regular customers are an important benefit as it guarantees a minimum income that, in addition, can also be accounted for in advance. Overall, such a linkage helps reducing uncertainties that small businesses might face. As with the linkage benefits described above, the majority of supply benefits are largely limited to income without leading to deeper spill-overs in terms of learning and performance gains. There might still be great potential to develop and exploit such linkages further. Among the other benefits mentioned are: recognition of the business and possibility for a broader client base; other business pays transport costs; customer are close-by.

The major (33%) perceived difficulty for businesses receiving goods or services are high transport costs and long distance, which might also cause delays in receiving the inputs. Moreover, 10% of the businesses mentioned high import taxes, which also indicates that they receive their supplies from abroad (in the sample, all businesses receiving goods from abroad do so from South Africa). Another 3% mentioned that they often get low quality or second-hand products (one business renting videos mentioned to only get second-hand videos that are of substantially lower quality than first-hand ones). The category ‘other’ includes high material costs; fear the other business might want to take the smaller one over; the relationship is not enough to make the business grow. The majority of businesses (44%), however, perceived that there are no difficulties. This might also be due to the simple nature of most of the linkages: if businesses only buy inputs or supplies less might go wrong than in a linkage where the business is part of the other business’ production chain. More complex linkages generally bear a higher risk for problems. With supply linkages, the major problem mainly relates to payment on time. Three businesses mentioned that payment often varied and posed some problems for the small business’ cash flow situation. The largest group is ‘other’, as it contains a number of problems that could not be classified in distinct groups. Problems mentioned here include: no

income in case of sickness (and when it is impossible to deliver); high import/ export taxes (for supplying abroad) and one not further specified problem. Four businesses mentioned that there were no problems with the linkage. Finally, respondents were asked whether they would be interested in future linkages with other businesses. Of the 297 businesses that provided information in this regard, nearly 2/3 were not interested in future business linkages. The major reasons mentioned include: the business is too small for this; I am better on my own; I don't want linkages because I can't trust anyone.

Points for discussion

- How can business linkages between SMEs and other companies be promoted that have potential benefits? One crucial aspect is to address the issue of trust
- How can the private sector in general and larger businesses in particular be encouraged to engage more in business linkages and SME development?
- What are larger businesses' requirements for engaging in linkages?
- What SMEs are suitable for business linkages?
- What is the role of regulations and policies to encourage linkages?
- One approach would be to identify linkage opportunities by addressing larger businesses' linkage potential and SMEs' capacities
- More targeted support is needed to identify and match potential partners

Section 7

SME Support

Types of BDS and the New BDS Paradigm

Types of BDS

- Physical: provision of space, utilities, infrastructure, inputs
- Social: networks, clusters, associations, self-help groups
- Natural: sustainable use of raw materials, environmental support
- Human: training, management skills, accounting, business planning

Reasons for providing BDS

- The logic of providing BDS is to provide them to those businesses that have not internalised these services themselves and that are not capable of purchasing these services externally.
- This is one of the major reasons for governments and donors to fund and provide BDS to small businesses

The New BDS Paradigm

- Old approach: direct provision of services by governments, donors and other agencies. One major objective was to build capacity of organisations providing business development services and to provide services directly, often at highly subsidised rates
- New approach: the focus is on enabling a market through which BDS services can be supplied and purchased at prevailing market rates

Businesses using Business Services

Conclusion 8:The majority of businesses do not make use of BDS, but a large proportion uses market-related business services, especially purchasing and sourcing and municipality services.

TABLE 28. No of SMEs using BDS (total number of businesses and percentage share of total)

	Accounting and book-keeping	Business Planning	Marketing Services	Purchasing and Sourcing	Training and Tech. Transfer	IT Services	Municipality Services	Other Services
ICT, Electronics and Business Consulting	6 (15%)	6 (15%)	12 (30%)	18 (45%)	5 (12.50%)	4 (10%)	14 (35%)	4 (10%)
Transport	4 (15.38%)	3 (11.54%)	1 (3.85%)	6 (23.08%)	1 (3.85%)	2 (7.69%)	2 (7.69%)	6 (23.08%)
Body Care, Health and Creches	2 (5.41%)	5 (13.51%)	6 (16.22%)	14 (37.84%)	5 (13.51%)	1 (2.7%)	17 (46%)	4 (10.81%)
Hospitality, Tourism and Crafts	3 (9.38%)	3 (9.38%)	10 (31.25%)	12 (37.5%)	6 (18.75%)	1 (3.13%)	14 (43.75%)	2 (6.25%)
Food: Manufacturing, Selling and Catering	9 (11.11%)	9 (11.11%)	10 (12.35%)	24 (29.63%)	6 (7.41%)	2 (2.47%)	42 (51.85%)	2 (2.47%)
Metal and Mechanics: Manufacturing Services	6 (17.65%)	6 (17.65%)	4 (11.76%)	18 (52.94%)	6 (17.65%)	1 (2.94%)	17 (50%)	3 (8.82%)
Textile and Leather: Manufacturing and Services	6 (15.38%)	7 (17.95%)	11 (28.21%)	18 (46.15%)	8 (20.51%)	1 (2.56%)	20 (51.28%)	0
Construction, Maintenance and Carpentry	3 (9.68%)	0	15 (48.39%)	14 (45.16%)	2 (6,45%)	0	10 (32.26%)	1 (3.23%)
Other	6 (35.29%)	1 (5.88%)	6 (35.29%)	14 (82.35%)	1 (5.88%)	1 (5.88%)	5 (29.41%)	1 (5.88%)
Total	45 (13.35%)	40 (11.87%)	75 (22.26%)	138 (40.95%)	40 (11.87%)	13 (3,86%)	141 (41.84%)	23 (6.82%)

Services mostly used by SMEs are purchasing and sourcing (41%), municipality services (42%) and marketing services (22%). The services least used are IT services, training and business plan preparation. About 13% of the businesses make use of regular accounting services. The majority uses private providers (accounting firms, consultants) or family members and friends. Only 2 businesses have used classical an NGO (as classical BDS providers) for accounting support. Business planning is a classical BDS service, and 11 businesses have used the support from NGOs or government agencies. The other businesses have mainly used family/ friends, specialised firms or individual consultants to prepare the business plan. The high usage of family/ friends is also due to the fact that the most important criteria for businesses to choose a provider is trust. Marketing services are also largely market-based and not classical BDS. The large majority of businesses use business cards, newspaper advertisements and radio. Only one business used a classical BDS service whereby an organisation helped in the preparation of marketing strategies. Most marketing services used are of low profile. Purchasing and sourcing represent classical supplier-buyer relationships, as most businesses sim-

ply buy inputs or raw materials for their business operation. They are not classical BDS, whereby an organisation supports businesses in sourcing supplies. Only five businesses mentioned to have used an agent or organisation that helped them to get the required supplies. All businesses having used training or technology transfer services have participated at training courses. A large part received the training from typical BDS providers, like NGOs and government agencies. A number of them also used private training providers, friends and family members or were trained by their suppliers. IT services are least used by businesses and most are market-based services and not BDS. Services include the servicing of computers or the network or the design of web-sites. The relatively high number of businesses using municipality services is due to the fact that many smaller businesses rent premises or market stalls from the municipality. Only six of the businesses made use of incubators. Other services include business related services such as courier services and security services. To conclude, the few businesses using business services use market-based (and often simple) business services, but hardly any typical business development services (BDS).

Businesses not using business services

One major objective of the survey on the usage of business services was also to obtain a better picture of why businesses don't use business services/ BDS and whether they fully understand them.

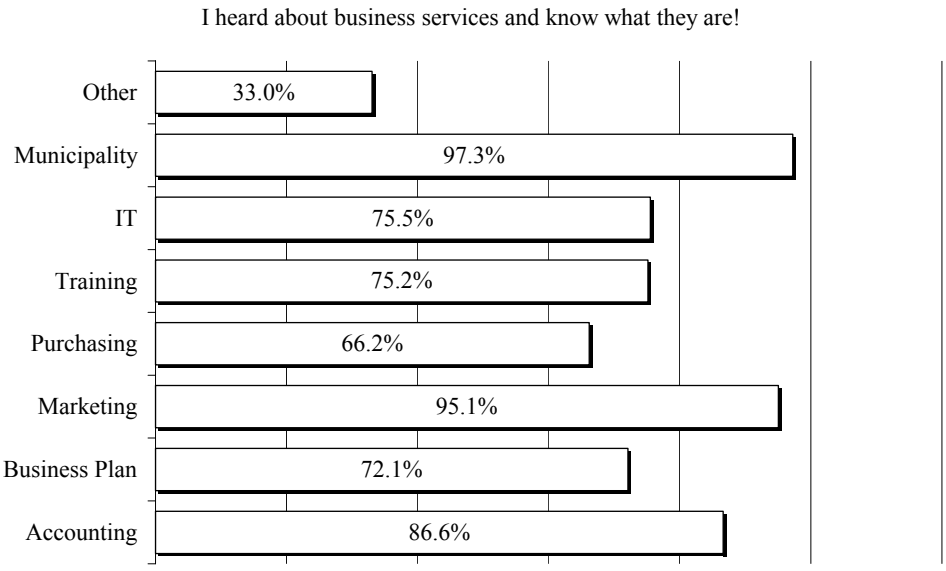

FIGURE 7. Understanding business services

Figure 7 reveals that the majority of businesses that haven't used a service know what the respective service is or what it involves. However, about 8% of all businesses don't know what accounting and bookkeeping services are, 16% don't know business planning services,

about 19% don't know purchasing and training services, 12% don't know about IT services. A number of businesses have heard about the different services but subsequently weren't able to explain or define the services correctly. Table 29 displays the main reasons for businesses not to use business services. Accounting services are not used because the majority of businesses not using them do it themselves. For business plans, most respondents thought that it was not required, which reflects that businesses might use business plans only when needed (e.g. for credit purposes).

TABLE 29. Reasons for not using a BDS (as percentage share of all responses per category)

	Accounting and book-keeping	Business Planning	Marketing Services	Purchasing and Sourcing	Training and Tech. Transfer	IT Services	Municipality Services	Other Services
That service is not required in my business	25,24%	41,98%	27,64%	34,74%	38,46%	49,58%	66,22%	18,60%
I get it done in-house	50,16%	9,88%	37,45%	11,74%	27,51%	8,86%	8,44%	0,91%
It's too expensive to purchase	5,43%	6,17%	20,36%	5,16%	5,92%	11,91%	8,44%	3,35%
I don't know where to get it	1,92%	3,09%	2,91%	5,16%	0,89%	2,22%	3,56%	1,52%
I haven't found a suitable supplier yet	0,32%	1,54%	1,45%	6,57%	0,00%	0,28%	0,00%	0,00%
Service provider is located too far away	0,32%	0,00%	0,73%	0,00%	0,30%	0,00%	0,00%	0,61%
Other	1,92%	0,93%	1,82%	1,88%	0,59%	0,28%	0,44%	0,61%
Because the service was not known	14,70%	36,42%	7,64%	34,74%	26,33%	26,87%	12,89%	74,39%
Total	100%	100%	100%	100%	100%	100%	100%	100%

Marketing services are either not required or done in-house, purchasing and training are largely perceived as not necessary. Most respondents not using municipality services mentioned that they rented their own place. Other services are not known..

TABLE 30. If you haven't used business services, do you intend to use any in the future? (No. of replies)

	Accounting and bookkeeping	Business Planning	Marketing Services	Purchasing and Sourcing	Training and Tech. Transfer	IT Services	Municipality Services	Other Services
Yes	14	23	39	12	11	27	22	7
No	278	267	199	172	269	285	153	295

The majority of the businesses that haven't used services don't plan to do so in the future, either. This reflects that there is no perceived need for business (development) services in the future.

Points for discussion

- What type of support (BDS) do businesses actually need?
- Does the current provision of BDS address businesses' needs?
- What businesses should receive BDS and how can they be identified?
- What is the potential for more market-based support as most business that have identified a need largely purchase market-based business services?
- Undifferentiated provision of BDS is a waste of resources, especially as only few BDS providers can provide detailed impact measurements
- The major approach should be to create awareness for services and support measures and to better identify businesses' needs
- Subsequent support and BDS should be targeted towards specific needs and demands instead of being supply driven. Not all businesses need BDS, nor would they be useful
- Support should be linked to performance and potential