

## The entrepreneurial ecosystem of South Africa: A strategy for global leadership

South Africa is an entrepreneurial leader in sub-Saharan Africa. The country has made significant progress to overcome structural factors and produce some of the most innovative and successful enterprises on the continent. The country provides the institutional support necessary for high-growth businesses to emerge and thrive, while government policies work to close historical gaps. With the addition of targeted, coordinated policies to address remaining bottlenecks, the country is poised to achieve greater growth through entrepreneurship.

### Overview

Entrepreneurship is a key driver of economic growth. South Africa is in a unique position in sub-Saharan Africa, with stronger supporting institutions than much of the rest of the continent and a resulting strong entrepreneurial ecosystem foundation. Since the 1990s, the South African government has been actively engaged in incorporating more of the South African population into the formal economy, whether into wage employment or entrepreneurship. To further strengthen the potential of entrepreneurship and innovation, South Africa does not necessarily need more entrepreneurs, it needs better, innovative and growth-oriented entrepreneurs that are motivated to grow and prosper within the South African environment and through engagement with the global economy. To facilitate this goal, South Africa needs a national entrepreneurship policy framework based on the strengths and weaknesses and causal factors that define the entrepreneurship ecosystem.

### Factors that impact the South African entrepreneurial ecosystem:

- **The current recession.** The South African economy has been growing slowly with 0.1% growth in 2016. Unemployment is almost 27.1% and incomes are falling. The major cause of this recession is the rebalancing of the Chinese economy, which is reducing the demand for South Africa's raw material exports.
- **Bureaucracy and red tape.** In combination with these two, the existence of large and well-established state-owned enterprises prevents private sector enterprises from entering key sectors dominated by these SOEs.
- **Large firm dominance.** In addition to state-owned enterprises, the South African economy is dominated by large companies that prefer doing businesses with trusted suppliers they have built a long-term relationship with over doing business with startups that are new to the market. Large firms account for more than 90 percent of the South African market.
- **The dual economy.** One-third of the working population is effectively excluded from the formal economy. A majority of entrepreneurs from disadvantaged communities tend to suffer from lack of resources due to their communities being underserved. The current market structure is not conducive to new market entrants, as there are structural barriers to market access for new entrants and small businesses, which contribute to their failure.

- **Infrastructure.** While South Africa leads sub-Saharan Africa in terms of infrastructure across categories, the economy struggles with energy constraints.
- **The education system.** “Eighteen years into democracy, South Africa remains a highly unequal society where too many people live in poverty and too few work. The quality of school education for most black learners is poor.” Appropriately, government action in the education sector is focused first on reducing inequality in education. In addition to inequality, the structure of the education system doesn’t allow for creativity and innovation, which impacts the level of innovative entrepreneurship activity which is needed for growth.

### **Strengths of the South African entrepreneurial ecosystem**

- In contrast to the weak showing of the sub-Saharan African region on average, the South African entrepreneurial ecosystem outperforms the region in the most growth-oriented components. South Africa performs better where it counts: in entrepreneurial aspirations, innovation, high growth, internationalisation and risk capital are the pillars that lead to economic growth.
- South Africa is also very strong on the depth of its capital markets, performing in the top 20 percent of countries. It also performs in the top 20 percent of countries for new products and new technologies and is a leading economy in terms of risk perception and competitiveness and regulation. The pillars that hold back overall performance are largely a factor of the dual economy – South Africa has the right institutional environment for high-growth firms to thrive, and efforts to address attitudes and abilities across the population will further strengthen this environment.

This means that South Africa’s institutions are holding people back by not creating adequate incentives. While South African institutions are strong relative to African countries they are rather weak compared to developed countries.

The pillars that are holding entrepreneurship back are:

- Startup skills (education and skill perception - people think they have the skills to start a business but the education level suggests that they do not). The poor education system is key to this.
- Risk capital
- Human capital (flexibility of labor markets, an institutional variable and staff training)
- Technology absorption

The areas that South Africa is strong on is:

- Competition
- Product innovation
- High-growth firms
- Process innovation

### **Bottlenecks**

The factors holding back South African entrepreneurship can be narrowed down to six areas. They are: Finance of new and growing firms, access to markets for firms both domestic and international, skills, education, networks and culture, and regulation/ red tape.

## Policy recommendations

1. The major problem we observe is due to the demographic structure of the country with almost 50% of the population under 24, youth unemployment close to 50% and unemployment of 25%. A young population could be an advantage for a country. Even a large advantage. Young people are more energetic, more ambitious, and should be better-educated than the older population. However, a young population also poses challenges for a country. Human development and education are crucial for a young population if they are to achieve their dreams and if a country is to benefit from their vitality. In other words a young population needs to be educated and be able to find employment to contribute to economic growth.
2. Second, South Africa, despite a real effort to improve the state of small business policy and the entrepreneurship ecosystem over the last decade, has not made much progress in improving the overall entrepreneurial ecosystem.
3. South Africa, however, is a lot different from other countries at similar levels of development in Africa. It has a much better-developed ecosystem than other African countries like Nigeria, Egypt or Ghana. While the South African entrepreneurial ecosystem is underdeveloped and unbalanced South Africa is stronger than most of its peer countries in competition, product and process innovation. For example, it is more like China than Russia and Brazil with weak innovation. This is the good news. However, it is like Russia and Brazil in technology absorption and human capital, the skills needed to close the distance to frontier gap. The distance to the frontier is the difference between countries that are using the best technologies and those that are not. That difference is the distance to the frontier that needs to be overcome.
4. The results of the analysis using the Global Entrepreneurship Index to gauge weaknesses in the South African entrepreneurial ecosystem are confirmed by the survey results. The weaknesses are, startup skills, risk capital, technology absorption, human capital and social capital. Each one of these weaknesses have both an institutional and an individual component.

## Recommendation detail:

### Improving startup skills:

- **Education:** A country that has the demographic structure of South Africa should make education the number-one priority for all of South Africans.
- **Starting a business:** South Africa should be the easiest country in Africa to start a business on account of its well-developed infrastructure - not the hardest. South Africa ranks 131st on the ease of starting a business index. It ranks 111th in getting electricity services connected. South Africa should engage in a massive deregulation of the start up ecosystem process for all sectors of the population.
- **Employment training:** An ecosystem-centric unemployment/re-employment training program that prioritises training of individuals without current employment options into new or existing firms or industries. For example, the United States offers an online service that matches the unemployed with training for jobs with new or existing firms.
- **Informal to formal:** Legitimise a pathway to formal entrepreneurship in the informal sector. It is important for enterprises to be able to become a part of the formal economy in order to grow the businesses and ensure that firms pay taxes. However, entering the formal economy should not and cannot be a burden on SMEs.
- **Wage subsidies can be used to address structural inequality:** A randomised control trial (RCT) of a wage subsidy voucher "led to a higher employment one year after receiving the

voucher. Wage subsidies provided to SMEs could be particularly impactful in terms of both unemployment and the affordability of skilled labor.

#### **Banking and finance for all:**

- **Mobile banking:** While South Africa has a very well-developed banking system, it has a weakness that is easy to address. First, most of the country does not have access to formal banking while other African countries made a serious effort to introduce mobile banking.
- **Crowd funding:** The second modern approach to entrepreneurial finance is crowd funding. However, this depends not only on banking but also on being connected to the internet. While this report will not go into the details for crowd funding South Africa should take the lead of the United Kingdom and adopt a hands-off regulatory approach to all crowd-funding donation, debt, equity. Once the system is up and running regulation can always be introduced afterwards.
- **Reduce lending risk among SME borrowers:** Evidence from India shows that “SME borrowers, who are regularly called either by a single assigned relationship manager, or by one manager randomly selected from a small team of managers, show much better repayment behaviour and greater satisfaction with the bank services than borrowers who either receive no follow up or only receive follow up calls from the bank when they are delinquent.”
- **The use of credit scores can reduce lending friction for SMEs:** This could be particularly important in reducing structural inequality through removing some subjectivity from lending processes.

#### **Technology absorption:**

- **Improve digital technologies:** Any country that does not embrace the digital age will fall behind the technological frontier and will not be able to compete in the global economy.
- **Increase digital inclusion:** South Africa must reverse this trend and make digital technologies, broadband, smartphones, mobile phones available to the whole population and make it available quickly, cheaply and easy to use. The 2014 UK Digital Inclusion Strategy states that “helping more people to go online can also help tackle wider social issues, support economic growth and close equality gaps.”
- **Build digital platforms:** South Africa is in a unique position to become a leader in the platform revolution. South Africa’s inequality presents an opportunity to create and harness disruptive platforms that provide needed products and services to large underserved populations. This is possible by applying resources from well-developed portions of the ecosystem efficiently through digital platforms that disrupt traditional product and service providers.

#### **Conclusion**

South Africa is an entrepreneurial leader in sub-Saharan Africa. The country has made significant progress to overcome structural factors and produce some of the most innovative and successful enterprises on the continent. The country provides the institutional support necessary for high-growth businesses to emerge and thrive, while government policies work to close historical gaps. With the addition of targeted, coordinated policies to address remaining bottlenecks, the country is poised to achieve greater growth through entrepreneurship.

Data shows that for growth-oriented entrepreneurs there is a vibrant portion of the ecosystem that is engaged with the global economy. As with all entrepreneurship ecosystems, some bottlenecks do remain – in South Africa’s case these are large-firm dominance, cultural perceptions of entrepreneurship, and structural inequality. However, South Africa benefits from some of the best

infrastructure in Africa, resources generated from growth-orientated enterprises, and strong policy momentum for addressing remaining issues.

Evidence suggests that several targeted actions could address key bottlenecks and further improve the entrepreneurship ecosystem in South Africa. In SME lending, higher touch-loan management and using credit scores could improve the risk environment. Wage subsidies could go some distance to address structural inequality, and prove particularly beneficial if targeted at SMEs. Improving market access could help ease large-firm dominance, and public and private sector programs will continue to add to South Africa's growing culture of entrepreneurship.

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