

RESEARCH ARTICLE:

Examining the Function and Contribution of Entrepreneurship through Small and Medium Enterprises as Drivers of Local Economic Growth in South Africa

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Abstract

The function and contribution of small and medium-sized firms in ensuring local economic growth are explored in this study. Previous studies show that small and medium-sized businesses (SMEs) have many different definitions and metrics. It was indicated that employment is the most popular metric for measuring company size in many different nations in terms of job creation through Small and medium-sized businesses and entrepreneurship. Although many nations, notably those in the European Union, adopt a lower cut-off point of 250 people, SMEs are typically classified as businesses with less than 500 employees. The goal of the research was to develop a better knowledge of the elements influencing the success of SMEs in South Africa. The study interrogates the question of what role entrepreneurship plays in inspiring the local economic growth of a country. Findings show that entrepreneurs and SMEs are key drivers of local development. The research calls for government investment in SMEs to help them overcome the problems they confront. The study indicated that the contribution and function of SMEs in local government is to stabilize the economy, especially in local communities with the perspective of empowering individuals. The study recommends that the government invest in SMEs to help them deal with socioeconomic issues including unemployment and poverty based on the obstacles encountered by SMEs.

Keywords: local economic development; local government; small and medium-sized businesses

Introduction

The study looked at the function and contribution of entrepreneurship with the establishment of small and medium enterprises (SMEs), which is critical to promoting and driving social and economic growth in South Africa. Scholars noted that SMEs have many different definitions and metrics, as SMEs have a significant impact on how nations develop economically (Enaifoghe and Vezi-Magigaba, 2023). Even while SMEs are important, an unacceptably and depressingly large proportion of these businesses fail during the first few years of existence (Van Scheers, 2011). The performance of SMEs is of interest to all countries due to the significance and difficulties faced by SMEs. The study also looked into how economic issues affect the success of SMEs. The role of SMEs in driving innovation dynamics has grown over the past few decades as income growth, and more specialized market demand (Enaifoghe and Vezi-Magigaba, 2023). This includes the evolving technologies that have allowed SMEs to strengthen their comparative advantages and lessen structural disadvantages brought on by resource limitations and a limited capacity to realize economies of scale. While not all SMEs are innovative, new and small businesses are frequently the catalyst for the kinds of radical innovations that are crucial for economic growth because they can operate outside of dominant paradigms and take advantage of technological or commercial opportunities that have been overlooked by more established businesses, perhaps, facilitate the commercialization of knowledge that would otherwise remain uncommercialized in universities and research organizations (OECD, 2010).

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For instance, SMEs represent 20% of patents in Europe's biotechnology-related disciplines, which is one indicator of innovation. SMEs also contribute to value creation by embracing innovations created elsewhere, incrementally adapting them to new contexts, and offering new or specialized goods that address a range of client needs. They also help by providing services in areas that lack the size to draw bigger businesses. New and small businesses have been able to boost their contributions to innovation thanks to the knowledge-based economy, a rise in non-technological innovation, and the emergence of open or network-based forms of invention (OECD, 2010a). Knowledge reverberations, network access, and opportunities for collaboration with other companies, especially larger businesses, all significantly impact how innovatively SMEs operate. To receive innovation inputs (ideas, finance, skills, and technologies). From abroad and to capitalize on its outputs (products and services, patents, licenses, etc.) in foreign markets, cross-border collaboration in innovation has become more crucial as a result of globalization. However, finding and connecting to the right local, national, and international knowledge partners and networks. As well as developing the right management practices and skills for coordinating and integrating knowledge produced by external partners with internal practices and innovation processes, represent major challenges for many SMEs.

This is a literature review that primarily utilised secondary sources to access available data in both private and public spaces through a thematic qualitative analysis approach. The qualitative study accessed the baseline literature through an advanced search (Russell and Gregory, 2003: 37). The phases of data collection and analysis are not as distinct and sequential as they are in quantitative research because the research is qualitative and because qualitative research is flexible, open, and responsive to the situation (Hak, 2007: 14). The data collection process rather than being connected linearly, the sampling, data collecting, analysis, and interpretation were bound to each other in a cyclical (iterative) manner (Fossey *et al.*, 2002: 717). The study used a qualitative research methodology and gathered data mostly through an expanded evaluation of the literature found in various databases.

The Role of Small and Medium-Sized Businesses (SMEs)

Small and medium-sized businesses (SMEs) play a significant role in most economies around the world, particularly those in developing and rising countries (Obi *et al.*, 2018; Ndiaye *et al.*, 2018). They account for 99% of all enterprises in the European Union (EU), have created 85% of the region's new jobs over the past five years, and account for two-thirds of all private sector activity overall (European Commission, 2019). For instance, there were around 23 million SMEs in 2015, which supported 90 million employees and produced an additional 3.9 billion EUR in added value (European Parliament, 2019). Compared to large firms, SMEs exhibit superior flexibility to technological transitions, stronger income distribution promotion, and better adaptability to market fluctuations and new consumer requirements, while their organizational structure enables more rapid decision-making (Perez-Gomez *et al.*, 2018). However, for SMEs to invest in growth possibilities and reach their full potential, they require a consistent source of long-term finance (Dowling *et al.*, 2019). The European Commission, therefore, developed a series of measures in tandem with a contemporary and cogent strategy for SMEs to foster Europe's entrepreneurial spirit and foster the circumstances for the practical development of creative ideas. This plan's primary goal is to aid in the expansion and development of SMEs close to the labour market (Commission of the European Communities, 2008). Since they play a key role in reducing poverty, creating jobs, promoting international trade, and innovating new technologies (Yoshino and Taghizadeh-Hesary, 2019, Luo *et al.*, 2016), SMEs are regarded as the foundation of an economy (Yoshino and Taghizadeh-Hesary, 2019). They also significantly contribute to the expansion of developing economies.

In light of this, the 2008 "Small Business Act" plan approved for Europe takes into account the implementation of the maxim "First, think at a small scale" (European Commission, 2012) addressing the adoption of rules, regulations, and policy measures that should offer support to SMEs' needs. Since 2010, the European Parliament has passed several resolutions, including those on the following topics: community policy to encourage innovation through European SMEs (European Parliament, 2010), industrial policy for globalization conditions (European Parliament, 2011), the competitiveness issue and the issue of business opportunities in the European Union (European Parliament, 2012), the re-industrialization of the economy to provide competitiveness and sustainability (European Parliament, 2014), and supporting information and communications technology (ICT) development regarding the European Union (European Parliament, 2017). The research program Horizon 2020 offers easy access for SMEs to finance options (European Parliament, 2016) and the acceleration of RandD and innovation processes, because SME development, enhances

growth, and supports the economy. Both local, regional, and national activities within communities have thus been promoted and stimulated by European and national policies, as well as through start-up funding programs or company incubators. Markets are becoming progressively more competitive, thus SMEs must assert themselves through the development of new products to compete with major corporations. As a result, innovation is essential to achieving competitive strength, and it is focused on new items, creative marketing and management strategies, as well as genuine technologies.

Entrepreneurship and SMEs in Competitive Global Markets

Governments have highlighted the role of small, medium, and microenterprise sectors (SMME) as one of the potential ways to improve prospects for wealth distribution and employment creation to foster an enabling environment (Ayandibu and Houghton, 2017; Department of Trade and Industry, 1995). The study responds to the question of whether the emphasis should be on creating skilled entrepreneurs, particularly among those who are categorized as previously disadvantaged people, if the government's aim to leverage the SMME sector is to have any substantial success. This study emphasizes the notion that businesses are part of a larger globalization and internationalization process, that is locally within a national or regional area, each with its unique economic or cultural qualities, and competitive advantage to develop and support economic growth. A competitive region, according to the European Commission, can "ensure both the number and the quality of jobs" (European Commission, 1999). The gross domestic product (GDP)/habitant is regarded as a suitable representation for this description. With accurate economic interpretations, it can be broken down into numerous parts (Gardiner, 2003). The term "regional competitiveness" refers neither to the macroeconomy nor the microeconomy because regions are neither only a collection of businesses from a particular area nor a nation on a smaller scale (Motta and Sharma, 2019). Consequently, it may be said that the regional level is significantly more difficult and complex to analyze.

Myslimi and Kacani (2016), indicated that regions are directly competing with one another to capture markets and draw in investments. Therefore, one place may have unbeatable competitive advantages if these include technological and social elements relating to infrastructure or superior institutional factors in comparison to other regions. These variables are independent of businesses yet help them grow and succeed. However, another unique characteristic of most developing countries is the presence of a bank-based formal financial structure with weak equity and debt markets (Chinembiri, 2011), as well as a dearth of expertise in innovation management and cutting-edge technology (Wellalage and Fernandez, 2019; Apanasovich *et al.*, 2016). Because of their limited access to financing, SMEs are significantly constrained in their ability to grow (Ullah, 2019). Secondly, the research contributes to the field by offering empirical data on the influence of innovation-related investments and expenditures on territorial growth in Romania, a topic that, to our knowledge, has not yet been investigated. To Guzmán and Santos (2001), the entrepreneurial spirit of the SMME owner is a crucial factor in determining an SUE's ability to overcome survival challenges and experience sustainable growth. The National Small Business Strategy (NSBS), a national strategy for the expansion of small businesses, was formally authorized by the South African legislature in 1995. When addressing the issues the SMME sector was having, the plan set out many crucial goals. The most prevalent issues were an unfavourable legal environment, a lack of access to commodities and purchasing, a lack of accessibility to financing and credit, a lack of skills, a lack of information access, and, finally, a lack of efficient, supporting institutions.

To meet the socioeconomic requirements of a given community, inside a specific geographic region, LED initiatives typically constitute a component of a holistic poverty alleviation strategy, notably at the local level of government. South African political economy has since "the start of the democratic era in 1994, much attention has been paid to fostering LED with the objectives of promoting empowerment, the creation of jobs, economic growth, and community development, with a focus on the function of small to medium-sized businesses (SMEs) in the local government sphere" (Enaifoghe, 2019). "The growth of SMEs inside local government is a crucial part of an LED strategy, which aims to, among other things, implement the constitutional mandate of local governments to promote economic development in general (Enaifoghe and Vezi-Magigaba, 2022). The Department of Cooperative Governance and Traditional Affairs (2009:45) states that the severe issues with rural development and a significant backlog of infrastructure are only two examples of the unique challenges encountered by South Africa's weaker and more vulnerable towns. To overcome the challenges with finance and service, exceptional steps are required. Because of inadequate infrastructural

development and a lack of the essential abilities to control and influence local economic growth, the Department claims that LED is crucial but has not been regularly applied. The rationale for this is that SME development in South African local government is an example of a component of an LED strategy to solve difficulties related to reducing poverty and unemployment.

Global Contributions of SMEs to National Development

Small firms are projected to account for one-third of industrial employment and a smaller percentage of production in First World countries like the United States of America and the United Kingdom. Third World countries, whose SMEs predominate among economically active enterprises, place significantly higher importance on SMEs' prosperity than do First World countries (Rwigema and Karungu, 1999). African SME activities are essential for promoting economic progress, generating jobs, and alleviating poverty (Rogerson, 2001a). Mead and Liedholm's (1998) research of SMEs in Africa, however, discovered that, on average, there are more SME closures than expansions, with just 1% of micro-enterprises moving from five or fewer people to ten or more. The argument that SMEs are crucial for job creation and economic progress has persisted for a long time, especially in countries with high unemployment rates like South Africa, where it is projected that the rate can reach 40% (Smit and Watkins 2012). The SME sector is critical to the South African economy's efforts to address sustainable development, according to the 2003 Human Development Report for South Africa (UNDP, 2003). (Rogerson, 2004). In South Africa, small, medium, or micro companies are estimated to make up about 90% of all official businesses (Rwigema and Karungu, 1999). The SME sector makes a significant contribution to the South African economy.

In addition to creating new jobs, the SMEs are seen as a source of economic growth. In Asian nations, where the SME employment contribution is estimated to be 80%, the SME sector accounts for 75% of new jobs, mostly as a result of the growth of new small business formations (Friedrich, 2004; Watson and Godfrey, 1999). The SME sector has been highlighted by the South African government as a strategy to achieve increased economic growth. Nonetheless, this goal was not met in large part due to the SME industry's high level of failure of 80% of businesses (Watson, 2004). Given the current supply-side policies and their success to date, smaller towns and rural areas receive even less support from government entities in creating an enabling environment conducive to beginning and/or developing SMMEs than metropolitan areas do (Peters, 2009). Apartheid resulted in the deliberate exclusion of formerly oppressed towns from urban centres, metropolitan areas, and—more significantly—development centres. This highlights the necessity of spatial planning. Municipalities are one example of a local government structure that offers several services under the aegis of local economic development (LED). Unfortunately, the majority of these towns cannot provide efficient or effective support to current and potential entrepreneurs, even though they are the most aware of the issues encountered by business owners in their particular districts. LED has grown significantly in popularity among developers. To facilitate market expansion and promote market-driven economic expansion and growth, the government's neo-liberal macroeconomic program is intended to "crowd in private investment and increase short-term economic performance" through infrastructure spending by local governments (RSA, 1996).

Development of Small and Medium Enterprises on Economic Development in South Africa

The South African government began actively promoting small enterprises in 1995 to encourage economic growth through competitiveness, the creation of jobs, and income distribution. Thus, it was made easier for SMEs to arise in South Africa, which led to the discovery of the useful function they play in economic development (Mmbengeni *et al.*, 2021; Barry and Sebone, 2009). Mahembe and Chiumya (2011), in an article on the National Credit Regulator (NCR), which addresses the availability of credit facilities to SMEs, provide additional evidence for this viewpoint. According to the author, a strong SME sector boosts the economy by expanding job possibilities, raising production levels, boosting exports, and fostering innovation and entrepreneurial abilities. According to Abor and Quartey's (2010) estimation, 91% of South Africa's official business entities were SMEs, which produced between 52% and 57% of the GDP and 61% of the jobs. The SA government has designated SMEs as significant economic builders as a result of this data suggesting the significance of SMEs in economic development and employment generation (Mahembe and Chiumya, 2011). Although these businesses play a significant role in stimulating economic growth, as was previously argued, the Global Entrepreneurship Monitor (GEM) report (2001–2010) noted that in addition to having less funding, SMEs in South Africa

also experience poor management skills as a result of inadequate training and education. Due to this, there are substantial failure rates, with South Africa having one of the lowest SME survival rates worldwide (GEM, 2010), a conclusion that is backed by Ahiawodzi and Adade (2012).

A financial crisis harms SMEs by slowing down their rate of development and increasing the number of bankruptcies, according to Hodorogel (2009). In addition, the author contends that start-ups are particularly vulnerable since they lack the means to weather a recession. This further raises the failure rate, which is stated to occur within the first five years of installation and is estimated at 80%, particularly in poor nations, according to Zimmerer *et al.* (2008). However, this phase may prove advantageous for a select few SMEs, those that recognize market shifts and respond quickly (Zimmerer *et al.*, 2008). Some SMEs, as opposed to large corporations, benefit from greater flexibility during times of crisis, being easier to implement new services and introduce new goods. They can respond quickly and come up with solutions tailored to market conditions if allowed to make their own decisions. The ability of SMEs to adapt is crucial for them to endure both internal and external events that have an impact on their success.

The Contributions of Small and Medium Enterprises in South African Socio-Economic Development

To understand the contributions of SMEs to South Africa's economy and society made, according to a study conducted by Musitha and Maloma (2017), SMEs can generate employment possibilities. They are crucial to the economies of nations with lower productivity gains than other countries, such as the United States of America and the United Kingdom, which employ an estimated one-third of the industrial sector. When SMEs manage economies in third-world nations, they are fortunate to be given greater weight than in first-world nations where SMEs predominate (Rwigema and Karungu, 1999). The actions of SMEs are crucial for boosting economic growth, generating employment, and reducing poverty in the nation (Rogerson, 2001). The average number of SMEs closing their doors in Africa is higher than the average number of SMEs opening, according to academics like Mead and Liedholm (1998). Since the economy of South Africa transitioned to democracy, the fundamental objective has been to strengthen competitiveness by fostering job creation and national economic expansion (Rogerson, 2006). The National Small Business Act of 1996 was changed by Act 29 of 2004 to implement the various positions of SMEs in the economy to accommodate an SME environment (Ntsika, 2001). According to the Human Development Report from 2003, SMEs help with sustainable development (job generation) for the growth of the South African economy (Rogerson, 2004). According to estimates, SMEs account for 90% of all formal businesses, making them the largest contributor to the economy and luring workers who were laid off by both the private and public sectors (Smit *et al.*, 2012). More than 75% of new jobs are produced by SMEs.

According to Friedrich (2004), SMEs employ more than 80% of the workforce in Asian nations. Due to inadequate attention to organizational dynamics, the majority of SMEs in South Africa are tiny businesses that don't exhibit any signs of growth (Smit *et al.*, 2012). SMEs are seen as a tool for generating economic growth by the South African government. However, given that 80% of businesses fail, it is challenging to meet the goals (Van Niekerk, 2005). Their expansion is dependent on the expansion of macroeconomics, and a decline in growth. The downturn has prevented businesses from operating at their full potential and growing. SMEs may fail due to a lack of managerial abilities. The finest governance legislation, such as the non-mandatory usage of King III, has not been adopted in South Africa. The government of South Africa has prioritized the SME sector for financial support and employment growth (Cant, 2012). For the next ten years, the government projects that 500 000 new employment would be added year, with the SME sector likely to contribute the majority of these new positions. According to research, 40% of new business endeavours fail in the first year (Van Scheers (2011). While around 60% fail within the first year, and 90% over the first ten years. There are many causes for these failures, and numerous authors have noted the difficulties these companies encounter. According to Jun and Cai (2003), SMEs have limited access to time, human, and capital resources.

Numerous studies have identified several factors that can help SMEs succeed. According to Rogerson (2001), "human capital" or "brainpower" has a beneficial effect on the development of the organization and determines whether it will succeed or fail. According to a study on African businesses, human capital is considered a crucial aspect, and organizations that invest in staff education and training are more likely to thrive (Rogerson, 2001). According to a study based on the success determinants of SMEs in Gauteng, South Africa, they lack the technical and managerial abilities necessary to ensure the company's success (Rogerson, 2001). Lack of managerial training and expertise is the root

cause of failure, according to research on ineffective SMEs in South Africa. The problems with the expansion of SMEs, however, cannot be solved by education and skill development (Rogerson, 2001). Numerous academics have identified mounting evidence that small businesses are more likely to collapse within the first five years of operation due to managerial and financial issues. Many African SMEs face significant capital constraints when they join a new market environment when they rely more heavily on savings from family members and personal loans as a source of initial capital (Rogerson, 2001). SMEs must apply important components (skill, financing, and business training) to improve the business climate and increase their competitiveness (Rogerson, 2001). Even though there may be laws to assist SMEs, a study by Musitha and Maloma (2017) indicated that government officials are not eager to support MSMEs, especially those who operate in the local areas.

The Effects of SMES on Economic Development in South Africa

Small and medium-sized businesses (SMEs) support the growth of the economy. Many nations boast this industry as their economic backbone. According to the majority of experts in the field of entrepreneurship, this industry has the potential to foster economic growth, the creation of jobs, the eradication of poverty, and the reduction of inequality (Mafini and Omoruyi, 2013; Saleh and Ndubisi, 2006). The National Development Plan (NDP) has established three imperatives that must be addressed: inequality, poverty, and unemployment. SMEs can be a tool to overcome these triple difficulties in the nation. The South African government has requested assistance for small firms and aspiring entrepreneurs, especially in rural areas, as a result of the SMEs' capacity to handle those three concerns (Fatoki and Smit, 2011; Chimucheka and Mandipaka, 2015).

This is not to say that obstacles are not faced by the SME sector in both developed and developing nations, which results in high failure rates (Fatoki, 2020). Saleh and Ndubisi (2006) identified two main obstacles SMEs encounter in their study: a lack of technical capabilities and a scarcity of qualified human capital resources. According to Mafini and Omoruyi (2013), other problems included a lack of logistical expertise within the workforce, high prices of information technology, and quick technical improvements. According to the Small Enterprise Development Agency (2015), and the USA Small Business Administration (2016), 75% of SMEs in South Africa fail during the first five years of operation. Unethical business practices, such as the sale of subpar goods, deceiving customers, and avoiding quality assurance certification, can harm the survival of SMEs. Bribery, extortion, deceit, and theft are a few of them. According to several studies (SME Survey, 2017) such unethical practices have a negative influence on consumer trust, reputation, and performance. The struggle for survival of SMEs in South Africa, as well as the particular dangers these organizations face, have an impact on their leaders' ethical behaviour. Ethics and profitability have a contradictory relationship since SMEs must maintain their ethical reputation to thrive, but they must also resist the urge to act unethically to do so.

In addition, numerous incidents involving officials from the public and private sectors have demonstrated the high level of fraud and corruption in South Africa's commercial climate. One of the major issues with South Africa's corporate governance system has been its pervasive corruption (The Open Democracy Advice Centre, 2013). Out of 180 nations that took part in its assessment, South Africa is ranked 73rd by Transparency International (TI). The TI index employs a scale from 0 to 100, with 0 being severely corrupt and 100 being very clean. With a score of 43, South Africa falls into the category of nations with scores below 50 (Transparency International, 2018). In the discourse on the role of small and medium enterprises in the implementation of local government, Oualalou (2012:57) asserts that SMEs play a significant economic and social role due to their presence in the economy and ability to create jobs, a function that is much valued during current difficult economic times and periods of rising unemployment. Despite this, the growth of SMEs can assist in addressing several issues related to the nation's economic development, including disparities, extremely high unemployment, demographic changes, and the need for structural reform (Ayandibu and Houghton, 2017). Additionally, the growth of SMEs provides several employment opportunities that can aid in reducing unemployment and addressing the demographic issues brought on by expanding populations (Malefane, 2013).

Additionally, the rise of the SME sector may help to boost productivity and competition, which would then encourage an increase in both overall and per capita income. As innovation and technological advancement are linked to a thriving small- and medium-sized business sector, this development will also encourage structural transformation. Sibanda (2013:663) agrees with the claim that the SME sector is crucial to the South African economy because it provides livelihoods for dependents and employment prospects for communities in the second economy. Regarding this, SMEs

in South Africa generate roughly forty-five (45%) of the GDP (Sibanda, 2013). Malefane (2013) asserts, however, that the government of South Africa's support for SMEs is widely regarded as the nation's effort to reduce poverty and facilitate economic restructuring. Conversely, this recognition is the result of the political and legislative commitment of governments to ensure the viability of SME development through policy and strategy. SME development in local government is an example of how to implement an LED strategy that, among other things, aims to fulfil the constitutional mandate of local governments to support economic development. This has led to legislation in South Africa outlining the country's goals for the SME economy (Geyer, 2006:2).

Conclusion

In conclusion, the goal of the research project was to develop a better knowledge of the elements influencing the success of SMEs in South Africa. The five areas of abilities necessary for the development of SMEs are general management, marketing management, production management, financial management, and human resource management. Even though there is a good correlation between economic conditions and the performance of SMEs, SME owners, managers, and the government must enhance small company strategies. Additional research might look into the barriers to finance access that new SMEs perceive (from the demand side). Additionally, additional research might look at the effectiveness of government initiatives to improve SME finance. The research calls for government investment in SMEs to help them overcome the problems they confront. The study indicated that the contribution and function of SMEs in local government is to stabilize the economy, especially in local communities with the perspective of empowering individuals and the historically underprivileged, including women, people with disabilities, and people of colour through the direction of the Black Economic Empowerment (BEE). The local economic growth projects run by municipalities have not greatly lessened the aforementioned problems. It has been concluded that a strong collaboration between the public and private sectors is necessary to promote economic growth and community development to expand the market where jobs would be created and to reduce poverty.

The study urges the government to invest in SMEs to help them deal with socioeconomic issues including unemployment and poverty based on the obstacles encountered by SMEs. This study confirms that SMEs The Department claims that LED is crucial but has not been regularly applied because of inadequate infrastructural development and a lack of the essential abilities to control and influence local economic growth rating, and coordinating the LED programs and efforts is open and reasonably priced. Interventions for skill development should be planned with an eye on both the present and future demands of the economy. To attract, maintain, and grow local enterprises, the focus should also be on vital skills in South Africa, including but not limited to agriculture, mining, manufacturing, and tourism. The government should allocate more funds to this cause to address the funding gap that prevents the effective implementation of LED policies.

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