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Report No. 55699 - ZA

The World Bank Group

South Africa: Second Investment Climate Assessment
Improving the Business Environment for Job Creation and
Growth

Draft Summary

July 2010

Finance and Private Sector Development

Africa Region

1. INTRODUCTION

This summary of the World Bank's Second Investment Climate Assessment of South Africa reviews some of the key business environment constraints to growth and job creation in the country.¹ The assessment analyzes results of a World Bank survey of enterprises undertaken in 2008 along with similar data on a group of comparators, and draws on the broader development policy literature on South Africa. It is a sequel to a 2003 assessment that examined the same issues based on a similar survey carried out by the Department of Trade and Industry (DTI) and the World Bank.

A key message of the report is that South Africa's overall business environment is good relative to its peer group of upper- middle-income economies, and has improved a great deal since 2003 in many respects. However, despite the advantages this should give it in export markets and as a location of investment, South Africa is exporting far less industrial output and attracting less foreign direct investment (FDI) than many in the same peer group. More significantly, it is not exporting or attracting FDI as much as it needs to tackle its twin challenges of high unemployment and widespread poverty in a reasonable time frame. A second message of the report is that South Africa needs to improve the allocative efficiency of domestic industry as a key export promotion strategy. South Africa is not doing as well as most in its peer group in terms of manufactured exports because its manufacturing productivity is relatively low, not because its manufacturers are inherently less productive than their counterparts within the peer group, but because allocative efficiency is lower in South African industry. South Africa's poorer allocative efficiency is associated with the relatively high concentration of its industries. Improving allocative efficiency will therefore require the institution of a more activist and innovative competition policy than has been pursued so far. Excessive concentration also may have deterred inward FDI.

A third key message of the assessment is that the tasks of improving allocative efficiency and raising productivity extend well beyond the realms of competition policy into other business environment issues. These include infrastructure, skills shortages, crime, and small business access to finance. Problems in each of these areas can only work against the growth of exports and FDI since they add to the average cost of doing business in South Africa relative to its peer group. They also distort the allocation of resources particularly at the expense of sectors that should be in the forefront of a jobs led growth process. These include labor-intensive industry sectors, and particularly small and microenterprises within those sectors.

South Africa should promote the growth and formalization of promising informal enterprises as an important tool of job creation. A key component of such promotion should be public support to the development of markets in business development services and financial products customized to the needs and capabilities of the sector. There are already important instances of these on the ground, but far more are needed to produce visible impact in terms of job creation and the growth of the small and medium enterprise (SME) sector.

Access to finance is a significant business environment issue for the SME sector as well. Although this is by no means unique to South Africa, the access gap between SMEs and larger firms is far greater in South Africa than in most of its peer group.

The assessment also looked into how much businesses were investing in job skills formation and if they were being helped by Sector Education and Training Authorities (SETAs). Skills shortage came out strongly as a growth bottleneck in the 2003 DTI-World Bank survey, in which a large percentage of respondents reported that growth of their businesses was being held back by a shortage of skilled manpower. The report concludes that SETAs are clearly supporting much of the ongoing investment in job training and that there is greater appreciation of their role than was the case in 2003. However, it is also clear that the rate of investment needs to increase to attain parity with South Africa's peer group, and that SETAs need to target their support more to smaller firms, which continue to under-invest at a rate higher than larger businesses.

2 THE ENTERPRISE SURVEY OF SOUTH AFRICA 2008

The Enterprise Survey of 2008, on which the assessment is based, was conducted by the survey firm EEC Canada on behalf the World Bank. The survey covered a sample of 1,056 business establishments sampled from four locations: Johannesburg (68 percent), Cape Town (14 percent), Port Elizabeth (6 percent), and Durban (12 percent). About two-thirds of the sample was drawn from selected manufacturing industries, as listed in Table 1. The balance was drawn overwhelmingly from retail services, which represented about 22 percent of the total sample. All but 120 of the 1,056 businesses each employed five or more regular, full-time workers, and are distributed by employment size groups as follows: five to 19 workers (40 percent), 20 to 99 workers (39 percent), and 100 workers or more (21 percent). All of the 120 microenterprises, employing less than five workers, were selected from Johannesburg. In addition to data on firms, the survey also collected labor market information on a sample of 1,732 workers selected from about one-third of the manufacturing establishments in the enterprise survey sample. About 12 percent of enterprises in the sample were foreign invested.

Of the total sample of the Enterprise Survey, 231 businesses were revisits from the sample of the 2003 Productivity and Investment Climate Survey. This assessment therefore uses repeat observations on a range of business environment and business performance variables in a five-year interval for a sizable number of enterprises. The Investment Climate Survey of 2003 was conducted by the survey firm Citizen Surveys of South Africa on behalf of the DTI and the World Bank. It covered a sample of 803 businesses, all employing at least five regular, full-time workers and all selected again from Johannesburg (63 percent), Cape Town (23 percent), Port Elizabeth (5 percent), and Durban (9 percent), and predominantly from the manufacturing industries listed in Table 1 (75 percent), retail and wholesale trade (11 percent), and construction (14 percent). The size distribution of the sample of the Investment Climate Survey was more skewed toward larger businesses employing 100 workers or more, which accounted for 45 percent of the sample.

Table 1: South Africa Enterprise Survey 2008 – Distribution of Sample by Industry

Industry	Number	Percent
Manufacturing (697):		
Food	122	11.55
Textiles	11	1.04
Garments	108	10.23
Chemicals	83	7.86
Plastics and rubber	22	2.08
Non metallic mineral products	8	0.76
Basic metals	2	0.19
Fabricated metal products	109	10.32
Machinery and equipment	34	3.22
Electronics (31 & 32)	22	2.08
Other manufacturing	176	16.67
Construction	16	1.52
Services (339):		
Wholesale	14	1.33
Retail	229	21.69
Hotels and restaurants	65	6.16
Transport (60-64)	2	0.19
Information Technology	4	0.38
Other Services	25	2.37
Other	4	0.38
Total	1,056	100

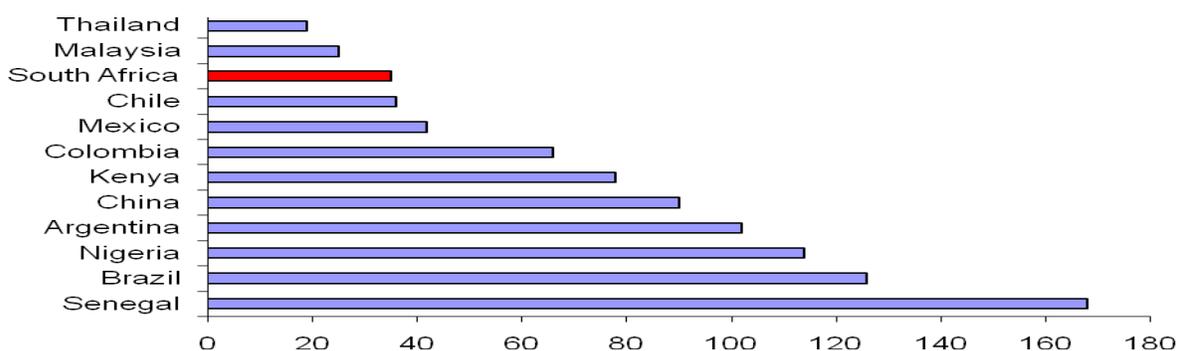
The survey instrument for both the 2003 and 2008 surveys was a questionnaire that was administered to enterprise managers through face-to face interviews. The instruments varied considerably, based on the type of business surveyed. Each variant of the instrument generated information on four broad areas : managers' ratings, on a common scale, of different aspects of their business environment; objective indicators of the various dimensions of the business environment; financial, production, employment, assets, sales, and technological information needed for the measurement of business productivity and growth; and key business characteristics such as business age, form of business organization, and other entrepreneurial characteristics.

3. DOING BUSINESS IS RELATIVELY EASY IN SOUTH AFRICA AND IS GETTING EASIER

On the overall Ease of Doing Business indicator, South Africa outscores many successful emerging market economies, including Argentina, Brazil, Chile, and China, and is not too far behind comparators such as Malaysia and Thailand (Figure 1). These countries are South Africa’s natural peers in many ways. All are middle-income economies and many are resource-rich. All are also relatively high-performing, and have recently undergone significant export-driven industrialization.

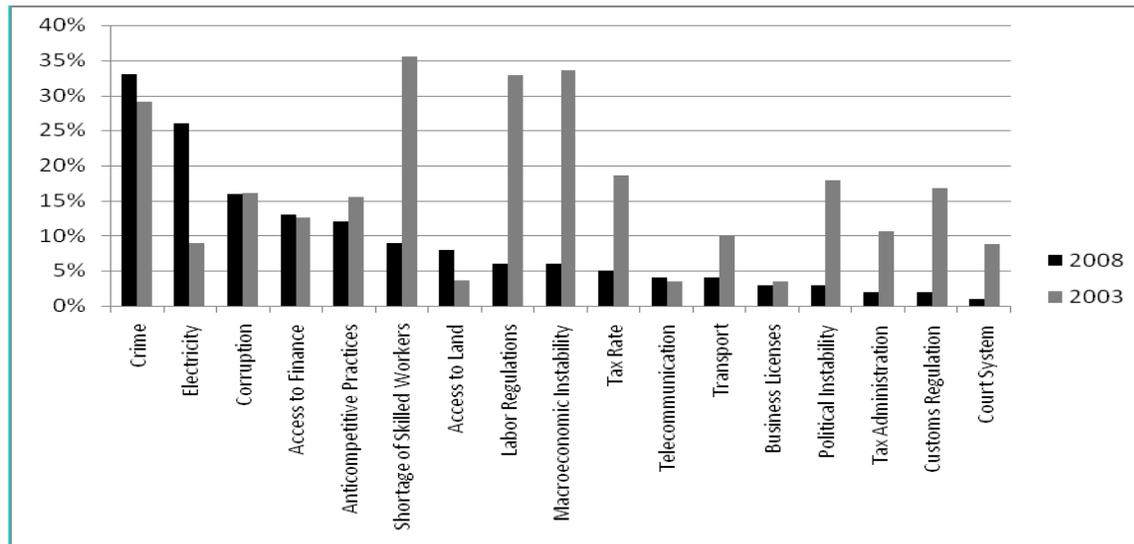
It is easier to set up or close a business in South Africa than in most peer group countries. Getting credit is also easier for South African firms than for those in most other countries in the group. All this reflects on the relatively high quality of South Africa’s contract enforcement institutions, and the high degree of security of property rights in the country.

Figure 1: Ease of Doing Business rank – 2008



Not surprisingly, one of the main findings of the 2008 Enterprise Survey was that the South African business community had a highly favorable view of the country’s business environment at the time. Disregarding crime and power shortages, fewer than 10 percent of the managers who responded to the survey rated any of the issues presented to them as serious obstacles to growth. In contrast, in 2003, there were several aspects of the business environment that one-third or more of respondents saw as “major” or “severe” impediments to operations (Figure 2). This improvement in how the business community sees the business environment holds up even when the analysis controls for changes in sample composition between surveys.

Figure 2: Firms ranking constraints as major or severe (%)—2003 vs. 2008



The 2003 survey identified four major constraints faced by managers: macroeconomic instability, labor regulation, shortage of skilled workers, and crime, in that order of importance (Figure 2). With the exception of crime, none of these was rated as a major obstacle by a significant percentage of the 2008 survey respondents. Other areas of significant change in perceptions include tax rates and tax administration, customs and trade regulation, business licensing and permits, and access to land. The rankings of problems in these areas fell—less than 10 percent of firms considered any of these to be a major obstacle to growth. In contrast, in 2003 almost 20 percent of firms rated high taxes as a major problem, and more than 15 percent rated customs and trade regulations likewise.

4. FOSTERING COMPETITION FOR ALLOCATIVE EFFICIENCY AND HIGHER PRODUCTIVITY

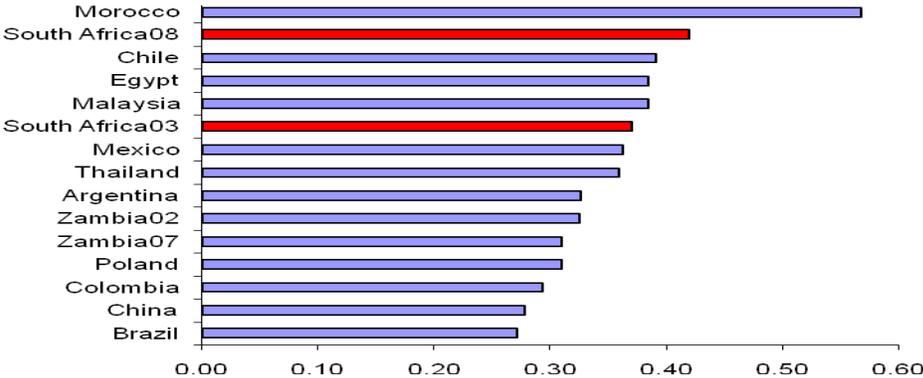
Despite the advantages of its relatively good business environment, South Africa faces high unemployment and widespread poverty. The proximate causes of these problems are that growth has been slow and has not absorbed as much labor as it could have. To grow faster and to increase annual jobs growth, South Africa needs to increase exports and attract more FDI. This is because domestic savings currently fall well short of what is needed for faster growth. In addition, FDI also helps boost productivity, as knowledge and technology transfers often accompany foreign investment projects.² Because manufacturing industries and the tradable sector more generally are the more labor-intensive parts of the economy, the expansion of manufacturing exports is also a useful strategy for employment generation.

The growth of manufactured exports is constrained by South Africa’s relatively high unit labor costs (benefits and wages paid to employees divided by net sales). In the Enterprise Survey data, South Africa's unit labor costs are high within the peer group, exceeding those for Brazil, Chile, and Argentina (Figure 3). Wages, however, are lower than in Argentina and Chile, meaning that South Africa’s unit labor costs are higher primarily because manufacturing labor productivity is significantly lower than in those two countries. Increasing manufactured exports to levels comparable to those two countries will require significant growth in labor productivity.³

As South African manufacturing industries are relatively capital intensive, it is important that increasing labor productivity is not driven entirely by increasing the capital intensity of production.

⁴ Otherwise the resulting export growth would not necessarily help ease the unemployment problem. In other words, to increase both manufacturing exports and employment, growth in total factor productivity (TFP) is needed.

Figure 3: Unit labor costs



South Africa’s economic growth has already benefitted from significant TFP growth over the past fifteen years, largely thanks to the trade liberalization measures of the 1990s. Combined with subsequent competition policy reforms, the opening up of the economy to foreign trade during that decade exposed domestic producers to far greater competition than would have been the case otherwise. In turn, the increase in domestic product market competition generated sustained productivity growth by improving the allocative efficiency of domestic industry, and by providing domestic producers greater incentives for innovation.

The Enterprise Survey data suggest that there is room for further productivity gains of this type through more competition, and the gains could be substantial since they show that the allocative efficiency of South African industry is rather low by the standards of the peer group. Allocative efficiency is understood here to mean the correlation between firms’ productivity and their market shares within the industry. The higher the correlation between market share and productivity at the firm level, the larger the aggregate productivity of the industry as a whole, because aggregate productivity is by definition a market-share- or scale-weighted average of firm-level productivity. Although average labor productivity in the South African survey sample is among the highest in its peer group, aggregate TFP for

South African industries is among the lowest (Figure 4). This is not because firms in the South African sample are inherently less productive. On the contrary, the (unweighted) average of within-firm TFP in the South African sample is one of the highest among the peer group (Figure 5). In other words, a larger proportion of firms in the South African sample are operating at the world technology frontier of their respective industries than is the case in many samples in the peer group. Aggregate industry TFP is therefore lower in the South African sample than in most other samples primarily because less productive firms tend to have higher market shares in South Africa than they would have in other countries (Figure 6).⁵

The role of competition policy in improving allocative efficiency is being stressed here for two reasons. On the one hand competition policy reforms undertaken since 1994 have helped reduce concentration and have thereby produced significant productivity gains.⁶ At the same time, South African industry remains to be highly concentrated by international standards, which can only be a significant factor in the weak correlation that exists between productivity and market shares in South Africa at the moment.⁷ The key link between market shares and productivity are entry barriers. The higher the entry barriers, the more protected are incumbent market shares, and the weaker is the correlation between market shares and firm level productivity.

This association is part of the reason why the promotion of productivity growth has been one of the concerns behind South Africa's competition policy reforms. The basic document of the current competition policy is the Competition Act of 1998, which is a radical departure from the earlier -1979-law. The reforms that the 1998 enactment introduced are believed to have succeeded in establishing an effective, transparent, and pro-competition mergers and acquisition review process.⁸ The process is driven by an enforcement mechanism consisting of three complementary institutions, namely, the Competition Commission, the Competition Tribunal and the Competition Appeal Court. A recent amendment has expanded the jurisdiction of these institutions to complaints against anti-competitive behavior more generally. But there is growing realization that further measures are needed to institute a more activist competition policy of the kind advocated in the recommendations of the international panel of experts on ASGISA. This could help generate significant allocative efficiency gains by lowering entry barriers even more than the current "complaints driven" competition policy regime.⁹

Figure 4: Aggregate TFP, Enterprise Survey samples

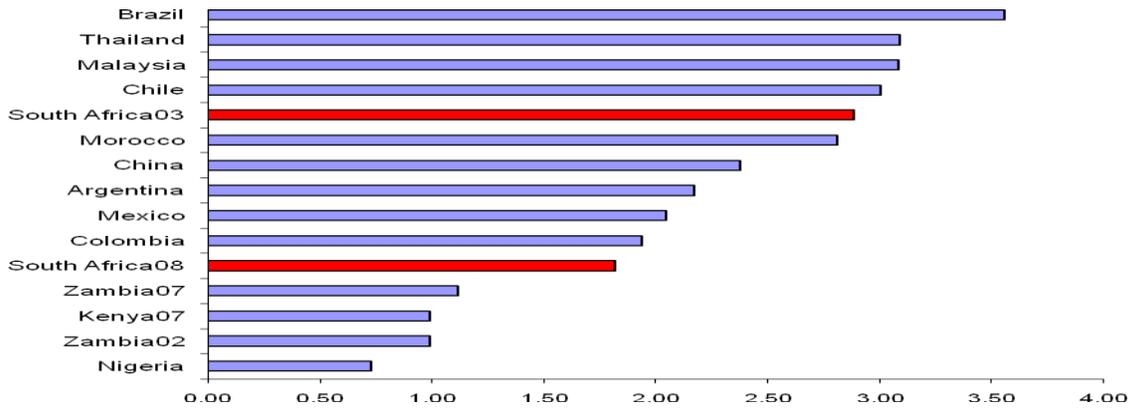


Figure 5: Average within-firm TFP

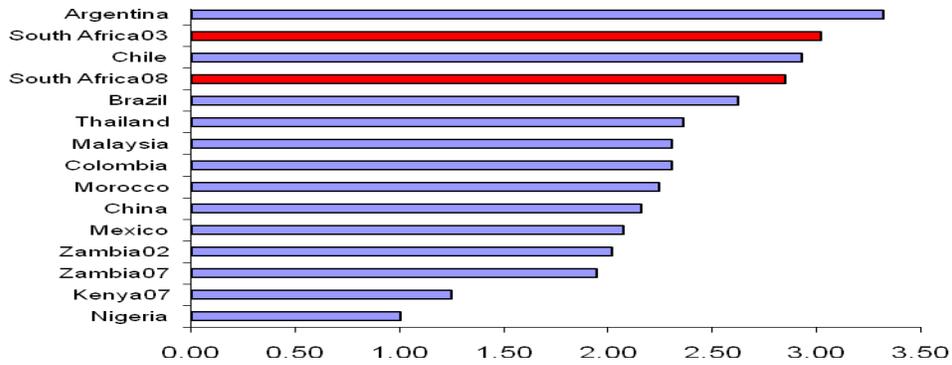
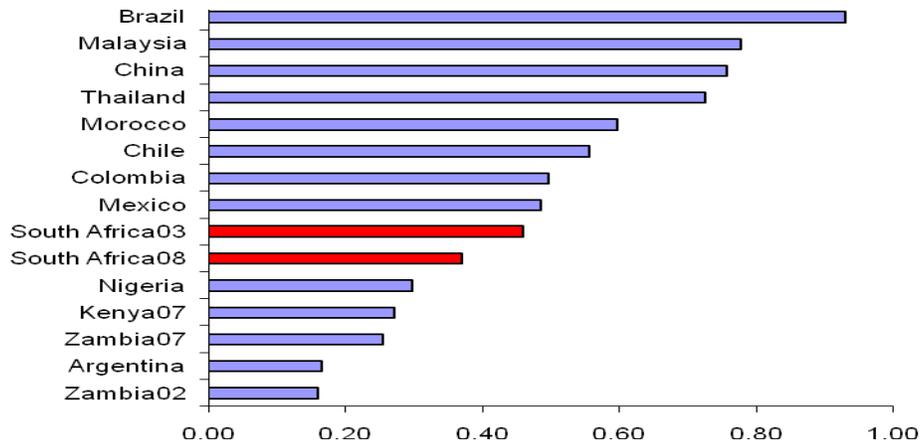


Figure 6: Allocative efficiency index – all industry



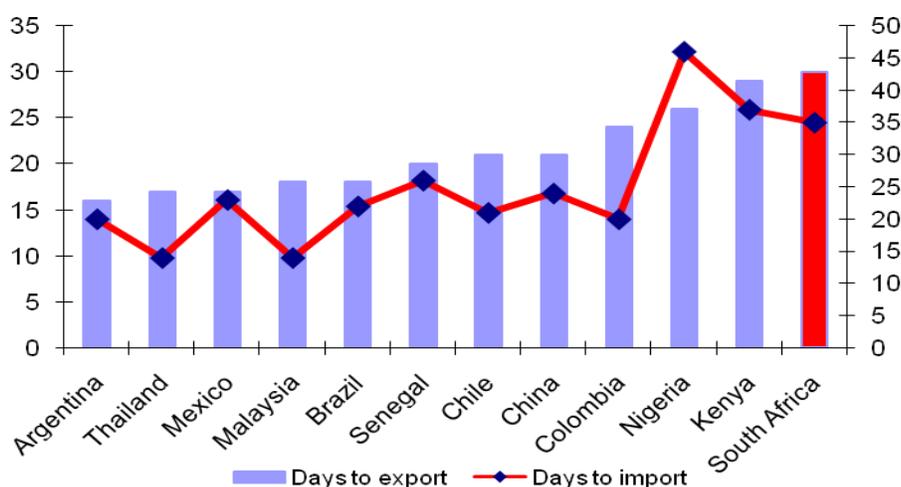
5. ELIMINATING HIDDEN MARKET DISTORTIONS

5.1 BUSINESS ENVIRONMENT ISSUES

Competition policy is only one of many influences on product market competition in South Africa at the moment, albeit an extremely important one. There are other business environment problems as well that limit competition and reduce aggregate productivity through the effect that they have on allocative efficiency and the incentives for innovation by domestic firms. These include inadequate physical infrastructure, regulatory sources of trade costs, limited access to finance by small businesses, crime and skills shortages.

One reason why the exporting potential of South African manufacturing industries is not being realized is that the country's firms face higher trade costs, both as potential exporters and as potential importers. Indeed, South Africa does not do well within its peer group on the Doing Business indicators in the category Ease of Trading Across Borders. For example, it takes twice as long to import or export a standard shipment to and from South Africa as it does in some of the better performing peer group economies (Figure 7). Transport bottlenecks are a large part of South Africa's relatively high trade costs. Skills shortage is the other impediment to export growth.

Figure 7: Doing Business – Number of days needed to ship standard cargo (2008)



The 2008 Enterprise Survey highlighted two business environment issues—crime and the power crisis of 2008 (see Figure 2 earlier). These generally were the constraints most cited in that survey, and were of far greater concern to managers than labor regulation, skills shortages, and macroeconomic

instability, none of which was named a serious business obstacle. Some 16 percent of manufacturers and 19 percent of retailers also cited petty corruption as a significant issue.

One-third of managers who responded to the 2008 Enterprise Survey rated crime as a major or severe obstacle to business growth (Figure 2). A similar proportion rated power shortages similarly (Figure 2). These rates represent a dramatic change in respondents’ priorities since the 2003 survey: in 2003, around one-third of respondents rated crime as a major obstacle to business expansion—but more cited labor regulation and skills shortages.

Compared to those in other upper-middle income countries, firms in South Africa are far more likely to rate crime as a major obstacle to growth (Figure 8). Average costs of crime as a percentage of sales are also higher for South African firms than for all other comparators except Argentina (Figure 9). These costs are of two types. First are costs directly incurred to secure business premises and merchandise in transit and to insure property against theft and robbery. Securing premises may include investment costs and running costs of special fences, alarm systems, cameras and other security devices, and of hiring and equipping guards and engaging security firms. The second type of cost is that incurred when a business becomes the victim of theft or robbery. The sum of the two cost types averaged 3.2 percent of sales in the 2008 Enterprise Survey sample.

The rating of power shortages as a business obstacle reflected the fact that the survey took place right in the middle of the 2008 electricity crisis. There is therefore little doubt that not many would rate the issue as they did in 2008 if the survey were to take place right now. Even at the height of the crisis, the issue does not seem to have significantly affected the international standing of South Africa’s business environment. Although a higher percentage of its firms cite electricity as a major problem than in Brazil, Thailand, Malaysia, and Poland, estimated outage-related output losses are relatively low by those countries’ standards.

Figure 8: Crime as a constraint to business expansion

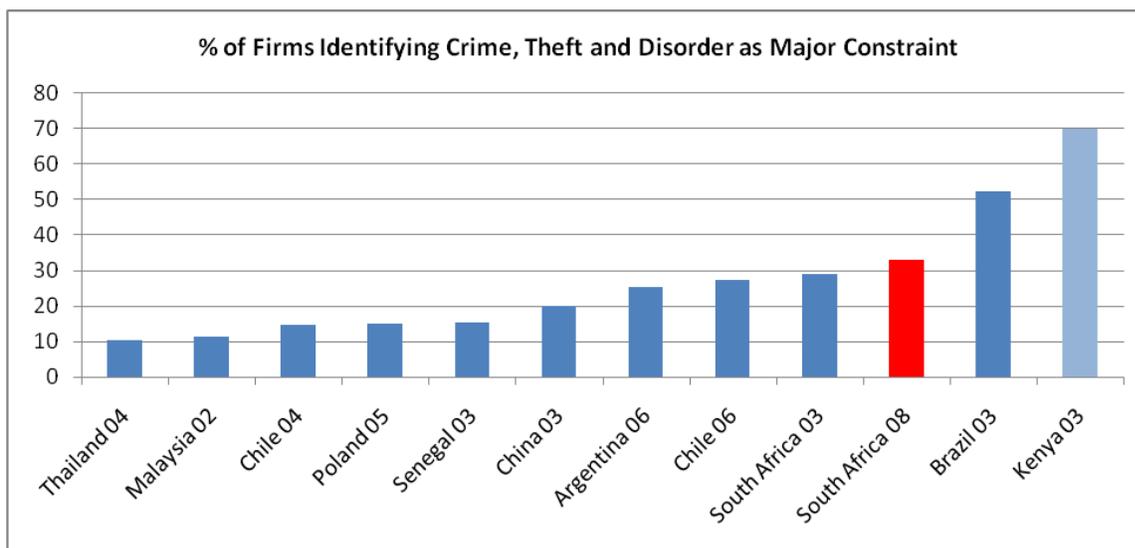
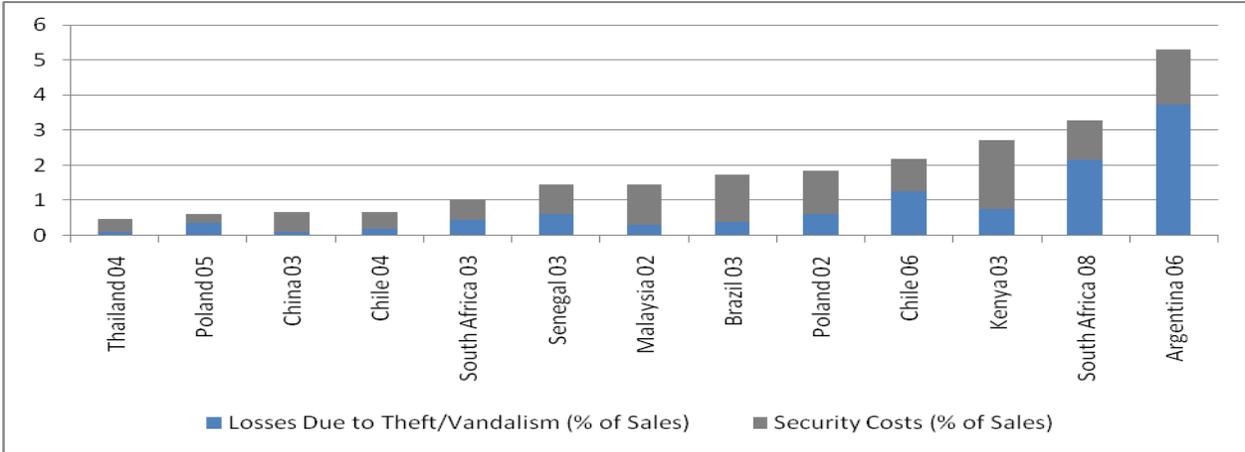


Figure 9: Losses due to crime and security costs - cross-country comparisons



5.2 BUSINESS ENVIRONMENT PROBLEMS AS DISCRIMINATORY TAXES

Business environment problems such as crime and power shortages adversely impact employment and productivity in part because they create market distortions in much the same way as a system of discriminatory taxes would: they prevent society from making the best use of its manpower and capital. Society ensures the best use of these resources only if firms can move the resources from low-return to high-return activities or locations whenever they are identified. This movement of resources to more profitable business lines or locations cannot happen if those lines or locations are taxed at a higher rate than others, or are more vulnerable to crime or suffer from more from power shortages. When firms cannot respond to opportunities for profitable investment because of such impediments to resource mobility, aggregate productivity and employment will be less than their potential. Thus there is significant evidence in the Enterprise Survey data that crime has hampered job creation in South Africa partly by reducing the overall rate of fixed investment, and partly by discouraging investment in labor-intensive sectors in particular. In the process, crime has reduced overall aggregate productivity.

Table 2: Selected business environment indicators by business groups-2008 Enterprise Survey

	Loss to outages (% sales)	Cost of crime (% sales)	Bribes (% sales)
Industry groups:			
Food	2.8	3.1	0.6
Textile and garments	2.4	5.0	0.7
Machinery and metals	1.6	3.3	0.7
Chemicals and plastics	2.7	1.3	0.7
Other manufacturing	1.9	2.8	0.2
Retail and wholesale trade	1.8	3.9	0.8
Other services	1.8	2.7	0.5
Other industries	1.5	1.6	0.0
All industries	2.0	3.2	0.6
Size and age groups:			
Aged Less than 15 years			
<100 workers	2.0	4.2	0.5
100 workers or more	2.2	0.7	0.1
Aged 15 years or more			
<100 workers	2.3	3.3	1.1
100 workers or more	1.6	1.6	0.3
Business type:			
unregistered micro	7.6	6.4	3.3
registered micro	3.5	6.0	8.3
SME	2.0	3.2	0.6
Regions:			
Eastern Cape	3.9	1.0	0.0
Gauteng	2.1	3.6	1.7
KwaZulu-Natal	2.8	3.4	0.4
Western Cape	2.0	3.8	0.0

6. MICROENTERPRISES AND JOB CREATION

6.1 LABOR ABSORPTION IN THE MICRO- AND SMALL ENTERPRISE SECTOR

This assessment highlights some of the business environment problems that are impeding the growth of wage employment in micro- and small enterprises.¹⁰ The rate of expansion of the SME sector, arguably the more labor-absorbing component of the economy, will depend on how well business environment problems that weaken this linkage are addressed. South Africa should, accordingly, promote the growth and formalization of promising informal enterprises as an important element of its job creation strategy. A key component of this effort should be to support the development of markets in appropriate business development services and financial products. Although there are important examples of these on the ground, far more are needed if there is to be visible impact on jobs creation and the growth of the SME sector.

For the purpose of this assessment, the informal sector comprises microenterprises that are not registered for tax purposes and employ fewer than five workers.¹¹ For the 2008 Enterprise Survey, 11 percent of the sample (120 businesses) were microenterprises. Of these, 67 were formal and 53 informal. South Africa's strong rule of law, superior enforcement of rules and regulations, and wider range and quality of services available to the formal sector, have all made the cost of informality quite high by African standards. As a result, a smaller proportion of South Africa's entrepreneurs operate informally than in other countries in the region.

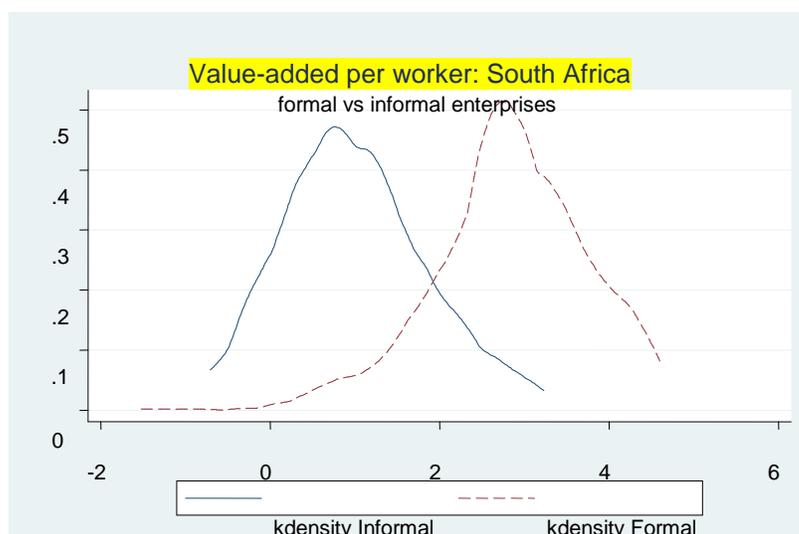
The country's informal entrepreneurs are also less skilled, on average, than their counterparts elsewhere in Africa, and for the same reasons. Nonetheless, the proportion of South Africa's entrepreneurs operating in the informal sector is still large in absolute terms. Identifying the more promising among them and facilitating the growth and formalization of their businesses should be an essential component of employment promotion strategies.

6.2 ENTERPRISE DEVELOPMENT VS. SKILLS DEVELOPMENT

“Promising informal enterprises” are microenterprises that are unregistered for tax purposes and run by owners as a matter of choice, not because they have no other means of earning a living. Available evidence, including from the Enterprise Survey, suggests that probably not more than one in five microenterprises belong in this group; for example, only 17 percent of the sample of a recent survey of informal sector operators would fit the category. This is not far off the proportion of informal microenterprises in the 2008 Enterprise Survey sample that were at least as productive as formal microenterprises and small enterprises (Figure 10).

The policy challenge that this group poses is different from that posed by the vast majority of informal microenterprises, which are survival mechanisms for people with no other means for earning a living. The main challenge is to facilitate the transition to the formal labor market of those self-employed who are young, which could be accomplished through training and wage subsidy schemes. By contrast, the policy challenge posed by promising informal enterprises is to lower barriers to their growth and formalization by supporting the growth of markets in business development services tailored to the needs and capabilities of microenterprises.

Figure 10: Kernel density estimates of log value added per worker, formal vs. informal microenterprises - South Africa Enterprise Survey 2008



6.3 BARRIERS TO MICROENTERPRISE DEVELOPMENT

Topping the list of barriers to formalization and growth of informal enterprises is the difficulty of access to finance, which almost one in every four informal operators rate as a severe obstacle to growth. This is low by African standards, but very high compared to the complaint rate among South Africa's formal microenterprises. In addition to access to finance, problems with crime, access to land, and lack of transport are also significant barriers.

In terms of hard indicators, only 10 percent of formal microenterprises have access to a bank credit line, and even fewer are servicing active loans—quite a low number by the standards of South Africa's SMEs. At the same time, there are clear indications that the lack of legal status of informal microenterprises has impeded their access to finance. Uncertainty of legal status is also linked to their more limited access to

infrastructure, as indicated by their higher complaint rates than formal businesses about access to land, transport, and electricity.

A network of governmental and private sector business support schemes has evolved in South Africa in recent years—in part under the aegis of the Department of Trade and Industry and local government authorities—and is addressing these problems. It is not clear, however, how far these schemes have succeeded in reaching out to microenterprises in general, and to the more promising informal enterprises within that group. While survey data suggest that current programs are supporting a significant number of larger small enterprises, they do not show significant coverage of microenterprises, formal or informal (Table 3). This could be entirely due to the limitations of our data, which consist of observations from a small sample of microenterprises drawn exclusively from Johannesburg. On the other hand, it is quite possible that our sample information is typical of at least the situation in large cities.

Table 3: Coverage of Enterprise Survey sample by business support schemes

Enterprises (No. of sample)	Received assistance	Applied for assistance	Not applied b/c (No. of sample: 599, 61, 48)			
			No need for support	Never heard about them	Not think qualified	Procedure too cumbersome
SMEs (599)	57	79	397	77	46	36
Micro formal (67)	2	9	19	13	7	14
Micro informal (53)	0	6	4	14	8	8

7. IMPROVING SMALL BUSINESS ACCESS TO FINANCE

7.1 WHY ACCESS TO FINANCE MATTERS

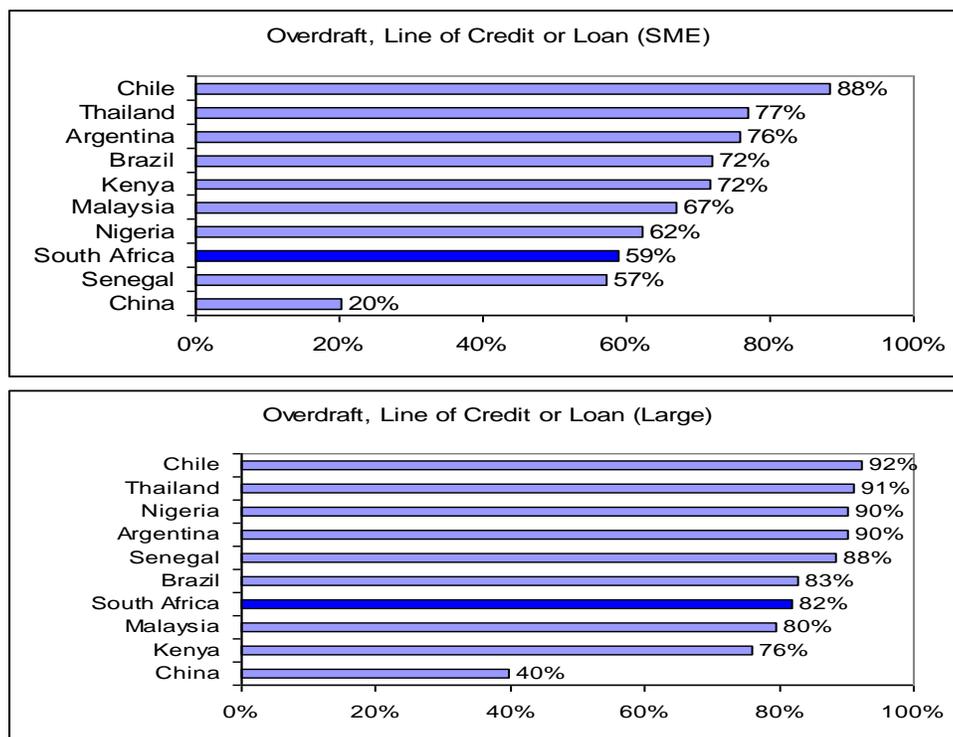
As a rule, formal-sector firms in South Africa do not see access to finance as a major problem, but a large proportion of microenterprises and a sizable segment of formal small businesses do. Among microenterprises, a far greater proportion of informal and unregistered enterprises than formal ones identify access to finance as a major obstacle to growth. There are also differences in access to finance among firms grouped along other dimensions, including industry sector, business age, and race or ethnicity of business owners.

To the extent that there are real access differences among groups of firms, it is quite likely that the gaps result in misallocation of capital, costing in job losses and in lost productivity. Finding reliable measures of gaps in access is a necessary step toward understanding the impacts of those losses.

7.2 MICROENTERPRISES HAVE LESS ACCESS THAN SMES

The 2008 Enterprise Survey data shows that it is more difficult for microenterprises than small enterprises to obtain credit, and more difficult for small enterprises than for large enterprises. Microenterprises are less likely to have a bank account and less likely to have access to any credit products (loans, overdrafts, or lines of credit). Within this group, only 17 percent have any credit products, compared with 49 percent of small, 69 percent of medium, and 82 percent of large firms. Microenterprises are also less likely to apply for loans, probably because they have very high rejection rates—89 percent—compared with 32 percent for small enterprises, 13 percent for medium, and 8 percent for large enterprises. As far as demand for loans is concerned, microenterprises are least likely to state “no need for a loan” as a reason for lack of a loan application. This is the reason stated by 39 percent of microenterprises, and 44 percent of small, 53 percent of medium, and 65 percent of large enterprises.

Figure 11 Cross Country Comparison of the Difference Between Large firms and SMEs



7.3 INFORMAL ENTERPRISES HAVE LESS ACCESS THAN FORMAL ENTERPRISES

Unregistered microenterprises have significantly less access to credit than those that are registered. None among the unregistered enterprises uses any credit product, while 25 percent of those registered do. This is not because unregistered microenterprises do not apply, but because their applications are more likely to be rejected. The rejection rate is also high among registered microenterprises, at 85 percent. Unregistered microenterprises are also excluded from receiving credit from suppliers.

7.4 SMES' DISADVANTAGE IN ACCESS TO FINANCE IS MORE PRONOUNCED IN SOUTH AFRICA

Within the formal sector, small firms have less access to credit than medium and large firms: they are less likely to have any credit products and less likely to apply for loans. Those that do apply are more likely to be rejected. This pattern is by no means unique to South Africa. However, it appears that SMEs in South Africa are more credit-disadvantaged than their peer group counterparts: only 59 percent

of SMEs have any credit products, as compared to 82 percent of large firms (Figure 11). The 23 percent difference in the access rates of the two groups is large compared to that in Argentina, Thailand, Malaysia, and Brazil, for which the gap is in the range of 10 to 14 percent.

8. INVESTING IN SKILLS

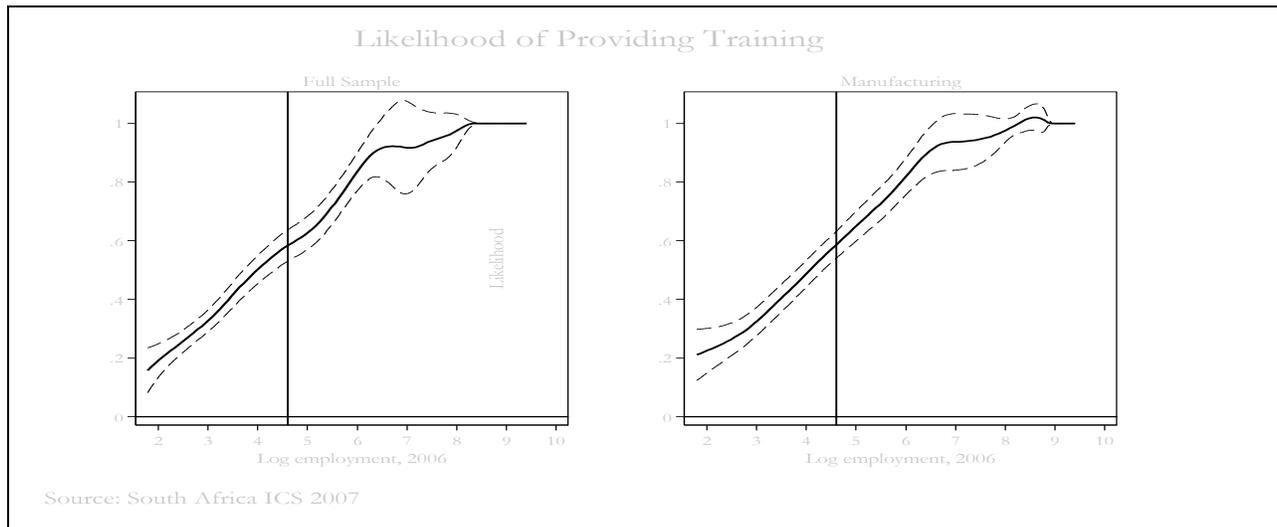
This assessment examined the extent to which South African firms were addressing the shortage of skills by financing on-the-job training. It also looked at the extent to which they were making use of government-initiated skills development schemes in that context. Skills shortage was one of the problems that topped managers' lists of obstacles to growth in the 2003 survey. Although by the time of the 2008 survey, it had slipped far behind crime and power shortages as a source of managers' concerns, but remains a significant growth bottleneck by all other indications.

8.1 WHO INVESTS IN EMPLOYEE SKILLS?

According to the Enterprise Surveys, South African firms are less likely to provide formal training to their workers than their peer group counterparts. In the 2008 sample, about 46 percent of firms were providing training, compared to more than 67 percent of firms in Brazil, Chile, Thailand, and China. Moreover, there was no significant change in South Africa in the incidence of training between the 2003 and 2008 surveys. The profile of firms that provide training also remained unchanged between the two surveys. In 2008, as in 2003, larger firms were more likely to provide training than smaller ones, and exporters were more likely to do so than non-exporters. The likelihood of training was also greater where the unionization rate was higher.

The correlation between business size and likelihood to provide training is particularly strong in South Africa. More than 65 percent of firms with 200 or more employees are likely to provide formal training to their workers, compared to about 35 percent for firms with 20 to 40 employees (Figure 12). This is quite important; a strong correlation between provision of training and firm size may signal a variety of constraints that are stronger for smaller enterprises than larger ones. These may include financing constraints and smaller firms' lacking the critical mass of trainees needed for profitable training programs. Smaller firms also may not have the extra workers needed to fill the gap when someone is takes a training course. This, in turn, has implications for the role Sector Education Training Authorities (SETAs) and their targeting policy, or lack thereof, especially as larger firms are currently far more likely to receive SETA support than smaller ones. Since the majority of the newly employed are likely to work in small and young firms, the skills development opportunities for these workers will likely be limited.

Figure 12: Firms with a large workforce are more likely to provide training



8.2 ARE SETAS HELPING?

While perceptions of SETA performance were very poor in the early years, collaboration with and appreciation of SETAs have improved considerably. Across the size distribution, a majority of firms with workplace training programs report working closely with SETAs. Overall, more than one-third of the firms that provide training report receiving some support from SETAs, and more than two of every five firms that provide training report that SETAs are effective. While we have no comparable data for the 2003 sample, other studies suggest considerable improvement in SETAs' effectiveness in supporting skills development in South Africa.

8.3 WHO GETS TRAINED?

Important determinants of a worker's likelihood to be formally trained at work include his or her schooling, ethnicity, and membership in a trade union. More educated workers are more likely to get training, all else being equal. Nonwhite workers are less likely to be trained on the job than white workers. And just as firms where the unionization rate is higher are more likely to offer training to their employees, union members are more likely to receive training at work than other workers. While the association between unionization and on-the-job training does not confirm any causal relationship, it suggests that workplace bargaining arrangements increase the likelihood that firms will invest in members' skills. An alternative explanation arises from the fact that tenure is considerably higher for union than for nonunion workers. The concern that turnover prevents firms from recouping the costs of

training is considerably less important for union members, who are relatively more attached to their firms according to the Enterprise Survey data.

9. CONCLUSION

South Africa has a relatively good business environment, which has improved in many respects in recent years. Nevertheless, the country faces the twin challenges of high unemployment and widespread poverty. To tackle these problems it needs to increase exports and attract more foreign direct investment

At the moment, the country exports a smaller share of its manufactured output than its peer group, in part because its manufacturing productivity is relatively low. This is despite the fact that the typical South African manufacturer operates closer to the global technological frontier than its counterparts in comparable economies. The country's relatively low aggregate manufacturing productivity is a consequence of low-productivity firms having higher market shares in South Africa than they would have in most other comparable economies.

This, in turn, is a consequence of the relatively high concentration of South African industry, and can only be addressed through a series of competition policy initiatives and other measures for increasing product market competition. Excessive concentration of industry may also have impeded inward FDI, but clearly is not the only barrier to export growth and higher investment rates.

South Africa needs also to address other problems in the current business environment that are placing a drag on investment as well as productivity. These include inadequate physical infrastructure in terms of power supply and transport, crime, small business access to finance, and addressing skills shortages. Problems in each of these areas have been significant sources of allocative inefficiency, which has distorted the allocation of resources against labor-intensive activities in general, and those in the SME sector in particular.

To promote jobs-led growth, South Africa needs to support the expansion of the SME sector by developing markets in business development services and financial products more tailored to the needs of the sector as a whole and to microenterprises in particular.

In the area of skills shortage, the short-term response should be to facilitate on-the-job skills formation and on-the-job training programs. Progress in this area seems to have been real, but modest. South African firms invest in on-the-job training at a lower rate than their counterparts in comparable economies. Investment rates are particularly low in SMEs, which should be targeted more explicitly by SETAs.

¹ The full report is available on web sites of the DTI and of the World Bank Group along with a longer summary.

² See Fedderke and Romm (2006) for evidence that these spillovers have been a significant source of recent productivity gains in South Africa.

³ Edwards and Golub (2003, 2004) show, the growth of South Africa's manufactured exports in the 1990s was fueled by steady decline in unit labor costs, defined as the ratio of wages (per employee) to labor productivity (or output per employee). This decline occurred as a result of growth in labor productivity. Jonsson and Subramanian (2001), and Aghion et al. (2008) show that the increases in labor productivity were made possible mainly by the trade liberalization measures of the period.

⁴ The economy-wide capital-to-labor ratio has been rising steadily in South Africa since the 1980, with significantly steeper rise in capital intensity in manufacturing industries and in the tradable sector more generally than in the non-tradable sector (Rodrik 2006). As a result, South Africa's manufacturing and service industries are today among the most capital intensive within its peer group. This is also reflected in the Enterprise Survey data where the mean capital intensity of South African enterprises, while comparable to that of Malaysian enterprises and significantly lower than those for the samples from Argentina and Chile, is higher than those of the samples from most countries in the group, including Brazil and Mexico.

⁵ The index in Figure 6 is the covariance component of the Olley-Pakes decomposition of industry level aggregate productivity as set out in Olley and Pakes (1996). The link between this index and the conventional sense of allocative efficiency as used in the third chapter of the report is that, empirically, the covariance term of the Olley-Pakes decomposition tends to be lower where the misallocation of resources due to market distortions is higher. The removal of the distortions increases aggregate output and, often, aggregate productivity by essentially reallocating market shares and resources from low-productivity firms or uses to high-productivity ones. There is a body of literature documenting historical processes of productivity gains through reallocation in many of the countries in South Africa's peer group.

⁶ Fedderke and Naumann (2005) show that African industry has become significantly less concentrated than it was in the early 1990s, while Aghion et al.(2007) show that the increase in competition due to lower concentration has led to significant TFP growth.

⁷ To give a sense of the degree of concentration involved, Roberts (2004) estimates that the largest four firms in South Africa account for more than half of industry output in 46 percent of the 57 main product groupings in the country. Fedderke et al. (2006) report higher values for a more inclusive concentration index for South Africa than for the US, and show that the greater concentration of South African manufacturing industries is associated with higher mark ups in South Africa.

⁸ The reforms have been the subject of several reviews, including those in OECD (2003), Roberts (2004) and Hartzenberg (2008).

⁹ See Hausman (2007).

¹⁰ See Kaplinsky (1995); Valodia et al. (2007); and Altman et al. (2008) on important historical impediments to the development of the SME sector and black entrepreneurship and implication therefore to labor absorption in the South African economy.

¹¹ Available estimates of the output share of the informal sector in the South African economy are dated. The latest we have is that of Valodia (2007) for 1999, which puts the share of the informal sector in GDP at 8 percent. Depending on how one classifies domestic workers, the share of informal workers in total employment stood between 23 percent and 30 percent, according to the 2005 LFS, which in absolute numbers means 2.8 million people if domestic workers are excluded and 3.7 million people otherwise (Benjamin 2008).

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