
Small, Medium and Micro-Sized Enterprises (SMMEs) and the Housing Construction Industry: A Possible Solution to South Africa's Socio-Economic Problems

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ABSTRACT

South Africa as a developing country faces many socio-economic problems like high unemployment, low levels of working skills, poverty and rampant crime. In this paper it is argued that by targeting SMMEs both in general and specifically in the housing construction industry, there is meaningful scope for the creation of jobs in the South African economy. This is mainly because SMMEs are labour intensive. Using Endogenous Growth theory as a basis, it is argued that by employing greater numbers of workers the level of skills in the economy can be raised too.

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1 INTRODUCTION

As a developing country, South Africa is faced with several daunting problems such as high unemployment, a labour force with low levels of skill as well as the resultant problems of poverty, crime and many more. It was estimated that the level of unemployment in South Africa in 1995 was 29 per cent. This rate has increased in the last three years due to the fact that the economy has continued shedding jobs (BEPA, 1998: 12).

In this paper it will be examined whether small, medium and micro-sized enterprises (SMMEs) as an institutional framework and the housing construction industry as a

sub-sector of the economy could help to alleviate some of the socio-economic problems in South Africa.

Two hypotheses will be tested in the paper. The first is that there is in fact scope for the creation of jobs in the South African economy, if SMMEs and the housing construction industry are explicitly targeted. The second hypothesis is that the level of skills of South Africa's labour force can be raised, if SMMEs and the housing construction industry are thus targeted.

As a point of departure endogenous growth theory will be briefly discussed. Then, SMMEs will be defined and discussed in the South African context. Next, the housing-construction industry in South Africa will be examined. Finally, the role of the informal sector will be discussed.

2 ENDOGENOUS GROWTH THEORY

The aggregate production function for the economy as a whole can be expressed as

$$Y_t = F(K_t, N_t, A_t)$$

where Y_t is level of output in the economy;

K_t and N_t are the levels of capital and labour in the economy;

and A_t is the level of technology. Technology includes not only physical technology but also knowledge (Froyen, 1996: 411).

The production function of an individual firm (i) in the economy can be expressed as

$$Y_{it} = F(K_{it}, L_{it}, A_t)$$

where Y_{it} is the level of output of the individual firm;

K_{it} and L_{it} are the levels of capital and labour in the economy;

and A_t is the level of technology in the economy as a whole (Froyen, 1996: 412).

The relationship between output and technology differs from that between output and other inputs, because although each firm's output depends on its own levels of labour and capital, its output is dependent on the level of technology in the whole economy. Improvements in technology (knowledge) in the economy as a whole raise the productivity of all firms (Froyen, 1996: 413).

In some models of Endogenous Growth theory, advances in technology (knowledge) are assumed to depend on growth in capital. The reason for this is that new investment promotes new inventions and improvements in machinery. This in turn raises the level of knowledge in the economy. In other models, increased use of labour as an input also increases the stock of knowledge. Stadler (1990: 763) expresses this process as follows:

The greater the level of labour input, the greater is the scope for learning and acquisition of new skills.

Arrow (1962: 155), expresses the importance of knowledge as follows:

The acquisition of knowledge is what is usually termed "learning", ... Learning is the product of experience. Learning can only take place through the attempt to solve a problem and therefore only takes place in activity.

Endogenous Growth theory has certain very important implications. Consider what would happen to output in the economy if all firms were to increase their use of both capital and labour by a certain percentage. The increase itself would usually lead to a percentage change in output of the same magnitude as the original percentage change in capital and labour. From the discussion above, however, it follows that increases in capital and labour serve to raise the level of technology (knowledge and skills) in the economy as a whole. This increase in technology again leads to a greater than proportional increase in the level of output in the economy, that is, increasing returns to scale (Froyen, 1996: 414).

There is a very important lesson to be learnt from the above discussion. South Africa, as a country with abundant unskilled labour, could raise its levels of skill by employing and training workers. Although a certain amount of specific training is

necessary, Endogenous Growth theory points to the fact that simply by employing people, levels of skill can be raised.

Having noted the importance of raising skills by increased employment of labour, the discussion now turns to the areas in the South African economy which have the greatest potential for labour employment.

3 SMMEs, EMPLOYMENT AND GROSS DOMESTIC PRODUCT IN SOUTH AFRICA

SMMEs are defined in the National Small Business Act of South Africa (NSBASA) as distinct business entities, which are not part of a group of companies. If an SMME does have subsidiaries and branches, they must all be included when measuring its size. An SMME should be managed by its owner or owners, and can therefore be a natural person, a sole proprietorship or partnership, or a legal person like a close corporation or a company (NTSIKA, 1997: 8).

Any business can be categorised according to three criteria, namely, employment, turnover and assets. Although all three criteria are applicable to a business firm, for practical purposes, the number of employees is regarded as the most important criterion when defining SMMEs. According to NSBASA, small businesses can be classified into one of four categories. Firstly, there are survivor enterprises, which generate income less than the minimum income standard or poverty line. A second category is that of micro enterprises. In this case the major criterion is that turnover is less than the VAT registration limit of R150 000 per year. In the third category of small enterprises, called "very small enterprises", employment per enterprise is less than ten paid workers. Finally there are those enterprises, where fewer than 50 people are employed. These categories are to be compared with a medium enterprise, which employs between 51 and 100 people (NTSIKA, 1997: 9).

SMMEs play an important role in the South African economy, particularly with regard to the creation of jobs. The contribution of SMMEs to employment is approximately 44 per cent. In Table 1 employment figures are broken down according to the sectoral contributions of SMMEs. From these statistics it follows

that small enterprises make a significant contribution to employment in the agricultural, trade, construction and manufacturing sectors of the South African economy. These figures reflect the large number of people employed by farmers as well as the many small traders operating in formal and informal markets. They also indicate that large numbers of people are employed by small contractors in the construction industry and by small factories. As far as medium-sized enterprises are concerned, it is evident from Table 1 that they are mostly active in the manufacturing and construction sectors. In the manufacturing sector, SMMEs are concentrated in eight economic sub-sectors. In order of importance, these are metal products, machinery, printing, food, furniture, other manufacturing, non-metal mineral products and clothing. Some economic activities clearly accommodate the relatively smaller entrepreneur more readily than others, and with some financial assistance (from financial institutions and the government) there are many opportunities for new entrepreneurs to exploit in the manufacturing sector.

Table 1: Sectoral contribution (percentage) to employment by size of business: 1995

Sector	Small Enterprise	Medium Enterprise	Large Enterprise
Manufacturing	17	25	58
Construction	39	24	37
Mining	2	3	95
Electricity	0	0	100
Agriculture	56	19	25
Transport	12	3	85
Finance	5	1	94
Trade	50	14	36

Source: NTSIKA 1997.

The contribution of SMMEs to the gross product of the various sectors of the South African economy is shown in Table 2. As one would expect, there appears a direct correlation between the percentage contribution of SMMEs to sectoral output and employment. As in the case of employment, SMMEs in the agriculture, trade, construction and manufacturing sectors contribute the most to GDP.

Table 2: Contribution of SMMEs towards GDP by sector (as a percentage of the total contribution of each sector): 1995

Sector	SMMEs	Large enterprises
Manufacturing	31	69
Agriculture	67	33
Transport	15	56
Construction	56	24
Mining	3	97
Trade	65	35
Electricity	0	100
Finance	7	93

Source: NTSIKA 1997.

Well-founded economic reasoning supports the case for employment creation by SMMEs. Small businesses are usually labour intensive, need relatively little capital and use local resources. By channeling scarce capital resources to the small business sector, particularly in a developing economy such as South Africa's, employment opportunities can be maximised and the unemployment rate reduced.

There is, moreover, another way in which SMMEs would have a positive effect on employment. Given the fact that SMMEs are highly labour intensive, increasing numbers of SMMEs would mean that increasing amounts of labour would be employed. This calls to mind the statements by Stadler (1990: 763) and Arrow (1962: 155) quoted in section two of this paper: "*The greater the level of labour input, the greater is the scope for learning and acquisition of new skills*" and "*Learning is the product of experience.*" Promotion of labour-intensive SMMEs would raise the level of knowledge in the South African economy as a whole and lead to increased output. By promoting labour intensive SMMEs, the level of skills in the South African economy would be raised too. The importance of this conclusion is stressed by the discussion of the role of SMMEs in the home construction sector that follows.

4 HOUSING PROVISION AND CONSTRUCTION SMMEs

The link between productivity, motivation and living conditions should not be underestimated. As far as the latter is concerned, housing is and has always been a critical factor. Informal slum settlements have often been established near places where work is available in a particular factory or trade. The existence of an extended family system with group-based support and contact networks, facilitates the entry of new urban migrants into the urban economy. These circumstances have influenced and still influence the decision of many households to live in informal settlements despite crowded conditions and lack of amenities. Thus, although such settlements offer “affordable accommodation”, which has facilitated the access by the urban poor to income-earning job opportunities, they are characterised by unhygienic living conditions, which are not conducive to improvements in human capital. The implication of this is that improvement in housing conditions for the millions of people living in informal settlements, should also improve the quality of their labour, and hence general welfare and economic conditions.

According to figures provided by the Department of Housing, there is currently a shortage of almost 2.2 million formal housing units in the urban areas of South Africa. It is estimated that this shortage increases by 200 000 houses per year (Newton, 1997: 19&37). This means that by the end of 1999, the shortage may have reached 2.4 million units. NEDLAC estimates that a further 400 000 houses might be needed in rural areas (NEDLAC, 1997).

Data from Central Statistical Services (CSS, now known as Statistics South Africa) and the Building Industries Federation concerning the construction of homes in 1994, point to the fact that 40 751 workers were employed to build approximately 25 500 houses (CSS, 1997a: 15). Using this data as a rough estimate, a ratio for houses per worker can be obtained, which proved to be 0.625 houses per worker, *ceteris paribus*. The reason for adding a *ceteris paribus* clause is that this ratio does not take into account that there may be increases in productivity as workers become more accustomed to their jobs. Given the limited data, it is however not possible to take increases in productivity into account. According to Newton (1997: 1), the government plans to supply 350 000 houses per year. To do so approximately 560 000 workers would be needed, given the above ratio. It must

be remembered that 200 000 of the 350 000 houses per year are needed to keep up with the demand for new houses. Only 150 000 houses per year would therefore go towards reducing the backlog. This means that 350 thousand houses would have to be built every year for 13 years, in order to reduce the backlog and make provision for the annual increase in this backlog. After the backlog has been eliminated, the number of new houses needed per year would be 200 000 if the present rate of population growth remains unchanged. Given the ratio of 0.625 mentioned above, approximately 320 000 workers would be needed to build these houses.

In 1994 there were 3 141 residential home construction enterprises in South Africa. These enterprises employed a total of 40 751 workers (CSS, 1997a: 9). Table 3 contains information pertaining to the sizes of these enterprises. As can be seen from the data, a large percentage of workers, namely 75.5 per cent, worked for enterprises which employed less than 50 workers (that is, small enterprises). There were 2 328 enterprises, that is 74 per cent of the residential home construction firms, which employed less than 50 labourers. Medium-sized enterprises on the other hand, employed 13.2 per cent of all the workers in the home-construction industry. The data therefore indicate that small and medium-sized home construction enterprises employ the most labourers.

Table 3: Employment size group of residential home construction enterprises, 1994

Employment Size Group	Number of Enterprises	Total Number of Workers
0-4	714	2198
5-9	1207	8816
10-19	769	9898
20-49	352	9865
50-99	80	5472
100-199	11	1443
200-299	2	-
300-399	4	-
400-499	-	-
500-999	2	3059
Total:	3141	40751

Source: CSS 1997a: 15.

The discussion above indicates that there is significant scope for job creation in the construction industry, given the large housing shortage which exists in South Africa. It also clearly indicates that small-scale enterprises in the home construction industry employ the largest number of workers and create the most employment in this sector in contrast with larger enterprises. The construction industry's job creation potential could be fully exploited if SMMEs in this industry were targeted and supported.

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It clearly follows from the above discussion that SMMEs in the construction industry employ more people than large enterprises. Promotion of SMMEs in the construction industry would therefore mean that greater numbers of workers would be employed there. Increased employment of labour would in turn increase the scope for the generation of skills and knowledge in the South African economy. It should also be noted that SMMEs are active not only in the formal sector of the economy; in many instances they play an active role in the informal sector too.

5 THE ROLE OF SMMEs IN THE INFORMAL SECTOR

Statistics South Africa has defined the informal sector as follows:

"It includes all types of market economic activity which conceptually are to be included in the flows of the National Accounts but which are underestimated or not measured at all, due to the informal business styles of vendors and enterprises that are not known of officially. It consists of those economic activities which generate factor incomes, that is wages, salaries and profits, arising from the production of

goods and services which cannot be estimated from statistical sources used to compile income measures of GDP." (CSS, 1997b).

According to the World Bank, the annual employment growth rate within the South African informal sector in 1995, was 24 per cent (SAIRR, 1997). This clearly indicates that the informal sector creates many jobs within the South African economy.

In 1995, an estimated 1.74 million people were working in the informal sector. Roughly 72.9 per cent of them were involved on a part-time basis. Moonlighters thus represent a significant portion of the total number of persons working in the informal sector. Housewives and students comprised almost 40 per cent of total employment in this sector. This implies that the informal sector serves as a means for enterprising people to improve their standard of living, and does not just provide jobs for the unemployed.

In 1990, the transport industry's contribution to estimated informal GDP amounted to 21.8 per cent. The contribution of manufacturing is relatively small due to the high level of skills required in order to be successful in this sector. Most people in the informal sector are involved in rudimentary work (a total number of 846 000), followed by 185 000 working in the craft and related trades. The remaining informal workforce consists of managers (94 000), professionals (15 000), technicians (46 000), clerks (4 000), service workers (89 000) and skilled agricultural workers (25 000). Expressed as a percentage of the total number of workers in the informal sector, people working in rudimentary occupations account for 70 per cent (CSS, 1997b). A large proportion of participants in the informal sector is therefore engaged in elementary work which does not require a high level of skill.

There are a number of reasons why the informal sector should be targeted and promoted for employment creation:

- a) It provides jobs for the unemployed.
- b) It serves as a safety net during periods of cyclical unemployment when many people cannot find formal employment.

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- c) It teaches prospective small formal entrepreneurs to develop their skills in areas of management and business operations.
 - d) It appears to have a greater capacity to absorb large numbers of people seeking employment, whereas formal sector business only has a limited capacity to provide jobs for the unemployed and new labour market entrants. This is mainly due to the fact that the informal sector is comparatively labour intensive.
 - e) It provides a large number of jobs which do not require high levels of training and skill.

Due to the fact that the informal sector is labour intensive, promotion of this sector would lead to higher levels of labour employment, and this would in turn raise the level of knowledge and skills in the South African economy.

6 CONCLUSION

At the beginning of this paper it was said that two hypotheses would be tested here. The first is that there is meaningful scope for the creation of jobs in the economy if SMMEs in general and particularly in the housing-construction industry are targeted as job-creators by the government. The second is that the level of skills of the labour force can be raised if SMMEs and the housing-construction industry are targeted in this way.

In section 3 it was concluded that SMMEs are labour intensive and that there is scope for the creation of jobs if SMMEs are supported by the government. It was also concluded that increased use of labour in SMMEs would, according to Endogenous Growth theory, serve to increase the skills of the South African labour force. In section 4 it was again concluded that there is significant scope for the creation of jobs by attempting to eliminate the housing backlog that currently exists. It was also concluded that SMMEs in the home construction industry are labour-intensive and currently employ more people than large enterprises in the industry. For this reason, job-creation could be maximised and levels of skill would be raised if home-construction SMMEs were to be targeted. Finally, it was concluded in section 5 that given the labour intensive nature of the informal sector, employment

would be maximised and levels of skill raised, if this sector were to be targeted for job-creation.

Given the conclusions drawn in these three sections of the paper, it clearly follows that neither of the above two hypotheses can be rejected. The evidence in this paper does *not* disprove that SMMEs and the home construction industry could be profitably used to create jobs in the South African economy. Nor does the evidence disprove that increased employment of labour in SMMEs would raise the level of skills in the South Africa economy.

In his *Theory of Economic Development* (1911), Schumpeter describes the economy as a circular flow, and adds that economic development takes place through new technology, which causes a marginal movement away from a previous state of equilibrium. Schumpeter describes five factors which would cause such a movement and two of these are "*The introduction of a new method of production, that is one not yet tested by experience, in the industry concerned...*" and "*The carrying out of the new organisation of any industry...*" (Rostow 1991: 406-407). Targeting SMMEs in general and in the home construction industry in particular, can indeed be regarded as the introduction of a new way of organising this area of the economy. By doing so, there is scope for the generation of employment as well as improvements in the level of skills of South African workers. This should in turn, hopefully, lead to reduced poverty and crime.

ENDNOTES

- ¹ Views expressed in this paper are those of the authors and do not necessarily reflect the views of any organisation with which they are associated.

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